CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

The global economy seems to be on the verge of recovery. The advanced economies, hit particularly hard by financial crises and the collapse in world trade, are showing signs of stabilization, driven mainly by an unprecedented public policy response. The shape of the recoveries will vary, however, with economies that suffered financial crises likely to experience weaker recoveries than those that were affected mainly by the collapse in global demand. The rebound in emerging and other developing economies is being led by a resurgence in Asia, most notably in China and India, fuelled by policy stimulus and a turn in the global manufacturing cycle. Other emerging economies are benefiting from commodity price increases, as well as from policy frameworks that are stronger than during previous crises. However, recovery in the Commonwealth of Independent States (CIS) and emerging Europe is likely to be difficult, especially for economies most affected by sharply falling capital flows and domestic financial sector turmoil.

The U.S. Economy Is Stabilizing as the Crisis Subsides

The U.S. economy is showing increasing signs of stabilization. Output declined substantially during the first half of 2009, and the unemployment rate rose to a level not seen since the early 1980s. Nevertheless, unprecedented monetary, financial, and fiscal policy interventions are helping stabilize consumer spending and housing and financial markets, which points to renewed moderate growth in the second half of 2009 (Figure 2.1).

Financial conditions have improved by considerably more than anticipated in the April 2009 *World Economic Outlook* (WEO) forecast. Interbank spreads have returned close to precrisis levels, and equity markets have rallied, although they remain way below previous peaks. High-grade corporate issues have rebounded, and corporate bond and mortgage spreads have tightened considerably, the latter in part reflecting massive purchases of mortgage-backed securities by the U.S. Federal Reserve. On the negative side, although the Term Asset Loan Facility has helped restart some securitization in markets for consumer and small business credit, overall securitization activity remains low. Credit also remains difficult to obtain for many households and businesses, with bank loan standards continuing to tighten, albeit at a slower pace.

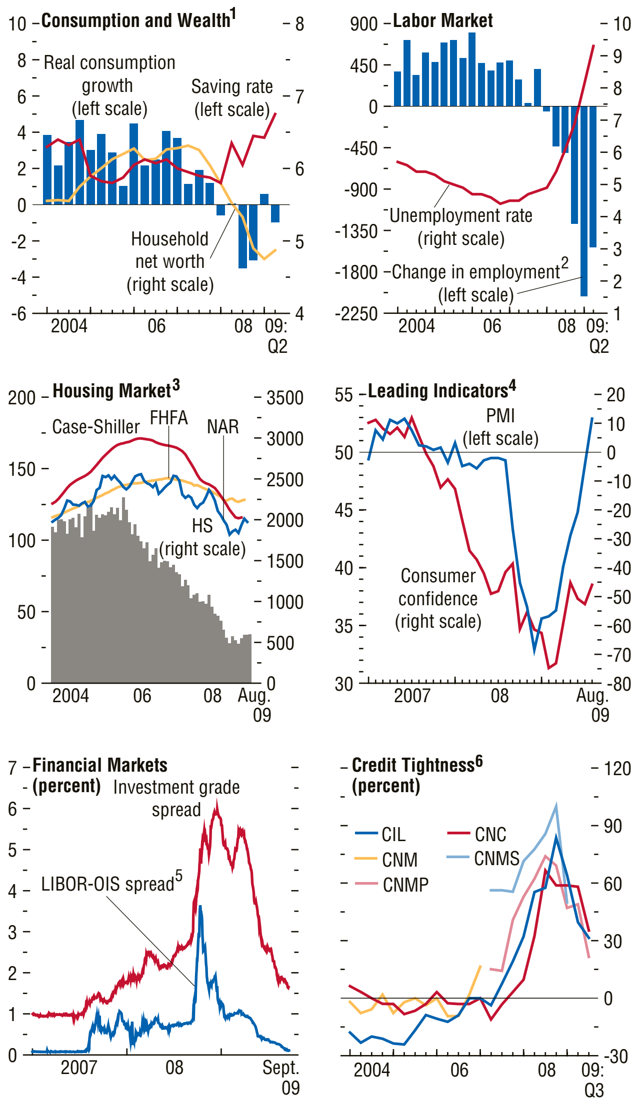
For banks, the results of the Supervisory Capital Assessment Program (SCAP) reported in May have bolstered investor confidence, with many banks subsequently raising common equity on public markets and issuing nonguaranteed debt. Results for the second quarter of 2009 outperformed expectations, although in part because of a temporary surge in underwriting revenues, even while provisions for losses on most asset classes continued to rise in view of the likely continued deterioration of loan performance.

Output data confirm that the economy is stabilizing, with the preliminary estimate for 2009 second-quarter real GDP showing a decline of only 1 percent (seasonally adjusted annual rate), a significant improvement from the 6.4 percent fall during the first quarter. Nonetheless, the saving rate continues to climb and business investment to sink. Given the collapse of demand in the rest of the world, exports have made a negative contribution in recent quarters, which has been more than offset by the reduction in imports. Positive contributions were made by state and federal spending in the second quarter, reflecting the impact of fiscal stimulus.

The U.S. economy is projected to contract by 2¾ percent in 2009, mainly because of the sharp contraction during the first half of the year (Table 2.1). Growth is expected to turn positive in the second half of 2009, reflecting the continuing fiscal boost and turns in both

Figure 2.1. United States: Signs of Stabilization

Although significant wealth has been destroyed and unemployment has surged, there are signs that the housing market is stabilizing and credit conditions are normalizing.



Sources: Bloomberg Financial Markets; Haver Analytics; and IMF staff calculations.

[1] Real consumption annualized quarterly growth and saving rate are in percent; household net worth is ratio to disposable income.

[2] Quarterly change in total nonfarm payrolls, thousands.

[3] Index: January 2002 = 100; Case-Shiller Composite 20; FHFA: Federal Housing Finance Agency; HS: housing starts in thousands; NAR: National Association of Realtors.

[4] PMI: manufacturing purchasing managers composite index. Positive values represent consumer confidence index optimism.

[5] LIBOR-OIS spread is the difference between the three-month London interbank offered rate (LIBOR) and the three-month overnight index swap (OIS) rate.

[6] All series come from the Senior Loan Officer Survey. CIL: banks tightening commercial and industrial loans to large firms; CNC: banks tightening standards for consumer credit cards; CNM: banks tightening standards for mortgages to individuals; CNMS: banks tightening standards for subprime mortgages to individuals; CNMP: banks tightening standards for prime mortgages to individuals.

the inventory and the housing cycles. However, although financial conditions have improved significantly in recent months, markets remain stressed, and this will weigh on investment and consumption. Combined with the impact of rising unemployment, the temporary nature of the fiscal stimulus, and subdued growth in trading partner economies, growth will remain sluggish, reaching 1½ percent for 2010 as a whole. Unemployment is expected to peak at above 10 percent in the second half of 2010, while rising economic slack should keep core inflation below 1 percent through most of next year.

Given the magnitude of shocks and the cloudy outlook for the rest of the world, there remains substantial uncertainty around the near-term outlook. On the upside, the strong policy response and a rapid recovery in emerging markets could lead to a virtuous circle of rising confidence, improving financial conditions, and strong aggregate demand growth. But receding downside risks remain a concern. In particular, continued household deleveraging and rising unemployment may weigh more on consumption than forecast, and accelerating corporate and commercial property defaults could slow the improvement in financial conditions.

Turning to the medium-term outlook, potential growth is likely to fall below 2 percent for a considerable time. Analysis of previous financial crises (see Chapter 4) suggests that many are followed by large, permanent output losses relative to precrisis trends, because impaired financial systems take time to heal and to again intermediate effectively, slowing investment and innovation. High cyclical unemployment could also raise structural unemployment, although the flexible nature of U.S. labor and product markets may make the needed reallocation of employment and capital across sectors more rapid and less painful than in some other regions with greater rigidity. On the demand side, although the personal saving rate has already climbed to about 5 percent, it may have to rise further given the need to rebuild household balance sheets.

Table 2.1. Advanced Economies: Real GDP, Consumer Prices, and Unemployment
(Annual percent change and percent of labor force)

	Real GDP				Consumer Prices				Unemployment			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Advanced economies	**2.7**	**0.6**	**–3.4**	**1.3**	**2.2**	**3.4**	**0.1**	**1.1**	**5.4**	**5.8**	**8.2**	**9.3**
United States	2.1	0.4	–2.7	1.5	2.9	3.8	–0.4	1.7	4.6	5.8	9.3	10.1
Euro area[1]	2.7	0.7	–4.2	0.3	2.1	3.3	0.3	0.8	7.5	7.6	9.9	11.7
Germany	2.5	1.2	–5.3	0.3	2.3	2.8	0.1	0.2	8.4	7.4	8.0	10.7
France	2.3	0.3	–2.4	0.9	1.6	3.2	0.3	1.1	8.3	7.9	9.5	10.3
Italy	1.6	–1.0	–5.1	0.2	2.0	3.5	0.7	0.9	6.1	6.8	9.1	10.5
Spain	3.6	0.9	–3.8	–0.7	2.8	4.1	–0.3	0.9	8.3	11.3	18.2	20.2
Netherlands	3.6	2.0	–4.2	0.7	1.6	2.2	0.9	1.0	3.2	2.8	3.8	6.6
Belgium	2.6	1.0	–3.2	0.0	1.8	4.5	0.2	1.0	7.5	7.0	8.7	9.9
Greece	4.0	2.9	–0.8	–0.1	3.0	4.2	1.1	1.7	8.3	7.6	9.5	10.5
Austria	3.5	2.0	–3.8	0.3	2.2	3.2	0.5	1.0	4.4	3.9	5.3	6.4
Portugal	1.9	0.0	–3.0	0.4	2.4	2.7	–0.6	1.0	8.0	7.6	9.5	11.0
Finland	4.2	1.0	–6.4	0.9	1.6	3.9	1.0	1.1	6.8	6.4	8.7	9.8
Ireland	6.0	–3.0	–7.5	–2.5	2.9	3.1	–1.6	–0.3	4.5	6.1	12.0	15.5
Slovak Republic	10.4	6.4	–4.7	3.7	2.7	4.6	1.5	2.3	11.0	9.6	10.8	10.3
Slovenia	6.8	3.5	–4.7	0.6	3.6	5.7	0.5	1.5	4.9	4.4	6.2	6.1
Luxembourg	5.2	0.7	–4.8	–0.2	2.3	3.4	0.2	1.8	4.4	4.4	6.8	6.0
Cyprus	4.4	3.6	–0.5	0.8	2.2	4.4	0.4	1.2	3.9	3.7	5.6	5.9
Malta	3.7	2.1	–2.1	0.5	0.7	4.7	2.1	1.9	6.4	5.8	7.3	7.6
Japan	2.3	–0.7	–5.4	1.7	0.0	1.4	–1.1	–0.8	3.8	4.0	5.4	6.1
United Kingdom[1]	2.6	0.7	–4.4	0.9	2.3	3.6	1.9	1.5	5.4	5.5	7.6	9.3
Canada	2.5	0.4	–2.5	2.1	2.1	2.4	0.1	1.3	6.0	6.2	8.3	8.6
Korea	5.1	2.2	–1.0	3.6	2.5	4.7	2.6	2.5	3.3	3.2	3.8	3.6
Australia	4.0	2.4	0.7	2.0	2.3	4.4	1.6	1.5	4.4	4.2	6.0	7.0
Taiwan Province of China	5.7	0.1	–4.1	3.7	1.8	3.5	–0.5	1.5	3.9	4.1	6.1	5.9
Sweden	2.6	–0.2	–4.8	1.2	1.7	3.3	2.2	2.4	6.1	6.2	8.5	8.2
Switzerland	3.6	1.8	–2.0	0.5	0.7	2.4	–0.4	0.5	2.5	2.7	3.5	4.5
Hong Kong SAR	6.4	2.4	–3.6	3.5	2.0	4.3	–1.0	0.5	4.0	3.5	6.0	6.5
Czech Republic	6.1	2.7	–4.3	1.3	2.9	6.3	1.0	1.1	5.3	4.4	7.9	9.8
Norway	3.1	2.1	–1.9	1.3	0.7	3.8	2.3	1.8	2.5	2.6	3.3	3.8
Singapore	7.8	1.1	–3.3	4.1	2.1	6.5	–0.2	1.6	2.1	2.2	3.6	3.7
Denmark	1.6	–1.2	–2.4	0.9	1.7	3.4	1.7	2.0	2.7	1.7	3.5	4.2
Israel	5.2	4.0	–0.1	2.4	0.5	4.6	3.6	2.0	7.3	6.2	8.2	8.6
New Zealand	3.2	0.2	–2.2	2.2	2.4	4.0	1.5	1.0	3.7	4.2	5.9	7.9
Iceland	5.6	1.3	–8.5	–2.0	5.0	12.4	11.7	4.4	1.0	1.6	8.6	10.5
Memorandum												
Major advanced economies	2.2	0.3	–3.6	1.3	2.1	3.2	–0.1	1.1	5.5	5.9	8.2	9.4
Newly industrialized Asian economies	5.7	1.5	–2.4	3.6	2.2	4.5	1.0	1.9	3.4	3.4	4.5	4.4

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

The strength and sustainability of the recovery will depend on meeting three key policy challenges:

- continued stabilization of the economy and financial system;
- an appropriately timed and orderly unwinding of public support for the financial system and development of a strategy to shrink the Federal Reserve's balance sheet; and
- addressing long-term imbalances in public, household, and financial balance sheets.

