Appendix 1
Regional Economic Prospects

East Asia and Pacific Region

Recent developments

THE YEAR 2001 WAS SHAPING UP AS A DIFficult year for East Asia and Pacific (EAP) even before the September 11 terrorist attacks on the United States. The unexpectedly sharp cyclical downturn in the world economy during the year had centered on a recession in the global high-technology (high-tech) sector, resulting in a plunge in the exports of the many East Asian economies that have become important suppliers of components and finished products for world high-tech markets. East Asian exports were also especially hurt by the fact that the slowdown in global demand has been steepest in the region's largest external markets, the United States and Japan, which together buy almost 40 percent of regional exports. By July or August economies with a high reliance on high-tech, such as the Republic of Korea, Malaysia, the Philippines, Singapore, and Taiwan (China), were seeing U.S. dollar export declines of around 20–25 percent on year earlier levels. There was, nevertheless, some comfort in the fact that, apart from the Philippines, the main impact of the high-tech recession was falling on high income or upper-middle-income countries with low poverty.

In the wake of the terrorist attacks, the region's export downturn is likely to become broader based, as falling consumer confidence in the United States and around the world dampens demand for the region's consumer and services exports. Overall, the global economic impacts of the terrorist attacks are likely to have pushed back the prospects for a recovery in world trade and in East Asian exports by six to nine months.

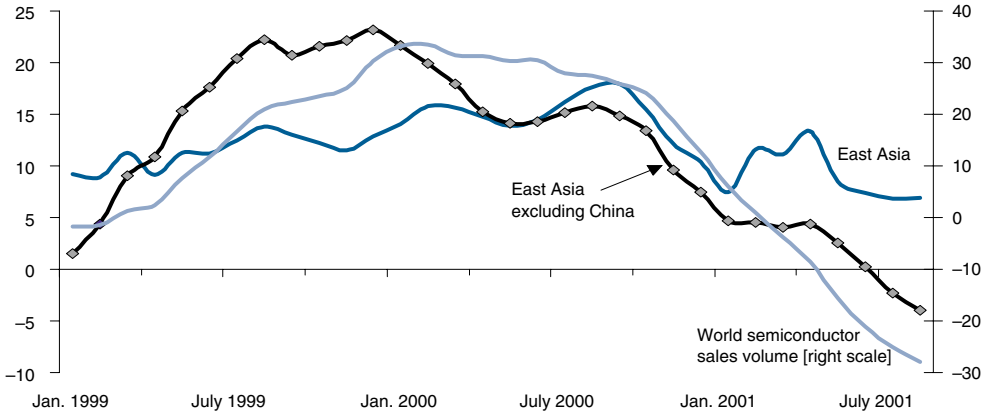
Near-term outlook

Growth in the developing East Asia region is expected to fall to 4.6 percent in 2001 from 7.5 percent in 2000, and to recover only mildly to around 5 percent in 2002. These would be the region's second weakest years for growth since 1990, bar only the near-zero-growth year of financial crisis, 1998. Most of the slowdown in growth is concentrated in the "Crisis 5" countries (that is, the five countries that were most affected by the financial crisis of 1997–98—Indonesia, Korea, Malaysia, the Philippines, and Thailand). Aggregate growth in this group is expected to slow to only 2–3 percent in 2001 from around 7 percent in 2000. Growth in 2001 will still reach around 7 percent in China, which contains two-thirds of the region's poor (at the $2 a day poverty line). With a more diversified export basket than some other countries in the region, China's export growth, while slowing sharply to an average 2 percent pace in June–August 2001, has at least avoided the huge 20–35 percent declines seen elsewhere. Growth has also been bolstered by a robust fiscal stimulus package to offset the export slowdown.

Other transition countries, such as Cambodia and Vietnam, which rely on low- or

Figure A1.1 Industrial production in East Asia and world semiconductor sales volumes

3-month moving average, percent y/y



Source: Semiconductor Industry Association through Bloomberg and World Bank.

medium-tech exports, have also been less affected by the high-tech recession, and showed continued buoyancy in domestic investment in the first part of the year. Growth prospects for the region in 2002 will depend significantly on the timing and scope of world recovery. It is probable that the steep cuts in interest rates, income tax cuts, and post-attack emergency spending in the United States, as well as policy measures in other industrial countries, will lead to a rebound in the second half of 2002, strengthening to a more full-blown global recovery in 2003.

Prospects for the region will also be affected by specific sectoral trends in the wake of the terrorist attacks. Oil prices have been volatile after the attacks and may have an upward bias for the rest of the year because of the risk of military action in the Middle East, with a mixed impact on the region. If major disruptions are avoided, weak world growth will tend to push oil prices lower in 2002. However, countries that rely on worker remittances could be hurt by political turmoil in the Middle East, as well as from weaker growth in Asia. Remittances to the Philippines are already down. Non-oil commodity prices have weakened in 2001, and are likely to weaken further with lower world growth after the attacks. Some of the smaller economies of the region that rely on commodity exports, such as Mongolia, Papua New Guinea, Fiji, and the island economies will be hurt by lower non-oil primary commodity prices. As regards other sectoral effects of the attacks, airline travel, tourism, and insurance are likely to be the worst affected, while inputs for military materials, information technology (IT) infrastructure, and telecommunications may benefit. As a result, East Asia, with its reliance on high-tech exports, may be less badly affected than other regions. However, selected Pacific islands and countries such as Thailand will feel a more significant effect of the pullback in world tourism.

Among other factors affecting near-term prospects, it is notable that, despite serious emerging capital market crises in Turkey and Argentina, there were few signs of a generalized contagion effect or pullback of private flows to the region in the first part of the year. Gross capital market flows to the region of about $31.5 billion in January–July 2001 were only slightly lower than during the same period in 2000. This overall stability reflected improvements in crisis countries' external balance sheets in the last several years, including a

buildup of foreign reserves and reductions in short-term debt. Exchange rates, while volatile, were not much different in early September from the start of the year, while the majority of equity markets had actually risen modestly over this period. Capital market stresses were concentrated on the Philippines and Indonesia, reflecting political uncertainties earlier in the year, as well as concerns about high public debt. After the Sept. 11 attacks, secondary market spreads for Indonesia and the Philippines widened. Equity prices fell sharply in most countries in the region. To some extent, the region will share in a more widespread investor pullback from emerging markets. Corporate restructuring and privatization efforts may be hampered by reduced foreign investor interest.

Among near-term policy responses to the slowdown, a number of countries have increased fiscal expenditures somewhat to help smooth the impact of the export shock, including China, Korea, Malaysia, and Thailand. Such expenditures can be especially helpful when carefully targeted to address social protection, infrastructure, or other particular sectoral needs that may be warranted in a sharply slowing economy. However, concerns about relatively high or growing public debt—especially when measured inclusive of contingent liabilities—mean that in most countries higher spending can only be sustainable for a limited time. Indeed, very high public debt levels will essentially preclude greater fiscal stimulus in Indonesia and the Philippines. Given these constraints, a temporary increase in spending—where possible—is best seen as a means of addressing specific social or sectoral objectives, and as a complementary policy that allows countries to continue to make progress on difficult structural policies such as corporate restructuring, even in the current weak economic climate.

The impact of this year's slowdown on poverty will be mitigated by the fact that the steepest declines in growth are in the high-income, newly industrialized economies (NIEs—including Hong Kong (China), Singapore, and Taiwan (China) and in the richer Crisis-5 countries, which have relatively low poverty rates. Still, with less growth, this year's downturn in East Asia will stall the pace at which income poverty in the region falls, while the risk of a rise in poverty has also increased. According to calculations by the Bank's East Asia and Pacific Region, the proportion of people living below the $2-a-day line may edge down from an estimated 47 percent in 2000 to a forecast 46 percent in 2001. Given continued robust growth in China

Table A1.1 East Asia and Pacific forecast summary
(percent per year)

				Baseline forecast			
Growth rates/ratios	1991–2000	1999	2000	2001	2002	2003	2004–2010
Real GDP growth	7.2	7.0	7.5	4.6	4.9	6.8	6.2
Consumption per capita	5.4	6.0	6.8	5.5	5.7	5.9	6.0
GDP per capita	6.0	5.9	6.4	3.6	4.0	5.9	5.4
Population	1.2	1.1	1.0	0.9	0.9	0.9	0.8
Inflation[a]	5.4	0.0	3.4	7.1	6.7	5.3	3.7
Gross Domestic Investment/GDP[b]	34.1	29.0	30.0	30.4	30.7	30.7	33.7
Central Gvt Budget Balance/GDP	–1.0	–2.5	–2.2	–2.0	–2.4	–2.3	–3.1
Export Volume[c]	13.0	7.7	23.7	0.4	6.2	11.3	7.3
Current Account/GDP	0.5	4.3	3.3	1.4	0.0	0.5	–0.8
Memorandum Items							
GDP growth: EAP excl. China	5.3	6.9	7.1	2.3	3.4	5.4	5.0

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

and other transition countries, which contain the large majority of the region's poor, the main source of slower region-wide poverty reduction in 2001 is likely to be the sharp slowdown in growth in Indonesia, the Philippines, and Thailand, which contain most of the rest of the region's poor.

