This chapter is from a prepublication version of Global Economic Prospects. The pagination here will be different from the final book, which will be available by December 14.

Appendix 1
Regional Economic Prospects

Sub-Saharan Africa

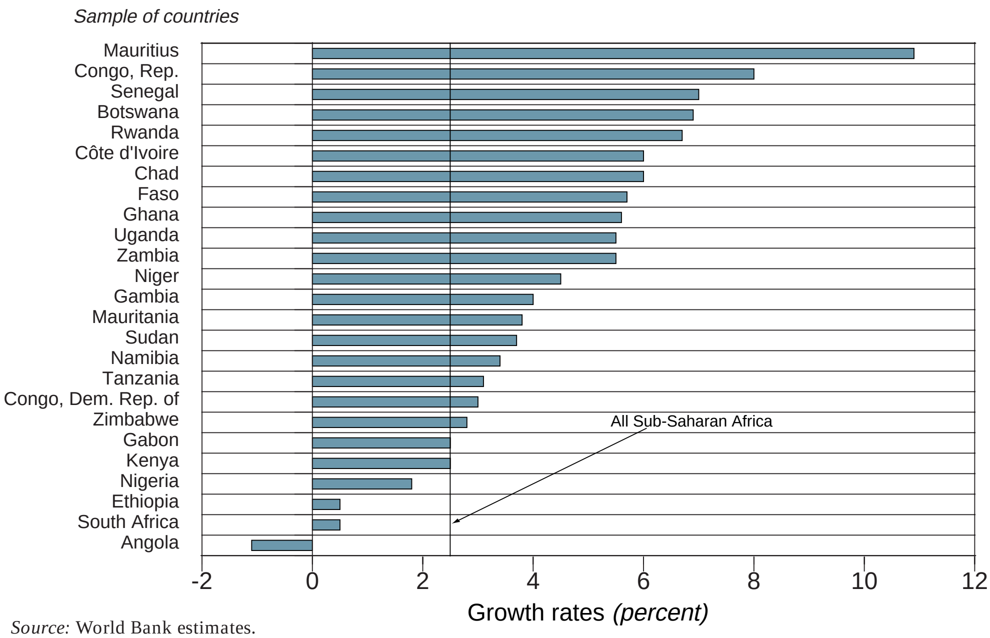
Following more than a decade of near-continuous decline, per capita income in Africa began to grow again in 1993, rising 1.2 percent a year from 1994 to 1997.[1] Private investment went from 12.7 percent of GDP to 13.6 percent, fiscal deficits (including grants) shrank from 4.3 percent of GDP to 2.9 percent, and inflation dropped, from 12.3 percent to 8.5 percent. Domestic factors accounted for much of the region's improved performance, from a lower incidence of civil strife, to greater macroeconomic stability, and modest progress in liberalizing markets and privatizing state enterprises. Countries that did better on these fundamentals reaped the benefits of improved economic efficiency, and grew at 5.5 percent on average in 1995–97, while countries that were directly affected by conflict performed poorly.[2]

Favorable external conditions also contributed, most notably the rapid growth in world trade, surging private capital flows, and a mini-boom in commodity prices (in 1994–95). These are encouraging signs after a decade of pessimism about the region's prospects. But most countries remain at substantial risk from external and internal shocks. The East Asian crisis is expected to buffet Africa through all three of the main transmission channels—private capital flows, terms of trade, and export market growth. How countries are affected and how hard they are hit will depend on the resilience of the economic structure and the soundness of initial conditions.

Growth has already begun to slow in Sub-Saharan Africa, from 4.2 percent in 1996 to 3.5 percent in 1997. Growth is expected to fall again in 1998 to 2.1–2.4 percent before rebounding to 3.5 percent in 1999–2000 under the relatively favorable baseline scenario assumptions (figure A1-1 and table A1-1).[3] The recent faltering reflects a diverse set of factors with the effects of the crisis in East Asia dominating. Among domestic factors, the most notable are the political transition in Nigeria, the effects of El Niño in eastern Africa, and the resur-

Growth slows in 1998…

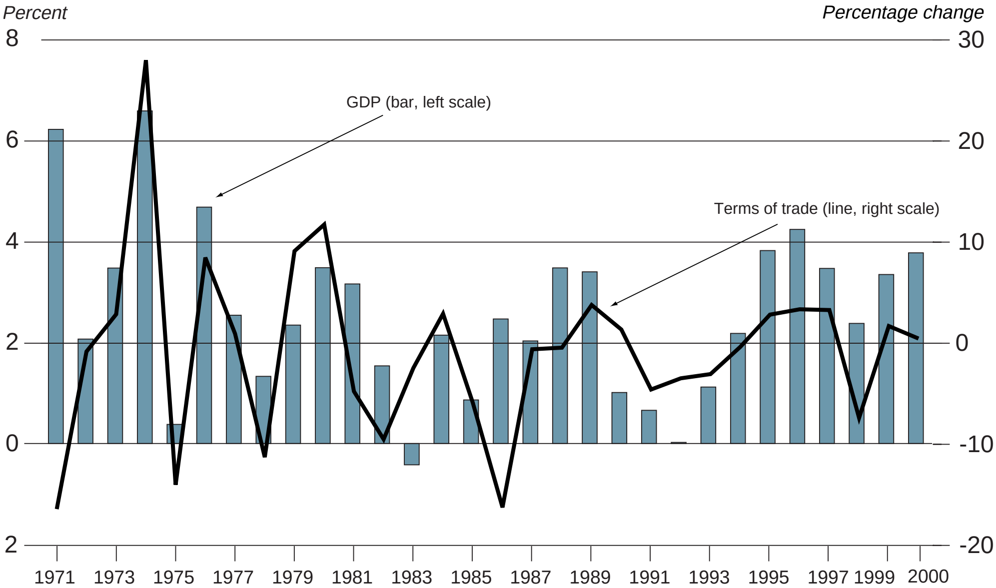
Figure A1-1a Sub-Saharan Africa: GDP growth, 1998



Source: World Bank estimates.

…but prospects improve toward 2000

Figure A1-1b Sub-Saharan Africa: GDP and terms of trade, 1971–2000



Source: World Bank data and projections.

Table A1-1 Sub-Saharan Africa forecast summary
(percent per year)

Growth rates/ratios	1988–97	1996	1997	Baseline forecast 1998	1999	2000	1998-2007
Real GDP growth	2.3	4.2	3.5	2.4	3.2	3.8	3.8
Consumption per capita	-0.4	0.8	0.8	-0.3	0.7	1.2	0.8
GDP per capita	-0.4	1.4	0.5	-0.5	0.4	1.0	1.0
Population 16–65 years	3.1	3.1	3.2	3.2	3.2	3.1	3.1
Median inflation[a]	10.2	7.1	6.6	7.5	7.7	7.6	8.0
Gross domestic investment/GDP	16.0	16.6	16.2	16.2	16.3	16.4	17.0
Budget balance/GDP	-6.0	-4.4	-3.8	-3.6	-3.6	-3.7	-3.7
Export volume[b]	4.8	10.1	8.1	4.0	4.7	4.8	5.2
Current account/GDP	-1.4	0.0	1.9	-0.3	0.0	0.2	0.3
Debt to export ratio[c]	345.0	300.0	290.0	300.0	295.0	290.0	275.0
Memorandum item							
GDP of major oil exporters[d]	3.9	4.0	4.4	1.2	2.6	3.0	3.4
GDP of region excluding South Africa and oil exporters	2.4	4.8	4.3	3.8	4.2	4.8	4.5

a. GDP deflator.
b. Goods and nonfactor services.
c. Ratio of long-term debt outstanding and disbursed to exports of goods and nonfactor services plus net worker remittances.
d. Nigeria, Gabon, and Angola.
Source: World Bank baseline forecast, November 1998.

gence of conflict in the Republic of Congo and in a number of other countries. Subpar growth in Nigeria and South Africa—the region's economic giants—had a decisive influence on the recent slowdown.

Recent region-wide slackening in growth is thus a setback, but prospects are not as bleak as the broad regional averages might suggest. The CFA countries, for example, have maintained close to 5 percent annual growth, and this pace should continue to be driven by their improved policies and strong ties to a resurgent Europe. Several other countries also stand to gain from reductions of their debt burdens (HIPC initiative) tied to improving policy performance, and others are also making progress.

