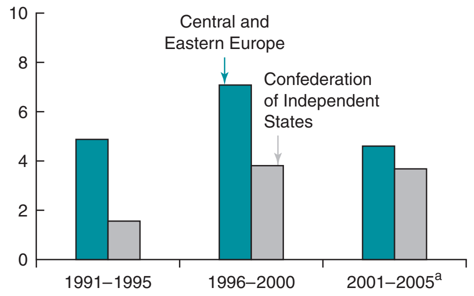
Figure A4 Growth of goods-and-services exports minus GDP growth

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 sharply in several of the larger economies. Output in Brazil is estimated to have increased 3.9 percent for the year as a whole. Mexico has also performed well; its economy expanded by an estimated 4 percent this year. New investments from large U.S. and European firms (Motorola, General Electric, and Electrolux) plus strong export growth among the maquiladora helped allay fears that Mexico was losing market share to Chinese competition. Other countries are also experiencing strong growth. Second quarter GDP increased 13.6 percent in the República Bolivariana de Venezuela, 11.5 percent in Uruguay, 6.7 percent in Argentina, 3.6 percent in Peru, and 3.5 percent in Colombia. Extensive hurricane damage has derailed developments in several Caribbean countries, and it may take several quarters before these countries start growing again—and even longer before economic activity returns to normal (table A3).

Commodity prices played an important role in these developments. Higher oil prices have benefited major oil exporters in the region, such as Colombia, Ecuador, Mexico, and the República Bolivariana de Venezuela, and have increased regional incomes by 0.7 percent of GDP, on average, since 2001. Oil importers, especially countries in Central America, the Dominican Republic, and Uruguay have been hurt, but their losses were attenuated by increases in other commodity prices. This was especially true for large exporters of agricultural products (Argentina, Bolivia, Brazil, Ecuador, and Paraguay) and metals (Chile, Jamaica, and Peru).

Increased international liquidity, fiscal tightening, and prudent monetary policy have improved the financial position of most countries in the region and have contributed to the upgrading of their debt and reductions in debt-servicing burdens. Overall, risk premia on the region's sovereign debt are low and have recovered from the surge observed in the spring. Countries in the region have taken advantage of low interest rates to restructure debt, and rating agencies have recently upgraded the sovereign debt of 15 Latin American countries (figure A5).

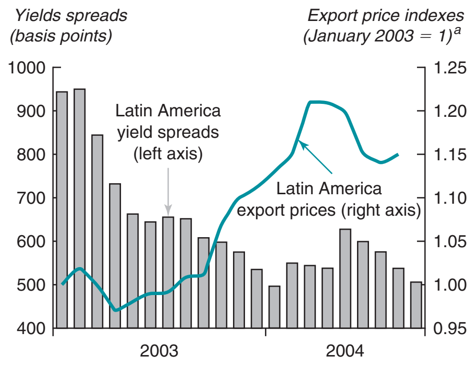
Table A3 Latin America and the Caribbean forecast summary

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]	3.3	−0.6	1.6	4.7	3.7	3.7	3.6
GDP per capita (dollars)	1.6	−2.1	0.2	3.2	2.3	2.3	2.4
PPP GDP[c]	3.4	0.0	1.6	4.5	3.7	3.6	. . .
Private consumption	4.0	−1.8	0.6	4.0	3.4	3.4	. . .
Public consumption	2.1	−0.3	1.2	1.9	3.0	2.7	. . .
Fixed investment	4.0	−7.0	−0.4	10.6	5.2	5.5	. . .
Exports, GNFS[d]	8.7	2.2	5.0	9.6	7.0	7.2	. . .
Imports, GNFS[d]	10.8	−6.1	0.5	10.3	9.6	8.1	. . .
Net exports, contribution to growth	−0.3	1.8	1.0	0.0	−0.5	−0.1	. . .
Current account balance (% of GDP)	−2.8	−0.9	0.1	0.7	−0.3	−0.9	. . .
GDP deflator (median)	12.3	6.6	4.2	4.0	4.0	4.0	. . .
Fiscal balance (% of GDP)	−2.4	−3.0	−2.7	−1.4	−1.3	−1.3	. . .
Memo items: GDP							
LAC excluding Argentina	3.1	1.1	0.6	4.3	3.7	3.7	. . .
Central America	4.5	2.1	3.3	3.2	3.3	2.9	. . .
Caribbean	4.1	3.2	1.1	0.9	2.7	3.0	. . .

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.

Figure A5 Latin America & the Caribbean benefits from a favorable external environment



a. Each country's aggregate export price reflects the commodity composition of its exports.

Source: World Bank.

