Prospects and Risks for Developing Countries

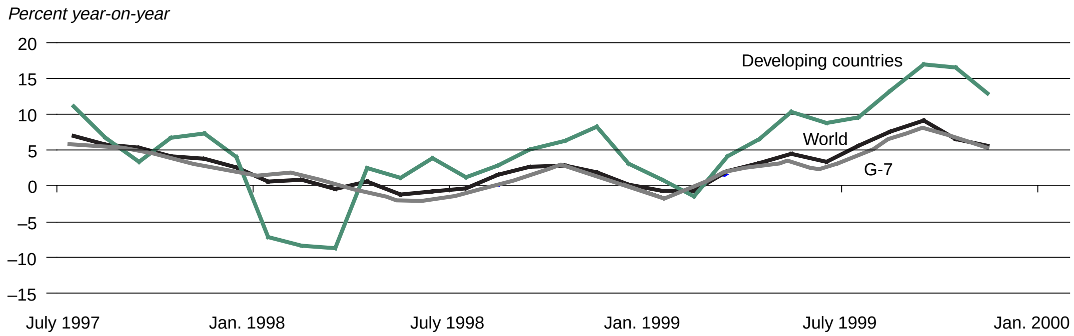
Introduction: an improved outlook

Growth in developing countries continues to recover from the global financial crisis, underpinned by stronger and more broadly based growth in industrial country output and in world trade, both of which have significantly exceeded earlier expectations in recent months. The main drivers of the recovery have included stimulative policy measures in the industrial countries (widespread interest rate cuts in late 1998 and, in Japan, fiscal stimulus), the return of confidence in East Asia, and a gradual easing of financial conditions throughout virtually the entire developing world. The renewed confidence in East Asia was prompted by an unprecedented current account adjustment, strengthening currencies, lower domestic interest rates, and expansionary fiscal policy. While primary commodity prices have firmed, overall inflationary pressures in the world economy remain contained, reflecting cautious monetary policies, significant potential output gaps in many parts of the world, and unexpectedly rapid increases in productivity in the United States.

This report revises upward the estimate for developing country growth in 1999 by 0.6 percentage points to 3.3 percent, from the forecast in last fall's *Global Economic Prospects*.[1] Given the strengthening momentum of the world recovery, it revises upward developing country forecast growth in 2000 by 0.4 percentage point to 4.6 percent, and in 2001–02 by 0.1 percentage point to 4.8 percent. Nevertheless, adjustment to the effects of the recent financial crisis is still far from complete in the developing world. Growth in 2000–02 is projected to remain somewhat below precrisis trends, as underlying fragilities exposed and exacerbated by the crisis will take time to address. Moreover, the contours of the recovery are changing as it matures, and the effects vary greatly from country to country. The main messages of this chapter are the following:

- World output growth has become more broadly based and stronger (figure 1.1). Growth in the United States was stronger than expected in 1999, and its projection has been revised upward for 2000, reflecting in part surprising advances in productivity that have contributed to containing core inflation. Growth in Europe accelerated through 1999 and is expected to top 3 percent in 2000, enhancing export prospects for developing countries in the European periphery and reducing risks implicit in excessive reliance on U.S. domestic demand growth alone. And recovery in industrial output growth continues across developing regions (figure 1.2). In this more buoyant global environment, projections for world trade growth have been raised, to top 8 percent in 2000, and projections for the recovery in primary commodity prices have also been modestly raised.
- Strengthening world activity is likely to be accompanied by a modest rise in policy interest rates in key industrial countries aimed at preempting a resurgence of inflationary pressures. The real six-month U.S. dollar LIBOR rate is expected to average from 3.5 to 4 percent in 2000–01, before slipping back below 3 percent in 2002, compared with an average of 2.9 percent in 1994–97, the period of sustained global expansion preceding the financial crisis (table 1.1). However, spreads on lending to developing countries fell by over 600 basis points in 1999 as risk perceptions

Figure 1.1 World industrial production

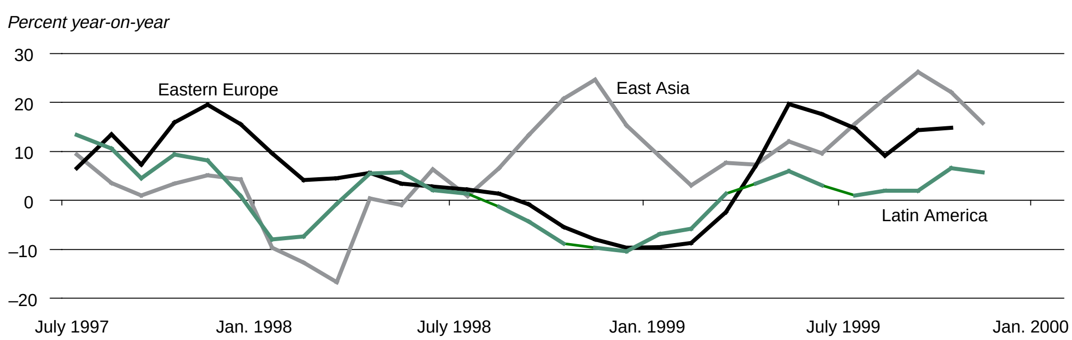


Note: Figures are three-month moving averages. Figure based on sample of countries comprising 83 percent of world GDP.
Source: Datastream; World Bank staff estimates.

abated, a process that is expected to underpin a recovery in capital flows to developing countries that is gradual in 2000 but faster thereafter, despite the deterrent effect of higher interest rates and increased demand for savings in industrial countries. (Reflecting a widening U.S. current account deficit and falling surpluses in Europe, the current account position of the G-7 countries has moved from balance to a deficit of 1 percent of GDP.)

- Developing country growth is estimated to have doubled from 1.6 percent in 1998, the trough of the financial crisis, to 3.3 percent in 1999, and is now projected to strengthen further to 4.6 percent in 2000. Substantial increases in 2000 growth of one percentage point or more are expected for all regions other than East Asia, where it had already reached a robust 6.5 percent in 1999. A large number of developing countries will see a return to positive per capita growth in 2000. The crisis of 1998–99 had resulted in falling per capita incomes in 45 developing countries with some 1.6 billion people, nearly a third of

Figure 1.2 Developing country industrial production



Note: Figures are three-month moving averages. Eastern Europe includes the Czech Republic, Hungary, and Poland. East Asia includes China, Malaysia, the Philippines, the Republic of Korea, and Thailand. Latin America includes Argentina, Brazil, Chile, Mexico, and Peru.
Source: Datastream; World Bank staff estimates.

Table 1.1 Growth, current account balances, and real interest rates, 1991–99 and forecast 2000–02

	History		Estimate	Forecasts		
	1991–97[a]	1998	1999	2000	2001	2002
GDP growth, G-7 countries (percent per year)	2.1	1.8	2.7	3.1	2.4	2.5
Current account balance, G-7 countries (percent of GDP)	0.0	–0.3	–1.0	–1.2	–1.0	–0.9
Current account balance, developing countries (percent of GDP)	–2.0	-0.5	0.3	0.3	–0.2	–0.4
Real U.S. dollar LIBOR[b]	2.1	3.9	3.1	3.7	3.8	2.8

a. Annual averages.
b. London interbank offered rate, deflated by the U.S. consumer price index.
Source: Datastream; World Bank.

the world's population. In 2000, that number is expected to fall to 14 countries with 140 million people.

- Nevertheless, while the improved external environment should tend to lift most boats, the costs of crises can be longer lasting, and the path of recovery from the crisis is likely to be differentiated. The fall in real incomes and employment during 1998–99 will take some years to reverse in the worst-affected developing countries. Some 41 countries with nearly 1 billion people—more than one-half of whom are low-income—will have barely crossed the threshold to positive gains in income in 2000—underlining the still fragile path of recovery and adjustment ahead. The fastest recovery in 2000–02 is likely to occur in newly industrializing middle-income countries that experienced substantial real exchange rate devaluations, that are significant diversified exporters, and that attract high levels of foreign direct investment (FDI) inflows, for example middle-income East Asian countries, countries in Eastern Europe eligible for accession to the European Union (EU), Brazil, and Mexico. China and India, with 46 percent of developing country population and 55 percent of the poor, are also expected to sustain fairly rapid growth while grappling with large domestic reform agendas. Other middle-income diversified exporters that are more reliant on external savings for their growth (as in Latin America) will also gain, but these gains may be constrained by still-hesitant capital flows. Oil exporters in the Middle East and elsewhere will experience income gains because of higher oil prices, but are expected to show below-average output growth, reflecting adjustment to past borrowing and fiscal deficits. Non-oil commodity exporters—mostly in Sub-Saharan Africa and Central America—will benefit less than other countries as the recovery in agricultural prices is anticipated to be gradual, yet their imports have been boosted by high oil prices.
- Short-term risks to this outlook are less than they were a year or even six months ago because of the momentum and broadening of the current global expansion. Indeed, in some sense the risks are now partly on the upside: for example, growth in Europe may be stronger, rapid productivity advances in the United States may continue, and growth of world trade may be faster than expected. But the risks on the downside are also not negligible, especially as one looks farther out. These risks originate from the need to achieve four transitions: bringing the high-flying U.S. economy to a "soft landing"; shifting from fiscal-stimulus-led to private-demand-led growth in Japan; achieving healthier financial and corporate sectors in Asia; and, finally, achieving an adjustment by oil exporters to an expected future fall in oil prices. In the near term, these are also risks originating from higher oil prices. Except for the possibility of a major stock market and growth correction in the United States, failure to smoothly achieve one or more of these transitions is unlikely to derail the current expansion of the global economy, but may weaken it and severely affect specific developing regions.

Industrial countries: recovery spreads to Europe

Growth in the industrial countries in 2000 and 2001 is now expected to be significantly faster than predicted in *Global Economic Prospects 2000* (GEP 2000) (table 1.3), reflecting a sharp accelera-

Table 1.2 Global conditions affecting growth in developing countries, 1999 and projections 2000–02

(percentage change from previous year except where stated otherwise)

	Current				*Global Economic Prospects 2000*			
	Estimate	Forecasts			Estimate	Forecasts		
	1999	2000	2001	2002	1999	2000	2001	2002
GDP growth								
World	2.9	3.5	3.1	3.1	2.6	2.9	2.8	3.0
G-7 countries[a]	2.7	3.1	2.5	2.5	2.6	2.4	2.1	2.4
Low- and middle-income countries	3.1	4.6	4.8	4.8	2.7	4.2	4.5	4.8
Excluding Eastern Europe and former Soviet Union	3.5	5.0	5.0	5.1	3.0	4.5	4.8	5.0
Low- and middle-income countries GDP per capita	1.7	3.2	3.3	3.5	1.2	2.8	3.1	3.4
World trade volume	5.2	7.8	6.7	6.5	5.0	6.4	6.3	6.3
Inflation[b]								
G-7 countries	1.3	1.8	1.9	2.0	1.3	1.6	1.8	2.0
United States	2.2	2.7	2.5	2.6	2.2	2.5	2.5	2.6
Commodity prices[c]								
Except oil	–11.2	5.6	3.9	3.3	–9.8	3.0	4.6	3.8
Oil (weighted average)	38.3	27.3	–17.4	–5.3	37.7	2.8	–2.7	0.0
Manufactures export unit value[d]	–0.6	2.5	2.5	2.6	–0.6	2.5	2.5	2.6
Interest rates								
Six-month U.S. LIBOR (percent per year)	5.5	6.5	6.5	5.5	5.5	6.0	6.0	5.5
Exchange rates								
Dollars per deutsche mark[e]	–4.4	...	...	...	–2.9	...	...	...
Dollars per yen	15.1	...	...	...	14.1	...	...	...

a. Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.
b. Change in consumer prices in local currency, aggregated using 1988–90 GDP weights.
c. Prices in nominal dollars.
d. Unit value index of manufactures exports from the G-5 (France, Germany, Japan, the United Kingdom, and the United States) countries to developing countries, in dollars.
e. A positive figure denotes appreciation of the local currency against the dollar.
Source: World Bank.

tion of growth in Europe throughout 1999 and the continuation of strong but noninflationary growth in the United States. G-7 growth is now expected to rise from 2.7 percent in 1999 to 3.0 percent in 2000, a 0.6 percentage point faster than earlier envisaged. After 2000, a slowing in the United States from the exceptionally rapid pace of growth of recent years, and a gradual revival of economic activity in Japan, should bring about greater convergence in industrial country growth (figure 1.3). Such a convergence would represent a more broadly based course of recovery in industrial country growth that is less susceptible to a decline in any single country—supporting stronger world trade, firmer commodity prices, and a smoother adjustment of current external imbalances among G-7 countries. G-7 growth is expected to average a longer term trend rate of 2.5 to 2.6 percent from 2001 onward.

