Europe and Central Asia

GDP growth in developing Europe and Central Asia[1] rebounded to an estimated 4.7 percent in 2010, following the 6.6 percent decline in 2009. The recovery has been slow owing to continued large-scale restructuring, reflecting the severity of impact of the crisis through multiple channels of transmission to the region—including the collapse in capital inflows, sharp contraction in external demand, plunge in commodity prices and large fall-off in remittances inflows. Coming out of the crisis, high levels of household indebtedness and widespread unemployment held back consumer demand, while banking-sector consolidation and elevated bad-loans constrained new lending. Countries with fixed exchange-rate regimes faced more limited policy options, often implying fiscal spending cuts to bring about adjustment in domestic demand. In contrast, a revival in external demand and firming international commodity prices—especially for hydrocarbons and metals—underpinned the recovery in regional growth in 2010. While also recovering, net international capital flows to Europe and Central Asia were tepid in 2010 (see main text), and in particular bank-lending remains severely limited compared to pre-crisis flows, accentuating rather than offsetting contractionary forces emanating from the domestic banking sector. Looking forward, growth in the region is expected to accelerate only slowly. Persistent and increasingly structural unemployment, significant personal debt burdens, and financial-sector restructuring are expected to keep growth modest, with GDP projected to expand only 4.0 percent in 2011 and 4.2 percent in 2012. (Table R2.1).

Significant variation in the extent of recovery at the individual country level broadly reflects initial conditions at the onset of the crisis and main channels of transmission. Countries that had relied heavily on international inflows to finance large current account deficits in the pre-crisis boom years, typically reported weaker rebounds in 2010, given ongoing large private sector debt deleveraging, continued banking sector consolidation and severely crimped domestic demand. In Bulgaria, Lithuania and Romania, for instance—which had posted sharp contractions in 2009—GDP growth was lackluster, and indeed contracted in Romania, and significantly lagged the regional average rebound. Where credit booms had been relatively more subdued ahead of the crisis, and where the transmission of the crisis was driven more strongly by swings in trade growth and commodity prices (which rebounded quickly)—such as in Armenia, Azerbaijan, Belarus, Georgia, Russia, Turkey, Turkmenistan, Uzbekistan—growth outturns in 2010 were stronger and exceeded the regional average.

Recent developments

Much of the impetus for recovery in Europe and Central Asia in 2010 was external in nature: strengthening demand in export markets, higher metals and energy prices, a revival in remittances inflows, and in some cases large inflows of crisis-related official aid. Nearly all of the economies in the region posted positive growth in 2010. The regional aggregate is dominated by Russia and Turkey, which together comprise nearly 75 percent of regional GDP, and which posted strong outturns of 3.8 percent and 8.1 percent, respectively. Russia's real-side recovery was supported by fiscal stimulus equivalent to 5.3 percent of GDP and strong oil and metals prices, which generated strong spillovers for other countries in the region in the form of import demand (up an estimated 7 percent) and remittances, which after falling 18 percent in 2009 picked up 11 percent in dollar terms during 2010. Turkey's recovery was more vibrant—a reflection of strengthening domestic demand, supported by rising foreign capital inflows, and an accommodative monetary and fiscal policy. GDP outturns were strongest in Turkmenistan, Uzbekistan and Belarus with growth of 11.7 percent, 8 percent and 7.0 percent, respectively, due to the rebound in natural gas prices and minerals prices. In contrast, Kyrgyz Republic saw GDP decline, given political and civil dislocation. Sharp fiscal consolidation and household balance sheet restructuring was reflected in a second year of GDP decline in Romania, and near zero growth in Bulgaria and Lithuania. In part this reflected the constraints of fixed exchange-rate regimes, and policy-makers were limited to fiscal policy-levers to implement adjustment through domestic demand.

