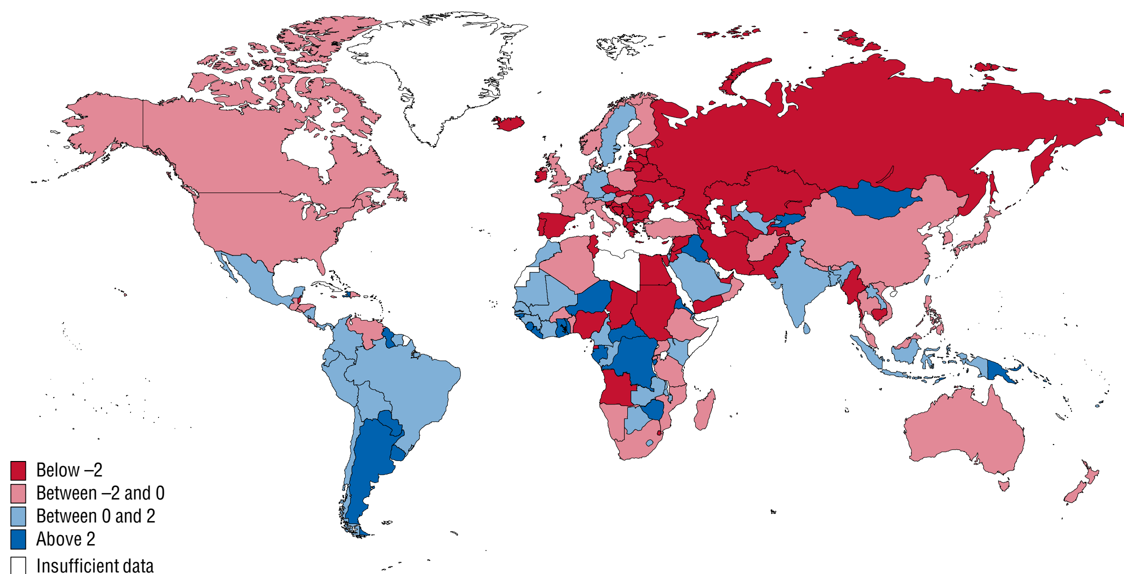
CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

The global economy has slowed, financial volatility and investor risk aversion have sharply increased, and performance has continued to diverge across regions (Figure 2.1). In the United States, weak growth and the lack of a credible medium-term fiscal plan to reduce debt are draining confidence. Europe is gripped with financial strains from the sovereign debt crisis in the euro area periphery. How these advanced economies confront their fiscal challenges will profoundly affect their economic prospects. Emerging and developing economies as a group continue to expand, a few at rates well above their precrisis averages. However, growth will likely moderate as the slowdown in major advanced economies weighs on external demand. Finally, inflation remains elevated (Figure 2.2). Although this is explained mainly by resurgent commodity prices in the first half of the year, in some economies, demand pressures—stoked by accommodative policies, strong credit growth, and capital inflows—have contributed as well. Policy tightening, to eliminate inflation pressure and strengthen fiscal accounts, is essential to sustain balanced growth in these economies. Where overheating and fiscal risks are not imminent, further tightening can wait until risks to global stability subside.

Almost three years after the crisis, the global economy continues to be challenged with intermittent volatility. Economic performance has become even more bipolar in nature, with anemic growth in economies with large precrisis imbalances and robust activity in many others. As discussed earlier, the unbalanced expansion reflects an inadequate transition from public to private demand in advanced economies and from external-demand-driven growth to domestic-demand-driven growth in key emerging and developing economies. Without progress on

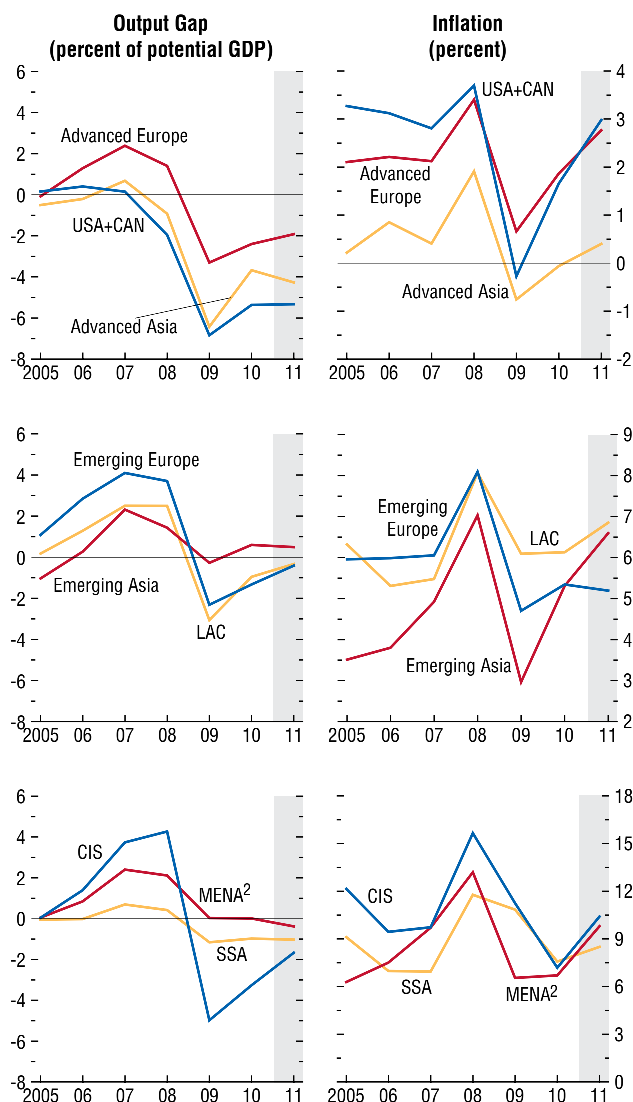
Figure 2.1. Current Global Growth versus Precrisis Average
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.
Note: There are no data for Libya in the projection years due to the uncertain political situation. Projections for 2011 and later exclude South Sudan. Due to data limitations, data for Iraq are the growth differential between the average in 2011–12 and 2005–07; for Afghanistan between the average in 2011–12 and 2003–07; and for Kosovo, Liberia, Malta, Montenegro, Tuvalu, and Zimbabwe between the average in 2011–12 and 2001–07.

Figure 2.2. Output Gaps and Inflation[1]

Economies that experienced the worst financial crises are still struggling with modest growth and persistent economic slack. Others are growing relatively strongly, with many emerging and developing economies hitting up against capacity constraints. Notwithstanding economic cycles, inflation remains elevated, reflecting resurgent commodity prices earlier in the year as well as demand pressures in some economies.



Source: IMF staff estimates.
[1]Advanced Asia: Australia, Japan, and New Zealand; CIS: Commonwealth of Independent States; LAC: Latin America and the Caribbean; MENA: Middle East and North Africa; SSA: sub-Saharan Africa; USA+CAN: United States and Canada. Regional aggregates are computed on the basis of purchasing-power-parity weights.
[2]Excludes Libya for the projection years due to the uncertain political situation. Projections for 2011 and later exclude South Sudan.

these fronts, global economic and financial stability will remain at risk.

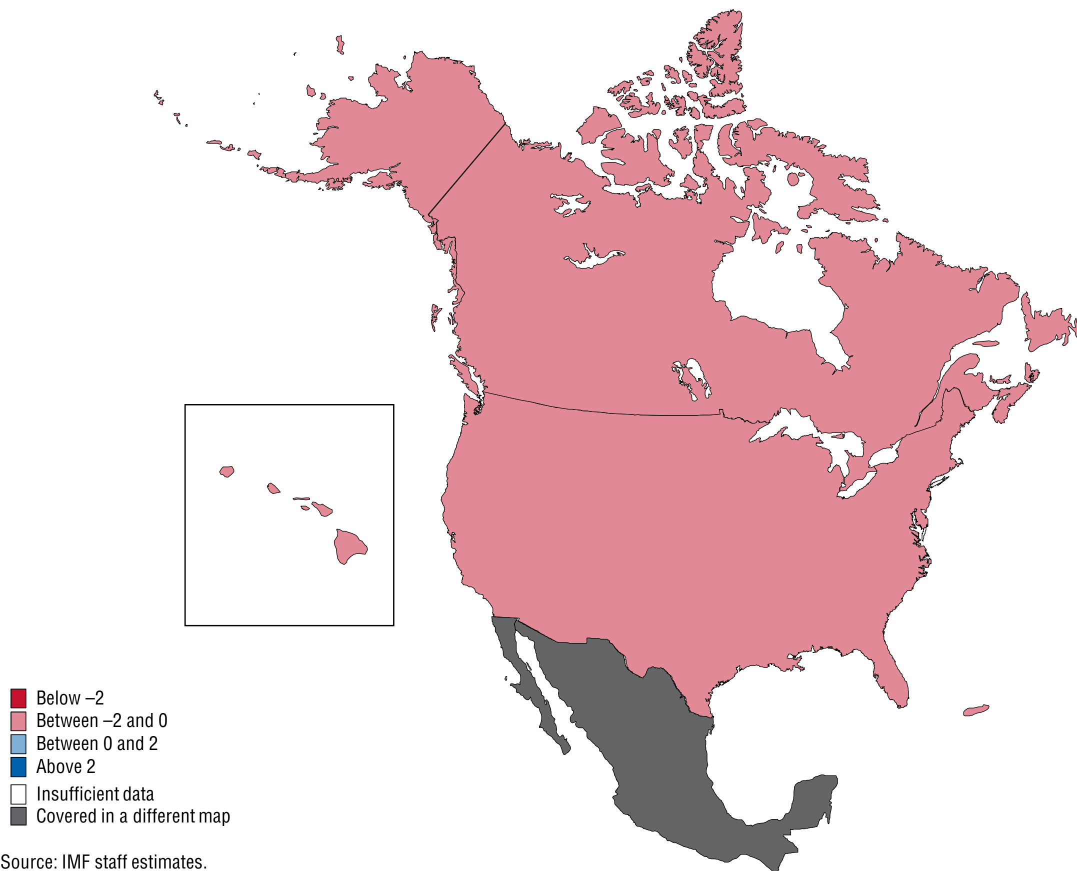
This chapter outlines the variable global outlook by region. Growth in the United States has weakened with a sluggish transition from public to private demand. In Europe, spillover risks from the financial and economic woes in the euro area periphery have intensified. Elsewhere, growth is more solid, but the loss in U.S. and euro area momentum will weigh on prospects. The recovery of the Commonwealth of Independent States (CIS) is being helped in part by strong commodity prices thus far. Japan is successfully pulling out of its recession inflicted by the March Great East Japan earthquake and tsunami. In emerging Asia, activity is still robust, despite the supply-chain disruptions caused by the Japanese earthquake. South America also shows strong growth but the Caribbean and Central America less so. In sub-Saharan Africa (SSA), many economies are gaining momentum. In the Middle East and North Africa (MENA), social unrest has hurt growth in some economies, but solid oil prices have boosted output in the region's oil exporters.

The United States: Weakening Again amid Daunting Debt Challenges

The U.S. economy is struggling to gain a strong foothold, with sluggish growth (Figure 2.3) and a protracted job recovery. Downside risks weigh on the outlook given fiscal uncertainty, weakness in the housing market and household finances, renewed financial stress, and subdued consumer and business sentiment. Bold political commitment to put in place a medium-term debt reduction plan is imperative to avoid a sudden collapse of market confidence that could seriously disrupt global stability. At the same time, renewal of some of the temporary stimulus measures—within the medium-term fiscal envelope—and accommodative monetary policy can partly cushion private activity. The prompt implementation of the Dodd-Frank Act will minimize risks to financial stability from a prolonged period of low interest rates. In Canada, downdrafts from its southern neighbor will be offset in part by relatively healthy economic fundamentals and still supportive commodity prices.

U.S. economic activity has lost steam in 2011 (Figure 2.4). Growth slowed from an annual rate of

Figure 2.3. United States and Canada: Current Growth versus Precrisis Average
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.

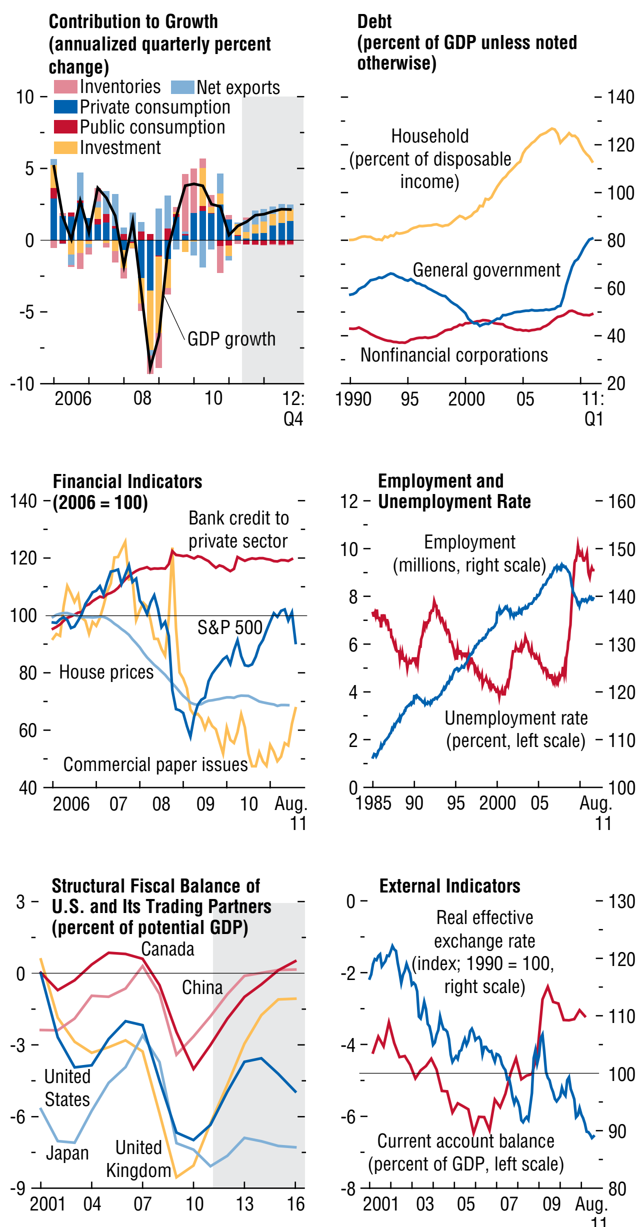
2¾ percent in the second half of 2010 to 1 percent in the first half of 2011. Although a slowdown was expected—given the automotive supply disruptions resulting from the Japanese earthquake and tsunami and the drag on domestic demand from steep oil price gains until April—the deceleration in activity was deeper than projected in the June 2011 *WEO Update.* In the meantime, household and business confidence have markedly deteriorated and market volatility significantly increased on concerns about the tepid recovery, the recent downgrade in the U.S. sovereign credit rating, and rising tensions from Europe. Inflation appears to have peaked with the recent retreat in commodity prices. Weak job growth and persistent economic slack are holding back wages.

