
Appendix 1

Regional Economic Prospects

East Asia and Pacific

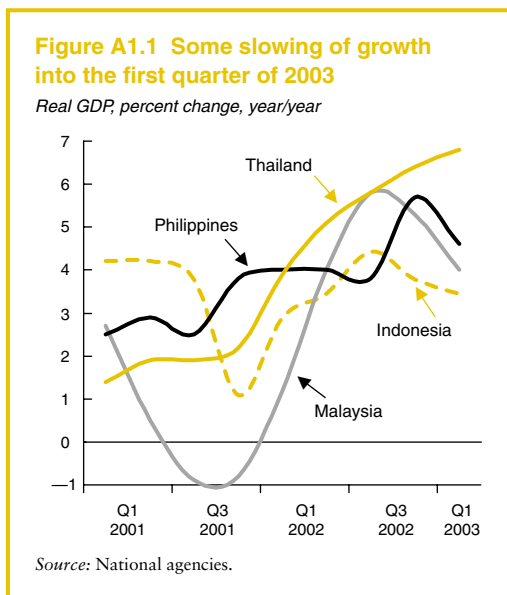
Recent developments

THE YEAR 2002 was one of solid recovery in much of East Asia. GDP growth in developing East Asia rose from 5.5 percent in 2001 to 6.7 percent in 2002. However, the renewed economic slowdown in the developed world, relatively high oil prices in the first part of 2003, and the SARS outbreak in the region, dampened the pace of the regional recovery in the first half of 2003. However, East Asian growth is expected to rebound progressively, as economies get beyond the short-run impact of SARS, oil prices wane, and global growth revives.

A smart rebound in exports was one important driver in the regional recovery in 2002—regional exports rose nearly 14 percent in dollar terms, after having been flat in 2001 as a result of the global slowdown and the deep recession in world high-tech demand. Intraregional exports were especially strong, in particular to China, which is emerging as a major hub for regional production and trade networks. Robust household consumption provided further support for the recovery, and, in several cases, the year saw the start of a stronger trend in fixed investment as well. But the regional picture was not uniformly upbeat, with more modest growth rates, or even continued outright recession in some of the smaller or lower-income economies.

As has been the case for some years, growth in 2002 was strongest in the transition economies, China and Vietnam, where sustained strength in exports, consumption, and investment pushed 2002 GDP growth to 8 percent and 7 percent, respectively. But growth also strengthened in several of the countries that had been hardest hit by 2001's fall in world-trade growth and high-tech demand, exceeding 6 percent in Korea, 5 percent in Thailand, and 4 percent in both Malaysia and the Philippines. Prompt policy action helped mute the impact of the Bali terrorist attack on Indonesia's economy, which nevertheless managed only 3–4 percent growth for a second year. Overall, the robust performance supported continued reductions in poverty.

The strong growth momentum of 2002 became more diffused in the first quarter of 2003, continuing in some countries, waning in others, and falling sharply in yet others. The strongest performances were in China and Thailand, where year-on-year first-quarter growth reached 9.9 percent and 6.7 percent, respectively, supported by both domestic demand and export growth. First-quarter growth was 4.5 percent in the Philippines—at the higher end of expectations. However, some signs of a downshift were already emerging in Malaysia, where first-quarter growth dipped to 4 percent from over 5 percent in the latter part of 2002, while in Indonesia growth continued at a modest 3.4 percent pace (figure A1.1).



Second-quarter data for China, at 6.7 percent growth, shows the domestic effects of SARS quite clearly. An increased deceleration was observed in the high-income or newly industrializing economies (NIEs) of the region. GDP in the first quarter fell by 1–2 percent in Korea and Hong Kong (at a quarter-on-quarter seasonally adjusted annual rate), while it rose at only 0.7 percent in Singapore (on the same basis). In Korea, policy efforts to restrict excessive growth in consumer borrowing and the impact of security concerns with regard to North Korea, contributed to a fall in consumer spending and machinery and equipment investment. Exports also slowed from the end of 2002, though they increased strongly year-on-year in dollar terms. The weaker trends in GDP growth and trade for the NIEs continued into the second quarter.

Among the factors contributing to slower East Asian growth in 2003 was the downturn in growth in most parts of the developed world in the last quarter of 2002 and early 2003. The still hesitant and uncertain pace of recovery in the global high-tech industry, to which East Asia is a key supplier, has been another factor affecting exports. World semiconductor sales, which had slumped 31 percent in 2001, inched

forward by about 1 percent in dollar terms for 2002 as a whole, despite a strong rebound on a quarter-to-quarter basis during much of 2002. However, global semiconductor sales peaked in the three months prior to November 2002, and trended lower in December and early 2003. These erratic developments in global and sectoral demand have had some impact in slowing East Asian export growth in the first part of 2003. Exports for East Asia as a whole started the year strongly, up 20 percent over year ago (oya) in the first quarter in dollar terms, but by April–May dollar export growth rates had slowed to below 10 percent in the majority of cases, or even below 5 percent in some. China and Thailand were the only countries where dollar exports continued to grow at rates of over 30 percent and 20 percent, respectively.

The World Health Organization's March alert about SARS sparked extraordinary public concern throughout East Asia and around the world. The number of cases worldwide rose from very few in mid-March to 8,360 by the end of May (most of which were in China and Hong Kong, with smaller numbers in Taiwan, China, and Singapore), and then leveled off at around 8,465 by mid-June, indicating that the outbreak had been brought under control, at least for the time being. Most of the economic impacts of the outbreak were the result of public perceptions and fears *about* the disease, and from precautions taken against it, rather than from the disease itself. The principal way SARS appears to spread is through droplet transmission, and so worst affected were service industries, which depend on face-to-face interaction between service providers and customers, especially tourism, and related sectors such as restaurants and hotels, retail sales, business travel, and transportation.

April tourist arrivals in Hong Kong and Singapore were down by 65–70 percent from year-earlier levels, for example, while passenger traffic in all Asia-Pacific air carriers fell by 45 percent in that month. With fears about SARS being at their height in April and May, before easing substantially in June, the economic im-

pacts will likely be concentrated in the second quarter, especially in economies with large tourism sectors, such as Hong Kong (China), Singapore, Thailand, and Malaysia. As noted, there was a significant impact in China, which had the largest number of SARS cases, though growth there is still expected to reach 7–8 percent for the year as a whole, because of the very strong momentum of the economy going into 2003, and the relatively small role of tourism.

Short-run outlook

Developing East Asian growth is expected to dip to around 6.1 percent in 2003 from 6.7 percent in 2002, before picking up pace in 2004 and later years. That is, the impacts of SARS and the global slowdown are expected to be modest. Several factors should support regional activity in the near term. For one thing, China is an increasingly important market for other East Asian countries, and continued growth there should provide some support for other East Asian economies' exports, despite the disruption caused by SARS. Chinese imports were still rising at a 30–40 percent year-on-year dollar rate in April–May.

Exports in several Southeast Asian countries have been boosted by higher prices for

agricultural primary commodities such as rice, rubber, palm oil, coconut products, and lumber from late 2001 on. International capital markets had been afflicted by high levels of volatility and risk aversion through much of 2002, but were showing intriguing signs of a turnaround late in 2002 and early 2003. Spreads on emerging market and high-yield corporate debt fell sharply, while flows to emerging market funds began to increase. Of course many East Asian countries already had achieved low spreads because of the dramatic increase in their foreign reserves and the large fall in their net foreign indebtedness in recent years. However, the improvement in general emerging market sentiment will be good news for countries such as the Philippines and Indonesia, which tend to face higher spreads because of their more precarious fiscal positions.

At the level of domestic policy, low inflation, a shift to greater exchange rate flexibility, and a marked improvement in external balance sheets have all enhanced the ability of central banks to implement supportive monetary policies in many East Asian countries. Real interest rates have fallen to historically low levels in recent years and this should provide an environment conducive to growth. Most regional stock

Table A1.1 East Asia and Pacific forecast summary

Growth rates/ratios (percent)	1991–2000	2001	2002	2003	2004	2005	2006–15
Real GDP growth	7.7	5.5	6.7	6.1	6.7	6.6	6.2
Consumption per capita	5.5	4.1	6.1	5.3	6.5	6.5	5.8
GDP per capita	6.4	4.5	5.8	5.2	5.8	5.7	5.4
population	1.2	0.9	0.9	0.9	0.9	0.8	0.8
Gross Domestic Investment/GDP ^a	28.8	30.5	33.0	33.7	34.4	35.2	30.4
Inflation ^b	6.8	2.6	3.3	3.7	4.6	2.8	
General gvt. budget balance/GDP	–0.9	–3.3	–3.4	–3.4	–3.2	–2.9	
Export Market Growth ^c	8.3	–2.2	3.9	6.9	8.2	8.1	
Export volume ^d	11.5	2.7	15.7	14.6	13.7	11.3	
Terms of trade/GDP ^e	–0.1	0.1	–0.1	0.6	–0.7	–1.1	
Current account/GDP	0.4	2.7	3.2	1.9	2.1	1.2	
<i>Memorandum items</i>							
East Asia excluding China	4.6	2.3	4.4	3.9	5.0	5.4	4.9

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

Source: World Bank baseline forecast July 2003.

markets rebounded quite sharply between late March (precisely when the SARS crisis was starting) and June, indicating that financial markets were looking beyond the near-term disruptions while currencies in most flexible exchange rate economies have also appreciated against the dollar. In several countries governments also felt able to undertake small programs of fiscal stimulus to bolster economic activity during the temporary SARS shock, in particular in Malaysia, Hong Kong, Singapore, and Korea.