Regional domestic demand remains subdued, given significant debt-overhang from pre-crisis borrowing, stagnant or falling household incomes, and tepid job-growth—which also underlie weak private-sector credit demand by borrowers. Ongoing recapitalization and provisioning of high non-performing loan ratios along with more restrictive lending standards are constraining bank-lending by lenders. Non-performing loans account for a median of 11 percent of all loans in the region, the highest among developing regions , with the ratio reaching as high as 42 percent, 27 percent, and 20 percent in the cases of Ukraine, Kazakhstan and Lithuania, respectively, in early-2010 (Figure R2.1).[2] Consequently, credit growth remained stagnant in most economies across the region in 2010. Credit expansion is somewhat stronger in Russia, but below the pre-crisis pace,

Table R2.1 Europe and Central Asia forecast summary
(annual percent change unless indicated otherwise)

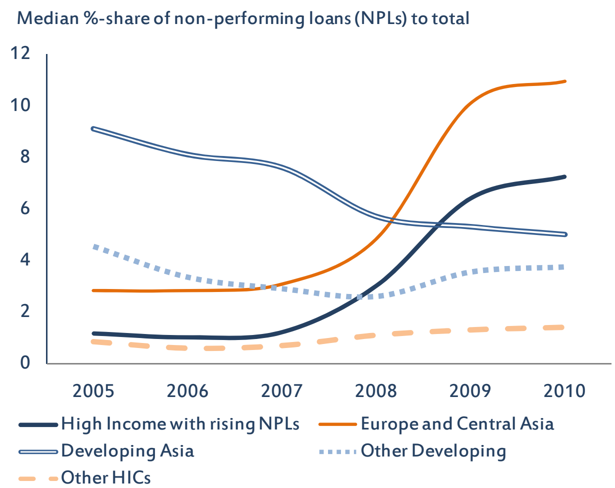
					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 US$) [b]	4.0	7.4	3.9	-6.6	4.7	4.0	4.2
GDP per capita (units in US$)	4.1	7.4	4.0	-6.5	4.7	4.0	4.2
PPP GDP [c]	4.0	7.7	4.3	-6.7	4.4	4.0	4.5
Private consumption	5.0	10.7	6.7	-6.3	4.4	4.4	4.6
Public consumption	1.8	4.4	3.2	2.5	1.7	2.3	2.7
Fixed investment	4.4	15.4	6.4	-18.5	6.9	6.4	7.9
Exports, GNFS [d]	7.5	7.3	3.0	-6.8	7.9	5.8	7.0
Imports, GNFS [d]	7.9	19.6	8.6	-24.0	12.3	8.4	8.0
Net exports, contribution to growth	0.3	-3.7	-2.0	6.5	-1.0	-0.7	-0.2
Current account bal/GDP (%)	2.0	-0.5	0.5	0.7	0.8	-0.3	-1.4
GDP deflator (median, LCU)	19.7	11.8	12.0	2.5	6.4	6.2	5.3
Fiscal balance/GDP (%)	-5.1	3.0	1.6	-5.5	-4.3	-3.1	-2.4
Memo items: GDP							
Transition countries [e]	3.9	5.2	2.1	-5.4	5.7	3.6	4.2
Central and Eastern Europe [f]	2.9	6.7	6.2	-7.3	-0.9	2.1	3.9
Commonwealth of Independent States [g]	4.0	8.8	5.1	-7.3	4.1	4.3	4.2
Russia	3.8	8.5	5.2	-7.9	3.8	4.2	4.0
Turkey	4.3	4.7	0.7	-4.7	8.1	4.1	4.3
Romania	2.2	6.0	7.1	-7.1	-1.9	1.5	4.4

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Transition countries: Albania, Bulgaria, Lithuania, Macedoneia, FYR, Romania, Turkey.
f. Central and Eastern Europe: Albania, Bulgaria, Lithuania, Macedonia, FYR, Romania.
g. Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldovia, Russian Federation, Ukraine, Uzbekistan.

Source: World Bank

in part reflecting continued capital outflows. Turkey too is an exception, where credit growth has been buoyed by the strong recovery and capital inflows.

Figure R2.1 Bank NPLs remain elevated in Europe and Central Asia

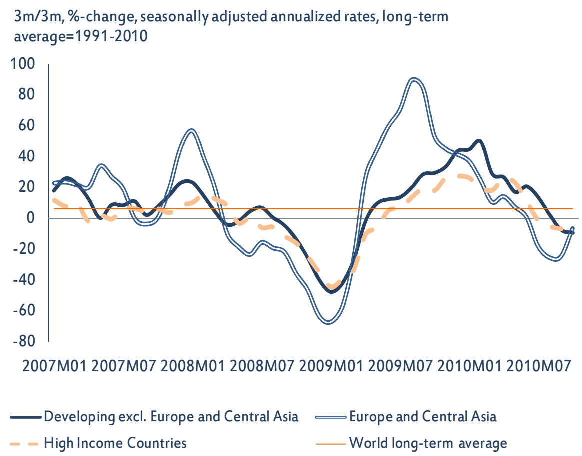


Source: Source: IMF Global Financial Stability Report and World Bank
Note: 2010*=most recent 2010-observation; 62 country sample

Unemployment rates in Europe and Central Asian remain significantly elevated, having risen for example, as of September 2010 from end-2009 in Bulgaria and Lithuania to 10 percent (from 8.6 percent) and to 18.4 percent (from 16 percent), respectively. While still elevated, unemployment rates appear to have peaked and are falling in Russia and Turkey.

