CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

The global recovery is expected to strengthen, led by advanced economies. Growth in emerging market and developing economies is expected to pick up only modestly. The balance of risks to global growth has improved, largely reflecting better prospects in advanced economies. However, important downside risks remain—notably a yet-greater general slowdown in emerging market economies; risks to activity from lower-than-expected inflation rates in advanced economies; incomplete reforms; and rising geopolitical tensions.

During the second half of 2013, growth in advanced economies rebounded by 1.3 percentage point and is expected to strengthen further in 2014–15. Growth is supported by monetary policy, reduced fiscal drag (except in Japan), and easing crisis legacies amid improving financial conditions in affected economies. In the stressed euro area economies, growth is projected to remain weak and fragile as high debt and financial fragmentation hold back domestic demand. In Japan, fiscal consolidation in 2014–15 is projected to result in some growth moderation. Still-large output gaps in advanced economies highlight the continued fragilities in the recovery.

Growth picked up only modestly in emerging market and developing economies in the second half of 2013—from 4.6 percent in the first half of 2013 to 5.2 percent in the second—although they continue to contribute much of global growth. However, robust or increasing growth was limited to the Asia and sub-Saharan Africa regions, with most other regions experiencing moderating or modest real growth rates. This comes despite the broadly positive lift from exports due to currency depreciation and the firming recovery in advanced economies in many regions, along with robust consumption supporting domestic demand. A worrying development is the downgrade of growth rates in a few large emerging market economies (e.g., Brazil, Russia, South Africa, Turkey) owing to domestic policy weaknesses, tighter domestic and external financial conditions, or investment and supply constraints. Hence only a modest pickup in growth in emerging market and developing economies is expected this year (Figure 2.1, panel 1).

Downside risks to global growth remain. Chief among them is a renewed increase in financial market volatility, especially in emerging market economies. If this risk materializes, capital inflows to emerging market and developing economies will likely decline, and growth in these economies will be lower compared with the baseline—with spillovers to advanced economies, as discussed in this chapter's Spillover Feature. The impact of a more prolonged slowdown in major emerging market economies because of lower investment—a scenario described in detail in Chapter 1—is shown in panel 2 of Figure 2.1. In advanced economies, downside risks to activity stem mainly from prospects of low inflation and the possibility of protracted stagnation, especially in the euro area and Japan. Other downside risks include adjustment fatigue and insufficient policy action in a still financially fragmented euro area and risks related to the exit from unconventional monetary policy. On the upside, the stronger-than-expected growth momentum during the second half of 2013 could buoy confidence in Germany, the United Kingdom, and the United States.

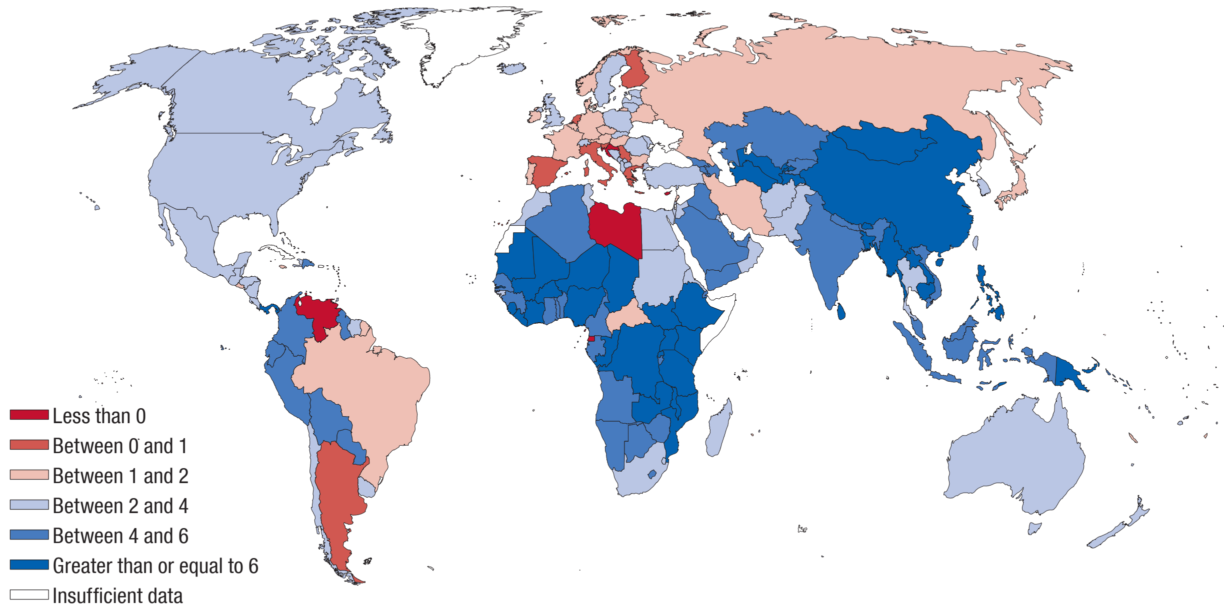
The United States and Canada: Firming Momentum

The U.S. economy grew at a faster-than-anticipated pace in the second half of 2013, led by buoyant domestic demand, robust inventory accumulation, and strong export growth. Although the harsher-than-usual winter weather may have slowed activity in early 2014, the underlying fundamentals of private demand remain strong, and growth is expected to advance at an above-potential rate for the rest of this year. In Canada, annual growth is expected to accelerate in 2014 thanks to stronger external demand and rising business investment.

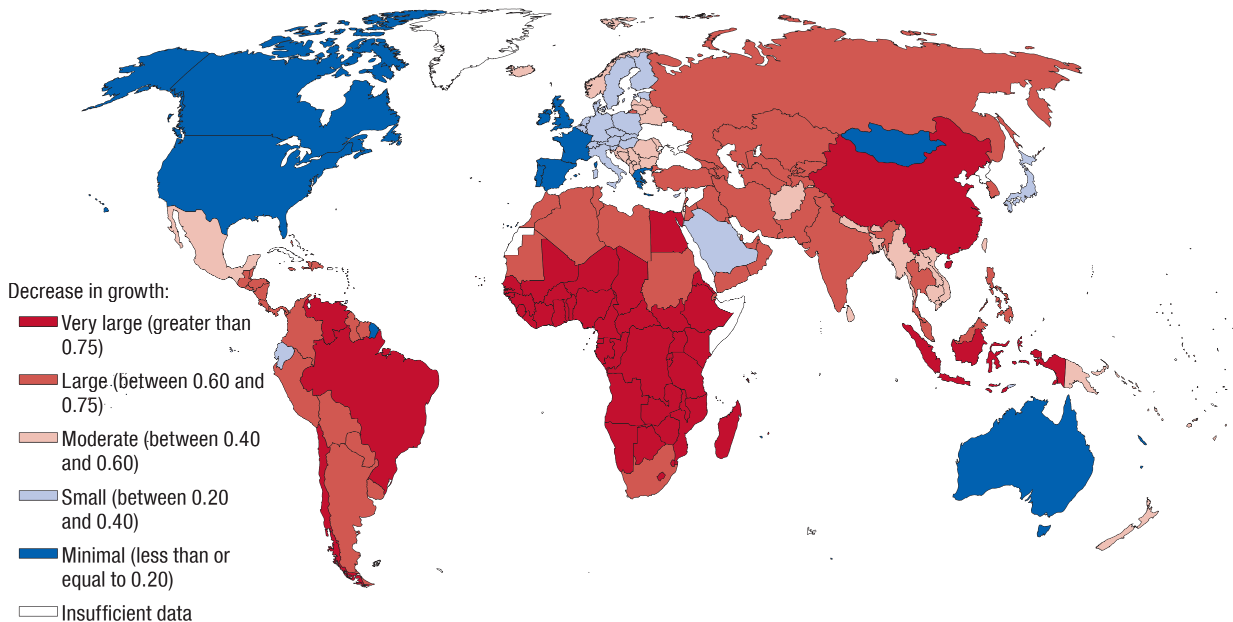
Growth in the United States was 1.9 percent in 2013, with the continued recovery of private domestic

Figure 2.1. 2014 GDP Growth Forecasts and the Effects of a Plausible Downside Scenario

1. 2014 GDP Growth Forecasts[1]
(percent)



2. Effects of a Plausible Downside Scenario
(peak growth deviation from 2014 baseline projections; percentage points)



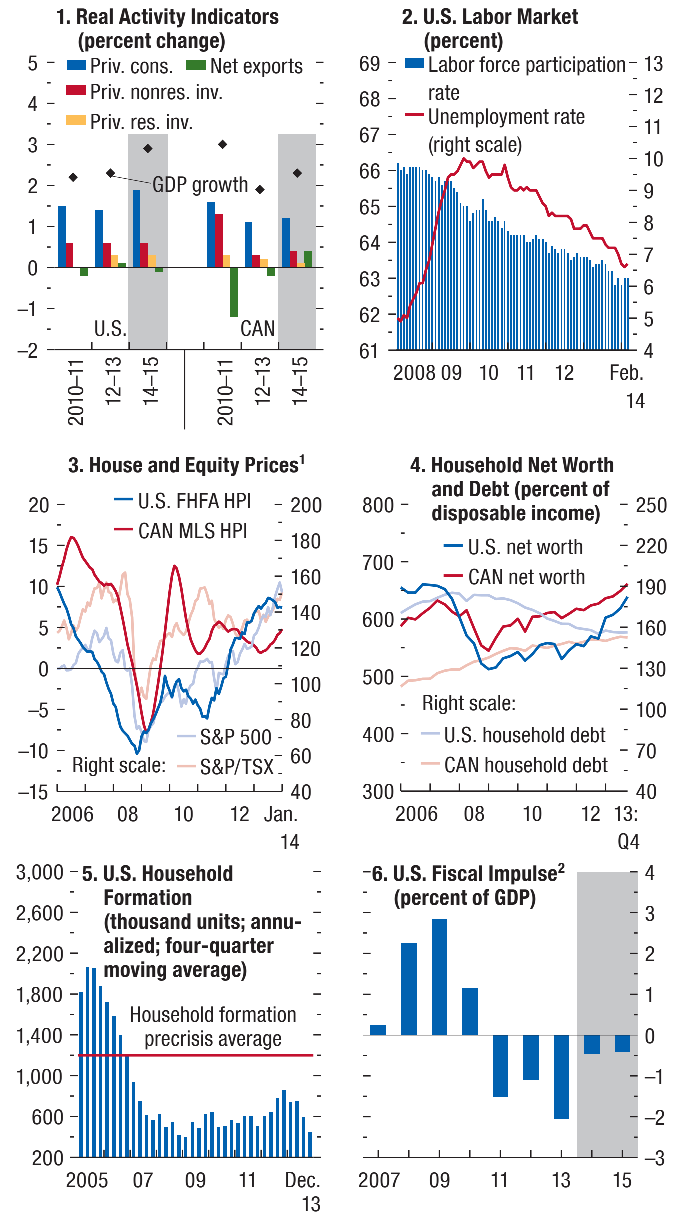
Source: IMF staff estimates.
Note: Simulations are conducted using the IMF's Flexible System of Global Models, with 29 individual countries and eight regions (other European Union, other advanced economies, emerging Asia, newly industrialized Asia, Latin America, Middle East and North Africa, sub-Saharan Africa, oil exporters group). Countries not included in the model are allocated to the regions based on the WEO classification of fuel exporters, followed by geographical regional classifications. Syria is excluded due to the uncertain political situation. Ukraine is excluded due to the ongoing crisis.
[1]The data for Argentina are officially reported data. The IMF has, however, issued a declaration of censure and called on Argentina to adopt remedial measures to address the quality of the official GDP data. Alternative data sources have shown significantly lower real growth than the official data since 2008. In this context, the Fund is also using alternative estimates of GDP growth for the surveillance of macroeconomic developments in Argentina. The Zimbabwe dollar ceased circulating in early 2009. Data are based on IMF staff estimates of price and exchange rate developments in U.S. dollars. IMF staff estimates of U.S. dollar values may differ from authorities' estimates. Real GDP is in constant 2009 prices.

demand partly offset by the hefty fiscal consolidation effort, which subtracted between 1¼ and 1½ percentage points from GDP growth. Economic momentum picked up during 2013; GDP grew at an average annualized rate of 3.3 percent in the second half compared with 1.2 percent in the first half. Consumer spending also picked up, boosted by higher house and stock prices and a further decline in household debt relative to disposable income, which raised household net worth above its long-term average (Figure 2.2). A faster pace of inventory accumulation and strong export growth (particularly in regard to petroleum products) also contributed to sustained activity in the second half of 2013. Mainly reflecting the October government shutdown, government spending contracted significantly at the end of the year, but financial conditions remained highly accommodative, with long-term rates declining after the sharp increase in mid-2013. The unemployment rate continued to fall in 2013, reaching 6.7 percent in February 2014. However, a major factor behind the decline was a further drop in the labor force participation rate, which stood at 63 percent in February of this year (see Chapter 1). Still-ample slack in the economy was manifest in subdued price pressures, with headline consumer price index inflation standing at 1.6 percent in February 2014. Largely on account of increases in domestic energy production and the associated drop in oil imports, the current account deficit narrowed further to 2.3 percent of GDP in 2013—the lowest in 15 years (Table 2.1).

The unusually harsh winter weather weighed on activity in early 2014, but growth is expected to rebound over the rest of the year—driven by strong growth in residential investment (bouncing back from very low levels and given substantial pent-up demand for housing), solid personal consumption, and a pickup in nonresidential fixed-investment growth as consumer and business confidence improves. Growth will also be supported by less fiscal drag, which is declining to ¼ to ½ percentage point of GDP this year, thanks in part to the Bipartisan Budget Act, which replaced some of the automatic spending cuts in fiscal years 2014 and 2015 with back-loaded savings. The debt limit has been suspended until March 2015, reducing the uncertainty that has characterized fiscal policy in the past few years. Overall, growth is projected to accelerate to 2.8 percent in 2014 and to 3.0 percent in 2015.

Figure 2.2. United States and Canada: Recovery Firming Up

In the United States, growth in 2013 was higher than expected, and recent data remain consistent with a further pickup in 2014 as improvement in the labor and housing markets continues and the fiscal drag wanes. In Canada, growth strengthened in 2013 and is expected to accelerate in 2014 as a result of rising business investment and firming external demand.



Sources: Bloomberg, L.P.; Canadian Real Estate Association; Congressional Budget Office; Haver Analytics; and IMF staff estimates.
Note: CAN = Canada; cons. = consumption; FHFA HPI = Federal Housing Finance Agency Housing Price Index; inv. = investment; MLS HPI = Multiple Listing Service Housing Price Index; nonres. = nonresidential; priv. = private; res. = residential; S&P = Standard & Poor's; TSX = Toronto Stock Exchange.
[1]Year-over-year percent change for house prices and index; January 2005 = 100 for S&P and TSX.
[2]The fiscal impulse is the negative of the change in the primary structural balance.

Table 2.1. Selected Advanced Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Advanced Economies	**1.3**	**2.2**	**2.3**	**1.4**	**1.5**	**1.6**	**0.4**	**0.5**	**0.4**	**7.9**	**7.5**	**7.3**
United States	1.9	2.8	3.0	1.5	1.4	1.6	–2.3	–2.2	–2.6	7.4	6.4	6.2
Euro Area[4,5]	–0.5	1.2	1.5	1.3	0.9	1.2	2.3	2.4	2.5	12.1	11.9	11.6
Japan	1.5	1.4	1.0	0.4	2.8	1.7	0.7	1.2	1.3	4.0	3.9	3.9
United Kingdom[4]	1.8	2.9	2.5	2.6	1.9	1.9	–3.3	–2.7	–2.2	7.6	6.9	6.6
Canada	2.0	2.3	2.4	1.0	1.5	1.9	–3.2	–2.6	–2.5	7.1	7.0	6.9
Other Advanced Economies[6]	2.3	3.0	3.2	1.5	1.8	2.4	4.8	4.7	4.3	4.6	4.6	4.5

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A6 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Based on Eurostat's harmonized index of consumer prices.
[5]Excludes Latvia. Current account position corrected for reporting discrepancies in intra-area transactions.
[6]Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries but includes Latvia.

The balance of risks is tilted slightly to the downside. On the external front, protracted sluggishness in the euro area would weigh on growth, particularly if deflation dynamics take hold. A slowdown in emerging market economies could also pose a risk, with output growth declining by 0.2 percentage point in response to a 1 percent reduction in those economies' GDP (see this chapter's Spillover Feature). On the domestic front, private domestic demand could also lose momentum if long-term yields rise more quickly than expected without an associated improvement in the outlook. In the medium term, heightened fiscal sustainability concerns could pose additional downside risks, while a continuation of the downward trend in the labor force participation rate would further dent potential output and, by reducing the slack in the economy, lead to an earlier-than-expected tightening of monetary policy. On the upside, a more buoyant housing market recovery, with feedback to and from lending conditions, balance sheets, and private demand, remains a possibility. Moreover, greater confidence in the economy's prospects (resulting from a relatively healthy financial sector and low energy costs) could induce businesses to shift more aggressively from cash hoarding toward real investment.

