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Acknowledgements

This report presents short-term prospects for the global economy in 2011, including major risks and policy challenges. The report draws inputs from the experts of Project LINK, as well as analysis of staff in the Department of Economic and Social Affairs. The LINK Country Reports, which contain detailed country forecasts and policy analyses submitted by the national LINK centres, are available on the websites of both the United Nations and the University of Toronto.[1]

Under the general direction of Rob Vos, this report was prepared by the Global Economic Monitoring Unit, led by Pingfan Hong, including Grigor Agabekian, Clive Altshuler, Alex Izurieta, Matthias Kempf, Hung-Yi Li, Nicolas Maystre, Oliver Paddison, Ingo Pitterle, and Sergio P. Vieira. Ann D'Lima and Cordelia Gow provided statistical assistance. The views expressed herein do not necessarily represent those of the United Nations or its Member States.

[1] http://www.un.org/esa/analysis/link and http://projects.chass.utoronto.ca/link/

Overview

The road towards recovery from the Great Recession is proving to be long, sinuous, and bumpy. After a year of fragile and uneven recovery, growth of the world economy is now decelerating on a broad front, presaging an even weaker growth for 2011.

The weakness of major developed economies continues to drag on global recovery. There seems to be no quick fix to many of the predicaments these economies are facing in the aftermath of the financial crisis. Credit remains short in supply and more broadly financial fragility continues. Unemployment remains elevated and domestic demand is anaemic. The impairment of the crisis on public finance, compounded by the fiscal costs of the policy measures adopted earlier in responses to the crisis, has heightened stress in financial markets and undermined political support for further fiscal stimulus as a means to strengthen recovery process. The contribution of government spending to GDP growth is expected to become negative in 2011, as a result of the announced fiscal consolidation in many of the advanced economies.

In contrast, developing countries and economies in transition have shown a strong economic recovery. While the global financial crisis heavily impacted these economies, many had sound macroeconomic fundamentals and strong enough policy buffers to absorb the shocks and rebound quickly. Quite a few developing economies managed to adopt aggressive stimulus packages, boosting a robust expansion in domestic demand. In the outlook, however, as the recovery in major developed economies falters, growth prospects in developing countries are expected to weaken in tandem.

The baseline outlook delineates a protracted and weak recovery. High uncertainties remain and the main risks are slanted to the downside. Risks for the world economy are mostly rooted in major developed economies, including those associated with persistently high unemployment, the continued fragility of the financial system, and looming sovereign debt stress. For developing countries and economies in transition, major risks are associated with surges in capital inflows, which are causing upward pressures on their currencies. Meanwhile, the increased volatility in the exchange rates of major reserve currencies and the difficulties in coordinating policies to redress the global imbalances, as well as some increase in protectionist measures, all pose serious risks to the stability of international trade and finance, and, unless addressed timely, will impede a strong, sustainable and balanced recovery of the global economy.

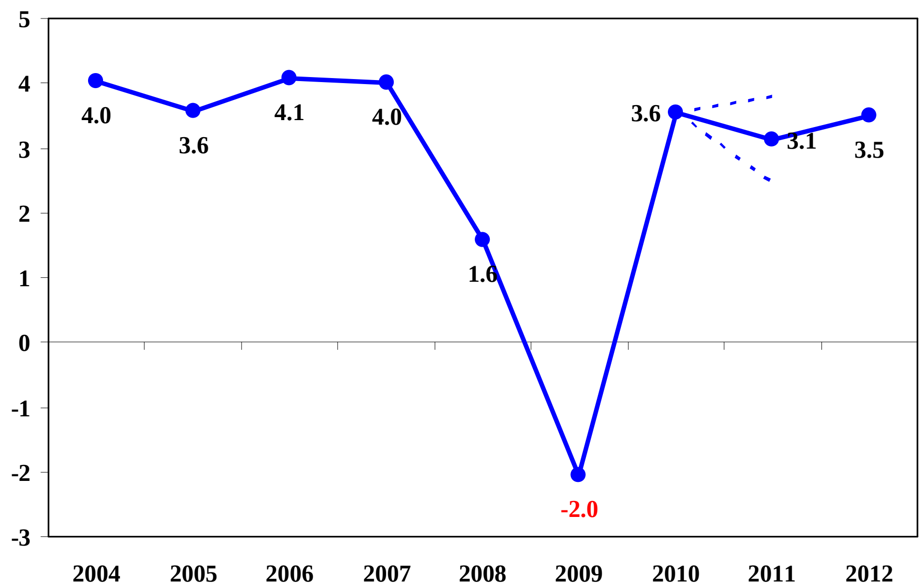
Mitigating these risks poses enormous policy challenges. In major developed economies, macroeconomic policy options are limited by political factors restraining further fiscal stimulus and market responses to sovereign debt distress. This has led policy makers to increasingly rely on monetary policy. Authorities in many developed countries have cut interest rates further and moved deeper into quantitative easing, but this will unlikely suffice to boost aggregate demand and create new jobs, especially not as financial sector weaknesses remain. The surge in capital flows to emerging and other developing economies and the consequent pressures on currencies are complicating the international environment for developing countries, making policies to restructure their economies to support sustained growth the more challenging. The spillover effects of national policies are significant and at present not facilitating a strong, balanced and sustained recovery of the global economy. This highlights once more the need for strengthened international policy coordination. In this regard, the waning of the cooperative spirit among policy makers of the major economies poses a further risk to global economic recovery.

Global macroeconomic prospects

Global growth is decelerating

After a year of fragile and uneven recovery, the global economy encountered a widespread deceleration in mid-2010. The prospects for the world economy in 2011 are anaemic, surrounded by great uncertainty and many downside risks. Premised on the major assumptions as delineated in box 1, growth of World Gross Product (WGP) is forecast to be only at 3.1 and 3.5 per cent in the baseline outlook for 2011 and 2012 respectively, notably weaker than the 3.6 per cent estimated for 2010, which was already considered to be a mediocre pace in the phase of recovery by historical standards (table 1 and figure 1).

Figure 1 - Growth of world gross product (% change), 2004-2012[a]



Source: Project LINK
a 2010 , 2011 and 2012 are forecasted figures. The dashed lines define the upper- and lower-bound of confidence interval.

[Insert Box 1, table 1 and figure 1]

Table 1 –Gross domestic product and world trade

Annual percentage change	Observed		October 2010 forecast [a]			Change from June 2010 report for	
	2008[b]	2009[b]	2010	2011	2012	2010	2011
Gross World Product (GWP)	1.6	-2.0	3.6	3.1	3.5	0.6	-0.1
GWP - PPP weighted	2.7	-0.8	4.5	4.0	4.3	0.6	0.0
Developed economies	0.4	-3.4	1.9	2.1	2.4	0.0	0.0
Canada	0.5	-2.5	2.9	2.5	3.1	-0.4	-0.7
Japan	-1.2	-5.2	2.7	1.1	1.4	1.4	-0.2
United States	0.0	-2.6	2.6	2.2	2.8	-0.3	-0.3
European Union (EU27)	0.5	-4.2	1.6	1.7	2.2	0.6	-0.1
France	0.1	-2.5	1.5	1.6	2.0	0.3	0.3
Germany	1.0	-4.7	3.4	2.2	2.5	1.9	0.8
Italy	-1.3	-5.0	1.3	1.1	1.2	0.5	0.1
United Kingdom	-0.1	-4.9	1.5	2.1	2.8	0.4	-0.2
Memo item: Euro Zone	0.4	-4.1	1.5	1.5	1.9	0.6	0.0
Economies in transition	5.1	-6.7	3.8	4.0	5.0	-0.1	0.6
Russian Federation	5.2	-7.9	3.9	3.7	5.0	-0.4	0.7
Developing countries and regions	5.3	2.3	7.0	6.0	6.0	1.1	0.2
Latin America and the Caribbean	4.0	-2.1	5.3	4.0	4.1	1.3	0.1
Argentina	6.8	0.9	7.0	4.5	4.4	3.0	2.0
Brazil	5.1	-0.2	7.6	4.5	5.2	1.8	-1.1
Mexico	1.5	-6.5	4.5	3.4	3.0	1.0	0.6
Africa	5.0	2.3	4.7	5.1	5.1	0.0	-0.2
North Africa	4.7	2.8	4.6	5.1	5.7	0.0	-0.2
Sub-Saharan Africa[c]	5.9	3.1	5.3	5.8	5.6	-0.3	-0.1
Nigeria	6.0	7.0	7.1	6.5	5.8	0.6	-0.5
South Africa	3.7	-1.8	2.6	3.2	3.2	-0.1	-0.3
East and South Asia	6.1	4.9	8.3	7.1	7.1	1.2	0.2
China	9.6	9.1	9.8	8.9	8.7	0.6	0.1
India	6.4	5.7	8.5	8.0	8.4	0.6	-0.1
Indonesia	6.0	4.5	6.1	5.8	6.2	0.5	0.0
Korea, Republic of	2.3	0.2	6.0	4.5	4.2	1.5	0.7
Malaysia	4.7	-1.7	7.0	4.9	5.3	1.7	0.4
Philippines	3.7	1.1	6.5	4.5	5.3	2.8	0.5
Thailand	2.5	-2.2	7.3	4.8	5.1	3.3	0.7
Western Asia	4.4	-1.0	5.5	4.7	4.4	1.3	0.7
Memo: World trade volume [d]	2.7	-11.2	10.3	6.4	6.3		

Source: LINK Global forecast.

[a] Pre-meeting forecasts.

[b] Actual or mote recent estimates

[c] Excluding Nigeria and South Africa.

[d] GEO has switched to also include the non-factor services in the trade calculation; the current result is not fully compatible with old figures.

Box 1. Major assumptions for baseline forecast in LINK/WESP 2011 and 2012

It is assumed that the United States Federal Reserve (Fed) holds the Federal Funds rate at its current level of 0-0.25 per cent until the fourth quarter of 2011, to be followed by a gradual increase in the rate in 2012. Similarly, the European Central Bank (ECB) is also expected to hold its main policy rate (the minimum bid rate) at its current level of 1 per cent until the end of 2011, with a gradual tightening in 2012. The Bank of Japan (BOJ) is expected to hold its policy rate at virtually zero per cent until the end of 2011, with a gradual tightening in 2012. The central banks of the three major developed economies are expected to continue their unconventional measures of quantitative easing.

Fiscal policy in the United States is assumed to be featured by a continued implementation of the remaining part of the American Recovery and Reinvestment Act of 2009 and an extension of the current tax cuts, but the overall fiscal policy stance will become negative in 2011 and 2012. Most economies in the euro area and the rest of Western Europe have announced plans for fiscal consolidation which are reflected in the baseline assumptions. The degree and timing of these vary significantly, but the overall stance for the region will be contractionary. Fiscal stimulus through public investment spending has already been phased out in Japan, but supportive tax policy measures are assumed to remain in place.

The exchange rates of major currencies have fluctuated significantly over the past two years. Given no significant change in interest differentials between the United States and the Euro area and no significant difference between the two regions' growth prospects, it is assumed that the dollar-euro exchange rate will remain average its current level of 1.35 for the year 2011 and 2012, though with fluctuations around that level.

The yen has been appreciating vis-à-vis both the dollar and the euro, with the its value reaching 83 yen/dollar in September 2010, the highest in 15 years, and triggering an intervention of the Japanese Government in the foreign exchange markets. It is assumed that the average exchange rate of the yen vis-à-vis the dollar will average 85 yen per dollar for the year 2011 and 2012.

The price of Brent crude oil is expected to average at about $75 per barrel in 2011, and $80 per barrel in 2012.

The weakness in major developed economies continues to drag on global recovery. There seems to be no quick fix to the predicaments these economies are facing in the aftermath of the financial crisis. The unprecedented scale of the policy measures taken by the Governments of these economies during the early stage of the crisis have no doubt helped stabilize financial markets and jump-start a recovery, but the adjustment of many structural gaps left by the crisis is proving to be a Herculean task and a protracted process. For example, despite a notable progress made so far by the banking sector in disposing of the troubled assets on their balance sheets, many banks in major developed economies remain vulnerable to multiple risks. Those risks include a further deterioration in real estate markets, more distress in sovereign debt markets, and persistent low credit growth as the de-leveraging in financial institutions and households is still far from complete. In addition, persistently high levels of unemployment with increasing numbers of workers that are structurally out of work are restraining private consumption, as much as threatening continued housing foreclosures which feedback into the financial fragility. At the same time, fiscal deficits have widened dramatically mainly as a consequence of the impact of the crisis on government revenue and social benefits, but also compounded by the fiscal stimulus measures. Mounting public indebtedness has engendered political and financial stresses in a number of developed countries and undermined support for further fiscal stimuli. Considering the plans for fiscal consolidation that have been announced so far, it should be expected that the contribution of the government spending to GDP growth will turn from clearly positive, as was the case over the past two years, to negative in the outlook for 2011 for major developed economies.

Among developed economies, the United States has been on the mend from the longest and deepest recession since World War Two, but the pace of the recovery has been the weakest in post-recession history. With an estimated growth of 2.6 per cent in 2010, the pace is expected to moderate further to 2.2 per cent in 2011 and 2.8 per cent in 2012. At this pace of recovery, the level of GDP will return to its pre-crisis peak by 2011, but a full recovery of employment would take several years at least, leaving the level of output well below the potential. The growth prospects for Europe and Japan are even more pessimistic. Assuming a continued moderate recovery in Germany, developed economies in euro area are forecast to register a growth of only 1.5 per cent in 2011 and 1.7 per cent in 2012, compared with the 1.5 per cent of 2010, as fiscal consolidation in the region will affect the recovery of domestic demand. European countries entrapped in sovereign debt distress and engaging in severe fiscal austerity, such as Greece, Portugal, Ireland and Spain, will either remain in recession or stagnate. Japan's initially strong rebound started to falter rapidly in the course of 2010. Challenged by persistent deflation and elevated public debt, the economy is expected to grow by a meagre rate of 1.1 per cent in 2011 and 1.4 in 2012.

Strong GDP growth in many developing countries and economies in transition has been the only promising sign for the world economy over the past year. The rebound is led by the large emerging economies in Asia and Latin America, particularly Brazil, China, and India. The impact of the global financial crisis on developing economies was indeed overwhelmingly detrimental, as discussed in length in previous issues of the LINK GEO and in other studies. Sound macroeconomic fundamentals and strong policy buffers, such as ample fiscal space and vast foreign exchange reserves, allowed them to cope with the severe external shocks. Many of these economies used their policy space to adopt aggressive stimulus packages, providing a major boost to domestic demand. From the second quarter of 2009, they also managed to lead the rebound in international trade, especially trade within the group of economies and benefit from the recovery in international prices of primary commodities. Together with return of capital inflows to many emerging markets, these factors have supported the rapid rise of their economies from the ruins of the crisis. By late 2010, both the trade flows and the industrial output for the group of developing countries have already recuperated to or beyond pre-crisis levels.

At issue, however, is whether the developing countries and economies in transition can sustain a robust pace of growth in 2011 and beyond, especially in a context where the recovery in major developed economies continues to falter. It is useful to draw some lessons from the earlier debate about the alleged de-coupling of the performance of developing economies from that of developed economies.[2] At the beginning of the crisis, a number of observers saw the significantly higher growth in developing countries as evidence of this hypothesis, leading some to assume that a recession in developed countries would no longer significantly affect the growth performance in developing countries. Indeed, in the very first stage of the global financial crisis, many developing economies seemed to be holding up relatively well, as evidence of the hypothesis. As soon would become clear, however, developing countries fell into a synchronized global recession. Even as developing country performance is outpacing that of the developed countries, global economic interactions have significantly intensified over the past decades including continued high dependence of developing countries on advanced markets in trade and finance. Consequently, much caution is needed in assessing the growth prospects for developing countries and economies in transition in the outlook, given the strong global linkages and the weakness in developed economies. As shown by the analysis in box 2, the statistical evidence indicates that the trend growth rate of developing economies has indeed become significantly higher than developed economies in recent two decades, but the correlation between the cyclical movements in the growth rates of these two groups has become even higher than in the past.

Growth of developing countries is expected to moderate to 6.0 per cent in 2011-2012, from the growth of 7.0 per cent estimated for 2010.

Box 2: Correlation between developing economies and developed economies

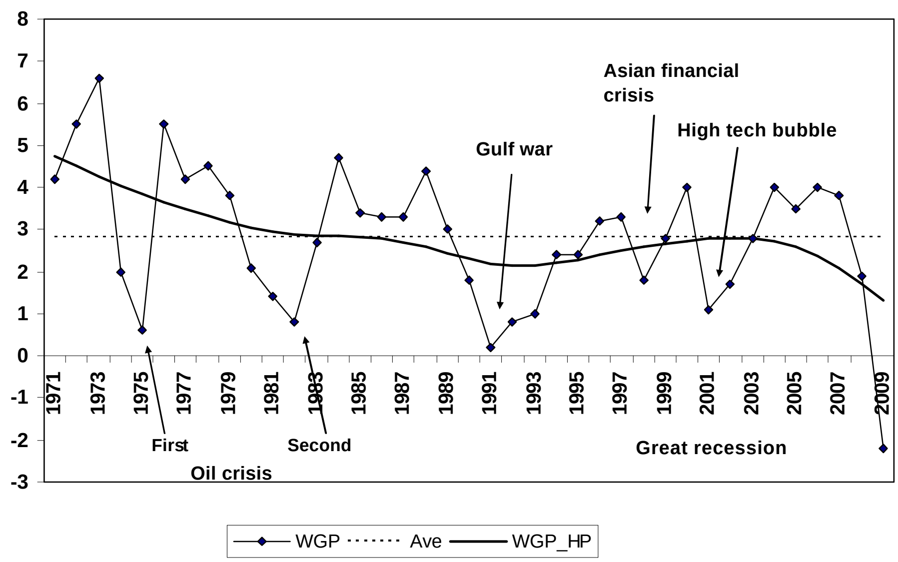
It is generally agreed among most forecasters that the growth in major developed economies would be anaemic in the outlook for the next few years, but views are split over the growth prospects for developing countries. Some forecasters believe developing countries can sustain robust growth, led by a group of merging economies, such as Brazil, China and India, implying that the growth of developing countries has become more self-

[2] See, for example, the issues in the past three years of the UN World Economic Situation and Prospects for a sceptical view of de-coupling and several issues of the IMF World Economic Outlook and the World Bank Global Economic Prospects for more supportive views of the hypothesis.

sustaining and less dependent on developed economies. Others, however, insist that the growth in developing countries will also moderate, given continued dependence of their trade on final demand of developed economies. Therefore, ascertaining the degree of dependence of developing-country growth on that of developed economies holds the key to the understanding of both the dynamics of the global economic cycle and the growth prospects for developing countries.

As shown in figure A, one can identify at least six obvious major recessions in the global business cycle.[3] Five of these six downturns originated in major developed economies. For example, although the two "oil crises" in the 1970s and 1980s were triggered by supply shocks outside of developed economies, the downturns in the global economy were clearly led by the recessions these shocks provoked in major developed economies. The global downturn in the late 1990s was led by the financial crisis in developing Asia, but even this recession had its root causes in large swings in capital flows from developed economies to emerging Asia. The latest global downturn, led by the debacle of the sub-prime mortgage in the United States, is patently the deepest, as the growth of world gross product (WGP) fell not only below its long-term trend, but also entered into negative territory for the first time since World War Two.

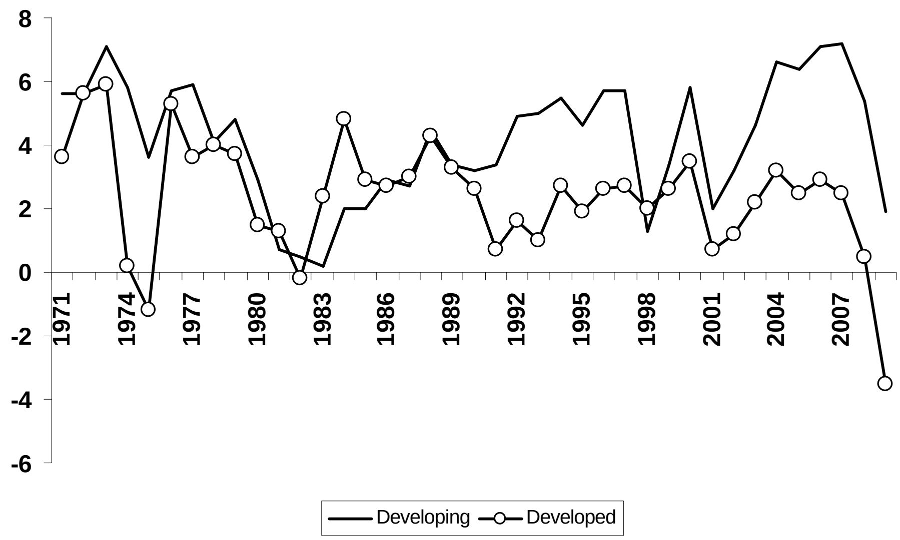
Figure A in Box 2 .Growth of world gross product



As shown in figure B, there seems to be a structural change after 1990 in the relationship between the growth of developing economies and the growth of developed economies. Before 1990, the growth rate of developing economies followed very closely to that of developed economies, in terms of both the level and the cyclical movement. After 1990, in contrast, the average growth of developing economies seemed to be notably higher than that of developed economies, while the cyclical movement between them were seemingly not as synchronized as in the earlier period.

[3] The blue line is the annual growth rate of WGP, the pink line refers to the average growth of this period and the green line indicates the trend as defined by the H-P filter.

Figure B in Box 2. Synchronicity between country groups



A closer look after further statistical analysis shows, however, that the correlation of the growth rates of these two groups has actually increased after 1990. The correlation coefficient increased from 0.49 in the 1970-1989 to 0.6 in the 1990s and the 2000s. This change is consistent with the increased global economic integration that has taken place since the early 1990s, both in international trade and capital flows. Moreover, the volatility in the growth rates of these two groups has also fallen somewhat, as the standard deviation of the growth rates for developed countries lowered from 1.9 per cent in the 1970s and the 1980s to 1.5 in the recent two decades. Output volatility in developing countries as measured by the standard deviation of GDP growth fell from 2.0 to 1.8.

The increased correlation in the growths of these groups is indicative of increased synchronization of the business cycles of developed and developing countries. but a further statistical analysis by Granger causality failed to prove a clearly causality from one group to another (at 90 per cent confidence interval) between these two groups in either period, from either direction. One possible explanation could be that the annual data belied the causality, which could otherwise be revealed more significantly in higher frequency data, such as quarterly data.

In short, the statistical evidence indicates that the trend growth rate of developing economies has become significantly higher than developed economies in the past two decades, but the cyclical movement in the growth of these two groups remains highly correlated. In other words, developing countries may have de-coupled from developed economies only in the sense that they could grow at a rate higher than the latter group, but their growth remains firmly coupled with developed economies in terms of cyclical movement.

Developing Asia continues to show the strongest growth performance, as the economies of China and India are expected to grow at a robust pace. GDP is expected to grow by 8.9 and 8.7 per cent for China in 2011 and 2012, respectively, and 8.0 per cent in 2011 and 8.4 per cent in 2012 for India, implying a deceleration from 2010 when they posted growth rates of, respectively, 9.8 per cent and 8.5 per cent. The anticipated slowdown partly reflects the softening external demand from major developed economies, but also reflects policy-engineered domestic adjustment in these economies. In the case of China, the Government is expected to keep measures in place to restrain growth of the housing sector so as to prevent a further inflation of the house price bubble, and the push to rebalance the drivers of growth by reducing dependence on exports and increasing private consumption will also continue. In India, both monetary policy and fiscal policy are expected to become less expansionary in response to inflationary pressures and a widening fiscal deficit

Growth in *Latin America*, particularly in South America, will also continue to be robust, at 4.0 per cent, despite a marked moderation from 5.3 per cent in 2010. Brazil continues to act as the engine of growth for the region, as well as a key linkage to emerging economies in Asia and other regions. After a robust growth of 7.6 per cent in 2010, Brazil is expected to moderate to 4.5 per cent in 2011, and 5.2 per cent in 2012.

In *West Asia*, after a pronounced economic recovery in 2010, the region will see solid economic growth of 4.7 per cent in 2011 and 4.4 per cent in 2012. At this pace, output growth remains below the levels reached in the years preceding the crisis. Oil-exporting economies of the region have not stepped up oil production since the significant reductions in output that took place in response to the global recession. Coupled with the expected level of oil prices, this also creates an environment for relatively more constrained GDP growth. The non-oil economies of the region are benefiting from the recovery in global trade as well as some positive impulses in the form of stronger investment demand and growth of tourism within the region.

Also most economies in *Africa* have achieved a fairly solid pace of recovery, boosted by the recovery in the demand for and international prices of primary commodities. Oil-exporting economies also saw strong growth of domestic demand. In addition, a large number of non-oil low income African countries, including Ethiopia, Malawi, Mozambique, Rwanda, Tanzania, Uganda and Zambia, continued to grow at more than 5 percent in 2010, driven by strong performance in industrial or services sectors in Uganda and Rwanda, increased investment in infrastructure development in Ethiopia and Malawi together with rising mining production in Tanzania, and increased agricultural output in Zambia. On the other hand, formidable challenges remain in the long-run development of many low-income countries. For instance, economies such as Burundi, Central African Republic, Comoros, Guinea and Niger are still entrapped in stagnation, with many of them suffering from political disturbances and insecurity and several are also affected by droughts.

Among the economies in transition, GDP of the *Commonwealth of Independent States* (CIS) rebounded by about 4 per cent in 2010, up from the deep contraction of more than 7 per cent in 2009. While the improvement in external demand, along with recovery in the prices of commodities, was the key driver, domestic demand remains weak, especially in Ukraine. Some deceleration in the recovery has also been shown in the region recently, and the growth for 2011 will at the best match that of 2010. After a prolonged period of contraction, most economies in *South-Eastern Europe* returned to positive output growth in 2010, except Croatia. Exports have been driving most of the recovery the region has seen, while domestic consumption and investment demand remain subdued. The pace of recovery is expected to be modest in 2011 and 2012.

Unemployment remains the Achilles' heel of the global recovery

Besides continued financial fragility, probably the weakest link in the global recovery is the lack of employment growth. Between 2007 and the end of 2009, at least some 30 million jobs were lost worldwide as a result of the financial crisis.[4] This figure, however, most likely underestimates the true depth of the jobs crisis, since this estimate is limited to official data, which in many developing countries only account for formal sector employment in urban areas. Due to the below-potential pace in the output growth of the recovery, particularly in developed economies, which barely matched the natural growth rate of the labour force, few new jobs have been created to hire back those workers who were laid off earlier. Meanwhile, as some governments embarked on fiscal consolidation, including tax hikes and spending cuts, the prospects for employment creation will be even more adversely affected, at least in the near term.

Among developed economies, only a few countries, such as Australia and Germany, have registered a discernable improvement in labour markets. In the United States, the labour market improved slightly in early 2010, but faltered again later, as state and local Governments started to lay off workers. The unemployment rate may increase to 10 per cent in early 2011, from the 9.6 per cent at present. It will take several years for the unemployment rate to retreat back to the pre-crisis level. In the Euro area, despite the improvement in Germany's jobs market, the average unemployment rate continued to drift upward. The unemployment rate has reached 20.5 per cent in Spain, 14.9 per cent in Ireland, and 10.1 per cent in France. In the outlook, unemployment in Europe is expected to come down at a snail pace. In Japan, the improvement in labour market was marginal during 2010, with the unemployment rate expecting to remain above 5 per cent in 2011. In addition, the share of long-term unemployed has increased in most developed countries since 2007. In the United States, the share of workers who have been unemployed for 27 weeks or more has been rising at an alarming pace, representing nearly half of the unemployed.

