Appendix 4
Regional Economic Developments and Prospects

East Asia and Pacific

Europe and Central Asia

Latin America and the Caribbean

Middle East and North Africa

South Asia

Sub-Saharan Africa

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East Asia and Pacific

GNI per capita, 2000: $1,060

Recent developments

Growth in the East Asia and Pacific region slowed sharply in 2001, from 7.4 percent in 2000 to 4.6 percent. Excluding China, growth slowed more, from 7 percent in 2000 to 2.3 percent in 2001. The downturn in growth was concentrated in the high-tech exporting countries, which suffered disproportionately from the global recession in high-tech sectors.[1] Chinese growth was maintained at rates above 7 percent through substantial fiscal stimulus. And Vietnam grew by 5.5 percent by further increasing its share in export markets. But, partly related to its export success, the country suffered significant terms-of-trade losses.

Regional merchandise export volumes showed little to no growth in 2001, following an advance of 23 percent in 2000. And dollar export revenues fell (3.7 percent) for the first time since 1998. Moreover, loss of tourism revenue was significant in the wake of September 11, especially for Thailand and the Philippines. Worker remittances in the latter country were down sharply, a direct effect of the slowdown in world trade and tourism, because a significant portion of remittances come from Philippine seamen on cargo and cruise vessels.

Many countries in the region were able to use countercyclical monetary and fiscal policies to limit the adverse effects on growth caused by worsening external conditions. Rapidly falling international interest rates facilitated domestic interest rate declines in several countries. Over the course of 2001, policy rates fell 140 basis points in the Republic of Korea and 550 basis points in the Philippines. In both countries unemployment stabilized in the first half of 2001 and decreased in the second half of the year.

Across the region fiscal balances deteriorated, but the impact of this stimulus on domestic inflation and exchange rate levels was limited. For Thailand, Korea, and the Philippines, currency depreciation vis-à-vis the dollar ranged between 2 and 6.5 percent during 2001. The 9 percent depreciation of the rupiah, despite a 400 basis point increase in policy interest rates, made Indonesia an exception in the region.

Despite a decisive reduction in current account surpluses, the region saw a $50 billion increase in reserves during the year. The improved external positions since the East Asian crisis made an increase in reserves possible despite a fall in export revenues and domestic stimulus, and a decline in capital flows. Indonesia, struggling with a difficult political and social environment, was one of the few countries where reserves declined.

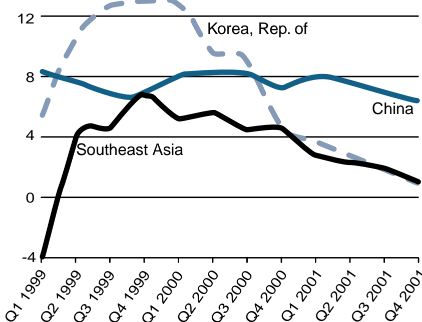
Capital market flows decline

Gross flows from the international capital markets fell dramatically during 2001. The aggregate of bond and equity issuance and bank lending dropped by $25.8 billion in the year (almost 40 percent) to reach a level of $40.9 billion—only moderately above the outturns of 1998, at the peak of the East Asian crisis. In contrast with conditions at that time—large-scale withdrawal of short-term banking debt—the 2001 downturn in flows reflects in part a decrease in demand for funds in the region, as well as limited investor supply of capital for high-tech ventures. The falloff in flows to East Asia amounted to one-half of the decline in flows to all emerging markets for the year.

Banking flows, which traditionally account for about 50 percent of

GDP growth in East Asia, 1999–2001

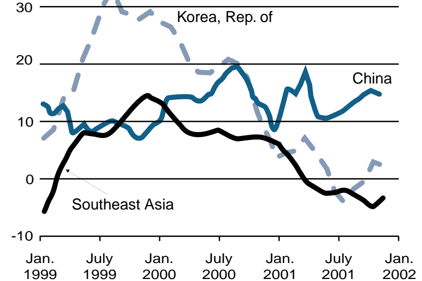
Year-over-year percentage change



Source: World Bank.

Industrial production in East Asia, 1999–2002

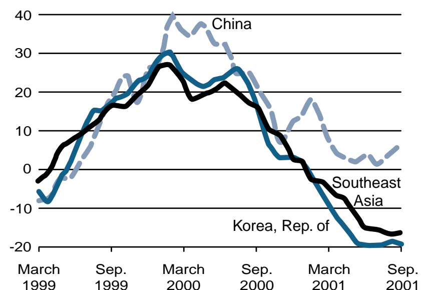
Three-month moving average, year-over-year percentage change



Source: Datastream and World Bank staff estimates.

Export in dollars, growth for East Asia, 1999–2001

Three-month moving average, year-over-year percentage change



Source: Datastream.

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market-based financing for the region, dropped by $10.7 billion, or 36 percent, with the decline in international bank credit broadly based across countries. This development likely reflects the confluence of several factors: increasing availability of preferred long-term capital through the international bond markets; decreasing demand for funds from a balance of payments perspective, against the background of continued (albeit diminishing) current account surpluses and record high reserve levels; and falling requirements for working capital and trade finance, with steep recession in high-tech manufacturing sectors across developing East Asia.

International equity placement fell from a record $23 billion in 2000 to $7.2 billion. China, which is the premier source of equity issuance among emerging markets ($21.9 billion placed in 2000, or 62 percent of total equity during that year), found international market conditions unfavorable for issuing larger share volumes (particularly for high-tech firms). And investor appetite for emerging market exposure was diminished during most of the year. Despite the less opportune environment, Korea and Thailand stepped up international placements, the former more substantially, from $1 billion in 2000 to $3.7 billion in 2001.

The shift from bank-sourced financing to the bond markets was of note during the year. Although bond issuance in East Asia advanced by about $1 billion over 2000 levels to $14.7 billion, a number of countries began to participate more fully in the market. China increased issuance by more than $1 billion to $2.5 billion, Malaysia by $750 million to $2.2 billion, and Thailand to $280 million. In contrast, Indonesia and the Philippines, under the weight of structural economic difficulties at present, were limited in their ability to expand use of the market, and issuance dropped by $200 million in the former and $625 million in the latter country during the year.

Bond market conditions were variable over the course of 2001. Spreads on East Asian secondary market debt increased moderately from an average 295 basis points in 2000 to 350 basis points in 2001—but these figures tend to mask the dynamics of financial market developments in the year. A narrowing of the regional spread by 50 basis points over the first half of 2001 was reversed by October as concerns regarding the Argentine situation and the health of the global economy mounted. By early January 2002, however, spreads fell quickly by 100 basis points, with the Philippines, a focus of some market concern, experiencing an easing of more than 200 basis points.

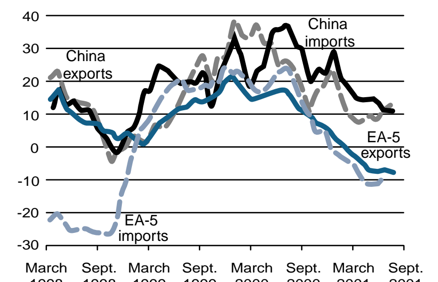
Foreign direct investment

Net inflows of foreign direct investment (FDI) to the region were $48.5 billion in 2001, a decline of $3.6 billion, or 6.9 percent, from 2000. At first glance, this amount must be considered a robust outturn in the context of global and East Asian regional recessions. Once more, such aggregates tend to mask a shifting distribution of investment flows across countries of the region.

The bulk of FDI flows continues to be directed to China, at $44 billion in 2001, a sharp $6 billion advance over the $38 billion recorded in 2000, returning flows to the record levels of 1997. But, with the exception of Vietnam, FDI flows into other large East Asian countries declined—in some cases precipitously—during the year. As an extreme case, for the fourth year in succession, FDI flowed out of Indonesia at an accelerated pace of $6 billion in 2001.[2] FDI dropped by $6

Export and import volume growth in East Asia, 1998–2001

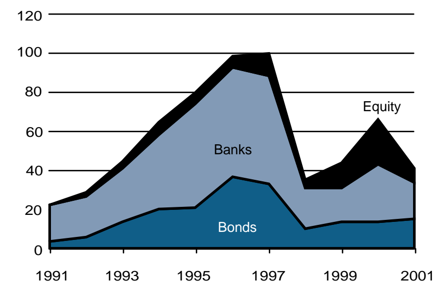
Three-month moving average, year-over-year percentage change



Note: EA-5 comprises Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.
Source: World Bank Economic Policy and Prospects Group.

Gross capital market flows to East Asia, 1991–2001

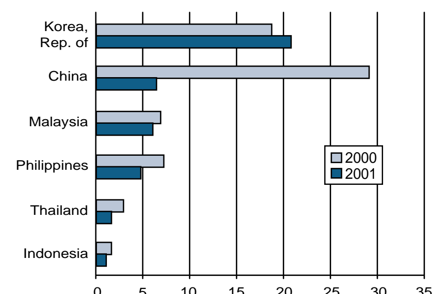
Billions of dollars



Source: Euromoney.

Capital market flows by country, 2000 and 2001

Billions of dollars



Source: World Bank Economic Policy and Prospects Group.

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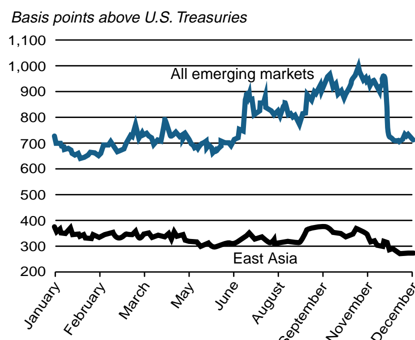
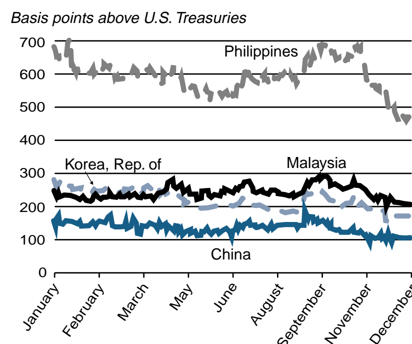
East Asian bond spreads, 2001

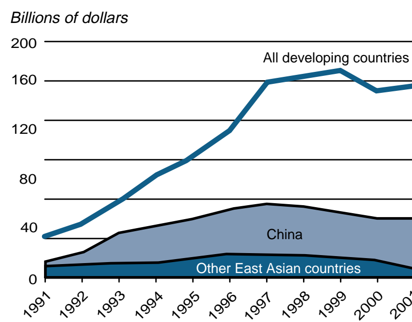


Source: J.P. Morgan Chase through Bloomberg.

Selected East Asian bond spreads, 2001



Foreign direct investment, 1991–2001



Source: World Bank.

billion, or two-thirds, in Korea; by $660 million, or 40 percent, in Malaysia; by 32 percent in Thailand; and by 20 percent in the Philippines.

The decline in FDI flows to these countries likely has its roots in the current downturn in the semiconductor and computer markets, where for several years overseas investment in new capacity had been buoyant. FDI flows to East Asia, excluding China, accumulated to $50 billion from 1998 to 2000, a good proportion of the accumulation occurring in the technology sectors.

Prospects and risks

Buoyed by the anticipated rebound in global high-tech markets (signs of which are now emerging in the United States), East Asia is expected to lead recovery in the developing world. During the fourth quarter of 2001, industrial production in high-tech East Asia, (Korea and Malaysia among middle-income countries, Singapore and Taiwan [China] among the newly industrialized economies) has turned the corner decisively, in line with an upturn in Asian semiconductor sales. However, recovery in GDP growth is likely to appear muted in annual figures for 2002, as regional output is expected to register 5.2 percent growth in the year, up from 4.6 percent in 2001. But in the absence of adverse surprises, the momentum underlying the current upswing could produce regional growth near 7 percent by 2003, growth similar to the robust outturns of 2000.

