

Appendix: Regional Outlooks

East Asia and the Pacific¹

Recent developments

The developing economies of the East Asia and Pacific region grew 9.5 percent in 2006, led by 10.7 percent growth in China (table A.1). For the region, this was the fastest growth in the last ten years, and the fourth year in a row that GDP in China expanded by more than 10 percent.

Industrial production slowed in the second half of the year in China (figure A.1) following the stagnation of U.S. import demand, a rise in domestic interest rates, and the imposition of administrative restrictions in some sectors. The latter caused investment volume growth to slow from a pace of more than 25 percent year-over-year in the first half

of 2006 to 19 percent in the fourth quarter. This contributed to weaker real import growth and slowed the growth of exports among other economies in the region. High-frequency data suggest that industrial production recovered into 2007 and that Chinese export growth and monetary aggregates accelerated in early 2007 compared with the last quarter of 2006 (although seasonal factors linked to the Chinese New Year may also be at play).

Growth in the rest of the region was also robust, expanding by 5.7 percent. Notwithstanding a pronounced slump in high-tech demand in the second half of 2006 and a weakening in Chinese import demand, growth in most countries

Table A.1 East Asia and Pacific forecast summary

annual percent change unless indicated otherwise

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
GDP at market prices (2000 \$) ^b	8.4	9.0	9.0	9.5	8.7	8.0	7.9
GDP per capita (units in \$)	7.1	8.1	8.1	8.6	7.8	7.2	7.1
PPP GDP ^c	—	9.2	9.2	9.6	8.8	8.2	8.0
Private consumption	7.3	6.8	6.4	7.5	7.5	6.9	6.5
Public consumption	9.0	6.7	8.8	8.4	7.6	7.2	6.8
Fixed investment	10.3	11.5	8.0	7.9	8.1	6.3	6.0
Exports, GNFS ^d	11.7	22.6	18.4	18.4	15.5	15.8	13.2
Imports, GNFS ^d	11.3	20.6	11.2	14.8	14.8	13.1	11.1
Net exports, contribution to growth	1.2	6.5	9.9	12.2	13.2	15.3	17.0
Current account balance/GDP (%)	0.1	3.5	6.1	8.1	7.8	7.6	6.5
GDP deflator (median, LCU)	6.5	6.1	4.0	4.2	5.4	3.9	3.9
Fiscal balance/GDP (%)	-0.7	-1.5	-1.6	-0.7	-0.9	-1.0	-1.1
Memo items: GDP							
East Asia excluding China	4.8	6.1	5.4	5.7	5.7	5.9	6.0
China	10.4	10.1	10.2	10.7	9.6	8.7	8.5
Indonesia	4.2	5.1	5.7	5.5	6.3	6.5	6.4
Thailand	4.5	6.2	4.5	5.3	4.5	4.5	5.0

Source: World Bank.

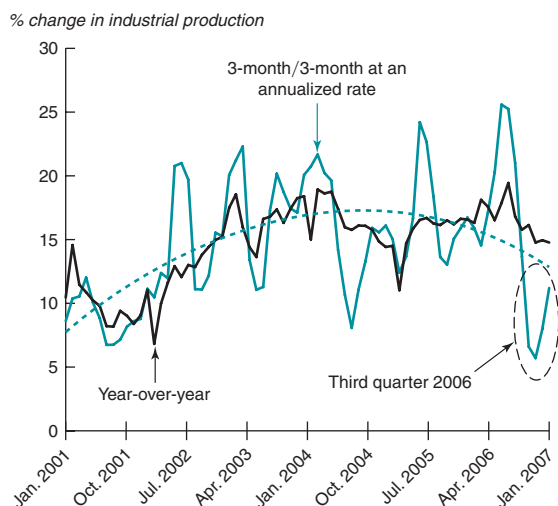
Note: e = estimate; f = forecast; LCU = local currency units; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

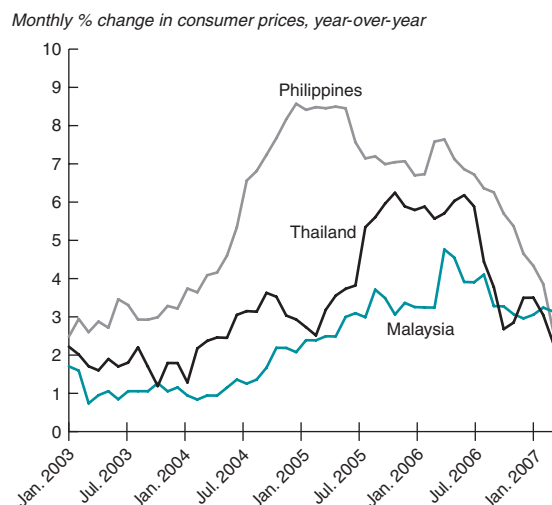
d. GNFS denotes goods and nonfactor services.

Figure A.1 Chinese industrial production

Sources: World Bank; Datastream.

exceeded 5 percent. The expansion was particularly strong in Vietnam and Cambodia (GDP was up an estimated 8.2 and 10.5 percent, respectively), backed by across-the-board strength in exports, domestic consumption, and investment. In Indonesia, growth slowed in the first half of 2006, reflecting an earlier tightening of monetary policy and the withdrawal of fuel subsidies. Growth picked up subsequently, coming in at 5.5 percent for the year as a whole, spurred by a rebound in domestic consumption and investment. Growth also picked up in Malaysia, with GDP rising 5.9 percent, supported by strengthening exports and domestic demand. In the Philippines, output experienced a modest increase, with growth coming in at 5.4 percent for the year. Economic activity in Thailand expanded by 5.3 percent in 2006, an improvement over the 4.5 percent outturn in 2005, mainly on the back of strong export growth. Growth in 2005–06 was, however, more than 1 percentage point less than in the previous three years, mainly because of depressed business and consumer confidence due in part to high oil prices, increased political uncertainty, and recent policy changes affecting foreign investment.

Trade continues to fuel the growth dynamic in the East Asia and Pacific region. The accession of Vietnam to the World Trade Organization (WTO) in January 2007 will provide another boost to trade flows. Apart from an average 4 percentage point reduction in import tariffs, the accession will

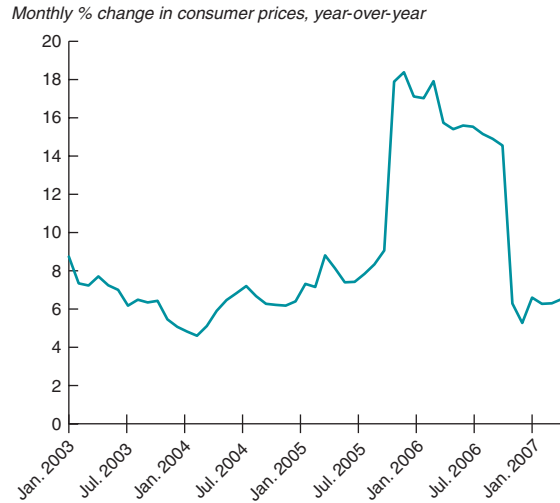
Figure A.2 Inflation in Malaysia, the Philippines, and Thailand

Source: World Bank.

strengthen regulations and financial management in Vietnam. Elsewhere in the region, the movement toward free trade persists. Since becoming a WTO member in 2001, China has launched a flurry of bilateral trade negotiations with more than 30 economies around the world. And in November 2006 the Asia Pacific Economic Cooperation forum (APEC) agreed to “seriously consider” negotiating a Free Trade Area of the Asia Pacific.

A generalized tightening of monetary policy in the region, following a pickup in consumer prices induced partly by high oil prices in 2005, has succeeded in lowering inflation in many economies (figure A.2). In Indonesia, the removal of energy subsidies has only temporarily raised inflation (figure A.3). The moderation of inflation has allowed Indonesia and Thailand to begin easing interest rates. Elsewhere, despite the downward trend in regional inflation, nominal interest rates have been stable or have declined less rapidly, leading, for example, to a tightening of monetary conditions in the Philippines. Given the continued robustness of growth, China increased interest rates and reserve requirements in the first quarter of 2007, the latest of several increases over the past year. Inflation there has been rising but was still fairly low at 3.3 percent in March 2007 (year over year).

Regional equity markets remain generally buoyant, although concern over valuations led to heightened volatility in February/March 2007,

Figure A.3 No permanent impact on inflation of a removal of energy subsidies in Indonesia

Source: World Bank.

reminiscent of the more widespread correction observed in May/June 2006. More generally, this volatility serves to remind investors and policy makers of the riskiness of emerging markets, which are relatively thinly traded and therefore more sensitive to changes in market sentiment.

Notwithstanding acceleration in the renminbi's appreciation with respect to the dollar, economic pressures for the appreciation of currencies in developing Asia are likely to remain strong. Overall, the region's balance of payments is in significant surplus (8.1 percent of GDP, or 4.8 percent of GDP excluding China). In addition to reducing global imbalances, greater currency flexibility and exchange rate appreciation would help contain inflationary pressures, improve domestic macroeconomic management capabilities, steady asset markets, and, over time, improve living standards for local populations.

The strong current account position of East Asia and Pacific countries reflects large financial inflows, particularly in the form of FDI (table A.2).

Table A.2 Net capital flows to East Asia and Pacific

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	59.4	50.0	45.4	36.7	56.1	73.4	92.2	179.1	272.2
as % of GDP	4.2	3.3	2.7	2.0	2.8	3.3	3.5	6.1	8.1
<i>Financial flows</i>									
Net private and official flows	21.2	40.0	35.4	41.4	47.3	67.9	120.4	167.2	167.6
Net private flows (debt + equity)	6.5	27.5	28.8	38.2	55.2	75.1	125.7	169.7	179.9
Net equity flows	54.7	51.7	51.7	49.5	60.8	66.0	85.1	123.0	136.7
Net FDI inflows	57.8	50.4	45.1	47.7	57.0	53.5	66.1	96.9	88.3
Net portfolio equity inflows	-3.1	1.3	6.6	1.8	3.8	12.5	19.0	26.1	48.4
Net debt flows	-33.5	-11.7	-16.3	-8.1	-13.5	1.9	35.3	44.2	30.9
Official creditors	14.7	12.5	6.6	3.2	-7.9	-7.2	-5.3	-2.4	-12.3
World Bank	2.8	2.4	1.8	0.9	-1.7	-1.5	-1.9	-0.6	-1.0
IMF	7.0	1.9	1.2	-2.5	-2.7	-0.5	-1.6	-1.6	-8.4
Other official	4.8	8.2	3.5	4.8	-3.5	-5.2	-1.7	-0.2	-2.8
Private creditors	-48.2	-24.2	-22.9	-11.3	-5.6	9.1	40.6	46.7	43.2
Net medium- and long-term debt flows	-3.5	-10.9	-13.1	-13.0	-12.4	-9.4	8.0	7.2	11.4
Bonds	1.0	0.9	-0.7	0.4	0.1	2.1	9.7	9.9	7.1
Banks	-4.8	-12.0	-11.3	-11.8	-10.2	-8.4	0.2	-0.6	7.2
Other private	0.3	0.2	-1.0	-1.6	-2.3	-3.1	-1.9	-2.2	-2.9
Net short-term debt flows	-44.7	-13.3	-9.9	1.7	6.8	18.5	32.6	39.5	31.8
Balancing item ^a	-58.7	-62.0	-72.4	-29.7	-14.2	-4.0	24.0	-130.4	-150.1
Change in reserves (- = increase)	-21.9	-28.0	-8.4	-48.4	-89.2	-137.2	-236.6	-215.8	-289.6
<i>Memo items</i>									
Bilateral aid grants	5.2	5.2	5.3	4.9	5.0	5.9	6.4	7.9	5.6
of which									
Technical cooperation grants	2.7	2.7	2.8	2.7	2.8	3.4	3.6	3.9	3.5
Other	2.5	2.5	2.5	2.2	2.2	2.5	2.8	4.0	2.1
Net official flows (aid + debt)	19.9	17.7	11.9	8.1	-2.9	-1.3	1.1	5.5	-6.7
Workers' remittances	12.9	15.7	16.7	20.1	29.5	35.3	38.8	45.1	47.2
Repatriated FDI Income	7.1	5.9	6.4	13.0	11.6	13.0	23.0	29.5	—

Sources: World Bank Debtor Reporting System and staff estimates.

Note: e = estimate; LCU = local currency units; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

FDI has been increasing during the course of the expansion but eased to some \$88 billion in 2006, with \$67 billion going to China. The region has also attracted significant levels of bank lending and more volatile equity investments.

Net capital inflows to East Asia and Pacific totaled \$167 billion in 2006, unchanged from 2005, marking a decrease in share of total flows to developing countries to 30 percent from 35 percent in 2005. The broad composition shifted from debt and FDI to portfolio equity. Higher equity inflows (up \$22 billion to \$48 billion) were offset by lower net (private and official) debt flows (down \$13.3 billion to \$30.9 billion) and lower net FDI inflows (down \$8.5 billion to \$88 billion). At \$7 billion in 2006, net bank lending finally showed some activity after being negligible in 2004–05 and averaging net *outflows* of \$10 billion in the six years following the Asian crisis in 1997. Repayments to official creditors outstripped lending by \$10 billion in 2006, mostly due to an \$8 billion prepayment by Indonesia to the IMF.

Net portfolio inflows to the region accounted for 53.5 percent of the total for all developing countries, up from an average of 47 percent over the previous five years. The increase reflected higher inflows to China (up \$11 billion to \$31 billion in 2006), mainly due to IPOs by the Industrial and Commercial Bank of China (\$12.8 billion) and the Bank of China (\$8.9 billion). Both transactions, launched on the Hong Kong exchange, were oversubscribed by a wide margin, defying the long-held belief that transactions of this magnitude needed to be listed in New York or London to gain access to a global pool of capital.

The estimated \$8.5 billion decline in FDI inflows to the region in 2006 was concentrated in China and Indonesia. FDI to Indonesia declined by \$3 billion following exceptional privatization and merger and acquisition activity in 2005 (totaling \$5 billion). FDI inflows to China also declined by \$3 billion, reducing its share from 28 to 23 percent of the total to all developing countries. FDI inflows to China have shifted from the manufacturing sector to the financial and real estate sectors, partly reflecting greater access by foreigners to investment in the banking and insurance sectors in compliance with WTO accession requirements.

Partly as a reaction to these strong inflows over the last 4–5 years, policy makers in the region have adopted increasingly flexible exchange rate

regimes. Both China and Malaysia announced their intentions to replace the dollar as the reference for their exchange rate management schemes with a basket of currencies in 2005.

Medium-term outlook

Growth is projected to slow in 2007, although to a still-robust 8.7 percent, and continue moderating toward 7.9 percent by 2009. Somewhat weaker investment in China should be partially offset by stronger consumer demand, so that China's overall GDP is projected to expand about 9.6 percent in 2007 before slowing to 8.5 percent in 2009 (table A.3). Notwithstanding currency appreciation, China's current account surplus is projected to remain high at 7.8 percent of GDP in 2009. In contrast, growth in the remainder of the region is expected to pick up over the period, reaching 6 percent in 2009, up from 5.7 percent in 2006. Output in Indonesia is expected to accelerate to 6.3 percent in 2007 and remain strong at around 6.5 percent over the next couple of years due to continued buoyant domestic demand, and despite weaker Chinese imports. Growth in Thailand is projected to weaken further in 2007, to 4.5 percent, as policy changes and political turmoil continue to impact output, before picking up to 5 percent in 2009. Growth in Malaysia and the Philippines is also expected to remain robust on the back of continued gains in domestic demand, with a recovery of export growth toward the end of the forecast period.

Risks and uncertainties

This relatively rosy outlook is subject to a number of uncertainties. In particular, the projected slowdown in China is predicated on trend moderation in export growth, as the period of very rapid growth following the relaxation of trade barriers that accompanied its accession to the WTO gives way to increases more reflective of underlying differentials in productivity growth. Output in other countries in the region will be sensitive to this downturn, as China has become the major initial destination for most of their exports. Should China's export growth not slow as quickly as predicted, the expansion throughout the region could be stronger than projected, potentially placing additional pressures on prices and requiring a further tightening of macroeconomic policies.

Table A.3 East Asia and Pacific country forecasts*annual percent change unless indicated otherwise*

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Cambodia							
GDP at market prices (2000 \$) ^b	—	10.0	13.4	10.5	9.0	6.8	6.5
Current account balance/GDP (%)	—	-3.7	-6.4	-7.9	-6.0	-5.8	-5.6
China							
GDP at market prices (2000 \$) ^b	10.4	10.1	10.2	10.7	9.6	8.7	8.5
Current account balance/GDP (%)	1.5	3.6	7.4	9.3	9.2	9.1	7.8
Fiji							
GDP at market prices (2000 \$) ^b	2.1	5.3	0.7	3.4	-2.5	2.0	2.5
Current account balance/GDP (%)	-3.1	-16.8	-16.3	-13.2	-9.0	-7.9	-8.4
Indonesia							
GDP at market prices (2000 \$) ^b	4.2	5.1	5.7	5.5	6.3	6.5	6.4
Current account balance/GDP (%)	-0.4	0.6	0.3	2.8	2.3	1.3	0.7
Lao PDR							
GDP at market prices (2000 \$) ^b	—	6.4	7.0	7.5	7.1	9.0	8.5
Current account balance/GDP (%)	—	-6.3	-24.6	-17.0	-26.6	-22.5	-18.8
Malaysia							
GDP at market prices (2000 \$) ^b	7.1	7.2	5.2	5.9	5.6	5.8	5.7
Current account balance/GDP (%)	-0.4	12.6	15.2	14.6	12.9	13.9	13.1
Papua New Guinea							
GDP at market prices (2000 \$) ^b	4.8	2.7	3.0	3.8	4.0	4.0	4.0
Current account balance/GDP (%)	2.2	-1.5	5.9	4.4	-2.0	-3.3	-3.5
Philippines							
GDP at market prices (2000 \$) ^b	3.0	6.2	5.0	5.4	5.6	6.0	6.0
Current account balance/GDP (%)	-3.1	1.9	2.4	3.5	3.2	2.5	2.1
Thailand							
GDP at market prices (2000 \$) ^b	4.5	6.2	4.5	5.3	4.5	4.5	5.0
Current account balance/GDP (%)	-1.2	4.2	-2.2	3.5	2.3	1.0	1.0
Vanuatu							
GDP at market prices (2000 \$) ^b	4.1	4.0	2.8	3.0	2.4	2.4	2.5
Current account balance/GDP (%)	-8.2	-19.7	-4.3	-4.4	-4.7	-4.4	-4.4
Vietnam							
GDP at market prices (2000 \$) ^b	7.6	7.7	8.5	8.2	8.0	8.0	7.8
Current account balance/GDP (%)	-5.1	-1.0	0.4	1.5	-0.5	-1.0	-1.0

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. American Samoa, the Federated States of Micronesia, Kiribati, the Marshall Islands, Myanmar, Mongolia, Northern Mariana Islands, Palau, the Democratic People's Republic of Korea, the Solomon Islands, Timor-Leste, and Tonga are not forecast owing to data limitations. e = estimate; f = forecast; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

Prospects in the region are also vulnerable to the possibility of a sharper-than-expected slowdown in the United States, a potential deterioration in global financial conditions, and an oil supply shock. While a substantial reduction in U.S. imports would certainly affect East Asian and Pacific exports, most of the region's export growth has reflected increased market share rather than very rapid import growth by the United States and other high-income countries. Moreover, direct trade links to the United States among the ASEAN countries, newly industrial economies, and Japan

have diminished as a share of GDP. As a result, the projected impact of the slowdown in the United States is expected to be relatively minor (see IMF 2006).