Long-term outlook

The years since the 1997 financial crisis have been ones of extraordinary volatility and uncertainty in the world economy. East Asian economies have actually come through this period reasonably well. Simple average growth in the five crisis countries was 4.6 percent in 1999–2002, while including China and Vietnam it reached 5.1 percent. Contributing to this reasonably positive experience has been a broad array of efforts at policy reform—albeit often gradual and incomplete—accompanied by a gradual strengthening of domestic demand. Robust household consumer spending helped underpin growth during 2001's export slowdown, and it also continued to bolster the regional recovery through much of 2002. Efforts to recapitalize and restructure the financial sector have been successful enough for banks to foster the emergence of new consumer credit markets, a positive development from a long-run standpoint, although bank management and regulators will need to ensure it does not become a source of vulnerability.

Investment spending has been strong in China and Vietnam, but in general it has remained erratic and, on the whole, still relatively weak in the crisis countries. But even here, there were some signs of an emerging pickup in 2002, for example in housing construction. A number of factors should support a stronger investment revival in due course, including continued domestic economic growth, improvement in corporate profitability and reduction in corporate indebtedness, the running

down of overcapacity, and continued macroeconomic stability. And structural and institutional reform efforts to improve the investment climate will also be important. These include reducing barriers to foreign direct investment in services; strengthening infrastructure and the provision of other public services important for business; and improving the regulatory, legal, and judicial frameworks. Also important will be continued financial and corporate sector restructuring and reform, including reforms to improve financial supervision and regulation, and strengthen corporate governance.

While some governments have undertaken counter-cyclical fiscal policies in 2003, given the significant public debt built up after the crisis, policy attention in the medium term is becoming more focused on the need for fiscal consolidation, and also, to some extent, on better addressing the risks of implicit or contingent liabilities. Looking forward, there is scope to focus on better public administration and financial accountability, improve public service delivery, and address questions of governance more broadly—that is, to provide growing volumes of critical public goods while maintaining sound fiscal positions. Developing East Asia is expected to achieve per capita growth of close to 5.5 percent in the medium to longer term, given continued steady efforts to improve structural policies and the quality of institutions.

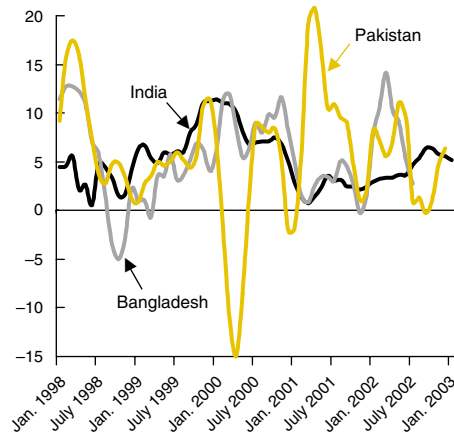
South Asia

Recent developments

GDP GROWTH in the South Asia region declined to 4.2 percent in 2002 from 4.9 percent in 2001, a downward revision from our previous estimate of an acceleration of growth as published in *Global Development Finance—2003*. The slowdown largely reflects adverse weather conditions and a decline in agricultural output in India, Nepal, and near stagnation in Bangladesh. Additionally, Nepal experienced a plunge in

Figure A1.2 Industrial production in selected South Asian countries

3-month moving average, percentage change, year/year



Source: National agencies.

tourism receipts and a sharp decline in manufacturing output, as the domestic insurgency intensified. Pakistan and Sri Lanka both enjoyed a rise in growth rates in 2002 over 2001, because of strong government consumption in Pakistan and a recovery in the services sector—along with improved political stability tied to progress on peace talks and a yearlong cease-fire—in Sri Lanka.

Industrial production in the main economies continued to register gains of 5–10 percent entering 2003 (figure A1.2). Driven largely by a recovery in India's exports, export volume growth accelerated for the region on average—despite sluggish external demand—thus reducing the region's net trade deficit. Current account balances in the two largest economies, India and Pakistan, posted surpluses, and the region's aggregate external balance strengthened. But exports from Nepal declined significantly, because of weak external demand and heightened competition.

A number of regional economies experienced a significant increase in remittances during 2002 over 2001, notably Bangladesh, India, Nepal, Pakistan, and Sri Lanka. In Bangladesh, the reported increase in inflows

of remittances is a reflection of incentives introduced by the government to channel remittances through official sources. In Pakistan and Sri Lanka, increases in remittances are largely attributed to the improvements in their domestic security situations and to progress in macroeconomic stabilization. High interest rate differentials in India may have contributed to a rise in banking transfers there. While net FDI inflows to Pakistan rose markedly in 2002, attracted by increased macroeconomic stabilization and progress in reforms, net inflows to India declined. In Bangladesh, FDI inflows fell by over 60 percent, mainly reflecting the determination of an absence of export markets (gas exploration) and the lack of progress in reforms of the infrastructure sector, such as in ports, power, and telecommunications.

India's and Pakistan's nominal exchange rates appreciated relative to the U.S. dollar during 2002, while the exchange rates of Bangladesh and Sri Lanka remained relatively flat. Nepal's exchange rate is pegged to the Indian rupee. Throughout much of South Asia, inflation remained broadly stable, as feed-through effects of higher oil prices were offset by easing price pressures tied to generally weaker domestic demand conditions. In Sri Lanka, inflationary pressures were reduced from 2001, but remained close to 10 percent on average in 2002.

There was some progress in the consolidation of persistent fiscal deficits, which are prevalent throughout the region (in large part because of weak revenue collection). By containing outlays and raising revenues, Bangladesh reduced its budget deficit to 4.7 percent of GDP in 2002 from just below 6 percent of GDP in 2001. It improved its financing profile by reducing its reliance on more expensive domestic financial markets and increasing its reliance on external financing sources. Sri Lanka also achieved a two-point reduction in its budget deficit, from 10.8 percent of GDP in 2001 to 8.8 percent in 2002, and was able to shift the composition of its financing to longer-term instruments. Pakistan brought its underlying

budget deficit down slightly to 5.1 percent of GDP. India's general government fiscal deficit was little changed from 11 percent of GDP (including both central and state deficits), despite increased revenue collection.

Near-term outlook

Growth is forecast to accelerate throughout the region in 2003, up to an average of 5.4 percent, assuming a return to trend agricultural production, a recovery in external demand, and continued improvements in political stability and regional security. Domestic demand, especially private consumption and fixed investment, is expected to accelerate, spurred by recovery in agricultural incomes. Growth in government spending is expected to accelerate less strongly. A projection of higher growth in India underpins this forecast, as it represents nearly 80 percent of the region's aggregate GDP. Aside from a recovery in agricultural output, growth in India is likely to be supported by continued strong expansion in the services sector especially in information technologies now burgeoning in the Bangalore area. A continued recovery in Pakistan's gross fixed investment rates, coupled

with a forecasted acceleration of private consumption growth, is projected to support growth in 2003. With higher domestic demand, import volume growth is forecast to accelerate on aggregate for the region in 2003, leading to a narrowing of the current account surplus.

Medium-term prospects

South Asian growth is expected to maintain an average of close to 5.4 percent over the medium term, assuming normal weather conditions—leading to recovery and acceleration of agricultural output—and a continued recovery in external demand. Declining oil prices, both in nominal and real terms, should reduce pressures on current account balances for the region, which is overwhelmingly a net energy importer. India should benefit from a recovery in domestic demand (particularly in the manufacturing sector) and firming export volume growth. Bangladesh is expected to witness strengthening domestic demand and recovering exports, and on the supply side, a strong performance of SMEs and export-oriented manufacturing units (provided proposed structural reforms are carried out). Both Pak-

Table A1.2 South Asia forecast summary

Growth rates/ratios (percent)	1991–2000	2001	2002	2003	2004	2005	2006–15
Real GDP growth	5.2	4.9	4.2	5.4	5.4	5.4	5.4
Consumption per capita	2.0	3.5	1.5	2.9	3.3	3.5	3.3
GDP per capita	3.3	3.1	2.5	3.7	3.7	3.8	4.1
population	1.9	1.7	1.7	1.6	1.6	1.5	1.3
Gross Domestic Investment/GDP ^a	21.3	22.0	22.8	22.7	22.5	22.3	25.0
Inflation ^b	7.8	3.0	1.8	5.1	5.8	4.7	
General gvt. budget balance/GDP	-10.5	-8.3	-9.8	-9.7	-9.3	-8.5	
Export Market Growth ^c	7.7	0.2	2.9	6.0	7.5	7.3	
Export volume ^d	11.5	9.1	3.5	5.9	7.4	8.0	
Terms of trade/GDP ^e	-0.1	0.0	0.5	0.7	0.4	0.1	
Current account/GDP	-1.5	-0.5	0.5	0.4	0.2	-0.1	
<i>Memorandum items</i>							
GDP growth: South Asia excluding India	4.4	3.2	3.6	4.8	5.3	5.6	5.2

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

Source: World Bank baseline forecast July 2003.

istan and Sri Lanka are projected to benefit from continued macroeconomic stability and an associated acceleration of growth. The peace process is expected to yield significant economic gains in Sri Lanka. Similarly, Nepal is likely to experience strengthening growth, assuming continued improvement in the security situation there, with a recovery in domestic demand, exports, and in tourism receipts. Further, recent steps toward improving relations between India and Pakistan may lead to greater stability in the sub-region, paving the way for increased business confidence and stability. Throughout the region, growth should be underpinned by continued firm expansion in services and industrial production.

Recovery in external demand and a gradual return to lower oil prices is likely to be more than offset by generally firming import demand, which is expected to lead to a moderate decrease in the region's aggregate current account surplus to an average balance near zero as a share of GDP over the medium term (2004–05). At the individual country level, India and Pakistan's projected current account surpluses are expected to roughly balance the projected deficits in Bangladesh, Nepal, and Sri Lanka.

