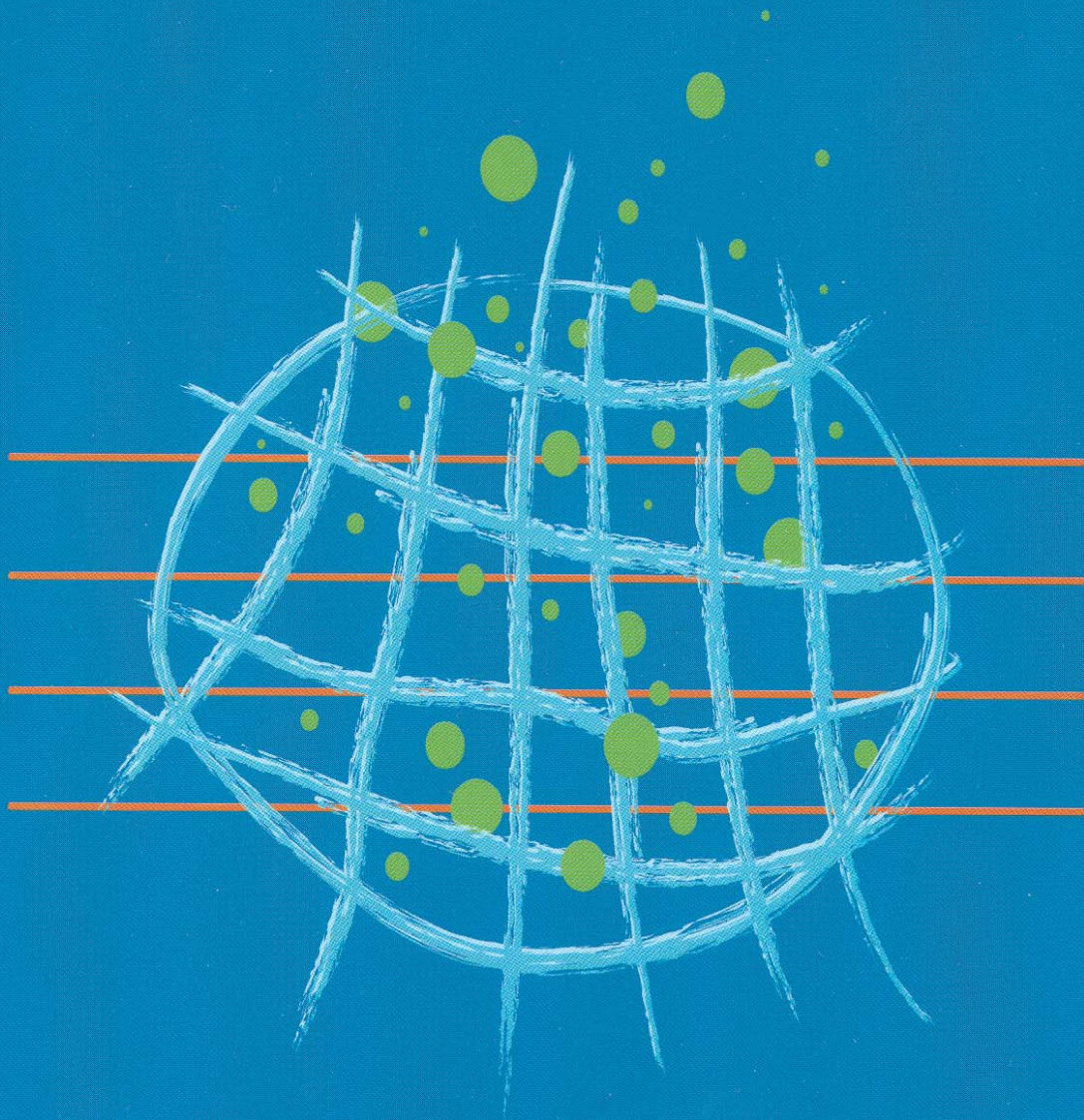


# World Economic Situation and Prospects 2007



United Nations

# World Economic Situation and Prospects 2007



United Nations  
New York, 2007

This report is a joint product of the Department of Economic and Social Affairs (DESA), the United Nations Conference on Trade and Development (UNCTAD) and the five United Nations regional commissions (Economic Commission for Africa (ECA), Economic Commission for Europe (ECE), Economic Commission for Latin America and the Caribbean (ECLAC), Economic and Social Commission for Asia and the Pacific (ESCAP), and Economic and Social Commission for Western Asia (ESCWA)). It provides an overview of recent global economic performance and short-term prospects for the world economy and of some key global economic policy and development issues. One of its purposes is to serve as a point of reference for discussions on economic, social and related issues taking place in various United Nations entities in 2007.

**For further information, please contact:**

*In New York*

Mr. José Antonio Ocampo  
Under-Secretary-General  
Department of Economic  
and Social Affairs  
Room DC2-2320  
United Nations, New York 10017, U.S.A.  
Phone: (212) 963-5958  
Fax: (212) 963-1010  
E-mail: [jaocampo@un.org](mailto:jaocampo@un.org)

*In Geneva*

Mr. Supachai Panitchpakdi  
Secretary-General  
United Nations Conference on  
Trade and Development  
Palais des Nations, Room E-9050  
1211 Geneva 10, Switzerland  
Phone: (41) (22) 917-5806/5634  
Fax: (41) (22) 917-0465  
E-mail: [sgo@unctad.org](mailto:sgo@unctad.org)

# Executive summary

## The global outlook

### *Slower global economic growth in 2007*

After a solid and broad-based growth for three consecutive years, the world economy is expected to decelerate in 2007, with the growth of world gross product (WGP) moderating to a pace of 3.2 per cent, down from the estimated 3.8 per cent for 2006.<sup>1</sup> The economy of the United States of America will be the major drag for this global slowdown, as its growth is forecast to soften on the back of a weakening housing market to a rate of 2.2 per cent in 2007. No other developed economy is expected to emerge as an alternative engine for the world economy, as growth in Europe is forecast to slow to around 2 per cent and in Japan to below 2 per cent in 2007. There are, furthermore, substantial downside risks associated with the possibility of a much stronger slowdown of the United States economy.

### *Continued robust growth in developing countries*

The developing countries and the economies in transition have continued their exceptionally strong economic performance during 2006, reaching average growth rates of 6.5 and 7.2 per cent, respectively. Growth is expected to remain robust in 2007, albeit with a mild moderation: 5.9 per cent for developing countries and 6.5 per cent for economies in transition. Among developing countries, sustained high growth in China and India has engendered more endogenous growth through increasing South-South trade and financial linkages. This is reflected in, among other things, continued strong demand for and higher prices of energy and primary commodities. Buoyant commodity prices benefit many developing countries and also the economies in transition, especially the Commonwealth of Independent States (CIS). The performance of the least developed countries also remains remarkably strong, averaging nearly 7 per cent in 2006. Growth in the poorest countries is expected to remain equally strong in 2007.

Notwithstanding the improvement in both their domestic economic conditions and stronger interregional linkages, most developing countries remain vulnerable to any slowdown in the major developed economies and to the volatility of international commodity and financial markets.

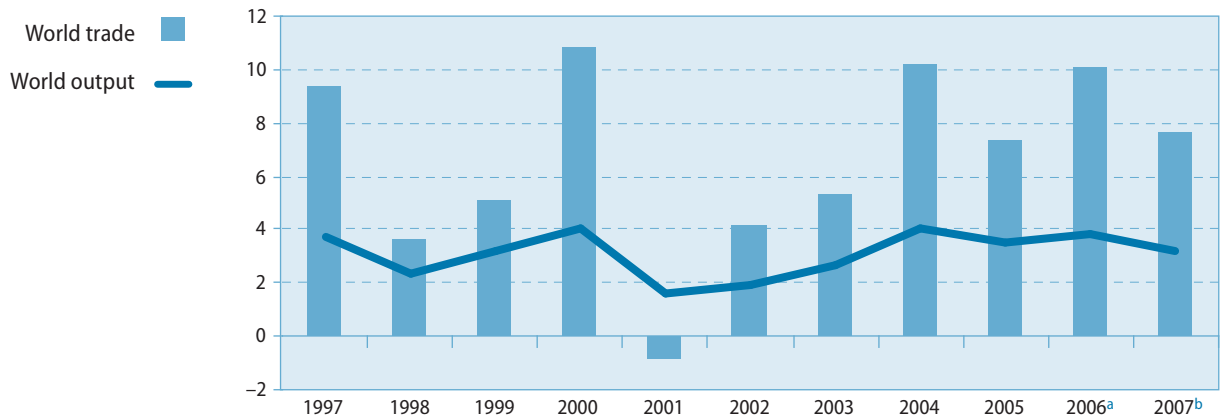
### *Insufficient employment growth*

The strong growth performance of the world economy has also helped improve labour-market conditions in a large number of countries. In most developed economies, unemployment rates have declined in 2006. Nonetheless, and despite higher output growth, in important parts of the developing world, employment growth has not been strong enough to substantially reduce unemployment rates. Various factors may have impeded sufficient

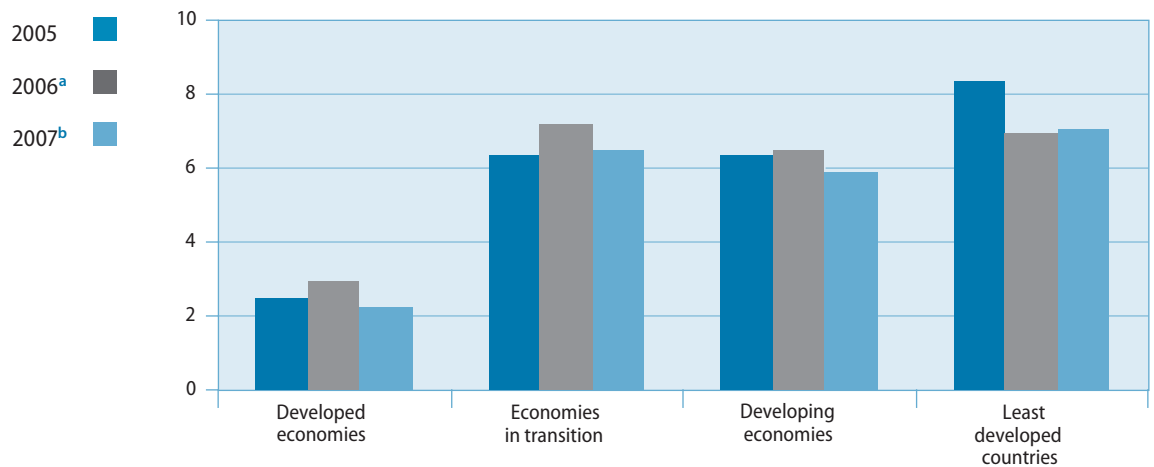
---

<sup>1</sup> In the United Nations estimates, the growth of world gross product (WGP) is calculated using country weights for gross domestic product (GDP) in dollars at market prices. When using purchasing power parity (PPP)-based weights, WGP growth would be 5.1 per cent for 2006 and 4.5 per cent for the forecast for 2007.

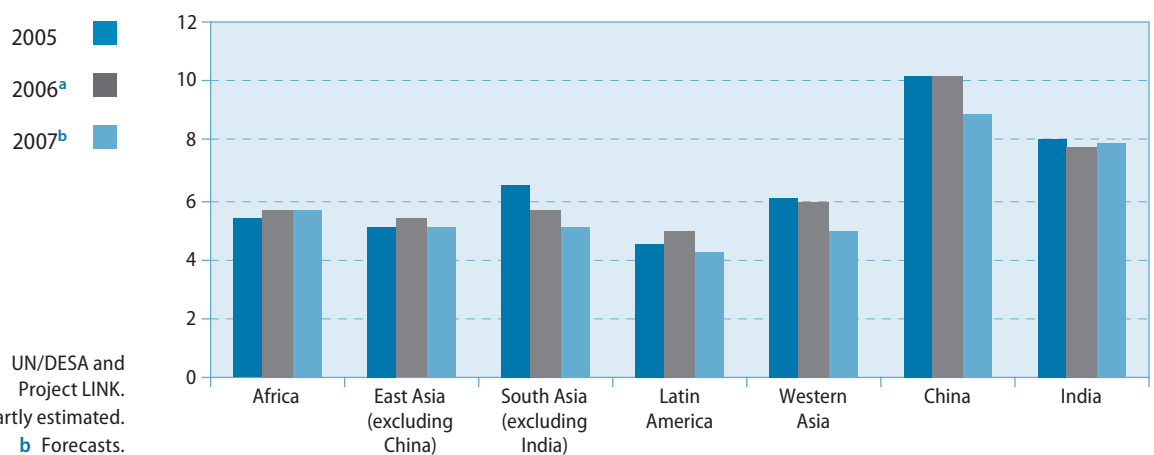
## World economic growth expected to slow down, 1997-2007 (annual percentage change)



## Growth in developing countries and economies in transition stronger than in developed countries (annual percentage change)



## Moderation is anticipated in most developing-country regions (annual percentage change)



Sources: UN/DESA and Project LINK.

<sup>a</sup> Partly estimated.

<sup>b</sup> Forecasts.

job growth and/or reductions in unemployment, including the capital-intensive nature of commodity-producing sectors, which has generated most of the growth stimulus in Africa; strong increases in labour participation in both Africa and Latin America; and, in China, labour shedding resulting from the restructuring of State-owned enterprises, strong productivity growth and labour shifts out of agriculture. The situation is similar in the economies in transition, where unemployment rates generally remain high, despite solid economic growth for several consecutive years.

### *Benign inflation outlook*

Headline inflation rates have risen in many economies in 2006, but most of the increase is attributable to first-round effects of higher oil prices. So far, there has been only limited pass-through of higher energy prices into core inflation. Inflationary pressures are expected to moderate in 2007 in view of the retreat of oil prices in the latter part of 2006, the expected slowdown in global economic growth and the tighter monetary policy stance in many economies. Exceptions include a few countries in Africa, which have experienced a sharp increase in inflation owing to food shortages, currency depreciation and/or stronger pass-through of higher oil prices to producers and consumers.

## **Uncertainties and downside risks**

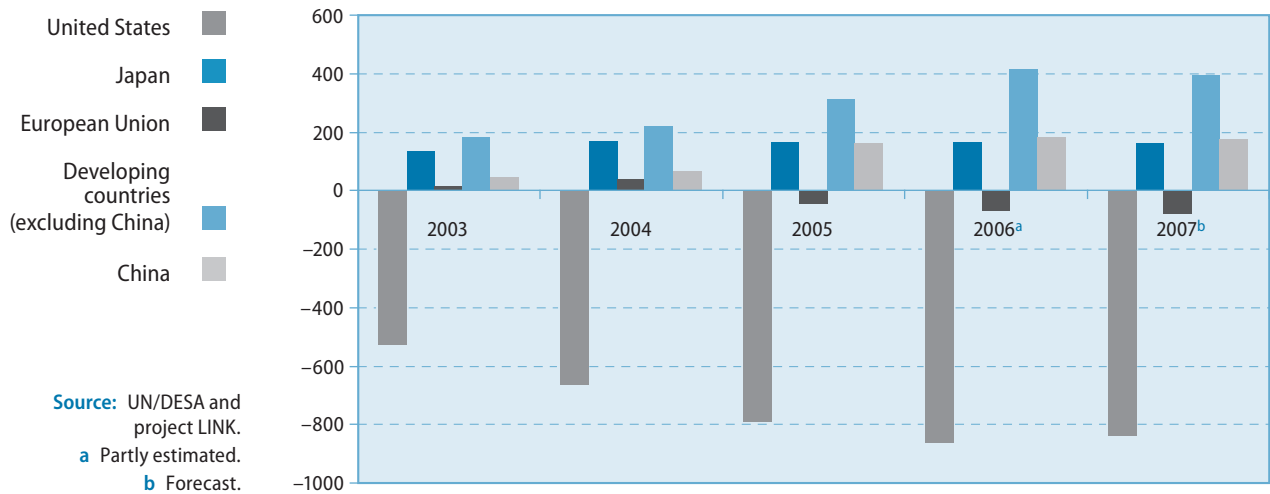
### *The risk of a further decline in house prices in the United States*

The possibility of a more severe downturn in housing markets represents a significant downside risk to the economic outlook. A number of economies have witnessed substantial appreciation of house prices over the past decade, and the associated wealth effects have contributed to solid economic growth rates. A reversal of the process may thus lead to significant negative fallout for world economic growth. Various indicators measuring the performance of the housing market in the United States show a significant recession in activity in 2006—a reduction of close to 20 per cent in recent months. While the baseline forecast assumes a mild adjustment in the housing market, and hence a moderate slowdown in the economy, an alternative, more pessimistic scenario shows that a more severe decline in house prices in the United States would not only undercut its own growth to a pace below 1 per cent in 2007 but also substantially reduce economic growth in the rest of the world by more than one percentage point. In addition, a collapse of house prices in major economies would provoke a crisis in the mortgage markets and set in motion a deflationary adjustment in the global imbalances, enhancing the risk of a major upheaval in financial markets.

### *Challenges posed by persistently higher oil prices*

Although oil prices have recently fallen significantly after reaching a historical high during 2006, they are forecast to remain high, but volatile, in 2007. The short-term prospect for oil prices is highly uncertain, however, owing to geopolitical tensions, new production capacities coming on stream and speculative demand. So far, higher oil prices have not had the same dampening effect on the world economy as they had in the previous episodes of comparable price movements. Among developing countries, oil exporters have benefited from the oil price increase. Buoyant non-oil commodity prices have offset rising import costs due to higher oil prices. A number of low-income, net oil-importing countries, however, did not see an improvement in their terms of trade and have been increasingly hurt

### Current-account imbalances have widened further in 2006



by the impact of higher energy prices. These economies have had to reduce non-oil imports and have incurred higher fiscal burdens owing to attempts to protect consumers from higher oil prices through subsidies. Economic growth costs in these countries have already been substantial and are likely to increase as oil prices remain high and oil dependency is not reduced.

#### *Risk of a disorderly adjustment of the global imbalances remains*

Current-account imbalances across regions and countries have widened further in 2006, featuring the United States running a current-account deficit of close to \$900 billion, matched by surpluses generated by Japan and Germany, and—most importantly—by developing regions and economies in transition, including the major oil exporters. As a result of its continued and widening current-account deficit, the indebtedness of the United States has deepened to a level which more seriously calls into question the sustainability of the current constellation of global imbalances. In 2007, the baseline scenario predicts a moderate reduction in these global imbalances as the slowdown in United States economic growth and the moderation in oil prices will generate a reduction in the import bill of the world's largest economy, while the expected depreciation of the dollar will stimulate exports and curb import demand. Nonetheless, the risk of a disorderly adjustment remains. Slow progress, if any, in the unwinding of the global imbalances will enhance the risk of a strong speculative wave towards dollar depreciation. Such exchange-rate depreciation could help reduce the external deficit of the United States, but given the dependence of global economic growth on demand stimuli from the world's largest economy, falling import demand in the United States would have further global deflationary repercussions. This, in turn, could quite easily unravel the momentum of economic growth in developing countries and jeopardize any further progress in poverty reduction. A hard landing of the dollar would further raise uncertainty among international investors and could upset financial markets.

## Macroeconomic policy coordination

### *Why international macroeconomic policy coordination is needed*

Existing national macroeconomic policy stances are not designed around the need for achieving an adjustment in the global imbalances. The current tendency towards more restrictive monetary and fiscal policies will have a dampening effect on demand in some of the surplus countries, such as Japan and Germany, making it more difficult for the United States to lower its external deficit through export growth. At the same time, the more expansionary fiscal policies conducted in some of the East Asian surplus countries seem insufficient either to compensate for such deflationary effects or to yield the necessary significant export growth for the United States economy, particularly in the absence of major exchange-rate adjustments.

A coordinated strategy, in contrast, could help avoid the negative growth effects and create confidence in the stability of financial and foreign-exchange markets. Cooperation would make use of the spillover effects of the policies of one country as an offsetting factor for the negative demand effects of the adjustment in another. Growth stimulus in Europe, Asia and the major oil-exporting countries, for instance, could then offset the initially contractionary effect of adjustment policies conducted by the United States.

Various proposals have been put forward as a framework for such policy coordination, including the idea of a new Plaza Agreement on specific policy measures aimed at reducing the imbalances. Despite the shortcomings of such an ad hoc initiative, it may well constitute the desirable second-best outcome in the absence of any more fundamental changes to the global monetary and financial system.

### *Obstacles to international policy coordination*

International policy coordination faces a series of obstacles. These include, among other things, the fact that major stakeholders have different perceptions regarding the risks posed by the current situation. There are also disagreements on the current position of individual economies. In the case of the United States, for example, there are divergent views on how robust economic conditions will remain and whether current imbalances can continue to be financed without major disruptions in international financial markets. Similar uncertainty exists regarding the strength of China's economic growth in the near future and the capacity of Japan and Europe to increase their potential growth rates in the short-to-medium run. These obstacles are likely to be compounded by a problem of commitment to any negotiated international policy solution, as national policy makers may prefer that other countries bear the brunt of the adjustment or may feel constrained to follow through on their commitments because of domestic resistance. Furthermore, an effective solution of the existing imbalances requires sustained action over time, and Governments may find it difficult to credibly commit themselves for a prolonged period.

### *What can be done?*

There are various forums in which such obstacles to international policy coordination could be overcome. An international consultation mechanism that includes an outside mediator such as the International Monetary Fund (IMF) could help generate consensus on the nature and extent of the current problems. Given the structure of the imbalances,



such consultations should involve all major players and would thus have to include a fair representation of developing countries. Existing ad hoc platforms, such as the Group of Eight (G8) and other forums, are unsuitable in this regard. The broader-based multilateral surveillance mechanisms launched this year by the IMF are, in this sense, an important step forward. At the national level, countries should issue multi-year commitments for policy adjustment in an internationally coordinated framework. The announcement of internationally agreed but nationally specific targets, for example, would increase the credibility of national policies as Governments would run the risk of incurring reputation costs in the case of policy failure. Finally, only more far-reaching reforms of the global monetary and financial system will help to prevent a re-emergence of the imbalances seen today. A new, supranational currency should be considered a key element of a more structural solution, but this can only be a long-term option. The more immediate solution should be oriented towards developing a multi-currency reserve system. Structural solutions of this kind, aimed at promoting world economic stability, should be as compelling as the pursuit of a multilateral trading system.

## International trade

### *Rapidly expanding trade flows*

World merchandise trade has expanded at a rapid pace during 2006. The expansion is featured by a continued sizeable increase in the value of trade flows of both oil and non-oil commodities, mainly due to the higher prices of these commodities, and also by a notable increase in the volume of trade flows of capital goods driven by the recovery in global investment. Growth of the volume of world exports is estimated to be above 10 per cent in 2006, up from 7.3 per cent in 2005. The value of world exports has increased by about 16 per cent. Growth of world exports is more than twice that of world output, indicating a further deepening of global economic integration. In the outlook, however, the growth of world trade is expected to moderate to a pace of 7.7 per cent.

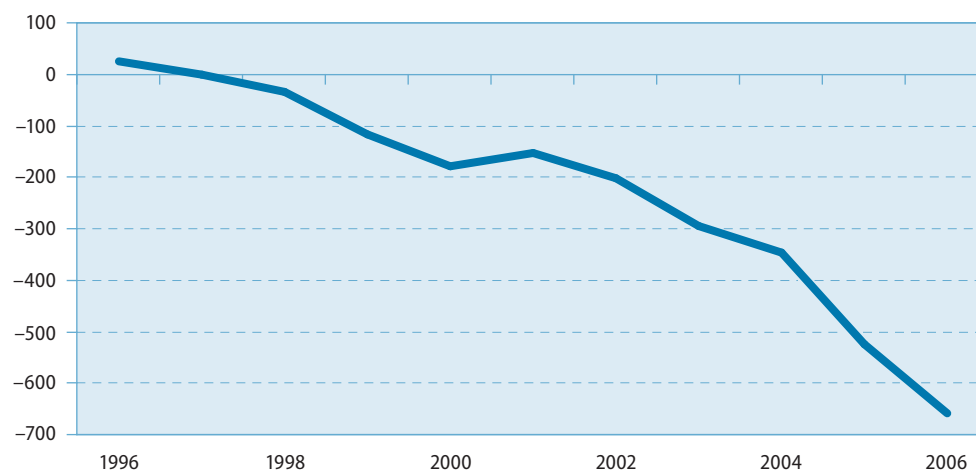
### *More volatile primary commodity prices*

Despite a significant drop from their peak in August, average oil prices were up by 20 per cent for the year compared with the average for 2005. Prices of base metals and minerals have increased even more markedly. Only the prices of a number of beverage and food commodities have experienced some moderation. However, the prices of commodities became more volatile during 2006, and most of them experienced a significant drop in mid-2006. In the outlook for 2007, the prices of most commodities are expected to moderate.

### *Uncertain future of multilateral trade negotiations*

Multilateral trade talks in the Doha Round were suspended in July 2006 owing to differences between major trading partners, especially in the area of agriculture and non-agricultural market access (NAMA), as well as to a more general sense that the economic and commercial benefits of any agreement would not outweigh the political costs of making additional concessions on issues often highly sensitive on the domestic political front. This represents a setback with respect to achieving the Millennium Development Goal of committing to an open and rule-based trading system. Furthermore, the proliferation of large numbers of bilateral and regional trade agreements has put the integrity of the multilateral

### Increasing negative net financial transfers to developing countries and economies in transition, 1996-2006 (billions of dollars)



**Sources:** UN/DESA, based on IMF World Economic Outlook database, September 2006, and IMF Balance of Payments Statistics.

**Note:** Net financial transfers are defined as net capital inflows less net interest and other investment income payments to abroad.

trading system at risk. While there is currently no agreement on the next steps in the negotiating process, efforts have intensified in order to reach consensus on the resumption of the Doha Round.

#### *The Aid for Trade Initiative*

Lower tariffs and improved market access have been a strong focus of international trade negotiations. In practice, however, many developing countries, especially the least developed among them, have been unable to fully reap the benefits of improved trading conditions. For developing countries to strengthen their export performance, they need financial resources to remove supply-side constraints through investments in trade infrastructure, technology and institutions. The United Nations World Summit of September 2005 recognized this, and world leaders pledged to support and promote increased aid for building the productive and trade capacities of developing countries. Subsequently, the Aid for Trade Initiative was endorsed by the Sixth Ministerial Conference of the World Trade Organization (WTO). Further guidelines for the implementation of the Initiative have been prepared, but consultations regarding the resource requirements are still ongoing. WTO members generally consider that the work on the Initiative should continue, despite the current suspension of the Doha Round negotiations.

## Finance for development

### *Lower, but still high, private capital flows to developing countries and transition economies*

The level of net private capital flows to developing countries and transition economies in 2006 has been high in historical terms, though lower than levels recorded during the previous year. The financial-market turbulence in the second quarter of the year, the slowdown in net borrowing from commercial banks and bond creditors because of pre-financing of obligations due in 2006, and bond buy-backs have contributed to the moderation. Mean-

while, the external financing costs for emerging market economies remain low. The spreads in the Emerging Markets Bond Index (EMBI) reached all-time lows in the first quarter of 2006, then increased during the turmoil in the global markets in May-June; since then, they have tended to fall again. The benchmark interest rates underlying the external financing costs for emerging market economies are also low, despite a continuous monetary tightening in the United States. In the outlook for 2007, the level of net private capital flows to developing countries will remain high, although the risk of a slowdown in the global economy or significant tightening in liquidity in major developed countries could lead to a sharper contraction in such flows and to higher risk premia for developing countries.

### *Increasing foreign direct investment*

Developing and transition economies play an increasingly important role as a source of global foreign direct investment (FDI) flows. The rapid industrialization in economies like China and India has led to policy-induced efforts to focus overseas investments on securing access to primary resources, while oil-producing countries have seen their investment position strengthened through higher oil revenues and strong growth rates. In this context, a sizeable portion of developing-country FDI has gone to other developing countries, broadening the range of potential sources of capital, technology and management skills for the receiving countries.

### *Yet, larger net transfers from poor to rich countries*

Developing economies as a group, together with the economies in transition, ratcheted up their net outward transfers of financial resources to developed countries. Net transfers refer to net capital inflows less net interest and other investment income payments. Net transfers to sub-Saharan Africa have also become negative, it having been the only region with positive net transfers in previous years. This trend of poor countries financing rich countries has continued for a decade, raising questions about its sustainability. The building-up of official reserves has been a key mechanism through which these financial net transfers have occurred. Developing countries now own well over \$3 trillion in foreign-exchange reserves, with China alone holding more than \$1 trillion. The strengthened reserve positions have provided greater protection in dealing with external shocks emanating from volatility in world markets. The mirror image of the accumulation of reserves in developing countries is the widening external deficit of the world's major reserve currency country, the United States. Thus, while their current reserve position may have made them less vulnerable to idiosyncratic shocks, it does not insulate developing countries from more systemic shocks, such as an abrupt adjustment of the external deficit in the United States and a large devaluation of the dollar.

### *Increased, but still insufficient, official development assistance*

Official Development Assistance (ODA) from OECD countries to developing countries rose to a record high of \$106 billion in 2005. This total represents 0.33 per cent of the Development Assistance Committee (DAC) countries' combined gross national income (GNI), up from 0.26 per cent in 2004. The current projections are that total ODA by the DAC member States is expected to reach the target of \$130 billion (0.36 per cent of the combined GNI of the DAC countries) set forth for 2010, although a steep climb in the flows is still required as the deadline approaches. It is important to note, however, that the recent increases

in ODA have to a considerable extent been due to one-time effects such as debt forgiveness grants to Iraq and Nigeria. Given these one-off effects, donors will have to significantly increase aid in order to achieve the target ODA levels set by the internationally agreed development goals. In addition to these trends, aid from non-DAC sources has increased notably. Countries like China and India are among these “emerging donors” which have begun to contribute significant additional funding for development assistance.

Efforts to improve aid effectiveness and donor coordination need to remain centre stage as aid volumes rise and more donors enter the arena. Since maintaining taxpayer support in developed countries is critical, managing development aid in a way that delivers real results is a key condition for sustaining the momentum of aid volume increases. In addition, harmonization of development cooperation has become more complex with the increase in the number of players. In this regard, the call of the United Nations General Assembly to convene a Development Cooperation Forum in 2007 within the framework of the Economic and Social Council is timely, as this Forum has the potential to build political oversight over aid effectiveness among all donors with the broad participation of developing countries.

### *More debt-relief*

The Heavily Indebted Poor Countries (HIPC) Initiative remains the primary international instrument for the provision of debt relief to low-income countries. The volume of debt relief has increased owing to both the progress made by eligible countries towards reaching the milestones of the HIPC Initiative process and the introduction of the Multilateral Debt Relief Initiative. However, a series of challenges remain, including increasing the resources effectively available for the implementation of poverty reduction programmes by HIPCs as well as the adoption of measures in order to avoid the re-emergence of unsustainable debt burdens.

### *First steps towards a reform of the international financial system*

The global financial system has recently witnessed some steps towards farther-reaching reforms as well as new policy approaches. The IMF Board of Governors adopted a resolution on quota and voice reform, aiming, among other things, at quota increases for China, Mexico, the Republic of Korea and Turkey, which are the most clearly underrepresented countries in the organization. These changes, however, will not significantly alter the present balance of voting power within the IMF. Negotiations about farther-reaching quota and voice reforms are to take place in the coming years. In addition, the International Monetary and Financial Committee agreed on the need for a new framework to strengthen multilateral surveillance, and a new vehicle for multilateral consultations involving systematically important members and groupings was established to complement other surveillance approaches. The first round of consultations involving China, the euro area, Japan, Saudi Arabia and the United States will focus on reducing the global imbalances while maintaining robust economic growth. While these are steps in the right direction, reaching agreement on quota and voting power reform and on strengthened multilateral surveillance is only a first step towards broader-based consultation processes. Bolder steps need to be taken to establish a credible process of macroeconomic policy coordination under multilateral guidance in order to avoid a disorderly adjustment of the global imbalances and a major disruption in world economic growth.



# Contents

	<i>Page</i>
Executive summary .....	iii
Contents .....	xiii
Explanatory notes.....	xvii
<b>I. Global outlook</b> .....	<b>1</b>
Macroeconomic prospects for the world economy .....	1
Expected deceleration of world economic growth in 2007 .....	2
A more volatile international economic environment for developing countries	10
The need for more employment growth .....	14
Benign inflation outlook.....	15
Uncertainties and downside risks for the global outlook .....	16
Burst of the housing bubble .....	16
The impact of higher oil prices.....	18
Widening global imbalances.....	21
The need for macroeconomic policy coordination.....	24
A new Plaza Agreement? .....	24
The case for policy coordination .....	25
Obstacles to policy coordination .....	26
What can be done? .....	29
<b>II. International trade</b> .....	<b>35</b>
Trade flows: can the momentum be sustained? .....	35
Primary commodity prices and markets .....	39
Non-oil commodities.....	39
World oil markets .....	44
Trade policy developments and trends .....	49
Doha negotiations: dealing with a complete deadlock.....	49
Aid for Trade: tentative progress in moving the Initiative forward.....	52
<b>III. Financial flows to developing and transition economies</b> .....	<b>57</b>
Net transfers.....	57
Private capital flows.....	58
Net private capital flows to developing countries .....	58
Continuing expansion of foreign direct investment.....	64
International financial cooperation.....	67
Official development assistance.....	67
The Heavily Indebted Poor Countries Initiative and other debt-relief measures ..	71
Governance of the global financial system.....	73
Quota and voice reform in the International Monetary Fund .....	73
Multilateral surveillance .....	75

	<i>Page</i>
Financing for crisis prevention .....	76
International Monetary Fund engagement with low-income countries .....	78
Regional financial cooperation.....	79
<b>IV. Regional developments and outlook .....</b>	<b>83</b>
Developed market economies .....	83
North America: the United States sees a significant downshift .....	83
Developed Asia and the Pacific: the economic recovery in Japan continues, but a slowdown is expected for 2007.....	87
Western Europe: the recovery continues .....	89
The new EU members: reaching record growth rates .....	93
Economies in transition: buoyant growth continues .....	95
South-eastern Europe: strong expansion, large imbalances .....	95
The Commonwealth of Independent States: sustaining strong growth.....	97
Developing economies.....	102
Africa: the growth momentum continues.....	102
East Asia: another year of export-driven growth, but domestic demand is set to strengthen .....	109
South Asia: continued strong growth and a chance to vanquish poverty .....	111
Western Asia: the boom fuelled by oil continues .....	114
Latin America and the Caribbean: domestic demand boosts growth.....	117
 <b>Annex</b>	
Statistical tables .....	121
 <b>Boxes</b>	
I.1 Key assumptions for the baseline global economic forecast for 2007 .....	1
I.2 An alternative scenario: the global implications of a collapse of the United States housing market.....	3
I.3 Prospects for the least developed countries .....	7
I.4 Higher oil prices have caused significant economic losses in lower-income oil-importing countries.....	19
II.1 The role of speculation in primary commodity markets .....	42
II.2 Market concentration in the mining industry .....	45
II.3 The scope of Aid for Trade financing.....	53
IV.1 Migration and migrant remittances within the Commonwealth of Independent States	98
IV.2 Inadequate infrastructure and energy supply: critical constraints to investment and trade in Africa .....	105
IV.3 Terms of trade and external adjustment in Latin America and the Caribbean.....	119
 <b>Figures</b>	
I.1a Nominal interest rates of the United States, 1961-2007 (first quarter) .....	8
I.1b Real interest rates of the United States, 1961-2007 (first quarter) .....	8
I.2 Net barter terms of trade of selected developing countries, 2000-2006 .....	11

	<i>Page</i>
I.3 Exchange-rate index for the United States, 1990-2006 .....	13
I.4 New home sales in the United States, 2002-2006 .....	17
I.5 Current-account balances, 2003-2007 .....	21
I.6 United States net international investment position, 1976-2006 .....	23
II.1 Ratio of the growth rate of world exports to the growth rate of gross world product, 2001-2007 .....	35
II.2 Value of world exports, 2000-2007 .....	37
II.3 Growth of merchandise export volume, 1996-2007 .....	37
II.4 Merchandise trade balances, 2004-2007 .....	40
II.5 Non-oil primary commodity prices, 2000-2006 .....	40
II.6 Baltic Exchange Dry Index of shipping rates, 2003-October 2006 .....	41
II.7 Brent oil: weekly premium over OPEC basket, January 2003-October 2006 .....	49
III.1 Net financial transfers to developing countries and economies in transition, 1997-2006 .....	57
III.2 Emerging Market Bond Index global composite stripped spreads, end December 2002-end September 2006 .....	60
III.3 Foreign direct investment out flows from developing and transition economies, 1980-2005 .....	66
III.4 Official development assistance from non-Development Assistance Committee donors, 2000-2004 .....	69
IV.1 Composition of GDP growth in the EU-12, Japan and the United States, 2000-2007 .....	84
IV.2 Housing market index in the United States, 1985-2006 .....	85
IV.3 GDP growth and inflation in Japan, 1998-2007 .....	88
IV.4 GDP growth in selected Western European countries, 2000-2007 .....	91
IV.5 Growth of real GDP in the EU-8, 1996-2007 .....	93
IV.6 Current-account balance of selected countries in South-eastern Europe, 2004-2006 ..	96
IV.7 Consumer Price Index inflation in selected Commonwealth of Independent States economies, January-September 2005 and 2006 .....	101
IV.8 Growth of real GDP in Africa, North Africa and sub-Saharan Africa, 2000-2007 .....	103
IV.9 Average annual GDP growth, 1998-2006 .....	104
IV.10 Western Asia: total GDP and GDP per capita, 2002-2006 .....	114
IV.11 Latin America and the Caribbean: current-account and fiscal balances, 2000-2006 ...	118

### Tables

I.1 Growth of world output, 2001-2007 .....	2
I.2 Frequency of high and low growth of per capita output, 2004-2007 .....	6
I.3 Impact of changes in terms of trade and net factor income payments on national income in selected developing-country groups, average for 2004-2006 .....	12
III.1 Net financial transfers to developing countries and economies in transition, 1995-2006 .....	58
III.2 Net financial flows to developing countries and economies in transition, 1995-2007 ....	59
III.3 Foreign direct investment inflows, by host region and major host economy, 2004-2006 .....	65



	<i>Page</i>
III.4 Cross-border merger-and-acquisitions sales, by sector/industry of seller . . . . .	65
III.5 Foreign direct investment by developing and transition economies in selected LDCs, various years . . . . .	67
III.6 Multilateral Debt Relief Initiative . . . . .	73
IV.1 Selected East Asian economies: real gross fixed investment, 2001-2006 . . . . .	110
IV.2 Poverty and inequality in South Asia . . . . .	112

# Explanatory notes

The following symbols have been used in the tables throughout the report:

- .. **Two dots** indicate that data are not available or are not separately reported.
- **A dash** indicates that the amount is nil or negligible.
- **A hyphen** indicates that the item is not applicable.
- **A minus sign** indicates deficit or decrease, except as indicated.
- . **A full stop** is used to indicate decimals.
- / **A slash** between years indicates a crop year or financial year, for example, 2006/07.
- **Use of a hyphen** between years, for example, 2006-2007, signifies the full period involved, including the beginning and end years.

**Reference to “dollars” (\$)** indicates United States dollars, unless otherwise stated.

**Reference to “tons”** indicates metric tons, unless otherwise stated.

**Annual rates** of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals, because of rounding.

**The following abbreviations have been used:**

<b>ABFs</b>	Asian Bond Funds
<b>ACU</b>	Asian Currency Unit
<b>ADB</b>	Asian Development Bank
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>ASGI-SA</b>	Accelerated and Shared Growth Initiative for South Africa
<b>BoJ</b>	Bank of Japan
<b>CGE</b>	computable general equilibrium
<b>CIS</b>	Commonwealth of Independent States
<b>CMEA</b>	Council for Mutual Economic Assistance
<b>CMI</b>	Chiang Mai Initiative
<b>CPI</b>	consumer price index
<b>DAC</b>	Development Assistance Committee (of OECD)
<b>DDA</b>	Doha Development Agenda
<b>DSF</b>	Debt Sustainability Framework
<b>DTIS</b>	Diagnostic Trade Integration Study
<b>ECA</b>	Economic Commission for Africa
<b>ECB</b>	European Central Bank
<b>ECE</b>	Economic Commission for Europe
<b>ECLAC</b>	Economic Commission for Latin America and the Caribbean
<b>EIA</b>	Energy Information Administration
<b>EMBI</b>	Emerging Markets Bond Index
<b>EMEAP</b>	Executives’ Meeting of East Asia-Pacific Central Banks
<b>EMU</b>	Economic and Monetary Union

<b>ERD</b>	Economic Relations Division, Bangladesh
<b>ERM</b>	Exchange Rate Mechanism
<b>ESCAP</b>	Economic and Social Commission for Asia and the Pacific
<b>ETF</b>	Exchange Traded Fund
<b>EU</b>	European Union
<b>EURIBOR</b>	Euro Interbank Offered Rate
<b>FDI</b>	foreign direct investment
<b>Fed</b>	United States Federal Reserve
<b>FOCAC</b>	Forum on China-Africa Cooperation
<b>GCC</b>	Gulf Cooperation Council
<b>GDP</b>	gross domestic product
<b>GNI</b>	gross national income
<b>GNP</b>	gross national product
<b>GWP</b>	gross world product
<b>HICP</b>	Harmonised Index of Consumer Prices
<b>HIPC</b>	heavily indebted poor countries
<b>IBSA</b>	India-Brazil-South Africa (Dialogue Forum)
<b>ICAC</b>	International Cotton Advisory Committee
<b>ICT</b>	information and communication technologies
<b>IDA</b>	International Development Association
<b>IF</b>	Integrated Framework (for Trade-Related Technical Assistance to least developed countries)
<b>IFF</b>	International Finance Facility
<b>IFSC</b>	Integrated Framework Steering Committee
<b>IMF</b>	International Monetary Fund
<b>IMFC</b>	International Monetary and Financial Committee
<b>IPO</b>	initial public offering
<b>IRSG</b>	International Rubber Study Group
<b>LDCs</b>	least developed countries
<b>LME</b>	London Metal Exchange
<b>LNG</b>	liquefied natural gas
<b>M&amp;As</b>	mergers and acquisitions
<b>mbpd</b>	million barrels per day
<b>MCA</b>	Millennium Challenge Account
<b>MDG</b>	Millennium Development Goals
<b>MDRI</b>	Multilateral Debt Relief Initiative
<b>MERCOSUR</b>	Mercado Común del Sur
<b>NAIRU</b>	Non-accelerating Inflation Rate of Unemployment
<b>NAMA</b>	non-agricultural market access
<b>NBER</b>	National Bureau of Economic Research
<b>NIEs</b>	newly industrialized economies
<b>ODA</b>	official development assistance
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>OFHEO</b>	Office of Federal Housing Enterprise Oversight

<b>OPEC</b>	Organization of the Petroleum Exporting Countries
<b>pb</b>	per barrel
<b>PPP</b>	purchasing power parity
<b>Project LINK</b>	international collaborative research group for econometric modeling, coordinated jointly by the Development Policy and Analysis Division of the United Nations Secretariat and the University of Toronto
<b>PRSP</b>	Poverty Reduction Strategy Paper
<b>PSI</b>	Policy Support Instrument
<b>R&amp;D</b>	research and development
<b>RAL</b>	Reserve Augmentation Line
<b>SACU</b>	South African Customs Union
<b>SDRs</b>	Special Drawing Rights (IMF)
<b>SGP</b>	Stability and Growth Pact (EU)
<b>SRF</b>	Supplemental Reserve Facility
<b>SU/SSC</b>	Special Unit for South-South Cooperation
<b>TNCs</b>	transnational corporations
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>UNFPA</b>	United Nations Population Fund
<b>VAT</b>	value-added tax
<b>WGP</b>	world gross product
<b>WTO</b>	World Trade Organization

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the United Nations Secretariat concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

The term "country" as used in the text of this report also refers, as appropriate, to territories or areas.

**Data presented in this publication incorporate information available as of 24 November 2006.**

**For analytical purposes, the following country groupings and subgroupings have been used:<sup>a</sup>**

*Developed economies (developed market economies):*

European Union, Iceland, Norway, Switzerland, Canada, United States of America, Australia, Japan, New Zealand.

*Major developed economies (the Group of Seven):*

Canada, France, Germany, Italy, Japan, United Kingdom of Great Britain and Northern Ireland, United States of America.

*European Union:*

Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom of Great Britain and Northern Ireland.

*EU-10:*

Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

*EU-8:*

All countries in EU-10, excluding Cyprus and Malta.

*Economies in transition:*

*South-eastern Europe:*

Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Montenegro, Romania, Serbia, The former Yugoslav Republic of Macedonia.

*Commonwealth of Independent States (CIS):*

Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

*Net fuel exporters:*

Azerbaijan, Kazakhstan, Russian Federation, Turkmenistan, Uzbekistan.

*Net fuel importers:*

All other CIS countries.

*Developing economies:*

Latin America and the Caribbean, Africa, Asia and the Pacific (excluding Japan, Australia, New Zealand and the member States of CIS in Asia).

*Subgroupings of Latin America and the Caribbean:*

*South America:*

Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela (Bolivarian Republic of).

*Mexico and Central America:*

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Mexico.

*Caribbean:*

Barbados, Cuba, Dominican Republic, Guyana, Haiti, Jamaica, Trinidad and Tobago.

*Subgroupings of Africa:*

*North Africa:*

Algeria, Egypt, Libyan Arab Jamahiriya, Morocco, Tunisia.

*Sub-Saharan Africa, excluding Nigeria and South Africa (commonly contracted to "sub-Saharan Africa"):*

All other African countries except Nigeria and South Africa.

*Subgroupings of Asia and the Pacific:*

*Western Asia:*

Bahrain, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, Yemen.

*East and South Asia:*

All other developing economies in Asia and the Pacific (including China, unless stated otherwise). This group is further subdivided into:

*South Asia:*

Bangladesh, India, Iran (Islamic Republic of), Nepal, Pakistan, Sri Lanka.

*East Asia:*

All other developing economies in Asia and the Pacific.

**For particular analyses, developing countries have been subdivided into the following groups:**

*Oil-exporting countries:*

Algeria, Angola, Bahrain, Bolivia, Brunei Darussalam, Cameroon, Colombia, Congo, Ecuador, Egypt, Gabon, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Mexico, Nigeria, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Trinidad and Tobago, United Arab Emirates, Venezuela (Bolivarian Republic of), Viet Nam.

*Oil-importing countries:*

All other developing countries.

*Least developed countries:*

Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen, Zambia.

*Landlocked developing countries:*

Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Lesotho, Malawi, Mali, Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, Swaziland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkmenistan, Uganda, Uzbekistan, Zambia, Zimbabwe.

*Small island developing States:*

American Samoa, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Cape Verde, Commonwealth of Northern Marianas, Comoros, Cook Islands, Cuba, Dominica, Dominican Republic, Fiji, French Polynesia, Grenada, Guam, Guinea-Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia (Federated States of), Montserrat, Nauru, Netherlands Antilles, New Caledonia, Niue, Palau, Papua New Guinea, Puerto Rico, Samoa, Sao Tome and Principe, Seychelles, Singapore, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu, U.S. Virgin Islands, Vanuatu.

*Heavily Indebted Poor Countries (countries that have reached their Completion Points or Decision Points):*

Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Chad, Democratic Republic of the Congo, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Uganda, United Republic of Tanzania, Zambia.

The designation of country groups in the text and the tables is intended solely for statistical or analytical convenience and does not necessarily express a judgement about the stage reached by a particular country or area in the development process.

<sup>a</sup> For definitions of country groupings and methodology, see *World Economic and Social Survey, 2004* (United Nations publication, Sales No. E.04.II.C.1, annex, introductory text).

## Chapter I

# Global outlook

### Macroeconomic prospects for the world economy

The world economy has registered another year of robust growth in 2006, marking at least the third consecutive year during which economic growth in many developing economies has reached its strongest pace in decades. Growth has also been very resilient in the least developed countries (LDCs), improving their prospects for fulfilling the Millennium Development Goals (MDGs). The year, however, also featured increased volatility in a number of market indicators for developing countries, especially in exchange rates, equity prices and the prices of primary commodities, although such volatility was transient and did not have a significant impact on the growth of these economies. The underlying momentum of the global economic growth also seems to have been tapering off during the second half of the year, and the moderation is expected to become even more noticeable in the outlook for 2007. According to the baseline forecast, which is premised on a number of assumptions (see box I.1), gross world product (GWP) is projected to expand by about 3.2 per cent in 2007, decelerating by about a half of one percentage point from 2006 (see table I.1). There are significant downside risks, however. A more pessimistic scenario could emerge if

The world economy registered another year of robust growth in 2006

#### Box I.1

##### Key assumptions for the baseline global economic forecast for 2007

The United Nations global economic forecast is prepared with the help of the global modelling framework of Project LINK (see <http://www.un.org/esa/policy/link/index.html>). To prepare the baseline scenario for the short-term macroeconomic outlook for a large number of countries in the world, a number of assumptions are made regarding the policy stance in the major economies and key international prices. The assumptions are summarized below and substantiated in the text.

The United States Federal Reserve is expected to maintain the Federal Fund interest rate at 5.25 per cent until mid-2007 and to reduce the rate by 50 basis points in the second half of 2007; the European Central Bank is expected to raise its policy rate by another 25 basis points over the course of the rest of 2006, bringing it to a level of 3.5 per cent, and to maintain that rate for 2007; the Bank of Japan has ended its policy of quantitative targeting for monetary policy and is expected to keep the policy interest rate at 0.25 per cent for the rest of 2006, but to raise the rate gradually by 100 basis points in 2007.

The assumptions regarding fiscal policy in individual countries are based mainly on official budget plans or policy statements.

The price of Brent crude oil is expected to average \$60 per barrel in 2007, down from an estimated average of \$64 per barrel for 2006. Prices of most non-oil commodities are expected to decline moderately in 2007, within a range of 5-10 per cent.

The United States dollar is expected to depreciate against most other major currencies in 2007. The dollar/euro exchange rate is expected to average 1.34 for 2007, compared with an estimated 1.25 in 2006 and the yen/dollar exchange rate is expected to average 108 for 2007, compared with an estimated 116 in 2006.

Table I.1  
**Growth of world output, 2001-2007** (annual percentage change)

	2001	2002	2003	2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
World output <sup>c</sup>	1.6	1.9	2.7	4.0	3.5	3.8	3.2
<i>of which:</i>							
Developed economies	1.2	1.2	1.9	3.0	2.5	2.9	2.2
Economies in transition	5.7	5.0	7.0	7.6	6.4	7.2	6.5
Developing economies	2.7	3.9	5.2	6.9	6.4	6.5	5.9
<i>of which:</i>							
Least developed countries	6.6	6.4	6.5	7.9	8.3	6.9	7.1
<i>Memorandum items:</i>							
World trade	-0.8	4.1	5.3	10.2	7.3	10.1	7.7
World output growth with PPP-based weights	2.6	3.0	4.0	5.2	4.8	5.1	4.5

**Source:** Department of Economic and Social Affairs of the United Nations Secretariat (UN/DESA).

**a** Partly estimated.

**b** Forecasts, based in part on Project LINK, an international collaborative research group for econometric modelling, coordinated jointly by the Economic Monitoring and Assessment Unit of the United Nations Secretariat and the University of Toronto.

**c** Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

the current slowdown in the United States housing market were to accelerate and cause a steep fall in demand and house prices. This would lead to stagnation in the United States economy and affect growth in the rest of the world. In this alternative scenario, the growth of GWP would decelerate to 1.9 per cent in 2007 (see box I.2).

## Expected deceleration of world economic growth in 2007

**Lower growth in the United States will slow the expansion of the world economy in 2007**

The expected slowdown in the world economy for 2007 will be mainly driven by the United States of America. Indeed, the United States economy has already decelerated notably during the second half of 2006. The slowdown is closely linked to the cooling down of the decade-long housing boom and is expected to cause an economy-wide slowdown during 2007 which will affect growth in the rest of the world. Growth in Europe and Japan, while close to potential, is not strong enough for these economies to act as new engines for the world economy. A deceleration of growth is also expected to be discernable in the developing countries and the economies in transition, but in varying degrees across countries. The recent boom in developing countries seems to have become increasingly endogenous within the group, propelled in particular by the rapid industrialization and growth of modern services in China, India and a few other emerging economies. Other developing countries, especially in Africa and Latin America, continue to be highly dependent on the production and exports of primary commodities and benefit from high prices in buoyant commodity markets strongly influenced by robust growth in a few major developing countries, especially China. Nevertheless, the lion's share of the global demand for primary commodities still originates from developed countries, to the extent that a slowdown in the United States, Europe and Japan will also significantly affect growth in developing countries. Furthermore, even the exports of major developing countries such as China and India

## Box 1.2

**An alternative scenario: the global implications of a collapse of the United States housing market**

To illustrate the implications of a burst of the housing bubble in the United States for world economic growth, an alternative scenario is simulated under more pessimistic assumptions.<sup>a</sup> The main difference between this scenario and the baseline is that it assumes a steeper decline of the housing market in the United States. Specifically, it is assumed that in 2007 house sales would be about 15 per cent and house prices 9 per cent lower than in the baseline.<sup>b</sup> Such a dramatic fall in the housing sector is expected to erode consumer and investor confidence, not only in the United States but also in the rest of world. As a result, a dwindling domestic demand in the United States would be accompanied by a recoiling of the willingness in the rest of the world to hold the financial assets of the United States, pushing up long-term interest rates on dollar-denominated capital market assets by about 150 basis points higher than in the baseline and reshaping the currently inverted yield curve on United States bonds (unusual by historical standards) to an upward-sloping one. At the same time, the United States dollar would depreciate more strongly with respect to other currencies than in the baseline.

As shown in the table below, GDP growth in the United States would drop to 0.5 per cent in 2007, substantially below the projected rate of growth of 2.2 per cent in the baseline. The growth costs of a housing slump of this magnitude in the United States would be equivalent to a drop of about 20 per cent in residential fixed investment. A sharper reversal in the housing boom would depress household spending. In this scenario, mortgage equity withdrawal would wilt amid falling house prices, rising interest rates and tightening scrutiny for mortgage loans. The precise impact of falling house prices on consumer spending remains an issue of debate among economists, but the more pessimistic scenario suggests that growth of household consumption would come to a standstill, whereas during the housing market boom private consumption increased by more than 3 per cent per year. Business investment would continue to increase in this scenario — partly because most American companies are in good financial condition owing to the high profitability over the past few years — but would do so at a much lower pace than in previous years.

The weakening of household consumption and business investment would translate directly into a curtailment in the import demand of the United States, which would be further aggravated by the income/price effects of the dollar depreciation vis-à-vis other currencies. In this scenario, real imports of the United States would register zero growth, in comparison with growth of about 6 per cent in previous years.

Weaker demand in the United States would be transmitted through trade linkages to the rest of the world. As the imports of the United States account for about 13 per cent of total world trade, a deceleration in its real import demand by about 6 per cent would lead to an immediate slowdown in the exports of other countries by about 1.5 per cent on average. The direct impact would be felt the strongest by those countries that have a large share of their exports in the market of the United States, particularly Canada, China and Mexico.

As also shown in the table below, in this scenario, world economic growth would drop by more than one percentage point compared to the baseline. In Europe and Japan, GDP growth would decrease by almost half a percentage point compared to the baseline.

GDP growth in developing countries would decelerate by almost two percentage points in this scenario. The prices of many primary commodities would drop as global demand severely weakens. Meanwhile, there would be significant negative wealth effects of a depreciated United States dollar for many developing countries with large amounts of dollar-denominated reserve assets.

How would China fare in this scenario? China's exports account for about 9 per cent of the world total. Meanwhile, the country's demand for energy and primary commodities has become

<sup>a</sup> This scenario was simulated using some of the existing Project LINK country models (rather than the full LINK system), along with an updated trade matrix. Consequently, the results presented here, particularly those for developing countries and the economies in transition, could be subject to a greater margin of error as international multiplier effects may have been underestimated.

<sup>b</sup> See Global Insight *U.S. Executive Summary*, September 2006, for more details.



Box 1.2 (continued)

### An alternative scenario: the global implications of a collapse of the United States housing market

increasingly important in determining the trends in the prices of these commodities as well as the economic growth of countries exporting them. China's exports, although quite diversified across all regions, remain highly correlated to the demand of the United States, as well as to other major developed economies. In the alternative scenario, China's exports would be affected further by a much stronger appreciation of the renminbi (by 8 per cent) against the United States dollar as compared to the baseline. As a result, China's export growth would weaken from the annual growth of 15 per cent in the baseline forecast to 7 per cent in the more pessimistic scenario. This deceleration of export growth would not translate into a commensurately lower GDP growth. China's GDP growth could be two percentage points lower in this scenario. As about 60 per cent of China's exports are categorized as "processing trade", this in turn would mainly harm exports of intermediate goods by many other Asian countries that are part of the same global production chain. The impact on primary commodities would be less. Meanwhile, as domestic demand in China could continue to expand, this could further cushion the impact on commodity-exporting countries by limiting the fall in the demand for and prices of primary commodities

An alternative scenario for the world economy in 2007 (percentage annual growth rate)

Selected indicators	Alternative	Baseline in comparison
World output growth	1.9	3.2
Developed economies	1.2	2.2
United States	0.5	2.2
Euro area	1.8	2.2
Japan	1.3	1.7
Developing economies	4.2	5.9
China	7.0	8.9
Economies in transition	5.7	6.5
World trade growth (volume)	5.5	7.7
US dollar exchange-rate index (annual percentage change)	-15.0	-7.0
Interest rate on 10-year US Treasury notes	6.0	4.5
United States current-account balance (billions of US\$)	-740	-840

Source: Project LINK.

The global imbalances would improve moderately in this scenario, as the current-account deficit of the United States would be reduced by \$100 billion compared to the baseline, mainly because of demand deflation. The more pessimistic scenario assumes that there is no policy stimulus in the rest of the world to counter the weaker demand in the United States. As a consequence, weakening demand for United States exports will limit the reduction of the current-account deficit.

In summary, although the probability of this more pessimistic scenario occurring is lower than for the baseline, most of the assumptions are not unrealistic and are in the order of magnitude of similar past events. The scenario highlights the possible implications of a rebalancing of the global economy at the cost of a considerable slowdown of economic activity. Such a downward adjustment may well enhance, rather than reduce, concerns about the sustainability of the United States and precipitate a steeper fall of the dollar and a shake up of financial markets. The case for internationally concerted macroeconomic policies in order to avoid such a scenario is therefore strengthened.

still largely depend on the demand of the major developed countries; consequently, their economies will also be affected.

The strong performance of the world economy in 2006 was remarkably broad-based. During 2006, 92 out of a total of 159 countries for which recent data are available succeeded in increasing per capita output by 3 per cent or more (see table I.2). This group of strong performers includes 60 developing countries, and the trend could signal further progress in poverty reduction.<sup>1</sup> At the same time, the number of countries that registered a decline in gross domestic product (GDP) per capita fell to only seven, less than in previous years. Nonetheless, the same table shows that there are still 47 developing countries which did not manage to reach a growth rate of 3 per cent in GDP per capita. This group includes a large number of African countries, suggesting that economic development in these countries falls short of what would be needed to achieve the internationally agreed poverty reduction goals. In the outlook for 2007, as the world economy moderates, the number of countries that will stay above the 3 per cent benchmark is expected to decline somewhat.

In order to measure the progress in achieving the MDGs, it is of particular interest to look at the performance of LDCs. Average economic growth of this group has remained strong, at 6.9 per cent, during 2006, although it decelerated compared to the exceptional performance recorded in 2005. Further moderation is expected for 2007, albeit with important variations across the poorest countries (see box I.3).

Among developed economies, growth in the *United States* has moderated significantly during the second half of 2006, and the weakness will likely linger into 2007. GDP is expected to grow at the subdued pace of 2.2 per cent in 2007, notably lower than the 3.2 per cent estimated for 2006 and markedly below potential growth. While a sharp downturn in the housing sector has been the major drag, worsening labour market and manufacturing output indicators signal that the economic deceleration has spread out. The more pessimistic scenario presented in box I.2 would predict a much stronger deceleration—to 0.5 per cent—of growth in the United States. At the same time, however, corporate finances are healthy and there is room for monetary easing; hence, the current moderation need not degenerate into a recession.

Economic growth in *Japan* remains robust by the standards of a mature developed economy, particularly in view of a sustained expansion since 2003 of an average rate of 2.5 per cent. In the outlook, however, the economy is expected to suffer a slowdown, as growth will drop from the rate of 2.5 per cent in 2006 to a rate of 1.7 per cent in 2007.

Growth in *Western Europe* has greatly exceeded expectations in 2006. GDP in the euro area is expected to grow by 2.5 per cent, the fastest since 2000, and about one percentage point higher than expectations in the early part of the year. Outside the euro area, rates of growth are also expected to be strong. This good performance has been anchored by healthy domestic demand, particularly investment expenditure, but net exports have contributed relatively little. A slowdown in activity is expected for 2007, however, with GDP growing at 2.2 per cent. The *new members of the European Union (EU)* have maintained momentum in 2006, benefiting from a broadly favourable external environment: an upturn in Western Europe and easy access to foreign financing. In addition to an impressive performance in the external sector, the contribution of domestic demand to

The strong growth in 2006 has been broad-based

LDCs have also witnessed high economic growth

The United States has moderated significantly

The Japanese economy is expected to slow down

Economic growth in Western Europe has been above expectations, but will moderate in 2007

<sup>1</sup> As a rule of thumb, 3 per cent per capita income growth is sometimes seen as the minimum required growth rate to achieve significant reductions in poverty, even in the absence of income redistribution.

Table I.2  
Frequency of high and low growth of per capita output, 2004-2007

	Number of countries monitored	Decline in GDP per capita				Growth of GDP per capita exceeding 3 per cent			
		2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>	2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
		Number of countries							
<b>World</b>	159	15	13	7	6	86	87	92	88
<i>of which:</i>									
Developed economies	33	1	2	0	0	14	11	14	12
Economies in transition	19	0	1	0	0	18	17	18	19
Developing countries	107	14	10	7	6	54	59	60	57
<i>of which:</i>									
Africa	51	10	6	6	5	20	26	23	25
East Asia	13	1	1	0	0	11	11	11	11
South Asia	6	0	0	0	0	5	5	5	5
Western Asia	13	2	2	1	1	7	5	8	4
Latin America	24	1	1	0	0	11	12	13	12
<i>Memorandum items:</i>									
Least developed countries	39	10	5	5	4	14	18	15	18
Sub-Saharan Africa <sup>c</sup>	44	10	6	6	5	16	20	17	19
Landlocked developing countries	25	3	4	2	1	12	14	12	13
Small island developing States	17	4	1	1	0	6	7	9	8
		Share <sup>d</sup>				Percentage of world population			
Developed economies	15.4	0.0	1.1	0.0	0.0	2.1	1.4	1.6	1.4
Economies in transition	5.6	0.0	0.1	0.0	0.0	5.2	5.0	5.0	5.0
Developing countries	79.0	1.8	1.4	0.6	1.1	67.0	68.9	66.5	68.0
<i>of which:</i>									
Africa	13.5	1.1	1.0	0.6	0.7	6.5	10.8	8.3	9.9
East Asia	30.8	0.0	0.0	0.0	0.0	30.3	30.2	30.0	29.9
South Asia	23.3	0.0	0.0	0.0	0.0	23.3	23.4	23.5	23.5
Western Asia	2.9	0.6	0.4	0.1	0.3	1.8	1.7	1.8	1.6
Latin America	8.6	0.1	0.0	0.0	0.0	5.1	2.9	3.0	3.0
<i>Memorandum items:</i>									
Least developed countries	10.4	1.3	0.8	0.4	0.7	7.6	8.1	7.7	7.8
Sub-Saharan Africa <sup>c</sup>	8.4	1.1	1.0	0.6	0.7	5.0	6.1	5.1	5.2
Landlocked developing countries	5.0	0.6	0.6	0.4	0.2	2.8	3.2	2.9	3.0
Small island developing States	0.8	0.2	0.0	0.0	0.0	0.3	0.4	0.4	0.4

**Source:** UN/DESA, including population estimates and projections from *World Population Prospects: The 2004 Revision*, vol. I, *Comprehensive Tables* and corrigendum (United Nations publication, Sales No. E.05.XIII.5).

<sup>a</sup> Partly estimated.

<sup>b</sup> Forecast, based in part on Project LINK.

<sup>c</sup> Sub-Saharan Africa excluding Nigeria and South Africa.

<sup>d</sup> Percentage of world population for 2000.

## Box 1.3

**Prospects for the least developed countries**

Economic performance in the least developed countries (LDCs) has been robust during 2006, recording GDP growth of about 6.9 per cent. While strong, growth has slowed compared to the exceptional performance in 2005 when the economies of the LDCs expanded at a rate of 8.3 per cent. The lower average growth is mainly due to a marked slowdown in a number of countries that did very well in 2005, such as Chad, Equatorial Guinea and Myanmar. The United Nations forecast for GDP growth in the LDCs is 7.1 per cent for 2007.

The good performance for the group as a whole masks important differences among individual countries. Oil-exporting LDCs such as Angola, Sudan and Mauritania sustained high growth rates, mostly in the double digits, underpinned by a further strengthening of oil-export earnings and increases in public spending. The economies of the Democratic Republic of Congo, Liberia and Sierra Leone also showed strength as a result of higher metal prices and post-conflict reconstruction activities. Continued political and economic reforms have contributed significantly to sustain growth above 5 per cent in countries such as Cape Verde, Madagascar, Mozambique, Senegal and Zambia. Similarly, Nepal's growth is expected to rebound considerably in the coming years owing to the improved political situation.

