



CHAPTER 1

GLOBAL OUTLOOK

The Turning of the Tide?

Global growth has eased, but remains robust, and is projected to reach 3.1 percent in 2018. It is expected to edge down in the next two years to 2.9 percent by 2020, as global slack dissipates, trade and investment moderate, and financing conditions tighten. Growth in advanced economies is predicted to decelerate toward potential rates, as monetary policy normalizes and the effects of U.S. fiscal stimulus wane. In emerging market and developing economies (EMDEs), growth in commodity importers will remain robust, while the rebound in commodity exporters is projected to mature over the next two years. Progress in per capita income growth will be uneven, however, remaining particularly subdued in Sub-Saharan Africa. Risks to the outlook remain tilted to the downside. They include disorderly financial market movements, escalating trade protectionism, heightened policy uncertainty, and rising geopolitical tensions, all of which continue to cloud the outlook. EMDE policymakers need to rebuild monetary and fiscal policy buffers and be prepared for rising global interest rates and possible episodes of financial market turbulence. In the longer run, EMDEs need to tackle ongoing structural challenges and boost potential growth by promoting competitiveness, adaptability to technological change, and trade openness.

Summary

Global growth remains robust but has softened in recent months, as manufacturing activity and trade have shown signs of moderation (Figure 1.1). The ongoing withdrawal of monetary policy accommodation in advanced economies has led to some tightening of global financing conditions, while oil prices are substantially higher than previously expected. Global inflation is trending up, but only gradually and from low levels.

In advanced economies, activity continues to grow above potential, notwithstanding some recent moderation, while additional fiscal stimulus measures are expected to provide a further lift to near-term growth in the United States. Labor markets have improved steadily. With output gaps nearly or already closed, inflation expectations have crept up and monetary policy is becoming less expansionary. Inflation, however, remains below central bank targets in many advanced economies.

Among emerging market and developing economies (EMDEs), the recovery in commodity exporters has continued, as consumption and investment firm. The upturn in many energy

exporters is still lagging that of exporters of other commodities, reflecting ongoing adjustments to the 2014-16 collapse in oil prices and production cuts in key oil exporters. Across commodity exporters, inflation is generally moderating as the impact of past currency depreciations wanes.

Activity in commodity importers continues to be robust. Growth in China is gradually slowing, but remains resilient, while constraints to growth are dissipating in other large commodity importers—notably India and Mexico, where investment is recovering. Inflation remains broadly stable so far, despite higher commodity prices and limited remaining slack.

Notwithstanding the ongoing global expansion, only 45 percent of countries are expected to experience a further acceleration of growth this year, down from 56 percent in 2017. Moreover, global activity is still lagging previous expansions despite a decade-long recovery from the global financial crisis. Accordingly, after reaching 3.1 percent in 2018, global growth is projected to moderate in 2019-20, edging down to 2.9 percent by the end of the forecast period. Global growth projections are above estimates of potential, suggesting that capacity constraints will become more binding and inflation will continue to rise during the forecast horizon.

Growth in advanced economies is expected to decelerate toward potential rates over the forecast period, as monetary policy stimulus is pared down, higher energy prices weigh on consumption, and the effect of U.S. fiscal expansion

Note: This chapter was prepared by Carlos Arteta and Marc Stocker, with contributions from Patrick Kirby, Ekaterine Vashakmadze, and Collette M. Wheeler. Additional inputs were provided by John Baffes, Alain Kabundi, Gerard Kambou, Eung Ju Kim, Csilla Lakatos, Peter Nagle, and Dana Vorisek. Research assistance was provided by Anh Mai Bui, Ishita Dugar, Xinghao Gong, Brent Harrison, Julia Roseman, and Jinxin Wu.

TABLE 1.1 Real GDP¹

(Percent change from previous year)

Percentage point differences
from January 2018 projections

| | 2015 | 2016 | 2017e | 2018f | 2019f | 2020f | 2018f | 2019f | 2020f |
|---|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| World | 2.8 | 2.4 | 3.1 | 3.1 | 3.0 | 2.9 | 0.0 | 0.0 | 0.0 |
| Advanced economies | 2.3 | 1.7 | 2.3 | 2.2 | 2.0 | 1.7 | 0.0 | 0.1 | 0.0 |
| United States | 2.9 | 1.5 | 2.3 | 2.7 | 2.5 | 2.0 | 0.2 | 0.3 | 0.0 |
| Euro Area | 2.1 | 1.8 | 2.4 | 2.1 | 1.7 | 1.5 | 0.0 | 0.0 | 0.0 |
| Japan | 1.4 | 1.0 | 1.7 | 1.0 | 0.8 | 0.5 | -0.3 | 0.0 | 0.0 |
| Emerging market and developing economies (EMDEs) | 3.7 | 3.7 | 4.3 | 4.5 | 4.7 | 4.7 | 0.0 | 0.0 | 0.0 |
| Commodity-exporting EMDEs | 0.5 | 0.8 | 1.8 | 2.5 | 3.0 | 3.0 | -0.2 | -0.1 | -0.1 |
| Other EMDEs | 6.1 | 5.9 | 6.2 | 5.8 | 5.8 | 5.7 | 0.1 | 0.1 | 0.0 |
| Other EMDEs excluding China | 5.2 | 4.9 | 5.3 | 5.1 | 5.1 | 5.1 | 0.3 | 0.0 | 0.0 |
| East Asia and Pacific | 6.5 | 6.3 | 6.6 | 6.3 | 6.1 | 6.0 | 0.1 | 0.0 | 0.0 |
| China | 6.9 | 6.7 | 6.9 | 6.5 | 6.3 | 6.2 | 0.1 | 0.0 | 0.0 |
| Indonesia | 4.9 | 5.0 | 5.1 | 5.2 | 5.3 | 5.4 | -0.1 | 0.0 | 0.1 |
| Thailand | 3.0 | 3.3 | 3.9 | 4.1 | 3.8 | 3.8 | 0.5 | 0.3 | 0.4 |
| Europe and Central Asia | 1.1 | 1.7 | 4.0 | 3.2 | 3.1 | 3.0 | 0.3 | 0.1 | 0.0 |
| Russia | -2.5 | -0.2 | 1.5 | 1.5 | 1.8 | 1.8 | -0.2 | 0.0 | 0.0 |
| Turkey | 6.1 | 3.2 | 7.4 | 4.5 | 4.0 | 4.0 | 1.0 | 0.0 | 0.0 |
| Poland | 3.8 | 2.9 | 4.6 | 4.2 | 3.7 | 3.5 | 0.2 | 0.2 | 0.4 |
| Latin America and the Caribbean | -0.4 | -1.5 | 0.8 | 1.7 | 2.3 | 2.5 | -0.3 | -0.3 | -0.2 |
| Brazil | -3.5 | -3.5 | 1.0 | 2.4 | 2.5 | 2.4 | 0.4 | 0.2 | -0.1 |
| Mexico | 3.3 | 2.9 | 2.0 | 2.3 | 2.5 | 2.7 | 0.2 | -0.1 | 0.1 |
| Argentina | 2.7 | -1.8 | 2.9 | 1.7 | 1.8 | 2.8 | -1.3 | -1.2 | -0.4 |
| Middle East and North Africa | 2.8 | 5.0 | 1.6 | 3.0 | 3.3 | 3.2 | 0.0 | 0.1 | 0.0 |
| Saudi Arabia | 4.1 | 1.7 | -0.7 | 1.8 | 2.1 | 2.3 | 0.6 | 0.0 | 0.1 |
| Iran | -1.3 | 13.4 | 4.3 | 4.1 | 4.1 | 4.2 | 0.1 | -0.2 | -0.1 |
| Egypt ² | 4.4 | 4.3 | 4.2 | 5.0 | 5.5 | 5.8 | 0.5 | 0.2 | 0.0 |
| South Asia | 7.1 | 7.5 | 6.6 | 6.9 | 7.1 | 7.2 | 0.0 | -0.1 | 0.0 |
| India ³ | 8.2 | 7.1 | 6.7 | 7.3 | 7.5 | 7.5 | 0.0 | 0.0 | 0.0 |
| Pakistan ² | 4.1 | 4.6 | 5.4 | 5.8 | 5.0 | 5.4 | 0.3 | -0.8 | -0.6 |
| Bangladesh ² | 6.6 | 7.1 | 7.3 | 6.5 | 6.7 | 7.0 | 0.1 | 0.0 | 0.3 |
| Sub-Saharan Africa | 3.1 | 1.5 | 2.6 | 3.1 | 3.5 | 3.7 | -0.1 | 0.0 | 0.1 |
| Nigeria | 2.7 | -1.6 | 0.8 | 2.1 | 2.2 | 2.4 | -0.4 | -0.6 | -0.4 |
| South Africa | 1.3 | 0.6 | 1.3 | 1.4 | 1.8 | 1.9 | 0.3 | 0.1 | 0.2 |
| Angola | 3.0 | 0.0 | 1.2 | 1.7 | 2.2 | 2.4 | 0.1 | 0.7 | 0.9 |
| Memorandum items: | | | | | | | | | |
| Real GDP¹ | | | | | | | | | |
| High-income countries | 2.3 | 1.7 | 2.2 | 2.2 | 2.0 | 1.8 | 0.0 | 0.1 | 0.0 |
| Developing countries | 3.7 | 3.8 | 4.6 | 4.7 | 4.8 | 4.8 | 0.0 | 0.0 | -0.1 |
| Low-income countries | 4.9 | 4.8 | 5.5 | 5.7 | 5.9 | 6.3 | 0.3 | 0.4 | 0.6 |
| BRICS | 4.0 | 4.4 | 5.3 | 5.4 | 5.4 | 5.4 | 0.1 | 0.0 | 0.0 |
| World (2010 PPP weights) | 3.4 | 3.2 | 3.7 | 3.8 | 3.8 | 3.7 | 0.1 | 0.1 | 0.0 |
| World trade volume⁴ | 2.7 | 2.8 | 4.8 | 4.3 | 4.2 | 4.0 | 0.3 | 0.3 | 0.2 |
| Commodity prices | | | | | | | | | |
| Oil price ⁵ | -47.3 | -15.6 | 23.3 | 32.6 | -1.4 | 0.1 | 23.2 | -3.1 | -1.6 |
| Non-energy commodity price index | -15.8 | -2.6 | 5.5 | 5.1 | 0.2 | 0.5 | 4.5 | -0.6 | -0.7 |

Source: World Bank.

Notes: PPP = purchasing power parity; e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. Country classifications and lists of emerging market and developing economies (EMDEs) are presented in Table 1.2. BRICS include: Brazil, Russia, India, China, and South Africa.

1. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights.

2. GDP growth values are on a fiscal year basis. Aggregates that include these countries are calculated using data compiled on a calendar year basis. Pakistan's growth rates are based on GDP at factor cost. The column labeled 2017 refers to FY2016/17.

3. The column labeled 2016 refers to FY2016/17.

4. World trade volume of goods and non-factor services.

5. Simple average of Dubai, Brent, and West Texas Intermediate.

For additional information, please see www.worldbank.org/gep.

wanes. A projected deceleration of capital spending in these economies, combined with that in China, will contribute to more moderate global trade growth in 2019 and 2020. Shifts in the policy mix of advanced economies—most notably, monetary policy tightening and fiscal policy loosening in the United States—are expected to result in a faster-than-previously-anticipated increase in global interest rates, and hence in EMDE borrowing costs.

As international trade and financial conditions become less supportive, and the cyclical upturn in commodity exporters matures, overall EMDE growth is projected to plateau, reaching 4.7 percent in 2019 and 2020. Over this period, only about half of commodity exporters, and less than half of commodity importers, are expected to grow above their pre-crisis long-term averages. In the longer term, absent policy reforms, potential growth in EMDEs is expected to weaken, reflecting softening productivity and demographic headwinds. Progress in per capita income growth will be uneven. Per capita growth in Sub-Saharan Africa, where nearly half of the extreme poor live, is projected to remain below or around 1 percent, while it is expected to reach 6 percent in South Asia, a region that includes the second largest number of people in extreme poverty.

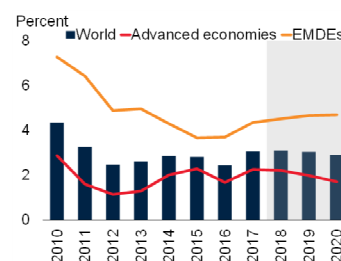
Uncertainty around global growth projections has risen, partly driven by the possibility of policy shocks from major economies (Figure 1.2). While a synchronous upturn in large economies could lead to further growth upgrades in the near term, risks remain tilted to the downside, with some becoming more acute.

In particular, the possibility of financial market disruptions has increased amid shifting monetary policy expectations in major advanced economies. A sudden tightening of global financing conditions, combined with disorderly exchange rate movements, would leave highly indebted EMDEs particularly vulnerable, with rising debt service costs hampering investment and heightening financial stability risks. The risk of mounting trade protectionism has also intensified. A worldwide escalation of tariffs up to the limits permitted under existing international trade rules could lead

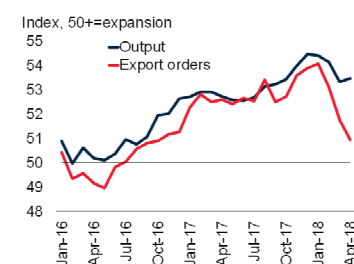
FIGURE 1.1 Summary - Global prospects

The global economic expansion remains robust but has softened, although commodity-exporting EMDEs continue to recover. Global activity still lags previous expansions, and growth is projected to decelerate in 2019-20 as trade and investment moderate. Progress in per capita income will be uneven and insufficient to tackle extreme poverty in Sub-Saharan Africa.

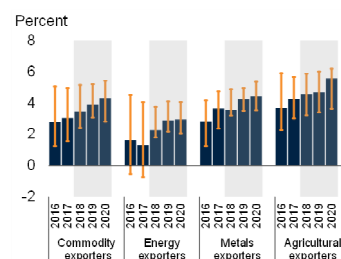
A. Global growth



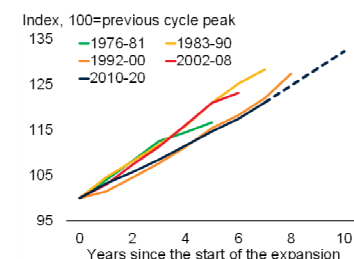
B. Global manufacturing output and export orders



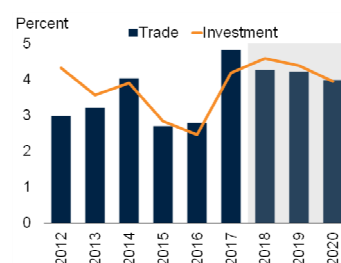
C. Growth in commodity-exporting EMDEs



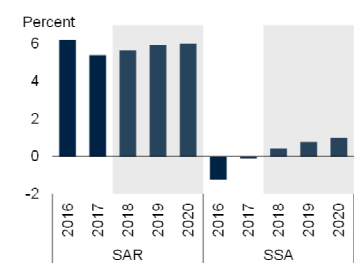
D. Global GDP during expansion periods



E. Global trade and investment growth, volumes



F. Per capita EMDE GDP growth, by region



Sources: Haver Analytics, World Bank.

A.C.E.F. Shaded areas indicate forecasts.

A. EMDEs = emerging market and developing economies. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Data for 2017 are estimates.

B. Figure shows Purchasing Managers' Index (PMI) for manufacturing output and new export orders. Readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is April 2018.

C. Simple average of GDP growth. Orange lines indicate interquartile ranges of growth in each group.

D. Global GDP levels in constant 2010 U.S. dollars, indexed to 100 at start of expansion periods.

Cycle dates based on global recessions and slowdowns identified in Kose and Terrones (2015).

Dashed line corresponds to 2018-20 forecasts.

E. Trade measured as the average of export and import volumes.

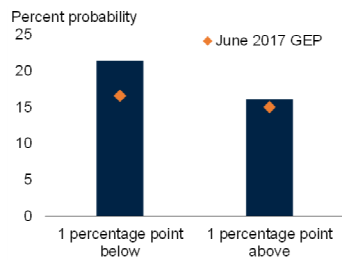
F. SAR = South Asia and SSA = Sub-Saharan Africa. GDP per capita calculated using constant 2010 U.S. dollar GDP weights.

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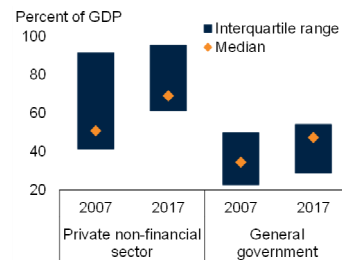
FIGURE 1.2 Global risks and policy challenges

Uncertainty surrounding the outlook remains elevated and risks are tilted to the downside. EMDEs are susceptible to a sudden increase in borrowing costs amid elevated debt levels, and could be severely impacted by escalating trade protectionism. Improving education outcomes could help raise EMDE per capita income levels and growth prospects. Regional trade agreements could rekindle stalled trade liberalization at the global level.

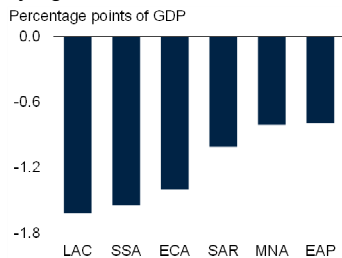
A. Probability of global growth in 2019 being below/above baseline



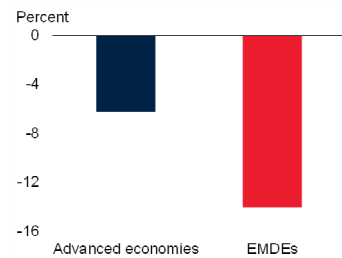
B. EMDE debt as a share of GDP, by borrowing sector



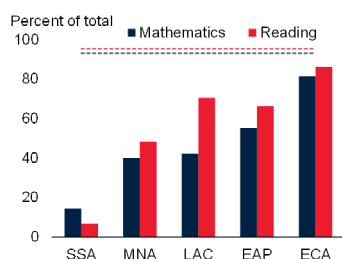
C. Impact of interest-rate shock on fiscal sustainability gaps in EMDEs, by region



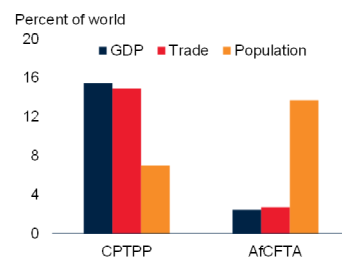
D. Impact on trade from worldwide increase in tariffs to bound levels by 2020



E. Students proficient in math and reading, by region



F. Size of new regional trade agreements



Sources: Bank for International Settlements, International Monetary Fund, Kose et al. (2017b), Kutlina-Dimitrova and Lakatos (2017), World Bank.

A. Bars show the probability that global growth is 1-percentage-point above or below baseline forecasts 18 months ahead. Probabilities for 2019 are computed from the forecast distribution of 18-month-ahead oil price futures, S&P 500 equity price futures, and term spread forecasts. Each of the risk factor's weight is derived from the model described in Ohnsorge, Stocker, and Some (2016). Last observation is May 2018.

B. Debt is defined as loans and debt securities. Sample includes 16 EMDEs.

C.E. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

C. Figure shows the estimated deterioration in the fiscal sustainability gap driven by a 1-standard deviation interest rate increase. Sustainability gap is measured as the difference between the primary balance and the debt-stabilizing primary balance. A negative bar indicates government debt is rising along an accelerated trajectory. Sample includes 70 EMDEs.

D. Bars denote the percent deviation from baseline in 2020. Data are calculated from simulations using the GDyn computable general equilibrium model (Ianchovichina and McDougall 2000; Ianchovichina and Walmsley 2012). Trade-weighted aggregates include 36 advanced economies and 71 EMDEs.

E. Data for South Asia are unavailable. Dashed horizontal lines show advanced-economy average.

F. CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership.

AfCFTA = African Continental Free Trade Area. Data are as of 2017.

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to cumulative trade losses equivalent to those experienced during the global financial crisis in 2008-09, with particularly severe consequences for EMDEs. Other risks include the possibility of increasing policy uncertainty and geopolitical tensions. A further rise in oil prices, while beneficial for oil exporters, could amplify current account fragilities in some oil-importing EMDEs.

The probability of an abrupt slowdown in global growth has risen and could increase further if one or several downside risks materialize. Many countries would be unprepared to confront such an outcome, in view of their depleted policy buffers and the moderating outlook for potential growth. In this context, both advanced economies and EMDEs face acute policy challenges.

The immediate policy challenge for advanced economies is to calibrate their fiscal, monetary, and trade policy stances to nurture the recovery and to avoid disorderly financial adjustments. In the longer term, they need to confront the slow pace of potential growth and demographic pressures through structural reforms that boost productivity, labor force participation, and fiscal sustainability.

In EMDEs, monetary and fiscal buffers need to be rebuilt in order to prepare for monetary policy tightening in advanced economies and restore the scope for policy support against negative shocks. In particular, rising global interest rates will heighten corporate vulnerability and raise EMDE debt-service costs and fiscal sustainability gaps. In the longer run, EMDE policy makers also need to confront intensifying structural challenges and accelerate measures to tackle poverty. The decisive implementation of growth-enhancing structural reforms is critical in light of the likelihood of weaker-than-expected long-term growth outcomes—which, given past experience, is a material possibility (Box 1.1).

For commodity exporters, prospects of a secular slowdown in demand for commodities call for accelerated efforts to diversify and transform their economies as a way of boosting income per capita and mitigating volatility. For all EMDEs, rapid technological changes highlight the need to

support skill acquisition and adaptability. This would assist the process of integration in regional and global value chains, as well as bolster firms' ability to absorb new technologies and compete internationally. For many low- and middle-income countries, improving basic numeracy, literacy, and skills related to information and communication technologies remains a key priority. Comprehensive preferential trade agreements can help boost income per capita of member countries and rekindle stalled trade liberalization at the global level. Recent regional initiatives are a promising step toward that goal.

Major economies: Recent developments and outlook

In advanced economies, growth remains above potential despite signs of softening. In the United States, significant fiscal stimulus will boost near-term activity. As the recovery matures over the forecast horizon and monetary policy accommodation is pared down, growth is projected to moderate toward its potential rate. In China, growth remains solid and is expected to gradually slow as rebalancing continues.

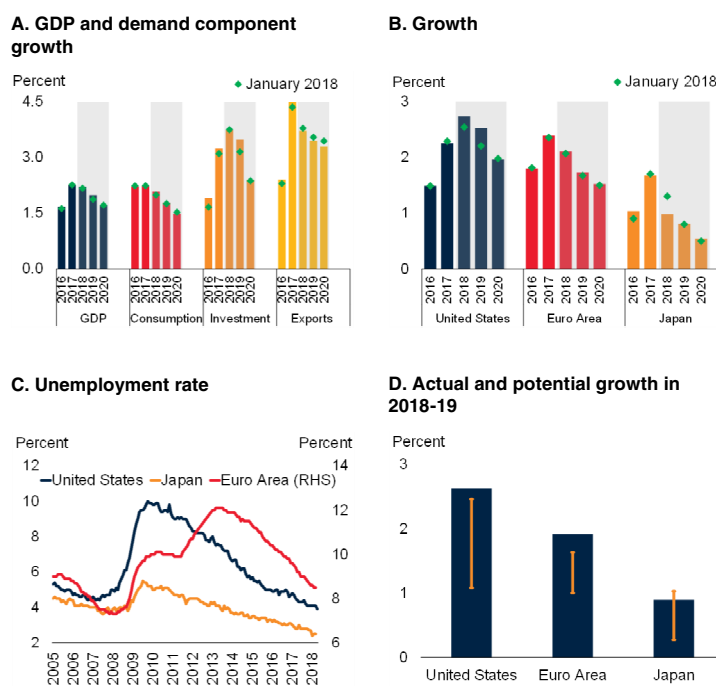
Although recent indicators in advanced economies suggest some moderation, they continue to point to solid investment and above-potential growth this year across countries (Figure 1.3). Consumer confidence is still high and new jobs are being created at a solid pace. In all, advanced-economy growth is projected at 2.2 percent for 2018—a slight deceleration from last year, as additional fiscal stimulus in the United States is offset by moderating growth in other major economies. Over the forecast period, growth is expected to decelerate toward its potential rate, as output gaps close and become positive, inflation rises toward target rates amid higher energy prices, and central banks continue to remove monetary stimulus.

United States

Growth in the United States reached 2.3 percent in 2017, supported by broad-based strength in domestic demand, especially investment. The economy may be near its productive potential, as both capacity utilization and the employment rate

FIGURE 1.3 Advanced economies

Despite recent signs of softening, growth in major advanced economies is still generally solid. It is projected to moderate toward subdued potential rates over the forecast horizon, as labor market slack diminishes and monetary policy stimulus is gradually withdrawn.



Sources: Haver Analytics, World Bank.

A.B. Green diamonds correspond with the January 2018 edition of the *Global Economic Prospects* report. Shaded areas indicate forecasts.

A. Aggregate growth rates and contributions calculated using constant 2010 U.S. dollar GDP weights. Data are seasonally adjusted. Last observation is April 2018 for the United States, and is March 2018 for Japan and the Euro Area.

D. Blue bars refer to average actual growth over 2018-19 period and vertical orange lines show the minimum-maximum range of potential growth estimates based on eight different methodologies (production function approach, multivariate filter, three univariate filters—Hodrick-Prescott filter, Christiano-Fitzgerald filter, and Butterworth filter—IMF *World Economic Outlook* estimates, and estimates in OECD *Economic Outlook* and *Long-Term Baseline Projections*), over 2018-19. For further details on potential growth estimates, refer to the January 2018 edition of the *Global Economic Prospects* report.

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are moving toward peaks attained prior to the financial crisis (Figure 1.4). Wage growth has picked up slightly, but is still weak compared to previous recoveries.

The Bipartisan Budget Act passed in early February, which will add about 1.5 percent of GDP in government spending to the economy over the next three years, is the main factor behind the forecast upgrade relative to January projections. Combined with the Tax Cuts and Jobs Act enacted last year, additional discretionary expenditures result in a highly procyclical fiscal stance, which is expected to cost almost 5 percent of GDP

BOX 1.1 Long-term growth prospects: Downgraded no more?

