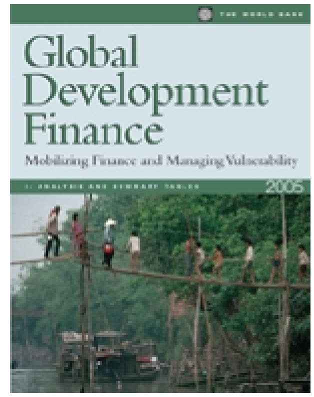
Eastern Europe & Central Asia

GDF 2005 Summary



Global Themes

- 2004 was a robust year for the global economy, especially for developing countries, where GDP grew by a record 6.6 percent. The global recovery strengthened, with much of the momentum coming from the United States and the East Asia / Pacific region (notably China), and broadened, with a pickup in Latin America, acceleration in Japan, and modest recovery in the European Union.
- Driven by favorable global conditions and strong domestic performance at home, the strong recovery of capital flows to developing countries that began in 2003 carried over to 2004, albeit at a reduced pace. Total private and official net debt flows totaled a record high of $324 billion, up significantly from $200 billion during 2000-02 and just above the $323 billion level reached in 1997. In relative terms, the pickup is much more modest -- net capital flows to developing countries equaled 4.5 percent of their GDP in 2004, significantly below highs exceeding 6 percent reached in the mid-1990s.
- Drawing on healthy trade balances, the current account *surplus* for developing countries as a group continued to widen, reaching 2.0 percent of GDP in 2004, up from 1.8 percent in 2003 (a dramatic turnaround from an average *deficit* position equal to 1.5 percent of GDP over the period 1976-2000). Combined with expanding capital flows, the growing surpluses contributed to accelerating reserve accumulation. Foreign reserves in developing countries increased by $378 billion during 2004, up from $292 billion during 2003. Although the largest reserve accumulation was concentrated in Asia, particularly in China where reserves increased by $207 billion, the phenomenon was widespread. More than three-quarters of developing countries accumulated reserves during 2004. A sizable portion of this new accumulation is invested in US Treasuries, indicative of the growing stake of developing countries in the functioning and health of the global financial system.
- FDI inflows to developing countries increased from $152 billion in 2003 to $165 billion in 2004, but remains below the peak of $182 billion reached in 1999. While the concentration of FDI flows remains high (five emerging-market economies—China, Brazil, Mexico, Russia and India—account for 60 percent of FDI, and 88 percent of the increase), the share flowing to low-income countries reached 11 percent, the highest in 15 years. Reported FDI outflows from developing countries surged dramatically, reaching an estimated $40 billion in 2004, up from only $3 billion in 1991. The bulk of the FDI outflows originated in countries that had been major recipients of inflows in recent years.
- Net medium- and long-term bond flows rebounded sharply, reaching a record high of $63 billion, up from $27 billion in 2003 and $11 billion in 2001/02. Net international medium-

and long-term bank lending declined by $2 billion in 2004. Gross bond issuance surpassed gross bank lending for the first time, although bank lending remains available to a larger group of countries. The strong gains in bond issuance over the past two years reflect both supply and demand factors – ample global liquidity, low advanced-country interest rates promoting a “search for yield,” and a broad-based improvement in credit fundamentals in many emerging markets. The EMBI index of emerging-market bond spreads fell steadily during 2004, falling below 350 basis points by the end of the year.

- Figures for 2004 confirm the continuing structural shift in development assistance from loans to grants over the last several years. Foreign aid grants have increased by a cumulative total of $20 billion over the past three years, while net official lending (to both middle- and low-income borrowers) has declined by $52 billion, implying a $32 billion decline in net official flows (aid and lending combined). The largest factor underlying this shift has been a $30 billion net decline in lending by the IMF, reflecting repayment of sizable crisis-related disbursements made in 2001. But net lending by the World Bank also fell by $9 billion over the period, as several countries repaid large structural adjustment loans and other Bank loans were repaid ahead of schedule.
- While figures for 2004 are not yet available, official development assistance (ODA) increased by just over $10 billion in 2003 to $69 billion (although after accounting for inflation and exchange rate changes, the real increase was only 4 percent). Sub-Saharan Africa has received 60 percent of increases in ODA disbursements over the five-year period 1998 to 2003. However, most of these funds were allocated to post-conflict situations, leaving little for development aid. ODA as a share of GNI in donor countries is projected to rise from 0.25 percent in 2003 to 0.30 percent in 2006—implying a 10 percent annual increase in ODA in real terms, about double that achieved over the past two years.