However, because of their narrow production and resource bases, the majority of LDCs remain vulnerable to weather shocks and are highly dependent on developments in commodity markets. Many LDCs benefited from increased agricultural output, but some, including Eritrea, Lesotho, Malawi and, to a lesser extent, the United Republic of Tanzania, suffered from drought and food shortages affecting the poor in particular and giving rise to inflationary pressures. Successes achieved in preceding years in diversifying economic activity away from the traditional agriculture sector and towards textiles and clothing in particular have been partially reversed by increased international competition following the termination of the Agreement on Textiles and Clothing and the related elimination of preferential export quotas. Production, exports and employment in textile industries declined sharply in Lesotho and Malawi in 2005. Despite some newly adopted agreements to restrain other competing countries from exporting textiles to the United States, growth has recovered only slowly in these countries in 2006. Bangladesh is one of the few LDCs that withstood the shock relatively well and managed to increase exports of ready-made garments and cotton textiles.

Higher oil prices, the weakening of some non-oil commodities prices, limited access to external financing and other adverse factors have undermined economic growth in the Central African Republic, the Comoros, Eritrea, Guinea, Guinea-Bissau and Togo, while delays in post-conflict reconstruction constrained economic activity in Haiti. Increased tensions on the Chad-Sudan border are partly responsible for the rapid deceleration of growth in Chad in 2006.

Fiscal and monetary policies will continue to be generally cautious in many LDCs, reflecting the commitments of these countries to comply with macroeconomic targets and benchmarks established by international financial institutions as the underlying conditions for external financial assistance. Some of the LDCs that recorded lower export receipts and increasing import costs will have to rely on additional external financing to avoid major recession. Providing additional official development assistance and debt relief to the LDCs has been at the heart of many multilateral and bilateral initiatives. These commitments, if fully implemented, should help to support the domestic actions of LDCs aimed at reaching the Millennium Development Goals.

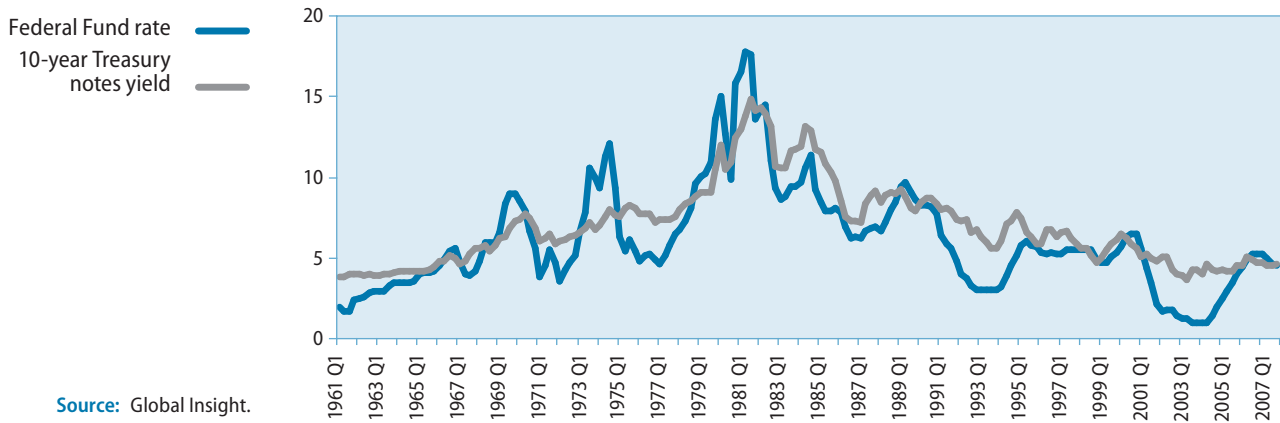
growth has become more important for Central European economies. Some slowdown is expected for 2007.

In other developed economies, weakening exports to the United States will likely drag the economic growth of *Canada* somewhat, but business investment and private consumption should remain robust. Similarly, growth in *Australia* is expected to be solid, as robust domestic demand is more than offsetting a drag in net exports caused in part by an appreciating currency.

Monetary policies have tightened during 2006

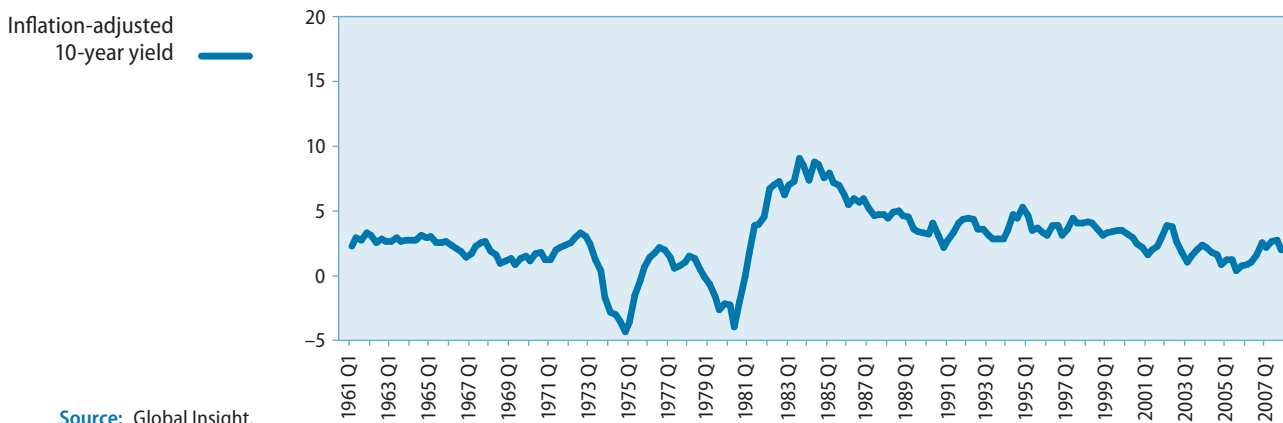
On the macroeconomic policy front, 2006 has been characterized by a general trend of monetary tightening, as the central banks of many economies have continued to raise interest rates. The monetary policy stance, however, remains accommodative in most economies, and the benchmark interest rates in world capital markets are still relatively low compared to historical levels, either in nominal or in real terms (see figure I.1a and 1b). Another feature of macroeconomic policy has been a notable improvement in the fiscal position of a large number of countries, mainly coming from stronger-than-anticipated government revenues resulting from robust economic growth. In the outlook, macroeconomic policies are expected to face more challenges. As the cyclical expansion of the world economies tapers off, central banks are likely to face competing demands. On the one hand, the monetary stance is required to remain accommodative in order to prevent the expected slowdown from deteriorating too far. On the other hand, however, inflation pressures may continue to linger as a result of the multi-year expansion phase in the business cycle, requiring further monetary tightening to curb inflation. Meanwhile, as growth is expected to

Figure I.1a  
Nominal interest rates of the United States, 1961-2007 (first quarter)



Source: Global Insight.

Figure I.1b  
Real interest rates of the United States, 1961-2007 (first quarter)



Source: Global Insight.

moderate, further cyclical increases in fiscal revenues will weaken, and in some countries structural problems in government finance remain difficult to deal with.

Among the economies in transition, the *Commonwealth of Independent States* (CIS) has maintained a strong pace in 2006, largely owing to high international prices of, and strong external demand for, oil, gas and metals. Rising export revenues have also spilled over into strong domestic demand in many of these economies. Private capital inflows have further contributed to the strong economic performance in the Russian Federation and Kazakhstan, while official financing and remittances remain an important source of funding of domestic spending for smaller economies, such as Georgia and Moldova. Robust regional growth is expected to continue in 2007, but moderate from the pace of 2006. Growth in *South-eastern Europe* has regained dynamism during 2006 as GDP accelerated to 5.9 per cent. Robust domestic demand has generated large external imbalances in the region. Despite measures to curb private credit growth and cool down domestic demand, household and corporate borrowings remain strong, boosting both residential and business investment. Supported by strong inflows of foreign direct investment (FDI), modernization of production bases has continued in the region. Growth is expected to maintain momentum in 2007.

Among developing countries, growth in *Africa* has maintained a strong pace, reaching almost 5.6 per cent in 2006. Many countries in Africa have sustained a relatively strong recovery since 2003, driven by increasing hydrocarbon export earnings, vibrant global demand for, and favourable international prices of, some non-oil commodities, vigorous domestic demand, and markedly growing FDI flows and donor support. This contrasts with a much poorer performance in the African countries suffering from protracted civil unrest and political disturbances, adverse weather conditions and/or decreased tourism revenues. The region's GDP is expected to expand by 5.6 per cent in 2007.

Growth in *East Asia* has continued to be buoyant at 7.7 per cent in 2006, with the acceleration in China setting the pace for the region. While China has posted a growth of over 10 per cent, the other economies in the region have also performed strongly, driven both by robust external demand for their exports and by a recovery of domestic demand in most countries. Some of this growth momentum was lost during the second half of the year as a result of tightening measures to take effect in China and a weakening global cycle of electronic products. The region is headed for a growth slowdown in 2007 to a more sustainable yet continued strong pace of 7.0 per cent. Growth in *South Asia* has remained strong at 6.7 per cent in 2006, despite a slight moderation from the previous year. India has largely maintained a brisk pace, driving the regional average. The other economies have also continued growing at above-trend rates, with Bangladesh and the smaller economies of Sri Lanka and Nepal accelerating owing to a sustained rebound in the agricultural sector, and—in the case of Nepal—the cessation of violence since April 2006. In 2007, regional GDP growth is expected to average 6.5 per cent. Increased oil revenues have once again buoyed growth in *Western Asia* during 2006, particularly in the oil-exporting countries. The decline in oil prices in the latter half of the year will have an impact on GDP growth prospects for 2007, but growth is still expected to remain at a strong pace. Growth will slow for the oil importers from an estimated 5.1 per cent in 2006 to 4.7 per cent in 2007.

Growth in *Latin America and the Caribbean* has been solid during 2006, owing to both strong external and domestic demand. While the South American countries as a group continue to lead the region's growth, Mexico and Central America have started to catch up, broadening growth throughout the region. The growth estimate for Brazil has recently been downgraded as a result of weaker-than-expected manufacturing output and export

Growth of the economies in transition is expected to remain robust in 2007

African economies are expected to continue to expand by 5.6 per cent in 2007

Asian economies are expected to settle at a lower, but sustainable, growth rate

A gradual slowdown of growth is expected in Latin America

growth. The other South American countries, except Chile, are performing better than expected by earlier forecasts. Mexico's prospects have also improved, private and public consumption having accelerated and real investment having increased, supported by strong public investment in an electoral year. The growth in the region is expected to slow down in 2007, albeit gradually.

### A more volatile international economic environment for developing countries

Developing countries need to be cautious about a possible deterioration of the international economic environment

The international economic environment for the developing economies and the economies in transition, as measured by trends in international prices of primary commodities, the costs of external financing, capital flows and trade flows, remains favourable by historical standards, but has shown increased volatility during 2006. Foreign-exchange and equity markets in many emerging market economies experienced considerable turmoil in May and June of 2006, when prices of many primary commodities also fell substantially. Although the turbulence was short-lived and most markets quickly recovered, both emerging market economies and international investors might well stand reminded of the risky nature of these markets (see chapter III for further discussion). Given the outlook for 2007, these countries should be cautious about the possible deterioration of their international economic environment. As global demand moderates, the prices of many primary commodities are expected to weaken and capital flows may slow. Moreover, the risks for a disorderly adjustment in the global imbalances remain high (see below), and the emerging market economies would suffer a disproportionately large impact from such adjustment should it occur.

The expansion of world trade has been robust...

The growth of world *merchandise trade volume* has been robust during 2006, increasing at a pace of approximately 10 per cent. The strength of global trade has been broad-based. Asian economies continue to lead the dynamism in global trade, with exports of China and India increasing by about 20 percent in real terms. Also, many developing countries in Africa and Latin America have managed to expand their exports at double-digit rates, owing to strong global demand for raw materials. Oil-exporting countries have continued to experience large increases in export revenues as oil prices increased further. Exports of the major developed countries have also been robust, driven by global demand for capital goods, as business investment in many countries continues to recover from the low levels experienced since the last downturn at the beginning of the century. In the outlook for 2007, growth of global trade is expected to moderate to about 8 per cent for the year along with the slowdown of the United States economy. (See chapter II for a more detailed discussion of trends in international trade and commodity markets.)

...despite a serious setback in negotiations on the world trading system

The world trading system suffered a serious setback during 2006 as the *multilateral trade negotiations* under the Doha Round in the World Trade Organization (WTO) were suspended in July. Earlier, the Sixth Ministerial Conference of the WTO that had taken place in Hong Kong Special Administrative Region (SAR) of China at the end of 2005 had achieved some modest results. However, further negotiations reached an impasse when no compromise could be made among major parties on export subsidies and domestic supports in the agricultural sectors. Attempts to restart the negotiations continue, but political obstacles to an early completion of the Doha Round as planned remain huge, as discussed in more detail in chapter II. Meanwhile, regional and bilateral free trade arrangements are mushrooming, intensifying the risk for an increasing fragmentation of the international

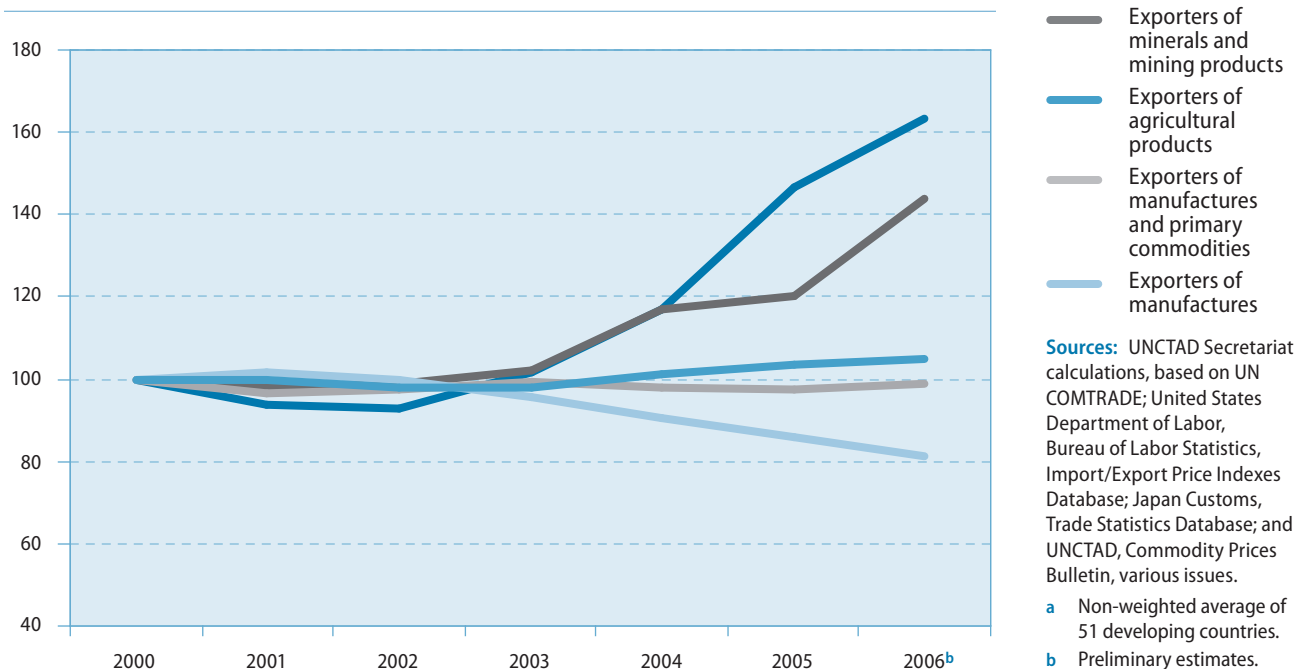
trade system. This might create difficulties in the interface between the international trading system and regional arrangements.

The *terms of trade* have continued to improve during 2006 for many commodity-exporting developing countries, as has been the case now for four consecutive years. Despite a drop of about 30 per cent from their peak in August, average oil prices were up by 20 per cent for the year compared to the average for 2005. Prices of base metals and minerals have increased even more markedly. Only the prices of a number of beverage and food commodities have experienced some moderation. As a result, countries specialized in oil and mining exports have experienced significant gains in their terms of trade, manufacture exporters experienced losses, and more diversified exporters and exporters of mainly agricultural products have witnessed little change (see figure I.2).<sup>2</sup>

Table I.3 estimates the impact of recent changes in the terms of trade and income payments on the national income in different groups of developing countries. For exporters of manufactures, the loss of national income due to the deterioration of their terms of trade has been about 1 per cent of GDP on average in 2004-2006. In contrast, net exporters of oil and exporters of other minerals and metals have obtained extraordinary income gains from terms-of-trade effects, amounting on average to as much as 8.0 and 5.4 percentage points of GDP per annum, respectively. In the case of exporters of minerals and metals, these gains were almost entirely offset by increased net factor investment income payments to abroad. The latter mainly involves increased profit remittances by transnational corporations that own large parts of the mining activities. Changes in net investment income payments on balance had little effect on the national income of oil

Terms-of-trade changes have had a sizeable effect on developing-country incomes

Figure I.2  
Net barter terms of trade of selected developing countries, 2000-2006<sup>a</sup>  
(indices: 2000 = 100)



<sup>2</sup> See UNCTAD, *Trade and Development Report 2006* (United Nations publication, Sales No. E.06.II.D.6), chap.1.



Table I.3  
**Impact of changes in terms of trade and net factor income payments on national income in selected developing-country groups, average for 2004-2006 (percentage of GDP)**

	Gains or losses from terms of trade	Effects of net factor income payments	Net observed direct impact
Exporters of manufactures	-1.0	-0.2	-1.1
Oil exporters	8.0	-0.3	7.7
Exporters of mineral and mining products	5.4	-4.8	0.5
Other commodity exporters	-0.4	-0.1	-0.5

**Sources:** UNCTAD calculations, based on United Nations Statistics Division, United Nations Common Database; IMF, Balance of Payments Statistics Database; Economist Intelligence Unit, *Country Forecasts*, various issues; national sources; and UNCTAD estimates of unit value and volume of exports and imports.

exporters, where a greater share of oil revenue is retained domestically in State-owned firms or by Governments through taxation and where higher investment income inflows are derived from accumulated foreign assets. This does not hold true for oil exporters in sub-Saharan Africa, where increased profit remittances to abroad do represent a significant drain on national income. Other primary commodity exporters suffered modest terms-of-trade losses between 2004 and 2006, especially those dependent on oil imports.

The increased volatility in commodity prices during 2006, as indicated by a sharp decline of 20-30 per cent in the prices of many commodities in May-June and more periodic retreats in the second half of the year, might be the harbinger of a further reversal in these prices. In the outlook, the terms of trade for many commodity-exporting countries are expected to deteriorate somewhat in 2007.

*Private capital flows* to emerging market economies peaked in 2005, and, as anticipated, moderated during 2006. A further moderation of the volume of net inflows to this group of countries is expected in 2007. A major part of the slowdown compared to 2005 has been due to a reduction in net borrowing from commercial banks and from the bond market. Many of these economies took advantage of very favourable market conditions during the previous year to pre-finance obligations due in 2006. On the other hand, FDI flows have continued to increase, although they are concentrated in a handful of emerging market economies. Meanwhile, official flows to this group of countries have continued to be largely negative as a result of increased net repayments to official creditors. In the outlook, the amount of net private capital flows to emerging markets will likely decline in 2007. Part of the decline will reflect the reduced demand for external financing, as many of these economies have been running current-account surpluses for several consecutive years and have accumulated vast amounts of foreign reserves, thus becoming less dependent on international capital, at least cyclically in the short run (see chapter III for a further discussion of recent trends in international finance).

The *external financing costs* for emerging market economies remain low. The spreads in the Emerging Markets Bond Index (EMBI) reached all-time lows in the first quarter of 2006, but then increased during the turmoil in the global markets in May-June; since then, they have tended to fall again. Meanwhile, the benchmark interest rates underlying the external financing costs for emerging market economies are also low, despite a continuous monetary tightening in the United States where short-term policy interest rates have increased over the past two years. As a result, the yield curve of the interest rates on the benchmark

Capital flows to emerging market economies have flattened

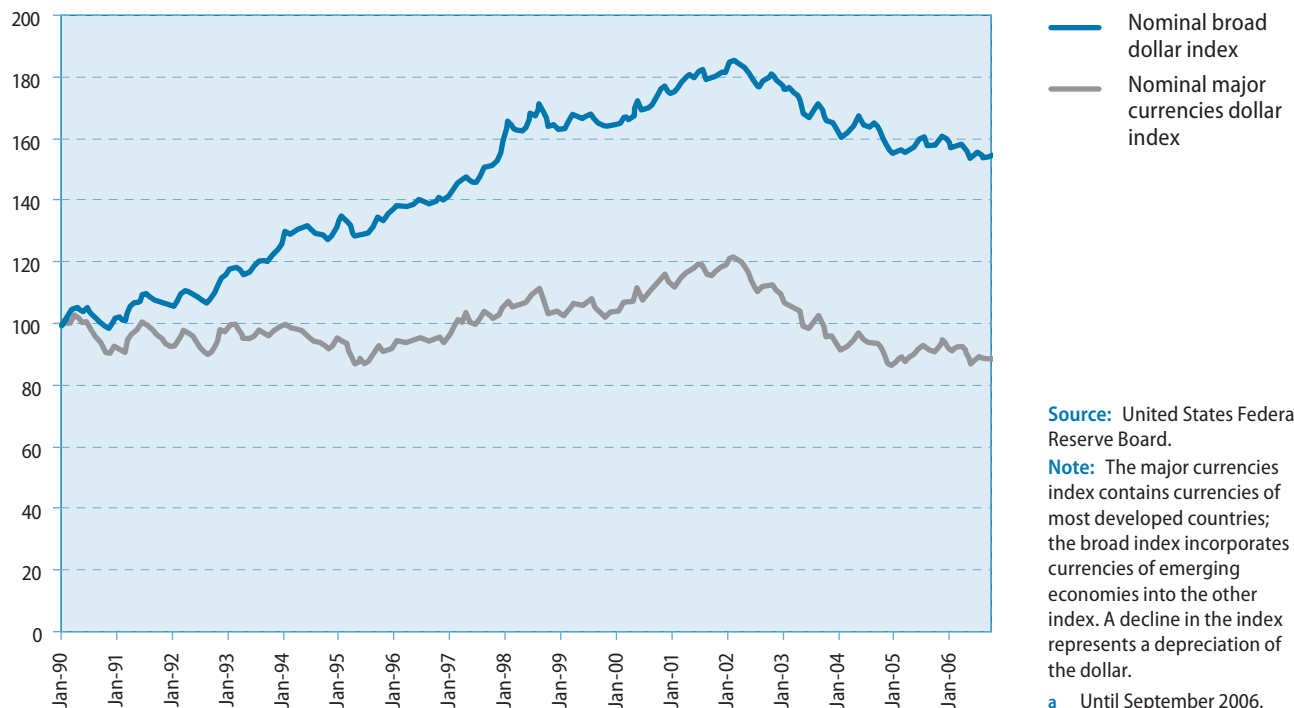
United States Treasuries is inverted. Such favourable external financing conditions may not be sustainable, however, as the ever-growing current-account deficit of the United States will eventually induce higher benchmark interest rates in capital markets.

Volatility has also increased in the *exchange rates* for many emerging market economies vis-à-vis the United States dollar during 2006, even though on the year-over-year basis their currency prices have changed only modestly, appreciating by about 2 per cent against the dollar on average. Some emerging market currencies appreciated against the dollar at the beginning of 2006, but there was a sharp reversal by 10-20 per cent in May-June. Most of the currencies have since resumed their trend of appreciation against the dollar. The exchange rates among the major currencies have also experienced some volatility during 2006, but with a clear weakening of the dollar towards the end of the year (see figure I.3).

Many developing countries have continued to accumulate *foreign-exchange reserves* during 2006. After totalling about 2 trillion in Special Drawing Rights (SDRs) by the end of 2005, foreign-exchange reserves for developing countries as a whole are estimated to have increased by another SDR 300-400 billion by the end of 2006, led by holdings in Asian economies. In early November, China's stock of foreign-exchange reserves surpassed \$1 trillion. In the outlook, the pace of reserve accumulation in developing countries is expected to slow in 2007. The increased foreign-exchange reserves have provided greater protection in dealing with external shocks, such as deteriorations in the terms of trade, reversals of capital inflows and speculative attacks on local currencies. The mirror image of the accumulation of foreign-exchange reserves by developing countries is the widening of the external-account deficit and increased net external-liability position of the major reserve-currency country, the United States. While this may look like a convenient constellation now, over time an

The accumulation of foreign-exchange reserves may not insulate developing countries from economic losses due to global systemic shocks

Figure I.3  
Exchange-rate index for the United States, 1990-2006<sup>a</sup>



increasing external-debt position of the United States would weaken the value of the dollar as confidence in the sustainability of the deficit begins to erode; this in turn would cause major capital losses for those countries that hold foreign-exchange reserves. This echoes Triffin's dilemma of the Bretton Woods monetary system dominated by a single national currency as the international reserve.<sup>3</sup> While the accumulation of more foreign-exchange reserves can make individual developing countries less vulnerable to idiosyncratic shocks, it will not isolate them from major economic losses due to global systemic shocks, such as an abrupt adjustment of the external deficit of the United States and a large devaluation of the reserve currency.

### The need for more employment growth

Job growth has not been commensurate with the high rates of GDP growth recorded in the world economy

The global employment situation has shown some improvement in 2006, as robust economic growth has stimulated job creation in some regions of the world. Job growth, however, has not been commensurate with the high rates of GDP growth recorded in the world economy, particularly in the developing economies, suggesting that structural factors underlie the weakening of the nexus between GDP growth and employment generation.

Unemployment rates have declined in most developed countries during 2006. The rate of unemployment in the United States has decreased to a five-year low of 4.6 per cent, although this is partly the result of a decline in labour-force participation. In Western Europe, the unemployment rate continued its downward trend in 2006, reaching the level achieved during the last cyclical nadir in 2001. In 2007, employment growth should remain steady and the unemployment rates could decline further, although only moderately. Meanwhile, labour market conditions have improved in almost all the new EU countries, most notably in Poland and the Baltic States. Increased migration to the EU-15 countries has further alleviated the unemployment problem in the EU-8 countries. The continued economic recovery in Japan has also resulted in a fall in the unemployment rate, and labour markets in Australia, Canada and New Zealand are also in good shape.

Robust output growth in developing countries has not visibly lowered unemployment rates

Despite a robust GDP growth in the developing countries, growth of employment has not been sufficient to substantially lower unemployment rates. The economic revival in Africa is being driven mainly by capital-intensive sectors, such as the oil and mining sectors, which have only minor backward and forward linkages with the rest of the economy, thus limiting the impact for reducing high rates of unemployment and underemployment. As growth prospects improve, labour participation has increased in some African and Latin American countries, limiting the drop in unemployment rates. In East Asia, with the exception of Hong Kong SAR, Taiwan Province of China and Singapore, unemployment rates have remained entrenched and, in many cases, have increased. Even China's spectacular economic growth has apparently not succeeded in solving all of the country's unemployment problems owing, among other things, to labour shedding in the restructuring of State-owned enterprises, strong productivity growth and labour shifts out of agriculture. Similarly, unemployment rates remain high in South Asia, as the formal sector is unable to absorb the rapidly growing labour force. The unemployment rate in Western Asia is also stubbornly entrenched and still in double-digit figures. Unemployment is exacerbated by the growing number of young people entering the labour market and the failure to create more employment opportunities for the domestic workforce.

<sup>3</sup> For a further discussion, see below, and chapter 6 of *World Economic and Social Survey 2005: Financing for Development* (United Nations publication, Sales No. E.05.II.C.1).

Among the economies in transition, in South-eastern Europe, unemployment continued to decline in Bulgaria and Croatia, but in many countries of the former Yugoslavia, unemployment rates remain stubbornly high, despite progress in the post-conflict reconstruction. In some of the CIS countries, unemployment rates also continue to be worryingly high, even though some sectors are suffering from labour shortages.

## Benign inflation outlook

Headline *inflation* rates have edged up notably in the majority of countries during 2006, but in most cases this has been caused by the direct impact of higher oil prices. Core inflation rates, excluding such highly volatile components as the prices of energy and food, have been much more stable, indicating that the pass-through of higher oil prices into overall inflation is limited. There have also been some growing concerns about the inflation implications of rising labour costs and the tightening rate of capacity utilization, mostly in major developed economies, but inflation expectations, as measured by various surveys and market indicators, remain stable. In the outlook, inflation is expected to moderate along with a slowdown in global demand.

Among developed economies, inflation in the United States accelerated notably in the first half of 2006, but stabilized thereafter. While the rate of headline inflation is running above 3 per cent for 2006, the core inflation measures have all been above 2 per cent and are thus beyond what is commonly perceived as the comfort zone by the Federal Reserve. Falling energy prices in the latter part of 2006 have eased some inflation worries, but the rise in labour costs is a new source of concern. Nonetheless, inflationary expectations remain stable at slightly over 2 per cent, as measured by the spread between the yield on the 10-year Treasury note and that of the Treasury Inflation-Protected Securities. In the euro area, the Harmonised Index of Consumer Prices (HICP) has remained well above 2 per cent for most of 2006. Core inflation has been much lower, but is also drifting upwards. The main impetus for the inflationary surge has been the rise in oil prices, but so far there has been minimal evidence of pass-through effects into the general price level or into inflationary expectations. Inflation concerns voiced by policy makers have recently also stemmed from certain estimates that GDP might have grown above potential and that the rate of unemployment might have approached the so-called Non-Accelerating Inflation Rate of Unemployment (NAIRU). Nonetheless, in the outlook, inflation is expected to moderate (but to remain above 2 per cent) in both the United States and the euro area, owing to expected monetary tightening in the latter. In Japan, a continued recovery in domestic demand has finally pushed the economy out of its deflationary spiral. In the outlook, inflation indicators are expected to be above zero in 2007.

Inflation has remained stable in most developing countries and economies in transition. A number of these economies have experienced higher rates of inflation during 2006, but in most cases this was mainly due to the direct effects of higher oil prices, with only limited second-round effects. Several economies only have encountered significant inflation pressures, caused by country-specific factors. In Africa, inflation for the region increased slightly in 2006, but remains low on average. In a few African countries, however, there were sharp increases in consumer prices as a consequence of food shortages, currency depreciation and/or an immediate pass-through of higher imported-oil prices to consumers. Inflation has been below 5 per cent for most East Asian economies, except Indonesia, where the removal of subsidies in oil prices in late 2005 caused a significant rise

Inflation is expected to moderate along with a slowdown in global demand

Inflation remains stable in most developing countries and economies in transition

in consumer prices. In China, defying concerns about overheating, inflation has remained low, running at just over 1 per cent. Inflation in South Asia has edged up slightly. In Western Asia, while a few oil-importing countries have seen a rise in inflation, inflation pressure has also built up in oil-exporting countries owing to the significant increase in oil revenues, which have fuelled wage increases. In most countries in Latin America, inflation was about 5 per cent in 2006. Only a few economies in the region registered inflation rates of above 10 per cent, but in these cases also inflation is on the decline. Inflation in most economies in transition remains close to 10 per cent, higher than in other regions, but it has not accelerated. The inflation outlook for most developing countries and economies in transition remains benign in 2007, particularly in view of an expected weakening of world market prices for oil.

## Uncertainties and downside risks for the global outlook

The outlook encompasses a number of uncertainties and risks

The outlook for the global economy encompasses a number of uncertainties and important risks, mainly downside ones. The major concerns relate to the likelihood of a burst of the housing bubbles in a number of countries, to uncertainties regarding oil price developments and to the mounting risk of a disorderly unwinding of the global imbalances. These uncertainties and risks are discussed below. Other (not negligible) risks include the possible outbreak of avian influenza<sup>4</sup> and unpredictable geopolitical shocks.

### Burst of the housing bubble

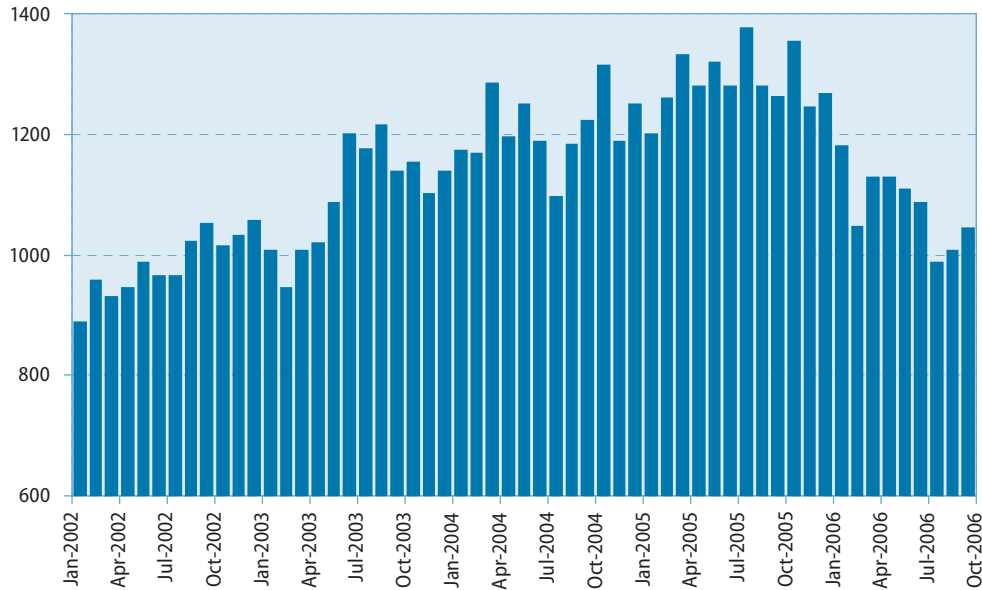
A number of economies have experienced a substantial appreciation in house prices over the past 10 years. House prices have increased by about 100 per cent in the United States, 150 per cent in Spain, 200 per cent in the United Kingdom of Great Britain and Northern Ireland and 300 per cent in Ireland, for example. Various housing indicators in those countries, such as the affordability ratio, price-to-rent ratio, mortgage loans-to-GDP ratio and ownership ratio are at historical highs, suggesting a peak in the value of houses relative to the underlying economic fundamentals. While the housing boom has contributed, in varying degrees, to the robust growth of these economies, a drop in house prices would work conversely. The notable growth moderation in Australia and the United Kingdom a year ago was unambiguously attributable to a cooling down of the housing sector.

The housing market in the United States has slowed further

The slowdown in the trend of various measures of the housing sector in the United States has accelerated during the course of 2006, despite some month-to-month variation in the data. For example, new home sales, which had been on a steady rise for several years, declined in 2006 by about 20 per cent from the level of 2005, down to their level of early 2003 (see figure I.4). Existing home sales have also dropped and all other housing market indicators show a clear slowdown. Nonetheless, so far, the adjustment in the level of house prices has been modest, but the rate of deceleration in the prices has been salient. According to the Office of Federal Housing Enterprise Oversight home price index, house prices

<sup>4</sup> The potential cost for the world economy of an avian flu pandemic was discussed in some detail in the World Economic Situation and Prospects as of mid-2006, available from [http://www.un.org/esa/policy/wess/wesp2006files/wesp06update\\_eng.pdf](http://www.un.org/esa/policy/wess/wesp2006files/wesp06update_eng.pdf).

Figure I.4  
New home sales in the United States, 2002-2006<sup>a</sup> (seasonally adjusted annual rate)



Source: United States Census Bureau.

<sup>a</sup> Until October 2006.

turned from an average annual gain of about 10 per cent in the past few years to a slight decline in the second half of 2006.

Further weakening of the housing sector is expected for the United States. Median sales prices of existing homes have registered a decline since August 2006, for the first time in eleven years. While the piling up of the inventory of both unsold new homes and existing homes for sale augurs a further weakening in sales and construction, the extent of the overvaluation in house prices implies that there is more room for the prices to drop. Since 1997, house prices in the United States have appreciated by about 80 per cent in real terms (adjusted by inflation rates)—in comparison with a real appreciation of just 10-20 per cent in booms of earlier years—leading to a deterioration in housing affordability.

Meanwhile, a few positive factors may prevent the housing sector from descending into a full-blown crisis. Interest rates on mortgage loans are still low by historical standards. Furthermore, although novel mortgage products such as interest-only loans, innovative forms of adjustable-rate mortgages and the allowance for a limited amount of negative amortization have been proliferating, the banking sector has in general sound balance sheets, particularly when compared to its condition prior to the savings-and-loans crisis of the late 1980s and early 1990s. Finally, the delinquency rates on mortgage loans have been low. The baseline outlook is, therefore, for a continued weakening in the housing sector with a modest decline in prices. Nonetheless, the risk for a much steeper decline in housing activity and prices cannot be precluded.

The impact of the unfolding housing slowdown on the United States economy will occur mainly through household spending. The housing sector is one of just a few industrial sectors that have created a sizeable number of new jobs in the last few years. The wealth effects and the impact on consumer confidence are also important. In the past few years, there has been an increase in mortgage equity withdrawal to finance consumption spend-

The impact on the economy will occur mainly through household spending

ing. The annual amount of such withdrawals increased from a very small amount in the late 1990s to more than \$600 billion in 2005, accounting for more than 6 per cent of disposable household income. Although not all withdrawals were directly used to finance current household spending, they have been a crucial factor in determining the strong growth of private consumption and the decline of the household saving rate to below zero. Mortgage borrowing has slowed, however, since the housing market peak in 2005. Mortgage equity withdrawals declined to about \$300 billion in 2006. Although the impact on household consumption and saving rates has been small so far, leading to some complacency in the policy response, the negative wealth effects on household spending will become more evident when house prices actually start to decline.

House prices have a bearing on the global imbalances

For the global economy, the risks associated with the housing sector are serious, not only because of the sheer size of the economies concerned, but also because of an inextricable linkage between the increase in house prices and global imbalances. A number of economies that have seen substantial appreciation in house prices are also running large external deficits (including, of course, the United States) and experiencing a decline in household savings to very low levels. In this regard, the housing booms in those countries have been indirectly financed by borrowing from the high-savings countries running external surpluses. Therefore, a collapse in house prices in major economies would provoke a contractionary and abrupt adjustment of global imbalances.

### The impact of higher oil prices

Oil prices have been on a steady upward, albeit more volatile, trend

Oil prices have been on a steady upward trend over the past few years, and the volatility seems to have increased significantly during 2006. The price of Brent crude reached a record high of \$78.69 per barrel on 8 August 2006, but has since dropped by about 30 per cent and is expected to be about \$60 per barrel by the end of the year.

In general, a tight worldwide oil production and refinery capacity, coupled with a solid global oil demand, has been the fundamental factor behind the uptrend in oil prices. Increased, and capricious, geopolitical tensions are among the major factors driving the volatility. This situation will likely remain, and oil prices are therefore expected to stay high and volatile. Should the ongoing moderation in world economic growth set through, however, oil prices may decline along with a moderation in global oil demand. Such an effect could well be offset by the announced reduction of production quotas by the Organization of the Petroleum Exporting Countries (OPEC).

Unlike the two previous oil crises of the 1970s and the 1980s, higher oil prices have thus far not generated contractionary effects on the world economy. There are three main reasons. First, there has not been any large-scale curtailment in global oil supply as experienced in those two episodes and, despite the increased fears of supply disruptions, global oil production has thus far continued to grow in recent years. Second, strong economic growth underlying the higher demand for oil has compensated for the negative welfare effects of higher oil prices. Third, unlike in the 1970s, there were no visible “second-round” inflationary effects triggered by higher energy costs and Governments did not turn to severe monetary tightening to contain inflation.

A number of lower-income and net oil-importing countries have been more vulnerable to the oil-price increases

Oil-exporting developing countries have obviously gained from the higher oil prices. At the same time, however, a significant number of lower-income and net oil-importing countries have been more vulnerable to the oil price increases. Out of some 75 low-income and lower-middle-income net oil importers, 35 belong to the group of LDCs, and 12 are small island developing States. These countries are in general more dependent on oil as the

primary source of energy. The weight of net oil imports in these countries varies, but in some cases it has reached over 40 per cent of total imports.

Because of the low short- and medium-run price elasticity of oil demand, the increased oil bill will be borne at the cost of demand for other goods and services. This has led a number of low-income countries to curtail other non-oil imports. For example, during 2003-2005, countries like Bhutan, Guyana, Lesotho, Mauritania and Myanmar had to reduce domestic demand in order to cut non-oil imports by more than 10 per cent of GDP, thus affecting output growth. In Nicaragua and Kenya, economic losses due to higher oil prices have been estimated at about 2-3 per cent of GDP per year on average between 2002 and 2006 (see box I.4).

Many countries have tried to protect domestic consumers from higher oil prices through subsidies, price controls or other compensatory measures. As oil prices stay high, these countries lack the means to avoid the pass-through of higher international oil prices to domestic prices as fiscal positions continue to deteriorate. The subsidies reduce the fiscal space for other essential public expenditures, engendering a situation that could jeopardize the necessary investments towards the achievement of the MDGs.

The recent decline in oil prices seems to have allayed the fears of an oil crisis and some analysts have even started to talk about the benefits of lower oil prices. The United Nations baseline outlook for the world economy, however, remains cautious about the impact of oil prices. First, if oil prices stay between \$50 and \$60 per barrel, they would continue to be a burden, rather than a boon, for many lower-income oil-importing countries. Second, although the international prices have declined by 30 per cent from their peak, the prices of oil products being faced by consumers in many countries have not declined accordingly, especially in those countries that have high taxes on oil products, substantial government subsidies or strict control on domestic oil prices. For these economies, the recent decline in oil prices will have minimal positive impact on consumer spending. Third, even for those countries in which the latest decline in oil prices has been translated directly into lower energy prices for consumers—such as in the United States, where the gasoline prices have dropped recently by 20-30 per cent—the positive effects of lower oil prices on household spending should not be overestimated. Lower household spending on energy does not necessarily lead to increases in spending on other goods and services. Instead, households may dig less into savings to cover their energy bills. In other words, lower oil prices could well

The recent decline in oil prices could be an indication of the slowdown in global demand; but lower oil prices will not reverse the slowdown

#### Box I.4

#### Higher oil prices have caused significant economic losses in lower-income oil-importing countries

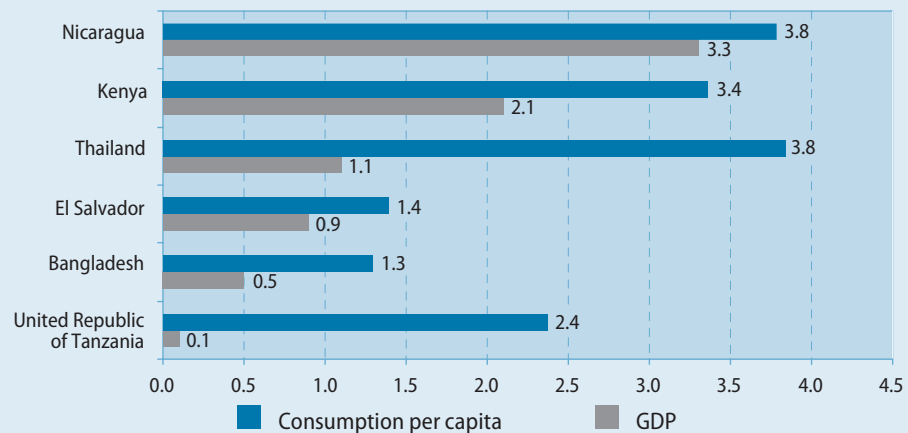
The growth costs of higher oil prices have been substantial in oil-importing developing countries, as high as 2-3 per cent of GDP per year in some cases. To assess the impact of rising oil-prices on the economic activity in net oil-importing countries, analyses were conducted using dynamic computable general equilibrium (CGE) models developed by the United Nations Department for Economic and Social Affairs for a number of low- and lower-middle-income net oil importers (Bangladesh, El Salvador, Kenya, Nicaragua, Thailand and the United Republic of Tanzania). To isolate the impact of the higher oil prices, counterfactual simulations were conducted to analyse the welfare outcomes that could have been achieved had oil prices not risen since 2001, and these results were compared with a baseline scenario with observed oil price levels. The main results can be summarized by the following four points:



## Box I.4 (continued)

**Higher oil prices have caused significant economic losses in lower-income oil-importing countries**

First, in all six countries, aggregate output would have been higher had oil prices not risen. The average annual loss of real GDP varies from 0.1 per cent in the United Republic of Tanzania to 2.1 in Kenya and 3.3 per cent in Nicaragua during 2002-2006 (see figure below). Nicaragua and Kenya are particularly affected because of the high share of oil in total imports, about 17 and 20 per cent respectively, and the transmission effects of higher production costs on the rest of the economy. In contrast, the output losses for the United Republic of Tanzania and Bangladesh are estimated to be minimal.

**Welfare costs in terms of output and consumption losses because of higher oil prices, average for 2002-2006 (percentage of GDP and per capita real household consumption)<sup>a</sup>**

Source: UN/DESA.

<sup>a</sup> Estimated on the basis of counterfactual simulations with CGE models. Cost in terms of GDP is estimated as the difference between baseline output and simulated output had oil prices not increased since 2001.

Second, trade balances have deteriorated in all countries. Apart from rising import bills, the oil price increase has raised production costs in export sectors, especially in Nicaragua where export production appears to be highly energy intensive. The widening trade deficit weakens real exchange rates, but the currency depreciation has not led to sufficient export growth. Instead, the real exchange-rate depreciation exacerbates the inflationary effect of rising oil prices and puts further downward pressure on real consumption. Thus, both supply effects (higher production costs) and demand effects (lower consumption) determine the lower output growth.

Third, lower growth has produced less demand for labour. Rising unemployment forms, together with increased consumer prices, the main transmission mechanism for lower household welfare resulting from higher oil prices. Real household consumption per capita in Kenya, Nicaragua and Thailand could have been more than 3 percentage points higher per annum without the oil price increases during 2002-2006.

Finally, the simulation results discussed above only consider the impact of higher oil prices. In reality, however, the adverse effects of rising oil prices for the period 2002-2006 have been mitigated by the positive impact of higher prices of non-oil commodities in some of these countries, specifically in Thailand and the United Republic of Tanzania. Additional simulations show welfare losses to be much less when the gains through higher prices of the main export commodities are taken into account. For instance, the gains of higher coffee prices alone have generated welfare gains of 0.7 per cent of GDP per year in the United Republic of Tanzania. In contrast, terms of trade have deteriorated in Bangladesh, Kenya and El Salvador, as prices of some of their main export commodities declined, thus exacerbating the growth costs caused by higher oil prices.

lead to a replenishment of savings, rather than to higher spending. In general, as indicated by many studies, the relationship between oil prices and economic growth tends to be asymmetric: higher oil prices usually forebode a slowdown in growth, but lower oil prices alone are a poor predictor of stronger growth.<sup>5</sup> In other words, while the recent decline in oil prices could be an indication of the incipient slowdown in global demand (among other factors), conversely, lower oil prices would not work as a factor mitigating the slowdown.

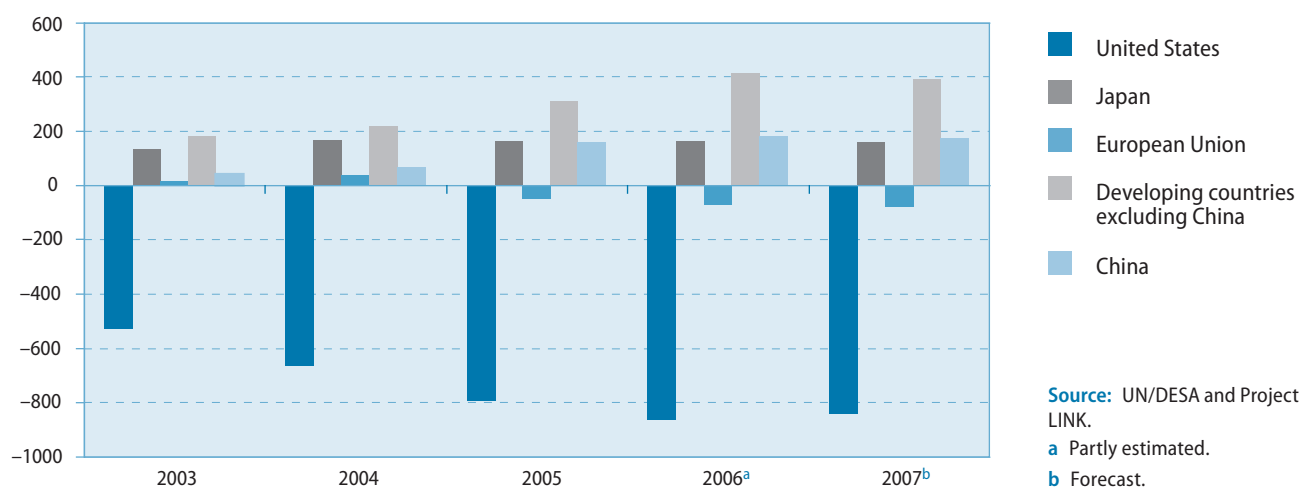
## Widening global imbalances

Current-account imbalances across countries have widened further during 2006. The deficit of the United States will rise to about \$870 billion by the end of 2006, an increase of \$80 billion from the previous year (see figure I.5). Meanwhile, the deficits of a few other developed countries, such as Australia, Spain and the United Kingdom have also become more substantial, either in absolute terms or relative to the size of their respective economies. In the aggregate, the current account of the developed economies shows a deficit of more than \$600 billion. While Germany has maintained a sizeable surplus of about \$120 billion, the euro area as a whole is showing a small deficit. Japan's surplus of \$170 billion remains the largest in absolute terms among developed countries.

Most developing regions are running surpluses, with the surplus in the group of oil-exporting countries increasing the most in 2006 and estimated to reach \$500 billion. The surplus in developing Asia remains above \$200 billion, concentrated almost exclusively in China, Hong Kong SAR and Taiwan Province of China. Latin America has managed to run a surplus for an unprecedented four consecutive years, though this has also been concentrated in a few countries, while Africa is also in a small surplus. While the surplus in the CIS group has surpassed \$100 billion, mainly because of the Russian Federation, the group of other economies in transition in Europe is running a sizeable deficit.

Current-account imbalances have widened further

Figure I.5  
Current-account balances, 2003-2007 (billions of dollars)



<sup>5</sup> See, for example, James D. Hamilton, "What is an oil shock?", *Journal of Econometrics*, vol. 113, No. 2, April 2003, pp. 363-398.

In the United States, the worsening current-account deficit reflects a widening of the private savings gap, as the deficit in the government account has improved by \$50 billion, or 0.4 per cent of GDP, during 2006. The household saving rate has dwindled further to -0.6 per cent of disposable income, while business investment has accelerated to offset a decline in residential investment. On the external side, most of the \$80 billion increase in the United States current account reflects a larger trade deficit (up by \$60 billion), much of which is due to higher oil and other commodity prices (see chapter II).

Investment rates have recovered

Worldwide, the phenomenon of a pervasive “investment anaemia” underlying the global imbalances, as delineated in the *World Economic Situation and Prospects 2006*,<sup>6</sup> seems to have lessened somewhat. In both Japan and Europe, the volume of investment increased moderately, by about 2 and 4 per cent in 2006, respectively, but investment growth in most other developed countries remains below the average rates of the late 1990s. Some improvement in investment has also been observed in developing countries, but the trend is divergent across countries. In East Asia (excluding China), the decline in investment rates was most evident in the years immediately following the Asian financial crises of the late 1990s. The recent recovery has tightened capacity utilization rates in manufacturing to their highest degree in the post-crisis period, suggesting that investment outlays should recover. However, investment recovery has not been consistent throughout the region. Investment demand in China has remained strong, growing at a rate of about 15 per cent in real terms. Among other developing regions and the economies in transition, investment growth has further strengthened in most oil- and commodity-exporting countries, fuelled by increased revenues and driven by the strong demand for infrastructure and new production capacity. Investment rates in many of the LDCs are still too low to form a prelude to sustained supply capacity growth.

The indebtedness of the United States has deepened

As a result of its widening current-account deficit, the indebtedness of the United States has deepened. This is undermining the sustainability of the current constellation of global imbalances. While the data for 2006 are not yet available, the latest official release for the net international investment position of the United States for 2005 could be used as a reference point for assessing development in 2006.<sup>7</sup> By the end of 2005, United States-owned assets abroad were about \$10 trillion (measuring the FDI component at current cost), while foreign-owned assets in the United States amounted to \$12.7 trillion. By implication, the United States net international investment position was negative, standing at -\$2.7 trillion and equivalent to 22 per cent of its GDP. In 2005, the net international investment position worsened by \$333 billion, despite a current-account deficit of \$790 billion. The difference between the increase in the net indebtedness of the United States and its current-account deficit reflects, aside from statistical discrepancies, valuation adjustments in both the United States-owned assets abroad and the foreign-owned assets in the United States related to, among other factors, exchange-rate changes and appreciation/depreciation of stocks. In recent decades, such valuation adjustments would almost always have been in favour of the United States, making the annual change in the net debt position of the United States measurably smaller than the amount of the current-account deficit. The net debt position has, however, been on the rise over the years, along with the growing current-account deficit. Against this backdrop, given the estimate of the current-account deficit at about \$870 billion in 2006, and taking into account the exchange-rate changes and the relative performance among major financial markets during 2006, the net international

<sup>6</sup> *World Economic Situation and Prospects 2006* (United Nations publication, Sales No. E.06.II.C.2).

<sup>7</sup> See United States Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, monthly, various issues (2006).

investment position of the United States will likely worsen by some \$400 billion by the end of 2006, to reach over \$3 trillion (see figure I.6).

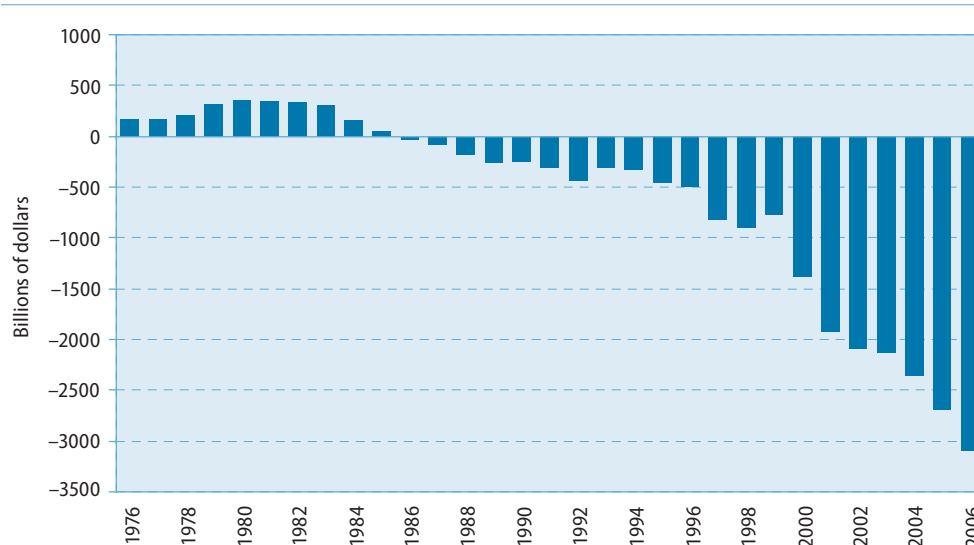
While the United States-owned assets abroad largely take the form of direct investment, stocks, and bank and non-bank claims, a sizeable share of the foreign-owned assets in the United States are allocated in holdings of the United States Treasury securities. For example, by the end of 2005, United States-owned direct investment abroad was about \$2.5 trillion, while its foreign counterpart was about \$1.9 trillion. A similar pattern has likely been maintained during 2006, as a number of countries with current-account surpluses have continued to accumulate foreign reserves. The share of the United States dollar was about 66 per cent of world total official reserves by the end of 2005; this share may have lowered slightly during 2006 as anecdotal evidence has indicated downward adjustments in the dollar-denominated reserves in some countries.

In the baseline outlook for 2007, the global imbalances are expected to decline, albeit only slightly. With the economic growth in the United States expected to moderate more than that of other major economies, its current-account deficit is expected to narrow slightly from an estimated \$870 billion in 2006 to \$840 billion in 2007. A continued cooling in the housing sector in the United States will likely curb household spending and raise savings, while the projected depreciation of the dollar is expected to keep up United States export growth and to restrain its imports. Meanwhile, the assumption of lower oil prices in the baseline for 2007 would also work to ameliorate the deficit of the United States.

The current and envisaged macroeconomic policy stances appear poorly designed to deal adequately with the problem of the widening global imbalances. The move towards more restrictive monetary and fiscal stances in Japan and other major surplus countries, such as Germany, is likely to lead to further increases in their respective surpluses. To the extent that this policy stance limits demand growth in these economies, it will induce a further slowdown of the world economy and make it more difficult for the major deficit country, the United States, to adjust its external imbalance through export growth. The more expansionary fiscal stance in some of the East Asian surplus countries seems insufficient to compensate for such deflationary effects in the absence of major exchange-rate adjustments.

The current macroeconomic policy stances cannot deal with the problem of the widening global imbalances

Figure I.6  
United States net international investment position, 1976-2006



Sources: United States Bureau of Economic Analysis (up to 2005) and Project LINK (estimate for 2006).

## The need for macroeconomic policy coordination<sup>8</sup>

Slow progress, if any, in the unwinding of the global imbalances will enhance the risk of a strong speculative wave towards dollar depreciation. Such exchange-rate depreciation could help reduce the external deficit of the United States, but given the dependence of global economic growth on demand stimuli from the world's largest economy, falling import demand in the United States would have further global deflationary repercussions. This in turn could quite easily unravel the momentum of economic growth in developing countries and jeopardize any further progress in poverty reduction. A hard landing of the dollar would further raise uncertainty among international investors and could upset financial markets.

Calls for coordinated macroeconomic policies to facilitate an orderly adjustment of the global imbalances have become more persistent

Such concerns have prompted calls for international coordination of macroeconomic policies to facilitate an orderly adjustment of the global imbalances while minimizing economic growth costs. As indicated, national policies may be able to move current-account balances in the desired direction, but this would likely be at the expense of lower economic growth and would keep policy makers from taking any steps to adjust the external balance. A coordinated strategy, in contrast, could help avoid the negative growth effects and create confidence in the stability of financial markets. Cooperation would make use of the spillover effects of the policies of one country as an offsetting factor for the negative demand effects of the adjustment in another country. Growth stimulus in Europe and Asia, for instance, could then offset the initially contractionary effect of adjustment policies conducted by the United States.

In order to rebalance the global economy and to reduce risks, the United Nations, the International Monetary Fund (IMF) and the World Bank alike have reiterated this need for international policy coordination. However, with the exception of some recent progress in strengthening multilateral surveillance and multilateral consultation at the IMF, no concrete actions have taken place. The obstacles to achieving effective policy coordination are formidable, yet there seem to be feasible solutions towards which the international community can work.

### A new Plaza Agreement?

Recent proposals for coordinated economic policies to facilitate an orderly adjustment of global imbalances include the idea of a “grand bargain”, as proposed by Buirra and Abeles, Cline’s proposal for a “new Plaza Agreement”, and calls by the Group of Twenty Four (G24) for a “coordinated response” on the part of systemically important countries.<sup>9</sup> Cline’s version is representative. He argues that there is a need for an initiative comparable to the 1985 Plaza Agreement to be undertaken by the Group of Twenty (G20), the group of industrial

<sup>8</sup> This section benefited greatly from a background paper prepared for the *World Economic Situation and Prospects 2007* by Barry Eichengreen, entitled “Should there be a coordinated response to the problem of global imbalances? Can there be one?”, University of California, Berkeley, September 2006 (available from <http://www.un.org/esa/policy/>).

<sup>9</sup> See, respectively, Ariel Buirra and Martin Abeles, “The IMF and the Adjustment of Global Imbalances,” submitted to the G24 Technical Group Meeting (16-17 March 2006, Geneva); William R. Cline, “The Case for a New Plaza Agreement,” *Policy Briefs in International Economics*, No. 05-4, (Washington, D.C.: Institute for International Economics, December 2005); and “Communiqué of the Intergovernmental Group of Twenty Four on Monetary Affairs and Development,” Washington, D.C., 21 April 2006, available from [www.imf.org](http://www.imf.org).

and emerging-market economies.<sup>10</sup> The United States would set out credible plans for eliminating its fiscal deficit over five years. United States trading partners would agree to allow their currencies to rise against the dollar. Countries that have been intervening in foreign-exchange markets to prevent their currencies from appreciating would pledge to stop doing so. The Bank of Japan and the European Central Bank, which have not been intervening, could pledge to sell dollar reserves. The IMF would provide advice on how much fiscal adjustment and currency realignment is required.<sup>11</sup>

A detailed analysis of the Plaza Agreement unearths a series of weaknesses and shortcomings.<sup>12</sup> For one thing, the accord actually came too late, when adjustment processes were already under way. Nonetheless, a comparable ad hoc initiative may well be the desirable second-best option for addressing the current global economic situation in the absence of any more fundamental changes to the global monetary and financial system. Indeed the observation that the Plaza Agreement came too late only strengthens the case for early concerted efforts for dealing with the imbalances in a timely manner, in order to ensure that any corrections in the world economy unfold in a gradual and non-disruptive manner.

Moreover, the world has changed since 1985 in ways that complicate efforts to coordinate policies. Financial markets have grown, making it even more difficult to manage exchange rates. There are more systemically significant countries—from China to the Russian Federation to Saudi Arabia—increasing the number and heterogeneity of countries that would have to be party to an effective agreement. In addition, there is even less agreement about the nature of the problem and the design of an appropriate response now than in 1985.

The world has changed since 1985 in ways that complicate efforts to coordinate policies

## The case for policy coordination

With the rising degree of integration of the world economy, the cross-country effects of national policies have also become more pronounced. Combining and making use of these spillover effects in a coordinated manner carries the potential to improve the stability and efficiency of the global economy, an issue which becomes increasingly relevant because of the opportunity costs associated with any disorderly unravelling of imbalances.

The current global imbalances form the starting point for justifying the need for international policy coordination. The imbalances have emerged within the context of a combination of various national policies. In terms of national account identities, a country's current account is equal to the difference between its savings and investment, but the sum of all current-account balances in the world should be equal to zero. This implies that the United States current-account deficit, which represents an excess of United States investment over United States savings, is mirrored in excess savings over investment and a current-account surplus in the rest of the world. Consequently, national policies cannot be considered in isolation but need to be seen in the context of the cross-border spillover effects they give rise to, which are likely to be greater in an international environment character-

The current global imbalances form the starting point for justifying the need for international policy coordination

<sup>10</sup> The G20 is made up of Finance Ministers and Central Bank Governors from 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States, plus two European Union representatives (the President of the Council and the President of the European Central Bank).

<sup>11</sup> A problem with Cline's variant, which will be evident in the light of the preceding, is that it does not include measures, fiscal or other, to directly stimulate spending outside the United States.

<sup>12</sup> See Barry Eichengreen, *op. cit.*

ized by an increasing interconnectedness of individual economies resulting from decreasing barriers to trade and capital flows.

Uncoordinated national policies can move current-account balances in the desired direction, but only at the expense of undesirable growth effects

Making the case for policy coordination, however, first requires an analysis of the national policy perspective and the derivation of a suboptimal outcome in the absence of any cooperation. For example, a decision by the United States to raise taxes or reduce government spending may have the direct effect of downsizing the United States current-account deficit, but at the cost of United States growth; this would likely be undesirable for national policy makers, even although it may also have the external effect of moving foreign current accounts in a desirable direction.<sup>13</sup> Similarly, decisions in Asia to cut taxes or raise government spending may have the direct effect of reducing Asia's current-account surpluses. In Japan, for instance, this may generate a desirable growth stimulus, but would probably also require more structural measures to increase the economies' potential output. Policy makers in China, on the other hand, may be concerned that this could overheat its fast-growing economy, even though this would also have the external effect of moving both the United States current account and United States growth in desirable directions. In other words, viewed individually, national policies can move current-account balances in the desired direction, but this could occur at the expense of undesirable growth effects and could therefore provide the rationale for national policy makers' not taking any steps towards current-account adjustment.

By contrast, a cooperative policy strategy would allow each country to achieve a superior outcome with a reduction in the imbalances and a neutral net effect on economic growth. More specifically, cooperation would make use of the spillover effects of the policies of one country as an offsetting factor for the negative element of the adjustment policy of another country.

### Obstacles to policy coordination

However, any coordinated policy approach will face obstacles. First, there is less than complete consensus on the risks posed by the current constellation of global imbalances, and even those Governments that agree that adjustments are necessary do not agree on their urgency. Second, Governments are uncertain about the initial position of their economies and about how policy initiatives will affect the current account or how their own economies will be affected by policy initiatives abroad. Third, even were they to agree on a desirable package of coordinated policy adjustments, they would still face resistance from domestic interest groups that stand to be adversely affected, notwithstanding the prospect of global welfare improvements. Finally, Governments may perceive that they lack control of effective policy instruments and will therefore face a commitment problem in that they would prefer that other countries bear the brunt of the adjustment and in that they may be reluctant to follow through on their part of the bargain. An effective resolution of existing imbalances requires sustained action over time, and Governments often find it difficult to credibly commit themselves, much less their successors in office.

