Appendix 1
Regional Economic Prospects

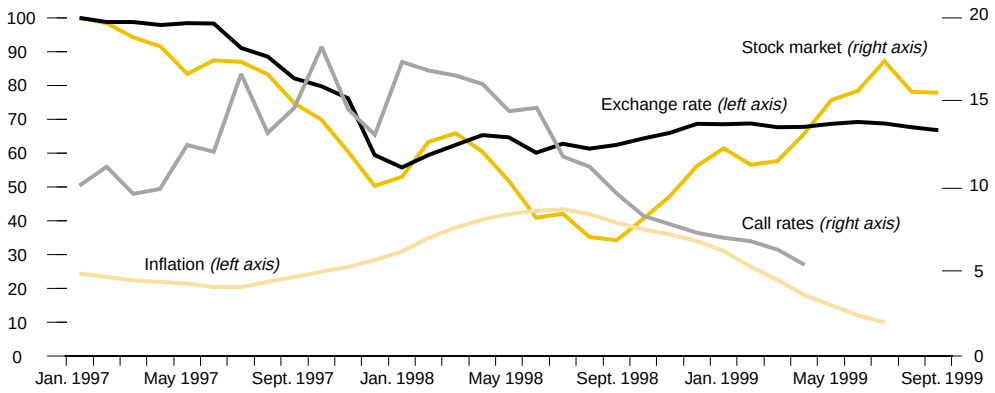
East Asia and Pacific

Recent developments

GROWTH FOR MOST OF THE EAST ASIA AND Pacific region in 1999, as anticipated earlier this year, will revive from the deep crisis-induced recessions of 1998. The turnaround has been much stronger than initially anticipated. Whereas the earlier forecast for the five crisis economies[1] saw growth rebounding to 0.2 percent in 1999, compared with a 7.9 percent decline in 1998, this year's performance now looks to be in the vicinity of 4.5 percent (table A1.1). Growth has been uneven across the five economies, with the Republic of Korea noticeably leading the group. Under current projections, Korea and the Philippines will return to their precrisis GDP levels this year, followed by Malaysia in 2000, and Thailand, just barely, in 2001. In contrast, Indonesia's output in 2001 could still be some 7 percent lower than precrisis levels.

Financial markets have improved markedly over the past year (figure A1.1). Currencies have appreciated between 10 and 20 percent since the low point of late 1998,

Figure A1.1 Stock index, exchange rate, inflation, and interest rate for East Asia-4



Note: East Asia-4 includes Malaysia, the Philippines, the Republic of Korea, and Thailand. Averages are calculated as simple arithmetic means for the four countries. Inflation is the 3-month moving average of the year-on-year inflation.
Source: Datastream.

with the exception of Indonesia where the appreciation has been over 100 percent.[2] Stronger currencies have been abetted by increasing reserve levels and declining levels of short-term debt. Prices have been subdued throughout 1999, providing scope for reduced interest rates and a related fall in public and private debt servicing.

China is confronting several economic problems. The uncertainties surrounding restructuring of state-owned enterprises (SOEs) and of employment prospects, coupled with almost two years of monthly deflation, have dampened consumer demand. This has led to a significant increase in unsold goods and has exacerbated the costs of corporate restructuring. Government efforts to spur demand through public investment programs were partially successful as temporary measures, and will be pursued to maintain growth. The government has taken a variety of measures to spur demand, but early evidence indicates that these measures have led to increased liquidity in equity markets, without markedly affecting personal consumption. Thus, growth in China is expected to slow compared with 1998, from 7.8 percent to 6.5 percent.

After lagging through the first half of 1999 a combination of factors are buttressing Chinese exports, including renewed growth in East Asia and continued import growth in the United States. China's improving international competitiveness, spurred by strengthening East Asian currencies, domestic deflation, and export-linked tax rebates, has also been a factor. Recorded imports have risen substantially this year, though this is mainly attributable to a crackdown on smuggling. The trade balance is likely to narrow, but will remain positive on aggregate.

Among the newly industrializing economies (NIEs), both Singapore and Taiwan (China) have benefited from the improving regional economy and the global electronics boom. Because of its stronger integration with the crisis economies, Singapore was more deeply affected than Taiwan (China) by the regional downturn. Hong Kong's (SAR, China) adjustment to the crisis has been more painful. The currency peg has forced down asset prices and real wages as Hong Kong attempts to remain competitive, and has depressed investment through high interest rates. But retail sales are finally picking up, tourist arrivals

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

				Baseline forecast			
Growth rates/ratios	1989–98	1997	1998	1999	2000	2001	1999–2008
Real GDP growth	7.5	6.6	0.1	5.5	6.2	6.2	6.2
Consumption per capita	5.2	3.0	–4.0	4.2	4.3	4.7	5.1
GDP per capita	6.1	5.4	–1.1	4.3	5.1	5.1	5.2
Population	1.3	1.2	1.1	1.1	1.0	1.0	0.9
Median inflation[a]	6.3	3.8	8.7	4.5	3.7	3.1	4.5
Gross domestic investment/GDP	35.0	36.2	31.0	32.6	33.9	34.6	35.3
Central government budget deficit/GDP	–0.6	–0.3	–2.2	–2.6	–3.0	–2.8	–2.4
Export volume[b]	11.9	17.6	7.0	7.9	8.1	7.8	8.0
Current account/GDP	–0.5	0.2	5.6	3.5	2.8	2.1	1.1
Memo items							
GDP of region, excluding China	5.7	4.4	–7.6	4.3	5.3	5.1	5.2
GDP of East Asia Crisis-5 countries[c]	5.7	4.5	–7.9	4.4	5.3	5.1	5.2

a. GDP deflator.
b. Goods and nonfactor services.
c. Indonesia, Malaysia, the Philippines, the Republic of Korea, and Thailand.
Source: World Bank Development Prospects Group, November 1999.

are increasing, and renewed Chinese exports will revive trade-related activities.

Near-term outlook

For the crisis countries improving macroeconomic conditions abetted by fiscal measures should set the stage for a further consolidation of growth, averaging 5 percent or more in 2000 and 2001. Inflation, which had been averaging 4.5–6 percent before the crisis, peaked in most of the crisis countries at less than 11 percent (except for Indonesia). The average year-on-year inflation rate is running at less than 2 percent in the East Asia-4 (Malaysia, the Philippines, Korea, and Thailand) and is in single digits in Indonesia after peaking at 80 percent at the end of 1998. Interest rates have fallen continuously since reaching highs in 1998. Overnight call rates in Korea, Malaysia, and Thailand are now well below precrisis levels.

