



# Global Economic Prospects

Uncertainties and  
Vulnerabilities

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World Bank  
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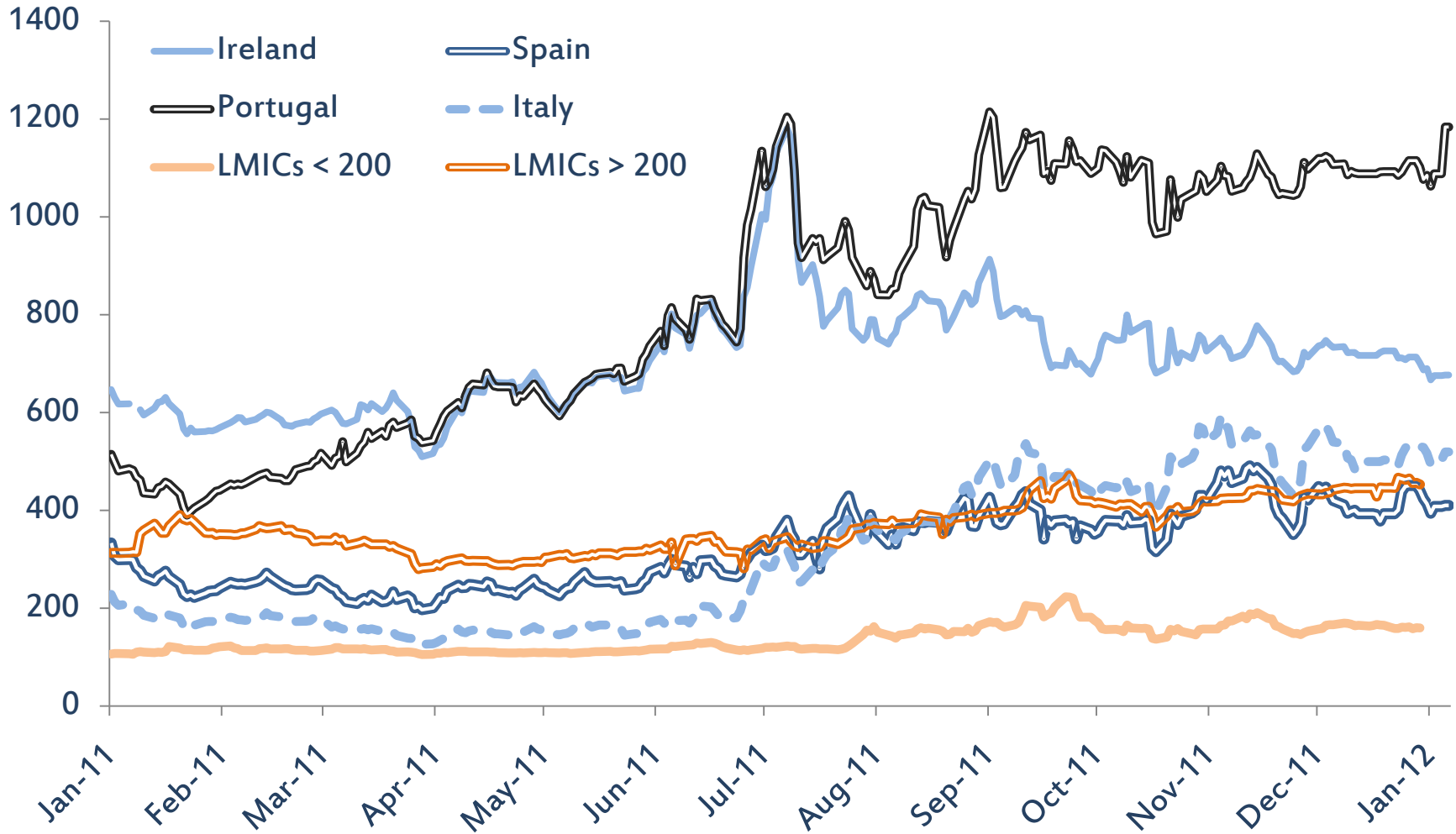


# Global environment has become much more precarious

- Turmoil since August has affected financial conditions in developing countries and economic activity worldwide
- Slow growth in large-middle-income countries and high-income Europe makes recovery fragile
- Developing countries to grow in 2012 by 5.4 %, high-income countries by 1.4% (vs June forecast of 6.2 and 2.7%)
- Baseline assumes no serious deterioration of conditions, should this materialize impacts for developing countries could be much worse
- Developing countries are vulnerable because of:
  - Reduced fiscal space
  - Maturing short-term and long-term debt
  - Potential deleveraging by banks in high-income world
  - Weaker export demand and remittances flows
  - Commodity prices

# Limited market relief for high-spread European and high-spread developing countries

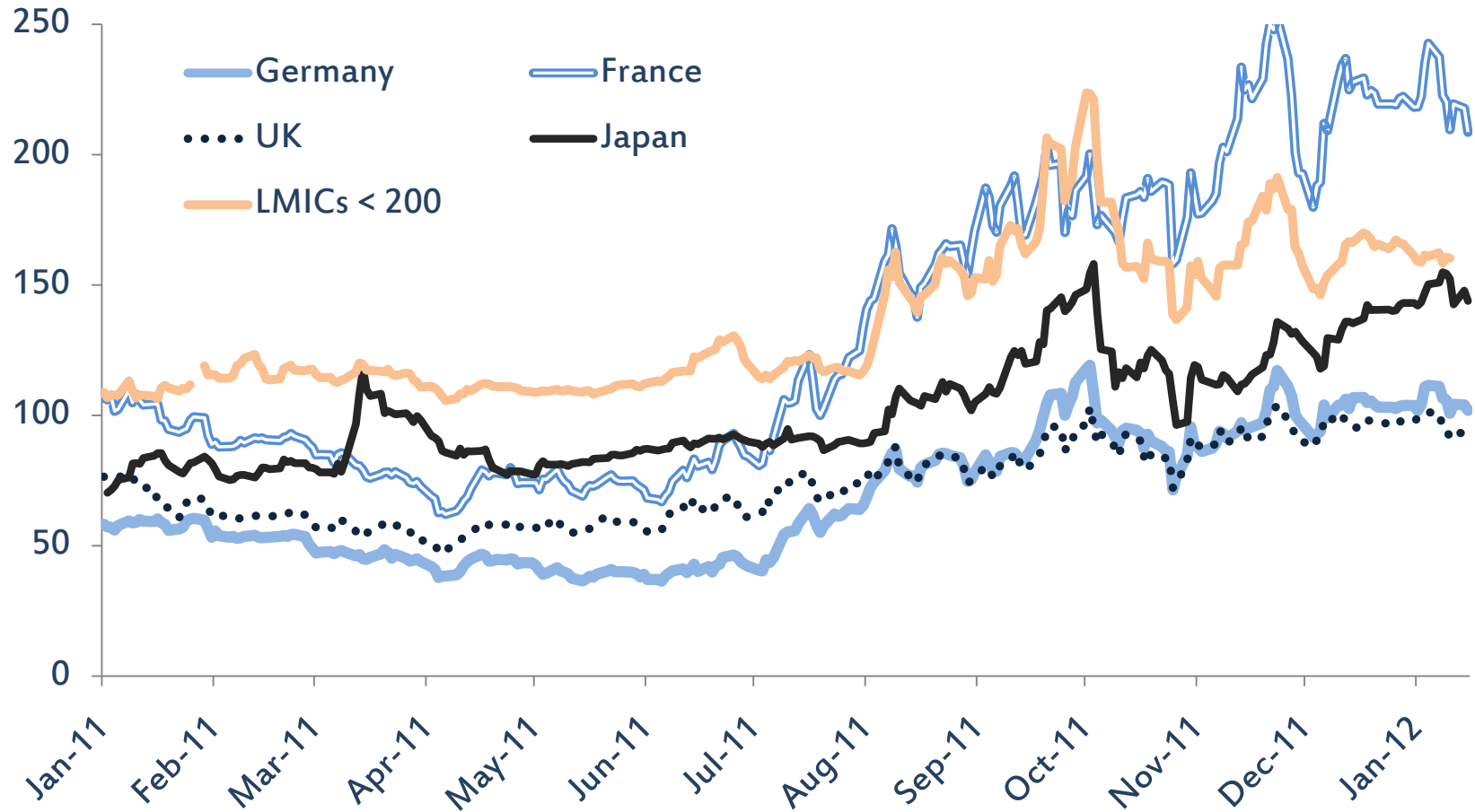
5-yr sovereign credit-default swap rates, basis points, Jan 2011-Jan 2012



Source: World Bank, Global Economic Prospects, 2012A.

# Contagion effects have diminished only somewhat

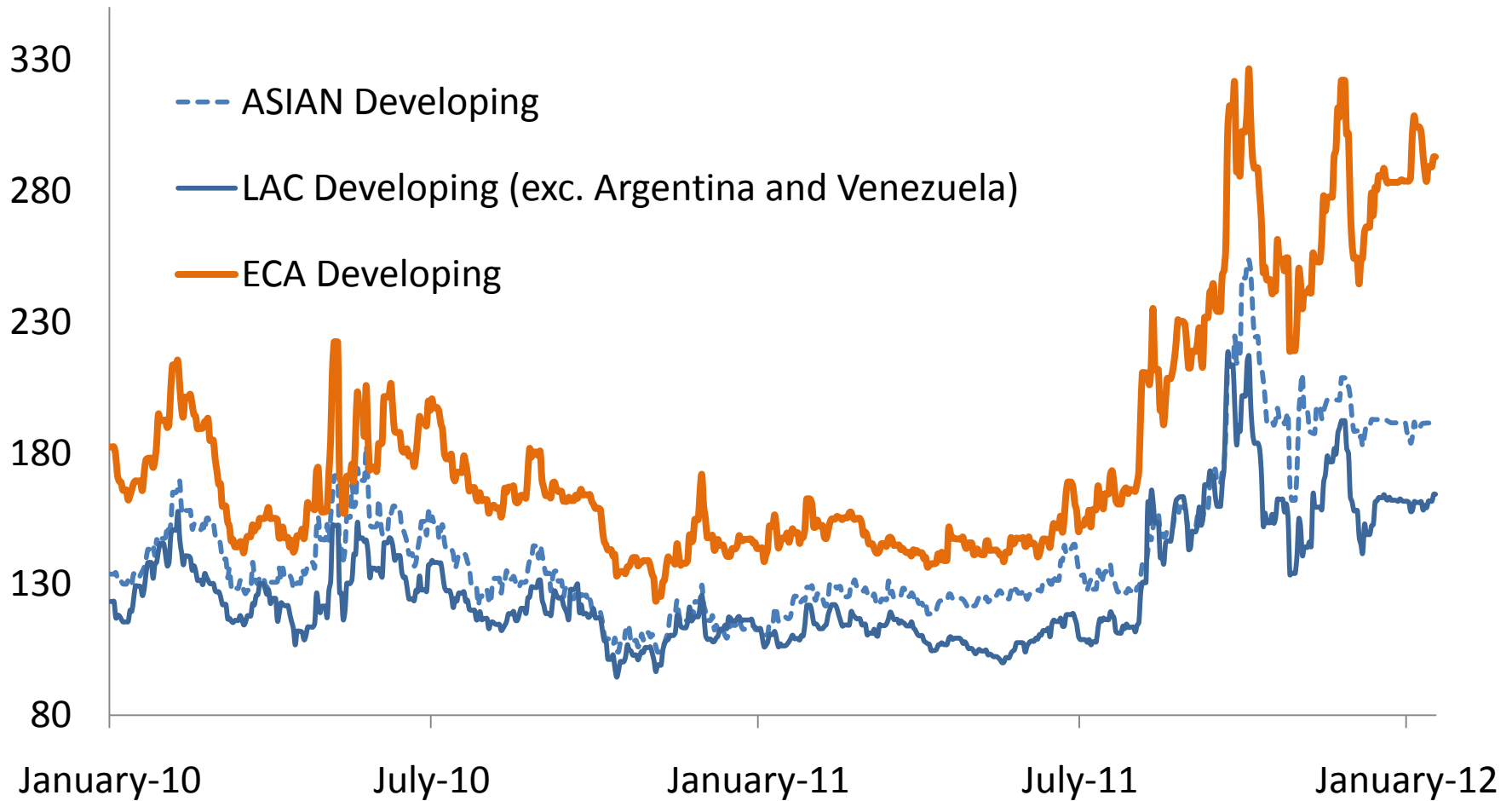
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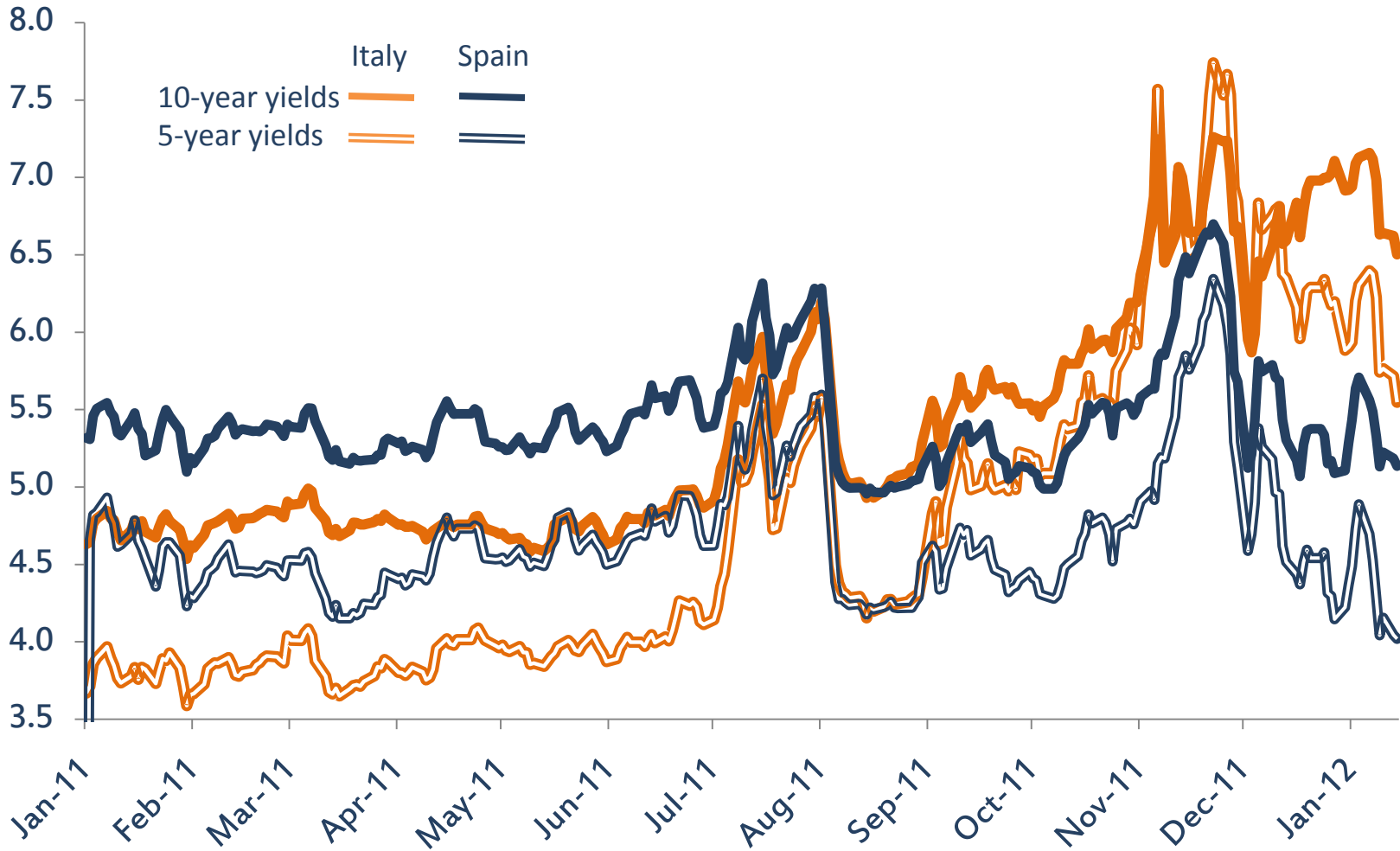
# Largest increase in the risk premia was in Eastern European and Central Asia