In a longer-term perspective, it is notable that the pace of poverty reduction in the region has slowed dramatically, something that, persisting over time, cannot help but have deep social, political, and policy implications. Between 1990 and 1996 the regional poverty rate at $2-a-day fell from 67 to 49 percent, but from 1996 to 2000 it fell only 2 percentage points more. The less numerically significant reason is the financial crisis and slow recovery in Indonesia, the Philippines, and Thailand. The other is slower income growth in China's rural areas—where most of China's poor live—even as urban income growth has gone from strength to strength. Thus the drama of East Asian poverty reduction will largely depend on how countries address disparities in rural-urban and intra-regional growth, as well as the structural and institutional improvements needed to bolster growth overall.

Long-term prospects

Despite these near-term weaknesses, the long-term prospects for East Asia remain broadly positive. Average annual growth rates could exceed 6 percent in the 2004–10 period. Most of the countries in the region are committed to strengthening the underlying determinants of strong and sustained growth—improvements in education, enhancing the rule of law, promoting high domestic savings (including prudential fiscal policies), and openness to trade and investment. As demonstrated over the last three decades, the region's economies have been able to scale the technology ladder and significantly close the production and income gap compared to the most industrialized nations. China's entry into the World Trade Organization (WTO) is a particularly notable event that has positive trade and productivity implications for the whole region.

The region is not without its vulnerabilities, as evidenced by the financial crisis of the late 1990s and the economic slowdown that started at the end of 2000. The financial crisis revealed in stark terms the deficiencies of the region's banking and financial institutions, and the lack of sufficient regulatory oversight to compensate for those deficiencies. In the aftermath of the crisis, many of the countries in the region have undertaken a significant overhaul of both the financial and the regulatory institutions, but the legacy of the crisis persists in many of the countries. Economic recovery and current account surpluses have provided some breathing room, but as the current slowdown indicates, the region's authorities need to pursue financial reform, in particular to boost financial intermediation to ensure that the most productive investments get funded.

Risks

A key issue for policymakers in the region is to position their countries in order to be able to take full advantage of the global recovery when it arrives. Medium-term structural reforms that strengthen the fundamental underpinnings of development are likely to have a more significant impact on growth and poverty reduction than possible short-term gains from fiscal stimulus. At the same time, this year's largely unexpected global downturn has shown the weakness in the strategy of simply trying to "grow out" of the problems left over from the financial crisis of 1997–98. Indeed, in the wake of the September 11 attacks, higher uncertainty and risk may become a more prevalent feature of international affairs for some time. Structural reforms should then also help make the region's economies more robust in riding through a more uncertain and volatile external environment. Among structural issues facing the region, the importance of renewed attention to corporate and financial restructuring; trade reform; and institutional and governance reforms are worth particular note. If the region is able to implement contemplated reforms in these areas, it will improve the climate favoring new investment

(foreign and domestic) and technological progress, opening the way to realizing its long-term potential.

South Asia

Recent developments

Even before the events of September 11, increasing fiscal deficits and the global slowdown adversely affected growth in South Asia, one of the poorest regions. GDP growth fell from 4.9 percent in 2000 to 4.5 percent in 2001. The energy import bill for the region increased dramatically as oil prices jumped in 2000. Higher fiscal deficits were the rule, as central and regional governments struggled unsuccessfully to meet revenue and expenditure targets. This resulted in serious economic problems in Pakistan where the IMF has estimated that the financing gap in the 2001–02 fiscal year will be over $3.4 billion. The external environment is another constraint on growth, albeit with small effects, given the low level of trade integration of the region. Export market growth fell from 13 percent in 2000 to 2.4 percent in 2001.

The tragic events of September 11 have focused attention on South Asia. Because the military response may affect neighboring Afghanistan, it presents special risks to the countries of the region. In Pakistan, for example, freight rates to the subcontinent have already been increased by 10 to 15 percent by major shipping lines.[1] Importers in other countries, fearing supply disruptions, have canceled orders for goods from Pakistan.[2] Pakistan is also struggling with a heavy external debt of $38 billion that absorbs more than 40 percent of Pakistan's exports earnings. One possible positive outcome is that Pakistan may receive additional bilateral economic support that would improve its long-term prospects.

Fiscal positions in India and Pakistan have been highly expansionary in recent years, with fiscal deficits of 5.3 and 5.8 percent of GDP respectively in 2000. India's fiscal deficit is 10.5 percent when consolidated to include central and regional governments. Monetary stance in India at present is expansionary, indicating, perhaps, higher inflation in the near future. Both countries have made some attempts to get fiscal positions under control; the deteriorating external position in Pakistan (higher oil prices, interest payments, and drought-affected exports), however, combined with high public debt and low levels of foreign reserves, has resulted in a financing gap for the current account that has required assistance from the IMF. Pakistan agreed to a program of debt stabilization and macroeconomic reform that includes tax reforms; trade liberalization; reform and privatization of state-owned enterprises; and governance reforms.

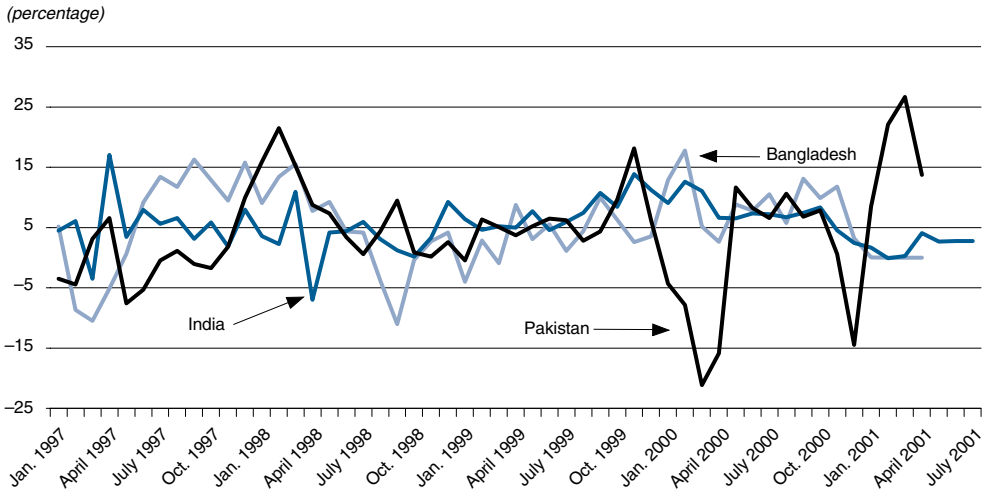
Weather conditions in late 2000 were highly unfavorable for India, Pakistan, and Bangladesh, with severe drought conditions in Pakistan. Agricultural production accounting for 25 percent of GDP was hit hard, exacerbating the slowdown in growth that was already apparent in early 2000. While agricultural production in the rest of the region improved in 2001, India was cushioned by a large stockpile of grains and the abatement of flood conditions in Bangladesh. There have been knock-on effects to hydroelectric energy production and irrigated agriculture due to the low water levels of many reservoirs. As a result, the current account deteriorated further, increasing the financing gap.

Weather conditions improved considerably in the second half of this year throughout the subcontinent. Normal, and in some cases excessive, monsoon rain has filled water reservoirs and water tables throughout the region. Agricultural production during the current year is expected to boost the overall economy enough to mitigate the negative external circumstances.

Near-term outlook

With the deterioration in the external environment, GDP growth in 2001 and 2002 in South Asia is likely to be 4.5 percent and 5.3 percent, respectively. Fiscal expansion had supported growth in the region, but the need for some

Figure A1.2 Industrial production in South Asia



Source: IMF, International Financial Statistics.

eventual fiscal consolidation will reduce governments' share of aggregate demand supporting growth. The need to constrain fiscal expansion is stronger in Pakistan, which has targeted the fiscal deficit to GDP at 4.9 percent in 2001–02 with further improvements thereafter. The pressure of fiscal and external deficits, as well as high debt levels, will continue to generate uncertainty and lower confidence and investment in the private sector. In India, although the pressures for fiscal balance are strong, there remains strong opposition do-

Table A1.2 South Asia forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Baseline forecast 2001	2002	2003	2004–2010
Real GDP growth	5.2	5.8	4.9	4.5	5.3	5.5	5.4
Consumption per capita	2.6	6.1	1.6	3.6	3.0	3.0	3.0
GDP per capita	3.3	3.9	3.0	2.8	3.6	3.8	4.0
Population	1.9	1.9	1.9	1.7	1.7	1.6	1.4
Inflation[a]	8.1	4.6	5.8	6.1	7.3	7.3	6.5
Gross Domestic Investment/GDP[b]	22.8	22.6	24.3	24.8	25.4	25.6	28.9
Central Gvt Budget Balance/GDP	–8.6	–4.0	–5.7	–4.8	–4.7	–4.5	–4.1
Export Volume[c]	9.3	1.8	7.5	6.0	8.8	9.2	7.9
Current Account/GDP	–1.4	–0.8	–0.3	–0.1	–0.5	–0.6	–0.8
Memorandum Items							
GDP growth: SAS excl. India	4.2	3.6	3.9	4.7	4.9	5.2	5.2

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

mestically to privatization and reform of state enterprises. A feature of recent government action has been the rollback of cuts in subsidies in food and fuel, which has proved unpopular.

