United Nations

Department of Economic and Social Affairs

Expert Group Meeting on the World Economy (Project LINK)

24-26 October 2011, New York

LINK Global Economic Outlook

October 2011

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Acknowledgements

This report presents short-term prospects for the global economy in 2012-2013, including major risks and policy challenges. The report draws upon 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]

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

1. Overview

The world economy is at a critical juncture. The momentum of the global growth is faltering at an alarming rate, with heightened risks for some major developed economies to slide into a double-dip recession in 2012, dragging the rest of the world into another dire economic downturn.

Many developed economies in particular are in a perilous situation. Economic growth in the United States decelerated substantially in the first half of 2011, while the euro zone is facing economic stagnation with its largest members at the brink of renewed downturn and the debt-ridden economies in the periphery entrapped in protracted recession. Japan is already in another recession. Growth in developing countries and the economies in transition remained strong, but also moderated. With a deteriorating international economic environment, including a renewed turbulence in global financial markets, reversal of capital inflows, heightened volatility in the prices of commodities and weakened external demand, these economies are also facing more challenges in the outlook.

The most threatening risks for the global recovery emanate from the weaknesses in the major developed economies. The sovereign debt crisis in a number of European economies is deteriorating, aggravating the still fragile banking sector in the region, propagating the distress to a growing number of other economies and triggering a renewed financial turbulence worldwide. The fiscal and financial woes, combined with elevated unemployment, widening income inequality and flagging economic growth, are posing formidable challenges for policy makers in major developed economies. However, a pervasive and deepening political divide in these countries on how to tackle these challenges has paralyzed otherwise a much urgently needed policy action, further eroding the already shattered confidence of businesses and consumers.

To save the global economy from falling into a dangerous downward spiral, policymakers worldwide, and those in major developed economies in particular, should take swift and concerted action, giving greater priority to revitalizing the recovery in output and employment in the short run.

2. Global macroeconomic prospects

Global growth is faltering dangerously

The prospects for the world economy in 2012 are seriously grim, surrounded by great uncertainties. Premised on a set of relatively optimistic assumptions, including an assumption that the sovereign debt crisis in Europe can be contained within a few small economies, and a number of policies as delineated in box 1, growth of world gross product (WGP) is forecast to be 2.6 per cent in the baseline outlook for 2012, a sharp downgrading from the 3.6 per cent projected in the last LINK exercise of mid-2011. In comparison, WGP is estimated to have grown by 2.8 estimated for 2011, lower than the

3.1 per cent projected a year ago, decelerated significantly from the rebound of 4.0 per cent in 2010 (table 1 and figure 1).

Box 1: Major assumptions for the baseline forecast

This box summarizes key assumptions underlying the baseline forecast, including monetary and fiscal policies for major economies, exchange rates for major currencies, international prices of oil and other primary commodities. Policy assumptions for other countries can be found in the text of regional outlook.

Monetary policy

The Federal Reserve of the *United States* (Fed) is assumed to keep the federal funds interest rate at the current low level, namely, between 0 and 0.25 per cent, until the end of 2013. The Fed will implement the panned swap of its holding of $400 billion in short-term Treasuries for long-term government bonds, and will also reinvest the receipt of matured assets, so as to maintain the size of its holding of assets. The *European Central Bank* (ECB) is assumed to keep the policy interest rate at 1.5 per cent through 2013. The ECB will continue to provide liquidity to banks through a number of facilities, such as refinancing operations of various term-lengths, and purchasing sovereign bonds under the Securities Market Program (SMP). The *Bank of Japan* (BoJ) will keep the policy interest rate at the current level (0.05 per cent), but will continue to use its balance sheet to manage liquidity, through the Asset Purchase Program (APP) to buy risk assets, such as commercial paper, corporate bonds, in addition to government bonds and bills. The BoJ is also expected to continue intervening in foreign exchange markets to stabilize the value of the yen. In major emerging economies, the *People's Bank of China* (PBC) is expected to pause monetary tightening, based on a contingent assumption that inflation in the economy starts to moderate.

Fiscal policy

It is assumed that in the *United States* the American Jobs Plan (AJP) will be enacted, and an agreement will be reached on the long-term deficit-reduction actions. In the *euro area*, as well as most economies in Western Europe, implementation of the plans for fiscal consolidation announced so far will continue. In *Japan*, a total size of the five-year post-quake reconstruction is estimated to cost ¥19 trillion, or 4% of GDP, to be financed mostly by increases in taxes. In *China*, fiscal stance is expected to remain "proactive", with increased spending on education, healthcare and social programmes.

Exchange rates among major currencies

It is assumed that the euro will fluctuate around an average of $1.38 per euro throughout the forecast. The Japanese yen is assumed to average about ¥78 per United States dollar, and the renminbi CNY6.20 per United States dollar in 2012 and CNY6.02 in 2013.

Oil prices

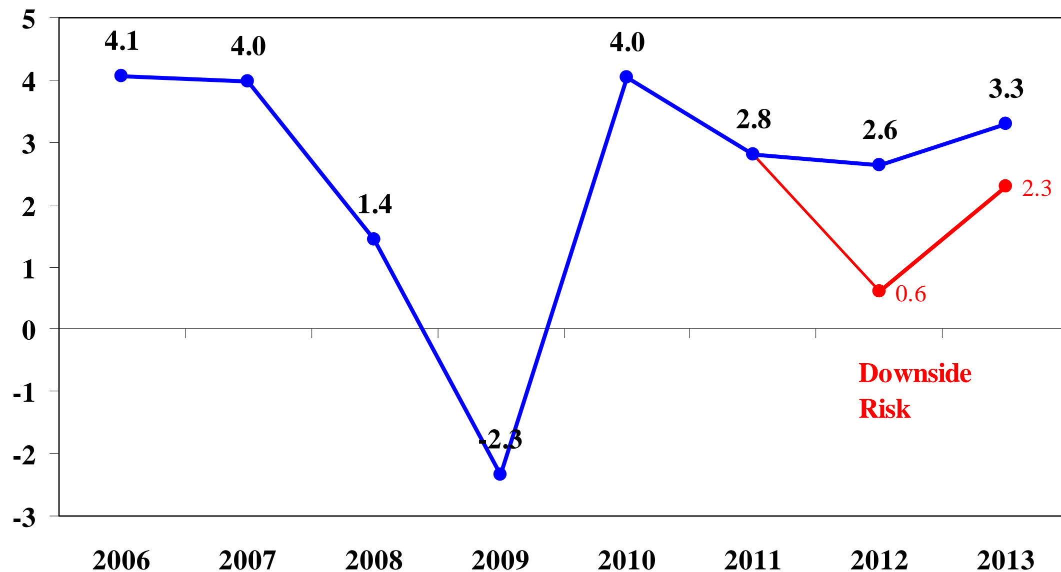
Oil prices (Brent) are assumed to average about $100 p/b during both 2012 and 2013, compared with $107 p/b in 2011.

Table 1: Gross domestic product and world trade (annual percentage change [a])

	2005-2008[a]	2009	2010 [b]	2011 [c]	2012 [c]	2013 [c]	Change from June 2011 forecast	
							2011	2012
World	3.3	-2.3	4.0	2.8	2.6	3.3	-0.5	-1.0
Developed economies	1.9	-4.0	2.7	1.4	1.3	2.1	-0.6	-1.1
United States of America	1.8	-3.5	3.0	1.7	1.5	2.4	-0.9	-1.3
Japan	1.3	-6.3	4.0	-0.5	2.0	2.0	-1.2	-0.8
European Union	2.1	-4.2	1.9	1.6	0.7	1.7	-0.1	-1.2
EU15	1.9	-4.3	1.9	1.5	0.6	1.5	-0.2	-1.1
New EU members	5.3	-3.6	2.2	2.9	3.0	3.4	-0.2	-1.0
Euro zone	2.0	-4.2	1.8	1.6	0.4	1.3	0.0	-1.2
Other European countries	2.6	-1.9	1.5	1.8	2.0	1.9	-0.2	0.0
Other Developed countries	2.6	-1.0	2.9	1.5	2.2	2.6	-1.3	-0.5
Economies in transition	7.0	-6.6	4.2	4.2	3.9	4.5	-0.2	-0.7
South-Eastern Europe	5.0	-3.7	0.5	1.8	2.7	3.3	-0.4	-0.4
Commonwealth of Independent States and Georgia	7.2	-6.9	4.5	4.4	4.0	4.6	-0.2	-0.8
Russian Federation	6.8	-7.8	4.0	4.1	3.7	4.2	-0.4	-0.9
Developing economies	6.9	2.5	7.5	6.1	5.5	5.9	-0.1	-0.7
Africa	5.7	2.2	4.5	2.9	5.0	5.2	-0.7	-0.4
North Africa	5.2	3.0	4.2	-0.5	4.7	5.5	-1.2	-0.3
Sub-Saharan Africa	5.9	1.8	4.7	4.7	5.2	5.1	-0.4	-0.3
Nigeria	6.7	5.6	7.8	6.3	6.8	7.0	0.6	0.5
South Africa	5.0	-1.7	2.8	3.1	3.7	3.5	-0.6	-1.1
Others	6.3	3.0	4.7	5.2	5.7	5.3	-0.7	0.0
East and South Asia	8.2	5.2	8.7	7.1	6.8	6.9	-0.1	-0.4
East Asia	8.4	5.1	9.2	7.3	6.8	6.9	0.0	-0.4
China	11.9	9.2	10.4	9.3	8.7	8.5	0.2	-0.2
South Asia	7.5	5.7	7.1	6.5	6.8	7.0	-0.4	-0.2
India	8.5	7.0	8.5	7.7	7.8	8.0	-0.4	-0.4
Western Asia	5.8	-1.0	6.6	6.7	3.7	4.3	0.9	-0.5
Latin America and the Caribbean	4.9	-2.1	6.0	4.2	3.2	4.1	-0.3	-1.7
South America	5.6	-0.5	6.4	4.5	3.6	4.4	-0.5	-1.6
Brazil	4.6	-0.6	7.5	3.7	2.7	3.8	-1.4	-2.6
Mexico and Central America	3.5	-5.4	5.3	3.8	2.5	3.5	0.0	-1.8
Mexico	3.3	-6.0	5.5	3.8	2.4	3.5	0.1	-1.9
Caribbean	6.1	0.8	4.3	3.2	3.5	4.1	-0.8	-1.2
Least developed countries	7.0	4.7	5.5	5.2	5.9	5.7	-0.4	0.1
Memorandum items:								
World trade [d]	7.1	-11.2	11.8	6.1	4.3	5.2	-2.8	-1.6
World output growth with PPP-based weights	4.4	-0.9	4.9	3.8	3.6	4.2	-0.3	-0.8

Source: UN/DESA
a Weighted average based on GDP in 2005 prices and exchange rates.
b Actual or most recent estimates.
c Forecast, based in part on Project LINK. d Includes goods and services

Figure 1
Growth of world gross product (% change), 2006-2013[a]



Source: Project LINK
a 2011 , 2012 and 2013 are forecasted figures.

Many developed economies are in dire straits. Most are suffering from a similar set of predicaments in the aftermath of the financial crisis, including the ongoing financial deleveraging in the banking and household sectors, large budget deficits, high public debt, elevated unemployment rates and enervated domestic demand. Macroeconomic policy stances are worsening matters. Monetary policies remain accommodative with the use of various unconventional measures, while fiscal policy has become increasingly restrictive with the degree of the fiscal austerity varying from country to country.

Among the developed economies, growth in the United States slowed notably in the first half of 2011. The Government is not facing difficulties in financing its current budget deficit, as the yields on the issuance of long-term government bonds in capital markets are at record lows, but political tensions seem to impede any additional fiscal stimulus strong enough to boost output and employment. As a result, a further weakening in GDP growth, with the possibility of mild contraction in parts of the year, is a likely scenario in the forecast for 2012. Growth in the euro area has slowed tremendously since the beginning of the year and the collapse in confidence displayed by a wide variety of leading indicators and measures of economic sentiment suggest a further slowing ahead, perhaps to stagnation by the end of 2011 and into early 2012. In the outlook, with even an optimistic assumption that the debt crisis can be contained within a few countries, growth is expected to be only marginally positive in the euro area for 2012, with the largest regional economies dangerously close to a renewed downturn and the debt-ridden

economies in the periphery either in protracted recession or very close. Japan was in another recession in the first half of 2011, caused mainly, but not exclusively, by the disasters of the March earthquake. While post-quake reconstruction is expected to lift GDP growth in Japan to above potential in the coming two years, risks remain on the downside, emanating from the challenges of financing the reconstruction and the possibility of a more pronounced and synchronized downturn along with other major developed economies.

Developing countries and economies in transition have acted as the engines of global growth over the past two years. Output growth in among the larger emerging economies in Asia and Latin America, such as China, India and Brazil, had been particularly robust. Since the beginning of 2011, however, economic growth in most developing countries and economies in transition has slowed notably, in part because of macroeconomic policy tightening in attempts to curb inflation and in part, especially from mid-2011 onwards, because of weaker external demand, declining international prices of primary commodities, and a reversal in capital flows.

In the outlook for 2012-2013, output growth in developing countries and the economies in transition is expected to be further affected by the economic woes in developed countries through trade and financial channels. If the major developed economies enter a period of stagnation or of mild recession, as projected in the baseline, GDP growth in developing countries and the economies in transition will decelerate by between one and two percentage points below their potential, less than the growth deceleration of more than 4 percentage points that these economies suffered during the Great Recession of 2009. Most of these economies, especially the larger emerging economies, still have some policy space to mitigate the impact of medium-size external shocks through more expansionary fiscal and monetary measures, including by using some of their large foreign exchange reserves.

Under the baseline assumptions, output growth in developing countries and the economies in transition is expected to average 5.5 per cent for 2012, revised downward from the 6.2 per cent projected in the last LINK forecast of mid-2011, down from 6.1 per cent estimated for 2011 (see the section on regional outlook for the details about each region).

However, in a more pessimistic scenario in which disorderly unfolding of the debt crisis would push the major developed economies into a deep recession, the adverse impact on developing countries and the economies in transition likely will be disproportionally larger, alike the accelerated downturn of late 2008 and early 2009. The risks for such a worse case scenario to unfold are high (see the section below on downside risks).

Elevated unemployment remains a key policy concern in many economies

Three years after the start of the Great Recession, unemployment rates remain elevated in many economies.

The rate of unemployment rate stood at 8.3 per cent on average in developed countries in 2011, still well above the pre-crisis level of 5.8 per cent registered recorded in 2007. At more than 20 per cent, the rate remains highest in Spain, while Norway's jobless rate is the lowest at 3.5 per cent. Notably, in the United States the unemployment rate has remained over 9 per cent since 2009 with virtually no improvement in the labour market during 2011, as layoffs in the public sector partly offset job creation in the private sector and labour force growth has kept pace with overall employment growth.

In many developed economies, the actual situation is worse than portrayed by the official unemployment rates. In the United States, for instance, labour participation rates have been on a steady decline since the start of the crisis. Increasing numbers of workers without a job for a prolonged period have stopped looking for a job and are no longer counted as part of the labour force. About 29 per cent of the unemployed in the United States has been without a job for more than one year, up from 9 per cent in 2007. Such a prolonged duration of unemployment tends to have significant long-lasting detrimental impacts on both individuals who lost their jobs and on the broad economy in general. The skills of the unemployed workers would deteriorate along with the duration of their unemployment, most likely leading to lower earnings for these individuals who can find new jobs in the future. At the aggregate level, the higher the proportion of the workers entrapped in a protracted duration of unemployment, the larger the adverse impact would be felt on the productivity of the economy in the medium to long run.

In developing countries, the employment recovery has been much stronger than in developed economies. For instance, unemployment rates are back down to have fully to the pre-crisis levels or below in most Asian developing countries, while also in Latin America employment has recovered in most countries. However, developing countries continue to face major challenges of high shares of workers being underemployed, poorly paid, with vulnerable job conditions and lacking access to any form of social security At the same time, open unemployment rates remain high at well over 10 per cent, in particular in a number of African and Western Asian countries. Women and youth are most likely to face vulnerable working conditions or be without a job (see Box 2).

Box 2. Youth unemployment

Youth unemployment rates (for those aged between 15 and 24 years), tend to be higher than other cohorts of the labour force in normal times in most economies, but the global financial crisis and its subsequent global recession have disproportionally increased this gap. With a caveat on the imperfection of data, the average unemployment rate for youth in the world is estimated to have increased from 12 per cent in 2007 to 21 per cent by the end of 2010.

Youth unemployment has increased sharply in developed economies, reaching 19.8 per cent in 2011, higher than the rest of other cohorts. An astonishing 40 per cent of Spain's youth are without a job. Also in developing economies, youth unemployment has increased more than in other age groups. Latin America and the Caribbean experienced the largest increases in youth unemployment during 2010. The situation started to improve in the first half of 2011. In other regions, such as Western Asia, South and East Asia and Africa, young workers have a high probability of facing vulnerable employment conditions.

The skilled and unskilled young workers are affected by unemployment in different ways, particularly in developing countries. The skilled youth that lose their jobs tend to have greater difficulty in getting a new job than more experienced workers and hence tend to face longer periods of unemployment than other workers and when they do find new jobs they mostly have to settle for lower salaries than they earned before. Since entry salaries affect future salaries, youth who lost jobs during this financial crisis would face the risk of getting lower salaries for a long period in the future even when the economy recovers. This group of unemployed educated youth has recently received attention in the political debate as the "lost generation". Unskilled young workers who lost jobs recently have been found to be at greater risk of becoming "discouraged workers", exiting the labour force and ending up dependent on families and social programmes in the long term, especially in developed economies where there are such programmes. In developing economies, unskilled youth in unemployment would face the additional risk of a permanent loss of access to decent work, staying outside the formal economy and earning much lower life time earnings.

Government responses have varied, ranging from measures to address supply-side barriers for employment creation, aggregate demand stimuli as means to induce employment indirectly, and policies of direct job creation through public sector employment programmes. The impact of these measures on employment varies from country to country.

Inflation has edged up, but will moderate

Inflation has increased worldwide over the past year, driven by a number of factors, but in particular by supply-side shocks that have pushed up food and oil prices and strong demand in large developing economies driven by income and wage growth. Reflationary monetary policies in major developed economies are also exercising upward pressure.

Among developed economies, inflation rates in the United States and Europe have increased in the past year, moving from the lower bound to the upper bound of the inflation target band set by central banks. This increase is in line with the policy objective in these economies to mitigate the risk of deflation in the aftermath of the financial crisis, as these central banks continued injecting more liquidity into the economy through

various unconventional policy measures. In Japan, the disruption caused by the earthquake in March 2011, along with other factors, pushed up the general price level, putting –at least for now– an end to a protracted period of deflation. Nonetheless, in general, inflation should not be a major policy concern for most developed economies. Inflation is expected to moderate in the outlook for 2012-2013 with subdued output growth and wage pressures as unemployment stays high, as well as because commodity prices are expected to moderate, barring major supply shocks,.

Inflation rates surpassed policy targets by a large margin in a fair number of developing economies. Governments of these economies have responded with a variety of measures, including by tightening monetary policy, increasing subsidies on food and oil, and providing incentives to domestic production. In the outlook, along with an anticipated moderation in global commodity prices and lower global growth, inflation in most developing countries is expected to decelerate in 2012-2013.

3. The international economic environment for developing countries and the economies in transition

Sudden reversal in portfolio equity capital flows to emerging economies

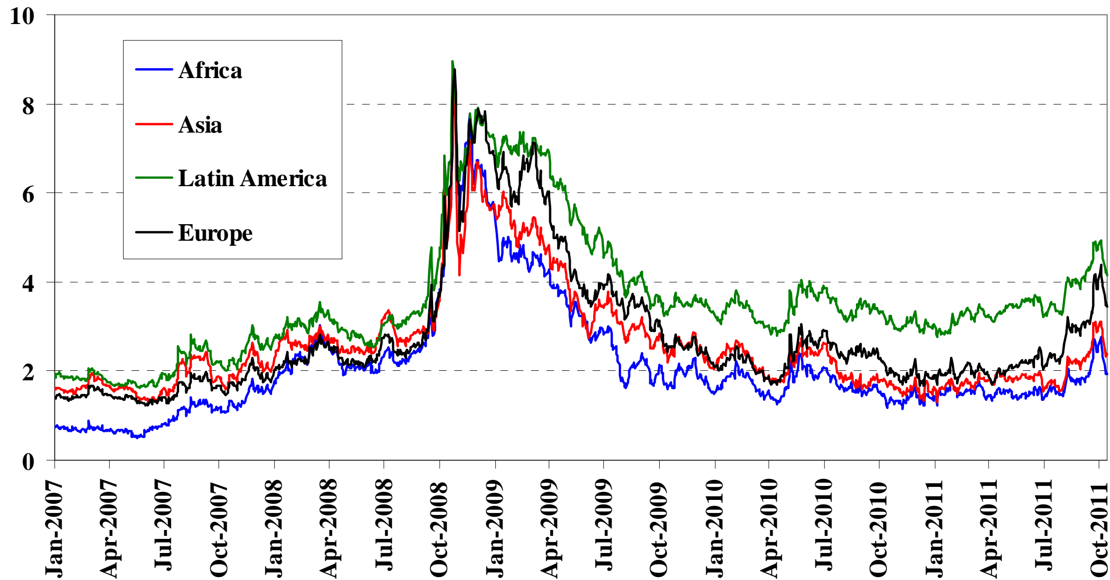
Amid a precipitous sell-off in equity markets worldwide in the second half of 2011, many emerging economies have experienced a sudden and sharp reversal of portfolio equity capital inflows. For example, the Morgan Stanley Capital International (MSCI) Emerging Markets Index dropped by about 23 per cent in the third quarter of 2011, and high-frequency indicators show that emerging market equity funds posted net capital outflows for nine consecutive weeks by the end of the same quarter.

Total net private capital inflows to emerging economies are estimated to reach about $1 trillion in 2011, almost the same as in 2010.[2] A continued recovery in the first half of 2011 from their precipitous decline during the global financial crisis of 2008-2009 was set back by a sharp deterioration in global financial market in the second half of the year. The current level is still about $200 billion below the pre-crisis peak registered in 2007 and the ratio of net capital inflows to GDP of these economies stands at about 4 per cent, about half of its peak level. In the outlook for 2012, the economic fundamentals for net capital inflows to most emerging economies will remain challenging. Continued sovereign debt distress in developed economies will sustain the present uncertainty and volatility in global financial markets and this likely will deter portfolio capital flows to emerging economies. This factor will be counteracted by the higher growth prospects for most emerging economies (despite the downgraded forecast) which will attract more foreign direct investment, while interest rates differentials will continue to favour lending

[2] The measurement of capital flows and the coverage of the emerging economies used here are the same as in Institute of International Finance "Capital flows to emerging market economies", September 25, 2011, but the projection of capital inflows for 2012 is made according to the global macroeconomic outlook of Project LINK.

to emerging economies even as the risk premiums for some of these economies may rise further, a trend already visible in the second half of 2011 (figure 2). On balance, net capital inflows to emerging economies may stay the same in 2012 though subject to volatility during the year.

Figure 2:
Daily yield spreads on emerging market bonds, January 2007-October 2011
(Percentage points)



Source: JP Morgan Chase.

Foreign direct investment (FDI) inflows remained the largest single component in 2011, increasing steadily to more than $400 billion or about 40 per cent of total private capital inflows. Asian emerging economies received most (about 45 per cent) of the FDI inflows, followed by Latin America. The surge in inflows of portfolio equity of the past two years came to an end and went into a tailspin in the second half of 2011. As a result, net inflows of portfolio equity to emerging economies are estimated to register a decline by about 50 per cent in 2011 from 2010 in a vivid proof of the high volatility that portfolio flows tend to be subject to.

Net debt inflows to emerging economies matched the size of net equity flows (direct and portfolio) in 2011. Net inflows of international bank lending to emerging economies continued to recover slowly from their sharp decline in 2009. Net lending to emerging markets recovered to only about 20 per cent of its pre-crisis peak level, as international banks headquartered in developed countries continue to struggle in the aftermath of the financial crisis, while conditions for domestic credit supply in emerging economies remain buoyant. In contrast, non-bank lending has recovered vigorously, as both private and public sectors in emerging economies managed to increase issuance of bonds by taking advantage of low interest rates in global capital markets.

Net capital exports from emerging economies totalled more than $1.4 trillion in 2011. Net private capital outflows are estimated to reach about $550 billion. China and a few other Asian developing countries further increased FDI in Latin America and Africa, primarily destined towards sectors producing oil, gas and other primary commodities.

The remainder of the capital outflows consists of increased accumulation of foreign exchange reserves. In 2011, emerging economies and other developing countries are estimated to have accumulated an additional $900 billion in foreign-exchange reserves to a total of about $7 trillion.

Net disbursements of official development assistance (ODA) reached a record high of $128.7 billion in 2010. Despite the record level, the amount of aid fell well short (by more than $20 billion) of the Gleneagles commitments made by the members of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) to increase aid to low-income countries. Total ODA increased by 6.5 per cent in real terms in 2010, but donor surveys the OECD suggest that bilateral aid from DAC members to core development programmes in developing countries will grow at a mere 1.3 per cent per year during 2011-2013 owing to the fiscal constraints of donors. At the current rate of progress, donors will not fully deliver on their commitments any time soon and will remain far from the long-standing United Nations target of providing 0.7 per cent of their gross national income (GNI) by 2015.

A dip in the upward trend in commodity prices

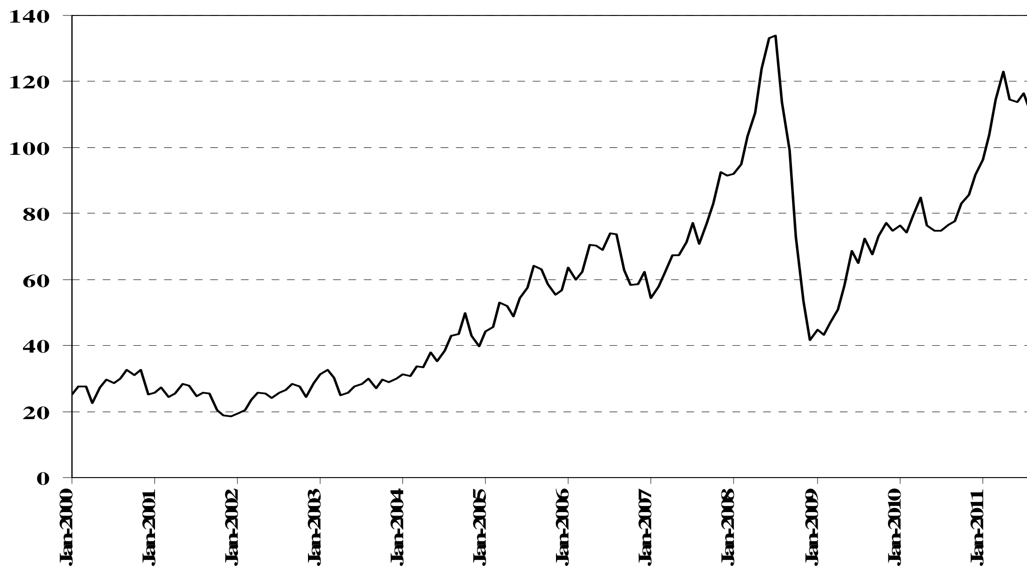
International prices of oil and other primary commodities continued to rise in early 2011, but declined sharply in the third quarter of 2011. The pattern resembles that of 2008, but the reversal has not been as drastic this time. Nonetheless, average price levels of most commodities for 2011 remained well above (by between 20 and 30 per cent) those in 2010 (figures 3 and 4). The reversals since mid-2011 have been driven by two key factors: weaker global demand for commodities resulting from bleaker prospects for the world economy and the sell-off in markets for financial commodity derivatives that occurred in sync with the downturn in global equity markets. In the outlook, the prices of most primary commodities are expected to moderate by about 10 per cent in both 2012 and 2013, consistent with the LINK forecast of weaker global economic growth. Commodity price volatility will continue to remain high.