Price of Credit Default Swap (CDS), median basis point



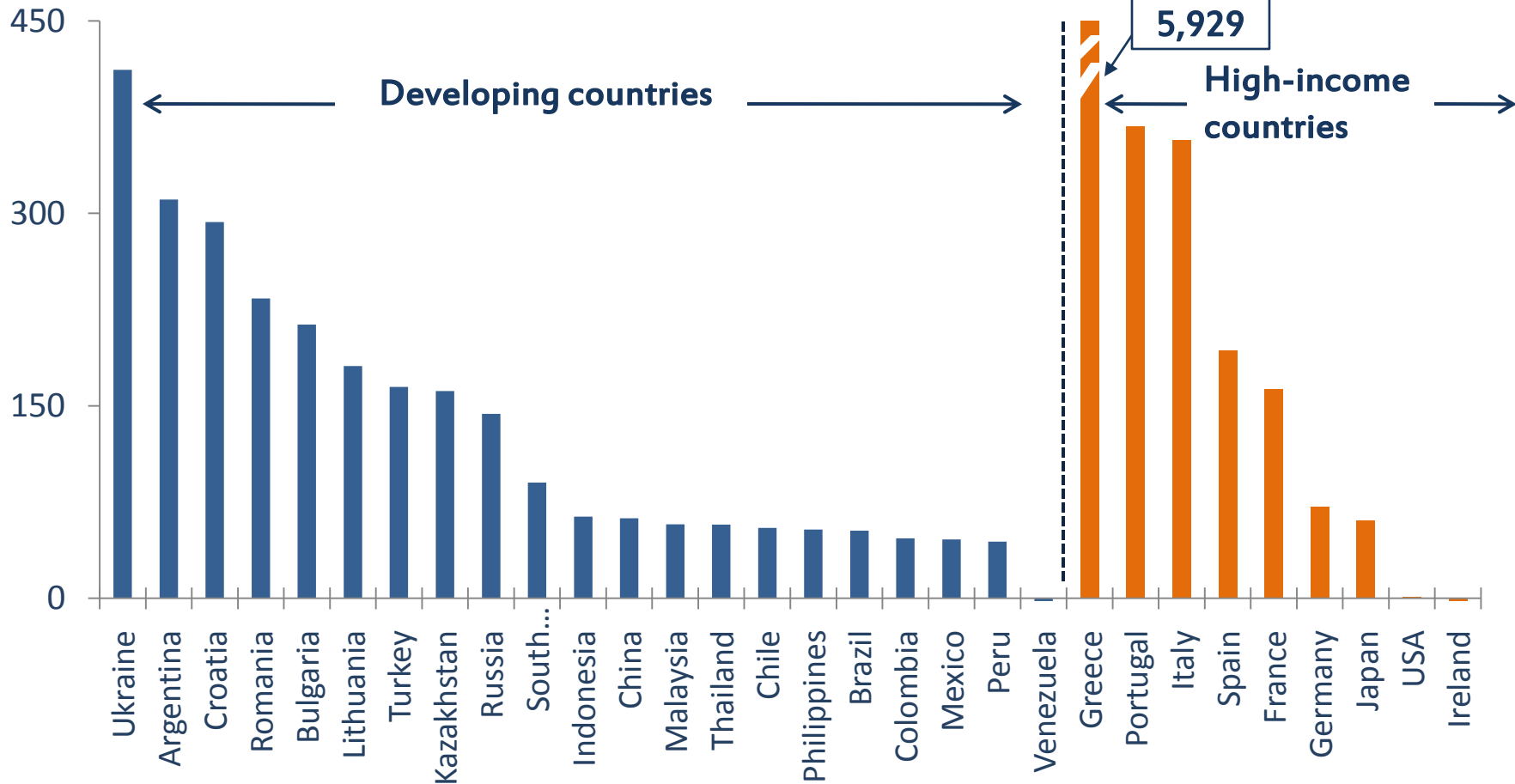
# Borrowing costs are falling for Italy and Spain following solid bond auctions

Government bond yields, percent



# Contagion has increased sovereign credit default swap rates worldwide

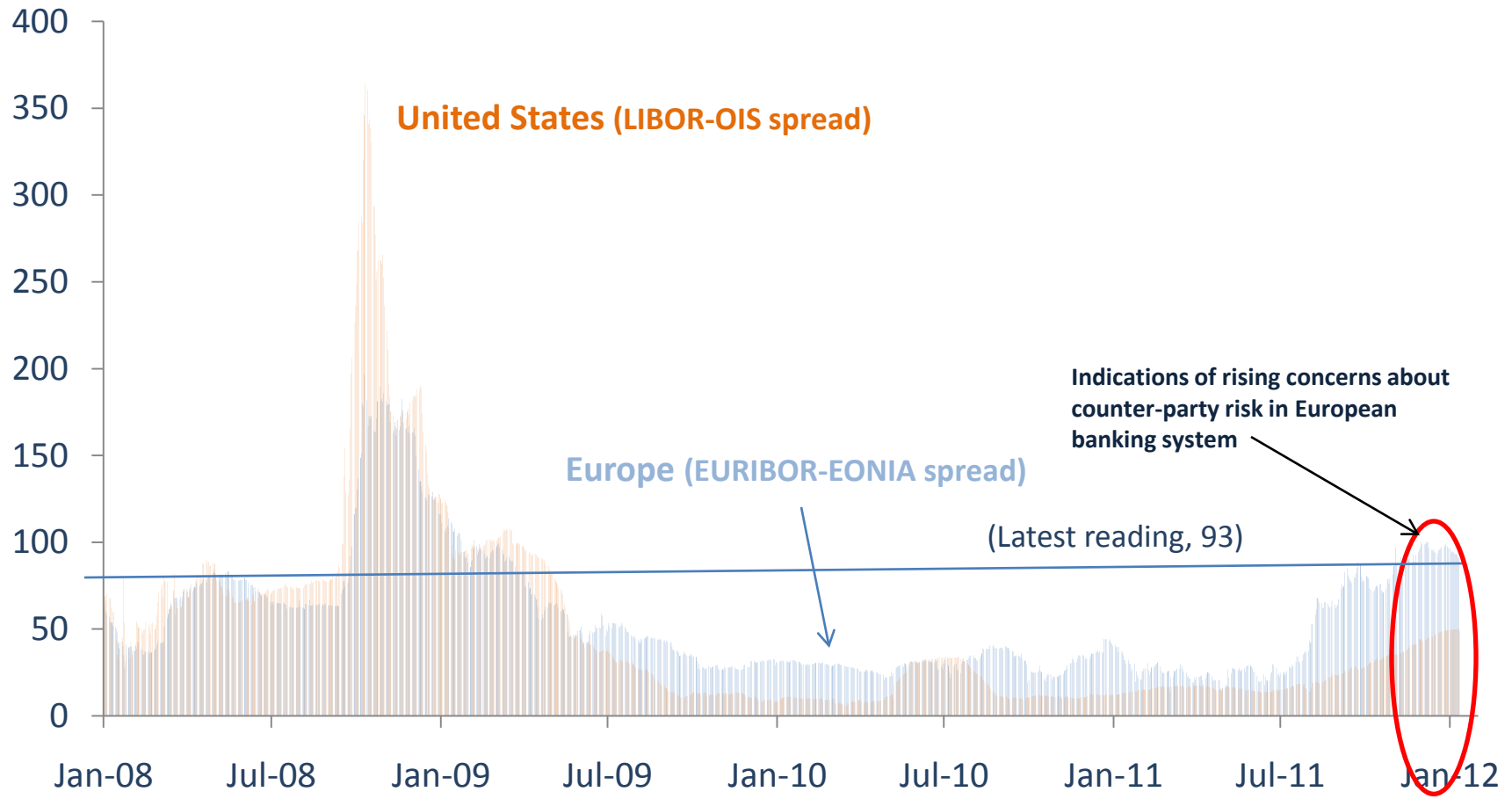
Change in 5-year sovereign credit-default swap, basis points (as of Jan. 6<sup>th</sup>, 2012)\*



\* Change since the beginning of July.