The global downturn in growth in 2001–02 will have some effects on the region, if more limited than in other regions. As oil prices fall and weather conditions improve, trade balances will benefit. The downturn in export market growth will be mirrored by falling import demand stemming from slower growth domestically, improving current accounts. Most countries in the region are seeking to depreciate their currencies to shore up foreign reserves and promote exports and increase competitiveness, which should have a positive effect on the trade balance. Bangladesh may struggle slightly in its clothing sector with the ending of a preferential trade agreement with the United States (which accounts for 30 percent of Bangladesh's exports) but by 2002 Bangladesh will receive duty-free access to European markets for its garment exports. Consumer price inflation in the region has been low, despite droughts and higher oil prices. Most countries have subsidies for fuel and some foods, which cushions the impact of imported inflation on consumer prices; the large stockpile of grains in India dampened the recent impacts of unfavorable weather conditions. The slowdown in demand will continue to restrain price rises, and perhaps allow further declines in interest rates.

Long-term prospects

Long-term growth in South Asia should average about 5.4 percent, similar to the projections of GEP 2001. This is similar to average growth in the short-term, and reflects the lower contribution of the public sector to GDP as governments attempt to balance their fiscal positions in the forecast period. Lower population growth in the next decade will ensure that per capita growth will be close to 4 percent per year. Potential output growth in the region is quite high, given the improvement in human capital indicators in recent years, with higher literacy rates and school enrollments, and lower infant mortality rates. Additionally, the high skill levels of Indian workers with training in technology sectors, a boom area of growth, will ensure that the highly productive investment in these sectors will continue in the long term. As scheduled privatization and reform of state-owned enterprises continues, private investment will account for a greater share of domestic investment, with the concomitant benefits flowing from higher productivity of private investment compared to that of public investment. Additionally, privatization will encourage foreign investment and the associated spillovers to the domestic economies. Trade liberalization is also expected to continue with the easing of tariff and nontariff barriers and import substitution policies, providing greater opportunities for trade integration with the global economy, particularly for the smaller countries within the region.

Risks

Besides political risks in the short run, other risks to the forecast stem from the major challenges that countries in the region face in the consolidation of their fiscal positions and external and domestic debt levels. Changes in the incidence of taxation will be necessary to decrease the reliance on trade taxes and broaden the tax base to stabilize revenue collections over time. More discipline will be required in fiscal expenditures to ensure fiscal sustainability, while being careful to maintain expenditures that are essential for development programs. Unproductive expenditures, particularly subsidies, should be a particular target. Broadening the tax base away from trade is also a part of the trade liberalization strategy that will ensure that exporters have access to cheaper inputs and consequently become more competitive in global markets. Sustainable fiscal revenues and a responsible expenditure program will be required in several countries, particularly Pakistan, to counter its existing severe financial vulnerability. Countries with healthy debt levels should also act to ensure sustainable fiscal positions to prevent a decline into unsustainable debt levels.

Latin America and the Caribbean

Recent developments

Growth out-turns for most countries in the region in 2001 were much worse than anticipated in the spring of the year. Adverse developments in the external environment and in domestic conditions in some countries were the primary reasons behind the sharp reduction in the region's GDP growth, from 3.8 percent in 2000 to an estimated 0.9 percent in 2001, about 2.8 percentage points lower than anticipated in the spring. The growth slowdown was most acute in the "Big Three" (Argentina, Brazil, and Mexico), reflecting the increasing impact of the global, and particularly the U.S. slowdown; economic difficulties in Argentina; and the energy crisis in Brazil. Uncertainties linked to the electoral process in Argentina this year and in Bolivia, Brazil, Colombia, Costa Rica, and Ecuador next year contributed to falling investment rates in a number of countries. Weaker growth in Argentina and Brazil, along with a worsening of the external environment, contributed to a deceleration of growth in other South American countries, while a collapse of commodity prices (especially for coffee and semiconductor prices) and a severe drought lowered growth rates in Central America. In contrast, Ecuador and República Bolivariana de Venezuela did better than in 2000 due to relatively high oil prices.

Rapid deterioration in global activity contributed to a sharp decline in export revenues. Excluding Mexico, dollar exports from the region grew by an average of about 8 percent (year over year or y/y) in the first half of the year—down from over 15 percent in 2000. With the exception of Brazil (where dollar exports grew by 11.5 percent y/y), most countries had exports growing below 4 percent. In Mexico, the decline was even more dramatic, from an average of 22.6 percent growth in 2000 to zero (0 percent) by June 2001. Moreover, capital market commitments to the region weakened markedly (that is, they fell by 21 percent (y/y) in the first half of the year)—reflecting the deteriorating conditions in Argentina and slower economic activity in the region as a whole—exerting downward pressure on most regional currencies.

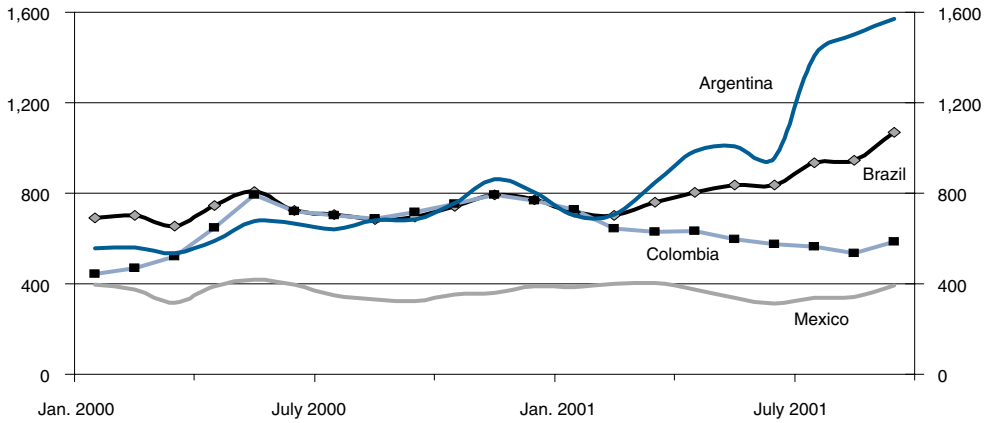
Large external financing requirements as a share of GDP coupled with fiscal deficits and high public debt reduced the ability for countercyclical fiscal and monetary policies in some countries. Despite falling U.S. interest rates, which reduce dollar debt-service payments—the depreciating exchange rates, slowing economic activity, and rising domestic interest rates (needed to maintain investor confidence) placed additional pressure on fiscal balances, limiting the scope for automatic stabilizers to function properly. Indeed, some countries, such as Brazil, had to tighten both fiscal and monetary policies in an effort to offset the combined negative effects of an energy crisis, a large reduction in FDI inflows, and contagion from the Argentine crisis, which resulted in a sharp reduction in capital market flows as secondary market spreads rose and remained high in the wake of the September 11 terrorist attacks (figure A1.3). Although these policies tended to keep inflation under control, they resulted in a sharp growth deceleration and exacerbated the already high level of unemployment throughout the region (16 percent in Argentina, for example).

In Argentina, recovery from the deep recession in 1999 has proven elusive, with each upturn in economic activity usurped by political stalemate on reforms, a weakening of fiscal accounts during the first half of the year, and volatile capital flows—reflecting investor uncertainty about solvency of public debt. GDP growth has remained in negative territory since the third quarter of last year. The authorities undertook a number of initiatives to bolster investor confidence—including a $29.5 billion debt swap, a severe fiscal adjustment aimed at zero deficit, and a package of tax reforms aimed at improving competitiveness of Argentine firms.

Negative fallout from Argentina was most acute in Brazil, and other Mercosur partners—slowing capital flows, especially FDI inflows; increasing yield spreads; and contributing to a

Figure A1.3 Secondary market spreads for selected LAC countries, 2000–2001

(basis points above U.S. Treasuries)



Source: JP Morgan's EMBI Global indices through Bloomberg.

weakening of the *real*. Brazil's drought-induced energy crisis and falloff in FDI, in conjunction with a depreciating currency, put upward pressure on inflation and set in motion tighter fiscal and monetary policies. Targets for the primary (before interest payments) fiscal surplus were raised, and policy interest rates rose by 325 basis points in the four months to August, contributing to a slowdown in growth. In contrast, Mexico suffered little contagion from the crisis in Argentina, with both the currency and equity markets rising strongly—reflecting the continuing positive impact of North America Free Trade Agreement (NAFTA) membership on FDI. Nonetheless, output growth contracted rapidly—in line with the sharp slowdown in U.S. activity, reaching zero (y/y) by the second quarter of 2001 after averaging nearly 7 percent in 2000.

Slowing economic activity in Argentina and Brazil along with falling copper prices affected growth negatively in Chile, but with lesser external financing concerns than in other countries, the authorities were able to reduce interest rates. GDP growth slowed in 2001 but by much less than in many other countries. In Peru, political uncertainties in the run-up to mid-year elections kept investment rates low and restrained consumer spending, resulting in growth slowing to below 1 percent from over 3 percent last year. Growth in Colombia also weakened compared with 2000, due to lower coffee prices and lower-than-expected investment caused by rising uncertainty (including the electoral cycle, legal infrastructure, and the guerrilla war). In contrast, growth in the oil exporters in the Andean region held up well due to high, although declining, oil revenues. Growth in Venezuela was sustained by large-scale public expenditure, while growth in Ecuador accelerated from the low or negative growth in 1998–2000 with the construction of a new oil pipeline.