The fiscal positions of the South Asian economies are forecast to improve moderately, assuming some progress in raising budget revenues and in the management of government expenditures. Inflation is projected to increase somewhat, albeit still at generally moderate levels, because of the assumed pick-up in growth and assumptions of a more accommodative monetary stance in a number of countries, though falling oil prices are expected to partially offset these factors.

Long-term outlook

Long-term growth in South Asia is forecast to average about 5.4 percent, in line with the GEP 2003 growth forecast. 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, not least of which is a larger contribution to 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 as birth rates are expected to decline at faster rates. Lower population growth in the coming decade, along with the forecast growth rates, implies that per capita GDP growth will be close to 4.0 percent per year.

Risks

There are a number of risks to the forecast. Persistent fiscal deficits continue to be a risk in a number of the region's economies, India in particular, as they can undermine fiscal sustainability, contribute to a growing debt-to-GDP ratio, and lead to higher interest rates, thereby crowding out private investment and diverging public outlays from investment to interest payments and limiting the scope for both fiscal and monetary policies. Fiscal consolidation is required, which would not only mitigate such vulnerabilities, but also provide for broader scope of action in macroeconomic policies to pursue sustained higher growth. The forthcoming phase-out of the Multi-Fibre Arrangement (MFA) in 2005 will imply greater competition for the region's textile exporters. While India and Pakistan appear to be gearing up for the impending increase in competition, the impact of the MFA phase-out on other South Asian regional economies is more uncertain, particularly in Bangladesh, Nepal, and Sri Lanka (where garment exports represent about 75 percent, 25 percent, and just over 50 percent of total merchandise exports, respectively). Given the importance of the agricultural sector to the region, the threat of

severe weather conditions and associated poor harvests remain a significant risk to growth outcomes. Political risks and uncertainties also remain a concern, because of both internal and external factors. Heightened domestic and regional instability could undermine growth prospects and slow the pace of economic reforms. Remittances could be affected by increased instability in the Middle East. And significantly higher-than-forecast energy prices would pose an additional burden on current account positions.

Latin America and the Caribbean

Recent developments

The Latin American region has begun to recover from last year's recession. The upturn this year reflects the tentative recovery in Argentina and Uruguay as well as calming of pre-election jitters in Brazil at the end of 2002. As a result, regional growth in 2003 is projected to reach 1.8 percent, compared to last year's contraction of 0.8 percent. Although the region is on a favorable recovery path, its growth rate remains well below potential and below that of other regions. In addition to Argentina and Uruguay, Chile, Mexico, Colombia, and Brazil, countries with generally stronger policy frameworks, registered a somewhat improved growth performance.

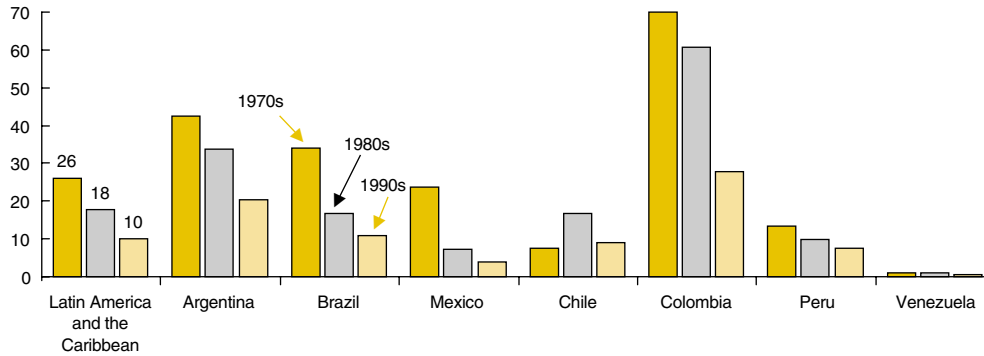
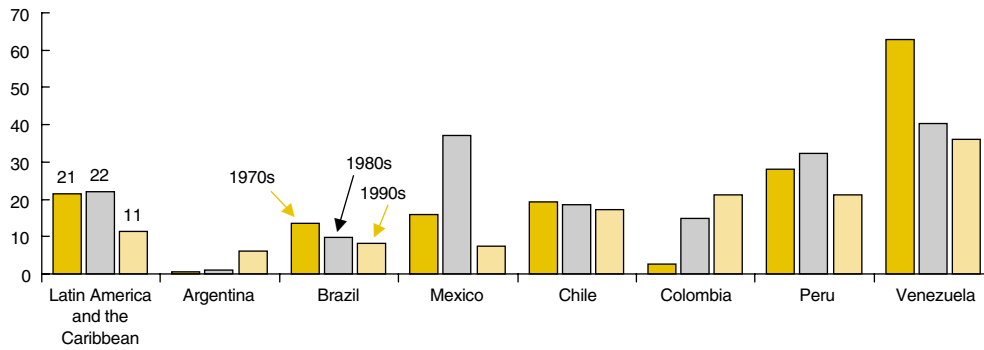
The fact that the 2002 recession was relatively short reflects both domestic structural policy, renewed confidence, and external factors. Domestic macropolicies have improved significantly: the region managed to reduce inflation to single-digit figures (for 2003–Q1, the regional inflation rate was 8.3 percent), proving that the commitment of central banks to low inflation is, although not universal, quite widespread across the region. Similarly, balanced fiscal policies have been applied and the expected 2003 regional public deficit should be about 2 percent of GDP. For example, the new president of Brazil has reiterated the country's commitment to balanced

macropolicies, and this has rapidly thwarted negative expectations for the future.

A second domestic factor explaining the region's enhanced resilience to crisis is found in the substitution of inward-oriented development policies (through the maintenance of high trade barriers and other perverse price incentives) by more liberal trade and market-friendly policies. This shift has helped the economies to diversify and has broadened the regional export base while diminishing its dependency on a narrow set of commodity prices. As shown in figure A1.3a, during the 1970s, exports of agricultural products, oil and other natural resources for the region as a whole, accounted for about one-quarter and one-fifth, respectively, of total exports; two decades later, both sectors accounted for about one-tenth of total exports, and manufacturing has become an important source of foreign exchange.

Additional important elements contributing to the success of this outward-oriented development strategy have been the NAFTA agreement—that directly benefited Mexico, but generated spillovers to other countries—and increased intraregional integration. Indeed, the revamping of *Mercosur* and other sub-regional integration arrangements are being discussed in Latin America, together with the plans for a hemispheric free-trade area. Chile and Mexico suffered least from the 2001–2 economic downturn, thanks to their effective integration in the global economy and good macroeconomic policies. Chile recently signed an FTA with the United States that is anticipated to be ratified by the two governments by end-2003, and become operational in 2004: the FTA grants free access to 87 percent of Chilean exports to U.S. markets.

A final factor is the achievement of healthier current account positions. The Latin American region has witnessed a drop of more than 3.5 points in the ratio of the current account balance to GDP (from –4.4 percent in 1998 to –0.8 percent in 2002) resulting from a reduction of the region's borrowing needs and the

Figure A1.3a Sectoral export shares (selected countries)
Agriculture
Shares in percent of total exports

Oil and other natural resources
Shares in percent of total exports


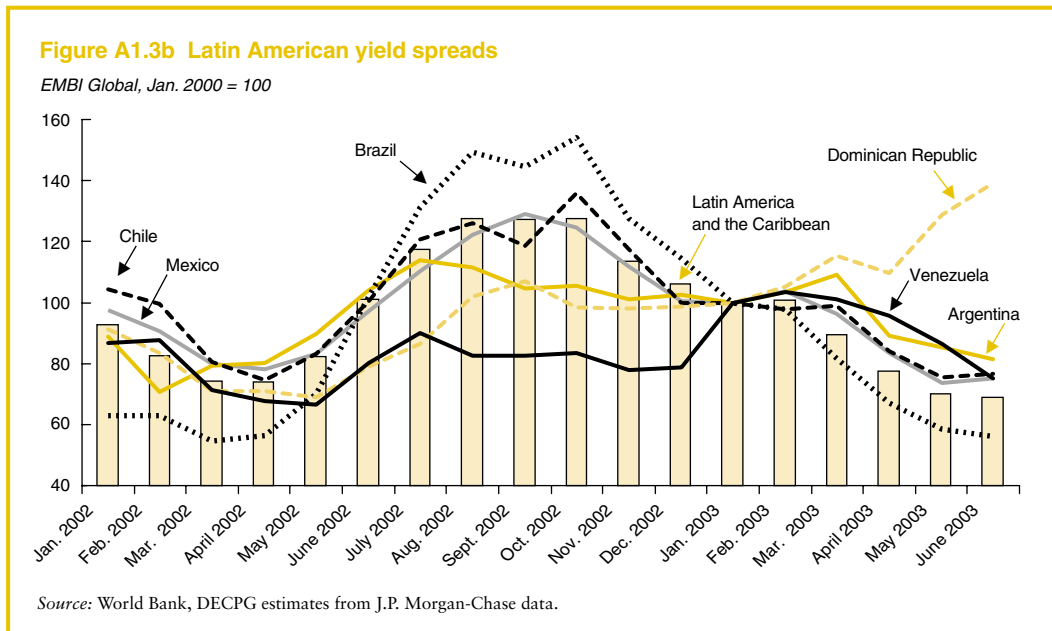
Source: World Bank, DECPG estimates from GTAP 5 databases.

reluctance of global investors to enter emerging markets. The adoption of more flexible exchange rate regimes is probably an important structural change. Anticipated increases in GDP growth are not expected to directly translate into large unsustainable current account deficits.

