Appendix 1
Regional Economic Prospects

East Asia and Pacific

Recent developments

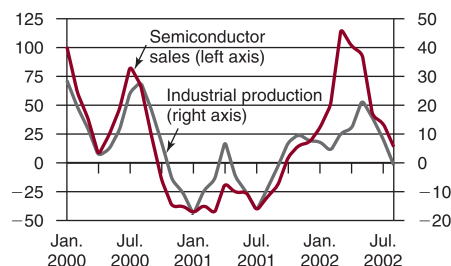
The East Asia economic recovery that began in late 2001 continued to strengthen in the first half of 2002, but momentum slowed after the summer and uncertainties have increased. Output growth in developing East Asia is estimated to have risen to 6.3 percent in 2002 from about 5.5 percent in 2001, led by China growing at more than 7 percent. Output growth has rebounded most rapidly in those economies, such as the Republic of Korea, Malaysia, Taiwan (China), Singapore, and Thailand, that had been hardest hit by 2001's steep fall in world trade and high-tech demand. Annualized growth in the first half of 2002 over the last half of 2001 jumped to a 5- to 10-percent range in most of these economies, although industrial production and trade data indicate that output growth softened in the second half of the year. Elsewhere in the region growth had in any case slowed less among transition economies such as China and Vietnam, because of continued strength in domestic demand and a less marked slowdown in exports. Growth in Indonesia and the Philippines had fallen less sharply to a 3- to 3.5-percent pace in 2001 from a 4- to 5-percent pace in 2000, and the cyclical rebound in these countries (while more pronounced in the Philippines), has also been less clear-cut than elsewhere in the region.

The recovery so far has been underpinned by both external and domestic demand. A gradual pickup in world conditions from 2001's severe global slowdown supported a revival of exports, including exports in the important high-tech sector. U.S. dollar prices for many important East Asian primary commodity exports such as rice, rubber, palm oil, coconut products, and lumber also rose sharply after late 2001, although they rose from the very low levels reached following several years in which steep declines in the terms of trade inflicted large income losses in many East Asian countries. Intraregional exports have been strong, most notably those to China, which jumped an amazing 50 percent in the first half of 2002. Supportive monetary and (in several cases) fiscal policy conditions have fueled domestic demand. Household spending in the region has been especially robust, boosting spending on cars and other consumer durables, but private investment still lags. Debt-equity ratios, though they have fallen in some instances, remain high by international standards in most cases, and together with low corporate profitability, continue to depress the investment climate and undermine the prospects for accelerated medium-term growth.

World semiconductor sales and orders for high-tech equipment in the United States rebounded strongly in late 2001, but growth rates had already peaked before the summer of 2002, and the levels remained far below the

Figure A1.1 Emerging high-tech Asia: semi-conductor dollar sales and industrial production*

(percent change, 3m/3m saar)



Note: Through August 2002. *Rep. of Korea, Malaysia, Singapore, and Taiwan (China).
Source: SIA and national sources through Datastream, World Bank staff estimates.

record levels of 2000 (figure A1.1). A sharp fall in North American semiconductor equipment bookings in August and September suggests that this year's incipient revival in the depressed global high-tech industry may have faded. Several East Asian countries report some slippage in August-September export and industrial production growth from the high rates reached around midyear.

Steep falls in global equity markets in June through September, evidence of renewed weakness in industrial country growth, continued turmoil in emerging markets, rising world oil prices, and terrorist attacks in the Philippines and Indonesia are among the factors that have substantially increased uncertainty about prospects for the region.

Near-term outlook

How well are East Asian countries able to ride out new external and internal shocks that may arise? Here the experience of the last two years is cautiously encouraging. Neither the serious export decline of 2001 nor the hefty terms-of-trade losses of recent years led to a new wave of corporate and financial failures in the countries previously hit by the 1997 crisis. Local East Asian financial markets have been remarkably resilient in the face of the global equity and emerging market turmoil.

On balance, countries in the region appear comparatively well placed to weather the present high levels of external risk, especially if they can build on recent successes and continue to advance reforms that further reduce their vulnerability to external shocks and foster sources of domestic productivity growth. Improvements in macroeconomic conditions have been key to cushioning the impact of external shocks and volatility in international capital markets on East Asian countries over the last three years. Most countries have strengthened national balance sheet positions by running continuous current account surpluses since the 1997 crisis, reducing foreign debts (including short-term debt), and building up foreign reserves. The adoption of more flexible exchange rate regimes has also allowed countries to adapt to external shocks more smoothly (while the recent fall in the U.S. dollar has alleviated concerns about a loss of competitiveness in countries with currencies on a dollar peg, such as China and Malaysia).

A potential source of macroeconomic vulnerability in East Asia, however, is the higher level of public sector debt (including contingent liabilities) accumulated after the 1997 crisis in several countries. Public debt levels are quite high in Indonesia and the Philippines, and are not insignificant elsewhere. Public debt-to-GDP levels are now starting to fall because of rising currencies and lower interest rates, and well-judged fiscal policy measures can build on this trend so as to secure medium-term fiscal sustainability.

Private investment in the crisis-affected countries still remains weak, compared with pre-1997 crisis levels. However, these peak levels were based on overoptimistic expectations and abundant foreign capital. Continued economic growth, macroeconomic stability, low interest rates, rising currencies, and policy efforts to improve the investment climate should lay the groundwork for an investment

revival in due course. Equity markets in East Asia also fell sharply in this period, but over the last one or two years they have generally outpaced industrial country equity markets. In countries with flexible regimes, currencies generally rose against the dollar during 2002 while remaining steady or depreciating modestly against the yen. The stronger trend in currencies occurred despite the fact that domestic interest rates in most countries were significantly lower than average 2001 levels, and is striking evidence of improving investor perceptions of the region.

The October terrorist attack in Bali is also expected to reduce near-term growth in Indonesia. Receipts from tourism represent 4 to 5 percent of gross domestic product (GDP) in Indonesia, and in Southeast Asia generally. Indonesian tourist arrivals could fall by around 20 percent, based on the experience of the 1997 terrorist attack on tourists in Luxor, the Arab Republic of Egypt, and the impact of previous political unrest in Indonesia itself. Lower levels of tourist arrivals and the adverse impact of the attack on consumer and business confidence could reduce Indonesia's growth by 1 percentage point in 2003. Governments in Southeast Asia must now grapple with a major security challenge that also has potentially divisive domestic political implications—all at a time when many countries are moving into the next turn of their electoral cycles. A loss of focus on development and reform priorities could result.

In this environment, acceleration of growth is unlikely, although there are also no signs of sharp deterioration. Regional GDP is expected to grow 6.1 percent in 2003 and 6.4 percent in 2004. Growth in the region, excluding China, is expected to reach 3.8 and 4.3 percent in 2003 and 2004 respectively. Median inflation is expected to remain low, albeit probably above the historically low 2.5 percent in 2002. With export volumes growing at a rate of around 9 percent, the current accounts remain on average at a comfortable surplus of 2.5 percent of GDP.

Long-term outlook

East Asian countries face growing demands for better-quality public goods and services,

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

Growth rates/ratios	1991–2000	2000	2001	2002	2003	2004	2005–15
				Baseline forecast			
Real GDP growth	7.7	7.0	5.5	6.3	6.1	6.4	6.2
Private consumption per capita	5.8	6.0	6.2	5.7	5.2	5.6	5.6
GDP per capita	6.4	5.9	4.5	5.4	5.2	5.6	5.4
Population	1.2	1.0	0.9	0.9	0.9	0.8	0.7
Gross domestic investment/GDP[a]	28.7	29.2	30.1	32.8	33.9	34.9	30.4
Inflation[b]	5.6	5.0	6.6	2.5	3.6	3.6	...
Central gvt. budget balance/GDP	−1.2	−3.3	−3.3	−3.6	−3.4	−3.3	...
Export market growth[c]	9.7	14.1	−2.5	3.6	9.2	8.7	...
Export volume[d]	11.4	22.5	2.5	15.9	15.7	11.3	...
Terms of trade/GDP[e]	0.0	0.0	−0.4	−0.5	−0.1	−0.3	...
Current account/GDP	0.5	3.6	2.7	2.7	2.7	2.5	...
Memorandum items							
GDP growth: East Asia excluding China	4.5	5.4	2.3	3.6	3.8	4.3	5.0

... Not available.
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 to GDP (percentage).
Source: World Bank baseline forecast, November 2002.

not least for better law and order. Protecting the lives and property of the public and upholding rule of law are essential complements to the ongoing emergence or consolidation of representative or democratic government in the region, as well as a basic underpinning for economic development. The Bali terrorist attack underlines the importance of strengthening security and law and order, through both national and cooperative regional efforts.

