Appendix
Regional Economic Prospects

East Asia and Pacific

GDP in the East Asia and Pacific Region is estimated to have increased by almost 8 percent in 2004 (for a second year), the strongest performance since the 1997–98 financial crisis. The regional boom has been led by extremely strong domestic demand and trade growth in China.

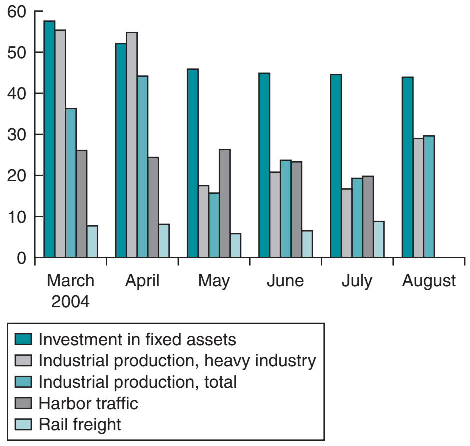
Chinese GDP is estimated to have increased by 8.8 percent, somewhat slower than in 2003. This slowdown reflects China's efforts to stave off an overheating of the economy and prevent an inflationary spiral that could derail long-term growth if recent hikes in food prices are passed through to wages and other consumer prices. Administrative controls on investments and restrictions placed on the issuance of new credits appear to be bringing expansion down to a more sustainable level. Investment growth slowed from over 40 percent to still high 20–30 percent rates between the first and third quarters (figure A1). In addition, the recent moderation in freight rates and the precipitous fall in October of the prices of copper, nickel, zinc, lead, and other commodities that are the building blocks of the Chinese boom appear to reflect perceptions that Chinese demand has been slowing (increases in Chinese demand represented 90 percent of the growth in global steel demand during 2003, and 66 percent of the increased demand for iron ore).

However, the effectiveness of these measures in slowing overall demand is less clear. Investment levels continue to exceed 50 percent of GDP, and retail sales volumes and the dollar value of imports are still expanding very rapidly.

Elsewhere in the region, GDP in 2004 is estimated to have increased by about 7 percent in Malaysia, by between 5.5 and 6.5 percent in the Philippines and Thailand, and by somewhat less than 5 percent in Indonesia. Buoyant consumer spending continues to make an important contribution in all these economies, while fixed investment spending, which has been subdued in the years since the financial crisis, has mounted a substantial recovery since late 2003.

Figure A1 A gradual slowing of China's growth

Selected indicators of activity, annual percent change



Source: National authorities.

Table A1 East Asia and Pacific forecast summary

Annual percent change unless otherwise indicated

	1990–2000[a]	2002	Est. 2003	2004	Forecast 2005	2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	7.7	6.7	7.9	7.8	7.1	6.6	6.1
GDP per capita (dollars)	6.3	5.8	7.0	6.9	6.2	5.7	5.3
PPP GDP[c]	8.4	7.1	8.4	8.1	7.3	6.8	. . .
Private consumption	6.8	5.5	6.5	8.2	7.3	7.0	. . .
Public consumption	7.7	6.8	6.7	5.8	5.4	5.4	. . .
Fixed investment	9.0	13.1	18.6	16.4	9.5	8.1	. . .
Exports, GNFS[d]	11.6	14.8	20.8	20.9	13.2	11.0	. . .
Imports, GNFS[d]	11.6	15.1	23.3	24.4	15.6	12.1	. . .
Net exports, contribution to growth	0.3	0.5	−0.1	−0.7	−0.8	−0.4	. . .
Current account balance (% of GDP)	0.4	3.5	3.1	1.5	1.6	1.6	. . .
GDP deflator (median)	6.8	3.9	3.6	3.9	3.0	3.5	. . .
Fiscal balance (% of GDP)	−1.2	−3.4	−2.8	−2.4	−2.3	−2.2	. . .
Memo items: GDP							
East Asia excluding China	4.6	4.4	5.2	5.8	5.6	5.4	5.0