In the *United States*, GDP growth in the fourth quarter of 1999 (seasonally adjusted annualized rate, saar) was estimated at an exceptional 6.9 percent, yielding around 4 percent output growth for a third successive year. Low unemployment, significant gains in earnings and disposable income, rising stock market wealth, record high consumer confidence, and rising personal credit all continued to support solid gains in consumer spending. Business inventories also accumulated at a hefty pace and contributed about 1 percentage point to growth in the quarter. On the downside, business and residential investment slackened somewhat as Y2K-related investment spending tapered off and as long-term interest rates on 30-year T-bonds rose to 6.50 percent from July's 5.95 percent. Large and rising budget surpluses, however, increase room for maneuvering of policymakers in the event of an economic downturn, place downward pressure on long-term interest rates, and may contribute to increased confidence as both consumers and investors anticipate possible tax cuts.

Improved productivity performance was a central factor in supporting the strong-growth, low-inflation environment. Productivity growth persists at rates well above the average for the

Table 1.3 Growth of real GDP by major world region, 1999 and projections 2000–02
(percentage change from previous year)

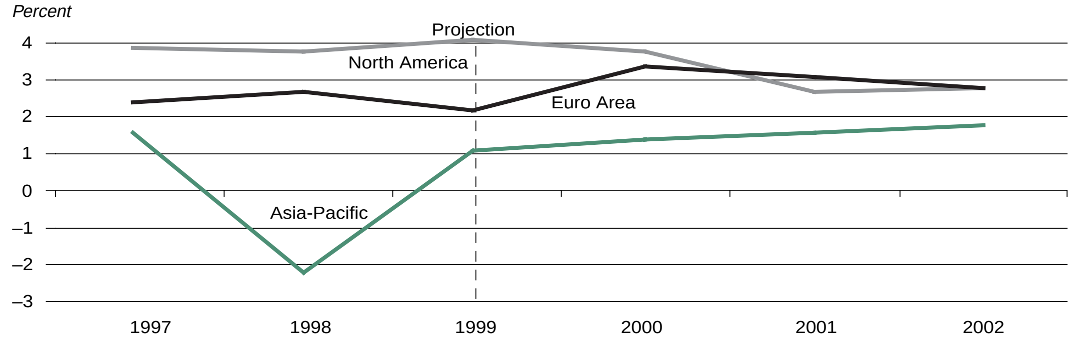
	Current				*Global Economic Prospects 2000*			
	Estimate	Forecasts			Estimate	Forecasts		
	1999	2000	2001	2002	1999	2000	2001	2002
World	2.9	3.5	3.1	2.6	2.9	2.9	2.8	3.0
High-income countries	2.7	3.2	2.6	2.6	2.6	2.5	2.3	2.5
OECD high-income	2.7	3.0	2.6	2.5	2.6	2.5	2.3	2.5
G-7 countries	2.7	3.1	2.5	2.5	2.6	2.4	2.1	2.4
United States	4.1	3.8	2.7	2.8	3.8	2.8	2.2	2.6
Japan	0.7	1.2	1.4	1.6	1.3	0.9	1.1	1.5
G-4 Europe[a]	1.8	3.3	3.0	2.6	1.6	2.7	2.8	2.6
Other OECD industrial	3.0	3.4	3.2	3.0	2.9	3.1	3.1	3.0
Non-OECD high-income	3.7	4.6	4.8	5.1	3.0	4.0	4.6	5.1
Asian NIEs[b]	4.6	5.5	5.4	5.7	3.6	4.9	5.2	5.7
Low- and middle-income countries	3.3	4.6	4.8	4.8	2.7	4.2	4.5	4.8
Excluding Central and Eastern Europe and former Soviet Union	3.5	5.0	5.0	5.1	3.0	4.5	4.8	5.0
Sub-Saharan Africa	2.5	3.2	3.7	3.8	2.3	3.1	3.4	3.4
Excluding South Africa and Nigeria	3.2	3.5	4.0	4.0	3.2	3.6	3.9	3.9
Asia and Pacific	6.3	6.4	6.1	5.9	5.4	6.0	5.9	5.9
East Asia and Pacific	6.5	6.6	6.3	6.1	5.5	6.2	6.2	6.2
Excluding China	5.6	5.7	5.4	5.1	4.3	5.3	5.1	5.1
East Asia Crisis-5[c]	5.8	5.7	5.4	5.1	4.4	5.3	5.1	5.1
South Asia	5.8	5.9	5.8	5.5	5.4	5.5	5.3	5.3
Europe and Central Asia	1.0	2.5	3.4	3.6	0.3	2.5	3.3	3.6
Central and Eastern Europe	1.5	3.4	4.1	4.4	1.0	3.2	4.3	4.4
Former Soviet Union	2.3	1.3	2.3	2.6	0.7	1.3	2.3	2.6
Middle East and North Africa	2.2	3.5	3.6	3.6	2.0	3.2	3.5	3.6
Maghreb	3.4	4.7	4.1	4.3	2.6	4.0	4.1	4.2
Mashreq	3.3	4.5	4.4	4.5	3.2	4.6	4.2	4.3
Developing GCC countries[d]	0.5	2.7	2.4	2.1	–0.3	1.7	2.1	2.3
Latin America and the Caribbean	0.0	3.6	3.8	4.4	–0.6	2.7	3.5	4.4
Memo items								
Oil exporters	1.2	2.6	3.1	3.2	0.5	2.4	3.1	3.2
Primary commodity exporters	2.3	3.8	4.2	4.3	2.2	3.7	4.1	4.3
Other (diversified) exporters	4.1	5.4	5.3	5.4	3.5	4.9	5.1	5.3

a. France, Germany, Italy, and the United Kingdom.
b. Newly industrializing economies—Hong Kong (China), Singapore, and Taiwan (China).
c. Indonesia, Malaysia, the Philippines, the Republic of Korea, and Thailand.
d. Gulf Cooperation Council (Bahrain, Oman, and Saudi Arabia).
Source: World Bank.

1990s and is contributing to a moderation of unit labor costs (figure 1.4). High-technology industries account for a large share of the acceleration of productivity, growth in equipment investment, and GDP growth in recent years.[2] The greater weight of these industries in economic activity, as well as the diffusion of their products through the rest of the economy, is likely to have been reflected in an acceleration of potential output, although the magnitude is difficult to assess with any confidence. Productivity growth is also likely to have benefited from the extensive structural and regulatory reforms undertaken in the United States during the 1980s and 1990s. The likelihood is that, over time, the effects of high-technology diffusion and structural reforms will also be increasingly felt in other industrial countries (as well as in certain developing countries that possess the necessary skills, access, and other preconditions). This represents an upside risk to the forecast over the medium and the long term.

The carryover of the strong momentum from the second half of 1999 makes it more likely that U.S. growth in 2000 will be faster than expected a few months ago. The growth projection for the year has been revised upward from 2.8 to 3.8 percent. Concerned about the robustness of growth sparking a revival of inflation, the Federal Reserve is expected to continue to tighten monetary policy in 2000. The base case scenario of a soft landing

Figure 1.3 Convergence of industrial country growth rates in the early 2000s

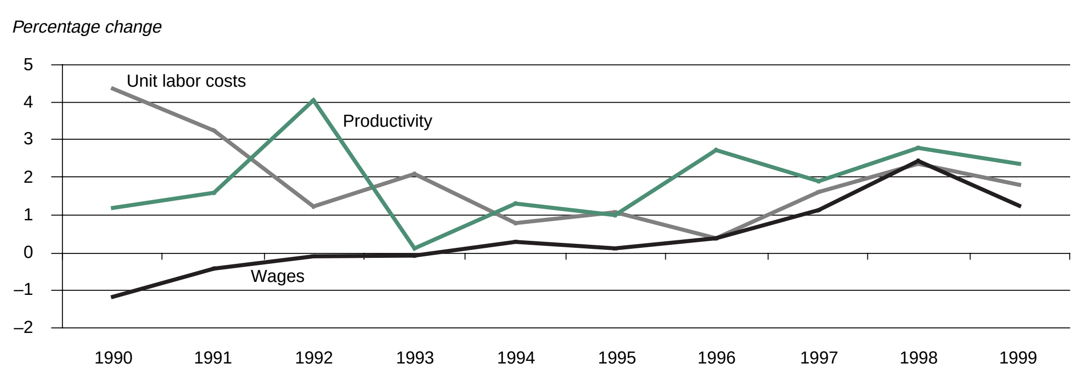


Note: North America includes Canada and the United States. Asia-Pacific includes Australia, Japan, and New Zealand.
Source: World Bank.

for the U.S. economy looks to an appreciable slowing in 2001–02, toward 2.7 percent, in response to Fed tightening. Nevertheless, there exist significant downside risks associated with the remarkable U.S. expansion and the run-up of equity values. These are briefly discussed in the concluding section of this chapter.

Europe too experienced accelerating momentum over the course of 1999, with growth rising to a near 4 percent rate seasonally adjusted annual rate (saar) in the second half, drawing strength in particular from a strong export rebound that reflected both acceleration in world trade and devaluation of the euro (8 percent by the end of the year in real effective terms). The United Kingdom rebounded from a short-lived near-recession at the end of 1998 and is estimated to have grown by 3.1 percent saar in the fourth quarter of 1999. Growth in large *Euro area* countries registered a sharp advance in the third quarter of 1999, including 3.9 percent growth in France, 3.8 percent in Italy, and 3.5 percent in Germany. Some of Europe's smaller countries—Belgium, the Netherlands, Portugal, and Spain—were recording annualized growth between 4 and 5 percent. Although fourth quarter data suggest a modest slowing from these rapid rates, consumer and business confidence remains high across the Euro area, and strong growth momentum is expected to be sustained through 2000. The German economy had been lagging behind

Figure 1.4 U.S. productivity and wages



Source: Datastream; World Bank staff estimates.

that of the broader Euro area, recent increases in export order volumes have been brisk, rising at 30 to 40 percent annualized rates in the three months through October, and export shipments have advanced at rates approaching 20 percent through September.

These largely positive developments have led to an upgrading of forecasts for growth in the Euro area in 2000 to 3.4 percent, following estimates of a 2.2 percent advance in 1999. Incipient signs of greater efficiencies stemming from the launch of the euro—evidenced, for example, in large-scale mergers and acquisitions (M&A) activity in the area—hold promise of medium-term gains in productivity and a catch-up relative to the United States. For the 2001–02 period, Euro area growth has been upgraded modestly to near 3.0 percent. The European economy is expected to contribute about 27 percent of the growth of global output in 2000 and 37 percent of world trade growth, making continuation of the global recovery less dependent on the United States. Europe is still in the early phase of its recovery, and its contribution to world import demand is likely to persist for some time. The region is also less susceptible to a large correction in equity prices, since stock market valuations are lower in proportion to GDP than in the United States, or than they were in Japan during the "bubble" period in the late 1980s.[3] Importantly, Europe also exhibited the lowest volatility of growth among the world's large economic regions in the 1980s and 1990s and the lowest correlation between its growth rate and that of the world as a whole (table 1.4).

Running counter to trends in the United States and Europe, *Japan's* third quarter 1999 GDP fell a sharp 3.9 percent (saar), followed by a sharper 5.5 percent contraction during the fourth, due in large measure to a decline in fiscal stimulus. Other missing ingredients include the consumer—retail sales remain volatile and stand some 2 percent below year-earlier levels—and investment. One positive element in the picture was a resurgence of Japanese exports, concentrated on shipments to the reviving countries of developing Asia and the newly industrialized economies (NIEs), which grew 30 to 40 percent over the course of 1999 from the depths of the crisis. Weakness in consumption and in both public and private investment has offset this positive element. Further, the appreciation of the yen in the latter part of 1999 (12 percent in real effective terms by year end) is expected to dampen the contribution of net exports in 2000.

Table 1.4 Measures of volatility of GDP growth, 1983–99

Country or region	Standard deviation of annual growth rate	Beta relative to world growth rate[a]
East Asia Crisis-5[b]	4.0	1.1
Latin America	2.2	–0.1
United States	1.5	1.0
Japan	2.3	1.4
European Union[c]	1.0	0.7

a. Calculated from a regression of the country or regional growth rate on the world growth rate.
b. Indonesia, Malaysia, the Philippines, the Republic of Korea, and Thailand.
c. The 15 current members.
Source: World Bank.