The effects of the East Asian crisis will be felt most directly by the region's largest oil exporters, Nigeria, Angola, and Gabon, which will see their terms of trade deteriorate by an average of 23 percent in 1998, implying a decline in income equivalent to almost 8 percent of GDP. These countries are also likely to experience the largest deceleration in export volumes, reflecting the sharp slowing in world demand for oil in the wake of the Asian recession. Foreign direct investment in Africa, which has grown substantially since 1990 (from near zero to near $4 billion in 1997), is directed mainly to the minerals and metals sector and is likely to decline in response to falling commodity prices and the shrinking profitability of firms in industrial countries as the world economy slows. The oil exporting countries will also face a large decline in fiscal receipts (amounting to several percentage points of GDP) resulting from lower oil-related revenues. Growth in these oil exporting countries is expected to slow from over 4 percent in 1997 to near 1 percent in 1998 and then to accelerate with a modest oil price recovery in 1999 to 2.6 percent.

South Africa, representing some 40 percent of the region's GDP, is the continent's most diversified exporter, with manufactures making up over one-third of exports, of which about 20 percent are destined for Asia. It is also the only country in the region whose financial markets are well integrated with international capital markets. Over the past 18 months or so, South Africa has experienced a sharp deterioration in its external environment, mainly through reduced capital inflow, increased capital flight, and rapid deceleration of exports. The terms of trade also deteriorated in both 1997 and 1998, reflecting the decline in gold prices. South Africa's economy is likely to slow from 1.7 percent growth in 1997 to under one percent in 1998 and then recover to 2 percent in 1999.

Africa's nonoil exporters, excluding South Africa, are a highly diverse group. They are less dependent on international private capital inflows and, for the most part, more dependent on exports of agricultural commodities, including cocoa, coffee (primarily robusta, in West Africa), cotton, and groundnuts. Cocoa and robusta coffee prices have held up relatively well in world markets, but cotton and groundnut prices have fallen sharply. Growth prospects in these countries, with few exceptions, will depend more on internal developments than on the external effects resulting from the Asian crisis. As a group, these economies should see aid flows continue at close to current levels in the near term, and a smaller overall deterioration in their terms of trade since falling import prices of oil and manufactures should largely offset price declines in their agricultural exports—although the latter hurts agricultural producer incomes more widely. The African nonoil exporters are also expected to experience only modest deceleration in export volumes. Aggregate growth for the group of nonoil exporters (excluding South Africa) is expected to remain near 4 percent over 1998 and 1999, in line with their growth performance over the past two years.

Some specialized exporters such as Zambia (copper), Mali (cotton, livestock, and gold), Zimbabwe (tobacco and gold), Malawi (tobacco), and Ethiopia (arabica coffee), will be hurt more by deteriorating terms of trade. In addition to the demand factors associated with the Asian crisis, supply factors also hurt African growth in 1998. Heavy rains reduced the output of coffee, tea, and cotton in east and central Africa. Uganda, Africa's largest coffee producer, is expected to export just 3.8 million bags in 1998, down from 4.5 million bags last year.

Other countries in this group, including several in West Africa, will suffer smaller terms of trade deterioration in the short term, reflecting the protection afforded them by institutional arrangements. The CFA countries have maintained the near 5 percent growth achieved since the devaluation of the CFA franc improved their competitiveness in 1994. At 4.8 percent forecast for 1998, their growth performance is expected to be similar to that in 1997, and better than that of a comparable group of non-CFA countries (4.2 percent).

Despite the challenges of adjusting to a less favorable external environment over the next two years or so, the longer term outlook for Africa offers the promise of significant improvement. Population growth is expected to remain high, but people should see their incomes rise by a modest 1 percent a year, thanks to annual growth rates near 4 percent for 1998–2007, a doubling of the 2 percent average in the past 10 years (1988–97). Underlying this projection are a moderately favorable external environment over the medium term and better policies at home leading to greater macroeconomic stability and lower budget deficits and inflation. The regions' current account deficit is expected to narrow (with improved export performance). The implementation of debt reduction initiatives and higher growth rates are expected to lead to reduced debt service burdens over the next ten years. Most of the output gains will come from greater efficiency in resource use, since only a small increase in investment as a share of GDP is projected, leaving Africa with the lowest investment share in GDP among developing regions. Long-term growth rates are a full percentage higher for the nonoil producers (excluding South Africa) than for the oil producers, a reflection of the pessimistic outlook for oil prices and for the policy responses of producer countries to these projections.

There are significant downside risks, however. The risks from the low-case scenario would be particularly harsh for the oil producers (no oil price recovery in 1999), and South Africa (the most vulnerable to financial contagion and a sharper downturn in world trade volumes). Another source of risks, with potentially catastrophic long-term implications is the proliferation of conflicts that could delay indefinitely the crucially important recovery in private investment in large parts of the continent.

South Asia

To reduce poverty and raise standards of living faster, the economies of South Asia—and their 1.2 billion people—need to accelerate growth rates to 7 percent and keep them there. Growth picked up significantly between 1992–96 following trade and investment liberalization and significant depreciation of real exchange rates, especially in India. Favorable global economic conditions helped out, giving exports and FDI inflows a boost. But new challenges are clouding the region's prospects, from the effects of economic sanctions to wavering attention to reform and worrisome dangers that the trade fallout of the East Asian crisis will impact South Asia.

Though still relatively insulated by the structure of their economies from the immediate fallout from the global financial crisis, South Asian economies are slowing perceptibly—growth went from about 7 percent in 1996 to 5 percent in 1997. The global economic slowdown will exert some drag on regional growth as a slackening in export markets pulls growth down to 4.6 percent in 1998 and holds it below 5 percent in 1999. Policy drift and weak industrial performance have slowed India's economy. Following the imposition of U.S. and G-8 sanctions (expected to reach $1.5 billion, or 2.5 percent of GDP) Pakistan's foreign reserves dipped to just 2–3 weeks of import coverage in the summer of 1998, leaving it much more fragile financially. Depressed export markets in East Asia and Japan are a blow since these markets had come to account for a significant share (and growth) of South Asia's exports. Competition from East Asia in other markets will slow the growth of exports, especially from India and Pakistan, while a slowdown in FDI from East Asia will hurt Bangladesh and Sri Lanka in particular. There are a few positive forces as well however. The steep drops in oil prices are a boon to the region's oil importers; the resulting improved terms of trade have improved purchasing power by about 1 percent of regional GDP.

While the effects of the East Asian crisis have been felt through trade and FDI links, the financial effects have been muted, largely because of the structure of these economies. First, their vulnerabilities to external shocks—represented by current account deficits—have been limited (except in Pakistan). Second, banks have not been permitted to fuel large domestic credit booms. Third, the modest rather than complete relaxation of capital controls has meant little external exposures for banks (with Indian banks having little short-term foreign debt). Finally, offshore forward markets for currencies remain thin and hard to use for speculative purposes. Some currencies, (including the Indian rupee) fell about 7.5 percent in the first quarter of 1998–99, but that reflected mainly concerns related to sanctions which cut foreign aid from the United States and Japan.

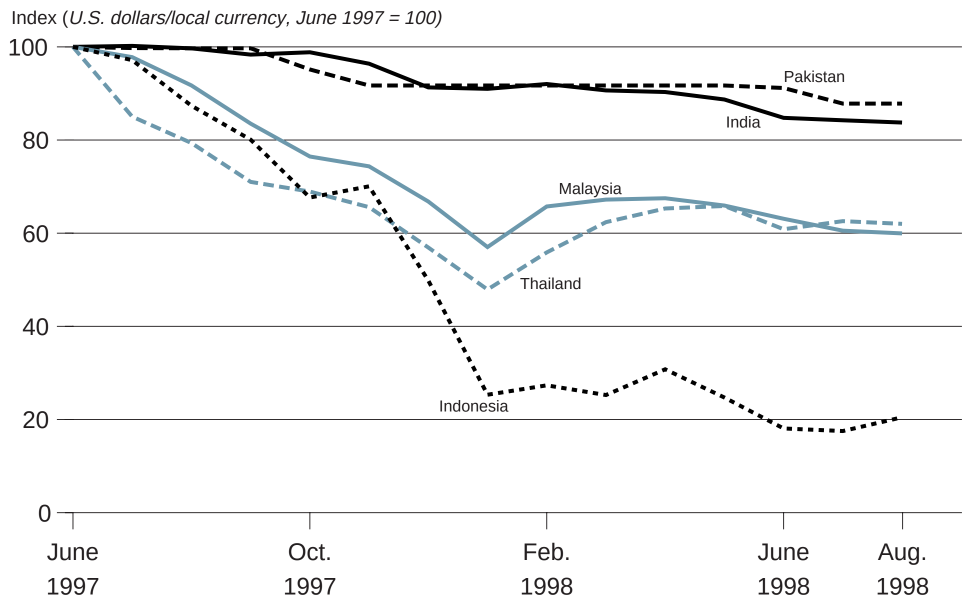
The Indian economy nevertheless slowed to 5 percent in fiscal 1997–98, following three years of rapid advances averaging 7.5 percent. While a decline in agricultural output was a contributing factor, nonagricultural GDP growth had begun to slow in 1996–97. Indeed, industrial output had fallen from 12.5 percent in 1995–96 to 6.4 percent in 1996–97 and then declined further to 5.7 percent in 1997–98. Contributing to the slowdown was the persistence of large public sector deficits (crowding out private investment), a decline in export growth since 1995–96, and cutbacks in investment because of uncertainty about reforms. The public sector deficit fell slightly to 9.1 percent of GDP in 1997–98 thanks to a cut in subsidies on petroleum products that brought domestic oil prices closer to world prices. But the 1998–99 budget contains no concrete proposals for substantial further reductions, and proposes to increase revenues through higher excise collections and import tariffs—potentially a step in the wrong direction. If growth targets of over 6 percent do not materialize, the total public sector deficit could well persist at more than 9 percent of GDP, representing one of the biggest challenges for the Indian economy. Domestic financial weaknesses remain a concern and will need to be addressed if the financial system is to be a source of strength rather than a drag on longer-term growth—as evidenced most recently by a run on deposits with the state-owned investment corporation, Unit Trust of India. Domestic stock markets, already depressed, slumped further in response.