As most countries in the region have generally kept real exchange rate levels below their precrisis averages, they are expected to benefit fully from the turnaround in global trade, with export growth of nearly 10 percent in 2003 and 2004.

Yet, downside risks to this more encouraging view remain large. The recovery in global high-tech sectors may not be as robust as has been the case in past cycles. In particular, the unprecedented bursting of the high-tech bubble in financial markets may exert a larger drag on the availability of funds for high-tech firms than is assumed in the baseline. In broader scope, near-term revival of world demand continues to hinge on the spending behavior of the U.S. consumer. And abrupt changes in consumer confidence could serve to delay or protract recovery for some time.

Within East Asia, the economic and political situation in Indonesia remains difficult, potentially dampening the recovery foreseen in the baseline. And the "war on terrorism" has increased global uncertainty, with several countries in the region potentially directly affected in future.

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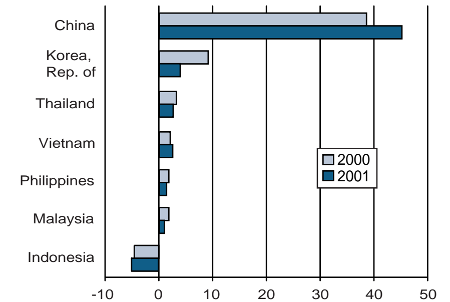
Notes

1. The most adversely affected were Korea and the newly industrialized economies (NIEs)—Hong Kong (China), Singapore, and Taiwan (China), which are not included in the aggregate for developing East Asia.

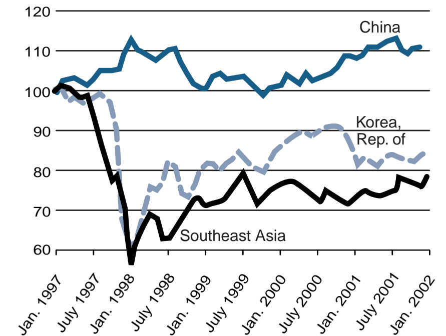
2. Negative net FDI in Indonesia is the result of repayments of intrafirm loans from foreign subsidiaries to their parents abroad.

Foreign direct investment by country, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

Real effective exchange rates, 1997–2002



Source: J.P. Morgan Chase.

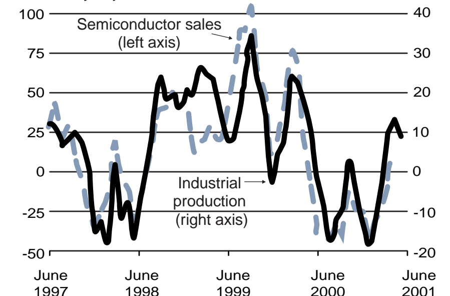
East Asia and Pacific forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	7.2	7.0	7.4	4.6	5.2	6.9	6.5
Consumption per capita	5.4	6.3	6.4	4.9	5.5	5.6	5.9
GDP per capita	6.0	5.9	6.4	3.7	4.2	6.0	5.6
Population	1.2	1.1	1.0	0.9	0.9	0.9	0.8
Gross domestic investment/GDP[a]	30.3	28.9	29.9	30.8	31.4	31.2	31.0
Inflation[b]	5.4	0.1	3.4	4.2	6.8	6.4	6.3
Central government budget balance/GDP	–1.1	–2.5	–2.7	–2.9	–2.9	–2.9	–2.5
Export market growth[c]	8.3	7.3	14.2	–0.3	2.6	7.8	7.6
Export volume[d]	12.7	7.5	22.0	2.6	7.1	9.4	10.7
Terms of trade/GDP[e]	–0.3	0.1	–0.9	–1.2	0.2	–0.5	–0.3
Current account/GDP	0.5	4.6	3.5	1.9	2.3	1.8	1.2
Memo items							
GDP growth: East Asia excluding China	5.3	6.9	7.0	2.3	3.5	5.9	5.5

a. Fixed investment, measured in real terms
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

High-tech emerging Asia:[a] Semiconductor dollar sales and industrial production, 1997–2001



Note: Through November 2001.
a. Republic of Korea, Malaysia, Singapore, and Taiwan (China).
Source: Datastream; World Bank staff estimates.

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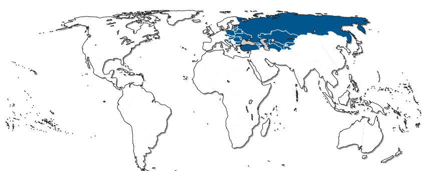
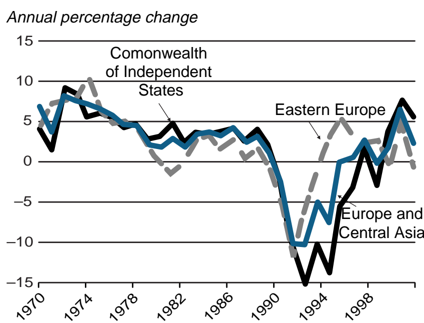


Europe and Central Asia

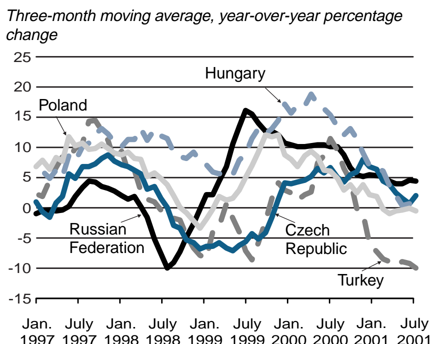
GNI per capita, 2000: $2,010

GDP growth rates, 1970–2001



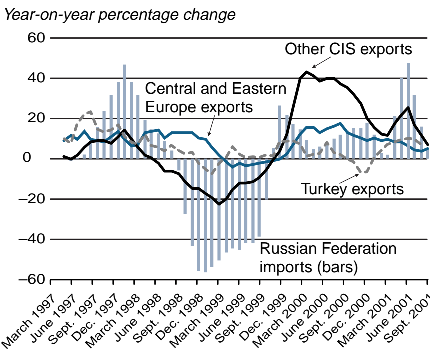
Source: World Bank.

Industrial production, 1997–2001



Source: Datastream.

Russian imports and partner exports, 1997–2001



Source: International Monetary Fund, *International Finance Statistics*; and World Bank.

Recent developments

Output growth in Europe and Central Asia slowed markedly to an estimated 2.2 percent in 2001 from 6.4 percent in 2000. A sharp deceleration in export markets contributed to this slowdown, but domestic factors were more significant—with a particularly pronounced downturn in Turkey and a notable deceleration of growth in Poland. While performance varied across countries, the general trend was an easing of growth during 2001. Most European and Central Asian countries experienced declining inflation—particularly in the Commonwealth of Independent States (CIS), where the median rate fell from 17.3 percent in 2000 to 8.8 percent in 2001—and falling interest rates, reflecting a drop in import prices and international interest rates. At the same time, a number of European and Central Asian countries (the Czech Republic, Kazakhstan, Poland, Ukraine, and Uzbekistan, among others) witnessed some deterioration in fiscal balances, generally because of the adoption of more expansionary fiscal policies.

The Central and Eastern European countries (including the Baltics and Turkey) experienced a contraction in output of 0.8 percent in 2001, following a robust 5 percent expansion in 2000. Pulling down the outturn for this group, the severe banking and currency crises in Turkey in February 2001 ushered in a sharp contraction of its economy over the year. Growth in the Central and Eastern Europe, excluding Turkey, declined to 2.9 percent in 2001 from 3.8 percent in 2000. This moderate deceleration reflected a slowdown in domestic demand in a few countries, especially in Poland, which had pursued a tight monetary policy through much of 2001; the former Yugoslav Republic of Macedonia, where civil war disrupted economic activity; and Slovenia, which witnessed a contraction in investment that was due in part to an increase in interest rates. Declining exports to Western Europe contributed to softening growth, given the Central and Eastern European economies' high exposure to Euro Area import demand. For example, Hungary, Poland, and the Slovak Republic's export volume growth decelerated markedly in 2001. However, import compression in a number of Central and Eastern European countries, including Turkey and Poland, mitigated weaker export performance from a balance of payments perspective.

The countries seeking accession to the European Union (EU) received a boost in November 2001, when the European Commission released its regular annual reports on the 10 European and Central Asian candidates—all Central and Eastern European countries.[1] The commission reported that all candidates made substantial progress in adopting the *aqcuis communautaire* (body of European Community law) over the year and that most of the countries (excluding Bulgaria and Romania) are expected to be ready to join in the near term. Some hurdles remain, as EU members have yet to formalize agreements in a number of important areas, mainly pertaining to agriculture and budgetary issues.

The CIS achieved strong 5.5 percent growth in 2001, though this is a significant moderation from the exceptionally robust 7.9 percent output advance of 2000. The slowdown mainly reflected easing energy prices from the highs witnessed in 2000. In

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Russia, some of the Caucasus countries, and Central Asia, firm energy prices funded increased fiscal outlays and investment. Further, domestic demand in Russia continued to benefit, albeit moderately, from ongoing import substitution spurred by the 1998 devaluation, as the ruble remains below precrisis levels. However, the 7 percent appreciation of the real effective exchange rate in 2001—culminating in the ruble losing roughly half of the competitive advantage it had gained because of the 1998 devaluation—is eroding this impetus. Firm growth in Russia, the CIS's largest economy, has also been key to generating strong external demand for other countries in Europe and Central Asia, especially those of the CIS and the Baltics.

Contagion from the financial crisis in Turkey was not notably apparent in the rest of Europe and Central Asia. For the region, excluding Turkey, spreads on secondary market debt instruments declined from an average of 1,020 basis points during 2000 to an average of 854 points during 2001. For example, spreads declined significantly in Russia from just below 1,340 basis points in 2000 to 955 for 2001, and in Croatia, from 380 basis points to 225. In Turkey, the average spread increased sharply from just over 530 basis points in 2000 to over 900 in 2001, and stabilized in the beginning of 2002 near 650 points.

Aside from rating downgrades for Turkish debt early in the year because of concerns about fiscal policy and the banking sector, (to B– from B+, according to Standard and Poor's [S&P]), credit ratings elsewhere in the region were upgraded. The Slovak Republic's rating was raised to investment grade by S&P, tied to progress in EU accession negotiations and the restructuring of state banks. A number of other European and Central Asian sovereigns were upgraded during 2001, including Bulgaria, Estonia, Kazakhstan, Romania, and Russia. The shifts in credit quality were attributed to various factors, including improvements in economic structure (Bulgaria, Estonia, and Russia), in the banking sector (Romania), or in external liquidity (Kazakhstan and Romania).

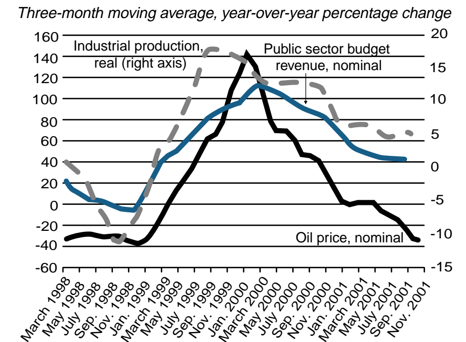
Gross capital market flows and foreign direct investment

Capital market commitments (bonds, bank lending, and portfolio equity) to Europe and Central Asia experienced a massive 34 percent decline during 2001 to $28.2 billion from a total $43 billion in 2000. The sharp drop-off is a reflection of the currency and banking sector crisis in Turkey, where flows fell by nearly $15 billion in the year, while gross capital market commitments to the rest of the region were flat at $21 billion. The largest decline for the region in aggregate was posted in banking flows, down from over $25 billion in 2000 to about $17 billion in 2001. Again, the decline in flows to Turkey of $6.5 billion accounts for the bulk of the reduction, though Poland and Russia experienced a moderate decline in banking flows.

