CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

The global growth constellation is changing. Activity in the major advanced economies has started to accelerate from subdued levels. By contrast, growth in China and many other emerging market economies in Asia and Latin America, and to a lesser extent in the Commonwealth of Independent States (CIS), has cooled, after a surge in output beyond potential following the recovery from the Great Recession. Structural factors have also played a role in the slowdown, although to varying degrees, reflecting infrastructure bottlenecks, a weak investment climate, and other supply-side constraints. Activity in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region has been held back by ongoing difficult political transitions in many countries and, more recently, slower oil production in oil exporters. Growth in sub-Saharan Africa (SSA) is still strong, driven by domestic demand, although at a slower pace than previously anticipated.

The changing growth dynamics have brought new risks to the fore. The growing conviction in markets that a turning point in U.S. monetary policy is being reached has led to a tightening in global financial conditions since late May of this year. Many emerging markets have experienced capital outflows and currency depreciations, wider bond spreads, and declining equity prices. Although the Federal Reserve recently decided not to taper yet, there is a distinct risk that financial conditions could tighten further from their current, still supportive levels (see Chapter 1). This would create spillovers to the rest of the world. At the same time, risks identified in recent *World Economic Outlook* (WEO) reports are still relevant: the euro area could fall into stagnation; the recovery in Japan could falter in the absence of ambitious structural reforms and medium-term fiscal consolidation plans with specific measures; still weaker investment and potential output growth could result in less of a growth bounce-back in emerging markets. Some economies could even face abrupt balance of payments adjustments if domestic vulnerabilities lead to more sizable capital outflows. Finally, geopolitical risks are also resurfacing. Even if these risks materialize only partially, all would suffer, including through spillovers. Chapter 1 discusses a plausible downside scenario under which mild versions of several of these risks materialize, and the regional implications are sketched out in this chapter (see Figure 2.1).

The United States and Canada: A Modest Recovery

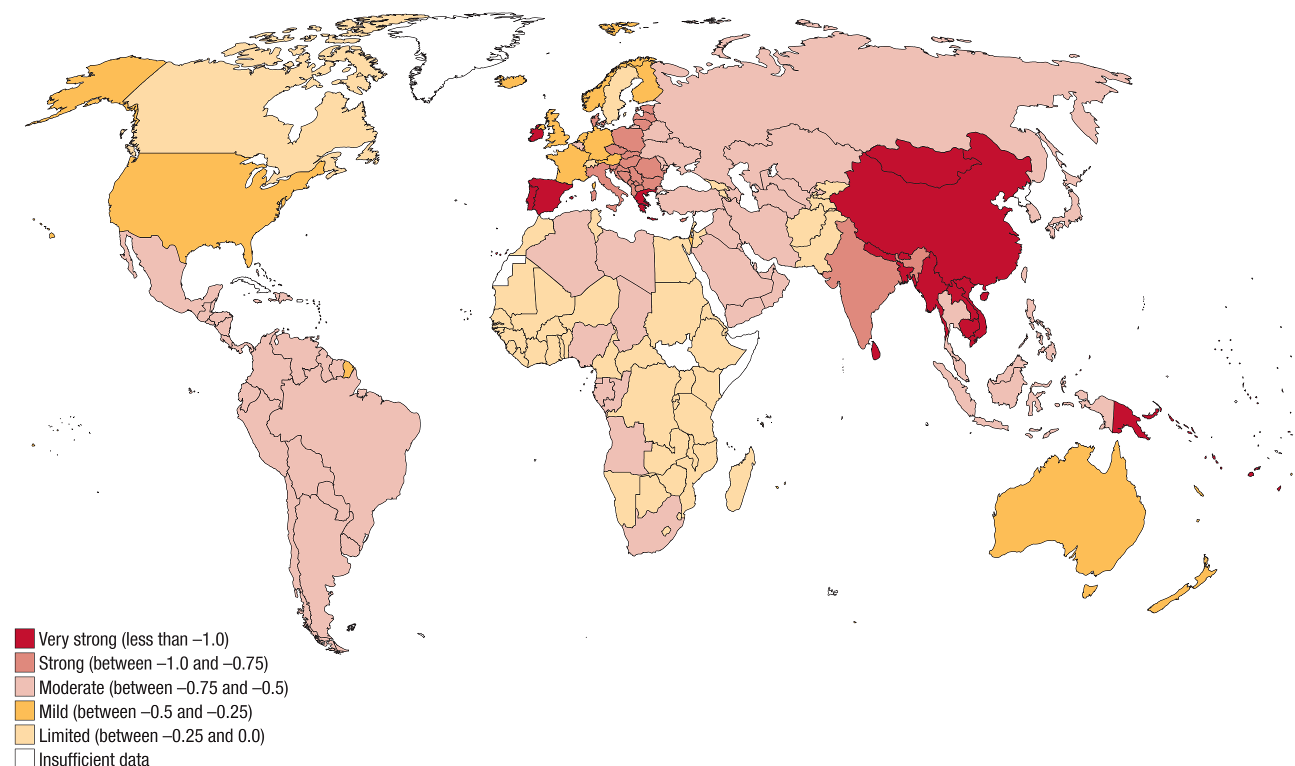
Although growth in the United States remains tepid amid strong fiscal consolidation, improving conditions bode well for a gradual acceleration in growth (Figure 2.2). In Canada, growth will pick up as export recovery and stronger business investment offset the slowdown in the housing market and the deceleration in private consumption growth.

Growth continued at a modest pace in the United States in the first half of 2013. GDP grew at an annual rate of about 1¼ percent, held down by sizable fiscal consolidation (Figure 2.3). With ample slack remaining in the economy, core inflation averaged only 1.8 percent in August. Recent indicators suggest that the underlying recovery is gaining ground, supported by a rebound in the housing market and higher household net worth, although tighter financial conditions since May have somewhat slowed the bounce-back in activity. The unemployment rate continued to fall from its peak of 10 percent in 2009 to 7.3 percent in August 2013, but much of the improvement stemmed from lower labor force participation. Despite a weak external environment, the current account deficit continued to shrink through the second quarter of 2013, thanks in part to increases in domestic energy production.

At the time of writing, a political standoff in the United States has led to a shutdown of its federal government. The projections assume that the shutdown is short, discretionary public spending is approved and executed as assumed in the forecast, and the debt ceiling—which may be reached by mid-October—is raised promptly. Predicated on these assumptions, the recovery is projected to accelerate in late 2013 and in 2014, as the pace of fiscal consolidation slows, growth continues to benefit from monetary accommodation, household balance sheets

Figure 2.1. The Effects of a Plausible Downside Scenario

(Growth deviation from 2014 baseline projections; percentage points)

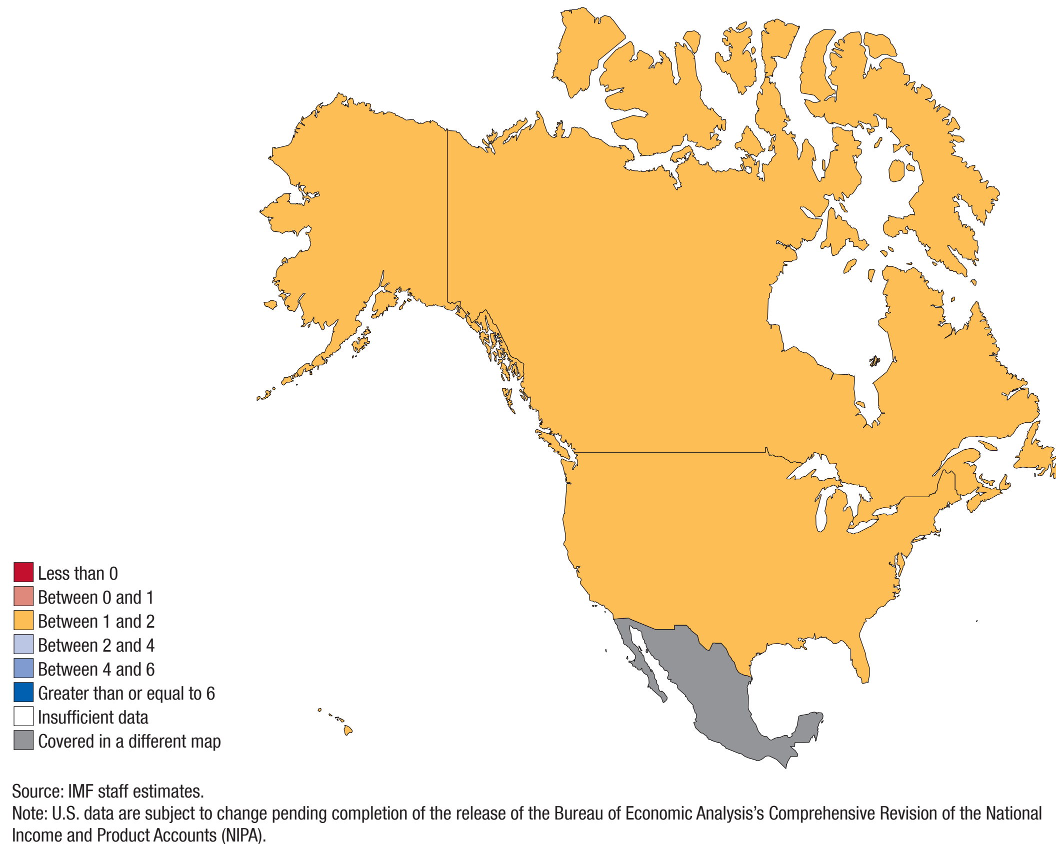


Source: IMF staff estimates.
Note: Simulations were conducted using the IMF's Flexible System Global Models, with 29 individual countries and eight regions (other European Union, other advanced economies, emerging Asia, newly industrialized Asia, Latin America, Middle East and North Africa, sub-Saharan Africa, oil exporters group). Countries not included in the model are allocated to the regions based on the WEO classification of fuel exporters, followed by geographical regional classifications.

strengthen further, and the housing market recovery continues despite higher mortgage rates. Growth will average 1½ percent in 2013 and accelerate to 2½ percent in 2014 (Table 2.1). These projections, weaker than the April 2013 forecast, largely reflect a prolonged budget sequester, until the end of September 2014. The forecast also assumes that the monetary policy stance will remain highly accommodative in that the Federal Reserve's asset purchases will be scaled back only gradually starting later this year and policy rates will remain near zero until early 2016. The unemployment rate is projected to decline gradually and inflation to regain some momentum while remaining subdued given the still wide output gap.

Despite some upside potential, risks to the outlook remain tilted to the downside. On the domestic front, private domestic demand could be weaker if the effect of the sequester, tax increases, and recent tightening in financing conditions on domestic demand and housing is stronger than anticipated. Moreover, even though the Federal Reserve recently communicated its intention to not yet begin tapering of asset purchases, yields have come down only marginally (see Chapter 1), and the risk of a further market-induced tightening of financial conditions even without a stronger recovery, cannot be ruled out. Other scenarios for larger-than-expected interest rate increases involve an unexpected pickup in inflation expectations or, over the medium term, higher sovereign risk premiums caused by a lack of further progress on fiscal consolidation. A longer shutdown could have sizable adverse growth implications. A failure to promptly raise the debt ceiling could also adversely affect financial markets and economic activity, with spillovers to the rest of the world. Overall, an untimely tightening in U.S. monetary conditions combined with shocks from the external front—such as further deceleration in growth in other major economies—as illustrated in the plausible downside scenario (see Figure 2.1) could lower U.S. growth by close to ½ percentage point over the next year and by 1 percent in the medium term.

Figure 2.2. United States and Canada: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).

On the upside, a more resilient housing market recovery could contribute to a virtuous cycle of easing lending conditions, rising house prices, increasing household net worth, and stronger consumption and investment, with beneficial growth effects for the United States as well as the rest of the world. Lower uncertainty and prospects for a faster recovery in consumer demand could induce businesses to shift away from cash hoarding toward real investment.

The biggest policy priority is to adopt a comprehensive fiscal consolidation plan to place public debt on a sustainable path over the medium term while supporting near-term growth. The fiscal deficit reduction under the sequester is excessively rapid and ill designed, and it is expected to subtract between 1½ and 1¾ percentage points from growth in 2013.[1] A more balanced and gradual fiscal consolidation process, with the automatic spending cuts replaced by back-loaded savings in entitlement spending and new revenues, would support the recovery.

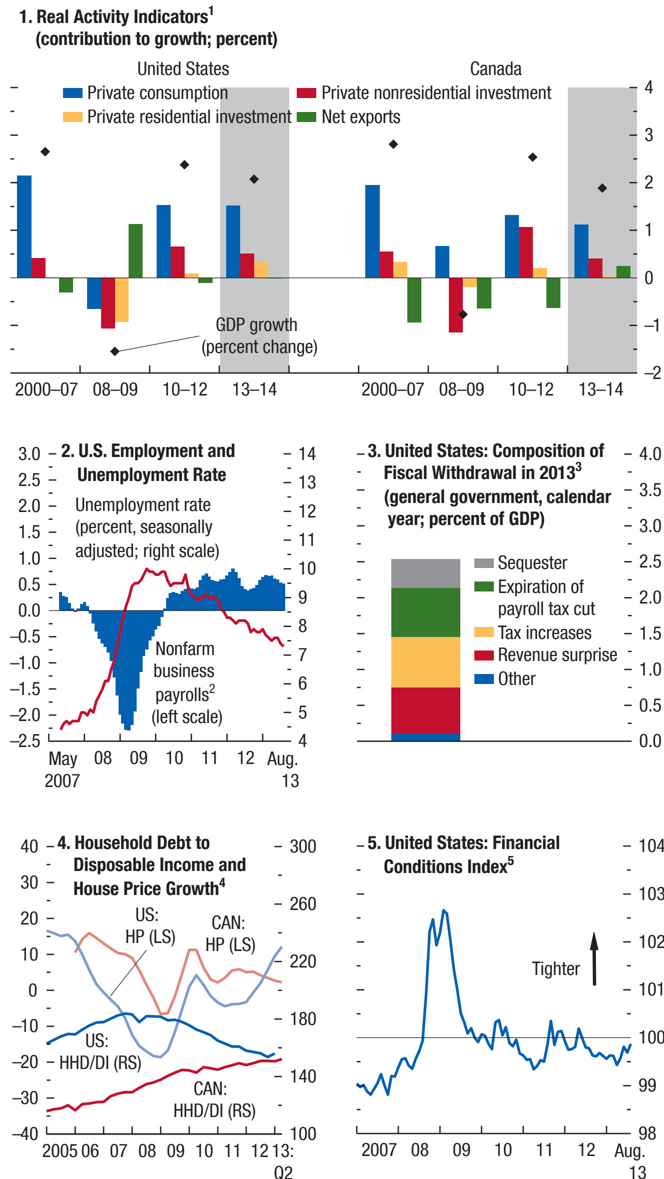
Given the sizable economic slack, slow employment recovery, and stable inflation expectations, the accommodative monetary policy stance continues to be appropriate. Any unwinding in monetary policy accommodation should be guided by the strength of the recovery, while considering other potential issues such as inflation and financial stability challenges. Careful calibration of the timing of exit, and effective communication about the strategy, will be critical to ensure a smooth normalization process and to minimize risks of negative global spillovers. If financial conditions tighten further and threaten to derail the nascent recovery, the Federal Reserve may need to ease monetary policy conditions through forward guidance or changing the timing and extent of the tapering.

The Canadian economy grew at an annual rate of 1¾ percent in the first half of 2013, driven by a rebound in the export and energy sectors, as well as private

[1]The implied fiscal multipliers are based on Appendix 1 of the April 2012 *Fiscal Monitor*.

Figure 2.3. United States and Canada: A Modest Recovery

Despite a large fiscal contraction, growth in the United States is expected to improve gradually given strong private consumption growth and still supportive financing conditions. However, there is considerable economic slack, and employment recovery will remain slow. In Canada, high household debt will dampen consumption growth, but GDP growth will be mainly supported by a positive contribution from net exports.



Sources: Bloomberg, L.P.; Canadian Real Estate Association (CREA); Congressional Budget Office; Haver Analytics; and IMF staff estimates.

[1]U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).