Despite the sluggish global economy, some specific improvements in the external environment are also contributing to recovery in the region. A weaker U.S. dollar is the first of these improvements: servicing the region's dollar-denominated external debt becomes less oner-

ous, net oil importers suffer less from oil price surges, and usually non-oil commodity prices surge with a falling dollar. Moreover, the weakening of the dollar against the euro should help manufacturing exporters with currencies following the dollar by raising the competitiveness of their goods in the euro zone and enabling their share of exports to the EU to rise.

The recent dramatic reduction of spreads on yields of foreign sovereign debt for the region is another favorable global financial development. The reduction in spreads—highlighted in figure A1.3b (in Brazil spreads narrowed from



a peak of 2,067 bp in October 2002 to 754 bp in April 2003, Mexican spreads have reached an all-time low, those of Peru and Colombia are at their lowest levels since 1998 and 2000, respectively)—has not yet been accompanied by large capital inflows. For Latin America, average monthly flows during the first half of 2003 registered \$5.3 billion, modestly above the \$4.3 billion average of the same period in 2002. In fact the bond price rally may be tied to an excess of global investors' demand for higher yield instruments over the supply of new issues by borrowers. However, it should be mentioned that Mexico has been quite active in international capital markets and that even Brazil has already been able to place issues twice this year.

Near-term outlook

Improving world trade growth coupled with increased OECD economic growth led by the United States should further boost the export-led recovery of Latin America in 2004–05. Also, by 2004, the region's largest economies will have surpassed the worst of their crises (Argentina and Uruguay) or potential for crises

(Brazil and Colombia) and, with some exceptions, all countries should experience a recovery of domestic demand and record positive rates of growth. The regional average growth rate should climb to 3.7 percent in 2004 and to 3.8 percent in 2005. Even if current account deficits increase in most of the expanding economies of the region, low world interest rates, lower perceived risks for Latin American assets (bonds, equities, or direct investments), the continuation of fiscal prudence in the region, and flexible exchange rates should maintain a cap on these incipient deficits. Even though the 2003 –0.5 percent ratio of current account deficit to GDP for the region is unlikely to be maintained, external deficit ratios are not foreseen anywhere near the 1995–99 average of more than 3 percent, but rather a modest –0.7 percent for 2004 and –1 percent for 2005.

Clearly some uncertainty remains, given that these projections assume that no (domestic or external) adverse development reverses the easing of financial pressure on the region's most vulnerable countries. High levels of debt still burden fiscal authorities and tight mone-

tary policies required to keep inflation under control may limit expansion. This is especially true for Brazil; however, thanks to its enhanced credibility, the central bank in this country may be able to ease its stance in the near future.

Furthermore, some country risks persist. Several challenges await Argentina: a) restructuring the banking system to reactivate credit (which is still contracting); b) replacing inefficient taxes, including on export and savings, with new efficient taxes; c) building a solid regulatory and institutional framework to protect property rights and deal with other governance issues; d) renegotiating public utilities tariffs that have been held well below the rate of inflation; and e) eventual restructuring of the defaulted debt. The Republica Bolivariana de Venezuela started to export oil again, but its political crisis is not over and macroeconomic instability, price controls, and other distortions need to be addressed. Recently, the government endorsed an Economic Stability agreement that pledges to make every effort to improve its external accounts by reestablishing the level of oil income and implementing the necessary adjustments to the currency control regime; however, previous similar attempts have failed.

The Caribbean countries, and this also applies to some small Central American countries, are still facing the difficult transition from being tropical agriculture export-oriented economies to becoming more diversified. Their preferential trade agreements are expiring or are severely eroded, and their successful attempts at diversifying toward tourism and financial services received a severe set-back in 2002 from which they have not yet recovered.

Long-term prospects

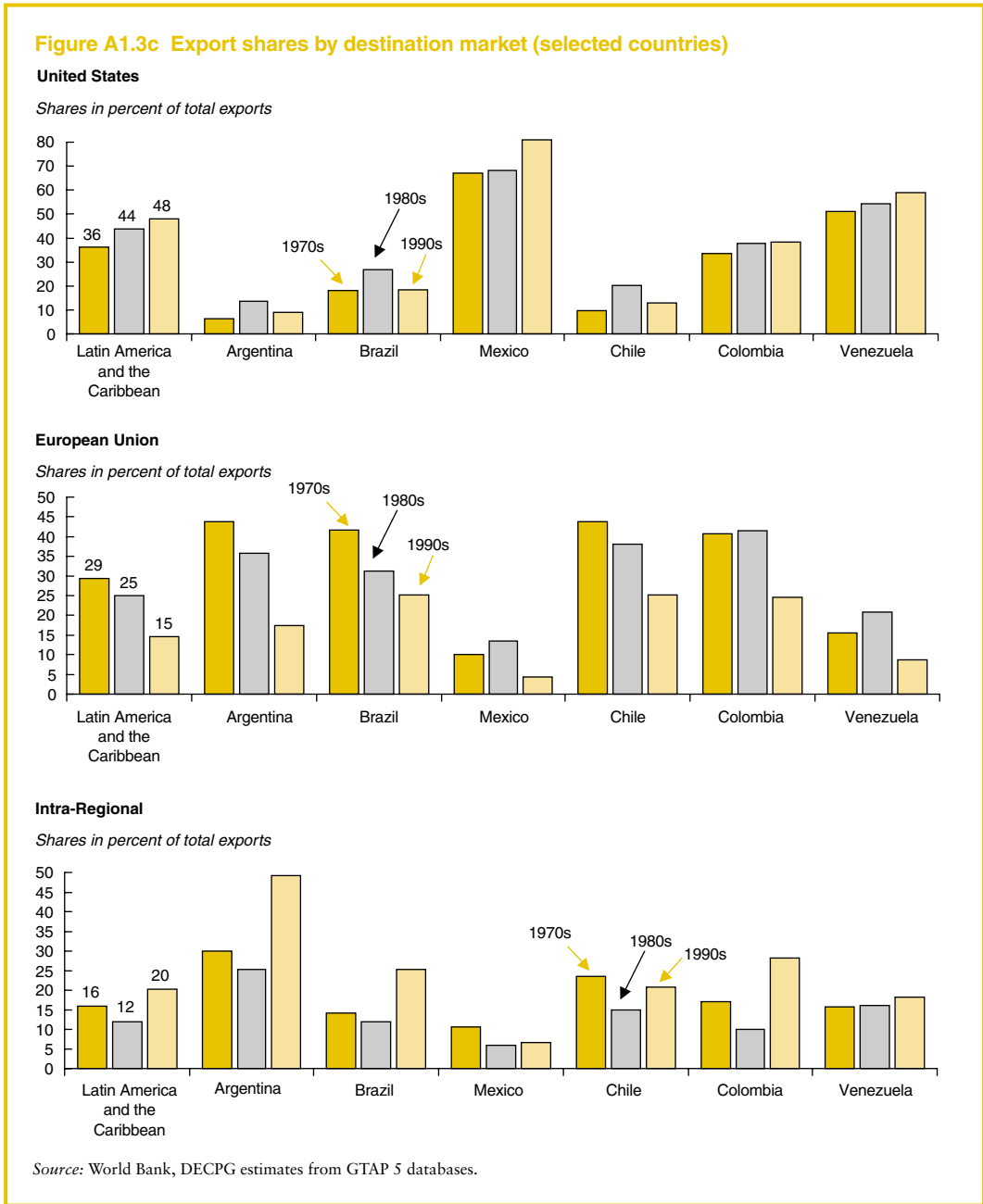
In the longer term, Latin American countries could achieve higher growth rates if they overcome several critical structural constraints (table A1.3). On the external front, a number of countries rely heavily on the United States

as a source of imports, as a destination for exports, and as a source of external finance. As shown in figure A1.3c, the United States has become the region's major export market destination, increasing from 36 percent of total exports in the 1970s to almost 50 percent in the 1990s.

Given the lackluster growth forecasts for the Euro zone, a stronger link to the United States may be considered positive; however, geographical diversification may reduce risks. In particular, European markets have lost importance for Latin American exporters and this may be corrected by pushing for more bilateral agreements and a more comprehensive lift of European restrictions to market access.

The rising share of intraregional trade is a positive sign and may help Latin American countries negotiate trade and other integration agreements as a block, vis-à-vis OECD countries. In fact, trade integration should be a priority among the long-term development policies—Latin America, compared to East Asia, shows much lower trade-to-GDP ratios—and deeper trade integration agreements bring additional benefits in terms of increased foreign investment and also boost credibility to sound macro policies.

On the internal front, some of the major impediments of the past, such as large fiscal imbalances and perverse price incentives, have been removed (though not consistently in all countries). However, smaller fiscal deficits have been obtained mainly through expenditure restraints, with potential long-term issues on infrastructure development and poverty eradication, and most countries still have relatively (with respect to more developed countries) low tax revenues to GDP ratios. Low tax revenues result from a strong reduction of international trade duties (in itself a positive development), inefficient collection, evasion, and other governance issues. Low revenues have been compensated by recurring to unstable non-tax revenues (oil royalties or other natural resources form of taxation, privatiza-



tion), generating a situation of inadequate and volatile government income.

In the long term, beyond macroeconomic stability and commitment to sound fiscal and monetary policies, LAC countries will have to tackle governance issues, attempt to correct a

skewed income distribution, and develop mature financial markets necessary to generate enough resources to become less dependent on foreign finance, allowing important investments in physical infrastructure and human capital to be financed domestically.

