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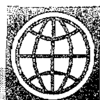

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Global Economic Prospects projects soft landing

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Strong developing country growth in 2000 is likely to be followed by a cyclical slowing in the near term, though longer-term prospects have improved.

The World Bank's just-released *Global Economic Prospects and the Developing Countries 2001* reports that developing country growth surged to 5.3 percent in 2000, up from 3.2 percent in 1999 and 1.0 percent in 1998 (table 1). All developing regions experienced faster growth, though to varying degrees.

World growth is expected to slow to a soft landing in 2001, reflecting monetary tightening in industrial countries, stock market declines, and high energy prices. Looking ahead, the potential for long-term growth may have improved globally, improving prospects for reducing poverty.

But there are notable risks to the outlook, including higher oil prices, further slides in stock markets, and a U.S. recession. These developments would seriously reduce developing countries' trade, growth, and access to capital. They could also worsen longer-term global performance if they lead countries to retreat from reform and openness.

Modest prospects for high-income countries

Growth in high-income countries was estimated at 3.8 percent in 2000, the highest in 10 years. U.S. growth exceeded 5 percent, supported by strong productivity growth, buoyant business and consumer confidence, and years of booming stock markets. Growth in the euro area (consisting of the 11 countries using the euro) also accelerated in 2000, to more than 3 percent, and was accompanied by higher employment. European exports benefited from a weak euro, while tax cuts revived confidence in several countries. Japan's growth rose to about 2 percent, supported by public investment and rising business profits and investment. But the Japanese recovery remains fragile because of high corporate debt, insufficient corporate and financial restructuring, low consumer confidence, and growing government debt.

Growth among OECD countries is expected to slip below 3 percent in 2001 as the U.S. economy slows. Consensus forecasts envisage a U.S. soft landing rather than outright recession. Over the longer term (2003–10) OECD growth is expected to average 2.8 percent. *Global Economic Prospects* argues that industrial countries, led by the U.S., are starting to see productivity payoffs from large investments in information and communications technology. European integration has induced greater competition and efficiency, along with more flexibility in labor markets. In Japan continued efforts at deregulation and financial and corporate restructuring could yield long-term efficiency gains.

The potential for long-term growth may have improved globally, improving prospects for reducing poverty

World trade: capping a decade of massive expansion

World trade volume rose an estimated 12.5 percent in 2000. This remarkable expansion caps a decade of trade growth averaging 10 percent for developing countries—three times the rate of the 1980s. Rapid trade growth reflects major multilateral and regional trade liberalization agreements (Uruguay Round, North American Free

TABLE 1 WORLD GROWTH AND THE GLOBAL ECONOMIC ENVIRONMENT (PERCENTAGE CHANGE FROM PREVIOUS YEAR EXCEPT LIBOR AND EURIBOR)

Indicator	Estimate 1999	Current forecasts 2000	2001	2002	March 2000 forecasts 2000	2001	2002
World GDP growth	2.8	4.1	3.4	3.2	3.5	3.1	3.1
High-income countries	2.7	3.8	3.0	2.8	3.2	2.7	2.6
U.S.	4.2	5.1	3.2	2.9	3.8	2.7	2.8
Japan	0.3	2.0	2.1	2.2	1.2	1.4	1.6
Euro area	2.4	3.4	3.2	2.8	3.4	3.1	2.8
Developing countries	3.2	5.3	5.0	4.8	4.6	4.8	4.8
Sub-Saharan Africa	2.1	2.7	3.4	3.7	3.2	3.7	3.8
East Asia and Pacific	6.9	7.2	6.4	6.0	6.6	6.3	6.1
East Asia crisis countries[a]	6.7	6.9	5.5	5.1	5.7	5.4	5.1
South Asia	5.7	6.0	5.5	5.5	5.9	5.8	5.5
Europe and Central Asia	1.0	5.2	4.3	3.9	2.5	3.4	3.6
Latin America and Caribbean	0.1	4.0	4.1	4.3	3.6	3.8	4.4
Middle East and North Africa	2.2	3.1	3.8	3.6	3.5	3.6	3.6
World trade volume	5.8	12.5	8.0	6.8	8.3	6.9	6.5
Inflation in G-7 countries[b]	1.2	2.0	1.9	1.9	1.8	1.9	2.0
Nonoil commodity prices[c]	-11.2	-0.8	3.4	4.9	5.6	3.9	3.3
Oil prices[c]	38.3	55.0	-10.7	-16.0	27.3	-17.4	-5.3
Manufactures export unit value[c, d]	-2.7	-2.3	3.6	3.7	2.5	2.5	2.6
Six-month LIBOR (percent a year)[c]	5.5	6.7	6.8	6.2	6.5	6.5	5.5
Six-month EURIBOR (percent a year)[e]	3.0	4.5	5.0	4.6	—	—	—

a. Indonesia, Republic of Korea, Malaysia, Philippines, Thailand.