The initial catalyst for growth was a revival in exports—led by electronics—driven by better than anticipated import growth in the United States and Japan, and intraregional multipliers. Low interest rates, rising asset prices, the end of the inventory cycle, and an improving near-term employment outlook, especially in Korea, have helped to broaden growth. Current account balances are likely to remain comfortably positive, though narrowing, as imports grow in tandem with consumption, production, and the end of the inventory cycle. Growth in the near term will be buttressed by strengthening consumer demand and inventory replenishment, with investment kicking in further down the road as capacity utilization improves.

On the downside, there could be a slowdown in the electronics sector in the second half of 1999 and perhaps into 2000. Equity prices have slumped more recently and they will have to rely on renewed growth in corporate profits rather than on liquidity. Interest rates have most likely reached a floor, and investment could continue to lag if banks' balance sheets fail to improve. Progress in the latter area has been uneven to date, and nonperforming loan (NPL) levels remain near their peaks. In Indonesia NPLs are estimated to range from 60 to 80 percent of outstanding loans and are close to 50 percent in Thailand. In Korea and Malaysia, they are a much more manageable 10–15 percent. Failure to achieve more substantial progress on restructuring could lead to renewed financial instability and could dampen near-term growth prospects (see chapter 3).

Expansionary fiscal policies are expected to fade out, though the remaining off-budget deficit will take longer to eliminate, and could accumulate further. The rapidly growing public debt in East Asia could pose a threat to recovery down the road, but historically low debt levels allow for a degree of flexibility. Nonetheless, Indonesia (with a history of high debt levels, political instability, and corruption), and to a lesser extent Thailand (with a persistently high level of NPLs), are in significantly more precarious positions.

Long-term prospects

Despite the current rapid rate of growth in the crisis countries long-term prospects for East Asia have not been revised since forecasts of one year ago. Lack of upward revision reflects the ongoing difficulties in Indonesia and, importantly, prospective industrial restructuring in China. In particular, the cost of restructuring the Indonesian bank balance sheets has risen dramatically, and troubles with Chinese commercial banks and their links with ailing SOEs have emerged more sharply this year. Inward investment in China has also been negatively influenced by the well-publicized collapse of several financial institutions. Despite the weak performance of the domestic economy, China seems determined to pursue its domestic reforms and to join the World Trade Organization (WTO). WTO membership is expected to benefit China, notwithstanding intensified competitive pressures on protected sectors. Beyond the one-time efficiency gains from reducing trade barriers, China could anticipate a boost in foreign direct investment and improved

access to foreign markets. For the region as a whole, long-term growth is expected to average 6.3 percent between 2002 and 2008, with the five crisis countries growing at 5.3 percent.

Success with regard to human capital growth will bolster longer term productivity gains in East Asia. Educational achievements over the last decades have been impressive, with primary school enrollment nearly universal and secondary school enrollment at high rates (for example, 50–60 percent in Thailand and Indonesia, and over 70 percent in China). Evidence from the hardest hit crisis countries suggests that these achievements were not reversed during the crisis. Governments made efforts to maintain expenditures on education (relative to GDP and total expenditures), and households adjusted consumption patterns to ensure continued school enrollment (see chapter 2). With the exception of Korea, which was a high-income country before the crisis, countries in East Asia—with per capita incomes ranging from $800 to $4,500, and an average close to $1,000—still have significant potential for moving toward NIE or industrial country income levels.

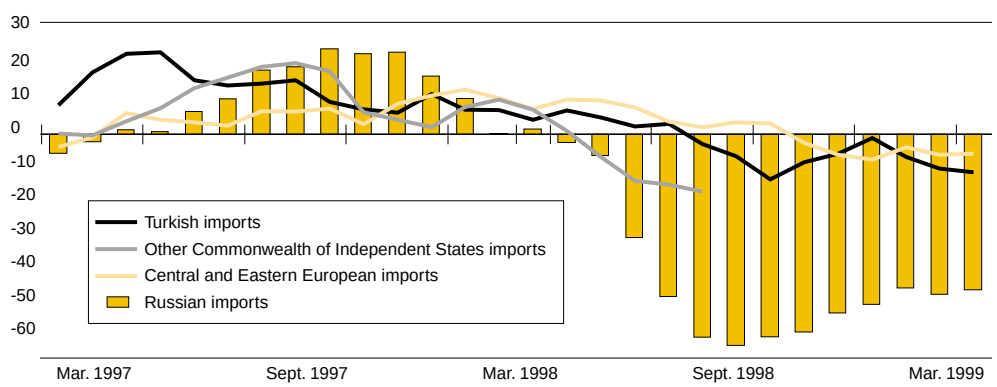
Europe and Central Asia

Recent developments

Economic output contracted by 0.2 percent in 1998 for the Europe and Central Asia (ECA) region as a whole, largely reflecting Russia's liquidity crisis in August 1998 and subsequent regional contagion. The ensuing economic downward spiral in Russia reverberated throughout the Commonwealth of Independent States (CIS), as these economies in particular retain strong trade links with the Russian market. Trade-finance and payments systems arrangements were interrupted and trade declined sharply as Russian demand collapsed (figure A1.2a) Central and Eastern European countries (CEECs) exports and balance of payments deteriorated as well, as sluggish growth in Western Europe translated into weak external demand for the more diversified regional exporters, dampening the internal dynamics of the region (figure A1.2b).

The region's weak growth performance is likely to improve during 1999. The firming of oil prices is improving prospects for the petroleum exporting countries of Russia and the Caspian Sea basin. While oil importers,

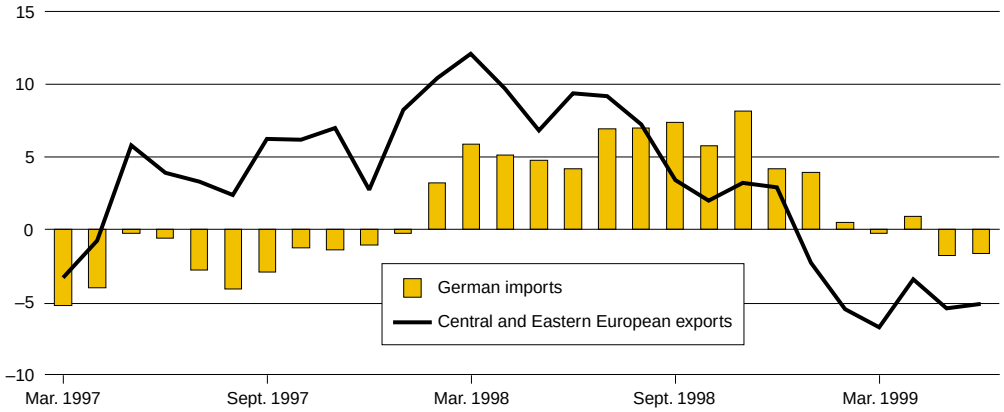
Figure A1.2a Russian imports and partner exports
Percent year-on-year of U.S. dollars trade



Note: Figures are three-month moving averages.
Source: Datastream.

