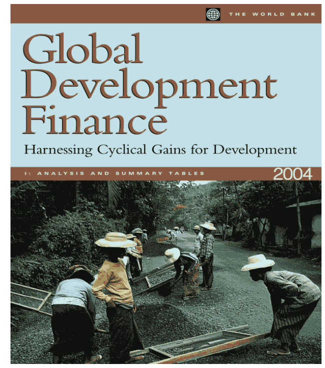

E. Europe & C. Asia

GDF 2004 Summary

Global Themes

- The global economic environment affecting capital flows to developing countries improved in 2003. Global growth gained momentum in the second half of the year as the locus of economic activity shifted towards business investment spending. Renewed confidence in international financial markets led to a considerable decline in risk spreads in bond markets and fueled a strong rally in equity prices. Worldwide, GDP growth increased from 1.8 percent in 2002 to 2.6 percent during 2003; it is projected to rise to 3.7 percent in 2004. But the global economy is emerging from the pervasive slowdown of recent years facing major macroeconomic challenges – including large fiscal deficits in many advanced economies and a large current-account deficit in the United States - which could have a critical bearing on the outlook for developing countries and the availability of external capital to finance their development.

- Developing countries as a group are markedly outperforming the high-income countries. Developing countries' GDP grew 4.8 percent in 2003, compared to a 2.1 percent advance in the high-income countries. The low-and middle-income countries are on track this year to match, or even surpass, the record 5.2 percent growth achieved in 2000, before the global slowdown. Since 2000, the developing world has been a net exporter of capital to the advanced economies. For developing countries as a whole, foreign-exchange reserves rose about $276 billion in 2003, bringing total reserves to $1,227 billion—equivalent to nearly four times their short-term external debt. This buildup reflects a precautionary reaction to the costly crises of the 1990s, as well as broader factors related to trade and exchange rates. It underlines the strong financial interdependence between developed and developing countries.

- Official development assistance is still an important source of external finance for many countries. But, as private capital flows have grown, official aid flows have risen only slightly, and remain below the levels needed to achieve the Millennium Development Goals (MDGs). Political developments and changes in attitudes are dramatically altering the landscape for official flows. Net official development assistance did increase to $58 billion in 2002, but half of the $6 billion rise reflects debt relief donor agencies, rather than increased resources provided directly to developing countries. Moreover, the increase represents little progress toward meeting the commitments for higher aid made at the 2002 Monterrey conference.

- From 1992 to 2003, total international investment in developing countries' infrastructure is estimated to have been $622 billion—an average of $52 billion a year or 3.8 percent of total gross domestic investment in the developing world. Infrastructure needs in developing countries remain largely unmet—1.1 billion people lack access to safe drinking water, 2.4 billion are affected by inadequate sanitation, 1.4 billion have no power, and telecommunication links are five times less dense than in the developed world. Worldwide, future demand for infrastructure is likely to come mainly from the developing world. The bottlenecks in assuring a healthy flow of capital from international markets to developing-country infrastructure are related to policies, institutions, and regulation. Multilaterals can play a crucial role in providing risk-mitigation instruments (including guarantees and political risk insurance) and promoting the development of local capital markets. Efforts also need to be taken to develop a strong institutional framework for the protection of creditors' rights, effective covenants, and reliable avenues of legal enforcement and remedy. No single solution will fit all sectors and all countries.

- Developing countries' international trade is equivalent to about one-half of their gross national income. Trade finance supplies the liquidity needed to conduct trade, and governments can support it by ensuring a sound and efficient financial system. Finance linked to trade transactions may hold up better during crises than other forms of foreign borrowing for several reasons - lenders can rely on security arrangements linked to traded goods; supplier's information on their borrowers may limit contagion; suppliers have an incentive to support their customers during cyclical downturns; and, in some cases, governments have provided preferential treatment to trade finance in the context of rescheduling agreements. Trade credit from suppliers and customers appears to have held up better during crises than bank lending.

- The development community should view remittances as a welcome source of external finance and strive to improve the financial infrastructure supporting them. Workers' remittances have become a major source of finance for many developing countries. On an aggregate basis, they increased by more than 20 percent during 2001–03, reaching an estimated $93 billion in 2003, with more remittances being diverted to formal channels from alternatives—a result of efforts to curb money laundering. The increased focus on remittances resulted in better reporting of data in many developing countries.

Regional themes

- The economies in the region grew by 5.5 percent in 2003, up from 4.6 percent the year before. Despite sluggish activity in the Euro area, growth in Central and Eastern Europe (excluding Turkey) accelerated from 3 percent in 2002 to 3.8 percent in 2003, as several countries increased export-market shares in the European Union as part of the broader integration process. The Russian Federation and other countries of the CIS expanded from growth of 4.7 percent in 2002 to 6.6 percent in 2003, powered by a significant increase in consumer spending and domestic investment as a result of strong oil revenues.