Economic growth is projected to average 1½ to 1¾ percent in 2011–12 (Table 2.1). The forecast assumes that the negative effects of the Japanese earthquake and energy prices will taper off in the second half of the year and that the temporary payroll tax cuts and increase in unemployment insurance will be renewed in 2012. However, the damage to consumer and business confidence from the ongoing equity market losses, weak house prices (which are assumed to pick up slowly from the second half of 2012), and, last but not least, the pressure to deleverage imply that growth will be modest relative to historical averages for years to come. Unemployment, currently at 9.1 percent, is expected to remain high through 2012. The sustained output gap will keep inflation in check, with headline inflation receding from 3 percent in 2011 to 1¼ percent in 2012, in line with the pullback in commodity prices.

In Canada, growth is forecast to moderate from 3¼ percent in 2010 to 2 percent during 2011–12, reflecting ongoing fiscal withdrawal and downdrafts from the U.S. slowdown. Although jobs

Figure 2.4. United States: Struggling to Gain a Foothold

Growth has weakened, and growing concerns about the recovery and uncertain fiscal stance have undermined confidence and financial stability. Fiscal policy needs to achieve medium-term debt sustainability while supporting the recovery through the renewal of temporary stimulus measures beyond 2011. Current fiscal plans will not help reduce external imbalances over the medium term, given more durable fiscal tightening projected for the largest U.S. trading partners.



Sources: Haver Analytics; and IMF staff estimates.

have rebounded at a faster pace than in the United States, a slower pace of recovery over the near term is expected to keep unemployment at 7½ to 7¾ percent during 2011–12.

Downside risks to the U.S. outlook have significantly increased. Growth will suffer if the temporary payroll tax cuts and increased unemployment insurance are not continued into 2012. Also, failure to reach political consensus on the design of debt reduction by this fall will result in more front-loaded deficit cuts than currently assumed, with attendant negative effects on growth. More fundamentally, delays in accomplishing an adequate medium-term debt-reduction plan could suddenly induce an increase in the U.S. risk premium, with major global ramifications. As recently observed, shocks to the U.S. bond and stock markets tend to reverberate through major economies, and U.S. interest rate shocks have a strong bearing on emerging market spreads.[1] Other risks include a more protracted house price recovery than assumed under the baseline, sustained losses in equity markets, and upside risks on commodity prices, which would further depress consumer spending. On the upside, growth in the second half of the year could be stronger if financial stability and consumer and business confidence are restored sooner than anticipated. However, risks point down overall. These risks also shape Canada's outlook, through real and financial spillovers.

The first priority for the U.S. authorities is to commit to a credible fiscal policy agenda that places public debt on a sustainable track over the medium term, while supporting the near-term recovery. For this, the fiscal consolidation plan should be based on realistic macroeconomic assumptions and should comprise entitlement reform and revenue-raising measures (for example, gradual removal of loopholes and deductions in the tax system and enhanced indirect taxes).[2] This would allow the near-term fiscal policy stance to be more attuned to the cycle, for example, through temporary stimulus to support labor and housing markets, state and local governments, and infrastructure spending. With a less

[1]See IMF (2011f).

[2]In the past decade, Japan, followed by the United States, had the lowest share of government tax revenue in GDP among G7 economies.

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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Advanced Economies	**3.1**	**1.6**	**1.9**	**1.6**	**2.6**	**1.4**	**–0.2**	**–0.3**	**0.1**	**8.3**	**7.9**	**7.9**
United States	3.0	1.5	1.8	1.6	3.0	1.2	–3.2	–3.1	–2.1	9.6	9.1	9.0
Euro Area[4,5]	1.8	1.6	1.1	1.6	2.5	1.5	–0.4	0.1	0.4	10.1	9.9	9.9
Japan	4.0	–0.5	2.3	–0.7	–0.4	–0.5	3.6	2.5	2.8	5.1	4.9	4.8
United Kingdom[4]	1.4	1.1	1.6	3.3	4.5	2.4	–3.2	–2.7	–2.3	7.9	7.8	7.8
Canada	3.2	2.1	1.9	1.8	2.9	2.1	–3.1	–3.3	–3.8	8.0	7.6	7.7
Other Advanced Economies[6]	5.8	3.6	3.7	2.3	3.3	2.8	5.0	4.7	3.7	4.9	4.4	4.3
Memorandum												
Newly Industrialized Asian Economies	8.4	4.7	4.5	2.3	3.7	3.1	7.0	6.4	6.1	4.1	3.5	3.5

[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]Percent. National definitions of unemployment may differ.
[4]Based on Eurostat's harmonized index of consumer prices.
[5]Current account position corrected for reporting discrepancies in intra-area transactions.
[6]Excludes the G7 economies (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and Euro Area countries.

ambitious medium-term fiscal strategy in place, fiscal consolidation would need to be more front-loaded, comprising a withdrawal of 1 to 1½ percent of GDP in 2012, but including at least temporary payroll tax cuts and increased unemployment insurance through 2012 to contain the drag on near-term growth.[3]

For Canada, which is in a sounder fiscal and financial position than the United States, ongoing fiscal tightening can continue, but there is policy room to pause if downside risks to growth keep rising.

The much weaker than previously projected U.S. outlook calls for a more sustained period of accommodative interest rates, as recently announced by the Federal Reserve. The Federal Reserve should also stand ready to implement further unconventional support, as needed, as long as inflation expectations remain subdued.

Given the U.S. dollar's dominant role as a global monetary anchor, U.S. monetary policy changes have significant global spillovers, which underscore the importance of maintaining financial sector stability both at home and abroad. Indeed, low U.S. interest rates may be driving capital flows elsewhere, which can be challenging to absorb for economies that are operating at or above potential.[4] Moreover, recent volatility in global risk aversion may increase capital flow variability. At the same time, an insufficiently accommodative monetary policy could stall the U.S. recovery and, as a consequence, hurt the global economy. In this regard, the bigger concern from an accommodative U.S. monetary policy stems from whether it could induce excessive risk taking. Thus, a prompt implementation of the U.S. financial sector reforms—combined with similar action to enhance financial stability elsewhere—would contain the buildup of excessive financial leverage in a low interest rate environment. The Dodd-Frank Act should be implemented as planned, with timely allocation of resources to fund the needed enhancements in regulation and supervision. Progress also needs to be made in identifying systemically important institutions—including nonbank institutions—that would be subject to higher regulatory standards and in

[3]See Chapter 1 and IMF (2011g) for details. In September, President Obama proposed a package of additional stimulus measures that would extend unemployment benefits, extend and deepen payroll tax deductions for workers, introduce new payroll tax reductions for employers and special tax credits for hiring the long-term unemployed, and increase spending on infrastructure and on transfers to state and local governments. The equivalent of about 40 percent of this package was already incorporated in IMF staff forecasts. The proposed package would be financed through revenue measures, including a cap on tax deductions and exemptions for high-income earners. If the package were approved and implemented in full, the fiscal deficit reduction projected for 2012 would largely disappear, and it would also imply a sizable fiscal withdrawal in 2013 if policies assumed for that year were to remain unchanged.

[4]See Chapter 4 of the April 2011 *World Economic Outlook*.

addressing cross-border resolution issues involving them. Heightened focus on systemic risks is also critical in an environment in which the financial sector is at the front line of renewed market volatility.

Policies to achieve internal balance, centered on judicious fiscal consolidation, will also help reduce the U.S. current account deficit—which is key to broader global rebalancing—but there are constraints. Unless fiscal consolidation proves durable, the current account deficit will widen again over the medium term, even if not above precrisis levels. Moreover, the effects of fiscal tightening on the U.S. current account balance will be diminished by the fact that key U.S. trading partners, including Canada and the United Kingdom, have already embarked on more ambitious and permanent fiscal adjustments (see Chapter 4).

Europe: Enduring Economic and Financial Turbulence

High public deficits and debt, lower potential output, and mounting market tensions are weighing on growth in much of advanced Europe (Figure 2.5). In addition, there is a transition under way toward greater differentiation between the sovereign debt risks of the euro area members, a shift that is proceeding in fits and starts. Outside the euro area, many central and eastern European (CEE) economies are enjoying a fairly strong rebound from their deep recessions. Even so, the forecast is for a slowdown in activity for much of Europe, with risks to the downside (Figure 2.6; Table 2.2). The responses of policymakers to the euro area's debt crisis will shape the continent's near-term prospects. In particular, a speedy implementation of the July EU summit measures will be key to gaining market credibility. Increased sharing of risk will need to be matched, however, with increased sharing of responsibility for macroeconomic and financial policies.

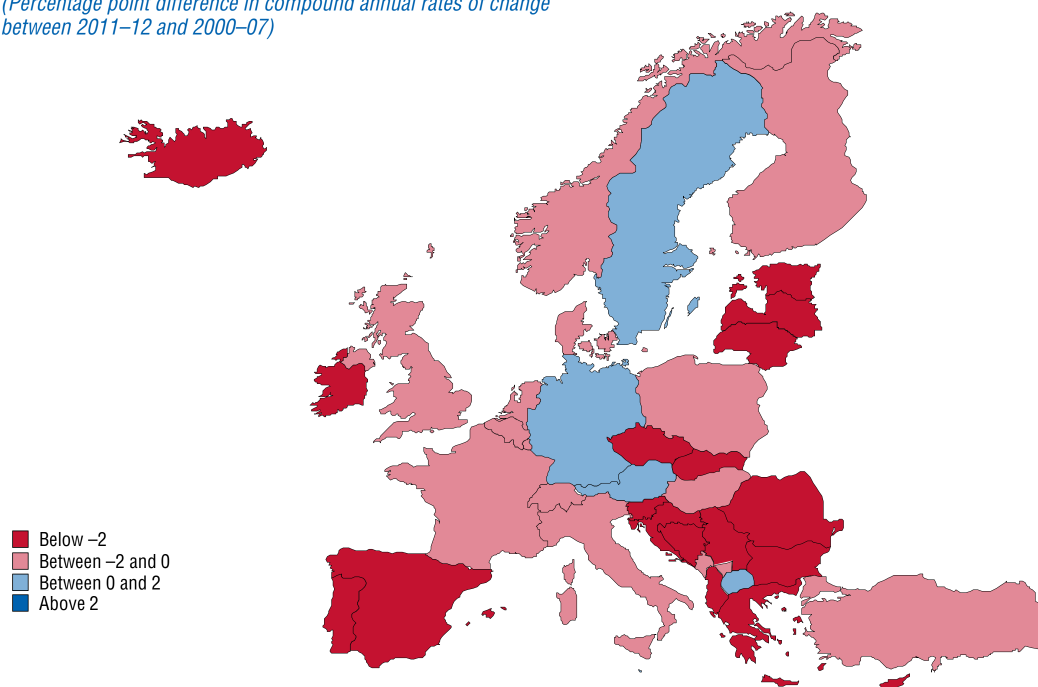
Europe is grappling with renewed market volatility and sharply elevated risks to financial stability.[5] Spreads have risen to new highs in sovereigns and banks in the euro area periphery (especially Greece). Strains have proved contagious, with elevated spreads even in economies that had not been affected thus far (Belgium, Cyprus, Italy, Spain, and to a lesser extent France), and markets further differentiating sovereign risk within the euro area on the basis of individual countries' economic and fiscal challenges and their banks' exposure to sovereigns and banks in the periphery. Global risk aversion, as measured by the Chicago Board Options Exchange Market Volatility Index (VIX), recently surpassed levels reached at the onset of the Greek debt crisis in spring 2010. The European Banking Authority's July 2011 stress tests did little to stabilize bank stocks in the short term. Investors remain concerned, notwithstanding recent modifications to the European Financial Stability Facility (EFSF), the July 2011 package of measures to help Greece address its debt crisis, and extension of the European Central Bank's (ECB's) unconventional measures.

After a strong first quarter, growth in the euro area fell sharply in the second quarter of 2011, in part due to the pressure of high commodity prices on real disposable incomes and to ongoing fiscal tightening, but also because of the effect of the crisis on consumer and business confidence across the region, including in the core economies. Domestic demand growth generally lagged behind GDP growth in most advanced European economies, reflecting mainly sluggish household consumption. In contrast, domestic demand growth in many CEE economies remained strong in the first half of the year, either reflecting demand pressures amid accommodative policy conditions thus far (Turkey) or a strong rebound from the recent crisis (Lithuania). External demand slowed for much of Europe, and will likely continue to moderate in line with the midcycle global slowdown.

Real GDP growth in the euro area is expected to slow from an annual rate of about 2 percent in the first half of 2011 to ¼ percent in the second half, before rising to a bit above 1 percent in 2012. The ongoing financial turbulence will be a drag on activity through lower confidence and financing, even as the negative effects of temporary factors such as high commodity prices and supply disruptions from the Japanese earthquake diminish. However, the projections assume that European policymakers will

[5]See also the September 2011 *Global Financial Stability Report.*

Figure 2.5. Europe: Current Growth versus Precrisis Average
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.
Note: Due to data limitations, data for Kosovo, Malta, and Montenegro are the growth differential between the average in 2011–12 and in 2001–07.

contain the crisis in the euro area periphery, consistent with their commitments at the July EU summit. In the CEE economies, growth will slow from 4¼ percent in 2011 to about 2¾ percent in 2012, as both domestic and external demand moderate.

Economic performance will vary widely across Europe:

- A few economies are operating close to average precrisis rates, with little or no excess capacity (for example, Denmark, Germany, Netherlands, Poland, Sweden, Switzerland, Turkey), and in some cases unemployment rates are at or below typical precrisis levels. These economies avoided major precrisis imbalances and have benefited from the strong rebound in global manufacturing. Turkey, however, is experiencing a boom, driven to a large extent by overly accommodative policies.
- Some economies are noticeably below precrisis growth rates because of sharp economic adjustments in the context of financial crises. These include the euro area periphery countries that remain engulfed in deep sovereign debt crises (Greece, Ireland, Portugal) with concurrent recessions or fragile growth. Others are recuperating from recent crises while addressing a number of challenges, including weak banking systems and/or high unemployment (Iceland, Latvia). These economies must steadfastly continue their balance sheet adjustment, which will likely keep output below capacity for some time.
- The rest of the region includes a wide spectrum of economies, most of which are likely to grow at less than precrisis averages. A few are shaken by contagion from the euro area periphery and are experiencing increasing market volatility and rising bond spreads (Italy, Spain), while others are less affected. Among the latter, some are projected to enjoy relatively solid growth (Bulgaria, Serbia); others continue to struggle (Croatia, United Kingdom).

Inflation pressure is expected to stay well contained, assuming receding commodity prices. Inflation in the euro area is expected to fall from 2½ percent in 2011 to about 1½ percent in 2012. In the CEE economies, the decline is expected to be from 5¼ percent in 2011 to 4½ percent in 2012.