A balanced, gradual, and credible fiscal plan that puts public debt firmly on a downward path continues to be the main policy priority. Such a plan would involve measures to gradually rein in entitlement spending, a revenue-raising tax reform, and replacement of the sequester cuts with back-loaded new revenues and mandatory savings. (The Bipartisan Budget Act is a modest step in this direction.) Although the continued economic momentum justifies the measured reductions in the Federal Reserve's asset purchase program, the overall monetary policy stance should remain accommodative, considering the sizable slack and steady inflation expectations (see Chapter 1). The return to qualitative forward guidance in March 2014 can provide the Federal Reserve with greater flexibility to achieve its employment and inflation goals. As the date of the liftoff draws nearer, the Federal Reserve will have to clearly convey to the market how it will assess progress toward achieving those objectives, in order to avoid an increase in policy uncertainty.

Canada's economy strengthened in 2013, but the much-needed rebalancing from household consumption and residential construction toward exports and business investment has not fully materialized. Growth is expected to rise to 2.3 percent in 2014, up from 2 percent in 2013, with the projected pickup in the U.S. economy boosting Canada's export and business investment growth (Table 2.1, Figure 2.2). Although external demand could surprise on the upside, downside risks to the outlook still dominate, including from weaker-than-expected exports resulting from competitiveness challenges, lower commodity prices, and a more abrupt unwinding of domestic imbalances. Indeed, despite the recent moderation in the housing market, elevated household leverage and house prices remain a key vulnerability (Figure 2.2). With inflation low and downside risks looming, monetary policy

should remain accommodative until growth gains further traction. Fiscal policy needs to strike the right balance between supporting growth and rebuilding fiscal buffers, especially at the federal government level, with less room to maneuver at the provincial level.

Europe

Advanced Europe: From Recession to Recovery

Advanced European economies are expected to resume growth in 2014, but inflation remains very low. Domestic demand in the euro area has finally stabilized and turned toward positive territory, with net exports also contributing to ending the recession. But high unemployment and debt, low investment, persistent output gaps, tight credit, and financial fragmentation in the euro area will weigh on the recovery. Downside risks stem from incomplete reforms, external factors, and even lower inflation. Accommodative monetary policy, completion of financial sector reforms, and structural reforms are critical.

The euro area has finally emerged from recession. Activity shrank by about ½ percent in 2013, but growth has been positive since the second quarter after a long period of output decline (Table 2.2). The turnaround—attributable, in part, to less fiscal drag and some impetus from private domestic demand for the first time since 2010—is materializing largely as anticipated. Budding growth and greatly reduced tail risks have buoyed financial markets, with marked compression in sovereign spreads in stressed economies, although these spreads have increased modestly with recent financial market volatility (see Chapter 1). National and collective policy actions have contributed to this positive turn of events.

Nevertheless, the legacy of the crisis—high unemployment, weak private and public balance sheets, contracting credit, and a large debt burden—and longer-term impediments to growth must still be fully addressed, raising concern about the strength and durability of the recovery.

- The recovery is uneven across countries and sectors. Pockets of stronger growth, such as Germany, are interspersed with stagnant or declining output elsewhere. Growth remains largely export led, although there has been an incipient revival in domestic demand (for example, in France, Spain, and particularly Germany). Private investment, however, has yet to revive strongly across the euro area. Despite some rebalancing (within the euro area), current account balances have improved asymmetrically, with persistent surpluses in some core economies and shrinking external balances in deficit economies.
- Substantial and persistent slack has led to a general softening in inflation rates, which were already well below the European Central Bank's (ECB's) objective (Figure 2.3).
- Pending bank reform and private sector deleveraging, financial fragmentation, though lessening, continues to impair monetary transmission. In countries under stress, the private sector faces high lending rates and contracting private sector credit.
- Longer-term concerns about productivity and competitiveness linger, despite important reforms in several countries.

The euro area recovery is expected to continue in 2014 (Table 2.2), with growth forecast to be 1.2 percent, reflecting a smaller fiscal drag, expectations of improving credit conditions, and stronger external demand. Euro area growth is projected to be about 1½ percent in the medium term. Persistently large output gaps—except in the case of Germany—are expected to moderate inflation to under 1¼ percent in 2014–15, well below the ECB's objective of close to 2 percent for the foreseeable future.

Other advanced economies recorded stronger growth, but durability is far from assured. Growth has rebounded more strongly than anticipated in the United Kingdom on easier credit conditions and increased confidence. However, the recovery has been unbalanced, with business investment and exports still disappointing. Switzerland regained momentum driven by domestic demand, and the exchange rate floor has stemmed deflation. Sweden was held back by continuing high unemployment, a strong krona, and structural labor market weaknesses, although activity is forecast to pick up this year on stronger external demand.

Notwithstanding a pickup in growth, downside risks dominate. The euro area recovery could be derailed should financial stress reemerge from stalled policy initiatives. High unemployment could foster reform fatigue, political uncertainty, and policy reversal, jeopardizing hard-won gains. External shocks—tighter financial conditions in the United States, financial contagion and trade disruptions from geopolitical events, and slower-than-expected emerging market growth—could hurt growth and stability. For instance, an external shock involving further growth disappoint-

Table 2.2. Selected European Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Europe	**0.5**	**1.7**	**1.9**	**1.9**	**1.6**	**1.8**	**1.9**	**2.1**	**2.2**	**. . .**	**. . .**	**. . .**
Advanced Europe	**0.1**	**1.5**	**1.7**	**1.5**	**1.1**	**1.3**	**2.6**	**2.6**	**2.8**	**10.8**	**10.6**	**10.2**
Euro Area[4,5]	–0.5	1.2	1.5	1.3	0.9	1.2	2.3	2.4	2.5	12.1	11.9	11.6
Germany	0.5	1.7	1.6	1.6	1.4	1.4	7.5	7.3	7.1	5.3	5.2	5.2
France	0.3	1.0	1.5	1.0	1.0	1.2	–1.6	–1.7	–1.0	10.8	11.0	10.7
Italy	–1.9	0.6	1.1	1.3	0.7	1.0	0.8	1.1	1.1	12.2	12.4	11.9
Spain	–1.2	0.9	1.0	1.5	0.3	0.8	0.7	0.8	1.4	26.4	25.5	24.9
Netherlands	–0.8	0.8	1.6	2.6	0.8	1.0	10.4	10.1	10.1	6.9	7.3	7.1
Belgium	0.2	1.2	1.2	1.2	1.0	1.1	–1.7	–1.3	–1.0	8.4	9.1	8.9
Austria	0.4	1.7	1.7	2.1	1.8	1.7	3.0	3.5	3.5	4.9	5.0	4.9
Greece	–3.9	0.6	2.9	–0.9	–0.4	0.3	0.7	0.9	0.3	27.3	26.3	24.4
Portugal	–1.4	1.2	1.5	0.4	0.7	1.2	0.5	0.8	1.2	16.3	15.7	15.0
Finland	–1.4	0.3	1.1	2.2	1.7	1.5	–0.8	–0.3	0.2	8.1	8.1	7.9
Ireland	–0.3	1.7	2.5	0.5	0.6	1.1	6.6	6.4	6.5	13.0	11.2	10.5
Slovak Republic	0.9	2.3	3.0	1.5	0.7	1.6	2.4	2.7	2.9	14.2	13.9	13.6
Slovenia	–1.1	0.3	0.9	1.6	1.2	1.6	6.5	6.1	5.8	10.1	10.4	10.0
Luxembourg	2.0	2.1	1.9	1.7	1.6	1.8	6.7	6.7	5.5	6.8	7.1	6.9
Latvia	4.1	3.8	4.4	0.0	1.5	2.5	–0.8	–1.6	–1.9	11.9	10.7	10.1
Estonia	0.8	2.4	3.2	3.5	3.2	2.8	–1.0	–1.3	–1.5	8.6	8.5	8.4
Cyprus[6]	–6.0	–4.8	0.9	0.4	0.4	1.4	–1.5	0.1	0.3	16.0	19.2	18.4
Malta	2.4	1.8	1.8	1.0	1.2	2.6	0.9	1.4	1.4	6.5	6.3	6.2
United Kingdom[5]	1.8	2.9	2.5	2.6	1.9	1.9	–3.3	–2.7	–2.2	7.6	6.9	6.6
Sweden	1.5	2.8	2.6	0.0	0.4	1.6	5.9	6.1	6.2	8.0	8.0	7.7
Switzerland	2.0	2.1	2.2	–0.2	0.2	0.5	9.6	9.9	9.8	3.2	3.2	3.0
Czech Republic	–0.9	1.9	2.0	1.4	1.0	1.9	–1.0	–0.5	–0.5	7.0	6.7	6.3
Norway	0.8	1.8	1.9	2.1	2.0	2.0	10.6	10.2	9.2	3.5	3.5	3.5
Denmark	0.4	1.5	1.7	0.8	1.5	1.8	6.6	6.3	6.3	7.0	6.8	6.7
Iceland	2.9	2.7	3.1	3.9	2.9	3.4	0.4	0.8	–0.2	4.4	3.7	3.7
San Marino	–3.2	0.0	2.2	1.3	1.0	1.2	. . .	. . .	. . .	8.0	8.2	7.8
Emerging and Developing Europe[7]	**2.8**	**2.4**	**2.9**	**4.1**	**4.0**	**4.1**	**–3.9**	**–3.6**	**–3.8**	**. . .**	**. . .**	**. . .**
Turkey	4.3	2.3	3.1	7.5	7.8	6.5	–7.9	–6.3	–6.0	9.7	10.2	10.6
Poland	1.6	3.1	3.3	0.9	1.5	2.4	–1.8	–2.5	–3.0	10.3	10.2	10.0
Romania	3.5	2.2	2.5	4.0	2.2	3.1	–1.1	–1.7	–2.2	7.3	7.2	7.0
Hungary	1.1	2.0	1.7	1.7	0.9	3.0	3.1	2.7	2.2	10.2	9.4	9.2
Bulgaria[5]	0.9	1.6	2.5	0.4	–0.4	0.9	2.1	–0.4	–2.1	13.0	12.5	11.9
Serbia	2.5	1.0	1.5	7.7	4.0	4.0	–5.0	–4.8	–4.6	21.0	21.6	22.0
Croatia	–1.0	–0.6	0.4	2.2	0.5	1.1	1.2	1.5	1.1	16.5	16.8	17.1
Lithuania[5]	3.3	3.3	3.5	1.2	1.0	1.8	0.8	–0.2	–0.6	11.8	10.8	10.5

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Excludes Latvia. Current account position corrected for reporting discrepancies in intra-area transactions.
[5]Based on Eurostat's harmonized index of consumer prices.
[6]Real GDP growth and the current account balance for 2013 refer to staff estimates at the time of the third review of the program and are subject to revision.
[7]Includes Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, and Montenegro.

ment in emerging market economies, if it materializes, could spill over to the euro area given nonnegligible trade linkages, and to the United Kingdom through financial linkages (see this chapter's Spillover Feature). More positively, stronger-than-expected business sentiment could jump-start investment and growth.

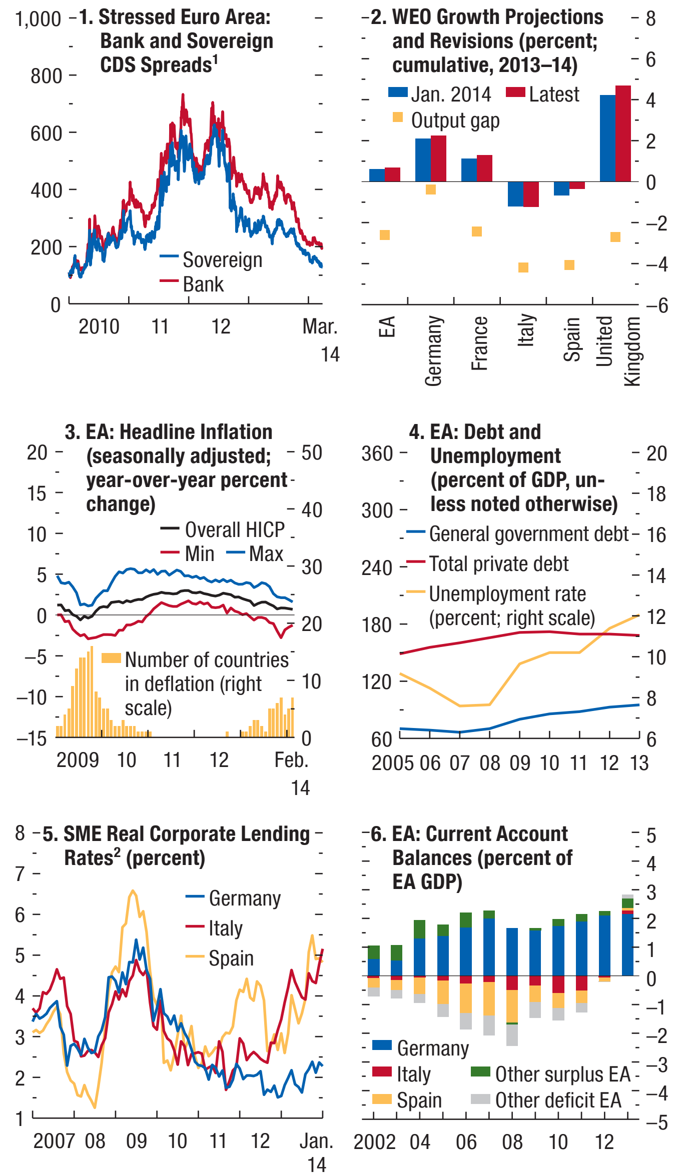
A key risk to activity stems from very low inflation in advanced economies. In the euro area, below-target inflation for an extended period could deanchor longer-term inflation expectations and complicate the task of recovery in the stressed economies, where the real burden of debt and real interest rates would rise.

The priority is to set the stage for stronger and more durable growth and tackle low inflation while ensuring financial stability. The policy mix is complex and interdependent, comprising fiscal and monetary policy, financial sector restructuring and reform, and structural reforms.

- Macroeconomic policies should stay accommodative. In the euro area, additional demand support is necessary. More monetary easing is needed both to increase the prospects that the ECB's price stability objective of keeping inflation below, but close to, 2 percent will be achieved and to support demand. These measures could include further rate cuts and longer-term targeted bank funding (possibly to small and medium-sized enterprises). The neutral fiscal stance for 2014 is broadly appropriate, but fiscal support may be warranted in countries with policy space if low growth persists and monetary policy options are depleted. In the United Kingdom, monetary policy should stay accommodative, and recent modifications by the Bank of England to the forward-guidance framework are therefore welcome. Similarly, the government's efforts to raise capital spending while staying within the medium-term fiscal envelope should help bolster recovery and long-term growth. Sweden's supportive monetary policy and broadly neutral fiscal stance remain adequate.
- Repairing bank balance sheets and completing the banking union are critical to restoring confidence and credit in the euro area (see Chapter 1). To this end, a sound execution of the bank asset quality review and stress tests are essential, supported by strong common backstops to delink sovereigns and banks, and an independent Single Resolution Mechanism to ensure timely, least-cost bank restructuring. The United Kingdom should continue to restore financial sector soundness, ensure that stress tests are well coordinated with those of the European Banking Authority, and guard against any buildup of financial vulnerabilities, including from surging house prices. Sweden should continue to improve bank capitalization and liquidity and introduce demand-side measures to curb household credit growth. Switzerland should ensure that its systemically important banks reduce leverage.
- Despite progress, there is still need to increase potential output and reduce intra-euro-area imbalances through improved productivity and investment. Structural reforms to create flexible labor

Figure 2.3. Advanced Europe: From Recession to Recovery

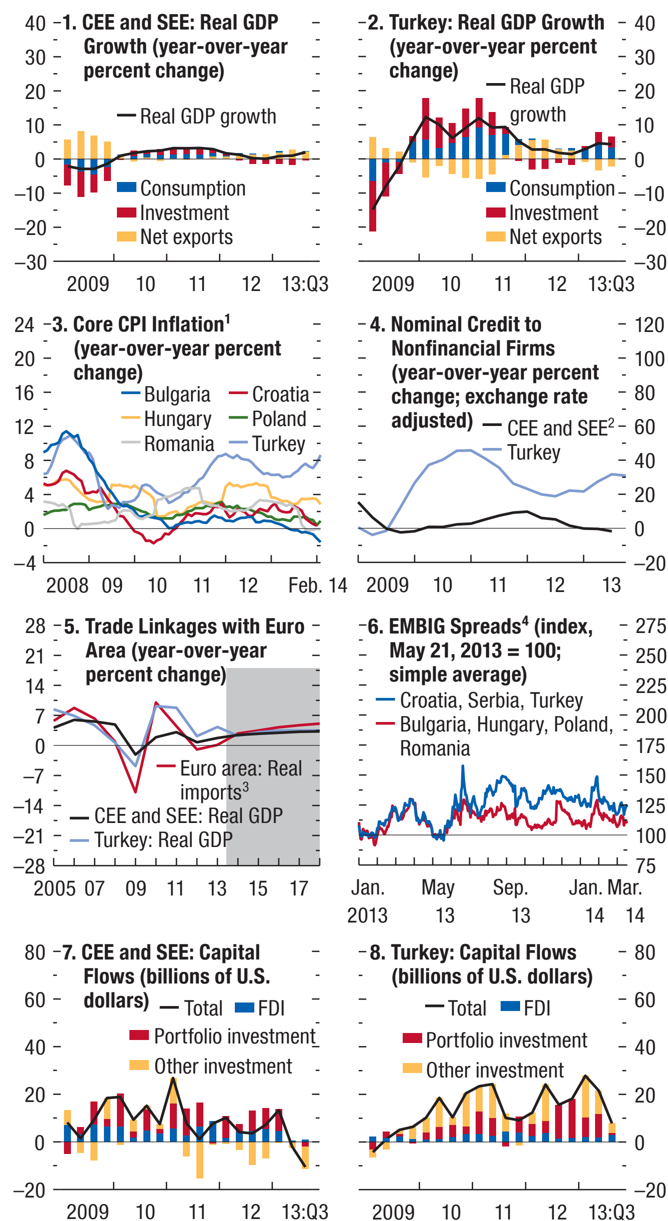
Financial markets in advanced Europe have been buoyant because of receding tail risks and the resumption of growth. Output gaps, however, remain large, reflected in low inflation, which lies well below the ECB's medium-term objective. Unemployment rates are stubbornly high, and debt levels are on an upward trajectory. Financial fragmentation persists. Current account balances have improved asymmetrically, with persistent surpluses in some core economies.