Continued public sector and governance reforms are important if greater fiscal discipline in East Asia is to be combined with meeting public demand for more and better public goods and services, such as law and order, health, education, basic research, technology dissemination, and infrastructure generally. Many of these things are valuable to consumers in their own right, are key elements of a productive investment climate, and provide a crucial underpinning for political legitimacy and stability. There is now open discussion and acknowledgment of these issues in the region, though the pace of reform is generally slow, except in the Republic of Korea, Malaysia, and Singapore.

Countries have generally continued to make some progress (at varying rates) on corporate and financial restructuring, reforms to improve financial supervision and regulation, and strengthening corporate governance. However, most countries need to deepen corporate and financial sector reform efforts, as well as further the broader institutional agenda of fostering private sector development and strengthening the investment climate. It is notable that the sectors which are more dynamic are those where the corporate restructuring agenda is less urgent, for example, small- and medium-scale enterprises or large exporters who have moved more quickly to resolve their debts. This is especially important because China's World Trade Organization (WTO) accession is leading to a restructuring of regional production networks, a surge in foreign direct investment (FDI) to China, and an increase in competitive pressures in other countries in the region, especially those competing directly with China in low wage sectors.

Efforts to strengthen regional cooperation in East Asia have gained ground in recent years, alongside the region's long-standing commitment to multilateral trade liberalization and integration. The Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA) came into force at the beginning of 2002 among the six original members. Association members now seek to build on their success in reducing tariff barriers and fostering deeper integration by tackling issues such as non-tariff barriers, product standards, customs procedures, trade in services, transport and logistics, and investment flows. At the same time the Initiative for ASEAN Integration (IAI) has been launched to help new and less-developed members (Cambodia, the Lao People's Democratic Republic, Myanmar, and Vietnam) build capacity and integrate more fully into the AFTA over time. Regional discussions and cooperation in the ASEAN+3 (ASEAN, China, Japan, and Korea) and other new forums also continue to develop.

Against this background, per capita GDP in the region could grow solidly at a rate of around 5.5 percent during the coming decade, although this implies a slowing by 1 percentage point compared with the previous decade of rapid catching up. As population growth also slows during the coming 15 years—being 0.5 percentage point lower than during the 1990s—the long-run trend in GDP growth is estimated to be 6.2 percent, 1.5 percentage point below the trend during the 1990s.

South Asia

Recent developments

Growth in the South Asia region is projected to average 4.6 percent in 2002. This downward revision from the *Global Economic Prospects 2002* forecast of 5.3 percent GDP growth for the year largely reflects adverse weather conditions, continued internal and external security concerns, and the more protracted than anticipated recent global economic slowdown. As a consequence,

given slower demand growth, inflation has remained low throughout most of the region, notwithstanding high oil prices. Further, government budget balances are expected to post rising deficits in most countries. On an aggregate level, current account balances—which strengthened during 2001, reaching a surplus in the case of India—are projected to show a slight improvement during 2002. This is partly due to lower levels of imports, which are generally projected to more than offset the negative impact of slow export volume growth dampened by weak external demand.

Because agriculture is a key sector in the region's economies, important to both employment and growth, the recent drought has restrained output, although the late rains (in some cases flooding) have somewhat ameliorated the shortfall for the season. As a consequence, 2002 harvests are expected to be generally smaller than in 2001, an outcome that is expected to put some additional pressure on government coffers through increased transfers for drought relief.

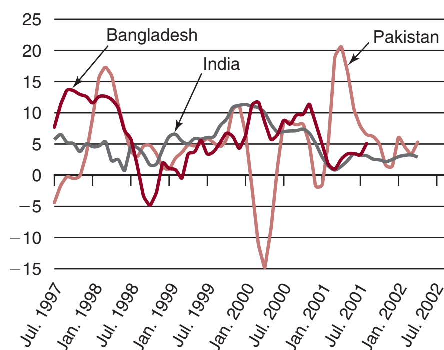
Security issues are an ongoing concern, although there has been some easing of tensions in parts of the region, paving the way for improved growth conditions. The diminished fighting in Afghanistan from late 2001, and the more recent introduction of a new government in June 2002, has led to a rebound in activity to begin rebuilding the economy from extremely low levels and contraction in 2001.

Throughout the region, the weakening of economic conditions has complicated efforts at fiscal consolidation. Although some countries were able to achieve budget targets by cutting expenditures—including spending on development programs—to offset revenue losses, India notably did not cut expenditures. Citing concerns about the magnitude of India's domestic debt—estimated at 70 percent of GDP—Standard and Poor downgraded Indian government paper to junk bond status in October 2002.

External demand in South Asia's major markets has been subdued in the first half of 2002, although it shows some firming relative to the contraction witnessed in 2001 for most of the region's economies. During the second half of 2002, preliminary data suggest some further acceleration of export volume growth, although not as strong as projected in *Global Economic Prospects 2002,* given the more protracted recovery in world trade volumes. Import volume growth has been dampened by sluggish demand for raw materials and intermediate goods by exporters and by weak domestic demand conditions. The overall impact of these factors has led to a net improvement in the region's trade balance. This improvement, combined with a rise in the region's aggregate worker remittances—reflecting portfolio shifts following the September 11 attacks and, in the case of Bangladesh, a sharp increase in private inflows due to improvements in the speed with which remittances are transferred through official channels—has contributed to an increase in the region's foreign reserve holdings. Given the recent weakness of the U.S. dollar, a number of currencies in the region have appreciated during 2002. However, a general monetary stance of maintaining competitiveness suggests that these short-term

Figure A1.2 Industrial production in South Asia

(3-month moving average, y/y percentage change)



Source: International Monetary Fund, International Financial Statistics.

cross-currency dynamics will reverse and that regional exchange rates will resume a path of depreciation.

Near-term outlook

Our near-term outlook is premised upon continued improvement in both domestic political stability and regional security issues—although tensions will remain evident. A marked improvement in Sri Lanka's political and policy environment, for example, should allow that country to enjoy a sharp acceleration of GDP over the near term—and, indeed, into the medium term. In contrast, continued domestic political pressures would cause Nepal to underperform relative to regional growth averages in the near-term forecast horizon.

We are also assuming a return to more normal weather patterns over the next two years, in contrast to the recent drought conditions discussed above. Agriculture accounts for approximately one-fourth of regional output, but the impact of improved harvests will be even more pronounced for the poorest households, for whom the rural economy provides the largest share of employment. Higher rural incomes will feed through into stronger private consumption growth, but prospects for investment—particularly in the private sector—are more mixed, as continued concerns over stability will at least partially offset the impetus to invest generated by stronger domestic and external demand. Industrial production will marginally underpace real GDP growth, as the service sector continues to provide the main near-term contribution to growth over much of the region.

Our global projections of a recovery in world trade prospects translate into strengthening external demand conditions for the economies in the South Asia region. Partly because of the above assessment of the domestic economy, the region is forecast to post a firming of growth to an average of 5.4 percent in 2003 and 5.8 percent in 2004. Trade balances should benefit, although import growth will also strengthen along with external demand, given the high import content of exports and high import intensity of consumption. Coupled with a modest deterioration in the

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

				Baseline forecast			
Growth rates/ratios	1991–2000	2000	2001	2002	2003	2004	2005–15
Real GDP growth	5.2	4.8	4.4	4.6	5.4	5.8	5.4
Private consumption per capita	2.0	1.4	4.1	2.6	3.6	4.0	3.2
GDP per capita	3.3	2.9	2.6	2.9	3.8	4.2	4.1
Population	1.9	1.9	1.7	1.7	1.6	1.6	1.3
Gross domestic investment/GDP[a]	21.9	24.2	24.9	25.8	25.8	25.5	24.8
Inflation[b]	7.9	3.9	6.1	5.0	5.1	6.8	…
Central gvt. budget balance/GDP	−10.3	−9.7	−10.3	−10.3	−9.8	−9.2	…
Export market growth[c]	12.8	13.1	0.4	2.8	7.3	7.9	…
Export volume[d]	10.9	7.4	5.3	8.3	8.8	8.5	…
Terms of trade/GDP[e]	−0.1	−0.8	0.4	0.0	0.2	0.2	…
Current account/GDP	−1.5	−0.8	−0.3	−0.1	−0.2	−0.2	…
Memorandum items							
GDP growth: South Asia excluding India	4.3	4.2	3.8	3.9	4.8	5.2	5.3

… Not available.
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 to GDP (percentage).
Source: World Bank baseline forecast, November 2002.

terms of trade, these growth patterns are expected to translate into a slight increase in the regional average current account deficit to GDP ratios.

Macroeconomic policies in the region have historically been biased toward accommodating growth and have generated fiscal imbalances. Generally, revenue mobilization remains a challenge in the region. The unsustainable nature of fiscal deficits has been widely recognized by governments across the region—although this does not imply that a consensus has been reached. Therefore, the introduction of prudent fiscal policies over the next two years could be tempered by political considerations, and by the need to address the lagged effects of the current downturn in agricultural output. Indeed, budget deficits in many countries could deteriorate in the next fiscal year. One of the key problems is the scale of public debt—large servicing requirements limit the scope for cutting expenditures, especially in conditions of extreme poverty. The main issue for the region is extending the tax base, but progress to date has not been as rapid as anticipated. The introduction of tax reforms in India, for example, has been delayed.