In Central America, growth in 2001 was lower by about 1.7 percentage points compared with 2000, due primarily to a weakening of economic activity in Mexico and in the United States, a collapse of coffee prices, and a major drought, which severely affected Honduras and Nicaragua. The sharp fall in semiconductor prices hurt Costa Rica particularly hard as semiconductors account for nearly two-fifths of their exports, resulting in merchandise exports declining by 21 percent (y/y) in the first half of

Table A1.3 Latin America and the Caribbean forecast summary
(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Baseline forecast 2001	2002	2003	2004–2010
Real GDP growth	3.3	0.1	3.8	0.9	2.5	4.5	3.9
Consumption per capita	1.5	–1.7	2.2	1.0	1.6	2.0	2.5
GDP per capita	1.6	–1.5	2.2	–0.7	1.0	3.0	2.6
Population	1.7	1.6	1.6	1.6	1.5	1.4	1.3
Inflation[a]	12.6	5.8	6.9	7.9	6.3	6.0	5.0
Gross Domestic Investment/GDP[b]	21.8	19.4	19.7	19.4	20.1	20.7	23.5
Central Gvt Budget Balance/GDP	–3.5	–4.4	–2.9	–3.2	–3.0	–2.5	–1.7
Export Volume[c]	8.4	5.7	9.7	2.6	4.2	9.5	6.7
Current Account/GDP	–2.8	–3.1	–2.4	–2.8	–3.3	–3.2	–2.2
Memorandum Items							
GDP growth: LAC excl. Brazil	3.8	–0.4	3.4	0.5	2.3	4.7	3.7
Central America	4.4	4.3	2.7	1.0	2.2	4.0	3.8
Caribbean	3.4	5.7	5.5	1.4	3.0	4.2	4.0

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

the year. Caribbean countries also saw a reduction in growth rates due to declining tourism revenues, especially in the latter part of the year.

Near-term outlook

The region's growth prospects for 2002 have dimmed in light of a significant worsening of the external environment over the past six months, and especially since the September 11 terrorist attacks in the United States. The region's GDP is now expected to grow by 2.5 percent in 2002—1.9 percentage points lower than the spring forecast—provided that those countries currently under financial stress are able to avoid debt-service defaults. The delay in the U.S. recovery, weak global output and trade growth, a continuation of soft non-oil commodity prices and falling oil prices, and the likelihood of reduced capital flows to developing countries underpin the moderate growth recovery for next year. (As a consequence, there is great uncertainty surrounding the forecast with more negative or positive responses of consumers and investors possible.) In 2003, GDP is expected to grow by 4.5 percent, reflecting the expected rapid growth momentum in the United States, and world output in the latter part of 2002 and into 2003.

Revisions to external conditions, as well as domestic considerations, will impact the growth prospects for countries differently. The expected delay in the U.S. recovery will have the most significant trade impacts in Mexico and the Central American and Caribbean countries. For many of these countries, export-processing zone (maquilas) exports destined mainly for the North American market are a significant proportion of total exports (30 percent of net exports in Costa Rica and El Salvador, for example). Moreover, remittances are also likely to decline at a time when many Central American countries are facing weak coffee prices (after a four-year decline) and the effects of a severe drought in 2001. Weakness in labor and equity markets in the United States and increased risk aversion to air travel will adversely impact tourism receipts—which are extremely important for Caribbean countries. Preliminary estimates indicate that loss of tourism revenues could reduce these countries' GDP by 1.5 to 5 percent with potentially damaging social impact in light of high unemployment in

the region. Argentina and Brazil are likely to be more hurt from disturbances in capital markets (if they were to be prolonged) than from direct trade impacts, due to weaker global activity. This reflects their high public and private debt and large current account deficits (nearly 3 percent of GDP for Argentina, about 5 percent for Brazil). Although lower U.S. interest rates will help to alleviate debt-service payments, risk perceptions have remained elevated—partly due to the view that debt restructuring may be necessary, as occurred in Ecuador in 1999—and have kept capital market flows subdued, reducing the ability of these countries to roll over debt. In Argentina, these factors are likely to keep the recovery modest. In Brazil, contagion from events in Argentina (despite a $15.58 billion IMF–led package) is reducing the room for countercyclical policies. In addition, presidential elections due next year could be another factor restraining a return of investor confidence and the acceleration of growth.

As oil prices soften in 2002–03, the adjustment that oil exporters will have to undergo will be difficult and growth-restraining. Venezuela, for example, used buoyant oil revenues to finance growth in 2001, resulting in the nonfinancial–public sector's fiscal balance shifting from a surplus of 2.9 percent in 2000 to a deficit of about 3.1 percent of GDP. In contrast, Ecuador may avoid a contraction in growth in 2002, because oil revenues may remain high with expanded output partially offsetting the expected decline in oil prices. Colombia's prospects hinge increasingly on fiscal deficit reduction and on progress in the peace process, but growth prospects will remain subdued with the expected weak oil and coffee prices. In Peru, the new administration will face tension between containing the fiscal deficit and reactivating growth quickly to reduce the danger of popular discontent, which could lead to political and social instability. However, the combination of weak metals prices, delayed FDI flows, and limited access to capital markets could delay the economic rebound. Bolivia, Paraguay, and Uruguay all have strong trade ties to Argentina and Brazil, limiting their growth prospects to the fortunes of those countries.

Long-term prospects

Per capita GDP growth over the long term (2004–10) is projected to average 2.6 percent a year, a full percentage point higher than what the region achieved in the 1990s. Key factors supporting the cautious optimism for growth in the 2000s compared with the 1990s include improvements in: (a) human capital (health, education, and literacy indicators have all improved over the course of the 1990s, although much remains to be done in this area); (b) macroeconomic management leading to greater domestic macroeconomic stability (inflation rates have fallen over the 1990s, for example, although they are still more volatile than in other regions); (c) investment climate attracting FDI; and (d) progress on deepening trade integration with the regional and global economies.

FDI as a share of region-wide GDP rose from less than 1 percent at the beginning of the 1990s to nearly 4 percent in 2000, with a significant share going into telecommunications; this represents benefits to the economy that are likely to accrue in the next decade. Regulation and supervision of financial sectors have been strengthened, and trade regimes have been liberalized, with trade doubling as a proportion of GDP over the last 10 years. These developments have contributed to a large rise in total factor productivity, from negative growth in the 1980s to nearly 1 percent a year in the 1990s. In the 2004–10 period, TFP growth is expected to remain in the 1 to 2 percent range, while improvements in the investment climate—including strengthening the financial sectors through better supervision and regulation—could contribute another 1 percentage point to regional growth.

Risks

The region remains vulnerable in a number of areas however. First, national saving rates remain low in many countries, resulting in a persistent dependence on foreign savings (of about

3 percent of GDP)—typically from volatile private capital markets. These markets have demonstrated their power in delivering severe external shocks to developing countries, and the region has had to endure at least two such episodes in the 1990s (Mexico in 1995, and Brazil in 1999). The case of Argentina is still developing, and will obviously impact risk perceptions in the region for some time.

Second, the prevalence of large debt overhangs (both in the public and the private sectors) in countries throughout the region requires rollover on a continuing basis. Although the region's debt-to-GNP ratio is in line with the average of developing countries, the debt-to-exports ratio is very high. This exposes some countries to exogenous shocks emanating from global capital markets, which are at times independent of domestic considerations.

Third, trade integration is incomplete with ratios of trade-to-GDP remaining low by international standards (Chile, Mexico, and small economies are exceptions), and diversification of exports is still limited—many countries are still commodity dependent.

Finally, the region still lags behind its potential in financial deepening (which could help raise national saving rates), infrastructure, and quality of institutions—areas which, if improved, can propel high and sustainable growth rates. Many countries in the region have made strides in addressing some of these areas and, should investor sentiment toward emerging markets improve significantly, the region could grow at a faster pace than in the current forecast.