[2]Moving quarterly absolute change; millions.

[3]Tax increases refer to the expiration of 2001, 2003, and 2009 tax cuts for upper-income taxpayers (including iteration with the Alternative Minimum Tax). "Other" includes war drawdown and removal of emergency funds for disaster relief.

[4]HHD/DI = household debt to disposable income (percent); HP = house prices (year over year; percent): S&P/Case-Shiller Home Price Index for the United States (US); CREA for Canada (CAN). RS = right scale; LS = left scale. US: HHD/DI data are through 2013:Q1.

[5]Goldman Sachs FCI (Financial Conditions Index).

consumption. The economy is projected to expand at slightly more than 1½ percent in 2013 and 2¼ percent in 2014, as net exports and business investment benefit from the U.S. recovery and more than offset slower consumption growth. The balance of risks to Canada's outlook is still tilted to the downside, emanating from potentially weaker external demand. Moreover, household debt remains historically high, which could amplify the negative growth impact of adverse shocks to the economy.

Policies need to continue to support near-term growth while reducing domestic vulnerabilities. Fiscal consolidation, particularly at the provincial level, must proceed as planned to rebuild fiscal space against future shocks. The current accommodative monetary policy stance remains appropriate, with gradual tightening expected to begin in the second half of 2014.

Europe: Supporting the Fledgling Recovery

Advanced Europe

Policy actions have reduced some important tail risks in the euro area and stabilized financial markets. Growth is beginning to resume but is still very weak (Figure 2.4). Unemployment is very high, and social and political tensions are hurting the reform momentum in the euro area. Actions to restore financial sector health and strengthen its infrastructure are essential to ensure financial stability and support the recovery. Furthermore, continued near-term demand support and deeper structural reforms to raise competitiveness and potential output are essential for growth and job creation.

The euro area returned to growth in the second quarter of 2013 after six quarters of recession. Recent high-frequency indicators suggest that activity is beginning to stabilize in the periphery and recover in the core. However, unemployment remains high, and labor markets remain depressed. Moreover, inflation remains below the European Central Bank's (ECB's) medium-term objective, raising concerns about underlying disinflationary or deflationary trends.

A multitude of factors, all legacies of the global financial crisis, will continue to interact to restrain growth and inflation in the euro area, on top of weakening exports from the deceleration in many emerging market economies (Figure 2.5):

- Demand is persistently weak as the public and private sectors continue to deleverage, especially in

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	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Advanced Economies	**1.5**	**1.2**	**2.0**	**2.0**	**1.4**	**1.8**	**–0.1**	**0.1**	**0.2**	**8.0**	**8.1**	**8.0**
United States[4]	2.8	1.6	2.6	2.1	1.4	1.5	–2.7	–2.7	–2.8	8.1	7.6	7.4
Euro Area[5,6]	–0.6	–0.4	1.0	2.5	1.5	1.5	1.3	1.8	1.9	11.4	12.3	12.2
Japan	2.0	2.0	1.2	0.0	0.0	2.9	1.0	1.2	1.7	4.4	4.2	4.3
United Kingdom[5]	0.2	1.4	1.9	2.8	2.7	2.3	–3.8	–2.8	–2.3	8.0	7.7	7.5
Canada	1.7	1.6	2.2	1.5	1.1	1.6	–3.4	–3.1	–3.1	7.3	7.1	7.1
Other Advanced Economies[7]	1.9	2.3	3.1	2.0	1.5	2.1	4.3	4.4	4.2	4.5	4.6	4.6

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

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

[2]Percent of GDP.

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

[4]U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).

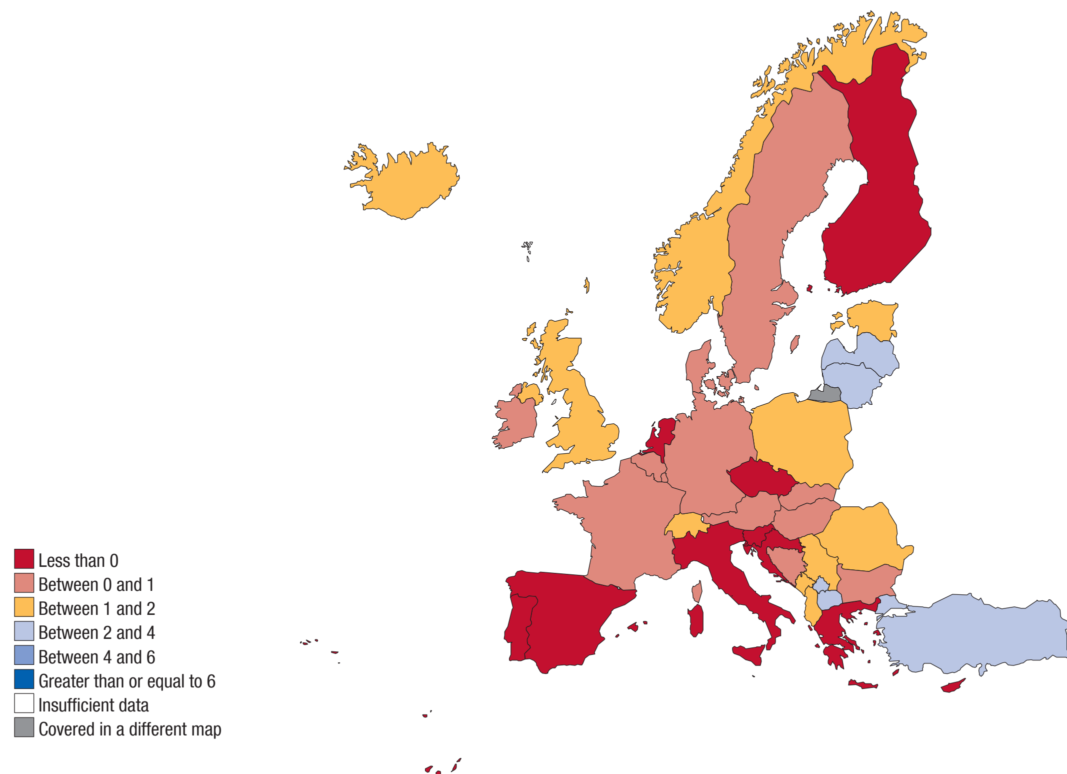
[5]Based on Eurostat's harmonized index of consumer prices.

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

[7]Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

Figure 2.4. Europe: 2013 GDP Growth Forecasts

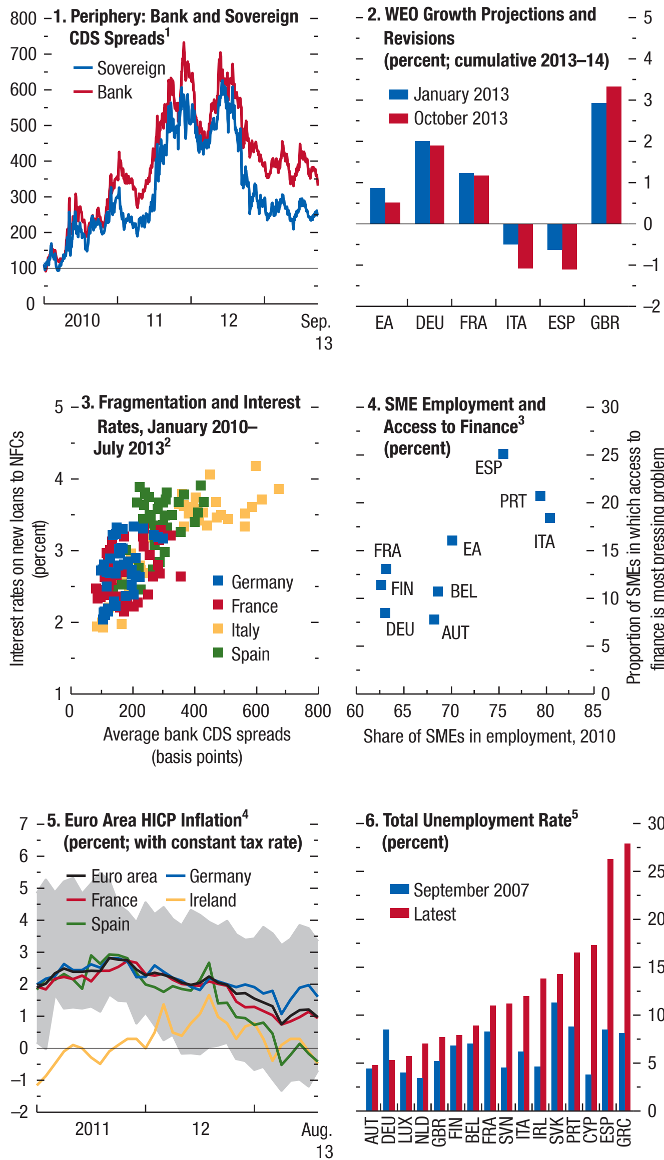
(Percent)



Source: IMF staff estimates.

Figure 2.5. Advanced Europe: Abating Tail Risks, but Prolonged Stagnation

Financial stresses have moderated in response to policy actions, but growth remains weak, spilling over from the periphery to the core. Financial fragmentation and impaired access to credit in the periphery continue. Inflation remains subdued. Unemployment remains high and is still rising.



Sources: Bloomberg, L.P.; European Central Bank; Eurostat; Haver Analytics; and IMF staff estimates.

Note: AUT = Austria; BEL = Belgium; CYP = Cyprus; DEU = Germany; EA = euro area; ESP = Spain; FIN = Finland; FRA = France; GBR = United Kingdom; GRC = Greece; IRL = Ireland; ITA = Italy; LUX = Luxembourg; NLD = Netherlands; PRT = Portugal; SVK = Slovak Republic; SVN = Slovenia. Periphery: ESP, GRC, IRL, ITA, PRT.

[1]Five-year credit default swap (CDS) spreads are in basis points weighted by general government gross debt. All periphery countries are included, except Greece.

[2]NFC = nonfinancial corporation.

[3]SME = small and medium enterprise.

[4]Ireland: Eurostat harmonized index of consumer prices (HICP) total excludes energy, food, alcohol, and tobacco. The band refers to the difference between the maximum and the minimum for the euro area, excluding Ireland.

[5]Latest data refer to July 2013, except for GRC (June 2013) and GBR (May 2013).

some periphery economies. In the core economies, despite recent improvements in confidence, private demand is also affected by concerns about global growth and continued uncertainty about euro area prospects and policies. Moreover, notwithstanding some relaxation in adjustment targets and a slowdown in the pace of adjustment, fiscal consolidation continues to weigh on near-term activity.

- Financial market fragmentation and weak bank balance sheets continue to impair the transmission of the ECB's accommodative monetary policy stance to the periphery, keeping private sector borrowing rates high and limiting banks' ability to lend.
- Despite significant reforms, long-standing labor and product market weaknesses continue to hamper relative price adjustment and competitiveness, especially in the periphery. As a result, the pace at which external imbalances within the euro area are narrowing has been slow.

Under current policies, activity in the euro area is forecast to shrink by about ½ percent in 2013 after a contraction of a similar magnitude in 2012 (Table 2.2). Growth is expected to recover from an annual rate of ¾ percentage point in the second half of 2013 to 1 percent in 2014, driven by a smaller fiscal drag, stronger external demand, and a gradual improvement in private sector lending conditions. Inflation is expected to stay at about 1½ percent over the next two years because of persistent output gaps. Over the medium term, growth is expected to remain subdued and inflation substantially below the ECB's medium-term objective.

Growth is also likely to be subdued in other advanced economies in Europe. In the United Kingdom, recent data have shown welcome signs of an improving economy, consistent with increasing consumer and business confidence, but output remains well below its pre-crisis peak. Growth is expected to be about 1½ percent in 2013 and 2 percent in 2014, slowly returning to trend in the medium term, but output levels will remain below potential for many years. Sweden's economy has been growing slowly along with its main Nordic and European trading partners, with prospects for a slow return to higher but still moderate growth.

Risks have become more balanced than six months ago, but still remain tilted to the downside. Amid a fragile recovery, limited policy space, and substantial slack, the region could be hit by further domestic or external shocks. Any turbulence in global financial markets, for example, as a result of further tightening

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	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Europe	**–0.1**	**0.3**	**1.4**	**3.0**	**2.0**	**1.9**	**1.3**	**1.6**	**1.7**	**. . .**	**. . .**	**. . .**
Advanced Europe	**–0.4**	**0.0**	**1.2**	**2.4**	**1.6**	**1.6**	**1.9**	**2.3**	**2.4**	**10.3**	**11.0**	**10.9**
Euro Area[4,5]	–0.6	–0.4	1.0	2.5	1.5	1.5	1.3	1.8	1.9	11.4	12.3	12.2
Germany	0.9	0.5	1.4	2.1	1.6	1.8	7.0	6.0	5.7	5.5	5.6	5.5
France	0.0	0.2	1.0	2.2	1.0	1.5	–2.2	–1.6	–1.6	10.3	11.0	11.1
Italy	–2.4	–1.8	0.7	3.3	1.6	1.3	–0.7	0.0	0.2	10.7	12.5	12.4
Spain	–1.6	–1.3	0.2	2.4	1.8	1.5	–1.1	1.4	2.6	25.0	26.9	26.7
Netherlands	–1.2	–1.3	0.3	2.8	2.9	1.3	10.1	10.9	11.0	5.3	7.1	7.4
Belgium	–0.3	0.1	1.0	2.6	1.4	1.2	–1.6	–0.7	–0.3	7.6	8.7	8.6
Austria	0.9	0.4	1.6	2.6	2.2	1.8	1.8	2.8	2.4	4.3	4.8	4.8
Greece	–6.4	–4.2	0.6	1.5	–0.8	–0.4	–3.4	–1.0	–0.5	24.2	27.0	26.0
Portugal	–3.2	–1.8	0.8	2.8	0.7	1.0	–1.5	0.9	0.9	15.7	17.4	17.7
Finland	–0.8	–0.6	1.1	3.2	2.4	2.4	–1.8	–1.6	–1.8	7.8	8.0	7.9
Ireland	0.2	0.6	1.8	1.9	1.0	1.2	4.4	2.3	3.0	14.7	13.7	13.3
Slovak Republic	2.0	0.8	2.3	3.7	1.7	2.0	2.3	3.5	4.2	14.0	14.4	14.4
Slovenia	–2.5	–2.6	–1.4	2.6	2.3	1.8	3.3	5.4	7.0	8.9	10.3	10.9
Luxembourg	0.3	0.5	1.3	2.9	1.8	1.9	5.7	6.0	6.6	6.1	6.6	7.0
Estonia	3.9	1.5	2.5	4.2	3.5	2.8	–1.8	–0.7	–0.2	10.2	8.3	7.0
Cyprus	–2.4	–8.7	–3.9	3.1	1.0	1.2	–6.5	–2.0	–0.6	11.9	17.0	19.5
Malta	1.0	1.1	1.8	3.2	2.0	2.0	1.1	1.1	0.8	6.3	6.4	6.3
United Kingdom[5]	0.2	1.4	1.9	2.8	2.7	2.3	–3.8	–2.8	–2.3	8.0	7.7	7.5
Sweden	1.0	0.9	2.3	0.9	0.2	1.6	6.0	5.7	5.5	8.0	8.0	7.7
Switzerland	1.0	1.7	1.8	–0.7	–0.2	0.2	11.2	10.5	10.1	2.9	3.2	3.2
Czech Republic	–1.2	–0.4	1.5	3.3	1.8	1.8	–2.4	–1.8	–1.5	7.0	7.4	7.5
Norway	3.0	1.6	2.3	0.7	1.8	1.8	14.2	11.8	11.3	3.2	3.3	3.3
Denmark	–0.4	0.1	1.2	2.4	0.8	1.9	5.6	4.7	4.8	7.5	7.1	7.1
Iceland	1.6	1.9	2.1	5.2	3.7	3.1	–4.9	–1.2	–1.9	5.8	5.1	4.6
San Marino	–4.0	–3.5	0.0	2.8	1.6	0.9	. . .	. . .	. . .	6.6	6.1	5.5
Emerging Europe[6]	**1.4**	**2.3**	**2.7**	**5.8**	**4.1**	**3.5**	**–4.3**	**–4.4**	**–4.5**	**. . .**	**. . .**	**. . .**
Turkey	2.2	3.8	3.5	8.9	6.6	5.3	–6.1	–7.4	–7.2	9.2	9.4	9.5
Poland	1.9	1.3	2.4	3.7	1.4	1.9	–3.5	–3.0	–3.2	10.1	10.9	11.0
Romania	0.7	2.0	2.2	3.3	4.5	2.8	–3.9	–2.0	–2.5	7.0	7.1	7.1
Hungary	–1.7	0.2	1.3	5.7	2.3	3.0	1.7	2.2	2.0	10.9	11.3	11.1
Bulgaria	0.8	0.5	1.6	2.4	1.4	1.5	–1.3	1.2	0.3	12.4	12.4	11.4
Serbia	–1.7	2.0	2.0	7.3	8.5	5.0	–10.5	–7.5	–6.5	23.1	25.0	24.9
Croatia	–2.0	–0.6	1.5	3.4	3.0	2.5	0.1	0.4	–0.7	16.2	16.6	16.1
Lithuania	3.6	3.4	3.4	3.2	1.3	2.1	–0.5	–0.3	–1.2	13.2	11.8	11.0
Latvia	5.6	4.0	4.2	2.3	0.7	2.1	–1.7	–1.1	–1.3	15.0	11.9	10.7

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

in U.S. monetary conditions, could aggravate fragmentation and complicate policies, although sovereign spreads in the euro area periphery have fallen below the low levels reached in late 2012. Disappointing growth in emerging market economies would also hurt external demand. On the upside, if the core economies experience a stronger pickup in investment after years of underinvestment, it could have positive spillovers to the entire region. However, this would require the delivery of current policy commitments, including at the euro area level. The main risk, therefore, relates to stalled policy commitments. Absent fundamental reforms, there is a high risk of stagnation, renewed stress in the short term, and a loss of potential output through hysteresis effects in the medium term.