Bond and equity flows to the region also fell sharply, both posting a drop-off of close to $3 billion. A large $6.3 billion decline in bond flows to Turkey was partially offset by substantial upswings in bond issuance by Hungary, Poland, Romania, and Russia. And a fall of $3 billion in equity placement from the region is almost wholly attributable to declines in flows to Turkey.

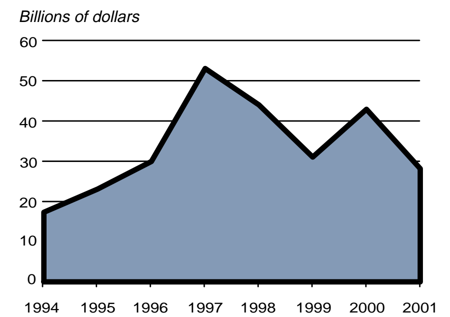
Foreign direct investment (FDI) flows remained much more resilient, totaling $28.5 in 2001, the same level

Russian Federation: Oil prices, fiscal linkage, and growth, 1998–2001



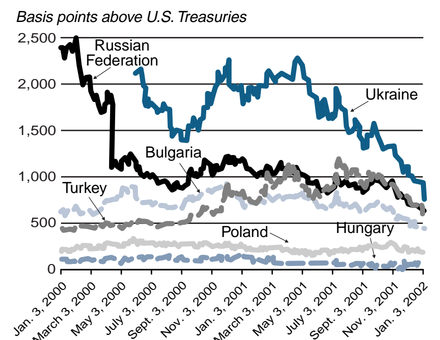
Source: World Bank.

Gross capital market commitments, 1994–2001



Source: World Bank.

Secondary market spreads for selected European and Central Asia countries, 2000–2002



Source: J.P. Morgan Chase

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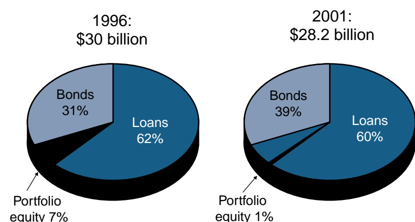
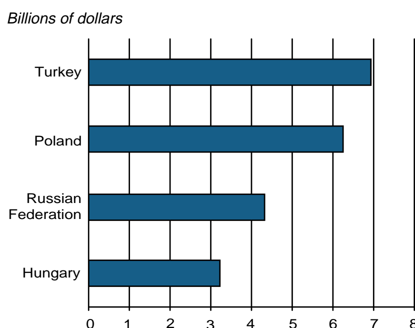
Composition of gross capital market commitments, 1996 and 2001



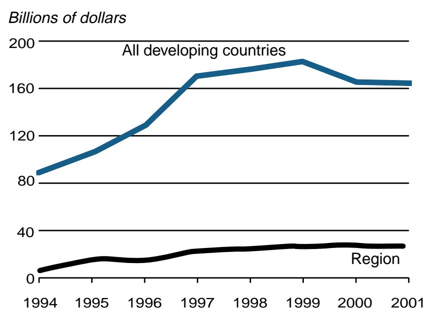
Source: World Bank.

Gross capital market commitments, 2001



Source: World Bank.

Net foreign direct investment, 1994–2001



Source: World Bank.

as posted in 2000. However, a majority of countries in Europe and Central Asia witnessed a decline in FDI from year-earlier levels. Poland experienced the largest falloff—nearly $3 billion in 2001 to $6.5 billion—followed by the Slovak Republic with a $1 billion decline, half the 2000 level. A $2.5 billion increase to $3.5 billion in FDI flows to Turkey and an increase of $1.3 billion to Kazakhstan (to $2.5 billion) served to offset the decline in flows to Poland and the Slovak Republic.

Debt negotiations

Georgia, Ukraine, and the Federal Republic of Yugoslavia concluded external debt-restructuring agreements with Paris Club creditors during 2001. These agreements are expected to reduce 2000 debt service to Paris Club creditors from $88 million to $33 million for Georgia, and from an initial amount of $800 million in 2001 to $285 million for Ukraine in 2002. For the Federal Republic of Yugoslavia, the debt-restructuring agreement is expected to restrict debt service to below $100 million per year through 2005. Russia was unsuccessful in its bid early in 2001 to restructure its external debt with Paris Club creditors, and has been paying its commitments in full under the existing agreement. In June 2001, the Turkish Treasury conducted a domestic swap auction to extend the maturity profile of domestic borrowing and reduce the financing requirement for 2001. And the Kyrgyz Republic is expected to begin negotiations for debt restructuring with the Paris Club creditors in March 2002.

Prospects and risks

Growth in the region is expected to firm moderately to about 3.2 percent in 2002 and to strengthen to 4.3 percent in 2003. An assumption of stabilization and recovery to positive growth in Turkey, together with firming external demand for the region, should provide the foundation for reacceleration of growth. And monetary easing in a number of countries following a period of policy tightening (for example, as pursued in Poland since late 2001) is expected to boost growth over the period. But for hydrocarbon exporters, growth is anticipated to slow moderately in 2002, reflecting lower oil prices and a concomitant slowdown in government spending and investment.

Aggregate growth in Europe and Central Asia is forecast to decelerate marginally to 4 percent in 2004, in part due to an expected moderation of external demand. For countries seeking accession to the EU (almost all of Central and Eastern Europe), deepening reforms, continued significant inflows of FDI, as well as steady external demand should provide continued strong impetus to growth. Growth for the Central and Eastern European countries is forecast to average 4.7 percent by 2004. The main threats to the forecast for Central and Eastern Europe emanate from fiscal and external deficits. There is also a modest risk that the EU accession process might be delayed, should remaining negotiations (such as on agricultural and budgetary issues) run into difficulties.

The outlook is more clouded for the CIS, with threats to the forecast on both the up- and downsides. These reflect the uncertainty in global oil markets and political factors. Growth in the CIS is projected to slow to close to 3 percent by 2004. One adverse factor is lower oil prices in real terms through 2004, down from the high levels witnessed in 2000 and 2001. The hydrocarbon-exporting countries of the CIS will need to manage commodity price volatility if they are to see stable growth. And in a number of CIS countries, large public sectors, overex-

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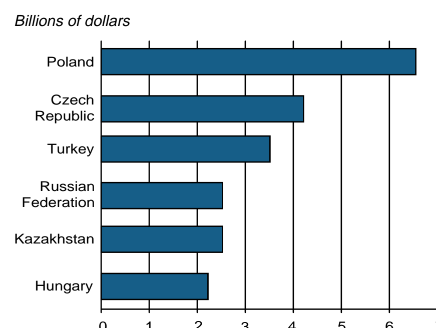
tended social security systems, and significant off-budget expenditures remain important challenges to achieving fiscal balance, which is essential for sustained growth. On the upside, the recent cooperation of a number of Central Asian countries with the U.S.-led intervention in Afghanistan is expected to lead to increased foreign assistance.

Note

1. The 10 countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic, and Slovenia. Turkey is also seeking EU membership.

Net foreign direct investment by country, 2001

Billions of dollars



Source: World Bank.

Europe and Central Asia forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	–2.3	1.6	6.4	2.2	3.2	4.3	4.0
Consumption per capita	–2.7	–1.9	5.0	0.8	3.2	3.6	3.5
GDP per capita	–2.5	1.5	6.2	2.1	3.1	4.2	3.9
Population	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Gross domestic investment/GDP[a]	22.0	20.9	21.4	20.5	21.0	21.4	21.6
Inflation[b]	347.7	7.6	7.4	5.9	6.1	6.3	6.9
Central government budget balance/GDP	–4.8	–4.5	–2.5	–1.7	–2.8	–3.0	–3.1
Export market growth[c]	5.3	–0.8	11.7	6.1	3.4	7.6	7.2
Export volume[d]	0.6	–0.7	12.0	9.8	7.0	10.8	9.8
Terms of trade/GDP[e]	–0.3	0.2	–1.3	0.2	–2.0	–0.5	–0.1
Current account/GDP	–0.4	0.2	2.2	2.2	–0.4	–0.8	–0.9
Memo items							
GDP growth: transition countries	–3.2	3.3	6.2	4.4	3.4	4.0	4.0
Central and Eastern Europe	1.6	–0.6	5.0	–0.8	2.6	4.8	4.7
Central and Eastern Europe[f]	0.7	2.1	3.8	2.9	2.8	4.1	4.9
CIS	–5.2	4.3	7.9	5.5	3.8	3.9	3.3

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
f. Excluding Turkey.
Source: World Bank baseline forecast, February 2002.

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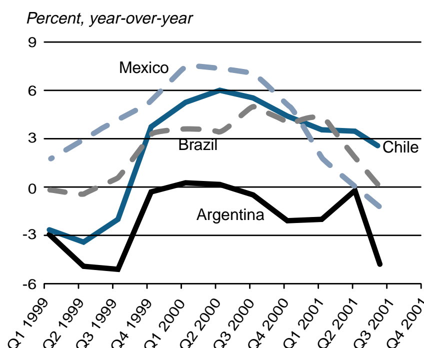
GNI per capita, 2000: $3,670

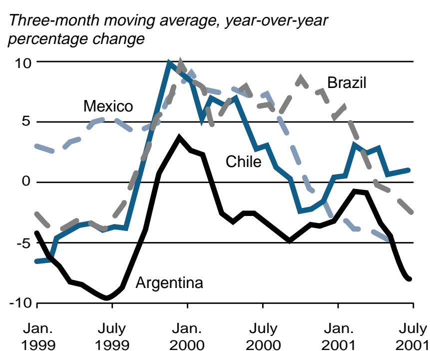
Latin America and the Caribbean

GDP growth in selected Latin America and the Caribbean countries, 1999–2001



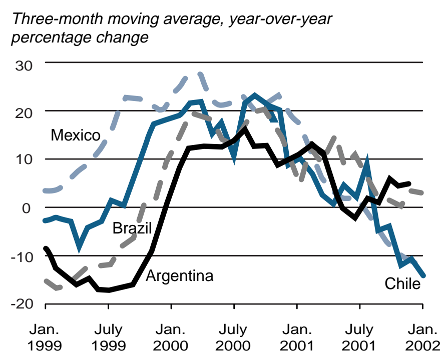
Source: World Bank.

Industrial production in selected Latin America and the Caribbean countries, 1999–2001



Source: Datastream.

Export in dollars, growth for selected Latin American and Caribbean countries, 1999–2002



Source: Datastream.

Recent developments

Regional gross domestic product (GDP) grew 0.6 percent in 2001, about 0.3 percentage points lower than the forecast in *Global Economic Prospects 2002*, and a substantial slowdown from the 3.8 percent growth recorded in 2000. Weak external conditions, a progressive worsening of the political and economic situation in Argentina, and weather-related adversity in Brazil and Central America were the main contributors to the growth slowdown in the region. GDP in the region (excluding Argentina) grew only 1.3 percent, while output growth in Central America was below 1 percent for the first time in a decade.

A sharp fall in world trade growth and steep declines in dollar prices of key commodities exported by the region reduced export revenues. Export volumes are estimated to have grown a paltry 1.4 percent in 2001 after growing by 9 percent in 2000, mirroring the collapse in import demand in export markets. Moreover, falling commodity prices caused aggregate exports, in U.S. dollars, to decline by 1.4 percent, a sea change from the 19 percent rise in 2000. Export revenues fell at a more rapid pace after September 11 as security tightened along the Mexican-U.S. border, commodity prices fell further, and tourism revenues collapsed. Weak exports and limited access to private capital markets slowed output growth, resulting in the region's dollar imports falling by 0.8 percent. Oil exporters saw their trade surpluses diminish while most others had an improvement in their trade balances. The net result was a widening of the region's trade surplus by about $17 billion. The regional current account deficit widened by $5 billion, reflecting the larger trade surplus being offset by lower receipts from tourism and remittances. The current account deficit (2.7 percent of GDP) was financed by drawing down reserves by about $1.2 billion, and by an increase in inflows from official creditors.