Europe and Central Asia

Recent developments

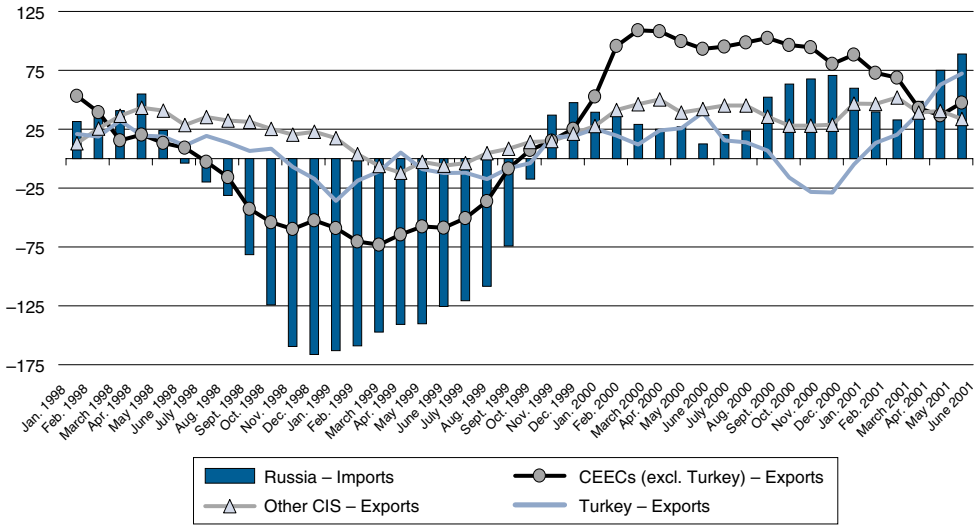
Real gross domestic product (GDP) growth for the Europe and Central Asia (ECA) region is projected to decelerate markedly in 2001 to about 2.1 percent, down from 6.3 percent in 2000. This rapid slowdown is dominated by three main factors. First, in Turkey domestic demand collapsed due to high interest rates and severe economic disruption in the wake of the financial crisis, which erupted in late 2000 and early 2001. Second, there has been a pronounced moderation of growth in the Russian Federation, Poland, and the former Yugoslav Republic of Macedonia (FYR Macedonia). In the Russian Federation, the impetus behind exceptionally strong growth of over 8 percent in 2000 (generated from a combination of high oil prices and import substitution, driven by devaluation) is receding. In Poland high interest rates, aimed at containing inflation, have stymied demand. In FYR Macedonia, the military conflict with the Albanian rebels, which began in March 2001, has clearly begun to take its toll on the budget and on economic activity. Third, the slowdown in global demand in 2001, particularly in the European Union (EU), has had a negative impact on growth in the ECA region, in contrast to 2000 when external demand acted as a strong engine for growth.

Countervailing some of these negative pressures on regionwide growth, domestic demand has strengthened in a number of countries (such as the Czech Republic, Hungary, Romania, and the Slovak Republic). Similarly, strong growth in domestic demand, particularly in private consumption, stimulated by an increased money supply through large hard currency inflows, among other factors, is providing a buffer to the slowdown in the Russian Federation. Within the Commonwealth of Independent States (CIS) subregion, strengthened domestic demand in the Russian Federation in 2001 has translated into a significant firming of import demand and has provided a boost to growth in a number of countries that export to the Russian Federation (for instance, Ukraine). In contrast, export sectors in a few countries with significant revenues from Turkey, (for instance, Bulgaria and Georgia) are expected to be impacted by the plunge in Turkish import demand.

For most countries in ECA, current account deficits are forecast to stay at 2000 levels or to deteriorate in 2001, although they should remain manageable. In the few cases where there are current account surpluses, they are expected to narrow. In some countries the cur-

Figure A1.4 Russian imports and partner exports in 1998–2001

(3-month moving average, y/y percent change (of US$ merchandise trade)



Source: IMF.

rent account deficits are already quite large or are growing rapidly relative to GDP (such as in Poland and Romania). For countries such as Poland, with an already high current account deficit, the EU slowdown will be felt more directly, although the sharp deceleration in domestic demand there will reduce imports. While the Russian Federation is expected to post a large surplus again for 2001, it will be significantly below the record $46 billion surplus in 2000. In Turkey the current account is expected to post a sizeable surplus due to a sharp contraction in imports and strengthening exports stimulated by the massive devaluation of the Turkish lire subsequent to the abandonment of the crawling-peg regime in February 2001.

Real foreign exchange rates throughout the region remained on a broadly stable path over the first half of 2001. The most notable exception is the sharp devaluation of the Turkish lire of about 60 percent in nominal terms, or about 30 percent in real terms, as of August 2001, year over year (y/y). The currencies of some other countries (for instance, Hungary and Poland) subsequently came under considerable downward pressure during July 2001, when international investors became more bearish on emerging market instruments. In contrast, the Russian ruble has remained relatively firm and generally appreciated in real terms over the year, bolstered, in particular, by a large current account surplus. Elsewhere in ECA, due in part to fixed currency regimes and inflation differentials, the Bulgarian (currency board) and Baltic (pegged) currencies have continued to appreciate.

Inflationary pressures in the ECA region on the whole were relatively contained in 2001, with the general rate of increase either declining somewhat or remaining flat. Turkey, with the consumer price index running at about 55 percent in 2001, is an important exception. Until domestic markets stabilize there, heightened uncertainty will contribute to higher inflationary pressures, as will the hefty increase in the cost of imports that will likely generate significant pass-through effects. Driven in most

Table A1.4 Europe and Central Asia forecast summary
(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Baseline forecast 2001	2002	2003	2004–2010
Real GDP growth	–2.3	1.8	6.3	2.1	3.0	4.2	3.6
Consumption per capita	–3.5	–2.9	4.2	3.8	3.0	2.9	3.9
GDP per capita	–2.5	1.7	6.1	1.9	2.9	4.1	3.5
Population	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Inflation[a]	347.1	7.3	7.5	7.5	5.9	5.4	4.3
Gross Domestic Investment/GDP[b]	23.6	18.0	19.0	19.4	19.5	19.7	24.3
Central Gvt Budget Balance/GDP	–19.0	–10.5	–7.4	–7.5	–7.2	–6.4	–4.8
Export Volume[c]	0.5	–1.4	11.1	8.5	2.8	8.3	5.9
Current Account/GDP	–0.6	0.0	1.9	1.2	–0.4	0.0	–1.4
Memorandum Items							
GDP growth: Transition countries	–3.1	3.3	6.1	4.0	3.1	3.8	3.4
Central and Eastern Europe	0.8	2.3	3.9	2.8	2.9	4.3	4.3
CIS countries	–5.2	4.1	7.8	4.9	3.2	3.5	2.6

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

cases by an accommodating fiscal stance, inflation remains at double-digit levels in a handful of other ECA countries, for example in Belarus, Romania, Tajikistan, and Uzbekistan. For the region's oil-importing countries, the recent pass-through impact of higher energy prices has begun to diminish. In contrast, strengthening domestic demand in a number of ECA countries could lead to higher inflationary pressures.

Near-term outlook

The severity and duration of the current slowdown in the EU, along with policy responses in the transition countries, will be important factors for near-term prospects. In the EU, a recovery is not expected until the second half of 2002, and much stronger external demand from the EU is not anticipated until 2003. This is especially significant for the Central and Eastern European countries (CEECs), because their economies have become well integrated with the EU. Another important near-term assumption is that the combination of slowing world energy demand and an accommodating stance by the Organization for Petroleum Exporting Countries (OPEC) will likely translate into lower nominal and real oil prices. For the hydrocarbon exporters of the CIS, this scenario implies a further slowdown in growth in 2002. For the ECA region oil-importers, the decline in the energy bill is expected to partially offset the negative impacts of a less favorable external environment. If indeed Turkey stabilizes and begins to recover in 2002, which is an assumption underlying our forecast, it will lift aggregate growth for the region.

Throughout the region, access to foreign private capital (including foreign direct investment, FDI) is expected to remain more difficult over the near-term, due to increased aversion to emerging markets by international investors. Correspondingly, domestic and foreign investment in the ECA economies is expected to decelerate through 2002, in part reflecting anticipated delays in privatization programs. Tourism, an important source of foreign currency in a number of ECA countries (such as Croatia and Turkey), is also projected to slow markedly.

In sum, over the near term (2002–03), growth is expected to stabilize at close to 3.5 percent for the region as a whole. At the subregion level, we are forecasting a pattern of diverging growth becoming manifest in 2003.

For the CEECs, aside from anticipated stronger external demand in 2003, the EU accession process is expected to stimulate a continuation of reforms and to further boost growth. In contrast, CIS growth is expected to slow in 2002 and to remain generally flat in 2003 as energy prices stabilize at lower levels, and the boost from high oil rents winds down in a policy environment of gradual reforms. As a consequence, import demand from the Russia Federation is expected to decline, which is in turn expected to result in lower export volumes for the smaller CIS countries.

Long-term prospects

Over the coming decade through 2010, GDP growth for the ECA region is forecast to average close to 4 percent, in contrast with the 2.3 percent region-wide average rate of contraction witnessed during 1991–2000, the first decade of transition. From a region-wide perspective, the main drivers of higher growth are an improved policy environment and a greater degree of macroeconomic stability leading to higher investment and savings rates as a share of GDP. Growth for the CEEC subregion is expected to average above 4 percent during the period 2001–10, up significantly from close to 1 percent posted during 1991–2000. Growth in the CIS subregion is expected to average somewhat below 3 percent, also a marked increase compared to the sharp contraction of about 5 percent annually registered during 1991–2000.

In the CEECs, during the second decade of transition, a number of factors are contributing to the anticipation of stronger growth performance, including rising investment as a share of GDP and continued restructuring of the capital base. Broad-based reforms and a well-educated labor force have been—and are expected to remain—important factors contributing to fruitful returns on rising investment.

