GLOBAL OUTLOOK
Fragile, Handle with Care
Global growth is expected to recover to 2.5 percent in 2020—up slightly from the post-crisis low of 2.4 percent registered last year amid weakening trade and investment—and edge up further over the forecast horizon. This projected recovery could be stronger if recent policy actions—particularly those that have mitigated trade tensions—lead to a sustained reduction in policy uncertainty. Nevertheless, downside risks predominate, including the possibility of a re-escalation of global trade tensions, sharp downturns in major economies, and financial disruptions in emerging market and developing economies (EMDEs). The materialization of these risks would test the ability of policymakers to respond effectively to negative events. Associated policy challenges are compounded by high debt levels and subdued productivity growth. Many EMDEs need to rebuild macroeconomic policy space to enhance resilience to possible adverse developments. They also need to pursue decisive reforms to bolster governance and business climates, improve tax policy, promote trade integration, and rekindle productivity growth, while protecting vulnerable groups. These policy actions would help foster inclusive and sustainable long-term growth and poverty alleviation.

Summary

Global growth decelerated markedly in 2019, with continued weakness in global trade and investment (Figures 1.1.A and 1.1.B). This weakness was widespread, affecting both advanced economies—particularly the Euro Area—and emerging market and developing economies (EMDEs). Various key indicators of economic activity declined in parallel, approaching their lowest levels since the global financial crisis (Figure 1.1.C). In particular, global trade in goods was in contraction for a significant part of 2019, and manufacturing activity slowed markedly over the course of the year; recent high-frequency readings suggest some tentative stabilization of manufacturing output at weak levels. To a lesser extent, services activity also moderated. A broad range of economies have experienced feeble growth, with close to 90 percent of advanced economies and 60 percent of EMDEs going through varying degrees of deceleration last year.

Bilateral negotiations between the United States and China since mid-October resulted in a Phase One agreement—including a planned partial rollback of tariffs—that has de-escalated trade tensions. This comes after a prolonged period of rising trade disputes between the two countries, which has heightened policy uncertainty and weighed on international trade, confidence, and investment. As a result of the increase of tariffs between the two countries over the past couple of years, a substantially higher share of world trade has become subject to protectionist measures (Figure 1.1.D).

Financial market sentiment improved appreciably toward the end of last year along with the alleviation of trade tensions. That said, it had been fragile for most of 2019. Concerns about growth prospects triggered widespread monetary policy easing by major central banks last year, as well as flight to safety flows into advanced-economy bond markets. In a context of subdued inflation, this pushed global yields down—in some advanced economies, further into negative territory—for most of 2019. Heightened risk aversion contributed to subdued EMDE capital inflows in the second half of last year, as a number of EMDEs faced renewed currency and equity price pressures. The subdued outlook led to declines in most commodity prices, which are expected to remain near current levels over the forecast period.

Against this international context, global growth weakened to an estimated 2.4 percent last year—the lowest rate of expansion since the global financial crisis. With some recent data pointing to an incipient stabilization of economic conditions, global growth is projected to edge up to 2.5 percent in 2020, 0.2 percentage point below previous forecasts, as investment and trade gradually recover. In particular, global trade growth—which is estimated to have slowed sharply from 4 percent in 2018 to 1.4 percent in
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Note: 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. The World Bank has ceased producing a growth forecast for Venezuela and has removed Venezuela from all growth aggregates in which it was previously included.

1. Headline aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates. World growth rates based on purchasing power parity (PPP) weights attribute a greater portion of global GDP to EMDEs relative to market exchange rates due to the PPP methodology, which uses an exchange rate that is calculated from the difference in the price levels of a basket of goods and services between economies.

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 2019 refers to FY2019/20.

3. The column labeled 2018 refers to FY2018/19.

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

5. Oil is the simple average of Brent, Dubai, and West Texas Intermediate. The non-energy index is comprised of the weighted average of 39 commodities (7 metals, 5 fertilizers, 27 agricultural commodities). For additional details, please see http://www.worldbank.org/en/research/commodity-markets.

Click here to download data.
2019, by far the weakest pace since the global financial crisis—is projected to firm throughout 2020 and reach 1.9 percent, assuming trade tensions do not re-escalate. In the near term, monetary policy across the world is generally expected to remain accommodative; however, fiscal policy support is likely to fade (Figure 1.1.E).

Near-term projections for global growth mask different contours in advanced economies and EMDEs. Growth in advanced economies is projected to slow to 1.4 percent this year—below previous projections, in part reflecting lingering weakness in manufacturing—and improve slightly over the rest of the forecast horizon.

In contrast, after decelerating to an estimated weaker-than-expected 3.5 percent last year, growth in EMDEs is projected to increase to 4.1 percent in 2020—0.5 percentage point below previous forecasts, reflecting downgrades to half of EMDEs due in part to downward revisions to trade and investment growth. Nonetheless, the recovery in aggregate EMDE growth this year—which assumes continued monetary policy support in many economies, no major swings in commodity prices, and generally benign borrowing costs—is not envisioned to be broad-based: About a third of EMDEs are expected to decelerate. Instead, it is largely predicated on a rebound in a small number of large EMDEs, most of which are emerging from deep recessions or sharp slowdowns but remain fragile. Excluding this group of countries, there would be almost no acceleration in EMDE growth this year—and, with advanced economies slowing, global growth would actually decelerate.

Going forward, EMDE growth is projected to stabilize at an average of 4.4 percent in 2021-22, as trade and investment firm. In low-income countries, growth is expected to remain little changed at 5.4 percent in 2020 and edge up to an average of 5.7 percent later in the forecast horizon, boosted by increased investment in infrastructure and rebuilding efforts in some countries following extreme weather-related devastation.

Even if the recovery in EMDE growth proceeds as expected, per capita growth will remain well below long-term averages and far from sufficient to meet...
FIGURE 1.2 Global risks and policy challenges

Current projections represent a benign but fragile outlook given ongoing global headwinds. Downside risks predominate and increase the likelihood of much weaker-than-expected global growth. However, recent policy actions that have reduced trade tensions could lead to a sustained mitigation of policy uncertainty and bolster investment. In advanced economies, the room for monetary accommodation is limited. In EMDEs, fiscal space is constrained by weak tax capacity and high debt levels, which also hinders the ability to fund basic public services. Boosting EMDE productivity, which has been on a downward trend in recent years, is essential to foster long-term growth and poverty reduction.

The near-term forecast for a pickup in EMDE growth represents a benign, but fragile, scenario given ongoing headwinds such as slowing advanced-economy growth, subdued global trade, and moderating commodity prices (Figure 1.2.A). More generally, a deeper global downturn could result if global trade tensions re-emerge, policy uncertainty persists and becomes entrenched, or activity in major economies deteriorates significantly. Other risks include financial stress in large EMDEs, heightened geopolitical tensions, or a higher incidence of extreme weather events.

Amid these downside risks, the probability that global growth in 2020 will be below baseline projections is above its historical average (Figure 1.2.B). That said, the projected recovery could be stronger than expected if recent policy actions—particularly those that have alleviated U.S.-China trade tensions—lead to a sustained reduction in policy uncertainty and bolster confidence, trade, and investment (Figure 1.2.C).

Against the backdrop of a fragile outlook, the policy challenges confronting the global economy are compounded by subdued productivity growth and high levels of debt (Chapters 3 and 4). In advanced economies, the weakness of the current expansion has made it difficult for central banks to create room for additional easing (Figure 1.2.D). Low global interest rates and the associated reduction in debt service burdens may provide some countries with additional flexibility for the implementation of structural reforms, such as investments in public infrastructure or the adoption of other growth-friendly policies. In addition, governments can create further fiscal space through better tax compliance and enforcement.

EMDEs are not well positioned to confront negative shocks, since policy buffers generally remain inadequate. While moderating inflation has allowed many EMDEs to cut policy rates to support growth, underlying price pressures are...
building in some cases, and policy space would be further eroded in the event of renewed financial market pressures. Many EMDEs, including LICs, face the additional challenge of phasing out price controls and their associated distortions amid moderate inflation (Special Focus 1 and Special Focus 2).

Although fiscal accommodation in some EMDEs may be warranted in response to adverse developments, record-high debt levels and fragile public finance positions limit the ability to implement countercyclical policy—indeed, a large share of EMDEs, particularly LICs, do not even have the capacity to adequately fund basic public services (Figure 1.2.E; Chapter 4). If faced with negative shocks, authorities would need to ensure that any fiscal support prioritizes growth-enhancing spending and domestic revenue mobilization to avoid further erosion of public debt sustainability. Tax policy reforms that broaden the revenue base are needed to fund investment, which could be complemented by measures that help reduce inequality.

EMDE policymakers also need to pursue decisive structural reforms, while protecting vulnerable groups, to promote inclusive long-term growth. Policy actions that improve EMDE governance frameworks and business climates, and facilitate integration in existing supply chains or spur the creation of new ones, could help counter the adverse effects of weak global growth and subdued international trade (World Bank 2019a). Measures to improve connectivity, lower trade costs, and ensure a stable and predictable legal environment could facilitate this integration. A strong and stable multilateral trading system remains an important foundation for robust growth in EMDEs.

The downward trend in EMDE productivity growth in recent years complicates these policy challenges (Figure 1.2.F; Chapter 3). Measures to boost EMDE productivity growth are essential to foster potential growth and ensure continued progress in improving living standards and alleviating poverty. To rekindle productivity growth, a comprehensive approach needs to be employed involving policies that facilitate investment in physical and human capital, encourage the reallocation of resources toward more productive sectors, reinvigorate technology adoption and innovation among firms, and promote a growth-friendly macroeconomic and institutional environment. Within this four-pronged approach, specific policy priorities will depend on country circumstances. In addition, investments in green infrastructure can also help achieve development goals and improve resilience to climate change.

**Major economies: Recent developments and outlook**

In major economies, activity has slowed more markedly than previously expected. Very weak manufacturing activity has dampened growth in advanced economies, and policy uncertainty associated with trade tensions has also weighed on activity in the United States and China.

The growth forecast for advanced economies has again been revised down as a consequence of weaker-than-expected trade and manufacturing activity (Figure 1.3.A). Recent data show particular weakness in investment and exports, particularly in the Euro Area. This, along with below-target inflation in many economies, has prompted a broad shift toward monetary policy easing (Figure 1.3.B). Labor markets and the services sector generally remain more resilient, but the latter has shown signs of moderation (Figure 1.3.C). Aggregate activity is expected to edge down in 2020, with continued softness in investment and trade (Figure 1.3.D).

**United States**

Growth has decelerated amid slowing investment and exports (Figure 1.4.A). Notwithstanding the recent trade deal with China, rising tariffs have increased trade costs, while policy uncertainty has weighed on investment and confidence (Baker, Bloom, and Davis 2016; Faigelbaum et al. 2019). As in many other advanced economies, the U.S. manufacturing sector has been very weak. Support from tax cuts and changes in government spending is expected to fade this year and become a drag on growth thereafter (Figure 1.4.B; IMF 2019a).
Despite these headwinds, the labor market remains robust and has benefited from a rising participation rate. Unemployment is near a five-decade low and wage growth has been solid, fueling resilient consumption. Concerns about the global outlook and persistent below-target inflation have resulted in the Federal Reserve cutting its policy rates by 75 basis points since mid-2019.

Growth is expected to slow over the course of the forecast period, from 2.3 percent in 2019 to 1.8 percent in 2020 and 1.7 percent in 2021-22. In the near term, the slowdown reflects the negative impacts of lingering uncertainty and a waning contribution from tax cuts and government spending, which are only partly offset by accommodative monetary policy. The forecast is predicated on tariffs staying at planned levels, fiscal policy progressing as currently legislated, and the heightened degree of policy uncertainty gradually dissipating. Additional progress in U.S.-China trade negotiations that leads to a further reduction in trade policy uncertainty could result in higher-than-expected U.S. growth.

**Euro Area**

Economic activity in the Euro Area has deteriorated significantly. Several economies were on the verge of recession at some point last year, with particular weakness in the German industrial sector as it struggled with falling demand from Asia and disruptions to car production (Figures 1.5.A and 1.5.B). Uncertainty concerning Brexit also weighed on growth.