Recent indicators nevertheless suggest that a modicum of growth will be maintained in the near term, based on an increase in industrial production (despite yen appreciation), and resumption of fiscal stimulus in the run-up to elections. In addition, the recent *Tankan* survey (Japan's most influential survey of business expectations) was surprisingly upbeat for 2000, particularly in the area of investment intentions. These factors, together with an eventual stabilization in consumer markets, should support modest output growth within a 1 to 1.5 percent range over the next two years. The expectation that Japan will not achieve growth above 2 percent (its estimated potential growth rate) for some time is related to two principal factors. First, the overhang of government debt (equal to 105 percent of GDP), built up over a decade of fiscal stimulus measures, will require financing over the coming years, and this will tend to keep interest rates high. Second, the corporate and financial restructuring now getting underway and gaining momentum—while a positive medium-term development—will exact costs in the short term in terms of bankruptcies, redundancies, and generally adverse effects on consumer sentiment.

World trade: a faster and more broadly based expansion

Sharp swings in world trade growth have been one of the most important channels through which the impacts of the recent financial crises have been transmitted through the world economy, both during the descent into crisis in 1997–98, and now, during the recovery from crisis. World import volume growth slumped to less than 4 percent in 1998 as import levels contracted in Japan, the crisis countries of East Asia, and in Russia and other transition economies of the former Soviet Union, pulling down world export growth by a similar magnitude. Only continued strong import demand growth in the United States and Europe prevented an even more severe downturn in world trade, and, with it, a further downward twist in world demand and output.

World import volumes rebounded sharply over the course of 1999 and are now estimated to have grown 6.4 percent, about 2.7 percentage points faster than in 1998. The principal component of the rebound was a sharp recovery in Japanese and East Asian import growth that began in the first quarter of 1999, in response to fiscal stimulus in Japan, strong output recovery in most of the crisis countries, and real appreciation of currencies in the region (table 1.5). East Asian regional import volumes are estimated to have jumped 16 percent in 1999 after slumping 16 percent in 1998. The Japanese and East Asian recovery was complemented by the continued voracious double-digit pace of import growth in the United States.

Due to a variety of statistical discrepancies, data for world exports in 1999 do not yet fully reflect the rebound in imports.[4] Nevertheless the recovering trend over time is apparent from data on world exports expressed in U.S. dollars, which increased by about 5.6 percent in the second half of the year, after falling for the 12 consecutive months to June 1999 (table 1.5). In general, world exports and imports showed an even more marked 1999 upswing in U.S. dollar value terms than in volume terms. This was due to cyclical recovery in prices for primary commodities such as oil and metals, and for manufactures such as semiconductors, as well as to a more general rise in dollar prices for tradables resulting from a fall in the effective exchange rate of the U.S. dollar, after several years of appreciation. East Asian countries' dollar export revenues rose especially quickly in the second part of 1999, buoyed in particular by the sharp upturns in intraregional trade and in world demand and prices for semiconductors and other electronics, both of which comprise important shares of these countries' exports. In general, rising trade prices and dollar export revenues will benefit developing countries with substantial dollar debt servicing commitments.

Looking forward, world imports are now projected to grow significantly faster than anticipated in GEP 2000, rising by a projected 8.6 percent in 2000 and a further 6.9 percent in 2001–02, fueled by stronger growth in the industrial countries and by the recovery in developing Asia and the larger Latin American economies. Among industrial countries, the broadening of strong import growth in Europe and in Japan is helping reduce overdependence on the United States as the engine of world demand (figure 1.5). In addition, the contribution to overall world trade growth of the developing countries and the Asian NIEs is anticipated

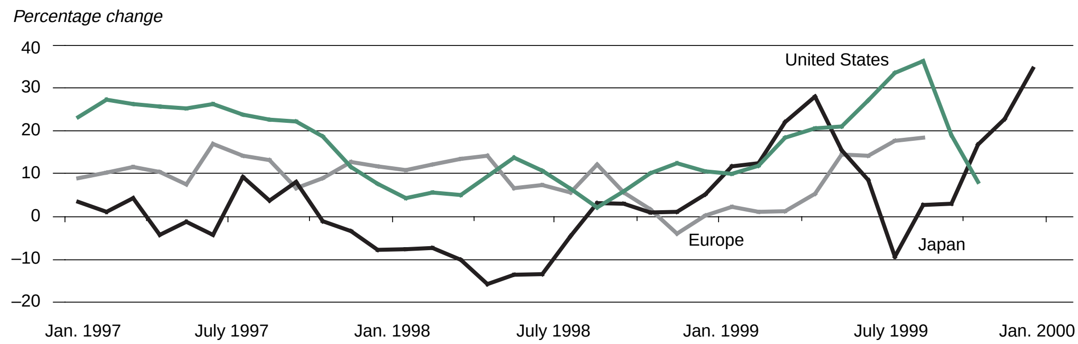
Table 1.5. Growth in export and import volumes, 1998–99

(percent year-on-year)

	Merchandise import volumes					Merchandise export volumes				
		1998		1999			1998		1999	
	Weight[a]	1st half	2nd half	1st half	2nd half[b]	Weight	1st half	2nd half	1st half	2nd half[b]
North America	20.3	11.7	9.0	10.4	12.1	16.2	4.8	2.7	3.2	6.7
Europe[c]	22.4	10.7	8.4	4.9	7.4	26.4	9.9	2.9	–0.4	4.3
Asia[d]	17.4	–4.6	–9.1	3.9	15.0	18.9	5.5	–2.1	1.4	9.7
Total	60.1	6.6	3.6	6.3	11.4	61.5	7.2	1.2	1.1	6.6
Memo item										
World trade value in current U.S. dollars	79.0	–0.5	–2.5	1.3	2.7	79.5	1.4	–1.5	–1.1	5.6

a. Weights are the shares of world imports or exports in 1997 for countries with reliable monthly trade data.
b. Average for July through November.
c. France, Germany, Italy, Spain, Sweden, and Switzerland. Figures in bold exclude France.
d. Japan, Hong Kong (China), the Republic of Korea, Singapore, and Taiwan (China).
Source: World Bank staff estimates.

Figure 1.5 Industrial countries' import volume growth



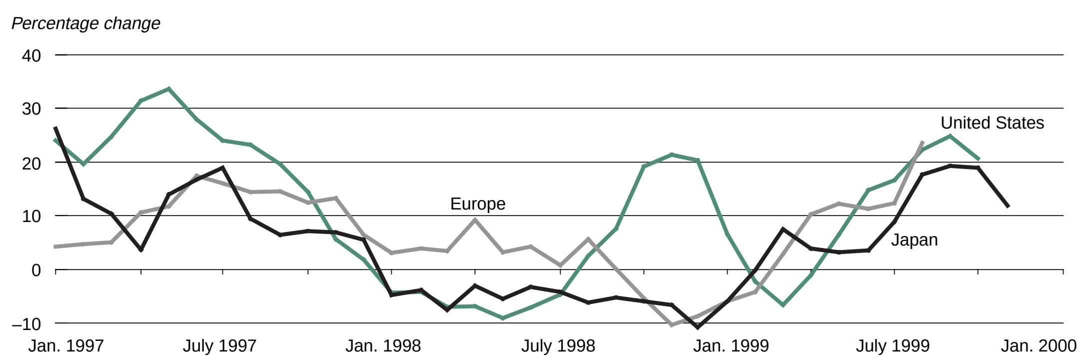
Note: Figures are three-month moving averages. Europe includes Germany, Ireland, Italy, Spain, Sweden, Switzerland, and the United Kingdom.
Source: Datastream and World Bank staff estimates.

to increase—from a net contraction in 1998, to a 25 percent contribution in 1999, to over 40 percent in 2000. Among developing regions, the largest increase in growth contribution between 1999 and 2000 is likely to come from Latin America and from developing Europe and Central Asia. In the latter region, the sharp decline in CIS (Commonwealth of Independent States) countries' imports that began in 1999 is likely to abate this year.

Industrial country exports are responding to the revival in world and developing country import demand (figure 1.6). Markets in developing Asia are providing an important driver for export growth in both the United States and Japan, while the incipient recovery in Latin America is now also contributing to growth in U.S. shipments. In Europe, the pickup in export growth reflects the real depreciation of the euro, resulting in double-digit growth to the industrial countries outside of the Euro area, as well as (for Germany) to the Central European countries.

Strengthening world import demand is also resulting in higher export volumes and higher prices for exports of developing countries (see next section). However, the extent of export gains at the individual-country level will be affected by the

Figure 1.6 Industrial countries' export volume growth



Note: Figures are three-month moving averages. Europe includes Ireland, Italy, Germany, Spain, Sweden, Switzerland, and the United Kingdom.
Source: Datastream and World Bank staff estimates.

Table 1.6 Growth of world merchandise trade, 1991–99 and forecasts, 2000–02
(percentage change from previous year)

Indicator and region	1991–98[a]	1998	1999	Forecasts 2000	Forecasts 2001	Forecasts 2002
World trade growth	6.5	4.2	5.2	7.8	6.7	6.5
World output growth	2.3	1.9	2.9	3.5	3.1	3.1
Import growth						
High-income countries	5.9	5.8	6.8	8.2	6.5	6.2
OECD countries	5.5	7.4	7.0	8.1	6.3	6.0
United States	8.1	11.4	11.7	10.5	6.0	5.9
European Union[b]	4.7	8.2	5.1	7.5	6.9	6.3
Japan	4.6	–6.3	9.7	8.5	6.5	6.0
Non-OECD high-income countries	9.7	–5.7	4.9	8.8	8.2	8.0
Developing countries	8.2	–2.7	5.1	10.1	8.9	7.8
Sub-Saharan Africa	4.8	3.2	0.3	6.2	4.9	4.7
East Asia and Pacific	9.1	–16.0	16.0	14.5	11.9	10.3
South Asia	11.3	9.8	5.4	7.9	7.8	8.2
Europe and Central Asia	5.5	2.1	–3.8	6.4	8.3	6.7
Latin America and the Caribbean	14.0	8.3	–0.7	9.3	7.2	6.0
Middle East and North Africa	0.9	3.5	6.0	5.9	5.0	5.1
Export growth						
High-income countries	5.8	3.8	3.3	7.8	6.3	6.1
OECD countries	5.4	4.1	3.0	7.7	6.1	5.9
United States	6.5	2.0	3.6	9.7	6.5	6.1
European Union	5.8	6.9	2.9	7.3	6.2	6.1
Japan	1.9	–1.8	2.1	8.1	6.3	5.7
Non-OECD high-income countries	9.1	2.1	5.9	8.3	7.7	7.6
Developing countries	9.3	6.7	5.9	8.5	7.7	7.4
Sub-Saharan Africa	2.5	–1.1	3.5	7.1	5.6	5.7
East Asia and Pacific	15.2	10.0	9.4	10.5	9.5	8.9
South Asia	9.5	1.7	6.0	7.5	7.8	7.7
Europe and Central Asia	5.6	6.0	–0.5	6.0	6.2	5.8
Latin America and the Caribbean	9.2	5.6	6.3	9.1	7.2	6.8
Middle East and North Africa	4.3	3.6	2.5	3.5	4.0	4.6
Memo items						
East Asia Crisis-5 imports[c]	6.7	–23.8	15.6	15.9	12.4	10.9
East Asia Crisis-5 exports[c]	14.7	12.3	9.7	10.0	8.9	8.5

a. Annual averages.
b. The 15 current members.
c. Indonesia, Malaysia, the Philippines, the Republic of Korea, and Thailand.
Source: World Bank data.

large shifts in real effective exchange rates that have occurred since the crises of 1997–99. Some countries have seen large real devaluations of 20 percent or more (the East Asia Crisis-5, Russia, and others), and most of these countries are likely to see large export revenue increases reflecting higher world demand, improved export prices, and greater international cost-competitiveness (figure 1.7). The East Asian countries are poised to benefit the most from a near doubling in the growth of their export markets in 2000–02 and are expected to register the fastest export growth (9.6 percent) among developing regions. Latin America and South Asia will also see faster growth in their export markets but have seen smaller changes in real exchange rates since 1997. (Brazil, Chile, Colombia, and Pakistan are exceptions.) Export growth for these regions are expected to be in the range of 7.5 to 8.0 percent in 2000–02.

Central European countries and Turkey should experience an export boost from faster import demand growth in the Euro area. In addition, import demand from Russia and some other CIS countries should stabilize after declining precipitously in 1999, helping stabilize market prospects for countries in the immediate region. Exports from Sub-Saharan Africa are expected to grow by 7.1 percent in 2000 and by an average of 5.6 percent in

Box 1.1 World trade post-Seattle

The Seattle meeting of the World Trade Organization (WTO), held in early December 1999, did not achieve expectations for agreement on an agenda to begin a new round of trade liberalization. Disagreement centered on agricultural policies, the practice of antidumping measures, the role of developing countries in the process, and the linking of trade policies with labor and environmental standards. Consensus on these issues could not be reached among industrial countries or between industrial and developing countries. In addition, the effect of public protests in Seattle certainly influenced the atmosphere and the public's perception of failure.

