feed through to core inflation, and the economy overheat, a much sharper policy response may be required. Finally, should oil prices not decline as projected in the baseline, the resulting adverse terms of trade consequences would act as a drag on growth within the region, because most of the larger economies in the region are significant net energy importers.

Over the long term, the East Asia and Pacific region is projected to continue generating strong growth. Since the 1997 financial crisis, GDP growth in the region has averaged 6.8 percent, and real per capita incomes have risen by almost 6 percent a year. While much of this strength reflects China's very rapid growth (8.1 percent on average), the rest of the region still enjoyed robust growth of 4.4 percent. Over the period 2006–15, regional per capita incomes are projected to continue rising rapidly, by about 5.3 percent a year in real terms.

Past reforms auger well for the future. Initiatives such as joining the WTO, the adoption of a much more welcoming attitude toward foreign capital, and efforts to recapitalize and restructure the financial sector in those countries most seriously affected by the 1997 financial crisis have underpinned growth in the recent period. They have done so by expanding markets and increasing the capital stock, which have allowed vast numbers of hitherto underemployed agricultural workers to be productively employed in the manufacturing sector, which increased both demand and output. At the same time, measures to consolidate public finances and reduce debt, including contingent liabilities, have also contributed to improved economic performance.

If real per capita incomes are to continue rising by the projected 5.3 percent a year, the reform agenda will have to be retained and expanded. Given the increased importance of financial markets and external investment, the region's growth prospects could be enhanced through further improvements to financial sector supervision and prudential rules, and by strengthening accounting and auditing standards. By raising investor confidence in regional markets, the domestic repercussions of higher world interest rates as well as the risk of contagion from financial turmoil elsewhere would be limited. Investment levels and growth would be further supported by strengthened insolvency laws, while public-sector governance reforms could significantly improve the state's ability to deliver key public goods and services. In China, clarifying the relations between the largely state-owned banking system and other state-owned enterprises would help reduce the likelihood of accumulating more bad loans.

Europe and Central Asia

Real GDP in Europe and Central Asia is estimated to have increased by 7 percent in 2004, a sharp acceleration from the 5.9 percent outturn in 2003. This strong performance outstrips the 2000 peak in growth of 6.7 percent. It marks a new record since the beginning of the transition period, with the commonwealth of independent states (CIS) showing the most rapid growth (table A2). The acceleration reflects several factors. Domestic consumption and investment in Russia and other CIS oil exporters were boosted by a surge in oil revenues, while the accession of a number of the region's countries to the European Union (EU) provided a further boost to investment demand and foreign direct investment inflows. Industrial production for the region as a whole was up an estimated 8.4 percent (figure A3). Strong domestic demand in Russia spurred increased imports from neighboring countries, mainly in the CIS, and the new EU members continued to increase their share of EU trade, reflecting past foreign direct investment from the EU. Overall, the region increased market share, and its exports grew almost 35 percent faster than world trade (figure A4).

Notwithstanding rapidly expanding production, fiscal deficits remain unsustainably high in a number of countries in central Europe. These deficits along with strong private-sector demand and higher oil prices have

Table A2 Europe and Central Asia forecast summary

Annual percent change unless indicated otherwise

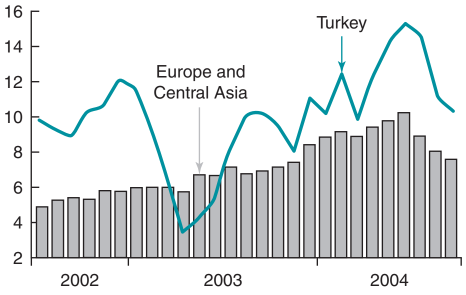
	1990–2000[a]	2002	Est. 2003	2004	Forecast 2005	2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	−1.4	4.6	5.9	7.0	5.6	5.0	3.5
GDP per capita (dollars)	−1.6	4.6	5.9	7.0	5.6	5.0	3.5
PPP GDP[c]	−2.1	4.7	6.3	7.4	5.8	5.1	. . .
Private consumption	0.8	5.5	7.2	6.5	5.5	5.0	. . .
Public consumption	−0.8	2.9	2.4	2.8	2.6	2.3	. . .
Fixed investment	−6.7	1.9	9.3	12.0	7.8	7.4	. . .
Exports, GNFS[d]	2.0	7.7	11.9	13.7	9.8	9.1	. . .
Imports, GNFS[d]	−1.0	8.6	13.5	12.4	10.2	9.4	. . .
Net exports, contribution to growth	1.1	−0.2	−0.5	0.8	0.0	0.0	. . .
Current account balance (% of GDP)	−0.6	0.7	0.1	0.1	−0.5	−0.6	. . .
GDP deflator (median)	. . .	4.2	4.4	4.8	4.2	4.2	. . .
Fiscal balance (% of GDP)	. . .	−3.4	−2.8	−2.4	−1.8	−1.7	. . .
Memo items: GDP							
Transition countries	−2.2	4.0	5.9	6.9	5.7	5.0	. . .
Central and Eastern Europe	1.0	2.8	4.0	5.0	4.6	4.7	. . .
Commonwealth of Independent States	−4.2	5.0	7.5	8.3	6.6	5.2	. . .