The ECB has provided monetary stimulus by pushing its policy rate deeper into negative territory, restarting quantitative easing, and providing inexpensive credit to banks. The overall fiscal position of the Euro Area is expected to be roughly balanced over the forecast period, providing little additional support to activity despite existing space in some economies.

Growth is expected to slow to 1 percent in 2020, 0.4 percentage point down from previous projections due to worse-than-expected incoming data, especially industrial production. Growth is forecast to recover modestly to an average of 1.3 percent in 2021-22, assuming that policy support gains traction, the Brexit process unfolds with minimal disruption, and there is no further escalation in trade restrictions.

**Japan**

Activity in Japan declined sharply following the impact of Typhoon Hagibis and the increase in the value-added tax (VAT) in October last year. The economy is also suffering from acute weakness in manufacturing and exports, particularly those to China, alongside declining consumer confidence. In response, the government is...
providing significant support. Despite recent weakness in activity, the unemployment rate remains near multidecade lows, labor force participation continues to climb, and per capita income growth remains healthy.

Growth is expected to slow from 1.1 percent in 2019 to 0.7 percent in 2020, as anticipatory purchases prior to the VAT increase in October 2019 are unwound. Growth in 2021-22 is expected to average about 0.5 percent.

China

Growth has decelerated more than previously expected amid cooling domestic demand and heightened trade tensions. Trade policy uncertainty and higher tariffs on trade with the United States weighed on investor sentiment for most of 2019. Industrial production growth has reached multiyear lows (Figure 1.6.A).

Trade flows have weakened substantially. Imports, especially those of intermediate goods, have declined, falling more than exports, partly reflecting a deceleration in domestic demand. The contraction in exports to the United States has deepened, although shipments to the rest of the world have been somewhat more resilient.

In response to the deceleration in activity, monetary policy has become more accommodative, but regulatory tightening to reduce non-bank lending has continued. The government has also stepped up some fiscal measures, including tax cuts and support for local governments for public investment spending (Figure 1.6.B; World Bank 2019b). Total debt has surpassed 260 percent of GDP, but the share of non-bank lending has continued to decline (World Bank 2019c).

After decelerating to an estimated 6.1 percent in 2019, growth is expected to moderate to 5.9 percent in 2020 and 5.8 percent in 2021—0.2 percentage point below previous projections in both years. This is the first time China will register a pace of expansion below 6 percent since 1990, amid a slowdown in labor productivity growth and continued external headwinds (Chapter 3; World Bank 2018a). A permanent and lasting resolution of trade disputes with the United States that builds upon recent progress could bolster China’s growth prospects and reduce reliance on policy support.

Global trends

International trade and investment have weakened further, impeded by slowing global demand, as well as heightened policy uncertainty and an overall increase in the level of tariffs despite recent de-
zf_inancial transactions, construction, and travel services, which together account for more than one-third of world services trade (WTO 2019a).

The slowdown in trade and manufacturing stems from a variety of factors. Weakening demand in Europe and Asia, in particular for trade-intensive automobiles and technology products, and the slowdown in investment growth have been important drags. Protectionist measures implemented by G20 countries since 2018 have affected over $1 trillion worth of trade flows, or nearly 7 percent of global goods trade (Figure 1.7.D; WTO 2019b). The number of regulatory restrictions affecting foreign direct investment flows has also been on the rise, increasing by more than a third in 2018 (UNCTAD 2019a).

Trade tensions between the United States and China escalated throughout most of 2019, and new tariffs were implemented on the majority of their bilateral trade. These tensions, and the ensuing increase in policy uncertainty, have resulted in sizable aggregate losses for world trade; while they have also had a positive impact on some EMDEs through trade diversion, this impact has been relatively small. Trade frictions have also risen elsewhere, including between the United States and some of its other trading partners such as the European Union (EU), as well as between Japan and the Republic of Korea.

Nevertheless, negotiations between the United States and China since mid-October resulted in a Phase One agreement between the two countries, including plans to partially roll back a subset of U.S. tariffs in exchange for Chinese commitments to make additional purchases of U.S. products, strengthen intellectual property protection, and pursue financial services liberalization. The recent agreement, coupled with continued negotiations and recent unilateral tariff reductions by China, signals a notable de-escalation of trade tensions. Moreover, protectionist measures implemented since 2016 have been partially offset by various liberalizing measures that affected 5 percent of financial transactions, construction, and travel services, which together account for more than one-third of world services trade (WTO 2019a).
Global goods trade in 2019. The U.S.-China Phase One agreement, as well as other positive developments—such as progress in the ratification or implementation of the Africa Continental Free Trade Agreement, the U.S.-Japan trade agreement, and the United States-Mexico-Canada Agreement—could give a much-needed boost to trade growth.

In sum, growth in global goods and services trade slowed sharply from 4 percent in 2018 to an estimated 1.4 percent last year, by far the weakest pace since the global financial crisis, and is projected to firm throughout 2020 and reach 1.9 percent. Critically, these projections assume no further escalation or reduction of trade restrictions going forward. An additional decline in trade tensions and the associated policy uncertainty—if, for instance, ongoing U.S.-China negotiations were to result in further reductions in tariffs—could lead to a stronger-than-expected pickup in global trade growth.

Financial markets

Global financing conditions eased considerably in 2019 (Figure 1.8.A). Bond yields in advanced economies fell to unprecedented lows, notwithstanding a pickup toward the end of the year amid improvement in market sentiment. Close to $12 trillion of outstanding global debt—nearly a quarter of the total stock, and almost entirely from Western Europe and Japan—is trading at negative interest rates. Major central banks, most notably the U.S. Federal Reserve and the ECB, eased monetary policy last year in the face of softening global economic prospects, heightened downside risks, and persistently low inflation. Despite weak global investment, corporate debt has been rising in many countries, with particularly rapid growth in some riskier categories, such as lending to highly leveraged firms in the United States and the Euro Area (FSB 2019a).

In general, EMDE borrowing costs have fallen and debt issuances have increased. Not all countries benefited equally, however—EMDEs that already had low spreads experienced further declines, while economies with low sovereign credit ratings suffered from a flight to safety (Figure 1.8.B). Investors were particularly cautious about equity markets in riskier EMDEs, which experienced significant portfolio outflows during the period of heightened trade tensions and global growth concerns starting around August of last year, before recovering more recently (Figure 1.8.C). While equity and bond market developments in EMDEs have diverged considerably according to risk perception, many EMDE currencies have
depreciated, and a growing share have fallen to their lowest exchange rate with the U.S. dollar in a decade (Figure 1.8.D).

Foreign direct investment (FDI) has continued its downward trend, with some of the recent weakness attributable to global policy uncertainty. FDI weakened across all EMDE regions in the first half of 2019, with the decline being particularly pronounced in EMDEs that had earlier experienced financial pressures (UNCTAD 2019b). By contrast, remittances to EMDEs continued to grow and recently surpassed FDI (World Bank 2019d).

Commodity markets

The prices of most commodities fell in 2019, mainly reflecting the deterioration in the growth outlook—especially that of EMDEs, which tend to have a larger income elasticity of demand for commodities (Figure 1.9.A; Baffes, Kabundi, and Nagle forthcoming). Forecasts have been revised down for most commodities in 2020 (Figure 1.9.B).

Oil prices averaged $61/bbl in 2019, a 10 percent fall from 2018 and $5/bbl below previous projections. Prices were supported by production cuts by OPEC and its partners, including the December 2019 decision to remove 0.5 mb/d of production on top of previous reductions of 1.2 mb/d implemented since January 2019. Production has also been constrained in the Islamic Republic of Iran and the República Bolivariana de Venezuela by a variety of geopolitical and domestic factors. However, these pressures were offset by weakening oil demand, as exemplified by downward revisions to demand projections (Figure 1.9.C; IEA 2019).

Oil prices are forecast to decline slightly to an average of $59/bbl in 2020 and 2021. U.S. supply is expected to continue to increase in 2020 as new pipeline capacity comes onstream. The greatest downside risk to the forecast is a further deterioration in growth. Current expectations are for oil consumption growth to pick up to just over 1 percent in 2020, which is comparable to the pace of global oil demand seen during previous global downturns (Figure 1.9.D). A critical upside risk to the forecast is the possibility of a further significant reduction in trade tensions between the United States and China, which could boost oil demand prospects.

Prices for most base metals weakened in the second half of 2019, primarily reflecting weaker
global growth and trade tensions. Metals prices are expected to decline further in 2020, reflecting subdued industrial commodity demand. As with oil, a significant continued mitigation of U.S.-China trade tensions presents a key upside risk to metals price projections. Agricultural prices declined in the second half of 2019 on improved weather conditions that ensured elevated stock levels for grains. Agricultural prices are expected to stabilize in 2020, with risks to the forecast broadly balanced.

**Emerging market and developing economies**

The outlook for EMDEs has weakened significantly. As trade and investment firm, EMDE growth is projected to pick up to 4.1 in 2020—0.5 percentage point below previous forecasts—and stabilize at 4.4 percent in 2021-22, with the pace of the recovery restrained by soft global demand and structural constraints, including subdued productivity growth. The near-term rebound in EMDE growth will be mainly driven by a projected pickup in a small number of large countries. Per capita income growth will remain well below long-term averages, making progress toward poverty alleviation and development goals more challenging.

**Recent developments**

EMDEs have continued to experience substantial weakness, with industrial production, trade flows, and investment decelerating sharply last year (Figures 1.10.A to 1.10.C). While services activity has been appreciably more resilient than manufacturing, it has also moderated (Figure 1.10.D). Growth has been particularly anemic in EMDEs that have experienced the lingering effects of varying degrees of financial pressures or other idiosyncratic factors in the past couple of years. \(^1\) This weakness has also spread to other economies that had previously shown resilience. In all, growth in about 60 percent of EMDEs is estimated to have slowed last year. In many economies, subdued economic activity has been somewhat cushioned by still-resilient consumption and a shift toward more supportive monetary policy.

Growth in EMDEs that experienced recent financial or country-specific stresses remains feeble (Kose and Ohnsorge 2019). To different degrees, these economies continue to face heightened policy uncertainty and various domestic challenges. With notable exceptions, activity has started to firm somewhat; however, the recovery in

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\(^1\) These EMDEs include: (1) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or (2) countries that have been subject to sanctions (Iran, Russia). Additional details about this classification can be found in World Bank 2019e.
most of these economies is proceeding at a markedly slower pace than previously envisioned. Some easing of lending conditions, as well as progress on the reform agenda, are beginning to support a modest pickup in Brazil. In the Russian Federation, monetary policy easing and public infrastructure projects from the National Projects program are buoying activity. In Turkey, activity is rebounding from earlier financial turmoil at a faster-than-expected pace as domestic demand improves; however, the pickup remains fragile amid subdued confidence and investment. In Mexico, easing monetary policy is providing some support to growth. In contrast, activity in Argentina has been contracting amid high policy uncertainty in the aftermath of severe financial stress in mid-2019. In Iran, sanctions have been weighing significantly on growth.

Growth in other EMDEs has generally softened owing to global and domestic headwinds. Economies that are deeply integrated into global and regional production and trade networks—most notably in Asia and Europe—particularly suffered from global trade tensions and decelerating trade flows last year (Philippines, Thailand; World Bank 2019f, 2019g, 2019h). Tighter credit conditions in the non-banking sector are contributing to a substantial weakening of domestic demand in India, while activity in Pakistan has decelerated in response to contractionary monetary policy intended to restore domestic and external balances. In some countries, capacity constraints are also limiting growth (Poland, Romania). Other economies have experienced temporary setbacks to construction and infrastructure projects (Costa Rica, Panama), the effects of natural disasters (Guatemala, Papua New Guinea), and the negative impact of social unrest (Bolivia, Chile).