Only Chile and the República Bolivariana de Venezuela had the flexibility to embark on expansionary macroeconomic policies to mitigate the growth slowdown. High public debt loads and large external financing requirements prevented most countries from adopting countercyclical policies. However, interest rates were reduced significantly in several countries with floating exchange rates (for example, Colombia, Mexico, and Peru). Argentina benefited little from the fall in international interest rates as domestic interest rates remained high because of heightened exchange and credit risks. Instead, fiscal policy was progressively tightened in the course of the year, further depressing growth. Brazil raised interest rates and fiscal revenues, while Mexico cut spending in order to limit the rise in the fiscal deficit caused by slowing growth and declining oil tax revenues. The result was a general increase in regional unemployment, falling inflation rates in most countries, and little change in real interest rates or in fiscal balances.

The economic and political situation in Argentina deteriorated throughout the year, culminating in a full-blown financial and currency crisis in December. With high debt service payments and limited access to international capital markets, the authorities pursued a "zero" fiscal deficit policy to seek debt relief from creditors. A successful swap for domestic debt was concluded in August, and a similar swap for external debt was planned for the fourth quarter. However, turmoil in international capital markets in the wake of September

11, as well as mounting civil and political resistance to the tight fiscal policy, proved too great for the government to overcome. Spreads on Argentina's international debt rose to more than 5,000 basis points, production collapsed, and tax revenues fell, causing the economy to enter a downward spiral. GDP declined for a third consecutive year, by 3.8 percent. In December, the de la Rua government fell, and the currency peg was eventually discarded in January.

Brazil suffered mild contagion from deteriorating conditions in Argentina—on top of a drought-induced energy crisis and a sharp decline in foreign direct investment (FDI) inflows. The Brazilian *real* depreciated by 30 percent between January and mid-October, and spreads rose by 570 basis points over the period. However, sharply tightening fiscal and monetary policies and a robust upturn in FDI during the fourth quarter reversed these trends and confirmed a decoupling from events in Argentina by year end. Output growth was about 2 percent in 2001. The smaller Mercosur partners were much more adversely affected by the Argentine situation and saw their GDP either fall (Paraguay and Uruguay) or grow tepidly (Bolivia). In Mexico, GDP was flat as slowing U.S. growth took its toll on exports, while the authorities followed the U.S. lead in lowering interest rates.

The Andean countries fared somewhat better. Growth was about 2.5 percent in the República Bolivariana de Venezuela as the government continued to expand fiscal policy even as oil revenues began to shrink. The economy weakened in the second half of the year as capital flight intensified, resulting in the level of reserves falling sharply and little new investment. Relations between the government, the private sector, and labor unions deteriorated over the course of the year, raising risks of a political crisis. In Ecuador, construction of an oil pipeline boosted growth to more than 5 percent and, along with falling oil prices, caused the current account to move from a sizable surplus in 2000 to deficit. Colombian growth slowed from income losses tied to lower coffee prices and falling oil revenues, and the current account deficit widened. Peru had a successful political transition in mid-year, and the investment climate improved thereafter, allowing growth to begin a modest recovery in the second half of the year.

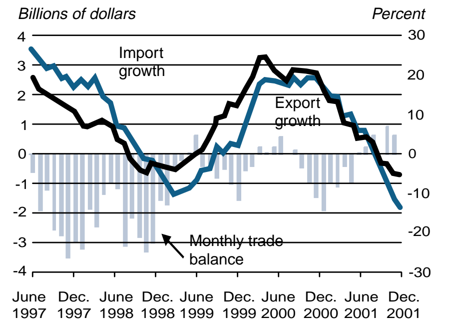
Central America and the Caribbean experienced a particularly difficult year. Drought in some Central American countries adversely affected agricultural production at the same time as coffee prices collapsed. This created famine conditions and raised the incidence of poverty sharply. Weakening labor markets in North America contributed to a falloff in remittances to the region, while Caribbean tourism revenues fell steeply in the fourth quarter, tied to generalized risk aversion on the part of travelers in the wake of September 11. Costa Rica, in addition to suffering from low coffee prices and weakened tourism revenues, was also negatively affected by the global slowdown in high-tech sectors.

Capital market flows fell

Capital market commitments to Latin America totaled about $75 billion in 2001, 17 percent below 2000 levels. The decline was due to sharp falloffs in commercial bank lending and international equity placement, while bond financing remained at 2000 levels. Were Argentina to be excluded from the year's outturns, bond volumes would have risen by 38 percent and bank lending and equity issues would have declined moderately, leading to a fall in total capital market commitments of just 4 percent.

Merchandise trade growth in Latin America and the Caribbean countries, 1997–2001

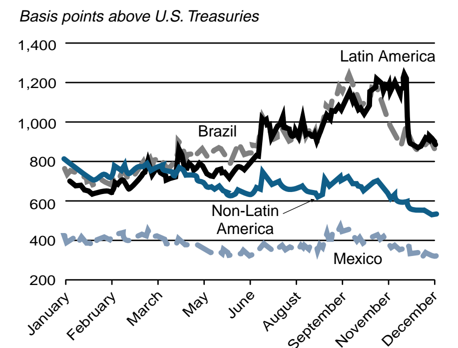
Three-month moving average, year-over-year percentage change



Note: Excluding the República Bolivariana de Venezuela. Monthly trade balance on left axis. Import and export growth calculated as a three-month moving average in current U.S. dollars.
Source: Datastream.

Latin American spreads, 2001

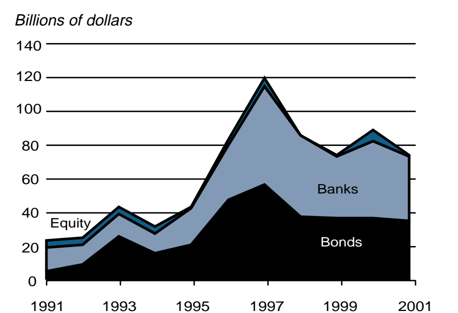
Basis points above U.S. Treasuries



Source: J.P. Morgan Chase through Bloomberg.

Gross capital market flows to Latin America and the Caribbean countries, 1991–2001

Billions of dollars



Source: Euromoney.

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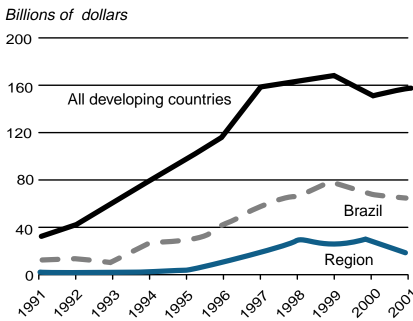
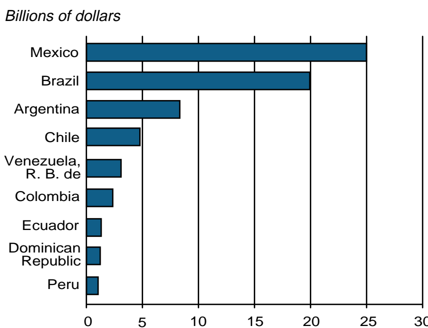
Foreign direct investment, 1991–2001



Source: World Bank.

Foreign direct investment by country, 2001



Source: World Bank.

Access to international bond markets in 2001 was good for most countries but intermittent. Spreads on secondary market debt—one indicator of investor risk perception regarding emerging markets—were fairly steady in the first half of the year, with those for investment-grade countries (such as Chile and Mexico), as well as for Colombia, compressing. As the Argentine situation began to deteriorate in July, spreads rose for most Latin countries (Colombia and Peru are exceptions) even while those for countries outside the region continued to narrow. Immediately after September 11, spreads for all emerging markets rose, but this trend was short-lived. Brazilian spreads followed Argentine spreads for most of the year, but the market made a decisive break in mid-October, with Brazilian spreads falling by 250 basis points by December. Bond volumes followed the pattern of spreads, with little issuance in September and October (after subdued flows in July and August). However, the bond market flourished in the last two months of the year. Many countries in the region raised more from bond issuance in 2001 than in 2000. Argentina was the exception, as bond issuance collapsed from over $12 billion in 2000 to about $1.5 billion in 2001.

Bank lending to Latin America fell by 18 percent in 2001, fairly uniformly across countries. This reflects the weaker international environment—smaller trade flows and fewer cross-border mergers and acquisitions—but the fall was less than the 25 percent decline in developing-country bank flows. International equity issuance was down more than 80 percent, also in line with the fall experienced by all emerging markets.

FDI flows held up

FDI flows to the region reached about $71 billion, 6 percent below the $75 billion registered in 2000. FDI to Argentina and Brazil (to a lesser extent) fell, but this was made up by increases in virtually all other countries. Mexico, with flows of approximately $25 billion, surpassed Brazil as the favored destination of investors in Latin America, and was second only to China among developing countries.

FDI has become the most important source of financing for the current account in many countries. More important, the size of last year's FDI inflow is a sign of improvement in macroeconomic management within the region and improved investor confidence, as large-scale privatization programs have begun to abate.

Prospects and risks

Prospects for 2002 have dimmed considerably in light of the weakening of the global environment after September 11 and the Argentine crisis. Growth rates in a number of countries softened into the fourth quarter of 2001, with negative carryover effects running into early 2002. The region's GDP is likely to grow by about 0.5 percent in the year.

While most countries could achieve somewhat faster growth this year than in 2001, Argentina and the República Bolivariana de Venezuela face difficult challenges. In Argentina, the combination of default, devaluation, and the freeze on deposits (instituted to stem a run on banks and capital flight) at the start of the year, and in the context of a fragile social situation, could result in protracted output reduction and instability. One risk is exchange rate "overshooting," causing inflation to rise significantly and output to decline sharply. Whether this scenario continues into 2003 depends on how quickly a credible program can be put into place. In the República Bolivariana de Venezuela, the political situation is deteriorating and capital flight is continu-

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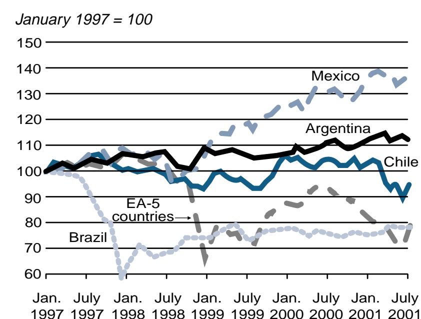
ing while oil prices are softening, limiting the authorities' ability to continue pursuing expansionary policies.

Expected regional growth for both 2003 and 2004 is 3.8 percent, reflecting a much improved external environment as well as different timing in the acceleration of growth across countries (particularly in Argentina). The baseline forecast is predicated on the assumption that countries will maintain macroeconomic stability, that the Argentine situation will stabilize and economic growth will resume during the course of 2003.

However, downside risks remain significant. Public sector debt remains high (above 50 percent of GDP) in a number of countries, and significant policy slippage could place public debt dynamics on an unsustainable path. Markets perceive that this risk is higher for countries facing presidential elections (Bolivia, Brazil, Colombia, and Ecuador) this year—although Brazil has implemented sound macroeconomic policies in recent years. Many countries in the region remain highly indebted and require debt rollovers on a continuing basis. And international interest rates are likely to rise in 2003 and 2004, raising debt-servicing costs. While the adoption of more flexible exchange rate regimes in recent years has improved export growth potential for many countries, for smaller countries in Central America and the Caribbean, export markets continue to be more narrowly based. Developing the institutional capability to break into global markets is still critical for many.

Real effective exchange rates, 1997–2001



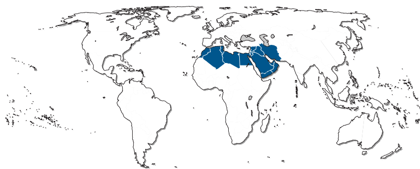
Note: EA-5 countries comprise Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.
Source: J.P. Morgan Chase.