- The outlook for 2004 and beyond is for continued robust growth in the region as a whole. Growth in Central and Eastern Europe is expected to approach 4.5 percent, as effective implementation of EU-related structural reforms provides a stronger foundation for expansion. In the CIS, growth is projected to ease to 5 percent by 2005–06, due in large measure to moderating oil prices and lower tax revenues.

- Net private debt flows to the region strengthened markedly in 2003 and surpassed the net equity flows for the first time since 1999. Net private debt flows to the region reached $36 billion in 2003 compared to $22.7 billion in 2002. The increase reflects the improving credit quality in the region, especially for EU accession countries. Average credit quality in the region reached its highest point since 1997.

- FDI flows into Europe and Central Asia fell sharply in 2003 to an estimated $26 billion from $33 billion in 2002. Few major privatization deals were completed reflecting the end of the privatization boom for some countries in the region. There was a sharp surge in FDI to the Russian Federation mostly in oil and gas sectors, however. Net portfolio flows to the region rose modestly $0.7 billion.

- After 1994, Europe and Central Asia attracted substantial amounts of infrastructure financing, as candidate countries prepared their infrastructure markets for accession to the European Union. For 1997–2003, infrastructure finance to the region more than tripled to an annual average of $10 billion (from $3 billion during 1990–96), reflecting vigorous efforts by the region's governments. The share of the region in total developing-country infrastructure finance increased from 9 percent to 19 percent during the period.

Other key regional points to note

- Benign financing conditions facilitated access for corporate borrowers from infrequent market participants such as Bulgaria, Estonia, and Kazakhstan. In addition, corporate borrowing from Russia reached an all-time high. Stock of international bank lending (entirely by European lenders) to "emerging Europe" has surged from $119 billion in 1997 to $222 billion in September 2003.

- By 2002, services sector accounted for almost 60 percent of FDI stock in the region. In terms of financing, equity capital was the largest component, which contributed 65 percent of FDI flows to the region during 1995-2002. Intercompany loans and reinvested earnings contributed 23 and 11 percent, respectively. Since the region receives significant amount of FDI to its extractive sector, the share of intercompany loans was higher compared to most other developing countries.

- FDI to the region is expected to recover. The Czech Republic, Hungary, and Poland are expected to receive more FDI in services as their competitive cost structure encourages investors to set up headquarters and R&D facilities where as light manufacturers may move to lower-cost accession countries such as Romania. Russia and Turkey are expected to receive higher levels of FDI in coming years.

- There was a notable number of stock-delistings in the region's stock markets during 1995-2003 because of stocks migrating to the larger European stock markets. In addition, voucher privatization (especially in the Czech Republic and the Slovak Republic) gave rise to a large number of firms being listed in the local stock exchanges, which did not trade for years and, later, delisted.

Eastern Europe and Central Asia outlook in summary, 1981-2004

	1981-90	1991-00	1998	1999	2000	2001	2002	2003e	2004f
Real economy									
(percent change, unless stated)									
Real GDP growth	1.6	-1.5	-0.2	2.9	6.8	2.4	4.6	5.5	4.9
Private consumption per capita	0.1	-0.5	0.4	-0.2	4.8	3.5	5.5	6.3	5.5
GDP per capita	0.9	-1.7	-0.2	2.9	6.8	2.4	4.5	5.4	4.9
Population	0.9	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Domestic Investment / GDP /a.	32.1	24.0	21.8	20.8	21.8	20.6	20.3	21.0	21.5
Inflation /b.	1.1	52.5	10.6	6.5	6.5	5.4	4.3	4.7	5.2
Central Gvt budget balance / GDP	-0.5	-4.4	-4.2	-4.4	-2.5	-3.7	-3.7	-3.8	-3.5
Export Market Growth /c	3.3	5.6	4.0	-0.3	13.6	4.9	4.4	9.0	8.1
Export Volume /d.	0.1	1.2	5.8	3.9	16.0	6.1	7.1	13.5	10.3
Terms of Trade / GDP /e.	-0.3	-0.7	-0.4	-0.5	2.6	-0.4	0.3	0.0	-0.7
Current Account / GDP	-0.5	-0.7	-2.5	0.0	1.9	1.9	0.8	0.6	-0.5
Workers Remittances ($ billion)	--	6.2	10.5	9.3	9.7	10.2	10.3	10.4	--
Memorandum item:									
GDP growth: Transition countries	1.2	-2.3	-0.9	4.7	6.7	4.5	3.9	5.6	4.9
Central and Eastern Europe	1.1	0.8	2.8	3.9	3.6	3.0	3.0	4.1	4.3
Commonwealth of Independent States	1.3	-4.2	-3.9	5.4	9.2	5.7	4.7	6.6	5.4