India's export performance shows large recent declines in nominal dollar value, though it has been more stable in volume terms. After three years of high (19 percent between 1993 and 1996) growth, the growth in the nominal value of export slowed dramatically to 4.6 percent in 1996–97 and 2.7 percent in 1997–98 (but volume growth dropped by much less, from 9 percent in 1996 to about 6 percent in 1998). Import value growth also fell, yielding a modest increase in the current account deficit to 1.6 percent of GDP (the real volume of imports fell reflecting the slowdown in domestic growth). While the 16 percent decline in the rupee against the dollar over the past year will offset some of the loss of export competitiveness to ASEAN countries, competitiveness conditions for Indian and other South Asian export growth to EU and North American markets will remain difficult for some time (figure A1-2 shows widening gaps in nominal exchange rate depreciation; the gap is generally smaller for real exchange rate movements and recent strengthening of exchange rates in East Asia will help ease the relative competitiveness difficulties for South Asia).

The outlook for Pakistan is more worrisome. Output growth slowed to 4.6 percent in 1995–96 and then to 3.1 percent in 1996–97 after implementation of adjustment programs weakened. Recent data show output rising by 5.4 percent in 1997–98, but against the background of recent developments, consensus projections for 1998–99 suggest a drop to 3.0 percent. The deficit on current account worsened significantly to 6.8 percent of GDP in 1995–96 and 6.4 percent in 1996–97. Preliminary figures suggest some improvement in 1997–98 because of compressed import growth and higher worker remittances. The government has been forced to implement

Currencies fell against the dollar—but less than in ASEAN competitors

Figure A1-2 India, Pakistan, and selected ASEAN countries: Exchange rate developments, June 1997–August 1998



Source: International Monetary Fund.

austerity measures, including sharp spending cuts and a 25 percent increase in gasoline prices. The convertibility of onshore foreign exchange accounts (with deposits of about $11 billion, of which over a third has since been withdrawn into rupees) has been frozen, and wide-ranging capital controls have been introduced. Imposed to stem capital flight and preserve scarce foreign reserves in the immediate term, these measures will discourage worker remittances and inhibit domestic and foreign investment, with potentially harmful effects on longer-term growth. Assuming that Pakistan gets back on track with an easing of sanctions and improved policies, the outlook should improve in the medium term, but very large risks remain. Recent difficulties with private power projects may mean, for example, that private foreign investment is unlikely to revive quickly even with the easing of sanctions.

Bangladesh's medium-term prospects are better. Although the worst floods in recent history are expected to cut growth sharply in 1998, the effect is temporary. Growth had picked up to 5.5 percent over the past couple of years, and export growth was strong at more than 15 percent in 1997–98. FDI soared from a meager $30 million in 1993 to an average of $320 million in 1994–97. Massive gas reserves have been discovered, and foreign investor interest has surged, but a weakening of FDI inflows and export markets is likely after the East Asian crisis. Bangladesh needs to address structural problems: the savings rate, while improving, remains low; the export base needs to become more diversified; and greater progress is needed in privatizing loss-making state enterprises. Elsewhere in the region, Sri Lanka's recent economic performance has also improved (5 percent growth), but Nepal's case is more difficult, with growth slipping to less than 3 percent in 1998.

Table A1-2 presents the consolidated regional forecast. Compared to the immediate past decade, when the momentum of reforms was stronger, growth is expected to moderate over the next decade to about 5.4 percent a year. This would

Table A1-2 South Asia forecast summary
(percent per year)

				Baseline forecast			
Growth rates/ratios	1988–97	1996	1997	1998	1999	2000	1998-2007
Real GDP growth	5.8	6.9	5.0	4.6	4.9	5.6	5.4
Consumption per capita	2.8	4.8	2.9	2.2	2.5	3.3	2.9
GDP per capita	3.7	5.0	3.1	2.7	3.1	3.8	3.6
Population 16–65 years	2.4	2.3	2.4	2.3	2.3	2.3	2.4
Median inflation[a]	9.6	7.0	8.2	7.6	7.1	6.9	6.8
Gross domestic investment/GDP	23.2	25.8	25.5	25.9	26.3	26.6	27.3
Budget balance/GDP	-6.9	-5.4	-4.5	-4.3	-4.3	-4.1	-3.7
Export volume[b]	10.6	6.6	8.9	5.6	7.3	8.9	9.9
Current account/GDP	-2.1	-2.1	-1.2	-0.6	-0.7	-1.0	-0.4
Debt to export ratio[c]	240.0	185.0	180.0	177.0	170.0	160.0	150.0

a. GDP deflator.
b. Goods and nonfactor services.
c. Ratio of long-term debt outstanding and disbursed to exports of goods and nonfactor services plus net worker remittances.
Source: World Bank baseline forecast, November 1998.

mark a small downward revision of 0.5 percentage points from last year's growth forecast. Achievement of this growth would still permit significant improvement in per capita incomes (although not as rapidly as had been occurring in the mid-1990s). The main sources of growth are expected to be rising investment rates and relatively rapid export growth (in part reflecting prospective gains from MFA abolition, which would especially benefit South Asia). Budget deficits are also expected to narrow and the current account deficits would remain small, with net capital inflows to the region moderated in the aftermath of the East Asian crisis. Inflation and external debt sustainability would improve. These relatively favorable prospects would however require substantial success in policy reforms. Reducing public deficits (thereby allowing private investment to rise and economy-wide efficiency to rise) will require broadening of the tax base (which still relies too heavily on trade and indirect taxes) and reducing subsidies to loss-making state enterprises. Moreover—and mindful of lessons of the East Asian crisis—reinvigorated liberalization of trade and investment (while managing capital accounts cautiously in step with improvements in institutional capabilities and financial regulation) would be essential to improve efficiency and to achieve forecast success in exporting. The risks to this outlook are, however, significant, originating mainly from domestic sources—from an inability to regain the momentum of required policy reforms. In addition, worsening of external trade and investment conditions are an immediate risk.

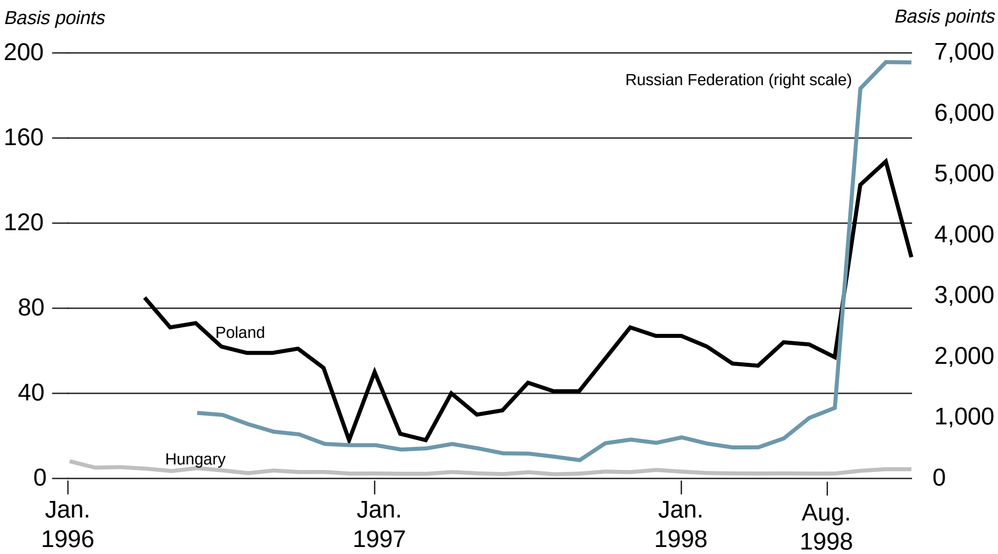
Europe and Central Asia

Regional growth averaged 2.6 percent in 1997—and the first advance (1.7 percent) for the transition group in Europe and Central Asia since the move to market began. Central and Eastern Europe benefited from improving conditions in Europe and strong growth in investment flows. The Russian Federation and the Ukraine seemed to be getting their macroeconomic house in order and looked on the road to recovery and growth in output. But the East Asian crisis—and its ripple effects—has played some part in altering that optimistic picture, especially for Russia and other countries of the Commonwealth of Independent States (CIS). This has created a sharp contrast in the region, since performance and prospects for the other Central and Eastern European countries look more favorable.