Oil prices (measured by Brent) averaged $111 per barrel (p/b) in the first half of 2011, compared with an average of $79 for 2010 as a whole. The surge was mainly driven by the political unrest in North Africa and Western Asia, which caused disruptions in oil production, especially in Libya. However, oil prices dropped sharply in the third quarter of 2011, amidst weakening global demand, the anticipated resumption of oil production in Libya, as well as a rebound of the exchange rate of the United States dollar.

During the first half of 2011, global oil demand increased by 1.6 per cent compared with the same period in 2010. Anaemic output growth in major developed

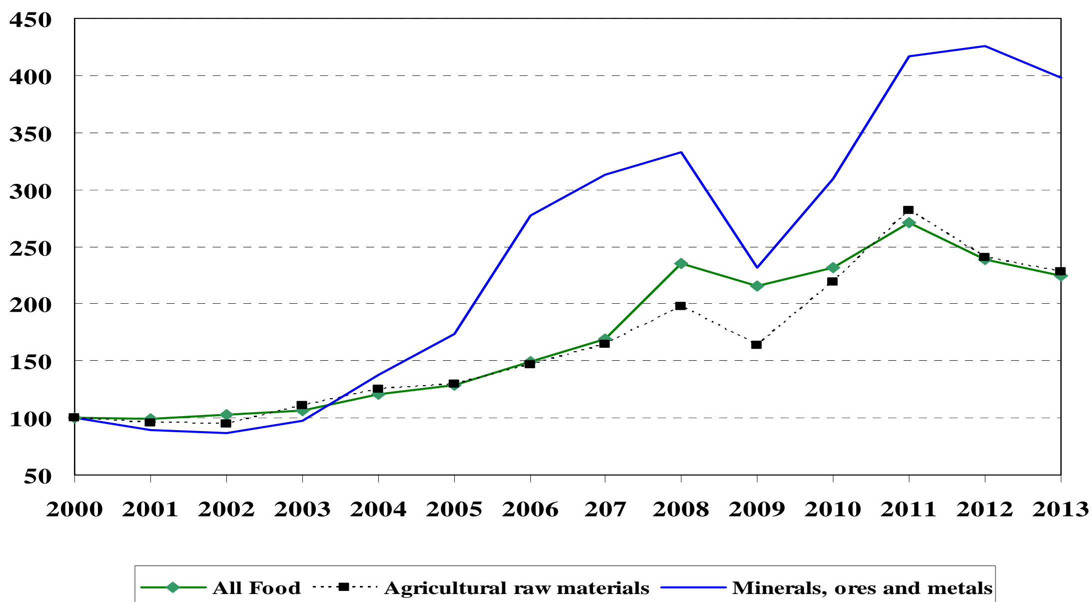
economies caused a 0.5 per cent decline in oil demand from the OECD countries, which was offset by a 4 per cent increase in the demand from emerging economies, particularly China and India. The share of non-OECD countries in global oil demand reached 48.8 per cent in 2011 and is expected to hit the 50 per cent mark in 2012.

Figure 3: Brent oil price, January 2000 - September 2011
(dollar per barrel)



Source: UN/DESA

Figure 4: Non-oil commodity price index (2000=100), 2000-2013



Source: UN/DESA

On the supply side, the Organization of the Petroleum Exporting Countries (OPEC) is estimated to have increased its production of oil by 0.35 million barrels per day (mb/d) in the first half of 2011. To compensate for the production losses in Libya, Saudi Arabia activated its spare capacity and raised supply by almost 1 mb/d above its average level in 2010. Total supply of oil by non-OPEC countries is estimated to have increased by 0.3 per cent in 2011.

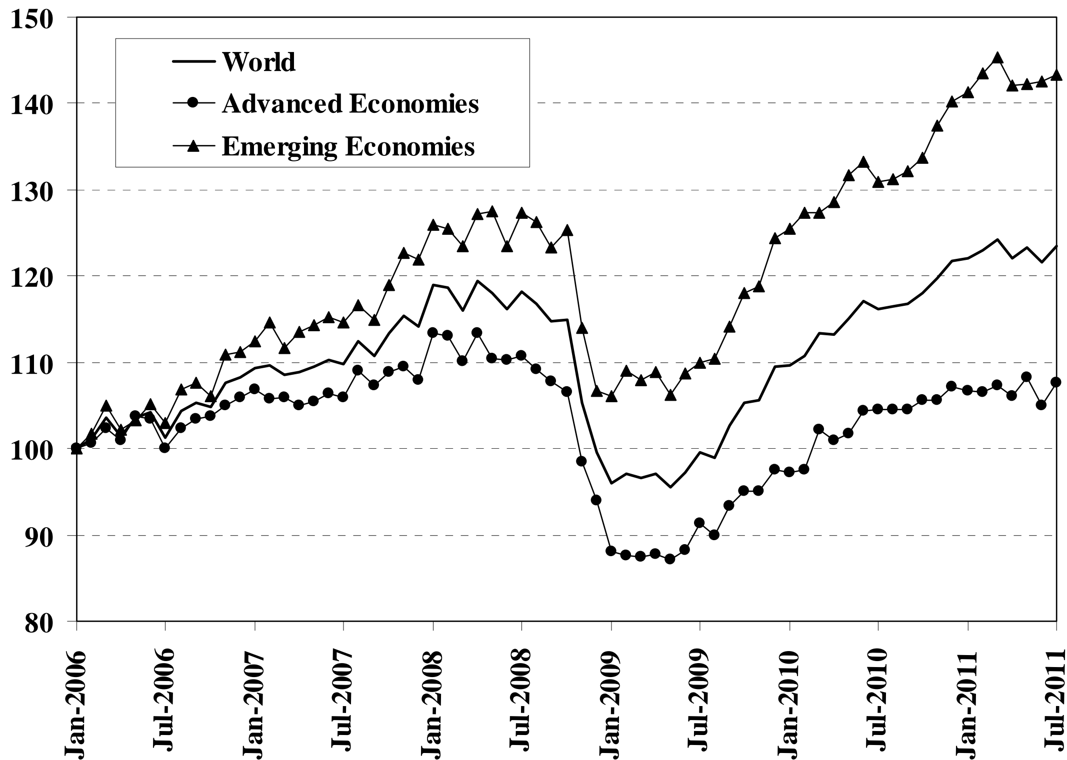
Oil stocks in the OECD countries decreased slightly in the first half of 2011, and in June the International Energy Agency (IEA) further decided to proceed to a coordinated release of 60 mb of strategic stocks for 30 days.

In the outlook for 2012, global oil demand is expected to weaken because of slower economic growth in developed countries. Yet, total demand is expected to continue to increase because of rising energy needs of developing countries. Global demand might even strengthen somewhat owing to the build-up of strategic stocks in Asia and restocking of oil inventories by the IEA members. Oil production is expected to resume progressively in Libya, while Saudi Arabia may keep its production at the current level. However, the continued geopolitical instability in North Africa and Western Asia is likely to keep the risk premium on oil prices up. All considered, the Brent oil price is expected to decline by 6 per cent in 2012 from 2011, and stay flat (on average) at about \$100 p/b in 2013. Having said this, price uncertainty and volatility will remain high, including because of the influence of financial factors, such as fluctuations in the value of the United States dollar and unpredictable trends in financial derivatives trading in commodities markets.

Moderating growth of world trade

World trade continued to recover in 2011, but at a much slower pace than in 2010. After a strong rebound of more than 14 per cent in 2010, the volume of world exports in goods is estimated to increase only by about 7 per cent in 2011 (figure 5). The level of world total exports had fully recovered to the pre-crisis peak by the end of 2010, but it remained below its long-term trend even by the end of 2011. As has been the case with the recovery of WGP, developing countries, particularly Asian economies with large shares in the trade of manufactured goods, led the recovery. While the level of trade in volume terms has already far surpassed the pre-crisis peak for developing countries as a group, the trade volume of developed economies is yet to fully recover from the global crisis. Commodity-exporting developing countries have experienced a strong recovery in the value of their exports, owing to the upturn in commodity prices, but saw little growth of export volumes. In the outlook, the volume growth of world trade is expected to moderate to about 4-5 per cent in 2012-2013. The dichotomy between a robust growth in trade in emerging economies and a weak one in developed economies will continue.

Figure 5:
World merchandise exports volume, January 2006 – July 2011
(Index, January 2006 = 100)

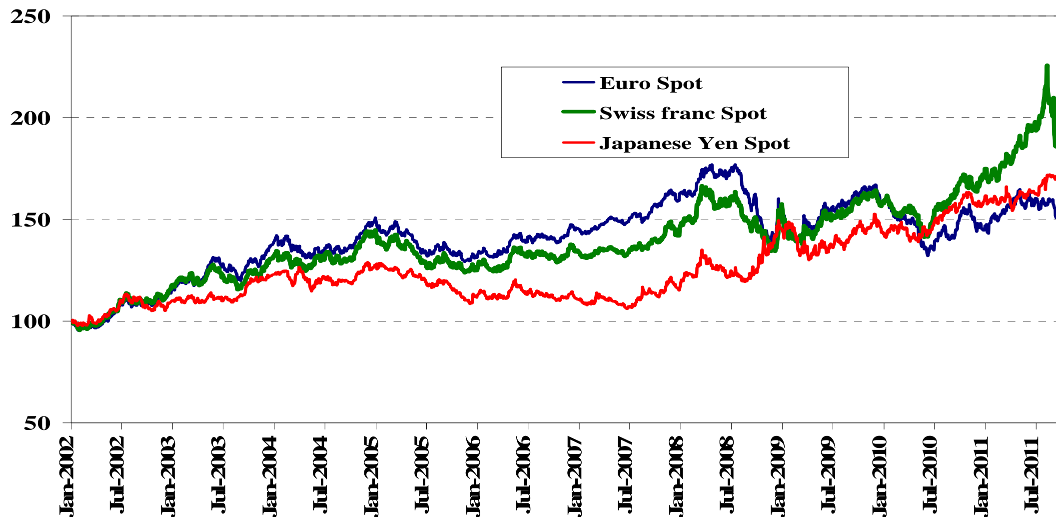


Source: CPB Netherlands Bureau for Economic Policy Analysis, re-based by UN/DESA

Increased volatility in exchange rates

Exchange rates among major international reserve currencies, namely, the United States dollar, euro and Japanese yen, continued to display large fluctuations during 2011 (figure 6), driven by multiple factors. Developing countries also witnessed greater exchange rate volatility. The dollar continued its downward trend against other major currencies in the first half of the year, but rebounded notably against the euro in the third quarter, when concerns about the sovereign debt crisis in the euro area intensified. Over the year as a whole, the Japanese yen appreciated against both the dollar and the euro, despite interventions by the Bank of Japan to curb the appreciation. Among other currencies in developed economies, the Swiss franc appreciated the most in the first half of the year, as a result of flight to safety, leading to the decision of the Swiss authorities not to tolerate any strengthening of the exchange rate below SF1.20 per euro.

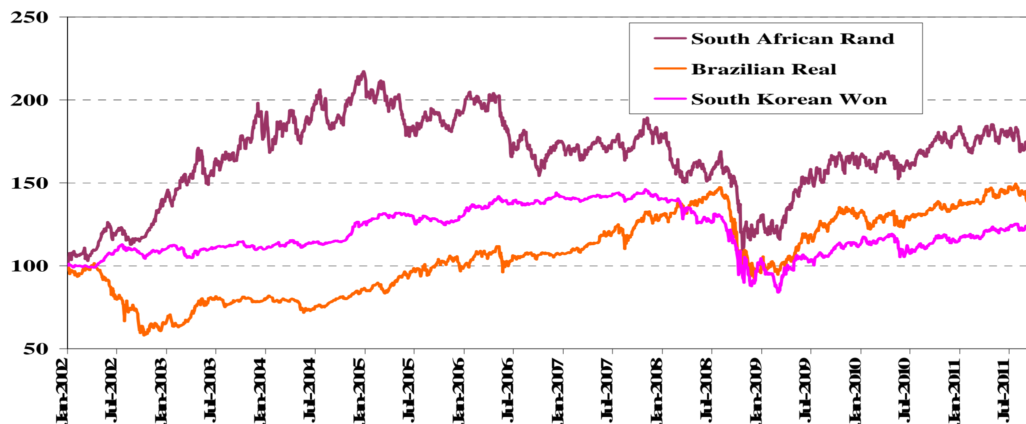
Figure 6: Exchange rate index of major currencies



Source: JPMorgan Chase

Stronger economic performance and strong capital inflows led to an appreciation of the currencies of most emerging economies over the past two years. This trend went into a tailspin with the heightened turbulence in global financial markets from mid-2011 (figure 7). For instance, Brazil's real fell 16 per cent against the United States dollar in the third quarter, while the Russian rouble and the South African rand depreciated by, respectively, 15 and 19 per cent. A more detailed analysis of recent exchange rate movements can be found in Box 3.

Figure 7: Exchange rates of selected emerging economies



Source: JPMorgan Chase

Box 3. Recent exchange rate volatility and policy implications

Despite the pronounced flight into the dollar in a bout of market panic in September 2011, the trend for many currencies remains to be an appreciation against the dollar since the beginning of 2009. For currencies in many emerging economies, such as Brazil, South Africa, the Republic of Korea, Indonesia and Thailand, the appreciation trends since 2009 partially reflected a retracing of the depreciation that occurred during the apex of the global financial crisis in 2008, while the Chinese renminbi has been on a managed gradual appreciation trend ever since 2005. Among the three major reserve currencies, the dollar largely remained under pressure against the euro and the yen, accompanied by phases of notably higher volatility. The currencies of Switzerland and, to a lesser degree, Sweden and Norway also experienced appreciation pressures against the dollar and euro, reflecting a heightened degree of risk aversion of investors and flight into perceived safe assets.

Sovereign debt distress in developed economies and, in a broader context, the concerns about institutional credibility have become key driving forces in the current episode of currency movements. In the United Sates, the political wrangling over the debt ceiling has damaged market confidence. In the euro area, the lack of policy direction and coherence in dealing with sovereign debt problems has had a similar effect. On a slightly different track, but fundamentally in the same vain, the United Kingdom has suffered its own version of a credibility crisis with the continued failure of the central bank to achieve its inflation target. This metamorphosis of policy failure and institutional weaknesses has been the key factor behind the depreciation pressure on the dollar and the euro, as well as the volatility in the exchange rates among major currencies.

In the case of emerging economies, another significant driving force for the appreciation trend has been the growth differential between these economies and developed countries, along with the associated increases in capital inflows to these economies. The high interest rate differentials between emerging economies and the developed countries, as well as the quantitative easing adopted by the latter, also contributed to the appreciation. The “carry trade” effect also applies to appreciation of Australia currency, at least before mid-2011. Another factor for the appreciation of currencies in a number of commodity-exporting countries has been the upward trend in commodity prices.

The higher relative value, in terms of trends, of their currencies poses a challenge for many developing countries and some of the European countries by reducing the competitiveness of their respective export sectors. While domestic demand has been taking on a more significant role as a driver of growth on the back of rising incomes in many of the emerging economies, a forced and premature shift away from an export-led growth model due to pronounced and sustained currency appreciation might create significant dislocations, especially in labour markets in the form of a spike in unemployment. Stronger currencies help on the import side to reduce inflation, but this advantage could be more than offset by the social costs of higher unemployment rates.

An additional problem tied to sustained exchange rate trends lies in an increased probability of sudden trend reversals, as happened in the third quarter of 2011. Contrary to many fundamental factors, virtual panic about the debt problems in Europe and the possibility of a global recession set off a flight into the dollar, which again confirmed its role as the safe-haven currency of last resort in situations of extreme market stress. Emerging market currencies that had experienced sustained appreciation pressure suffered a precipitous fall in their values in a very short time span, illustrating the unpredictable nature of developments in currency markets.

Meanwhile, the increased volatility in a number of currencies injected an additional element of uncertainty into currency markets and created significant feed-through effects into the real economy. As companies face greater difficulties in pricing their products and anticipating their costs, business planning becomes more uncertain, underpinning a generally more cautious approach that also includes an even greater reluctance in hiring new employees.

A number of countries have already taken measures to address the challenges posed by the appreciation pressure. The Swiss National Bank stated that it will defend the Swiss franc against any appreciation to a rate of less than 1.20 Swiss francs to the euro. The immediate effect was a convergence of the exchange rate to the desired level, but questions regarding the sustained effectiveness and risks of this policy measure remain. Rising foreign currency reserves increasingly subject the central bank to the vagaries of the euro and dollar bond markets. In addition, shutting the pressure valve on the Swiss franc increases investors' focus on the remaining perceived safe-haven currencies such as those of Japan, Sweden and Norway.

Among emerging markets, Brazil reacted to its appreciating currency by cutting its policy interest rate, reducing the favourable interest rate spread over other currencies and, thereby, also the relative profitability of capital allocations into its currency. However, the still-elevated inflation rate complicates policy making, as policy makers need to judge whether the combined impact of policy interest rates and the prevailing exchange rate level is adequate with respect to ensuring price stability. In the Republic of Korea, policymakers took a series of measures to contain the impact of capital inflows on currency appreciation and volatility. In addition to reintroducing a capital gains tax on Korean government bonds, government authorities have also imposed a macro-prudential levy on banks' non-deposit foreign-currency liabilities.

At the multilateral level, concerted actions by the major central banks to provide liquidity to commercial banks in the euro area helped to dampen at least for the time being market fears regarding a possible liquidity squeeze.

Uncertainties and risks

Risk of a double-dip global recession triggered by problems in major developed economies

The most acute risk for the global economy in the outlook for 2012-2013 is the possible policy failure in developed economies of Europe and the United States. This could trigger a global recession. These economies are at the brink of entering into a vicious circle of four mutually reinforcing weaknesses: sovereign debt distress, fragile banking sector, weak demand (associated with high unemployment), and policy paralysis caused by political gridlock and institutional deficiencies.

The baseline forecast assumes that the euro area will be able to come up with enough political consensus and financial resources to contain Greece's debt crisis. Even as a default seems inevitable, the baseline assumes there will be an orderly workout, with adequate measures put in place to recapitalize European banks and to prevent contagion of a Greek default on other economies. For the United States, the baseline assumes that the Government will put in place a policy package that will provide some minor stimulus in the short run, while cutting government spending and increasing taxes over the medium run. In both cases, it is assumed that policies will be adequate for these economies to "muddle through" in the short run, but insufficient to catapult a robust economic recovery.

However, given the serious challenges these economies are facing and given the political gridlock and the institutional weaknesses that were exposed during 2011, the risk is high that these relatively benign baseline assumptions will prove to be overly optimistic. Critically, it is well possible that policy makers in the euro area will not come to an orderly solution of the sovereign debt crisis in Greece if they fail to galvanize enough political will and financial support for a bail out. A contained Greek default would afflict controllable damage to the banking sector and limit contagion to other economies in the region. A disorderly default, however, could wreck havoc in the region and beyond. A large number of banks in the area would suffer huge losses, leading to a credit crunch and collapse of financial markets in a déjà vu of the collapse of Lehman Brothers Inc. in late 2008. Such a financial meltdown would no doubt lead to a deep recession, not only in those economies in sovereign debt distress, but in all other major economies in the area and with the intensity of the downturn in late 2008 and early 2009.

The political wrangling in the United States may worsen and could harm economic growth if leading to severe fiscal austerity coming into effect immediately. This would push up unemployment to new highs, further depress the already much-rattled confidence among households and businesses, and exacerbate the beleaguered housing market to lead to more foreclosures, which in turn would put the banking sector at risk again. The economy would fall into another recession. If this were to occur, the United States Federal Reserve might adopt more aggressive monetary measures, for example through another round of quantitative easing, but in a depressed economy with

highly risk-adverse agents this may have even less effect in terms of boosting economic growth than the measures taken in previous years.

A recession in either Europe or the United States may not be enough to induce a global recession, but if both economies go under it most likely will. Table 2 illustrates such as scenario.

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Table 2. An alternative scenario for the world economy

	Downside scenario			Deviation from baseline	
GDP growth rate (%)	2011	2012	2013	2012	2013
World	2.8	0.6	2.3	-2.1	-1.0
Developed economies	1.4	-0.8	1.3	-2.1	-0.8
USA	1.7	-0.8	1.5	-2.3	-0.9
Japan	-0.5	0.5	1.2	-1.5	-0.8
European Union	1.6	-1.5	1.0	-2.3	-0.6
Economies in transition	4.2	1.3	3.6	-2.5	-0.9
South-eastern Europe	1.8	1.2	2.8	-1.5	-0.5
CIS and Georgia	4.4	1.4	3.7	-2.6	-0.9
Developing economies	6.1	3.6	4.5	-1.9	-1.4
Africa	2.9	3.2	3.4	-1.8	-1.8
East and South Asia	7.1	5.4	5.7	-1.4	-1.2
Western Asia	6.7	1.1	2.5	-2.7	-1.8
Latin America and the Caribbean	4.2	0.4	2.3	-2.8	-1.8
LDC	5.2	4.1	3.9	-1.8	-1.8

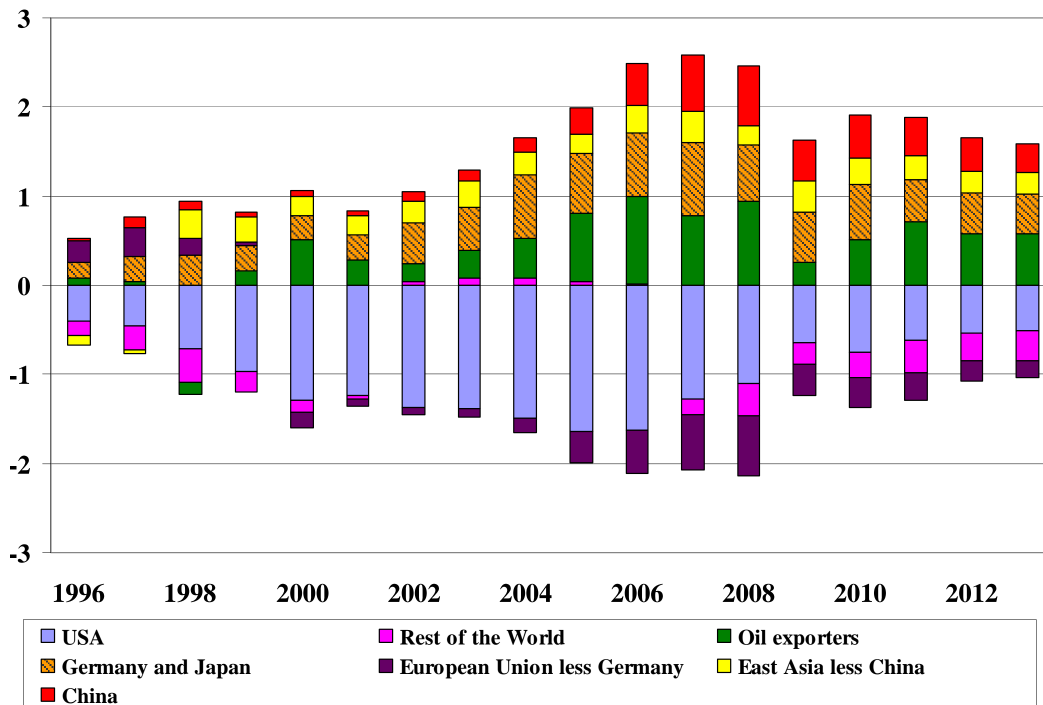
Source: UN/DESA

Uncertainties associated with the global imbalances

After a substantially narrowing during the Great Recession, relative to GDP, the *global imbalances*, that is the wide current account imbalances across major economies, stabilized at about half of their pre-crisis peak levels during 2010-2011 (figure 8). The United States remained the largest deficit economy, with an estimated external deficit of about $450 billion (3 per cent of GDP) in 2011, but the deficit has come down substantially from its peak of $800 billion (6 per cent of GDP) registered in 2006. The external surpluses in China, Germany, Japan and a group of fuel-exporting countries, which form the counterpart to the United States deficit, have narrowed, albeit in varying degree. China, for instance, is estimated to register a surplus of about $250 billion (less than 4 per cent of GDP) in 2011, dropping from a high of 10 per cent of GDP in 2007. Japan is estimated to register a surplus of 2.5 per cent of GDP in 2011, a reduction of one percentage point of GDP compared with the level in 2010, and it is about half the size of

its peak level reached in 2007. While Germany's surplus remained about 5 per cent of GDP in 2011, the current account for the euro area as a whole was virtually in balance. Large surpluses, relative to GDP, were still found in oil-exporting countries, reaching 20 per cent of GDP or more in some of the oil-exporting countries in Western Asia.

Figure 8.
Global imbalances, 1996-2013
(Current account balances in per cent of world gross product, WGP)



Source: IMF *World Economic Outlook* database, September 2011 for historical data, and Project LINK for the forecasts in 2011-2013.

At issue is whether the adjustment of the imbalances in major economies has been mainly a cyclical or structural. In the United States, some of the corresponding adjustment in the domestic saving-investment gap seems to be structural. For example, the household saving rate increased from about 2 per cent of disposable household income before the financial crisis to about 5 per cent in the past few years. It is likely that the saving rate will stay at this level in the coming years, given the changes that have taken place in house financing and the banking sector after the financial crisis. On the other hand, a significant decline in the business investment rate and a surge in the government deficit in the aftermath of the financial crisis are more likely to be cyclical. Business investment has been recovering slowly, while the budget deficit is expected to come down somewhat. As a result, the external deficit of the United States may stabilize around 3 per cent of GDP in the medium run in the baseline scenario.

In the surplus countries, the decline in the external surplus of China has also been driven in part by structural change. China's exchange rate policy has become more flexible, with the renminbi appreciating gradually but steadily vis-à-vis the United States dollar over the past year.[3] Meanwhile, the government has scaled up measures to boost household consumption, aligning the goal of reducing China's external surplus with that of rebalancing the structure of the economy towards greater reliance on domestic demand. The process of rebalancing can, however, only be gradual over the medium to long run for it not to be disruptive. In Japan, a continued appreciation of the yen has kept lid on its external surplus. In Germany, room remains for policies to stimulate more domestic demand so as to further narrow its external surplus. The surpluses in oil-exporting countries are of a quite different nature from other economies, as these countries would need to share the wealth generated by the endowment of oil with future generations via a continued accumulation of the surplus in the foreseeable future.

