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NEWS RELEASE

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**AS WORLD ECONOMY SLOWLY RECOVERS, DEVELOPING WORLD
FACES SCARCE FINANCING, SAYS WORLD BANK**

Developing countries facing higher borrowing costs, lower credit levels, and reduced international capital flows

Bangkok, January 21, 2010—The global economic recovery that is now underway will slow later this year as the impact of fiscal stimulus wanes. Financial markets remain troubled and private sector demand lags amid high unemployment, according to a new report from the World Bank.

Global Economic Prospects 2010, released today, warns that while the worst of the financial crisis may be over, the global recovery is fragile. It predicts that the fallout from the crisis will change the landscape for finance and growth over the next 10 years.

Global GDP, which declined by 2.2 percent in 2009, is expected to grow 2.7 percent this year and 3.2 percent in 2011¹. Prospects for developing countries are for a relatively robust recovery, growing 5.2 percent this year and 5.8 percent in 2011 -- up from 1.2 percent in 2009. GDP in rich countries, which declined by 3.3 percent in 2009, is expected to increase much less quickly—by 1.8 and 2.3 percent in 2010 and 2011. World trade volumes, which fell by a staggering 14.4 percent in 2009, are projected to expand by 4.3 and 6.2 percent this year and in 2011.

While this is the most likely scenario, considerable uncertainty continues to cloud the outlook. Depending on consumer and business confidence in the next few quarters and the timing of fiscal and monetary stimulus withdrawal, growth in 2011 could be as low as 2.5 percent and as high as 3.4 percent.

“Unfortunately, we cannot expect an overnight recovery from this deep and painful crisis, because it will take many years for economies and jobs to be rebuilt. The toll on the poor will be very real,” said **Justin Lin, World Bank Chief Economist and Senior Vice President, Development Economics**. *“The poorest countries, those that rely on grants or subsidized lending, may require an additional \$35-50 billion in funding just to sustain pre-crisis social programs.”*

¹ (or -1, 3.5 and 4 percent when aggregated using Purchasing Power Parity weights)

In this still weak environment, oil prices are expected to remain broadly stable, averaging about \$76 a barrel; and other commodity prices should rise by only 3 percent per year on average during 2010 and 2011.

The report warns that, despite the return to positive growth, it will take several years before economies recoup the losses already endured. It estimates that about 64 million more people will be living in extreme poverty (on less than \$1.25 a day) in 2010 than would have been the case had the crisis not occurred.

Further, over the next 5 to 10 years, increased risk aversion, a more prudent regulatory stance, and the need to curb some of the riskier lending practices during the boom period that preceded the crisis can be expected to result in scarcer, more expensive capital for developing countries.

“As international financial conditions tighten, firms in developing countries will face higher borrowing costs, lower levels of credit, and reduced international capital flows. As a result, over the next 5 to 7 years, trend growth rates in developing countries may be 0.2 to 0.7 percent lower than they would have been had finance remained as abundant and inexpensive as in the boom period,” said **Andrew Burns, lead author of the report.**

While all forms of finance are likely to be affected, foreign direct investment (FDI) should be less constrained than debt flows. However, parent firms will face higher capital costs, reducing their ability to finance individual products. As a result, FDI inflows are projected to decline from recent peaks of 3.9 percent of developing country GDP in 2007 to around 2.8-3.0 percent over the medium term. The consequences of such a decline could be serious, as FDI represents as much as 20 percent of total investment in Sub-Saharan Africa, Europe and Central Asia and Latin America.

“While developing countries cannot avoid tighter international financial conditions, they can and should reduce domestic borrowing costs and promote local capital markets by expanding regional financial centers and improving competition and regulation in local banking sectors,” said **Hans Timmer, Director of the World Bank Prospects Group.** *“Although likely to take time to bear fruit, such steps could expand access to capital and help put developing countries back on the higher growth track from which they were derailed by the crisis.”*

The report finds that very relaxed international financial conditions from 2003 through 2007 contributed to the boom in developing country finance and growth. Much lower borrowing costs caused both international capital flows and domestic bank lending to expand, which contributed to a 30 percent increase in investment rates in developing countries. The resulting rapid expansion of the capital stock explained more than half of the 1.5 percentage point increase in the rate of growth of potential output among developing countries.

While very strong developing country growth during the boom period may reflect underlying growth potential, the global financial conditions that fueled it were clearly unsustainable.