Consensus forecasts for long-term growth have recently stabilized after a series of downgrades since 2010. Although this development could be another encouraging sign the global economy is finally enjoying a healthy expansion, long-term forecasts are often overly optimistic. While well below levels expected a decade ago, these forecasts are above potential growth estimates. Moreover, adverse structural forces continue to overshadow long-term growth prospects.

A prolonged period of weaker growth expectations, characterized by the systematic downgrading of long-term forecasts, seems to have come to an end. For the first time since 2010, the 10-year-ahead consensus forecast for global growth appears to have stabilized (Figure 1.1.1). In 2018, long-term growth expectations were upgraded for more than half of countries—the largest number since 2010—and there have also been recent upgrades in short-term forecasts.

A sustained upgrading of long-term forecasts could be another sign that the legacies of the global financial crisis are fading. Growth is expected to remain at a post-2011 high this year, and the negative global output gap is likely to be closed for the first time since 2008 (World Bank 2018a). The recent synchronized global upturn has even sparked hopes that the crisis-induced damage to potential growth—“hysteresis” effects, which entrench weak growth after deep recessions—could be reversed if investment, productivity and employment continue to improve (Yellen 2016; Draghi 2018).¹

However, such enthusiasm needs to be tempered by several considerations. First, the benign short-term global growth outlook is predicated on highly accommodative monetary policy by major central banks and, in some advanced economies, significant fiscal stimulus. Second, long-term global growth forecasts are stabilizing at levels well below those expected a decade earlier and well below current

growth rates. Third, long-term growth expectations have in the past proven overly optimistic and above model-based estimates of potential growth, which has been dampened by multiple structural forces.

Against this background, this box briefly analyzes the behavior of long-term global growth expectations to address the following questions:

- How have long-term global growth expectations evolved?
- How do these expectations compare with actual outcomes and estimates of potential growth?
- When do long-term growth expectations tend to be higher?
- What does the recent stabilization in forecasts imply for long-term prospects?

Over the past decade, the implications of rapid technological innovations for long-term growth prospects have been a subject of intense debate. Some claim that in the coming decades the global economy will enjoy a surge in productivity growth driven by new digital technologies (Brynjolfsson and McAfee 2014). Others argue that growth will be much slower because of the declining marginal impact of new technologies on productivity (Gordon 2016). This box focuses on long-term growth prospects as captured in 10-year-ahead growth forecasts and model-based potential growth estimates. It is very difficult, if not impossible, to undertake a credible quantitative analysis of the impact of new technologies on long-term productivity and growth outcomes.

Long-term growth expectations here refer to 10-year-ahead growth forecasts of real GDP from *Consensus*

Note: This box was prepared by M. Ayhan Kose, Franziska Ohnsorge and Naotaka Sugawara. Research assistance was provided by Shijie Shi.

¹Hysteresis effects caused by the global financial crisis were sizable and persistent (Ball 2014; Lo and Rogoff 2015; Oulton and Sebastián-Barriol 2017). Some argue that, absent monetary and fiscal demand stimulus, growth may have been much lower because of the underlying forces of “secular stagnation,” a phenomenon of a rising propensity to save, weak demand and persistently low real interest rates (Summers 2015, 2016; Rachel and Smith 2015).

BOX 1.1 Long-term growth prospects: Downgraded no more? (continued)

*Economics.*² Short-term growth forecasts are defined as 1-year-ahead consensus forecasts. All forecasts are for annual growth and refer to averages of semi-annual or quarterly projections.

Evolution of expectations

Pre-crisis upgrades, post-crisis downgrades. The global financial crisis marked a turning point in long-term global growth expectations. From 1998 to 2007, long-term expectations improved slightly (from 3 percent to 3.4 percent). During the same period, 18 of the 38 economies' long-term growth forecasts were upgraded. Following the 2007-09 global financial crisis, however, long-term forecasts have steadily declined, from 3.3 percent in 2010 to 2.5 percent in 2017, reflecting a broad-based downgrading of growth prospects. Since the crisis, long-term growth forecasts were lowered for all economies (by about 1.4 percentage points, on average). The evolutions of forecasts over various horizons (from 2- to 10-year-ahead) all point to gradual deterioration in global growth expectations since the financial crisis.

The pattern of initial strength and subsequent weakness in growth expectations is broadly shared, albeit at different speeds and intensities, among different country groups and alternative measures of growth. Emerging market and developing economies (EMDEs) enjoyed improvements in their growth prospects before the crisis, while advanced economies began experiencing a gradual decline in growth forecasts in the early 2000s. Post-crisis, both groups witnessed deteriorating long-term growth forecasts. Similar trends occurred in per capita growth and medium-term (5-year-ahead) forecasts. In addition,

the post-crisis decline in long-term output growth expectations was accompanied by weakening forecasts for global investment and consumption growth.

The pattern of pre-crisis upgrades and post-crisis downgrades in long-term forecasts was also evident in some major economies (Figure 1.1.2). In 1998, U.S. growth was expected to be about 2.4 percent over the following decade but, by 2008, the long-term growth forecasts had been revised upwards by 0.3 percentage point. Similarly, growth in China was expected to be 7.5 percent over the following decade in 1998, but by 2008, the long-term forecast had been increased by 0.2 percentage point following its remarkably strong performance in the previous decade. Although long-term growth forecasts for Brazil and India were upgraded in 2008 relative to expectations a decade earlier, these upgrades did not last. By 2018, all of these economies' long-term growth forecasts had declined (0.3-2.4 percentage points) below their 1998 levels.

Recent stabilization. Since 2017, long-term growth expectations have stabilized. In 21 of 38 economies, long-term growth expectations improved from 2017 to 2018—the largest number of countries since 2010. Ten-year-ahead forecasts for EMDEs registered their first upgrade in 2018 following seven consecutive years of declines.

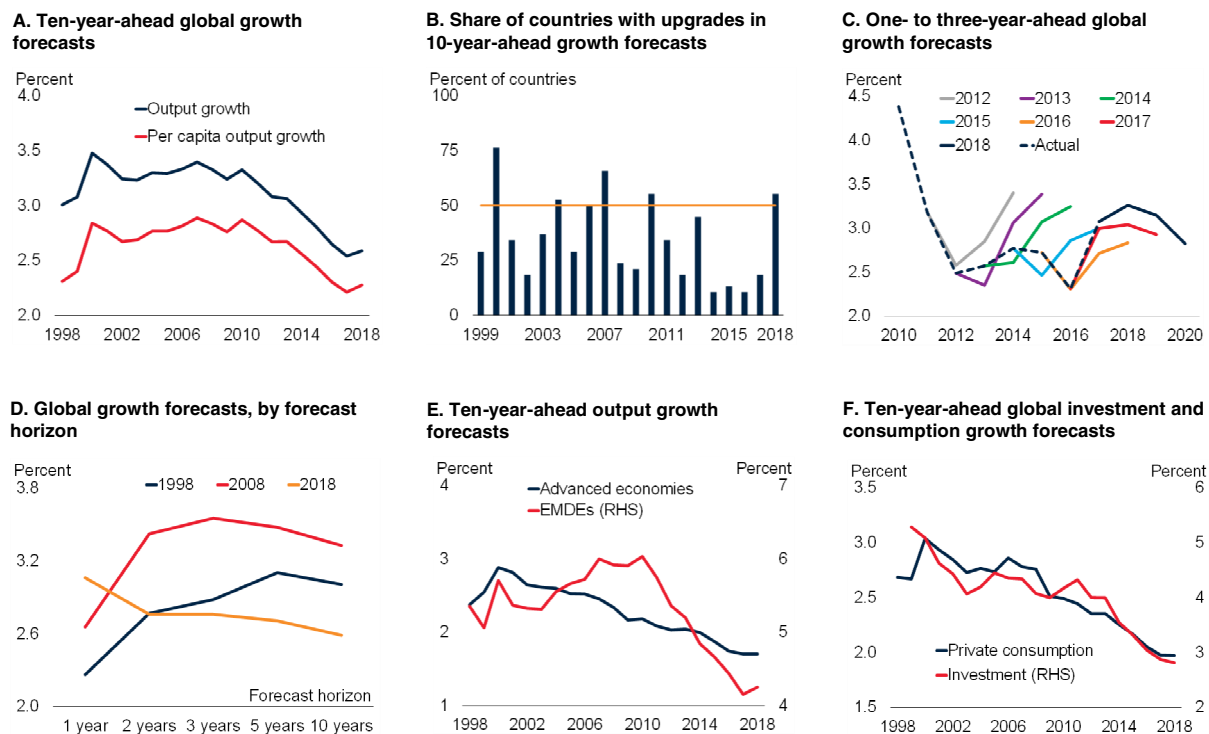
Factors driving the evolution of forecasts. The evolution of long-term forecasts has reflected the global economy's roller coaster ride over the past two decades. Pre-crisis strength in growth prospects in part reflected rapid expansion of investment and international trade and financial flows with the spread of information and communications technology (Kose and Prasad 2010; World Bank 2018a). Thanks to these developments, the global economy registered one of its best growth records since the early 1970s in the 2003-07 period.

Tailwinds, however, turned into headwinds during the 2009 global recession, which was followed by an anemic recovery, especially in advanced economies. The post-crisis period was marked by widespread unemployment and weak investment growth. In many countries, elevated debt burdens weighed on

² Consensus Economics reports an average of 6- to 10-year-ahead growth forecasts, which are labelled here as "10-year-ahead forecast." These forecasts are consistently available for 38 countries (20 advanced economies and 18 EMDEs) from 1998. These 38 countries constitute 87 percent of global GDP in 2010-18. Forecasts are available for 45 countries (25 advanced economies and 20 EMDEs) for as early as 1989. Consensus Economics has been canvassing long-term forecasts from multiple institutions four times a year since 2015. Prior to that, long-term forecasts were made available twice a year or three times a year. The forecast made in a particular year is defined as the average of the 2-4 available forecast vintages in that year. For 2018, the forecast is the average of January and April vintages.

BOX 1.1 Long-term growth prospects: Downgraded no more? (continued)**FIGURE 1.1.1 Growth forecasts: Global, groups, and aggregates**

After a prolonged period of downgrades, long-term forecasts of global growth, per capita growth, investment, and consumption may have stabilized in 2018, while short-term forecasts have been upgraded recently. This still leaves current long-term forecasts considerably lower than a decade ago. Downgrades were particularly steep, but started later (after the global financial crisis), for EMDEs than for advanced economies.



Sources: Consensus Economics, United Nations, World Bank.

Notes: Sample includes 38 countries, consisting of 20 advanced economies and 18 EMDEs, for which consensus forecasts are consistently available during 1998-2018. These economies account for 87 percent of global GDP over 2010-18. Unless otherwise noted, annual averages of results from multiple surveys conducted in each year are presented.

A,B,E,F. The horizontal axis refers to the year of consensus forecast surveys.

A,C,D,E. Global, advanced-economy, and EMDE growth is computed with constant 2010 U.S. dollar GDP weights.

A. Per capita global output growth is computed as the difference between 10-year-ahead global growth forecasts and population growth estimates in the years for which forecast surveys are conducted.

B. Share of countries with positive changes in 10-year-ahead growth forecasts from the previous year.

C. Lines are based on consensus forecast surveys conducted in September or October of denoted years, except 2018, for which data are based on surveys in April.

D. Lines show the years of consensus forecast surveys.

F. Global private consumption and investment growth is computed, respectively, with constant 2010 U.S. dollar private consumption and investment weights.

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investment growth (World Bank 2017a). Over 2010-15, long-term prospects were further clouded by the 2011-12 Euro Area debt crisis, and by a sharp slowdown in EMDEs that was partly related to the bursting of the commodity price boom.

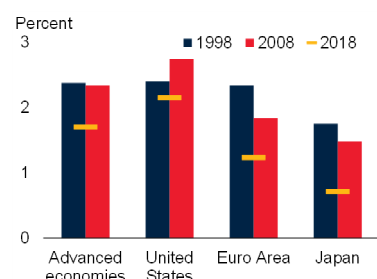
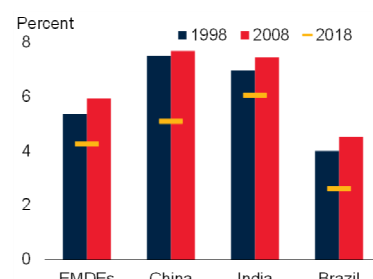
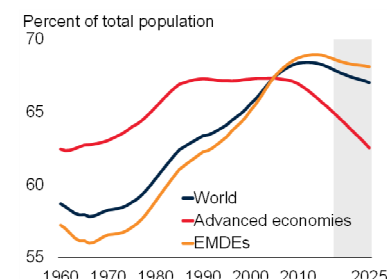
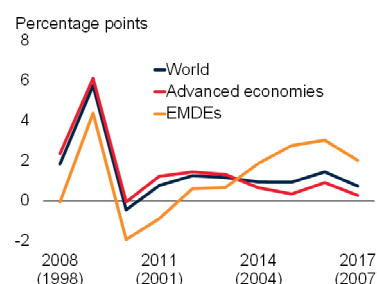
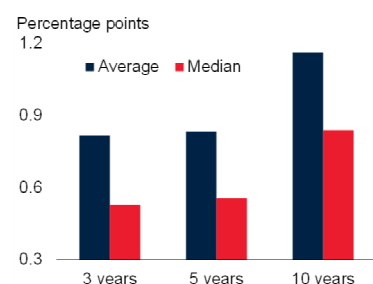
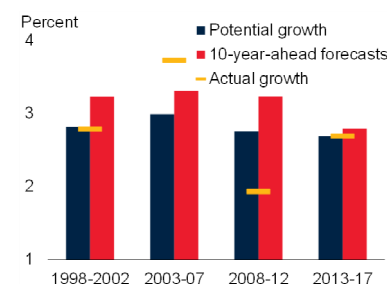
These adverse cyclical effects were compounded by structural weaknesses, namely poor productivity growth and a broadening slowdown in the growth of working-age population (Didier et al. 2015; World

Bank 2018a). A slowdown in total factor productivity growth that had begun in advanced economies in 2004 was compounded, from 2008, by an even steeper decline in EMDEs.³ Similarly,

³In advanced economies, the highly synchronized slowdown in productivity growth has been attributed to several factors, including the lack of transformative technologies, slowing improvements in educational attainment, and the maturation of information technologies (Cetty, Fernald, and Mojon 2016; Hirata, Islamaj, and Kose 2018; Kilic Celik et al. 2018; World Bank 2018a).

BOX 1.1 Long-term growth prospects: Downgraded no more? (continued)**FIGURE 1.1.2 Growth forecasts in major economies and in comparison with actual and potential growth**

Since the global financial crisis, long-term growth forecasts have declined in all major economies. This slowdown has followed adverse cyclical effects, compounded by structural weakness, including declines in the share of the working-age population. For most countries, long-term growth forecasts have systematically exceeded potential growth and actual growth over the past decade, and forecast optimism is stronger for longer-term forecasts than for shorter-term forecasts.

A. Ten-year-ahead growth forecasts in advanced economies**B. Ten-year-ahead growth forecasts in EMDEs****C. Global working-age population****D. Ten-year-ahead growth forecast errors****E. Global growth forecast errors, by forecast horizon****F. Comparison of global forecasts and potential growth**

Sources: Consensus Economics, Kilic Celik et al. (2018), United Nations, World Bank.

Notes: Sample includes 38 countries (20 advanced economies and 18 EMDEs).

A.B. Years denoted show the years of consensus forecast surveys.

A.B.D.E.F. For growth forecasts, annual averages of results from multiple surveys conducted in each year are presented.

A.B.D.F. Growth in aggregate groups is computed with constant 2010 U.S. dollar GDP weights.

A. Euro Area is a weighted average of France, Germany, Italy, the Netherlands, and Spain.

C. Population-weighted averages. The working-age population is defined as people aged 15-64 years. Shaded area refers to forecasts.

D. A forecast error is defined as a difference between consensus output growth forecasts a decade earlier and actual growth, weighted by GDP. The horizontal axis refers to the years for which growth forecasts are surveyed, with the forecast survey years in parentheses.

E. A forecast error is defined as a difference between growth forecasts at different horizons (over three years, five years, and 10 years) and actual growth. Averages and medians are computed from available observations up to 2017.

F. Figure shows period averages of GDP-weighted global actual growth, potential growth, and growth forecasts. For 10-year-ahead growth forecasts, the horizontal axis refers to the forecast survey years. Potential growth is measured by production function.

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in 2010, the share of the working-age population in EMDEs began, first, to plateau and, then, started to fall—a turning point that advanced economies had already passed in the mid-1980s. As a result, global potential growth—the rate of change in output an economy would sustain at full capacity utilization and full employment—was 0.9 percentage point lower in 2013-17 than a decade earlier (World Bank 2018a).

The recent stabilization in long-term growth expectations is associated with improved global growth and trade since mid-2016, tight labor markets and a rebound in industrial production in major advanced economies that also benefited their trading partners, and recoveries in some large commodity-exporting EMDEs. Indeed, global GDP is expected to return to its potential this year for the first time since 2008.

BOX 1.1 Long-term growth prospects: Downgraded no more? (*continued*)

Comparison with outcomes and potential growth

Systematic optimism. Not surprisingly, during 2008-17, long-term global growth forecasts made a decade earlier exceeded actual growth outcomes in all years except 2010. Growth forecasts were higher than eventual growth outcomes in the majority of countries in almost all years since 2008, except during 2010-11. Even during those two years, forecasts were overly optimistic for around 50 percent of advanced economies and 25 percent of EMDEs. The analysis here covers mainly the crisis and post-crisis periods that witnessed an unusual series of negative growth shocks. However, it is widely documented that forecasts for long-term growth tend to be more optimistic than growth outcomes even in data samples that include the pre-crisis period (Ho and Mauro 2016). Moreover, the longer the forecast horizon, the larger the degree of over-optimism is. On average, 10-year-ahead growth forecasts overshot by 1.2 percentage points and 5-year-ahead forecasts over-estimated growth by 0.8 percentage point over the period until 2017.⁴

Above potential growth. Since long-term growth expectations presumably abstract from cyclical effects, they should reflect forecasters' judgment about an economy's potential growth. By comparison, model-based estimates of potential growth can be made using a number of methods. To study whether long-term growth expectations differ from other measures of potential growth, estimates of potential growth based on a production function model are compared with 10-year-ahead growth forecasts made in the same year (Kilic Celik et al. 2018; World Bank 2018a). Ten-year-ahead forecasts for global growth often exceed the model-based global potential growth over the next decade.⁵ The

gap between long-term expectations and the model-based estimate is mostly driven by advanced economies but long-term growth forecasts are currently larger than potential growth in the majority of countries.

Causes of optimism. The over-optimism in long-term growth forecasts is a result of both cyclical and structural factors. In part, this optimism reflected an initial underappreciation of the headwinds to potential growth, especially in advanced economies, from demographics and weak investment and productivity. In part, optimism was a natural outcome of the failure to predict, or even recognize in real time, shocks that could trigger crises or business cycle turning points and their lasting impact (Juhn and Loungani 2002; Ho and Mauro 2016).⁶

The global financial crisis, one of the largest such episodes in a century, was not foreseen by most forecasters. The post-crisis period has also been marked by additional severe and unforeseen shocks, such as the Euro Area debt crisis and the 2014-16 oil price collapse. These episodes—which could not be foreseen 10 years earlier—were followed by substantial and persistent downward growth revisions. They were accompanied by weak business confidence and policy uncertainty. Long-term forecasts adjusted gradually, as new information revealed the lasting damage these shocks had dealt to the global economy. Indeed, long-term growth forecast downgrades have been historically associated with disappointing growth outcomes: when growth fell short of 1-year-ahead forecasts in three consecutive years (in a sample of 55 country-year episodes), 10-year-ahead forecasts were, on average, downgraded by 0.2 percentage point. When compared with forecast changes in other years, this downgrade was statistically significant.

Factors associated with higher long-term forecasts

As shown in the preceding section, long-term forecast revisions are quite common over time and across

⁴ For 5-year-ahead forecasts, this is larger than the average growth disappointments of 0.34 percentage point in *World Economic Outlook* forecasts for 188 countries for 1990-2012 (Ho and Mauro 2016).

⁵ Estimating potential output is fraught with measurement challenges (World Bank 2018a). However, 10-year-ahead forecasts remain above multiple model-based measures of potential growth available in Kilic Celik et al. (2018). For commodity exporters, accounting for resource rents can materially alter potential growth estimates and may account in part for the difference between 10-year-ahead forecasts and cross-country-consistent potential growth estimates.

⁶ The average 10-year-ahead forecast error for the growth in years up to 2000-08 was correspondingly smaller, at 0.1 percentage point, compared with 1.2 percentage points for the sample from 2000-17.

BOX 1.1 Long-term growth prospects: Downgraded no more? (continued)

countries. To analyze the major factors associated with higher forecasts, two simple event studies are undertaken. These illustrate how forecasts are revised during periods of strong output or investment growth. These episodes are particularly relevant considering that the recent stabilization in growth expectations has also coincided with above-potential growth in some major economies and an acceleration in investment since mid-2016.

Sustained output growth. Sustained periods of above-potential growth were generally accompanied by higher 10-year-ahead growth forecasts. The event study sample includes 55 episodes (of which 43 concluded before the global financial crisis in 2009) during which actual growth exceeded potential growth in at least three consecutive years. Conversely, in 49 setback episodes, of which 17 straddled the crisis and 24 were pre-crisis, actual growth fell short of potential growth in three or more consecutive years. During growth spurts, long-term growth forecasts were, on average, 0.3 percentage point (and statistically significantly) higher than during growth setbacks (Figure 1.1.3).

Investment surges. The event sample includes 88 episodes (of which 66 ended before 2009) in which investment growth was positive in at least three consecutive years and 41 setback episodes in which investment growth was negative for at least three consecutive years. Again, long-term growth forecasts were, on average, 1 percentage point (and statistically significantly) higher during investment growth spurts than investment growth contractions.

Implications: A respite from gloom about growth prospects?

Recent long-term growth forecasts indicate that the period of post-crisis gloom about growth prospects may be coming to an end. Long-term growth forecasts currently envision global growth in 2028 at 2.6 percent—slightly higher than a year ago but less than this year's projected growth (3.1 percent). If the recent stabilization of long-term growth forecasts heralds a period of sustained upgrades, it may signal that the effects of the global financial crisis are waning.

However, past experience cautions that long-term forecasts may yet again turn out to be overly optimistic. Specifically, if forecast errors of the magnitude observed in the past materialize yet again, growth in the coming decade may turn out to be much weaker than current long-term growth forecasts, around 2.1 percent instead of 2.8 percent. Over-optimism has reflected an underappreciation of structural headwinds to potential growth as well as a failure to forecast global recessions. Over the past half-century, the global economy experienced a recession every decade (in 1975, 1982, 1991, and 2009).⁷ This record suggests that it is possible that the global economy is due for another recession over the next 10 years.

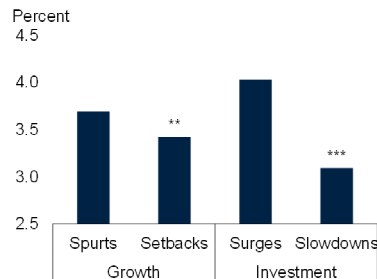
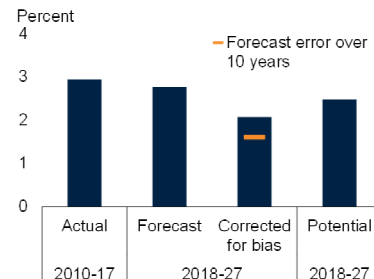
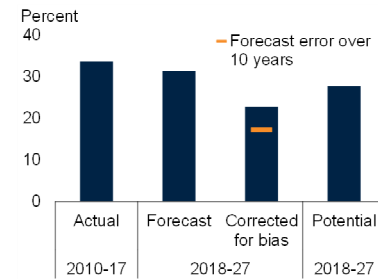
Yet, even if a growth forecast disappointment is not triggered by an outright global recession, average potential growth over the next decade is estimated to be slower than during 2013-17. This reflects an awareness that weak productivity growth, increasingly unfavorable demographic trends, and subdued investment prospects are likely to weigh on global potential growth in the coming years. Model-based estimates suggest that average global potential growth during 2018-27 will be about 2.5 percent, much lower than the post-crisis average actual growth of 3 percent (World Bank 2018a).

Over a decade, such seemingly small differences in growth outcomes translate into significant changes in global income and living standards. For example, should global growth average current consensus forecasts, incomes a decade from now would be, cumulatively, 31 percent higher than in 2018 (but 3 percentage points less than if growth remained at its post-crisis average pace). This income gain could turn

⁷ In 1975, a surge in oil prices coincided with recessions in major advanced economies and debt crises in EMDEs. In 1982, monetary policy tightening in major advanced economies precipitated further debt crises in many EMDEs. In 1991, an abrupt tightening of credit in the United States coincided with banking and currency crises in many European countries. And in 2007-09, there were particularly deep financial crises in major advanced economies. In addition to these four global recessions, the global economy experienced two major slowdowns: during 1997-98, the Asian Crisis was followed by the Russian crisis and, in 2001, the U.S. stock market corrected in the dot-com crash (Kose and Terrones 2015).

BOX 1.1 Long-term growth prospects: Downgraded no more? (concluded)**FIGURE 1.1.3 Growth forecasts and change in global GDP**

Revisions in long-term growth forecasts are common over time and across countries. Ten-year-ahead forecasts became higher during sustained growth spurts and investment surges. Over a decade, growth disappointments can make a major difference to global incomes.

A. Ten-year-ahead growth forecasts during strong growth and investment episodes**B. Global growth forecasts and potential growth****C. Cumulative change in global GDP, 2018-27**

Sources: Consensus Economics, Kilic Celik et al. (2018), World Bank.

Note: For growth forecasts, annual averages of results from multiple surveys conducted in each year are presented.