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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Europe	**2.2**	**2.0**	**1.5**	**2.4**	**3.1**	**2.1**	**0.3**	**0.1**	**0.4**	. . .	. . .	. . .
Advanced Europe	**1.8**	**1.6**	**1.3**	**1.9**	**2.8**	**1.7**	**0.8**	**0.8**	**1.0**	**9.4**	**9.2**	**9.1**
Euro Area[4,5]	1.8	1.6	1.1	1.6	2.5	1.5	–0.4	0.1	0.4	10.1	9.9	9.9
Germany	3.6	2.7	1.3	1.2	2.2	1.3	5.7	5.0	4.9	7.1	6.0	6.2
France	1.4	1.7	1.4	1.7	2.1	1.4	–1.7	–2.7	–2.5	9.8	9.5	9.2
Italy	1.3	0.6	0.3	1.6	2.6	1.6	–3.3	–3.5	–3.0	8.4	8.2	8.5
Spain	–0.1	0.8	1.1	2.0	2.9	1.5	–4.6	–3.8	–3.1	20.1	20.7	19.7
Netherlands	1.6	1.6	1.3	0.9	2.5	2.0	7.1	7.5	7.7	4.5	4.2	4.2
Belgium	2.1	2.4	1.5	2.3	3.2	2.0	1.0	0.6	0.9	8.4	7.9	8.1
Austria	2.1	3.3	1.6	1.7	3.2	2.2	2.7	2.8	2.7	4.4	4.1	4.1
Greece	–4.4	–5.0	–2.0	4.7	2.9	1.0	–10.5	–8.4	–6.7	12.5	16.5	18.5
Portugal	1.3	–2.2	–1.8	1.4	3.4	2.1	–9.9	–8.6	–6.4	12.0	12.2	13.4
Finland	3.6	3.5	2.2	1.7	3.1	2.0	3.1	2.5	2.5	8.4	7.8	7.6
Ireland	–0.4	0.4	1.5	–1.6	1.1	0.6	0.5	1.8	1.9	13.6	14.3	13.9
Slovak Republic	4.0	3.3	3.3	0.7	3.6	1.8	–3.5	–1.3	–1.1	14.4	13.4	12.3
Slovenia	1.2	1.9	2.0	1.8	1.8	2.1	–0.8	–1.7	–2.1	7.3	8.2	8.0
Luxembourg	3.5	3.6	2.7	2.3	3.6	1.4	7.8	9.8	10.3	6.2	5.8	6.0
Estonia	3.1	6.5	4.0	2.9	5.1	3.5	3.6	2.4	2.3	16.9	13.5	11.5
Cyprus	1.0	0.0	1.0	2.6	4.0	2.4	–7.7	–7.2	–7.6	6.4	7.4	7.2
Malta	3.1	2.4	2.2	2.0	2.6	2.3	–4.8	–3.8	–4.8	6.9	6.3	6.2
United Kingdom[5]	1.4	1.1	1.6	3.3	4.5	2.4	–3.2	–2.7	–2.3	7.9	7.8	7.8
Sweden	5.7	4.4	3.8	1.9	3.0	2.5	6.3	5.8	5.3	8.4	7.4	6.6
Switzerland	2.7	2.1	1.4	0.7	0.7	0.9	15.8	12.5	10.9	3.6	3.4	3.4
Czech Republic	2.3	2.0	1.8	1.5	1.8	2.0	–3.7	–3.3	–3.4	7.3	6.7	6.6
Norway	0.3	1.7	2.5	2.4	1.7	2.2	12.4	14.0	12.8	3.6	3.6	3.5
Denmark	1.7	1.5	1.5	2.3	3.2	2.4	5.1	6.4	6.4	4.2	4.5	4.4
Iceland	–3.5	2.5	2.5	5.4	4.2	4.5	–10.2	1.9	3.2	8.1	7.1	6.0
Emerging Europe[6]	**4.5**	**4.3**	**2.7**	**5.3**	**5.2**	**4.5**	**–4.6**	**–6.2**	**–5.4**	. . .	. . .	. . .
Turkey	8.9	6.6	2.2	8.6	6.0	6.9	–6.6	–10.3	–7.4	11.9	10.5	10.7
Poland	3.8	3.8	3.0	2.6	4.0	2.8	–4.5	–4.8	–5.1	9.6	9.4	9.2
Romania	–1.3	1.5	3.5	6.1	6.4	4.3	–4.3	–4.5	–4.6	7.6	5.0	4.8
Hungary	1.2	1.8	1.7	4.9	3.7	3.0	2.1	2.0	1.5	11.2	11.3	11.0
Bulgaria	0.2	2.5	3.0	3.0	3.8	2.9	–1.0	1.6	0.6	10.3	10.2	9.5
Serbia	1.0	2.0	3.0	6.2	11.3	4.3	–7.2	–7.7	–8.9	19.6	20.5	20.6
Croatia	–1.2	0.8	1.8	1.0	3.2	2.4	–1.1	–1.8	–2.7	12.2	12.7	12.2
Lithuania	1.3	6.0	3.4	1.2	4.2	2.6	1.8	–1.9	–2.7	17.8	15.5	14.0
Latvia	–0.3	4.0	3.0	–1.2	4.2	2.3	3.6	1.0	–0.5	19.0	16.1	14.5

[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]Percent. National definitions of unemployment may differ.

[4]Current account position corrected for reporting discrepancies in intra-area transactions.

[5]Based on Eurostat's harmonized index of consumer prices.

[6]Also includes Albania, Bosnia and Herzegovina, Kosovo, former Yugoslav Republic of Macedonia, and Montenegro.

In a highly uncertain environment dominated by tension from the euro area sovereign debt crisis, risks to growth are mainly to the downside. An overarching concern is whether investment will pull the recovery along, especially as higher sovereign and banking spreads in various euro area members are eventually transmitted to corporate funding costs. Moreover, should the periphery's debt crisis continue to propagate to core euro area economies, there could be significant disruption to global financial stability.[6] Although CEE economies' direct trade and financial exposure to the euro area periphery is limited, an escalation of sovereign debt and financial sector troubles to the core euro area would undermine

[6]See IMF (2011a and 2011e).

growth in emerging Europe, given tight financial and economic linkages. External risks also point down, with negative spillovers from a slower U.S. growth path or collapse in market confidence in U.S. fiscal policy resulting in a sharp retrenchment of capital inflows, or from rebounding commodity prices.

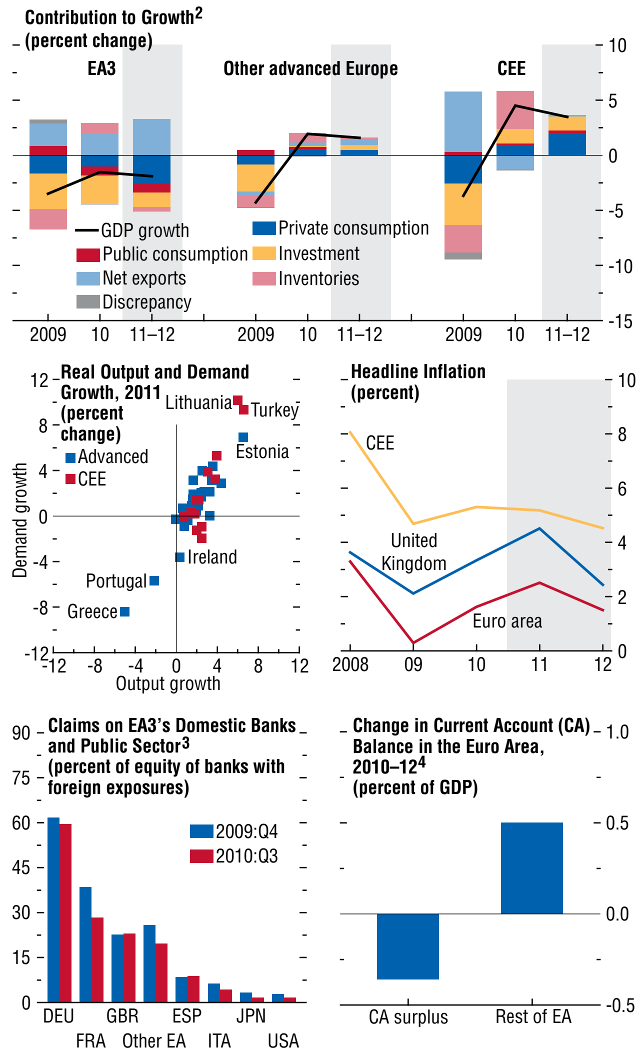
Fiscal policies are generally appropriate as currently planned in the euro area economies, although additional entitlement reform would help create more policy room. Recent announcements by several countries of measures to further tighten the fiscal stance and/or bring forward some measures are welcome and should be implemented as announced. However, some countries need to identify the measures that will be used to attain their medium-term fiscal targets (France, Spain). In some European countries (for example, Germany, Netherlands, Sweden), stronger fiscal prospects provide room to allow automatic stabilizers to work fully to deal with growth surprises. If activity were to undershoot current expectations, countries that face historically low yields should also consider delaying some of their planned adjustment (Germany, United Kingdom). Where the recovery has already been established (for example, Poland, Turkey), stepped-up fiscal consolidation is needed to strengthen fiscal accounts and build fiscal room in the event of a sustained reversal in capital inflows and also to stave off inflation pressure. Everywhere, fiscal consolidation should be supported by structural measures to bolster growth prospects.

In the euro area, given a weak recovery, declining inflation pressure, and an overall highly uncertain economic and financial environment, the ECB should lower its policy rate if downside risks to growth and inflation persist. Also, the ECB should maintain its unconventional support to contain market volatility at least until the implementation of the July EU summit commitments. Elsewhere, including in most CEE economies, monetary tightening could be more gradual in light of the significant weakening in the economic environment.

Strengthening the financial system remains a major priority. Efforts to raise capital from private sources to fill the gaps identified during the recent stress tests should move ahead immediately and should be more ambitious than supervisors deemed necessary. The objective should be to lift bank equity beyond

Figure 2.6. Europe: An Uneven Performance and Elevated Risks[1]

European economic performance has been unbalanced, with growth in many economies in the core euro area and emerging Europe stronger than in the euro area periphery. However, contagion pressures from the deteriorating situation in the latter are a rising concern, the containment of which is critical for regional and global stability. Current fiscal consolidation plans should help reduce intra-euro-area external imbalances.



Sources: Bankscope; BIS Consolidated Banking Statistics; and IMF staff estimates.

[1]Euro area (EA): Austria, Belgium, Cyprus, Estonia, Finland, France (FRA), Germany (DEU), Greece, Ireland, Italy (ITA), Luxembourg, Malta, Netherlands, Portugal, Slovak Republic, Slovenia, and Spain (ESP). Central and eastern Europe (CEE): Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, Latvia, Lithuania, former Yugoslav Republic of Macedonia, Montenegro, Poland, Romania, Serbia, and Turkey. Aggregates for the external economy are sums of individual country data. Aggregates for all others are computed on the basis of purchasing-power-parity weights.

[2]EA3: Greece, Ireland, and Portugal. Other advanced Europe comprises non-EA3 euro area countries and Czech Republic, Denmark, Iceland, Portugal, Sweden, Switzerland, and United Kingdom (GBR). Due to data limitations, Kosovo is excluded from CEE.

[3]Other EA: Austria, Belgium, Ireland, Portugal, and Netherlands. Japan (JPN), United States (USA).

[4]CA surplus: Austria, Belgium, Finland, Germany, Ireland, Luxembourg, and Netherlands.

the Basel III minimums and well ahead of the Basel III timetable, while allowing flexibility in the use of macroprudential tools to address country-specific financial and systemic risks. Given the greater vulnerability of euro area banks to potentially impaired wholesale funding markets, the July EU summit commitments must be promptly adopted by fully implementing the EFSF's expanded mandate through purchasing securities from secondary markets and supporting bank capitalization. Among the crisis economies in the CEE, banking systems are gradually stabilizing, but financial sector vulnerability persists where asset quality and profitability remain low. In these cases, a slower withdrawal of crisis-related support measures is justified as the banking sector heals. Among others, including those that until recently experienced strong credit growth driven by capital flows, financial supervision should remain watchful for a possible worsening in banking system stability affected by a potential drying up of wholesale financing or deterioration in asset quality.

The overriding policy challenge, beyond containing the crisis, is to push forward with European integration. Stronger European governance frameworks are essential to aligning fiscal policies and limiting external imbalances. More integrated and flexible labor, product, and services markets would facilitate adjustment in response to shocks. This is particularly important for the financial sector, which urgently needs a truly integrated financial stability framework, featuring a single rules book, integrated supervision, and burden sharing. This offers the greatest hope for greater resilience against future shocks. Good progress has been made in putting in place a framework for sharing sovereign risk in the euro area.[7] The challenge is to ensure that any support disbursed through it is conditional on arrangements that foster sustained adjustment to better fiscal and external positions. Crucially, increased sharing of risk will need to be accompanied by increased sharing of responsibility for macroeconomic and financial policies. Countries must stand ready to sacrifice some policy autonomy for the common European good.

[7]See the September 2011 *Fiscal Monitor* for important institutional reforms in other European economies.

External rebalancing has progressed in the euro area, owing primarily to low domestic demand growth. However, current account deficits have narrowed much less in the crisis-hit euro area periphery, compared with some CEE economies during their 2008–09 crises (Latvia, Lithuania). In the former, private capital inflows have been replaced largely with ECB and official financing. In the latter, the reversal of capital flows forced a sharp adjustment in the current account deficits, which are now gradually unwinding. Therefore, in the euro area periphery, rebalancing will need to continue for some time with domestic adjustment programs and resulting weak growth fostering wage moderation and restructuring. In this regard, the current nature of euro area fiscal plans—with less adjustment in surplus economies and more in deficit economies, including use of permanent measures rather than simply the end of stimulus—supports further narrowing of intra-euro-area current account imbalances. In many other economies in emerging Europe (for example, Turkey) continued fiscal tightening remains key to reducing the risks of an unexpected sharp adjustment in the current account in the future.

Commonwealth of Independent States: Moderate Growth Performance

The recovery in the CIS region is taking hold even as ongoing household and financial sector deleveraging continues to bridle activity. Growth has thus far been supported by strong commodity prices, but downside risks have risen with the global slowdown. As in other emerging and developing economies, efforts should be focused on rebuilding fiscal room and keeping inflation in check. Major reforms are also needed to enhance the business environment, develop financial systems, and build strong institutions to raise the region's growth potential.

With strong commodity prices thus far, growth in the CIS region has continued to recover, although modestly compared with precrisis rates of expansion (Figure 2.7). Private demand is still subdued in economies with weak financial systems and ongoing deleveraging. Also, remittances and capital flows are well below their levels

during the run-up to the crisis, when many economies in the region were facing growing overheating pressures. The global economic slowdown and increase in investor risk aversion will challenge the region through a more subdued external financing environment.

Growth is expected to average 4½ percent during 2011–12 (Figure 2.8; Table 2.3). However, prospects vary considerably across the region:

- Growth in Russia is projected to reach about 4¼ percent during 2011–12. Prospects for oil prices, although still strong, are weaker than in the June 2011 *WEO Update*. Moreover, capital flows—which fueled credit, private demand, and growth before the crisis—have yet to return because investors remain wary of the political uncertainty in the run-up to presidential elections and the uninviting business climate.
- In most of the other energy-exporting economies, growth is also projected to moderate as energy prices recede somewhat in 2012. However, in Azerbaijan, maintenance-related disruptions in oil production will result in a sharp slowdown in growth in 2011—despite an acceleration in non-oil GDP growth, reflecting a sizable supplementary budget approved in May—followed by a rebound next year. In general, growth of oil output is expected to decline over the medium term as existing fields approach their capacity. In Kazakhstan, the increase in oil production is expected to be lower than in previous years. Non-oil GDP growth is also expected to ease slightly from the strong rebound in 2010 in Kazakhstan as well as in Turkmenistan.
- Energy-importing economies, on average, are expected to expand at roughly the same pace as in 2010. However, various idiosyncratic factors will lift growth in some of these economies: a recovery from last year's poor harvest in Armenia and a rebound in the Kyrgyz Republic from the contraction caused by previous civil unrest and political turmoil. At the other end of the spectrum, Belarus is expected to experience a sharp slowdown as domestic demand contracts with the currency crisis and a reversal in capital flows.