With regard to the first obstacle outlined above, one influential view questioning *the urgency of adjusting the imbalances* suggests that there is no need for adjustment as long as

Any coordinated policy approach will face various obstacles

Different views exist on the urgency of adjusting the imbalances

<sup>13</sup> This assumes that the direct expenditure effects of the fiscal initiative (United States residents spend less, including on imported goods) dominate its financial effects (fiscal consolidation by the United States puts downward pressure on interest rates and leaves more savings to finance investment abroad).

emerging markets are willing to continue financing the United States current account for an extended period, regardless of whether there are questions about its ultimate sustainability.<sup>14</sup> The most influential argument along these lines is that emerging markets—above all China, but also the rest of Asia and other regions—benefit from maintaining exchange rates that are pegged at low levels against the dollar and exporting their way to faster growth. Japan pioneered this strategy in the 1950s and 1960s, and virtually every emerging market that has sustained high growth for an extended period has subsequently emulated its example. The export sector is the locus of learning, productivity growth and spillover effects; a stable, competitively valued currency that boosts the growth of exports also makes a country a more attractive destination for inward FDI and portfolio capital flows. Furthermore, the steady flow of imports that constitutes the United States trade deficit provides cheap consumption goods that lower consumer prices and help contain inflation. In addition, by recycling their trade surpluses into United States Treasury bonds, the East Asian and other surplus countries contribute to the continuation of the favourable low interest-rate environment. East Asian countries not only benefit from exporting to the United States, but their Governments are also willing to continue accumulating dollar-denominated financial assets and maintain undervalued exchange rates vis-à-vis the dollar, thus ensuring a steady stream of financing for United States deficits at current interest and exchange rates. This might suggest that the current situation is sustainable. However, even if the dollar ultimately stands to lose value against other currencies, Asian governments and central banks, for fear of disrupting this process of export-led growth, will be reluctant to curtail the foreign-exchange market intervention that keeps their currencies from appreciating and results in their massive accumulation of international reserves. If the consequence is capital losses on dollar reserves, then this is an acceptable price to pay for prosperity.

The appeal of this line of argument is its consistency with the observation that foreign central banks and not private investors have been providing much of the finance for the United States deficit in recent years. It helps to explain the bond market “conundrum” insofar as foreign central banks are the marginal purchasers of United States Treasury bonds, as well as the coexistence of United States deficits with low interest rates. It should be noted, however, that the argument is not that the current constellation of imbalances is sustainable indefinitely. Ultimately, emerging markets, in Asia and elsewhere, will exit the stage of export-led growth and allow their currencies to appreciate, as Japan did in the 1970s and 1980s. Like Japan before it, China cannot suppress the growth of the service sector forever. Nor will it wish to do so insofar as the service sector, and not just industry, can be a locus of knowledge spillover effects and learning by doing. Sooner or later China will want to graduate from a growth model based on exports of merchandise to one based on a better balance between domestic and foreign demand, and between the industrial and service sectors.

The problem for policy coordination is that this transition is not without risks. China and other Asian countries are understandably reluctant to tamper with success. And even if it is in the collective interest of Asian countries to keep the dollar up and, by implication, their currencies down, it is in their individual interests to curtail their purchases of dol-

---

14 This is sometimes referred to as the “Bretton Woods II” or “global co-dependency” view. See, for example, Michael Dooley, David Folkerts-Landau and Peter Garber, “An Essay on the Revived Bretton Woods System,” *NBER Working Paper*, No. 9971 (Cambridge MA: National Bureau for Economic Research, 2003); and Catherine Mann, “Managing Exchange Rates: Achievement of Global Re-Balancing or Evidence of Global Co-Dependence?,” unpublished manuscript, (Washington D.C.: Institute for International Economics, 2004).



lar-denominated assets and diversify their reserves into other currencies in order to avoid capital losses. Consequently, maintaining the present situation also poses a problem of collective action, providing a further reason for arguing that the current constellation of global imbalances will not persist indefinitely.

Interpretive disagreements also exist on the current position and prospects of the economies

The second area of interpretive disagreements concerns the *current position of the economies* concerned. If economic growth in the United States remains robust, then the kind of tax increases and expenditure reductions described in the previous section can contribute to the correction of the country's twin deficits without damaging the prospects for continued growth. But if the odds of a recession are high—for instance, owing to the further weakening of the housing market—then tax increases are the last thing that the economy needs. Similarly, if the Chinese economy is seen to be at risk of overheating, then monetary tightening and currency appreciation will help to produce a more sustainable growth path. If, on the other hand, current rates of economic growth are seen to be sustainable and the danger of overheating is perceived to be minimal, the contractionary effects of monetary tightening cum currency appreciation would actually be undesirable and contrary to the objective of rebalancing the global economy, and should thus be offset by expansionary fiscal policy.

In addition to the current position of the economies, there is also likely to be disagreement on economic prospects, for example with regard to how rapidly the economies of the United States and the major surplus countries can grow, how quickly these countries can move away from their current growth models, and how long the dollar will retain its “exorbitant privilege” as the leading international currency. In the euro area, for instance, countries' fiscal policies are bound to the Stability and Growth Pact and, moreover, there are differing views about whether sustaining long-term growth and keeping social security systems viable would not require more fiscal consolidation, rather than expansion. In Japan, as indicated, current growth is near its potential and views differ on how to raise potential more structurally. Many of the oil-exporting countries, particularly in the Middle East, may find it difficult to raise the absorptive capacity of their economies in the short run.

Conflicting interests hamper policy coordination

*Domestic interest groups* may present a third set of obstacles to policy coordination. Different constituencies—exporters versus producers for domestic markets, high- versus low-income households, capital versus labour—are affected differently by the same macroeconomic policy adjustments. Even when there is agreement that a coordinated set of national policy adjustments is good for each country overall, it may work to the disadvantage of a subset of residents. Moreover, in the absence of mechanisms for compensating the losers, they will resist implementation. In the United States, for example, the construction industry and other sectors producing non-traded goods have reasons of self-interest to oppose a weaker dollar that would shift resources into traded goods' production. The direct beneficiaries of the tax cuts of the last six years—high-income groups by most calculations—have a self-interest in resisting calls to reverse or sunset those measures. Cuts in capital gains taxation, estate taxation and top marginal rates disproportionately benefit high-income households. Thus, even if it is accepted that cutting the budget deficit, and therefore the current-account deficit, is good for the country as a whole, whether unilaterally or in conjunction with complementary policy adjustments abroad, interest groups within the country may prevent these policies from being implemented.

In China's case, it is less obvious that the central Government in Beijing is constrained by special-interest politics, but it must work in harmony with local governments, many of which have a strong interest in boosting exports from their region and thus have

reason to resist significant currency appreciation. The governments of the coastal regions that benefit disproportionately from the current export-based development model (owing to their location) would similarly resist a change in the policy mix that shifted demand toward non-traded goods.

For those convinced that coordinated policy adjustments would be a global welfare improvement, the issue then becomes how to mobilize the special interests that stand to benefit from the direct effects, and how to compensate the losers.

A fourth obstacle relates to the *perceived lack of effective policy instruments*, which may erode the commitment of Governments to a particular concerted policy package for redressing the global imbalances. For example, one often-heard recommendation is that the United States Government should try to boost private savings rates. It is easier to put forward this request than for policy makers to implement it. In practice, we know relatively little about how the standard policy variables affect household savings—the component of private saving that has fallen most dramatically in recent years. To express it in other words, we have at best a limited understanding of why savings rates vary so dramatically. The determinants of savings rates pointed to by standard approaches like the life-cycle model or interest rates, for example, explain only a small part of observed variations. Also, the predictions of the so-called Ricardian equivalence hypothesis, which suggest that private savings should move inversely with the aggregate fiscal balance, are contradicted by the recent behaviour of household savings in the United States. If both monetary policy, which shapes the evolution of interest rates, and fiscal policy, which helps to determine the budget balance, have little systematic impact on household savings behaviour, there may be little that macroeconomic policy makers can do to reliably influence private savings.

There is a perceived lack of effective policy instruments

However, even where policy makers are faced with less uncertainty regarding the link between policy instruments and policy targets, there are at least two caveats that might stand in the way of successful, sustained international policy cooperation. First, policy makers may be confronted with a lack of the degree of freedom to adjust domestic policies as part of international negotiations. Monetary policy, for example, is the responsibility of the central bank and not the Government, which is typically the party to international negotiations. In addition, even in the areas where the Government has the main authority over the policy-making process, it might see its room for manoeuvre limited to varying degrees by institutional and procedural arrangements, such as the need for approval by the legislative assembly for fiscal policy measures. In this context, any adjustments have to be negotiated not only internationally, but also in the domestic policy arena.

Second, a Government that is party to a cooperative policy agreement has an incentive to renege. Having announced its willingness to engage in coordinated policy adjustments, a Government will feel inclined not to follow through on its part of the agreement in the hope of reaping the benefits stemming from other Governments' actions without incurring any costs itself. As sustaining the cooperative outcome will require repeated interaction, an outside mechanism would be needed to make commitments credible.

## What can be done?

In summary, the fact that the imbalance between the United States and the principal surplus economies arises out of policies and conditions in all the countries concerned makes it unlikely that any one Government would be prepared to bear the costs of the policy initia-

tives needed to correct that imbalance on its own. That the deficits of one set of countries are the surpluses of the rest of the world means that measures by either group to reduce the imbalance also reduce the imbalance of the other—in other words, there are cross-border spillovers that accrue as an externality. Moreover, when the effects are external to a particular country, national policy makers operating in isolation will not have an incentive to implement globally optimal policies. Together, these observations point to the desirability of coordinating the response. Ideally, that response would combine measures to reduce the growth of spending in the United States with measures to stimulate the growth of spending in other countries. Reducing the growth of United States spending relative to the growth of spending in the rest of the world, hence reducing its trade deficit, will require some adjustment of relative prices; as part of this coordinated response, Governments will also have to permit adjustment of the exchange rate between the dollar and other currencies, including Asian currencies.

The expected gains from policy coordination and, more particularly, avoidance of the opportunity costs of a disorderly adjustment should provide the starting point for searching for feasible pathways to overcome the obstacles observed above. In carrying out this exercise, Governments and international organizations should work towards taking the following steps to address the current global imbalances:

(1) *Develop a consensus on common goals through international consultations with outside mediation*

There is unlikely to be international action to address global imbalances without agreement that those imbalances are a problem. Agreement on goals is more likely when there is a sharing of information and analysis and when an outside body exists to impartially adjudicate disputes. This is the idea behind the multilateral consultations inaugurated by the IMF in the spring of 2006. According to the IMF, these consultations will provide a “forum for debate” among parties to a common economic issue.<sup>15</sup> The aim is to enable the Fund and its members to agree on policy actions to address vulnerabilities affecting both individual countries and the global financial system. Members will exchange information and views, with the IMF acting as an honest broker. The first such consultation, as announced by the Managing Director on 5 June 2006, will focus on global imbalances and involve the United States, the euro area, Japan, China and Saudi Arabia. Its focus, appropriately, is to be on “spillovers and linkages among these and other economies, rather than on domestic economic issues”. Bilateral consultations with the five parties, as the first stage, will be followed with multilateral meetings, out of which, it is hoped, will develop an agreement on a package of mutually beneficial policy adjustments.

To be sure, there is no shortage of other venues, including some of long standing, for discussion and debate among national policy makers: the IMF Executive Board and the International Monetary and Financial Committee, the IMF’s Steering Committee, made up of Finance Ministers and Central Bank Governors from the same 24 countries represented on the Executive Board, where major issues concerning world economic developments and financial stability are discussed.

Greater consensus-building  
is needed

<sup>15</sup> See IMF, “IMF to Begin Multilateral Consultations with a Focus on Global Imbalances”, 5 June 2006, available from [www.imf.org](http://www.imf.org).

The strongest argument for a new mechanism and for the premise that consultations with outside mediation can make a difference, however, is that none of these other groups is appropriately constituted for the problem at hand. In the case of global imbalances, the Group of Five (G5), Group of Seven (G7), Group of Eight (G8) and Group of Ten (G10) do not include important emerging market economies like China or major oil exporters like Saudi Arabia. An advantage of a new mechanism is that it can be appropriately constituted to address the problem at hand. It would possess the flexibility needed to address new issues and, at the same time, should have more legitimacy than consultations by ad hoc groups of countries.

## *(2) Enhance the context for mediation and the perceived legitimacy of the mediator*

Agreement on coordinated policy adjustments that work to everyone's advantage is likely to be easier to reach against a backdrop of progress on other global political and security issues, reached through deliberations in the United Nations General Assembly, the Security Council and other venues. In addition, mediation is unlikely to work when doubts exist about the impartiality of the mediator. In the present context, there is the problem that the IMF is a creature of its shareholders and that two of the parties to the first multilateral consultation, the United States and the euro area, have more votes and leverage in the Fund than other participants. Thus, reforming governance and representation in the IMF so that seats in the Executive Board and votes in the Fund better represent developing country interests in the decision-making process is critical for enhancing the legitimacy of the Fund's mediation. A first step in this direction was taken at the annual meetings of the IMF and World Bank in Singapore, where it was agreed to increase quotas and votes for four particularly underrepresented countries (China, Mexico, the Republic of Korea and Turkey) and to raise the number of basic votes cast by every country (regardless of size) as a way of enhancing the voices of poor countries (see chapter III for further discussion). The proposed changes in voting rights will not significantly alter the present balance of power in the IMF. Hence, a more comprehensive governance reform is still required. There is a need for agreement on a new quota formula so that other rapidly growing countries see that their problem of underrepresentation is addressed—and that such problems will continue to be addressed over time. There is also a need to update the composition of the Executive Board, where largely for historical reasons European countries occupy as many as 9 of the 24 seats (depending on whether Spain holds the chair of its largely Latin American constituency at any particular moment). There is the need to reform leadership selection, to ensure that the Managing Director and, indeed, the entire management team are chosen on the basis of their qualifications rather than as a matter of national prerogative. Furthermore, there is the need for greater independence of management and staff to reassure all members that IMF advice is not unduly affected by political pressure from particular shareholders. All this will ultimately be needed to enhance the legitimacy of the multilateral consultation process.

Finally, the governance reform of the IMF should not be restricted to the role it would have to play in strengthened multilateral surveillance, but should also consider a revision of the modalities for official liquidity provision and internationally coordinated policies on the resolution of financial crises, issues discussed at greater length in chapter III. Active use of regional funds and mechanisms of surveillance and policy con-

The legitimacy of the multilateral consultation needs to be enhanced

sultations, which have been developing recently, may well complement the IMF's more central role.<sup>16</sup>

### (3) *Address commitment problems by issuing multi-year schedules for policy adjustments*

Multi-year schedules for policy adjustments can address commitment problems

A gradual approach to adjusting the global imbalances may be preferable in that it avoids shocking the economy with significant changes in fiscal, monetary and exchange-rate policies all at once. Such a gradual approach will likely be more reassuring for financial markets. Investors will only be reassured if the commitment to continued adjustment is credible, however. A small down payment on adjustment may not do much to reduce financial vulnerabilities if the markets doubt that Governments will follow up with additional instalments. If a Government is unconvinced of the need for adjustment, it may agree to token adjustments to get off the hook with its foreign partners although it may have no intention of following up. There will be no perfect solution to politically grounded commitment problems, but a partial solution would be to publish a multi-year schedule for adjustment. Announcing specific targets, in the form of a schedule, and then not meeting them has costs in terms of reputation, as does specifying a series of policy actions and then failing to implement them. Commitments, in order to be credible, must be attainable and readily monitored, which requires that they should be explicit, measurable and public.

Governments already pre-specify schedules of actions in an effort to enhance the perception of commitment. The United States has declared its commitment to cutting its budget deficit as a share of GNP in half by 2009. The United States Congress has established a Congressional Budget Office charged with issuing non-partisan, multi-year projections and analyses of whether current policies will succeed in achieving such goals and, if not, what policy adjustments are needed. Member States of the EU are required to submit annually a multi-year (generally, five-year) Stability Programme (in the case of members of its Economic and Monetary union) or a Convergence Programme (in the case of countries that are not yet members of the euro area). These programmes are then vetted by the European Commission and by the Ecofin Council of Economics and Finance Ministers.

One can imagine similar schedules emanating from the IMF's consultations. The "deliverable" from the consultations process (the "multilateral letter of intent") should be a sequence of policy adjustments tied to a specific schedule, to be made public at the end of the multilateral round. In this regard, it will be important that any multilateral letter of intent focus on a limited number of targets—reconciling the correction of external imbalances with the maintenance of growth and price stability at home—and verify that the number of instruments (the number of policy instruments for which settings will be modified) at least equal the number of targets (without exceeding their number to the extent that monitoring compliance becomes problematic).

<sup>16</sup> With the deepening of intraregional trade and investment flows, several platforms of regional economic cooperation have emerged. Therefore, a case could be made for a more active use of regional financial arrangements as a complement to the IMF's role as discussed in the text. Spillover effects of national policies have important regional dimensions. In this regard, macroeconomic policy dialogue and stronger forms of regional surveillance and policy consultations could internalize, at least in part, the externalities that national macroeconomic policies have on regional partners. See José Antonio Ocampo, "The Case for and the Experience with Regional Financial Cooperation", in José Antonio Ocampo (ed.), *Regional Financial Cooperation* (Washington D.C.: Brookings Institution Press and ECLAC, 2006).

#### (4) *Initiate systemic reforms in the field of international monetary and financial affairs*

In the long run, only deeper and more far-reaching reforms of the global monetary and financial system as a whole will be able to prevent a similar constellation of imbalances from arising again and to deal with the asymmetries that are currently inherent in the global adjustment mechanisms. As indicated, the current situation emerged, in part, because developing countries, following the financial crises of the 1990s, saw it necessary to accumulate international reserves as protection against renewed instability.<sup>17</sup> Since the dollar was the leading reserve currency, this meant accumulating dollars, which in turn meant providing easy finance for the United States current account. Now that developing countries have augmented their dollar balances, they are reluctant to alter their reserve portfolios or the policies that facilitated the emergence of the United States deficit for fear of precipitating a fall in the dollar and inflicting capital losses upon themselves. This situation allows the United States deficit to persist and the country's foreign indebtedness to grow until some inevitable point at which doubts about the sustainability of its debts precipitate reserve diversification and other policy adjustments by one creditor country, leading others to flee the dollar in order to avoid taking substantial losses.

This is an intrinsic problem in a system in which a single national currency is used as international reserves, as Keynes emphasized in the negotiations that led to the creation of the Bretton Woods System and Robert Triffin analysed in his writings predicting its demise.<sup>18</sup> Rapidly growing countries require additional reserves, which allows the slower-growing reserve-currency country to run balance-of-payments deficits for a time. Eventually, however, the fact that the external obligations of the reserve-currency country grow faster than its economy places the sustainability of its external position in doubt. And when those doubts reach a critical mass, flight from that currency may occur, causing its exchange rate to come crashing down.

Over time, a market solution to this problem may develop. If a number of competing reserve currencies existed, each of which were to account for a significant share of foreign-reserve portfolios, it would be easier for central banks to alter the composition of their reserves continuously over time and avoid situations where serious doubts would arise about the value of a specific reserve currency and the sustainability of the obligations of its issuer. Such a market solution is problematic, however, as it would likely not be smooth and more likely would involve a collapse of the dollar, which would disrupt financial markets.

The emergence of a new, supranational currency based on the scaling-up of SDRs is probably the best solution for redesigning the global reserve system in a stable way, but this can only be a long-term option.<sup>19</sup> Therefore, the more immediate reform would be to promote an officially backed multi-currency reserve system. This idea should be as compelling as the pursuit of a multilateral trading system. Similar to multilateral trade rules, a well-designed multilateral financial system should create equal conditions for all parties and avoid unfair competition and an asymmetric burden-sharing of exchange-rate

Systemic reforms of the international monetary system are needed for a long-run solution

<sup>17</sup> See, for example, UNCTAD, *Trade and Development Report 2006*, op. cit.

<sup>18</sup> See Robert Triffin, "National Central Banking and the International Economy", *Postwar Economic Studies* 7, 1947, pp. 46-81 and Robert Triffin, *Gold and the Dollar Crisis: The Future of Convertibility* (New Haven: Yale University Press, 1960). The point is also extensively discussed in chapter 6 of *World Economic and Social Survey 2005*, op. cit.

<sup>19</sup> See *World Economic and Social Survey 2005*, ibid.

adjustments. It should also help to increase stability in the international financial system by reducing the likelihood of a crisis scenario where capital flight out of the major single reserve currency causes potentially far-reaching repercussions throughout the global economy.

## Chapter II

# International trade

### Trade flows: can the momentum be sustained?

World merchandise trade has expanded at a rapid pace during 2006. The expansion features a continued large increase in the value of trade flows of oil and non-oil commodities, mainly due to higher prices, and also a notable increase in the volume of trade flows of capital goods driven by the recovery in global investment. Growth of the volume of world exports is estimated to be above 10 per cent, up from 7.4 per cent in 2005, while the value of world exports increased by about 16 per cent. Growth of world exports is more than double the growth of world output, indicating a further deepening of global economic integration (see figure II.1). In the outlook, however, the growth of world trade is expected to moderate to a pace of about 7 per cent (see table A.16).

The strong growth of world trade has been bolstered by broad-based *import* demand across a majority of economies. Import demand for capital goods has increased with the recovery of business investment in a large number of economies. Demand for primary commodities has also remained strong by historical standards, owing in particular to the continued rapid pace of industrialization in China, India and other emerging developing countries.

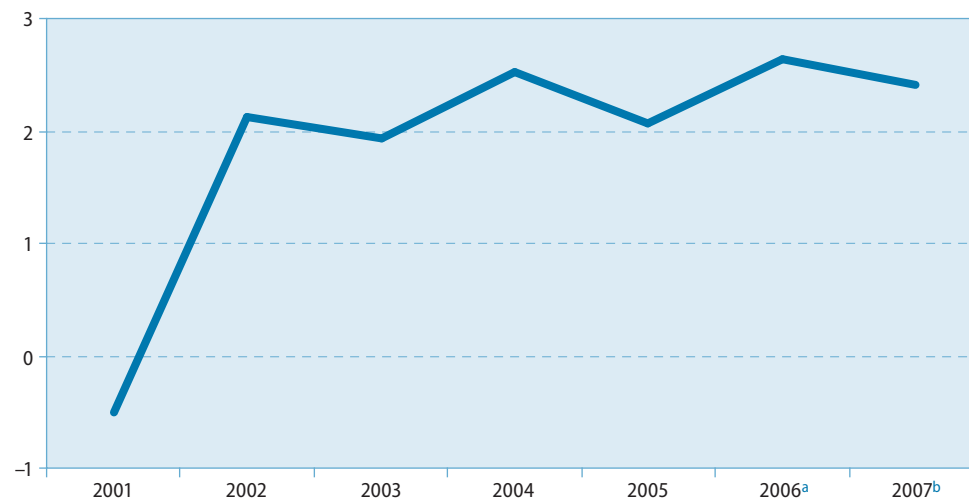
The United States of America remains the major locomotive for world trade, with its import demand accounting for about 13 per cent of the world total. During 2006, the total value of imports of goods and services of the United States has increased by about 12 per cent, reaching an estimated level of \$2.2 trillion. Import demand in the United States has increased in all categories, but the demand for oil and raw materials surged the most, with oil alone increasing by \$70 billion. Most of the value increase for these two items is due to price effects. The volume of oil imports, for example, has remained flat. In the aggregate,

Growth in international trade, while still strong, is expected to moderate in 2007

Imports of capital goods and primary commodities have been the main drivers of trade growth

The United States remains the main source for expanding world trade...

Figure II.1  
Ratio of the growth rate of world exports to the growth rate of gross world product, 2001-2007



Sources: UN/DESA and Project LINK.

a Partly estimated.

b Forecast.



the import volume is estimated to grow by about 6 per cent in 2006, decelerating somewhat from the previous year, and below the average import growth of the last decade. While imports of capital goods, particularly computer-related goods, have continued to grow at a robust pace of more than 10 per cent, imports of consumer goods have subsided notably, reflecting the moderation in household spending as a consequence of the cooling of the housing market and higher oil prices. A further moderation in the import demand of the United States is expected for 2007.

...but other developed countries have also seen solid import growth

In other developed countries, import demand in the European Union (EU) has accelerated from the previous year, reflecting a better-than-expected growth recovery in Western Europe. Import volume growth accelerated to nearly 10 per cent, following a continued boom in the new EU member States. In the latter group, for example, strong growth in private consumption and in consumer credit have fuelled import demand for consumption goods, while foreign direct investment (FDI) flows have induced strong imports of capital goods. Imports in Japan have also been rising gradually along with the expansion in domestic demand, but the growth has slowed somewhat in the second half of 2006. Imports of capital goods in Japan have been on a solid upward trend, reflecting stronger business investment demand. In contrast, imports of food and other consumer goods have been relatively weak since the spring of 2006.

Sustained economic growth and improved terms of trade have led to an acceleration of import demand from developing countries

Import demand in volume in most developing economies and the economies in transition has accelerated during 2006, owing to a sustained economic growth in these economies, as well as a continued improvement in the terms of trade for a large number of economies. Real import demand in the oil-exporting and mineral- and metal-exporting economies in Africa, Latin America and Western Asia has been growing at double digits, driven by strong consumption demand and demand for new production capacity and infrastructure. Import demand in Asian economies has also been strong, although most of these economies are facing a deterioration in their terms of trade. In addition to a robust domestic demand, imports in many Asian economies have also been boosted by the ongoing relocation of manufacturing bases and further differentiation in the international production chains in the region, as reflected in the strong growth of intra-Asian trade flows. For example, 60 per cent of China's imports originated from the other Asian economies and grew at a pace of about 20 per cent during 2006. Among the economies in transition, import demand in the Commonwealth of Independent States (CIS) economies has been strong, bolstered by domestic demand, as well as currency appreciation. As discussed in chapter I, terms of trade did not move favourably for a number of lower-income oil-importing countries. Rising import bills have forced several of these countries to reduce domestic demand in order to restrain non-oil imports.

Developing countries have gained international market shares

From the perspective of exports, the strength of world trade has also been broadly shared across countries. Developing countries as a group gained market shares. As indicated in figure II.2, the share of exports of developing countries, measured in current United States dollar prices, has increased steadily in recent years, reaching a level of about 35 per cent in 2006. Developed countries maintain, with 60 per cent, the largest share of world export trade. While the substantial increases in oil prices and the prices of other commodities in recent years may have inflated the share for the developing countries, volume growth of exports has also outpaced that of developed countries by several percentage points (see figure II.3).

Strong export growth in the United States has been driven in particular by demand for capital goods owing to the global recovery in investment

Exports in the United States have expanded at the strongest pace in many years. During 2006, exports are estimated to have increased by about 12 per cent in value terms

Figure II.2  
Value of world exports, 2000-2007 (billions of dollars)

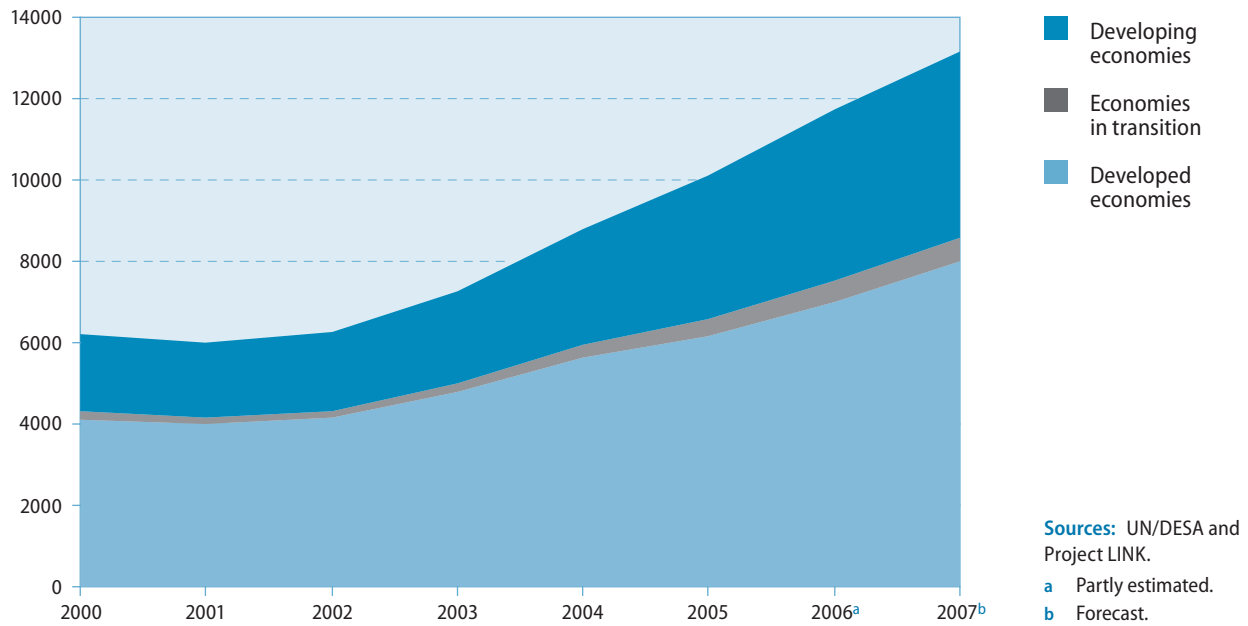


Figure II.3  
Growth of merchandise export volume, 1996-2007 (percentage)



and by more than 10 per cent in volume terms. Exports of capital goods, growing at about 14 per cent, are leading the expansion, fuelled by the investment recovery in much of the rest of the world, especially in Europe and Japan. Exports of computers and accessories, semiconductors, telecommunications equipment and electric items, as well as machinery and generators, have increased the most. Among the destinations of the United States,

growth of exports to the group of oil-exporting countries has been strongest, at a rate of about 30 per cent. Exports to Latin America have also increased strongly by about 20 per cent, followed by Asia and Europe. In the outlook, the growth of the volume of exports of the United States is expected to moderate to about 8 per cent in 2007.

Western Europe's export growth has accelerated despite currency appreciation

In Western Europe, export growth has also accelerated to almost 10 per cent in volume terms during 2006. The appreciation of the euro and other European currencies against both the United States dollar and some Asian currencies had only a minor negative impact on export growth. Among the major economies in this group, the exports of the United Kingdom of Great Britain and Northern Ireland and Germany have posted the strongest gains in 2006, while those of Italy and Spain have been sluggish, curbed by declining competitiveness as a consequence of rising production costs. Exports in Western Europe are expected to decelerate in 2007 as world demand slows and local currencies appreciate further. Exports of the new EU members have expanded by 10 to 15 per cent during 2006. Productivity growth has been strong and higher than real wage increases, allowing these economies to maintain competitiveness despite currency appreciation. Export growth has been particularly strong in the automotive industry in the Czech Republic and Slovakia. New assembly plants will be opened by the end of 2006 and the growth of this sector is expected to provide a further boost to exports in the near future.

Japan has seen regionally balanced export growth

Japan's export volume has continued to increase at a pace of about 9 per cent during 2006. Among its destinations, exports to the United States have maintained a steady growth, although the growth in automobile-related goods has eased somewhat. Exports to the EU have also continued their solid increases. Exports to East Asia have been on an upward trend, mainly in capital and intermediate goods. Meanwhile, exports to other regions have continued to register relatively high growth. Exports of automobile-related goods have continued to increase steadily, but exports of information and communication technologies (ICT)-related goods have weakened slightly.

Asia leads export growth among developing countries

Asia continues to lead developing-country export growth. In East Asia, most economies have maintained a growth of exports in revenue terms at 10 to 20 per cent, with China exceeding 20 per cent. At the current pace, China is expected to surpass Germany and the United States in three years to become the largest exporting country in the world; however, it is worth noting that more than 50 per cent of China's exports are produced by foreign-owned companies and about 60 per cent are "processing trade", namely the processing and assembling of imported intermediate goods for exporting. Growth of exports in South Asia has also been strong, particularly in textiles and ready-made garments. The main driver of merchandise export growth from India—which reached about 20 per cent in 2006—remained engineering goods, with machinery and instruments, and electronic goods the strongest performers.

In Western Asia, export revenue has continued to increase substantially in 2006, driven mainly by the higher price of oil exports. In volume terms, exports have shown little expansion. Iraq has increased exports by 50 per cent in 2006 in value terms, while the Syrian Arab Republic witnessed a record high in export revenue, both with limited production capacity. Meanwhile, the Israeli-Lebanese conflict has slowed export growth in those two countries during 2006. Turkey's real exports have also been weak as wage competitiveness declined.

Production constraints in the oil sector have limited Africa's export growth

The volume of African exports continues to expand in 2006, albeit at a lower pace than in 2005. This deceleration reflects, to a large degree, the decline or slow growth of oil production in Chad, Equatorial Guinea, Gabon and Nigeria, and a weak manufacturing export growth in South Africa. In the outlook, the growth of real exports is expected to

remain robust in 2007, with an increase in hydrocarbon production in Algeria, Angola and Mauritania, the start of operations at new mines in Ghana, Mali and Namibia, and the resumption of timber and rubber exports in Liberia.<sup>1</sup>

In Latin America and the Caribbean, export revenues have increased by 20 per cent during 2006, boosted largely by a continued improvement in commodity prices, while the volume of exports has increased at about 8 per cent. Chile and Peru have benefited the most from increases in the value of basic metals and minerals exports. Similarly, Bolivia and the Bolivarian Republic of Venezuela have been favoured, respectively, by higher prices of natural gas and oil. Meanwhile, the two largest exporters of the region, Mexico and Brazil, have expanded their export volume in 2006. In 2007, however, exports are expected to weaken as a result of an anticipated slowdown in external demand, the appreciation of local currencies in some countries and an anticipated softening in the prices of commodities.

Among the economies in transition, export revenues in the resource-rich countries of the CIS members have expanded further, owing to higher prices for oil and gas, metals and cotton, while the volume of exports is estimated to have grown by about 5.7 per cent during 2006. Leading in real export growth are Azerbaijan and Kazakhstan, owing to strong oil exports, and Ukraine, owing to steel exports. Exports in volume terms have also accelerated in the Russian Federation after a slowdown in the previous year. In the outlook, appreciation of the currencies in the oil-exporting countries vis-à-vis the dollar may curb the exports of the region. Exports of South-eastern Europe have also been strong, owing largely to increased trade with the EU members as well as growth of intraregional trade. The value of exports of these economies also increased because of higher prices of metals and metal products. Their export growth is expected to remain strong, supported by further FDI flows into export sectors.

The imbalances in the trade accounts across regions has widened during 2006 (see figure II.4). The trade deficit in the United States is estimated to rise to about \$770 billion by the end of 2006, an increase of \$60 billion from the previous year. Meanwhile, the deficit of the EU as a whole has also increased, although Germany is still running a large surplus. Major surplus countries and regions include the oil-exporting countries, China and Japan.

Some reduction in the trade imbalances is expected in 2007, as the United States is expected to narrow its deficit with a stronger growth of exports compared to imports.

The imbalances in the trade accounts across regions account for a large proportion of the global imbalances in the current accounts (see chapter I for a more detailed discussion). Along with the further widening of the global imbalances, various forms of international protectionism have been on the rise.

## Primary commodity prices and markets

### Non-oil commodities

Non-oil primary commodity prices generally followed an upward trend from January to May 2006. On average, prices increased by 22 per cent in United States dollar terms and 19 per cent in Special Drawing Right (SDR) terms. From May 2006 onwards, however, the situation seems to have begun to change as the composite price fell by 4 per cent between May and October in dollar terms and by 3 per cent in SDR terms (see figure II.5). The bulk of this reversal took place in May and June, when the turmoil in international financial and

Higher commodity prices have underpinned exports in Latin America and the Caribbean...

...as well as in the economies in transition

Trade imbalances have widened in 2006...

...although some narrowing is expected for 2007

Non-oil primary commodity prices continued their upward trend until May 2006

<sup>1</sup> The United Nations Security Council lifted the ban on Liberian timber exports in June 2006.

Figure II.4  
Merchandise trade balances, 2004-2007 (billions of dollars)

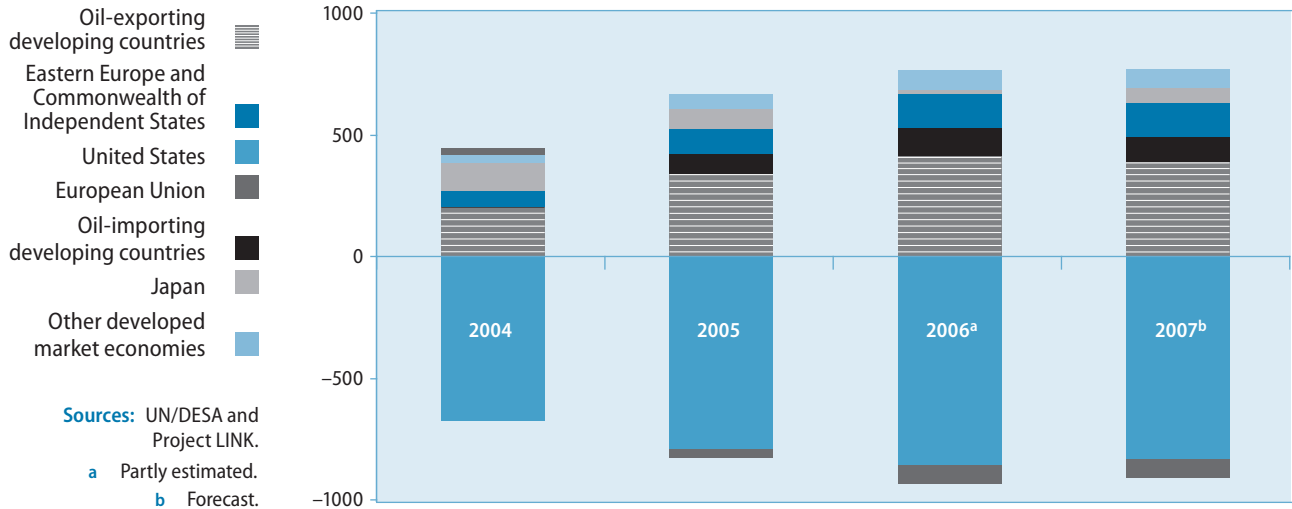
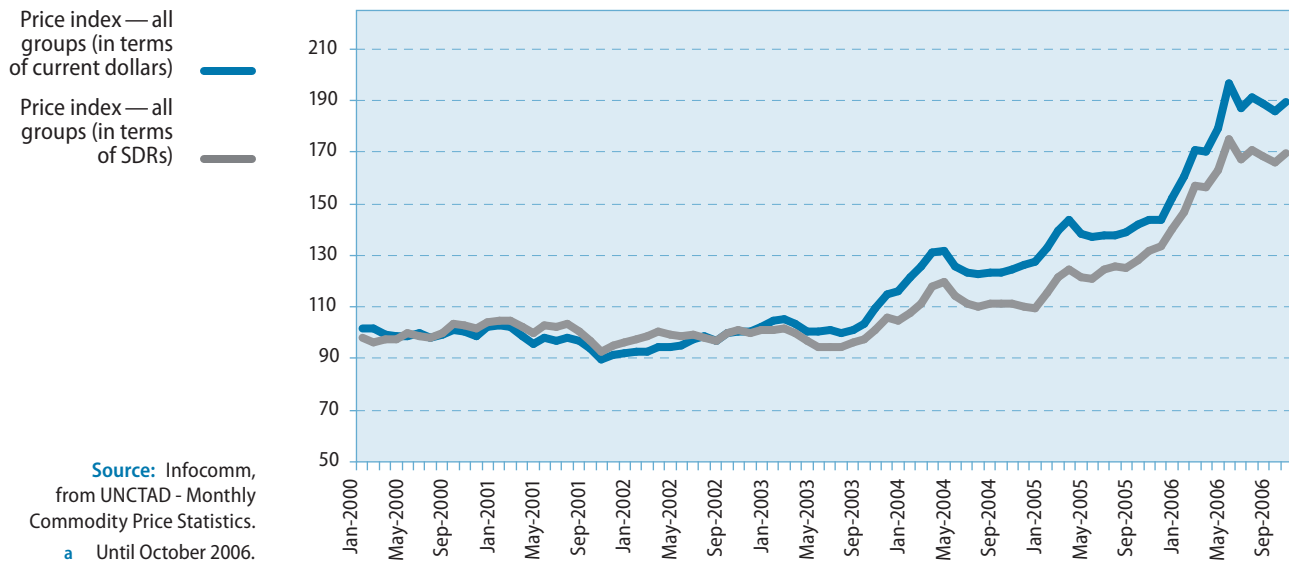


Figure II.5  
Non-oil primary commodity prices, 2000-2006<sup>a</sup>



commodity markets resulted in a decrease in the composite non-oil commodity price by 5 per cent in dollar terms (4 per cent in SDR terms). Since then, prices have remained stable and have even recovered slightly.

The rise in prices over the first ten months of 2006 was mainly driven by the boom in metal and mineral prices (more than 40 per cent) as well as increases in the prices of some vegetable oilseeds. The gradual rise of international crude oil prices and the slight strengthening of world economic growth during 2006 are the most important factors behind the non-oil commodity price increases. As a consequence, prices of commodities

**Metal and mineral prices, as well as oil prices, were the main drivers of non-oil commodity price growth**

that are substitutes for oil-based products took off. Freight rates had also risen starkly from September 2003, reaching a peak in December 2004. The boom had been brought on by rapidly increasing demand for shipping of coal and iron ore, as well as congestion in Asian and Australian ports. From January until August 2005, these conditions had changed and the index for dry bulk shipping rates fell steadily (see figure II.6). Freight rates as captured by the Baltic Dry Bulk Index<sup>2</sup> increased again thereafter to over 4,000 points, a level well below that reached during the boom, but nonetheless 70 per cent above the average price of the past six years.

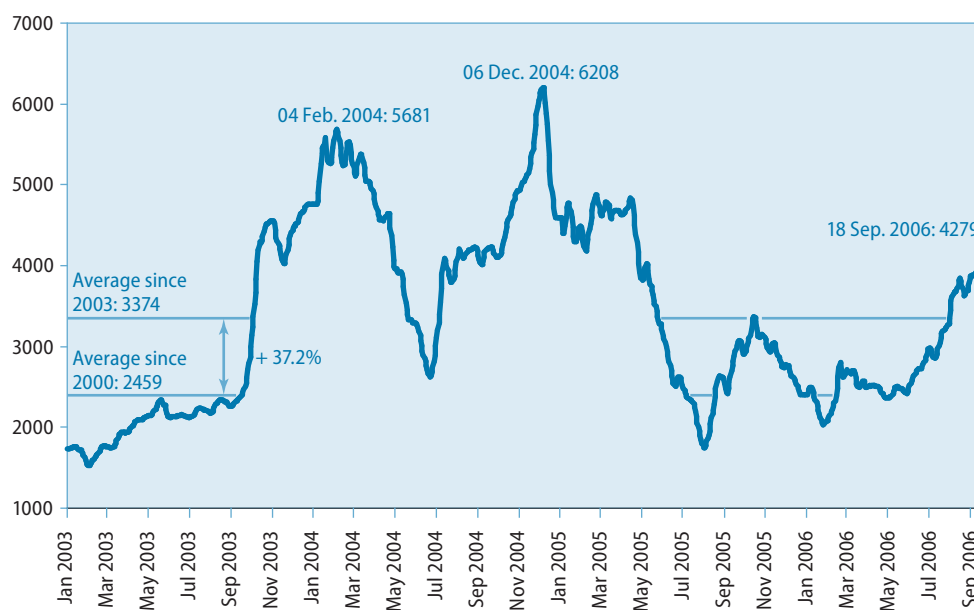
Rapidly expanding Chinese demand has been a particularly important factor for many commodities. China remains the principal consumer of a wide range of metals (steel, copper, aluminium, zinc and lead) and of several other commodities (cotton and rubber). Chinese iron ore imports increased by 32 per cent in 2005, constituting the sixth consecutive year of double-digit growth.

While supply and demand fundamentals determine the direction of the price trend, the actual price levels of some commodities have also been influenced by speculation (see box II.1).

Food prices rose by 12 per cent from January to May 2006, then fell by 7 per cent from May to October. As a result, food prices posted an average growth of 4 per cent over the first ten months of the year, with strong increases in some categories. The highest price increases were registered for fishmeal (39 per cent) and pepper (88 per cent), while prices for wheat and maize also rose by more than 30 per cent. In the first five months of 2006, the prices of most food categories increased, but the rise was the most pronounced for bananas and fishmeal, whose prices increased by 51 and 36 per cent, respectively. The drop in the

Food prices rose slightly in 2006

Figure II.6  
Baltic Exchange Dry Index of shipping rates, 2003-October 2006



Source: Thomson Financial.

2 The Baltic Dry Bulk Index measures ocean freight rates for dry bulk cargoes (which include commodities such as coal, ore and grains) by combining information for different vessel sizes and routes.

## Box II.1

**The role of speculation in primary commodity markets**

The boom in international commodity prices has attracted new investors to primary commodity markets. The appetite for investing in commodity markets has been driven by the strong perception among financial market participants that the prices of commodity financial instruments are negatively correlated with those of other assets—a perception that is supported by analytical studies. Aside from this portfolio diversification motive, the interest in commodities diversification has been reinforced by low interest rates and relatively robust economic growth worldwide.

Most importantly, while, in the 1990s, most participants in commodity markets were actually involved, directly or indirectly, in commodity production or trade, financial investors and speculators with no stake in commodity markets, sometimes using exotic financial vehicles, have now become important market participants. These agents seem to prefer indirect strategies to avoid the risk and transaction costs of holding physical commodities. To do so, investors, and particularly hedge funds, put a large amount of money in commodity-based indices, which have the same characteristics as traditional financial assets. About 200 billion euros are currently invested in commodity-market instruments worldwide, half of them in commodity indices.<sup>a</sup>

The recent trend towards treating commodities as financial assets has impacted on different stakeholders in different ways. First, massive financial flows have supported major mining and energy companies, providing them with resources to invest in exploration and increased production capacities, while giving them a comparative advantage vis-à-vis smaller companies that are less interesting to investors (mainly because the stocks of the latter are seen as too speculative even for speculators and because their total capitalization is too small to allow significant investment). Second, increased price instability is making it more difficult for agricultural and mining companies and producers to plan ahead, especially as regards commodities that take a few years to be produced and to reach the market place. Third, as a result of high basis risk,<sup>b</sup> it will be increasingly difficult for producers to hedge, since the “normal” correlation between the physical and futures prices has been, at least temporarily, undermined.

Future developments will depend on the resilience of the commodity-related speculative appetite when central bank monetary policies turn more restrictive and interest rates rise worldwide, particularly as commodities are currently showing an unusual positive correlation with conventional equities. Under these circumstances, commodities may become less attractive to financial market participants.

Speculation in primary commodity markets likely enhances price volatility, increasing the policy challenges of primary commodity-exporting developing countries in maintaining macroeconomic stability.

<sup>a</sup> “Matières premières, pourquoi les marchés perdent leurs repères”, *Le Monde*, dossier économie, 13 June 2006.

<sup>b</sup> The risk that prices in the underlying cash market are not exactly correlated with prices in the futures market.

composite index after May is mainly attributable to falling banana and sugar prices, which declined by 42 and 31 per cent, respectively. Sugar prices have nonetheless remained well above trend levels of the past decades and should remain robust as the global sugar production deficit persists. The current excess demand in world sugar markets is mainly due to the increase in demand for substitutes for oil products (for example, ethanol) and concerns related to weather conditions in Brazil, the world’s major producer.

After a marked rebound of the *tropical beverages* index in January and February 2006 compared to the end of 2005, as a group, prices for these commodities decreased up until October 2006. Much of the drop was due to declining Arabica coffee prices, which fell by

17.5 per cent between January and June 2006. The decline in Robusta coffee prices over the same period was less pronounced (4 per cent). Since June, prices in both categories have risen again. Even though by October the index was still 5 per cent below its January level, it was 4 per cent higher than its annual average in 2005. By the end of the year and into 2007, Arabica prices are likely to come under downward pressure as a consequence of an anticipated expansion of world production by about 14 per cent during the 2006-2007 production cycle. The expansion in coffee production is led by Brazil, where it is up by 25 per cent. The resulting fears of oversupply and the relatively high Robusta prices could lead to a decline in demand for Robusta coffees relative to Arabicas. Cocoa prices have remained relatively stable between January and August 2006, but have dropped by 5 per cent since then. Market conditions may continue to change, however, depending on the political situation in Côte d'Ivoire, the largest cocoa producer.<sup>3</sup>

During the first ten months of 2006, *oilseed* prices increased by 13 per cent after some fluctuations. The most dynamic oilseed has been palm oil, which recorded a 20 per cent increase between January and October, mainly owing to the rise in crude oil prices and the resulting increased demand in palm oil for the production of biodiesel.

Prices of *agricultural raw materials* rose by 16.5 per cent in the first six months of 2006, but began to decrease thereafter, registering a decline of 15 per cent between June and October 2006. During the year, price fluctuations have been influenced mainly by movements in international rubber prices. After an increase by 29 per cent in the first half of the year, rubber prices fell back by 20.5 per cent between June and October, resulting in only a slight price increase of 2 per cent over the first ten months. While the pronounced decline in the second half of the year was in line with the decline in crude oil prices, rubber prices are expected to continue on an upward trend over the medium term. This is a result of continuing strong demand, mostly from China, and a continued shift in demand from synthetic to natural rubber, as oil prices are expected to moderate only slightly in 2007. Moreover, since rubber is a perennial crop and because it takes several years before a newly planted tree yields rubber, supply cannot adjust quickly to changing demand conditions. It is worth mentioning that the shortage of natural rubber in part also results from rapidly rising demand for supersize tyres used on large trucks and other heavy equipment from the mining industry. Because of the tyre shortage, delivery times for large trucks have at times over the past year exceeded six months. The situation does not seem about to change as, according to International Rubber Study Group (IRSG) forecasts, rubber consumption (all sources combined) should increase by 4 per cent a year until 2009, with natural rubber use growing by 4.7 per cent per year. In addition, the planned removal of Chinese import duties on natural rubber (currently at 20 per cent) at the end of 2006 is likely to lead to a further increase in Chinese demand and, consequently, generate renewed pressure on international prices.

After a 7 per cent decline between January and May 2006, cotton prices recovered by 5 per cent between May and October. Prices are expected to remain firm in the months to come since the supply deficit is expected to reach 1.2 million tons in the 2006/07 crop year, according to the forecast of the International Cotton Advisory Committee (ICAC). A major factor behind this is the growth in Chinese mill demand (up by 6 per cent compared to crop year 2005/06). However, decisions and measures taken by the main cotton-

Increases in palm oil prices dominated the oilseed price index

Fluctuations in the price of agricultural raw materials are driven by developments in the natural rubber market

After an initial decline, cotton prices firmed up in late 2006

<sup>3</sup> United Nations Security Council resolution 1721, adopted on 1 November 2006, endorsed the decision of the Peace and Security Council of the African Union to extend the mandates of the President and the Prime Minister of Côte d'Ivoire for another year. Elections are expected to be organized before 31 October 2007.



supplying country, the United States, and the main consumer, China, will strongly influence market prices. United States export subsidies have depressed world cotton prices in the past. However, Brazil and other cotton-producing countries filed complaints with the World Trade Organization (WTO), and the relevant panel of that organization's Dispute Settlement Body decided that these subsidies were violating multilateral trade agreements. The United States agreed to comply with the decision, and elimination of these subsidies became effective on 1 August 2006. After the announcement by the United States that it would comply, but prior to the new legislation's coming into force, larger-than-usual quantities of cotton were exported to China through the "consignation" scheme.<sup>4</sup> This surge in supply likely exercised downward pressure on prices in the first half of the year.

The boom in international *metal and mineral prices*, which has lasted for several years now, has strengthened further in 2006, especially during the first five months of the year, when prices soared by 45 per cent. Prices are up owing to strong overall world economic growth and particularly rapid demand growth in China. Almost all metals have benefited from this upward movement. For example, zinc and copper prices increased by about 70 per cent during the first five months of 2006, but slightly decreased thereafter, by about 7 per cent up to October. The price of nickel has followed a continuous and stark upward trend during 2006, increasing by 125 per cent between January and October. This surge is on top of already substantial price rises in earlier years. The steady drop in London Metal Exchange (LME) inventories since the beginning of the year has been a major contributing factor.<sup>5</sup> Zinc stocks have also fallen dramatically. Aluminium prices remained relatively stable during the first ten months of 2006, hovering within a margin of 4 per cent, around \$2,400 per ton, except for May and October, when prices peaked at \$2,861 and \$2,654 per ton, respectively. Iron ore price negotiations led to an increase of 19 per cent in the prices of fines and concentrates and a 3 per cent reduction in pellet prices. Following the 71 per cent increase in 2005, these prices are now very high by historical standards. Nonetheless, there is no sign of any slowing of iron ore demand before 2007. Crude steel production is expected to rise by 9 per cent in 2006.

Increased business concentration in the mining industry does not appear to be a key factor in the increases in metal and mineral commodity prices, as corporate strategies of transnational mining companies have moved towards diversifying stakes in different types of metals rather than maximizing market shares in one particular product (see box II.2).

## World oil markets

The oil price trend in 2006 was marked by both strong gains and considerable volatility. Oil prices reached a record high of nearly \$80 per barrel (pb) in August 2006, following the shutdown of the Prudhoe Bay field in Alaska for pipeline repairs and the heightened uncertainty about the Iranian nuclear issue. However, by late October, as growth in oil demand showed signs of moderating and supply-side fears calmed, the price had dropped by about 25 per cent to below \$60 pb.

In general, tight worldwide oil production and refinery capacity, coupled with a solid global oil demand, has been the fundamental factor behind the uptrend in oil prices, while geopolitical tensions are among the major factors driving the volatility. The combination

The boom in metal and mineral prices continued in 2006

Tight worldwide oil production and refinery capacity as well as solid global oil demand are behind the oil price increase; geopolitical tensions are behind oil price volatility

<sup>4</sup> This scheme allows exporters to ship their cotton to the country before finding a buyer for it.

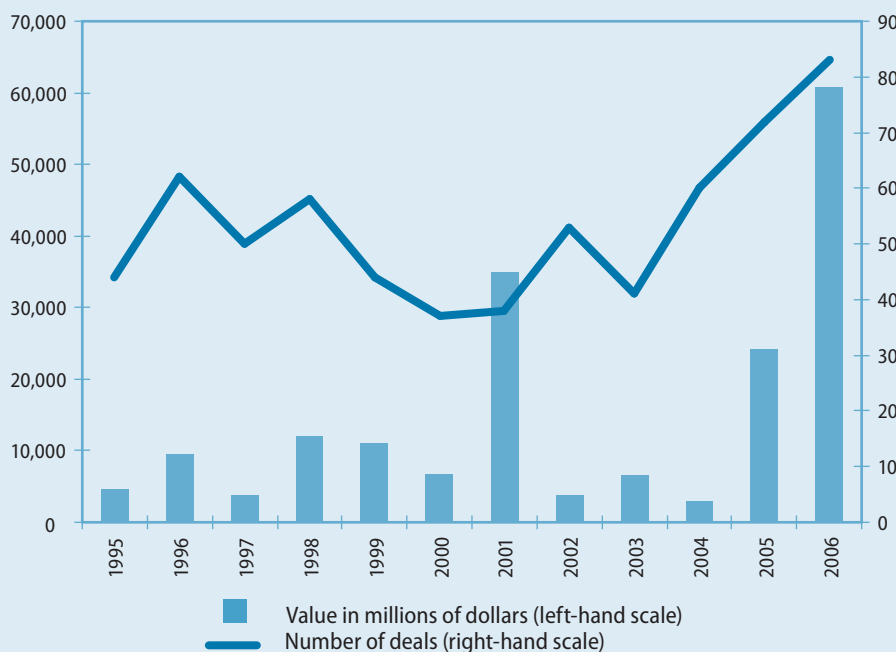
<sup>5</sup> Inventories fell from 36,000 tons on 3 January to less than 10,000 tons on 30 June, and fell below the level of daily world consumption in July.

## Box II.2

**Market concentration in the mining industry**

Recent high metals and minerals prices have allowed mining companies to significantly increase their turnover and profits and to practice a stronger external growth policy. In 2005 and 2006, the number and value of deals (mergers and acquisitions) in the mining sector have drastically increased compared to those recorded over the past decade. Eighty-three deals were closed in 2006 (as of the end of the third quarter) with a total transaction value of around \$60.8 billion. Between 1995 and 2005, the average was 51 deals per year with an annual average total transaction value of \$10.9 billion. (See figure below.)

**Number and transaction value of mergers and acquisitions in the mining industry, 1995-2006**



Source: Thomson Financial.

The purchase of Falconbridge by Xstrata for a transaction market value of \$19.3 billion and CVRD's purchase of Inco for \$18.6 billion are the biggest deals recorded so far during 2006, and they are also the largest in the history of the mining industry of the last ten years (see table below).

Next to the increase in the size of the mergers, the concentration strategy followed by mining companies also seems to have changed. The current trend is to consolidate mining groups with diversified interests in various hard commodities, rather than to create giant companies specialized in one metal. This new strategy of market concentration is intended to reduce price-risk exposure.

Between 2002 and the end of the third quarter of 2006, the market value of the world's 20 largest mining companies had tripled, from \$168 to \$510.8 billion. Among these companies, the largest 10 account for about 80 per cent of the total market value.

Since 2002, developing countries (namely Brazil, South Africa and Mexico) have accounted for about 22 per cent of the total market value, with three companies ranked among the first twenty.

Contrary to what one might expect, the increasing concentration in the mining industry may have little effect on world metal prices. This is so for two reasons. First, as already mentioned, many of the mergers and acquisitions aim to diversify the metals portfolio of companies, rather than strengthen their position in any individual market. Second, since most major metals are traded at commodity exchanges, it is difficult even for companies with a very large market share to exercise any

## Box II.2 (continued)

**Market concentration in the mining industry**

direct influence over the market price. The exception is iron ore, for which prices are set in annual contract negotiations and where three companies account for more than two thirds of world seaborne trade (which can be considered equivalent to the market that is exposed to competition). Even in this case, however, there are strong offsetting factors, such as the willingness of steel mills to invest in new iron-ore capacity by independent companies.

**Major deals and largest mining companies, 1995-2006**

Top 10 deals between 1995 and 2006			Top 10 mining companies by market value <sup>a</sup>		
Year	Target	Acquirer	Transaction value (billions of dollars)	Company's name	Market Value (billions of dollars)
2006	Falconbridge Ltd (CAN)	Xstrata PLC (CH)	19.3	Bhp Billiton	108.3
2006	Inco Ltd (CAN)	CVRD (BR)	18.6	Rio Tinto	72.4
2001	Billiton PLC (USA)	BHP Ltd (AUS)	15.6	Anglo American	63.6
2001	De Beers Consolidated Mines (SA)	DB Investments (UK)	11.0	CVRD	49.0
2005	Placer Dome Inc	Barrick Gold Corp (CAN)	10.3	Xstrata	28.8
2006	Glamis Gold Ltd (USA)	Goldcorp Inc (CAN)	8.7	Barrick Gold	26.8
2005	WMC Resources Ltd	BHP Billiton Ltd (AUS)	7.7	Anglo Platinum	22.3
1998	Minorco SA (LUX)	Anglo American Corp of SA Ltd (SA)	3.5	Newmont Mining	18.2
1996	Diamond Fields Resources Inc	Inco Ltd (CAN)	3.3	Teck Cominco	13.3
2003	MIM Holdings Ltd (AUS)	Xstrata PLC (CH)	3.0	CAMECO	13.1

Source: Thomson Financial.

<sup>a</sup> As at the end of the third quarter of 2006.

The increasing size and growing financial strength of mining and metals companies might, however, affect the balance of bargaining power between foreign investors and host countries. This may become a factor, as many Governments are currently reviewing their legislation with respect to foreign mining investment. Nonetheless, the precise consequences are as yet difficult to predict.

of these two factors, though currently stable, will likely keep prices capricious. Oil prices are therefore expected to remain at about \$55-\$60 pb, although continued volatility may result in temporary deviations from that level. There is some possibility that oil prices may drop further, particularly if the ongoing moderation in world economic growth develops into a "hard landing". But the probability of such a scenario occurring is not a strong one. Meanwhile, the Organization of the Petroleum Exporting Countries (OPEC) has recently

decided to reduce production quotas by about 1 million barrels per day (mbpd) to prevent the prices from sliding any further.

World oil demand has increased from 83.5 mbpd in 2005 to 84.6 mbpd in 2006. This implies a significant deceleration to 1.3 per cent, the lowest growth rate in three years. Although the specific trends differ across regions, the deceleration is due mainly to the effects of high oil prices, mild weather conditions and substitution of other, less expensive, energy inputs for oil.

In the developed countries, oil demand has dropped slightly, by 0.02 per cent, in 2006, but with a more visible slowdown in the second and third quarters. In the United States, higher oil prices have encouraged fuel switching as some power plants moved to less expensive natural gas, while milder weather and the end of the summer driving season has added to the lower oil demand. Milder weather in Europe, combined with the high build-up in inventories, has also contributed to the slowdown in developed-country oil demand. Overall, oil demand is expected to remain constant in 2007, owing to higher oil prices and the possibility of an economic slowdown in the United States.

In recent years, there has been stronger oil-demand growth from developing countries, which have accounted for 92 per cent of the increase in world demand in 2006. Oil demand in China will remain strong, as the economy retains its dynamic growth path. China's oil demand increased by 6.6 per cent in 2005 and is expected to be up by 7.0 per cent in 2006. The Middle East will likewise retain its economically driven oil-demand growth, increasing from 6.1 per cent in 2005 to 6.5 per cent in 2006. In contrast, oil demand in India is estimated to have slowed somewhat, despite strong economic gains as a result of bad weather conditions and, to a lesser extent, the higher oil prices.

Although oil-demand growth in developing countries will continue to have an upward impact on prices, the counterbalancing effect of flat demand in the developed countries, which represent about 60 per cent of the total world oil demand, makes it likely that demand factors will not drive developments in the world oil market and that developments in supply will assume a more important role.

The increasing tightness of the world oil market has been eased somewhat by the substitution of alternative fuels for oil. Natural gas serves as both a complement and a substitute for oil—as oil prices increase, natural gas becomes more attractive as a heating source. However, as nearly two thirds of oil usage is in the transportation sector, where suitable substitutes are less available, the overall impact of alternative fuels is not significant.<sup>6</sup> On the horizon, it can be expected that liquefied natural gas (LNG), which can be used as an alternative to vehicle fuel and natural gas supply operations, will play an increasingly important role in world energy consumption.<sup>7</sup> The movement of LNG production facilities to more cost-competitive locations in the Asian region, coupled with lower costs for shipping and storage, has made it more desirable as an alternative energy source. The United States is poised to increase LNG imports by 2.6 per cent in 2007.<sup>8</sup> Use of ethanol

Growth in oil demand has slowed down considerably

Developing countries have contributed 92 per cent of the increase in world oil demand in 2006

Oil substitutes have eased world oil markets somewhat

<sup>6</sup> See Robert Kaufmann, "The forecast for world oil markets", paper presented at the Project LINK meeting, Geneva, 30 October-1 November 2006, available from <http://www.chass.utoronto.ca/link/meeting200610.htm>.

<sup>7</sup> See Energy Information Administration (EIA), "U.S. LNG Markets and Uses", Office of Oil and Gas, 2003, available from [www.eia.doe.gov/pub/oil\\_gas/natural\\_gas/feature\\_articles/2003/lng/lng2003.pdf](http://www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2003/lng/lng2003.pdf).

<sup>8</sup> See EIA, "Short-Term Energy Outlook", November 2006, available from <http://www.eia.doe.gov/emeu/steo/pub/contents.html>.

Improved supply conditions brought some stability to oil markets

and biodiesel in vehicles is also expanding rapidly and is likely to continue doing so, and, although their global market share is still modest, it is high in individual countries where efforts have been made to replace petroleum (two thirds of new cars in Brazil run on any combination of petroleum and ethanol), illustrating the potential for substitution.

Improvements in supply conditions brought some stability to oil markets in the latter part of 2006, which eased prices. In particular, the calm hurricane season, the easing of geopolitical tensions in the Middle East and the restoration of production facilities in developed countries had a favourable impact on oil supply. Together, these developments signify that capacity squeezes are gradually ceasing to be the main determinant of oil prices, leaving larger scope for supply management by OPEC countries.

This notwithstanding, in October, OPEC announced its intention to cut production by about 1 mbpd from its 28 mbpd quota to keep prices at a “reasonable” level, citing higher inventories and uncertain economic conditions. It is not the reduction in oil production per se, but the distribution of these cuts, which may prove problematic because of the imbalance in production among OPEC member countries. Algeria and the Libyan Arab Jamahiriya currently produce more than their quota, while other OPEC members that face persistent supply constraints are consistently under their quota. For example, in Nigeria, oil production is often disrupted by civil unrest and attacks on oil stations; in Venezuela production has been below its quota since the oil-workers strike in 2002; and in Indonesia, ageing oil fields and bureaucratic delays allow that country to reach barely 60 per cent of its 1.45 mbpd quota.<sup>9</sup> Therefore, if a consensus cannot be reached regarding the allocation of production cuts among the countries, the reductions may not have the intended impact of keeping oil prices above the \$55-\$65 pb floor set by OPEC.