A. Bars show average growth forecasts during events. *** and ** denote that average forecasts between two events are statistically significantly different at the 1 percent and 5 percent levels, respectively. Sample includes 45 countries for which consensus forecasts are available even over the shorter period. Growth spurt and setback events are defined as, respectively, at least three consecutive years of actual growth above and below potential growth: 55 spurts in 37 countries and 49 setbacks in 36 countries. Investment surge and slowdown events are defined as, respectively, at least three consecutive years of positive and negative investment growth from the previous year: 88 surges in 42 countries and 41 slowdowns in 26 countries.

B.C. Growth in aggregate groups is computed with constant 2010 U.S. dollar GDP weights. Potential growth is measured by production function. Sample includes 38 countries.

B. Actual growth (2010-17) and potential growth (2018-27) are period-averages. A bar for "forecast" is an average of growth forecasts for 2018-27 surveyed in 2018. Bias in forecast is corrected in the following ways: A bar refers to an average of consensus growth forecasts for 2018-27 after an average forecast error for each time horizon (as partly shown in Figure 1.1.2.E) is adjusted; and an orange ticker shows average forecast growth corrected for the average error over 10 years.

C. Cumulative change in global GDP since 2018, when growth in every year during 2018-27 is assumed to be as defined in Panel B.

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out to be 4 percentage points lower should growth instead average its estimated potential rate, and about 9 percentage points lower should growth fall short of consensus forecasts by the average historical forecast error.

The analysis here warns that the recent stabilization in long-term growth prospects may be fleeting. The

risk of further adverse shocks and underlying structural weaknesses still suggest an urgent need to press ahead with growth-enhancing policy adjustments—including reforming product and labor markets, raising investment in human capital, and building the policy buffers needed to allow an appropriate counter-cyclical response to shocks when they materialize.

over 2018-2020 (CBO 2018a; CBO 2018b; CBO 2018c; JCT 2017). In all, the stimulus adds just over 1 percentage point to the growth forecast over the next couple of years, but is expected to lead to budget deficits of around 5 percent of GDP for the next decade, up from 3.5 percent in 2017. As a consequence, net federal public debt, currently at about 80 percent of GDP, is set to rise in coming years (Auerbach, Gale, and Krupkin

2018). As fiscal stimulus measures have been introduced and inflation has moved toward target, the Federal Reserve has signaled a faster pace of policy tightening.

Recent trade policy changes are not expected to have a substantial effect on U.S. growth, which is projected to reach 2.7 percent in 2018 and edge down to 2.5 percent in 2019. As fiscal and

monetary stimulus fade, growth is forecast to slow to 2 percent in 2020, above the mid-point of the 1 to 2.4 percent range of estimates of its potential pace (Fernald et al. 2017; World Bank 2018a).

Euro Area

The Euro Area economy grew 2.4 percent in 2017, its fastest increase since the financial crisis, reflecting strong consumption, investment, and exports. However, data releases since the start of 2018 point to decelerating activity (Figure 1.5). Headline inflation stands at 1.2 percent, well under the central bank target of close to, but below, 2 percent. Wages and inflation expectations have edged up intermittently, pointing to incipient signs of rising price pressures. The European Central Bank (ECB) has committed to growing its balance sheet until at least September 2018, with its policy rate remaining unchanged “well past” this date, until inflation is clearly converging toward target (ECB 2018).

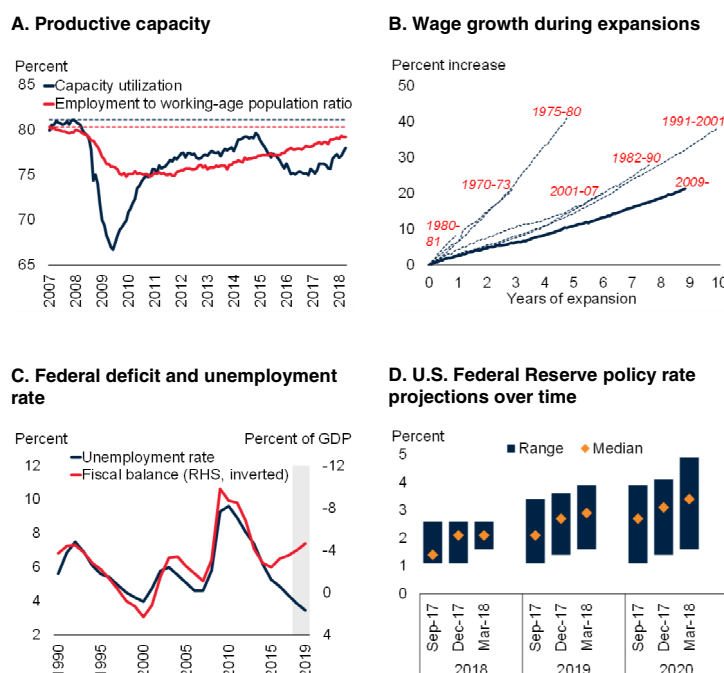
Amid continued monetary policy stimulus, growth is projected to be 2.1 percent in 2018. It is forecast to slow to 1.7 percent in 2019 and 1.5 percent in 2020, as slack dissipates, higher oil prices weigh on consumption, monetary accommodation is gradually unwound, and borrowing costs increase. Net exports are also expected to become a drag on near-term growth, as the earlier strengthening of the euro and improving domestic demand translate into a narrowing of the sizable current account surplus. Positive spillovers from expansionary U.S. fiscal policy are expected to be limited. Throughout the projection horizon, growth is projected to remain above the mid-point of the 0.7 to 1.5 percent range of potential growth estimates (ECB 2017; World Bank 2018a).

Japan

Growth in Japan reached 1.7 percent in 2017, underpinned by supportive financial conditions and strong exports, but contracted at the beginning of this year. Nonetheless, unemployment is falling to levels not seen since the 1990s, while the participation rate has increased, primarily due to greater entry of women into the labor force (Figure 1.6). Inflation remains low,

FIGURE 1.4 United States

The U.S. economy remains robust and may be near its productive capacity. Nevertheless, wage growth remains soft, especially compared to previous expansions. Procyclical fiscal stimulus is expected to provide a temporary boost to growth, which has contributed to a rise in the Federal Reserve’s policy rate projections.



Sources: Board of Governors of the Federal Reserve System, Bureau of Labor Statistics, Congressional Budget Office, Federal Reserve Bank of St. Louis, Haver Analytics, World Bank.

A. The dashed horizontal lines indicate the peak values for capacity utilization and the employment to working-age population ratio in the two years prior to the global financial crisis (i.e., December 2005 to December 2007). The local peak was 81.1 percent for capacity utilization and 80.3 percent for the employment to working-age population ratio. Last observation is April 2018.

B. Wage growth is the average hourly earnings of private, non-farm production, and nonsupervisory employees. Wages have been indexed to the trough of the corresponding National Bureau of Economic Research (NBER) business cycle. Last observation is April 2018.

C. Shaded area indicates forecasts. Forecast for the federal deficit based on the most recent Congressional Budget Office (CBO) baselines. Forecast for the unemployment rate based on World Bank calculations using an Okun's law coefficient of 0.5.

D. Figure shows the minimum-maximum range and median of the federal funds rate projections for 2018, 2019, and 2020 released in September 2017, December 2017, and March 2018. The projections show the median and range of FOMC participants' (i.e., Federal Reserve Board members and Federal Reserve Bank presidents) assessment of the midpoint of the projected appropriate target range for the federal funds rate, or the projected appropriate target level for the federal funds rate at the end of the specified calendar year.

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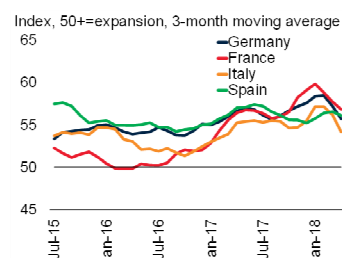
and wages and inflation expectations have been generally stable, suggesting that monetary policy will likely remain accommodative for some time.

Over the forecast period, growth is expected to decelerate to 1 percent in 2018, 0.8 percent in 2019, and 0.5 percent in 2020, as higher oil prices erode real incomes, employment growth slows, and fiscal consolidation starts to drag on growth, notably due to the effects of the VAT hike

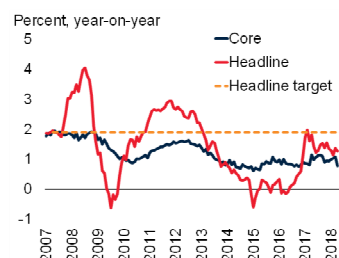
FIGURE 1.5 Euro Area

While data releases since the start of 2018 point to decelerating activity, growth is still above potential. Inflation continues to be below target, though wage growth and inflation expectations have edged up intermittently. The current account surplus remains sizable.

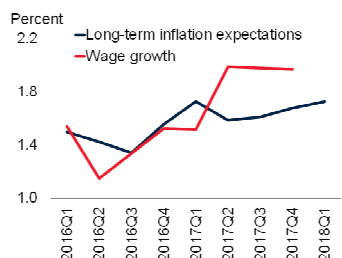
A. Composite PMIs



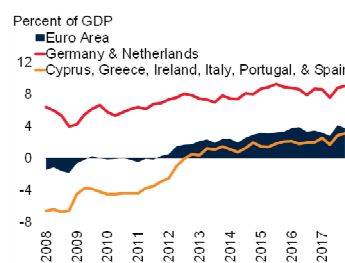
B. Headline and core inflation



C. Inflation expectations and wage growth



D. Euro Area current account balance



Sources: Bloomberg, European Central Bank (ECB), Haver Analytics, World Bank.

A. Purchasing Managers' Index (PMI) readings above 50 indicate expansion in economic activity; readings below 50 indicate a contraction. Last observation is April 2018.

B. Horizontal line represents 1.9 percent, consistent with the ECB's inflation target of close to, but below, 2 percent. Last observation is April 2018.

C. Long-term inflation expectations are derived from 5-year over 5-year forward swap rates, averaged over the quarter. Wage growth is year-on-year, and includes industry and services, excluding public administration. Last observation is 2018Q1 for inflation expectations and 2017Q4 for wage growth.

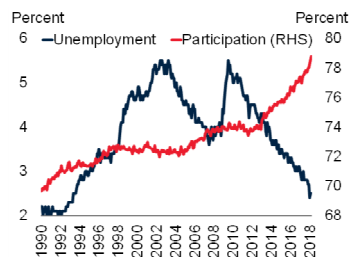
D. Aggregates calculated using constant 2010 GDP weights. Last observation is 2017Q4.

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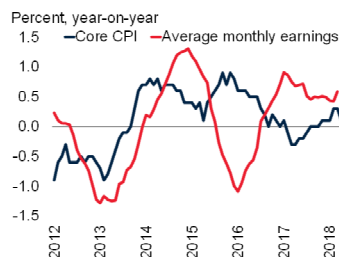
FIGURE 1.6 Japan

Despite a contraction in activity at the start of 2018, the labor market continues to add workers as unemployment falls and the participation rate rises. Increases in earnings have been moderate, and core inflation remains low.

A. Unemployment and labor participation rates



B. Core inflation and wage growth



Sources: Haver Analytics; Japan Ministry of Health, Labor, and Welfare; Japan Ministry of Internal Affairs and Communications.

A. Last observation is March 2018.

B. Average monthly earnings are 12-month moving averages and are the average monthly earnings of workers in companies with 30 or more employees, in all industries. The core CPI index excludes fresh food and energy, and has been adjusted to exclude the impact of Value-Added Tax (VAT) hikes. Last observation is April 2018 for core CPI and March 2018 for average monthly earnings.

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scheduled for late 2019. The long-term growth outlook remains constrained by an aging and shrinking labor force (World Bank 2018a).

China

Growth in China reached 6.9 percent in 2017 and has remained solid this year (Figure 1.7; World Bank 2018b). Activity continues to shift to consumption, while investment growth rates remain well below those in recent years. Industrial production has stabilized following significant cuts in overcapacity sectors implemented over the past two years. In the first quarter of 2018, China recorded its first current account deficit since 2001.

During the first half of 2018, fiscal policy has become less expansionary, while monetary and prudential policies continue to rein in excessive credit growth, especially shadow financing. The stock of outstanding debt is high, although the largest component—credit to non-financial corporations—has been declining as a share of GDP (BIS 2018a). Tight housing market regulations have contributed to some correction in the housing sector. Consumer price inflation remains below target, and producer price inflation has moderated. Tight enforcement of capital flow management measures continues to limit capital outflows and exchange rate pressures.

China's growth is projected to edge down to 6.5 percent in 2018 and slow further to 6.3 percent on average in 2019-20, as export growth moderates and deleveraging takes hold. In addition, policy accommodation is expected to further diminish as authorities continue to tighten macroprudential regulation and gradually remove their supportive fiscal stance. Downside risks to the outlook stem from financial sector vulnerabilities and an intensification of trade tensions amid increased protectionism in key trading partners.

Global trends

Global trade was robust last year, benefiting from an upturn in capital spending and manufacturing activity. It is expected to moderate over the forecast

period amid decelerating global investment. Financing conditions are expected to tighten more rapidly than previously envisioned, along with the possibility of faster normalization of monetary policy in major advanced economies, in part because of expanded U.S. fiscal stimulus measures. Capital flows to EMDEs have eased amid rising borrowing costs and are likely to further moderate. Oil prices are substantially higher than previously expected, and other commodity prices have also risen. While near-term projections for commodity prices have been revised up, they are expected to level off later in the forecast horizon.

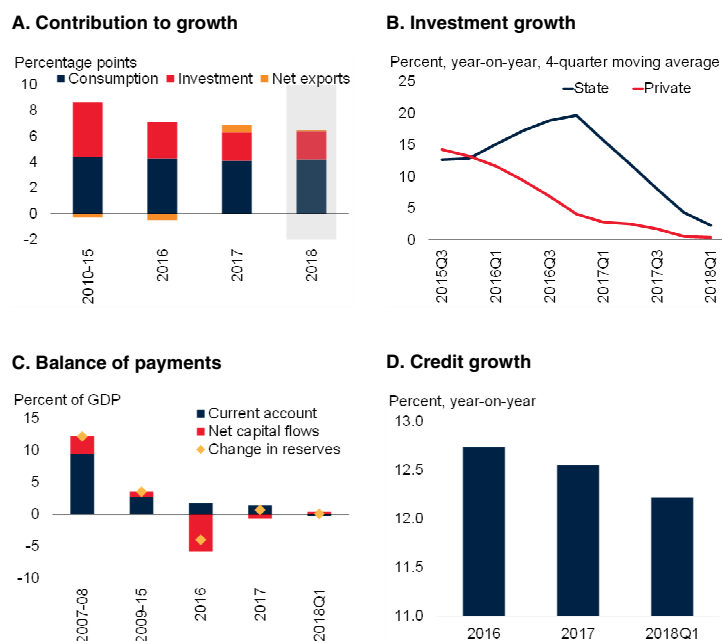
Global trade

Following a prolonged period of marked weakness, a cyclical recovery in global manufacturing and investment propelled global goods trade growth to 4.6 percent in 2017, three times the pace observed the previous year. The momentum remained sustained in early 2018, despite easing export orders (Figure 1.8). Services trade also gained strength last year. Since the global financial crisis, services trade has grown at a faster pace and continues to have the largest untapped potential for future growth (Georgieva, Loayza, and Mendez-Ramos 2018; Lodefalk 2017; Miroudot and Cadestin 2017).

Overall, growth in global trade of goods and services combined is expected to moderate to 4.3 percent in 2018, down from a six-year high of 4.8 percent in 2017. These projections have been revised up due to stronger-than-expected intra-regional trade growth in Asia and import demand from major advanced economies. The additional fiscal stimulus in the United States is expected to lift U.S. import growth, benefiting key U.S. trading partners. Although benefits from the strength of global trade are broad-based across EMDE regions, they were most pronounced in East Asia and Pacific and Eastern Europe and Central Asia. Export growth in these two regions peaked in 2017 and is forecast to remain robust in 2018-19. More generally, a projected deceleration of capital spending in China and in most advanced economies will contribute to more moderate global trade growth over the forecast horizon (Freund 2018; Auboin and Borino 2017).

FIGURE 1.7 China

Growth in China remains solid and rebalancing continues, amid robust consumption and a slowdown in investment. In the first quarter of 2018, China recorded its first current account deficit since 2001. Stricter enforcement of capital flow management measures has helped ease capital outflows and exchange rate pressures. Credit growth continues to decline because of regulatory tightening.



Sources: China National Bureau of Statistics, Haver Analytics, International Institute of Finance, People's Bank of China, World Bank.

A. Shaded area indicates forecasts. Investment refers to gross capital formation, which includes change in inventories.

B. Investment refers to fixed asset investment (urban area). Deflated by fixed asset investment price index. Last observation is 2018Q1.

C. Current account balance is based on seasonally adjusted data. Net capital flows and change in reserves are estimates. Last observation is 2018Q1 for the current account balance.

D. Credit refers to total loans in domestic and foreign currency. Last observation is 2018Q1.

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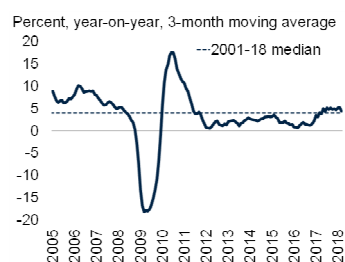
Over the medium term, structural factors—including slower growth of global value chains and a reduced appetite for further trade liberalization—will continue to constrain global trade growth. These factors have contributed to the decline in the long-run income elasticity of trade over the last decade.

On trade policy front, the outcome of some trade negotiations is still uncertain, and the risk of escalating trade restrictions has intensified, as new tariff announcements by the United States have led to retaliatory responses by major trading partners. In other policy developments, the European Union and the United Kingdom reached agreement on guidelines for trade

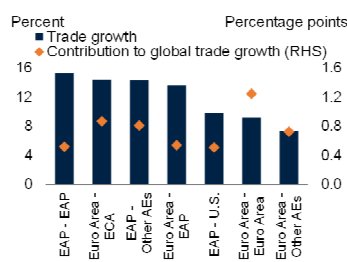
FIGURE 1.8 Global trade

Goods trade was particularly strong in 2017, supported by solid flows in Asia and Europe, while services trade also recovered. However, trade growth is moderating and should continue to ease in 2019-20 as global investment decelerates, while structural factors are still weighing on the income elasticity of trade. Trade flows between the United States and China have been the subject of intense policy discussions.

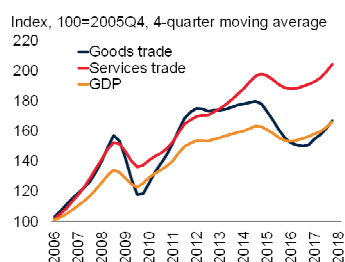
A. Global goods trade growth, volumes



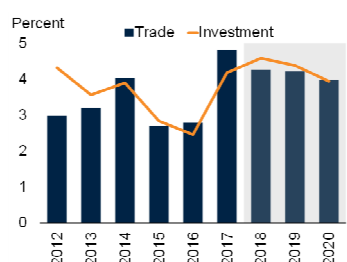
B. Goods trade growth between major regions in 2017, values



C. Global goods and services trade, values



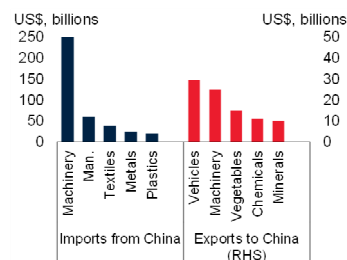
D. Global trade and investment growth, volumes



E. Income elasticity of trade



F. Trade flows between the United States and China



Sources: CPB Netherlands Bureau for Economic Policy Analysis, International Monetary Fund, U.S. Census Bureau, World Bank, World Trade Organization (WTO).

A. Dashed horizontal line indicates the historical median, which is computed from January 2001 to March 2018. Last observation is March 2018.

B. Global trade growth from 2016 to 2017. Average of export and import values. Bilateral trade flows measured using the Direction of Trade Statistics. Last observation is December 2017.

C. Trade measured as the average of export and import values. GDP measured in current U.S. dollars. Data are 4-quarter moving averages, indexed to 100 in 2005Q4. Last observation is 2017Q4.

D. Trade measured as the average of export and import volumes. Shaded area indicates forecasts.

E. Income elasticity measured as the ratio of real trade growth to real GDP growth. Horizontal line denotes an income elasticity of one, which would indicate a proportional relationship between income and trade.

F. Figure shows top five traded goods categories based on 2017 trade values in U.S. dollars. Man. denotes miscellaneous manufactured goods, plastics refers to plastic and rubber goods, and metals is base metals.

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negotiations, the U.S.-Korea Free Trade Agreement was successfully re-negotiated, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) was signed by 11 member countries, and leaders from more than 40 African nations endorsed a framework establishing a future African Continental Free Trade Area.

Financial markets

Following a prolonged period of stable and exceptionally favorable global financing conditions, prospects of a faster withdrawal of monetary policy accommodation in advanced economies have led to rising global borrowing costs since the start of 2018. In particular, U.S. long-term yields have hovered around 3 percent, their highest level since mid-2014, as inflation expectations picked up and markets factored in the possibility of accelerated interest rate hikes by the Federal Reserve, amid expanded U.S. fiscal stimulus measures (Figure 1.9). This reassessment—along with fears of escalating trade tensions and rising geopolitical risks—contributed to bouts of volatility in global equity markets in the first half of 2018. Concerns in some advanced economies about overstretched stock valuations, as well as the increasing use of complex derivatives allowing investors to make bets on volatility, have also amplified price movements (BIS 2018b).

Looking forward, global interest rates are expected to rise at a faster pace than previously predicted, as upward revisions to the U.S. growth outlook lead to a somewhat steeper pace of U.S. interest rate hikes in 2019-20 (FOMC 2018). Above-trend growth and narrowing economic slack will also lead to further monetary policy normalization in other advanced economies. Policy interest rates in the Euro Area and Japan are not expected to increase before 2019, but a drawdown of net asset purchases by major central banks is projected to put upward pressure on global long-term yields. In particular, the European Central Bank is expected to bring its asset purchase program to a close by the end of 2018, and the U.S. Federal Reserve is on track to shrink its balance sheet by 4 percent of GDP by the end of 2020. The latter reduction could add a cumulative 40 basis points to U.S. long-term yields over the same period (Bonis, Ihrig, and Wei 2017).

A rise in global interest rates, combined with U.S. dollar appreciation, have contributed to tighter external financing conditions for EMDEs in 2018. In particular, some EMDE currencies have fallen sharply. More generally, capital inflows to EMDEs have decelerated. During recent periods of financial market volatility, EMDEs experienced portfolio outflows, reminiscent to those during previous episodes. Credit quality has continued to deteriorate, leading to further debt rating downgrades in several countries in 2018. Although appetite for higher-yielding EMDE debt has diminished and borrowing costs have increased, international bond issuance remains robust, so far matching the record levels observed in 2017. The pace of international debt issuance is currently driven by corporate borrowing in China and a significant uptick in sovereign issuance in Sub-Saharan Africa.

Foreign direct investment (FDI) flows to EMDEs continue to be subdued, as flows to China remain below their long-term trend and the recent recovery in commodity prices has not been sufficient to stimulate a significant revival of investment in resource sectors. Increased participation in more complex global value chains could foster stronger FDI in many countries, particularly in Sub-Saharan Africa (World Bank et al. 2017; Amendolagine et al. 2017). Over the forecast horizon, capital flows to EMDEs are expected to further moderate, as global financing conditions continue to tighten. Investors are also likely to increasingly differentiate among countries, depending on their exposure to rising interest rates and currency pressures.

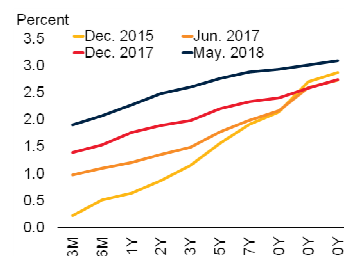
Commodities

Crude oil prices rose 10 percent in the first quarter of 2018 and have averaged \$67 per barrel (bbl) over the first half of 2018 (Figure 1.10). Oil demand has been robust, with consumption increasing 1.6 million barrels per day (mb/d), or 1.6 percent, in the first quarter of 2018 from a year earlier. An agreement between most Organization of the Petroleum Exporting Countries (OPEC) members and some non-OPEC oil producers to extend output cuts to the end of 2018 boosted prices in late 2017 and into 2018—despite further increases in U.S. oil

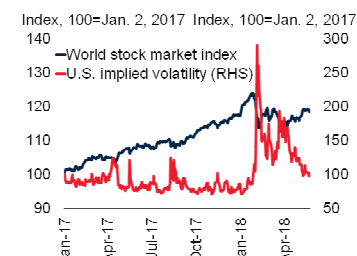
FIGURE 1.9 Global finance

U.S. long-term yields have increased this year, reflecting rising inflation expectations and prospects of a faster pace of U.S. interest rate hikes. This contributed to bouts of stock market volatility, higher borrowing costs, and capital outflows in EMDEs. However, EMDE debt issuance remained solid, so far matching record levels reached in 2017. As global bond yields are expected to continue to increase, capital inflows to EMDEs are likely to moderate further.

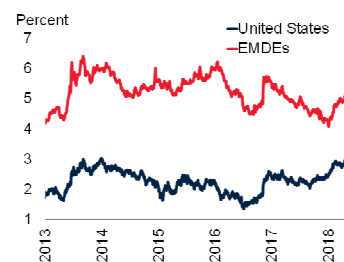
A. U.S. yield curve since the start of the tightening cycle in December 2015



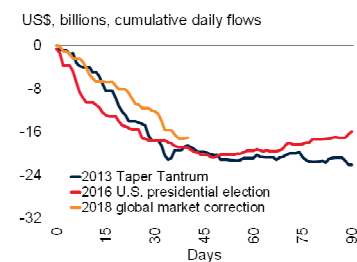
B. Global equity market



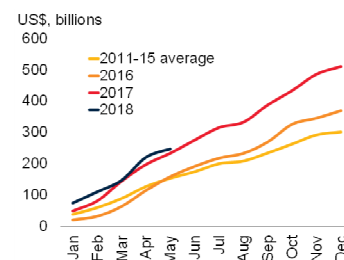
C. Long-term U.S. and EMDE bond yields



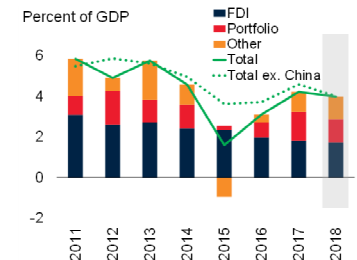
D. EMDE portfolio flows during selected episodes



E. EMDE international bond issuance



F. Capital inflows to EMDEs



Sources: Bloomberg, Dealogic, Federal Reserve Bank of St. Louis, Haver Analytics, Institute of International Finance, J.P. Morgan, U.S. Department of the Treasury, World Bank.