Figure A1.2b German imports and Central and Eastern European exports

Percentage change year-on-year



Note: Figures are three-month moving averages in U.S. dollars.
Source: Datastream.

such as Turkey and the Central European countries, are experiencing some terms of trade losses, many of these countries are benefiting from the incipient strengthening of demand in Western Europe. The end of the war in the Federal Republic of Yugoslavia (Serbia/Montenegro) has allowed reconstruction efforts to begin and cross-border trade to resume, albeit constrained by the need to rebuild the transportation infrastructure. Russia has made some progress on debt restructuring and on gaining another round of funding from the International Monetary Fund (IMF). Inflationary pressures have been reduced significantly, such that monthly inflation has slowed to 1.4 percent in September from 11 percent in December 1998. Bond spreads throughout the region in secondary markets have generally narrowed, which is a reflection of improving international financial market sentiment. For example, Poland's spread returned to early 1998 precrisis levels. The most striking exception to this trend is Ukraine, where the economy remains vulnerable and Eurobond spreads are still elevated at close to 8,300 basis points in mid-November 1999, up from about 3,000 points in June 1999. Spreads for Russia remained above 2,300 basis points in November 1999, down from 5,200 basis points in April 1999.

Estimates for growth in the ECA region for 1999 have been revised upward, from the 1.5 percent decline expected in *Global Development Finance (GDF) 1999* to plus 0.3 percent. Russian GDP is now forecast to increase by close to 1.0 percent (compared with the 5 percent contraction anticipated in *GDF 1999*), due largely to higher than expected oil prices and increased production for import substitution. While GDP and industrial production contracted in the first quarter of 1999, both posted gains in the second and third quarters. With positive spillover effects anticipated in neighboring countries, the forecast for growth in the Commonwealth of Independent States (CIS) has been revised from minus 5.5 percent to a 0.7 percent advance. The most notable exception to the region's generally lackluster output is Turkmenistan, where double-digit growth is expected as a large natural gas project comes onstream. In contrast to the CIS, expectations for growth in 1999 in the Central Eastern European coun-

tries have been revised downward, from 2.3 percent to 1 percent, reflecting weaker than anticipated growth in Europe and higher prices for these countries' energy imports. Also, the war in Kosovo has greatly reduced economic prospects in the Balkans. Not only must the region bear the direct consequences of the destruction and disruption in the theater of conflict, but it must also absorb the impact of the movement of refugees into neighboring countries, the disruption of regional and transit trade, and a sharp fall in tourism revenues.

Near-term outlook

Accelerating world trade and stabilizing commodity prices should contribute to a stronger recovery in the ECA region in 2000, and real GDP is expected to increase by 2.5 percent. A recent history of high real investment growth (in double digits for some countries since the mid-1990s), boosted by strong FDI inflows (albeit tied in part to one-off privatization sales), should provide additional impetus for future growth in the CEECs and the Baltic countries. Greater integration with the European Union, as the CEECs progress at varying stages toward EU membership, will also improve growth prospects. Average national production growth for the CEECs is forecast at 3.2 percent in 2000. Output in most CIS countries is projected to recover more gradually, owing to expected slow growth in Russia, where the aggressive implementation of structural reforms is likely to await the results of the June 2000 presidential elections. Nevertheless, the depreciation of the ruble and of other CIS countries' currencies is expected to boost their exports to a degree which, combined with more positive external demand and sustained higher oil prices, should contribute to more positive growth of 1.3 percent in 2000 (table A1.2).

Long-term prospects

The long-term growth forecast (2002–2008) for the ECA region has been reduced from 5 percent per annum to 4 percent. This change is due largely to a downward revision to the projections for Russia, which continues to underperform relative to its underlying potential. Despite stabilizing more quickly than anticipated in 1999 after the August 1998 financial collapse, the fundamentals required

Table A1.2 Europe and Central Asia forecast summary
(percent per year)

				Baseline forecast			
Growth rates/ratios	1989–98	1997	1998	1999	2000	2001	1999–2008
Real GDP growth	–3.5	2.7	–0.2	0.3	2.5	3.3	3.4
Consumption per capita	–2.1	3.4	1.0	1.4	3.0	3.1	3.3
GDP per capita	–3.8	2.6	–0.4	1.0	3.2	3.1	3.4
Population	0.3	0.1	0.1	–0.7	–0.7	0.2	0.1
Median inflation[a]	37.0	50.0	12.3	8.4	7.4	7.5	8.5
Gross domestic investment/GDP	27.2	24.4	23.0	22.4	22.5	22.9	23.5
Central government budget deficit/GDP	–7.3	–5.5	–5.3	–5.2	–4.3	–4.0	–4.2
Export volume[b]	0.5	11.5	6.1	–0.3	4.9	6.6	5.6
Current account/GDP	0.7	–0.5	–1.1	–1.0	–1.5	–1.7	–1.5
Memo items							
GDP of middle-income Western Europe	4.2	7.5	2.9	–2.2	4.6	4.3	4.3
GDP of Central and Eastern Europe	–0.8	2.6	2.1	1.0	3.2	4.3	4.1
GDP of CIS states	–6.3	1.4	–2.7	0.7	1.3	2.3	2.6

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank Development Prospects Group, November 1999.

to support longer term growth have deteriorated. Savings and investment rates have fallen; the financial sector and state enterprises are in need of significant restructuring; the level of FDI remains constrained; and capital outflows continue. Population growth is projected to continue to fall by 0.3 percent per year, with the labor force contracting by 0.5 percent. While fiscal and monetary policies are likely to improve in the coming years, the degree of support for implementing far-reaching reforms to address the many imbalances in the economy is uncertain.

Risks to the forecast are mainly on the downside and are primarily linked, within the region, to achieving a sustainable recovery in Russia, where the situation remains fragile. A further downturn in Russia would have significant negative repercussions in the rest of the CIS and in Turkey, in particular, as occurred in the aftermath of the 1998 crisis. The economic situation in both Ukraine and Romania is tenuous, reflecting high debt-servicing payments. Turkey also faces significant economic challenges, as its economy is suffering from a sharp slowdown in growth, a growing budget deficit, and high short-term debt turnover requirements. The disruption of the August earthquake (estimated to cost between 2.5 percent and 5 percent of GDP) has compounded the situation. Throughout the region, slippage in reforms and failure to address significant financial and enterprise sector problems represent an ongoing risk. ECA's relationships with the EU pose both opportunities and challenges. A slowdown in Europe could weaken growth in ECA, especially in the CEECs. In the longer term, however, favorable prospects for several countries are tied to EU enlargement.