Sources: Bloomberg, L.P.; European Central Bank (ECB); Eurostat; Haver Analytics; and IMF staff estimates.
Note: Euro area (EA) = Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovak Republic, Slovenia, Spain. Stressed euro area = Greece, Ireland, Italy, Portugal, Spain. CDS = credit default swap; HICP = harmonized index of consumer prices; SME = small and medium-sized enterprises.
[1]Bank and sovereign five-year CDS spreads in basis points are weighted by total assets and general government gross debt, respectively. Data are through March 24, 2014. All stressed euro area countries are included, except Greece.
[2]Monetary and financial institutions' lending to corporations under €1 million, 1–5 years.

Figure 2.4. Emerging and Developing Europe: Recovery Strengthening, but with Vulnerabilities

Growth decelerated in emerging and developing Europe in 2013, as the region contended with large capital outflows, tighter monetary conditions, and rising financial market volatility.



Sources: Bloomberg, L.P.; CEIC Data Management; European Bank for Reconstruction and Development; Haver Analytics; and IMF staff estimates.
Note: Central and eastern Europe (CEE) and southeastern Europe (SEE) include Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, FYR Macedonia, Montenegro, Poland, Romania, and Serbia, wherever the data are available. All country group aggregates are weighted by GDP valued at purchasing power parity as a share of group GDP unless noted otherwise. CPI = consumer price index; EMBIG = J.P. Morgan Emerging Markets Bond Index Global; FDI = foreign direct investment.
[1]Data through February 2014 except in the case of Croatia (January 2014).
[2]Data through third quarter of 2013.
[3]Excludes Latvia.
[4]Data through March 25, 2014.

markets and competitive product and service markets, ease entry and exit of firms, and simplify tax systems would be necessary. Reducing persistently large current account surpluses would bring beneficial spillovers across the euro area; for example, more public investment could lower the current account surplus in Germany while also raising growth in both Germany and the region. A targeted implementation of the European Union (EU) Services Directive would open up protected professions. A more flexible wage formation process would help address high unemployment in Sweden, especially among vulnerable groups.

Emerging and Developing Europe: Recovery Strengthening but Vulnerabilities Remain

Growth decelerated in emerging and developing Europe in the second half of 2013 as the region contended with large capital outflows. Despite positive spillovers from advanced Europe, the recovery is expected to weaken slightly in 2014. Fragilities in the euro area, some domestic policy tightening, rising financial market volatility, and increased geopolitical risks stemming from developments in Ukraine pose appreciable downside risks. Policies aimed at raising potential output remain a priority for the region.

During 2013 economic recovery in emerging Europe continued to be driven by external demand, except in the cases of Turkey and the Baltic countries, where growth was led by private consumption. In contrast, the rise in private consumption reflected mostly procyclical macroeconomic policies in Turkey, and in the Baltic countries it reflected better labor market conditions. After an initial improvement, financial market volatility has increased since early fall in most countries. As a result, the region, excluding Turkey, experienced capital outflows (Figure 2.4).

Stronger growth in the euro area is expected to lift activity in most of emerging and developing Europe. However, the region as a whole will see slightly weaker growth in 2014 than it did in 2013, mainly on account of Turkey, whose economy is much more cyclically advanced than those of other countries in the region (Table 2.2).

- Despite a projected improvement in net exports, growth in Turkey is expected to weaken in 2014 to 2.3 percent from 4.3 percent in 2013, mainly as a result of a sharp slowdown in private consumption

driven by macroprudential measures, the sizable exchange rate adjustment, and interest rate hikes. Public investment will likely hold up in line with the 2014 budget targets.

- Growth in Hungary and Poland is forecast to strengthen in 2014 to 2.0 and 3.1 percent, from 1.1 and 1.6 percent in 2013, respectively. In both economies the strengthening is being driven by a pickup in domestic demand, supported by monetary easing, improvements in the labor market, and higher EU funds, which are expected to boost public investment. In Hungary, still-high external vulnerabilities, although declining, could weigh on growth.
- As was the case last year, the growth pickup in southeastern Europe will be moderate in 2014 at about 1.9 percent, mostly on account of improving external demand. Domestic demand in a few countries will benefit from EU spending. However, demand will remain constrained because of slow progress in resolving nonperforming loans, persistent unemployment, and the need for fiscal consolidation in some countries.

Inflation is expected to decline or remain moderate in most countries in the region. Core inflation is low in several countries and has been decreasing in Bulgaria, Croatia, and Romania, reflecting a still-negative output gap, depressed domestic demand, weak bank credit, and negative external price developments, among other factors (Figure 2.4). Deflation risks, however, are low for emerging Europe as domestic demand takes hold and the effects of one-off factors dissipate.

Delayed recovery in the euro area and renewed volatility in financial markets resulting from geopolitical events or the onset of Federal Reserve tapering are the main downside risks across the region. Regional growth is highly correlated with euro area growth, and with strong financial links, the euro area remains the main source of shocks for emerging and developing Europe. With large declines in portfolio investment, gross capital inflows to central and southeastern Europe turned sharply negative in the third quarter of 2013 and dropped substantially for Turkey (Figure 2.4). Accelerated outflows become a risk if financial market volatility spikes again, with negative consequences for financing still-sizable fiscal deficits in many countries and external deficits in some. In addition, a further escalation of geopolitical risks related to Ukraine could have significant negative spillovers for the region through both financial and trade channels. Finally, uncertainties associated with the resolution of foreign-currency-denominated mortgages in Hungary, financial sector and corporate restructuring in Slovenia, and achieving the needed fiscal discipline in Serbia also weigh negatively on the outlooks for these countries.

Policies aimed at raising potential growth, including by addressing high structural unemployment, making progress in resolving the large stock of nonperforming loans, and enhancing the role of the tradables sector, remain a priority. Low growth largely reflects structural rigidities in many countries, although negative output gaps in most countries in the region also point to cyclical weaknesses. However, room for policy maneuvering is available only to a few: already-low policy rates and the risk of renewed financial turmoil reduce the scope for further monetary easing in most countries. At the same time, elevated public debt and high headline fiscal deficits highlight the need for consolidation, largely relying on expenditure cuts, in several countries.

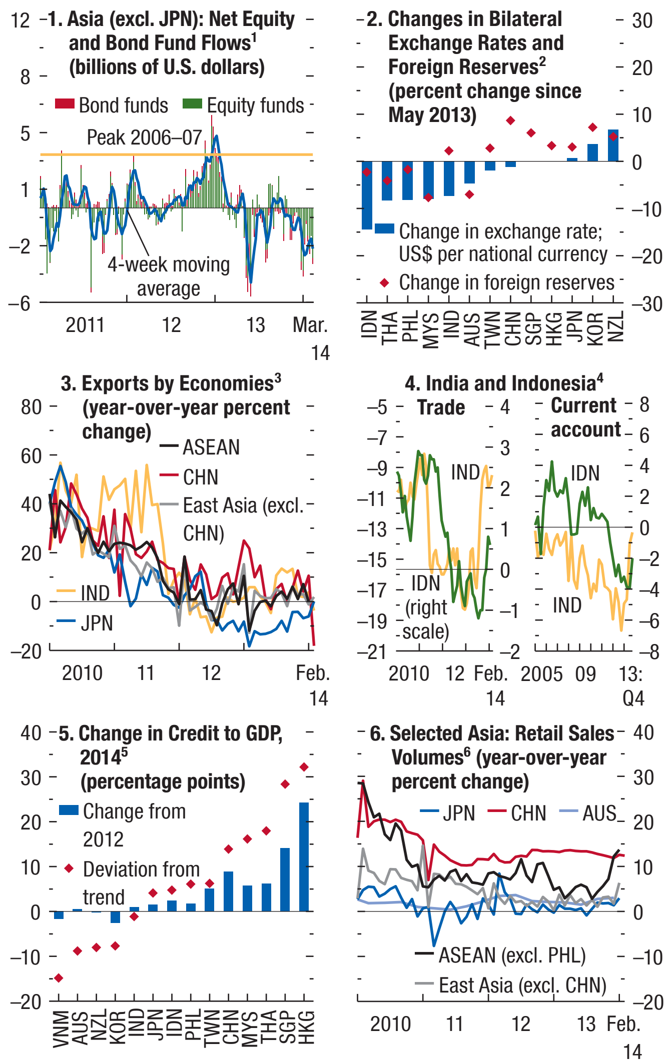
Asia: Steady Recovery

Except in the case of Japan, growth in Asia picked up in the second half of 2013 on recovering exports and robust domestic demand. Global downside risks are still significant and are particularly relevant for economies already weakened by domestic and external vulnerabilities. In addition, homegrown vulnerabilities in China continue to rise, especially those stemming from growth in credit. Policy priorities vary across the region, with some economies tightening, whereas others are still able to support growth. Supply-side reforms would improve resilience and growth prospects.

Economic activity in Asia picked up speed in the second half of 2013, as exports to advanced economies accelerated. Domestic demand has been solid, and retail sales across much of Asia have been brisk. Exports, particularly to the United States and the euro area, have gained momentum. In Japan, while private consumption and public spending remained robust, GDP growth slowed in the second half of 2013 on slow recovery of exports and a surge in import demand due to sustained high energy imports and strong domestic demand (see Chapter 1). Countries with strong fundamentals and policies managed to navigate the pressures seen in mid-2013 and early 2014 from slowing capital flows, with many in emerging Asia unscathed and looking more positive. Despite increas-

Figure 2.5. Asia: Steady Recovery

Activity in Asia picked up in the second half of 2013 as exports recovered owing to stronger demand from advanced economies. With domestic demand still robust, growth is projected to rise to 5.5 percent in 2014 as external demand recovers further.



Sources: Bloomberg, L.P.; CEIC; Haver Analytics; IMF, International Financial Statistics database; and IMF staff calculations.

Note: Asia = Australia (AUS), China (CHN), Hong Kong SAR (HKG), India (IND), Indonesia (IDN), Korea (KOR), Malaysia (MYS), New Zealand (NZL), Philippines (PHL), Singapore (SGP), Thailand (THA), Taiwan Province of China (TWN), Vietnam (VNM). ASEAN = Association of Southeast Asian Nations (IDN, MYS, PHL, SGP, THA). East Asia = CHN, HKG, KOR, TWN. JPN = Japan. Country group aggregates are weighted by purchasing-power-parity GDP as a share of group GDP.

[1]Data include exchange-traded fund flows and mutual fund flows; data are through Mar. 19, 2014.

[2]Exchange rate data are for Mar. 2014; reserves data are for Feb. 2014 except in the case of NZL (Jan. 2014) and CHN (Dec. 2013).

[3]ASEAN data are through Jan. 2013.

[4]Trade balance data are in three-month moving averages and are through Jan. 2014 for IDN. Current account balance data are in percent of GDP.

[5]Latest monthly availability. Trend calculated using Hodrick-Prescott filter over the period 2000–12.

[6]AUS, CHN, JPN, and ASEAN (excluding PHL). Data are through Dec. 2013 for AUS; Jan. 2014 for JPN, east Asia (excluding CHN), and ASEAN (excluding PHL). Linear interpolation is applied on quarterly data for AUS.

ing volatility, financial conditions remain accommodative, partly because weaker currencies are providing some offset (Figure 2.5).

For Asia as a whole, growth is expected to accelerate modestly, from 5.2 percent in 2013 to about 5.5 percent in both 2014 and 2015 (Table 2.3). The improved outlook in advanced economies, alongside more competitive exchange rates in some cases, will help boost exports. Domestic demand will continue to be supported by strong labor markets and still-buoyant credit growth. Policies are expected to remain accommodative, although in a few cases (India, Indonesia) interest rate hikes on the one hand will attenuate vulnerabilities, but on the other hand could weigh on growth. In Japan, fiscal consolidation will be a headwind. Inflation is expected to increase slightly, albeit remaining generally low across the region, as output gaps close. The main exceptions are India and Indonesia, whose high inflation rates should continue to moderate further.

- In *Japan,* GDP growth is expected to moderate to about 1.4 percent in 2014 as fiscal policy weighs on activity. The positive effect of the recently approved stimulus measures is expected to be more than offset by the negative impact of the consumption tax hike and the waning of reconstruction spending and past stimulus measures. Monetary support will ensure that financial conditions remain accommodative, and inflation will rise temporarily to 2¾ percent this year as a result of the consumption tax increase (see Chapter 1).
- In *Korea*, the economy should continue its recovery, with growth accelerating to 3.7 percent in 2014. Stronger growth will be driven mostly by exports, which will be lifted by improving trading partner demand. Domestic demand should also pick up, benefiting from past fiscal stimulus and monetary accommodation as well as continued robust labor market conditions.
- In *Australia*, growth is expected to remain broadly stable at 2.6 percent in 2014 as the slowdown in mining-related investment continues. In *New Zealand*, growth should pick up to 3.3 percent, helped by reconstruction spending.
- In *China,* growth recovered somewhat in the second half of 2013 and should remain robust this year, moderating only marginally to 7.5 percent, as accommodative policies remain in place. The announcement of the government's reform blueprint

Table 2.3. Selected Asian Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Asia	**5.2**	**5.4**	**5.6**	**3.5**	**3.9**	**3.7**	**1.4**	**1.6**	**1.6**	**. . .**	**. . .**	**. . .**
Advanced Asia	**2.1**	**2.3**	**2.2**	**1.1**	**2.4**	**2.2**	**2.0**	**2.1**	**2.0**	**4.0**	**4.0**	**4.0**
Japan	1.5	1.4	1.0	0.4	2.8	1.7	0.7	1.2	1.3	4.0	3.9	3.9
Korea[4]	2.8	3.7	3.8	1.3	1.8	3.0	5.8	4.4	3.5	3.1	3.1	3.1
Australia	2.4	2.6	2.7	2.4	2.3	2.4	–2.9	–2.6	–2.8	5.7	6.2	6.2
Taiwan Province of China	2.1	3.1	3.9	0.8	1.4	2.0	11.7	11.7	10.9	4.2	4.2	4.1
Hong Kong SAR	2.9	3.7	3.8	4.3	4.0	3.8	3.1	3.3	3.9	3.1	3.1	3.1
Singapore	4.1	3.6	3.6	2.4	2.3	2.6	18.4	17.7	17.1	1.9	2.0	2.1
New Zealand	2.4	3.3	3.0	1.1	2.2	2.2	–4.2	–4.9	–5.4	6.1	5.2	4.7
Emerging and Developing Asia	**6.5**	**6.7**	**6.8**	**4.5**	**4.5**	**4.3**	**1.1**	**1.2**	**1.4**	**. . .**	**. . .**	**. . .**
China	7.7	7.5	7.3	2.6	3.0	3.0	2.1	2.2	2.4	4.1	4.1	4.1
India	4.4	5.4	6.4	9.5	8.0	7.5	–2.0	–2.4	–2.5	. . .	. . .	. . .
ASEAN-5	**5.2**	**4.9**	**5.4**	**4.4**	**4.7**	**4.4**	**0.1**	**0.3**	**0.3**	**. . .**	**. . .**	**. . .**
Indonesia	5.8	5.4	5.8	6.4	6.3	5.5	–3.3	–3.0	–2.7	6.3	6.1	5.8
Thailand	2.9	2.5	3.8	2.2	2.3	2.1	–0.7	0.2	0.3	0.7	0.7	0.8
Malaysia	4.7	5.2	5.0	2.1	3.3	3.9	3.8	4.0	4.0	3.1	3.0	3.0
Philippines	7.2	6.5	6.5	2.9	4.4	3.6	3.5	3.2	2.6	7.1	6.9	6.8
Vietnam	5.4	5.6	5.7	6.6	6.3	6.2	6.6	4.3	3.5	4.4	4.4	4.4
Other Emerging and Developing Asia[5]	**6.2**	**6.7**	**7.1**	**6.8**	**6.6**	**6.4**	**–2.1**	**–1.4**	**–1.2**	**. . .**	**. . .**	**. . .**
Memorandum												
Emerging Asia[6]	6.5	6.7	6.8	4.5	4.4	4.2	1.2	1.3	1.4	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Korea's real GDP series is based on the reference year 2005. This does not reflect the revised national accounts released on March 26, 2014, after the WEO was finalized for publication. These comprehensive revisions include implementing the 2008 System of National Accounts and updating the reference year to 2010. As a result of these revisions, real GDP growth in 2013 was revised up to 3 percent from 2.8 percent.
[5]Other Emerging and Developing Asia comprises Bangladesh, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao P.D.R., Maldives, Marshall Islands, Micronesia, Mongolia, Myanmar, Nepal, Palau, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, Tuvalu, and Vanuatu.
[6]Emerging Asia comprises the ASEAN-5 economies, China, and India.

has improved sentiment, but progress on rebalancing the economy remains tentative (see Box 1.2). Fiscal reforms are expected to increase the efficiency of the tax system, and ongoing financial reforms should improve the allocation of capital and efficiency of investment, although they could also create some near-term volatility in China's capital markets (see Chapter 1). Although the inflation outlook is expected to remain benign, concerns about overinvestment and credit quality should mean a continuation of the withdrawal of monetary support for the economy through slower credit growth and higher real borrowing costs.