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

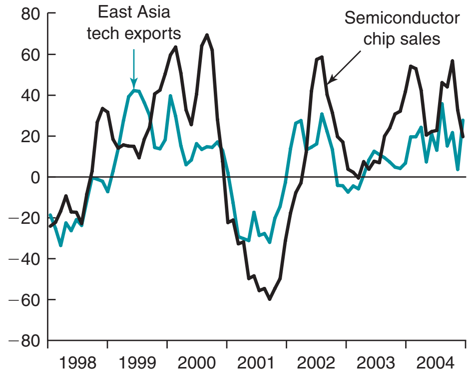
Output in the region is expected to slow through 2006, when it is projected to increase by 6.6 percent. By then Chinese GDP growth is forecast to ease to a more manageable 7 percent pace. It is assumed that administrative controls on investment and credit restrictions are calming the torrid pace of investment. As a result, the overall contribution of investment to GDP growth is projected to decline by more than 3 percentage points, with slower consumer demand also making a contribution as the pace of economic activity moderates.

Excluding China, GDP growth in the region is projected to remain robust, easing somewhat to around 5.5 percent by 2006 (table A1). This mainly reflects the slowing in economic activity among the region's major trading partners (China, Japan, and the United States) and, at the sectoral level, a weakening in world demand for high-tech products (G-3 orders for semiconductors fell 8.5 percent in the three months ending August 2004, as compared with the still robust growth of the second quarter) (figure A2).

This relatively benign outlook is subject to downside risks. In particular, overinvestment and excess capacity in China could lead to a sharp downswing in new investment, which would result in a much more abrupt slowdown than forecast. This slowdown would, in turn, have a significant impact on China's major trading partners in the region. In addition, should rapidly rising headline inflation

Figure A2 The global high-tech cycle may be easing

Selected high-tech indicators, rolling quarterly annualized rates, three month moving average, seasonally adjusted, percent



Sources: Semiconductor Industry Association, National sources, and World Bank.

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

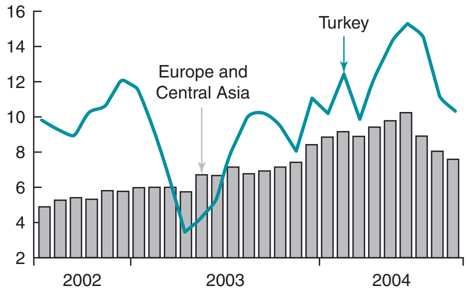
	1990–2000[a]	2002	Est. 2003	2004	Forecast 2005	2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	−1.4	4.6	5.9	7.0	5.6	5.0	3.5
GDP per capita (dollars)	−1.6	4.6	5.9	7.0	5.6	5.0	3.5
PPP GDP[c]	−2.1	4.7	6.3	7.4	5.8	5.1	. . .
Private consumption	0.8	5.5	7.2	6.5	5.5	5.0	. . .
Public consumption	−0.8	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



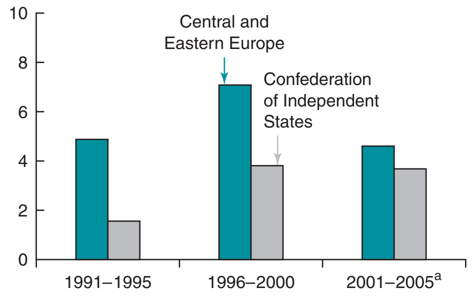
Source: World Bank.

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 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).

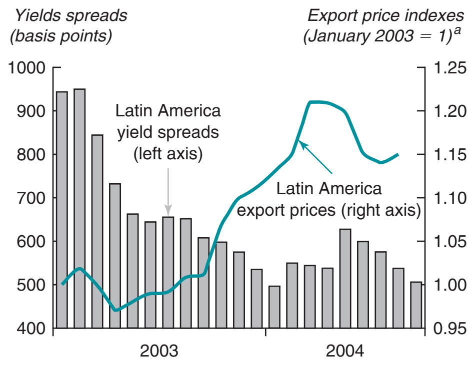
Table A3 Latin America and the Caribbean forecast summary

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.