Commodity exporters

Growth in commodity exporters slowed from 2 percent in 2018 to an estimated 1.5 percent in 2019, 0.6 percentage point below earlier forecasts, reflecting softer-than-projected commodity prices, oil production cuts, decelerating investment in extractive sectors, and weakness in the largest countries that earlier experienced financial pressures or other country-specific stresses—particularly Argentina, Brazil, Iran, and Russia (Figure 1.11.A). Weakening global demand and ongoing domestic challenges—including large macroeconomic imbalances and domestic policy uncertainty—continue to discourage investment and delay recovery in many commodity exporters (Nigeria, South Africa; World Bank 2019h).

Despite supportive fiscal policy and stable non-oil activity, difficulties in the oil sector and heightened geopolitical tensions are weighing on activity in oil exporters in the MENA region.
In other commodity exporters with more policy space, countercyclical policy measures have been partly offsetting the drag from weakening global demand and lower commodity prices, resulting in stable or moderately slower growth (Indonesia, Peru).

**Commodity importers**

Growth in commodity importers excluding China eased from 5 percent in 2018 to an estimated 3.3 percent in 2019—0.9 percentage point below previous projections and the slowest rate since the global financial crisis (Figure 1.11.B). This slowdown in part reflected a marked deceleration in Turkey due to earlier financial stress, in Mexico due to heightened policy uncertainty, and in India due to a tightening of domestic non-bank credit conditions. Policy adjustments to address macroeconomic imbalances in Pakistan also weighed on aggregate growth in this group.

For many commodity importers, momentum last year was weaker than expected, reflecting declining exports and investment, only partly offset by more accommodative monetary policy stances and fiscal support measures (Philippines, Thailand; World Bank 2019j). Nonetheless, growth in many commodity importers remains solid due to robust private consumption and supportive policies in a context of subdued inflation and resilient capital flows (Bangladesh, Cambodia, Vietnam). Moreover, decelerating activity in some commodity importers also reflected a narrowing of positive output gaps (Poland, Romania).

**Low-income countries**

The recovery in low-income countries (LICs) has faltered amid softening external demand, weaker commodity prices, political instability, and devastation from extreme weather events (Box 1.1; Steinbach 2019; World Bank 2019e). Growth among fragile LICs, in particular, has slowed markedly. In the Democratic Republic of Congo, falling metals prices stifled mining activity, while the Ebola outbreak in the conflict-affected northeastern region has persisted. Subdued growth in Mozambique reflected widespread damage caused by two tropical cyclones and weaker-than-expected coal production.

Activity in other LICs, however, has been somewhat more robust, reflecting improved harvests (Malawi, Nepal), as well as continued services sector strength and solid public and private investment growth (Guinea-Bissau, Uganda). Nonetheless, softer external demand and lower agricultural prices have dampened export revenues and slowed growth in some countries (Madagascar, Rwanda).

**Outlook**

**Growth outlook**

EMDE growth is expected to experience a moderate cyclical recovery from an estimated 3.5 percent last year to 4.1 percent in 2020—0.5 percentage point lower than previously projected (Figure 1.12.A). Forecasts for almost all regions and half of EMDEs have been downgraded for this year, largely reflecting weaker-than-expected exports and investment (Box 1.2; Chapter 2). EMDE growth is projected to stabilize at an average rate of 4.4 percent in 2021-22, as trade and investment firm. These baseline projections are predicated on resilient consumption, a diminishing drag from earlier pressures in some...
BOX 1.1 Recent developments and outlook for low-income countries

Growth in low-income countries (LICs) has faltered in 2019, falling to 5.4 percent. The slowdown partly reflects global factors (softening external demand and weaker commodity prices), and idiosyncratic factors (political instability and devastation from extreme weather events). Growth is expected to firm over the forecast horizon, reaching an average of 5.7 percent in 2021-22. This pickup assumes improved stability, recovery from extreme weather events, continued investment in infrastructure, and the implementation of structural reforms and measures to strengthen business environments. Nonetheless, projected growth will be insufficient to markedly reduce poverty, particularly in LICs affected by fragility, conflict, and violence. Risks to the outlook include slower-than-expected growth in major trading partners, rising debt vulnerabilities, and growing insecurity.

Recent developments

Economic activity. The recovery in low-income countries (LICs) stalled in 2019 as global and idiosyncratic factors dampened activity. The global backdrop reflected softening external demand and weaker commodity prices, while activity in some countries was weighed down further by political instability and extreme weather events. Growth in LICs fell to an estimated 5.4 percent, 0.3 percentage point lower than previous forecasts (Figure 1.1.1.A).

The weaker-than-expected performance reflected a marked slowdown in activity among fragile LICs. Growth in the Democratic Republic of Congo decelerated as weakening external demand and lower metal prices weighed on exports. The conflict-affected northeastern region of the country is grappling with the second-largest Ebola outbreak on record, which began in the middle of 2018. In Haiti, growth is estimated to have contracted in 2019 amid severe political instability, rapid exchange rate depreciation, elevated inflation, and rising food insecurity exacerbated by drought. Similarly, in Liberia, the estimated contraction in activity last year reflected the erosion of incomes from elevated inflation, weak harvests, and moderating mining production due to lower commodity prices. In Mozambique—which has been on a reduced growth path since 2016—slowing growth in 2019 was largely due to the devastation caused by last year’s cyclones alongside moderating coal production. In addition to their heavy human toll, the cyclones have likely reversed recent gains in poverty reduction in affected economies (Malawi, Mozambique; Baez, Caruso and Niu 2019; World Bank 2019k).

Activity also slowed among other LICs (Benin, Burkina Faso, Madagascar, Rwanda, The Gambia, Tajikistan). In Rwanda—one of the fastest growing economies in the world—growth edged down as weakening external demand and lower commodity prices constrained export revenues; however, sustained public investment helped offset some of this weakness. Nonetheless, activity remained resilient, or strengthened, among some LICs. Improved harvests supported rising agricultural production (Malawi, Nepal), and services sector activity continued to accelerate (Guinea-Bissau, Uganda). In Malawi, agricultural production strengthened despite the impact of Cyclone Idai, reflecting improved tobacco and maize harvests in unaffected districts. In Ethiopia—the largest LIC economy—agricultural production slowed while constrained hydroelectric power generation due to low dam levels dampened industrial activity; however, these weaknesses were more than offset by continued robust services sector activity, particularly in travel, banking, and telecommunications. On the demand side, activity was supported by robust private consumption helped by strong harvests (Malawi, Nepal), and solid investment growth—both public and private (Guinea-Bissau, Uganda). Despite a sharp fall in aluminum prices, growth edged up in Guinea, partly due to continued infrastructure investment in mining-related activities. In Sierra Leone, the resumption of iron ore production helped boost activity.

External positions. Current account balances widened among more than half of LICs. In some countries, larger deficits reflected weaker exports related to softening external demand and lower international commodity prices (Guinea-Bissau, Rwanda, Togo). Elsewhere, deficits widened primarily due to imports of capital goods related to large infrastructure investment projects (Mozambique, Togo, Uganda). Imports associated with cyclone-related reconstruction added to existing deficits (Malawi, Mozambique). In Ethiopia, however, the current account deficit narrowed amid improved services exports—largely transport services with Addis Ababa increasingly becoming a key regional hub—and as fiscal consolidation contributed to slower import growth. By the second half of 2019, capital flows into LICs appear to have weakened noticeably, as growing concerns over global growth prospects and heightened trade tensions weighed on investor sentiment. As a result, international reserves in the median LIC have weakened somewhat and remain below the three-months-of-imports benchmark in about one-

Note: This box was prepared by Rudi Steinbach. Research assistance was provided by Hazel Macadangdang.

1 Fragile LICs are those affected by fragility, conflict, and violence, according to the World Bank’s Harmonized List of Fragile Situations.
Fiscal positions. LIC fiscal balances deteriorated, on average, in 2019 with the average deficit widening to an estimated 3 percent, from 2.6 percent in 2018 (Figure 1.1.1.B). Fiscal deficits mostly widened among fragile LICs, partly reflecting low domestic revenue mobilization while public spending remained elevated. In the Democratic Republic of Congo, efforts to contain spending were not sufficient to offset the decline in fiscal revenues resulting from the weaker mining sector performance. In contrast, increased fiscal consolidation supported by greater revenue mobilization, as well as broad-ranging tax administration reforms have helped deficits improve in several LICs (Burkina Faso, Ethiopia, Malawi, Mali).

Outlook for 2020-22

Economic growth. Growth in LICs is projected to remain unchanged at 5.4 percent in 2020, before firming to an average of 5.7 percent in 2021-22. Forecasts for this year and next are 0.6 percentage point lower than previous projections, reflecting weaker external demand, lower commodity prices, and policy tightening among some large LICs. The expected pickup is predicated on no further deceleration in external demand and a stabilization of commodity prices, albeit at lower levels.

Among fragile LICs, growth is forecast to rise to 3.7 percent in 2020, from 3.2 percent in 2019, in part due to improved political stability in some countries, strengthening business environments, and as the lingering effects of extreme weather events wane. In Afghanistan, greater political stability following elections in late 2019 is expected to help support activity. Notable business environment reforms in Togo will continue to bolster growth (World Bank 2020). In Chad and Mozambique, investment in new production capacity should spur growth and boost exports, more than offsetting softer commodity prices and weaker external demand. In the Democratic Republic of Congo, however, growth is projected to moderate further as lower metal prices—particularly for cobalt—continue to suppress mining production.

In other LICs, economic activity is expected to remain resilient, with growth above 6 percent over the forecast horizon. In countries such as Benin and Rwanda, the expansion will be supported by public investment in infrastructure, strong agricultural growth, and increased private sector activity as reforms continue to bolster the business environment. Accommodative monetary policy stances amid relatively subdued inflation will further support activity in some countries (Malawi, Tanzania; Special Focus 2; Figure 1.1.1.C). In Uganda, growth will be boosted by public and private infrastructure investments, as well as in energy projects, as the country
prepares to export oil by 2023. Similarly, higher growth in Niger in 2022 reflects a sharp pickup in crude oil exports as oil production is expected to quadruple from current levels. Activity in Guinea will benefit from investments in new mining production capacity. In Ethiopia, however, growth is expected to slow due to tighter fiscal and monetary policy stances aimed at containing inflation.

Prospects for per capita income convergence and poverty alleviation. Per capita GDP growth in LICs is expected to
remain broadly unchanged at 2.5 percent in 2020, before firming to an average of 2.9 percent in 2021-22. This pace is insufficient to yield substantial progress in poverty reduction as growth in LICs is often not inclusive and the conversion of growth into poverty reduction is therefore low (Christiaensen, Chuhan-Pole, and Sanoh 2013; Christiaensen and Hill 2018; Figure 1.1.2.A). Among fragile LICs—which the incidence of extreme poverty is even higher—per capita GDP is expected to grow by a mere 1 percent in 2020-22, after having contracted in 40 percent of cases last year. As a result, the number of people in LICs living below the international poverty line of $1.90 per day will remain elevated, while continuing to rise among fragile LICs (Figure 1.1.2.B).

**TABLE 1.1.1 Low-income country forecasts**
(Real GDP growth at market prices in percent, unless indicated otherwise)

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Note: 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 Republic, the Democratic People’s Republic of Korea, Somalia, Syria, and Yemen are not forecast because of data limitations.

b. Aggregate growth rate calculated using GDP weights at 2010 prices and market exchange rates.

c. GDP growth based on fiscal year data. For Nepal, the year 2019 refers to FY2018/19.

d. Due to changes in the official list of countries classified as low income by the World Bank, the sample of LICs in this table is not comparable to June 2019. However, an identical sample is used for the comparison of the aggregate LIC GDP projection.

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To raise LIC growth over the medium term requires sustained improvements in labor productivity (Chapter 3). Labor productivity—average output per worker—in LICs is a mere 2 percent of that in the average advanced economy and one-tenth of the productivity level in the average emerging market and developing economy (EMDE), and LIC productivity growth has been persistently below that of EMDEs (Figure 1.1.2.C). This partly reflects LICs’ heavy reliance on agricultural sectors, including widespread subsistence farming, as well as the misallocation of resources—often caused by distortionary price controls (Special Focus 1). Raising LIC aggregate productivity will face several challenges. The reallocation of labor from mostly agriculture to higher-productivity sectors such as mining and construction has been an important driver of LIC productivity in the pre-crisis period; however, this engine of productivity growth has largely stalled following the collapse in global industrial commodity prices (Figure 1.1.2.D). Moreover, longer-term prospects for commodity demand are weakening as growth in China—the largest source of commodity demand—slows and shifts towards less resource-intensive sectors (World Bank 2018b). Climate change will pose increasing challenges to efforts to raise productivity in the agricultural sector, with large falls in crop yields expected as global temperatures rise (Fuglie et al. 2019).