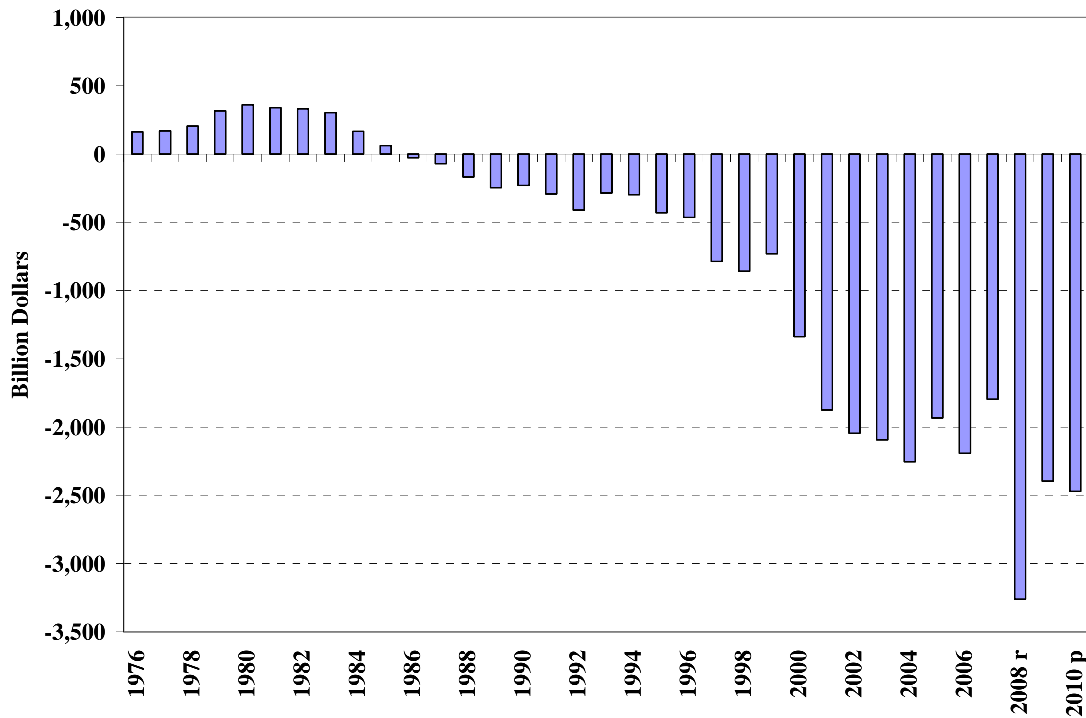
The net external liability position of the United States seems to have also stabilized at about $2.5 trillion (17 per cent of GDP) over the past two years (figure 9), down from its peak of $3.3 trillion (23 per cent of GDP) in 2008. The foreign assets owned by the United States totalled about $20 trillion by the end of 2010, an increase of about $0.5 trillion (after valuation changes) from 2008. Assets in the United States owned by the rest of the world totalled more than $22 trillion in 2010, about the same as the value recorded in 2008. The composition of external assets owned by the United States differs from that of its external liabilities. Assets mainly comprise holdings of foreign private equities, while holdings by foreigners of United States government debt dominate the liability composition. The value of overseas equity holdings (direct investment plus portfolio equities) owned by the United States total about $9 trillion, nearly twice the amount of private equity owned by the rest of the world in the United States. On the other hand, Governments of other countries have invested about $4 trillion of their official foreign exchange reserves in United States Treasury bills In contrast, the United States' holdings of official foreign reserves, including the SDR, amount to a mere $0.1 trillion.

As a result of differences in yields on different types asset and liability holdings, the United States received $658 billion in investment income on assets held abroad, but had to pay only $484 billion in returns on United States assets owned by foreigners, despite the nation's vast net international liability position

At current trends, the global imbalances are not expected to widen by a significant margin in the coming two years to become an imminent treat to the stability of the global economy. Should the global economy fall into another recession, the imbalances could narrow further, though not in a benign way.

[3] The renminbi has appreciated by about 30 per cent against the dollar after China abandoned the peg to the dollar in 2005.

Figure 9: Net International Investment position of the United States



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

Policy challenges

During 2011, macroeconomic policies in most developed economies were characterized by a combination of extremely loose monetary policy stance and shifts towards fiscal austerity. Central banks of the United States, the euro area and Japan all maintained their policy interest rates at low levels (table 2), and expanded the size of their balance sheets to inject more liquidity through various unconventional monetary measures. The fiscal policy stance in most developed economies was tightened through austerity measures, inducing a drain on GDP growth. Macroeconomic policy in developing economies, in contrast, showed a great variety across countries. Monetary tightening in efforts to stem inflation was perhaps the more common feature among major emerging economies. In general, developing countries possess stronger fiscal positions than most developed economies.

Table 3: Timeline of policy interest rate action for selected monetary authorities
(as of 14 October 2011)

	Official interest rate	Last change		Current (%)	Change since (bp)	
		Date	Change		Peak[b]	Trough[b]
Australia	Cash rate	2 November 2010	+25bp	4.75	-250	175
Brazil	SELIC overnight rate	31 August 2011	-50bp	12.00	-775	325
Canada	Overnight funding rate	8 September 2010	+25bp	1.00	-350	75
Chile	Discount rate	14 June 2011	+25bp	5.25	-300	475
China	1-year working capital	6 July 2011	+25bp	6.56	-91	125
Colombia	Repo rate	29 July 2011	+25bp	4.50	-550	150
Czech Republic	2-week repo rate	6 May 2010	-25bp	0.75	-300	0
Euro area	Refi rate	7 July 2011	+25bp	1.50	-275	50
Hong Kong, SAR[a]	Discount window base	17 December 2008	-100bp	0.50	-625	0
Hungary	2-week deposit rate	24 January 2011	+25bp	6.00	-500	75
India	Repo rate	16 September 2011	+25bp	8.25	-75	350
Indonesia	BI rate	11 October 2011	-25bp	6.50	-625	0
Israel	Base rate	26 September 2011	-25bp	3.00	-250	250
Japan	Overnight call rate	5 October 2010	-5bp	0.05	-47	0
Korea	Base rate	10 June 2011	+25bp	3.25	-200	125
Malaysia	Overnight policy rate	5 May 2011	+25bp	3.00	-50	100
Mexico	Repo rate	17 July 2009	-25bp	4.50	-525	0
New Zealand	Cash rate	10 March 2011	-50bp	2.50	-575	0
Norway	Deposit rate	12 May 2011	+25bp	2.25	-350	100
Peru	Reference rate	12 May 2011	+25bp	4.25	-225	300
Philippines	Reverse repo rate	5 May 2011	+25bp	4.50	-300	50
Poland	7-day intervention rate	8 June 2011	+25bp	4.50	-200	100
Romania	Base rate	4 May 10	-25bp	6.25	-400	0
Russia	Overnight deposit rate	14 September 2011	+25bp	3.75	-350	100
South Africa	Repo rate	18 November 2010	-50bp	5.50	-650	0
Sweden	Repo rate	5 July 2011	+25bp	2.00	-275	175
Taiwan, Province of China	Official discount rate	30 June 2011	+12.5bp	1.875	-175	62.5
Thailand	1-day repo rate	24 August 2011	+25bp	3.50	-150	225
Turkey	1-week deposit rate	4 August 2011	-50bp	5.75	-1175	0
United Kingdom	Bank rate	5 March 2009	-50bp	0.50	-525	0
United States	Federal funds rate	16 December 2008	-87.5bp	0.125	-513	0

Source: UN/DESA based on data of JPMorgan.
a Special Administrative Region of China.
b Refers to peak rate between 2007-08 and trough rate from 2009 to present.

Fiscal policy in developed economies is challenged by major economic and political obstacles. Overcoming those challenges holds the key to the economic prospects not only for these countries as much as for the world as a whole.

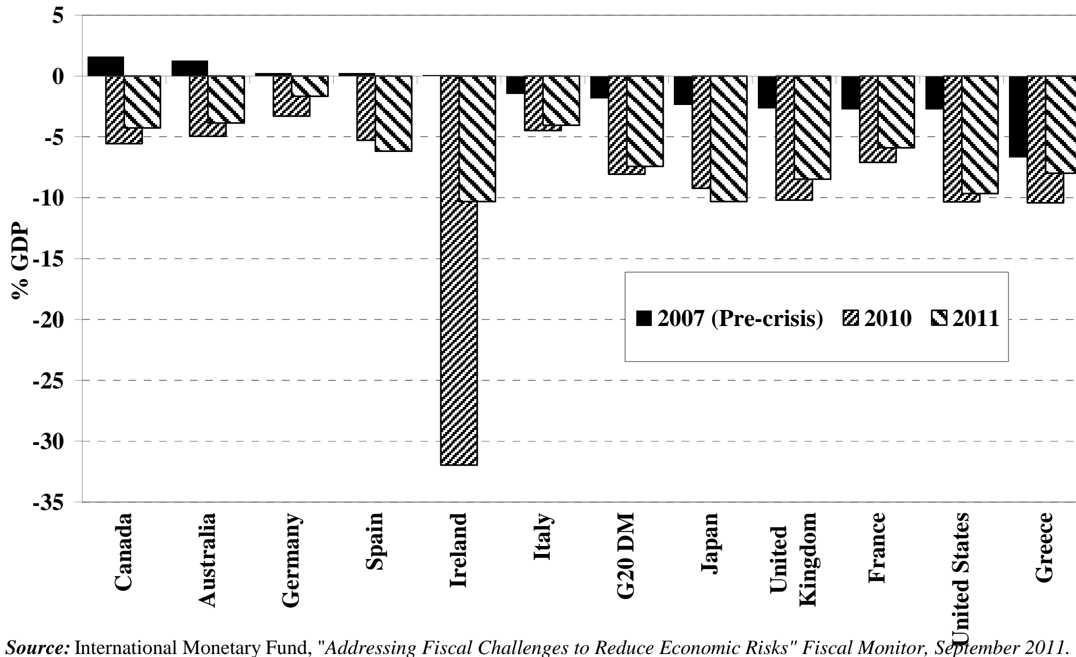
Fiscal policy challenges in major developed economies

The large fiscal imbalances many developed economies encountered in the aftermath of the global financial crisis have been reduced since 2010, thanks to the economic recovery and policies of fiscal consolidation. The prospects for further improvement are uncertain as the economic outlook for 2012 has dimmed. A few developed economies registered budget surpluses, such as Norway, Sweden, and Switzerland, but many others remained in deficit. Yet, only Japan experienced a substantial widening of its fiscal deficit during 2011. The earthquake of March pushed the deficit to above 10 per cent of GDP. In the euro area, budget deficits dropped on average by an estimated 1.7 percentage points in 2011, while that of the United States fell by a bit less than one percentage point.

Public indebtedness continued to increase in most developed economies. In the euro area, the ratio of public debt to GDP increased by more than 2 percentage points in 2011, towards 90 per cent. In Greece, the ratio increased by more than 20 percentage points to almost 190 per cent of GDP. Iceland, Ireland and Portugal also experienced substantial increases of about 5 percentage points. In these economies, as well as in Italy, public debt now exceeds 100 per cent of GDP. In the United States, public debt increased by 5 percentage points, also surpassing the mark of 100 per cent of GDP. In Japan, the public debt ratio surged another 13 points to near 240 per cent of GDP (see figures 10 and 11).

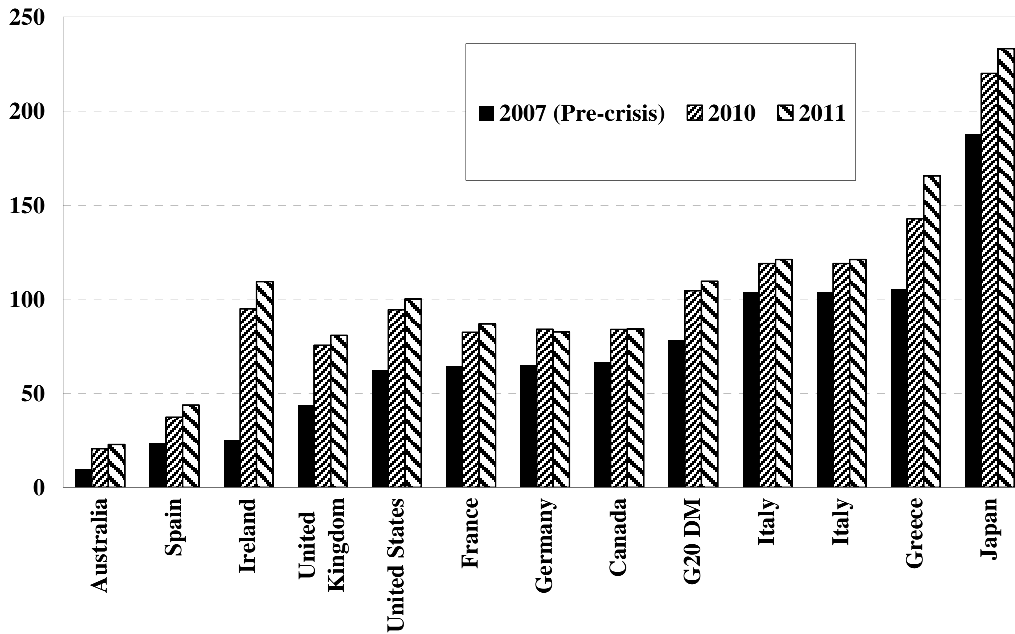
However, a high ratio of debt to GDP alone does not necessarily imply that debt is unsustainable. Debt sustainability depends on a number of factors. For instance, countries that have significant levels of debt with shorter maturities have a more pressing need to roll over their funding needs, making them more vulnerable to short-term events. Similarly, a high proportion of externally held debt may increase vulnerability as foreign investors are more likely to liquidate holdings than domestic investors. This may explain in part why Japan, where less than 5 per cent of government debt is held by non-residents, has been able to maintain levels of public debt that far exceed those in any other developed country. In contrast, more than three-quarters of Greece's public debt is held by non-residents. Meanwhile, domestic saving rates, the current account balance, potential GDP growth, as well as monetary policy and exchange rate regime, would also be important in determining debt sustainability for a specific country. Capital markets appear to differentiate risks among these economies, suggesting investors do not exclusively consider debt-to-GDP ratios. Risk premiums have gone up for Greece and a few other European economies (see figure 12), but not so for Japan, the United States, and some other highly indebted rich countries that continue to enjoy low borrowing costs.

Figure 10. Fiscal deficit of selected developed economies, 2007 - 2011



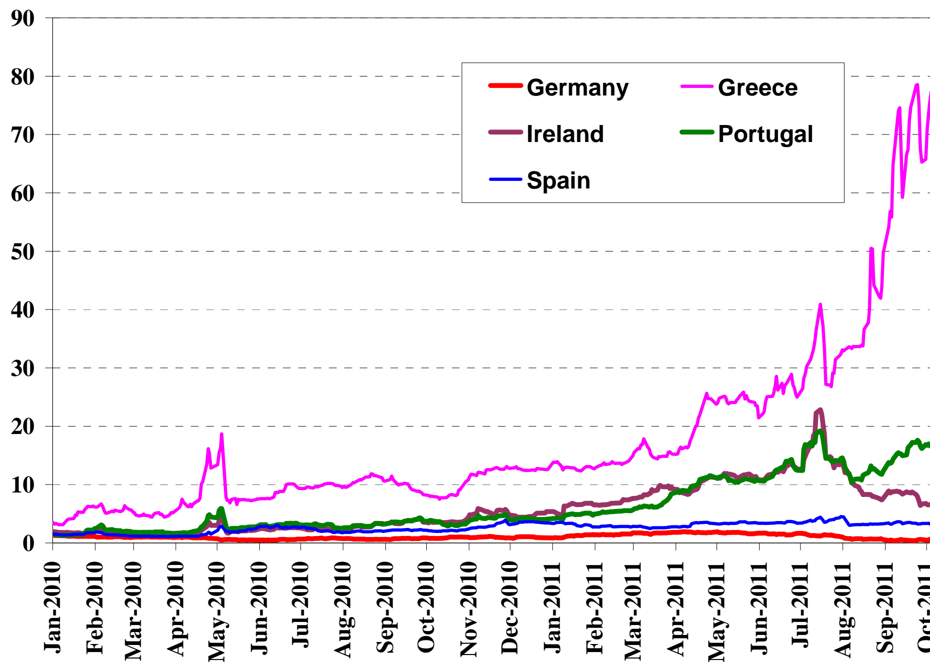
Source: International Monetary Fund, "*Addressing Fiscal Challenges to Reduce Economic Risks" Fiscal Monitor, September 2011.*

Figure 11. Public debt in a group of selected developed economies (per cent of GDP)



Source: International Monetary Fund, *"Addressing Fiscal Challenges to Reduce Economic Risks" Fiscal Monitor* , September 2011.

Figure 12. Yields on two year government bonds



Source: JPMorgan

Where borrowing costs have increased, the pressure for deficit reduction has also increased. Much of the political debate, especially in Europe, has become narrowly focused on fiscal consolidation through austerity measures. Such an approach may not work. With high unemployment and weak private demand, a premature fiscal tightening may derail the fragile recovery, and thus lead to further worsening of fiscal balances. Fiscal austerity measures that are being implemented in a number of developed countries would need to be reviewed and redesigned such that renewed stimulus emerges directly (by increasing aggregate demand) and/or indirectly (by incentives to create jobs, promote structural change and boost private investment). A stronger recovery emerging this way will ease fiscal consolidation over the medium run (see box 4).

Box 4. A "J" curve shaped fiscal adjustment?

Two years after the Great Recession, fiscal policy in many developed economies is facing dual challenges: a need for preventing a double-dip recession as the economic recovery falters and a need for safeguarding the fiscal sustainability in the long run. For the few European economies where the debt situation has grown beyond limits of continued financing in capital markets, they probably have not much leeway other than frontload austerity measures. Other developed economies, however, where the cost of financing public debt remains low, have more space to implement a fiscal framework that allows for more stimulus in the short run to bolster the economic recovery run and would aim to bring public debt to more sustainable levels over the long run. This box postulates a

possible trajectory of "J" curve for fiscal balance in some developed economies and discusses some conditions for such a policy option.

In the context presently faced by many developed economies of a large fiscal deficit, below-potential growth and elevated unemployment, in particular, substantial cuts in government spending and increases in taxes may or may not be able to reduce the deficit, but certainly will harm GDP growth, at least in the short run. In a worse case scenario, the economy may be triggered into a downward spiral along with a continued worsening in fiscal balance, leading eventually to a debt default. Even in a more benign scenario in which a double-dip recession is avoided, economic growth may stay below potential for a prolonged period, thus keeping up unemployment. In this case, government revenue will not recover sufficiently and the large budget deficit will linger and public debt will continue to rise.

There are better policy options, at least for some developed economies. In economies with low financing costs in capital markets, Governments have policy space to sustain or enhance deficit-financed fiscal stimulus until GDP growth reaches a point at which unemployment rates fall visibly. In this case, the fiscal deficit would be allowed to deteriorate further for another few years. More robust GDP and employment growth will boost government revenues, facilitating swifter and less harmful budget deficit reduction. Further structural fiscal reforms may be put into place thereafter, if needed, to gradually reduce the public debt-to-GDP ratio. In this process, the fiscal balance would evolve in the shape of a "J" curve: worsening first and strongly improve subsequently.

The feasibility to achieve such a "J" curve depends on a number of economic conditions. One that needs to be satisfied is that the fiscal multiplier in the economy is greater than 1, meaning that an increase of one dollar in government spending generates an increase in GDP of more than one dollar. If the multiplier is smaller than one, an increase in government spending will crowd-out resources available to finance private consumption and investment; as a second round effect, government revenue would not increase sufficiently to reduce the budget deficit.

Do major developed economies meet this condition? A review of various studies shows that the estimated value of the fiscal multiplier in the United States over the past three decades has been in the range between 0.8 and 1.5, thus leaving some uncertainty as to whether this condition is present.[4] However, the estimate of the multiplier in most of these studies is the average value over a time span that includes both economic booms and recessions.[5] Indeed, the multiplier is likely to be much larger during recessions, when there is slack in capacity utilization and when households and businesses are too risk averse to spend, as is the case now.[6] Moreover, the composition of fiscal stimulus will

[4] Valerie Ramey (2011), "Can government purchases stimulate the economy?" *Journal of Economic Literature 2011*, 49(3), pp 673-685.
[5] Jonathan Parker (2011), "On measuring the effects of fiscal policy in recessions" *Journal of Economic Literature 2011*, 49(3), pp 703-718.
[6] For example, in Auerbach, Alan and Yuriy Gordnichenko, forthcoming "Measuring the output responses to fiscal policy", *American Economic Journal: Economic Policy*, the estimate shows that the multipliers range between 0 and 0.5 in economic expansions, but between 1 and 1.5 in economic recessions.

influence the size of the multiplier. Increases in government spending on infrastructure investment, for instance, tend to have larger multipliers than tax credits or direct income transfers, especially when comparing the cumulative multiplier effects over a number of years.

Another necessary condition is that the cost of government borrowing in capital markets (the nominal interest rate on long-term bonds) should be less than the rate of potential nominal GDP growth. This will ensure benign debt-GDP growth dynamics. Currently, in the United States, Japan and Germany, long-term interest rates on government bonds are clearly lower than their respective potential nominal GDP growth rates. It is uncertain, however, whether further increases in government spending and budget deficits would push these interest rates substantially higher, as has happened in the European economies that are now facing severe debt distress, or not. One way to mitigate the uncertainty in capital markets is for governments to present credible and concrete plans for effectively resolving structural fiscal problems over the medium to long run.

In addition to these and other economic conditions, the feasibility for a "J"-curved fiscal balance is also highly subject to political conditions. For example, broad-based political trust is needed when taking the calculated risk of allowing a further worsening of the fiscal deficit to provide more fiscal stimulus in the short run, while committing to solving the structural debt problems over the medium to long run.

Among developed economies, Europe faces the most complex fiscal policy challenges. The overall economic fundamentals of the euro area are in fact relatively healthy, with the aggregate fiscal deficit and levels of debt lower than other developed economies. Nevertheless, three economies in the euro area are mired in sovereign debt crisis, and a few others are facing increasing market pressures.

Greece has been receiving emergency financing since May 2010 as part of a €110 billion bailout package. An emergency bailout package to the tune of €85 billion was also established for Ireland in November 2010 and one of €78 billion for Portugal in May 2011. Both Portugal and Ireland are currently on track to meet their commitments as set out as part of the rescue financing. These include a four-year plan for $20 billion in spending cuts and new taxes that would slash unemployment benefits and cut welfare payments in Ireland, and the agreement to reduce Portugal's fiscal deficit to 3 per cent by in 2013 (from 9.1 per cent in 2010). In contrast, Greece has been less successful in meeting its target, which includes a target deficit of 3 per cent by the end of 2014. In July 2011, a second Greek debt bailout was put together after the initial one proved unable to stabilise Greece's strained finances.

In response to the crisis in Greece, the European Council set up a European Financial Stabilization Mechanism and a European Financial Stability Facility (EFSF) in 2010. Later, these facilities were also used to assist Ireland and Portugal. In early 2011, a

permanent crisis management mechanism—the European Stability Mechanism (ESM) with a size up to €440 billion was agreed upon. In July 2011, euro area government leaders further agreed to substantiate the ESM by broadening the mandate of the ESM and EFSF, including on provision for precautionary lending, on provision of loans to sovereigns that are not part of a program for restoring capital buffers, and on using the mechanism to purchase sovereign bonds in secondary markets.

The major challenge in finding a solution to the sovereign debt crisis of the euro area is how to prevent the fiscal problems from causing a major banking crisis. Sovereign and bank risks have become closely intertwined because Europe's banking system has bought vast amounts of government bonds. During the financial crisis of 2008-2009, central banks injected vast amounts of liquidity into the banking system to shore up their balance sheets. Borrowing at near zero interest rates and facing little credit demand from households and businesses, banks purchased higher-yielding and safer (or so they were perceived) government bonds on a large scale. Now, as many banks are holding large amounts of government debts that are now in distress, rising sovereign debt risk is threatening the liquidity and solvency of the banking system.

In response, the European Central Bank has continued to provide liquidity provision to the banking system, through refinancing operations with fixed-rate tender procedures by taking collateral that includes the sovereign securities of countries receiving financial assistance. Since May 2010, when the debt crisis in Greece erupted, the ECB has also been buying sovereign securities in the secondary market, via a Securities Markets Programme (SMP), to help maintain the order in sovereign debt markets. In August 2011, the ECB enlarged this program, when the yields of the sovereign debts of Italy and Spain were rising in markets. SMP amounts to about €130 billion by the end of third quarter of 2011.

These measures, however, have proven insufficient to arrest the crisis from spreading from those three economies to other European countries, with capital markets pushing the yields for a few other larger euro economies higher. At the time of writing of this report, European leaders were still working on a new strategy, which could include a write-down of Greek debt, recapitalization of banks, and massively enhancing the financial strength of the newly-enhanced EFSF.

The sovereign debt crisis in the euro area has exposed a critical institutional deficiency of the monetary union: the lack of a fiscal union. No matter how, overcoming this institutional shortcoming will be a long term affair. In the short run, however, policy makers of the euro area could consider revisiting some of the fiscal consolidation measures implemented so far, to ensure greater coherence and consistency across the member states. For instance, the large fiscal cuts that are being undertaken by some countries may be counter-productive as they threaten to increase unemployment and further weaken the economic outlook. Some economies in the area, such as Germany, which registered trade surplus of almost €79 billion in the first half of 2011, could afford to spend more to stimulate growth. By spending more at home and increasing imports

from weaker countries that are unable to stimulate their own economies, the surplus countries could boost the growth for the region.

In other developed economies, the United States can also afford an additional round of fiscal stimulus. With persistently high unemployment and a private sector that is de-leveraging, public demand needs to compensate for low private demand. However, additional stimulus must be more carefully designed to maximise the economic impact. For instance, under the American Recovery and Reinvestment act (ARRA) of 2009, expenditure on goods and services by the Federal Government and transfer payments to State and local governments for infrastructure had multipliers ranging between 1.0 and 2.5. In contrast, tax cuts for higher-income people and the extension of the first-time homebuyer credit had multipliers ranging only between 0.2 and 0.8.[7] The proportion of the ARRA that was directed towards the more effective components were too small (only 0.21 and 0.05 per cent of GDP respectively) to have had a significant effect on the overall economy.[8] Stimulus measures must therefore be targeted in support of employment growth. The new job creation plan that has been put forward by the administration would be a step in the right direction. These measures must also be coupled with credible long-term deficit and debt reduction to ensure that markets do not lose faith in the ability of the Treasury to repay its obligations. Credible measures include tackling entitlement reform. They must also include a more partisan approach to repealing some of the tax cuts introducing in the previous administration and closing tax loopholes.

In Japan, the implementation of the supplementary budget and plans for further action that were introduced in the wake of the March 2011 earthquake have caused the budget deficit to widen further. While fiscal imbalances are expected to improve in the outlook, they will remain large, exceeding 7 per cent of GDP. At the same time, levels of public debt are expected to increase to more than 250 per cent of GDP by 2016. However, the authorities aim to balance Japan's primary budget (that is, excluding debt-servicing) by the fiscal year to March 2021 as a long-term goal. The fact that market concerns about Japan's debt sustainability have remained subdued owes to several factors. For one, Japan's net debt in 2011 was less than 60 per cent of its gross debt, compared to more than 70 per cent for the United States and more than 77 per cent for the Euro zone. Moreover, Japan runs a current account surplus and has a sufficiently high savings rate to absorb domestic debt.