The rebound in Europe and Central Asia was led by a surge in merchandise export volumes (notably of commodities) starting mid-2009, while import growth (reflecting lackluster domestic demand) remained weak. Export growth decelerated sharply starting in early-2010, ahead of the more generalized global slowdown that began mid-year, turning strongly negative in the third quarter before beginning to expand once again in the fourth quarter (Figure R2.2). Services trade has posted a much more modest recovery, albeit from a less severe contraction in 2009. Tourism remained a drag on services receipts, with arrivals estimated to have

Figure R2.2 Europe and Central Asia's merchandise goods exports remain in duldrums in late-2010



Source: Thomson Datastream and World Bank

continued contracting in 2010, albeit slightly by 0.3 percent after the sharp 8.2 percent downturn in 2009.

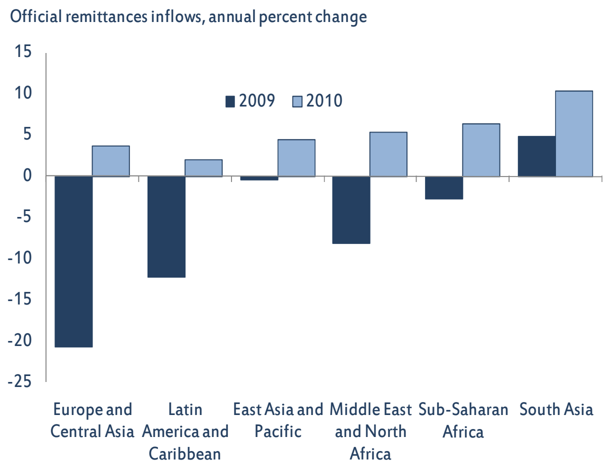
Remittances are also up a modest 3.7 percent in US dollar terms following the sharp 23 percent decline in 2009. Higher oil prices and strengthened activity in Russia were main factors supporting increased flows into neighboring Commonwealth of Independent States, for which Russia represents a key migrant destination country. Tajikistan continued to record the highest share among developing countries, with official inflows for 2010 estimated at 35 percent of GDP, followed within Europe and Central Asia region by Moldova (fourth among LMICs), where official flows are estimated to have reached 23 percent in 2010. Notably, corrected for inflation and shifts in exchange rates, remittances inflows actually contracted in Romania, Russia, Turkey and Ukraine. (Figure R2.3).

Despite the strong rebound in exports, subdued recovery in domestic demand and imports and resumption of the US-dollar value of remittances inflows, the regional current account surplus shrank as a share of GDP in 2010. This largely reflected a sharp increase in Turkish imports, which contributed to a near-tripling of its current account deficit from 2.3 to 5.9 percent of GDP.

Most other regional economies that posted deficits in 2009 recorded shrinking deficits in 2010 (Albania, Bosnia and Herzegovina, Bulgaria, Georgia, FYR Macedonia, and Montenegro) or increased surpluses (Azerbaijan, Russia and Uzbekistan).