Table A1.3 Latin America and the Caribbean forecast summary

Growth rates/ratios (percent)	1991–2000	2001	2002	2003	2004	2005	2006–15
Real GDP growth	3.4	0.3	–0.8	1.8	3.7	3.8	3.8
Consumption per capita	2.4	–0.9	–3.5	–0.1	1.8	1.9	2.3
GDP per capita	1.7	–1.2	–2.3	0.4	2.3	2.5	2.5
population	1.7	1.6	1.5	1.4	1.4	1.3	1.2
Gross Domestic Investment ^a	19.8	19.1	18.0	17.6	18.4	18.4	22.6
Inflation ^b	12.0	5.5	4.7	4.1	4.0	4.0	
General gvt. budget balance/GDP	–3.0	–1.8	–2.9	–2.0	–1.0	–0.6	
Export Market Growth ^c	9.4	–1.2	0.5	5.0	8.6	7.2	
Export volume ^d	8.7	1.0	2.2	9.2	11.2	10.2	
Terms of trade/GDP ^e	1.7	–0.2	0.1	–0.4	0.1	–0.7	
Current account/GDP	–2.7	–2.7	–0.8	–0.5	–0.7	–1.0	
<i>Memorandum items</i>							
GDP growth: LAC excluding							
Argentina	3.2	1.2	1.0	1.5	3.6	3.9	
Central America	4.4	1.5	1.9	2.4	3.1	3.8	
Caribbean	4.0	3.1	3.0	0.9	2.4	4.1	

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

Source: World Bank baseline forecast July 2003.

Eastern Europe and Central Asia

Recent developments

GDP IS NOW estimated to have expanded by 4.6 percent in 2002 for ECA, an upward revision from the 4.1 percent projected in the last forecast presented in *Global Development Finance 2003* (World Bank 2003). Growth prospects proved to be more resilient than previously anticipated, primarily because of the strength of domestic demand, which was more than able to offset lackluster growth in the region's main export markets. The firming of ECA regional economic growth in 2002—over the 2.2 percent growth posted in 2001—was driven by the huge 15 percentage point swing in Turkey's performance (from a contraction of 7.4 percent in 2001, following the financial crisis, to an upswing of 7.8 percent in 2002). The ECA average growth excluding Turkey registered a slowing to 3.9 percent in 2002, contrasted with 4.5 percent in 2001. This latter trend largely reflected the aggregate slowdown in the CIS region.

Growth in the Central and Eastern European Countries (CEECs), excluding Turkey, was unchanged in 2002 relative to 2001 at 2.9 percent. Including Turkey, GDP growth averaged 4.5 percent for the group, swinging up sharply from a 0.8 percent contraction posted in 2001. Regional growth was underpinned by expanding domestic demand, often spurred by fiscal policy (Hungary, Czech Republic, Poland, Slovenia, Slovakia) and/or easing monetary policies (Czech Republic, Latvia, Lithuania, Romania). Furthermore, despite tepid external demand, export growth remained firm in many of the CEECs.

In the Commonwealth of Independent States (CIS), GDP growth continued to slow to an average of 4.7 percent in 2002, down from 5.8 percent in 2001, and following the spike in CIS average growth of 8.4 percent posted in 2000. The slowdown largely reflects a deceleration of growth in Russia, as the effects of the devaluation of the 1998 crisis and the rents from high energy prices eroded. Diminished import demand from Russia—representing an important export market for the remaining CIS

countries—contributed to the easing of growth in the rest of the region. In addition, growth decelerated in Turkmenistan, because of a poor cotton harvest and slower growth of natural gas exports (the result of pipeline constraints), and suffered a decline in Kyrgyz Republic, tied to an accident at its largest gold mine and a temporary decline in exports. The South Caucasus countries (Armenia, Azerbaijan, and Georgia) and Belarus, however, experienced an acceleration of growth.

Near-term outlook

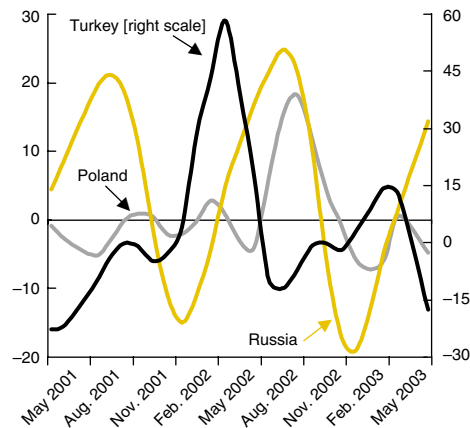
ECA aggregate growth is forecast to slow moderately to 4.3 percent in 2003. This projected growth rate for 2003 is higher than anticipated in GDF 2003, and reflects stronger than expected growth in a number of countries, particularly in Russia, which has exhibited firming domestic demand during the first quarter of 2003 (figure A1.4). The deceleration of ECA aggregate growth between 2002 and 2003 is primarily because of a projected moderation of growth in Turkey following the sharp upswing in 2002.

Growth in Turkey is projected to decelerate largely because of base effects following the strong recovery in 2002. Other factors affecting Turkey's near-term outlook include the continued required fiscal consolidation, the expected slowdown in inventory building, weaker tourism revenues because of the Iraq conflict, and limited foreign investment. The current account deficit has been rising rapidly, driven by rising imports, the recovery in domestic demand, and higher oil prices. Export growth has remained relatively robust despite the recent real appreciation of the lira and weak external demand. As of end-April, the Turkish government appeared on track for the Fund's program, but the pace of reforms will need to accelerate to sustain growth.

In the CEECs, excluding Turkey, growth in 2003 is projected to accelerate moderately (by 0.5 percentage points) because of continued penetration in new export markets and an expected boost to consumer confidence because of progress in the EU accession process.¹ In

Figure A1.4 Industrial production in selected ECA countries

3-month moving average, percentage change, year/year



Source: National agencies.

particular, growth is projected to accelerate moderately in Albania, the Czech Republic, Poland (which represents 13 percent of the region's GDP), and Slovenia. Growth in the remaining economies is forecast to either remain flat or decelerate moderately.

In the CIS, growth is projected to strengthen in 2003, as domestic demand has begun to accelerate in Russia, underpinning growth there, which in turn should support growth in other CIS countries dependent on Russia's import demand. First-quarter data for 2003 show strong growth in energy exports and industrial activity in Russia, spurring stronger investment, especially in the energy sector. This, coupled with an increase in private consumption—boosted by strong growth in real incomes and falling unemployment—is leading to higher output. Further, the recent appreciation of the euro against the dollar has led to increased import prices for Russian imports from Europe, relative to US dollar-denominated oil export revenues, which in turn is stimulating increased demand for cheaper domestic products. While oil prices have declined in recent months, they are still high relative to the average over the last few years and

are projected to average \$26.5/bbl in 2003 (given the spike during the first quarter), up from \$24.9/bbl in 2002 (and well above the \$21/bbl reference price used for the Russian budget). The southern-tier energy exporters of Kazakhstan and Azerbaijan are expected to continue to post high growth rates, driven by the ongoing oil sector investment boom, and supported by strong FDI inflows. Manufacturing and services related to investment in the oil sector are expected to continue to expand as well. GDP growth in most other CIS economies is anticipated to either remain flat or decelerate in 2003, with the exceptions of Georgia, where a rise in investment is projected, linked to the construction of oil and gas transit pipelines, and the Kyrgyz Republic, which is anticipated to benefit from a revival in its gold production.

Medium-term prospects

ECA regional growth is expected to first accelerate to 4.5 percent in 2004, and then to decelerate to 4.1 percent in 2005, reflecting divergent trends at the sub-regional levels: accelerating growth in the CEECs and slowing activity in the CIS.

Growth in the CEECs (including Turkey) is projected to accelerate from 3.5 percent in 2003 to 4.3 and 4.7 percent in 2004 and 2005, respectively, in part because of a gradual buildup in external demand. The first round of new EU members, in particular, is expected to continue to receive significant inflows of FDI (in addition to EU transfers)—which will remain an important source of external finance and support for long-term growth. Sustained growth in Turkey assumes the country will remain committed to the Fund's program, and that structural reforms will contribute to a correction in internal and external balances. These factors, along with the assumption of declining interest rates, are expected to help spur domestic demand in Turkey.

Growth is expected to slow in the CIS from 5.3 percent in 2003 to 4.6 and 3.4 percent in 2004 and 2005, respectively, assuming significant decline in oil price in both 2004 and

2005—from \$26.5/bbl in 2003 to \$22/bbl and \$20/bbl in 2004 and 2005, respectively—and a corresponding decline in the growth impetus through fiscal linkages.

Long-term prospects

Higher investment rates and ongoing restructuring of the capital base are expected to contribute to stronger growth in the CEE countries during the second decade of transition than posted during the previous decade. Further, 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 sub-region'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, facilitating the introduction of a number of reforms to oil-exporting countries, and contributing 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 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 \$19 per barrel for the 2005–10 period, in the underlying forecast—implies a ratcheting down of the sub-region's growth from recent high rates.

Risks

There are three main risks to the forecast:

- *Global trade and growth prospects:* More sluggish than anticipated world growth prospects, and/or a delayed re-

Table A1.4 Europe and Central Asia forecast summary

Growth rates/ratios (percent)	1991–2000	2001	2002	2003	2004	2005	2006–15
Real GDP growth	-1.6	2.2	4.6	4.3	4.5	4.1	3.4
Consumption per capita	0.0	3.2	5.4	5.1	4.8	4.5	3.1
GDP per capita	-1.8	2.0	4.5	4.3	4.4	4.0	3.3
Population	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Gross Domestic Investment/GDP ^a	24.6	21.7	20.8	21.1	21.5	22.0	28.8
Inflation ^b	76.0	6.1	4.0	5.8	6.5	2.7	
General gvt. budget balance/GDP	-4.0	-8.4	-9.3	-8.4	-7.1	-6.2	
Export Market Growth ^c	6.6	4.6	2.4	8.2	7.2	7.4	
Export volume ^d	10.0	5.5	6.7	8.1	8.5	8.4	
Terms of trade/GDP ^e	0.8	0.9	-1.6	1.7	0.0	-0.3	
Current account/GDP	-2.5	-1.4	1.1	0.6	0.1	-0.5	
<i>Memorandum items</i>							
GDP growth: transition countries ^f	-2.5	4.5	3.9	4.5	4.4	3.8	
Central and Eastern Europe ^f	0.6	2.9	2.9	3.4	4.2	4.4	
CIS	-4.4	5.8	4.7	5.3	4.6	3.4	

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

f. Excluding Turkey.