The strong growth, large capital inflows into the private sector, and rising asset prices might seem strikingly similar to the situation 10 years ago, just before the 1997–98 crisis, when a reversal in investor sentiment resulted in a liquidity squeeze and a severe recession. However, it is unlikely that history will repeat. Contrary to the 1990s, most countries in the region now have

large current account surpluses and have accumulated reserves well beyond what is needed to absorb sudden reversals in capital flows.

Reduced vulnerability to external financial shocks and the expansion of domestic debt and equity markets has shifted the balance of risks to domestic financial markets. Despite improvements in capitalization, governance, risk management, and operational efficiency in the banking sectors, there is still significant risk linked to limited availability of good information to price securities accurately. Therefore, improving corporate governance and the degree and quality of corporate financial disclosure remains a priority.

Europe and Central Asia

Recent developments

GDP in the Europe and Central Asia region is estimated to have increased 6.8 percent in 2006, up from 6.0 percent growth the year before (table A.4). An acceleration of growth in high-income Europe, still-low real interest rates, and further increases in incomes of regional oil exporters² helped to generate an acceleration in output among many countries in the region (notably

in Bulgaria, Estonia, Latvia, Poland, Romania, Russia, and other oil exporters, the Slovak Republic, and Ukraine). Growth in Bulgaria and Romania was also bolstered by improved confidence and capital inflows tied to EU accession in January 2007. Strong capital inflows, including significant levels of FDI, into countries that recently joined or expect to join the EU,³ coupled with extremely rapid domestic credit expansion and in some cases loose fiscal policy (such as Hungary and the Slovak Republic), are at the root of excess demand in several countries (including the Baltic countries, Bulgaria, Hungary, Romania, the Slovak Republic, and Turkey).

Among the region's larger economies, GDP in Russia increased 6.7 percent, boosted by rising oil revenues (oil prices were up 20 percent for the year as a whole) that fed into increased government spending, private consumption, and investment. In Poland, a welcome expansion in consumption, thanks to rising wages and employment and double-digit increases in investment volumes, helped to propel growth to 6.1 percent after a relatively modest and mainly export-led 3.5 percent expansion in 2005. In contrast, growth in Turkey declined from 7.4 to 6.0 percent between

Table A.4 Europe and Central Asia forecast summary

annual percent change unless indicated otherwise

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
GDP at market prices (2000 \$) ^b	–0.9	7.2	6.0	6.8	6.0	5.7	5.8
GDP per capita (units in \$)	–1.1	7.2	6.0	6.7	6.0	5.7	5.7
PPP GDP ^c	–0.8	7.4	6.0	6.9	6.1	5.8	5.9
Private consumption	0.5	8.3	7.4	8.2	6.9	6.4	6.3
Public consumption	0	2.0	2.9	3.6	3.6	3.5	3.3
Fixed investment	–6.1	13.1	11.5	13.8	10.2	10.4	9.6
Exports, GNFS ^d	1.4	13.4	7.9	9.5	9.0	9.0	9.4
Imports, GNFS ^d	–0.9	17.6	9.9	13.6	10.8	10.8	10.5
Net exports, contribution to growth	0.5	0.4	–0.5	–2.6	–3.6	–4.7	–5.6
Current account balance/GDP (%)	—	0.3	1.0	0.6	–0.8	–1.6	–1.8
GDP deflator (median, LCU)	104.7	6.1	6.1	3.9	6.0	5.5	5.3
Fiscal balance/GDP (%)	–5.8	–0.9	1.0	1.7	0.7	0.3	0.3
<i>Memo items: GDP</i>							
Transition countries	1.8	6.7	5.6	6.2	5.4	5.4	5.1
Central and Eastern Europe	1.0	5.6	4.6	6.2	5.9	5.3	5.0
Commonwealth of Independent States	–4.2	8.0	6.8	7.7	6.9	6.3	6.6
Russian Federation	–3.9	7.1	6.4	6.7	6.3	5.6	5.8
Turkey	3.6	8.9	7.4	6.0	4.5	5.5	5.4
Poland	3.8	5.3	3.5	6.1	6.5	5.7	5.0

Source: World Bank.

Note: e = estimate; f = forecast; LCU = local currency units; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

d. GNFS denotes goods and nonfactor services.

2005 and 2006, as private investment and consumption growth slowed markedly in response to the tightening of monetary policy in the wake of the May 2006 currency crisis.

The European recovery, coupled with rapidly growing demand from large regional oil exporters, notably Russia, bolstered exports among oil importers, whose economies grew 6.3 percent. Moldova represented a notable exception to this strong regional performance. Growth there declined sharply from 7.1 to 4.0 percent between 2005 and 2006 due to higher gas import prices and Russia's imposition of trade restrictions on Moldovan exports (especially on wine, which generates 30 percent of Moldova's GDP). High oil prices and the coming on stream of oil projects and export capacity lifted the 2006 GDP growth among smaller oil exporters to 13.7 percent (notably Azerbaijan, where GDP rose by 34.5 percent, and Kazakhstan, where GDP rose by 10.6 percent).

Macroeconomic policy varies considerably across Europe and Central Asia. All but seven countries in the region have general government deficits of less than 3 percent of their GDP, with Albania, Croatia, the Czech Republic, Hungary, the Kyrgyz Republic, the Slovak Republic, and Tajikistan being the exceptions. Despite strong regional growth, fiscal positions deteriorated by nearly 1 percentage point or more of GDP in Azerbaijan (2.5 percentage point deterioration), FYR Macedonia (0.9), Hungary (3.0), Moldova (1.0), and Romania (0.9), which contributed to strong demand but also added to risks. Among oil importers, several have used strong revenue growth to

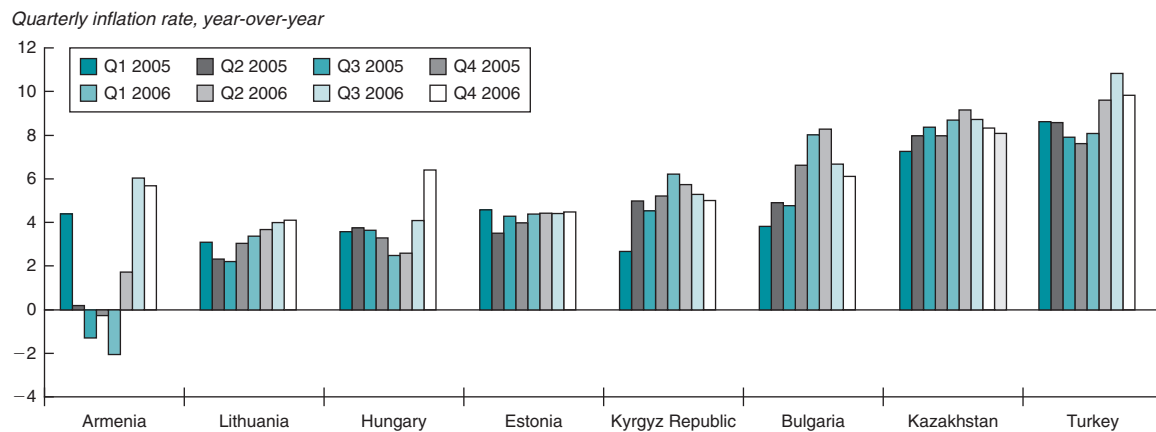
reduce deficits. Government spending has increased rapidly among hydrocarbon exporters, although elevated energy sector revenues have kept balances in the black, and fiscal surpluses have actually risen as a share of GDP in Kazakhstan, Russia, Turkmenistan, and Uzbekistan.

Several years of fast growth, a rapid expansion of credit (often fueled by capital inflows), and the rise in fuel prices have exacerbated inflationary pressures in a number of countries. Median consumer price inflation in the region accelerated to 6.6 percent in 2006, up from 5.8 percent in 2005—the highest rate since 2001. Inflation rose by 1 or more percentage points in several countries: Armenia, Bosnia and Herzegovina, Bulgaria, Kazakhstan, the Kyrgyz Republic, FYR Macedonia, the Slovak Republic, and Turkey (figure A.4). Many other countries had inflation rates in excess of 5 percent: Bosnia and Herzegovina, Bulgaria, Latvia, Romania, Turkey, and all countries in the Commonwealth of Independent States except Armenia.

Tighter monetary policy helped Belarus, Romania, Russia, Serbia and Montenegro, and Ukraine to lower inflation by 2 percentage points or more. Ukraine brought its inflation rate down significantly in 2006, to 9.1 percent, from 13.5 in 2005. For some EU member countries, achieving inflation rates in line with the Maastricht criteria (2.8 percent in 2006) remains a challenge, especially for those seeking to adopt the euro at an early date.

The very strong domestic demand and capital flows that underlie the rise in regional inflation have also generated a substantial increase in

Figure A.4 Building inflationary pressure in Europe and Central Asia



Sources: World Bank; Datastream.

external imbalances among regional oil importers, whose current account deficits deteriorated sharply from 4.7 percent of GDP in 2005 to 6.3 percent of GDP in 2006. Current account positions deteriorated precipitously, by 4 percent of GDP or more, in a number of oil-importing countries: Belarus, Bulgaria, Estonia, Georgia, the Kyrgyz Republic, Lithuania, and Ukraine. In the Kyrgyz Republic, an exceptionally sharp deterioration of over 15 percent of GDP reflected a surge in imports and a fall-off in gold production, which represents roughly one-third of total exports. Current account deficits in excess of 10 percent of GDP were posted in Bosnia and Herzegovina, Bulgaria, the Baltic countries, Kyrgyz Republic, Montenegro, Romania, and Serbia.

Net capital inflows to the region surged by \$71 billion in 2006, reaching a record \$241 billion and accounting for 42.6 percent of total flows to all developing countries, up from 35.5 percent in 2005 (table A.5). Private capital flows have

expanded tremendously over the past five years, rising from a low of \$27 billion (2.8 percent of regional GDP) in 2001 to \$271 billion in 2006 (11 percent of regional GDP). In contrast, repayments to official creditors continued to outstrip lending by a wide margin (\$30 billion in 2006), as plentiful oil revenues enabled Russia to finish paying off its Soviet-era debt with a \$22 billion prepayment to Paris Club creditors, following a \$15 billion prepayment in 2005. Multinational companies with headquarters located in the region contracted \$135 billion in foreign debt in 2006, accounting for 40 percent of cross-border borrowing by companies in developing countries, with most of the funds financing the oil and gas sectors.

FDI inflows increased from \$62.8 billion (3.6 percent of GDP) in 2004 to \$116 billion (4.6 percent of GDP) in 2006, accounting for over one-third of the total to all developing countries, with most of the flows concentrated in Russia (\$28 billion), Turkey (\$19 billion), Poland

Table A.5 Net capital flows to Europe and Central Asia

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	-24.7	-1.1	16.7	17.7	6.0	-0.1	4.8	22.6	13.8
as % of GDP	-2.1	-0.1	1.8	1.8	0.5	0	0.3	1.0	0.6
<i>Financial flows</i>									
Net private and official flows	68.3	44.2	47.9	29.3	52.9	88.7	148.6	170.7	241.4
Net private flows (debt + equity)	59.8	44.6	47.8	27.2	50.3	95.7	158.7	206.9	271.4
Net equity flows	26.6	25.2	26.0	26.8	26.5	33.6	68.1	80.0	126.9
Net FDI inflows	23.7	23.4	25.4	27.2	26.4	34.2	62.8	73.7	116.4
Net portfolio equity inflows	2.9	1.8	0.6	-0.4	0.1	-0.6	5.3	6.3	10.5
Net debt flows	41.7	19.0	21.9	2.5	26.4	55.1	80.5	90.7	114.5
Official creditors	8.5	-0.4	0.1	2.1	2.6	-7.0	-10.1	-36.2	-30.0
World Bank	1.5	1.9	2.1	2.1	1.0	-0.6	0.4	-0.7	0.3
IMF	5.3	-3.1	-0.7	6.1	4.6	-2.0	-5.9	-9.8	-5.6
Other official	1.6	0.8	-1.3	-6.1	-3.0	-4.4	-4.6	-25.6	-24.6
Private creditors	33.2	19.4	21.8	0.4	23.8	62.1	90.6	126.9	144.5
Net medium- and long-term debt flows	27.1	18.9	13.4	6.3	19.1	31.1	70.7	103.9	114.4
Bonds	14.4	7.8	5.6	1.2	3.7	9.5	23.3	28.4	48.3
Banks	13.7	11.9	9.3	7.2	17.0	21.7	48.7	76.7	66.9
Other private	-1.0	-0.7	-1.5	-2.2	-1.6	-0.2	-1.3	-1.2	-0.8
Net short-term debt flows	6.1	0.5	8.4	-5.9	4.7	31.0	19.9	23.0	30.1
Balancing item ^a	-38.8	-36.9	-46.0	-36.4	-14.9	-27.7	-74.9	-99.9	-80.2
Change in reserves (- = increase)	-4.8	-6.2	-18.6	-10.5	-43.9	-60.9	-78.6	-93.4	-175.0
<i>Memo items</i>									
Bilateral aid grants	9.5	12.5	11.4	10.5	13.1	12.7	14.4	6.6	13.0
of which									
Technical cooperation grants	4.2	4.4	2.9	3.5	4.7	4.3	4.3	2.6	1.9
Other	5.3	8.1	8.5	7.0	8.4	8.4	10.1	4.0	11.1
Net official flows (aid + debt)	18.0	12.1	11.5	12.6	15.7	5.7	4.3	-29.6	-17.0
Workers' remittances	14.4	12.2	13.4	13.0	14.4	17.3	22.7	31.4	31.7
Repatriated FDI Income	2.5	2.4	2.9	4.2	7.1	12.2	16.4	27.8	—

Sources: World Bank Debtor Reporting System and staff estimates.

Note: e = estimate; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

(\$12 billion), and Hungary (\$9 billion). Major privatizations and mergers and acquisitions in several countries, notably Turkey, Kazakhstan, Hungary, and Ukraine, contributed to the strong gains in FDI inflows to the region. In Turkey, despite the recent deterioration in external balance, quality of financing has improved as the share of short-term flows dropped to 18 percent in 2006 from 41 percent in 2005. FDI inflows reached a historic high of \$19.2 billion (4.8 percent of GNP) in 2006, up from \$8.7 billion (2.4 percent of GNP) in 2005.

Private debt flows to the region increased from \$0.4 billion in 2001 to \$144 billion in 2006, accounting for almost two-thirds of the total to all developing countries. Substantial external borrowing by banks in several countries in the region (notably Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Russia, and Ukraine) has financed a surge in credit growth, accompanied by mounting inflationary pressures (in Estonia, Latvia, Kazakhstan, and Ukraine). There are also growing concerns about exchange rate exposures in the banking sector in countries such as Hungary, Romania, Ukraine, and the Baltics, where half of the total value of loans is denominated in foreign currency, as well as concerns about interest rate risk in the banking sector in the Baltics, Ukraine, Kazakhstan, and Russia, where short-term bank lending is prevalent.

Foreign exchange reserves increased strongly, by \$175 billion, during 2006, nearly double the \$93 billion level of reserve accumulation recorded in 2005. This primarily reflects increases posted in the region's oil-exporting countries, with foreign reserves rising \$120 billion in Russia and \$12 billion in Kazakhstan. Worker remittances are projected to have been sustained at the 2005 level of over \$31 billion, falling somewhat as a share of GDP to 1.3 percent in 2006 from 1.5 percent in 2005, although still above the average of 1.2 percent recorded during 2000–04.

Medium-term outlook

Output in the region is expected to decelerate to 6.0 percent in 2007 and to remain close to that more sustainable level until 2009 (table A.6). Among oil exporters, lower oil prices and a moderation in the pace at which new productive capacity comes online is projected to lower the pace of growth from 7.7 percent in 2006 to about 6.8 percent in 2009. For oil importers, growth should also ease from 6.3 percent in 2006 to 5.2 percent in 2009 due to tighter policy conditions and less robust demand from regional oil exporters. An expected tightening of monetary policy in high-income Europe will likely contribute to the slowdown by raising the opportunity cost of investment in emerging markets, resulting in an expected slowdown in FDI and other financial inflows.