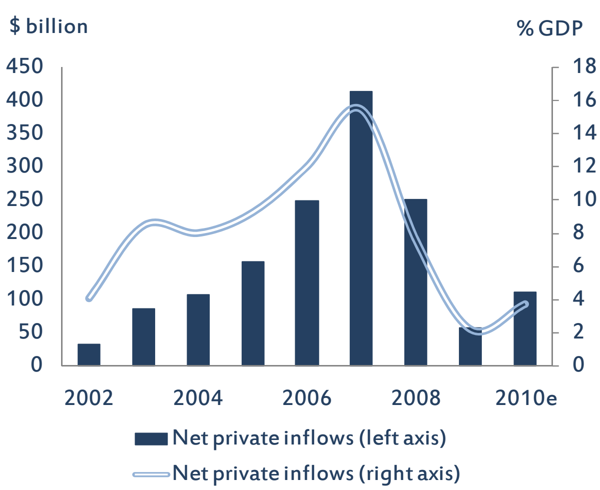
The pickup in Turkish imports is a partial reflection of the sharp increase in foreign capital inflows, which helped boost credit growth and contributed to an appreciation of its currency. Overall, net private capital inflows to Europe and Central Asia nearly doubled in 2010–reaching $111 billion or about 3.6 percent of GDP, but remain only about a quarter of their peak level of $414 billion or 15.5 percent of GDP in 2007. (Figure R2.4) The uptick was led by a firming in international bond issuance, which was concentrated in Montenegro, Romania, Russia and Turkey. In contrast, foreign direct investment to the region declined, reflecting continued adjustment in both source and recipient economies. While net bank-lending to the region firmed slightly, it remained sharply compressed compared with pre-crisis levels—equivalent to less than one-tenth of the 2007 and 2008 levels—reflecting ongoing banking sector consolidation and loan provisioning in both source and recipient countries.

Figure R2.3 Remittances inflows declined most in Europe and Central Asia, tepid recovery tied to slow E.U. job-growth



Source: Source: World Bank, Migration and Development Brief, no. 13, 2010

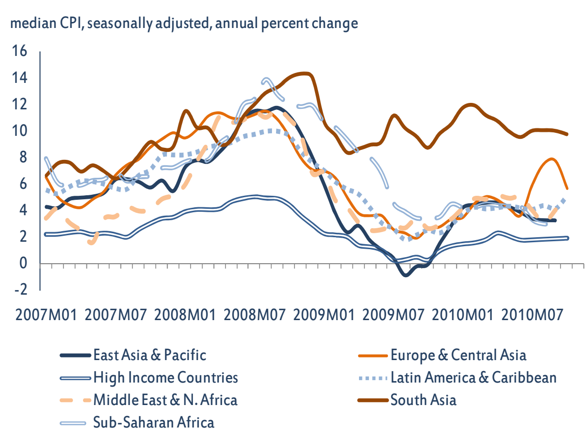
Figure R2.4 Net private capital inflows to Europe and Central Asia projected to have firmed in 2010



Source: World Bank

Extensive spare capacity throughout the region has kept core inflation in check, but the severe drought and extensive wild fires (notably in Russia and Kazakhstan) provoked a sharp rise in food prices and a temporary uptick in median inflation in the region, which rose from 2.3 percent in 2009 to 6.7 percent in 2010. Administrative price hikes in Romania and Ukraine have also played a role, while capacity constraint and capital inflows have contributed to an acceleration of Turkish prices. (Figure R2.5).

Figure R2.5 Inflation is quiescent in most regions; temporary upswing in ECA tied to drought



Source: Thomson Datastream and World Bank

Outlook

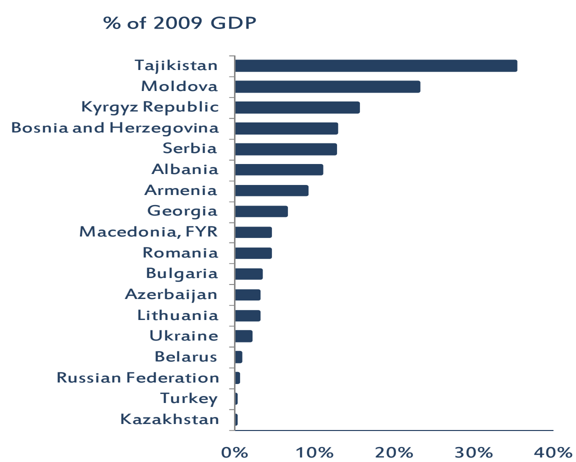
GDP growth in Europe and Central Asia is projected to slow to 4.0 percent in 2011 from 4.7 percent in 2010, before firming to 4.2 percent in 2012. Growth rates will remain well-below the boom-period average of 7.4 percent recorded during 2003-07, and will not be strong enough to make a significant impact on regional unemployment. Both investment and consumer demand will continue to be held back by high unemployment, and household and banking-sector restructuring, even as domestic demand growth plays an increasing role in the recovery. The deceleration in 2011 mainly reflects weaker exports due to slower growth in export markets (notably with high-income Europe), while expected improvement in domestic conditions underpin the modest acceleration in 2012. Reflecting strengthening domestic demand, imports are expected to grow more quickly than exports and the regional current account is projected to incrementally shift into deficit of 1.4 percent of GDP in 2012 from a slight surplus of 0.8 percent in 2010 and slight deficit of 0.3 percent in 2011.