**Risks.** Risks to the outlook are firmly to the downside. A faster-than-expected deceleration in growth of major world economies and key trading partners—such as the United States, the Euro Area, or China—would adversely affect export demand and investment in several LICs. Together, these three economies account for four-tenths of both LIC goods exports and foreign direct investment, and about one-quarter of remittance inflows. Countries that depend on extractive industries—specifically metals producers—would be hard-hit by a sharp slowdown in China, as it accounts for more than half of global metals demand (World Bank 2018b).

LIC government debt reached 55 percent of GDP, on average, in 2019—a 19 percentage point rise since 2013—keeping debt sustainability concerns elevated (World Bank 2019I). By November 2019, 12 out of 28 LICs were regarded as being in debt distress, or at high risk thereof, under the IMF-World Bank debt sustainability framework—two more than at the end of 2018 (Figure 1.1.2.C). The ratio of interest payments to GDP has doubled since 2013, in part reflecting the rising share of non-concessional debt as commercial creditors have become an important source of credit (Essl et al. 2019; World Bank 2019m; World Bank and IMF 2018). Non–Paris Club creditors have also become a more important source of financing over the past decade, especially in Sub-Saharan Africa (World Bank 2015). Increased access to market-based debt may also be increasing governments’ exposure to interest rate and refinancing risks. Sharp increases in debt-servicing costs would undermine much-needed fiscal consolidation efforts and absorb revenues that could otherwise be used for productivity-enhancing investments in health care, education, and infrastructure.

LICs’ weakening reserve buffers mean that renewed episodes of financial stress, accompanied by an unexpected tightening of international financial conditions, could disrupt capital inflows, fuel disorderly exchange rate depreciations, and raise financing costs. LICs with weaker macroeconomic fundamentals, higher foreign-currency-denominated debt, or greater political risks would be most vulnerable.

Insecurity, conflicts, and insurgencies—particularly in the Sahel and conflict-affected economies in the Middle East and North Africa—may further weigh on economic activity as well as food security in many countries if they were to intensify (Burkina Faso, Central African Republic, Chad, the Democratic Republic of Congo, Ethiopia, Mali, Niger, Republic of Yemen, Somalia, South Sudan, Syrian Arab Republic; FAO 2019). Moreover, the large populations that are forcibly displaced by these conflicts cluster in areas that often become a source of further instability, with poverty rates being worse than in their places of origin (Figure 1.1.2.D; Beegle and Christiaensen 2019).

Natural disasters related to growing climate extremes, such as flooding or severe and prolonged drought episodes, remain an important risk for many LICs, as agricultural output often accounts for a high share of domestic value added, and infrastructure is generally less resilient than in more developed economies (World Bank 2019e).

Health crises are a continuous concern. Although the pace of new Ebola infections in the Democratic Republic of Congo has slowed in the second half of 2019, efforts to contain the second-largest outbreak in history have been complicated by conflict (Wannier et al. 2019). As evidenced by the West African Ebola outbreak of 2014-16, the current outbreak poses a significant risk to economic activity, particularly if it were to spread to major urban centers, or to neighboring countries (De la Fuente, Jacoby, and Lawin 2019).
large economies, reduced policy uncertainty, varying degrees of monetary policy support, generally benign borrowing costs, no major swings in commodity prices, no further deterioration in global activity, and no new adverse shocks. They therefore represent a benign but fragile scenario, given the ongoing global headwinds of slowing advanced-economy growth, subdued global trade, and declining commodity prices (Figure 1.12.B).

The expected pickup in aggregate EMDE growth is not broad-based: A third of EMDEs are projected to decelerate this year. Instead, it is largely predicated on a rebound in a small group of large EMDEs, most of which are emerging from deep recessions or sharp slowdowns caused by earlier financial pressures or other idiosyncratic factors. Indeed, about 90 percent of the pickup in EMDE growth in 2020 is accounted for by just eight countries—Argentina, Brazil, India, Iran, Mexico, Russia, Saudi Arabia, and Turkey—even though they represent just a third of EMDE GDP (Figure 1.12.C). Excluding these eight countries, aggregate EMDE growth would experience almost no acceleration. More generally, aggregate economic slack in EMDEs will persist in the near term, and actual EMDE growth this year will remain below potential (Figure 1.12.D).

Projections for Argentina have been downgraded following the severe financial market turmoil last year; the impact of this event is assumed to gradually diminish over the forecast horizon. In Brazil, Russia, and South Africa, elevated policy uncertainty is expected to moderate; however, recovery in these countries is projected to be fragile due to continued challenges associated with the implementation of reforms, sanctions, or infrastructure bottlenecks. Growth in some other large economies (Egypt, India, Thailand) is expected to pick up, supported by policy easing and gradually improving business confidence in response to recent reforms.

Growth in LICs is projected to remain little changed at 5.4 percent in 2020 and edge up to an average of 5.7 percent in 2021-22. Forecasts for this year and next are 0.6 percentage point lower than previous projections, reflecting weaker external demand, lower commodity prices, and policy tightening among some large LICs (Box 1.1). The expected pickup later in the forecast horizon assumes that activity among fragile LICs recovers as political stability improves (Afghanistan, Guinea-Bissau), investments in new capacity offset weaker external demand (Chad, Mozambique), and as rebuilding efforts following last year’s cyclones boost activity (Malawi, Mozambique; World Bank 2019h). Among other LICs, activity is expected to remain generally

FIGURE 1.12 EMDE outlook

EMDE growth is expected to recover moderately, reaching 4.1 percent in 2020 and stabilizing at an average of 4.4 percent in 2021-22. This is a benign but fragile scenario given ongoing global headwinds. The recovery will not be broad-based and will instead be driven by a projected pickup in a small number of large economies. Aggregate economic slack in EMDEs will persist in the near term, with actual EMDE growth expected to remain below potential.

A. Growth outlook

B. Average share of EMDEs with annual growth accelerating by more than 0.1 percentage point, 1962-2019

C. Contributions to the change in EMDE annual growth

D. EMDE growth

Source: J.P. Morgan; World Bank.

A.C. Data for 2019 are estimates. “Main drivers of pickup” includes the eight largest EMDEs that account for 90 percent of the acceleration in EMDE growth between 2019 and 2020 (Argentina, Brazil, India, Iran, Mexico, Russia, Saudi Arabia, and Turkey). Aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates. Shaded areas indicate forecasts.

A. Green lines indicate 2000-19 simple averages.
B. AE = advanced economies. “Subdued trade” refers to growth below 2.5 percent. “Moderating commodity prices” refers to a year-on-year contraction in the non-energy commodity index.
D. Estimates of potential growth are from a multivariate filter model of World Bank (2018a). Aggregate growth rates are calculated using GDP weights at 2010 prices and market exchange rates. Sample includes 57 EMDEs. Data for 2020 are forecasts.

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EMDE productivity growth is expected to persist or deepen (Chapter 3; World Bank 2018a). Going forward, EMDE potential growth is likely to be dampened by the lingering effects of past weak investment and subdued investment prospects, diminishing demographic dividends, and more limited avenues for technological diffusion, especially in the face of rising protectionism (World Bank 2019e).

Per capita income growth and poverty

The number of people living in extreme poverty—below $1.90 per day—has fallen by more than 1 billion over the past three decades, and remarkable progress has been made on several development indicators. Yet, meeting the Sustainable Development Goals (SDGs) by 2030 appears out of reach for many EMDEs (Figure 1.13.A). Extreme poverty rates are estimated to exceed 30 percent of the population in one-quarter of economies. Around 830 million people still live without electricity. Approximately 2 billion people do not have access to at least basic sanitation services. In LICs, child mortality rates are around triple their SDG target, while access to essential health services remains deficient.

To meet the infrastructure-related SDGs alone will require annual investment equivalent to 4.5 percent to 8.2 percent of low- and middle-income countries’ GDP between 2015 and 2030 (Rozenberg and Fay 2019; Vorisek and Yu, forthcoming). The severity of this challenge has been amplified by the loss of momentum in EMDE per capita income growth during recent years (Figures 1.13.B and 1.13.C). Given sustained headwinds to activity, per capita income growth in EMDEs is expected to slow due to tighter fiscal and monetary policy stances aimed at containing inflation.

Longer-term growth prospects for EMDEs are also challenging (Ruch 2019a). In particular, the post-crisis weakness in several fundamental drivers of resilient spurred by sustained public investment in infrastructure along with greater private sector activity (Benin, Rwanda, Uganda). In some countries, more accommodative monetary policy amid relatively subdued inflation will support growth (Special Focus 2; Malawi, Tanzania). However, in Ethiopia—the largest LIC—growth is expected to slow due to tighter fiscal and monetary policy stances aimed at containing inflation.

A. Sustainable Development Goals

B. Per capita growth in EMDEs

C. Cumulative per capita income gains and losses relative to 1990-2014 trend

D. Global extreme poverty

FIGURE 1.13 EMDE per capita income growth and poverty

Despite significant gains in poverty alleviation over the last three decades, meeting the Sustainable Development Goals by 2030 appears out of reach for many EMDEs, partly because of the recent loss of momentum in per capita income growth. In Sub-Saharan Africa, per capita growth is expected to remain below 1 percent, exacerbating the concentration of extreme poverty.

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In about one-quarter of EMDEs—mostly commodity exporters—per capita growth will be inadequate to prevent income gaps from widening relative to advanced economies. In Sub-Saharan Africa—home to 24 of the 31 LICs and almost 60 percent of the world’s extreme poor—per capita
**BOX 1.2 Regional perspectives: Recent developments and outlook**

Growth in almost all EMDE regions was weaker than expected in 2019, reflecting downgrades to more than half of EMDEs. Activity in most regions is expected to pick up in 2020-21, but the recovery will largely depend on a rebound in a small number of large EMDEs, some of which are emerging from deep recessions or sharp slowdowns.

**East Asia and Pacific.** Growth in the region is projected to slow from an estimated 5.8 percent in 2019 to 5.7 percent in 2020 and moderate further to 5.6 percent in 2021-22. Easier financing conditions and fiscal policy support will partly mitigate the lingering impact of trade tensions amid domestic challenges. In China, growth is expected to slow gradually, from an estimated 6.1 percent in 2019, to 5.9 percent in 2020, and to 5.7 percent by 2022. In the rest of the region, growth is expected to recover slightly to 4.9 percent in 2020 and firm further to 5 percent in 2021-22. The balance of risks has improved, but risks to the outlook are still tilted to the downside. They include a sharp slowdown in global trade due to renewed escalation of trade tensions amid a fragile global outlook; a sharper-than-expected slowdown in major economies; and a sudden reversal of capital flows due to an abrupt deterioration in financing conditions, investor sentiment, or geopolitical relations. An upside risk to the forecast is related to stronger-than-expected recovery of regional investment and trade amid a sustained de-escalation of trade tensions between China and the United States.

**Europe and Central Asia.** Growth in the region decelerated to an estimated 2 percent in 2019, reflecting a sharp slowdown in Turkey as a result of acute financial market stress in 2018, as well as in the Russian Federation amid weak demand and cuts in oil production. Regional growth is projected to strengthen in 2020, to 2.6 percent, as activity recovers in Turkey and Russia, and to stabilize to 2.9 percent in 2021-22. Key external risks to the regional growth outlook include spillovers from weaker-than-expected activity in the Euro Area and escalation of global policy uncertainty. The region also remains vulnerable to disorderly commodity and financial market developments.