Source: World Bank baseline forecast July 2003.

covery, especially in the EU, could undermine or reduce the export led component of growth, especially for the CEECs;

- *Domestic policies and investor confidence:* Delays in fiscal consolidation in countries with large budget deficits (Turkey, Hungary, Poland, Czech Republic), which would risk diminished use of automatic stabilizers; skewed fiscal and monetary policies (as witnessed in Poland, for example); crowding out of private investment; and a slowdown of structural reforms. In Turkey, failure to achieve substantial decline in real interest rates would result in significantly lower growth outcomes. For the EU accession candidate countries with large fiscal deficits, overall fiscal consolidation as well as public expenditure restructuring will be necessary to join the European exchange rate mechanism and to absorb EU transfers, which require national co-financing; the growth outlook will also partly depend on a recovery in external demand, which could cushion the adjustment process. Countries with large twin fiscal and external deficits (Turkey, Croatia, etc.) could un-

dermine confidence of foreign investors and result in difficulties in maintaining access to financing;

- *Energy prices:* A sharper decline in oil price (induced, for example, by low world growth outcomes), could translate into a marked deceleration in growth for both CIS energy exporters and countries dependent on Russia's consumer markets. For the ECA region's energy exporters, effective management of large government oil revenues and continued structural reforms are required to pave the way for sustained long-term growth, economic diversification, and employment creation. Medium- and long-term prospects depend largely on rapid diversification of the production base and exports.

Sub-Saharan Africa

Recent developments

A SUBDUED EXTERNAL environment, together with poor weather and home-grown problems of governance and civil strife, held real growth in Sub-Saharan

Africa (SSA) to 2.8 percent in 2002, down from 3.2 percent in 2001. Faced with Europe's faltering economy and rising geopolitical uncertainty, real export growth slumped to just 0.7 percent, the worst outcome in a decade, while net exports contributed -0.8 percent to GDP growth. Meanwhile, domestic absorption was flat at 3.6 percent. Notably, investment spending was relatively resilient, especially in South Africa and a number of oil exporters. Early indications from the first half of 2003 are that performance will be similar in the current year and growth in SSA is expected to remain at 2.8–3 percent.

In domestic economies, adverse weather compounded by civil strife has seriously disrupted food production for more than half the region's population, and as many as 40 million persons are facing acute hunger.² Drought has been particularly severe in the horn of Africa, comprising Ethiopia and Eritrea and parts of the Sudan, leaving over 15 million urgently in need of food aid. But disruptions have occurred in numerous other countries as well because of weather or civil strife, including Angola, Burundi, Democratic Republic of Congo, the Gambia, Malawi, Mauritania, Senegal, and Zimbabwe. Apart from the humanitarian crises, with agriculture representing nearly one-fifth of GDP—over one-quarter excluding South Africa—the macroeconomic impact is to reduce household incomes and expenditure. On average, consumption grew by just 2.4 percent in 2002 (0.1 percent per capita), down from 3.1 percent in 2001.

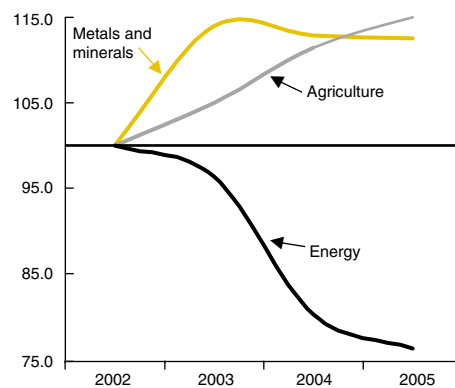
For the region as a whole, the terms of trade strengthened in 2002, thanks both to gains in export prices and a decline in the cost of manufactured imports. Oil prices were up 2.4 percent over 2001 which, with net energy exports accounting for some 8 percent of GDP, contributed 0.2 percent to incomes. Non-energy commodities are also enjoying a significant rebound, albeit from very low levels after the dizzying declines of the late 1990s. This rebound is primarily the result of supply constraints rather than growth in demand. Compared to low points reached since 2000, the price of gold in 2002 was up 14 percent, cop-

per up 13 percent, cotton up 24 percent, and cocoa up a sharp 107 percent. Year over year, agricultural export prices gained an average of 20.5 percent and though metals and minerals declined a further 2.3 percent, the export-weighted average price of non-energy commodities for the region was up 13.5 percent, while non-oil exporters' terms of trade strengthened by 4.2 percent. Moreover, higher frequency data on metals indicate signs of recent strength as well. No sustained upward trend is anticipated given highly competitive new suppliers coming on stream, but at least key export markets appear to be stabilizing around present levels (figure A1.5a).

Tourism has been affected not only by weak income growth in the OECD, especially Europe, but also by security concerns arising from the September 2001 terrorist attacks and the run-up to the Iraq war. If the rest of the world needed a reminder that travel to the region is risky, it came in the form of a terrorist attack in Kenya in November 2002 that left fifteen dead, including three Israeli tourists. Barring further negative shocks, the low point for tourism was likely reached at the time of the Iraq war when travel to SSA was down by nearly one-quarter compared to the year before. Nevertheless, that virtually guarantees a

Figure A1.5a SSA commodity price outlook favors non-oil exporters

Prices in US\$, indices 2002 = 100



Source: DECPG Commodities Group.

mediocre year at best and the World Travel and Tourism Council (WTTC) forecasts a slight decline of 0.2 percent in GDP and employment in the tourism sector in 2003. At the same time, however, South Africa was the world's fastest growing tourist destination in 2002, with 20 percent growth in arrivals over the year before, and the momentum continued into 2003, though the pace is likely to slow with the stronger rand. Thus, superimposed on the overall pattern of growth has been a southward shift in the industry's center of gravity. Whether this will be reversed remains to be seen.

In spite of the overall disappointing results, there were some positive developments. Average per capita income rose for a fourth successive year in 2002, which is the longest sustained increase in over two decades. Moreover, the slowdown was largely attributable to a small group of poor performers. In Nigeria, a lower OPEC quota and budget gridlock offset much of the potential gain from higher oil prices, Ethiopia and Eritrea suffered through another year of increasingly savage drought, and deepening political crises paralyzed Côte d'Ivoire and Zimbabwe. For this group of countries—representing around one-third of the region's population and GDP—growth fell by two-thirds, from 1.7 percent to 0.6 percent in the year. This same group also contributed to most of the retrenchment in exports. By contrast, elsewhere in the region, GDP growth slowed only marginally. As usual, politics played an overarching role and countries in conflict or experiencing civil disruption were at the bottom of the league. Even here there is a glimmer of hope, though, in the growing institutional strength of initiatives such as the African Union, NEPAD, and the East African Community.

Also encouraging is further evidence of Africa's potential competitiveness, given the right incentives and opportunities. An impressive recent example is the growth of nontraditional exports under the U.S. African Growth and Opportunity Act (AGOA), which extends preferential access to imports from a growing list of eligible countries. So far, there have

been relatively few beneficiaries—Nigeria, South Africa, Gabon, Lesotho, and Kenya account for nearly 93 percent of U.S. imports under AGOA preferences—and three-quarters of the total consists of oil. But non-oil exports grew rapidly in 2002. Despite a slump in the U.S. economy that led to an overall decline of nearly 16 percent in AGOA exports, nontraditional exports were sharply higher—textiles and apparel more than doubled from 2001, while transportation equipment and agricultural products were up 80 percent and 38 percent respectively.³

In South Africa, the sharp fall of the rand beginning in 2000 provided a strong stimulus to growth, but much of that was reversed through 2002 and into 2003 as the currency bounced back because of tight money and the unwinding of the Reserve Bank's net open forward position which had unnerved investors. Growth in 2002 was a still-robust 3.0 percent, though the contribution to growth from trade declined to negative territory, while domestic demand soared by 4.1 percent. Though the domestic economy slowed in the first quarter of 2003, growth remained relatively strong at 3.5 percent (saar), particularly investment, which was up an impressive 8 percent. Given the momentum evident in the first quarter, domestic demand should remain relatively strong, though with the rand remaining firm, net exports will be a drag on growth and GDP is expected to grow only around 2.8 percent. Especially worthy of note is an auspicious turnaround in the labor market in 2002, with formal sector payrolls increasing after seven straight years of decline, even though the increase of 70,000 jobs is small compared to the official estimate of 4.8 million unemployed.

In Nigeria, slower growth in 2002 reflected OPEC production constraints and the impact of budget gridlock that limited spillovers from oil production to the rest of the economy in spite of strong prices. Hydrocarbons constitute almost all Nigerian exports, but gas is taking an increasing share, and in 2002 a one-third increase in liquid natural gas (LNG) production partially offset a 6 percent fall in oil. Produc-

tion in the first quarter of 2003 was up around 5 percent from 2002, somewhat below the average increase for OPEC as a whole.⁴ Nigeria would like an increase in its quota from the current level of 2.1mb/d that is well below capacity. But a significant rise in the near term is unlikely, as slow growth in the industrial economies will constrain the global sector. Nevertheless, higher production in 2003 in addition to further growth in LNG and continuing price strength, will underpin a stronger performance this year. The most encouraging recent news from Nigeria concerned the presidential election which has strengthened the fragile political process. But, equally important, meaningful progress on economic reform has been frustratingly slow. On balance, growth this year and in the medium term is likely to be only moderate.