Initiatives are currently underway to revive the talks. The WTO is proposing to start negotiations on the so-called built-in agenda focusing on agriculture and services. Potential agreement on other measures are also intended to rebuild confidence in the process, notably efforts to eliminate trade barriers in industrial countries on imports from the least developed countries, and the accession of China into the WTO. Confidence will also need to be rebuilt in the public mind about the benefits of world trade. Although it is understood that the impacts of a new successful trade round would take some years to be fully felt and ratified—for example, it took eight years to negotiate the Uruguay Round—the failure in Seattle threatens to slow or even reverse the momentum toward freer trade established over eight trade rounds since 1947. This is especially true for final implementation of the Uruguay Round, scheduled to be completed in 2005, and the continuation of trade reform at the unilateral, bilateral, and regional levels that is currently underway. Nonetheless, with world trade recovering robustly from the recent global financial crisis, the short-term implications of the outcome of these negotiations for global trade growth are unlikely to be major. However, in the longer term, agreement on a broad-ranging round will be critical to sustain higher world trade and economic growth.

2001–02, reflecting the coming onstream of a large natural gas project in Nigeria, the signing of a trade agreement between the EU and South Africa, and efficiency gains in the reforming countries. The Middle East and North Africa region—where countries tend to have a high export dependence on oil and other primary commodities—is projected to see relatively slow export volume growth (4 percent in 2000–02), though export revenue gains will be boosted by higher export prices.

Commodities: prices becoming firmer

Sharp declines in world demand in the wake of the international financial crises contributed to very large falls in many primary commodity prices, exacerbating the burden of adjustment on many commodity-exporting developing countries. The index of nonenergy commodity prices fell 11.2 percent in 1999, on the back of a 15.7 percent decline in 1998. Oil prices also slumped by over 30 percent in 1998, the trough year of the crisis. Taken in perspective, non-oil commodity prices deflated by the manufactures unit value (MUV) index have fallen by about 50 percent since 1980, and oil prices are down over 70 percent over the same period. Nevertheless, the prices of most commodities did reach their troughs and began to recover during the course of 1999, due to rising demand for commodities closely linked to industrial production, such as metals and petroleum products, and to cuts in supply by producers, most notably of oil, whose price surged nearly 40 percent. The prices of most major commodity groups are expected to strengthen further in 2000, but, except for oil and metals, few of these increases are expected to be especially robust. Prices are expected to rise even more mutedly from 2001. Thus, while commodity exporters are in general expected to be spared the burden of adjustment to further terms of trade declines, they would not be justified in expecting any significant windfall gains in income from this source either.

The recent recovery in commodity prices was led by petroleum, which reached a low in December 1998 of $10.40 per barrel, then rose to a nine-year high of $27.22 per barrel in February 2000. The combination of supply reductions and rising demand sharply depleted stocks in 1999 and early 2000. Uncertainty about the timing and magnitude of higher oil production kept oil prices high, and the outlook for prices in 2000 has been raised to $23 per barrel, 27 percent above the average price in 1999. Stocks for most metals remain stubbornly high (nickel is an exception), but strengthening demand should outstrip supply, boosting prices in 2000 beyond what

Figure 1.7a Asian real effective exchange rates

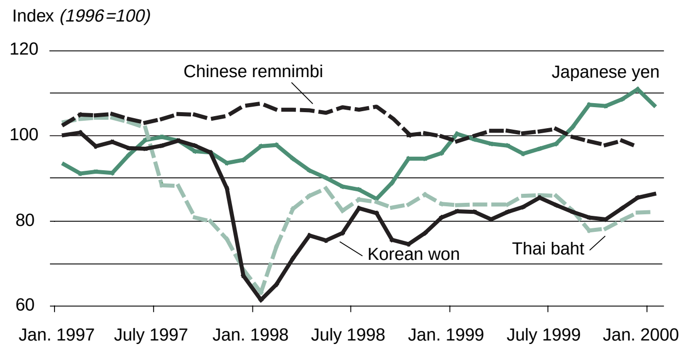


Figure 1.7b European real effective exchange rates

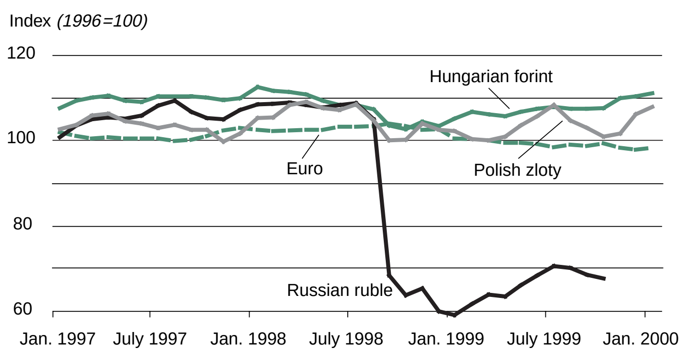
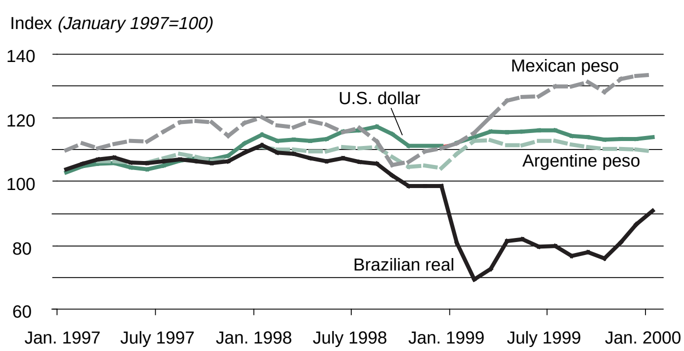


Figure 1.7c Americas' real effective exchange rates



Source: J.P. Morgan.

was previously expected (prices are now projected to rise 11.7 percent, compared with 6 percent in GEP 2000). The outlook for gold is less robust, because supply will be bolstered by central banks' sales, albeit at lower levels than in the past year.

Agricultural goods witnessed the sharpest price decline during 1999: the overall index was down 13.6 percent. Unlike metals and petroleum, the supply of agricultural commodities did not contract substantially in response to lower prices, and therefore stocks of many commodities remain high. Although agricultural prices have likely bottomed out (average prices rose 5 percent between July and December 1999), they are expected to remain volatile over the course of the projection period as markets react to news about possible supply cuts. Within agriculture, grains prices are expected to rise a reasonably robust 8 percent in 2000 (after falling nearly 40 percent during the past three years), as market fundamentals are improving and stocks are expected to continue declining in 2000. Beverage prices are, however, expected to decline in 2000 because of market surpluses for cocoa (production will increase 8 percent) and coffee (production will again exceed consumption by some 4 to 6 million bags). Tea prices are expected to retain their 1999 levels. Prices for agricultural raw materials such as rubber and cotton are expected to mount a mild recovery in 2000–01 from the extremely low prices of recent years. However, in general, exporters of foodstuffs and raw materials are unlikely to see prices in the forecast period recover to their 1990–96 averages (figure 1.8).

The rather skewed pattern of recovery in commodity prices has impacted developing countries differently. Oil exporters have gained substantially: while terms-of-trade changes reduced their real incomes (expressed as a share of GDP) by about 3 percent in 1998, they generated a 5 percent increase in 1999 and are projected to yield another 3 percent gain in 2000 (figure 1.9). Terms-of-trade shifts among non-oil commodity exporters have also been significant, amounting to an income loss of over 1 percent of GDP in 1999, although certain countries that export agricultural commodities suffered much larger losses. Taking 1999 and 2000 together, several agricultural commodity exporters in Sub-Saharan Africa and Central America could see terms-of-trade-based income losses amounting to 5 percent of GDP in some cases. The expected decline in prices for beverages in 2000 will affect countries in Latin America (Brazil, Colombia, and several Central American countries) and in Sub-Saharan Africa (Côte d'Ivoire, Ghana, Ethiopia, Kenya, and Uganda, to name a few). Diversified developing-country exporters, on the other hand,

Table 1.7 Changes in commodity prices, 1981–99 and forecasts, 2000–02
(percentage change from previous year)

Commodity group	1981–90	1991–97	1998	1999	Forecasts 2000	Forecasts 2001	Forecasts 2002
Non-oil commodities	–2.3	17.6	–15.7	–11.2	5.6	3.9	3.3
Food	–3.3	16.1	–9.8	–16.6	6.4	3.8	3.6
Grains	–2.9	12.1	–9.7	–14.7	7.7	6.4	5.1
Beverages	–5.8	70.7	–17.7	–23.4	–1.9	4.6	3.2
Raw materials	–0.5	13.7	–23.2	1.3	6.4	5.0	3.4
Fertilizers	–2.5	19.7	2.0	–6.6	–1.9	0.0	2.2
Metals and minerals	0.6	–9.8	–16.2	–2.3	11.7	2.7	3.0
Petroleum	–4.7	–16.2	–31.8	38.3	27.3	–17.4	–5.3
G-5 MUV[a]	3.3	1.1	–3.9	–0.6	2.5	2.5	2.6

Note: Data are changes in World Bank commodity price indexes calculated from prices in nominal dollars.
a. Manufactures Unit Value Index.
Source: World Bank data.

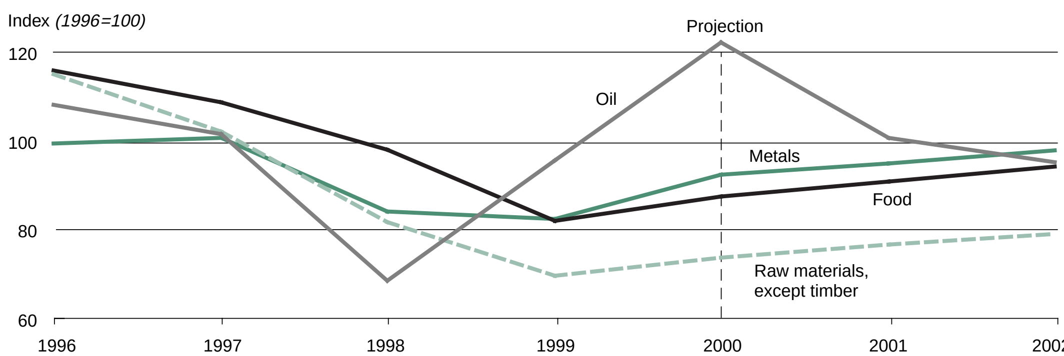
have seen relatively small changes in their terms of trade, and this pattern is expected to continue as higher commodity import prices are offset by a modest rise in the price of manufactures exports.

Interest rates: on an uptrend

Inflation is picking up moderately among the industrial countries (except Japan), and market expectations are for policy interest rates to continue their upward movement in 2000. Real short-term U.S. dollar interest rates[5] are expected to average 3.5 to 4 percent over the projection period, compared with an average of 2.9 percent in 1994–97. The current projections for real interest rates are only marginally higher than in GEP 2000, by about 20 basis points in 2000. Nevertheless, an element of uncertainty continues to be attached to the expected path of policy interest rates, depending on the future evolution of inflation.

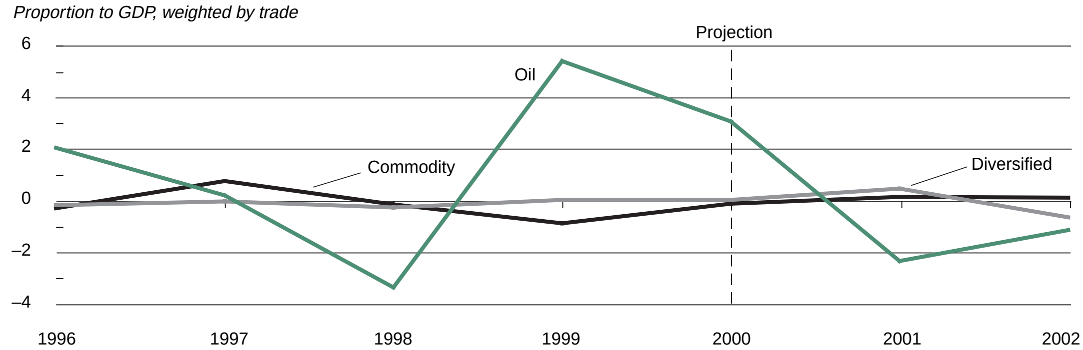
In the United States, economy-wide wage gains have remained moderate, while productivity growth in manufacturing continued at over 6 percent during 1999, yielding declines in unit labor costs. These factors have restrained consumer prices. Nonetheless, external pressures stemming from higher import prices (especially for petroleum) are feeding into the U.S. production pipeline and are likely to underpin somewhat higher inflation in 2000. In the three months through November 1999, import prices advanced by 9 percent (figure 1.10; all data are seasonally adjusted), producer prices by 4.5 percent, and consumer

Figure 1.8 Commodity price indices, 1996–2002



Source: World Bank.