The crisis in Russia—and the potential for spillover effects within the region—dominates near-term concerns (figure A1-3a). Still, output is expected to rise in 21 of 25 countries during 1998, with Russia, Ukraine, and Romania, as well as the Czech Republic, being the critical exceptions (figure A1-3b).[4] The widening recovery in Western Europe, particularly in Germany, has allowed several Central European and Baltic countries to keep exports booming at double-digit rates during 1998. These countries also enjoyed substantial gains in terms of trade as oil and raw material prices fell, in part because of falling demand in Asia. Performance suffered the largest setbacks in Russia and Ukraine. This poses a threat to the smaller CIS states, including the Transcaucasus countries and the Kyrgyz Republic, whose stabilization programs and other reforms

Secondary market spreads rise…

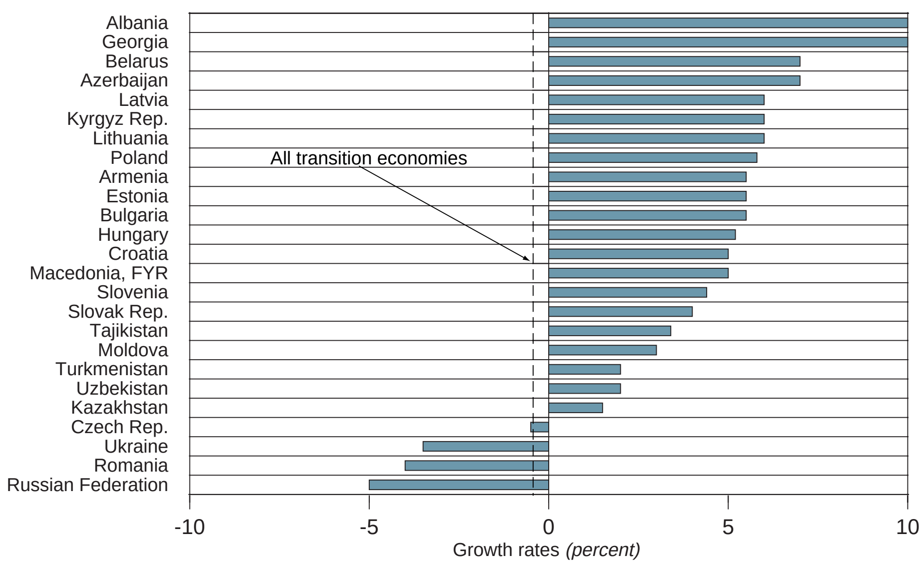
Figure A1-3a Secondary market spreads on benchmark sovereign bonds of selected Central and Eastern European countries



Source: Bloomberg.

…but positive growth is expected in nearly all transition economies

Figure A1-3b Transition economies: GDP growth, 1998



Source: World Bank estimates.

were beginning to yield improvements in growth. Many have also seen their terms of trade deteriorate.

Acute fiscal and financial difficulties in Russia, aggravated by declining international oil prices, prompted strong but ultimately unsuccessful measures to defend the ruble. A large international support program in July 1998 failed as well, a victim of the non-supportive political and economic environment into which it was channeled. In August, the authorities opted for a devaluation of the ruble, a restructuring of domestic public debt, and a 90-day moratorium on repayments of certain foreign liabilities. Although the fundamental causes of Russia's fiscal imbalance are domestic, the loss of confidence in international capital markets following the East Asian crisis also played a major role.

The main indirect spillover of the Russian crisis has been a rise in spreads on lending (figure A1-3) and the risk of a reversal of capital flows. However, in Central and Eastern Europe policy responses to avoid capital outflows and currency declines have been prudent, in part reflecting lessons from earlier crises experienced by most countries in the region. Poland and the Baltic countries have taken measures to curb too-rapid credit growth and to ensure adequate commercial bank provisioning. Several countries have raised interest rates sharply when their currencies have come under pressure and some have widened bands of variation for crawling-peg regimes to deter speculative inflows of capital. These measures may slow economic activity in the short run, but they likely helped to avoid more harmful consequences for a number of countries.

Equity markets in Central Europe and Russia fared well for a time as private capital withdrawn from East Asia sought alternative markets. Poland attracted a record $6.6 billion in FDI flows during 1997, while Hungary issued a large Eurobond at favorable spreads after Moody upgraded its sovereign debt ratings in May 1998. Since then, however, Russia's equity and treasury-bill markets have collapsed, credit ratings have been downgraded, and Eurobond spreads rocketed (figure A1-3). Russia's difficulties imply large direct effects for other CIS countries with substantial trade links with Russia, and for countries that had benefited from informal cross-border trade in consumer goods (especially Poland and Turkey).

Developments in international commodity markets had highly differentiated effects across the region. The 30 percent decline in oil prices and similar drops in metals and agricultural-resource prices pressured Russia's current account into deficit, (and 25 percent of government revenues are tied to oil and gas sales). Resource-dependent Azerbaijan, Kazakhstan, and Uzbekistan are being hurt as well. Terms of trade for the CIS countries are down an estimated 13.5 percent in 1998 (1.5 percent of GDP). Central European countries and Turkey in contrast saw a 6 percent gain in terms of trade (2 percent of GDP).

These sharply divergent conditions among the main groups of countries are reflected in the long-term growth forecasts for the region (table A1-3). For middle-income Western Europe, growth is likely to slow sharply from about 7 percent to below 5 percent, as Turkey faces much more

Table A1-3 Europe and Central Asia forecast summary
(percent per year)

Growth rates/ratios	1988–97	1996	1997	Baseline forecast 1998	1999	2000	1998-2007
Real GDP growth	-2.7	0.0	2.6	0.5	0.1	3.4	3.9
Consumption per capita	-1.1	1.9	3.0	1.0	-0.4	2.7	3.1
GDP per capita	-3.2	0.0	2.5	0.0	-0.4	2.9	3.4
Population 16–65 years	0.6	0.1	0.3	0.6	0.6	0.7	0.8
Median inflation[a]	36.0	32.7	50.0	43.8	14.0	13.0	16.3
Gross domestic investment/GDP	32.1	27.8	27.5	27.0	27.4	27.9	28.6
Budget balance/GDP	-7.5	-6.7	-5.5	-5.0	-4.5	-4.0	-3.8
Export volume[b]	-0.4	6.6	7.9	3.8	5.5	5.6	5.7
Current account/GDP	1.3	0.5	1.0	0.4	0.7	0.7	0.8
Debt to export ratio[c]	135.0	110.0	105.0	110.0	105.0	107.0	115.0
Memorandum item							
GDP of mid-income Western Europe	4.1	6.7	7.1	4.8	3.6	5.1	5.5
GDP of Central and Eastern Europe	-0.9	3.3	2.3	4.0	4.0	4.5	4.7
GDP of former Soviet Union	-5.3	-4.3	1.3	-3.7	-4.3	1.7	2.6

a. GDP deflator.
b. Goods and nonfactor services.
c. Ratio of long-term debt outstanding and disbursed to exports of goods and nonfactor services plus net worker remittances.
Source: World Bank baseline forecast, November 1998.

severe difficulties in external financing. For the second group of countries in Central and Eastern Europe, expectations for longer-term growth of 4.7 percent remain largely unchanged from the projections in *Global Economic Prospects 1997*.