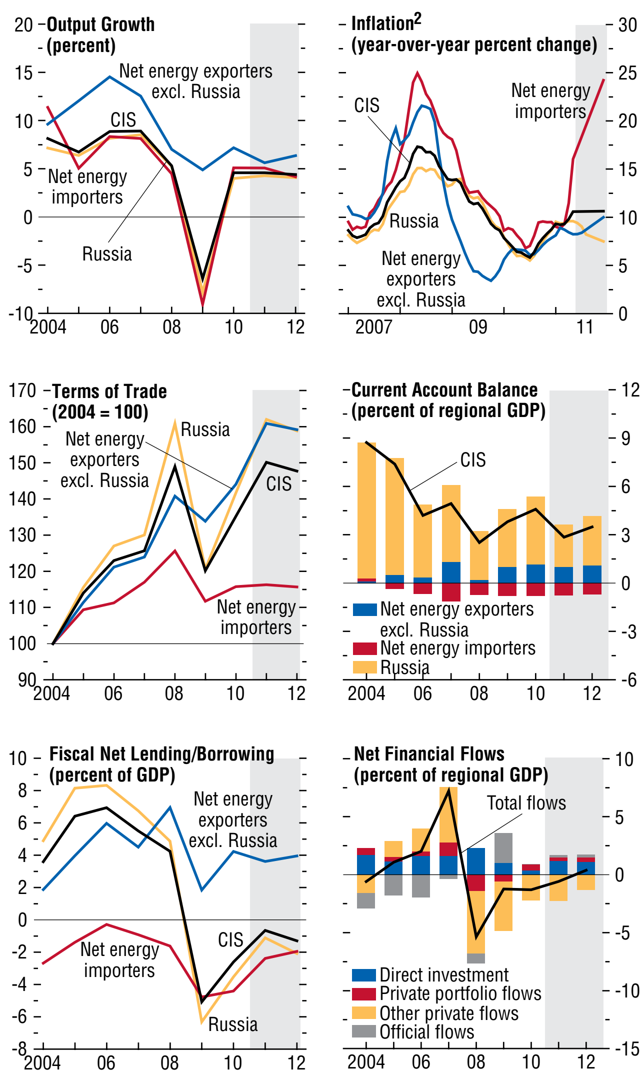
Figure 2.7. Commonwealth of Independent States: Current Growth versus Precrisis Average

(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)

Source: IMF staff estimates.
Note: Includes Georgia and Mongolia.

Figure 2.8. Commonwealth of Independent States: A Gradual Recovery[1]

The recovery in the CIS region is taking hold on the back of strong exports and a pickup in activity in Russia. Strong commodity prices have helped strengthen external and fiscal balances. However, the priority is to discontinue procyclical policies, build policy buffers, and increase the region's resilience to future shocks.



Sources: Haver Analytics; and IMF staff estimates.

[1]Net energy exporters: Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan. Net energy importers: Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, and Ukraine. Aggregates for the external economy are sums of individual country data. Aggregates for all others are computed on the basis of purchasing-power-parity weights.

[2]Due to data limitations, Turkmenistan and Uzbekistan are excluded from the group of net energy exporters excluding Russia.

Headline inflation has begun to pick up and is forecast to reach double digits in several of the region's economies. This reflects mostly the sharp uptick in commodity prices in the first half of the year and the high share of food in the consumption baskets, but in some cases, it is also due to current or recent demand pressure (Azerbaijan, Belarus, Kyrgyz Republic, Uzbekistan).

The CIS region is particularly vulnerable to spillovers from the rest of world, as evidenced by the economic collapse during the global financial crisis. Commodity prices largely determine the economic fortunes of most of the large economies in the region, whereas foreign funding has been crucial for growth in investment and consumption. In turn, economic performance in these economies, particularly in Russia, has major repercussions for many others in the region, notably through workers' remittances.[8]

Against this backdrop, net downside risks to the outlook have increased. On the upside, energy exporters stand to benefit from a further rise in oil prices, and higher import costs for energy importers will be somewhat cushioned by higher remittances from Russia. Conversely, a sharper global slowdown would further reduce commodity prices, dampening the prospects for the region. In addition, with elevated global risk aversion, capital flows may stay away from these economies for longer than expected, dragging down regional growth. Finally, the region's sociopolitical environment, with long-standing tensions and unresolved conflicts, remains a source of risk, further exacerbated by the possibility of spillovers from events in the MENA region.

It is time for the CIS region to discontinue procyclical policies and build on structural reforms to increase its resilience to future shocks. A number of countries have started raising interest rates to contain price pressure (for example, Azerbaijan, Kyrgyz Republic, Russia) and strengthening reserve and liquidity requirements. However, with increased uncertainty in the global outlook, the pace of monetary tightening could be slower in economies where overheating pressures are still well contained. In this light, increasing the transparency of monetary

[8]See the April 2011 *Regional Economic Outlook: Middle East and Central Asia.*

Table 2.3. 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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Commonwealth of Independent States (CIS)[4]	**4.6**	**4.6**	**4.4**	**7.2**	**10.3**	**8.7**	**3.8**	**4.6**	**2.9**	. . .	. . .	. . .
Russia	4.0	4.3	4.1	6.9	8.9	7.3	4.8	5.5	3.5	7.5	7.3	7.1
Ukraine	4.2	4.7	4.8	9.4	9.3	9.1	–2.1	–3.9	–5.3	8.1	7.8	7.4
Kazakhstan	7.3	6.5	5.6	7.4	8.9	7.9	2.9	5.9	4.6	5.8	5.7	5.6
Belarus	7.6	5.0	1.2	7.7	41.0	35.5	–15.5	–13.4	–9.9	0.7	0.7	0.7
Azerbaijan	5.0	0.2	7.1	5.7	9.3	10.3	27.7	22.7	19.3	6.0	6.0	6.0
Turkmenistan	9.2	9.9	7.2	4.4	6.1	7.2	–11.7	–2.9	–2.6	. . .	. . .	. . .
Mongolia	6.4	11.5	11.8	10.2	10.2	14.3	–14.9	–15.0	–10.5	3.3	3.0	3.0
Low-Income CIS	**6.5**	**6.5**	**6.2**	**8.3**	**12.3**	**9.4**	**–0.7**	**–0.7**	**–0.7**	. . .	. . .	. . .
Uzbekistan	8.5	7.1	7.0	9.4	13.1	11.8	6.7	8.0	7.4	0.2	0.2	0.2
Georgia	6.4	5.5	5.2	7.1	9.6	5.0	–9.6	–10.8	–9.2	16.3	16.2	16.0
Armenia	2.1	4.6	4.3	7.3	8.8	3.3	–13.9	–11.7	–10.7	7.0	7.0	7.0
Tajikistan	6.5	6.0	6.0	6.5	13.6	10.0	2.1	–3.6	–6.7	. . .	. . .	. . .
Kyrgyz Republic	–1.4	7.0	6.0	7.8	19.1	9.4	–7.2	–7.7	–7.6	9.3	8.4	8.3
Moldova	6.9	7.0	4.5	7.4	7.9	7.8	–8.3	–9.9	–10.3	7.4	7.3	7.0
Memorandum												
Net Energy Exporters[5]	4.5	4.5	4.4	6.9	9.0	7.6	5.2	6.0	4.1	. . .	. . .	. . .
Excluding Russia	7.2	5.6	6.4	7.2	9.6	9.2	7.5	9.2	7.8	. . .	. . .	. . .
Net Energy Importers[6]	5.1	5.1	4.2	8.7	16.8	14.7	–6.5	–7.1	–7.0	. . .	. . .	. . .

[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]Percent. National definitions of unemployment may differ.

[4]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.

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

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

policy—by more clearly communicating inflation developments and objectives—will also help anchor expectations.

Establishing a prudent fiscal stance is crucial for macroeconomic stability and sustained, balanced growth in the region. To ensure its durability, consolidation must be supported by strong fiscal frameworks and fundamental structural reforms, including in pensions, health care, and social protection. For energy exporters, the challenge will be to resist pressure to increase spending while there is still ample fiscal room and to improve the efficiency of public spending. Energy importers should start rebuilding the fiscal buffers depleted during the crisis to prepare for potential future needs and to ensure medium-term fiscal sustainability (for example, Kyrgyz Republic, Tajikistan).

Further action is also needed to restore financial system strength. In Russia, the financial system remains fragile due to the high share of nonperforming assets and inadequate provisioning. Regulatory gaps need to be addressed, including enhancing the central bank's authority to conduct effective supervision. In other economies (for example, Kazakhstan, Kyrgyz Republic, Tajikistan, Ukraine), impaired balance sheets still weigh on credit growth and efficient resource intermediation. Strengthened risk management practices, reforms in the legal and regulatory system to improve collateral recovery and increase bank competition, and an end to directed lending would prevent the recurrence of such impairments.

These immediate economic challenges should not distract from the region's longer-term objec-

tives of reducing external vulnerability and raising potential growth through a more diversified pattern of economic development. Improving the business environment, increasing the role of the private sector, further developing the financial sector, and enhancing institutions are key to such efforts. These measures will also help increase the region's export potential and improve external balances—independent of commodity prices—and help attract more durable sources of external financing and capital flows.

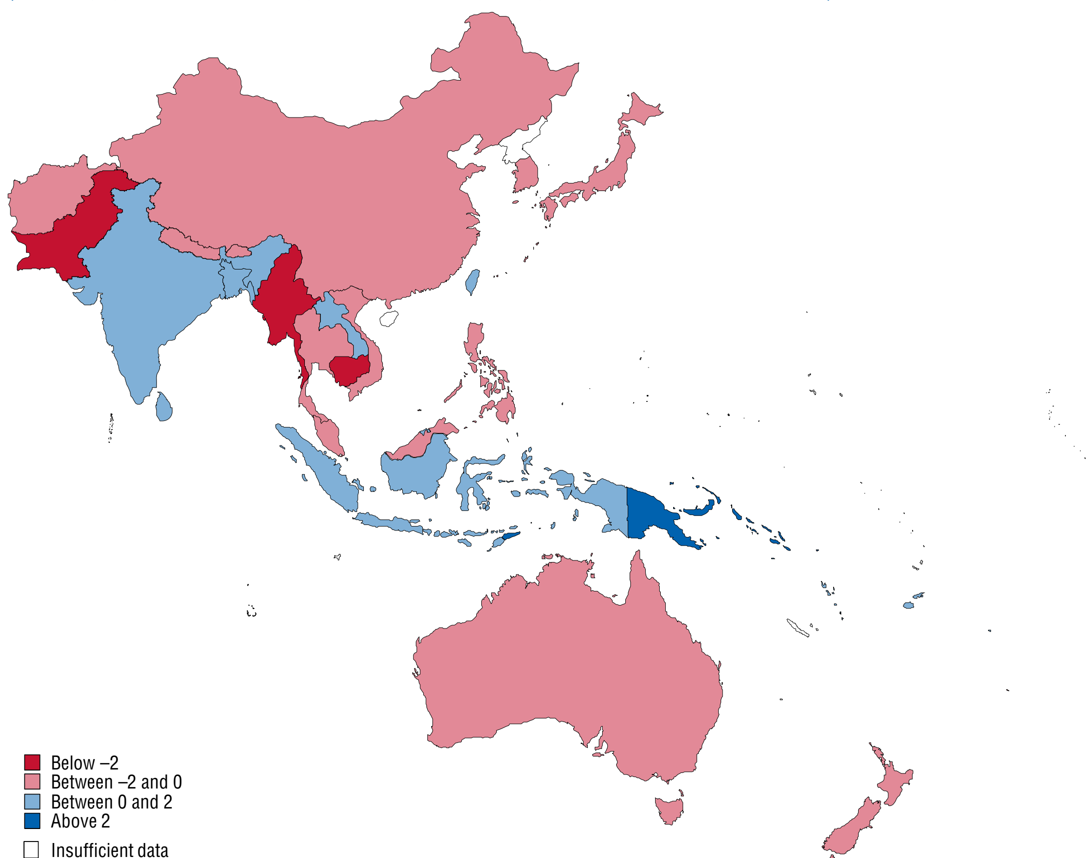
Asia: Securing a More Balanced Expansion

Asia's track record during the crisis and the recovery has been enviable. Growth remains strong, although it is moderating with emerging capacity constraints and weaker external demand. Downdrafts from weaker activity in major advanced economies suggest that a pause in the policy tightening cycle may be warranted for some economies, and underscore the importance of rebalancing growth toward domestic sources. Greater exchange rate flexibility needs to be a key policy tool for much of the region to alleviate price pressures in goods and asset markets and—along with structural reforms—to foster more balanced growth in economies with persistent current account surpluses.

Activity in Asia remained solid but moderated somewhat in the first half of 2011 owing to the temporary disruption in supply chains from the Japanese earthquake and tsunami, especially in the automotive and electronics sectors. Some economies

Figure 2.9. Asia: Current Growth versus Precrisis Average

(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.
Note: Due to data limitations, data for the Islamic Republic of Afghanistan are the growth differential between the average in 2011–12 and 2003–07, and for Tuvalu between the average in 2011–12 and 2001–07.

Table 2.4. 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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Asia	**8.2**	**6.2**	**6.6**	**4.1**	**5.3**	**4.0**	**3.3**	**2.9**	**2.9**	**. . .**	**. . .**	**. . .**
Advanced Asia	**5.4**	**1.7**	**3.3**	**0.8**	**1.6**	**1.3**	**3.3**	**2.5**	**2.3**	**4.8**	**4.4**	**4.4**
Japan	4.0	–0.5	2.3	–0.7	–0.4	–0.5	3.6	2.5	2.8	5.1	4.9	4.8
Australia	2.7	1.8	3.3	2.8	3.5	3.3	–2.7	–2.2	–4.7	5.2	5.0	4.8
New Zealand	1.7	2.0	3.8	2.3	4.4	2.7	–4.1	–3.9	–5.6	6.5	6.4	5.6
Newly Industrialized Asian Economies	**8.4**	**4.7**	**4.5**	**2.3**	**3.7**	**3.1**	**7.0**	**6.4**	**6.1**	**4.1**	**3.5**	**3.5**
Korea[4]	6.2	3.9	4.4	3.0	4.5	3.5	2.8	1.5	1.4	3.7	3.3	3.3
Taiwan Province of China	10.9	5.2	5.0	1.0	1.8	1.8	9.3	11.0	11.0	5.2	4.3	4.2
Hong Kong SAR	7.0	6.0	4.3	2.3	5.5	4.5	6.2	5.4	5.5	4.3	3.6	3.7
Singapore	14.5	5.3	4.3	2.8	3.7	2.9	22.2	19.8	18.5	2.2	2.3	2.3
Developing Asia	**9.5**	**8.2**	**8.0**	**5.7**	**7.0**	**5.1**	**3.3**	**3.3**	**3.4**	**. . .**	**. . .**	**. . .**
China	10.3	9.5	9.0	3.3	5.5	3.3	5.2	5.2	5.6	4.1	4.0	4.0
India	10.1	7.8	7.5	12.0	10.6	8.6	–2.6	–2.2	–2.2	. . .	. . .	. . .
ASEAN-5	**6.9**	**5.3**	**5.6**	**4.4**	**6.1**	**5.6**	**3.3**	**2.5**	**1.6**	**. . .**	**. . .**	**. . .**
Indonesia	6.1	6.4	6.3	5.1	5.7	6.5	0.8	0.2	–0.4	7.1	6.8	6.6
Thailand	7.8	3.5	4.8	3.3	4.0	4.1	4.6	4.8	2.5	1.0	1.2	1.2
Malaysia	7.2	5.2	5.1	1.7	3.2	2.5	11.5	11.3	10.8	3.3	3.2	3.1
Philippines	7.6	4.7	4.9	3.8	4.5	4.1	4.2	1.7	1.3	7.2	7.2	7.2
Vietnam	6.8	5.8	6.3	9.2	18.8	12.1	–3.8	–4.7	–3.8	5.0	5.0	5.0
Other Developing Asia[5]	**5.2**	**4.6**	**5.0**	**9.1**	**10.9**	**9.5**	**–0.4**	**–0.1**	**–1.3**	**. . .**	**. . .**	**. . .**
Memorandum												
Emerging Asia[6]	9.3	7.7	7.5	5.2	6.6	4.9	3.9	3.8	3.8	. . .	. . .	. . .