Table A.6 Europe and Central Asia country forecasts

annual percent change unless indicated otherwise

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
Albania							
GDP at market prices (2000 \$) ^b	1.4	5.9	5.5	5.0	6.0	6.0	6.2
Current account balance/GDP (%)	-5.6	-4.8	-7.8	-7.2	-7.5	-7.3	-7.2
Armenia							
GDP at market prices (2000 \$) ^b	-3.8	10.5	14.0	13.4	9.0	7.0	6.7
Current account balance/GDP (%)	-12.0	-4.5	-3.9	-4.0	-4.5	-4.8	-4.8
Azerbaijan							
GDP at market prices (2000 \$) ^b	-5.2	10.2	26.2	34.5	27.0	21.0	25.0
Current account balance/GDP (%)	-15.8	-29.8	1.3	17.7	22.0	24.0	26.8
Belarus							
GDP at market prices (2000 \$) ^b	-1.2	11.4	9.2	9.3	6.3	5.2	4.8
Current account balance/GDP (%)	—	-5.2	1.5	-3.1	-5.5	-5.3	-4.1
Bulgaria							
GDP at market prices (2000 \$) ^b	-1.7	5.7	5.5	6.3	6.0	5.2	5.4
Current account balance/GDP (%)	-2.3	-6.0	-11.2	-15.8	-13.0	-11.6	-10.6
Croatia							
GDP at market prices (2000 \$) ^b	-1.5	3.8	4.3	4.8	4.5	4.2	4.3
Current account balance/GDP (%)	1.1	-5.2	-6.6	-7.4	-7.0	-6.0	-5.8

(Continues)

Table A.6 (Continued)

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Czech Republic							
GDP at market prices (2000 \$) ^b	0.3	4.2	6.1	5.9	4.9	4.6	4.3
Current account balance/GDP (%)	-2.5	-6.0	-2.0	-4.4	-4.1	-3.3	-3.2
Estonia							
GDP at market prices (2000 \$) ^b	-0.8	7.8	9.8	11.4	9.2	7.9	7.0
Current account balance/GDP (%)	-4.5	-13.0	-10.5	-14.8	-14.8	-13.9	-12.4
Georgia							
GDP at market prices (2000 \$) ^b	-9.3	5.9	9.3	9.0	7.5	7.0	6.7
Current account balance/GDP (%)	—	-8.3	-5.4	-9.5	-13.0	-8.6	-7.9
Hungary							
GDP at market prices (2000 \$) ^b	0.8	5.2	4.1	3.9	2.4	2.8	4.0
Current account balance/GDP (%)	-5.4	-8.5	-7.3	-6.8	-5.5	-4.9	-3.5
Kazakhstan							
GDP at market prices (2000 \$) ^b	-3.6	9.6	9.7	10.6	9.0	8.8	9.4
Current account balance/GDP (%)	-1.8	0.8	-1.8	-2.3	-7.0	-6.5	-6.0
Kyrgyz Republic							
GDP at market prices (2000 \$) ^b	-4.0	7.0	-0.2	2.7	5.5	5.0	4.8
Current account balance/GDP (%)	-10.6	-3.4	-8.3	-23.6	-11.0	-10.9	-10.8
Latvia							
GDP at market prices (2000 \$) ^b	-2.8	8.6	10.2	11.9	10.0	7.5	6.5
Current account balance/GDP (%)	-1.6	-12.9	-12.7	-16.5	-17.8	-16.7	-15.6
Lithuania							
GDP at market prices (2000 \$) ^b	-3.3	7.0	7.6	7.4	6.5	6.3	6.1
Current account balance/GDP (%)	-5.9	-7.7	-7.2	-11.5	-10.5	-10.4	-10.2
Macedonia, FYR							
GDP at market prices (2000 \$) ^b	-0.9	4.1	3.8	3.1	4.5	4.0	4.3
Current account balance/GDP (%)	—	-8.0	-1.4	-0.4	-3.2	-3.8	-4.3
Moldova							
GDP at market prices (2000 \$) ^b	-9.8	7.4	7.1	4.0	5.0	5.0	5.2
Current account balance/GDP (%)	—	-2.0	-9.1	-9.4	-6.7	-5.7	-4.5
Poland							
GDP at market prices (2000 \$) ^b	3.8	5.3	3.5	6.1	6.5	5.7	5.0
Current account balance/GDP (%)	-3.5	-4.2	-1.7	-2.3	-2.9	-3.0	-3.1
Romania							
GDP at market prices (2000 \$) ^b	-1.7	8.4	4.1	7.5	6.2	6.0	5.8
Current account balance/GDP (%)	-4.8	-8.5	-8.7	-10.5	-10.8	-10.0	-9.3
Russian Federation							
GDP at market prices (2000 \$) ^b	-3.9	7.1	6.4	6.7	6.3	5.6	5.8
Current account balance/GDP (%)	—	10.0	10.9	10.2	6.4	3.6	2.1
Slovak Republic							
GDP at market prices (2000 \$) ^b	0.3	5.5	6.0	8.3	8.5	6.2	5.7
Current account balance/GDP (%)	—	-3.1	-8.6	-7.8	-4.8	-3.8	-3.5
Turkey							
GDP at market prices (2000 \$) ^b	3.6	8.9	7.4	6.0	4.5	5.5	5.4
Current account balance/GDP (%)	-1.1	-5.2	-6.5	-8.2	-6.9	-6.4	-5.7
Ukraine							
GDP at market prices (2000 \$) ^b	-8.0	12.1	2.6	6.8	5.3	5.8	5.7
Current account balance/GDP (%)	—	10.7	3.2	-1.7	-5.1	-5.2	-5.1
Uzbekistan							
GDP at market prices (2000 \$) ^b	-0.2	7.7	7.0	7.3	5.0	5.0	5.0
Current account balance/GDP (%)	—	10.1	13.6	18.4	15.3	15.1	13.8

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. Bosnia and Herzegovina, Tajikistan, Turkmenistan, and the former Yugoslavia (Serbia and Montenegro) are not forecast owing to data limitations. e = estimate; f = forecast; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

In Russia, the region's largest economy, GDP growth rate is projected to decline from 6.7 percent in 2006 to 5.8 percent by 2009, reflecting weaker oil revenues, capacity constraints in the oil and other sectors, and a deceleration in investment as implementation of much needed structural reforms is slow. The still-robust domestic demand, exacerbated by an expected appreciation in the ruble, is projected to yield a marked reduction in the current account surplus from about 10 percent of GDP in 2006 to about 2 percent in 2009.

In Turkey, growth is expected to decelerate further to 4.5 percent in 2007 due to sustained higher interest rates, which have already led to a dampening of growth. Inflation at just below 10 percent remains well above the central bank's target and therefore policy is expected to remain tight in an effort to break inflationary expectations. These efforts and sustained fiscal restraint (Turkey has a primary government surplus of 7.0 percent of GDP in 2006) are expected to help gradually restore internal and external balance, allowing policy to relax somewhat toward the end of 2007 or in 2008. As a result, growth is projected to pick up to around 5.5 percent in 2008 and 2009.

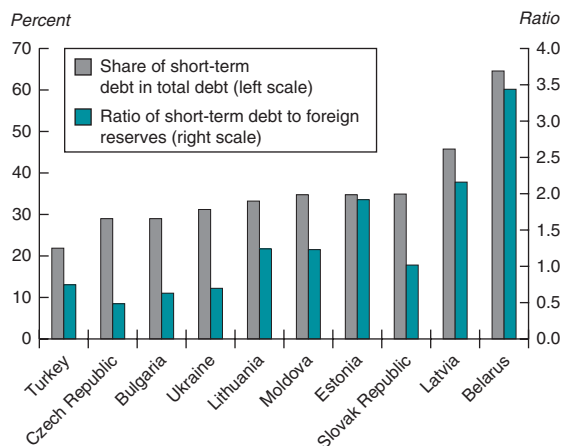
In Poland, growth is projected to accelerate further to 6.5 percent in 2007 from 6.1 percent in 2006 due to strong private consumption—supported by accelerated lending and improvements in the labor market—and by double-digit investment growth, which will be bolstered by high corporate profits, rising FDI, and improving absorption of EU structural funds. Assuming that more restrictive fiscal policy is instituted, growth is projected to decelerate in 2008 and 2009, coming in at a sustainable 5.0 percent in 2009. Growth in Hungary is expected to weaken further, to around 2.4 percent in 2007, under the weight of substantial fiscal and monetary policy tightening (interest rates were increased 425 basis points in 2006). However, growth should begin to pick up toward the end of the forecast period as the initial impact of these measures wears off. In the Czech Republic, an anticipated tightening of monetary policy, a deterioration in business and consumer confidence tied to political wrangling within the coalition government, and delays in structural reforms are expected to cause growth to slow to below 5.0 percent in 2007 and toward a more sustainable 4.3 percent pace by 2009.

Growth among the region's small hydrocarbon exporters is projected to slow as the expansion in production and export capacity that have underpinned recent strong growth wind down and energy prices fall. Azerbaijan and Kazakhstan are expected to receive a boost to growth in 2009 as new oil capacity comes on stream. The projected deceleration of growth in Russia and other oil exporters, along with a general deceleration in the pace of world trade volumes, should contribute to slower growth in many countries in the Commonwealth of Independent States. Growth in Central Europe is also projected to ease. In addition to weaker demand for the region's exports, growth among the first round of accession countries is expected to slow due to tighter monetary conditions and a reduced growth impetus from EU integration.

Risks and uncertainties

The combination of rising inflation and elevated current account deficits poses a persistent challenge for policy makers in the region. To the extent that the contractionary influence of higher interest rates continues to be offset by capital inflows, further fiscal tightening may be unavoidable—even if it means pushing government balances into surplus in some countries.

While the baseline forecast assumes policy makers are able to manage soft landings, the risks involved with a bumpier adjustment process remain significant for countries that have become dependent on large capital inflows, even if inflows were in the form of less volatile FDI. Capital inflows are expected to remain strong, motivated by investment opportunities associated with EU integration. However, the real-side disequilibrium they have provoked (domestic demand in excess of supply and unsustainably large current account deficits) makes these countries sensitive to a change in investor sentiment, as was the case for Turkey in May 2006. If private capital inflows drop sharply, adjustment in countries with relatively inflexible exchange rate regimes, such as Bulgaria, Croatia, Estonia, and Lithuania, could be particularly challenging. Absorbing the impact of a sudden drop in capital inflows would also pose difficulties to countries with large current account deficits, such as Turkey, given the large financing requirement. Countries with strong reliance on short-term capital inflows are especially vulnerable (figure A.5).

Figure A.5 Short-term debt in selected countries of Europe and Central Asia, Q3 2006

Source: World Bank.

An upside risk derives from the timing of Russia's accession to the WTO. While the boost to Russian exports is expected to be modest, this is nevertheless an important step binding the country more firmly into the system of world trade rules and could provide a significant boost to investor

confidence and have a positive effect on medium-term growth.

On the other hand, declining populations, evident in Russia and many other European and Central Asian economies, will pose a significant challenge that may dampen medium-term growth prospects. The declines stem from both dynamics of more deaths than births (high mortality and low fertility) and emigration in countries including Bulgaria, Latvia, Lithuania, Moldova, Poland, Romania, and Ukraine. For other countries, including Belarus, Russia, and the Central European countries that are new EU members, declining populations are the result of natural population declines not being fully offset by immigration.

Latin America and the Caribbean

Recent developments

Economic growth in Latin America and the Caribbean strengthened to 5.6 percent in 2006, up from 4.7 percent in 2005 (table A.7). This marks the third year of solid growth for the region. Over the past three years, regional GDP has increased more than twice as quickly as during

Table A.7 Latin America and the Caribbean forecast summary

annual percent change unless indicated otherwise

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
GDP at market prices (2000 \$) ^b	3.4	6.2	4.7	5.6	4.8	4.3	3.9
GDP per capita (units in \$)	1.6	4.7	3.2	4.2	3.5	3.0	2.6
PPP GDP ^c	4.3	5.9	4.5	5.5	4.8	4.3	3.9
Private consumption	3.4	5.4	6.8	6.1	5.1	4.4	3.8
Public consumption	1.5	3.3	3.1	3.7	3.2	2.5	2.5
Fixed investment	4.7	12.5	11.0	12.5	9.1	7.1	6.1
Exports, GNFS ^d	8.1	12.0	8.0	6.9	5.2	5.9	5.9
Imports, GNFS ^d	10.7	15.3	12.2	12.7	8.4	7.5	6.8
Net exports, contribution to growth	-0.3	1.0	0	-1.4	-2.2	-2.6	-2.9
Current account balance/GDP (%)	-2.8	1.0	1.6	1.8	0.7	0.1	-0.2
GDP deflator (median, LCU)	10.8	7.4	6.2	7.2	5.3	4.6	4.2
Fiscal balance/GDP (%)	—	0	0.4	0.8	0.3	0.2	0.1
Memo items: GDP							
LAC excluding Argentina	3.2	5.8	4.0	5.1	4.4	4.0	3.9
Central America	3.6	4.1	3.0	4.9	3.6	3.7	3.7
Caribbean	3.6	2.6	6.5	8.7	5.3	4.9	4.6
Brazil	2.7	5.7	2.9	3.7	4.2	4.1	3.9
Mexico	3.5	4.1	2.8	4.8	3.5	3.7	3.6
Argentina	4.5	9.0	9.2	8.5	7.5	5.6	3.8

Source: World Bank.

Note: e = estimate; f = forecast; LCU = local currency units; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

d. GNFS denotes goods and nonfactor services.

Box A.1 New GDP estimates for Brazil

On March 21, 2007, the Brazilian Institute of Geography and Statistics published a revision of the nominal and real values of Brazil's GDP between 1995 and 2005. The headline news is that the country's economy in 2005 was 10.9 percent larger than previously thought and its growth rate since 2000 has increased from an annual average rate of 2.6 percent to 3.0 percent.

The revisions rely more than previously on annual surveys which sample economic activities of firms and households. As a result of these better measurements, two

major changes emerged: a) in the new 2000 base year, services' value added as a share of total value added increased by 10 percentage points (from 56 percent to 66 percent); b) on the demand side, household private consumption increased from 60.9 percent to 63 percent of total GDP. The contribution of investment to GDP declined from 19.3 to 16.8 percent due to a change in structure, as machinery and equipment were previously undervalued and construction was overvalued.

the preceding six years. Growth slowed in only six countries and accelerated in the rest. In 2006, output expanded by 3.5 percent or more in 22 of the 27 economies of the region. Many countries have benefited from increasing commodity prices, which boosted export revenues and contributed to higher incomes and domestic and import spending. Fixed investment, which grew at double-digit rates, and rapid growth of private consumption were the dominant factors in the acceleration of output (figure A.6).

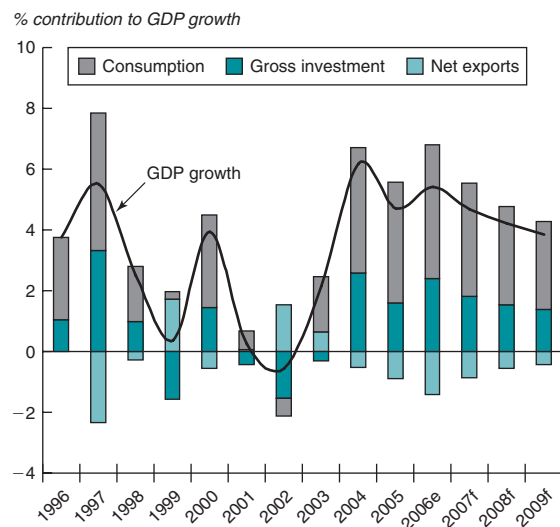
Following a slow start in 2006, GDP in Brazil accelerated in the second half of the year in re-

sponse to an easing of monetary policy and increased fiscal stimulus. Using the National Statistical Office's revised methodology (see box A.1), GDP increased by 3.7 percent, faster than the 2.9 percent growth recorded in 2005, with the acceleration concentrated in industrial and mining activities. Real interest rates are declining and are currently below 9 percent. This still-elevated level provoked an appreciation of the real and contributed to a decline in inflation from 5.7 percent in 2005 to 3.1 percent in 2006, the lowest rate since the adoption of the inflation targeting regime in 1999. Monthly inflation picked up toward the end of the year and into the first quarter of 2007, partly reflecting an increase in regulated prices, although most analysts concur that inflation will continue its recent downward trend in the near future.

GDP in Mexico accelerated sharply to 4.8 percent in 2006 from 2.8 percent in 2005 as lower interest rates boosted domestic demand and construction activity. Stronger sales of cars to the United States and oil exports also contributed to the pickup in growth. While growth in Argentina eased somewhat, domestic demand remains very strong, and GDP expanded by 8.5 percent—significantly above potential. Inflation in Argentina, which had reached 12.3 percent toward the end of 2005, dropped to 9.1 percent in March 2007 with the help of administrative price measures.

Growth elsewhere in Latin America continues to be supported by very strong commodity prices. GDP in República Bolivariana de Venezuela expanded by an unsustainable 10.3 percent in 2006, fueled by rising government transfers. Despite price controls, inflation accelerated further to 18.5 percent in March 2007. Falling oil production and

Figure A.6 Contribution of consumption, investment, and exports to GDP growth in Latin America and the Caribbean



Sources: World Bank; Datastream.
Note: e = estimate; f = forecast.

weak investment growth, which has been discouraged by high taxes and royalties and antibusiness policies, meant that despite strong demand, industrial production declined 4.9 percent in the 12 months ending February 2007. Domestic demand in Colombia is also growing fast and inflation picked up to 5.8 percent in March 2007. As a result, the central bank has increased interest rates twice in the first few months of the year, bringing its benchmark rate to 8 percent. In Chile, mining stoppages, a waning investment boom, and higher imports contributed more than 2 percentage points to the slowing of the economy despite booming copper prices. The authorities have responded to the weakening of growth by lowering interest rates for the first time in three years and there are some signs of a strengthening in domestic demand and activity.

Growth accelerated in most Central American and Caribbean countries in 2006, boosted by robust private consumption and investment. The construction sector has been an important driver of activity as the region continues to recover from the damage caused by Tropical Storm Stan. In contrast to most of the region, growth in Nicaragua has been weak due to poor rainfalls that have held back the agricultural sector and reduced external receipts. Despite the expectation of accelerating growth following the implementation of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), big gains are unlikely in the near future. Members who have ratified the agreement (congressional debate on the agreement continues in Costa Rica) are still losing market share of their maquila exports to China, while Guatemala and El Salvador are experiencing increased competition from low-wage regional exporters such as Honduras and Nicaragua. Despite healthy revenues from tourism and mining, export volume growth in the Dominican Republic and Jamaica have been disappointing. Elsewhere, robust remittances have offset the deterioration in the trade balance. While some countries, most notably Guatemala, have adopted a more relaxed fiscal and monetary stance, others, such as Costa Rica, have taken advantage of strong private sector growth to increase tax receipts and significantly reduce the size of the fiscal deficit.

