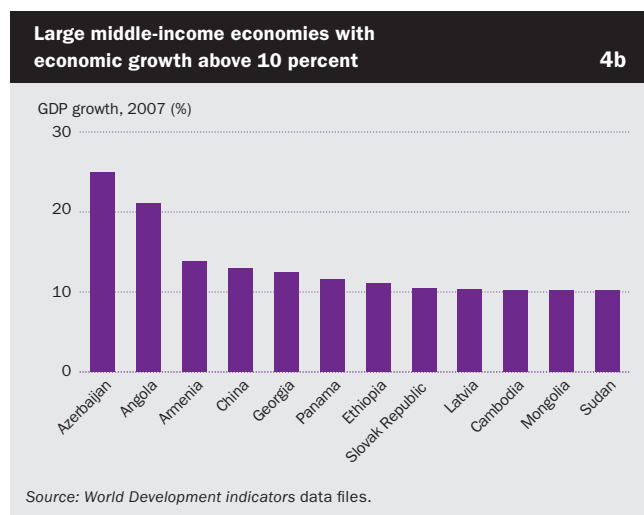
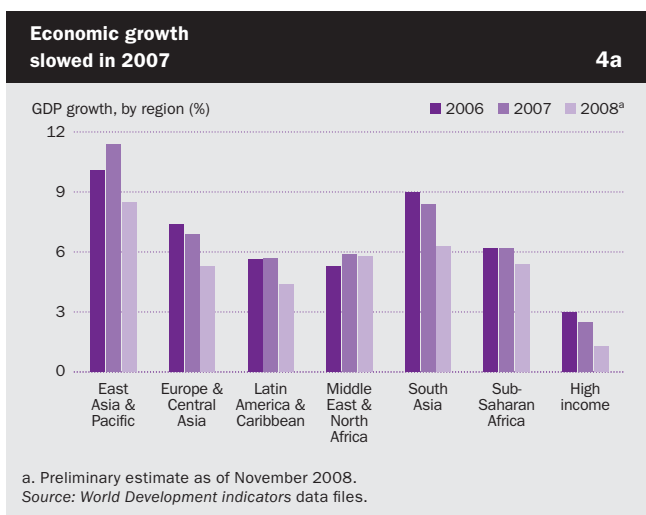


**ECONOMY**

## The global economy in 2007

Global output grew 3.8 percent in 2007, receding slightly from 4 percent in 2006. The downturn was greatest in high-income economies, where growth fell from 3 percent to 2.5 percent, affected by the cooling of the housing market, a precursor to the 2008 financial crisis. Low- and middle-income economies, which have grown faster on average, reached a peak of 8.1 percent annual growth in 2007. Their strong performance was led by the economies of East Asia and Pacific and South Asia (figure 4a), dominated by China at 13 percent annual growth and India at 9 percent. After a decade of sustained growth India's gross national income (GNI) per capita (using the *World Bank Atlas* method) now places it with China among the lower middle-income economies. Cambodia, Lao PDR, Malaysia, Mongolia, the Philippines, and Vietnam in East Asia and Pacific all grew faster than 6 percent, as did all South Asian economies except Afghanistan and Nepal (figure 4b).

Sub-Saharan Africa achieved 6.2 percent growth for the second year in a row, thanks to higher prices for its oil and commodity exports. The commodity boom also helped the Middle East and North Africa and Latin America and the Caribbean achieve their highest growth rate since 2004. Egypt, Iran, Jordan, Libya, Syria, and Tunisia grew more than 6 percent. About half the countries in Latin America and the Caribbean grew more than 6 percent, with Argentina at 9 percent and Venezuela at 8 percent. Similarly, 28 of the 47 Sub-Saharan countries grew 5 percent or more. Growth slowed in Europe and Central Asia, but annual rates remained above 5 percent, except for Moldova.