Most regional economies have a general monetary policy posture involving depreciation aimed at shoring up foreign reserves and promoting exports through increased competitiveness, which is forecast to also have a positive impact on current account balances. This conduct of monetary policies had been facilitated by relatively weak inflationary pressures across the region. In general, consumer price inflation in the region has been relatively low, despite the droughts and firm oil prices of recent years. Several countries have subsidies for fuel and some foods, a policy that cushions the impact of imported inflation on consumer prices. However, these are being lifted in some cases (for example, Pakistan). While the recent slowdown in demand will restrain price rises initially, inflation is forecast to rise moderately later in 2003 and in 2004 as growth momentum builds, and as the average prices of non-oil imports rise.

Long-term prospects

Long-term growth in South Asia is forecast to average about 5.5 percent, in line with the growth forecast in *Global Economic Prospects 2002*. This forecast is somewhat higher than the 5.2 percent average real growth posted during the 1990s. The higher projected growth over the coming decade, through 2015, reflects a number of underlying assumptions, such as the assumption of a larger contribution of growth by the private sector. This in turn reflects the expectation of progress with fiscal consolidation and continued structural reforms, including reforms in trade, banking, privatization, and infrastructure. These factors, combined with the improvement in human capital indicators in recent years—such as rising literacy rates and school enrollments, and declining infant mortality rates—will lead to an increase in productivity. Despite a projection of declining infant mortality rates, overall the South Asian population growth rate is projected to decelerate because birthrates are expected to decline faster. Lower population growth in the coming decade, along with the forecast growth rates, implies that per capita GDP growth will be close to 4 percent per year.

Risks

Downside risks to the forecast include a weaker than anticipated recovery in global demand, translating into slower export growth and lower regional GDP. Similarly, a continuation of adverse weather conditions would result in lower than anticipated growth caused by lower agricultural output. Domestic political uncertainty could slow down implementation of fiscal and other structural reforms. Regional political tensions also pose important threats to the growth forecasts, potentially aggravating economic disruptions and increasing poverty rates, as well as generating less severe effects, such as declines in tourism revenues and the reduction of foreign assistance. Generally, the region faces a number of vulnerabilities, as evidenced by the covariant shocks over recent years—such as droughts in

Pakistan, floods in Bangladesh, natural disasters in parts of India, and civil war in Sri Lanka. Vulnerability to such shocks has contributed to the high incidence of transient poverty in a country such as Pakistan, and probably explains the large year-to-year fluctuations in income and poverty that are observed. Such vulnerability can also have a profound impact on the growth prospects of a country, since uninsured risk can affect the ex ante behavior of economic agents.

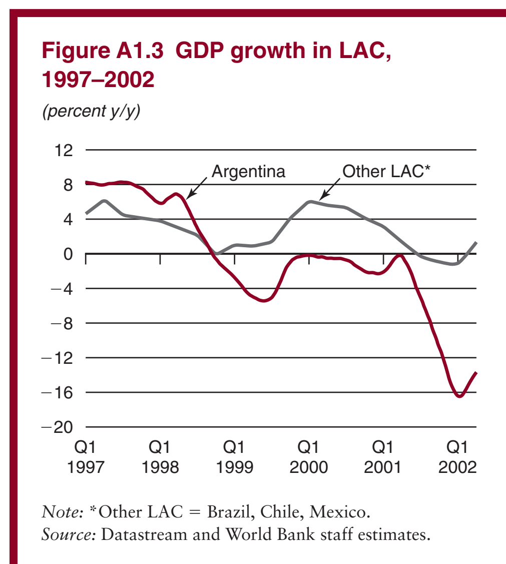
Latin America and the Caribbean

Recent developments

Unlike most other developing regions where economic growth strengthened in 2002, GDP contracted 1.1 percent in Latin America, about 1.6 percentage points lower than anticipated in the spring. This growth deceleration from 0.4 percent in 2001, however, was the result of enormous economic contraction in a handful of countries, fueled in large part by the external environment and aggravated by domestic factors. Growth performance in the region, excluding Argentina, is expected to be 0.7 percent in 2002, somewhat lower than last year's growth of 1.2 percent. Negative spillover effects from the meltdown in Argentina began to affect neighbors in the region in the second half of the year.

Figure A1.3 GDP growth in LAC, 1997–2002

(percent y/y)

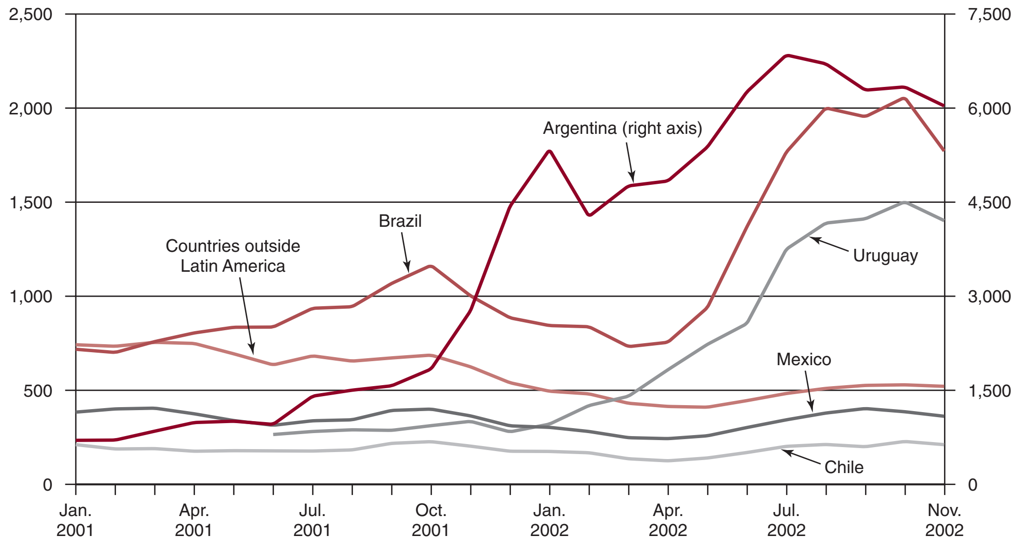


Note: *Other LAC = Brazil, Chile, Mexico.
Source: Datastream and World Bank staff estimates.

The external environment for most of Latin America was more adverse than expected at this stage of the global economic recovery. Despite low interest rates in industrial countries, capital flows to developing countries fell, and the decline was especially pronounced in the Latin America and the Caribbean (LAC) region, partly because of the crisis in Argentina and its small neighbors. After falling for most developing countries between October 2001 and April 2002, spreads on external debt rose sharply for many LAC countries—Chile, Mexico, and small Central American and Caribbean countries had only a small rise (figure A1.4). Few countries were able to attract the necessary capital flows to sustain a strong growth recovery in the absence of rising domestic savings. U.S. growth, after a strong start in the first quarter of 2002, weakened significantly thereafter, while European growth was anemic, resulting in lower growth expectations for LAC principal markets in the short term. The region's export market growth rate was a disappointing 1.2 percent in 2002 and was not helped by the price fall in key commodities exported by the region (for example, sugar fell by 26.5 percent, arabica coffee by 8.8 percent, bananas by 7.4 percent, aluminum by 6.5 percent, and copper by 0.2 percent). Moreover, tourism revenues were weak because of reduced air travel from North America (affecting the Caribbean countries), and the collapse of income in Argentina significantly affected tourism in Paraguay and Uruguay as well as workers' remittances to Bolivia and Paraguay.

Domestic factors are important in explaining the weak economic performance in a small set of countries, and these countries contributed most to the region's dismal growth performance in 2002. In Argentina, the lack of political consensus on a sustainable macroeconomic framework has delayed an International Monetary Fund (IMF) program, shrunk

Figure A1.4 Spreads for selected LAC countries
(basis points above U.S. Treasuries)



Source: Datastream and World Bank staff estimates.

net capital flows even further, and led to a deep, protracted economic contraction in excess of 10 percent. This affected other Mercosur affiliates deeply, especially Uruguay and, to a lesser extent, Paraguay and Bolivia. In Brazil, uncertainty associated with the elections as well as with the global outlook weighed on investor confidence in spite of sound macroeconomic policies, slowing the pace of growth recovery. In the República Bolivariana de Venezuela, an acute political crisis that culminated in a short-lived coup contributed to a resurgence in large-scale capital outflows, little investment outside of the oil sector, and a steep decline in growth.