The key priorities for all advanced economies in the region are to bolster growth while ensuring financial stability. Attaining this goal requires action in four interrelated areas:

- Bank balance sheets should be repaired expeditiously to improve confidence and revive credit and demand in the euro area and the United Kingdom. A credible, comprehensive, forward-looking, independent assessment of capital shortfalls in the euro area is needed in the context of the forthcoming bank balance sheet assessment. Such an assessment must

be supported with a clear plan to meet bank capital requirements and a credible area-wide backstop to avoid disorderly deleveraging in the short term and help economies, especially those that are fiscally challenged, to address capital shortfalls without threatening debt sustainability. In the United Kingdom, the health of the two government-intervened banks is crucial for credit growth, and a clear strategy is needed for the Royal Bank of Scotland, with a view to returning both to private ownership. Sweden should continue to strengthen financial stability by further improving bank funding, liquidity, and capital; introducing measures to contain the buildup in household debt; and improving mortgage amortization.

- Reforms are also needed to strengthen the financial sector architecture. A more complete banking union is necessary to reverse fragmentation and weaken bank-sovereign links in the euro area. There must be political commitment to build on the progress made to operationalize the recently established Single Supervisory Mechanism and finalize the Bank Recovery and Resolution and the Deposit Guarantee Scheme Directives. A strong resolution mechanism, based on a centralized authority backed by a common fiscal backstop with power to trigger resolution and make decisions on burden sharing, is critical to ensure timely and least-cost resolution. The United Kingdom needs greater coordination across regulatory bodies, continued efforts to ensure that the newly established supervisors are adequately resourced and operationally independent, and that the Financial Policy Committee has a strong macroprudential toolkit. Structural banking reforms must be internationally coordinated to avoid regulatory arbitrage.
- Additional near-term support will be needed to reverse weak growth. In the euro area, more monetary easing is necessary, including further policy rate cuts, further reliance on forward guidance to anchor interest rate expectations, and additional unconventional monetary support to reduce fragmentation and improve credit access, especially for small and medium enterprises (see Figure 2.5, panels 3 and 4). Despite the recent postponement of Excessive Deficit Procedures deadlines for some economies, meeting fiscal targets may still prove challenging in some cases, and more flexibility may be needed if growth disappoints. However, given high debt levels, fiscal adjustment should be anchored by a credible medium-term framework. Monetary policy should also stay accommodative in the United Kingdom, and the Bank of England's recently adopted forward guidance framework is an important step toward greater transparency about the factors that will guide policy rates. In an environment of still low interest rates and underutilization of resources, public investment can also be brought forward to offset the drag from planned near-term fiscal tightening, while staying within the medium-term fiscal framework. In Sweden, fiscal and—assuming household credit growth remains contained—monetary policy should continue to support the recovery in the short term, with room for further easing if downside risks materialize.
- Reforms are also needed to boost potential growth and competitiveness. In the euro area, this will involve implementing the Services Directive to help remove country-specific barriers for protected professions and to the entry and exit of firms, and tackling vested interests in product markets. Improved pension portability and unemployment benefits would foster labor mobility. National labor market reforms could raise participation, level the playing field between protected and unprotected workers, and, where necessary, promote more flexible bargaining arrangements that foster job creation.

Emerging Europe

Emerging Europe is tracking a moderate recovery in 2013 and 2014, but downside risks and domestic policy challenges remain significant.

Emerging Europe experienced a sharp slowdown in 2012, reflecting weak exports due to the euro area recession, decreased funding for subsidiaries of western European banks, and the impact of bad weather in some economies. Activity picked up in the first half of 2013 thanks to easier financial conditions on account of monetary easing, improved external funding, and a bounce-back from the bad weather (Figure 2.6).

The recent global financial market volatility has led to some renewed tightening of local financial conditions, including in Turkey. Economies with relatively larger portfolio inflows were more affected than others, as were countries with higher external imbalances. Still, incoming data suggest that the adverse impact of tighter financial conditions on activity is modest in

most economies, likely reflecting the offsetting effects from currency depreciation.

Growth in the region is expected to pick up from 1½ percent in 2012 to 2¼ percent in 2013 and further to 2¾ percent in 2014, unchanged from the April 2013 WEO forecast. However, there are large differences across countries, with strong growth in Turkey and the Baltics, an incipient recovery in southeastern Europe and Hungary, and further weakening in Poland.

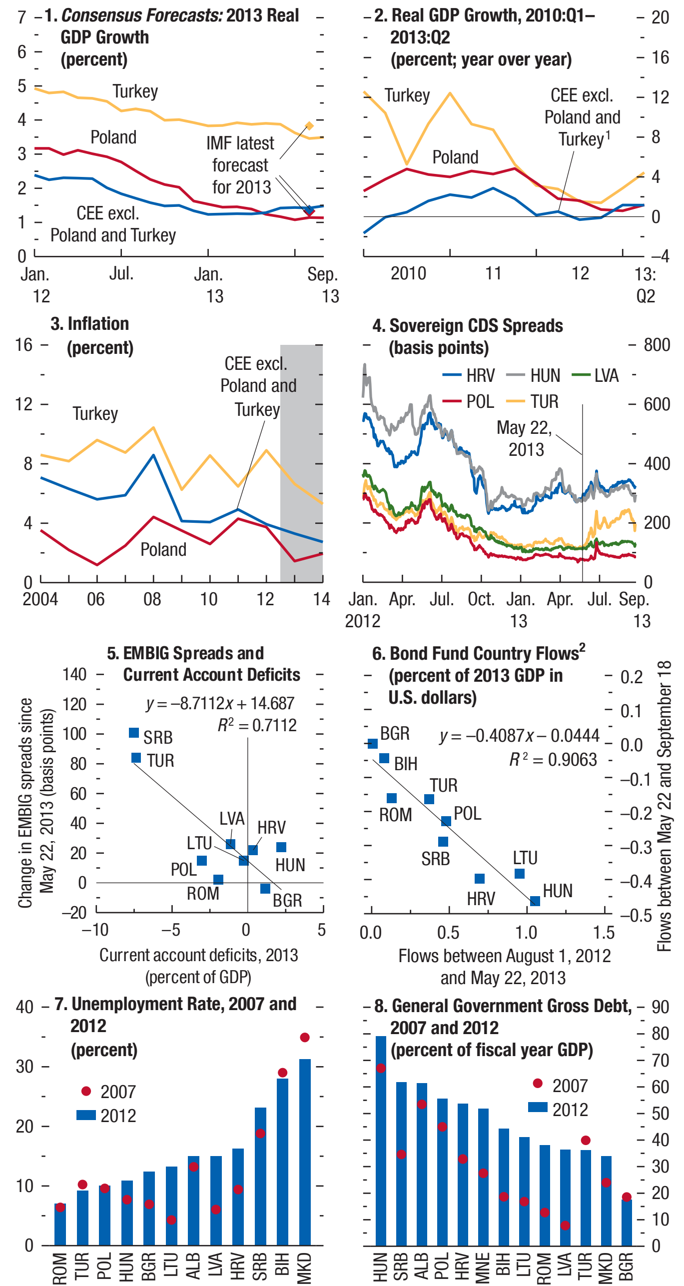
- Growth in Turkey, which slowed sharply last year, is projected to pick up to 3¾ percent this year, decelerating to 3½ percent in 2014. The recent financial tightening is expected to result in some slowing of activity in the second half of 2013. In terms of annual growth in 2013–14, however, the impact of this slowing will be more than offset by the much-stronger-than-anticipated growth in the first half of 2013, reflecting the boost to domestic demand from monetary easing and a sharp increase in government investment.
- Growth in Poland is expected to decelerate from 2 percent in 2012 to 1¼ percent this year, picking up gradually to 2¼ percent in 2014. Not only has the economy been hurt by the weakness in the euro area, but a long period of strong increases in domestic demand seems to have run its course.
- Southeastern Europe, which was affected by both a very cold winter and severe drought in summer 2012, is recovering this year; only Croatia will remain in a mild recession. Better weather will also help Hungary, although activity will be broadly flat this year, recovering by 1¼ percent in 2014.
- Growth in the Baltics is projected to ease but remain strong.

With a few exceptions, moderate economic growth will keep a lid on inflation pressure. However, annual average inflation will remain elevated in 2013 in Turkey (6½ percent) and Serbia (8½ percent), reflecting inflation inertia and the impact of currency depreciation.

The balance of risks to the outlook is tilted to the downside. A more protracted recession in the euro area is a key risk, especially for countries with strong intra-European links (notably, Croatia, Hungary, Poland). Further deterioration in external financing conditions is another major concern, particularly for countries with relatively large fiscal or external imbalances or both, such as Turkey and Serbia. Prolonged financial

Figure 2.6. Emerging Europe: Growth Continues despite Increased Financial Volatility

Growth is forecast to rebound this year after bottoming out in 2012. However, the region is exposed to downside risks from a slowdown in Europe and to potentially greater financial market volatility. Policies should focus on rebuilding fiscal balances to maintain market confidence and implementing structural reforms to raise growth potential and lower still high unemployment.



Sources: Bloomberg, L.P.; *Consensus Forecasts*; EPFR Global/Haver Analytics; Haver Analytics; and IMF staff estimates.
Note: ALB = Albania; BGR = Bulgaria; BIH = Bosnia and Herzegovina; CEE = central and eastern Europe; HRV = Croatia; HUN = Hungary; LTU = Lithuania; LVA = Latvia; MKD = FYR Macedonia; MNE = Montenegro; POL = Poland; ROM = Romania; SRB = Serbia; TUR = Turkey. CDS = credit default swap (rates on five-year bonds); EMBIG = JPMorgan EMBI Global Index.
[1]Data for 2013:Q2 exclude Albania.
[2]EPFR flows provide a limited proxy for overall balance of payments (BoP) flows, although recent studies have found a close match in the pattern of EPFR flows and BoP gross portfolio flows (see Fratzscher, 2012).

market volatility could also constrain the funding of western banks' regional subsidiaries.

Policies should aim to nurture the recovery and reduce vulnerability from still elevated fiscal and current account deficits in some countries. The recent financial market turbulence calls for a differentiated policy response. In countries with high debt or deficits, rollover risks have increased in recent months, and action will be needed to reduce those vulnerabilities. By contrast, in countries where public debt and deficits are at more moderate levels, giving full play to automatic stabilizers would help cushion the near-term impact on activity. In countries where the inflation outlook is benign, there may be room to further ease monetary policy.

Policies should also focus on lifting potential growth, which is estimated to have dropped sharply since the global financial crisis. For many countries where a large share of the high unemployment appears to be structural (for example, Bulgaria, Croatia, Poland), a bold reform agenda will be needed to alleviate growth bottlenecks. The agenda will vary by country but includes addressing low labor force participation, boosting external competitiveness, and completing the transition agendas.

Asia: A Lower Growth Trajectory

Growth has disappointed across the region, largely because of weaker demand, although supply factors have also played a role in some economies. Capital inflows have declined, and domestic assets have been repriced and exchange rates depreciated, especially in countries where fundamentals were perceived to be weaker. Still, financial conditions remain generally supportive from a historical perspective, and external demand is expected to gradually strengthen. The outlook is for continued strong growth, but risks are tilted to the downside. Policies need to strike a balance between supporting growth and guarding against inflation and financial stability risks. Where supply-side constraints are binding, continued structural reforms are crucial and will also help reduce vulnerabilities.

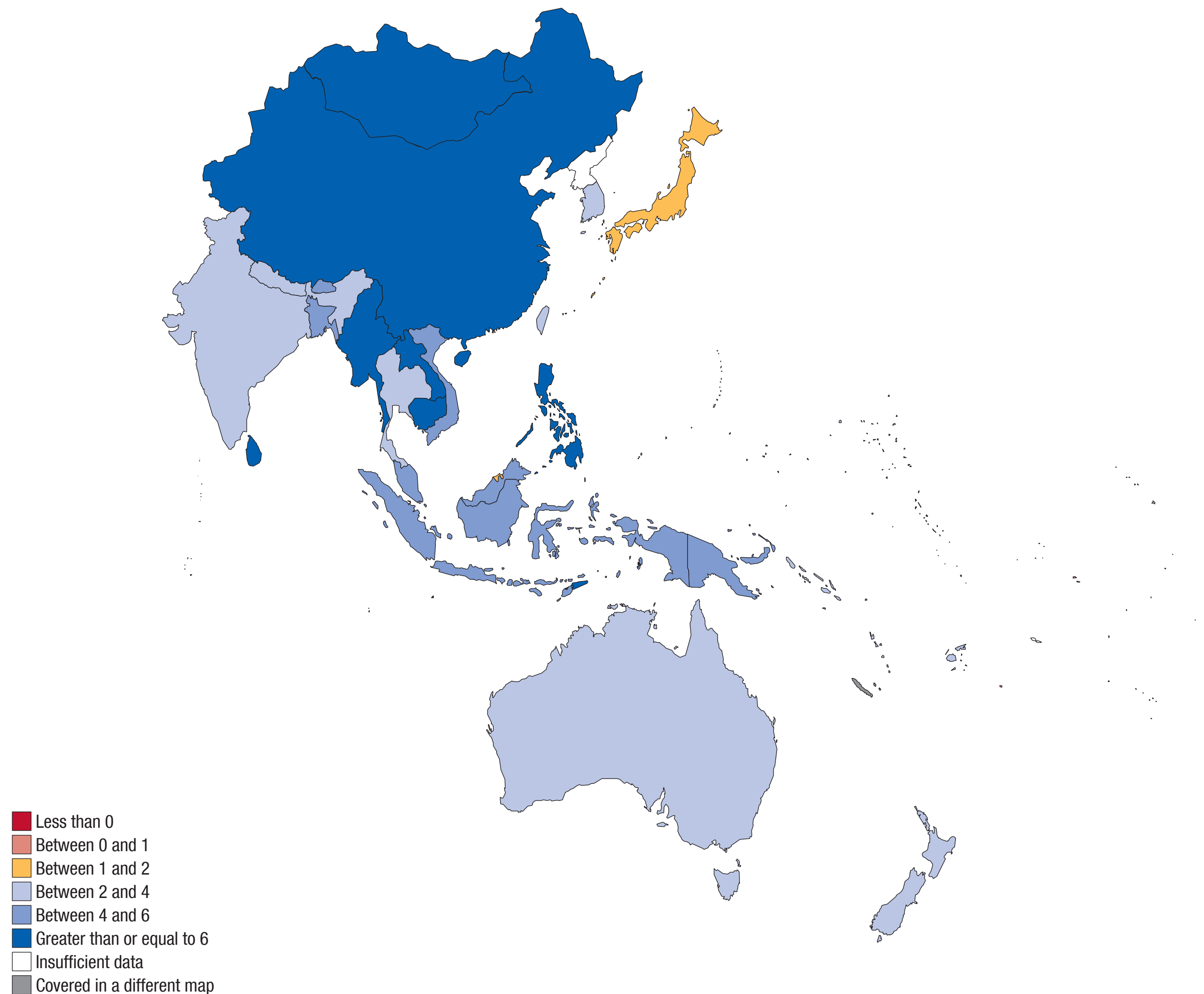
During the first half of 2013, growth in Asia generally moderated and was weaker than anticipated in the April 2013 WEO. This was due to a more rapid slowdown in the pace of growth in China, which affected industrial activity in much of emerging Asia, including through supply-chain links, while India faced persistent supply-side constraints. By contrast, Japan was the main bright spot, reflecting the new policy momentum, which has boosted asset prices and private consumption (see Box 1.4 in Chapter 1).