In the non-OPEC countries, oil supply is expected to improve only slightly in 2006 as better-than-expected developments in the United States and developing countries balance the inertia in Western Europe. Production at the Prudhoe Bay field in Alaska is steadily increasing, and the field is expected to return to full capacity by the end of 2006. Additionally, output increased in the Caspian Sea, Africa and Latin America, where the fruit of new investment projects in Brazil is finally beginning to materialize. In Western Europe, production remains relatively unchanged—although safety precautions have shut down facilities in Norway.<sup>10</sup>

Paradoxically, strong economic growth has curtailed investment projects and refinery upgrades

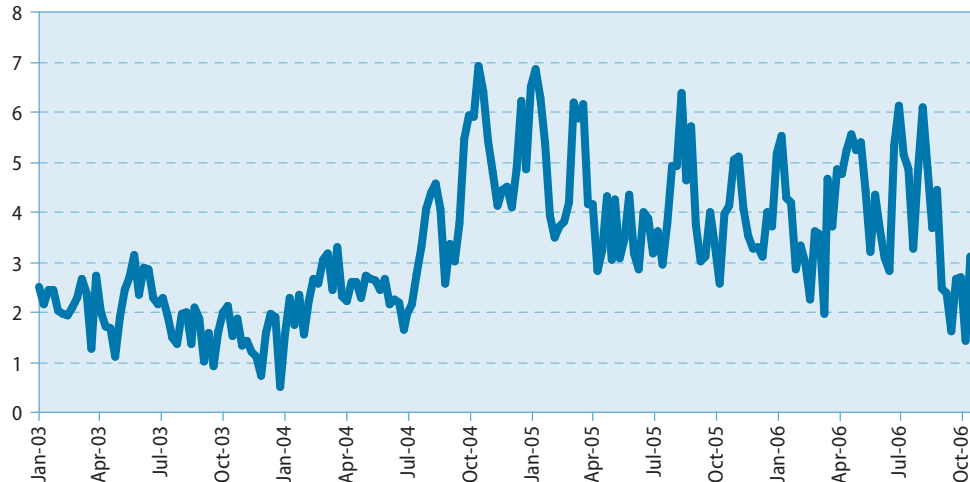
Although the overall global supply of oil remains intact, there has been a distinct change in the quality of new oil production, as lower investment and production in ageing premium-grade oil fields has been dwindling. Paradoxically, strong global economic growth has curtailed investment projects and refinery upgrades. The reason for this is that, as long as high oil prices do not dampen economic growth, there is no incentive for producers to expand production, which could ultimately lower prices.<sup>11</sup> In the meantime, the increasing share of heavier, more corrosive crudes in the total oil supply has placed a premium on lighter crude oil such as Brent Crude, which has a lower density and sulphur content and is more environmentally friendly. Over the past two years, there has been a considerable widening between the price of Brent premium and OPEC basket (see figure II.7), although this difference lessened considerably in the latter part of the year as overall oil demand slowed.

9 See Robert Kaufmann, “The forecast for world oil markets”, op. cit.

10 See Organization of the Petroleum Exporting Countries (OPEC), “Monthly Oil Market Report”, October 2006, available from <http://www.opec.org/home/Monthly%20Oil%20Market%20Reports/2006/mr102006.htm>.

11 See EIA, *Annual Energy Outlook*, 2006, available from <http://www.eia.doe.gov/oiaf/aeo/index.html>.

Figure II.7  
**Brent oil: weekly premium over OPEC basket, January 2003-October 2006**  
 (dollars per barrel)



Source: US Energy Information Administration.

Continued stability on the supply side, coupled with a slowdown in economic growth, should ease prices further during the outlook period. However, the balance between demand and supply is extremely tight, and should OPEC make good on its intent to cut production or should any number of the other supply-side risks materialize, prices could be driven upward again. These factors suggest that prices will likely remain well above a floor of \$52 pb over the outlook period. At the same time, strong regional demand, particularly in developing economies, will continue to drive oil prices. Consequently, Brent premium will average \$65.87 pb in 2006 and fall in 2007 to an average of \$60 pb.

The current outlook is subject to uncertainties about the demand and supply sides. Major disruptions on the supply side could be triggered by geopolitical concerns and adverse weather, which would lead to increasing oil prices. Additionally, a stronger-than-expected global economic slowdown, as well as an increase in the demand elasticity in oil prices, may impact adversely on oil demand.

Oil prices are expected to fall to an average of \$60 per barrel in 2007

## Trade policy developments and trends

### Doha negotiations: dealing with a complete deadlock

The Doha Round of multilateral trade negotiations has been under way for more than five years, much longer than initially scheduled. Following the results achieved at the Sixth Ministerial Conference of the WTO in Hong Kong Special Administrative Region of China in December 2005,<sup>12</sup> the negotiations entered their most crucial phase, with an agreed objective to complete negotiations in all areas by the end of 2006.

After more intense negotiations in early 2006...

<sup>12</sup> See Doha Work Programme, Ministerial Declaration adopted at the Sixth Ministerial Conference of the World Trade Organization (WTO), document WT/MIN(05)/DEC, 22 December 2005. For a discussion of the Hong Kong Ministerial Conference, see *World Economic Situation and Prospects 2006* (United Nations publications, Sales No. E.06.II.C.2), pp. 45-51.

In early 2006, negotiations intensified to meet a critical deadline of 30 April 2006 for establishing full negotiating modalities in agriculture and non-agricultural market access (NAMA). The momentum in the negotiations was supported by several specific actions. A series of “reference papers” on aspects of agriculture negotiations were issued to serve as a basis for negotiating modalities. Furthermore, informal simulation exercises were conducted on various tariff-reduction scenarios in NAMA to assess possible outcomes and inform negotiators. Other actions were initiated, including the start of plurilateral negotiations on services, the establishment of the Task Force on Aid for Trade and a follow-up on duty-free, quota-free market access for LDCs.

However, the April deadline was not met, and by July 2006 it became clear that the crucial objective of completing negotiations by the end of 2006 could not be reached. Negotiations have been extremely difficult and complex owing to the differing expectations and ambitions, as well as to the policy objectives and domestic sensitivities of major trading partners, primarily in two negotiating areas—agriculture and NAMA.<sup>13</sup> Despite numerous attempts to agree on negotiating modalities in these two areas, including meetings at the ministerial and highest political levels, the necessary consensus remained elusive. This led the Director-General of WTO to recommend the WTO General Council on 27 July 2006 “to suspend the negotiations across the Round as a whole to enable the serious reflection by participants”, without setting any time frames for resumption.

The negotiations appeared to have suffered from the conclusion by key players, both among developed and developing countries, that the economic and commercial benefits which could realistically be expected were not substantial enough to outweigh the political costs of making additional concessions on several highly sensitive issues in agriculture and NAMA. The perception of “increasingly diminishing gains” and the probability of the so-called Doha-lite outcomes—particularly in such areas as agriculture, NAMA, services and development issues—thus seem to be the major factors behind the Round’s suspension.

The breakdown of the negotiations was not due to one specific obstacle or one particular country’s negotiating position, but rather to a confluence of individual interests and goals.<sup>14</sup> Both the United States and the EU have been concerned about support for or protection of their domestic agricultural sectors. Japan also has focused on protecting its agricultural sector by insisting on protectionist farm policies and aiming for less severe reductions in agricultural tariffs, while seeking to achieve lower tariffs on manufactured goods. China, one of the main driving forces behind the expansion in global trade, faced criticism for not going beyond the regulations agreed to as part of its WTO accession. However, the domestic reforms and economic and social transition costs associated with its WTO membership are likely to constrain, at least to some extent, the country’s willingness to make any further trade concessions. India also focused on limiting any reforms in the area of agriculture, while at the same time seeking to improve market access for its service industry. The effect of these national positions was further compounded by a seemingly mercantilist negotiating strategy in the WTO framework, as individual countries are primarily preoccupied with seeking solutions that would increase their exports and do not appear to give much weight to

...the Doha Round collapsed in July 2006, primarily due to differences on agriculture and NAMA

Major parties perceived that economic benefits did not outweigh political costs

The breakdown in trade talks was due to a combination of competing interests as well as the prevalence of a mercantilist negotiating approach in WTO

<sup>13</sup> For example, the informal text of draft possible negotiating modalities on agriculture (circulated in June 2006) was 74 pages and contained about 760 square brackets for removal in the negotiations.

<sup>14</sup> See Sallie James, “Doha round not yet dead”, *Washington Times*, 30 April 2006; and Press Release GA/EF/3162 on the panel discussion held on 30 October 2006 by the Second Committee of the sixty-first session of the United Nations General Assembly, available from <http://www.un.org/News/Press/docs/2006/gaef3162.doc.htm>.

the possible benefits which the Doha Round could bring in the form of lower import costs, more choice for consumers and higher productivity through more intense competition. Such benefits only underline the urgent need to revive the negotiations, as they can provide the cooperative outcome needed for individual countries to mitigate the transitional costs of reforms aimed at achieving higher growth in the long run.<sup>15</sup>

The suspension may have several major policy implications for the future of the multilateral trading system, especially taking into account the flurry of bilateral and regional trade activities around the world. It is a clear setback for multilateral cooperation as a whole, particularly for the eighth Millennium Development Goal (MDG-8) committing to “an open, rule-based, predictable, non-discriminatory trading and financial system”. The balanced and development-oriented outcome of the Doha Round was widely anticipated to bring substantial gains for development and poverty eradication, thus contributing directly to achieving the MDGs. On the other hand, the unprecedented proliferation of bilateral and regional trade agreements poses significant challenges for the integrity of the multilateral trading system (up to 400 such agreements could be implemented by 2010, including North-South and South-South agreements). Concerted efforts are thus required to ensure that these trade agreements are complementary to the multilateral trading system and do not erode its basic rules and disciplines.

The suspension may have other long-term, systemic implications. A failure or prolonged suspension of the Round could lead to the resurgence of protectionist forces accompanied by confrontational and devastating trade disputes which could substantially damage international trade relations.

In the short term, the progress achieved at the Hong Kong Ministerial Conference in several development-related areas has been “put on hold” pending the resumption of the Round. Such issues include duty-free and quota-free market access for the least developed countries, development and trade concerns of several poor African cotton producers and the elimination of all forms of export subsidies in agriculture by 2013. The huge distortions caused by subsidies in world agricultural trade will persist, thereby effectively arresting the prospects of agricultural trade liberalization and reform.

No formal agreement exists among WTO members on the pattern or timetable of the next stage of the Doha negotiations in terms of the nature, scope and duration of the suspension, timing and conditions for resumption, and whether or not, in the meantime, work could continue on some issues like the development-related aspects of the trade negotiations. A number of countries have emphasized the importance of preserving the integrity of the Doha mandate, including the “single undertaking”, meaning that any agreements should be adopted as a unique package by all participants. On the other hand, work has continued on some complementary development-related areas falling outside the formal negotiating areas of the Doha Round, such as the Aid for Trade Initiative described below.

Intense diplomatic activities and consultations at various levels have been intensifying during the final months of 2006 with a view to agreeing on conditions for the Round’s resumption. This led to the announcement by the Director-General of the WTO on 16 November 2006 that informal technical work could start immediately to explore the scope for any future compromises. This work would be led by the chairperson of the relevant negotiating body.

The breakdown is a setback for achieving the international goal of strengthening global partnerships

The suspension of multilateral trade negotiations may have further systemic implications

The next stage of the Doha negotiations is uncertain

<sup>15</sup> See Jeffrey Schott, “Completing the Doha Round”, Peterson Institute for International Economics, Policy Brief 06-7, October 2006.



Political factors are likely to hinder any quick resumption of the talks

There are, however, a number of additional political factors which would directly influence the prospects for the Round's resumption and its eventual outcomes. The changing domestic political landscape, legislative agendas and electoral processes in several countries will, it is widely believed, affect developments in 2007. Furthermore, decisions on the expiry of the United States Trade Promotion Authority on 30 June 2007 and the future of the United States Farm Bill (also set to expire in 2007) would be required to clarify the negotiating prospects in 2007. A growing number of countries, both developed and developing, have emphasized the shared responsibility of all participants in demonstrating renewed political will and additional flexibilities to facilitate the resumption of work, but they have also called for a greater role to be played by some major partners such as the United States and the EU. Observers have recognized that there is a window of opportunity for concluding the Round in 2007, albeit a rather small one, should negotiations resume somewhere between December 2006 and March 2007.

The suspension should in no case lead to a lowering of priorities regarding the development objectives of the Doha Round

In any possible scenario, it is crucial to ensure that the suspension of the negotiations would not lead to a lowering of agreed priorities in the Round's development objectives as set out in the Doha mandates (known also as the Doha Development Agenda (DDA)). Achieving meaningful and substantial development content remains crucial for a successful outcome of the Doha negotiations in all areas. The resumed negotiating process should also ensure full transparency and inclusiveness for all participants, so as to reflect the growing membership of the WTO and its members' diversity of interests.

## Aid for Trade: tentative progress in moving the Initiative forward

Enhanced trading capacities are needed for developing countries to reap the benefits of international trade

Trade is a critical engine for the growth and development of the developing countries. However, there is now overwhelming evidence that many developing countries, particularly the least developed, require not only lower tariffs or improved market-entry conditions but also enhanced supply and trading capacities in order to benefit from the open, global economy through the production and trading of competitive goods and services. To enable developing countries to strengthen their export performance, they need, besides improved market access to high-income markets (in both North and South), financial resources to remove supply-side constraints through investments in trade infrastructure, technology, production capacity, human resources and institutions.

In the wake of the 2005 World Summit, the concept of aid for trade has gained momentum

At the United Nations World Summit in September 2005, leaders pledged to support and promote increased aid for building the productive and trade capacities of developing countries. Since then, the concept has acquired substantial momentum. At the Sixth Ministerial Conference of the WTO, ministers endorsed the Aid for Trade Initiative and invited the WTO Director-General: (a) to set up a task force to provide recommendations, by July 2006, on how to operationalize the Initiative; and (b) to consult with members as well as with the International Monetary Fund (IMF) and World Bank, relevant international organizations and the regional development banks, with a view to reporting to the WTO General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate through grants and concessional loans.

A WTO task force has put forward its recommendations on promoting aid for trade...

The WTO Aid for Trade Task Force was established in February 2006, and it submitted its recommendations in July 2006.<sup>16</sup> The recommendations are focused on three

<sup>16</sup> See WTO, "Recommendations of the Task Force on Aid for Trade", WT/AFT/1 (27 July 2006), available from <http://docsonline.wto.org/DDFDocuments/t/WT/AFT/1>.

aspects: first, the scope of Aid for Trade financing (see box II.3) and how it relates to the development dimensions of the DDA; second, the operationalization of Aid for Trade; and, third, the identification of appropriate delivery and monitoring mechanisms. Concerning procedures and mechanisms for operationalizing Aid for Trade, the task force recommends the following: an in-country process for mainstreaming trade into national development strategies and identifying aid-for-trade needs, similar to that of the Integrated Framework for least developed countries (LDCs), but separately funded for non-LDC, IDA-only countries; the establishment of national and regional Aid for Trade committees; global periodic reviews of Aid for Trade by a monitoring body in the WTO; and the conducting of an Aid for Trade needs assessment in developing countries, particularly those most affected, including LDCs, after the completion of the DDA.

On the funding response, the Task Force recommends a number of guidelines. First, donors and agencies should move towards a programme and/or sector budget approach (when certain conditions are met in recipient countries), including having a robust system of financial accountability in place. Second, they should target funds at building infrastructure and removing supply-side constraints, possibly as part of co-financing arrangements with multilateral development banks. Third, donors should consider channelling Aid for Trade funds multilaterally, when appropriate. The Task Force further recommends that an ad hoc consultative group be set up in WTO to take forward the practical follow-up of its recommendations.

Regarding the relationship of Aid for Trade with the development dimensions of the DDA, the Task Force noted in its report that “Aid for Trade is important in its own right. It should assist developing countries to benefit from increased trade opportunities multilater-

...including guidelines on funding...

... and a clarification on the development dimension of aid for trade

### Box II.3

#### The scope of Aid for Trade financing

The WTO Task Force adopted the following definition of the scope of Aid for Trade: “Projects and programmes should be considered Aid for Trade if these activities have been identified as trade-related development priorities in the recipient country’s national development strategies”.<sup>a</sup> For monitoring purposes, the Task Force recommended six categories for reporting Aid for Trade related flows:

(a) *Trade policy and regulations, including:* Training of trade officials, analysis of proposals and positions and their impact, support for national stakeholders to articulate commercial interest and identify trade-offs, dispute issues, institutional and technical support to facilitate implementation of trade agreements and to adapt to and comply with rules and standards.

(b) *Trade development, including:* Investment promotion, analysis and institutional support for trade in services, business support services and institutions, public-private sector networking, e-commerce, trade finance, trade promotion, market analysis and development.

(c) *Trade-related infrastructure, including:* Physical infrastructure.

(d) Building productive capacity.

(e) *Trade-related adjustment, including:* Supporting developing countries to put in place accompanying measures that assist them to benefit from liberalized trade.

(f) *Other trade-related needs.*

Categories (a) and (b) are the definitions used in the Joint WTO/OECD Trade Capacity Building Database. Categories (c), (d), (e) and (f) are to be reported as Aid for Trade only when these activities have been explicitly identified as trade-related priorities in the recipient country’s national development strategies, such as the poverty reduction strategies.

<sup>a</sup> World Trade Organization, Aid for Trade Task Force, “Recommendations of the Task Force on Aid for Trade”, WT/AFT/1, 27 July 2006, p. 2.

ally (both from previous rounds and from the anticipated results of the DDA), regionally, bilaterally and unilaterally.... At the same time, [it] ... is a complement to, not a substitute, for a successful Doha Round.... A successful conclusion of the Round will increase the need for assistance to implement new agreements...to ease adjustment costs, and to make use of new market access". Given this recognition of the role of the Aid for Trade Initiative, WTO members generally consider that, despite the current suspension of the Doha Round negotiations, work on the Initiative should nevertheless continue.

The task force urges the securing of additional financial resources for the Initiative

The recommendations of the Task Force do not address the issue of resource requirements, but the Task Force did urge the WTO Director-General, as part of his mandate, to consult on "appropriate mechanisms to secure additional financial resources for Aid for Trade" and to seek confirmation from donors and agencies that funds are readily available for the implementation of the Aid for Trade Initiative. In an interim report to the WTO General Council in July 2006, the WTO Director-General reported that he had focused his consultations on securing clarification from donors on the Aid for Trade pledges they had made in 2005 at the G8 Summit at Gleneagles and during the Hong Kong ministerial meeting.<sup>17</sup> The issues for which he had sought clarification included: how donors intended to address the issues of additionality, what they meant in their pledges, the baseline they intended to use to measure such additionality, the criteria they would use to decide between grants and soft loans, the procedures to be adopted for disbursing the Aid for Trade funds and whether on this basis one could announce a target amount of funding support for the Initiative by the end of 2006. In his report to the WTO General Council in December 2006, the Director-General indicated that all donors who had made pledges in Hong Kong SAR had reconfirmed those pledges.

As a first step in implementing the Task Force's recommendation, the WTO General Council, at its December 2006 meeting, agreed that WTO would play a key role in monitoring and evaluating progress on Aid for Trade through periodic global reviews, assisted by an Ad Hoc Consultative Group comprising relevant agencies and organizations and institutional representatives of the private sector.<sup>18</sup>

An enhanced integrated framework aims at delivering aid for trade to LDCs

The Integrated Framework for Trade-Related Technical Assistance to LDCs (IF), which has been in existence since 1997, is an important instrument for delivering aid for trade to LDCs. A task force was established in October 2005 to design an "enhanced" IF. The WTO Hong Kong Ministerial Declaration endorsed this approach and confirmed that the Task Force should report back to the IF Steering Committee (IFSC) by April 2006 so that the enhanced IF could enter into force no later than 31 December 2006. The Task Force submitted its final report in June 2006<sup>19</sup> and its recommendations were endorsed by the IFSC and welcomed by the WTO General Council in July 2006.

<sup>17</sup> In Hong Kong SAR, Japan announced development assistance spending on trade, production and distribution infrastructure of \$10 billion over three years; the United States announced Aid for Trade grants of \$2.7 billion a year by 2010, and the EU and its member States announced trade-related development assistance spending of €2 billion per year by 2010.

<sup>18</sup> Monitoring and evaluation will take place on three levels, including a global assessment of Aid for Trade flows (using data compiled by the OECD/DAC); individual donor and agency progress on additionality and effectiveness (using self-assessments); and in-country evaluations (based on inputs from the IF and Trade Policy Reviews, national Aid for Trade committees, and other relevant mechanisms).

<sup>19</sup> See "Report of the Chairman of the Task Force on an Enhanced Integrated Framework, including Recommendations", (WT/IFSC/W/15), 29 June 2006, available from [www.integratedframework.org/files/W15\\_Eng.pdf](http://www.integratedframework.org/files/W15_Eng.pdf).

The main new features of the IF enhancement are:

- *Funding*: Additional funding amounting to about \$400 million to cover an initial period of five years for approximately 40 LDCs provides for resources for core activities/functions (Tier 1 of the IF Trust Fund) and implementation of the Action Matrices (Tier 2). Funding will involve a multilateral channel (IF Trust Fund) and bilateral contributions consistent with the goals of the IF.
- *Country Ownership*: The development and strengthening of in-country capacity in LDCs to facilitate greater ownership and thus improve IF management and implementation. This includes the strengthening of institutional structures and the Focal Point, and the establishment of implementation units as necessary; giving the lead role to the country in preparing and/or updating its Diagnostic Trade Integration Study (DTIS); and providing for clear modalities of cooperation between the IF secretariat, the beneficiary Governments, the agencies, and the bilateral and regional donors.
- *Governance structure*: The establishment of an independent IF executive secretariat located in Geneva, headed by a Chief Executive Officer, administratively housed in the WTO, and surrounded by a strong firewall; the establishment of a Board based on, but replacing, the current IF Agency Working Group and reporting to the IFSC. The new secretariat will consolidate the management and administration of the IF, bringing under one roof current functions scattered in three separate agencies, that is to say, the WTO (secretariat), the World Bank (DTIS) and UNDP (management of the IFTF).

In the meantime, a Transitional Team has been established, composed of donors, LDCs and agencies' representatives, charged with the task of working out the operational details regarding the recommendations of the IF Task Force on IF in-country operations, financial issues and administrative/legal issues.



## Chapter III

# Financial flows to developing and transition economies

## Net transfers

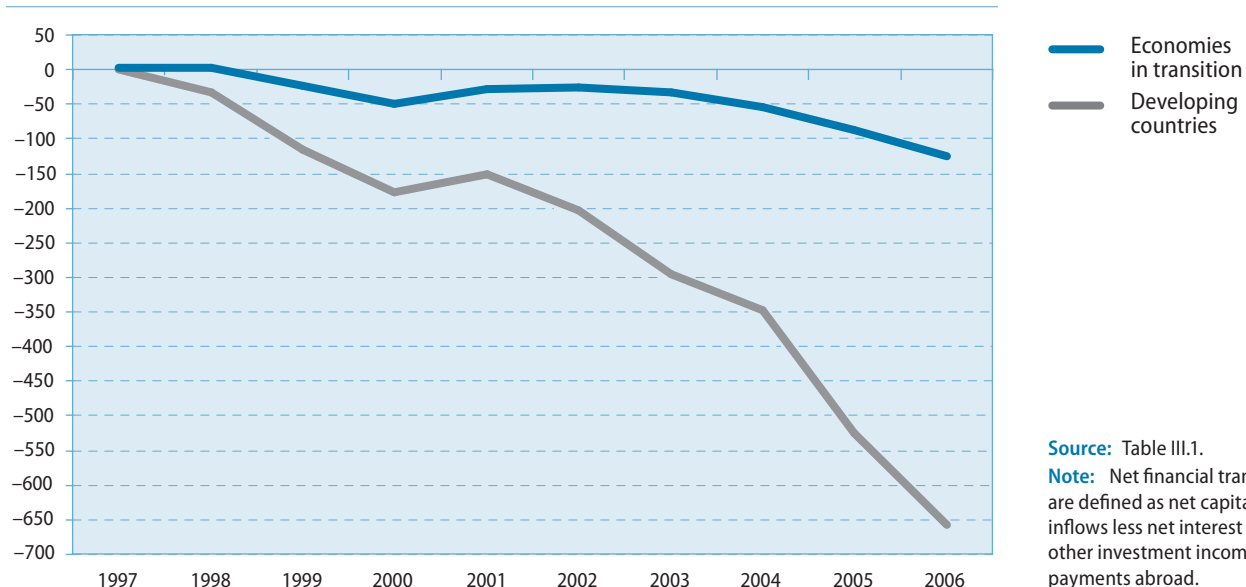
In 2006, developing economies as a group further increased their net outward transfers of financial resources to developed countries to an estimated \$657.7 billion (see figure III.1). Net transfers from economies in transition to developed countries rose to \$125.1 billion. Even in sub-Saharan Africa, net financial transfers have turned negative at \$10.1 billion in 2006 (see table III.1).

In the last decade, a paradoxical flow of financial resources from poor to rich countries has taken place and forms part of the pattern of global imbalances analysed in chapter I. The building up of official reserves has been a key mechanism through which these financial net transfers have occurred. This mechanism not only tends to pose opportunity costs for developing countries but, as the reserve build-up becomes excessive, the sterilization of the consequent monetary effects becomes increasingly harmful to the domestic economy.

While on balance considerable financial resources have been transferred by developing and transition countries, they have, at the same time, also been enjoying substantial net private inflows and, for some, especially the Heavily Indebted Poor Countries (HIPC)s, there have also been important increases in aid flows and debt write-offs. At the same time, the favorable financing conditions for emerging market economies which have lasted for several years suffered major volatility in May-June of 2006. Though markets calmed there-

The net transfer of financial resources from developing to developed countries increased further

Figure III.1  
Net financial transfers to developing countries and economies in transition, 1997-2006  
(billions of dollars)



Source: Table III.1.

Note: Net financial transfers are defined as net capital inflows less net interest and other investment income payments abroad.

Table III.1

**Net financial transfers to developing countries and economies in transition, 1995-2006***(billions of dollars)*

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>
<b>Developing economies</b>	46.2	24.4	-0.6	-33.8	-115.9	-178.2	-151.9	-202.7	-295.6	-346.8	-525	-657.7
Africa	5.9	-5.5	-4.7	15.6	4.2	-27.7	-16.8	-6.7	-21	-35	-63.4	-95.3
Sub-Saharan (excluding Nigeria and South Africa)	7.5	5.4	7.6	12.1	8.9	2.8	7	5.3	6.8	4.5	0.6	-10.1
East and South Asia	21.8	18.8	-31.9	-128.4	-137.6	-119.1	-115.6	-146	-170.7	-162.1	-230.5	-244.7
Western Asia	20.1	10.6	12.6	34.8	7.7	-29.7	-23.8	-18.4	-43.3	-69.8	-125.9	-194.7
Latin America	-1.7	0.6	23.4	44.3	9.8	-1.6	4.3	-31.6	-60.6	-80	-105.2	-123.1
<b>Economies in transition</b>	-2.7	-6.3	2.8	3.6	-23.7	-49.4	-29.1	-26.1	-33.7	-54.6	-86.8	-125.1
<i>Memorandum item:</i>												
Heavily indebted poor countries (HIPC)	6.7	7	7.4	8.5	9.7	7.8	8.2	10.3	9.6	10.2	11.5	9.8
Least developed countries	11.8	10.4	9.3	12.5	10.8	5.7	8.8	7.1	8.5	5.4	2.6	-4.3

**Sources:** UN/DESA, based on IMF, World Economic Outlook database, September 2006, and IMF, Balance of Payments Statistics.

**Note:** The developing countries' category does not include economies in transition; hence, data in this table may differ from those reported for country groupings reported in the IMF sources.

<sup>a</sup> Estimates.

after, it remains to be seen whether it has been a portent of a more fundamental correction which could affect private capital flows to developing countries in the coming years.

## Private capital flows

### Net private capital flows to developing countries

Since 2002, developing countries have been attracting high and growing levels of private capital flows (see table III.2). In line with this trend, the level of net private capital flows to developing countries increased in 2005, with all components registering significant gains. This strong growth is matched by the decline in risk premia on emerging market investments as measured by yield spreads on emerging market bonds (figure III.2). Net private capital flows to developing countries have fallen back in 2006, though their levels continue to be high by historical standards. This slowdown has been due to a number of factors, which include the financial market turbulence in May and June that affected portfolio equity flows; a slowdown in net borrowing from commercial banks and bond creditors as many sovereign and private borrowers took the opportunity of very favourable market conditions in 2005 to pre-finance obligations due in 2006; and the buying back by a number of companies of a substantial volume of their bonds that have high coupon rates. In addition, the changes in the volume and pattern of private capital flows can be said to reflect to some extent the reduction in global liquidity that has taken place.

The short-lived unsteadiness in equity markets and currencies in May-June took place in the context of tightening monetary conditions in the main currency areas and initially featured a general flight from risk, with equity markets that had seen the largest run-up in prices since 2005 experiencing some of the biggest declines. This was the case in Argentina, Colombia, Hungary, India, Peru, Poland, the Russian Federation and Turkey, among other countries. The correction in equity prices was accompanied by strong exchange-rate

**The unsteadiness in equity markets and currencies was short-lived early in 2006 but could signal more adjustments to come**

Table III.2

Net financial flows to developing countries and economies in transition, 1995-2007 (billions of dollars)

	Average annual flow				
	1995-1997	1998-2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
<b>Developing countries</b>					
Net private capital flows	180.5	66.7	131.6	133.6	117.1
Net direct investment	104.6	138.8	203.5	209.5	191.2
Net portfolio investment <sup>c</sup>	56.6	-13.6	-0.6	-38.5	-12.2
Other net investment <sup>d</sup>	19.4	-58.6	-71.4	-37.4	-61.9
Net official flows	3.8	-10.3	-126.5	-206.4	-167.9
Total net flows	184.3	56.3	5.0	-72.8	-50.8
Change in reserves <sup>e</sup>	-92.0	-180.3	-487.5	-536.2	-593.0
<b>Africa</b>					
Net private capital flows	8.1	9.1	29.9	24.9	23.0
Net direct investment	4.7	15.0	30.9	31.7	30.1
Net portfolio investment <sup>c</sup>	5.0	0.7	5.4	4.5	4.3
Other net investment <sup>d</sup>	-1.7	-6.5	-6.4	-11.3	-11.4
Net official flows	-2.5	1.5	-15.2	-18.6	-3.4
Total net flows	5.6	10.6	14.7	6.2	19.6
Change in reserves <sup>e</sup>	-8.6	-12.0	-60.4	-86.7	-104.7
<b>East and South Asia</b>					
Net private capital flows	88.8	27.8	65.6	97.7	68.5
Net direct investment	54.1	60.5	101.6	95.5	97.5
Net portfolio investment <sup>c</sup>	20.7	-1.5	-12.7	-14.3	-10.5
Other net investment <sup>d</sup>	13.9	-31.2	-23.3	16.5	-18.5
Net official flows	-3.1	-4.7	-11.3	-8.2	-12.1
Total net flows	85.7	23.1	54.3	89.5	56.4
Change in reserves <sup>e</sup>	-42.1	-148.7	-300.1	-369.4	-356.8
<b>Western Asia</b>					
Net private capital flows	16.4	-1.1	22.1	-1.7	7.1
Net direct investment	5.1	7.2	21.8	36.2	17.0
Net portfolio investment <sup>c</sup>	3.7	-10.5	-18.6	-33.0	-16.7
Other net investment <sup>d</sup>	7.6	2.3	18.9	-4.8	6.8
Net official flows	5.2	-14.5	-70.0	-167.0	-150.2
Total net flows	21.6	-15.6	-47.9	-168.7	-143.1
Change in reserves <sup>e</sup>	-16.0	-13.4	-94.2	-40.2	-82.2
<b>Latin America and the Caribbean</b>					
Net private capital flows	67.3	30.9	14.0	12.7	18.5
Net direct investment	40.6	56.3	49.2	46.1	46.6
Net portfolio investment <sup>c</sup>	27.2	-2.2	25.4	4.3	10.7
Other net investment <sup>d</sup>	-0.5	-23.2	-60.6	-37.7	-38.8
Net official flows	4.2	7.4	-30.1	-12.6	-2.2
Total net flows	71.5	38.3	-16.0	0.2	16.2
Change in reserves <sup>e</sup>	-25.4	-6.2	-32.8	-39.9	-49.3



Table III.2 (continued)

Net financial flows to developing countries and economies in transition, 1995-2007 (billions of dollars)

	Average annual flow				
	1995-1997	1998-2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
<b>Economies in transition</b>					
Net private capital flows	2.8	7.0	54.9	41.8	24.5
Net direct investment	5.9	10.7	24.5	33.1	29.6
Net portfolio investment <sup>c</sup>	1.9	-0.1	-4.5	1.5	-1.2
Other net investment <sup>d</sup>	-4.8	-3.7	34.9	7.4	-3.4
Net official flows	-0.8	-5.2	-22.2	-29.6	-3.3
Total net flows	2.0	1.8	32.6	12.2	21.2
Change in reserves <sup>e</sup>	-2.7	-22.0	-84.3	-123.4	-141.2

Source: IMF, World Economic Outlook database, September 2006.

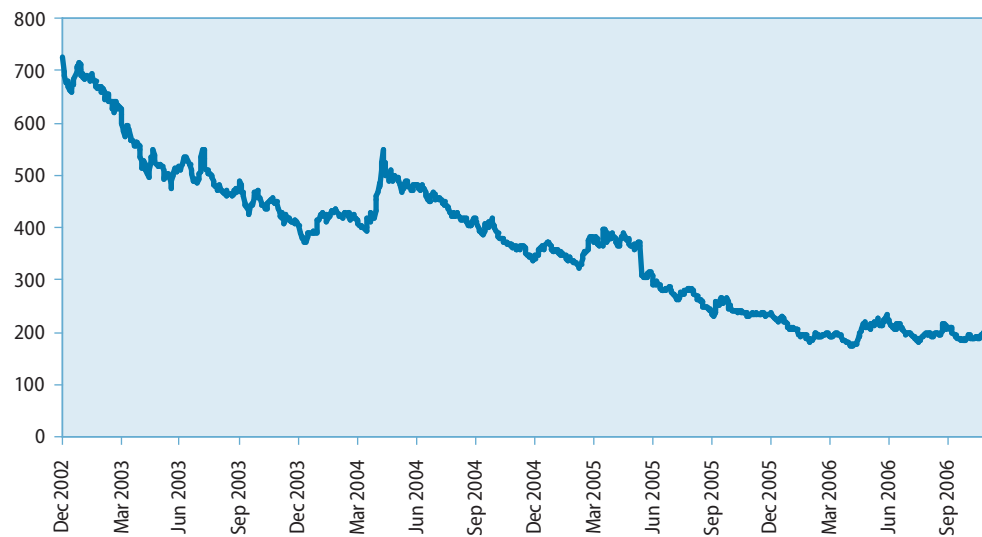
a Estimates.

b Forecasts.

c Including portfolio and equity investment.

d Including short- and long-term bank lending, and possibly including some official flows to data limitations.

e Negative values denote increases in reserves.

Figure III.2  
Emerging Market Bond Index global composite stripped spreads,  
end December 2002-end September 2006 s(basis points)

Source: JP Morgan Securities.

adjustments as more speculative investors, especially hedge funds, quickly retreated from leveraged carry trades in higher yielding emerging market currencies (such as in Brazil, Indonesia and Turkey). Equity markets were particularly hit, while debt markets fared much better. It would seem that, initially, the correction was mainly driven by increased risk perceptions owing to prospects of further monetary tightening in developed countries and uncertainty about valuations in some markets rather, than by economic fundamentals of individual countries. Indeed, those stock markets that had risen the furthest in previ-

ous months fell the most during the correction. For instance, the Russian and Saudi Arabian markets fell by 24 per cent and 50 per cent, respectively, despite rising oil prices and solid external and fiscal fundamentals. It has also been argued that price declines in some markets might have a contagious effect, increasing uncertainty about the sustainability of recent gains in other markets and thereby prompting investors to sell.<sup>1</sup> Also, there was selling pressure on many higher-yielding emerging market currencies, including the Brazilian real and the Turkish lira, that appreciated significantly during 2005 and early 2006. Unlike in stock and currency markets, fundamentals might have played a more important role in sovereign debt markets from the very beginning of the correction. According to the International Monetary Fund (IMF), external debt spreads moved by about half as much during the May-June 2006 correction as they had in the previous large correction of 2004, also induced by a reassessment of interest rate expectations.<sup>2</sup> This could be attributed to improved sovereign creditworthiness.

Further down the road, however, investors began to differentiate among emerging markets, paying more attention to economic fundamentals. In this regard, countries with large current-account deficits financed by bank and portfolio flows are perceived to be the most vulnerable. As a result, there has been further exchange-rate depreciation in Turkey and South Africa and several countries in Central and South-eastern Europe. Conversely, Brazil's real has recovered. Additionally, debt spreads in countries considered vulnerable remained higher while stock indexes were lower than their pre-correction levels.

On the other hand, global factors were more important than local events in determining investors' perceptions of the soundness of the fundamentals in many emerging markets and thus had a larger impact on asset prices. Indeed, the renewed optimism surrounding global economic prospects in the second half of 2006 and the likelihood of a soft landing in the United States led to the resumption of a reduction of the spreads on emerging market debt and significant increases in equity prices.

While interest in corporate equity placements and emerging market stocks is likely to continue during the coming year, this outlook could change in the wake of a slowdown in the global economy and/or a further contraction in global liquidity. Though short-lived, the financial turbulence highlighted the risks and policy challenges for several emerging market economies. In Turkey and, to a lesser extent, South Africa, exchange-rate depreciation has increased inflationary pressures leading monetary authorities to raise interest rates substantially. Such exchange-rate adjustment poses risks for countries with currency mismatches generated by large private capital inflows.

The 2006 levels of net non-bank lending (mostly bond lending) have been below those registered in 2005. This has been due to a combination of large pre-financing efforts in 2005 and the accelerated ongoing buy-back of outstanding bonds in 2006 by countries such as Brazil, Colombia, Mexico and Venezuela (the Bolivarian Republic of). These buy-backs are in line with the liability management and de-leveraging practices that many developing countries have pursued over the past few years to improve the terms and risk profile of their external debt. In fact, a number of developing countries have been accumulating foreign-exchange reserves and this has also limited overall debt flows. The growing and more diversified institutional investor base has also improved the ability of this asset class to absorb shocks. Given the above, the average spread on emerging market sovereign

---

1 See BIS Quarterly Review, June 2006, p. 9.

2 See IMF, *Global Financial Stability Report: Market Developments and Issues* (Washington, D.C.: IMF, September 2006).

bonds, which touched a record low of 174 basis points in May 2006, did not significantly increase after the May-June turbulence. Towards the end of 2006, it fluctuated between 190 and 200 basis points.<sup>3</sup> In line with improved economic fundamentals, bond lending to developing countries is expected to rebound during the coming year. However, a tightening in global liquidity could lead to increased risk aversion and force investors to discriminate more finely among emerging markets.

The average cost of bank lending has increased but the average maturity of bank loans has also risen

Like bond lending, commercial bank net lending to developing countries has slowed down in 2006 in comparison with the previous year. This is due primarily to the repayment of short-term loans by some major companies in emerging market economies and efforts to limit external borrowing in some developing countries. These aggregate figures disguise some interesting facts, however. First, there has been a surge in lending by commercial banks in the advanced countries to Central and Eastern Europe in 2005 and 2006. While on the surface this can be seen as a healthy development, there have also been concerns about such a strong increase given the shorter-term horizons and greater volatility associated with bank lending in comparison with, for example, FDI. Another development relates to the cost and maturity of cross-border bank lending. According to the Institute of International Finance, the average cost of bank lending has increased recently but, at the same time, the average maturity of bank loans has also risen (by about four years since 2004).<sup>4</sup> Overall, commercial bank net lending to developing countries is likely to slow down further in 2007 as net repayments of loans by some countries, especially in Latin America, are expected to increase.

FDI has historically been the most stable component of cross-border private capital flows. The levels of FDI have been particularly high over the past couple of years, buoyed by strong economic growth and improvements in the investment climate in a number of countries (see below for further discussion). A number of developing countries have also attracted FDI through privatizations, mergers and acquisitions (M&As). While the inflow of FDI has been strong in a number of countries, the increase has been especially noticeable in emerging Europe during the past few years. Overall, inflows of FDI to the developing world are expected to remain strong over the coming year owing to healthy growth prospects, the ongoing liberalization in a number of countries, including in prominent economies such as China and India, and the reinvestment of corporate profits from direct investment.

The level of net private flows to developing countries in 2006 was high by historical standards but lower than levels seen in the previous year

In summary, the level of net private capital flows to developing countries in 2006 has been relatively high in historical terms, though lower than levels recorded during the previous year. Capital flows are likely to remain strong in 2007, though factors such as continuing repayments and limited external borrowing by some developing countries in the wake of stronger external accounts could lead to some further contraction. The risk also exists that a slowdown in the global economy or significant tightening in liquidity could lead to a sharper contraction in net private flows to developing countries. The countries most at risk include those with large current-account deficits financed by private portfolio flows and those which already face inflationary pressures as well as concerns about the credibility of their policies.

The aggregate data on net private capital flows mask a number of features and developments. Of great relevance is the fact that these flows remain concentrated in just a few devel-

<sup>3</sup> Data from JP Morgan Securities.

<sup>4</sup> See Institute of International Finance, Capital Flows to Emerging Market Economies, 15 September 2006, available from <http://www.iif.com/press/press+13.php>.

oping countries. For instance, around 10 countries account for close to 70 per cent of bond issuance in the developing world, and 70 per cent of bank lending to the developing world again goes to only 10 countries. At the same time, however, there are signs that the concentration in FDI has declined in recent years. Although the top 10 countries accounted for about a 70 per cent share of total FDI, this figure declined to about 65 per cent in 2005.<sup>5</sup>

A related issue is that of regional differences. Asia, and especially the region's emerging market economies, account for over 70 per cent of gross portfolio equity flows as well as the lion's share of net private flows (see table III.2). This is a function of strong economic conditions and improving investment climate in that group of countries. Private capital flows to emerging Europe have also surged in recent years, and a favourable environment for cross-border M&As and a new wave of privatizations in the new member countries of the European Union (EU) have attracted large levels of FDI. Moreover, as mentioned earlier, the region has also experienced a surge in lending by commercial banks.

Private flows to Latin America have been well below the levels recorded in the late 1990s, during the wave of privatizations and before the economic difficulties experienced by major economies such as Argentina. More recently, the debt buy-back programmes in the region have limited flows in 2006, though there is likely to be a recovery during the coming year. Finally, net private capital flows to Africa have been on an upward trend during the past decade, with emerging economies such as South Africa and Egypt attracting increasing investor interest.

An interesting development has been the growth of local currency bond markets in some countries. While, from a global perspective, the local currency bond markets in emerging economies are still small, accounting for just 7.9 per cent of global domestic market debt as of September 2005, they are the fastest-growing segment of emerging market debt. Driven largely by domestic institutional and individual investors, these markets grew from \$1.3 trillion at the end of 1997 to \$3.5 trillion in September 2005. Local currency bond markets are concentrated in a few countries (such as Brazil, China, India, Malaysia, Mexico, the Republic of Korea, Turkey and South Africa), and in many cases their development has been driven by Governments' desires to limit levels of foreign currency debt.<sup>6</sup> There has been a growing interest among emerging market international investors in local currency instruments. The factors behind this include the limited supply of foreign currency external debt and, in some cases, the potential for local currency appreciation. In addition, the obstacles to foreigners investing in local currency bonds have been removed in some economies. This, together with gradual capital-account liberalization in a number of developing countries, could increase international interest in these instruments. However, the advantages of this trend may be smaller than generally thought. This is partly because the reduction of *currency* mismatches has been at the cost of increasing *maturity* mismatches. Moreover, the increased investment by foreigners may heighten volatility during periods of financial disturbance, when exchange rates come under attack.

A final issue, touched upon above, is the continued broadening of the investor base for emerging market securities. An increasing number of institutional investors are allocating portions of their portfolios to emerging markets as part of their diversification strategies.

<sup>5</sup> In all these cases, the concentration of private capital flows is stronger than for trade and output; these respective top 10 country groupings have a concentration of just under 50 per cent of developing country GDP, and about 40 per cent of total developing country trade.

<sup>6</sup> Some countries, such as the Republic of Korea and Malaysia, have been able to build up relatively large corporate bond markets over the past decade.

Local currency bond markets in emerging economies are the fastest-growing segment of emerging market debt

This has provided more stability in external financing as steady institutional investor flows have mitigated the impact of withdrawals by more speculative investors, as evidenced during the second quarter of 2006.<sup>7</sup> This trend of a larger and more diversified investor base may also point to emerging markets' increasingly becoming a mainstream asset class for some institutional investors.

### Continuing expansion of foreign direct investment

Though short of the record flows of 2000 (\$1.4 trillion), the level of global FDI flows are estimated to have increased for the third consecutive year, to \$1.2 trillion (see table III.3) in 2006. Relatively high gross domestic product (GDP) growth in both developed and developing regions has had a favourable influence on further FDI growth, although regional performance may vary greatly. Increased corporate profits (and resulting increased stock prices) boosted the value of cross-border M&As, which constitute a large share of FDI flows. The continuing liberalization of investment policies and trade regimes added further stimulus, although in some countries in Africa and Latin America there were some notable changes in general policy orientation towards a greater role for the State, as well as in policies that would affect investments in specific sectors, in particular the exploitation of natural resources.

Despite more restrictive policies in these industries, FDI grew in 2005 in mining, quarrying and petroleum, according to data on cross-border M&As (see table III.4). However, the first half of 2006 did not register similar growth in these sectors, although investments in resource-based manufacturing such as petroleum refining and rubber products continued to rise. It is expected that high demand for natural resources, and the opening up of new potentially profitable opportunities in the primary sector (for example, gas and oil in Algeria), would attract further FDI to the extractive industry.

In developed countries, there was a further increase in FDI flows, reaching \$800 billion (table III.3). The United States of America recovered its position as the largest single host country in the world, overtaking the United Kingdom of Great Britain and Northern Ireland. The EU as a whole continued to be the largest host region, accounting for 45 per cent of total FDI inflows in 2006.

Over the past few decades, however, the geography of FDI has undergone some major shifts. Developing countries as hosts for FDI have gained in importance. Their average share in total world inflows rose from 20 per cent in 1978-1980 to 35 per cent in 2003-2005. The distribution of these flows among developing countries has been quite uneven, however. The top five developed-country recipients get 50 per cent of world FDI inflows and the top five developing-country recipients get 20 per cent. At the same time, developing countries have become more important as a source (home base) of FDI. Their share in global outward FDI stock fluctuated between 8 and 15 per cent over the past 25 years, but this share has been on the rise recently. In 2005, developing countries invested \$117 billion abroad—4 per cent more than in the previous year. Outward FDI from economies in transition, especially from the Russian Federation, has increased, reaching \$15 billion in 2005. Together, economies in transition and developing countries accounted for 17 per cent of global FDI outflows in 2005, the highest since 2000 (see figure III.3).

East and South Asia are the largest home regions, accounting for 62 per cent of the total FDI stock from developing countries and economies in transition in 2005. FDI flows from Asia declined by 11 per cent in 2005 to \$68 billion, but the absolute size of the flows

FDI in mining, quarrying, and petroleum is being driven by high demand for natural resources

Developing countries have become important sources of FDI

<sup>7</sup> See IMF, Global Financial Stability Report, op. cit.

Table III.3  
Foreign direct investment inflows, by host region and major host economy, 2004-2006  
(billions of dollars)

Host region/economy	2004	2005	2006 <sup>a</sup>	Growth rate (percentage)
World	710.8	916.3	1 230.4	34.3
Developed economies	396.1	542.3	800.7	47.7
Europe	217.7	433.6	589.8	36.0
European Union	213.7	421.9	549.0	30.1
United States	122.4	99.4	177.3	78.2
Developing economies	275.0	334.3	367.7	10.0
Africa	17.2	30.7	38.8	26.5
Latin America and the Caribbean	100.5	103.7	99.0	-4.5
Asia and Oceania	157.3	200.0	229.9	15.0
Western Asia	18.6	34.5	43.3	25.5
South, East and South-East Asia	138.0	165.1	186.7	13.1
South-eastern Europe and CIS	39.6	39.7	62.0	56.2

Source: UNCTAD.

Note: Data refer to gross inflows, in contrast to table III.2, which is based on net flows. World FDI inflows are projected on the basis of 76 economies for which data are available for part of 2006, as of 3 November 2006. Data are estimated by annualizing their available data — in most cases the first two quarters of 2006. The proportion of inflows to these economies as a proportion of total inflows to their respective region or subregion in 2005 is used to extrapolate the 2006 data. Because of the greater number of countries, the data in this table are not strictly comparable to those presented in table III.3 of the *World Economic Situation and Prospects 2006*, which used data for 59 economies for estimating world foreign direct investment flows.

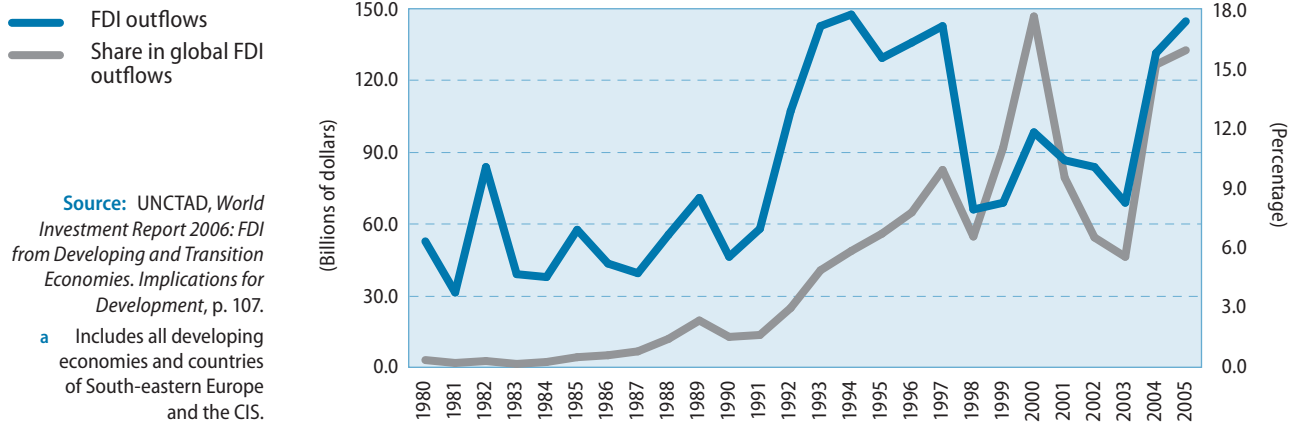
a Preliminary estimates.

Table III.4  
Cross-border merger-and-acquisitions sales, by sector/industry of seller (millions of dollars)

Industry / sector	2004	2005		2006	
		Total	First half	Second half	First half
Total industry	380 598	716 302	254 413	461 889	354 477
Primary	19 414	115 420	11 103	104 317	16 733
of which:					
Mining, quarrying and petroleum	18 169	113 596	9 492	104 103	14 348
Secondary	120 747	203 730	89 693	114 037	86 380
of which:					
Food, beverages and tobacco	23 870	44 816	17 240	27 576	13 097
Chemicals and chemical products	41 788	54 438	20 189	34 250	26 159
Services	240 437	397 152	153 617	243 535	251 364
of which:					
Transport, storage and communications	36 530	97 502	37 835	59 667	88 115
Finance	81 809	93 795	26 880	66 915	59 114
Business activities	55 261	93 127	41 836	51 291	37 406

Source: UNCTAD, cross-border M&A database, available from [www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics).

Figure III.3  
Foreign direct investment outflows from developing and transition economies,<sup>a</sup> 1980-2005



was still twice as large as that from the second largest region, Latin America and the Caribbean. China saw a sixfold increase in outward investments, reaching \$11 billion in 2005. Outflows from Western Asia more than doubled, to a level of \$16 billion, backed by huge amounts of petrodollars and strong economic growth. FDI outflows (excluding investments in offshore financial centres) from Latin America and the Caribbean rose by 19 per cent to reach \$33 billion. Colombia and Mexico contributed most to the increase. Outflows from South-eastern Europe and the Commonwealth of Independent States (CIS) rose modestly from \$14 to \$15 billion, with flows from the Russian Federation declining somewhat.

Increasing FDI from developing countries is not only driven by corporate factors but is also influenced by government policies aimed at ensuring access to strategic resources, such as minerals.<sup>8</sup> This trend is likely to continue if recent patterns of rising demand for these resources generated by growing economies such as India and China are sustained.

Also, in a number of LDCs, a significant share of FDI inflows originates from other developing countries (see table III.5). For developing host economies, FDI from other developing countries provides a broader range of potential sources of capital, technology and management skills into which they can tap. FDI by developing-country transnational corporations (TNCs) has the potential for greater employment-generating capacity.<sup>9</sup> A study of sub-Saharan Africa suggests that, in the majority of industries, the labour intensity of developing-country TNCs tends to be higher than that of developed-country TNCs.<sup>10</sup> Developing-country TNCs also engage more in greenfield investments than in M&As as a mode of entry. This applies especially to investment in developing host countries. In this context, it is these investments that are more likely to have an immediate effect on improving productive capacity in developing countries.

<sup>8</sup> Based on evidence from a survey of developing-country transnational corporations. Some developing-country transnational corporations seeking to secure access to natural resources are in fact State-owned, such as the Chinese firms CNPC, CNOOC, India's ONGC and Turkey's oil company, TPAO. For further discussion, see UNCTAD *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11), pp. 161-162.

<sup>9</sup> See UNCTAD, *ibid.*

<sup>10</sup> See UNCTAD, *ibid.*, pp. 192-195.

Developing country TNCs tend to engage more in greenfield investments than in M&A as a mode of entry

Table III.5  
Foreign direct investment by developing and transition economies in selected LDCs,  
various years

Recipient economy	Flows		Stock	
	Period/year	Share in total FDI (percentage)	Year	Share in total FDI (percentage)
Bangladesh	(1995-1997)	9	(1995)	17
	(2002-2004)	39	(2001)	13
Cambodia	(1995-1997)	63	(1994)	81
	(2002-2004)	64 <sup>a</sup>	(2002)	73
Ethiopia	(1992-1994)	100	(1995)	77
	(2002-2004)	51	..	..
Lao People's Dem. Rep.	(1995-1997)	93 <sup>a</sup>	(1990)	47 <sup>b</sup>
	(2002-2004)	45 <sup>a</sup>	(1999)	70 <sup>b</sup>
Madagascar	(2003)	29	(2003)	27
	(2004)	54	(2004)	36
Mozambique	(2003)	103 <sup>b</sup>	..	..
	(2004)	47 <sup>b</sup>	..	..
Myanmar	(1995-1997)	39 <sup>a</sup>	(1990)	33 <sup>b</sup>
	(2002-2004)	56 <sup>a</sup>	(2004)	61 <sup>b</sup>
Nepal	(1990-1992)	46 <sup>b</sup>	(1990)	58 <sup>b</sup>
	(1996-1998)	65 <sup>b</sup>	(1999)	63 <sup>b</sup>
Solomon Islands	(1994-1996)	56 <sup>b</sup>	..	..
Uganda	..	..	(1999)	48
	..	..	(2003)	36
United Rep. of Tanzania	..	..	(1998)	36
	(1999-2001)	41	(2001)	44
Vanuatu	(1999)	7	..	..
	(2000-2002)	19	..	..
Zambia	..	..	(2000)	21
	..	..	(2001)	20

Source: UNCTAD, *World Investment Report 2006: FDI from Developing and Transition Economies. Implications for Development*, p. 121.

<sup>a</sup> Based on information provided by the ASEAN secretariat.

<sup>b</sup> Data are on an approval basis.

## International financial cooperation

### Official development assistance

Achieving the Millennium Development Goals (MDGs) requires an increase of aid flows to at least \$150 billion per year, according to estimates of the UN Millennium Project. This is also consistent with the commitment the donors have made under the Monterrey Consensus of the International Conference on Financing for Development to work towards reaching the United Nations target of 0.7 per cent of gross national income (GNI).<sup>11</sup> Following

ODA reached a record level of \$106 billion in 2005...

<sup>11</sup> See *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7).



...but disaster relief and one-time debt-relief exercises explain a large part of the surge of ODA levels in 2006

the promises made by the EU and by the Group of Eight (G8) at its summit in Gleneagles to increase aid by some \$50 billion by 2010, and benefiting from the exceptional mobilization of resources in the wake of the Indian Ocean tsunami and other natural disasters such as the South Asia earthquake, official development assistance (ODA) from the countries of the Organization for Economic Cooperation and Development (OECD) to developing countries rose to a record high of \$106 billion in 2005. This total represents 0.33 per cent of the Development Assistance Committee (DAC) countries' combined GNI, up from 0.26 per cent in 2004.<sup>12</sup> A large part of this apparent surge in aid, however, was the result of one-time debt relief exercises, such as DAC member countries' debt forgiveness grants of nearly \$14 billion to Iraq and over \$5 billion to Nigeria in 2005.

Once these one-time responses recede, donors will have to substantially increase other forms of aid in order to achieve the target ODA levels. Indeed, donors will have to keep increasing aid by an average of over 8 per cent per year, a rate comparable to the 2005 surge of 8.7 per cent in real terms. This means that for most DAC countries, ODA will have to rise at a rate above that of total government expenditure, year after year, which is a challenge at a time when OECD countries' budgets are under considerable pressure.

Furthermore, not all of the increase in aid is being delivered as envisaged. For example, at the financing for development conference in Monterrey, the United States declared its intention to commit \$5 billion of its pledged 50 per cent increase in ODA under the new Millennium Challenge Account (MCA). Although expenditure under the MCA started in 2005, the Administration's request of \$3 billion for the budget for the 2006 financial year was reduced by Congress to \$1.77 billion in recognition of the more-gradual-than-planned progress in implementation. On the other hand, expenditure on Iraq and Afghanistan, not foreseen at Monterrey, has boosted United States aid spending, although its effectiveness in terms of reconstruction and development has been disappointing thus far.

Despite these problems, recent developments offer hope of gradually accelerating increases in ODA over the coming years. EU aid is forecast to reach 0.43 per cent of GNI in 2006, against its 0.39 per cent target. This assumes that all EU members of the DAC achieve the agreed minimum level of 0.33 per cent of GNI—which will require large proportionate increases from some EU members, such as a 125 per cent increase in the case of Italy. Based on current information, DAC member countries will reach about \$130 billion by 2010—an increase of nearly \$50 billion compared with 2004. That would be the largest expansion in ODA history, although the level of 0.36 per cent of GNI to be reached by 2010 for DAC members as a whole would only marginally exceed the 0.33 per cent level seen in the 1980s and early 1990s and would remain well below the level of over 0.50 per cent recorded in the early years of DAC existence.

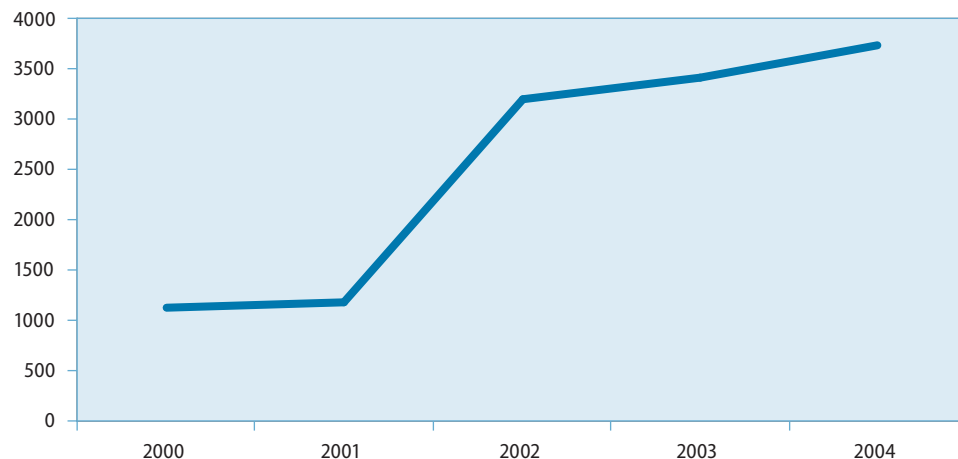
With these additional sources, total ODA is expected to reach the ambitious targets set forth for 2010, although the path of the increases will require a steep climb as the deadline approaches. The prospect for aid delivery may even require an upward revision if more flows are forthcoming from innovative sources of financing, such as the International Finance Facility (IFF) or levies on air travel, although the uncertainty associated with these schemes is great at present.

In addition, aid from non-DAC sources is likely to be on a rising trend, as the “emerging donors”, such as China and India, have begun to contribute significant additional funding (see figure III.4). China's announcement of an additional \$10 billion at the

Emerging donors, such as China and India, are becoming important contributors to ODA

<sup>12</sup> See OECD, The DAC Journal: *Development Co-operation Report 2005: Efforts and Policies of the Members of the Development Assistance Committee*, vol. 7, No. 1 (Paris: OECD, 2006).

Figure III.4  
**Official development assistance from non-Development Assistance Committee donors, 2000-2004 (millions of dollars)**



Source: OECD, *Development Cooperation Report, 2005*, p. 243, table 33.

United Nations 2005 World Summit was particularly significant, although an undefined proportion thereof would be in the form of export credits with a grant component. China's ODA is geared towards the poorest countries in particular. At its first summit meeting from 3 to 5 November 2006, the Forum on China-Africa Cooperation, the "Beijing Summit of the Forum on China-Africa Cooperation", adopted an Action Plan for cooperation for the period 2007-2009. The Plan called for, among other things, the doubling of aid to Africa by 2009 and extended an offer of \$5 billion in loans and credit.<sup>13</sup> It also announced the signing of investment guarantees between China and African countries totalling \$1.9 billion and a target doubling of trade by 2010.<sup>14</sup> China provides zero tariff treatment to selected products from all the 39 least developed countries (LDCs) with which it has diplomatic relations, and has made a commitment to increase aid to the HIPC and LDCs and to write off or forgive in other ways, within the next two years, all the overdue parts recorded by the end of 2004, of the interest-free and low-interest governmental loans owed by the HIPC countries with which it has relations.<sup>15</sup> It pledged to provide, within the next 3 years, \$10 billion in concessional loans and preferential export buyers' credit to developing countries to improve their infrastructures and to promote business-sector cooperation on both sides. China has been extending sizeable project loans to Cambodia, the Lao People's Democratic Republic, Myanmar and the Philippines to build roads and other infrastructure.<sup>16</sup>

<sup>13</sup> The Forum on China-Africa Cooperation (FOCAC) was established in October 2000 with the purpose of fostering a China-Africa strategic partnership based on political equality, mutual trust and mutually beneficial economic cooperation.

<sup>14</sup> See "FOCAC ends with 16 agreements between China and African countries", China Knowledge News release, 6 November 2006, available from [www.chinaknowledge.com/news/news\\_print.aspx?ID=4871&cat=general](http://www.chinaknowledge.com/news/news_print.aspx?ID=4871&cat=general).

<sup>15</sup> See "Will emerging donors change the face of international cooperation?", lecture at the Overseas Development Institute by Richard Manning, Chairman of OECD/DAC, 6 March 2006, available from [www.odi.org.uk](http://www.odi.org.uk).

<sup>16</sup> See "China Competes With West in Aid to Its Neighbors", *New York Times*, 18 September 2006.

Oil-exporters are expected to scale-up aid volume

The new EU/non-OECD member countries have also committed to making best efforts to reach these two targets by 2010 and 2015. The countries of the Middle East and the Organization of the Petroleum Exporting Countries (OPEC), which are significant sources of untied and grant aid, are estimated to scale up their aid volumes in light of strong revenues from the world oil market. Their major aid beneficiaries will continue to be the Islamic world and Africa. Other notable donors include Taiwan Province of China, whose aid is almost equal to that of the Republic of Korea; the Russian Federation, which continues to be a main source of aid to some CIS countries; Malaysia and Thailand, which have shown interest in joining the DAC; and Brazil, which plays a major bilateral and multilateral role in development cooperation, including within the Lusophone Commonwealth.

Non-DAC OECD countries have pledged to increase aid

Other emerging donors come from the group of non-DAC OECD member countries, including Turkey, Mexico, the Republic of Korea and several European countries. Some (for example, the Republic of Korea and Turkey) are already sizeable ODA donors, and all countries have plans to increase their aid. The Republic of Korea also has decided to increase its ODA to 0.10 per cent of its GNI by 2010, which implies more than doubling its aid to around \$1 billion. The non-DAC OECD/EU country members (the Czech Republic, Hungary, Poland and Slovakia), all former Council for Mutual Economic Assistance (CMEA) aid donors, have committed under EU decisions to make best efforts to have their respective aid equal 0.17 per cent of GNI by 2010, and 0.33 per cent by 2015.

A subsequent question is whether, with this additional aid and with more sources of aid from which developing countries can choose to finance their development, participating countries will take a more cavalier attitude towards adhering to the standards that traditional donors have set for the use and management of aid. First, since calculations have shown that DAC will continue to be the main source of ODA for the foreseeable future, it is assumed that it will wield the same degree of influence regarding how best to use and manage aid, ensuring, in effect, sustained adherence to agreed “best practices” for use of ODA.