Latin America and the Caribbean

Recent developments

The initial impact of the East Asian crisis on Latin American countries was not large. Most economies were at the peak of their business cycles. Nonetheless, the adverse impact of the East Asian crisis on the global environment—through falling world export prices and volumes, and reduced capital flows to developing countries—eventually took its toll on Latin American countries. In 1998 the region's terms of trade fell by about 4 percent (a loss equivalent to 0.6 percent of GDP) and export volume growth slowed from 11.5 percent in 1997 to 5.6 percent, widening the region's current account deficit by $22 billion.

Mexico, which benefited from strong U.S. import-demand growth and which had a flexible exchange rate, was the least affected by the slowdown in world trade. Excluding Mexico, the region's export volume growth slowed from 9.5 percent in 1997 to 3.3 percent in 1998, due to worsening competitiveness. The countries with targeted exchange rates saw their real effective exchange rates rise by an average 17 percent above their 1990–96 levels (before the East Asian crisis), compared with a decline of 25 percent in the East Asian crisis countries. Capital flows from international markets dried up in the wake of the Russian default of August 1998, causing gross new flows to fall 25 percent in 1998 compared to 1997 levels. This precipitated a massive credit squeeze and a sharp reduction in current account deficits in several countries. The contagion effect from the Russian crisis made it impossible for countries to finance the part of the trade shock that could be treated as temporary. Even Chile, a country with solid credit ratings, experienced speculative attacks and was eventually forced to float its currency.

The combination of a deterioration in the external environment, high initial debt levels, a large dependence on foreign savings, and tight monetary policies—aimed at preserving existing exchange rate regimes during an election year for many large countries—caused regional GDP growth to slow from 5.4 percent in 1997 to 2.1 percent in 1998. By the fourth quarter of 1998 Argentina, Brazil, Chile, Colombia, Ecuador, Peru, and Venezuela were all experiencing recessions. In Brazil, Colombia, Ecuador, and Venezuela high do-

mestic interest rates in the second half of 1998 added to government debt service and, alongside lower tax revenues in the wake of the economic slowdown, widened fiscal deficits and put pressure on exchange rates. With the exception of Venezuela, these countries were eventually forced to abandon targeting their exchange rate, with the Brazilian and Ecuadorian devaluations being the most acute, after massive losses of reserves. In the case of Colombia (and Chile), the decision to float currencies was not accompanied by large devaluation because reserves were still at reasonable levels. As in other cases (Russia and Turkey), the East Asian crisis may not have been the fundamental cause of the downturn that ensued, but it was a contributing factor and triggered a reaction to more deep-seated problems. By and large, countries where policies are sounder (Chile and perhaps Mexico) avoided the worst.

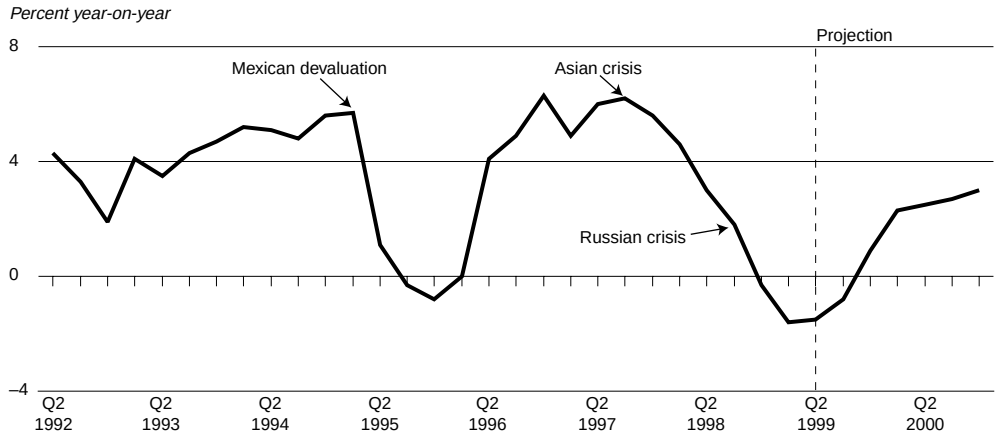
Brazil's devaluation, uncertainties in the run-up to elections, and tighter U.S. monetary policy helped spread the economic downturn in the region in 1999. The Brazilian devaluation worsened the external environment for many countries in the region, though to a much lesser extent than the Russian crisis. Prices of key commodities exported by Brazil (coffee, soybeans, and sugar) fell sharply in the first half of the year at the same time that Brazilian import demand collapsed, significantly reducing export revenues in a number of countries. Forthcoming elections in Argentina and Chile, coupled with increasing civil resistance to further fiscal tightening in some countries (Colombia, Ecuador, and Venezuela), led to greater uncertainty on the part of domestic investors. The tightening of U.S. monetary policy in mid-year, in conjunction with the debate over increasing the burden-sharing of international bond holders, contributed to a reduction in the supply of private capital available to the region from international markets. Ecuador's prospective default on its Brady bonds and calls for debt restructuring in Venezuela added to the uncertainty that private investors faced. The net result was the spread of the economic downturn within the region, with GDP in 1999 falling in nine countries, compared with only four countries in 1998. However, the expected economic outcome for Brazil will likely be much better than envisioned six months ago (no growth now versus –3.9 percent then) and should keep the decline in the region's GDP to about –0.6 percent. The region's current account deficit narrowed by about $33 billion in 1999, due to a contraction in imports of 2.6 percent.

Growth in per capita income of the Caribbean countries averaged 2.2 percent in 1999 but economic performance varied widely, and growth prospects are expected to remain diverse. Per capita GDP growth in 1999 averaged 3–4 percent in Barbados, Dominican Republic, and Trinidad & Tobago; 2–3 percent in the Leeward and Windward islands; 0–1 percent in Guyana and Haiti; but was negative in Jamaica for the third consecutive year. Movements in the terms of trade explain part of this diversity in growth performance—the faster growing economies rely more on tourism and oil for export revenues while most of the others depend heavily on exports of bananas and sugar, whose prices on world markets fell 12 and 30 percent, respectively.

