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Global Development Finance projects slow growth for 1999

Global Development Finance 1999 ***forecasts that global economic growth will slow further to 1.8 percent in 1999. Developing country growth is expected to fall to 1.5 percent—the lowest rate since 1982.***

The World Bank's *Global Development Finance 1999* finds that the growth prospects of developing countries have worsened over the past six months. World trade growth has slowed. Capital flows are unlikely to recover to precrisis levels in the near term. And commodity prices are weak. The outlook is somber despite recent positive developments such as looser monetary policies in the United States and Europe, major fiscal stimulus and financial restructuring plans in Japan, and signs of stabilization in East Asian and Latin American crisis countries.

GDP growth in low- and middle-income countries is now expected to decelerate to 1.5 percent in 1999—1.2 percentage points less than was projected by World Bank staff in October 1998 (table 1). Per capita income will stagnate for the second year in a row for developing countries as a whole—and will fall in Brazil, Russia, and 40 other countries. In 2000 growth will pick up to 3–4 percent. But it will remain below the nearly 5 percent performance in the years preceding the crisis.

Lower private capital flows

The financial crises in emerging markets since 1997 have reduced most countries' access to international capital flows. Russia's default on debt in August 1998 led investors to desert emerging market and other high-risk instruments in favor of safer and more liquid assets. Brazil's currency crisis in January 1999 injected fresh uncertainty into the emerging market outlook. Still, the spillover effects from Brazil have largely been limited to Latin America and the Caribbean. Interest rate spreads in East Asia—as well as in fast-reforming transition economies like Hungary and Poland—declined in early 1999.

The growth prospects of developing countries have worsened over the past six months

Excluding foreign direct investment, net long-term flows (bond issues, bank loans, and portfolio equity) to developing countries dropped from $136 billion in 1997 to $72 billion in 1998—the lowest level since 1992. The fall was mainly felt in East Asia (down $24 billion, excluding the Republic of Korea) and Latin America (down $38 billion). Foreign direct investment was more resilient, declining to just $155 billion in 1998 from its peak of $163 billion in 1997.

Private capital flows to developing countries in 1999 are expected to increase somewhat but remain well below precrisis levels. Latin America and the Caribbean and Europe and Central Asia will experience the largest external adjustments, accompanied by falling GDP. In the medium term private flows to developing countries are expected to recover because the fundamentals favoring such flows—policy reforms, improvements in transport and communications technology, differences in factor endowments—remain largely in place. But the pace of recovery during the next year or two is likely to be modest because of slow growth in global output

TABLE 1 REAL GDP GROWTH AND THE GLOBAL ECONOMIC ENVIRONMENT
(percentage change from previous year, except LIBOR)

Indicator	Estimate 1998	Current forecasts 1999	2000	2001	Global Economic Prospects 1998/99 forecasts 1999	2000	2001
World GDP growth	1.9	1.8	2.4	2.8	1.9	2.7	3.0
High-income countries	1.9	1.8	2.1	2.3	1.6	2.3	2.5
Low- and middle-income countries	1.9	1.5	3.7	4.6	2.7	4.3	4.8
Sub-Saharan Africa	2.1	2.5	4.0	4.0	3.2	3.8	3.9
East Asia and Pacific[a]	1.8	4.0	5.5	6.3	4.8	5.9	6.3
East Asia crisis countries[b]	–7.7	0.3	3.5	4.5	0.1	3.2	4.5
South Asia	5.2	4.4	4.8	5.2	4.9	5.6	5.7
Europe and Central Asia	–0.3	–1.5	2.3	3.6	0.1	3.4	4.3
Latin America and Caribbean	2.0	–0.8	2.5	3.9	0.6	3.3	4.1
Middle East and North Africa	1.5	0.7	2.5	3.3	2.8	3.1	3.5
World trade volume	4.8	4.2	5.9	6.2	5.7	6.2	6.3
Inflation in G–7 countries[c] (consumer prices)	1.3	1.4	1.8	2.0	1.9	2.3	2.6
Commodity prices except oil (nominal U.S. dollars)	–15.7	–6.3	1.7	5.1	–2.2	3.5	3.2
Oil prices (weighted average, nominal U.S. dollars)	–31.8	–8.2	25.0	6.7	9.5	10.0	2.9
Manufactures export unit value[d] (nominal U.S. dollars)	–3.7	1.3	2.6	2.7	1.3	2.6	2.7
Six-month LIBOR (U.S. dollars, percent a year)	5.6	5.0	4.9	5.1	5.0	6.0	6.0

Note: LIBOR stands for London interbank offered rate.
a. Excludes Republic of Korea.
b. Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand.
c. Canada, France, Germany, Italy, Japan, United Kingdom, United States. In local currency, aggregated using 1988–90 GDP weights.
d. Unit value index of manufactures exports from G–5 (France, Germany, Japan, United Kingdom, United States) to developing countries, expressed in U.S. dollars.

and trade, credit downgrades of sovereign and corporate borrowers, and concerns in developing countries about the potential risks attached to private flows.