The question of aid effectiveness remains centre stage as aid volumes rise

More generally, the question of aid effectiveness needs to remain centre stage as aid volumes rise. Since maintaining taxpayer support in developed countries is critical, managing development aid in a way that delivers real results is a key condition for sustaining the momentum of aid volume increases. The MDGs offer a set of universally recognized quantitative outcomes against which aid effectiveness can be measured. The application of management for development results, together with the monitoring and evaluation of outcomes, offers an arena for collaboration between donors and developing countries, with the latter increasingly taking a leading role. This requires rigorous and credible evaluations of the impact of jointly funded programmes, and there is a need for a more coordinated push to encourage developing country Governments to evaluate the effectiveness of specific development programmes. The World Bank is doing evaluations of this nature for some of its programmes, and the DAC is holding a Roundtable on Managing for Development Results in 2006 to share good practices from developing countries and the donor community in this area. Also, and crucially, the full application of the principles of the Paris Declaration on Aid Effectiveness may call for a broadening of targets. Adhering fully to the principles of ownership and donor alignment would imply greater allocation of resources in the form of budget support, for which no specific target has yet been set.<sup>17</sup>

<sup>17</sup> See *World Economic and Social Survey: Financing for Development* (United Nations publication, Sales No. E.05.II.C.1), pp. 120-121.

For the majority of developing countries, the relationship with the donor community is marked by an asymmetry of power, which can be extreme for the smaller and poorer countries. The Paris Declaration sets a target according to which, by 2010, two thirds of country analytical work should be done jointly. Case studies have begun to document the result of specific efforts to implement the principles of the Paris Declaration.<sup>18</sup> It is evident that there is a need to augment the capability of many recipient countries to design and negotiate their ODA-funded programmes. The potential for coordination and harmonization of work among donor countries depends heavily on the donors and personalities involved on the ground. The Paris Declaration originated from an OECD initiative. As noted above, some developing countries are themselves becoming important aid donors. With the increase in the number of donors, harmonization of development cooperation has become more complex. In this regard, the call of the United Nations General Assembly to convene, within the framework of the Economic and Social Council, a Development Cooperation Forum in 2007 has the potential to build political oversight over aid effectiveness with the broad participation of developing countries.

Given the expectation of substantially increased flows of aid over the coming years, the poverty reduction strategies that recipient countries have designed might now need to be reformulated to reflect the greater availability of resources and the more ambitious programmes needed to reach the MDGs. The African countries have already put forward the Abuja Commitment of May 2006 for pushing forward this scaling-up agenda. However, to scale up the effort towards achieving the MDGs, countries need to plan for the medium term and to know, up front, how much they can expect from donors. This poses the challenge of sufficient predictability of disbursements, which requires early and medium-term commitments of aid and help with managing the volatility of the aid through contingent planning.

### The Heavily Indebted Poor Countries Initiative and other debt-relief measures

The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996 to address the unsustainable debt problems of poor countries. By September 2006, 29 countries had reached the decision point under the enhanced Initiative — the point at which the international community commits to providing a country with additional assistance beyond traditional debt relief. Of these countries, 20 had reached completion point, while the remaining 9 countries were in the interim stage between the decision and completion points. Three countries are expected to complete the Initiative by the end of 2006.<sup>19</sup>

The sunset clause has been extended to the end of 2006 for countries that have yet to participate in the enhanced HIPC Initiative. The IMF and World Bank have identified

The new Development Cooperation Forum of the United Nations could build oversight over aid effectiveness among all donors and with full participation of recipient countries

<sup>18</sup> See, for example, papers presented at the 2006 Regional Forum on Aid Effectiveness held in Manila from 18–20 October 2006, available from <http://www.adb.org/Documents/Events/2006/Aid-Effectiveness/thematic-papers/ts1-ex-sum.pdf> (accessed 26 November 2006).

<sup>19</sup> See IDA and IMF, “Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation”, paper prepared by the Staffs of International Development Association and International Monetary Fund, August 2006, available from <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:21050877~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>.

11 countries that are potentially eligible for assistance under the extended clause, including 4 additional countries identified as being eligible in 2006.<sup>20</sup> Five of these eligible countries have yet to start an IMF- or International Development Association (IDA)-supported programme, and are required to do so before the expiration of the sunset clause in order to meet the necessary eligibility requirements.<sup>21</sup>

HIPC experience demonstrates that debt relief can positively influence the development process

The HIPC experience demonstrates that debt relief can positively influence the development process. However, the amounts allocated in the context of the Initiative have not been sufficient to put all low-income countries on a sustainable debt repayment path that will allow them to engage in serious efforts to reduce poverty. The Multilateral Debt Relief Initiative (MDRI), proposed by the G8 countries and launched in 2005, offers to reduce further the external debt of HIPCs and provide additional resources to help them meet the MDGs. Through the MDRI, additional debt reduction of around \$50 billion is to be achieved, meaning an average of over \$1 billion in annual debt relief flows over the next decade and close to \$2 billion per year in the following decade.<sup>22</sup>

Not all HIPCs will benefit equally from the MDRI, as not all regional financial institutions will provide debt relief under the Initiative. The African Development Fund does take part, however; more recently, the Inter-American Development Bank also agreed in November 2006 on a debt relief package for five of its poorest borrowing countries (Bolivia, Guyana, Haiti, Honduras and Nicaragua). The remaining 20 eligible HIPCs will be entitled to receive this additional debt relief upon completion of the HIPC Initiative. The details of some of the modalities of eligibility and delivery of the MDRI debt relief are presented in table III.6.

Rising debt ratios of completion point HIPCs are a cause for concern

One issue of concern is the return of countries to rising debt ratios after having reached the Initiative's completion point. According to a World Bank evaluation of the HIPC Initiative,<sup>23</sup> 11 out of 13 countries for which the required data are available have experienced deteriorated debt positions since reaching the completion point. Eight of these countries have debt ratios exceeding the HIPC thresholds of sustainability. In addition, while the implementation of the MDRI is expected to substantially lower the debt-service ratios of the HIPCs that have reached completion point in the medium term, these ratios are projected to rise in the long run, owing in part to new borrowing.<sup>24</sup>

Among the 29 decision point countries, there has been a rise in poverty reduction expenditures and a fall in debt service as a ratio of government revenue. This trend is not surprising, as the provision of such expenditures was incorporated into the Poverty Reduction Strategy Paper (PRSP) process. However, despite the increase in these expenditures, the additional resources resulting from debt relief remain below what is needed for these countries to achieve the MDGs. Many of the countries have made only modest progress

20 The newly identified countries are Eritrea, Haiti, Kyrgyzstan and Nepal. Other potential beneficiaries from the sunset clause that had been identified earlier are the Central African Republic, the Comoros, Côte d'Ivoire, Liberia, Somalia, the Sudan and Togo. Bhutan, the Lao People's Democratic Republic and Sri Lanka, which also meet the HIPC eligibility criteria, have chosen not to participate in the Initiative.

21 Comoros, Eritrea, Liberia, Somalia and the Sudan.

22 See The World Bank and IMF, *Global Monitoring Report 2006: Strengthening Mutual Accountability: Aid, Trade and Governance* (Washington, D.C., The World Bank, 2006), p. 87.

23 See The World Bank, *Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative*, Independent Evaluation Group, The World Bank, Washington, DC, 2006, pp. 18-19.

24 See IDA and IMF, op. cit., p.9.

Table III.6  
Multilateral Debt Relief Initiative<sup>a</sup>

	Eligible countries as of September 2006	Potentially eligible countries	Total estimated cost (billions of dollars)	Cut-off date	Implementation date
IMF	22 <sup>b</sup>	20	8	1-Jan-2005	5-Jan-2006
IDA	20 <sup>c</sup>	20	37	31-Dec-2003	1-Jul-2006
AfDF	16 <sup>d</sup>	17	8.5	31-Dec-2004	1-Sep-2006 <sup>e</sup>

Sources: IMF Factsheet September 2006; World Bank Press Release June 2006; AfDF Press Release September 2006.

<sup>a</sup> Does not include announced debt relief for Bolivia, Guyana, Haiti, Honduras and Nicaragua, to be granted by the Inter-American Development Bank at a total estimated cost of between \$2.1 and \$3.5 billion.

<sup>b</sup> Completion point HIPC, Cambodia and Tajikistan.

<sup>c</sup> Completion point HIPC.

<sup>d</sup> African Completion point HIPC.

<sup>e</sup> Effective date following approval from the Board of Governors of AfDF.

towards attaining some of the goals, with the majority of countries likely to fall considerably short of the targets set for 2015.<sup>25</sup>

Moreover, the provision of debt relief, which was intended to free up resources for increased public expenditures, was based on the assumption that such relief would be in addition to the aid flows that otherwise would have been provided in the absence of debt relief. Again, the judgement about additionality in this sense is largely a matter of interpretation and assumptions about the counterfactual. But a decomposition of nominal ODA flows from DAC members suggests that debt relief thus far has not been fully additional under the HIPC Initiative.<sup>26</sup>

It must also be noted that the limited participation of non-Paris Club creditors in debt write-offs, as well as litigation by some private creditors who have not accepted any write-offs of their claims, remains a hurdle to resolving the debt problem of HIPC and to limiting the risk of debt crises in the future.

## Governance of the global financial system

### Quota and voice reform in the International Monetary Fund

On 18 September 2006, the IMF Board of Governors adopted a resolution on quota and voice reform.<sup>27</sup> One of the main self-stated goals of the reform is ensuring that the distribution of quotas adequately reflects member countries' economic weight and role in the global economy. This would imply an increase in the voting power of developing countries. The reform of IMF governance is of utmost importance, as the issue of voice and representation is at the heart of the Fund's credibility and legitimacy as an international institution overseeing the stability of the global economy and as a potential mediator in the process of reaching internationally concerted macroeconomic policies to address the problem of the global imbalances, as discussed in chapter I.

<sup>25</sup> See UNCTAD, *Trade and Development Report 2006* (United Nations publication, Sales No. E.06.II.D.6), pp. 94-95.

<sup>26</sup> See section on official development assistance above; and UNCTAD, *ibid.*, p. 97.

<sup>27</sup> See "IMF Board of Governors Approves Quota and Related Governance Reforms", Press Release No. 06/205, available from [www.imf.org](http://www.imf.org).

There was an ad hoc increase in voting power for four clearly underrepresented countries, but more fundamental reforms are needed

As a first step, an ad hoc quota increase was approved for China, Mexico, the Republic of Korea and Turkey, which were the most clearly underrepresented countries. A plan of action was also outlined for more fundamental reforms, including an agreement on a simpler and more transparent quota formula giving more weight to the size (measured by GDP) and degree of openness of economies. The new formula will provide the basis for the second round of ad hoc quota increases directed at correcting a broader range of cases of substantial underrepresentation. Moreover, the resolution calls for at least a doubling of basic votes that would protect, at a minimum, the existing voting share of low-income countries as a group, as well as the introduction of a mechanism to subsequently safeguard the proportion of basic votes in total voting power.

Agreement on a new quota formula is a key element of the reform package. In this regard, it has already been argued that, if the measurement of GDP is made using market exchange rates (rather than purchasing power parity (PPP)) and the “openness” variable takes into consideration trade conducted between countries having a common currency, the result of a realignment of quota shares might well be a further increase in the ample majority which developed countries already have in the total voting power of the Fund.<sup>28</sup> The report of the Executive Board on quota and voice reform notes that large advanced economies may be willing to consider foregoing, or at least limiting, the increases to which they might be entitled under the new formula and to maintain their current shares.<sup>29</sup> In other words, large developed economies are being asked to voluntarily exercise self-restraint. However, an ex ante request for certain countries to withhold or limit the possible quota increase they would be entitled to may be counterproductive as this prejudices an open discussion on a new formula. Besides, this could be a fragile arrangement. If a commitment regarding the capping of advanced-economy countries to certain levels of representation is considered necessary, an agreement on the issue should be incorporated into the new formula itself. It would be preferable to develop clear rules that stand up on their own and do not need to be supported by implicit agreements.

Even if the consolidated share of developing countries is not reduced, the result of the reform could be far from satisfactory. It is possible that an increase in the share of some emerging market economies could be at the expense of all other developing countries. It could also be the case that if the shares of low-income countries are preserved as a result of an increase in basic votes, the realignment would likely be entirely at the expense of a selected group of middle-income countries.

All elements of the quota formula need to be critically re-examined

The relative weights of the different variables will have a major impact on the allocation of quotas.<sup>30</sup> Without prejudging, all four variables (GDP, openness, variability of external accounts and reserves) should be re-examined to ensure that they not only accurately reflect the relative economic importance of countries, but also determine adequate contributions to the Fund’s resources as well as reflect the countries’ contribution to the stability of the international financial system in the form of self-insurance via international reserve accumula-

<sup>28</sup> See Statement by Guido Mantega, Minister of Finance of Brazil, at the meeting of the International Monetary and Financial Committee of the IMF, Singapore, 17 September 2006, para. 17, available from [www.imf.org](http://www.imf.org).

<sup>29</sup> See “Report of the Managing Director to the International Monetary and Financial Committee on IMF Quota and Voice Reform”, IMF, 14 September 2006, p. 3, available from [www.imf.org](http://www.imf.org).

<sup>30</sup> For an extensive survey of the various IMF quota reform proposals, see, for instance, David P. Rapkin and Jonathan R. Strand, “Reforming the IMF’s Weighted Voting System”, *World Economy*, vol. 29, March 2006, pp. 305-324.

tion. Further, the “openness” variable needs close scrutiny, given the well-known problem of taking into account trade conducted between countries having a common currency, because this kind of trade does not generate balance-of-payments difficulties.<sup>31</sup> Also, as suggested by the Group of Twenty-Four (G24), a quota formula should capture the potential need for Fund resources by giving larger weight to the variability of external accounts.<sup>32</sup>

With regard to basic votes, the augmentation recommended by the resolution is aimed only at avoiding further erosion of the voting power of low-income countries as a result of agreed increases in the Fund’s total quota. This, however, does not address the substantial decline in the share of basic votes prior to this effort.<sup>33</sup> This is one of the reasons why the G24 has insisted that any package of reforms should include an “early and substantial increase in basic votes—at least a tripling...”.<sup>34</sup>

Reaching an agreement on quota and voice reform will likely be an extremely challenging exercise, as it is both highly technical and fundamentally political. Therefore, it will be critical to engage in a wide-ranging consultation process to build a broad consensus.

## Multilateral surveillance

In April 2006, the International Monetary and Financial Committee (IMFC) agreed on the need for a new framework aimed at strengthening surveillance and making it more effective, independent and accountable.<sup>35</sup> There is agreement that surveillance should focus more on multilateral issues, on the spillover effects of members’ macroeconomic and financial policies to other countries and on the benefits for the international monetary system, rather than attempt to provide advice on a broad range of domestic policies that may go beyond the Fund’s core mandate. Moreover, the Fund’s coverage of financial sector and capital market developments, particularly at the global level, should be brought to a par with other core areas of expertise in surveillance. It is also recognized that, however high the quality of the Fund’s surveillance, its effectiveness will critically depend on each country’s willingness to adhere to the principles of multilateral cooperation.

A new vehicle for multilateral consultations, involving systemically important members and regional groupings, has been established to complement other surveillance approaches. The new instrument could potentially be very important in promoting multilateral action and in helping to reinforce the Fund’s role as the central forum for discussion on global issues. The focus of the first multilateral consultations involving China, the euro area, Japan, Saudi Arabia and the United States is on narrowing global current-account imbalances while maintaining robust growth. The expectation is that consultations will produce a common understanding on collective policy response as well as on the role the Fund can play as a forum for implementing the common approach. The significance of the ongoing multilateral consultations extends much beyond the specific theme. The readiness

Multilateral consultations, involving systemically important countries, are focusing on narrowing global imbalances

31 See, for instance, *World Economic and Social Survey 2005: Financing for Development*, op. cit., pp.188-189.

32 See “Communiqué of the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development”, 16 September 2006, [www.g24.org](http://www.g24.org).

33 Basic votes initially constituted about 11 per cent of total voting power in the Fund. With the increases in quotas and not considering an adjustment in basic votes, the latter now represents only 2 per cent of total voting power.

34 See “Communiqué of the Intergovernmental Group of Twenty-Four...”, op. cit.

35 See Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, IMF, 22 April 2006, available from [www.imf.org](http://www.imf.org).



of the members directly involved in the exercise to make progress in a concerted fashion may be a sign of enhanced effectiveness of the IMF in facilitating policy coordination among key countries that do not borrow from the Fund.

One of the key initiatives aimed at developing the new framework is the ongoing review of the 1977 decision on surveillance over exchange-rate policies. The major goal of the current review is a clearer and more effective understanding of Fund members' responsibilities and the Fund's role in supporting the international financial system. There are, however, divergent views on the scope and desired outcome of the review. For instance, it has been argued that it is necessary to develop specific rules to clarify how the Fund will discharge its responsibilities by undertaking surveillance of fiscal, monetary, exchange-rate and financial-sector policies, and identifying cases where domestic economic and financial policies can have adverse international spillover effects. In the latter case, these rules should clarify the steps to be taken when countries are found to be engaging in policies, including currency manipulation, that negatively affect other members or the stability of the international monetary system itself.<sup>36</sup> An opposing view is that attempts to enhance the role of the Fund as an enforcer of members' obligations under Article IV would be counterproductive. According to this view, the surveillance activity can only be effective if it rests on the power of persuasion and not on a policing role, an issue which has already caused significant damage to the reputation of the Fund.<sup>37</sup>

Consequently, the challenge in attaining more effective surveillance is for the Fund to find the right balance between its role as a "trusted adviser" to Governments and its core responsibilities to support a well-functioning global economy.

While the need to enhance exchange-rate surveillance and to extend this exercise to the currencies of the major emerging economies is recognized, there is strong opposition to the publication of exchange-rate assessments that may not be beneficial for economic and financial stability. The prevailing view is that surveillance over exchange rates should focus on whether the adopted exchange-rate regime is appropriate and consistent with a member's macroeconomic policies rather than on the exchange-rate level.

One of the elements of the new surveillance framework is the introduction of an annual remit for both bilateral and multilateral surveillance. The aim of the remit is to consolidate and clarify the medium-term objectives and operational priorities of the multi-layered surveillance framework in a single concise document. Some progress has already been achieved in making the remit operational. However, according to many observers, further clarification of its content and structure is needed to guarantee that it would truly strengthen the surveillance framework.

## Financing for crisis prevention

There is a growing recognition that the Fund has to broaden its crisis-prevention toolkit to foster closer engagement with emerging market members. Over the past several years, many emerging market economies have strengthened policies, lowered vulnerabilities, improved debt profiles and built up significant reserves. Additionally, in East Asia, regional reserve-pooling arrangements have been expanded and there are proposals to set these up

<sup>36</sup> See, for instance, Rachel Lomax, "International monetary stability—can the IMF make a difference?", the Gam Gilbert de Botton Award lecture, London, 1 November 2006, available from [www.bis.org](http://www.bis.org).

<sup>37</sup> See Statement by Felisa Miceli, Minister of Economy and Production of Argentina, at the meeting of the IMFC, Singapore, 17 September 2006, para. 19, available from [www.imf.org](http://www.imf.org).

elsewhere (see further below). At the same time, the sharp growth of volatile cross-border capital flows may have rendered the Fund's traditional methods of crisis prevention and resolution much less potent than they used to be. Accordingly, the reserve build-up may, at least partly, be a symptom of uncertainty about the future stability of the international financial system and the efficacy of existing multilateral instruments of crisis prevention. Hence, the world community should provide financial support that is predictable, flexible and substantial in order to allow emerging market economies to meet the challenges they might face.

Since the expiration of the Contingent Credit Line in November 2003, the IMF has been exploring other ways to develop a high access contingent financing vehicle to support crisis prevention efforts by members active in capital markets. Reconciling different demands on such an instrument will likely be very difficult. Any solution should balance a country's need for assurances that it can draw on the Fund's resources quickly and in sufficient amounts should a capital-account crisis occur without being seen by the markets as a potential crisis case. There will also be a need to incorporate the guarantee of an appropriate policy response to address the underlying cause of crisis and of timely repayment to the Fund. There should also be assurances that conditionality would be tailored to forestalling crises rather than to serving broader or more general objectives. Besides, insurance instruments inherently face an exit problem that should be addressed. Indeed, the termination of arrangements with participating countries that allowed policy slippages may cause an adverse market reaction.

In August 2006, IMF staff put forward a sample design of a crisis prevention facility, entitled the Reserve Augmentation Line (RAL).<sup>38</sup> According to the proposal, the new facility would be available to members with strong macroeconomic policies, a sustainable debt situation and proven credibility in policy implementation but which are still faced with vulnerabilities to capital-account crises. The adherence by the participating member to a policy framework that meets the standards of upper credit tranche conditionality would be reviewed by the Board semi-annually. There would be no performance criteria. Access would be 300 per cent of quota, the full amount being available from the outset, provided the programme was on track. The RAL would be established as part of the Supplemental Reserve Facility (SRF) and have a one-year duration.

Several emerging market economies have indicated that the RAL proposal is an important step forward, although much remains to be done. In particular, it is important to further enhance the reliability of access to financial resources and to reinforce the positive signal to markets in order to overcome the potential stigma associated with the facility. In the latter case, it has been suggested that, to reduce uncertainty and build-up credibility, the reviews should be limited to the time of the Article IV consultations and that the facility be extended for a period of at least two to three years. It is also considered important to establish a clear differentiation between this, precautionary, facility and those applicable to regular Fund programmes. The IMF is expected to present a concrete proposal for a new liquidity instrument at the IMFC meeting in April 2007. It is important to take advantage of the favourable current environment to rethink the approach to crisis prevention.

The sharp growth of volatile cross-border capital flows have rendered the Fund's traditional methods of crisis prevention and resolution much less potent

The IMF has proposed a crisis prevention facility...

...a step forward, but more needs to be done

38 See "Consideration of a New Liquidity Instrument for Market Access Countries", IMF, 3 August 2006, available from [www.imf.org](http://www.imf.org).

## International Monetary Fund engagement with low-income countries

The IMF plays an important role in low-income countries through surveillance, technical assistance and concessional lending. To further strengthen its engagement with these countries, a new set of instruments has been created, including the Policy Support Instrument (PSI) and the Exogenous Shock Facility. Moreover, a decision has been made to provide appropriate financing for the Poverty Reduction and Growth Facility Trust for the period 2007-2011. In addition, debt relief under the HIPC and MDRI initiatives (see above) has contributed to improving the financial position of low-income countries. These initiatives have released resources that can be dedicated to poverty-reducing expenditures.

The PSI is designed to address the needs of low-income countries that do not need or want Fund financing, but which wish the Fund to support, monitor and endorse their policies. As of September 2006, PSI arrangements had been approved for three countries: Cape Verde, Nigeria and Uganda.<sup>39</sup>

Assisting low-income countries in effectively managing expected increases in aid flows is critical

In helping low-income countries implement macroeconomic policies that foster sustainable growth and support the achievement of the MDGs, the Fund is expected to concentrate more on addressing new challenges facing this group of countries, including effective management of expected increases in aid flows, maintenance of debt sustainability and more effective use of the fiscal and balance-of-payment space created by debt relief. In this regard, the Fund, in close cooperation with the World Bank and other agencies, is to intensify its advice to low-income countries on public expenditure management and on the consistency of projected aid flows with both macroeconomic stability, including real exchange-rate effects, and the estimated costs of achieving countries' development goals.

By supporting the MDRI, HIPC and other debt-relief initiatives, both creditors and debtors agreed to a new framework designed to end the lend-and-forgive cycle in LDCs. To ensure that debt prospects improved by debt relief will not deteriorate through excessive additional borrowing, the IMF is expected to expand its assistance in building fiscal and debt-management capacity in low-income countries and to strengthen debt monitoring under the joint Bank-Fund Debt Sustainability Framework (DSF). In this regard, the IMFC urged all creditors to work with the IMF and the World Bank with a view to adhering to responsible lending.<sup>40</sup>

The World Bank and the IMF are making efforts to strengthen the debt-sustainability framework to make it more comprehensive, practical, widely accepted and forward-looking. To have these qualities, it will be important that the framework include stable and objective criteria consistent with the development needs of the indebted country, particularly its financing needs, to achieve the MDGs. Focusing the criteria solely on debt-servicing capacity could lead to insufficient resource allocation for long-term public investments. Furthermore, the sustainability of total public debt should be considered, not just that of the external debt.

<sup>39</sup> See "Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda", IMF, 15 September 2006, p. 10, available from [www.imf.org](http://www.imf.org).

<sup>40</sup> See Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, IMF, 17 September 2006, available from [www.imf.org](http://www.imf.org).

## Regional financial cooperation

The debate on the international financial architecture, which intensified in the aftermath of the financial crises of the late 1990s, largely neglected the possible role of regional arrangements in macroeconomic policy coordination and the development of regional institutions able to perform the functions traditionally assigned to the international financial organizations. There are, nevertheless, a number of arguments in favour of regional cooperation in macroeconomic and financial areas, particularly the fact that the current globalization process is also one of “open regionalism”, and increased regional interdependence requires a certain degree of coordination and mutual surveillance of macroeconomic policies.<sup>41</sup> The regional nature of the severe currency crises of the 1990s created a strong stimulus for countries to engage in regional cooperation in order to elaborate commonly agreed targets and mutual surveillance mechanisms and to provide financial assistance to one another in order to avoid the contagion effects of a financial crisis. There are, however, also barriers to such cooperation, such as the inadequate capacity of countries to provide the necessary financial services, the lack of a proper institutional framework and the possibility of inequitable distribution of the benefits of such cooperation.

In contrast to the area of development financing, with its plentiful evidence of success, macroeconomic cooperation with the development of the corresponding financial arrangements at the regional level still remains immature. In this area, with the notable exception of the Economic and Monetary Union (EMU) in Europe, progress has been limited to a number of initiatives launched by the developing countries in recent years. These initiatives are often based on regional trade agreements and to a certain extent try to emulate the EMU. Apart from stronger intraregional trade linkages, there are additional reasons for countries to coordinate their policies, such as sheltering the region from the possibility of a financial crisis and targeting the real exchange rate in order to avoid unnecessary competition affecting export performance.

The regional initiatives launched by developing countries aim at creating a forum for policy discussion, elaborating mutual monitoring and surveillance procedures, coordinating exchange rates and, in particular cases, eventually launching a single currency. The initiatives taken by the members of the Gulf Cooperation Council and the countries of the Caribbean Community, aimed at the eventual adoption of a single currency, are examples of such strategies but have not shown much progress so far.

In Africa, a monetary cooperation programme aimed at a single currency was adopted in 2000 by the Economic Community of West African States, and five of its member States later agreed to create a monetary zone, which will eventually merge with the existing West African Economic and Monetary Union.

In Latin America, although creating a monetary union was not a straightforward goal, attempts were made to create a macroeconomic policy coordination framework within the major regional integration agreements (such as MERCOSUR, the Andean Community and the Community of Central American Countries). In 2000, the MERCOSUR group of countries decided to coordinate their macroeconomic policies by establishing common macroeconomic and financial targets, including those for the fiscal deficit, public debt and inflation, and by establishing a macroeconomic monitoring mechanism. However, the development of sufficient incentives for compliance with the declared goals proved to

Macroeconomic cooperation with the development of the corresponding financial arrangements at the regional level remains immature

The Latin American Reserve Fund has successfully provided liquidity funding during crises

<sup>41</sup> For further discussion, see José Antonio Ocampo (ed.), *Regional Financial Cooperation* (Washington D.C.: Brookings Institution Press and ECLAC, 2006).

be difficult, and, following the Argentine crisis in 2001, this endeavour came to an end. Further progress made in the region in this direction has so far been marginal. In spite of increased integration among the region's countries, mutual support for balance-of-payment financing remains weak and the only viable institution in the area of liquidity financing is the Latin American Reserve Fund. This Reserve Fund, though limited in membership (the Andean countries and Costa Rica), has had successful experience in supporting member countries during the debt crisis of the 1980s and during the Asian crisis of the late 1990s. In addition to providing financial support to its member States and improving the countries' reserve management, it also has as an objective the coordination of the monetary and fiscal policies of its members. Besides the Latin American Reserve Fund, the region has a well-developed network of subregional financial institutions, including three major development banks: the Andean Development Corporation (CAF), the Central American Bank for Economic Integration (CABEI) and the Caribbean Development Bank (CDB). CAF is the most dynamic of these three banks and may be one of the developing world's best examples of risk pooling, holding an investment-grade status, regardless of the fact that none of its Andean member States have such a status.

The most elaborate system of regional multilateral financial institutions "owned" by developing countries can be found in the Arab and Islamic world. Most of these institutions started operating in the 1970s and function essentially as vehicles to transfer resources from the oil-rich countries to poorer regional members, particularly in the Islamic world and Africa. The Islamic Development Bank, the largest of these multilateral agencies, is an exception in that it also includes some major non-oil-exporting countries as shareholders. In November 2006, it announced a major funding operation in support of MDG-related expenditures among its member States. The second-largest is the Arab Fund for Economic and Social Development, which provides soft lending for Arab League countries, mainly for infrastructure projects.

In East Asia, the focus of initiatives has been on improving regional surveillance, developing collective liquidity-support mechanisms and promoting financial development. These collective actions aim to both reduce the region's vulnerabilities to future financial crises and improve the allocation of savings. The collective liquidity support under the Chiang Mai Initiative (CMI) in May 2000 involves bilateral currency swap arrangements among the Association of Southeast Asian Nations (ASEAN) member countries plus China, Japan and the Republic of Korea (ASEAN+3). As of May 2006, the size of the CMI was approximately \$75 billion. Under the arrangement, a disbursement of 20 per cent of the maximum drawing is automatic. Any country drawing more than 20 per cent would have to be taking part in an IMF programme. This regional framework is complementary to the IMF global facilities and does not negate the need for a crisis-prevention framework for the IMF itself. Due to the benign global environment of the past several years, the effectiveness of the CMI in crisis prevention has yet to be tested.

CMI members are seeking to overcome potential problems, such as the slow response of the mechanism under the bilateral swap arrangements in times of speculative attacks. To this end, a collective decision-making procedure for CMI activation has been adopted that would allow the simultaneous and prompt provision of liquidity support to any party involved in bilateral swap arrangements. Also, in May 2006, the CMI members agreed to pursue a study on various possible options towards CMI multilateralization (Post-CMI).

There is an understanding that the multilateralization of the bilateral swap arrangements would require a more formalized and rigorous surveillance system. Although the

The Arab and Islamic world has well-developed multilateral financial institutions of its own

In East Asia, there has been a focus on collective actions to reduce vulnerability to future financial crises

A more formalized and rigorous surveillance system is needed to underpin regional monetary cooperation in East Asia

ASEAN+3 Economic Review and Policy Dialogue is the most advanced multilateral peer review mechanism in Asia, it is still not strong enough to support reserve-pooling arrangements. In this regard, the Group of Experts and the Technical Working Group on Economic and Financial Monitoring have been launched to explore ways for further strengthening surveillance capacity in East Asia, including the development of an early-warning system to detect and assess regional financial vulnerabilities.

Beyond these initiatives, discussions, albeit of a preliminary nature, on the creation of a single Asian currency are under way. In this regard, in May 2006, East Asian Governments decided to study the idea of an Asian Currency Unit (ACU). At this stage, an ACU is seen as a non-tradable weighted average of regional currencies. An ACU would serve mainly as a means of monitoring the extent of movements of participating currencies against each other.

The Asian Bond Markets Initiative is a complementary effort, aimed at developing well-functioning, local currency bond markets. The main objectives of the Asian Bond Funds are to diversify debt financing, encourage a convergence in financial and capital market policies, recycle regional savings intraregionally and lessen the extent of currency and maturity mismatches.<sup>42</sup> The Asian Development Bank (ADB) plays an important role in the promotion of local currency bond markets. For instance, in September 2006, it launched a \$10 billion Asian Currency Note Programme. The programme links the domestic capital markets of Singapore, Hong Kong Special Administrative Region of China, Malaysia and Thailand. Bonds in local currencies will be issued in respective domestic markets under a single unified framework with a common set of documents. The first step under the programme involves the issue by the ADB of 300 million five-year Singapore dollar notes in Singapore and 1 billion three-year Hong Kong dollar notes in Hong Kong. The programme is structured to accommodate other markets in the region as and when the terms are approved by national regulators.<sup>43</sup>

The implications of regional financial cooperation for the international financial system will vary from region to region. One way to view efforts to deepen and expand monetary cooperation in Asia is that these are policy responses which are being driven by the dilemmas that are spawned by increased trade linkages within the region, as had been the case earlier in Europe, and by the systemic uncertainties created by a global financial payments system in transition. If this is in fact the case, then these regional efforts have the potential for bolstering the international system's capacity to consult and coordinate on collective issues and assist in their implementation. Because of its robust trade with the rest of the world, the region has an inbuilt interest, as in the case of Europe, in the vitality of the global economy.

These forms of regional financial cooperation can play a critical role in development financing, as several institutions in Latin America and the Caribbean and in the Arab and Islamic world, as well as the more recent Asian Bond Market Initiative indicate. A case can also be made for a more active use of regional financial arrangements as a complement to the IMF's role as discussed in chapter I. More intensive macroeconomic policy dialogue

Asian regional cooperation has also involved the development of local currency bond markets

<sup>42</sup> For more details on Asian Bond Funds, see, for instance, Ramakishan Rajan "Monetary and Financial Cooperation in Asia: Emerging Trends and Prospects", RIS Discussion Paper No. 107, March 2006, available from [www.ris.org.in](http://www.ris.org.in).

<sup>43</sup> See "ADB Launches US\$10 Billion Asian Currency Note Program", News Release, 14 September 2006, available from [www.adb.org](http://www.adb.org).

and stronger forms of regional surveillance and policy consultations could internalize, at least in part, the externalities that national macroeconomic policies have on regional partners. Thus, while the IMF should play a central role in policy coordination at the global level, there is plenty of room for regional and subregional processes of a like nature. In a similar vein, while regional and international contagion effects in financial markets and management of the main balance-of-payments crises should be the main concern of the IMF, regional funds could provide effective rescue mechanisms for smaller and more local financial crises.

## Chapter IV

# Regional developments and outlook

### Developed market economies

The pattern of growth across the developed market region began to shift in 2006, marking a tentative beginning to some rebalancing of activity between economic areas. The United States of America saw a significant slowdown, with growth dropping well below potential during the year, but in the euro area and Japan growth picked up sharply. While the latter two economies have slowed during the second half of the year and are expected to grow at this slower rate in 2007, they are still close to their potential, whereas the United States is expected to continue to grow well below its potential rate.

Growth trends not only differed across the developed countries, but the demand composition of growth has also shifted. In the United States, growth has become more reliant on net exports, moving away from its dependence on domestic demand, especially private consumption. In contrast, in Europe and Japan, domestic demand has become more important in the recovery of their economies (see figure IV.1). How significant these changes are and whether they continue or reverse themselves will be an important element in resolving the global imbalance problems discussed in chapter I.

### North America: the United States sees a significant downshift

Economic growth in the United States has moderated significantly during the second half of 2006, and the weakness will likely linger into the years to come. Gross domestic product (GDP) is expected to grow at a subdued pace of 2.2 per cent in 2007, notably lower than the 3.2 per cent growth estimated for 2006 and markedly below estimates of potential growth (see table A.1). While a sharp downturn in the housing sector has been the major drag, indicators for the labour market and the manufacturing sector have also recently sent signals for a broader deceleration in the economy. On the bright side, corporate finances are healthy and the policy space for macroeconomic stimuli has improved, so the current moderation is expected to be prevented from degenerating into a recession. Nevertheless, downside risks do exist. Given the negative savings rate of households, a deeper-than-expected fall in house prices could lead to much weaker consumer spending, as well as to weaker import demand, which in turn could trigger an abrupt adjustment in the enormous external deficit, not only resulting in a possible contraction in the domestic economy but also derailing the world economy as a whole.

By various measures, the slowdown in the housing sector has accelerated during 2006. With the inventory of unsold new homes at more than 40 per cent above the level of the previous year, homebuilder's confidence has dropped to the lowest level in 15 years (see figure IV.2). So far, the adjustment in the level of house prices has been fairly modest, but the rate of deceleration in prices has been salient. Further weakening in the housing

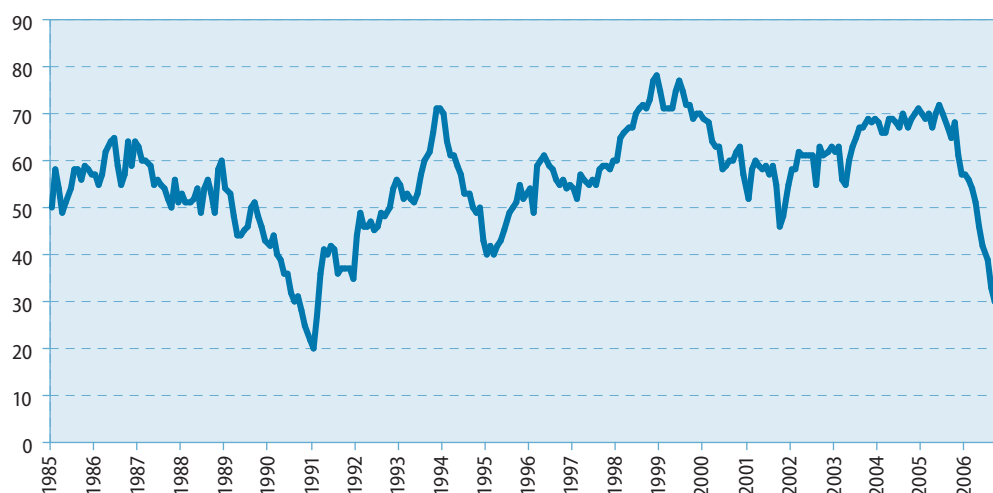
The housing sector in the United States slows, leading to weaker household spending



Figure IV.1  
**Composition of GDP growth in the EU-12, Japan and the United States, 2000-2007**  
*(contributions in percentage points)*



Figure IV.2  
Housing market index in the United States, 1985-2006<sup>a</sup> (seasonally adjusted)



Source: National Association of Home Builders.

<sup>a</sup> Until November 2006.

sector is expected in 2007. Just as the housing boom has significantly contributed to the strength in household spending over the past few years, the unfolding downturn in this sector is expected to work conversely, through such effects as changes in employment and income generated by the sector, and changes in the wealth and confidence of consumers. More adverse effects of the housing sector on consumer spending are expected to become evident in 2007. Moreover, as indicated by the alternative scenario in chapter I, risks exist for a more severe downturn in the housing market, and should one occur, the economy of the United States would be driven into stagnation in 2007, if not into recession.

While a slowdown in household spending is inevitable, many analysts expect business investment to remain sufficiently strong to offset part of the weakness in private consumption. Corporate finances are indeed in a sound position as a result of the double-digit annual growth in corporate profits for the past 5 years (with a more than 30 per cent increase for 2005 alone). One caveat is that a lofty cash position is a necessary though insufficient condition for businesses to increase their capital spending. Business investment accelerated at the beginning of 2006, particularly for information and communication technologies (ICT)-related capital, but it has softened notably since. In the outlook for 2007, growth in business spending is also expected to moderate slightly, but the growth of the total fixed investment will be dragged down by a substantial decline in residential investment.

The labour market has continued to improve during 2006, with the unemployment rate recently dropping to 4.6 per cent, the lowest in five years, although still higher than the 4 per cent recorded in the late 1990s. The current low unemployment rate, however, belies several structural problems in the labour market. On the supply side, labour participation rates have been declining. Millions of workers between the ages of 30 and 55 have dropped out of regular work. The number of people in this group currently not working at all increased to 13 per cent of the total, up from 5 per cent in the 1960s. On the demand side, ever since the trough of the last business cycle in 2001, employment growth has been concentrated in three sectors: health care-related services, housing-related activities and government services. All other sectors have recorded job losses, with the ICT industries shedding the most. Employment trends differ, however, by data source. The labour force survey indicates a solid gain in employment of 271,000 jobs in September 2006, but pay-

Investment expenditure offsets weakness in private consumption

The unemployment rate continued to fall in 2006, but the growth slowdown will lead to an increase in 2007

roll statistics record a much lower increase by 51,000. Historical employment data have also been revised and the growth in payrolls for the period from March 2005 to March 2006 has been restated at 2.8 million, from the 2 million originally reported. Such data problems may have created confusing signals to investors, consumers and policy makers, who will have found difficulty in ascertaining the actual condition in the labour market. Nonetheless, most analysts seem to agree that employment growth has indeed trended downward during the second half of 2006. In the outlook, employment growth in 2007 is expected to become even more sluggish, and the unemployment rate is expected to rise (see table A.7).

Inflation rises, but worries may be exaggerated

Inflation accelerated notably in the first half of 2006, but has since stabilized. The consumer price index (CPI) is estimated to increase by about 3.3 per cent for 2006, the same as in 2005. Other measures of inflation, such as the core CPI or the core price index for personal consumption expenditure (both excluding the prices of food and energy), are all rising at an annual rate clearly above 2 per cent, which is beyond the ceiling of the comfort zone for the Federal Reserve Bank (Fed). While falling energy prices since August have eased one important source of inflationary concerns, more recently, attention has shifted to rising labour costs. Unit labour costs have risen gradually since 2004, but have accelerated noticeably to an annual rate of 5 per cent during 2006. This has led to worries about the possible emergence of a wage-inflation spiral similar to that of the 1980s. A closer scrutiny of the labour cost data suggests, however, that such worries may be exaggerated. Unit labour costs have not accelerated during 2006 (until September) according to the employment cost index. This index differs from the alternative non-farm compensation index as it excludes such items as stock options and managers' bonuses.<sup>1</sup> Furthermore, inflationary expectations remain tame. In the outlook, inflation is expected to decelerate in 2007, with the annual rate of the CPI dropping below 2.5 per cent (see table A.4).

Net trade becomes an important source of growth

For many years, the external sector has been a net drag on the overall growth of the United States economy, as its trade deficit has continued to widen. The year 2006 marked a turning point as the contribution of net exports to GDP became positive. Real exports have outpaced real imports by a notable margin. In volume terms, imports are estimated to increase by about 6 per cent in 2006, decelerating from the growth in 2005 and falling below average import growth of the last decade. On the other hand, export volume growth accelerated to over 10 per cent, the strongest pace in many years. In the outlook, both exports and imports are expected to moderate in 2007, but exports will expand faster than imports. Even though the trade deficit is on the decline in real terms, it reached new highs in nominal terms in 2006. The nominal trade deficit is expected to stabilize in 2007.

The Fed pauses; the next move will be downward

After a two-year tightening cycle, raising its main policy interest rate, the federal funds rate, to 5.25 per cent, the Fed has decided to pause, with no further change in policy since August 2006. Decision-making is hovering between giving in to concerns about continued inflationary pressures, on the one hand, and addressing the weakening of aggregate demand, on the other. Policy makers will need to consider further the lagged cumulative effects of monetary tightening in the recent past. In the outlook, the Fed is expected to hold the federal funds rate at 5.25 per cent until mid-2007, to be followed by a cut of 50 basis points.

The fiscal position continues to improve, but higher taxes will be needed to keep the deficit under control

The fiscal position has benefited from the robust growth so far. Despite the increased spending related to the post-hurricane reconstruction and increases in other spending measures, revenues have improved so strongly that the federal budget deficit has been narrowing

<sup>1</sup> See Global Insight, *U.S. Economic Outlook*, monthly, various issues.

during 2006. The deficit for fiscal 2006 (ending in September) is estimated to come in at \$264 billion, well below the \$319 billion deficit in fiscal 2005. Although higher taxes would be needed to keep the deficit under control, at present some of the previous tax reduction measures will not be allowed to expire as scheduled, with the tax rate cuts for capital gains and dividends already being extended to 2010. In general, the fiscal stance is expected to remain modestly stimulatory.

The Canadian economy is expected to grow by 2.8 per cent in 2006, with private consumption, business investment as well as an expansionary fiscal policy stance being the main drivers. In 2007, the economy is likely to see a slowdown in growth to 2.6 per cent, mainly due to the weakening in the United States economy. The economic outlook continues to be characterized by an increasing dichotomy between the strong performance of the primary, resource-based sector, especially in the western provinces, and the problems stemming from the stronger Canadian dollar for the manufacturing sector, mainly in the eastern provinces. The moderate slowdown in economic growth, along with tax cuts, will help to keep inflation under control, allowing policy makers to keep monetary policy on hold into 2007. On the fiscal side, the budget is expected to remain in surplus, although at a lower level, because of higher public spending, tax cuts and increased transfer payments by the federal Government to the provinces.

A moderate slowdown will be accompanied by a dichotomy between economic sectors and regions in Canada

### Developed Asia and the Pacific: the economic recovery in Japan continues, but a slowdown is expected for 2007

Japan's economy continues to perform in line with the previously projected recovery scenario, with economic growth forecast to reach 2.5 per cent this year. However, fiscal consolidation, higher interest rates, exchange-rate appreciation and the negative impact of the expected slowdown in the United States economy on exports will lead to a moderation in economic growth to 1.7 per cent in 2007 (see table A.1).<sup>2</sup>

Strong domestic demand has become a key pillar of the continued expansion of the Japanese economy, driven in particular by strong business investment on the back of higher profits and the recent fall in oil prices. Solid growth in private consumption has provided further support for domestic demand, helping to outweigh the drag caused by weakness in inventory investment and residential construction as well as continued fiscal consolidation. Domestic demand is expected to continue to support growth in 2007, although expected higher consumption taxes will reduce the impulse from private consumption. As for external demand, exporters have benefited from stronger competitiveness due to productivity gains as well as lower nominal prices as a result of the economy's deflationary cycle. However, the expected appreciation of the yen and the slowdown in the United States economy are forecast to reduce the contribution of external demand to economic growth in 2007.

Solid domestic and external demand have consolidated economic growth

The overall positive growth picture has also had a positive impact on the labour market in the form of more hiring by firms and a fall in the unemployment rate, although

Labour market conditions in Japan will continue to benefit from the economic expansion

<sup>2</sup> This needs to be seen in the context of potential growth of slightly less than 2 per cent, according to estimations by the Bank of Japan (Bank of Japan Review 2006-E-3, available from <http://www.boj.or.jp/en/type/ronbun/rev/data/rev06e03.pdf>). Potential growth is defined in this context as the state of the economy which implies price stability, and the Bank of Japan estimates potential growth using a production function approach.

there has been little upward pressure on wages so far, keeping labour costs in check and underpinning businesses' increased profitability. In the outlook, the unemployment rate is expected to remain at its current level, with labour market flexibility providing sufficient cushion against the expected slowdown in growth (see table A.7).

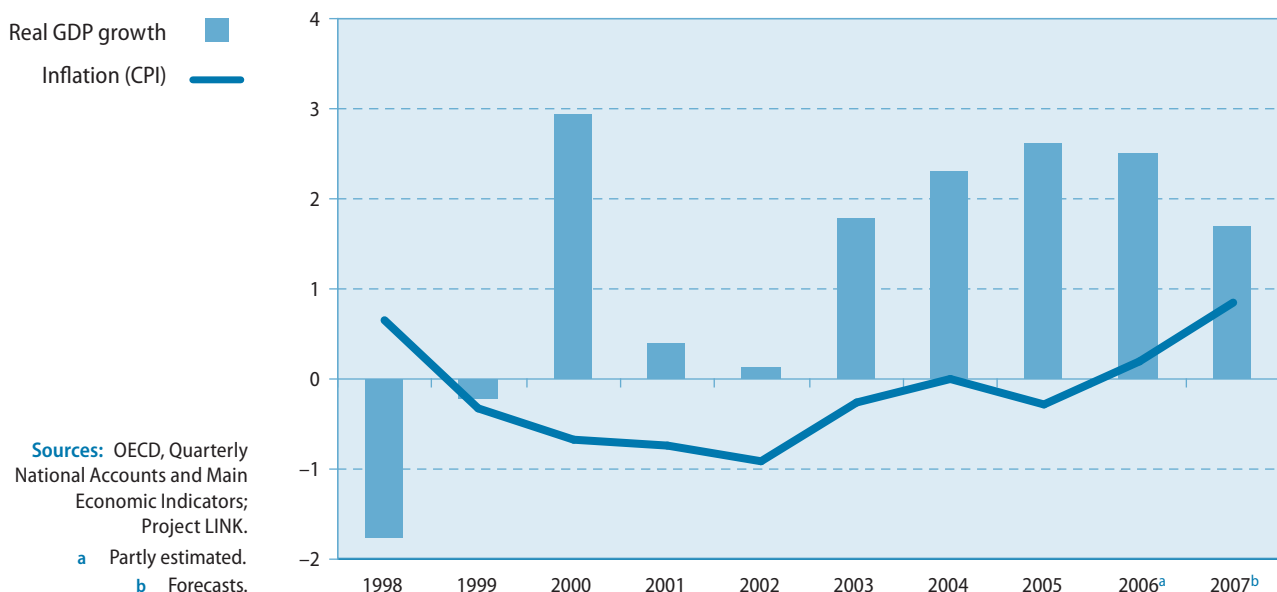
Driven by solid domestic demand and, to some extent, the pass-through of previous increases in energy prices, consumer prices have edged out of deflationary territory during the year and are forecast to increase by 0.2 per cent in 2006 after a decline of 0.3 per cent in 2005, marking the end of a protracted deflationary cycle that started in 1999 (see figure IV.3). Against this background, the Bank of Japan (BoJ) raised interest rates from 0 to 0.25 per cent in July, marking the turning point, away from an expansionary monetary policy stance aimed at injecting liquidity into the financial system and spurring consumption onto a course that would put more emphasis on a normalization of the level of interest rates. The BoJ is expected to keep interest rates on hold until at least the end of 2006, as a change in the base for the calculation of the CPI resulted in a pronounced downward revision to measured inflation and there are still some concerns regarding the firmness of the economic recovery. In the course of 2007, interest rates are likely to increase by 100 basis points to reach 1.25 per cent by the end of the year, owing to increased inflationary pressure stemming from stronger demand and capacity utilization.

The upward movement in interest rates in Japan combined with the reversal in the United States monetary policy stance will support the Japanese yen against the United States dollar and reduce the attractiveness of carry trades between the yen and the dollar. Likewise, steady interest rates in the euro area will support the Japanese yen against the euro. Combined with the continued improvement in the macroeconomic fundamentals of Japan's economy and the ensuing attraction of capital flows into the Japanese capital market, this situation is expected to lead to an appreciation of the Japanese yen against both the United States dollar and the euro in 2007.

Interest rates are expected to rise in 2007

Falling interest rate spreads will support the Japanese yen

Figure IV.3  
GDP growth and inflation in Japan, 1998-2007 (in per cent)



Japan's fiscal policy remains focused on reducing the deficit in the primary budget, both through tax increases as well as spending cuts. However, any progress towards the Government's medium-term objective of a balanced primary budget will depend on the political feasibility of the proposed fiscal reform package as well as a further consolidation and no renewed weakening in economic growth over a period of several years. In the outlook, the primary budget deficit is expected to remain at 3.8 per cent of GDP in 2006 and 2007, before falling to 3.0 per cent at the end of the following two years.

Australia's economy is estimated to expand by 2.5 per cent in 2006, driven by private consumption in view of the positive effect of tight labour-market conditions on consumer confidence as well as robust fixed investment. In 2007, growth will accelerate and exceed 3.0 per cent due to strong export growth and a solid expansion in private and public investment. The positive outlook for exports hinges less on the economic performance of Australia's trading partners than on the removal of infrastructure bottlenecks and an increase in production capacity in Australia's resource sector. In the longer run, however, increasing import penetration and restructuring in the manufacturing sector will have a negative impact on the economy's export capacity, putting pressure on the external sector's contribution to economic growth. Inflation continues to run above the central bank's target range owing to strong domestic demand, increasing upward pressure on wages as well as higher fuel prices. Authorities have responded with a tightening of the monetary policy stance. As inflationary pressures subside, monetary authorities will likely reverse course in the second half of 2007. On the fiscal side, the budget surplus, combined with the federal elections to be held at the beginning of 2008, is likely to lead to additional expansionary measures, implying a modest fall in the size of the fiscal budget surplus over the forecast period.

Economic growth accelerated to 2.2 per cent in New Zealand in 2006. The expansion has been based on a solid performance of the external sector which has offset the weakening in private consumption growth. Although inflation is forecast to remain above the central bank's target range in the short term, interest rates are expected to remain on hold into 2007, when slightly weaker economic growth of 2.1 per cent and previous interest rate hikes will remove some of the inflationary pressure and allow a loosening of the monetary policy stance. Fiscal policy will be expansionary beyond 2007, with an emphasis on increased capital spending on public services and infrastructure, leading to a decline in the fiscal surplus.

## Western Europe: the recovery continues

Growth in Western Europe has accelerated significantly in 2006. GDP in the euro area is estimated to have grown by 2.5 per cent, the fastest since 2000, and well above estimates of potential growth.<sup>3</sup> Activity outside of the euro area has also been strong. Growth reached a cyclical peak in the second quarter of 2006, with the euro area recording the strongest performance of all the major developed economies. Short-term indicators have retreated in the months since, but the levels of these indices remain consistent with continued expansion and the current-conditions component of many of these indices indicate continuing strong growth, with the major share of the overall decline coming from the expectations

The extent of fiscal consolidation hinges on political constraints as well as sustained growth

Australia's economic growth will be propelled by investment and exports in 2007

New Zealand is expected to see uneven but steady growth

<sup>3</sup> The European Commission estimates that potential growth in the euro area is currently around 2 per cent per annum. See section 7 of the AMECO database available from [http://ec.europa.eu/economy\\_finance/indicators/annual\\_macro\\_economic\\_database/ameco\\_contents.htm](http://ec.europa.eu/economy_finance/indicators/annual_macro_economic_database/ameco_contents.htm).

component. Consequently, growth has decelerated in the second half of 2006, but remains relatively strong. The brunt of the slowdown is expected to occur in 2007, with growth of 2.2 per cent in the euro area, but will still be near potential (see table A.1).<sup>4</sup> The growth differential between the major economies narrowed significantly: German growth picked up sharply; Italy was stronger as well but still significantly slower than the euro area average; the United Kingdom of Great Britain and Northern Ireland also saw a strong pick-up; and Spain, while decelerating, continued to have the strongest growth performance (see figure IV.4).

Domestic demand supports growth while net exports drag

Growth in the region has been anchored by domestic demand, particularly investment expenditure as well as strong export performance, but net trade made a minimal impact as imports, boosted by the strong domestic demand and appreciated currencies, have been equally strong. The slowdown has a number of sources. Exports are expected to decelerate with the slowing of external demand, and the further appreciation of the euro means that exporters will face difficulties maintaining market share. Tighter fiscal policies in many of the major European economies will be another moderating factor. Further increases in interest rates, coupled with the continuing feed-through of the effect of past rate hikes, will also dampen activity.

Investment spending accelerated in 2006

Investment spending has been a key driver of growth performance in 2006, particularly machinery and equipment but also housing investment, showing further evidence that the investment anaemia, highlighted in the *World Economic Situation and Prospects 2006*,<sup>5</sup> has turned around. One very positive development was that housing investment in Germany increased for the first time since the reunification boom, eliminating a major drag to German performance over the recent past. Investment expenditure is expected to continue to make a strong contribution to growth, albeit at a diminished pace, supported by continued favourable financing conditions. Real interest rates, while rising, remain below their historical averages and bank credit has expanded strongly.<sup>6</sup> In addition, corporate profit margins are up, corporate balance sheets have improved and capacity utilization rates have generally increased. Housing investment is expected to cool slightly but to remain supportive, though in varying degrees across countries.

Consumption expenditure remains a weak spot

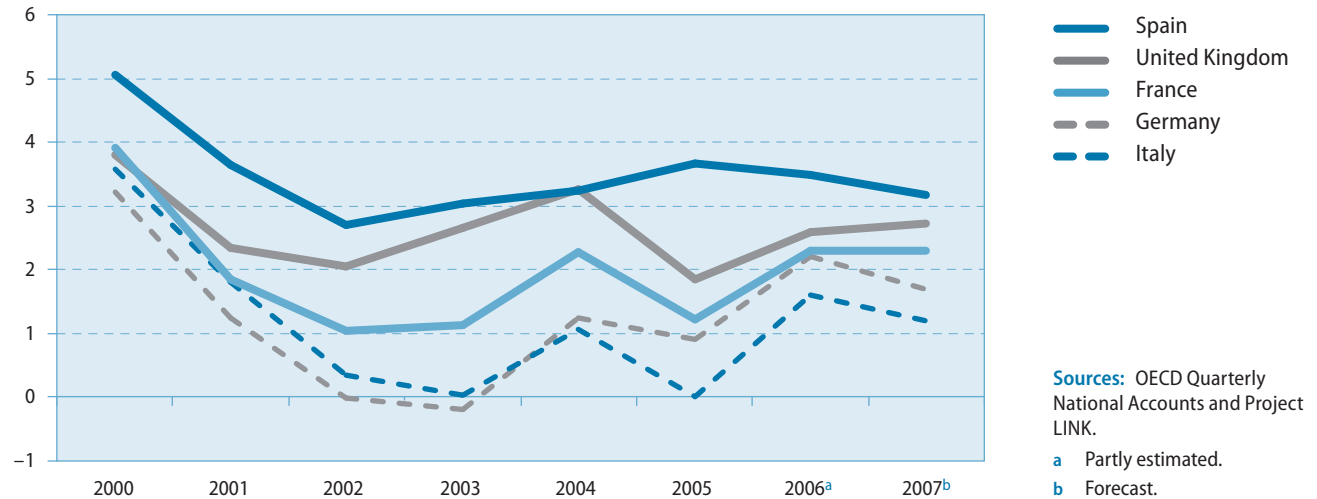
Consumption expenditure has been very slow to pick up in the present recovery, but over the course of 2006, confidence has improved and it has provided support to growth for the year as a whole. Consumption is expected to slow in 2007 but will remain an important source of growth compared to previous years. Continued job creation, coupled with modest wage growth, implies a better outlook for disposable income of many households, and the generally better labour market outlook reduces uncertainty. Consequently, the savings rate is expected to decline slightly. The planned tightening of fiscal policy in the major economies will dampen prospects—in Germany, this is expected to lead to a sharp slowdown in consumption (see footnote 4).

<sup>4</sup> The quarterly growth profile will be affected by the substantial rise in German value-added tax (VAT) rates slated to begin in January 2007 (from 16 to 19 per cent). Purchases are expected to be brought forward to the final quarter of 2006, boosting growth towards the end of the year and slowing it at the beginning of 2007. Measured German inflation will also be significantly affected in 2007.

<sup>5</sup> *World Economic Situation and Prospects 2006* (United Nations publication, Sales No. E.06.II.C.2).

<sup>6</sup> For the period January 1994 to September 2006, the average short-term real rate for the euro area was 2.1 per cent, which should be compared to the September 2006 value of 1.9 per cent. The real rate is calculated as the 3-month EURIBOR minus the growth of the core CPI, and uses data from the OECD Main Economic Indicators.

Figure IV.4  
GDP growth in selected Western European countries,  
2000-2007 (in per cent)



In the euro area, the Harmonised Index of Consumer Prices (HICP) remained well above 2 per cent for the first eight months of 2006, while core inflation (excluding energy, food, alcohol and tobacco) had been much lower, although drifting slowly upwards. As energy prices fell, however, the HICP dropped sharply in September and October,<sup>7</sup> essentially closing the gap. So far, there is minimal evidence of second-round effects of energy prices in the general price level, as evidenced by the continued moderation in core inflation, or in inflationary expectations, which have also been fairly stable. Nominal wage growth has remained about 2 per cent in 2006, that is to say, similar to 2005. Labour productivity picked up in 2006 and unit labour costs are therefore expected to be contained. Inflationary risks still remain on the upside, however, with GDP growth exceeding estimates of potential growth in the first half of 2006 and expected to slow to around potential in 2007. Furthermore, the rate of unemployment has fallen to a level where a tighter labour market could give rise to upward pressures on wages. In the outlook, the slowing of activity and the tightening of monetary conditions should lead to continued moderation of inflation in 2007, although on yearly averages inflation is expected to remain above 2 per cent (see table A.4).

Unemployment continued its downward trend in 2006. The rate of unemployment registered 7.4 per cent for the EU-15 and 7.8 per cent for the EU-12 in August 2006, nearing levels achieved during the last cyclical trough in 2001, and about 1 percentage point below the previous cyclical peak. At the country level, the picture is more mixed: Spain has seen a drop of more than 2 percentage points from its previous highpoint; Germany, France and Italy have witnessed less than a 1 percentage point drop; and the United Kingdom has experienced a rise in unemployment (although this picture is clouded by the large influx of immigrants during the period). In addition, Germany and France remain well above their previous low points. Given the growth profile in the outlook, and with real wages expected

Inflation remains contained  
but still above target

Labour-market  
developments are positive

7 Another factor in the sharp drop was a favourable base effect resulting from a year-over-year comparison to a period of very high oil prices in 2005, but this statistical effect will unwind in 2007.



Budget deficits narrowed in most countries, but policy is expected to be mildly contractionary

to increase only moderately, employment growth should remain steady, and, coupled with a slow evolution of the labour force, yield a continued, but modest, decline in unemployment rates (see table A.7).

Stronger-than-anticipated growth has led to positive budget surprises in many countries, with deficit-to-GDP ratios declining faster than anticipated. However, pressure remains for countries with large deficits to continue fiscal consolidation programmes, especially those that are close to or exceed the 3 per cent Stability and Growth Pact (SGP) limits. In Germany, quite a potent fiscal consolidation will be under way (see footnote 4). In Italy, which has the largest deficit-to-GDP ratio of the major euro area economies, fiscal policy is set to become increasingly restrictive. In France, the deficit remains just below 3 per cent and the consolidation programme is expected to be more gradual. The deficit in the United Kingdom is estimated to have fallen just below 3 per cent in 2006 and, given the planned further moderate fiscal consolidation, should fall further in 2007. Europe's overall fiscal stance is thus expected to be moderately contractionary, but countries with balanced or positive budget positions will have more leeway.

Monetary policy is tightening across Europe. The European Central Bank (ECB) is in the midst of a tightening cycle aimed at bringing policy to a more neutral stance. It raised its main policy interest rate to 3.25 per cent in October, its fourth tightening of policy in 2006, and a cumulative 125 basis points since late 2005. It is assumed the stance will tighten further.<sup>8</sup> Headline inflation has run higher than the ECB target of just below 2 per cent for most of the year and, despite the recent drop, is expected to remain above 2 per cent in 2007. Given that growth is expected to remain at potential, the need for substantial monetary stimulus has receded and a neutral stance is appropriate. Real interest rates remain below a neutral level. In addition, monetary growth and credit to the private sector have been increasing robustly. The degree of stimulus is offset somewhat by the strength of the euro, particularly against the yen, but the overall monetary climate remains accommodative. It is assumed that there will be one further 25 basis point increase before the end of 2006, bringing the short-term rate to 3.5 per cent. Rates are assumed to remain on hold during 2007. Monetary policy is also set to tighten in the United Kingdom as, under current policy, inflation is expected to remain above the upper bound of its inflation target over the medium term.

The euro remains strong

The euro was quite volatile against the United States dollar and the yen in 2006, appreciating sharply against the dollar at several junctures during the year, while, against the yen, it continued to move up, reaching record highs. Changes in monetary policy, both actual and expected, and their implications for interest rate spreads, have been a major driver. The Fed has reached the probable end of its tightening cycle and is expected to loosen as the economy slows, the ECB is in the midst of its cycle, and the BoJ is at the beginning of its cycle. This means that the large premium for holding dollar-denominated assets will narrow significantly, removing a major source of support to the United States dollar. In the outlook, the euro is expected to lose some ground against the yen but gain further against the dollar (see box I.1 in chapter I).

Risks to the outlook are slightly towards the downside

Aside from the primary global risks identified in chapter I, there are some regional risks. Consumption may falter, particularly in light of the tightening of fiscal policy in the major economies. There is also a risk that inflationary pressures could accelerate due to elevated wage demands, requiring more active response from monetary authorities. On

<sup>8</sup> The Governing Council of the ECB raised the main policy interest rate to 3.5 per cent in December.

the upside, employment growth could be more robust than expected, which would lead to stronger consumption expenditure.

### The new EU members: reaching record growth rates

The strong economic momentum gained by the new European Union (EU) members in 2005 has continued in 2006. Aggregate GDP growth in the EU-8 accelerated to 5.7 per cent (see figure IV.5). This reflects a rebound in Poland, a record high growth in the Czech Republic and Slovakia and an exceptionally strong performance in the Baltic States. Some slowdown is expected to follow in 2007 owing to the implementation of a fiscal adjustment package in Hungary, along with monetary tightening, and an expected moderation of growth in the Baltic States (see table A.1).

