



THE WORLD BANK

Working for a World
Free of Poverty

NEWS RELEASE

News Release No. 2007/58/DEC

Contacts:

Merrell Tuck (202)473-9516 mtuckprimdahl@worldbank.org
TV/Radio: **Cynthia Case** (202) 473-6287 ccase@worldbank.org

DEVELOPING COUNTRY GROWTH RESILIENT IN THE FACE OF FINANCIAL TURMOIL AND SOARING FOOD AND ENERGY PRICES *Strong growth in Europe and Central Asia, but risks include uncertain external financing*

Warsaw, June 13, 2008 – In the wake of financial turmoil in high income countries and amidst high food and energy prices, developing countries' growth is easing but is still robust. Private capital flows to emerging markets, which hit a record \$1 trillion in 2007, are expected to drop to around \$800 billion by 2009, which would still be the second highest level ever, says a new World Bank report.

Global Development Finance 2008 predicts a slowdown in world GDP growth from 3.7% in 2007 to 2.7% in 2008, while growth in developing countries is expected to slow from an extraordinary 7.8% in 2007 to 6.5 % in 2008.

Europe and Central Asia achieved a remarkable 6.8% GDP growth in 2007, down from 7.3% in 2006, against a backdrop of global financial turmoil, steep rises in commodity prices, and the slowing of demand becoming apparent in the Euro area. Growth is expected to slow to 5.8% in 2008 and stabilize at about 5.4 % over 2009 and 2010.

Among CIS countries—which recorded their second-strongest growth in a decade in 2007 at 8.6 %—**Russia's** GDP grew by a strong 8.1 % during 2007 and is likely to ease to 7.1 % in 2008 and 6.3 % in 2009. Among CEE countries—which grew overall at 6.1% in 2007—**Poland** grew at 6.5 % in 2007 and will likely moderate to 5.7 % in 2008 and 5.1% in 2009.

The major risk for the region is the unfavorable and uncertain external financing environment. External financing needs will not abate, and current account positions are unlikely to turn around in 2008, largely because the slowdown in Western Europe offers fewer export opportunities, while the region's import demand will not slow as much as its exports.

With the exception of the CIS hydrocarbon exporters, almost all the region's economies showed deteriorating current account balances in 2007. Deficits have crossed 10 % of GDP in the **Baltics, Bulgaria, Romania, Georgia, the Kyrgyz Republic, and Moldova**, underscoring concerns about unsustainable growth in several economies.

“Many countries in the region seem more vulnerable than most other developing countries outside of Europe and Central Asia,” said **Hans Timmer, co-author and Lead Economist and Manager in the World Bank's Development Prospects Group**. “Several countries face reduced capital inflows and the threat of inflation also looms alongside the worldwide surge in commodity prices and strong real wage growth.”

Developing country growth in recent years has been powered in part by expanding capital flows, including by foreign banks that have expanded their presence in developing countries through acquisitions and the establishment of local affiliates. As of end-June 2007, foreign claims on developing-country residents held by major international banks stood at \$3.1 trillion, up from \$1.1 trillion at the end of 2002.

After a major surge in 2006, net capital flows to Europe & Central Asia increased by \$72 billion to \$404 billion in 2007, accounting for about 40% of the total flows to developing countries. Net private capital flows to the region increased only moderately by \$44 billion to reach \$409 billion in 2007.

“The presence of foreign banks in developing countries expands access to credit and as well as financial services, which can spur efficiency and innovation in domestic banks,” said **Mansoor Dailami, Manager of International Finance in the Development Prospects Group, and lead GDF author.** “However, the ripple effect of shocks from the credit squeeze in the US could impact local financial markets, including in countries like **Hungary, Kazakhstan, Russia, Turkey, and Ukraine.**”

While some low-income countries have recently accessed the international bond market, the bulk of private capital flows to developing countries go to just a few big economies, among them Brazil, Russia, India and China. The poorest nations remain reliant upon official aid, which further declined in 2007.

DETAILED FINDINGS

- A year ago, total developing-country foreign exchange reserves amounted to \$3.2 trillion, many countries were posting strong economic growth, emerging equity markets were rallying, and spreads on emerging-market bonds had reached record low levels. With the onset of the sub-prime crisis in the U.S., credit conditions deteriorated markedly. Even though emerging markets have shown considerable resilience so far, the balance of risks has plainly tilted to the downside.
- Nevertheless, despite a downward adjustment, the projected developing-country growth rate of 6.5% in 2009-10 is above the average over the first half of this decade (5.6%) and well above the average of the 1980s and 1990s (3.4%).
- High food and energy prices are now the dominant force behind increased inflation across developing countries—and worryingly, they are hitting the poorest people the hardest. However, the situation in Europe & Central Asia is more subtle, and harder to contain. Unlike other regions where inflation is mainly caused by high food and energy prices, Europe & Central Asia has already experienced strong wage growth due to tightening labor markets.
- Net FDI inflows to developing and high-income countries continued to surge in 2007, with global inflows reaching an estimated \$1.7 trillion, just over a quarter of which went to developing countries. Net FDI inflows to developing countries as a whole increased to an estimated \$471 billion. This was led by strong gains in Brazil (\$16 billion) and **Russia** (\$22 billion). In Europe and Central Asia, net FDI inflows increased from \$125 billion in 2006 to \$162 billion in 2007, with **Russia** accounting for the largest share (\$52 billion), followed by **Turkey** (\$22 billion), and **Poland** (\$18 billion).
- Although Europe & Central Asia’s two largest economies--Russia and Turkey--have low foreign bank presence, other countries in the region have extensive foreign bank presence as a result of regional integration into the European Union. In **Turkey**, 4% of banking assets were held by foreign-controlled banks in 2006, while in **Russia**, the share was 13 %. In **Hungary, Albania, Lithuania, Croatia, Bosnia-Herzegovina, Macedonia, Kyrgyzstan, Poland** and **Bulgaria**, the share is in the 70-100 % range.

- ### -

Media can get pre-embargo access via the Online Media Briefing Center: <http://media.worldbank.org/secure>

Accredited journalists needing a password may request one via: <http://media.worldbank.org/>

The report will be available on the web after the embargo expires at: <http://www.worldbank.org/gdf2007>

For additional resources, visit: www.worldbank.org/globaloutlook

WB51616

C:\Documents and Settings\WB51616\My Documents\ABCDE and GDF 08\news releases and advisories\gdf june3 tailored ECA release.doc
06/03/2008 5:34:00 PM