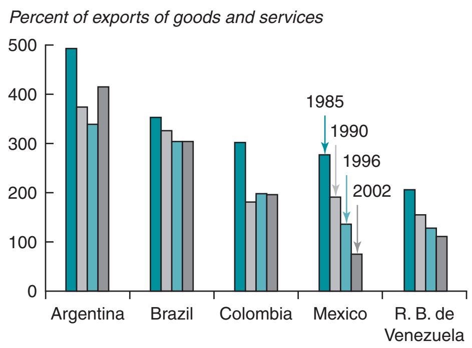
Regional growth is forecast to moderate, with GDP growth slowing to a still robust 3.7 percent by 2006. A number of factors are expected to contribute to this cooling. The projected slowing of world trade growth, and the consequent moderation in both oil and other commodity prices will reduce the pace of income growth and restrain domestic demand. At the same time, the combination of rising world interest rates, lackluster business confidence indicators, and emerging domestic inflationary pressures are expected to slow investment growth (notably in Brazil)—even though investment levels have yet to regain past peaks, and capacity utilization is close to all-time highs in many countries in the region. Capacity constraints in the oil sector are also likely to slow growth in oil-exporting countries.

In Argentina, growth is expected to moderate over the next two years. The boost to growth that was generated by its 2001 devaluation is waning, and the rise in commodity prices is leveling off or declining. At the same time, the recovery is beginning to bump up against capacity constraints in the energy sector, where price controls have discouraged new investment. Moreover, lingering uncertainty surrounding its defaulted bonds are likely to limit the country's access to external financing, constraining much needed capital accumulation.

The most significant downside risk for the region is still its vulnerability to higher interest rates and financial turmoil. Prudent budgetary policies in recent years, a general shift toward more flexible exchange rate regimes, and market opening initiatives have improved the financial position of many countries in the region. External debt of the region as a share of exports (a common indicator of external vulnerability) has fallen from 241 to 164 percent between 1990 and 2002, while inflation and both current account and fiscal balances have improved (figure A6).

However, some of this improvement has been cyclical in nature. Even the moderate downturn and higher interest rates incorporated into the projection will reverse some of this progress. Were the slowdown to be more pronounced or world interest rates higher than forecast, the impact would be large for some countries. Restraining government spending and implementing an efficient tax structure now, when economic growth and government revenues are strong, would help prevent an excessive deterioration in public finances as growth slows. Failure to do so would likely force governments to once again cut spending during the next downturn, exacerbating rather than smoothing the cycle.

Figure A6 Latin American external debt



Source: World Bank.

Long-term prospects for the region are improving. During the period 2006–15, growth is projected to average 3.6 percent and real per capita incomes to rise by 2.4 percent on average. Prospects for achieving this kind of healthy expansion have been improved by the substantial reduction of the fiscal imbalances and the perverse price incentives that have held back growth in the past. As a result of these efforts, debt-to-GDP ratios are falling. Consolidating these gains over the longer term, principally by restraining government spending during upturns, will be critical to ensuring future growth.

Increased reliance on medium-term expenditure frameworks would help increase stability in program financing and tax policy by eliminating the too frequent episodes where fiscal consolidation is undone by rapid increases in spending during periods of strong economic expansion. Keeping expenditure growth on an even keel, even when revenues are high, for cyclical or temporary reasons, will obviate the need for subsequent destabilizing cuts to program spending in order to reestablish internal balance. Establishing a more stable revenue base by reducing reliance on transitory nontax revenues or distortionary tax handles (e.g., oil royalties or other natural resource taxes, taxes on exports, taxes on bank checks, privatization, and so forth) would also help. More cost-effective public spending and a reallocation of resources toward growth-enhancing projects, such as infrastructure development, poverty eradication, education, and health enhancement programs, would further improve economic efficiency and growth.

Middle East and North Africa

GDP in the Middle East and North Africa Region increased by 4.7 percent in 2004, easing from a near-record 5.7 percent advance during 2003. For oil-exporting countries in the region, high and rising oil prices are boosting incomes and contributing to robust growth in domestic demand (figure A7). However, the very large increases in oil production that underlay the strong growth outturns for 2003 have largely run their course. As a result, GDP growth among oil exporters eased from 6.6 percent in 2003 to a still very high 5.0 percent in 2004. Buoyant oil revenues have pushed the overall region's current account balance to a surplus of some $92 billion or 14.4 percent of GDP (table A4). And if high-income countries such as the United Arab Emirates and Kuwait are included as part of the broader geographic region, the surplus rises to $120 billion or 15.5 percent of GDP—unprecedented since the first oil shock of the early 1970s.[1]

Oil importers of the region, though suffering rising import bills, have also benefited indirectly from higher oil prices, and GDP is estimated to have accelerated somewhat in 2004, expanding 4.2 percent. Increased regional demand for their exports and stronger remittance flows have contributed to incomes and production levels—although the labor-scarce oil exporters do not appear to have increased the number of guest workers to the same extent as during past oil price hikes.

The conflict in Iraq has also influenced economic activity across the region. Perceived increases in risk have reduced foreign direct investment inflows and disadvantaged regional investment projects, while heightened security concerns in the developed world have boosted transport costs for regional exports. Terrorist threats, both in Iraq and those potentially targeting the region's oil infrastructure, are an important element underlying the substantial "premium" on oil prices. However, the war has also stimulated demand for logistics and related functions, thereby boosting activity in several economies of the region. Revenues from the Suez Canal have skyrocketed with increased transits; and tourism nights in Egypt have increased by 35 percent as of mid-2004, reflecting an increased propensity among Middle East and North African residents to restrict travel to within the region.

Regional growth is forecast to remain strong in 2005 before easing to 4.5 percent