[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]Percent. National definitions of unemployment may differ.

[4]The 2011 annual GDP growth forecast is as of September 5, 2011. The recent revision of the second quarter GDP data would imply a revision of the 2011 annual GDP growth forecast to 4 percent.

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

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

in emerging Asia also experienced a slowdown in export growth, although domestic demand continued to be supported by relatively accommodative policies, solid growth in credit and asset prices in the first half of the year, firm consumer and business sentiment, and strong labor markets. Also, capital flows were sizable until recently, although more volatile in 2011. Activity in advanced Asia also bounced back fairly strongly after the initial setback caused by the natural disasters. However, the recent volatility in U.S. and euro area financial markets rippled through many Asian equity markets, which if sustained could affect the region's future economic prospects.

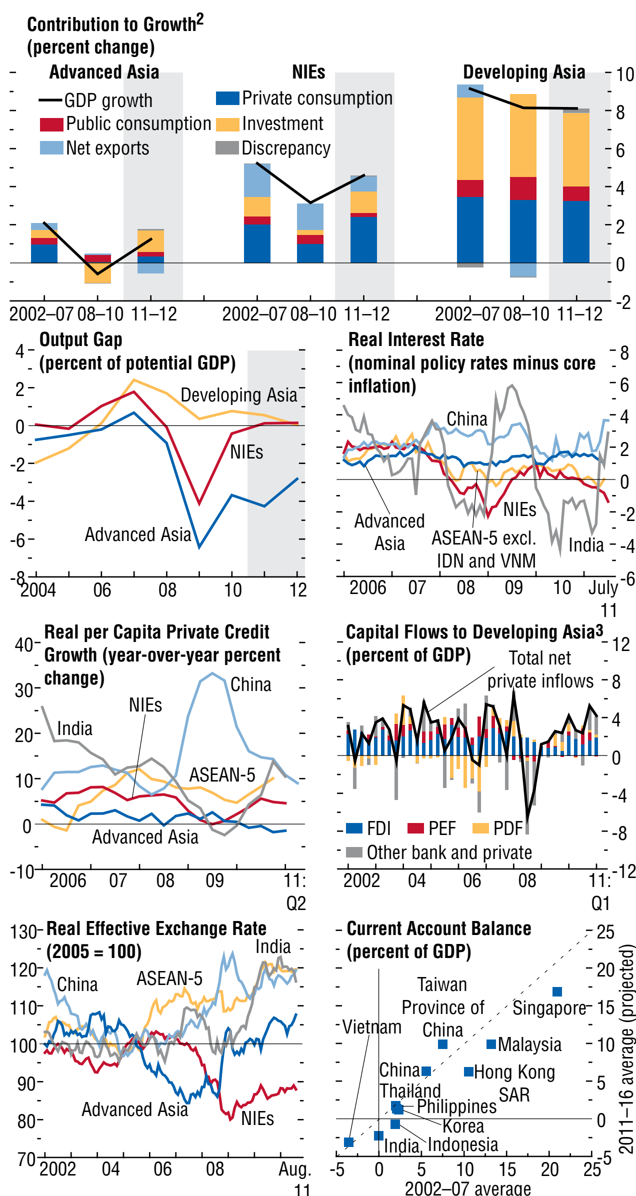
Growth is projected to decelerate but remain strong and self-sustained, assuming that the global financial tensions do not escalate (Figures 2.9–2.10; Table 2.4). For emerging Asia, although the slowdown in the United States and euro area will dampen external demand, domestic demand is expected to continue supporting growth. In advanced Asia, activity will be boosted by reconstruction investment.

The nature of expansion and the drivers of growth will differ significantly across the region:

- In China, growth will average 9 to 9½ percent during 2011–12, less than the average of 10½ percent during 2000–07, as ongoing policy tightening and a smaller contribution from net external demand moderate activity. Investment growth has decelerated with the unwinding of the fiscal stimulus, but it remains the principal contributor to growth. Although inflation pressure remains,

Figure 2.10. Asia: A Bright Spot in the World Economy[1]

Growth is expected to remain strong, with weaker external demand offset by still solid domestic demand. That said, there has been limited progress in external rebalancing that would durably enhance the role of domestic demand in growth—currencies have appreciated at a slower pace in economies with current account surpluses than in others, and these surpluses are projected to remain large or to widen further over the medium term.



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

[1]Advanced Asia: Australia, Japan, and New Zealand; newly industrialized Asian economies (NIEs): Hong Kong SAR, Korea, Singapore, and Taiwan Province of China; developing Asia: rest of Asia; ASEAN-5: Indonesia (IDN), Malaysia, Philippines, Thailand, and Vietnam (VNM). Aggregates for the external economy are sums of individual country data. Aggregates for all others are computed on the basis of purchasing-power-parity weights.

[2]Excludes Bhutan, Brunei Darussalam, Republic of Fiji, Kiribati, Lao People's Democratic Republic, Maldives, Samoa, Timor-Leste, Tonga, Tuvalu, and Vanuatu due to data limitations.

[3]FDI: foreign direct investment; PEF: portfolio equity flows; PDF: portfolio debt flows.

efforts to withdraw credit stimulus—through administrative limits on credit growth, higher interest rates, and tighter reserve requirements—and to rein in property price inflation through loan-to-value limits in mortgage credit and restrictions on multiple home purchases have been gaining traction: property price inflation and credit growth have softened from recent record levels.

- In India, growth is forecast to average 7½ to 7¾ percent during 2011–12. Activity is expected to be led by private consumption. Investment is expected to remain sluggish, reflecting, in part, recent corporate sector governance issues and a drag from the renewed global uncertainty and less favorable external financing environment. A key challenge for policymakers is to bring down inflation, which is running close to double digits and has become generalized. Despite policy tightening, real interest rates are much lower than precrisis averages, and credit growth is still strong.
- In the newly industrialized Asian economies (NIEs), growth is expected to slow from almost 8½ percent in 2010 to a bit above 4½ percent during 2011–12, as activity moderates to close positive output gaps. The contribution from net exports is forecast to remain positive, in part due to limited appreciation of real effective exchange rates despite sustained current account surpluses.
- Near-term growth in the ASEAN-5[9] is projected to average 5½ percent, pulled by domestic demand—in particular, robust investment—which will offset the slowdown in export momentum. While commodity prices will remain supportive, they will provide less of a boost to growth for the commodity exporters (Indonesia, Malaysia).
- In Japan, the supply constraints from the March earthquake and tsunami have been easing, confidence has picked up, and activity is starting to rebound. The economy is expected to contract by ½ percent this year, but growth is forecast to reach 2¼ percent in 2012, with activity sharply rebounding on reconstruction investment.
- Recent natural disasters slowed growth only temporarily in Australia, and despite recent

[9]The Association of Southeast Asian Nations (ASEAN) includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

earthquakes, New Zealand's recovery has gained traction, supported by strong terms of trade and positive trade spillovers from the region. Growth is forecast to pick up from 1¾ percent in 2011 to 3¼ percent in 2012 for Australia and from 2 percent to 3¾ percent for New Zealand.

Headline inflation in Asia is projected to average 5¼ percent in 2011, before receding to 4 percent in 2012, assuming commodity prices remain stable. However, inflation pressures are disparate across the region—higher in economies with sustained strong credit growth, positive output gaps, and/or relatively accommodative policies (for instance, India, Korea, Vietnam). For these economies, the risks around inflation continue to point up. For the rest of the region, risks are more balanced. In Japan, prices are expected to remain broadly flat, with little or no inflation. Property prices have also continued to rise (China, NIEs), although thanks to the use of a wide range of macroprudential measures, the pace has started to ease in many economies.

As elsewhere, the risks around the outlook point down, mainly due to the deterioration in the external environment. Upside risks from continued support from accommodative policies are more than offset by a potentially larger drag from external demand, potential pressure on commodity prices, and persistent financial shocks from the euro area and the United States that threaten to eventually impinge on domestic demand and regional financial stability. Conversely, if upside risks to inflation materialize, the authorities could be forced to sharply tighten policies and provoke a hard landing. Given Asia's rising systemic importance, a sharp deceleration in activity in some key Asian economies could stall regional and global activity through standard trade channels, a fall in demand for commodities and in their prices, or confidence effects.[10] In Japan, in addition to external negative risks from downbeat external demand and potentially sustained appreciation pressure from safe haven flows, longer than anticipated delays in correcting its supply-side disruptions and rebuilding electricity-generating capacity could undermine confidence and further restrain domestic demand. Despite its small share in global trade, the aftereffects of the earthquake were a reminder of Japan's ability to originate and transmit shocks because of its role as a key supplier of sophisticated inputs in the global supply chain. Moreover, although Japanese government bond yields remain low, a loss of market confidence related to Japan's high public debt could lead to a rise in bond yields in other economies with similar problems.[11]

Against this backdrop, further exchange rate flexibility remains a key policy priority for emerging Asia. However, real effective exchange rates in many current account surplus economies (for example, China, Korea) have moved less than those in deficit economies (for example, India) and are lower than their precrisis levels, and foreign reserves have continued to build up. For these economies, a stronger exchange rate, combined with structural reforms (see below), would raise domestic purchasing power and allow external rebalancing, while also containing inflation pressure. More generally, exchange rate flexibility complemented with macroprudential tools would reduce the perception of a one-way exchange rate bet and slow the pace of debt-creating capital inflows and the buildup of short-term external liabilities (for example, in Korea).

Beyond further exchange rate appreciation in surplus economies, monetary policy requirements vary across Asia. Given the unusual uncertainty in the external environment, a wait-and-see approach may be warranted for some economies. However, inflation pressure needs to be carefully monitored. In some economies, despite nominal policy rate hikes, the real cost of capital is at historical lows because of elevated inflation (India, Korea, Vietnam), and inflation expectations are inching up. In these economies, the monetary tightening phase needs to be sustained for as long as the baseline scenario prevails. Elsewhere, tightening could be paused unless upside risks to inflation grow further. In China, the transparency and effectiveness of monetary policy should be enhanced by relying more on interest rates than quantitative measures of monetary control. In Japan, monetary policy should remain accommodative to eliminate the risk of deflation given a chronic output gap. In particular, the Bank of Japan could purchase more longer-dated public securities and expand its asset purchase program for private assets.

[10]See IMF (2011d).

[11]See IMF (2011b).

Although the region has made good progress in enhancing the strength of its financial system, significant growth in credit and property prices over the past few years raises financial stability risks. In many economies, banking systems are strong, thanks to comfortable capital positions and loan loss provisioning levels, high liquidity, and enhancement of domestic stress-testing frameworks (China, Indonesia, Korea). However, the rapid rise in nonbank intermediation means that the perimeter of financial supervision needs be widened to ensure that vulnerabilities are detected early and contained. In addition, financial sector development and liberalization still remain a top priority in some economies. For instance, in China further progress in financial liberalization, including the use of market-determined interest rates, will create incentives for financial institutions to better manage their market risks; remove the artificially low cost of capital, which favors investment over consumption; and, at the same time, strengthen the transmission of monetary policy.[12]

Fiscal policy priorities are also diverse across the region. Under baseline assumptions, increasing the pace of fiscal withdrawal is more urgent in economies with limited fiscal room and high public debt (for example, India, Vietnam). Fiscal savings will also create the room needed for funding infrastructure needs (for example, India, Indonesia, Malaysia). For Japan, although the immediate focus should be on infrastructure reconstruction, a comprehensive plan to put public debt on a sustainable footing over the medium term is essential. In this light, the proposed increase in the consumption tax to 10 percent by the middle of this decade is an important first step. However, a more ambitious deficit reduction plan—based on entitlement reform and a gradual increase of the consumption tax to 15 percent—is needed to put the debt ratio on a downward track. Adoption of a fiscal rule could help safeguard fiscal adjustment gains. In Australia, the planned return to surplus by 2012/13 is welcome, as it will increase fiscal room and take pressure off monetary policy and the exchange rate. The mining boom also provides an opportunity to build fiscal buffers further over the medium term and contribute to national saving. In New Zealand, while the recent earthquake will adversely affect near-term fiscal balances, planned medium-term consolidation will help build policy room, contain the current account deficit, and put the budget in a stronger position to deal with rising costs related to aging and health care. If downside risks to growth materialize, however, most countries in the region have the fiscal room to slow or reverse the pace of fiscal consolidation.

Asia needs a durable and multifaceted approach to demand rebalancing. The narrowing of surpluses relative to precrisis highs is explained largely by the moderation in the global cycle and slower domestic demand growth in advanced economies. In key surplus economies (China), current account surpluses are set to remain high or widen again as the global expansion continues. In others, surpluses narrow very slowly over the medium term. Moreover, the ongoing fiscal stimulus withdrawal will likely boost external surpluses, with the exception of Thailand, where recently announced public policies target boosting domestic demand and in particular consumption. As a result, strong emphasis needs to be put on other elements of the policy agenda, including further exchange rate appreciation for some economies and structural reforms to enhance the role of domestic demand in growth. This would imply raising the contribution of household consumption for some (for example, China) and investment for others (for example, Indonesia, Korea, Malaysia).[13] Given Asia's large and rising systemic importance, steady and well-paced rebalancing in Asian economies would help foster more balanced growth in its trading partners as well.

Latin America and the Caribbean: Moving toward More Sustainable Growth

Much of the region has thus far benefited from strong terms of trade and easy external financing conditions. In many economies, activity is above potential, credit growth is high, inflation is trending near or above the upper target range, and current account deficits are widening despite supportive commodity prices. The outlook is still strong, although downside risks have come to the

[12]See IMF (2011c).