# European banking-sector counterparty-risk concerns persist despite pledge to recapitalize

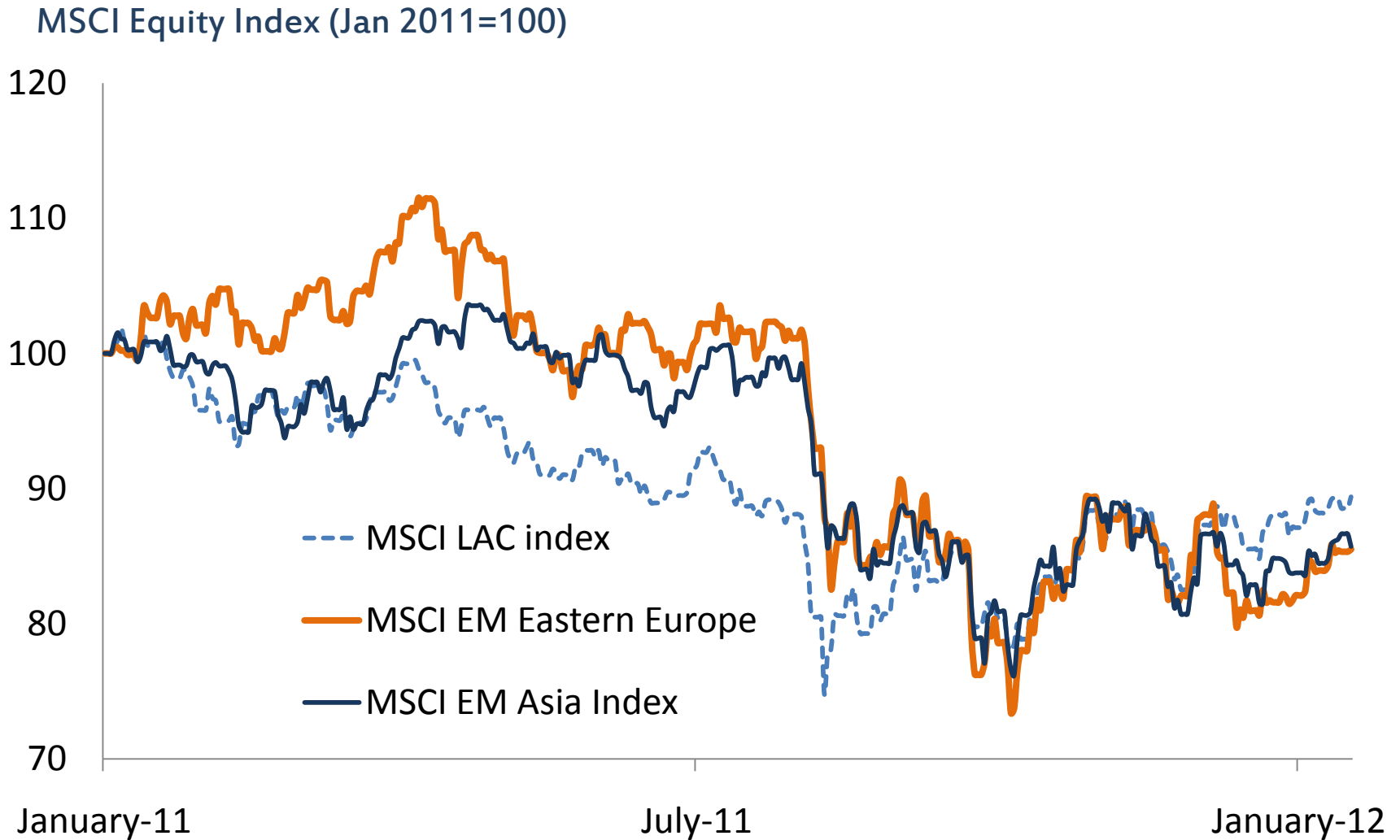
Interbank overnight spreads, basis points



# Market jitters translated into large-scale reduction in capital flows to developing countries in 2011H2

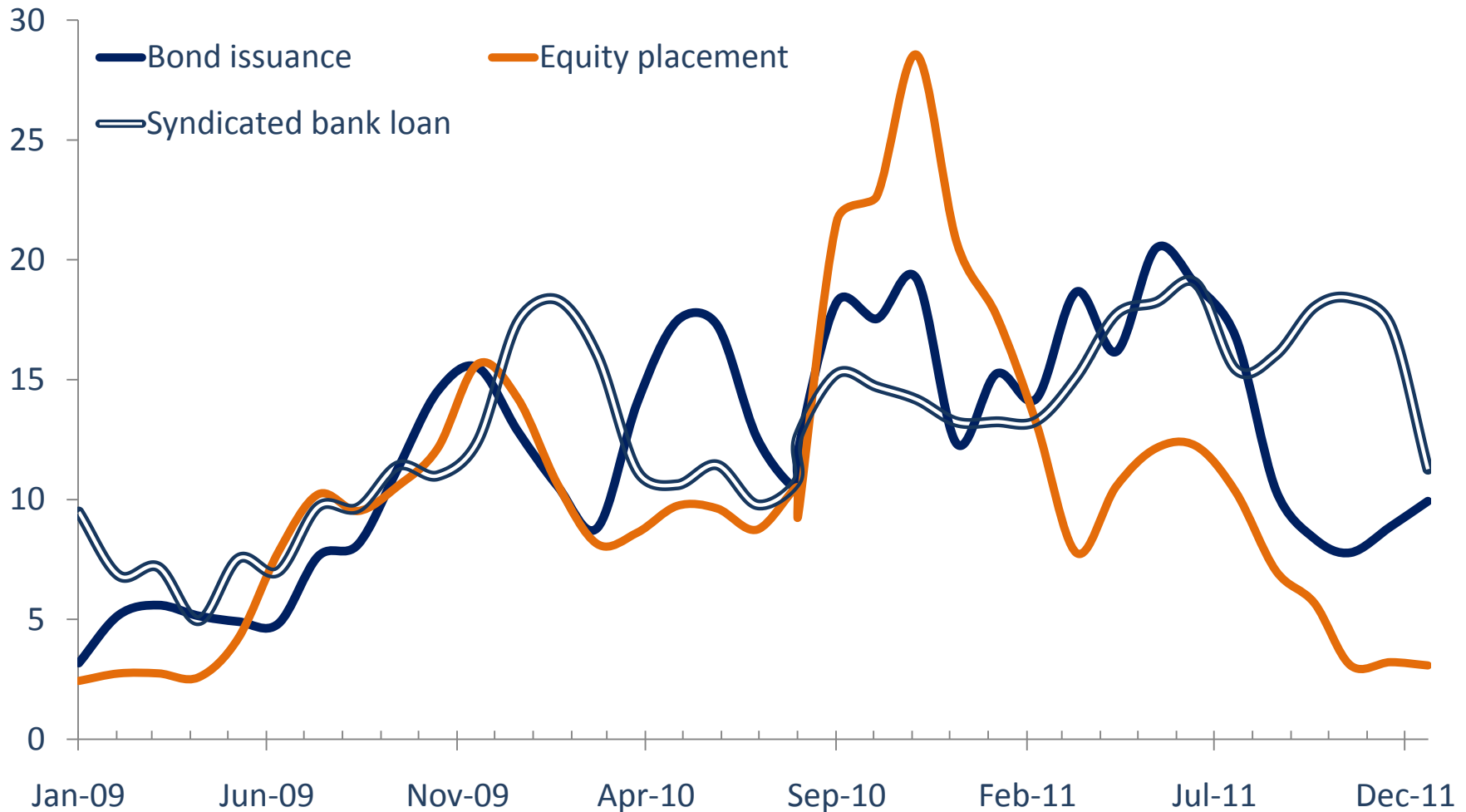
- Since July 31, 2011
  - Developing equity markets are off 8.5%
  - High-income markets off 4.2%
  - Total decline, c. \$6.5 trillion (9.5% of global GDP)
- Emerging-market equity mutual funds posted net **outflows** of about \$48 billion in 2011, versus a \$97 billion **inflow** in 2010.
- Gross capital flows to developing countries down 50% and 45% in the second half from the like periods of 2009 and 2010, respectively

# Steepest stock market declines were in Eastern European and Central Asia

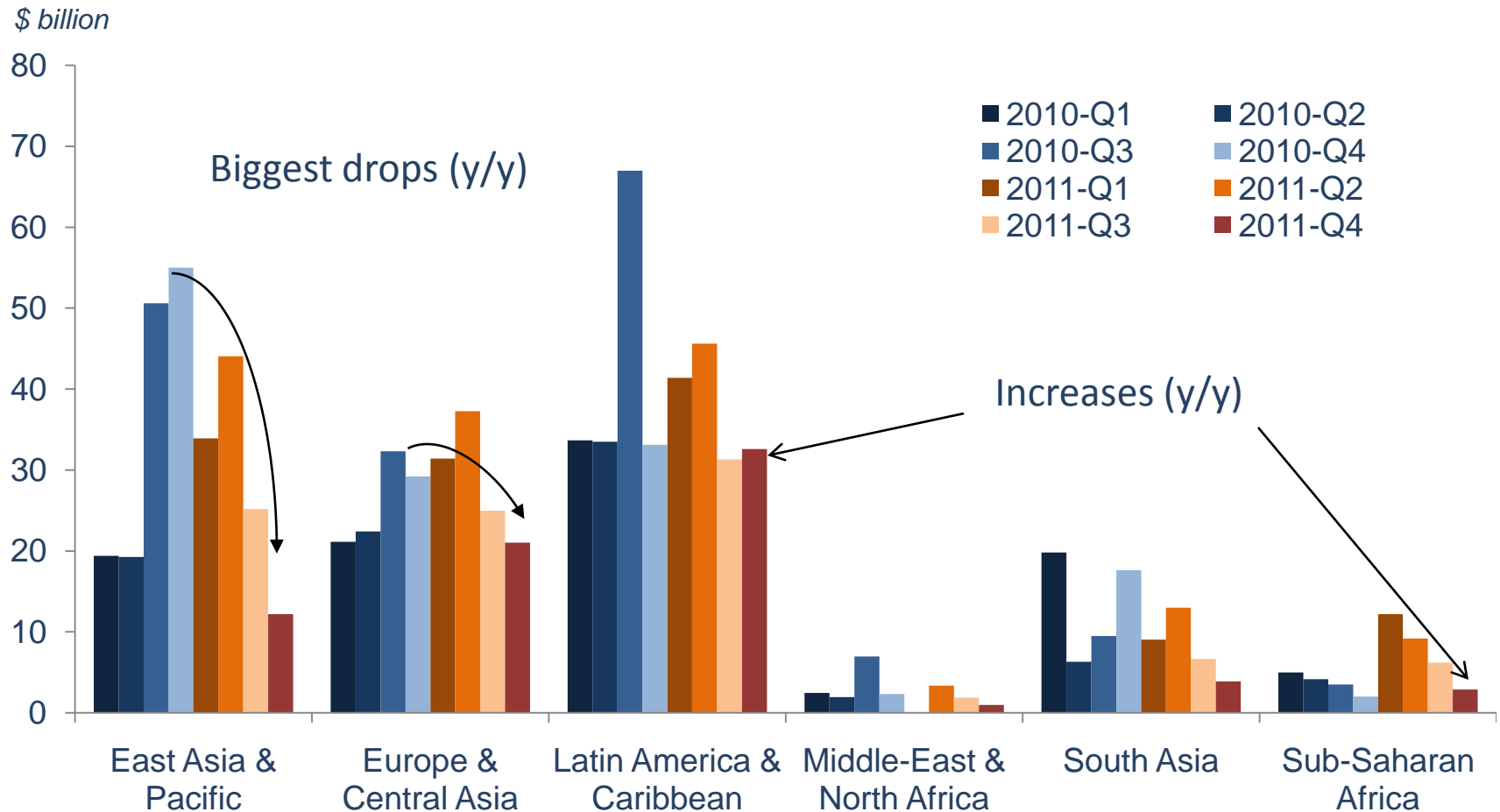


# Gross capital flows to developing countries down 50 percent in second half of 2011

3-month moving average (\$ billion)



# Capital flows to developing countries down 50 percent from 2010 levels



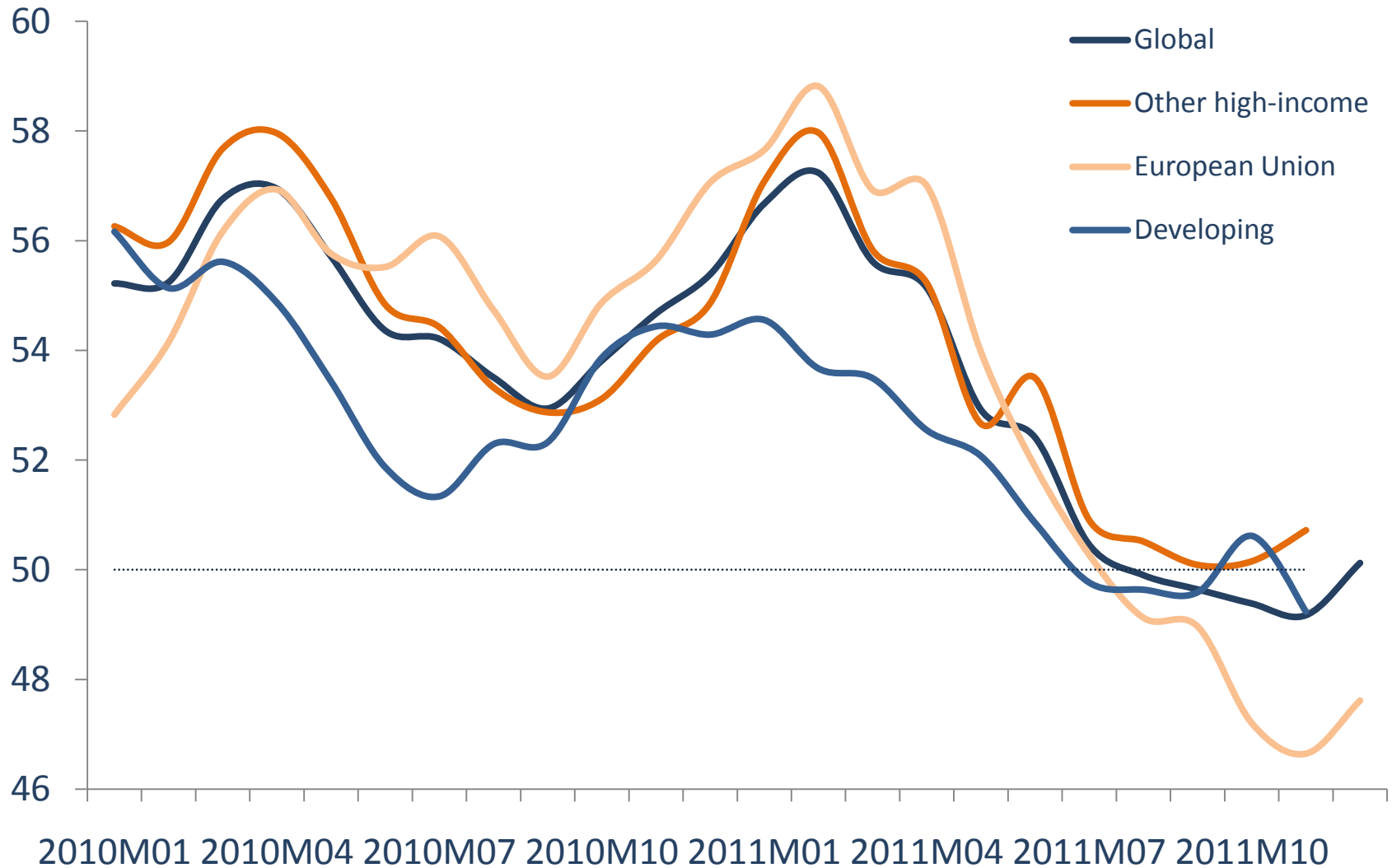
Source: World Bank.