Projected growth paths vary significantly at the sub-regional level. For example, Turkey is projected to post a deceleration in GDP growth to 4.1 percent in 2011 from an estimated 8.1 percent in 2010, due to falling export competitiveness and weaker base effects. Growth in the Central European economies at 2.1 percent and 3.9 percent in 2011 and 2012, respectively, will continue to be held back by restructuring. In contrast, the Commonwealth of Independent States are projected to post somewhat stronger real GDP growth of 4.3 percent and 4.2 percent in 2011 and 2012, respectively. (Table R2.2).

The more commodity-dependent Commonwealth of Independent States economies, such as Russia, Ukraine and Uzbekistan, should continue to benefit from elevated key export prices for hydrocarbons and metals. And, in the case of Turkmenistan, added export capacity will also be a factor. In contrast, in Azerbaijan growth is projected to slow to more sustainable rates, as the pace of capacity expansion slows. In Russia, growth is projected to firm to 4.2 percent in 2011 from 3.8 percent in 2010, reflecting strengthening domestic demand, higher oil prices and supportive base effects. However, in 2012 Russian GDP growth is projected to moderate to 4.0 percent and converge toward potential, as underlying structural factors are expected to increasingly constrain activity. In Kazakhstan the recovery is expected to slow over the forecast horizon, given ongoing banking sector problems that are expected to impinge on credit growth.

Economic activity within the Commonwealth of Independent States will also be supported by the recovery in Russia, a major export market and important migrant destination country within the sub-region. Armenia, Moldova and Tajikistan, in particular, are expected to benefit, among others. Just over 45 percent of Commonwealth of Independent States remittances inflows originate from Russia, and 50 percent from the EU-15. The recovery in remittances inflows to the region in aggregate is expected to progressively firm by 6.5 percent and 10.4 percent in 2011 and 2012, respectively (in US-dollar value-terms). While this would result in remittances inflows reaching a projected $43bn in 2012, the level would remain 6 percent below the record high posted in 2008 (Figure R2.6).[3]

Figure R2.6 Remittances inflows to Europe and Central Asia



Source: World Bank, Migration and Development Brief, no. 13, 2010

Better economic performance should see fiscal balances improve. Further fiscal consolidation in Central and Eastern Europe, partly under the aegis of IMF programs, should help set the stage for more balanced and sustainable growth in the future. However, given existing significant hurdles, only gradual progress in reducing large fiscal deficits is expected. Russia is expected to continue unwinding the large stimulus measures introduced during the crisis, but significant tightening is unlikely until after the presidential elections in the spring of 2012. In Armenia,