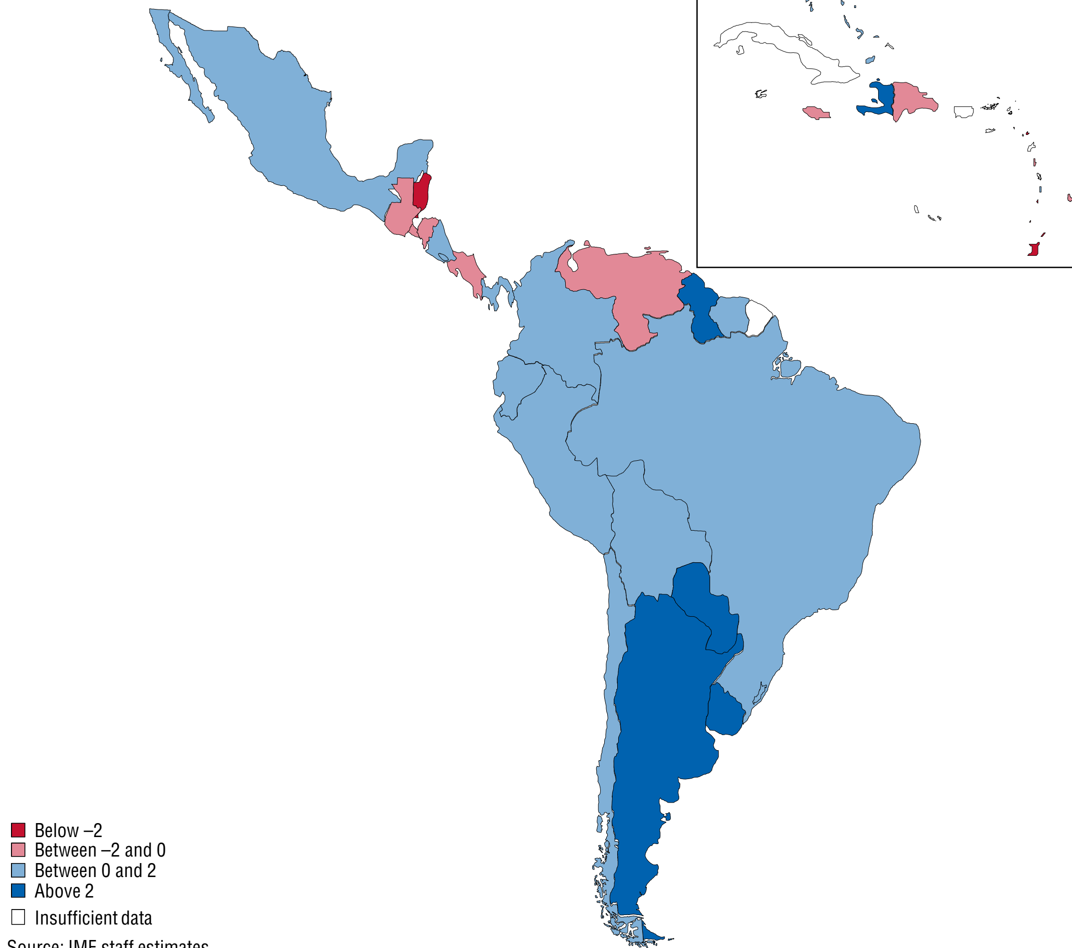
[13]See the October 2010 *World Economic Outlook*.

fore and commodity prices will provide less momentum in the future. Further macroeconomic tightening is still essential to rebuild room for policy maneuvering and to contain demand pressures. But in most economies, monetary tightening can pause until uncertainty abates.

The Latin American and Caribbean (LAC) region expanded rapidly in the first half of 2011, led by vibrant activity in many of the region's commodity exporters. Buoyant domestic demand underpinned by accommodative macroeconomic policies, strong capital inflows (although more volatile lately), and favorable terms of trade supported the momentum. The pace of expansion, however, has begun to moderate, as many economies have fully recovered from the global crisis, and macroeconomic policies are being tightened (Figure 2.11). Nonetheless, growth remains above potential, and a number of economic indicators—including positive output gaps, above-target inflation levels, deteriorating current account balances, rapid credit growth, strong asset prices, and sustained appreciation of real exchange rates—suggest that some economies may be overheating (Figure 2.12). Elsewhere, including in Central America and the Caribbean, economic activity is still subdued, reflecting stronger real linkages with the United States and other advanced economies, and in some cases, high levels of public debt.

Figure 2.11. Latin America and the Caribbean: Current Growth versus Precrisis Average

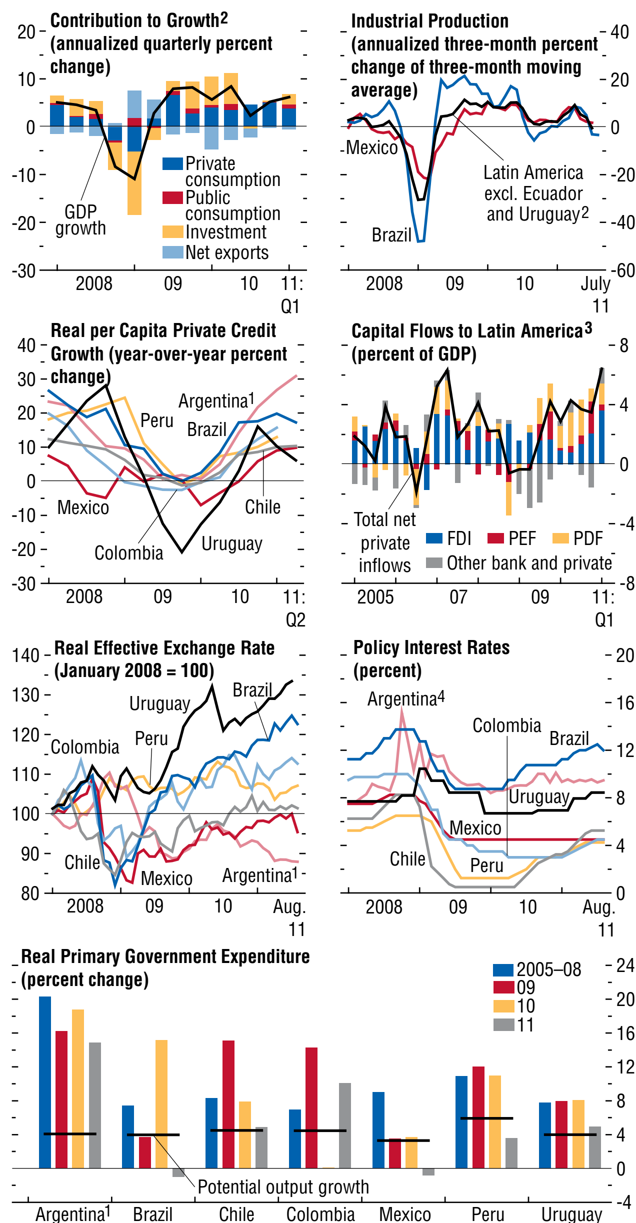
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.

Figure 2.12. Latin America: Maintaining the Growth Momentum[1]

Growth in the region remains strong, supported by buoyant domestic demand, easy external financial conditions, and still favorable terms of trade. The key now is to maintain healthier growth momentum as macroeconomic policies move to a more neutral position. Boom-bust risks must be contained, including through tighter fiscal and macroprudential policies.



Sources: Bloomberg Financial Markets; Haver Analytics; IMF, *Balance of Payments Statistics;* IMF, *International Financial Statistics;* and IMF staff estimates.

[1]Calculations are based on the official consumer price index and GDP for Argentina.

[2]Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela. Aggregates are computed on the basis of purchasing-power-parity weights.

[3]FDI: foreign direct investment; PEF: portfolio equity flows; PDF: portfolio debt flows.

[4]The policy rate is proxied by the short-term interbank lending rate.

Financial conditions have become somewhat more unsettled with the synchronized increase in volatility in global equity markets and the rise in global risk aversion, but the impact on the region has been limited thus far.

The LAC region is projected to expand by 4½ percent in 2011, moderating to about 4 percent in 2012, with output remaining above potential (Table 2.5). Economic growth is projected to slow, as domestic demand growth moderates in response to less accommodative macroeconomic policies and external demand weakens as projected. Overall, external conditions are projected to remain supportive, although with somewhat greater risk aversion and a weaker push from commodity prices. Near-term baseline growth prospects vary substantially across the region:

- Growth will be led by many of South America's commodity exporters—particularly Argentina, Chile, Paraguay, Peru, and Uruguay—all of which are expected to grow at levels near or above 6 percent in 2011. Growth in South America is projected to moderate toward potential in 2012, in the range of 3½ to 5½ percent. In the case of Brazil, growth has already begun to moderate, with activity expanding by 4 percent in the first half of 2011, compared with 7½ percent in 2010. Near-term growth is expected to slow below potential and bring inflation toward the target, in part reflecting the less favorable external outlook.
- In Mexico, growth was fairly robust during the first half of the year, despite weak U.S. growth and the effects on the automotive sector of the Japanese earthquake and tsunami. However, negative spillovers from the anemic U.S. recovery will keep growth around 3¾ percent for 2011–12.
- In Central America and the Caribbean, growth will continue to be constrained by a slow recovery in remittances and tourism, and in much of the Caribbean by the challenges posed by high public debt.

Inflation is forecast to recede from 6¾ percent in 2011 to 6 percent in 2012 as activity moderates and commodity prices stabilize, although with considerable intra-regional differences. In the inflation-targeting countries (Brazil, Chile, Colombia, Mexico, Peru, Uruguay), it is projected to stay within the target

Table 2.5. 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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
North America	**3.3**	**1.8**	**2.0**	**1.9**	**3.0**	**1.5**	**–3.1**	**–3.0**	**–2.2**	**. . .**	**. . .**	**. . .**
United States	3.0	1.5	1.8	1.6	3.0	1.2	–3.2	–3.1	–2.1	9.6	9.1	9.0
Canada	3.2	2.1	1.9	1.8	2.9	2.1	–3.1	–3.3	–3.8	8.0	7.6	7.7
Mexico	5.4	3.8	3.6	4.2	3.4	3.1	–0.5	–1.0	–0.9	5.4	4.5	3.9
South America[4]	**6.6**	**4.9**	**4.1**	**6.7**	**7.9**	**7.0**	**–1.1**	**–1.3**	**–1.7**	**. . .**	**. . .**	**. . .**
Brazil	7.5	3.8	3.6	5.0	6.6	5.2	–2.3	–2.3	–2.5	6.7	6.7	7.5
Argentina[5]	9.2	8.0	4.6	10.5	11.5	11.8	0.8	–0.3	–0.9	7.8	7.3	6.9
Colombia	4.3	4.9	4.5	2.3	3.3	2.9	–3.1	–2.6	–2.5	11.8	11.5	11.0
Venezuela	–1.5	2.8	3.6	28.2	25.8	24.2	4.9	7.3	5.8	8.6	8.1	8.0
Peru	8.8	6.2	5.6	1.5	3.1	2.4	–1.5	–2.7	–2.8	7.9	7.5	7.5
Chile	5.2	6.5	4.7	1.5	3.1	3.1	1.9	0.1	–1.5	8.3	7.2	7.2
Ecuador	3.6	5.8	3.8	3.6	4.4	4.9	–3.3	–3.0	–3.1	7.6	7.3	7.5
Uruguay	8.5	6.0	4.2	6.7	7.7	6.5	–0.4	–1.6	–3.0	6.7	6.6	6.6
Bolivia	4.1	5.0	4.5	2.5	9.8	4.8	4.6	4.2	3.9	. . .	. . .	. . .
Paraguay	15.0	6.4	5.0	4.7	8.7	7.8	–2.8	–3.9	–3.7	6.1	5.8	5.6
Central America[6]	**3.7**	**3.9**	**4.0**	**3.9**	**6.0**	**5.7**	**–5.2**	**–6.3**	**–6.4**	**. . .**	**. . .**	**. . .**
Caribbean[7]	**3.3**	**3.3**	**4.3**	**7.1**	**7.8**	**5.9**	**–3.7**	**–3.6**	**–2.7**	**. . .**	**. . .**	**. . .**
Memorandum												
Latin America and the Caribbean[8]	6.1	4.5	4.0	6.0	6.7	6.0	–1.2	–1.4	–1.7	. . .	. . .	. . .
Eastern Caribbean Currency Union[9]	–1.1	1.1	2.0	2.5	3.5	3.0	–21.4	–23.3	–21.0	. . .	. . .	. . .

[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]Percent. National definitions of unemployment may differ.

[4]Also includes also Guyana and Suriname.

[5]Figures are based on the official GDP and consumer price index (CPI) data. The authorities have committed to improve the quality of Argentina's official GDP and CPI, so as to bring them into compliance with their obligations under the IMF's Articles of Agreement. Until the quality of data reporting has improved, IMF staff will also use alternative measures of GDP growth and inflation for macroeconomic surveillance, including estimates by: private analysts, which have shown growth that is, on average, significantly lower than official GDP growth from 2008 onward; and provincial statistical offices and private analysts, which have shown inflation considerably higher than the official inflation rate from 2007 onward.

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

[7]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.

[8]Latin America and the Caribbean comprises Mexico and economies from the Caribbean, Central America, and South America.

[9]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.

range during 2011, but near or above the upper bound (Brazil, Peru, Uruguay). In other economies, such as Argentina and Venezuela, inflation is projected to remain in double digits, reflecting expansionary policies.[14]

The risks to the near-term regional outlook point down. A sharper slowdown in advanced economies, notably the United States, would dampen growth, particularly in economies dependent on trade, tourism spending, and remittances (the Caribbean, Central America, Mexico). If global risk aversion continues to stay elevated, it could increase external financing risks for the region through a potential reversal in capital inflows and a sharp adjustment of current account imbalances and exchange rates. The strong presence of Spanish banks in the region could raise some risks in a tail scenario, but these risks should be offset by the existing subsidiary model. Last, potential spillovers from China could show up through trade—that is, manufacturing and commodity prices—in that a sharper policy-based slowdown in China could

[14]Private sector analysts estimate that consumer price inflation in Argentina since 2007 has been considerably higher than official estimates.

dampen the outlook for the region's commodity exporters. However, some upside risks still remain—domestic demand growth could exceed expectations if global risks unwind relatively quickly, resuming the strong wave of capital flows to the region and if macroeconomic policy tightening does not progress sufficiently.

Against this backdrop, policies need to be designed to address two offsetting forces: containing domestic overheating pressure and the buildup of financial vulnerabilities, while responding appropriately to the souring external environment. In this context, efforts thus far to normalize monetary policies to a neutral stance are welcome, although in countries where inflation pressure has lessened, a temporary pause in monetary tightening could be considered until uncertainty abates. Further monetary tightening is likely warranted in a few economies where overheating risks appear more imminent (Argentina, Paraguay, Venezuela). In Mexico, given firmly anchored inflation expectations along with potentially larger downdrafts from the United States, monetary policy can remain accommodative as long as inflation pressure and expectations remain at bay.

Fiscal consolidation should continue, however (especially where it is needed to maintain debt sustainability), while protecting social and infrastructure spending.[15] Fiscal policy in commodity-exporting countries needs to avoid procyclical spending, and consideration should be given to adopting structural fiscal targets (that control for the cycle and commodity prices) and binding medium-term plans. In Central America, policies should shift toward rebuilding the policy buffers used during the crisis and adopting structural reforms aimed at boosting medium-term growth. Greater resolve is required for reducing debt overhang in the Caribbean while addressing weak competitiveness.