# Real economy has slowed and recovery looks fragile

- Diverging trends: Strength in US and Japan; policy induced slowdown in large MIC; Europe entering recession; modest growth elsewhere
- Global trade has sharply weakened; driven by falling European imports
- Slow growth in Europe and several middle-income countries could be self-reinforcing

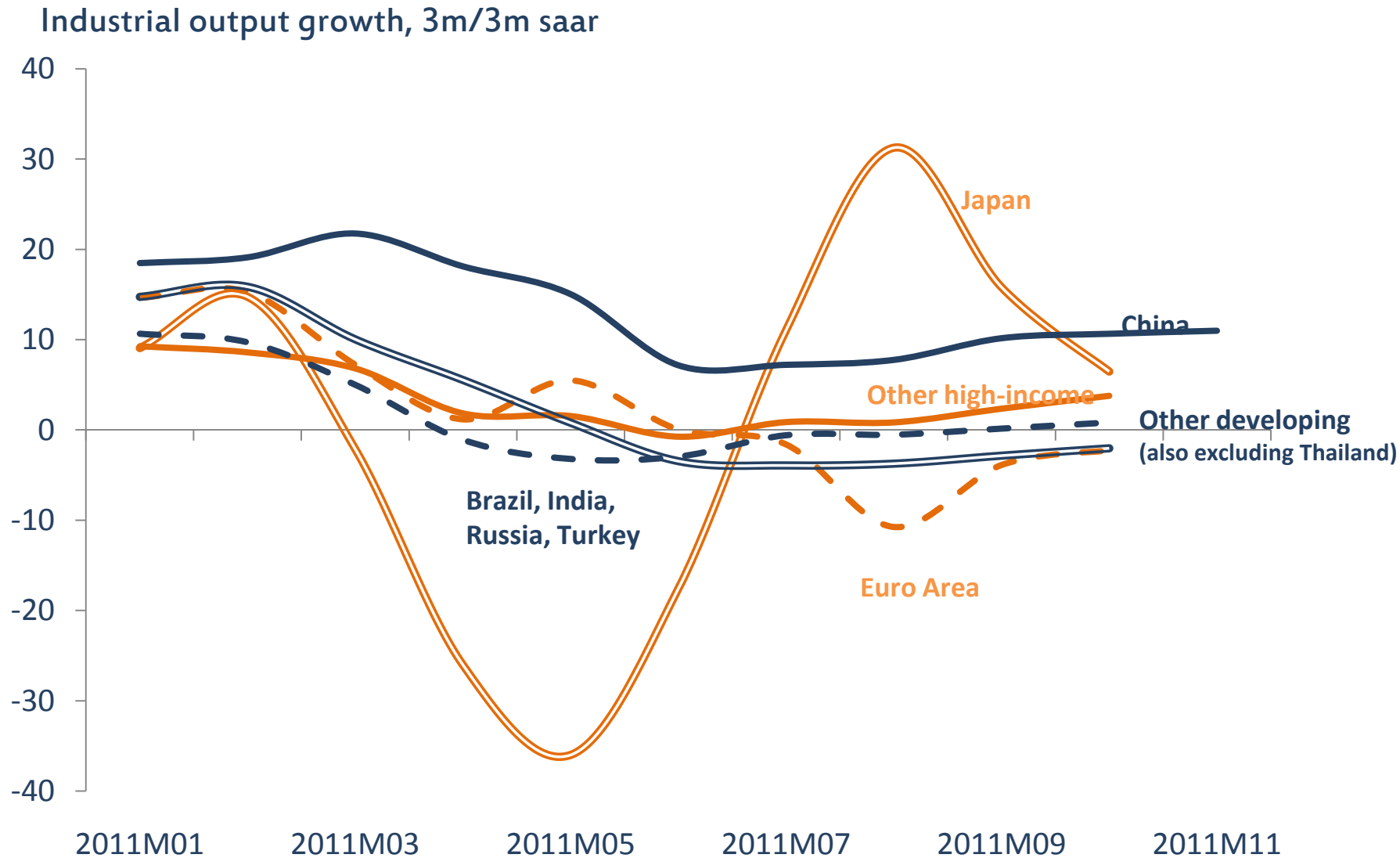
# Business outlook improving but weak

Purchasing managers index (PMI), points



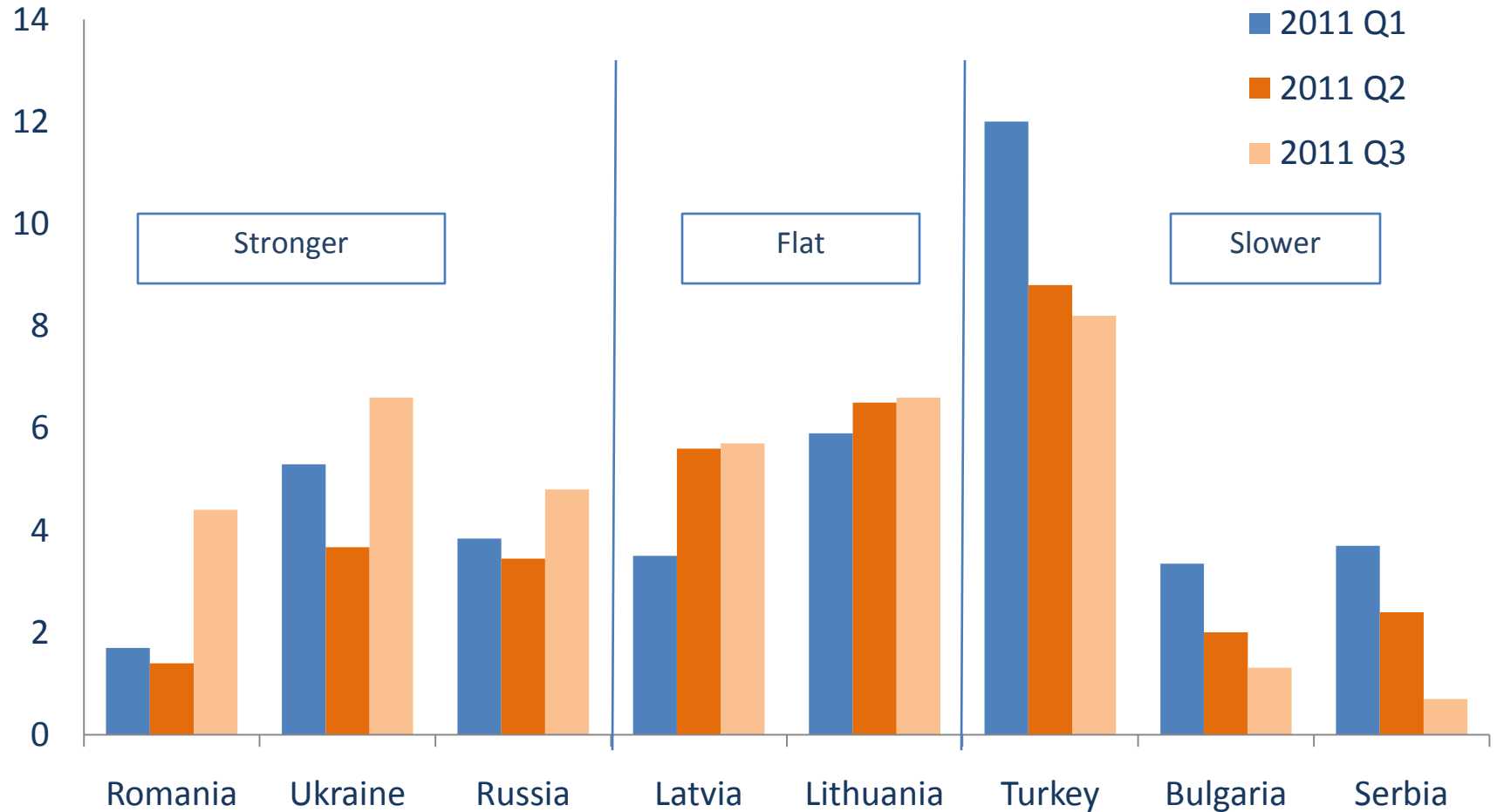
Source: World Bank, Global Economic Prospects, 2012A.

# Domestically rooted slow growth in large developing countries and European downturn create challenging environment



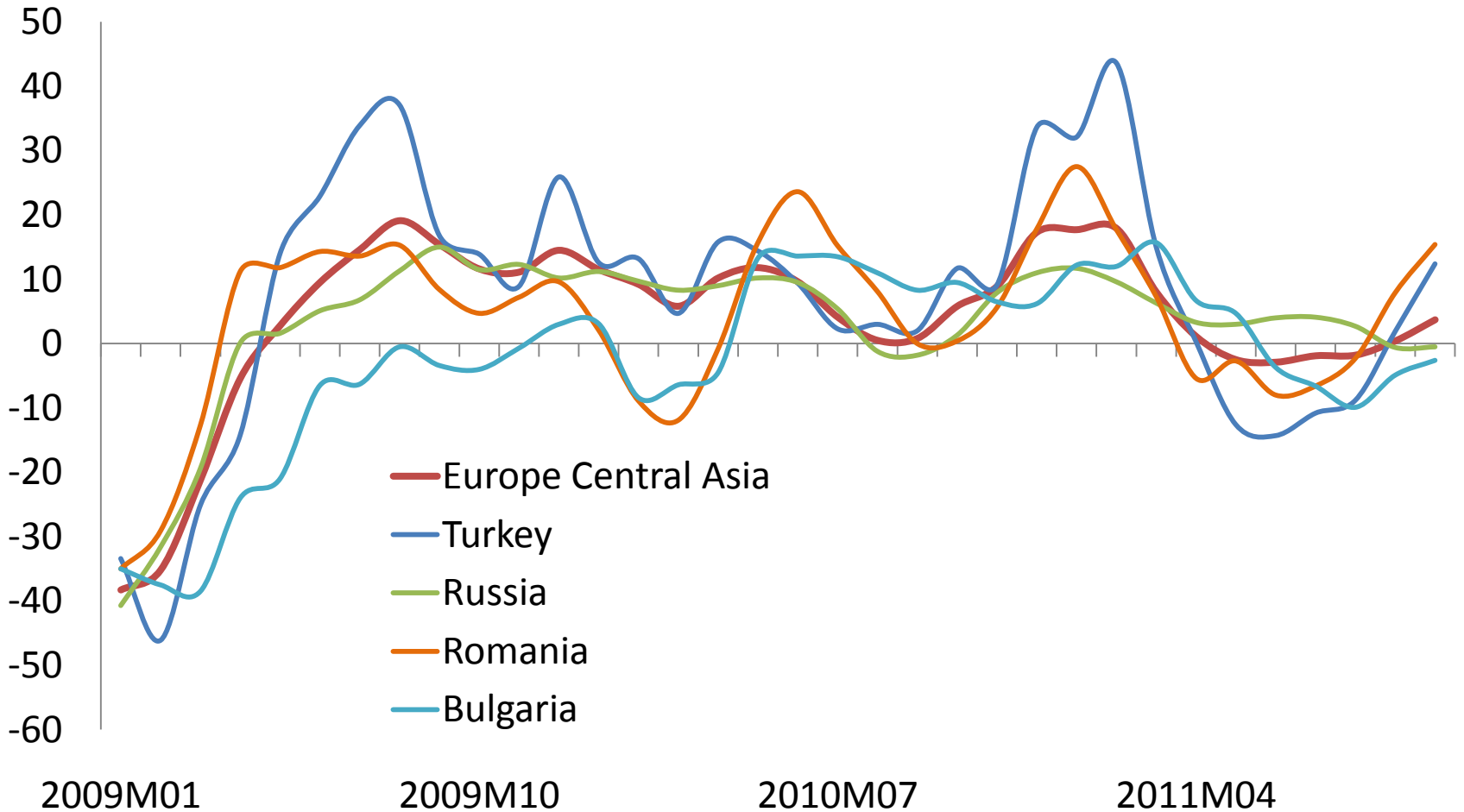
# Mixed economic performance in the third quarter