b. Canada, France, Germany, Italy, Japan, United Kingdom, U.S.. In local currency, aggregated using 1995 GDP weights.

c. Measured in U.S. dollars.

d. Unit value index of manufactures exports from G-5 (France, Germany, Japan, United Kingdom, U.S.) to developing countries.

e. Measured in euros.

Trade Agreement, deeper European integration) as well as unilateral tariff cuts by many countries. Trade growth has also been stimulated by reforms enhancing competition, encouraging comparative advantage through international trade, and reducing communications and transport costs. World trade growth is expected to ease to about 8 percent in 2001 and 7 percent in 2003–10. This will be 2.1 times the rate of world output growth—somewhat lower than in the 1990s but well above the pace of the 1980s.

The difficulties in launching the next round of multilateral trade talks in Seattle in 1999 showed that developing countries are an increasingly important part of the world economy. They must exert influence more effectively to achieve their objectives in the next round.

Divergent trends in commodity prices

Oil prices rose 55 percent in 2000, to $28 a barrel. Supply increases in response to these high prices may reduce prices to $25 a barrel in 2001 and $21 a barrel in 2002. But an unusually cold winter or unanticipated supply disruptions could raise prices to $30 a barrel in 2001. In the longer run, continued improvements in supply and conservation should cut prices to $18–19 a barrel.

Industrial countries have been relatively unscathed by the oil price shock because their output has become less energy-intensive. Oil-importing developing countries have suffered more because their economies are more energy-intensive and have less access to external financing. Many have also been hurt by declining prices for their commodity exports. Among the hardest hit are Côte d'Ivoire, Kenya, and Uganda, where agriculture accounts for 40–60 percent of exports and oil for 20–30 percent of imports.

There has been some respite for exporters of metals and minerals because of a modest price recovery in 2000. In the longer run, nonoil commodity prices are expected to

decline in real terms as technology reduces exploration and production costs.

Continued volatility in capital flows

Private capital flows to developing countries fell about 25 percent between their peak in 1997—the year of East Asia's financial crisis—and 1999. Though they increased slightly to $285 billion in 2000, volatility remained high.

Many emerging stock markets corrected sharply in 2000. Spreads on emerging market debt remained high and volatile. And for the first time in 10 years, foreign direct investment appears to have declined from its previous-year peak ($180 billion in 1999), reflecting fewer new projects in major recipient countries, slower merger and acquisition activity, and the near-completion of privatization in many countries. Still, foreign direct investment flows have been fairly stable since 1997, at $170–180 billion a year.

Over the longer term, private flows to developing countries should regain momentum. Growth in developing countries continues to exceed that in industrial countries, and privatization, fewer controls on foreign direct investment, and financial reform continue to advance. But the pace of private flows will probably be slower than during the boom of 1991–97—and many of the poorest countries will continue to be excluded. In addition, capital market flows will continue to be highly volatile, implying risks even for countries with access.

Developing country prospects improve

GDP per capita in developing countries is projected to rise 3.7 percent a year in 2000–10, more than twice the rate in the 1990s. To some extent this increase reflects the end of the 1990s collapse in output in transition economies after the fall of communism. But economic fundamentals are stronger too.

Developing countries are more open to foreign trade and investment. Macroeconomic policies are better, keeping inflation low and reducing fiscal deficits. Human capital has improved, with better enrollment, literacy, and health conditions. The scope for catching up with industrial countries remains large. Still, prospects vary substantially by region.

Growth in the five countries in *East Asia* hit hardest by the 1997–98 crisis (Indonesia, Republic of Korea, Malaysia, Philippines, Thailand) rebounded to about 7 percent in 1999 and 2000, bolstered by strong export growth. The unwinding of domestic debt problems was aided by low inflation and interest rates, as well as some progress on corporate and financial restructuring.