Table R2.2 Europe and Central Asia country forecasts
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Albania							
GDP at market prices (2005 US$) [b]	5.4	6.0	7.5	2.5	3.0	3.7	4.2
Current account bal/GDP (%)	-5.5	-10.6	-15.4	-15.6	-12.2	-10.9	-9.9
Armenia							
GDP at market prices (2005 US$) [b]	8.6	13.7	6.8	-14.4	4.0	4.6	4.9
Current account bal/GDP (%)	-11.7	-6.4	-11.6	-15.7	-12.7	-11.6	-10.5
Azerbaijan							
GDP at market prices (2005 US$) [b]	10.2	25.0	10.8	9.3	3.7	3.5	3.9
Current account bal/GDP (%)	-16.6	27.3	35.6	23.7	27.2	24.4	24.0
Belarus							
GDP at market prices (2005 US$) [b]	6.7	8.6	10.2	0.2	7.0	6.0	5.5
Current account bal/GDP (%)	-3.2	-6.8	-8.7	-13.0	-14.0	-14.2	-13.3
Bulgaria							
GDP at market prices (2005 US$) [b]	2.8	6.4	6.2	-4.9	0.0	2.5	2.7
Current account bal/GDP (%)	-3.4	-27.2	-21.9	-9.7	-2.4	-3.1	-3.4
Georgia							
GDP at market prices (2005 US$) [b]	6.6	12.3	2.3	-3.9	5.5	4.0	4.7
Current account bal/GDP (%)	-9.8	-20.9	-25.3	-12.3	-12.1	-12.0	-11.1
Kazakhstan							
GDP at market prices (2005 US$) [b]	6.4	8.9	3.3	1.2	5.5	4.5	5.1
Current account bal/GDP (%)	-2.3	-7.9	4.7	-3.7	3.8	4.4	4.0
Kosovo							
GDP at market prices (2005 US$) [b]		6.3	6.9	2.9	4.3	5.7	5.2
Current account bal/GDP (%)		-8.3	-15.2	-17.0	-19.7	-18.2	-17.0
Kyrgyz Republic							
GDP at market prices (2005 US$) [b]	4.7	8.5	8.4	2.3	-3.5	7.0	4.5
Current account bal/GDP (%)	-10.2	-6.9	-14.6	-6.6	-5.4	-9.4	-9.1
Lithuania							
GDP at market prices (2005 US$) [b]	6.1	9.8	2.8	-15.0	0.4	3.3	3.1
Current account bal/GDP (%)	-7.8	-14.5	-11.8	4.4	2.6	1.3	1.2
Moldova							
GDP at market prices (2005 US$) [b]	2.3	3.1	7.8	-6.5	2.6	3.0	3.6
Current account bal/GDP (%)	-7.9	-16.5	-17.3	-9.9	-10.0	-10.3	-10.6
Macedonia, FYR							
GDP at market prices (2005 US$) [b]	2.2	5.9	4.8	-0.7	1.2	3.0	4.5
Current account bal/GDP (%)	-6.0	-7.6	-12.8	-7.0	-4.4	-5.3	-5.1
Romania							
GDP at market prices (2005 US$) [b]	2.2	6.0	7.1	-7.1	-1.9	1.5	4.4
Current account bal/GDP (%)	-5.8	-13.6	-11.9	-4.5	-6.3	-6.4	-6.5
Russian Federation							
GDP at market prices (2005 US$) [b]	3.8	8.5	5.2	-7.9	3.8	4.2	4.0
Current account bal/GDP (%)	7.6	6.0	6.2	4.0	5.1	3.3	1.1
Tajikistan							
GDP at market prices (2005 US$) [b]	4.6	7.8	7.9	3.4	5.5	5.0	5.0
Current account bal/GDP (%)	-4.5	-8.6	-7.7	-4.9	-3.5	-5.4	-5.4
Turkey							
GDP at market prices (2005 US$) [b]	4.3	4.7	0.7	-4.7	8.1	4.1	4.3
Current account bal/GDP (%)	-1.5	-5.9	-5.7	-2.3	-5.9	-5.8	-5.6
Ukraine							
GDP at market prices (2005 US$) [b]	2.7	7.9	2.1	-15.1	4.3	4.0	4.5
Current account bal/GDP (%)	2.7	-3.7	-7.1	-1.5	-2.2	-3.1	-3.4
Uzbekistan							
GDP at market prices (2005 US$) [b]	4.6	9.5	9.0	8.1	8.0	7.3	8.3
Current account bal/GDP (%)	3.3	7.3	8.7	2.7	4.3	8.3	9.6

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.
Bosnia and Herzegovina, Turkmenistan, Serbia, Montenegro are not forecast owing to data limitations.
a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.

Source: World Bank.

Georgia, Kyrgyz Republic, Moldova, Tajikistan and Ukraine improved conditions are expected to see policy shift toward a more neutral stance beginning in 2010.

Financing external imbalances will be facilitated by continued improvement in international financial market conditions and rising international flows to the region, which will also support stronger investment growth. Although financial conditions are much tighter than during the pre-crisis boom, international borrowing costs have fallen sharply and consolidation efforts are beginning to bear fruit. Several countries in the region have seen their credit ratings upgraded (Azerbaijan, Georgia, Moldova, Montenegro, Turkey, and Ukraine -- although Montenegro also received one downgrade).

Reflecting these improving conditions, net private inflows into the region (excluding official inflows) are projected to expand by 30 percent and 16 percent in 2010. Similarly, FDI is projected to firm over the forecast horizon, partly because of an expected pick up in privatization, reaching 3.3 percent of regional GDP in 2012. (Table R2.3).

Risks

Banking system balance sheets remain impaired in a number of Europe and Central Asia countries, and significantly lower growth outturns could further undermine positions. In a number of countries, decisive actions—including improved provisioning and supervision standards—are required to help restore normal credit expansion.