GDP Growth (y-o-y, percent)

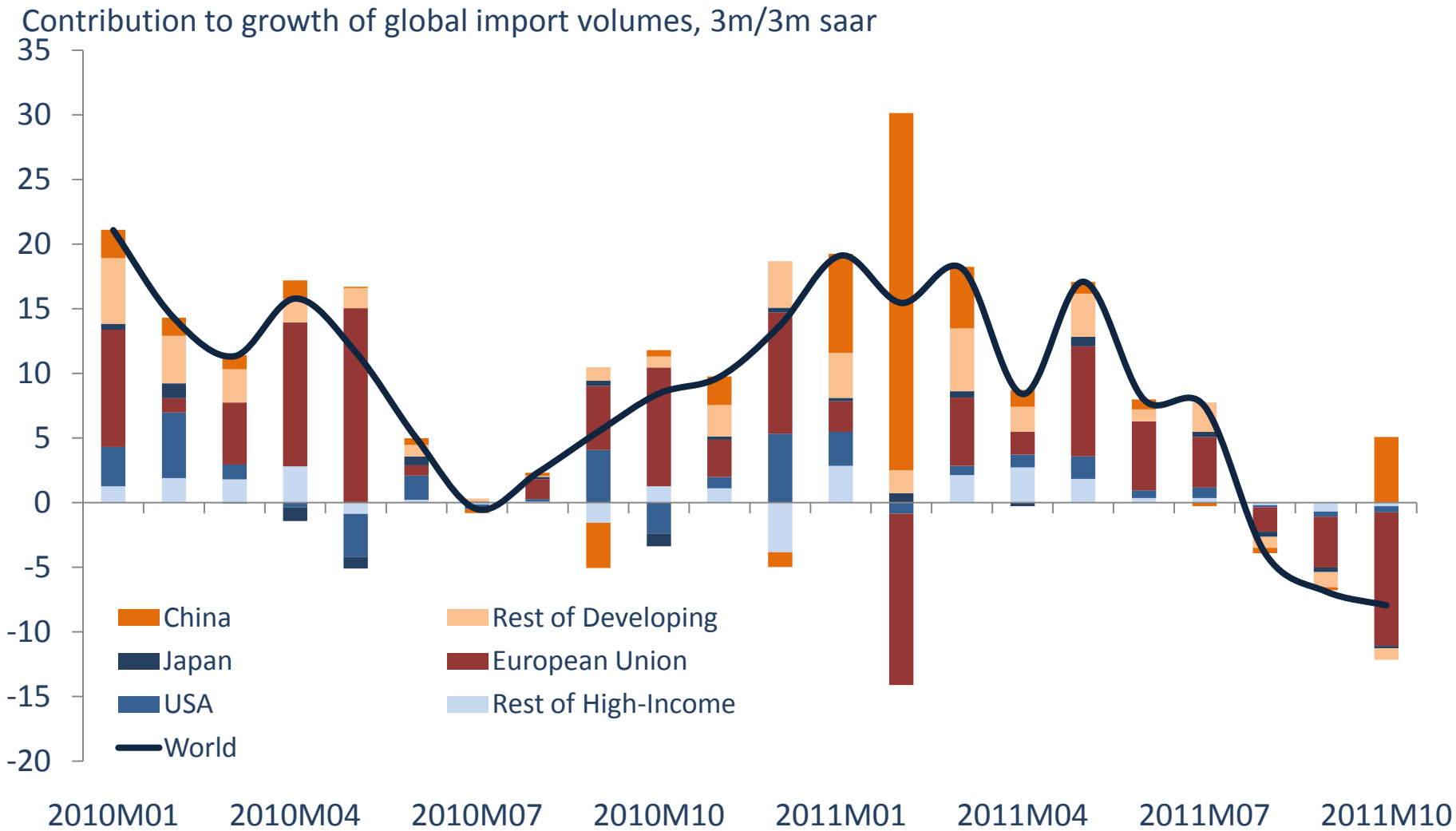


# Industrial production growth in ECA had a rebound in October

Industrial Production Volume Growth (3m/3m saar. percent)



# Import volumes appear to have declined sharply in August



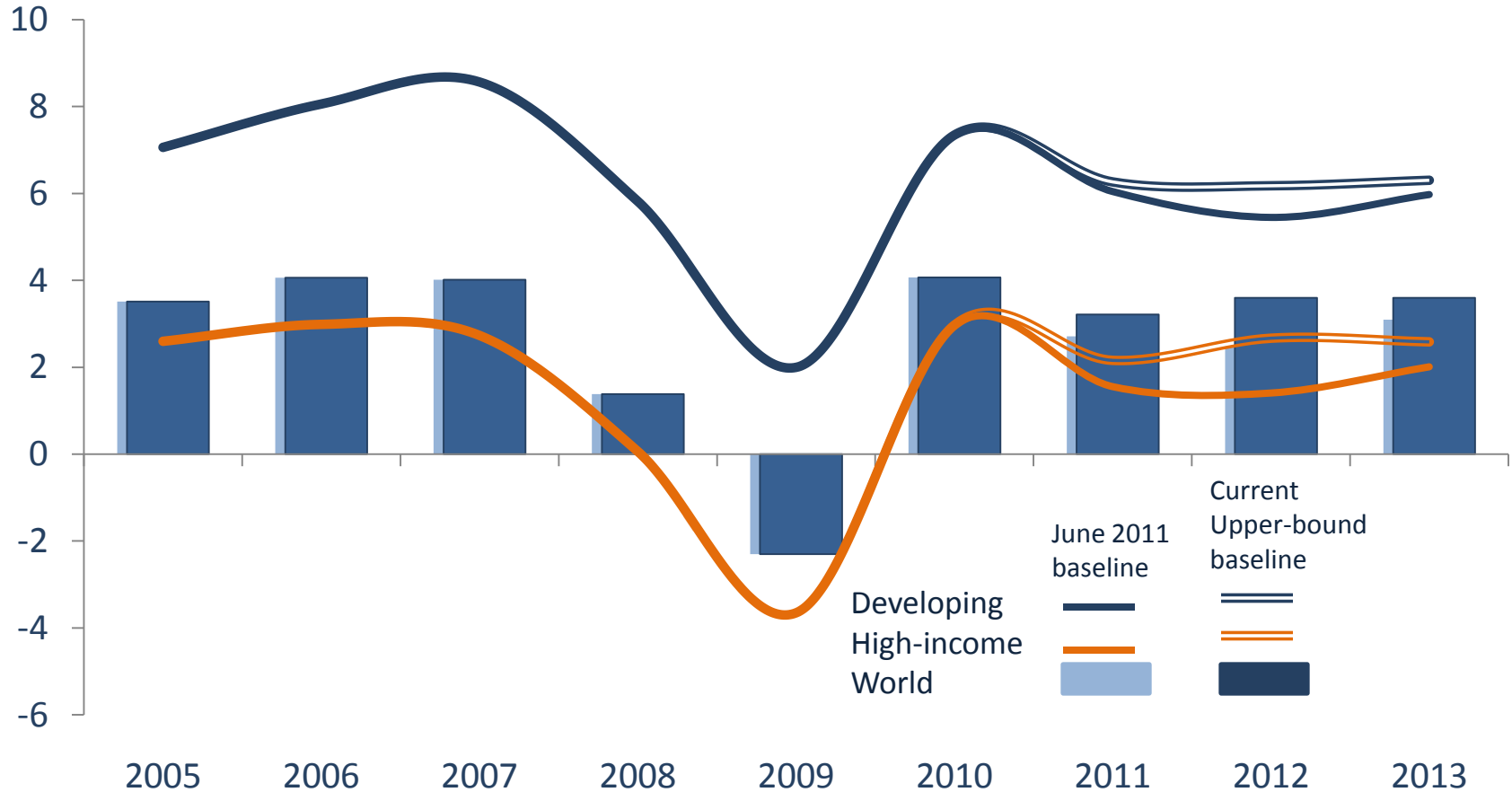
Source: World Bank, Global Economic Prospects, 2012A.

# Developing countries at risk from a deterioration of conditions in high-income countries

- Baseline shows significant markdown since June, assuming limited confidence effects outside Europe
- Much more serious consequences could be envisaged, if financial-sector solvency is affected or a market-induced credit event occurs.
- Downside scenarios necessarily speculative, but potentially as significant as 2008/09

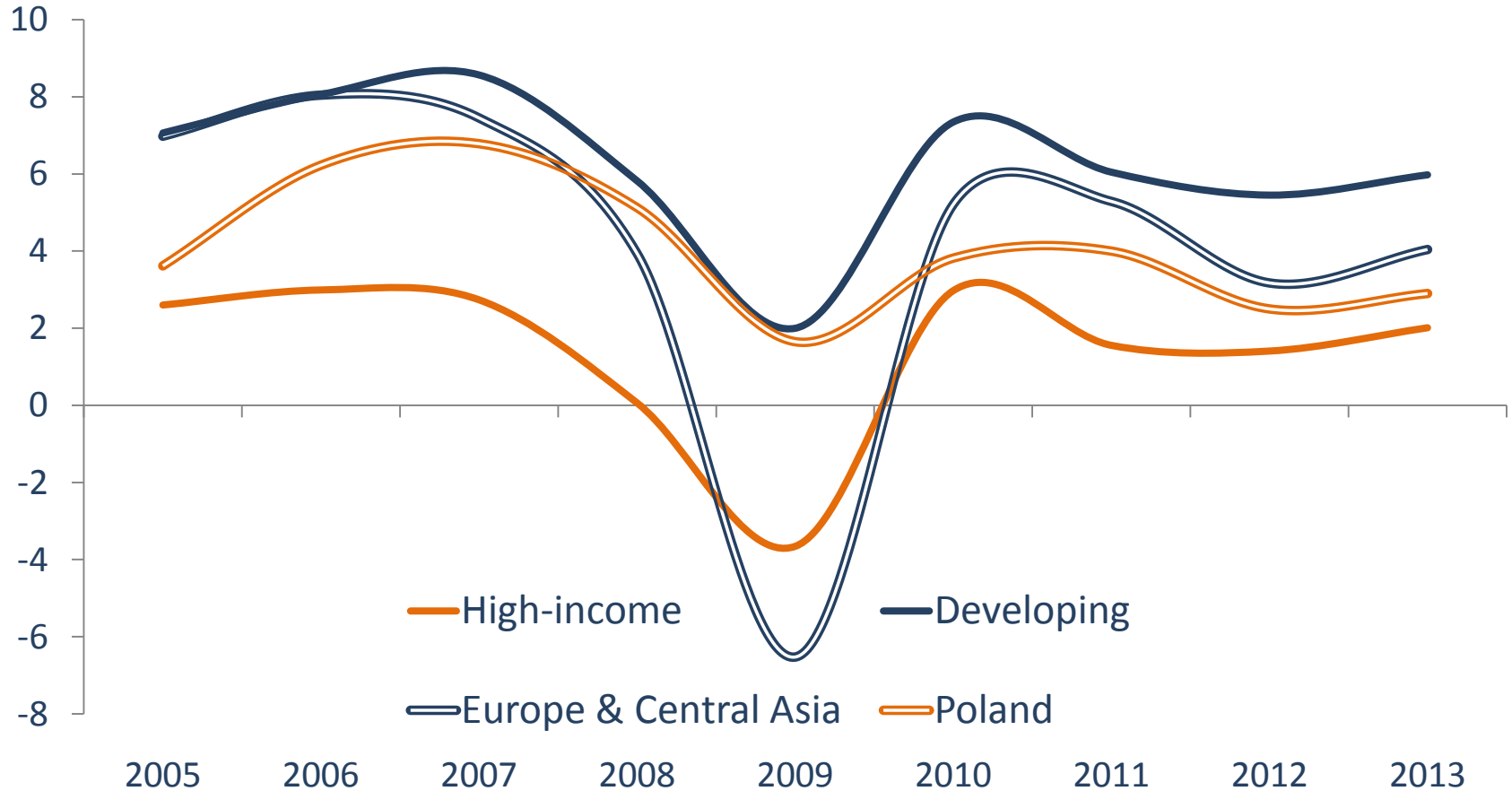
# Growth forecasts have been downgraded further since September