Monetary and fiscal support should be kept in place until the recovery is well established. If downside tail risks materialize and the recovery falters, there will likely be a need for further measures to support demand on the fiscal side given that the federal funds rate is close to the zero bound, although the Federal Reserve could

set up additional targeted credit facilities and purchase more assets. Moreover, efforts must continue toward returning financial institutions to full health through recapitalization and the repair of balance sheets—this is the indispensable condition for sustained growth. The results of the SCAP undoubtedly boosted investor confidence in major financial institutions. This could be undermined, however, if the recovery falters, leading to depressed earnings, an increase in nonperforming assets, and further capital losses.

Helping financial institutions clear their balance sheets of troubled assets will also contribute to their renewed ability to resume lending. The Public-Private Investment Program (PPIP) was set up to achieve this, by leveraging both public and private capital within public-private partnerships to purchase distressed assets, allowing banks and other financial institutions to free up capital and stimulate new credit. The PPIP comprises two related parts. The Legacy Loan Program seeks to draw private capital into loan markets by providing debt guarantees from the Federal Deposit Insurance Corporation and equity co-investment from the U.S. Treasury; the Federal Deposit Insurance Corporation is currently proceeding with a pilot. The Legacy Securities Program seeks to target legacy securities by providing debt financing from the Federal Reserve and by matching private capital raised for purchasing such securities. Fund managers have been appointed, although no assets have yet been purchased. It remains to be seen how successful these programs ultimately will be, particularly if banks prefer to hold assets to maturity rather than selling them and recognizing losses up front.

Once a recovery gains traction and wide output gaps start to close, the process of unwinding the monetary stimulus will need to start. Although this point remains well in the future, early communication of a clear exit strategy is key to maintaining market confidence. A premature withdrawal of support before the financial system has healed would impede the recovery. Calibrating the timing will be especially challenging given the uncertainty regarding how much the financial crisis has reduced potential output. Moreover, the massive increase in bank reserves (one consequence of the ballooning Federal Reserve balance sheet) must not be allowed to transform into excessive credit growth and lead to inflation.

Even though many of the short-term liquidity facilities are already unwinding as market conditions improve, the large quantity of longer-term assets on the Federal Reserve's balance sheet will be harder to reduce, and this exposes the Federal Reserve to significant interest rate risk. This is especially true for assets that, unlike government securities and agency mortgage-backed securities, lack a liquid market. Timing the sale of such longer-term assets will be delicate, especially given the potential market impact, but the Federal Reserve can use other tools—reverse repos and interest paid on deposits—to start tightening conditions as needed, even while its balance sheet remains large.

Regarding financial sector regulation, the crisis has revealed major weaknesses, particularly a failure to recognize the buildup of systemic risk. The Obama Administration's proposals for regulatory reform are sensible, including an enhanced focus on systemic risk through creation of a Financial Services Oversight Council and new mechanisms for prompt, corrective action for all large, interconnected institutions (including conservatorship and receivership powers). The key will be to implement the measures as a comprehensive package, rather than in piecemeal fashion, and to tackle the problem of having firms that are "too big or connected to fail." One solution to the latter is penalizing size and complexity via higher capital requirements. This would also help to partly address increasing concentration in the U.S. financial system, which if not resolved could markedly reduce competition and innovation.

The fiscal legacy of the crisis is a high and rising debt trajectory that could become unsustainable without significant medium-term measures. Deficits are forecast to be 10 percent of GDP for 2009/10 and 2010/11. Although deficits will fall below the 10 percent level thereafter, the level

of gross general government debt will continue to rise rapidly, reaching nearly 110 percent of GDP by 2014, a worrisome deterioration given looming health care and pension pressures related to population aging. The current budget proposal increases transparency about such pressures by including medium-term forecasts, but these are based on growth assumptions that seem optimistic. More adjustment will likely be needed to ensure long-term fiscal sustainability, particularly on the revenue side, given that non-defense discretionary spending is near historical lows. The shape of health care reform will also be critical. Whereas richer nations such as the United States can be expected to spend relatively more on health care, there are significant inefficiencies in the U.S. health care system, as evidenced by the fact that similar health care outcomes are achieved at different costs across the U.S. states. With this is mind, coverage should only be expanded in a budget-neutral manner, and measures are needed to bring down the rate of cost growth to help maintain debt sustainability.

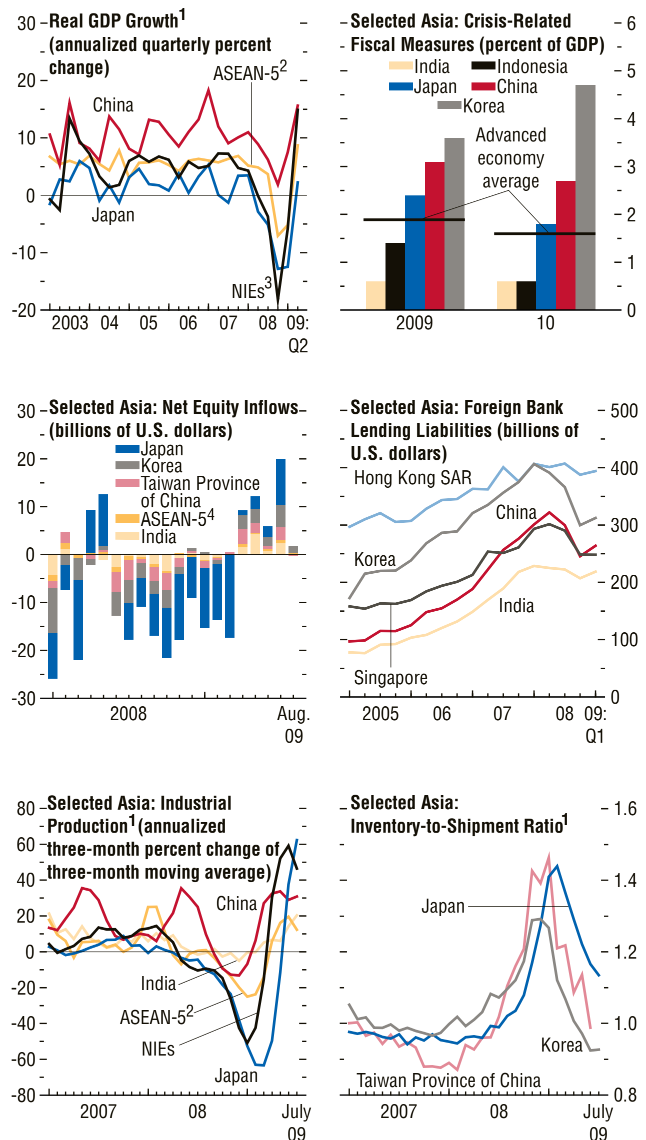
Asia: From Rebound to Recovery?

Although Asia's export-oriented economies were battered by the abrupt global downturn, the economic outlook for the region improved markedly during the first half of 2009. Recent developments point to a strengthening of domestic demand and exports, but questions remain about whether the rebound can become a self-sustaining recovery—ahead of a stronger growth pickup in the rest of the world.

The recent, swift turnaround of economic fortunes is remarkable. At the onset of the crisis, Asian exporters were hit hard by the collapse of external demand. The deterioration of activity was especially rapid for the more export-oriented economies (Figure 2.2). In Japan, GDP shrunk by well above 10 percent on an annualized basis in the two quarters following the Lehman Brothers bankruptcy in September 2008. Slumping demand for durable goods, especially cars, and a decline in investment

Figure 2.2. Advanced and Emerging Asia: Can the Recovery Be Sustained?

Signs of a strengthening recovery are increasingly helped by large fiscal stimulus packages. Financial markets have rebounded, and capital has begun to flow back into equity markets, while the pullback of foreign banks has ceased. Meanwhile, industrial production began to grow again in the first half of the year helped by an unwinding of inventory adjustments.



Sources: Bank for International Settlements; Horton and others (2009); and IMF staff calculations.
[1]Seasonally adjusted.
[2]Excluding Vietnam.
[3]Newly industrialized Asian economies (NIEs) comprise Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.
[4]Excluding Malaysia.

activity in the emerging economies in the region hurt manufacturing exports. Domestic demand faltered amid rapidly falling confidence, rising uncertainty, weakening labor markets, tightening financial conditions, and rising spare capacity. In other parts of Asia, the manufacturing-oriented economies (Korea, Singapore, Taiwan Province of China) also slumped and, by the end of 2008, had recorded peak declines in industrial production of about 25 percent compared with levels one year earlier. Only China, Indonesia, and India escaped a severe recession, the result of a large policy stimulus and, in the case of India, less dependence on exports.

The downward slide moderated during the first half of 2009. Recent indicators point to a strengthening recovery led by a rapid rebound in China, where growth accelerated to an annual rate of 7.1 percent in the first half of the year, driven entirely by domestic demand. In Japan, the turnaround was more gradual. Industrial production began to grow again in March, and retail sales followed in April, leading to a return to growth in the second quarter (2.3 percent). Other emerging and developing Asian economies showed similar signs of stabilization, with rising industrial production in Hong Kong SAR, India, Korea, Philippines, Taiwan Province of China, and Thailand, which lifted growth during the second quarter into positive territory in several of these economies. The rebound was led by the electronics sector, which had experienced a sharp drop in production right at the onset of the crisis. The overall health of banking sectors in the region also limited the impact of the financial crisis.

The intensifying rebound in Asia can be linked to three factors: (1) expansionary fiscal and monetary policy, which has been very aggressive in some countries; (2) a rebound in financial markets and capital inflows, which eased financing constraints for smaller export enterprises and improved consumer and business confidence; and (3) the growth impulse for industry following large inventory adjustments.

Extensive fiscal and monetary support helped ease tensions in financial markets and helped soften the decline in domestic demand, even bolstering demand in China and India. Central banks provided ample liquidity (Japan) and lowered policy rates (India, Indonesia, Korea, Malaysia, Philippines, Taiwan Province of China, Thailand). In China, a relaxation of credit ceilings and low interest rates buoyed credit growth (private credit grew by 24 percent during the first six months of 2009). Given its comparably robust fiscal position at the onset of the crisis, discretionary support in Asia has been stronger than in other regions. Fiscal packages in China and Japan will reach close to 5 percent of GDP for 2009–10. Most programs are aimed at bolstering consumption, especially for durables (Japan, Korea) and at upgrading infrastructure and retooling factories (China).

The rebound in equity markets and the resumption of capital inflows in the context of a generalized decline in risk aversion is providing a further impetus for the Asian economies. Stock markets rose during the first eight months of the year by 28 percent in Japan, 65 percent in the ASEAN-4 economies,[1] and 52 percent in the newly industrialized Asian economies (NIEs).[2] This upward shift was accompanied by renewed capital inflows. Sovereigns tapped international capital markets, and net equity inflows turned positive in the second quarter. In addition, creditor banks in advanced economies stopped reducing their exposure in emerging Asia. In tandem, most currencies strengthened, although they remained below precrisis levels. These developments were accompanied by a decline in the spread for Asian corporate debt of more than 250 basis points since January 2009, which helped ease financing constraints on corporations and households. Nonetheless, credit growth has stabilized in several Asian economies, including India and the NIEs, as private domes-

[1]The largest four economies in the Association of Southeast Asian Nations: Indonesia, Malaysia, Philippines, Thailand.

[2]Hong Kong SAR, Korea, Singapore, Taiwan Province of China. Based on the corresponding Morgan Stanley Capital International indices.

tic demand picked up and banks benefit from ample liquidity and sound capital positions.

A third factor contributing to the rebound in activity has been inventory rebuilding. In much of Asia, firms responded to the sharp decline in demand in the fourth quarter of 2008 by reducing production and inventories. By mid-2009, this destocking process was far advanced in Japan, Korea, and Taiwan Province of China, implying that the current rebound in external demand, together with progress in inventory adjustment, will provide impulses for increased production in the export sector.

Despite these positive signs, a sustained turnaround is not assured. Weakening labor markets will likely put a drag on consumption, and significant excess capacity in industry will dampen investment demand. Furthermore, the main driver of past recoveries—a durable rebound in external demand from outside the region—may be lacking this time around. Overall, exports from Asia are still far below 2008 peaks (about 30 percent lower), including in key sectors such as electronics. That said, the sharp increase in domestic demand has boosted Chinese imports from the region, especially from Indonesia and Korea, and this has helped arrest the sharp contraction in the region's export sector.