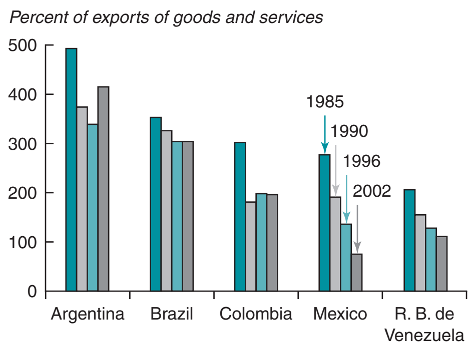
Regional growth is forecast to moderate, with GDP growth slowing to a still robust 3.7 percent by 2006. A number of factors are expected to contribute to this cooling. The projected slowing of world trade growth, and the consequent moderation in both oil and other commodity prices will reduce the pace 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

Table A4 Middle East and North Africa forecast summary

Annual percent change unless indicated otherwise

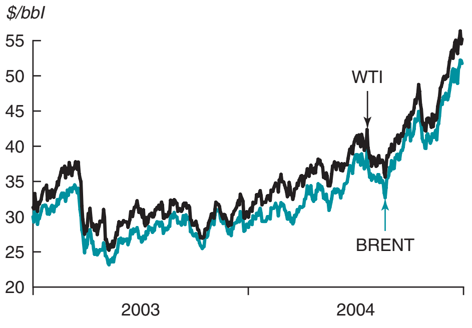
	1990–2000[a]	2002	Est. 2003	Forecast 2004	2005	2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	3.4	3.2	5.7	4.7	4.7	4.5	4.4
GDP per capita (dollars)	1.2	1.4	3.8	2.8	2.8	2.5	2.6
PPP GDP[c]	3.6	4.0	5.6	5.0	5.0	4.7	. . .
Private consumption	2.0	3.0	3.9	4.1	4.2	4.5	. . .
Public consumption	1.7	0.2	4.7	6.0	5.7	4.0	. . .
Fixed investment	3.5	5.2	5.6	8.0	7.2	6.8	. . .
Exports, GNFS[d]	4.8	1.6	10.1	5.1	3.9	4.4	. . .
Imports, GNFS[d]	1.9	3.0	4.6	5.9	5.1	4.5	. . .
Net exports, contribution to growth	0.9	−0.3	2.0	0.1	−0.1	0.2	. . .
Current account balance (% of GDP)	−1.9	4.6	8.1	14.4	11.2	6.7	. . .
GDP deflator (median)	6.8	2.1	3.5	3.9	4.0	4.0	. . .
Fiscal balance (% of GDP)	−1.0	−3.8	−1.7	−2.2	−2.1	−2.1	. . .
Memo items: GDP							
MENA Geographic Region[e]	3.7	2.9	6.0	4.8	4.7	4.4	. . .
Resource poor- Labor abundant[f]	3.8	3.0	4.1	4.2	4.5	5.2	. . .
Resource rich- Labor abundant[g]	3.5	5.9	6.2	6.1	5.7	5.0	. . .
Resource rich- Labor importing[h]	3.7	0.6	7.0	4.2	4.0	3.3	. . .