Projected growth



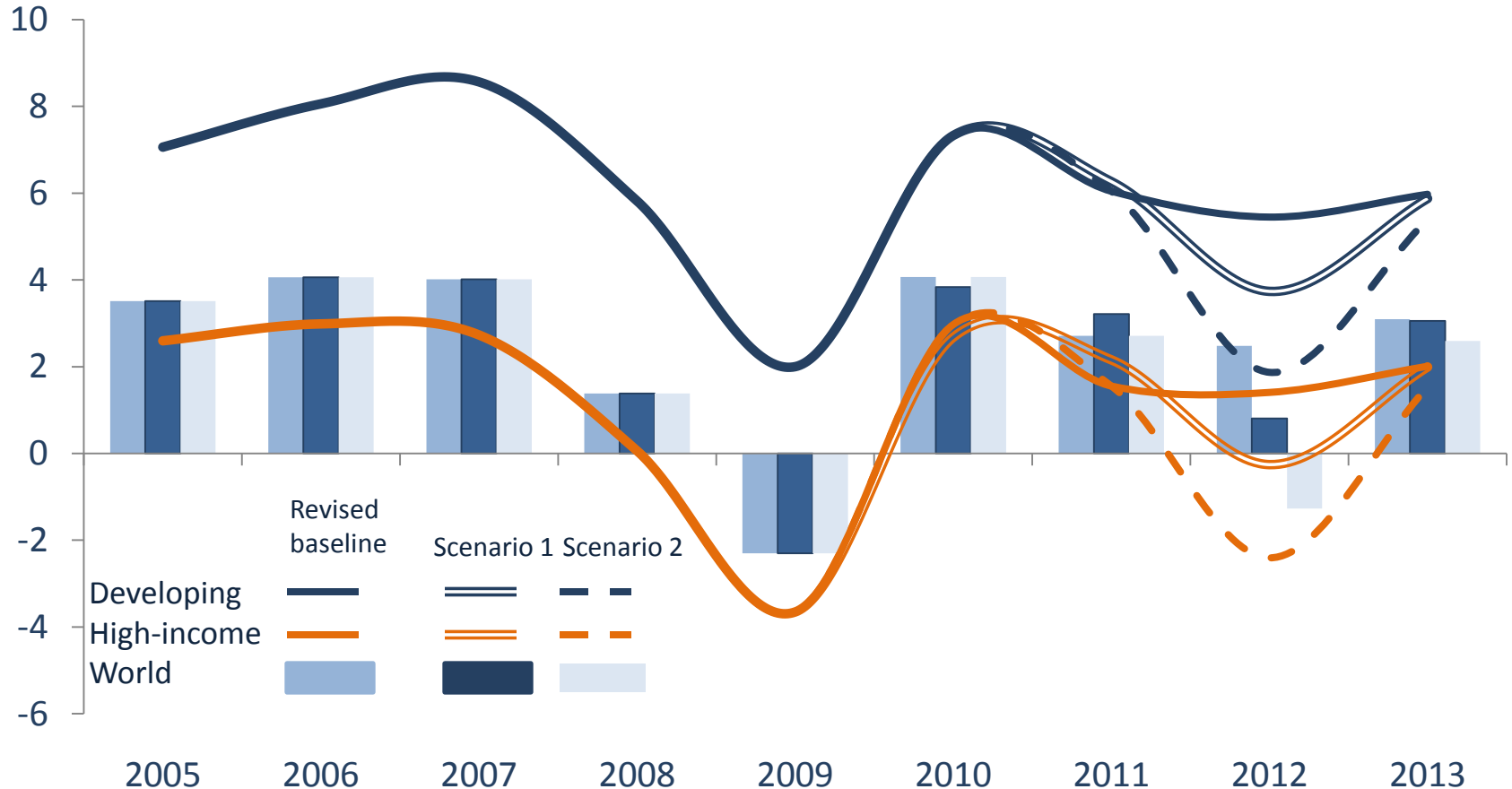
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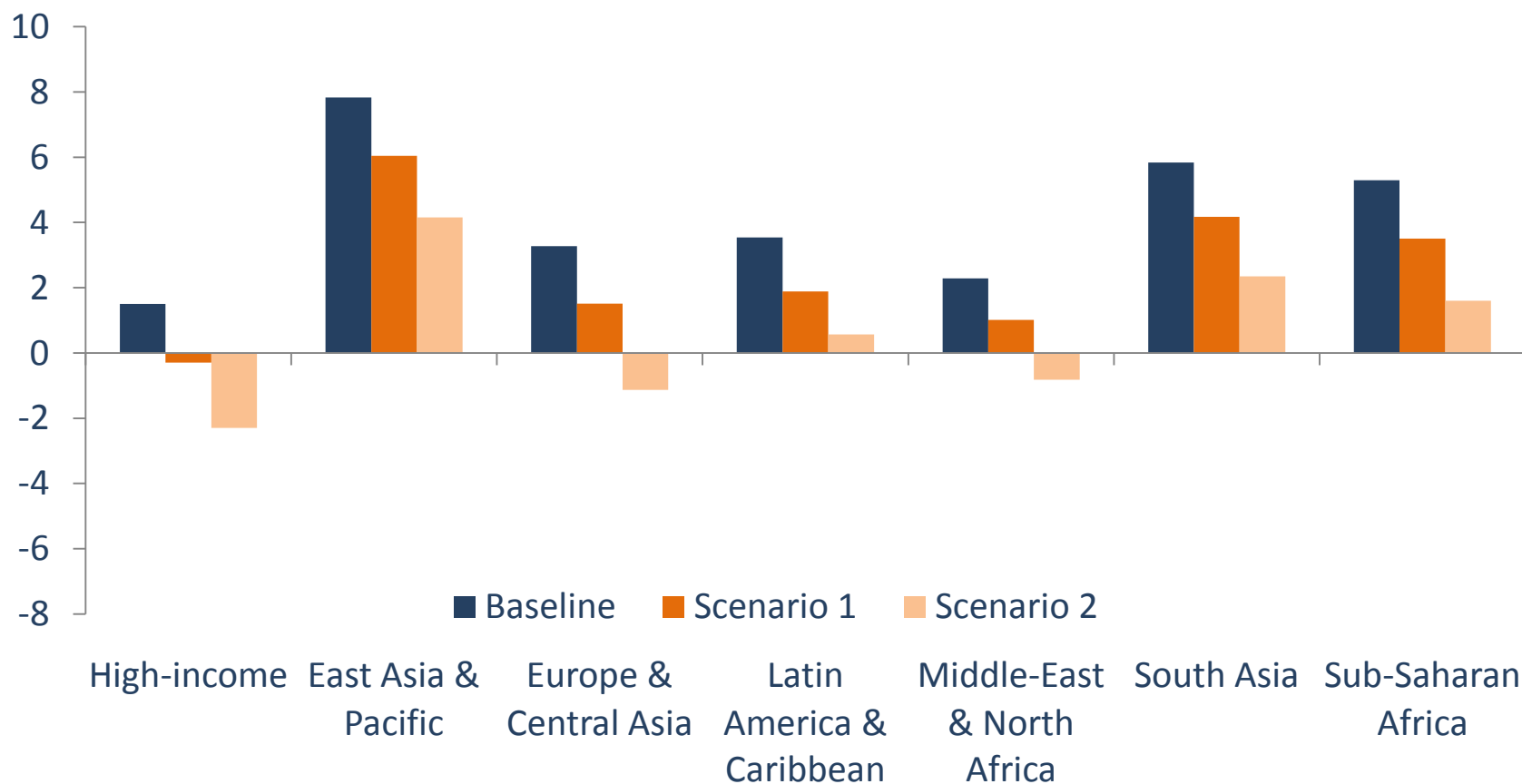
# Combination of weak middle-income growth and fiscal crisis in Europe pose downside risks

Projected and Simulated GDP growth



# A deterioration in conditions could have serious consequences for developing countries

GDP growth, 2012 various scenarios



**Notes:** Baseline assumes muddling through; scenario 1 assumes an additional freezing out from capital markets of two small Euro Area economies equal to around 3-4 percent of Euro Area GDP; Scenario 2 assumes crisis spreads to 1-2 larger European countries whose total weight equals around 30 percent of Euro Area GDP.

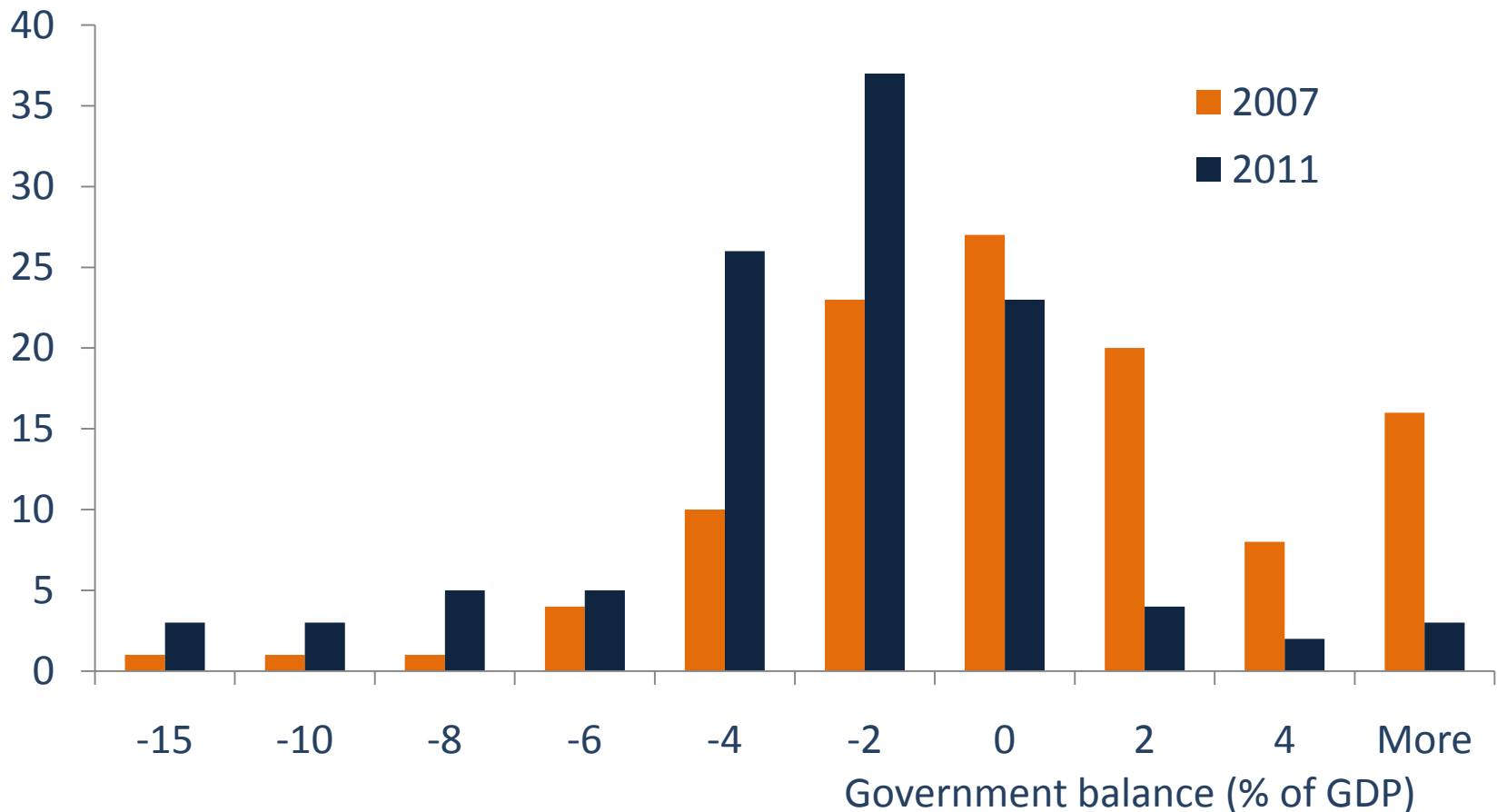
Source: World Bank, Global Economic Prospects, 2012A.