A. Yield values from the yield curve at fixed maturities, from 3 months to 30 years. Last observation is May 25, 2018.

B. World MSCI indices are weighted benchmarks that use large- and mid-cap securities in emerging and developed markets, respectively, in order to reflect market conditions across relevant regions and sectors. Volatility is measured by the VIX implied volatility index of option prices on the U.S. S&P 500. Last observation is May 25, 2018.

C. EMDE long-term yields are estimated using the U.S. 10-year treasury yield augmented by J.P. Morgan's Emerging Market Bond spread (excluding Venezuela). Last observation is May 21, 2018.

D. Horizontal axis indicates number of days of outflows since event. The 2018 global market correction starts on April 15, 2018. Last observation is May 25, 2018.

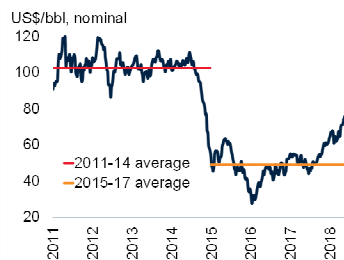
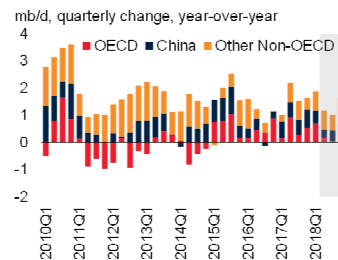
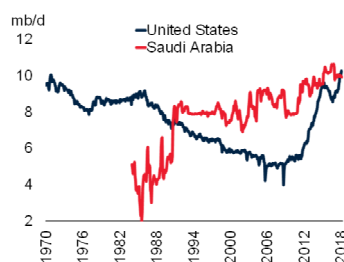
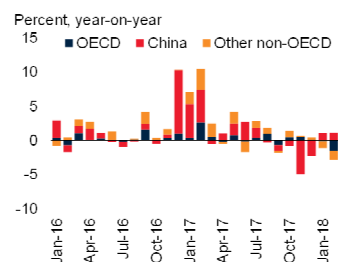
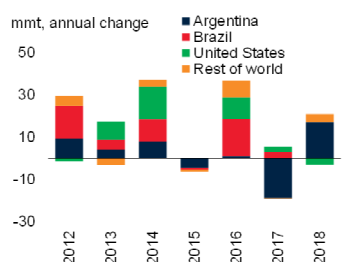
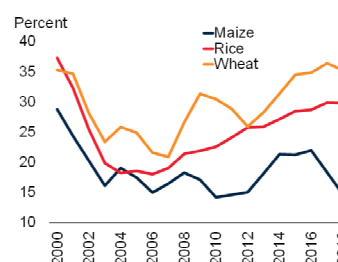
E. Last observation is May 2018.

F. Shaded area indicates forecasts. Total non-resident inflows. The 23 EMDEs in the sample include Argentina, Brazil, Chile, China, Colombia, Egypt, Hungary, India, Indonesia, Lebanon, Malaysia, Mexico, Nigeria, Philippines, Poland, Russia, Saudi Arabia, South Africa, Thailand, Turkey, United Arab Emirates, Ukraine, and Venezuela.

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FIGURE 1.10 Commodity markets

Crude oil prices rose substantially over the first half of 2018 amid robust demand and supply concerns related to recent geopolitical developments, despite rising U.S. oil production. Metals prices increased in the first half of the year following a pickup in demand from China. Grain stocks, in general, remain very high, which will continue to weigh on agricultural prices, while soybean production has fallen substantially.

A. Crude oil prices**B. Contribution to oil consumption growth****C. Crude oil production****D. Contribution to metals demand growth****E. Soybean production****F. Stocks-to-use ratios of main grains**

Sources: Bloomberg, Energy Information Administration, International Energy Agency, U.S. Department of Agriculture, World Bank, World Bureau of Metal Statistics.

A. Average of Brent, Dubai, and WTI. Weekly data. Last observation is May 25, 2018.

B. Shaded area (2018Q2-2018Q4) represents IEA projections.

C. Data for Saudi Arabia are unavailable before 1984. Last observation is April 2018 for Saudi Arabia and February 2018 for the United States.

D. Last observation is March 2018.

E.F. Data reflect the May 10, 2018 update of the USDA's *World Agricultural Supply and Demand Estimates*. Years represent crop seasons (e.g., 2016 refers to 2016-17 crop season).

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2014, after the U.S. government announced that it would reinstate sanctions on the Islamic Republic of Iran. Although there is considerable uncertainty regarding the ultimate impact of the sanctions, it is possible that they will reduce Iranian exports by several hundred thousand barrels per day. The rise in oil prices was partially reversed in late May on news that Saudi Arabia and Russia were discussing an easing of production caps, by up to 1mb/d, given concerns about weaker oil supply and higher prices.

Oil prices are expected to average \$70/bbl in 2018 and \$69/bbl in 2019, up \$12/bbl in 2018 and \$10/bbl in 2019 relative to January forecasts. Upside price risks primarily arise from geopolitical developments involving key oil-producers in the Middle East and North Africa—particularly those related to the reinstatement of sanctions on Iran. In addition, the recent imposition of sanctions on República Bolivariana de Venezuela could lead to further declines in Venezuelan oil production, where output has already fallen 0.9 mb/d over the past two years. Downside price risks include a loosening of the OPEC/non-OPEC planned cuts, which could be decided at the June OPEC meeting; faster-than-expected U.S. shale oil production; or lower demand for oil as a result of higher prices.

Metals prices, which increased 24 percent in 2017 due to robust global demand and environmentally-driven supply cuts in China, rose modestly in the first quarter of 2018. Prices posted further gains in April, after the imposition of U.S. sanctions on a large Russian aluminum producer. Metals prices are expected to increase 9 percent in 2018, reflecting strong demand, but then moderate in 2019. Upside risks to prices include stricter pollution-control policies in China or stronger-than-expected demand, since China accounts for about half of global metals consumption (Special Focus 1). A broadening of sanctions on key metals producers could also lead to higher prices.

production, which reached an estimated 10.6 million barrels per day in April.

Geopolitical concerns boosted the price of Brent crude in May to \$80/bbl, its highest level since

Agricultural prices gained 4 percent during the first half of 2018 compared to a year earlier, following three years of price stability. The price uptick was primarily driven by lower plantings of

wheat and maize in the United States, as well as some weather-related disruptions to soybean production in South America. Lower plantings have contributed to a decline in stocks-to-use ratios—a measure of global supply availability relative to demand—for some grains. However, these remain high by historical standards, reducing the likelihood of a food price spike.

Emerging and developing economies: Recent developments and outlook

EMDE growth is expected to reach 4.5 percent in 2018. The rebound in commodity exporters has continued, and activity in commodity importers remains robust. Beyond this year, however, EMDE growth is projected to strengthen only slightly, approaching its potential pace, as the recovery in commodity exporters matures. Over the forecast horizon, commodity exporters and importers will see uneven progress in per capita income growth, which is projected to remain subdued in Sub-Saharan Africa.

Recent developments

Growth in EMDEs accelerated to 4.3 percent in 2017 and has generally continued to firm in 2018. This reflects an ongoing cyclical upturn in commodity exporters, whose contribution to overall EMDE growth is rising, as well as robust activity in commodity importers (Figure 1.11).

The recovery in commodity exporters has broadened, as investment has strengthened amid higher commodity prices, rising corporate earnings, and supportive monetary policies. Private consumption growth has also firmed, benefiting from improving labor markets and rising household income amid moderating inflation. Trade flows have risen, although by varying degrees. In commodity importers, growth remains strong, supported by robust domestic demand and solid exports. Activity in EMDEs excluding China has firmed, led by countries in Europe and Asia, which have particularly benefited from the recovery of global manufacturing, investment, and trade.

Recent economic activity data and sentiment indicators across EMDEs—including confidence, industrial production, and purchasing managers indexes (PMIs)—have remained mostly solid. However, some are showing signs of softening, partly reflecting country-specific developments. In particular, confidence has deteriorated in some large EMDEs that have recently experienced financial market stress.

Commodity-exporting EMDEs

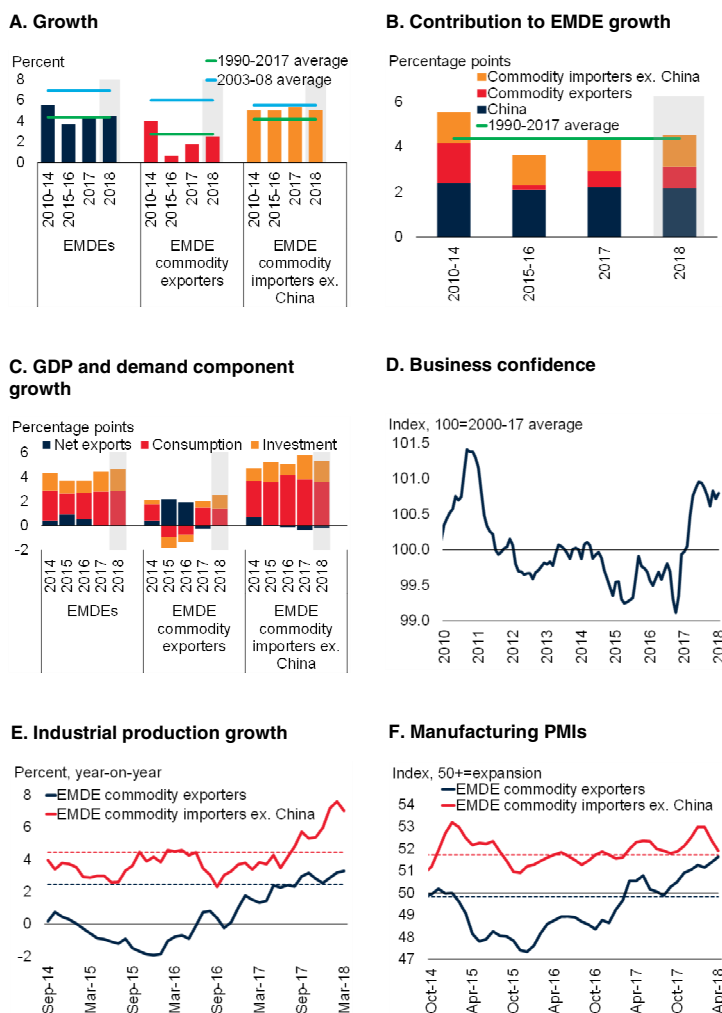
After a strong rebound in 2017, activity in commodity exporters has continued to pick up in 2018 (Figure 1.12). The recovery is expected to continue in a majority of countries in this group. Almost all economies that experienced a recession in the past two years—about 20 percent of commodity exporters in 2016 and about 10 percent in 2017—are expected to see positive growth this year.

Many commodity exporters have eased monetary policy as inflation moderates (e.g., Azerbaijan, Brazil, Colombia, Kazakhstan, Mozambique, Peru, Russian Federation, Uganda, South Africa, Zambia). Although fiscal consolidation continues, its pace has generally diminished as revenues from commodity exports increased. Higher commodity prices and robust trade have supported the ongoing recovery.

Against this backdrop, investment is rebounding in more than two thirds of commodity exporters. This partly reflects increased commodities production (e.g., Chile, Nigeria, Peru), as well as large infrastructure investment programs (e.g., Colombia, Côte d'Ivoire, Qatar, Saudi Arabia, Senegal, United Arab Emirates). Private consumption is also recovering (e.g., Armenia, Azerbaijan, Brazil, Kazakhstan, Russia, South Africa, United Arab Emirates, Zambia), boosted by wage gains, improving labor markets, and stronger consumer purchasing power amid moderating inflation and firming currencies. To varying degrees, export and import growth in commodity exporters have generally continued to recover, as domestic demand strengthens and global trade remains robust.

FIGURE 1.11 Activity in EMDEs

EMDE growth has generally continued to strengthen, mainly reflecting the ongoing cyclical recovery in commodity exporters. Domestic demand, particularly investment, has firmed in commodity exporters and remains robust in commodity importers. High-frequency indicators have for the most part remained solid, but they are showing signs of softening.



Sources: Haver Analytics, Organisation for Economic Co-operation and Development, World Bank. A.-C. Shaded areas indicate forecasts. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights.

B. Horizontal line indicates EMDE average.

D. Median of confidence index for Brazil, Chile, Colombia, Hungary, Indonesia, India, Mexico, Poland, Russia, Turkey, and South Africa. Confidence is normalized through amplitude adjustments, such that any cyclical movements have the same amplitude and the long-term average of a respective country series is equal to 100. Last observation is April 2018.

E.F. Figures show 3-month moving averages.

E. Dashed horizontal lines indicate 1995-2017 averages. Last observation is March 2018.

F. PMI = Purchasing Managers' Index. Readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Dashed horizontal lines indicate January 2012-April 2018 averages. Last observation is April 2018.

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albeit lackluster, as the impact of oil production cuts and policy uncertainty has been offset by more accommodative monetary policy and higher oil prices (World Bank 2018d). In South Africa, the political transition and economic reform initiatives have supported investor confidence and contributed to stronger activity this year (World Bank 2018e). Recent indicators for these economies have, however, been mixed, highlighting lingering headwinds.

The cyclical recovery continues in several other large commodity exporters with negative output gaps (e.g., Azerbaijan, Colombia, Saudi Arabia, United Arab Emirates; World Bank 2018d, World Bank 2018f). In particular, in oil-exporting economies that implemented significant reductions in oil production in 2017 (e.g., Algeria, Iraq, Kuwait), growth has been recovering this year, reflecting diminishing fiscal adjustment amid substantially higher oil prices and easing oil production cuts (World Bank 2018f). In contrast, activity remains weak in energy exporters that delayed policy adjustment to the earlier terms-of-trade shock, or that face country-specific challenges such as exchange rate misalignments, social tensions, and security issues (e.g., Equatorial Guinea, Venezuela). In all, growth in many energy exporters continues to lag that of exporters of other commodities.

Activity continues to show resilience in a number of more diversified economies and agriculture exporters (e.g., Benin, Burkina Faso, Côte d'Ivoire, Ethiopia, Indonesia, Malaysia, Morocco, Senegal, Uganda; World Bank 2018e). Supported by higher metals prices, growth among metals exporters continues to improve, albeit at varying degrees, reflecting country-specific conditions. In some economies, temporary disruptions previously weighing on growth (e.g., policy uncertainty in Peru, mining strikes in Chile) have dissipated. In others, new mines are coming on stream and investment into existing mines continues (e.g., Armenia, Mongolia, Zambia).

Commodity-importing EMDEs

Growth in commodity importers remains strong, although it is moderating somewhat this year

Among the largest commodity exporters, supportive policies in Brazil continue to underpin a recovery of domestic demand (World Bank 2018c). In Russia, growth has remained stable,

(Figure 1.13). With output gaps closed, or in many cases positive, capacity constraints are becoming increasingly binding. Accommodative policies and solid labor markets have continued to support domestic demand in a number of economies. However, with price and wage pressures rising, and amid markedly higher oil prices, several large commodity importers have begun to tighten policies (e.g., Georgia, Pakistan, the Philippines, Romania, Turkey). The moderation in activity is most notable in countries where highly accommodative policies are being scaled back or financial markets have shown signs of strain.

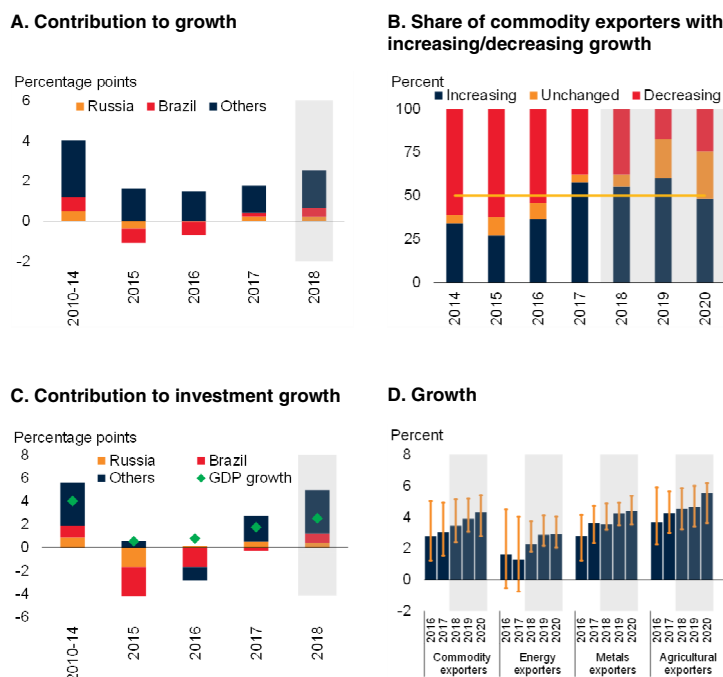
Aggregate investment in commodity importers excluding China remains solid, partly reflecting a cyclical rebound in Mexico and Thailand, where it was previously held back by country-specific factors (World Bank 2018b). In India, investment growth has firmed recently, as the effects of temporary factors wane. Still robust sentiment and support from European Union structural funds are bolstering investment in Europe and Central Asia. Investment in EMDEs in Asia is receiving an additional boost from pan-Asian infrastructure initiatives, supported by the China-led Belt and Road initiative (e.g., Bangladesh, Cambodia, Pakistan, Sri Lanka; World Bank 2018b; World Bank 2018g).

Trade flows have continued to firm this year, although to varying degrees, reflecting strong global manufacturing activity, trade, and investment, as well as stronger intra-regional trade, especially in emerging Asia and Europe. Robust investment and exports are boosting demand for imports of machinery, equipment, and intermediate goods.

Positive trade and financial spillovers from stronger Euro Area growth and steady activity in Russia are supporting activity in Europe and Central Asia, and in the Middle East and North Africa (e.g., Belarus, Bosnia and Herzegovina, Bulgaria, Arab Republic of Egypt, Georgia, Hungary, Jordan, former Yugoslav Republic of Macedonia, Moldova, Poland, Romania, Tunisia). Asian economies continue to benefit from robust growth in China and India, including resurgent trade and substantial infrastructure investment (e.g., Cambodia, Maldives, Sri Lanka, Thailand,

FIGURE 1.12 Activity in EMDE commodity exporters

The recovery in commodity exporters continues to reflect improvements in large economies, but it is also broad-based across countries. Investment is strengthening amid higher commodity prices and greater monetary policy accommodation. Despite a notable increase in energy prices, growth in many energy exporters continues to lag behind that of other commodity exporters, mainly due to ongoing production cuts.



Source: World Bank.

A.-D. Shaded areas indicate forecasts.

A.B. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights.

B. Sample includes 85 commodity-exporting EMDEs. Increasing/decreasing growth are changes of at least 0.1 percentage point from the previous year. Countries with a slower pace of contraction from one year to the next are included in the increasing growth category.

C. Investment refers to fixed asset investment.

D. Simple average of GDP growth. Orange lines indicate interquartile ranges of growth in each group.

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Vietnam). In Latin America, growth in Mexico is improving, reflecting positive spillovers from strong U.S. growth, which have been offsetting the uncertainties related to the renegotiation of NAFTA and upcoming elections.

Low-income countries

The economic recovery among low-income countries (LICs) is firming (Box 1.2). Among metals exporters, mining production is increasing, as new projects come onstream and investment in the expansion of existing mines continues, encouraged by the recovery in metals prices (e.g., Democratic Republic of Congo, Guinea). Oil

BOX 1.2 Low-income countries: Recent developments and outlook

Growth in low-income countries is expected to rise to 5.7 percent in 2018 and to an average of 6.1 percent in 2019-20, from 5.5 percent in 2017. This upswing reflects rising mineral production, spurred by higher oil and metals prices, improving agricultural output, and continued infrastructure investment. However, poverty headcounts are projected to decline only slightly. The main downside risks to the outlook are lower commodity prices, heightened policy uncertainty, and weak implementation of reforms.

Recent developments

Economic activity has strengthened in most low-income countries (LICs), helped by favorable external conditions (Figure 1.2.1).¹ Among metals exporters, mining production has risen, as new projects came on stream and investment in the expansion of existing mines continued, encouraged by higher metals prices (e.g., Democratic Republic of Congo, Guinea). Nevertheless, in some cases, high government debt levels are weighing on activity (e.g., Mozambique, Sierra Leone). Among non-resource-intensive countries, the economic pickup is supported by improving agricultural output following droughts and continuing infrastructure investment (e.g., Rwanda, Uganda). In some countries, rising household spending, helped by low inflation and recovering remittance flows, has underpinned the economic expansion, along with some improvement in political stability (e.g., The Gambia, Haiti). However, oil exporters (e.g., Chad) are struggling to emerge from recession as they continue to adjust to the sharp decline in oil revenues.

Poverty levels are high in most LICs. Nearly half of the population in LICs continues to live below the international poverty line—\$1.90 a day, at 2011 purchasing power parity (PPP) exchange rates. The proportion of the LICs' population below the poverty line is higher in Sub-Saharan Africa (SSA) than in other regions, reflecting the relatively slow decline in poverty levels among fragile countries and metals exporters in SSA (Beegle et al 2016).

Note: This box was prepared by Gerard Kambou. Research assistance was provided by Xinghao Gong.

¹ For the current 2018 fiscal year, low-income economies are defined as those with a gross national income (GNI) per capita, calculated using the World Bank Atlas method, of \$1,005 or less in 2016.

Current account deficits are widening in many countries. They are rising among metals exporters, reflecting the effects of a pickup in import-intensive mining investment. In non-resource-intensive countries, these deficits are expected to widen, as import growth remains strong due to high public investment levels. However, in oil exporters, the marked improvement in current account deficits in 2017 is expected to continue, helped by higher oil prices and subdued import growth due to soft domestic demand. Foreign reserve positions have gradually improved. However, in many countries, foreign reserves are well below the three-month-of-imports benchmark, indicating continued vulnerability to terms-of-trade shocks.

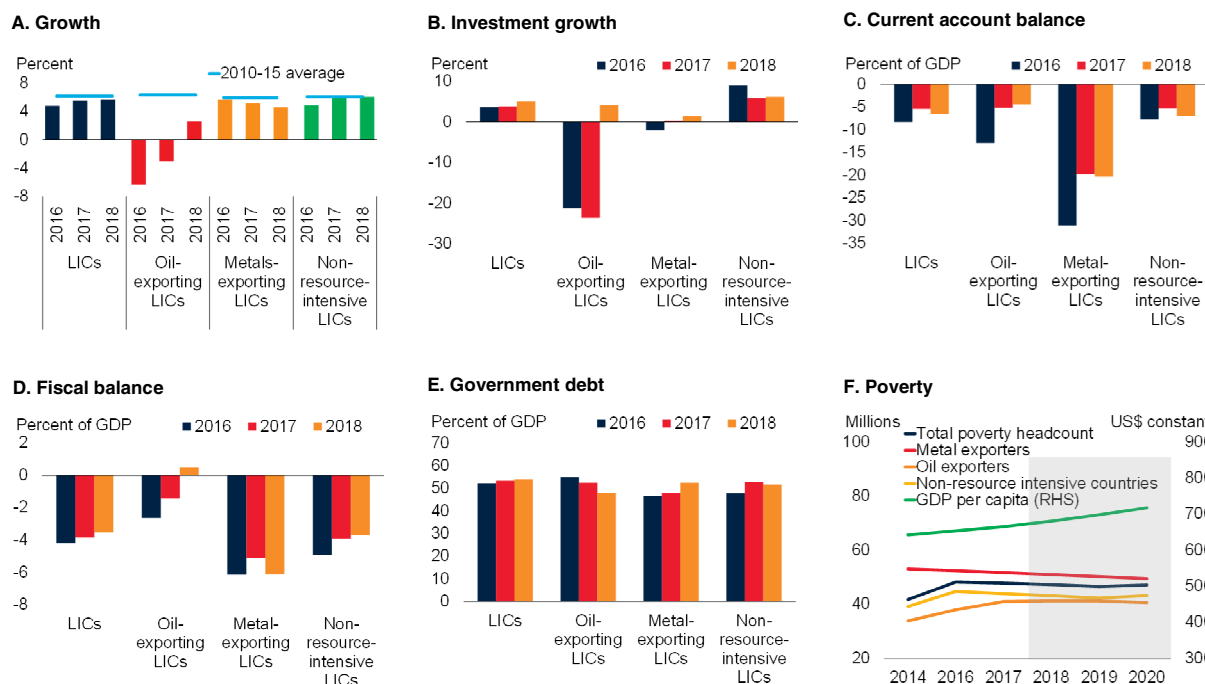
Exchange rates have been broadly stable in real effective terms, reflecting tight domestic policies in some countries. Remittances have also rebounded, following two years of decline (World Bank 2017b). Non-oil foreign direct investment flows have risen in some countries (e.g. Ethiopia, Guinea), and portfolio inflows have continued, led by sovereign bond issuances (e.g., Senegal). Inflation continues to fall across LICs, helped by declining food prices, prompting central banks in some countries to further cut interest rates (e.g., Mozambique, Uganda). However, inflationary pressures are high in several countries, owing to currency depreciations (e.g., Democratic Republic of Congo, Ethiopia, Liberia).

Fiscal deficits have gradually narrowed across LICs. The improvement reflects strong fiscal adjustment in some oil exporters (e.g., Chad), and an increase in domestic revenue among non-resource-intensive countries where commodity revenues account for a smaller share of total revenue. Fiscal deficits remain elevated among metals exporters, as governments struggle to raise revenue and control spending.