The confluence of these factors weakened the acceleration in growth that one would expect in the context of recovering global activity. Policy responses, constrained by high debt levels, high external borrowing requirements, and contracting external financing, were unavoidably contractionary. In Uruguay, a financial crisis ensued as Argentines withdrew a large amount of dollar deposits, depleting reserves and causing the currency to float, and forcing the authorities to embark on fiscal consolidation and monetary tightening. GDP growth is estimated to have fallen by about 10 percent. Brazil was forced to tighten fiscal policy but was able to lower short-term policy rates only temporarily and experienced significant increases in long rates. The initial surge in Brazilian investment at the beginning of the year gave way to a more muted second-half growth. In Colombia, the fiscal accounts remain vulnerable, with the government making small progress in reducing the fiscal deficit to bring debt dynamics onto a sustainable path in the wake of presidential elections, escalating civil war, and lower-than-expected growth. Peru, in contrast, was able to make progress in addressing the fiscal deficit and in keeping the public debt situation under control; growth accelerated in 2002. Ecuador benefited from relatively high oil prices, but the authorities had difficulty in reducing the fiscal deficit, a move necessary to maintain macroeconomic discipline in a dollar

economy. In Central America, low export earnings from falling coffee prices and weak demand in the United States, and relatively high fiscal and external deficits, limited fiscal expansion. And some Caribbean countries were faced with little scope for fiscal expansion or monetary easing in light of declining tourism revenues; weak prices of bananas, sugar, and aluminum; and, in the case of Jamaica, a large debt overhang that was exacerbated by the financial sector crisis in the mid-1990s. In Mexico, the government stuck to fiscal discipline—helped by higher-than-expected oil prices—and is making slow progress with key reforms, while being only partially successful in increasing non-oil government revenues.

Overall, policies in Latin America were instrumental in keeping inflation from accelerating in most countries. However, countries that had a sharp adjustment in their exchange rates due to a sharp fall in net capital flows did face inflationary pressures. Inflation (as measured by consumer price index—CPI) rose to fairly high levels in Argentina (about 45 percent), in Venezuela (in excess of 20 percent), and in Uruguay (about 20 percent). Given high debt levels and worsening public debt dynamics—due to high interest rates and depreciating currencies—most authorities were unable to pursue countercyclical policies, and unemployment remained high throughout the region (21.5 percent [May] in Argentina, 19 percent [September] in Uruguay, 16.2 percent [June] in Venezuela, 17.2 percent [September] in Colombia, and 9.7 percent [September] in Chile).

Slow world growth and external financing constraints compelled an adjustment in the region's external accounts. Import volumes fell for a second consecutive year (mostly due to sharp declines in Argentina, Uruguay, and Venezuela), and the current account deficit narrowed from over $50 billion (or 2.9 percent of GDP) in 2001 to below $25 billion (or 1.5 percent of GDP) in 2002, with most of the adjustment coming after April. The level of foreign reserves in August was around $10 billion lower than at the end of last year, due primarily to sharp declines in Argentina and Uruguay.

Near-term outlook

The region's growth prospects are expected to improve in 2003, supported by strengthening of the global economy, particularly in trade volumes, commodity prices, and capital flows. The region's GDP is now expected to grow by 1.8 percent in 2003—still almost 2 percentage points lower than the spring forecast and in line with the downgrading of world growth, provided there is a turnaround in the current uncertain political and financial market outlook. Greater fiscal adjustment in a number of countries with high debt and relatively large financing requirements is a necessity for reducing economic vulnerabilities. This, along with reforms currently on the agendas of many countries, is needed to restore investor confidence (which will lower interest costs), attract more equity external financing, and reinvigorate growth.

In the baseline forecast, it is assumed that Argentina will put in place an externally supported macroeconomic program that will be reaffirmed by the new government after the election in March 2003. Depending on its actual timing, this would lead to a revival of growth, possibly by midyear—but may not show up in strong annual growth until 2004. If this scenario were to materialize, it would improve prospects for the smaller Mercosur countries. The base case also depicts a new Brazilian government that maintains prudent macroeconomic policies and succeeds in restoring market confidence. Regional GDP growth is expected to rise to 3.7 percent in 2004.

There are a number of positive factors for the region that give credence to the baseline forecast. Mexico has weathered the recent global downturn very well. Sound policies have kept investors confident and inflows large, and the upturn in U.S. growth should bolster a rapid expansion in 2003. Chile also has fared well in light of negative effects from

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

Growth rates/ratios	1991–2000	2000	2001	Baseline forecast 2002	2003	2004	2005–15
Real GDP growth	3.3	3.7	0.4	−1.1	1.8	3.7	3.8
Private consumption per capita	2.3	2.4	−1.1	−2.8	−0.3	1.9	2.5
GDP per capita	1.6	2.1	−1.2	−2.6	0.3	2.3	2.6
Population	1.7	1.6	1.6	1.5	1.4	1.4	1.2
Gross domestic investment/GDP[a]	19.8	19.7	19.3	18.0	17.3	18.1	22.0
Inflation[b]	12.5	6.4	6.9	5.0	4.2	4.4	…
Central gvt. budget balance/GDP	−3.1	−1.8	−1.8	−2.6	−3.1	−3.0	…
Export market growth[c]	11.4	11.9	−1.5	1.2	8.2	8.8	…
Export volume[d]	8.6	10.5	1.4	4.7	11.1	10.9	…
Terms of trade/GDP[e]	0.2	0.6	−0.5	−0.1	−0.3	−0.5	…
Current account/GDP	−2.8	−2.4	−2.9	−1.5	−1.3	−1.8	…
Memorandum items							
GDP growth: LAC excluding Argentina	3.1	4.5	1.2	0.7	1.9	3.6	3.8
Central America	4.4	2.9	1.6	2.1	3.1	3.6	4.0
Caribbean	3.5	6.2	2.7	3.6	4.3	4.3	4.2

… Not available.
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 to GDP (percentage).
Source: World Bank baseline forecast, November 2002.

Argentina and adverse terms of trade, and expected firming of copper prices should underpin growth. The policy stance of the new Colombian administration has been positive for investors, and it has strong support from the United States for assistance in resolving the guerrilla war. Expected strengthening of metals prices next year should help Peru to reduce the rise in external financing as the economy recovers from the 2001 recession. And the small island states in the Caribbean have shown resilience in the face of strongly negative external and domestic factors—Jamaica has stayed the course with tight fiscal policy (a primary surplus of 9 to 11 percent of GDP in the past three years); Trinidad and Tobago's economy continued to grow despite political uncertainty.

However, risks are on the downside in the short term. Argentina faces enormous obstacles in its financial system, and while the situation has stabilized somewhat in 2002, the authorities will face a difficult situation in containing inflation in 2003—with the monetary overhang and weak public finances. While it is assumed that the required political consensus will be attained before the March 2003 elections, there are risks that the consensus may not materialize that quickly. The incoming Brazilian administration will have to take confidence-building measures to reverse the current market uncertainty. Should Brazil fail to maintain a sustainable macroeconomic policy framework, its correspondent weak economic performance will have a major impact on regional economic prospects. Venezuela will be facing lower oil prices, which will make necessary adjustment even more painful. And Caribbean countries face the possibility of a delayed recovery in tourism, which would reduce the fiscal space to tackle the ever-present risk of natural disasters.

Long-term prospects

Per-capita GDP growth over the long term (2005–15) is projected to average 2.6 percent a year, 1 percentage point higher than the

growth achieved by the region in the 1990s. Improvement in macroeconomic management in a number of countries throughout the 1990s, albeit emanating from crises, should provide the basis for a good investor climate. This has already encouraged FDI into the region at the fastest pace of all regions, even though this has been due partly to privatization of public enterprises and mergers and acquisitions. The next wave of FDI is likely to be in greenfield activities, as witnessed in Costa Rica's attracting high-tech firms. Regulation and supervision of financial sectors have been strengthened since the early 1990s, but there remains room for further improvement. Potential gains from global trade have increased with trade liberalization during the 1990s, leading to high and rising ratios of trade to GDP (Chile, Mexico, the Caribbean Community and Common Market, and other small economies are examples). Moreover, the region has been proactive in deepening trade integration, especially with North America, through negotiations to establish a Free Trade Association of the Americas (FTAA) and bilateral agreements (Chile and Central America with the United States).

At the same time, the region remains more vulnerable than many other developing regions. First, a high debt overhang from the 1980s remains a problem to finance in many countries. In the 1990s, some countries continued to rely on significant debt financing, particularly in the public sector. Public debt-to-GDP ratios rose in some countries and the maturity of that debt shortened in duration, increasing their vulnerability to shifts in investor sentiment as they question debt sustainability. LAC countries may have to learn to live with less debt in the future, adjusting public expenditures as required. Countries need to create fiscal space during good times (boom years) to be able to conduct countercyclical policies in future downswings in economic activity. Second, many countries, especially the low-income coffee producers, also need to further diversify their export base to reduce vulnerability to large swings in commodity prices. Finally, the region still lags in financial deepening (which could help raise national saving rates), infrastructure, and quality of institutions—areas that need to be improved before the region can attain high sustainable growth rates.