Although the currencies of a number of countries were affected by the financial turbulence in May 2006, the adjustments were either welcome corrections or short-lived. Stock markets also

underwent a major correction. The resilience of countries in the region to this shock, and to the smaller one of February 2007, reflects improved fiscal and monetary policies and reduced indebtedness. Indeed, with a few notable exceptions, inflation is on a downward trend in the region despite the cyclical upturn and fiscal policy has been less expansionary during the upswing and recent elections than in the past.

Net capital inflows to the region increased slightly to \$68 billion in 2006, up from \$65 billion in 2005, but were well below the \$110 billion level attained in 1998. As a percentage of GDP, net capital inflows declined from 2.8 to 2.5 percent and represented less than half the 5.5 percent of GDP level observed during the late 1990s (table A.8). Net private (debt and equity) inflows declined by \$3.4 billion in 2006, with net equity inflows of \$80.5 billion were substantially higher than net private debt inflows of \$12.3 billion. The pace at which countries in the region repaid existing debt to official creditors declined and, as a result, net capital outflows from the region fell from \$31.2 billion in 2005 to \$24.6 billion in 2006. In 2006, the outflows were mainly due to large voluntary prepayments by Argentina (\$9.6 billion) and Uruguay (\$2.5 billion) to the IMF, and by Mexico (\$2.5 billion) to the Inter-American Development Bank and the World Bank.

Net FDI inflows were unchanged at \$70 billion in 2006, declining from 3.0 to 2.5 percent of GDP. Net bank lending surged from zero in 2005 to \$17.4 billion in 2006, due entirely to a record \$17.6 billion bridge loan contracted by the Brazilian mining company Companhia Vale do Rio Doce (CVRD), to acquire the Canadian mining company Inco.

The large buybacks of sovereign debt by Brazil (\$15 billion), Mexico (\$5.4 billion), República Bolivariana de Venezuela (\$4.6 billion), and Colombia (\$4.3 billion) in 2006 reduced the average cost of capital of these countries and significantly improved their debt-servicing profiles. With less than \$6 billion outstanding, Brady bonds, once the mainstay of the emerging-market asset class, have been almost completely retired. Despite these improvements in the external debt statistics, dependence on foreign capital has likely declined to a lesser extent because sales of bonds issued on domestic debt markets purchased by foreigners are not recorded in these statistics. Two other developments are worth mentioning: the

Table A.8 Net capital flows to Latin America and the Caribbean

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	-89.6	-55.8	-47.4	-52.8	-15.6	8.5	21.1	37.1	51.1
as % of GDP	-4.5	-3.2	-2.4	-2.8	-0.9	0.5	1.0	1.6	1.8
<i>Financial flows</i>									
Net private and official flows	109.8	101.2	75.4	95.2	50.4	63.8	58.0	65.0	68.2
Net private flows (debt + equity)	98.7	99.6	86.5	74.9	37.7	59.1	68.3	96.2	92.8
Net equity flows	71.9	85.0	79.4	73.1	53.2	47.4	61.9	82.4	80.5
Net FDI inflows	74.1	88.6	80.0	70.6	51.8	44.0	62.5	70.0	69.4
Net portfolio equity inflows	-2.2	-3.6	-0.6	2.5	1.4	3.4	-0.6	12.4	11.1
Net debt flows	37.9	16.2	-4.0	22.1	-2.8	16.4	-3.9	-17.4	-12.3
Official creditors	11.1	1.6	-11.1	20.4	12.7	4.7	-10.3	-31.2	-24.6
World Bank	2.4	2.1	2.0	1.3	-0.3	-0.4	-1.0	-0.8	-4.4
IMF	2.5	-0.9	-10.7	15.6	11.9	5.6	-6.3	-27.6	-10.9
Other official	6.2	0.4	-2.4	3.5	1.1	-0.4	-3.0	-2.9	-9.3
Private creditors	26.8	14.6	7.1	1.8	-15.5	11.7	6.4	13.8	12.3
Net medium- and long-term debt flows	55.1	19.5	8.0	16.4	-5.0	9.0	-0.9	16.6	10.2
Bonds	17.7	20.1	8.4	2.9	-0.4	11.0	-1.8	16.6	-7.1
Banks	39.1	-1.4	0.4	15.2	-2.6	-1.0	0.9	0.1	17.4
Other private	-1.7	0.8	-0.8	-1.6	-1.9	-0.9	0	-0.1	0
Net short-term debt flows	-28.3	-4.9	-0.9	-14.6	-10.5	2.6	7.3	-2.8	2.1
Balancing item ^a	-29.2	-52.7	-25.3	-40.5	-32.9	-37.7	-54.1	-67.3	-64.0
Change in reserves (- = increase)	9.0	7.3	-2.7	-1.9	-1.9	-34.6	-25.0	-34.8	-55.3
<i>Memo items</i>									
Bilateral aid grants	5.5	5.2	5.2	6.1	5.7	6.6	8.7	8.0	6.6
of which									
Technical cooperation grants	2.3	2.3	2.7	2.9	2.9	3.6	3.8	3.2	2.9
Other	3.2	2.9	2.5	3.2	2.8	3.0	4.9	4.8	3.7
Net official flows (aid + debt)	16.6	6.8	-5.9	26.5	18.4	11.3	-1.6	-23.2	-18.0
Workers' remittances	15.9	17.7	20.1	24.4	28.1	35.0	41.4	48.2	52.5
Repatriated FDI Income	13.8	12.6	14.0	14.6	12.7	14.7	18.8	29.7	—

Sources: World Bank Debtor Reporting System and staff estimates.

Note: e = estimate; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

accumulation of reserves and the rapid expansion of remittance inflows. The latter supported import spending, especially in Central American and Caribbean countries.

Medium-term outlook

Regional GDP growth is expected to moderate from 5.6 percent in 2006 to 4.8 percent in 2007 and ease further to 3.9 percent in 2009 (table A.9). However, this slowdown in regional growth mainly reflects a return toward more sustainable growth rates in Argentina and República Bolivariana de Venezuela, following a postcrisis rebound in growth. Excluding these two countries, expansion in the rest of the region is projected to remain relatively steady at 4.1 percent during the forecast period, down only 0.6 percentage points from 2006.

Prospects for individual countries reflect a number of offsetting influences. The projected slowdown in global activity should moderate

demand for commodities, resulting in a modest decline in their prices and slower volume growth. As a result, growth among commodity exporters will moderate, although their export revenues will remain elevated in historical perspective. GDP growth for exporters of agricultural commodities is expected to decelerate from 7.7 percent in 2006 to 5.2 percent in 2008. Despite softening metal prices, growth among exporters of these commodities should pick up due mainly to expansionary monetary policies in Chile and Brazil. Notwithstanding lower projected oil prices, growth of small oil importers (excluding Brazil and Chile) is projected to slow from 7.1 percent in 2006 to 4.5 percent in 2009 due to weaker demand in the United States and slower investment growth in Central American and Caribbean countries.

The positive trends recently observed in Brazil—decreasing unemployment, creation of formal jobs, recovery of real earnings, and

Table A.9 Latin America and the Caribbean country forecasts*annual percent change unless indicated otherwise*

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Argentina							
GDP at market prices (2000 \$) ^b	4.5	9.0	9.2	8.5	7.5	5.6	3.8
Current account balance/GDP (%)	-3.1	2.1	2.8	3.1	2.3	1.6	1.2
Antigua and Barbuda							
GDP at market prices (2000 \$) ^b	3.3	4.3	5.2	5.6	5.8	5.7	5.6
Current account balance/GDP (%)	-6.0	-11.9	-11.4	-12.0	-12.3	-12.3	-11.7
Belize							
GDP at market prices (2000 \$) ^b	5.9	4.6	3.1	4.0	2.8	3.3	3.4
Current account balance/GDP (%)	-7.3	-14.4	-12.0	-8.7	-6.3	-6.1	-6.0
Bolivia							
GDP at market prices (2000 \$) ^b	3.8	3.9	4.1	4.5	4.6	4.1	3.5
Current account balance/GDP (%)	-6.1	3.9	5.2	8.1	8.3	7.9	7.6
Brazil							
GDP at market prices (2000 \$) ^b	2.7	5.7	2.9	3.7	4.2	4.1	3.9
Current account balance/GDP (%)	-2.1	1.9	1.9	1.5	1.0	0.3	0.6
Chile							
GDP at market prices (2000 \$) ^b	6.4	6.2	6.3	4.2	5.1	5.0	4.9
Current account balance/GDP (%)	-2.7	1.7	0.6	3.8	1.7	0	-0.7
Colombia							
GDP at market prices (2000 \$) ^b	2.5	4.8	5.3	6.8	5.5	4.8	4.5
Current account balance/GDP (%)	-1.9	-0.9	-1.7	-1.9	-2.4	-2.7	-2.9
Costa Rica							
GDP at market prices (2000 \$) ^b	5.2	4.1	5.9	7.6	5.7	4.6	4.3
Current account balance/GDP (%)	-3.6	-4.3	-4.8	-4.7	-4.6	-4.2	-4.2
Dominica							
GDP at market prices (2000 \$) ^b	1.8	3.2	3.6	2.5	2.6	2.5	2.4
Current account balance/GDP (%)	-16.6	-6.4	-6.1	-6.3	-6.5	-6.7	-6.9
Dominican Republic							
GDP at market prices (2000 \$) ^b	6.0	2.0	9.3	10.7	6.8	5.2	4.8
Current account balance/GDP (%)	-3.2	4.3	-1.9	-2.5	-2.6	-2.5	-1.8
Ecuador							
GDP at market prices (2000 \$) ^b	1.8	7.9	4.7	4.6	3.4	3.2	3.1
Current account balance/GDP (%)	-2.3	-1.7	0.8	3.0	1.8	0.4	0.2
El Salvador							
GDP at market prices (2000 \$) ^b	4.6	1.8	2.8	4.2	3.4	3.4	3.3
Current account balance/GDP (%)	-2.0	-4.0	-4.6	-5.6	-4.4	-4.1	-4.0
Guatemala							
GDP at market prices (2000 \$) ^b	4.1	2.7	3.2	4.6	3.9	4.1	4.0
Current account balance/GDP (%)	-4.6	-4.4	-4.3	-5.5	-4.4	-3.4	-3.0
Guyana							
GDP at market prices (2000 \$) ^b	4.9	3.3	-3.0	4.5	3.8	3.0	3.0
Current account balance/GDP (%)	-15.1	-2.5	-18.6	-15.1	-14.0	-14.3	-14.5
Haiti							
GDP at market prices (2000 \$) ^b	-1.3	-2.2	2.3	2.8	3.0	3.3	3.5
Current account balance/GDP (%)	-1.8	-1.7	1.4	-0.4	-2.0	-3.5	-3.6
Honduras							
GDP at market prices (2000 \$) ^b	3.3	5.0	4.3	5.2	3.9	4.0	4.0
Current account balance/GDP (%)	-7.7	-5.7	-0.5	-1.6	-2.3	-1.9	-2.0
Jamaica							
GDP at market prices (2000 \$) ^b	1.9	1.1	1.4	2.7	3.1	3.0	2.9
Current account balance/GDP (%)	-2.7	-5.7	-11.1	-8.1	-7.7	-8.0	-7.8
Mexico							
GDP at market prices (2000 \$) ^b	3.5	4.1	2.8	4.8	3.5	3.7	3.6
Current account balance/GDP (%)	-3.7	-1.0	-0.6	-0.2	-1.2	-1.5	-1.8
Nicaragua							
GDP at market prices (2000 \$) ^b	3.4	5.1	4.0	3.5	3.0	3.2	3.1
Current account balance/GDP (%)	-28.7	-15.5	-16.3	-12.8	-14.2	-15.1	-14.1

(Continues)

Table A.9 (Continued)

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Panama							
GDP at market prices (2000 \$) ^b	5.1	7.6	6.4	7.5	6.1	5.0	4.8
Current account balance/GDP (%)	-4.8	-7.5	-8.5	-3.7	-3.4	-4.3	-4.6
Paraguay							
GDP at market prices (2000 \$) ^b	1.8	4.1	2.7	3.8	3.8	3.4	3.1
Current account balance/GDP (%)	-2.2	2.0	-0.3	-3.4	-2.0	-1.6	-1.2
Peru							
GDP at market prices (2000 \$) ^b	4.0	5.2	6.4	8.0	6.6	5.7	5.2
Current account balance/GDP (%)	-5.5	0	1.5	2.8	1.8	1.2	-0.4
St. Lucia							
GDP at market prices (2000 \$) ^b	3.1	3.9	6.5	6.1	5.7	5.2	4.9
Current account balance/GDP (%)	-11.4	-6.4	-7.1	-6.5	-6.2	-5.8	-5.3
St. Vincent and the Grenadines							
GDP at market prices (2000 \$) ^b	2.1	5.4	2.8	3.2	3.4	3.1	3.0
Current account balance/GDP (%)	-19.8	-10.5	-12.5	-12.4	-12.1	-11.3	-10.6
Trinidad and Tobago							
GDP at market prices (2000 \$) ^b	3.2	6.5	7.0	12.0	4.7	6.3	5.8
Current account balance/GDP (%)	0.2	11.9	27.0	33.4	27.2	20.7	20.2
Uruguay							
GDP at market prices (2000 \$) ^b	3.0	11.8	6.8	6.9	5.1	4.1	3.8
Current account balance/GDP (%)	-1.5	0.3	0	-1.6	-0.9	-0.8	-1.1
Venezuela, R. B. de							
GDP at market prices (2000 \$) ^b	2.1	17.9	10.3	10.3	6.5	3.3	3.0
Current account balance/GDP (%)	2.6	14.1	18.5	14.4	8.2	5.6	3.1

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in Bank documents. Barbados, Cuba, Grenada, and Suriname are not forecast owing to data limitations. e = estimate; f = forecast.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

improvements in productive capacity—will most likely continue to bolster economic activity in the coming months. There remains scope for further loosening of monetary policy, although the central bank has reduced the pace of monetary easing (during the most recent meetings, the Selic target rate was cut by 25 basis points as compared with 50 basis points earlier during the current easing cycle). Additionally, the recently reelected administration has launched a growth acceleration plan (PAC) whose centerpiece is an investment program of \$240 billion, equivalent to 27 percent of 2006 GDP, to be carried out over 2007–10. These factors will support a strong GDP growth of around 4.1 percent in the forecast period.

Lower oil prices and the declining contribution of government spending are expected to slow the growth rate of domestic demand in República Bolivariana de Venezuela, resulting in a significant slowdown in GDP growth from 10.3 percent in 2006 to 6.5 percent in 2007 and around 3 percent in the following two years. While this should

prevent further deterioration in the current account balance and reduce inflationary pressures, inflation is expected to remain high until domestic supply catches up with demand levels. GDP growth in other energy exporters is projected to slow from 6.2 percent in 2006 to about 4.4 percent by 2008. In the case of Mexico, the anticipated cycle in the United States will reduce export growth and is projected to slow GDP by 1.3 percentage points to 3.5 percent in 2007, followed by somewhat stronger growth in 2008–09.

In Argentina, the slowdown is expected to be more gradual. Growth in industrial production has been strong recently, which has attracted additional capital inflows that have supported strong domestic demand. As a result, growth is projected to remain strong in 2007 (7.5 percent). Macroeconomic policy restraint will be needed to align growth with potential output over the medium term, as sustained expansionary policy raises the risk that growth will have to slow more abruptly to reestablish equilibrium between demand and supply.

Risks and uncertainties

A major uncertainty for the region concerns the future path of commodity prices and export demand, both of which are likely to be sensitive to growth developments in the United States. A more forcible spreading of the housing recession to other sectors in the U.S. economy could have important consequences for Latin American and Caribbean countries with close trade links with the United States, notably Mexico. Indirect channels may also be important. In particular, a sharp slowdown in U.S. demand could cause commodity prices to weaken much more rapidly than anticipated in the baseline. The combination of weaker demand and lower prices for the exports of countries in the region could generate significant difficulties for some countries, where underlying problems may have been hidden by the commodity boom of the past few years.

In general, the region has become more resilient to external shocks in the past few years and most countries have taken steps to restructure and reduce debt burdens as well as to establish ample international reserves. For many countries, reserves accumulation was supported not only by recent favorable international financial market conditions but also by improved competitiveness and stronger current account positions. These developments, combined with a higher share of FDI in capital inflows, have reduced the vulnerability of the region to sudden capital flow reversals. The end-February 2007 declines in equity markets that started in China and quickly reverberated in other markets (Brazil's market fell 6.6 percent, Russia's fell 3.3 percent, Turkey's fell 4.5 percent, and the Dow Jones Industrial Average fell by around 3 percent) did not produce lasting negative effects on sovereign bond spreads (the EMBI Global rose to about 195 basis points but has since leveled off at 190 basis points, a historically low level for this index).

Several Latin American and Caribbean countries have adopted a number of policies that could significantly reduce their long-term growth potential, increasing the likelihood of a sharp growth disruption should today's virtuous cycle of strong external growth, robust export prices, and low interest rates turn into a vicious circle characterized by falling commodity prices, rising interest rates, and slower demand. With the external environment toughening and some internal tensions

remaining, markets may become more volatile going forward, as was illustrated by the recent increase in the VIX index, a measure of investors' forecasts regarding risk and an indication of risk aversion.

Middle East and North Africa⁴*Recent developments*

The low- and middle-income countries of the Middle East and North Africa⁵ region continued on a robust growth path during 2006, with real GDP increasing by 5 percent (3.2 percent in per capita terms), a significant improvement from the 4.3 percent gain posted the year before (table A.10). Notwithstanding a further 20 percent hike in oil prices during 2006, GDP growth for the resource-poor economies⁶ of the region accelerated from 3.8 percent in 2005 to 5.6 percent, partly reflecting a rebound in growth among Maghreb countries following a severe drought in 2005. Growth among the oil-exporting economies dipped to 4.5 percent in 2006 from 4.7 percent in 2005, principally as hydrocarbon production in Algeria languished, restricting overall growth in that country to 1.4 percent.