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.
b. GDP measured in constant 1995 dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.
e. Geographic region includes high-income countries: Kuwait and UAE.
f. Egypt, Jordan, Morocco, and Tunisia.
g. Algeria, Iran, Syria, and Yemen.
h. Bahrain, Kuwait, Oman, Saudi Arabia, and UAE.
Source: World Bank.

in 2006; shifts in the sources of growth are likely. Growth in oil exporting countries is projected to moderate to a respectable 4.1 percent by 2006. The current medium-term view that oil prices will be sustained above $30 per barrel beyond 2006,[2] suggests that the region will continue accumulating large surplus positions, and high oil-related incomes should keep domestic demand robust. The current account surplus for the broader Middle East and North Africa Region is projected to ease from $120 billion in 2004 to $100 billion in 2005, before dropping more substantially to $60 billion or 6.5 percent of GDP by 2006 (figure A8).

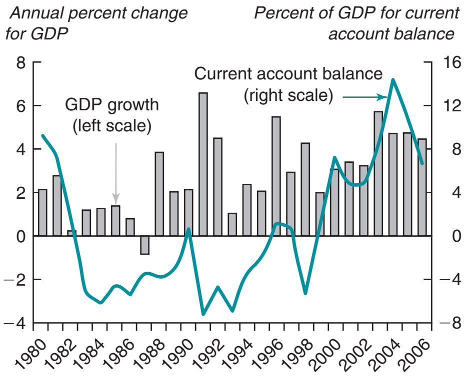
In contrast, growth is expected to accelerate among regional oil importers, supported by still high levels of demand from oil exporters and stronger European export demand, as the long-awaited recovery takes hold there. The Maghreb economies should be particularly sensitive to this increase because the European Union (EU) accounts for some 70 percent of their exports. Robust activity in Europe will also likely benefit several resource-poor and labor–abundant economies in the region—among them Egypt, Jordan, and Lebanon.

Figure A7 Oil prices rise on fears of supply disruption



Sources: Datastream and World Bank.

Figure A8 MENA: GDP growth and current account balance



Source: World Bank.

These countries, having signed EU-Mediterranean trade agreements, will benefit from preferential access to that market and can be expected to increase their market shares. However, countries in the region will also likely face increased competition from the new members of the EU, who are now benefiting from almost full market access and strong capital inflows. Meeting this challenge will require reinforced efforts to improve productivity and enhance the quality of regional export products.

In the longer-term, a return to lower oil prices and the need for enhanced reforms across the region will offer substantial challenges. How policymakers manage today's revenue windfalls will have an important long-run impact on the region. Current efforts to allocate surplus revenues to "Oil Funds" and to debt repayment should reduce upward pressure on regional currencies and protect the competitiveness of domestic non-oil firms (the "Dutch disease"). At the same time, such measures should help restrict the expansion of the domestic money supply and help insulate regional economies from overheating.

Longer-term prospects for the region will depend, to a large degree, on the success with which non-oil sectors can develop and flourish. It is important that continuing oil windfalls not delay needed reforms to the "investment climate" across the region, including economic structures and institutions that can promote more balanced growth, employment creation, and the achievement of longer-run poverty reduction goals.[3] Demographic pressures are mounting, and the need for job creation is urgent. At the same time, progress in these areas is complicated by the uncertainties regarding outcomes in the Iraqi conflict, which add an overlay of tension that is a concern for policymakers worldwide.

South Asia

GDP in South Asia is estimated to have slowed considerably in 2004, increasing by 6 percent, down from 7.5 percent in 2003. Much of the slowdown reflects a deceleration in agricultural output (up 3.4 percent) due to poor rainfall, while elsewhere, services, manufacturing, and export demand showed considerable strength. The brunt of the slowdown was felt in India, where the most serious impacts of the delayed onset of the monsoon were felt. In addition to the direct effect on agricultural output, the poor crop had important feed-through effects on rural private consumption, which in India accounts for about a quarter of GDP (over half of the population is dependent on the agricultural sector) (figure A9). India's services sector made strong advances, supported by productivity gains and greater market penetration, and the manufacturing sector continued to post high growth. Overall Indian GDP is estimated to have slowed from an increase of more than 8 percent in 2003 to one of about 6 percent in 2004.