Near-term outlook

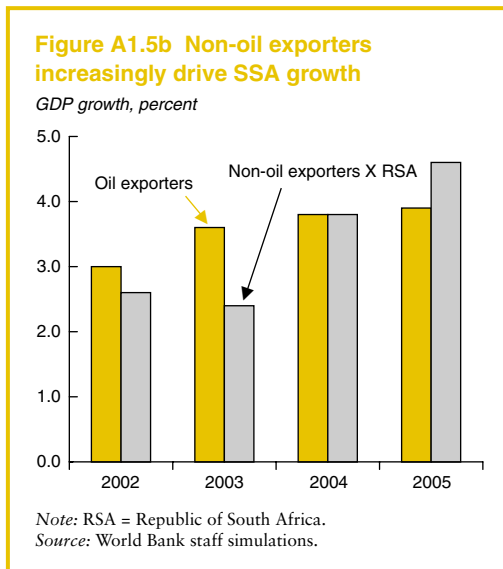
Though the forecast calls for world economic growth to accelerate in the second half of 2003, the pace of recovery is expected to remain sluggish, especially in Europe where the economy stalled in the first quarter and the risk of outright recession has risen. Even with a pickup in momentum going into the second half, the EU is expected to grow by only 0.9 percent in 2003 and 1.9 percent in 2004. SSA should benefit from a more rapid expansion of European imports thanks to the appreciation of the euro, but the 4.1 percent increase in EU import demand anticipated over the next two years is barely half the pace of the late 1990s. Moreover, travel and tourism will continue to reflect security concerns, fanned recently by the UK government's decision in May (since retracted) to ban commercial flights to Kenya, though, as noted, there will be differences within the region. However, for SSA overall the external environment will provide only modest support for growth in the current year, with exports rising 2.9 percent. A further acceleration to 4.9 percent is expected in 2004 as the recovery continues to build.

The forecast anticipates stronger growth for both energy and non-energy exporters in the

medium term as the global recovery consolidates. Energy sectors are expected to contribute significantly to regional growth, especially with a moderate rebound in Nigeria from a weak performance in 2002. But, more generally, West Africa is emerging as an energy hot spot, with mainly offshore exploration and development activities underway from Angola through the Gulf of Guinea, and extending to nontraditional energy producers from São Tomé and Príncipe, to Mauritania. Major energy-related infrastructure projects including the West African Gas Pipeline and Nigeria's plan to end gas flaring by 2004 will also have a direct impact on investment and incomes. Though linkages to non-energy sectors are generally weak, increased fiscal revenues will permit relatively expansionary fiscal policies. Overall, oil exporters' growth is expected to reach 3.6 percent in 2003 and accelerate further to 3.9 percent by 2005. Despite some retrenchment in non-oil commodity prices in the second quarter, non-oil exporters will benefit from better terms of trade in the current year and relative stability after that. Policy improvements are expected to have a cumulative impact on competitiveness and will help attract investment. Realistically, though, this is a slow process and many of the benefits will be realized only in the longer term (figure A1.5b).

Long-term prospects

In the longer run, SSA will continue to face formidable obstacles to growth from low savings and investment rates, limited quantity and quality of infrastructure and human capital, and especially HIV/AIDS. As a result of the growing severity of the HIV/AIDS epidemic, population growth for the region has been revised downward by 0.3 percent to 1.9 percent per annum. Total GDP growth has been lowered by the same amount. The expectation is that per capita GDP growth will remain at 1.6 percent. This expectation may be optimistic given the long-run performance of the region, but even so it is barely half of what is needed to achieve the MDGs. There is little doubt that SSA will continue to lag behind



other developing regions over the forecast period, with outcomes well behind best practice in other regions.

The expectation of a reversal of SSA's lengthy downward spiral hinges on strong assumptions about ending conflicts and improv-

ing governance and policymaking in general. For the region as a whole, real per capita income in absolute terms peaked in 1974, declining since then at an average annual rate of 0.7 percent. Yet differences across the region are striking. The worst performances have inevitably been associated with failed states and civil conflict, including Sierra Leone where growth has averaged -3.0 percent over the period, Democratic Republic of Congo at -5.6 percent, and Liberia at -5.8 percent. But, at the other end of the spectrum, long-term growth averaged 4.4 percent in Mauritius and 5.6 percent in Botswana. In between, there are success stories of spectacular turnarounds. Mozambique, after a protracted civil war and average growth of -1.8 percent during the 1980s, averaged 5.6 percent from 1992-2001. Already Mozambique, and other countries such as Uganda and Tanzania, have made substantial progress and have results to show for it, while many others are at an earlier stage of the process. By early 2003 almost all countries in the region were participating in the PRSP process, with 15 having completed PRSPs and

Table A1.5 Sub-Saharan Africa forecast summary

Growth rates/ratios (percent)	1991-2000	2001	2002	2003	2004	2005	2006-15
Real GDP growth	2.3	3.2	2.8	2.8	3.5	3.8	3.5
Consumption per capita	-0.3	0.6	0.1	0.5	0.8	1.1	1.2
GDP per capita	-0.3	0.8	0.5	0.5	1.3	1.6	1.6
Population	2.6	2.4	2.3	2.3	2.2	2.2	1.9
Gross Domestic Investment/GDP ^a	17.4	19.3	19.8	20.2	20.0	20.1	20.8
Inflation ^b	10.5	5.8	4.2	3.7	4.2	4.7	
General gvt. budget balance/GDP	-4.5	-1.6	-1.0	-1.6	-1.6	-1.7	
Export Market Growth ^c	7.3	0.4	2.0	5.0	7.3	7.1	
Export volume ^d	4.5	3.8	0.7	2.9	4.9	5.4	
Terms of trade/GDP ^e	0.1	-1.5	0.5	-0.4	-0.8	-0.5	
Current account/GDP	-2.0	-2.2	-2.2	-2.7	-2.5	-2.6	
<i>Memorandum items</i>							
GDP growth: SSA excluding South							
Africa	2.9	3.6	2.7	2.8	3.8	4.3	
Oil exporters	2.6	4.3	3.0	3.6	3.8	3.9	
CFA countries	2.6	3.1	1.9	2.2	3.1	3.5	

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

Source: World Bank baseline forecast July 2003.

SSA is Sub-Saharan Africa. CFA is Communauté Financière Africaine.

another 25 having I-PRSPs. Meanwhile, regional initiatives are enhancing the credibility of governments and strengthening intra-regional cooperation. At the same time, however, deep-seated conflicts in West and Central Africa remain to be resolved and in many areas political processes remain fragile.

In principle, higher standards of governance and improved policies will encourage higher savings and investment, and raise productivity and growth. Yet, at the same time it will remain a struggle to overcome low levels of human and physical capital, poor infrastructure, HIV/AIDS, and negative perceptions of international investors. Moreover, the region remains highly dependent on primary commodity exports, hence exposed to high external volatility. While these factors indicate downside risks to the projections, achieving the moderate improvement in performance envisaged by the forecast seems a plausible baseline expectation.

Middle East and North Africa

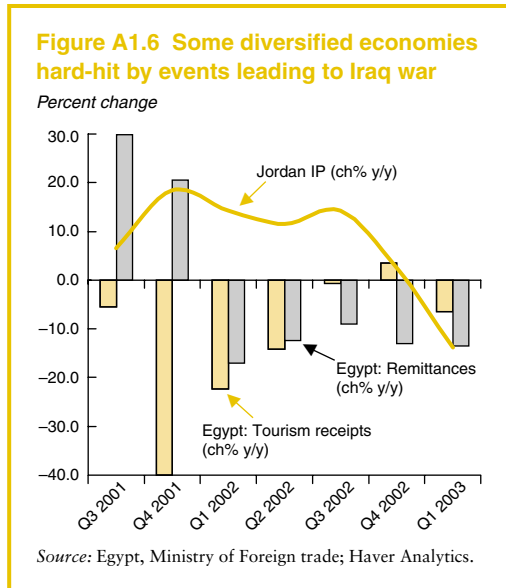
Recent developments

THE OVERARCHING event in the Middle East and North Africa in 2002–03 was the buildup toward the war in Iraq, provoking continued high oil prices, further shocks to the tourism sector, and declining confidence in the private sector. Uncertainty before the war had an even larger impact than the war itself. However, the economic shocks resulting from the conflict highlighted several weaknesses in regional economies—the slackening of the investment climate, weakness in the private sector, and the relatively poor prospects for new foreign direct investment.

In the rise of uncertainty surrounding the situation in the Gulf in 2002 and early 2003, oil prices surged and oil exporters lifted oil production. Combined with fiscal expansion programs, it led to an acceleration of output growth to 3.2 percent in oil-exporting countries in 2002. High oil prices helped to keep current account balances in surplus in 2002

for oil exporters at \$20 billion, 4.8 percent of GDP. Algeria continued expenditures under the PSRE (*Programme de soutien a la relance économique*), boosting the construction and services sectors and offsetting weakness in the agricultural sector, which was affected by a severe drought, particularly devastating for cereal crops. Private sector growth in Saudi Arabia and several Gulf countries is expected to remain weak as a result of the disruption caused by the war in Iraq, but companies from Saudi Arabia and Kuwait will benefit from subcontracting work associated with the reconstruction of Iraqi infrastructure. In Iran, the lifting of import restrictions in the past year has allowed the non-oil industrial and manufacturing sector to raise production, and domestic demand has been a strong driver for growth.