**Latin America and the Caribbean.** Growth in the region slowed markedly in 2019, to an estimated 0.8 percent, held back by idiosyncratic factors in large economies, headwinds from slowing global trade, and social unrest in several countries. As activity in Brazil gathers pace amid improving investment conditions, policy uncertainty in Mexico fades, and the recession in Argentina eases after bouts of severe market stress, regional growth is projected to rise to 1.8 percent in 2020 and about 2.4 percent in 2021. This recovery will not be sufficient to reverse the growing per capita income gap with advanced economies in some LAC economies. Moreover, the regional outlook is subject to significant downside risks, including from market volatility and adverse market responses to weak fiscal conditions; deeper-than-expected spillovers from slowdowns in Argentina, China, and the United States; heightened social unrest; and disruptions from natural disasters and severe weather.

**Middle East and North Africa.** Regional growth decelerated to an estimated 0.1 percent in 2019. Geopolitical and policy constraints on oil sector production slowed growth in oil-exporting economies, despite support from public spending. Growth in oil importers remained stable, as reform progress and resilient tourism activity were offset by structural and external headwinds. Regional growth is projected to pick up to 2.4 percent in 2020 and to about 2.8 percent in 2021-22, as infrastructure investment and business climate reforms proceed. Risks are tilted firmly to the downside—geopolitical tensions, escalation of armed conflicts, slower-than-expected pace of reforms, or weaker-than-expected growth in key trading partners could heavily constrain activity.

**South Asia.** Growth in the region is estimated to have decelerated to 4.9 percent in 2019, reflecting a sharper-than-expected and broad-based weakening in domestic demand. In India, activity was constrained by insufficient credit availability, as well as by subdued private consumption. Regional growth is expected to pick up gradually, to 6 percent in 2022, on the assumption of a modest rebound in domestic demand. While growth in Bangladesh is projected to remain above 7 percent through the forecast horizon, growth in Pakistan is projected to languish at 3 percent or less through 2020 as macroeconomic stabilization efforts weigh on activity. Growth in India is projected to decelerate to 5 percent in FY2019/20 amid enduring financial sector issues. Key risks to the outlook include a sharper-than-expected slowdown in major economies, a reescalation of regional geopolitical tensions, and a setback in reforms to address impaired balance sheets in the financial and corporate sectors.

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Note: This box was prepared by Patrick Kirby with contributions from Rudi Steinbach, Temel Taskin, Ekaterine Vashakmadze, Dana Vorisek, Collette Wheeler, and Lei Ye. Research assistance was provided by Hazel Macadangdang.
**BOX 1.2 Regional perspectives: Recent developments and outlook (continued)**

**FIGURE 1.2.1 Regional growth**

Growth in almost all EMDE regions was weaker than expected in 2019, reflecting downgrades to more than half of EMDEs. Activity in most regions is expected to pick up in 2020-21, but the recovery will largely depend on a rebound in a small number of large EMDEs, some of which are emerging from deep recessions or sharp slowdowns.

**A. Regional growth, weighted average**

**B. Regional growth, unweighted average**

**C. Regional investment, weighted average**

**D. Regional exports, weighted average**

**E. GDP growth in ECA, weighted average**

**F. GDP growth in LAC, weighted average**


A.-D. Bars denote latest forecast; diamonds correspond to January 2020 forecasts in the Global Economic Prospects report. Average for 1990-2019 is constructed depending on data availability. For Europe and Central Asia, the long-term average uses data for 1995-2019 to exclude the immediate aftermath of the collapse of the Soviet Union.

A.C.D.E.F. Aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates. Since the largest economies account for about 50 percent of GDP in some regions, weighted averages predominantly reflect the developments in the largest economies in each region. Shaded areas indicate forecasts.

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

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**Sub-Saharan Africa.** Growth in the region moderated to a slower-than-expected 2.4 percent in 2019. Activity was dampened by softening external demand, heightened global policy uncertainty, and falling commodity prices. Domestic fragilities in several countries further constrained activity. Growth is projected to firm to 2.9 percent in 2020 and strengthen to 3.2 percent in 2021-22—notably weaker than previous projections. The growth pickup is predicated on improving investor confidence in some large economies, a strengthening cyclical recovery among industrial commodity exporters along with a pickup in oil production, and robust growth among several exporters of agricultural commodities. Nonetheless, these growth rates will be insufficient to make significant progress in reducing poverty in many countries in Sub-Saharan Africa, highlighting the need for lasting improvements in labor productivity to bolster growth over the medium term. Downside risks to the outlook include a sharper-than-expected deceleration in major trading partners; increased investor risk aversion and capital outflows triggered by elevated debt burdens; and growing insecurity.
income growth over the forecast horizon is expected to remain below 1 percent. In contrast, per capita incomes are forecast to rise close to 5 percent per year in East Asia and Pacific and South Asia. As a result, the rapid declines in the number of extreme poor living in these two fast-growing regions are likely to continue over the near term. Absent major policy efforts to lift per capita growth, global extreme poverty will become increasingly concentrated in Sub-Saharan Africa (Figure 1.13.D; Beegle and Christiaensen 2019; World Bank 2018c).

**Risks to the outlook**

Global growth, which weakened to an estimated 2.4 percent in 2019, is projected to edge up to 2.5 percent this year, following an expected recovery of trade and investment. Despite a recent notable reduction in the threat of protectionism, risks to the global outlook remain on the downside. A re-escalation of global trade tensions could further weigh on world activity. Amid financial sector vulnerabilities, major economies could slow more than expected. EMDEs remain at risk of financial stress, especially those with elevated debt, while some EMDE regions could be affected by geopolitical tensions, social unrest, large swings in commodity prices, or increasingly volatile weather patterns. On the upside, further de-escalation of trade tensions between the United States and China could continue to mitigate global policy uncertainty and bolster activity.

**Summary of global outlook and risks**

In light of softening trade and manufacturing, global growth weakened to an estimated 2.4 percent last year. This was the slowest pace of expansion since the global financial crisis—below that registered in 2012, when the Euro Area suffered a serious debt crisis, and in 2015-16, when many EMDE commodity exporters were facing large declines in commodity prices and concerns about China’s economy were widespread. As international trade and investment recover, global growth is projected to edge up to 2.5 percent in 2020—0.2 percentage point below previous forecasts—and gradually firm over the forecast horizon, reaching 2.7 percent by 2022.

Near-term projections for global growth mask diverging contours for the forecasts for advanced economies and EMDEs. Aggregate growth in advanced economies is expected to slow from 1.6 percent in 2019 to 1.4 percent in 2020, primarily reflecting a deceleration in the United States and anemic activity elsewhere. In contrast, EMDE growth is envisioned to pick up from 3.5 percent in 2019 to 4.1 percent this year, mostly as a result of a pickup in a small number of large economies, some of which are emerging from deep recessions or sharp slowdowns and whose outlooks are therefore fragile. Absent this group of countries, EMDE growth would be essentially stagnant and, with advanced economies decelerating, global growth would actually slow. This indicates that weaker-than-expected activity in this small set of EMDEs could derail the expected recovery in EMDE—and global—growth.

The contribution of EMDEs to the projected pickup in global growth also hinges on the weighting methodology. Using market exchange rates, as is done in these baseline projections, yields the aforementioned tepid recovery of global growth. Using purchasing power parity (PPP), however, places greater weight on EMDEs—which are forecast to grow faster than advanced economies—and thus results in a somewhat more pronounced global pickup.

As a result of the greater emphasis on the contribution of EMDEs—especially large, fast-growing ones—to global activity, global growth is projected at 3.2 percent in 2020 using PPP weights, compared to 2.5 percent using market exchange rates (Table 1.1). This is because EMDEs are expected to account for 40 percent of this year’s global output using market exchange rates but 60 percent using PPP weights. In particular, China’s share of global GDP in 2020 is expected to be around 15 percent using market exchange rates but 20 percent using PPP weights. In fact, of the 0.7 percentage point difference in 2020 global growth projections between the two weighting methods, China accounts for over 50 percent, with the three next largest contributors to the difference in global growth accounting for the vast majority of the remainder.
Regardless of the weighting scheme, baseline projections for global growth represent a scenario based on numerous benign assumptions. These include no re-escalation of global trade tensions, a mitigation in global policy uncertainty, no sharp slowdown in major economies, no financial stress in large EMDEs, stability in commodity prices, and—critically—the avoidance of policy missteps. Accordingly, there is substantial uncertainty surrounding these baseline projections (Figure 1.14.A).

On balance, risks to the outlook are on the downside (Ruch 2019a). The trade conflict between the United States and China could re-escalate, and trade tensions involving other major economies could emerge. Policy uncertainty could rise significantly and persistently. Some EMDEs could suffer full-blown financial crises. Commodity markets could see disruptive swings. The United States or the Euro Area could suffer deepening slowdowns, or China could slow sharply—and the potentially large associated spillovers could substantially erode the EMDE outlook. Importantly, many of these risks are intertwined.

The materialization of one or more of these risks could lead to a more severe global downturn—a situation many economies are not adequately prepared to confront (Ruch 2019b). Reflecting a preponderance of downside risks, the probability that global growth in 2020 will be at least one percentage point below baseline projections is almost 20 percent, above historical averages. (Figure 1.14.B).

Although downside risks predominate, there is also the possibility that major headwinds dissipate and the expected recovery is stronger than expected. In particular, recent policy developments—particularly those that have mitigated U.S.-China trade tensions—could lead to a sustained reduction in policy uncertainty and bolster confidence, trade, and investment, which is an important upside risk to the outlook.

Rising trade barriers and protracted policy uncertainty

After decades of trade liberalization, protectionist measures have been implemented on a growing share of global trade (WTO 2019b). At the same time, the number of trade agreements coming into effect has fallen sharply. Progress on the ratification of important trade agreements such as EU-MERCOSUR has stalled. The WTO dispute settlement system became deadlocked in December, threatening a key pillar of the global rules-based trading system. Without a well-established arbitration system, countries may use damaging unilateral or retaliatory trade policies to resolve the increasing number of trade disputes (Figure 1.15.A). The rising number of trade restrictions and the associated uncertainty around them have contributed to the recent contraction in global trade and the slowdown in global growth. The ratio of global trade-to-GDP growth has fallen below 1, far exceeding the slowdown that would be expected from the ongoing maturation of global value chains (Figure 1.15.B).

Additional tariffs have been imposed on the majority of bilateral trade between the United States and China over the past year. Despite the announcement of the Phase One trade agreement that resulted in the cancellation of planned tariff increases, re-escalation remains possible—many
commitments, including items related to the expansion of bilateral trade, intellectual property, and technology transfer, may be difficult to enforce.

The United States and China together account for nearly 40 percent of global GDP, nearly a quarter of global trade, and an even larger share of capital goods trade (Figure 1.15.C). Accordingly, renewed disruption to U.S.-China economic ties could result in damage not only to these two economies but to the rest of the world, as its effects would propagate through trade, financial, and commodity linkages. There is also the risk that trade tensions could extend to a broader set of countries. The imposition of U.S. tariffs on automobiles and parts imports would impact a globally important sector that is already struggling, likely resulting in retaliation. The global multilateral trading system could be put at risk by a continuous rise in trade barriers stemming from many countries.

In the longer run, protectionism would have serious negative consequences for the global economy, including by contributing to a further decline in the trade intensity of global growth, reducing productivity growth, and lowering real incomes (Barattieri, Cacciatore, and Ghironi 2018). The fragmentation of global value chains would cause efficiency losses for producers and higher prices for consumers. Exporting firms, which tend to be more productive than exclusively domestic firms, may need to redesign their supply chains using costlier inputs and bearing the cost of writing off stranded assets (Atkin, Khandelwal, and Osman 2017; Bernard and Jensen 2004).

Despite recent progress in the resolution of trade conflicts, the impact of rising protectionism on global growth has been magnified by protracted policy uncertainty and a decline in confidence (Figure 1.15.D). A further increase in trade policy uncertainty could continue to be a material contributor to the softening of global growth (Caldara et al. 2019). Companies that are uncertain about the framework for doing business in the future are reluctant to invest, often preferring to delay major, irreversible decisions until the uncertainty has been resolved (Handley and Limão 2015; Stokey 2016). If, in contrast to baseline assumptions, policy uncertainty was to rise further, the resulting impact on investment would have critical consequences for activity in both the short and long term.