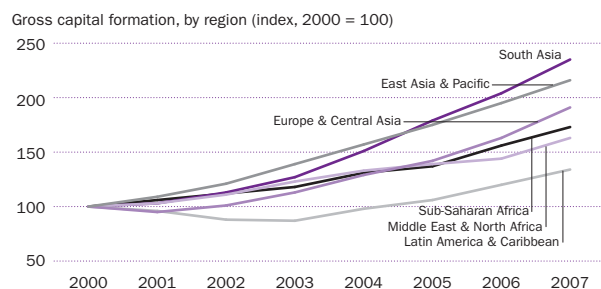
## Savings and investment were higher in 2007

The rapid growth of developing economies since 2000 has been marked by large increases in investment (figure 4c). Between 2000 and 2007 investment rates rose from 32 percent of gross domestic product (GDP) to 38 percent in East Asia and Pacific and from 23 percent to 34 percent in South Asia. Investment in China, India, Lao PDR, Mongolia, and Vietnam exceeded 37 percent of GDP during 2005–07. Sub-Saharan Africa saw its investment grow 73 percent, Europe and Central Asia 91 percent, and the Middle East and North Africa 63 percent. At 34 percent, investment growth in Latin America and the Caribbean was not as rapid.

Most of the increase was financed by rising savings. Annual gross savings in developing economies grew from 25 percent of GDP to 31 percent between 2000 and 2007. East Asia and Pacific saw the largest increase, from 36 percent of GDP to 47 percent, followed by South Asia, from 25 percent to 34 percent (figure 4d). Countries enjoying a surge in demand for their exports of fuels, other commodities, or manufactures—such as Algeria, Azerbaijan, Botswana, China, Gabon, Iran, and Mongolia—saved more than 40 percent of their GDP during 2005–07.

### Asian countries invested more

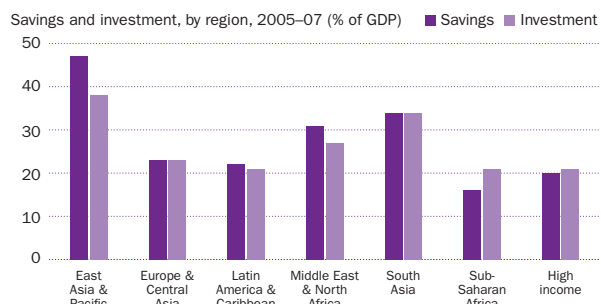
4c



Source: World Development Indicators data files.

### East Asia and Pacific is the largest saver

4d



Source: World Development Indicators data files.

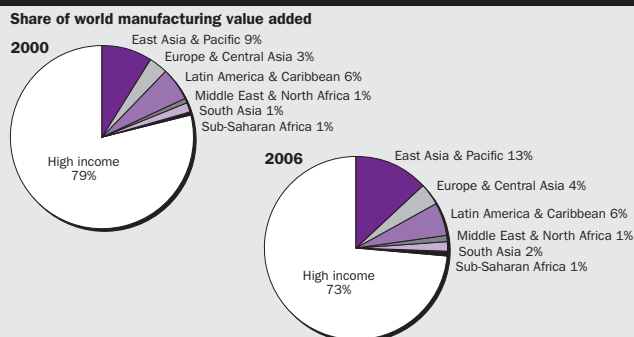
## High-income economies still dominate manufactured output and exports

During their industrial revolutions today's developed economies transformed themselves from agrarian economies into producers and exporters of manufactured goods. Manufacturing has yet to take off in most developing economies. Value added in manufacturing accounted for as much as 20 percent of GDP in only about a dozen developing countries in 2007, among them China, Indonesia, Lao PDR, Philippines, and Vietnam. China's share was 32 percent. Some developing economies have been investing in and expanding their services, which in 38 countries accounted for more than 50 percent of GDP, among them Bangladesh, India, Pakistan, and Sri Lanka. Resource extraction remains important for many countries: minerals and petroleum were the leading sources of growth in many Sub-Saharan, and Middle Eastern and North African economies.