Excluding India, growth in the region is projected to rise to 6 percent in 2004 from 5.6 percent in 2003, supported by robust manufacturing sectors in Bangladesh and Pakistan, and by strengthening services and agricultural sector growth in Nepal and Sri Lanka (table A5). For the subregion as a whole, strong external demand (exports were up 11 percent) and a general rise in remittances from abroad helped boost incomes and

Table A5 South Asia forecast summary

Annual percent change unless indicated otherwise

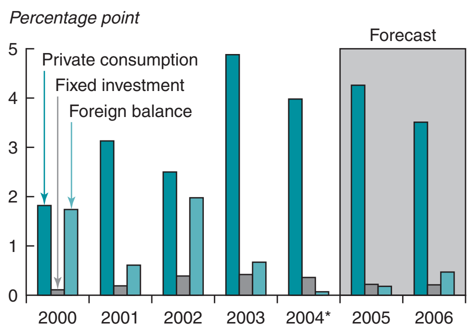
	1990-2000[a]	2002	Est. 2003	Forecast 2004	2005	2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	5.2	4.6	7.5	6.0	6.3	6.0	5.5
GDP per capita (dollars)	3.3	2.8	5.8	4.3	4.7	4.4	4.1
PPP GDP[c]	5.3	4.6	7.6	6.0	6.3	6.0	. . .
Private consumption	4.2	3.9	7.6	6.2	6.6	5.4	. . .
Public consumption	5.2	3.5	3.8	3.4	2.2	2.1	. . .
Fixed investment	6.0	8.4	8.7	7.1	8.5	8.2	. . .
Exports, GNFS[d]	11.1	18.2	11.4	9.8	14.9	10.9	. . .
Imports, GNFS[d]	10.0	5.5	8.4	10.8	15.7	9.6	. . .
Net exports, contribution to growth	0.0	2.0	0.7	0.1	0.2	0.5	. . .
Current account balance (% of GDP)	−1.5	1.1	1.2	−0.5	−0.5	−0.1	. . .
GDP deflator (median)	7.9	3.6	5.2	3.7	5.3	4.7	. . .
Fiscal balance (% of GDP)	−11.0	−9.6	−8.2	−8.4	−7.8	−7.5	. . .
Memo items: GDP							
South Asia excluding India	4.4	4.5	5.6	6.0	5.6	5.8	5.3

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

domestic demand, with private consumption accounting for virtually all of the increment to demand. In Pakistan, consumer demand was supported by robust increases in consumer credit and worker remittances. Rising investment rates reflected progress in structural reform and improved investor sentiment. Bangladesh's GDP growth is estimated to have been broadly stable between 2003 and 2004, although a sectoral breakdown indicates that this result reflects a combination of stronger manufacturing production (export-led growth) with some moderation of agricultural output (flooding and lower harvests). Growth in Nepal and Sri Lanka was held back by political tensions, which have cut into both tourism revenues and investor confidence. Meanwhile, donor assistance and relative peace, combined with a recovery in the agricultural sector after a prolonged drought, helped boost real GDP growth in Afghanistan by an estimated 16 percent, excluding the opium sector (which accounts for roughly a third of output).

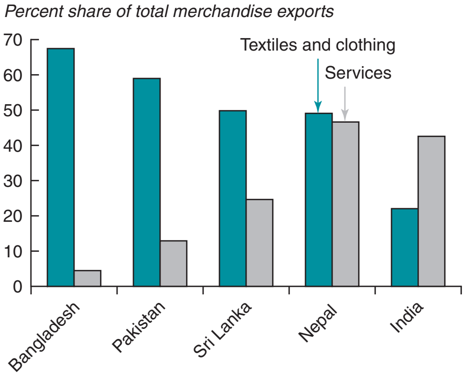
There has been some building of inflationary pressures in the region. In India, producer prices were up 7.9 percent in September 2004 compared with 5.0 percent a year before, while in Pakistan producer inflation in the same period increased from 3.7 to 8.0 percent. Rising inflationary pressures mainly reflect higher food prices and some transmission of the rapid escalation of oil prices. The region's net current account surplus is expected to slip into a small deficit in 2004, due to the high energy import bill. However, robust external demand and continued market penetration are providing a substantial counterbalance.