Latin America and the Caribbean forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	3.3	0.0	3.8	0.6	0.5	3.8	3.8
Consumption per capita	1.2	–1.9	2.1	–0.5	–1.3	1.8	2.1
GDP per capita	1.6	–1.6	2.2	–1.0	–1.0	2.3	2.4
Population	1.7	1.6	1.6	1.6	1.5	1.4	1.4
Gross domestic investment/GDP[a]	19.5	19.6	20.2	19.9	19.8	20.0	20.5
Inflation[b]	12.7	4.8	8.6	5.5	4.3	4.1	4.0
Central government budget balance/GDP	–3.5	–4.4	–2.7	–2.6	–2.8	–2.6	–2.2
Export market growth[c]	9.0	5.1	12.0	–0.4	1.6	7.7	7.3
Export volume[d]	8.5	6.9	9.1	1.4	5.3	11.5	8.9
Terms of Trade/GDP[e]	0.1	0.3	0.6	0.9	–0.4	0.0	0.1
Current account/GDP	–2.8	–3.2	–2.4	–2.7	–2.7	–2.8	–3.0
Memo items							
GDP growth:							
excluding Brazil	3.8	–0.4	3.4	–0.4	–0.7	3.6	3.9
Central America	4.4	4.4	2.7	0.7	1.6	3.6	3.8
Caribbean	3.5	5.0	5.3	1.4	3.0	3.7	3.8

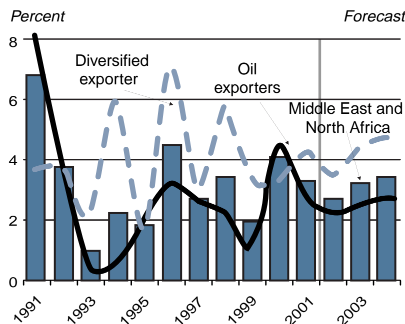
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.



Middle East and North Africa

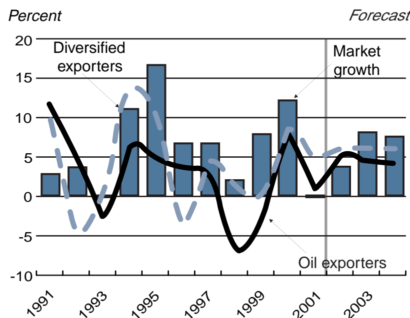
GNI per capita, 2000: $2,090

Gross domestic product growth, 1991–2004



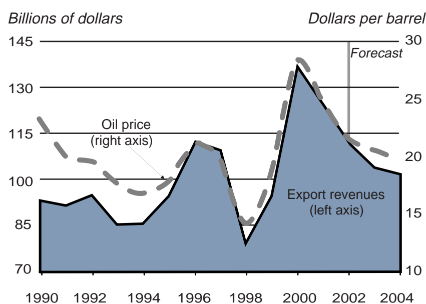
Source: World Bank Economic Policy and Prospects Group.

Export volume growth vis-à-vis export market growth, 1991–2004



Source: World Bank Economic Policy and Prospects Group.

World oil price and Middle East and North Africa oil producer exports, 1990–2004



Source: World Bank Economic Policy and Prospects Group.

Recent developments

Growth in the Middle East and North Africa (MENA) region slowed to 3.1 percent in 2001, following a 4.2 percent advance in 2000, which reflected high oil prices and booming global growth and trade. Oil prices and external demand for oil moderated sharply over the course of 2001, resulting in lower output growth, narrowing current account surpluses, and higher budget deficits among the oil-dominant economies of the region. At the same time, progressive weakening of economic activity in continental Europe—the dominant export market for countries of the Maghreb and several of the Mashreq—exacted a heavy toll on export performance. And these adverse trends were exacerbated for several countries by declines in tourism receipts and worker remittances because of heightened security concerns after September 11. This trend was most acute for the Arab Republic of Egypt, but it was also important for Morocco and Tunisia.

Oil exporters faced much less favorable terms of trade in 2001, as the world oil price fell to $24.40 per barrel from $28.20 in 2000 (a decline of 14 percent).[1] Several cutbacks in Organization for Petroleum Exporting Countries (OPEC) quotas were imposed to establish a floor under prices, especially later in the year as global activity fell sharply. In the real sector, hydrocarbons production and export volumes declined, leading to gross domestic product (GDP) outturns of 2.5 percent, down from 3.6 percent growth in 2000. The growth of incomes also moderated, and current account surpluses and fiscal balances—the latter of which eased recently with oil prices near $30 per barrel—were squeezed by the fall in oil-related revenues.

Despite the fall in oil prices and global demand, financial positions among the middle-income exporters of the region remained positive in 2001. Public debt was retired, foreign reserves rose, and public expenditures were relatively restrained. Algeria and the Islamic Republic of Iran have both channeled surplus oil revenues into oil stabilization funds. By the end of July 2001, Algeria had accumulated around $7 billion. The Islamic Republic of Iran accumulated around $6 billion by March 31, and this is expected to grow by a further $3.9 billion by March 2002. These surpluses will be used to smooth consumption if oil prices fall below a predetermined level, and in the case of the Islamic Republic of Iran, a portion will also be set aside for domestic lending.

In a broader perspective, current account balances for all major oil exporters of the region (including the high-income producers Kuwait and the United Arab Emirates) remained positive at $40 billion, albeit lower than the $59 billion surplus of 2000. Government deficits, which had shrunk to zero or gone into surplus in many countries, also deteriorated slightly, but with few financing problems. In the case of Saudi Arabia, despite public sector wage restraint, the 2002 budget foresees a deficit of some $6 to $7 billion, contrasted with a surplus of similar magnitude in 2000. A potential medium-term concern for oil exporters is appreciation of real exchange rates, which would tend to diminish the competitiveness of the non-hydrocarbon sectors and, for example, in the Islamic Republic of Iran, make the transition to a unified exchange rate more difficult.

Growth in the *diversified exporters*[2] in 2001, at 3.6 percent, was similar to 2000 outturns (3.7 percent),

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despite booming agricultural output in Morocco, following several years of severe drought, and stable growth in Jordan. Growth for this group, excluding Jordan and Morocco, registered deceleration of some 0.4 percentage points, as activity in most countries fell below trend rates of the 1990s. A substantial portion of the lower growth outturns can be accounted for by the deterioration of external factors such as export market growth, tourism, services receipts, and transfers. The dramatic slowing of economic activity in the Euro Area was exacerbated by the abrupt loss of confidence and rise of uncertainty in the industrial countries as well as the Middle Eastern and South Asian regions following September 11. This continues to affect aviation-passenger and freight-related insurance costs, tourism, and near-term prospects for privatization of aviation-related parastatals in the MENA region. These factors have contributed to a doubling of the current account deficit for the diversified exporters to more than $2 billion in 2001.

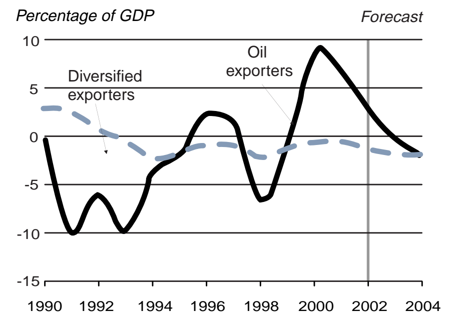
Internal difficulties, many of which were present in these countries prior to the downturn in global activity, were also responsible for the poorer growth performance in 2001 in several countries. Egypt is still dealing with the consequences of twin deficits in its fiscal and current accounts, with the current account deficit reaching 1.6 percent of GDP in 2000 and the fiscal deficit growing to more than 5 percent of GDP in 2001. An adverse investment climate, high real interest rates, and some uncertainty about the direction of the exchange rate have slowed GDP growth to under 3 percent in 2001. Similar adverse fiscal trends are affecting countries such as Morocco and Tunisia, and may broaden across the diversified exporters as external revenue shortfalls become more acute in the near term.

But some countercyclical policy action has been possible. Recent improved inflation performance in Egypt has allowed a full percentage point reduction in the central bank discount rate; and exchange rates have been falling relative to the dollar as well as the euro over the second half of 2001, in Egypt, Morocco, Tunisia, and the Republic of Yemen. These measures may help to mitigate the effects of the global slowdown to a modest degree; but given the importance of the European Union as an export market and principal source of remittance and tourism income, recovery there will be necessary for a return of more buoyant external conditions.

Gross capital flows from international capital markets and FDI

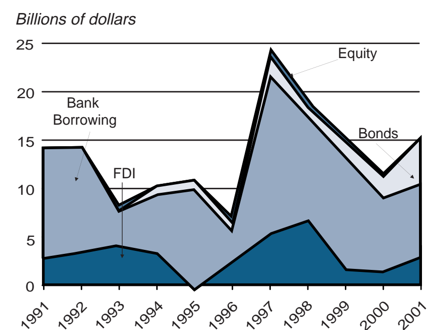
Gross capital flows from international markets (bonds, bank lending, and equity placement) to the Middle East and North Africa rose during 2001, by $2.7 billion (an increase of 26 percent), fully offsetting the drop-off in flows that occurred in 2000. Commercial bank financing continues to dominate flows to the region and increased by some $165 million in the year to reach $7.7 billion. The increase, in a year that bank financing to other developing regions was falling, reflects the unique characteristics of oil-exporting economies. Egypt, the Islamic Republic of Iran, Oman, and Saudi Arabia remain the principal recipients of bank financing. Bond issuance jumped by $2.9 billion in the year to $5.3 billion, as those countries with access to the markets at present—Egypt, Lebanon, Morocco, and Tunisia—stepped up issuance as opportunities arose. Lebanon garnered some $3.1 billion in Eurobond issues, Egypt some $1.5 billion, and Tunisia $460 million in the year. Although tensions regarding the war on terrorism led to an increase in mar-

Current account balances, 1990–2004



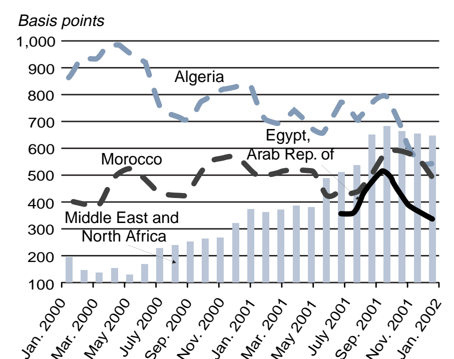
Source: World Bank Economic Policy and Prospects Group.

Composition of gross market flows plus foreign direct investment, 1991–2001



Source: World Bank Economic Policy and Prospects Group.

Emerging market bond spreads in the Middle East and North Africa region and selected countries, 2000–02



Note: Regional spread is dominated by weight of Lebanon in terms of outstanding international bond issuance.
Source: J.P. Morgan/Chase.

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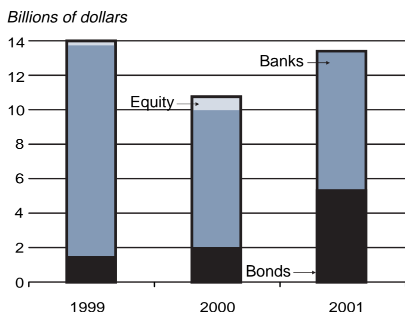
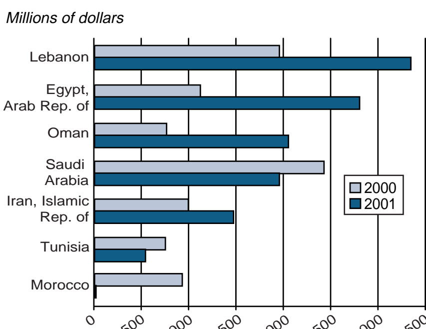
Gross capital market flow commitments to the Middle East and North Africa region, 1999–2001



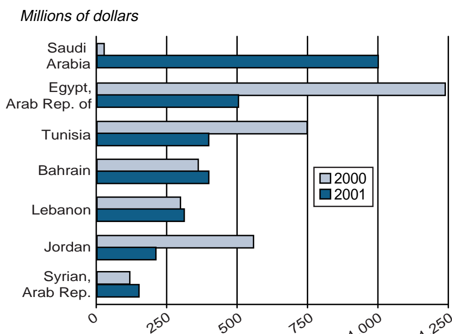
Source: Euromoney and the World Bank Economic Policy and Prospects Group.