In developing countries and economies in transition, most job losses caused by the global financial crisis were in export sectors. At the same time, informal employment has increased and with it the number of vulnerable workers. The strong output recovery in East Asia has boosted employment growth in the manufacturing, construction and

[4] See the report of the International Labour Organization, The challenges of growth, employment and social cohesion, at http://www.osloconference2010.org/discussionpaper

service sectors. As a result, unemployment rates in most East Asian economies are back to pre-crisis levels, except Hong Kong Special Administrative Region of China and Taiwan Province of China. Small improvements in employment are also visible in some of the economies in South America, South Asia, and the CIS, but many other developing countries and economies in transition continue to be challenged by high levels of structural unemployment and underemployment, with the situation particularly acute for women and youth.

Inflation is edging up, but should be of no policy concern

Inflation outlook remains benign at the global level (Annex table A.3 and A.4). Except in some Asian developing economies, where inflation has edged up notably driven by food prices, inflation in other economies has caused little policy concern.

Among developed economies, inflation rates dropped below zero in a number of countries during the nadir of the recession in 2009, but they have rebounded back to positive territory along with the recovery in output. During 2010, the inflation rate has been in the range of between 1 per cent and 2 per cent in most developed countries. Japan is an exception, where deflation persists, partly related to the structural problem of an ageing and declining population.

With the huge amounts of liquidity injected by the central banks of developed countries, the extremely low interest rates, and the widening government deficits, some analysts have warned of risks for escalating inflation. However, not only the current inflation rates remain low, but also inflationary expectations, as measured by inflation-indexed bonds and various business surveys, remain muted. As explained in the section on monetary policy below, much of the liquidity provided by the central banks has been retained in the banking system, with hardly any growth in credit supplies to the real economy. The stagnation in credit growth, along with wide output gaps and elevated unemployment in most developed economies gives rise to little concern that inflation would escalate much further any time soon. Moreover, central banks in developed economies have already announced plans to withdraw liquidity once the recovery has matured to pre-empt any surge in inflation

Among developing countries and economies in transition, inflation is only a serious concern in South Asia, where consumer price inflation is expected to average 11.4 per cent in 2010. Food price inflation has eased somewhat in the second half of 2010 owing to good harvests, but continues to push the general price level higher. In other developing regions, inflation rates have also increased over 2010, but only modestly such that they are still below pre-crisis levels.

International economic conditions for developing countries and economies in transition

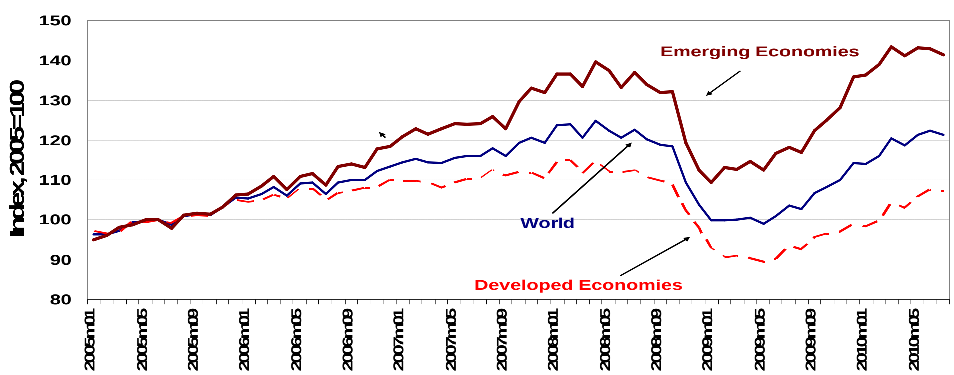
The international economic environment for developing countries and economies in transition has improved during 2010. Capital inflows have returned, external financing costs have dropped, prices of primary commodities have rebounded, and trade flows have revived. Many challenges remain, however. For example, some emerging economies are facing strong increases in portfolio capital inflows, pressuring their currencies to appreciate, posing risks for asset price bubbles to emerge, and challenging macroeconomic management in these economies. Some developing countries are also facing rising protectionism which is harming their exports. Several major developed economies, in particular, have imposed new trade barriers in attempts to address domestic problems, including high unemployment. Surging capital inflows and increased volatility in the exchange rates of major reserve currencies has perturbed currencies of emerging economies.

Many low-income economies have weaker policy buffers and limited access to capital markets. Stagnation in flows of official development assistance (ODA) and shortfalls in the delivery on commitments made by donor countries to increase those flows in support of achievement of the millennium development goals (MDGs) is limiting the scope for countercyclical responses in low-income countries.

Trade flows of developing economies back to pre-crisis levels

World trade continues to recover in 2010, but after a strong pace in the first half of the year, the momentum started to peter out in the second half. Measured by volume, the exports of many emerging economies, such as Brazil, China, India and a number of other economies in Asia, have already recovered to, or beyond, the pre-crisis peaks. In contrast, exports of developed economies remain about 10 per cent below their pre-crisis peaks, weighing on the recovery of the world exports (figure 2). In the outlook, world trade, measured here in terms of the volume of exports, is expected to grow by about 6.5 per cent in 2011 and 2012, moderating from the 10 per cent rebound in 2010.

Figure 2. World merchandise trade volume, January 2005 – July 2010



Source: CPB Netherlands Bureau for Economic Policy Analysis. Calculations: UN-DESA

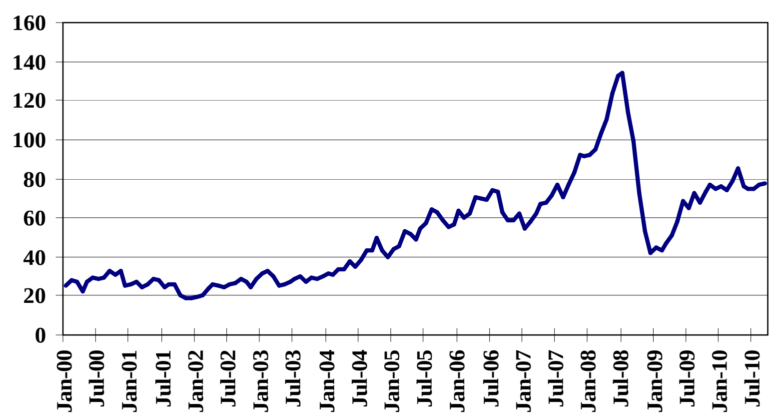
During the crisis, imports of the EU, Japan and the United States plummeted on average by 40 per cent between mid-2008 and early 2009, causing a collapse in global trade. So far, after a gradual recovery for almost two years, the volume of imports from these three major developed economies still remain 15 per cent below pre-crisis peaks. In comparison, the volume of exports in these economies has been recovering in a faster pace than imports, particularly in Japan and the United States.

Consequently, developing countries and economies in transition have been leading the recovery in world trade. In many East Asian countries and some Latin American economies, imports have indeed increased faster than exports during 2010, and the volume of imports for these economies has already surpassed the peaks of the pre-crisis. For instance, in China, the contribution of net exports to GDP growth was negative during 2010, implying the contribution of China's net imports to the growth of GDP in the rest of the world has been positive. The question is whether emerging economies can continue to lead growth of world trade in the outlook. As discussed in the previous section, there are reasons for caution. The dynamics of the initial phase of the recovery seems to be fading, especially as growth in developed countries remains sluggish. Without a stronger recovery in import demand from developed economies, export growth of developing countries is also bound to slow.

The prices of primary commodities may have reached a plateau

The prices of *crude oil* have fluctuated in a range around $78 per barrel in 2010 (figure 3). On the demand side, after a cumulative contraction of 2 per cent in 2008-2009, global oil demand is estimated to have increased by more than 2 per cent in 2010. During 2010, oil demand in most developed economies has continued on a downward trend of the last several years, except in the United States, where oil demand resumed an increase. Demand in developing countries strengthened notably, however, led by a strong GDP growth in emerging economies, such as China, although total oil demand in developed countries is still ten per cent higher than that of developing countries and the economies in transition.

Figure 3. Brent oil price, January 2000 - September 2010

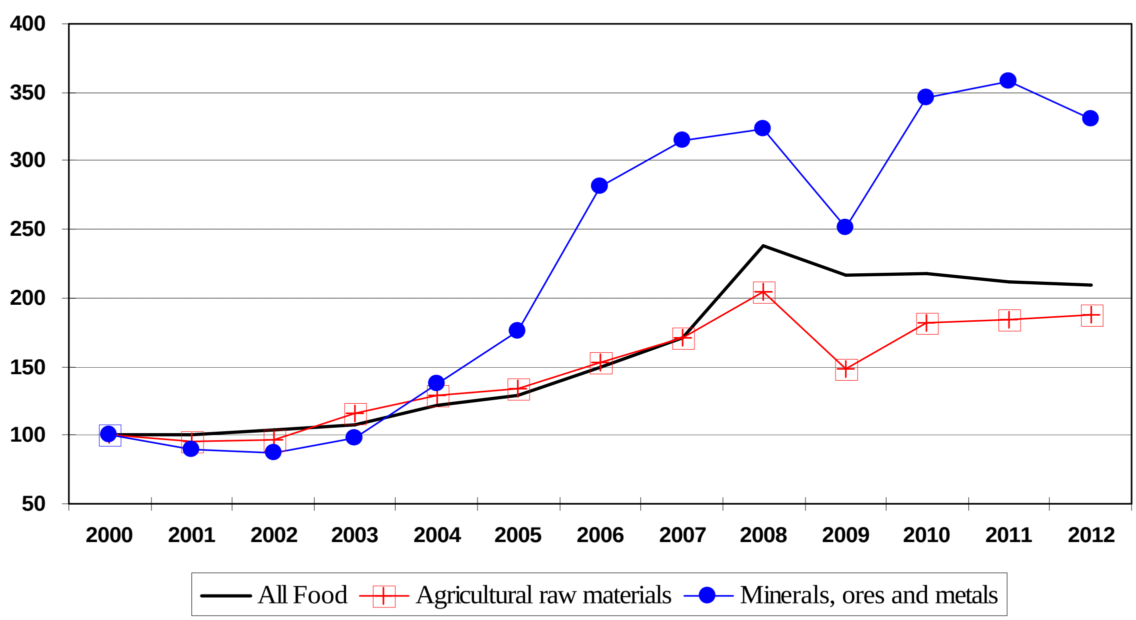


Source: UN/DESA

In the outlook for 2011, global oil demand is expected to increase further, but at a more moderate pace than 2010. Emerging economies, such as China and India, will continue to provide the bulk of the expansion in demand. In these economies, efforts to increase energy efficiency are outweighed by the effects of strong economic growth and higher incomes for consumption and living standards. In contrast, oil demand in developed economies will register a modest decline, due to subdued economic growth, further efficiency gains, as well as the progressing substitution of conventional fuel with ethanol and biofuels. On the supply side, non-OPEC countries will post a small increase in output in 2011, driven by non-OECD producers such as Brazil, Azerbaijan and Colombia. OECD oil producers will see their production fall, led by decline in maturing oil fields in Europe. Ample spare capacity remains among OPEC producers.

For non-oil commodities (figure 4), the movement of *metal prices* followed a pattern similar to oil prices in 2010, sensitive to changes in global growth prospects, particularly the growth in emerging economies, such as China. China's demand for copper, aluminium and other base metals is estimated to account for about 40 per cent of the world total, although a sizeable proportion of China's demand for these metals may also be used in producing manufactured goods to export to other countries. In the outlook for 2011, global demand for metals is expected to stabilize at the current level, partly reflecting a slowdown in investment as government fiscal stimulus packages are expected to phase out. Supply seems to have little role in price changes in the short run, and metal prices are expected to increase only slightly in 2011 and 2012.

Figure 4. Non-oil commodity price index (2000=100), 2000-2012



Source: UN/DESA

Food prices declined during the first half of 2010, but started to move up again in the second half. Food prices are more sensitive to changes in supply conditions than to changes in global economic growth. The expansion of global acreage in response to higher prices during 2005–2008 led to the rise in supply, plus favourable weather patterns in key producing areas. In the second half of 2010, the estimates for global supply of the major crops have been reduced, particularly for wheat due to adverse weather conditions in the Russian Federation, Ukraine, and to a lesser extent North America. The impact on other food prices has so far been limited, partly because of relatively ample wheat inventories, but the assessment can be further downgraded along with more information on the output of 2010. On the demand side, emerging economies continue to account for much of the growth in demand for major crops during 2010-2012. Meanwhile, slowdown in the growth of biofuel production, due to lower fuel prices, has reduced global demand for crops. In the outlook for 2011 and 2012, food prices may be vulnerable to more supply shocks.

Recovery of capital inflows to emerging economies continues

Net private capital inflows to emerging economies[5] continued to recover during 2010, from the precipitous decline in late 2008 and early 2009. A better economic performance of emerging economies, in comparison with developed economies, has been conducive to the recovery of private inflows. In some cases, the extremely low nominal interest rates and unprecedented quantitative easing in major developed economies have also pushed the inflows to emerging economies in search for higher returns. The expectations of currency appreciation in emerging economies and improved prospects for the prices of primary commodities that many emerging economies export are also among the factors for driving the capital inflows to these economies. There seems to be a reallocation of global assets by international institutional investors in the aftermath of the financial crisis, reducing their holding of assets in developed economies while increasing assets in emerging economies. Given the pro-cyclical nature of foreign capital inflows, driven by the herding behaviour, some emerging economies are indeed challenged by the increasing inflows.

Net private inflows to these economies are estimated to be above $800 billion in 2010, more than 30 per cent increase from the previous year, but still about $400 billion lower than pre-crisis peak levels registered in 2007. The momentum of the capital inflows to these economies tapered off somewhat in late 2010, and the outlook for 2011 is for only a slight increase in the inflows.

Foreign direct investment inflows (FDI) are still the largest component, accounting for more than 40 per cent of the total inflows to emerging economies in 2010.

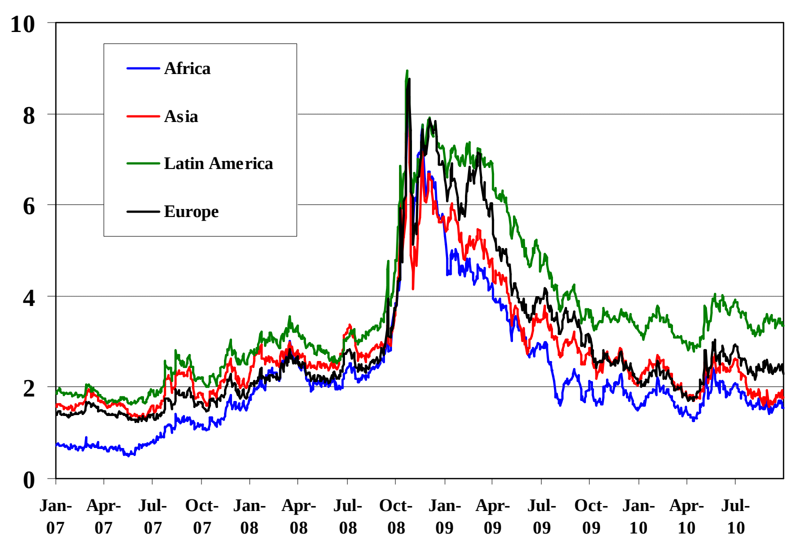
[5] The reference is to a group of some 30 developing countries and economies in transition, which are well integrated into the global economy through trade and finance linkages. For more details, see Institute of International Finance, *Capital Flows to Emerging Market Economies*, October 2010 http://www.iif.com

China remains the largest recipient of FDI inflows, accounting for 25 per cent of the total, while the BRIC countries combined account for 51 per cent. The overall recovery in FDI inflows has been slow.

By contrast, recovery in inflows of portfolio equity have been particularly strong in 2010, up 25 per cent from 2009, reflecting a return of confidence of international investors in emerging market after they substantially withdrew the funds from these economies during the global financial crisis. While inflows of portfolio equity to Asia account for the lion's share, the rebound in inflows to Latin America has been particularly strong, almost doubling the level of 2009. In the outlook for 2011, some moderation is expected in these inflows.

Inflows of bank lending to emerging economies have also recovered in 2010, from a net outflow in 2009. However, compared with the pre-crisis period, inflows of bank lending as a share of the total capital inflows have shrunk significantly, in line with the ongoing de-leveraging in international banks. It is also a reflection that the demand for foreign bank lending in emerging economies is weak, as local banks in these countries seem to be well positioned to meet the local credit demands and are well funded locally. Non-bank lending has recovered more vigorously than bank lending, as both private and public sectors in emerging economies increased their issuance of bonds in developed countries, to take the advantage of low interest rates in the latter. The *external financing costs* for emerging economies have indeed retreated to the pre-crisis levels, as measured through the Emerging Markets Bond Index (EMBI) (figure 5).

Figure 5. Figure 5 Daily yield spreads on emerging market bonds, January 2007-September 2010



Source: JPMorgan

Outward capital flows from emerging economies have increased significantly in recent years. Excluding their holding of foreign reserves, the outward flows from these economies peaked above $800 billion in 2007. The global financial crisis caused a decline in the outward flows, but the decline was much milder than inflows. For example, FDI outflows from emerging economies fell by 23 per cent in 2009 from 2008,[6] compared with a fall by more than 25 per cent in FDI inflows to these economies. Developing countries and economies in transition continue to accumulate massive amounts of foreign exchange reserves in 2010, adding about $500 billion to the total of $5.4 trillion by the end of 2009. A large proportion was accumulated by Asia, particularly China, which is holding about $2.6 trillion in foreign exchange reserves.

Uncertainties and risks

While the baseline outlook for 2011 projects a continued recovery at a moderated pace, major uncertainties and risks remain on the downside. The risks for a much weaker performance of the world economy are mainly rooted in the weaknesses in major developed economies, including persistently high unemployment, the continued fragility of the financial system, and sovereign debt distress. For the dynamic developing countries and economies in transition, the recent surge in capital inflows is posing challenges, especially in the form of currency appreciation and risk of domestic credit and asset price bubbles. These problems are related to the financial weaknesses and policy stance in developed countries and are compounded by the increased volatility in the exchange rates among major currencies and the difficulties in coordinating a global rebalancing in the aftermath of the crisis. Without internationally concerted efforts, attempts by national Governments to offload pressures on their currencies may well trigger an undesirable process of competitive devaluations and protectionist responses which in turn will put the stability of international commodity and financial markets at risk and impede further global economic recovery.

Risks associated with persistently high unemployment rates

The recovery of most developed economies can be characterized as "jobless". This is not uncommon in the recent history of business cycles. In fact, the unemployment data for the United States since World War Two suggest that the time needed for employment levels to recover after a recession has become successively longer. In the 1950s and 1960s, after a recession, it would take about one year for the economy to recover the jobs lost in the downturn, in the 1970s and 1980s, about one year and a half to two years, and in the 1990s and early 2000s, about two to three years. The rise in the unemployment rate in the United States in this Great Recession has been the fastest and highest (relative to the unemployment rate before the recession) and it will take several years for the job market to heal (figure 6).

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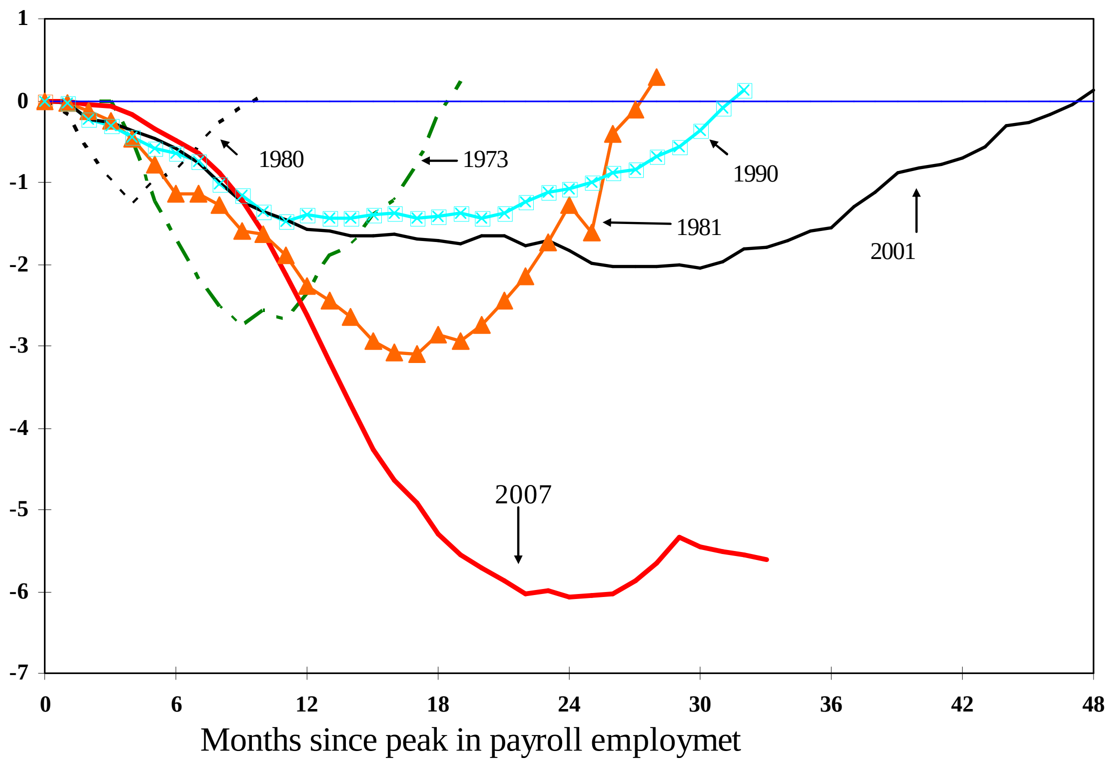
[6] See the UNCTAD *World Investment Report 2010*, http://www.unctad.org/Templates/Page.asp?intItemID=1465

Figure 6. Recovery of employment in the United States
(from the peak before each recession)



Source: UN/DESA based on payroll employment data from United States Bureau of Labor Statistics

A few interrelated factors explain the lagging recovery in the job markets of major developed economies.

First, the pace of GDP growth in the recovering phase has become less and less robust after each business cycle. For instance, the magnitude of the downturn in GDP in the United States during this recession was similar to that in the early 1980s, but the recovery of the 1980s featured high output growth rates of between 5 per cent and 8 per cent for six consecutive quarters, while, the current recovery registered only one quarter of growth recovery of 5 per cent before it started to falter. Rapid technological progress along with the structural economic change, especially in the form of a smaller share of manufacturing and a larger share of services sectors in the economy, explain why pure cyclical movements have become less important than structural factors in determining the upward and downward swings in developed economies. In earlier business cycle episodes, workers who lost jobs during the downturn would mostly be able to regain employment relatively quickly in the upturn in the same sector, if not the same company, where they had worked before. Nowadays, however, more and more job losses during the downturn tend to become permanent, forcing unemployed to find jobs in other sectors during the recovery, often requiring different skills as compared with their previous jobs, and highly depending on development of new industrial sectors in the economy.

Second, developed economies have become more integrated into the world such that a recovery in domestic demand does not have the same pulling effect on domestic supply as in the earlier periods, and thus has become also less effective on pulling up employment. One policy implication here is that the fiscal stimulus adopted in developed economies to boost consumption demand would have less effect on domestic supply and domestic employment than as in the past.

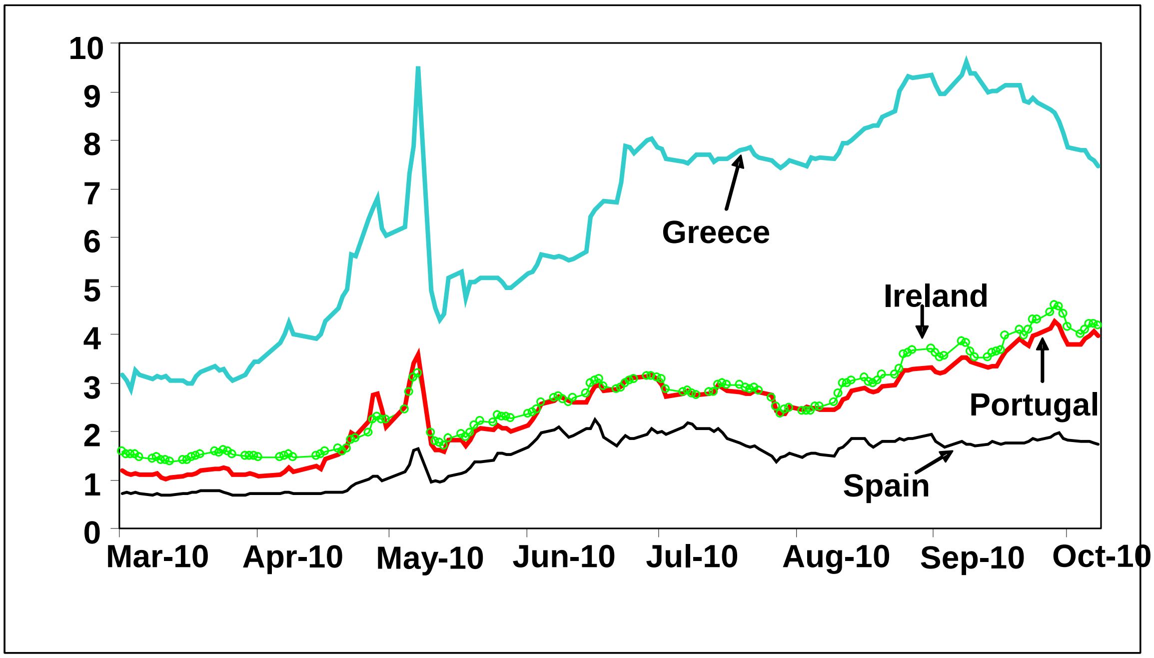
Persistent high unemployment and subdued output recovery can push the economy in a vicious circle and entrap it into a protracted period of below-potential growth, or, in some cases, it may even cause a double-dip recession. High unemployment will constrain the recovery in household consumption, which in turn will drag output growth. Below-potential output growth, in turn, will constrain employment growth. The longer this vicious circle lasts, the higher the risk for the “cyclical’ unemployment to turn into the “structural” unemployment, impairing the potential growth for the economy in the longer run. Meanwhile, the high employment rates in many developed countries may also become a political factor behind the rise of international protectionism, leading to escalated international tensions

Risks associated with sovereign debt

The heightened concerns about the fiscal sustainability in a number of European economies triggered a surge in the cost of public borrowing for these countries. It was also the source of the turmoil in global financial markets in early 2010. The turmoil could only be contained following internationally coordinated support programs and announcements of drastic fiscal austerity plans by the Governments of these countries. However, signs of continued sovereign debt distress re-emerged for several European economies in September. This was reflected in the sharply widening of yield spreads in Greece, Ireland and Portugal (figure 7). Managing fiscal consolidation has proved difficult in a number of countries. While Spain and Ireland seem to be on track towards their fiscal targets for the year, there has been some slippage in Greece and Portugal. Budget concerns also remain in Ireland, but mainly over the increasing fiscal burden of the Government’s support to banks. Since the announcement of Ireland’s financial stability programme last May, support to banks has increased, likely pushing the country’s fiscal deficit up to 32 per cent of GDP in 2010.

The average deficit for developed economies soared to 10 per cent of GDP by the end 2009, with public debt reaching over 80 per cent of GDP. The deficit is estimated to decline to about 9 per cent in 2010. The decline is mainly on account of the phasing-out of government spending related to the bailout of the financial sector in the United States. Many developed economies continued to experience deficit increases. The projected deficits for 2011 suggest an improvement by one percentage point of GDP, on the premise of a continued GDP growth as delineated in the baseline, a smooth implementation of the announced fiscal consolidation plans, and accommodative capital markets. The public debt of developed countries will continue to increase, surpassing 100 per cent of GDP on average in the next few years. Any worse-than-expected development in these factors could trigger another round of heightening sovereign debt risks, possibly leading to another round of global financial turmoil and a new downturn in the world economy.