Debt levels are high and rising across a wide range of LICs, especially in SSA (IMF 2018). This is raising

BOX 1.2 Low-income countries: Recent developments and outlook (continued)**FIGURE 1.2.1 Recent developments in low-income countries**

The rebound in activity in low-income countries (LICs) has continued. Output and investment have picked up in oil and metals exporters, encouraged by higher commodity prices. Fiscal and current account deficits are narrowing among oil exporters, reflecting strong fiscal adjustment, but are rising among metals exporters due to high expenditure and import levels. In non-resource-intensive countries, rising domestic revenue is helping reduce fiscal deficits, but current account deficits are widening, as import demand remains strong. Debt burdens are high, especially among metals exporters. The poverty headcount is also high among metals exporters, reflecting persistently low per capita growth.



Sources: Haver Analytics, International Monetary Fund, World Bank.

Notes: LICs = low-income countries. Non-resource-intensive countries include agricultural-based economies and commodity importers.

A. GDP-weighted averages.

B-E. Median of country groups.

F. Based on the international poverty line of \$1.90 a day, at 2011 purchasing power parity (PPP) exchange rates. Shaded area indicates forecasts.

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concerns about debt sustainability in some countries (Devarajan 2018). Debt levels among metals exporters are increasing, reflecting previously undisclosed borrowing in Mozambique and low domestic revenue in other economies (e.g., Liberia, Sierra Leone). Although fiscal consolidation efforts are helping to stabilize debt levels among oil exporters, the debt burden remains high in some of them (e.g., Chad). A large part of Chad's debt is owed to commercial creditors. Debt levels among non-resource-intensive countries are also elevated (e.g., The Gambia), and continue to rise in some cases (e.g., Ethiopia). In The Gambia, the deteriora-

tion in the debt-to-GDP ratio partly reflects governance issues, including the weak management of state-owned enterprises. In Ethiopia, low public saving rates and high public investment are contributing to the increase in government debt. The high and rising debt levels point to the need for significant fiscal consolidation, as well as higher domestic revenue in a number of LICs.

Outlook

Growth in LICs is expected to pick up to 5.7 percent in 2018, and strengthen to an average of 6.1 percent in 2019-20, slightly below the level reached earlier in

BOX 1.2 Low-income countries: Recent developments and outlook (continued)

the decade (Figure 1.2.2). This upswing is predicated on firming commodity prices and policy actions to tackle macroeconomic imbalances. These forecasts are higher than in January, and reflect a stronger-than-expected recovery in some metals exporters, as higher metals prices help boost mining production. In metals exporters such as Mozambique, growth will remain subdued, reflecting the effects of rising debt levels on investor sentiment. The recovery in oil exporters will also be slower than previously envisioned, as the fiscal adjustment that is still needed to stabilize government debt is expected to weigh on growth.

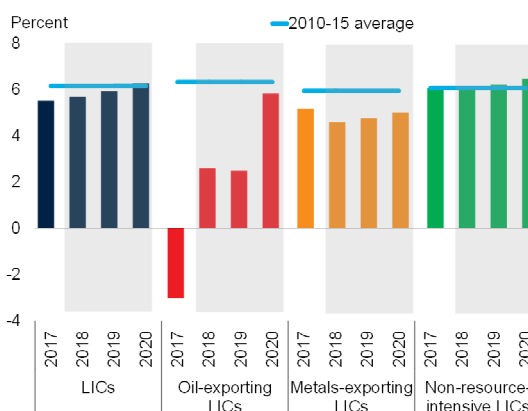
Growth among non-resource-intensive countries is expected to remain robust, supported by increasing agricultural production, high public investment levels, and rising remittance flows, with the larger economies expanding at a faster pace. Although growth in Ethiopia—the largest LIC—is projected to soften as policy tightens to contain inflationary pressures, it will remain high. In some smaller economies (e.g., The Gambia, Haiti), improved political stability will allow for a modest pickup in activity, as opportunities for reforms boost investor sentiment; however, in fragile countries, security concerns will continue to weigh on investment (e.g., Afghanistan, Burundi). In Malawi, growth is expected to be lower than anticipated, reflecting the adverse effects of a dry spell and the spread of the fall armyworm—a pervasive agricultural pest—on food production.

Per capita GDP growth is projected to rise from 1.6 percent in 2017 to 2.3 percent in 2018, and to an average of 2.5 percent in 2019–20. Nonetheless, the effect on poverty alleviation seems likely to be subdued. The poverty headcount among LICs is projected to decrease only modestly, and decline most slowly among fragile countries and metals exporters in SSA. Higher population growth is worsening the poverty headcount. Furthermore, growth for a significant proportion of LICs in SSA centers around capital-intensive sectors, which contribute less to poverty reduction (Bhorat and

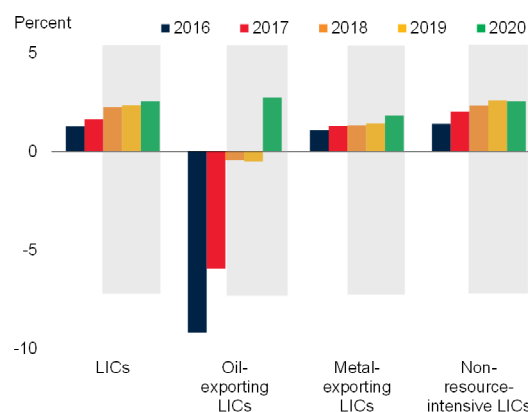
FIGURE 1.2.2 Outlook

The ongoing recovery in LICs is expected to pick up further this year and firm in 2019–20, reflecting a gradual rebound among oil and metals exporters and continued robust growth in non-resource-intensive countries. However, per capita income growth will recover only slowly among oil exporters and remain modest among metals exporters.

A. GDP growth forecasts



B. Per capita GDP growth



Source: World Bank.

Note: Shaded area indicates forecasts.

A. GDP-weighted averages.

B. Median of country groups. Non-resource-intensive countries include agricultural exporters and commodity importers.

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Tarp 2016). These structural constraints will prevent faster poverty reduction unless structural reforms are introduced to increase productivity and support economic diversification (Chapter 1).

BOX 1.2 Low-income countries: Recent developments and outlook (continued)**TABLE 1.2.1 Low-income country forecasts^a**

(Real GDP growth at market prices in percent, unless indicated otherwise)

Percentage point differences from
January 2018 projections

| | 2015 | 2016 | 2017e | 2018f | 2019f | 2020f | 2018f | 2019f | 2020f |
|--|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Low Income Country, GDP^b | 4.9 | 4.8 | 5.5 | 5.7 | 5.9 | 6.3 | 0.3 | 0.4 | 0.6 |
| Afghanistan | 1.3 | 2.4 | 2.6 | 2.2 | 2.5 | 3.3 | -1.2 | -0.6 | 0.2 |
| Benin | 2.1 | 4.0 | 5.6 | 6.0 | 6.1 | 6.3 | 0.0 | -0.2 | -0.4 |
| Burkina Faso | 3.9 | 5.9 | 6.4 | 6.0 | 6.0 | 6.0 | 0.0 | 0.0 | 0.0 |
| Burundi | -3.9 | -0.6 | 0.5 | 1.9 | 2.3 | 2.5 | 0.4 | -0.2 | 0.0 |
| Chad | 2.8 | -6.3 | -3.0 | 2.6 | 2.5 | 5.8 | -1.1 | -0.4 | -1.0 |
| Comoros | 1.0 | 2.4 | 2.5 | 2.9 | 3.0 | 3.0 | 0.2 | 0.1 | 0.1 |
| Congo, Dem. Rep. | 6.9 | 2.4 | 3.4 | 3.8 | 4.1 | 4.4 | 0.8 | 0.8 | 1.1 |
| Ethiopia ^c | 10.4 | 7.6 | 10.3 | 9.6 | 9.7 | 9.9 | 1.4 | 1.9 | 2.1 |
| Gambia, The | 4.3 | 2.2 | 3.5 | 5.4 | 5.2 | 4.9 | 1.9 | 1.0 | 0.7 |
| Guinea | 3.8 | 10.5 | 8.2 | 6.0 | 5.9 | 6.0 | 0.2 | 0.0 | 0.1 |
| Guinea-Bissau | 6.1 | 5.8 | 5.7 | 5.1 | 5.2 | 5.4 | -0.1 | -0.2 | 0.0 |
| Haiti ^c | 1.2 | 1.5 | 1.2 | 1.8 | 2.4 | 2.4 | -0.4 | -0.1 | -0.1 |
| Liberia | 0.0 | -1.6 | 2.5 | 3.2 | 4.7 | 4.8 | -0.7 | -0.3 | -1.2 |
| Madagascar | 3.1 | 4.2 | 4.1 | 5.1 | 5.6 | 5.3 | 0.0 | 0.0 | -0.1 |
| Malawi | 2.8 | 2.5 | 4.0 | 3.7 | 4.1 | 4.9 | -1.3 | -1.3 | -0.5 |
| Mali | 6.0 | 5.8 | 5.3 | 5.0 | 4.7 | 4.7 | 0.0 | 0.0 | 0.0 |
| Mozambique | 6.6 | 3.8 | 3.7 | 3.3 | 3.4 | 3.6 | 0.1 | 0.0 | 0.2 |
| Nepal ^c | 3.3 | 0.6 | 7.9 | 6.3 | 4.5 | 4.2 | 1.7 | 0.0 | -0.3 |
| Niger | 4.0 | 5.0 | 5.2 | 5.3 | 5.4 | 5.8 | 0.1 | 0.0 | 0.2 |
| Rwanda | 8.8 | 6.0 | 6.1 | 6.8 | 7.1 | 7.5 | 0.9 | 0.3 | 0.7 |
| Senegal | 6.5 | 6.7 | 6.8 | 6.8 | 6.8 | 7.0 | -0.1 | -0.2 | 0.0 |
| Sierra Leone | -20.5 | 6.3 | 4.3 | 5.1 | 5.7 | 6.5 | -1.2 | -1.0 | -0.2 |
| Tanzania | 7.0 | 7.0 | 6.4 | 6.6 | 6.8 | 7.0 | -0.2 | -0.1 | 0.1 |
| Togo | 5.3 | 5.0 | 4.4 | 4.8 | 5.0 | 5.0 | -0.5 | -0.4 | -0.4 |
| Uganda ^c | 5.2 | 4.7 | 4.0 | 5.5 | 6.0 | 6.5 | 0.4 | 0.3 | 0.5 |
| Zimbabwe | 1.7 | 0.6 | 3.4 | 2.7 | 3.8 | 4.0 | 1.8 | 3.6 | 3.8 |

Source: World Bank.

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.

a. Central African Rep., Democratic People's Republic of Korea, and Somalia are not forecast due to data limitations.

b. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

c. GDP growth based on fiscal year data. For Nepal, the year 2017 refers to FY2016/17.

For additional information, please see www.worldbank.org/gep.**Risks**

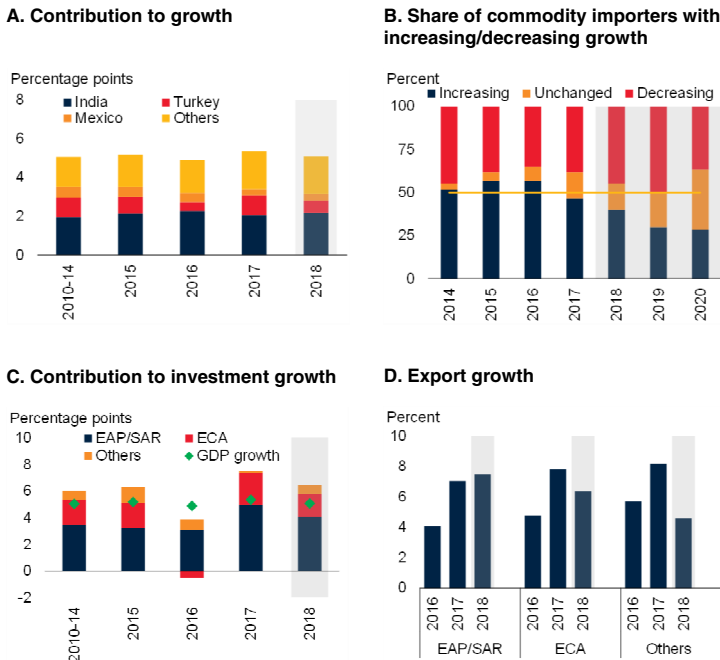
Risks to the outlook remain tilted to the downside. On the external front, a large drop in commodity prices could have a significant impact on sentiment toward LICs, given that many of these countries depend on extractive industries. A collapse in oil and metals prices would also severely undermine efforts at fiscal consolidation and to rein in the public debt burden, and crowd out poverty-reducing expenditures.

On the domestic front, while political uncertainty has declined in some LICs, it remains a key risk for growth and reform momentum. For example, in Ethiopia, political tensions could intensify following the reimposition of the state of emergency. Risks to

debt sustainability are also high in some LICs. Inadequate fiscal adjustment or large currency depreciation could lead to an increase in the cost of servicing external debt. Based on the LIC debt sustainability framework, The Gambia and Ethiopia are deemed to be facing high risk of debt distress. Chad and Mozambique were rated as in debt distress by end-2017. In addition, most LICs remain highly vulnerable to weather-related shocks, and a return of drought conditions could severely disrupt ongoing recoveries. The Ebola outbreak in the Democratic Republic of Congo could slow economic activity in the country and the sub-region, if it spreads faster than anticipated to major urban centers and to neighboring countries.

FIGURE 1.13 Activity in EMDE commodity importers, excluding China

Growth in commodity importers excluding China remains solid but is moderating somewhat this year, partly due to capacity constraints. Investment growth continues to be robust, particularly in EMDE commodity importers in Europe and Asia. Export growth has generally been strong this year, albeit to varying degrees.



Source: World Bank.

A.-D. Shaded areas indicate forecasts. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights.

A.C.D. Others refer to other commodity-importing EMDEs, excluding China.

B. Sample includes 60 commodity-importing EMDEs. Increasing/decreasing growth are changes of at least 0.1 percentage point from the previous year. Countries with a slower pace of contraction from one year to the next are included in the increasing growth category.

C.D. EAP = East Asia and Pacific, excluding China; SAR = South Asia; ECA = Europe and Central Asia.

C. Investment refers to fixed asset investment.

D. Data refer to trade volume of goods and non-factor services.

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exporters (e.g., Chad) are slowly emerging from recession, helped by rising oil prices. In non-resource-intensive countries, the pickup in economic activity is being supported by improving harvests following droughts (e.g., Rwanda, Uganda), infrastructure investment (e.g., Benin, Senegal), and consumer spending as inflation moderates and remittances recover (e.g., The Gambia, Haiti). However, debt burdens are high and rising in a number of LICs, reflecting a mix of factors including the disclosure of previously unreported debt (e.g., Mozambique), governance issues (e.g., The Gambia), the earlier plunge in oil prices (e.g., Chad), and low public saving (e.g.,

Ethiopia). Poverty levels are elevated, especially among LICs in Sub-Saharan Africa, where nearly half of the population lives below the poverty line.

EMDE outlook

Growth outlook

EMDE growth is expected to accelerate from 4.3 percent in 2017 to 4.5 percent in 2018 and stabilize at 4.7 percent in both 2019 and 2020, reflecting a continued, but maturing, cyclical recovery in commodity exporters (Figure 1.14). In the near term, the positive spillovers of U.S. fiscal stimulus on EMDE activity are assumed to be offset by a faster pace of U.S. monetary policy normalization, which contributes to higher borrowing costs and a moderation in EMDE capital flows. Toward the end of the forecast horizon, the projected slowdown in advanced-economy growth toward potential rates is expected to put a lid on further acceleration in EMDE growth.

As global financing conditions continue to tighten, the cyclical rebound in investment in EMDEs, especially among commodity exporters, is projected to moderate in 2019-20. Moreover, the ongoing monetary policy easing in commodity exporters is expected to gradually end, while fiscal consolidation will continue, particularly in many oil-exporting economies. Policies in commodity importers are expected to tighten, as capacity constraints become more binding and price pressures accelerate amid higher energy prices.

Growth in commodity exporters is projected to plateau toward the end of the forecast horizon. After reaching 2.5 percent in 2018—the highest pace since 2013—it is projected to strengthen only slightly and stabilize at an average of 3 percent in 2019 and 2020, as output gaps close and labor market slack gradually diminishes. By the end of the projection period, only about half of commodity exporters are expected to grow at or above their pre-crisis long-term averages. Forecasts were adjusted slightly down from January, as an upward revision to a number of large commodity exporters (e.g., Angola, Brazil, Kazakhstan, South Africa) was more than offset by a downgrade in

some other economies (e.g., Argentina, Nigeria, Venezuela). This overall outlook of a maturing cyclical recovery is also reflected in forecasts for EMDE regions with a substantial number of commodity exporters (Box 1.3; Chapter 2).

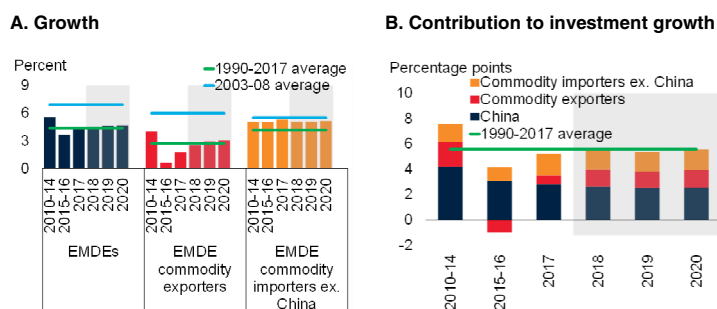
Growth in commodity importers is expected to decelerate to 5.8 percent in 2018 and edge further down to 5.7 percent by 2020, broadly in line with its potential rate. A structural slowdown in China is expected to be partly offset by a moderate pickup in other large economies, including India and Mexico. In commodity importers excluding China, an upgrade to growth projections in 2018 reflects an upward revision to forecasts for some large economies (e.g., Egypt, Mexico, Poland, Thailand).

Growth in low-income countries is projected to pick up to 5.7 percent in 2018, and stabilize at about 6.1 percent on average in 2019-20, slightly below the level reached earlier in the decade (Box 1.2). These forecasts are higher than in January, reflecting a stronger pickup in some metals exporters as higher metals prices help boost mining production. Growth in non-resource-intensive countries is projected to remain solid, supported by increasing agricultural production, infrastructure investment, and a rebound in remittances, with the larger economies expanding at a faster pace. In some fragile countries (e.g., The Gambia, Zimbabwe), political transitions will allow for a pickup in activity, as opportunities for reforms boost investor sentiment. However, the recovery will be slower than previously anticipated among oil exporters, as they continue to adjust to low oil revenue and the heavy burden of external commercial debt.

Despite the projected firming of activity in EMDEs in the near term, underlying potential growth—which has fallen considerably over the past decade—appears likely to decline further over the long term, reflecting earlier investment weakness, softening productivity, and increasingly adverse demographic patterns. Trends in these fundamental drivers of long-term growth suggest that EMDE potential growth could decrease by 0.5 percentage point on average over 2018-27. Notwithstanding its recent turnaround, investment growth in many EMDEs is still modest

FIGURE 1.14 EMDE growth prospects

The recovery in EMDE growth is projected to mature during the forecast horizon, as negative output gaps in commodity exporters gradually narrow and investment growth stabilizes.



Source: World Bank.

A.B. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Shaded area indicates forecasts.

B. Investment refers to fixed asset investment.

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compared to its long-term average and will not be sufficient to offset headwinds to potential growth. Furthermore, tightening global financing conditions, higher borrowing costs, moderating capital flows, and lingering policy uncertainty may hamper investment growth in the coming years, further constraining potential growth (World Bank 2018a).

Outlook for per capita income and poverty

Current near-term growth prospects are encouraging but may not be sufficient to ensure continued progress toward global poverty alleviation (World Bank 2016). Countries that are home to most of the world's poor are expected to grow at a faster clip than other EMDEs. However, their population growth is also generally higher, implying that per capita prospects in those countries are still modest, particularly where extreme poverty is more prevalent (Figure 1.15). That said, significant disparities exist between the outlooks for the two regions comprising more than 80 percent of the world's extreme poor: South Asia and Sub-Saharan Africa. In South Asia, GDP per capita growth remains significantly above EMDE averages and will likely help a further reduction in poverty rates in coming years. In Sub-Saharan Africa, per capita income growth in countries with high poverty headcounts will remain modest, complicating efforts to reduce

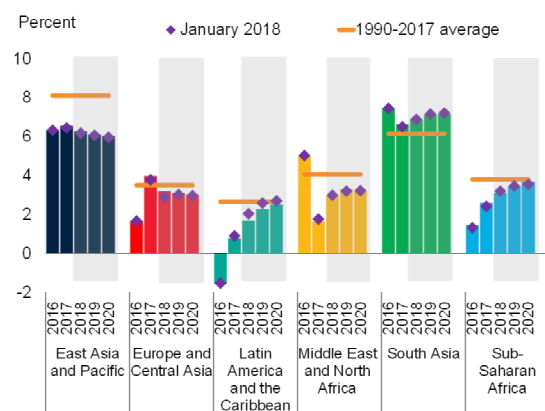
BOX 1.3 Regional perspectives: Recent developments and outlook

The ongoing cyclical recovery in most EMDE regions with a substantial number of commodity exporters is projected to continue in 2018. Thereafter, the upturn in these regions is expected to mature, as commodity prices plateau. Robust activity in EMDE regions with large numbers of commodity importers is forecast to continue. Risks to the growth outlook continue to tilt to the downside.

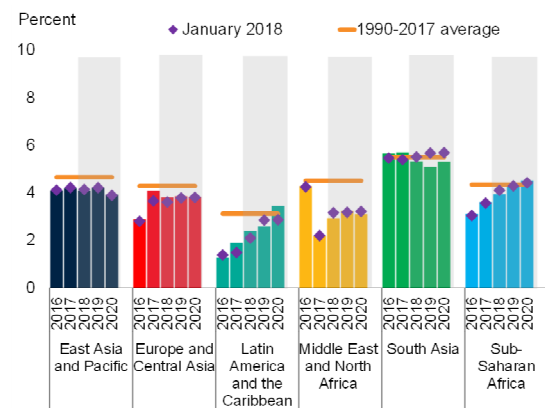
FIGURE 1.3.1 Regional growth

The ongoing cyclical recovery in most EMDE regions with a substantial number of commodity exporters is projected to continue in 2018, but mature thereafter as commodity prices level off. Robust growth in EMDE regions with large numbers of commodity importers is projected to continue. Risks to the growth outlook continue to tilt down.

A. Regional growth, weighted average



B. Regional growth, unweighted average



Source: World Bank.

A.B. Averages for 1990-2017 are constructed depending on data availability. For Europe and Central Asia, the long-term average uses data for 1995-2017 to exclude the immediate aftermath of the collapse of the Soviet Union.

A. Bars denote latest forecast; diamonds correspond to January 2018 *Global Economic Prospects* forecasts. Since the largest economies account for about 50 percent of GDP in some regions, weighted averages predominantly reflect the development in the largest economies in each region.

B. Unweighted average regional growth is used to ensure broad reflection of regional trends across all countries in the region.

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East Asia and Pacific. Growth in the region is projected to moderate to 6.3 percent in 2018, and to 6.1 percent on average in 2019-20. The structural slowdown in China will slightly offset a modest further pickup in the rest of the region. While upside surprises to global activity could lead to stronger-than-expected regional growth, risks to the regional forecast are tilted to the downside. They include the possibility of an abrupt tightening of global financing conditions and intensified trade restrictions. Highly leveraged economies and countries with large or rapidly rising fiscal deficits are particularly vulnerable to disruptions in real and financial activity.

Europe and Central Asia. Regional growth is anticipated to ease to 3.2 percent in 2018, as idiosyncratic factors supporting the recovery in some of the largest regional economies fade. Growth is expected to decline to 3 percent by 2020, as activity moderates in commodity importers amid increasing capacity constraints and less accommodative fiscal and monetary policies. Downside risks include the possibility of a disorderly tightening of financing conditions, lower-than-projected oil prices, and heightened policy uncertainty. If stronger-than-expected demand from advanced economies were to materialize, it would benefit trading partners in the region.

Latin America and the Caribbean. The modest regional recovery is projected to continue, with growth anticipated to rise to 1.7 percent in 2018 and average 2.4 percent in 2019-20. In the near term, the pickup will be supported by a cyclical recovery in Brazil and improving conditions in Chile, Colombia, Mexico, and Peru. Regional

Note: This box was prepared by Carlos Arteta with contributions from Gerard Kambou, Yoki Okawa, Temel Taskin, Ekaterine Vashakmadze, Dana Vorisek, and Lei Ye. Research assistance was provided by Jinxin Wu.

BOX 1.3 Regional perspectives: Recent developments and outlook (concluded)

growth through 2020 will mainly reflect firming private consumption and investment. Downside risks are significant, however, including negative spillovers from a possible abrupt tightening of financing conditions or shift in investor sentiment regarding EMDEs, a breakdown in NAFTA negotiations or a rise in U.S. trade protectionism, escalation of domestic policy uncertainty, and disruptions from natural disasters. Larger-than-expected spillovers from the U.S. fiscal stimulus could result in stronger regional growth.

Middle East and North Africa. Growth in the region is expected to rebound from last year—when it decelerated to 1.6 percent due to oil production cuts and fiscal adjustments among oil exporters—and reach 3 percent in 2018. Activity among oil exporters is picking up in response to an easing of fiscal stances and momentum from the non-oil sector, while oil importers continue to benefit from improved competitiveness and foreign-investor confidence. Regional growth is projected to accelerate to an average of 3.3 percent in 2019-20, as domestic demand and exports further improve in both oil exporters and importers. The key downside risks are geopolitical tensions, renewed volatility in oil prices, and slower-than-expected pace of reforms. Rapid reconstruction progress in war-torn areas represents an important upside risk.