A deepening slowdown in major economies

The United States, the Euro Area, and China are the world’s largest economies. All three suffered a marked deceleration of activity in 2019 and face downside risks (Figure 1.16.A). A deepening slowdown in any of these economies would worsen economic prospects in countries around
FIGURE 1.16 A deepening slowdown in major economies

Activity decelerated substantially in major economies in 2019. The U.S. corporate sector and the Euro Area banking sector exhibit vulnerabilities that could contribute to a deeper slowdown, which would have sizable spillovers and increase the probability of a global downturn. In China, private debt as a share of GDP is well above levels observed prior to slowdowns in other EMDEs. Stress in the financial system could lead to either a crisis or an extended period of slow growth as deleveraging drags on activity.

A. Growth in the United States, Euro Area, and China

B. U.S. financial vulnerability indicators

C. Measures of health for Euro Area banks

D. Probability of global downturn given U.S. or Euro Area recession

E. Private sector debt in China compared with peaks in other EMDEs

F. Share of EMDEs slowing after reaching debt peaks

Source: Bank for International Settlements; Center for Economic and Policy Research; Economic Cycle Research Institute; European Central Bank; Haver Analytics; Institute of International Finance; International Monetary Fund; Kose and Terrones (2015); Laeven and Valencia (2018); National Bureau of Economic Research; Shiller (2015); World Bank.

The world through direct trade linkages and commodity prices, as well as through financial and confidence channels. This could derail the anticipated recovery in EMDE growth (World Bank 2016a). The Latin America and the Caribbean region would be particularly impacted by a sharp deceleration in the United States, while economies in Europe and Central Asia would be disproportionately affected by deepening weaknesses in the Euro Area. Spillovers from a slowdown in China would have sizable effects on the country’s trading partners and in commodity producers (Ahmed et al. 2019; Stocker et al. 2018; World Bank 2016a).

United States

In the United States, growth is expected to decelerate as earlier tariff increases, lingering uncertainty, and fiscal policy all exert a drag on activity. High corporate debt and elevated equity valuations increase the economy’s susceptibility to a more severe downturn (Figure 1.16.B). In the current environment of low rates, some high-yield borrowers have benefited from investors’ search for yield. For example, leveraged loan issuance has increased rapidly, with borrowers benefitting from low spreads and loose lending standards. This increase has been facilitated by financial institutions bundling many lower-rated loans into more highly rated securities known as collateralized loan obligations (Federal Reserve Board 2019). A sudden decline in the perceived creditworthiness of borrowers could lead to a rapid fall in asset valuations and a localized credit crunch (Bank of England 2019). More generally, rising interest rates could slow activity across the entire corporate sector. Consumption has been the sole pillar supporting economic growth in recent quarters, but this would be undermined if tightening credit conditions and declining business confidence—for example, triggered by further increases in policy uncertainty—slowed hiring and wage growth.

Euro Area

The Euro Area economy has already weakened considerably. Vulnerabilities in the banking system could lead to a further slowdown, given that banks are the region’s primary source of credit through the process of deleveraging.
and—despite some recent improvement—continue to suffer from low profitability and elevated levels of non-performing loans (Figure 1.16.C). Negative interest rates in the region could further undermine bank profitability and erode financial stability, possibly impacting sovereign borrowing costs through the “sovereign-bank” nexus (Arteta et al. 2016; Feyen and Zucardi 2019; Molyneux, Reghezza, and Xie forthcoming). An unexpected bank failure—generated, for example, by exposure to Germany’s struggling industrial sector or sharp movements in asset prices following Brexit—could trigger broader financial stress and an associated loss of confidence. As with the United States, a severe slowdown in the Euro Area would substantially increase the probability of a more severe global downturn (Figure 1.16.D).

China

China’s primary vulnerability is its high and rising stock of private debt in its increasingly complex and interconnected financial system (Arteta and Kasyanenko 2019; IMF and World Bank 2017). Credit to non-financial corporates and households as a share of GDP nearly doubled in the last decade, reaching about 210 percent in the first quarter of 2019, well above the share observed prior to previous growth slowdowns and financial crises in other EMDEs (Figure 1.16.E). The effectiveness of credit in stimulating growth appears to be declining, which implies that the benefits of any further increase in credit would diminish while risks would rise (Chen and Kang 2018). Rising defaults in local banks or in the shadow banking system, a collapse in property prices, or large capital outflows alongside a sharp adjustment in asset prices could all ripple through the highly leveraged financial system. This risk is only partly mitigated by the country’s low reliance on external financing and ample capacity for fiscal and monetary support.

Alternatively, while a crisis could be avoided with policy support given China’s sizable policy buffers, the transition toward consumer-led and less credit-driven growth may lead to an extended period of subdued growth in the absence of deep structural reforms. Moreover, private deleveraging may act as a persistent drag on activity, as is commonly the case following periods of rapid debt accumulation (Figure 1.16.F; Kose, Sugawara, and Terrones 2019).

Financial stress in EMDEs

EMDE debt burdens for both public and private borrowers have grown considerably in recent years as part of the most recent global wave of debt (Figure 1.17.A; Chapter 4). Generally benign global financial conditions have reduced debt-service burdens for many EMDEs, but they may also be encouraging further debt accumulation, with prospect of persistently low advanced-economy interest rates pushing some foreign lenders to look for higher returns in EMDEs. In some areas, debt is increasingly flowing to riskier borrowers. Elevated debt can make economies vulnerable to large depreciations, capital outflows, financial stress, and abrupt policy tightening, particularly when it is financed from abroad. In addition, solvency risks in the non-bank financial sector are mounting in some large EMDEs (Arteta and Kasyanenko 2019).

Recent credit booms in EMDEs have largely been used to fund consumption rather than investment (Figure 1.17.B; Chapter 4; Arteta and Kasyanenko 2019). This carries the risk that rising debt will not be matched by rising growth, increasing the likelihood and impact of a loss of investor confidence. When such a loss is combined with an elevated proportion of debt denominated in foreign currency, capital flight and depreciation would add to existing debt sustainability concerns and magnify the negative feedback loop (Bruno and Shin 2018).

In the past, EMDEs have been vulnerable to a broad-based strengthening of the U.S. dollar (Figure 1.17.C). Amid rapidly increasing non-financial-sector debt, sharp dollar appreciation due to interest rate differentials or generalized flight to safety can expose currency and maturity mismatches and trigger widespread corporate insolvencies (Caballero, Fernández, and Park 2019; Chui, Kuruc, and Turner 2016). Large depreciations are associated with higher borrowing costs, and monetary authorities are often required to tighten to stabilize currencies or resist the passthrough of higher import costs to domestic
Inflation (Figure 1.17.D). Similarly, large swings in commodity prices can potentially lead to disruptive currency movements and balance of payments difficulties for vulnerable EMDEs.

The risk of contagion of country-specific financial distress across markets may be growing. Foreign portfolio investors and global mutual funds are becoming more active in local bond markets, accounting for an increasing share of local-currency-denominated sovereign bonds. As a result, EMDE financial markets are now more tightly integrated into the global financial system. While this has benefits, it also facilitates the contagion of global financial shocks both to foreign-currency and, to a lesser extent, local-currency debt markets (Agur et al. 2018; Arteta and Kasyanenko 2019; Cerutti, Claessens, and Puy 2019). The risk of contagion is further amplified by constrained policy room for crisis response and weaker buffers against external shocks.

Geopolitical and region-specific downside risks

Downside risks to the global outlook are compounded by various geopolitical and region-specific concerns. Geopolitical risks remain acute globally and in several regions (Ruch 2019a). The disruption in Saudi oil production in mid-September highlights the potential for renewed tensions in the Middle East. In addition, if skirmishes in Eastern Europe and in South Asia escalate, there could be important consequences for growth in the associated regions.

Amid geopolitical concerns, a sustained disruption in oil production may increase energy prices, to the detriment of affected suppliers and commodity importers. While commodity producers left unaffected by the disruption could potentially benefit from higher prices, these benefits can be undone if the price increase is accompanied by heightened volatility (van Eyden et al. 2019). Alternatively, regions with a large presence of oil producers, particularly MENA, would be adversely affected by a sharp fall in oil prices resulting from weaker-than-expected demand amid subdued global growth. A sudden increase in supply—reflecting, for instance, increased production in the United States—could also lead to a more meaningful decline in prices. Such a decline could lead to substantial fiscal tightening, as was the case in 2014-16 (Figure 1.18.A; Stocker et al. 2018). Falls in metals or agricultural prices could follow a similar pattern and would also have a serious impact on economies in regions such as Sub-Saharan Africa, Latin America and the Caribbean, or Europe and Central Asia. While regions with large numbers of commodity importers would face...
a positive terms-of-trade shock, these gains would likely be diffused across many economies, only partially offsetting the relatively larger losses faced by commodity exporters.

Social unrest has been on the rise in a growing number of countries in various regions, motivated by discontent about some combination of inequality, slow growth, governance, and economic policy. Unrest has the potential to disrupt activity and damage infrastructure. It may also make fiscal consolidation efforts more challenging for governments trying to ease tensions.

Climate change is increasing the frequency of severe weather events and lowering agricultural productivity in some regions (IPCC 2018). As such, its impact is more detrimental for regions that have large numbers of countries with less resilient infrastructure and a larger share of agricultural production. These countries tend to be poor and can ill-afford the lost infrastructure and income that accompanies extreme weather and poor harvests. Similarly, regions with large coastal populations are at risk, not only from extreme weather, but also from rising sea levels. Climate change also presents risks to the financial system in some EMDEs, as the need to incorporate climate risks into asset valuations and insurance coverage calculations increases the risk of mispricing (Figure 1.18.B). Rapid repricing is possible, for example, as more information becomes available about what assets are most at risk from rising sea levels or less habitable weather conditions (NGFS 2018).

Upside risks

Although downside risks predominate, there is also the possibility that the global recovery is stronger than expected. Existing headwinds to growth—including those related to policy uncertainty—could further dissipate, or additional macroeconomic policy support could be deployed in response.

Heightened policy uncertainty exerted a notable drag on activity throughout 2019, much of it related to concerns about rising trade barriers. The recent trade agreement between the United States and China that reverses some tariff increases could be the beginning of a constructive process leading to a sustained reduction in policy uncertainty and trade barriers. This could significantly improve confidence and unlock pent-up demand for investment, bolstering growth (Figure 1.19.A). Similarly, rapid progress on the post-Brexit trade negotiations between the United Kingdom and the European Union could lift a cloud on Europe’s outlook.

Central banks provided significant accommodation over the course of 2019, which is expected to contribute to the pickup in activity over the near term. On a global level, falling policy rates have coincided with declining inflation, suggesting that there is scope for further monetary easing, mainly for some EMDEs (Figure 1.19.B). In addition to the potential boost to growth from monetary policy, some major advanced economies with sufficient space could choose to provide additional fiscal support.
Policy challenges

Challenges in advanced economies

Very low interest rates highlight the limited room that advanced-economy central banks have to provide additional accommodation. If persistent, they may also erode the health of financial institutions. However, low borrowing costs have loosened some of the constraints on fiscal policy allowing for increased public investment or other support in countries with fiscal space, if needed. Fiscal positions could also be improved through better tax compliance and enforcement. Productivity growth in advanced economies has declined due to weak investment growth and aging populations. Reducing policy uncertainty would buttress capital formation.

Monetary and financial policies

The combination of feeble growth and stubbornly subdued inflation in the post-crisis period has made it difficult for major central banks to remove policy accommodation (Figure 1.20.A). Policy rates remain very low in most countries, and close to their effective lower bound, greatly limiting the ability to further cut rates. Other policy tools, such as policy guidance or quantitative easing, have been used to help lower long-term interest rates as short-term rates approached their lower-bound (Woodford 2012). However, the limits of these tools may also have been reached, with long-term yields in many economies, including Germany and Japan, now below zero (Figure 1.20.B). The downward trend in interest rates, and the associated challenges for monetary policy, appears to be a persistent phenomenon, driven in part by a fundamental weaknesses in investment demand across advanced economies (Rachel and Summers 2019; Williams 2016).