Figure 7. Spreads of selected government bonds over German Bunds (10-year), March–September 2010



Source: UN/DESA, JPMorgan

Continued slow GDP growth in developed economies will have significant implications for fiscal sustainability. If the ongoing trend of deceleration in the global growth continues, leading to a much lower growth than the baseline, or even a double-dip recession in some developed economies, the fiscal position of these economies would deteriorate further. Government balances in a number of European economies are especially vulnerable to lower GDP growth, and so is Japan.

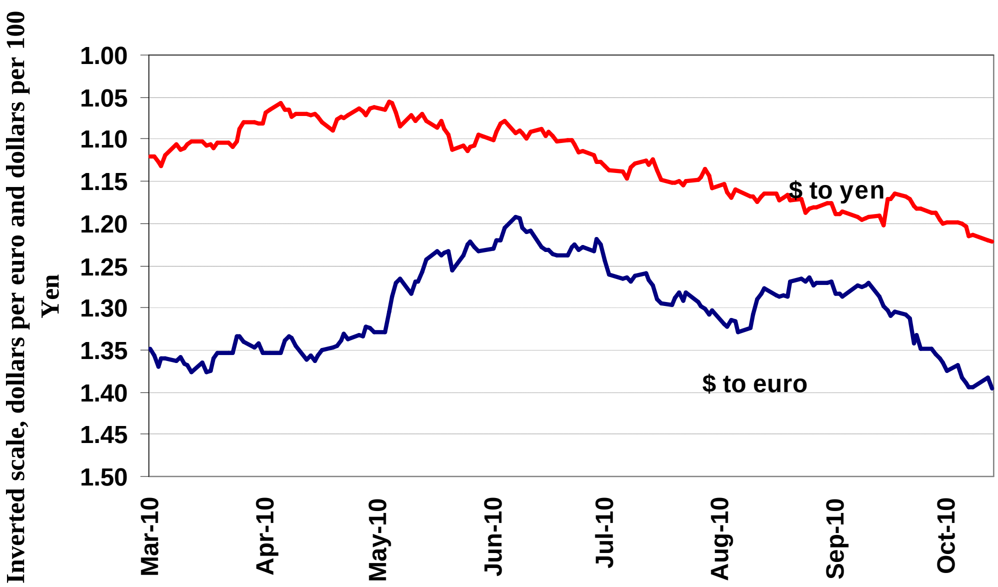
In the outlook, Governments of many advanced economies will face large and increasing funding needs, the cost of which will be highly vulnerable to changes in market sentiment. If sovereign risk premia in capital markets continue to surge, this will jeopardize market access for some of these countries, as shown in the cases for Greece and a few other countries in 2010.

The increased linkages between the sovereign debt and the banking sector during the crisis in many developed economies have complicated matters. On the one hand, Governments have guaranteed vast amounts of bank liabilities and in some cases taken partial ownership of banks. On the other hand, banks, stashed with cash, have been purchasing large amounts of government bonds at home and abroad. As a result, a heightened risk for the financial health in any of these two parties will feed into the other, possibly forming a vicious circle to amplify the risk into the whole economy. For example, higher sovereign credit spreads for some countries can lead to increase bank spreads, putting funding pressures for both the governments and the banks.

Risks associated with instability in the exchange rates among major currencies

The exchange rates among major currencies experienced extremely high volatility during 2010, with an escalated tension spreading rapidly to other currencies. The volatility in the first half of 2010 featured the sharp devaluation of the euro, triggered by the heightened concerns about the sovereign debts in a few European economies. From the beginning of the year to June, the euro depreciated by about 20 per cent against the United States dollar and the Japanese yen (figure 8). Since mid-2010, the tide in foreign-exchange markets has reversed, featuring a sharp weakness of the dollar, driven by the deteriorating growth prospects for the United States, along with – as indicated - the anticipated needs for further quantitative easing, that is, more dollar printing. As a result, the euro rebounded by nearly 20 per cent vis-à-vis the dollar, while the yen hit a 15-year high against the dollar, engendering intervention by the Japanese Government in foreign-exchange markets.

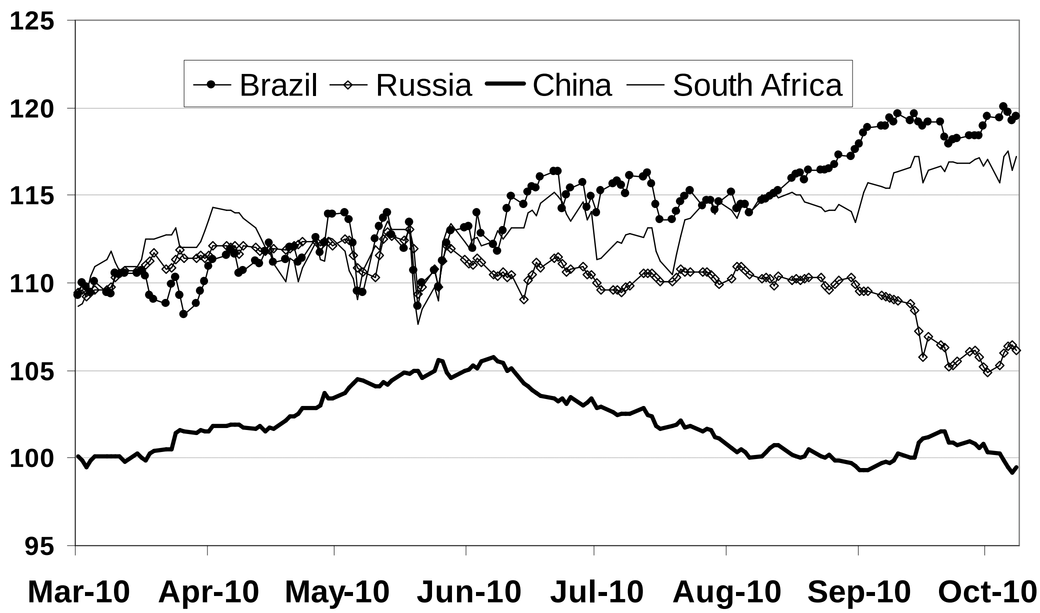
Figure 8. US dollar exchange rate vis-à-vis Euro and Yen



Source: UN/DESA

A failure to maintain the exchange-rate stability among the three major international reserve currencies has also affected currencies of emerging economies. The surge in capital inflows to emerging economies, partly fuelled by quantitative easing in developed countries, has led to upward pressure on the exchange rates of emerging economies. For example, Brazil's real appreciated by 20 per cent vis-à-vis the currencies of its trading partners in 2010 (figure 9)

Figure 9. Trade-weighted effective exchange rate index for selected countries, March–October 2010 (2009 = 100)



Source: UN/DESA calculations, based on J.P. Morgan data.

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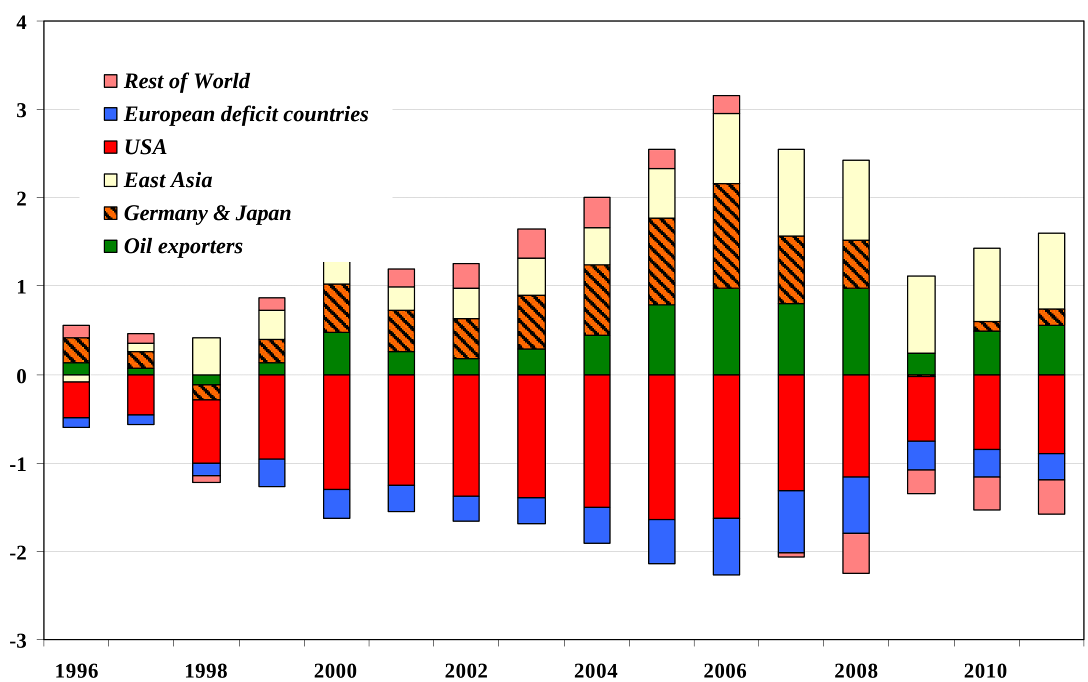
Developing countries have responded by intervening in currency markets, buying foreign exchange or imposing capital controls in order to avoid soaring exchange rates and loss of competitiveness. Brazil, for instance, doubled the tax rate on foreign purchases of its domestic debt, while Thailand announced a 15 per cent withholding tax for such purchases. A downward spiral of competitive devaluations is dangerous. Growth in developed countries likely will remain sluggish for years and, as more Governments shift to fiscal austerity, they will be inclined to engage in further quantitative easing to stimulate domestic demand, thereby possibly further complicating exchange rate problems. Developing countries would then be pushed to tighter capital controls and currency market interventions to avoid loss of competitiveness and further inflation of domestic financial bubbles.

In this context the solution is not to solely focus on a realignment of exchange rates, but rather on broader concerted measures allowing for a rebalancing of global demand, away from indebted developed countries and towards more spending in developing countries. Exchange rate realignment may be part of the solution, but such a shift needs more structural reforms and broader macroeconomic policy coordination. Meanwhile, issuing countries of international reserve currencies should have primary responsibility for maintaining the stability of the exchange rates among these currencies, providing a stable anchor for other currencies.

Recent development in the global imbalances

The *global imbalances* narrowed markedly along with the global recession (figure 10). The large external deficit of the United States declined from its peak of 6 per cent of GDP before the recession, to a trough of 2.6 per cent in 2009. Commensurately, the external surpluses in China, Germany, Japan and a group of oil-exporting countries, have also reduced. China's surplus, for instance, dropped from a high of 10 per cent of GDP, to 6 per cent in the same period. Related changes were also made in domestic savings and investment in these economies. In the United States, the household savings rate increased from about 2 per cent to 5.9 per cent between 2007 and 2009, although a large part of the increase in private savings was offset by the rise in the government deficit. In China, the ratio of private consumption to GDP started to rise for the first time in a decade, although the ratio remains extremely low, below 40 per cent, compared with 60 to 70 per cent in many other economies.

Figure10. Global imbalances, 1996 - 2011
(Current account balances in per cent of world gross product, WGP)



Source: UN/DESA WESP and IMF WEO database

In 2010, the global imbalances edged up slightly along with the global recovery. The external deficit of the United States increased slightly to above 3 per cent of GDP, while surpluses of oil-exporting countries, Germany, and Japan widened. China's external surplus, however, continued to decline to about 4 per cent of its GDP.

At present, the global imbalances may be considered moderate compared with the pre-crisis situation. A critical issue is whether the global imbalances will widen again substantially in the coming years and a possible source of renewed instability of the world economy.

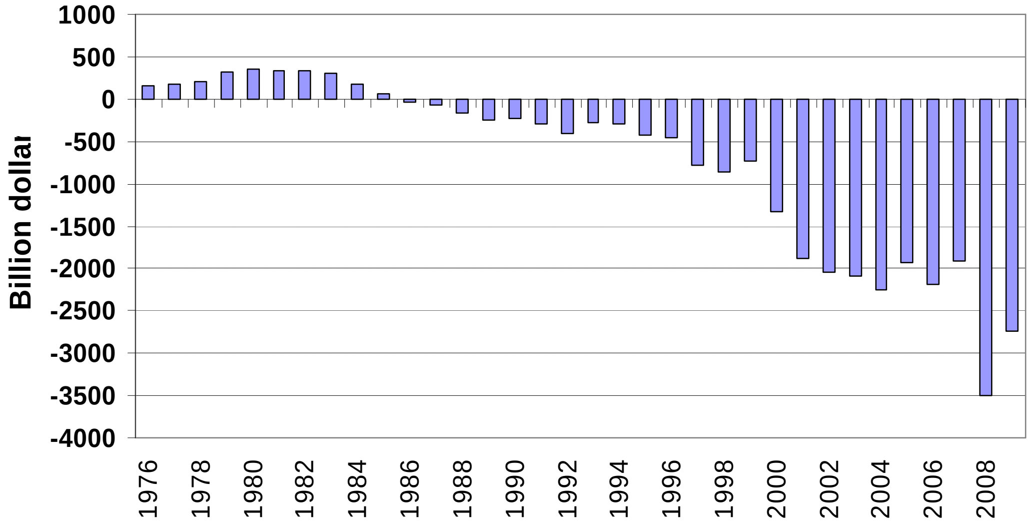
In the near-term outlook, it seems unlikely for the imbalances to widen significantly. Households in the deficit countries, mainly the United States, are not expected to resume the debt-financed expansion of consumption quickly and further widening of the government deficit relative to GDP likely will be politically constrained. With a mild growth in demand from the deficit countries, the room for an increase of the external surpluses in the surplus countries will also be small.

The prospects for the imbalances in the longer run will depend on how successful economies will be in making structural adjustments. Changes in the right direction are visible in both deficit and surplus countries. For example, China has taken various measures to boost private consumption, reducing its dependence on exports. But it will take a long time before more significant structural change is achieved to also make a global impact. The structural change would also entail important sectoral shifts and institutional change, which will take time to effectuate. Household savings in the United States have increased, as a result of more cautious consumption behaviour and ongoing deleveraging of household balance sheets. Uncertainties remain regarding the future path of these adjustments, particularly given the uncertainty how the risks of further slowing of growth and persistent unemployment, sovereign debt problems, and further exchange rate instability play out. Clearly, without more effective international policy coordination that recognizes the interconnectedness between these problems, the risk of a disorderly adjustment in the global imbalances remains high.

The trend in the position of net foreign investment of the United States is closely related to that in the global imbalances. The global financial crisis caused a surge in the net foreign liability position of the United States, reaching a record high of $3.5 trillion by the end of 2008 (figure 11), but the position retreated somewhat during 2009, to a level of $2.7 trillion, mainly reflecting the appreciation of the price of United States owned foreign assets, which was larger than the revaluation effect of foreign-held United States assets, and the appreciation of major currencies against the United States dollar that raised the dollar value of United States assets held abroad. During 2009, United States' foreign assets decreased by $0.87 trillion to a level of just over $18 trillion, while assets held by foreigners in the United States decreased by $1.6 trillion to $21 trillion.[7]

[7] For more information, see the United States Bureau of Economic Analysis, at http://www.bea.gov/international/index.htm#iip

Figure 11. Net international investment position of United States



Source: UN/DESA based on United States Bureau of Economic Analysis data

Further depreciation of the dollar will help reduce the foreign liability position of the United States, which may also be factor behind the latest tension on the exchange rates of currencies. In any case, the net foreign investment position of the United States is expected to remain in large debit, looming as a risk for the global financial stability.

Policy challenges

Increasing constraints on fiscal policy

Fiscal policy is facing tremendous challenges, particularly in major developed economies. A large number of countries responded to the financial crisis with fiscal stimulus packages to support aggregate demand, and, in some developed economies, fiscal resources were also used to strengthen balance sheets of private financial institutions. Together with monetary policy and financial measures, fiscal policy has indeed played an important role in preventing the world economy from falling into otherwise a much deeper recession. In fact, fiscal stimuli were the key driver for the global recovery from mid-2009 to early 2010.

However, the costs of fiscal stimuli and the adverse impact of the crisis on government revenues, have led to a surge in fiscal deficit and public debt, which is especially acute in many developed economies. In response, many countries have already announced plans to consolidate fiscal deficit, including withdrawal of fiscal stimuli, inopportunely in the middle of a decelerating global recovery.

Governments face a dilemma in dealing with two seemingly conflicting demands. The first one is the need of further fiscal support to strengthening the recovery. The recovery in private sector is clearly not on a solid footing in any developed economies, particularly from the perspective of the elevated unemployment rates. Without a continued and further fiscal stimulus, several developed economies are facing considerably risk of a double-dip recession, or at best, a protracted period of subdued jobless growth. The second demand is the need to keep fiscal deficits and public debts within a safe range so as to safeguard the fiscal sustainability in the medium run (the specific range can vary significantly from country to country, depending on many factors). Although the second need is more for the medium run, it has important short-term implications: financial market agents' perceptions about medium-term fiscal sustainability strongly influence the cost of public borrowing in the short run.

While a number of European economies are already facing the consequences of soaring risk premia on sovereign borrowing, the constraints on fiscal policy in most other developed countries are mainly political in nature. Some European countries have already taken fiscal consolidation measures in 2010, and more countries in the region will follow in 2011. In Greece, for instance, the authorities have front-loaded fiscal consolidation aiming to reduce the budget deficit by 4 percentage points in 2010 and have targeted to bring the overall deficit to below 3 per cent of GDP by 2012. These are dramatic cuts considering that the fiscal deficit reached 13.6 per cent of GDP in 2009. Portugal similarly has adopted a drastic austerity plan that aims to reduce the budget deficit by 10.7 percentage points of GDP by 2013. Similarly, spending cuts amounting to €15 billion have been announced in Spain, while in the United Kingdom a number of tax increases (such as in the VAT rate) and a 25 per cent cut in government department budgets will contribute to decreasing the fiscal deficit by 6 percentage points of GDP by 2013. Germany, France, Italy and The Netherlands will all implement consolidation measures in 2011.

Japan and the United States managed to increase stimulus measures during 2010, but in both cases the added stimulus was small. The contribution of government spending to GDP is expected to become negative in 2011 in these two economies as well.

The fiscal position in many developing countries and economies in transition is relatively better. A number of developing countries have already initiated the implementation of fiscal consolidation plans in response to the sharp increases in budget deficits, but generally are able to do so in a more auspicious environment. In South Asia, for instance, a number of countries will benefit from increased tax and non-tax revenues as well as lower expenditures. India aims to narrow the fiscal deficit to 4.8 per cent in 2011/12 (compare to 6.6 per cent in 2009/10) through, for instance, higher tax revenues and reforms of the fuel-subsidy program. Sri Lanka is expected to reap a peace dividend in the form of higher tourism revenues and a gradual reduction in defence spending. A progressive withdrawal of fiscal stimuli and a narrowing of fiscal deficits are also expected in South America, Western and Central Asia throughout 2011. Most East Asian Governments are likely to gradually move towards a neutral fiscal stance, with fiscal deficits expecting to narrow relative to GDP in 2011-2012.

A number of developing countries continue to maintain an expansionary fiscal policy. In Egypt, Kenya, Mauritius and South Africa, for instance, stimulus packages will continue to support economic activities in 2011. In Ghana fiscal policy has been expansionary in order to support increases infrastructure investment and pro-poor expenditures, whereas public spending in Nigeria is due to rise by 50 per cent in 2010. Indeed, in Algeria the Government has planned a massive development plan for the period up to 2014 equivalent to 180 per cent of its 2010 GDP.

Can monetary policy do the job?

As many economies are still struggling for gaining traction in their economic recovery, monetary policy is expected to remain accommodative worldwide.

For many *developed economies* facing increasing fiscal constraints, monetary policy are being seen by policy makers as the only option left for providing additional stimulus. For major developed economies of the United States, Europe and Japan, in which policy interest rates have reached zero bound, further monetary easing would have to rely on quantitative easing. However, the effectiveness of this unconventional measure on stimulating demand remains uncertain.

Among developed economies, most central banks have maintained their policy interest rates at very low level for 2010, except in Australia, Canada, New Zealand, Norway, and Sweden, where the central banks have raised the rates (table 2). Even after the increases, monetary policy stance in most of these economies remains accommodative by historical standards.

The Federal Reserve (Fed) of the United States, Bank of Japan, and the European Central Bank (ECB) have all kept the main policy rate near the zero bound for about two years, but each has fine-tuned the unconventional measures introduced during the financial crisis. In general, they have phased out those short-term liquidity measures that were introduced in the crisis to directly support banks, other depository institutions and other financial institutions, as well as borrowers and investors in key credit markets, as the financial market conditions improved, but they have maintained, or even scaled up, the measures that were introduced to accommodate aggregate demand.

For example, the Fed has wound down most of its emergency facilities, such as the Term Asset-Backed Securities Loan Facility, but kept the longer-term securities, for example, mortgage-backed securities and longer-term Treasury securities, it has purchased on the balance sheet, and even increased purchase of long-term Treasury bills. The ECB has phased out its program of making limited purchases of covered bonds as well as its 12-month long-term refinancing operation, but decided to purchase government bonds in response to the heightened concerns about the sovereign debts of a few European economies. The Bank of Japan terminated its commercial paper and corporate bond purchasing program, but expanded a fund-supplying facility and kept purchasing of government bonds.

Table 2. Timeline of policy interest rate action for selected monetary authorities (as of 8 October 2010)

	Official interest rate	Last change		Current (%)	Change from Aug 2007 (bp)
		Date	Change		
Australia	Cash rate	4 May 2010	+25bp	4.50	-175
Brazil	SELIC overnight rate	21 July 2010	+50bp	10.75	-125
Canada	Overnight funding rate	8 September 2010	+25bp	1.00	-325
Chile	Discount rate	16 September 2010	+50bp	2.50	-250
China	1-year working capital	22 December 2008	-27bp	5.31	-126
Colombia	Repo rate	30 April 2010	-50bp	3.00	-600
Czech Republic	2-week repo rate	6 May 2010	-25bp	0.75	-200
Euro area	Refi rate	7 May 2009	-25bp	1.00	-300
Hong Kong, SAR[a]	Discount window base	17 December 2008	-100bp	0.50	-625
Hungary	2-week deposit rate	26 April 2010	-25bp	5.25	-250
India	Repo rate	16 September 2010	+25bp	6.00	-175
Indonesia	BI rate	5 August 2009	-25bp	6.50	-200
Israel	Base rate	27 September 2010	+25bp	2.00	-200
Japan	Overnight call rate	5 October 2010	-5bp	0.05	-48
Korea	Base rate	9 July 2010	+25bp	2.25	-225
Malaysia	Overnight policy rate	8 July 2010	+25bp	2.75	-75
Mexico	Repo rate	17 July 2009	-25bp	4.50	-270
New Zealand	Cash rate	29 July 2010	+25bp	3.00	-500
Norway	Deposit rate	5 May 2010	+25bp	2.00	-250
Peru	Reference rate	9 September 2010	+50bp	3.00	-150
Philippines	Reverse repo rate	9 July 2009	-25bp	4.00	-350
Poland	7-day intervention rate	24 June 2009	-25bp	3.50	-100
Romania	Base rate	4 May 2010	-25bp	6.25	-75
Russia	1-week deposit rate	31 May 2010	-50bp	2.75	-25
South Africa	Repo rate	9 September 2010	-50bp	6.00	-350
Sweden	Repo rate	2 September 2010	+25bp	0.75	-275
Switzerland	3-month Swiss Libor	12 March 2009	-25bp	0.25	-225
Taiwan, Province of China	Official discount rate	30 September 2010	+12.5bp	1.50	-163
Thailand	1-day repo rate	26 August 2010	+25bp	1.75	-150
Turkey	1-week deposit rate	20 May 2010	-25bp	7.00	-1050
United Kingdom	Repo rate	5 March 2009	-50bp	0.50	-500
United States	Federal funds rate	16 December 2008	-87.5bp	0.125	-512.5

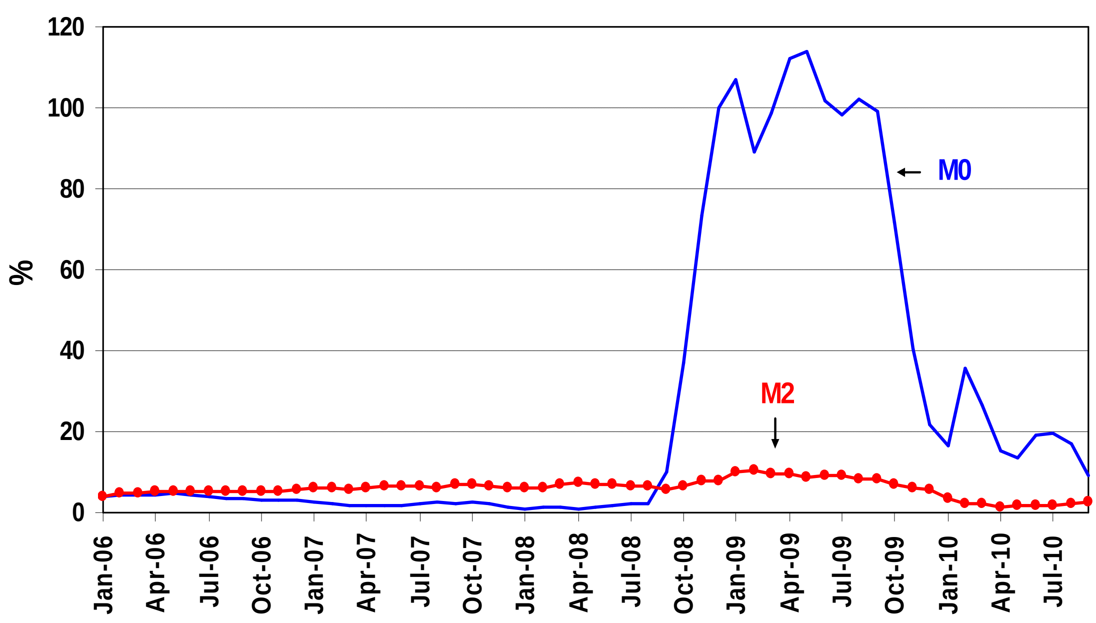
Source: UN/DESA based on data of JPMorgan.

[a] Special administration region of China

In the outlook, the central banks of the major developed economies are expected to keep the policy rates at the current low levels to the end of 2011, and will continue to use their balance-sheets for quantitative easing.

The unconventional monetary measures adopted by these major central banks have so far been helpful for easing the stresses in financial markets and supporting various financial institutions, but their effectiveness on boosting effective demand in the real economy is not certain, or, to say the least, not straightforward. As shown by the experience of Japan in the past two decades, measures of quantitative easing were not sufficient to extricate the economy from a protracted deflation. In the current context, the expansion of the balance sheet of the Fed seems to have led to a rapid growth of the base money, M0, but the growth of broad money supply, M2, remains sluggish (figure 12). A similar figure can be drawn for Japan and the euro area. This indicates that the extra liquidity injected by the central banks stayed mostly within the banking system, in the form of the excess reserves of the commercial banks on the liability side of the balance sheet of the central bank, with little increase in credit growth in the real economy to boost effective aggregate demand and employment. By purchasing the long-term government bonds, the central banks can lower the financing costs for businesses and households, but for the workers in unemployment, they are unlikely to get mortgage, or refinance, no matter how low the mortgage interest rates go.

Figure 12. Annual growth rate of M0 and M2 for United States: January 2006 - September 2010



Source: UN/DESA based on United States Federal Reserve System data

The central banks in some *developing countries and economies in transition* are facing different challenges. Credit growth in some economies of Asia and Latin America seems to have recovered faster than expected, along with a rapid return of capital inflows, posing risks of asset bubbles and heightening inflation pressures. A key challenge for monetary policy in these economies is therefore how to strike a balance among the different needs of further supporting the recovery in the real economy, preventing the inflation of bubbles in equity and housing prices, and maintaining a stable exchange rate.