South Asia. Growth in the region is projected to accelerate to 6.9 percent in 2018, mainly reflecting strengthening domestic demand in India as temporary policy-driven disruptions fade. Elsewhere in the region, ongoing recoveries in Bangladesh,

Pakistan, and Sri Lanka are expected to be accompanied by moderating activity in Afghanistan, Bhutan, and Maldives. Over the medium term, growth is expected to remain strong and reach 7.2 percent by 2020 amid robust domestic demand. Downside risks continue to predominate. They include the possibility of fiscal slippages, delays in reforms to resolve financial vulnerabilities and improve the health of regional banking systems, and a faster-than-expected tightening in global financing conditions. Stronger-than-envisioned global growth could result in better regional growth outcomes.

Sub-Saharan Africa. Regional growth is projected to accelerate to 3.1 percent in 2018. This upswing reflects rising oil and metals production, encouraged by a recovery in commodity prices, and improving agricultural production following droughts. A rebound in consumer spending amid declining inflation and an increase in investment also underpin the pickup. Growth is expected to firm to an average of 3.6 percent in 2019-20, as the recovery strengthens in Angola, Nigeria, and South Africa—the region's largest economies. However, growth will remain below its long-term average and insufficient to substantially reduce poverty. Public debt levels are high and rising, and debt servicing costs will absorb a large share of government revenue in some countries. The main downside risks include a faster tightening of global financing conditions, lower-than-expected commodity prices, heightened conflicts, and weak implementation of reforms. Renewed growth momentum in advanced economies could provide positive spillovers to the region.

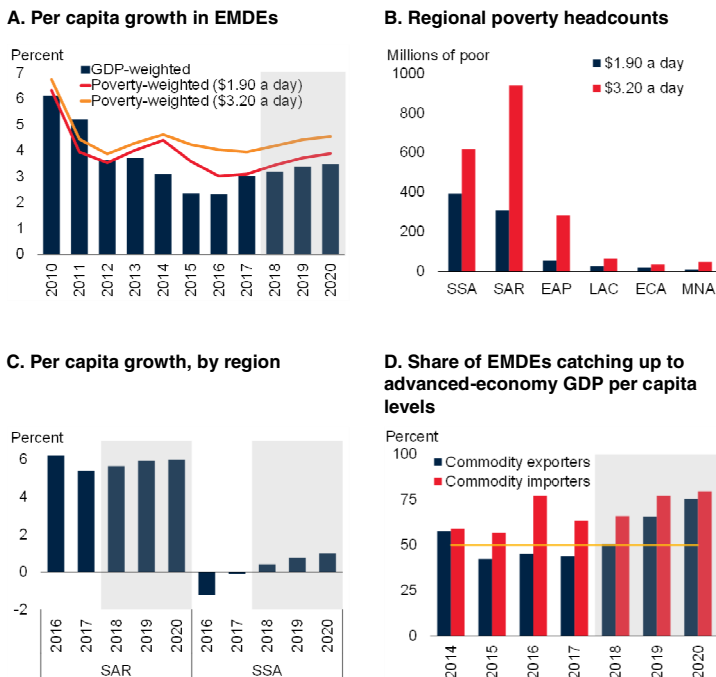
poverty rates. Per capita GDP growth is expected to stagnate among many oil and metals exporters in the region, where poverty headcounts are already high.

More generally, per capita income growth in commodity-exporting EMDEs, which has been weak in recent years, is expected to recover

modestly throughout the forecast horizon. Nevertheless, it will remain appreciably below that of commodity importers. Per capita income growth will be particularly weak in a number of oil exporters. At the projected pace, growth will be insufficient to restart the catch-up of income per capita with advanced economies in about one-third of EMDEs.

FIGURE 1.15 Per capita growth and poverty in EMDEs

Countries with the largest number of poor are expected to grow at a somewhat faster clip in 2018-20; however, per capita growth in Sub-Saharan Africa is projected to remain subdued, despite some recovery. In about one-third of EMDEs, income per capita growth will be insufficient in coming years to restart a catch-up process with advanced economies.



Source: World Bank.

A.C.D. Shaded areas indicate forecasts.

B.C. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

A. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. The poverty-weighted estimate of the per capita GDP growth excludes countries for which poverty head counts were not available.

B. Blue bars indicate the number of people living on or below the international poverty line of \$1.90 per day, red bars are the number of people living on or below the lower-middle income poverty line of \$3.20 per day. Data as of 2016.

D. EMDEs with per capita GDP growth of at least 0.1 percentage point higher than advanced-economy per capita GDP growth are those counted as converging. Advanced-economy growth rates calculated using constant 2010 U.S. dollar GDP weights. Sample includes 73 EMDE commodity exporters and 44 EMDE commodity importers.

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Risks to the outlook

Risks to the outlook remain tilted to the downside. They include the possibility of disruptive financial market developments and escalating trade protectionism amid elevated policy uncertainty. If a combination of downside risks were to materialize, it could trigger a sharper-than-expected slowdown in global growth, with particularly negative effects for countries with depleted policy buffers and sizable vulnerabilities. There is also the possibility that growth in major economies may surprise on the upside, with positive spillovers to trading partners.

Baseline forecasts point to global growth at 3.1 percent this year, helped by still-solid growth in advanced economies, robust activity in Asia, and a cyclical recovery in commodity-exporting EMDEs. However, with growth currently surpassing its estimated potential, world economic activity is expected to moderate in 2019 and 2020, as major central banks remove post-crisis accommodation, global capacity constraints become more binding, China's structural slowdown continues, and the upturn in commodity exporters levels off. With the rise of global interest rates, debt service costs will increase in both advanced economies and EMDEs. Shifting policies in major economies will have a significant bearing on the outlook and risks for global growth.

Risks to the outlook are tilted to the downside, with some becoming more acute (Figure 1.16). Following a prolonged period of exceptionally low interest rates and elevated asset prices, financial market risks have increased. A sudden tightening of global financing conditions could be triggered by a reassessment of inflation risks; by shifting expectations about monetary policies across major advanced economies; or by increased concerns about credit risks, including in EMDEs. The impact could be particularly severe in an environment where debt levels have reached record highs, refinancing needs are mounting, and credit quality has deteriorated in a number of EMDEs. An escalation of trade restrictions among major economies is also a major threat to the outlook, as it could derail the recovery in global trade and dampen confidence and investment worldwide. Heightened policy uncertainty and rising geopolitical tensions could also buffer activity. The materialization of these downside risks could lead to a sharper-than-expected global slowdown. This could represent a significant hurdle for many countries, especially for those that have not rebuilt fiscal buffers.

That said, the possibility of a stronger or longer-lasting upturn in major economies cannot be ruled out. This could lead to larger-than-expected cross-border spillovers in the near term, as well as improved supply-side conditions over the medium term.

A quantification of uncertainty around the global growth outlook suggests a wide range of possible outcomes, while confirming the predominance of downside risks (Ohnsorge, Stocker, and Some 2016). At current market conditions, the probability of global growth being more than 1 percentage point below baseline in 2019 is estimated at 21 percent, while that of growth being more than 1 percentage point above baseline is 16 percent. That range has widened from a year ago, reflecting increased uncertainty embedded in the distribution of key risk factors, particularly equity and oil price futures.

Disorderly tightening of financing conditions

The risk of an abrupt tightening of global financing conditions and associated financing stress has increased in 2018, reflecting a possible reassessment of inflation risks amid shifting market expectations of advanced-economy monetary policy, stretched asset valuations, and the possibility of further U.S. dollar appreciation. Such developments could have particularly severe consequences for more indebted EMDEs facing substantial refinancing needs in coming years. A sudden rise in borrowing costs could be triggered by a convergence of factors.

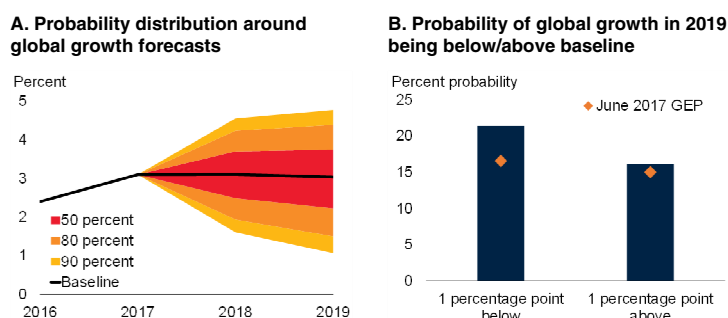
Inflation risks

Market participants currently ascribe a low probability of a rapid acceleration in inflation in major advanced economies. This follows a prolonged period of undershooting of central banks' inflation targets, and reflects the view that technological changes and globalization could keep inflation persistently low (Autor and Dorn 2013; Eickmeier and Kühnlenz 2013; Elsby, Hobijn, and Şahin 2013). However, a number of factors could contribute to a more pronounced increase in inflation than currently predicted.

First, a period of persistently low unemployment and increased labor market churning could reinforce workers' bargaining power, potentially leading to faster wage growth (Danninger 2016; Davis and Haltiwanger 2014). At comparable unemployment rates, wage growth in advanced economies during the previous business cycle was

FIGURE 1.16 Risks: Tilted to the downside

Global growth is expected to remain solid in the near term. However, uncertainty is elevated and downside risks have increased.



Sources: Bloomberg, World Bank.

A.B. The fan chart shows the forecast distribution of global growth using time-varying estimates of the standard deviation and skewness extracted from the forecast distribution of three underlying risk factors (oil price futures, the S&P 500 equity price futures, and term spread forecasts). Each of the risk factor's weight is derived from the model described in Ohnsorge, Stocker, and Some (2016). Values for 2018 are computed from the forecast distribution of 6-month-ahead oil price futures, S&P 500 equity price futures, and term spread forecasts. Values for 2019 are based on 18-month-ahead forecast distributions. Last observation is May 2018.

B. Bars show the probability that global growth is 1-percentage-point above or below baseline forecasts 18 months ahead.

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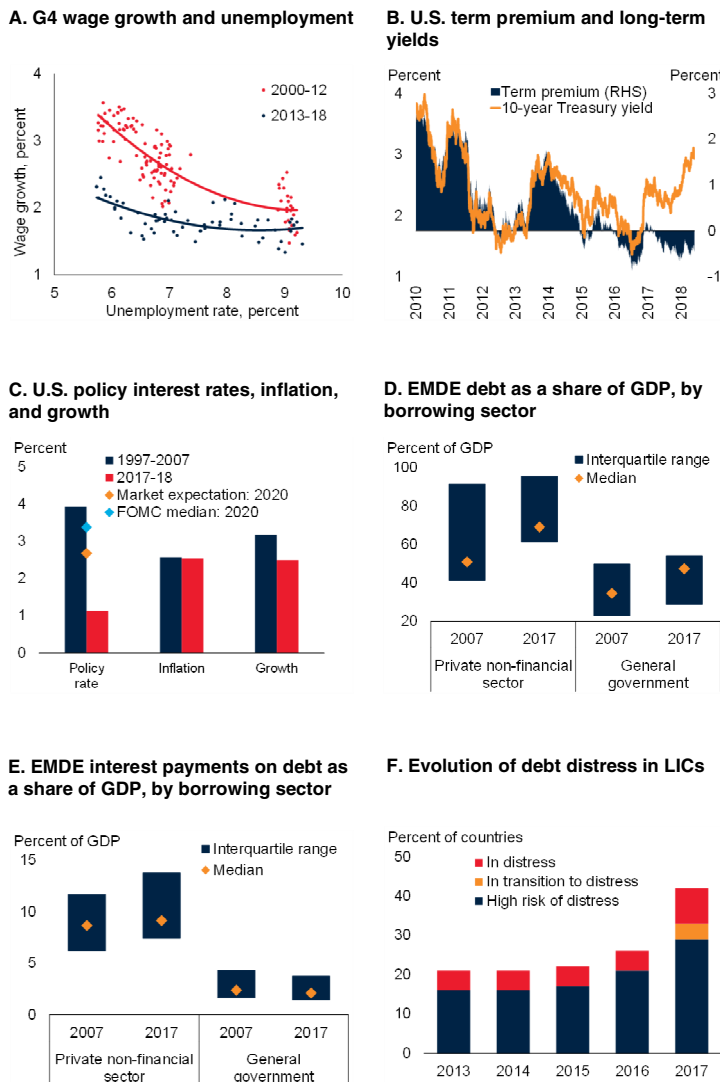
considerably higher (Figure 1.17). If not matched by similar increases in productivity growth, a faster-than-expected recovery in wage growth could lead to an increase in current and future expected inflation. Second, U.S. fiscal stimulus will provide a boost to growth in an economy already operating close to full employment, increasing the risk of overheating. Third, the global output gap is expected to disappear this year, with potentially far-reaching implications for inflation dynamics in traded goods (World Bank 2018a). A reassessment of inflation risks could contribute to a sudden rise in term premiums from current exceptionally low levels, which would push up long-term yields and generate substantial volatility in U.S. and global bond markets.

Monetary policy uncertainty

Changes in market expectations about interest rate and balance sheet policies of major central banks could trigger financial stress. Several factors make financial markets particularly vulnerable to such a reassessment. Policy interest rates in the United States remain well below neutral levels, and market and policymaker expectations about their

FIGURE 1.17 Downside risks: Financial stress

A sudden reassessment of the pace of wage growth in advanced economies could contribute to a jump in long-term yields, particularly in the United States, where term premiums are negative and policy interest rates are increasing. EMDEs remain susceptible to such risks, with both private and public debt levels considerably higher than in the pre-crisis period. Debt in low-income countries has been trending up, as has the number of countries at risk of debt distress.



Sources: Adrian, Crump, and Moench (2013); Bank for International Settlements; Bloomberg; Federal Reserve Bank of St. Louis; Haver Analytics; International Monetary Fund; World Bank.

A. The G4 includes the Euro Area, Japan, the United Kingdom, and the United States. Last observation is March 2018.

B. Term premium estimates from the term structure model of Adrian, Crump, and Moench (2013). Last observation is May 25, 2018.

C. Figure shows period averages. Policy rate refers to the effective federal funds rate. Last observation is April 2018.

D. Debt is defined as loans and debt securities. Sample includes 16 EMDEs.

E. Interest payments include interest paid on loans and debt securities. Sample includes 12 EMDEs.

F. Figure shows the percent of low-income and developing countries eligible to access the IMF's concessional lending facilities that are either at risk of, or in, debt distress. The sample represents a larger group of countries than that defined in Table 1.2.1 as low-income by the World Bank.

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outlook still diverge. In addition, strong foreign demand for U.S. Treasuries has played a major role compressing U.S. long-term interest rates, partially offsetting the impact of a faster pace of U.S. interest rate hikes. Unlike the bond market “conundrum” in 2005-06, when rising demand from foreign official institutions had a similar dampening effect, the recent increase in demand was mostly driven by foreign private investors (Cœuré 2018). These inflows have been encouraged by continued aggressive monetary policy easing in the Euro Area and Japan, contributing to a growing gap between U.S. Treasury and comparable sovereign bond yields in those jurisdictions—and, during 2018, to a renewed appreciation of the U.S. dollar. Shifting expectations about advanced-economy monetary policy could lead to sudden portfolio adjustments, faster-than-expected increases in global interest rates, or disorderly exchange rate developments.

Stretched asset price valuations

A prolonged period of very low interest rates has encouraged risk-taking in financial markets and rising asset price valuations (Lian, Ma, and Wang 2017). Elevated asset prices make global financial markets more prone to sudden adjustments and bouts of volatility (BIS 2017). The equity price-to-earnings ratio is historically high in the United States, while corporate bond spreads in both advanced economies and EMDEs remain significantly below pre-crisis averages. A correction in asset valuations could weaken growth prospects through tighter financing conditions, lower confidence, and negative wealth effects (Bluedorn, Decressin, and Terrones 2013).

EMDE vulnerabilities

EMDEs remain vulnerable to risks of sudden market adjustments and tighter global financing conditions, which could be amplified by further U.S. dollar appreciation, triggering disorderly exchange rate developments. Credit growth has slowed in most countries but corporate sector vulnerabilities remain elevated, and both private and public debt levels are considerably higher than in the pre-crisis period. Rising borrowing costs could substantially increase the burden of debt

servicing, which was compressed in recent years by low global interest rates and risk premiums. In turn, rising debt service costs could weaken investment and lower medium-term growth (Special Focus 2; Borensztein and Ye forthcoming; Drehmann, Juselius, and Korinek 2017; Jordà, Schularick, and Taylor 2013; Lombardi, Mohanty, and Shim 2017). A reversal in capital inflows and sharp currency depreciations could also increase default risks and raise financial stability concerns among economies with external vulnerabilities. EMDE debt denominated in U.S. dollars remains elevated in many countries and increased in 2017 amid favorable borrowing conditions.

Large current account deficits, elevated short-term external debt, and reliance on portfolio flows render some countries particularly vulnerable to rollover risk and sudden stops in capital flows. In some oil-importing EMDEs, rising oil prices could further exacerbate current account deficits and associated fragilities. The transmission of global financial shocks can be amplified in EMDEs with pegged exchange rate regimes compared with countries with flexible ones (Obstfeld, Ostry, and Qureshi 2018).

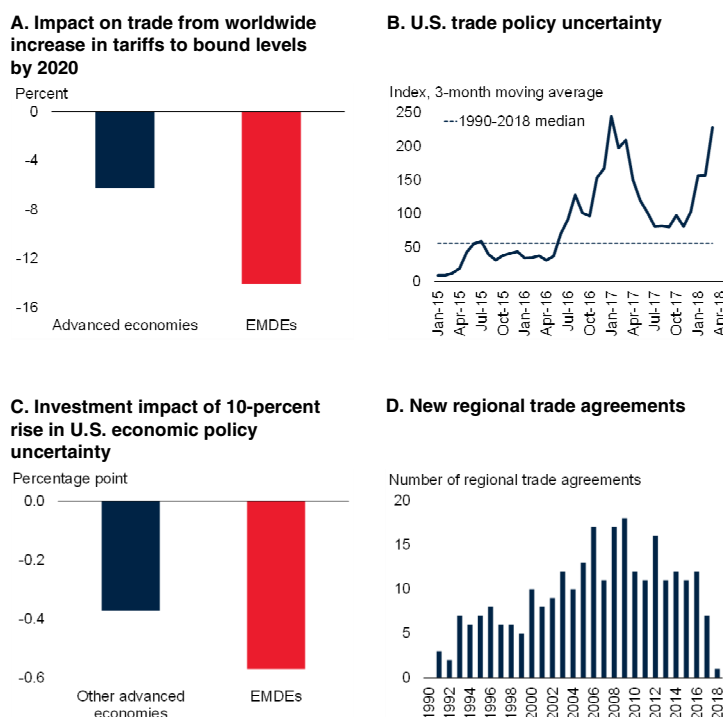
Public debt burdens and vulnerabilities continue to rise across low-income countries (LICs). More than 40 percent of LICs are in debt distress or at high risk of debt distress—more than twice the share in 2013 (IMF 2018; World Bank 2018e). In these countries, the increase in public debt levels has been accompanied by a substantial change in creditor composition and debt instruments. Increased reliance on commercial loans with shorter maturities has exposed debtor countries to currency, interest rate, and refinancing risks (Devarajan 2018; Gill and Karakulah 2018). Debt vulnerabilities among LICs could become more acute in the absence of measures to increase domestic revenue mobilization, rationalize public spending, and boost growth.

Escalating trade protectionism

The risk of escalating trade restrictions has substantially intensified amid ongoing trade disputes between the United States and major trading partners. A broad-based increase in tariffs

FIGURE 1.18 Downside risks: Trade protectionism

An escalation of tariffs up to legally-allowed limits could have large negative effects on trade, particularly in EMDEs. Even the threat of shifting trade policies, particularly in the United States, could have negative effects on EMDE investment. The drive toward trade liberalization has slowed, with the number of new trade agreements falling to an 18-year low in 2017.



Sources: Baker, Bloom, and Davis (2016); Bloomberg; Haver Analytics; Kutlina-Dimitrova and Lakatos (2017); World Bank; World Trade Organization.

A. Bars denote the percent deviation from baseline in 2020. Data are calculated from simulations using the GDyn computable general equilibrium model (Ianchovichina and McDougall 2000; Ianchovichina and Walmsley 2012). Trade-weighted aggregates include 36 advanced economies and 71 EMDEs.

B. Dashed horizontal line reflects the historical median from January 1990 to March 2018. Trade policy-related uncertainty in the United States is based on an index presented in Baker, Bloom, and Davis (2016), and computes the frequency of articles in domestic newspapers mentioning terms related to trade policy (e.g., import tariffs, import barriers, WTO, dumping, etc.). Last observation is March 2018.

C. Figure shows median impact. Cumulative impulse response after 1 year on investment growth in 23 advanced economies and 18 EMDEs to a 10-percent increase in the U.S. economic policy uncertainty (EPU). Vector autoregression estimated for 1998Q1-2016Q2 with two lags. The model for advanced economies includes U.S. EPU, MSCI index for advanced economies (MXGS), U.S. 10-year bond yields, aggregate real GDP and investment growth in 23 advanced economies. The model for EMDEs includes U.S. EPU, MSCI emerging market equity price index, J.P. Morgan's Emerging Market Bond Index Global (EMBIG), aggregate real GDP growth, and investment growth in 18 EMDEs. G7 real GDP growth, U.S. 10-year bond yields, and MSCI world equity price index are added as exogenous variables.

D. Bars denote the number of regional trade agreements in force.

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worldwide would have major adverse consequences for global trade and activity (Ossa 2014; Nicita, Olarreaga, and Silva forthcoming). An escalation of tariffs up to legally-allowed bound rates could translate into a decline in global trade flows amounting to 9 percent, similar to the drop seen during the global financial crisis in 2008-09 (Figure 1.18; Kutlina-Dimitrova and

Lakatos 2017). The impact of increased protectionism would be more severe in EMDEs than in advanced economies. Highly protected sectors, such as agriculture and food processing, would be likely to be among the most negatively affected. Non-tariff barriers could also be raised, adding to the cost of trading across borders. Costs associated with shipping, logistics, legal and regulatory impediments are already far outstripping tariff costs, particularly in EMDEs (UNESCAP 2017).

If it were to materialize, a substantial escalation of trade-restrictive measures between the United States and China could lead to economic losses for these two economies and cascading trade costs through global value chains (Bown 2017; Erbahar and Zi 2017; Escaith 2017; Irwin 2017). Sectoral dislocations associated with shifting trade patterns could have persistent negative effects on labor markets (Autor, Dorn, and Hanson 2016). Any setbacks to activity in the either country would result in significant negative spillovers for the rest of the world through trade, confidence, financial, and commodity-market channels (Kose et al. 2017a; Huidrom, Kose, and Ohnsorge 2017).

Even the threat of substantial shifts in trade policies in major economies, and associated uncertainty, could have negative consequences for financial markets, investment, and activity worldwide. The impact of U.S. policy uncertainty is particularly significant for investment in EMDEs, especially in those with large trade or financial market linkages with the United States (World Bank 2017a; Bhattarai, Chatterjee, and Park 2018).

Uncertainty surrounding the outcome of negotiations for major trade agreements and the non-renewal of preferential schemes could have adverse consequences for involved countries. Despite the recent ratification of a number of deeper trade agreements that include comprehensive provisions beyond the liberalization of tariff barriers, the appetite for trade liberalization has generally waned, particularly across major advanced economies. This is reflected in the number of new trade agreements falling to an 18-year low in 2017.

Policy uncertainty and geopolitical developments

Measures of global policy uncertainty are still above historical norms, albeit below a peak in 2016 (Figure 1.19). The risks of destabilizing policy and political changes remain elevated, reflecting the increased polarization of public opinion, a backlash against globalization, and rising support for populist parties across the world (Rodrik 2018; Inglehart and Norris 2016).

Electoral outcomes in a number of EMDEs and advanced economies, including in Europe, could lead to renewed uncertainty. Periods of significant government changes and political instability are generally associated with lower growth in the affected economies (Aisen and Veiga 2011; Perotti 1996). If the affected economies are sizable and tightly interconnected with trading partners (for example, a large Euro Area member state), the resulting negative spillovers could depress activity and investment in other countries, including EMDEs (World Bank 2015; World Bank 2017a). A lack of trust in governments also increases the risk of instability during economic downturns (Nunn, Qian, and Wen 2018).

Geopolitical risks remain elevated amid persistent tensions on the Korean Peninsula and intensifying strains in the Middle East. In that region, continued conflict, heightened tensions, and renewed uncertainties following the reintroduction of sanctions on Iran could exacerbate volatility in oil markets, hamper confidence, and further amplify instability (Karasapan 2017; Polachek and Sevastianova 2012). Security conditions remain precarious in many Sub-Saharan African countries. In the past, protracted periods of low commodity prices have tended to increase the probability of civil unrest in that region, as well as in others with large numbers of commodity exporters (Bazzi and Blattman 2014; Ciccone 2018). Heightened diplomatic tensions involving Russia's relationship with the United States and the European Union could also lead to an escalation of retaliatory measures. Renewed intensification of geopolitical risks could severely impact growth and development prospects for the affected regions, and even hinder activity at the global level.

A combination of global downside risks

After a decade of recovery from the global financial crisis, economic activity is still lagging previous expansions and is expected to decelerate in coming years (Figure 1.20). Whether the slowdown will be gradual, as currently predicted, or abrupt will depend on a number of factors, including the materialization of some of the aforementioned downside risks. Currently, the probability of a recession in major economies, such as the United States, is low (Bauer and Mertens 2018). However, the global economy has experienced an abrupt slowdown or recession in every decade, which was invariably preceded by a period when a significant majority of countries were operating above capacity. This proportion is estimated to be around 50 percent in 2018, and is expected to increase further in 2019.

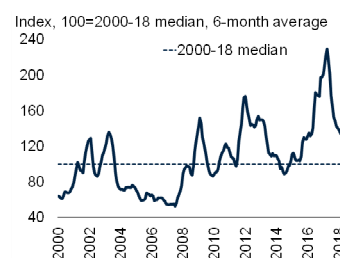
The next global slowdown or recession could be triggered by the combined materialization of several downside risks. For instance, a full-blown escalation of trade-restrictive measures along with a sudden resurgence of global inflation could negatively impact confidence and lead to disruptive financial market developments. Weakening growth and higher borrowing costs could intensify debt and financial stability concerns, while rising unemployment could amplify political uncertainties and protectionist tendencies.