Principal capital market participants, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

Principal foreign direct investment recipients, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

ket spreads toward 700 basis points, the situation eased somewhat in late 2001 and early 2002, and spreads for the region showed some improvement, falling by 250 basis points for Algeria, 150 points for Egypt, and 90 points for Morocco. However, spreads for Lebanon remain high as public debt continued to increase to very high levels. A general easing of investor risk aversion may be a welcome development moving into 2002, as signs of recovery in economic activity in the United States and East Asia have become clearer, and availability of finance is improving (liquidity in the industrial countries has risen substantially in a lower interest rate environment).

Portfolio equity issuance, traditionally small in the region, was virtually nil in 2001, as it fell to $7 million from $375 million in 2000, and from a recent peak of $720 million in 1997. This was in- line with the large decline in equity placement worldwide, which fell 75 percent in 2001, as stock markets around the world responded to declines in earnings and profitability. On balance, market-based flows to the region proved fairly resilient in the face of deteriorating global (and local) conditions.

FDI flows into the region increased, particularly to oil-exporting countries. FDI rose from $1.2 billion in 2000 to $2.6 billion in 2001. For the first time in three years, Saudi Arabia experienced net positive inflows of $1 billion, as limited foreign participation in hydrocarbon projects was approved. But many of the diversified exporters, such as Egypt and Jordan, experienced considerable falloffs in FDI, as current global conditions suggest that the prospects for privatization-related FDI, particularly in telecommunications and aviation, will be considerably dampened through the medium term, remaining well below 1997–98 levels.

Prospects

Given difficult conditions in the external environment, near-term prospects appear muted: growth recovery in the European Union is likely to lag behind that of North America and East Asia; underlying demand for hydrocarbons will require some time to reach 1999–2000 levels, and uncertainty associated with the war on terrorism will likely remain a dampening factor for regional dynamism. GDP growth is anticipated to fall to 2.7 percent in 2002, while recovery over the 2003–04 period may be protracted relative to other developing regions, rising to an average of 3.3 percent.

The slowdown in external demand will continue to affect the Middle East and North Africa well into 2002. Average oil prices have fallen below $20 per barrel early in the year, eroding the large current account surpluses and oil revenue boosts seen recently by governments in oil-exporting countries. Cuts in oil production quotas in OPEC countries will also reduce GDP growth prospects for some oil-exporting countries, although this will be balanced in countries such as the Islamic Republic of Iran and Algeria, which have large investment programs in the hydrocarbons sector. As a result, GDP growth among the oil exporters is likely to soften in 2002 to 2.2 percent, while the aggregate current account surplus may fall from $40 billion in 2001 (9.9 percent of GDP) to $6 billion (1.5 percent).

Lower export volumes, services income, and tourism receipts will continue to constrain growth in the diversified exporters, and current account deficits are likely to worsen in 2002. GDP growth in the year is anticipated to weaken to 3.1 percent, as Moroccan growth falls from post-drought highs in 2001. Tunisia and Jordan will benefit from the expected upturn in global activity in late 2002 and as the impacts

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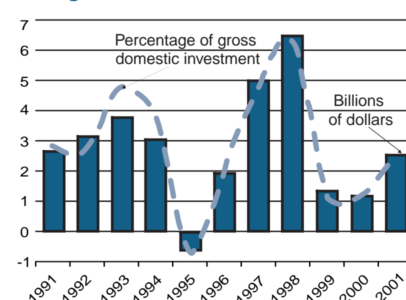
of September 11 on tourism fade, although the intifada in the West Bank and Gaza may persist and cause more acute concerns for tourism in the Levant. The weak economic situation in Egypt has led the government to consider a range of policies to improve the business climate, including capital market reforms and independence for the central bank. Tax reforms, to ease the corporate tax burden and encourage compliance, are also being considered.

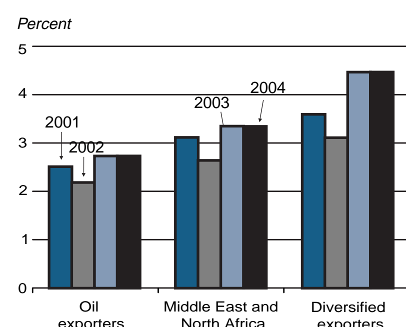
The rebound of the global economy in late 2002 into 2003 should help to stabilize growth in the region. There may be some upside potential for oil prices, but this will most likely be negated by higher non-OPEC supply, potentially implying a further deterioration of fiscal deficits and current account balances of oil exporters from the positive balances seen in recent years. However, given the recovery of foreign exchange reserves, the resources available to countries such as the Islamic Republic of Iran and Algeria in their oil stabilization funds, as well as the lower levels of foreign debt achieved in recent years, oil exporters should have little problem in financing deficits. Improvement in external conditions should also be a boost to the diversified exporters, particularly Jordan and Tunisia, where export volumes have exceeded export market growth in 2001. Conditions in Egypt point to continued domestic weakness into 2003, as the government is likely to lower the fiscal deficit while the economy is growing much more slowly than during the late 1990s. Moroccan growth is heavily reliant on weather conditions but will also be affected by low prices for its commodity exports, and Morocco faces the challenge of increasing the competitiveness of its manufacturing sector as it implements the next stages of its European Union Association Agreement.

Foreign direct investment, 1991–2001



Source: World Bank Economic Policy and Prospects Group.

GDP growth, 2001–2004



Source: World Bank Economic Policy and Prospects Group.

Middle East and North Africa forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	3.2	2.0	4.2	3.1	2.7	3.3	3.3
Consumption per capita	0.4	0.5	1.7	1.4	1.0	0.8	0.9
GDP per capita	1.0	0.1	2.2	1.2	0.7	1.4	1.3
Population	2.2	1.9	2.0	1.9	1.9	1.9	1.9
Gross domestic investment/GDP[a]	21.2	21.5	21.7	22.1	22.4	22.6	22.8
Inflation[b]	5.3	5.7	3.8	3.8	3.4	3.3	3.1
Central government budget balance/GDP	–1.2	–1.2	–1.0	–0.5	–0.9	–1.1	–1.4
Export market growth[c]	7.2	8.2	12.9	0.1	2.2	7.9	7.4
Export volume[d]	4.9	4.0	7.4	2.1	3.0	5.2	4.7
Terms of trade/GDP[e]	0.5	5.3	8.8	–2.5	–3.7	0.1	–1.7
Current account/GDP	–1.7	1.4	7.6	5.5	0.7	0.9	–0.9
Memo items							
GDP growth: oil exporters	2.5	0.2	3.6	2.5	2.2	2.8	2.8
Diversified exporters	4.0	3.6	3.7	3.6	3.1	4.4	4.4

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

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On balance, growth for the diversified exporters during 2003–04 is projected to pick up to 4.4 percent; that for the oil-dominant economies to 2.8 percent, yielding an overall regional growth rate of 3.3 percent. Against a background of continued rapid population growth, this implies per capita income growth of about 1.5 percent over the period, suggesting continued difficulties in mitigating unemployment among the region's increasing, and increasingly youthful, work force.

Notes

1. Low- and middle-income oil-dominant countries in the MENA region reported here, supported by available data, are Bahrain, the Islamic Republic of Iran, Oman, Saudi Arabia, and the Republic of Yemen. High-income oil exporters include Kuwait and the United Arab Emirates; insufficient data are available for Qatar.

2. The group of diversified exporters of the region comprises Egypt, Jordan, Morocco, the Syrian Arab Republic, and Tunisia.

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South Asia

GNI per capita, 2000: $440

Recent developments

Gross domestic product (GDP) in the South Asia region increased by 4.3 percent in 2001, up from 4 percent growth recorded in 2000, yet well below the 5.8 percent growth of 1999. The slowdown in world trade and the regional tensions after September 11 slowed merchandise exports from the region to merely 1.1 percent growth in 2001 compared to a robust 12.3 percent posted in 2000. There was also a sharp fall in growth rates of industrial production.

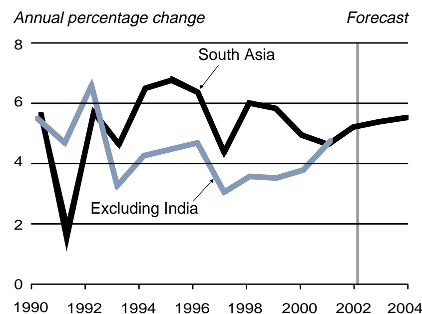
Importantly for growth, the agricultural sector recovered in the second half of 2001, after drought-induced stagnant output in the first half of 2001, with a bumper cotton crop in Pakistan and a good harvest in the Indian kharif season. Bangladesh showed around 6 percent growth in gross agricultural output (about the same growth as in recent years), reflecting government policies of encouraging the cultivation of high-yield crops. The service sector in India (50 percent of the Indian economy and about 35 percent of regional GDP), increased by almost 7 percent in 2001. Software exports from India grew 25 percent, despite the malaise in the global high-tech markets.

The external positions of major countries remained comfortable. Declines in key commodity prices (cotton prices fell by 20 percent) were balanced by the fall in oil prices, and the regional current account deficit deteriorated only marginally, to –1.3 percent of GDP compared with –0.8 percent in 2000. Pakistan, as a frontline state against terrorism, will receive ample financial support from the international community. Pakistan's reserve position improved significantly during 2001 to about three months of import coverage from a low of one month import coverage in September 2000. Also, India has substantial foreign reserves, and with the relatively closed nature of its capital market, it is unlikely to face a financing problem in the near term.

Chronically high fiscal deficits are the Achilles heel of the region and they increased across the region in 2001. There was a steep decline in tax collections as a result of lower imports and stagnant corporate incomes in the manufacturing sectors. In Pakistan, overall tax collection was more than 3 percent below target in the third quarter of 2001, while collections from customs were 12 percent below target. In India, both import duties—more than 25 percent of total tax revenues—and corporate tax revenues are projected to be 8 percent below target in 2001. It is unlikely that the Indian central government will meet its deficit target of 4.7 percent of GDP for fiscal 2001–02, as it had already reached 50 percent of the deficit target by the first quarter of the fiscal year. The consolidated public sector deficit in India remained unchanged at 10.6 percent of GDP.

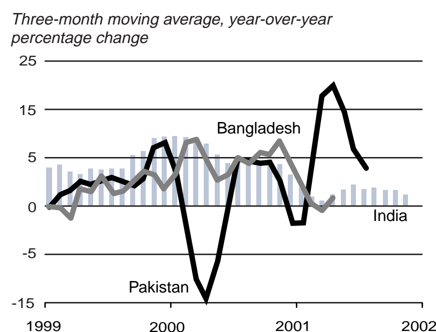
Inflation, as measured by the consumer price index, averaged 3.4 percent for the region. As in earlier years, government subsidies through the public distribution system cushioned the impact of poor crop production and higher oil prices (in the first part of the year) on consumer prices—which in turn is being reflected in a low rate of consumer inflation and growing fiscal and current account deficits. Responding to the slowdown in the economy and helped by global monetary easing and subdued domestic inflation, the Reserve Bank of India lowered the bank rate to 6.5 percent, the lowest rate since 1973. By contrast, interest rates in other countries

Gross domestic product growth rates, 1990–2004



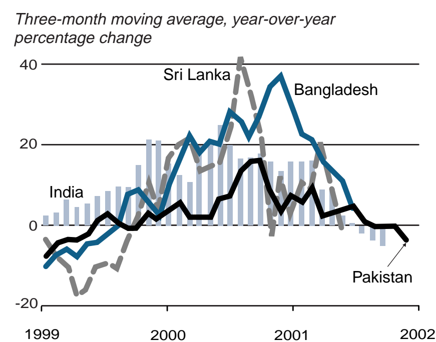
Source: World Bank Economic Policy and Prospects Group.