Awareness of an approaching turning point in U.S. monetary policy, combined with slower growth momentum in many Asian economies, resulted in increased financial volatility in the region in recent months, with capital outflows in most countries. However, tighter financial conditions have affected a few economies so far (notably, India and Indonesia).

Growth in the region is expected to remain solid in the second half of 2013 and 2014, in line with a projected moderate global recovery—and still supportive financial and monetary conditions in many economies—and exchange rate depreciations that have dampened the impact of recent asset price corrections (Figures 2.7 and 2.8). Overall, growth is projected to average about 5¼ percent in 2013–14, which is some ½ percent and ¾ percent weaker for 2013 and 2014, respectively, compared with the April 2013 WEO (Table 2.3). Consistent with the moderate pickup in growth and a stable outlook for global commodity prices, inflation is expected to remain generally within central banks' comfort zones.

- Growth in Japan is projected at 2 percent in 2013, buoyed by the fiscal stimulus and monetary easing to support private consumption and investment. Helped by yen depreciation and a pickup in external demand, exports should also strengthen. Growth is forecast to decelerate to 1¼ percent in 2014, with fiscal stimulus withdrawal and the increase in the consumption tax. However, if an additional "stimulus package" does go ahead, growth in 2014 would be higher than currently projected. Inflation will temporarily rise toward 3 percent in 2014, reflecting the effects of the consumption tax hike, although underlying inflation is projected to be closer to 1¼ percent.
- In China, growth is projected to decelerate to 7½ percent this year, in line with the authorities' target, and further to 7¼ percent next year. Policymakers have refrained from further stimulating growth, which is consistent with the objectives of safeguarding financial stability and moving the economy to a more balanced and sustainable growth path.
- Supported by the recent fiscal and monetary stimulus, the Korean economy is set for a modest recovery. Growth is projected to rise to 2¾ percent

Figure 2.7. Asia: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.

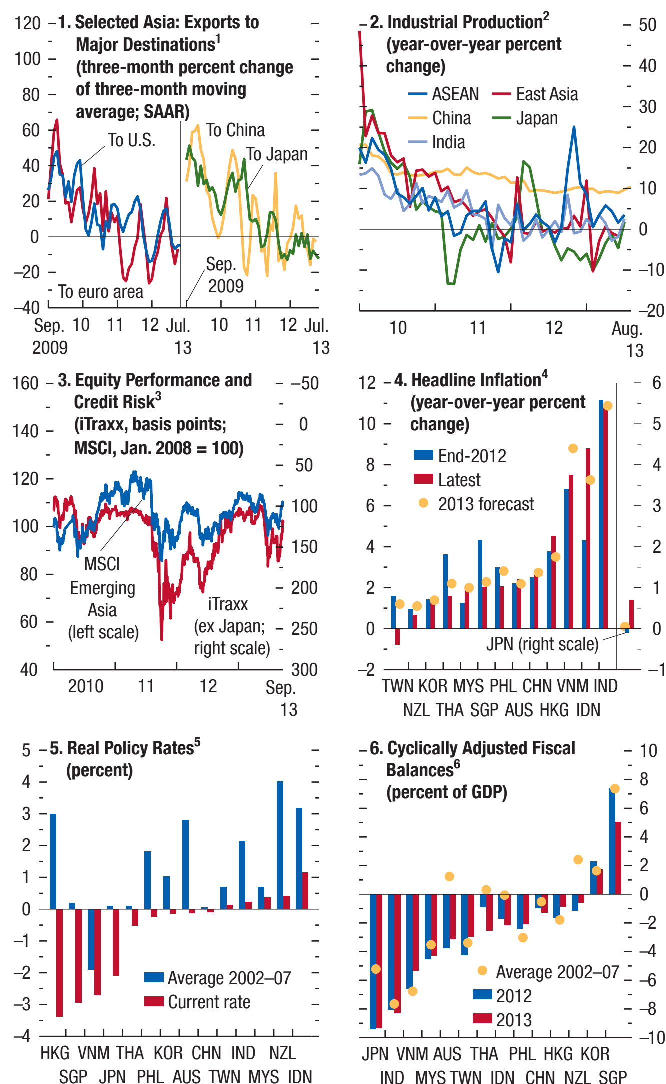
in 2013, after bottoming out at 2 percent in 2012, and rise further to 3¾ percent in 2014.

- In India, growth in fiscal year 2013 is expected to be around 3¾ percent, with strong agriculture production offset by lackluster activity in manufacturing and services, and monetary tightening adversely affecting domestic demand. For fiscal year 2014, growth is projected to accelerate somewhat to 5 percent, helped by an easing of supply bottlenecks and strengthening of exports.[2] Inflation is expected to stay high at almost 11 percent this year and 9 percent in 2014, driven by continued domestic food price pressures.
- In the Association of Southeast Asian Nations economies, solid domestic demand should support growth, particularly in Malaysia and the Philippines. In Thailand, after the slowdown in the first quarter of 2013, growth should return to potential during the second half of the year, driven by private demand and higher public spending. Growth in Indonesia will slow, however, due to sluggish

[2]Note that, in accordance with international standards, growth for India is presented in Table 2.3 for GDP at market prices. In terms of GDP at factor cost, growth is estimated to be 5 percent in fiscal year 2012 and is projected at 4¼ percent in 2013 and about 5 percent in 2014.

Figure 2.8. Asia: A Lower Growth Trajectory

Economic activity was disappointing during the first half of 2013. Growth will pick up slowly from the second half of the year as external and domestic demand recover at a moderate pace.



Sources: Bloomberg, L.P.; CEIC; *Consensus Forecasts*; Haver Analytics; Markit/Haver Analytics; and IMF staff estimates.

Note: AUS = Australia; CHN = China; HKG = Hong Kong SAR; IDN = Indonesia; IND = India; JPN = Japan; KOR = Korea; MYS = Malaysia; NZL = New Zealand; PHL = Philippines; SGP = Singapore; THA = Thailand; TWN = Taiwan Province of China; VNM = Vietnam. East Asia includes CHN, HKG, KOR, and TWN. CDS = credit default swap.

[1]Selected Asia includes east Asia, JPN, MYS, THA, PHL, SGP, and VNM. Indonesia is excluded due to a data lag. SAAR = seasonally adjusted annual rate. Data are through June 2013 (to China; to euro area).

[2]ASEAN = Association of Southeast Asian Nations (IDN, MYS, PHL, SGP, THA). East Asia excludes HKG and CHN in this panel. Data are through July 2013 for ASEAN, IND, JPN; and June 2013 for east Asia.

[3]The Markit iTraxx Asia ex Japan Investment Grade index comprises 40 equally weighted investment grade CDS indices of Asian equities that typically trade on a five-year maturity, and a new series is determined on the basis of liquidity every six months. The MSCI EM Asia Index captures large and mid-cap representation across eight emerging market economies: CHN, IDN, IND, KOR, MYS, PHL, THA, TWN. With 541 constituents, the index covers approximately 85 percent of the free-float-adjusted market capitalization in each country.

[4]Data for India are based on the Industrial Workers Consumer Price Index. Latest data refer to August 2013, except for India and Japan (July 2013); Australia and New Zealand (June 2013).

[5]Data are as of September 23, 2013. Real policy rates are adjusted for the one-year-ahead inflation expectations. For India this is based on the fiscal year.

[6]General government structural balance for Hong Kong SAR and New Zealand.

investment and weaker commodity demand from other emerging market economies, as well as tighter financing conditions.

- Given weakening external demand until recently, growth in other developing Asian economies is projected to slow from 6¼ percent in 2012 to a still robust 6 percent this year before picking up again next year.

Risks to growth in the region are tilted to the downside. A major downside risk is a synchronized global slowdown, which would take a heavy toll on the region's export-dependent economies. Another risk is that capital outflows—due to a further tightening in U.S. monetary conditions or deteriorating domestic fundamentals—could intensify. This could lead to further declines in domestic asset prices, tighter overall financial conditions and, ultimately, slower growth, especially in economies with weaker fundamentals and less policy space. Although in some countries, diminished inflows may alleviate previous concerns about potential credit booms, in others, risks of harder landings or financial instability have increased. That said, many countries operate under flexible exchange rate regimes that would help mitigate these effects, especially where inflation pressure is absent and high reserve levels give them room to smooth excess volatility. A persistent deceleration in investment activity because of structural weaknesses is yet another concern. Given its high regional integration, Asia would be affected by an unexpected slowdown in any of its larger economies, particularly China. In Japan, in the absence of credible fiscal and structural reforms, the new macroeconomic framework may be ineffective in raising growth and inflation expectations, with adverse effects on the rest of Asia as well. Indeed, under the plausible downside scenario, growth in the region would decline substantially. Growth in Japan in the first year would be ¾ percentage point lower, while in the rest of the region it would decrease by 1 percentage point.

Policymakers need to strike a balance between supporting demand and guarding against financial stability risks. For many, against the backdrop of greater downside risks to growth and a generally benign inflation outlook, the accommodative stance is broadly appropriate. However, country circumstances differ given differences in inflationary and financial stability risks—for instance Bank Indonesia recently had to tighten amid downward currency pressure and higher expected inflation. In Japan, efforts should be focused on meet-

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

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Asia	**5.1**	**5.2**	**5.3**	**3.6**	**3.8**	**4.1**	**1.2**	**1.4**	**1.6**	**. . .**	**. . .**	**. . .**
Advanced Asia	**2.1**	**2.3**	**2.4**	**1.1**	**0.9**	**2.6**	**1.5**	**1.9**	**2.1**	**4.2**	**4.1**	**4.2**
Japan	2.0	2.0	1.2	0.0	0.0	2.9	1.0	1.2	1.7	4.4	4.2	4.3
Korea	2.0	2.8	3.7	2.2	1.4	2.3	3.8	4.6	3.9	3.2	3.2	3.2
Australia	3.7	2.5	2.8	1.8	2.2	2.5	–3.7	–3.4	–3.5	5.2	5.6	6.0
Taiwan Province of China	1.3	2.2	3.8	1.9	1.2	2.0	10.5	10.0	9.6	4.2	4.2	4.2
Hong Kong SAR	1.5	3.0	4.4	4.1	3.5	3.5	2.7	2.3	2.5	3.3	3.2	3.1
Singapore	1.3	3.5	3.4	4.6	2.3	2.7	18.6	18.5	17.6	2.0	2.1	2.3
New Zealand	2.7	2.5	2.9	1.1	1.1	2.1	–5.0	–4.2	–4.2	6.9	6.0	5.3
Developing Asia	**6.4**	**6.3**	**6.5**	**4.7**	**5.0**	**4.7**	**0.9**	**1.1**	**1.3**	**. . .**	**. . .**	**. . .**
China	7.7	7.6	7.3	2.6	2.7	3.0	2.3	2.5	2.7	4.1	4.1	4.1
India	3.2	3.8	5.1	10.4	10.9	8.9	–4.8	–4.4	–3.8	. . .	. . .	. . .
ASEAN-5	**6.2**	**5.0**	**5.4**	**3.9**	**4.9**	**5.1**	**0.6**	**–0.1**	**–0.1**	**. . .**	**. . .**	**. . .**
Indonesia	6.2	5.3	5.5	4.3	7.3	7.5	–2.7	–3.4	–3.1	6.1	5.9	5.8
Thailand	6.5	3.1	5.2	3.0	2.2	2.1	0.0	0.1	–0.2	0.7	0.7	0.7
Malaysia	5.6	4.7	4.9	1.7	2.0	2.6	6.1	3.5	3.6	3.0	3.1	3.0
Philippines	6.8	6.8	6.0	3.2	2.8	3.5	2.9	2.5	2.2	7.0	7.0	7.0
Vietnam	5.2	5.3	5.4	9.1	8.8	7.4	5.8	5.6	3.3	4.5	4.5	4.5
Other Developing Asia[4]	**6.3**	**6.0**	**6.5**	**7.0**	**7.0**	**6.5**	**–2.1**	**–1.6**	**–1.7**	**. . .**	**. . .**	**. . .**
Memorandum												
Emerging Asia[5]	5.8	5.9	6.2	4.4	4.5	4.4	1.8	2.0	2.1	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Other Developing Asia comprises Bangladesh, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao P.D.R., Maldives, Marshall Islands, Micronesia, Mongolia, Myanmar, Nepal, Palau, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, Tuvalu, and Vanuatu.
[5]Emerging Asia comprises all economies in Developing Asia, Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.

ing the authorities' inflation target in the near term. This requires that the accommodative monetary policy stance be implemented fully and supported with other much-needed measures (such as structural reforms) that raise medium-term growth prospects.

Amid heightened global financial market volatility, micro- and macroprudential tools will continue to play a role in achieving financial stability. Measures that strengthen the resilience of financial systems will also help economies weather the consequences of a potential sudden stop in capital inflows. In some economies, including China, further financial reform is needed to safeguard financial stability, improve the allocation of credit, and guide the economy to a more sustainable growth path.

Fiscal targets, where needed, should be defined in cyclically adjusted terms, allowing automatic stabilizers to operate. In many economies, buffers should be rebuilt to open up space for growth-enhancing infrastructure, social spending, and future countercyclical policy. In China, strengthening the management, transparency, and overall governance framework of local government finances would also help contain the risks from rising local government debt. In Japan, the recently announced decision to implement the first stage of the consumption tax increase to 8 percent in April 2014 is a welcome step forward. The planned additional stimulus for 2014 to mitigate the growth impact of this measure puts a premium on developing a concrete and credible medium-term plan as quickly as possible to place public debt on a sustainable path. A successful implementation of Abenomics would have clear growth benefits not only to Japan but also to other economies in the rest of Asia (see also Box 1.4 in Chapter 1). Finally, for a few countries, the recent market pressure has put a further premium on strengthening public finances and implementing structural reforms (for example, India).

If downside risks to growth materialize, exchange rate flexibility and monetary easing should generally be the first lines of defense in economies where inflation is low and expectations are firmly anchored. In some economies, however (for example, India and Indonesia), more tightening may be called for given continued inflation pressure, further amplified by currency depreciation. On the fiscal side, automatic stabilizers should be allowed to play, but high deficits make fiscal consolidation a priority in a number of economies, such as India, Japan, and Vietnam. In others, stimu-

lus should be considered only if a serious slowdown threatens.

Latin America and the Caribbean: Growth Is Subdued

Less supportive external conditions and domestic supply-side constraints have dampened activity in Latin America and the Caribbean. Output growth is projected to moderate to 2¾ percent in 2013 (Figure 2.9). Growth is expected to recover gradually in 2014 as external demand strengthens, but risks remain on the downside. Allowing exchange rates to adjust to changes in fundamentals will help partly offset the effects of tighter financial conditions. Gradual fiscal consolidation should continue in countries with limited fiscal space and those with still tight capacity constraints. With weaker growth prospects and heightened capital flow volatility, safeguarding financial stability is a key policy priority. Growth in the tourism-dependent Caribbean economies remains low, and policy challenges include addressing high debt, weak competitiveness, and fragile financial systems.