The capacity of many countries to confront a synchronous slowdown has diminished since the global financial crisis. Monetary policy in advanced economies could face renewed constraints, as policy interest rates are still at historic lows, and fiscal space has deteriorated in both advanced economies and EMDEs. Moreover, potential growth has deteriorated and long-term investment prospects have continued to worsen, despite a tentative stabilization of market expectations about the long-term growth outlook (Box 1.1). These conditions render the global economy vulnerable to adverse shocks that may lead to a global slowdown or recession. Such an event could further damage potential growth, particularly if accompanied by financial stress and significant deleveraging pressures (World Bank 2018a; Kose and Terrones 2015).

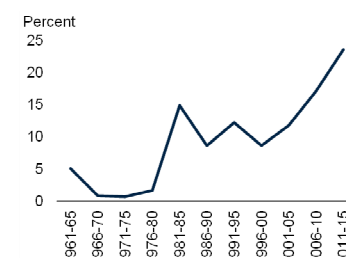
FIGURE 1.19 Downside risks: Policy and geopolitical uncertainty

Global policy uncertainty is still above historical norms, but has generally moderated from a peak reached in 2016. The risk of unanticipated political swings remains elevated amid rising support for populist parties. In the past, periods of low commodity prices were associated with an increased incidence of conflict in commodity exporters.

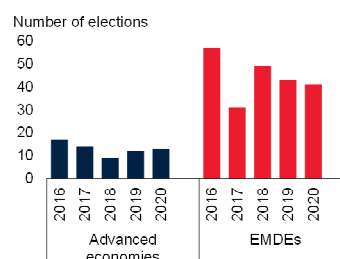
A. Global economic policy uncertainty



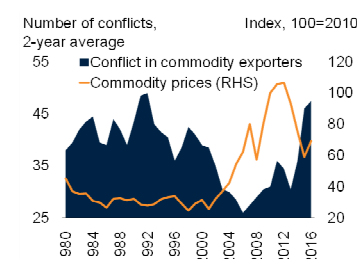
B. Global rise of populism



C. Elections in advanced economies and EMDEs



D. Conflict in EMDE commodity exporters and commodity prices



Sources: Allansson, Melander, and Themnér (2017); Baker, Bloom, and Davis (2016); Election Guide, International Foundation for Electoral Systems; national sources; Rodrik (2018); World Bank. A. Policy uncertainty is the Economic Policy Uncertainty index computed by Baker, Bloom, and Davis (2016), and is based on the frequency of articles in domestic newspapers mentioning economic policy uncertainty. The index is normalized to equal 100 at its January 2000–April 2018 median, as indicated by the dashed horizontal line. Last observation is April 2018. B. Data measures the vote share, or support, for populist parties, defined as those which pursue an electoral strategy of emphasizing divisions between an in-group and an out-group, over time among countries with at least one populist party, as defined and computed by Rodrik (2018). Sample includes 8 EMDEs and 11 advanced economies. C. Bars indicate the number of presidential and parliamentary elections held in EMDEs and advanced economies in each year. The sum excludes local authority elections. D. Conflicts are the two-year average of the sum of armed conflicts, or conflicts that involve two armed and opposing actors. Commodity index is the average of energy, non-energy, and precious metals price indexes, based on nominal U.S. dollar prices.

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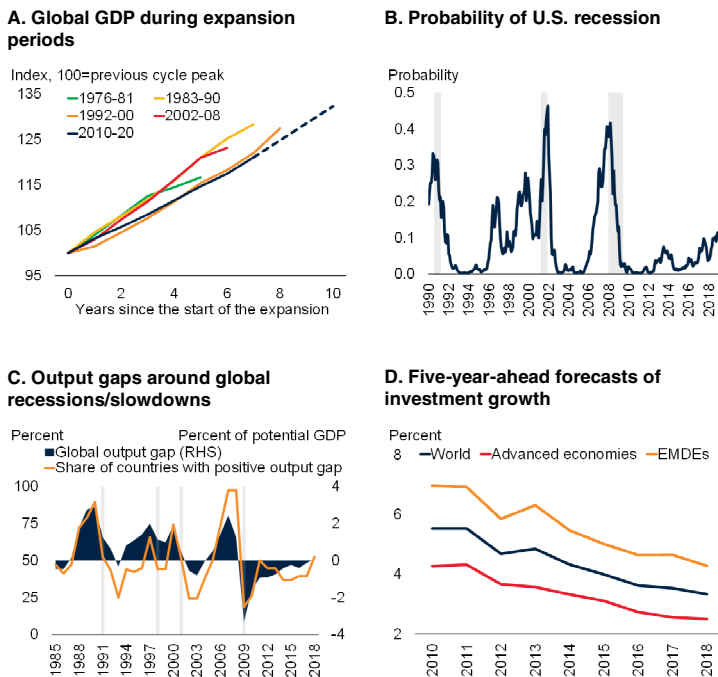
Region-specific downside risks

There are various region-specific downside risks that accompany the global risks discussed earlier. Most regions face domestic policy uncertainties associated with the possibility of fiscal slippages, reform setbacks, and lingering financial stability concerns.

Renewed geopolitical tensions in Europe and Central Asia, the Middle East and North Africa, South Asia, as well as around the South China Sea

FIGURE 1.20 Downside risks: History repeating itself?

Activity has recovered but still lags behind previous expansions. While the probability of a recession in major economies, such as the United States, remains low, it may be creeping up. Past global recessions were preceded by a period when most countries operated at or above full capacity. The next episode could be triggered by the materialization of a combination of downside risks, which could further weaken long-term investment prospects.



Sources: Consensus Economics, Federal Reserve Bank of New York, National Bureau of Economic Research (NBER), World Bank.

A. Global GDP levels in constant 2010 U.S. dollars, indexed to 100 at start of expansion periods. Cycle dates based on global recessions and slowdowns identified in Kose and Terrones (2015). Dashed line corresponds to 2018-20 forecasts.

B. Figure shows probability of a recession in 12 months. Probabilities derived from the U.S. yield curve model of the Federal Reserve Bank of New York. Shaded areas indicate recessions, as identified by the National Bureau of Economic Research (NBER). Last observation is April 2018 (12-month-ahead probability).

C. Output gaps calculated using multivariate filter. Methodology is described in Box 1.1 of the January 2018 edition of the *Global Economic Prospects* report. Grey bars indicate the two global recessions in 1991 and 2009, and the two global slowdowns in 1998 and 2001.

D. Five-year-ahead forecasts of investment growth, where the horizontal axis is the forecast vintage. Figure uses data surveyed for the latest available month in each year. Unweighted averages of 24 advanced economies and 21 EMDEs. Last observation is April 2018.

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and the Korean Peninsula, could weaken confidence and disrupt trade, investment, and migrant flows in these regions. A worsening of political instability or armed conflict could have substantial adverse effects in Sub-Saharan Africa. Lower-than-expected commodity prices could also derail the recovery in key commodity-exporting economies that are important economic partners for other countries in their regions. Finally, natural disasters, such as severe storms or droughts, could become more frequent, buffeting

activity in many regions, including in East Asia and Pacific, Latin America and the Caribbean, South Asia, and Sub-Saharan Africa.

Stronger and longer-lasting cyclical recovery

Despite various downside risks, a more sustained and longer-lasting recovery in major advanced economies and EMDEs remains possible, particularly if policy uncertainty dissipates. This could generate larger-than-expected spillovers through global trade and confidence channels. In particular, positive growth surprises in the United States would be a notable boost for activity among trading partners, including many EMDEs (Figure 1.21; Kose et al. 2017a; Huidrom, Kose, and Ohnsorge 2017). A persistent period of elevated confidence across major economies could further amplify the recovery, making it more synchronous and self-sustained (Angeletos, Collard, and Dellas 2017; Benhabib, Wang, and Wen 2015; Levchenko and Nayar 2017).

Over time, the cyclical recovery could help reverse some of the damage to potential output growth caused by the global financial crisis (World Bank 2018a). In particular, a persistent period of weak aggregate demand since 2008 might have contributed to the loss of skills and matching efficiency on labor markets (Bell and Blanchflower 2010; Bell and Blanchflower 2011), weak corporate sector performance (Nguyen and Qian 2014), financing constraints (Queralto 2013), and to slowing total factor productivity growth (Oulton and Sebastián-Barriol 2017). In the United States, these factors have accounted for a significant share of the slowdown in potential output growth since the crisis (Reifschneider, Wascher, and Wilcox 2015; Summers 2014). There is also evidence of lasting damage from the crisis in other advanced economies and in EMDEs (Ball 2014; World Bank 2018a).

Absent the build-up of macroeconomic and financial imbalances, a prolonged period of strong aggregate demand could help raise labor participation, investment and productivity growth. A pickup in productivity in major advanced economies would allow for additional growth without a rise in inflation, which would help

sustain favorable financing conditions and generate positive cross-border and inter-industry spillovers (Badinger and Egger 2016). An investment revival in EMDEs would help counterbalance the forces weighing down on potential growth in those countries.

Policy challenges

Challenges in advanced economies

Advanced-economy monetary policy will gradually become less stimulative, as output gaps become positive and inflation picks up. Fiscal policy is expected to be broadly neutral for growth, with the significant exception of the United States. As monetary and fiscal stimuli wane in the medium term and potential growth softens in the longer term, the outlook is expected to weaken, highlighting the need for structural reform to boost productivity and labor force participation.

Monetary and financial policies

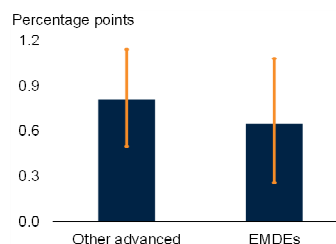
As the recovery firms and output gaps become positive, inflation should gradually rise toward central bank targets. The pace of this convergence, however, is subject to considerable uncertainty. Throughout the recovery, inflation has generally been overestimated (Figure 1.22). Recent inflation has been less responsive to strengthening activity than might have been expected, perhaps reflecting hidden slack or structural forces. Inflation expectations may have shifted down following a period of persistently low and below-target actual inflation (Kiley and Roberts 2017; Hills, Nakata, and Schmidt 2016). Globalization may have reduced the sensitivity of inflation to domestic pressures (Auer, Levchenko, and Sauré 2017; Ihrig et al. 2010). Trends in technology and competition may be suppressing wages and prices (Kurz 2017; Autor et al. 2017). Central banks are appropriately taking a gradual approach to policy normalization.

Major central bank balance sheets remain large by historical standards, but have likely peaked globally. The Federal Reserve has started to withdraw quantitative easing, while the European Central Bank is tapering its asset purchases. Changing market expectations about the speed of

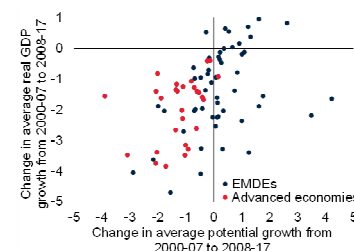
FIGURE 1.21 Upside risks: Longer-lasting upturn

Upside risks stem from the possibility of stronger-than-expected growth in major economies, particularly in the United States. Absent the build-up of macroeconomic and financial imbalances, a longer-lasting recovery could help repair crisis-related damages to potential growth.

A. Impact of a 1-percentage-point increase in U.S. growth after 1 year



B. Actual and potential output growth in advanced economies and EMDEs in the post-crisis period



Source: World Bank.

A. Cumulative impulse responses of a 1-percentage-point increase in U.S. growth on growth in other advanced economies and in EMDEs. Solid bars represent medians and error bars represent 16-84 percent confidence intervals.

B. Red dots indicate advanced economies and blue dots are EMDEs. Sample includes 34 advanced economies and 66 EMDEs.

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the process could lead to sudden financial market movements, reminiscent of the 2013 Taper Tantrum. Careful and transparent communication by central banks about their plans for both policy rates and balance sheets can avoid adverse financial market reactions, particularly in an environment where high asset prices are based on assumptions that monetary policy tightening will proceed in an orderly fashion.

Fiscal policy

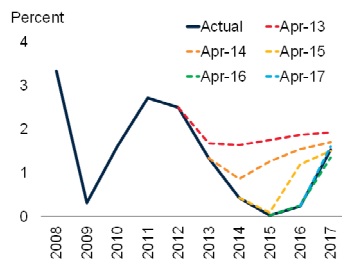
The fiscal policy stance of advanced economies turned from contractionary to expansionary, on balance, between 2015 and 2017, contributing to the upturn in growth during this period. In most advanced economies, the fiscal stance is expected to be largely neutral for growth over the forecast horizon.

The major exception is the United States, which is undertaking a substantial, and procyclical, fiscal expansion. Fiscal stimulus is an important part of countercyclical policy, especially when monetary policy is constrained (Christiano, Eichenbaum, and Rebelo 2011). However, for an economy operating close to full potential, the benefits of stimulating demand are reduced, while the costs

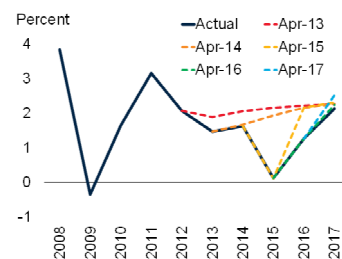
FIGURE 1.22 Monetary and fiscal policies in advanced economies

Inflation has generally come in below forecasts in recent years, suggesting that central banks should take a gradual approach to raising rates. Major central bank balance sheets are close to their peak size, and managing the unwinding of unconventional policy will require careful communication. Fiscal balances have stabilized in most advanced economies, with the key exception of the United States, where fiscal policy will be highly procyclical, with limited growth spillovers. Debt levels in advanced economies have risen significantly in the past decade, which may hinder their ability to respond to future negative shocks.

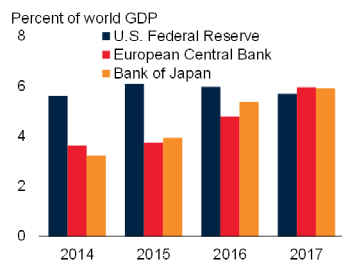
A. Euro Area Consensus inflation forecasts



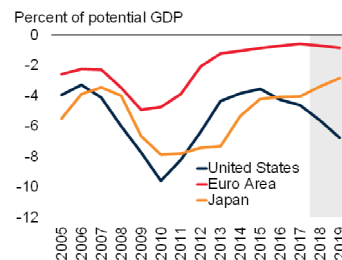
B. U.S. Consensus inflation forecasts



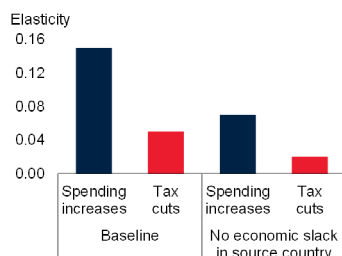
C. Central bank balance sheets



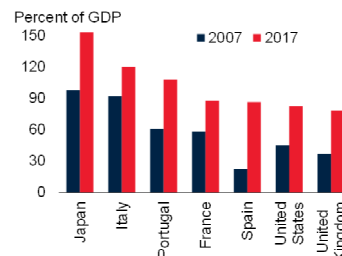
D. Structural fiscal balance



E. Estimates of cross-border spillovers from fiscal policy



F. Public debt



Sources: Consensus Economics, European Central Bank, Federal Reserve Bank of St. Louis, Haver Analytics, International Monetary Fund, World Bank.

A.B. Series indicate date at which inflation forecast surveys were taken.

C. Annual average of monthly assets of central banks. Data use current U.S. dollar GDP weights.

D. Shaded area indicates forecasts. Structural balance is the fiscal balance adjusted for the economic cycle and for one-off effects.

E. Average one-year response of recipient country GDP to a fiscal shock equal to 1 percent of source country GDP, as calculated by Blagrove et al. (2017).

F. Net general government debt as a percentage of GDP. For cross-country comparability, the U.S. figure is adjusted to exclude unfunded pension liabilities of government employees' defined-benefit pension plans.

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are magnified as interest rates rise and private investment is crowded out. The same conditions also limit the magnitude of positive spillovers to other countries (Blagrove et al. 2017).

More generally, many advanced economies have added significantly to their public debt load, which may hinder their ability to respond to negative shocks in the future (Romer and Romer 2017). Accordingly, they need to take advantage of the confluence of strong global growth and still low borrowing costs to rebuild fiscal space (Kose et al. 2017b; IMF 2018).

Structural policies

Potential output in advanced economies is constrained by aging populations and weak productivity growth (Figure 1.23). As the recovery matures, and policy stimulus is gradually withdrawn, growth will tend to converge toward its slower pace of potential. Structural reforms can raise this pace by boosting labor participation and productivity growth.

A critical challenge is to continue to support an open and fair global trade system and pursue further trade liberalization. One area with untapped potential is trade in services, which comprises a rising share of global trade despite being subject to considerable restrictions. Reducing barriers to services trade—for instance, by increasing regulatory cooperation and reducing barriers to entry for foreign service providers—has the potential to boost long-term growth prospects while reducing policy uncertainty (Borchert, Gootiiz, and Mattoo 2012; OECD 2017). More generally, increasing trade openness should be accompanied by actions to facilitate re-employment for workers in regions and sectors dislocated by globalization (IMF, World Bank, and WTO 2017).

In contrast, actions to protect certain domestic sectors, such as steel or aluminum tariffs, may lead to net domestic job losses. The increase in costs for downstream users can reduce more jobs than the protected sector gains (François and Baughman 2018). Such losses would be multiplied if other countries retaliate in kind (Akcigit, Ates, and Impullitti 2018).

Challenges in emerging and developing economies

EMDE policymakers need to be able to respond to a rise in inflation and cope with advanced-economy monetary policy normalization, as well as manage possible bouts of financial market volatility. Deteriorating debt dynamics have reduced fiscal space, underlining the importance of revenue mobilization and medium-term fiscal frameworks to rebuild buffers. EMDEs face various structural challenges to boost longer-term prospects. They include the need to intensify economic diversification in commodity exporters, boost skills and adaptability to confront rapid technological change, and promote regional trade integration. China's key policy challenge is to manage the transition to slower but more balanced and sustainable growth.

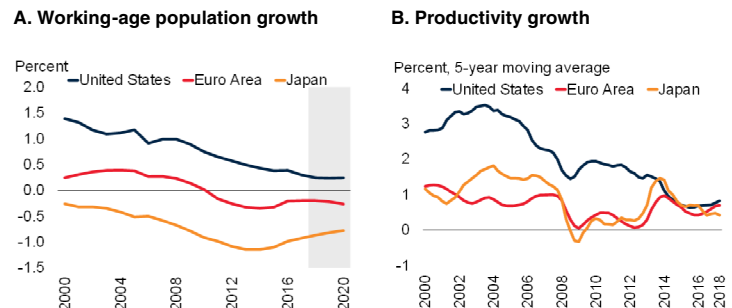
Policy challenges in China

Authorities in China have implemented a wide range of reforms in recent years (IMF 2017a; World Bank 2017c; World Bank 2018a). These include steps to reduce excess capacity in the industrial sector (Figure 1.24; World Bank 2018b). Notable progress has been made on mixed-ownership reforms aimed at diversifying the ownership structure of state-owned enterprises (SOEs). Currently, more than two-thirds of China's centrally administered SOEs and their subsidiaries have allowed outside investors, restructured, or gone public. Following progress in opening its equity and bond markets to foreigners, China is now taking additional steps to remove foreign ownership limits in financial institutions and some other sectors.

Reforms have also included stricter regulatory policies for the housing market, as well as monetary, financial, and regulatory measures that have contributed to some reduction in corporate debt as a share of GDP, even if household and public-sector debt have continued to increase (BIS 2018a). The authorities have also made progress in fiscal and regulatory reforms. For example, the tax burden on consumers and businesses, as well as transport logistics costs, are being further lowered through cuts in value-added tax rates, social security contributions, tariffs, and road tolls. In addition, recent regulatory measures are expected

FIGURE 1.23 Structural policy in advanced economies

Potential output in advanced economies is constrained by weak population and productivity growth, suggesting that current levels of growth cannot be maintained in the longer term.



Sources: Haver Analytics, World Bank.

A. The series is a year-on-year percentage change in the working-age population, which is defined as individuals between ages 15-64 years.

B. Productivity measures output per employed person. Last observation is 2018Q1.

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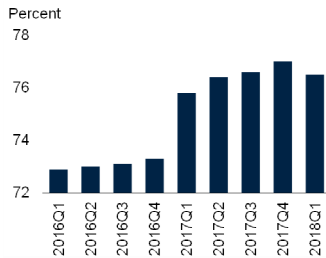
to significantly shorten the processing time for starting business and streamline foreign business registration.

The key economic policy challenge is to manage the transition to slower but more balanced and sustainable growth. This will require continued implementation of reforms to reduce financial vulnerabilities, promote market competition and private sector development, reallocate capital and labor toward more productive firms and sectors, and foster innovation through stronger intellectual property rights, as well as additional research and development. This will also necessitate further actions to bolster household consumption, including additional reforms to make the fiscal system more progressive and rebalance the intergovernmental allocation of revenues and expenditures. Reallocation of public spending from investment to education, health, pensions, and safety nets would increase aggregate consumption and boost human capital. Advancing the reform of the household registration (hukou) system, and of rural land transfers, would contribute to a reduction of income inequality. Encouraging market mechanisms to promote green growth and more efficient, sustainable use of natural resources would enhance environmental sustainability (World Bank 2018a; World Bank 2018h).

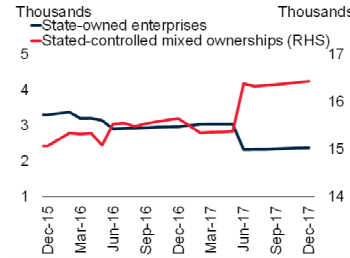
FIGURE 1.24 Policy challenges in China

China has implemented a wide range of reforms, including significant steps to reduce excess capacity and to diversify the ownership structure of state-owned enterprises. While monetary and prudential policies have contributed to some reduction of corporate debt, the stock of total debt has continued to increase due to still rising household and public-sector debt. Progress on fiscal reforms includes the reduction of tax and social security burdens on businesses.

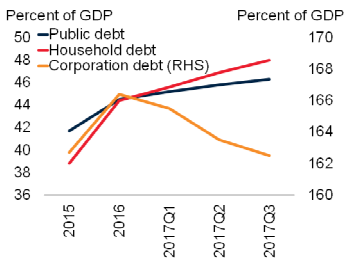
A. Industrial capacity utilization



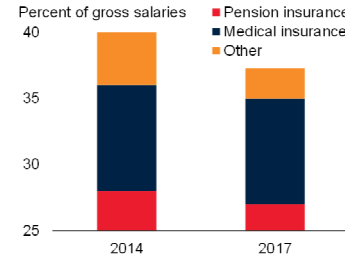
B. Industrial state-owned enterprises and state-controlled enterprises with mixed ownerships



C. Public, household, and corporate debt



D. Social security contribution, highest mandatory tax rates



Sources: Bank for International Settlements, China National Bureau of Statistics, Haver Analytics, Institute of International Finance, Ministry of Finance of the People's Republic of China, Ministry of Human Resources and Social Security of the People's Republic of China, World Bank.

A. Last observation is 2018Q1.

B. Both lines represent industrial enterprises. State-controlled mixed ownership enterprises refer to enterprises of whose total assets the state-owned assets have a majority or dominate share. Last observation is December 2017.

C. Total debt comprises of credit to household and non-financial corporations and general government debt (broad definition). The sum of credit to household and non-financial corporations is consistent with the People's Bank of China Aggregate Financing to the Real Economy (stock) level. Public debt, which is general government debt, includes central and local government debt and social security funds, but excludes public enterprises. Data presented in the chart are broadly consistent with the IMF estimates of total debt. Includes debt swaps and other debt restructuring operations.

D. Measures the sum of employer and employee contributions.

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EMDE monetary and financial policies

Among EMDEs more generally, median inflation in commodity exporters has been moderating toward that of commodity importers. Policy interest rate adjustments this year have consisted mostly of cuts in commodity exporters, extending easing cycles already underway in some economies (e.g., Brazil, Colombia, Kazakhstan, Peru, Russia, Zambia; Figure 1.25). Thus far, short-term, survey-based inflation expectations in EMDEs

have shown modest upward momentum. However, with oil prices rising and the aggregate EMDE output gap closing, there may be greater upward pressure on inflation going forward. Moreover, a closed global gap could amplify this tendency through imported inflation (World Bank 2018a).

The challenges associated with increasing inflation pressures could be compounded if monetary policy normalization in advanced economies, and the associated tightening of international financing conditions, leads to capital outflows and currency depreciation among EMDEs (Chari, Stedman, and Lundblad 2017; Dahlhaus and Vasishtha 2014). Some countries have already had to adjust their monetary policy stance in response to rapid adjustments in exchange rates and capital flows in the first half of 2018. The current policy mix in the United States amplifies the challenge of sudden changes in market sentiment. If the Federal Reserve were to hike policy rates more steeply than markets expect to offset overheating and inflationary pressures generated by the large fiscal expansion, there could be additional pressure for rate increases in some EMDEs. At the same time, policymakers in EMDEs need to continue preparing their domestic financial sectors for potentially adverse spillovers from post-crisis banking regulatory tightening in advanced economies (Briault et al. 2018).

How susceptible individual countries may be to capital flow reversals depends on their existing vulnerabilities and other domestic factors, such as their degree of financial openness and institutional quality (Byrne and Fiess 2016). In anticipation of rising borrowing costs and the possibility of renewed, more persistent episodes of market volatility, it is critical for EMDE policymakers to maintain an environment where expectations of longer-term inflation are low and stable. This includes credible commitment to explicit inflation targets in those countries that have implemented such a framework. In some countries, it will also be necessary to tackle vulnerabilities, such as sizable current account deficits or high stocks of corporate debt. Although maintaining an appropriate level of exchange rate flexibility and building policy buffers should be first lines of

defense in confronting sudden financial shocks, EMDE policymakers also need to be prepared to use additional tools, such as intervention in foreign exchange markets, or even targeted capital inflow management measures if other options have been exhausted and a financial crisis is imminent (IMF 2017b). To reduce financial stability risks associated with elevated corporate debt, prudential policies and bankruptcy protection regimes should be reinforced, while access to equity finance should be further developed (Special Focus 2).