Industrial production index, 1999–2002



Source: Datastream.

Merchandise exports, 1999–2002



Source: Datastream

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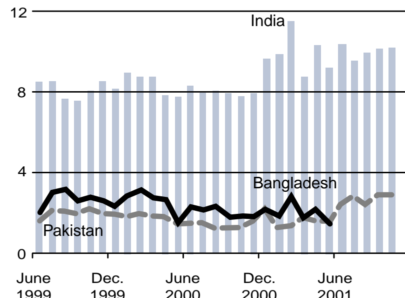
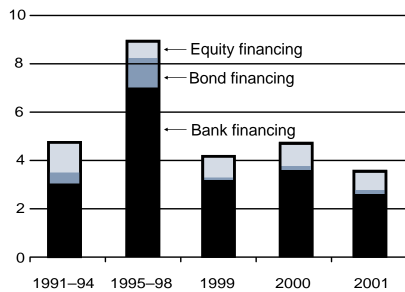
International reserves, 1999–2001



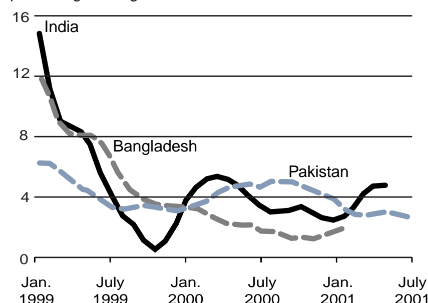
Source: World Bank.

Gross capital market flows, 1991–2001



Source: Euromoney.

Consumer price index, 1999–2001



Source: World Bank.

in the region were stable or slightly rising (for example in Pakistan.)

Capital flows

FDI to South Asia rose to $4.2 billion in 2001, a 35 percent increase from the previous year. Nevertheless, FDI to the region remains small, only 0.5 percent of GDP. South Asia produces 9 percent of developing countries' GDP but attracts only 2 percent of FDI flows to developing countries. The relatively small FDI flows into the region in part reflect little progress in privatization, glacial industrial regulations, and slow reforms in the labor market. Notwithstanding the recent successful sale of two highly profitable public enterprises in India, Videsh Sanchar Nigam Limited and IBP, privatization of other, often money losing, public companies remains a huge challenge. Nonetheless, FDI in India increased by a full $1 billion in the year, to reach $3.3 billion. But in Pakistan, privatization of the Pakistan Telecommunications Company and the United Bank has been delayed. The distribution of FDI flows within the region is more or less proportional to GDP, with 75 percent going to India and roughly 10 percent going to Pakistan and Bangladesh. This amount represents an impressive increase for Pakistan, which attracted only 0.5 percent of regional FDI inflows in 1996.

Lending by foreign banks, which accounts for the bulk of external private capital market commitments to the region, declined by more than $1 billion in 2001. Equity placement, which was hit hard due to heightened uncertainty created by the global economic slowdown and the September 11 events, declined by almost 50 percent. However, because these flows are relatively small and official aid increased, the decline in equity placement did not prevent a general improvement of reserves in the region, despite the slight deterioration in the current account.

Prospects and risks

The region is expected to recover modestly in 2002, with an average growth rate of 4.9 percent, and thereafter remain at a rate around 5.3 percent. Domestic factors will be the immediate impetus to an up-tick in growth during the first half of 2002, while a recovery in the developed economies in the second half of 2002 will further accelerate growth. Agricultural output is expected to improve in the first half of 2002. This improvement should have a stimulating effect on the industrial sector, particularly the durable goods sector, because traditionally farmers tend to buy big ticket items (such as furniture, motorcycles, and bicycles) during periods of good harvest and consequently increased incomes. The war-related aid for Pakistan, especially to the export sector, is expected to quicken the recovery of its economy.

Assuming that the countries in the region follow their declared policies, the average fiscal deficit is expected to decline from 10.3 percent of GDP[1] in 2001 to 9.2 percent in 2004. In Pakistan, the International Monetary Fund–supported program is expected to result in a significant fall in the fiscal deficit and in the public debt burden. Following the Eleventh Finance Commission and Expenditure Reform Commission reports, the Indian central government has proposed medium-term fiscal policy reforms[2] that aim to cut the revenue deficit to zero by fiscal 2005–06, mainly by reforming the tax system, rationalizing expenditure, and reducing the number of central government employees by 10 percent. Realization of this program will be an imposing challenge, however. In India, efforts to reduce subsidies and spur privatization of public industries have had mixed suc-

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cess. In addition, the recent increase in regional tensions may put pressure on the budgets of the region.

The current account deficit is expected to improve marginally to 1 percent of GDP in 2002 and continue to decline steadily thereafter. In the early part of 2002, export growth is likely to be slow given sluggish growth in the region's major export markets (the United States and Europe). Recovery of the export sector should begin in earnest during the second half of 2002. Removal of sanctions by the United States and Japan on India and Pakistan will benefit the two countries in the medium term. However, continuation of military activity in the region is likely to have a depressing impact on exports due to an increased risk perception by Organisation for Economic Co-operation and Development–area importers. A major source of gains in the medium term will be exports of services, especially software, data, and business services, from India. The region is not expected to cut import tariffs in the near term and, therefore, import growth is expected to remain slow.

This forecast faces significant downside risks. As of the time of this writing, tensions between India and Pakistan remained at high levels. Even if recent moves toward peace bear fruit, the potential for additonal terrorist attacks cannot be ruled out. The war in Afghanistan appears to be drawing to a close, but that country may still be a source of regional instability. Over the longer term, the success of efforts to restrain fiscal deficits while continuing to achieve high growth rates remains uncertain. And the entry of China into the World Trade Organization creates a major competitive challenge for the manufacturing industries of the region.

Notes

1. For India we have used the consolidated public sector deficit.

2. As of the writing of this report, the proposed Fiscal Responsibility and Budget Management Bill is yet to be ratified by the Indian Parliament.

South Asia forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	5.2	5.8	4.0	4.3	4.9	5.3	5.2
Consumption per capita	2.6	6.1	1.2	2.2	1.8	2.0	1.9
GDP per capita	3.2	3.9	2.1	2.6	3.2	3.6	3.6
Population	1.9	1.9	1.9	1.7	1.7	1.6	1.6
Gross domestic investment/GDP[a]	21.9	22.6	24.0	24.7	25.4	25.8	26.4
Inflation[b]	8.1	4.6	5.8	6.1	5.0	5.1	5.1
General government budget balance/GDP	–10.3	–9.8	–9.7	–10.3	–10.3	–9.7	–9.2
Export market growth[c]	7.3	7.2	12.7	1.1	2.6	7.3	6.9
Export volume[d]	9.3	1.8	7.7	3.8	5.3	10.0	8.1
Terms of trade/GDP[e]	–0.1	–0.5	–0.7	0.4	–0.1	0.2	0.1
Current account/GDP	–1.5	–0.9	–0.8	–1.3	–1.1	–0.8	–0.4
Memo items							
GDP growth: excluding India	4.3	3.6	4.2	3.8	3.9	4.8	5.2

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

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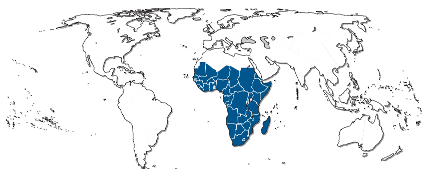
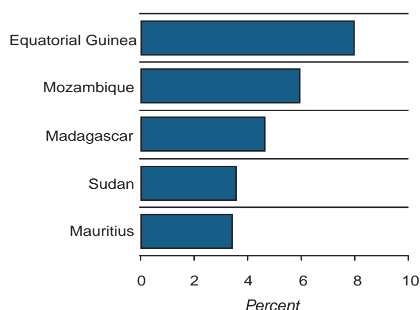
Sub-Saharan Africa



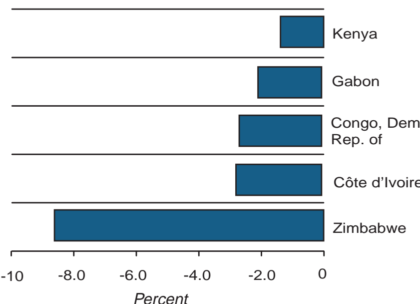
GNI per capita, 2000: $470

Per capita gross domestic product growth: The five best in 2001



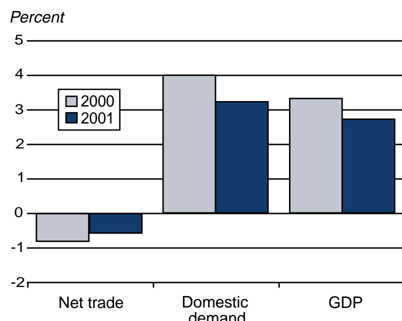
Source: World Bank.

Per capita gross domestic product growth: The five worst in 2001



Source: World Bank.

Contributions to growth, 2000 and 2001



Source: Datastream and DECPG staff estimates.

Recent developments

Growth slowed across much of Sub-Saharan Africa in 2001, reaching only 2.6 percent for the year, down from 3.1 percent in 2000. The slowdown was not evenly distributed. In a number of countries performance even improved while in others poor outcomes were attributable to a variety of factors, not least of which were civil strife and poor governance. Nevertheless, a common factor across the region was a marked deterioration in external sector performance. The global slowdown depressed import demand in Sub-Saharan Africa's main trading partners and held real merchandise export growth to just 2.1 percent compared to 7.5 percent in 2000. At the same time, export prices denominated in dollars fell by an average of 6.3 percent and the dollar value of export earnings fell 4.3 percent. The terms of trade deteriorated by 2.9 percent, which was equivalent to a further reduction in real income of 0.8 percent of gross domestic product (GDP).

Despite an increase in debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative, official aid flows declined slightly while at the same time commercial flows remained limited. As a result the weak export performance served to compress imports. This compression was achieved with the help of weak income growth and currency depreciation and was reflected in a narrowing of the real trade deficit.

September 11 reinforced global and domestic factors that triggered the slowdown. Commodity prices fell sharply in the immediate aftermath, though except for oil, they largely reverted to trend over the next two months. Security concerns and the disruption to international air travel compounded local factors (crime and political instability in southern Africa) contributing to a disappointing year-end tourist season. But a weak performance in 2001 was already in the cards by the time of the attacks: 50 to 90 percent of the drop in commodity prices for the year had already occurred by August, as had much of the exchange rate depreciation.

In South Africa, quarterly national accounts data showed a clear weakening in the first three quarters of the year after a strong finish to 2000.

Several positive factors helped to mitigate the impact of the trade slowdown. First, generally better weather conditions led to a substantial recovery of agricultural production throughout the Horn of Africa, eastern and southern Africa, the great lakes region, and the Sahel. Though scattered drought conditions persisted in these regions, major failures of food and export crop production were largely avoided (Somalia was an exception). Meanwhile, in West Africa and the Sahel good rains contributed to bumper harvests.[1]

Second, there was a major expansion of debt relief under the HIPC Initiative. Ten Sub-Saharan African countries reached decision points in December 2000 and two more during the course of 2001, which more than doubled the number of countries in the region receiving debt service reduction, while two more countries reached completion points.[2] The timing was fortuitous insofar as it helped to relieve some of the pressure on current accounts.

Third, exchange rates fell across the region by an average of 15 percent in nominal terms or 8 percent in real terms,[3] reinforcing the adverse terms-of-trade shock, but boosting export competitiveness and helping to offset some of the impacts of commodity price weakness on commodity exporters. The real devaluation also implied a redistribution of income from

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importers to exporters. In the medium term the devaluations may prove inflationary, but at least for the time being a combination of lower food prices, depressed economic conditions, and tighter monetary management helped to contain inflation. Indeed, the median inflation rate fell from 6.1 percent to 5.4 percent in the year.