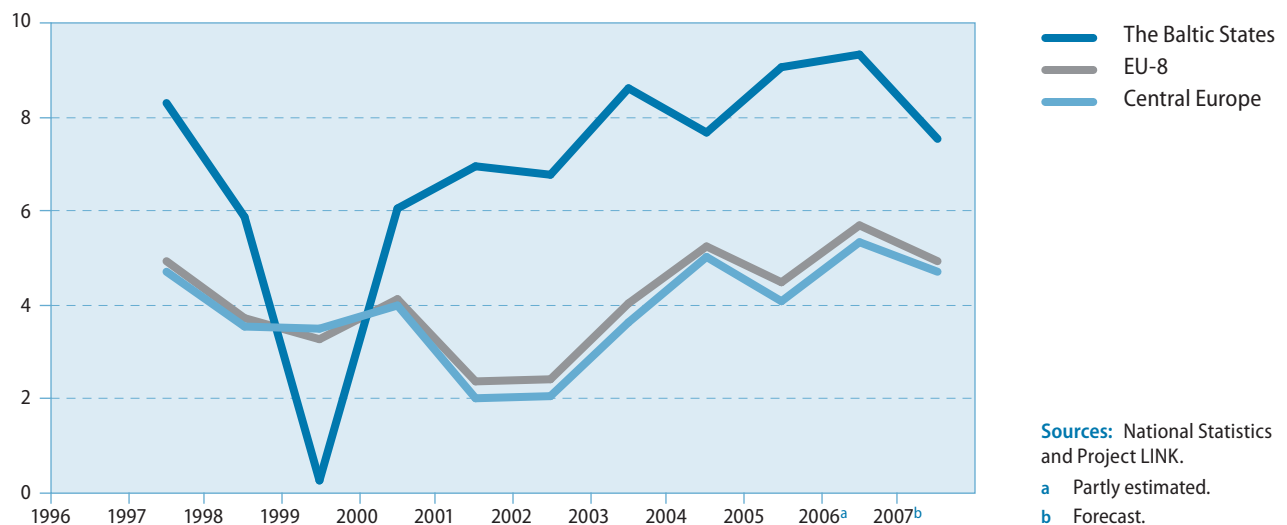
The EU-8 economies have benefited particularly from the upturn in the EU-15, EU support and generally easy access to foreign financing. In addition to strong export performance, the contribution of domestic demand to growth has become more important for the countries in Central Europe. Strengthened consumer and business confidence and overall growth of borrowing by individuals have led to a strong expansion in the retail industry and residential construction throughout the EU-8. Rising real wages, improved labour market conditions and exceptionally strong growth in consumer credit continued to drive growth in the Baltic States. The expanding mortgage market fuelled a housing boom. Investment rates are up in all new EU member States, as EU-supported public investment projects for infrastructure development and foreign direct investment (FDI) flows have increased strongly. In the Czech Republic and Slovakia, the car industry has become the driver of export and GDP growth, as the sector has strong spillover effects on other businesses.

Labour-market conditions have improved in most of the EU-8 countries; most notably in Poland where the unemployment rate has dropped to about 15 per cent in 2006, down from

Growth is mainly driven by domestic demand

Labour-market conditions have improved, helped by strong growth as well as by labour migration

Figure IV.5  
Growth of real GDP in the EU-8, 1996-2007  
(percentage change, year-on-year)



19 per cent in early 2005. This improvement is largely cyclical and related to the economic upturn, except in the Baltic States, where structural unemployment also fell. In addition to the creation of new jobs, increased migration of workers to the EU-15 countries alleviated the slack in the labour market. As more of the EU-15 countries are opening their labour markets to the EU-8 nationals, this trend is expected to continue. At the same time, increased outward migration has already resulted in labour shortages in a number of sectors.

Inflationary pressures increase but are expected to be contained

Inflation has remained moderate in the EU-8 in 2006, with the exception of the Baltic States, but inflationary pressures have increased on the supply side. Higher prices of energy and raw materials have been slow in passing through to consumer price inflation, in part because in some countries excise taxes on fuel have been frozen. In the Baltic States, strong growth in real wages and domestic credit supplies has created excess demand conditions, pushing up inflation rates. These conditions have delayed the planned adoption of the euro. Inflation in the Baltic States is expected to decelerate in 2007 as domestic demand moderates; however, in Central Europe inflation rates will remain about the same or increase, especially in Hungary where an increase in the value-added tax (VAT) and the abolishing of subsidies to households will push prices up.

Profit repatriation and strong import demand keep current accounts in deficit

The current-account balances of the EU-8 have remained in deficit. In the countries of Central Europe, a negative balance on investment income transactions account for most of the deficit. External deficits of the Baltic States are mainly the result of a negative trade balance. The strong credit growth has boosted private consumption and residential investment in these economies, prompting substantial increases in imports of consumer goods and construction materials. Foreign borrowing has increased, although FDI remains the main source for financing the current-account deficits. This pattern is expected to continue. The current-account imbalances do not pose risks for economic growth and stability in the short run, as external financing is available at low cost and most countries have buoyant foreign-reserve positions.

Fiscal adjustment is mainly driven by cyclical effects

Macroeconomic policies in the region pursue somewhat contradictory goals of converging with the EU-15 and adopting the single currency. In 2006, many of the EU-8 countries kept fiscal deficits within the limits set by the SGP. Fiscal adjustment has been only cyclical and revenue-based in nature, however. The structural component of the deficits remains high, delaying the adoption of the euro for most of Central Europe. Moreover, some of the draft budgets for 2007 envisage deficits inconsistent with the EU convergence programmes adopted earlier. In Hungary, where the budget deficit is expected to exceed 10 per cent of GDP in 2006, an austere fiscal consolidation programme has been adopted. In the medium term, government budgets will remain under pressure of social security spending and co-financing of the EU-related projects.

Monetary policy tightens

Monetary policy in the region responded to increased inflationary pressures with a series of interest rate increases. Further tightening is possible in 2007. Yet, monetary conditions in general remain accommodative, and strong growth in private credit denominated in foreign currency may even contain some risks. Among the countries in the region that joined the European Exchange Rate Mechanism (ERM-II), only Slovenia will adopt the euro in 2007. The Baltic States will not, as these countries do not comply with the inflation criterion.

Specific risks for this region relate to the increased competition from Asia at all levels of the production chain, a possibility of a slowdown in the EU-15 and fiscal imbalances in Central Europe.

## Economies in transition: buoyant growth continues

The year 2006 has turned out to be another year of buoyant economic growth in the economies in transition. Compared to the previous year, aggregate GDP growth accelerated considerably in both South-eastern Europe and the Commonwealth of Independent States (CIS), the latter remaining among the fastest-growing regions in the world. The energy-exporting CIS economies benefited from high world market prices for oil and natural gas. The spillover effects associated with the energy boom to other countries in this subregion were generally positive, mainly through increased trade and remittances as well as through energy-related infrastructure investments, but there were negative implications as well, as the Russian Federation moved to claim higher prices for natural gas exported to neighbouring CIS economies. The South-eastern European economies also managed a respectable pace of growth, underpinned by strong domestic demand.

### South-eastern Europe: strong expansion, large imbalances

Economic activity in South-eastern Europe has been vibrant, with aggregate GDP growing by some 6 per cent in 2006. The average growth figures were boosted by the strong upturn in Romania, where GDP growth accelerated by more than 2 percentage points. Dynamic economic activity prevailed in most of the other South-eastern European countries (see table A.2).

In 2006, economic growth in the subregion has remained predominantly driven by buoyant domestic demand, reflecting the ongoing economic reconstruction and expanding credit supplies which fuelled the growth of private consumption and fixed investment. The expected EU accession by Bulgaria and Romania in 2007 has given an additional boost to consumer and investor sentiment, underpinning a further surge in inward FDI. The strong GDP growth in Bosnia and Herzegovina in 2006 suggests that the prolonged period of sluggish recovery may be over.

The formal dissolution of the federal State of Serbia and Montenegro did not have major economic implications as the two entities had already been performing as separate economies with their own trade regimes, different currencies and decentralized fiscal accounts. Economic growth has accelerated in Serbia in 2006 as the economy overcame the upshot of weak manufacturing performance at the beginning of the year. The lacklustre performance in the manufacturing sector in the former Yugoslav Republic of Macedonia has been a key factor behind its relatively sluggish aggregate economic growth.

The short-term outlook for South-eastern Europe is generally positive. It is expected that GDP will continue to be driven by domestic demand during 2007 and grow at rates close to those seen in 2006 in most countries.

Inflation generally remained under control, but there has been a slight upturn in inflation rates in some countries in 2006 (see table A.5). The reasons for this differed from country to country, but were largely related to demand-push pressures and increases in regulated prices. With the exception of Serbia, macroeconomic policies in South-eastern Europe were generally balanced, contributing to the relatively stable macroeconomic environment. The double-digit inflation rates in Serbia mirror a chronically lax macroeconomic stance in recent years; in 2006 this stance was tightened, but carry-over effects remained.

Economies remain  
dynamic...

...as does credit growth

The separation of Serbia  
and Montenegro has not  
affected their economies

Inflation accelerates for  
country-specific reasons

While there are no imminent threats to macroeconomic stability in the subregion, moderate inflationary pressures are likely to persist in the short run as more of the effects of the higher energy prices can be expected to be passed on to consumers.

Labour-market conditions improved in some countries, but unemployment remains high in others

There have been positive developments in the labour markets of some South-eastern European economies in 2006 (see table A.8). In Bulgaria and Croatia, the steady growth in employment continued for a fifth consecutive year, reflected in falling rates of unemployment, and in Romania the decline in employment seems to be coming to an end. However, the situation remains precarious with persistent, excessively high rates of unemployment in the rest of South-eastern Europe.

Strong economic growth in recent years, combined with improved macroeconomic stability and consumer confidence, has led to increased credit demand in South-eastern Europe. Ongoing financial deepening, an increased share of foreign banks in the banking industry and remonetization of the financial sector, together with strong private capital inflows, have created conditions for an unprecedented credit expansion. This may pose certain risks for the banking sector should favourable external conditions deteriorate and, since a large fraction of credit is denominated in foreign currency, may even endanger financial stability in the subregion.

External imbalances, driven by large trade deficits, pose the major risk and policy challenge

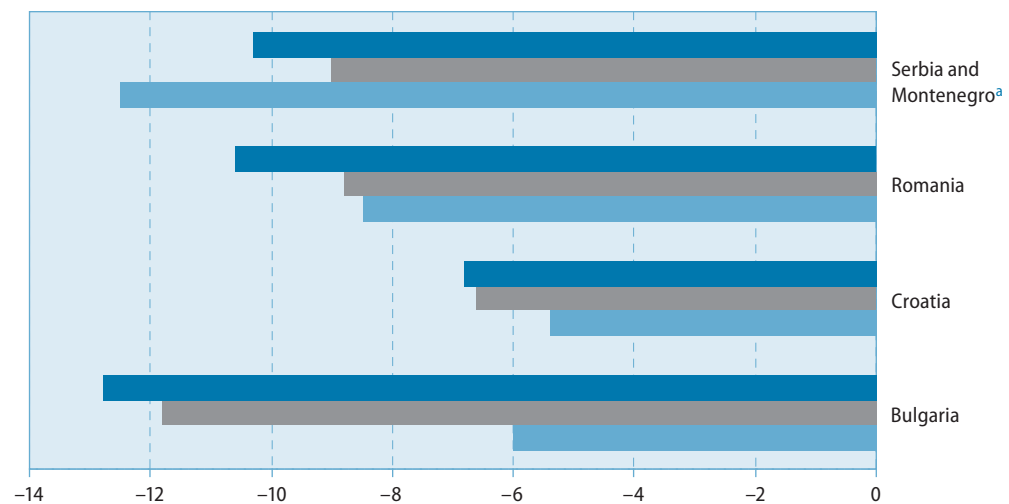
Throughout the subregion, the already large current-account deficits have continued to grow in 2006 (figure IV.6) and are likely to persist in the short run. These external imbalances—generally mirroring deficits in merchandise trade—have been driven by the strong domestic demand in recent years and further fuelled by a lasting credit boom. Merchandise imports generally continued to outpace exports in most countries in 2006. The services balance, even when positive, was not sufficient to offset the growing deficit in merchandise trade. While current-account deficits are not uncommon in fast-growing economies, their magnitude and their link to domestic credit expansion is an issue of concern as these deficits may be a source of financial vulnerability. Strong private capital inflows and domestic banking sector reforms, including the increased entry of foreign banks, have fuelled an unprecedented expansion of bank credit to the private sector, much

Figure IV.6  
Current-account balance of selected countries in South-eastern Europe, 2004-2006  
(percentage of GDP)

2004 ■  
2005 ■  
2006 ■

Sources: National Statistics, Economic Commission of Europe and Project LINK.

<sup>a</sup> The membership of Serbia and Montenegro in the United Nations was continued by Serbia as of 3 June 2006. On 28 June 2006, the General Assembly admitted Montenegro as the 192<sup>nd</sup> Member State of the United Nations. Figure IV.6 reflects statistics for Serbia only.



of which, however, is denominated in foreign currency. Should external conditions deteriorate and exchange rates come under pressure, this may endanger the stability of the financial sector. Dealing with this risk is presently the biggest challenge to policy makers in South-eastern Europe.

## The Commonwealth of Independent States: sustaining strong growth

In 2006, there has been a further surge in economic activity in the CIS, with the rate of growth of aggregate GDP reaching 7.5 per cent. This acceleration from 6.8 per cent in the previous year has been largely helped by higher international prices for oil, gas, metals and cotton, relatively low interest rates at international capital markets and increasing domestic demand throughout the subregion. The outlook is for continued strong regional growth in 2007, although the rate is expected to moderate compared to 2006 as international prices for oil and gas weaken.

Faster growth in the CIS has been broad-based and has reflected a recovery in Ukraine from the sharp slowdown in 2005, improved performance in the Russian Federation and acceleration in Central Asia (see table A.2). The Russian Federation, the largest economy in the region, continued to serve as a regional growth engine, thanks to robust domestic and import demand which spilled over into growth in intraregional trade. Apart from the impetus coming from energy-related economic activities and the extractive industries in general, the resurgence in output of the Russian Federation was also the result of strong performance in the services and construction sectors. Aggregate output in Kazakhstan also continued to expand rapidly, underpinned by strong growth across most sectors. Ukraine's growth momentum reflects not only better capacity utilization in the important steel sector but also a strong performance in retail trade, transport and construction. GDP growth in Azerbaijan has been exceptionally fast for a second consecutive year and is likely to continue in 2007 as a positive upshot of the exploitation of new pipelines. Between 2002 and 2006, Azerbaijan's GDP more than doubled, making it the fastest-growing economy in the world in this period. Economic expansion in some of the smaller non-oil producing economies has been more moderate. Despite the expected deceleration of growth in most CIS countries, including the Russian Federation and, particularly, Ukraine, economic expansion overall is projected to remain strong in 2007, with aggregate GDP likely to grow by around 6.7 per cent.

Domestic demand growth has been strong in most countries, fuelled by, among other factors, buoyant commodity prices, workers' remittances, strong capital inflows and/or fiscal loosening. While, in the Russian Federation, investment demand picked up, underpinned by the strength of the construction sector, it moderated in Kazakhstan, but still remained robust. Consumer demand remained solid in all these countries. Net external demand continued to be a drag on economic growth. The main exception was Azerbaijan, where, after years of strong investment in the energy sector, the necessary infrastructure is now in place, resulting in soaring exports. In the remaining oil-producing countries, positive terms-of-trade effects have boosted incomes, despite the fact that most of the oil-price premium was absorbed by the tax systems. In many of the poorer CIS countries, migrant remittances have provided an important source of additional income (see box IV.1). After many years of sluggish performance, massive FDI has started to flow into the Russian Federation, and its dynamics show a significant momentum, while, in turn, Russian investors

Continued growth in the CIS is supported by high prices for oil and gas

Domestic demand growth has been strong

## Box IV.1

**Migration and migrant remittances within the Commonwealth of Independent States**

The global importance of international migration and the ensuing migrant remittances as an adjustment mechanism to economic hardship has grown considerably. When analysing these phenomena, attention is commonly paid to migration flows from developing and transition economies to mature industrialized countries. In recent years, the economic importance of migration within the Commonwealth of Independent States (CIS) has also increased considerably, despite the fact that average per capita incomes even in the wealthiest CIS economies are still well below the income levels in developed market economies. However, the existing large differences in per capita incomes within the CIS itself and the economic revival of the large CIS economies have started to incite sizeable migration flows within the region.

The available official statistical records are likely to underestimate the importance of both migration and migrant transfers, as many of the migrants find employment in the informal economy or transfer money outside the official channels. In principle, migrant transfers are reflected in the balance of payments as compensation of employees and as part of current and capital transfers; however, a breakdown in this regard is not always available. Moreover, the balance-of-payments statistics in some countries are still inadequate. Despite these data problems, the available figures suggest that remittances play a very significant role in many CIS countries, particularly among the low-income economies.

The Russian Federation — the wealthiest and by far the largest CIS economy — has started to attract sizeable numbers of temporary and permanent workers from other CIS countries, and this process has accelerated with the country's fast economic expansion in recent years.<sup>a</sup> According to data published by the Russian Federal State Statistics Service, in 2005 net migrant inflows rose by 80 per cent (to 132,489 persons) compared to 2004 and increased by a further 9 per cent year-on-year in the first half of 2006. However, as noted, these statistics likely underestimate the actual migrant inflows. According to the International Organization for Migration, the estimates of irregular migrants residing in the Russian Federation range from 3-5 million.<sup>b</sup> In addition, there are 12-15 million people visiting the country annually in search of temporary employment. At the same time, according to the Russian Ministry of the Interior, there were only around 700,000 migrants working legally in the Russian Federation in 2005.<sup>c</sup>

In terms of their effect on labour supply in the Russian Federation, migrant inflows are moderating the adverse effect of the negative natural growth of Russia's population. The large migrant inflows have also contributed to a greater flexibility in Russia's labour markets, especially in dynamic sectors such as construction and trade, and have helped in containing the overheating pressures associated with rapid expansion. Kazakhstan has also attracted significant numbers of CIS workers to these sectors, although, compared to the Russian Federation, the magnitude of these flows is more modest.

Total outward net migrant remittances from the Russian Federation to the CIS have been steadily growing in recent years (see figure below). The importance of these flows for some countries is even more pronounced when they are calculated as a proportion of GDP. It should be noted that the poor quality of the available statistics precludes a precise evaluation of the flows, but even a rough estimate based on migrant money transfers (see table below) provides a sense of their magnitude. Even when considering only the flows of migrant money transfers channelled through money transfer systems and post offices from the Russian Federation in 2005,<sup>d</sup> these add up to more than 20 per cent of GDP

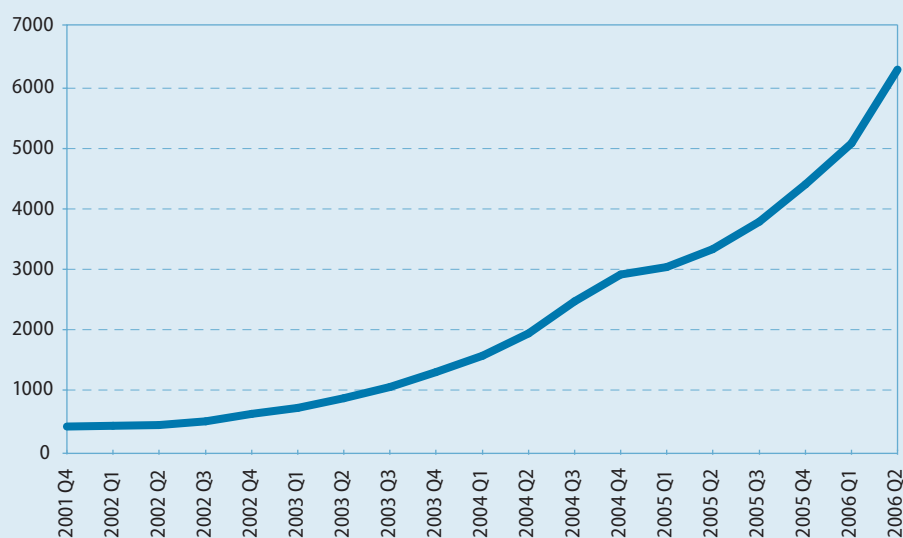
<sup>a</sup> The repatriation of ethnic Russians from other CIS countries accounted for a significant share of the official migration flows during the 1990s. These type of flows, however, have been on the decline and, in recent years, even the officially reported migrant flows seem to be dominated by economic migration.

<sup>b</sup> The country profile is available from <http://www.imo.int>.

<sup>c</sup> Available from <http://eng.mvdrf.ru/index.php?docid=421>.

<sup>d</sup> In 2006, the Central Bank of the Russian Federation reported for the first time figures on the breakdown by countries of some of the remittance flows, in particular, money transfers through identified companies and post offices. Data on the breakdown of the total remittances flows are so far not available.

### Net migrant remittances from the Russian Federation to other CIS countries, 2001-2006<sup>a</sup> (millions of dollars)



**Source:** Central Bank of the Russian Federation.

<sup>a</sup> Rolling cumulative value for the last four quarters.

### Estimates of the annual net flow of migrant money transfers from the Russian Federation to other CIS countries, 2005 (millions of dollars and per cent)

	Net migrant money transfers from the Russian Federation			Memorandum item:
	Millions of dollars	As a percentage of GDP at current exchange rates	As a percentage of GDP at current PPPs	Average gross wages as a percentage of Russian wages at current exchange rates
Armenia	316	8.4	2.2	37.7
Azerbaijan	244	1.9	0.6	41.4
Belarus	12	0.0	0.0	72.3
Georgia	199	3.1	1.3	34.5 <sup>a</sup>
Kazakhstan	-50	-0.1	0.0	84.3
Kyrgyzstan	253	10.4	2.4	20.8
Moldova	303	10.4	3.5	34.7
Tajikistan	505	21.9	5.7	9.6
Turkmenistan	7	0.0	0.0	..
Ukraine	522	0.6	0.2	52.2
Uzbekistan	520	4.5	1.0	23.0 <sup>b</sup>
Total	2 830	n.a.	n.a.	n.a.

**Sources:** Central Bank of the Russian Federation; International Monetary Fund; ECE estimates.

**Note:** The estimates of the country flows in 2005 are performed by applying their reported breakdown in the second quarter of 2006 (when reported for the first time) to the aggregate level of these flows from the Russian Federation to other CIS countries in 2005. GDP at PPP rates for 2005 are estimates.

<sup>a</sup> 2004 data. <sup>b</sup> 2003 data.



Box IV.1 (continued)

### Migration and migrant remittances within the Commonwealth of Independent States

(at current exchange rates) in Tajikistan, about 10 per cent in Moldova and Kyrgyzstan and 8 per cent in Armenia. Remittances to Ukraine are far less significant as a percentage of GDP. In juxtaposing remittance flows and relative wages in the CIS (see table above), the estimates tend to suggest that the poorer the country, the greater the relative importance of migrant remittances.

For the recipient countries, migration provides alternative employment opportunities, income support to family members and an important source of financing of external imbalances. The flows of migrant remittances are likely to increase further, provided the large economies (primarily that of the Russian Federation, but also Kazakhstan and possibly Ukraine) continue their fast expansion. Strong wage differentials and network effects associated with the growing presence of migrant communities will encourage further migratory inflows.

Remittances introduce a new channel for the intraregional transmission of shocks within the CIS. Migrant transfers are usually considered less volatile than other flows and provide a cushion in cases of financial instability. However, remittances are likely to reflect the performance of the host economy. In the CIS region, the direct effects of slower growth in the host countries through lower import demand — which could be especially pronounced in the case of the Russian Federation as an important trading partner for its neighbours — would be amplified by the impact on remittances of a worsened labour-market situation. To reduce the recipient countries' vulnerability to such negative cyclical effects, policy should seek to create conditions that encourage the channelling of remittances into productive investment, including human capital.

Large remittances can also create problems for monetary management by adding upward pressures on the exchange rate and by fuelling inflationary tensions. These effects are more pronounced in the context of underdeveloped financial systems where central banks have a limited set of monetary instruments and insufficient information regarding monetary flows at their disposal. On the other hand, growing migrant transfers can stimulate the development of the banking system, provided the policy arrangements encourage the circulation of these flows through official banking channels.

have been active in some CIS countries. Domestic demand is projected to remain robust in the short run, supported by the continued rapid real income growth and the ongoing process of financial deepening. Investment, in particular, is expected to perform well, addressing emerging capacity constraints and in some cases enjoying the support of public programmes.

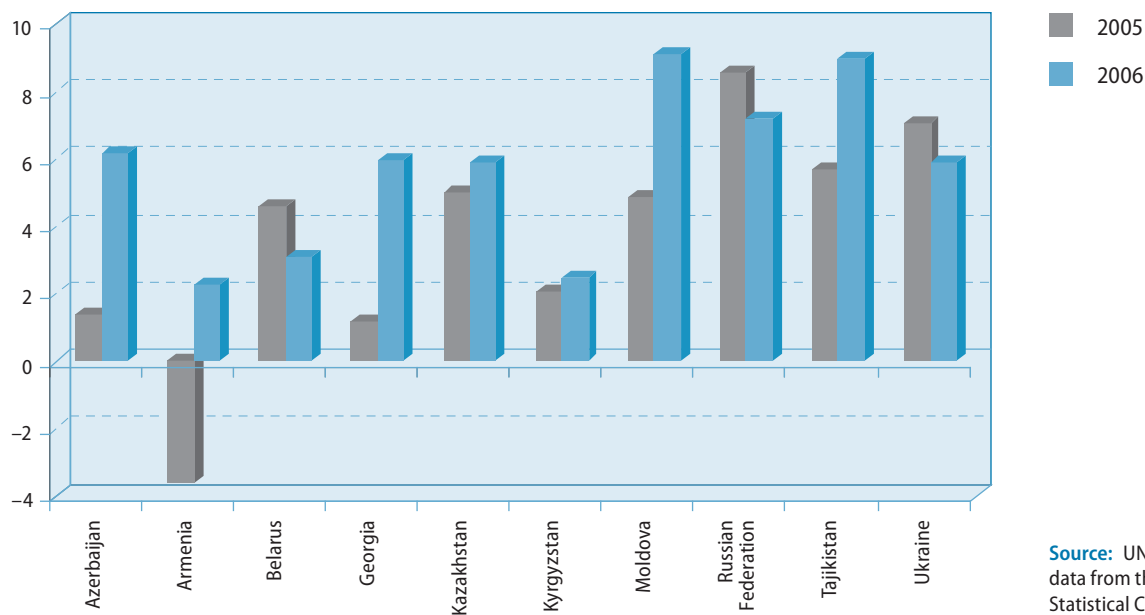
In 2006, the macroeconomic policy mix has continued to provide—albeit moderately—further impetus to economic activity in most countries. Central banks in the oil-exporting countries generally continued to actively intervene in the foreign-exchange markets in an attempt to restrict the appreciation of national currencies, resulting in a loosening of monetary conditions. Fiscal policy has been the main factor in offsetting this externally induced economic stimulus in recent years. However, the burden on monetary policy has tended to increase as a larger share of oil revenues is being spent. The effectiveness of monetary policy and the range of instruments available remains limited, restricting the impact of tightening measures adopted in some countries. Future fiscal plans, notably in the Russian Federation, suggest a more expansionary stance.

The inflation record of the CIS economies in 2006 has been mixed (see figure IV.7). The observed declines in inflation rates in Belarus, the Russian Federation and Ukraine

The macroeconomic policy stances remain moderately accommodative

Managing resurgent inflation is proving difficult

Figure IV.7  
Consumer Price Index inflation in selected Commonwealth of Independent States economies, January-September 2005 and 2006



Source: UN/DESA, based on data from the CIS Interstate Statistical Committee.

were partially attributable to administrative limits on tariff hikes or a limited pass-through of energy-price increases. In most other economies in the subregion, consumer price inflation accelerated, driven by increases in the price of services (see table A.5). In Azerbaijan, a demand push was largely responsible for the sharp pick-up in inflation, as high oil revenues fed into higher pensions and wages. The inflationary effect of foreign-exchange inflows was not limited to the energy-producing countries. Remittances also created similar problems for some of the lower-income non-oil economies in the subregion.

Employment growth has been limited in 2006 and has remained negative in some of the small CIS economies, despite sustained economic expansion. In most countries, with the notable exception of those in which the energy sector has received substantial investment, the industry continued to shed jobs. The most dynamic job markets are found in those countries where construction has performed strongly, such as Kazakhstan and the Russian Federation. Mirroring the structural nature of unemployment, high unemployment rates coexist with shortages of labour (in particular, skilled labour) in some sectors. Reducing unemployment and bridging the skill mismatch would thus require further efforts in education and vocational training and, possibly, more open migration policies.

Despite growing import demand, current-account balances have moved further into surplus in the oil-exporting countries. In the Russian Federation, net private capital inflows have surged at the same time, resulting in a balance-of-payments surplus which added substantial amounts to the stock of foreign-exchange reserves. In contrast, non-oil exporters in the subregion, except for Uzbekistan, saw further widening of their current-account deficits. Thus far, financing these deficits has not posed a problem as FDI inflows have increased and borrowing in international markets has been relatively easy.

Employment growth has been disappointing in the light of strong output growth

Current-account balances of resource-rich countries moved further into surplus

Nonetheless, financial concerns are emerging in a number of countries. In Azerbaijan, Georgia, Kazakhstan and the Russian Federation, the foreign liabilities from the private sector have increased strongly in recent years and this has fuelled credit growth in the banking system. This has amplified these countries' vulnerability to the risk of a tightening of the external financial conditions and/or adverse currency movements. In addition, accumulation of excessive external borrowing through the public sector in some other countries, particularly in Kyrgyzstan and Tajikistan, could pose further risk to the outlook.

Against this background, the outlook for the CIS as a whole remains overly dependent on commodity prices, particularly those of oil, gas and steel. Some oil-exporting countries managed to hedge the risk of a reversal in price trends by accumulating reserves in oil stabilization funds and by running budget and current-account surpluses. In others, such as Ukraine, the sharp drop in steel prices could have more destabilizing implications. Also, higher prices for gas imported from the Russian Federation are likely to have adverse effects on the gas-importing countries, in particular Belarus and Ukraine, as the Russian Federation seeks to bring gas tariffs closer to those charged to other European countries. The risks of excessive commodity specialization and the vulnerabilities due to energy dependence can be reduced through economic diversification, providing the basis for sustainable growth in the subregion.

Excessive dependence on commodity prices needs to be addressed

## Developing economies

Growth in the developing economies has remained strong. The pace of growth stepped up slightly from 6.4 per cent in 2005 to 6.5 per cent in 2006. Buoyant export growth, fuelled by rising commodity prices and strong external demand in the manufacturing sector helped to bolster external account positions in many economies. The resource-poor economies reaped some of the benefits through enhanced regional trade, tourism and worker remittances. East and South Asia continue to lead developing-country growth based on strong manufacturing export performances, followed by Western Asia, which has benefited from persistent oil demand and the rise in the price of oil.

Despite gains in economic growth, there are still significant disparities within the group of developing economies. Some gained from strong oil and other commodity prices; others, especially some lower-income oil importers felt increasing adverse impacts from higher oil prices. Furthermore, with the exception of Latin America and some parts of East Asia, the employment situation in the developing economies has improved little. A rapidly increasing labour force, particularly in Africa and Western Asia, complicates the challenge of generating sufficient jobs.

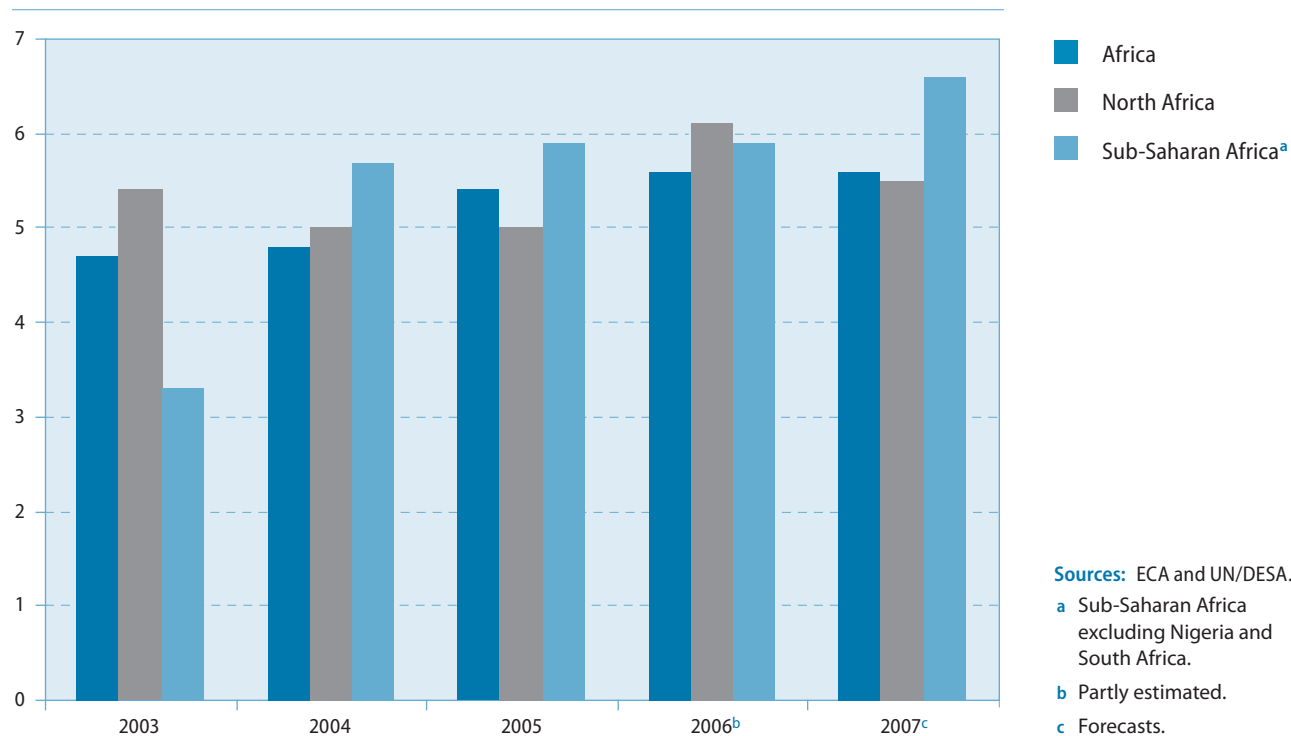
### Africa: the growth momentum continues

Africa's GDP has expanded by 5.6 per cent in 2006, continuing the momentum of strong growth achieved over the previous three years (see figure IV.8). This record represents a major turnaround from the previous decades of economic stagnation.

Despite the strong recovery observed on the continent, in most countries, growth rates remain insufficient to achieve development goals. Growth is highly concentrated in a narrow range of activities, making many African economies extremely vulnerable to exogenous factors such as weather conditions, terms of trade developments and aid flows. As a result,

Despite the strong recovery, growth remains insufficient to achieve development goals

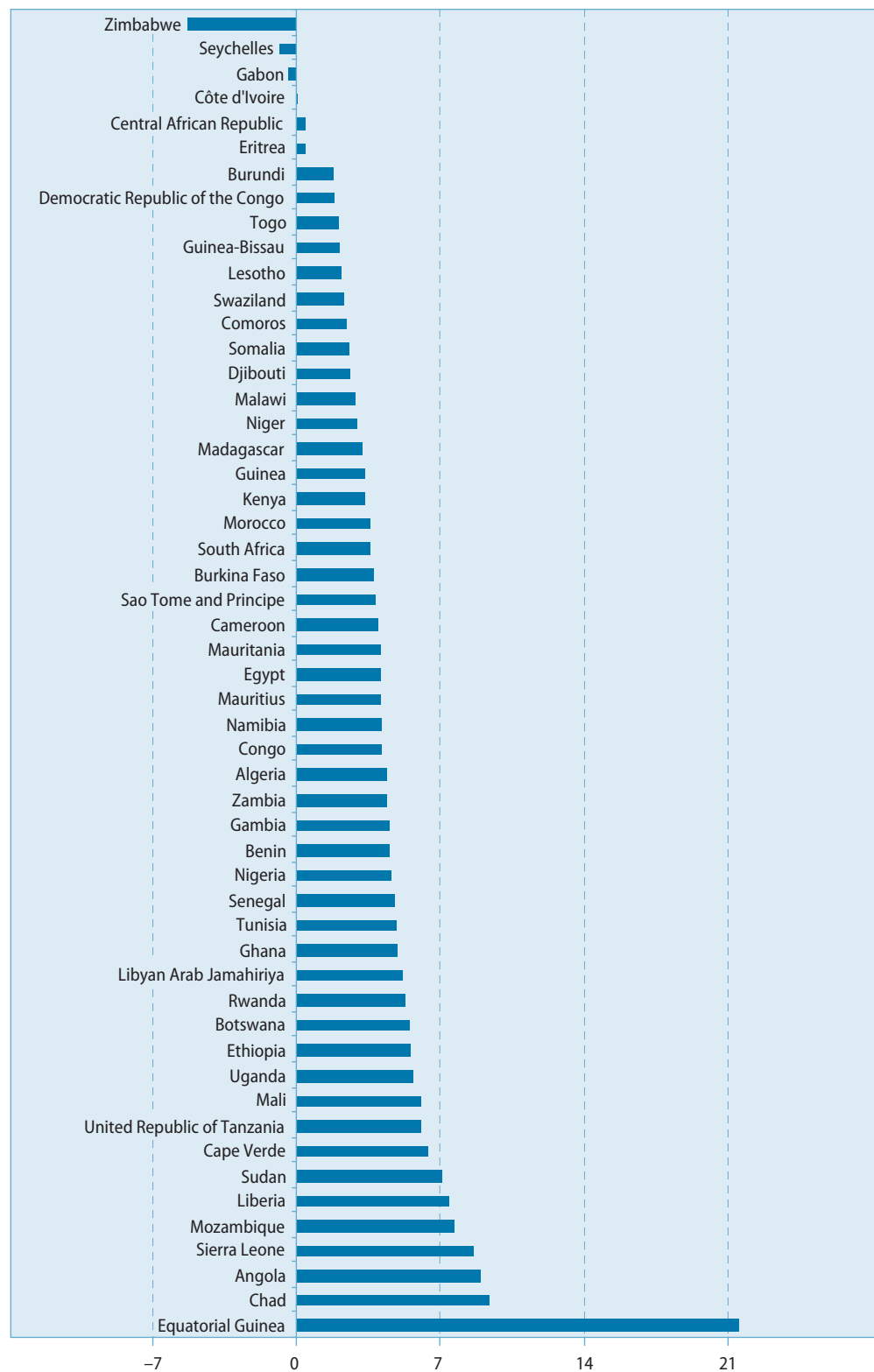
Figure IV.8  
Growth of real GDP in Africa, North Africa and sub-Saharan Africa,  
2003-2007<sup>a</sup>



most African countries have been unable to sustain sufficiently high growth rates over the medium term. From 1998 to 2006, only 7 countries out of the 52 countries monitored by the Economic Commission for Africa (ECA) achieved an average real GDP growth rate of more than 7 per cent, considered by some approaches as the minimum growth rate required to halve extreme poverty in the region by 2015.<sup>9</sup> By this measure, and at current trends, few countries would be on track to achieve the Millennium Development Goals (MDGs) by 2015 (see figure IV.9). Hence, the continent faces the dual challenge of further increasing growth rates and sustaining these rates over an extended period. This will require, next to enhanced expenditures for human development, sustained improvements in domestic investment climate to promote private-sector activity, improved provision of infrastructure

<sup>9</sup> Economic Commission for Africa, *Economic Report on Africa 1999: The Challenges of Poverty Reduction and Sustainability* (Sales No. E.99.II.K.4, United Nations: Addis Ababa), available from [http://www.uneca.org/eca\\_resources/publications/espd/economic\\_report\\_1999.htm](http://www.uneca.org/eca_resources/publications/espd/economic_report_1999.htm). In chapter I, reference was made to a threshold of 3 per cent growth of per capita income per annum. Population growth rates have undergone abnormal changes in the African continent, including substantial decelerations related to the HIV/AIDS pandemic and other factors. In cases with population growth decelerations, one might associate improvements in per capita incomes with improved economic performance, whereas in reality they may reflect to a large extent the heavy human toll of the AIDS pandemic. For this reason, reference is made here to the threshold for GDP growth, rather than GDP per capita growth.

Figure IV.9  
Average annual GDP growth, 1998-2006



Sources: ECA & UN/DESA.

## Box IV.2

**Inadequate infrastructure and energy supply: critical constraints to investment and trade in Africa**

Africa's GDP has grown at a brisk pace in recent years. The sustainability of such a performance and its translation into deep changes in the structure of production are far from certain, however. The lack of efficient infrastructure and the inadequate energy supply can potentially limit supply response, thus hampering Africa's ability to achieve high and sustainable growth rates, which in turn is a critical condition for achieving national development goals.

Transportation and communication infrastructure in Africa is currently both insufficient and of poor quality. Africa has a road density of less than 7 km per 100 square kilometres, compared to 12 km in Latin America and 18 km in Asia.<sup>a</sup> Additionally, less than 30 per cent of the approximately 2 million km of the continent's roads are paved and the trans-African highway network is poorly integrated, thereby undermining its efficiency.

African countries also face the challenge of insufficient and unreliable energy supply, which has failed to keep pace with urbanization and industrialization. Despite substantial endowment in energy sources, less than 30 per cent of the African population has access to electricity<sup>b</sup> and electricity consumption is half that of East Asia and one third of that in Latin America (see table below).

**Selected infrastructure indicators, 2002**

	Electric power consumption (kWh per capita)	Telephone mainlines (per 1,000 people)
Benin	76	9
Congo	82	7
Ethiopia	25	5
Kenya	120	10
Senegal	135	22
Zambia	583	8
<i>Memorandum items</i>		
East Asia & the Pacific	891	131
Latin America & the Caribbean	1506	169
Sub-Saharan Africa	457	15

**Source:** World Bank, World Development Indicators, 2005.

Poor transportation and communication infrastructure and unreliable energy supply raise the costs of production and hamper diversification of exports and the development of the manufacturing sector.<sup>c</sup> Some activities, like food processing or horticulture, become unprofitable and unsustainable due to lack of reliable transportation and energy networks. The provision of public infrastructure and reliable energy sources is essential for unlocking the potential of the private sector and increasing access to social services and markets for the poor; it should therefore be an important element of poverty-eradication efforts at all levels.

The problems of transportation and communication infrastructure and energy supply in Africa are in part due to insufficient budgetary allocations and insufficient external financing. The poor

<sup>a</sup> Economic Commission for Africa (ECA), *Assessing Regional Integration in Africa II: Rationalizing Regional Economic Communities* (Sales No. E.06.II.K.2, United Nations: Addis Ababa, 2006).

<sup>b</sup> ECA, *Economic Report on Africa 2004: Unlocking Africa's Trade Potential* (Sales No. E.04.II.K.12, United Nations: Addis Ababa, 2004).

<sup>c</sup> UNCTAD, *Review of Maritime Transport 2002* (Sales No. E.02.II.D.23, United Nations: Geneva, 2002); and ECA, 2004, op. cit.

## Box IV.2 (continued)

**Inadequate infrastructure and energy supply: a critical constraint to investment and trade in Africa**

quality and low level of infrastructure stocks reflect both the low new public investment in infrastructure and the heavily underfunded maintenance of the existing stock of infrastructure.

Budgeting for infrastructure improvements thus needs to explicitly consider maintenance costs. Furthermore, building and improving infrastructure is characterized by large indivisible fixed costs. Such costs cannot be financed from domestic sources alone because of the absence of well-developed capital markets in many African countries. External assistance is therefore critically needed to fill the gap. In view of the long-term nature of the investment in infrastructure, it is not only the increase of aid resources made available for infrastructure investment that matters, but also the stability and predictability of aid flows.

Although increased aid can boost supply capacity in the long run, countries might face short-term tradeoffs, including real appreciation. Massive additional aid flows increase the demand for imports and domestically produced non-tradable goods. In the absence of spare capacity in the non-tradable sector, the additional demand will push up the relative price of non-tradable goods, implying an appreciation of the real exchange rate, which may cause a contraction of the tradable goods sector.<sup>d</sup> The apprehensions about such short-term side effects of scaling up aid have influenced the decision of some policy makers in the continent to sterilize additional aid inflows and build impressive foreign reserves. Evidence, however, suggests that the concern over real exchange rate appreciation may be exaggerated, among other things because many countries tend to operate below capacity and a number of production factors are in abundant supply.<sup>e</sup> This is all the more true if aid is allocated to finance infrastructural works that are relatively labour intensive and can make use of idle capacity in the economy. Thus there may be less need for sterilization, the pressure for the real exchange rate to appreciate may be limited and unemployment can be reduced.

<sup>d</sup> This basically reflects a situation of a fixed exchange-rate regime. In the case of a flexible exchange rate, real exchange appreciation comes through a nominal appreciation.

<sup>e</sup> See, for instance, Terry McKinley, "Why is 'the Dutch Disease' Always a Disease? The Macroeconomic Consequences of Scaling up ODA." UNDP, International Poverty Centre, Working Paper No. 10, Brasilia, 2005; IMF, "The Macroeconomics of Managing Increased Aid Inflows: Experiences of Low-Income Countries and Policy Implications." Policy Development and Review Department, Washington D.C., 2005; and, Dani Rodrik, "The Social Cost of Foreign Exchange Reserves", forthcoming, *International Economic Journal* (2006).

(see box IV.2), measures to minimize the adverse impact of external shocks on incomes of the poor and, most importantly, progress in the diversification of production and exports.

Africa is expected to grow at a rate of 5.6 per cent in 2007, the same pace as 2006, as public consumption gathers speed, investment for the expansion of productive capacities and infrastructure development continues, and new mines and oil fields come on stream in many countries (see table A.3).

Growth is uneven across countries and subregions, with oil-exporting countries growing much faster than oil-importing countries. In North Africa, economic activity rebounded very strongly, jumping from 5.0 per cent in 2005 to 6.1 per cent in 2006. The return to normal agricultural output levels and continued strong activity in services contributed to strong economic recovery in Morocco and Tunisia, while oil exporters such as Algeria and the Libyan Arab Jamahiriya benefited from higher export revenues and buoyant public consumption and investment. The Egyptian economy grew more vigorously in 2006, attributable to robust domestic demand and increasing receipts from tourism and the Suez Canal. The same factors are expected to maintain the growth momentum in 2007.

**Growth remains uneven**

Economic growth in sub-Saharan Africa, excluding Nigeria and South Africa, has reached 5.9 per cent in 2006. Growth of the majority of the economies in the region has clustered in the range of 3 to 7 per cent. South Africa's GDP growth, although still relatively robust, has decelerated slightly in 2006, reflecting a slow expansion in the agricultural sector and weak export growth. Growth of the Nigerian economy has moderated to 5.1 percent in 2006, down from the 6.9 per cent recorded in 2005, owing mainly to a decline in oil production. GDP is expected to accelerate to 6.0 per cent in 2007, driven by increased FDI, particularly in the hydrocarbon sector, continued expansion of agricultural production and increasing investment in infrastructure development.

A smaller number of sub-Saharan countries have expanded by more than 7 percent in 2006, and these are expected to maintain very similar growth levels in 2007. Most of the oil-exporting countries, such as Angola and the Sudan recorded double-digit GDP growth rates, reflecting the continued strength in oil-export revenues and robust public spending. Growth was also particularly strong in the Democratic Republic of the Congo, Liberia, Mozambique and Sierra Leone, where stronger metal prices and post-conflict reconstruction activities lent strong support to GDP expansion.

Continued political tensions in Côte d'Ivoire and Zimbabwe, and the decline in tourism receipts and export earnings in the Comoros and Seychelles stalled growth in these economies in 2006.

The recent strong GDP growth has not been accompanied by commensurate job creation, raising serious concerns about the continent's ability to reduce poverty. South Africa is a case in point, where an impressive growth performance in recent years has not translated into visible reductions in un- and underemployment rates. This pattern of apparent jobless growth can be explained by myriad factors across countries.<sup>10</sup> First, in many countries, growth rates have not been strong or sustainable enough to generate sufficient labour demand for the increasing labour force. Second, the high volatility of GDP growth increases uncertainty regarding future profitability, ultimately hampering private-sector job creation. Third, economic activity has shifted away from agriculture into more capital-intensive sectors, such as mining and oil production. This diversification of economic activity away from agriculture has been accompanied by little or no increase in productivity in the agricultural sector and very low absorption of labour into the non-agricultural sector, resulting in high underemployment in the rural and agricultural sector. Fourth, in most African countries, employment objectives are not well integrated into macroeconomic policy frameworks as an explicit goal of macroeconomic policy. Most, if not exclusive, importance is given to much more narrowly defined policy goals of macroeconomic stabilization, focusing on controlling inflation and reducing budget deficits.<sup>11</sup>

The fiscal policy stance in the African region has been relatively expansionary in 2006. In Algeria, the implementation of the Growth Consolidation Plan, an ambitious public investment programme, and the increase in public-service wages led to a significant growth in public spending. Likewise, South Africa is currently devising the Accelerated and Shared Growth Initiative for South Africa (ASGI-SA), which aims to achieve higher sustained economic growth, significantly reduce unemployment and poverty and tackle other

Strong growth has not translated into significant employment gains

The fiscal policy stance has been expansionary in Africa

<sup>10</sup> See Economic Commission for Africa (ECA), *Economic Report on Africa 2006: Capital Flows and Development Financing in Africa* (Addis Ababa, Ethiopia: ECA).

<sup>11</sup> See, for instance, *World Economic and Social Survey 2006: Diverging Growth and Development* (United Nations publication, Sales No. E.06.II.C.1), chapter IV; and R. Pollin, G. Epstein, J. Heinz, and L. Ndikumana, *An Employment Targeted Economic Program for South Africa* (New York: UNDP, 2006).



pressing social problems. The Government has already increased spending in essential services such as power generation and distribution, rail transport, housing and the construction of oil pipelines.

Although public expenditures, and in particular capital expenditures, rose, fiscal positions recorded surpluses or moderate deficits in many countries, reflecting improved domestic revenue collection and significant current grants. However, in many oil-importing countries, such as the Central African Republic, Eritrea, Guinea, Guinea-Bissau and Zimbabwe, the lack of any significant increase in domestic government revenues and limited access to external financing, coupled with rising oil prices, has left fiscal positions fragile.

On average, monetary policies have been cautious. Private-sector credit as a share of broad money has declined slightly in some countries, suggesting a tightening of monetary policy to counter the expansionary fiscal stance. Many oil-producing countries also implemented a variety of measures aimed at controlling the rapidly increasing liquidity in banking systems. These measures included mopping up excess liquidity through open-market operations, transferring oil receipts from commercial banks to the central bank and increasing reserve requirements on demand deposits.

Despite the region's relatively low inflation, Eritrea, Guinea, Kenya, Sao Tome and Principe and Zimbabwe experienced sharp increases in consumer prices due to a variety of country-specific developments, including food shortages, currency depreciation and increased domestic prices of petroleum products.

Many countries, especially the oil-producing countries, have continued to post increasing trade-balance and current-account surpluses. The observed improvements, however, mask the persistent marginalization of the African continent in the global economy. Africa's share in world exports remains small and has declined systematically over the past few decades. This is a result of the concentration of African exports in a few commodities (low diversification), slow growth and lack of competitiveness in the manufacturing sector and deterioration of the terms of trade.

Africa's external debt eased in 2006 as the result of continued debt relief, stronger export revenues and more prudent debt management. However, this situation is partially influenced by improvements in the largest economies, especially oil exporters such as Nigeria and Algeria. In many other African countries, expenditures on debt servicing continues to outstrip those of social services such as education and health, undermining the continent's growth prospects and limiting its ability to invest in social service delivery to meet the rising demand.

The outlook is positive, but subject to a number of political and economic downside risks. The presidential elections scheduled in a number of countries, including Nigeria and Kenya, in 2007 might increase political uncertainties, have a negative effect on the policy environment and have an impact on economic stability. Continued political tensions and/or civil unrest in Chad, Côte d'Ivoire, the Democratic Republic of the Congo and the Darfur region of the Sudan could have spillover effects on neighbouring countries, weakening their growth prospects. Finally, a worse-than-expected slowdown in the rest of the world could significantly hamper the region's prospects, as exports remain a key engine of growth in the continent.

Africa remains  
marginalized in the global  
economy

The outlook is positive in  
the absence of political and  
economic shocks

## East Asia: another year of export-driven growth, but domestic demand is set to strengthen

Economic growth in East Asia has remained buoyant at 7.6 per cent in 2006, surpassing the strong performance of 2005 (see table A.3). As in the previous year, soaring growth in China set the regional pace, driving up the average and creating positive spillover effects. Growth in East Asia, excluding China, reached 5.3 per cent, which is also higher than in 2005. Economic activity in the first half of the year was particularly strong, as robust export and investment growth boosted the Chinese economy. The other countries also benefited from strong external demand for their exports. In the second half of 2006, this growth momentum slowed somewhat as tightening measures started to take effect in China, the global electronics cycle showed initial signs of weakening and commodity prices started to ease. These trends are set to continue in 2007, and the expected global economic slowdown will contribute to a decrease in regional growth to about 7 per cent.

The stellar investment growth in China in the first half of 2006 has raised renewed worries about an “overheating” of the economy. Consequently, in late April, the Government implemented administrative and monetary measures to moderate investment growth, including increases in interest rates and reserve ratios for commercial banks, as well as sector-specific measures, such as a tightening of land use policies and restrictions for foreign investors in the housing market. The observed investment slowdown in the second half of 2006 will likely continue in 2007, as the Government is putting increased emphasis on a more equitable and sustainable growth path. Together with an expected slowdown in export growth, this will result in a reduction of GDP growth to about 9 per cent in 2007.

Growth in the newly industrialized economies (NIEs)<sup>12</sup> is also forecast to slow in 2007, as the global electronic cycle continues to weaken and export growth decelerates. While domestic demand in the Republic of Korea is slowly recovering from its slump of the two previous years, domestic demand in the other NIEs is expected to compensate as unemployment decreases and private consumption is expected to rise. In contrast, growth in Indonesia, Malaysia, the Philippines and Thailand (Association of Southeast Asian Nations (ASEAN) 4) is expected to accelerate or remain stable in 2007, supported by a rebound in private consumption in Indonesia as monetary policy is loosened, and by continued healthy domestic consumption growth in the other countries. In Thailand, 2007 could bring some renewed consumer and investor confidence after a year of political uncertainty and policy stagnation in 2006, depending on the performance of the interim government.<sup>13</sup>

While strong external demand has been one important factor behind the recent export-led growth model for many countries in the region, persistently weak or even declining growth of domestic investment has been another (for example, in Indonesia, the Republic of Korea, the Philippines, Taiwan Province of China and Thailand (see table IV.1)). Political uncertainty has been a drag on the investment climate in Thailand and the Philippines. In the former, investment growth fell from a three-year average of 15 per cent per annum to 3.6 per cent year-on-year in the second quarter of 2006. In the latter, the invest-

East Asia experienced a renewed growth spurt in 2006, but is expected to decelerate in 2007

China's growth slowdown in the second half of 2006 will continue in 2007

Elsewhere in the region, growth trends are diverging in 2007

Domestic investment still needs to recover

<sup>12</sup> NIEs include Hong Kong Special Administrative Region (SAR) of China, the Republic of Korea, Singapore and Taiwan Province of China.

<sup>13</sup> Political uncertainty began in February and was prolonged until early October, when a new interim government was installed.

Table IV.1  
**Selected East Asian economies: real gross fixed investment, 2001-2006**  
*(annual percentage change)*

	2001	2002	2003	2004	2005	2006 <sup>a</sup>
Hong Kong SAR <sup>b</sup>	2.6	-4.5	0.9	3.0	4.1	4.8
Indonesia	6.5	4.7	0.6	14.6	9.9	0.9
Republic of Korea	-0.2	6.6	4.0	2.1	2.3	2.8
Malaysia	-2.8	0.3	2.7	3.1	4.7	5.7
Philippines	-13.0	2.1	3.8	1.3	-3.9	4.6
Singapore	-3.9	-11.4	-3.2	10.2	-1.9	4.1
Thailand	1.1	6.5	12.1	13.8	11.3	6.5
Taiwan Province of China	-19.9	-0.6	-0.9	17.5	1.2	-0.2

Sources: United Nations Statistics Division; Project LINK.

<sup>a</sup> Estimate.

<sup>b</sup> Special Administrative Region of China.

ment climate suffered from perceptions regarding the Government's instability in 2005, but appears to have rebounded in the second half of 2006. Institutional weaknesses and the lag in the implementation of announced reforms have negatively affected investment demand in Indonesia as firms postponed capital spending in 2006.

Consumer price inflation in the region has remained broadly stable in 2006: at 2.9 per cent on average for the region (see table A.6). Indonesia was an exception, as the hike in domestic fuel prices in October 2005 continued to feed into inflation throughout 2006, but strict monetary tightening helped bring monthly inflation rates down as early as March 2006. Inflationary pressures stemming from higher international oil and other commodity prices were counteracted in most countries by tighter monetary policies, a decrease in food prices and some appreciation of national currencies against the United States dollar. As these trends are expected to continue in 2007, inflation will remain at similar levels.

Central banks in East Asia are expected to maintain their vigilant stance in 2007. Although active policy tightening in Indonesia, the Philippines and Thailand came to an end in 2006, further tightening measures are possible in much of the rest of East Asia. While vigilance against inflation is important for central bank credibility, the process of monetary tightening could start to conflict with exchange-rate objectives in the region. Rapid growth and higher interest rates have induced higher capital inflows, which together with current-account surpluses will continue to generate vast balance-of-payments surpluses in 2007, posing problems of excess liquidity. To date, central banks have sterilized much of these inflows, but it is unlikely that this process can be sustained indefinitely.

Fiscal policies in the region follow divergent patterns. China has turned towards a more expansionary fiscal stance, with an increased focus on health and education spending in rural areas. Fiscal expansion in Taiwan Province of China emanates from increased social security and infrastructure spending. The other NIEs, however, are maintaining or—in the

Inflation remains fairly stable in 2006 and 2007

Central banks must balance the goal of price stability with the effects of interest-rate increases on speculative capital inflows

Fiscal policies follow divergent patterns

case of the Republic of Korea—returning to a more neutral fiscal stance. In the ASEAN 4, different fiscal adjustment paths are followed in line with country-specific conditions.

Impressive GDP growth has led to decreasing unemployment in Hong Kong Special Administrative Region (SAR) of China, Taiwan Province of China and Singapore. Elsewhere, however, there is growing concern that the region's strong economic performance has failed to generate adequate employment growth. Even in fast-growing China, official statistics have shown no reduction in unemployment rates since 2003.<sup>14</sup> This would suggest that China's economic growth has been "jobless". The lack of reduction in unemployment rates may have been the result of the continued economic restructuring, strong productivity increases and internal labour migration. Productivity increases and a steadily growing labour force are also preventing unemployment rates from receding in the ASEAN 4.<sup>15</sup>

Export growth in the region remained strong in 2006 (between 10-25 per cent in value terms), on the back of robust electronics exports and high non-oil commodity prices. With the exception of China and Thailand, import growth was even faster. The two main factors driving import bills were higher international oil prices and growing domestic demand. Slowing external demand for the region's exports in 2007 will cause trade surpluses to decrease further. As a result, current-account surpluses are also expected to decrease, although in some economies, such as Hong Kong SAR and Singapore, this will be at least partially offset by continuing strong service receipts.

The expected, albeit modest, real appreciation of the renminbi (either through a gradual revaluation of the nominal exchange rate or inflation, if the renminbi is not allowed to strengthen) will inevitably result in a weakening of China's competitiveness. This will likely benefit the other emerging economies in the region, providing an additional stimulus to the region's exports (excluding China) in 2007 and inducing a diversification away from China towards the global marketplace.

While the outlook for 2007 foresees a slight moderation in growth, there are several downside risks. In addition to the risk of a sudden and disorderly unwinding of global imbalances, there also exists the possibility of a return to more protectionist trade policies in the region's main export destinations as well as a renewed increase in international oil prices. Avian influenza also still bears close monitoring.<sup>16</sup>

## South Asia: continued strong growth and a chance to vanquish poverty

In 2006, aggregate economic growth has been strong at 6.7 per cent, only slightly below 2005, and was led by India. The largest economy in the region has maintained its brisk pace

<sup>14</sup> However, since official unemployment statistics do not cover those workers who migrated to the cities from rural areas and who do not have an urban resident card, the unemployment rate may understate the strength in the employment situation.

<sup>15</sup> For a more extensive discussion of jobless growth in Asia, see ESCAP, *Economic and Social Survey of Asia and the Pacific 2006, Energizing the global Economy* (United Nations publication, Sales No. E.06.2.F.10), pp.166-172, available from <http://www.unescap.org/pdd/publications/survey2006/sv06-full.pdf>.

<sup>16</sup> On the economic implications of the continued threat of an avian flu pandemic, see United Nations, "World Economic Situation and Prospects as of mid-2006", available from [http://www.un.org/esa/policy/wess/wesp2006files/wesp06update\\_eng.pdf](http://www.un.org/esa/policy/wess/wesp2006files/wesp06update_eng.pdf).

Several countries are experiencing jobless growth

Current-account surpluses are expected to decrease in 2007...

...and the expected real appreciation of the renminbi will decrease China's competitiveness

Downside risks include a sudden unwinding of global imbalances, protectionist trade measures, higher oil prices and avian flu

South Asia sees some slowdown, but remains strong

Table IV.2  
Poverty and inequality in South Asia

	Poverty headcount rate <sup>a</sup>		Inequality (Gini coefficient)	
	Start period	End period	Start period	End period
Bangladesh	33.8 (1989)	30.0 (2003)	28.9 (1989)	31.8 (2000)
India <sup>b</sup>	42.3 (1993)	31.0 (2003)	29.7 (1990)	31.7 (1999)
Islamic Republic of Iran	2.0 (1990)	2.0 (1998)	43.6 (1990)	44.1 (1998)
Nepal	34.4 (1996)	24.1 (2004)	37.7 (1996)	47.2 (2004)
Pakistan	47.7 (1991)	17.0 (2002)	33.2 (1991)	30.6 (2002)
Sri Lanka	3.8 (1990)	5.8 (2002)	30.1 (1990)	40.2 (2002)

**Sources:** World Bank, World Development Indicators, available from <http://devdata.worldbank.org/dataonline>; Asian Development Bank, Key Indicators, available from [http://www.adb.org/Documents/Books/Key\\_Indicators/2006/default.asp](http://www.adb.org/Documents/Books/Key_Indicators/2006/default.asp).

<sup>a</sup> Proportion of population below \$1 per day (measured in 1993 PPP) and based on household expenditure data.

<sup>b</sup> Gini coefficient for India based on UNU-WIDER, World Income Inequality database (2005), available from <http://www.wider.unu.edu/wiid/wiid.htm>.

of expansion at around 8 per cent (see table A.3). The other economies have also continued growing at above trend rates, with Bangladesh, Sri Lanka and Nepal outperforming their 2005 growth, owing to a sustained rebound of agriculture, and, in the case of Nepal, the cessation of violence since April 2006. In 2007, average GDP growth is expected to slow further, as most countries have reached their cyclical peak, in line with the anticipated slowdown in global growth. The Islamic Republic of Iran will likely witness the largest deceleration, by almost 1 percentage point, owing to the expected decrease in international oil prices. In contrast, Nepal is likely to reap a peace dividend, while India is expected to maintain growth rates similar to those in previous years.

Despite the robust growth performance, unemployment rates in South Asia are broadly unchanged, and substantial under- as well as unemployment remain problems in all countries. The main reason is the inability of the formal sector to absorb the rapidly growing work force. On the upside, strong economic growth dented official unemployment rates in Pakistan. Over the last two years, unemployment also fell in Sri Lanka, owing partly to the absorption of labour by reconstruction efforts after the 2004 tsunami and partly to the implementation of the graduate employment programme.

Despite disappointing employment growth and past trends of rising inequality in most countries (see table IV.2), the region remains on track to achieve the MDG of reducing extreme poverty by half by 2015 if current economic growth rates can be sustained.<sup>17</sup> The challenge for these countries is, therefore, to sustain high rates of growth while making economic development more inclusive in order to achieve a more rapid reduction in poverty.

Growth in 2006 has been broad-based across economic sectors. Benign monsoon rains contributed to strong agricultural growth in most countries, with the notable exception of Pakistan, where crop output actually fell. The manufacturing sector was another strong driver of growth. The textile and ready-made garment industry, in particular, continued to benefit from strong external demand and from investment and restructuring measures since the abolition of the world quota system in 2005. The service sectors generally benefited from strong growth in the other sectors, and, in India, it remained an important

<sup>17</sup> See ESCAP, UNDP, ADB, “The Millennium Development Goals: Progress in Asia and the Pacific 2006”, available from <http://www.mdgasiapacific.org/2ndMDGReport/MDG-Progress2006.pdf>.

Despite some improvement, under- and unemployment rates remain high...

...but the MDGs are within reach

Regional growth is broad-based

driver of growth in its own right. These trends are expected to continue in 2007, although agriculture is likely to slow down somewhat after two consecutive strong years, and the anticipated global slowdown will decelerate external demand for the region's exports.

Consumer price inflation seems to have peaked in 2006, at 9.4 per cent, 1.3 percentage points above the regional average in 2005 (see table A.6). A common driver of price increases in all oil-importing countries was the further increase in international oil prices, combined with an increased pass-through to domestic consumers. In addition, food prices also contributed to inflationary pressures in several countries, such as Pakistan. In 2007, crude oil prices are expected to stabilize, and food-price inflation will moderate, owing mainly to improved agricultural production. This, combined with continued monetary tightening, is expected to bring inflation down to a regional average of 8.9 per cent.

In the light of the persisting inflationary pressures, monetary tightening continued in 2006 in all countries except in the Islamic Republic of Iran. While these policies are starting to show some effect, central banks will remain vigilant, as further increases of domestic fuel and utility prices are expected to continue exerting upward pressure on price levels. With still relatively low real interest rates, the current tightening cycle is not likely to end before late 2007.

The fiscal stance in the region has remained broadly expansionary throughout 2006, with increased government focus on spending needs in infrastructure, and in the education and health sectors. This trend is expected to continue in 2007. While domestic fuel prices were raised in all economies, they still do not reflect international price levels and, hence, energy-price subsidies continue to pose an additional fiscal burden.

Pakistan's budget deficit increased to 4.3 per cent of GDP in fiscal year 2005/06, partly owing to rising expenditures in the wake of the October 2005 earthquake. Similarly, the deficit in Sri Lanka has remained high in 2006, driven by ongoing reconstruction spending after the 2004 tsunami and by higher defence expenditures in the wake of the recent upsurge in internal conflict. In India, the consolidated fiscal deficit is projected to decrease by 1 percentage point in fiscal year 2006/07 (to 6.5 per cent of GDP) as strong economic growth supports the revenue side.