Rising oil prices during the first eight months of 2006 served to bolster revenues and domestic demand among the major oil-exporting countries in the region. Many governments have used revenues to boost spending. Measures included substantial investments to augment oil-sector capacity, infrastructure projects, and other nonoil-sector investments in human and social capital, all of which should help boost future supply. However, a significant share of the additional spending, such as substantial civil service wage increases in several countries, and increased spending on fuel subsidies, merely stoked demand and may prove difficult to sustain should oil prices decline further.

Though their oil import bill has soared, oil importers such as Morocco and Tunisia have also benefited from the region's boom in oil revenues as FDI flows from the Gulf Cooperation Council (GCC), comprised of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and the Republic of Yemen have picked up considerably, while recovery in the Euro Area has served to boost tourism revenues and remittance inflows. Strong Suez Canal revenues in Egypt and better crops following a drought in the Maghreb are additional

Table A.10 Middle East and North Africa forecast summary*annual percent change unless indicated otherwise*

	1991-2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
GDP at market prices (2000 \$) ^b	3.8	4.8	4.3	5.0	4.5	4.6	4.8
GDP per capita (units in \$)	1.6	3.0	2.6	3.2	2.7	2.8	3.1
PPP GDP ^c	4.7	4.8	4.3	5.3	4.5	4.6	4.8
Private consumption	3.8	6.3	2.6	6.4	5.6	6.9	6.6
Public consumption	4.3	2.7	5.8	3.8	4.8	5.0	5.0
Fixed investment	3.3	8.1	12.0	12.5	11.4	9.4	8.9
Exports, GNFS ^d	4.4	8.6	3.4	5.2	4.7	4.1	4.4
Imports, GNFS ^d	1.6	15.2	4.5	12.6	11.2	10.8	9.5
Net exports, contribution to growth	-0.8	-1.7	-2.0	-4.4	-6.6	-8.9	-10.9
Current account balance/GDP (%)	-0.3	2.6	6.6	6.3	4.0	2.9	1.9
GDP deflator (median, LCU)	7.4	9.1	13.5	8.5	3.5	4.4	4.0
Fiscal balance/GDP (%)	-2.7	-2.7	0.8	0.6	0.5	0.9	0.6
Memo items: GDP							
MENA geographic region ^e	3.4	5.0	5.3	5.4	5.0	4.9	4.9
Resource poor, labor abundant ^f	4.2	4.8	3.8	5.6	4.9	5.1	5.5
Resource rich, labor abundant ^g	3.3	4.9	4.6	4.3	4.0	4.2	4.1
Resource rich, labor importing ^h	3.0	5.2	6.8	6.0	5.7	5.2	4.9
Egypt, Arab Rep. of	4.3	4.2	4.6	6.9	5.3	5.4	6.0
Iran, Islamic Rep. of	3.7	5.1	4.4	5.8	5.0	4.7	4.5
Algeria	1.7	5.2	5.3	1.4	2.5	3.5	4.0

Source: World Bank.

Note: e = estimate; f = forecast; LCU = local currency units.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

d. GNFS denotes goods and nonfactor services.

e. Geographic region includes high-income countries: Bahrain, Kuwait, and Saudi Arabia.

f. Egypt, Jordan, Lebanon, Morocco, and Tunisia.

g. Algeria, the Islamic Republic of Iran, Syria, and the Republic of Yemen.

h. Bahrain, Kuwait, Oman, and Saudi Arabia.

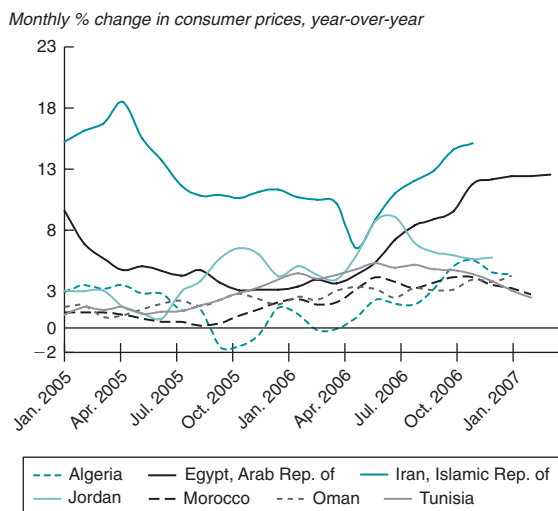
factors that explain the acceleration of growth in these countries from 3.8 to 5.6 percent between 2005 and 2006. An exception to the strong growth performance was Lebanon, where the conflict between Israel and Hezbollah and political uncertainty caused GDP to contract by about 5.5 percent in 2006.

Despite strong demand growth, industrial production declined by 0.2 percent in 2006, reflecting capacity constraints among both oil importers and oil exporters, real effective exchange rate appreciation related to Dutch disease in several countries, and OPEC-dictated cuts in hydrocarbon production. The combination of rapidly expanding demand and declining or relatively stagnant industrial production led to a 2 percentage point increase in regional inflation, a notion of concern, although the increase was moderate in relation to the scope of the region's oil price boom, suggesting that countries are coping better with these pressures than they have in the past. Rising imported agricultural and other raw-material

prices, coupled with increased domestic energy costs (several countries lifted subsidies on gasoline and other fuels), also contributed to the pickup in consumer inflation from 3.2 percent at the end of 2005 to 5.6 percent in the final months of 2006. Inflation in the Islamic Republic of Iran remains in the double digits, while the consumer price index picked up in Algeria, Egypt, and Oman over the course of 2006. Tighter policy in Tunisia and Morocco has helped reestablish a downward trajectory for inflation in those countries. Inflation in Jordan has declined somewhat in recent months, though it is still higher than it was a year earlier (figure A.7).

Tourism revenues, which rose by 11 percent to \$17.8 billion in 2006, account for 7 percent of the region's external receipts, and an even larger share for resource-poor countries. Gross remittance inflows to countries in the region were up 8.8 percent in 2006, double the pace of 2005, standing at \$25.1 billion. Together, remittances and tourism represent some 28 percent of recipients' foreign

Figure A.7 Rising inflation in selected countries of the Middle East and North Africa



Sources: World Bank; Datastream.

currency revenues. While Morocco is the most important destination for remittances (\$5.2 billion), Jordan received a larger share of its income (17.5 percent of GDP in 2006) from this source, mainly reflecting transfers from citizens working in regional high-income oil-exporting countries. Partly because of these revenues, the current account position of resource-poor and oil-importing countries remained in balance, despite deterioration in merchandise trade balances.

The divergence between higher oil prices (on average, oil prices were up 20 percent in 2006) and reduced oil export volumes meant that petroleum and related receipts of the region's low- and middle-income oil exporters increased by only \$10 billion (compared with a \$30 billion increase in 2005). This, combined with a rapid increase in domestic demand, meant that the aggregate current account surplus of these countries edged lower from 11.2 to 10.9 percent of GDP. Moreover, despite strong oil revenues, aggregate fiscal surplus slipped from 5.5 to 4.4 percent of GDP. In contrast, the same reduction in energy subsidies that served to increase domestic inflation rates among the region's oil importers also helped them to reduce their fiscal deficits from an average of 6.8 percent of GDP in 2005 to a still-high 6.2 percent in 2006.

For the region, 2006 was a year of ample financial liquidity, strong revival of privatization, and robust cross-border mergers and acquisitions, particularly in the banking industry. Regional investment demand, fueled in part by intraregional FDI flows, increased by more than 12 percent for the second year in a row. Total FDI flows reached a new high of more than \$19 billion in 2006, or 3 percent of regional GDP (table A.11), concentrated in Egypt, Jordan, Lebanon, and Tunisia. In contrast with equity markets elsewhere in the developing world, markets in the region considered as a whole have yet to recover from the turbulence introduced in May/June 2006. Prices in dollar terms remain below levels of early June, although this mainly reflects weakness in Iranian and Iraqi markets. Prices elsewhere continue to rise rapidly, outpacing the rest of the developing world (figure A.8).

The combination of high trade surpluses and large capital inflows has boosted the region's financial resources, adding to central banks' foreign exchange reserve holdings and increased foreign investment, not only in the energy sector but also in infrastructure, real estate, and tourism. As in other regions, sovereigns in the Middle East and North Africa continued to reduce their external debt through debt repayment.

Traditionally strong local and regional banks have benefited from the favorable combination of growing local economies, ample oil-generated foreign currency liquidity, closer regional financial integration, and a new wave of privatization and banking sector reform implemented in several countries, including Egypt, Algeria, and Lebanon. Shares of several state-owned banks (for example, Bank of Alexandria in Egypt) have been offered to both local and foreign investors. Rising real estate prices have created a growing market opportunity for banks to expand lending. However, the combination of increased bank borrowing from overseas markets to help finance this sharp rise in activity, efforts to strengthen capital adequacy through foreign equity injections, and a surge in other capital inflows may make the region vulnerable to overpricing of assets and sudden corrections similar to those of May/June 2006.

Aid grants provided by bilateral donors to the Middle East and North Africa region increased substantially over the last few years, although

Table A.11 Net capital flows to the Middle East and North Africa

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	-14.6	3.1	22.5	13.2	8.4	12.8	12.9	38.1	42.1
as % of GDP	-4.1	0.9	5.9	3.3	2.1	2.9	2.6	6.6	6.3
<i>Financial flows</i>									
Net private and official flows	7.6	0.5	1.2	4.8	6.0	9.3	10.4	20.7	13.9
Net private flows (debt + equity)	9.2	3.0	3.9	6.0	8.5	11.8	14.3	24.3	23.4
Net equity flows	4.0	3.5	5.0	4.0	4.6	8.4	7.5	16.1	20.8
Net FDI inflows	3.8	2.8	4.8	4.1	4.9	8.1	6.8	13.8	19.2
Net portfolio equity inflows	0.2	0.7	0.2	-0.1	-0.3	0.3	0.7	2.3	1.6
Net debt flows	3.6	-3.0	-3.8	0.8	1.4	0.9	2.9	4.6	-6.9
Official creditors	-1.6	-2.5	-2.7	-1.2	-2.5	-2.4	-4.0	-3.6	-9.5
World Bank	-0.2	0.2	-0.3	-0.1	-0.3	-0.3	-0.6	0	-0.9
IMF	0	0	-0.2	-0.1	-0.3	-0.6	-0.5	-0.7	-0.1
Other official	-1.4	-2.8	-2.2	-1.0	-2.0	-1.6	-2.8	-2.8	-8.5
Private creditors	5.2	-0.5	-1.1	2.0	3.9	3.4	6.8	8.2	2.6
Net medium- and long-term debt flows	1.8	-1.4	0.8	3.8	4.5	0.2	2.4	4.9	0.6
Bonds	1.3	1.4	1.2	4.4	5.0	0.7	3.3	2.6	-2.3
Banks	2.0	-1.6	0.5	-0.1	-0.2	-1.0	-0.8	3.4	4.4
Other private	-1.5	-1.2	-0.9	-0.5	-0.2	0.5	-0.2	-1.0	-1.5
Net short-term debt flows	3.3	1.0	-1.9	-1.8	-0.6	3.1	4.5	3.2	1.9
Balancing item ^a	5.4	-4.5	-19.0	-8.8	-2.3	0	-9.1	-37.7	-19.0
Change in reserves (- = increase)	1.6	0.9	-4.7	-9.2	-12.1	-22.1	-14.3	-21.1	-37.0
<i>Memo items</i>									
Bilateral aid grants ^b	4.9	4.7	4.1	4.6	7.8	10.7	27.2	11.9	15.4
of which									
Technical cooperation grants	1.6	2.1	1.5	1.8	2.1	2.1	1.8	2.2	2.9
Other	3.3	2.6	2.6	2.8	5.7	8.6	25.4	9.7	12.6
Net official flows (aid + debt)	3.3	2.2	1.4	3.4	5.3	8.3	23.2	8.3	5.9
Workers' remittances	13.1	12.8	12.9	14.7	15.8	20.3	23.0	24.0	25.1
Repatriated FDI Income	1.7	2.0	2.6	3.3	3.3	4.4	6.0	6.7	—

Sources: World Bank Debtor Reporting System and staff estimates.

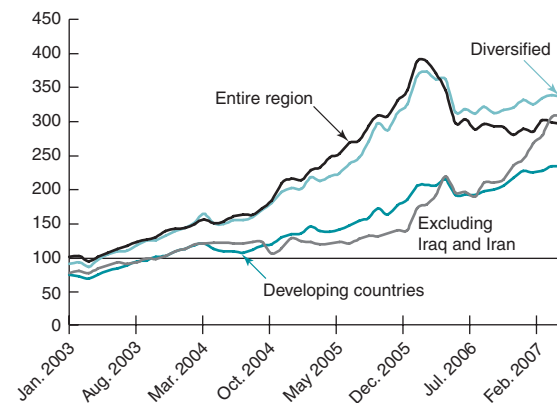
Note: e = estimate; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

b. Including aid grants provided to Iraq, which are not included in the financial flows because they do not report to the Debtor Reporting System.

Figure A.8 Stock market valuations in the Middle East and North Africa

Stock market valuations in \$, index = 100



Sources: World Bank; Datastream.

Note: Diversified economies are countries whose exports comprise a mix of goods and services and include Jordan, Lebanon, Morocco, and Tunisia.

much of the increase in flows was in the form of debt relief to Iraq by Paris Club creditors (\$13.9 billion during 2005 and \$3.4 billion in 2006). Assistance provided to Iraq accounted for more than 40 percent of total ODA flows to the region in the last two years. In January 2007, a gathering of donors (Paris III) pledged some \$7.5 billion to facilitate the rebuilding process in Lebanon, grounded in a renewed program of fiscal and economic reforms.

Medium-term outlook

Prospects for the region through 2009 are broadly favorable. A gradual easing of growth among the resource-rich economies, in tandem with softening oil prices, implies that oil revenues are likely to decline. Weaker output growth among oil exporters is projected to be compensated for by a pickup among the resource-poor economies. On balance,

Table A.12 Middle East and North Africa country forecasts*annual percent change unless indicated otherwise*

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
Algeria							
GDP at market prices (2000 \$) ^b	1.7	5.2	5.3	1.4	2.5	3.5	4.0
Current account balance/GDP (%)	3.2	13.2	20.4	23.2	17.9	16.2	12.8
Egypt, Arab Rep. of							
GDP at market prices (2000 \$) ^b	4.3	4.2	4.6	6.9	5.3	5.4	6.0
Current account balance/GDP (%)	0.9	5.0	3.0	1.5	1.3	-0.7	-0.5
Iran, Islamic Rep. of							
GDP at market prices (2000 \$) ^b	3.7	5.1	4.4	5.8	5.0	4.7	4.5
Current account balance/GDP (%)	1.6	0.9	7.4	5.3	2.4	2.2	1.0
Jordan							
GDP at market prices (2000 \$) ^b	5.1	8.4	7.3	6.3	5.0	5.0	5.5
Current account balance/GDP (%)	-4.3	-0.2	-19.6	-23.0	-22.2	-17.3	-9.8
Lebanon							
GDP at market prices (2000 \$) ^b	7.2	6.3	1.0	-5.5	4.5	2.9	3.5
Current account balance/GDP (%)	..	-16.5	-18.8	-22.9	-20.9	-19.3	-17.1
Morocco							
GDP at market prices (2000 \$) ^b	2.2	4.2	1.7	7.3	3.5	4.5	4.6
Current account balance/GDP (%)	-1.4	1.8	2.1	4.1	2.9	2.0	0.8
Oman							
GDP at market prices (2000 \$) ^b	4.6	3.1	5.6	6.4	5.7	4.8	4.8
Current account balance/GDP (%)	-3.7	2.3	15.7	21.2	23.1	18.7	15.3
Syrian Arab Rep.							
GDP at market prices (2000 \$) ^b	5.1	3.9	4.5	5.1	3.2	3.5	3.2
Current account balance/GDP (%)	1.0	-2.5	1.2	1.2	-2.1	-2.3	-2.7
Tunisia							
GDP at market prices (2000 \$) ^b	4.7	6.0	4.2	5.3	5.6	6.0	6.2
Current account balance/GDP (%)	-4.3	-2.0	-1.1	-1.2	-1.5	-1.2	-1.1
Yemen, Republic of							
GDP at market prices (2000 \$) ^b	5.5	2.5	3.8	3.9	2.5	3.0	2.5
Current account balance/GDP (%)	-4.3	1.7	4.6	-4.5	-8.4	-11.4	-11.0

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in Bank documents. Djibouti, Iraq, Libya, and the West Bank and Gaza are not forecast owing to data limitations. e = estimate; f = forecast.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

regional GDP growth is projected to ease only modestly from 5 percent growth in 2006 to 4.8 in 2009 (table A.12).

For oil exporters, a projected decline in oil prices and the resurgence of non-OPEC supply underpin an expected slowdown in growth from 4.5 percent in 2006 to 4.2 percent by 2009. Already, OPEC has cut production by some 0.55 million barrels per day (mbpd) in contrast to the average increase of 1.7 mbpd during 2004 and 2005. Falling oil prices and production levels are expected to restrain government spending in the region. While oil revenues remain very high and should continue feeding domestic demand in oil-producing countries, capacity constraints are expected to limit domestic production growth, causing imports to continue to rise rapidly as export

volumes and prices ease. As a result, the current account balances of developing oil exporters are projected to decline from a 10.9 percent of GDP surplus in 2006 to about 4.4 percent of GDP in 2009, while fiscal surpluses are expected to narrow from 4.4 percent of GDP to about 2.9 percent of GDP in 2009.

For resource-poor and oil-importing economies, growth is expected to ease to about 4.9 percent in 2007, as one-off factors that boosted growth in 2006 fade. Output should pick up once again beginning in 2008 and reach 5.5 percent in 2009 as the supply effects of the recent FDI boom begin to be felt. Stronger growth in high-income Europe should bolster exports of North African countries, for which Europe is the destination of 40–80 percent of merchandise exports⁷ and

is a dominant source of tourism and remittance revenues. Oil importers' current account positions are expected to remain broadly stable as the beneficial effects of lower oil prices are offset by increased leakages from strengthening domestic demand. Government revenues should benefit from reduced expenditures on energy subsidies both because of lower prices and measures to reduce these subsidies. As a result, the fiscal deficit of oil importers is projected to improve from 6.2 percent of GDP in 2006 to 2.9 percent of GDP in 2009.