Near-term outlook

Economic recovery in 2000–2001 is likely to be gradual, as further fiscal tightening is necessary in many countries and reform fatigue is becoming widespread. Recovery should begin by the fourth quarter and into 2000 for many of the countries experiencing recession in 1999 (figure A1.3). External factors behind the rebound include: an acceleration of world trade; the stabilization of commodity prices and the rise in some (for example, oil and metals); a slow recovery of capital flows; greater exchange rate flexibility in many countries; and less external debt amortization in 2000. Domestically, the ending of destocking facilitated by improved financial conditions (lower domestic interest rates, higher stock market valuations) should support a stabilization and consequent upturn in production.

Figure A1.3 Latin America and the Caribbean quarterly GDP



Source: World Bank staff estimates.

However, there are a number of reasons why the economic recovery in 2000 is expected to be modest compared with 1996 (post-Mexico crisis). First, fiscal tightening is required in a number of countries to sustain investor confidence and help exchange rate stability (Argentina, Colombia, Ecuador, Venezuela, and possibly Brazil). Implementation of further fiscal tightening could encounter resistance, especially since unemployment rates are high. Second, political uncertainties are likely to persist into 2000 as Mexico and Peru elect new presidents and many new administrations lack clear majorities in their respective congresses (Brazil, Colombia, and Ecuador). This uncertainty is likely to result in investor wariness. In addition, the expected slowdown in the United States in 2000–2001 could restrain Latin America's export growth. The combination of these factors is likely to lead to a moderate economic recovery, with the region's GDP growing by 2.7 percent in 2000 before accelerating toward 3.5 percent in 2001. The current account deficit during the next two years is expected to rise to a range of $60 to $70 billion from the 1999 level of $56 billion.

Near-term uncertainties. If private capital inflows remain weak into 2000, or capital outflows increase sharply in response to political developments, pressures on some currencies could increase. Although the baseline scenario assumes that Argentina will implement fiscal adjustment and obtain sufficient external support for financing its fiscal deficit and external payment obligations, risks remain that the process will not be smooth. Tighter monetary conditions in the industrial countries are likely to keep Argentina's cost of capital relatively high and the volume of capital inflows modest. Venezuela has persisted in maintaining a crawling exchange rate band, even though the country's real effective exchange rate is now 50 percent higher than its 1990–96 average. Although Venezuela has been able to fend off speculative exchange rate attacks in the past, and the rise in oil prices will help with potential future episodes, uncertainty on the policy front could lead to capital flight on a scale beyond the administration's ability to counteract. Both Chile and Colombia, with a history of much better macroeconomic management were forced to move toward an exchange rate float in 1999.

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

Growth rates/ratios	1989–98	1997	1998	Baseline forecast 1999	2000	2001	1999–2008
Real GDP growth	2.9	5.4	2.1	–0.6	2.7	3.5	3.5
Consumption per capita	1.6	4.0	1.5	–3.6	0.2	1.4	1.3
GDP per capita	1.1	3.7	0.5	–2.2	1.1	2.0	2.0
Population	1.8	1.7	1.6	1.6	1.6	1.5	1.4
Median inflation[a]	17.0	8.5	7.9	8.3	7.9	6.8	6.3
Gross domestic investment/GDP	22.1	24.2	24.0	22.8	23.5	24.1	24.6
Central government budget deficit/GDP	–2.8	–1.8	–3.7	–2.8	–1.6	–1.4	–1.3
Export volume[b]	8.0	8.9	5.6	3.8	6.9	6.0	6.5
Current account/GDP	–2.4	–3.3	–4.5	–3.1	–3.3	–3.5	–3.4

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank Development Prospects Group, November 1999.

Long-term prospects

Output growth for the region in the long term (2002-2008) is now projected to average 4.2 percent (2.8 percent in per capita terms), which is a reduction of 0.2 percentage points compared to *Global Economic Prospects 1998/99* (table A1.3). The lower forecast is based on several factors which, although characteristic of the region for many years, have become more evident during 1999. National saving rates in several large countries have not risen in the 1990s and most continue to rely on foreign savings to accommodate increases in investment. High external indebtedness has increased reliance on international capital markets to finance debt repayments, and there is increasing evidence of reform fatigue in a number of countries. In Brazil the large increase in domestic debt over 1997–99 and a continued low saving rate will require a strong and sustained fiscal adjustment, which has been encountering public resistance. A similar situation exists in Argentina, where savings remain insufficient for sustainable growth. GDP per capita growth for the Caribbean countries is likely to average 2.5 percent a year reflecting the difficult structural transition that these countries will have to undergo in the face of increasing global competition of commodity exports to traditional markets.

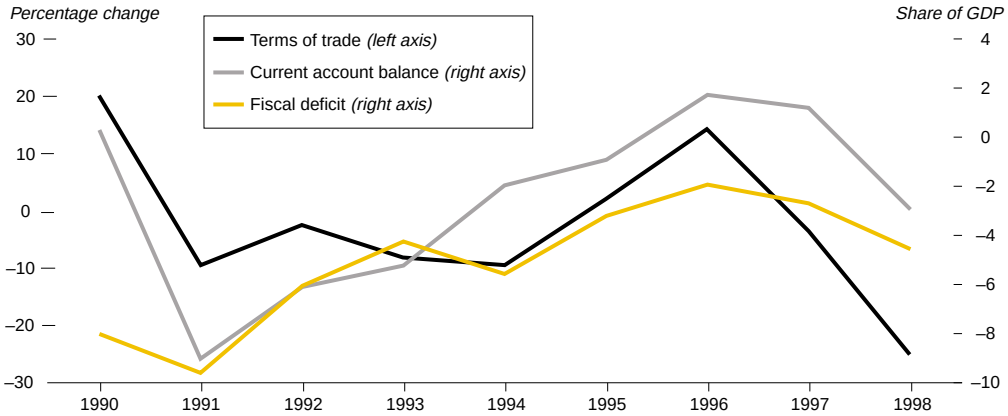
Despite these uncertainties, longer term growth prospects—contrasted with the 1980s and 1990s—are favorable, as efficiency gains from past reforms are realized. Growth in total factor productivity, regionwide, is likely to continue its upward trend as Brazil, the last of the large economies in the region to embark on liberalization, overcomes current difficulties. The privatization of large state enterprises in the water, electricity, transportation, and telecommunications sectors should begin to bear fruit into the first decade of the 2000s. Privatization, combined with the increasing market power of the Southern Cone countries through Mercosur, should encourage FDI inflows, and the nature of FDI should shift from acquiring existing capital stock through privatization to investment in new capacity in the services and manufacturing sectors.