Figure 1.9 Change in terms of trade as a share of GDP

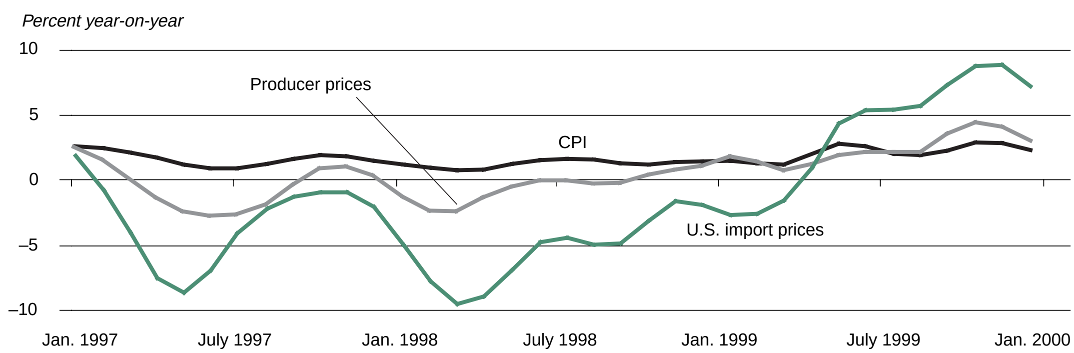


Source: World Bank.

prices by 2.9 percent. Given the backdrop of a prospective acceleration of inflation, continued strong domestic demand growth, and a burgeoning external imbalance, financial markets have discounted at least a 50 basis-point increase in the Federal Funds rate over the first half of 2000. Inflation in the 1990s has remained subdued compared with similar long expansions in the 1960s and 1980s, and in part this reflects a more preemptive stance in monetary policy. Figures 1.11a–11c show that the real Federal Funds rate has consistently exceeded the rate of inflation since 1997 despite the decision to reduce interest rates in the fall of 1998, during the worst of the financial crisis.

The European Central Bank (ECB) is now reexamining its accommodative monetary stance against a background of firming activity, prospective higher wage settlements in key German industries, a weak exchange rate, and higher oil and other commodity prices. Signs of incipient inflation pressures have appeared, with harmonized price increases moving toward 1.9 to 2.0 percent (year-on-year) in December, up from only 1.0 percent as recently as July. Higher interest rates in the United States and a 25-basis-point hike by the Bank of England in early January may elicit a modest tightening response from the ECB in the spring. At the same time, the Bank of Japan is expected to maintain the cost of funds to the banking system at ef-

Figure 1.10 U.S. consumer, producer, and import prices, 1997–2000



Note: Figures are three-month moving averages.
Source: U.S. Bureau of Labor Statistics.

Figure 1.11a U.S. inflation and real interest rates, March 1961–December 1969

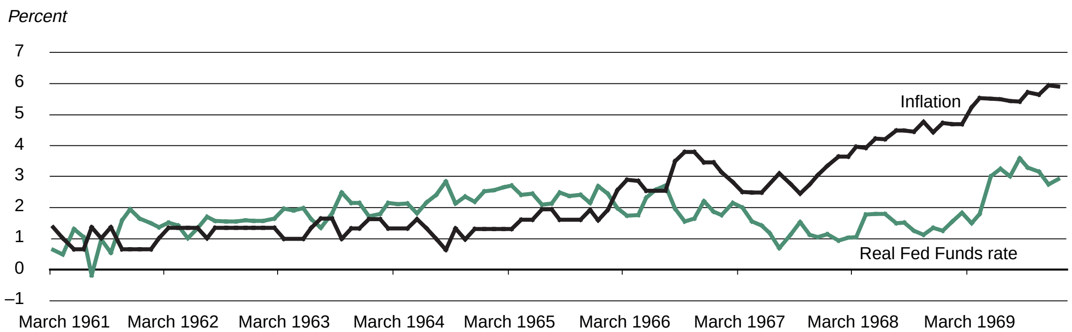


Figure 1.11b U.S. Inflation and real interest rates, December 1982–July 1990

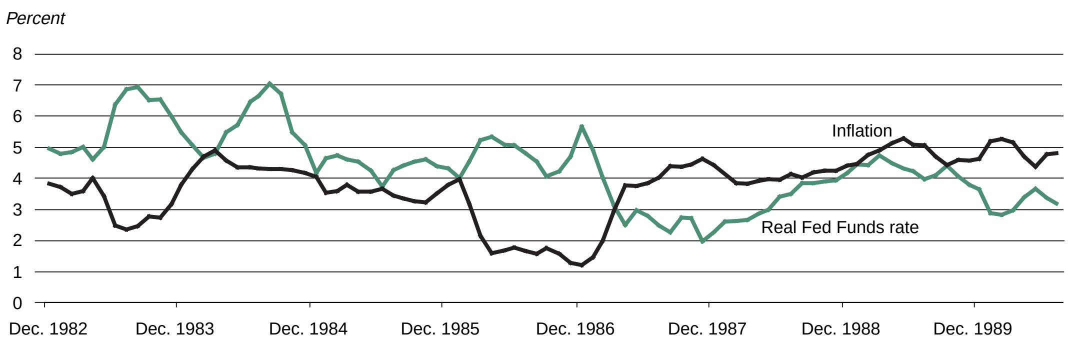
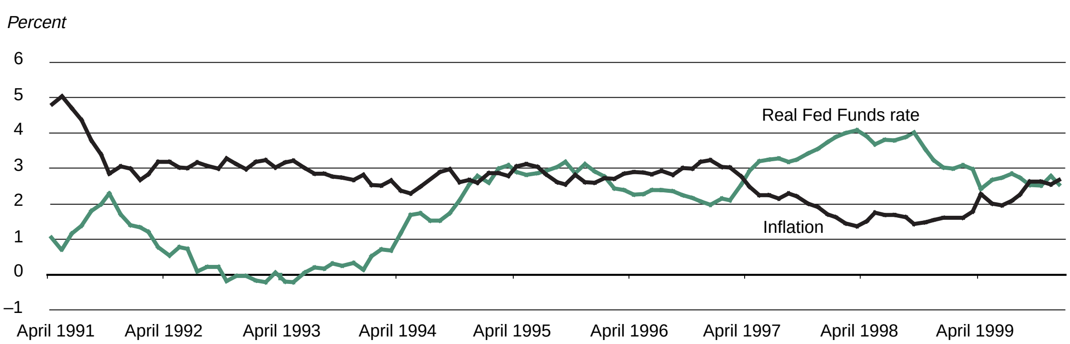


Figure 1.11c U.S. inflation and real interest rates, April 1991–present



Source: Datastream; U.S. Federal Reserve Board; World Bank staff estimates.

fectively zero, until stronger signs of private-sector recovery emerge. Long-term interest rates in Japan are likely to trend higher, however, as the massive financing requirements of a succession of public stimulus programs begin to be met in the domestic bond markets.

Private capital flows to developing countries: a gradual recovery

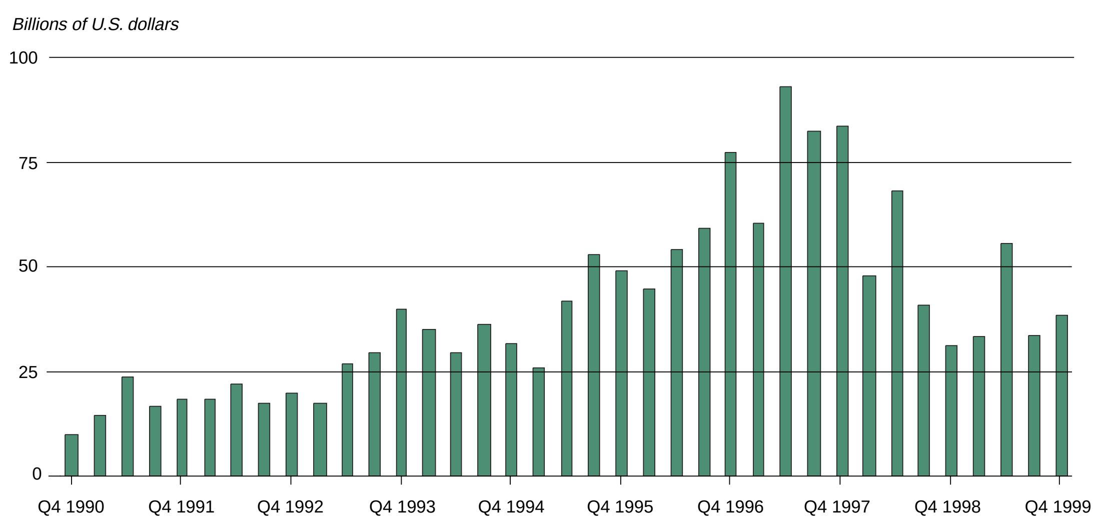
Capital flows to developing countries from international capital markets fell by 14 percent in 1999 on a gross basis, and by much more on a net basis. (See chapter 2 for a more detailed analysis of trends in capital flows.) As a result, the share of emerging markets in global capital market financing fell to 4.5 percent in 1999 compared with 6.4 percent in 1998 and 11 percent in 1997. Nevertheless, as figure 1.12 indicates, gross capital market flows in the second half of 1999 appeared to be at least stabilizing around year-earlier levels.

The outturn for the latter part of 1999 might seem lower than could have been expected given the reduction in risk perceptions during the year, reflected in a fall in emerging market spreads of almost 600 basis points since the start of the year and of around 200 basis points since September. However, demand for foreign borrowing in East Asia remained muted by a substantial decline in investment, as reflected in large current account surpluses. Demand for external capital in oil exporting countries that had previously been active borrowers in capital markets is also likely to have been reduced by the rise in oil prices, combined with a need to rein in fiscal deficits. Financial conditions in developing countries continued to loosen, reflecting these still soft aggregate demand conditions, as well as increased investor confidence. In most emerging markets, currencies strengthened, real interest rates declined, and the real value of stock markets continued to rise, as they have since the fourth quarter of 1998 (table 1.8).

Private capital flows to developing countries are likely to recover moderately in 2000, as forecast in GEP 2000, but at a slightly faster pace. Interest rate increases in the U.S. are not expected to adversely affect capital flows to developing countries. Gross capital flows from international capital markets are now projected to rise from $161 billion in 1999 to around $185 billion in 2000, and to $220 to 230 billion in 2001. This would represent a return in the ratio of capital flows to developing-country GDP to the relatively high levels of 1995, itself the result of a strong rise in private flows over the first half of the 1990s (figure 1.13). The projection for 2001 would remain below the extraordinary levels of private capital flows experienced during the speculative bubble of 1996 and 1997, in the run-up to the outbreak of the financial crises. But, given the current absorptive capacity of developing countries, that may be more appropriate.

At the same time, FDI to developing countries, which proved resilient in 1998 and 1999, is likely to increase to about $200 billion in 2000 and $215 billion in 2001, from an estimated $183 billion in 1999. This reflects better growth prospects for developing countries and acceleration of world trade. The relatively modest pace of increase in FDI flows to developing countries represented by these numbers may reflect in part a natural stock-adjustment

Figure 1.12 Gross capital flows to emerging markets



Source: Euromoney; World Bank staff estimates.