Among developing countries and economies in transition, monetary policy stance varies, as the strength of economic recovery is also uneven. A number of central banks have increased interest rates during 2010, for example, Brazil, India, Israel, Korea, Malaysia, and Peru, while a few others increased cash reserve requirements, such as China, India, and Turkey, or adopted other measures to directly curb credit growth. Such tightening measures have so far been gradual. While some of these economies have experienced an increase in inflation, but mostly reflecting increases in the prices of goods in certain categories, such as foods, rather than in general prices. The more challenging concern for the monetary authorities in some Asian economies is high credit growth that is fuelling booms in real estate sectors.

In the outlook for 2011, monetary policy in developing countries and economies in transition will likely continue to be diverse across countries, meeting country-specific needs for supporting recovery and managing inflation. Unlike in major developed countries where fiscal policy is under constraint while monetary policy plays solo, in developing countries, monetary policy can be more effectively combined with fiscal policy, as well as other measures, to strengthen further economic recovery and maintain a broad macroeconomic stability, including effective prevention of asset bubbles and high volatility in exchange rates.

Strengthened policy coordination more needed than ever

The premature withdrawal of fiscal stimulus is endangering an already fragile recovery in the developed economies and which may become a drag on thus far robust recovery in many developing countries in the outlook. Governments in the developed world are turning to further monetary easing in efforts to keep up domestic demand as fiscal stimulus is phased out. However, in a context of continued high economic uncertainty, financial fragility and high unemployment, little of this is translated to larger credit supplies for productive investment. Rather, it is fuelling high capital flows to emerging markets and other developing countries, creating exchange rate problems and inflating asset bubbles in those parts of the world.

The need for strengthened international policy coordination, as stressed in numerous LINK GEO’s and the UN’s World Economic Situation and Prospects before and after the crisis, seems larger than before. Yet, the cooperative spirit that emerged in the immediate aftermath of the crisis seems to be waning as Governments in major economies have become more focused on domestic policy challenges than on the spillover effects of their actions. While it is clear that global demand needs rebalancing, away from indebted deficit countries in the developed world to more domestic spending in developing countries, achieving this will not be easy as it will take structural reforms and several years of continued efforts to achieve. The focus in present policy debates on exchange rate realignment is too narrow and bilaterally focused and seems to reflect a misunderstanding of the global spillover effects of present macroeconomic policy stances. The G20's framework for strong, balanced and sustainable global growth provides a broader and likely more fruitful approach, if only its own instigators would make more serious work to try and put it into effect.

Regional Prospects

Developed economies

United States

After four quarters of continuous decline, the United States economy resumed growth in the third quarter of 2009. Initially, the speed of growth was comparable with that observed during typical recoveries. However, in the second quarter of 2010, the GDP growth rate has decelerated to less than 2 per cent (at annualized rate) and other indicators also point to mild or even weak growth in the coming quarters.

During the first four quarters of this recovery, the change in inventory has contributed about 60 percent of growth. In addition, private consumption also contributed to growth, although to a lesser extent than the restocking of inventory, especially in the early stage of the recovery. Over the same period, government consumption expenditure and gross investment only contributed a small proportion to the recovery. As a relief to the recession, the federal government has introduced certain stimulus packages; nevertheless governments at the state and local level will have to reduce their expenditure to accommodate lower revenues caused by the recession. Net exports have technically helped to stabilize the decline of GDP during the recession period by cutting down imports. However, net exports resumed the role of a draining factor for GDP again after the economy entered the recovery stage, as imports of goods and services have again been rising faster than exports. Among the major components of fixed capital stock formation, residential investment and business structure investment either contributed marginally to or even reduced the speed of recovery; only business investment in equipments and software has shown solid growth.

One of the momentous consequences of the recession has been the deterioration of the labour market. Employment started to decline from late-2007 as economic growth started to slow. Based on household survey data, civilian employment declined almost 6 per cent before it reached the through in late-2009. Since then, employment has increased around 1 per cent, still remaining about 5 per cent lower than its peak level. This weak healing in the labour market has not been enough to bring down the unemployment rate which has stayed about 5 per cent above its pre-crisis level.

Besides reducing employment income, another negative impact on households of the massive and persistent unemployment is the raised uncertainty faced by families about the future income flow. Given that so many American families have seen the value of their wealth (financial and housing) eroded over the crisis, the persistent unemployment enforced the trend for households to save more to rebuild their portfolios. This adjustment in behaviour is expected to be of a longer-term nature and will constrain consumption expenditure, which is expected to grow by only 1.6 percent in 2010 and 2.2 per cent in 2011. This is based on an annual average unemployment rate that will lie in the range of 9.5 to 10 per cent in 2010 and only less than half a percentage point lower next year.

The situation in the housing market has not shown any real improvement yet. The Government has introduced the homebuyer tax credit programme, which helped to make qualified buyers bring forward their purchasing actions. Nevertheless, after the expiration of the programmer earlier in 2010, the buying and building activities of residential housing dropped significantly. Housing prices also have lost the support provided by the programme and may start to dwindle again. On the other hand, interest rates have been at a very low level and the United States Federal Reserve (Fed) may not change its stance soon. In this context, it is also noticeable that many corporations are holding a significant amount of cash. This can be a favourable environment for business investment. In all, fixed investment is predicted to grow by 2.7 and 6.5 per cent in 2010 and 2011, respectively.

For 2010 and 2011, both exports and imports of goods and services are predicted to grow by around 10 and 9 per cent, respectively, in real terms. Given the net trade deficit in the base year, this means net exports will not contribute to GDP growth in the near term. But the expansion of the trade deficit will only be mild and may increase the current account deficit by about 10-20 billion dollars annually.

Another noticeable consequence of the recession has been the deterioration of the public fiscal situation. The federal deficit amounts to about 10 per cent of nominal GDP in the fiscal years 2009 and 2010. The general situation of state and local governments is also very gloomy. It is hence expected that government consumption will not be able to grow noteworthy and may even need to be cut in order to reduce deficits. Government consumption is expected to increase by 0.6 per cent in 2010 before declining by 0.3 per cent next year. All these components lead to the forecast that GDP will grow by 2.6 and 2.2 per cent, respectively, in 2010 and 2011.

The high unemployment rate and low capacity utilization ratio implies significant slack capacity. Businesses have also been able to achieve productivity gains to reduce unit labour costs. Commodity and energy prices are also not expected to repeat their performance of 2008 and 2009. Consequently, price levels, especially the core index excluding energy and food items, are expected to increase mildly. The baseline outlook predicts that the headline consumer price index will increase only 1.4 percent in the current and coming year.

The Fed has kept its policy rate at an extremely low level and is expected to continue doing so for 'an extended period'. The baseline assumption interprets this as very late-2011 or early-2012. The Fed has originally stopped the purchase of long-term securities in March 2010. Over the summer, it has decided to resume the purchases to replace the maturing GSE debt and MBS with government securities and maintain the amount of holdings. Subsequently, it also indicated the possibility to expand the holdings if necessary. The baseline outlook includes the assumption of purchases in the amount of 500 billion dollars spread over 2010 and 2011.

For the United States, the major risk is a vicious cycle between the housing sector and the financial sector. If housing prices keep on declining and force more mortgages into foreclosure, financial institutions are likely to tighten the supply of credit further to the remaining affordable buyers. The reduced mortgage supply will further reduce the number of potential buyers for foreclosed homes, further pushing down prices. This type of cycle will impact the economy in many ways. First, it will lower consumers' confidence. Second, declining housing prices will encourage more mortgage holders to abandon their homes, weakening financial institutions. Third, it will reduce the value of MBS and further weaken the financial health of holders of this type of securities. Given the international distribution of MBS, this may trigger the demand of a higher risk premium for United States securities by foreign investors.

Japan

The economy of Japan started the year of 2010 with a strong pace of recovery, but the momentum tapered off dramatically over the year. After rebounding at a rate of nearly 5 per cent in the first quarter, GDP growth decelerated to a pace below 2 per cent in the flowing quarters of 2010. Against a deep recession of 5 per cent in 2009, GDP growth is estimated to be about 2.7 per cent for 2010, and the growth forecast for 2011 is even more anaemic, standing at only 1.1 per cent. Weak domestic demand, particularly the phasing-out of the earlier stimulus measures of public investment, continue to drag on growth, while exports continue to provide support, although at a decelerating pace. A new stimulus package announced in September of 2010 is expected to backstop a further slide of the economy into a double-dip recession, but the scale seems to be too small to provide a strong boost to growth. Persistent deflation and elevated public debt are among the key policy challenges in the outlook.

Exports remain a key driver for output growth in Japan. After falling at an annual rate of 50 per cent in the global downturn by the end of 2008 and early 2009, Japan's exports rebounded at a rate of the same magnitude in early 2010 along with the global recovery, especially in light of a strong recovery in demand by China, which has now become the largest destination for Japan's exports. Since mid-2010, however, the growth of Japan's exports decelerated to a pace below 20 per cent, and is expected to decelerate further in the outlook, to a pace of about 10 per cent in 2011. Demand by China and other Asian economies will remain firm, but demand by many developed economies will be limited. While the large appreciation of the yen is expected to have some adverse impact on Japan's exports, some analysts believe the impact is manageable, as the trend in domestic deflation will keep export prices low, and a continued improvement in productivity can maintain the competitiveness of Japan's exports.

Domestic demand has been recovering at a slow pace. Public investment started to decline in mid 2010 with the fading of earlier stimulus measures. Business fixed investment has been gradually recovering, as corporate profits continue to improve, although excessive capacity continues to curb the pace of business capital spending in the outlook. Private consumption has picked up, mainly driven by policy support, but the growth of private consumption will likely be weak as the employment and income situation remains challenging.

After the unemployment rate rose to an all-time high of 5.7 per cent in 2009, the improvement in the labour market has been marginal during 2010, with the unemployment rate remaining above 5 per cent. Labour income, which had been declining since 2008, started to show some improvement in late 2010.

Japan has been in deflation for the most part of the last two decades. Indeed, deflation has worsened since 2009 as all price indices fell significantly. Although deflation is an indication of substantial slack in the economy, it may also be related to the structural problem of an ageing and declining population in Japan.

In response to the global financial crisis, the Bank of Japan implemented various monetary policy measures in three main areas, including reductions in the policy interest rate, measures to ensure stability in financial markets, and measures to facilitate corporate financing. Facing a tenacious deflation, further measures have been taken to inject new funds into the economy, through outright purchasing of corporate debt and long-term government bonds. By September 2010, as the yen reached a 15-year high vis-à-vis the dollar, the Bank of Japan intervened in the foreign exchange market for the first time since 2004. By selling the yen and buying the dollar, without sterilizing, the Bank of Japan also injects more liquidity into the economy, as part of the so-called quantitative easing. Immediately afterward, the Bank of Japan also cut its policy interest rate to zero per cent, from the already low level of 0.1 per cent. In the outlook, monetary policy is expected to maintain its current extremely accommodative stance until late 2011, to be followed by a gradual increase in policy interest rates.

A series of fiscal stimulus packages have been launched since mid-2008, including extra-budgetary government spending totalling about 5 per cent of GDP. Certain adjustments were made in the budget during 2010, including a reduction in public investment and an increase in direct support to households. In late 2010, in light of the risk of a faltering economic recovery, the Government announced a new stimulus package of ¥915 billion in public spending, which is expected to boost GDP by about 0.3 percent through creating 200,000 jobs and encouraging consumer and business spending. Japan's budget deficit widened to over 6 per cent of GDP in 2010, and public debt reached about 200 per cent of GDP, but the increase in the government deficit has been matched by increases in corporate and household savings so far, and Japan continues to be a net exporter of capital to the rest of the world.

Australia and New Zealand

Australia has been the only developed economy to have avoided a recession during the latest global financial crisis. Buttressed by stimulus measures, growth of domestic demand has been exceptionally strong since late 2009, particularly in private investment in the booming mining sector. The rise in the prices of Australia's commodity exports, together with the rebound in exports, particularly to emerging economies, pushed the trade balance to its largest surplus as a share of GDP since the 1970s. Some moderation in growth was witnessed in mid-2010, but GDP is still estimated to grow by 3.2 per cent for the year. In the outlook, public demand is expected to subtract from GDP growth as stimulus projects are gradually completed, but private consumption should continue to grow and employment continues to expand. GDP is forecast to grow at 2.7 per cent in 2011.

The Reserve Bank of Australia has been raising interest rates since 2009, but the Central Bank is expected to keep the policy interest rate at the current level of 4.5 per cent in the outlook for 2011, based on the fact that the economy is growing at a pace of the long-run trend, several measures of inflation expectations have eased most recently, and the recovery in the rest of the world is moderating.

New Zealand has been recovering at a moderate pace from a prolonged recession. While net exports have made a solid contribution to growth, household consumption and business investment have also increased, driven by low interest rates. Consumer and business confidence continued to improve, but credit conditions remain tight and businesses continue to de-leverage, leading to modest growth in the outlook. The damage of the earthquake in September 2010 at Canterbury is estimated to drag down quarterly GDP by about 0.3 per cent, but the reconstruction in the aftermath will boost growth. GDP is estimated to grow by 2.6 per cent in 2010 and is forecast to moderate to 2.3 per cent in 2011.

Canada

The Canadian economy resumed its growth in the second half of 2009. However, after several quarters of solid growth, the speed of expansion is expected to slow down over the second half of 2010. Nevertheless, GDP growth is predicted to be 2.9 per cent in 2010 and 2.5 per cent in 2011.

Private consumption is expected to grow by around 3 per cent in both 2010 and 2011. Relatively healthy balance sheets made it not necessary for households to adjust their consumption behavior fundamentally. The recovery in the labour market also provided the remedy to the loss of income during the recession.

Fixed capital formation will remain strong in both years. Residential investment has grown rapidly until mid-2010, which was caused partially by the change in consumption taxes in some provinces. The investment in machinery and equipment and non-residential construction will remain strong and contribute five per cent of growth to total investment in both years.

The external sector was a major cause of the slowdown in 2008 and 2009. The concentration of exports to the United States transmitted the recession into the Canadian economy. The slower-than-usual recovery in the United States and the appreciation of the Canadian dollar vis-à-vis the United States dollar over the past few years will keep the current account in deficit over the forecast period. Net exports are expected to drag down growth both in 2010 and 2011.

Over 2010, the labour market in Canada has basically regained the jobs lost during the recession. Employment in the third quarter is as high as the peak reached in 2008. However, the continuous expansion of the labour force will keep the annual average unemployment rate at around eight percent, which is still about two percentage points higher than the level in 2008.

Western Europe

Economic activity has continued to pick up from its low point in the first quarter of 2009, with GDP growth reaching 1 per cent (qoq) in the second quarter of 2010, after 0.3 per cent in the first quarter. Exports have been the driving force together with inventory restocking and fiscal stimulus. But there has also been a first tentative transition to domestic demand led growth with gross fixed capital formation finally showing positive growth in the second quarter as well as being the largest contributor to growth, while private consumption maintained its steady but low rate of growth. With foreign demand expected to slow in the second half of the year and fiscal stimuli gradually being withdrawn or in a number of cases transitioning to fiscal consolidation, growth is expected to slow in the second half of the year, and maintain only a moderate pace in 2011 and 2012. Given the strong carry over from the first half of the year and continued moderate activity as suggested by survey data, growth is expected to register 1.6 per cent in 2010 and to strengthen slightly in 2011 to 1.8 per cent. The aggregate figures, however, mask underlying tensions in the region, as growth is characterized by two speeds: higher-growth countries led by Germany, which is expected to grow by 3.4 per cent in 2010, while the countries affected by the fiscal crisis such as Greece, Portugal, Ireland and Spain will either remain in recession or grow by minimal amounts.

Industrial production picked up continuously until mid-year but has subsequently been moving sideways, indicating some loss of momentum. For the euro area it remains 13.3 per cent below its peak of February 2008**.** Intermediate and capital goods have been strongest. Construction has been far more volatile, affected strongly by bad winter weather with a subsequent rebound, but appears to have bottomed out and may be at a turning point. Retail trade remains weak and may just have passed its recession low-point, although it did not suffer the steep decline that manufacturing and construction did.

Survey data for the euro area as a whole are consistent with continuing growth but indicate some loss of momentum. The European Commission's Economic Sentiment

Indicator, for example, moved above its long term (since 1990) average in July, but remains well below its previous cyclical peak and while continuing to increase in subsequent months, the pace has slowed. At the sectoral level, industrial confidence moved above its long term average in April and has continued to increase since, but is still below its previous peak. Services confidence has been more erratic in the last few months and remains well below its long term average. Construction confidence has moved sideways and remains far below its long term average. Consumer confidence has improved but also remains well below its long term average.

Germany has seen the sharpest rebound so far and this has been tracked closely by its IFO Business climate index, which is now above its previous cyclical peak. The expectations component is also above its previous cyclical peak while the current conditions component is below. The manufacturing sector is leading the recovery but all sectors are improving, even construction, although the German construction sector was not involved in the bubble and its subsequent collapse.

The recovery has thus far been a mix of an export-driven industrial rebound, pushed by the revival of global trade - particularly in Asia, with its strong capital goods demand - and Government fiscal support measures of varying intensities. But there is evidence of some broadening and maturing of the recovery. Fixed capital investment finally showed positive growth in the second quarter of 2010 for the euro area, after eight consecutive quarters of decline, while consumption continues to provide modest support and turned up in Germany and France. Going forward, growth dynamics in the second half of 2010 are expected to slow to a more subdued pace, as global trade slows, the inventory cycle turns and fiscal stimulus measures fade. This lower pace is expected to continue into 2011 and 2012 as fiscal consolidation packages come more into force.

Private consumption expenditure, while decelerating, provided support in many countries during the downturn, but has yet to show sufficient vigour to lead the recovery. Labour market conditions, while not nearly as bad on average as expected earlier in the year, remain extremely weak, with unemployment still high in all countries and wages subdued. In the outlook, some improvement is expected. Rates of unemployment have either stabilized at high levels or are coming down in some cases, savings rates have retreated from their highs during the financial crisis as uncertainty has decreased, inflation is expected to continue to remain subdued and consumer loans (save housing) are increasing although financing conditions still remain more challenging than before the crisis.

The precipitous decline in investment, both in equipment and housing, was a major driver of the recession and evidence for a turnaround at the regional level is sparse, with the second quarter seeing the first positive growth since the recession. Going forward, investment is expected to pick up gradually, registering positive but low rates of growth in 2011 and 2012. Capacity utilization has moved up significantly since its record low of 69.6 per cent in the third quarter of 2009, reaching 77.4 per cent in the third quarter, but remains below its long run average of 81.2 per cent. But some countries have closed the gap; Germany is very close to its long term average and Austria is above.

Export order books continue to improve and are close to their long term average. Business profits have improved. However, financing conditions remain difficult. The cost of external finance is low, but euro area banks continued to tighten credit standards as recently as July. Loans to non-financial corporations continue to decline but at a dampening pace, indicating that a turning point may be near. This may pose a significant restraint only later in the recovery as in the early stages of a recovery firms tend to use internal financing.

The rebound in global trade has been a key driver of the current recovery, aided by a sharp depreciation of the euro and other regional currencies in the first half of the year. After falling by double digit rates across the region in 2009, real exports are expected to grow by double digit rates in many countries in 2010, with close to 10 per cent growth in the euro area. Much of the demand has come from the strong manufacturing revival in Asia, particular in capital goods, which has benefited countries such as Germany, Austria, and Italy. The revival of regional activity has also generated strong intraregional trade. The rebound in real import volumes is nearly as strong. But in level terms, in general, neither export nor import volumes have reached pre-crisis levels. Going forward, export and import volumes are expected to grow by around 4.5-5 per cent per annum. Given these developments, current account balances deteriorated sharply in 2009 but have rebounded subsequently.

Euro area unemployment has drifted up from a relative low of 7.2 per cent in March of 2008 to 10.1 per cent in August of 2010, but with tremendous divergence across countries. In August, Spain registered an unemployment rate of 20.5 per cent, in Ireland it stood at 14.9 per cent, in France at 10.1 per cent, while Germany it was 6.8 per cent. Additionally, at the euro area level, the rise in unemployment has been barely perceptible for all of 2010, increasing by only 0.3 percentage points since September 2009, and remaining at 10.1 per cent since May. At the country level, unemployment has fallen in Germany by 0.8 percentage points since its peak in January, but continues to rise in countries such as Spain and Greece. This divergence is explained by relative growth performances, differential success in labour market policies and structural differences. In Spain, much of the increase in unemployment came in the construction sector, which will likely take years to rebound, so there is a skills mismatch. In the outlook, unemployment is expected to have peaked in 2010 for the euro area, but to come down only extremely gradually over the forecast horizon, held back by low levels of growth and structural difficulties in some cases. Again there will be tremendous variation at the country level.

Headline inflation, as measured by the Harmonized Index of Consumer Prices (HICP), increased slightly in the first half of 2010, as global commodity prices increased, statistical base effects in food and oil prices were positive and the euro depreciated. Core inflation, which abstracts from energy food, alcohol and tobacco, in an attempt to measure underlying inflationary pressures, bottomed at 0.8 per cent in May and has ticked up since, but there is no evidence of either an acceleration or a deceleration in inflation. Weak labour market conditions mean that wage growth will remain slow and with rising productivity, unit labour costs are falling. The output gap is large and will narrow only slowly over the forecast horizon. Pressure from commodity prices is limited given the forecast assumptions and exchange rates are assumed to remain near current levels. Consequently, headline inflation is expected to rise slightly but to remain below 2 percent.

Fiscal policy and the workings of automatic stabilizers played a major role in softening the impact of the financial crisis and recession on the economies of the regions, but at the cost of large increases in fiscal deficits and debt. Policies across the region are now turning to budget consolidation.

The euro area deficit rose from 2 per cent of GDP in 2008 to 6.2 per cent in 2009, while the debt to GDP level rose from 69.3 per cent in 2008 to 78.7 per cent. Both are expected to continue to rise in 2010, with the deficit rising to 6.6 percent and debt to close to 90 per cent of GDP. More ominously, a number of countries moved to positions of questionable sustainability: the deficit to GDP ratio reached 14.3 per cent in Ireland in 2009, 13.6 per cent in Greece, 11.5 per cent in the UK, 11.2 per cent in Spain and 9.1 per cent in Portugal. In the case of Greece, this was also coupled with a debt to GDP ratio of 115.1 per cent. This led to increased sovereign bond spreads vis-à-vis the German Bund, in some cases reaching record levels in concert with credit agency downgrades. In mid-year, a sovereign debt crisis erupted that was only quelled with the announcement of a massive European financial stabilization mechanism worth 720 billion euros, consisting of government-backed loan guarantees and bilateral loans provided by Euro zone members, an expansion of the existing balance of payments facility (involving all EU members) and money provided by the IMF.

Currently all members of the euro area, except Luxembourg and Finland, have a deficit greater than the 3 per cent of GDP limit enshrined in the Stability and Growth Pact (SGP) and hence are under the Excessive Deficit Procedure (EDP), meaning that they must submit stability programs with explicit plans with target dates for bringing their deficits under 3 per cent. These consolidations typically are scheduled to start in 2011 and take two to four years to complete. The countries involved in the crisis, however, were forced to announce immediate consolidation packages and the degree of consolidation is considerable. In the case of Greece for example, they are expected to reduce the deficit by more than 10 percentage points of GDP by 2014.

Monetary policy continues to rely on unconventional measures. In the early part of the crisis, regional central banks aggressively cut their main policy rates: the ECB cut its main policy interest rate from 4.25 per cent in July 2008 to the current 1 per cent in May of 2009. The Bank of England as well as all of the other regional central banks also brought rates down dramatically, to in most cases near zero. Since then, central banks have adopted a wide variety of unconventional policies.

The ECB modified and extended its refinancing operations by moving from a variable rate tender with fixed allotment to a fixed rate tender with unlimited allotment of liquidity and then extended the set of lending maturities up to one year. Other policies included providing foreign currency liquidity, purchasing covered bonds, expanding the list of eligible assets for use as collateral, lowering the credit rating for accepted collateral and purchasing sovereign bonds. The Bank of England adopted quantitative easing through the Asset Purchase Facility, whereby the BOE purchased UK government securities (gilts) in the secondary market as well as high-quality private sector assets, including commercial paper and corporate bonds.

Some of these measures have already been phased out but others are assumed to be only gradually phased out over the forecast horizon, with the shift to normalizing policy interest rate not expected to happen until 2011.

Risks to the forecast are weighted to the downside. The impact of the fiscal consolidation programs, either currently in force or coming into force in 2011, could be greater than anticipated, leading to a renewed downturn. The sovereign debt crisis could re-emerge, as markets lose confidence in the affected countries' ability to service their debt and sovereign debt spreads increase further, leading to default, with ensuing solvency problems for banks holding this debt. The euro could appreciate further if United States prospects deteriorate, cutting export competitiveness and reducing the key current support to demand.

The maturing and strengthening of the recovery depend on investment and consumption transitioning to the main driving forces of activity, but bank lending could remain constrained, hampering the rebound in investment. Consumption spending could falter if labour market conditions are too slow to improve.

Positive risks to the outlook include stronger exports as emerging market demand remains stronger than anticipated and stronger investment dynamics if bank lending conditions ease more than expected.

The new EU members

Following the sharp economic downturn of 2009, the new EU member states from Eastern Europe entered a cautious recovery in 2010. The recovery was predominantly driven by rebounding exports, which benefited from the stronger import demand in the EU-15 and in other trading partners, as well as by rebuilding inventories in the first half of the year. Private consumption and investment demand in those countries, by contrast, either stagnated or contracted even further, restrained by lower wages, high unemployment, fiscal austerity measures, higher indirect taxes and a still continuing credit crunch. Despite improved business sentiment, low capacity utilization rates acted as a deterrent to investment, undermining the region's long-run growth prospects.

Most of the new EU members are expected to return to growth in 2010. However, the export-led recovery remains fragile and only Poland will exhibit a relatively solid economic performance in 2010, with its GDP increasing by over 3 per cent. In most other countries, the upturn will be feeble, and in Latvia, Lithuania and Romania economic contraction will continue. The aggregate GDP of the region, after shrinking by 3.5 per cent in 2009, is expected to increase by 1.7 per cent in 2010. Growth is expected to strengthen to 3.2 per cent in 2011, provided domestic demand gradually recovers, the countries return to higher investment rates and improve absorption of the EU funds. This outlook, however, is subject to certain risks.

The external economic conditions for the new EU members in 2010 were largely favourable, as import demand, for durable consumer goods and capital and intermediate goods in particular, strengthened in many important trading partners in the first half of the year. Continuation of subsidies for scrapped cars in some of the EU-15 countries supported automotive industries in Central Europe. In addition, new markets for those countries are gaining importance. For example, sales to China from one of the car-making factories in the Czech Republic have increased by 80 per cent in the first half of 2010. Industrial production in the new EU countries rebounded, including in the Baltic States, which are exposed to relatively low-growth countries, such as Finland and the UK.

The terms of access to international capital markets were favourable as well, as portfolio investors increased their exposure to emerging markets. However, failure to adopt credible strategies for reducing public debt levels may lead to less accommodative terms of borrowing in 2011. While IMF programs for Latvia and Romania, launched to provide balance-of-payment support, remain on track, the Fund, together with the EU, suspended its lending for Hungary over the disagreements on fiscal consolidation policies. Hungary did not draw from the IMF funds since 2009, and currently has sufficient access to capital markets to rollover its short-term debt. The flow of the EU funds, which continued in 2010, is expected to increase in 2011, and improving their utilization plays an important role in the recovery strategies in the region. The financial sectors of the new EU countries remain stable and the parent banks avoided massive withdrawal of capital. The crisis in Greece should not pose an imminent danger for the new EU members, although it may affect Bulgaria and Romania through reduced FDI and remittances inflows.