Worsening terms of trade

Dollar export prices for developing countries fell 11 percent in 1998, with both primary commodities and manufactures suffering. Commodities suffered the most: the aggregate index for nonenergy commodities dropped 16 percent, the second largest annual drop in 40 years. This index is expected to fall another 6 percent in 1999. Oil prices fell by almost one-third in 1998 but have recovered recently. In real terms (deflated by the manufactures export unit value index) the prices of most commodities in 1999 will be near their lowest point since 1960.

What explains the weak demand? For the most part, Japan and other crisis countries, and the recent slowing of growth in some European countries. And in recent years primary commodity production has accelerated because of better technology and economic policies. Many developing countries have privatized state-owned oil and mineral production companies. World aluminum production increased more than 10 percent in 1995–97, but consumption grew only 6 percent during this period. Similar oversupply affected other commodities. Supply increases are also being stimulated by large devaluations in many commodity-producing countries.

Prices of manufactured exports from developing countries have also declined. Looking at the price of U.S.-manufactured imports from developing countries, the year-on-year rate of decrease jumped from 3.6 percent in January 1998 to 6.1 percent in October 1998. This is steeper than the 3–4 percent decline in industrial countries' manufactured export prices in 1998 (which owed something to the strength of the dollar). Cyclical declines hit commodity electronics prices, and many Asian manufacturers cut export prices after devaluing to increase market share. The price of manufactured exports from Asian newly industrialized economies to the United States fell 9.5 percent in October 1998, compared with a 3.3 percent decline for goods originating in Latin America. The Brazilian devaluation in 1999 will put more pressure on Latin American export prices.

The terms of trade of developing countries are expected to decline another 1 percent in 1999, after declining 5–6 percent in 1998. In 1998 developing countries suffered an income loss (measured as the loss in import purchasing power of a given amount of exports) of about 1 percent of GDP, the second largest drop in 30 years. The worst hit were heavily oil- and commodity-dependent regions such as the Middle East and North Africa and Sub-Saharan Africa. South Asia and Central and Eastern Europe, which import oil and exports manufactures, were the only regions to experience a gain in terms of trade.

Slowing world trade

World trade fell 1 percent in current dollars in 1998, the first decline since 1993. Developing country exports (in dollars) fell 7–8 percent, squeezed by weakening volume growth and falling prices. These countries will experience only minor growth in 1999, followed by more substantial increases in 2000. During 1998–2000 developing countries' dollar exports are expected to grow by just 2–3 percent a year—far below the 9 percent average of 1991–97 (figure 1).

Developing countries pay a spread above the London interbank offered rate (LIBOR) on their borrowings. Their export growth is expected to be far below LIBOR, which is projected at 5 percent a year in 1998–2000 (see figure 1). This divergence will tend to increase the external debt burden of developing countries, reversing the trend so far in the 1990s. (Developing countries' ratio of external debt to exports fell from 167 percent in 1993 to 129 percent in 1997.)

Global trade volume in goods grew only 4–5 percent in 1998, the slowest advance since 1992 and barely half the performance in 1997. Imports continued to expand rapidly in the United States and Europe but shrank in Japan and crisis countries. The credit crunch in the wake of the Russian crisis forced extensive balance of payments adjustments in developing countries. Their growth in overall imports slid from around 9 percent in 1997 to just 1.4 percent in 1998, while growth in exports decelerated from 10 percent to 4 percent.

The outlook for 1999 remains clouded. World trade growth is likely to remain at a sluggish 4 percent. Slowing economic activity in the United States and Europe will decelerate their import growth rates to around 6 percent. Import volumes are likely to fall in Latin America, Russia, and other formerly Soviet countries as they adjust to lower capital flows and weaker terms of trade. Low commodity exports will continue to restrain the ability of many countries to increase imports. Only East Asia is expected to see any notable improvement in trade volume growth, as it takes advantage of the bottoming out of the Japanese economy. Rising exports will also enable East Asia to import more.