Figure A9 Contributions to growth



Source: World Bank.

Figure A10 Exports of services, and textile and clothing



Note: Data observations are for 2002, with the exception of Nepal, which is for 2001.
Source: World Trade Organization.

Regional GDP is forecast to accelerate, expanding by 6.3 percent in 2005, before moderating somewhat in 2006. The acceleration is largely driven by an anticipated recovery of agricultural sector growth in 2005; it is forecast despite slower GDP and trade growth elsewhere in the world. The subsequent slowdown in 2006 is connected to a return to trend growth rates in the agricultural sector, which will moderate income and private consumption growth. Nonagricultural sectors are projected to continue expanding at a fast pace. Lower oil prices and better crops (assuming no further weather-related disruptions) should result in an easing of inflationary pressures in the near-term.

The slowdown in world trade growth should be reflected in regional exports, although South Asia is projected to continue increasing its share in both world goods and services markets. The entry of 10 new member countries into the EU should provide a fillip to regional exports. Many of these countries have large textile sectors, which now benefit from a more preferential trading regime and are likely therefore to increase their demand for inputs from South Asia. However, prospects for the South Asian textile sector remain clouded by the impending final phase-out of the Agreement on Textile and Clothing in 2005, which could have significant impacts on the balance of payments, production levels, and employment in a number of smaller countries in the region (figure A10).

Long-term growth in South Asia is forecast to average about 5.5 percent during 2006–15 as the contribution to growth from the private sector continues to rise. Buoyed by an ongoing consolidation of fiscal deficits (diminishing crowding out) and by rising private savings as dependency ratios decline, private investment is expected to play an increasingly large role in the region. The pursuit of trade reforms, banking-sector liberalization and re-regulation, privatization, and infrastructure development should all contribute to improving the investment climate, productivity growth, and ultimately, incomes. These product market reforms are being complemented by progress in raising education and skill levels and reducing infant mortality rates—factors that should further boost productivity. Moreover, demographics should help boost incomes, because despite declining infant mortality rates, falling birth rates mean that South Asian population growth is projected to decelerate and dependency ratios to decline over the forecast horizon. All of these factors suggest that per capita incomes will advance significantly in the coming decades, expanding by an average of 4.1 percent per year for the period 2006–15.

Policymakers in the region face a number of challenges to realize these high rates of growth. Substantial segments of the region's population remain vulnerable to weather patterns and natural disasters. Building capacity to mitigate their impacts without distorting economic incentives should be a priority. Recent peace agreements have eased regional tensions and are contributing to enhanced regional stability, which improves business confidence and increases intraregional trade. However, some international and domestic tensions remain, and the possibility of a deterioration in relations continues to present downside risks to growth outcomes and poverty reduction.

Sub-Saharan Africa

GDP in Sub-Saharan Africa grew by an estimated 3.2 percent in 2004, much faster than in the 1990s, but slower than almost everywhere else in the world. As a result, per capita incomes increased by only 1.1 percent in real terms, and rather than catching up, the region fell further behind both developed and other developing economies (table A6). Performance within the region was varied. Growth in oil-exporting countries was strong at 4.4 percent but was down substantially from the 7.9 percent pace recorded in 2003 as spare oilproduction capacity dried up. Nevertheless, high oil revenues helped fuel a 6 percent increase in personal consumption and investment demand in oil-exporting countries, factors that contributed to strong import demand and an overall negative contribution to growth from the external sector.