The postcrisis rapid increase in credit and equity prices in many LAC economies, boosted in part by strong capital flows, calls for continued vigilance to limit the attendant risks to financial stability. The region has responded to capital flows and vibrant credit growth with a combination of policies. Countries mostly have allowed their currencies to be flexible and have intervened in foreign exchange markets to different degrees (Brazil, Peru, and Uruguay more than Colombia and Mexico). Others have also introduced macroprudential measures, including tightening reserve requirements and raising capital requirements for certain consumer credit operations (Brazil, Peru). In some cases, these measures have been complemented with capital controls (Brazil). Overall, the banking system is strong, and prudential indicators have generally improved, including capital adequacy, the ratio of nonperforming loans, and provisioning levels.[16] That said, the sheer growth of credit points to a potential deterioration in credit quality, and banks' exposure to wholesale funding has increased, although from a small base. In this regard, it is important to continue to monitor potential financial sector vulnerabilities and strengthen financial sector supervision, including for nonbank financial intermediaries, to contain the buildup of excessive leverage and avoid boom-bust credit cycles.

The region's external current account deficits are set to widen slightly during 2011–12, despite the strength in commodity prices. Indeed, the reliance on capital flows to finance these deficits has increased the region's susceptibility to a sudden turnaround in investor sentiment. Enhanced macroprudential measures and supervision (discussed above) remain imperative for maintaining financial stability, and capital controls could provide some temporary relief in the face of strong capital inflows, but these measures should not substitute for needed macroeconomic adjustment. The greater use in the region of exchange rate flexibility as a shock absorber is indeed welcome, but more fiscal policy tightening is needed, not just to reduce fiscal vulnerability but also to abate the pressures on the real exchange rate and support external balances.

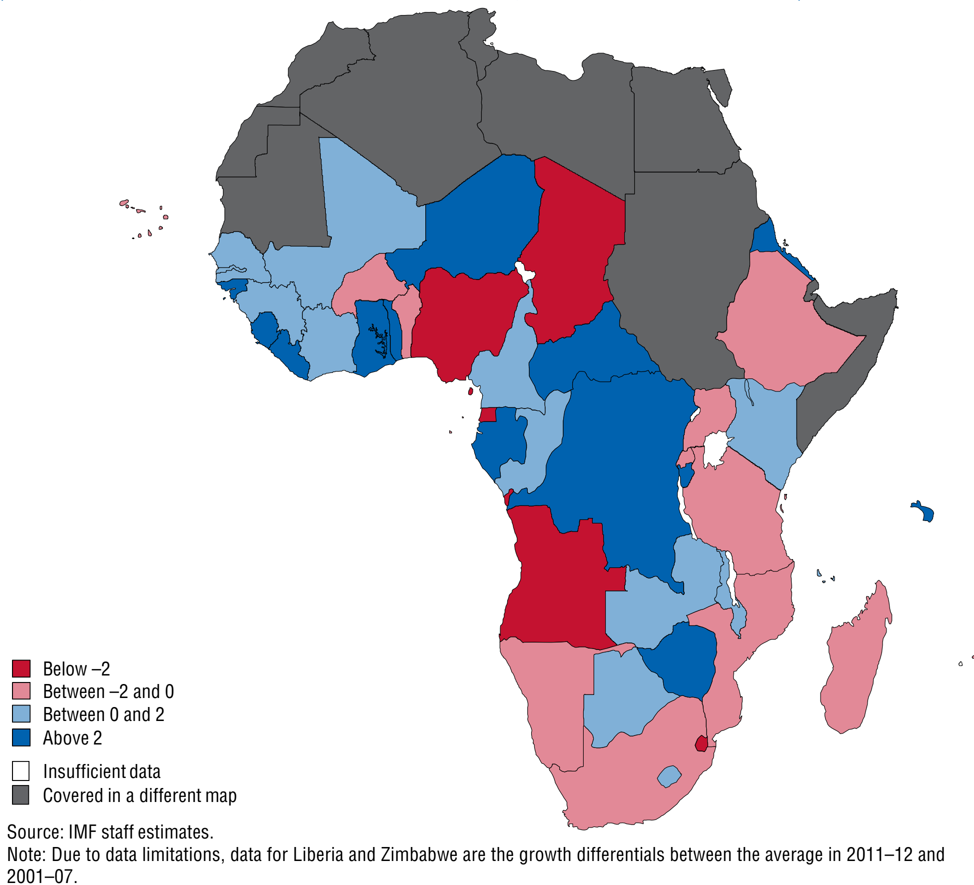
Sub-Saharan Africa: Sustaining the Expansion

The SSA region is showing solid macroeconomic performance, with many economies already growing at rates close to their precrisis averages (Figure 2.13). The global slowdown has not significantly affected the region thus far, but downside risks have risen. Inflation has

[15] See the September 2011 *Fiscal Monitor.*

[16] See the April 2011 *Western Hemisphere Regional Economic Outlook.*

Figure 2.13. Sub-Saharan Africa: Current Growth versus Precrisis Average
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.
Note: Due to data limitations, data for Liberia and Zimbabwe are the growth differentials between the average in 2011–12 and 2001–07.

increased perceptibly in a number of countries in the region. Under the baseline scenario, with a strong recovery under way, this is an opportune time to return to the region's long-standing priorities of improving policy and institutional frameworks, building resilience to commodity price swings, and developing financial markets, all of which would help lift the region's potential growth and alleviate poverty. In the event of a pronounced global downturn, countries that have policy buffers should aim to support growth.

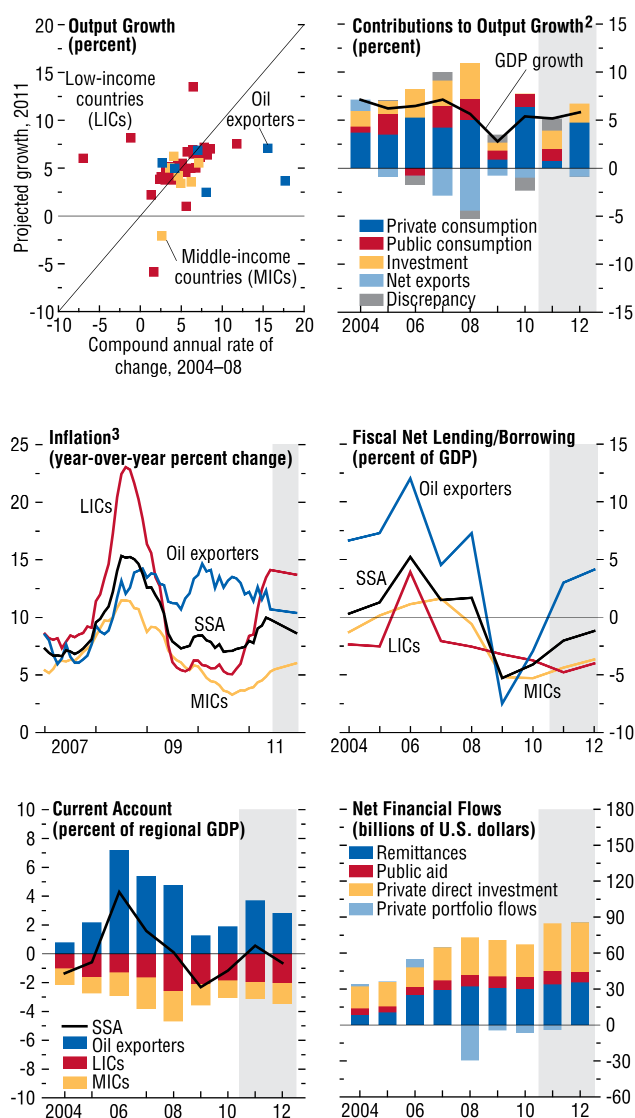
Real activity in the region expanded strongly in 2010 and so far in 2011. Robust private and public consumption underpinned this strength, as many countries used available macroeconomic policy room to help speed the recovery from the crisis-induced slowdown. The earlier surge in commodity prices fueled a rise in inflation. Reflecting the relatively accommodative monetary conditions, there are signs of nontrivial inflation pressure in some economies (including Ethiopia, Kenya, and Uganda). However, private capital flows, which had been gaining importance as a source of external financing before the crisis, have resumed only to a handful of emerging and frontier economies (Ghana, Mauritius, South Africa).

The region is poised for continued economic expansion in the near term, provided the recent rise in financial and economic instability in major advanced economies remains contained (Figure 2.14; Table 2.6). Real GDP growth in the SSA region is projected to average 5¼ to 5¾ percent during 2011–12, with considerable differences across the region:

- Largely shielded from the global financial crisis owing to their limited integration into global manufacturing and financial networks, most of the

Figure 2.14. Sub-Saharan Africa: Continued Strength[1]

Recovery is well under way, with growth in many economies back to the highs of the early 2000s. Strong domestic demand, closing output gaps, and rising inflation call for normalization of the fiscal stance. Building policy room is key to containing risks emanating from a further deterioration in the global outlook.



Sources: Haver Analytics; and IMF staff estimates.
[1]Aggregates for the external economy are sums of individual country data. Aggregates for all others are computed on the basis of purchasing-power-parity weights.
[2]Excludes Liberia and Zimbabwe due to data limitations.
[3]Due to data limitations, the following countries are excluded: Chad, Republic of Congo, and Equatorial Guinea from oil exporters; Burundi, Cameroon, Central African Republic, Comoros, Democratic Republic of Congo, Eritrea, Guinea, Guinea-Bissau, Liberia, Malawi, São Tomé and Príncipe, Togo, Zambia, and Zimbabwe from LICs.

region's low-income countries (LICs) have returned to their precrisis growth rates. The severe drought in the horn of Africa has precipitated a major humanitarian crisis in a few economies in the region and caused inflation to increase to sharply higher levels. Average growth for the LIC group is projected at 6 percent in 2011, on the back of strong domestic demand and accelerating exports. In 2012, growth is expected to gather speed to 6½ percent as investment strengthens in Kenya, economic activity normalizes in Côte d'Ivoire after severe disruption following the 2010 elections, and large oil and mining projects come online in Niger and Sierra Leone.

- Oil-exporting economies have a similarly positive outlook, with growth of about 6 percent in 2011, increasing to 7¼ percent in 2012. The acceleration in growth in 2012, despite lower oil prices than projected in the June 2011 *WEO Update*, reflects continued strength in domestic public investment spending, as well as some idiosyncratic factors, such as a strong rebound in oil production in Angola following a disruption in 2011.
- Middle-income countries (MICs), whose greater integration with global markets made them more vulnerable to the crisis, have yet to fully recover from its impact. A surge in unemployment, high household debt, low capacity utilization, the slowdown in advanced economies, and substantial real exchange rate appreciation are making for a hesitant recovery in South Africa, the largest economy in the region. Yet, over the next 12 months, its output gap is projected to close as growth picks up to about 3½ percent during 2011–12. Economic growth will be driven by private consumption and reinvigorated investment, supported by a low interest rate environment and a return to the issuance and renewal of mining licenses.

Across the SSA region, there has been a marked increase in inflation. The earlier surge in commodity prices risks fueling inflation further amid the limited economic slack of the LICs (for example, Uganda), especially in net staple importers (such as Ethiopia) or where there is significant pass-through from international to domestic food prices (for example, Kenya). Among oil exporters, inflation is projected to remain

Table 2.6. 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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Sub-Saharan Africa	**5.4**	**5.2**	**5.8**	**7.5**	**8.4**	**8.3**	**–1.2**	**0.6**	**–0.6**	**. . .**	**. . .**	**. . .**
Oil Exporters	**7.3**	**6.0**	**7.2**	**12.3**	**10.5**	**9.4**	**6.0**	**11.1**	**8.6**	**. . .**	**. . .**	**. . .**
Nigeria	8.7	6.9	6.6	13.7	10.6	9.0	8.4	13.5	11.1	4.5	4.5	4.5
Angola	3.4	3.7	10.8	14.5	15.0	13.9	8.9	12.0	7.3	. . .	. . .	. . .
Equatorial Guinea	–0.8	7.1	4.0	7.5	7.3	7.0	–24.2	–9.6	–10.5	. . .	. . .	. . .
Gabon	5.7	5.6	3.3	1.4	2.3	3.4	10.5	14.8	12.3	. . .	. . .	. . .
Republic of Congo	8.8	5.0	7.0	5.0	5.9	5.2	5.1	7.4	9.7	. . .	. . .	. . .
Chad	13.0	2.5	6.9	–2.1	2.0	5.0	–31.3	–18.9	–13.0	. . .	. . .	. . .
Middle-Income	**3.1**	**3.5**	**3.7**	**4.4**	**6.0**	**5.1**	**–3.1**	**–3.0**	**–3.8**	**. . .**	**. . .**	**. . .**
South Africa	2.8	3.4	3.6	4.3	5.9	5.0	–2.8	–2.8	–3.7	24.9	24.5	23.8
Botswana	7.2	6.2	5.3	6.9	7.8	6.2	–4.9	–4.3	–1.7	. . .	. . .	. . .
Mauritius	4.2	4.2	4.1	2.9	6.7	5.3	–8.2	–9.9	–8.0	7.8	8.2	8.4
Namibia	4.8	3.6	4.2	4.5	5.0	5.6	–1.3	–0.7	–3.3	. . .	. . .	. . .
Swaziland	2.0	–2.1	0.6	4.5	8.3	7.8	–18.5	–11.8	–9.0	. . .	. . .	. . .
Cape Verde	5.4	5.6	6.4	2.1	5.0	4.9	–11.2	–12.9	–11.9	10.3	. . .	. . .
Low-Income[4]	**5.8**	**5.9**	**6.5**	**6.2**	**8.8**	**10.3**	**–6.3**	**–7.0**	**–7.0**	**. . .**	**. . .**	**. . .**
Ethiopia	8.0	7.5	5.5	2.8	18.1	31.2	–4.4	–6.3	–8.6	. . .	. . .	. . .
Kenya	5.6	5.3	6.1	4.1	12.1	7.4	–7.0	–8.9	–8.5	. . .	. . .	. . .
Ghana	7.7	13.5	7.3	10.7	8.7	8.7	–7.0	–6.5	–4.9	. . .	. . .	. . .
Tanzania	6.4	6.1	6.1	10.5	7.0	9.4	–8.8	–8.8	–10.2	. . .	. . .	. . .
Cameroon	3.2	3.8	4.5	1.3	2.6	2.5	–2.8	–3.8	–3.3	. . .	. . .	. . .
Uganda	5.2	6.4	5.5	9.4	6.5	16.9	–8.8	–4.0	–8.9	. . .	. . .	. . .
Côte d'Ivoire	2.4	–5.8	8.5	1.4	3.0	2.5	5.0	1.0	–0.4	. . .	. . .	. . .

[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]Percent. National definitions of unemployment may differ.

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

high, dominated by price developments in Nigeria and Angola, where rapid monetary expansion before the crisis (Nigeria) and a sharp increase in domestic fuel prices (Angola) fed into price increases. The incomplete recovery from the crisis in the region's MICs will limit the rise in inflation in these economies.

A further deterioration of the global economic environment could have substantial spillovers to the SSA region. A faltering U.S. or European recovery could undermine prospects for exports, remittances, official aid, and private capital flows. Asset market spillovers from continued market turbulence or spikes in risk aversion would likely be limited to the few frontier markets, as they were during the 2008–09 crisis, and the situation thus far is well contained. Finally, a sharp increase in oil prices, while boosting growth in oil exporters, would pose significant challenges for oil importers.[17] Similarly, a continued surge in non-oil commodity prices would entail large social and fiscal costs for the region's net commodity importers. Other risks to the outlook are primarily domestic—for example, political uncertainty and weather shocks also have the potential to dampen growth prospects.