Outlook for developing regions

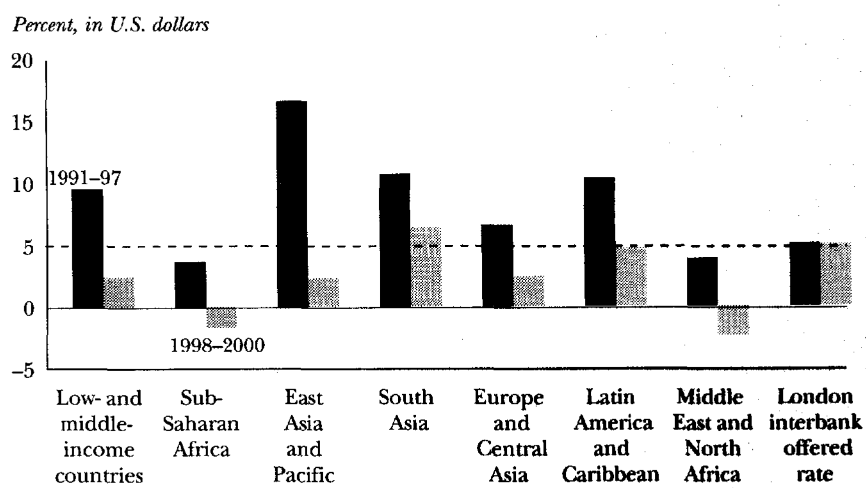
Global Development Finance 1999 reckons that the three adverse shocks hitting developing countries in 1998—lower private capital flows, worsening terms of trade, and slowing world trade—may have reduced aggregate demand by 3–4 percent, lowering their GDP growth to 1.9 percent. Growth is expected to decelerate further to 1.5 percent in 1999 as domestic adjustments to these shocks continues. Even so, significant differences in performance are expected between regions and countries.

Significant differences in performance are expected between regions and countries

In East Asia strenuous adjustment efforts are yielding fruit, although political uncertainties cloud the outlook for Indonesia. China's growth is expected to slow in 1999, yet should be fast enough to bring East Asia's overall growth in 1999 to 4 percent—among the highest of all developing regions.

Growth in Latin America and the Caribbean will likely turn negative in 1999. The baseline scenario projects Brazil launching a credible fiscal adjustment program, targeting interest rates to control inflation, and remaining broadly compliant with the IMF's stabilization program. Inflation could be 10–20 percent, and GDP could fall 3–4 percent. These developments would have spillover effects on neighbors in Mercosur

FIGURE 1 GROWTH IN EXPORT REVENUES IN DEVELOPING REGIONS AND INTERNATIONAL INTEREST RATES, 1991–2000



(Argentina, Chile, Uruguay), a large portion of whose exports go to Brazil. Brazil's crisis has also affected the entire region's access to global capital. Mildly higher world growth and commodity prices should support a modest recovery in 2000.

Economic prospects in Europe and Central Asia differ greatly between strong and weak reformers. Russia has been contracting sharply since August 1998, and members of the Commonwealth of Independent States with strong economic ties to Russia are being hit by sharp declines in export demand and worker remittances. Output in the Commonwealth of Independent States should stabilize in 2000—but much depends on positive policy developments and a recovery in oil prices. Strong reformers, such as Hungary and Poland, fared well in 1998. They will slow modestly in 1999 because of decelerating import demand from Western Europe.

There are significant risks to even this somber outlook

After several years of stronger growth, Sub-Saharan Africa experienced a setback in 1998 as a result of sharp declines in commodity prices, adverse weather patterns, and renewed civil strife in some countries. Nevertheless, many reforming countries achieved positive growth in 1998. Sound policies should help the region achieve a mild improvement in growth in 1999 and a more significant improvement in 2000. Growth in 1999 should also be helped by more normal weather patterns. South Africa is likely to benefit from the stabilization of its currency at more competitive levels. In addition, long-term prospects in Nigeria have improved with the move toward democracy.

Growth in the Middle East and North Africa is expected to fall to near zero in 1999, mainly because of low oil prices. Growth among the more diversified economies of Egypt, Jordan, Morocco, Syria, and Tunisia is expected to hold up better, though they will be affected by slower growth in European markets and increased competition from Eastern European and Asian producers. Regional growth is forecast to recover to 2–3 percent in 2000, contingent on some revival in oil prices.

South Asia has weathered the international financial crisis better than other regions. Regional growth in 1999–2000 is forecast at 4–5 percent—impressive, but too slow to make much of a dent on widespread poverty. Growth in India will be hampered by high public deficits, restrictive trade policies, and chronic infrastructure bottlenecks. Pakistan suffered a severe balance of payments crisis in 1998, recovery from which is likely to be protracted.

Risks to the forecast

Global Development Finance 1999 notes significant downside risks to even this somber outlook. Weaknesses in policy implementation and in consumer and business confidence could lead to further contraction in the Japanese economy. Growth in the United States and Europe could be adversely affected by serious corrections in highly priced stock markets. A protracted withdrawal of external financing from Latin America and other developing regions could force even sharper balance of payments and output adjustments, with worsening social and political conditions and tensions. Finally, protectionist sentiment in the United States and Europe could revive should economic activity contract.

This note was prepared by Swaminathan S. Aiyar (Consultant, Development Data Group) and Milan Brahmbhatt (Principal Economist, Economic Policy, PREM Network) drawing on chapter 1 of Global Development Finance 1999 *(Development Prospects Group, 30 March 1999).*

Questions on the prospects discussion should be addressed to Bertram Wolfe, x85663. If you are interested in similar topics, consider joining the Globalization Thematic Group or Growth, Investment, and Savings Thematic Group. Contact Milan Brahmbhatt, x33960, or click on Thematic Groups on PREMnet.

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