In South Africa, which accounts for almost 50 percent of area GDP, but only 11 percent of the population, growth continued to be dampened by the 40 percent effective appreciation of the rand (since 2002). As a result, exports were weak and imports strong so that despite robust domestic demand (up some 5 percent), GDP increased by only an estimated 2.7 percent. Most of the remaining countries in the region are oil-importers and are impoverished. These poor countries represent more than two-thirds of the population of the subcontinent but less than one-third of GDP; their output rose by an estimated 3 percent, up sharply from 1.7 percent in 2003. Strong agricultural and metal prices helped boost incomes in several countries and are reflected in a surge in consumption, investment activity, and imports. Overall, however, oil-importing Sub-Saharan countries suffered a 0.5 percent of

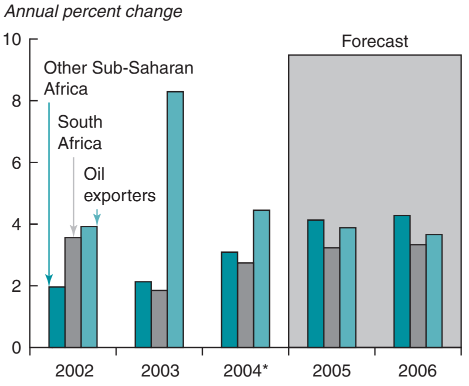
Table A6 Sub-Saharan Africa forecast summary

Annual percent change unless indicated otherwise

	1990–2000[a]	2002	Est. 2003	Forecast 2004	Forecast 2005	Forecast 2006	2006–15[a]
GDP at market prices (1995 dollars)[b]	2.3	3.1	3.0	3.2	3.6	3.7	3.5
GDP per capita (dollars)	−0.4	0.9	0.9	1.1	1.6	1.7	1.6
PPP GDP[c]	2.6	3.6	3.9	3.6	3.8	3.7	. . .
Private consumption	2.1	2.6	3.3	4.0	3.8	4.0	. . .
Public consumption	3.5	4.6	3.5	4.1	2.9	2.9	. . .
Fixed investment	3.4	5.3	7.3	7.2	5.0	5.0	. . .
Exports, GNFS[d]	5.1	0.0	2.3	2.0	6.5	6.4	. . .
Imports, GNFS[d]	5.8	3.5	5.3	6.9	6.6	6.4	. . .
Net exports, contribution to growth	−0.3	−1.3	−1.2	−1.9	−0.4	−0.4	. . .
Current account balance (% of GDP)	−1.6	0.4	−0.2	1.3	0.9	−0.3	. . .
GDP deflator (median)	12.8	5.9	4.2	4.1	4.0	4.0	. . .
Fiscal balance (% of GDP)	−4.4	−2.6	−2.7	−3.0	−2.9	−2.7	. . .
Memo items: GDP							
SSA excluding South Africa	2.9	2.7	4.3	3.6	4.0	4.0	. . .
Oil exporters	2.6	4.2	7.9	4.4	3.9	3.7	. . .
CFA countries	2.2	1.4	1.8	2.7	3.2	3.5	. . .

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

Figure A11 Sub–Saharan Africa real GDP growth



Note: 2004 data is an estimate; 2005–2006 are forecasts.
Source: World Bank.

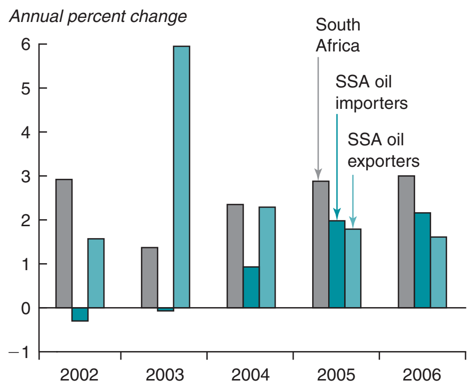
GDP terms of trade loss, as the negative income effect of elevated oil prices more than offset the positive effect of higher agricultural and metal prices (figure A11).