Inflation among the new EU members remained moderate in 2010, as their economies operated well below full capacity, domestic consumption and investment demand remained depressed and disposable income either stagnated or declined. The weakening of the euro versus other major currencies has contributed somewhat to imported inflation in the euro area members Slovakia and Slovenia, but in both these countries inflation remained low, especially in Slovakia, where the annual inflation should not exceed 1 per cent. In Latvia and Lithuania, the countries with fixed currencies, where nominal wages continued to decline, the annual inflation rate is expected to be negative. On the other hand, the increase in energy prices and indirect taxes pushed headline inflation up in some countries with flexible exchange rates, most notably in Romania, where the Central Bank has revised its year-end inflation forecast from 4.2 to 7.8 per cent.

In the outlook, a build-up of serious inflationary pressures among those countries in 2011 is unlikely, as wage growth in the near-term is likely to remain subdued and capacity utilization will stay below its historical average. Headline inflation may increase by between 1 and 2 percentage points in response to higher commodity and energy prices and possible further increases in indirect taxes.

Among the new EU member states, only Bulgaria and Estonia (which is admitted to the euro area) will comply with the 3 per cent of GDP budget deficit threshold of the Stability and Growth Pact (SGP) of the EU in 2010. In other countries, loss of tax and tariff revenues pushed deficits up, to over 8.0 per cent of GDP in Latvia and Lithuania. Amid growing concerns about fiscal sustainability and in line with their commitments to the SGP, the Governments aim at gradual reduction of the deficits to 3 per cent of GDP within the following three to four years. In 2010, most of the Governments continued to reduce wages and cut employment in the public sector, which triggered serious social protests in a number of countries. In addition, the fiscal authorities seek to introduce changes in the structure of public finances, in particular by reforming pension systems, to put them on a more sustainable footing. However, the cost of pension reform will put another strain on public finances and, if not excluded from deficit calculation, will delay meeting the SGP criteria. On the revenue side, among other measures, Hungary introduced a new tax on financial institutions and it cannot be ruled out that other countries may follow this example, although it may adversely affect lending and endanger much needed flows of capital from the parent banks in the EU-15.

The central banks of the new EU members continued to maintain low policy rates in 2010, as monetary authorities seek to restart private lending as well as to discourage speculative capital flows. The cycle of interest rate cuts continued in the Czech Republic and Hungary, with policy rates being cut to a record-low level in both countries, and in Romania. Slovakia and Slovenia are members of the Euro zone and as a result have very low policy rates, set by the ECB. Estonia, in turn, will adopt the single currency in January 2011, consequently transferring its monetary policy decisions to the ECB, and in line with ECB rules, is gradually reducing mandatory reserve requirements for liabilities maturing in less than two years to 2 per cent. It is expected that until the new EU economies show a solid rebound, the focus of monetary policy will not shift to price stability and the policy will remain accommodative. However, despite the improving deposit base and abundant liquidity, the banks in many of the new EU countries remain reluctant to lend, facing the increasing share of non-performing loans, and low policy rates yet have to lead to increased lending.

The increase in unemployment in the region, caused by the recession, slowed down in the first quarter of 2010, partly because export-oriented companies preferred to retain workers. In the subsequent months, the rate of unemployment started to decline in many countries, in parallel with increasing job creation. In Latvia, in particular, the unemployment rate, which had reached 19.7 per cent in the fourth quarter of 2009, was falling at fast speed, reaching 15 per cent in August. Nevertheless, the withdrawal of some fiscal stimulus measures implemented during the recession and the cuts in the public workforce will prevent significant improvement prior to the second half of 2011, when domestic demand is expected to recover and companies are expected to improve their balance sheets.

The high rates of unemployment pose serious policy challenges. One of them is to prevent the rise of structural unemployment, which in addition to its social costs would lower potential output. Many countries in the region developed policies to reverse those trends and to address the skill mismatch in the labour market.

The current account balances in the Baltic States, which moved to surplus in 2010, are expected to remain in positive territory in 2011, although the surpluses will diminish as imports gradually pick up and the deficit on investment income widens. In the other new EU member states, where current accounts were in deficit in 2010, the deficits may further increase, but should not pose risks to macroeconomic stability, unless there is a serious disruption in capital inflows.

Major risks to the region include the possible dampening impact of the fiscal austerity measures in the EU-15 on the demand for the new EU members' exports, too strong an effect of fiscal consolidation on their economies, deleveraging by foreign banks and a possible outflow of capital should those banks come under stress at home, and the possibility of social unrest and early elections leading to unstable government coalitions unable to pursue a coherent economic policy.

Economies in transition

South-eastern Europe

Following several quarters of contraction, almost all economies in South-eastern Europe returned to growth in 2010, with the exception of Croatia, where the satisfactory export performance was insufficient to offset the continuing decline in domestic demand, especially in investment. The improvement in the SEE economies was mostly driven by net exports, which benefited from the recovering global demand for commodities, in particular metals, higher commodity prices, and from stronger demand for imports in their main trading partners in the EU. The competitiveness of the SEE exports has also improved, helped by the cuts in nominal wages, and in the case of Serbia, a depreciating currency. Industrial production, excluding construction, showed positive trends in 2010. While exports recovered, private consumption in the region remained subdued as slow or negative wage growth, high unemployment, increased taxes and declining house values along with lower inflow of remittances restrained consumer spending. Gross capital formation either stagnated or declined, despite some recovery of FDI inflows into the region and the provision of subsidized loans. Although the weakness in domestic demand acted as a drag on aggregate output, it may also reflect a shift to a new pattern of development through increasing exports and investing into export-oriented sectors.

The aggregate GDP of South-eastern Europe is expected to grow by a mere 0.1 per cent in 2010 (this is explained by the relatively large share of Croatia in total regional output). Only in Albania and Serbia, growth may exceed 2 per cent. The recovery may accelerate in 2011, with aggregate GDP growth reaching 2.3 per cent, assuming favourable external conditions and a modest recovery in domestic demand.

Inflation in South-eastern Europe remained subdued in 2010, with annual inflation rates at 1 to 2 per cent, as freezes in nominal wages in the public sector and in pensions and lower wages in the private sector contained demand-pull inflation. In addition, formal or de-facto currency pegs in the region contributed to price stability. The only exception to the low-inflation pattern was Serbia, where the currency repeatedly came under pressure due to an increase in risk premiums and agricultural prices have increased over the summer. This may lead to annual inflation of about 5 per cent in 2010. In 2011, as the freeze on public wages and pensions is expected to be removed, inflation in Serbia may slightly accelerate before returning to a disinflationary trend. In other SEE economies, inflation may increase by 0.5 to 1.0 percentage points in 2011, as domestic demand gradually picks up.

The Governments in the region have little room for direct fiscal stimulus and the recovery policies are mostly restricted to improving the business environment, providing businesses with access to finance and seeking strategic investors. Fiscal consolidation remains a priority throughout the region, since most of the countries have to rely on domestic sources to finance their deficits. Bosnia and Herzegovina and Serbia have to adhere to the conditions of their IMF programs and to continue cuts in public sector spending, including in wages and benefits, as well as employment in the public sector, although implementation of the latter measure is not assured. The ongoing fiscal consolidation should allow for more financial resources to become available for the business sector.

Monetary policies in the region remained supportive to growth in 2010. In Albania, Croatia, Serbia and in the Former Yugoslav Republic of Macedonia, either interest rates were cut or mandatory reserve requirements for commercial banks were reduced (in September, however, the Central Bank had to increase the policy rate in Serbia in response to rising inflationary pressures). While in some of the SEE countries, the provision of credit improved in 2010, banks still face an increasing number of non-performing loans and in Serbia, for example, prefer to lend in foreign currency due to small fraction of domestic currency savings, while customers and businesses on the other hand try to avoid exchange rate risk. Accommodative monetary policy is expected to continue in 2011, as boosting credit to the private sector is a key part of the recovery strategies in the region.

The unemployment rate has increased in the region in 2010, with the exception of Albania, although the monthly dynamics suggest that a positive trend is emerging in the labour market of some countries, in particular in Croatia, although this may reflect seasonal factors. Among the SEE economies, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia have especially high rates of unemployment, which is largely structural by its nature. As the economic recovery gains speed in 2011 and more jobs are created in the private sector, the labour markets in the region should improve somewhat, although they will remain among the priorities of economic policymakers.

The current account deficits in the region continued to decline, as import growth was subdued or even turned negative, but still remained at high (double-digit) levels in

Albania and Montenegro. With the exception of those two countries, the deficits may increase somewhat in 2011 as domestic demand strengthens and leads to stronger imports of capital and consumer goods.

There are some risks to the outlook. Lower global demand for commodities and weak import demand in the EU may interrupt the tentative recovery in the region. Although foreign banks, operating in South-eastern Europe, continued to keep their exposure to those countries, the subsidiaries of Greek banks potentially may become a channel of crisis spillover against the backdrop of the high degree of euroization of loans. The fiscal crisis in Greece may also directly affect Albania, the former Yugoslav Republic of Macedonia and Montenegro through lower remittances and weaker export performance.

Commonwealth of Independent States (CIS)

Following a sharp contraction by 7 per cent in 2009 as the CIS was particularly affected by the global economic and financial crisis, economies in the region benefited in 2010 from an improved external environment, which manifested itself through a significant recovery in commodity prices and a general improvement in external demand. Supported by continued fiscal and monetary support, regional output is forecast to expand by 4.1 per cent in 2010 and is expected to grow at a similar pace in 2011.

Most economies of the CIS recovered significantly in 2010. Indeed, several countries will see growth rates in 2010 that exceed their 2009 values by more than 10 percentage points. While this is in part due to base effects - in Ukraine, for instance, GDP growth of 6 percent in the second quarter of 2010 must be contrasted with a rate of contraction that exceeded 20 per cent a year earlier - inventory recovery and rebounding commodity prices have contributed significantly to the improved performance in the region. This is reflected in the performance of their external sector. While net fuel exporters reaped the benefits of higher oil and gas prices, others, such as Uzbekistan and Kyrgyzstan, benefited from higher gold prices. However, the performance of domestic markets in the region has been mixed. While stronger consumer demand contributed to growth in retail sales in Kazakhstan, and Belarus, sales have been relatively anaemic in Ukraine. In Belarus, the construction sector has contributed to an improved growth performance (and investment), but it remains extremely weak in Ukraine and is still underperforming in the Russian Federation. In addition, adverse weather has had a detrimental impact on agriculture in the region. Overall, the more favourable external environment and inventory recovery have benefited industrial sectors, many of which registered double-digit increases in the first 8 months of 2010: in Kazakhstan, for example, manufacturing increased by almost a fifth, while in the Russian Federation machinery surged by 16 per cent. However, a slight deceleration of growth has been observed in many economies from the second quarter of 2010 onwards. This slowdown is also reflected in the stock market performance in the region, with market indices having lost many of the gains registered up to the first quarter of 2010. Thus, the RTS index in the Russian Federation increased by only 2.2 per cent, while the KASE index in

Kazakhstan lost all gains made in the first quarter of 2010 and ended 16.6 per cent lower at the end of August relative to the end of 2009.

Having significantly shed labour in the 2009 downturn, labour markets improved in many countries in the region due to the more favourable economic environment. The rate of unemployment declined in the Russian Federation during the course of 2010 and is expected to reach 7.6 per cent in 2010, compared to 8.4 per cent in 2009. Similarly, in Kazakhstan, unemployment reached 5.8 per cent at the end of the first half of 2010, compared to 6.6 per cent at the end of 2009. Although stronger labour markets in these two economies have had a positive impact on the region, particularly on the low-income economies, the performance of labour markets in low-income countries has in general been rather poor. While migration continues to provide an alternative to scarce local employment opportunities, it no longer does so on the scale that was observed in the years before the crisis. Although overall remittances from the Russian Federation to CIS countries increased by 15 per cent in the first quarter of 2010, they were almost a fifth lower than the respective amount in 2008. In general, the outlook for unemployment in 2011 remains uncertain. While a global weakening in the second half of 2010 and expected fiscal consolidation in the region in 2011 are likely to dampen prospects for employment, the revival of credit and the strengthening of domestic demand will provide a positive impulse.

Notwithstanding the economic recovery in the first half of 2010, inflationary pressures have in general remained subdued such that inflation in the region abated to 7.1 per cent in 2010, compared to 11.6 per cent in 2009. In most economies, inflation is expected to be in the single digits in 2011. Having declined during the first half of the year, inflationary pressures however re-emerged in the second half, particularly in Kazakhstan, the Russian Federation and Ukraine, where the impact of drought and wildfires on agriculture contributed to higher food prices. While a more robust economic performance in Belarus has contributed to higher inflation, border-crossing problems are to blame for inflationary pressures in Central Asia. Overall, these pressures are expected to increase in 2011 such that regional inflation may reach 8.6 per cent in 2011.

The loose monetary policy stance that most central banks in the region adopted in the wake of the crisis in 2008 was generally maintained in 2010, particularly in the larger economies of the region. Although authorities in Armenia responded to mounting inflationary pressures by increasing policy rates, the authorities in Belarus, the Russian Federation and Kazakhstan continued to ease their monetary policy in an attempt to increase credit flows, support domestic liquidity and to stimulate demand. In doing so, they were able to benefit from gradual currency appreciations, particularly against the euro. However, the combination of funding problems and rising non-performing loans (NPLs) – in Kazakhstan these are expected to peak at around 30 per cent while in Ukraine the official estimate of NPLs reached almost 12 per cent in August 2010 and is projected to continue to rise further – has led to reluctance to extend new credit by a still fragile banking sector. Despite improved liquidity, credit growth therefore remains, in general, sluggish throughout the region, constrained by the desire of banks to rebuild their balance sheets and constrained by weak demand. Indeed, among the largest countries there have been clear signs of improvement only in the Russian Federation. In addition, foreign currency lending and foreign currency deposits continue to play a significant role in the region, reflecting a mixture of macroeconomic concerns, risk mis-pricing and pre-crisis access to international funding. However, several countries have introduced regulatory changes to reduce external vulnerabilities. In Ukraine, for instance, foreign currency lending to households has been prohibited, while stronger provisioning requirements have been established in other countries to reduce foreign currency risk.

Fiscal deficits in the region decreased in 2010 as greater economic activity contributed to increased revenues. This was particularly the case in net fuel exporting countries where higher fuel prices amplified the revenue generated from higher trade turnover. Nevertheless, while Armenia, Ukraine, Kyrgyzstan, the Republic of Moldova, Tajikistan and Ukraine continue to receive resources from the IMF to support their economies (Belarus completed its stand-by arrangement with the IMF in 2010), stabilization funds in the resource-rich countries continue to be drawn upon to finance countercyclical policy measures. In the Russian Federation, for instance, the balance of the Reserve Fund decreased by a third to $40 billion in September (prior to the crisis it held $142 billion). In contrast, assets of the Kazakh national oil fund increased to an all-time high of $28 billion in August, notwithstanding a transfer of almost $5 billion to the state budget in the first half of the year. Indeed, authorities in Kazakhstan have introduced legislation that limits annual transfers from the fund to $8 billion. The general trend of decreasing deficits was only bucked in Belarus, where increases in the price of gas imports from the Russian Federation contributed to a worsening of the overall fiscal balance, and in Kyrgyzstan, where greater public expenditure, especially for reconstruction resulting from the ethnically motivated violence that marred the country in the first quarter of 2010, contributed to a widening of the fiscal deficit by more than 10 percentage points of GDP. Overall, fiscal deficits in the region are expected to continue to decline in 2011 as countries continue to shift towards fiscal consolidation.

Increased export volumes and higher export prices, particularly of natural commodities such as oil and gas, but also of various metals and cotton, have contributed to a significant improvement in the external balance of the CIS, notwithstanding a larger import bill due to greater domestic demand. Thus, in the first half of 2010, the combined current account surplus of the Russian Federation and Kazakhstan, the two largest net fuel exporters, almost quadrupled to $56 billion. In general, trade deficits also narrowed in net fuel importing countries such as Armenia, Belarus, and Tajikistan, which benefited from growing prices for their commodities exports. Indeed, Ukraine registered its first current account surplus in the second quarter of 2010 since 2007.

Although domestic demand in the region is gradually strengthening, performance of the CIS remains dependent upon external circumstances. Its reliance on access to external finance and its pattern of export specialisation make it vulnerable to external shocks. Since the onset of the crisis, growing expenditures have left public finances more exposed to the consequences of falling commodity prices. Moreover, reversing the fiscal expansions that played a countercyclical role during the downturn will pose difficult choices and may contribute to the dampening of economic performance. In addition, the financial sector remains fragile in many economies and political certainty cannot be taken for granted in all countries.

Developing countries

Africa

Output growth in the region is projected to reach 4.7 per cent in 2010 and 5.1 percent in 2011, compared to 2.4 per cent in 2009. The recovery has been strengthened by the rebounds in the prices of hydrocarbons and minerals as well as the buoyant demand from emerging economies. Robust domestic demand in several African economies—driven by strong government expenditure, particularly in infrastructure—, together with higher capital inflows, the revival of tourism and the fast-growing telecommunication sector have also supported the economic expansion. However, the strength of the recovery has varied across countries.

Overall, oil-exporters have registered stronger rebounds, even though the non-oil sector of these economies has often been the driver of economic growth. For instance, in Nigeria, this sector grew by 8.3 per cent in the first half of 2010 while the growth of the oil and gas sector rebounded to 4 per cent only. The stellar performance of the non-oil sector in Africa's most populous country in the first half of 2010 is mainly attributed to three factors: the solid performance of agriculture, which produces 40 per cent of GDP and has consistently grown at a solid rate between 5 per cent and 6 per cent for several quarters; the double-digit expansion of commerce, Nigeria's second-largest sector; and the extremely fast-growing telecommunication sector which expanded by more than 30 per cent in the first semester. Yet, this "oil-exporter" classification still masks a large degree of heterogeneity. In Angola, GDP growth is still forecast to reach about 5 per cent this year. By contrast, Equatorial Guinea's GDP will only increase by a meagre 1.1 per cent, after posting double-digit growth rates for many years, as oil output declined. In between, growth in most of the North African oil-exporters has been almost back to their pre-crisis level averages owing to strong government spending, robust domestic consumption and the revival of private capital inflows.

In Africa's oil-importing middle income countries, economic conditions have also been more favourable, though national disparities remain. Mineral-exporters from Southern Africa, like Botswana and Namibia, have benefited from a regain in external demand for mining activities and will show repeated robust positive growth rates in 2010 and 2011. By contrast, growth in South Africa is more subdued after it slowed to an annualized and seasonally adjusted rate of 3.2 per cent during the second quarter, down from a rate of 4.6 per cent in the first quarter. In particular, the mining output shrank by 20.8 per cent after growing by 15.4 per cent, owing to stoppages resulting from both routine maintenance and labour strikes. Growth of manufacturing output also decelerated to 6.9 per cent from 8.4 per cent. In the third quarter, the wave of strikes also hit other sectors, both public and private, eroding the short-lived boost induced by the FIFA world cup tournament. In North Africa, despite the continued economic challenges in some members of the euro zone, Morocco and Tunisia will post robust growth rates in the next two years on the back of robust domestic demand, continued investments in human capital and infrastructure as well as higher tourism revenues and remittances.

Among Africa's low-income countries, two different groups emerge. On the one hand, the recovery will fail to gather significant strength in most of the countries that consistently posted relatively weak economic growth in the recent past, like in Burundi, Central African Republic, Comoros, Guinea and Niger, where major domestic constraints to growth persisted. In addition to political disturbances and insecurity that affect most of these economies, drought in some parts of Niger significantly reduced the food production and slowed the overall economic activity, despite rising mining output.

On the other hand, a large number of non-oil producing low-income African countries, including Ethiopia, Malawi, Mozambique Rwanda, Tanzania, Uganda and Zambia, have continued to grow at more than 5 percent in 2010. The main growth factors include a strong performance in industrial or services sectors in Uganda and Rwanda, increased investment in infrastructure development in Ethiopia and Malawi together with rising mining production in Tanzania, and increased agricultural output in Zambia.

The lack of decent jobs remains one of the major challenges of the continent. This is particularly true for women and young adults whose unemployment rates are often a multiple of the aggregate national figure. The scarcity of data and the differences among countries make it hard if not impossible to provide an accurate picture of the employment situation in the continent. Nevertheless, evidence suggests that the rebound of the external sector—particularly in the trade of services, along with the revival of foreign direct investment—as well as the rapid expansion of the telecommunication sector have slightly benefited the employment situation in the region. However, the levels of unemployment and vulnerable employment are expected to remain high in the outlook, as job creation will not be sufficient to absorb the rapid expansion of the labour force.

Among the four countries for which quarterly employment figures are available for 2010, the picture is rather mixed owing to countries' individual characteristics and idiosyncratic shocks. In the first set of countries, the employment situation in Egypt and Mauritius has improved. In the former, employment increased by about 5 per cent in the second quarter of 2010 compared to the same period in 2009, exceeding growth of the labour force. Hence, the unemployment rate slightly declined from 9.4 per cent to 9 per cent. In the latter, employment rose by 4.7 per cent during the same period and unemployment declined from 8.3 per cent to 7.6 per cent owing to a rebound in tourism. In the second set of countries, the situation deteriorated in Morocco and South Africa. In Morocco, the revival in the non-agricultural sector was not enough to offset lower labour demand in agriculture owing to a weaker harvest this year. The unemployment rate increased to 8.2 per cent in the second quarter from 8.0 per cent in the same period last year. In South Africa, the situation is more problematic, in particular in the private sector. Employment declined sharply and has failed to rebound, especially in the construction, manufacturing and the financial sectors. At the end of the second quarter of 2010, the unemployment rate reached 25.3 per cent, a 1.7 percentage point increase year-on-year.

This figure also masks hundreds of thousands of discouraged work-seekers who are no longer taken into account in the unemployment figure.

In most African countries, inflation is expected to ease in 2010 and 2011, as the depreciation of the dollar has limited imported inflation. In addition, the deceleration of the global recovery will also contribute to less inflation pressures. Moreover, the slowdown in food inflation in many African countries has also played a significant role, although this trend is unlikely to continue further. Nevertheless, inflation is expected to remain in double digits in several countries. By contrast, inflationary pressures have been increasing in Ethiopia, Mozambique and Sierra Leone after the recent depreciation or devaluation of their currency.

Revenues from Africa's exports have continued to recover, with hydrocarbons and minerals comprising approximately four-fifths of total exports, owing to higher commodity prices and buoyant demand from emerging economies. Africa’s exports to China—Africa’s largest bilateral trade partner—have increased from $15.2 billion in 2009 to $33.2 billion in 2010. Nevertheless, Africa’s total exports are not forecast to exceed their pre-crisis high before 2011 as demand from advanced economies remains subdued. Exports to G7 countries during the first half of 2010 have only regained 40 per cent of the decline that had occurred between 2008 and 2009. Africa’s import bill has also been growing, albeit at a slower pace, and imports grew faster than exports in volume. The net improvement of Africa’s terms of trade in 2010 could well switch to surplus the balance of goods in 2010. However, this might melt away in 2011 if the prices of hydrocarbons and minerals dwindle. Exports in services, particularly tourism, have also picked up. Tourist arrivals rose 20 per cent in Kenya and 10 per cent in Morocco in July 2010. In addition, the FIFA world cup tournament in South Africa also provided at significant boost to tourist arrivals, which increased by about 40 per cent in June 2010. The income account will remain in deficit, as will the current account at the regional level. At the country level, it is also estimated that more than 40 African countries will still register a current account deficit in 2010 and 2011.

Private capital flows to Africa have been growing at a strong pace from their short-lived slump in the last part of 2008 and the early months of 2009. Foreign direct investments (FDI) rebounded sharply, particularly in the primary sector owing to the growing interest from Asian and South American companies, but also in the service and light manufacturing sectors. By contrast, FDI in Egypt fell 16 per cent to $6.8 billion during the fiscal year 2009/10, pulled even lower by slowing inflows to the oil and gas sector. Meanwhile, there has been a growing interest for cross-border mergers and acquisitions of South Africa’s enterprises.

Portfolio flows - mainly destined for the two largest stock markets in the region, South Africa and Egypt - have also experienced a reversal as foreign investors appear to be rebuilding their positions following a retrenchment during the global financial crisis.

In addition, workers' remittances have also increased sharply. In Egypt, for instance, private transfers from abroad soared by 235 per cent during the second quarter of 2010 to $4.19 billion.

There has also been a surge in other private creditor inflows, like in South Africa, where large interest rate differentials have stimulated carry trades. The net purchases of South African bonds by non-residents rose to a record $9.2 billion during the first eight months of 2010 compared to $2.3 billion in the whole of 2009.

According to OECD, the net bilateral official development assistance (ODA) destined to Africa was $28 billion in 2009, representing an increase of 3 per cent in real terms over 2008. $25 billion of this aid went to sub-Saharan Africa, an increase of about 5.0 per cent over 2008. Though there has been an increase in ODA for Africa, the continent is likely to receive only about $11 billion of the $25 billion increase envisaged at Gleneagles, due mainly to some European donors who give large shares of their ODA to Africa but are not on track to meet their ambitious targets.

Finally, the two Bretton Woods institutions recently announced another long-awaited debt relief of $12.3 billion for the Democratic Republic of the Congo, a few months after the Paris Club agreed to write off $1.3 billion and reschedule $1.7 billion of the $6.9 billion debt owed to it by the country. The IMF and the World Bank also decided to support a $4.6 billion debt relief scheme for Liberia in June, which is supposed to reduce Liberia's external debt stock by more than 90 per cent to about 15 percent of its GDP.

The currencies of the three largest economies in Africa have strengthened, owing mainly to large portfolio and carry trade inflows. In early October 2010, effective exchange rates for the Egyptian Pound, the Nigerian Naira and the South African Rand were 4.1 per cent, 7.7 per cent and 16.5 per cent higher, respectively, compared to their 2009 average.

Several central banks of large African economies, like Algeria, Kenya, Morocco, South Africa and Tunisia, are expected to keep their key policy rates unchanged or even to continue their monetary easing policies, particularly in the first half of the outlook period. In September 2010, the South African Reserve Bank reduced its repurchase rate by 50 basis points to 6 per cent to provide additional stimulus in view of the somewhat fragile recovery of the domestic economy and insisted that while the scope for further downward movement is seen to be limited, it will still be assessed against future developments. In the other countries mentioned, the key interest rates were unchanged that month as weaker global conditions still contrasted with robust domestic activities.

By contrast, the Central Bank of Nigeria started some policy actions aimed at moderating the inflationary pressures in the country, particularly given the outlook for government spending in an election year and the sufficient progress made in banking sector reforms. As a result, its Monetary Policy Committee (MPC) increased its operating target rate - i.e. the "Monetary Policy Rate" (MPR) - by 25 basis points (bp) from 6 per cent to 6.25 per cent. In addition, the MPC decided to adjust the lower limit of its corridor from 500 bp to 300 bp below the MPR, which effectively increased the interest payable on standing deposits with the Central Bank by 225 basis points.

Aside from the interest rate management, there has been growing discontent about the franc CFA for reasons ranging from the overvaluation of the currency to financial scandals. While any radical change still remains very unlikely in the near future, the status quo of the largest monetary union among developing countries is not fully guaranteed in the medium- or long-term.