Table 1.8 Movements in real effective exchange rates, real stock prices, and real interest rates in selected developing countries, 1998–2000

	Real effective exchange rate indices ($/local currency, June 1996–97=100)			Real stock market indices (in local currency, June 1997=100)[a]			Real interest rates indices (3-month interbank, June 1997=100)[b]		
	Sept. 1998	Sept. 1999	Jan. 2000	Sept. 30 1998	Sept. 30 1999	Jan. 31 2000	Sept. 1998	Sept. 1999	Jan. 2000
Indonesia	47	64	75	20	40	45	80	104	104
Korea, Rep. of	77	82	87	38	103	115	96	99	98
Malaysia	75	73	73	33	58	78	97	96	95
Philippines	75	75	74	40	63	59	102	100	103
Thailand	81	76	80	43	67	82	93	94	93
Argentina	104	107	106	46	66	70	105	105	104
Brazil	99	75	88	51	81	116	115	99	97
Mexico	98	122	123	67	82	103	120	105	105
Russia	68	68	67	17	36	78	137	76	96
Turkey	105	108	115	52	73	153	106	104	78

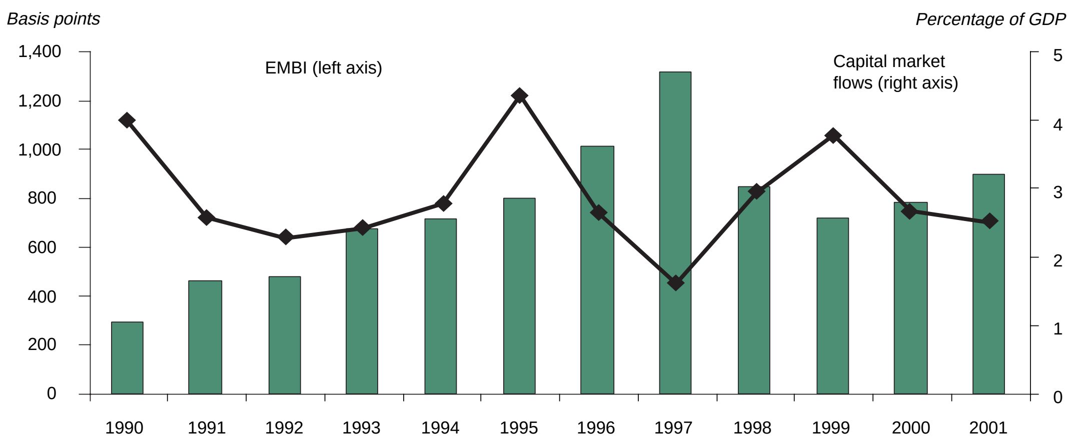
a. End of period, deflated by CPI inflation.
b. Three-month interbank rates, monthly averages, deflated by CPI inflation.
Source: Bloomberg, J.P. Morgan for real effective exchange rates.

process in which multinational corporations have moved closer to their desired capital stock in developing countries that have been recipients of large FDI flows for many years. FDI flows in the next few years may also be restrained by a somewhat reduced pace of mergers and acquisitions activity in the crisis-affected East Asian countries, as well as lower privatization proceeds in Latin America and in Eastern Europe, where most blue-chip enterprises have already been privatized.

Outlook for developing countries: generally improving but highly differentiated

Faster growth of exports (and, in many instances, firming export prices), looser financial conditions, and the return of investor confidence should bolster developing-country growth over the forecast period. Developing countries in East Asia are expected to see a gradual decline in their large current account surpluses as domestic demand con-

Figure 1.13 Gross capital market flows as a ratio of developing country GDP and spreads on Emerging Market Bond Index (EMBI)



Source: Euromoney; IMF; World Bank staff estimates.

tinues to recover. The region is also likely to revert to greater reliance on the expansion of intra-regional trade to fuel growth. If, as assumed, U.S. imports continue to grow at fairly rapid rates, capital flows recover gradually, and commodity prices are firmer, then the Latin American countries will see a large improvement in their external environment, and their growth recovery will strengthen. In Central Europe, the improved prospects of several countries for EU accession should spur reforms and stimulate the interest of foreign direct investors. In addition, the cyclical acceleration in the Euro area will contribute significantly to growth in developing countries that are highly dependent on European markets; these include virtually all developing countries in Europe and Central Asia, the Middle East and North Africa, and Sub-Saharan Africa. However, the outturn is likely to be differentiated across countries, depending on their progress on domestic reforms and on their structural characteristics:

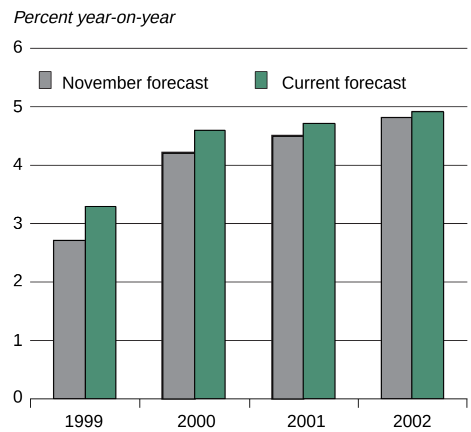
- Despite benefiting from the highest oil prices since 1990, *oil exporters* are still adjusting to the effects of the Asian crisis. The crisis contributed to a collapse of oil prices, which drastically cut both foreign currency receipts and tax revenues and followed a protracted period of low and declining oil prices extending (with a few brief interruptions) back to the 1980s. Unlike the oil price hikes of the 1970s, the current surge in oil prices is widely expected to be temporary. This reinforces the need to sustain efforts at fiscal consolidation and structural reforms to create the preconditions for successful diversification of the economy. Oil production and export volumes have been restrained in an effort to boost prices, and this was reflected in output growth outturns in 1999 for several OPEC members. Out of 17 developing countries that are oil exporters, 7 are anticipated to experience negative growth in per capita GDP in 2000, contrasted with 13 countries during the 1998–99 crisis period. But even those exporters showing a rise in GDP per capita are likely to see only a modest acceleration (less than 2 percent). Several oil exporters (among them several CIS countries, Ecuador, and Indonesia) are among the worst-affected by the crisis, and their recovery will be even more difficult and protracted.
- Real incomes of non-oil commodity-exporting countries were less adversely affected by the crisis than were those of the oil producers, as declines in key commodity export prices were more than offset by the initial sharp fall in oil prices. Nonetheless, the slowdown in export market growth (stemming particularly from the collapse of demand in Asia but also from the slowing of growth in Europe) exacted some toll. Out of a sample of 57 non-oil commodity exporters, 22 experienced declines in income per capita during 1998–99. In 2000 the number of these countries experiencing falling incomes per capita is expected to drop to 7. Still, only moderate gains in commodity prices, combined with surging oil prices, imply a deterioration in their terms of trade. Historically, short-term fluctuations in the terms of trade have had little measured impact on output growth in non-oil commodity exporters in Sub-Saharan Africa, perhaps because of the long lags involved in adjusting production in the agricultural and mining sectors, which account for the largest share of output in these economies. Furthermore, adverse shocks to the terms of trade have usually been accompanied by a widening of the current account deficit, which suggests that countries have been able to finance consumption and investment spending to some extent. In light of these considerations, the performance of per capita growth among non-oil commodity exporters is forecast to improve with rising export volumes, but is likely to be held below 2 percent.
- Exporters of manufactures and diversified goods are likely to see the largest output acceleration in response to rising export demand, reflecting both the greater sensitivity of their exports to world income and demand and, in several cases, real depreciation of their currencies. Several of these countries (which tend to be middle-income developing economies) are dependent on capital flows and some are implementing the most comprehensive reforms of any developing countries in the wake of the crisis. Although 10 out of 30 diversified exporters experienced negative growth in income per capita during the crisis period, current projections suggest that only a few will see further declines during 2000. Virtually all the most trade-dependent diversified exporters

(those with trade–GDP ratios greater than 70 percent) are expected to register advances in GDP per capita of 2 percent or more, contrasted with 60 percent of those economies that are less dependent on world trade.

Developing country output is estimated to have grown by 3.3 percent in 1999; it is now projected to advance by 4.6 percent in 2000 and by an annual average of 4.8 percent in 2001–02 (figure 1.14). However, revisions to these numbers are not uniform across regions: Europe and Central Asia and Sub-Saharan Africa received only modest upgrades (figure 1.15). Although the revisions may appear moderate given the recent very encouraging news on industrial countries and world trade, and given that one might expect recovery to be rapid after a severe downturn, three factors suggest caution in anticipating a more rapid acceleration in developing country growth.

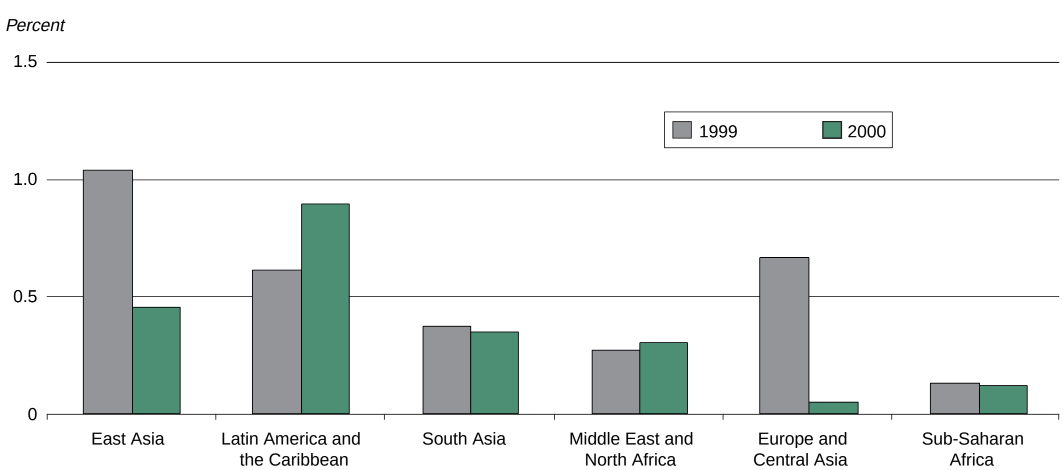
First, domestic adjustment to the effects of the recent crisis is far from complete, especially in the financial sector, in a number of Asian and Latin American countries. Although rapid growth in some East Asian countries is improving conditions in their financial sectors, stress indicators such as the level of nonperforming loans (NPLs) remain high in Indonesia and Thailand, and complacency could slow the unfinished restructuring. The banking sector in Mexico remains weak four years after the tequila crisis, despite rapid growth during the interim, and the potential cost to the government of its bailout of the sector in 1995–96 continues to increase. Despite their encouraging recent progress, the process of fiscal consolidation in the crisis countries and in some of the largest developing

Figure 1.14 Real GDP growth for developing countries



Source: World Bank (February 2000); *Global Econonic Prospects 2000* (November 1999).

Figure 1.15 Revisions to GDP growth in developing regions, 1999–2000



Note: Revisions in both years are to the forecasts in *Global Economic Prospects 2000* (November 1999).
Source: World Bank.

economies less affected by the crisis is likely to be difficult and drawn-out.

Second, growth in several of the larger highly indebted developing countries remains vulnerable to the incomplete recovery and continued volatility of private capital inflows. Although average spreads on emerging market debt have declined sharply in the last year, they remain above their precrisis levels, and private sector borrowers' access to external capital is still limited in many countries.

Third, as mentioned above, the terms of trade are likely to worsen in the short term for developing countries that export primarily agricultural products, because prices for these commodities are expected to recover more slowly than prices for oil, metals, and manufactured goods. Although a large effect on growth is not expected, the implied deterioration in the balance of payments and (in some cases) fiscal balances will make these economies more vulnerable to other adverse shocks and will reduce policymakers' room to maneuver.

A synopsis of *regional outlooks* follows (more detail is included in the annex to this chapter).

East Asia: The recovery in this region is progressing as broadly anticipated in GEP 2000, but growth in the five crisis economies was faster than estimated in 1999: 5.8 percent compared with 4.4 percent expected previously. Stronger-than-anticipated growth in the United States and a rapid rise in domestic demand in the crisis countries, particularly for consumer durable goods (notably automobiles), are major factors in the upward revision, combined with the effect of strong intra-regional trade multipliers. The strengthening of consumer demand was abetted by the persistence of low interest rates and a relatively rapid turnaround in labor markets. For example, the unemployment rate in Korea (where the recovery has been most spectacular) fell from a postcrisis peak of 8.6 percent in February 1999 to 4.5 percent by November. Booming exports and imports (both enjoying about 2 percentage points more-rapid growth than earlier expected) resulted in a slight increase in the region's current account surplus and a further rise in reserves of some $50 billion—about 16 percent more than at the end of 1998. Despite the sharp rise in oil prices, inflation remained relatively benign thanks to the combination of a substantial output gap and appreciation of local currencies against the dollar.