Growth in most of the Latin America and Caribbean (LAC) region in the first half of the year was weaker than envisaged in the April 2013 WEO. Activity was held back by infrastructure bottlenecks, lower commodity prices, and policy tightening in some cases (Figure 2.10). The unexpected slowdown in Mexico was related to lower government spending, a decline in construction activity, and sluggish demand from the United States. In Brazil, growth picked up on the back of stronger investment, including inventories. However, high-frequency indicators point to some moderation in activity going into the second half of the year.

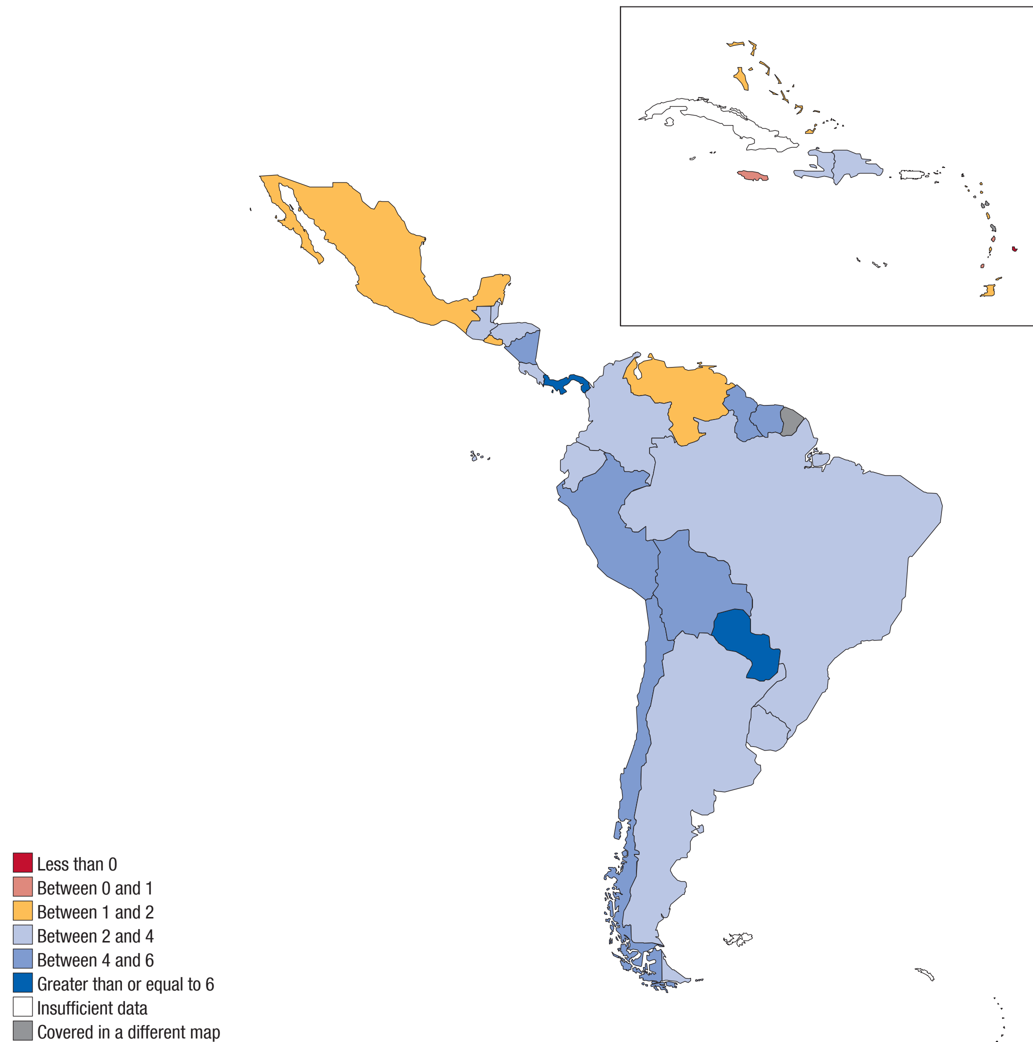
The recent increase in global financial market volatility hit the region's exchange rates, sovereign spreads, and stock markets. In some countries, governments responded to market turbulence by easing capital controls and intervening to contain exchange rate volatility. In many cases, depreciation brought exchange rates more in line with fundamentals. Moreover, sovereign and corporate yields are still relatively low from a historical perspective.

Output in the LAC region is projected to grow by 2¾ percent in 2013 and 3 percent in 2014, some ¾ percentage point lower than forecast in the April 2013 WEO (Table 2.4). The downward revisions reflect the weaker-than-expected outturn in the first half of 2013 and the effect of tighter financial conditions on growth going forward. Growth rates in the medium term are also expected to remain below the cyclically high rates recorded after the Great Recession:[3]

- In most of the financially integrated economies (Chile, Colombia, Peru, Uruguay), growth is expected to moderate to more sustainable levels. Strong wage growth and low unemployment should support consumption. Despite some deceleration, credit growth is expected to remain relatively strong. External current account deficits are projected to widen further in 2013 as commodity prices have softened and domestic demand continues to outpace output. Inflation pressure is broadly contained, except in Uruguay, where inflation remains above target.
- Brazil's economy is expected to grow by 2½ percent in 2013. The recent depreciation of the currency will improve external competitiveness and partially offset the adverse impact of increases in sovereign yields. But higher inflation has lowered real incomes and may weigh on consumption, while supply constraints and policy uncertainty may continue to constrain activity.
- In Mexico, growth is expected to slow to 1¼ percent in 2013, largely reflecting the weakness in activity in the first half of the year. Growth is projected to recover gradually and return to 3 percent in 2014, as manufacturing picks up on the back of a recovery in U.S. demand, public spending regains momentum, and ongoing structural reforms begin to bear fruit. In the medium term, growth is expected to rise to an annual average of 3½ to 4 percent, based on the IMF staff's preliminary estimates of the effects of structural reforms.
- Growth in other commodity-exporting countries is generally expected to remain strong, except in Venezuela, where energy shortages and exchange controls are curtailing economic activity. Growth in Argentina has recovered due to a strong harvest, but activity continues to be constrained by foreign exchange and other administrative controls.
- Output growth will slow in Central America, given weaker-than-expected external demand and sluggish remittances.

[3]See Chapter 3 in the May 2013 *Western Hemisphere Regional Economic Outlook*.

Figure 2.9. Latin America and the Caribbean: 2013 GDP Growth Forecasts
(Percent)



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

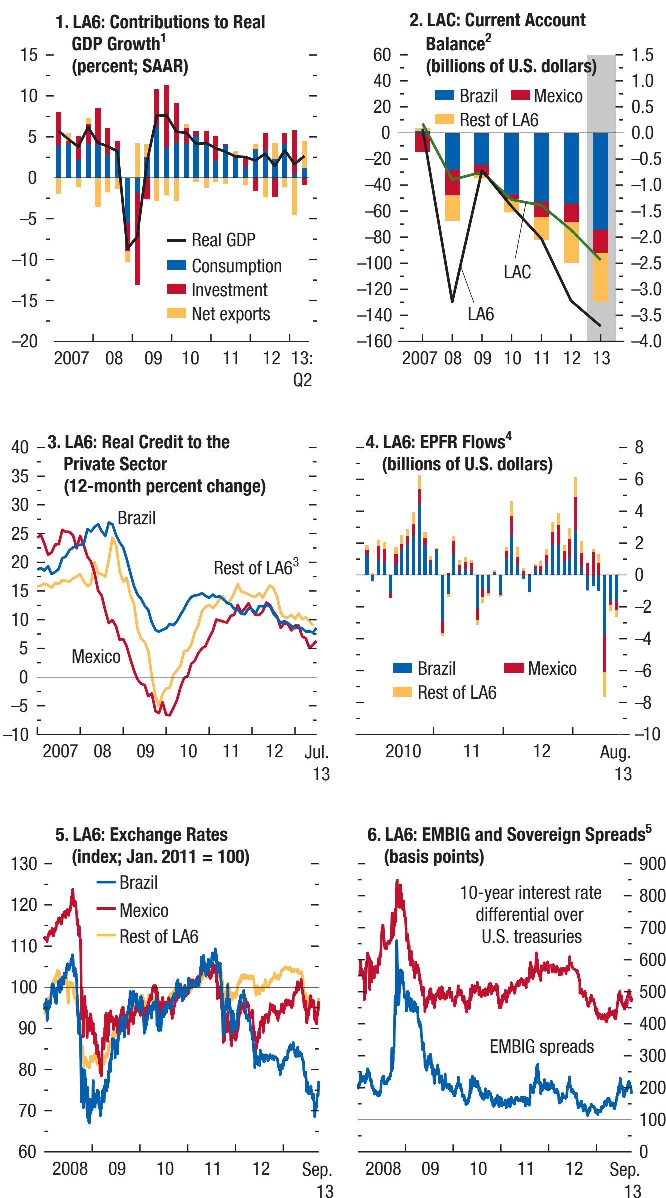
- Activity will be weak in much of the Caribbean as tourism flows remain subdued and construction activity contracts. High debt levels, weak competitiveness, and rising financial vulnerabilities continue to constrain fiscal policy and growth prospects.

Overall, downside risks dominate the outlook. Given the LAC region's strong dependence on commodities, a key external risk is a sharp drop in commodity prices. As illustrated in the plausible downside scenario, slower growth in major economies outside of the region, including in China, would reduce growth in Latin America by ½ percentage point through its effect on commodity prices and exports. Renewed financial market volatility and continued capital outflows represent another risk.

Policymakers should calibrate macroeconomic policies based on a realistic assessment of their economies' supply potential. Maintaining unsustainably high growth rates through fiscal policy stimulus would weaken public finances and widen current account deficits. In the context of limited economic slack and still relatively favorable external conditions in most of

Figure 2.10. Latin America: Growth Is Subdued

Growth has slowed with weaker external and domestic demand. Despite increases in financial volatility and lower commodity prices, external conditions are still broadly supportive. Policies should aim at improving the quality and sustainability of growth and reducing domestic financial volatility.



Sources: Bloomberg, L.P.; EPFR Global/Haver Analytics; Haver Analytics; national authorities; and IMF staff estimates.
Note: LAC = Latin America and the Caribbean. LA6 = Brazil, Chile, Colombia, Mexico, Peru, Uruguay. Rest of LA6 refers to total for Chile, Colombia, Peru, and Uruguay (unless noted otherwise).
[1]Purchasing-power-parity GDP-weighted averages of LA6. SAAR = seasonally adjusted annual rate.
[2]LA6: simple average; percent of GDP, right scale. LAC: percent of GDP, right scale.
[3]Simple average for Chile, Colombia, Peru, and Uruguay. Data are through June 2013.
[4]EPFR flows provide a limited proxy for overall balance of payments (BoP) flows, although recent studies have found a close match in the pattern of EPFR flows and BoP gross portfolio flows (see Fratzscher, 2012).
[5]Sovereign bond yields are average of Brazil, Chile, Colombia, Mexico, and Peru, depending on availability. EMBIG = JPMorgan EMBI Global Index.

Latin America, countries should proceed with gradual fiscal consolidation while protecting critical public investment and social spending. Fiscal consolidation remains critical for countries with high debt and deficits, including in the Caribbean. In countries with low inflation and anchored inflation expectations, exchange rate flexibility and monetary policy should continue to be the first line of defense if downside risks materialize, while guarding against excessive exchange rate volatility. Where inflation pressure persists (including in Brazil), monetary tightening remains appropriate.

Prudential oversight of the financial system needs to be stepped up, with the goal of identifying and addressing potential vulnerabilities, particularly against a backdrop of recent rapid credit growth that was fueled in part by capital inflows.

Strengthening competitiveness, raising productivity, and increasing saving and investment rates remain critical medium-term challenges for the LAC region. With labor participation already high and unemployment rates low, countries will need to rely increasingly on capital accumulation and productivity gains to maintain high growth rates. Raising domestic savings will allow increased investment without additional reliance on foreign borrowing.

Commonwealth of Independent States: Slower Growth amid Weak External and Internal Demand

Growth in the Commonwealth of Independent States (CIS) has slowed, reflecting both a weak external environment and supply-side constraints in some economies (Figure 2.11). Reforms are needed to boost the region's growth potential, while in several countries policies also need to reduce macro imbalances, given heightened risks and limited buffers.

Growth in the European CIS economies, including Russia, slowed in the first half of 2013 (Figure 2.12). Soft external demand was a factor but weak domestic investment also contributed, particularly where output gaps were small and supply constraints were binding. In the Caucasus and central Asia (CCA), however, economic activity continued to grow at a strong pace as in 2012, supported by an expansion of productive capacity in extractive sectors for the commodity exporters, as well as a stable inflow of remittances thus far. The recent increase in global financial volatility hit the

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

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
North America	**2.8**	**1.5**	**2.6**	**2.2**	**1.6**	**1.7**	**–2.7**	**–2.6**	**–2.7**	. . .	. . .	. . .
United States[4]	2.8	1.6	2.6	2.1	1.4	1.5	–2.7	–2.7	–2.8	8.1	7.6	7.4
Canada	1.7	1.6	2.2	1.5	1.1	1.6	–3.4	–3.1	–3.1	7.3	7.1	7.1
Mexico	3.6	1.2	3.0	4.1	3.6	3.0	–1.2	–1.3	–1.5	5.0	4.8	4.5
South America[5]	**2.6**	**3.2**	**3.1**	**6.8**	**8.0**	**8.0**	**–1.8**	**–2.6**	**–2.5**	. . .	. . .	. . .
Brazil	0.9	2.5	2.5	5.4	6.3	5.8	–2.4	–3.4	–3.2	5.5	5.8	6.0
Argentina[6]	1.9	3.5	2.8	10.0	10.5	11.4	0.0	–0.8	–0.8	7.2	7.3	7.4
Colombia	4.0	3.7	4.2	3.2	2.2	3.0	–3.2	–3.2	–3.2	10.4	10.3	10.0
Venezuela	5.6	1.0	1.7	21.1	37.9	38.0	2.9	2.8	2.2	7.8	9.2	10.3
Peru	6.3	5.4	5.7	3.7	2.8	2.5	–3.6	–4.9	–5.1	6.8	6.0	6.0
Chile	5.6	4.4	4.5	3.0	1.7	3.0	–3.5	–4.6	–4.0	6.4	6.2	6.4
Ecuador	5.1	4.0	4.0	5.1	2.8	2.4	–0.2	–1.1	–1.4	5.3	5.5	5.5
Bolivia	5.2	5.4	5.0	4.5	4.8	4.1	7.8	4.2	3.1	6.4	6.4	6.3
Uruguay	3.9	3.5	3.3	8.1	8.5	8.6	–5.4	–4.9	–4.1	6.0	6.7	6.8
Paraguay	–1.2	12.0	4.6	3.7	3.2	4.6	0.4	0.5	–0.2	5.8	5.4	5.5
Central America[7]	**5.0**	**3.9**	**3.9**	**4.4**	**4.4**	**4.4**	**–6.1**	**–6.2**	**–6.1**	. . .	. . .	. . .
Caribbean[8]	**2.3**	**1.7**	**2.9**	**5.0**	**5.0**	**4.9**	**–4.9**	**–4.0**	**–3.6**	. . .	. . .	. . .
Memorandum												
Latin America and the Caribbean[9]	2.9	2.7	3.1	5.9	6.7	6.5	–1.9	–2.4	–2.4	. . .	. . .	. . .
Eastern Caribbean Currency Union[10]	–0.2	1.0	2.0	2.9	2.5	2.5	–16.0	–16.2	–16.7	. . .	. . .	. . .