For resource-poor economies in the Middle East and North Africa, inflationary pressures are expected to recede over 2007–09, in part as the workout of oil-price-related pressures from earlier lifting of fuels subsidies comes into play. From a 5.8 percent pace in 2006,⁸ CPI should ease to 4 percent in 2007. Thereafter, inflation is expected to diminish to 3.4 percent by 2009, on the back of further terms-of-trade improvement and nascent gains in productivity. For oil exporters in the current regional sample, price pressures are anticipated to remain elevated, due to continued fiscal and monetary stimulus in the Islamic Republic of Iran. From a GDP-weighted 8.7 percent advance in 2006, inflation is predicted to range between 10.5 and 11 percent through 2009, as Iranian inflation accelerates to 17 percent by the end of the forecast period.

Risks and uncertainties

The past few years represent the region's best growth performance in a decade. A major uncertainty facing the region concerns its ability to sustain such growth in the face of a less supportive international environment characterized by slower growth, lower oil prices, and increased competition. Downside risks can be clearly envisioned under a more substantial deterioration of conditions in the external environment than posited in the baseline assumptions. Additionally, the economic and political challenges of the next few years are magnified by rapidly growing populations and large cohorts of youth, who are looking for—or will be looking for—work.

For the oil exporters of the region, the future path of oil prices, global oil demand, and non-OPEC supply are critical sources of uncertainty. OPEC faces the very difficult challenge of maintaining prices at levels that are high enough to

maximize revenues for the group, but which are not so high as to induce substantial additional supply. The group's past success in achieving this balancing act is not encouraging, although long-term trends suggest that the organization's market power is likely to grow and therefore its capacity to manage global demand and supply conditions are likely to strengthen.

Managing the windfall oil revenues of the last years is a continuing challenge for oil exporters. The risk of overheating domestic demand and its potential inflationary consequences loom as an overarching threat. It appears, however, that in contrast with earlier episodes of oil booms, judicious use of oil stabilization funds and other financial management approaches have served to counter overheating and to augment the nonoil supply potential of the economy. Continued pursuit of these approaches should remain a priority. Importantly, domestic reform efforts may stand at some risk against the background of abundant liquidity and rapid growth. Should oil prices take a sudden and sustained downturn, economies may find adjustment difficult.

The emergence of large-scale capital flows within the broader region, largely among the GCC and from GCC to the resource-poor economies in the region, offers new opportunities as well as risks. The 2005/06 crash of GCC equity markets serves as a reminder of the potential of overshooting in a new financial environment. At the same time, FDI-based flows from the GCC to the Maghreb and Mashreq appear to be more deeply integrated with the structures of the host economies, and hence less subject to the risks associated with capital flight.

South Asia

Recent developments

GDP in South Asia expanded a robust 8.6 percent in 2006, reflecting generally expansionary policy conditions, although down slightly from 2005 due primarily to a deceleration of growth in Pakistan (table A.13). Inflation remains high and has shown limited signs of declining, despite lower oil prices in the second half of the year and a modest tightening of fiscal and monetary policies. Price pressures are partly being kept in check by product-specific tax cuts and direct and indirect subsidization of consumer energy prices, but by

Table A.13 South Asia forecast summary*annual percent change unless indicated otherwise*

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
GDP at market prices (2000 \$) ^b	5.2	7.8	8.7	8.6	7.9	7.5	7.2
GDP per capita (units in \$)	3.2	6.1	7.0	7.0	6.4	6.0	5.8
PPP GDP ^c	6.4	7.9	8.8	8.7	8.0	7.5	7.3
Private consumption	4.0	5.7	7.3	8.5	7.1	6.5	6.2
Public consumption	3.9	5.3	8.9	5.6	5.3	4.8	4.6
Fixed investment	5.5	10.2	14.0	12.3	11.2	10.5	10.2
Exports, GNFS ^d	9.0	14.5	19.1	21.8	13.5	13.0	12.7
Imports, GNFS ^d	7.9	32.9	21.7	24.2	12.9	12.0	11.7
Net exports, contribution to growth	-3.6	-2.6	-3.4	-4.4	-4.4	-4.4	-4.3
Current account balance/GDP (%)	-1.6	-1.3	-1.9	-2.4	-2.3	-2.1	-2.1
GDP deflator (median, LCU)	8.0	4.9	4.6	7.6	8.6	6.7	6.1
Fiscal balance/GDP (%)	-7.8	-6.7	-6.7	-6.2	-5.9	-5.6	-5.3
Memo items: GDP							
South Asia excluding India	4.4	6.1	6.8	6.4	6.1	6.2	6.2
India	5.5	8.3	9.2	9.2	8.4	7.8	7.5
Pakistan	3.9	6.4	7.8	6.6	6.4	6.3	6.1
Bangladesh	4.8	6.3	6.0	6.2	6.0	6.1	6.4

Source: World Bank.

Note: e = estimate; f = forecast; LCU = local currency units.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

d. GNFS denotes goods and nonfactor services.

supporting real incomes these measures are contributing to strong domestic demand. Higher oil prices in the first half of 2006 and strong domestic demand contributed to deterioration in the region's current account balance despite strong exports and remittances inflows.

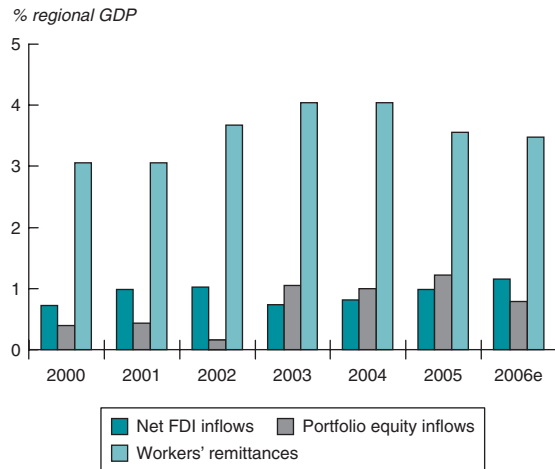
With the exception of Nepal, which is only now emerging from political strife, growth throughout the region was strong in 2006. In India, GDP increased by 9.2 percent, although signs of slowing appeared toward the end of the year. In the fourth quarter, GDP growth slowed to 8.6 percent, due mainly to weak (1.5 percent) agriculture growth (down from 8.7 percent in the fourth quarter of 2005), despite a firming in manufacturing output to 10.7 percent (relative to 8.2 percent in the fourth quarter of 2005). In Pakistan, GDP increased by 6.6 percent in 2006, significantly down from the 7.8 percent growth rate recorded the previous year. In part, the slowdown reflects a weakening of industrial production in the third quarter, itself likely a reflection of the waning effect of the boost to production provided by the reintroduction of quotas on Chinese clothing and textile exports the year before. Indeed, growth in the value of merchandise exports in the region declined from 30 percent in mid-year to 16 percent by the end of the year.

Output among the smaller countries in the region increased a strong 6.4 percent, the notable exception being Nepal, where economic activity expanded a disappointing 1.9 percent on account of political turmoil. Output in the Maldives was supported by a rebound in tourism and post-tsunami reconstruction efforts, while a new hydroelectric plant helped boost output in Bhutan.

Notwithstanding robust export growth, robust domestic demand and a 20 percent increase in oil prices for the year as a whole caused the regional current-account deficit to deteriorate from 1.9 percent of GDP to 2.4 percent in 2006, with Sri Lanka exhibiting the largest deterioration. Strong remittance inflows have helped finance foreign purchases in the region for some time now (figure A.9), with such remittances having helped to propel the current account of Bangladesh to a 0.6 percent of GDP surplus in 2006.

Rapid growth and the relatively expansionary stance of fiscal and monetary policies in the region have provoked a rise in inflation. Successive hikes in policy rates in India have led to higher interest rates across the spectrum, but higher inflation means that real rates remain low (figure A.10). In Pakistan, tighter monetary policy brought inflation down to 6.6 percent in January 2007 and to 7.9 percent during 2006 from 9.3 percent in 2005,

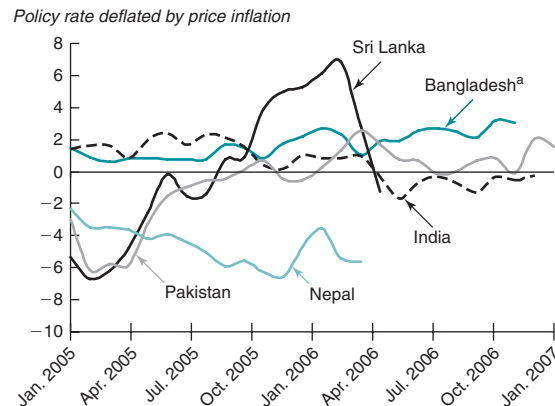
Figure A.9 Strong workers' remittances in South Asia



Source: World Bank.

Note: e = estimate.

Figure A.10 Real interest rates in South Asia



Source: World Bank.

a. Deposit rates deflated by consumer price inflation.

although it showed signs of accelerating more recently, rising again to 7.7 percent year-over-year in March 2007. Prices have been rising particularly rapidly in Sri Lanka, reflecting pressures on domestic demand resulting from loose monetary policy. Strong capital inflows have also played a role, boosting domestic liquidity and stock market valuations. As of early March, the Standard & Poor's/IFC Global (S&P/IFCG) index⁹ was up 92 percent compared to January 2006, despite the global decline in market valuations the previous month.

Net capital inflows to South Asia increased to \$40.1 billion (3.6 percent of GDP) in 2006, up from \$28.3 billion (2.8 percent of GDP) in 2005, with most of the increase in going to India (table A.14). Strong capital inflows were largely due to a \$12 billion expansion in net private debt flows, while net equity inflows to the region increased only slightly, as a \$3 billion increase in FDI was partly offset by a decline in portfolio equity flows. At \$22.9 billion in 2006, net equity inflows nonetheless account for the bulk (60 percent) of net private inflows to the region.

Much of the FDI inflows into India were concentrated in the service sector (telecommunications in particular) in response to liberalization policies designed to attract FDI, such as easing ownership restrictions. FDI outflows from India are also on the rise due to increasing cross-border M&A purchases by Indian companies, mainly in high-income economies. Since 2004, FDI flows from India to the United Kingdom exceeded flows from the United Kingdom to India. The Indian multinational Tata acquired the Dutch steel company Corus for more than \$10 billion in early 2007. FDI inflows to Pakistan increased from \$2.2 billion in 2005 to \$3.5 billion in 2006 with much of investment in the oil and gas and financial sectors, along with installments made on a major telecom privatization deal in 2005.

Reserve accumulation in India picked up significantly in 2006, by \$39 billion, to reach \$171 billion, 6 percent of the total stock of reserves held by all developing countries. Given the strong rise in imports, foreign reserves in terms of months of import cover (for merchandise trade) declined to 11.2 months on average for 2006 from 13 in 2005.

Medium-term outlook

Regional GDP growth should moderate to about 7.5 percent and 7.2 percent in 2008 and 2009, respectively, due to a combination of tighter policy conditions and weakening of external demand (table A.15). Despite these factors, sustained high government deficits—currently running about 6.5 percent as a share of GDP in India, over 8.0 percent in Sri Lanka, and about 3.5 percent in Bangladesh and Pakistan—and strong international capital inflows are expected to keep domestic demand expanding rapidly, albeit not as strongly as in recent years. Robust domestic

Table A.14 Net capital flows to South Asia

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	-9.5	-5.3	-6.3	2.2	11.4	10.6	-11.5	-19.6	-26.7
as % of GDP	-1.8	-0.9	-1.1	0.4	1.8	1.4	-1.3	-2.0	-2.4
<i>Financial flows</i>									
Net private and official flows	7.6	6.0	10.3	8.1	7.3	14.0	24.7	28.3	40.1
Net private flows (debt + equity)	5.3	3.5	9.8	6.0	9.7	15.6	23.7	24.9	37.7
Net equity flows	2.9	5.5	6.8	8.8	7.7	13.6	16.1	22.1	22.9
Net FDI inflows	3.5	3.1	4.4	6.1	6.7	5.6	7.3	9.9	12.9
Net portfolio equity inflows	-0.6	2.4	2.4	2.7	1.0	8.0	8.8	12.2	10.0
Net debt flows	4.7	0.5	3.5	-0.7	-0.4	0.4	8.6	6.2	17.2
Official creditors	2.3	2.5	0.5	2.2	-2.4	-1.7	1.0	3.4	2.5
World Bank	0.8	1.0	0.7	1.5	-1.0	-0.2	2.0	2.2	1.8
IMF	-0.4	-0.1	-0.3	0.3	0.1	-0.1	-0.3	0	-0.1
Other official	2.0	1.6	0	0.4	-1.5	-1.5	-0.7	1.2	0.8
Private creditors	2.4	-2.0	3.0	-2.8	2.0	2.0	7.6	2.8	14.8
Net medium- and long-term debt flows	3.7	-2.1	3.9	-1.9	0.2	1.3	4.9	1.2	12.0
Bonds	4.2	-1.2	5.4	-0.4	-0.7	-3.1	4.1	-2.9	2.0
Banks	0.7	-0.5	-2.0	-1.1	1.0	4.4	1.1	4.2	9.9
Other private	-1.1	-0.4	0.5	-0.3	-0.1	0	-0.3	-0.1	0.1
Net short-term debt flows	-1.3	0.1	-0.9	-0.9	1.8	0.7	2.6	1.6	2.8
Balancing item ^a	4.8	4.6	0.7	-0.1	8.2	11.3	14.0	-3.0	28.3
Change in reserves (- = increase)	-2.9	-5.3	-4.6	-10.2	-27.0	-35.9	-27.2	-5.7	-41.7
<i>Memo items</i>									
Bilateral aid grants	3.2	3.4	3.1	4.2	3.7	5.4	5.0	6.6	3.9
of which									
Technical cooperation grants	1.1	1.1	1.0	1.0	1.2	1.5	1.5	1.6	1.8
Other	2.1	2.3	2.1	3.2	2.5	3.9	3.5	5.0	2.2
Net official flows (aid + debt)	5.5	5.9	3.6	6.4	1.3	3.7	6.0	10.0	6.4
Workers' remittances	13.4	15.1	17.2	19.2	24.2	31.1	31.3	35.6	38.8
Repatriated FDI Income	0.4	0.4	1.6	1.2	1.3	1.9	1.5	2.0	—

Sources: World Bank Debtor Reporting System and staff estimates.

Note: e = estimate; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.15 South Asia country forecasts

annual percent change unless indicated otherwise

	1991-2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Bangladesh							
GDP at market prices (2000 \$) ^b	4.8	6.3	6.0	6.2	6.0	6.1	6.4
Current account balance/GDP (%)	-0.4	-0.5	-0.2	0.6	0.2	-0.5	-0.8
India							
GDP at market prices (2000 \$) ^b	5.5	8.3	9.2	9.2	8.4	7.8	7.5
Current account balance/GDP (%)	-1.2	-1.4	-1.9	-2.2	-2.1	-2.0	-2.0
Nepal							
GDP at market prices (2000 \$) ^b	5.0	3.7	2.7	1.9	3.0	4.5	4.7
Current account balance/GDP (%)	-6.4	-0.7	0	0.6	-0.6	-1.6	-2.4
Pakistan							
GDP at market prices (2000 \$) ^b	3.9	6.4	7.8	6.6	6.4	6.3	6.1
Current account balance/GDP (%)	-3.7	-0.8	-3.3	-4.9	-4.3	-3.6	-3.0
Sri Lanka							
GDP at market prices (2000 \$) ^b	5.2	5.4	6.0	7.4	6.0	6.2	6.3
Current account balance/GDP (%)	-4.6	-3.4	-3.2	-4.9	-4.0	-3.9	-3.3

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. Afghanistan, Bhutan, and the Maldives are not forecast owing to data limitations. e = estimate; f = forecast.

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

demand, combined with the delayed pass-through of higher oil prices, is expected to maintain inflationary pressures in the region and to sustain import growth in the double digits. As a result, the external sector is expected to make a significant negative contribution to growth, with the regional current account deficit projected to exceed 2.0 percent of GDP over the forecast horizon.

In India, more restrictive policy conditions are expected to lead to deceleration in investment growth and weaker private consumption and government spending, contributing to a slowdown in GDP growth to 7.8 percent and 7.5 in 2008 and 2009, respectively. In Pakistan, growth is also forecast to ease, although more gradually, as policy conditions are expected to remain broadly accommodative in the lead-up to the 2007 presidential elections, which are scheduled to take place during September and October. Recent heightened political tensions are expected to hamper business and consumer confidence and to partly contain the impact of stimulative policy conditions. Tightening of fiscal and monetary policies is expected in 2008, leading to further restraint of domestic demand and further deceleration of growth to 6.1 percent in 2009.

Among the smaller economies in the region, growth in Sri Lanka is projected to hover close to 6.0 percent during 2007–09, down from 7.4 percent in 2006, due to disruptive effects of civil war, which are partially mitigating the positive growth impacts of the ongoing recovery from the tsunami (including the reconstruction of roads and buildings). Growth is projected to strengthen in Nepal due to improved political conditions and cessation of fighting. In Bhutan, growth is expected to remain robust, rising by a projected 17 percent in 2007—a sharp acceleration from the estimated 5.5 percent in 2006—driven primarily by the stimulative effects of the Tala hydropower project (the plant is expected to begin operating at full capacity in mid-2007), and to a lesser extent by the expanding tourism industry. Growth in Bhutan is expected to decelerate to 10 percent in 2008 and 5 percent in 2009 as the stimulative impacts of the hydropower project unwind. In Afghanistan, GDP growth is expected to accelerate over the forecast horizon, initially due to an anticipated recovery from drought in the agricultural sector, and over the forecast horizon due to the stimulative impact

of donor-led construction projects. In the Maldives, an expansion of GDP growth is expected to be supported by the ongoing reconstruction effort following the devastating December 2004 tsunami.