The growth forecast for the broader region in 2000 has been raised by 0.4 percentage points, to 6.5 percent, as the considerable output gap that remains within the crisis countries is partly closed. Estimates of the output gap across the five crisis countries vary from 10 to 20 percent; even in Korea the gap is substantial. This should prompt monetary authorities in the region to continue accommodative policies in the foreseeable future and allow for only a modest renewal of investment, particularly for capital equipment; recovery in the construction sector will take longer. Growth prospects for 2001–02 remain in line with earlier forecasts despite a major development since that time, namely, the signing of a trade agreement (still to be ratified) between the United States and China that will facilitate China's entrance into the WTO. In the very short term, China's eventual WTO accession is unlikely to lead to a significant acceleration of growth, because improvements in the private investment climate—including inward FDI—could be offset by an increase in unemployment as restructuring progresses and private consumption slows. Among the crisis-affected countries, the forecast for 2001–02 remains largely unchanged, as developments in corporate and financial restructuring are unfolding as expected—making progress, but at a relatively slow pace.

Latin America: Various strands of recent evidence suggest that the recovery here will be stronger than earlier expected. Output is now estimated to be flat in 1999 (an upward revision of 0.6 percentage points) and is likely to grow 3.6 percent in 2000 (up by 0.9 percentage points). A stronger U.S. market and improvement in the prices of the region's commodities are key factors behind the upward revisions for 1999–2000. These external factors have combined with benign inflation performance, despite depreciating currencies in several countries and more accommodative monetary policies to buoy the business climate.

Industrial production in Argentina, Chile, Mexico, and, to a lesser extent, Brazil rebounded sharply in the second half of 1999. Although unemployment rates remain high in a number of countries (ranging from 9 to 18 percent in Argentina, Chile, and Colombia), they have begun to recede, most rapidly in Chile and Colombia (by over two percentage points between September and December), signaling that recessions have bottomed out. Despite the devastating mudslides in the Republica Bolivariana de Venezuela in December, and despite political turmoil in Ecuador, rising oil prices have restrained output declines in these countries. Brazil's macroeconomic indicators have been positive, especially in light of the crisis conditions that prevailed at the beginning of 1999. Inflation has dropped below 9 percent and the fiscal primary surplus target of 3.1 percent of GDP was met, allowing a sharp reduction in nominal interest rates over the course of the year. These rates fell from 43 percent in February to 19 percent in December, or in real terms from a range of 25 to 35 percent to about 10 percent. Negotiations aimed at revitalizing trade among the Mercosur countries—which fell sharply in 1999—are underway.

Prospects for the region's recovery remain moderate in 2000, as a number of factors will tend to offset the strong acceleration in growth that the boost from world trade would normally imply. First, the expected rise in U.S. LIBOR (normally a benchmark for dollar debt)—to 100 basis points above the average for 1999—will tend to increase the cost of debt servicing and of new borrowing, unless offset by a reduction in risk perceptions through lower spreads. Second, the region's net oil-importing countries will be facing significant deterioration in their terms of trade, which could widen their trade deficits and translate into higher imported inflation. Third, food prices are likely to recover after large declines in 1998–99—a contributing factor to relatively low inflation in Brazil—putting additional upward pressure on inflation rates. Finally, the region-wide current account deficit will remain above 3 percent of GDP in 2000 and beyond, a sizeable downward adjustment from 4.5 percent in 1998, but still at a level that may keep foreign investors from accelerating their investment in the region. Nonetheless, the overall improvement in world trade in 2000 is expected to allow faster growth of output in the region than earlier expected. The region's GDP growth in 2001 is projected at a conservative 3.8 percent, largely reflecting the anticipated slackening of demand in the United States together with high international interest rates. In 2002, growth is expected to accelerate to near 4.5 percent as countries progressively overcome factors that have restrained past growth—high debt and low saving rates.

South Asia: GDP growth estimates for this region for 1999 have been revised upward by 0.4 percentage point to 5.8 percent, reflecting stronger growth in the agricultural sector and improved investor confidence. Agricultural output in India turned out better than expected in the first half of the country's fiscal 1999, and Bangladesh has largely recovered from the devastation caused by floods in 1998. Debt restructuring agreements have been concluded in Pakistan, and investor confidence is slowly recovering. Growth of the region's exports and imports has been broadly in line with earlier estimates, averaging about 6 and 5.5 percent respectively in 1999. Reserves increased in most countries with the exception of Bangladesh and Sri Lanka (which suffered from a sharp decline in their terms of trade as the price of tea fell sharply in 1999).

Growth prospects for 2000 have been revised upward by 0.4 percentage points, to 5.9 percent, largely in response to favorable developments in domestic policies and better-than-expected indicators of short-term activity. India's newly elected government initiated a country-wide value added tax. India is also pursuing liberalization of its insurance industry and the conversion of nontariff trade barriers to tariffs. These steps have contributed to improved investor confidence. In Pakistan, sentiment improved following the new government's announcement of a reform of the tax system and efforts to resolve a long-standing dispute with a foreign-owned power company. Although the region is expected to see export market growth return to precrisis rates over the forecast period, its international cost-competitiveness has been eroded by large depreciations in Southeast Asia (by 10 to 25 percent between 1997 and 1999, compared with virtually no change for India in real effective terms). In addition, reflecting India's large weight in the region, South Asia's trade as a share of GDP is among the lowest of all developing regions, implying that the effects of the recovery of world trade on domestic activity will be modest. Rising crude oil prices are estimated to add over $900 million (0.17 percent of GDP) to the region's import bill in 2000, but this is likely to be partly offset by a gain of $230 million from rising prices for edible oil exports. Projections for growth in 2001–02 have been revised upward by 0.3 percentage point from the previous forecast. The need to correct large fiscal deficits in India and Pakistan is likely to continue to hold the region back from the even faster economic growth of which it is capable.

Middle East and North Africa: The dramatic rise in oil prices in the second half of 1999 led to an improvement in short-term fiscal positions and growth outturns for many countries in this region. The net upward revision of the region's GDP was limited to 0.3 percentage points in 1999, to 2.2 percent, as much of the growth impact of the oil price rise had been anticipated in previous forecasts. Growth in the region's oil-exporting countries is estimated to have reached 0.5 percent in 1999, reflecting restrictions on oil production. The continued buoyancy of oil prices over the forecast period is expected to underpin a modest recovery of GDP growth. However, several oil exporters are expected to maintain a rather tight fiscal stance despite the increase in revenue from the oil price rise, in an effort to balance the significant foreign and domestic debt incurred to smooth consumption when oil prices reached their trough. Additionally, public expenditure reforms are underway in several countries, and these may contribute to limiting fiscal loosening. In the high-absorption oil exporters (Algeria, the Islamic Republic of Iran), growth is likely to be constrained by the impact of drought, particularly on private consumption. However, in Algeria the prospects of recovery in 2000 and a first wave of foreign investment in the oil sector should cause growth to accelerate from the very low levels registered in the 1990s. Among the region's diversified exporters, drought conditions in several countries (including Jordan, Morocco, the Syrian Arab Republic, and Tunisia) will dampen agricultural incomes in 1999–2000. The region's current account has improved markedly, with the 1998 deficit of $8 billion turning into more than $20 billion surplus in 1999. This turnaround reflects large-scale gains in terms of trade and higher receipts from tourism and worker remittances.

Prospects for growth in 2000 remain broadly in line with, but slightly higher than, the GEP 2000 forecast, at 3.5 percent. The improved external environment and steady oil prices will support faster growth in the short term despite steps toward fiscal consolidation (which should also improve the sustainability of growth at higher levels). Better performance is expected in the high-absorption exporters, where the opening to foreign investment and reforms in domestic markets and institutions should contribute to improved confidence. No significant loosening of monetary policy is assumed in the forecast; it is expected that countries—especially those importing agricultural commodities to compensate for drought conditions—will seek to contain inflationary pressures from external sources. GDP growth in the diversified exporters is expected to recover to more than 4.5 percent per year in 2001–02, as the effects of policies already underway to comply with EU association agreements contribute to improved confidence and spur efficiency. As several countries in the region recover from severe drought conditions, as privatization progresses, and as reforms to product markets and regulatory regimes continue, output is expected to accelerate gradually over the forecast period. Growth in income per capita is expected to reach 1.5 percent per year over 2001–02, a respectable outcome compared with those of the 1980s and 1990s, which were generally characterized by oil price weakness and hesitant reforms in many countries.

Europe and Central Asia: Real GDP in 1999 in this region is estimated to have expanded slightly by 1 percent, about 0.7 percentage points higher than previously forecast—with offsetting changes at the subregion level. The impact of the August earthquake in Turkey was greater than earlier anticipated: GDP is now estimated to have fallen by about 4 percent. Growth in Romania and the Balkans has also been revised downward slightly, as political consensus to pursue reforms has not yet been achieved. These disappointing results were offset by faster-than-expected growth in several Central European economies, including Bulgaria, Hungary, and the Slovak Republic, facilitated by stronger growth in Western Europe. Growth for the CIS as a group also turned out higher, at just over 2 percent, because of firm oil prices and faster-than-expected growth in Russia.

The region's GDP forecast for 2000 of a modest recovery to 2.5 percent is in line with the previous forecast, albeit with offsetting subregion revisions. The higher growth forecast for Western Europe and improved investor confidence in the region are the primary reasons for upward revisions. The improvement in confidence is partly due to the Helsinki Summit agreement to invite five more Central and Eastern European countries and Turkey to apply for EU membership. In addition, Turkey's $4 billion standby agreement with the IMF will focus that government's attention on long-standing structural problems, including high and unsustainable public sector domestic debt, inefficient state enterprises, and entrenched inflation. The comprehensiveness of the program and the front-loading of reforms are boosting investor confidence, as evidenced by the booming stock market. However, in some Central European economies, such as Poland, more restrictive fiscal and monetary policies aimed at curbing inflation and stemming the widening current account deficits are expected to partly offset the gains generated through greater external demand in 2000. The outlook for Russia and a number of other CIS countries has not changed substantially, despite the upward revision of the oil price forecast. This is because the import-substitution-led recovery in Russia may be short-lived, as the effects of the August 1998 devaluation are receding, and has not translated into a recovery of domestic demand. Significant structural imbalances remain, and capital flight from Russia (estimated at about $1.5 billion per month in the latter part of 1999) remains a serious problem. Reforms of the financial and corporate sectors, and several other aspects of institutional reform, are still in the initial stages.

The region's growth projection for 2001–02 (3.5 percent per year) has not been revised significantly, although there are now clear upside risks. Investor confidence outside of the CIS countries has been boosted by the Helsinki agreement and should bring about a steep increase in capital flows to these economies over the medium term. However, the accession process will prove challenging for many countries and will engender significant adjustment costs as these countries seek to align fiscal deficits and inflation rates with EU standards. Among the downside risks to the forecast, Russia in particular is vulnerable to an eventual softening of oil prices.

Sub-Saharan Africa: A number of factors combined to slow growth in Sub-Saharan Africa in 1999: low commodity prices and weak export demand, poor weather conditions, renewed civil strife, and higher interest rates in South Africa in the wake of the Asia crisis. Events in the region's two largest economies, Nigeria and South Africa, were largely anticipated. Both countries achieved a peaceful political transition, and South Africa's economic slump is proving short-lived, with a strong upward trend apparent in official data available through the fourth quarter. Nevertheless, for 1999 as a whole, growth in both countries, like that more generally throughout the region, was between two and three percentage points below that in 1996–97. Although minor adjustments were made to the country-level forecasts for 1999, these approximately balanced out, leaving growth unchanged overall at 2.5 percent.

For 2000, GDP growth is expected to rise moderately to 3.2 percent, 0.1 percentage point higher than the GEP 2000 forecast. Fueling the growth will be expected better performance in the agricultural sector and stronger export demand as a result of Asia's rebound and robust growth in the G-7 countries. Oil exporters in particular will contribute to the stronger performance, as will South Africa, which should benefit from faster trade growth and more investment from abroad. The unanticipated strength of oil prices will generate higher export receipts and tax revenues and translate into faster growth for major oil exporters (and for new entrants' such as Sudan). However, for most non-oil commodity producers, the external environment is actually less favorable than envisaged earlier. West Africa will be particularly affected by weak cocoa, coffee, and cotton prices. Nevertheless, agricultural output should continue to recover throughout eastern and southern Africa following two years of severely disrupted weather patterns. By contrast, metals and minerals prices are firming, but various constraints on expanding production will limit the ability of producers to take full advantage. Gold production continues on a path of progressive decline in South Africa, and Ghana's Ashanti Goldfields remains in deep financial distress. The restoration of Zambian copper mining needs more time and substantial new investment. Political instability in the Democratic Republic of Congo is impeding any imminent resurgence of mining activity there.