In the baseline projections, growth momentum will build during the second half of 2009, forming the basis for a generally moderate recovery in 2010, as external demand from advanced economies strengthens (Table 2.2). China and India will lead the expansion this year and will grow at rates of 8.5 and 5.4 percent, respectively, boosted by large policy stimulus that is increasing demand from domestic sources. In Japan, after a sharp first-quarter fall, activity is expected to contract by 5.4 percent in 2009 as a whole, although a sizable fiscal stimulus and a modest increase in exports will support growth in the second half of 2009 and will lead to a recovery of 1.7 percent in 2010. Given the significant slack in the economy, inflation will remain negative until 2012. The outlook for growth and inflation is similar in the export-oriented NIEs. Output will contract during 2009 by 2.4 percent but will accelerate in the second half of the year, paving the way for a moderate expansion in 2010 (3.6 percent). For the ASEAN economies, the outlook is more mixed. In the more export-oriented economies (Malaysia, Thailand), activity will increase gradually during the second half of 2009, with stronger growth in 2010.

The risks to the growth outlook are gradually becoming more balanced. The pickup in activity is so far being supported by many factors that could turn out to be temporary: rebounding capital markets, inventory adjustment, and expansionary fiscal and monetary policy. These forces may not be able to bring about a self-sustaining recovery if activity does not strengthen in other regions. On the upside, however, the policy stimulus in China could support recoveries in other parts of Asia.

With the recovery gaining strength, the policy challenge is to determine when and how to withdraw policy support while ensuring a successful transition to more balanced medium-term growth. Asia's dependence on export demand has contributed to rising global imbalances and has made the region vulnerable to global demand developments (Table 2.3). A return to past growth and demand patterns is unlikely—given drawn-out adjustments in the United States and Europe—and many Asian economies therefore need to shift their composition of growth to be more focused on domestic demand.

From this perspective, some caution is warranted about the sustainability of the rapid level of credit growth in a few countries, especially China. Maintaining credit growth at this level carries the risk of creating incentives for overinvestment, unsustainable asset price inflation, and a worsening of credit quality in the banking system. Recent monetary expansion should therefore be unwound as soon as there are clear signs that economic recovery is established. To promote growth that is based more on strengthened domestic demand and less on investment and exports, fiscal support should encourage private consumption as in Japan, Korea, and

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Emerging Asia	**9.8**	**6.7**	**5.0**	**6.8**	**4.9**	**7.0**	**2.7**	**3.2**	**6.7**	**5.6**	**5.2**	**5.3**
Newly industrialized Asian economies	**5.7**	**1.5**	**–2.4**	**3.6**	**2.2**	**4.5**	**1.0**	**1.9**	**5.7**	**4.4**	**6.4**	**5.9**
Korea	5.1	2.2	–1.0	3.6	2.5	4.7	2.6	2.5	0.6	–0.7	3.4	2.2
Taiwan Province of China	5.7	0.1	–4.1	3.7	1.8	3.5	–0.5	1.5	8.6	6.4	7.9	8.0
Hong Kong SAR	6.4	2.4	–3.6	3.5	2.0	4.3	–1.0	0.5	12.3	14.2	10.7	10.8
Singapore	7.8	1.1	–3.3	4.1	2.1	6.5	–0.2	1.6	23.5	14.8	12.6	12.5
Developing Asia[3]	**10.6**	**7.6**	**6.2**	**7.3**	**5.4**	**7.5**	**3.0**	**3.4**	**7.0**	**5.9**	**5.0**	**5.2**
China	13.0	9.0	8.5	9.0	4.8	5.9	–0.1	0.6	11.0	9.8	7.8	8.6
India	9.4	7.3	5.4	6.4	6.4	8.3	8.7	8.4	–1.0	–2.2	–2.2	–2.5
ASEAN–5	**6.3**	**4.8**	**0.7**	**4.0**	**4.3**	**9.2**	**2.6**	**4.6**	**4.9**	**2.6**	**3.3**	**2.0**
Indonesia	6.3	6.1	4.0	4.8	6.0	9.8	5.0	6.2	2.4	0.1	0.9	0.5
Thailand	4.9	2.6	–3.5	3.7	2.2	5.5	–1.2	2.1	5.7	–0.1	4.9	2.7
Philippines	7.1	3.8	1.0	3.2	2.8	9.3	2.8	4.0	4.9	2.5	3.2	1.2
Malaysia	6.2	4.6	–3.6	2.5	2.0	5.4	–0.1	1.2	15.4	17.9	13.4	11.0
Vietnam	8.5	6.2	4.6	5.3	8.3	23.1	7.0	11.0	–9.8	–11.9	–9.7	–9.4
Other developing Asia[4]	**6.5**	**3.9**	**3.3**	**4.1**	**10.1**	**12.8**	**11.6**	**8.3**	**0.0**	**–2.3**	**–1.0**	**–1.4**
Pakistan	5.6	2.0	2.0	3.0	7.8	12.0	20.8	10.0	–4.8	–8.3	–5.1	–4.8
Bangladesh	6.3	6.0	5.4	5.4	9.1	7.7	5.3	5.6	1.1	1.9	2.1	1.0

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]The country composition of this regional group can be found in Table F in the Statistical Appendix.
[4]Includes Islamic Rep. of Afghanistan, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao PDR, Maldives, Myanmar, Nepal, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, and Vanuatu.

Taiwan Province of China, for example. In some economies, concerns about fiscal sustainability must be addressed, including through development of credible medium-term consolidation plans (India, Japan, Malaysia). Particular attention also must be given to devising exit strategies from credit-guarantee programs for corporations, which were adopted in many parts of Asia during the crisis. Experiences in Japan and Korea during the past decade show that such programs can encourage excessive risk taking and that scaling them back can be challenging.

Shifting toward a more balanced growth path will require a combination of demand- and supply-side measures.

By developing or improving social safety nets and health care systems, many emerging and developing economies can help reduce precautionary saving by households. This would free up resources for consumption and create a larger market for domestic suppliers.

Development of the financial sector should help ensure efficient allocation of credit. As financial markets become deeper and more robust, they can offer stable saving and investment vehicles, which would reduce reliance on foreign financing and make household savings a more important funding base for the financial sector. Easier access to market-based domestic financing for smaller enterprises may also help lower high corporate saving rates, help develop domestic services sectors, and support consumption. Of course, the development of the financial sector should take place in the context of proper supervisory and regulatory frameworks.

More flexible exchange rate regimes would help rebalance growth. Appreciating exchange rates in economies where there is productivity growth would imply an increase in real house-

Table 2.3. Advanced Economies: Current Account Positions
(Percent of GDP)

	2007	2008	2009	2010
Advanced economies	**–0.9**	**–1.3**	**–0.7**	**–0.4**
United States	–5.2	–4.9	–2.6	–2.2
Euro area[1]	0.3	–0.7	–0.7	–0.3
Germany	7.5	6.4	2.9	3.6
France	–1.0	–2.3	–1.2	–1.4
Italy	–2.4	–3.4	–2.5	–2.3
Spain	–10.0	–9.6	–6.0	–4.7
Netherlands	7.6	7.5	7.0	6.8
Belgium	1.7	–2.5	–1.0	–0.9
Greece	–14.2	–14.4	–10.0	–9.0
Austria	3.1	3.5	2.1	2.0
Portugal	–9.4	–12.1	–9.9	–9.7
Finland	4.1	2.4	0.5	2.0
Ireland	–5.3	–5.2	–1.7	0.6
Slovak Republic	–5.3	–6.5	–8.0	–7.8
Slovenia	–4.2	–5.5	–3.0	–4.7
Luxembourg	9.8	9.1	7.6	7.0
Cyprus	–11.7	–18.3	–10.0	–9.8
Malta	–7.0	–5.6	–6.1	–6.1
Japan	4.8	3.2	1.9	2.0
United Kingdom	–2.7	–1.7	–2.0	–1.9
Canada	1.0	0.5	–2.6	–1.8
Korea	0.6	–0.7	3.4	2.2
Australia	–6.3	–4.6	–3.2	–5.6
Taiwan Province of China	8.6	6.4	7.9	8.0
Sweden	8.6	7.8	6.4	5.4
Switzerland	9.9	2.4	6.1	7.1
Hong Kong SAR	12.3	14.2	10.7	10.8
Czech Republic	–3.1	–3.1	–2.1	–2.2
Norway	15.9	19.5	13.9	15.6
Singapore	23.5	14.8	12.6	12.5
Denmark	0.7	1.0	1.1	1.5
Israel	2.8	1.0	3.2	2.4
New Zealand	–8.2	–8.9	–7.1	–6.7
Iceland	–19.9	–40.6	–5.3	0.7
Memorandum				
Major advanced economies	–1.3	–1.5	–1.1	–0.8
Euro area[2]	0.1	–0.5	–1.0	–1.0
Newly industrialized Asian economies	5.7	4.4	6.4	5.9

[1]Calculated as the sum of the balances of individual euro area countries.
[2]Corrected for reporting discrepancies in intra-area transactions.

hold incomes as import prices decline, thereby strengthening domestic demand, and would also send a signal to businesses to shift supply toward the domestic sector. More flexible exchange rates would also allow Asian economies to develop monetary policy into an independent tool for macroeconomic management, which would help buffer the economic impact of external and domestic shocks.

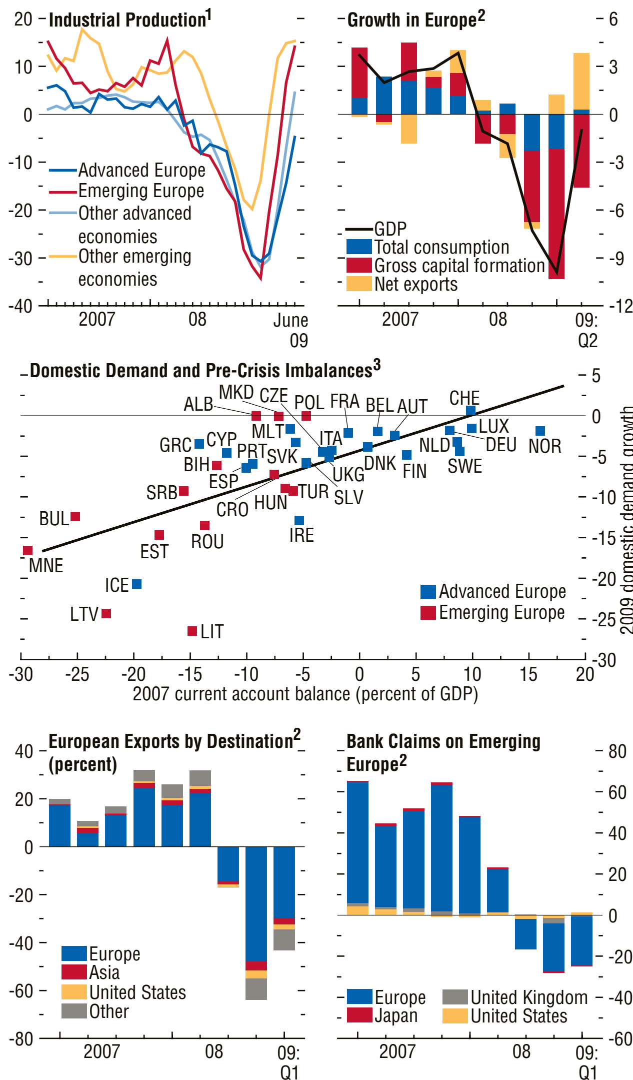
Europe: A Sluggish Recovery Lies Ahead

Recent data from Europe suggest that the pace of decline is moderating. In the second quarter of 2009, euro area GDP contracted less than previously expected, with France and Germany posting positive growth and the United Kingdom registering a more moderate decline. Although contraction continues in much of emerging Europe, Poland recorded positive growth in both the first and second quarters. Even so, the rebound in Europe is likely to be slow. Financial market conditions in the region have improved, but the largely bank-based financial system will take time to fully resume its intermediating role. Tight credit conditions will limit private investment, and rising unemployment will weigh on consumption, even as public support will need to be gradually withdrawn. Emerging Europe will need to adapt to much tighter external financing constraints.

The output decline across the region was driven by a combination of falling domestic demand—especially investment—and shrinking trade within the tightly integrated region, with individual economies suffering to varying extents depending largely on their precrisis imbalances (Figure 2.3). Abrupt reversals of asset price booms, especially in real estate, caused sharp falls in activity in Ireland, Spain, the United Kingdom, and a number of other economies, including some in emerging Europe. Iceland was hit especially hard and is receiving IMF support following the collapse of its financial sector. Economies with moderate current account deficits or surpluses have generally seen smaller downturns. However, given its export-oriented economy, Germany was severely affected by the fall in external demand, although activity is now benefiting more than elsewhere in the region from the recovery in global trade. In comparison, the downturn in France was somewhat less pronounced, in part because of lower trade openness and a larger public sector.

Figure 2.3. Europe: A Slow Rebound

The recession is giving way to recovery. The depth of the downturn was linked, in part, to the extent of domestic and external imbalances in individual economies. The collapse in intraregional trade and cross-border financing weighed heavily on the closely integrated regional economy.