Under the baseline scenario, with growth recovering, especially among the LICs, rebuilding fiscal room and reorienting fiscal policy toward longer-term investment and poverty-reduction objectives should

[17]Simulations suggest that growth in oil-importing SSA economies would decline by 0.5 to 0.7 percent should oil prices increase to an average of $150 in 2011 (see the April 2011 *Sub-Saharan Africa Regional Economic Outlook).*

be a priority. For oil exporters, the challenge will be to manage the current revenue bonanza, especially given the somewhat weakened outlook for prices. Spending targets guided by absorption capacity and anchored within a medium-term fiscal framework will help. Targeted and time-bound policy interventions to mitigate the impact of high commodity prices on vulnerable groups should be considered. With inflation picking up, monetary policy should also revert to a more neutral stance, as is already happening in a number of economies (Kenya, Tanzania, Uganda).

Should global growth slow down significantly, economies with adequate policy buffers should aim to support growth. The likes of South Africa, for example, should allow automatic stabilizers to operate on the fiscal side and ease monetary conditions. LICs should also aim to support activity by using the available room for maneuvering—by protecting spending while allowing revenues to fluctuate with activity to the extent financing allows.

The region's aggregate external balance is expected to improve slightly in 2011, but to deteriorate in 2012. External current account surpluses in commodity exporters will narrow somewhat with the slight retreat in commodity prices. Current account deficits are projected to be sustained among the remaining economies, in line with the continued strength in their domestic demand, although they will remain contained over the medium term.

Middle East and North Africa: Growth Stalling amid Uncertainty

Commodity price movements and social unrest continue to shape the region's experience and prospects. The short-term outlook is still subject to unusually large uncertainties, stemming mainly from the fluid political and security situation in some MENA economies as well as growing uncertainty about external demand. Preserving macroeconomic stability while building social cohesion is a key immediate priority; restoring fiscal health and designing a growth model to achieve inclusive medium-term growth and employment also remain critical.

Elevated oil prices thus far have boosted the fortunes of the region's oil exporters, while creating challenges for oil importers. Among oil exporters, activity has also been spurred by broadly stimulatory macroeconomic policies. At the same time, activity in several MENA economies is being adversely affected by social unrest and ongoing conflict, which are weighing heavily on tourism receipts, capital flows, and investment.

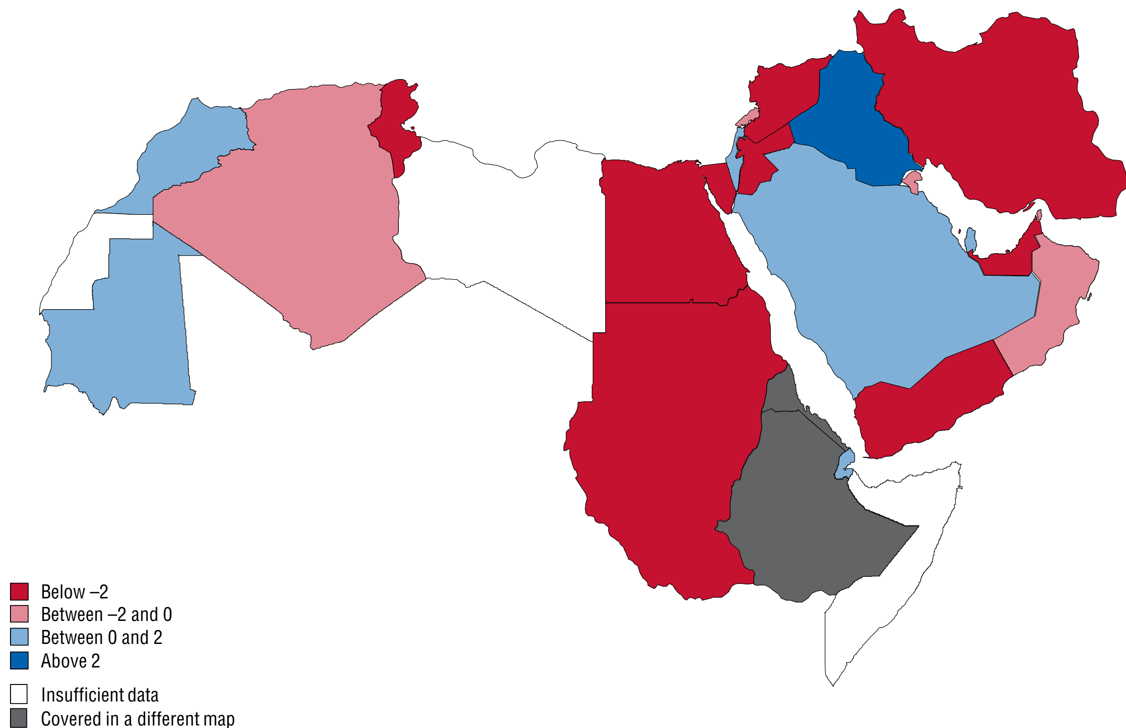
Growth in oil-exporting economies is forecast to reach 5 percent in 2011 and about 4 percent in 2012 (Figures 2.15 and 2.16; Table 2.7)—with growth led by Qatar (driven by expanding natural gas exports), Iraq, and Saudi Arabia. The outlook for oil importers is much more subdued (especially for Egypt, Syrian Arab Republic, and Tunisia), with growth projected at 1½ percent in 2011. Activity in a few economies will be constrained by domestic social unrest and an associated slow recovery in tourism receipts and remittances. Oil importers' growth is projected to reach 2½ percent in 2012, underpinned by a slow recovery in investment.

MENA inflation will remain elevated in 2011 but will fall somewhat in 2012, reflecting receding commodity prices. Inflation is forecast to fall from 10¾ percent in 2011 to 7½ percent in 2012 for oil exporters, while staying under 8 percent during 2011–12 for oil importers.

The outlook is subject to large downside risks. External risks relate to the unfolding weaker outlook in the United States and Europe, which could sharply depress activity and hence commodity prices or further slow external financing flows to the region. However, most risks pertain to continued domestic instability, compounded by intraregional contagion. The political turmoil has seen risk premiums rise and private financing and tourism receipts fall—not only in those economies directly affected by the turmoil but throughout the region. Any intensification of the political crises would exacerbate the economic plight of the region, with the tail risk that MENA oil production could be further affected with ramifications for global energy markets. Global spillovers from the disruption of oil production in Libya until recently were mitigated by increased production from other MENA economies, notably Saudi Arabia.

The region faces serious policy challenges. Beyond securing economic and social stability, shorter-

Figure 2.15. Middle East and North Africa: Current Growth versus Precrisis Average
(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF staff estimates.
Note: There are no data for Libya in the projection years due to the uncertain political situation. Projections for 2011 and later exclude South Sudan.

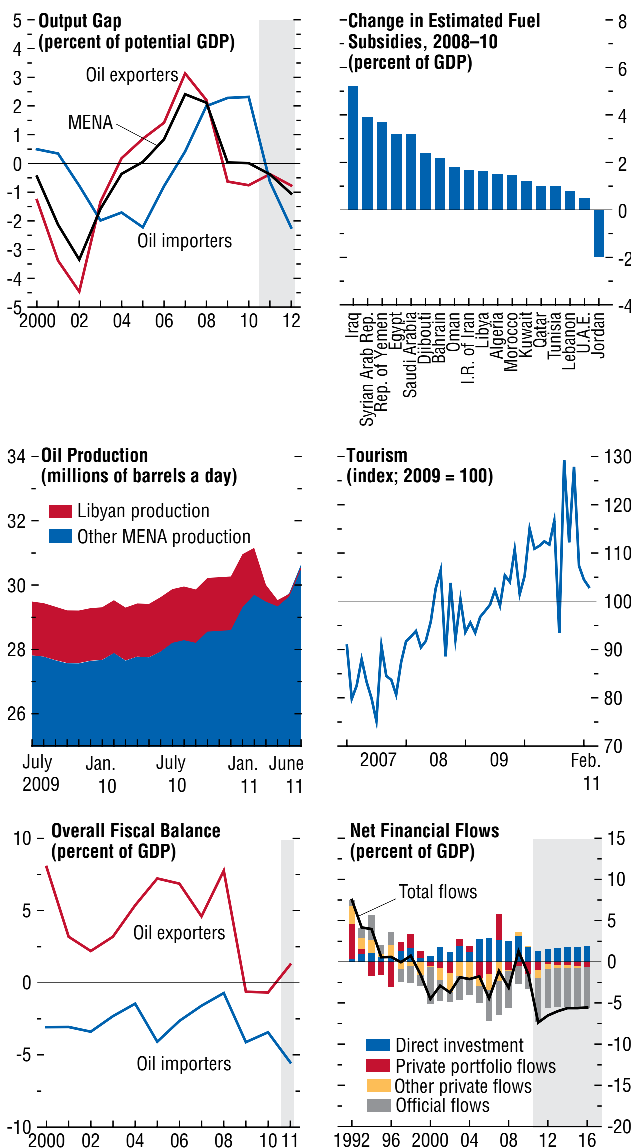
term challenges focus on the need to place public finances on a sustainable footing. For oil exporters, governments need to seize the opportunity presented by high oil prices to move toward sustainable and more diversified economies. In addition, the social disruption seen in MENA countries highlights the need for an inclusive medium-term growth agenda that establishes strong institutions to stimulate private sector activity, opens up greater access to economic opportunities, and addresses chronically high unemployment, particularly among the young.

Fiscal policy priorities in MENA economies are quite diverse, with the need for fiscal consolidation greatest among oil-importing economies, which face growing concerns over fiscal sustainability. In all MENA countries, a key medium-term objective is the reorientation of fiscal policies to attain poverty reduction and productive investment goals. However, governments recently have been under pressure to increase current spending—to support both increased social spending and commodity subsidies—and to address pressing social problems. Increased spending on fuel and food subsidies (with the Islamic Republic of Iran an important exception), along with pressures to raise civil service wages and pensions, is placing a strain on public finances (particularly for oil-importing economies), which will not be sustainable over the medium term. Moreover, procyclical fiscal expansion could further crowd out needed private investment, perpetuating the problems with job creation in the private sector.

The region's external balance is expected to remain high during 2011–12, although it will narrow somewhat in 2012 with the slight pullback in commodity

Figure 2.16. Middle East and North Africa: Weakening Activity in an Uncertain Environment[1]

The level of economic activity is slowing, with output moving further away from its potential. High unemployment, growing social unrest, and rising food prices are dampening growth prospects, especially in oil-importing economies. Oil-driven fiscal and current account surpluses (deficits) have widened for oil exporters (importers).



Sources: Haver Analytics; International Energy Agency; International Labor Organization; IMF, Primary Commodity Price System; national sources; and IMF staff estimates.

[1]Oil exporters: Algeria, Bahrain, Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Sudan, United Arab Emirates (U.A.E.), and Republic of Yemen. Oil importers: Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Syrian Arab Republic, and Tunisia. Aggregates for the external economy are sums of individual country data. Aggregates for all others are computed on the basis of purchasing-power-parity weights. Excludes Libya for the projection years due to the uncertain political situation. Projections for 2011 and later exclude South Sudan.

prices. Among oil exporters, high commodity prices will maintain strong external positions and enhance reserves. Current account deficits in oil importers will remain wide at about 4¾ percent amid pressing commodity import bills, declining remittances, and shrinking tourism receipts. Current account balances are projected to deteriorate most in the Mashreq (Jordan, Lebanon, Syrian Arab Republic). In terms of external financing in 2011, private capital inflows (chiefly foreign direct investment) will likely be insufficient to offset oil importers' growing current account deficits, resulting in a drawdown of international reserve cushions.

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Table 2.7. 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	
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Middle East and North Africa	**4.4**	**4.0**	**3.6**	**6.8**	**9.9**	**7.6**	**7.7**	**11.2**	**9.0**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**4.4**	**4.9**	**3.9**	**6.6**	**10.8**	**7.6**	**10.6**	**15.0**	**12.4**	**. . .**	**. . .**	**. . .**
Islamic Republic of Iran	3.2	2.5	3.4	12.4	22.5	12.5	6.0	7.8	7.1	14.6	15.3	15.6
Saudi Arabia	4.1	6.5	3.6	5.4	5.4	5.3	14.9	20.6	14.2	10.0	. . .	. . .
Algeria	3.3	2.9	3.3	3.9	3.9	4.3	7.9	13.7	10.9	10.0	9.8	9.5
United Arab Emirates	3.2	3.3	3.8	0.9	2.5	2.5	7.0	10.3	9.2	. . .	. . .	. . .
Qatar	16.6	18.7	6.0	–2.4	2.3	4.1	25.3	32.6	30.1	. . .	. . .	. . .
Kuwait	3.4	5.7	4.5	4.1	6.2	3.4	27.8	33.5	30.4	2.1	2.1	2.1
Iraq	0.8	9.6	12.6	2.4	5.0	5.0	–3.2	–0.9	–1.2	. . .	. . .	. . .
Sudan[5]	6.5	–0.2	–0.4	13.0	20.0	17.5	–6.7	–7.3	–7.6	13.7	13.4	12.2
Oil Importers[6]	**4.5**	**1.4**	**2.6**	**7.6**	**7.5**	**7.7**	**–3.9**	**–4.8**	**–4.7**	**. . .**	**. . .**	**. . .**
Egypt	5.1	1.2	1.8	11.7	11.1	11.3	–2.0	–1.9	–2.2	9.0	10.4	11.5
Morocco	3.7	4.6	4.6	1.0	1.5	2.7	–4.3	–5.2	–4.0	9.1	9.0	8.9
Syrian Arab Republic	3.2	–2.0	1.5	4.4	6.0	5.0	–3.9	–6.1	–6.1	8.4	. . .	. . .
Tunisia	3.1	0.0	3.9	4.4	3.5	4.0	–4.8	–5.7	–5.5	13.0	14.7	14.4
Lebanon	7.5	1.5	3.5	4.5	5.9	5.0	–10.9	–14.7	–13.8	. . .	. . .	. . .
Jordan	2.3	2.5	2.9	5.0	5.4	5.6	–4.9	–6.7	–8.4	12.5	12.5	12.5
Memorandum												
Israel	4.8	4.8	3.6	2.7	3.4	1.6	2.9	0.3	0.7	6.7	5.9	5.8
Maghreb[7]	3.5	2.9	3.9	3.1	3.1	3.8	4.4	4.9	3.7	. . .	. . .	. . .
Mashreq[8]	4.9	0.8	1.9	9.6	9.6	9.5	–3.6	–4.5	–4.7	. . .	. . .	. . .

[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]Percent. National definitions of unemployment may differ.

[4]Also includes Bahrain, Libya, Oman, and Republic of Yemen. Excludes Libya for the projection years due to the uncertain political situation.

[5]Projections for 2011 and later exclude South Sudan.

[6]Includes also Djibouti and Mauritania.

[7]The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia. It excludes Libya for the projection years due to the uncertain political situation.

[8]The Mashreq comprises Egypt, Jordan, Lebanon, and Syrian Arab Republic.