For the five countries on the short-list for EU accession (the Czech Republic, Estonia, Hungary, Poland, and Slovenia), policy will increasingly be driven by the need to harmonize economic and financial standards and institutions with those of the EU. Negotiations are expected to continue for some time, as many difficult issues—agriculture important among them—will need to be addressed for integration to proceed smoothly. Anticipation of accession may provide an incentive for additional large inflows of direct investment to the applicant countries, supporting rapid investment and export-led growth. Strengthening financial sectors and reducing inflation to European norms will prove a significant challenge for policymakers. Nevertheless, assuming a consolidation of EU recovery, improving domestic policies, and diminishing adverse effects of the Russian crisis, output growth of 4–5 percent is likely for the group, with continued strong advances in Poland, improved performance in Hungary, and gradual acceleration in the Czech Republic.

Elsewhere in the second group of Central European reformers, Bulgaria and Romania have made progress in their stabilization programs, and signs of recovery are apparent. In Bulgaria, the currency board and closure of several weak banks appear to have stabilized the banking system. In the Slovak Republic, rising inflation and fiscal deficits have resulted in a downgrading of credit ratings. Even as monetary policy remains tight and the exchange rate firm in the Baltic states, growth has been strong, driven by a booming services sector; but despite efforts to cool economic activity, current account deficits remain at around 10 percent of GDP. Continued FDI financing and a pick-up in exports will be required to make these imbalances more manageable. The near-term outlook for these countries, and for Croatia and the former Yugoslav Republic of Macedonia, will thus reflect a mix of export strength with European recovery and policy impacts on domestic demand—rising in countries emerging successfully from adjustment programs (Bulgaria, Romania) and moderating in others.

The outlook for the third group of countries, Russia and the other CIS countries, is now murkier. Clouded by financial crisis and a new government of uncertain policy intentions, hopes for a near-term broadening of recovery in Russia have evaporated. Private forecasts see a decline of 4–6 percent in 1998, followed by similar contractions in 1999. Getting on a path of robust longer-run growth will require fundamental institutional reforms, together with economic stabilization and tax and investment reforms that replenish public resources while supporting the private sector. Recent events have underscored the institutional fragility of a number of CIS states. With growth in Russia (and Ukraine) falling or severely constrained, and Central Asia hurt by developments in commodity markets, 10-year growth projections for the region as a whole have been lowered to 2.6 percent, a major 2.4 percentage point revision from *Global Economic Prospects 1997*.

Latin America and the Caribbean

Latin America and the Caribbean grew strongly in 1997 and the first half of 1998, propelled by a surge in exports and investment made stronger by recent policy reforms (and the successful response to the Mexican peso crisis of 1994). The region continued to attract large flows of private capital which supported robust growth. The East Asian crisis had little immediate effect on the region (for a detailed discussion see Perry and Lederman 1998). But in November of last year, Brazil was forced to announce severe austerity measures which induced a sharp slowdown in growth. And with the spread of the crisis to Russia in August 1998, investors began pulling their money out of all emerging markets, with especially severe consequences in Latin America. In other developments, some countries in the region such as Peru, Ecuador, and El Salvador were also affected adversely by El Niño earlier in the year, lowering their growth and exports; the more recent Hurricane Mitch in November 1998 has also had devastating effects in some Central American countries (especially Honduras and Nicaragua), destroying a significant part of productive capacity in agriculture and infrastructure.

The region's 5 percent advance in 1997 is expected to slide to 2.5 percent in 1998 and further to 0.6 percent in 1999, before eventually recovering to an expected longer-term growth rate of about 4 percent. The sharp slowdown reflects primarily a severe deterioration in the world economic environment that will hurt Latin America through all three channels—drastic cutbacks in international capital flows and rising costs of external financing (following the flight to safety in world markets), large price declines for both oil and nonoil commodities (which still account for much of the region's export earnings), and a sharp slowdown in world trade growth (following the collapse of Asian demand). But the effects of the global crisis are expected to be less severe than in Asia, in large part because of the generally improved policy environment and earlier experience with such crises. No country in the region has suffered a currency free-fall. Almost a third of countries are expected to grow 4 percent or faster during 1998, with only a handful growing less than 2 percent (figure A1-4a), and, under the base-case assumptions, the slowdown in 1999 would not be protracted.

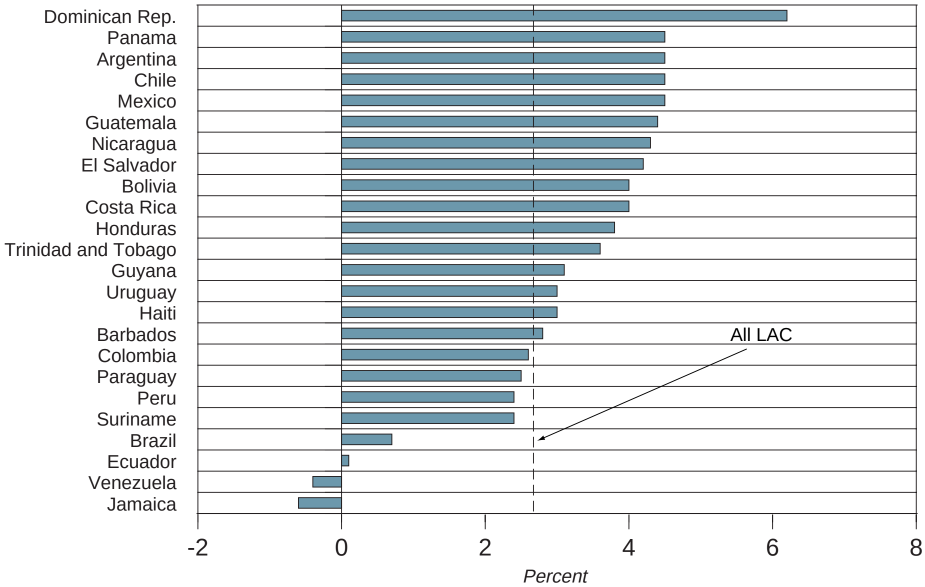
Some countries were more resilient than others during this shock. Countries that were on the upswing of their business cycles as a result of past policy improvements—Argentina, Chile, Mexico, and Peru growing by 7 to 8 percent in 1997 (figure A1-4b)—were better able to adjust. Some of these countries had already experienced several crises—most recently the Mexican peso crisis of 1994–95—and management teams were prepared to address shifts in investor sentiment. Brazil, although it was somewhat behind in the regional growth and policy improvement cycle, was still able respond effectively in November 1997 by tightening monetary policies, and again in late 1998, when amid renewed turbulence in global capital markets after the Russian crisis concerns surfaced about its fiscal and current account deficits. Many countries in the region had already encountered difficulties with their banking systems and had made real progress in addressing problems. Though the reform agenda remains incomplete (for example, in Mexico), financial sectors are generally less exposed to external shocks than in Asia; bank intermediation is less than 40 percent of GDP compared with more than 100 percent in many East Asian countries. Working against these positive factors in the region, however, were widening current account deficits, large budget deficits in some countries (such as in Brazil), growing reliance on external financing, and a bunching of elections throughout the region.

As growth of domestic economies accelerated in 1997 and early 1998, trade and current account balances worsened across the region, especially in the larger countries (figure A1-5). Terms of trade deteriorated for commodity exporting countries, especially as prices of key commodity exports (oil, coffee, copper, and wheat) fell. The region as a whole suffered a terms of trade decline of about 0.6 percent of GDP (with Bolivia, Colombia, Ecuador, Peru, Trinidad and Tobago, and Venezuela experiencing much larger declines). Regional export volume growth slowed from 11 percent in 1997 to near 6 percent in 1998 on weaker world import demand (as in Chile and Peru, for example) and greater competition from Asian exporters (as in Brazil and Mexico, for example), as well as the effects of adverse weather from El Niño in some countries. Low commodity prices are also affecting adversely prospects in the Caribbean.