Sources: Bank for International Settlements; Haver Analytics; IMF, *Direction of Trade Statistics*; and IMF staff estimates.

[1]Annualized percent change of three-month moving average over previous three-month moving average. Advanced Europe: Austria (AUT), Czech Republic (CZE), Denmark (DNK), Finland (FIN), France (FRA), Germany (DEU), Greece (GRC), Ireland (IRE), Italy (ITA), Netherlands (NLD), Norway (NOR), Portugal (PRT), Slovak Republic (SVK), Slovenia (SLV), Spain (ESP), Sweden (SWE), and United Kingdom (UKG); Emerging Europe: Bulgaria (BUL), Estonia (EST), Hungary (HUN), Latvia (LTV), Lithuania (LIT), Poland (POL), Romania (ROU), and Turkey (TUR); Other advanced economies: Canada, Israel, Japan, Korea, Singapore, Taiwan Province of China, and the United States; Other emerging economies: Argentina, Brazil, Chile, China, Colombia, India, Indonesia, Malaysia, Mexico, Peru, Philippines, Russia, South Africa, Thailand, and Ukraine.

[2]Annualized quarterly contributions to growth. Croatia, Denmark, Ireland, Luxembourg and Turkey are not included in 2009:Q2.

[3]ALB: Albania; BEL: Belgium; BIH: Bosnia and Herzegovina; CHE: Switzerland; CRO: Croatia; CYP: Cyprus; ICE: Iceland; LUX: Luxembourg; MKD: Macedonia, FYR; MLT: Malta; MNE: Montenegro; SRB: Serbia.

Emerging Europe has been hit particularly hard by the drop in capital inflows. This led to major contractions in the Baltic economies, Bulgaria, and Romania, although exchange rates acted as a shock absorber in economies with flexible regimes. Bosnia, Hungary, Latvia, Romania, and Serbia are currently receiving IMF balance of payments support, whereas Poland has access to the IMF Flexible Credit Line in order to safeguard market confidence. In recent months, the pace of contraction has slowed dramatically in much of the region, with risk appetite returning, exports accelerating, and the inventory drawdown moderating, although private credit remains sluggish and unemployment is on the rise (Figure 2.4).

The strength of the initial macroeconomic policy response has been largely determined by policy room, which varied considerably across the region. With inflation rates low and credit markets severely disrupted, central banks in the advanced economies reduced interest rates aggressively and introduced some unconventional measures, including direct acquisition of assets by the Bank of England and purchases of covered bonds by the European Central Bank. Many advanced economies committed considerable budgetary resources to support the financial sector, mainly through guarantees. Capital injections and asset purchases have generally been more limited so far, with the exception of Austria, Belgium, Ireland, the Netherlands, Norway, and the United Kingdom. A number of countries, including Germany, Spain, and the United Kingdom, introduced large discretionary stimulus packages to support the economy more broadly, in addition to the considerable support provided by automatic stabilizers. At the same time, countries with more limited policy room at the onset of the recession, such as Greece, Italy, and most of the emerging economies, were not in a position to introduce major stimulus. Moreover, most countries of emerging Europe have also been constrained by the outflow of foreign capital (or the risk thereof), with some forced to tighten their monetary stance and consolidate fiscal accounts, particularly those economies

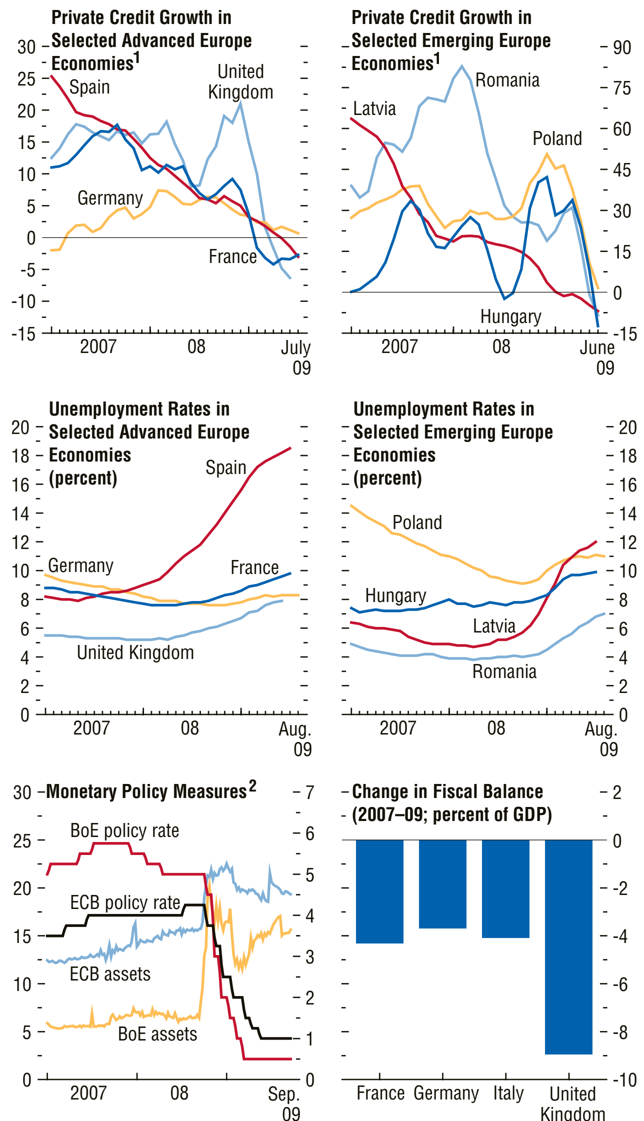
with fixed exchange rates. More recently, subsiding risk aversion has allowed some emerging economies to cut interest rates.

The pace of decline in activity appears to be moderating, but the recovery will likely be modest during the coming quarters. The turnaround during the second half of 2009 is expected to be driven mainly by rising exports and a turn in the inventory cycle, with continued support from policy stimulus. The euro area is projected to emerge from the recession in the second half of 2009, with recovery strengthening over the course of 2010, while inflation should remain low (see Table 2.1). The turnaround is most apparent on a fourth-quarter-over-fourth-quarter basis, from a decline of 2.5 percent in 2009 to an increase of 0.9 percent in 2010. The modest pace of recovery is consistent with continued housing market pressures in some economies, enduring strains in the largely bank-based financial sector, and a drag from the labor markets. Even though initial job cuts were moderate, unemployment is projected to approach 10 percent during 2009 and to reach almost 12 percent by 2011, with job creation likely subdued as widespread reductions in hours worked are reversed. In the United Kingdom, real GDP growth is expected to turn positive in the second half of 2009, as the real estate and financial markets stabilize and the weakened sterling supports net exports. In emerging Europe, following a contraction in real GDP of 5¼ percent in 2009, a return to positive growth is expected in 2010 (Table 2.4). The recovery is expected to be slower than in other emerging regions because many economies will continue to face serious adjustment problems, given that cross-border capital flows will likely remain lower for some time. And the recovery will be uneven: some emerging European economies—notably the Baltics—will continue to contract in 2010, but sizable output gains are expected elsewhere, notably in Poland and Turkey.

Downside risks to the outlook for Europe are receding, and some upside risk has surfaced in several economies. The recovery may be more sluggish than expected if conditions in the

Figure 2.4. Europe: Challenges Ahead

The recovery will likely be slow, with tight credit conditions limiting private investment and rising unemployment weighing on consumption. Coordinated policy action remains key to regaining growth momentum in the region, while exit needs to be careful and well timed.



Sources: Haver Analytics; IMF, *International Financial Statistics;* and IMF staff estimates.
[1]Annualized percent change of three-month moving average over previous three-month moving average.
[2]ECB: European Central Bank; BoE: Bank of England. Assets are in percent of 2008 GDP and are on the left scale. Policy rate is in percent and is on the right scale.

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Emerging Europe	**5.5**	**2.9**	**–5.2**	**1.8**	**6.2**	**8.0**	**4.7**	**4.2**	**–7.6**	**–7.6**	**–2.7**	**–3.6**
Turkey	4.7	0.9	–6.5	3.7	8.8	10.4	6.2	6.8	–5.8	–5.7	–1.9	–3.7
Excluding Turkey	6.0	4.1	–4.3	0.5	4.5	6.5	3.8	2.5	–8.9	–8.9	–3.2	–3.5
Baltics	**8.9**	**–0.7**	**–17.4**	**–3.7**	**7.3**	**12.2**	**2.6**	**–2.5**	**–17.7**	**–11.4**	**2.3**	**2.6**
Estonia	7.2	–3.6	–14.0	–2.6	6.6	10.4	0.0	–0.2	–17.8	–9.3	1.9	2.0
Latvia	10.0	–4.6	–18.0	–4.0	10.1	15.3	3.1	–3.5	–21.6	–12.6	4.5	6.4
Lithuania	8.9	3.0	–18.5	–4.0	5.8	11.1	3.5	–2.9	–14.6	–11.6	1.0	0.5
Central Europe	**5.5**	**3.9**	**–0.7**	**1.5**	**3.7**	**4.6**	**3.6**	**2.9**	**–5.2**	**–6.1**	**–2.4**	**–3.1**
Hungary	1.2	0.6	–6.7	–0.9	7.9	6.1	4.5	4.1	–6.5	–8.4	–2.9	–3.3
Poland	6.8	4.9	1.0	2.2	2.5	4.2	3.4	2.6	–4.7	–5.5	–2.2	–3.1
Southern and southeastern Europe	**6.1**	**6.1**	**–7.5**	**–0.1**	**5.1**	**8.4**	**4.5**	**3.0**	**–13.9**	**–13.8**	**–6.6**	**–6.0**
Bulgaria	6.2	6.0	–6.5	–2.5	7.6	12.0	2.7	1.6	–25.2	–25.5	–11.4	–8.3
Croatia	5.5	2.4	–5.2	0.4	2.9	6.1	2.8	2.8	–7.6	–9.4	–6.1	–5.4
Romania	6.2	7.1	–8.5	0.5	4.8	7.8	5.5	3.6	–13.5	–12.4	–5.5	–5.6
Memorandum												
Slovak Republic	10.4	6.4	–4.7	3.7	2.7	4.6	1.5	2.3	–5.3	–6.5	–8.0	–7.8
Czech Republic	6.1	2.7	–4.3	1.3	2.9	6.3	1.0	1.1	–3.1	–3.1	–2.1	–2.2

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

financial and corporate sectors get worse and if unemployment rises faster than currently anticipated. Financial institutions are vulnerable to a further deterioration in asset quality, because losses in the corporate sector may rise while capitalization remains fairly low. Emerging Europe is especially vulnerable to further contractions in cross-border funding, and large cross-border exposures by Austria, Belgium, and a number of other advanced economies remain a risk to banks in these countries. The recourse to shortened work hours in an effort to preserve jobs may have slowed the fall in employment so far, but as labor market pressures continue in the months ahead and as employment-support programs reach their limits, job shedding could intensify more than currently projected. The downside risks could become more pronounced if policy support in the advanced economies is withdrawn too early, if political pressures delay financial sector repairs, or if policy coordination falters. The upside risks lie mainly in a faster-than-anticipated recovery of global trade and confidence.

Over the medium term, GDP growth is likely to return to precrisis rates only gradually, as supply remains sluggish and balance sheet adjustment continues to weigh on demand. Unemployment is forecast to remain high for some time, and it is likely that some of the increase will become structural, as displaced labor finds reentry difficult, especially in the euro area and some emerging economies. As credit conditions remain tight and public support is gradually withdrawn, investment will likely remain low, and some of the existing capital stock will need to be scrapped as corporations in a number of countries restructure. Indeed, past experience indicates that employment, capital accumulation, and productivity remain sluggish for a long time following financial crises (see Chapter 4). At the same time, private demand is likely to remain particularly subdued in the many European countries that have undergone an abrupt unwinding of precrisis asset price and credit booms. Linked to this, current account deficits are expected to narrow in a number of countries, in particular, Greece,

Ireland, Spain, and much of emerging Europe. Current account surpluses are forecast to diminish in Germany and a few other countries in 2009 but to widen again later on.

Forceful and innovative policy measures have significantly reduced the negative risks in economies that faced severe pressure, but more needs to be done to ensure a sustained recovery throughout the region. Challenges remain for policy coordination, especially in developing approaches to financial sector stress and providing assistance for hard-hit economies. There have been steps in the right direction, including the recently announced overhaul of the European Union's financial stability architecture, coordinated stress tests of the largest EU banks, and stress tests of banks in central, eastern, and southern Europe conducted with the help of the IMF. However, these steps need to be followed by bank recapitalization to restore confidence in the financial system and rebuild lending capacity. Moreover, considerable uncertainty remains regarding the value of distressed assets and asset quality in general, which continues to raise questions about banks' capital bases and their capacity to extend financial intermediation. Furthermore, a comprehensive and transparent framework for bank resolution, especially for cross-border banks, remains a priority. Steps have also been taken to meet the challenges in the hard-hit emerging economies, including through the Bank Coordination Initiative to support cross-border banking flows, but a common strategy and supporting framework for assisting hard-hit countries and for dealing with accumulating debt is still lacking.