Middle East and North Africa

Recent developments

The historically low oil prices of 1998 depressed growth in the Middle East and North Africa (MENA) region (see chapter 4). Current account imbalances grew and government revenues came under severe pressure (figure A1.4). The low absorption oil exporters (Bahrain, Oman, and Saudi Arabia) utilized

Figure A1.4 Terms of trade, current account balance, and fiscal deficits in the Middle East and North Africa, 1990–98



Source: World Bank.

foreign reserves and external portfolios to finance the deterioration of fiscal deficits and trade balances in the short term. Other oil exporters, such as Algeria, the Islamic Republic of Iran, and the Republic of Yemen had similar pressures but faced tighter financing constraints. This led to a different adjustment path, including deeper expenditure cuts, exchange rate devaluation, rescheduling of external debt, and, in the case of the Islamic Republic of Iran, import compression and liquidity stress as foreign reserves declined and import cover fell. The net oil importers benefited from lower oil prices, although some countries experienced a fall in workers' remittance receipts from the oil exporting countries. The low level of regional integration into global capital markets ensured some protection against the worst effects of the East Asian crisis.

GDP growth in the region averaged 2 percent in 1999, 1.4 percentage points higher than anticipated earlier in the year, due to stronger than expected oil prices and higher domestic investment in the diversified exporters. The terms of trade of oil exporters rose by 35 percent (equivalent to nearly 9 percent of GDP), boosting government revenues and contributing to an easing of fiscal constraints. Nevertheless, the restriction of export volumes in order to support oil prices (OPEC cut production by 2 million barrels a day in April 1999) limited the real output recovery in the oil exporting countries.

GDP growth in the more diversified exporters (the Arab Republic of Egypt, Jordan, Morocco, the Syrian Arab Republic, and Tunisia) slowed to 3 percent in 1999, from 3.5 percent in 1998. The decline in activity in oil-exporting countries, as well as slower growth in Europe, put downward pressure on receipts from worker remittances. Those countries with exchange rates pegged to the dollar experienced slower export growth, in part as the value of the dollar increased and as the competitiveness of East Asian exporters in textiles, clothing, and machinery improved. Drought conditions in several countries (Jordan, Morocco, and Syria) led to a decline in agricultural incomes, as well as to further pressures in urban labor markets and higher food import bills.

Near-term outlook

GDP growth in the region should accelerate to 3.2 percent in 2000. The recovery in oil prices

Table A1.4 Middle East and North Africa forecast summary
(percent per year)

Growth rates/ratios	1989–98	1997	1998	Baseline forecast 1999	2000	2001	1999–2008
Real GDP growth	3.0	3.7	3.2	2.0	3.2	3.5	3.4
Consumption per capita	–0.1	0.3	1.8	0.8	1.3	1.3	1.4
GDP per capita	0.6	1.5	1.2	–0.1	1.1	1.5	1.4
Population	2.4	2.1	2.1	2.1	2.1	2.1	2.0
Median inflation[a]	8.7	4.9	3.3	5.3	4.9	4.9	4.5
Gross domestic investment/GDP	22.8	23.9	23.7	23.8	23.9	24.1	24.7
Central government budget deficit/GDP	–5.2	–2.6	–4.5	–3.6	–3.3	–2.9	–2.2
Export volume[b]	4.5	5.0	2.6	1.4	3.4	4.0	3.9
Current account/GDP	–2.2	3.8	–1.5	4.2	4.5	3.6	2.2
Memo items							
GDP of oil dominant economies	3.6	2.9	1.6	1.1	2.2	3.0	2.9
GDP of diversified exporters	3.7	3.1	3.5	3.0	4.7	4.4	4.4

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank Development Prospects Group, November 1999.

in mid-1999, following the implementation of the OPEC oil quotas and the high level of compliance thus far, points to a stabilization of economic activity in oil exporting countries, and GDP growth for this group is expected to range between 2.5–3 percent in 2000–2001. Output growth will continue to be constrained by quotas on oil production and the need to contain fiscal deficits and public debt levels. Recent increases in sales tax and utility charges and cuts in subsidies in the oil exporting countries are expected to have modest inflationary impact. But central banks in the low absorption oil exporters are likely to maintain tight monetary policies to help keep inflation low and maintain exchange rate stability. Inflation is likely to be more of a problem in the Republic of Yemen and the Islamic Republic of Iran. The diversified exporters are likely to grow by 4.7 percent in 2000, as growth in partner imports improves, the renewed drive for reform in several countries encourages domestic investment, the effects of drought conditions fade, and tourism receipts rise (table A1.4).

Long-term prospects

Despite an anticipated near-term revival of activity, forecasts for long-term output growth (2002–2008) have not been revised from earlier projections at 3.7 percent. Oil prices are likely to remain under downward pressure in the longer term (see chapter 1), which will constrain oil exporting countries' fiscal and foreign exchange revenues. But the diversified exporters are expected to maintain a growth rate of 4.6 percent, supported by continued structural reforms and the linkages that are developing as a result of the Euro-Mediterranean agreements. Several North African countries are implementing restructuring programs in line with their association agreements to boost efficiency in preparation for open competition from European firms. Privatization programs in Egypt, Jordan, Morocco, and Tunisia, in conjunction with a deepening of capital markets, are attracting foreign investment. Programs are in place to transfer public enterprises to the private sector, and new projects in minerals and infrastructure are being implemented under private contracts or on a build-own-operate-transfer basis. Large public enterprises such as utilities and telecommunications are being sold or corporatized prior to sale. A beneficial by-product of divestment of public enterprises will be the lowering of fiscal deficits and public debt.

Additionally, the peace process in the Middle East, which appears to be bearing fruit, may contribute to a lowering of risk perceptions, particularly in the Mashreq countries, and may provide an opportunity for increased dynamism in trade and capital flows.

South Asia

Recent developments

In 1999, for a second consecutive year, South Asia was the fastest growing developing region, averaging 5.4 percent GDP growth. Negative external factors that slowed growth elsewhere had a smaller effect on the region. Among domestic factors, the most positive was a favorable Indian monsoon, which led to impressive agricultural sector performance, while among the smaller economies domestic factors led to lower-than-trend growth. The aftereffects of 1998 floods in Bangladesh and Pakistan's stabilization program dampened growth in those two countries.

Relative independence from external influences is a constant structural feature of the Indian economy, and India experienced only moderate spill-over effects from the series of crises in 1997–99. The country's main export markets are in Europe and the United States, so the crisis did not greatly reduce demand for India's exports. As well, financial liberalization in India has been limited, and the country was not subject to capital account reversals. However, several other countries of the region were adversely affected. Bangladesh, Pakistan, and Sri Lanka were hit by weak external markets and falling commodity prices, particularly for tea, rubber, and cotton.