Strengthening international policy coordination

Mitigating the risks of another global recession would require credible and effective policy coordination among major economies. Policymakers in major economies should continue to be vigilant, and should continue to make efforts in adjusting the structural

[7] Congressional Budget Office (2011), "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from April 2011 through June 2011". *Publication No. 4339, CBO, Washington. August 2011.*

[8] John B. Taylor (2011), "An empirical analysis of the revival of fiscal activism in the 2000s", *Journal of Economic Literature 2011*, 49(3), pp 686-702.

factors within their economies and at the international level as the causes for the imbalances, as guided by the G-20 framework for *Strong, Sustainable, and Balanced Growth*. However, rebalancing alone may not be sufficient to boost global growth. Facing the risk of a double-dip recession, the focus of international policy coordination should not be on rebalancing demand across major economies. Instead, the priority should be on how to boost growth, particularly sustained employment growth. Global rebalancing should be more properly placed in international policy focus when the world economy is in boom, but not when the economy is in an anaemic recovery, as it is currently the case. Unfortunately, G-20 discussions leading up to the G20 leaders' Summit in France in early November do not point in the direction of any much stronger concerted policy actions than those already laid out in national policies and which have already been subsumed in the baseline assumptions of the forecast.

Amid a trend of fiscal austerity in major developed economies, the international community should ensure that sufficient resources are made available to low-income developing countries, especially those possessing limited fiscal space and facing large development needs. These resources will be needed, in particular, to accelerate progress towards the achievement of the Millennium Development Goals (MDGs) and for investments in sustainable and resilient growth, especially for the LDCs. Apart from delivering on existing aid commitments, donor countries should consider mechanisms to delink aid flows from their business cycles so as to prevent delivery shortfalls in times of crisis, when the need for development aid is most urgent.

Regional prospects

Developed economies

United States

Economic growth in the United States has slowed down significantly during 2011. In the first two quarters, the annualized quarter-over-quarter growth rates for gross domestic product (GDP) were only 0.4 per cent and 1.3 per cent, respectively; the lowest since the start of the recovery in 2009. For the year of 2011 as a whole, GDP is expected to grow by 1.7 per cent, 1.5 per cent in 2012 and 2.4 per cent in 2013. This relatively weak outlook is underpinned by weak private consumption demand and limited macroeconomic policy support.

On the monetary policy side, the Federal Reserve (Fed) has maintained its policy rate, the federal fund rate, at the extremely low range of 0 to 25 basis points since 2008. According to the Fed's announcement in August 2011, this policy will be maintained until at least mid-2013. The forecast assumes that it will eventually be maintained until early-2014. The Fed has also introduced two rounds of quantitative-easing (QE) actions in 2009 and 2010, under which it has bought large amounts of long-term securities from the market. By doing so, the Fed has increased the level of deposits of depository financial institutions at the Fed. Another objective of these actions was to bring down the

interest rate on long-term securities. According to the Fed's communications, market concerns regarding a possible recession and deflation have motivated the action taken. In September 2011, the Fed announced that it will, by the end of June 2012, swap $400 billion of Treasury securities maturing within three years or less into Treasury securities maturing within six to 30 years. By doing so, the Fed hopes to bring down the long-term interest rate further. However, the long-term interest rates had already been very low even before the Fed's last action and it remains to be seen how much further downward adjustment this "Twist" operation can create. For the outlook, it is assumed that there will be no more large-scale quantitative-easing action by the end of 2013.

On the fiscal policy front, it is assumed that the United States economy will not receive much further stimulus over the forecast period. Since the mid-term elections in 2010, the decision procedure for fiscal policy has become extremely protracted. For example, for fiscal year 2011, which covers the period from October 2010 to September 2011, the federal government budget was not finalized until April 2011 and the impasse during the process almost forced a government shutdown. In mid-2011, negotiations to raise the ceiling on the level of the federal public debt and related issues created further significant uncertainty at the domestic as well as global level. A major political struggle emerged over how to cut the fiscal deficit over the medium and long run. Although a stop-gap agreement was finally reached at the last minute to avoid the much-feared default on Treasury debt, it was not enough to stop one credit-rating company (Standard and Poor's) from downgrading the rating for the United States long-term Treasury debt by one notch. While that agreement left the mid- and long-term details to be finalized by the end of 2011, it seems inevitable (for political reasons) that federal government expenditure will be trimmed continuously in the coming years. Correspondingly, the federal government fiscal deficit is assume to decline from the level of about 8.4 per cent of GDP for fiscal year 2011 to about 5.2 per cent for fiscal year 2013.

Compared with previous recessions in the United States after the Second World War, the recovery in employment is very weak during this cycle. Household survey data indicate that civilian employment has declined by more than 8.6 million over 25 months until December 2009. Since, only about 2 million jobs have been recovered up to September 2011. Except for two months, the unemployment rate never fell below 9 per cent, despite a continuous flow of discouraged workers that have left the labour market. As of the third quarter of 2011, almost 45 per cent of the unemployed have been out of work for more than 27 weeks; the share used to be less than 20 per cent before the recession. Over the forecast period, employment is expected to grow only slowly and the annual average rate of unemployment will remain around 9 per cent.

In late 2010, international prices for commodities, including crude oil, experienced a significant spike. As a consequence, headline inflation edged up in the first quarter of 2011. Core inflation remained low, however. In the second half of 2011, commodity prices either stabilized or, like crude oil, started to decline. Under the basline assumptions for international commodity prices, consumer price inflation in the United States is expected to be mainly driven by domestic factors. As the slack in the labour market remains high, the cost-pushing force for higher prices will be subdued in the

short- and mid-term. The headline CPI inflation for the United States is expected to average at 3.2 per cent in 2011 and to decelerate to 1.7 per cent in 2012 and 1.8 per cent in 2013.

Private consumption is expected to grow by less than 2 per cent per year during the forecast period, less than in the years before the global crisis. Weak labour income growth is one main reason for the weakness in consumer demand. Weak employment growth (by about one per cent per year in the baseline outlook) and persistent high unemployment will limit any increase in nominal wages. In addition, uncertainty regarding the availability of unemployment support will further limit disposable household income for many families. Before the recession, many households tended to use home equity to finance consumer spending, but with depressed house prices and more restricted home and consumer financing this push to consumer spending is no longer there. Although there are indications that house prices have escaped from their downward trend around mid-2011, real estate prices are still significantly lower than just a few years ago. The situation is especially dire for those home owners with negative home equity, meaning that the value of their mortgage exceeds the market value of their home.

The global financial turmoil in mid-2011 also provoked high volatility in United States equity markets. Over the second and third quarter of 2011, lower stock prices negatively affected household net worth and decelerated efforts to re-build their balance sheets. This is likely to induce households to further increase saving and reduce consumption.

Private fixed investment, especially in equipment and software, has grown steadily during the recovery. Financing conditions have been favourable, as large corporations accumulated vast amounts of cash during the process of deleveraging, the cost of borrowing has been falling and tax benefits for new investments have also been included in the fiscal stimulus package. Small and medium businesses, on the other hand, continue to face much tougher financing conditions. Banks' lending standards remain too high for most small firms to access finance, thereby deterring business in many sectors.

Under the baseline assumptions for monetary and fiscal policy, however, it is expected that fixed investment (including in residential and non-residential structures) will continue to expand, despite the overall weakening of the economy.

After receding to a level of about $80 billion per quarter in the second quarter of 2009, the current account deficit increased again to around $120 billion per quarter in the first half of 2011, which was still much lower than the level of $170 billion per quarter for 2008. During the recession, a sharp fall in import demand was the main factor underlying the narrowing of the external deficit. With the resumption of the medium-term trend of dollar depreciation, export volumes have increased, helping a further adjustment of the trade deficit. The turmoil in international financial markets reversed some of the dollar's effective depreciation in the third quarter of 2011. The baseline assumption is that the value of the dollar against major currencies of developed economies will fluctuate around its current level. If this is a correct assumption, it is likely that the trend towards a narrowing United States current account deficit will continue and the external deficit would drop further to 3 per cent of GDP by 2013, down from 3.6 per cent in 2010.

At present, the greatest uncertainty for the United States economy is about fiscal policy. Although it is widely agreed that the recent level of the federal fiscal deficit (9-10 per cent of GDP) is not sustainable, the political process to reach necessary agreements on this issue has become very protracted, as indicated. Events observed in the first three quarters show that consumer and business confidence have been adversely affected by the political stalemate. The current constellation of political power in Congress seems to augur for deeper and accelerated cuts in federal government spending. This, in turn, would heighten the probability of another recession.

Japan

The economy of Japan contracted by about 3 per cent in the first half of 2011 in the aftermath of the devastating earthquake in March. The recovery was strong in the third quarter, but has tapered off towards year's end, as global demand for Japanese exports weakened. While GDP is estimated to fall by 0.5 per cent for 2011 as a whole, growth of about 2.7 per cent is forecast for 2012 and 2.5 per cent for 2013, as post-quake reconstruction is expected to strengthen in the coming two years to lift growth above its potential. However, the risks the economy is facing are slanted to the downside: much weaker demand in other major economies, challenges in the government budget to finance the reconstruction, and the persistent long-run deflationary pressures could all drag the economy of Japan down to a much weaker growth than what is projected in the baseline.

The earthquake and tsunami in March, as well as the subsequent nuclear power plant crisis, have caused a tremendous drop in output in Japan, with GDP falling by 3.6 per cent in the first quarter. While household consumption registered a rise in April, industrial output continued to slide up to May. After the economy declined by another 2.1 per cent in the second quarter, the recovery in the third quarter was bolstered by two successive government supplementary budgets totalling 1.2 per cent of GDP. However, the momentum of the recovery seemed to be faltering in late 2011, in part because of the slowdown in the rest of the world. In the outlook, based on the assumption of a successful implementation of the newly announced post-quake reconstruction projects, totalling ¥13 trillion (2.6% of GDP) for the next five years, economic growth is expected to accelerate to a pace above potential during 2012-2013.

The employment situation has been aggravated by the disasters, although the unemployment rate, at about 4.8 per cent in late 2011, is still notably lower than the peak of 5.6 per cent registered in 2009. The ratio of job offers to applicants has been improving, but nonetheless nominal wages per employee declined somewhat during most of 2011.

Higher international prices of oil and other primary commodities and the disruptive shock of the earthquake have pushed up the general price level in Japan in 2011, lifting the economy out of a protracted deflation. The consumer price index is estimated to rise by about 0.5 per cent in 2011, from the deflation of about 1 per cent in

the previous two years. In the outlook, however, prices may fall again in 2012-2013, as a result of slack capacity and above-trend unemployment in the economy.

Japanese exports were disrupted majorly by the disasters of March, but have rebounded steadily from May. Export growth decelerated later in the year, however, as global demand softened. A steady appreciation of the yen may have also curbed exports, but the past experience shows that global income has a more important impact on Japan's exports than exchange rate shifts. Imports rose notably shortly after the natural disaster, particularly pushed by higher demand for food, but import growth has slowed since. Japan's trade surplus dropped significantly during 2011, while the current account surplus decreased by about one percentage point of GDP. In the outlook, the surplus is expected to stay somewhat below 3 per cent of GDP.

With policy interest rates near zero for many years, monetary policy in Japan has mainly featured the expansion of the balance sheet of the Central Bank. For example, after the earthquake, the Bank of Japan (BoJ) offered to inject ¥15 trillion into the overnight call market, its largest single operation ever, to meet the significant increase in demand for liquidity. Later in 2011, the BoJ also increased the size of the Asset Purchase Program (APP), including the purchase of risky assets, such as commercial paper, corporate bonds, in addition to government bonds. In the outlook, BoJ will continue to rely on the APP, combined with intervention in the foreign exchange market to prevent further appreciation of yen.

Fiscal policy in Japan is facing a dual challenge: providing adequate financing for the government reconstruction projects in the short run while reducing public debt to more sustainable levels in the long run. In order to limit the impact of reconstruction spending on the budget deficit, the government is working on various options, including increases in taxes on income, corporate and other items, as well as selling off some government assets (the government holds some ¥20 trillion of equities). The gross government debt of Japan is currently more than 200 per cent of GDP, the highest among developed countries. The borrowing costs of Japan remain low, but a further increase in its debt may heighten the risk of a debt crisis in the years to come. The government has proposed an increase in the consumption tax to 10 percent by 2015, but it is highly uncertain whether this will suffice to bring down the debt-to-GDP ratio.

Australia and New Zealand

In Australia, the recovery from the worst flood in the eastern states has been slower than what was originally expected. GDP is estimated to grow by only 1.5 per cent during 2011. While a gradual recovery in coal production from the flood damage and a continued increase in mining sector investment supported growth, investment in other sectors has been weakening, along with a weak labour market and consumer sentiment. In the outlook, GDP is expected to grow above 3 per cent in 2012-2013, to be supported by further reconstruction of infrastructure as well as mining investment.

The inflation rate through 2011 has been above the upper limit of the target range of 2-3 per cent set by the Reserve Bank of Australia (RBA), but the central bank has maintained its policy rate at 4.75 per cent since late 2010, a much higher level than that of other developed economies. Any increase in the policy rate is expected to be limited in the outlook for 2012-2013. Fiscal policy has been tightening as the government is aiming at returning the budget to surplus in 2013, although the extra spending on reconstruction related to the flood damage may challenge the budget target.

The major downside risk for the economy lies in a weaker than expected global demand, particularly from East Asia. Domestically, a key economic concern in the longer run is an increasing imbalance in the structure of the economy. A boom in the resource sector, accompanied by appreciated exchange rates, high interest rates, shortages in skilled labour and inflationary pressures, seem to have increasingly crowded out non-resource industries, such as manufacturing and key service industries, including tourism. This structural imbalance may lead to low productivity growth, high unemployment and lower potential economic growth in the longer run.

In New Zealand, the impact of the earthquake that occurred in February of 2011 in the Canterbury region on the overall economy has been smaller than expected. The damage to infrastructure and buildings in the region has been tremendous, but an economy-wide recession could be avoided. GDP increased by about 1.5 per cent in 2011. Business investment has been on a recovery since the earthquake, along with the reconstruction, but private consumption is lacklustre, as consumers are constrained by wealth loss due to the quake and a high level of debt. The inflation rate has been above 4 per cent in 2011, partly due to the supply shock of the earthquake. In the outlook, GDP is expected to recover to about 3 per cent in 2012-2013. Reconstruction will boost growth through a strong increase in investment, but growth in consumer spending is expected to remain modest.

In response to the impact of the earthquake, the Reserve Bank of New Zealand cut its policy interest rate by 50 basis points in March of 2011 and is expected to maintain the rate at 2.5 per cent until mid-2012. Fiscal policy is challenged by the need of a large amount of financing needed for reconstruction and the need to reduce debt in the long run. Two of the three major international rating agencies downgraded New Zealand's sovereign debt rating in September 2011, triggered by concerns over the elevated level of the country's external debt, which stands at about 80 per cent of GDP. The high external debt compounds the vulnerability of the economy, which heavily depends on primary exports. The government has planned a number of measures, including significant spending cuts in the medium term and some partial privatization of state-owned assets, aiming at returning the budget to surplus in 2014-2015.

Canada

In Canada, the recovery also stalled in the second quarter of 2011, during which GDP declined at an annualized rate of 0.4 per cent from the previous quarter. High frequency data show that expansion might have taken place since. Nevertheless, data also hinted

that growth will be lower than what has been observed since the recovery started. For 2011 as a whole, GDP is expected to grow by 2.0 per cent, followed by 1.7 per cent and 2.6 per cent for 2012 and 2013, respectively.

As in the case of the United States, investment in machinery and equipment has grown very rapidly. In addition, residential investment kept on growing at a high speed until the second quarter of 2011, when the standard for mortgages was raised by the Government. Its expansion then slowed down to a more sustainable speed. Correspondingly, the inflation of prices for new housing has slowed down through to the middle of the year.

The governing party gained the majority in parliament following a federal election in May. This will enhance its capacity to balance the budget by 2016. Based on this, it is assumed that government expenditure (as a share of GDP) will fall over the forecast period.

The external sector will continue to be the dragging factor for the Canadian economy. The Canadian currency has appreciated significantly against the dollar and weakened the competitiveness of Canadian exports to the United States, which traditionally absorbs more than 75 per cent of the country's total exports. The slowdown in the recovery of the United States economy is further dampening export demand. Over the forecast period, the current account balance for Canada is expected to remain in deficit.

For Canada, the most significant risk is a renewed recession in other developed economies, especially the United States. Lower commodity prices, especially for crude oil and natural gas, caused by lower demand will also inject significant shocks.

Another home-brewed risk stems from the debt burden of households. Over a decade, the household debt-to-income ratio has increased by about 20 percentage points to more than 100 per cent in mid-2011. This may cause a strong shock to households when housing prices reverse or interest rates rebound strongly from their current extremely low level.

Western Europe

Western Europe grew strongly in the first quarter of 2011, with GDP increasing by 0.8 per cent quarter on quarter in the euro area, but activity decelerated sharply in the second quarter with growth of only 0.2 per cent. Given very strong headwinds, growth is expected to be very slow over the entire forecast period.

To some extent, the second quarter figures were influenced by unusual factors: the closing of German nuclear power plants, the disruptions from the Japanese tsunami and the normalization in the construction sector after its sharp rebound in the first quarter from the bad winter weather, as well as the sharp rise in oil prices. But the overall trend is still one of deceleration, as leading indicators show a clear and substantial decline in

sentiment across countries and sectors. There are also substantial headwinds: the global manufacturing cycle has peaked and is now in a downturn phase as global demand is slowing, particularly in East Asia and the United States of America; fiscal consolidation programs are in force across the region; the sovereign debt crisis that erupted in Greece in May and which subsequently spread first to Ireland and Portugal, then to Spain and Italy, has progressively impacted on economic performance. The debt crisis has multiple negative impacts on economic activity: it has forced the affected countries to adopt extreme fiscal tightening programs; led to renewed financial crisis through a weakening of the already delicate banking system; and led to plunging confidence of both producers and consumers. These headwinds are expected to remain intact throughout the forecast period.

Growth is expected to be 1.6 per cent in the euro area in 2011, nearly identical to the forecast from the spring, due to the much stronger than anticipated first quarter, but balanced by a much weaker than expected final two quarters of the year. Given the extremely low momentum going into 2012, combined with weaker global demand and still high levels of uncertainty, growth in 2012 is expected to be only 0.6 per cent, a substantial downward revision from the spring forecast.

High frequency data and leading indicators depict a recovery in the first quarter of the year that was led by a sharp rebound in the manufacturing sector, with services following a more muted path, and construction playing a restraining role. Consumption spending was beginning to play an important supportive role. But the dynamics have changed since March, with all leading indicators pointing to a slowing of activity going forward.

Industrial production data through July show no sign of a turnaround, but more of a deceleration, and currently rests about 9 per cent (for the euro area) below its peak of March 2008. Construction, which never demonstrated any convincing turnaround, remaining only marginally above its trough, also shows no sign of downturn. Retail trade shows some deceleration but again no major downturn. Survey data is, however, more definitive, indicating a clear change in direction with broad-based declines across both country and sectoral surveys.

The European Commission's Economic Sentiment Indicator reached a peak in March and has moved sharply down since, going below its long term average in August. All sectors have shared in the decline but continue to show marked differences in strength: industrial confidence had fully regained its pre-recession peak and, while declining substantially, remains just above its long term average; the services sector regained only its long term average but has seen a very sharp drop since March; construction never regained its long term average but has only recently turned down; consumer confidence did regain its long term average, but has also turned down sharply since March. These impressions are confirmed by other survey data such as the composite PMI survey for the euro area which shows a similar decline and has reached a point where it is consistent with a contraction in activity going forward.

Growth in the region had been transitioning from net-export led to domestic-demand led in the final quarter of 2010 and first quarter of 2011, as would be expected as an expansion matures. However, this came to a halt in the second quarter, as private consumption expenditure declined and fixed investment decelerated sharply, so that domestic demand made no contribution to growth. To some extent this result is driven by the poor performance of construction, while investment in metal products, machinery and transport grew quite strongly. Given the still moderate activity in the manufacturing sector at the beginning of the third quarter but in light of the increasingly negative headwinds going forward, growth is expected to be of similar magnitude in the third quarter, but will decelerate further to a near stalling of activity in the fourth quarter, and then remain very subdued throughout 2012.

Earlier in the year, consumption had been supported by a moderate improvement in real disposable income through good labour market performance in a number of countries with unemployment coming down and nominal wages picking up, and low inflation, as well as greatly improved confidence. Since, higher oil prices started to hit disposable income, while the sovereign debt crisis led to a dramatic drop in confidence and, in some cases, far tighter fiscal policy. In the outlook, consumption is expected to remain subdued. Continuing fiscal consolidation measures, less certain labour market prospects, and uncertainty from the debt crisis weigh on consumption. Slowing inflation on the other hand provides some support. In the crisis affected countries, consumption is expected to continue to contract.

Investment in equipment was an increasingly important driver of activity in the higher growth economies, particularly those most geared to export markets and capital goods. The strong manufacturing rebound, fuelled by external demand, coupled with increasing capacity utilization (which reached 81.6 per cent in the second quarter of 2011 in the euro area), high business profits, and stabilizing financing conditions all provided good support. Confidence was at record highs in Germany. But the deceleration in external demand, coupled with deteriorating financing conditions and declining capacity utilization, and more generally the increase in uncertainty is expected to lead to weak growth in fixed investment expenditure. Housing investment has been a drag to activity since the beginning of the recovery and is expected to remain lacklustre.

Export volumes have been the key driving factor to the recovery, but are decelerating in line with the slowdown in global growth. Import volume growth has lagged that of exports, as domestic demand has been more subdued than the growth in foreign markets. This meant that net exports have been a continuing source of growth and are expected to continue to be so in the outlook. The surge in the value of the euro in the second quarter had some dampening effect, but the currency has come down somewhat since and is assumed to remain on average near current levels.

Labour markets have been improving gradually since the end of the recession, with the exception of the sovereign debt crisis countries. For the euro area as a whole, the rate of unemployment has been stuck near 10.0 per cent since the end of 2009, but this results from a balancing of countries such as Germany, Austria and Belgium that have

seen large improvements, with countries that have seen large deteriorations including all of the crisis countries, while the rest have seen little change. These different performances can be attributed to relative growth performances (heightened by the tremendous fiscal consolidations going on in some countries), different degrees and types of labour market policies, and structural differences. Given the subdued outlook, unemployment is expected to remain near current levels for the euro-area, with further deterioration in the crisis countries and some minor improvements in the more dynamic economies.

Headline inflation, as measured by the Harmonized Index of Consumer Prices (HICP), has been rising steadily throughout 2010 and into 2011, breaching 2.0 per cent in the fourth quarter of 2010 and reaching near 3 per cent in the second quarter of 2011. Core inflation on the other hand remained quite stable in 2010 and only started to pick up in the second quarter. The rising price of oil and other commodity prices were key factors in explaining this sustained increase, as except for the first quarter, growth has been insufficient to make much headway in closing the output gap, and real wages have been lagging productivity improvements. Going forward, weakening activity is expected to put downward pressure on prices.

The euro area fiscal deficit increased substantially during the recession from 2.0 per cent of GDP in 2008 to 6.3 per cent in 2009 and dipped only slightly to 6.0 per cent in 2010. All members of the euro area, except Luxembourg and Finland and new member Estonia, registered deficits of greater than 3 per cent of GDP in both 2009 and 2010, which is the limit enshrined in the Stability and Growth Pact (SGP). Under the Excessive Deficit Procedure (EDP) these countries had to submit stability programs with explicit plans for bringing their deficits back to below 3 per cent. Most members of the euro area are tightening their budgets, with a minimum requirement of an improvement in budget deficits of 0.5 per cent of GDP per annum. But the per-annum consolidations are much higher in the crisis affected countries and may need to be strengthened if there are short falls in revenues. The United Kingdom is also under pressure, after its deficit rose sharply, and is pursuing a dramatic consolidation program.

Until recently, the European Central Bank (ECB) has placed its conventional monetary policy on hold, leaving its main policy interest rate at 1.0 per cent. Further policy stimulus was undertaken via unconventional policies, mainly by supplying liquidity directly to the banking system as well as purchasing government bonds in secondary markets. It was thought that these latter policies would be phased out prior to the resumption of conventional policy where policy interest rates would be brought back to a neutral level. However, the ECB enacted two increases in its main policy rate for a total of 50 basis points, one in April and one in July, after which it paused. But at the same time, it has kept alive its unconventional policies which were being used almost exclusively to support banks and the sovereign debt of the crisis affected countries. These policies have been strengthened with the introduction of further refinancing operations at various term lengths and a reintroduction of both the covered bond purchase program and the provision of United States dollar liquidity in concert with other major central banks.

In the outlook it is assumed that conventional policy remains on hold throughout the forecast period and that these unconventional policies remain available.

Key risks to the forecast are weighted to the downside and are led by the ever expanding sovereign debt crisis, with threats of further contagion to the larger economies of the region and to the fragile banking system, both of which would place far larger demands on financing needs and in the case of the banking system a renewed financial crisis. Another and not un-related risk is that the current fiscal consolidation programs are either strengthened, as a result of the pressures from the crisis, or that their impact on growth is more than anticipated. Finally, the prolonged period of low growth and hence high unemployment in many regional economies, risks increasing the rate of long term unemployment in the region, making it far more difficult to reduce unemployment in the future and also reducing the growth rate of potential output.

The new EU members

Although at a different speed, the economies of the new EU member states from Eastern Europe in 2011 continued to recover from the deep recession that started in late 2008. The recovery, however, is still mired by weak labour markets, feeble consumer and business confidence in many of those countries and strong social discontent towards the Governments' fiscal austerity measures. While in a number of economies the initial export-led expansion has evolved into a more broad-based recovery, with strengthening household consumption and increasing investment rates, in others, exports still remain the sole driving force. Mirroring their main export markets in the euro zone, many of the new EU economies lost their steam in the second quarter of 2011 and the stock markets in the region embarked on a downward trend during the summer. Most of the new EU members still remain vulnerable to adverse external developments, such as a sovereign debt crisis or a banking crisis in the euro zone. Against the backdrop of a possible slowdown in their major export markets in 2012, the nature and speed of the recovery in domestic demand will determine how soon those countries will return to a sustainable growth trajectory. Growth of aggregate GDP of the region is expected to accelerate from 2.2 per cent in 2010 to 2.9 per cent in 2011, and to 3.0 per cent in 2012.

The largest and least export-dependent economy in the new EU, Poland, maintained its strong economic momentum in 2011. The construction sector in the country expanded rapidly, boosted in particular by preparations for the Euro-2012 football championship and public infrastructure spending, supported by EU funds. This also contributed to growth. GDP is expected to increase by 4 per cent, largely supported by domestic demand. This pattern is more or less expected to continue in 2012, provided that robust investment spending is sustained and a more competitive exchange rate partially offsets weaker import demand from the EU. However, a weaker currency will constrain consumer spending, as households have to repay their foreign currency loans.

For the smaller economies of Central Europe, growth was predominantly driven by exports, especially by the automotive and electronic sectors, although those exports grew less impressively compared with 2010 due to the base year effect. FDI flows into those countries have modestly recovered and are expected to rise in coming years, as

many leading automakers pledged massive investments. The Baltic States have recorded higher growth rates in 2011, as they are recovering from a deeper recession, and Estonia became the growth champion of the EU.