Turning to macroeconomic policies, the policy stance in the advanced economies should continue to support demand until the recovery gains a much stronger foothold. As a result of the severe downturn in activity and the sharp declines in commodity prices from their precrisis peaks, headline inflation is low throughout the region. Against this background, there is ample room to maintain very low interest rates and use unconventional instruments to counter adverse feedback loops between the real and financial sectors. However, as the recovery takes hold, a careful exit needs to be engineered, consistent with continued support for the economy yet forestalling a rise in inflation as output gaps diminish, especially given that potential output has likely fallen. Discretionary fiscal stimulus should not be withdrawn too early, but the fiscal costs of the crisis are high. Public finances in the advanced economies are expected to deteriorate sharply, with the average general government deficit in excess of 5 percent of GDP in 2009 and 2010 and with debt levels rising fast. Debt sustainability is a major concern, as excessive debt buildup may crowd out private capital accumulation and further depress potential growth, amid growing demographic pressures. Thus, fiscal stimulus should be allowed to unwind and consolidation plans should be implemented once the recovery takes hold, supported by effective national fiscal frameworks and by the EU's Stability and Growth Pact.

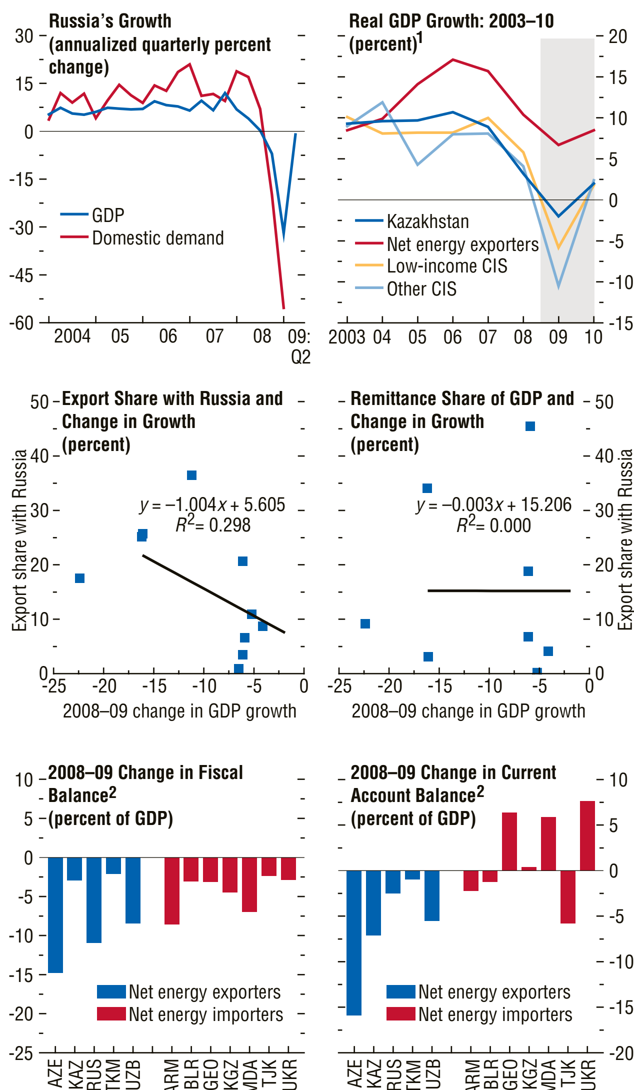
Given the prospect of slow growth over the medium term, more needs to be done to ensure that unemployed workers can be reabsorbed into the labor force. Labor market policies continue to focus on protecting insiders, while continuing to leave out other groups (for example, migrant workers) that are likely most at risk of hysteresis. At the same time, as economies recover, provisions for higher and longer unemployment and social benefits and subsidies for reduced work time will need to be reversed to prevent lasting damage to employment incentives. Service and product market reforms are needed to raise productivity growth and facilitate a reallocation of resources between the tradable and nontradable sectors. In this regard, the crisis could present an opportunity to push forward with ambitious reforms that would help energize growth in Europe for years to come.

Commonwealth of Independent States: A Difficult Recovery for Some and Damage Containment for Others

The economic fallout of the global crisis on the CIS has been intense and is weighing heavily

Figure 2.5. Commonwealth of Independent States (CIS): An Arduous Road to Recovery

A severe recession in Russia has led to significant spillovers within the region as remittances and demand for exports have fallen sharply. Energy exporters, with the exception of Kazakhstan, experienced a moderate slowdown and declining commodity prices have led to deteriorating fiscal and external balances.



Sources: Haver Analytics; IMF, *International Financial Statistics;* and IMF staff estimates.
[1]Net energy exporters include Azerbaijan, Turkmenistan, and Uzbekistan. Low-income CIS include Armenia, Georgia, Kyrgyz Republic, Moldova, and Tajikistan. Other CIS include Belarus and Ukraine.
[2]ARM: Armenia; AZE: Azerbaijan; BLR: Belarus; GEO: Georgia; KAZ: Kazakhstan; KGZ: Kyrgyz Republic; MDA: Moldova; RUS: Russia; TJK: Tajikistan; TKM: Turkmenistan; UKR: Ukraine; UZB: Uzbekistan.

on the region's economic outlook. A sharp contraction in Russia, on top of the effects of the global recession and financial crisis, has led to painful adjustments in lower-income net energy importers in the region. With many of these economies still dependent on Russia for remittances and export earnings, the crisis depressed domestic demand, upended credit booms, and in some cases shut down access to foreign capital markets. Most of the energy-exporting countries are weathering the financial turmoil and the drop in energy prices comparatively well, because they could draw on large policy buffers and are less dependent on developments in Russia.

Russia is reeling from the unraveling of an oil-boom-related surge in capital inflows, which culminated in the devaluation of the ruble in January 2009 (Figure 2.5). The earlier focus on exchange rate stability had encouraged substantial foreign-currency borrowing by banks and corporations and contributed to unsustainably high rates of credit growth. The drop in commodity prices and a sudden reversal of capital flows led to a fall in fixed investment and shattered the nexus of high growth in investment, productivity, and real wages. As a result, GDP plummeted by almost 10 percent in the first half of 2009 relative to the same period a year earlier. Recent data indicate however that the contraction has begun to moderate: the rate of growth of industrial production recovered to –1.0 percent in the second quarter of 2009 from a trough of –40 percent earlier this year,[3] and the pressure on the capital account and the exchange rate have eased.

Lower-income CIS economies have seen a large fall in activity accompanied by currency devaluations (Armenia, Kyrgyz Republic, Tajikistan). Many economies had previously enjoyed rapid growth based on foreign-financed credit booms and buoyant domestic demand supported by remittance income. As these funding sources dried up, activity came to a halt, espe-

[3]Annualized percentage change of three-month moving average over previous three-month average.

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

(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Commonwealth of Independent States[3]	**8.6**	**5.5**	**–6.7**	**2.1**	**9.7**	**15.6**	**11.8**	**9.4**	**4.2**	**4.9**	**2.9**	**4.4**
Russia	8.1	5.6	–7.5	1.5	9.0	14.1	12.3	9.9	5.9	6.1	3.6	4.5
Ukraine	7.9	2.1	–14.0	2.7	12.8	25.2	16.3	10.3	–3.7	–7.2	0.4	0.2
Kazakhstan	8.9	3.2	–2.0	2.0	10.8	17.2	7.5	6.6	–7.8	5.1	–2.0	3.9
Belarus	8.6	10.0	–1.2	1.8	8.4	14.8	13.0	8.3	–6.8	–8.4	–9.6	–7.1
Turkmenistan	11.6	10.5	4.0	15.3	6.3	14.5	0.4	3.5	15.5	18.7	17.8	29.1
Azerbaijan	23.4	11.6	7.5	7.4	16.6	20.8	2.2	5.3	28.8	35.5	19.6	23.1
Low-income CIS countries[3]	**14.2**	**8.8**	**3.0**	**5.4**	**12.6**	**15.9**	**5.8**	**6.6**	**8.2**	**12.0**	**5.5**	**7.9**
Armenia	13.7	6.8	–15.6	1.2	4.4	9.0	3.0	3.2	–6.4	–11.5	–13.7	–13.7
Georgia	12.3	2.1	–4.0	2.0	9.2	10.0	1.2	3.0	–19.7	–22.7	–16.3	–17.6
Kyrgyz Republic	8.5	7.6	1.5	3.0	10.2	24.5	8.0	6.7	–0.2	–8.2	–7.8	–12.4
Moldova	3.0	7.2	–9.0	0.0	12.4	12.7	1.4	7.7	–17.0	–17.7	–11.8	–11.9
Tajikistan	7.8	7.9	2.0	3.0	13.2	20.4	8.0	10.9	–8.6	–7.9	–13.7	–13.3
Uzbekistan	9.5	9.0	7.0	7.0	12.3	12.7	12.5	9.5	7.3	12.8	7.2	6.7
Memorandum												
Net energy exporters[4]	8.6	5.8	–6.1	2.1	9.4	14.5	11.5	9.4	5.6	7.0	3.9	5.5
Net energy importers[5]	8.4	4.4	–9.6	2.4	11.3	21.4	13.5	9.1	–5.2	–8.7	–4.5	–4.2

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Georgia and Mongolia, which are not members of the Commonwealth of Independent States, are included in this group for reasons of geography and similarities in economic structure.
[4]Includes Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan.
[5]Includes Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, and Ukraine.

cially in construction sectors. The crisis is taking a particularly sharp toll in Ukraine, which is a major steel exporter and borrower in international markets and now receives IMF support. Energy exporters in the CIS fared comparatively better, with the recovery of energy prices, and growth slowed only moderately during the first half of 2009. An exception is Kazakhstan, for which the global crisis provided a further blow to a financial sector already weakened by a sudden reversal of capital inflows in early 2008 and then a real estate market meltdown thereafter.

The path toward recovery will be difficult for most CIS economies (Table 2.5). Russia is projected to experience a deep recession in 2009, with GDP contracting by 7.5 percent, followed by a tentative recovery in 2010, helped by expansionary fiscal policy, improving commodity prices, and recovery in Europe and the United States. Without this regional growth locomotive, the lower-income, non-oil-exporting CIS economies (Armenia, Kyrgyz Republic, Moldova, Tajikistan) are expected to experience steep growth declines in 2009 followed in 2010 by a modest recovery—growth of less than 3 percent. The recession is expected to be very deep for Ukraine, which continues to struggle for external financing—GDP is forecast to be –14 percent in 2009.

For energy-exporting economies, the growth outlook is more benign. Azerbaijan and Uzbekistan are projected to experience only a moderate slowdown in 2009, followed by unchanged growth in 2010, as energy prices recover and fiscal expansions support domestic demand. An exception is Kazakhstan, which is projected to contract by 2 percent this year as its economy works through adjustment in the financial sector. A projected modest recovery in 2010 is mainly the result of a $10 billion anticrisis plan aimed at recapitalizing banks and supporting economic recovery.

The risks to the outlook for the region are tilted downward, with greater risks for economies that are in deeper recessions and face difficult financing conditions. For these economies, room for supportive fiscal policy is limited in light of sustainability concerns, and measures to ease credit may have only a limited effect. A protracted global downturn would also delay the recovery in Russia, with negative repercussions for economies closely tied to its fortune. For energy exporters, the risks to the outlook are linked to energy price developments, which are in turn tied to the fate of the global recovery during 2010. On the upside, positive impulses could come from China, which has growing trade ties with the region, especially for energy exporters, such as Kazakhstan.

A main policy challenge, given the scale of the slowdown, is to provide effective fiscal support. In Russia, planned fiscal measures should be well targeted and temporary to mitigate the risk of deficits becoming entrenched. The hard-hit energy importers should aim to support domestic demand by providing transfers to groups most severely affected (such as those who have lost remittances), but the extent of such support is constrained by the availability of funds and sustainability concerns. Some of these economies may need to draw on multilateral assistance or enhanced donor support. Energy exporters, on the other hand, should use available funds to smooth domestic demand (for example, by advancing infrastructure investment).

The main challenge for monetary policy is to strike the right balance between domestic and external stability. After the currency devaluations earlier in 2009, monetary policy has been directed toward safeguarding stability through higher interest rates. Where these policies have succeeded and external conditions have become more favorable, as in Russia, monetary policy could become more accommodative to respond to rising output gaps. In the lower-income economies of the region, exchange rate flexibility should be maintained to ensure that depreciations protect the competitiveness of ailing export sectors.

The overarching challenge for financial sector policies is to lay the foundation for a resumption of credit growth on a much sounder basis than in the recent past. This will require that many economies draw up a comprehensive approach that includes intensified monitoring by regulators and action to keep rising shares of nonperforming loans from causing systemic problems. Policymakers should also be prepared to act quickly if strains in the financial sector reemerge, by supplying liquidity, providing capital to ailing but sound financial institutions, and facilitating restructuring in the financial sector or elsewhere in the economy.