Almost all of the CEECs are EU accession candidates, and have significantly benefited from the EU accession process, which has provided an incentive to address underlying structural and institutional impediments to growth. The EU accession process is expected to continue to boost FDI into the subregion, although as privatization programs wind down, this is expected to diminish somewhat. These flows have largely financed the subregion's shortfall in domestic savings. Domestic savings rates are forecast to increase over the forecast horizon as FDI inflows moderate, but they are not expected to increase sufficiently to close the gap over the forecast horizon. This potential imbalance between savings and investment exposes the CEECs to the risk that investment demand will be bridled by inadequate domestic savings or by a sudden drop in foreign inflows. Nevertheless, prospects are broadly positive as most of the countries of the subregion have achieved a significant degree of stability and realignment of institutions and markets over the last decade and are on a path to continue the process. The CEEC subregion growth forecast of just over 4 percent over the long term, albeit not insignificant, suggests only slow convergence with EU per capita income levels.

As with the CEECs, high educational attainment provides a strong positive contribution to growth potential in the CIS. However, investment in human capital in the region has declined substantially following the breakup of the Soviet Union and in the wake of the 1997–98 crisis. Should a turnaround in the investment in human capital not materialize, an important positive dynamic of the subregion's growth picture will deteriorate further. The recent surge in growth in the CIS subregion of hydrocarbon exporters has created an important opportunity to introduce reforms more actively. The Russian Federation is an example of where this process has begun, especially during 2001. However, there the implementation process is just being initiated, and much remains uncertain. Significant institutional and structural impediments remain constraints to growth. Consequently for the CIS countries as a group—and in contrast to the CEECs—investment as a share of GDP is expected to remain at relatively low ratios, after having declined during the 1990s. Also, considerable excess capacity remains, though much of it could be obsolete, so investment demand could kick in sooner if the

economy picks up. If good policy reforms are introduced more aggressively, then the CIS economies could shift to a higher growth path.

Risks

Over the near- to medium-term, risks to the forecast are predominantly on the downside. Within the region the main risks include the possibilities of a deepening of the crisis in Turkey or a sharper economic slowdown in the Russian Federation, or both. In either case, growth prospects in smaller economies of the region would also decline. Another internal risk factor is an escalation of political tensions and instability in the Balkans. The September 11 terrorist attacks have increased both external and internal risks. With regard to the former, there is the possibility of greater risk aversion to emerging markets and capital flight. Regarding the latter, a risk of increased political uncertainty is an important factor, especially in the countries of Central Asia, due to the heightened conflict and instability in Afghanistan. There could also be an influx of refugees to the ECA countries bordering Afghanistan, namely Tajikistan, Turkmenistan, and Uzbekistan.

Other external risks are mainly associated with the EU, both in terms of its growth prospects and with public support for the accession process. A stronger and more protracted decline in external demand from the EU would add pressure to external balances and likely reduce growth outcomes, particularly in the CEECs. An important aspect of an extended slowdown in the EU is the timing—that is, coinciding with important EU accession negotiations—because it will likely reduce maneuverability for both candidate countries and existing members. Correspondingly, support for the EU accession process (both within the existing EU countries[3] and within prospective member countries) has been diminishing. This could become a higher risk over the near term because more difficult issues—such as the free movement of labor and capital, agriculture, and the distribution of structural funds—are now shifting to the front burner in enlargement negotiations. Extensive delays in the EU accession process could slow the reform process and undermine long-term growth prospects within the CEECs.

Potential output could be increased if reform programs in the CIS were to move forward more aggressively than anticipated. In the case of the Russian Federation, this would generate positive demand dynamics throughout the CIS and in Turkey. Depending on dynamics both internal and external to the region, there is the upside risk that the EU accession process will regain stronger positive momentum and proceed more smoothly and more rapidly than currently envisioned. Notably, the recent terrorist crisis could act as a catalyst to strengthen political resolve in both the EU and applicant countries to move forward with the accession process. Turkey, the Russian Federation, and Central Asian countries might also benefit from strengthened political backing from the west and a possible increase in official assistance as a reward for supporting U.S.–led strikes into Afghanistan.

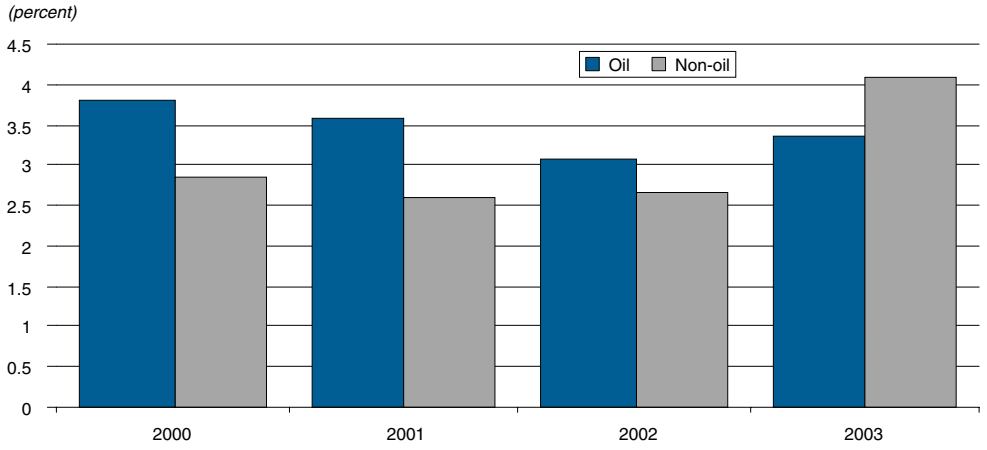
Sub-Saharan Africa

Recent developments

Growth in Sub-Saharan Africa (SSA) slowed to 2.7 percent in 2001 from 3 percent in 2000, interrupting a progressive recovery from the slowdown of the late 1990s. With population growing at 2.4 percent, the rise in per capita GDP was minimal. The slowdown was widespread throughout the region, in East, West, and Southern Africa, and in both oil and non-oil commodity exporters.

The primary cause was the slowdown in developed countries. In the face of weaker demand from the United States and the Euro Area, merchandise exports managed just 3.4 percent growth in volume terms compared to 8.8 percent in 2000. Services exports, including tourism, were also affected, growing by 3.6 percent. Commodity prices remained well below levels of the late 1990s, including those that rebounded from recent lows. Beverage

Figure A1.5 Real GDP growth of SSA oil and non-oil exporters



Source: Economic Policy and Prospects Group.

producers were particularly hard hit, with coffee prices down over 25 percent from 2000 and cocoa prices—although they were up around 10 percent in 2001—only 75 percent of the average for 1995–2000. While oil prices eased back from their peak of nearly $30 a barrel in mid-2000 they remained strong, and oil exporters outperformed the region as a whole, growing at an average of 3.6 percent for the year, compared to 2.6 percent for non-oil exporters. Oil constitutes less than a third of SSA exports, however, and net energy exports are only 5 percent of GDP. Thus on balance, recent world commodity market trends represented a major drag on growth and incomes.

Apart from the external environment, developments within the region painted a mixed picture. Better weather boosted agricultural production and household incomes in a number of countries in East and Southern Africa, including Ethiopia, Kenya, Mozambique, and Tanzania. However, localized drought conditions persisted in these and many other countries. In Southern Africa, food production fell by as much as 25 percent, due to both adverse weather conditions and civil disturbance. Overall, the Food and Agriculture Organization of the United Nations (FAO) estimates that the need for food aid will be unchanged from last year at around 2.7 million tonnes (FAO 2001). Weather also contributed to a 12 percent reduction in the cocoa crop in West Africa after the bumper harvest of 1999–2000, according to the International Cocoa Organization (*African Business*, July/August 2001).

In the political sphere, some progress toward stability was achieved in the Democratic Republic of Congo, Guinea, and Sierra Leone, but peace seemed as elusive as ever in Angola, Liberia, and the Sudan, and Zimbabwe's crisis intensified with the approach of elections in spring 2002. Countries in conflict or experiencing severe governance problems[4] recorded the worst performances, growing at –0.4 percent in 2001. On the plus side, robust growth continued in a number of countries, including Ethiopia, Madagascar, Mozambique, and Uganda, reflecting better policy and economic management. Finally, 19 countries reached decision points under the enhanced Heavily Indebted Poor Countries Initiative, cutting debt servicing costs by a third, and relaxing balance of payments and budgetary pressures.

In South Africa, the region's largest economy, a robust recovery in the second half of 2000 dissipated in the first half of 2001 as in-

adequate rains led to a disappointing maize harvest. The impact spilled over from agriculture into manufacturing and, on the demand side, into consumer spending, and growth slowed to 2.4 percent. Both public and private investment remained strong, as did productivity growth, although the investment rate at only 16 percent of GDP remains well below the level needed to support adequate employment growth. The rand came under strong selling pressure in the second half of the year as a result of ongoing uncertainty about emerging markets generally and the situation in Zimbabwe specifically.

In Nigeria, the energy sector registered strong gains, thanks to both oil and natural gas revenues and to keen investor interest, particularly in the offshore sector. However, it is increasingly evident that progress on reforms to date has had little impact on the non-oil economy. A one-year, $1 billion standby credit from the IMF was extended from August to October despite the government's failure to meet important conditionalities, but especially with the approach of elections in late 2002, the future of the reform process is uncertain.