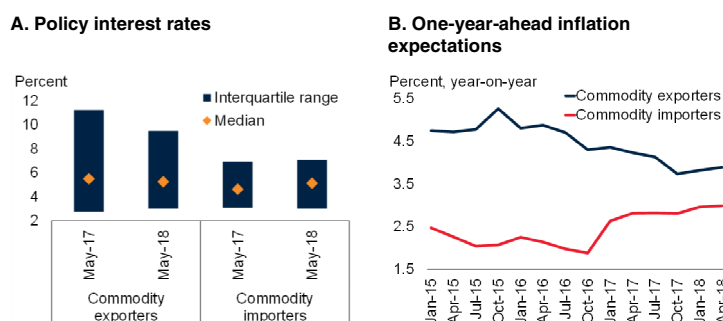
EMDE fiscal policy

Public finances are fragile in various EMDEs. Many economies are running sizable government deficits—a trend expected to persist over the next two years—while adverse debt dynamics will continue to constrain fiscal space across EMDEs (Figure 1.26). Limited fiscal buffers leave EMDEs short of an effective fiscal instrument should they need to react to a negative economic shock. In LICs, public debt-to-GDP ratios remain below levels observed prior to the mid-2000s following debt relief initiatives, but have increased rapidly in recent years. Debt vulnerabilities are compounded in those countries by rising exposure to international markets, a lack of transparency, and limited debt management capabilities. The increased reliance on commercial loans and non-traditional sources has created debt-service difficulties in some countries. Across EMDEs more generally, the challenges posed by inadequate fiscal buffers are expected to be amplified as global financing conditions tighten, especially if procyclical U.S. fiscal measures are accompanied by higher-than-expected U.S. and global interest rates.

In oil exporters, fiscal deficits narrowed in 2017, in part aided by recovering energy prices, but are projected to remain large (e.g., Algeria, Bahrain, Ghana, Nigeria; World Bank 2018a). Government revenue growth was positive in 2017 and is set to accelerate in 2018. However, the improvement is not enough to bring revenues as a share of GDP back to levels observed before the 2014-16 oil price collapse, and government debt continues to rise.

FIGURE 1.25 EMDE monetary policy

Policy interest rate actions in commodity exporters in the first half of 2018 consisted mostly of cuts, extending easing cycles already well underway in some economies. This is consistent with moderating inflation and still negative output gaps. Survey-based inflation expectations are rising in commodity importers, and have stabilized in commodity exporters after an extended period of downward adjustment.



Sources: Consensus Economics, Haver Analytics, World Bank.

A. The blue bars show the interquartile range of policy rates for each country group. Sample includes 37 commodity exporters and 26 commodity importers.

B. Figure shows median one-year-ahead inflation expectations based on a quarterly survey conducted by Consensus Economics. Sample includes nine commodity exporters and 11 commodity importers. Last observation is April 2018.

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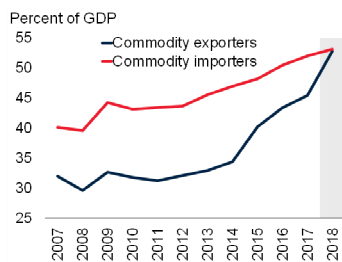
In other commodity exporters, government finances deteriorated following the decline in commodities prices after 2011. Fiscal balances bottomed out in 2015-16 and are envisaged to further improve; however, they remain firmly negative. Although the fiscal sustainability gap in commodity exporters is expected to narrow in 2018, the improvement is not yet sufficient to place debt on a sustainable path. These trends suggest that there is still significant need for fiscal consolidation in commodity exporters. In commodity importers, robust growth has supported government revenues. However, government expenditure growth is expected to outpace that of revenues, contributing to rising gross government debt.

Going forward, tightening global financing conditions will have substantial implications for fiscal policy in EMDEs. For sovereign borrowers, public balance sheets could come under stress as governments face rising costs in financing deficits and rolling over maturing debt (IMF 2017b). EMDEs with elevated external borrowing—especially from private creditors—are vulnerable to capital flow reversals, which can increase refinancing risks and the burden of servicing debt.

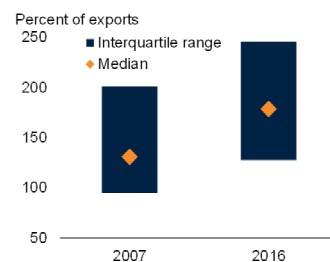
FIGURE 1.26 EMDE fiscal policy

Government debt has been rising across EMDEs, further constraining fiscal space. In LICs, external and non-concessional debt have been increasing, putting further strain on domestic revenues as interest payments continue to climb. Fiscal sustainability gaps could deteriorate across all EMDE regions in response to increasing interest rates. Tax policy appears to be procyclical across many EMDEs, which could exacerbate fluctuations in their business cycles.

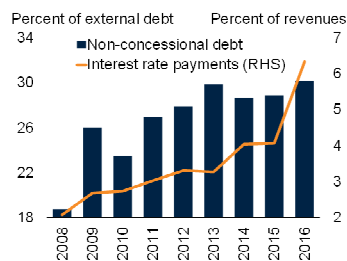
A. Gross government debt



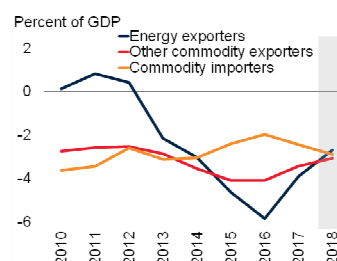
B. External debt in LICs



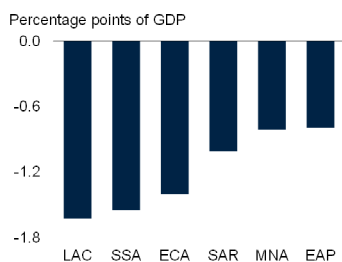
C. Non-concessional debt and interest payments on debt in LICs



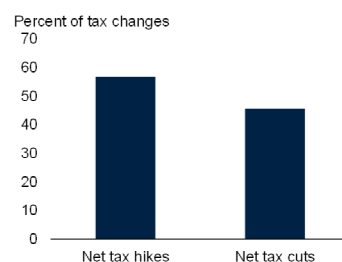
D. Fiscal balances



E. Impact of interest-rate shock on fiscal sustainability gaps in EMDEs, by region



F. Share of tax changes during contractions, 1981-2017



Sources: Haver Analytics, International Monetary Fund, Kose et al. (2017b), Végh and Vuletin (2015), World Bank.

A.D. Shaded area indicates forecasts.

A. Figure shows the constant 2010 U.S. dollar GDP-weighted average for each country group of gross government debt, using an unbalanced sample. The sample in 2018 includes 80 commodity exporters and 60 commodity importers.

B.C. LICs = low-income countries.

B. External debt measures debt owed to non-residents. The unbalanced sample includes 21 LICs.

C. Figure shows median values for LICs. The unbalanced sample includes 29 LICs for non-concessional debt and up to 15 LICs for interest rate payments, depending on data availability. Interest rate payments include those made on government debt to domestic and foreign residents.

D. Figure shows median in each country group. Sample includes 36 energy exporters and 54 other commodity exporters (i.e., agricultural and metals exporters), as well as 63 commodity importers.

E. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

Figure shows the estimated deterioration in the fiscal sustainability gap driven by a 1-standard deviation interest rate increase. Sustainability gap is measured as the difference between the primary balance and the debt-stabilizing primary balance. A negative bar indicates government debt is rising along an accelerated trajectory. Sample includes 70 EMDEs.

F. A net tax hike occurs when the number of tax hikes exceeds the number of tax cuts, while a net tax cut occurs when the number of tax hikes is less than the number of tax cuts. Tax changes are measured as the change in statutory rates in either the corporate income, personal income, or value-added tax as described in Végh and Vuletin (2015). Output gaps that are more negative than -1 percent of potential GDP indicate an economic contraction. Unbalanced sample, where data for 2017 includes 16 EMDEs.

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(IMF 2018). Although aggregate corporate debt in EMDEs has fallen modestly since 2016, it remains, on average, 27 percentage points of GDP higher than in 2006 (Special Focus 2; Beltran, Garud, and Rosenblum 2017). Deterioration of corporate debt profiles could lead to rising contingent liabilities for the public sector, which would compound the challenges associated with elevated public debt.

Although favorable global growth and recovering revenues are likely to improve fiscal space, EMDE policymakers need to continue to actively address underlying fiscal vulnerabilities. Placing government finances on a more sustainable path could prevent the need for procyclical fiscal consolidation in the presence of negative shocks—as was the case in commodity exporters in 2016-17, when sizable negative output gaps were accompanied by contractionary fiscal stances (World Bank 2018a). Realigning government spending with revenues could also help stabilize growing public debt levels, while managing the composition of debt could ease the servicing burden on tax revenues. The urgency to strengthen or rebuild fiscal buffers should be balanced against other pressing considerations. These include protecting social safety nets and financing growth-enhancing investment, including in infrastructure. Mobilizing fiscal revenues and reallocating spending toward investment and infrastructure projects can prioritize such needs when fiscal space is constrained, which is generally the case in LICs. Across EMDEs, introducing medium-term expenditure frameworks and fiscal rules to contain deficits, as well as improving overall governance, can build credibility to support revenue collection and buck the historical trend of procyclical fiscal policy. This should be complemented by measures to enhance debt transparency, improve debt management capacity, and promote sustainable lending practices, particularly in LICs.

EMDE structural policies

While EMDE growth is expected to continue to accelerate in 2018, potential growth has declined considerably over the past decade, and structural challenges are intensifying. For commodity

exporters, prospects of a secular slowdown in the demand for commodities call for accelerated efforts to diversify their economies (Special Focus 1). For all EMDEs, rapid changes in manufacturing and technology imply rising challenges and opportunities, putting ever-increasing emphasis on education, skills, and adaptability to bolster long-term growth prospects.

Fostering diversification

Resource-rich countries need to enhance the overall competitiveness of their economies. In addition to fostering human and physical capital and improving institutions and governance, they need to pursue policies that help diversify their economies away from natural resources (Gill et al. 2014). For low- and middle-income countries, increased diversification is generally associated with higher levels of income per capita (Figure 1.27; Cadot, Carrère, and Strauss-Kahn 2011; Imbs and Wacziarg 2003). For resource-intensive countries, low levels of economic diversification are particularly challenging, as sharp commodity price fluctuations disproportionately impede investment, growth, and stability in those countries (Bahar 2016; Hesse 2008; Lederman and Maloney 2007; Papageorgiou and Spatafora 2012; IMF 2016). Furthermore, there appears to be an inverse relationship between resource intensity and education outcomes, which could reflect a lower quality of institutions more generally. This can further hamper the potential for development in resource-rich countries (World Bank 2018i).

In the long run, the prospect of persistently moderate commodity prices intensifies the need for reforms to encourage economic diversification, particularly in less diversified oil producers. Such a process generally occurs with incremental changes around existing sectors and comparative advantages, leveraging available skills and infrastructure (Hausmann, Hwang, and Rodrik 2007).

- The successful diversification experience of some energy producers (e.g., Malaysia, Mexico) suggests the need to support both vertical diversification in oil, gas, and petrochemical sectors, as well as horizontal diversi-

fication beyond these sectors. Continued commitment to reforms aimed at improving governance and the business climate, and reducing regulatory barriers to competition and to foreign investment, has the potential to diminish reliance on the oil sector (Callen et al. 2014; Devarajan 2017; Stocker et al. 2018).

- Similarly, metals and agricultural exporters can benefit from vertical diversification—the development of industries closely related to existing production and export structures—and the expansion of high value-added resource-based manufacturing activities. For instance, mining and forestry have become knowledge-intensive sectors with high technological content in both upstream and downstream activities. Successful examples of vertical diversification include Thailand, Chile, and Uganda (Hesse 2008; Gylfason and Nguessa Nganou 2014; Maloney and Valencia Caicedo 2017).

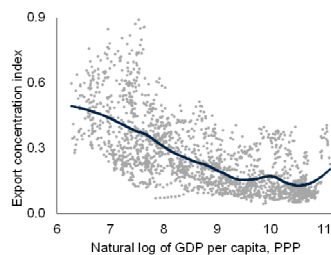
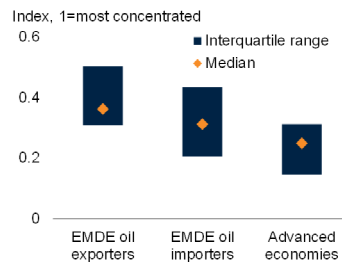
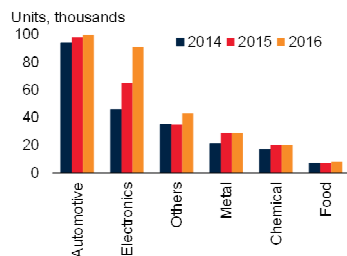
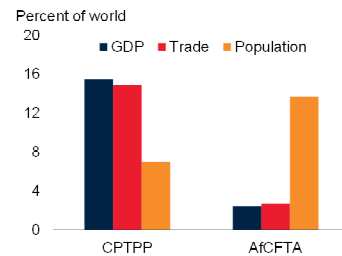
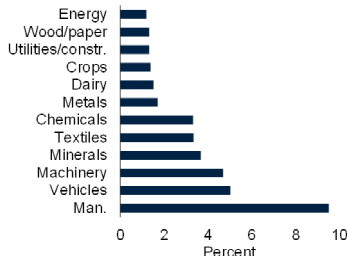
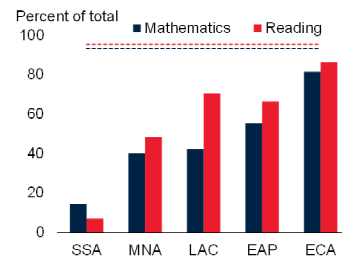
While incremental diversification around resource sectors can help foster learning and the adoption of new technologies, proper regulatory and institutional frameworks need to be in place to attract new investments, help the development of higher value-added export sectors, and boost competitiveness and participation in regional and global value chains. Regulations and institutions that slow the emergence of new sectors should be identified and reformed in order to support efficiency-seeking and productivity-enhancing investments, including through improved competition policies. Rapid technological changes also offer new opportunities for private-sector-led growth, including in digital services and information technologies (World Bank 2018i). Diversification can be hindered by the absence of local market access, emphasizing the need for further regional integration, particularly in Sub-Saharan Africa (Imbs 2018).

Adapting to technological change

Despite heightened uncertainty about trade policies in major economies, the potential for export-led manufacturing growth remains

FIGURE 1.27 EMDE structural policy

Decreasing export concentration is generally associated with rising income per capita. The need for increased diversification is particularly acute among oil-exporting EMDEs. Automation creates new challenges for manufacturing-led growth in EMDEs. Regional trade agreements offer prospects of increased integration, particularly in Sub-Saharan Africa. Improving basic reading and mathematics proficiency remains a major priority in some regions.

A. Export concentration and GDP per capita levels**B. Export concentration, 2016****C. Supply of industrial robots, by industries worldwide****D. Size of new regional trade agreements****E. Impact of AfCFTA on employment, by sector****F. Students proficient in math and reading**

Sources: International Federation for Robotics; Saygili, Peters, and Knebel (2018); United Nations Conference on Trade and Development (UNCTAD); World Bank.

A.B. Herfindahl-Hirschmann concentration index measures the degree of product concentration, where values closer to 1 indicate a country's exports are highly concentrated on a few products.

A. GDP per capita measured in Purchasing Power Parity (PPP) terms. Trend computed using a local polynomial regression over a sample of 104 countries and over the period 1995 to 2015. Outlier data trimmed at the 10 percent level using a density based clustering algorithm.

B. Orange diamonds denote the median and blue bars represent the interquartile range of individual country groups. Sample includes 34 oil-exporting EMDEs (excludes South Sudan), 116 oil-importing EMDEs, and 36 advanced economies.

C. Estimated annual supply of industrial robots at year-end.

D. CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership, AfCFTA = African Continental Free Trade Area. Data are as of 2017.

E. Man. refers to other manufactured goods. Utilities/constr. refers to utilities/construction. The employment effects of the African Continental Free Trade Area (AfCFTA) have been estimated using the Global Trade Analysis Project (GTAP) model. The GTAP model is a static, multi-regional, multi-sectoral general equilibrium model assuming perfect competition, constant returns to scale, and imperfect substitution between foreign and domestic goods and among imports from different sources.

F. SSA = Sub-Saharan Africa, MNA = Middle East and North Africa, LAC = Latin America and Caribbean, EAP = East Asia and Pacific, ECA = Eastern Europe and Central Asia. Data for South Asia are unavailable. Dashed horizontal lines show advanced-economy average.

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significant in many EMDEs, as their productivity levels, which lag the global technological frontier, have substantial scope for convergence. A rising share of manufacturing employment and increased vertical specialization have generally been associated with higher productivity and income per capita levels (Diao, McMillan, and Rodrik 2017; Hallward-Driemeier and Nayyar 2018; Szirmai and Verspagen 2015). Manufacturing can foster the diffusion of technologies, particularly for countries that are currently less integrated into global value chains, and thus boost long-term growth prospects.

Rapid technological changes—including increased digitalization and the use of advanced robotics—may significantly affect countries' comparative advantages. Increased diffusion and adoption of digital technologies in EMDEs are likely to be positive for growth and job creation, particularly in countries with elevated levels of digital literacy. Mobile and internet technologies can lower costs of market access, foster entrepreneurship, and improve labor market efficiency, thereby helping workers and firms match skills to jobs.

While evidence of employment-saving industrial automation is limited in EMDEs, task-replacing technologies could potentially contribute to labor displacement over time, including in more traditional manufacturing activities (Acemoglu and Restrepo 2018; Autor and Salomons 2018; Maloney and Molina 2016). At the same time, the increasing services intensity of manufacturing can create important labor market opportunities and productivity advancement in EMDEs (Enache, Ghani, and O'Connell 2016; Kinfe Michael and Morshed 2015; WTO 2017; UNCTAD 2017a).

These trends suggest rapid changes in the types of investments and skills needed for manufacturing-led growth in EMDEs. Opportunities and risks will vary across sectors, depending on the extent of trade in international markets, the degree of export concentration, the level of automation, and the importance of complementary services. Labor-intensive industries, including commodity-based and less-automated manufacturing processes, remain important entry points for less-industrialized economies. This applies to rapidly

expanding urban areas in Sub-Saharan Africa, where an improved manufacturing base and greater openness to regional and international trade could unlock potential for higher per capita income growth (Lall, Henderson, and Venables 2017).

For manufacturing sectors that are more easily automated, and where trade is more concentrated, advanced technology may be more disruptive and labor-saving, but necessary to raise efficiency and maintain competitiveness. Successful industrialization strategies will need to focus on strengthening international competitiveness, increase skills and adaptability, support firms' capacity to absorb new technologies, and foster the development of complementary services.

Promoting trade openness

Measures that reduce barriers to trade could contribute to boosting value chain integration, investment, and productivity. Despite the lack of progress in multilateral trade negotiations, new trade agreements have been concluded or are being negotiated, including the Comprehensive and Progressive Agreement for a Trans-Pacific Partnership (CPTPP), the European Union–Mercosur trade agreement, the Regional Comprehensive Economic Partnership between the Association of Southeast Asian Nations (ASEAN) countries and six of their major trading partners, and the African Continental Free Trade Area (AfCFTA). These have the potential to boost not only intra-regional trade and incomes of member countries, but also to provide a counterbalance against rising protectionist sentiments.

Full implementation of the CPTPP, signed by 11 countries, together accounting for 16 percent of global GDP and 14 percent of global trade, is expected to provide a boost to trade flows for its members, even if potential gains have been reduced following the withdrawal of the United States from the original TPP (Maliszewska, Oleksyuk, and Osorio-Rodarte 2018). The AfCFTA was launched by countries representing a notably smaller share of global GDP and trade; however, once ratified by its 44 members, it would

be the largest free-trade area in terms of population and number of countries. The AfCFTA has the potential to substantially foster intra-regional trade flows, contribute to greater economic diversification, and lead to higher value-added products and greater innovation in Africa (Saygili, Peters, and Knebel 2018; UNCTAD 2017b).

Deep regional trade agreements—those that go beyond tariff reductions and that contain wide-ranging commitments in the areas of competition, investment, services, and the protection of intellectual property rights—are associated with larger trade and income gains (Constantinescu et al. forthcoming; Hofmann, Osnago, and Ruta 2017). Promoting such commitments could therefore yield sizable dividends for EMDEs. Successful regional trade arrangements also need to be platforms for further integration with the rest of the world, as shown by the positive experiences in Europe and Asia.

Improving education and training

Policies related to education and training programs can be redesigned to adapt available skills to changing development needs and new technologies, thereby boosting growth and employment prospects (World Bank 2018j). As countries become increasingly engaged in more complex production processes, higher levels of tertiary school enrollment and investment in skills related to information and communication technology (ICT) have a bigger payoff. Training programs that are responsive to changing industry needs are particularly important (Hallward-Driemeier and Nayyar 2018). As technologies are likely to change more quickly than national education systems are able to adapt to them, innovative ways of imparting skills will need to be developed, including through experimentation and impact evaluation. The importance of equipping people with the necessary skills to adapt to new opportunities is emphasized in the G20's agenda on the future of work.

For many low- and middle-income countries—particularly in Sub-Saharan Africa and in the Middle East and North Africa—improving basic numeracy, literacy, and ICT-related skills remains

a key priority. Even though school enrollment and average years of schooling have markedly increased over the last decade, learning and the acquisition of basic skills remain insufficient in these countries (Altinok, Angrist, and Patrinos 2018). Early learning deficits are magnified over time and tend to accentuate inequality, whereas higher inter-generational mobility in education is associated with higher growth and lower poverty (PASEC

2015; World Bank 2017d). Improving learning outcomes requires better measurement and monitoring, improved school practices, and greater accountability. Helping to develop “soft” skills that foster adaptability, as well as initiative and problem solving, could come at a premium in view of the rapid and unforeseen changes in skills requirements and the increasing automation of repetitive tasks.

TABLE 1.2 List of emerging market and developing economies¹

| Commodity exporters ² | | Commodity importers ³ | |
|----------------------------------|-----------------------|----------------------------------|--------------------------------|
| Albania* | Madagascar | Afghanistan | Philippines |
| Algeria* | Malawi | Antigua and Barbuda | Poland |
| Angola* | Malaysia* | Bahamas, The | Romania |
| Argentina | Mali | Bangladesh | Samoa |
| Armenia | Mauritania | Barbados | Serbia |
| Azerbaijan* | Mongolia | Belarus | Seychelles |
| Bahrain* | Morocco | Bhutan | Solomon Islands |
| Belize | Mozambique | Bosnia and Herzegovina | Sri Lanka |
| Benin | Myanmar* | Bulgaria | St. Kitts and Nevis |
| Bolivia* | Namibia | Cabo Verde | St. Lucia |
| Botswana | Nicaragua | Cambodia | St. Vincent and the Grenadines |
| Brazil | Niger | China | Swaziland |
| Burkina Faso | Nigeria* | Comoros | Thailand |
| Burundi | Oman* | Croatia | Tunisia |
| Cameroon* | Papua New Guinea | Djibouti | Turkey |
| Chad* | Paraguay | Dominica | Tuvalu |
| Chile | Peru | Dominican Republic | Vanuatu |
| Colombia* | Qatar* | Egypt | Vietnam |
| Congo, Dem. Rep. | Russia* | El Salvador | |
| Congo, Rep.* | Rwanda | Eritrea | |
| Costa Rica | Saudi Arabia* | Fiji | |
| Côte d'Ivoire | Senegal | Georgia | |
| Ecuador* | Sierra Leone | Grenada | |
| Equatorial Guinea* | South Africa | Haiti | |
| Ethiopia | Sudan* | Hungary | |
| Gabon* | Suriname | India | |
| Gambia, The | Tajikistan | Jamaica | |
| Ghana* | Tanzania | Jordan | |
| Guatemala | Timor-Leste* | Kiribati | |
| Guinea | Togo | Lebanon | |
| Guinea-Bissau | Tonga | Lesotho | |
| Guyana | Trinidad and Tobago* | Macedonia, FYR | |
| Honduras | Turkmenistan* | Maldives | |
| Indonesia* | Uganda | Marshall Islands | |
| Iran* | Ukraine | Mauritius | |
| Iraq* | United Arab Emirates* | Mexico | |
| Kazakhstan* | Uruguay | Micronesia, Fed. Sts. | |
| Kenya | Uzbekistan | Moldova, Rep. | |
| Kosovo | Venezuela* | Montenegro | |
| Kuwait* | West Bank and Gaza | Nepal | |
| Kyrgyz Republic | Zambia | Pakistan | |
| Lao PDR | Zimbabwe | Palau | |
| Liberia | | Panama | |

* Energy exporters.

¹ Emerging market and developing economies (EMDEs) include all those that are not classified as advanced economies. Dependent territories are excluded. Advanced economies include Australia; Austria; Belgium; Canada; Cyprus; the Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hong Kong SAR, China; Iceland; Ireland; Israel; Italy; Japan; the Republic of Korea; Latvia; Lithuania; Luxembourg; Malta; Netherlands; New Zealand; Norway; Portugal; Singapore; the Slovak Republic; Slovenia; Spain; Sweden; Switzerland; the United Kingdom; and the United States.

² An economy is defined as commodity exporter when, on average in 2012-14, either (i) total commodities exports accounted for 30 percent or more of total goods exports or (ii) exports of any single commodity accounted for 20 percent or more of total goods exports. Economies for which these thresholds were met as a result of re-exports were excluded. When data were not available, judgment was used. This taxonomy results in the classification of some well-diversified economies as importers, even if they are exporters of certain commodities (e.g., Mexico).

³ Commodity importers are all EMDEs that are not classified as commodity exporters.

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