Other Advanced Economies: On the Path to Recovery

After experiencing severe recessions or slowdowns, Australia, Canada, and New Zealand are transitioning to recovery. Real GDP growth in the first quarter of 2009 was negative for Canada and New Zealand and slightly positive for Australia. However, the recent evolution of industrial production, retail sales, and confidence indicators suggests that Australia is on its way to recovery and that the Canadian and New Zealand economies are stabilizing (Figure 2.6). Activity is expected to grow in the second half of 2009 for all three economies. The recent rebound in commodity prices and reduced reliance on manufactured products have helped exports, particularly for Australia. Because of weak performance during the first half of 2009, the baseline projections show a contraction in real GDP in 2009 followed by modest growth in 2010 (see Table 2.1). On a fourth-quarter-over-fourth-quarter basis, real GDP growth in these economies is projected at about 3 percent in 2010. New Zealand and, to a lesser degree, Australia, with their sizable short-term external debts, are more vulnerable than a number of other advanced economies to a weakening in investor confidence.

Australia, Canada, and New Zealand took advantage of the prolonged period of prosperity in the run-up to the current global recession to

put in place sound macroeconomic and regulatory frameworks. As a result, they have had ample room to implement expansionary policies to limit the damage from the global recession and to support recovery as needed. Since September 1, 2008, these central banks have significantly reduced interest rates (between 275 and 550 basis points). Floating exchange rates have acted as a shock absorber and have helped to mitigate the impact of external shocks. Large fiscal stimulus packages for 2009 and 2010 are being implemented to help support domestic demand—in the range of 2 percent of GDP a year for Canada and Australia. In the event that the recovery falters, these economies will have further room for stimulus, both monetary and fiscal (Australia and Canada). Nonetheless, they face important challenges. There is a need to develop and implement strategies to unwind the expansionary policies and to further strengthen financial supervision and regulation. Specifically, the liquidity guidelines to encourage banks in New Zealand and Australia to reduce their reliance on short-term wholesale funding need to be implemented, whereas Canada needs to carry out the announced move to centralized supervision of securities.

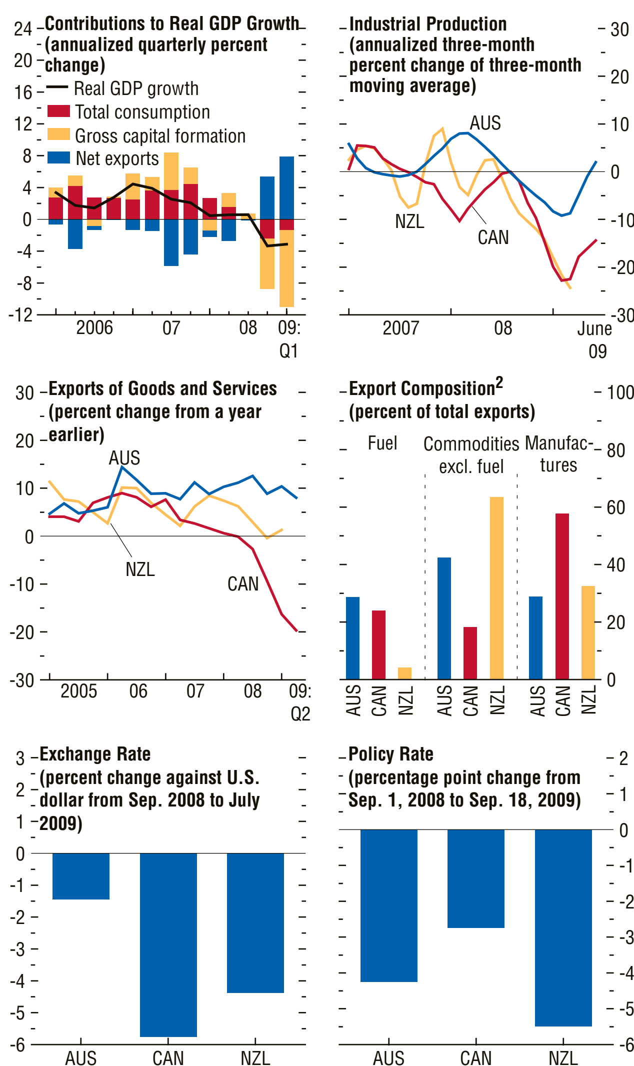
Latin America and the Caribbean: Policy Frameworks Have Promoted Resilience

The Latin America and Caribbean region is showing signs of stabilization and recovery. These economies are helped by improving conditions in global financial and commodity markets and stronger policy frameworks that promoted resilience and allowed timely policy responses to support economic activity.

Activity contracted in the fourth quarter of 2008 and the first quarter of 2009, as consumption, investment, and exports fell sharply as a result of tighter external financing conditions, a deterioration in the region's external demand, and lower worker remittances. The deterioration in activity varied across the region and greatly depended on the nature and intensity of the external shocks and on country-specific char-

Figure 2.6. Australia, Canada, and New Zealand: Turning the Page[1]

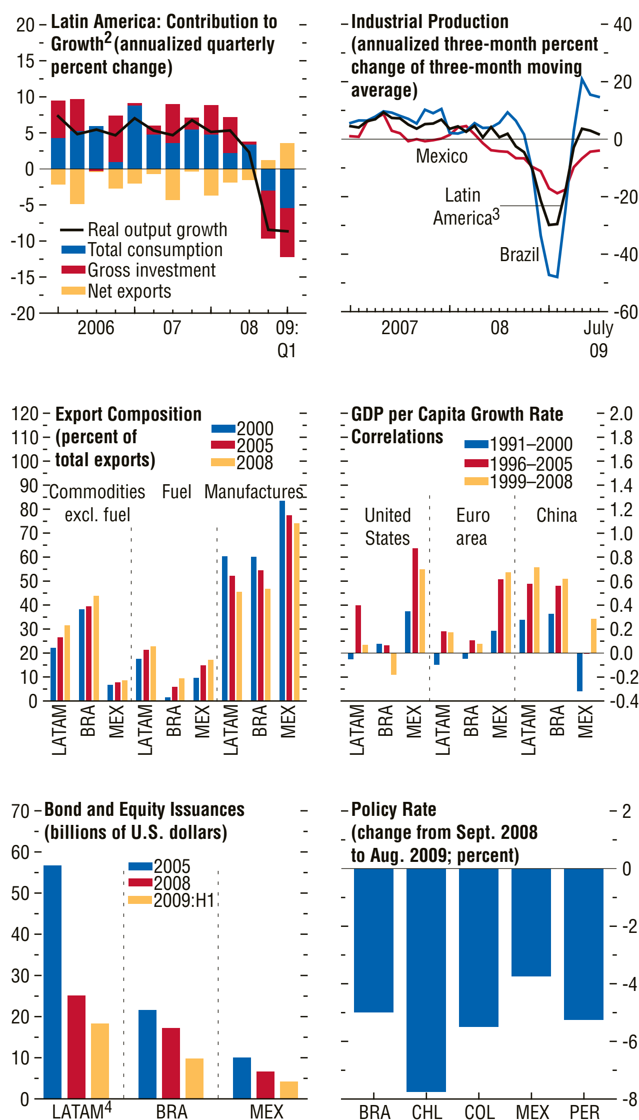
There are signs that economic activity in these economies is rebounding. Australia's export performance has been remarkable. Export composition (lower manufacturing exports) and markets (more reliant on China) seem to be the key to this performance.



Sources: Haver Analytics; United Nations Comtrade database; and IMF staff calculations.
[1]AUS: Australia; CAN: Canada; NZL: New Zealand.
[2]Average of 2005 and 2008.

Figure 2.7. Latin America: Recovery Is within Reach[1]

Recovery in Latin America is not homogenous across countries, with Brazil leading the recovery in the region. Mexico, the hardest-hit economy in the Western Hemisphere, is expected to start recovering later this year. This heterogeneity can be explained by differences in the composition and destination of exports and by other factors, such as the degree of integration into the world economy and the policy response to the crisis.



Sources: Dealogic; Haver Analytics; United Nations Comtrade database; and IMF staff calculations.
[1]LATAM: Latin America; BRA: Brazil; CHL: Chile; COL: Colombia; MEX: Mexico; PER: Peru. Latin America consists of the countries above and Argentina, Ecuador, Uruguay, and Venezuela.
[2]LATAM excluding Uruguay.
[3]LATAM excluding Ecuador and Uruguay.
[4]LATAM excluding Ecuador, Uruguay, and Venezuela.

acteristics. For example, the decline in worker remittances and tourism earnings severely affected several economies in Central America and the Caribbean. Net commodity exporters, including the region's largest economies (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela) suffered terms-of-trade losses. Especially significant export revenue losses were experienced by the energy-intensive economies of Bolivia, Ecuador, and Trinidad and Tobago. For many economies in the region, the intensity of these shocks has been mitigated by an enhanced ability to implement countercyclical monetary and fiscal policies, more resilient financial sectors, and a willingness to use the exchange rate as shock absorber.

There are indications that recovery got under way during the second quarter of 2009, and it should gather moderate speed in the second half of the year, led by Brazil (Figure 2.7). Capital flows have restarted to the region, and sovereign spreads have narrowed. Industrial production has picked up in many economies, notably Brazil, and the contraction in Mexico is moderating. The recent rebound of commodity prices is also improving the overall outlook for the region, given the prominence of commodity exports. Consumer and business confidence have improved, and retail sales have firmed up.

Despite these positive signs, real GDP in the region is still projected to contract by 2.5 percent in 2009 (Table 2.6), reflecting weak activity in the first half of the year, before growing by 2.9 percent in 2010. The pace of recovery, however, is not uniform across economies. Brazil will lead the way, in part because of its large domestic market and its diversified export products and markets, especially its increasing links to Asia. The Peruvian economy, after several years of rapid growth, virtually stagnated in the first half of 2009 but will resume strong growth in the second half of the year. In contrast, Mexico—the hardest-hit economy in the Western Hemisphere[4]—will recover more slowly

[4]The swine flu has compounded the adverse impact of the global recession on Argentina and Mexico. The real

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Western Hemisphere	**5.7**	**4.2**	**–2.5**	**2.9**	**5.4**	**7.9**	**6.1**	**5.2**	**0.4**	**–0.7**	**–0.8**	**–0.9**
South America and Mexico[3]	**5.7**	**4.2**	**–2.7**	**3.0**	**5.3**	**7.7**	**6.3**	**5.3**	**0.7**	**–0.3**	**–0.6**	**–0.6**
Argentina[4]	8.7	6.8	–2.5	1.5	8.8	8.6	5.6	5.0	1.6	1.4	4.4	4.9
Brazil	5.7	5.1	–0.7	3.5	3.6	5.7	4.8	4.1	0.1	–1.8	–1.3	–1.9
Chile	4.7	3.2	–1.7	4.0	4.4	8.7	2.0	2.3	4.4	–2.0	0.7	–0.4
Colombia	7.5	2.5	–0.3	2.5	5.5	7.0	4.6	3.7	–2.8	–2.8	–2.9	–3.1
Ecuador	2.5	6.5	–1.0	1.5	2.3	8.4	5.0	3.0	3.5	2.3	–3.1	–3.0
Mexico	3.3	1.3	–7.3	3.3	4.0	5.1	5.4	3.5	–0.8	–1.4	–1.2	–1.3
Peru	8.9	9.8	1.5	5.8	1.8	5.8	3.2	2.0	1.1	–3.3	–2.1	–2.3
Uruguay	7.6	8.9	0.6	3.5	8.1	7.9	7.5	7.4	–0.3	–4.6	–1.6	–2.0
Venezuela	8.4	4.8	–2.0	–0.4	18.7	30.4	29.5	30.0	8.8	12.3	1.8	5.4
Central America[5]	**6.9**	**4.2**	**–0.7**	**1.8**	**6.8**	**11.2**	**3.8**	**3.8**	**–7.0**	**–9.3**	**–5.0**	**–6.6**
Caribbean[5]	**5.6**	**3.0**	**–0.5**	**1.6**	**6.7**	**11.9**	**3.5**	**5.2**	**–2.0**	**–3.7**	**–4.1**	**–2.3**

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Includes Bolivia and Paraguay.
[4]Private analysts estimate that consumer price index inflation has been considerably higher. The authorities have created a board of academic advisors to assess these issues. Private analysts are also of the view that real GDP growth has been significantly lower than the official reports since the last quarter of 2008.
[5]The country composition of these regional groups can be found in Table F in the Statistical Appendix.

because its economy has suffered a sharper drop in trade flows, because of its high trade integration, dependence on the United States, and reliance on manufacturing exports.