- *India*'s growth is expected to recover from 4.4 percent in 2013 to 5.4 percent in 2014, supported by slightly stronger global growth, improving export competitiveness, and implementation of recently approved investment projects. A pickup in exports in recent months and measures to curb gold imports have contributed to lowering the current account deficit. Policy measures to bolster capital flows have further helped reduce external vulnerabilities. Overall growth is expected to firm up on policies supporting investment and a confidence boost from recent policy actions, but will remain below trend. Consumer price inflation is expected to remain an important challenge, but should continue to move onto a downward trajectory.
- Developments in the Association of Southeast Asian Nations (ASEAN) economies will remain uneven. *Indonesia*'s growth is projected to slow this year as subdued investor sentiment and higher borrowing costs weigh on the domestic economy, although the currency depreciation since mid-2013 should give exports a lift. In *Thailand*, the near-term outlook remains

clouded by the political situation; the economy is slowing as private demand weakens and public investment plans are delayed. *Malaysia* and the *Philippines*, however, are on a more positive trajectory, and growth is expected to remain robust in both countries.

- For developing Asia, the economic outlook is largely for continued solid growth with some additional benefit from the ongoing recovery in world trade. However, in *Bangladesh*, domestic demand is expected to recover in 2014 as activity normalizes following a year of political unrest. In addition, macroeconomic imbalances related to rapid credit growth and high current account deficits in *Lao P.D.R.* and *Mongolia* are an ongoing risk.

Concerns linked to the external environment remain, but Asia is also facing various idiosyncratic domestic risks. Overall, there are three broad concerns confronting the region in the coming year (see Chapter 1)—over and above more idiosyncratic risks stemming from political tensions and uncertainties in several countries (for example, Thailand):

- *Tightening global financial conditions:* As growth in the United States improves, Asia will have to adapt to a steady increase in the global term premium. Economies with weaker fundamentals and greater reliance on global finance and trade would be most affected. In some cases, the impact could be amplified by domestic financial vulnerabilities arising from leverage in firms or households, thus negatively affecting the balance sheets of banks.
- *Less effective Abenomics:* In Japan, policy measures could prove less effective at boosting growth than envisaged if they fail to raise inflation expectations, nominal wages, exports, and private investment. Slower growth could have significant negative spillovers for economies with strong trade and foreign direct investment linkages with Japan, such as Indonesia and Thailand—especially if the risk of deflation returns.
- *A sharper-than-envisaged slowdown and financial sector vulnerabilities in China:* A sharper-than-envisaged slowdown in China—for instance, from the implementation of structural reforms—would have significant spillovers for the rest of the region, especially in economies linked to the regional supply chain and commodity exporters. A near-term financial crisis is unlikely, but given recent rapid credit growth and the growth of shadow banking, there could be continued news of credit problems among the trusts or potential debt-servicing problems among local governments. These could spark adverse financial market reaction both in China and globally, but they might also improve the pricing of risk and thus would be welcome.

In addition to tackling near-term vulnerabilities, Asia should also continue to push ahead with structural reforms to enhance medium-term prospects. Generally, reforms should focus on removing structural impediments to growth in India and across the ASEAN economies through higher public and private investment (particularly in infrastructure). In China, reforms that liberalize the financial system and raise the cost of capital will be key to improving the allocation of credit and boosting productivity growth. In Japan, structural reforms are needed to achieve a sustainable pickup in growth and a durable exit from deflation.

Latin America and the Caribbean: Subdued Growth

Economic activity in Latin America and the Caribbean is expected to remain in relatively low gear in 2014. The recovery in advanced economies should generate positive trade spillovers, but these are likely to be offset by lower commodity prices, tighter financial conditions, and supply bottlenecks in some countries. Growth in the Caribbean remains constrained by high debt levels and weak competitiveness. Policymakers need to focus on strengthening fiscal positions, addressing potential financial fragilities, and pressing ahead with growth-enhancing structural reforms to ease supply-side constraints.

Economic activity across Latin America and the Caribbean stayed in relatively low gear last year. Full-year growth for 2013 is estimated to have been 2¾ percent, significantly less than the growth rates observed during previous years (Figure 2.6). Weak investment and subdued demand for the region's exports held back activity, as did increasingly binding supply bottlenecks in a number of economies. Countries with stronger fundamentals were generally affected less by the market pressures in mid-2013 and early 2014 (see Chapter 1). Nonetheless, most currency, equity, and bond markets across Latin America and the Caribbean continue to trade well below the levels of 12 months ago, reflecting tighter external conditions and a reassessment of medium-term growth prospects.

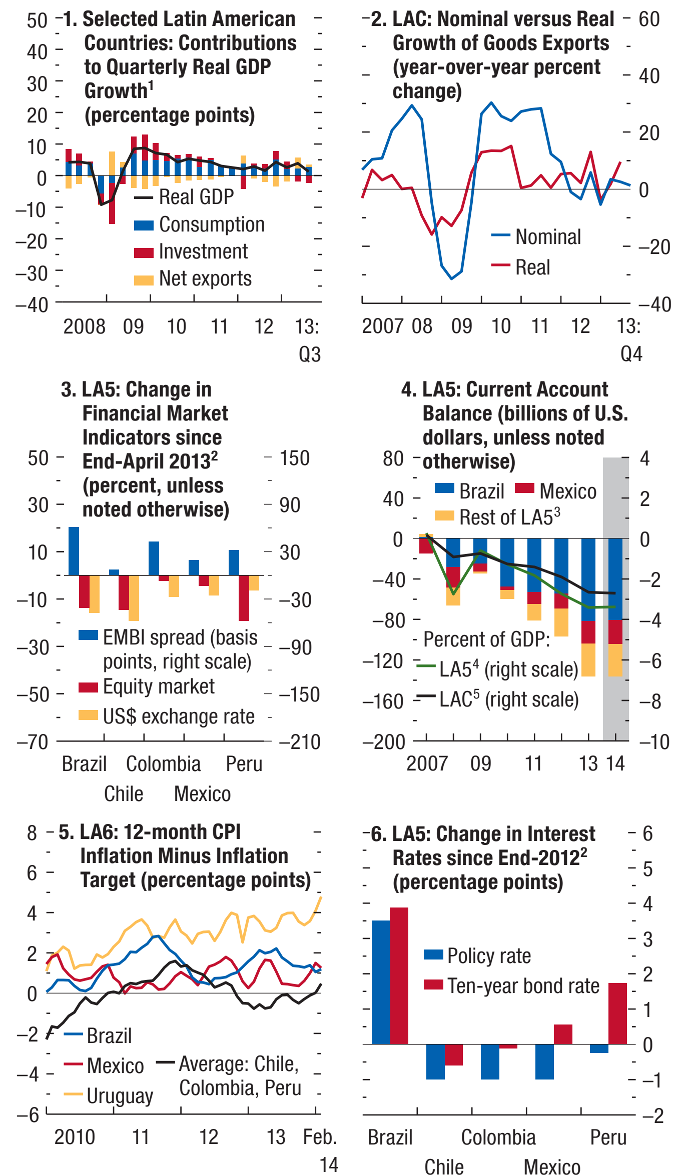
Looking ahead, regional growth is projected to remain subdued in 2014, at 2½ percent. The recovery in the advanced economies is expected to generate positive trade spillovers, but these are likely to be offset by

the impact of lower commodity prices, tighter financial conditions, and supply-side constraints in some economies. However, there is considerable variation in the outlook for different parts of the region (Table 2.4):

- Growth in *Mexico* is expected to rebound to 3 percent this year, after an unexpectedly weak growth rate of 1.1 percent in 2013. Several of the earlier headwinds to activity have eased, with fiscal policy shifting to a more accommodative stance and U.S. demand picking up. Headline inflation is forecast to stay close to the upper end of the inflation target range in the near term, as a result of one-time effects of certain tax measures. However, core inflation and inflation expectations remain well anchored. Looking further ahead, Mexico's ongoing economic reforms, especially in the energy and telecommunications sectors, herald higher potential growth for the medium term.
- *Brazil's* economy is expected to remain in low gear, with growth slowing to 1.8 percent in 2014. Weighing on activity are domestic supply constraints, especially in infrastructure, and continued weak private investment growth, reflecting loss of competitiveness and low business confidence. Inflation is expected to remain in the upper part of the official target range, as limited spare capacity and the recent depreciation of the *real* keep up price pressures. The policy mix has been skewed toward monetary tightening over the past year, with fiscal policy (including policy lending) expected to maintain a broadly neutral stance in 2014.
- Among the other financially integrated economies, *Colombia* and *Peru* are forecast to continue expanding at fairly rapid rates. Activity in *Chile* is projected to moderate somewhat because private investment growth is decelerating markedly, including in the mining sector. In all three countries, domestic consumption remains brisk, supported by record-low unemployment rates and solid growth in real wages. Nonetheless, price pressures are projected to remain contained.
- Activity in *Argentina* and *Venezuela* is expected to slow markedly during 2014, though the outlook is subject to high uncertainty. Persistently loose macroeconomic policies have generated high inflation and a drain on official foreign exchange reserves. The gap between official and market exchange rates remains large in both countries, and has continued to widen in Venezuela. Administrative measures taken to manage domestic and external imbalances, including controls on prices, exchange rates, and trade, are weighing further on confidence and activity. Recently, both countries adjusted their exchange rates, and Argentina raised interest rates, but

Figure 2.6. Latin America and the Caribbean: Subdued Growth

Growth in Latin America and the Caribbean eased further in 2013, amid subdued export performance and a continued slowdown in investment. Activity is expected to remain in low gear this year, and renewed turbulence in financial markets represents a downside risk, especially for economies with sizable external funding needs or domestic policy weaknesses.



Sources: Bloomberg, L.P.; Haver Analytics; IMF, International Financial Statistics database; national authorities; and IMF staff estimates.
Note: CPI = consumer price index; EMBI = J.P. Morgan Emerging Markets Bond Index; LAC = Latin America and the Caribbean. LA6 = Brazil, Chile, Colombia, Mexico, Peru, Uruguay. LA5 = LA6 excluding Uruguay.
[1]Weighted by GDP valued at purchasing power parity as a share of group GDP for Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, and Peru.
[2]Data as of March 24, 2014.
[3]Simple average for Chile, Colombia, and Peru.
[4]Simple average.
[5]Weighted by GDP valued at purchasing power parity as a share of group GDP.

Table 2.4. Selected Western Hemisphere Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
North America	**1.8**	**2.8**	**3.0**	**1.6**	**1.6**	**1.8**	**–2.3**	**–2.2**	**–2.5**	. . .	. . .	. . .
United States	1.9	2.8	3.0	1.5	1.4	1.6	–2.3	–2.2	–2.6	7.4	6.4	6.2
Canada	2.0	2.3	2.4	1.0	1.5	1.9	–3.2	–2.6	–2.5	7.1	7.0	6.9
Mexico	1.1	3.0	3.5	3.8	4.0	3.5	–1.8	–1.9	–2.0	4.9	4.5	4.3
South America[4]	**3.2**	**2.3**	**2.7**	**8.1**	. . .	. . .	**–2.7**	**–2.8**	**–2.9**	. . .	. . .	. . .
Brazil	2.3	1.8	2.7	6.2	5.9	5.5	–3.6	–3.6	–3.7	5.4	5.6	5.8
Argentina[5,6]	4.3	0.5	1.0	10.6	. . .	. . .	–0.9	–0.5	–0.5	7.1	7.6	7.6
Colombia	4.3	4.5	4.5	2.0	1.9	2.9	–3.3	–3.3	–3.2	9.7	9.3	9.0
Venezuela	1.0	–0.5	–1.0	40.7	50.7	38.0	2.7	2.4	1.8	9.2	11.2	13.3
Peru	5.0	5.5	5.8	2.8	2.5	2.1	–4.9	–4.8	–4.4	7.5	6.0	6.0
Chile	4.2	3.6	4.1	1.8	3.5	2.9	–3.4	–3.3	–2.8	5.9	6.1	6.2
Ecuador	4.2	4.2	3.5	2.7	2.8	2.6	–1.5	–2.4	–3.1	4.7	5.0	5.0
Bolivia	6.8	5.1	5.0	5.7	6.8	5.3	3.7	3.7	2.4	6.4	6.3	6.2
Uruguay	4.2	2.8	3.0	8.6	8.3	8.0	–5.9	–5.5	–5.2	6.3	6.8	6.9
Paraguay	13.0	4.8	4.5	2.7	4.7	5.0	0.9	–0.9	–1.6	5.4	5.5	5.5
Central America[7]	**4.0**	**4.0**	**4.0**	**4.2**	**3.8**	**4.4**	**–6.9**	**–6.5**	**–6.2**	. . .	. . .	. . .
Caribbean[8]	**2.8**	**3.3**	**3.3**	**5.0**	**4.4**	**4.5**	**–3.7**	**–3.2**	**–3.2**	. . .	. . .	. . .
Memorandum												
Latin America and the Caribbean[9]	2.7	2.5	3.0	6.8	. . .	. . .	–2.7	–2.7	–2.8	. . .	. . .	. . .
Excluding Argentina	2.5	2.8	3.2	6.4	6.8	5.9	–2.8	–2.9	–3.0	. . .	. . .	. . .
Eastern Caribbean Currency Union[10]	0.5	1.4	1.8	1.0	1.2	1.8	–17.6	–17.1	–16.7	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.

[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.

[2]Percent of GDP.

[3]Percent. National definitions of unemployment may differ.

[4]Includes Guyana and Suriname. See note 6 regarding consumer prices.

[5]The data for Argentina are officially reported data. The IMF has, however, issued a declaration of censure and called on Argentina to adopt remedial measures to address the quality of the official GDP data. Alternative data sources have shown significantly lower real growth than the official data since 2008. In this context, the Fund is also using alternative estimates of GDP growth for the surveillance of macroeconomic developments in Argentina.

[6]The data for Argentina are officially reported data. Consumer price data from January 2014 onwards reflect the new national CPI (IPCNu), which differs substantively from the preceding CPI (the CPI for the Greater Buenos Aires Area, CPI-GBA). Because of the differences in geographical coverage, weights, sampling, and methodology, the IPCNu data cannot be directly compared to the earlier CPI-GBA data. Because of this structural break in the data, staff forecasts for CPI inflation are not reported in the Spring 2014 *World Economic Outlook*. Following a declaration of censure by the IMF on February 1, 2013, the public release of a new national CPI by end-March 2014 was one of the specified actions in the IMF Executive Board's December 2013 decision calling on Argentina to address the quality of its official CPI data. The Executive Board will review this issue again as per the calendar specified in December 2013 and in line with the procedures set forth in the Fund's legal framework.

[7]Central America comprises Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

[8]The Caribbean comprises Antigua and Barbuda, The Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

[9]Latin America and the Caribbean comprises Mexico and economies from the Caribbean, Central America, and South America. See note 6.

[10]Eastern Caribbean Currency Union comprises Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, as well as Anguilla and Montserrat, which are not IMF members.

more significant policy changes are needed to stave off a disorderly adjustment.

- *Bolivia*'s economy expanded strongly last year and is expected to remain above potential in 2014, driven by a sharp increase in hydrocarbon exports and accommodative macroeconomic policies. Growth in *Paraguay* also rebounded in 2013 as the agricultural sector recovered from a severe drought.
- Growth in *Central America* is expected to remain broadly unchanged, at 4.0 percent, as the boost from the pickup in economic activity in the United States is offset by fiscal policy tightening in some countries, the effects of a disease on coffee production, reduced financing from Venezuela, and other country-specific factors.
- The *Caribbean* continues to face a challenging economic environment, marked by low growth, high indebtedness, and financial fragilities. Nonetheless, activity is expected to recover modestly this year in the tourism-dependent economies as tourism flows firm up.

Risks to the outlook remain considerable. On the upside, a stronger-than-expected pickup in U.S.

growth could lift the region's exports, although positive trade spillovers would be concentrated in Mexico and a few Central American and Caribbean countries. On the downside, a faster-than-anticipated rise in U.S. interest rates could cause fresh financial headwinds, especially if capital flows were to reverse abruptly. In addition, further downward pressure on commodity prices caused by a sharper-than-expected investment slowdown in China or other factors would be a drag on the commodity exporters in the region.

Against this backdrop, policymakers across Latin America and the Caribbean should focus on improving domestic fundamentals to reduce their economies' vulnerability to external shocks. A gradual reduction in fiscal deficits and public debt levels remains appropriate for countries with large fiscal imbalances, as well as those with limited spare capacity and elevated external current account deficits. Further improvements in the transparency and credibility of fiscal frameworks would also help strengthen investor confidence. In the same vein, it is critical to ensure strong prudential oversight of the financial sector and preemptively address fragilities that could come to the fore if interest rates were to rise sharply or growth to slow further.

Exchange rate flexibility has already helped countries adjust to last year's financial market turmoil and should remain an important buffer in the event of renewed volatility. Meanwhile, monetary policy easing remains the first line of defense against a further growth slowdown in economies with low inflation and anchored inflation expectations. In countries with persistent inflation pressures, which could be exacerbated by further exchange rate depreciation, both monetary and fiscal policy should focus on anchoring inflation expectations.

Structural reforms to raise productivity and strengthen competitiveness are also crucial. Above all, the region needs to invest more, and more effectively, in infrastructure and human capital; address obstacles to greater labor force participation in the formal sector; and improve the business and regulatory environment.

Commonwealth of Independent States: Subdued Prospects

Growth in the Commonwealth of Independent States (CIS) remains subdued despite robust consumption, reflecting weak investment, political tensions, and policy uncertainty in some cases. Geopolitical tensions are casting a pall on part of this region. By contrast, growth is brisk in the Caucasus and Central Asia (CCA). Policies should focus on implementing reforms and increasing investment to raise growth potential, and for some countries, correcting serious imbalances is another priority.

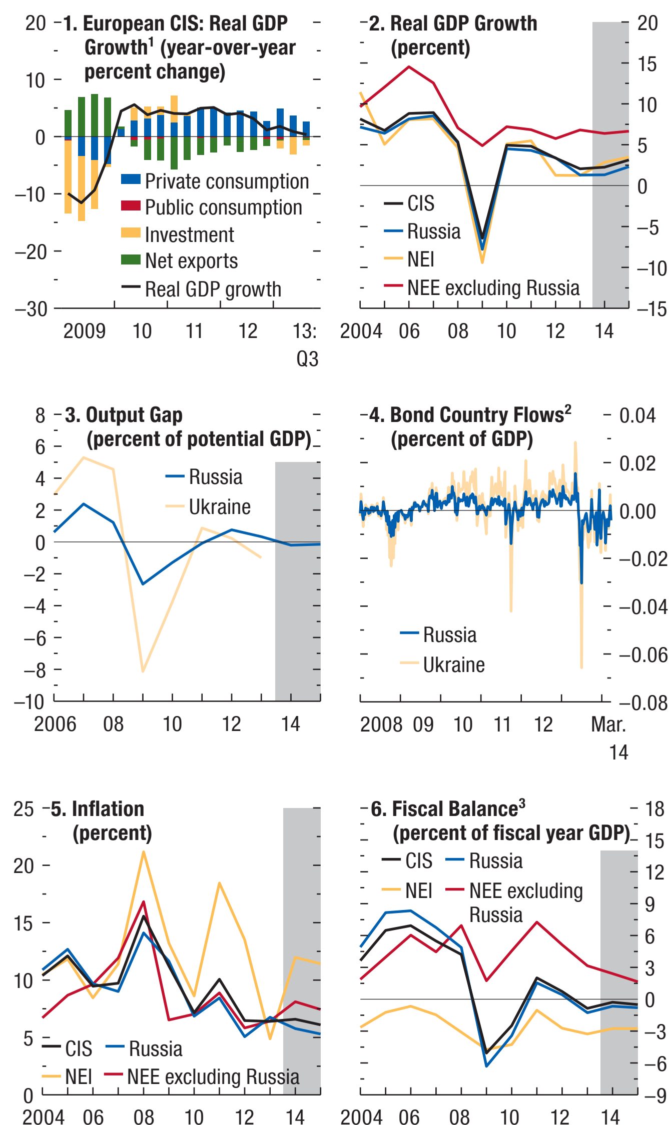
Growth in the European CIS economies continued to soften in the second half of 2013 and was further slowed by geopolitical tensions in early 2014 (Figure 2.7). Russia's growth remained subdued during 2013. Despite strong consumption, activity was constrained by weak investment and the slow global recovery. A bumper harvest and resilient private consumption lifted Ukraine from recession in the fourth quarter of 2013, but large domestic and external imbalances have persisted. Volatility in capital flows increased sharply from the summer onward as concerns over Federal Reserve tapering intensified. In early 2014 domestic political turmoil and the takeover of the Crimea by Russia adversely affected Ukraine's economy and sent spillover waves across the region. The near-term growth outlook for Russia, already weakened, has been further affected by these geopolitical tensions. As the ruble faced downward pressures, with capital outflows intensifying, the central bank temporarily reverted to discretion and increased its foreign exchange intervention. Growth in the CCA region increased by about 1 percentage point to about 6½ percent in 2013, despite the slowdown in Russia, one of the region's main trading partners.

Growth in the European CIS economies will remain weak, while the near-term outlook for the CCA is expected to soften to 6.2 percent in 2014 (Table 2.5).

- *Russia*'s GDP growth is projected to be subdued at 1.3 percent in 2014. The fallout from emerging market financial turbulence and geopolitical tensions relating to Ukraine are headwinds on the back of already weak activity.
- In *Ukraine*, output will likely drop significantly as the acute economic and political shocks take their toll on investment and consumption. Toward the end of 2014, net exports and investment recovery should bring back moderate growth.
- *Belarus*'s growth will remain lackluster at 1.6 percent in 2014. In *Moldova,* GDP growth will moderate to 3½ percent in 2014, mainly reflecting the expected slowdown in agriculture.
- Strengthening external demand as well as recovery of domestic demand in *Armenia* and *Georgia* owing to fiscal easing, and increased hydrocarbon exports from *Turkmenistan* on past expansions in productive capacity, will support economic activity in the CCA,

Figure 2.7. Commonwealth of Independent States: Subdued Prospects

Growth in the Commonwealth of Independent States (CIS) has continued to soften, reflecting further deceleration in Russia and weak external demand elsewhere, and capital flows to the region have declined. Policies should focus on implementing stronger reforms to raise growth potential, and for some countries, correcting serious imbalances.



Sources: EPFR Global/Haver Analytics; Haver Analytics; and IMF staff estimates.
Note: Net energy exporters (NEE) = Azerbaijan, Kazakhstan, Russia, Turkmenistan, Uzbekistan. Net energy importers (NEI) = Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Tajikistan, Ukraine. All country group aggregates are weighted by GDP valued at purchasing power parity as a share of group GDP. Projections for Ukraine are excluded due to the ongoing crisis.
[1]European CIS includes Belarus, Moldova, Russia, and Ukraine.
[2]Data through March 18, 2014.
[3]General government net lending/borrowing except in the case of NEI, for which it is the overall balance.

despite a temporary weakening of oil output growth in *Kazakhstan* and flat gold exports from the *Kyrgyz Republic.*

Inflation will be broadly stable at about 6 percent in 2014, but remains high in some economies (Table 2.5). In Russia, it exceeded the target range in 2013 partly because of a temporary uptick in food prices and ruble depreciation and will likely remain higher than the 2014 midpoint target. In Kazakhstan, the recent devaluation of the tenge will add to inflation pressure this year. Inflation has declined in Belarus but will remain in double digits under current policies, whereas it is expected to remain within central banks' targets in most of the CCA countries. In Georgia, inflation is expected to come close to the 5 percent target in 2015, on a pickup in domestic demand and some recent currency depreciation. In Uzbekistan, inflation will continue to linger in the double digits because of increases in administered prices, currency depreciation, and strong credit growth.

The balance of risks remains to the downside, considering rising geopolitical uncertainties following the takeover of the Crimea by Russia, tightening financial conditions, and volatile capital flows. Intensification of sanctions and countersanctions could affect trade flows and financial assets. Contagion could spread through real (trade, remittances) and financial (asset valuation, banking) channels. Even in the absence of sanctions, lower growth in Russia and Ukraine could have a significant impact on neighboring economies over the medium term. Softer commodity prices (see the Commodity Special Feature in Chapter 1) would delay recovery in Ukraine and hamper growth in Russia and in the CCA hydrocarbon exporters. However, countries with large foreign asset buffers would be less affected. Growth in the CCA oil importers would also weaken if growth prospects in emerging markets were to be revised down, with adverse effects on trade, remittances, and project funding, especially considering limited external and fiscal buffers. A slowdown in Russia owing to unsettled conditions would affect the CCA through both real sector and financial channels, particularly if energy supply is disrupted and oil and gas prices rise. On the upside, a stronger recovery in advanced economies could keep oil and gas prices high, benefiting both the oil and gas exporters and the commodity importers through a stronger-than-expected recovery in Russia.

Policies should aim to preserve macroeconomic stability and boost growth potential with ambitious reforms. To manage the potential effects of emerging market

Table 2.5. Commonwealth of Independent States: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Commonwealth of Independent States	**2.1**	**2.3**	**3.1**	**6.4**	**6.6**	**6.1**	**0.7**	**1.9**	**1.5**	**. . .**	**. . .**	**. . .**
Net Energy Exporters	**2.2**	**2.2**	**3.1**	**6.7**	**6.2**	**5.7**	**1.9**	**2.5**	**1.9**	**. . .**	**. . .**	**. . .**
Russia	1.3	1.3	2.3	6.8	5.8	5.3	1.6	2.1	1.6	5.5	6.2	6.2
Kazakhstan	6.0	5.7	6.1	5.8	9.2	7.5	0.1	1.9	2.0	5.2	5.2	5.2
Uzbekistan	8.0	7.0	6.5	11.2	11.0	11.0	1.7	2.2	1.9	. . .	. . .	. . .
Azerbaijan	5.8	5.0	4.6	2.4	3.5	4.0	19.7	15.0	9.9	6.0	6.0	6.0
Turkmenistan	10.2	10.7	12.5	6.6	5.7	6.0	–3.3	–1.1	1.3	. . .	. . .	. . .
Net Energy Importers	**1.2**	**2.8**	**3.5**	**4.9**	**12.0**	**11.4**	**–8.9**	**–9.0**	**–7.5**	**. . .**	**. . .**	**. . .**
Ukraine[4]	0.0	. . .	. . .	–0.3	. . .	. . .	–9.2	. . .	. . .	7.4	. . .	. . .
Belarus	0.9	1.6	2.5	18.3	16.8	15.8	–9.8	–10.0	–7.8	0.6	0.6	0.6
Georgia[5]	3.2	5.0	5.0	–0.5	4.0	4.6	–6.1	–7.9	–7.3	. . .	. . .	. . .
Armenia	3.2	4.3	4.5	5.8	5.0	4.0	–8.4	–7.2	–6.8	18.5	18.0	17.9
Tajikistan	7.4	6.2	5.7	5.0	5.4	5.9	–1.9	–2.1	–2.3	. . .	. . .	. . .
Kyrgyz Republic	10.5	4.4	4.9	6.6	6.1	6.6	–12.6	–15.5	–14.3	7.6	7.6	7.5
Moldova	8.9	3.5	4.5	4.6	5.5	5.9	–4.8	–5.9	–6.4	5.2	5.6	5.3
Memorandum												
Caucasus and Central Asia[6]	6.6	6.2	6.4	6.0	7.7	7.1	2.6	3.0	2.4	. . .	. . .	. . .
Low-Income CIS Countries[7]	7.1	6.0	5.8	7.7	8.3	8.4	–2.2	–2.3	–2.2	. . .	. . .	. . .
Net Energy Exporters Excluding Russia	6.8	6.4	6.7	6.4	8.1	7.4	3.6	4.2	3.4	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Projections for Ukraine are excluded due to the ongoing crisis.
[5]Georgia, which is not a member of the Commonwealth of Independent States (CIS), is included in this group for reasons of geography and similarity in economic structure.
[6]Includes Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
[7]Low-Income CIS countries comprise Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.

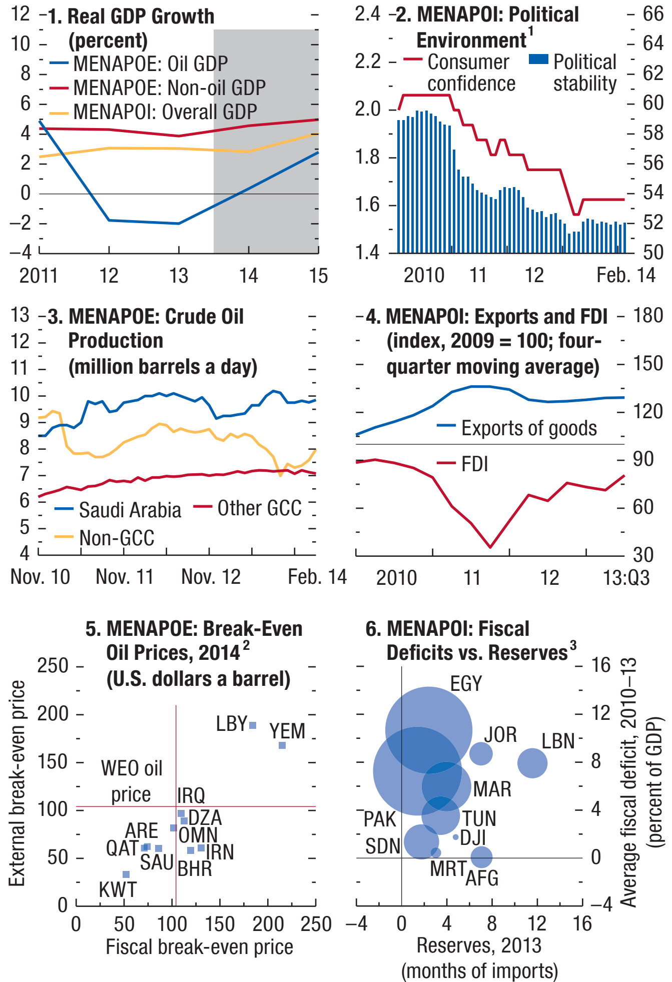
financial turmoil and geopolitical tensions, Russia should continue to rely on exchange rate flexibility to facilitate adjustment while avoiding excessive volatility, keep monetary policy focused on anchoring inflation, and maintain a broadly neutral structural fiscal policy while allowing automatic stabilizers to work. Fiscal consolidation and tapering of quasi-fiscal losses in the energy sector are critical for economic stabilization in Ukraine. Although financial support from Russia could provide Belarus with some short-term breathing space, steps to reduce wage and credit growth and to increase exchange rate flexibility should be taken expeditiously to narrow imbalances. While remaining committed to medium-term consolidation, Armenia and Georgia are planning some fiscal stimulus in 2014. Structural reforms to improve the business environment, diversify the economy, and enhance external competitiveness are also needed across the region for strong growth to last and become more inclusive in the years ahead.

The Middle East and North Africa: Turning the Corner?

Growth was tepid across the Middle East and North Africa, Afghanistan, and Pakistan (MENAP) in 2013, as declines in oil production and weak private investment growth amid continued political transitions and conflict offset increases in public spending. Economic activity will strengthen in 2014–15 as export growth improves in line with trading partners' recoveries and public and private investment accelerates. However, weak confidence, high unemployment, low competitiveness, and in many cases, large public deficits will continue to weigh on economic prospects in the region. Risks are tilted to the downside on slow progress in reforms during complex political transitions. Reforms to raise and diversify potential output and improve competitiveness and resilience are essential for achieving sustainable and inclusive growth and creating jobs.

Figure 2.8. Middle East, North Africa, Afghanistan, and Pakistan: Turning a Corner?

Growth was tepid across the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) in 2013, as high public spending was offset by declines in oil supply and weak non-oil exports amid continued sociopolitical upheaval. Robust non-oil activity on high public spending and recovery in oil production, however, should accelerate activity this year.



Sources: Haver Analytics; IMF, Direction of Trade Statistics database; International Energy Agency; national authorities; PRS Group, Inc., *International Country Risk Guide;* and IMF staff estimates.
Note: MENAP oil exporters (MENAPOE) = Algeria (DZA), Bahrain (BHR), Iran (IRN), Iraq (IRQ), Kuwait (KWT), Libya (LBY), Oman (OMN), Qatar (QAT), Saudi Arabia (SAU), United Arab Emirates (ARE), and Yemen (YEM); MENAP oil importers (MENAPOI) = Afghanistan (AFG), Djibouti (DJI), Egypt (EGY), Jordan (JOR), Lebanon (LBN), Mauritania (MRT), Morocco (MAR), Pakistan (PAK), Sudan (SDN), Syria (SYR), and Tunisia (TUN). FDI = foreign direct investment; GCC = Gulf Cooperation Council. Data from 2011 onward exclude SYR. Country group aggregates for panel 1 and exports of goods in panel 4 are weighted by purchasing-power-parity GDP as a share of group GDP; panel 2 shows simple averages (excludes AFG, DJI, and MRT); panel 3 and FDI (for EGY, MAR, PAK, and TUN) in panel 4 show sums.
[1]Consumer confidence on the left scale and political stability on the right scale. Higher values of the consumer confidence measure (political stability rating) signify greater consumer confidence (political stability).
[2]Prices at which the government budget and current account are balanced, respectively. YEM data are for 2013.
[3]Bubble size is relative to each country's 2013 purchasing-power-parity GDP.

Oil-Exporting Economies

For MENAP oil exporters, economic activity moderated in 2013 to about 2 percent, less than half the growth rate experienced in recent years. Growth in the non-oil economy was supported by sustained public investment in infrastructure and private credit expansion. However, tepid global oil demand, increased oil supply from the United States, and regional oil supply disruptions—mainly those in Libya, where a wave of instability caused oil output to fall to about one-third of capacity—slowed growth in the oil sectors (Figure 2.8; also see the Commodity Special Feature in Chapter 1).

As oil output stabilizes alongside strengthening global activity and sustained consumption and investment, total GDP growth is expected to rise to about 3½ percent in 2014 (Table 2.6). In the United Arab Emirates, where real estate prices are rising at a fast pace, the award of World Expo 2020 has further strengthened growth prospects. Likewise, Qatar has embarked on a large public investment program to advance economic diversification and prepare for the Fédération Internationale de Football Association 2022 World Cup.

Softening food prices are expected to contain inflation at less than 5 percent in most oil exporters. A notable exception is the Islamic Republic of Iran, which is experiencing stagflation despite some recent improvements in the outlook resulting from temporary easing of some international sanctions.

Falling oil revenues are already causing fiscal surpluses to decline, to 2.6 percent in 2014, despite withdrawal of the fiscal stimulus initiated by many countries during the global recession and the Arab Spring. Large current account surpluses are also expected to decline because of lower oil revenues (Table 2.6). Although fiscal positions have been weakening across the Gulf Cooperation Council (GCC) economies over the past several years, most still have substantial buffers to withstand large shocks to oil prices, provided the shocks are short lived.

Risks to the near-term outlook for oil exporters have declined. The recent interim agreement between the P5+1 and Iran has eased geopolitical tensions, and the potential for further large oil supply disruptions in other non-GCC countries now appears more limited. Faster-than-expected growth in the U.S. oil supply and lingering risks of weaker-than-expected global oil demand because of a slowdown in either emerging markets or

Table 2.6. Selected Middle East and North African Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Middle East and North Africa	**2.2**	**3.2**	**4.5**	**10.5**	**8.4**	**8.3**	**10.3**	**8.7**	**6.6**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**2.0**	**3.4**	**4.6**	**11.3**	**8.4**	**8.3**	**14.1**	**11.9**	**9.7**	**. . .**	**. . .**	**. . .**
Iran	–1.7	1.5	2.3	35.2	23.0	22.0	8.1	5.2	2.8	12.9	14.0	14.6
Saudi Arabia	3.8	4.1	4.2	3.5	3.0	3.2	17.4	15.8	13.3	5.5	. . .	. . .
Algeria	2.7	4.3	4.1	3.3	4.0	4.0	0.4	0.5	–1.3	9.8	9.4	9.0
United Arab Emirates	4.8	4.4	4.2	1.1	2.2	2.5	14.9	13.3	12.4	. . .	. . .	. . .
Qatar	6.1	5.9	7.1	3.1	3.6	3.5	29.2	25.4	20.5	. . .	. . .	. . .
Kuwait	0.8	2.6	3.0	2.7	3.4	4.0	38.8	37.4	34.2	2.1	2.1	2.1
Iraq	4.2	5.9	6.7	1.9	1.9	3.0	0.0	1.0	1.2	. . .	. . .	. . .
Oil Importers[5]	**2.7**	**2.7**	**4.2**	**7.9**	**8.5**	**8.2**	**–6.4**	**–5.5**	**–6.4**	**. . .**	**. . .**	**. . .**
Egypt	2.1	2.3	4.1	6.9	10.7	11.2	–2.1	–1.3	–4.6	13.0	13.0	13.1
Morocco	4.5	3.9	4.9	1.9	2.5	2.5	–7.4	–6.6	–5.8	9.2	9.1	9.0
Tunisia	2.7	3.0	4.5	6.1	5.5	5.0	–8.4	–6.7	–5.7	16.7	16.0	15.0
Sudan	3.4	2.7	4.6	36.5	20.4	14.3	–10.6	–8.2	–7.1	9.6	8.4	8.0
Lebanon	1.0	1.0	2.5	3.2	2.0	2.0	–16.2	–15.8	–13.9	. . .	. . .	. . .
Jordan	3.3	3.5	4.0	5.5	3.0	2.4	–11.1	–12.9	–9.3	12.2	12.2	12.2
Memorandum												
Middle East, North Africa, Afghanistan, and Pakistan	2.4	3.2	4.4	10.1	8.5	8.3	9.5	8.0	6.1	. . .	. . .	. . .
Pakistan	3.6	3.1	3.7	7.4	8.8	9.0	–1.0	–0.9	–1.0	6.7	6.9	7.2
Afghanistan	3.6	3.2	4.5	7.4	6.1	5.5	2.8	3.3	–0.3	. . .	. . .	. . .
Israel[6]	3.3	3.2	3.4	1.5	1.6	2.0	2.5	1.4	1.7	6.4	6.7	6.5
Maghreb[7]	2.0	2.9	7.5	3.3	3.9	4.0	–3.2	–6.1	–5.8	. . .	. . .	. . .
Mashreq[8]	2.1	2.2	3.9	6.4	9.3	9.7	–4.7	–4.3	–6.1	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Includes Bahrain, Libya, Oman, and Yemen.
[5]Includes Djibouti and Mauritania. Excludes Syria due to the uncertain political situation.
[6]Israel, which is not a member of the region, is included for reasons of geography. Note that Israel is not included in the regional aggregates.
[7]The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia.
[8]The Mashreq comprises Egypt, Jordan, and Lebanon. Excludes Syria due to the uncertain political situation.

advanced economies present downside risks to oil prices and GCC production. Policy priorities continue to be centered on diversifying these economies to reduce dependence on oil, increase employment opportunities in the private sector for nationals, and enhance resilience to shocks. Reforms to foster entrepreneurship, along with public wage and employment restraint, are key. Fiscal policy needs to manage demand pressures, preserve wealth for future generations, and ensure efficient public capital spending. Reduction of energy subsidies, currently ranging from 4 percent to 12½ percent of GDP, would curtail energy consumption and free up resources for targeted social spending and to help finance public investment. Eliminating subsidies should be gradual and would require an effective communications strategy to broaden public support and reduce the risk of policy reversals.

Oil-Importing Economies

In 2013, three years after the Arab Spring, recovery in the MENAP oil importers remained sluggish. Uncertainties arising from political transitions and social unrest and drag from unresolved structural problems continued to weigh on confidence and economic activity. Despite supportive fiscal and monetary policies, growth has hovered around 3 percent since 2011—half the rate needed to reduce the region's high and persistent unemployment and improve living standards.

The outlook is for continued slow recovery, with growth lingering around 3 percent in 2014 before rising to 4 percent in 2015. Export growth will strengthen gradually as internal demand in trading partner countries, particularly those in Europe, recovers. Recent

reforms set in motion to relax supply-side constraints and enhance competitiveness should also help improve confidence, spurring economic activity and foreign direct investment. However, domestic demand will remain subdued because of lingering policy uncertainty. In some countries, fiscal stimulus will turn into a slight fiscal drag, because consolidation is necessary to arrest erosion of fiscal and external buffers. Inflation will rise slightly to 8.5 percent, with upward pressure from energy subsidy phase-outs partly offset by declining global commodity prices (Table 2.6).

Beyond these broad trends, country-specific outlooks are as follows:

- In *Egypt,* growth in 2014 is expected to be broadly the same as in 2013, as political uncertainty will continue to weigh on tourism and foreign direct investment, notwithstanding the fiscal stimulus supported by GCC financing. Large imbalances will persist unless structural reforms and fiscal consolidation are initiated.
- The Syrian conflict continues to weigh heavily on *Lebanon*, with intensification of sectarian violence, hampered confidence, and added pressures to a deteriorating fiscal position—leaving growth flat in 2014. The conflict has also significantly increased the fiscal adjustment and financing burden in *Jordan.*
- In *Pakistan*, faster-than-expected manufacturing sector recovery, reflecting improved electricity supply and recent exchange rate depreciation, is being partly offset by weak cotton production.
- *Tunisian* growth is expected to strengthen, spurred by improved confidence from a new constitution, reduced security tensions, and preelection reforms.
- Economic activity in *Morocco* will slow, albeit increasingly driven by the nonagricultural sectors, owing to reforms supporting economic diversification.

The recovery remains fragile, and risks are to the downside. Political transitions, intensification of social and security tensions, and spillovers from regional conflicts could damage confidence and threaten macroeconomic stability. Lower-than-expected growth in emerging market economies, Europe, or the GCC could slow exports. Domestic interest rates may rise in countries with limited exchange rate flexibility if global financial conditions tighten sharply, although reliance on official external financing and bond guarantees should limit these effects. On the upside, faster progress in political transitions and economic reforms could boost confidence and growth.

A lasting improvement in economic prospects will require structural reforms, from lowering the cost of doing business to deepening trade integration with international and regional markets. Many of these reforms are difficult to implement during political transitions. However, some measures can be pursued immediately and should help improve confidence: streamlining business regulations, training the unemployed and unskilled, and improving customs procedures, for example.

Macroeconomic policies need to balance the dual goals of bolstering growth and ensuring economic stability. Broadening the tax base in some countries as a means of mobilizing resources to finance higher social spending and public investment would help. Increases in public investment and social support to the poor can also help boost domestic demand. Given large fiscal deficits and debt, these public expenditures have to be financed by reorienting spending away from generalized subsidies that benefit the rich. Fiscal consolidation can proceed at a gradual pace, if financing allows, anchored in credible medium-term plans to ensure continued willingness of investors to provide adequate financing. Accommodative monetary policy, and in some cases greater exchange rate flexibility, can soften the near-term adverse impact of fiscal consolidation on growth, while strengthening external buffers.

Sub-Saharan Africa: Accelerating Growth

Growth in sub-Saharan Africa remains robust and is expected to accelerate in 2014. Tight global financing conditions or a slowdown in emerging market economies could generate some external headwinds, especially for middle-income countries with large external linkages, producers of natural resources, and frontier economies.[1] However, some of the most salient risks are domestic, stemming from policy missteps in various countries, security threats, and domestic political uncertainties ahead of elections. Policymakers should avoid a procyclical fiscal stance in fast-growing countries, tackle emerging risks in countries facing major fiscal imbalances, address vulnerabilities in those countries more exposed to external shocks, and foster sustainable and inclusive growth.

Growth in sub-Saharan Africa remained strong in 2013 at 4.8 percent, virtually unchanged from 2012, underpinned by improved agricultural production and

[1]Frontier market economies in sub-Saharan Africa include Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

Table 2.7. Selected Sub-Saharan African Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Sub-Saharan Africa	**4.9**	**5.4**	**5.5**	**6.3**	**6.1**	**5.9**	**–3.6**	**–3.6**	**–3.9**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**5.8**	**6.7**	**6.7**	**7.4**	**6.9**	**6.6**	**3.9**	**3.3**	**2.1**	**. . .**	**. . .**	**. . .**
Nigeria	6.3	7.1	7.0	8.5	7.3	7.0	4.7	4.9	4.0	. . .	. . .	. . .
Angola	4.1	5.3	5.5	8.8	7.7	7.7	5.0	2.2	–0.4	. . .	. . .	. . .
Equatorial Guinea	–4.9	–2.4	–8.3	3.2	3.9	3.7	–12.0	–10.2	–10.9	. . .	. . .	. . .
Gabon	5.9	5.7	6.3	0.5	5.6	2.5	10.6	6.9	4.5	. . .	. . .	. . .
Republic of Congo	4.5	8.1	5.8	4.6	2.4	2.4	–1.2	2.0	0.1	. . .	. . .	. . .
Middle-Income Countries[5]	**3.0**	**3.4**	**3.7**	**5.8**	**5.9**	**5.5**	**–5.7**	**–5.1**	**–4.9**	**. . .**	**. . .**	**. . .**
South Africa	1.9	2.3	2.7	5.8	6.0	5.6	–5.8	–5.4	–5.3	24.7	24.7	24.7
Ghana	5.4	4.8	5.4	11.7	13.0	11.1	–13.2	–10.6	–7.8	. . .	. . .	. . .
Cameroon	4.6	4.8	5.1	2.1	2.5	2.5	–4.4	–3.5	–3.6	. . .	. . .	. . .
Côte d'Ivoire	8.1	8.2	7.7	2.6	1.2	2.5	–1.2	–2.2	–2.0	. . .	. . .	. . .
Botswana	3.9	4.1	4.4	5.8	3.8	3.4	–0.4	0.4	0.2	. . .	. . .	. . .
Senegal	4.0	4.6	4.8	0.8	1.4	1.7	–9.3	–7.5	–6.6	. . .	. . .	. . .
Low-Income Countries[6]	**6.5**	**6.8**	**6.8**	**6.0**	**5.5**	**5.5**	**–11.8**	**–11.8**	**–11.7**	**. . .**	**. . .**	**. . .**
Ethiopia	9.7	7.5	7.5	8.0	6.2	7.8	–6.1	–5.4	–6.0	. . .	. . .	. . .
Kenya	5.6	6.3	6.3	5.7	6.6	5.5	–8.3	–9.6	–7.8	. . .	. . .	. . .
Tanzania	7.0	7.2	7.0	7.9	5.2	5.0	–14.3	–13.9	–12.9	. . .	. . .	. . .
Uganda	6.0	6.4	6.8	5.4	6.3	6.3	–11.7	–12.6	–12.1	. . .	. . .	. . .
Democratic Republic of the Congo	8.5	8.7	8.5	0.8	2.4	4.1	–9.9	–7.9	–7.2	. . .	. . .	. . .
Mozambique	7.1	8.3	7.9	4.2	5.6	5.6	–41.9	–42.8	–43.2	. . .	. . .	. . .
Memorandum												
Sub-Saharan Africa Excluding South Sudan	4.7	5.4	5.4	6.4	6.1	5.9	–3.6	–3.6	–4.0	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Includes Chad and South Sudan.
[5]Includes Cabo Verde, Lesotho, Mauritius, Namibia, Seychelles, Swaziland, and Zambia.
[6]Includes Benin, Burkina Faso, Burundi, Central African Republic, Comoros, Eritrea, The Gambia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Niger, Rwanda, São Tomé and Príncipe, Sierra Leone, Togo, and Zimbabwe.

investment in natural resources and infrastructure. Growth was robust throughout the region, especially in low-income and fragile states.[2] Outside these groups, in Nigeria growth remained strong owing to relatively high oil prices, despite security problems in the north and large-scale oil theft in the first half of 2013. In contrast, growth in South Africa continued to decelerate, constrained by tense industrial relations in the mining sector, tight electricity supply, anemic private investment, and weak consumer and investor confidence (Table 2.7).

[2]Fragile states include Burundi, the Central African Republic, the Comoros, the Democratic Republic of the Congo, Côte d'Ivoire, Eritrea, Guinea, Guinea-Bissau, Liberia, São Tomé and Príncipe, Togo, and Zimbabwe. This list does not include some fragile countries where oil sales account for a major share of exports and government revenue, which are classified as oil exporters.

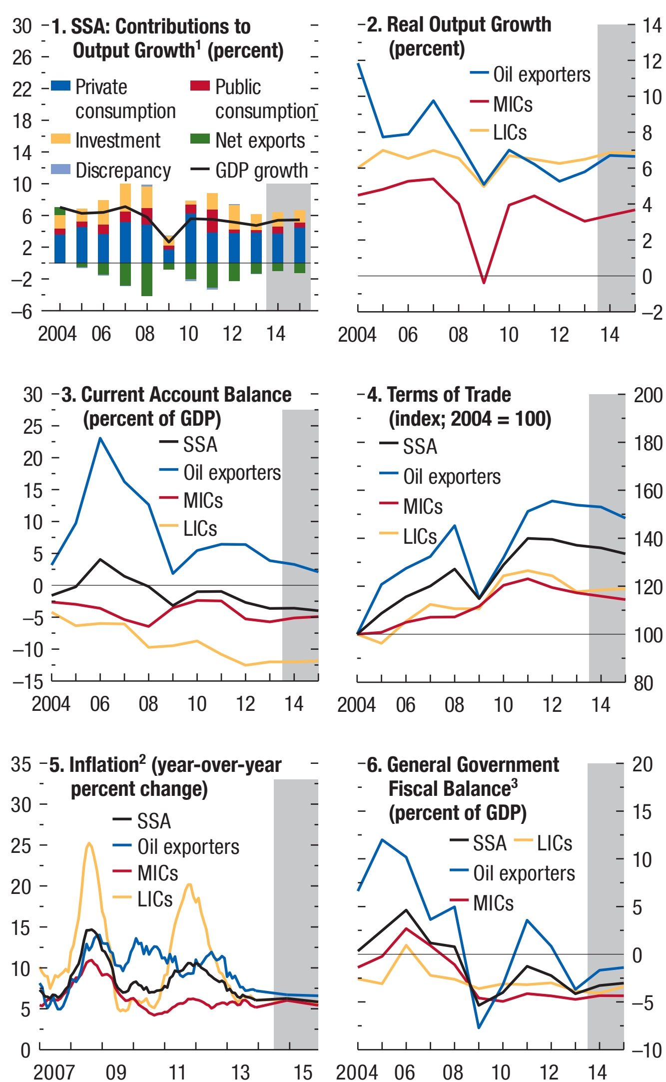
Inflation continued to abate, with a few exceptions (Figure 2.9). The currencies of South Africa and some frontier market economies weakened, reflecting tightening global monetary conditions and, in some instances, weak external or fiscal balances (Ghana, Nigeria, South Africa, Zambia). Because of high fiscal deficits, a few countries' credit ratings were downgraded, putting additional pressure on yields, and some countries postponed sovereign bond issuance.

Growth is projected to accelerate to about 5½ percent in 2014, reflecting positive domestic supply-side developments and the strengthening global recovery:

- In *South Africa,* growth is forecast to rise moderately, driven by improvements in external demand, but risks are to the downside. (See Chapter 1 for details.)
- *Nigerian* growth is projected to rebound by 0.8 percentage point, as major oil pipelines are repaired

Figure 2.9. Sub-Saharan Africa: Accelerating Growth

In 2013, investments in natural resources and infrastructure and good harvests sustained robust growth in sub-Saharan Africa. Inflation continued to abate, but fiscal deficits widened, driven by increased expenditure on investment and wages, contributing to a worsening of current account balances. Growth is projected to accelerate in 2014, helped by improved domestic supply and a favorable global environment. In the face of significant domestic and external downside risks, countries in the region should improve their resilience to shocks by strengthening their fiscal balances and increasing their budget flexibility.



Sources: Haver Analytics; IMF, International Financial Statistics database; and IMF staff estimates.
Note: LIC = low-income country (SSA); MIC = middle-income country (SSA). SSA = sub-Saharan Africa. See Table 2.7 for country groupings and the Statistical Appendix for country group aggregation methodology.
[1]Liberia, South Sudan, and Zimbabwe are excluded because of data limitations.
[2]Because of data limitations, the following are excluded: South Sudan from oil exporters; Eritrea and Zimbabwe from LICs.
[3]General government includes the central government, state governments, local governments, and social security funds.

and production in the non-oil sectors continues to expand. Other oil producers are also expected to see a significant growth pickup.

- Growth is also expected to accelerate in other countries, including several fragile states, in the wake of an improved domestic political and security situation *(Mali),* massive investments in infrastructure and mining *(Democratic Republic of the Congo, Mozambique, Niger),* and maturing investments *(Mozambique).*

Moderate food prices and prudent monetary policies should facilitate further declines in inflation in much of the region, and fiscal balances are projected to improve by about ½ percent of GDP on average. Nevertheless, the average current account deficit is not expected to narrow, owing to relatively tepid prospects for commodity prices (see the Commodity Special Feature in Chapter 1) and demand from emerging market economies, and to continuing high levels of foreign-direct-investment-related imports.

In several countries, the largest downside risks are domestic, including policy uncertainty, deteriorating security conditions, and industrial tensions. External risks are particularly important for natural resource exporters, which could suffer from a slowdown in emerging markets and a shifting pattern in China from investment- to consumption-led growth. In addition, they are important for countries with external market access, such as South Africa and frontier markets, which are most exposed to a reversal of portfolio flows if global financial conditions tighten further.

To avoid a procyclical fiscal stance and increase their resilience to shocks, fast-growing economies in the region should take advantage of the growth momentum to strengthen their fiscal balances. In a few cases in which deficits have become large or public debt is at high levels, fiscal consolidation needs to be pursued to ensure continued macroeconomic stability, and in many countries mobilizing resources for high-value spending remains a priority. Throughout the region, urgent requirements include improving the efficiency of public expenditure; investing in strategic and carefully selected projects to develop energy supply and critical infrastructure; and implementing structural reforms aimed at promoting economic diversification, private investment, and competitiveness. Monetary policies should remain focused on consolidating the gains on the inflation front. In some countries, sustained exchange rate depreciations may pose risks to the inflation outlook.

South Africa and the group of frontier market economies should prepare to weather further tightening of global financing conditions by preserving their budget flexibility and, where vulnerabilities are of particular importance, by tightening policies. These countries should be ready to adjust their financing plans in a scenario of greatly reduced access to external funding, while allowing their exchange rates to respond to changes in capital flows. Consideration should also be given to prefinancing rollovers when reasonable conditions arise. Countries should also bolster macroprudential supervision to address potential areas of strain and step up international cooperation to supervise cross-border banks and subsidiaries.

Spillover Feature: Should Advanced Economies Worry about Growth Shocks in Emerging Market Economies?

Economic activity in emerging market economies weakened during the past few months, raising concern in some quarters about the implications of a further synchronized downturn in these economies for the global economy as a whole and for the still-fragile recovery in advanced economies. Although spillovers to advanced economies from previous episodes of weak growth in emerging market economies were limited, an across-the-board negative growth shock to these economies in the present climate would likely have some effect on advanced economies, given stronger economic links between these two groups.[1]

A common growth shock in emerging market economies can spill over into advanced economies through several channels. A negative growth shock will affect demand for advanced economies' exports, which tend to be capital-intensive goods. Shocks capable of disrupting global supply chains would also adversely affect advanced economies with an upstream position in global trading networks. A growth shock in emerging market economies could influence their asset prices and currencies, which would hurt advanced economies with substantial financial exposure to these markets. Financial stresses in emerging market economies could also raise global risk aversion and lead to sharp corrections in advanced economy financial markets.

This Spillover Feature analyzes the impact on advanced economies of growth shocks emanating from emerging markets. Specifically, it addresses the following questions: What are the spillover channels and how have they changed over time? What were the spillover effects on the advanced economies from previous broad-based growth downturns in emerging market economies? How much would a widespread growth shock in emerging market economies today affect advanced economies' output growth?

The analysis in this feature suggests that a negative growth shock to emerging market economies, akin to those experienced in the mid- to late 1990s but not necessarily crisis driven, would have moderate effects on all advanced economies, with Japan affected the most. Trade has been the most prominent spillover channel. There is evidence to suggest, however, that the financial channel could play a bigger role in future transmission of growth shocks in emerging markets.

The Evolution of Trade and Financial Links between Advanced Economies and Emerging Market Economies

The growing role of emerging markets in the global economy is good reason for concern about a possible downturn. During the past half century, emerging market economies have moved from peripheral players to systemically important trade and financial centers (IMF, 2011a). In the new global economic landscape, economic linkages among advanced and emerging market economies are stronger, and advanced economies are more exposed to economic developments in the latter group.

Trade linkages between the two groups have increased sharply (Figure 2.SF.1).[2] Exports of goods to emerging market economies represent, on average, 3 percent of GDP in advanced economies (compared with 1.6 percent in 1992–2002). During the past decade, emerging market economies absorbed close to 20 percent of total exports of goods from advanced economies, and China absorbed a quarter of those exports (compared with 13 percent in the 1990s). The ratios presented in the figure are calculated using the IMF's Direction of Trade Statistics database, which measures trade in gross terms and includes both intermediate and final goods, and the IMF's World Economic Outlook (WEO) database. As discussed in IMF (2011a) and Koopman and others (2010), gross exports tend to overstate the exposure of advanced economies to emerging market economies. The reason

The author of this spillover feature is Juan Yépez, with research assistance from Angela Espiritu. Ben Hunt and Keiko Honjo prepared the model simulations.

[1]For this feature, advanced economies comprise four euro area countries (France, Germany, Italy, Spain), Japan, the United Kingdom, and the United States. Emerging market economies included are Argentina, Brazil, Chile, China, Colombia, India, Indonesia, Malaysia, Mexico, the Philippines, Poland, Russia, South Africa, Thailand, Turkey, and Venezuela.

[2]Trade linkages among emerging market economies have markedly increased as well, with exports to other emerging market economies representing, on average, 10 percent of GDP, concentrated in the largest such economies. These links, in turn, make larger emerging market economies more systemically important, particularly to commodity exporters with relatively less-diversified economies (Roache, 2012; Ahuja and Nabar, 2012).

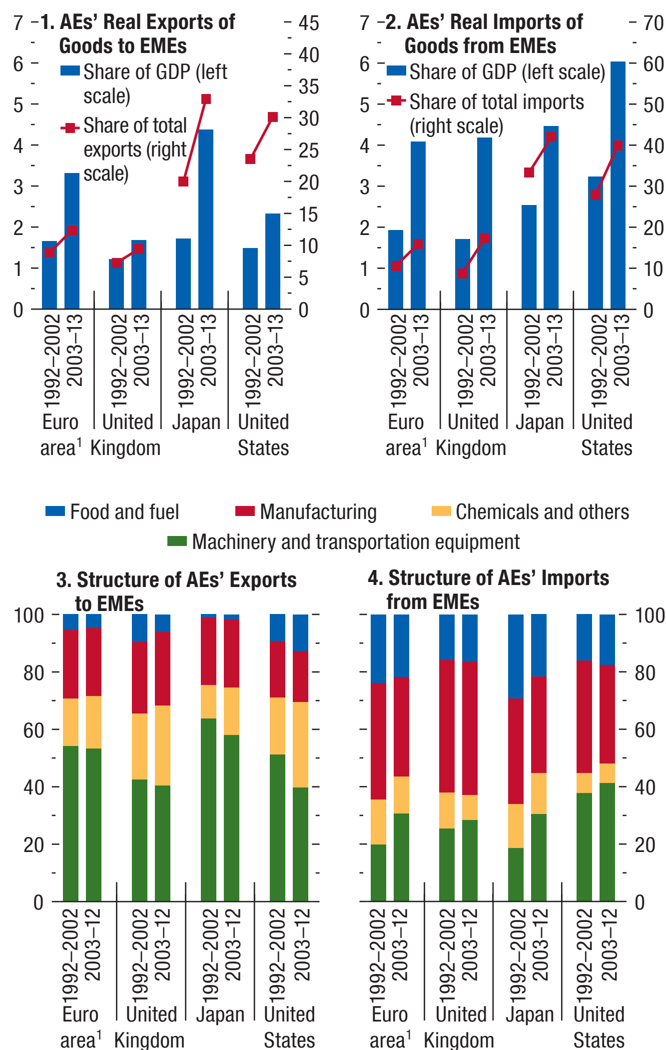
is that exports' gross value is much larger than the value added in exports to economies that engage heavily in assembly and processing trade, such as those in east Asia, because gross exports incorporate inputs from these economies. This implies that only a part of gross exports to emerging market economies depends on domestic demand in those economies. This appears to be particularly true for large manufacturing exporters such as Japan (Table 2.SF.1).

Exports from advanced economies to emerging markets are concentrated in capital goods and related products (for example, machinery and transportation equipment), although the share of capital goods in total exports has declined considerably since 2000 as high-technology exports have shifted toward the most dynamic emerging markets (IMF, 2011a).[3] Despite their marked reduction as a share of total exports in advanced economies, capital goods still represent, on average, 50 percent of total imports in emerging market economies. An abrupt downturn in the largest of these economies, accompanied by a sharp drop in investment, could hurt advanced economies that have large trade exposures to emerging market economies, particularly in capital goods. For example, capital goods constitute the bulk of exports to emerging market economies for Japan (58 percent) and the euro area (53 percent).

Advanced economies' imports from emerging market economies have also increased markedly. Imports from these economies represent, on average, 30 percent of advanced economies' total imports, and the ratio of imports to GDP has doubled as well. The composition of imports from these economies continues to be dominated by commodities (fuels and food products) and low-technology manufactured goods (food and textiles). Since 2000, however, there has been a sizable increase in the share of machinery and transportation equipment in advanced economies' imports from emerging markets—evidence of the larger role of emerging markets in global supply chains. As a result, large manufacturing exporters (namely, Japan and Germany) are particularly susceptible to any disruption in trade flows. These exporters are vulnerable because of their upstream position in regional and global supply

Figure 2.SF.1. Real Trade Linkages between Advanced Economies and Emerging Market Economies
(Percent)

Trade linkages between advanced economies (AEs) and emerging market economies (EMEs) have increased sharply in recent years. Exports from advanced economies to emerging market economies are concentrated in capital-related goods (namely, machinery and transportation equipment), whereas imports from emerging market economies continue to be dominated by commodity and low-technology manufacturing goods.



Sources: IMF, Direction of Trade Statistics database; and U.N. Commodity Trade Statistics Database.
[1]Euro area = France, Germany, Italy, and Spain. Unweighted average.

[3]This is particularly important in the United States, where machinery and transportation equipment in 2012 accounted for roughly 30 percent of total exports to emerging market economies, compared with close to 50 percent in the 1990s.

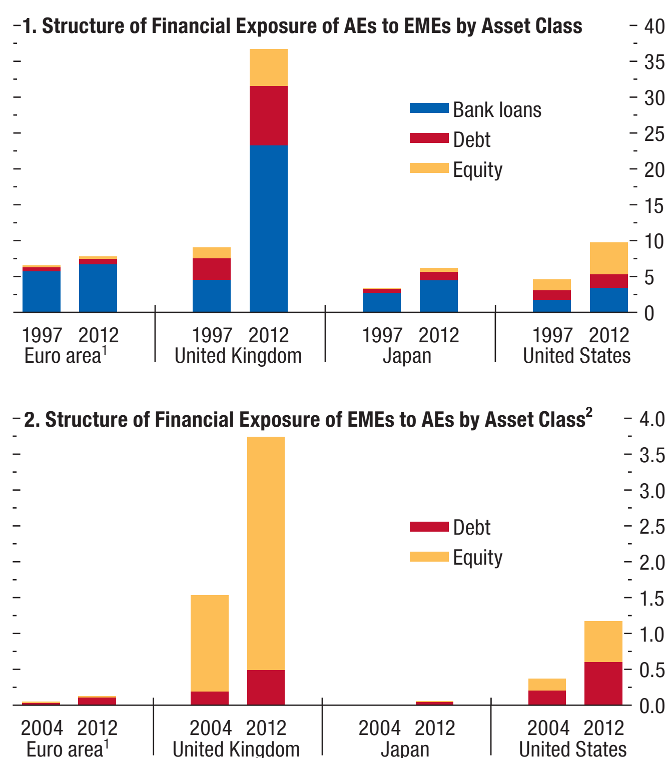
Table 2.SF.1. Exports to Emerging Market Economies, 1995 versus 2008

	(1) Ratio of Gross Exports in 2008 to Gross Exports in 1995	(2) Ratio of Value-Added Exports in 2008 to Value-Added Exports in 1995	(1)/(2) Ratio of Gross Exports to Ratio of Value-Added Exports
Euro Area	1.71	1.54	1.11
United Kingdom	1.20	1.27	0.95
Japan	2.45	1.99	1.23
United States	1.30	1.23	1.06

Source: Organization for Economic Cooperation and Development–World Trade Organization Trade in Value-Added database.

Figure 2.SF.2. Financial Exposure of Advanced Economies to Emerging Market Economies
(Percent of GDP)

Financial exposure of advanced economies (AEs) to emerging market economies (EMEs) remains concentrated in foreign bank claims, although exposure through portfolio investment has recently surged. Advanced economies that are financial centers have seen the largest increase in exposures to emerging market economies. Except in the case of China, risks from a reduction in the demand of emerging market economies for advanced economies' securities appear limited.



Sources: Bank for International Settlements; and IMF, Coordinated Portfolio Investment Survey database.
[1]Median value for France, Germany, Italy, and Spain.
[2]Excluding China.

chains and as trade networks continue to expand and become more dispersed.

Financial links have also strengthened in recent years. The median exposure of advanced economies to emerging market economies, measured as gross external asset holdings, reached 8.7 percent of GDP in 2012—an increase of almost 3.5 percentage points of GDP from the median value in 1997 (Figure 2.SF.2). Although financial exposure remains concentrated in bank claims, exposure through portfolio investment has increased, particularly in equity investment. Not surprisingly, advanced economies that are financial centers have seen the largest increase in exposures to emerging market economies. In the United Kingdom, bank claims on these economies currently represent 14 percent of total foreign bank claims, up from just 4 percent a decade ago. It is important to note that because the United Kingdom is a major financial center, gross financial exposures could overstate actual financial linkages between the United Kingdom and emerging markets.[4] Advanced economies with large exposures to emerging market economies could be susceptible to significant valuation and wealth effects resulting from sharp movements in asset prices and currencies in these economies. Given that large output drops in emerging market economies have often preceded past default episodes (Levy-Yeyati and Panizza, 2011), increased economic turbulence in those economies, coupled with bad memories of past crises, could sour investors' risk sentiment and result in sharp corrections in global financial centers.

Advanced economies could also be vulnerable to a sudden reduction in demand from emerging market economies for their debt instruments. China is the second-largest exporter of capital in the world, after the United States, and China's central bank is the

[4]In addition, most of these claims are held by two banks that, although notionally British, have very limited banking presence in the United Kingdom. This could overstate the financial exposure of the United Kingdom to emerging market economies.

largest purchaser of U.S. financial assets. (See the April 2013 *Global Financial Stability Report.*) A shock to emerging market economies capable of slowing the pace of reserves accumulation in China or causing a sell-off of its reserves in an attempt to defend its currency could affect advanced economies by raising their long-term yields. Long-term yields in the United States and other advanced economies could also rise if China gradually changes its portfolio away from U.S. to emerging market treasuries (IMF, 2011b).

Spillover Effects on Advanced Economies during Previous Episodes of Financial Turbulence in Emerging Market Economies

To obtain some order of magnitude of the effects from past spillovers, an event study is conducted around past episodes with synchronized growth slowdowns in emerging market economies: the Mexican Tequila crisis in 1995, the east Asian crisis in 1997, and the Russian crisis in 1998.[5] The analysis focuses on the dynamics of trade and financial variables during a four-quarter window after the realization of each event.[6]

Results suggest that during episodes of financial turmoil, import demand in emerging market economies was an important spillover channel, particularly during the east Asian and Russian crises (Figure 2.SF.3). During these events, bilateral real exports contracted by at least one standard deviation from their 15-year average. Japanese exports have been particularly vulnerable to shocks stemming from emerging market economies, which could be explained by Japan's high trade interconnectedness with emerging market economies in east Asia and the high share of capital goods in its export structure.

Although imports from emerging market economies have also tended to decline during these episodes, partly as a result of supply-chain disruptions, reductions have been more moderate. The behavior of exports around these events could be explained by the dynamics of bilateral nominal exchange rates, with

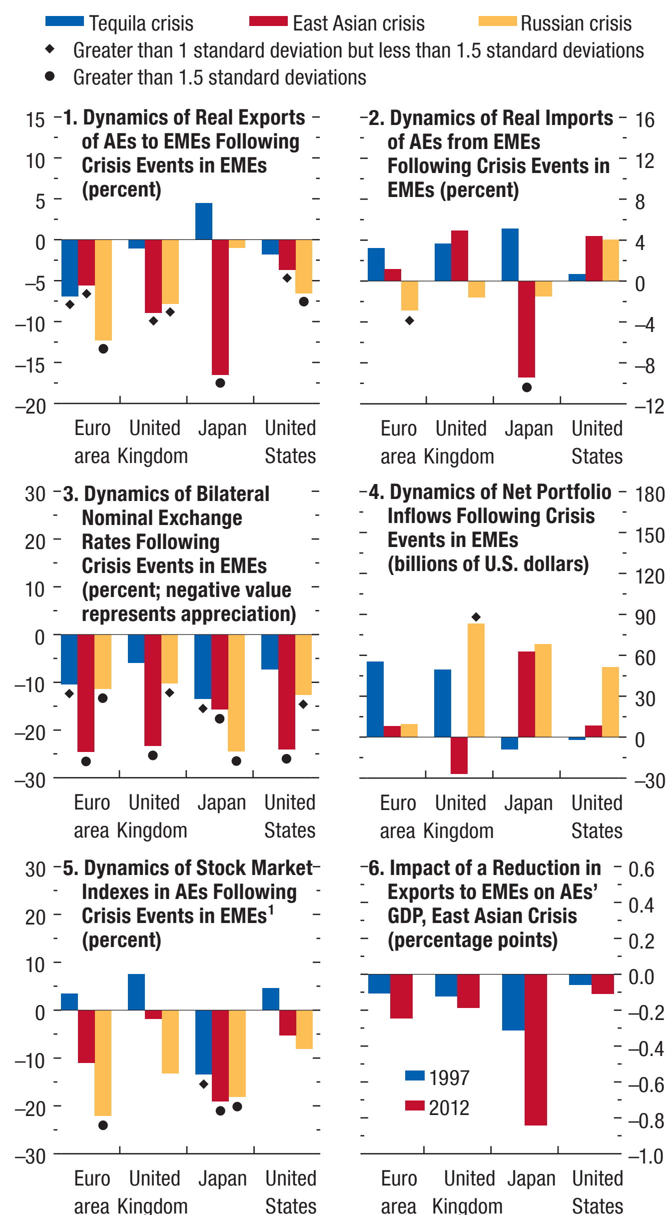
[5]The analysis starts in 1990 because of data limitations for emerging market economies. The 1995 Mexican Tequila crisis, the 1997 east Asian crisis, and the 1998 Russian crisis could be characterized as events in emerging market economies that, to a certain extent, were unrelated to developments in advanced economies. The dates of the events are obtained from the chronology in Laeven and Valencia (2012).

[6]With the exception of the analysis of the dynamics of stock market indexes, in which the behavior of these indexes is examined three months after the realization of each event.

Figure 2.SF.3. Event Studies around Downturn Episodes in Emerging Market Economies

(Peak effect in four quarters)

Event studies built around major episodes of financial turmoil in emerging market economies (EMEs) point to the sensitivity of import demand in those economies during these events. The sharp reduction in exports from advanced economies (AEs) to emerging market economies during these episodes came hand in hand with substantial appreciation of their currencies, in part explained by a spike in capital inflows. The dynamics of stock markets during these episodes also shed light on the importance of financial markets in transmitting these shocks to emerging market economies. Given that trade and financial linkages are now stronger, similar growth downturn events are likely to have sizable effects on most exposed advanced economies.



Sources: Haver Analytics; IMF, Direction of Trade Statistics database; and IMF staff calculations.

[1]Standard & Poor's 500 for United States, Nikkei 225 for Japan, FTSE 100 for United Kingdom, and average of Deutscher Aktien Index and Société des Bourses Françaises 120 for the euro area.

currencies in advanced economies appreciating, on average, more than 20 percent, 1½ standard deviations above their mean. The strengthening of advanced economies' currencies also points to a flight-to-safety scenario, as evidenced by large spikes in portfolio inflows. In addition, dynamics of stock market price indexes in advanced economies show that shocks from emerging market economies can be transmitted via financial markets, most notably in Japan and the euro area.

The east Asian crisis stands out in the brief event analysis because it was triggered by a common shock whose effect on regional comovements was almost as large as that of the global financial crisis (Chapter 3 of the October 2013 WEO). What was the spillover effect of a shock of the magnitude of the east Asian crisis on Japan's output growth?[7] An informal estimate suggests that the 15 percent drop in exports in Japan during the east Asian crisis could have represented a 0.3 percentage point decline in Japan's real GDP growth, given that Japanese exports to emerging markets were 2 percent of GDP in 1997. A similar shock in 2012 would have implied a much larger decline in output growth (that is, 0.8 percentage point), because the share of exports to emerging market economies in Japan's GDP has more than doubled since the east Asian crisis.

Quantifying the Spillover Effects of Emerging Market Economy Growth Shocks on Advanced Economies' GDP

The impact of a growth shock in emerging market economies on advanced economies is estimated using a standard vector-autoregression-based (VAR-based) approach and through simulations from a dynamic stochastic general equilibrium model. These estimates are much more informative than the simple informal calculations reported earlier.

The first element of the empirical analysis involves estimating country-wise VARs for each advanced economy with the following recursive specification: the growth rate of output of all advanced economies excluding the advanced economy for which the VAR is estimated, the growth rate of output in the advanced economy of interest, the growth rate of output in emerging market economies, and the growth rate of real bilateral exports from the advanced economy of interest to emerging market economies. Because the global financial crisis was an exceptional event with unusual effects, a modified version of the VAR model is also estimated. In this modified version, the regressors are also allowed to interact with a dummy variable that equals one from the last quarter in 2007 to the first quarter in 2009 and zero otherwise.[8]

The spillover effects on advanced economies of a 1 percentage point drop in the GDP growth of emerging market economies range from a 0.15 percentage point drop in output growth in the United Kingdom to a 0.5 percentage point decline in Japan (Figure 2.SF.4). In line with the findings discussed in the event study analysis, results from the empirical exercise suggest that the impact of shocks to emerging market economies' output on advanced economies' output is significant (both economically and statistically) in Japan and the euro area.[9] Based on the decomposition of the responses of advanced economies' GDP growth, it appears that the trade channel is particularly important for the transmission of shocks to Japan, whereas nontrade effects seem to dominate in other advanced economies.[10] Results from the interaction VAR estimation show that, when the global financial crisis is controlled for—that is, when the dummy is equal to zero—elasticities are reduced by half (except in the case of the United Kingdom) and spillovers are neither statistically nor economically significant across advanced economies.

The results from the simple VAR analysis illustrate the magnitude of possible spillover effects; however, they do not identify the sources of the growth slowdown, which matter for the spillovers. Different spillover transmission channels may be involved, depending on the nature of the shock.

[7]Japan experienced its own banking crisis in 1997–98; therefore the large growth spillover impact on Japan during the east Asian crisis should be interpreted cautiously.

[8]The country-wise VARs are estimated using seasonally adjusted quarterly data from 1996 through 2013, with two lags based on the Akaike information criterion. The second specification implements an interaction VAR framework introduced by Towbin and Weber (2013).

[9]The large effect observed in Japan could reflect a banking crisis experienced at the same time as the east Asian crisis and the use of gross instead of value-added real bilateral exports in the VAR analysis. As discussed earlier, gross trade linkages tend to overstate direct trade exposures to emerging market economies in countries with an upstream position in global trade networks.

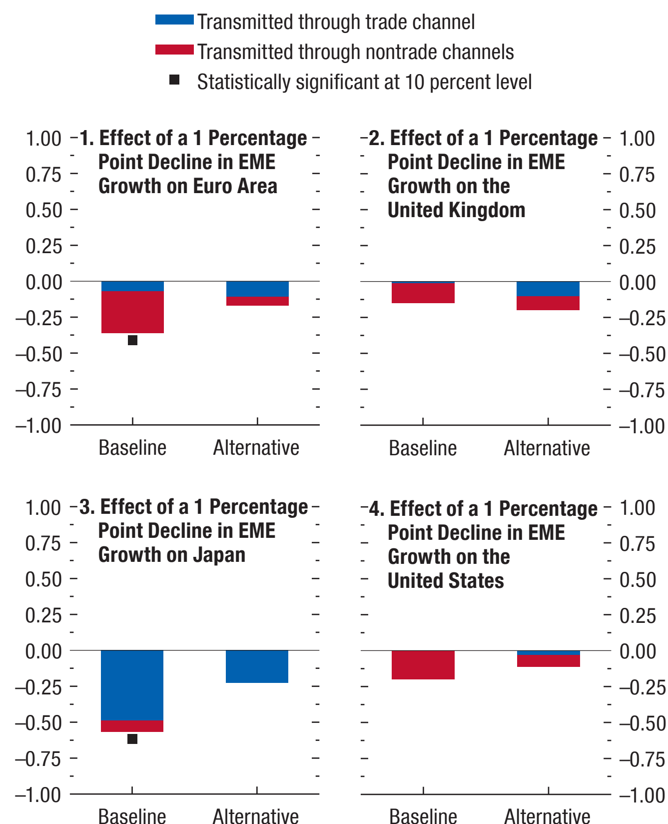
[10]The nontrade transmission channel corresponds to the estimated responses of GDP growth in advanced economies using the full VAR dynamics, but with real bilateral exports treated as an exogenous variable (that is, the GDP growth equation coefficients on real bilateral exports set to zero).

To illustrate the potential impact of emerging market economy shocks on advanced economies under a more structural simulation, the IMF's Flexible System of Global Models is used.[11] The baseline model is calibrated such that a 1 percentage point drop in emerging market economy GDP growth reduces the growth rate of total exports of advanced economies, on average, by 1.3 percentage points (a value of similar magnitude to the average response observed in the baseline VAR estimations). In a second specification, the baseline model is modified to incorporate a capital flight scenario by assuming that turbulence in emerging market economies is accompanied by an increase in the sovereign risk premium of 200 basis points and an increase in the corporate risk premium of 400 basis points.[12] Both scenarios show a slight real currency appreciation in advanced economies, whereas emerging market economy currencies depreciate, on average, by 0.2 percent from baseline. In addition, import demand in emerging market economies softens by 4 percent in both scenarios. In line with the VAR estimations presented earlier, Japan is most susceptible to an emerging market economy growth shock, with output growth declining by 0.32 percentage point in response to a 1 percent reduction in emerging market economy GDP (Figure 2.SF.5). The United Kingdom is the least affected by the shock. Estimations from this model are likely to be on the high side, given that monetary policy responses across advanced economies to a slowdown in emerging market economies are constrained by the zero bound on nominal interest rates.

It is important to note that in both scenarios, the trade channel is the main transmitter of the shock in the emerging market economies to advanced economies. This result hinges, however, on the assumption that there are no direct financial spillovers from emerging market to advanced economies. Depending on the origin of the slowdown in the emerging market economies, this assumption could be too restrictive. For example, if risk premiums in advanced economies react to the growth shock in emerging market economies—possibly because of concern about balance sheet

Figure 2.SF.4. Peak Effect of a Growth Shock to Emerging Market Economies on Advanced Economies' Output Growth
(Four quarters after impact; percentage points)

The impact of shocks to emerging market economies' (EMEs') output on advanced economies' (AEs') output is significant (both statistically and economically) only for Japan and the euro area. The trade channel is particularly important for the transmission of shocks to Japan, whereas nontrade effects appear to dominate in other advanced economies. The impact of growth shocks in emerging market economies on advanced economies' output tends to be attenuated, and become negligible, when the effects of the global economic crisis are controlled for.



Source: IMF staff calculations.
Note: "Baseline" refers to the model in which advanced economies' GDP growth is contemporaneously exogenous to emerging market economies' GDP growth. "Alternative" refers to elasticities obtained from the interaction vector autoregression model, when the dummy variable denoting global economic crisis is equal to zero.

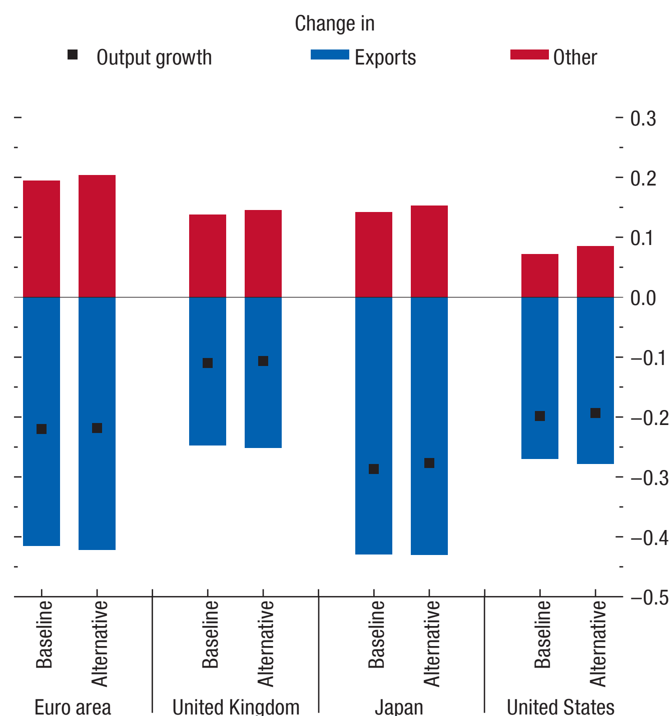
[11]The Flexible System of Global Models is an annual, multiregional general equilibrium model, combining both micro-founded and reduced-form formulations of various economic sectors. It has a fully articulated demand side and some supply-side features. International linkages are modeled in aggregate for each region. It does not model intermediate goods; therefore, supply chain effects are not captured in these simulations.

[12]Shocks last for one year.

Figure 2.SF.5. Model Simulations of Potential Growth Spillover Effects from Emerging Market Economies on Advanced Economies

(Contribution to change in output growth; percentage points)

A synchronous shock has nonnegligible effects across the advanced economies. Japan is particularly susceptible to emerging market economies' growth shock, and the United Kingdom is the least affected by the shock. Spillovers are transmitted mainly through the trade channel, given the assumption that risk premiums in advanced economies are not affected by the growth downturn in emerging market economies. However, simulation-based estimates from this model are likely to be on the high side, because monetary policy response across advanced economies to a slowdown in emerging market economies is constrained by the zero bound on nominal interest rates.



Source: IMF staff calculations.
Note: "Baseline" refers to the baseline simulation. "Alternative" refers to results from simulation in which a negative growth shock to emerging market economies is accompanied by a rise in the sovereign risk premium of 200 basis points and a rise in the corporate risk premium of 400 basis points.

exposure of financial intermediaries—the spillover could be larger and financial channels come into play. Similarly, once cross-border asset linkages are incorporated, shocks to asset prices in emerging market economies could also have wealth and other direct effects on aggregate demand of advanced economies.

Conclusions

Macroeconomic fundamentals in many emerging market economies are generally stronger today than in the 1990s and early 2000s, and a simultaneous shock to all emerging market economies similar to those two decades ago is unlikely. Nevertheless, a recurrence of similar events could now have different outcomes for advanced economies, given that the global economic landscape and economic linkages between these two groups have changed. Emerging market economies are now much larger and more integrated into global trade and financial markets, which has increased the exposure of advanced economies to these economies. Spillovers from a synchronized downturn in emerging market economy output, operating primarily through trade channels, could be sizable for some advanced economies, but would likely remain manageable and probably short lived. At the same time, financial links between advanced economies and emerging market economies have strengthened recently, and although the magnitudes are much more challenging to quantify, financial spillovers in the case of a slowdown in emerging market economies and their effects on advanced economies could be important. The recovery of advanced economies from the global financial crisis is still fragile, and policymakers in these economies should closely monitor growth in emerging markets and be prepared to take action to mitigate the impact of external disturbances.

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