Pakistan's economy decelerated sharply in 1998 and 1999 due to a wide range of causes. Many of these causes were related to deeper seated structural imbalances, especially tied to fiscal performance and shortfalls in private savings. The result was an emerging balance of payments crisis, compounded by the sanctions that followed nuclear testing in 1998. Bangladesh suffered an economic downturn in 1998, due to extensive flooding which destroyed food crops, cut export volume, increased imports of food, and damaged infrastructure. Expenditure throughout the economy was affected as rural incomes were cut. The East Asian crisis may have weakened demand for ready-to-wear garments manufactured in Bangladesh. GDP growth dropped from 5.7 percent in 1998 to 3.5 percent in 1999. Sri Lanka, the most open of the South Asian economies, exports 37 percent of its GDP. It depends on exports to provide a market for its manufactures and on strong world demand to sustain prices for tea, rubber, and

Table A1.5 South Asia forecast summary

(percent per year)

				Baseline forecast			
Growth rates/ratios	1989–98	1997	1998	1999	2000	2001	1999–2008
Real GDP growth	5.5	4.7	5.1	5.4	5.5	5.3	5.2
Consumption per capita	3.3	2.1	3.1	3.2	3.3	3.5	3.6
GDP per capita	3.5	3.0	3.3	3.5	3.6	3.6	3.7
Population	1.9	1.8	1.8	1.9	1.8	1.7	1.5
Median inflation[a]	9.5	9.1	7.6	7.2	5.8	5.2	5.3
Gross domestic investment/GDP	22.0	22.9	23.2	23.3	23.5	23.6	23.5
Central government budget deficit/GDP	–6.3	–4.4	–3.1	–3.0	–2.9	–2.8	–3.1
Export volume[b]	9.8	2.6	1.9	6.0	7.7	7.8	7.7
Current account/GDP	–1.9	–1.2	–1.8	–2.0	–2.1	–2.3	–2.5

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank Development Prospects Group, November 1999.

other materials. The slowdown in world demand was important in keeping tea and rubber prices low and reducing export receipts (table A1.5).

Near-term outlook

Looking ahead, several positive factors will help India sustain growth in 2000 and 2001. These include a high level of private sector business confidence and a commitment in principle by both major political parties to a broad range of economic reforms. But there are also forces that could restrain growth, including twin fiscal and balance of payments deficits, the deteriorating state of infrastructure, and a large public sector deficit. Substantially faster growth would require increased fixed capital formation and saving, and foreign direct investment would be a crucial element of financing. Absent policy changes, prospects for Bangladesh and Pakistan are not particularly encouraging. An improvement in external conditions, including an acceleration of world trade growth and the stabilization of commodity prices, would be helpful in the near term, but the recent surge in petroleum prices will exact a toll on fragile import bills for both countries. The implications for economic growth of the recent coup in Pakistan are not yet clear. For Bangladesh, most of the flood damage has been repaired, the water level has fallen, and crops were replanted for the 2000 harvest. Conditions should allow the economy to revive toward 5 percent growth in 2000. Sri Lanka is well situated to benefit from an acceleration in world trade growth in 2000 and an increase in commodity prices over the same period.

Long-term prospects

Despite cautious optimism concerning a near-term increase in economic activity in the region, prospects covering 2002–2008 have been downgraded from previous projections. The main requirement for a strong long-term outlook is economic reform: in Pakistan, the implementation of key reforms in banking, power, taxation, and public spending; and in Bangladesh, the improvement of macroeconomic management, governance, and infrastructure. But critically, India's long-term potential output growth is linked to policy actions, which must redress the current fiscal deficit (over 6 percent of GDP), continued high (and increasing) tariff barriers, and increases in nonperforming loans and other structural problems in the banking system.

Sub-Saharan Africa

Recent developments

Sub-Saharan Africa's economic growth slowed progressively from 4.7 percent in 1996 to less than 2.5 percent in 1998–99. Several factors were responsible. A steep fall in oil prices in 1997–98 hurt countries that export significant amounts of oil and other hydrocarbons.[3] Numerous conflicts—many of which had appeared to be moving toward resolution—flared up, including in Angola, Democratic Republic of Congo, Ethiopia and Eritrea, Guinea-Bissau, Lesotho, and Sierra Leone. Poor weather disrupted agriculture and tourism throughout eastern and southern Africa and heavy rains damaged infrastructure. Finally, South Africa, the region's largest and most open economy, was caught in the turbulence of the East Asian crisis as a reversal of capital inflows in mid-1998 sent interest rates sharply higher and dampened interest-sensitive sectors through the first half of 1999.

Despite these adverse developments, pro-market reforms, trade liberalization, and better governance sustained growth elsewhere in the region—in Mozambique, Uganda, and generally throughout the CFA zone, where the devaluation of the CFA franc in 1994 triggered a sustained boom in investment and exports. Moreover, developments in 1999 augur well for near-term prospects. Especially encouraging have been the smooth political transition in Nigeria; renewed prospects for peace in Sierra Leone, Liberia, and the Democratic Republic of Congo, and a swift return of international investors to South Africa.

Near-term outlook

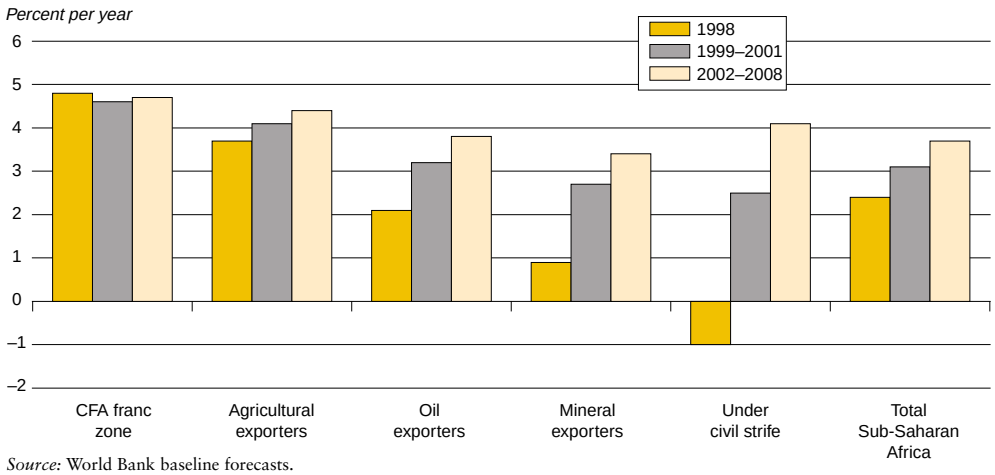
Growth in 1999 will be near the pace achieved in 1998—around 2.3 percent, or 3.2 percent excluding South Africa and Nigeria. This falls short of what is needed to recover the ground lost in recent years, and per capita incomes will decline modestly for a second successive year. Nevertheless, a gradual recovery from the slowdown appears to be underway. Growth is anticipated to rise to 3.3 percent over 2000–2001. Underpinning the stronger performance will be a pick-up in exports over the next 12–24 months, based on sharp gains in oil prices, the unexpected strength of the recovery in East Asia, and the euro's weakness against the U.S. dollar, which will further boost the competitiveness of CFA zone countries. Following a decline of 0.3 percent in 1998, merchandise exports are expected to grow by 3.8 percent in 1999, 6.3 percent in 2000, and 4.7 percent in 2001. On top of the broader recovery, export performance in 2000 will reflect the revival of Nigeria's hydrocarbon sector, and especially the commencement of liquid natural gas shipments from the new Bonny Island facility. Excluding South Africa and Nigeria, Sub-Saharan export growth is predicted to reach 4.3 percent in 1999 and 4.6 percent in 2000–2001.