In 2001–02, growth in Sub-Saharan Africa is expected to strengthen to 3.7 percent a year—implying an annual rise of 1.3 percent in per capita terms—on the assumption that governance improves and policy reforms continue. Current account deficits, which had been compressed sharply in 1999, are expected to widen as a result of a moderate increase in official aid, including debt relief from the Heavily Indebted Poor Countries (HIPC) Debt Initiative. A number of civil conflicts moved toward resolution in 1999, although a swath of instability continues to cut across the north and center of the region. This will differentiate performance sharply as countries experiencing civil unrest fare significantly worse than others. The December coup in Côte d'Ivoire has refocused attention on stability and governance in the region.

Risks to the forecast: four transitions

Risks to the outlook presented here are less than they were a year or even six months ago; they are also pushed out in time, reflecting the momentum of the recovery in world output, the broader base of world import demand, and the containment of global inflationary pressures. Whereas after the outbreak of the crisis the preponderance of risks to the forecast was clearly on the downside, those risks are now more balanced. Upside risks include the possibility of stronger growth in Europe, perhaps reinforced by increased investment in high-technology industries, more good news on productivity in the United States, and faster world trade growth as the recovery spreads to developing countries. But the risks on the downside are still significant, and they originate from the need to achieve four transitions over the forecast period:

- *The transition to a soft landing in the United States*. The hard-landing scenario depicted in GEP 2000 contained several key elements. One was continued strong growth in domestic demand in 1999 and into 2000, outstripping the rise in economywide productivity in the context of tight labor markets and firming commodity prices, and raising inflationary expectations. A second element was a market overreaction to the 100-basis-point increase in the Fed Funds rate, which caused equity prices to fall by some 30 percent, which in turn led to a sharp fall in both consumption and investment. In this scenario a recession would ensue, contributing to a severe slowdown in world economic activity and an aborted recovery of capital flows to developing countries. In light of the U.S. economy's continued very rapid growth, the prospects for a large policy-induced interest rate shock depend in part on whether recent strong productivity gains continue. However, the Federal Reserve has also indicated that it may act preemptively, in anticipation of overall supply and demand imbalances, and not only in reaction to (as-yet tame) changes in price indices. Closely related sources of risk are the decline in the private savings rate (which reflects wealth effects from the booming stock market) and the ballooning of the U.S. current account deficit and external financing requirement. (The latter has risen from $144 billion in 1997 to $233 billion for the first three quarters of 1999 and is likely to reach $390 billion in 2000.) The increase in the deficit to date, however, has been easily financed—mainly by foreign purchases of U.S. corporate bonds and by FDI, which has risen sharply from a slight outflow in 1997 to a more than $100 billion inflow in 1999—and indeed the dollar has continued to strengthen, but sentiment could change. As mentioned earlier, the spread of recovery to Europe, which absorbs 30 percent of developing country exports and accounts for 16.5 percent of world imports (excluding intra-European trade), significantly reduces the risk that a sharp U.S. slowdown will abort the world recovery. Furthermore, the severity of any U.S. slowdown would depend on the policy response, which is likely to be vigorous given that budget surpluses are mounting and real policy interest rates are currently high.
- *The transition from fiscal stimulus to private demand-led growth in Japan*. Japan's currently anemic growth is still heavily reliant on fiscal stimulus. Estimates for 1999 suggest that the contributions to the country's 0.7 percent GDP growth for the year were highly uneven: government spending contributed 1.4 percentage points, stock-building accounted for 0.1 percentage points, net exports accounted for –0.2 percentage points, and private domestic demand (which accounts for 80 percent of Japanese output) contributed negatively to the growth rate, on the order of –0.6 percentage points. Gross private fixed investment declined by 5.5 percent, the seventh year of falling investment since 1991. Continuation of this pattern of growth is not sustainable: the government is running a fiscal deficit of 7.6 percent of GDP, and the national debt is 105.4 percent of GDP.[6] Although the financial markets have expressed their confidence in the Japanese recovery so far, the eventual implications of further fiscal stimulus may be a rise in real long-term interest rates, which would further reduce the likelihood of a recovery in private investment. Essential to the recovery of private demand is continued progress on financial and corporate restructuring, which will set the stage for restoring investor confidence and an adequate flow of private credit. While the recovery of

Box 1.2 A higher oil price scenario

Oil prices rose sharply in the first three months of 2000 and this has been reflected in the baseline to average about $23/bbl in 2000 before easing toward $19/bbl in 2001. However, potential developments on the supply side—should major oil producers attempt a regime shift toward a target of $25/bbl in the medium term—and continued rapid growth in world demand could plausibly lead oil prices to average $30/bbl in 2000 and $25/bbl in 2001. Under this scenario, and using a simulation model, growth of world output would be expected to be lower than the base scenario by 0.2 percentage points in 2000 and by 0.4 percentage points in 2001, and would also reduce non-oil commodity prices by 0.3 percentage points in 2001. This would result primarily from the combined effects of terms of trade-based income loss in oil-importing countries, and global interest rates induced higher by about 25 basis points in both years because of rising imported inflation (by 0.3 percentage point in each year) in industrial countries. This scenario would be much less adverse than previous episodes of sharp oil price increases that triggered global recessions due to three factors: (a) much lower oil dependence in the industrial countries (as a share of output); (b) lower core inflationary expectations; and (c) real oil prices that are still only half the levels of the early 1980s. Nevertheless, a fall in consumer and investor confidence could result in more adverse consequences than modeled here.

In this lower oil price scenario, developing country GDP would be expected to fall significantly with respect to the base, by 0.3 percentage points in 2000 and by a further 0.6 percentage point in 2001. Oil-importing commodity exporters, mostly in South Asia and in Sub-Saharan Africa, would fare worse—growth slipping by about 1.4 percentage points or more over two years—as they experience an income loss, higher inflation, and lower world demand for their exports. Those that export mainly agricultural commodities are at greatest risk in this scenario—agricultural prices are 0.4 percentage point more affected than the average of all commodity prices. Middle-income economies with a more diversified export base (largely in East Asia, Central Europe, Latin America and South Africa) would fare somewhat better. But the high-debt countries among this group are potentially more vulnerable, should interest rate risk premia rise in response to incipient balance of payments difficulties against a background of higher international interest rates.

$30/bbl oil price scenario

(difference in growth rates from baseline, %)

	2000	2001
World	–0.2	–0.4
G-7	–0.1	–0.3
Asian NIEs	–0.4	0.0
Developing countries	–0.3	–0.6
Sub-Saharan Africa	–0.4	–0.8
East Asia	–0.2	–0.4
South Asia	–0.2	–1.4
Europe and Central Asia	–0.4	–0.7
Middle East and North Africa	–0.3	–1.7
Latin America and the Caribbean	–0.3	–0.4
Memo		
Non-oil commodity exporters	–0.3	–1.1

Note: The Oxford Economic Forecasting model (OEF) was used in this exercise on a $20/bbl baseline for 2000–01. The results were validated against analysis prepared by the OECD, JP Morgan and other institutions and analysts.
Source: The World Bank, March 2000.

Output growth of the oil exporters, especially those in the Middle East and North Africa region, would be affected in the short term—as curtailment of oil production would be necessary to sustain the $25/bbl target—though national income would rise substantially. Growth outturns for oil exporters in two of three previous episodes of sharp increases in oil prices support these results. GDP growth slowed two years after the 1974 and 1979–80 shock compared with the two preceding years. These shocks (considered as a permanent increase in oil prices) produced a large expansion of domestic demand but were offset by large increases in imports that, in conjunction with the curtailment of oil production, reduced GDP growth. The 1990 episode, however, was very different. The sharp rise in oil prices was induced by a shortfall in oil supply caused by the Gulf war and was viewed as a temporary phenomenon. Major oil producers expanded production sharply while investment and import shares to GDP remained stable, leading to an acceleration in growth. Under a higher oil price scenario for 2000, the growth effects are expected to be somewhere in between, but with healthier fiscal and external balances for oil exporters.

world trade helps Japanese exports, its locomotive effect on the Japanese economy is limited in light of the relatively small share of Japanese output that is exported, as well as by the recent appreciation of the yen. A reversal to stagnation or recession in Japan would have adverse implications for developing countries in Asia, although slow growth in Japan (which has been the norm throughout much of the 1990s) is unlikely to severely dent the Asian recovery unless it is accompanied by a sharp U.S. slowdown.

- *The transition to healthier financial and corporate sectors in Asia.* The transformation of the strong cyclical recovery in the Asian crisis countries into sustained high growth will depend heavily on the improving health of the banking sector and the associated restructuring of companies that cannot repay their debts (see chapter 3 of *GEP 2000*). Although bad debts have begun to decline in most of the crisis countries, they remained high in late 1999, representing over 45, 41, and 18 percent of GDP respectively in Malaysia, Thailand, and Korea.[7] Furthermore, corporate restructuring, as measured by bankruptcies, mergers, and acquisitions, appears to be progressing slowly. Although the origins of the problems in the state-owned enterprise and state banking sectors in China are quite different from those in the Asian crisis countries, they nevertheless represent a brake on China's growth and are a cause of large-scale capital misallocation. As long as the developing countries in Asia remain in the midst of this painful transition, they will be vulnerable to a turn in investor sentiment in the wake of external shocks or a major bankruptcy at home.
- *The transition to lower oil prices.* Oil prices reached their highest levels in 9 years (about $28 a barrel for Brent crude in February 2000) but are expected to ease substantially over the forecast period. The reason is that agreements to limit production will become difficult to sustain in the face of long-term market fundamentals that are not especially favorable. Technological improvements and investments are expanding supply, while demand is growing at a rate below that of world output. Although a fall in oil prices would help many developing countries that are large importers (for example, India), it would severely affect the recovery prospects of oil exporters that are currently still feeling the aftershocks of the global crisis, including Indonesia, Russia, Nigeria, the Republica Bolivariana de Venezuela, and Ecuador (which have been benefiting from currently higher oil prices). In recent years the saving rates of many developing country oil exporters have declined (see chapter 4 of *GEP 2000*), as they have spent a large share of the proceeds of high oil prices and failed to reduce consumption when oil prices declined. Several of these countries are suffering from a legacy of delayed adjustment to the large price declines that preceded the recent production agreement: they have achieved little success in export diversification, their state sectors and budget deficits remain large, and their policy frameworks continue to be inadequate.

In the absence of a severe hard landing in the United States, failure to achieve any one of these transitions is unlikely to derail the current expansion of the global economy. However, until each of these transitions is achieved, several countries remain vulnerable to various adverse shocks, and the problems can accumulate. In the near term, however, the recent surge in oil prices—if sustained at current high levels—would be an element of concern. Risks are discussed in box 1.2, page 31.

Notes

1. Forecasts were completed in early October 1999.

2. High technology is defined here as the information and telecommunications (IT) sectors, which now account for 8.2 percent of U.S. GDP, compared with 5.8 percent in 1990. Value-added in these sectors rose an average of 10.4 percent per year from 1990 to 1997, compared with 0.5 percent in other industries. Between 1993 and 1998, IT equipment contributed more than 50 percent of growth in equipment spending and accounted for 35 percent of real economic growth over 1995–98, despite its much lower share of GDP.

3. Stock market capitalizations in October 1998 were 127.5 percent of GDP in the United States, 99.2 percent in Japan, and 55.3 percent in the Euro area.

4. The second half of 1998 and the first half of 1999 saw a widening of the gap between the growth rates of world export volumes and world imports (see table 1.5). The annual figures for 1999 show a discrepancy of about 2.5 percentage points between export and import growth, in contrast to a 1-percentage-point difference in 1998. One possible explanation is the large swings in exchange rates, making quantification of trade prices difficult. Others may include difficulties in tracking trade flows due to the start of the European monetary union and the possibility of overinvoicing of imports (and underinvoicing of exports) for purposes of capital flight. This is especially likely to have happened in countries that experienced crises. The discrepancy has led to an increase in the world current account deficit by $120 billion in 1999, complicating the forecasting of global capital flows.

5. Nominal 6-month LIBOR deflated by contemporaneous CPI inflation.

6. These figures are for general government financial balance and gross financial liabilities respectively (*OECD Economic Outlook*, December 1999). J.P. Morgan estimates that the fiscal deficit for fiscal 1999 (which ends in March 2000) will be 10.7 percent of GDP and that gross debt will reach 115 percent of GDP.

7. Estimates are for September 1999, and are taken from the World Wide Web site of the Asian Development Bank: http://aric.adb.org/indicators/all/rnpl.asp. These figures include NPLs purchased by asset management companies (AMCs) created in response to the crisis. NPL to GDP ratios excluding those held by AMCs are 12 and 32 percent for Korea and Malaysia, respectively. Note that in Indonesia the cost of bank recapitalization is estimated to range from 50 to 60 percent of GDP (*GEP 2000*, and J.P. Morgan *Asian Financial Markets*, First Quarter, 2000).