# Developing countries are more vulnerable to a renewed crisis than in 2008

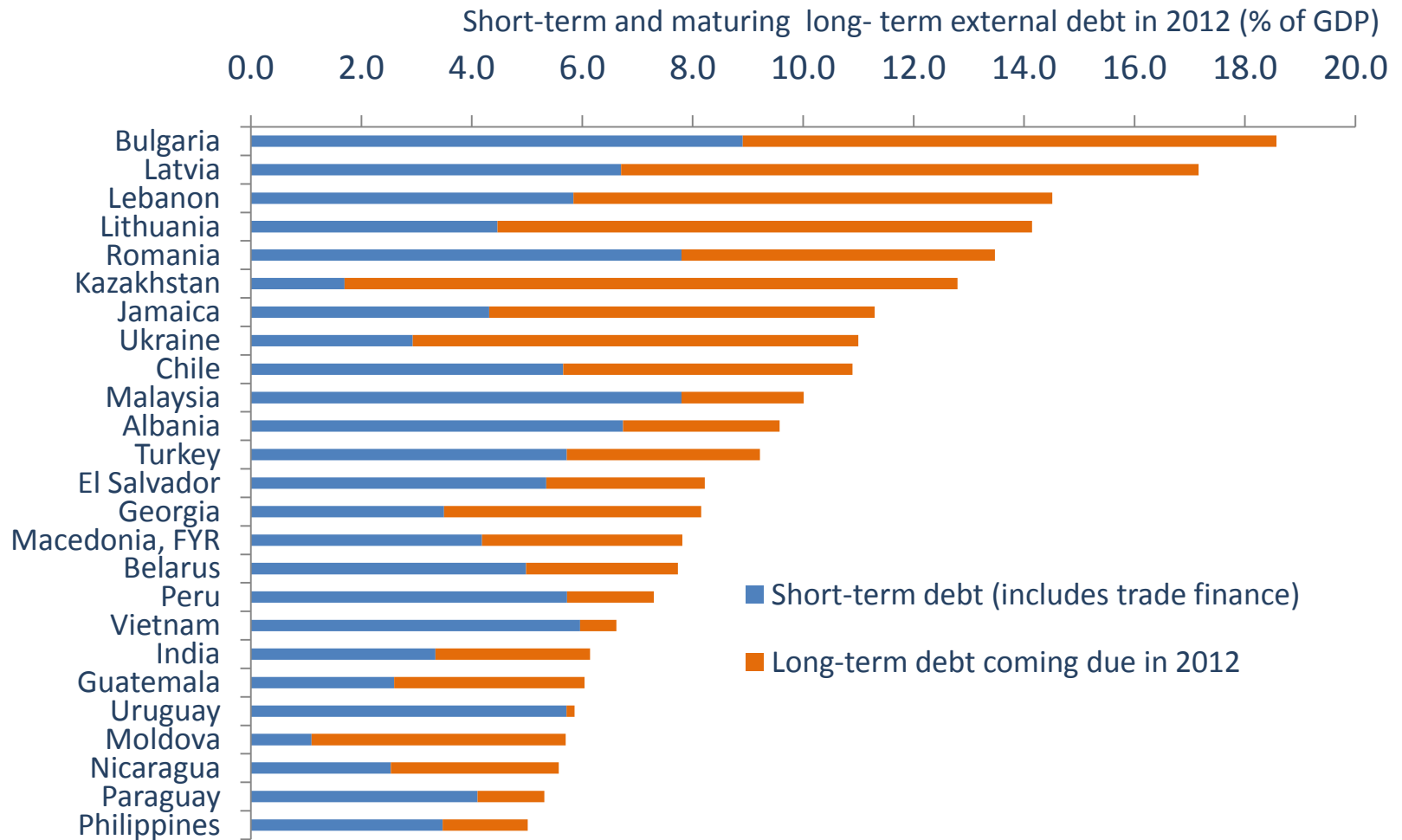
- Policy response constrained by reduced fiscal space
- Countries with large amounts of ST and maturing LT debt should seek to refinance early to limit effects of a potential freezing of capital markets.
- Countries should stress-test their banking systems, especially if credit has grown rapidly in recent years or they are heavily reliant on wholesale financing.
- Commodity exporters could be hurt by collapse in commodity prices
- Remittance dependent countries may also be vulnerable

# 38% of developing countries had a government deficit greater than 4% of GDP in 2011 (18% in 2007)

Percent of developing countries

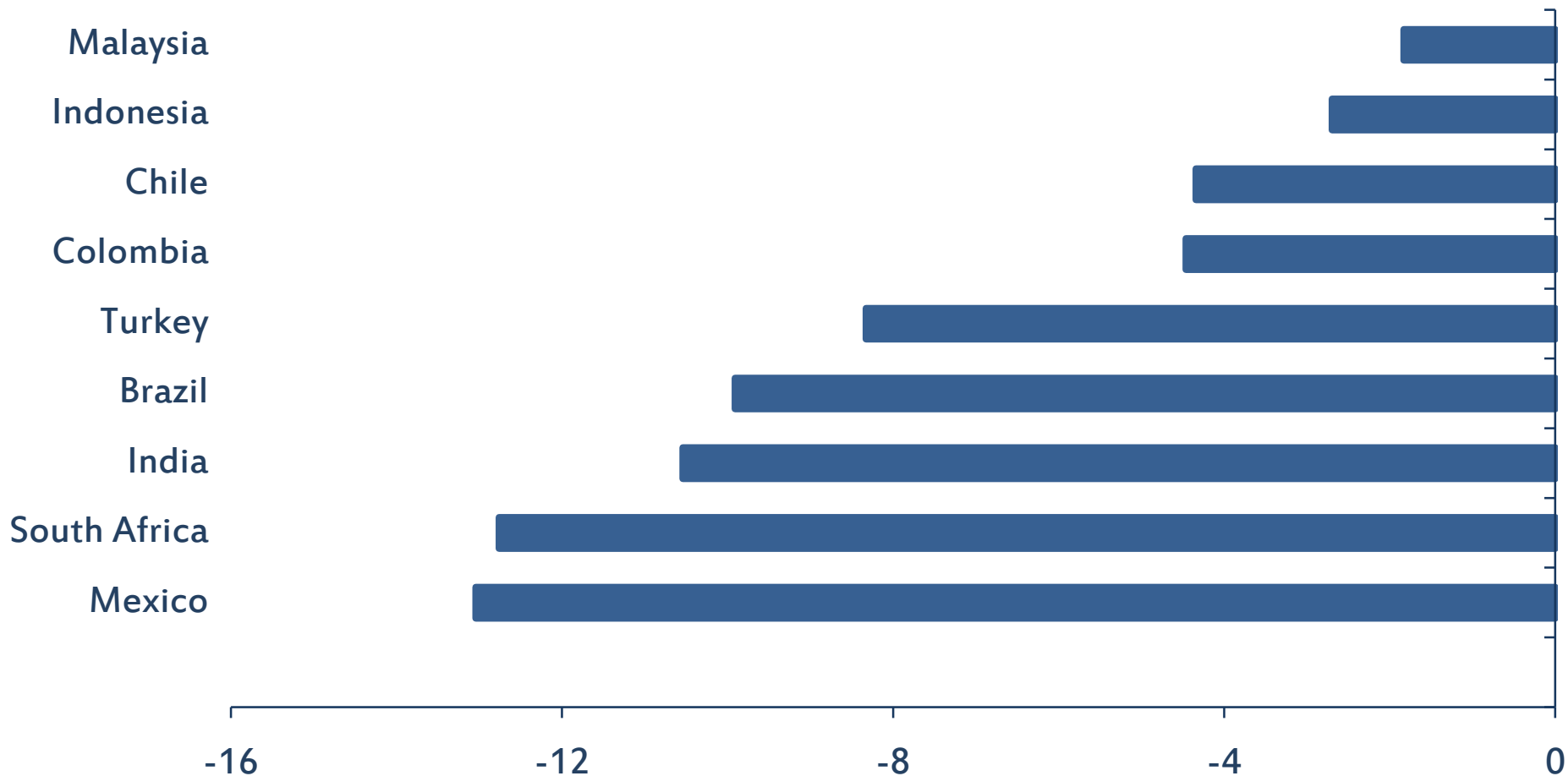


# High levels of external short- or maturing long-term debt place countries at risk



# Capital outflows caused currency depreciations in many countries

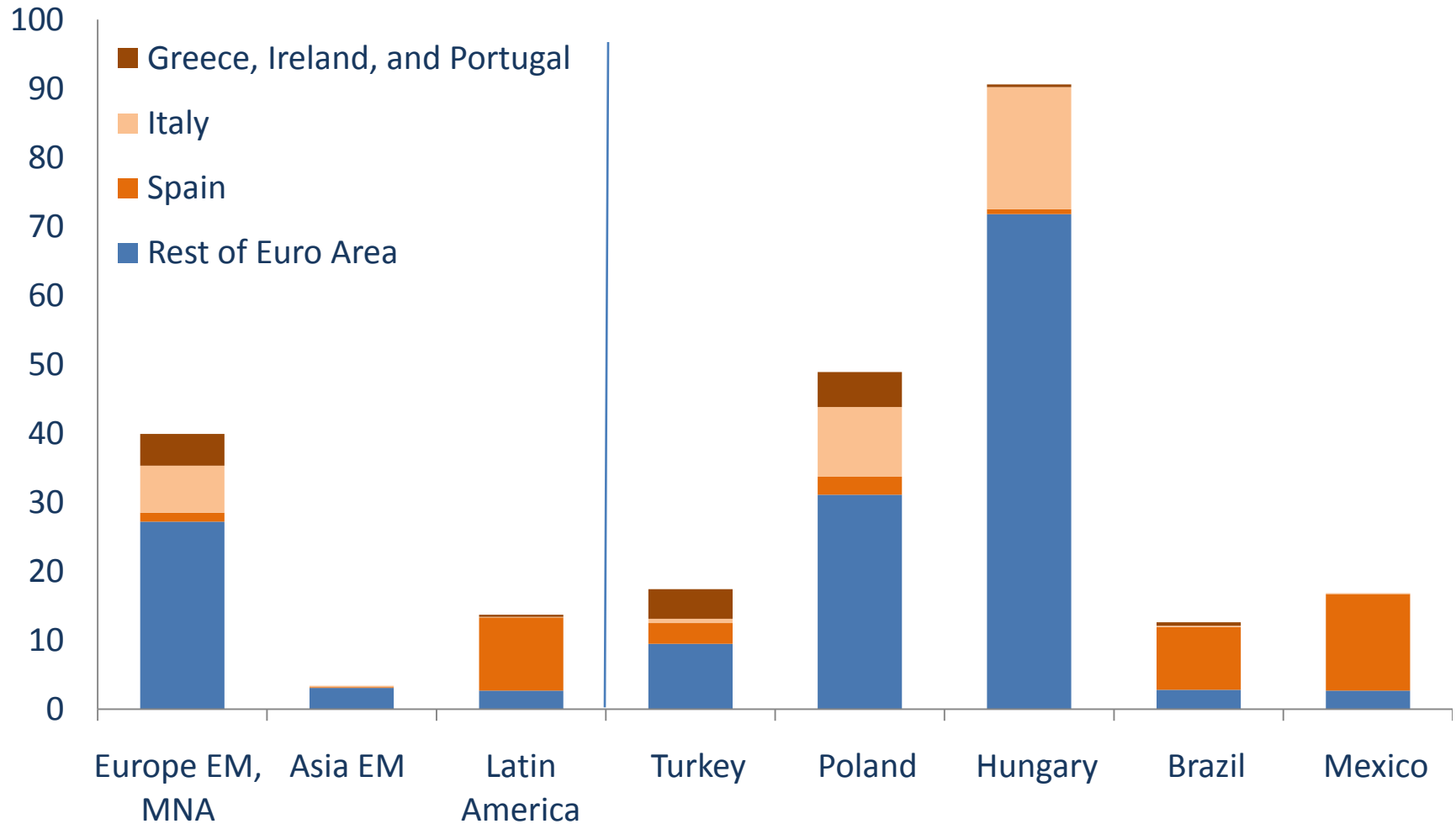
Percent change in nominal effective exchange rate (Jul- Dec 2011)