Services are now the largest sector in high-income economies, accounting for more than 70 percent of GDP. Although their manufacturing share has fallen, they still accounted for 73 percent of global manufactured output in 2006, down from 79 percent in 2000 (figure 4e). They also accounted for the largest share of manufactures exports (figure 4f). East Asia and Pacific made the largest inroads, improving its share of global manufactured output by 4 percentage points, from 9 percent to 13 percent.

### High-income economies still produce the largest share of manufactured goods . . .

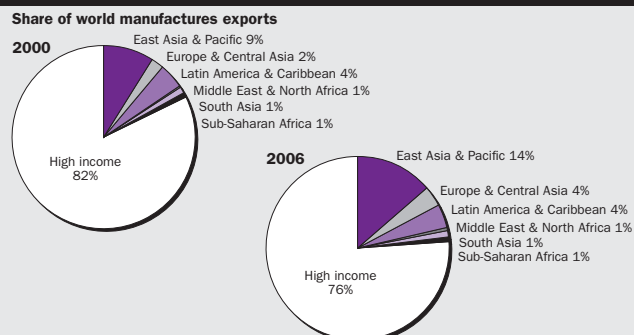
4e



Source: World Development Indicators data files.

### . . . And account for the largest share of manufactures exports

4f



Source: World Development Indicators data files.

## Macroeconomic stability and fiscal space

Macroeconomic stability is good for economic growth. Despite concerns that strict fiscal and monetary policies were preventing countries from pursuing aggressive antipoverty programs and progressing toward the Millennium Development Goals, most developing economies have reduced their fiscal deficits, controlled inflation, and kept real interest rates low.

In periods of rapid growth monetary policy is crucial in maintaining macroeconomic stability. But in a deep recession it has limitations because interest rates cannot go below zero.

The current financial crisis has renewed interest in fiscal policy to stimulate economic growth. Discretionary fiscal spending is possible when a country has “fiscal space,” the difference between current government spending and the maximum spending a government can undertake without jeopardizing its fiscal solvency—that is, without jeopardizing its current and future ability to service its debt. Indicators that assess fiscal space include the ratios of public debt to GDP, external debt to GDP, and fiscal balance to GDP. The ratio of the current account balance to GDP and of private capital flows excluding foreign direct investment to GDP are also relevant to determining the extent of fiscal space.

Fiscal space can be created without issuing new debt, through improved efficiency and public expenditure, increased revenue mobilization, and additional grant aid. But some

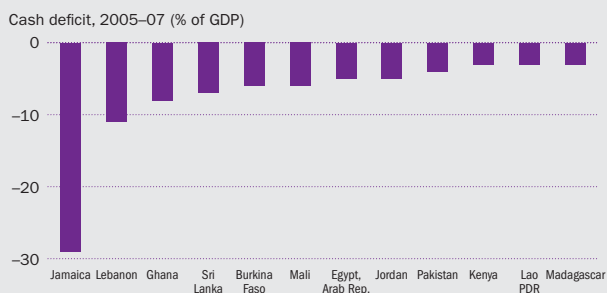
countries may also be able to undertake fiscal stimulus programs by taking on additional debt within the available fiscal space. Among large economies with data for 2005–07, 34 had a cash surplus and 16 had a cash deficit greater than 2 percent and 12 developing economies had a deficit greater than 3 percent (figure 4g). In 2007, five developing economies had a public debt to GDP ratio greater than 60 percent (figure 4h).

Maintaining fiscal solvency is one aspect of fiscal policy. A second is macroeconomic stability. The ability to increase public spending while maintaining macroeconomic stability has been referred to as having “macroeconomic space.”

High inflation limits the possibility of fiscal expansion. Rapid growth, supply constraints, and rising demand for commodities by developed and developing economies boosted prices globally, and inflation rose modestly in many countries (figure 4i), even as the highest rates were being brought under control.