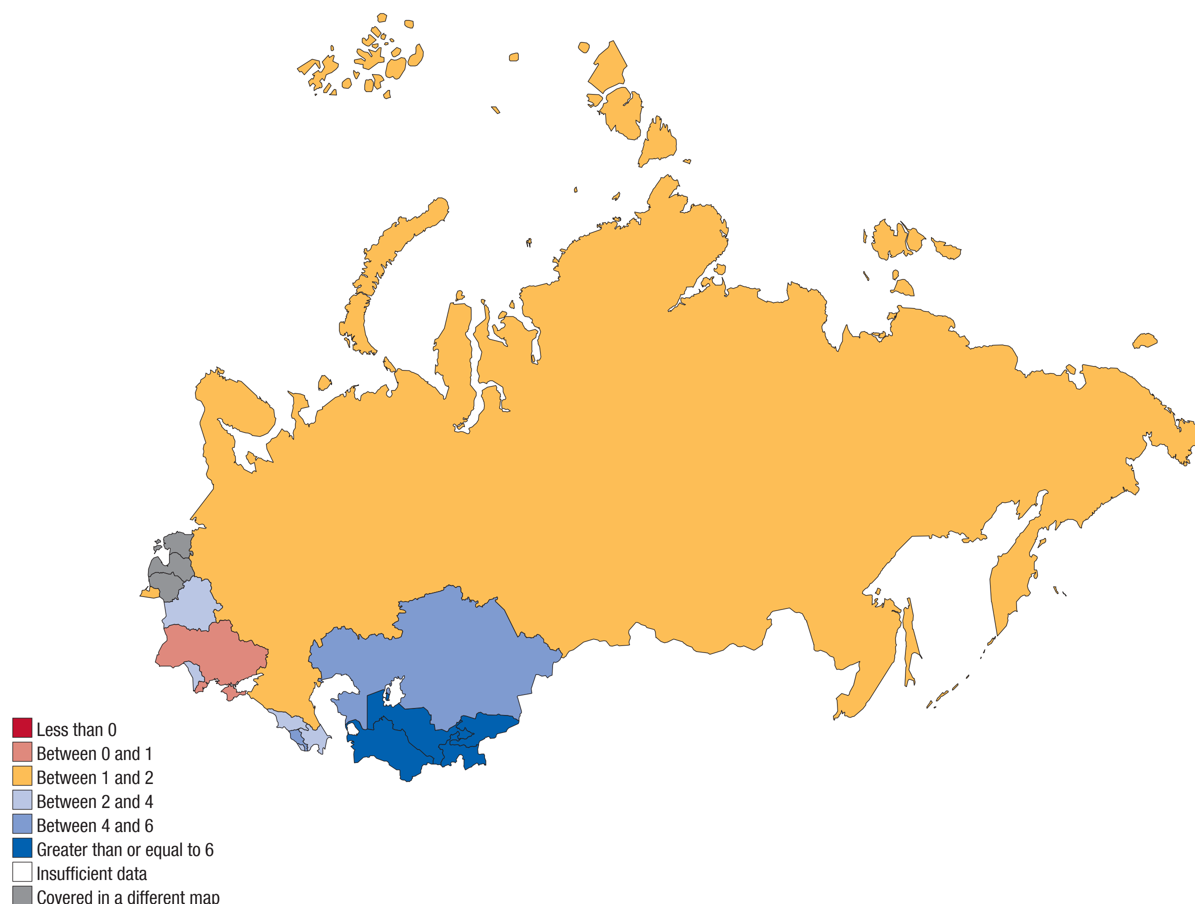
Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).
[5]Includes Guyana and Suriname.
[6]The data for Argentina are officially reported data. The IMF has, however, issued a declaration of censure and called on Argentina to adopt remedial measures to address the quality of the official GDP and CPI-GBA data. Alternative data sources have shown significantly lower real growth than the official data since 2008 and considerably higher inflation rates than the official data since 2007. In this context, the IMF is also using alternative estimates of GDP growth and CPI inflation for the surveillance of macroeconomic developments in Argentina.
[7]Central America comprises Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.
[8]The Caribbean comprises Antigua and Barbuda, The Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.
[9]Latin America and the Caribbean comprises Mexico and economies from the Caribbean, Central America, and South America.
[10]Eastern Caribbean Currency Union comprises Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines as well as Anguilla and Montserrat, which are not IMF members.

major European CIS economies more than the CCA, given the latter's limited external financial exposure.

Growth in the CIS economies is projected to decelerate slightly from 3½ percent in 2012 to about 2 percent this year, before rising to 3½ percent in 2014 (Table 2.5). Prospects vary within the region, with weaker growth in the European CIS economies and net energy importers, and stronger growth in the CCA economies and the net energy exporters:

- In Russia, growth is projected to average 1½ percent in 2013, increasing to 3 percent in 2014. This estimate reflects a downward revision of close to 2 percentage points for 2013 and ¾ percentage point for 2014 relative to the April 2013 WEO. Although consumption is still supported by strong real wage and retail credit growth, growth prospects have been dampened by a weak external environment, some acceleration of capital outflows and declining equity prices, and subdued investment.
- Outside Russia, growth in the region's energy exporters is forecast to remain strong. In Kazakhstan, growth will average 5 percent in 2013 and 5¼ percent in 2014, driven by a recovery in oil production and strong activity in the industrial and services sectors.
- In Ukraine, which has been in recession since mid-2012, growth will be near zero this year. Activity will be held back by weak exports, political uncertainty, and tight monetary conditions in defense of an exchange rate under pressure because of the economy's twin deficits. Growth is projected to rise to 1½ percent in 2014.
- Most of the other energy importers have not seen large capital inflows, in part due to weak recent

Figure 2.11. Commonwealth of Independent States: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: Includes Georgia for reasons of geography and similarity in economic structure.

economic performance or limited linkages to external financial markets. Growth is projected to remain low in Belarus, reflecting structural rigidities and declining competitiveness. Activity will rebound in Moldova, driven by agriculture, exports, and consumption. The Kyrgyz Republic is projected to grow at 7 percent for 2013–14 as the economy recovers from earlier disruptions in gold mining and sustains strong performance in construction, trade, and services.

- Growth in Armenia and Georgia is expected to decelerate this year. In Armenia, this reflects slower growth in the agricultural sector in 2013 after a strong performance in 2012 related to favorable weather, upward price adjustments in gas and electricity tariffs, and budget underspending. Growth in Georgia is expected to moderate given slower private investment, weak credit growth, and budget underspending.

Inflation in the region will average 6–6½ percent in 2013–14 and is a pressing issue in a few economies (Belarus, Uzbekistan). In Belarus, inflation has been declining, but is projected to remain in double digits. Inflation in Uzbekistan is also expected to stay in double digits, reflecting continuing depreciation of the currency, higher local food and administered prices, and wage increases. In Russia, inflation is projected to fall to about 6¼ percent by the end of 2013, just above the upper end of the central bank's target range of 5 to 6 percent, as the effects of temporary supply-side shocks fade. Inflation is expected to remain above the central bank's point inflation target of 4½ percent in 2014.

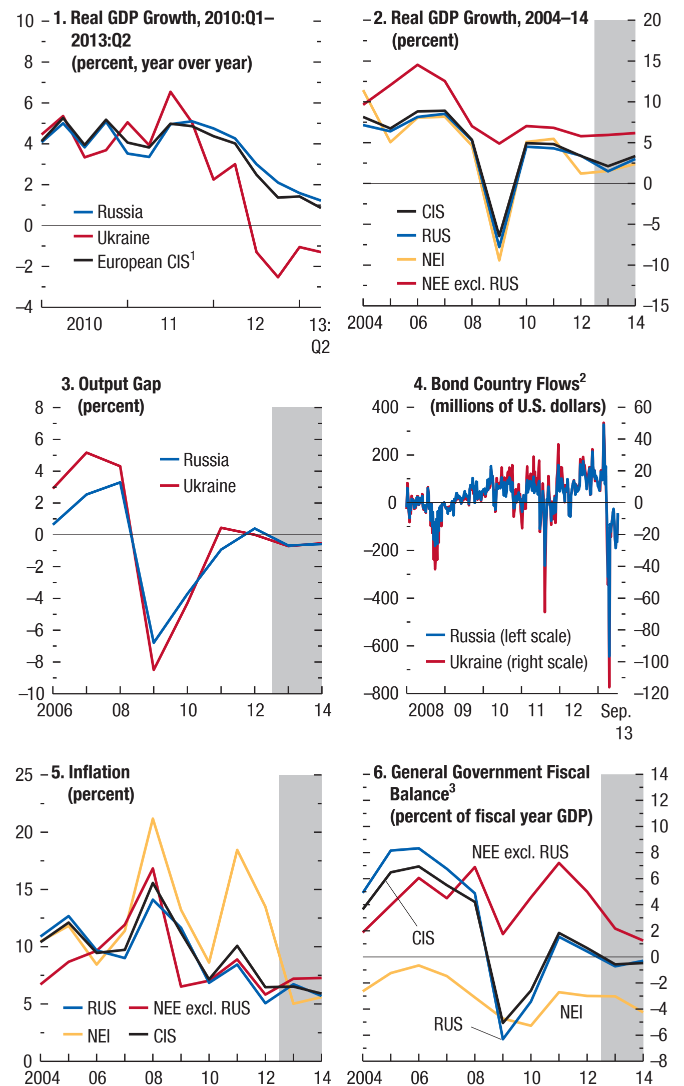
Risks are tilted to the downside. Higher government bond yields and borrowing costs or more difficult access to global capital markets would worsen the outlook for the region, especially for countries with relatively large fiscal and/or external imbalances and limited buffers, such as Belarus and Ukraine (which has seen sovereign credit default swap yields rise to prohibitive ranges in recent months). For the CCA commodity importers, however, the large share of longer-term instruments in the financing of their current account deficits would be a mitigating factor. Lower-than-anticipated growth in emerging market economies elsewhere would lower commodity prices, which would have a large negative impact on activity in Russia, Ukraine, and the CCA commodity exporters. Given the prominence of Russia in trade, and remittance flows in the region, the CCA commodity importers would be affected indirectly through the sharper-than-expected slowdown in Russia.

Policies should continue to maintain macroeconomic stability and implement reforms to boost potential growth. Russia is now in a better position to absorb external shocks than it used to be because of its more flexible exchange rate, improved crisis-management capacity, higher reserves, and narrower balance sheet mismatches. The priority is to raise the growth potential, improve the investment regime, facilitate new energy production, scale back government involvement in the economy, and gradually strengthen fiscal buffers. Ukraine would benefit from a more flexible exchange rate regime, tighter fiscal policy, an increase in domestic gas and heating tariffs, and a restart of structural reforms. Belarus will need to coordinate fiscal and monetary policies to tightly manage domestic demand and adopt structural reforms to achieve sustainable growth. Kazakhstan should continue to move toward a long-lasting solution to its high stock of nonperforming loans and revamp its monetary and fiscal policy frameworks. Azerbaijan and Turkmenistan should remove fiscal stimulus to keep inflation at bay and improve fiscal sustainability while further enhancing the efficiency of government spending. Monetary tightening should continue in Uzbekistan to contain second-round effects on inflation from local food and administered price increases.

For some economies, budget underspending has resulted in an unexpected fiscal tightening, which has also contributed to the recent slowdown (Armenia, Georgia). For these economies, the priority should be

Figure 2.12. Commonwealth of Independent States: Slower Growth amid Weak External and Internal Demand

Growth in the CIS economies is increasingly dampened by supply constraints. Supply-side reforms are needed to boost the region's growth potential. In several countries macroeconomic policies should avoid widening macro imbalances given heightened financial risks and limited buffers.



Sources: EPFR Global/Haver Analytics; Haver Analytics; and IMF staff estimates.
Note: CIS = Commonwealth of Independent States. Georgia, which is not a member of the CIS, is included in this group for reasons of geography and similarity in economic structure. Net energy exporters (NEE): Azerbaijan, Kazakhstan, Russia (RUS), Turkmenistan, Uzbekistan. Net energy importers (NEI): Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Tajikistan, Ukraine. NEE excl. RUS = net energy exporters excluding Russia.
[1]European CIS comprises Belarus, Moldova, Russia, and Ukraine.
[2]EPFR flows provide a limited proxy for overall balance of payments (BoP) flows, although recent studies have found a close match in the pattern of EPFR flows and BoP gross portfolio flows (see Fratzscher, 2012). In addition, these high-frequency data are more up to date than the BoP series. Moreover, the EPFR bond flows can be considered a proxy for sovereign bond flows, which were the most prominent part of portfolio flows toward countries in the region in recent years.
[3]General government fiscal balance refers to net lending/borrowing except for NEI, where it is the overall balance.

Table 2.5. Commonwealth of Independent States: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Commonwealth of Independent States (CIS)	**3.4**	**2.1**	**3.4**	**6.5**	**6.5**	**5.9**	**2.9**	**2.1**	**1.6**	**. . .**	**. . .**	**. . .**
Net Energy Exporters	**3.8**	**2.2**	**3.5**	**5.2**	**6.8**	**6.0**	**4.1**	**3.2**	**2.6**	**. . .**	**. . .**	**. . .**
Russia	3.4	1.5	3.0	5.1	6.7	5.7	3.7	2.9	2.3	6.0	5.7	5.7
Kazakhstan	5.1	5.0	5.2	5.1	6.3	6.3	3.8	4.3	3.1	5.3	5.3	5.3
Uzbekistan	8.2	7.0	6.5	12.1	12.1	10.4	0.7	0.2	1.1	. . .	. . .	. . .
Azerbaijan	2.2	3.5	5.6	1.0	3.7	6.3	21.7	13.3	9.2	6.0	6.0	6.0
Turkmenistan	11.1	12.2	10.4	5.3	7.6	7.0	0.0	0.2	3.8	. . .	. . .	. . .
Net Energy Importers	**1.2**	**1.5**	**2.4**	**13.5**	**5.0**	**5.6**	**–7.4**	**–7.5**	**–7.2**	**. . .**	**. . .**	**. . .**
Ukraine	0.2	0.4	1.5	0.6	0.0	1.9	–8.4	–7.3	–7.4	7.5	8.0	8.0
Belarus	1.5	2.1	2.5	59.2	17.5	14.8	–2.9	–8.3	–6.7	0.6	0.6	0.6
Georgia[4]	6.1	2.5	5.0	–0.9	–0.3	4.0	–11.5	–6.5	–7.8	15.0	16.7	17.3
Armenia	7.2	4.6	4.8	2.5	7.0	3.5	–11.3	–10.0	–8.6	19.0	18.5	18.0
Tajikistan	7.5	6.7	5.8	5.8	7.5	7.2	–1.3	–1.7	–2.2	. . .	. . .	. . .
Kyrgyz Republic	–0.9	7.4	6.5	2.8	8.6	7.2	–15.3	–9.6	–8.3	7.7	7.6	7.6
Moldova[5]	–0.8	4.0	4.0	4.6	4.4	4.3	–7.0	–7.6	–8.8	5.6	6.2	5.7
Memorandum												
Caucasus and Central Asia[6]	5.8	5.8	6.1	5.2	6.9	7.0	4.8	3.9	3.1	. . .	. . .	. . .
Low-Income CIS Countries[7]	6.6	6.0	5.9	7.5	8.7	8.0	–4.2	–3.3	–2.8	. . .	. . .	. . .
Net Energy Exporters Excluding Russia	5.8	5.9	6.2	5.8	7.2	7.3	6.4	5.0	4.1	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Georgia, which is not a member of the Commonwealth of Independent States, is included in this group for reasons of geography and similarity in economic structure.
[5]Moldova predictions are based on data available for the first quarter of 2013.
[6]Includes Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
[7]Low-Income CIS countries comprise Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.

to allow policies to be more accommodative for productive spending to support demand. In Georgia, this year's policy rate cuts should help reduce deflationary pressures, although resolution of recent political uncertainty is needed to restore investor confidence.