For more information on GEP 2010, visit www.worldbank.org/gep2010 to download the report or www.worldbank.org/globaloutlook for interactive data.

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Fact Sheet--Global Economic Prospects 2010: Regional Outlook

The **East Asia and the Pacific** region led the rebound in the global economy last year, reflecting robust fiscal policy steps and strong domestic demand. China, with 8.4 percent growth last year, was an engine for regional growth, a pattern expected to continue this year, with Chinese GDP projected to grow 9 percent. GDP in the region is estimated to have increased 6.8 percent in 2009 and is forecast to edge up 8.1 percent this year. Capital flows to the region are returning and local financial market developments have provided further impetus to the recovery. Continuing excess capacity in manufacturing and only moderate advances in world trade growth will restrain GDP growth from accelerating much faster than 8.2 percent in 2011.

Reflecting pre-existing vulnerabilities in many countries (in particular current account deficits arising from large private sector savings-investment imbalances), developing **Europe and Central Asia** was hardest hit by the crisis, with GDP falling by an estimated 6.2 percent in 2009. Although GDP is projected to rise by 2.7 percent in 2010 and 3.6 percent in 2011, growth rates in most economies will remain below potential and unemployment and bank restructuring will continue to be pervasive. Much higher non-performing loans, higher interest rates and weak international capital flows will remain key challenges in the near term. Compared to the pre-crisis period, high non-performing loans, weak public finances and low international capital flows are likely to dampen investment growth in many countries. Moreover, significant downside risks persist, including the possibility of a double-dip recession or increased financial difficulties for banks in the region. Despite better international financing conditions and domestic adjustments, the region's external financing needs are expected to exceed inflows by as much as \$54 billion in 2010.

Stronger fundamentals helped the **Latin America and the Caribbean** region weather this crisis much better than in the past. Following an estimated 2.6 percent drop in GDP last year, regional output is projected to increase by 3.1 percent in 2010 and 3.6 percent in 2011, but weaker investment will keep growth from attaining boom year levels. Remittances and to some extent tourism (both important sources of external finance for Caribbean countries) are expected to recover only modestly in the 2010–11 period, undermined by weak labor market conditions in the United States and other high-income countries. Key challenges include the winding down of stimulus measures; providing for the unemployed in a fiscally sustainable manner; and maintaining openness towards international trade and investment.

The **Middle East and North Africa** region was less sharply impacted by the crisis than other regions, with overall GDP growth slowing to 2.9 percent in 2009. Growth among oil-importing developing countries was an estimated 4.7 percent in 2009. Among developing oil-exporters, growth eased to 1.6 percent, reflecting production restraint and reduced oil revenues. For the region as a whole, GDP is projected to grow 3.7 percent in 2010 and 4.4 percent by 2011. The forecast for recovery is premised on a revival in global oil demand, stabilizing oil prices and a rebound in key export markets. Despite a gradual withdrawal of fiscal stimulus measures, moderate advances in consumer and capital spending are expected to underpin firmer growth.

South Asia appears to have escaped the worst effects of the crisis. Nevertheless, its estimated 5.7 percent GDP growth in 2009 (the same growth rate as in 2008) represents a marked deceleration from the boom period, largely driven by a pronounced fall-off in investment growth. Private capital inflows—a key transmission channel of the crisis—are less significant as a share of South Asia's GDP (particularly foreign direct investment), compared with most other regions. Also, domestic demand in the region was relatively resilient, having been cushioned by counter-cyclical macroeconomic policies. Growth is expected to rebound to 6.9 and 7.4 percent in 2010 and 2011.

Sub Saharan Africa was also hard hit. It initially felt the crisis through trade, foreign direct investment, tourism, remittances, and official assistance channels. Regional GDP is estimated to have increased by only 1.1 percent last year. Oil exporters and middle income countries were hit more severely than low-income, fragile and less integrated countries – at least initially. In 2010 GDP is expected to grow by 4.8 percent in Sub-Saharan African countries excluding South Africa, with growth of 4.2 percent in fragile countries and 4.8 percent in low-income countries. South Africa is expected to grow by 2 percent this year after having contracted by 1.8 percent in 2009, while middle-income countries growth will accelerate to 3.5 percent. The overall regional outlook remains uncertain and the strength of the recovery will largely depend on demand from key export markets.