There are indications of a recovery in domestic demand in the Czech Republic and in the Baltic countries. In Bulgaria, Hungary and Romania, on the other hand, domestic demand remains depressed. The appreciation of the Swiss franc placed strong pressure on households and businesses in Hungary and Poland, which earlier borrowed heavily in that currency, and may seriously affect the spending and investment rate, as well as economic policies.

One of the principal goals of economic policymakers in the region is to reduce the budget deficits, as required by the European Union. In addition, the Governments of the new EU countries are aiming to reform public finances, in particular pension systems, to improve their sustainability. Most of them have to reduce deficits to less than 3 per cent of GDP in the medium-term. On the expenditure side, Governments have reduced wages and cut employment in the public sector. They may continue with similar measures in 2012. On the revenue side, in a number of countries indirect taxes were increased. The Government of Hungary intends to retain the extra taxes introduced in 2010 on financial institutions and on large corporations. Diverting private pension saving into the state-run system has led to a one-off budget surplus in Hungary in 2011, but affected bank lending and worsened investor sentiment. Those countries, which showed a good record of fiscal consolidation, such as the Czech Republic, have gained improved portfolio investors' perception and easy access to external finance. The terms of borrowing are important for the new EU members since those countries, which received international assistance during the financial crisis, are completing their respective IMF programs and have to start repayments to the IMF and the EU in the near term, and may need to refinance their debt. The region should receive more funding from the EU in 2012, however the ongoing fiscal retrenchment may complicate the required co-financing of the EU-related projects.

The spike in oil and food prices has lead to higher inflation in the region in early 2011, although its impact on the overall CPI varied across the countries. Some recorded relatively high inflation rates (especially Bulgaria and Romania), while in the Czech Republic inflation remained contained. Increases in indirect taxes, already undertaken or planned by the Governments to strengthen fiscal revenue and to compensate for earlier reductions in the personal income tax, contributed to inflationary pressure as well. Those factors were offset by weak domestic demand and subdued wage growth. Inflation moderated in the second half of the year, as food prices (although not all of them) retreated. Producer prices, especially energy costs, which increased sharply in early 2011 (by double-digits in some cases), slowed their growth as well. In 2012, inflation should stay in low single digits and within the official targets, as wage growth should not outpace gains in productivity.

The central banks in Hungary and Poland responded to rising inflation by reversing the accommodative monetary policy stance adopted in late 2010 and early 2011 and increasing interest rates. Other central banks in the region refrained from rate hikes.

Provided no strong inflationary pressure is recorded, interest rates should stay low in 2012.

Estonia adopted the euro in January 2011 and, in line with the ECB rules, has drastically reduced mandatory reserve requirements for commercial banks. The liquidity, which was released as a result, was used to repay the foreign debt of commercial banks, rather than to extend new credit. Although banks in the new EU countries are not facing liquidity constraints, they still remain reluctant to lend, as the declined house values have led to a negative equity for many mortgage borrowers and have eroded bank's assets.

The region's labour markets continued to recover in 2011, although in some countries the rate of unemployment has increased in the second quarter. The largest improvement took place in the Baltic States. In Latvia, for instance, the rate of registered unemployment has declined to about 11 per cent from over 18 per cent a year ago. On the other hand, in Central Europe, progress is slower. The still fragile business sentiment and cuts in the public workforce prevented any significant improvement in 2011. Only in 2012 are labour markets set for a gradual recovery, as the private sector is expected to create more jobs. The rise of structural unemployment and skill mismatch in the labour market is meanwhile affecting potential output of the region in the long-run. In 2011, the remaining countries in the EU-15, which still retained restrictions on the free movement of labour from the new EU members, opened their labour markets for those countries, with the exception of Bulgaria and Romania. To which extent the possible outward migration of workers to those countries will alleviate the unemployment situation in the region still remains to be seen.

The current accounts of Latvia and Lithuania have returned to deficit in 2011.Stronger domestic demand and a recovery in investment spurred import growth, commodity prices increased, and the deficit on investment income has widened. For similar reasons, the surpluses in Estonia and Hungary have shrunk, although the surplus in Hungary has nevertheless mitigated the country's external financing needs. In other new EU member states, current accounts deficits increased further and are expected to widen in 2012, but should not endanger macroeconomic stability, provided that no reversal in capital flows occurs.

The outlook for the region is subject to certain risks. A sovereign debt crisis in the euro zone would strongly affect the balance sheets of many large EU-15 banks present in the new EU, stifling credit growth in the region and possibly leading to deleveraging by foreign banks. Possible worsening of investor's sentiment towards the emerging markets would complicate refinancing of external debt obligations of the new EU members.

Economies in transition

South-eastern Europe

A solid economic recovery in the countries of South-eastern Europe has yet to materialize. Thanks to increased demand and higher prices for commodities, metals in particular, exports from the region performed well in 2011, supporting the strength of industrial output. In addition, a satisfactory tourism season and a modest recovery in remittances contributed to the modest acceleration of growth. By contrast, domestic demand, especially investment, is rebounding slowly, and the limited improvement in output recorded in 2011 was again largely driven by exports, although in the second half of the year the contribution of domestic demand to growth strengthened.

For the South-eastern European countries, GDP growth in 2011 is estimated to vary between 1 and 3 per cent, exceeding 3 per cent only in Albania and the FYR of Macedonia. In the outlook for 2012, strong growth rates for most of the region are also unlikely, given that their major export markets in the EU face the prospect of a protracted slowdown, and weak labour markets, cuts in public wages and the indebtedness of the private sector continue to hold back domestic consumption and investment. FDI flows into the region remain below the pre-crisis level. The room for countercyclical economic stimulus in South-eastern Europe is limited, as the Governments implement fiscal austerity measures. In the short-term, the economic performance of the region will depend on whether exports outweigh the impact of fiscal austerity policies and on the speed of recovery in domestic demand.

GDP growth is expected to average 1.8 per cent in South-eastern Europe in 2011, and could accelerate to 2.7 per cent in 2012, assuming a modest revival in domestic demand. The slowdown in the region's major export market, the EU, would limit external sector's contribution to growth. This outlook, however, is subject to a number of downside risks. The stagnating investment delays progress in achieving the important goal of reindustrialization of those economies.

The region is increasingly relying on external financing. In 2011, Serbia received an $800 million loan from the World Bank for budget support and investment in infrastructure and another 100 million dollar loan to provide support to low-income families. To counteract possible balance-of-payment problems, Serbia also obtained a precautionary stand-by loan from the IMF, worth about $1.5 billion. Facing difficulties in issuing a Eurobond on favourable terms, the Government of the FYR of Macedonia has decided to withdraw funds from the IMF precautionary credit line in early 2011.

Following a contraction in 2010, private consumption strengthened somewhat in South-eastern Europe in 2011, but only by about 1 or 2 percentage points, as growth in real wages often was negative, credit growth is lagging and consumer confidence remains weak. The retail sectors largely remained depressed. Earlier heavy borrowing in foreign currency, in Swiss franc in particular, placed additional pressure on consumer spending, especially in Croatia. If households in Croatia accept the five-year fixed exchange rate

loan repayment scheme, offered by the Government, which assumes deferred financial obligations, they are likely to save more and to spend even less.

The surge in global food and energy prices propelled inflation in the region in early 2011, against the backdrop of the relatively large share of food in the consumption basket of those countries, leaving Governments to deal with both macroeconomic and social consequences of inflation. In the second half of 2011 inflation moderated, and slow wage growth and weak consumer confidence helped to cap inflationary pressure. For most of the region, average annual inflation in 2011 is expected to be in low single digits, with the exception of Serbia, where the consumer price index may increase by over 11 per cent. In 2012, absent serious supply-side shocks, a moderate inflation rate of about 2-3 per cent is expected in the region, as wages will grow slowly and consumers will remain cautious, although in Serbia inflation may be somewhat higher.

After enacting countercyclical policies during the crisis, the Governments across the region had to consolidate their finances. In Bosnia and Herzegovina and in Serbia (the countries that are under IMF arrangements) public expenditure shrunk in 2011 by 2 to 3 per cent in order to meet the fiscal deficit targets agreed with the IMF, although those targets are most likely to be missed. The Government of Croatia, in contrast, refrained from reducing its budget deficit any further to avoid social repercussions, and has been successful in tapping the bond market. In Albania and the FYR of Macedonia, planned public spending on infrastructure led to a higher deficit in 2011. In 2012, further reductions in public expenditure are planned in Serbia. Governments primarily aim at reducing current expenditure, simultaneously attempting to increase capital expenditure and to allocate funds for business lending to diversify their economies. However, progress in utilizing those funds has been slow. The reductions in public wages and in pensions adversely affected private consumption and consumer confidence.

Some countries in the region maintain formal or de facto currency pegs, which constrain the conduct of monetary policy. The monetary authorities in the region, wherever possible, aim at accommodative monetary conditions to support credit to the private sector. In early 2011, the central banks in Bosnia and Herzegovina and Croatia cut certain mandatory reserve requirements for commercial banks to release liquidity and to channel it to business loans. However, facing currency depreciation pressures, the Croatian National Bank decided in September to withdraw some liquidity from the banking system by increasing the reserve requirement. Facing double-digit inflation, the National Bank of Serbia increased its key policy rate in 2011 several times to keep inflation within the target range. It maintains the highest policy rate in Europe. With the exception of Albania, both demand for credit and bank’s willingness to lend still have to strengthen in the region.

The region’s labour markets worsened notably in early 2011, especially in Croatia and Serbia. In both countries, the registered unemployment rate exceeded 19 per cent, and in spite of some improvement later in the year, remains precariously high. Bosnia and Herzegovina and the FYR Macedonia have even higher unemployment rates, although in Macedonia the unemployment rate fell by 1-2 percentage points in 2011. Stronger

demand for the region's exports did not generate enough jobs. Given the largely structural nature of unemployment in the region and expected cuts in the public sector, a drastic improvement in 2012 is not likely, although a gradual revival in the construction sector and retail services may alleviate the situation.

The current account deficits in most of the region are expected to widen in 2011 reflecting higher imported energy and food prices, and some expansion in imports of capital and consumer goods. However, the downcast consumer sentiment and faltering investment have led to a reduction in the current account deficit in Croatia. The deficit contracted also in Montenegro. In contrast to earlier years, those deficits are not fully, or largely, covered by FDI and may become a potential source of vulnerability.

The goal of EU integration remains the macroeconomic policy anchor for the region. However, the growing uncertainty about the speed of further EU enlargement (only Croatia has a firm accession date) complicates formulation of a coherent economic policy and implementation of often unpopular measures, despite the continuing financial assistance from the EU.

The region remains exposed to spillover risks from the Greek debt crisis, mostly through the financial channel due to the heavy presence of Greek banks, as well as via reduced FDI flows. In addition, Albania, the FYR Macedonia and Montenegro can face economic setbacks through contraction in remittances and a weaker export performance.

Commonwealth of Independent States (CIS)

Economic growth in the CIS weakened somewhat in 2011. Following a 4.5 per cent expansion in 2010, the region's gross domestic product grew by 4.4 per cent in 2011. In part this was due to a fading of base effects that characterized the recovery in 2010. It is, however, also a result of continued deleveraging of the financial sector and its dampening impact on credit growth and domestic demand and investment, which offset the beneficial impact of higher commodity prices on the region in 2011. The continued high reliance on exports of natural resources, external financing, and its vulnerability to external events imply that growth prospects in the outlook hinge upon the prospects of a stronger recovery in developed economies. As this is unlikely to materialize in the outlook, regional GDP is expected to weaken to 4.0 per cent in 2012, before strengthening in 2013.

Economic performance in the region was uneven in 2011. While a number of economies were able to benefit from favourable external conditions, including higher commodity prices, and stronger domestic demand, particularly in the first half of 2011, performance in others disappointed, partly as a result of the continued deleveraging that took place throughout the region. Moreover, the fading of base effects following the deep recession of 2009 will contribute to lower growth rates in 2011 relative to 2010, as will the deterioration of the global economy in the second half of 2011. Performance in 2011 has been disappointing in the Russian Federation. Despite a marginal increase in growth in 2011 to 4.1 per cent, domestic demand was dampened by high inflation and

constrained lending, as banks consolidated their balance sheets. Investment continued to suffer from political uncertainty and a deteriorating business environment, prohibiting the economy to benefit fully from favourable commodity prices; overall output remained below pre-crisis levels in 2011. In contrast, domestic demand was stronger in Ukraine and Kazakhstan due to real wage growth and improved prospects for employment, as evidenced by a double-digit rise in retail trade in the period up to June. In Ukraine, a stronger harvest and increased construction in preparation for the Euro 2012 football championships, contributed further to an increase in growth in 2011. In contrast, growth in Kazakhstan declined somewhat as stronger growth in the non-oil sector, particularly manufacturing, was not enough to fully offset the weaker-than-expected performance of the oil-sector. The same is true of Azerbaijan, where output of oil and gas, which account for more than half of GDP, contracted in the first seven months of the year, and contributed to a slowdown in growth to 2 per cent in 2011, contrasting sharply to the 9.3 per cent growth that was realized at the peak of the crisis in 2009. In the Kyrgyz Republic, output grew by 6 per cent in 2011, a sharp rebound from the 1.4 per cent contraction in 2010 that was triggered by social and political instability. The economy benefitted particularly from record gold prices and a rebound in trade following the re-opening of borders with Kazakhstan and Uzbekistan after their closure during the ethnic strife in 2010. However, the outlook remains fragile as tensions in the run-up to the presidential elections of October 30 may rise. Meanwhile, Belarus has tumbled into a crisis: large state spending and unsustainable growth in wages and credit in the run-up to the presidential election in December 2010 ultimately triggered a devaluation of the Belarusian rouble by more than 35 per cent in May as authorities needed to react to significant pressures on foreign exchange reserves resulting from higher import demand. This will undo the strong performance that was registered during the first half of 2011 (GDP grew at 11 per cent) and is expected to have a significant impact on the economy in the outlook.

In 2011, labour markets improved in the region due to the more favourable economic environment. Unemployment is expected to decline to 6.8 per cent, compared to 7.5 per cent in 2010, in the Russian Federation and to 7.9 per cent in Ukraine (compared to 8.1 per cent in 2010). Despite these declines, unemployment levels in these two economies remain above their pre-crisis lows. This contrasts to Kazakhstan, where unemployment reached 5.3 per cent in 2011, half a percentage points lower than in 2010. These dynamics had positive spillovers to the region as these economies are important destinations for migrant workers, and vital sources of remittances. For instance, total remittances to Georgia, more than half of which originate from the Russian Federation, increased by more than a fifth in the year to July; in the Republic of Moldova they increased by 15 per cent. In the outlook, labour market indicators are expected to improve modestly.

Average consumer price inflation increased in the region in 2011, reaching 12.4 per cent, compared to 7.2 per cent in 2010. Most of the increase must be attributed to the increasing trend in food prices and commodity prices that commenced in the second half of 2010 and that continued during the first half on 2011. However, inflationary pressures eased in the second half of 2011, mainly due to improved harvests. Consumer price

inflation reached double-digit rates in Tajikistan, Uzbekistan, the Kyrgyz Republic and Belarus. In Uzbekistan and Belarus, significant increases in public sector wages amplified inflationary pressures, as did weaker currencies by boosting imported inflation. In Belarus, inflation is expected to reach about 40 per cent in 2011 due to the devaluation of the rouble. Annual rates exceeded 60 percent in August 2011. This raises the risk of a vicious cycle of inflation and depreciation. In the outlook, lower food prices and more subdued economic performance due to the global economic slowdown will lead to more moderate increases in prices in the region.

Responding to the increase in inflationary pressures, most central banks in the region reversed the accommodative monetary stance adopted in the wake of the crisis. In the Russian Federation, Ukraine and Azerbaijan, authorities increased reserve requirements in 2011; interest rates were raised by 50 basis points in the Russian Federation, Kazakhstan and Georgia, and up to 230 basis points in Armenia, Azerbaijan and Moldova. However, real interest rates remain negative in many countries. In Belarus, interest rates were raised by 2000 basis points to 30 per cent in September, yet further increases will be needed to restrain credit growth, which reached 48 per cent in the year to June, as even at 30 percent, real rates remain negative. Growing down-side risks to the global economy and lower inflationary pressures that ensued in the second half of 2011 have enabled authorities in the region to reduce the pace of monetary tightening and could prompt a wider loosening of the monetary stance in the outlook. This has already taken place in Georgia and Armenia, where the deteriorating economic outlook coupled with fears of deflation prompted a reduction of key interest rates in the second half of 2011 and, in the case of Georgia, looser reserve requirements to stimulate the long-term financing of commercial banks.

Fiscal deficits continued to decrease in the region in 2011 as greater economic activity strengthened revenues. In net fuel exporting countries, higher fuel prices amplified the revenue generated from higher trade turnover. In Kazakhstan, a $40 duty per tonne of oil exports that was implemented in 2011 helped reduce the deficit to 2.3 per cent of GDP. At the same time, assets of its National Oil Fund increased by 30 per cent to $40 billion in the first three quarters of the year. In the Russian Federation, expenditure restraint contributed to a reduction of the fiscal deficit in 2011. However, the non-oil deficit remains large, at around 11 per cent of GDP, and its *Reserve Fund* increased only by 5 per cent to $27.8 billion in the first three quarters of the year. Moreover, with a weakening of oil prices, deficits are expected to widen in the outlook. Meanwhile, several countries in the region continue to receive external resources from the IMF to support their economies, including Armenia, Georgia, Kyrgyzstan, the Republic of Moldova, Tajikistan and Ukraine. Belarus has not yet agreed upon an IMF program, following the authorities' incomplete compliance with the previous lending agreement that expired in March 2010. However, Belarus obtained a $3 billion bail out loan from the Eurasian Economic Community in response to the crisis that the country has fallen into. This stipulates that the budget deficit in 2011-13 must fall to below 1.5 per cent of GDP, which authorities will almost meet in 2011, benefiting from the budget surplus registered during the first half of the year.

Increased export volumes and favourable export prices, particularly of primary commodities, contributed to an improvement of the external balance in net fuel exporting countries of the region in 2011. In contrast, in most net fuel importing countries current account balances deteriorated. The weaker global outlook and downward pressure on commodity prices is likely to weaken external balances in the outlook, however. In the Russian Federation, the current account surplus will reach $100 billion in 2011, up from $71 billion in 2010. The trade surplus was even larger, but some of that was transferred abroad as profit remittances by foreign investors increased. At $49.3 billion in the first three quarters of 2011, net capital outflows reached almost 4 per cent of GDP, and already exceeded the $35.3 billion registered in 2010 as a whole. In Azerbaijan, a slight improvement in the trade balance was also offset by a worsening in the investment income balance. Yet, the overall surplus remains a sizeable $14.5 billion, equivalent to almost 25 per cent of GDP. In Kazakhstan, the current account surplus widened by more than 50 per cent in the first half of 2011 and is expected to reach almost 6 per cent of GDP in 2011, twice its level in 2010. In most net fuel importing countries, current account balances deteriorated in 2011. In Ukraine, the current account deficit will widen by more than 50 per cent to about 4 per cent of GDP as strong import demand due to investment and construction related to Euro 2012 championships, held jointly with Poland, will offset higher exports. In Belarus, the current account deficit of the first quarter of 2011 was more than 40 per cent of the entire deficit for 2010. As said, with pressures on foreign exchange reserves increasing significantly – reserves had fallen to under one month's worth of imports in March –authorities in Belarus were forced to devalue the Belarusian rouble in May.

The region's dependence on the external sector and its continued vulnerability to external events imply that the largest risks to the region entail a global economic slowdown and a rapid decline in the price of oil: in the Russian Federation, for instance, the balanced 2012-2014 budget revision relies on a projected oil price of $100 per barrel. Large capital outflows from the region, primarily from the Russian Federation are also a cause for worry if trends persist. Moreover, despite continued deleveraging, the financial sector remains fragile in several economies. This is dampening domestic demand.

Developing countries

Africa

Africa is forecast to see an increase in its overall growth figure from 2.9 per cent in 2011 to 5.0 per cent in 2012, marking a pronounced recovery from the disruptions caused by political unrest, as well as the return to the solid growth trend that had emerged after the economic slowdown at the peak of the global economic crisis. Important driving forces for this trend, which is forecast to lead to growth of 5.2 per cent in 2013, will be relatively strong commodity prices, solid external capital inflows and a continued expansion of demand and investment from Asia. However, the continent will continue to see a wide range of growth outcomes at the country level, with military conflicts, a lack of infrastructure, corruption and severe drought conditions being some of the factors that

will severely depress growth in some countries and, much more importantly, take a grave humanitarian toll.

Economic growth in North Africa remains in the grip of dramatic political problems and change. The economy of Libya will contract by 25 per cent in 2011 in the wake of the toppling of the country's regime, although reconstruction is expected to lead to a pronounced rebound in 2012. Political instability is also causing the economic contraction in Yemen during 2011. The economy may rebound in 2012, but this is subject to high uncertainty regarding further internal political developments. Egypt, Morocco and Tunisia will all see a more pronounced increase in economic growth in 2012, largely due to the lower base for comparison in 2011 because of the fallout from political unrest.

In Sub-Saharan Africa, South Africa will experience accelerating growth in 2012, underpinned by favourable external demand, rising consumption in light of higher wages and continued fiscal stimulus. Elevated oil prices will continue to create significant upside potential for oil-producing economies such as Nigeria, Angola and Ghana. However, infrastructure shortfalls, especially in the energy sector, as well as political instability in the Niger Delta and institutional deficits will prevent Nigeria from exploiting its full growth potential. In Angola, the start of operations at a new liquefied natural gas project will boost growth in 2012, overshadowing significant problems in developing a more viable private sector economy in light of the strong position of the public sector and institutional shortcomings.

Meanwhile, in East Africa, the economic picture offers stark contrasts. Kenya will see continued strength in its headline growth figure, driven by infrastructure investment, the expansion of the telecommunication sector and increased banking participation rates. Likewise, Uganda will see strong growth on the back of strong energy investments, for example in a new refinery project, while solid growth in Ethiopia will reflect continued infrastructure improvements, especially in the energy sector, that overshadow the negative impact of drought conditions in some areas on agricultural output. In contrast to this, large areas in the Horn of Africa have been hit by a severe drought, taking a high humanitarian toll, forcing many people to flee their home areas and prompting the United Nations to officially declare the situation a famine. Conditions are especially precarious in Somalia, where drought, poverty and military conflict have trapped many people in a live-threatening situation in which any chance for survival has become tied to meaningful external assistance.

Inflation rates are expected to fall back slightly on average across the continent in 2012, following a more pronounced impact of higher fuel and food prices in 2011. The franc zone is expected to see average inflation of less than 4 per cent in 2012 in light of normal forecast harvest patterns. At the other extreme end of the spectrum lies West Africa, where inflation will recede slightly but remain solidly in the double digits in 2012. In Nigeria, for example, strong government spending and high liquidity will remain sources of inflation pressure, which will imply a continued tightening stance by the central bank. Likewise, Ghana will also see double-digit inflation of around 10 per cent in 2012, although subsidy cuts and wage increases are counter-balanced by tighter fiscal

policy and strong agricultural output, resulting in a relatively more stable inflation picture. In East Africa, the catastrophic drought has also led to a strong jump in food prices. The baseline envisages more normal harvest patterns in 2012, resulting in reduced inflation pressure. In South Africa, rising wages and electricity rates will only partially be offset by the impact of spare capacities, resulting in an inflation rate of around 7.5 per cent in 2012. Across the continent, monetary policy will maintain a tightening bias over the forecast horizon.

Fiscal policy remains subject to a number of often conflicting factors. The need for significant investment in infrastructure and a lack of employment opportunities, compounded to some extent by the fallout from the global economic crisis, will underpin continued targeted increases in fiscal spending. At the same time, a number of governments will maintain an overall fiscally prudent approach in order to ensure the sustainability of public finances. For example, South Africa will register a budget deficit of around 5 per cent of GDP in 2012, but fiscal caution combined with the positive growth prospects will subsequently lead to a decline in the budget deficit to around 4 per cent of GDP, while the debt level will remain below 50 per cent of GDP. The assumed slight decline of oil prices will prevent the creation of any significant additional policy space for oil exporters such as Nigeria, whose budget deficit is expected to remain at around 4 per cent over the forecast period.

In North Africa, Egypt, Morocco and Tunisia are expected to see lower current account deficits in 2012 on the back of a more solid performance of the tourism sector in the wake of the disruptions caused by the political unrest in the region. At the same time, the recovery in oil production in Libya is projected boost its current account surplus to around 20 per cent of GDP in 2012. In Sub-Saharan Africa, oil producers such as Nigeria and Angola are expected to see sharply lower current account surpluses in 2012, with stronger private consumption as well as infrastructure investments underpinning relatively strong import growth. Likewise, in South Africa, strong capital good imports combined with weak demand from developed countries on the export side likely will result in a deeper current account deficit in 2012. However, a major risk in this respect constitutes a sharper than expected slowdown in China, which is the largest export destination for South Africa and which would lead to an even bigger external deficit.

High unemployment rates remain a major problem across the continent, as even the relatively solid expected growth trajectory will remain below the threshold level seen as required to make a dent in terms of employment and, by extension, in reducing poverty. The underlying factors include a lack of economic diversification, in particular into higher-value adding economic activities, skill shortages, low productivity and inflexible labour market arrangements. In South Africa, for example, unemployment will decrease only marginally in 2012 and 2013 and remain above 20 per cent. In North Africa, high unemployment, especially among the young, was a major catalyst for the protests that led to the change in government in Egypt and Tunisia. In the short term, the disruption to economic activity resulting from the political change will lead to a further increase in unemployment, but more significant reforms, also in terms of privatizations, stand to provide significant impetus to a more dynamic private sector. Correspondingly,

in Egypt, for example, the unemployment rate will jump from 9 per cent in 2010 to around 12 per cent in 2011, before moderately receding from 2012 onwards back to around 10 per cent.

East Asia

East Asia's strong growth momentum moderated in 2011, especially in the second half of the year, as the region felt the impact of sluggish demand in developed economies and increased global uncertainty. The region's GDP expanded at an estimated rate of 7.3 per cent in 2011, down from 9.2 per cent in 2010. While domestic demand is expected to remain robust in the outlook period on the back of strong labour markets, growth is projected to moderate further to 6.8 per cent in 2012 and 6.9 per cent in 2013. This primarily reflects continuing weakness of exports to developed countries, which will have a particularly negative impact on growth in the region's strongly export-oriented economies. In view of the increased risks to growth, the region's central banks have shifted to a wait-and-see approach, with the possibility of easing monetary conditions in the coming quarters. At the moment, they remain reluctant to do so since core inflation continues to be elevated even though lower food and commodity prices have led to a slowdown in headline inflation.