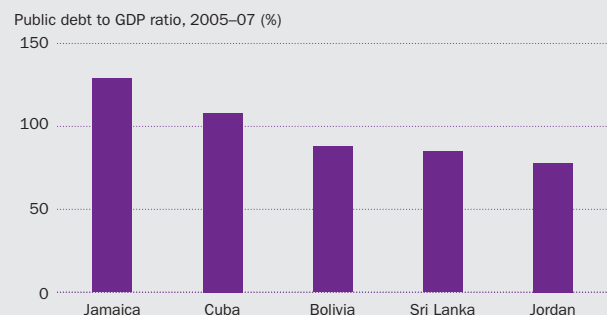
Some countries responded by raising interest rates between 2005 and 2007, but real interest rates continued to fall in many others (figure 4j). Now, faced with a crisis that began in the United States in 2007 and spread to other economies in 2008, developing economies will face difficult policy choices as they continue to grow while maintaining a stable—and sustainable—fiscal stance.

**Twelve developing economies had a cash deficit greater than 3 percent of GDP** 4g



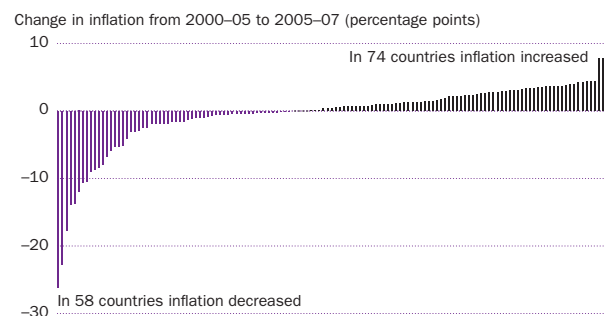
Source: World Development Indicators data files.

**Five developing economies had a public debt to GDP ratio greater than 60 percent over 2005–07** 4h



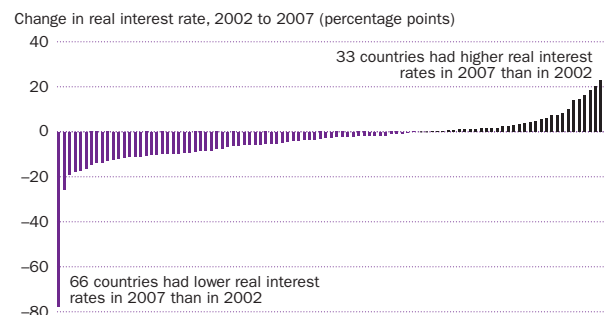
Source: World Development Indicators data files.

**Modest inflationary pressure affected 74 countries** 4i



Source: International Monetary Fund and World Development Indicators data files.

**Real interest rates declined in 66 countries** 4j



Source: International Monetary Fund and World Development Indicators data files.

## Growth in GDP and investment

Quarterly data for selected major economies in each of the six developing regions show that the 2008 global crisis has affected countries differently (figure 4k–4p). In Brazil GDP rose slightly in 2008 over 2007. In China and India GDP growth has declined but remains above 7 percent. The GDP growth rate fell significantly in the Russian Federation in the fourth quarter of 2008, to 1.1 percent. South Africa and Egypt saw their GDP growth rates decline rapidly in the second half of 2008. However, overall GDP growth remained positive in all six countries.

## Growth in industrial production

In the current global crisis growth in the industrial sector, particularly the manufacturing sector, has fallen sharply. The large developing economies shown here, with the exception of China, saw their industrial production fall into the negative range by the end of 2008 (figures 4q–4v). Even China saw a large decline in its industrial output due to falling demand.

## Lending and inflation rates

Countries need macroeconomic space to pursue monetary policies to stimulate their economies. But many countries are still experiencing double-digit inflation despite cooling economies (figure 4w–4bb). Egypt has a high inflation rate. But China's lending rate and inflation rate are both below 10 percent.

## Central government debt

With monetary policy limited in scope during the current crisis, countries are looking to fiscal policy to lift them out of the economic crisis (figures 4cc–4hh). China seems to have the fiscal space to afford a large stimulus package. Brazil and India have a more constrained fiscal environment, limiting the actions they can take without affecting fiscal solvency. For the Russian Federation the falling price of oil and the depreciation of the ruble may also limit the scope for fiscal policy.