Middle East, North Africa, Afghanistan, and Pakistan: Growth Hinges on Improvements in Oil Production and Confidence

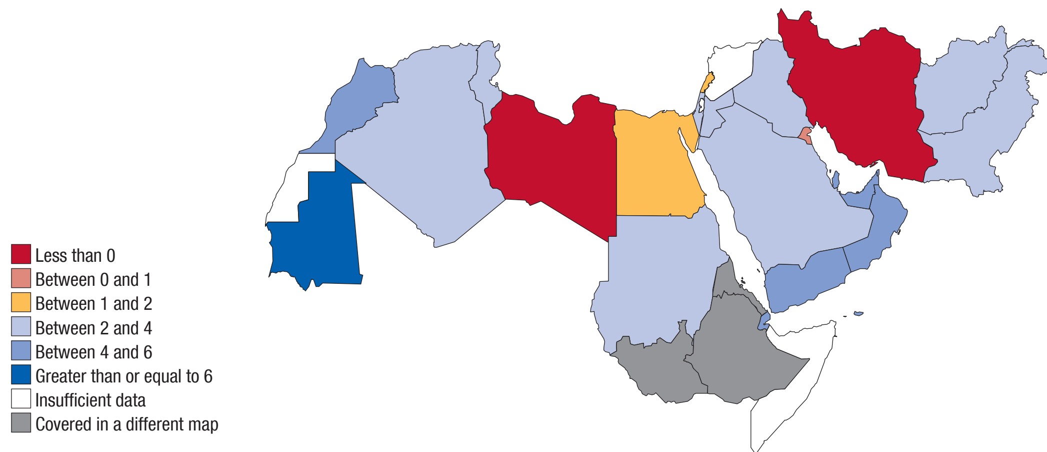
Growth in the MENAP region is expected to decline in 2013 (Figure 2.13). Weak global demand and domestic supply disruptions have reduced oil production. Meanwhile, uncertainties arising from prolonged political transitions, and a weak external environment, weigh on confidence in the oil importers. Growth is expected to pick up in 2014 with improved global conditions and a recovery in oil production (Figure 2.14). However, sustainable and equitable growth over the medium term depends on an improved sociopolitical environment and macroeconomic stability, increased economic diversification, and accelerated job creation.

Oil-Exporting Economies

Growth in the oil exporters decelerated substantially in the first half of 2013, driven by falling oil production. In a number of economies, such as the Islamic Republic of Iran, Iraq, and Libya, high geopolitical tension, economic sanctions, unscheduled maintenance, and deteriorating security have disrupted the oil supply. All in all, the region's hydrocarbon output is expected to fall by 1 percent in 2013, with the decline driven broadly by Libya and Iran. Saudi Arabia's oil production for the year as a whole is also projected to decline slightly, as it continued to play a stabilizing role in the global oil market: it reduced production in late 2012 through early 2013 in the face of slowing global demand and rising supply from suppliers outside the Organization of the Petroleum Exporting Countries (OPEC), and raised it later in the year to compensate for oil production disruptions elsewhere in the region. In contrast to oil GDP, non-oil GDP is holding up well in most countries, supported by high government spending and recovering credit growth.

During the recent increase in financial market volatility, sovereign and corporate bond yields for the

Figure 2.13. Middle East, North Africa, Afghanistan, and Pakistan: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: Includes Israel only for reasons of geography. Iran's real GDP growth for 2012 and beyond has not been significantly updated from the April 2013 WEO in light of the pending publication of national accounts by the central bank and the new authorities' plans.

MENAP oil exporters rose, but not significantly and from low levels, reflecting generally limited financial linkages with global markets and large external buffers.

For the year as a whole, growth is projected to average 2 percent—a downward revision of 1¼ percentage point from the April 2013 WEO—largely on account of lower oil production. Growth will likely increase to 4 percent in 2014 with a recovery in global demand and higher oil production in Saudi Arabia, Iraq, and Libya (Table 2.6). Growth in non-oil GDP is forecast to increase from about 3¾ percent in 2013 to 4½ percent in 2014.

Average inflation is not an immediate concern for most oil exporters. In the Gulf Cooperation Council (GCC) economies, inflation rates have been gradually rising, largely because of food prices and/or higher housing costs, but are expected to remain moderate at about 3¼ percent in 2013–14. By contrast, in Iran, inflation has accelerated markedly since late 2012, reflecting pass-through from the large currency depreciation. Elsewhere, inflation has declined further with the alleviation of supply bottlenecks, moderating food prices, and, in Algeria, a withdrawal of policy accommodation, but is expected to remain higher than in the GCC economies.

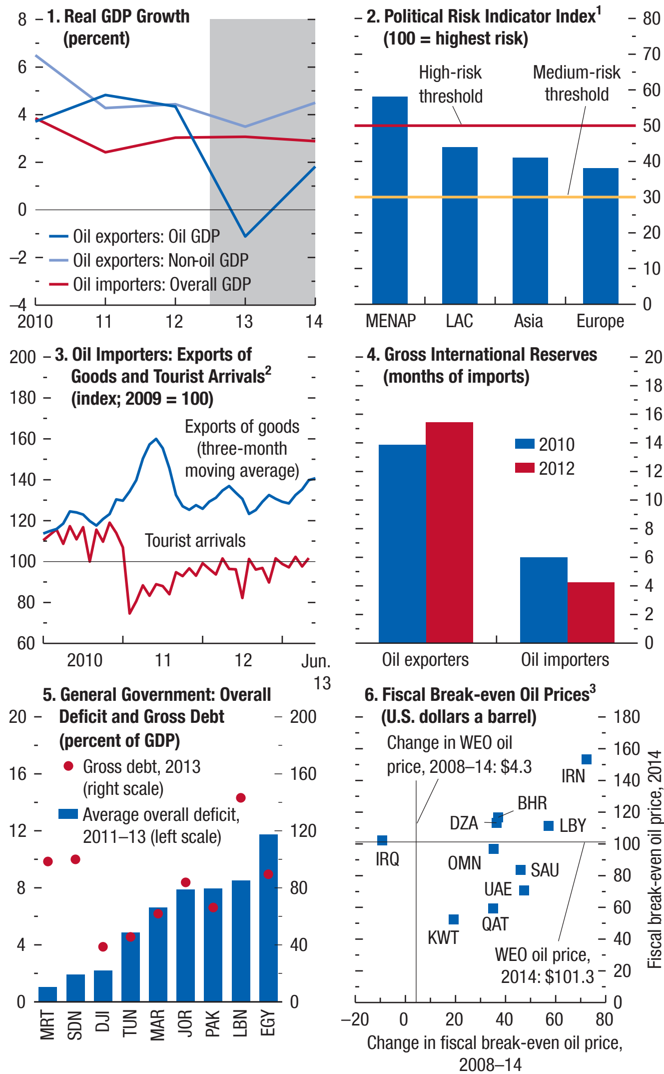
Risks to the near-term regional outlook are broadly balanced. On the upside, geopolitical shocks and supply disruptions in the region may push oil prices higher, benefiting growth in oil suppliers with spare capacity as they compensate for shortfalls in other oil exporters. On the downside, weaker global demand, particularly a further slowdown in emerging market economies, or a faster-than-expected increase in non-OPEC supply, could put downward pressure on oil prices and growth in oil exporters in the region. Although a sharper-than-expected tightening in global monetary conditions would lead to higher domestic interest rates in GCC economies whose currencies are pegged to the U.S. dollar, the overall growth effects are likely to be small as long as oil prices remain strong.

A sustained decline in oil prices would leave many oil exporters in the region with fiscal deficits. Over the past several years, increased spending has raised fiscal break-even oil prices (oil prices at which government budgets are balanced) faster than actual oil prices have risen. As a result, a number of economies (Algeria, Bahrain, Iran, Iraq, Libya, Yemen) have fiscal break-even prices above the projected oil price for 2014. Although the remaining economies are running surpluses and public debt levels are still relatively low, most have not been accumulating wealth fast enough to build sufficient reserves for future generations and as a buffer against declines in oil revenue.

The policy priority for the region's oil exporters is to increase resilience to oil revenue shocks while diversifying their economies for a rapidly growing labor force. Only a few GCC economies with long production horizons and substantial fiscal buffers have the scope to

Figure 2.14. Middle East, North Africa, Afghanistan, and Pakistan: Growth Hinges on Improvements in Oil Production and Confidence

Growth in the region is decelerating on account of declining oil production among the oil-exporting countries and continued challenges from difficult political transitions in oil importers. Priorities are to improve the sociopolitical environment, strengthen macroeconomic stability, reduce fiscal and external imbalances, and implement reforms for sustainable and inclusive growth, further diversification, and job creation.



Sources: Haver Analytics; national authorities; PRS Group, Inc., *International Country Risk Guide* (ICRG); United Nations World Tourism Organization, World Tourism Barometer; and IMF staff estimates.

Note: Middle East, North Africa, Afghanistan, and Pakistan (MENAP) oil exporters: Algeria (DZA), Bahrain (BHR), Iran (IRN), Iraq (IRQ), Kuwait (KWT), Libya (LBY), Oman (OMN), Qatar (QAT), Saudi Arabia (SAU), United Arab Emirates (UAE), Yemen (YMN); oil importers: Afghanistan (AFG), Djibouti (DJI), Egypt (EGY), Jordan (JOR), Lebanon (LBN), Mauritania (MRT), Morocco (MAR), Pakistan (PAK), Sudan (SDN), Syria (SYR), Tunisia (TUN). Data projections from 2011 and onward exclude Syria.

[1]The index is calculated using ICRG political risk scores and socioeconomic indicators including unemployment, poverty, growth, and inequality. MENAP: DZA, EGY, JOR, LBN, MAR, PAK, TUN; LAC: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Jamaica, Mexico, Panama, Peru, Uruguay, Venezuela; Asia: China, India, Indonesia, Malaysia, Philippines, Sri Lanka, Thailand, Vietnam; Europe: Albania, Belarus, Bulgaria, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Serbia, Turkey, Ukraine.

[2]Exports of goods data for June exclude AFG, DJI, MRT, SDN, SYR. Tourist arrival data are through May 2013: seasonally adjusted; the aggregate: EGY, JOR, LBN, MAR, TUN.

[3]The fiscal break-even oil price is the oil price at which the government budget is balanced. For Yemen, the fiscal break-even price in 2013 is $214.8 a barrel.

use countercyclical fiscal policy against downside risks; in others, there is either little or no fiscal space. Fiscal policy should focus on building buffers against oil price shocks by finding non-oil sources of revenue and containing hard-to-reverse current expenditures, while maintaining social and high-quality capital spending in support of economic diversification, growth, and accumulating wealth for future generations.

Measures to raise the quality of education and better align it with the needs of the private sector could, in conjunction with measures to promote entrepreneurship and female labor force participation, help boost non-oil GDP growth and reduce the reliance on fiscal spending from oil revenues as a source of economic growth. In the GCC economies, labor market initiatives, including appropriate training, to attract GCC citizens to private sector work should be complemented with public sector wage restraint and contained expectations of future government employment. Non-GCC economies should aim to promote private sector activity through enhanced basic infrastructure and a better business climate.

Oil-Importing Economies

Economic conditions are difficult in MENAP oil importers. While there are nascent signs of improvement in tourism, exports, and foreign direct investment (FDI) in a number of countries, owing in part to increased demand from the GCC economies, continued political and economic policy uncertainty weigh on confidence and economic activity. The intensifying conflict in Syria and developments in Egypt have sparked concerns about wider destabilization, which further complicates economic management. Moreover, in many countries, external and fiscal buffers are running low.

Overall, growth is expected to remain at about 3 percent in 2013–14. In most economies, this will result in continued high unemployment and stagnating living standards, likely contributing to continued social discontent.

- In Egypt, political developments will largely determine the pace of policy reforms, confidence, and domestic activity against a backdrop of large fiscal and external imbalances. Financing from several GCC countries is alleviating short-term constraints, and as a result the authorities have announced a fiscal stimulus package aimed at supporting growth and creating jobs.

Table 2.6. Selected Middle East and North African Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Middle East and North Africa	**4.6**	**2.1**	**3.8**	**10.8**	**12.3**	**10.3**	**13.2**	**10.3**	**9.3**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**5.4**	**1.9**	**4.0**	**11.4**	**13.8**	**10.8**	**17.4**	**13.9**	**12.4**	**. . .**	**. . .**	**. . .**
Iran[5]	–1.9	–1.5	1.3	30.5	42.3	29.0	5.0	3.1	0.3	12.2	13.2	14.5
Saudi Arabia	5.1	3.6	4.4	2.9	3.8	3.6	23.2	19.3	17.7	5.5	. . .	. . .
Algeria	3.3	3.1	3.7	8.9	5.0	4.5	5.9	1.8	1.2	10.0	10.0	9.8
United Arab Emirates	4.4	4.0	3.9	0.7	1.5	2.5	17.3	15.2	15.6	. . .	. . .	. . .
Qatar	6.2	5.1	5.0	1.9	3.7	4.0	32.4	29.6	25.6	. . .	. . .	. . .
Kuwait	6.2	0.8	2.6	3.2	3.0	3.5	43.2	38.7	37.7	2.1	2.1	2.1
Iraq	8.4	3.7	6.3	6.1	2.3	5.0	7.0	0.7	0.8	. . .	. . .	. . .
Oil Importers[6]	**2.0**	**2.8**	**3.1**	**8.7**	**7.8**	**8.9**	**–7.7**	**–6.7**	**–4.9**	**. . .**	**. . .**	**. . .**
Egypt	2.2	1.8	2.8	8.6	6.9	10.3	–3.1	–2.6	–0.9	12.3	13.0	12.8
Morocco	2.7	5.1	3.8	1.3	2.3	2.5	–10.0	–7.2	–6.1	9.0	8.9	8.8
Tunisia	3.6	3.0	3.7	5.6	6.0	4.7	–8.1	–8.0	–6.6	17.6	16.7	16.0
Sudan	–3.3	3.9	2.5	35.5	32.1	27.4	–10.8	–11.9	–7.0	18.0	19.0	20.0
Lebanon	1.5	1.5	1.5	6.6	6.3	3.1	–16.2	–16.7	–16.7	. . .	. . .	. . .
Jordan	2.8	3.3	3.5	4.8	5.9	3.2	–18.1	–9.9	–9.1	12.2	12.2	12.2
Memorandum												
Middle East, North Africa, Afghanistan, and Pakistan	4.6	2.3	3.6	10.7	11.7	10.0	12.1	9.4	8.6	. . .	. . .	. . .
Pakistan	4.4	3.6	2.5	11.0	7.4	7.9	–2.1	–1.0	–0.6	6.5	6.7	6.9
Afghanistan	12.5	3.1	3.5	4.5	7.1	5.5	3.9	2.5	1.8	. . .	. . .	. . .
Israel[7]	3.4	3.8	3.3	1.7	1.6	2.1	0.3	2.3	3.0	6.9	6.8	6.8
Maghreb[8]	15.5	2.7	6.7	5.9	4.3	4.6	5.0	–2.8	–2.7	. . .	. . .	. . .
Mashreq[9]	2.2	1.9	2.7	8.2	6.8	9.1	–6.2	–5.2	–3.7	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a complete list of reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Includes Bahrain, Libya, Oman, and Yemen.
[5]Iran's real GDP growth for 2012 and beyond has not been significantly updated from the April 2013 WEO in light of the pending publication of national accounts by the central bank and the new authorities' plans.
[6]Includes Djibouti and Mauritania. Excludes Syria.
[7]Israel, which is not a member of the region, is included for reasons of geography. Note that Israel is not included in the regional aggregates.
[8]The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia.
[9]The Mashreq comprises Egypt, Jordan, and Lebanon. Excludes Syria.

- In Lebanon, political spillovers and refugees from the conflict in Syria will continue to shake confidence and deter tourism and growth, which will strain the fiscal position and put pressure on external balances.
- Pakistan's newly elected government has a mandate to tackle large fiscal and external deficits, which will initially weigh on growth. However, reforms in the energy sector, combined with relatively stable worker remittances and agricultural production and support from international and bilateral donors, are expected to support growth over the medium term.
- Political and security developments in Tunisia will continue to weigh on the economic outlook and the pace of fiscal, financial, and structural reforms.
- Morocco's growth is expected to slow in 2014 as rain-dependent agricultural production normalizes after an exceptional harvest in 2013.
- Escaping regional trends, some economies are projected to enjoy continued solid growth. In Djibouti, strong shipping activity will stimulate construction and attract FDI. In Mauritania, a thriving mining sector and public infrastructure work will buoy economic activity.

In most countries, inflation remains elevated, although it has moderated recently, given decreasing global food and energy prices. In Pakistan, past currency depreciation and reduced energy subsidies will likely result in higher inflation.