Europe and Central Asia

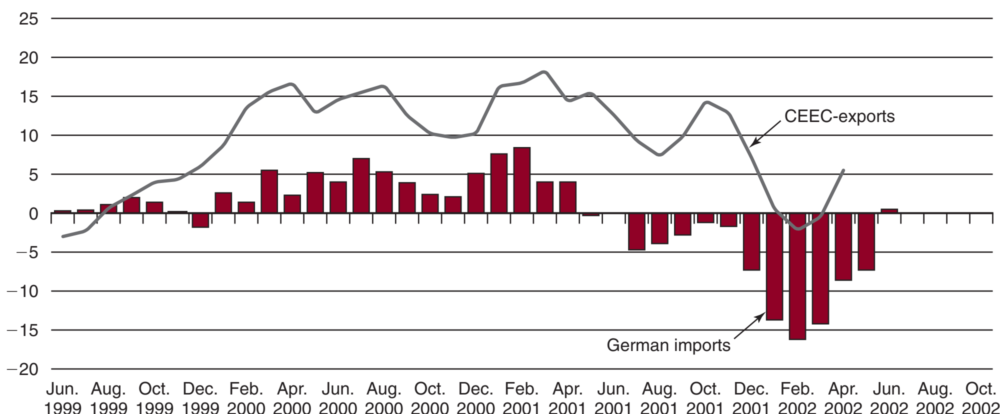
Recent developments

The slack external environment, especially in Western Europe, is contributing to a general slowdown of growth in most of the countries of the Europe and Central Asia (ECA) region in 2002 relative to 2001. However, the region has weathered the recent global economic downturn relatively well, largely because of fairly strong domestic demand throughout most ECA countries, and sustained high oil prices to the benefit of the oil-exporting Commonwealth of Independent States (CIS) countries. Whereas almost all ECA countries are facing a moderation of growth in 2002, Turkey is expected to post a recovery—a massive swing from the over 7 percent collapse in GDP that it posted in 2001—which is raising the region's average growth for the year. As a consequence, aggregate growth for the ECA region is projected to expand from an estimated 2.3 percent in 2001 to 3.6 percent in 2002. Growth in the ECA region (excluding Turkey) is forecast to decelerate to 2.3 percent in 2002 from 2.9 percent in 2001.

The Central and Eastern European (CEE) countries, in particular, have been affected by weakening demand from Western Europe—their main export market—as well as by exchange rate appreciation in many of the subregion's economies. As a result, export volume growth has slowed significantly, although it still remains at impressive levels in a number of countries (such as the Czech Republic, Hungary, and Poland), as they have increased market penetration (see box 1.2 in chapter 1). Thus, the consequent drag on GDP is not as high as it might have been. Furthermore, easing import volumes—which largely reflect

Figure A1.5 German imports and CEECs exports in dollars, 1999–2002

(3-month moving average, y/y percentage change)



Source: International Monetary Fund, International Financial Statistics.

high import intensity of exports in all of the CEEs—are helping to reduce the impact of the slowdown in export volumes. Strong domestic demand, witnessed in most of the CEE countries, is partially offsetting the loss in impetus to growth from the slowdown in the external sector. Domestic demand has been generally supported by lower inflation, easing interest rates, and expanding private consumption. In some countries, fiscal policy has become more expansionary, notably in the Czech Republic, Hungary, and the Slovak Republic. Poland is the main exception to this picture of relatively strong domestic markets, with tight monetary conditions, weak wage growth and record unemployment rates translating into anemic domestic demand. While inflationary pressures have generally been subsiding in the CEE subregion, they remain significant (in double digits) in Romania, Turkey, and the Federal Republic of Yugoslavia. Many of the CEE countries continue to run relatively high current account deficits of above 4 percent, although sufficient external financing has been sustained. Continued significant FDI inflows, in particular, are helping to finance the current account deficits, in addition to generally supporting domestic demand and regional growth.

Turkey remains a key question mark. Indicators for early 2002 point to a recovery, facilitated in part by the new reform program, lower interest rates, and improved confidence relative to 2001. However, uncertainty linked to the continued implementation of the current economic program of the new government, as well as heightened political instability in the Middle East, could contain the building growth momentum, as interest rates have begun to rise and market sentiment is becoming more cautious. Lowering interest rates remains important to achieving a sustainable public debt.

Relatively firm oil prices—fueling fiscal linkages in oil producers and bolstering intra-CIS trade—have sustained the recent recovery in the CIS subregion, partially buffering it from the deterioration in external conditions. Nevertheless, given the moderation in external demand, exchange rate appreciation in a number of countries (such as the Russian Federation), and some easing in oil prices in the first half of 2002, growth is moderating throughout the CIS subregion. Hydrocarbon exporters—Azerbaijan, Kazakhstan, Russia, and Turkmenistan—in particular have experienced robust growth, although growth has

slowed significantly from 2001. Increased investment in production capacity in the energy sector has also supported economic activity in these countries. Among the energy-importing CIS countries, other factors have contributed to the continued strong growth, including relatively good harvests in the Kyrgyz Republic (combined with increased gold production), Tajikistan (combined with increased aluminum production), and Ukraine. Not only because Russia represents the largest weight in the subregion, but also because it represents a major export market for many of the CIS countries (in addition to some of the CEEs), continued strong growth in Russia has also sustained growth in the subregion. As in many CEE countries, domestic demand has been underpinned in the CIS countries by falling inflation rates and lower interest rates. While inflationary pressures have eased in all the CIS countries, they remain a source of concern in some cases, particularly in Belarus and Uzbekistan. Inflation rates in Russia and Tajikistan are also expected to post in the double digits in 2002, but at more moderate levels. While energy-related receipts boosted revenues, fiscal positions remained relatively prudent in the energy-exporting CIS countries, although they became somewhat more expansionary in Azerbaijan and Kazakhstan. To provide for budgetary smoothing, Azerbaijan and Kazakhstan have created national funds for windfall oil rents. With the decline in energy prices posted in 2001 (in both real and nominal terms) from the spike posted in 2000, the fiscal surplus in Russia narrowed, although recent firming in oil prices should contribute to some stabilization of budget receipts for 2002 over 2001. In other CIS countries, fiscal policy has been more expansionary, in general, generating widening deficits (for example, in Ukraine). Throughout the CIS subregion, current account surpluses (for instance, in Russia and Ukraine) are narrowing and deficits (in most of the remaining CIS economies) are widening somewhat, because of exchange rate appreciation, rising imports, and, until more recently, moderating oil export earnings. Russia's current account surplus has narrowed, although it remains very large.

Near-term outlook

Growth in the CEE countries is expected to begin increasing again in 2003, assuming a firming of European Union (EU) import demand in 2003, which is projected to strengthen significantly in 2004. For Turkey, assuming relative political stability and the continued pursuit of the current reform program by the new government, the recovery is expected to be sustained in 2003. Growth in the CEE subregion is forecast to accelerate from 2.3 percent in 2002 to 3.1 percent and 4.3 percent in 2003 and 2004, respectively. As the EU accession process moves forward, it is expected that the first round of new members in particular will continue to receive significant FDI inflows (in addition to EU transfers), which will remain an important source of external finance and underpin long-term growth.[1] While a number of important hurdles remain—linked in particular to the negotiations on the existing common agricultural policy (CAP), on the EU's budget, and on transfers to new member countries—the process is still on schedule.[2] Growth is expected to slow in the CIS subregion (through fiscal and trade linkages) through 2004, assuming significant declines in oil prices in both 2003 and 2004 (from a projected $25 per barrel in 2002 to a forecast of $23 per barrel and $20 per barrel in 2003 and 2004, respectively). CIS GDP is forecast to decline from a projected 4.4 percent in 2002 to 3.5 percent and to 3 percent in 2003 and 2004, respectively. While Russia's current account is expected to remain in surplus over the near term, it is forecast to narrow markedly as energy prices soften. In 2003 and 2004, growth is expected to average 3.4 percent and 3.6 percent, respectively, for the ECA region as a whole.