Many countries reacted to widening deficits by attempting to tighten fiscal and monetary policies, and some through a widening of their currency bands, but deficits still grew because of the depth of the slowdown in Asian growth and the resulting weakness in commodity prices. Many also were facing elections in 1998, which delayed adjustment measures. Elections were held in Ecuador (June), Colombia (July), Brazil (October), and are

One-third of countries to grow 4 percent or more in 1998

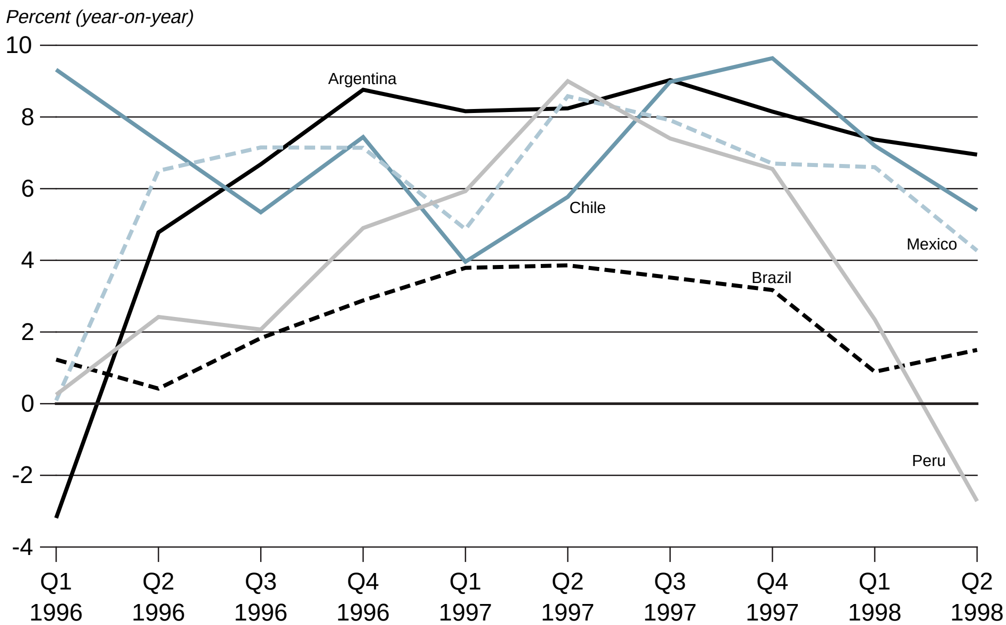
Figure A1-4a Latin America and the Caribbean: GDP growth, 1998



Source: Bloomberg.

Some countries were on an upswing when the crisis hit

Figure A1-4b GDP growth for selected Latin American countries



Source: World Bank estimates.

expected shortly in Venezuela (December).

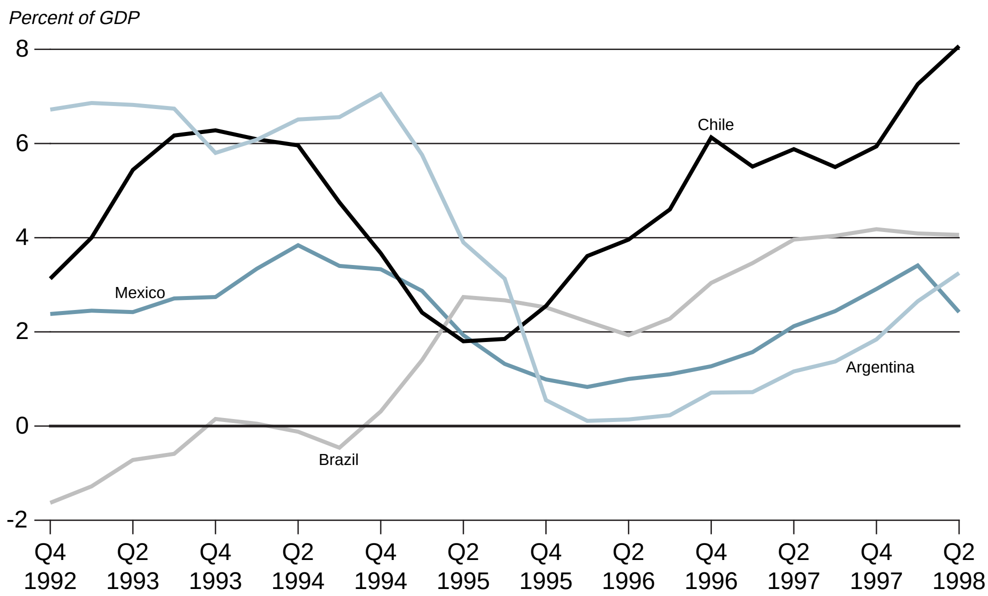
Countries in the region remain vulnerable to shifts in international investor sentiment, particularly in the wake of developments in Russia. Little improvement in domestic private savings rates over earlier periods means that countries continue to rely heavily on external private capital flows. Risks have increased as widening current account deficits create larger external financing needs, which have become more costly and difficult to obtain. Average spreads on Latin American bonds rose about 150 basis points between mid-1997 and mid-1998, and by August secondary market spreads on benchmark international bonds of Latin American countries had increased sharply, especially for Brazil (figure A1-5b). Several countries encountered severe pressure on their currencies. Colombia had to devalue by 9 percent, Ecuador by 10 percent, the Mexican peso lost 12 percent of its value, and Brazil used up $25 billion in reserves to shore up the real.

Reliance on foreign savings means that growth and current account deficits are closely correlated (figure A1-6). With an inevitable forced reduction in current account deficits because of reduced private capital flows, the region's GDP growth will slow sharply in 1999. Brazil is still at an early stage in its structural adjustment, and the correction of its twin deficits to improve investor confidence will mean a period of even slower growth. Argentina is sensitive to a recession in Brazil and has to complete reforms to make its labor market more flexible—a key element in improving economy-wide efficiency. Other countries in the region will also experience slower growth with the expected downturn in the global economy and reduced capital flows. There also remains some risk that if the region faces an extended shutdown of private financing (requiring the current account deficit to swing to zero instead of to lower, but still significant, net flows under the baseline), regional growth might slip to -2 percent in 1999. Announced increases in official support (and contingency credit lines) are likely to avert such a scenario, however.

Prospects are still good for stronger regional growth in the longer term given the strength of recent reforms (see Easterly, Loayza, and Montiel 1997)—reaching about 4.5 percent a year toward the end of the projection period—for a number of reasons. First, total factor productivity growth turned positive in the 1990s after declining during the 1970s and 1980s.[5] Privatization in the telecommunications and transport sectors in the early 1990s contributed to this trend. Privatization of Brazil's telecommunications giant Telebras is likely to raise total factor productivity growth in the next few years, as similar efforts did in Argentina and Chile earlier. Second, labor productivity has been growing in the 1990s, after contributing negatively to GDP growth in the 1980s.[6] Labor market reforms have been slow in Latin America, due in part to political sensitivities, but they are progressing. Third, FDI is now producing capacity expansion, not just a transfer of asset ownership as in the early 1990s. According to the United Nations Economic Commission for Latin America and the Caribbean, FDI inflows reached an estimated $50 billion in 1997 and could easily rise once the current downturn in markets eases. FDI has also been shifting away from

Current account balances worsened in 1997 and 1998...

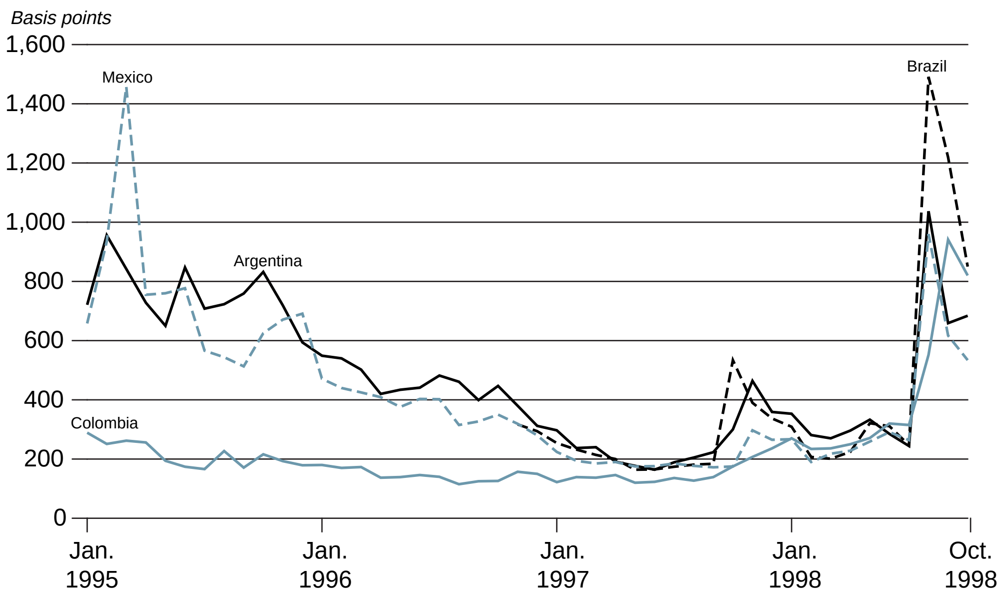
Figure A1-5a Current account deficits in Latin America and the Caribbean



Source: Bloomberg.