Domestic and regional factors are the main sources of risks, which remain tilted to the downside. Setbacks in political transitions and continued social and security tensions could delay a return of confidence and reforms. Downside risks to growth in the euro area and the GCC economies also present risks for the region's oil importers, through spillovers on tourism, trade, and

remittances. Limited exposure to international capital markets should limit risks of a sudden stop in capital inflows for most countries. Still, with limited exchange rate flexibility, tighter global monetary conditions could result in higher domestic interest rates, which would dampen growth.

In an environment of increased risks due to regional tensions and heightened political uncertainty, policy goals are threefold: (1) creating jobs, (2) making inroads into fiscal consolidation, and (3) embarking on structural reforms.

- High and rising unemployment calls for an urgent focus on job creation. Delays in the revival of private investment suggest the need for the government to play a key role in shoring up economic activity over the near term. With limited room for widening fiscal deficits, spending on broad-based subsidies needs to be reoriented toward growth-enhancing public investment, while improving protection of vulnerable groups through well-targeted social assistance. External partners could provide additional financing based on the existence of adequate policy frameworks.
- With concerns about debt sustainability rising and fiscal and external buffers eroded, most countries need to start putting their fiscal house in order. That said, in some cases, there may be scope for phasing the fiscal adjustment to limit its impact on economic activity in the short run. A credible medium-term fiscal consolidation strategy would be needed to ensure continued willingness of domestic and foreign investors to provide adequate financing. In some cases, greater exchange rate flexibility can also help to soften the short-term impact of fiscal consolidation on growth and help to rebuild international reserves.
- A bold structural reform agenda is essential for propelling private sector activity and fostering a more dynamic, competitive, and inclusive economy. Reforms need to focus on a multitude of areas, including improving business regulation and governance, expanding access of businesses and consumers to finance, and increasing the flexibility of labor and product markets while protecting the vulnerable through well-targeted social assistance. Early steps in these areas can help to signal governments' commitment to reforms and improve confidence.

Delays in economic recovery and rising unemployment underscore the urgency of policy reforms. Early progress across all three priority areas—supported by the international community through scaled-up financing, enhanced access, and technical assistance—is essential to start achieving the much-awaited dividends from the recent economic and political transitions.

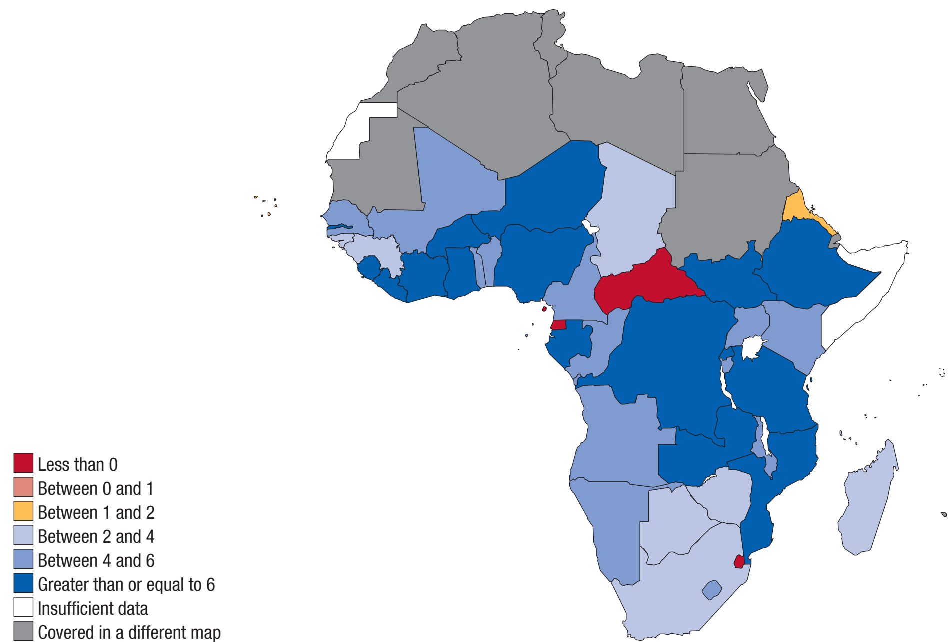
Sub-Saharan Africa: Continued Dynamism

Growth in sub-Saharan Africa remained robust in 2012–13 and is expected to accelerate somewhat in 2014 (Figure 2.15), reflecting strong domestic demand in most of the region. Nevertheless, spillovers from sluggish external demand, reversal of capital flows, and declines in commodity prices are contributing to somewhat weaker growth prospects in many countries relative to the April 2013 WEO. Policies should aim to rebuild room for policy maneuvering where it has been eroded, and more broadly to mobilize revenue to address social and investment needs. To achieve sustainable and inclusive growth in the medium term, governments should deepen structural reforms and give priority to infrastructure investment and social spending.

Activity in sub-Saharan Africa remained strong in the beginning of 2013, although marginally down from 2012, supported in most countries by domestic demand (Figure 2.16). Growth was particularly strong in low-income and fragile states, with the notable exceptions of Mali and Guinea-Bissau, which were affected by internal civil conflicts. Angola benefited from a recovery in oil production. In Nigeria, still high oil prices underpinned strong growth, notwithstanding temporary downdrafts from security problems in the north and oil theft. In Ethiopia, declining coffee prices and supply bottlenecks slowed growth slightly from a very high level. However, South Africa's growth slowed further, in large part due to tense industrial relations, anemic private investment, and weaker consumption growth, the latter affected by slowing disposable income growth and weakening consumer confidence. With a few exceptions, inflation remained broadly stable in the region.

Recent global financial market volatility has affected several economies in the region, although most low-income countries experienced little impact given their limited links with global financial markets. Among frontier markets, Nigeria's currency weakened against the U.S. dollar at the peak of the volatility, although financial conditions have since stabilized. In South

Figure 2.15. Sub-Saharan Africa: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.

Africa, the currency suffered a steep decline, bond spreads widened, and equity prices fell due to external factors combined with domestic economic vulnerabilities. However, with inflows returning during July and August, by early September South African asset prices appeared to be stabilizing.

Growth is projected to increase from about 5 percent in both 2012 and 2013 to 6 percent in 2014. This represents a more than ½ percentage point downward revision for 2013 relative to the April 2013 WEO for the whole region, and close to a ½ percentage point downward revision for 2014 for the middle-income countries (Table 2.7):

- In Angola, the revisions reflect delays in budget execution. In Nigeria, among other factors, they mainly reflect reduced oil production.
- In South Africa, growth is forecast to improve gradually in 2014 and beyond as global growth improves and infrastructure bottlenecks are alleviated. However, the tighter financing environment, still weak investor and consumer confidence, continued tense industrial relations, policy uncertainty, and elevated household debt will weigh on economic performance.
- Elsewhere, growth is forecast to remain fairly robust, driven by investment in infrastructure, energy, and natural resources projects, as well as increased output from projects coming onstream (Ghana, Mozambique, Niger, Sierra Leone). However, the recent weakness in international commodity prices may delay mining investment in a few countries (Guinea). Medium-term growth in some resource exporters will also be affected by the Chinese economy's slower growth trajectory.[4]

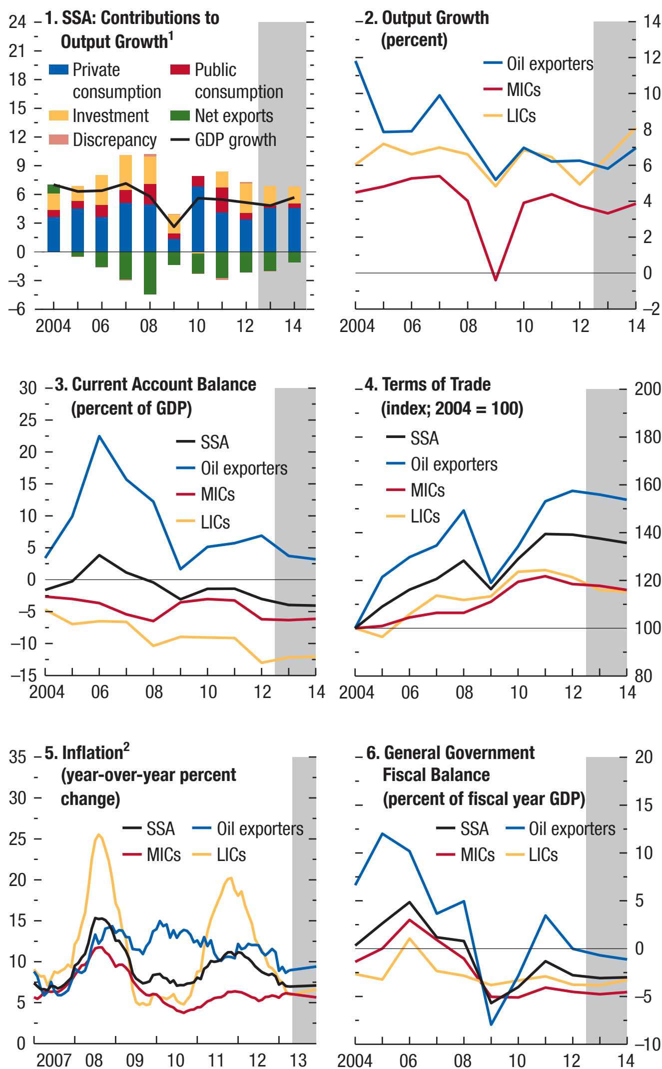
Inflation is expected to decline further in 2013 through much of the region, helped by some moderate global food prices and prudent monetary policies. However, current account balances are projected to continue to weaken, including because of lower global commodity prices (for example, Burkina Faso and Nigeria) and continued FDI-financed investment in infrastructure and natural resources (Mozambique, Sierra Leone).

The main threats to the outlook are a global economic downturn or a further deceleration of growth in China or other major emerging markets that could

[4]See also the Commodities Special Feature in Chapter 1.

Figure 2.16. Sub-Saharan Africa: Continued Dynamism

Growth remains robust and will accelerate further, although at a slower pace than previously expected. Activity is being helped by strong domestic demand and increases in commodity-related investment, and spillovers have so far been small given limited financial linkages. Continued economic strength calls for better efforts to rebuild policy buffers, contain inflation, and boost potential growth.



Sources: Haver Analytics; IMF, International Financial Statistics database; and IMF staff estimates.
Note: LIC = low-income country (SSA); MIC = middle-income country (SSA); SSA = sub-Saharan Africa.
[1]Liberia, South Sudan, and Zimbabwe are excluded due to data limitations.
[2]Due to data limitations, the following are excluded: Chad, Republic of Congo, and Gabon from oil exporters; Cameroon, Swaziland, and Zambia from MICs; Comoros, Democratic Republic of the Congo, Eritrea, The Gambia, Guinea, Guinea-Bissau, Liberia, São Tomé and Príncipe, South Sudan, and Zimbabwe from LICs.

weaken exports through lower commodity prices or reduced inflows of aid and FDI. A sharp or protracted decline in oil and commodity prices would affect commodity exporters that do not yet have sufficient fiscal buffers (Angola, Nigeria) and could affect planned or ongoing resource development projects (Ghana, Guinea, Liberia). South Africa is also vulnerable to further slowdowns or sudden stops in capital inflows, which could be triggered by global repricing of risk or domestic shocks, especially escalating industrial tensions. Some frontier markets, such as Ghana and Nigeria, could also be vulnerable to such slowdowns of private financial flows. Domestic risk from further social and political unrest (for example, in the Sahel and Central African Republic) and further security problems in northern Nigeria might also adversely affect neighboring countries. Given the significance of subsistence agriculture, lack of rain can also present the risk of food insecurity and generate price increases in various pockets of the region. Insufficient capacity in electricity generation could be an additional drag on growth in a large number of countries.

Macroeconomic policies should generally remain focused on rebuilding buffers where these have been depleted and on keeping inflation under control. Revenue mobilization is an important objective in low-income countries more generally, where it can help address social and investment needs. Related to this, it will also be crucial to prioritize capital and social spending while continuing to improve project selection and execution capacity. Although debt cancellation under the Heavily Indebted Poor Country and Multilateral Debt Relief Initiatives has improved overall debt sustainability, continued prudence is needed to keep debt levels under control, especially where it has increased recently (for example, Cape Verde and Senegal). Where inflation remains relatively high, tight monetary policies are also warranted (Angola, Tanzania). In some oil-exporting countries (Angola), steps need to be taken to improve transparency and public control over the management of oil revenue. South Africa needs decisive progress in implementing structural reforms to strengthen education and the effectiveness of government services, ease infrastructure bottlenecks, and increase product market competition and labor market flexibility.

In the medium term, all countries in the region will need to step up their efforts to promote sustainable and inclusive growth by investing in physical and

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

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Sub-Saharan Africa	**4.9**	**5.0**	**6.0**	**9.0**	**6.9**	**6.3**	**–3.0**	**–4.0**	**–4.0**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**6.3**	**5.8**	**7.0**	**10.8**	**8.7**	**7.6**	**6.9**	**3.7**	**3.2**	**. . .**	**. . .**	**. . .**
Nigeria	6.6	6.2	7.4	12.2	9.9	8.2	7.6	3.2	3.6	. . .	. . .	. . .
Angola	5.2	5.6	6.3	10.3	9.2	8.5	9.2	7.1	4.6	. . .	. . .	. . .
Equatorial Guinea	5.3	–1.5	–1.9	3.4	5.0	5.4	–12.6	–15.1	–16.9	. . .	. . .	. . .
Gabon	5.6	6.6	6.8	2.7	–1.5	2.5	13.2	9.7	6.3	. . .	. . .	. . .
Republic of Congo	3.8	5.8	4.8	5.0	5.3	2.8	–1.3	7.5	5.1	. . .	. . .	. . .
Middle-Income Countries[5]	**3.8**	**3.3**	**3.9**	**5.5**	**5.9**	**5.5**	**–6.2**	**–6.3**	**–6.1**	**. . .**	**. . .**	**. . .**
South Africa	2.5	2.0	2.9	5.7	5.9	5.5	–6.3	–6.1	–6.1	25.1	26.0	26.2
Ghana	7.9	7.9	6.1	9.2	11.0	9.8	–12.2	–12.9	–10.7	. . .	. . .	. . .
Cameroon	4.6	4.6	4.9	2.4	2.5	2.5	–3.7	–4.1	–3.7	. . .	. . .	. . .
Côte d'Ivoire	9.8	8.0	8.0	1.3	2.9	2.5	–1.3	–2.9	–2.5	. . .	. . .	. . .
Botswana	4.2	3.9	4.1	7.5	6.8	5.8	–4.9	–1.8	–1.2	. . .	. . .	. . .
Senegal	3.5	4.0	4.6	1.4	1.2	1.6	–10.3	–9.5	–8.5	. . .	. . .	. . .
Low-Income Countries[6]	**4.9**	**6.5**	**8.1**	**12.7**	**6.3**	**5.8**	**–13.0**	**–12.2**	**–12.1**	**. . .**	**. . .**	**. . .**
Ethiopia	8.5	7.0	7.5	24.1	7.2	8.2	–6.6	–6.4	–6.1	. . .	. . .	. . .
Kenya	4.6	5.9	6.2	9.4	5.4	5.0	–9.3	–7.8	–7.3	. . .	. . .	. . .
Tanzania	6.9	7.0	7.2	16.0	8.5	5.8	–15.3	–14.9	–14.1	. . .	. . .	. . .
Uganda	2.8	5.6	6.5	14.0	5.0	4.9	–10.5	–12.0	–13.9	. . .	. . .	. . .
Democratic Republic of the Congo	7.2	6.2	10.5	2.1	4.4	6.0	–9.6	–12.9	–17.0	. . .	. . .	. . .
Mozambique	7.4	7.0	8.5	2.1	5.5	5.6	–36.5	–40.1	–41.7	. . .	. . .	. . .
Memorandum												
Sub-Saharan Africa Excluding South Sudan	5.1	4.8	5.7	8.9	6.9	6.3	–2.8	–3.9	–4.2	. . .	. . .	. . .

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

human capital, deepening financial sectors, promoting agriculture, improving the business climate, and encouraging economic diversification. In many countries there is scope for expanding the funding of priority expenditures by broadening the tax base or reducing energy subsidies (for example, Cameroon and Nigeria).

Reference

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