Long-term prospects

In the CEE, during the second decade of transition, a number of factors are expected to contribute to stronger growth than posted during the previous decade. These include

Table A1.4 Europe and Central Asia forecast summary

(percent per year)

Growth rates/ratios	1991–2000	2000	2001	Baseline forecast 2002	2003	2004	2005–15
Real GDP growth	−1.7	6.6	2.3	3.6	3.4	3.6	3.6
Private consumption per capita	0.2	9.1	1.5	4.8	4.0	3.8	3.7
GDP per capita	−1.9	6.4	2.2	3.5	3.3	3.5	3.5
Population	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Gross domestic investment/GDP[a]	23.6	22.1	21.9	20.6	20.8	21.2	28.6
Inflation[b]	128.0	9.8	7.0	3.2	5.8	5.7	...
Central gvt. budget balance/GDP	−4.4	−5.4	−6.5	−6.2	−6.0	−5.5	...
Export market growth[c]	10.7	12.9	6.7	2.1	6.4	8.1	...
Export volume[d]	9.4	10.9	8.8	6.4	8.2	7.5	...
Terms of trade/GDP[e]	0.0	−1.6	3.0	−2.5	−1.3	0.1	...
Current account/GDP	−2.3	−4.9	−1.8	−2.4	−2.4	−2.3	...
Memorandum items							
GDP growth: transition countries[f]	−2.6	6.4	4.6	3.5	3.3	3.5	...
Central and Eastern Europe[f]	0.6	3.8	2.9	2.3	3.1	4.3	...
CIS	−4.4	8.4	5.9	4.4	3.5	3.0	...

... Not available.
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 to GDP (percentage).
f. Excluding Turkey.
Source: World Bank baseline forecast, November 2002.

higher investment rates and ongoing restructuring of the capital base. Continued improvements in the policy environment, including greater macroeconomic stability, are expected to underpin the projected higher growth rates. The EU accession process and coming membership will continue to act as an anchor for structural reforms and will help attract significant inflows of FDI. While structural reforms are being pursued in many CIS countries, in general, implementation is not as advanced or as widespread as in the CEE subregion's economies, and in some cases there is significant resistance to structural reforms. This implies lower long-run growth in comparison. The recent boom in hydrocarbon rents has provided an impetus to growth, facilitated the introduction of a number of reforms in many of the oil-exporting countries, and contributed to an increase in investment outlays (particularly in the energy sector). However, given the volatility of energy market prices, these economies will not be able to sustain recently achieved higher growth rates until diversification from energy becomes much more broadly based. Given the degree of energy dependence in many of the CIS economies, particularly Russia, the projected softening of oil prices—to an average nominal price of about $18 to $19 per barrel for the 2005–10 period, in the underlying forecast—implies a ratcheting down of the subregion's growth from recent high rates.

Risks

Weaker than anticipated recovery in the EU area would reduce external demand for regional economies, particularly for the CEE countries, and thus translate into lower growth. In many CEE countries high current account deficits could become an important downside risk for international credit, if FDI inflows suddenly dry up (which a pronounced delay in the EU accession process could trigger). For CIS hydrocarbon exporters, which are highly dependent on energy prices,

a sharper decline in oil prices than forecast poses a significant downside risk. In Russia, as a consequence, a more rapid decline in growth than projected would result in lower external demand for a number of the other economies of the CIS and of some CEEs (that is, the Baltic states). Greater political uncertainty or a reversion from the reform program in Turkey could undermine its fledgling recovery and result in much lower than anticipated growth—and affect some of its trade partners (including Bulgaria). Some of the poorest CIS countries (Georgia, the Kyrgyz Republic, and Tajikistan) have relatively high external debt (up to 200 percent of exports), placing them at risk of default if growth does not materialize as anticipated and external assistance is not forthcoming. Greater political instability and heightened tensions in the Middle East could prove destabilizing to economic (and political) positions in the neighboring ECA countries, particularly in Turkey and in some of the southern-tier CIS countries. Aside from potentially undermining tourism revenues, there could be trade disruptions and a general rise in the perception of risks in the region leading to higher interest rates.

Sub-Saharan Africa

Recent developments

Sub-Saharan Africa was not immune to the chilling effects of the global recession. The slowdown may have been less pronounced there than elsewhere, but the collapse in world trade and steep declines in commodity prices had a depressing effect on economic performance. Services exports, primarily tourism, were further affected by the September 11 terrorist attacks. In real terms, GDP growth slowed from 3.2 percent in 2000 to 2.9 percent in 2001 and 2.5 percent in 2002. With the exception of Nigeria, oil exporters generally outpaced the region, especially those where production was increasing—Angola, Equatorial Guinea, Sudan—as oil prices, though down from 2001, remained relatively strong. Meanwhile, countries where severe drought put a damper on agricultural production fared worse and, as usual, the worst outturns were to be found in countries experiencing civil and political strife. But slowdown was widespread throughout the region.

The subdued economic performance in 2002 is attributable to the region's export dependence on European markets, where growth was weak. As a result, exports remained basically stagnant in real terms. On the plus side, there was a turnaround in non-oil commodity prices, albeit from historically depressed levels. After reaching a low in October 2001, non-energy commodity prices rebounded sharply, gaining 26 percent in export weighted terms by August 2002. The main contributor was cocoa, which was up 80 percent, but other commodities gained as well—robusta coffee up by 20 percent, cotton up by 33 percent, copper by 7 percent, and gold by 10 percent. Because the upward momentum began late in the year, on an annual basis many commodity prices exhibited declines in 2002, and most remain well below peak levels of the mid-1990s. Nevertheless, modest real price gains over the medium term will deliver a measure of relief to external balances. Oil prices, too, remained stronger than expected, an outcome that, though unwelcome to non-oil exporters, was a positive benefit to the region as a whole.

The disappointing results for tourism, which accounts for 11 percent of regional export receipts, reflected not only the weakness of Europe's economy, but the aftermath of September 11. Some important destinations—such as Mauritius, which benefits from its reputation as a safe destination—saw an increase in the flow of arrivals in 2002. Most other countries, however, only partially recovered from the impact of September 11. According to estimates by the World Travel and Tourism Council (WTTC),[3] Sub-Saharan travel and tourism exports slowed to just 1.5 percent growth in 2001 before recovering to 4.3 percent in 2002. Both years represent growth significantly below potential. The WTTC estimates September 11 to have cost 3.2 percent

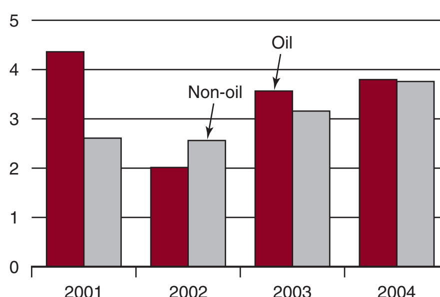
of exports and 1.3 million jobs over the period 2001–02.

In the domestic sphere, agricultural production was disrupted by drought and, in the case of Zimbabwe, political disturbances. As a result, nearly 30 million persons were left in need of emergency food aid. Approximately half of them were in southern Africa, which experienced a second successive year of poor harvests. Malawi, Zambia, and Zimbabwe were most affected, and because agriculture constitutes a large share of their economies, incomes and consumption spending were depressed. But Ethiopia suffered the worst, with drought putting at risk an estimated 15 million persons. However, the effects were quite localized. South Africa experienced a bumper maize harvest, which gave a strong boost to domestic spending.

South Africa sustained a recovery through the first half of 2002, with broad-based strength in agriculture, as well as in export-oriented mining and manufacturing, which benefited from the rand's weakness. On the expenditure side, domestic demand grew at a 2.3 percent annual pace in the first half, reflecting buoyant fixed investment, strong private consumption, and a moderately expansionary fiscal stance, though weak inventory accumulation slowed the pace. In the external

Figure A1.6 Real GDP growth of Sub-Saharan Africa oil and non-oil exporters

(percent)



Source: World Bank staff estimates.

Table A1.5 Sub-Saharan Africa forecast summary

(percent per year)

Growth rates/ratios	1991–2000	2000	2001	Baseline forecast 2002	2003	2004	2005–15
Real GDP growth	2.2	3.2	2.9	2.5	3.2	3.8	3.7
Private consumption per capita	−0.6	−1.4	0.7	0.3	0.8	1.3	1.2
GDP per capita	−0.4	0.7	0.5	0.1	0.9	1.5	1.5
Population	2.6	2.5	2.4	2.4	2.3	2.3	2.2
Gross domestic investment/GDP[a]	16.9	17.9	18.7	18.9	18.6	18.2	21.1
Inflation[b]	9.8	6.3	5.4	4.3	3.9	4.2	...
Central gvt. budget balance/GDP	−3.0	−0.6	−0.3	−0.4	−0.5	−0.3	...
Export market growth[c]	14.4	10.8	0.1	2.4	7.1	7.8	...
Export volume[d]	4.1	4.3	2.8	1.1	5.3	5.8	...
Terms of trade/GDP[e]	0.0	2.1	−1.1	−1.5	0.2	−0.8	...
Current account/GDP	−2.1	−2.3	−2.2	−3.0	−1.8	−1.2	...
Memorandum items							
GDP growth: SSA excluding South Africa	2.7	3.3	3.6	2.7	3.7	4.2	...
Oil exporters	2.5	4.8	4.4	2.0	3.6	3.8	...
CFA countries	2.6	2.3	3.2	2.9	3.3	3.8	...