A number of ideas have been put forward to improve the traction of monetary policy, including targeting price levels or nominal GDP rather than inflation, stimulating activity through direct transfers to households, and eliminating the lower bound by subordinating paper money to central-bank electronic money (Agarwal and Kimball 2019; Buiter 2014; Mertens and Williams 2019). These come with their own risks.

FIGURE 1.20 Monetary and financial policies in advanced economies

Weak growth and low inflation have prevented major central banks from removing policy accommodation in the post-crisis period. As a result, policy rates are at or close to their effective lower bounds in many economies. Longer-term yields have also fallen, limiting the remaining room for other policy tools, such as forward guidance and quantitative easing.

A. Monetary policy rate increases during current and previous expansions

B. Policy rates and 10-year sovereign yields

Source: Bank of Japan; Bloomberg; European Central Bank; Federal Reserve System; Haver Analytics; World Bank.


B. Figure shows data as of December 18, 2019.

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and tradeoffs, including the difficulty of transitioning from one framework to another while maintaining the credibility and public understanding that is essential for the effective operation of monetary policy.

Aside from the constraints it places on monetary policy, an extended period of low or negative interest rates may also be detrimental to the health of financial institutions, as their interest rate margins become squeezed (Arteta et al. 2016; Brunnermeier and Koby 2019). For banks, low interest rates can reduce profitability—and therefore resilience in the face of negative shocks—and encourage greater risk taking. Non-bank financial institutions, which account for an increasing share of credit issuance, are also affected. Pension funds and insurance companies often have fixed future liabilities and may be compelled to invest in riskier and less liquid assets in order to meet their nominal return targets. Increased lending to over-leveraged borrowers may be sowing the seeds for future financial stress, especially given uncertainty about non-bank behavior and its impact on the financial system during a downturn (IMF 2019b). Regulatory reforms have made the global financial system more resilient since the global financial crisis; however, prudential authorities need to remain vigilant to risks originating from the growing importance of non-bank financial institutions, and be wary of vulnerabilities being masked by technological innovations and complex financial products (FSB 2019b).

**Fiscal policy**

In many advanced economies, households are deleveraging and corporate investment is weak, leaving aggregate demand unusually dependent on government borrowing (Figure 1.21.A). Further fiscal support may become necessary given the combination of slowing activity, elevated downside risks, and limited room for monetary policy accommodation. Many countries are carrying persistent deficits, however, despite the budgetary benefits of the global decline in interest rates.

One growth-friendly approach that advanced economies can take to improve their fiscal positions is through better tax compliance and enforcement (OECD 2019a). Preventing corporate tax avoidance through profit shifting is one way to broaden the revenue base, especially with respect to companies that provide digital services in a given jurisdiction without any physical presence (World Bank 2018d). Providing tax agencies with more resources to bring down tax non-compliance could increase revenues while helping reduce inequality (Sarin and Summers 2019).

Should governments choose to provide fiscal support, the focus should be on spending that has a high multiplier. This could include transfers to low-income individuals, as well as to regional governments, whose spending tends to be more credit constrained and procyclical (Whalen and Reichling 2015). These multipliers may be particularly large when interest rates are constrained by their effective lower bound, and can benefit other countries through spillovers, especially if action is taken in an internationally coordinated fashion (Auerbach and Gorodnichenko 2013; Wieland 2010; Woodford 2011). By contrast, multipliers tend to be low when debt levels are elevated (Huidrom et al. 2019).

**FIGURE 1.21 Fiscal policy in advanced economies**

In many advanced economies, households are deleveraging and corporate investment is weak, leaving aggregate demand unusually dependent on government borrowing. Public investment can bolster growth in both the short and long term, and increase the stock of public capital, which has fallen in a number of economies.
Public investment may be an especially effective form of fiscal support in many advanced economies, as it can bolster growth in the short term by crowding in private capital, and in the long term by increasing productivity growth and mitigating climate change (Bouakez, Guillard, and Roulleau-Pasdeloup 2017; Dreger and Reimers 2016; World Bank 2019j). The falling stock of public capital as a share of GDP in some advanced economies suggests the need to fill infrastructure needs (Figure 1.21.B; Heintz 2010). To the extent that it boosts demand and potential output, borrowing to finance public investment may ultimately have a limited impact on public debt ratios (Abiad, Fuerceri, and Topalova 2015).

**Structural policies**

Potential growth has been slowing in advanced economies due to a combination of demographic trends and decelerating productivity growth. The latter primarily reflects the appreciably diminished role of capital deepening as a contributor to growth since the global financial crisis (Figure 1.22.A). There are a variety of tools policymakers can use to help reverse this trend. Pursuing growth-enhancing public investment, fostering innovation, and increasing human capital can all be effective means of boosting productivity (Chapter 3).

The simplest option, however, is to avoid policy choices that actively hinder investment. The rise of trade protectionism and the associated uncertainty has made companies more reluctant to invest until the framework for global trade is normalized (Handley and Limão 2015; World Bank 2017a). A stable, predictable system based on a multilateral consensus about the rules governing global trade would foster investment and, thereby, strengthen potential output.

Alongside weak investment, the other main drags on productivity in advanced economies are related to slowing gains in education and gender equality (Figure 1.22.B). In addition, the working-age share of the population continues to shrink, which can slow productivity growth as younger generations tend to adopt new technology more rapidly (Chapter 3). This trend is expected to continue in coming decades, but could be partially mitigated by allowing new migrants, who tend to be prime-aged, in an orderly fashion and as appropriate to country-specific circumstances.

**Challenges in emerging market and developing economies**

While subdued inflation has allowed many EMDEs to cut policy rates, a deterioration in investor sentiment could require policy tightening. With the space for fiscal support constrained by record-high debt, tax policy reforms are needed to broaden the tax base to fund growth-enhancing and climate-friendly investment. Measures to improve governance and business climates and phase out price controls can make institutional environments more conducive to growth. Encouraging EMDE integration in supply chains could counterweigh the effects of weak global trade. Bolstering productivity growth by encouraging diversification and upgrading to high-value added, technology-intensive industries will be critical to shore up long-term growth. China’s key policy challenge is to address lingering disruptions associated with trade tensions while shifting to more balanced and sustainable growth.
Policy challenges in China

China’s authorities have provided monetary and fiscal support to mitigate the impact of higher tariffs on bilateral trade with the United States and weakening global demand. The central bank has eased policy mainly by cutting bank reserve requirements. On the fiscal front, authorities have focused on measures to accelerate investment spending at the subnational level. A number of initiatives to improve market access for foreign investors and various reforms to improve the business climate have also been implemented (World Bank 2019c, 2020).

China’s key policy challenge is to achieve a permanent and lasting resolution of trade tensions while continuing to shift to more balanced growth and gradually reducing excessive leverage. This would require enhancing productivity by boosting investment in human capital; further improving market access, competition, and financial discipline; strengthening intellectual property rights; reducing barriers to entry; continuing the gradual opening of China’s financial system to international investors; and fostering innovation (Chapter 3; World Bank 2018c; World Bank and DRC 2019).

EMDE monetary and financial policies

Consistent with flagging global growth, negative output gaps, and moderating inflation in many EMDEs, including some LICs, nearly 75 percent of EMDEs have lower policy rates now than at the start of 2019, with more than half implementing multiple cuts (Figure 1.23.A). Many EMDEs have space to cut rates further as interest rates remain relatively high and inflation below target (Figures 1.23.B and 1.23.C). However, the effectiveness of monetary policy in EMDEs is likely more limited than in advanced economies, as the interest rate channel may be weaker and the impact of external financing conditions larger (Aoki, Benigno, and Kiyotaki 2018; Choi et al. 2017).

Although global financing conditions have generally eased, policy uncertainty and risk aversion have tightened financing conditions in some EMDEs. An abrupt change in market sentiment could reignite capital outflows and currency depreciation, as well as force policy interest rate hikes, exerting greater pressure on economies still suffering the lingering effects of previous financial market stress. EMDEs with large external imbalances tend to be the most vulnerable to financial stress, including those that rely on short-term capital inflows to finance current accounts, borrow heavily in foreign-denominated currencies and from external lenders, and lack adequate reserve coverage levels.

Many EMDEs lack buffers to confront financial shocks—in nearly half of EMDEs, international reserves are currently below levels that would be consistent with reserve adequacy (IMF 2011; Kose and Ohnsorge 2019). Among LICs, reserve coverage has fallen to a two-year low (Figure 1.23.D). Following the taper tantrum of 2013, depreciations were less severe in countries with larger reserves, highlighting the importance of restoring monetary buffers (BIS 2019). In anticipation of renewed episodes of market volatility, EMDE policymakers need to keep expectations of longer-term inflation moderate and stable. This includes demonstrating a credible commitment to inflation targets in economies that have implemented such a framework (World Bank 2019n).

Since the global financial crisis, more than two thirds of EMDEs have strengthened macro-prudential policies to rein in the growth of credit to non-financial corporations and households (Figure 1.23.E; Cerutti, Claessens, and Laeven 2017; Koh and Yu 2019; World Bank 2019o). Supervisory and regulatory frameworks need to be further strengthened to confront future shocks and shore up financial stability, especially in a context where cross-border lending has shifted from banks headquartered in advanced economies to EMDE-headquartered banks (Figure 1.23.F). Macro-prudential measures, such as countercyclical capital buffers and limits on foreign-currency borrowing, can help contain systemic risk in banking and corporate sectors. Additionally, carefully calibrated regulatory measures, such as reporting and licensing criteria, could help support confidence and resilience in new platforms that expand the access to credit through financial technology innovations (BIS 2017). However, EMDEs will need to strike a careful balance when
considering the trade-offs between managing macroprudential risk and fostering financial development (Krishnamurti and Lee 2014).

**EMDE fiscal policy**

Many EMDEs face narrowing fiscal space and may struggle to quickly rebuild buffers, limiting their options to address a severe downturn (Figure 1.24.A; Ruch 2019b). Aggregate EMDE debt reached a historical high last year and is expected to rise further (Chapter 4). Fiscal sustainability remains a critical challenge in many EMDEs, reflecting increased spending in commodity exporters and reduced revenues in commodity importers (Figures 1.24.B and 1.24.C). Should a negative shock occur, the scope for fiscal accommodation may be constrained by the need to ensure long-term fiscal stability. The case for providing fiscal support would be strengthened where there are clear needs, such as infrastructure gaps, and a transparent public expenditure review process. In many cases, however, the expansion of credit over the past decade has not been channeled into investment, and was instead used to fund consumption (Chapter 4; Arteta and Kasyanenko 2019).

In particular, EMDE commodity exporters need to grapple with lower commodity prices, especially in those oil exporters where fiscal breakeven prices are higher than oil prices. In many commodity exporters, fiscal revenues are not well diversified, leaving revenues highly dependent on commodity production and exposed to global commodity price volatility (Gunter et al. 2019).

For fiscally constrained economies, building tax capacity is a crucial step towards mobilizing domestic resources, providing essential public services, pursuing appropriate redistributive policies to address inequality, and building fiscal buffers (Doumbia and Lauridsen 2019). This is particularly true in LICs, 80 percent of which lack the tax revenues to provide even basic services, let alone to meet the SDGs (Figure 1.24.D; Gaspar, Jaramillo, and Wingender 2016). Overall, policymakers need to ensure that public spending is cost effective and yields a positive growth dividend, while also protecting critical social safety nets and supporting climate-friendly measures.
Measures that help mitigate and adapt to climate change, such as environmental tax reforms, can reap a triple dividend by lowering pollution, raising welfare, and generating positive externalities (World Bank 2019p).