Risk and uncertainties

The high growth rates posted in recent years have helped South Asia make significant progress toward achieving the Millennium Development Goals. Most notably, the percentage of people living on less than a dollar a day declined to just over 30 percent in 2003 from 40 percent in 1990, and is now projected to reach about 13 percent in 2015—below the initial goal of 20 percent. These headline numbers, while heartening, mask persistent social inequalities, as well as considerable subregional and subnational variation. Sustained growth will be necessary for continued poverty reduction, and achieving further improvements in institutional service delivery will be critical to making progress in all other dimensions of the MDGs.¹⁰

Sustaining high growth will require continued economic reform, expansion of infrastructure capacity, and further reduction of security threats. These efforts will also contribute to higher capital inflows, which have been spurred by progress in these areas in recent years. Revamping tax collection systems to reduce evasion and improve tax collection to help finance the extensive government agendas is also important. In Pakistan, for example, tax evasion is reportedly very high: it is estimated that less than 1 percent of the population pays income tax.

Given vibrant domestic demand and high oil prices, a significant portion of the cushion that was built up in terms of foreign currency reserves and a regional current account surplus (last recorded in 2003) has been absorbed. Since 2003, the period for which imports could be covered by foreign reserves has declined by about four months in both India and Pakistan. While reserves in India remain significantly above the level of three months worth of imports, they are much closer to that level now in Pakistan and below it in both Bangladesh and Sri Lanka, suggesting that each country would be vulnerable to a significant terms-of-trade shock, such as another hike in oil prices. In Pakistan, relatively modest (5.5 percent

as of end-2006) increases in reserve holdings since 2003 in conjunction with a more than doubling of imports (GNFS) resulted in a sharp fall in the import-cover ratio, an unsustainable trend.

Downside risks to growth are also tied to the inexorable lifting of restrictions on Chinese textile and clothing exports at end-2007 and to a stronger than projected slowdown of demand from the United States in 2007, an important trade partner for most countries in the region.

The recent surge in cross-border bank lending to multinational corporations in India has raised concerns that borrowing abroad by the corporate sector could contribute to inflationary pressures, which would require a more aggressive monetary policy response and possibly have negative repercussions for growth prospects over the medium term.

Increased political instability represents another main risk. Heightened security concerns could hurt investor sentiment and undermine foreign capital inflows, which have contributed to the region's record four-year expansion. The continued easing of political tensions between the governments of India and Pakistan bodes well for continued progress toward improved relations.

Sub-Saharan Africa

Recent developments

Strong global growth, improved macroeconomic performance, significant aid flows, rising FDI, and a continued spell of relative political stability helped GDP in Sub-Saharan Africa expand by 5.6 percent in 2006, the third consecutive year that growth exceeded 5 percent (table A.16). Despite high oil prices, oil-importing countries in the region (even when excluding South Africa) continued to grow rapidly, with output increasing by close to 5.0 percent. Output growth among oil exporters was also strong, but the expansion slowed from 7.4 percent in 2005 to 6.9 percent in 2006 as some countries pushed against production constraints and unrest in the Niger Delta undermined growth in Nigeria's oil sector.

Growth was broadly based, with output in half of the countries in the subcontinent advancing by 5.0 percent or more. Only 7 of 34 oil-importing economies grew by less than 2.0 percent: the Comoros, Eritrea, Guinea-Bissau, Swaziland, the Seychelles, Togo, and Zimbabwe. While export growth has been strong, domestic demand has provided the largest contribution to growth. Investment is estimated to have contributed more

Table A.16 Sub-Saharan Africa forecast summary

annual percent change unless indicated otherwise

	1991–2000 ^a	2004	2005	2006 ^e	2007 ^f	2008 ^f	2009 ^f
GDP at market prices (2000 \$) ^b	2.3	5.3	5.8	5.6	5.8	5.8	5.4
GDP per capita (units in \$)	-0.4	2.9	3.4	3.5	3.7	3.8	3.4
PPP GDP ^c	3.4	5.5	6.0	5.9	6.2	6.0	5.7
Private consumption	1.2	5.6	5.9	5.9	4.9	4.7	4.8
Public consumption	2.6	4.4	6.5	6.7	6.3	6.3	6.4
Fixed investment	3.7	9.0	10.0	15.5	11.6	12.3	9.4
Exports, GNFS ^d	4.7	6.4	7.4	5.8	6.9	6.4	6.8
Imports, GNFS ^d	4.4	9.4	10.2	12.7	8.6	8.6	8.4
Net exports, contribution to growth	0.5	-1.4	-2.4	-4.8	-5.5	-6.5	-7.2
Current account balance/GDP (%)	-2.1	-1.1	-0.1	-0.5	-1.4	-2.3	-2.7
GDP deflator (median, LCU)	10.1	7.0	6.7	7.2	5.0	4.5	4.5
Fiscal balance/GDP (%)	-4.0	-0.7	1.1	3.3	0.9	-1.4	-3.0
<i>Memo items: GDP</i>							
Sub-Saharan Africa excluding South Africa	2.6	5.5	6.2	5.9	6.6	6.2	5.7
Oil exporters	2.7	6.0	7.4	6.9	8.3	7.4	6.6
CFA countries	2.6	4.1	3.8	3.2	3.4	4.2	3.5
South Africa	1.8	4.8	5.1	5.0	4.4	5.2	4.9
Nigeria	2.8	6.0	6.9	5.6	6.4	6.6	5.9
Kenya	1.9	4.9	5.8	5.9	5.1	5.2	4.9

Source: World Bank.

Note: e = estimate; f = forecast; LCU = local currency units.

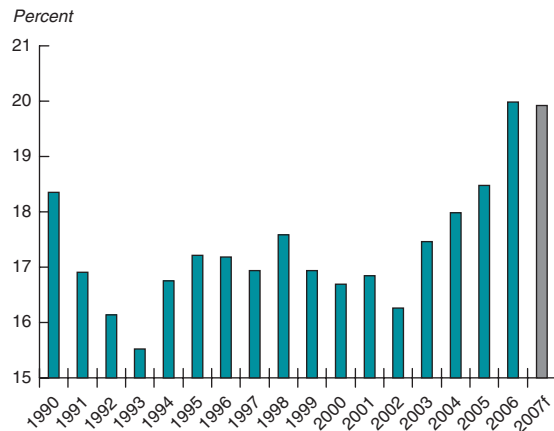
a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

c. GDP measured at PPP exchange rates.

d. GNFS denotes goods and nonfactor services.

Figure A.11 Ratio of nominal investment to nominal GDP among Sub-Saharan oil importers



Source: World Bank.
Note: f = forecast.

than 2 percentage points to the growth of oil-importing economies in 2006 and investment has risen to represent some 20 percent of GDP among oil-importing countries from an average of 17 percent in the 1990s (figure A.11). Resource-poor and landlocked countries, typically expected to perform poorly in an environment characterized by high oil prices, have also recorded stronger economic growth from a historical perspective (3.8 and 5.9 percent, respectively).

The performance of South Africa, the region's largest economy, continued to surprise on the upside, with GDP expanding by 5.0 percent for the third consecutive year. Robust domestic demand underpinned this growth, with consumer demand and investment responding to low interest rates, rising real incomes, and public-sector investment in transportation and sports infrastructure in the runup to the FIFA World Cup in 2010. GDP grew at a 5.6 percent annualized clip in the fourth quarter, despite an 8.4 percent contraction in the agricultural sector, due to particularly rapid growth in mining and manufacturing. Overall, the external sector's contribution to growth has been negative, reflecting strong import growth fueled by robust household consumption. As a result (notwithstanding high prices for metals), South Africa's current account deficit ballooned to 6.4 percent of GDP in 2006, which contributed to the sharp depreciation of the rand during May and June. Overall, the rand has depreciated 17.4 percent as of

March 2007 on a trade-weighted basis since March 2006, which has contributed to boost inflation to 6.1 percent in March 2007, up from 3.4 percent a year earlier. Nevertheless, consumer confidence remains at historically high levels, although recent retail sales data point to some softening in consumer demand.

In Nigeria, the region's second-largest economy, a vibrant private sector and strong investment spending kept overall growth at 5.6 percent in 2006, despite an estimated 1.6 percent contraction in the oil sector caused by unrest in the Niger Delta. Non-oil GDP expanded in excess of 8.0 percent, boosted by government infrastructure spending. Despite the strength of domestic demand, inflation declined during the course of the year as a stronger currency reduced import costs and the inflationary effects of the removal of subsidies in 2004 and 2005 played out on the year-on-year comparison. There were, however, some signs of a resurgence in inflationary pressures in the third and fourth quarters. Among other oil exporters, growth has been particularly robust in Angola (16.9 percent), Sudan (11.8 percent), and Mauritania (14.2 percent), which began oil production in February 2006.

Elsewhere, high international metal and mineral prices are generating buoyant domestic demand and prompting additional investments, which have contributed to strong growth in Burundi, the Democratic Republic of Congo, Ghana, Mali, Mozambique, Tanzania, and Zambia. Economic performance was also strong in reform-oriented economies such as Burkina Faso, Ghana, Mali, Mozambique, Senegal, and Tanzania, as well as in countries emerging from conflict—Burundi, Sierra Leone, Liberia, and the Democratic Republic of Congo.

Growth throughout the continent, however, is still hampered by multiple and diverse obstacles. Drought-related crop failure, high fuel costs, and energy rationing have contributed to weakened results for East African oil-importing countries. In addition, while the number and the intensity of conflicts in Sub-Saharan Africa have subsided, the risks associated with political turmoil remain high and are undermining growth in Chad, Côte d'Ivoire, the Democratic Republic of Congo, Eritrea, Lesotho, Nigeria, the Seychelles, Somalia, Sudan, Swaziland, and Zimbabwe. Limited progress on reforms and stagnant oil production

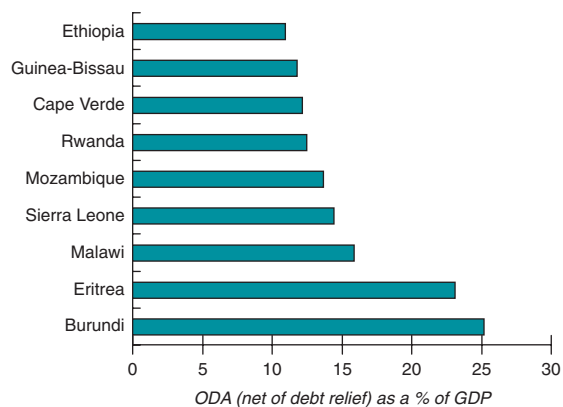
in Cameroon and Gabon, in conjunction with the ongoing sociopolitical crisis in Côte d'Ivoire and a moderate real-effective appreciation of the currency have undermined economic performance in the CFA zone countries, where growth is significantly weaker than elsewhere on the subcontinent.

High fuel costs and energy scarcity, which combined have led to rationing and widespread blackouts, have kept economic growth below potential in a number of countries, most notably in East Africa. Power outages have become more frequent in recent years, as rapidly increasing demand is outpacing the increase in generating capacity, which has suffered from years of underinvestment and neglect, in part due to pricing policies that have forced electricity providers to produce at a loss. The problem is especially acute in rapidly growing economies such as Ghana, Kenya, Senegal, and Tanzania. Even oil-producing countries like Nigeria are facing power shortages due to lack of generating capacity. With most electricity grids operating at or near capacity and demand expected to increase by more than 5 percent per year over the medium term, the energy problem is likely to constrain growth over the medium term, especially in the mining and manufacturing sectors.

Oil-exporting countries have been the principal beneficiaries of the estimated 43.5 percent increase in FDI into the Sub-Saharan Africa region outside South Africa. As in the past, FDI has flowed mostly into resource-rich countries and predominantly into extraction and related services, for which cross-border mergers and acquisitions tripled in the first half of 2006. Because linkages between mining industries and the local economies are limited, a distinct two-speed growth pattern has emerged, with the resource sectors growing faster than the rest of the economy.

Current accounts have come under pressure in several oil-importing economies in the region (notably, as discussed, in South Africa), although higher commodity prices and increased official and private transfers have helped contain the deterioration. Net ODA, excluding debt relief, to Sub-Saharan Africa climbed to \$13.2 billion in 2005 up from \$7.7 billion in 2002, but it declined in 2006. In almost half of the oil-importing countries, aid (excluding debt relief) accounted for more than 5.0 percent of GDP on average over 2003–05. In countries including Burundi, Eritrea,

Figure A.12 ODA (net of debt relief) in selected Sub-Saharan African countries, 2003–05



Sources: OECD; World Bank.

Malawi, Sierra Leone, Mozambique, Rwanda, Guinea-Bissau, and Ethiopia, ODA exceeded 10 percent of GDP on average (figure A.12).

The pace of foreign exchange reserve accumulation is picking up in the region, with reserves rising by \$33 billion in 2006, following increases of just over \$20 billion in 2004–05, with about half of the accumulation in just three countries: Nigeria (\$5.9 billion), Angola (\$5.4 billion), and South Africa (\$4.5 billion). Reserves provided cover for at least three months of imports in 80 percent of the countries in the region in 2006, up from two-thirds in 2005.

Net private capital inflows to Sub-Saharan Africa recorded another year of significant gains in 2006, as foreign investors continued to search for higher yields and as robust growth and improvements in macroeconomic stability, creditworthiness, and the investment climate made some countries more attractive to investors. Total net capital inflows increased from \$28.9 billion or 4.6 percent of GDP in 2005, to \$39.8 billion, or 5.6 percent of GDP in 2006 (table A.17). The region's share of net capital flows to developing countries remains small at 7.0 percent, relatively unchanged from the 6.4 percent share received on average over the previous three years. Net private capital flows exceeded bilateral aid grants in 2006, the first time since 1999. Net equity flows increased \$7 billion to \$31 billion, and net private lending almost doubled to \$10.6 billion, while net official lending declined by \$1 billion. The increase in net private lending was mainly in the

Table A.17 Net capital flows to Sub-Saharan Africa

\$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	-17.7	-9.9	3.5	-4.9	-5.9	-3.2	-6.0	-0.9	-3.8
as % of GDP	-5.4	-3.1	1.0	-1.5	-1.7	-0.7	-1.1	-0.1	-0.5
<i>Financial flows</i>									
Net private and official flows	14.4	17.8	10.9	12.2	10.0	18.3	23.9	28.9	39.8
Net private flows (debt + equity)	13.9	17.4	10.2	12.2	7.4	16.9	22.0	29.6	41.6
Net equity flows	15.7	18.7	11	14.3	9.9	15.3	19.1	24.0	31.0
Net FDI inflows	7.1	9.7	6.8	15.2	10.3	14.6	12.4	16.6	18.5
Net portfolio equity inflows	8.6	9.0	4.2	-0.9	-0.4	0.7	6.7	7.4	12.5
Net debt flows	-1.3	-0.9	-0.1	-2.1	0.1	3.0	4.8	4.9	8.8
Official creditors	0.5	0.4	0.7	-0.1	2.6	1.4	1.9	-0.7	-1.8
World Bank	1.3	1.1	1.5	1.8	2.2	2.2	2.5	2.4	1.8
IMF	-0.3	0	0.1	0.1	0.5	-0.1	-0.1	-0.4	0.1
Other official	-0.5	-0.7	-0.8	-2.0	0	-0.7	-0.4	-2.7	-3.7
Private creditors	-1.8	-1.3	-0.8	-2.1	-2.5	1.6	2.9	5.6	10.6
Net medium- and long-term debt flows	-1.3	-0.7	0.3	0	-0.7	2.5	1.3	2.5	7.4
Bonds	0.3	1.2	1.0	1.9	2.7	4.6	1.2	0.4	1.3
Banks	-1.3	-1.7	-0.7	-1.6	-2.7	-1.3	0.4	2.2	6.4
Other private	-0.2	-0.2	0	-0.3	-0.7	-0.7	-0.3	-0.2	-0.4
Net short-term debt flows	-0.5	-0.6	-1.1	-2.1	-1.8	-1.0	1.6	3.2	3.3
Balancing item ^a	2.0	-6.6	-8.4	-6.8	-3.8	-11.0	4.4	-7.1	-3.2
Change in reserves (- = increase)	1.2	-1.3	-6.0	-0.5	-0.3	-4.0	-22.3	-20.9	-32.8
<i>Memo items</i>									
Bilateral aid grants	14.0	13.2	13.6	13.9	18.4	27.2	29.6	36.5	36.9
of which									
Technical cooperation grants	3.9	3.3	3.6	3.8	4.4	5.1	5.4	5.8	7.0
Other	10.1	9.9	10.0	10.1	14.0	22.1	24.2	30.7	29.9
Net official flows (aid + debt)	14.5	13.6	14.3	13.8	21.0	28.6	31.5	35.8	35.1
Workers' remittances	4.3	4.4	4.6	4.6	5.0	5.8	7.6	8.7	8.7
Repatriated FDI Income	3.4	4.4	7.1	7.5	7.3	7.3	8.2	11.2	—

Sources: World Bank Debtor Reporting System and staff estimates.

Note: e = estimate; — = not available.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

form of cross-border bank loans, up \$5 billion to \$7.4 billion, most of which were medium- and long-term loans. Net FDI flows to the region rose by \$2 billion to \$18.5 billion, and continued to be largely resource-seeking, with Nigeria, South Africa, Sudan, Equatorial Guinea, and Angola accounting together for more than two-thirds of total regional net FDI inflows. Net portfolio equity inflows have increased from less than \$1 billion in 2003 to \$12.5 billion in 2006, and now account for 30 percent of all private capital flows to the region, significantly higher than the 12 percent share for all developing countries.

Despite improvements in creditworthiness and favorable financing conditions, few countries in the region managed to gain access to the international bond market over the past few years. In 2006, the Seychelles became the first country in the region aside from South Africa to issue a sovereign or corporate bond in the international

market in the past two decades. Four additional countries—Ghana, Kenya, Nigeria, and Zambia—are expected to launch debut sovereign bond issues in international markets this year. There has been, however, growing interest on the part of foreign investors in local currency bond markets, most notably in Botswana, Nigeria, Kenya, and Zambia. High commodity prices in conjunction with currency appreciations have boosted returns on local currency bonds in commodity-exporting countries such as Nigeria and Zambia. In the latter, the share of outstanding public debt held by nonresidents increased from a negligible amount in 2004 to 13 percent by the end of 2006. A lack of timely, comprehensive data makes it difficult to assess the prominence of foreign participation in domestic debt markets, however.