... Not available. SSA is Sub-Saharan Africa. CPA is Communaute Financiere Africaine.
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 to GDP (percentage).
Source: World Bank baseline forecast, November 2002.

accounts, tourism has been slow to recover from the effects of September 11, but the weaker rand boosted net visibles trade, and the current account balance moved back into a small surplus. The main concern for the South African economy was an uptick in inflation—not surprising after a nearly 40 percent depreciation of the rand in 2001, but nevertheless putting upward pressure on interest rates. Robust wage gains were only partially offset by higher productivity, resulting in a substantial rise in unit labor costs. Nevertheless, indications are that monetary restraint will prevail, and the outlook is for inflation to ease. The rand stabilized at an average of 10.9 against the dollar in the first three quarters of the year, after weakening to above 12 in late 2001.

In Nigeria, adherence to reduced Organization of Petroleum Exporting Countries (OPEC) quotas more than offset the impact of stronger-than-expected oil prices, while budget gridlock constrained government spending, resulting in a real GDP decline estimated at 0.6 percent from 2001. Unfortunately, the strength of oil revenues may have also relieved pressure to implement urgently needed structural reforms, as evidenced by the discontinuation of the informal monitoring arrangement with the IMF. Politically, the situation remains tense. Local elections have been postponed twice, and national elections are now scheduled for April 2003. President Obasanjo has come under strong pressure by the National Assembly on budgetary issues. If oil prices decrease, as expected in the near term, Nigeria's problems will mount, though there are indications that these problems may be offset by a significant medium-term expansion of the energy sector, consistent with expected OPEC policies. The United States is particularly interested in expanding oil purchases from Nigeria in an effort to diversify sources of supply to decrease dependence on the Middle East.

Near-term outlook

The forecast calls for growth to accelerate in 2003–04 on the strength of a pickup in external performance. Overall, the forecast anticipates real growth rising to 3.2 percent in 2003 and 3.8 percent in 2004, around 1.1 percent in per capita terms. Faster growth in Europe will boost export volumes, and price trends will remain broadly favorable as supply-demand balances for most commodities tighten with the recovery in the world economy. Cocoa, already at a 15-year high, is the main exception. Oil prices are expected to ease, though they remain significantly above late-1990s lows. While large, real price gains for commodities important to Sub-Saharan Africa are unlikely to be sustained in the medium term, the widespread introduction of structural reforms and market liberalization are expected to raise export competitiveness, and the region should remain a significant commodity supplier for the foreseeable future. On balance, with import price inflation remaining low, non-oil exporters' terms of trade are forecasted to strengthen marginally in 2003–04.

Along with a modest improvement in external sectors, the forecast assumes a stronger domestic performance. The expectation is for a return to more normal weather conditions, which will underpin a recovery of agriculture and consumption spending, while faster growth stimulates a cyclical upturn in investment. Overall, domestic demand will remain the primary source of GDP growth, as rising import demand—constrained mainly by the availability of financing—holds net exports in check. Indeed, current account balances are expected to narrow marginally as foreign direct investment eases back from recent levels with a slowdown in privatization offerings such as Air Madagascar, though at the same time more favorable economic conditions overseas should have a positive impact on remittances.

For the region's oil producers, weaker export prices will be offset by higher production. Major new offshore developments are scheduled to come onstream in the Gulf of Guinea (Angola, Equatorial Guinea, and Nigeria) over the next few years, and despite the fall in prices oil sectors should remain highly

profitable. As in the past, however, more general spillovers to non-oil sectors will be relatively muted. As a result, growth of oil producers will improve from 2 percent in 2002 to 3.6 percent in 2003 and 3.8 percent in 2004. Falling terms of trade will widen current account deficits, though oil prices are expected to remain comparatively strong, above $20 per barrel, containing the pressure on external performance and fiscal accounts.

Long-term prospects

The forecast anticipates per capita growth averaging 1.5 percent over the 2005–15 period, near the levels achieved in the mid-1990s. The outlook is optimistic—such a result would signify a reversal of the region's long-term historical decline—but even so growth will fall short of what is needed to reduce poverty and achieve the Millennium Development Goals. Sub-Saharan Africa will continue to lag behind other developing regions, and by 2015 the number of persons living on less that $1 per day is forecasted to rise by nearly 30 percent, from 315 million to 404 million.

The outlook is predicated on a continuation of broad trends toward better standards of governance and economic policies. The great majority of countries in the region have begun preparing Poverty Reduction Strategy Papers, and nine are in different stages of implementation of the strategies. Early results seem promising. At the same time, NEPAD (the New Partnership for Africa's Development) and other regional initiatives are enhancing the credibility of governments and strengthening intraregional cooperation. There has been encouraging progress as well toward resolving intractable conflicts in central Africa, even though events in Côte d'Ivoire, Madagascar, and Zimbabwe underscore the fragility of the region's political processes. Improved policy environments should stimulate faster productivity growth and diversification from agriculture, and reduce export dependence on primary commodities.

These internal developments, coupled with modest improvements in the external environment, will promote diversification, encourage higher savings and investment, and stimulate productivity growth. Despite a dismal overall record, the region boasts a number of exemplary performers (Botswana and Mauritius) and cases in which policy reform has produced dramatic turnarounds (Ethiopia, Mozambique, Tanzania, and Uganda). At the same time, a panoply of deep-rooted problems will continue to plague economic performance. There are no quick solutions to low levels of human and physical capital, poor infrastructure, HIV/AIDS, civil strife and negative perceptions of international investors, and excessive export specialization will continue to expose external sectors to high price volatility. Nevertheless, if the new realism that appears to be taking hold on the continent proves to be more than just rhetoric, there is adequate reason to believe the moderate improvement in overall performance that the forecast anticipates can be achieved.

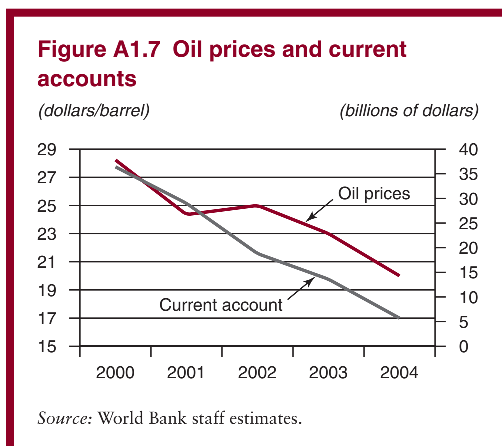
Middle East and North Africa

Recent developments

Despite a continuation of high oil prices, growth in the Middle East and North Africa (MENA) region slowed in 2002 to 2.5 percent, down from 3.2 percent in 2001 as the events of September 11, 2001, continue to reverberate throughout the region.

For the oil-exporting countries, growth remained above 2 percent. The larger increases in growth that might have been expected from both high oil prices and increased public expenditures were offset by a slowdown in production and exports, a result of tightened OPEC quotas put into place in 2001 to support higher oil prices. To counter these effects, some oil exporters have implemented expenditure programs financed with increased oil revenues. In the absence of a strong private investment response to the reform program it had implemented, Algeria, for example, put a four-year economic recovery program in place worth about 10 percent of 2001 GDP, aimed at

Figure A1.7 Oil prices and current accounts



Source: World Bank staff estimates.

supporting growth in domestic demand while enhancing social and economic infrastructure.

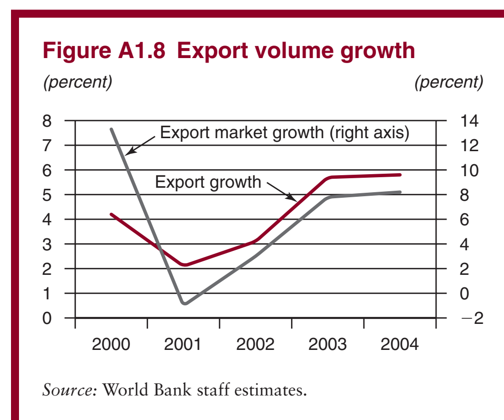
Diversified exporters faced worsening conditions in 2002, with GDP growth falling to 2.2 percent, a decline of 2 percent from 2001. External factors leading to this decline include the deterioration in export market growth for Egypt, Morocco, and Tunisia, as well as sharp declines in the tourism sector in North Africa and the several countries in the Levant, following the events of September 11, 2001. In Egypt, the number of tourists fell 41 percent year-on-year in the last quarter of 2001, and even by the end of the first half of 2002, tourism had not yet returned to precrisis levels. In Morocco, tourist arrivals were down by over 20 percent in the first half of 2002. For some countries in the region, however, the declines in tourism from abroad have been partially offset by MENA nationals diverting their tourism to within the region. Tourist receipts may likely show an even larger decline than tourist numbers, as many firms in the tourist sectors have discounted heavily. Exports to the EU have also suffered, in particular Moroccan textiles and electronics exports to the EU. Jordan has been somewhat insulated from this situation, as its export demand from India and the United States continued to grow quite strongly in 2002.