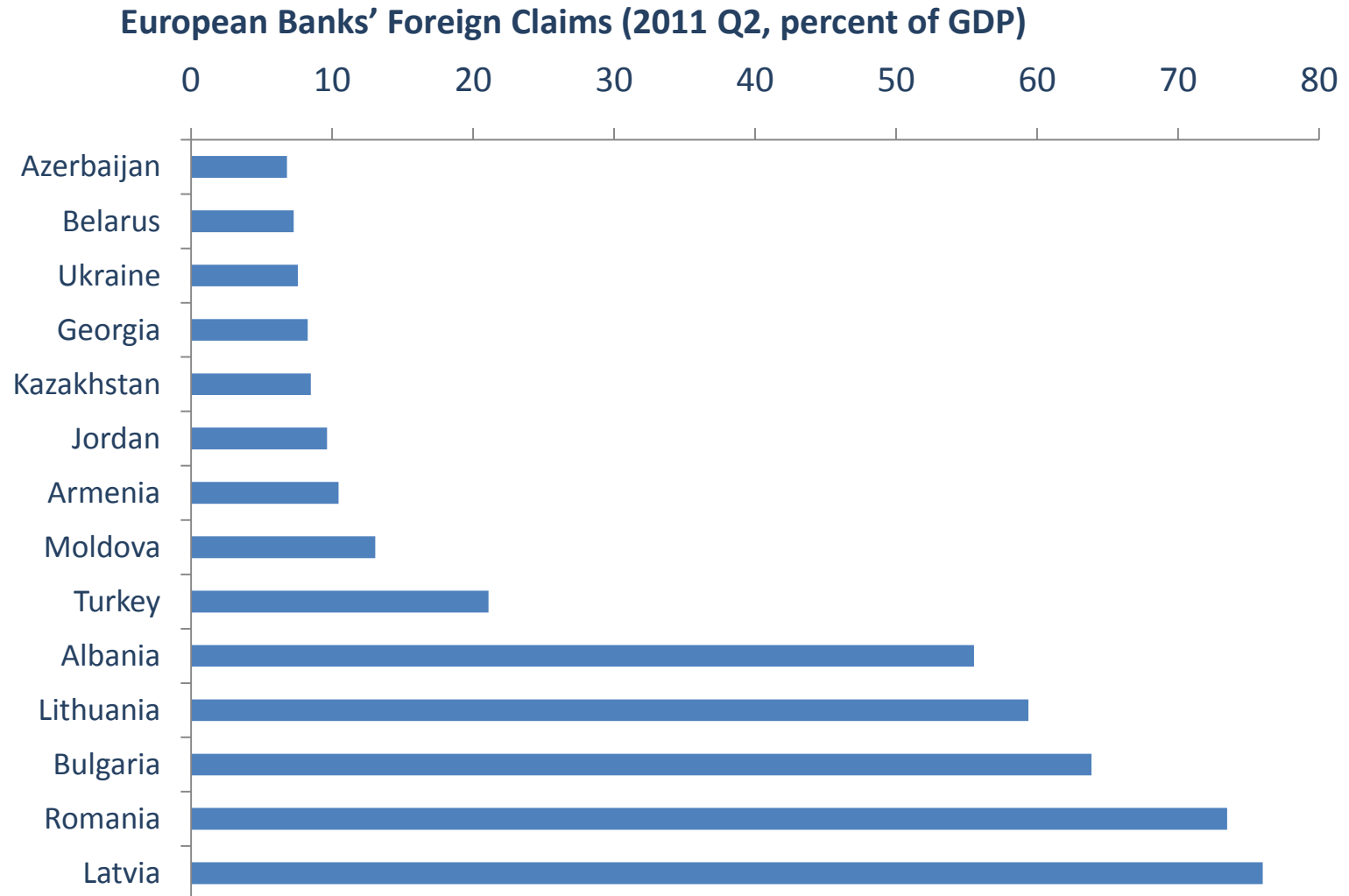
Source: World Bank, Global Economic Prospects, 2012A.

# Deleveraging effects could be strongest among countries with close ties to Euro area banks

Foreign assets in regional/ country banking system, % of GDP

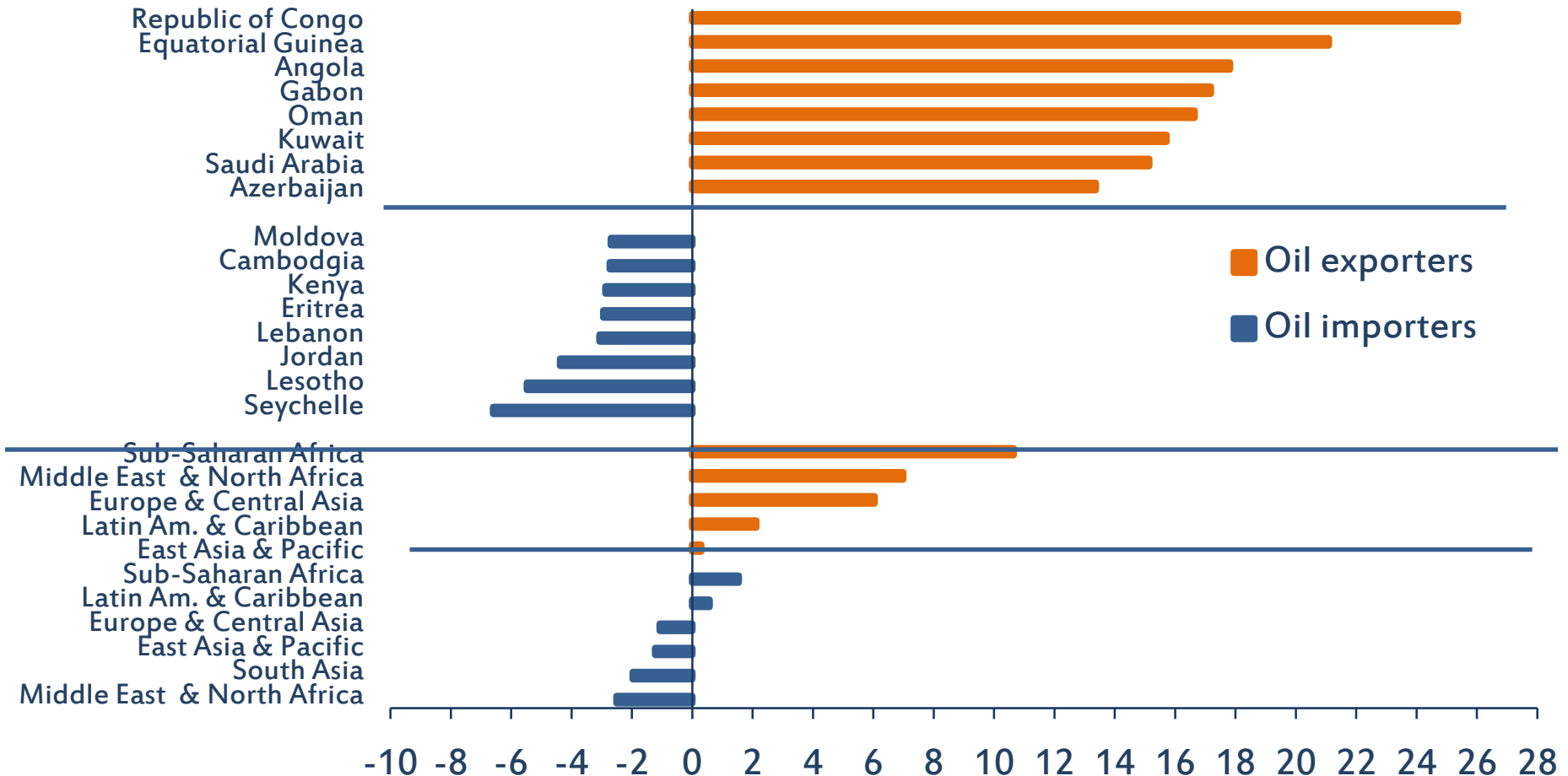


# Strong banking linkages to high-income European countries



# Falling commodity prices can have large income effects

2011 over 2010, period avg. price changes, %-share of GDP



Source: World Bank, Global Economic Prospects, 2012A.

# A drop in commodity prices could yield binding cuts in government revenues

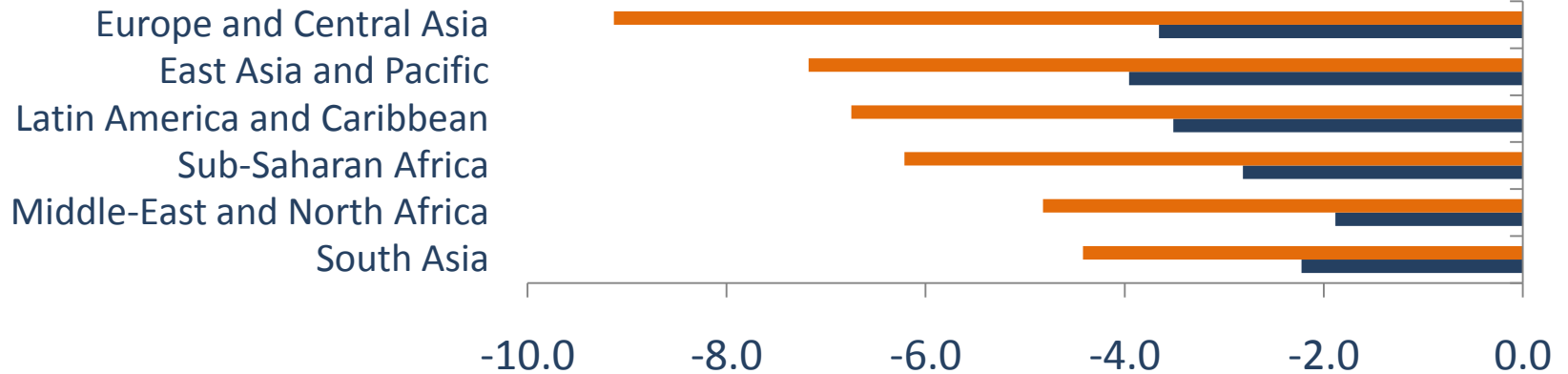
Fiscal impact of a drop in commodity prices similar to that observed in 2008/09.

Change in fiscal balance (% of GDP)

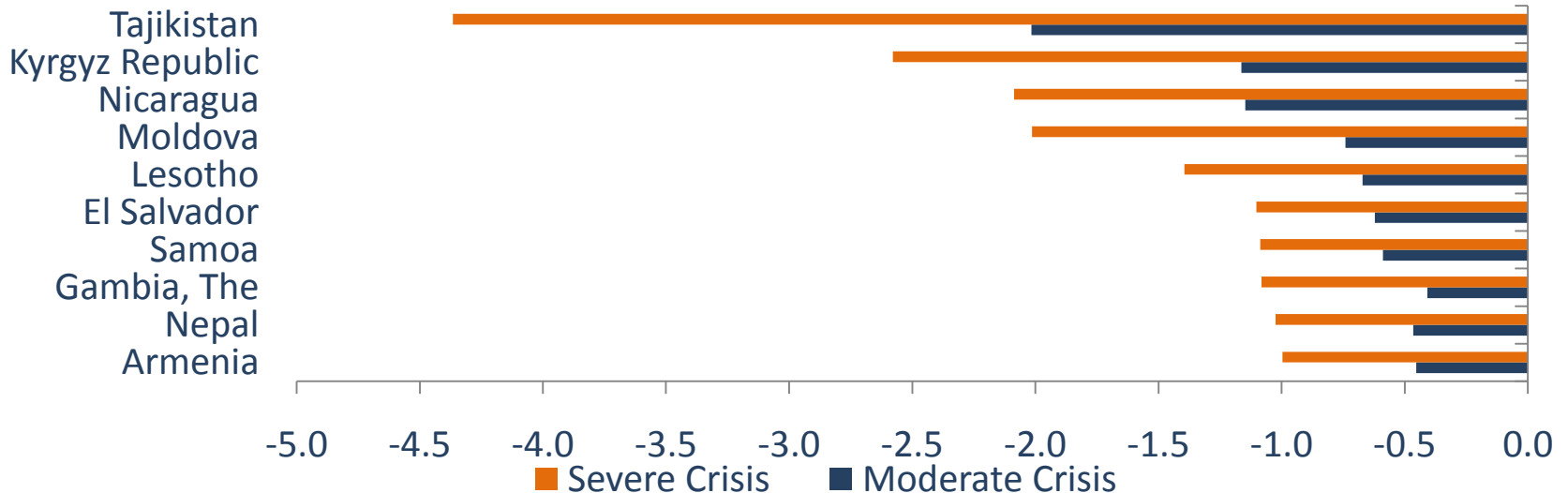
<b>World</b>	<b>-0.1</b>
High income countries	0.4
Developing countries	-1.0
Oil exporting	-4.3
Oil importing	0.4
East Asia and Pacific	0.7
Europe and Central Asia	-2.9
Latin America and Caribbean	-2.4
Middle East and North Africa	-4.8
South Asia	0.3
Sub-Saharan Africa	-4.0

# Remittances could fall by more than 6 percent in a severe crisis scenario

Percent change in remittances (from baseline)



Change in remittances (from baseline), % of GDP



Source: World Bank, Global Economic Prospects, 2012A.

## Developing countries should prepare for the possibility of a serious downturn

- Engage in contingency planning and prioritize spending programs in case financing freezes up
- Stress-test domestic banking sector
- Avoid trade disputes and allow commodity prices to decline with weaker activity
- Longer-term need to identify new drivers for growth

# Concluding remarks

- The global recovery is at a difficult juncture with significant downside risks.
- Slow growth in large middle-income countries and financial turmoil in Europe are generating headwinds.
- A sharp deterioration in conditions could imply a cycle as large as the 2008/09 crisis – potentially longer lasting because of reduced policy space.
- Developing countries activity will be vulnerable to varying degrees to:
  - A further decline in international capital flows;
  - Reduced exports; falling commodity prices or remittance levels;
  - A reduction in international aid



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<http://globaloutlook.worldbank.org> (GEP interactive web-site)  
<http://prospects.worldbank.org> (high-frequency data)  
<http://blogs.worldbank.org/prospects/> (daily commentary)

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