In most African countries, fiscal policy for 2010 and 2011 is expected to remain expansionary. In countries like Egypt, Kenya, Mauritius and South Africa, planned stimulus packages will continue to support economic activities. In Algeria, with the aim boosting growth and reducing the high unemployment rate, the Government has embarked on a massive \$286 billion development plan for 2010-14, corresponding to about 180 per cent of the forecasted 2010 GDP. In Angola, supportive fiscal policy - although slightly scaled back in August - involving investment spending on infrastructure is also supporting the growth prospects. Ghana has also loosened its fiscal policy in 2010 to support infrastructure, investment, and pro-poor expenditures. In Nigeria, fiscal policy has also been expansionary in 2010 with an approved budget of \$31 billion, which implied a planned 50 per cent rise in spending compared with the 2009 budget. On the revenue side, a gradual shift away from aid dependence has become increasingly visible as African nations start using less concessional financing from development banks, export credit agencies and sovereign international and local bonds. Ghana, Senegal and Gabon have tapped into international debt capital markets through a sovereign bond, raising \$750 million, \$200 million and \$1 billion, respectively. Nigeria, Kenya and Zambia are expected to follow suit in the near future. Although government revenues will rise in 2010, fiscal balances and government debts are overall expected to deteriorate further. South African public debt, for instance, is expected to rise from 23 per cent of GDP in the fiscal year 2008/09 to about 40 per cent in 2013, and will only stabilize in 2015. An important caveat to this prediction relates to the large oil-exporting economies that have also experienced larger revenues.

Looking forward, the prospects for 2011 are positive. Factors similar to those that prevailed in 2010 are expected to strengthen economic expansion in Africa in 2011, albeit at a pace which is slightly below the pre-crisis levels. This continued recovery is, however, subject to a number of downside risks and uncertainties. Externally, some of the downside risks include the strength and duration of the recovery of the global economy which is now under way, and more specifically the level of growth in emerging economies, such as China and India, which influences the demand and price for Africa's primary commodities. Another risk and uncertainty relates to the situation in advanced economies, in particular Europe. A third one is linked to the growing volatility of several food commodities traded by African countries. For Africa's imports, sharp rises of global food prices might trigger inflationary pressures and the risk of hunger. For Africa's exports, increased volatility is likely to reduce investments in affected sectors.

Internally, adverse weather conditions, like less rain in certain regions due to *la Niña*, and political disturbances could also hamper the prospects for a more sustained revival of growth across the continent. Finally, the generation of stable and high-income employment to absorb the increasing number of unemployed, especially among vulnerable groups such as youth and women, remains a high priority. As growth accelerates, Governments in Africa face the challenge of ensuring that their countries do not remain in a jobless growth trap.

East Asia

Driven by strong growth in China, East Asia continued to lead the global recovery in 2010. Economic activity expanded at a rapid pace, particularly in the first half of the year, on the back of strong consumption and investment demand. Regional GDP is estimated to increase by 8.6 per cent in 2010, up from 4.9 per cent in 2009. Notably, growth in 2010 has increasingly been driven by private sector demand. Government spending continued to provide significant stimulus in many countries, but contributed less to growth than in 2009. Export sectors across East Asia continued to rebound thanks in particular to a restocking of inventories and rising import demand from China. However, since import spending rose even faster than export revenues in most countries, net exports served as a drag on GDP growth in 2010. The outlook for the region for 2011 and 2012 is largely favourable, although growth is expected to moderate in the quarters ahead owing to a baseline effect and the adverse growth impact associated with a withdrawal of monetary and fiscal stimulus measures in the region itself as well as in developed economies. Consumption demand across the region is estimated to grow at a robust pace on the back of strong labour markets. This will help cushion the growth slowdown, with regional GDP forecast to expand by 7.1 per cent in 2011 and 7.5 per cent in 2012. Despite the vigorous recovery from the crisis, consumer price inflation has remained at low to moderate levels, generally within the target zone of central banks. As uncertainties about the global recovery persisted, most monetary authorities maintained an accommodative monetary policy stance in 2010. In several countries, interest rates were slightly raised, but remained at historically low levels. Fiscal policy also continued to support growth, with some Governments cautiously starting to withdraw stimulus measures introduced in 2008/09. This trend will continue in 2011 and 2012 as Governments gradually move towards a neutral fiscal policy.

While economic activity has expanded strongly virtually everywhere in East Asia in 2010, the fastest-growing economies of the region are China, Singapore and Taiwan Province of China. China recorded year-on-year growth of almost 11 per cent in the first half of 2010 as domestic demand soared and exports recovered. Fiscal and monetary stimulus introduced in response to the global crisis continued to be a major driver of growth. Following government measures to slow credit expansion, investment spending and property speculation in the first and second quarter, the economy has started to slow down, with full-year growth in 2010 estimated at 9.8 per cent. The moderating trend is likely to continue in 2011, when the economy is forecast to expand by 8.9 per cent. Strong demand from China has boosted growth across the region, most notably in economies with a high share of manufacturing exports in GDP, such as Malaysia, Singapore and Taiwan Province of China. In these economies, gross fixed capital formation recorded exceptionally strong rates of growth in the first half of 2010. However, the strong dependency of these economies on manufacturing exports means that they are likely to experience a significant slowdown in 2011 as demand from developed countries weakens. By contrast, countries that are less dependent on manufacturing exports for growth, such as Indonesia and Viet Nam, are expected to perform strongly in 2011.

Strong economic growth in the first half of 2010 boosted employment across East Asia, especially in the manufacturing, construction and service sector. As a result, unemployment rates continued to decline and are back to (or even below) pre-crisis levels in all economies except Hong Kong Special Administrative Region of China and Taiwan Province of China. While direct and indirect government measures to support employment helped mitigate the impact of the global crisis on the region's labour markets, it was mainly the recovery in the private sector that has led to significant job creation since the second half of 2009. Notably, the employment situation has improved in Indonesia and the Philippines, the two countries with the highest unemployment rates in the region. In the Philippines, the rate declined from 7.6 per cent in July 2009 to 6.9 per cent in July 2010 as exports and industrial production recovered much faster than expected. In parallel, the underemployment rate fell from 19.8 per cent to 17.9 per cent. In Indonesia, the unemployment rate dropped to 7.1 per cent in the first quarter of 2010, the lowest level in almost 10 years. In China, rapidly growing demand for labour, combined with more slowly rising supply of young workers, has resulted in upward pressure on wages. The wage component in the per capita rural income, which reflects the combined effect of employment, population and wage changes, increased by 18 per cent year-on-year in the first half of 2010. However, the total per capita income in rural areas remains at only about 30 per cent of the income in urban areas. In 2011 and 2012, labour market trends in East Asia will likely continue to be favourable, with rates of unemployment and underemployment declining slowly.

Consumer price inflation across East Asia has picked up in 2010, but remains at a moderate level in most economies despite the vigorous recovery from the crisis. On average, annual inflation is expected to rise from a decade-low of 0.6 per cent in 2009 to 3.0 per cent in 2010 and 3.1 per cent in 2011. In all economies, except Myanmar, Papua New Guinea and Viet Nam, the annual inflation rate for 2010 is estimated to be below 5.0 per cent. Most of the increase in consumer prices over the past year can be attributed to higher food prices, whereas core inflation continues to be low. In China, for example, food prices increased at an average rate of 5.9 per cent during the first eight months of 2010, well above the increase in the consumer price index of 2.8 per cent. Overall, the recent rise in food prices is unlikely to have major spillover effects on the rest of the economy. Inflationary pressures in the region have been held down in 2010 by persistent output gaps, well-contained inflationary expectations and strong currencies.

Central banks across East Asia maintained an accommodative monetary policy stance in 2010 as inflation forecasts continued to be within target range and uncertainties about the global recovery persisted. Despite the rebound of economic activity in the region, authorities have generally been very cautious in withdrawing monetary policy stimulus, keeping interest rates at or close to the very low levels adopted in 2008/09. Policy rates were raised – between 25 and 75 basis points – in Malaysia, the Republic of Korea, Taiwan Province of China and Thailand since March 2010. Only the Monetary Authority of Singapore, which does not rely on short-term interest rates or monetary aggregates as policy instruments, tightened monetary conditions significantly in April by re-centring the Singapore dollar's trading band and shifting from a policy that targets a zero percent appreciation to one of modest and gradual appreciation. China has continued to keep a moderately loose monetary policy despite raising the reserve requirement by a total of 150 basis points in the first half of 2010. After growth of money supply and credit accelerated sharply in 2009, it returned to more sustainable levels in the course of 2010. Given ongoing concerns about the recovery in the major developed countries, a likely growth slowdown across East Asia and low inflationary pressures, monetary authorities will remain cautious about raising interest rates in the quarters ahead. Moreover, as policy rates in developed countries are expected to remain close to zero, rate hikes in East Asia would increase the interest rate differential, thus encouraging additional short-term capital inflows.

Several East Asian currencies have strengthened considerably in 2010 as the rising growth differential with developed countries triggered large inflows of short-term capital, some of speculative nature. In nominal effective terms, the Malaysian ringgit appreciated by 8 per cent between January and July and the Thai Baht gained 7 per cent between January and September, with appreciations against the dollar being even stronger. In other economies, such as China and Hong Kong Administrative Region of China, the capital inflows have fuelled asset price inflation. A number of countries, including Indonesia, the Republic of Korea and Taiwan Province of China, have therefore introduced measures to manage short-term capital inflows. Since June 2010, the People's Bank of China resumed the basket exchange rate regime, which was adopted in 2005 but had been suspended since mid-2008, allowing for a more flexible exchange rate of the renminbi. However, the appreciation of the renminbi has so far been very mild as the authorities remain concerned about the possible shock to the domestic financial system, as well as to the export sector. The slow pace of the appreciation has triggered increased criticism from other countries, most notably the United States. These countries expect to see a significant, sustained appreciation over time, which is deemed necessary to address global imbalances and foster growth in other parts of the world.

Across East Asia, fiscal policy continued to support economic growth in the first half of 2010. In many countries, stimulus measures that were announced during the height of the global financial crisis are being implemented this year. This is particularly the case for infrastructure investment, which represents the largest component in most stimulus packages. Government consumption expenditure expanded at a robust pace in the first two quarters of 2010 compared to the previous year. Like other countries in the region, China continued its proactive fiscal policy in 2010, aiming at faster economic restructuring. Total fiscal expenditure of the central Government and local Governments increased by 19.2 per cent in the first eight months of 2010. Owing to the combination of exceptionally large expansions in government expenditures and lower revenues, fiscal balances worsened significantly in 2009. Thailand's fiscal deficit, for example, increased from 1.1 per cent of GDP in 2008 to 4.4 per cent in 2009. However, compared to other regions, deficits remained at low or moderate levels in most countries. One exception is Malaysia, which recorded a deficit of more than 7 per cent of GDP in 2009. The Malaysian Government has announced gradual spending cuts, aiming to reduce the deficit to 5.3 per cent in 2010 and 2.8 per cent in 2015. Going forward, most East Asian Governments are likely to gradually move towards a neutral fiscal policy. In general, Governments in strongly export-oriented economies such as Malaysia and Singapore may reduce the stimulus earlier than others. With growth expected to remain robust in the forecast period, fiscal deficits are expected to narrow relative to GDP in 2011 and 2012.

Driven by a restocking of inventories and rising import demand from China, export sectors across East Asia continued to rebound in 2010. In most economies, total export earnings for the first nine months of the year were up by more than 30 per cent compared to the same period in 2009 despite a moderate slowdown in the third quarter. The manufacturing sector accounted for most of the growth as demand for machinery and electrical equipment increased rapidly. This lifted in particular the export revenues of the strongly export-dependent economies in the region, including Malaysia, Singapore and Taiwan Province of China. Commodity-exporting countries such as Indonesia and Papua New Guinea gained from significant price increases for their main export goods (e.g. oil, minerals, gold, and copper). Overall, intra-regional trade rebounded faster than trade with the United States and European countries, mainly owing to soaring demand from China which was boosted by monetary and fiscal stimulus measures. In 2011, export revenues are expected to grow further, but at a much slower pace than this year. In many East Asian countries, import spending in 2010 increased even faster than export revenues as a result of growing domestic demand for consumption and investment and higher international commodity prices. Trade and current account balances thus worsened, but continued to record a surplus in most economies.[8] This trend is likely to continue in 2011 and 2012 as external demand from developed economies and intra-regional demand slows.

In China, the trade balance surplus for the first eight months of 2010 was 15 per cent lower than a year ago after import spending soared early in the year. However, exceptionally strong export growth in the second quarter led to a renewed increase in the trade and current account surplus. As a share of GDP, the current account surplus for 2010 is forecast at 5 per cent, down from 10.6 per cent in 2007. In the forecast period, this share is expected to decline further mainly owing to continuing strong output growth. The pace of the decline also depends upon whether the Government will succeed in rebalancing the country's macroeconomic structure by increasing the importance of private consumption.

Despite East Asia's strong economic performance in 2010 and sound macroeconomic fundamentals, there are significant downside risks to the outlook. On the one hand, a further slowdown of growth in developed economies – or even renewed

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[8] Countries with persistent trade balance deficits include Hong Kong Special Administrative Region of China, Philippines and Viet Nam.

output contractions – would weaken economic activity in the region considerably. A deterioration of the sovereign debt crisis in Europe may lead to a renewed increase in global risk aversion, hampering the ability of the corporate sector in East Asia to refinance itself. On the other hand, a further increase in short-term capital flows to the region could lead to additional currency appreciations, increased risks of asset price bubbles and – in some cases – stronger inflationary pressures. Such a scenario would create major challenges for the conduct of monetary policy in the region. Competitive devaluations, combined with other protectionist measures, would be particularly damaging to growth in the region.

South Asia

After proving resilient to the global downturn, economic activity in South Asia gained further strength in 2010, driven by strong domestic consumption and investment demand. Favourable weather conditions, a rebound in manufacturing export industries and continuing growth in remittances supported economic growth in the region. On average, South Asia is expected to record the second-highest growth rate of any developing region this year, after East Asia. Gross domestic product is estimated to increase by 7.0 per cent in 2010 and by 6.8 per cent in 2011. However, high average growth in the region masks large differences among countries. India and Sri Lanka have experienced a sharp rebound of activity since mid-2009 and the outlook for these two economies is largely positive. The Islamic Republic of Iran, Nepal and Pakistan continue to face major structural obstacles and growth is likely to remain relatively weak in the forecast period. Bangladesh falls in between these two categories, with growth expected to be robust, but well below potential. Inflation has declined slightly in the course of 2010, following sharp increases at the beginning of the year. However, in several South Asian countries, including India, consumer price inflation has remained at double-digit levels, with food prices rising particularly fast. Several central banks have started to tighten monetary policy, most notably the Reserve Bank of India, which responded to the improved economic outlook and continued high inflationary pressures by increasing interest rates five times in 2010, more than any other monetary authority in the world. At the same time, most Governments have started to implement fiscal consolidation plans in order to reduce the large budget deficits. The combination of tighter monetary and fiscal policy will serve as drag on growth in 2011 and 2012.

India and Sri Lanka continued to be the most vibrant economies in South Asia in 2010. India’s economy expanded by 8.7 per cent in the first half of 2010 on the back of rapid growth in gross fixed capital formation and robust consumption demand. The manufacturing sector grew by almost 15 per cent from the first half of 2009 thanks to strong domestic and external demand. Good monsoon rains helped bolster the agricultural sector, which expanded faster than in previous years. Full-year growth for 2010 is estimated at 8.5 per cent, following a moderate slowdown in the second half of the year. Sri Lanka recorded its strongest growth in several years during the first six months of 2010. Gross domestic product increased by almost 8 per cent year-on-year as all economic sectors – agriculture, industry and services – reaped a peace dividend. Since the end of the civil war in 2009, the tourism sector is experiencing a boom; tourism earnings for the period January to July 2010 were almost 70 per cent higher than a year ago. In India and Sri Lanka, growth is expected to slow down somewhat in 2011 as the international environment weakens and manufacturing sectors expand less rapidly.

In sharp contrast to these two economies, the Islamic Republic of Iran, Nepal and Pakistan are growing at a subdued pace, mostly owing to country-specific structural factors such as political uncertainties, weak infrastructure and a poor investment climate. For these countries, growth rates in 2010-12 are expected to range between 3 per cent and 5 per cent. In Pakistan, the worst flooding in the history of the country inflicted immense damage on the economy, destroying large parts of the infrastructure in the affected areas, including roads, bridges, irrigation systems and power plants, as well as crops. Growth in 2011 is expected to be at least one percentage point lower than previously expected.

The strong economic recovery in some South Asian economies during the past year has led to improvements in the labour markets. According to a recent survey, employment in India's export-oriented industries improved considerably between July 2009 and March 2010 owing to stronger global demand. The employment gains in India over the past few quarters seem to have outweighed the previous losses. In Sri Lanka, the unemployment rate stood at 5.4 per cent in the second quarter of 2010, down from 6.2 per cent a year ago. However, despite these gains, most countries continue to face serious employment challenges, including high rates of vulnerable and informal employment, large labour surpluses in rural areas and low productivity in the agricultural sector. Moreover, unemployment and underemployment rates are very high among young people aged 15 to 24. In Sri Lanka, for example, 18.6 per cent of young men and 24.6 per cent of young women are unemployed. The employment situation is particularly grave in Pakistan, where – according to recent ILO estimates – more than 5.3 million jobs have been lost and/or affected by the floods that hit the country in July and August 2010. By losing their jobs, even temporarily, many workers in the affected districts are likely to have fallen into poverty.

In most South Asian economies, inflation has declined in the second and third quarter of 2010, following sharp increases at the beginning of the year. In India, Nepal and Pakistan, consumer price inflation continues to be at double-digit levels and remains a key concern for policymakers. For the region as a whole, consumer price inflation is expected to average 11.4 per cent in 2010, following 11.3 per cent in 2009. Food price inflation has somewhat eased in recent months owing to good harvests, but continues to outstrip general price inflation. In India, steep increases in retail food prices owing to insufficient monsoon rains in 2009 were accompanied by rising fuel prices and stronger demand side pressures. These factors contributed to higher wages and rising prices of manufactured goods and property assets. Fearing an inflationary spiral, the Reserve Bank of India has raised interest rates aggressively since March 2010. As a result, inflation has slowed in the second and third quarter. In several countries, including the Islamic Republic of Iran and Pakistan, upward adjustments in administered energy prices impacted on production and transportation costs in 2010, causing prices of other consumer goods and services to rise as well. In Pakistan, inflationary pressures have further increased as the flooding in July and August destroyed cotton, rice, corn and wheat crops, leading to food shortages and further driving up food prices. In the outlook, inflation is forecast to decline gradually in most countries, averaging 8.6 per cent in 2011 and 8 per cent in 2012, owing to further slowing food price increases and tighter monetary policies.

Against the backdrop of an improved economic outlook and ongoing high inflation, several central banks in South Asia have started to tighten monetary policy. The Reserve Bank of India (RBI) raised its key interest rates more often than any other central bank in Asia this year in order to curb double-digit inflation. Between March and September 2010, it increased the repurchase rate (the rate at which it lends overnight money to banks) and the reverse repurchase rate (the short term borrowing rate) five times, lifting the former from 4.75 per cent to 6.0 per cent and the latter from 3.25 per cent to 5.0 per cent. According to the RBI, these moves reflect a normalization of the monetary policy stance, following the enormous policy rate reductions in late 2008 and early 2009. With inflationary pressures likely to moderate in the quarters ahead, the RBI is expected to raise interest rates more slowly in 2011. The Bangladesh Bank and the State Bank of Pakistan also increased their key policy rates in the third quarter of 2010 as high inflation was perceived as a significant risk to macroeconomic stability. In the outlook period, both central banks may further raise interest rates at a modest pace, although growth, especially in Pakistan, remains well below potential. In contrast, the Central Bank of Sri Lanka loosened monetary policy in July and August 2010, cutting its reverse repurchase rate by a total of 75 basis points to 9 per cent after inflation declined considerably in the first half of 2010. Since inflationary pressures have started to rise again and private sector credit demand has accelerated, Sri Lanka's monetary authorities may see the need to tighten monetary policy in 2011.

Most Governments in South Asia have started to implement fiscal consolidation plans in response to the sharp rise in budget deficits in recent years. To mitigate the effects of the global economic crisis, Bangladesh, India and Sri Lanka had used expansionary fiscal policies, thus increasing the already high budget deficits. At 9.9 per cent of GDP, Sri Lanka had the highest deficit in the region in 2009, followed by India with 6.6 per cent of GDP (fiscal year 2009/10). Thanks to a strong economic recovery, both countries have a good chance to achieve the deficit reduction plans outlined earlier this year, which are based on a combination of increased tax and non-tax revenues and lower expenditures. India's Government aims at narrowing the fiscal deficit to 5.5% in 2010/11 and 4.8% in 2011/12. Most of the improvement will come from higher tax revenues, reforms of the fuel-subsidy program and auctions of third-generation (3G) telecommunications licenses, through which the Government raised almost 15 billion dollars in May 2010. Sri Lanka is benefiting from improved security conditions, which facilitate higher receipts – total revenues during the first six months of 2010 were 22.7 per cent higher than a year ago – and allow for a gradual reduction in defense spending. Unlike in India and Sri Lanka, fiscal deficits are forecast to rise in Bangladesh and Pakistan in the outlook period as expenditures grow faster than revenues owing to a combination of cyclical and structural factors. In the past fiscal year, both countries had tax-to-GDP ratios below 9 per cent, the lowest rates in South Asia. Pakistan's budget is also burdened by increased military expenditures, delays and shortfalls in budgetary support from donors, and the post-flood reconstruction work.

Despite a rebound in export earnings, trade deficits in most South Asian economies widened markedly during the first three quarters of 2010, thus subtracting from GDP growth. Stronger demand from China and other East Asian economies for agricultural commodities and manufacturing goods boosted export revenues, most notably in India. During the first eight months of 2010, India's export earnings increased by 30 per cent from a year ago. Sectors with the largest gains include petroleum products, gems and jewellery and textiles. In Bangladesh, the garment sector, which accounts for almost 70.0 per cent of the country's merchandise exports, has returned to robust growth after slowing in late 2009 and early 2010. The gains are partly linked to a shift in orders from China to Bangladesh, where production costs tend to be lower. Despite the improved export performance, trade deficits increased in most South Asian countries in 2010. Stronger domestic demand and higher prices for energy products meant that import spending grew faster than export revenues. In India, the trade deficit for the period from January to August 2010 was up by 50 per cent from a year ago. Higher trade deficits will partly be balanced by larger surpluses in the current transfer balances as overseas workers remittances continued to grow in 2010, albeit at a slower rate than in the recent past. Bangladesh and Pakistan saw remittances increase by only 5 per cent during the first half of 2010, following double-digit growth in previous years. In 2011 and 2012, trade deficits are expected to widen further, however at a slower pace than this year.

Significant downside risks to the economic outlook for South Asia are related to the tightening of monetary and fiscal policies that has started in most economies of the region. Governments and Central Banks may find it particularly hard to bring inflation back to target and consolidate fiscal balances if energy and food prices increase in the quarters ahead. Moreover, weather and security conditions represent constant risks for the region's economies. In Pakistan, a further deterioration of the security situation would hinder the reconstruction of the flood-hit areas and lead to a further slowdown of the economy. The country's recovery also depends upon whether donor countries follow through on their commitments. In Nepal, the economic revival hinges in large part on the ability of the Government to improve law and order, as the country's poor security conditions and political instability limit the Government's capacity to spend money and boost rural incomes.

Western Asia

After a pronounced economic recovery in 2010, the region will see solid economic growth of 4.7 per cent in 2011 and 4.4 per cent in 2012, although this remains below the levels reached in the years preceding the global economic crisis. In the oil-exporters, the significant output cuts initiated in response to the crisis remain in place, which, coupled with the lower level of oil prices, generally create an environment of relatively more constrained growth rates. The non-oil exporters benefit from the recovery in global trade as well as some positive regional impulses in the form of investment and tourism.

The economic performance of oil-exporters remains a mirror picture of the trajectory of oil prices. After dropping by 37 per cent in 2009, the annual average oil price is expected to have increased by 28 per cent in 2010 and to fall by 5 per cent in 2011. Against this background, oil-exporters will register growth rates in 2011 that are around those for this year. In Saudi-Arabia, for example, which is the second-largest producer of crude oil after Russia and where oil-related activities represent almost 30 per cent of GDP, both government consumption and public investment will constitute two stronger drivers of economic growth in an overall fairly balanced growth performance. The picture is similar in the United Arab Emirates, with government spending underpinning robust growth in 2011. However, in a sign of the payback on a continued diversification strategy, both the services sector, in particular tourism, and industrial production are also providing significant growth impulses. Yemen, by contrast, is confronted with a number of challenges. While the economy will benefit from increases in its gas production capacity, water shortage is hampering the agricultural sector and political instability casts a shadow over the general economic performance.

The non-oil exporters are forecast to see continued solid growth rates, with private consumption representing a major pillar of support. This is the case for example in Turkey, whose economy contracted by 4.7 per cent in 2009 and where supportive monetary and fiscal policies have been propelling private consumption and investment, leading to a pronounced jump in growth to 7.4 per cent in 2010. This picture will also carry over into 2011, with the forecast more moderate growth rate of 4.6 per cent not least due to the fading effect of positive base effects. A similar constellation emerges in Israel, where strong private consumption will more than offset the dampening effect from relatively weaker export demand, resulting in growth rates of around 3 per cent in both 2011 and 2012. As an example of the positive ripple effects of generally positive regional growth conditions, Lebanon is forecast to register growth of more than 5 per cent in 2011 and 2012. One of the main drivers of this performance remains tourism, which has significant positive impacts on construction activity, employment and, thus, available household incomes and private consumption.

In the oil-exporting countries, external balances will overall continue to show solid surpluses in 2011 in light of the combination of slightly lower oil prices and largely stable output. In Saudi-Arabia, for example, the current account surplus is forecast to remain at around 10.0 per cent of GDP in 2011, after more than doubling to around 12 per cent in tandem with recovering oil prices in the immediate aftermath of the global economic crisis in 2010. The general dynamics of global trade also remain relevant for the oil-exporting economies, as illustrated by the case of Oman. The economy will benefit not only from its oil sector, but also the increasing role of re-exports through its port facilities. The outlier in the region remains Qatar, where major new LNG projects will lead to a tripling of the trade surplus in 2010 and a further increase by around 65 per cent in 2011.

By contrast, non-oil exporters saw an increase in trade deficits during the recovery of the crisis, not least due to vigorous domestic demand that outpaced impulses from the main export markets. In 2011, trade balances will register further increases in deficits as the effect of slightly lower oil prices on the import bill is more than offset by strength in domestic demand. This will generally keep current accounts in deficit. However, in the case of Israel, a strong performance of the service account based on exports of business services, including in particular computer software, will continue to ensure a solid current account surplus. Across the board, non-oil exporters remain especially exposed to the state of economic conditions in the major developed economies. In the case of Turkey, for example, almost half of exports go to the European Union, while about 40 per cent of the exports of Israel go to the United States. Consequently, any renewed economic slowdown in these export markets holds the potential to significantly alter the growth trajectory in the region.

The employment situation generally remains challenging, referring to both open and hidden unemployment as well as underemployment. However, some relatively positive signs of some improvement have emerged in the aftermath of the peak of the crisis. In Turkey, after a jump above 14.0 per cent in 2009, the unemployment rate is expected to fall modestly to below 13.0 per cent in 2010 and 2011. Likewise, in Israel, after reaching 7.6 per cent in 2009, unemployment will drop below the 7 per cent-mark in 2011. The global recovery, not least reflected in the revival of international trade, has been a major factor in this respect.

Inflation will fall modestly overall in the region and stay below 5 per cent in both 2011 and 2012. Fading base effects in the wake of the economic crisis and little inflationary impulses from commodity prices will be the main drivers in this respect. In 2011, relatively stable or even lower oil prices will help reduce input costs and keep a lid on liquidity in the region, preventing a stronger surge in consumption expenditure. At the same time, price subsidies will continue to help produce rather tepid inflation figures. As a downside risk to inflation, any strength of the dollar will help to reduce import prices for those countries with a currency peg.

Monetary policy in the region will maintain a modest bias towards a tightening stance. In Turkey, the central bank is expected to increase its policy interest rate in the first half of 2011 in view of rising price pressures on the back of stronger demand. By contrast, in Israel, where monetary policy tightening has already been in progress since 2009, the central bank is expected to proceed more slowly with any further interest rate hikes in light of a slight drop in inflation to 2.4 per cent in 2011.