Growth in energy exporters remains very reliant on hydrocarbon exports and volatile international oil prices. Significantly lower-than-projected commodity prices could lead to weaker growth outcomes for the mineral-export-led and

Table R2.3 Net capital flows to Europe and Central Asia
$ billions

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	20.3	36.7	48.5	37.6	-13.6	8.1	14.6	33.6	21.2	12.2
as % of GDP	2.0	2.7	2.9	1.8	-0.5	0.2	0.6	1.1	0.6	0.3
Financial flows:										
Net private and official inflows	81.0	99.9	127.8	218.2	410.4	262.1	89.8	134.7		
Net private inflows (equity+debt)	85.8	107.2	156.2	248.9	413.5	251.0	57.6	111.0	144.2	167.8
..Net private inflows (% GDP)	8.5	8.0	9.3	12.0	15.5	7.5	2.2	3.6	4.3	4.4
Net equity inflows	25.3	43.7	57.8	104.6	160.2	145.0	90.0	86.0	112.2	135.3
..Net FDI inflows	23.8	41.9	51.1	92.3	133.2	160.1	85.1	79.0	103.2	124.3
..Net portfolio equity inflows	1.5	1.8	6.7	12.3	27.0	-15.1	5.0	7.0	9.0	11.0
Net debt flows	55.8	56.2	70.0	113.6	250.2	117.1	-0.2	48.7		
..Official creditors	-4.7	-7.3	-28.4	-30.7	-3.0	11.1	32.2	23.7		
....World Bank	-0.2	1.0	-0.7	0.2	0.2	0.7	2.8	2.2		
....IMF	-2.0	-5.9	-9.8	-5.8	-5.0	6.2	20.2	10.5		
....Other official	-2.5	-2.5	-18.0	-25.1	1.8	4.2	9.3	11.0		
..Private creditors	60.5	63.5	98.4	144.3	253.3	106.0	-32.5	25.0	32.0	32.5
....Net M-L term debt flows	34.0	52.2	80.0	108.9	177.5	121.3	5.3	24.0		
......Bonds	7.3	14.4	16.6	32.3	55.9	16.2	-1.7	13.5		
......Banks	27.1	39.0	64.7	77.5	122.6	105.7	7.3	10.5		
......Other private	-0.4	-1.3	-1.3	-0.8	-1.0	-0.6	-0.4	0.0		
....Net short-term debt flows	26.5	11.3	18.4	35.4	75.7	-15.3	-37.7	1.0		
Balancing item /a	-52.3	-67.7	-89.3	-84.2	-170.7	-328.0	-78.4	-121.2		
Change in reserves (- = increase)	-49.1	-68.8	-87.0	-171.6	-226.1	57.8	-26.0	-47.2		
Memorandum items										
Workers' remittances	11.6	16.0	23.3	28.4	39.3	45.8	35.4	37.0	39.0	43.0

Source: World Bank
Note: Countries covered are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Kazakhstan, Kosovo, Kyrgyz Republic, Lithuania, Macedonia FYR, Moldova, Montenegro, Romania, Russian Federation, Seychelles, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan
e = estimate, f = forecast
/a Combination of errors and omissions and transfers to and capital outflows from developing countries

interlinked CIS economies. And, while the build-up of oil revenue savings-funds prior to the onset of the crisis—albeit significantly drained in the interim (Azerbaijan, Russia, Kazakhstan)—have created some cushioning for downturns, diversification to other sources of growth would further underpin sustainable long-term growth. Continued improvement in the investment climate (for example in public administration and judicial reforms) would facilitate private sector development.

Given the extent to which the region, particularly the CEE economies, has become tightly integrated with high-income Europe (trade, finance and labor), a significantly lower-than-projected growth-outturn in the Euro Area represents a downside risk. Further, a number of the Europe and Central Asian economies (e.g., Bulgaria, Romania) have some exposure to the banking systems of high-income Euro Area countries with elevated sovereign debt (e.g., Greece), where recovery is particularly fragile. While spill-over of heightened risk-aversion from the Euro Area countries has been limited so far, Europe and Central Asia's bond markets remain vulnerable to downswings in investor sentiment. As sustainability of public debt and concerns about the health of banking systems will remain a key concern over the forecast horizon, countries with large external financing needs face the risk that international financial markets might require greater fiscal consolidation to maintain confidence.

Notes:

1. For the purposes of this report the developing Europe and Central Asia comprises only low- and middle-income countries

2. IMF Global Financial Stability Report, October 2010.

3. Ratha, Dilip et al, "Migration and Development Brief (number 13)", November 8, 2010, The World Bank.