Growth in China also accelerated in 2000, with a resurgence in exports and public investment. But regional growth will slow in 2001 as export growth wanes because of the U.S. slowdown and a cyclical downswing in electronics.

Growth in *South Asia* was about 6 percent in 1999 and 2000, largely because of impressive gains in India. But Pakistan continued to be constrained by severe external financing difficulties. The region's growth is expected to slow in 2001 because of falling exports and rising oil import bills.

Since 1980 South Asia's per capita growth has averaged 3.5 percent, the second fastest level among developing regions. Over the next 10 years this could rise toward 4 percent if chronic fiscal deficits are controlled and trade is liberalized further.

Growth in *Latin America* jumped to 4 percent in 2000 from zero in 1999. That average cloaked a wide range of outcomes, ranging from 6–7 percent growth in Chile and Mexico to little or no growth in Argentina and Ecuador. The regional recovery is expected to consolidate in 2001–02, with some prospects for sustained moderate growth over the longer term.

Favorable factors include the unfolding benefits of reforms, relatively strong financial and banking sectors, and growing trade and foreign direct investment links with North America and Europe. Unfavorable factors include low savings, high debt, and vulnerability to volatility in capital flows.

Average growth in *Europe and Central Asia* rose to more than 5 percent in 2000, up from 1 percent in 1999. The sharp rise in world gas and oil prices transformed Russia's fiscal

Private flows to developing countries should regain momentum

and current account positions. The spillover effects have been felt elsewhere in the Commonwealth of Independent States.

Central and Eastern Europe is benefiting from recovery in Western Europe and from reforms geared toward EU accession. Growth is likely to stabilize at about 4 percent in 2001–02, in part as oil prices ease. Longer-run growth is expected to average 4.5–5.0 percent in Central and Eastern Europe and 3 percent in the Commonwealth of Independent States.

Risks remain of a more severe global downturn

Growth in *Sub-Saharan Africa* rose to 2.7 percent in 2000. Oil exporters benefited from higher prices, and countries with better policies (Botswana, Uganda, several countries in the CFA zone) enjoyed growth of around 5 percent. But countries experiencing civil strife or political disruptions (Angola, Democratic Republic of Congo, Ethiopia, Sierra Leone, Zimbabwe) saw only 0.2 percent growth.

Growth in the region should accelerate to 3–4 percent a year in 2001–02. Additional petroleum capacity should come onstream, benefiting oil producers, and highly indebted countries will benefit from debt relief. Progress on reform and debt alleviation has improved longer-term prospects in the region, and per capita income is projected to rise by 1.3 percent a year over the next decade.

Growth in the *Middle East and North Africa* picked up to 3.1 percent in 2000. Higher oil revenues have reduced budget deficits, and strong growth in Western Europe has sparked a tourist boom and higher worker remittances. Growth should reach 3–4 percent a year in 2001–02.

For diversified exporters, the export boom is being counterbalanced by strong currencies, high fiscal deficits in Egypt and Lebanon, and declining stock markets. Progress on structural and fiscal reforms should help boost growth in the longer term. But problems remain, such as large and inefficient public sectors, low savings, and a lack of diversification in many countries.

Risks to the forecast

Risks of a more severe global downturn are not insignificant and may emerge through some combination of higher oil prices, further declines in stock markets, and a recession in the U.S. These effects would be magnified by a renewed loss of confidence and downturn in capital flows to developing countries.

The impact on developing countries would vary widely. Latin America is highly indebted and dependent on trade with the U.S., and so is most vulnerable to a U.S. recession. East Asia also depends on exports to the U.S.. Middle Eastern and North African countries are less vulnerable because they have more of a European focus. India is likely to exhibit its usual resilience, but Pakistan would be hit hard by worsening international financial conditions. Transition economies would suffer weaker growth, though without returning to the travails of the 1990s. Sub-Saharan Africa could suffer a further worsening of terms of trade.

This note was written by Swaminathan Aiyar (Consultant, Knowledge, Products, and Outreach Division, World Bank Institute) and Milan Brahmbhatt (Lead Specialist, Economic Policy Division, PREM Network) and is based on chapter 1 of Global Economic Prospects and the Developing Countries 2001.

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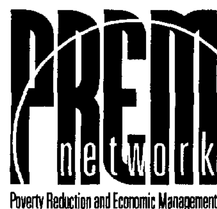

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