Inflation pressures in the region have eased, reflecting the continued weakness in economic activity and large output gaps. In particular, inflation is projected to fall from about 8 percent in 2008 to 6.1 percent in 2009 and 5.2 percent in 2010. Despite the potential pass-through effects of currency depreciation, inflation-targeting regimes have helped anchor price expectations, and inflation in these economies is projected to be in the 2–5 percent range. Venezuela will continue to post the highest inflation rate in the Western Hemisphere because of strong public spending and easy monetary policy, and there continue to be data issues related to the inflation rates recorded in Argentina.[5]

The current account deficit for the region is projected to widen slightly but remain modest in 2009, driven by the collapse of current account surpluses in Venezuela and other energy exporters. Nevertheless, the current account deficits of several economies of the region, including most in Central America, are projected to narrow in 2009, as the large import contraction outweighs the decline in exports.

Downside risks to this outlook are receding but remain a concern. A weaker-than-expected global recovery could lead to a simultaneous drop in exports and remittances, dampening the prospects for recovery in some economies. A tightening of global financial conditions could increase external financing costs and reduce capital inflows, affecting some of the more vulnerable corporations and governments in the region.

The policy response to the external shocks has been rapid and, in some cases, aggressive.[6]

GDP growth losses associated with this illness in Mexico are estimated at between ½ and 1 percent in 2009.

[5]The authorities have created a board of academic advisors to assess these issues.

[6]Some countries in the region are currently receiving IMF support. Costa Rica, El Salvador, and Guatemala

The inflation-targeting economies (Brazil, Colombia, Chile, Mexico, Peru, Uruguay) had more policy room than other economies, reflecting their strengthened policy frameworks and macroeconomic fundamentals at the onset of the global recession. In particular, these economies have cut their policy rates by between 375 and 775 basis points since September 2008, while allowing their currencies to float. Other central banks in the region (including in the Dominican Republic and Venezuela) have also eased monetary conditions. A number have complemented such policies with steps to provide liquidity, including through lower bank reserve requirements (Argentina, Brazil, Colombia, Peru) and an expanded set of instruments that can be used at the discount window. These central banks should keep interest rates low until a recovery is solidly under way and upward inflation pressures become relevant. In the event that growth is weaker than expected, some economies may have room to reduce interest rates still further.

Fiscal policy in many economies in the region has, for the first time in decades, been countercyclical. This is a reflection of improved macroeconomic frameworks, lower debt levels, and larger reserve buffers. Several countries in the region announced fiscal stimulus packages ranging from ½ percent of GDP in Brazil to about 3 percent of GDP in Chile. The timely implementation of these packages has been helpful in supporting the recovery, whereas increased coverage of social programs has mitigated the social costs of the downturn. Falling oil revenues and the drop in economic activity have led to a sharp deterioration in the fiscal balances of some economies (Venezuela), reducing significantly the room for additional fiscal stimulus. In addition, room for countercyclical fiscal policy is limited in many countries in the Caribbean, as a result of a sharp decline in budgetary revenues, high debt, and limited access to external financing.

have balance of payments support, whereas Colombia and Mexico have access to the new Flexible Credit Line.

The domestic financial systems in Latin America have endured the global financial crisis rather well. In particular, the banking systems have generally remained sound, reflecting in part the important regulatory and supervisory changes introduced before the global crisis. As credit growth to the private sector slowed, public banks were encouraged to increase their lending operations to private corporations (most notably in Brazil). This development should be closely monitored to avoid a buildup of contingent fiscal liabilities.

The region faces important medium-term challenges. Continued progress is essential in strengthening fiscal and financial management frameworks, including adopting a long-term approach to fiscal policy. Tax and pension reforms are also needed in some countries, particularly where government revenues rely heavily on energy revenues. In order to increase resilience to future external shocks, oil and commodity exporters should consider developing or enhancing frameworks for countercyclical policies tied to oil and commodity prices, learning from the successful experience of Chile. These countries also need to ensure that investment regimes provide adequate incentives for investment in new facilities to forestall dwindling production capacity.

Middle East: Strengthening Growth Prospects

The outlook for the Middle East has improved recently, with the global economy stabilizing and oil prices rebounding. These economies have been hit hard by the global recession and, as a result, growth has decelerated sharply. In particular, the collapse in oil prices and sharp contraction in worker remittances and foreign direct investment have weighed on the economies in the region. The recent improvement in global financial conditions and rise in commodity prices, however, are helping restore the pace of economic activity. Nonetheless, the aftermath of the regional asset price collapse continues to weigh down the outlook.

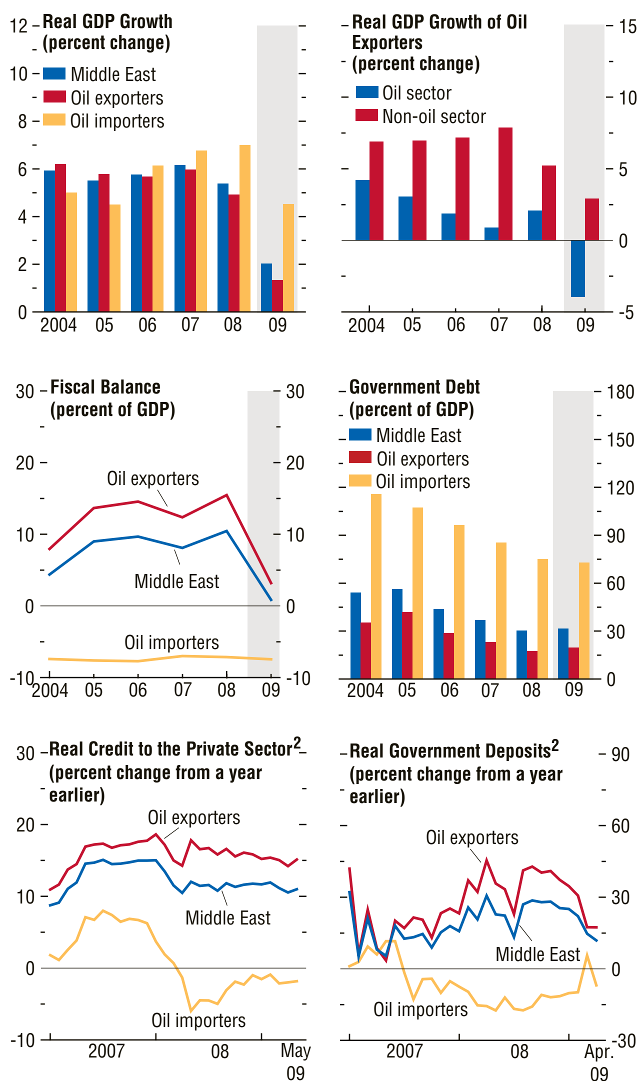
Real GDP growth for the region is projected at 2 percent in 2009 and almost 4¼ percent in 2010 (Figure 2.8; Table 2.7). Real GDP growth of oil importers is projected at about 4½ percent in 2009, more than three times the growth rate of the oil exporters. The sharp slowdown in activity of oil exporters reflects cutbacks in oil production, a result of efforts by the Organization of Petroleum Exporting Countries to stabilize oil prices, although most oil exporters have maintained strong public spending growth to help their non-oil sector. Part of this spending has spilled over to the non-oil producers in the region, providing important support to these economies. Within these regional aggregates, there are important cross-country differences. For instance, among oil exporters, the United Arab Emirates (UAE) non-oil sector has been most affected by its linkages to global trade and financial markets and by the fall in real estate prices. In contrast, Lebanon continues to demonstrate strong resilience to the global crisis because improved security conditions have buoyed economic activity, particularly in tourism and financial services.

Inflation in the Middle East has subsided as economies have slowed. For the region as a whole, inflation is projected to decline from 15 percent in 2008 to 8.3 percent in 2009. At the country level, Jordan and Lebanon are projected to experience the sharpest drop in inflation (from double digits in 2008 to low single digits in 2009), as a result of the decline in the prices of imported food and fuel experienced by these import-dependent economies. Inflation in Egypt and the Islamic Republic of Iran is projected to remain in double digits, however. The current account surplus of the region is projected to narrow by 15¾ percent of GDP in 2009, primarily from a sharp reduction in oil exports (Kuwait, Qatar, Saudi Arabia).

The key risk to the outlook is the possibility that the global recovery may not be sustained and that oil prices may fall sharply, which could have important implications for oil exporters and their regional trading partners. In an attempt to bolster fiscal positions, oil exporters may need to cut

Figure 2.8. Middle East: Resuming Growth[1]

The growth prospects in the Middle East region have strengthened following an improvement in global financial conditions and a rebound in oil prices. Policies should remain supportive of economic growth after the drying up of bank credit and the collapse of asset prices, which weigh on the strength of the recovery.



Sources: Haver Analytics; IMF, *International Financial Statistics;* World Economic Outlook database; and IMF staff calculations.

[1]Oil exporters include Bahrain, Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Republic of Yemen. Oil importers include Egypt, Jordan, Lebanon, and Syrian Arab Republic.

[2]Deflated by consumer price index.

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

(Annual percent change unless noted otherwise)

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Middle East	**6.2**	**5.4**	**2.0**	**4.2**	**11.2**	**15.0**	**8.3**	**6.6**	**18.1**	**18.3**	**2.6**	**7.9**
Oil exporters[3]	**6.0**	**4.9**	**1.3**	**4.2**	**11.8**	**15.8**	**7.0**	**6.3**	**21.5**	**21.8**	**4.0**	**10.4**
Iran, Islamic Rep. of	7.8	2.5	1.5	2.2	18.4	25.4	12.0	10.0	11.9	6.7	3.0	3.6
Saudi Arabia	3.3	4.4	–0.9	4.0	4.1	9.9	4.5	4.0	24.3	28.6	4.1	11.4
United Arab Emirates	6.3	7.4	–0.2	2.4	11.1	12.3	2.5	3.3	16.1	15.7	–1.6	5.2
Kuwait	2.5	6.3	–1.5	3.3	5.5	10.5	4.6	4.4	44.7	44.7	29.4	35.3
Mashreq	**6.8**	**7.0**	**4.5**	**4.4**	**9.1**	**12.3**	**13.0**	**7.5**	**–1.6**	**–2.7**	**–4.1**	**–4.4**
Egypt	7.1	7.2	4.7	4.5	11.0	11.7	16.2	8.5	1.9	0.5	–2.4	–2.8
Syrian Arab Republic	4.2	5.2	3.0	4.2	4.7	15.2	7.5	6.0	–3.3	–4.0	–3.2	–4.3
Jordan	8.9	7.9	3.0	4.0	5.4	14.9	0.2	4.0	–17.2	–11.3	–10.0	–8.8
Lebanon	7.5	8.5	7.0	4.0	4.1	10.8	2.5	3.5	–6.8	–11.6	–11.3	–10.5
Memorandum												
Israel	5.2	4.0	–0.1	2.4	0.5	4.6	3.6	2.0	2.8	1.0	3.2	2.4

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]The country composition of the group can be found in Table E of the Statistical Appendix.

public spending. This expenditure compression could have important regional spillover effects on the oil-importing countries by significantly reducing worker remittances. Another risk is that the banking systems of several oil-exporting countries could come under severe stress if global financial conditions tighten again.

Public policies should be geared to supporting domestic demand while recoveries remain fragile, provided countries have enough policy room. Monetary policy should balance the need to continue supporting domestic demand while avoiding the risk of allowing inflation pressures to build (Egypt). Some economies have been reducing interest rates (Kuwait, Saudi Arabia, UAE) as inflation has fallen. Although there is now limited room for further interest rate cuts, some central banks could modestly reduce interest rates if their economies slow.

Fiscal policies have been supportive of domestic demand in many Middle Eastern economies. In particular, oil exporters have maintained high levels of public spending despite a sharp drop in revenues. Countries with fiscal room should continue with these policies (which serve a similar function as automatic stabilizers) to help the recovery gain momentum. Saudi Arabia, which had sizable government surpluses during the oil boom, is implementing the largest fiscal stimulus program (as a percent of GDP) among the Group of 20 countries. However, countries with weaker fiscal positions will need to cut back unproductive spending to avoid an unsustainable debt path. As part of such efforts, subsidy policies should be reined in.

An important task for some countries in the region is to return financial sectors to health and lay the foundation for greater stability. Bank supervisors should closely monitor the health of these institutions, particularly in the Gulf Cooperation Council, including through regular stress testing, and should assess potential recapitalization needs. Progress is needed in introducing mechanisms for cross-border supervision as well. Bank credit to the private sector in the region dried up following the financial sector problems in Bahrain and Dubai, the region's main financial centers, and this is sapping the strength of the recovery.[7] To support their banking systems,

[7]Dubai has been particularly affected by the correction in asset prices that started in the second quarter of 2008

some central banks injected liquidity, whereas some provided guarantees for private sector deposits and increased their own deposits at commercial banks. Finally, sovereign wealth funds should be managed under more transparent frameworks, particularly given their growing participation in domestic economies.