Government spending will remain a driving force for sustaining economic growth, not least through its positive effects on household incomes and private consumption. Oil-exporters will post solid budget surpluses in 2011, although these will be moderately lower than in 2010 in reflection of slightly lower oil prices. By contrast, non-oil exporters will face increasing fiscal policy constraints. Both Lebanon and Jordan, for example, will continue to run budget deficits of around 10 per cent of GDP in 2010 and 2011. Consequently, outstanding public debt and the implied interest payments are a significant factor that is limiting fiscal room for manoeuvring.

The outlook for the region is subject to a number of risks and uncertainties. These include a more pronounced change in oil prices, a renewed dip in global economic activity and concerns regarding the security situation in the region.

Latin America and the Caribbean

In 2010, Latin America and the Caribbean sustained its economic recovery at a faster pace than anticipated, notwithstanding severe discrepancies across the region. GDP growth for the region is expected to reach 5.3 per cent, after a contraction of 2.1 per cent in 2009. In 2011, economic growth is expected to slow to a still solid level of 4 per cent.

The strong economic recovery is being led by South America as a result of dynamic internal and external demand. For instance, during the first half of 2010, the economic recovery was particularly strong in Argentina, Brazil, Paraguay, Peru and Uruguay, where GDP grew by 9.4, 8.9, 11.7, 8.2 and 9.6 per cent, respectively. This robust economic growth reflects in part the role of countercyclical macroeconomic policies implemented in 2009, which restored confidence and strengthened domestic demand through 2010. In addition, the recovery of commodity prices, despite some fluctuations in 2010, and strong demand from Asia favoured a rebound of agricultural and mine exports. Looking at the intra-regional commercial dynamics, countries such as Argentina, Paraguay and Bolivia have also benefited from trade ties with Brazil, in particular as the Real appreciated against their currencies. By contrast, the economy of the Bolivarian Republic of Venezuela shrank 3.5 per cent in the first half of 2010 due to a considerable fall in domestic demand and oil production. As a whole, South America is expected to register 5.9 per cent of GDP growth in 2010, before slowing down to 4.5 per cent in 2011, as countercyclical measures will be gradually withdrawn.

The economic recovery in Mexico, Central America and the Caribbean has been slower, as these countries continue to be highly dependent on the economic cycle of the United States. Mexico has achieved a steady recovery in the first half of 2010, supported mainly by external demand from the United States for its manufactured goods. This upward trend in exports is expected to decrease as the United States economy is loosing its momentum. The domestic market in Mexico will not contribute much to offset lower external demand, as consumer confidence still remains low and the government is favouring fiscal consolidation. In 2010, the Mexican economy is expected to grow by 4.5 per cent, before slowing down to 3 per cent in 2011. In Central America and, in particular, the Caribbean, the economic situation is expected to continue to be challenging during the forecast period. Several of these countries face high public debt and prospects for tourism and remittances remain weak.

Inflation rates have been increasing from 2009 levels in some countries, but remain relatively low when compared with pre-crisis levels. In general, stronger internal demand has generated higher inflation pressures in South America, but the outlook remains positive in most of the countries. The situation is, however, more challenging in Argentina and the Bolivarian Republic of Venezuela, where inflation rates are expected to remain in double digits. In Mexico, Central America and the Caribbean, inflation has been increasing due to the withdrawal of subsidies and higher international prices of food and energy, but is expected to remain under control.

The dynamic economic activity in South America has increased employment and decreased unemployment figures in several countries through 2010. This is for instance the case in Argentina, Brazil, Chile and Peru. The situation is more challenging in some Caribbean countries such as Jamaica, where unemployment rates continue their upward trend in the double digits. The unemployment figure for the region as a whole is expected to drop to 7.8 per cent in 2010, from 8.2 per cent in 2009, which is still higher than the rate of 7.3 per cent recorded in 2008. Real wages have increased, as formal employment has expanded in South America and inflation rates dropped significantly from 2008 levels.

The rebound in global trade and commodity prices has boosted exports especially in South America, which has been benefiting from trade linkages with Asia. Mexico, Central America and the Caribbean have instead suffered from less sustained demand from the United States. Meanwhile, import volumes have increased at a faster pace, driven in particular by capital expansion, after a weak year of 2009. Considering the evolution of exports in relation to import volumes, the contribution of net exports to growth is expected to be negative in 2010. In 2011, this situation may not improve as demand for commodities from Asia is expected to slow moderately.

The terms of trade have improved, mainly for commodity exporters, and are projected to rise by 7.1 per cent in 2010 for the region as a whole. Despite such gains in the terms of trade, the regional trade surplus observed in 2009 is expected to be eroded in 2010 and 2011, as import volumes will increase faster than export volumes. The current account balance is expected to deteriorate moderately during the forecast period, posting a deficit of about 0.5 per cent of regional GDP in 2010.

Remittances inflows have been improving modestly through 2010 and are expected to rise by 5 per cent in 2010. As labour markets in developed countries are not expected to improve rapidly, prospects for remittances remain weak in 2011 and will not offset the losses observed in 2009. Capital inflows resurged through 2010, in particular in South America. This helped in keeping financing available to stimulate domestic demand, but has also contributed to currency appreciations. Therefore, several countries have introduced capital controls on inflows. In Brazil, for instance, direct taxes on fixed incomes and equity inflows were introduced. In Latin America and the Caribbean, the average exchange rate is expected to continue to appreciate by about 4.5 per cent in 2010, despite the devaluation of Venezuela's currency in January 2010.

In the context of the strong economic recovery, regional fiscal revenues are expected to increase by about 1 per cent in 2010 and the primary deficit will tend to narrow. In South America, as the economic rebound has been stronger, a withdrawal of fiscal stimulus can be expected through 2011. However, a lot of South American countries can adjust the pace of fiscal withdrawal if growth slows down more than expected in 2011 given the higher level of fiscal revenues. Especially in the case of Chile, fiscal spending may be reduced more slowly in order to continue the post-earthquake reconstruction. Mexico, Central America and particularly the Caribbean countries do not enjoy such fiscal space in 2011. Several of these countries will need external support in order to support their public finances.

As domestic demand rebounded strongly and fears of an overheating of the economy increased, several countries in South America started to tighten their monetary policy. Several central banks, such as in Brazil, Chile and Peru, have increased their policy interest rates and increased their reserve requirements for banks in order to stem excessive lending. For the moment, central banks have stopped the interest rate tightening cycle, as the inflation outlook is positive and economic activity is expected to slow down. This policy stance is expected to remain in place through 2011, unless economic growth resumes at a faster pace than forecast. In several countries in Central America and the Caribbean, monetary policy is expected to be relatively loose at least until the end of 2010 as the economic recovery continues to be moderate.

Risks to the outlook are associated to external and domestic factors. External risks are related to a worse than anticipated economic slowdown in developed economies. This could affect commodity prices and export volumes in general, being particularly negative for countries more dependent on the United States economic recovery such as Mexico, Central America and the Caribbean region. Further appreciation of national currencies against the dollar could also affect negatively exporting sectors. Internally, fears of an overheating of the economy or lack of fiscal space can push countries to withdraw their monetary and fiscal stimulus faster than expected, affecting the recovery of domestic demand.

LINK Global Economic Outlook

October 2010

Annex Table

Table A.1
World and regions: rates of growth of real GDP, 2005-2012
(Annual percentage change[a])

	2005	2006	2007	2008	2009	2010[b]	2011[c]	2012[c]
World	3.6	4.1	4.0	1.6	-2.0	3.6	3.1	3.5
Developed economies	2.5	2.8	2.5	0.1	-3.5	2.2	1.9	2.3
North America	3.1	2.7	2.0	0.0	-2.6	2.6	2.2	2.8
Asia and Oceania	2.1	2.1	2.7	-0.7	-4.2	2.8	1.5	1.7
Europe	2.0	3.2	3.0	0.5	-4.1	1.6	-1.8	2.1
European Union	2.0	3.3	3.0	0.5	-4.2	1.6	1.7	2.1
EU-15	1.8	3.0	2.8	0.3	-4.2	1.6	1.6	1.9
New EU Members	4.7	6.5	6.2	3.9	-3.5	1.7	3.2	4.3
Other Europe	2.8	3.1	3.3	1.4	-1.8	0.7	-2.3	3.0
Memorandum items:								
Euro Zone	1.7	3.1	2.8	0.4	-4.1	1.5	1.5	1.7
Major developed economies (G-7)	2.3	2.6	2.2	-0.2	-3.6	2.4	1.9	2.3
OECD	2.6	2.9	2.6	0.2	-3.4	2.4	2.0	2.4
Economies in transition	6.5	8.3	8.6	5.1	-6.7	3.8	4.0	5.0
South-eastern Europe	4.6	5.1	6.1	4.3	-3.7	0.1	2.3	3.4
Commonwealth of Independent States	6.6	8.6	8.8	5.2	-7.0	4.1	4.1	5.1
Developing countries	6.8	7.5	7.9	5.3	2.3	7.0	6.0	6.0
Africa	5.5	5.9	6.0	5.0	2.3	4.7	5.1	5.1
North Africa	5.1	5.4	5.0	4.7	2.8	4.6	5.1	5.7
Sub-Saharan Africa	5.7	6.2	6.5	5.1	2.0	4.7	5.0	4.7
East and South Asia	8.0	9.0	9.9	6.1	4.9	8.3	7.1	7.1
East Asia	8.0	9.2	10.2	6.4	5.0	8.6	7.1	7.1
South Asia	8.0	8.5	8.9	5.1	4.8	7.0	6.8	7.2
Western Asia	6.9	6.1	5.1	4.4	-1.0	5.5	4.7	4.4
Latin America and the Caribbean	4.6	5.6	5.6	4.0	-2.1	5.3	4.0	4.1
South America	5.0	5.5	6.5	5.3	-0.3	5.9	4.5	4.8
Mexico and Central America	3.4	5.1	3.7	1.8	-5.9	4.3	3.3	3.0
Caribbean	8.1	10.3	6.5	3.6	0.7	2.7	3.1	2.8
Memorandum items:								
Least developed countries	7.6	7.6	8.1	6.7	4.0	5.2	5.6	5.5
Sub-Saharan Africa (excluding Nigeria and South Africa)	6.2	6.7	7.2	5.9	3.1	5.3	5.8	5.5
East Asia (excluding China)	5.0	5.7	5.9	2.8	0.0	7.0	4.8	4.9
South Asia (excluding India)	5.9	6.1	6.8	2.2	3.0	3.7	4.0	4.3
Western Asia (excluding Israel and Turkey)	6.3	5.6	5.3	6.9	0.9	4.6	4.9	4.2

Source : Project LINK

a Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.
b Partly estimated.
c Forecasts, based in part on Project LINK.

Table A.2
Rates of growth of real GDP, 2005 -2012
(Annual percentage change)

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
Developed economies								
North America								
Canada	3.0	2.8	2.2	0.5	-2.5	2.9	2.5	3.1
United States	3.1	2.7	1.9	0.0	-2.6	2.6	2.2	2.8
Asia and Oceania								
Australia	3.2	2.6	4.8	2.2	1.2	3.3	3.7	3.0
Japan	1.9	2.0	2.4	-1.2	-5.2	2.7	1.1	1.4
New Zealand	3.2	1.0	2.8	-0.1	-1.6	2.7	2.4	3.0
European Union								
EU-15								
Austria	2.5	3.6	3.7	2.2	-3.9	1.8	2.0	2.1
Belgium	2.0	2.7	2.8	0.8	-2.7	1.6	1.0	1.2
Denmark	2.4	3.4	1.7	-0.9	-4.7	1.4	1.8	2.0
Finland	2.9	4.4	5.3	0.9	-8.0	2.6	3.0	2.5
France	2.0	2.4	2.3	0.1	-2.5	1.5	1.6	2.0
Germany	0.8	3.4	2.7	1.0	-4.7	3.4	2.2	2.5
Greece	2.2	4.5	4.5	2.0	-2.0	-4.6	-3.8	0.2
Ireland	6.0	5.3	5.6	-3.5	-7.6	-2.9	4.3	3.9
Italy	0.7	2.0	1.5	-1.3	-5.0	1.3	1.1	1.2
Luxembourg	5.4	5.6	6.5	0.0	-4.1	2.6	2.1	2.2
Netherlands	2.0	3.4	3.9	1.9	-3.9	1.7	1.5	2.5
Portugal	0.8	1.4	2.4	0.0	-2.6	0.6	-1.0	0.3
Spain	3.6	4.0	3.6	0.9	-3.7	-0.7	0.4	1.0
Sweden	3.2	4.3	3.3	-0.4	-5.1	4.3	3.4	3.0
United Kingdom	2.2	2.8	2.7	-0.1	-4.9	1.5	2.1	2.8
New EU Member								
Bulgaria	6.2	6.3	6.2	6.0	-5.0	0.4	3.4	5.5
Cyprus	3.9	4.1	5.1	3.6	-1.7	2.0	1.9	1.9
Czech Republic	6.3	6.8	6.1	2.5	-4.1	1.5	2.0	2.5
Estonia	9.4	10.6	6.9	-5.1	-13.9	1.2	3.0	3.0
Hungary	3.5	4.0	1.0	0.6	-6.3	0.8	2.8	3.5
Latvia	10.6	12.2	10.0	-4.2	-18.0	-2.5	3.0	3.5
Lithuania	7.8	7.8	9.8	2.8	-14.8	-0.6	2.7	2.8
Malta	4.0	3.6	3.7	2.6	-2.1	0.8	1.5	1.5
Poland	3.6	6.2	6.8	5.0	1.8	3.6	4.2	5.5
Romania	4.2	7.9	6.3	7.4	-7.1	-1.5	2.5	4.5
Slovak Republic	6.7	8.5	10.6	6.2	-4.7	2.4	3.1	3.9
Slovenia	4.5	5.8	6.8	3.5	-7.8	0.6	2.4	3.1
Other European								
Iceland	7.5	4.6	6.0	1.0	-6.8	-3.4	0.5	0.5
Norway	2.7	2.3	2.7	0.8	-1.4	-1.9	3.4	5.5
Switzerland	2.6	3.6	3.6	1.9	-1.9	2.9	1.6	1.3
Economies in transition								
South-eastern Europe								
Albania	5.8	5.4	5.9	7.7	3.3	2.5	3.0	3.5
Bosnia and Herzegovi	4.0	6.1	6.1	5.7	-3.1	1.0	2.5	3.0
Croatia	4.2	4.7	5.5	2.4	-5.8	-1.7	1.6	2.7
Montenegro	4.2	8.6	10.7	6.9	-5.7	0.8	3.0	4.0
Serbia	5.4	5.2	6.9	5.5	-3.0	1.5	3.0	4.5
The former Yugoslav Republic of Macedonia	4.1	3.9	6.1	5.0	-0.8	1.5	3.0	3.0
Commonwealth of Independent States								
Armenia	13.9	13.2	13.7	6.9	-14.2	3.5	4.5	3.0
Azerbaijan	26.4	34.5	25.0	10.8	9.3	3.5	3.0	6.5
Belarus	9.4	10.0	8.6	10.2	0.2	5.0	7.0	5.0
Kazakhstan	9.7	10.7	8.9	3.2	1.2	5.5	5.3	5.5
Kyrgyzstan	-0.2	3.1	8.5	8.4	2.3	-3.5	6.0	6.0
Republic of Moldova	7.5	4.8	3.0	7.8	-6.5	3.5	3.5	3.0
Russian Federation	6.4	8.2	8.5	5.2	-7.9	3.9	3.7	5.0
Tajikistan	6.7	7.0	7.8	7.9	3.4	5.0	5.5	5.0
Turkmenistan	13.0	11.4	11.6	10.5	6.1	10.0	10.0	5.0
Ukraine	2.7	7.3	7.9	2.1	-15.1	4.1	4.5	5.1
Uzbekistan	7.0	7.5	9.5	9.0	8.1	8.0	7.0	9.0
Georgia	9.6	9.4	12.3	2.3	-3.9	6.0	6.5	4.0

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
Developing economies								
Africa								
Algeria	5.1	2.0	3.0	2.4	2.0	4.7	4.3	6.3
Angola	20.6	18.6	20.3	13.3	-0.4	5.1	5.9	5.9
Benin	2.9	3.8	4.6	5.0	2.5	3.1	4.8	5.5
Botswa	1.6	5.1	4.8	3.1	-3.7	8.5	5.5	5.8
Burkina Faso	8.7	5.5	3.6	5.2	3.2	4.4	4.7	5.5
Burundi	0.9	5.1	3.6	4.5	3.5	4.0	4.5	4.2
Cameroon	2.3	3.2	3.3	2.9	2.0	2.6	2.9	4.5
Cape Verde	6.5	10.1	8.7	5.6	4.1	4.3	5.8	3.2
Central African Republic	2.4	3.8	3.7	2.2	1.2	2.7	4.1	5.4
Chad	7.9	0.2	0.2	-0.4	-1.6	4.4	3.9	5.5
Comoros	4.2	1.2	0.5	1.0	1.8	2.3	1.5	2.0
Congo	7.8	6.2	-1.6	5.6	7.6	12.0	7.5	5.5
Côte d'Ivoire	1.9	0.7	1.6	2.3	3.8	3.0	4.0	4.5
Democratic Republic of the Congo	7.8	5.6	6.3	6.2	2.8	5.8	4.3	3.5
Djibouti	3.2	4.8	4.8	5.8	5.0	4.5	5.4	6.3
Egypt	4.5	6.8	7.1	7.2	4.7	5.5	6.4	6.7
Equatorial Guinea	9.7	1.3	21.4	10.7	5.3	1.1	2.3	2.4
Eritrea	2.6	-1.0	1.3	1.0	-4.3	3.7	2.9	3.2
Ethiopia	12.6	11.5	11.8	11.2	9.9	12.7	9.4	9.2
Gabon	3.0	1.2	5.3	2.7	-1.4	5.3	4.9	3.4
Gambia	0.3	3.4	6.0	6.3	5.6	5.0	5.2	4.8
Ghana	5.9	6.4	5.7	7.2	4.1	5.7	15.0	8.0
Guinea	3.0	2.5	1.8	4.9	-0.3	3.5	5.0	3.8
Guinea-Bissau	5.0	2.2	0.2	3.6	3.0	3.5	4.1	4.3
Kenya	6.0	6.3	6.9	1.3	2.4	4.6	5.5	5.0
Lesotho	1.1	6.5	2.4	4.5	1.6	3.8	2.4	3.2
Liberia	5.3	7.8	9.4	7.1	4.6	6.3	7.0	6.1
Libyan Arab Jamahiriya	10.3	6.7	7.5	2.3	-2.3	3.5	4.0	4.3
Madagascar	4.6	5.0	6.2	7.1	-3.7	0.9	4.4	4.1
Malawi	2.6	7.7	5.8	8.8	8.0	7.4	5.4	5.5
Mali	6.1	5.3	4.3	5.0	4.4	5.1	6.3	5.3
Mauritania	5.4	11.4	1.0	3.7	-1.1	4.6	5.2	5.4
Mauritius	1.5	3.9	5.4	5.0	2.5	4.9	6.4	6.6
Morocco	3.0	7.8	2.7	5.6	4.9	4.1	5.0	4.5
Mozambique	8.7	6.3	7.3	6.7	6.3	6.5	7.5	7.7
Namibia	2.5	7.1	5.4	4.3	-0.8	4.0	4.5	3.6
Niger	8.4	5.8	3.4	8.7	-0.9	2.3	3.4	3.3
Nigeria	5.4	6.2	7.0	6.0	7.0	7.1	6.5	5.8
Rwanda	9.4	9.2	5.5	11.2	4.1	7.6	5.8	6.3
Sao Tome and Principe	5.7	6.7	6.0	5.8	5.2	4.5	6.0	5.4
Senegal	5.6	2.4	5.0	3.2	2.2	4.0	3.5	4.0
Sierra Leone	7.2	7.3	6.4	5.5	3.2	4.8	5.5	6.0
Somalia	2.4	2.6	2.6	2.6	-2.0	-1.0	0.0	
South Africa	5.3	5.6	5.5	3.7	-1.8	2.6	3.2	3.2
Sudan	6.3	11.3	10.2	6.8	4.5	4.8	5.5	5.0
Togo	1.2	3.7	1.9	2.2	3.1	1.9	3.3	3.4
Tunisia	4.0	5.7	6.3	6.1	3.0	4.3	4.9	4.7
Uganda	6.3	10.8	8.4	8.7	7.2	6.8	6.8	10.1
United Republic of Tanzania	7.4	6.7	7.1	7.4	6.0	7.0	6.5	6.3
Zambia	5.3	6.2	6.2	5.7	6.3	5.7	5.9	6.4
Zimbabwe	-4.0	-3.7	-3.7	-12.6	3.7	6.0	4.5	4.3
East and South Asia								
Bangladesh	6.3	6.5	6.3	6.0	5.7	5.7	5.9	6.1
Brunei Darussalam	0.4	4.4	0.2	-1.9	-0.5	1.2	1.2	1.6
China	11.3	12.7	14.2	9.6	9.1	9.8	8.9	8.7
Hong Kong, Special Administrative Region of China	7.1	7.0	6.4	2.2	-2.8	6.3	4.3	4.7
India	9.2	9.7	9.9	6.4	5.7	8.5	8.0	8.4
Indonesia	5.7	5.5	6.3	6.0	4.5	6.1	5.8	6.2
Iran, Islamic Republic of	4.7	5.8	7.8	1.0	1.8	3.0	3.1	3.4
Korea, Republic of	4.0	5.2	5.1	2.3	0.2	6.0	4.5	4.2
Malaysia	5.3	5.8	6.5	4.7	-1.7	7.0	4.9	5.3
Myanmar	13.6	13.1	11.9	3.6	1.3	4.8	4.7	5.1
Nepal	3.5	3.4	3.4	6.1	4.9	3.8	4.5	4.5
Pakistan	7.7	6.1	5.6	1.6	3.4	3.3	3.8	4.2
Papua New Guinea	3.9	2.3	7.2	6.7	4.5	5.8	6.0	6.5
Philippines	5.0	5.3	7.1	3.7	1.1	6.5	4.5	5.3
Singapore	7.4	8.6	8.5	1.8	-1.3	13.5	4.7	5.1
Sri Lanka	6.2	7.7	6.8	6.0	3.5	7.0	6.8	6.8
Taiwan, Province of China	4.7	5.4	6.0	0.7	-1.9	8.5	4.4	4.9
Thailand	4.6	5.1	4.9	2.5	-2.2	7.3	4.8	5.1
Vietnam	8.4	8.2	8.5	6.3	5.3	6.6	6.8	6.9

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
Western Asia								
Bahrain	7.9	6.7	8.4	6.3	3.1	4.0	3.8	4.2
Iraq	-0.7	6.2	1.5	9.5	4.2	5.0	5.5	6.4
Israel	4.9	5.7	5.3	4.2	0.8	4.0	3.5	3.0
Jordan	8.1	7.9	8.5	7.6	2.3	3.1	3.5	3.7
Kuwait	10.4	5.3	4.5	5.5	-4.6	4.4	3.6	4.2
Lebanon	1.0	0.6	7.5	8.5	6.7	6.9	5.6	5.4
Oman	4.0	5.5	6.8	12.8	3.6	4.3	3.9	3.7
Qatar	7.6	18.6	26.8	25.4	8.6	13.4	14.0	6.1
Saudi Arabia	5.6	3.2	2.0	4.2	0.6	3.4	3.8	3.9
Syrian Arab Republic	4.5	5.1	4.3	5.2	4.0	5.6	6.0	5.3
Turkey	8.4	6.9	4.7	0.7	-4.7	7.4	4.6	5.0
United Arab Emirates	8.2	8.7	6.1	5.1	-1.9	2.7	3.2	3.3
Yemen	5.6	3.2	3.3	3.6	2.8	3.5	3.4	3.2
Latin America and the Caribbean								
Argentina	9.2	8.5	8.7	6.8	0.9	7.0	4.5	4.4
Barbados	3.9	3.6	3.8	-0.2	-5.5	-0.5	1.0	3.0
Bolivia, Plurinational State of	4.4	4.8	4.6	6.1	3.4	4.1	3.5	4.0
Brazil	3.2	4.0	6.1	5.1	-0.2	7.6	4.5	5.2
Chile	5.5	4.6	4.6	3.7	-1.5	4.8	5.5	4.5
Colombia	5.0	7.1	6.3	2.7	0.8	4.5	5.0	4.5
Costa Rica	5.9	8.8	7.9	2.8	-1.1	4.0	3.3	3.8
Cuba	11.2	12.1	7.3	4.3	1.0	2.0	3.0	2.0
Dominican Republic	9.3	10.7	8.5	5.3	3.5	5.8	4.0	4.0
Ecuador	5.7	4.8	2.0	6.5	0.4	2.0	1.8	2.5
El Salvador	3.3	4.2	4.3	2.4	-3.5	1.5	1.5	3.0
Guatemala	3.3	5.4	6.3	3.3	0.5	2.5	2.0	3.0
Guyana	-1.9	5.1	7.0	2.0	3.0	2.5	2.2	-2.6
Haiti	1.8	2.2	3.3	0.8	2.9	-8.5	7.0	4.0
Honduras	6.1	6.7	6.2	4.0	-1.9	2.5	2.0	3.0
Jamaica	1.1	3.0	1.4	-0.9	-3.0	-0.5	1.0	2.0
Mexico	3.2	4.9	3.3	1.5	-6.5	4.5	3.4	3.0
Nicaragua	4.3	4.2	3.1	2.8	-1.5	2.2	1.8	3.8
Panama	7.2	8.5	12.1	10.1	3.0	5.2	4.0	4.0
Paraguay	2.9	4.3	6.8	5.8	-3.8	9.0	6.0	5.0
Peru	6.8	7.7	8.9	9.8	0.9	6.9	5.9	5.7
Trinidad and Tobago	6.2	13.2	4.8	2.4	-3.5	2.1	1.9	2.5
Uruguay	6.8	4.3	7.5	8.5	2.9	7.5	4.5	3.9
Venezuela, Bolivarian Republic of	10.3	9.9	8.2	4.8	-3.3	-2.6	2.5	3.0

Source: Project LINK

a Partly estimated.
b Forecasts, based in part on Project LINK.