...and secondary market spreads rose sharply in mid-1998

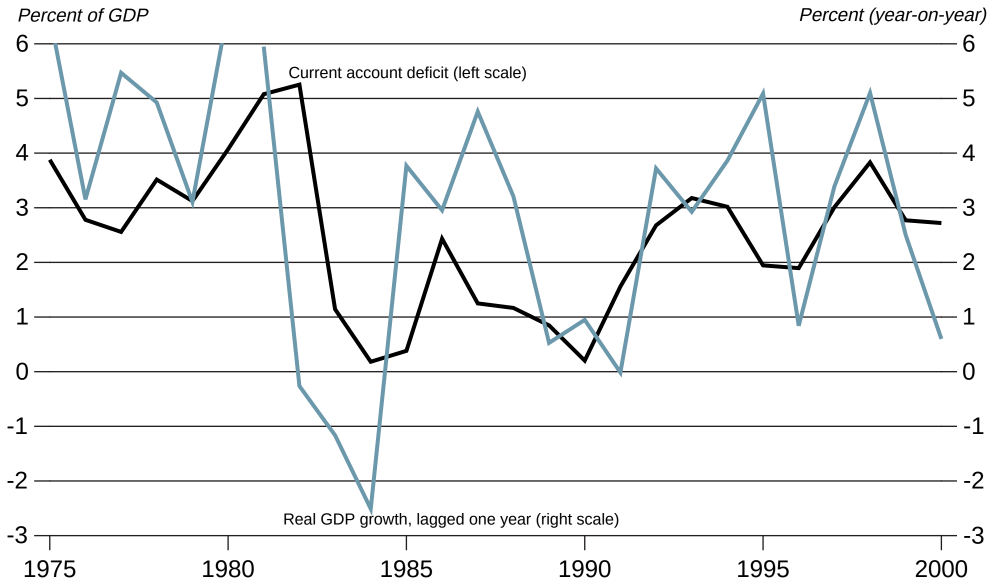
Figure A1-5b Secondary market spreads on sovereign bonds of major Latin American countries



Source: Bloomberg.

Growth and current account deficits

Figure A1-6 Current account deficit and real GDP, Latin America and the Caribbean



Source: Bloomberg.

traditional mining and energy sectors and toward services and manufacturing (especially automobile production in Argentina, Brazil, and Mexico). Finally, and most importantly, domestic savings rates need to rise, reducing the region's reliance on external financing for growth. As pension reform takes hold in more countries over the next five years there is an expectation that savings may rise, although the evidence for this is mixed (Samwick 1998).

These factors are reflected in the prospects presented in table A1-4. GDP growth is forecast to recover to an average of 3.7 percent for the ten-year projection period, with modestly rising investment rates, but lower budget deficits, lower inflation, and a current account deficit that is contained to about 2.5 percent of GDP, implying significantly improved resource use, macroeconomic stability, and higher domestic savings. Nonetheless, Latin America faces a difficult transition. Many countries remain highly indebted or heavily dependent on commodity exports and are therefore vulnerable to interest rate and terms of trade shocks. Access to international capital markets has tightened in the current environment, raising the possibility of a sharper required reduction in external deficits over the next few years. Elections in a number of large countries in the next two years may increase investor nervousness about a slippage on fiscal policy at a time when these economies must still rely heavily on private capital flows to refinance existing debt—although actions on the fiscal front have been strongest in Argentina

Table A1-4 Latin America and the Caribbean forecast summary
(percent per year)

Growth rates/ratios	1988–97	1996	1997	Baseline forecast 1998	1999	2000	1998-2007
Real GDP growth	2.6	3.4	5.1	2.5	0.6	3.3	3.7
Consumption per capita	1.3	1.7	3.8	1.1	-1.9	1.1	1.8
GDP per capita	0.8	1.7	3.5	1.0	-0.9	1.8	2.2
Population 16–65 years	2.4	2.3	2.2	2.1	2.1	2.1	2.1
Median inflation[a]	18.8	11.4	9.0	9.8	9.8	9.2	8.3
Gross domestic investment/GDP	21.1	21.8	23.0	23.4	23.1	23.5	24.2
Budget balance/GDP	-3.0	-1.9	-2.3	-2.0	-1.5	-1.0	-1.5
Export volume[b]	8.7	10.3	9.4	6.3	6.1	6.3	6.4
Current account/GDP	-2.0	-1.9	-3.1	-3.8	-2.8	-2.7	-2.6
Debt to export ratio[c]	200.0	163.0	164.0	180.0	178.0	175.0	160.0

a. GDP deflator.
b. Goods and nonfactor services.
c. Ratio of long-term debt outstanding and disbursed to exports of goods and nonfactor services plus net worker remittances.
Source: World Bank baseline forecast, November 1998.

and Mexico, two countries facing elections. On balance, the growth potential of many countries in the region has improved with better public and private management, suggesting a growth potential in per capita incomes averaging 2.2 percent a year over the next 10 years (a full percentage point higher than in the past 10 years), although risks to this outlook remain large, especially in the near term.

Middle East and North Africa

Signs of a more favorable outlook for the region began to emerge last year. Reforms were gaining momentum in some large economies in the region, (notably in the Arab Republic of Egypt, the largest country by population), while reviving growth in the EU (an important trade partner), was contributing to faster growth along with progress on structural reforms in trade, investment, and other areas. But the East Asian crisis has clouded prospects in the region, especially for some countries, with effects coming through all three channels: a decline in terms of trade (especially severe for oil producers), slowing export growth, and reduced capital flows.

The region's oil exporters are experiencing the largest terms of trade shocks related to the Asian crisis. Economic growth in the region will consequently slow to about 2 percent in 1998 (from 3.1 percent in 1997) and recover only modestly in 1999. The shift from growth to contraction in the region's important oil exporters will, however, be offset by output recovery in North Africa (following a drought in 1997) and stronger growth (3.8 percent in 1998, up from 3.5 percent in 1997) in other countries with diversified exports and trade ties to Europe. But, even for the diversified exporters, there is a risk that export prices and market shares may weaken as they face increasingly intense competition from East Asia, especially in textiles, clothing, and related goods. Prospects for recovery in the region, particularly in the Gulf and the Mashreq, remain contingent on a pick-up in global demand for fuel and stabilization of oil prices—with OPEC producers expected to restrain output (a move that will slow their GDP growth).

The key development for the region's sparsely populated oil producers—mainly Bahrain, Oman, and Saudi Arabia—is the enormous 27 percent deterioration in their terms of trade, equivalent to some 8.5 percent of GDP. The energy price decline, in large part (but not wholly) traceable to the effects of the East Asian crisis, is expected to cut developing Gulf Cooperation Council (GCC) countries' export receipts by more than $15 billion and lead to cuts in government and other spending. GDP is expected to contract by about 2.5 percent in 1998. These economies, which have some capacity to finance current account deficits from reserves, may also be able to borrow abroad.

The high-population oil producers face a similar environment, but their more diversified economies give them greater resilience. The 24 percent deterioration in their terms of trade in 1998, equivalent to about 5 percent of GDP, is large enough to slow growth in Algeria and the Islamic Republic of Iran but not so large as to cause output to contract. Unlike the low-population oil exporters, these countries may be forced to cut imports or use reserves since their capacity to finance a current account deficit with new debt is limited. The Islamic Republic of Iran will likely use its international reserves to remain current on its debt service.