Regional themes

- Growth in the region was very strong in 2004, led by Russia where high oil prices boosted incomes significantly. GDP in the region as a whole grew by 6.8 percent in 2004, up from 5.9 percent in 2003. Trade volumes have also expanded substantially -- export volumes increased by 15.3 percent in 2004, following a 12.0 percent increase in 2003 -- enhanced by ten countries in the region acceding to the EU.
- Inflationary pressures are building in most countries in the region – CPI inflation for the regional as whole increased to 6.8 percent in 2004, up from 5.4 percent in 2003 and 4.2 percent in 2002. Impending inflationary pressures could lead to tighter monetary conditions in the region, which would curtail growth somewhat in the short run, particularly if coupled with continued appreciations of real effective exchange rates in a number of larger economies in the region, and a leveling off of oil revenues. Growth in the region is projected to decline to a more sustainable rate of 5.5 percent in 2005.
- Net private (debt and equity) flows to the region increased from $99.3 billion in 2003 to a record $103.4 billion, up significantly from the $50 billion level recorded in 1999-2000. Private debt flows totaled $62.3 billion in 2004, down slightly from $63.1 billion in 2003, but up significantly from $0.6 billion in 2001. The composition of private debt flows changed significantly in 2004, however, with a large shift from bank to bond financing. Net medium- and long-term bond flows surged by $20.6 billion as net medium and long-term bank lending declined by $18.3 billion.
- Net equity flows increased by $5 billion in 2004, reaching $41.2 billion, accounting for 21 percent of equity flows to all developing countries. Foreign direct investment (FDI) to the region increased slightly in 2004 to $37.6 billion from $35.6 in 2003. The major part of the increase came from Czech Republic and Turkey while FDI flows to other major recipients in the region—Hungary, Poland and Russian Federation—stabilized.

- Net official lending to the region declined by $6.2 billion in 2004 for the second consecutive year, reflecting the net repayments of loans to official lenders, particularly by Turkey and the Russian Federation.

Other key regional points to note

- The external burden of some countries in the region has increased significantly over the past few years. Moreover, the portion of external debt maturing within a year has increased from 15 percent in 1997 to 20 percent in 2003, making countries in the region more vulnerable to sharp increases in interest rates. In addition, the capacity to service external debt has deteriorated as debt service payments have increased from 12 percent to 20 percent of exports since 1997. There is also concern about mounting public debt burdens in some countries, notably Poland and Turkey which account for some 70 percent of domestic debt issued by the region.

Europe and Central Asia outlook in summary, 1981-2005

Real Economy *(percent change, unless stated)*	1981-90	1991-00	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
Real GDP growth	1.8	-1.4	3.0	6.7	2.4	4.6	5.9	6.8	5.5
Private consumption per capita	0.6	-0.3	-0.2	4.4	3.4	5.7	6.7	7.0	6.3
GDP per capita	0.9	-1.6	2.8	6.2	2.4	4.6	5.9	6.8	5.4
Population	0.9	0.2	0.2	0.5	0.0	0.0	0.0	0.0	0.0
Gross domestic investment/GDP[a]	40.6	23.9	20.9	21.5	20.6	20.3	21.0	22.2	22.7
Inflation[b]	1.1	52.5	6.0	7.6	6.5	4.2	5.4	6.8	6.2
Central Government Budget Balance/GDP	-0.5	-4.4	-4.2	-2.5	-3.5	-3.7	-3.1	-2.1	-2.5
Export market growth[c]	3.9	5.4	-0.5	11.4	4.9	5.9	8.5	10.5	6.7
Export volume[d]	3.1	1.3	4.0	15.9	6.3	7.9	12.0	15.3	9.4
Terms of Trade/GDP[e]	-0.3	-0.7	-0.5	2.5	-0.6	-0.7	0.4	-0.7	0.6
Current Account/GDP	-0.3	-1.1	-0.1	1.8	2.0	0.5	0.0	0.6	0.1
Workers remittances (billions of dollars)	2.1	8.0	10.7	11.0	11.4	11.5	12.9	12.9	--
Memorandum items									
GDP growth: Transition countries	1.4	-2.2	4.7	6.6	4.4	4.0	6.0	6.5	5.5
Central and Eastern Europe	0.4	1.0	4.0	3.7	2.8	2.9	4.0	5.0	4.5
CIS	2.0	-4.2	5.4	9.2	5.8	5.0	7.6	7.7	6.2