After growth across East Asia was largely driven by a rebound in exports and investment in 2010, private consumption became a more important factor in 2011. In almost all economies, with notable exceptions of Thailand and Viet Nam, consumption growth gained further strength in 2011. This has been supported by rising wages and incomes as well as persistently low real interest rates as most central banks tightened monetary policy only cautiously. However, sluggish growth in developed economies led to a slowdown in export demand, particularly in the second half of the year. Since this trend is projected to persist in 2012, countries with large domestic demand bases, notably China and Indonesia, will continue to be in a better position to maintain high growth than strongly export-oriented economies such as Singapore and Taiwan Province of China. As in previous years, China's economy served as the engine of growth in the region, expanding by 9.3 per cent in 2011, down by only one percentage point from 2010. In the outlook period, growth in China is expected to slow gradually to 8.7 per cent in 2012 and 8.5 per cent in 2013 as slower growth in investment and exports is only partly offset by higher consumption.

Unlike in other regions, labour markets in East Asia remain strong, with unemployment rates near or below the pre-crisis levels of 2007/08. In most countries, unemployment rates continued to decline in 2011. The Republic of Korea continues to be the OECD country with the lowest unemployment rate, estimated at 3.0 per cent in August 2011, down from 3.3 per cent a year ago. Unemployment rates in Hong Kong Special Administrative Region of China and Indonesia fell to decade-lows of 3.2 per cent and 6.8 per cent, respectively, in 2011. Across the region, strong economic growth since mid-2009 has boosted employment in the manufacturing and the services sector. In Indonesia and the Philippines, the countries with the highest unemployment rates in the region, fast employment growth has been primarily driven by the services sector, where

productivity is estimated to be only half the level of industry. Despite recent progress, the proportion of vulnerable employment in total employment remains high in several countries, notably Indonesia and Thailand. With growth projected to remain fairly robust in the outlook period, unemployment rates are expected to show little change in 2012 and 2013. Real wages and salaries continued to move up in 2011 on the back of productivity gains, a trend that is expected to continue, especially in the economies with lower per-capita income such as China, Indonesia and Viet Nam. China's five-year plan for 2011-15 aims at increasing the minimum wage by at least 13 per cent per year.

After accelerating in the first half of 2011, inflation has started to moderate in most East Asian economies as food and commodity price gains eased. However, price pressures have abated only slowly and core inflation has remained elevated. In some cases, such as China, year-on-year consumer price inflation is still significantly above the comfort level of the central bank. For the region as a whole, consumer price inflation averaged 5.1 per cent in 2011, up from 3.2 per cent in 2010 and ranging from 1.5 per cent in Taiwan Province of China to 18.5 per cent in Viet Nam. In the majority of economies, food prices were the main driver of inflation throughout 2011. The sharp upturn in food prices reflects the impact of supply disruptions, such as heavy flooding in East China, higher input costs (particularly for fuel) and rapidly growing demand in the wake of rising wages and incomes. Inflation has also been fuelled by strong credit growth, notably in China and Viet Nam, massive capital inflows during the first half of 2011, and higher inflationary expectations. While consumption demand across East Asia is likely to remain fairly robust in the outlook period, based on strong wage growth, a softening of international commodity prices will reduce inflationary pressures in the outlook period. Average consumer price inflation is projected to decline gradually to 3.8 per cent in 2012 and 3.3 per cent in 2013.

With the world economy facing a renewed downturn and price pressures across the region starting to ease, most of East Asia's central banks have moved to a wait-and-see approach, delaying further monetary tightening. Since early July 2011, only the Bank of Thailand has increased its policy rate, whereas the State Bank of Viet Nam and the Bank of Indonesia cut rates. The recent policy shift in the region follows a period of gradual tightening in the form of interest rate hikes and increases in reserve requirements. The People's Bank of China and the Bank of Korea, for example, had raised the main interest rates five times (by a total of 125 basis points) between July 2010 and July 2011. However, most central banks remained reluctant to tighten monetary policy more aggressively owing to concerns over the stability of the global recovery as well as fears that interest rate hikes could trigger further short-term capital inflows. In several economies, real interest rates became negative in 2011 as inflation accelerated rapidly. In the near-term, most central banks are expected to keep their current wait-and-see approach. However, if growth across the region decelerates more than expected, a shift towards easier monetary conditions is likely.

Most economies in East Asia continue to have strong fiscal positions, with relatively low levels of public and private debt. Government spending expanded at a solid pace in 2011, although more slowly than in the aftermath of the 2008/09 crisis. After

government budgets across the region improved significantly in 2010 because of a surge in revenues amidst rapid economic growth, trends have been more mixed in 2011. In the Philippines, the Republic of Korea and Singapore, government budgets are estimated to have strengthened further, with the latter two countries as well as Hong Kong Special Administrative Region of China registering surpluses in 2011. By contrast, Indonesia, Malaysia and Thailand are likely to have seen a slight widening of deficits as government spending increased markedly. As in previous years, government spending in Indonesia appears to have fallen short of the budgeted level owing to ongoing difficulties in disbursing funds, resulting in a lower than targeted deficit of about 1 per cent of GDP. Malaysia is the economy with the largest deficit in the region, estimated at 6.9 per cent of GDP in 2011, up from 5.6 per cent in 2010. China's budget deficit, which excludes local government finances, is projected at about 1.5 per cent of GDP in 2011. During the first six months of the year, both fiscal revenues and spending in China increased by 31 per cent compared with the same period in 2010. Several stimulus-related infrastructure projects were gradually phased out, but this was partly offset by increased spending on education, healthcare and pensions. In the outlook period, fiscal balances across East Asia are projected to remain healthy, with moderate expansions of government expenditure. While most Governments have ample fiscal space, they will only consider new large-scale stimulus measures if growth prospects deteriorate sharply.

East Asia continued to see strong growth in exports and imports in 2011 despite some moderation in the second half of the year as global economic conditions worsened and international commodity prices eased. Compared to 2010, total export receipts (in United States dollar value terms) increased by about 20 per cent in China, Indonesia and the Republic of Korea. Rapidly expanding trade within East Asia, driven in particular by strong demand in China, as well as with other emerging countries, notably India, accounted for most of the growth. In contrast, yearly exports in the Philippines grew only by 2 per cent in 2011 as shipments of electronics goods, which account for almost half of the country's exports, fell amidst weak demand in the United States and Japan. In most economies, import spending increased at a rate similar to that of export revenues, which led to largely unchanged trade balances in 2011. With the exception of Viet Nam, all economies in East Asia recorded a current account surplus in 2011. China's current account surplus, which had reached 10.6 per cent of GDP in 2007, is estimated to have declined to about 3.5 per cent of GDP in 2011. In China and in most other East Asian economies, import growth is expected to outpace export expansion in the outlook period as demand in developed countries is projected to remain weak. Moreover, in several countries, most notably in China, the Government's focus has shifted from exports to domestic demand, which will support import spending.

Following a surge in net capital flows to East Asia in 2010 and the first half of 2011, the region experienced massive outflows in the third quarter of the year. Increased risk aversion among global investors and concerns that the crisis in developed economies could lead to a marked growth slowdown in East Asia resulted in a sharp decline in the region's stock markets. The massive capital outflows led to a drop in the value of national currencies against the dollar, with several central banks intervening to prevent their currencies from depreciating too rapidly. The Korean won lost about 10 per cent against

the dollar in the second half of September, falling to its lowest level in over a year. The region's stock and foreign exchange markets will likely be characterized by elevated volatility as East Asia is projected to see further net capital inflows, coupled with gradual currency appreciation, following a decline in global risk aversion.

While East Asia is not immune to a downturn in developed countries, the region is in a strong position to tackle the challenges arising from weaker external demand. However, deep and prolonged recessions in major developed countries would still have a severe impact on economic growth in the region as falling exports and increased uncertainty could trigger a slowdown in investment and private consumption demand. A more-rapid-than-expected deceleration of growth in China constitutes an additional major risk for the region. In this context, a specific concern is the health of China's property market after prices have started to decline and real estate developers encountered balance sheet problems.

South Asia

Economic growth in South Asia moderated in 2011 primarily owing to a slowdown of the Indian economy. After expanding by 7.1 per cent in 2010, South Asia's gross domestic product grew by 6.5 per cent in 2011. The region is expected to remain mostly resilient to the global economic downturn and sustain its robust growth momentum in the outlook period, with GDP forecast to expand by 6.7 per cent in 2012 and 7.0 per cent in 2013. Consumer price inflation has remained stubbornly high across the region in 2011, and is forecast to decline only slowly in the outlook period. As inflationary pressures ease, central banks are expected to end monetary tightening and move towards a neutral or even accommodative policy stance.

While private consumption and investment continued to be the main growth drivers in 2011, strong external demand and a solid expansion of government spending also contributed positively to growth. However, growth disparities within the region have remained large: Bangladesh, India and Sri Lanka recorded growth of 6.7 per cent or higher, whereas the Islamic Republic of Iran, Nepal and Pakistan saw growth below 4 per cent. India's economy slowed in 2011 as the Central Bank tightened monetary policy aggressively to reduce stubbornly high inflation. This led to a weakening of domestic demand, and in particular private investment spending. Gross domestic product expanded by 7.7 per cent, down from 8.5 per cent in 2010. Given India's strong fundamentals and the expected end of the Central Bank's tightening cycle, growth is forecast to pick up slightly to 7.8 per cent in 2012 and 8.0 per cent in 2013. Strong domestic demand, supported by a further increase in remittance inflows, will also continue to underpin economic growth in Bangladesh and Sri Lanka. In the Islamic Republic of Iran, Nepal and Pakistan, long-standing structural problems such as weak policy implementation, security concerns and low levels of investment in physical and human capital continue to constrain economic growth. A slight improvement of economic conditions is expected in all three countries in the outlook period, leading to a recovery of consumption and investment, but growth will remain well below potential.

Recent employment surveys in South Asia provide a mixed picture. While the labour market situation in the fast-growing economies of India and Sri Lanka appears to have improved, it remained weak in other parts of the region, notably in crisis-ridden Pakistan and the Islamic Republic of Iran. According to a recent labour market report, employment in manufacturing industries in India increased in 2010 and early 2011, particularly in export-oriented sectors. This indicates that the national unemployment rate may have come down a bit from its last officially estimated level of 9.4 per cent in the fiscal year 2009/10. In Sri Lanka, the unemployment rate declined to an all-time low of 4.3 per cent in the first quarter of 2011 on the back of continuing strong growth in the service and industry sector. In the Islamic Republic of Iran and Pakistan, sluggish growth over the past few years has had a negative impact on the employment situation. The unemployment rate is estimated to have increased in the Islamic Republic of Iran from 11.9 per cent in the fiscal year 2009/10 to 14.6 per cent in the fiscal year 2010/11 and in Pakistan from 5.6 per cent in the fiscal year 2009/10 to 6.0 per cent in the fiscal year 2010/11. In addition to elevated national unemployment rates, the labour markets in South Asia face deep-rooted structural challenges such as the highest share of vulnerable employment among all developing regions and widespread youth unemployment. In Sri Lanka, almost one in five persons aged 15 to 24 is out of work. Moreover, in all countries of the region, unemployment rates among women are far higher than among men.

Consumer price inflation remained stubbornly high across South Asia in 2011. Regional inflation averaged 10.2 per cent, down only slightly from 11.2 per cent in 2010 and ranging from 7.6 per cent in Sri Lanka to 17 per cent in the Islamic Republic of Iran. The increases in consumer prices were driven by a variety of factors, including higher international food and energy prices, domestic supply shortages, the reduction of fuel subsidies in several countries and buoyant demand conditions in Bangladesh, India and Sri Lanka. In addition, inflationary expectations are elevated and persistent in most economies. After increasing sharply in the second half of 2010, upward pressures on food prices moderated somewhat in the course of 2011, mainly owing to improved supply conditions in the agricultural sector. In India, food inflation averaged 8.9 per cent (year-on-year) in the third quarter of 2011, well below the 16.6 per cent increase recorded in the same period in 2010. Nevertheless, food prices have continued to be the main contributor to consumer price inflation, notably in Bangladesh and Pakistan. At the same time, food price increases have increasingly spilled over to the rest of the economy, as indicated by a rise in non-food inflation in most countries. Inflation is forecast to decline slowly in 2012 and 2013 as the pressure from higher food and energy prices eases and the impact of tighter monetary policy is being felt in Bangladesh and India. However, there are substantial risks for inflation to increase again, including renewed supply shocks such as insufficient monsoon rains and a sharp rise in international commodity prices.

In view of continuing strong inflationary pressures, several central banks in South Asia further tightened monetary policy during 2011. The Reserve Bank of India (RBI) maintained its firm anti-inflationary policy stance despite a significant weakening of domestic demand over the past few quarters. Since March 2010, the RBI has hiked the main policy rates twelve times, lifting the repurchase rate from 4.75 to 8.25 per cent and the reverse repurchase rate from 3.25 to 7.25 per cent. The Bangladesh Bank also

continued to increase policy rates to contain inflation, which rose to double-digit levels during 2011. In addition, the central bank aims at discouraging credit flows to unproductive sectors, including real estate and stock market investment. The State Bank of Pakistan, by contrast, eased monetary conditions in August and October 2011, cutting its benchmark interest rate by a total of 150 basis points to 12.5 per cent. A slowdown in inflation during the third quarter of 2011 has given Pakistan's authorities scope to loosen monetary policy after total gross investment declined to a 40-year low of 13.4 per cent of GDP during the fiscal year 2010/11. Pakistan's Government has vowed to maintain zero net borrowings from the central bank in 2011/12 in order to anchor inflationary expectations. Given that inflation in most economies is expected to decline gradually in the outlook period, further monetary tightening is likely to be limited. The Reserve Bank of India is expected to move to a more neutral policy stance, whereas the State Bank of Pakistan will likely ease monetary conditions further.

In most South Asian countries, fiscal deficits declined slightly in the past year despite significant increases in development and non-development expenditures. The region's Governments have expanded spending on key development needs such as infrastructure, education and healthcare, while attempting to strengthen fiscal balances by widening the tax base and improving tax collection. However, tax reforms and other measures to increase revenues often face severe opposition from interest groups and political opponents. A case in point is Pakistan, where failure to implement a reformed general sales tax owing to domestic political opposition limited progress in fiscal consolidation during the past fiscal year. The country recorded a deficit of 5.7 per cent of GDP in 2010/11, missing the IMF target by a significant margin. While the Government aims at reducing the budget deficit to 4.0 per cent in the fiscal year 2011/12 on the back of stronger growth, the fiscal situation remains challenging. In India and Sri Lanka, rapid economic growth helped boost government revenues, leading to a narrowing of the deficit. India's Government also benefited from strong non-tax revenues as the proceeds from the sale of 3G telecommunications licenses exceeded initial expectations. The budget deficit narrowed to 5.1 per cent of GDP in 2010/11, down from 6.1 per cent in the previous fiscal year. However, the Government is likely to miss its deficit target of 4.6 per cent of GDP for the fiscal year 2011/12 as tax revenues are expected to fall short of budgeted levels because of slowing growth. Sri Lanka continues to have the largest budget deficit in the region, estimated at 6.8 per cent of GDP in 2011, following 7.9 per cent in 2010. In view of the country's favourable growth prospects, a further narrowing of the deficit is forecast for 2012 and 2013, although at a pace slower than expected by the Government. The Islamic Republic of Iran is the only country in the region that persistently recorded budget surpluses in recent years owing to soaring oil revenues. However, given an expected decline of oil production and strong spending pressures, the fiscal balance may deteriorate markedly in the outlook period.

After recording exceptionally strong growth in the first half of 2011, South Asia's export sectors have seen a moderation in demand owing to deteriorating conditions in developed economies. Nonetheless, in most countries of the region total export earnings (in dollar) are estimated to have risen by 20 to 30 per cent in 2011. Bangladesh, Pakistan and Sri Lanka benefited from a strong recovery in demand for textiles and garments,

partly as a result of significant cost increases in China and political turmoil in North Africa and Western Asia. In India, exports of engineering goods, petroleum products and gems and jewelry soared. Import spending in 2011 was boosted by high oil and commodity prices and strong domestic demand, notably in Bangladesh, India and Sri Lanka. As in most countries imports started from a higher base than exports, nominal trade deficits widened further in 2011. India's merchandise trade deficit is estimated to have grown by 15 per cent to about $150 billion. The increase in merchandise trade deficits has been partly offset by improvements in the service balance and higher remittance inflows. In India, the information technology and business process sector has continued to grow strongly, while Sri Lanka has experienced a strong upturn in tourism inflows. In Pakistan, the increase in the current transfer balance, partly owing to a surge in remittance inflows, has led to a sharp reduction of the current account deficit. In 2012, export growth is likely to decelerate, leading to a further widening of trade deficits in most countries.

Europe continues to be a key export market for South Asia and a main source of tourism revenues. A prolonged recession in some of Europe's major economies could thus have a severe impact on growth across South Asia. Renewed increases in international commodity prices also represent a risk for South Asia as this would complicate fiscal consolidation efforts and monetary policy decisions, while also leading to a widening of current account deficits.

Western Asia

After having experienced a regionally balanced recovery in 2010 with growth in most economies of the region rebounding by more than 4 per cent, performances have been more contrasted in Western Asia in 2011, mainly due to unforeseen political developments and their impact on the international oil market.

Most oil exporters strongly benefited from rising oil prices as political turmoil spread across the region. Indeed, during at least eight months in 2011, oil traded above $100 per barrel, well above the 2010 average price of $80 per barrel. Furthermore, when the conflict in Libya reduced global oil supply by 1.6 million barrel per day (mbd), Bahrain and the United Arab Emirates stepped up oil production, as well as Saudi Arabia, which increased its crude supply to a record high of 9.8 mbd in August, well over the OPEC quota of 8.05 mbd. Qatar also benefited from rising energy prices as its natural liquefied gas production increased by 40 per cent during the first half of 2011. Although political unrest deterred potential investors, the generous social spending measures announced by many Arab Governments boosted economic growth through increased public and private spending. As a result, most Gulf Cooperation Council (GCC) countries as well as Iraq are expected to fare even better in 2011 than they did in 2010. In 2012, under the assumption of returning political stability and high oil prices, GDP is forecast to grow by more than 3 per cent in oil exporting countries: 3.7 per cent in Bahrain, 4.7 per cent in Kuwait, 6.2 per cent in Qatar, 3.9 per cent in Saudi Arabia and 3 per cent in the United Arab Emirates. A forecast of growth based on a country model is not yet available for Iraq.

In the Syrian Arab Republic and Yemen, lasting social turmoil has shattered any prospects of positive growth in 2011. Additionally, the United States and the European Union have imposed economic sanctions on the Syrian Arab Republic, including a ban on oil imports. Given the transportation cost, the small quantities involved, and the political pressure, the Syrian Government may well have to offer a 20 per cent discount to the countries willing to buy its oil, foregoing earnings in foreign reserves amounting to almost one per cent of GDP. Unlike the Syrian Arab Republic and Yemen, Bahrain will register a positive economic growth rate in 2011. In 2012, in a scenario where political stability is restored in Yemen, GDP is forecast to rebound and grow by 5 per cent. A forecast of growth based on a country model is not yet available for the Syrian Arab Republic.

Fuel importers experienced continued growth on sometimes shaky grounds. The modest economic support measures announced in Jordan stimulated private consumption on the back of growing budget deficits, making the country more dependent on international assistance and financial markets. The unrest in the Syrian Arab Republic has affected neighboring countries by disrupting trade and shying away tourists. Jordan and Lebanon are most affected by the observed decline in tourism, as this activity is estimated to directly account for 7 and 9 per cent of employment and indirectly for 18 and 32 per cent of GDP, respectively. Lebanon is expected to be the most affected because of its reliance on arrivals of European tourists, accounting for around 40 per cent of total arrivals, four times more than in Jordan. Declining tourism revenue is weighing on employment and household income, but also negatively affects real estate investments and construction activity. As a result, while growth is expected to decrease only slightly from 3.1 to 2.8 per cent in Jordan in 2011, it will slow down substantially in Lebanon from 7.5 to 1.7 per cent. In 2012, GDP is forecast to grow by 3.1 per cent in Jordan and in Lebanon.

In Turkey, counter-cyclical fiscal policy and unorthodox monetary policy led to a strong recovery in 2010 and the economy grew by 10.2 per cent in the first half of 2011 on the back of strong private consumption and investment and despite strong imports. Construction, trade, transportation and communication were among the most dynamic sectors. In Israel, even though the Government played a less active role in the recovery, a similar though more modest growth pattern unfolded in 2011 and is expected to continue. In 2012, GDP is forecast to grow by 2.5 per cent in Israel and 3.2 per cent in Turkey. A forecast of growth based on a country model is not yet available for the Palestinian Territories.

For all countries in the region, economic prospects for 2012 and 2013 appear very uncertain, as continuing political unrest could potentially be reignited in countries where it has been contained so far, with far reaching consequences on tourism and borrowing costs as well as on the international oil market.

Recent political unrest highlights the poor employment situation as well as common problematic features of many labour markets in the region. Female economic participation rates are extremely low with women accounting for barely one fifth of the

labor force in Jordan or Saudi Arabia. Despite curtailed economic participation, unemployment rates in the region are among the highest in the world, especially among educated youth, while migrant workers represent on average more than 70 per cent of the labor force in GCC countries. These outcomes point at persisting poor coordination of education and economic as well as industrial policies. In order to counter the threat of spreading unrest, many governments have promised to quickly create jobs for nationals in the public sector (100,000 in Saudi Arabia, 20,000 in Bahrain, 50,000 in Oman) and increase wages. Saudi Arabia is even trying to impose quotas for nationals in private businesses. In Turkey, after a peak above 14 per cent in 2009, the unemployment rate is now oscillating around 9 per cent. In Israel, unemployment was at 5.4 per cent in July, below its pre-crisis level, after having peaked at 7.9 per cent two years earlier. Despite this apparent improvement in the labour market, rising income disparities, high cost of living and other factors have led the struggling middle class to organize the largest social protests the country has experienced since its creation.

Inflation was on the rise in all countries of the region during the first half of 2011 on the back of increasing food and energy prices as well as government and private consumption. The weakness of the dollar reignited the debate in GCC countries about whether their pegs should be based on a basket of major international currencies instead of the United States dollar alone in order to dampen imported inflation. In recent months, inflation slightly decreased and remained below 5 per cent in most countries. If energy (or food) subsidies were to be phased out, as is recommended by the International Monetary Fund, price stability would probably be challenged, as is currently the case in Iran. Higher-than-targeted inflation alarmed policy-makers during the first half of 2011 in Israel and Turkey. These trends developed on the back of very strong private consumption. In Israel, this was compounded by the dramatic rise in housing prices, which have soared by 60 per cent since 2007. Due to decisive action of policymakers, inflation is however expected to stay in the target zones of the central bank, which lies between 1 and 3 per cent in Israel and between 3.5 and 7.5 per cent in Turkey.

Monetary policy in most countries of the region focuses on reigning in inflation only. In countries of the Gulf Cooperation Council (GCC) that peg their currency to the American dollar, interest rates will remain unchanged until the Fed starts hiking its rates in 2013. While some central banks might be tempted to anticipate those hikes to address issues related to rising inflation, their scope for action is limited by the risk of fostering carry-trade. The project to establish a common currency in GCC countries is likely to be postponed as long as an example has not been set to solve the current sovereign debt crisis in the euro area. In Israel, the Central Bank raised its policy rate four times in 2011 before reducing it twice as lower demand from its main export markets threatened to affect domestic demand. As long as inflation expectations remain under control, the central bank is expected to lower the interest rate in reaction to slackening external demand. As low interest rates and timid growth perspectives in developed countries led to rising capital flows towards emerging markets during the first half of 2011, the Central Bank of Turkey pursued an unorthodox policy mix consisting of capping loan growth instead of raising interest rates to avoid overheating. This enabled the central bank to simultaneously stabilize inflation while discouraging carry-trade, thus weakening the lira

and limiting the current account deficit. Concerned that slow global demand may weaken economic growth, Turkish monetary authorities recently reduced their policy rate and may do so again if necessary.

Fiscal policy in Western Asia was strongly influenced by political unrest spreading in the Arab world. The threat of potentially destabilizing protests forced governments to rapidly devise unprecedented social spending measures. Most spectacularly, the Saudi king announced two extraordinary spending packages worth a combined 30 per cent of GDP ($130 billion). In the short run, these packages have been used to raise public sector wages and pay a one-time bonus for civil servants, as well as to set up the first unemployment assistance scheme and increase the budget for various public credit agencies. Over the next five years, the announced measures will aim at creating 100,000 new public sector jobs and building 500,000 homes. Other countries threatened by political unrest adopted similar, although more modest, spending packages. These moves boosted economic activity mainly through consumption, but also increased budget deficits. High energy prices allowed oil exporters to fund such expenses themselves, but in the long run the fiscal sustainability of measures increasing short and medium-term consumption rather than long-term productivity may be at risk if oil revenues were to decrease substantially. In fuel-importing countries such as Jordan or Syria, the budget deficit is expected to grow to 6 and 10 per cent of GDP, respectively. Rising indebtedness will reinforce the dependence on foreign development assistance and complicate their access to international financial markets. In Iraq, the Government increased expenditures by 19 per cent in 2011, mainly to invest into much needed infrastructure to address chronic electricity shortages. There are concerns that due diligence may not have been respected in granting lucrative contracts to multinational corporations. Furthermore, slower-than-expected oil production capacity expansion will weigh on revenues, translating into a budget deficit of more than 10 per cent of GDP. In Turkey and Israel, budget deficits are decreasing as growth boost revenues.

External balances in fuel-exporting countries will show solid surpluses in 2011 in light of the combination of higher oil prices and increased output. Returns on their stock of assets accumulated abroad by recycling petrodollars will further improve their external positions. Their current accounts will however be negatively affected by the region-wide repricing of risk that is raising borrowing costs as well as by declining foreign direct investment as a consequence of accrued political risk. Non-oil exporters will suffer from a slowdown in the recovery in their main export markets as well as from high oil and commodity prices, deteriorating their trade balance. Remittances from GCC countries and Europe will continue to limit their current account deficit. In Israel, where exports amount to 40 per cent of GDP, slackening demand in Western markets is affecting export revenues; the negative effect may be more pronounced in 2012 if the United States and Europe intensify fiscal austerity measures. In Turkey, strong domestic demand contributes to the chronic trade deficit, but the depreciation of the Turkish lira in 2011 increases the competitiveness of Turkish goods and, despite lower-than-expected returns on Turkish bonds, financial markets remain willing to fund foreign exchange liquidity needs.

Political unrest represents a major risk. In case of a renewed sharp rise of the oil price, even oil exporters would be negatively affected by the consequences of such a development for the world economy. By contrast, if austerity measures negatively impact global aggregate demand, oil prices may drop and jeopardize fiscal sustainability in oil-exporting countries. As growth prospects in emerging countries remain sound and the energy consumption of the middle class continues to rise, this risk also remains a distant one. In the long run, inaction in relation to the dire employment situation and, more broadly, the failure to devise and implement a more inclusive development paradigm represent major risks to political stability and economic performance.

Latin America and the Caribbean

In the first half of 2011, Latin America and the Caribbean experienced on average robust growth. After a strong first quarter, economic activity slowed down in the second quarter and it is expected to further moderate in the second half of 2011 and through 2012.

On average the region's income is expected to grow by 4.5 percent in 2011 and by 4 percent in 2012 year-on-year, with stark differences between countries. Indeed, two different speeds of growth can be observed.

