Chapter II

THE WORLD ECONOMY: PERFORMANCE AND PROSPECTS

A. Introduction

In contrast to the turbulence of the previous year, 1999 was characterized by a stabilization of global economic conditions and a revival of world production and trade. The widely anticipated major disruptions, and even the threat of global recession, arising from the "Y2K computer bug", turned out to be, in effect, a non-event. Although the risk itself may have been exaggerated, the absence of serious disruptions is perhaps a reflection of the massive business spending undertaken to cope with the problem. While there are no reliable figures, the most widely quoted amounts for such expenditure on global information technology (IT) range from $300 billion to $600 billion,[1] which is some 1–2 cent of global GDP. It appears to have provided an important boost to the world economy, giving an additional stimulus to the United States and helping recovery in East Asia.

World GDP growth picked up significantly in 1999, to reach 2.7 per cent, having slowed to 1.8 per cent in 1998 from 3.4 per cent in 1997 (table 2.1). Of particular significance is the turnaround from recession to growth in Japan and the transition economies as well as the recovery in developing countries. The major factor underlying faster growth in developing countries as a whole was a steep rebound in East Asia, which more than compensated for a mild slowdown in Africa and a more severe one in Latin America. As a consequence, overall growth in developing countries was once again higher than that of developed countries, for the second time since 1988.

In 1999, output of the United States continued to maintain its expansion at a pace faster than 4 per cent. Its sustained import demand was the main driving force behind the improvement in the global economy and particularly in Asia and Europe. Following recession in 1998, the Japanese economy rebounded sharply in the first half of 1999 but slowed again later in the year. Growth in EU was significantly lower in 1999 than in 1998 but developments during the year were positive. Despite increased monetary and financial convergence, growth rates continued to diverge considerably among EU countries.

Prospects are for a slowdown in the United States, but whether it will be an orderly transition to more moderate and sustainable growth rates or take the form of a "hard landing" is still an open question. The Japanese economy is expected to strengthen unless there is a premature tightening of monetary and fiscal policy or a sharp appreciation of the yen. Growth in Europe is likely to exceed the 1999 rate unless it is cut short by rising United States interest rates. Prospects in the developing and transition economies depend very much on what happens in the industrial world. Under the consensus forecast, growth in these economies should, on average, be stronger and more evenly distributed among countries. However, there is also the risk of a double squeeze: on the financial side, through rising interest costs of external finance and falling capital inflows; and, on the real side, through falling export earnings.

Table 2.1

WORLD OUTPUT, 1990–1999

(Percentage change over previous year)

Region/country	*1990–1995*[a]	*1996*	*1997*	*1998*	*1999*[b]
World	2.1	3.5	3.4	1.8	2.7
Industrialized economies	1.8	3.1	2.9	2.0	2.5
of which:					
United States	2.5	3.6	4.2	4.3	4.2
Japan	1.4	5.0	1.6	-2.5	0.3
European Union	1.6	1.6	2.5	2.7	2.3
of which:					
Germany	2.0	0.8	1.5	2.2	1.5
France	1.1	1.1	2.0	3.4	2.7
Italy	1.3	1.1	1.8	1.5	1.4
United Kingdom	1.6	2.6	3.5	2.2	2.0
Transition economies	-6.9	-0.1	2.2	-0.6	2.4
Developing economies	4.9	5.7	5.5	1.3	3.4
of which:					
Africa	1.3	5.2	3.0	3.0	2.7
Latin America	3.6	3.6	5.3	1.9	0.1
Asia	6.1	6.8	5.9	0.9	5.1
of which:					
China	12.0	9.6	8.8	7.8	7.1
Other economies	4.9	6.1	5.1	-1.0	4.4
Memo item:					
Developing economies, excluding China	4.1	5.1	5.0	0.3	2.8

Source: UNCTAD secretariat calculations, based on data in 1995 dollars.
a Annual average.
b Estimated.

B. Developed countries

1. United States

The United States economy continued to defy forecasters and economic theorists in 1999. Consensus forecasts were for growth to slow to some 2.5 per cent, which was widely considered as the highest sustainable rate consistent with price stability. While the 2.8 per cent growth in the first half of the year suggested that the forecasts might prove correct, the rapid acceleration in the second half, to an annualized 6.5 per cent, strongly influenced by business investment in IT, and large liquidity injections by the Federal Reserve to insure against a Y2K breakdown of the payments system, produced the third consecutive year of growth in excess of 4 per cent, with falling unemployment having no appreciable impact on inflation. By the end of the year the economy was growing at a rate well above 5 per cent with no

signs of deceleration in the first quarter of 2000, driving unemployment below 4 per cent for the first time since the 1950s.

The acceleration of the economy in the second half of 1999 led the Federal Reserve to reverse the policy of interest rate cuts that had been used to combat the global liquidity crisis in the fall of 1998, and to resume in August the process of monetary tightening "in small steps" that it had started in 1997. The target Federal Funds Rate was raised from 5 per cent to 6 per cent in 25 basis-point increments, before a 50 basis-point increase took it to 6.5 per cent in May 2000. In addition, the reversal of the large injections of liquidity to insure against a Y2K breakdown have further tightened monetary conditions. Although productivity and labour force growth have continued above historical trends, the Federal Reserve is concerned that the supply response to the rapid growth in demand may be insufficient to prevent the emergence of inflationary pressures. In addition, recovery in Europe, East Asia and Latin America adds to the pressure on world prices, most clearly reflected in the rise in oil prices.

The United States expansion, now the longest in post-war history, is a textbook case of one driven by private spending sufficiently high to produce constantly falling unemployment and a rising fiscal surplus in conditions of price stability. However, there are a number of aspects which suggest that growth at present rates is unsustainable and will eventually be reduced, either directly through monetary policy or by the reaction of markets to the increasing financial and trade imbalances in the economy.

The role of the United States as global "buyer of last resort" after the East Asian crisis has raised its current-account deficit from less than 2 per cent of GDP in 1997 to nearly 4 per cent in 1999. In 1998 earnings on net external assets turned negative and the figure more than doubled in 1999, adding to the rising trade deficits. The deterioration in the external balance is aggravated by the strength of the dollar, which has served to reduce the dollar value of foreign exchange earnings (since over 50 per cent of United States claims are on Europe and the euro had depreciated by some 20 per cent against the dollar in 1999), and by return differentials in favour of dollar assets. Irrespective of the financing of its trade deficit, the United States has now to borrow every year to meet the servicing of its net foreign liabilities.

Private spending, which had been financed largely by internally generated funds at the beginning of the recovery, is now financed by borrowing by both households and business. The private sector savings ratio has reached historical lows and household saving has been negative in some months. This also suggests that some private-sector borrowing is undertaken to meet interest payments.

Finally, as in the past, sustained expansion has been accompanied by buoyant asset markets which create a fertile climate for financial excess. The last United States expansion, in the 1980s, produced the bubble in real estate prices due to excessive lending by savings and loan associations, which led to a collapse of the thrift industry,[2] and many argue that the recent rise in equity prices has been excessively rapid and represents a bubble based on self-fulfilling expectations rather than solid earnings prospects. It thus represents similar risks of a dramatic collapse. Returns to investors in equity markets have been driven by the rapid improvements in the quotations of initial public offerings (IPOs) of companies utilizing the new information and communications technology (ICT), but which often have no record or expectation of positive earnings. One analyst has described this process as equivalent to Keynes' recommendation for a depression cure based on burying money in bottles and allowing people to dig it up: internet IPOs are "a newly elegant flip on Keynesianism: pay people to start companies that never make money, but that spread a lot of money around to others in the meantime".[3] The success of these new issues has had beneficial effects on traditional sectors such as automobiles, real estate and business-related services. The collapse of this source of financing would thus have serious ramifications for the entire economy.

The ability of the United States economy to sustain expansion is clearly linked to its ability to sustain its borrowing to finance the current-account deficit, its negative private savings, and the creation of new business enterprises through the new issues market. But, as is usual in periods of sustained expansion, lending goes increasingly to projects whose success depends on the expansion being sustained. This gives rise to financial instability and financial distress when the expansion comes to its inevitable end.

The recovery in East Asia and Europe suggests that there should be some relief in this

precarious pattern for the financing of the current-account balance. The dollar has declined from its peaks of late 1998, so United States exports should benefit from both higher foreign demand and increased competitiveness. However, the consequent improvement in net exports will not help the Federal Reserve in slowing domestic demand growth, although it should reduce the risks of a sharp decline in the dollar and panic sales of dollar assets that would lead to an equity market collapse. While increasing interest rates may also lend support to the dollar, it is important to recall that the last round of tightening by the Federal Reserve in 1994 led to dollar weakness rather than strength.

Since private spending is clearly linked to lending, the United States economy may be returning to the model of the 1960s, when monetary policy worked by increasing borrowing costs to the construction sector and quickly reduced new construction and employment. Now the link between monetary policy and economic activity is provided mainly by start-up business in ICT, which is highly dependent on continued financing either from banks or from the stock market. Thus, the rise in interest rates and its dampening impact on the stock market will eventually cause business expenditure to slow. The question is whether the result will be a sharp decline, leading to a recession, or whether there will be a "soft-landing" whereby the growth rate stabilizes at around 3 per cent.

The first signs that the economy might be slowing started to emerge in the spring of 2000, when retail sales, durable goods orders, new housing starts and new mortgage applications all declined, and unemployment claims rose. The unemployment rate rose back above 4 per cent and average hours worked fell. Household consumption grew by less than household income, leading to a reversal of the decline in the savings ratio. As always, the resumption of interest rate increases by the Federal Reserve has heightened uncertainty about asset prices, and stock market volatility has grown sharply with price variations in the Nasdaq index, as measured by the standard deviation of daily returns exceeding 5 per cent in April. The index, which covers most of the new internet and technology companies, fell by nearly 40 per cent in three months, from March to May 2000, while the Dow Jones industrial average has been virtually unchanged over the same period, suggesting substantial capital losses to households and a sharp reversal of the bubble that was providing much of business and household financing. So far the dollar has not come under heavy pressure in this period of substantial market losses in sectors that have been of greatest interest to foreign investors.

2. Japan

Japan has been struggling to emerge from a prolonged recession that has been plaguing the economy since the collapse of the equity and property market bubble at the beginning of the past decade. Expectations of a sustainable recovery took hold in 1999 as the Japanese equity market finally showed signs of a recovery at the end of 1998, climbing by around 25 per cent in the course of 1999. This was accompanied by a recovery of the yen, which appreciated from more than 140 yen to the dollar in the summer of 1998 to around 100 yen by the end of 1999. Much of the demand for Japanese equities came from foreign buyers, with United States investors accounting for 60 per cent of total foreign purchases of some 11,000 billion yen in 1999, compared to 2,000 billion yen in 1998. There was also a sharp reversal in other forms of capital flows, from a net outflow to a net inflow. This was mainly due to the disappearance of the yen premium, which had previously resulted in lending by Japanese parent banks to their overseas branches, and in the use of swaps by foreign banks operating in Japan. Repayment of these loans, the unwinding of swaps and repatriation of capital due to closures of many of the overseas branches of Japanese banks combined to produce what must be considered a one-off reversal in capital flows.

The expectation of recovery was less dominant in Japan itself, and private spending remained stagnant, while growth was driven by government expenditures and exports. Quarterly GDP growth rates, which had been in the range of 3–5 per cent in the first half of the year, seemed to indicate a turnaround, but negative growth at similar rates in the second half left the result for 1999 as a whole at 0.3 per cent. The contribution of public investment, which had accounted for around half of GDP growth in the first half, turned negative in the second half, as did the contribution of private expenditure.

At an annual rate of 10 per cent, the preliminary GDP growth figures for the first quarter of

2000 show an even stronger start to the year than in 1999, pushing the growth for the whole fiscal year towards the government target of 0.6 per cent. This is the highest quarterly increase since the first quarter of 1996. At the time, the performance for the first quarter did not prove to be sustainable, so caution may be needed in interpreting the current figures, but the industrial production data, which are considered to provide a more accurate gauge of the state of the economy, and operating ratios for the manufacturing industry show a similar trend. While public investment made a negative contribution to GDP growth in the first quarter of 2000, private consumption is reported to have increased by nearly 5 per cent and added a full percentage point to quarterly GDP growth, with investment and net exports accounting for the rest.

So far the failure of domestic private demand to recover is largely the result of continued adjustment to overinvestment that took place during the boom years of the late 1980s, including elimination of excess capacity and labour. The unemployment rate is now nearing 5 per cent, and real wages have hardly risen as nominal wage declines often exceed the decline in consumer prices. In response to the increased uncertainty over their future income, households have raised their savings rate. According to a Bank of Japan study, "in recent years, income risk is functioning as a factor to increase savings rates, especially for the low- and middle-income households".[4] It is also noted that these are precisely the income groups that have suffered the largest rise in unemployment. Thus, private consumption is unlikely to make an independent contribution to cyclical recovery until the process of restructuring of the Japanese economy is completed. This may still take some time, since surveys suggest that Japanese firms still consider that they have excess capacity and excess labour.

With erratic household spending, rising savings ratios, excess capacity and falling prices, there is little to drive private investment except the need to restructure and the response to recovery in East Asia. Recent figures show that capital investment in industry rose by 3.3 per cent in the first quarter of 2000 on a year-on-year basis, for the first time in nine quarters. At the same time, profits before tax of manufacturing firms rose for the fifth straight quarter, with an increase by more than 40 per cent in the first quarter of 2000, suggesting that a certain amount of restructuring is taking place. Lending by domestic commercial banks also stopped declining in the first quarter, suggesting that government programmes to restructure the banking system are starting to bear fruit.

Japan has been a major beneficiary of the recovery in East Asia thanks mainly to the large presence of Japanese producers in the region. Thus, after falling sharply in 1998 Japanese exports rose rapidly in 1999 despite the appreciation of the yen, with the increase reaching 30 per cent for exports to the Republic of Korea. Capital goods and spare parts accounted for much of this increase as Japanese-owned assembly facilities have boosted imports from Japan to raise production in response to a strong demand for ICT products in the United States, Europe and Japan itself, as well as in the domestic markets of the countries concerned. As in the past, appreciation of the yen has created a more profitable operating environment outside of Japan, but this time Japanese firms have responded by raising production in their existing subsidiaries in East Asia rather than relocating production through new investment in the region. Thus, the situation does not seem to be similar to the previous period of the high yen and the "hollowing out" of Japanese industry. Outward FDI flows from Japan show a decline to Indonesia, Malaysia and Thailand from the already sharply reduced levels of 1998, and only flows to the Republic of Korea have increased.

The expansion in the first quarter of 2000 appears to be more balanced than in 1999 and is evenly spread between domestic private spending and exports. Public spending is no longer the major determinant. Despite the experience of rapid expansion followed by a downturn on several occasions in the past,[5] it can be concluded that the risk of continued recession has passed. However, there remain a number of risks. As a result of public expenditure programmes that have been supporting the economy, fiscal deficits now amount to 10 per cent of GDP and public debt to 105 per cent. A too hasty attempt to reverse public deficits might cut off recovery, as occurred in the past with the restoration of the consumption tax in 1997 or the sudden cessation of spending programmes. The lesson of the United States may be instructive here. In that country the reduction in fiscal deficits was in the context of rapid economic growth which helped to raise productivity trends. In Japan, the prospective 2 per cent growth is insufficient to permit fiscal action to reduce the

deficit over and above what is already implicit in the running down of existing public expenditure programmes.

The central bank has been operating a policy of virtual zero intervention rates, while real interest rates are still positive because of the fall in prices. The official position is that the zero rate policy will continue as long as deflationary pressures persist. The policy has had the impact of reducing long-term interest rates to relatively low levels compared with the past. Many long-term securities have been purchased by banks, hoping to profit from the yield differential between short and long rates. Were long-term rates to rise substantially as a result of tightening by the central bank before recovery is fully in place, there would be substantial losses on banks' bond portfolios, which would restrict their ability to provide the domestic financing needed to support the recovery. Recent hints by the central bank that the policy will not be pursued indefinitely may constitute an admonition to financial institutions to make the necessary restructuring now rather than an indication of policy reversal, since recovery has not yet been translated into rising prices and there seems to be virtually no risk of overheating or inflation.

3. European Union

Forecasters have been surprised not only by the continued strong growth of the United States economy in 1999, but also by the failure of Europe to embark on a strong recovery which had been widely expected to allow it to relieve the United States of its role as the main engine of global expansion. Indeed, as anticipated in last year's *TDR*, Europe had difficulty in 1999 in achieving growth in excess of 2 per cent and was unable even to maintain the 1998 rate. Full recovery from the downturn that began in the early 1990s thus still remains to be achieved. Europe now appears not so much to have an asynchronous cyclical relationship with the United States as to have a stable potential growth rate that is increasingly divergent from that of the United States. While on current trends growth is generally expected to reach 3 per cent in 2000, a number of possible developments may lead to a weakening in the second half of the year, including higher interest rates, a partial recovery of the euro, and a slowdown in the United States and East Asia.

While the process of integration continues to produce monetary and financial convergence in "Euroland", growth divergence among the member countries does not seem to be declining. There are significant growth differentials between the larger and the smaller members of European Monetary Union (EMU); in 1999 growth in most major economies, including Germany and Italy, was less than 2 per cent while in the smaller economies, such as Finland, Ireland, Netherlands and Portugal, it was much higher. Monetary tightening, while appropriate for some of the smaller economies showing signs of overheating, makes it more difficult for the larger economies to expand. In the absence of centrally coordinated fiscal measures, there is little prospect for convergence of growth rates.

One of the major reasons for the establishment of EMU was to create a single, unified internal market, with a common currency, that was sufficiently large to be isolated from external shocks, particularly those emanating from the United States, and to free monetary policy from the need to keep intra-European exchange rates stable. Somewhat paradoxically, the successful integration of European financial markets has occurred at the same time as the closer integration of global financial markets, and the introduction of the euro has made the integration of European assets into global portfolios even more rapid. As a result, capital flows to Europe, and hence European interest rates, have become much more responsive to interest rates in the United States. The volatility of United States interest rates has thus started to exert a greater constraint on European monetary policy at a time when the introduction of the euro was expected to give greater policy autonomy.

As has occurred on several occasions in the past, the European recovery is taking place just as the United States expansion is reaching a point that is deemed unsustainable by the country's monetary authorities. Increases in United States interest rates have so far been mirrored by the European Central Bank, despite the fact that inflation in EU continues to be contained around the target rate of 2 per cent and that growth is below potential. Indeed, with unemployment rates still above 9 per cent, several years of growth at above potential could be achieved without running into labour or other supply constraints. Thus monetary tightening appropriate for an economy growing in excess of 6 per cent is being applied in Europe, which is growing less than half as fast.

It has been widely observed that the creation of the single currency turned 11 countries that were individually extremely dependent on external trade into one single currency area, in which external trade and the exchange rate no longer play a major role in determining the level of economic activity, since all intra-European transactions take place as if they were domestic transactions. By the same token, growth in the 11 countries would largely depend on domestic demand, and there was considerable optimism regarding the impact of the introduction of the single currency itself on internal demand and growth. Such expectations are yet to be fulfilled. Indeed, one of the main reasons for the lack of expansion in the larger economies, such as Germany, has been the failure of domestic demand to expand. Ironically, therefore, the failure of domestic demand to expand rapidly has meant that European recovery has become more dependent on external demand. For example, quarterly rates of increase in German net exports to the United States in 1999 were in the range of 10–20 per cent. The EU ran a small surplus with the United States in 1998, with an increase in net exports of $8 billion over the preceding year. In the first three quarters of 1999 its trade surplus continued to grow, more than doubling in the third quarter alone.

The initial estimates of GDP growth in EU for the first quarter of 2000 show an annual expansion of 3.2 per cent relative to the first quarter of 1999. Although household consumption was relatively stagnant, private investment rose by over 2 per cent, in large part due to higher investment in manufacturing associated with increased exports. Whether this first-quarter growth rate can be sustained throughout 2000, to result in an annual growth exceeding 3 per cent, will thus depend on global markets and recovery in consumer spending. Since there is evidence of a slowing in East Asia and the United States, it is unlikely that exports will continue to rise at the rates experienced in 1999. Further, rising European interest rates can be expected to check investment spending. Finally, in addition to falling global demand European exporters may lose competitiveness as a result of a recovery of the euro. Clearly, if there is a substantial slowdown in the United States and a sharp correction in the dollar, European recovery will again be cut off before it has had a chance to work through to higher household incomes and consumption.

The absence of strong consumer spending is not the only difference between Europe and the United States. The high-tech investments associated with the creation of new companies floated on the equity market, and the consequent spinoffs for the financial and services sectors, have yet to appear in Europe. The contribution of information- and computer-related production to growth is estimated at around half a percentage point of GDP in Italy and Germany – only one third of what it is in the United States.[6] As long as European growth remains dependent on external demand rather than consumer spending and technological innovation and restructuring, it is difficult for Europe to replicate the experience of the United States and to replace that country as the engine of global growth.

C. Developing countries

1. Latin America

The economic situation in Latin America deteriorated further in 1999 following a relatively poor performance in the previous year. The region continued to suffer from the impact of the international financial crises for a second consecutive year, as economic downturns deepened in many countries in the wake of the Russian crisis of August 1998. Aggregate output of the region stagnated for the first time since 1990, after growth had fallen to less than 2 per cent in 1998 from 5.3 per cent in 1997 (table 2.2). The outcome, in terms of GDP per capita, was a contraction of 1.3 per cent.

The regional average for 1999 masks not only sharp differences among countries, but also di-

Table 2.2

GROWTH IN DEVELOPING COUNTRIES BY REGION, 1990–1999

(Percentage change over previous year)

Region/country	1990–1995[a]	1996	1997	1998	1999[b]
Latin America	3.6	3.6	5.3	1.9	0.1
of which:					
Argentina	5.8	5.5	8.0	3.9	-2.9
Bolivia	4.1	4.5	4.1	4.6	1.0
Brazil	3.1	2.5	3.5	-0.1	0.8
Chile	8.7	6.9	6.8	3.1	-1.1
Colombia	4.7	2.1	3.4	0.5	-5.2
Ecuador	3.4	2.3	3.9	1.0	-7.3
Mexico	1.4	5.4	6.8	5.0	3.6
Paraguay	3.2	1.1	2.4	-0.6	0.5
Peru	5.5	2.3	8.6	0.1	3.8
Uruguay	3.7	5.0	5.0	4.6	-3.4
Venezuela	3.4	-0.4	6.6	-0.2	-7.2
Africa	1.3	5.2	3.0	3.0	2.7
of which:					
Algeria	0.1	3.8	1.1	5.1	3.4
Cameroon	-1.9	5.0	5.1	5.0	4.4
Côte d'Ivoire	1.9	6.8	6.0	4.5	4.3
Egypt	3.4	4.3	5.0	5.3	6.0
Ghana	4.3	3.5	4.2	4.6	5.5
Kenya	1.6	4.1	2.1	2.1	1.8
Mozambique	3.3	7.1	11.3	12.0	9.7
Nigeria	2.4	6.4	3.1	1.9	1.1
South Africa	0.8	4.2	2.5	0.6	1.2
Uganda	7.0	7.8	4.5	5.4	7.8
Zimbabwe	0.6	8.7	3.7	2.5	0.5
Asia	6.1	6.8	5.9	0.9	5.1
Newly industrializing economies	6.9	6.2	5.8	-2.6	7.5
Hong Kong, China	5.3	4.5	5.0	-5.1	2.9
Republic of Korea	7.4	6.8	5.0	-6.7	10.7
Singapore	8.6	7.5	8.4	0.4	5.4
Taiwan Province of China	6.4	5.7	6.8	4.7	5.5
ASEAN-4	7.0	7.4	3.1	-9.6	2.8
Indonesia	7.1	8.0	4.5	-13.2	0.2
Malaysia	8.7	10.0	7.5	-7.5	5.4
Philippines	2.2	5.8	5.2	-0.5	3.2
Thailand	8.6	5.9	-1.8	-10.4	4.2
ASEAN-4 plus Republic of Korea	7.2	7.1	4.0	-8.2	6.5
South Asia	4.5	6.5	5.1	4.5	6.0
Bangladesh	4.4	5.1	5.3	4.7	4.3
India	4.5	7.1	5.8	4.7	6.8
Nepal	5.2	4.0	1.9	4.0	5.0
Pakistan	4.8	5.0	1.2	3.3	3.1
Sri Lanka	5.4	3.8	6.4	4.7	4.0
West Asia	1.3	4.4	5.5	2.6	0.0
China	12.0	9.6	8.8	7.8	7.1

Source: UNCTAD secretariat calculations, based on data in 1995 dollars.
a Annual average.
b Estimated.

verse developments within economies in the course of the year. Close links to the United States economy through *maquila* and other industrial exports and tourism gave Mexico the best performance amongst the large economies, but only with a modest growth of 3.6 per cent. The economies of Central America and the Caribbean also benefited from the continued United States expansion, and growth was as high as 6–7 per cent in some of the smaller economies (e.g. Costa Rica, Dominican Republic and Nicaragua).

By contrast, most South American countries experienced deep recessions, with output falling by more than 5 per cent in Colombia, Ecuador, and Venezuela. Even Chile registered negative growth, for the first time in 15 years. The sharp turnaround in oil prices was a key factor in limiting the impact on output of natural disasters in Venezuela, while in Ecuador there was political turmoil and continued financial instability. In Colombia, the economic situation was aggravated by internal armed conflict, while El Salvador and Honduras have yet to recover fully from the devastation caused by hurricanes in 1998.

Adjustment policies similar to those that had been employed after the financial crisis in East Asia were initially adopted in response to the adverse spillovers from financial crises, including high interest rates and fiscal tightening to defend exchange-rate arrangements and to maintain market confidence. As in East Asia, these policies led to a slowdown in economic activity, accentuating or initiating recessions. As described in chapter III, some countries (Brazil, Chile and Colombia) were forced to abandon their currency bands and float their currencies in the course of 1999, but the subsequent depreciations have not led to a rapid acceleration of inflation: for the third year in a row inflation was around 10 per cent for the region, the lowest level in half a century.

Notwithstanding the poor performance of the region in 1999, the overall output growth turned out to be better than initially expected, mainly because of a rapid turnaround in economic activity in Brazil, which accounts for some 40 per cent of the region's output. The difference in performance between Brazil and Argentina provides a useful contrast for comparing alternative policy approaches. Until the beginning of 1999 policies in both countries were designed to defend exchange-rate regimes through high interest rates and fiscal restraint. High interest rates had caused structural imbalances as the interest cost of outstanding government debt more than offset primary budget surpluses and the increased servicing costs of foreign debt offset improvements in export performance. As a result, both countries experienced a progressive loss of international investor confidence and severe pressures on their external payments positions.

As discussed in last year's *TDR*, since most foreign investors and Brazilian banks had been expecting the exchange-rate adjustment, capital outflows after the suspension of the peg were not substantial. Continued privatization sales to foreigners, as well as the return of optimism due to increased competitiveness and relaxation of policies, produced a recovery of FDI inflows. The currency stabilized and interest rates were steadily reduced, providing a sharp reduction in the fiscal deficit and improvement in external debt servicing. Belying widespread forecasts of a contraction of some 4 per cent in 1999, the economy managed to grow by about 1 per cent. Annual growth in the first quarter of 2000 was above 3 per cent, with manufacturing output registering an increase of nearly 8 per cent over the same quarter a year earlier. The trade balance remained in deficit; export earnings fell by 7.5 per cent, while imports contracted by almost 15 per cent.

In contrast to Brazil, which has had a better than anticipated growth performance after the collapse of the currency, Argentina's growth has been below expectations after the successful defence of its dollar peg. In addition to the sharp reduction in exports to Brazil as a result of the currency adjustment, Argentina was adversely affected by high real interest rates needed to support the exchange rate, and by low grain prices. Furthermore, falling domestic prices reduced government revenues, requiring expenditure cuts and wage reductions in the public sector to meet fiscal targets agreed with IMF. Average wages per worker in manufacturing were down almost 4 per cent in the fourth quarter of 1999 from a year earlier, and the fall in consumer prices continued, down 1 per cent in May 2000 from a year earlier. Thus Argentina is facing a full-scale price deflation, and is attempting to reduce costs and expenditures in step, creating further downside risks. While conditions somewhat stabilized in the fourth quarter of 1999, expectations of growth, ranging from 2.6 per cent to 4.0 per cent (see table 2.4 below) in 2000 may not be realized, as the only net contributor to growth is net exports. The

economy would be adversely affected by a continued increase in United States interest rates or continued strength in the dollar, requiring another downward adjustment of wages and prices, which is the normal mechanism of adjustment for countries operating a currency-board regime.

For Latin America as a whole, the trade deficit improved significantly in 1999 mainly as a result of a contraction of imports, resulting in a sharp reduction in the current-account deficit from $87.5 billion (4.5 per cent of GDP) in 1998 to $56.5 billion (3.2 per cent). Falling capital inflows (described in chapter III) and rising profit remittances combined to produce a sharp contraction in the net transfer of resources. Only a few countries, notably those in Central America, attracted more capital. Because of the decline in total inflows, many countries had to resort to the use of international reserves and compensatory borrowing. Brazil, by contrast, repaid some of the official debt incurred during the currency crisis. Mexico, on the other hand, has been accumulating excess reserves as a hedge against possible financial turmoil in the aftermath of its July general election.

For 2000, the prospects for Latin America depend very much on the evolution of the external economic environment and the scope to use monetary and fiscal policy to support domestic demand. If global output and world trade continue to improve, the United States market remains buoyant and interest rates are kept stable, growth for the region as a whole may reach 4 per cent. Although the pickup in growth will be general, it will also be uneven in view of various country-specific factors. Recovery in countries such as Colombia, Ecuador, Guatemala, Peru and Venezuela is likely to be hindered by the problems in their fragile financial sectors.

2. Asia

In developing Asia as a whole, excluding China, there was a sharp upturn in 1999, with growth reaching some 4.4 per cent, compared to a slight contraction in the previous year. However, the strength of economic activity and the timing of recovery varied considerably among countries. While growth came to a halt in West Asia, it accelerated somewhat in South Asia. By contrast, in East Asia, in both the newly industrializing economies (NIEs) and ASEAN-4, there was a strong recovery from the deep recession of 1998.

Economic activity in *West Asia* stagnated in 1999 despite a strong recovery in oil prices. While performance improved somewhat in a number of oil-importing countries, such as Israel and Jordan, growth remained weak in Saudi Arabia and Kuwait as a result of lower oil output. There was a sharp contraction in Turkey due to the August earthquake and spillovers from the financial crisis in the Russian Federation.

Prospects of the region continue to be dominated by developments in the oil market and progress in the Middle East peace process. Inasmuch as the economic contraction in Turkey appears to have bottomed out, aggregate output of West Asia is expected to pick up markedly in 2000 as the effects of the sharp rise in oil prices and revenues filter through to higher consumption and a recovery of investment in oil-exporting countries. In the countries of the Gulf Cooperation Council,[7] unemployment continues to be high. As oil continues to account in most countries of the region for about 40 per cent of GDP and over 80 per cent of government receipts, they remain highly vulnerable to fluctuations in oil prices. The oil-importing countries are also affected, through the impact on the level of grants and workers' remittances. The lack of notable progress in the Middle East peace process, as well as the economic sanctions on Iraq, continues to discourage intraregional trade, investment and tourism, thereby impeding a strong and sustained recovery.

The economic performance of the countries of *South Asia* in 1999 was mixed. The acceleration in GDP growth from 4.5 per cent in 1998 to 6.0 per cent for the subregion is primarily a reflection of the strength of the Indian economy, whereas there was a mild slowdown in Bangladesh and Pakistan (table 2.2). The diversity of performance is attributable to differences in various factors, including climatic and political conditions as well as domestic policy and structural problems. Overall, external conditions were relatively favourable, and for both India and Pakistan the negative effects of the economic sanctions following nuclear tests were no longer in evidence. In Pakistan, the economic sanctions were partially waived in January 1999 and international financial institutions subsequently resumed their assistance.

The acceleration in growth in India is accounted for by industry and services, where faster growth more than offset the sharp slowdown in agricultural growth to less than 1 per cent, from 7.2 per cent in the previous year, as a result of erratic monsoon in some areas and serious damage caused by a cyclone that struck the Orissa coast in October 1999. In Pakistan, continued political instability, acute balance-of-payments problems and macroeconomic imbalance resulted in a moderate slowdown in 1999. Growth also slowed in Bangladesh, where manufacturing was seriously hampered by floods during the first half of 1999 and by political instability, as well as in Sri Lanka, due to declining industrial output. For most countries in the subregion, notably India and Sri Lanka, fiscal imbalances continue to be a cause for concern. Nevertheless, growth momentum is expected to continue in 2000, with modest improvements in some countries.

The *East Asian* economies that were in severe recession in 1998 as a result of the financial crisis made a spectacular recovery in 1999. Signs of a revival became evident in the first half of the year and the momentum has continued into 2000. As discussed in greater detail in chapter IV, the recovery was initiated by the reversal of contractionary monetary and fiscal policies, which was eventually reinforced by a recovery in exports that brought to an end the process of severe import compression and destocking. The high degree of regional integration that had been a major factor responsible for contagion and poor export performance worked to bring about a significant improvement in exports in 1999.[8] Exports were also helped by currency depreciations as well as the buoyancy of the United States market. Of particular importance to Malaysia, the Philippines, Singapore, Taiwan Province of China and Thailand was a surge in worldwide demand for electronics associated with the rapid and sustained expansion of the IT sector in developed countries, as well as the response to the Y2K computer bug risk noted in the introduction to this chapter.

The combination of expansionary policies and rising exports helped to increase capacity utilization rates, stabilized unemployment and brought a recovery to domestic consumption that was reflected in higher imports towards the end of the period. As described in chapter III, there was a rise in private capital inflows into the region, primarily in the form of FDI that was driven in part by foreign acquisition of companies in financial distress.

Aggregate GDP of the four NIEs rebounded strongly in 1999, growing by 7.5 per cent, compared to a contraction in the previous year (table 2.2). However, performance varied significantly. After a sharp decline in 1998, growth in the Republic of Korea exceeded 10 per cent, the highest rate since 1988. The recovery in Hong Kong (China) was much less spectacular. The turnaround, which also brought recovery in local asset markets, started in the second quarter of 1999, after six consecutive quarters of decline, and was reinforced by improved conditions in neighbouring economies. Growth in Singapore was stronger, after virtual stagnation in 1998, mainly due to the strong external demand for ICT-related products, but the non-electronic segment of manufacturing also performed well.

In contrast to most other economies in the region, Taiwan Province of China suffered relatively little from the East Asian financial turmoil, thanks to its pre-emptive devaluation and large foreign exchange reserves. Nevertheless, output growth slowed to a 15-year low of 4.7 per cent in 1998. There was a modest pickup in 1999, but productive capacity and physical infrastructure suffered considerably from the earthquake in September 1999.[9] Reconstruction of damaged structures may provide a major stimulus to economic activity.

The ASEAN-4 economies all grew in 1999 after output contractions in 1998, which ranged from less than 1 per cent in the Philippines to as much as 13 per cent in Indonesia. The Philippines managed to avoid a deep recession thanks to its strong export performance arising from closer trade ties with the United States market. After an initially tenuous start in early 1999, recovery in the subregion became more rapid and broad-based than anticipated (table 2.2).

Growth in developing Asia in 2000 can be expected to be more balanced among countries than in 1999, with the rate slowing to 7–8 per cent in the Republic of Korea, while recovery in ASEAN-4 is expected to gather momentum: Malaysian growth, which reached double-digit figures in the first months of 2000, will have to be moderated to prevent a return to the labour shortage conditions experienced before the crisis. There are considerable downside risks for Indonesia; Hong Kong (China) will be affected by the impending accession of China to WTO, but the immediate effects are uncertain.

The economy of *China* continued to perform relatively well in 1999, with growth exceeding 7 per cent, thanks in part to the recovery of other economies in East Asia and in part also to various fiscal packages. This relatively rapid growth was nonetheless low by Chinese standards; it was the slowest rate in the past decade, representing the seventh successive decline since the peak of 14.2 per cent in 1992. Moreover, the economy is characterized by price deflation, over-production and excess capacity. The continued fall in prices since mid-1997, together with the appreciation of other currencies in the region, has helped to reverse the real appreciation of the yuan and stimulate exports, which have also benefited from export tax rebates.

Faced with the challenge to counter near-term deflationary forces generated by structural reforms, the Chinese Government has continued since mid-1998 to ease monetary and fiscal policy, and implemented a series of measures, such as large infrastructure spending and cuts in interest rates, to boost domestic demand. However, the impact on consumer spending and investment other than that undertaken by the Central Government has been minimal. Consumer confidence has remained low, mainly because of job and income insecurity arising from growing unemployment and restructuring of State-owned enterprises (SOEs). The annualized rate of expansion of fixed investment fell in 1999 from 15 per cent in May to negative numbers in September, as compared to increases of over 40 per cent per annum during 1992–1995.

Although the Chinese economy was not subject to direct contagion from the Asian crisis, the collapse of the region's capital markets had an adverse impact on capital inflows. The total FDI inflow into China stagnated in 1998 and declined by 11 per cent in 1999. Efforts made since early 1998 to restructure or privatize SOEs ran into difficulty as the urban unemployment rate climbed to politically and socially unacceptable levels (7–8 per cent), and the authorities were obliged to allow social stability to take priority over reform. However, the reform of SOEs continues to be a major objective of economic policy.

In the search for new sources of economic growth, greater importance is being attached to opportunities in the country's less developed interior, a shift which was already visible in the five-year plan for 1991–1995. In January 2000, the State Council set up a high-level inter-ministerial Western Development Committee, charged with the task of mapping out long-term strategies to guide the development of China's western provinces over the next 15 years. The development of the western region also constituted an important item on the agenda of the 9th National People's Congress in March 2000, and 70 per cent of total fixed investment in the budget for 2000 has been earmarked for developing the infrastructure of the western regions.

Apart from providing an immediate boost to economic growth, focus on the new development frontier provides a means for the Chinese authorities to address the increasingly glaring income disparities between the coastal areas and the interior. Per capita GDP on the coast is more than double that of any province in the interior, which contains two thirds of China's population. Furthermore, successful economic development of the western regions over the longer run will help to reduce poverty and ethnic tensions, as well as protect the environment and reduce population pressure on the coast. The western region, however, is not a homogenous entity. Some parts are more developed than others because of richer natural resources or investment in defence-related heavy industry. Land-locked provinces such as Gansu and Ningxia are likely to remain trapped in poverty for some time.

Although the fall in prices appears to be bottoming out, the government is not likely to reverse its expansionary fiscal policy. Fiscal stimulus and rising exports should keep GDP growth within the 7–8 per cent range in 2000. China's impending membership of WTO is expected to provide a timely boost to economic growth by helping to expand exports and attract new FDI, but it may also lead to considerable adjustment costs, at least in the short term. The precise effect of membership is difficult to predict and depends, *inter alia*, on how the agreements with various parties are interpreted and implemented.

3. Africa

Output growth in Africa in 1999 was slightly lower than the 3.0 per cent attained in the previous two years, barely keeping pace with population growth (table 2.2). The poor economic performance of the region in the past three years, following

relatively strong growth in 1996, suggests that domestic and external conditions are nowhere close to what is needed to produce the much hoped-for take-off into rapid and sustained growth, particularly in sub-Saharan Africa.

Average growth rates in both East and North Africa in 1999 were significantly higher than in other subregions. Relative to 1998 growth was lower in Central, North and West Africa, but higher in East and Southern Africa.[10] Continuing armed conflict and civil unrest have severely undermined economic performance in a number of countries, notably in the Great Lakes region of Central Africa, and, as in the Ethiopia-Eritrea border conflict, contributed to poor performance in neighbouring countries. Similarly, differing weather conditions have played an important role in the variation of economic performance among subregions. Vulnerability to such conditions is once more shown by the effects of recent floods in Southern Africa in the aftermath of two tropical storms in February 2000, which hit a number of countries, including Botswana, Madagascar, Mozambique, Namibia, Zambia and Zimbabwe, and caused significant loss of lives, displacement of population and extensive damage to crops and infrastructure.

Economic performance in Central Africa, which accounts for about 6 per cent of the continent's GDP, is highly dependent on world prices of oil and other primary commodities, notably coffee, cocoa, timber and copper. Growth in both Cameroon and Rwanda was lower in 1999 than in 1998 but still considerably higher than the overall regional average. Depressed coffee prices offset the benefits of higher oil prices for Cameroon, and of stronger performance of agriculture and services, due largely to FDI from South Africa and aid inflows, in Rwanda. The prices of these commodities will continue to have an significant influence on growth in 2000.

In East Africa, which accounts for about 7 per cent of the continent's output, some countries have been adversely affected by armed conflicts. Performance in Kenya has been disappointing in recent years due to deteriorating infrastructure, increased labour unrest, and a loss of investor confidence. By contrast, growth accelerated sharply in Uganda, due in part to official debt relief, increased FDI, and recovery in agriculture. Despite uncertainties associated with its dependence on rain-fed agriculture, East Africa is expected to maintain a moderate pace of growth in the years ahead.

Economic growth in North Africa, which accounts for 39 per cent of the continent's overall output, was adversely affected by civil war and political instability in the 1990s, but prospects have improved in recent years. Growth increased moderately in Egypt in 1999 due largely to a strong performance of agriculture (wheat production more than doubled) and higher oil prices, but fell sharply in Algeria as unfavourable weather reduced farm output. This was also the case in Morocco and Tunisia. Weather conditions, together with oil prices, will continue to be determining factors in these countries.

The poor performance of Southern Africa in recent years is a reflection of the situation in South Africa, which accounts for 85 per cent of the output of the subregion. While its economy had been adversely affected by the financial contagion from the Asian crisis and weak commodity prices, especially of gold, its leading export, the decline in economic activity appears to have bottomed out in 1999. Growth in Mozambique, one of the fastest-growing economies in the world, slowed in 1999, but in spite of the devastating flood it is likely to reach 5 per cent this year.

Armed conflicts and political instability have also affected several countries in West Africa, which accounts for 13 per cent of Africa's output. The CFA economies have continued to perform well since the large devaluation of the CFA franc in 1994. The decline of the euro against the dollar has also improved their competitiveness at a time when the prices of some of their main exports, especially cocoa, coffee, cotton, gold and some metals, were depressed. The upturn in CFA economies in 1999 was more than offset by the slowdown in other countries of West Africa, due mainly to lower prices for some of their leading exports, especially cocoa, timber and natural rubber. Growth in Nigeria, by far the largest economy in the subregion and highly dependent on oil (which accounts for over 96 per cent of export earnings and 80 per cent of government revenues), has continued to fall after peaking in 1996. The decline was due to the reduced oil output following the lowering of OPEC quotas and civil unrest in oil-producing regions, although the adverse effects were mitigated to some extent by higher prices and faster growth in the non-oil sector.

An important factor in the variation of economic performance among African countries is disparate changes in commodity prices, since different countries' exports are concentrated on different commodities.[11] The strengthening of prices of industrial commodities such as oil and copper, compared to continued weak prices of beverages, especially a sharp downturn in cocoa and coffee prices, played an important role in the relative economic performance of these countries. In particular, while higher oil prices have increased export earnings and government revenue in oil-exporting countries, their adverse impact on the balance of payments and inflation has been acute for oil-importing countries.

Short-term growth prospects depend on the prices of oil and non-oil commodities; the CFA countries will also be affected by the movement of the euro against the dollar. Growth may rise moderately in 2000 if oil prices remain at relatively high levels and other commodity prices strengthen. Even so, much of the growth is likely to be concentrated in North Africa. Growth may also accelerate in South Africa following the sluggish performance of 1998 and early 1999.

For most sub-Saharan African economies, growth in the longer term remains constrained by low savings and investment and foreign-exchange gaps. In this connection official capital inflows can play a crucial role in setting off a faster and sustained growth and eventually reducing the dependence of the region on aid. According to estimates by the UNCTAD secretariat, if growth in sub-Saharan Africa could be raised to some 6 per cent per annum and sustained at that rate for at least a decade, through a large injection of aid accompanied by appropriate domestic policies, the need for official financing would gradually diminish as alternative sources of financing came forward. First, rapidly rising income would allow domestic savings to be raised faster than output, thereby closing the savings gap. Secondly, sustaining growth would attract private capital, as a substitute for official financing.[12]

Clearly, debt relief can play a role in this process. In this respect, some progress has been made over the past year in the context of the Initiative for the Heavily Indebted Poor Countries (HIPC), including: modifying the framework so as to lower debt sustainability targets, thereby enlarging the number of countries eligible for assistance; the provision of enhanced interim relief once countries are declared eligible; and the possibility to complete the HIPC process more rapidly for countries implementing strong reform and poverty reduction programmes. The total number of HIPCs expected to become eligible under the enhanced initiative has risen from 29 to 36, of which 30 are in sub-Saharan Africa. However, even if the enhanced HIPC initiative is fully and rapidly implemented, the scale of its impact will be limited. Many African countries are unable to meet their external debt-servicing obligations, and for them debt relief will simply formally acknowledge a situation that already exists and stop the cumulation of arrears which are unlikely ever to be paid.

D. Transition economies[13]

GDP in the transition economies as a whole increased by 2.4 per cent in 1999, the highest rate in the past decade. The overall figure, however, masks an unusual degree of volatility during the year, as well as considerable variations among countries. Output grew unexpectedly by some 3 per cent in the Commonwealth of Independent States (CIS) as a whole, compared to 1.4 per cent for Eastern Europe, whereas the Baltic States plunged into sharp recession (table 2.3).

Economic growth slowed sharply in virtually all the transition economies at the beginning of 1999 largely as a consequence of the effects of the East Asian and Russian financial crises, aggravated in some cases by the conflict in Kosovo

Table 2.3

TRANSITION ECONOMIES: SELECTED ECONOMIC INDICATORS, 1997–1999

	GDP			Consumer prices			Current-account balance		
	Change over previous year[a]								
	(Percentage)						(Percentage of GDP)		
Region/country	1997	1998	1999	1997	1998	1999	1997	1998	1999[b]
Eastern Europe	2.1	1.8	1.4	..	..	..	-4.3	-4.6	-5.5
of which:									
Bulgaria	-7.0	3.5	2.6	578.7	0.9	6.2	4.2	-0.5	-5.5
Croatia	6.8	2.5	-0.3	4.0	5.6	4.6	-11.5	-7.1	-7.2
Czech Republic	-1.0	-2.2	-0.2	9.9	6.7	2.5	-6.1	-2.4	-2.0
Hungary	4.6	4.9	4.5	18.4	10.4	11.3	-2.1	-4.9	-4.3
Poland	6.9	4.8	4.1	13.2	8.5	9.9	-3.0	-4.4	-7.5
Romania	-6.1	-5.4	-3.2	151.7	40.7	54.9	-6.1	-7.2	-3.8
Slovakia	6.5	4.4	1.9	6.5	5.5	14.4	-10.0	-10.1	-5.7
Slovenia	4.6	3.9	4.9	8.8	6.6	8.1	0.2	–	-3.0
Baltic States	8.4	4.5	-1.7	..	..	..	-9.5	-11.1	-9.6
Estonia	10.6	4.0	-1.4	12.3	6.8	3.9	-12.2	-9.2	-4.9
Latvia	8.6	3.9	0.1	7.0	2.8	3.3	-6.1	-11.1	-12.1
Lithuania	7.3	5.1	-3.0	8.5	2.4	0.3	-10.2	-12.1	-10.3
CIS	1.1	-3.0	2.9	..	..	..	-0.4	-1.4	6.7
of which:									
Belarus	11.4	8.4	3.4	63.4	181.6	251.3	-5.9	-7.5	-0.4
Russian Federation	0.9	-4.9	3.2	11.0	84.5	36.7	0.9	0.7	11.2
Ukraine	-3.0	-1.7	-0.4	10.1	20.0	19.2	-2.7	-3.1	3.3

Source: ECE, *Economic Survey of Europe 2000,* no. 1. United Nations publication, sales no. E.00.II.E.12, New York and Geneva, 2000, tables 3.1.1 and 3.1.2.

a For consumer prices change from December to December.

b Full year for Eastern Europe and Baltic States; January–September for CIS. Current-account balances for the Baltic States are based on extrapolations of January–September trends.

and a slowdown in import demand in Western Europe. The Russian crisis had severe consequences particularly for the Baltic economies, where it resulted in large cuts in exports to the Russian Federation and a severe deterioration in output and employment. However, the unwinding of various factors in the second half of 1999 led to a marked improvement in Central Europe and a more moderate one in the Baltic States. The recovery in exports to EU was important, especially for Central Europe, but for the Baltic countries it was not sufficient to offset the loss in the CIS markets. At more than 4 per cent, growth in Hungary, Poland and Slovenia was considerably faster than the 2.4 per cent average for the transition economies, thanks in large part to strong domestic demand. The biggest surprise in 1999 was the recovery in the Russian Federation, where GDP rose by over 3 per cent, in contrast to an expected fall of 2.5 per cent, thanks to the sharp rise in oil prices and the devaluation of the rouble.

Discernible also in 1999 in the transition economies was increased inflation. The process of steady disinflation which had been under way for several years was interrupted; in most economies price increases were larger than in 1998, especially in the countries members of CIS, which were affected by the devaluation of the rouble. Primarily responsible for higher inflation in many

other economies was the sharp increase in the world price of crude oil, together with the appreciation of the dollar.

Relatively weak foreign demand was a major factor in the poor trade performance of many economies in 1999. For the transition economies as a whole, exports fell in both volume and value, but the decline in imports was even steeper (see table 3.1 below). In Eastern Europe, the value of total trade (imports plus exports) fell for the first time since 1991. The contraction in trade was also evident in most of the CIS countries, and was particularly large in the Baltic States.

Deep cuts in imports reflected the tightened balance-of-payments constraint in view of a reduction in capital inflows. Several countries encountered difficulties in obtaining international finance. The net inflow into Eastern Europe and the Baltic States fell below the level of 1998, and there was a large increase in capital outflow from the Russian Federation. The tighter balance-of-payment constraints forced a reduction in domestic demand and imports in a number of economies, notably those of CIS countries (other than the Russian Federation). Current-account balances generally improved, with the exception of Bulgaria and Poland.

As a consequence of the Kosovo conflict, the attention of the international community has been directed to measures needed for the economic regeneration of a specific group of seven South-East European economies,[14] with a view also to strengthening the prospects for both peace and political stability in the area. These are countries which have lagged far behind in the process of transition and have been greatly affected by the Kosovo conflict and its aftermath. Despite modest growth in Bulgaria and The former Yugoslav Republic of Macedonia, output for the group as a whole contracted by nearly 3 per cent in 1999.

The economic problems of South-East Europe are for the most part essentially those of underdevelopment, despite the fact that on a number of indicators, such as education, they are closer to Western Europe than the traditional group of developing countries. In some of them (Albania, Bulgaria, Romania) the legacy of the command system remains much stronger than elsewhere. The macroeconomic situation in most of these economies is still quite fragile. While inflation has been successfully reduced, current-account deficits have been large and persistent, resulting in a rapid accumulation of foreign debt. At 17 per cent, unemployment is much higher than in Central Europe. Domestic investment remains weak and foreign investment is not attracted to the region in any significant amount.

Given the sheer scale of the problems facing the governments of these seven countries, the probability of crises continues to be high, particularly in the absence of sustained and targeted assistance from abroad. International efforts are now extensive, but it is becoming increasingly clear that they suffer from many of the same shortcomings that have beset the programmes of assistance to most other transition economies since 1989, including a large gap between commitments and actual disbursement of aid and poor coordination among the 29 countries and international organizations under the Stability Pact.

For 2000, prospects for the transition economies in general have improved considerably since the beginning of the year. Both domestic conditions and the external environment are more favourable. Growth is expected to average around 3 per cent, ranging from some 4 per cent in Eastern Europe to 3 per cent in the Baltic States and 2 per cent or more in the CIS countries (depending on the developments in the Russian Federation). Reflecting a rebound from a very low base, governments in a number of South-East European transition economies are expecting relatively high growth rates in 2000. The current recovery in the Russian Federation is fragile, but the official forecast of growth for 2000 has now been raised from around 2.0 per cent to more than 4.0 per cent.

E. Prospects and forecasts

While the prospects for the global economy have become increasingly more optimistic since the end of 1999, the risk that global imbalances may create another financial disruption has also strengthened. The better-than-expected performance in 1999, in particular in the United States, East Asia and Brazil, has led to an upward revision of short-term forecasts of growth for all major economic regions. This tendency has been reinforced by the fact that the global economy has continued to gather strength as the expansion of demand and output has become more widespread. However, perceptions of such developments vary considerable among various international organizations and other institutions. As can be seen from table 2.4, the forecast of world output growth in 2000 ranges from 3.5 per cent to 4.3 per cent, compared to an estimated only 2.7 per cent achieved in 1999 (table 2.1). There are also significant differences in growth rates forecast for different regions. For example, there is much uncertainty associated with the widely expected slowdown of the United States economy and the recovery in Japan and Europe, while in the developing world there are questions concerning the sustainability of the rapid expansion in the Republic of Korea and the likelihood of recovery in Argentina.

There are already some clear signals that suggest that the United States economy is starting to slow from its rapid pace of growth at the turn of the year, while the vigour of economic activity in Europe appears to be broadening but without great momentum. This has led to some downward revision of optimistic forecasts for these economies. Recovery in most developing economies in East Asia has been stronger than expected, but there are signs of deceleration. The slowdown in China appears to have bottomed out, but the Chinese authorities still consider stimulus necessary. While recovery in Latin America is under way, the situation in Argentina remains fragile, the financial crisis in Ecuador is unresolved, and the sustainability of recovery in Brazil is crucially dependent on conditions in world markets.

Thus, despite the sharply improved performance of the world economy in 1999 and early 2000, there is much uncertainty concerning the short-term outlook and many challenges remain. For a variety of reasons, the recent steep rise in the price of oil has not had an impact comparable to that of the oil shocks of the 1970s, and is unlikely to have a comparable impact unless there are exceedingly steep increases to follow. At least for the time being, global deflation has replaced inflation as a source of concern, and the shift in monetary policy in most major countries will act as a further brake on continued growth. Exchange-rate and financial instability are always potential threats in the presence of large global imbalances. A sharp appreciation of the yen or lack of progress in structural reforms, for example, could jeopardize the nascent recovery in Japan. The recovery in emerging markets may be adversely affected by rising international interest rates if the United States economy remains excessively strong, or by reduced financial flows in the event of a dollar collapse or a global liquidity crisis. Most forecasts of continued global expansion are based on the “Goldilocks” scenario in which the United States economy is neither too hot nor too cold, allowing Europe and Japan to grow and providing support for continued recovery in Latin America and Asia. In assessing the forecasts for accelerated global growth it is as well to remember that Goldilocks is a fairy tale.

Table 2.4

FORECASTS OF GDP GROWTH IN 2000 BY REGION AND FOR SELECTED COUNTRIES BY VARIOUS INSTITUTIONS

(Percentage change over 1999[a])

	IMF	World Bank	OECD	UN/LINK	JP Morgan
World	4.2	3.5	4.3	3.5	4.1
Industrial countries	3.4	3.2[b]	4.0[b]	3.0	3.7[b]
United States	4.4	3.8	4.9	4.1	4.9
Japan	0.9	1.2	1.7	0.9	1.6
European Union	3.2	.	3.4	3.1	3.8[c]
Germany	2.8	.	2.9	2.5	3.5
France	3.5	.	3.7	3.6	4.0
Italy	2.7	.	2.9	2.6	3.5
United Kingdom	3.0	.	2.9	3.3	3.4
Transition economies	2.6	2.5	.	3.0	5.4[d]
Russian Federation	1.5	.	4.0	2.5	6.5
Developing countries	5.4	5.0	.	5.2	.
Africa	4.4	.	.	4.4	.
Asia	6.2	6.4	.	6.2[e]	6.6[f]
Newly industrializing economies	6.6	5.5	.	.	.
Hong Kong, China	6.0	.	5.2	4.9	6.5
Republic of Korea	7.0	.	8.5	8.2	8.0
Singapore	5.9	.	.	6.7	5.0
Taiwan Province of China	6.2	.	.	6.4	7.0
ASEAN-4	4.0	.	.	.	5.1[g]
Indonesia	3.0	.	3.0	4.3	4.0
Malaysia	6.0	.	6.2	7.2	6.5
Philippines	4.5	.	3.5	4.1	4.5
Thailand	4.5	.	5.5	4.8	6.0
ASEAN-4 plus Republic of Korea	.	5.7	.	.	.
South Asia	.	5.9	.	.	.
China	7.0	.	7.7	7.5	7.0
Latin America	4.0	3.6	.	3.7	4.3
Argentina	3.4	.	2.6	2.8	4.0
Brazil	4.0	.	3.2	3.6	3.7
Mexico	4.5	.	4.8	4.8	5.5

Source: IMF, *World Economic Outlook*, April 2000; World Bank, *Global Development Finance*, April 2000; OECD, *OECD Economic Outlook*, June 2000; UN/LINK, Pre-LINK meeting forecast (April 2000); and JP Morgan, *World Financial Markets*, New York, 14 April 2000.

a Based on weights in terms of purchasing power parity for IMF, World Bank and OECD, and in terms of market exchange rates for LINK and JP Morgan.

b Including also Mexico and the Republic of Korea.

c The 11 EMU countries.

d Bulgaria, Czech Republic, Greece, Hungary, Poland, Russian Federation and Turkey.

e South and East Asia.

f China, Hong Kong (China), India, Indonesia, Malaysia, Philippines, Republic of Korea, Singapore, Taiwan Province of China and Thailand.

g Including also Singapore. ■

Notes

1 Figures given by individual companies and national estimates are not comparable, since spending on hardware replacement, for example, is not always included. Estimates higher than the $600 billion given by the Gartner Group include $675 by Software Productivity Research and $1,200 billion by Cap Gemini.

2 See *TDR 1998*, Part One, annex to chap. III.

3 Fallows J, Week in review, *New York Times*, 13 February 2000: 3.

4 Shinobu Nakagawa, Why has Japan's household savings rate remained high even during the 1990s?, *Bank of Japan Monthly Bulleti*n, April 1999: ii.

5 See the discussion in *TDR 1999* that expressed scepticism of the sustainability of the expansion in 1999.

6 See Crédit Suisse First Boston, The best is not yet to come, *Euro-11 Weekly*, 19 May 2000.

7 Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

8 For an analysis of this regional interdependence see *TDR 1996*, Part Two, chaps. I and II; and *TDR 1993*, Part Two, chap. IV and annex 3.

9 For example, production losses due to the interruption of power supply to microchip manufacturers at the high-tech industrial park in Hsin-Chu City were estimated to be $320 million. See *Asian Development Outlook 2000*, Asian Development Bank, Manila, 2000: 56.

10 The subregions distinguished in this subsection are as defined by the African Development Bank: (1) Central Africa (Burundi, Cameroon, Central African Republic (CAR), Chad, Congo, Democratic Republic of Congo, Equatorial Guinea, Gabon, Rwanda and Sao Tome and Principe); (2) East Africa (Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Seychelles, Somalia, Uganda and United Republic of Tanzania); (3) North Africa (Algeria, Egypt, Libyan Arab Jamahiriya, Mauritania, Morocco, Sudan and Tunisia); (4) Southern Africa (Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe); and (5) West Africa (CFA countries: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo; non-CFA countries: Cape Verde, Ghana, Guinea, Gambia, Nigeria, Liberia and Sierra Leone).

11 Crude oil accounts for more than 95 per cent of total export earnings in Angola, Equatorial Guinea, Gabon and Nigeria, and is also important for Cameroon, Congo and Côte d'Ivoire. South Africa is the world's largest gold producer, but gold is also an important export item for Ghana, Guinea, Mali, Zimbabwe, and (increasingly) the United Republic of Tanzania. Côte d'Ivoire is the world's largest producer of cocoa, which is also important for Ghana. Whereas cocoa is the dominant export crop in West Africa, tea dominates commodity exports for many East and Southern African countries. Next to Kenya, leading African tea exporters include Malawi, Rwanda, Uganda, United Republic of Tanzania and Zimbabwe. Coffee is important in both East and West Africa. Côte d'Ivoire, Ethiopia and Uganda are the region's three largest coffee producers, but Burundi, Cameroon, the Democratic Republic of Congo, Kenya, Madagascar, Rwanda, Togo and the United Republic of Tanzania are also significant exporters.

12 *Capital Flows and Growth in Africa* (UNCTAD/GDS/MDPB/7), New York and Geneva, 2000.

13 This subsection draws on Economic Commission for Europe, *Economic Survey of Europe 2000,* no. 1, United Nations publication, sales no. E.00.II.E.12, New York and Geneva, 2000.

14 Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, The former Yugoslav Republic of Macedonia, and Yugoslavia.