Table A.3
World and regions: consumer price inflation, 2005-2012
(Annual percentage change[a])

	2005	2006	2007	2008	2009	2010[b]	2011[c]	2012[c]
World	3.1	3.2	5.6	4.7	1.4	2.5	2.5	2.5
Developed economies	2.3	2.4	2.1	3.3	0.1	1.4	1.5	1.6
North America	3.3	3.2	2.8	3.8	-0.2	1.4	1.4	1.6
Asia and Oceania	0.2	0.8	0.4	1.9	-0.9	0.5	0.4	1.1
Europe	2.1	2.2	2.2	3.5	0.8	1.8	1.9	1.8
European Union	2.2	2.2	2.2	3.5	0.8	1.8	1.9	1.8
EU-15	2.1	2.2	2.1	3.3	0.7	1.7	1.8	1.7
New EU Members	3.4	3.0	4.0	6.1	3.0	2.8	2.9	2.7
Other Europe	1.4	1.8	0.8	3.2	1.0	1.3	1.6	1.8
Memorandum items:								
Euro Zone	2.2	2.2	2.1	3.3	0.3	1.4	1.6	1.8
Major developed economies (G-7)	2.3	2.3	2.1	3.2	-0.1	1.3	1.4	1.5
OECD	2.4	2.5	2.3	3.5	0.4	1.6	1.6	1.7
Economies in transition	11.7	9.2	9.0	14.7	10.7	6.4	8.1	7.0
South-eastern Europe	6.8	5.9	3.7	7.8	3.4	2.6	3.5	3.0
Commonwealth of Independent States	12.2	9.5	9.6	15.4	11.5	6.8	8.6	7.4
Developing countries[d]	4.7	4.6	5.4	8.0	4.4	5.5	5.0	4.7
Africa[d]	6.8	5.4	6.4	10.1	8.7	6.8	6.0	5.7
North Africa	3.8	3.1	5.7	7.4	7.3	5.9	4.8	4.7
Sub-Saharan Africa[d]	8.3	6.6	6.7	11.5	9.4	7.2	6.6	6.3
East and South Asia	3.6	3.7	5.0	7.2	3.0	5.0	4.5	4.2
East Asia	2.9	2.7	3.9	6.0	0.6	3.1	3.3	3.2
South Asia	6.0	7.4	8.7	11.8	11.6	11.6	8.9	7.9
Western Asia	5.2	7.0	7.0	10.2	4.2	5.1	4.6	4.6
Latin America and the Caribbean	6.2	5.1	5.3	7.8	6.1	6.2	5.9	5.5
South America	7.2	5.7	5.8	8.7	6.7	7.3	7.2	7.0
Mexico and Central America	4.4	3.9	4.3	5.7	5.1	4.3	3.6	3.1
Caribbean	7.4	8.3	7.2	12.9	4.3	8.1	6.0	4.5
Memorandum items:								
Least developed countries	9.7	9.3	9.4	12.5	10.7	8.2	7.3	7.0
Sub-Saharan Africa [d] (Excluding Nigeria and South Africa)	8.8	7.5	6.8	11.5	10.3	7.3	6.7	6.4
East Asia (excluding China)	3.2	3.9	3.9	3.0	6.0	1.9	3.2	3.2
South Asia (excluding India)	11.0	11.0	9.8	12.8	21.2	12.6	10.7	9.2
Western Asia (excluding Israel and Turkey)	1.7	2.7	3.9	5.3	11.0	3.7	3.8	4.1

Source: Project LINK

a Calculated as a weighted average of individual country growth rates of consumer price index (CPI), where weights are based on GDP in 2005, in United States dollars .
b Partly estimated.
c Forecasts, based in part on Project LINK.
d Excluding Zimbabwe.

Table A.4
Consumer price inflation, 2005-2012
(Annual percentage change)

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
Developed economies								
North America								
Canada	2.2	2.0	2.1	2.4	0.3	1.8	2.3	2.2
United States	3.4	3.2	2.9	3.8	-0.3	1.4	1.4	1.6
Asia and Oceania								
Australia	2.7	3.5	2.3	4.4	1.8	1.3	1.4	1.6
Japan	-0.3	0.3	0.0	1.4	-1.4	0.3	0.1	1.0
New Zealand	3.0	3.4	2.4	4.0	2.1	2.5	4.0	2.4
European Union								
EU-15								
Austria	2.1	1.7	2.2	3.2	0.4	1.7	1.8	1.7
Belgium	2.5	2.3	1.8	4.5	0.0	2.4	2.5	1.9
Denmark	1.8	1.9	1.7	3.4	1.3	2.3	1.9	1.0
Finland	0.8	1.3	1.6	3.9	1.6	1.6	1.9	2.0
France	1.9	1.9	1.6	3.2	0.1	1.6	1.7	1.8
Germany	1.9	1.8	2.3	2.8	0.2	1.1	1.4	1.5
Greece	3.5	3.3	3.0	4.2	1.4	2.9	1.0	1.2
Ireland	2.2	2.7	2.9	3.1	-1.7	-1.1	0.0	0.5
Italy	2.2	2.2	2.0	3.5	0.8	0.9	1.6	2.1
Luxembourg	2.5	2.7	2.3	3.4	0.4	2.1	2.0	2.0
Netherlands	1.5	1.7	1.6	2.2	1.0	1.2	1.5	2.0
Portugal	2.1	3.0	2.4	2.7	-0.9	1.2	1.5	2.4
Spain	3.4	3.6	2.8	4.1	-0.2	2.1	1.9	2.0
Sweden	0.8	1.5	1.7	3.3	2.0	1.8	1.0	1.0
United Kingdom	2.0	2.3	2.3	3.6	2.1	3.1	2.7	1.7
New EU members								
Bulgaria	6.0	7.4	7.6	12.0	2.5	2.3	4.5	4.0
Cyprus	2.0	2.2	2.2	4.4	0.2	2.0	2.0	2.0
Czech Republic	1.8	2.5	2.9	6.3	1.0	1.5	1.9	1.5
Estonia	4.1	4.4	6.6	10.4	-0.1	2.5	2.5	2.5
Hungary	3.6	3.9	7.9	6.1	4.2	4.2	4.7	3.5
Latvia	6.9	6.6	10.1	15.3	3.5	-1.0	0.8	2.0
Lithuania	2.7	3.8	5.8	11.1	4.2	1.0	1.0	2.8
Malta	2.5	2.6	0.7	4.7	1.8	2.0	2.0	2.0
Poland	2.1	1.0	2.5	4.2	3.5	2.6	2.5	2.5
Romania	9.0	6.6	4.8	7.8	5.6	6.0	4.8	4.0
Slovak Republic	2.8	4.3	1.9	3.9	0.9	1.5	2.1	2.3
Slovenia	2.5	2.5	3.6	5.7	0.9	2.0	2.3	2.5
Other Europe								
Iceland	4.0	6.8	5.0	12.4	12.0	5.5	5.5	4.0
Norway	1.5	2.3	0.7	3.8	2.2	1.7	2.3	2.6
Switzerland	1.2	1.1	0.7	2.4	-0.5	0.7	0.8	1.0
Economis in transition								
South-eastern Europe								
Albania	2.4	2.4	2.9	3.4	2.2	3.5	3.5	3.5
Bosnia and Herzegovina	3.6	6.1	1.5	7.4	-0.4	1.9	2.5	2.1
Croatia	3.3	3.2	2.9	6.1	2.4	1.5	2.8	2.7
Montenegro	3.4	3.0	4.2	8.5	3.4	1.5	3.0	3.0
Serbia	17.3	12.7	6.5	12.4	8.1	5.0	5.4	4.0
The former Yugoslav Republic of Macedonia	0.5	3.2	2.3	8.3	-0.8	1.6	2.3	2.6
Commonwealth of Independent States								
Armenia	0.6	2.9	4.4	9.0	3.5	6.7	5.2	6.0
Azerbaijan	9.7	8.4	16.6	20.8	1.5	5.0	4.6	4.8
Belarus	10.3	7.0	8.4	14.8	13.0	7.1	10.0	8.0
Kazakhstan	7.9	8.7	10.8	17.1	7.3	7.0	6.5	7.3
Kyrgyzstan	4.3	5.6	10.2	24.5	6.8	4.5	5.5	5.2
Republic of Moldova	11.9	12.7	12.4	12.7	0.0	7.3	6.2	3.0
Russian Federation	12.7	9.7	9.0	14.1	11.7	6.4	8.0	6.9
Tajikistan	7.3	10.0	13.2	20.4	6.5	7.5	8.3	9.5
Turkmenistan	10.7	8.2	6.3	14.5	-2.7	6.0	7.0	9.0
Ukraine	13.5	9.1	12.8	25.2	15.9	9.8	14.9	11.5
Uzbekistan	10.0	14.2	12.3	12.7	14.1	12.0	13.0	8.0
Georgia	8.3	9.2	9.2	10.0	1.7	6.2	7.0	1.3

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
	Developing							
Africa								
Algeria	1.6	2.3	3.6	4.9	5.7	4.5	3.9	4.6
Angola	23.0	13.3	12.2	12.5	13.7	13.5	12.5	12.8
Benin	5.4	3.8	1.3	8.0	2.2	2.5	2.8	2.8
Botswana	8.6	11.6	7.1	12.6	8.1	6.9	6.6	6.5
Burkina Faso	6.4	2.4	-0.2	10.7	2.6	2.3	2.0	2.0
Burundi	13.5	2.7	8.3	24.4	10.7	6.8	6.4	7.8
Cameroon	2.0	4.9	1.1	5.3	3.0	3.0	2.7	2.7
Cape Verde	0.4	4.8	4.4	6.8	1.0	1.3	2.0	1.3
Central African Republic	2.9	6.7	0.9	9.3	3.5	2.0	2.9	2.5
Chad	3.7	7.7	-7.4	8.3	10.1	6.0	3.0	3.0
Comoros	3.0	3.4	4.5	4.8	4.8	2.5	2.9	3.3
Congo	2.5	4.7	2.6	6.0	4.3	4.0	3.0	3.0
Côte d'Ivoire	3.9	2.5	1.9	6.3	1.0	1.7	1.9	2.8
Democratic Republic of the Congo	21.4	13.2	16.7	18.0	46.2	9.0	8.0	8.0
Djibouti	3.1	3.5	5.0	12.0	1.7	3.0	4.0	3.5
Egypt	8.8	4.2	11.0	11.7	16.2	12.1	9.5	8.4
Equatorial Guinea	5.7	4.5	2.8	4.3	7.2	7.0	6.2	6.3
Eritrea	12.5	15.1	9.3	19.9	38.9	19.0	14.0	13.0
Ethiopia	6.8	12.3	15.8	25.3	36.4	14.7	16.0	10.1
Gabon	1.2	-1.4	5.0	5.3	2.1	7.5	9.0	10.5
Gambia	5.0	2.1	5.4	4.5	4.6	4.0	3.8	4.0
Ghana	15.1	10.2	10.7	16.5	19.3	10.4	9.0	8.0
Guinea	31.4	34.7	22.9	18.4	4.7	16.0	14.5	11.2
Guinea-Bissau	3.3	0.7	4.6	10.4	-1.6	1.2	2.0	1.8
Kenya	9.9	6.0	4.3	16.2	9.3	4.5	4.7	5.0
Lesotho	3.4	6.1	8.0	10.7	7.2	6.1	6.5	5.7
Liberia	6.9	7.2	13.7	17.5	7.4	7.4	6.9	8.0
Libyan Arab Jamahiriya	2.9	1.4	6.2	10.4	2.8	3.6	3.2	1.9
Madagascar	18.4	10.8	10.4	9.2	9.0	6.5	3.7	3.7
Malawi	15.5	13.9	7.9	8.7	8.4	8.0	6.3	5.8
Mali	6.4	1.5	1.5	9.1	2.2	2.1	2.6	2.8
Mauritania	12.1	6.2	7.3	7.3	2.2	4.8	4.8	5.0
Mauritius	4.9	9.0	8.8	9.7	2.5	2.5	2.5	3.6
Morocco	1.0	3.3	2.0	3.9	1.0	1.0	0.9	2.1
Mozambique	6.4	13.2	8.2	10.3	3.3	15.0	8.0	5.6
Namibia	2.3	5.1	6.7	10.0	9.1	4.8	4.1	3.0
Niger	7.8	0.1	0.1	10.5	1.1	6.7	3.5	3.5
Nigeria	17.9	8.2	5.4	11.6	12.4	11.5	8.6	8.1
Rwanda	9.1	8.8	9.1	15.4	10.4	6.1	5.8	5.4
Sao Tome and Principe	17.2	23.1	18.5	26.1	17.0	7.5	-1.6	8.0
Senegal	1.7	2.1	5.9	5.8	-1.7	-2.6	-2.4	-0.9
Sierra Leone	12.1	9.5	11.7	14.8	9.2	15.5	7.8	8.7
Somalia	12.0	14.0	15.0	30.0	25.0	25.0	25.0	25.0
South Africa	3.4	4.7	7.1	11.5	7.1	5.1	5.6	5.3
Sudan	8.5	7.2	8.0	14.3	11.3	10.0	9.0	9.0
Togo	6.8	2.2	0.9	8.7	1.9	1.9	2.5	1.9
Tunisia	2.0	4.2	3.4	4.9	3.8	4.5	3.5	3.3
Uganda	8.0	6.6	6.8	7.3	14.2	9.6	12.3	9.4
United Republic of Tanzania	4.4	7.3	7.0	10.3	12.1	7.0	5.5	5.5
Zambia	18.3	9.0	10.7	12.4	13.4	8.2	7.5	6.5
Zimbabwe	302.1	1096.7	24411.0	0.0	0.0	5.0	5.0	5.0
East and South Asia								
Bangladesh	7.0	6.8	9.1	8.9	5.4	4.3	3.1	5.1
Brunei Darussalam	1.1	0.2	0.3	2.7	1.8	3.6	0.4	0.5
China	1.8	1.5	4.8	5.9	-0.7	3.0	3.5	3.6
Hong Kong, Special Administrative Region	0.9	2.0	2.0	4.3	0.5	-1.4	-2.2	-1.6
India	4.2	6.2	6.4	8.3	10.9	12.9	9.0	7.0
Indonesia	10.5	13.1	6.0	9.8	4.8	9.4	8.8	7.2
Iran, Islamic Republic of	10.4	11.9	18.4	25.4	10.8	8.5	10.3	12.6
Korea, Republic of	2.8	2.2	2.5	4.7	2.8	3.1	3.3	3.2
Malaysia	3.0	3.6	2.0	5.4	0.6	3.1	3.2	3.0
Myanmar	10.7	26.3	32.9	22.5	18.4	18.5	14.3	11.0
Nepal	4.5	8.0	6.4	7.7	13.2	6.2	6.9	5.9
Pakistan	9.3	7.9	7.8	12.0	20.8	12.2	8.7	6.6
Papua New Guinea	1.8	2.4	0.9	10.8	6.9	6.5	7.1	6.6
Philippines	7.6	6.2	2.8	9.3	3.2	7.6	6.0	5.1
Singapore	0.5	1.0	2.1	6.6	0.6	-1.9	-1.1	0.4
Sri Lanka	11.0	10.0	15.8	22.6	3.4	6.8	8.4	10.7
Taiwan, Province of China	2.3	0.6	1.8	3.5	-0.9	0.5	0.3	0.5
Thailand	4.5	4.6	2.2	5.5	-0.8	3.5	3.1	1.9
Viet Nam	8.4	7.5	8.3	23.1	6.7	7.8	6.9	5.9

	2005	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]
Western Asia								
Bahrain	2.6	2.0	3.3	3.5	2.8	2.2	1.9	2.6
Israel	1.4	2.1	0.5	4.6	3.3	2.6	2.4	2.5
Jordan	3.5	6.3	4.7	13.9	-0.7	4.0	4.2	3.6
Kuwait	4.1	3.1	5.5	10.6	4.0	3.5	3.2	3.3
Oman	1.9	3.4	5.9	12.6	3.5	2.4	1.8	2.0
Qatar	8.8	11.8	13.8	15.0	-4.9	0.5	2.6	4.1
Saudi Arabia	0.6	2.3	4.1	9.9	5.1	4.9	4.5	5.2
Syrian Arab Republic	7.2	10.4	4.7	15.2	2.8	4.3	4.0	4.8
Turkey	8.2	9.6	8.8	10.4	6.3	7.9	6.5	5.4
Yemen	9.9	10.8	7.9	19.0	3.7	8.5	8.9	8.4
Latin America and the Caribbean								
Argentina	9.6	10.9	8.8	8.6	6.3	11.0	10.0	10.0
Barbados	6.1	7.3	4.0	8.1	3.7	5.3	3.7	2.1
Bolivia, Plurinational State of	5.4	4.3	8.7	14.0	3.3	1.7	4.0	3.5
Brazil	6.9	4.2	3.6	5.7	4.9	5.0	4.6	4.5
Chile	3.1	3.4	4.4	8.7	1.7	2.0	3.0	3.0
Colombia	5.0	4.3	5.5	7.0	4.2	2.5	2.6	3.6
Costa Rica	13.8	11.5	9.4	13.4	7.8	5.6	4.6	4.0
Dominican Republic	4.2	7.6	6.1	10.6	1.4	6.8	5.0	4.0
Ecuador	2.1	3.3	2.3	8.4	5.2	4.0	3.5	3.0
El Salvador	4.7	4.0	4.6	7.3	0.4	1.1	2.8	2.8
Guatemala	9.1	6.6	6.8	11.4	1.9	4.0	4.5	4.2
Guyana	6.9	6.7	12.2	8.1	3.0	3.7	4.6	4.0
Haiti	16.8	14.2	9.0	14.4	3.4	4.9	8.5	5.5
Honduras	8.8	5.6	6.9	11.5	8.7	4.6	5.5	5.3
Jamaica	15.1	8.5	9.3	22.0	9.6	12.7	5.8	5.4
Mexico	4.0	3.6	4.0	5.1	5.3	4.3	3.5	3.0
Nicaragua	9.6	9.1	11.1	19.8	3.7	6.0	6.4	6.4
Panama	2.9	2.5	4.2	8.8	2.4	3.4	3.0	2.5
Paraguay	6.8	9.6	8.1	10.2	2.6	4.6	5.0	3.9
Peru	1.6	2.0	1.8	5.8	2.9	1.6	2.5	2.0
Trinidad and Tobago	6.9	8.3	7.9	12.0	7.0	9.0	8.0	5.0
Uruguay	4.7	6.4	8.1	7.9	7.1	6.2	5.4	5.2
Venezuela, Bolivarian Republic of	16.0	13.7	18.7	30.4	27.1	30.0	32.0	29.0

Source: Project LINK

a Partly estimated.
b Forecasts, based in part on Project LINK.

Table A.5
World trade: changes in trade value of goods and non-factor services, by major country group, 2005-2012
(annual percentage change)

Region	Flow	2005	2006	2007	2008	2009[a]	2010[b]	2011[b]	2012[b]
World	Exports	13.5	15.1	15.8	14.4	-20.0	12.1	8.3	8.9
	Imports	13.1	14.3	15.2	15.3	-21.6	10.5	6.9	8.6
Developed economies	Exports	9.2	12.4	15.1	11.1	-20.2	10.0	7.1	7.7
	Imports	11.2	12.6	12.9	11.2	-22.0	7.8	6.1	8.0
North America	Exports	11.0	11.5	11.7	9.8	-17.3	13.1	10.6	9.7
	Imports	13.0	10.6	6.6	7.5	-22.5	12.8	9.7	10.6
Asia and Oceania	Exports	8.5	8.6	11.1	14.0	-23.8	25.9	10.0	5.5
	Imports	12.7	9.6	10.5	21.8	-24.1	12.0	6.2	5.0
Europe	Exports	8.7	13.3	16.8	11.0	-20.6	6.8	5.5	7.4
	Imports	10.1	14.0	16.2	11.3	-21.5	5.1	4.6	7.2
European Union	Exports	8.3	13.3	16.8	10.5	-20.8	6.7	5.7	7.8
	Imports	10.0	14.1	16.1	11.3	-21.8	4.9	4.7	7.5
EU-15	Exports	7.9	12.8	16.1	10.0	-20.7	6.5	5.6	7.7
	Imports	9.8	13.6	15.4	10.6	-21.6	4.8	4.4	7.2
New EU Members	Exports	16.6	21.9	26.5	18.6	-21.2	9.4	7.1	9.8
	Imports	13.3	22.9	26.5	20.7	-25.3	6.0	8.6	12.0
Other Europe	Exports	14.6	13.8	16.8	18.6	-18.1	8.5	2.9	1.5
	Imports	12.4	10.9	18.0	11.7	-15.5	9.3	3.1	2.5
Euro Zone	Exports	7.7	12.4	17.7	10.9	-20.3	7.0	5.4	7.5
	Imports	9.6	13.6	16.8	12.1	-21.1	4.1	4.1	7.1
Economies in transition	Exports	28.7	24.6	21.0	33.9	-39.6	9.8	1.4	4.3
	Imports	23.3	26.2	34.4	30.2	-31.1	1.7	-1.1	3.7
Developing countries	Exports	20.9	19.3	16.6	18.2	-17.6	15.4	10.6	10.8
	Imports	17.0	17.1	18.5	22.3	-20.0	15.9	8.6	9.8
Africa	Exports	28.0	25.5	12.4	22.9	-30.2	19.0	11.3	8.8
	Imports	20.1	19.7	25.1	20.9	-17.7	18.3	10.4	9.6
North Africa	Exports	32.3	15.0	19.8	22.3	-31.0	14.7	8.0	6.3
	Imports	20.6	15.8	29.2	23.9	-13.4	18.7	7.8	7.8
Sub-Saharan Africa	Exports	24.9	33.6	7.5	23.3	-29.7	22.1	13.5	10.4
	Imports	19.7	22.0	22.9	19.1	-20.3	18.1	12.1	10.8
Sub-Saharan Africa	Exports	29.3	26.1	10.9	16.7	-21.0	18.8	11.1	9.7
(Excluding Nigeria & South Africa)	Imports	18.9	15.4	20.5	18.2	-12.0	19.2	10.5	10.0
East and South Asia	Exports	18.3	18.6	18.1	14.9	-14.5	20.0	12.8	12.7
	Imports	16.1	16.1	16.3	22.6	-19.8	16.8	8.5	10.7
East Asia	Exports	17.5	18.5	17.9	15.2	-14.8	20.0	12.7	12.5
	Imports	14.7	15.7	15.6	23.6	-20.1	17.0	8.5	10.7
South Asia	Exports	27.1	19.6	20.1	11.6	-11.1	19.4	13.6	14.1
	Imports	27.7	19.5	21.0	15.7	-17.6	15.3	8.6	10.7
Western Asia	Exports	30.5	19.2	16.4	33.5	-20.2	-0.9	1.7	5.6
	Imports	18.6	19.9	26.0	23.7	-22.0	7.5	5.7	7.6
Latin America and the Caribbean	Exports	20.3	18.9	12.7	15.9	-21.3	9.6	6.9	5.9
	Imports	18.5	18.1	19.2	20.2	-20.6	17.2	9.7	7.7
South America	Exports	25.7	20.8	15.7	22.9	-23.4	5.3	8.4	5.1
	Imports	25.5	21.8	27.7	29.0	-20.8	14.9	13.7	9.3
Mexico and Central America	Exports	13.8	15.3	9.5	6.0	-17.6	16.6	4.6	7.0
	Imports	12.7	14.7	11.0	10.2	-20.3	20.3	4.3	5.1
Caribbean	Exports	21.0	37.1	1.4	9.5	-23.6	7.9	10.4	9.4
	Imports	16.1	14.7	11.2	14.8	-21.6	16.3	12.6	10.2
Least developed countries	Exports	30.9	29.6	10.5	13.2	-19.2	14.3	11.8	10.4
	Imports	20.2	17.1	20.6	15.5	-11.7	16.5	10.7	10.4

Source: UN/DESA

a Partly estimated.
b Forecasts, based in part on Project LINK.

Table A.6
World trade: changes in trade volume of goods and non-factor services, by major country group, 2005-2012
(annual percentage change)

Region	Flow	2005.0	2006.0	2007.0	2008.0	2009[a]	2010[b]	2011[b]	2012[b]
World	Exports	7.7	9.2	7.1	2.6	-11.7	10.5	6.4	6.2
	Imports	8.3	9.3	7.0	2.7	-10.8	10.2	6.4	6.5
Developed economies	Exports	5.6	8.5	6.0	1.9	-12.7	9.9	6.2	5.7
	Imports	6.2	7.7	4.5	0.4	-12.5	8.9	5.7	5.5
North America	Exports	5.5	6.9	7.4	3.7	-10.5	9.7	7.9	7.2
	Imports	6.3	5.9	3.2	-2.0	-13.9	10.9	8.3	7.9
Asia and Oceania	Exports	5.9	8.3	7.4	1.7	-19.9	19.6	6.2	5.0
	Imports	6.3	4.5	4.0	4.0	-14.6	12.2	7.0	5.2
Europe	Exports	5.6	9.0	5.3	1.4	-12.3	8.6	5.6	5.3
	Imports	6.2	9.0	5.2	1.0	-11.7	7.5	4.4	4.4
European Union	Exports	5.7	9.2	5.2	1.3	-12.6	8.8	5.8	5.5
	Imports	6.1	9.1	5.1	1.1	-11.9	7.6	4.4	4.5
EU-15	Exports	5.5	8.8	4.8	1.0	-12.7	8.9	5.8	5.4
	Imports	6.1	8.6	4.6	0.7	-11.8	7.6	4.1	4.2
New EU Members	Exports	9.7	15.9	12.4	5.7	-11.2	7.1	6.9	7.1
	Imports	6.2	16.1	13.1	5.8	-12.5	7.2	7.9	8.3
Other Europe	Exports	4.8	5.8	6.9	2.5	-7.4	6.1	1.8	1.8
	Imports	7.9	7.3	6.7	0.5	-8.0	6.9	3.5	2.9
Euro Zone	Exports	5.1	8.6	6.2	1.0	-13.2	10.2	5.7	5.1
	Imports	5.8	8.5	5.6	1.0	-11.6	8.0	4.4	4.4
Economies in transition	Exports	3.8	6.5	6.9	1.2	-22.6	6.2	1.7	2.0
	Imports	12.2	17.4	23.3	12.2	-2.1	-7.6	-2.8	1.5
Developing countries	Exports	11.9	10.8	9.0	4.0	-9.1	11.7	6.9	7.3
	Imports	12.6	12.2	11.1	6.3	-8.2	14.1	8.3	8.5
Africa	Exports	14.6	6.9	7.6	2.7	-12.8	8.3	5.8	5.4
	Imports	10.3	13.4	15.8	8.9	-6.7	9.7	7.4	6.9
North Africa	Exports	9.2	8.3	9.5	-2.1	-8.8	6.8	4.8	4.3
	Imports	11.0	12.3	15.9	9.8	-3.4	10.9	6.6	6.6
Sub-Saharan Africa	Exports	19.1	5.9	6.2	6.6	-15.7	9.5	6.7	6.3
	Imports	9.8	14.0	15.7	8.4	-8.6	9.0	7.9	7.2
Sub-Saharan Africa	Exports	14.2	5.8	7.9	6.8	-9.5	8.2	6.1	5.8
(Excluding Nigeria & South Africa)	Imports	10.8	4.0	13.0	7.2	1.5	8.0	6.8	6.3
East and South Asia	Exports	13.2	13.3	10.4	6.1	-8.1	14.0	7.8	8.3
	Imports	12.6	11.7	9.2	6.6	-7.6	14.9	8.2	8.8
East Asia	Exports	13.2	13.1	11.2	5.8	-8.4	14.4	7.8	8.3
	Imports	11.0	11.0	9.6	4.8	-8.1	15.3	7.9	8.7
South Asia	Exports	13.6	15.3	2.1	8.9	-4.8	10.4	8.5	7.9
	Imports	27.1	17.6	6.2	20.3	-4.2	12.3	10.1	9.4
Western Asia	Exports	8.6	5.7	6.5	-4.5	-11.6	3.9	5.0	4.5
	Imports	16.3	12.0	16.6	-2.6	-4.6	8.3	6.9	6.2
Latin America and the Caribbean	Exports	7.9	6.6	5.9	2.3	-10.1	7.9	3.9	4.7
	Imports	11.2	13.7	13.3	10.1	-14.0	17.4	9.8	9.3
South America	Exports	8.4	4.3	5.3	3.0	-7.9	6.5	4.4	4.5
	Imports	15.0	17.5	19.2	14.8	-11.8	18.3	13.4	12.8
Mexico and Central America	Exports	6.9	10.5	6.7	1.2	-13.0	10.0	3.4	5.1
	Imports	8.2	11.9	7.6	4.8	-17.0	16.8	5.2	4.5
Caribbean	Exports	15.2	-5.1	3.8	7.8	-7.3	3.2	2.8	2.9
	Imports	5.3	-18.1	9.4	10.2	-9.0	3.5	4.0	4.1
Least developed countries	Exports	17.6	7.4	11.8	8.5	-9.5	6.9	5.9	6.0
	Imports	12.4	4.3	15.2	6.0	3.5	6.1	7.1	6.9

Source: UN/DESA

a Partly estimated.
b Forecasts, based in part on Project LINK.