In 2006, as in 2005, import growth outpaced export growth in value terms in most countries. This was mainly driven by another increase in international oil prices, but also by increased import volumes across all product categories, owing to growth in domestic consumption and investment demand. The region's exports also posted strong growth, driven particularly by textiles and ready-made garments. Nonetheless, trade deficits increased, causing current-account deficits to widen to levels between 0.5 per cent of GDP in Bangladesh and 4.5 per cent of GDP in Sri Lanka. Apart from net oil exporter the Islamic Republic of Iran, Nepal was the only country with a current-account surplus in 2006, owing to strong remittance inflows that offset the trade deficit. While stronger tourism inflows in 2007 and a pick-up in international aid should contribute to an increase in Nepal's current-account surplus, the other economies in the region are likely to see a further widening of their deficits.

Renewed increases in international oil prices are a major source of uncertainty for the region, potentially affecting current accounts, fiscal positions and inflation. Several countries suffer from internal conflicts which also add to uncertainty. As in the past, countries are prone to natural disasters, and poor weather conditions can adversely affect the agriculture sector. Escalation in political tensions during an election year, as is the case in Bangladesh and Pakistan in 2007, could also present a drag on economic growth.

Consumer price inflation peaked in 2006, driven by domestic fuel prices

Central banks will remain vigilant of inflationary pressures...

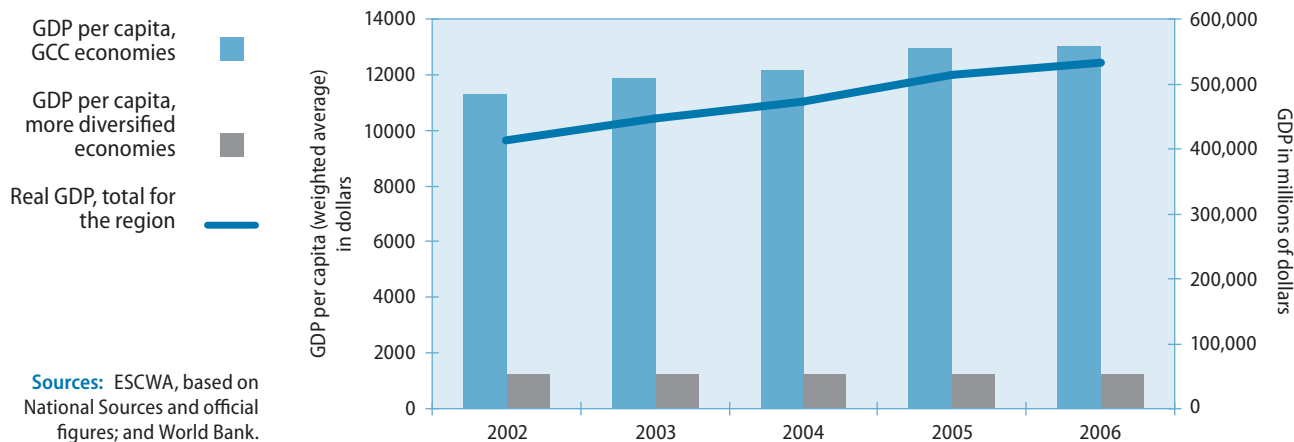
...while Governments continue their expansionary fiscal stance

As a result, fiscal consolidation is lagging

Trade deficits present a drag on current accounts of the region's oil importers

Volatile international oil prices and internal tensions are the main downside risks

Figure IV.10  
Western Asia: total GDP and GDP per capita, 2002-2006



### Western Asia: the boom fuelled by oil continues

The oil boom continues...

Led by strong oil exports, the Western Asian region has maintained its fourth consecutive year of robust growth. The surge in oil export revenues, resulting mainly from rising oil prices in the first half of 2006, helped the region maintain an estimated growth rate of 5.7 per cent in 2006. A lower growth of 5.1 per cent was witnessed in the more diversified oil-importing economies, but they too benefited from the region's boom through various spillover channels. The momentum of moderating oil prices, which began in the third quarter of 2006, will temper growth somewhat in the outlook period, but growth will still remain healthy at 4.9 cent in 2007 (see table A.3).

...but regional disparities remain

The overall regional gains, however, mask the growth disparities within the region as polarized development has continued—growth in the Gulf Cooperation Council (GCC)<sup>18</sup> economies was further spurred by the oil-market momentum, while those economies impacted by conflict lost even more skilled people, investment, potential incomes, capital and welfare. Instability in Iraq and the Palestinian territories accompanied by the mid-year Lebanese-Israeli conflict undermined growth prospects in those economies. In 2006, the GCC has generated 90 per cent of Western Asia's oil-export revenues, while Iraq, the Syrian Arab Republic and Yemen have contributed 10 per cent, despite having significantly larger populations. Per capita income in the GCC economies dwarfs that of the more diversified economies in the region (Jordan, Lebanon, the Syrian Arab Republic and Yemen) by a factor of 10, a rift that has steadily been increasing since 2002 (see figure IV.10).

Tourism and worker remittances that spill over from other parts of the region are important income sources for oil importers

The strong growth in oil revenues has bolstered fiscal and trade-account positions in the GCC economies in 2006. Growth has been supported by increased private investment and robust consumer expenditures. Rising household incomes and corporate profits have created positive spillover effects to the other economies in the region through tourism, workers remittances and FDI. Quarter-to-quarter, Jordan's tourism receipts rose by 16.1

<sup>18</sup> The Gulf Cooperation Council consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

per cent in the second quarter of 2006, and workers remittances remained buoyant at 51 per cent of total Jordanian exports for 2005 and the first half of 2006. In Yemen, workers remittances reached \$1.3 billion in 2005, representing 20.5 per cent of total exports. In general, however, these spillover effects from oil-exporting to oil-importing countries seem to be weakening.<sup>19</sup>

In Lebanon, the robust growth registered in the first six months of the year was abruptly halted by the ensuing conflict, which dampened growth prospects for the rest of 2006. In the months prior to the June conflict, strong regional trade and tourism had helped the economy grow at 5 per cent, but after the hostilities commenced the economy declined considerably, and by the end of the year output had fallen to an average annual growth rate of 3.2 per cent. Reconstruction has moved rapidly, however, and economic growth is expected to rebound in 2007, provided no further political instability emerges.

Slower growth has also been witnessed in Israel, but the economy remains resilient. Supported by increased government expenditures and a strong export sector, output growth will be sustained at 4.6 per cent in 2006, although that will remain below the 5.3 per cent growth of 2005. The anticipated depreciation of the shekel and the country's niche in research and development (R&D)-intensive technological exports should sustain robust Israeli exports in 2007, despite the anticipated slowdown in its major export partner, the United States.

Despite recent financial turbulence in June of this year, the Turkish economy is still expected to grow by about 6 per cent in 2006. Since the implementation of the stabilization programme of the International Monetary Fund (IMF), inflation has been reined in to manageable levels and interest rates, though still high, have fallen dramatically. High unemployment, however, remains a considerable problem. In addition, the widening of the current-account deficit has continued in 2006, primarily owing to the growing deficit in merchandise trade as major export industries lost competitiveness, owing among other factors, to the appreciation of the currency. Uncertainty surrounding EU accession could undermine economic stability in the outlook period, as the economy is suffering some financial fragility.

The strong growth in the region has had little impact on reducing the high rates of unemployment. Rapid population and labour force growth underpinned by increasing female participation rates, burgeoning youth cohorts and the steady stream of labour migrants to the GCC have caused excess labour supplies. At the same time, demand for national workers has remained stagnant. The public sector, which is the main employer of the domestic labour force, remains oversaturated, so much so that new employment creation has become increasingly reliant on a cost-sensitive private sector, which currently predominately employs expatriate workers.

In Jordan, "official" unemployment rates fell slightly from 14.8 to 14.4 per cent between 2005 and 2006. Redundancies are rising in Lebanon as its hitherto vibrant tourism sector and industry were hit hard by the war, but reconstruction efforts should generate greater employment over the outlook period. In Israel, unemployment is expected to fall slightly to 8.6 per cent in 2006 and to 8.5 per cent in 2007. The prospects for employment in the region are challenging. Employing national workers instead of using imported labour is difficult, particularly in the GCC cluster, as expatriates tend to be employed either in jobs requiring very low skills or in those requiring advanced training. In many Western Asian countries,

Growth in conflict countries slowed

Turkey's current-account deficit widened

Unemployment remains a problem in the region

<sup>19</sup> World Bank, *Economic Developments and Prospects: Financial Markets in a New Age of Oil* (Washington, D.C., 2006).



low-skilled jobs tend to be shunned by the national labour force, while highly-skilled workers are in short supply in the domestic labour market. Even so, there is a policy push towards the gradual replacement of foreign workers with workers of national origin. In Saudi Arabia, for example, expatriates have been banned from more than 30 job categories and medium and larger-sized enterprises must have at least 30 per cent of their workforce represented by nationals. Such policies will have long-run implications for regional labour migration, particularly in the lower-skilled job categories where substitution requires a change in attitude of workers rather than skill upgrading. Should the policies meet the target, this would likely reduce the flow of worker remittances and hence have repercussions elsewhere in the region.

Monetary policy is accommodative in most Western Asian countries

Most economies in Western Asia have an accommodative monetary stance, which has been supportive of domestic expansion. These policies have produced an expansion of domestic credit and favourable mortgage terms that have acted as a catalyst for substantial investment in real-estate and equity markets. In addition, the fixed or semi-fixed peg to the United States dollar has kept the currencies and interest rates stable.

Inflation is on the rise

The accommodative monetary stance has been a significant factor in demand-pull inflation. Private perceptions of increasing wealth continue to prop up expenditure and demand for credit, both of which stimulate prices. To some extent, however, lagged public expenditure increases have tempered the boom-bust cycles of aggregate demand, maintaining price level as output and incomes fluctuate. Also, in the GCC economies, the accumulation of foreign reserves partially sterilized excess liquidity, while investment institutions channelled surpluses abroad. However, inflation grew more significantly in the oil-importing economies, which were less able to limit the pass-through of higher oil prices (see table A.6).

Fiscal surpluses have increased among oil exporters, while deficits have widened among oil importers

The GCC economies further increased fiscal surpluses. Accumulated budget surpluses now add up to about 20 per cent of GDP. Saudi Arabia's budget surplus doubled from \$28.5 to \$57.1 billion between 2005 and 2006. On average, oil exporters have been saving about two thirds of increased oil revenues by adding to foreign-exchange reserves and oil-stabilization funds, as well as by repaying domestic public debt. Oil importers, in contrast, are facing considerable budgetary pressures owing largely to higher oil prices that have increased production costs and to their subsidizing of domestic energy prices. For example, in Jordan, oil subsidies represent 5.8 per cent of GDP. Although some steps have been taken to reduce this fiscal burden, these have not been pushed through in full because of concerns about the adverse impact they would have on the economically disadvantaged in the population.

The outlook for Western Asia is clouded by financial risks and lack of economic diversification

The downside risks for the medium-term outlook include the possible collapse of equity prices in oil-exporting economies, which could have a severe impact on the balance sheets of financial institutions that have become overexposed to positions in domestic and regional asset markets. Oil-importing countries face concerns that geopolitical factors may adversely affect FDI and tourism. Other risks stem from the lack of economic diversification in the oil-exporting economies. Although there has been some diversification into other energy production, industrial diversification has been limited. Diversification would reduce dependence on volatile oil prices, form a basis for more sustainable growth and strengthen the link between economic growth and employment generation.

## Latin America and the Caribbean: domestic demand boosts growth

The Latin American and Caribbean region's economy grew by about 5 per cent in 2006, as both external and domestic demands were relatively strong. However, growth is expected to slow down in 2007 to 4.2 per cent, as global economic activity will ease moderately and commodity export prices will slow from their previously accelerated pace. This completes four years of average growth of almost 5 per cent, which is 2 percentage points over the average of the past decade, and an average annual GDP per capita growth of 2.8 per cent during the same period (see table A.3). Although these growth rates are the lowest in the developing region, they are accompanied by regional current-account surpluses, reduced fiscal deficits and debt reduction, making the region relatively less vulnerable to external shocks and less reliant on external savings than has historically been the case. However, a disorderly unwinding of the global imbalances could reverse this situation.

Over the past few years, domestic demand has become the main driver of economic growth in the region. Gross fixed capital formation has been the fastest-growing component of demand, with growth rates of 13 per cent in 2004, 10.7 per cent in 2005 and similar rates in 2006. The average rate of investment now constitutes 22 per cent of GDP, but is still below the pre-financial-crises level of 1997. Export volumes have increased owing to continuous external demand, and the resulting greater economic activity has spurred an increase in import demand, diminishing the net export contribution to GDP during the past two years.

Although the South American countries as a group have been leading in terms of growth rates, the gap with Mexico and Central America has narrowed, resulting in broader-based growth throughout the region.

Mexico's results were above expectations, boosted by accelerating private and public consumption as well as an increase in real investment supported by strong public investment in an electoral year. Mexico's external demand was also favoured by strong demand from the United States for its manufactured goods and by higher oil-export prices. Similarly, the economies of the Central American isthmus and the Caribbean grew at a faster pace, underpinned by greater demand for their export products and tourism.

Brazil's growth rate has been downgraded from the previous forecast, as second quarter results were lower than expected due to a fall in manufacturing industry growth rates and exports, lowering somewhat the expectations for recovery. However, the rest of the South American subregion, led by Argentina and the Bolivarian Republic of Venezuela, performed better than expected. Private consumption and real investment continued to support Argentina's recovery, while higher oil-export prices have favoured the Bolivarian Republic of Venezuela, and, to a lesser extent, Colombia and Ecuador. Chile and Peru continue to perform well as demand for their export commodities, especially metals and minerals, remains strong.

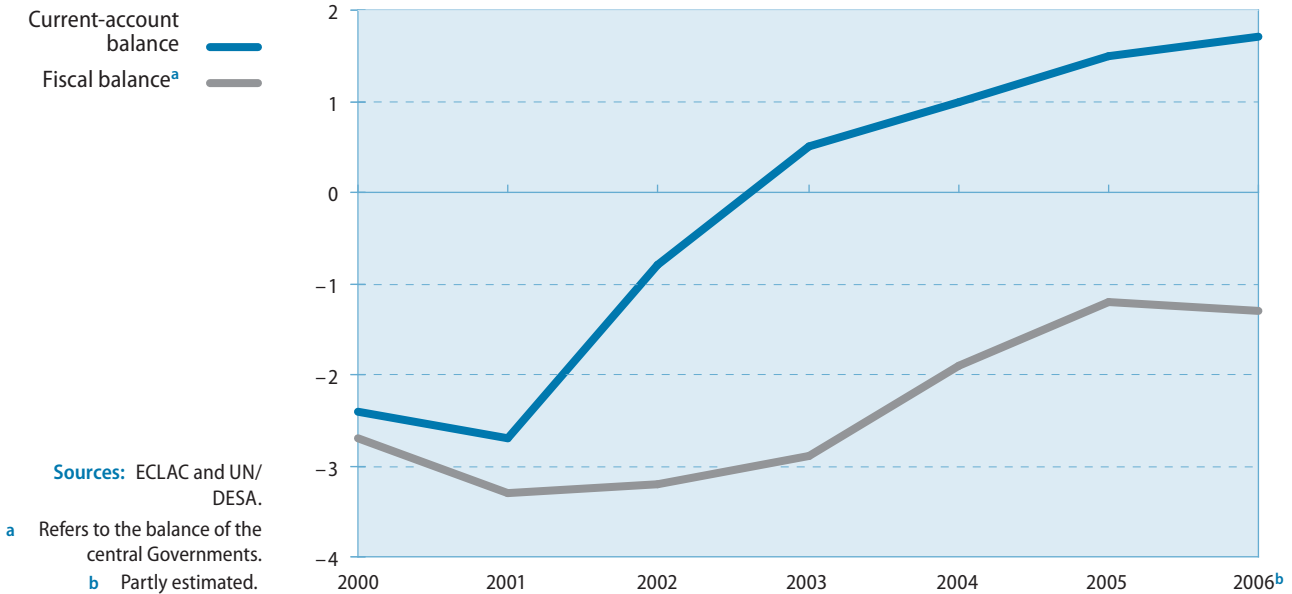
Official interest rates increased in the majority of countries in the region in pursuit of explicit inflation targets. This increase was reflected in a rise of the interbank rates. Real lending rates remain about 10 per cent in most countries, with the exception of Paraguay and Peru (20 per cent), Brazil (40 per cent) and the Bolivarian Republic of Venezuela, which has a negative real lending rate. Mexico ended its loose macroeconomic policy stance at the end of August 2006, as growth prospects improved and inflation pressures kindled. Meanwhile, Brazil will continue easing its monetary policy (which it started in August

Domestic demand is the  
main driver of growth

Growth is broader-based  
than in 2005

Monetary policy is cautious  
in most countries

Figure IV.11  
**Latin America and the Caribbean: current-account and fiscal balances,**  
**2000-2006 (percentage of GDP)**



2005) as a result of a deceleration in economic activity and lower inflation. In real terms, however, interest rates remain at high levels.

#### Fiscal space has increased

Fiscal deficits in the region have decreased steadily since 2003, as shown in figure IV.11. However, increased revenues have also allowed Governments to increase expenditures, slightly increasing deficits in 2006. Public debt ratios have decreased and their composition has also improved to more favourable terms. However, many countries, including Argentina and Brazil, still have large outstanding public debts equal to more than 50 per cent of GDP.

#### Inflation continues its descent...

Average inflation has continued to decrease for the third consecutive year, from 11.1 per cent in 2003 to 5.7 per cent in 2006 (see table A.6). Lower inflation in Brazil strongly contributed to the drop in the regional average. Inflation also fell notably in Argentina, Brazil, Costa Rica, Guatemala, Haiti, Honduras and Panama. Although Argentina still faces relatively high average inflation (11 per cent in 2006), it has decelerated. To reduce inflation further, the country will continue to apply price controls through informal agreements with suppliers. Similarly, the Bolivarian Republic of Venezuela's excess liquidity from public spending has kept inflation high, although it has been lowered in 2006 through price controls.

#### ...and unemployment decreases

Greater economic growth has helped increase employment by 0.5 percentage points and unemployment rates have decreased to around 8.7 per cent, their lowest level since the mid-nineties. This decrease is more moderate than in 2005, as participation has increased slightly. Formal employment increased in almost all countries throughout the region in 2006. Real wages have also increased for the first time in several years. Brazil's relatively low growth performance, however, has impeded any significant reduction in the unemployment rate.

#### Latin America's current account is in surplus for the fourth consecutive year

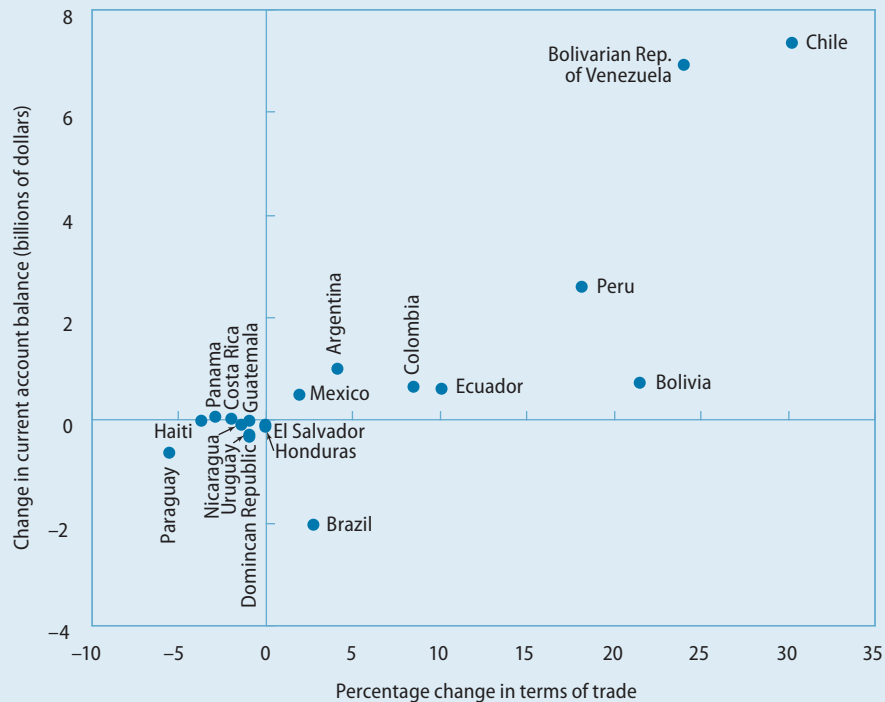
The favourable external environment has been supportive of strong growth in export volumes and improved terms of trade for the South American countries and Mexico. As a

## Box IV.3

## Terms of trade and external adjustment in Latin America and the Caribbean

The gains from high commodity prices in recent years have been distributed relatively unevenly across the countries of Latin America and the Caribbean. Mainly, the countries that are net oil exporters have witnessed positive terms-of-trade gains during 2005-2006. Chile, Peru and, to a lesser extent, Brazil form an exception, as these net oil importers saw the increase in the prices of their export commodities compensate for the rise in oil prices. In contrast, the terms of trade deteriorated substantially for most other oil-importing countries in the region. Based on trade data for 2005, Brazil, Chile, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Peru and Uruguay are net oil importers.

Most oil-importing countries with deteriorating terms of trade have seen their external accounts fall further into deficit. In contrast, the countries with improved terms of trade could reduce their current-account deficits or add to their surpluses and strengthen their international reserve positions. (See figure below.) In effect, the region's \$52.7 billion current-account surplus estimated for 2006 originates from eight countries only, with the Bolivarian Republic of Venezuela contributing the bulk (\$32.2 billion) and two other oil-exporters, Trinidad and Tobago and Ecuador, contributing \$5.1 and \$0.5 billion, respectively. The other surplus countries include Argentina, Bolivia, Brazil, Chile and Peru, all of which benefited from terms-of-trade gains. This pattern has been by and large unchanged since 2003.

Changes in terms of trade and current-account balances, 2006<sup>a</sup>

Source: UN/DESA, based on ECLAC data.

<sup>a</sup> Preliminary figures.

result, trade and current-account surpluses have increased further for the fourth consecutive year. The terms of trade have improved for five consecutive years, increasing by 6.4 per cent in 2006, and the relative export-import price is now 31 per cent higher than the average of the nineties. The region's current-account surplus grew by almost \$20 billion in 2006. This surplus is mainly concentrated in a few South American economies, however, with Chile generating \$10.5 billion and the Bolivarian Republic of Venezuela contributing \$6.6 billion. The Central American countries, in contrast, ran a combined current-account deficit of \$4.8 billion, slightly larger than in 2005. These countries are experiencing declining terms of trade mainly due to higher oil prices and other import commodities (see box IV.3). A boost in FDI throughout the entire region resulted in a capital-account surplus, increasing international reserves.

Increased capital flows have strengthened local currencies

The real effective exchange rate in Latin America and the Caribbean appreciated on average as the region's export commodity prices continued to increase, especially prices of metals, minerals and hydrocarbons. This has led several central banks in the region, such as those in Argentina, to intervene heavily in the foreign-exchange market to sterilize excess liquidity and avoid further exchange-rate appreciation. Similarly, remittances have continued to play an important role in the appreciation of some Central American currencies.

Latin American countries have strengthened their presence in international bond markets

Latin American countries have continued to strengthen their presence in international bond markets, despite turbulence in the markets and a busy electoral calendar. In addition, sovereign risk rates have reached historically low levels, narrowing the gap with the rest of the emerging markets. Argentina has returned vigorously to these markets, with, among other things, significant sales of sovereign bonds to the Bolivarian Republic of Venezuela. Brazil, Colombia, Mexico and Uruguay have issued long-term bonds denominated in their local currencies. External debt for the whole region has continued to decrease in 2006 in terms of GDP.

Risks are tied to trade

The medium-term prospects for the Latin American and Caribbean region will depend, first and foremost, on its commercial ties. A slowdown in the United States economy could affect Mexico and Central America more than the rest of the region, since their export structure is more dependent on that market. In addition, a large percentage of Mexico's and Central America's exports are manufactures that are designed to meet destination-market specifications, making it more difficult for them to divert to other markets in the short run. South America, by contrast, has a more diversified export market structure in which, in addition to Europe, China and other Asian economies are playing an increasingly important role. At the same time, most economies in South America benefited strongly from the commodity price boom in recent years and thus are vulnerable to greater volatility and weakening of commodity prices. In contrast, a continued increase in the price of oil would affect small oil importers that have not benefited from higher non-oil commodity prices, especially in Central America. Finally, a disorderly response to the imbalances, resulting in higher international interest rates would weaken the region's previously favourable external position.

# Annex

## List of tables

<b>I. Global output and macroeconomic indicators</b> .....	123
A.1. Developed economies: rates of growth of real GDP, 1997-2007 .....	123
A.2. Economies in transition: rates of growth of real GDP, 1997-2007 .....	125
A.3. Developing economies: rates of growth of real GDP, 1997-2007 .....	126
A.4. Developed economies: consumer price inflation, 1997-2007 .....	128
A.5. Economies in transition: consumer price inflation, 1997-2007 .....	130
A.6. Developing economies: consumer price inflation, 1997-2007 .....	131
A.7. Developed economies: unemployment rates, 1997-2007 .....	133
A.8. Economies in transition and developing economies: unemployment rates, 1997-2007	135
A.9. Major developed economies: quarterly indicators of growth, unemployment and inflation, 2004-2006 .....	138
A.10. Selected economies in transition: quarterly indicators of growth and inflation, 2004-2006 .....	139
A.11. Major developing economies: quarterly indicators of growth, unemployment and inflation, 2004-2006 .....	140
A.12. Major developed economies: financial indicators, 1997-2006 .....	142
A.13. Selected economies: real effective exchange rates, broad measurement, 1997-2006 .....	143
<b>II. International trade</b> .....	145
A.14. Indices of prices of primary commodities, 1997-2006 .....	145
A.15. World oil supply and demand, 1998-2007 .....	146
A.16. World trade: changes in value and volume of exports and imports, by major country group, 1997-2007 .....	147
<b>III. Global macroeconomic balances and international finance</b> .....	149
A.17. Balance of payment on current account, by country or country group, summary table, 1997-2005 .....	149
A.18. Balance of payment on current account, by country or country group, 1997-2005 ....	150
A.19. Net ODA from major sources, by type, 1985-2005 .....	153
A.20. Total net ODA flows from OECD Development Assistance Committee (DAC) countries, by type of flow, 1993-2005 .....	154
A.21. Commitments and net flows of financial resources, by selected multilateral institutions, 1996-2005 .....	155







Table A.1 (continued)

**Developed economies: rates of growth of real GDP, 1997-2007 (annual percentage change<sup>a</sup>)**

	1997–2005	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Other Europe	2.1	3.2	2.8	1.7	3.3	1.8	0.6	0.4	2.7	2.2	2.6	2.2
Iceland	4.4	4.4	5.8	4.0	4.4	3.6	-0.3	2.7	7.7	7.5	4.6	4.6
Norway	2.6	5.2	2.6	2.1	2.8	2.7	1.1	1.1	3.1	2.3	2.1	2.9
Switzerland	1.7	1.9	2.8	1.3	3.6	1.0	0.3	-0.2	2.3	1.9	2.9	1.6
<b>Major developed economies</b>	<b>2.4</b>	<b>3.1</b>	<b>2.3</b>	<b>2.9</b>	<b>3.5</b>	<b>1.0</b>	<b>1.1</b>	<b>1.9</b>	<b>3.0</b>	<b>2.5</b>	<b>2.8</b>	<b>2.1</b>
North America	3.2	4.5	4.2	4.5	3.8	0.8	1.7	2.5	3.9	3.2	3.2	2.2
Western Europe	2.3	2.8	2.9	3.0	3.8	1.9	1.1	1.2	2.4	1.7	2.7	2.4
Asia and Oceania	1.3	1.6	-1.3	0.2	3.0	0.6	0.5	1.9	2.4	2.6	2.5	1.9

**Sources:** UN/DESA, based on OECD, *Main Economic Indicators* and individual national sources.

- a** Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.
- b** Partly estimated.
- c** Forecasts, based in part on Project LINK.

Table A.2

Economies in transition: rates of growth of real GDP, 1997-2007 (annual percentage change<sup>a</sup>)

	1997-2005	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Economies in transition	4.6	0.9	-2.7	3.9	7.9	5.7	5.1	7.0	7.7	6.4	7.2	6.5
South-eastern Europe	3.0	-0.7	0.3	-1.5	3.5	4.8	4.9	4.7	6.7	4.7	5.9	5.5
Albania	5.0	-10.9	8.6	13.3	6.5	7.1	4.3	5.8	6.2	5.6	5.5	6.0
Bosnia and Herzegovina	9.9	36.6	16.6	9.5	5.5	4.3	5.3	4.0	5.7	5.3	6.0	5.5
Bulgaria	3.4	-5.6	4.0	2.3	5.4	4.1	4.9	4.5	5.7	5.5	5.8	5.6
Croatia	3.8	6.8	2.5	-0.9	2.9	4.4	5.6	5.3	3.8	4.3	4.5	4.3
Romania	2.0	-6.0	-4.7	-1.1	2.2	5.8	5.2	5.3	8.5	4.1	6.8	6.0
Serbia and Montenegro <sup>d</sup>	2.2	7.4	2.5	-17.7	5.2	5.3	3.8	2.1	8.3	6.0	5.5	5.5
The former Yugoslav Republic of Macedonia	2.3	1.4	3.4	4.3	4.6	-4.5	0.9	2.8	4.1	4.0	4.0	4.3
Commonwealth of Independent States	5.0	1.4	-3.6	5.4	9.1	6.0	5.2	7.6	7.9	6.8	7.5	6.7
Net fuel exporters	5.0	1.4	-4.3	6.2	9.7	5.6	5.1	7.3	7.4	7.1	7.5	6.7
Azerbaijan	11.2	5.8	10.0	7.4	11.1	9.9	10.6	11.2	10.2	26.4	32.5	28.0
Kazakhstan	7.0	1.7	-1.9	2.7	9.8	13.5	9.8	9.3	9.6	9.5	9.5	8.5
Russian Federation	4.7	1.4	-5.3	6.4	10.0	5.1	4.7	7.3	7.2	6.4	6.7	5.8
Turkmenistan	4.2	-11.4	7.1	16.5	5.5	4.3	0.3	3.3	4.5	9.6	6.5	6.5
Uzbekistan	5.1	5.2	4.4	4.4	4.0	4.5	4.2	4.4	7.7	7.0	6.5	6.0
Net fuel importers	5.2	0.9	0.7	1.0	5.5	7.9	5.6	9.2	11.3	4.9	7.3	6.6
Armenia	9.1	3.3	7.3	3.3	5.9	9.6	15.1	14.0	10.1	13.9	13.0	9.0
Belarus	7.4	11.4	8.4	3.4	5.8	4.7	5.0	7.0	11.4	9.2	9.0	8.5
Georgia	6.0	10.5	3.1	2.9	1.8	4.8	5.5	11.1	5.8	9.3	8.0	7.0
Kyrgyzstan	4.4	9.9	2.1	3.7	5.4	5.3	0.0	7.0	7.0	-0.6	4.0	6.0
Moldova	3.1	1.6	-6.5	-3.4	2.1	6.1	7.8	6.6	7.4	7.1	4.0	4.5
Tajikistan	7.3	1.7	5.4	3.7	8.3	10.2	9.5	10.2	10.6	6.7	7.5	6.1
Ukraine	4.3	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	2.6	6.5	5.8

Source: UN/DESA, based on data of Economic Commission for Europe (ECE).

<sup>a</sup> Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

<sup>b</sup> Partly estimated.

<sup>c</sup> Forecasts, based in part on Project LINK.

<sup>d</sup> The membership of Serbia and Montenegro in the United Nations was continued by Serbia as of 3 June 2006. On 28 June 2006, the General Assembly admitted Montenegro as the 192<sup>nd</sup> Member State of the United Nations.

Table A.3  
**Developing economies: rates of growth of real GDP, 1997-2007** (annual percentage change<sup>a</sup>)

	1997-2005	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
<b>Developing countries<sup>d</sup></b>	4.6	5.4	2.1	3.5	5.7	2.7	3.9	5.2	6.9	6.4	6.5	5.9
<b>Africa</b>	3.8	3.2	3.4	2.8	3.2	3.7	3.4	4.7	4.8	5.4	5.6	5.6
North Africa	4.0	2.7	4.5	3.5	2.8	3.5	3.2	5.4	5.0	5.0	6.1	5.5
Sub-Saharan Africa (excluding Nigeria & South Africa)	4.2	4.5	4.3	2.6	2.4	4.9	4.0	3.3	5.7	5.9	5.9	6.6
Net fuel exporters	4.1	3.5	3.8	2.9	3.3	3.0	3.4	6.1	4.9	6.4	6.1	6.4
Net fuel importers	3.6	2.9	3.0	2.7	3.0	4.3	3.4	3.5	4.7	4.6	5.2	4.8
<b>East and South Asia</b>	5.9	5.9	1.2	6.3	7.1	4.5	6.5	6.9	7.8	7.5	7.4	6.9
East Asia	6.1	6.6	0.2	6.7	7.8	4.5	6.9	6.8	8.0	7.5	7.6	7.0
South Asia	5.5	4.0	4.3	5.1	4.9	4.2	5.4	7.1	7.1	7.3	6.7	6.5
Net fuel exporters	5.0	3.2	3.0	3.0	5.3	4.2	6.7	7.2	5.7	6.6	5.6	4.9
Net fuel importers	6.0	6.2	1.0	6.7	7.3	4.5	6.5	6.8	8.0	7.5	7.6	7.1
<b>Western Asia</b>	3.8	4.6	4.3	-0.7	5.9	-0.3	3.0	4.6	6.6	6.2	5.7	4.9
Net fuel exporters	4.0	3.6	5.1	0.2	4.9	2.6	2.1	5.1	6.2	6.1	6.2	5.0
Net fuel importers	3.5	5.9	3.3	-1.7	7.2	-4.1	4.2	4.1	7.2	6.2	5.1	4.7
<b>Latin America and the Caribbean</b>	2.7	5.5	2.5	0.5	4.0	0.2	-0.8	2.0	5.9	4.5	5.0	4.2
South America	2.2	5.0	1.3	-1.4	2.8	0.2	-1.9	2.1	7.0	5.1	5.3	4.7
Mexico and Central America	3.5	6.6	5.0	3.9	6.2	0.0	1.0	1.6	4.2	3.1	4.3	3.2
Caribbean	4.0	4.0	3.1	5.8	5.6	2.3	2.9	2.9	3.4	6.5	6.8	4.9
Net fuel exporters	2.8	6.8	3.7	-0.1	3.9	-0.7	-3.0	2.5	6.8	5.4	5.8	4.3
Net fuel importers	2.6	3.9	1.0	1.2	4.0	1.4	1.9	1.4	4.9	3.5	4.1	4.0
<i>Memorandum items:</i>												
Least developed countries	6.4	5.4	4.9	5.6	5.8	6.6	6.4	6.5	7.9	8.3	6.9	7.1
East Asia (excluding China)	4.0	4.9	-4.6	6.1	7.4	1.7	5.2	4.2	6.2	5.1	5.3	5.1
South Asia (excluding India)	4.8	3.0	3.1	3.4	5.0	3.6	6.0	6.8	5.8	6.5	5.7	5.1
Western Asia (excluding Israel and Turkey)	3.9	3.7	5.0	0.4	4.7	2.7	2.2	5.0	6.1	5.8	5.8	4.9
Landlocked developing economies	4.7	3.5	3.2	3.3	3.7	5.7	4.5	4.6	6.7	7.1	7.7	7.6
Small island developing economies	4.4	5.7	1.2	6.3	7.6	0.2	3.4	3.0	6.0	6.1	6.5	5.1
<b>Major developing economies</b>												
Argentina	1.9	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.7	9.0	9.2	8.0	6.1
Brazil	2.2	3.3	0.1	0.8	4.4	1.3	1.9	0.6	4.9	2.3	3.3	3.5
Chile	3.9	6.6	3.2	-0.8	4.5	3.4	2.2	3.9	6.2	6.3	4.7	5.5
China	9.0	9.3	7.8	7.6	8.4	8.3	9.1	10.0	10.1	10.2	10.2	8.9
Colombia	2.2	3.4	0.6	-4.2	2.9	1.5	1.9	4.1	4.9	5.2	5.5	5.0
Egypt	4.2	4.0	6.1	5.4	3.5	3.2	3.1	3.2	4.2	5.0	5.0	5.0
Hong Kong SAR <sup>e</sup>	3.8	5.1	-5.5	4.0	10.0	0.6	1.8	3.1	8.6	7.3	6.2	6.2
India	6.2	5.2	5.6	6.9	4.7	4.9	4.7	7.4	8.5	8.0	7.7	7.9
Indonesia	2.2	4.7	-13.1	0.8	4.9	3.8	4.4	4.7	5.1	5.6	5.3	6.0

Table A.3 (continued)

Developing economies: rates of growth of real GDP, 1997-2007 (annual percentage change<sup>a</sup>)

	1997-2005	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Iran, Islamic Republic of	4.8	2.8	2.8	2.9	5.2	4.0	6.7	7.2	5.5	6.5	5.4	4.7
Israel	3.0	3.3	3.6	2.5	8.2	-0.3	-1.5	1.3	4.7	5.3	4.6	4.5
Korea, Republic of	4.2	4.7	-6.9	9.5	8.5	3.8	7.0	3.1	4.7	4.0	5.0	4.3
Malaysia	4.0	7.3	-7.4	6.1	8.9	0.3	4.4	5.4	7.1	5.0	5.5	6.0
Mexico	3.5	6.8	4.9	3.9	6.6	-0.2	0.8	1.4	4.2	3.0	4.2	3.0
Nigeria	4.2	2.9	2.8	1.2	4.9	3.1	1.5	10.7	4.0	6.9	5.1	6.0
Pakistan	4.3	1.8	3.1	4.0	3.5	2.5	4.1	5.7	7.1	7.2	6.5	6.2
Peru	3.3	6.8	-0.7	0.9	2.9	0.2	4.9	3.8	4.8	6.4	6.5	5.5
Philippines	3.8	5.2	-0.6	3.4	4.7	1.8	4.3	4.7	6.2	5.0	5.5	5.7
Saudi Arabia	3.3	2.6	2.8	-0.8	4.9	0.5	0.1	7.7	5.3	6.6	5.8	5.6
Singapore	4.8	8.3	-1.4	7.2	10.0	-2.3	4.0	2.9	8.7	6.4	7.0	5.5
South Africa	3.0	2.6	0.5	2.4	4.2	2.7	3.6	2.8	3.7	4.9	4.6	4.1
Taiwan Province of China	4.2	6.4	4.5	5.7	5.8	-2.2	4.2	3.4	6.1	4.0	4.1	4.2
Thailand	2.4	-1.4	-10.5	4.4	4.8	2.1	5.4	6.9	6.4	4.5	4.2	4.8
Turkey	3.8	7.5	3.1	-4.7	7.4	-7.5	7.9	5.8	8.9	7.4	6.1	4.8
Venezuela, Bolivarian Republic of	1.7	6.4	0.3	-6.0	3.7	2.8	-8.9	-7.7	17.9	9.3	8.5	6.0

Sources: UN/DESA, based on data of UN Statistics Division; IMF, *International Financial Statistics*.

- a Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.
- b Partly estimated.
- c Forecasts, based in part on Project LINK.
- d Covering countries that account for 98 per cent of the population of all developing countries.
- e Special Administrative Region of China.

Table A.4

Developed economies: consumer price inflation, 1997-2007 (average annual percentage change<sup>a)</sup>)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Developed economies	2.2	1.5	1.4	2.3	2.0	1.3	1.7	1.9	2.2	2.3	1.9
United States	2.3	1.6	2.1	3.4	2.8	1.7	2.2	2.7	3.4	3.3	2.2
Canada	1.6	1.0	1.7	2.7	2.5	2.3	2.8	1.8	2.2	2.0	1.3
Japan	1.8	0.7	-0.3	-0.7	-0.8	-0.9	-0.2	0.0	-0.3	0.2	0.9
Australia	0.3	0.8	1.5	4.5	4.4	3.0	2.8	2.3	2.7	3.6	3.2
New Zealand	1.2	1.3	-0.1	2.6	2.6	2.7	1.8	2.3	3.0	3.8	3.2
European Union	2.4	2.0	1.4	2.6	2.5	2.1	2.1	2.2	2.2	2.3	2.3
EU-15	2.0	1.6	1.2	2.3	2.4	2.0	2.1	2.1	2.2	2.2	2.3
Euro zone	1.8	1.3	1.1	2.2	2.5	2.1	2.0	2.0	2.1	2.1	2.1
Austria	1.3	0.9	0.6	2.3	2.7	1.8	1.4	2.1	2.3	1.6	1.6
Belgium	1.6	1.0	1.1	2.5	2.5	1.6	1.6	2.1	2.8	2.3	2.1
Finland	1.2	1.4	1.2	3.0	2.6	1.6	0.9	0.2	0.6	1.6	1.8
France	1.2	0.6	0.5	1.7	1.6	1.9	2.1	2.1	1.7	1.8	1.8
Germany	1.9	0.9	0.6	1.5	2.0	1.4	1.0	1.7	2.0	1.8	2.4
Greece	5.5	4.8	2.6	3.1	3.4	3.6	3.6	2.9	3.6	3.4	3.0
Ireland	1.6	2.4	1.6	5.6	4.9	4.7	3.5	2.2	2.4	3.9	3.4
Italy	2.0	2.0	1.7	2.5	2.8	2.5	2.7	2.2	2.0	2.3	1.6
Luxembourg	1.4	1.0	1.0	3.1	2.7	2.1	2.1	2.2	2.5	4.2	3.4
Netherlands	2.2	2.0	2.2	2.4	4.2	3.3	2.1	1.2	1.7	1.3	1.5
Portugal	2.3	2.8	2.3	2.9	4.4	3.6	3.3	2.4	2.3	2.7	2.3
Spain	2.0	1.8	2.3	3.4	3.6	3.1	3.0	3.0	3.4	3.3	3.1
Other	2.4	2.6	1.3	2.8	2.0	1.8	2.6	2.4	2.4	2.8	2.8
Denmark	2.2	1.8	2.5	2.9	2.4	2.4	2.1	1.2	1.8	2.0	2.1
Sweden	-1.5	-1.9	-1.1	2.1	2.7	2.3	1.5	0.1	0.1	1.5	1.9
United Kingdom	3.1	3.4	1.6	2.9	1.8	1.6	2.9	3.0	2.8	3.1	3.0
EU-10	12.6	10.5	6.3	8.2	5.8	2.7	1.9	3.9	2.5	2.6	3.2
EU-8	13.0	10.9	6.5	8.4	5.9	2.7	1.9	4.0	2.5	2.6	3.2
Czech Republic	8.5	10.7	2.1	3.9	4.8	1.8	0.1	2.8	1.9	2.8	3.7
Estonia	10.6	8.2	3.3	4.0	5.7	3.6	1.3	3.0	4.1	5.0	3.4
Hungary	18.3	14.2	10.0	9.8	9.1	5.3	4.6	6.7	3.6	3.6	6.0
Latvia	8.4	4.7	2.4	2.6	2.5	1.9	2.9	6.2	6.8	6.0	3.6
Lithuania	8.9	5.1	0.8	1.0	1.3	0.3	-1.2	1.2	2.7	3.5	3.0
Poland	14.9	11.6	7.1	9.9	5.4	1.9	0.7	3.4	2.2	1.7	2.5
Slovakia	6.2	6.6	10.7	12.0	7.3	3.2	8.6	7.5	2.7	4.5	2.8
Slovenia	8.4	7.9	6.2	8.9	8.4	7.5	5.6	3.6	2.5	2.5	2.5
Other	3.5	2.3	1.7	3.7	2.3	2.9	3.0	2.4	2.7	2.7	2.6
Cyprus	3.6	2.2	1.6	4.2	2.0	2.8	4.1	2.3	2.6	2.6	2.5
Malta	3.1	2.4	2.1	2.4	2.9	3.0	0.5	2.8	3.0	3.0	3.0

Table A.4 (continued)

**Developed economies: consumer price inflation, 1997-2007 (average annual percentage change<sup>a</sup>)**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Other Europe	1.4	0.9	1.5	2.2	1.9	1.0	1.4	0.7	1.4	1.6	0.6
Iceland	1.8	1.7	3.2	5.1	6.4	5.2	2.1	3.2	4.0	4.0	4.0
Norway	2.6	2.3	2.3	3.1	3.0	1.3	2.5	0.5	1.5	2.4	1.5
Switzerland	0.5	0.0	0.8	1.6	1.0	0.6	0.6	0.8	1.2	1.0	-0.1
<i>Memorandum item:</i>											
Major developed economies	2.1	1.4	1.3	2.1	1.8	1.1	1.6	1.9	2.2	2.3	1.9

**Sources:** UN/DESA, based on OECD, *Main Economic Indicators* and individual national sources.

**a** Data for country groups are weighted averages, where weights for each year are based on GDP in 2000, in United States dollars.

**b** Partly estimated.

**c** Forecasts, based in part on Project LINK.

Table A.5  
Economies in transition: consumer price inflation, 1997-2007 (average annual percentage change<sup>a</sup>)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
<b>Economies in transition</b>	59.8	26.6	65.7	26.0	21.8	14.2	11.9	10.0	11.2	8.9	8.2
<b>South-eastern Europe</b>	217.6	32.7	24.7	30.2	26.5	12.9	8.1	7.5	7.0	6.9	5.3
Albania	33.2	20.6	0.4	0.0	3.1	5.5	2.6	2.3	2.4	2.8	2.5
Bosnia and Herzegovina	11.8	4.9	-0.6	1.7	1.8	0.9	0.2	-0.4	2.5	3.0	6.0
Bulgaria	1058.4	18.7	2.6	10.3	7.4	5.8	2.2	6.4	5.0	7.1	5.1
Croatia	4.1	6.4	3.7	5.4	4.6	1.7	1.5	2.1	3.3	3.4	2.7
Romania	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11.9	9.0	8.0	5.8
Serbia and Montenegro <sup>d</sup>	23.2	30.4	44.1	77.5	90.4	19.3	9.6	10.4	15.4	14.0	10.0
The former Yugoslav Republic of Macedonia	1.3	0.6	-1.3	6.6	5.2	2.3	1.1	1.0	0.0	3.0	2.6
<b>Commonwealth of Independent States</b>	19.5	25.1	76.2	24.9	20.6	14.5	12.9	10.7	12.3	9.4	9.0
<b>Net fuel exporters</b>	18.4	25.3	75.8	20.0	20.4	15.2	13.3	10.7	12.4	9.6	8.9
Azerbaijan	3.6	-0.8	-8.6	1.8	1.6	2.8	2.1	6.7	9.6	10.0	9.5
Kazakhstan	17.4	7.2	8.3	13.2	8.4	5.8	6.4	6.9	7.6	9.0	8.5
Russian Federation	14.8	27.7	85.7	20.8	21.5	15.8	13.7	10.9	12.7	9.5	8.7
Turkmenistan	112.0	16.7	23.5	7.0	8.2	15.0	15.3	10.0	12.0	9.0	8.5
Uzbekistan	58.8	17.7	29.0	25.0	26.6	21.6	19.0	14.2	15.0	10.5	12.5
<b>Net fuel importers</b>	26.6	23.6	79.0	54.8	21.7	10.2	10.3	10.5	11.6	8.3	9.6
Armenia	13.9	8.7	0.7	-0.8	3.1	1.1	4.8	5.8	0.6	1.5	3.0
Belarus	63.9	73.2	293.7	168.9	61.4	42.8	28.5	18.3	10.4	8.5	9.5
Georgia	7.1	3.6	19.2	4.1	4.6	5.6	4.8	5.7	8.2	9.5	7.5
Kyrgyzstan	23.4	10.5	35.9	19.7	6.9	2.1	3.0	4.1	4.4	6.2	5.5
Moldova	11.8	6.6	45.9	31.3	9.8	5.3	11.8	12.5	12.0	12.5	10.5
Tajikistan	85.4	43.1	27.4	32.8	38.6	12.2	16.3	7.2	7.2	7.5	5.0
Ukraine	15.9	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5	8.5	10.5

Source: UN/DESA, based on data of Economic Commission for Europe (ECE).

a Data for country groups are weighted averages, where weights for each year are based on GDP in 2000, in United States dollars.

b Partly estimated.

c Forecasts, based in part on Project LINK.

d The membership of Serbia and Montenegro in the United Nations was continued by Serbia as of 3 June 2006. On 28 June 2006, the General Assembly admitted Montenegro as the 192<sup>nd</sup> Member State of the United Nations.

Table A.6  
 Developing economies: consumer price inflation, 1997-2007 (average percentage change<sup>a</sup>)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
<b>Developing countries by region</b>	10.3	10.3	6.9	5.9	5.8	6.4	6.4	5.3	5.0	5.1	5.1
<b>Africa</b>	9.4	6.3	7.1	9.9	9.3	5.8	5.8	6.3	5.3	6.1	5.3
North Africa	4.2	3.9	2.5	2.0	2.5	2.4	3.3	6.9	3.1	5.3	4.4
Sub-Saharan Africa (excluding Nigeria and South Africa)	19.2	8.4	17.3	27.8	20.4	5.4	7.0	5.7	7.7	7.0	5.1
Net fuel exporters	5.7	5.5	3.2	3.3	6.5	4.7	5.9	10.3	5.7	6.6	6.3
Net fuel importers	12.3	7.0	10.1	14.9	11.5	6.8	5.9	3.5	5.1	5.7	4.6
<b>East and South Asia</b>	5.6	8.2	3.3	2.6	3.2	3.1	3.7	4.6	4.2	4.6	4.5
East Asia	3.7	6.2	1.1	1.0	2.2	1.5	2.1	3.4	2.9	2.9	3.0
South Asia	11.0	14.0	10.2	7.7	6.4	7.8	8.4	8.2	8.1	9.4	8.9
Net fuel exporters	16.0	16.7	18.5	12.9	10.2	13.2	15.2	14.0	12.8	14.5	14.5
Net fuel importers	4.4	7.3	1.7	1.5	2.5	2.0	2.4	3.6	3.3	3.5	3.4
<b>Western Asia</b>	27.7	26.3	19.9	16.1	16.8	14.9	8.3	4.3	4.8	5.1	6.9
Net fuel exporters	0.8	-0.2	-1.2	-1.2	0.3	0.5	0.7	1.9	2.6	2.7	2.6
Net fuel importers	54.6	52.8	40.9	33.4	33.3	29.3	15.8	6.6	7.0	7.4	11.2
<b>Latin America and the Caribbean</b>	13.6	10.0	9.2	7.7	5.9	10.2	11.1	6.8	6.6	5.7	5.8
South America	10.7	7.6	6.1	7.0	5.6	12.9	14.1	7.0	7.7	6.6	6.6
Mexico and Central America	19.4	15.0	15.4	9.2	6.4	5.1	4.6	4.9	4.5	3.8	4.3
Caribbean	8.6	5.8	5.7	7.2	7.9	5.5	18.9	29.1	7.9	8.8	7.7
Net fuel exporters	24.5	19.3	17.4	12.0	8.0	7.8	8.7	7.2	5.8	5.0	5.8
Net fuel importers	5.8	3.5	3.3	4.7	4.4	11.9	12.8	6.5	7.1	6.2	5.9
<i>Memorandum items:</i>											
Least developed countries	21.3	18.8	19.1	22.0	19.9	16.2	13.8	7.1	8.8	11.0	13.3
East Asia (excluding China)	4.4	11.5	2.9	1.4	3.3	3.2	2.8	3.0	3.8	4.2	3.7
South Asia (excluding India)	14.9	14.8	15.6	11.3	9.2	11.3	12.9	12.7	12.0	13.3	12.8
Western Asia (excluding Israel and Turkey)	0.9	0.0	-0.9	-1.0	0.6	0.8	1.0	2.2	2.9	3.1	2.9
<b>Major developing economies</b>											
Argentina	0.5	0.9	-1.2	-0.9	-1.1	25.9	13.4	4.4	9.6	11.0	10.6
Brazil	6.9	3.2	4.9	7.1	6.8	8.5	14.7	6.6	6.8	4.3	4.0
Chile	6.1	5.1	3.3	3.8	3.6	2.5	2.8	1.1	3.1	3.7	3.4
China	2.8	-0.8	-1.4	0.4	0.7	-0.8	1.2	3.9	1.8	1.3	2.0
Colombia	18.5	18.7	10.9	9.2	8.0	6.3	7.1	5.9	5.0	4.5	4.0
Egypt	4.6	3.9	3.1	2.7	2.3	2.7	4.5	11.3	4.9	7.3	5.8
Hong Kong SAR <sup>d</sup>	5.8	2.8	-3.9	-3.7	-1.7	-3.2	-2.1	-0.1	1.2	1.5	1.7
India	7.2	13.2	4.7	4.0	3.7	4.3	3.9	3.7	4.2	5.6	4.9
Indonesia	6.2	58.4	20.5	3.7	11.5	11.9	6.8	6.1	10.5	13.3	7.0
Iran, Islamic Republic of	17.3	17.9	20.1	14.4	11.3	14.3	16.5	14.8	13.4	15.3	15.4
Israel	9.0	5.4	5.2	1.1	1.1	5.6	0.7	-0.4	1.3	2.7	2.5
Korea, Republic of	4.4	7.5	0.8	2.3	4.1	2.8	3.5	3.6	2.7	2.5	2.8



Table A.6 (continued)

Developing economies: consumer price inflation, 1997–2007 (average percentage change<sup>a</sup>)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Malaysia	2.7	5.3	2.7	1.5	1.4	1.8	1.1	1.5	3.0	3.5	3.2
Mexico	20.6	15.9	16.6	9.5	6.4	5.0	4.5	4.7	4.0	3.4	4.0
Nigeria	8.2	10.3	4.8	8.8	18.8	13.0	14.0	19.4	13.5	10.2	11.3
Pakistan	11.4	6.2	4.1	4.4	3.1	3.3	2.9	7.4	9.1	8.5	6.5
Peru	8.6	7.2	3.5	3.8	2.0	0.2	2.3	3.7	1.6	2.1	2.4
Philippines	5.6	9.3	5.9	4.0	6.8	3.0	3.5	6.0	7.6	6.9	4.6
Saudi Arabia	0.1	-0.4	-1.3	-1.1	-1.1	0.2	0.6	0.3	0.7	1.0	1.0
Singapore	2.0	-0.3	0.0	1.4	1.0	-0.4	0.5	1.7	0.4	1.0	1.1
South Africa	8.6	6.9	5.2	5.3	5.7	9.2	5.8	1.4	3.5	5.0	4.7
Taiwan Province of China	0.9	1.7	0.2	1.3	0.0	-0.2	-0.3	1.6	2.3	1.4	1.5
Thailand	5.6	8.1	0.3	1.6	1.6	0.6	1.8	2.8	4.5	5.1	4.1
Turkey	85.7	84.6	64.9	54.9	54.4	45.0	25.3	10.6	10.1	9.9	16.6
Venezuela, Bolivarian Republic of	50.0	35.8	23.6	16.2	12.5	22.4	31.1	21.8	16.0	13.5	16.1

Source: UN/DESA, based on IMF, *International Financial Statistics*.

<sup>a</sup> Data for country groups are weighted averages, where weights are based on GDP in 2000 prices and exchange rates.

<sup>b</sup> Partly estimated.

<sup>c</sup> Forecasts, based in part on Project LINK.

<sup>d</sup> Special Administrative Region of China.

Table A.7  
 Developed economies: unemployment rates,<sup>a,b</sup> 1997-2007 (percentage of labour force)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>c</sup>	2007 <sup>d</sup>
<b>Developed economies</b>											
United States	4.9	4.5	4.2	4.0	4.7	5.8	6.0	5.5	5.1	4.8	5.0
Canada	9.1	8.3	7.6	6.8	7.2	7.7	7.6	7.2	6.8	6.4	6.5
Japan	3.4	4.1	4.7	4.7	5.0	5.4	5.3	4.7	4.4	4.1	4.1
Australia	8.3	7.7	6.9	6.3	6.8	6.4	6.1	5.5	5.1	4.9	4.7
New Zealand	6.6	7.4	6.8	6.0	5.3	5.2	4.6	3.9	3.7	3.8	3.8
<b>European Union</b>											
<b>EU-15</b>	<b>9.8</b>	<b>9.2</b>	<b>8.5</b>	<b>7.6</b>	<b>7.2</b>	<b>7.6</b>	<b>8.0</b>	<b>8.1</b>	<b>7.9</b>	<b>7.5</b>	<b>7.0</b>
Euro Zone	10.5	10.0	9.1	8.2	7.8	8.2	8.8	8.9	8.7	8.0	7.6
Austria	4.4	4.5	4.0	3.6	3.6	4.2	4.3	4.9	5.2	4.8	4.9
Belgium	9.2	9.3	8.5	6.9	6.6	7.5	8.2	8.4	8.4	8.1	7.6
Finland	12.7	11.3	10.2	9.8	9.1	9.1	9.0	8.9	8.4	7.8	7.5
France	11.5	11.1	10.5	9.1	8.4	8.9	9.5	9.6	9.8	9.3	9.1
Germany	9.2	8.8	7.9	7.2	7.4	8.2	9.3	9.6	9.5	8.7	8.0
Greece	9.6	11.1	12.0	11.3	10.8	10.3	9.7	10.5	9.9	9.2	8.8
Ireland	9.9	7.5	5.7	4.3	4.0	4.5	4.7	4.5	4.3	4.2	4.1
Italy	11.2	11.3	11.0	10.1	9.1	8.6	8.4	8.0	7.7	7.7	7.6
Luxembourg	2.7	2.7	2.4	2.3	2.1	2.8	3.7	5.1	4.5	4.9	5.0
Netherlands	4.9	3.8	3.2	2.8	2.2	2.8	3.7	4.6	4.7	3.6	2.8
Portugal	6.8	5.1	4.5	4.0	4.0	5.0	6.3	6.7	7.6	7.5	7.1
Spain	16.7	15.0	12.5	11.1	10.3	11.1	11.1	10.7	9.2	8.0	7.1
Other	7.0	6.3	5.9	5.3	4.9	5.0	5.0	5.0	5.1	5.2	5.0
Denmark	5.3	4.9	5.1	4.3	4.5	4.6	5.4	5.5	4.8	3.7	3.6
Sweden	9.9	8.2	6.7	5.6	4.9	4.9	5.6	6.3	7.8	7.3	6.5
United Kingdom	6.8	6.1	5.9	5.4	5.0	5.1	4.9	4.7	4.7	5.0	4.9
<b>EU-10</b>											
<b>EU-8</b>											
Czech Republic	4.8	6.4	8.6	8.7	8.0	7.3	7.8	8.3	7.9	7.4	7.0
Estonia <sup>e</sup>	9.6	9.2	11.3	12.8	12.4	10.3	10.0	9.7	7.9	7.0	6.8
Hungary	9.0	8.4	6.9	6.4	5.7	5.8	5.9	6.1	7.2	7.6	8.0
Latvia <sup>e</sup>	15.2	14.3	14.0	13.7	12.9	12.2	10.5	10.4	9.0	8.0	7.6
Lithuania <sup>e</sup>	..	13.2	13.7	16.4	16.5	13.5	12.4	11.4	8.3	8.0	7.8
Poland	10.9	10.2	13.4	16.1	18.2	19.9	19.6	19.0	17.7	15.0	14.5
Slovakia	11.9	12.6	16.3	18.8	19.3	18.7	17.6	18.2	16.4	15.0	14.0
Slovenia <sup>e</sup>	6.9	7.4	7.3	6.7	6.2	6.3	6.7	6.3	6.3	6.1	5.8
Other											
Cyprus	4.8	4.8	5.1	4.8	3.9	3.6	4.1	4.7	5.3	5.4	5.2
Malta	7.4	7.5	7.8	6.7	7.6	7.5	7.6	7.4	7.3	7.6	7.5

Table A.7 (continued)

Developed economies: unemployment rates,<sup>a,b</sup> 1997-2007 (percentage of labour force)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>c</sup>	2007 <sup>d</sup>
Other Europe	4.1	3.4	3.1	2.9	3.0	3.4	4.3	4.4	4.4	3.8	3.7
Iceland <sup>e</sup>	3.9	2.7	2.0	2.3	2.3	3.3	3.4	3.1	2.6	2.1	2.7
Norway	4.0	3.2	3.3	3.4	3.6	3.9	4.5	4.4	4.6	3.4	3.3
Switzerland	4.2	3.6	3.0	2.7	2.6	3.2	4.2	4.4	4.4	4.1	4.0
<i>Memorandum item:</i>											
Major developed economies	6.4	6.2	6.0	5.6	6.0	6.7	6.9	6.7	6.4	6.1	6.0

**Source:** UN/DESA, based on data of OECD and Economic Commission for Europe (ECE).

- a** Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Organization (see OECD, *Standardized Unemployment Rates: Sources and Methods* (Paris, 1985)).
- b** Data for country groups are weighted averages, where labour force is used for weights.
- c** Partly estimated.
- d** Forecasts, based in part on Project LINK.
- e** Not standardized.

Table A.8.  
Economies in transition and developing economies: unemployment rates,<sup>a</sup> 1997-2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
<b>South-eastern Europe</b>											
Albania <sup>d</sup>	14.9	17.7	18.4	16.8	16.4	15.8	15.0	14.4	14.2	13.9	13.6
Bosnia and Herzegovina <sup>d</sup>	39.0	38.7	39.0	39.4	39.9	42.7	44.0	44.9	46.6	46.0	45.0
Bulgaria	14.4	14.1	15.7	16.9	19.7	17.8	13.7	12.0	10.1	9.0	8.0
Croatia	9.9	11.4	13.6	16.1	15.8	14.8	14.3	13.8	12.7	12.0	11.0
Romania	5.3	5.4	6.2	6.8	6.6	7.5	6.8	7.6	7.7	8.0	8.6
Serbia and Montenegro <sup>d,e</sup>	25.6	27.2	27.4	26.6	27.9	26.0	28.0	28.0	30.0	30.0	28.0
The former Yugoslav Republic of Macedonia	..	..	32.4	32.2	30.5	31.9	36.7	37.2	37.3	36.5	36.0
<b>Commonwealth of Independent States</b>											
<b>Net fuel exporters</b>											
Azerbaijan <sup>d</sup>	1.3	1.4	1.2	1.2	1.3	1.3	1.4	1.4	1.4	1.3	1.3
Kazakhstan	..	..	..	12.8	10.4	9.3	8.8	8.4	8.1	7.4	7.3
Russian Federation	10.8	11.9	12.9	10.5	9.0	8.0	8.6	8.2	7.6	6.7	6.4
Turkmenistan <sup>d</sup>	..	..	..	..	..	..	..	..	..	..	..
Uzbekistan <sup>d</sup>	0.3	0.4	0.4	0.4	0.4	0.4	0.3	..	..	..	..
<b>Net fuel importers</b>											
Armenia <sup>d</sup>	11.0	8.9	11.5	10.9	9.8	9.1	10.1	9.0	7.6	7.6	7.4
Belarus <sup>d</sup>	2.8	2.3	2.1	2.1	2.3	3.0	3.1	1.9	1.5	1.4	1.3
Georgia	7.6	14.5	13.8	10.3	11.1	12.6	11.5	12.6	..	..	..
Kyrgyzstan <sup>d</sup>	3.1	3.1	3.0	3.1	3.2	3.1	2.9	2.9	3.3	3.4	3.3
Moldova <sup>d</sup>	..	..	..	8.5	7.3	6.8	7.9	8.1	7.3	6.4	6.4
Tajikistan <sup>d</sup>	2.8	3.2	3.0	2.7	2.3	2.6	2.3	2.0	2.1	2.0	2.0
Ukraine	..	..	11.6	11.6	10.9	9.6	9.1	8.6	7.2	6.8	6.4
<b>Africa</b>											
Algeria	..	..	..	..	27.3	..	23.7	17.7	15.3	..	..
Botswana	..	20.8	..	15.8	19.6	..	23.8	..	..	..	..
Egypt	8.4	8.2	8.1	9.0	9.2	10.2	11.0	10.3	11.2	11.3	..
Mauritius	6.6	6.9	7.7	8.8	9.1	9.7	10.2	8.5	9.6	..	..
Morocco	..	..	13.9	13.6	12.5	11.6	11.4	10.8	11.0	10.0	..
South Africa	..	..	..	25.4	27.9	30.1	29.6	27.1	26.5	26.6	..
Tunisia	15.7	..	15.8	15.6	15.1	15.3	14.5	14.2	14.2	..	..
<b>Developing America</b>											
Argentina <sup>f,g</sup>	14.9	12.9	14.3	15.1	17.4	19.7	17.3	13.6	11.6	10.4	..
Barbados	14.5	12.3	10.4	9.2	9.9	10.3	11.0	9.8	9.1	8.1	..