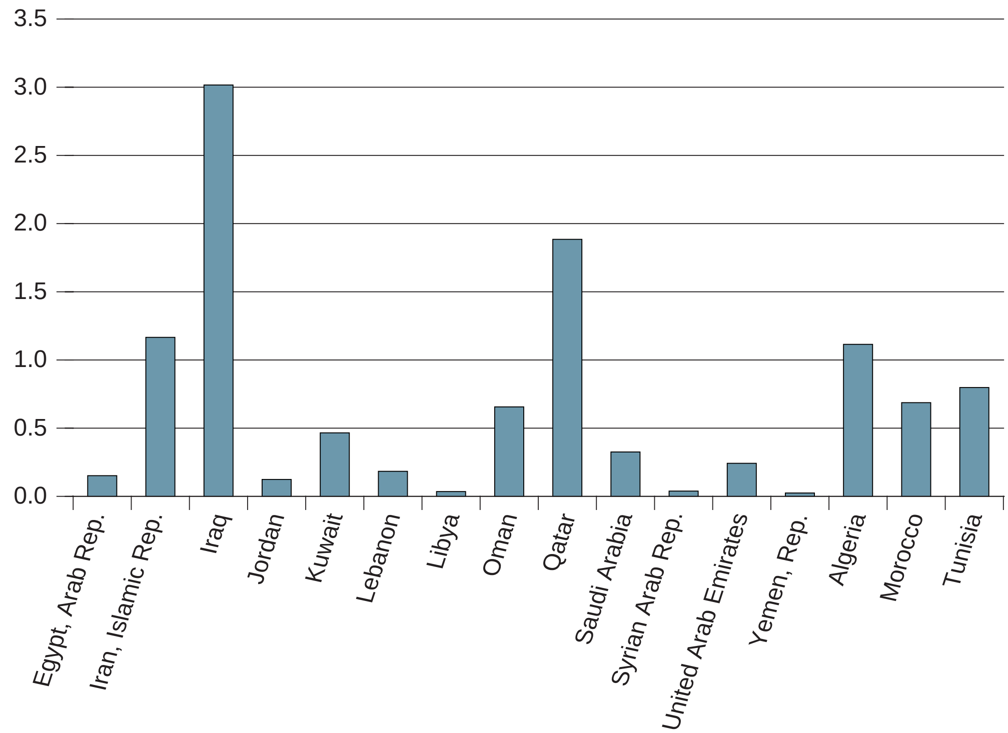
Economic performance among the reforming and relatively diversified economies in the region (Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, and Tunisia,) is likely to hold up fairly well in 1998, with growth of 3.5 to 4 percent. The aggregate current account deficit will widen moderately. A small deterioration in terms of trade (0.5 to 1.5 percent), equivalent to less than 0.5 percent of GDP, should be offset by a 3 to 3.5 percent increase in export volume (mainly to Europe) and a drop in food imports as drought conditions ease in the Maghreb. But the effect of lower oil prices will be spread through the region because of smaller remittances from expatriate workers, less generous transfers in some cases, and reduced intraregional trade.

The main financial impact of the Asian crisis on the region will be reduced access to portfolio capital. Before the crisis in 1997, Egypt, Lebanon, and Morocco collectively tapped international capital markets for nearly $1.5 billion in long-term financing. This represented an 80 percent increase over 1996 and a 130 percent increase over 1995. This financing dried up once the East Asian crisis emerged in 1998. Foreign interest in equity markets also diminished, resulting in a drop in IFC equity indexes for Egypt, Jordan, Morocco, and Tunisia.

A smaller but more widespread impact is being transmitted through financial markets. Not all banks in the region are protected by a cushion of substantial net foreign assets, but few have large net foreign liabilities (figure A1-7). Macroeconomic risks do not point in the direction of banking crises. Unlike the East Asian economies, economies in the Middle East and North Africa exhibit neither excessive domestic credit growth nor rising inflation. And, with the possible exception of Lebanon, there is little evidence of a speculative real estate boom. Furthermore, thanks in part to fiscal consolidation

Low foreign liabilities of the banking system

Figure A1-7 Middle East and North Africa: ratio of foreign liabilities to foreign assets by country with BIS reporting banks, year-end 1997



Source: World Bank.

and adjustment efforts, budget and balance of payments deficits are, on the whole, manageable.

Problems are particularly unlikely in the Gulf countries because most banks in this region are large, well-capitalized, and still profitable. While ultimately the fate of the Gulf banks depends on the oil market, they were in good shape at the end of 1997. The Bank for International Settlements (BIS) reported that the net foreign assets of Gulf banks grew during 1995–97, buoyed by firmer oil prices. At the end of that period, every Gulf country except Qatar, which is financing a major gas development project, had positive net assets with the OECD. With oil prices in decline, however, net assets can be expected to fall. Elsewhere in the region, banks show greater vulnerability because of low transparency, inadequate capitalization, and dominance by state-held banks.

Once the effects of the Asian crisis have dissipated, growth in the Middle East and North Africa region is expected to recover (table A1-5). Average growth for the coming decade should approach 3.4 percent a year, a significant improvement over the 2.6

Table A1-5 Middle East and North Africa forecast summary
(percent per year)

Growth rates/ratios	1988–97	1996	1997	Baseline forecast 1998	1999	2000	1998–2007
Real GDP growth	2.6	5.3	3.1	2.0	2.8	3.1	3.4
Consumption per capita	-0.5	3.0	0.1	-0.8	0.0	0.3	0.6
GDP per capita	-0.1	2.9	0.6	-0.5	0.3	0.6	0.9
Population 16–65 years	3.1	2.9	3.0	3.0	3.0	2.9	2.8
Median inflation[a]	8.2	8.1	4.5	4.1	6.0	6.3	6.0
Gross domestic investment/GDP	22.6	23.3	23.9	24.0	24.3	24.7	25.4
Budget balance/GDP	-4.7	-0.2	-1.7	-1.4	-1.5	-1.4	-3.0
Export volume[b]	5.5	3.6	5.1	-2.1	3.2	4.8	3.8
Current account/GDP	-2.5	2.5	1.8	-4.0	-2.0	0.0	0.0
Debt to export ratio[c]	210.0	177.0	174.0	170.0	175.0	170.0	160.0
Memorandum item							
GDP of oil dominant economies	3.2	4.6	2.7	0.5	2.0	2.5	2.7
GDP of diversified exporters	4.1	6.5	3.5	3.9	4.0	4.2	4.4

a. GDP deflator.
b. Goods and nonfactor services.
c. Ratio of long-term debt outstanding and disbursed to exports of goods and nonfactor services plus net worker remittances.
Source: World Bank baseline forecast, November 1998.

percent growth for 1988–97. The improvement is expected to be especially significant for the diversified exporting economies of Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia, whose growth could recover to about 4.4 percent a year for the next 10 years, reaching nearly 5 percent toward the middle of the forecast period. If this growth is achieved, per capita incomes (and employment growth) would improve substantially. These prospects are, however, contingent on further fiscal reforms, a shift toward private sector growth, rising domestic savings, and expanding nonoil exports. For the oil exporters, however, absent significant reforms, growth may be significantly below the previous 10-year average (with rising budget deficits) and per capita incomes may stagnate or fall.

For the diversified group of exporting countries, realization of the better growth prospects will depend on successful consolidation of domestic and international economic policy reforms (such as privatization). Problems of low labor productivity and high unemployment will have to be dealt with. Solutions will require decisions on a smaller role for the state and a larger one for the private sector in development, including heavy pruning of overgrown public sectors and excessive government spending. Countries in the region spend 9.8 percent of GDP on public wages, nearly twice as much as the average (5 percent) in the OECD countries, Asia, and Latin America (World Bank 1997a). It is difficult to imagine dynamic growth in the region without solid progress in the Middle East peace process and without an end to the daily occurrence of civil strife in the Arab world.

Also important for the diversified exporters is how well they manage globalization in light of the East Asian experience. The most important step is to implement reforms so that domestic producers can compete successfully in the EU under the Euro-Mediterranean Initiative.[7] For Maghreb countries, it is a matter of preparing for implementation of an agreement already in place. For Mashreq countries, it is a matter of completing negotiations, implementing agreements, and restructuring economies to adapt to competition. Intensified competition from the Central and Eastern European applicants to the EU and from the now more price competitive East Asian exporters makes this task even more challenging. Countries like Morocco and Tunisia need to find new export markets as well, especially since EU growth prospects, while on the upswing, are still modest (2–3 percent) and attention has shifted to the Central European applicants to the EU and away from the Maghreb (to some degree).

Endnotes

1 This appendix covers the prospects for all developing regions other than East Asia. East Asia's prospects are discussed in detail in the main text of Chapter 1, and generally, in the main report.

2 This section draws heavily from Gelb 1998.

3 The region's overall growth forecast for 1998 might be somewhat lower (2.1 percent in 1998), based on recent data revisions and consistency checks.

4 Latest data suggest the possibility of growth slipping to a small negative level (–0.5 percent growth) in the Czech Republic in 1998, instead of the small positive level reported here.

5 Growth in total factor productivity for a sample of 19 Latin American countries was estimated to be 0.4 a year in 1991–95, up from –0.7 and –2.4 in the 1970s and 1980s (Lora and Barrera 1997).

6 Labor productivity growth has improved (1.1 in 1991–95 compared with –1.3 in the 1980s), but there is still need for greater labor market flexibility, notably in Argentina (Lora and Barrera 1997).

7 Euro-Mediterranean bilateral association agreements were signed by Tunisia in 1995, and thereafter by Morocco, Jordan, and the Palestinian Authority. Such agreements are currently being negotiated with Algeria, Egypt, and Syria. Partnership is a precursor to entry into the proposed Euro-Med free-trade area by 2010, but also covers more diverse issues such as human rights, social, cultural, and environmental issues.

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