Import growth will not keep pace with exports, allowing the current account deficit to shrink from an unsustainable $14.2 billion (4.6 percent of GDP) in 1998. For the region as a whole, the current account deficit is projected to narrow to 2.8 percent of GDP in 1999 and 2.6 percent in 2000. While falling short of the level of performance in 1997–98, import growth will remain adequate to support purchases of capital and intermediate goods for production and investment needs. Meanwhile, the forecast anticipates a continuation of policy reforms and a move away from the inward-looking trade regimes that contributed to Sub-Saharan Africa's relative isolation over the past 25 years. Overall, trade will continue to outpace GDP growth, resulting in higher trade shares and increasing openness (figure A1.5).

Long-term prospects

Output for the region is expected to achieve growth of 3.6 percent from 2002–2008 (figure A1.5). That represents a 0.5 percentage point downward revision from last year's *Glo-*

Figure A1.5 Real GDP growth by analytical groups for Sub-Saharan Africa



Source: World Bank baseline forecasts.

Table A1.6 Sub-Saharan Africa forecast summary
(percent per year)

Growth rates/ratios	1989–98	1997	1998	Baseline forecast 1999	2000	2001	1999–2008
Real GDP growth	2.4	3.7	2.4	2.3	3.1	3.4	3.4
Consumption per capita	–0.4	2.5	1.0	–0.8	–0.1	0.5	0.9
GDP per capita	–0.3	0.8	–0.2	–0.2	0.6	0.9	1.0
Population	2.8	2.9	2.6	2.6	2.5	2.5	2.4
Median inflation[a]	9.7	8.2	6.5	8.1	5.5	5.4	5.5
Gross domestic investment/GDP	16.8	17.0	17.4	17.5	17.7	17.9	18.4
Central government budget deficit/GDP	–5.3	–3.3	–3.6	–4.1	–4.0	–4.1	–4.1
Export volume[b]	4.3	5.6	–0.3	4.1	6.1	4.8	4.9
Current account/GDP	–2.0	–2.8	–4.6	–2.8	–2.6	–2.6	–2.0
Memo items							
GDP of major oil exporters[c]	2.9	4.2	1.3	1.3	3.4	3.6	3.2
GDP of region, excluding South Africa and oil exporters	3.1	4.6	4.0	3.3	3.6	3.9	3.9

a. GDP deflator.
b. Goods and nonfactor services.
c. Angola, Gabon, and Nigeria.
Source: World Bank Development Prospects Group, November 1999

bal Economic Prospects and reflects greater pessimism about prospects in commodity and financial markets, as well as an assessment that South Africa will require a more extended period to reach its long-run potential output growth. A sustained 3.6 percent expansion of GDP, together with a gradual slowing of the region's population growth (from current rates of 2.6 toward 2.4 percent), will permit a moderate rise in per capita incomes of 1.3 percent per year over the long-term forecast period. The ability to encourage private investment will be the key to stronger performance, and those countries with better policy environments, effective export strategies, and more diversified economies will tend to do better (table A1.6).

Despite the downward revision, the outlook remains for a substantial improvement over the 2 percent average growth achieved during the past two decades. Many of the region's intractable conflicts are likely to be resolved, and there has been a broad-based transition to democratic rule and more responsible governance. An accumulation of evidence indicates that these developments are producing results—for instance, they have contributed to the rise in investment and exports during the 1994–97 growth cycle (see chapter 4). However, these factors will be offset by other less favorable trends: commodity prices of critical importance to the region are expected to show only weak advances, putting a damper on investment and exports; a poor outlook for foreign aid and negative foreign investor sentiment will squeeze current account balances and compress imports; falling budget support is likely to cut into social spending, reducing the growth rate of human capital. Finally, the extent of the AIDS epidemic is becoming clearer, and with it the inevitability of a sustained, negative impact on economic performance. Medium-term projected population growth in the worst affected countries has been lowered by as much as 1–2 percent annually compared to what would have been expected without AIDS. Moreover, since the disease preponderantly affects better educated and more productive urban workers, output growth in these countries will slow by a substantially higher amount. For the region as a whole, a reduction in per capita growth of 0.3 percent tied to this development seems likely.

Especially given the lackluster expectations for commodity prices and the poor climate for foreign aid, countries will need to continue diversifying and opening their economies to sustain adequate growth. Ongoing structural adjustment over the forecast period should raise domestic savings and investment, as well as make Sub-Saharan Africa more attractive to potential foreign investors. FDI is increasingly being attracted not only to extractive and resource-based sectors, but also to telecommunications, transportation, and utilities sectors as they are privatized and deregulated. Meanwhile, though prospects for foreign aid are not promising, many Sub-Saharan countries stand to benefit from debt relief under enhanced terms of the Heavily Indebted Poor Countries Initiative (HIPC), improving the sustainability of current account positions. Of the 36 countries eligible under the enhanced framework, 30 are in Sub-Saharan Africa, and the region stands to receive over 80 percent of the relief worth $27 billion in net present value terms. Not only will there be a transfer of real resources for poverty reduction and other purposes, but stronger balance sheets and improved creditworthiness will facilitate the integration of recipient countries into the world economy.

Notes

1. Indonesia, Malaysia, the Philippines, the Republic of Korea, and Thailand.

2. Since July the currencies have been drifting somewhat downward for a number of reasons—restructuring problems in Korea; corruption and conflict in East Timor in Indonesia; and tensions between Taiwan (China) and China have affected the former.

3. Angola, Cameroon, Congo (Brazzaville), Equatorial Guinea, Gabon, and Nigeria.