South America and Panama are expected to grow by 4.8 percent in 2011 and by 4 percent in 2012, driven by internal and external demand. At home, growing internal demands are fuelled by strong labor market dynamics and falling poverty and inequality (notably in Brazil). Urban unemployment is lower in South America than it was before the crisis. Private and public investment, helped by abundant credit and solid banks' balance sheets, also contributed to growth. Last but not least, macroeconomic policies and social programs accommodated demand, or directly supported disposable incomes. From the outside, growing commodity prices fueled large export revenues while massive capital inflows – fleeing uncertainty in Europe and the United States – sustained investment.

The economies of Mexico, Central America and the Caribbean, on the other hand, are expected to grow by 4 per cent in 2011 and by 3 percent in 2012. These economies are held back by closer links to the United States economy and other high-income countries, which have been slowing down in 2011 and are expected to slow further in 2012. Additionally, economies in the Caribbean rely heavily on remittances and tourism from the EU and the United States and are burdened by large public debts whose sustainable service requires faster growth.

For the region as a whole, current account deficits are expected to grow to 1.5 percent of GDP in 2011 from 1.2 in 2010, mainly due to imports of services. The aggregate trade balance is positive by about 1 percent of GDP. Caribbean countries reflect the aggregate with current account deficits except for Trinidad and Tobago, Suriname and Jamaica, which recorded surpluses owing to large commodity exports.

Terms of trade are expected to improve in 2011 by more than 6 percent for the region, with commodity exporters recording large gains and importers suffering losses. Larger gains are expected by exporters of metals and minerals (Chile and Peru), followed by oil and gas exporters (Bolivarian Republic of Venezuela, Colombia, Ecuador, Bolivia) and exporters of agricultural commodities (Argentina, Brazil, Paraguay and Uruguay). Terms of trade deteriorated in Caribbean countries such as Haiti, which in July was listed by the Food and Agriculture Organization among the countries requiring external food assistance.

Growing trade in commodities, high interest rates and growth prospects attracted large capital flows to the region, aiming both at productive investment and speculation. Until recently, these inflows caused concerns regarding inflation and exchange rates, but eliminated shortages of private capital. However, the return of high financial volatility in the second half of the year induced a sudden reversal of capital flows.

On average, inflation was slightly below 8 per cent in the first half of 2011, but differences between countries were very large. Countries that have focused exclusively on monetary stability adopting inflation targeting (Brazil, Chile, Colombia, Mexico, Peru, Uruguay) have recorded consumer price indices near the upper bound of their target range. Notably, Brazil, Peru and Uruguay recorded inflation rates above their respective upper bounds. In Argentina and the Bolivarian Republic of Venezuela, inflation is expected to reach double-digit levels in 2011. In Argentina in particular, where there are mounting concerns over the reliability of official statistics, data point at a 25 per cent inflation rate.

Financial flows, both domestic and external, were boosted by growing commodity and equity prices in the first half of the year but moderated in the third quarter. After initial euphoria, growing global risk aversion took a toll on the region's stock markets, which recorded large losses in September, while currencies also lost ground.

The banking sector in most countries remains strong, setting itself apart from the United States and EU where banks' balance sheets are plagued by large amounts of sovereign bonds of uncertain value. Non-performing loans are comparatively low in Latin America and the Caribbean, although the strong presence of Spanish banks causes some concerns.

Risks to the outlook appear mostly of a downside nature. A sharper than expected slowdown of high-income economies may hinder growth in Central America, the Caribbean and Mexico, which are forecast to see a slowdown to 3 percent in the baseline scenario in 2012. This may lead to a vicious circle of lower tax revenues, difficult debt service, fiscal austerity and even lower growth. A slowdown of the Chinese economy may lead to slower dynamics for manufacturing and commodity prices, spilling over to commodity exporters through the trade channel. In addition, the persistence of high global risk aversion, closely associated with the uncertainty over the value of European sovereign debts, and the possibility of drying up of dollar funding make private financing more expensive or unavailable for some countries in the region. Finally, a shortfall of

demand may come directly from domestic factors as reduced credit and confidence weaken growth of domestic consumption and investment. Some financial institutions, including the International Monetary Fund and some central banks, see possible upside risks in the event that global uncertainty dissipates more quickly than expected and growth of domestic demand and foreign direct investment resumes strongly.

Early data for the fourth quarter of 2011 seem to confirm the downside trend that appeared in July. Sell-offs in stock markets and large depreciations of some currencies may have signalled the start of a period of tighter finance. Prices of industrial metals dropped in September, affecting mainly Argentina and Peru.

Governments will be facing these risks, while counting on less fiscal space than in 2008/2009. As a result, the potential for counter-cyclical policies, which spared many countries in the region an economic downturn, is not as great as it was two years ago.

In the first quarter of 2011, monetary policies in the region were characterized by a series of restrictive interventions, mostly in the form of policy rates hikes, aimed at avoiding overheating. As economic activity slowed down in the second and third quarter, many central banks cut rates and increased liquidity, especially in commodity exporting countries. In Mexico, the stance of monetary policy has remained accommodative.

On the fiscal policy front, the region saw a consolidation effort in the first quarter and partially in the second quarter of 2011. In Brazil and Peru, this was the result of the interruption of programs put in place in 2009 to respond to the global contraction. In the third quarter, however, concerns about a second global downturn induced governments to prepare stimulus measures to deploy in the event of an excessive slowdown. Some commodity exporters, such as Peru and Chile, prepared to tap the resources accumulated in months of rallying commodity prices to expand social cash transfer programmes.

Governments (in particular those of Argentina, Brazil, Peru, Uruguay, Colombia, Costa Rica and Mexico) also resumed foreign exchange interventions. While exchange rates have generally been left free to fluctuate, several countries have intervened to mitigate appreciations in the second and third quarters. Macro-prudential measures have been introduced by both Brazil and Peru, while some countries have experimented with indirect measures, such as stockpiling of international reserves and pre-payment of external debt.

Brazil has been particularly active in trying to influence the value of the real. Amidst concerns of overvaluation and loss of competitiveness, the government intervened to lower the exchange rate in September and soon after was forced to change course and support the rate in order to stop a free fall. As capital movements remained very volatile, Brazil introduced mild forms of capital account regulation aiming at stabilizing the value of its currency and gaining stronger control over monetary policy.

LINK Global Economic Outlook
October 2011

Annex Table

Table A.1
World and regions: rates of growth of real GDP, 2006-2013
(Annual percentage change[a])

	2006	2007	2008	2009	2010 [b]	2011[c]	2012[c]	2013[c]
World	4.1	4.0	1.5	-2.3	4.0	2.8	2.6	3.3
Developed economies	2.8	2.5	-0.1	-4.0	2.7	1.4	1.3	2.1
North America	2.7	2.0	-0.3	-3.4	3.0	1.8	1.5	2.4
Asia and Oceania	2.1	2.7	-0.7	-5.0	3.7	-0.3	2.1	2.1
Europe	3.2	3.0	0.3	-4.1	1.9	1.6	0.8	1.7
European Union	3.2	3.0	0.3	-4.2	1.9	1.6	0.7	1.7
EU-15	3.0	2.8	0.0	-4.3	1.9	1.5	0.6	1.5
New EU	6.5	6.2	4.0	-3.6	2.2	2.9	3.0	3.4
Other Europe	3.1	3.3	1.4	-1.9	1.5	1.8	2.0	1.9
Memorandum items:								
Euro Zone	3.0	2.8	0.4	-4.2	1.8	1.6	0.5	1.3
Major developed	2.6	2.2	-0.4	-4.2	2.9	1.4	1.3	2.1
OECD	3.0	2.6	0.0	-3.9	2.9	1.6	1.4	2.2
Economies in transition	8.0	8.3	5.2	-6.6	4.2	4.2	3.9	4.5
South-eastern Europe	5.1	6.1	4.2	-3.7	0.5	1.8	2.7	3.3
Commonwealth of Independent States	8.3	8.5	5.3	-6.9	4.5	4.4	4.0	4.6
Developing countries	7.6	7.9	5.3	2.5	7.5	6.1	5.5	5.9
Africa	6.0	6.0	5.1	2.2	4.5	2.9	5.0	5.2
North Africa	5.4	4.7	4.7	3.0	4.2	-0.5	4.7	5.5
Sub-Saharan	6.4	6.6	5.3	1.8	4.7	4.7	5.2	5.1
East and South Asia	9.0	9.8	6.2	5.2	8.7	7.1	6.8	6.9
East Asia	9.2	10.2	6.4	5.1	9.2	7.3	6.8	6.9
South Asia	8.3	8.5	5.4	5.7	7.1	6.5	6.8	7.0
Western Asia	6.5	5.1	4.3	-1.0	6.6	6.7	3.7	4.3
Latin America and the	5.5	5.6	4.0	-2.1	6.0	4.2	3.2	4.1
South America	5.5	6.6	5.3	-0.5	6.4	4.5	3.6	4.4
Mexico and	5.0	3.8	1.8	-5.4	5.3	3.8	2.5	3.5
Caribbean	10.3	6.5	3.6	0.9	3.9	3.3	3.6	4.2
Memorandum items:								
Least developed countries	7.5	8.1	6.2	4.6	5.4	5.2	5.9	5.7
Sub-Saharan Africa (excluding Nigeria and South Africa)	6.5	7.4	5.1	3.0	4.7	5.2	5.7	5.3
East Asia (excluding China)	5.7	5.9	2.7	0.1	7.7	4.6	4.2	4.6
South Asia (excluding India)	6.1	6.2	3.8	2.8	3.9	3.7	4.2	4.4
Western Asia (excluding Israel and Turkey)	6.5	5.4	6.7	1.0	5.6	6.6	4.3	3.8

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 Actual or the most recent estimate.
c Forecasts, based in part on Project LINK.

Table A.2
Rates of growth of real GDP, 2006 -2013
(Annual percentage change)

	2006	2007	2008	2009	2010 [a]	2011 [b]	2012 [b]	2013 [b]
Developed economies								
North America								
Canada	2.8	2.2	0.7	-2.8	3.2	2.2	1.9	2.6
United States	2.7	1.9	-0.3	-3.5	3.0	1.7	1.5	2.4
Asia and Oceania								
Australia	2.4	4.8	2.4	1.4	2.5	0.5	2.8	2.6
Japan	2.0	2.4	-1.2	-6.3	4.0	-0.5	2.0	2.0
New Zealand	2.1	3.4	-0.7	0.0	2.5	1.4	2.5	3.0
European Union								
EU-15								
Austria	3.6	3.7	1.4	-3.8	2.3	3.0	1.3	2.2
Belgium	2.7	2.9	1.0	-2.7	2.2	2.0	1.1	1.6
Denmark	3.4	1.6	-1.1	-5.2	1.8	0.8	0.2	1.2
Finland	4.4	5.3	1.0	-8.2	3.6	3.8	2.6	2.4
France	2.2	2.4	-0.1	-2.7	1.5	1.6	0.3	1.4
Germany	3.4	2.7	1.1	-5.1	3.7	2.9	1.0	1.4
Greece	4.5	4.3	1.0	-2.3	-4.3	-5.1	-2.2	0.0
Ireland	5.3	5.6	-3.0	-7.0	-0.4	1.5	0.0	0.8
Italy	2.0	1.5	-1.3	-5.2	1.3	0.6	-0.3	1.0
Luxembourg	5.0	6.6	1.4	-3.6	3.5	3.4	1.0	3.0
Netherlands	3.4	3.9	1.8	-3.5	1.7	1.5	1.0	1.2
Portugal	1.4	2.4	0.0	-2.5	1.3	-1.7	-3.4	-1.5
Spain	4.0	3.6	0.9	-3.7	-0.1	0.7	0.3	1.1
Sweden	4.3	3.3	-0.6	-5.2	5.6	4.3	1.9	3.4
United Kingdom	2.8	2.7	-1.1	-4.4	1.8	0.9	1.1	2.6
New EU Member								
Bulgaria	6.5	6.4	6.2	-5.5	0.2	1.8	2.5	3.8
Cyprus	4.1	5.1	3.6	-1.7	1.0	0.5	0.5	1.0
Czech Republic	6.8	6.1	2.5	-4.1	2.4	2.1	2.0	2.7
Estonia	10.6	6.9	-5.1	-13.9	3.1	6.4	3.2	3.2
Hungary	3.6	0.8	0.8	-6.7	1.2	1.4	1.5	1.6
Latvia	12.2	10.0	-4.2	-18.0	-0.3	3.8	3.2	4.0
Lithuania	7.8	9.8	2.9	-14.7	1.3	5.6	3.2	3.8
Malta	3.6	3.7	5.2	-3.4	3.7	2.2	1.3	2.5
Poland	6.2	6.8	5.1	1.6	3.8	4.0	4.2	4.4
Romania	7.9	6.3	7.3	-7.1	-1.3	1.5	2.1	3.0
Slovak Republic	8.5	10.5	5.8	-4.8	4.0	3.0	2.1	2.5
Slovenia	5.9	6.9	3.7	-8.1	1.2	2.4	3.6	3.6
Other European								
Iceland	4.6	6.0	1.4	-6.9	-3.5	1.2	1.1	2.0
Norway	2.3	2.7	0.7	-1.7	0.4	1.6	2.9	2.6
Switzerland	3.6	3.6	1.9	-1.9	2.6	2.0	1.3	1.3
Economies in transition								
South-eastern Europe								
Albania	5.4	6.0	7.7	3.3	3.5	3.5	3.6	4.0
Bosnia and Herzegovina	6.1	6.2	5.7	-2.9	1.0	1.9	2.0	2.3
Croatia	4.7	5.5	2.2	-6.0	-1.2	0.8	2.0	3.0
Montenegro	8.6	10.7	6.9	-5.7	1.1	2.3	2.5	3.6
Serbia	5.2	6.9	5.5	-3.1	1.8	2.6	3.6	4.0
The former Yugoslav Republic of Macedonia	4.0	6.1	5.0	-0.9	1.8	3.0	3.0	3.6
Commonwealth of Independent States								
Armenia	13.2	13.7	7.0	-14.1	2.1	6.8	4.5	7.2
Azerbaijan	34.5	25.1	10.7	9.3	5.0	2.0	3.5	4.5
Belarus	10.0	8.6	10.2	0.2	7.5	4.8	1.5	3.5
Kazakhstan	10.6	8.7	3.3	1.2	7.0	6.8	5.6	6.0
Kyrgyzstan	3.1	8.5	8.4	2.9	-1.4	6.0	5.7	5.0
Republic of Moldova	4.8	3.0	7.8	-6.0	7.0	5.6	6.5	4.5
Russian Federation	7.7	8.1	5.2	-7.8	4.0	4.0	3.7	4.2
Tajikistan	6.7	7.6	7.6	4.0	6.5	6.0	5.7	6.0
Turkmenistan	11.4	11.6	14.7	6.1	9.2	9.7	7.0	7.0
Ukraine	7.3	7.9	2.3	-14.8	4.2	4.6	5.1	6.3
Uzbekistan	7.4	9.6	9.0	8.1	8.5	7.3	7.0	7.0
Georgia	9.4	12.3	2.3	-3.8	6.4	5.5	5.0	4.7

	2006	2007	2008	2009	2010 [a]	2011 [b]	2012 [b]	2013 [b]
Africa								
Algeria	1.8	3.0	2.9	2.0	4.1	4.6	4.0	4.5
Angola	18.6	20.3	3.2	2.4	3.3	7.4	9.2	7.5
Benin	3.8	4.6	5.0	2.7	2.6	3.4	4.3	4.6
Botswana	5.1	4.8	3.1	-3.6	1.3	5.8	5.9	4.0
Burkina Faso	5.5	3.6	6.4	3.2	7.9	4.4	5.8	5.6
Burundi	5.1	3.6	4.3	3.5	3.6	3.5	4.5	4.2
Cameroon	3.2	3.3	2.9	2.0	2.8	3.0	4.3	4.3
Cape Verde	10.1	8.7	5.6	4.1	4.3	5.8	3.2	3.2
Central African Republic	3.8	3.7	-15.3	1.0	3.3	4.3	4.8	4.6
Chad	0.2	0.2	-0.4	-1.6	4.4	3.9	5.5	5.5
Comoros	1.2	0.5	1.0	1.8	2.3	1.5	2.0	2.0
Congo	6.2	-1.6	5.6	7.6	12.0	7.5	5.5	5.5
Côte d'Ivoire	0.7	1.6	3.8	0.0	2.6	-4.0	3.5	4.0
Democratic Republic of the Congo	5.6	6.3	6.2	2.8	5.8	4.3	3.5	3.5
Djibouti	4.8	4.8	5.8	5.0	4.5	5.4	6.3	6.3
Egypt	7.1	7.2	7.1	4.7	5.1	1.3	3.8	5.5
Equatorial Guinea	1.3	21.4	10.7	5.3	1.1	2.3	2.4	2.4
Eritrea	-1.0	1.3	1.0	-4.3	2.7	2.9	3.2	3.2
Ethiopia	10.8	11.1	10.8	8.7	6.3	7.4	8.1	8.2
Gabon	1.2	11.8	1.7	-0.4	5.6	5.6	4.7	3.0
Gambia	3.4	6.0	6.3	5.6	5.0	5.2	4.8	4.8
Ghana	6.4	5.7	8.4	4.0	7.7	12.2	7.4	7.1
Guinea	2.5	1.8	4.9	-0.3	3.5	5.0	3.8	3.8
Guinea-Bissau	2.2	0.2	3.6	3.0	3.5	4.1	4.3	4.3
Kenya	6.3	7.0	1.5	2.6	5.6	4.7	5.7	5.3
Lesotho	6.5	2.4	4.5	1.6	3.8	2.4	3.2	3.2
Liberia	7.8	9.4	7.1	4.6	6.3	7.0	6.1	6.1
Libya	6.7	5.1	2.7	0.4	3.3	-22.0	13.2	11.5
Madagascar	5.0	6.2	7.1	-4.1	0.5	1.6	4.7	4.9
Malawi	7.7	5.8	8.3	8.9	5.2	4.4	6.1	6.5
Mali	5.3	4.3	5.0	4.4	5.1	6.3	5.3	5.3
Mauritania	11.4	1.0	3.7	-1.1	4.6	5.2	5.4	5.4
Mauritius	3.9	5.4	5.0	2.5	4.9	6.4	6.6	6.6
Morocco	7.8	2.7	5.6	5.0	3.7	3.8	3.3	4.5
Mozambique	6.3	7.3	6.7	6.3	6.5	7.5	7.7	7.7
Namibia	7.1	5.4	4.3	-0.8	4.0	4.5	3.6	3.6
Niger	5.8	3.4	8.7	-0.9	2.3	3.4	3.3	3.3
Nigeria	7.5	6.9	9.1	5.6	7.8	6.3	6.8	7.0
Rwanda	9.2	5.5	11.2	4.1	7.6	5.8	6.3	6.3
Sao Tome and Principe	6.7	6.0	5.8	5.2	4.5	6.0	5.4	5.4
Senegal	2.4	5.0	3.2	2.2	4.2	4.3	4.5	5.5
Sierra Leone	7.3	6.4	5.5	3.2	4.8	5.5	6.0	6.0
South Africa	5.6	5.5	3.6	-1.7	2.8	3.1	3.7	3.5
Sudan	11.3	10.2	6.8	4.5	4.8	5.5	5.0	5.0
Togo	3.7	1.9	2.2	3.0	1.9	3.3	3.4	3.4
Tunisia	5.5	6.3	4.4	1.1	3.7	-0.6	3.2	3.6
Uganda	7.0	8.1	10.4	4.4	5.6	5.6	5.1	6.3
United Republic of Tanzania	6.7	7.1	7.4	6.0	6.8	6.3	6.9	4.0
Zambia	6.2	6.2	5.7	6.3	5.7	5.9	6.4	6.4
Zimbabwe	-3.7	-3.7	-12.6	3.7	6.0	4.5	4.3	4.3
East and South Asia								
Bangladesh	6.5	6.3	6.1	5.7	6.1	6.7	6.8	7.0
Brunei Darussalam	4.4	0.2	-1.9	-1.8	2.8	2.4	1.6	1.5
China	12.7	14.2	9.6	9.2	10.3	9.3	8.7	8.5
Hong Kong, Special Administrative Region of China	7.0	6.4	2.3	-2.7	7.0	5.0	4.1	4.5
India	9.4	9.6	6.2	7.0	8.5	7.7	7.8	8.0
Indonesia	5.5	6.3	5.0	4.6	6.1	6.4	6.0	6.3
Iran, Islamic Republic of	5.9	7.8	3.5	1.9	3.2	2.6	3.0	3.1
Korea, Republic of	5.2	5.1	2.3	0.3	6.2	3.9	3.6	4.0
Malaysia	5.8	6.2	4.7	-1.7	7.2	4.6	4.4	5.0
Myanmar	13.1	12.0	10.3	10.4	10.4	5.1	4.7	5.1
Nepal	3.5	3.7	5.4	4.5	4.1	3.9	4.2	4.4
Pakistan	5.9	3.8	2.9	2.8	3.1	3.3	4.2	4.5
Papua New Guinea	2.3	7.2	6.7	4.5	7.1	7.6	5.5	5.2
Philippines	5.3	7.1	4.2	1.2	7.6	4.3	4.4	4.9
Singapore	8.7	8.2	1.5	-0.8	14.5	5.0	4.0	4.5
Sri Lanka	7.7	6.8	6.0	3.5	8.0	7.9	7.2	7.0
Taiwan, Province of China	5.4	6.0	0.7	-1.9	10.8	4.6	3.9	4.3
Thailand	5.1	4.9	2.5	-2.3	7.8	3.5	3.9	4.2
Vietnam	8.2	8.5	6.3	5.3	6.8	5.8	6.0	6.3

	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]	2013[b]
Western Asia								
Bahrain	6.6	8.4	6.3	3.1	4.5	2.9	3.7	4.0
Iraq	6.2	1.5	9.5	4.2	5.0	9.0	12.0	7.0
Israel	5.3	5.2	4.2	0.8	4.6	4.3	2.5	2.9
Jordan	8.1	8.9	7.6	2.3	3.1	2.8	3.1	3.0
Kuwait	5.2	4.4	6.4	-2.7	3.4	6.2	4.7	4.5
Lebanon	0.6	7.5	9.3	8.0	7.5	1.7	3.1	4.0
Oman	5.5	6.8	12.8	1.1	4.2	4.9	4.7	4.0
Qatar	18.6	26.8	25.4	8.7	23.7	18.0	6.2	4.3
Saudi Arabia	3.2	2.0	4.2	0.2	3.8	6.8	3.9	3.5
Syrian Arab Republic	5.1	4.3	5.2	4.0	5.6	-2.0	2.0	3.5
Turkey	6.9	4.7	0.7	-4.8	8.9	7.5	3.2	5.4
United Arab Emirates	13.0	6.2	3.3	-1.6	1.4	3.6	3.0	3.4
Yemen	3.8	4.4	4.7	4.7	8.0	-2.0	5.0	3.0
Latin America and the Caribbean								
Argentina	8.5	8.7	6.8	0.8	9.2	7.6	7.2	7.2
Barbados	3.2	3.4	0.2	-5.3	5.1	1.9	3.1	3.6
Bolivia, Plurinational State of	4.8	4.6	6.2	3.4	4.1	4.2	3.8	3.8
Brazil	4.0	6.1	5.2	-0.6	7.5	3.7	2.7	3.8
Chile	4.6	4.6	3.7	-1.7	5.2	6.4	3.4	6.0
Colombia	6.7	6.9	3.6	1.4	4.3	4.4	4.0	3.8
Costa Rica	8.8	7.9	2.7	-1.3	4.2	3.9	3.9	4.0
Cuba	12.1	7.3	4.1	1.5	3.0	2.5	3.0	4.5
Dominican Republic	10.7	8.5	5.3	3.4	7.7	5.2	4.2	4.1
Ecuador	3.9	2.5	7.2	0.4	3.2	4.3	3.0	3.2
El Salvador	4.2	4.3	1.3	-3.1	1.4	2.6	3.3	3.1
Guatemala	5.4	6.3	3.3	0.6	2.6	2.9	4.1	3.4
Guyana	5.1	7.0	2.0	3.3	3.6	4.7	4.7	3.7
Haiti	2.2	3.3	0.8	2.9	-5.0	5.5	6.0	6.0
Honduras	6.6	6.3	4.2	-2.1	2.8	3.4	4.6	4.9
Jamaica	2.7	1.5	-0.5	-3.0	-1.1	1.7	2.3	2.0
Mexico	4.8	3.4	1.5	-6.0	5.5	3.8	2.4	3.5
Nicaragua	4.2	3.1	2.8	-1.5	4.5	2.9	2.3	3.3
Panama	8.5	12.1	10.7	2.6	7.5	5.6	5.0	4.1
Paraguay	4.3	6.8	5.8	-3.8	15.3	5.0	3.4	4.6
Peru	7.7	8.9	9.8	0.8	8.7	5.9	5.2	4.6
Trinidad and Tobago	13.5	4.6	2.4	-3.5	2.5	1.7	4.4	4.4
Uruguay	4.3	7.5	8.6	2.6	8.5	5.1	3.3	2.7
Venezuela, Bolivarian Republic of	9.9	8.2	4.2	-3.3	-1.3	3.5	2.0	3.8

Source: Project LINK

a Actual or most recent estimate.
b Forecasts, based in part on Project LINK.

Table A.3
World and regions: consumer price inflation, 2006-2013
(Annual percentage change[a])

	2006	2007	2008	2009	2010 [b]	2011[c]	2012[c]	2013[c]
World	3.0	3.1	4.7	1.3	2.5	3.7	2.6	2.6
Developed economies	2.3	2.2	3.3	0.0	1.3	2.6	1.6	1.7
North America	3.1	2.8	3.7	-0.2	1.7	3.0	1.4	1.9
Asia and Oceania	0.8	0.4	1.8	-1.5	-1.0	1.2	1.0	1.0
Europe	2.2	2.2	3.5	0.8	1.9	2.8	1.9	1.8
European Union	2.2	2.2	3.5	0.8	1.9	2.9	2.0	1.8
EU-15	2.2	2.1	3.3	0.7	1.9	2.9	1.9	1.7
New EU Members	3.2	4.1	6.1	3.2	2.9	3.8	3.1	2.7
Other Europe	1.8	0.8	3.1	1.0	1.5	1.2	1.1	1.4
Memorandum items:								
Euro Zone	2.2	2.1	3.3	0.3	1.6	2.5	1.8	1.7
Major developed economies (G-7)	2.3	2.1	3.1	-0.2	1.2	2.6	1.4	1.6
OECD	2.4	2.3	3.4	0.3	1.5	2.8	1.7	1.8
Economies in transition	9.3	9.2	14.7	10.8	6.9	9.3	7.6	6.5
South-eastern Europe	5.8	3.6	7.7	3.4	2.9	5.1	3.6	3.2
Commonwealth of Independent States and Georgia	9.7	9.7	15.4	11.5	7.3	9.7	8.0	6.8
Developing countries[d]	4.5	5.2	8.1	4.3	5.5	6.6	5.5	4.9
Africa[d]	5.5	6.0	10.8	7.8	6.8	7.2	6.4	6.0
North Africa	4.1	5.2	9.2	5.9	6.7	7.1	5.7	5.3
Sub-Saharan Africa[d]	5.8	6.7	11.7	8.1	5.5	6.4	6.0	5.5
East and South Asia	3.7	4.9	7.5	2.9	5.0	6.3	5.1	4.4
East Asia	2.7	3.9	6.0	0.6	3.2	5.1	3.9	3.4
South Asia	7.1	8.5	12.7	11.2	11.6	10.4	9.2	8.1
Western Asia	6.1	6.2	10.0	4.8	6.0	6.8	5.2	4.6
Latin America and the Caribbean	5.1	5.3	7.8	6.1	6.1	7.1	6.2	5.6
South America	5.7	5.8	8.8	6.7	7.1	8.4	7.2	6.3
Mexico and Central America	3.9	4.2	5.7	5.1	4.1	4.5	4.4	4.3
Caribbean	8.2	7.2	12.1	4.3	8.1	10.2	7.4	5.8
Memorandum items:								
Least developed countries	8.9	9.4	13.3	8.6	8.2	9.1	8.0	7.3
Sub-Saharan Africa [d] (Excluding Nigeria and South Africa)	8.1	7.1	13.0	9.0	6.6	7.6	6.6	6.2
East Asia (excluding China)	3.9	3.1	6.1	1.8	3.0	4.5	3.6	3.2
South Asia (excluding India)	9.8	12.8	21.3	11.9	10.8	14.3	12.2	10.5
Western Asia (excluding Israel and Turkey)	3.9	5.3	11.0	3.8	4.6	5.7	4.5	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 Actual or the most recent estimate.
c Forecasts, based in part on Project LINK.
d Excluding Zimbabwe.