Near-term outlook

While many idiosyncratic factors will bear on near-term performance, the slowdown in industrial countries during 2001 and sluggish recovery in the first half of 2002 virtually guarantee a poor out-turn for the coming year. Weak demand will continue to depress export prices and volumes. However, as recovery consolidates in OECD trade partners, demand for the region's exports will strengthen setting the stage for stronger gains in 2003. For the region as a whole, merchandise exports are expected to grow by only 2.9 percent in 2002, while terms of trade fall by 6.2 percent, equivalent to 1.8 percent of GDP. The subdued external performance will hold GDP growth to 2.7 percent for a second year, again leaving per capita incomes flat. Oil prices are expected to fall to $21 a barrel in 2002, implying steep terms-of-trade losses for oil exporters of 4.1 percent of GDP; their real growth will average 3.1 percent, down from 3.6 percent in 2001. However, other commodity prices should firm on average, even though non-oil exporters' terms of trade deteriorate slightly because of higher import prices. The modest improvement in the external environment will raise non-oil exporters' growth to 2.7 percent from 2.6 percent 2001. For the SSA region as a whole in 2003, the forecast anticipates a strong acceleration in export volume growth to 6.4 percent, pushing GDP growth to 3.9 percent. With decent rains, the actual outcome might be even better. Nevertheless, terms-of-trade weakness is expected to persist through the forecast period, especially for oil exporters, as oil prices fall further to below $20 a barrel.

Despite weak energy prices, substantial investment in oil exporters promises to sustain real growth in oil sectors in the medium term. Nigeria has struggled recently to meet OPEC quotas, but plans to increase capacity significantly over the next few years and a second liquid natural gas train at Bonny Island will boost production by 50 percent beginning in 2002. Meanwhile, recent offshore discoveries could substantially raise medium-term production and exports for non-OPEC Angola and Equatorial Guinea. Even in the near term, exploration and development activity—including the Chad-Cameroon pipeline project—is helping to offset terms-of-trade losses, keeping real growth higher than otherwise would have been the case. For non-oil exporters, faster world growth will tighten the supply demand balance in primary commodity markets allowing export prices and terms of trade to strengthen. In addition to the rebound in the world economy generally, export prospects will also benefit from a number of specific trade initiatives, including the United States' Africa Growth and Opportunities Act (AGOA), the EU's "Anything but Arms" initiative, and the EU–South Africa Free Trade Agreement. Early evidence from the first half of 2001 shows that 13 SSA countries benefited from $3 billion of exports under AGOA preferences (USTR 2001). Nonetheless, SSA's medium term performance will remain subdued as a result of inelastic export demands and a lack of diversification.

Table A1.5 Sub-Saharan Africa forecast summary
(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Baseline forecast 2001	2002	2003	2004–2010
Real GDP growth	2.2	2.5	3.0	2.7	2.7	3.9	3.7
Consumption per capita	–0.6	0.0	0.4	0.2	0.5	0.9	1.1
GDP per capita	–0.4	0.0	0.5	0.3	0.3	1.6	1.5
Population	2.6	2.4	2.5	2.4	2.4	2.3	2.2
Inflation[a]	9.7	5.3	6.3	6.0	5.0	4.5	4.1
Gross Domestic Investment/GDP[b]	17.4	17.1	17.2	17.5	17.6	17.8	18.4
Central Gvt Budget Balance/GDP	–7.4	–8.1	–2.2	–3.4	–3.3	–3.2	–2.8
Export Volume[c]	4.3	3.0	7.0	3.4	2.4	7.6	6.3
Current Account/GDP	–2.1	–2.2	–1.5	–1.0	–2.4	–2.0	–1.8
Memorandum Items							
GDP growth: SSA excl. South Africa	2.6	3.0	2.9	3.0	2.8	4.0	4.2
Oil exporters	2.7	2.6	3.8	3.6	3.1	3.4	3.6
CFA countries	2.6	2.4	2.7	2.4	2.9	3.6	3.8

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

Long-term prospects

Over the long term, the expectation is for a continuation of the trend toward better economic policies and management and a broadly favorable external environment. Internal market reforms, deregulation, and privatization have raised productivity and improved incentives, and encouraged nontraditional exports such as fish and horticulture at a time when prospects for many traditional crops are poor. Notably a number of well-managed reformers have sustained high growth even through difficult external conditions. In the baseline scenario, which assumes a continuation of current productivity trends, output growth averages 3.7 percent from 2004–10. With population growth falling to 2.2 percent, real per capita income growth will average 1.5 percent, reaching $640 in real (1995 dollars) terms by 2010. For many countries, export diversification and favorable price trends will sustain performance well above the regional average.

This performance will fall short of what is needed to achieve the international development goals, and SSA will continue to lag behind other regions in the developing world. Low domestic savings combined with only modest private foreign capital inflows will limit investment rates to an average of below 19 percent of GDP. Although up from barely 17 percent currently, this is far from what is needed. As a result, capital accumulation will contribute less than 1 percent annually to growth—not even a quarter of the rate anticipated for East Asia. Low rates of human capital investment and slow progress on rebuilding infrastructure will hold productivity growth to around the same rate.

Despite the somewhat pessimistic outlook, if the forecast is accurate the coming decade will see the region's best sustained performance since the 1960s. There are manifold reasons for SSA's historically poor performance—disease, civil strife, poor governance, inauspicious climate, low savings and investment, and falling terms of trade. Some of these conditions are unlikely to change any time soon, but for others there are signs of real improvement. Political and economic reforms have gained pace since the mid-1980s, and are contributing to higher standards of governance and economic management. Private sector growth and increasing regional integration are helping to boost efficiency and rationalize production. Greater openness and debt relief are relaxing

balance of payments constraints, easing import restrictions, and over time encouraging more foreign investment interest. But even as some countries notch up high growth rates, overall performance will continue to be constrained by the devastating effects of HIV/AIDS, slow progress on governance in some countries, and the limited availability of resources to rehabilitate productive capacity and infrastructure.

Middle East and North Africa

Recent Developments

Developments in the Middle East and North Africa were strongly positive in 2000, with a rare convergence of simultaneous increases in oil prices and export volumes contributing to stronger-than-anticipated growth of 3.9 percent. Growth in 2001 will be lower at 3.4 percent, as declines in OPEC export quotas affect oil production and increasingly weak growth in industrial countries affects demand for goods and services from the region. Short-term prospects have weakened considerably since September 11 in the face of a slowdown in external demand, with economic recovery in Europe and the United States delayed into 2002.

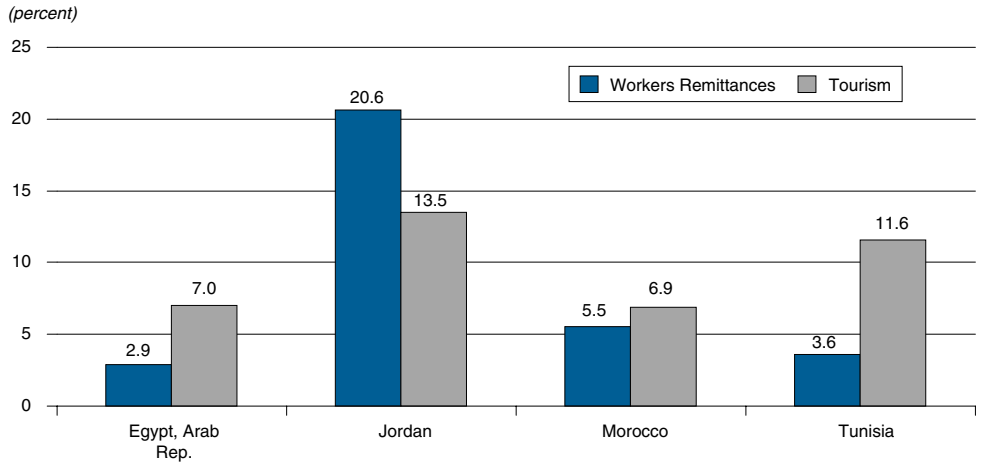
The oil exporters have reaped the benefits of higher demand and disciplined adherence to OPEC quotas, boosting both export volume and revenue growth in 2000, with GDP growth of over 4 percent in several countries. Export volume growth is weaker in 2001 because OPEC quotas were reduced throughout the year in an effort to target supply around a price of $25 a barrel, with growth falling to 3.1 percent. The boost in revenue has fostered income gains and led to strong growth in domestic demand through stronger consumption and import growth. Current account surpluses rose to 14.9 percent of GDP in 2000 and 8.4 percent in 2001. Domestic interest rates fell, and there was an increase in investment in the oil and non-oil sectors, with several countries also benefiting from higher foreign investment. Oil exporters have had few problems refinancing liabilities. Government revenues have also benefited from high oil prices. Many oil exporters achieved balanced budgets or surpluses in 2000, and some of that momentum has continued in 2001. Governments did spend more than previously budgeted from their revenue windfall but most were relatively restrained, given the expenditure profiles of earlier windfall gains. For example, the Saudi government received 58 percent more revenue than budgeted in 2000 but only spent approximately 10 percent more than planned, with much of the extra spending being used to pay domestic arrears.