Developments were more adverse for diversified exporters, particularly those in the Middle East. The prospects for war in Iraq led to continued stagnation of tourism, which had not fully recovered from the events of September 11. These factors and the waning of external demand, particularly in Europe in late 2002, drought conditions in several countries, and a weak investment climate in several North Africa countries all contributed to a fall in growth from 3.8 percent in 2001 to 2.8 percent in 2002. Growth in Egypt appeared set for recovery in late 2002 with a recovery in tourist arrivals and increasing business confidence, but tourist arrivals fell in the first half of 2003. The Egyptian exchange rate was floated in January 2003, but the central bank is maintaining higher interest rates to prevent further depreciation of the pound, curbing private investment. Production in Jordan plummeted over late 2002 and into early 2003 (figure A1.6). Contraction in the agricultural sector was caused by drought conditions in Tunisia, the fourth consecutive year of drought. Exports, particularly from the manufacturing sector, were adversely affected by the waning of demand from the European Union in late 2002. A tighter fiscal stance, in the face of a widening current account deficit, also con-



strained growth. However, Tunisia continued to pursue reforms in the financial sector and continued to attract FDI in 2002 thanks to the award of a second GSM license when global flows to developing countries were shrinking. Conversely, Morocco had positive agricultural growth in 2002, but the industrial modernization program under the Euro-Med Association Agreement and the privatization programs have tended to stagnate. The exception to this generally gloomy picture is Jordan, with buoyant GDP and export growth despite a slowdown in export market growth and a stagnating tourism sector.

Short-term prospects

Prospects in 2003–04 will be shaped by the path of oil prices and public expenditures in oil-exporting countries; the recovery of external demand; the speed of recovery in the tourism, trade, and transportation sectors in the Middle East post-war; weather conditions; and the policy response to slackening of the investment climate in the diversified exporters. Growth in the region is expected to rise slightly in 2003 to 3.3 percent as oil exporters increase production and exports and diversified ex-

porters recover from the adverse impacts of slowing external demand and drought conditions. The diversified exporters should begin to recover in 2004 as external demand improves and as growth in oil exporters is buoyed by further fiscal expansion, somewhat offsetting the impacts of lower oil prices and production.

Most of the acceleration in 2003 will occur in the oil-exporting countries, which are expected to grow more quickly in 2003 as a result of fiscal pump-priming and increased oil production quotas. GDP growth in oil exporters should reach 3.9 percent in 2003–04. Oil production levels for the oil exporters in 2003 will be higher than 2002, ensuring that the oil sector will make large, positive contributions to GDP volume growth. High profitability in oil, and in services sectors, such as telecommunications and banking, has led to surges in stock markets in Iran and Saudi Arabia, particularly as a result of thin markets. Firms in the Gulf Cooperation Council (GCC) countries are expected to benefit from contracting agreements as the reconstruction of Iraq gets underway in the second half of 2003, helping to boost the weak private sector. Evidence is also emerging that citizens of oil-exporting countries, particularly in the Gulf, are traveling less and boosting domestic consumption.

Saudi Arabia and Iran have begun to push through needed reforms in several sectors such as mining, capital markets, and insurance, as well as privatizing state concerns to encourage foreign investment in the oil sector. But Algeria has abandoned proposed hydrocarbons reforms. Moving into 2004, the impetus to growth from the oil sector should wane in these countries as oil prices and production fall, but continued fiscal stimulus and a rebound in private sector activity should maintain GDP growth. Growth in Algeria will be supported in 2004 by the online debut of a major gas project, but fiscal stimulus under the PSRE is being absorbed more slowly than expected.

Growth in the diversified exporters is forecast to remain sluggish in 2003 at 2.4 percent, caused by stagnation in tourism in the first half of the year because of the Iraq war. The agricultural sector in Tunisia will expand in the wake of good rains, and agricultural expansion will continue in Morocco, but slow import demand in Europe will keep the manufacturing sectors depressed. The countries most affected by the Iraq war were border nations Syria and Jordan. Both countries have extensive trade links with Iraq, and Jordan sourced its oil from Iraq at concessional rates. Prior to the war, Jordan's exports to Iraq were growing strongly. The disruption to oil supplies from Iraq and to haulage routes through Iraq has meant that output growth in the first half of 2003 in these countries was adversely affected. The Jordanian government has decreased fuel subsidies and broadened the tax base to ease the impact on the fiscal accounts of higher oil prices, affecting the current balance. Jordanian exports to other destinations, particularly to the United States through the "Qualified Industrial Zones," are unaffected by the disruption caused by the conflict, but uncertainty in the private sector has decreased confidence.

In response to this range of negative growth factors, central banks in several countries (Jordan, Morocco, Tunisia) have reduced interest rates to stimulate domestic demand. Growth conditions should improve later in 2003 and into 2004 as confidence returns to the tourism market, the European economy rebounds, and the effects of lower interest rates filter through to domestic investment. Diversified economies are expected to grow 3.7 percent in 2004. This is below the average of the diversified exporters during the 1990s, where GDP growth achieved annual growth of 4.2 percent. The lackluster investment climate in these countries requires further attention in the reform process.

Long-term prospects

Reducing unemployment through higher GDP growth remains the key challenge for the re-

gion, particularly given the very high rates of growth expected in the labor force, as the age structure of the population shifts to reduce the dependency ratio, constituting a "demographic gift." The region has achieved macroeconomic stability for the most part, with low inflation and stable external debt positions, but growth in the region is not reaching its potential, with many countries still stuck with per capita GDP growth of around 1.5 percent. Prospects for growth and sustainable employment can be improved through reforms in trade regimes and a strengthened investment climate. Traditional trade liberalization, such as lowering tariff and non-tariff barriers, is vital considering that the Middle East and North African (MENA) region is one of the more highly protected developing regions. While MENA's export products (excluding oil) are not highly integrated into global trade markets, the region has strong potential for non-energy exports. The Mediterranean countries are well on the way to trade reforms through their commitments over the coming decade to the Euro-Med agreements, bilateral trade agreements, and WTO membership. But trade reforms must also include 'behind the border' reforms (trade facilitation, services liberalization, and improved competitiveness) designed to increase productive efficiency.

Reform of the investment climate is needed to ensure sustainable employment growth, because trade reforms increase growth only when they stimulate new investment. Much of the impetus to growth in recent years in many countries has come from the public sector, and much of the FDI flowing into the region is targeted to extractive industries or parastatals that have been privatized. To capture greater benefits from trade and financial market integration, policy-makers in the region should focus on structural and microeconomic impediments to efficient resource allocation and to improve competition. Policy reforms are required to ensure a sound regulatory environment in product and factor markets. Improving governance, improving the quality of public institutions,

Table A1.6 Middle East and North Africa forecast summary

Growth rates/ratios (percent)	1991–2000	2001	2002	2003	2004	2005	2006–15
Real GDP growth	3.4	3.2	3.1	3.3	3.9	3.5	4.3
Consumption per capita	0.2	4.8	1.8	1.0	1.3	1.3	2.3
GDP per capita	1.2	1.3	1.1	1.3	1.9	1.5	2.5
Population	2.2	1.9	1.9	1.9	1.9	1.9	1.7
Gross Domestic Investment/GDP ^a	21.4	21.3	21.6	21.8	22.0	22.1	26.2
Inflation ^b	7.5	2.6	3.8	4.0	4.0	4.0	
General gvt. budget balance/GDP	-1.2	-0.8	-3.0	-2.3	-3.2	-2.2	
Export Market Growth ^c	7.5	-1.1	2.2	8.3	8.1	7.9	
Export volume ^d	5.7	3.6	1.2	4.2	5.5	5.2	
Terms of trade/GDP ^e	0.3	-1.8	0.1	-2.2	-1.7	-1.1	
Current account/GDP	-1.9	4.2	3.5	0.3	-1.5	-2.6	
<i>Memorandum items</i>							
GDP growth: Oil exporters	3.0	2.9	3.2	3.9	3.9	3.3	
Diversified exporters	4.2	3.8	2.8	2.4	3.7	3.8	

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-factor services.

e. Change in terms of trade, measured as a proportion of GDP (percentage).

Source: World Bank baseline forecast July 2003.

and enforcing public accountability are necessary if a vibrant public sector is to evolve. Combating bureaucratic delays and inefficiency, improving the quality of infrastructure services, and fighting corruption are also essential elements of a better investment climate.

With only one-third of the labor force active today, women represent a huge untapped resource in the region. Experience from around the world suggests that women, particularly the young and well-educated, can reap gains from trade and investment climate reforms. These gains are already evident in the garment and textile industry in Egypt, Jordan, Morocco, and Tunisia. Provided that economic and social barriers to women are dismantled, women can more widely participate in economic life, thereby boosting economic growth and productivity in the region.

Notes

1. In April 2003, eight transition countries signed the accession treaty to join the EU in May 2004, along with Malta and Cyprus.

2. The UN's FAO's Global Information and Early Warning System identifies 25 countries representing 56 percent of total Sub-Saharan population where agricultural production has been seriously disrupted. (<ftp://ftp.fao.org/docrep/fao/005/y9304e/y9304e00.pdf>) According to the UN WFP, 40 million persons in SSA are facing acute hunger because of drought, disease, and conflict (<http://www.wfp.org/index.asp?section=3>).

3. <http://www.agoa.gov/resources/TRDPROFL03.pdf>. AGOA rules of origin are to be tightened in 2004 and it remains to be seen how long lasting the benefits will be.

4. According to data from the Energy Information Agency of the US Department of Energy. See <http://www.eia.doe.gov/emeu/ipsr/t11a.xls>.