External Financing and debt *(billions of dollars unless stated)*	1996	1997	1998	1999	2000	2001	2002	2003	2004e
Net inward FDI	16.4	22.6	26.1	28.4	29.2	31.4	35.0	35.6	37.6
Net inward portfolio equity flows	4.3	4.0	4.0	2.0	1.3	0.4	-0.1	0.6	3.6
Net inward debt flows	24.1	35.3	43.0	18.9	19.9	2.7	28.0	56.9	56.0
From public sources	8.6	6.6	7.5	-0.6	0.0	2.2	2.6	-6.2	-6.2
From private sources	15.4	28.7	35.5	19.5	19.9	0.6	25.4	63.1	62.3
Gross market-based capital flows	25.7	46.0	42.9	30.1	45.5	26.0	34.6	58.5	87.0
Total external debt	368.3	391.2	490.3	503.5	510.8	507.8	560.2	676.0	728.5
Medium- and long-term	315.1	331.7	414.8	423.7	424.1	425.1	472.0	541.2	562.9
Short-term	53.2	59.5	75.5	79.7	86.7	82.6	88.2	134.8	165.6
Owed by public-sector borrowers	286.9	288.9	321.2	316.5	305.0	292.6	309.8	334.6	340.3
Owed by private-sector borrowers	81.5	102.3	169.1	186.9	205.8	215.2	250.4	341.4	388.2
Owed to public-sector creditors	160.0	156.2	172.4	171.4	166.8	159.2	165.4	176.2	169.6
Owed by private-sector creditors	208.3	235.0	317.9	332.1	344.0	348.6	394.8	499.8	558.9
Gross foreign exchange reserves	83.4	90.8	95.9	102.3	120.4	131.5	175.3	236.2	303.8

-- Not Available
Note: e = estimate, *f* = forecast.
a. Fixed investment, measured in real terms.
B. Local currency GDP deflator, median.
C. Weighted average growth of import demand in export markets.
D. Goods and non-factor services.
E. Change in terms of trade, measured as a percentage of GDP.

External Financing: Europe and Central Asia, 1998-2004

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	-25.8	-2.5	15.5	17.4	3.8	-2.6	9.6
as % GDP	-2.5	-0.1	1.8	2.0	0.5	0.0	0.6
Financed by:							
Net equity flows	30.1	30.4	30.4	31.8	34.9	36.2	41.2
Net FDI inflows	26.1	28.4	29.2	31.4	35.0	35.6	37.6
Net portfolio equity inflows	4.0	2.0	1.3	0.4	-0.1	0.6	3.6
Net debt flows	43.0	18.9	19.9	2.7	28.0	56.9	56.0
Official creditors	7.5	-0.6	0.0	2.2	2.6	-6.2	-6.2
World Bank	1.5	1.9	2.1	2.1	1.0	-0.7	0.6
IMF	5.3	-3.1	-0.7	6.1	4.6	-2.0	-4.4
Others	0.6	0.7	-1.4	-6.0	-3.0	-3.5	-2.4
Private creditors	35.5	19.5	19.9	0.6	25.4	63.1	62.3
Net M-L term debt flows	29.8	17.9	11.6	5.9	20.5	30.9	33.4
Bonds	16.0	8.2	5.3	1.6	4.0	9.6	30.2
Banks	14.7	10.4	7.9	6.6	18.1	23.3	5.0
Others	-0.9	-0.8	-1.6	-2.2	-1.6	-2.0	-1.7
Net short-term debt flows	5.7	1.6	8.3	-5.4	4.9	32.2	28.8
Balancing item *	-42.2	-40.5	-47.7	-40.8	-23.0	-29.6	-39.2
Change in reserves (- = increase)	-5.1	-6.4	-18.2	-11.1	-43.7	-60.9	-67.6
Memo items:							
Bilateral aid grants (ex technical co-operation grants)	5.4	8.2	8.6	7.1	8.6	8.7	9.0
Net private flows (debt+equity)	65.6	49.9	50.4	32.4	60.4	99.3	103.4
Net official flows (aid+debt)	12.9	7.7	8.6	9.3	11.2	2.4	2.7
Workers' remittances	12.8	10.7	11.0	11.4	11.5	12.9	12.9

Note: e = estimate

* Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries