CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

As the global economy comes out of its deepest downturn since World War II, the prospects for growth vary substantially across and within regions (Figure 2.1). In some economies average growth during 2010–11 is projected to exceed 10 percent, whereas in others it is expected to be negative. Apart from the differences in trend growth rates, the pattern observed in the world growth map reflects the varying speeds of recovery toward full-capacity output across economies and regions.

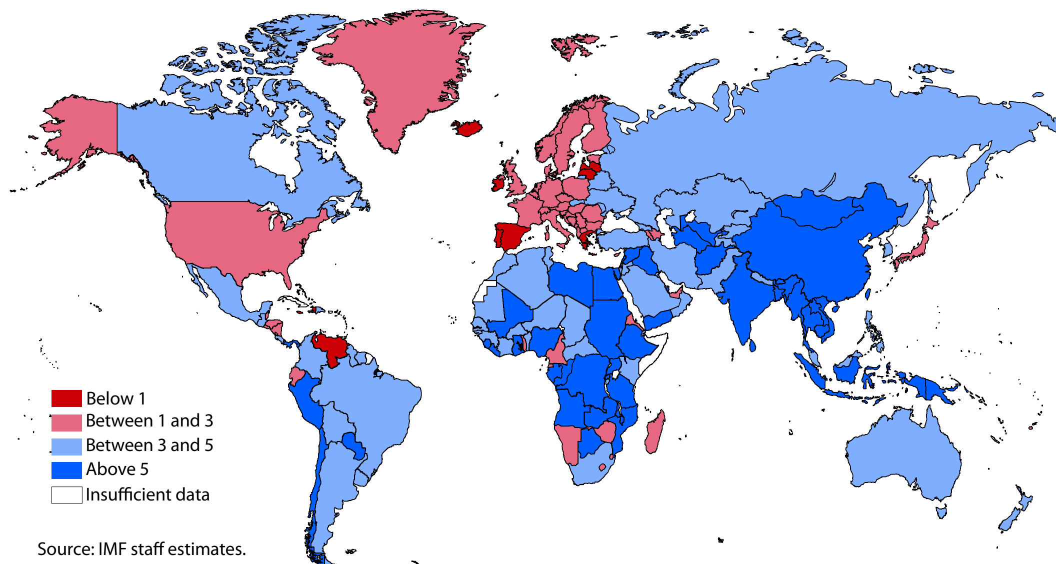
As discussed in Chapter 1, supporting the recovery are easing financial conditions, normalizing trade, rebounding capital flows, a turn in the inventory cycle, and, importantly, growth-stimulating policies. In some cases, however, holding back the recovery are unhealed financial systems and weak public or household balance sheets. The relative importance of these factors differs greatly across economies and regions.

What helps explain the different speeds of recovery across economies? Although there is no simple answer to this question, the analysis of current (near-term) growth projections reveals several striking patterns (Figure 2.2). In particular, economies with larger output losses during the Great Recession are expected to recover more slowly than those that fared better. Moreover, those that entered the crisis with preexisting domestic imbalances (as evidenced by large current account deficits, credit booms, and the like) are typically projected to experience more sluggish recoveries. More limited room for policy maneuvers, as measured by high public debt levels, is also associated with more muted projected recoveries. Of course, there are exceptions to these patterns, and many other country-specific factors remain important.

Two additional features of the projections stand out. First, many advanced economies are expected to undergo more subdued recoveries than most emerging and developing economies. Second, the recovery is projected to be strongest in Asia and weakest in emerging Europe.

Against this backdrop, Chapter 2 presents the economic outlook and discusses key policy challenges across economies and regions, starting with North America (Canada, United States), followed by Asia and other advanced economies (Australia, New Zealand), Europe, the Commonwealth of Independent States (CIS), Latin America and the Caribbean (LAC), the Middle East and North Africa (MENA), and sub-Saharan Africa.

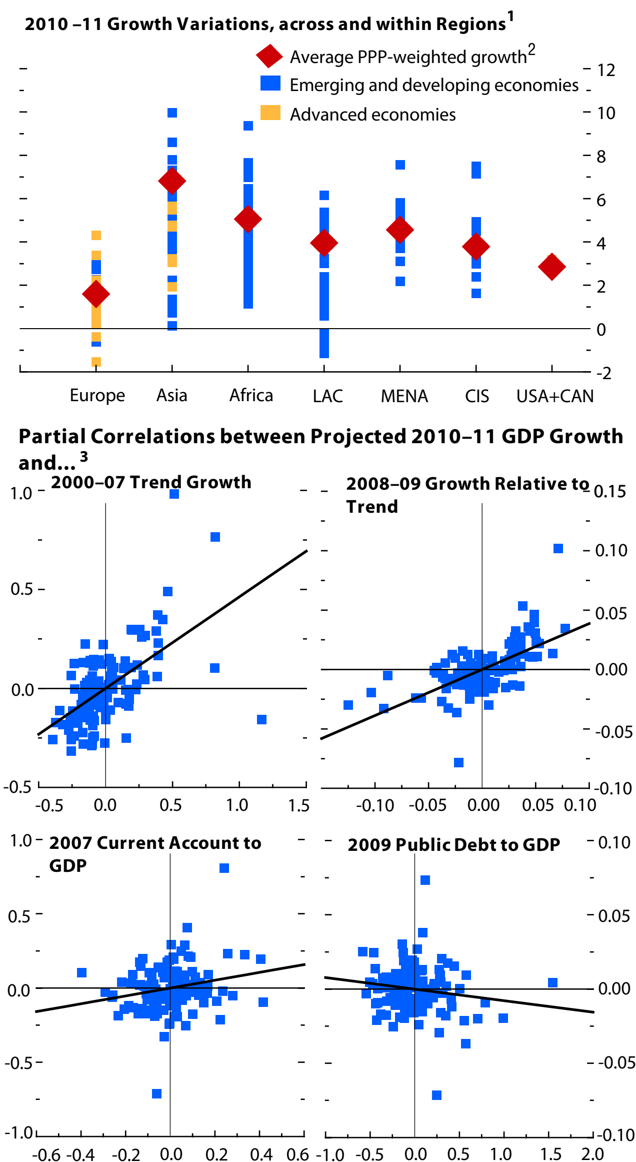
Figure 2.1. Average Real GDP Growth during 2010–11
(Percent)



Source: IMF staff estimates.

Figure 2.2. Decomposing the Variation in 2010–11 Growth Projections

The large variation in the 2010–11 growth outlook, both across and within regions, reflects differences in underlying (trend) growth, the severity of the downturn during the crisis, precrisis current account positions, and the level of public debt, among other factors.



Source: IMF staff estimates.

[1]CIS: Commonwealth of Independent States, Georgia, and Mongolia; LAC: Latin American and the Caribbean; MENA: Middle East and North Africa; USA+CAN: United States and Canada.

[2]PPP = purchasing power parity.

[3]Based on a regression of projected 2010–11 average GDP growth on these variables, as well as the projected 2010–11 partner GDP growth and the 2008–09 change in the real effective exchange rate. Each partial regression scatterplot shows the relationship between projected 2010–11 growth and one variable, after controlling for the effect of all the other variables.

A Stimulus-Driven U.S. Recovery Is under Way

A stimulus-led recovery is under way in the United States, but private demand remains soft. Substantial monetary and fiscal easing, alongside other policies aimed directly at the financial and housing sectors, has provided a broad-based fillip to growth—the IMF staff estimates that the fiscal stimulus boosted real GDP growth by about 1 percentage point in 2009. In response to the stimulus and a robust inventory cycle, real GDP grew at a seasonally adjusted annualized rate of 2.2 percent in the third quarter of 2009 and by 5.6 percent in the fourth quarter (Figure 2.3). But private final demand is still subdued and remains well below precrisis levels. In the fourth quarter, consumption rose by only 1.6 percent as households continued to rebuild wealth; reduced inventory drawdowns contributed more than half of growth. During the same period, net exports also made a modest positive contribution to growth, as the rebound in global trade and recovery in partner economies boosted exports.

The labor market remains unusually weak. Since the start of the crisis, more than 7 million jobs have been lost, and 8.8 million people are involuntarily working part-time. The rate at which jobs are being lost has slowed substantially, but employment growth remains negative, and the unemployment rate had reached 10 percent by the end of 2009, although it decreased marginally during the first quarter of 2010. The increase in the unemployment rate is somewhat greater than expected given the behavior of GDP. As discussed in more detail in Chapter 3, the house price bust and an extraordinary degree of financial stress help explain this more adverse unemployment response.

Financial market strains have continued to ease, but credit conditions remain on the tight side. Liquidity spreads such as the LIBOR-OIS (the difference between the three-month London interbank offered rate and the three-month overnight index swap rate) and investment-grade spreads have mostly returned to precrisis levels. Equity markets have recovered from lows reached in early 2009, and corporate bond issuance is now running above

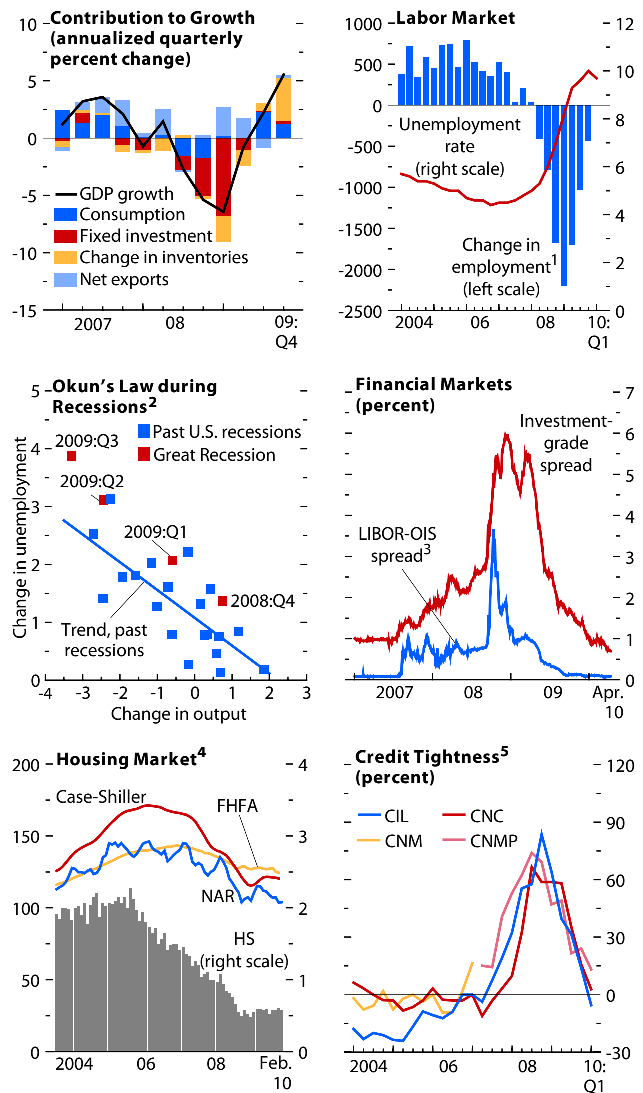
precrisis levels. However, as discussed in Chapter 1 of the April 2010 *Global Financial Stability Report* (GFSR), lending surveys indicate weak loan demand, as many sectors continue to deleverage. Moreover, with banks' balance sheets still not fully repaired from the crisis, and with losses mounting in certain sectors such as commercial real estate, financial conditions may remain a drag on growth, particularly for small and medium-size enterprises that cannot access capital markets. In addition, private securitization remains largely moribund; given the importance of this funding channel for lending in the precrisis period, a continued lack of securitization will pose an increasing constraint to finance and growth.

Reflecting these conditions, the recovery ahead is expected to be gradual, particularly when the effects of the stimulus subside. Real GDP is projected to grow by 3 percent in 2010 (Table 2.1), an upward revision of ½ percentage point relative to the January 2010 *WEO Update* and 1½ percentage points relative to the October 2009 *World Economic Outlook* (WEO). The recovery will be tempered by households' continued need to rebuild wealth, the expected slow but necessary process of financial sector repair and deleveraging, and continued weakness in the labor market. The removal of policy stimulus will subtract from growth, which will moderate to 2.6 percent in 2011. Unemployment is projected to remain high in 2010, at 9½ percent (year-average basis; Table 2.2), before declining to 8¼ percent in 2011 as employment growth picks up. And inflation is expected to remain subdued, at 2 percent in 2010 and 1¾ percent in 2011, given continued economic slack.

Uncertainty around the outlook remains elevated but is lower than in the October 2009 WEO, and the risks to the 2010 growth projection appear roughly balanced. Continued weakness in real estate (including the commercial sector) or fresh turbulence in financial markets could weigh negatively on activity. However, these risks could be offset by more-resilient-than-expected private demand if confidence improves, by additional stimulus, or by a more-buoyant-than-expected inventory cycle. The balance of risks for 2011 and beyond remains on the downside; any further stimulus would likely

Figure 2.3. United States: A Stimulus-Supported Recovery

Substantial stimulus has supported the U.S. recovery, but private demand remains muted and the labor market is unusually weak. Financial market conditions have normalized and the housing market has tentatively stabilized. But credit conditions, although no longer tightening, remain tight.



Sources: Bloomberg Financial Markets; Haver Analytics; and IMF staff calculations.
[1]Quarterly change in total nonfarm payrolls, thousands.
[2]Change in output is percent change from one year earlier. Change in unemployment is percentage point difference from one year earlier.
[3]LIBOR-OIS spread is the difference between the three-month London interbank offered rate (LIBOR) and the three-month overnight index swap (OIS) rate.
[4]Index: January 2002 = 100; Case-Shiller Composite 20; FHFA: Federal Housing Finance Agency; HS: housing starts in millions; NAR: National Association of Realtors.
[5]All series come from the Senior Loan Officer Survey. CIL: banks tightening commercial and industrial loans to large firms; CNC: banks tightening standards for consumer credit cards; CNM: banks tightening standards for mortgages to individuals; CNMP: banks tightening standards for prime mortgages to individuals.

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Advanced Economies	**0.5**	**–3.2**	**2.3**	**2.4**	**3.4**	**0.1**	**1.5**	**1.4**	**–1.3**	**–0.4**	**–0.4**	**–0.5**
United States	0.4	–2.4	3.1	2.6	3.8	–0.3	2.1	1.7	–4.9	–2.9	–3.3	–3.4
Euro Area[3,4]	0.6	–4.1	1.0	1.5	3.3	0.3	1.1	1.3	–1.5	–0.6	–0.3	–0.2
Japan	–1.2	–5.2	1.9	2.0	1.4	–1.4	–1.4	–0.5	3.2	2.8	2.8	2.4
United Kingdom[3]	0.5	–4.9	1.3	2.5	3.6	2.2	2.7	1.6	–1.5	–1.3	–1.7	–1.6
Canada	0.4	–2.6	3.1	3.2	2.4	0.3	1.8	2.0	0.5	–2.7	–2.6	–2.5
Other Advanced Economies	1.7	–1.1	3.7	3.9	4.3	1.5	2.2	2.2	3.1	5.1	4.4	4.3
Memorandum												
Newly Industrialized Asian Economies	1.8	–0.9	5.2	4.9	4.5	1.3	2.3	2.3	4.9	8.9	6.6	6.6

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A6 in the Statistical Appendix.
[2]Percent of GDP.
[3]Based on Eurostat's harmonized index of consumer prices.
[4]Current account position corrected for reporting discrepancies in intra-area transactions.

boost growth mainly this year, and a negative near-term shock to the housing or financial markets would likely have its largest impact next year.

This outlook frames the balancing act facing fiscal policy—the need to support growth now and to secure fiscal stability over the medium term. Given the present weaknesses and risks in the labor and housing markets, a case can be made for additional, targeted support to those sectors. However, given the size of U.S. fiscal imbalances, a credible plan for fiscal sustainability will need to accompany any such measures to limit the risk of rising long-term interest rates, which would dampen growth. Such a plan would also allow fiscal room to maneuver in 2011 if downside risks materialize.

When the recovery is solidly under way, fiscal consolidation should be a top priority. The medium-term fiscal outlook is daunting—under conservative assumptions about growth and interest rates and absent action, the deficit would rise to 8 percent of GDP in 2020, with the federal debt exceeding 100 percent of GDP—and significant additional adjustment would be needed to put public debt on a sustainable path. Furthermore, health care reform will be essential to bring medical costs under control. The recent progress toward reform is welcome, including signs that it may contribute modestly to medium-term deficit reduction, although the yield in terms of cost control remains uncertain. Accompanying headway in social security reform could help address entitlement spending (yielding smaller, but more predictable, gains compared with health care reform).

Meanwhile, the ongoing, extraordinarily accommodative stance of monetary policy should continue to support recovery. Although the Federal Reserve has communicated its exit strategy and continued to develop tools to implement the exit, it has also stressed its intention to maintain accommodation as needed. It has also signaled that it is committed to withdrawing excess liquidity and normalizing monetary policy gradually—an appropriate strategy in light of uncertainties about both the economic outlook and the strength of the monetary transmission mechanism, particularly given high excess liquidity and remaining weaknesses in financial sector balance sheets.

Looking beyond the recovery, restoring the financial sector to full health and addressing the gaps in regulation highlighted by the crisis will be essential for stable medium-term growth. A consensus is building around reforms that would strengthen supervision and regulation, including through an expanded perimeter; improving the resolution mechanism for systemically important nonbank financial institutions to provide options other than bankruptcy and bailout; and shoring up the infrastructure for financial markets. Reforms would also provide an opportunity to address the "too-big-to-fail" problem by creating incentives to reduce

Table 2.2. Advanced Economies: Unemployment
(Percent)

			Projections	
	2008	2009	2010	2011
Advanced Economies	**5.8**	**8.0**	**8.4**	**8.0**
United States	5.8	9.3	9.4	8.3
Euro Area	7.6	9.4	10.5	10.5
Germany	7.2	7.4	8.6	9.3
France	7.9	9.4	10.0	9.9
Italy	6.8	7.8	8.7	8.6
Spain	11.3	18.0	19.4	18.7
Netherlands	2.8	3.5	4.9	4.7
Belgium	7.0	8.0	9.3	9.4
Greece	7.6	9.4	12.0	13.0
Austria	3.9	5.0	5.4	5.5
Portugal	7.6	9.5	11.0	10.3
Finland	6.4	8.3	9.8	9.6
Ireland	6.1	11.8	13.5	13.0
Slovak Republic	9.6	12.1	11.6	10.7
Slovenia	4.4	6.2	7.4	6.8
Luxembourg	4.4	7.0	6.2	5.7
Cyprus	3.6	5.3	6.1	6.4
Malta	5.8	7.1	7.3	7.2
Japan	4.0	5.1	5.1	4.9
United Kingdom	5.6	7.5	8.3	7.9
Canada	6.2	8.3	7.9	7.5
Korea	3.2	3.7	3.5	3.4
Australia	4.3	5.6	5.3	5.1
Taiwan Province of China	4.1	5.9	5.4	4.9
Sweden	6.2	8.5	8.2	7.7
Switzerland	2.7	4.1	5.0	4.1
Hong Kong SAR	3.5	5.1	4.8	4.5
Czech Republic	4.4	6.7	8.8	8.5
Norway	2.6	3.2	3.5	3.5
Singapore	2.2	3.0	2.8	2.6
Denmark	1.7	3.3	4.2	4.7
Israel	6.1	7.7	7.4	7.1
New Zealand	4.2	6.2	7.2	6.6
Iceland	1.6	8.0	9.7	8.6
Memorandum				
Newly Industrialized Asian Economies	3.4	4.3	4.1	3.8

size and complexity. This would help streamline the U.S. regulatory structure, avoid gaps and inconsistencies, and support renewed (but safer) securitization activity.

In turn, a more sustainable foundation for U.S. growth will facilitate the rebalancing of global demand. The key to putting growth on a more sustainable footing is repairing both private and public balance sheets—and, in particular, savings. Households have stepped up their saving to rebuild their wealth, but the outlook for private saving remains uncertain. This reinforces the need for the government to shift its focus toward medium-term fiscal consolidation to provide the boost in national saving necessary to reduce the external imbalance. Accordingly, it is less likely that current account deficits—which shrank substantially in the past year—will return to the unusually large levels that prevailed before the crisis.

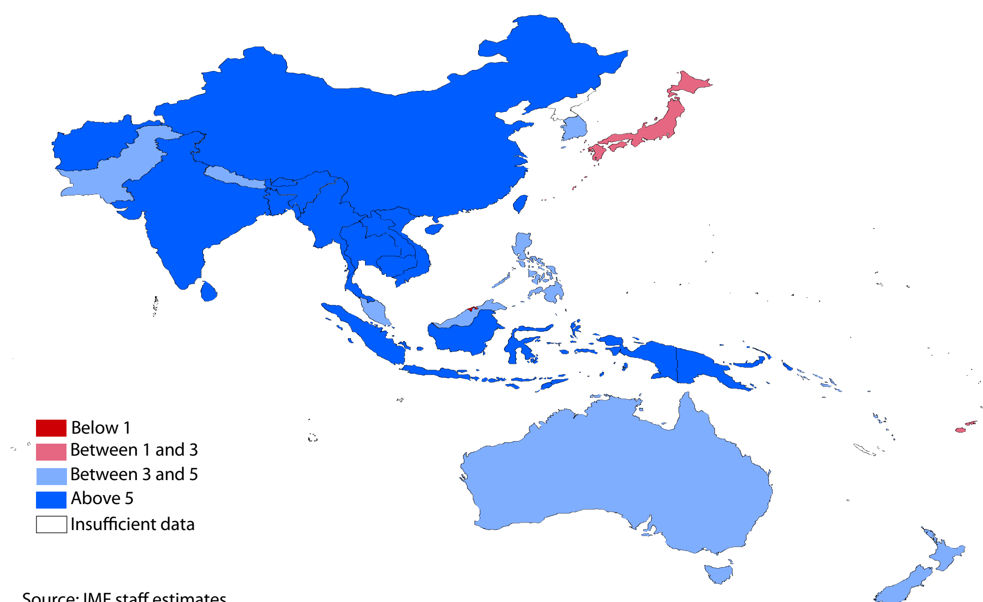
Turning to Canada, the recovery there is also expected to be protracted, reflecting more moderate demand growth than in the United States as well as the substantial strengthening of the Canadian dollar. Output growth is projected at 3 percent in 2010 and 3¼ percent in 2011 (see Table 2.1). Canada entered the global crisis in good shape, and thus the exit strategy appears less challenging than elsewhere. The main priorities are returning Canada's debt to a downward trajectory, ensuring that financial stability remains intact—amid rising house prices—and raising Canada's labor productivity and potential growth.

Asia Is Staging a Vigorous and Balanced Recovery

Although the downturn in many Asian economies in late 2008 was steeper than expected, the recovery came quickly and was just as sharp. Output growth in 2009 in almost all Asian economies was stronger than projected in the October 2009 WEO, with Japan a notable exception. The V-shaped recovery points to an overall slowdown that was more moderate than in other regions. The recovery has also been more balanced in Asia than elsewhere, with output growth in most economies supported by both external and domestic demand. And even though macroeconomic stimulus was substantial, private demand also gained traction in many economies. Ample policy room and strong sectoral balance sheets suggest that for many economies in the region, the recovery will be relatively robust.

Four factors have supported Asia's recovery. First, the rapid normalization of trade following the financial dislocation in late 2008 greatly benefited

Figure 2.4. Asia: Average Real GDP Growth during 2010–11
(Percent)



Source: IMF staff estimates.

the export-oriented economies in the region. Second, the bottoming out of the inventory cycle, both domestically and in major trading partners such as the United States, is boosting industrial production and exports. Third, a resumption of capital inflows into the region—in response to widening growth differentials and a renewed appetite for risk—has created abundant liquidity in many economies. Finally, domestic demand has been resilient, with strong public and private components in many of the region's economies. This resilience is in part attributable to the fact that stronger balance sheets were in place at the onset of this crisis, in both the private sector and the public sector. Low public debt levels allowed many Asian economies to implement strong and timely countercyclical policy responses to the crisis—IMF staff estimates indicate that fiscal stimulus added 1¾ percentage points to Asia's growth in 2009. Monetary loosening also eased financial conditions across the region—through aggressive cuts in policy interest rates and, in some economies, measures to increase liquidity.

Against this backdrop, Asia's GDP is projected to grow by 7 percent in both 2010 and 2011 (Figure 2.4; Table 2.3). Significant differences remain within the region, however:

- In both China and India, strong domestic demand will support the recovery. In China, GDP growth exceeded the government's 8 percent target in 2009 and is expected to be close to 10 percent in both 2010 and 2011. What has been so far mainly a publicly driven growth path, built on infrastructure investment, is expected to turn toward stronger private consumption and investment. In India, growth is projected to be 8¾ percent in 2010 and 8½ percent in 2011, supported by rising private demand. Consumption will strengthen as the labor market improves, and investment is expected to be boosted by strong profitability, rising business confidence, and favorable financing conditions.
- The strength in final domestic demand in India and especially China is expected to have positive spillovers for other Asian economies, particularly exporters of commodities and capital goods. In Korea, economic activity is expected to expand by 4½ percent in 2010 and 5 percent in 2011, strongly accelerating from ¼ percent in 2009. This reflects not just strong export growth—with capital exports to China an important element—but also a continued boost from the inventory

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Asia	**5.2**	**3.5**	**6.9**	**7.0**	**5.8**	**2.0**	**4.1**	**2.8**	**4.0**	**3.6**	**3.4**	**3.3**
Advanced Asia	**0.2**	**–3.0**	**3.1**	**3.2**	**2.8**	**–0.1**	**0.3**	**0.8**	**2.4**	**3.1**	**2.6**	**2.4**
Japan	–1.2	–5.2	1.9	2.0	1.4	–1.4	–1.4	–0.5	3.2	2.8	2.8	2.4
Australia	2.4	1.3	3.0	3.5	4.4	1.8	2.4	2.4	–4.4	–4.1	–3.5	–3.7
New Zealand	–0.1	–1.6	2.9	3.2	4.0	2.1	2.1	2.5	–8.6	–3.0	–4.6	–5.7
Newly Industrialized Asian Economies	**1.8**	**–0.9**	**5.2**	**4.9**	**4.5**	**1.3**	**2.3**	**2.3**	**4.9**	**8.9**	**6.6**	**6.6**
Korea	2.3	0.2	4.5	5.0	4.7	2.8	2.9	3.0	–0.6	5.1	1.6	2.2
Taiwan Province of China	0.7	–1.9	6.5	4.8	3.5	–0.9	1.5	1.5	6.2	11.2	8.5	7.7
Hong Kong SAR	2.1	–2.7	5.0	4.4	4.3	0.5	2.0	1.7	13.6	11.1	12.1	10.1
Singapore	1.4	–2.0	5.7	5.3	6.5	0.2	2.1	1.9	19.2	19.1	22.0	22.4
Developing Asia	**7.9**	**6.6**	**8.7**	**8.7**	**7.4**	**3.1**	**5.9**	**3.7**	**5.7**	**4.1**	**4.1**	**4.1**
China	9.6	8.7	10.0	9.9	5.9	–0.7	3.1	2.4	9.4	5.8	6.2	6.5
India	7.3	5.7	8.8	8.4	8.3	10.9	13.2	5.5	–2.2	–2.1	–2.2	–2.0
ASEAN-5	**4.7**	**1.7**	**5.4**	**5.6**	**9.3**	**2.9**	**4.8**	**4.6**	**2.7**	**5.1**	**3.3**	**2.2**
Indonesia	6.0	4.5	6.0	6.2	9.8	4.8	4.7	5.8	0.0	2.0	1.4	0.4
Thailand	2.5	–2.3	5.5	5.5	5.5	–0.8	3.2	1.9	0.6	7.7	2.5	0.3
Philippines	3.8	0.9	3.6	4.0	9.3	3.2	5.0	4.0	2.2	5.3	3.5	2.3
Malaysia	4.6	–1.7	4.7	5.0	5.4	0.6	2.0	2.1	17.5	16.7	15.4	14.7
Vietnam	6.2	5.3	6.0	6.5	23.1	6.7	12.0	10.3	–11.9	–7.8	–6.9	–6.0
Other Developing Asia[3]	**3.9**	**3.7**	**4.3**	**5.0**	**12.9**	**11.5**	**9.1**	**7.4**	**–2.3**	**–0.8**	**–1.0**	**–1.3**
Memorandum												
Emerging Asia[4]	7.0	5.6	8.2	8.2	7.0	2.9	5.4	3.5	5.6	4.9	4.5	4.5

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Tables A6 and A7 in the Statistical Appendix.

[2]Percent of GDP.

[3]Other Developing Asia comprises Islamic Republic of Afghanistan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao People's Democratic Republic, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, and Vanuatu.

[4]Emerging Asia comprises all economies in Developing Asia and the Newly Industrialized Asian Economies.

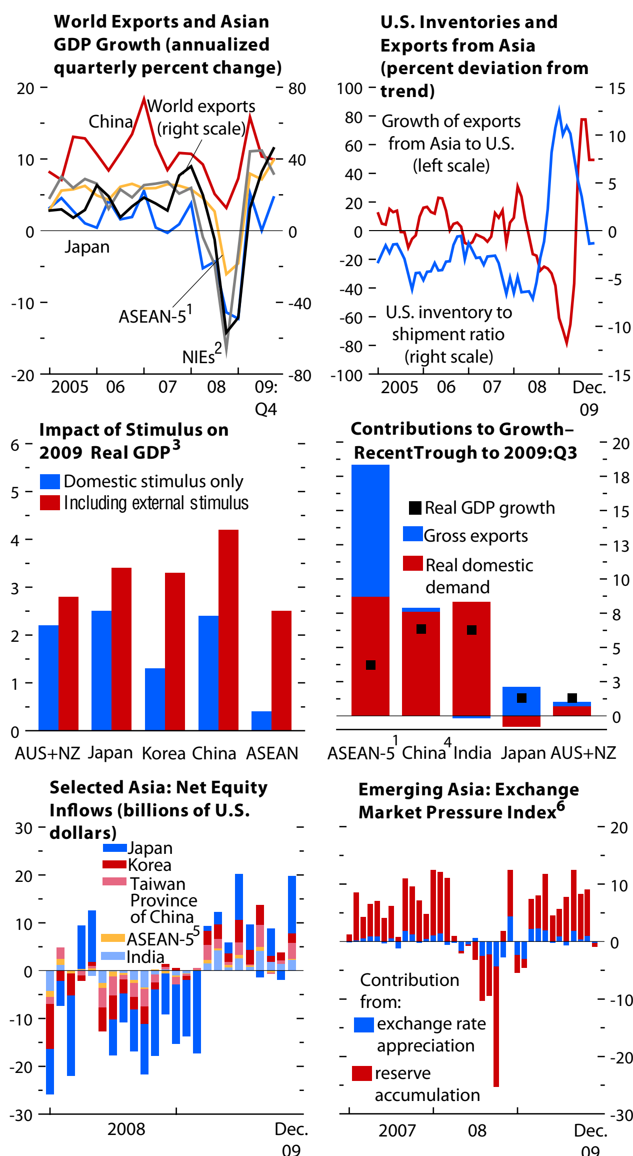
cycle and a boost in business investment in response to high capacity utilization and strong business confidence. All these factors should help offset the impact of the expected withdrawal of fiscal stimulus in 2010.

- The ASEAN-5 economies[1] are projected to grow by 5½ percent in 2010. Private domestic demand is expected to be the main driver of growth, with net exports playing a lesser role than in the past, reflecting stronger imports relative to historical standards. Among the ASEAN-5, the Indonesian economy has proved to be remarkably resilient, with output growing at 4½ percent in 2009 compared with 1¾ percent for the ASEAN-5 as a whole, thanks to strong domestic demand and less dependence on trade. Indonesia's growth is expected to accelerate to 6 percent in 2010 and to 6¼ percent in 2011, reflecting a pickup in private investment.
- Australia's GDP growth is projected to be 3 percent in 2010 and 3½ percent in 2011, helped by strong demand for commodities, particularly from China. Growth in 2010 will be led by domestic demand, both private and public, with the pickup in commodity prices expected to boost investment in the resource sector. New Zealand's output growth—projected at 3 percent in 2010 and 3¼ percent in 2011—will be supported by higher commodity export prices, especially for dairy products, and by stronger domestic demand on the back of higher farm incomes, permanent income tax cuts, and recovering house prices.

[1] Association of Southeast Asian Nations comprising Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Figure 2.5. Asia: A Vigorous and Balanced Rebound

The normalization of global trade, a turn in the inventory cycle, and stimulus-supported demand have underpinned Asia's quick recovery. Renewed capital inflows have put pressure on exchange rates, which has been absorbed mainly by further reserve accumulation.



Sources: Haver Analytics; and IMF staff calculations.
[1]Excluding Vietnam.
[2]Newly industrialized Asian economies (NIEs) comprise Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.
[3]"Domestic stimulus only" refers to the impact of fiscal stimulus in the country or country group; "Including external stimulus" adds the impact of regional and global fiscal stimulus measures. Estimates are based on multipliers from the IMF's Global Integrated Monetary and Fiscal Model. AUS+NZ= Australia and New Zealand.
[4]For China, quarter of slowest growth (2009:Q1) to 2009:Q3.
[5]Excluding Malaysia.
[6]The exchange market pressure index is defined as the change in nominal exchange rate vis-à-vis U.S. dollar plus the ratio of change in international reserves to the monetary base. The index is the average of China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, Philippines, Singapore, and Thailand.

- In Japan, exports have helped support a tentative recovery, but spillovers to autonomous domestic demand have so far been limited; domestic demand is likely to remain weak as a result of several factors, including the reemergence of deflation, continued excess capacity, and a weak labor market. Continued yen appreciation in 2010 could dampen the contribution of net exports to growth, particularly in comparison with the rest of Asia. As a result, the outlook depends crucially on planned fiscal policy support and the global upturn. GDP is projected to grow by 2 percent in 2010, supported by fiscal stimulus and rising exports. A more broad-based recovery is expected for 2011, following a moderate pickup in business investment.

Varied policy challenges face the region's economies. For those that have depended on exports to drive growth, the primary challenge will be to deal with slowing demand from major trading partners such as the United States. For economies such as India, which are relatively more closed and which have relied on stimulus to support growth, the main challenge will be to ensure durable fiscal consolidation, including by implementing fiscal and other structural reforms. And Japan faces significant challenges in strengthening domestic demand and fighting off deflation, given the need to bring down the high level of public debt and with the policy rate near the zero bound.

For policymakers in Asia's export-driven economies, who now face the prospect of weaker external demand conditions, a key challenge is to effect a durable rebalancing toward domestic sources of growth. Stimulus measures have played a major role in the recent strength of domestic demand in many of the region's economies (Figure 2.5), and for domestic demand to remain robust, autonomous private demand will have to strengthen further. Rebalancing away from external demand, however, is likely to entail different measures for different economies in the region. For example, boosting domestic consumption will be a priority in China, through improved access to finance for small enterprises and households and stronger corporate governance and social safety nets to reduce precautionary saving. On the other hand, Korea's and Japan's

growth prospects will benefit mainly from raising productivity in the service sector. For many ASEAN economies, notably the Philippines, Thailand, and Malaysia, improving the environment for private investment can play an important role in boosting private domestic demand. Greater exchange rate flexibility in many economies would also facilitate rebalancing by raising households' purchasing power and helping shift productive resources from the tradables to the nontradables sector.

Given the region's strong recovery, planning the speed and sequencing of the exit from stimulative macroeconomic policies must become a policy priority. Withdrawing accommodative policy stances is becoming an option in several economies, but the fragility of the recovery in major advanced economies suggests that there are risks from moving too swiftly in that direction. Persistent differences in domestic cyclical conditions within Asia also warrant different timing and sequencing in the exit from policy support.

On the fiscal front, despite the relatively stronger fiscal response in 2009, only a few Asian economies appear to face debt-sustainability challenges on a scale similar to those in many advanced economies. If the strength of autonomous private domestic demand is uncertain, continued fiscal support would be appropriate, especially in economies that face weaker demand from abroad and demand-rebalancing challenges. For regional economies with high public debt levels and the need to maintain fiscal support—such as Japan—developing and communicating credible medium-term consolidation plans would be advisable, for several reasons. First, it would make the remaining fiscal support even more effective. Second, it would help restore the fiscal room necessary to deal with future shocks and help address aging-related spending pressures. And finally, it would help reduce the likelihood of negative spillovers from fiscal concerns in other advanced economies.

With regard to monetary policy, it may not be too early to start unwinding the stimulus if output gaps are closing and inflation pressures are beginning to emerge. This appears to be the case already for a few economies in the region, including Australia, India, and Malaysia, where authorities have already started tightening monetary policy. In China, the withdrawal of the exceptional monetary stimulus introduced in 2009 will also minimize the risks from excessively easy credit conditions. For other economies in the region where the recovery of private demand is more uncertain and where output gaps are likely to close more slowly, policymakers should avoid premature tightening of monetary conditions. And for Japan, with the reemergence of deflation, the current accommodative monetary policy stance remains appropriate, but additional easing measures may be necessary if deflation persists.

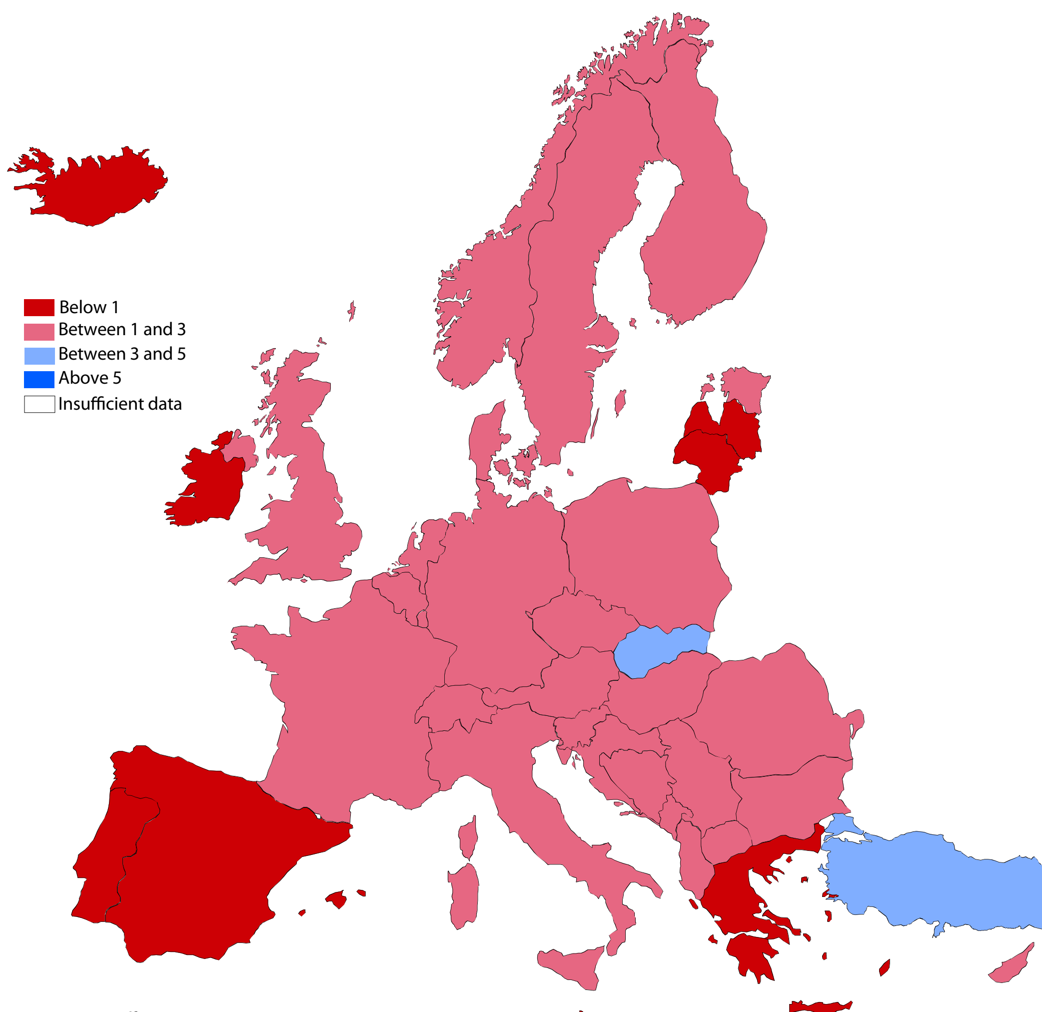
Although domestic cyclical considerations may argue for early monetary tightening in some economies, these should be weighed against the risk of attracting further capital inflows. Large capital inflows can complicate macroeconomic management with their potential to generate inflation pressures, feed credit and asset price boom-and-bust cycles, and create pressure for steep and sudden real exchange rate appreciation. Although asset price increases to date appear to be mostly in line with those in previous recoveries, as discussed in the April 2010 GFSR, conditions of high external and domestic liquidity and rising credit growth could give rise to bubbles in the medium term.

An appropriate response to the risks from large capital inflows may well involve a variety of measures, depending on circumstances—an issue discussed in greater detail in Chapter 4 of the April 2010 GFSR. For economies where excessively large surpluses contribute to global imbalances, slowing the effects of inflows on credit growth by allowing more exchange rate flexibility would help address both problems. Other potential policy responses include strengthening macroprudential measures, tightening fiscal policy, and, if still needed, some form of capital controls.

Europe Is Facing an Uneven Recovery and Complex Policy Challenges

Among the hardest hit during the global crisis, Europe is coming out of recession at a slower pace

Figure 2.6. Europe: Average Real GDP Growth during 2010–11
(Percent)



Source: IMF staff estimates.

than other regions. Within both advanced and emerging Europe, country experiences and recovery prospects vary considerably. A substantial macroeconomic stimulus has supported the recovery in core advanced European economies, although private demand has yet to take a firm hold. At the same time, large current account and fiscal imbalances threaten the recovery in some smaller European countries, with potentially damaging effects on the rest of the region.

Having entered the crisis with substantial imbalances, Europe suffered greatly. Among the worst performers were advanced and emerging European economies that had experienced large current account deficits and domestic imbalances. External financing constraints forced a sharp decline in output in some emerging European economies, particularly those with large current account deficits and heavy dependence on foreign financing (for example, Baltics, Bulgaria, Romania). The reversal of construction and credit booms, accompanied by banking sector problems, led to an output collapse in some euro area countries. Substantial output

losses, costly crisis-related measures, and one-time factors led to very large fiscal deficits in a number of countries (for example, Greece, Ireland, Lithuania, Portugal, Spain, United Kingdom). And although current account imbalances have adjusted in many emerging European countries, they remain substantial (and difficult to unwind) in a number of euro area countries that cannot use currency depreciation as a mechanism to improve competitiveness.

There are several powerful forces holding back the recovery in Europe. Sizable fiscal and current account imbalances are constraining recovery in several euro area countries, with potentially negative spillover effects to the rest of Europe. Indeed, concerns about sovereign solvency and liquidity in Greece (and possible contagion effects on other vulnerable euro area countries) have threatened the normalization in financial market conditions. Separately, unresolved problems in the banking sector, which plays a key role in financial intermediation in Europe, have hampered the return to normality. In addition, remaining external financing constraints, vulnerable household and corporate balance sheets, and financial sector deleveraging have limited the speed of the recovery in the hardest-hit economies in emerging Europe.

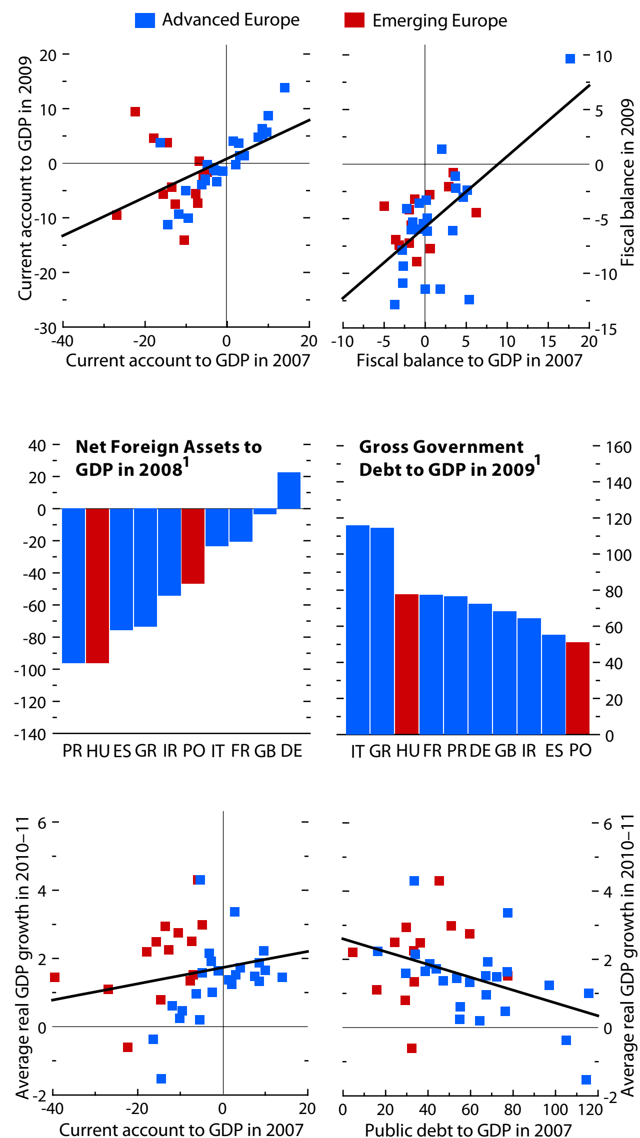
Nevertheless, the ongoing recovery in Europe has been supported by several factors. First, the turn in the inventory cycle boosted activity in the euro area during the second half of 2009. Second, the normalization of global trade has contributed significantly to growth in the euro area and in emerging Europe. Third, forceful policies have also fostered recovery, including supportive macroeconomic and financial sector measures for many European economies and coordinated assistance from multilateral institutions for the hardest-hit economies in the region.

Against this backdrop, Europe's growth performance is expected to be modest. In particular, advanced Europe's GDP is projected to grow at 1 percent in 2010, edging up to 1¾ percent in 2011. Emerging Europe's growth in real activity is expected to be 3 percent in 2010, picking up to 3½ percent in 2011. These aggregate projections, however, do not capture the pronounced differences in outlook across the region (Figures 2.6 and 2.7; Table 2.4):

Figure 2.7. Europe: A Moderate Recovery Held Back by Fiscal and External Imbalances

(Percent)

Many economies in advanced and emerging Europe faced the global crisis with substantial current account imbalances and weak fiscal positions. Current account deficits narrowed during the crisis in many cases, especially in emerging Europe. But fiscal balances deteriorated sharply across the board, as a result of large output losses and costly crisis-related measures. Consequently, some countries in the region emerged from the crisis with weak external and public sector balance sheets. These imbalances are dimming the prospects for growth in these countries.



Source: IMF staff estimates.

[1]DE: Germany; ES: Spain; FR: France; GB: United Kingdom; GR: Greece; HU: Hungary; IR: Ireland; IT: Italy; PO: Poland; PR: Portugal.

Table 2.4. Selected European Economies: Real GDP, Consumer Prices, and Current Account Balance
(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Europe	**1.0**	**–4.0**	**1.3**	**1.9**	**4.0**	**1.2**	**2.0**	**1.7**	**–0.7**	**0.2**	**0.3**	**0.4**
Advanced Europe	**0.7**	**–4.1**	**1.0**	**1.7**	**3.4**	**0.6**	**1.4**	**1.4**	**–0.1**	**0.4**	**0.7**	**0.8**
Euro Area[3]	0.6	–4.1	1.0	1.5	3.3	0.3	1.1	1.3	–1.5	–0.6	–0.3	–0.2
Germany	1.2	–5.0	1.2	1.7	2.8	0.1	0.9	1.0	6.7	4.8	5.5	5.6
France	0.3	–2.2	1.5	1.8	3.2	0.1	1.2	1.5	–2.3	–1.5	–1.9	–1.8
Italy	–1.3	–5.0	0.8	1.2	3.5	0.8	1.4	1.7	–3.4	–3.4	–2.8	–2.7
Spain	0.9	–3.6	–0.4	0.9	4.1	–0.3	1.2	1.0	–9.6	–5.1	–5.3	–5.1
Netherlands	2.0	–4.0	1.3	1.3	2.2	1.0	1.1	1.3	4.8	5.2	5.0	5.3
Belgium	0.8	–3.0	1.2	1.3	4.5	–0.2	1.6	1.5	–2.5	–0.3	–0.5	–0.1
Greece	2.0	–2.0	–2.0	–1.1	4.2	1.4	1.9	1.0	–14.6	–11.2	–9.7	–8.1
Austria	2.0	–3.6	1.3	1.7	3.2	0.4	1.3	1.5	3.5	1.4	1.8	1.7
Portugal	0.0	–2.7	0.3	0.7	2.7	–0.9	0.8	1.1	–12.1	–10.1	–9.0	–10.2
Finland	1.2	–7.8	1.2	2.2	3.9	1.6	1.1	1.4	3.0	1.4	2.0	1.8
Ireland	–3.0	–7.1	–1.5	1.9	3.1	–1.7	–2.0	–0.6	–5.2	–2.9	0.4	–0.1
Slovak Republic	6.2	–4.7	4.1	4.5	3.9	0.9	0.8	2.0	–6.5	–3.2	–1.8	–1.9
Slovenia	3.5	–7.3	1.1	2.0	5.7	0.8	1.5	2.3	–6.2	–0.3	–1.5	–1.2
Luxembourg	0.0	–4.2	2.1	2.4	3.4	0.8	1.0	1.3	5.3	5.7	11.2	11.6
Cyprus	3.6	–1.7	–0.7	1.9	4.4	0.2	2.7	2.3	–17.7	–9.3	–11.4	–10.9
Malta	2.1	–1.9	0.5	1.5	4.7	1.8	2.0	2.1	–5.4	–3.9	–5.1	–5.1
United Kingdom	0.5	–4.9	1.3	2.5	3.6	2.2	2.7	1.6	–1.5	–1.3	–1.7	–1.6
Sweden	–0.2	–4.4	1.2	2.5	3.3	2.2	2.4	2.1	7.8	6.4	5.4	5.8
Switzerland	1.8	–1.5	1.5	1.8	2.4	–0.4	0.7	1.0	2.4	8.7	9.5	9.6
Czech Republic	2.5	–4.3	1.7	2.6	6.3	1.0	1.6	2.0	–3.1	–1.0	–1.7	–2.4
Norway	1.8	–1.5	1.1	1.8	3.8	2.2	2.5	1.8	18.6	13.8	16.8	16.7
Denmark	–0.9	–5.1	1.2	1.6	3.4	1.3	2.0	2.0	2.2	4.0	3.1	2.6
Iceland	1.0	–6.5	–3.0	2.3	12.4	12.0	6.2	3.8	–15.8	3.8	5.4	1.8
Emerging Europe	**2.9**	**–3.8**	**2.9**	**3.4**	**8.0**	**4.7**	**5.3**	**3.6**	**–7.3**	**–2.0**	**–3.3**	**–3.6**
Turkey	0.7	–4.7	5.2	3.4	10.4	6.3	9.7	5.7	–5.7	–2.3	–4.0	–4.4
Poland	5.0	1.7	2.7	3.2	4.2	3.5	2.3	2.4	–5.1	–1.6	–2.8	–3.2
Romania	7.3	–7.1	0.8	5.1	7.8	5.6	4.0	3.1	–12.2	–4.4	–5.5	–5.5
Hungary	0.6	–6.3	–0.2	3.2	6.1	4.2	4.3	2.5	–7.2	0.4	–0.4	–1.0
Bulgaria	6.0	–5.0	0.2	2.0	12.0	2.5	2.2	2.9	–24.2	–9.5	–6.3	–5.8
Croatia	2.4	–5.8	0.2	2.5	6.1	2.4	2.3	2.8	–9.2	–5.6	–6.3	–6.8
Lithuania	2.8	–15.0	–1.6	3.2	11.1	4.2	–1.2	–1.0	–11.9	3.8	2.7	2.6
Latvia	–4.6	–18.0	–4.0	2.7	15.3	3.3	–3.7	–2.5	–13.0	9.4	7.0	6.3
Estonia	–3.6	–14.1	0.8	3.6	10.4	–0.1	0.8	1.1	–9.4	4.6	4.7	3.9

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Current account position corrected for reporting discrepancies in intra-area transactions.

- In advanced Europe, recovery is projected to be gradual and uneven among euro area countries. Specifically, euro-area-wide GDP is expected to grow at 1 percent in 2010 and 1½ percent in 2011. The recovery is expected to be moderate in Germany and France, where export growth is limited by external demand, investment is held back by excess capacity and credit constraints, and consumption is tempered by higher unemployment. Coming out even more slowly from the recession will be smaller euro area economies, where growth is constrained by large fiscal or current account imbalances (Greece, Ireland, Portugal, Spain). Outside the euro area, the prospects for recovery in advanced Europe are similarly diverse. In the United Kingdom, the recovery is projected to continue at a moderate pace, with previous sterling depreciation bolster-

ing net exports even as domestic demand likely remains subdued.

- In emerging Europe, growth prospects also vary widely. Economies that weathered the global crisis relatively well (Poland) and others where domestic confidence has already recovered from the initial external shock (Turkey) are projected to rebound more strongly, helped by the return of capital flows and the normalization of global trade. At the same time, economies that faced the crisis with unsustainable domestic booms that had fueled excessively large current account deficits (Bulgaria, Latvia, Lithuania) and those with vulnerable private or public sector balance sheets (Hungary, Romania, Baltics) are expected to recover more slowly, partly as a result of limited room for policy maneuvers.

The uncertainty around the outlook in Europe has increased since the October 2009 WEO, with two downside risks becoming more pronounced. In the near term, the main risk is that, if unchecked, market concerns about sovereign liquidity and solvency in Greece could turn into a full-blown sovereign debt crisis, leading to some contagion (see Chapter 1 of the April 2010 GFSR). This reinforces the importance of efforts by the Greek authorities to reestablish the credibility of their fiscal policy. The financial support package agreed upon by euro area countries, the European Commission, and the European Central Bank to be provided if necessary is a welcome and important step to ensure that jitters about Greece do not lead to financial instability or create significant adverse effects on balance sheets and banking systems in Europe. A second downside risk lies in the need to adjust fiscal and current account imbalances in peripheral economies. Although resolving these imbalances is expected to dampen growth, delays in taking decisive policy action could lead to a protracted process punctuated with occasional crises.

Regarding fiscal policy, the priority is to make credible commitments to debt sustainability while proceeding with planned stimulus measures in 2010 where this is feasible. In some cases, large deficits need to be reversed promptly to address concerns about debt sustainability (Greece, Ireland, Portugal, Spain). However, in core euro area economies where fiscal sustainability is not in question (Germany), the current plans to execute stimulus measures in full remain appropriate. Outside the euro area, several economies have already undertaken early consolidation (Hungary, Iceland, Latvia, Turkey). Across most European economies, however, the key fiscal challenge will be to commit, prepare, and communicate credible plans for fiscal consolidation. These should involve moving to sufficiently high primary surpluses in order to place public debt on a stabilizing and, eventually, declining path.

Monetary policy should remain highly accommodative in most cases. Recovery prospects are still sluggish, and so inflation pressures remain subdued. Indeed, in advanced Europe, core inflation is projected to remain low and stable (about 1 percent in the euro area), as inflation expectations are well anchored. Hence, in the euro area, it is appropriate to keep interest rates exceptionally low and to withdraw quantitative measures and unwind collateral requirement changes very gradually. This will help support the recovery in core economies while facilitating fiscal and real-economy adjustments in peripheral economies. In emerging Europe, inflation prospects are generally contained but more differentiated, owing to the variation in exchange rate regimes and output-recovery prospects across these economies (see Table 2.4). In most of these countries (with flexible exchange rate regimes and independent monetary policy), central banks could also afford to keep interest rates relatively low in the near term in order to support activity.

Another key policy challenge relates to Europe's financial sector. To the extent that they remain unresolved, banking sector issues will likely hamper the credit supply (see Chapter 1 of the April 2010 GFSR). These include the need for continued deleveraging to rebuild liquidity and capital buffers, the uncertainty about future bank restructuring, and the need to absorb additional write-downs. Moreover, growing sovereign risk poses another challenge for financial systems in Europe. These issues call for completion of the restructuring and recapitalization of vulnerable financial institutions, stabilizing funding, and reevaluating bank models.

In many ways, the most important task ahead is to strengthen EU policy frameworks to promote better adjustment mechanisms in good times and bad. The global crisis and its ripple effects have exposed weaknesses in existing policy arrangements on various fronts that need to be corrected to ensure Europe's future financial stability and growth.

- A reformed fiscal framework should incorporate a better mechanism for preventing and resolving fiscal imbalances. It could move in the direction of common fiscal rules and should include close monitoring of fiscal policies and public balance sheets.
- A stronger structural policy framework would help economies raise productivity, improve competitiveness, and reduce imbalances. Major amendments to the EU 2020 Agenda will be necessary to ensure its credible and effective delivery. A workable strategy rather than a focus on rigid targets should be at its core, which will require moving beyond the open method of coordination.
- Finally, given the cross-border nature of many European financial institutions and the potential for large spillovers across countries within the region, there is a strong case for an improved financial framework. The proposed new supervisory and regulatory structure should be put in place as planned and complemented with further work on an integrated crisis-prevention, -management, and -resolution mechanism.

The CIS Economies Are Recovering at a Moderate Pace

Having suffered a large output collapse during the crisis, the CIS region is emerging from the recession at a moderate pace. As in Europe, economic prospects across the region differ considerably.

Underpinning recovery in the CIS are several factors. First, higher commodity prices (oil, gas, metals) are once again supporting production and employment in commodity-exporting economies in the region. Second, the normalization of global trade and capital flows is helping CIS economies recover. Third, the turnaround in real activity in Russia is benefiting the rest of the region by boosting external demand for employment, capital, and goods from these economies. Fourth, IMF programs are supporting several economies in the region, and, whenever possible, expansionary domestic policies are fostering domestic demand. In addition to these positive forces, there are also negative factors that are holding back growth in several economies in the region, including lingering financial sector vulnerability and heavy dependence on external financing.

In this context, real activity in the CIS region is projected to expand by 4 percent in 2010, before moderating slightly to 3½ percent in 2011. But within the region, growth prospects are diverse (Figure 2.8; Table 2.5):

- In Russia, growth is expected to stage a modest recovery, reaching 4 percent in 2010. However, this largely reflects base effects and a turn in the inventory cycle. Despite relatively high oil prices and substantial government stimulus, underlying private domestic demand is likely to be subdued, with bad loans in the banking system expected to stifle credit and consumption growth.
- Benefiting from high commodity prices, energy exporter Uzbekistan is expected to remain among the top performers in the region in 2010, growing at 8 percent. Higher volumes of gas exports and large-scale investments are expected to raise growth in Turkmenistan, which is projected at 12 percent in 2010. More generally, economies with less externally linked financial sectors are expected to continue to do best.

Risks to the outlook in the CIS region are broadly balanced. For most CIS economies, growth prospects remain highly dependent on the speed of recovery in Russia, which could surprise in either direction.

Faced with different economic circumstances, the policy challenges in the region are also diverse.

- On the financial front, the main policy tasks vary widely across economies. For instance, in Russia, these include completing the exit from crisis-related liquidity and other measures by restoring more stringent regulatory requirements, developing plans for unwinding the forbearance already

Figure 2.8. Commonwealth of Independent States: Average Real GDP Growth during 2010–11[1]
(Percent)

Source: IMF staff estimates.
[1]Includes Georgia and Mongolia.

granted, and dealing with undercapitalized or insolvent banks. In Kazakhstan, the top priority is to implement a comprehensive solution to the problems in the banking sector, including by means of detailed independent assessment of the balance sheets of large banks.

- For monetary policy, because most economies in the region operate under pegged or heavily managed exchange rate regimes, the main challenge will be to calibrate the policy response to both domestic and external considerations. In many CIS economies, inflation is projected to decline, although it will remain at relatively high levels (Figure 2.9). Amid a more favorable external environment, and in some instances due to IMF programs supporting confidence, many regional currencies have reversed previous depreciations, leaving greater room than during the crisis for monetary accommodation in response to sluggish domestic demand.
- On the fiscal front, some policymakers have rightly undertaken countercyclical fiscal expansion (for example, Russia), although concerns remain about the size and reversibility of expenditures. In some of the hardest-hit economies, however, policy room has been more limited despite the presence of multilateral and donor support, which helped prevent even deeper adjustments in fiscal balances.

Latin America and the Caribbean Are Recovering at a Robust Pace

Having weathered the global downturn comparatively well, the LAC region is posting a strong

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Commonwealth of Independent States (CIS)[3]	**5.5**	**–6.6**	**4.0**	**3.6**	**15.6**	**11.2**	**7.2**	**6.1**	**4.9**	**2.6**	**4.0**	**3.6**
Russia	5.6	–7.9	4.0	3.3	14.1	11.7	7.0	5.7	6.2	3.9	5.1	4.6
Ukraine	2.1	–15.1	3.7	4.1	25.2	15.9	9.2	8.9	–7.1	–1.7	–2.3	–2.3
Kazakhstan	3.2	1.2	2.4	4.2	17.1	7.3	7.3	6.6	4.6	–3.1	0.7	–0.2
Belarus	10.0	0.2	2.4	4.6	14.8	13.0	7.3	6.2	–8.6	–12.9	–10.4	–9.2
Azerbaijan	10.8	9.3	2.7	0.6	20.8	1.5	4.7	3.5	35.5	23.6	25.3	24.2
Turkmenistan	10.5	4.1	12.0	12.2	14.5	–2.7	5.0	5.4	18.7	–9.7	–8.7	1.3
Mongolia	8.9	–1.6	7.2	7.1	26.8	6.3	7.3	5.3	–14.0	–5.6	–6.6	–16.5
Low-Income CIS	**8.6**	**4.7**	**4.5**	**3.9**	**15.8**	**6.2**	**6.8**	**6.3**	**12.0**	**7.9**	**8.6**	**8.1**
Uzbekistan	9.0	8.1	8.0	7.0	12.7	14.1	9.2	9.4	12.5	5.1	5.1	5.0
Georgia	2.3	–4.0	2.0	4.0	10.0	1.7	4.9	5.0	–22.7	–12.2	–14.2	–13.8
Armenia	6.8	–14.4	1.8	3.0	9.0	3.4	6.8	5.2	–11.5	–13.8	–13.0	–12.6
Tajikistan	7.9	3.4	4.0	5.0	20.4	6.5	7.0	8.3	–7.7	–7.3	–8.0	–8.3
Kyrgyz Republic	8.4	2.3	4.6	5.3	24.5	6.8	8.4	7.6	–8.1	3.5	–15.4	–12.5
Moldova	7.8	–6.5	2.5	3.6	12.7	0.0	7.7	5.7	–16.3	–7.9	–9.7	–9.7
Memorandum												
Net Energy Exporters[4]	5.7	–6.0	4.1	3.5	14.5	10.9	7.0	5.8	7.0	3.8	5.3	4.8
Net Energy Importers[5]	4.5	–9.6	3.3	4.3	21.3	13.1	8.4	7.8	–8.6	–5.7	–5.9	–5.9

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.

[2]Percent of GDP.

[3]Georgia and Mongolia, which are not members of the Commonwealth of Independent States, are included in this group for reasons of geography and similarities in economic structure.

[4]Net Energy Exporters comprise Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan.

[5]Net Energy Importers comprise Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, and Ukraine.

recovery. More balanced than in most other areas, output growth in the region is supported by both external and domestic demand.

Recovery in the LAC region has been shaped by a number of factors. First, accommodative policies are helping underpin domestic demand. Second, good fundamentals (sound financial systems, solid balance sheets) are helping the region recover and reattract capital flows in an improved global financial environment. Third, higher commodity prices and external demand are supporting growth in many economies, given their dependence on commodity-related earnings. However, weak external demand for tourism from North America and Europe is impeding growth in a number of economies in the region, especially in the Caribbean, whereas lower remittances are affecting many LAC economies.

Against this backdrop, GDP in the LAC region is projected to grow at 4 percent in 2010 and 2011, although prospects vary considerably across the region (Figure 2.10; Table 2.6).

- The recovery is projected to be especially strong in many commodity-exporting, financially integrated economies, which account for about two-thirds of the LAC region's GDP. In Brazil, growth in 2010 is expected to rebound to 5½ percent, led by strong private consumption and investment. Despite a devastating earthquake, Chile's GDP is projected to grow at about 4¾ percent in 2010 and 6 percent in 2011, supported by highly accommodative policies, a recovery in commodity prices, and reconstruction efforts. In Mexico, growth is expected to rebound to 4¼ percent in 2010, helped in part by the U.S. recovery. In Peru, the top growth performer of the region, GDP is projected to expand by 6¼ percent in 2010, mostly thanks to favorable internal dynamics and high commodity prices.
- Growth prospects are more subdued in other commodity-exporting economies in the region, although there is still considerable variation within this group. For instance, the rebound is projected to be relatively strong in Bolivia and Paraguay, whereas the recovery is expected to be

delayed and weak in Venezuela, given ongoing power shortages.

- The recovery is also expected to be less strong in many commodity-importing economies in the region that have large tourism sectors (Antigua and Barbuda, The Bahamas, Barbados, St. Lucia). Weaker prospects for tourism, coupled with limited policy room to support the recovery, are expected to weigh on near-term growth.

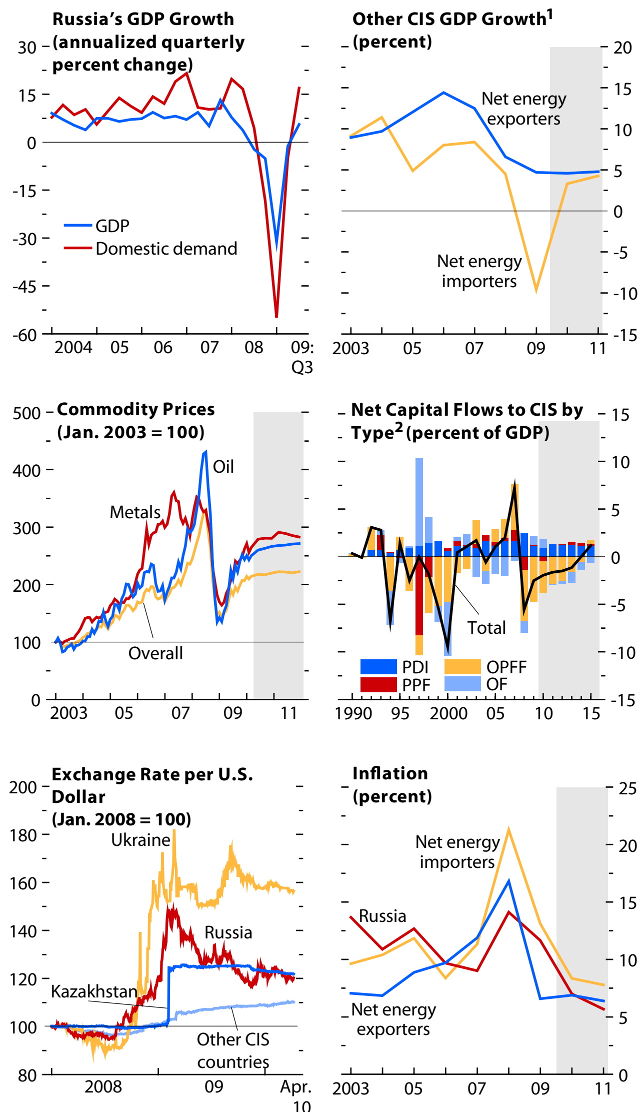
The risks to LAC growth are substantial but broadly in balance. The main downside risks are external to the region. They relate to the fragility of the recovery in advanced economies and a potential weakness in commodity prices. There are also significant upside risks, however. These include even stronger internal dynamics, which could attract higher capital flows.

Given the region's diverse growth outlook, policy challenges vary widely across LAC economies. For many of the strong performers in the region, the central issue is related to when and how to exit from accommodative macroeconomic policies. For most tourism-intensive economies, the key challenge is to manage the recovery and maintain macroeconomic stability with limited policy choices, given high levels of public debt. Across the region, the issue of how to respond to large capital inflows will require deft policy management.

On the fiscal front, the sluggish recovery in advanced economies calls for keeping existing stimulus in place until domestic recoveries are firmly entrenched, especially where the economy is below potential. Nevertheless, the reversal of policy stimulus will need to proceed as soon as risks of domestic overheating (Brazil) or adverse debt dynamics become a concern. In economies with more limited fiscal room, the focus should be on maintaining targeted measures that ease hardship on the poor (for example, in the Caribbean). Once the recovery has gathered momentum, the stance of monetary policy should start moving from highly accommodative to more neutral. As output gaps are narrowing and inflation pressures are building at varying speeds, some of the economies with inflation-targeting regimes (Brazil) seem closer to that turning point than others (Colombia, Mex-

Figure 2.9. Commonwealth of Independent States (CIS): A Modest Recovery Ahead

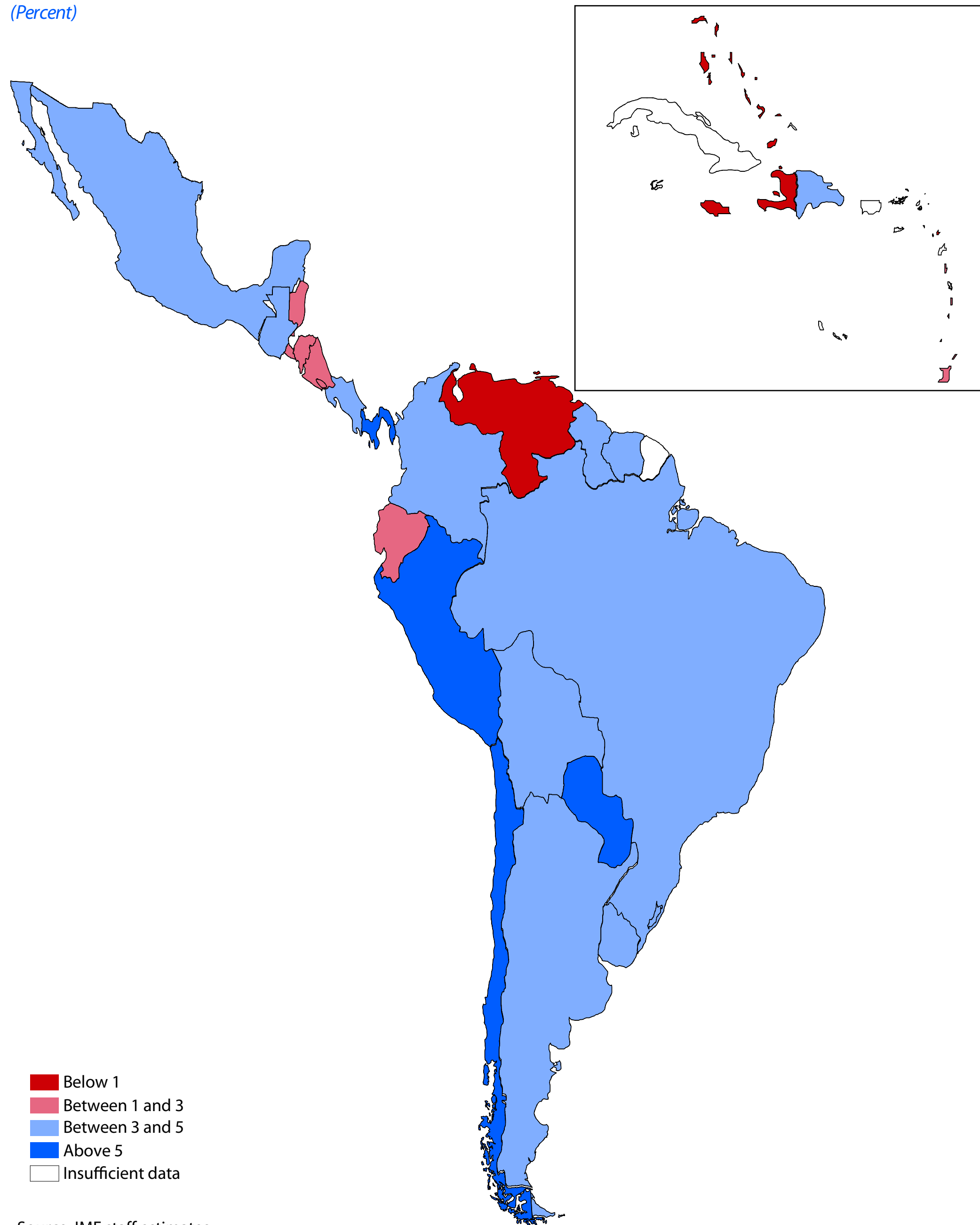
The CIS region is coming out of the recession at a moderate pace, with considerable differentiation in economic prospects across the region. The turnaround in Russia is helping other economies in the region. Higher commodity prices are supporting the recovery in net energy exporters. Amid a more favorable external environment, capital flows are expected to return, but only gradually. Some regional currency depreciations have reversed, helping slow inflation.



Sources: Haver Analytics; IHS Global Insight; IMF Primary Commodity Price System; and IMF staff estimates.
[1]Net energy exporters include Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan. Net energy importers include Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, and Ukraine.
[2]OF: official flows; OPFF: other private financial flows; PDI: private direct investment; PPF: private portfolio investment.

Figure 2.10. Latin America and the Caribbean: Average Real GDP Growth in 2010 –11

(Percent)



Source: IMF staff estimates.

Table 2.6. Selected Western Hemisphere Economies: Real GDP, Consumer Prices, and Current Account Balance
(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Western Hemisphere	**4.3**	**–1.8**	**4.0**	**4.0**	**7.9**	**6.0**	**6.2**	**5.9**	**–0.6**	**–0.5**	**–1.0**	**–1.2**
South America and Mexico	**4.3**	**–1.9**	**4.1**	**4.0**	**7.6**	**6.1**	**6.3**	**6.0**	**–0.3**	**–0.3**	**–0.9**	**–1.1**
Brazil	5.1	–0.2	5.5	4.1	5.7	4.9	5.1	4.6	–1.7	–1.5	–2.9	–2.9
Mexico	1.5	–6.5	4.2	4.5	5.1	5.3	4.6	3.7	–1.5	–0.6	–1.1	–1.4
Argentina[3]	6.8	0.9	3.5	3.0	8.6	6.3	10.1	9.1	1.5	2.8	2.8	2.0
Colombia	2.4	0.1	2.2	4.0	7.0	4.2	3.5	3.7	–2.8	–1.8	–3.1	–2.9
Venezuela	4.8	–3.3	–2.6	0.4	30.4	27.1	29.7	33.1	12.3	2.5	10.5	10.8
Peru	9.8	0.9	6.3	6.0	5.8	2.9	1.5	1.8	–3.7	0.2	–0.7	–1.8
Chile	3.7	–1.5	4.7	6.0	8.7	1.7	2.0	3.0	–1.5	2.2	–0.8	–2.1
Ecuador	7.2	0.4	2.5	2.3	8.4	5.1	4.0	3.5	2.2	–1.1	–0.6	–1.6
Bolivia	6.1	3.3	4.0	4.0	14.0	3.5	3.3	3.7	12.1	3.5	2.6	2.0
Uruguay	8.5	2.9	5.7	3.9	7.9	7.1	6.2	6.0	–4.8	0.8	–1.0	–0.9
Paraguay	5.8	–4.5	5.3	5.0	10.2	2.6	3.9	3.6	–2.4	–0.2	–1.5	–1.2
Central America[4]	**4.3**	**–0.6**	**2.7**	**3.7**	**11.2**	**3.5**	**3.5**	**4.1**	**–9.1**	**–2.0**	**–5.4**	**–5.7**
Carribean[5]	**2.9**	**0.4**	**1.5**	**4.3**	**12.0**	**3.6**	**6.4**	**4.8**	**–1.6**	**–3.1**	**–2.0**	**–1.2**

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.

[2]Percent of GDP.

[3]Private analysts estimate that consumer price index inflation has been considerably higher. The authorities have created a board of academic advisors to assess these issues. Private analysts are also of the view that real GDP growth has been significantly lower than the official reports since the last quarter of 2008.

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

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

ico). In the event that risks to growth materialize, monetary policy in these economies should stay nimble in both directions. Nevertheless, there is also an argument for keeping interest rates low for a longer period than justified by domestic cyclical considerations, because higher interest rates may attract speculative capital inflows.

Given its comparatively strong rebound, the LAC region may draw further inflows of foreign capital, which would pose an additional policy challenge. Although the current account position of the region is projected to remain in a small deficit, key economies have already attracted sizable flows into domestic equities and government bonds (Figure 2.11). Recent policy responses in the region have included allowing currency appreciation, accumulating foreign exchange reserves, and reintroducing capital controls. The appropriate response to potential further pressures in the region will continue to depend on economy-specific circumstances. In addition to the above-mentioned policies, it may also include adjusting the macroeconomic policy mix, specifically tightening fiscal policy and strengthening macroprudential measures.

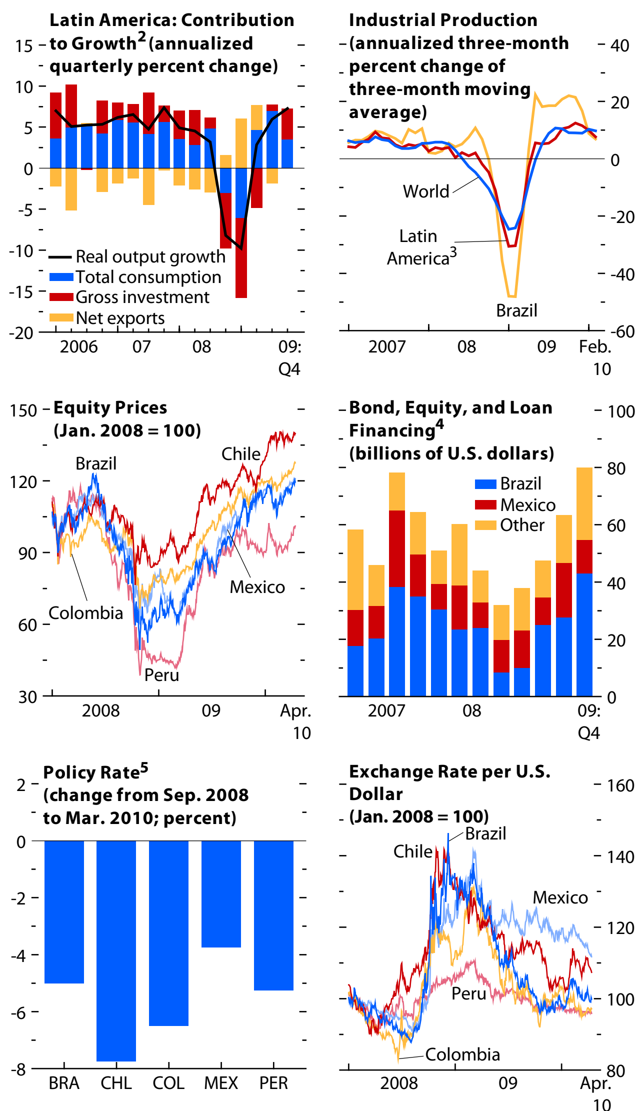
The Middle East and North Africa Region Is Recovering at a Good Pace

The MENA region is growing out of its downturn at a good speed. Economic prospects across the region are quite diverse (Figure 2.12), shaped by different constellations of underlying forces.

There are several factors molding the shape of the MENA region's recovery. Pushing it forward are at least two forces. First, higher commodity prices and external demand are boosting production and exports in many economies in the region. Second, government spending programs are playing a key

Figure 2.11. Latin America and the Caribbean: A Robust Recovery[1]

Growth in Latin America and the Caribbean has rebounded, led by strong domestic consumption. Production levels have increased sharply, especially in Brazil. The ongoing recovery has been supported by improving financial conditions. Equity prices have reversed their declines and even exceeded precrisis levels in some economies. Despite accommodative monetary policies, good fundamentals are helping the region reattract capital flows, leading to currency appreciation in some cases.



Sources: Bloomberg Financial Markets; Dealogic; Haver Analytics; IHS Global Insight; and IMF staff calculations.

[1]Latin America includes Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela.

[2]Latin America excluding Uruguay.

[3]Latin America excluding Ecuador and Uruguay.

[4]Total issuance.

[5]BRA: Brazil; CHL: Chile; COL: Colombia; MEX: Mexico; PER: Peru.

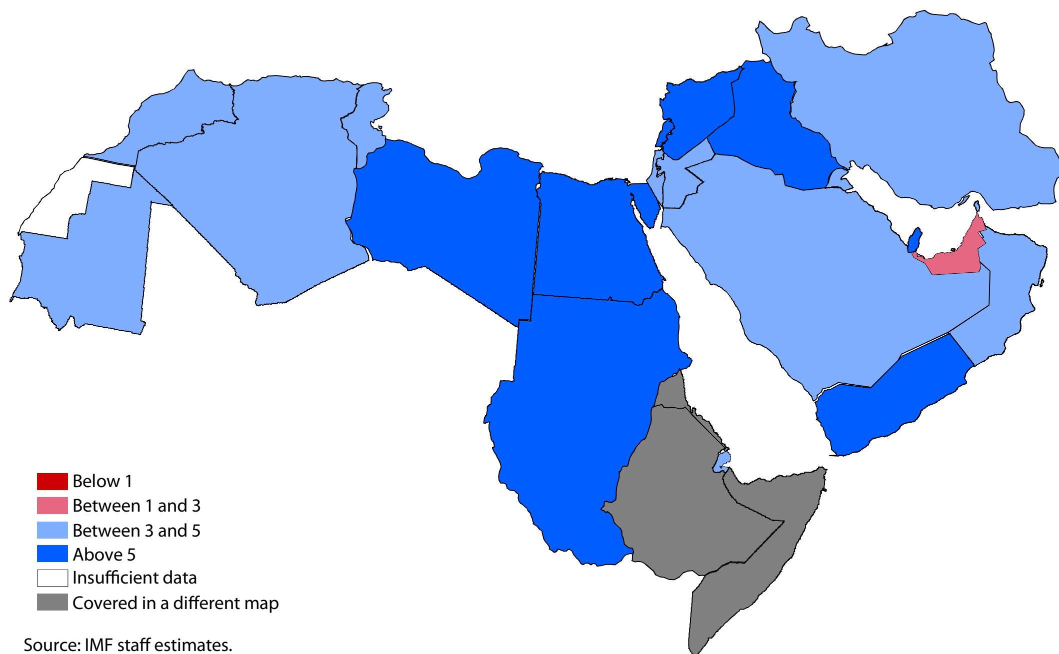
role in fostering the recovery. In some economies, vulnerable financial sectors and weak property markets are holding it back (Kuwait, United Arab Emirates). The sluggish recovery in Europe is putting a damper on export growth, workers' remittances, and tourism revenues in other parts of the MENA region (Morocco, Tunisia), although the latest data suggest that these flows are gradually improving.

Considering these and other factors, GDP in the Middle East and North Africa is projected to grow at 4½ percent in 2010, edging up to 4¾ percent in 2011. As in other regions, recovery prospects vary substantially across MENA economies (Figure 2.13; Table 2.7).

- In the group of oil exporters, the strongest performer is Qatar, where real activity is projected to expand by 18½ percent in 2010, underpinned by continued expansion in natural gas production and large investment expenditures. In Saudi Arabia and Kuwait, GDP is expected to grow at about 3¾ percent and 3 percent, respectively, this year supported in both cases by sizable government infrastructure investment. In the United Arab Emirates, growth in 2010 is projected to be subdued at 1¼ percent, with property-related sectors expected to contract further.
- In the group of oil importers, Egypt's GDP is projected to grow 5 percent in 2010 and 5½ percent in 2011, helped by stimulative fiscal and monetary policies. Morocco and Tunisia will continue to grow at rates of 3¼ to 4 percent in 2010 and 4½ to 5 percent in 2011, assuming exports, tourism, remittances, and foreign direct investment continue to improve.

There is substantial uncertainty about this outlook, with two key risks on the downside. The first risk is that a slower-than-expected recovery in advanced economies could dampen commodity prices and tourism. This would adversely affect the region's export earnings, fiscal and external balances, and growth. The second risk relates to the aftermath of the Dubai World debt crisis, whose economic impact has so far been relatively limited but whose full impact may

Figure 2.12. Middle East and North Africa: Average Real GDP Growth in 2010–11
(Percent)



Source: IMF staff estimates.

not be felt for some time. In particular, a possible repricing of quasi sovereign debt could have a lasting effect on financial systems, corporate sectors, and, more generally, economic activity in the area.

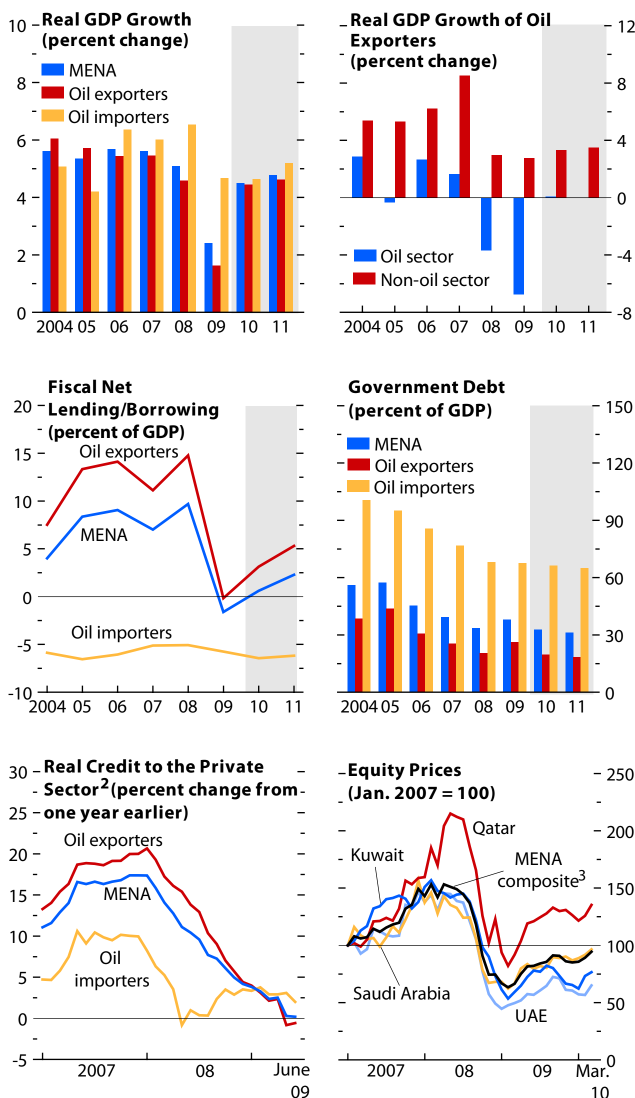
Fiscal policy has played a critical role in cushioning the impact of the global crisis on the region and in supporting its recovery. Government investment programs, especially in infrastructure, will continue to boost domestic demand in the near term in many MENA economies. These measures should remain in place to help cement the recovery. High debt levels, however, constrain the scope for fiscal stimulus in some oil-importing economies.

Given subdued inflation pressures, monetary policy should continue to be used as a countercyclical tool, if feasible. This pertains to MENA economies with nonpegged exchange rate regimes (Egypt). For other economies in the region that have hard pegs to the dollar (Saudi Arabia, United Arab Emirates), monetary policy mirrors U.S. policy and is appropriately stimulative.

With regard to financial sector policy, assistance to financial systems has helped contain vulnerabilities and spillovers, especially from the Gulf Cooperation Council region. In spite of such support, banks in the region have become more cautious, following recent episodes of financial sector distress that occurred amid sharp corrections in property

Figure 2.13. Middle East and North Africa (MENA): Growing out of Its Downturn[1]

Higher commodity prices and external demand are boosting production and exports in many economies in the region. Government spending programs are playing a key role in fostering the recovery, especially in oil-exporting countries with stronger public debt positions. Nevertheless, real credit is expected to be sluggish as credit demand remains weak in many economies and credit supply is held back by declining property markets and vulnerable financial sectors in some economies.



Sources: Haver Analytics; IMF, *International Financial Statistics*; and IMF staff estimates.

[1]Oil exporters include Algeria, Bahrain, Iraq, Islamic Republic of Iran, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Sudan, United Arab Emirates (UAE), and Republic of Yemen. Oil importers include Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Syrian Arab Republic, and Tunisia.

[2]Deflated by consumer price index.

[3]Includes Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and UAE.

markets. This will likely curb the availability of bank loans and, ultimately, credit growth.

Turning to the external sector, current account surpluses in the MENA region are expected to widen again as the recovery proceeds. Specifically, the current account surplus of the region, which declined from 15½ percent of GDP in 2008 to 1¾ percent of GDP in 2009, is now projected to rise to 5¼ percent of GDP in 2010. But the recent increases in public spending on non-energy-related sectors should be helpful in diversifying activity toward these sectors, rebalancing regional growth, and reducing the region's current account surplus. Nonetheless, further efforts are needed to achieve such diversification, which will benefit not only the MENA region but the global economy as well.

Africa Is Coming through the Crisis Well

Sub-Saharan Africa has weathered the global crisis well, and its recovery from the slowdown in 2009 is expected to be stronger than following past global downturns. Although some middle-income and oil-exporting economies were hit hard by the collapse in export and commodity markets, the region managed to avoid a contraction in 2009, growing by 2 percent last year. Its growth is projected to accelerate to 4¾ percent this year and to 6 percent in 2011 (Figure 2.14; Table 2.8). The region's quick recovery reflects the relatively limited integration of most low-income economies into the global economy and the limited impact on their terms of trade, the rapid normalization in global trade and commodity prices, and the use of countercyclical fiscal policies. Remittances and official aid flows have also been less affected than anticipated by the recessions in advanced economies (Figure 2.15). Banking sectors have so far proved generally resilient, and private capital inflows have resumed into the region's more integrated economies.

Shocks from the global crisis hit sub-Saharan Africa mainly through the trade channel. Reflecting their greater openness to trade, the region's middle-income economies were among the hardest hit. Output in South Africa declined by 1¾ percent

Table 2.7. Selected Middle East and North African Economies: Real GDP, Consumer Prices, and Current Account Balance

(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Middle East and North Africa	**5.1**	**2.4**	**4.5**	**4.8**	**13.5**	**6.6**	**6.5**	**6.4**	**15.5**	**1.8**	**5.2**	**7.0**
Oil Exporters[3]	**4.6**	**1.6**	**4.5**	**4.6**	**14.6**	**5.7**	**6.0**	**6.3**	**19.6**	**3.4**	**7.8**	**10.0**
Islamic Republic of Iran	2.3	1.8	3.0	3.2	25.4	10.3	8.5	10.0	7.2	2.4	2.3	1.7
Saudi Arabia	4.3	0.1	3.7	4.0	9.9	5.1	5.2	5.0	27.9	5.5	9.1	10.8
Algeria	2.4	2.0	4.6	4.1	4.9	5.7	5.5	5.2	20.2	0.3	2.5	3.4
United Arab Emirates	5.1	–0.7	1.3	3.1	11.5	1.0	2.2	3.0	8.5	–3.1	7.8	7.7
Kuwait	6.4	–2.7	3.1	4.8	10.5	4.7	4.5	4.0	40.8	25.8	31.6	32.6
Iraq	9.5	4.2	7.3	7.9	2.7	–2.8	5.1	5.0	15.1	–19.4	–21.0	–5.5
Qatar	15.8	9.0	18.5	14.3	15.0	–4.9	1.0	3.0	33.0	16.4	25.1	39.4
Sudan	6.8	4.5	5.5	6.0	14.3	11.3	10.0	9.0	–9.0	–12.9	–8.4	–8.5
Oil Importers[4]	**6.5**	**4.7**	**4.6**	**5.2**	**10.1**	**9.1**	**8.0**	**6.7**	**–3.4**	**–4.2**	**–4.4**	**–4.1**
Egypt	7.2	4.7	5.0	5.5	11.7	16.2	12.0	9.5	0.5	–2.4	–2.6	–2.1
Morocco	5.6	5.2	3.2	4.5	3.9	1.0	2.0	2.6	–5.2	–5.0	–5.0	–4.4
Syrian Arab Republic	5.2	4.0	5.0	5.5	15.2	2.5	5.0	5.0	–3.6	–4.5	–4.0	–3.5
Tunisia	4.6	3.0	4.0	5.0	5.0	3.7	4.2	3.5	–4.2	–3.4	–2.7	–3.0
Lebanon	9.0	9.0	6.0	4.5	10.8	1.2	5.0	3.4	–11.5	–11.1	–12.8	–12.8
Jordan	7.8	2.8	4.1	4.5	14.9	–0.7	5.3	4.6	–10.3	–5.6	–8.9	–9.7
Memorandum												
Israel	4.0	0.7	3.2	3.5	4.6	3.3	2.3	2.6	0.7	3.7	3.9	3.7
Maghreb[5]	3.7	2.9	4.2	4.7	5.5	3.7	4.2	4.0	16.3	1.3	4.5	5.3
Mashreq[6]	7.0	4.8	5.0	5.4	12.3	11.9	10.0	8.1	–2.5	–4.0	–4.4	–4.0

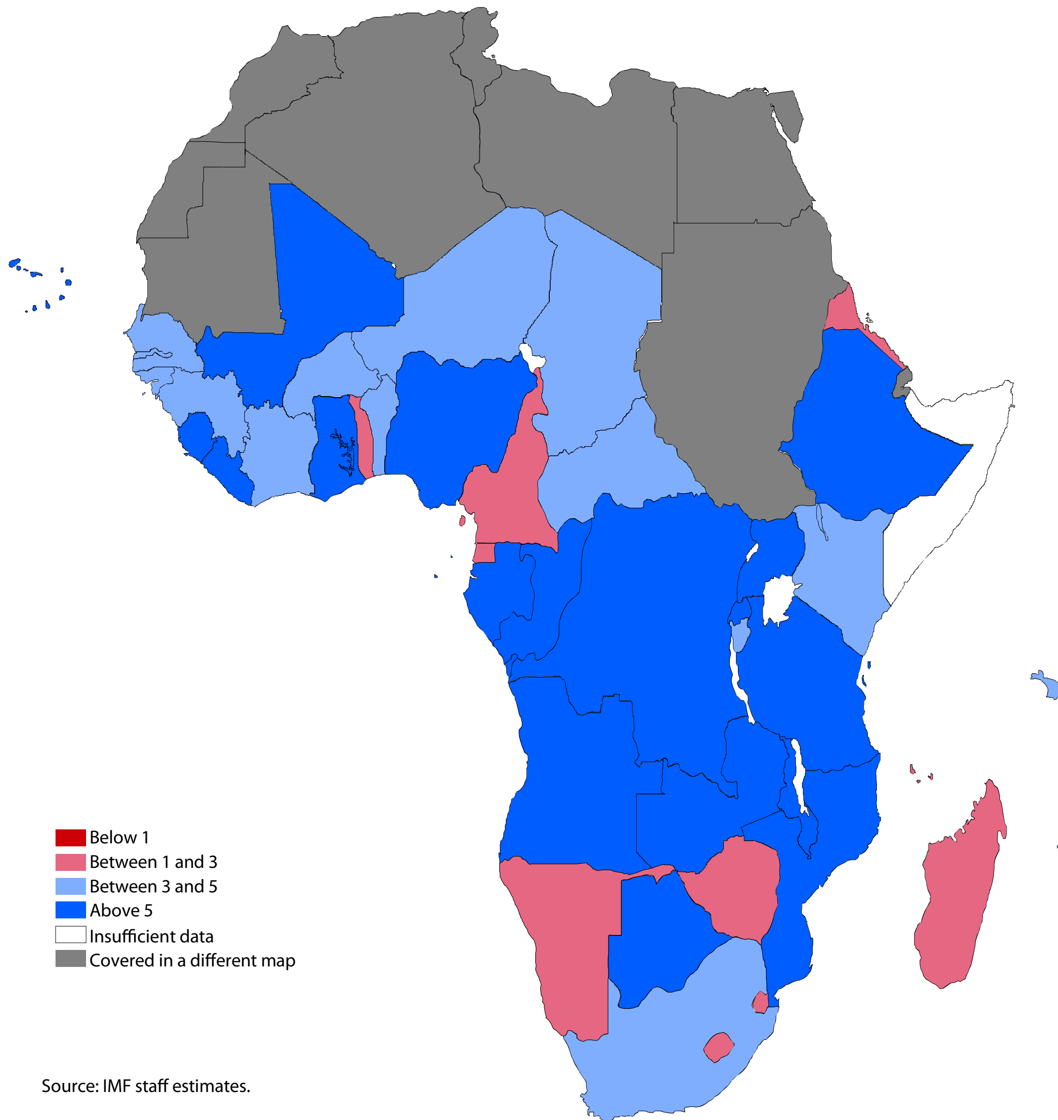
[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Includes Bahrain, Libya, Oman, and Republic of Yemen.
[4]Includes Djibouti and Mauritania.
[5]The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia.
[6]The Mashreq comprises Egypt, Jordan, Lebanon, and Syrian Arab Republic.

in 2009. Although the rebound in world trade is supporting recovery, South Africa's growth—projected at 2½ percent in 2010 and 3½ percent in 2011—will be tempered by high unemployment, tight credit conditions, and the recent strength of the rand.

Declining global demand and the collapse in oil prices also dealt a blow to the region's major oil exporters. Fiscal surpluses, some of which had been substantial, were cut markedly, and some economies swung into fiscal deficit. As a result, output growth in these economies slowed by 3½ percentage points to 4 percent in 2009, although strong performance in the non-oil economy allowed Nigeria, the region's largest oil producer, to avoid a substantial slowdown. The recovery of oil prices and stronger global demand will raise growth for these economies to 6¾ percent in 2010 and 7 percent in 2011.

In the region's low-income economies the slowdown in economic activity was more modest, owing to their more limited trade and financial integration. Growth in a number of the more fragile economies even accelerated last year, reflecting mainly stronger policies and reconstruction assistance following periods of civil conflict, economic instability, and previous external shocks. For the low-income economies as a whole, output is projected to grow by 4¾ percent in 2010 and 6¾ percent in 2011.

Figure 2.14. Sub-Saharan Africa: Average Real GDP Growth in 2010–11
(Percent)



Source: IMF staff estimates.

Table 2.8. Selected Sub-Saharan African Economies: Real GDP, Consumer Prices, and Current Account Balance
(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
			Projections				Projections				Projections	
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Sub-Saharan Africa	**5.5**	**2.1**	**4.7**	**5.9**	**11.6**	**10.6**	**8.0**	**6.9**	**0.9**	**–2.1**	**–1.7**	**–2.0**
Oil Exporters	**7.4**	**3.9**	**6.8**	**7.1**	**10.9**	**11.7**	**11.5**	**9.0**	**15.1**	**5.0**	**7.7**	**7.3**
Nigeria	6.0	5.6	7.0	7.3	11.6	12.4	11.5	9.5	20.4	11.6	12.4	12.0
Angola	13.2	–0.4	7.1	8.3	12.5	14.0	15.0	9.8	7.5	–3.3	3.6	3.1
Equatorial Guinea	10.7	5.3	0.9	2.1	4.3	7.1	7.1	6.6	9.9	–13.8	–5.0	–10.8
Gabon	2.7	–1.4	5.4	4.9	5.3	2.1	7.5	9.0	21.3	11.6	2.1	2.3
Chad	–0.4	–1.6	4.4	3.9	8.3	10.1	6.0	3.0	–13.7	–32.5	–29.7	–26.3
Congo, Republic of	5.6	7.6	12.1	6.6	6.0	4.3	4.0	3.0	–1.2	–12.4	–0.5	2.9
Middle-Income	**3.6**	**–1.8**	**2.8**	**3.7**	**11.5**	**7.1**	**5.7**	**5.7**	**–6.5**	**–4.2**	**–5.4**	**–6.9**
South Africa	3.7	–1.8	2.6	3.6	11.5	7.1	5.8	5.8	–7.1	–4.0	–5.0	–6.7
Botswana	3.1	–6.0	6.3	5.1	12.6	8.1	6.1	6.2	4.9	–5.1	–7.6	–7.7
Mauritius	4.2	1.5	4.1	4.7	9.7	2.5	2.1	2.4	–10.4	–8.2	–8.6	–8.3
Namibia	3.3	–0.7	1.7	2.2	10.0	9.1	6.5	5.9	2.7	–2.2	–6.6	–5.0
Swaziland	2.4	0.4	1.1	2.5	13.1	7.6	6.2	5.6	–4.1	–6.3	–12.8	–12.4
Cape Verde	5.9	4.1	5.0	5.5	6.8	1.2	1.4	2.0	–12.4	–19.4	–25.1	–24.3
Seychelles	–0.9	–7.6	4.0	5.0	37.0	31.8	3.2	2.5	–44.7	–23.1	–32.5	–28.8
Low-Income[3]	**5.8**	**4.3**	**4.7**	**6.7**	**12.4**	**12.9**	**7.0**	**6.1**	**–8.5**	**–6.6**	**–8.0**	**–7.5**
Ethiopia	11.2	9.9	7.0	7.7	25.3	36.4	3.8	9.3	–5.6	–5.0	–7.8	–9.3
Kenya	1.5	2.1	4.1	5.8	13.1	11.8	8.0	5.0	–6.9	–6.2	–6.7	–6.4
Tanzania	7.4	5.5	6.2	6.7	10.3	12.1	7.8	5.0	–9.8	–9.4	–8.0	–8.2
Cameroon	2.9	2.0	2.6	2.9	5.3	3.0	3.0	2.7	–1.8	–2.7	–4.3	–4.9
Uganda	8.7	7.1	5.6	6.4	7.3	14.2	10.5	7.5	–3.2	–4.8	–5.3	–6.1
Côte d'Ivoire	2.3	3.8	3.0	4.0	6.3	1.0	1.4	2.5	2.4	7.3	4.4	3.2

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.

[2]Percent of GDP.

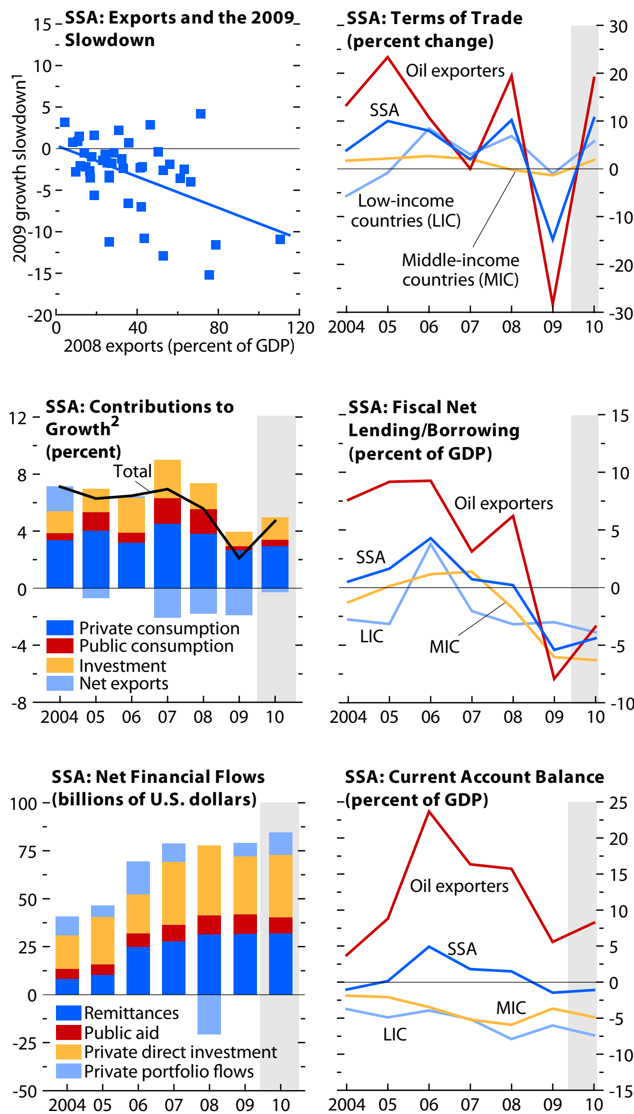
[3]Includes Benin, Burkina Faso, Burundi, Central African Republic, Comoros, Democratic Republic of the Congo, Eritrea, The Gambia, Ghana, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Togo, Zambia, and Zimbabwe.

The risks to the outlook in the region are varied, but three are worth highlighting. First, in addition to the direct impact of a more hesitant recovery in advanced economies, a recovery pattern that gave rise to large swings in commodity prices would have varied effects on the region. For example, higher-than-expected energy prices would benefit oil exporters but dampen growth and raise inflation in the region's oil importers. Second, although bilateral aid held up relatively well during the global downturn, the outlook for official aid flows to the region as a whole is subject to downside risks, given the large output declines in major donor economies, their possibly protracted recoveries, and heightened fiscal pressures. Finally, political uncertainty in several economies, particularly in West Africa, has the potential to dampen their economic growth and spill over to their neighbors.

The use of countercyclical fiscal policy during the global downturn, in contrast to previous downturns, was a welcome development in the region. In most cases, the sustainability of public debt trajectories has not been adversely affected, a testament to improved fiscal positions in a number of sub-Saharan African economies in the run-up to the downturn. As private and external demand begins to recover, countries will need to rebuild fiscal room, turning from the near-term objective of stabilizing output to medium-term considerations, such as increasing spending on growth-enhancing priorities, including infrastructure, health, and education.

Figure 2.15. Sub-Saharan Africa (SSA): Rebounding Strongly

Declining trade and commodity prices hurt sub-Saharan Africa during the crisis, but the recovery of both is supporting the rebound. Countercyclical fiscal balances and the stability of nonportfolio flows have also helped cushion the impact of the crisis in the region.



Source: IMF staff estimates.
[1]2009 real GDP growth relative to average real GDP growth in 2003–07.
[2]Excluding Liberia, São Tomé and Príncipe, and Zimbabwe.

Finally, attracting private capital flows—and ensuring that macroeconomic policy successfully accommodates them—will continue to be a major policy challenge. More than a third of economies in sub-Saharan Africa remain on the margins of international capital markets and dependent on official forms of external financing. For these economies, the same reforms that are needed to raise productive potential—including promoting trade and financial sector development, encouraging domestic saving and investment, raising standards of governance, and strengthening institutions—are also likely to help attract private inflows on a sustained basis. For the region's more advanced economies, macroeconomic policy will need to take into account the renewed inflows of foreign capital to avoid overheating, unwarranted appreciation, and asset price booms.