Internal factors have also contributed to a decline in growth in several countries. The positive agricultural growth of 2001 in Morocco slowed down somewhat in 2002 because of the less favorable weather conditions. To prevent a potentially steep increase in the current account deficit, fiscal and monetary policies were tightened in Tunisia; this action contained domestic demand pressures and reduced pressures on external balance but exacerbated the impact of the slowdown stemming from the external shocks. Though tourism has begun to recover gradually in Egypt, the recovery of the private sector has been hampered by unresolved problems with the exchange rate regime, which have their roots in the late 1990s.

Short-term prospects

Growth prospects for MENA are clearly contingent upon whether military actions are taken in the region. Assuming that there is no conflict over the next year (and thus that there is a gradual resumption in confidence in the region), the region's growth is forecast at 3.7 percent for 2003–04. A recovery would be expected for both oil-exporting countries and diversified exporters. The public expenditure programs being implemented by oil-exporting countries over the next several years to improve infrastructure, agriculture, and support reforms in social sectors would help to increase the public sector's contribution to growth. Growth is expected to average 3.6 percent

Figure A1.8 Export volume growth



Source: World Bank staff estimates.

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

Growth rates/ratios	1991–2000	2000	2001	Baseline forecast 2002	2003	2004	2005–15
Real GDP growth	3.2	4.2	3.2	2.5	3.5	3.7	3.2
Private consumption per capita	0.3	1.4	1.1	0.6	0.8	0.8	1.1
GDP per capita	1.0	2.2	1.3	0.6	1.5	1.7	1.4
Population	2.2	2.0	1.9	1.9	1.9	1.9	1.8
Gross domestic investment/GDP[a]	21.2	21.6	22.0	22.5	22.7	22.9	24.3
Inflation[b]	6.0	4.8	4.2	4.1	4.0	4.0	...
Central gvt. budget balance/GDP	−1.1	−1.4	−1.1	−2.1	−2.4	−2.4	...
Export market growth[c]	10.1	13.3	−1.0	3.0	7.8	8.2	...
Export volume[d]	5.0	7.6	2.4	2.7	5.7	5.8	...
Terms of trade/GDP[e]	0.5	8.4	−0.9	−0.9	−1.1	−1.4	...
Current account/GDP	−2.1	6.8	5.2	3.3	2.3	0.9	...
Memorandum items							
GDP growth: Oil exporters	2.4	3.6	2.4	2.4	3.7	3.6	...
Diversified exporters	4.0	3.7	4.3	2.2	2.7	3.6	...

... Not available.
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-actor services.
e. Change in terms of trade, measured as a proportion to GDP (percentage).
Source: World Bank baseline forecast, November 2002.

for the oil-exporting countries, supported by likely increases in OPEC oil quotas in 2003 to meet growing demand in a period of tight crude inventories. Additionally, Algeria's crude production capacity is set to increase, and its gas exports are expected to experience growth unfettered by quotas, indicating higher growth in the short term. However, much of the growth increase in Algeria in the medium term would come from the large public sector stimulus currently under way. This would revive domestic demand for the duration of the expenditure program. In Saudi Arabia, the stock market is performing well, and credit to the private sector is rising, auguring favorably for 2003–04. The Islamic Republic of Iran will see the revival of the agricultural sector after several years of drought, with the expansion in gas exports and the continuing relaxation of import restrictions buttressing growth in the non-oil sector.

Growth in diversified exports would be expected to increase to 2.7 percent in 2003 and 3.6 percent in 2004. Export market growth would be expected to rise considerably in 2003–04, and the tourism industry would also be expected to recover from its slide since September 11, 2001, as the external environment gradually improves through 2004. Some of the diversified exporters, such as Morocco and Tunisia, will not be able to rely on government stimulus for growth because of the need to pursue fiscal consolidation and keep large inflexible expenditures, especially the government wage bill, under control. Overcoming the vulnerabilities unveiled by the external shocks would call for a faster pace of structural reforms to improve prospects for private sector investment. Morocco must rely on privatization receipts to lower budget deficits, but this financing option will diminish over the medium term as the better candidates for privatization are sold off and the revenues from the former parastatals decrease, implying higher deficits in the future unless expenditure reforms occur. This will require, among other things, public sector reforms, in particular reforms related to the wage bill,

that underlie high expenditures. Weaknesses will remain in the private sectors of several countries. Jordan is weathering the downturn more successfully than other countries because of the high demand for its exports in India and the United States, but weak consumer demand and subdued rates of lending to the private sector indicate that domestic weakness will continue. Egyptian private sector activity is weak, reflecting credit conditions and tight monetary policy (although the recent 100 basis point fall in the discount rate to 10 percent will help somewhat); falling bank earnings in 2002 indicate that private sector investment will remain sluggish in the short term. In the current policy context, the government will continue expansionary fiscal policy despite already high deficits and will put off the implementation of reforms that might have the potential for high social costs.

Recent political events obviously cast a shadow over prospects in the region. The continuing uncertainty stemming from the potential actions against Iraq would significantly affect the gradual recovery in the short-term forecast. Oil exporters would benefit from increased quotas and higher oil prices initially, but these impacts would probably be short lived. Diversified exporters would suffer more, particularly from declines in the tourism industry. Even the expectations surrounding military action within the region could significantly affect growth in the short term. Moreover, the effects of military action on confidence in already fragile global capital markets may lead to increased spreads and a flight to quality, particularly from countries in the region close to the field of war.

Long-term prospects

Even if relatively stronger growth performance is managed in the short term, growth in the long term is expected to average just over 3.2 percent.

The policy environment affecting long-term growth is gradually improving in many countries in the region, albeit at a gradual pace. Jordan is reaping the benefits of a more open trade regime, and many of the North African countries are pressing ahead with more liberal trade relations. However, budget deficits in these countries could lead to problems, particularly in those countries that rely heavily on privatization revenues to finance increased expenditures. The temporary nature of receipts from privatization makes reforms in public expenditures (and the public sector policies that underlie them) and taxation of paramount importance in the future. Furthermore, many of the Mediterranean countries are currently facing sluggish growth or stagnation in the private sector, with low levels of growth in private investment. This indicates the need for strengthening the investment climate and removing bottlenecks in access to finance and backbone productive inputs that hamper private sector investment. In Egypt, long-term prospects appear weak. The policy reform agenda has slowed, mirroring the slowdown in the domestic economy. The current policy mix includes an expansionary fiscal policy to counter the tight monetary policy necessary to support the exchange rate.

In the oil-exporting countries, Iran has unified its exchange rate, allowed the formation of private banks, reaffirmed its commitment to privatization, and is pushing ahead with fiscal reforms. Algeria is considering the deregulation of the power industry and opening the sector to private investment, and has announced the privatization of public companies. In Saudi Arabia, customs tariffs have been reduced to pave the way for a customs union with the Gulf Cooperation Council in 2003, negotiations are under way with the WTO, and new legislation is being prepared to increase competition in domestic capital, labor, and insurance markets. However, many of these changes are occurring very gradually, and some are being greatly delayed. Algeria has not pushed ahead with its announced privatizations, and reform in the power sector is very slow. Many of the oil-exporting countries in the region still have large and inefficient

public sectors, and low rates of private investment in the non-hydrocarbon sectors. Reforms in these sectors leading to efficiency gains and higher potential growth rates will be required.

In the long term, the region has to continue to address several obstacles. The region relies very heavily on a narrow range of external revenue sources, particularly oil, remittances, and tourism, and this reliance introduces the potential for vulnerability in export earnings. Although several countries have adjusted nominal exchange rates in recent years, fixed exchange rate regimes in several countries may adversely affect export competitiveness and offset gains made from trade and customs reforms. Receipts from tourism and remittances are vulnerable to the sluggish income growth in source countries and recurring political conflicts and potential military action in the region. Oil revenue windfalls are usually temporary, and real long-term oil prices are expected to decline, particularly after 2005–06, when Caspian oil production is expected to come onstream.

Notes

1. At both the June 2002 summit in Seville and October 2002 summit in Brussels, the European Community (EC) confirmed that eight of the ECA EU accession candidate countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia) are on track to conclude accession negotiations at the end of 2002 and to sign formal accession treaties in 2003. The official target is for enlargement to happen in time for the mid-2004 European Parliament elections. Bulgaria and Romania are at an earlier stage in the accession process and are expected to accede somewhat later. Turkey is also an accession candidate, although it has yet to begin formal negotiations.

2. Following the forthcoming EC Copenhagen summit in mid-December 2002, the existing 15 EU member countries' national parliaments will vote to approve or reject enlargement.

3. WTTC. 2002. The Impact of Travel and Tourism on Jobs and the Economy—2002. http://www.wttc.org.