Finally, it is worth noting that although the slowdown was widespread, nearly a third of Sub-Saharan African countries achieved stronger growth. The best performer by a wide margin was Mozambique, where growth picked up from 2.1 percent in 2000 to 8.3 percent in 2001 as a result of agriculture's recovery from devastating floods in 2000 and a sharp rise in aluminum and electricity exports. But a number of other countries also showed gains, including Ethiopia and Uganda, where weather improved; Angola, Chad, and Cameroon, where there were major investments in energy sectors; Madagascar, which achieved strong export performance in textiles and tourism; and Sierra Leone, which enjoyed a down payment on a peace dividend.

Savings behavior and adjustment to the commodity cycle

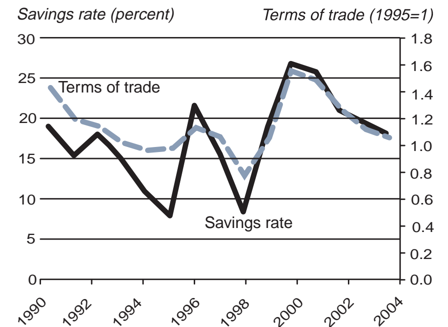
External developments negatively affected both oil and non-oil commodity exporters in 2001, though circumstances were very different for the two groups. For oil exporters, terms of trade deteriorated by 8.9 percent in 2001, but that gave back only a small portion of a massive 80 percent rise over the previous two years, and conditions remained relatively buoyant. Growth eased from 4.4 percent in 2000 to 4 percent in 2001 but remained strong, particularly in the nontraditional oil exporters, Equatorial Guinea and Sudan. Terms-of-trade gains of the magnitudes experienced over the past few years would be expected to give rise to substantial savings. This was the case as savings rates of the oil exporters tripled from 8.7 percent of GDP in 1998 to 27.2 percent in 2000 before falling marginally in 2001.[4] Roughly two-thirds of the savings increase took the form of a net accumulation of foreign assets, the rest took the form of a sharp rise in domestic investment, particularly in offshore oil and gas development. Oil rents accrued initially to the public sector before being transferred in large part to the private sector through subsidies and higher public spending.[5] Though data are not available to distinguish public and private savings, fiscal deficits narrowed from 8 percent of GDP in 1998 to 2.4 percent in 2000. Though oil prices remained relatively high in 2001, deficits again widened. Windfall savings, properly managed, afford a cushion against likely price reversals. But long experience and recent observation caution against fiscal expenditure booms followed by painful adjustment. The risk is particularly high for Nigeria in the run-up to elections in early 2003.

In contrast to oil producers, terms of trade for non-oil commodity exporters were little changed as falling oil prices on the import side offset some of the declines in export prices. Depressed commodity prices imposed severe hardship in many cases and pushed some countries to intervene by subsidizing farm prices, which had implications for budgetary spending. But overall macroeconomic adjustment was relatively limited. Terms of trade have fallen steadily since 1996, suggesting that there is little room for further dissaving.

Financial flows

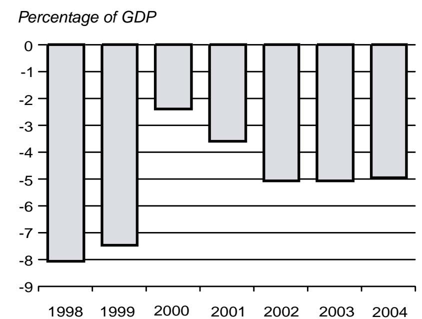
Official aid remained the main source of foreign resource inflows in 2001,

Terms of trade and savings rate in Sub-Saharan Africa oil exporters, 1990–2004



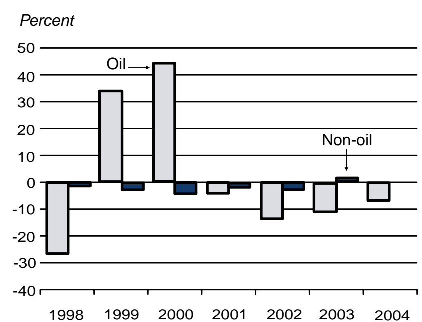
Source: World Bank Economic Policy and Prospects Group.

Oil exporters' fiscal balance, 1998–2004



Source: World Bank Economic Policy and Prospects Group.

Rate of change in terms of trade for oil and non-oil exporters, 1998–2004



Source: World Bank Economic Policy and Prospects Group.

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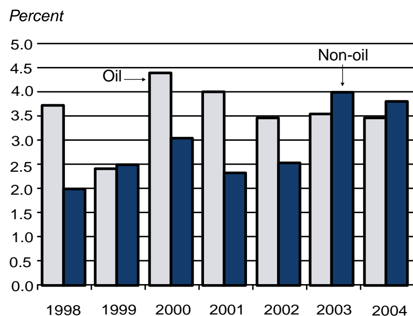
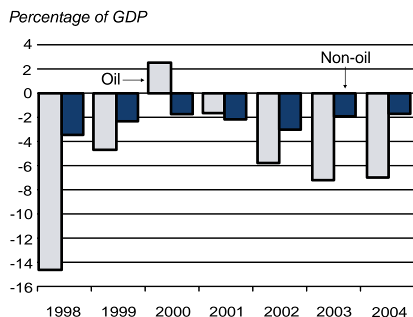
Gross domestic product growth of oil and non-oil exporters, 1998–2004



Source: World Bank Economic Policy and Prospects Group.

Current account balance of oil and non-oil exporters, 1998–2004



Source: World Bank Economic Policy and Prospects Group.

but worldwide, total official development assistance (ODA) declined from $39.5 billion to $37.5 billion and provisional estimates indicate that official flows to Sub-Saharan Africa declined proportionately. As noted, HIPC debt relief offered substantial benefits to some countries. For oil exporters, relatively strong current account positions helped to mitigate overall financing needs.

Foreign direct investment (FDI) appeared to jump sharply in 2001, nearly doubling to $13.7 billion from $6.8 billion in 2000. But almost all of the increase was to South Africa and reflected, in essence, a financial restructuring—the purchase of De Beers by Anglo-American—which shifted ownership of assets from South Africa to London without generating substantial new investment. Excluding the De Beers purchase, the figures show a decline from $6.6 billion in 2000 to $6.2 billion in 2001. Roughly 60 percent of this amount went to oil exporters, the largest recipient being Angola, which accounted for nearly 30 percent. Overall, a downward trend is evident, with energy-related FDI in particular expected to decline fairly sharply over the forecast period in light of lower prices.

Prospects and risks

The deep slowdown in the world economy and delayed recovery in industrial-country import demand will continue to depress commodity markets over the next 12 months. For Sub-Saharan Africa, the negative impact on exports and investment is expected to hold GDP growth to only 2.6 percent in 2002. In domestic economies, fixed capital formation will bear the brunt of the slow growth in expenditure—particularly in energy sectors, which will face weaker prices—while private and public consumption maintain a steadier pace. Near-term prospects are especially bleak in southern Africa because of political uncertainty in Zimbabwe, though it is hoped that the situation there will move toward resolution with the presidential election in March. In the outer years of the forecast, exports are expected to accelerate with the recovery in the world economy, raising GDP growth across the region to 3.6 percent.

External performance will be the prime driver of the regional economy over the forecast period. Overall, the forecast anticipates that merchandise exports will grow by just 2 percent in real terms in 2002. In value terms, large price declines are expected for oil exporters, more than offsetting small gains for the rest; as a result export earnings will fall by 2 percent. Demands for tourism and other services exports are also likely to remain subdued, reflecting security concerns and the weak outlook for the European economy. As the world recovery accelerates in the second half of 2002, exports should begin to pick up, setting the stage for more robust growth of around 6 percent in 2003–04. Though trade prices in general should strengthen as the world economy gains pace, the impact on commodity markets is likely to be more muted, which will keep Sub-Saharan Africa's terms of trade from recovering strongly before the end of the forecast period.

The situation for oil exporters will be most challenging. Because oil prices will not return to the recent high levels, terms of trade are likely to trend lower and the opportunity to compensate by increasing real exports will be limited. Thus, major adjustments will be required to keep current account deficits at sustainable levels, and these adjustments will depress domestic demand, especially investment and public expenditure. Growth in oil exporters is expected to average around 3.2 percent over the forecast period. For non-oil producers, commodity export

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prices are expected to stabilize or even become slightly firmer in the outer years of the forecast, though a return even to the levels of the mid-1990s, let alone earlier times, seems unlikely. As the terms of trade stabilize or recover modestly, GDP growth should accelerate to near 4 percent, while current account deficits narrow slightly. While lower world commodity prices can only strengthen the impetus to diversify exports, African commodity producers should be competitive at the new, lower level of prices, especially with cheaper oil as an offset.

For the region's largest economy, South Africa, the slowdown is compounding the frustration with the slow pace of results from the government's promarket policy stance, though there is no credible alternative. Nigeria faces more severe challenges because of upcoming elections (in early 2003), lower social cohesion, and a deteriorating external environment. Nevertheless, for Nigeria, as for the region as a whole, policymakers will likely continue to be constrained by a growing acceptance of the need to improve macroeconomic management and maintain better relations with the International Monetary Fund. In Nigeria's case, that is especially true as debt relief on nearly $30 billion of external debt hangs in the balance.

Notes

1. Food and Agriculture Organization. 2001. "Food supply situation and crop prospects in Sub-Saharan Africa.".

2. Prior to December 2000, eight countries were at decision points: Benin, Burkina Faso, Cameroon, Mali, Mauritania, Mozambique, Senegal, and Tanzania; and Uganda was at a completion point. By December 2001, 17 countries were at decision points: Benin, Burkina Faso, Cameroon, Chad, Ethiopia, the

Sub-Saharan Africa forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	2.2	2.4	3.1	2.6	2.6	3.6	3.6
Consumption per capita	–0.2	0.1	0.6	0.3	0.5	1.4	1.2
GDP per capita	–0.4	0.0	0.6	0.1	0.2	1.3	1.3
Population	2.6	2.4	2.5	2.4	2.4	2.3	2.3
Gross domestic investment/GDP[a]	16.8	17.5	18.0	18.5	18.4	18.1	17.9
Inflation[b]	9.7	5.2	6.1	5.4	4.5	4.2	4.1
Central government budget balance/GDP	–5.0	–3.0	–3.1	–3.6	–3.7	–3.4	–3.2
Export market growth[c]	7.0	6.4	10.8	1.1	2.2	7.3	6.8
Export volume[d]	4.3	3.5	5.6	1.8	2.2	5.5	5.8
Terms of trade/GDP[e]	0.0	1.4	2.3	–1.0	–1.2	0.5	–0.7
Current account/GDP	–2.2	–2.2	–0.6	–1.8	–2.4	–1.4	–1.4
Memo items							
GDP growth: excluding							
South Africa	2.7	2.8	3.1	3.0	2.9	4.0	4.0
Oil exporters	2.8	2.4	4.4	4.0	3.1	3.3	3.2
CFA countries	2.5	2.1	2.7	2.4	2.5	4.0	3.7

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

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Gambia, Guinea, Guinea-Bissau, Madagascar, Malawi, Mali, Mauritania, Niger, Rwanda, São Tomé and Principe, Senegal, and Zambia; and three were at completion points: Uganda, Mozambique, and Tanzania.

3. Averages described in the remainder of this paragraph are calculated using GDP weights for 43 countries with data available. Note that median inflation (6 percent in 2001, see table) is substantially below mean inflation (13.5 percent in 2001) because of a few countries with very high inflation.

4. A rational response is to save transitory income fluctuations, and it is hard to imagine such a windfall would not be recognized as transitory. Both cross-country and case studies find typically 50 to 80 percent or more of major commodity windfalls are saved, at least initially. See, for example, Deaton and Miller 1996 and Collier and Gunning 2000.

5. Such as the 25 percent pay raise for Nigerian civil servants, announced for 2001, then temporarily delayed until 2002.

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