In many EMDEs, tax policy reform is a challenging process. To protect the most vulnerable, adjusting income tax brackets to rising inflation can ease the tax burden and prevent the erosion of real net incomes. Harmonizing tax rates across different savings instruments or a well-designed earned income tax credit can support labor participation and poverty reduction without distorting the incentive to work and save (OECD 2019a). When there is a clear rationale for tax cuts, negative revenue effects can be partly offset by measures that increase compliance—such as the introduction of a withholding mechanism or a simplification of the tax structure—or that spur innovation and investment—such as tax credits on vocational education and research and development (Clavey et al. 2019; Correa and Guceri 2013; World Bank et al. 2015). Additional measures that broaden the tax base, including those that eliminate costly loopholes, can be complemented with reforms that strengthen tax administration and collection to reduce avoidance, base erosion, and profit shifting (Awasthi and Bayraktar 2014; OECD 2017; Packard et al. 2019; Prichard et al. 2019; World Bank 2018d).

EMDEs with unsustainable fiscal positions can also prioritize rebuilding policy space by improving spending efficiency, by shifting spending toward growth-enhancing, climate-friendly investment from unproductive current spending, and by strengthening governance to contain and eliminate wasteful spending (World Bank 2017b). If public expenditure needs are high, rebalancing the tax structure can provide maneuvering room, particularly in economies with lower initial tax rates (Gunter et al. 2018, 2019). The realization of costly fiscal risks to public balance sheets, such as contingent liabilities, could be stemmed through use of macroprudential measures that help ensure the resilience of the banking sector. Building credible and transparent medium-term expenditure frameworks that align with the strategic goals of the government is also crucial (Koh and Yu 2019; Munoz and Olaberria 2019).

**EMDE structural policies**

Over the long run, EMDE policymakers need to undertake the necessary structural reforms to buttress potential growth. Inadequate governance and business climates need to be improved to foster an institutional environment that is more conducive to growth. In a context of subdued trade growth, further integration of EMDEs into...
global value chains needs to be promoted. Critically, amid slowing capital deepening, productivity growth—an essential driver of long-term growth and poverty reduction—needs to be rekindled. Many EMDEs, including LICs, face the added challenge of phasing out distortionary price control policies that impede growth and development. In tackling these challenges, care should be taken to protect vulnerable populations by improving social safety nets.

Moreover, investment in green infrastructure and its integration with traditional infrastructure can lower costs, help achieve development goals, and contribute to improving infrastructure systems’ resilience to climate change (Browder et al. 2019). Private sector financing to meet large infrastructure investment needs and foster capital formation and the leveraging of digital technologies to promote the inclusion, efficiency, and innovation of firms in EMDEs are all crucial in boosting potential growth (World Bank 2016b).

Implementing governance and business climate reforms

Governance reforms in EMDEs have stalled, and renewed momentum is needed (World Bank 2018a). The number of countries whose ranking for rule of law and control of corruption have significantly worsened in the last two decades outnumber those whose rankings have improved (Figure 1.25.A). Strikingly, very few large EMDEs had significant gains in any of the worldwide governance indicators, nor did LICs as a group. Strengthening institutional quality and governance to protect property rights would encourage the shift from informal to more productive formal activities (World Bank 2017c). Measures that improve public sector efficiency through the provision of high-quality and cost-effective public goods also need to be considered as they can help raise firm productivity (Giordano et al. 2015).

Since 2009, only about a third of EMDEs increased their doing business score significantly, with notable regional variations (Figure 1.25.B). Reforms should aim to accelerate improvements in the business climate by tackling burdensome regulations and enhancing the ease of doing business, in order to pave the way for more jobs, higher incomes, and reduced poverty (World Bank 2020).

Phasing out distortionary price controls

While introduced with the best social intentions, price control policies, often coupled with onerous subsidies, pose important obstacles to growth and development in many EMDEs, including LICs (Special Focus 1). The removal of these costly controls can reduce misallocation of capital and labor, spur investment, and increase competition in sectors subject to these policies. Moreover, when paired with targeted social safety nets, their removal can help reduce poverty and inequality (Verme and Araar 2017). Some of the fiscal savings from the reforms can be used to fund growth-enhancing education and infrastructure spending.

Promoting integration into global value chains

The rise in the incidence of protectionist measures over the past couple of years not only weighs on global trade growth but could lead to the fragmentation of global supply chains and deprive EMDEs of a key source of growth and poverty reduction. Policy measures that help facilitate trade in EMDEs by boosting their integration in existing supply chains and spurring the creation of new ones could provide a counterweight to the global slowdown in growth and trade (World Bank 2019a). A 10-percent increase in GVC participation is estimated to boost per capita income growth by more than 10 percent, about twice as much as standard trade (Figure 1.25.C). Firms integrated in GVCs tend to be more productive and capital intensive; they represent only about 15 percent of all trading firms, yet account for almost 80 percent of total trade. GVC participation is positively associated with foreign direct investment in EMDEs, as well as technology and knowledge transfers (Martínez-Galán and Fontoura 2019; World Bank et al. 2017).

Reducing distortions to international trade can contribute to boosting EMDE participation in GVCs (Figure 1.25.D; OECD 2019b). The liberalization of barriers (both tariff and non-tariff) affecting imported intermediate inputs could expand sources of supply available to EMDEs and
their ability to specialize. A one-standard-deviation decrease in a country’s average manufacturing tariffs—8 percentage points—is associated with an increase in the country’s backward GVC participation (captured by the foreign value-added content of exports) of about 0.2 standard deviations (Fernandes, Kee, and Winkler 2019). Liberalizing barriers to services trade, which are significantly higher than those for goods trade, is also important in promoting GVC growth.

Trade facilitation policies that improve connectivity by enhancing trade and transport logistics and lower trade costs can help EMDEs better integrate into GVCs. For many goods traded in GVCs, a day’s delay has costs equivalent to a tariff of 1 percent or more. Improving customs and border procedures, promoting competition in transport services, and improving port structure and governance are all strategies that can help reduce trade costs related to time and uncertainty (Pathikonda and Farole 2016).

Because GVCs thrive on the flexible formation of networks of firms, a stable and predictable legal environment and contract enforcement are crucial (Ignatenko, Raei, and Micheva 2019). Better contract enforcement supports the supply of business services, which encourages the development of GVCs. The ability to enforce contracts relating to intellectual property is also important for more innovative and complex value chains.

Complementary policies are also needed to ensure that the gains from participation in GVCs are evenly distributed. These include labor market policies to help workers who may be hurt by structural change; mechanisms to ensure compliance with labor regulations; appropriate tax policies to attract GVCs without undermining tax revenues; and environmental protection measures (Taglioni and Winkler 2016).

Fostering productivity growth

EMDE productivity growth has been in a broad-based downward trend in recent years (Figure 1.26.A; Chapter 3). This deceleration has coincided with a slowdown in improvements in many correlates of strong productivity growth (Figure 1.26.B) The structural tailwinds that boosted EMDE productivity growth prior to 2008 are fading. Output per worker in EMDEs is, on average, less than one fifth that of advanced economies, and at current rates of productivity growth the average EMDE would take over 100 years to close half of the productivity gap with

FIGURE 1.25 EMDE structural policies—Governance, business climate, and GVC participation

The number of EMDEs whose rankings for some key governance indicators have significantly worsened in the last two decades outnumber those whose rankings have improved. Since 2009, only about a third of EMDEs increased their Doing Business score significantly. This highlights a critical need to foster institutional environments more conducive to trade growth. Trade liberalization can help boost EMDEs’ participation in global value chains and contribute to rising per capita incomes.

<table>
<thead>
<tr>
<th>A. Change in Worldwide Governance Indicators, 1996 to 2018</th>
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<td>B. Change in Doing Business scores, 2009 to 2019</td>
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<tr>
<td>C. Impact of 1 percent increase in GVC participation on GDP per capita</td>
</tr>
<tr>
<td>D. Impact of input tariffs on GVC participation</td>
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A. Based on indicators from the Worldwide Governance Indicators (WGI) measuring aspects of governance. The four indicators are government effectiveness, regulatory quality, rule of law, and control of corruption.

B. 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, SSA = Sub-Saharan Africa.

C. Backward participation is defined as the share of foreign inputs in domestic value added. Forward participation is the share of domestic value added in exports.

C. GDP per capita increase as a result of 1 percent increase in x-axis indicators. Blue vertical lines indicate 95 percent confidence interval and red squares indicate point estimates. Estimates obtained from a panel of standard Solow growth models augmented with measures of GVC using System Generalized Method of Moments (World Bank 2019a). Panel includes 100 countries across income groups for the period of 1990-2015. Non-GVC exports is defined as exports that neither include foreign value-added nor are exports of domestic value added that are re-exported in other countries’ exports.

D. Figure shows standardized beta coefficients for each variable from each of the three separate regressions listed. Results obtained from regressions using three-year lag of each determinant in addition to country-year fixed effects and sectoral fixed effects.

Click here to download data and charts.
FIGURE 1.26 EMDE structural policies—Productivity

EMDE productivity growth has been in a broad-based downward trend in recent years. This deceleration has coincided with a slowdown in improvements in many correlates of strong productivity growth. A reform package that combines investing in infrastructure, boosting human capital, and improving the adoption of new technologies could lift productivity significantly. Fostering productivity is key to alleviate poverty.

A. EMDE productivity growth

B. Share of EMDEs with a slowdown in productivity drivers in 2008-17 relative to 1998-2007

C. EMDE productivity reform scenario

D. Productivity growth and global poverty

Source: Barro and Lee (2015); Observatory of Economic Complexity; Penn World Table; Rozenberg and Fay (2019); The Conference Board; United Nations; World Bank.

Note: Productivity is defined as output per worker. Sample includes 29 advanced economies and 74 EMDEs. Refer to Chapter 3 for details. Aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates.

A. Figure shows 5-year moving averages.

B. Econ. complexity = economic complexity. Post-crisis slowdown defined as the share of economies where improvements in each underlying driver of productivity during 2008-2018 was less than zero or the pace of improvement during the pre-crisis period 1998-2007. Unbalanced sample of 74 economies. Variables corresponding to each concept are (sample in parentheses): Demography = share of working-age population, Investment = investment to GDP ratio, Innovation = patents per capita, Gender equality = ratio of female labor market participation rate to male, Urbanization = urban population (% total), Institutions = WGI Rule of Law, Income equality = (1)*Gini coefficient, Education = years of schooling, ECI defined as Economic Complexity Index of Hidalgo and Hausmann (2009). Orange line indicates 50 percent.

C. The reform scenario assumes: (1) Fill investment needs: the investment share of GDP increases by 4.5 percentage points as in the Rozenberg and Fay (2019) preferred infrastructure scenario. The increase is phased in linearly over 10 years; (2) Boost human capital: average years of education increases in each EMDE at its fastest cumulative 10-year pace during 2000-08; (3) Reinvigorate technology adoption: Economic complexity (Hidalgo & Hausmann 2009) increases at the same pace as its fastest 10-year rate of increase during 2000-08.

D. Poverty is defined as the extreme poor living at or below $1.90 per day, in 2011 PPP terms.

Policies to boost sectoral diversification are crucial, particularly for commodity exporters that have historically experienced low productivity growth—total factor productivity in commodity exporters has contracted by around 0.8 percent per year over the past four decades. Sectoral diversification may encourage productivity gains in sectors that are less dependent on volatile commodity prices (Bahar and Santos 2018; Frankel 2010). Removing bottlenecks and barriers to investment in high value-added services sectors provides opportunities for rapid catch-up in productivity growth.

Social safety nets play a key role in mitigating the adverse effects of new technologies that may initially be disruptive to employment. Policies that improve social insurance for unemployment are needed in the formal and informal sectors. Policies that incentivize adult learning, particularly for high-order cognitive skills that complement new technologies, could help reintegrate displaced workers into the labor force (Andrews, Avitabile, and Gatti 2019; World Bank 2018d). Measures that help close the gender gap and improve female labor force participation would also contribute to raising growth and productivity (Ianchovichina and Leipziger 2019). Overall, a reform package that combines filling investment needs, boosting human capital, and improving the adoption of new technologies could lift productivity growth by just over half of a percentage point over 10 years (Figure 1.26.C). By bolstering productivity, these policies will support poverty alleviation (Figure 1.26.D).
### TABLE 1.2 Emerging market and developing economies

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<tr>
<th>Commodity exporters</th>
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<td>Albania*</td>
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1. Emerging market and developing economies (EMDEs) include all those that are not classified as advanced economies and for which a forecast is published for this report. 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.
References