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.
b. GDP measured in constant 1995 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.
Source: World Bank.

contributed to rising current account deficits and inflation. A notable exception to increasing inflationary pressures is Turkey, where fiscal consolidation and a tightening of monetary policy has helped bring inflation down from 68 percent in 2001 (18 percent in 2003) to only 9 percent in the fall of 2004. While it is still too early to tell, this may herald a new beginning for Turkey whereby economic decision making and growth are no longer constrained by price uncertainty.

Figure A3 Strong industrial production growth

Annual percent change, three month moving average



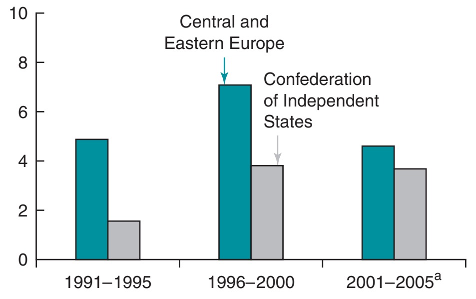
Source: World Bank.

Regional growth is forecast to moderate over the near-term, with output rising by 5.6 and 5 percent in 2005 and 2006, respectively. This aggregate performance masks relatively stable growth in the central European region, where slower growth in trade volumes elsewhere in the world is expected to offset an acceleration in western European demand for products of the region. The slowdown in the CIS is projected to be much sharper, and mainly reflects slower growth in Russia, as energy production tops out at very high levels. For the region as a whole, still high oil revenues should boost domestic demand and employment growth, helping to create a virtuous circle that can maintain growth at high levels. Lower oil prices will lead to a shift in the regional current account balance from surplus to deficit.

Progress in fiscal consolidation, diversification of production, and advancing reforms will influence regional growth outturns. A re-

Figure A4 Growth of goods-and-services exports minus GDP growth

Constant prices, period annual averages



a. 2004 and 2005 data are forecasts.
Source: World Bank.

duction in public expenditure by the governments of new EU members and South Eastern European states, achieved by cutting back on poorly targeted spending and improving public expenditure management would help spur investment in this region and accelerate convergence to EU income levels. Moreover, such steps would prevent a substantial deterioration of public finances when these economies return to slower growth. By slowing the now rapid debt accumulation, a more prudent fiscal policy would also reduce the domestic impact of higher international interest rates and reduce the possibility of disruptive spikes in short-term debt flows. For Turkey, further success in tightening fiscal policy, paying down debt, and controlling inflation would contribute to both improved growth prospects and greater macroeconomic stability.

In the next 10 years, Europe and Central Asian growth is forecast to average 3.5 percent. GDP in the Central and Eastern European countries over the next 15 years is projected to expand much more quickly than it did during the first 10 years of transition. Growth should continue to be led by high investment rates (both foreign and domestic), rising intraregional trade, and expansion in world market share, as these countries continue to reap the benefits of the extensive structural reforms they have implemented and from EU membership. If implemented, further improvements in the policy environment, including greater macroeconomic stability, would help to underpin these higher growth rates.

In general, the structural reform process in many of the CIS is less advanced than in the Central and Eastern European countries, although it is progressing. As a result, long-term growth prospects for the subregion are lower. Indeed, some countries have demonstrated significant resistance to the kinds of reforms that have served their western neighbors so well. High oil prices have provided an impetus to growth, which has facilitated the introduction of a number of reforms in oil-exporting countries and contributed to an increase in investment outlays (particularly in the energy sector). However, as energy prices retreat from their recent highs, countries in the region will need to rely on productivity improvements and product- and labor-market reforms to spur much needed investment.

Prospects in Turkey should be bolstered by the implementation of significant reforms, which could ultimately reduce inflation to historically low levels and bring the fiscal deficit down to a more manageable rate. The European Commission's recommendation that the EU begin accession talks with Turkey should help strengthen public support for further reforms. As these reforms progress, higher investment and improved productivity can be expected. Nevertheless, the process has only begun and underlying fundamentals remain difficult, pointing to significant downside risks and underscoring the importance of maintaining recent reform momentum.

Latin America and the Caribbean

Regional GDP in Latin America and the Caribbean is estimated to have increased by 4.7 percent in 2004, bringing to an end a three-year period of stagnation. Most countries in the region have had a solid year, and growth has accelerated