Political and natural developments continue to play a large role in the region. The strong increase in growth in Ethiopia (to 6.2 percent in 2004) owes much to improved weather conditions, although structural reforms have also played a role. Similarly, an end to the drought reinforced the upswing in Malawi and Rwanda. More stable political conditions in Burundi, the Central African Republic, and Madagascar have improved investment prospects and consumer confidence, allowing normal economic activity and growth to resume. Reduced tensions in the Democratic Republic of Congo have contributed to a better economic performance there, although in some parts of the country, insecurity continues to prevent economic development. Insecurity and political uncertainty are also impeding economic progress in Côte d'Ivoire and Zimbabwe.

Sub-Saharan Africa GDP growth is projected to accelerate in 2005 and 2006, rising to 3.7 percent by 2006. The easing of oil prices and tight capacity constraints are expected to force a slowing in the pace of output among oil exporters. Nevertheless, given still high incomes and robust domestic demand, their annual growth should exceed 3.5 percent. As the effects of the depreciation wane, growth in South Africa should accelerate, reaching 3.3 percent in 2006. Partly in response to stronger South African growth, activity in other oil-importing countries is also projected to accelerate somewhat, reaching 4.3 percent in 2006. While the difference in growth rates from 2004 is small (1.3 percentage points), it represents a doubling in the rate of increase of real per capita incomes, or a doubling in the speed of poverty reduction (figure A12). Overall inflation is expected to remain broadly stable. The easing of oil prices should improve the current account position of oil importers and reduce the surplus among exporters.

The pace and fragility of growth in the region remains a serious challenge. While potential growth rates in the Sub-Saharan Region have increased markedly since the 1980s and 1990s, the economies of the region remain vulnerable to bad weather, disease, and political turmoil. Such disruptions form an important and regular feature in the economic life of countries in the region. In such an environment, especially given the highly indebted nature of some of these countries, budgetary

Figure A12 Per capita GDP growth



Source: World Bank.

policy should be based on prudent macroeconomic assumptions. Allowing for such contingencies in budgetary plans would not only help prevent disruptive swings in program spending, it would also help prevent spending from following a pro-cyclical path.

In the long run, per capita GDP is projected to grow by about 1.6 percent per annum, in contrast to the falling incomes that characterized the 1980s and 1990s. Sadly, even such sustained and historically strong growth represents barely half of what is needed to meet the region's Millennium Development Goals by 2015. Moreover, the rest of the developing world is projected to grow more quickly. As a result, notwithstanding an expectation of significant improvements in living standards, Sub-Saharan Africa can be expected to continue falling behind rather than catching up.

Recent improvements in economic performance reflect significant progress in terms of macroeconomic management and development of social and physical infrastructure within the region. In this regard, the highly indebted poor country initiative should help free up resources, which, if directed toward such policies, could help improve prospects for these countries. However, further progress in implementing reforms will be essential if the region is to reach or exceed this projected growth performance, especially given the formidable obstacles faced by the region: a pattern of disruptive civil strife, repeated natural disasters, the limited quantity and quality of infrastructure and human capital, and especially the HIV/AIDS epidemic. In the past, these have been major factors underlying poor performance. Per capita income levels fell substantially in conflict zones during the 1980s and 1990s, while HIV/AIDS has ravaged the population of many African countries. And high mortality and invalidity rates among working-age adults are important factors holding back growth.

Notes

1. A $10/bbl rise in crude oil price is estimated to increase net oil revenues in the geographic region by $60 billion. For oil exporters this amounts to 8.7 percent of 2004 GDP; for the region's net oil importers, the same price hike increases their oil import bill by $1.1 billion or 1.2 percent of GDP.

2. This price refers to an unweighted average of the prices of West Texas Intermediate, Brent, and Dubai crude oils.

3. See the MENA Development Report series, which examines topics of importance to the region: trade and investment, governance, gender, and employment (World Bank 2003).