Table A.8 (continued)

Economies in transition and developing economies: unemployment rates,<sup>a</sup> 1997-2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Bolivia <sup>f</sup>	4.4	6.1	7.2	7.5	8.5	8.7	9.2	6.2	8.2	..	..
Brazil <sup>h,i</sup>	5.7	7.6	7.6	7.1	6.2	11.7	12.3	11.5	9.8	10.1	..
Chile	6.1	6.4	10.1	9.7	9.9	9.8	9.5	10.0	9.2	7.9	..
Colombia <sup>l</sup>	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4	14.0	13.0	..
Costa Rica	5.9	5.4	6.2	5.3	5.8	6.8	6.7	6.7	6.9	6.0	..
Dominican Republic	16.0	14.4	13.8	13.9	15.6	16.1	16.7	18.4	18.0	16.4	..
Ecuador <sup>k</sup>	9.3	11.5	14.4	14.1	10.4	8.6	9.8	11.0	10.7	10.1	..
El Salvador	7.5	7.6	6.9	6.5	7.0	6.2	6.2	6.5	7.3	5.7	..
Guatemala	...	...	...	...	...	5.4	5.2	4.4	...	...	..
Honduras	5.8	5.2	5.3	...	5.9	6.1	7.6	8.0	6.5	5.2	..
Jamaica	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7	11.3	11.2	..
Mexico <sup>l</sup>	5.4	4.7	3.7	3.4	3.6	3.9	4.6	5.3	4.7	4.6	..
Nicaragua	14.3	13.2	10.7	7.8	11.3	11.6	10.2	9.3	7.0	...	..
Panama	15.4	15.5	13.6	15.2	17.0	16.5	15.9	14.1	12.1	10.4	..
Paraguay <sup>f</sup>	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0	7.6	...	..
Peru <sup>f,m</sup>	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4	9.6	8.5	..
Trinidad and Tobago	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.4	8.0	6.8	..
Uruguay <sup>f</sup>	11.5	10.1	11.3	13.6	15.3	17.0	16.9	13.1	12.2	11.6	..
Venezuela (Bolivarian Republic of)	11.4	11.3	15.0	13.9	13.3	15.8	18.0	15.3	12.4	9.8	..
<b>Developing Asia</b>											..
China	3.0	3.1	3.1	3.1	3.6	4.0	4.3	4.2	4.2	4.1	..
Hong Kong SAR <sup>n</sup>	2.2	4.7	6.2	4.9	5.1	7.3	7.9	6.8	5.6	4.9	..
India	2.6	3.6	..	4.3	..	..	..	5.0	..	..	..
Indonesia	4.7	5.5	6.4	6.1	8.1	9.1	9.6	9.9	10.3	..	..
Iran (Islamic Republic of)	13.1	12.4	13.5	14.2	14.2	12.8	..	10.3	11.5	..	..
Israel	..	8.6	8.5	8.9	9.4	10.3	10.7	10.4	9.0	8.6	..
Jordan	..	..	..	13.7	14.7	14.4	14.8	12.5	14.8	14.4	..
Korea, Republic of	2.6	6.8	6.3	4.4	4.0	3.3	3.6	3.7	3.7	3.5	..
Kuwait	0.7	0.7	0.7	0.8	0.8	1.1	1.3	1.7	..	..	..
Malaysia	2.5	3.2	3.4	3.0	3.5	3.5	3.6	3.5	3.5	3.6	..
Pakistan	6.1	5.9	5.9	7.8	7.8	8.3	8.3	7.7	7.7	..	..
Palestinian Occupied Territory	20.3	14.4	11.8	14.1	25.2	31.2	25.4	26.7	23.5	..	..
Philippines <sup>o,p</sup>	7.9	9.6	9.6	10.1	9.8	10.2	10.2	10.9	7.4	8.1	..
Singapore <sup>q</sup>	2.0	3.5	3.8	3.7	3.7	4.8	5.2	4.4	4.1	3.5	..
Sri Lanka	10.7	10.6	9.1	8.0	7.7	8.7	9.2	8.5	7.7	..	..

Table A.8 (continued)

Economies in transition and developing economies: unemployment rates,<sup>a</sup> 1997-2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>c</sup>
Taiwan Province of China	2.7	2.7	2.9	3.0	4.6	5.2	5.0	4.4	4.1	3.9	..
Thailand	0.9	3.4	3.0	2.4	2.6	1.8	1.5	1.5	1.4	..	..
Turkey	6.7	6.8	7.7	6.5	8.4	10.3	10.5	10.3	10.2	10.3	..
Vietnam	2.9	2.3	2.3	2.3	2.8	2.1	2.3	2.1	..	..	..

**Sources:** UN/DESA, based on data of Economic Commission for Europe (ECE); ILO LABORSTAT database and KILM 4th edition; Economic Commission for Latin America and the Caribbean (ECLAC); Asian Development Bank (ADB) Asian Development Outlook 2006; national sources.

**a** As percentage of labour force.

**b** Partly estimated.

**c** Forecasts.

**d** End-of-period registered unemployment data (as percentage of labour force).

**e** The membership of Serbia and Montenegro in the United Nations was continued by Serbia as of 3 June 2006. On 28 June 2006, the General Assembly admitted Montenegro as the 192<sup>nd</sup> Member State of the United Nations.

**f** Urban areas.

**g** Break in series: new methodology starting in 2003.

**h** 6 main cities.

**i** Break in series: new methodology starting in 2002.

**j** 13 main cities.

**k** Covers Quito, Guayaquil and Cuenca from 2000.

**l** 32 cities.

**m** Metropolitan Lima.

**n** Special Administrative Region of China.

**o** Philippines definition: this adopts partly the ILO definition, that is to say, it does not include one ILO criterion which is "currently available for work".

**p** Break in series: new methodology starting in 2005.

**q** Resident unemployment rate.

Table A.9  
Major developed economies: quarterly indicators of growth, unemployment and inflation, 2004-2006

	2004 quarters				2005 quarters				2006 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
<i>Growth of gross domestic product<sup>a</sup> (percentage change in seasonally adjusted data from preceding quarter)</i>											
Canada	4.1	4.4	4.1	2.1	2.2	3.4	3.2	2.6	3.8	2.0	1.7
France	2.3	2.9	0.7	2.5	0.3	-0.2	3.1	0.7	2.0	4.8	-0.1
Germany	1.5	-0.4	-0.6	0.1	2.6	1.1	2.1	1.1	3.2	4.4	2.6
Italy	1.5	1.4	0.8	-1.7	-1.6	2.6	1.2	-0.1	2.7	2.2	1.3
Japan	2.6	-1.7	1.4	-0.7	5.3	5.1	2.0	4.1	3.2	1.5	2.0
United Kingdom	2.9	3.7	1.5	2.4	0.9	1.8	2.1	2.7	2.6	2.8	2.8
United States	3.8	4.0	3.1	2.6	3.4	3.3	4.2	1.8	5.6	2.6	2.2
Major developed economies	3.1	2.2	2.1	1.4	3.1	3.1	3.1	2.2	4.2	2.6	2.0
Euro zone	3.0	1.3	0.9	0.8	1.6	1.5	2.6	1.4	3.4	4.0	2.1
<i>Unemployment rate<sup>b</sup> (percentage of total labour force)</i>											
Canada	7.3	7.2	7.1	7.1	7.0	6.8	6.8	6.5	6.4	6.2	6.4
France	9.6	9.5	9.5	9.6	9.7	9.9	10.0	9.8	9.6	9.3	9.0
Germany	9.4	9.5	9.7	9.6	9.7	9.7	9.5	9.3	8.8	8.3	8.5
Italy	8.2	8.1	7.9	7.9	7.8	7.7	7.5	7.8	7.2	6.8	..
Japan	4.9	4.7	4.8	4.5	4.6	4.3	4.3	4.5	4.2	4.1	4.1
United Kingdom	4.7	4.7	4.6	4.6	4.6	4.7	4.7	5.0	5.2	5.5	5.6
United States	5.7	5.6	5.5	5.4	5.3	5.1	5.0	5.0	4.7	4.7	4.7
Major developed economies	6.4	6.3	6.3	6.2	6.2	6.1	6.0	6.0	5.8	5.6	..
Euro zone	8.9	8.9	8.9	8.8	8.8	8.7	8.6	8.5	8.1	7.8	7.8
<i>Change in consumer prices<sup>c</sup> (percentage change from preceding quarter)</i>											
Canada	1.9	4.8	0.7	1.7	1.4	3.8	3.7	0.2	2.0	4.6	0.2
France	2.1	3.7	0.6	1.9	0.6	3.6	1.4	0.9	1.2	4.2	0.5
Germany	3.1	2.7	1.5	0.6	2.2	2.5	3.3	1.1	1.0	2.7	1.5
Italy	2.3	3.1	1.7	0.9	2.0	2.8	2.4	1.4	2.0	3.1	2.2
Japan	-0.9	1.1	0.2	1.7	-2.7	0.5	-0.7	0.0	-0.4	1.7	1.1
United Kingdom	2.0	5.6	2.4	3.8	1.0	4.9	1.5	2.1	1.1	7.1	3.5
United States	3.8	5.7	1.5	2.6	2.6	5.5	4.7	2.1	2.1	7.1	2.1
Major developed economies	2.3	4.1	1.2	2.1	1.0	3.8	2.8	1.4	1.3	5.0	1.7
Euro zone	1.1	5.3	0.4	2.2	0.4	5.2	1.4	2.5	0.4	5.4	0.4

Sources: UN/DESA, based on data of IMF, *International Financial Statistics*; Organisation for Economic Cooperation and Development (OECD) and national authorities.

- a Expressed as annualized rate. Major developed economies is calculated as a weighted average, where weights are based on annual GDP in 2000 prices and exchange rates.
- b Seasonally adjusted data as standardized by OECD.
- c Expressed as annualized rate. Major developed economies is calculated as a weighted average, where weights are based on 2000 GDP in United States dollars.

Table A.10  
Selected economies in transition: quarterly indicators of growth and inflation, 2004-2006 (percentage)

	2004 quarters				2005 quarters				2006 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
Rates of growth of gross domestic product <sup>a</sup>											
Armenia	7.8	10.5	11.9	10.0	7.8	11.6	13.1	18.4	8.0	14.0	..
Belarus	9.8	11.5	12.2	11.8	9.8	8.2	8.5	10.5	11.1	9.6	..
Bulgaria	4.7	5.5	6.2	6.3	5.9	6.5	4.6	5.5	5.6	6.6	..
Croatia	4.2	3.8	3.6	3.6	1.8	5.1	5.2	4.8	6.0	3.6	..
Georgia	6.3	7.3	5.2	4.9	5.6	10.6	11.8	8.9	8.4	..	..
Kazakhstan	9.2	8.9	8.9	11.2	9.0	8.8	8.9	11.2	..	..	..
Kyrgyzstan	4.1	9.4	5.5	8.3	0.6	-1.7	-0.5	-0.7	2.4	..	..
Moldova	7.5	2.2	7.7	10.5	8.2	9.0	8.2	3.9	6.2	4.1	..
Romania <sup>b</sup>	6.2	6.6	7.9	8.4	6.0	5.1	4.0	4.1	6.9	7.4	..
Russian Federation	7.2	7.9	7.2	6.7	5.0	5.7	6.6	7.9	5.5	7.4	..
Ukraine	12.9	12.7	14.2	9.0	4.8	3.3	1.0	1.8	3.2	7.1	..
Change in consumer prices <sup>a</sup>											
Armenia	6.7	6.2	7.2	3.3	4.4	0.3	-1.8	-0.3	-0.9	2.9	..
Belarus	22.4	19.7	17.0	14.6	12.4	10.6	9.9	8.6	7.8	7.1	6.3
Bulgaria	7.1	6.8	6.8	4.7	3.8	4.9	4.8	6.7	8.1	8.3	..
Croatia	1.9	2.3	1.8	2.4	3.2	3.1	3.3	3.8	3.4	3.8	..
Georgia	5.9	4.9	5.5	6.4	9.4	9.4	7.0	7.3	..	..	..
Kazakhstan	6.4	6.7	7.3	7.0	7.0	7.7	8.0	7.6	8.5	9.0	..
Kyrgyzstan	5.3	2.9	5.6	2.6	2.6	5.0	4.5	5.2	6.2	5.7	..
Moldova	14.6	13.0	11.0	11.7	13.1	13.6	11.0	10.2	10.8	..	..
Romania	13.6	12.3	11.9	9.9	8.9	9.8	8.8	8.5	8.5	7.1	..
Russian Federation	10.6	10.2	11.0	11.7	13.1	13.7	12.7	11.3	10.9	9.4	..
Ukraine	7.4	7.3	9.6	11.8	13.6	14.6	14.5	11.6	9.7	7.2	8.0

Sources: UN/DESA, based on data of Economic Commission for Europe (ECE) and Eurostat.

<sup>a</sup> Percentage change from the corresponding period of the preceding year.

<sup>b</sup> Estimated from cumulative data.



Table A.11  
Major developing economies: quarterly indicators of growth, unemployment and inflation, 2004-2006

	2004 quarters				2005 quarters				2006 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
Rates of growth of gross domestic product <sup>a</sup>											
Argentina	11.3	7.3	8.7	9.1	8.0	10.2	9.2	9.2	8.8	7.9	..
Brazil	4.0	5.1	5.9	4.7	2.8	4.0	1.0	1.4	3.3	1.2	3.2
Chile	4.8	5.5	6.9	7.4	6.6	7.2	5.8	5.8	5.2	4.4	2.9
China	9.7	9.7	9.5	9.5	9.5	9.5	9.4	9.9	10.2	10.9	10.7
Colombia	5.9	5.8	3.7	4.1	4.5	5.9	6.7	3.9	5.5	6.0	..
Ecuador	7.5	12.0	7.6	4.9	4.6	4.7	4.4	5.3	5.5	4.8	..
Hong Kong SAR <sup>b</sup>	8.1	12.4	6.8	7.5	6.0	7.2	8.2	7.5	8.0	5.5	6.8
India	7.9	7.9	6.7	7.0	8.6	8.5	8.4	7.5	9.3	8.9	9.2
Indonesia	3.8	4.5	4.9	6.7	6.3	5.6	5.6	4.7	4.6	5.2	5.5
Israel	4.5	4.4	4.8	5.4	5.1	5.8	4.9	6.2	5.0	6.1	4.8
Korea, Republic of	5.3	5.9	4.9	2.9	2.6	3.2	4.5	5.3	6.1	5.3	4.8
Malaysia	8.0	8.6	6.8	5.9	6.1	4.1	5.3	5.2	5.9	6.2	5.8
Mexico	3.6	3.7	4.5	4.8	2.4	3.3	3.4	2.7	5.5	4.7	4.4
Philippines	6.7	7.4	6.6	5.6	4.2	5.4	4.8	5.3	5.7	5.8	4.8
Singapore	8.0	12.7	8.3	8.1	3.4	5.7	7.6	8.7	10.7	8.2	7.2
South Africa	3.5	3.9	5.5	6.3	6.1	4.9	4.8	4.7	4.4	4.3	4.5
Taiwan Province of China	7.6	9.0	5.5	2.5	2.5	2.9	4.2	6.4	4.9	4.6	5.0
Thailand	6.7	6.4	6.3	5.3	3.2	4.6	5.4	4.7	6.1	4.9	..
Turkey	13.9	15.7	5.7	6.6	7.5	4.7	8.0	10.2	6.4	8.5	..
Venezuela, Bolivarian Republic of	36.1	13.1	15.7	3.2	17.1	11.7	10.2	10.9	10.1	10.2	10.2
Unemployment rate <sup>c</sup>											
Argentina	14.4	14.8	13.2	12.1	13.0	12.1	11.1	10.1	11.4	10.4	..
Brazil	12.2	12.3	11.2	10.2	10.5	9.7	9.4	9.7	9.8	9.9	10.4
Chile	9.6	10.2	10.3	10.1	9.7	9.4	9.2	9.0	8.8	8.4	7.6
Colombia	15.3	14.1	12.8	12.1	13.4	12.0	11.5	10.2	12.6	11.4	12.8
Hong Kong SAR <sup>b</sup>	7.0	6.9	7.0	6.6	5.9	5.8	5.9	5.2	4.9	4.9	5.1
Israel	10.9	10.5	10.1	9.8	9.2	9.0	8.9	8.8	8.8	8.9	..
Korea, Republic of	4.0	3.5	3.6	3.6	4.2	3.7	3.6	3.5	3.9	3.4	3.3
Malaysia	3.8	3.7	3.4	3.3	3.5	3.1	3.8	3.8	3.8	3.4	..
Mexico	3.9	3.6	4.0	3.5	3.8	3.8	3.5	3.3	3.4	3.4	3.6
Philippines	11.0	13.7	11.7	10.9	11.3	12.7	10.9	7.4	8.1	8.2	..
Singapore	4.5	4.3	3.0	3.0	3.3	3.4	3.2	2.6	2.6	2.8	2.7
Taiwan Province of China	4.5	4.4	4.6	4.2	4.2	4.1	4.3	4.0	3.9	3.9	4.0
Thailand	2.9	2.5	1.5	1.5	2.6	2.1	1.4	1.5	1.8	1.7	1.2
Turkey	12.4	9.3	9.5	10.0	11.4	9.5	9.4	10.6	11.5	9.2	..
Uruguay	13.9	13.1	13.3	12.1	12.1	12.3	12.3	12.1	12.6	10.8	10.7
Venezuela, Bolivarian Republic of	17.3	16.1	15.0	15.3	14.3	12.1	12.1	10.5	11.0	10.0	10.1

Table A.11 (continued)

## Major developing economies: quarterly indicators of growth, unemployment and inflation, 2004-2006

	2004 quarters				2005 quarters				2006 quarters			
	I	II	III	IV	I	II	III	IV	I	II	III	
	Change in consumer prices <sup>a</sup>											
Argentina	2.4	4.1	5.4	5.7	8.2	8.8	9.8	11.7	11.6	11.4	10.6	
Brazil	6.8	5.5	6.9	7.2	7.4	7.8	6.2	6.1	5.5	4.3	3.8	
Chile	0.0	0.4	1.5	2.3	2.3	2.8	3.3	3.8	4.1	3.8	3.5	
China	2.8	4.4	5.3	3.6	2.8	1.7	1.3	1.4	1.2	1.4	1.3	
Colombia	6.2	5.6	6.0	5.7	5.2	5.0	4.9	5.1	4.3	4.0	4.5	
Ecuador	3.6	3.0	2.4	1.9	1.5	1.5	2.6	4.0	3.9	3.4	2.8	
Hong Kong SAR <sup>b</sup>	-1.8	-0.9	0.8	0.4	0.4	0.7	1.2	1.3	1.6	2.1	2.3	
India	4.0	2.7	4.2	4.2	4.2	4.0	3.7	5.0	4.5	5.9	5.9	
Indonesia	4.9	6.7	7.0	6.4	7.7	7.6	8.4	17.8	16.9	15.5	14.9	
Israel	-2.5	-0.7	0.6	1.0	0.8	0.3	1.7	2.6	3.1	3.6	2.0	
Korea, Republic of	3.3	3.3	4.3	3.4	3.1	3.0	2.4	2.5	2.4	2.3	2.3	
Malaysia	0.9	1.2	1.5	2.3	2.4	2.9	3.4	3.2	3.8	4.1	3.6	
Mexico	4.3	4.3	4.8	5.3	4.4	4.5	4.0	3.1	3.7	3.1	3.5	
Philippines	4.1	4.7	6.9	8.1	8.4	8.2	7.1	6.9	7.3	6.9	6.1	
Singapore	1.3	1.9	1.9	1.6	0.2	0.0	0.5	1.1	1.4	1.2	0.8	
South Africa	0.4	0.7	1.3	3.2	2.9	3.2	3.9	3.7	3.8	4.0	4.6	
Taiwan Province of China	0.5	1.2	2.9	1.9	1.6	2.1	3.0	2.5	1.4	1.5	-0.3	
Thailand	1.9	2.7	3.3	3.2	2.8	3.7	5.6	6.0	5.7	6.0	3.6	
Turkey	9.5	7.4	8.1	9.4	8.6	8.6	7.9	7.6	8.1	9.6	10.8	
Venezuela, Bolivarian Republic of	24.0	22.4	21.5	19.5	17.0	16.3	15.4	15.2	12.6	11.2	14.6	

Source: IMF, International Financial Statistics, and national authorities.

<sup>a</sup> Percentage change from the corresponding quarter of the previous year.

<sup>b</sup> Special Administrative Region of China.

<sup>c</sup> Reflects national definitions and coverage. Not comparable across economies.

Table A.12  
Major developed economies: financial indicators, 1997-2006 (percentage)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>
Short-term interest rates <sup>b</sup>										
Canada	3.3	4.9	4.7	5.5	4.1	2.5	2.9	2.2	2.8	4.8
France <sup>c</sup>	3.2	3.4	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.4
Germany <sup>c</sup>	3.2	3.4	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.4
Italy <sup>c</sup>	6.9	5.0	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.4
Japan	0.5	0.4	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.2
United Kingdom	6.6	7.2	5.2	5.8	5.1	3.9	3.6	4.3	4.7	5.6
United States	5.0	4.5	5.0	6.0	1.3	0.8	2.0	3.2	3.5	5.9
Long-term interest rates <sup>d</sup>										
Canada	6.4	5.5	5.7	5.9	5.8	5.7	5.3	5.1	4.1	5.1
France	5.6	4.7	4.7	5.5	5.0	4.9	4.2	4.2	3.4	4.5
Germany	5.1	4.4	4.3	5.2	4.7	4.6	3.8	3.8	3.4	4.4
Italy	6.9	4.9	4.7	5.6	5.2	5.0	4.2	4.3	3.6	4.8
Japan	1.7	1.1	1.8	1.7	1.3	1.3	1.0	1.5	1.4	2.0
United Kingdom	7.1	5.4	4.7	4.7	4.8	4.8	4.6	4.8	4.4	5.3
United States	6.4	5.3	5.6	6.0	5.0	4.6	4.0	4.3	4.3	5.7
General government financial balances <sup>e</sup>										
Canada	0.2	0.1	1.6	2.9	0.7	-0.1	-0.4	0.5	1.4	0.9
France	-3.0	-2.6	-1.7	-1.5	-1.5	-3.2	-4.2	-3.7	-2.9	-2.7
Germany	-2.6	-2.2	-1.5	1.3	-2.8	-3.7	-4.0	-3.7	-3.2	-2.3
Italy	-2.7	-2.8	-1.7	-0.8	-3.1	-2.9	-3.5	-3.4	-4.1	-4.7
Japan <sup>f</sup>	-4.1	-5.9	-7.5	-7.7	-6.4	-8.2	-8.0	-6.3	-5.3	-4.6
United Kingdom	-2.1	0.1	1.1	3.9	0.9	-1.7	-3.3	-3.2	-3.3	-2.9
United States	-0.8	0.4	0.9	1.6	-0.4	-3.8	-4.8	-4.6	-3.7	-2.3

Sources: UN/DESA, based on IMF, *International Financial Statistics*; OECD *Economic Outlook*; and EUROPA (EU on line), *European Economy*.

a Average for the first ten months.

b Money market rates.

c From January 1999 onward, representing the three-month Euro Interbank Offered Rate (EURIBOR), which is an interbank deposit bid rate.

d Yield on long-term government bonds.

e Surplus (+) or deficit (-) as a percentage of nominal GNP or GDP.

f The 1998 deficit does not take account of the assumption by the central Government of the debt of the Japan National Railway Settlement Corporation and the National Forest Special Account, which amounts to 5.2 percentage points of GDP. Deferred tax payments on postal savings accounts are included in 2000 and 2001.

Table A.13  
Selected economies: real effective exchange rates, broad measurement, <sup>a</sup> 1997-2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>
<b>Developed economies</b>										
Australia	109.1	100.2	101.7	100.0	95.2	98.8	111.4	121.6	129.7	136.2
Canada	107.1	102.1	101.3	100.0	96.2	94.7	102.9	104.6	108.4	112.5
Denmark	101.1	104.9	105.9	100.0	102.5	106.7	113.8	114.1	111.4	109.5
Euro zone	108.9	112.2	107.9	100.0	101.0	105.3	117.4	121.1	119.5	121.2
Japan	88.4	88.8	98.0	100.0	89.7	84.2	83.3	83.9	78.7	73.6
New Zealand	132.3	117.0	112.1	100.0	99.8	112.6	132.1	141.7	148.2	135.1
Norway	98.5	98.9	100.1	100.0	102.5	109.2	108.5	110.8	117.0	121.9
Sweden	108.2	109.2	105.0	100.0	91.3	94.2	97.8	97.3	94.1	94.3
Switzerland	102.3	106.8	106.5	100.0	103.1	109.7	111.1	108.7	104.5	99.9
United Kingdom	99.4	103.6	102.3	100.0	97.7	98.3	95.7	99.8	97.3	96.6
United States	90.8	98.7	98.9	100.0	106.2	105.8	97.5	91.7	89.5	86.5
<b>Developing economies</b>										
Argentina	93.8	96.3	102.6	100.0	105.0	55.5	62.1	60.7	60.1	58.0
Brazil	112.8	112.2	83.0	100.0	90.3	89.0	98.8	106.4	130.7	141.9
Chile	101.8	97.9	95.3	100.0	94.5	92.8	92.6	99.9	109.1	117.5
China	97.8	101.9	97.0	100.0	105.0	101.9	97.2	95.7	98.6	100.3
Colombia	125.0	119.7	107.8	100.0	101.2	98.8	88.3	95.8	105.6	102.2
Ecuador	84.5	82.0	76.6	100.0	100.9	110.3	112.4	112.8	120.4	137.6
Egypt	89.5	95.6	98.6	100.0	91.1	81.6	64.5	66.6	72.4	73.5
Hong Kong SAR <sup>c</sup>	105.2	114.2	106.2	100.0	101.8	100.9	94.8	89.8	86.8	83.8
India	102.8	69.7	106.4	100.0	97.0	118.0	124.0	114.1	116.5	143.4
Indonesia	134.8	97.8	98.5	100.0	102.5	98.6	98.2	99.5	102.7	98.2
Israel	95.5	94.1	93.8	100.0	99.2	88.9	87.6	85.2	86.4	86.7
Korea, Republic of	105.0	86.3	94.4	100.0	90.8	93.9	92.9	96.6	106.3	112.7
Kuwait	94.5	99.3	97.3	100.0	107.4	108.6	101.7	94.6	96.6	94.1
Malaysia	122.1	101.3	99.3	100.0	105.1	104.4	100.0	95.8	95.3	94.7
Mexico	82.2	81.8	90.4	100.0	105.7	105.3	98.7	97.8	103.5	105.6
Morocco	92.6	97.6	99.7	100.0	97.2	98.5	98.9	97.1	94.6	93.3
Nigeria <sup>d</sup>	172.4	196.1	98.8	100.0	111.1	111.0	105.0	107.8	123.8	133.8
Pakistan	106.2	101.6	99.8	100.0	95.5	100.2	101.2	100.5	103.4	106.0
Peru	107.3	107.6	99.4	100.0	103.9	103.6	99.5	99.2	99.1	98.7
Philippines	121.6	97.6	103.6	100.0	108.3	112.3	107.6	101.5	109.2	130.9
Saudi Arabia	96.1	101.8	99.3	100.0	103.6	101.7	93.9	87.4	85.3	83.6
Singapore	99.1	93.7	92.3	100.0	99.4	97.8	97.1	99.1	106.8	115.0

Table A.13 (continued)

Selected economies: real effective exchange rates, broad measurement,<sup>a</sup> 1997-2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>
South Africa	115.8	104.9	102.1	100.0	89.6	82.5	109.9	118.8	119.4	113.1
Taiwan Province of China	107.0	102.0	96.6	100.0	95.8	93.3	89.2	91.5	89.6	88.8
Thailand	109.0	100.6	102.9	100.0	97.0	100.6	100.4	100.9	103.6	111.9
Turkey	93.4	92.2	90.8	100.0	87.2	100.3	108.6	116.5	124.8	119.7
Venezuela, Bolivarian Rep. of	78.0	88.8	96.2	100.0	109.4	90.6	94.3	98.7	99.5	106.5

Sources: JPMorgan Chase and IMF *International Financial Statistics*.

- <sup>a</sup> Indices based on a "broad" measure currency basket of 18 OECD currencies (including the euro) and 30 developing-economy currencies (mostly Asian and Latin American). The real effective exchange rate, which adjusts the nominal index for relative price changes, gauges the effect on international price competitiveness of the country's manufactures due to currency changes and inflation differentials. A rise in the index implies a fall in competitiveness and vice versa. The relative price changes are based on indices most closely measuring the prices of domestically produced finished manufactured goods, excluding food and energy, at the first stage of manufacturing. The weights for currency indices are derived from 2000 bilateral trade patterns of the corresponding countries.
- <sup>b</sup> Average for the first ten months.
- <sup>c</sup> Special Administrative Region of China.
- <sup>d</sup> Data is from International Financial Statistics (IFS).

## II. International trade

Table A.14  
Indices of prices of primary commodities, 1997-2006

	Non-fuel commodities					Combined index		Manufactured export prices	Real prices of non-fuel commodities <sup>a</sup>	Memorandum item
	Food	Tropical beverages	Vegetable oilseeds and oils	Agricultural raw materials	Minerals and metals	Dollar	SDR			Crude petroleum <sup>b</sup>
1997	136	177	158	123	112	132	127	110	120	67.7
1998	118	150	170	108	91	114	112	110	104	44.5
1999	98	118	125	97	89	98	95	105	94	63.3
2000	100	100	100	100	100	100	100	100	100	100.0
2001	103	79	94	96	89	96	100	98	98	83.8
2002	102	89	117	94	87	97	99	99	98	88.3
2003	104	94	137	112	98	105	99	107	98	101.8
2004	119	100	155	123	137	126	112	115	110	130.6
2005	127	126	141	132	173	141	126	118	119	183.5
2003 I	108	101	133	105	93	105	101	104	101	110.7
II	101	93	130	107	92	101	95	108	93	93.7
III	99	92	128	111	97	101	96	107	95	99.2
IV	109	91	158	126	109	114	104	110	103	104.6
2004 I	118	99	175	130	133	126	112	114	111	111.4
II	124	95	162	120	134	127	115	114	111	124.7
III	116	99	143	119	137	123	111	115	107	141.6
IV	116	107	141	125	145	126	110	119	106	145.0
2005 I	129	132	139	126	165	139	121	122	114	159.7
II	125	132	144	129	167	138	122	119	116	178.8
III	125	120	139	137	173	140	126	117	119	204.4
IV	130	120	139	138	188	147	135	116	126	191.1
2006 I	151	136	137	149	220	167	153	118	142	209.0
II	155	129	141	162	285	188	168	121	155	234.6
III	148	133	149	155	301	189	168	...	...	238.4

Sources: UNCTAD, *Monthly Commodity Price Bulletin*; United Nations, *Monthly Bulletin of Statistics*; and Middle East Economic Survey, available from [http://www.mees.com/Energy\\_Tables/basket.htm](http://www.mees.com/Energy_Tables/basket.htm).

<sup>a</sup> Combined index of non-fuel commodity prices in dollars deflated by manufactured export price index.

<sup>b</sup> Composite price of the OPEC basket of seven crudes. Effective 16 June 2005, the OPEC basket is composed of 11 crudes.

Table A.15  
World oil supply and demand, 1998-2007

	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
World oil supply <sup>c,d</sup> (millions of barrels per day)	75.5	74.1	76.9	77.1	76.9	79.8	83.2	84.5	84.6	86.8
Developed economies	18.4	18.1	18.5	18.3	18.3	17.8	17.4	16.5	16.4	16.8
Economies in transition	7.5	7.7	8.1	8.7	9.6	10.5	11.4	11.8	12.2	12.7
Developing economies	48.0	46.7	48.6	48.3	47.3	49.7	52.6	54.2	54.2	55.4
OPEC	30.8	29.4	30.8	30.4	28.8	30.8	33.1	34.2	33.8	34.4
Non-OPEC	17.1	17.3	17.8	17.9	18.5	18.9	19.5	19.9	20.4	21.0
Processing gains <sup>e</sup>	1.6	1.7	1.7	1.7	1.8	1.8	1.8	1.9	1.9	1.9
World total demand <sup>f</sup>	73.5	75.4	76.2	77.3	77.7	79.3	82.4	83.5	84.6	86.0
Oil prices (dollars per barrel)										
OPEC Basket <sup>g</sup>	12.3	17.5	27.6	23.1	24.4	28.1	36.1	50.6	61.8	...
Brent Oil	12.7	17.8	28.3	24.4	25.0	28.9	38.3	54.4	64.1	60.0

Sources: United Nations, World Bank, International Energy Agency, U.S. Energy Information Administration, and *Middle East Economic Survey*, available from [http://www.mees.com/Energy\\_Tables/basket.htm](http://www.mees.com/Energy_Tables/basket.htm) (accessed on 24 November 2006).

a Partly estimated.

b Forecasts.

c Including crude oil, condensates, natural gas liquids (NGLs), oil from non-conventional sources and other sources of supply.

d Totals may not add up due to rounding.

e Net volume gains and losses in refining process (excluding net gain/loss in the economies in transition and China) and marine transportation losses.

f Including deliveries from refineries/primary stocks and marine bunkers, and refinery fuel and non-conventional oils.

g Data for 2006 is the January to September 2006 average. Effective 16 June 2005, the OPEC basket is composed of 11 crudes.

Table A.16

**World trade: changes in value and volume of exports and imports, by major country group, 1997-2007**  
(annual percentage change)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
<b>Dollar value of exports</b>											
<b>World</b>	3.6	-1.7	3.6	13.4	-3.7	4.7	16.1	21.2	14.6	15.5	11.7
Developed economies	2.5	1.1	1.8	7.3	-2.8	3.5	15.0	18.0	9.1	13.3	12.9
North America	10.0	-0.8	4.5	13.4	-6.6	-4.2	5.0	12.6	11.5	12.3	8.6
EU plus other Europe	-0.2	3.9	-0.1	3.5	1.1	6.5	18.9	19.3	8.3	14.0	14.3
Developed Asia	2.6	-8.5	7.0	14.0	-13.6	3.2	12.8	20.1	9.5	10.9	12.2
Economies in transition	-0.4	-11.6	-1.4	34.2	0.1	7.6	26.5	39.8	32.2	24.1	10.7
South-eastern Europe	-3.0	0.2	-6.5	16.6	6.7	14.5	25.6	32.6	27.0	19.2	11.7
Commonwealth of Independent States	0.0	-13.7	-0.4	37.7	-1.0	6.3	26.7	41.2	33.1	24.9	10.5
Developing economies	6.9	-7.8	8.7	27.3	-5.9	7.1	17.4	26.0	23.5	18.4	9.7
Latin America and the Caribbean	10.9	-3.5	5.8	19.7	-3.7	-0.2	10.3	22.9	27.2	19.1	3.0
Africa	-0.7	-17.2	12.6	26.1	-8.1	2.7	24.2	30.6	34.1	25.7	8.1
Western Asia	6.1	-19.6	24.8	81.4	-7.0	6.6	19.1	28.3	32.7	14.7	6.4
East and South Asia	3.9	-7.6	7.2	19.2	-9.7	6.0	12.0	21.3	14.0	14.6	11.2
China	21.0	0.5	6.1	27.8	6.8	22.4	34.6	35.4	28.4	24.5	15.0
<b>Dollar value of imports</b>											
<b>World</b>	3.9	-0.4	3.7	12.9	-3.4	3.5	16.2	21.9	13.6	15.3	11.2
Developed economies	2.4	3.1	5.0	10.3	-3.7	2.9	15.8	19.1	11.4	14.0	10.7
North America	10.6	4.5	11.5	17.6	-6.2	1.5	7.9	16.1	13.8	11.0	4.5
EU plus other Europe	-0.3	5.8	1.1	5.3	-1.3	4.2	20.2	20.5	9.9	14.6	14.2
Developed Asia	-2.4	-14.7	10.4	17.8	-8.3	-0.3	15.4	19.7	13.9	19.6	7.4
Economies in transition	5.4	-12.4	-21.0	14.8	14.5	12.2	25.7	31.2	25.0	21.4	14.4
South-eastern Europe	9.0	-0.6	-6.8	12.9	15.4	16.5	27.3	29.0	22.9	15.9	10.3
Commonwealth of Independent States	4.4	-16.1	-26.2	15.6	14.2	10.3	25.0	32.2	26.0	23.9	16.3
Developing economies	7.4	-7.7	2.7	19.7	-4.0	4.4	16.5	27.9	17.3	17.5	11.9
Latin America and the Caribbean	18.5	5.8	-2.4	15.8	-2.1	-8.5	2.9	22.4	24.5	18.2	8.6
Africa	8.0	1.4	-6.6	1.0	3.1	2.0	21.4	27.0	19.2	15.0	10.4
Western Asia	8.6	-4.2	2.1	21.7	0.0	7.0	16.3	31.7	14.7	18.1	10.3
East and South Asia	4.2	-16.3	4.1	20.6	-10.2	5.0	12.8	25.3	15.0	15.5	11.9
China	2.5	-1.5	18.2	35.8	8.2	21.2	39.8	36.0	17.6	21.5	16.0
<b>Volume of Exports</b>											
<b>World</b>	10.4	5.2	4.3	13.2	-0.8	4.1	5.3	10.2	7.3	10.0	7.7
Developed economies	11.0	4.3	4.4	12.6	-1.0	2.1	2.5	8.3	5.3	9.7	6.5
North America	12.8	1.9	3.5	14.0	-5.5	-2.4	0.5	6.8	6.2	8.3	7.7
EU plus other Europe	10.2	6.6	4.8	11.9	2.2	2.9	2.1	8.0	4.8	9.8	6.5
Developed Asia	11.2	-1.4	4.7	12.7	-6.6	6.8	7.9	12.1	6.2	11.6	4.9
Economies in transition	1.4	3.5	5.8	15.2	4.2	8.8	10.3	13.2	7.0	6.4	6.5
South-eastern Europe	1.2	2.9	-4.7	13.5	8.6	12.0	10.0	17.7	19.4	13.5	8.4
Commonwealth of Independent States	1.4	3.6	7.8	15.4	3.5	8.3	10.4	12.4	4.7	5.7	6.0



Table A.16 (continued)

**World trade: changes in value and volume of exports and imports, by major country group, 1997-2007**  
(annual percentage change)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>	2007 <sup>b</sup>
Developing economies	9.8	7.4	4.0	14.5	-1.0	7.9	10.6	13.6	10.9	10.8	9.8
Latin America and the Caribbean	11.5	13.7	0.5	4.6	0.2	0.9	6.1	11.5	7.9	8.9	7.1
Africa	4.9	15.3	3.1	-9.2	-1.9	1.0	9.2	10.0	11.6	12.8	14.9
Western Asia	9.9	1.2	7.9	37.2	2.9	6.0	5.7	5.3	4.3	-2.4	10.3
East and South Asia	6.9	4.9	3.8	15.3	-5.6	7.4	8.1	12.7	7.8	9.6	9.0
China	24.7	6.9	8.1	24.6	9.7	24.6	34.1	33.9	26.2	24.1	12.5
<b>Volume of Imports</b>											
World	9.2	3.0	6.1	13.8	-0.5	3.7	6.5	11.9	7.4	10.3	6.8
Developed economies	10.2	8.7	7.6	11.0	-0.7	2.5	4.4	9.2	6.1	9.1	5.2
North America	14.7	11.4	11.1	12.3	-3.6	3.2	4.7	10.4	6.9	5.9	3.5
EU plus other Europe	9.9	9.8	5.9	10.7	0.9	1.9	3.8	8.7	6.1	9.7	6.5
Developed Asia	1.3	-3.7	6.6	9.0	0.3	3.2	7.0	8.0	3.5	15.7	3.6
Economies in transition	2.1	-7.5	-18.4	21.8	15.2	11.4	13.9	17.0	13.3	17.2	11.5
South-eastern Europe	8.3	-5.1	-6.8	17.4	17.0	13.2	10.3	14.5	15.1	10.4	8.1
Commonwealth of Independent States	-0.1	-8.5	-22.9	23.9	14.4	10.6	15.6	18.1	12.5	20.2	12.9
Developing economies	7.8	-8.7	4.0	20.8	-1.0	6.4	11.0	17.7	9.7	12.3	9.6
Latin America and the Caribbean	18.2	4.7	-0.9	17.5	-0.4	-5.5	1.0	13.4	11.0	12.4	9.7
Africa	6.9	-0.8	-1.3	1.8	6.0	1.6	7.6	13.6	8.1	12.0	10.1
Western Asia	11.5	-5.5	4.0	22.9	2.4	6.8	6.7	18.7	7.1	8.1	7.0
East and South Asia	4.9	-16.2	4.6	20.3	-7.0	7.3	9.0	15.9	8.9	10.5	8.9
China	9.4	6.0	18.6	52.8	12.1	17.8	38.4	29.9	13.3	17.9	12.2

Sources: UN/DESA/STAT, ECA, ECE, ECLAC, ESCAP, ESCWA and IMF.

<sup>a</sup> Partly estimated.

<sup>b</sup> Forecasts, based in part on Project LINK.

### III. Global macroeconomic balances and international finance

Table A.17

Balance of payment on current account, by country or country group, summary table, 1997-2005 (billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Developed economies</b>	53.3	-61.2	-192.0	-324.5	-277.0	-301.9	-325.3	-392.4	-601.6
Japan	96.6	119.1	114.5	119.6	87.8	112.6	136.2	172.1	165.7
United States	-140.4	-213.5	-299.8	-415.2	-389.0	-472.4	-527.5	-665.3	-791.5
Europe <sup>a</sup>	122.0	61.5	17.5	-30.8	17.1	63.9	88.9	126.1	49.8
EU 15	102.2	52.0	1.9	-66.4	-13.1	34.4	39.4	76.6	-21.6
EU 10	-15.6	-16.2	-21.8	-20.2	-15.6	-18.1	-21.9	-34.2	-26.3
<b>Economies in transition</b>	-10.9	-13.3	19.0	44.3	27.3	23.0	25.5	46.9	68.0
South-eastern Europe	-4.5	-6.0	-4.8	-3.9	-5.9	-7.4	-10.5	-15.6	-19.6
Commonwealth of Independent States	-6.4	-7.4	23.8	48.3	33.2	30.3	36.0	62.4	87.7
<b>Developing economies</b>	-51.7	-17.7	36.0	96.3	78.3	129.2	227.1	290.6	475.6
Net fuel exporters	4.5	-51.9	7.2	91.4	42.6	29.9	79.2	127.7	256.2
Net fuel importers	-56.1	34.2	28.8	4.9	35.8	99.3	147.9	162.9	219.4
<b>Latin America and the Caribbean</b>	-65.0	-88.9	-55.6	-47.5	-52.6	-15.0	8.2	19.3	35.5
Net fuel exporters	-11.5	-28.7	-10.8	-5.1	-17.3	-8.7	2.7	8.0	23.0
Net fuel importers	-53.5	-60.2	-44.8	-42.4	-35.3	-6.2	5.5	11.3	12.5
<b>Africa</b>	-3.8	-22.2	-13.9	14.0	4.8	-6.5	3.9	10.3	37.0
Net fuel exporters	6.6	-9.8	-4.1	23.0	12.0	-0.4	13.8	26.1	58.6
Net fuel importers	-10.4	-12.4	-9.8	-9.0	-7.3	-6.1	-10.0	-15.9	-21.5
<b>Western Asia</b>	-0.1	-20.5	1.5	36.8	31.6	22.1	44.5	72.2	131.0
Net fuel exporters	10.6	-16.0	7.0	49.4	31.7	25.9	52.6	88.4	154.6
Net fuel importers	-10.8	-4.6	-5.5	-12.6	-0.1	-3.8	-8.1	-16.2	-23.6
<b>East and South Asia</b>	17.3	114.0	104.0	92.9	94.5	128.5	170.5	188.8	272.0
Net fuel exporters	-1.2	2.6	15.2	24.1	16.1	13.0	10.1	5.2	20.1
Net fuel importers	18.5	111.3	88.8	68.8	78.5	115.5	160.4	183.7	251.9
<b>World residual<sup>b</sup></b>	-9.3	-92.2	-137.0	-183.9	-171.3	-149.8	-72.7	-54.9	-58.0

Sources: International Monetary Fund (IMF), *World Economic Outlook, September 2006*, IMF Balance of Payments Statistics.

<sup>a</sup> Europe consists of EU 25 plus Iceland, Norway and Switzerland.

<sup>b</sup> Statistical discrepancy.

Table A.18  
**Balance of payment on current account, by country or country group, 1997-2005** (billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Developed economies</b>									
Trade balance	57.4	-18.7	-158.0	-292.9	-257.1	-257.7	-306.5	-412.7	-625.8
Services, net	90.9	82.3	82.3	77.5	71.2	88.9	102.6	143.9	175.8
Income, net	21.3	6.3	16.3	28.4	33.0	8.0	47.1	74.3	65.6
Current transfers, net	-116.3	-131.1	-132.7	-137.5	-124.0	-141.1	-168.5	-197.9	-217.2
Current-account balance	53.3	-61.2	-192.0	-324.5	-277.0	-301.9	-325.3	-392.4	-601.6
<b>Japan</b>									
Trade balance	99.7	120.9	121.3	114.9	69.2	92.5	104.0	128.5	93.9
Services, net	-52.4	-47.7	-52.2	-45.9	-42.7	-40.7	-31.4	-34.3	-24.1
Income, net	58.1	54.7	57.4	60.4	69.2	65.8	71.2	85.7	103.5
Current transfers, net	-8.8	-8.8	-12.1	-9.8	-7.9	-4.9	-7.5	-7.9	-7.6
Current-account balance	96.6	119.1	114.5	119.6	87.8	112.6	136.2	172.1	165.7
<b>United States</b>									
Trade balance	-198.1	-246.7	-346.0	-452.4	-427.2	-482.3	-547.3	-665.4	-782.7
Services, net	90.2	82.1	82.7	74.9	64.4	61.2	52.4	54.1	66.0
Income, net	12.6	4.3	13.9	21.1	25.1	12.2	36.6	27.6	11.3
Current transfers, net	-45.1	-53.2	-50.4	-58.7	-51.3	-63.6	-69.2	-81.6	-86.1
Current-account balance	-140.4	-213.5	-299.8	-415.2	-389.0	-472.4	-527.5	-665.3	-791.5
<b>Europe<sup>a</sup></b>									
Trade balance	134.7	95.4	48.6	3.6	51.9	100.8	112.1	93.3	25.8
Services, net	60.4	54.2	57.2	52.1	54.1	71.8	88.5	133.8	145.8
Income, net	-9.9	-18.6	-17.4	-16.5	-22.9	-36.0	-20.1	7.2	1.4
Current transfers, net	-63.2	-69.6	-70.9	-70.0	-66.1	-72.6	-91.6	-108.2	-123.2
Current-account balance	122.0	61.5	17.5	-30.8	17.1	63.9	88.9	126.1	49.8
<b>EU 15</b>									
Trade balance	148.5	123.1	66.1	7.2	51.1	95.3	104.4	81.4	-2.4
Services, net	34.6	28.0	32.8	24.0	27.7	46.3	60.3	99.2	106.8
Income, net	-19.1	-29.9	-28.7	-29.0	-27.9	-36.8	-35.2	3.4	-3.3
Current transfers, net	-61.8	-69.1	-68.3	-68.6	-63.9	-70.3	-90.1	-107.4	-122.7
Current-account balance	102.2	52.0	1.9	-66.4	-13.1	34.4	39.4	76.6	-21.6
<b>EU 10</b>									
Trade balance	-24.9	-27.4	-27.7	-26.7	-22.1	-21.4	-22.3	-25.2	-19.7
Services, net	10.9	11.6	8.1	9.1	9.4	7.9	7.0	9.3	11.6
Income, net	-5.0	-5.1	-6.2	-6.8	-7.6	-10.2	-13.5	-26.1	-27.8
Current transfers, net	3.4	4.7	4.1	4.1	4.7	5.7	6.9	7.7	9.5
Current-account balance	-15.6	-16.2	-21.8	-20.2	-15.6	-18.1	-21.9	-34.2	-26.3

Table A.18 (continued)

## Balance of payment on current account, by country or country group, 1997-2005 (billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Economies in transition</b>									
Trade balance	-1.4	-4.0	23.6	51.3	33.6	30.3	36.6	61.7	92.5
Services, net	-2.5	-1.8	-1.9	-4.0	-6.9	-7.1	-5.9	-10.4	-12.7
Income, net	-10.5	-12.2	-8.1	-9.1	-5.6	-7.8	-15.3	-16.9	-26.7
Current transfers, net	3.5	4.6	5.5	6.1	6.3	7.5	10.2	12.6	14.8
Current-account balance	-10.9	-13.3	19.0	44.3	27.3	23.0	25.5	46.9	68.0
<b>South-eastern Europe</b>									
Trade balance	-8.0	-12.0	-10.1	-11.4	-15.1	-18.2	-25.2	-32.3	-37.7
Services, net	2.3	1.9	1.9	2.9	3.7	4.5	7.0	7.0	7.3
Income, net	-1.1	0.8	0.3	0.7	1.3	1.3	0.8	0.6	0.3
Current transfers, net	2.3	3.3	3.2	3.8	4.2	5.0	6.9	9.1	10.6
Current-account balance	-4.5	-6.0	-4.8	-3.9	-5.9	-7.4	-10.5	-15.6	-19.6
<b>Commonwealth of Independent States</b>									
Trade balance	6.6	8.1	33.8	62.7	48.7	48.6	61.7	94.0	130.3
Services, net	-4.7	-3.7	-3.8	-6.9	-10.7	-11.7	-12.9	-17.4	-19.9
Income, net	-9.4	-13.0	-8.5	-9.8	-6.9	-9.1	-16.1	-17.5	-26.9
Current transfers, net	1.2	1.3	2.3	2.3	2.0	2.5	3.3	3.4	4.2
Current-account balance	-6.4	-7.4	23.8	48.3	33.2	30.3	36.0	62.4	87.7
<b>Developing economies</b>									
Trade balance	39.1	66.4	134.9	204.8	178.0	221.0	296.3	355.3	534.2
Services, net	-62.5	-52.1	-49.0	-57.4	-63.3	-61.8	-60.9	-57.6	-67.0
Income, net	-75.1	-79.3	-105.7	-111.3	-103.7	-109.1	-108.4	-121.4	-128.1
Current transfers, net	46.8	47.3	55.8	60.2	67.3	79.0	100.2	114.4	136.5
Current-account balance	-51.7	-17.7	36.0	96.3	78.3	129.2	227.1	290.6	475.6
<b>Net fuel exporters</b>									
Trade balance	82.1	15.7	81.1	186.5	130.6	128.5	181.1	241.9	379.0
Services, net	-58.7	-52.3	-46.5	-59.6	-57.4	-62.8	-67.7	-74.8	-88.9
Income, net	-11.0	-8.5	-22.8	-30.8	-26.6	-34.5	-38.1	-47.2	-47.9
Current transfers, net	-8.0	-6.8	-4.6	-4.7	-4.0	-1.3	4.0	7.7	14.1
Current-account balance	4.5	-51.9	7.2	91.4	42.6	29.9	79.2	127.7	256.2
<b>Net fuel importers</b>									
Trade balance	-43.0	50.7	53.8	18.3	47.4	92.6	115.2	113.3	155.1
Services, net	-3.8	0.2	-2.5	2.2	-5.9	1.0	6.8	17.2	21.9
Income, net	-64.1	-70.8	-82.9	-80.5	-77.1	-74.6	-70.4	-74.2	-80.1
Current transfers, net	54.7	54.1	60.4	64.9	71.3	80.3	96.2	106.6	122.4
Current-account balance	-56.1	34.2	28.8	4.9	35.8	99.3	147.9	162.9	219.4

Table A.18 (continued)

Balance of payment on current account, by country or country group, 1997-2005 (billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Latin America and the Caribbean</b>									
Trade balance	-16.3	-38.5	-9.7	0.7	-6.6	20.4	42.0	55.7	79.3
Services, net	-17.4	-17.0	-13.8	-14.7	-16.9	-11.8	-10.6	-11.1	-15.1
Income, net	-47.3	-51.2	-52.3	-55.1	-55.4	-53.4	-59.3	-68.1	-78.8
Current transfers, net	16.0	17.8	20.2	21.6	26.2	29.8	36.1	42.9	50.1
Current-account balance	-65.0	-88.9	-55.6	-47.5	-52.6	-15.0	8.2	19.3	35.5
<b>Africa</b>									
Trade balance	3.2	-14.3	-4.4	28.0	16.6	7.6	20.3	33.7	64.5
Services, net	-6.0	-8.9	-7.1	-7.3	-8.1	-9.4	-9.4	-11.1	-14.0
Income, net	-16.2	-14.7	-17.3	-22.6	-20.1	-22.4	-27.8	-36.6	-43.7
Current transfers, net	15.2	15.7	14.9	15.8	16.2	17.7	20.6	24.2	30.2
Current-account balance	-3.8	-22.2	-13.9	14.0	4.8	-6.5	3.9	10.3	37.0
<b>Western Asia</b>									
Trade balance	27.6	-7.0	25.8	66.7	63.5	61.8	84.9	112.8	172.4
Services, net	-28.5	-16.9	-22.5	-24.7	-25.7	-28.1	-26.7	-30.3	-34.4
Income, net	8.4	10.8	5.3	2.9	3.6	-0.7	-2.4	0.7	7.2
Current transfers, net	-7.7	-7.4	-7.1	-8.2	-9.9	-10.8	-11.4	-11.0	-14.1
Current-account balance	-0.1	-20.5	1.5	36.8	31.6	22.1	44.5	72.2	131.0
<b>East Asia</b>									
Trade balance	42.0	148.5	135.3	118.5	115.8	139.0	164.3	182.7	260.6
Services, net	-7.8	-9.2	-5.6	-11.5	-13.5	-13.3	-16.2	-11.5	-14.3
Income, net	-14.0	-17.5	-35.2	-28.9	-25.3	-25.3	-11.1	-11.0	-3.5
Current transfers, net	2.6	3.6	8.7	8.7	10.1	14.5	19.6	24.6	29.5
Current-account balance	22.8	125.4	103.2	86.8	87.1	114.9	156.6	184.8	272.3
<b>South Asia</b>									
Trade balance	-17.4	-22.3	-12.1	-9.2	-11.3	-7.8	-15.3	-29.7	-42.6
Services, net	-2.7	-0.1	-0.1	0.8	0.8	0.8	1.9	6.4	10.9
Income, net	-6.1	-6.6	-6.2	-7.6	-6.6	-7.3	-8.0	-6.4	-9.2
Current transfers, net	20.7	17.5	19.2	22.1	24.6	27.9	35.2	33.7	40.7
Current-account balance	-5.5	-11.5	0.8	6.1	7.4	13.6	13.9	4.1	-0.2
<b>World residual<sup>b</sup></b>									
Trade balance	95.2	43.7	0.5	-36.8	-45.5	-6.4	26.3	4.2	0.9
Services, net	26.0	28.4	31.4	16.1	0.9	20.1	35.8	75.9	96.1
Income, net	-64.3	-85.1	-97.5	-92.0	-76.2	-108.9	-76.6	-64.1	-89.1
Current transfers, net	-66.1	-79.2	-71.4	-71.2	-50.5	-54.6	-58.2	-71.0	-65.9
Current-account balance	-9.3	-92.2	-137.0	-183.9	-171.3	-149.8	-72.7	-54.9	-58.0

Sources: International Monetary Fund (IMF), *World Economic Outlook, September 2006*, IMF Balance of Payments Statistics.<sup>a</sup> Europe consists of EU 25 plus Iceland, Norway and Switzerland.<sup>b</sup> Statistical discrepancy.

Table A.19  
Net ODA from major sources, by type, 1985-2005

Donor group or country	Growth rate of ODA <sup>a</sup> (2003 price and exchange rates)		ODA as a percentage of GNI	Total ODA (millions of dollars)	Percentage distribution of ODA by type, 2005						
	1985-1994	1995-2004			2005	2005	Bilateral			Multilateral	
							Total	Grants <sup>b</sup>	Technical cooperation	Loans and other	Total
Total DAC countries	1.39	1.26	..	106 461	77.0	76.3	20.3	0.6	23.0	4.9	18.1
Total EU	2.36	0.93	..	55 688	68.9	68.6	14.3	0.3	31.1	4.9	26.1
Austria	-3.41	7.06	0.52	1 552	78.0	78.8	10.4	-0.7	22.0	1.7	20.3
Belgium	-2.78	6.39	0.53	1 975	63.9	64.9	18.9	-1.0	36.1	4.5	31.6
Denmark	4.28	0.84	0.81	2 107	64.2	65.5	4.7	-1.3	35.8	14.1	21.7
Finland	1.72	3.67	0.47	897	65.8	65.1	20.6	0.7	34.2	10.3	23.9
France <sup>c</sup>	3.02	-1.91	0.47	10 059	72.0	77.0	23.8	-5.0	28.0	2.0	26.1
Germany	0.75	-0.62	0.35	9 915	71.9	81.8	26.3	-9.9	28.1	3.9	24.2
Greece	..	..	0.24	535	67.3	67.3	45.0	..	32.7	1.3	31.4
Ireland	4.50	14.67	0.41	692	70.1	70.1	2.0	..	29.9	9.0	20.9
Italy	3.96	-4.28	0.29	5 053	43.9	42.9	..	0.9	56.1	6.0	50.1
Luxembourg	16.59	12.01	0.87	264	75.8	75.8	1.8	0.0	24.2	4.7	19.5
Netherlands	0.73	2.49	0.82	5 115	72.0	72.3	11.9	-0.3	28.0	8.0	20.0
Portugal	25.89	5.90	0.21	367	56.8	52.1	28.8	4.7	43.2	2.7	40.6
Spain	18.65	2.45	0.29	3 123	64.4	..	..	..	35.6	..	..
Sweden	2.80	1.90	0.92	3 280	70.8	70.5	4.4	0.3	29.2	12.1	17.1
United Kingdom	1.31	4.62	0.48	10 754	75.3	78.7	9.8	-3.4	24.7	4.3	20.4
Australia	0.53	0.72	0.25	1 666	86.2	86.2	48.4	0.0	13.8	3.1	10.7
Canada	1.66	-1.70	0.34	3 731	75.9	76.4	15.6	-0.5	24.1	6.7	17.4
Japan	1.44	-1.58	0.28	13 101	79.4	70.2	14.3	9.3	20.6	7.8	12.7
New Zealand	0.24	3.22	0.27	274	80.7	80.7	16.8	0.0	19.3	6.6	12.7
Norway	2.48	3.14	0.93	2 775	71.9	69.5	12.0	2.3	28.1	17.9	10.3
Switzerland	3.26	3.20	0.44	1 771	79.7	78.6	..	1.1	20.3	6.2	14.1
United States	-1.17	4.12	0.22	27 457	92.0	94.8	36.3	-2.8	8.0	1.9	6.1

Sources: UN/DESA, based on OECD, *The DAC Journal of Development Co-operation Report 2005* and DAC on line database available from <http://www.oecd.org/dac/stats/idsonline> (accessed on 5 December 2006).

<sup>a</sup> Average annual rates of growth, calculated from average levels in 1983-1984, 1993-1994 and 2003-2004.

<sup>b</sup> Including technical cooperation.

<sup>c</sup> Excluding flows from France to the Overseas Departments, namely Guadeloupe, French Guyana, Martinique and Réunion.

Table A.20  
**Total net ODA flows from OECD Development Assistance Committee (DAC) countries, by type of flow, 1993-2005**

	1993-1994 average	2001	2002	2003	2004	2005
<i>Net disbursements at current prices and exchange rates (millions of dollars)</i>						
Official Development Assistance	57 484	52 435	58 292	69 085	79 553	106 464
1. Bilateral grants and grant-like flows, of which:	34 329	33 522	39 813	50 908	57 366	81 255
Technical co-operation	12 911	13 602	15 452	18 352	18 815	21 604
Emergency & distress relief <sup>a</sup>	3 359	3 276	3 869	6 221	7 339	12 728
Debt forgiveness	3 077	2 514	4 534	8 338	7 109	..
2. Bilateral loans	5 665	1 602	939	-1 153	-2 940	-1 322
3. Contributions to multilateral institutions <sup>b</sup>	17 489	17 311	17 540	19 330	25 123	..
<i>Share of total net flows (percentage)</i>						
Official Development Assistance	38	49	80	55	53	..
1. Bilateral grants and grant-like flows, of which:	23	31	54	40	38	..
Technical co-operation	9	13	21	15	13	..
Emergency & distress relief <sup>a</sup>	2	3	5	5	5	..
Debt forgiveness	2	2	6	7	5	..
2. Bilateral loans	4	1	1	-1	-2	..
3. Contributions to multilateral institutions <sup>b</sup>	12	16	24	15	17	..

**Sources:** UN/DESA, based on OECD, *The DAC Journal of Development Co-operation Report 2005* and DAC on line database available from <http://www.oecd.org/dac/stats/idsonline> (accessed on 5 December 2006).

<sup>a</sup> Emergency food aid was included with developmental food aid up to and including 1995.

<sup>b</sup> Grants and capital subscriptions. Does not include concessional lending to multilateral agencies.

Table A.21

Commitments and net flows of financial resources, by selected multilateral institutions, 1996-2005 (millions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Resource commitments <sup>a</sup>	66 827	89 713	95 118	65 568	63 085	72 177	95 292	67 593	55 895	71 712
Financial institutions (excluding IMF)	44 701	45 760	57 928	42 770	36 882	41 787	38 523	43 053	45 678	51 385
Regional development banks <sup>b</sup>	16 525	20 431	21 133	19 437	16 235	19 349	16 751	20 393	21 468	23 039
World Bank Group	27 729	24 899	36 352	22 899	20 238	22 004	21 382	22 230	23 743	27 677 <sup>c</sup>
IBRD	15 325	15 098	24 687	13 789	10 699	11 709	10 176	10 572	10 792	13 611
IDA	6 490	5 345	7 325	5 691	5 861	6 859	8 040	7 550	8 387	8 696
IFC	5 914	4 456	4 340	3 419	3 678	3 436	3 166	4 108	4 564	5 370
IFAD	447	430	443	434	409	434	390	430	467	669
IMF (billions of dollars)	18	41	33	19	22	26	52	18	3	13
UN operational agencies <sup>d</sup>	3 726	3 453	4 290	4 198	3 803	4 690	4 569	6 740	7 617	7 708
Net flows	2 060	21 227	28 825	-7 450	-10 859	14 931	2 001	-11 655	-20 235	-39 609
Financial institutions (excluding IMF)	1 460	6 827	9 525	5 150	-59	1 431	-11 199	-14 755	-10 235	835
Regional development banks <sup>b</sup>	2 376	5 334	7 971	4 229	327	1 696	-3 904	-8 025	-6 570	-1 668
World Bank Group	-915	1 493	1 554	921	-386	-265	-7 295	-6 730	-3 665	2 503
IBRD	-6 128	-3 265	-2 723	-3 019	-4 079	-4 570	-12 126	-11 241	-8 930	-2 898
IDA	5 213	4 757	4 276	3 940	3 693	4 432	4 831	4 511	5 265	5 401
IMF (billions of dollars)	1	14	19	-13	-11	14	13	3	-10	-40
Memorandum item (in units of 2000 purchasing power) <sup>e</sup>										
Resource commitments (millions of dollars)	54 776	78 696	87 264	62 446	63 085	73 650	97 237	63 171	48 604	60 773
Net flows (millions of dollars)	1 689	18 620	26 445	-7 095	-10 859	15 236	2 042	-10 892	-17 596	-33 567

Sources: Annual reports, various issues of the multilateral institutions.

<sup>a</sup> Loans, grants, technical assistance and equity participation, as appropriate; all data are on a calendar-year basis.<sup>b</sup> African Development Bank (AfDB), Asian Development Bank (AsDB), Caribbean Development Bank (CDB), European Bank for Reconstruction and Development (EBRD) and Inter-American Development Bank (IaDB) (including Inter-American Investment Corporation (IaIC)).<sup>c</sup> Data is for fiscal year 2005.<sup>d</sup> United Nations Development Programme (UNDP), United Nations Population Fund (UNFPA), United Nations Children's Fund (UNICEF) and the World Food Programme (WFP).<sup>e</sup> Totals deflated by the United Nations index of manufactured export prices (in dollars) of developed economies: 2000 = 100.



---

### كيفية الحصول على منشورات الأمم المتحدة

يمكن الحصول على منشورات الأمم المتحدة من المكتبات ودور التوزيع في جميع أنحاء العالم . استعلم عنها من المكتبة التي تتعامل معها أو اكتب إلى : الأمم المتحدة ، قسم البيع في نيويورك أو في جنيف .

#### 如何购取联合国出版物

联合国出版物在全世界各地的书店和经售处均有发售。请向书店询问或写信到纽约或日内瓦的联合国销售组。

#### HOW TO OBTAIN UNITED NATIONS PUBLICATIONS

United Nations publications may be obtained from bookstores and distributors throughout the world. Consult your bookstore or write to: United Nations, Sales Section, New York or Geneva.

#### COMMENT SE PROCURER LES PUBLICATIONS DES NATIONS UNIES

Les publications des Nations Unies sont en vente dans les librairies et les agences dépositaires du monde entier. Informez-vous auprès de votre libraire ou adressez-vous à : Nations Unies, Section des ventes, New York ou Genève.

#### КАК ПОЛУЧИТЬ ИЗДАНИЯ ОРГАНИЗАЦИИ ОБЪЕДИНЕННЫХ НАЦИЙ

Издания Организации Объединенных Наций можно купить в книжных магазинах и агентствах во всех районах мира. Наводите справки об изданиях в вашем книжном магазине или пишите по адресу: Организация Объединенных Наций, Секция по продаже изданий, Нью-Йорк или Женева.

#### COMO CONSEGUIR PUBLICACIONES DE LAS NACIONES UNIDAS

Las publicaciones de las Naciones Unidas están en venta en librerías y casas distribuidoras en todas partes del mundo. Consulte a su librero o diríjase a: Naciones Unidas, Sección de Ventas, Nueva York o Ginebra.

---