It is worth noting that cross-border lending from banks located in other developing countries plays a prominent role in the region. Over the

Table A.18 Sub-Saharan Africa country forecasts*annual percent change unless indicated otherwise*

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Angola							
GDP at market prices (2000 \$) ^b	0.8	11.2	20.6	16.9	25.1	14.2	13.4
Current account balance/GDP (%)	-6.1	3.5	16.1	18.6	15.4	7.1	5.4
Benin							
GDP at market prices (2000 \$) ^b	4.8	3.1	3.9	4.3	4.4	4.2	4.1
Current account balance/GDP (%)	-6.8	-7.8	-6.9	-7.3	-6.1	-6.4	-6.6
Botswana							
GDP at market prices (2000 \$) ^b	6.2	5.9	6.2	4.8	4.3	4.2	4.1
Current account balance/GDP (%)	8.1	2.9	14.3	14.8	12.3	11.7	12.9
Burkina Faso							
GDP at market prices (2000 \$) ^b	4.0	3.9	4.8	5.7	5.5	5.7	5.4
Current account balance/GDP (%)	-5.6	-10.7	-11.7	-9.7	-9.8	-9.1	-8.3
Burundi							
GDP at market prices (2000 \$) ^b	-2.0	4.8	0.9	5.4	5.1	5.3	5.1
Current account balance/GDP (%)	-3.4	-8.1	-12.7	-16.1	-15.3	-14.8	-14.8
Cameroon							
GDP at market prices (2000 \$) ^b	1.4	3.7	2.0	3.9	4.1	3.9	3.5
Current account balance/GDP (%)	-3.0	-2.6	-1.8	0.5	-1.7	-3.1	-3.3
Cape Verde							
GDP at market prices (2000 \$) ^b	5.8	4.5	5.9	5.8	6.1	6.3	6.2
Current account balance/GDP (%)	-8.3	-7.3	-4.5	-6.7	-8.8	-10.9	-13.2
Central African Republic							
GDP at market prices (2000 \$) ^b	1.6	1.3	2.2	3.3	3.6	3.4	3.1
Current account balance/GDP (%)	-4.3	-4.6	-3.3	-3.9	-3.6	-4.1	-4.4
Chad							
GDP at market prices (2000 \$) ^b	2.3	29.5	5.6	1.7	-1.4	5.1	2.1
Current account balance/GDP (%)	-5.5	-18.7	0.7	0.1	2.0	-0.9	-3.7
Comoros							
GDP at market prices (2000 \$) ^b	1.1	-0.2	4.2	1.3	2.6	2.7	2.4
Current account balance/GDP (%)	-6.8	-3.4	-5.0	-6.8	-6.0	-4.8	-3.5
Congo, Democratic Rep. of							
GDP at market prices (2000 \$) ^b	-5.6	6.6	6.5	5.3	7.2	6.8	6.4
Current account balance/GDP (%)	2.0	-8.8	-4.4	-4.1	-4.6	-4.6	-4.8
Congo, Rep. of							
GDP at market prices (2000 \$) ^b	1.5	3.6	7.7	6.3	0.9	6.1	6.2
Current account balance/GDP (%)	-16.5	15.5	12.0	19.4	5.1	6.7	3.6
Côte d'Ivoire							
GDP at market prices (2000 \$) ^b	2.3	1.8	1.8	1.3	1.9	2.5	2.6
Current account balance/GDP (%)	-4.0	1.6	0.7	2.1	2.1	1.1	-0.5
Equatorial Guinea							
GDP at market prices (2000 \$) ^b	18.4	10.0	6.5	1.2	6.9	9.0	-1.4
Current account balance/GDP (%)	-42.4	8.8	4.7	2.7	5.7	10.5	11.0
Eritrea							
GDP at market prices (2000 \$) ^b	—	1.9	4.8	1.7	1.9	2.0	1.8
Current account balance/GDP (%)	—	-13.6	-6.3	-2.9	-3.0	-2.9	-2.8
Ethiopia							
GDP at market prices (2000 \$) ^b	2.3	12.3	8.7	7.3	6.1	5.5	5.4
Current account balance/GDP (%)	-0.8	-6.9	-9.3	-11.0	-10.0	-8.8	-7.6
Gabon							
GDP at market prices (2000 \$) ^b	2.4	1.4	2.8	1.2	3.5	2.1	2.3
Current account balance/GDP (%)	5.7	12.8	17.5	20.5	13.1	8.8	4.1
Gambia, The							
GDP at market prices (2000 \$) ^b	3.3	5.1	5.0	6.4	3.8	4.1	3.9
Current account balance/GDP (%)	-1.6	-11.1	-16.1	-14.5	-11.5	-11.2	-7.6
Ghana							
GDP at market prices (2000 \$) ^b	4.3	5.6	5.9	6.1	5.9	6.0	6.1
Current account balance/GDP (%)	-6.4	-3.6	-8.2	-8.1	-7.5	-8.1	-7.8

(Continues)

Table A.18 (Continued)

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Guinea							
GDP at market prices (2000 \$) ^b	3.9	2.7	3.3	3.1	2.9	3.2	3.0
Current account balance/GDP (%)	-5.7	-4.3	-3.7	-4.2	-4.7	-5.7	-6.5
Guinea-Bissau							
GDP at market prices (2000 \$) ^b	1.5	2.2	3.5	1.9	3.4	3.7	3.4
Current account balance/GDP (%)	-24.0	-4.9	-3.4	-4.8	-15.4	-15.5	-16.3
Kenya							
GDP at market prices (2000 \$) ^b	1.9	4.9	5.8	5.9	5.1	5.2	4.9
Current account balance/GDP (%)	-1.6	-2.2	-2.6	-4.3	-4.6	-4.2	-3.4
Lesotho							
GDP at market prices (2000 \$) ^b	3.4	3.1	1.2	2.8	1.6	1.2	2.2
Current account balance/GDP (%)	-13.3	-5.6	-2.7	-1.9	-0.8	-0.4	-1.9
Madagascar							
GDP at market prices (2000 \$) ^b	1.7	5.3	4.6	4.8	5.0	5.3	5.1
Current account balance/GDP (%)	-7.8	-12.4	-11.2	-9.4	-8.1	-8.4	-8.8
Malawi							
GDP at market prices (2000 \$) ^b	3.4	7.1	2.6	8.3	5.4	5.6	5.4
Current account balance/GDP (%)	-8.5	-4.7	-12.9	-8.3	-2.9	-1.4	-0.7
Mali							
GDP at market prices (2000 \$) ^b	4.0	2.2	6.1	4.9	5.3	5.2	5.1
Current account balance/GDP (%)	-8.9	-8.4	-9.0	-8.8	-6.1	-5.9	-5.4
Mauritania							
GDP at market prices (2000 \$) ^b	2.9	5.2	5.4	14.2	7.4	8.4	6.7
Current account balance/GDP (%)	-0.3	-20.1	-43.9	-3.1	-4.0	-8.0	-8.0
Mauritius							
GDP at market prices (2000 \$) ^b	5.3	4.7	2.5	4.6	2.9	2.7	2.5
Current account balance/GDP (%)	-1.6	-1.9	-3.7	-7.0	-6.9	-5.6	-4.2
Mozambique							
GDP at market prices (2000 \$) ^b	5.2	7.5	7.7	7.4	7.1	6.8	6.7
Current account balance/GDP (%)	-18.2	-5.6	-9.8	-12.7	-11.4	-11.6	-13.8
Namibia							
GDP at market prices (2000 \$) ^b	4.2	6.0	4.2	4.4	4.6	4.3	3.8
Current account balance/GDP (%)	4.1	10.0	7.3	12.8	12.5	9.5	6.6
Niger							
GDP at market prices (2000 \$) ^b	1.8	0	6.8	3.4	4.1	4.3	4.5
Current account balance/GDP (%)	-6.9	-7.6	-7.9	-7.3	-10.0	-9.8	-10.0
Nigeria							
GDP at market prices (2000 \$) ^b	2.8	6.0	6.9	5.6	6.4	6.6	5.9
Current account balance/GDP (%)	-0.8	6.8	11.9	11.3	7.4	6.5	5.2
Rwanda							
GDP at market prices (2000 \$) ^b	0.2	4.0	6.0	4.4	5.0	4.9	4.6
Current account balance/GDP (%)	-3.5	-3.9	-4.4	-7.7	-8.3	-6.9	-6.5
Senegal							
GDP at market prices (2000 \$) ^b	2.9	5.6	5.5	3.3	4.7	5.1	4.6
Current account balance/GDP (%)	-6.0	-7.0	-8.0	-10.3	-9.4	-8.6	-8.2
Seychelles							
GDP at market prices (2000 \$) ^b	4.6	-2.0	-2.3	-1.1	-0.8	-0.5	1.1
Current account balance/GDP (%)	-7.4	-9.1	-25.8	-15.6	-18.8	-20.6	-23.3
Sierra Leone							
GDP at market prices (2000 \$) ^b	-4.7	7.4	7.3	7.1	6.1	6.2	6.0
Current account balance/GDP (%)	-9.0	-5.4	-8.1	-6.2	-5.4	-5.5	-5.5
South Africa							
GDP at market prices (2000 \$) ^b	1.8	4.8	5.1	5.0	4.4	5.2	4.9
Current account balance/GDP (%)	-0.2	-3.2	-3.8	-6.4	-6.0	-6.4	-6.7
Sudan							
GDP at market prices (2000 \$) ^b	5.7	5.2	8.0	11.8	10.1	9.2	8.1
Current account balance/GDP (%)	-6.7	-4.1	-10.9	-7.6	-7.3	-8.4	-8.9

(Continues)

Table A.18 (Continued)

	1991–2000 ^a	2004	2005	2006e	2007f	2008f	2009f
Swaziland							
GDP at market prices (2000 \$) ^b	3.1	2.1	1.8	1.5	1.4	1.1	1.2
Current account balance/GDP (%)	-2.6	4.6	1.7	1.5	-0.3	-2.4	-4.3
Tanzania							
GDP at market prices (2000 \$) ^b	2.9	6.7	6.8	5.7	7.1	6.6	6.2
Current account balance/GDP (%)	-12.5	-2.2	-6.0	-11.3	-12.5	-11.1	-11.2
Togo							
GDP at market prices (2000 \$) ^b	2.2	3.0	1.2	1.9	1.6	1.8	2.1
Current account balance/GDP (%)	-8.5	-10.0	-12.0	-11.8	-9.6	-10.0	-10.2
Uganda							
GDP at market prices (2000 \$) ^b	6.8	5.5	6.6	5.1	5.7	5.8	5.7
Current account balance/GDP (%)	-7.0	-2.8	-2.9	-4.8	-5.3	-6.2	-6.2
Zambia							
GDP at market prices (2000 \$) ^b	0.7	5.4	5.1	5.7	5.8	5.7	5.5
Current account balance/GDP (%)	-10.5	-10.3	-7.8	-8.3	-9.1	-8.9	-8.5
Zimbabwe							
GDP at market prices (2000 \$) ^b	0.9	-3.8	-6.5	-3.9	-3.7	-2.5	-2.1
Current account balance/GDP (%)	-7.5	20.7	8.5	-1.8	-1.2	-1.1	-1.2

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. Liberia, Mayotte, Somalia, and São Tomé and Príncipe are not forecast owing to data limitations. e = estimate; f = forecast; — = not available.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.

b. GDP measured in constant 2000 \$.

2004–06 period 20 percent of cross-border South-South syndicated loan commitments went to borrowers in low- and lower-middle-income countries in Sub-Saharan Africa, of which three-quarters were provided by Chinese banks, compared to a much smaller 6 percent share of the North-South syndicated loan commitments.

Workers' remittances remained unchanged at \$8.7 billion in 2005–06, an amount equal to less than one-quarter of net private capital flows (\$41.6 billion) and bilateral aid grants (\$37 billion), but are almost certainly underestimated by a wide margin.

Medium-term outlook

GDP growth for the region as a whole is projected to remain broadly stable, coming in at about 5.4 percent in 2009. In South Africa, higher interest rates are projected to dampen growth this year, despite strength in the mining and manufacturing sectors, before the latter forces and preparation for the FIFA World Cup in 2010 generate a recovery in 2008. For the region as a whole, South Africa's continued solid growth is expected to be partly offset by weaker growth among oil exporters and other commodity-rich countries as prices ease and capacity constraints impose themselves.

Growth is projected to remain strong in reform-oriented economies such as Burkina Faso, Mali, Mozambique, and Tanzania, while robust government spending ahead of elections should boost output in countries like Senegal and Ghana. The pace of the expansion is expected to slow marginally but remain robust in Ethiopia and Kenya, while limited progress on reforms in Cameroon and Gabon, in conjunction with the ongoing sociopolitical crisis in Côte d'Ivoire and currency appreciation, will keep growth in the CFA zone countries below 5 percent.

In the baseline projection, emerging electrical shortages due to insufficient generating capacity are expected to constrain output in Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda, and Zambia, but improved rainfall in East and West Africa should help replenish hydroelectric dams, thereby improving electrical supply, and easing the stress on manufacturing production. An end to drought should also boost agricultural growth and domestic incomes, although weaker agricultural prices and high fertilizer prices may negatively affect crops and could represent a drag on growth.

Lower commodity prices, and in particular lower oil prices, and appreciating currencies should help reduce inflation in Sub-Saharan Africa,

notwithstanding robust economic growth. Food supply remains the wild card, as drought-induced food scarcity could result in an overshooting in inflation rates, notwithstanding lower fuel prices.

Aid continues to play a prominent role in the region, accounting for more than 10 percent of GDP for one-quarter of countries. Preliminary data show that the amount of aid allocated to the region by bilateral donors increased by only about 2 percent in 2006, excluding the nearly \$11 billion in debt relief provided to Nigeria by its Paris Club creditors. Donors will have to scale up the amount of aid provided to the region significantly over the next four years in order to achieve their objective of doubling aid to the region by 2010 (\$50 billion) from the 2004 level (\$25 billion).

To ensure that the scaling up in aid is most effective, it is necessary that the right mix of policies are implemented to avoid a buildup in inflationary pressures and currency appreciation in the recipient countries, and the subsequent Dutch disease symptoms. It is necessary to ensure that the large aid inflows will not result in undesirable structural changes and that the public sector, which in many cases is the largest recipient of aid, will not crowd out the private sector as public spending surges.

Risks and uncertainties

Sub-Saharan Africa's economic growth is subject to a series of global risks, including a sharper-than-expected slowdown in the global economy, which would cause commodity demand and prices to drop sharply. This would reverberate throughout the region, cutting incomes and undermining private consumption. In the baseline, we project investment growth rates of about 9 percent in oil-importing economies, and of around 13 percent for oil-exporting countries. A sharp drop in commodity prices may prompt investors to postpone their investments. A second significant risk is that of sharp increases in food prices on the global markets, which would disproportionately affect low-income countries, where food accounts for a large share of private expenditure.

At a regional level, political and social instability continue to remain a palpable risk, notwithstanding notable improvements on these fronts in the recent past. Political turmoil remains severe and is undermining growth in Chad, Côte d'Ivoire, the Democratic Republic of Congo, Eritrea,

Lesotho, the Seychelles, Somalia, Sudan, Swaziland, and Zimbabwe. The move toward more democratic institutions is illustrated by the fact that this year, 17 countries are scheduled to hold presidential or legislative elections (or both). Notable is the possibility that elections will be finally held in Côte d'Ivoire toward the end of the year. If the elections are successfully conducted, they would restore a sense of stability in a country marred by five years of political and social tensions. In controversial election races, however, there is scope for political violence that would derail growth.

The possibility of drought is also a concern, especially in East Africa, which tends to be more frequently and more severely affected by the problem. A severe drought would cause food prices to surge and would further reduce the supply of energy, which is already at critically low levels.

Notes

1. In addition to the Prospects for the Global Economy Web site (<http://www.worldbank.org/outlook>) the World Bank's *East Asia Update* provides more detailed information on recent developments and prospects for the East Asia and Pacific region. (<http://www.worldbank.org/eapupdate/>). This appendix partly summarizes that more extended publication.

2. Regional oil exporters (oil and natural gas) included in the forecast are Azerbaijan, Kazakhstan, Russia, and Uzbekistan; regional oil importers are Albania, Armenia, Bulgaria, Belarus, Croatia, the Czech Republic, Estonia, Georgia, Hungary, the Kyrgyz Republic, Latvia, Lithuania, Moldova, FYR Macedonia, Poland, Romania, the Slovak Republic, Turkey, and Ukraine. Slovenia is grouped with the high-income countries and is not included in the regional aggregates here.

3. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia became EU members in 2004, and Bulgaria and Romania joined in 2007.

4. The World Bank's Middle East and North Africa Web site, *Economic Developments and Prospects-2007* (<http://www.worldbank.org/mena>) provides a more comprehensive discussion of recent economic developments, projections, and policy priorities for the region. It should be noted that the country composition of the region—and hence references to economic growth and other concepts—differs between the Middle East and North Africa region's EDP report and this appendix. In particular, high-income Gulf Cooperation Council countries are considered an integral part of the Middle East and North Africa in the region's analysis and forecasting exercises.

5. For the purposes of this appendix the developing countries of the region are Algeria, Egypt, Jordan, the Islamic Republic of Iran, Lebanon, Morocco, Oman, Syria, Tunisia, and the Republic of Yemen. Among middle-income

economies, Djibouti, Iraq, and Libya were excluded from the projections due to a lack of data. Important regional economies such as Bahrain, Kuwait, and Saudi Arabia are included in the high-income aggregate. Among the high-income group, data limitations excluded Qatar and the United Arab Emirates from the analysis.

6. The resource-poor economies are Egypt, Jordan, Lebanon, Morocco, and Tunisia; all except Egypt are oil importers.

7. For Egypt, Europe is the destination of 40 percent of exports. Ratios are similar for other economies: 50 percent for Algeria, 60 percent for Syria, 70 percent for Morocco, and 80 percent for Tunisia.

8. Consumer price changes are aggregated using real GDP weights.

9. The S&P/IFCG index tracks the performance of the most actively traded stocks in various emerging markets, including India.

10. See <http://ddp-ext.worldbank.org/ext/GMIS/gdmis.do?siteId=2&menuId=LNAV01REGSUB5>.

Reference

IMF (International Monetary Fund). 2006. *World Economic Outlook: Financial Systems and Economic Cycles*. Washington, DC: IMF.