Africa: Regaining Momentum

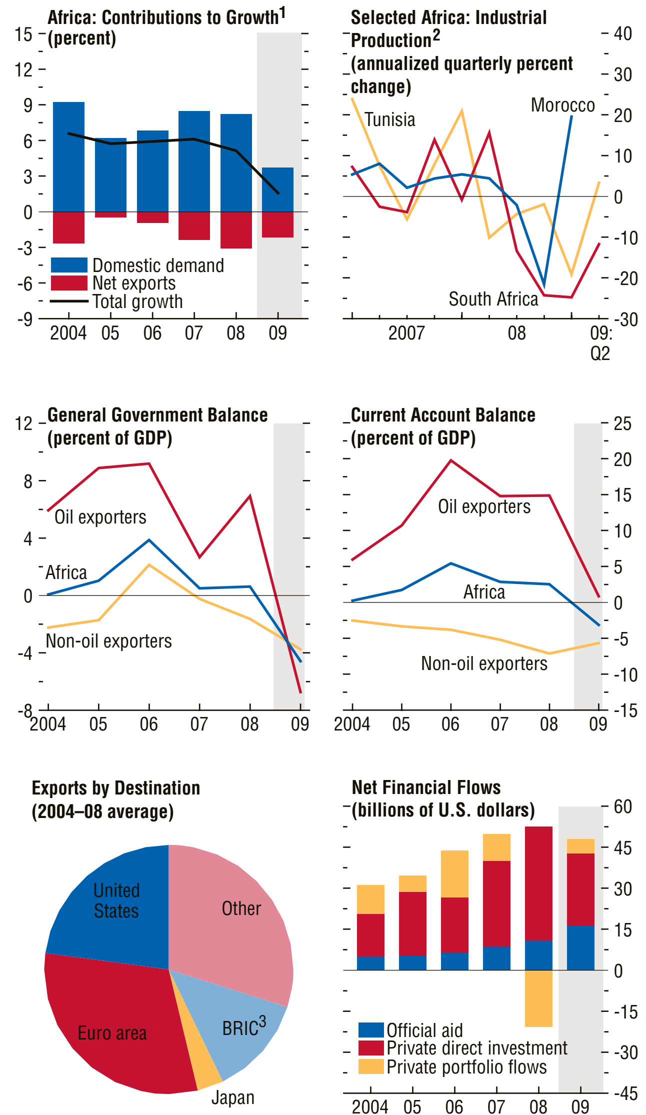
Growth in Africa has slowed significantly as a result of the collapse of global trade and disruptions in global financial markets, but growth is expected to regain momentum as the global recovery gets under way. The effect of the global recession was initially felt most strongly in those economies more highly integrated into global financial markets, including South Africa. Subsequently, the impact of the fall in financial flows propagated to oil exporters (including Algeria, Angola, Libya, Nigeria), manufacturing exporters (Morocco, Tunisia), and commodity exporters (Botswana) as global trade collapsed. The recent improvement in financial conditions and commodity prices, however, will help these economies recover from the damage.

Real GDP growth in Africa is projected to decline from an average of 6 percent in 2004–08 to 1¾ percent in 2009, before accelerating to 4 percent in 2010 (Table 2.8). This growth performance, while disappointing in light of the experience of the mid-2000s, is still encouraging given the severity of the external shocks. An important factor behind this outcome has been that many governments in the region have been able to use fiscal balances as shock absorbers, sustaining domestic demand and helping contain employment losses. Net exports are expected to subtract from growth, mainly reflecting the region's sharp drop in exports (Figure 2.9). Relative to their 2004–08 performance, oil exporters (Angola, Equatorial Guinea, Nigeria) are expected to experience the sharpest growth slowdowns in 2009, as oil

and intensified with the escalation of the global financial crisis in September 2008.

Figure 2.9. Africa: Resilient Economies

Africa has been resilient during the global recession. There are indications that economic conditions are improving, driven by domestic demand and higher commodity prices. Policies have played an important role in supporting domestic demand.



Sources: Haver Analytics; IMF, *Direction of Trade Statistics*; and IMF staff estimates.
[1]Excluding Dem. Rep. of Congo, São Tomé and Príncipe, and Sudan.
[2]Data for Morocco and Tunisia were seasonally adjusted using TRAMO-SEATs methodology developed by the Bank of Spain. Data for South Africa were seasonally adjusted by the source.
[3]Brazil, Russia, India, and China.

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

	Real GDP				Consumer Prices[1]				Current Account Balance[2]			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Africa	**6.3**	**5.2**	**1.7**	**4.0**	**6.0**	**10.3**	**9.0**	**6.5**	**2.9**	**2.5**	**–3.1**	**–1.7**
Maghreb	**3.5**	**4.1**	**3.2**	**3.6**	**3.0**	**4.4**	**3.9**	**3.2**	**12.0**	**10.6**	**–1.1**	**1.8**
Algeria	3.0	3.0	2.1	3.7	3.6	4.5	4.6	3.4	22.6	23.2	2.7	7.3
Morocco	2.7	5.6	5.0	3.2	2.0	3.9	2.8	2.8	–0.1	–5.4	–5.5	–4.7
Tunisia	6.3	4.6	3.0	4.0	3.1	5.0	3.5	3.4	–2.5	–4.2	–3.8	–2.9
Sub-Sahara	**7.0**	**5.5**	**1.3**	**4.1**	**6.8**	**11.9**	**10.5**	**7.3**	**0.2**	**0.2**	**–3.7**	**–2.7**
Horn of Africa[3]	**10.4**	**8.7**	**5.4**	**6.0**	**11.2**	**18.7**	**21.0**	**7.4**	**–10.1**	**–8.1**	**–9.0**	**–9.2**
Ethiopia	11.5	11.6	7.5	7.0	15.8	25.3	36.4	5.1	–4.5	–5.6	–5.6	–9.3
Sudan	10.2	6.8	4.0	5.5	8.0	14.3	11.0	9.0	–12.5	–9.0	–11.2	–9.1
Great Lakes[3]	**7.3**	**5.8**	**4.3**	**5.1**	**9.1**	**11.9**	**14.9**	**8.2**	**–4.8**	**–8.1**	**–8.9**	**–9.4**
Congo, Dem. Rep. of	6.3	6.2	2.7	5.4	16.7	18.0	39.2	14.6	–1.5	–15.3	–14.6	–23.7
Kenya	7.1	1.7	2.5	4.0	9.8	13.1	12.0	7.8	–4.1	–6.8	–8.1	–6.3
Tanzania	7.1	7.4	5.0	5.6	7.0	10.3	10.6	4.9	–9.0	–9.7	–9.9	–9.1
Uganda	8.4	9.0	7.0	6.0	6.8	7.3	14.2	10.8	–3.1	–3.2	–5.5	–5.7
Southern Africa[3]	**11.6**	**8.5**	**0.0**	**6.1**	**7.6**	**12.6**	**11.0**	**10.8**	**6.3**	**0.2**	**–6.3**	**–3.8**
Angola	20.3	13.2	0.2	9.3	12.2	12.5	14.0	15.4	15.9	7.5	–3.4	2.2
Zimbabwe[4]	–6.9	–14.1	3.7	6.0	–72.7	156.2	9.0	12.0	–10.7	–29.5	–21.4	–19.9
West and Central Africa[3]	**5.8**	**5.3**	**2.6**	**4.4**	**4.5**	**10.1**	**8.8**	**6.6**	**8.0**	**9.3**	**1.4**	**4.3**
Ghana	5.7	7.3	4.5	5.0	10.7	16.5	18.5	10.2	–12.0	–18.7	–12.7	–15.4
Nigeria	7.0	6.0	2.9	5.0	5.4	11.6	12.0	8.8	18.8	20.4	6.9	13.8
CFA franc zone[3]	**4.6**	**4.1**	**1.8**	**3.6**	**1.5**	**7.0**	**3.7**	**3.0**	**–2.6**	**–1.0**	**–2.9**	**–4.1**
Cameroon	3.3	2.9	1.6	2.7	1.1	5.3	2.9	2.0	–0.8	–1.0	–7.2	–4.6
Côte d'Ivoire	1.6	2.3	3.7	4.0	1.9	6.3	5.9	3.2	–0.7	2.4	24.6	1.1
South Africa	**5.1**	**3.1**	**–2.2**	**1.7**	**7.1**	**11.5**	**7.2**	**6.2**	**–7.3**	**–7.4**	**–5.0**	**–6.5**
Memorandum												
Oil importers	5.3	4.7	1.4	3.3	6.3	10.8	8.9	5.7	–5.2	–7.1	–5.7	–7.3
Oil exporters[5]	7.8	6.1	2.2	5.1	5.5	9.4	9.4	7.8	14.8	14.9	0.9	6.2

[1]Movements in consumer prices are shown as annual averages. December–December changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]The country composition of these regional groups can be found in Table F in the Statistical Appendix.
[4]The Zimbabwe dollar ceased circulating in early 2009. Data are based on IMF staff estimates of price and exchange rate developments in U.S. dollars.
[5]The country composition of the group can be found in Table E of the Statistical Appendix.

revenues have fallen hard. GDP growth in oil importers is projected to decelerate as well, from about 5 percent in 2004–08 to 1½ percent in 2009, as their exports contract. Real GDP in South Africa, the largest economy of the region and an oil importer, is projected to contract by 2.2 percent in 2009. Growth is expected to resume during the second half of 2009, supported by expansive fiscal and monetary policies and the projected recovery in global trade. The recent pickup in capital flows to South Africa is also expected to contribute to the recovery, particularly given the recent upgrade in its sovereign credit rating. Two of the economies hardest hit by the global recession are Botswana and Seychelles. Botswana's economy is being hit by the collapse in international demand for diamonds; in Seychelles, which is undertaking a comprehensive reform program, the economy is being affected by a sharp contraction in tourism receipts. On the other hand, many low-income countries in the region that have more diversified commodity exports seem to be weathering the global recession fairly well and are placed to quickly return to the higher growth paths of the mid-2000s.

Inflation in the African region is projected to fall from about 10¼ percent in 2008 to 9 percent in 2009, before easing to 6½ percent in 2010. Excluding Zimbabwe, a country for which information is unreliable, there are three economies (Democratic Republic of Congo, Ethiopia,

Seychelles) with projected average inflation rates for 2009 in excess of 20 percent. The majority of economies belonging to the CFA franc zone and Maghreb region, in contrast, are expected to have inflation rates below 5 percent. In contrast with the past, many countries in the region have had the fiscal policy room to allow automatic stabilizers to operate. As a result, the fiscal balance of the region is projected to switch from a surplus of over ½ percent of GDP in 2008 to a deficit of 4½ percent of GDP in 2009. The increased policy room was achieved through relatively prudent fiscal policies, together with debt relief in recent years.

The outlook for the region is subject to significant uncertainty. A weaker-than-expected recovery of the global economy would slow the recovery in commodity markets and worsen the prospects for inflows, including remittances and foreign direct investment. Moreover, a tightening of global financial conditions may have repercussions for the emerging markets of the region, although probably less than elsewhere because of the relatively limited reliance on private financing. However, donor countries, themselves mired in severe recessions, may reduce aid flows to the region with serious repercussions for those countries where external aid finances are a large fraction of total revenues. Poverty could also increase significantly in the sub-Saharan region as real GDP per capita contracts in 2009—the first decline in a decade—unemployment rises, and the region suffers from a lack of extensive social safety nets.

Policies should be geared toward mitigating the impact of the global recession on economic activity and poverty, while continuing to strengthen the foundations for sustained growth.

The fiscal policy response should be supportive of economic recovery. In countries with policy room, the priority is to implement already announced stimulus measures. As the recovery becomes firmly grounded, the focus of fiscal policy should move toward growth and fiscal sustainability considerations. Countries with no policy room should focus on reprioritizing spending or increasing revenues, which would allow increased spending on infrastructure and social safety nets without worsening debt sustainability.

Monetary policy should continue to be supportive of domestic demand, and exchange rates should act as external shock absorbers. In countries with high inflation, central banks should reiterate their commitment to low inflation and, if needed, should tighten monetary policy. In countries with low inflation and flexible exchange rates, monetary policy should continue to sustain domestic demand until growth is back on a healthy path.

Financial institutions in the region have been largely resilient to the downturn. However, bank balance sheets in some economies have been affected by the region's slowdown. Financial supervisors should identify vulnerabilities in the banking sector, including by conducting frequent bank stress tests to identify credit risks and potential solvency and liquidity issues, and should take action as needed.

Looking beyond the short-term challenges, Africa must move ahead with a series of reforms to strengthen the region's resilience to external shocks and growth prospects. The development and implementation of sound and transparent public policies need to be further promoted, including through improved capacity for public financial management and the implementation of medium-term economic frameworks. A priority for the public sector should be creating and using fiscal room for the enhancement of transport infrastructure and health and education services and introducing well-targeted poverty-reduction programs. To facilitate private sector growth, continued progress is needed in reforming the business environment, including reducing start-up costs for new enterprises. In the financial sector, banking supervisory capacity should be strengthened, and the perimeter of financial sector regulation and supervision should be expanded. Some countries also need to take measures to further integrate their economies with the rest of the world.