The diversified economies grew 3.4 percent in 2000, lower than their historical average. Drought conditions in Morocco, Tunisia, and the Levant contributed to lower production and agricultural exports, despite high export market growth in 2000. Additionally, domestic condition in the Arab Republic of Egypt deteriorated significantly as the budget and current account deficit increased, placing pressures on interest rates, exchange rates, and domestic investment. GDP growth in the diversified exporters will rise to 4.4 percent in 2001. Morocco, which had a partial recovery from drought this year, accounts for the increase in GDP growth. Additionally, stronger oil prices and a relief from drought are behind increased growth in Syria. A weaker external environment, particularly in Europe, has affected trade prospects with falling growth expected in most countries as export market growth fell from 13 percent in 2000 to 1.9 percent in 2001. Workers' remittances, tourism, and services receipts will be similarly affected.

Near-term outlook

Looking forward, GDP growth in the region is expected to fall to 2.9 percent in 2002 and to recover to 3.6 in 2003. The sharper downturn in industrial countries and the delayed recovery into mid-2002 will reduce the external impetus to growth. Slower world demand growth will keep oil prices at the lower end of the OPEC price band (around $21 a barrel) and production and income growth will be adversely affected. The diversified exporters face lower

Figure A1.6 Tourism and workers remittances as a share of GDP in 2000



Source: IMF Balance of Payments.

trading partner–import growth, and adverse impacts on tourism from lower external income growth. Growth will probably fall in 2002 to 4.2 percent, but will recover along with the oil exporters in 2003, if, as anticipated, Europe and other trading partners gather momentum.

The momentum of growth in the oil exporters will slow in 2001–02, as weaker global growth affects energy demand and OPEC keeps a tight rein on oil production quotas. Production and export volumes in 2002 are expected to be lower than 2001 levels, thus ensuring that export volumes and GDP growth will decline from 2000 and 2001 rates. As the oil price falls to $21 a barrel in 2002, the terms-of-trade gains made over the last several years will decline, and current account surpluses, which reached 14.9 percent of GDP in 2000, will fall to 1.7 percent of GDP in 2002. Similarly, government balances will show some deterioration, both as oil revenues fall and governments implement new expenditures. The Islamic Republic of Iran is locked into a balanced budget rule, and, with the conservative oil price assumptions used for budget purposes, should retain fiscal balances. Algeria is expected to increase fiscal expenditures greatly in 2001–02, but the oil stabilization fund will be used to finance deficits and retire debt. However, if fiscal policy becomes too expansionary, it will be difficult to maintain the lower interest rates and inflation that have been apparent recently.

The windfall gains have provided opportunities for several oil exporters, particularly the Islamic Republic of Iran and Algeria, to amortize external debt and retire domestic debt. Oil exporters in the Gulf have built up foreign reserves and had few problems maintaining their fixed exchange rates. The Islamic Republic of Iran appears on-track to unify its exchange rate regime in the 2002/03 fiscal year; as a result, it may face a dose of imported inflationary pressures in the forecast period. For most countries, however, inflationary pressures should remain low. Interest rates in oil exporters have been falling, along with rapid growth in liquidity; therefore, there will be continued support to growth from domestic demand as demand for oil softens.

Short-term prospects in diversified exporters are mixed. Growth is expected to average around 4.3 percent in 2002–03. Morocco and the Syrian Arab Republic are expected to recover from the debilitating droughts of recent

Table A1.6 Middle East and North Africa forecast summary
(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Baseline forecast 2001	2002	2003	2004–2010
Real GDP growth	3.2	2.2	3.9	3.4	2.9	3.6	3.3
Consumption per capita	0.4	0.3	3.1	1.7	0.7	0.8	0.9
GDP per capita	1.0	0.3	1.9	1.5	1.0	1.6	1.4
Population	2.2	1.9	2.0	1.9	1.9	1.9	1.9
Inflation[a]	5.2	3.5	3.4	4.5	4.5	4.0	4.0
Gross Domestic Investment/GDP[b]	22.7	22.4	23.4	23.9	24.2	24.3	25.4
Central Gvt Budget Balance/GDP	–1.6	–2.7	–2.5	–3.0	–2.9	–2.6	–2.2
Export Volume[c]	5.8	13.1	6.2	3.0	4.0	5.7	4.6
Current Account/GDP	–1.9	–1.0	8.1	4.7	0.8	–0.9	–2.3
Memorandum Items							
GDP growth: Oil exporters	2.6	1.8	3.3	2.6	2.3	3.3	2.7
Diversified exporters	4.0	3.3	3.4	4.4	4.2	4.3	4.3

a. Local currency GDP deflator; median.
b. Investment ratio measure in real terms.
c. Goods and non-factor services.

Source: World Bank baseline forecast, October, 2001.

years, and agricultural production and exports will provide support for growth in the near term. This will offset, to some extent, the expected external slowdown in demand in 2001–02. The slower activity in the European economy in 2001–02 will adversely affect all the diversified exporters, with merchandise export growth falling from 7 percent in 2000 to 1.9 percent in 2001, before recovering to 4.9 percent in 2002. Jordan is enjoying a broad-based increase in activity, but deterioration in the external environment (tourism, remittances, and capital flows) could dampen growth next year. Current account deficits, which widened in recent years in drought-stricken countries, will remain higher than previously anticipated due to lower export volume growth. Fiscal policy in the drought-stricken countries has by necessity been somewhat expansionary to counter declines in agricultural incomes. Several countries that have signed EU Association Agreements (such as Morocco and Tunisia) have lowered or eliminated customs duties that were a source of revenue, placing upward pressures on fiscal deficits. Consequently, the public sector will continue to play a large role in growth.

Tourism and workers' remittances, two of the mainstays for diversified exporters, will not fare well in the near term. The majority of tourists come from Europe and, with low-income growth in Europe into 2002, and confidence eroded because of the events of September 11, tourism will suffer. Political uncertainty may also contribute to a decline in tourism, particularly in the Levant and in Egypt. This can already be seen in Egypt, where after an almost 15 percent rise in tourist arrivals in 2000, arrivals fell by 8.1 percent in April 2001 and 8.5 percent in May over the same period in the previous year. Jordan's tourism receipts fell by 3.6 percent in the first half of 2001 compared to a year ago. Tunisia and Morocco will suffer less from the effects of the political instability in the Levant. Indeed, Tunisia should continue to experience some growth, and Morocco is investing heavily in tourist infrastructure. Remittances will remain stagnant or grow very slowly as growth slows in the near term in oil exporters, and as income growth is dampened in Western Europe, the main source of remittances for the region.

Long-term prospects

Long-term prospects in the Middle East and North Africa are less positive than in most other developing regions. Growth for the oil ex-

porters in the long term is expected to average 2.7 percent; in the diversified exporters growth is expected to average 4.3 percent. In each case, growth is only slightly higher than the average for the 1990s. Growth in 2004–10 for the region is expected to average 3.3 percent, similar to the average of the 1990s and lower than the average of 3.5 percent for 2000–03. The reasons for the lack of acceleration of growth in the forecast period include the real long-term decline in oil and other commodity prices expected in the next 10 years; the high level of vulnerability of countries in the region to commodity price and other external shocks; and the low level of attractiveness of the region to foreign investment outside commodity sectors.

The main external sources of growth and income in the region come from commodity exports, tourism, and workers' remittances. Each of these sectors is highly vulnerable. In the long-term, energy prices are not expected to increase—in fact, the real crude oil price in 2010 is projected to be approximately half its 2000 level. On the supply side, it is expected that non-OPEC supply will grow in the next several years, indicating that OPEC production and exports must decline in order to maintain prices above $20 a barrel, given expected demand conditions. Without further diversification in oil-exporting countries, many of which receive up to 95 percent of export revenues from hydrocarbons, the external impetus for growth seen since 2000 will diminish. The agricultural and mineral exports of the diversified exporters should fare better as prices increase in the next decade, but the recovery will be slight, and will come from the extremely low levels seen in recent years. In terms of agricultural exports, the scope for increasing penetration of markets is limited by the restrictions remaining on agriculture in the initial Association Agreements signed with the EU by the Mediterranean countries.

Tourism receipts are an important source of revenue for many of the Mediterranean countries but, as can be seen in the current context, they are highly vulnerable to issues concerning political stability. Current events in Israel and the West Bank and Gaza have affected tourism, not just in these areas but in the entire Levant and in Egypt. While countries such as Tunisia and Morocco are making concerted efforts to improve accommodations and service, they still face fierce competition from other destinations that have lower levels of political conflict and better facilities and services. Remittances by nationals working in the Gulf countries and in Europe are also an important source of income, but remittances from the Gulf are not expected to continue growing rapidly. The Gulf countries have begun programs to increase the numbers of their own nationals in their domestic workforce, and this will certainly be at the expense of non-nationals. With slower growth expected in the oil exporters in the long term, remittances are also expected to decline or to grow very slowly.

Notes

1. Dawn Internet Edition, Pakistan, September 20, 2001, http://www.dawn.com.

2. The News International, Pakistan, September 20, 2001, http://www.jang.com.pk

3. Support for eastward expansion of the EU has waned markedly in existing member countries, which was highlighted most recently by Ireland's June 2001 "No" vote on the Treaty of Nice (which makes changes to the voting structure of the EU to accommodate expansion).

4. Angola, Burundi, Côte d'Ivoire, Democratic Republic of Congo, Guinea-Bissau, Kenya, Sierra Leone, and Zimbabwe. No reliable data are available for Liberia or Somalia.

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