Table A.4
Consumer price inflation, 2006-2013
(Annual percentage change)

	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]	2013[b]
Developed economies								
North America								
Canada	2.0	2.1	2.4	0.3	1.8	2.8	1.9	1.8
United States	3.2	2.9	3.8	-0.3	1.6	3.0	1.4	1.9
Asia and Oceania								
Australia	3.5	2.3	4.4	1.7	1.9	2.8	3.8	4.8
Japan	0.2	0.1	1.4	-2.1	-1.5	0.8	0.5	0.3
New Zealand	3.4	2.4	4.0	2.0	2.3	4.4	3.0	2.3
European Union								
EU-15								
Austria	1.7	2.2	3.2	0.4	1.7	3.2	2.1	1.8
Belgium	2.3	1.8	4.5	0.0	2.3	3.3	2.3	2.5
Denmark	1.8	1.7	3.6	1.1	2.2	2.8	2.1	2.2
Finland	1.3	1.6	3.9	1.6	1.7	3.4	2.1	2.1
France	1.9	1.6	3.2	0.1	1.7	2.2	1.7	1.8
Germany	1.8	2.3	2.8	0.2	1.1	2.3	1.8	1.7
Greece	3.3	3.0	4.2	1.4	4.7	2.8	1.0	0.7
Ireland	2.7	2.9	3.1	-1.7	-1.6	1.2	1.3	1.0
Italy	2.2	2.0	3.5	0.8	1.6	2.7	1.7	1.6
Luxembourg	2.7	2.3	3.4	0.4	2.3	3.4	2.6	2.0
Netherlands	1.7	1.6	2.2	1.0	0.9	2.3	2.0	1.6
Portugal	3.0	2.4	2.7	-0.9	1.4	3.2	1.0	1.2
Spain	3.6	2.8	4.1	-0.2	2.0	3.1	1.8	1.9
Sweden	1.5	1.7	3.4	1.9	1.9	1.4	1.1	2.1
United Kingdom	2.3	2.3	3.6	2.2	3.3	4.6	2.5	1.7
New EU members								
Bulgaria	7.3	8.4	12.3	2.8	3.0	4.0	5.1	2.5
Cyprus	2.5	2.3	4.7	0.4	2.4	3.5	2.9	2.7
Czech Republic	2.5	3.0	6.3	1.0	1.5	1.9	2.6	2.3
Estonia	4.4	6.6	10.4	-0.1	3.0	5.1	3.2	3.0
Hungary	3.9	8.0	6.1	4.2	4.7	3.5	3.6	3.2
Latvia	6.5	10.1	15.4	3.6	-1.2	4.2	3.0	2.5
Lithuania	3.7	5.8	10.9	4.4	1.3	4.2	3.0	2.5
Malta	2.8	1.3	4.3	2.1	1.5	2.8	2.3	2.7
Poland	1.3	2.4	4.2	3.8	2.7	3.9	2.9	2.5
Romania	6.6	4.8	7.9	5.6	6.1	6.0	3.9	3.6
Slovak Republic	4.5	2.8	4.6	1.6	0.7	4.0	2.4	2.6
Slovenia	2.5	3.6	5.6	0.8	2.0	2.4	2.8	2.8
Other Europe								
Iceland	6.7	5.1	12.7	12.0	5.4	4.0	4.0	4.0
Norway	2.5	0.7	3.4	2.3	2.3	1.4	0.9	1.6
Switzerland	1.1	0.7	2.4	-0.5	0.7	0.9	1.2	1.2
Economies in transition								
South-eastern Europe								
Albania	2.4	2.9	3.3	2.3	3.6	3.8	3.6	3.2
Bosnia and Herzegovina	6.1	1.5	7.4	-0.4	2.1	4.0	3.0	3.0
Croatia	3.2	2.9	6.0	2.4	1.1	2.3	2.7	2.9
Montenegro	3.0	4.3	9.0	3.8	0.6	3.5	3.0	3.0
Serbia	11.8	6.1	12.4	8.1	6.3	11.0	5.5	3.8
The former Yugoslav Republic of Macedonia	3.3	2.8	7.2	-0.3	1.6	4.2	3.0	3.0
Commonwealth of Independent States								
Armenia	2.9	4.4	8.9	3.4	8.2	8.2	5.5	4.0
Azerbaijan	8.2	16.6	20.8	1.4	5.6	8.0	6.0	6.0
Belarus	7.0	8.2	14.9	12.9	7.7	38.0	30.0	10.0
Kazakhstan	8.6	10.8	17.1	7.3	7.1	8.5	8.5	6.0
Kyrgyzstan	5.6	10.1	24.5	6.9	8.0	19.5	9.5	8.0
Republic of Moldova	12.8	12.3	12.8	-0.1	7.4	7.8	5.0	6.0
Russian Federation	9.7	9.0	14.0	11.6	6.9	8.7	6.9	6.7
Tajikistan	10.0	13.4	20.9	6.4	6.5	13.0	9.0	6.0
Turkmenistan	8.2	6.3	14.5	-2.7	4.5	6.5	8.0	8.0
Ukraine	9.1	12.8	25.2	15.9	9.4	9.2	9.5	7.0
Uzbekistan	27.1	23.9	22.9	17.9	18.5	13.0	12.0	12.0
Georgia	9.2	9.2	9.9	1.8	7.1	6.0	6.0	7.0

	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]	2013[b]
Developing economies								
Africa								
Algeria	2.5	3.5	4.9	5.7	3.9	4.0	3.9	4.3
Angola	13.3	12.2	12.1	14.1	14.5	14.8	13.8	11.2
Benin	3.8	1.3	8.0	2.2	2.3	2.3	3.8	3.5
Botswana	11.6	7.1	12.7	8.0	7.0	7.7	6.0	5.0
Burkina Faso	2.3	-0.2	10.7	2.6	-0.8	3.6	3.4	3.5
Burundi	2.8	8.3	24.1	11.0	6.4	9.0	11.0	7.0
Cameroon	5.1	0.9	5.3	3.0	3.0	2.7	2.7	2.7
Cape Verde	5.4	4.4	6.8	1.0	1.3	2.0	1.3	1.3
Central African Republic	6.7	0.9	2.1	-6.5	2.8	9.0	11.0	7.0
Chad	8.0	-9.0	10.3	10.0	6.0	3.0	3.0	3.0
Comoros	3.4	4.5	4.8	4.8	2.5	2.9	3.3	3.3
Congo	6.5	2.7	7.3	5.0	4.0	3.0	3.0	3.0
Côte d'Ivoire	2.5	1.9	6.3	1.0	1.7	1.9	2.8	4.0
Democratic Republic of the Congo	13.1	16.9	17.3	46.2	9.0	8.0	8.0	8.0
Djibouti	3.5	5.0	12.0	1.7	3.0	4.0	3.5	3.5
Egypt	7.6	9.3	18.3	11.8	11.1	13.3	11.0	9.1
Equatorial Guinea	4.4	2.8	6.6	7.2	7.0	6.2	6.3	6.3
Eritrea	15.1	9.3	19.9	38.9	19.0	14.0	13.0	13.0
Ethiopia	12.3	17.2	44.4	8.5	7.9	15.1	11.7	10.6
Gabon	-1.4	5.0	5.3	1.9	1.5	1.6	3.2	3.0
Gambia	2.1	5.4	4.5	4.6	4.0	3.8	4.0	4.0
Ghana	10.9	10.7	16.5	19.3	10.7	9.0	8.5	8.0
Guinea	34.7	22.9	18.4	4.7	16.0	14.5	11.2	11.2
Guinea-Bissau	2.0	4.6	10.5	-1.7	1.2	2.0	1.8	1.8
Kenya	14.5	9.8	26.2	9.2	4.0	11.5	6.4	6.4
Lesotho	6.0	8.0	10.7	7.2	6.1	6.5	5.7	5.7
Liberia	7.2	13.7	17.5	7.4	7.4	6.9	8.0	8.0
Libya	1.5	6.3	10.4	2.5	13.3	10.4	5.6	4.7
Madagascar	10.8	10.3	9.2	9.0	9.3	10.0	8.0	6.0
Malawi	14.0	8.0	8.7	8.4	7.4	7.5	7.0	6.7
Mali	1.5	1.4	9.2	2.2	2.1	2.6	2.8	2.8
Mauritania	6.2	7.3	7.3	2.2	4.8	4.8	5.0	5.0
Mauritius	8.9	8.8	9.7	2.5	2.5	2.5	3.6	3.6
Morocco	3.3	2.0	3.7	1.0	1.0	2.2	1.8	2.4
Mozambique	13.2	8.2	10.3	3.3	15.0	8.0	5.6	5.6
Namibia	5.1	6.7	10.4	8.8	4.8	4.1	3.0	3.0
Niger	0.0	0.1	11.3	4.3	6.7	3.5	3.5	3.5
Nigeria	8.2	5.4	11.6	11.5	13.5	10.8	10.1	10.1
Rwanda	8.9	9.1	15.4	10.4	6.1	5.8	5.4	5.4
Sao Tome and Principe	23.1	18.5	26.1	17.0	7.5	-1.6	8.0	8.0
Senegal	2.1	5.9	5.8	-1.1	1.3	2.0	3.4	2.8
Sierra Leone	9.5	11.7	4.8	9.3	15.5	7.8	8.7	8.7
Somalia	14.0	15.0	30.0	25.0	25.0	25.0	25.0	25.0
South Africa	3.2	6.2	10.1	7.2	4.1	5.0	5.3	4.8
Sudan	7.2	8.0	14.3	11.2	10.0	9.0	9.0	9.0
Togo	2.2	1.0	8.7	2.0	1.9	2.5	1.9	1.9
Tunisia	4.5	3.1	4.9	3.5	4.4	3.5	3.3	3.4
Uganda	7.3	6.1	12.1	13.0	3.8	12.1	9.6	8.5
United Republic of Tanzania	7.3	7.0	10.3	12.1	6.2	12.0	6.0	6.0
Zambia	9.0	10.7	12.4	13.4	8.2	7.5	6.5	6.5
Zimbabwe	1096.7	24411.0	0.0	0.0	5.0	5.0	5.0	5.0
East and South Asia								
Bangladesh	6.8	9.1	8.9	5.4	8.1	10.5	8.8	7.8
Brunei Darussalam	0.2	1.0	2.1	1.0	0.5	1.9	1.6	1.5
China	1.5	4.7	5.9	-0.7	3.3	5.7	4.2	3.6
Hong Kong, Special Administrative Region	2.1	2.0	4.3	0.6	2.3	5.2	3.8	3.3
India	5.8	6.4	8.3	10.9	12.0	8.5	7.7	6.9
Indonesia	13.1	6.5	10.2	4.4	5.1	5.6	5.1	5.2
Iran, Islamic Republic of	11.9	17.2	25.6	13.5	10.1	17.0	14.5	12.5
Korea, Republic of	2.2	2.5	4.7	2.8	2.9	4.6	3.5	3.0
Malaysia	3.6	2.0	5.4	0.6	1.7	3.1	2.7	2.5
Myanmar	20.0	35.0	26.8	1.5	7.7	8.2	7.7	6.5
Nepal	7.6	6.1	10.9	11.6	10.0	9.2	7.9	7.5
Pakistan	7.9	7.6	20.3	13.7	13.9	13.3	11.5	9.4
Papua New Guinea	2.4	0.9	10.8	6.9	6.0	9.0	7.8	7.0
Philippines	6.2	2.8	9.3	3.2	3.8	4.7	4.2	4.0
Singapore	1.0	2.1	6.5	0.6	2.8	5.1	3.0	2.3
Sri Lanka	10.0	15.8	22.6	3.4	5.9	7.6	6.9	6.5
Taiwan, Province of China	0.6	1.8	3.5	-0.9	1.0	1.5	1.4	1.4
Thailand	4.6	2.3	5.4	-0.9	3.3	3.9	3.4	3.5
Viet Nam	7.4	8.3	23.1	7.1	8.9	18.5	13.8	9.0

	2006	2007	2008	2009	2010 [a]	2011 [b]	2012 [b]	2013 [b]
Western Asia								
Bahrain	2.0	3.3	3.5	2.8	2.0	2.7	4.1	4.0
Israel	2.1	0.5	4.6	3.3	2.7	3.6	1.2	2.1
Jordan	6.3	5.4	14.9	-0.7	5.0	5.0	6.0	5.5
Kuwait	3.1	5.5	10.6	4.0	4.0	5.9	4.0	3.5
Oman	3.2	6.0	12.1	3.9	3.2	3.9	4.0	3.8
Qatar	11.8	13.8	15.1	-4.9	-2.4	2.9	4.5	3.9
Saudi Arabia	2.2	4.2	9.9	5.1	5.3	6.2	4.4	3.9
Syrian Arab Republic	10.0	3.9	15.7	2.9	4.3	4.0	4.8	4.8
Turkey	9.6	8.8	10.4	6.3	8.6	8.9	7.0	6.0
Yemen	10.8	7.9	19.0	5.4	11.2	8.0	8.0	8.0
Latin America and the Caribbean								
Argentina	10.9	8.8	8.6	6.3	10.8	11.0	11.0	10.5
Barbados	7.3	4.0	8.1	3.6	5.8	8.5	5.0	5.2
Bolivia, Plurinational State of	4.3	8.7	14.0	3.4	2.5	9.8	8.0	5.5
Brazil	4.2	3.6	5.7	4.9	5.0	7.3	5.6	4.6
Chile	3.4	4.4	8.7	0.4	1.4	3.2	3.0	4.0
Colombia	4.3	5.5	7.0	4.2	2.3	3.5	3.5	4.2
Costa Rica	11.5	9.4	13.4	7.8	5.7	5.2	7.0	5.0
Dominican Republic	7.6	6.1	10.6	1.4	6.3	13.2	8.8	5.5
Ecuador	3.0	2.3	8.4	5.2	3.6	4.2	3.1	3.1
El Salvador	4.0	4.6	6.7	1.1	1.2	3.7	4.5	4.2
Guatemala	6.4	6.5	11.4	1.9	3.9	8.0	4.9	5.4
Guyana	6.6	12.3	8.1	2.9	2.1	4.7	2.5	3.0
Haiti	13.1	8.5	0.0	3.0	4.0	6.0	7.5	7.5
Honduras	5.6	6.9	11.4	5.5	4.7	10.9	7.5	6.5
Jamaica	8.6	9.3	22.0	9.6	12.6	12.4	8.0	7.8
Mexico	3.6	4.0	5.1	5.3	4.2	4.3	4.3	4.3
Nicaragua	9.1	11.1	19.8	3.7	5.5	10.0	6.3	6.2
Panama	2.1	4.2	8.8	2.4	3.5	5.3	5.3	5.0
Paraguay	9.6	8.1	10.2	2.6	4.7	8.3	8.0	4.5
Peru	2.0	1.8	5.8	2.9	1.5	3.2	2.5	3.0
Trinidad and Tobago	8.3	7.9	12.1	7.0	10.6	4.0	4.5	5.0
Uruguay	6.4	8.1	7.9	7.1	6.7	7.9	7.3	6.5
Venezuela, Bolivarian Republic of	13.7	18.7	31.4	28.6	29.1	25.0	22.5	17.5

Source: Project LINK

a Actual or most recent estimate.
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, 2006-2013
(annual percentage change)

Region	Flow	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]	2013[b]
World	Exports	15.2	16.3	14.1	-19.9	17.1	14.3	9.7	9.2
	Imports	14.5	16.0	14.4	-20.6	17.5	14.2	9.7	9.2
Developed economies	Exports	12.6	15.6	11.4	-20.1	13.6	12.5	4.7	6.1
	Imports	13.0	13.6	11.3	-22.5	14.2	14.4	5.4	6.5
North America	Exports	11.5	11.7	10.0	-17.1	17.1	9.7	4.1	6.7
	Imports	10.6	6.5	7.6	-22.2	19.7	9.4	3.2	4.2
Asia and Oceania	Exports	8.5	11.1	14.0	-23.4	30.5	8.9	6.7	4.0
	Imports	9.6	10.5	20.8	-24.8	23.2	16.9	9.9	6.5
Europe	Exports	13.6	17.4	11.5	-20.5	10.4	13.9	4.5	6.2
	Imports	14.5	17.1	11.6	-22.3	10.9	16.1	5.7	7.4
European Union	Exports	13.6	17.4	11.0	-20.6	10.3	14.4	4.6	6.4
	Imports	14.7	17.0	11.6	-22.6	10.9	16.3	5.6	7.5
EU-15	Exports	12.8	16.4	10.0	-20.4	9.4	13.5	3.9	6.0
	Imports	13.6	15.7	10.8	-21.5	10.1	14.6	4.8	6.9
New EU Members	Exports	19.9	25.4	18.4	-22.3	15.9	20.2	8.7	8.7
	Imports	22.6	26.4	16.4	-29.6	16.2	26.9	10.1	10.8
Other Europe	Exports	13.8	16.8	18.3	-18.1	11.8	6.5	3.2	2.3
	Imports	10.9	18.0	12.1	-15.5	11.3	11.7	6.5	5.1
Euro Zone	Exports	12.4	18.3	11.1	-20.4	9.6	14.1	4.3	5.8
	Imports	13.8	17.4	12.1	-21.8	10.1	16.3	5.2	6.7
Economies in transition	Exports	24.3	21.6	30.9	-32.0	27.2	17.5	12.7	12.1
	Imports	23.8	33.7	28.6	-30.2	21.4	22.1	13.0	10.5
South-eastern Europe	Exports	18.5	23.9	18.9	-21.2	10.5	9.4	8.5	8.3
	Imports	15.4	30.9	22.3	-28.4	1.4	18.1	7.3	7.9
Commonwealth of Independent States	Exports	24.8	21.4	32.0	-32.8	28.7	18.2	13.0	12.4
	Imports	25.4	34.2	29.7	-30.5	24.6	22.6	13.7	10.9
Developing countries	Exports	19.2	17.0	17.0	-18.1	21.8	16.7	16.7	13.1
	Imports	17.2	19.4	19.3	-15.9	23.0	13.2	16.5	13.3
Africa	Exports	23.8	14.4	27.1	-22.3	14.3	8.8	10.7	14.4
	Imports	19.1	27.5	26.8	-13.7	6.7	17.3	11.1	13.4
North Africa	Exports	14.9	16.0	30.9	-26.1	7.3	-7.4	14.9	18.7
	Imports	15.6	24.5	38.8	-12.2	3.1	10.5	9.0	11.6
Sub-Saharan Africa	Exports	30.9	13.3	24.5	-19.5	19.0	18.8	8.7	12.2
	Imports	21.3	29.3	19.8	-14.7	9.2	21.7	12.3	14.4
Sub-Saharan Africa	Exports	18.3	27.6	28.8	-18.1	13.8	14.4	9.0	11.3
(Excluding Nigeria & South Africa)	Imports	12.8	35.0	29.3	-4.1	5.1	16.9	11.8	13.3
East and South Asia	Exports	18.8	18.6	13.7	-14.8	22.2	17.4	16.9	15.2
	Imports	16.4	16.8	17.5	-14.6	25.7	15.1	12.8	14.1
East Asia	Exports	18.6	18.1	13.5	-15.4	22.9	17.5	17.3	15.4
	Imports	15.7	15.7	16.9	-16.0	25.8	15.2	12.4	13.7
South Asia	Exports	21.5	23.7	14.8	-9.2	16.5	16.4	13.0	13.3
	Imports	21.9	25.6	21.7	-5.2	25.2	14.4	15.0	16.4
Western Asia	Exports	19.0	15.4	28.3	-26.7	15.1	20.2	9.1	8.7
	Imports	19.9	28.8	22.4	-17.5	13.1	12.8	17.7	10.8
Latin America and the Caribbean	Exports	18.6	12.9	15.5	-21.0	31.2	14.5	25.8	7.1
	Imports	18.1	19.5	20.7	-20.5	29.0	3.8	36.2	11.7
South America	Exports	20.9	15.9	21.4	-22.0	36.2	18.0	26.1	7.2
	Imports	22.3	28.2	30.5	-19.0	31.5	0.8	41.9	10.8
Mexico and Central America	Exports	15.2	9.7	7.1	-18.4	24.8	8.4	26.7	6.9
	Imports	14.5	11.0	9.5	-22.2	26.9	6.2	29.0	13.6
Caribbean	Exports	22.7	3.7	12.6	-29.5	13.9	14.0	9.9	7.7
	Imports	13.5	15.4	18.3	-24.1	13.1	27.4	27.6	7.7
Least developed countries	Exports	20.3	32.4	26.8	-17.3	14.0	13.5	14.0	12.2
	Imports	13.3	36.7	30.4	2.2	6.4	15.4	14.5	15.5

Source: UN/DESA

a Actual or the most recent estimate.
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, 2006-2013
(annual percentage change)

Region	Flow	2006	2007	2008	2009	2010[a]	2011[b]	2012[b]	2013[b]
World	Exports	9.4	7.0	2.7	-9.2	12.3	6.0	4.0	5.1
	Imports	9.5	7.5	2.6	-10.7	13.4	6.2	4.3	5.2
Developed economies	Exports	8.5	6.1	1.9	-12.2	11.0	5.2	3.0	4.3
	Imports	8.1	5.0	0.3	-13.0	10.4	4.8	2.7	3.5
North America	Exports	6.7	7.2	3.5	-10.4	10.3	5.1	2.8	6.0
	Imports	5.9	2.9	-2.0	-13.6	12.6	4.0	1.7	2.9
Asia and Oceania	Exports	7.7	7.0	2.1	-17.5	18.2	1.2	5.8	4.7
	Imports	4.5	3.9	2.6	-14.0	10.6	5.4	6.0	3.4
Europe	Exports	9.2	5.7	1.5	-12.0	10.3	5.8	2.6	3.7
	Imports	9.5	6.0	0.8	-12.7	9.6	5.0	2.6	3.7
European Union	Exports	9.4	5.6	1.4	-12.4	10.7	6.2	2.8	4.0
	Imports	9.6	5.9	0.8	-12.9	9.7	5.0	2.6	3.9
EU-15	Exports	8.9	5.2	1.0	-12.4	10.0	5.2	2.4	3.6
	Imports	8.6	4.9	0.6	-11.7	8.9	3.5	1.8	3.2
New EU Members	Exports	13.4	8.8	4.4	-12.6	15.5	12.5	5.5	5.7
	Imports	16.3	12.4	2.2	-20.1	14.5	14.1	7.1	7.3
Other Europe	Exports	5.3	6.5	2.3	-6.3	4.3	-0.5	-0.4	0.1
	Imports	7.3	6.7	1.2	-8.1	7.5	4.8	1.9	0.9
Euro Zone	Exports	8.5	6.1	0.9	-13.2	11.2	6.1	2.3	3.3
	Imports	8.6	6.0	0.4	-12.6	9.5	4.9	1.9	3.2
Economies in transition	Exports	7.0	7.4	2.0	-6.9	4.2	4.3	2.4	4.8
	Imports	15.7	21.8	11.5	-26.1	11.1	6.1	6.7	7.3
Developing countries	Exports	11.2	8.4	4.2	-4.4	15.3	7.3	5.8	6.3
	Imports	12.2	11.7	6.6	-4.5	18.8	8.6	6.7	7.4
Africa	Exports	12.4	3.9	8.9	-6.5	3.5	-3.6	8.3	8.5
	Imports	11.6	17.0	10.8	-4.4	3.9	7.3	7.4	7.1
North Africa	Exports	6.3	6.5	8.2	-4.6	2.0	-16.3	12.2	13.0
	Imports	9.1	15.0	15.1	-3.7	3.6	2.7	6.4	6.3
Sub-Saharan Africa	Exports	17.4	2.1	9.5	-7.8	4.8	6.0	6.0	5.7
	Imports	13.2	18.3	8.0	-4.8	4.1	10.4	8.1	7.5
Sub-Saharan Africa	Exports	4.0	9.8	7.9	2.2	1.9	3.5	4.4	3.7
(Excluding Nigeria & South Africa)	Imports	2.9	18.5	16.7	3.0	5.3	5.4	4.5	4.0
East and South Asia	Exports	13.7	10.7	4.6	-2.5	20.1	7.9	6.5	6.9
	Imports	12.0	9.2	5.3	-0.5	21.1	8.1	6.9	7.6
East Asia	Exports	13.4	11.2	3.9	-2.6	21.3	7.7	6.4	6.8
	Imports	11.3	9.2	3.8	-0.5	22.9	7.9	6.7	7.4
South Asia	Exports	16.4	5.9	11.6	-1.2	9.7	9.8	7.2	8.4
	Imports	17.8	9.2	16.9	-0.5	8.8	9.3	8.4	8.7
Western Asia	Exports	6.2	5.6	2.4	-5.9	4.8	12.0	1.7	3.2
	Imports	10.7	19.7	8.0	-10.6	11.0	10.8	8.3	4.0
Latin America and the Caribbean	Exports	6.5	4.8	1.8	-10.1	11.1	5.5	5.2	4.8
	Imports	14.4	13.5	8.5	-15.6	23.5	10.2	4.6	9.6
South America	Exports	4.0	4.1	1.7	-8.4	5.4	5.2	6.0	5.6
	Imports	17.8	19.2	13.0	-13.6	26.5	11.5	6.7	11.2
Mexico and Central America	Exports	10.5	6.6	1.2	-12.6	21.2	6.2	4.3	3.8
	Imports	11.5	7.5	3.0	-18.2	20.9	8.6	0.9	7.2
Caribbean	Exports	11.7	-0.4	9.1	-14.4	11.4	3.8	2.6	3.2
	Imports	7.6	7.6	6.2	-17.3	6.6	6.5	8.1	6.0
Least developed countries	Exports	7.6	11.0	8.3	3.7	2.3	2.5	6.6	4.7
	Imports	6.0	17.0	16.5	7.1	4.8	5.1	5.8	5.5

Source: UN/DESA

a Actual or the most recent estimate.
b Forecasts, based in part on Project LINK.