External Financing and Debt	1995	1996	1997	1998	1999	2000	2001	2002	2003e
(billions of dollar unless stated)									
Net inward FDI	17.4	16.4	22.6	26.2	28.4	29.3	31.8	32.9	26.2
Net inward portfolio equity flows	1.7	4.3	4.0	4.0	2.0	1.2	0.3	-0.4	0.7
Net inward debt flows	23.4	22.9	32.8	41.5	16.1	21.0	2.0	24.9	29.5
From public sources	6.8	8.6	6.6	7.4	-0.7	-0.1	2.0	2.2	-6.5
From private sources	16.7	14.3	26.3	34.1	16.9	21.1	0.1	22.7	36.0
Gross Market Based Capital Inflows	21.9	26.9	51.2	43.4	31.0	41.4	26.6	35.0	58.0
Total External Debt	349.0	367.1	387.5	485.2	495.6	503.9	498.9	545.8	577.4
Medium and Long Term	304.7	315.0	331.6	414.5	423.3	423.5	423.9	468.9	484.2
Short Term	44.3	52.1	56.0	70.7	72.3	80.4	75.0	77.0	93.2
Owed by Public Sector Borrowers	286.6	286.8	288.7	320.9	316.1	304.4	292.0	310.6	323.8
Owed by Private Sector Borrowers	62.4	80.3	98.8	164.3	179.5	199.5	206.9	235.2	253.5
Owed to Public Sector Creditors	156.1	160.1	156.1	172.3	171.1	166.4	158.8	165.0	167.9
Owed to Private Sector Creditors	192.9	207.1	231.4	312.9	324.5	337.5	340.0	380.8	409.5
Gross Foreign Exchange Reserves	81.1	83.4	90.7	95.6	102.8	119.6	130.0	174.9	235.6

-- Not Available

Note: e = estimate, *f* = forecast.

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 non-factor services.

e. Change in terms of trade, measured as a percentage of GDP.

External financing: Eastern Europe and Central Asia, 1997-2003
(billionsof dollars)

	1997	1998	1999	2000	2001	2002	2003e
Current account balance	-26.8	-25.1	-1.6	16.2	16.6	6.3	7.5
as % GDP	-2.5	-2.5	0.0	1.9	1.9	0.8	0.6
Financed by:							
Net equity flows	26.7	30.1	30.4	30.5	32.1	32.5	26.9
Net FDI inflows	22.6	26.2	28.4	29.3	31.8	32.9	26.2
Net portfolio equity inflows	4.0	4.0	2.0	1.2	0.3	-0.4	0.7
Net debt flows	32.8	41.5	16.1	21.0	2.0	24.9	29.5
Official creditors	6.6	7.4	-0.7	-0.1	2.0	2.2	-6.5
World Bank	3.9	1.5	1.9	2.1	2.1	1.0	-0.7
IMF	2.4	5.3	-3.1	-0.7	6.1	4.6	-2.1
Others	0.3	0.6	0.5	-1.5	-6.2	-3.4	-3.7
Private creditors	26.3	34.1	16.9	21.1	0.1	22.7	36.0
Net M-L term debt flows	17.7	29.7	17.9	11.6	6.8	21.2	18.9
Bonds	9.2	16.0	8.2	5.3	1.6	4.1	13.9
Banks	8.4	14.8	10.6	8.0	7.4	18.7	7.1
Others	0.1	-1.1	-0.9	-1.7	-2.1	-1.6	-2.0
Net short-term debt flows	8.5	4.4	-1.0	9.5	-6.8	1.4	17.1
Balancing item *	-25.4	-41.7	-37.7	-50.9	-40.4	-18.8	-3.1
Change in reserves (- = increase)	-7.3	-4.9	-7.2	-16.8	-10.3	-44.9	-60.7
Memo items:							
Bilateral aid grants (excluding technical co-operation grants)	5.4	5.4	8.2	8.6	7.1	8.5	9.1
Net private flows (debt+equity)	52.9	64.2	47.2	51.5	32.2	55.2	62.9
Net official flows (aid+debt)	12.0	12.8	7.5	8.5	9.1	10.7	2.5
Workers' remittances	7.3	10.5	9.3	9.7	10.2	10.3	10.4

Note : e = estimate

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries