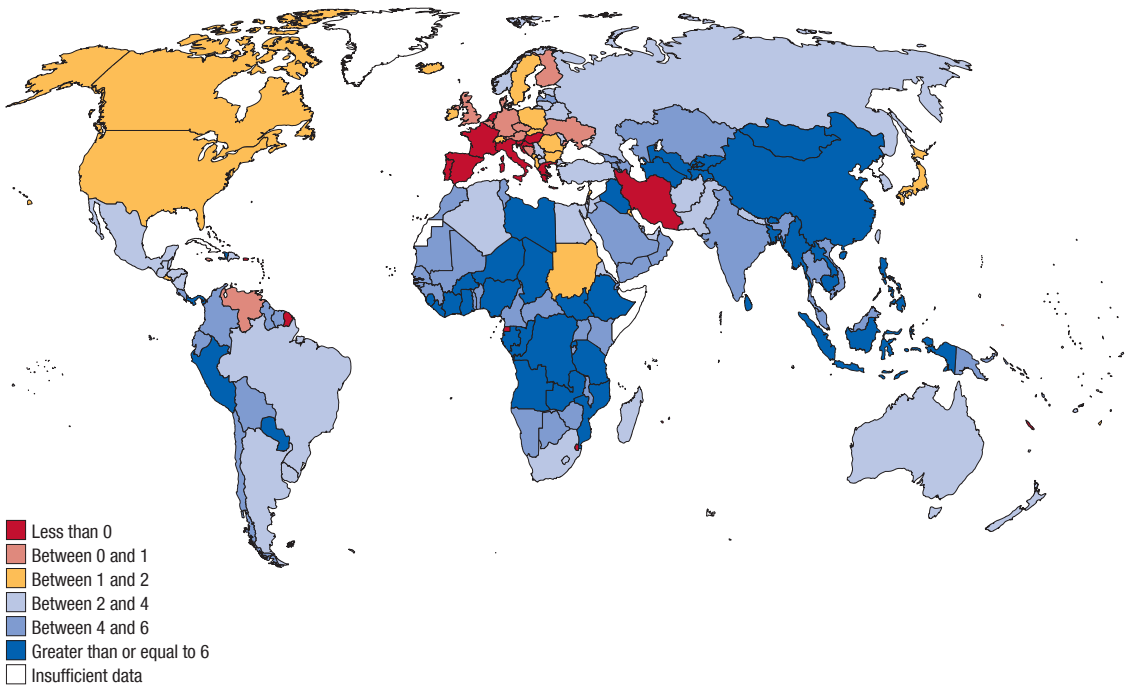
CHAPTER 2

COUNTRY AND REGIONAL PERSPECTIVES

The balance of risks to global growth has improved since the October 2012 World Economic Outlook (WEO), but the road to recovery remains bumpy and uneven for advanced economies. Over the past six months, policy actions have diminished risks of an acute crisis in both Europe and the United States, although the baseline outlook for these two regions diverges: in the euro area, balance sheet repair and still-tight credit conditions continue to weigh on growth prospects, whereas underlying conditions in the United States are more supportive of recovery, even with the sequester inducing a larger-than-expected fiscal consolidation. In many emerging market and developing economies, activity has already picked up following the sharper-than-expected slowdown in the middle of 2012. Policy easing in many of these economies helped arrest that slowdown, and growth in Asia, Latin America and the Caribbean (LAC), and sub-Saharan Africa is slated to strengthen further this year, while growth in the Commonwealth of Independent States (CIS) will be on par with last year (Figure 2.1). The Middle East and North Africa (MENA) region is a notable exception: a pause in oil production growth among oil-exporting countries is expected to lead to a temporary deceleration in the region's growth, while ongoing political transitions and a difficult external environment are preventing a quicker recovery in some oil-importing countries.

While tail risks to the global outlook have diminished and upside risks now exist, downside risks still predominate and could have important spillovers across regions. As noted in Chapter 1, the possibility of renewed setbacks remains in the euro area, because of either adjustment fatigue or a more general loss of

Figure 2.1. World: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.

momentum for reform. A tail risk in the medium term is that lingering fiscal problems in the United States, and especially in Japan, could result in a reassessment of sovereign risks in these economies, leading to rising interest rates and lower growth that could spill over to other regions. And the mid-2012 slowdown was just the latest in a string of downside surprises to growth in many large emerging market economies in the past two years. Combined with the fact that many of these economies have less policy room to maneuver than before the Great Recession, investors' reassessments of their growth prospects could lead to sharply lower investment and increased capital outflows. The regional effects of these risks are discussed in the sections that follow.

The Spillover Feature in this chapter assesses the extent to which policy uncertainty in the United States and Europe has affected economic activity in other regions. It finds that sharp spikes in U.S. and European policy uncertainty are associated with temporarily lower output in other regions, with the magnitude varying across regions. A reduction in policy uncertainty in the United States and Europe may thus give an added fillip to global activity.

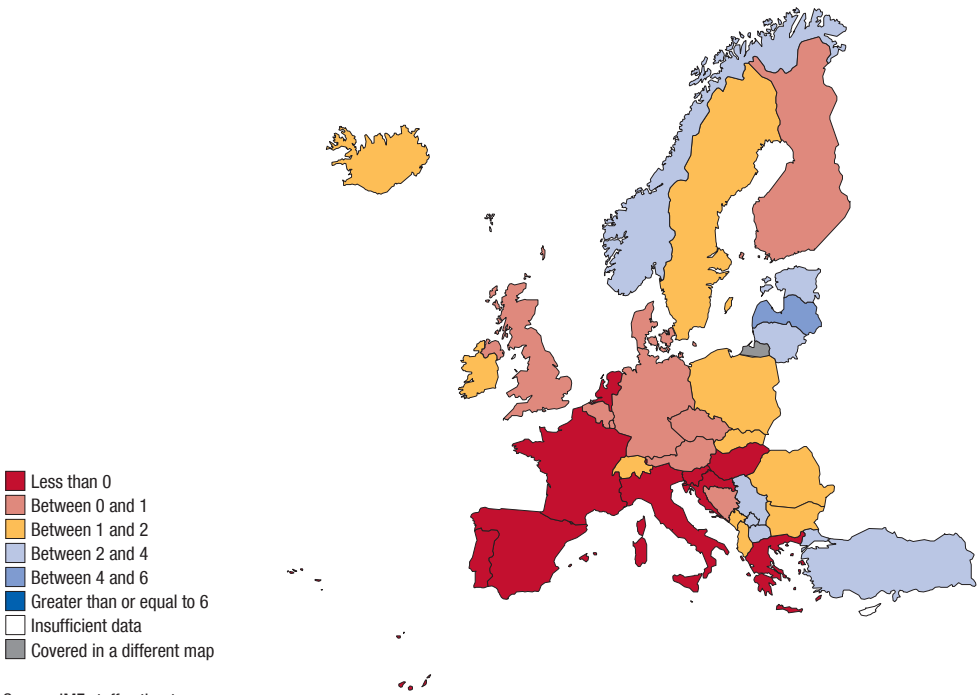
Europe: Diminished Crisis Risks amid Prolonged Stagnation

Advanced Europe

Since the October 2012 WEO, financial stress in the euro area has moderated in response to policy actions at both the national and European levels. But economic activity remains weak, and growth projections for 2013 have been lowered because weakness has spilled over from the periphery to the core (Figure 2.2). Downside risks to the outlook include stagnation and the reemergence of stresses if policy momentum is not sustained or if events in Cyprus lead to prolonged financial market fragmentation.

Since the October 2012 WEO, acute crisis risks in the euro area have diminished. Decisive policy actions at the European level—including Outright Monetary Transactions (OMTs), the completion of the European Stability Mechanism, the deal on Greek debt relief, and the agreement on the Single Supervisory Mechanism—have increased confidence in the viability of the Economic and Monetary Union. Along with progress on economic adjustment by national governments, this

Figure 2.2. Europe: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: Projections for Cyprus are excluded due to the ongoing crisis.

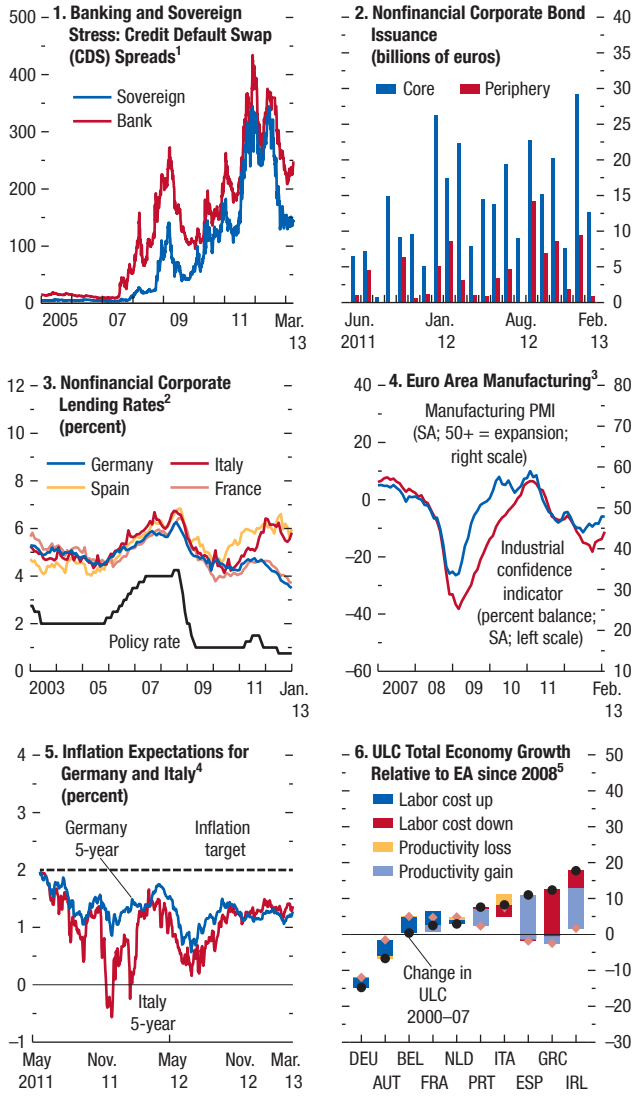
has greatly improved financial conditions for sovereigns and banks (Figure 2.3).

But lower sovereign spreads and improved bank liquidity have yet to translate into either improved private sector borrowing conditions or stronger economic activity. Achieving these gains could prove even more challenging given that financial conditions remain highly vulnerable to shifts in market sentiment, as evidenced by the renewed volatility in the wake of the inconclusive outcome of Italy's elections and recent events in Cyprus. Analysis in the April 2013 *Global Financial Stability Report* (GFSR) suggests that euro area bank deleveraging is proceeding broadly in line with the baseline scenario in the October 2012 GFSR. Euro area credit has continued to contract, mainly because of conditions in the periphery economies, and lending conditions remain tight. This delayed transmission to credit conditions led euro area activity to contract by 2¼ percent in the fourth quarter of 2012, with deep recessions continuing across much of the periphery and weakness spilling over to the core, reinforcing weaker near-term growth dynamics in these economies. The need to repair public and private balance sheets, as well as continued policy uncertainty, appears to be weighing against a robust recovery in investment and consumption in both the periphery and the core, which has contributed to a steady rise in unemployment rates in many countries.

- The near-term outlook for the euro area has been revised downward, with activity now expected to contract by ¼ percent in 2013, instead of expanding by ¼ percent as projected in the October 2012 WEO (Table 2.1). This reflects declines in growth projections across all euro area countries, with notable revisions in some core members (France, Germany, Netherlands). Growth will strengthen gradually through the year, reaching 1 percent by the fourth quarter, as the pace of fiscal consolidation (at ¾ percent of GDP) is eased by almost half during 2013. But growth will generally remain subdued as improvements in private sector borrowing conditions are hampered by financial market fragmentation and ongoing balance sheet repair. Further headwinds to growth could result from a sustained appreciation of the euro that lowers competitiveness and dampens export growth.
- Activity is also subdued in the other advanced economies of the region. In the United Kingdom, the recovery is progressing slowly, notably in the context of weak external demand and ongoing fiscal

Figure 2.3. Advanced Europe: Diminished Crisis Risks amid Prolonged Stagnation

Financial stresses have moderated in response to policy actions. But economic activity remains weak because the weakness of the periphery economies has spilled over into the core. Inflation expectations remain subdued. There has been some progress toward internal rebalancing within the euro area.



Sources: Bloomberg, L.P.; European Central Bank (ECB); European Commission; Eurostat; Markit/Haver Analytics; and IMF staff calculations.
Note: Core: Austria (AUT), Belgium (BEL), Estonia, Finland, France (FRA), Germany (DEU), Luxembourg, Netherlands (NLD); periphery: Greece (GRC), Ireland (IRL), Italy (ITA), Portugal (PRT), Spain (ESP). SA = seasonally adjusted.
[1]Five-year CDS spreads in basis points weighted by general government gross debt. All euro area countries included, except Greece.
[2]New loans with maturities of one to five years up to 1 million euros, and the ECB policy rate.
[3]Manufacturing Purchasing Managers' Index (PMI): 50+ = expansion and 50– = contraction. The euro area composite comprises eight member countries only: Austria, France, Germany, Greece, Ireland, Italy, Netherlands, and Spain. This is estimated to be 90 percent of the euro area manufacturing activity.
[4]Inflation expectations were derived from market rates for five-year-ahead inflation-linked and nominal government bonds.
[5]In percentage points. ULC = unit labor cost; EA = euro area. Change in ULC from 2008 to latest available data (mostly 2012:Q3) is represented by the distance between a circle and a diamond.

Table 2.1. Selected European Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Europe	**0.0**	**0.3**	**1.5**	**2.9**	**2.2**	**2.0**	**1.4**	**1.5**	**1.4**	**. . .**	**. . .**	**. . .**
Advanced Europe	**–0.3**	**0.0**	**1.2**	**2.4**	**1.8**	**1.7**	**2.0**	**2.2**	**2.2**	**10.3**	**11.0**	**11.0**
Euro Area[4,5]	–0.6	–0.3	1.1	2.5	1.7	1.5	1.2	2.3	2.3	11.4	12.3	12.3
Germany	0.9	0.6	1.5	2.1	1.6	1.7	7.0	6.1	5.7	5.5	5.7	5.6
France	0.0	–0.1	0.9	2.0	1.6	1.5	–2.4	–1.3	–1.4	10.2	11.2	11.6
Italy	–2.4	–1.5	0.5	3.3	2.0	1.4	–0.5	0.3	0.3	10.6	12.0	12.4
Spain	–1.4	–1.6	0.7	2.4	1.9	1.5	–1.1	1.1	2.2	25.0	27.0	26.5
Netherlands	–0.9	–0.5	1.1	2.8	2.8	1.7	8.3	8.7	9.0	5.3	6.3	6.5
Belgium	–0.2	0.2	1.2	2.6	1.7	1.4	–0.5	–0.1	0.2	7.3	8.0	8.1
Austria	0.8	0.8	1.6	2.6	2.2	1.9	2.0	2.2	2.3	4.4	4.6	4.5
Greece	–6.4	–4.2	0.6	1.0	–0.8	–0.4	–2.9	–0.3	0.4	24.2	27.0	26.0
Portugal	–3.2	–2.3	0.6	2.8	0.7	1.0	–1.5	0.1	–0.1	15.7	18.2	18.5
Finland	–0.2	0.5	1.2	3.2	2.9	2.5	–1.7	–1.7	–1.8	7.7	8.1	8.1
Ireland	0.9	1.1	2.2	1.9	1.3	1.3	4.9	3.4	3.9	14.7	14.2	13.7
Slovak Republic	2.0	1.4	2.7	3.7	1.9	2.0	2.3	2.2	2.7	14.0	14.3	14.3
Slovenia	–2.3	–2.0	1.5	2.6	1.8	1.9	2.3	2.7	2.5	9.0	9.8	9.4
Luxembourg	0.1	0.1	1.3	2.9	1.9	1.9	6.0	6.6	6.8	6.0	6.3	6.4
Estonia	3.2	3.0	3.2	4.2	3.2	2.8	–1.2	0.0	0.1	9.8	7.8	6.2
Cyprus[6]	–2.4	. . .	. . .	3.1	. . .	. . .	–4.9	. . .	. . .	12.1	. . .	. . .
Malta	0.8	1.3	1.8	3.2	2.4	2.0	0.3	0.5	0.8	6.3	6.4	6.3
United Kingdom[5]	0.2	0.7	1.5	2.8	2.7	2.5	–3.5	–4.4	–4.3	8.0	7.8	7.8
Sweden	1.2	1.0	2.2	0.9	0.3	2.3	7.1	6.0	6.8	7.9	8.1	7.8
Switzerland	1.0	1.3	1.8	–0.7	–0.2	0.2	13.4	12.6	12.3	2.9	3.2	3.2
Czech Republic	–1.2	0.3	1.6	3.3	2.3	1.9	–2.7	–2.1	–1.8	7.0	8.1	8.4
Norway	3.0	2.5	2.2	0.7	1.5	1.5	14.2	11.7	10.9	3.2	3.1	3.3
Denmark	–0.6	0.8	1.3	2.4	2.0	2.0	5.3	4.7	4.7	7.6	7.6	7.2
Iceland	1.6	1.9	2.1	5.2	4.7	4.0	–4.9	–2.8	–1.7	5.8	5.0	4.6
San Marino	–4.0	–3.5	0.0	2.8	1.6	0.9	. . .	. . .	. . .	6.6	6.1	5.5
Emerging Europe[7]	**1.6**	**2.2**	**2.8**	**5.8**	**4.4**	**3.6**	**–4.3**	**–4.7**	**–4.9**	**. . .**	**. . .**	**. . .**
Turkey	2.6	3.4	3.7	8.9	6.6	5.3	–5.9	–6.8	–7.3	9.2	9.4	9.5
Poland	2.0	1.3	2.2	3.7	1.9	2.0	–3.6	–3.6	–3.5	10.3	11.0	11.0
Romania	0.3	1.6	2.0	3.3	4.6	2.9	–3.8	–4.2	–4.5	7.0	7.0	6.9
Hungary	–1.7	0.0	1.2	5.7	3.2	3.5	1.7	2.1	1.8	11.0	10.5	10.9
Bulgaria	0.8	1.2	2.3	2.4	2.1	1.9	–0.7	–1.9	–2.1	12.4	12.4	11.4
Serbia	–1.8	2.0	2.0	7.3	9.6	5.4	–10.9	–8.7	–8.6	23.1	23.0	22.9
Croatia	–2.0	–0.2	1.5	3.4	3.2	2.3	–0.1	0.0	–0.5	15.0	15.2	14.7
Lithuania	3.6	3.0	3.3	3.2	2.1	2.5	–0.9	–1.3	–1.7	13.2	12.0	11.0
Latvia	5.6	4.2	4.2	2.3	1.8	2.1	–1.7	–1.8	–1.9	14.9	13.3	12.0

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country.

[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.

[2]Percent of GDP.

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

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

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

[6]Projections for Cyprus are excluded due to the ongoing crisis.

[7]Includes Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, and Montenegro.

consolidation. Growth is forecast at ¾ percent this year, down ¼ percentage point from the October 2012 WEO. Here too, domestic rebalancing from the public to the private sector is being held back by deleveraging, tight credit conditions, and economic uncertainty, while declining productivity growth and high unit labor costs are holding back much needed external rebalancing. Growth in other advanced economies (Sweden) has generally remained stronger, largely owing to more resilient domestic demand and relatively healthier financial systems.

Current account balances of adjusting economies have improved significantly, and this improvement is expected to continue this year. This increasingly reflects structural improvements, including falling unit labor costs, rising productivity, and trade gains outside the euro area. But cyclical factors also play a role, notably layoffs of less productive workers, and would reverse with eventual economic recovery. Both core and other advanced economies continue to benefit from trade with faster-growing emerging market economies.

Inflation pressure has moderated in the euro area and is expected to moderate further. Headline inflation declined throughout 2012 and has recently been close to target, and core inflation has been subdued, declining since mid-2012. Inflation is expected to be reduced further, to 1¾ percent from 2½ percent in 2012, because of negative growth revisions, the diminishing effects of crisis-related fiscal measures, and lower oil prices.

Amid reduced market pressure and very high unemployment, the near-term risks of incomplete policy implementation at both the national and European levels are significant, while events in Cyprus could lead to more sustained financial market fragmentation. Incomplete implementation could result in a reversal of financial market sentiment. A more medium-term risk is a scenario of prolonged stagnation in the euro area. Under such a scenario, described in more detail in Chapter 1, growth would hover around 1 percent in the medium term, gradually deepening disinflation pressure and exacerbating the challenge of reducing debt and generating negative spillovers to other regions. There are also some upside risks to the outlook, as described in Chapter 1. If euro area policymakers were to quickly implement a comprehensive banking union and if structural reforms already implemented were to deliver a larger-than-expected growth dividend, growth in the euro area could reach 2 to 2¼ percent, driven by a strong rebound in the periphery economies.

Minimizing the downside risks and bolstering the upside risks will require sustaining policy momentum. For the euro area, this means arresting the decline in demand and making further progress on banking union and fiscal integration.

- At the national level, countries should press on with needed balance sheet repair and structural reforms. Long-standing structural rigidities need to be tackled to raise long-term growth prospects. Southern Europe needs to increase competitiveness in the tradables sector, especially through labor market reforms. In the North, reforms would help generate a more vibrant services sector. These measures will help reduce unemployment and rebuild competitiveness in the periphery; as Box 1.3 notes, relative unit labor costs have fallen from their peaks in these economies. The pace of fiscal consolidation should remain credible, with targets set in structural rather than nominal terms.
- Given moderating inflation pressure, monetary policy should remain very accommodative. Room is still available for further conventional easing, as inflation is projected to fall below the European Central Bank's target in the medium term.
- The mere existence of the OMTs may be insufficient to keep sovereign spreads low. OMTs should be made available to countries with programs that are delivering on adjustment, which may accelerate the countries' return to durable market access.
- The Single Supervisory Mechanism is a key step toward strengthening financial stability and reducing fragmentation. To ensure its timely and effective implementation at the European Central Bank, legislative agreements should be swiftly adopted, a single rulebook established, and operational details clarified.
- Tangible progress toward a single resolution authority and a deposit insurance fund—both backed by common resources—is essential to weakening sovereign-bank links and should be further supported by making direct European Stability Mechanism recapitalization available as soon as possible.
- Greater fiscal integration is needed to help address gaps in Economic and Monetary Union design and mitigate the transmission of country-level shocks across the euro area. Building political support will take time, but the priority should be to ensure a common fiscal backstop for the banking union.

Continued near-term support is important in other advanced economies while fiscal buffers are secured to guard against future risks, including from large financial sectors (Denmark, Sweden). In the United Kingdom, other forms of monetary easing could be considered, including the purchase of private sector assets and greater transparency on the likely future monetary stance. Greater near-term flexibility in the path of fiscal adjustment should be considered in the light of lackluster private demand.

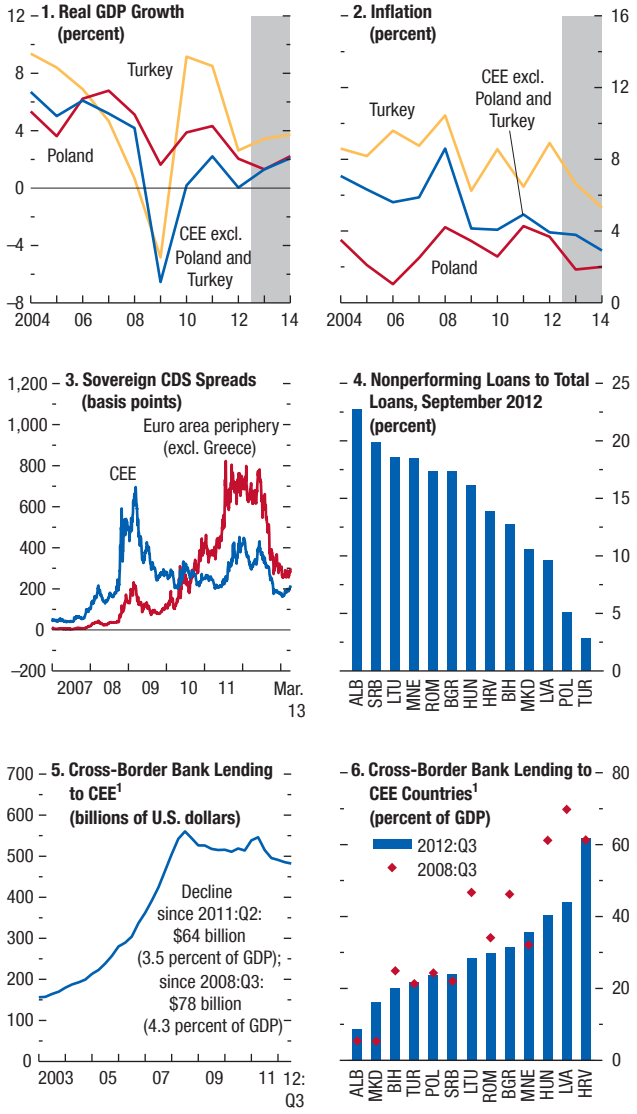
Emerging Europe

Emerging Europe experienced a sharp growth slowdown in 2012, reflecting spillovers from the euro area crisis and domestic policy tightening in the largest economies in response to new capacity constraints. Only a moderate recovery lies ahead for 2013–14.

The intensification of the euro area crisis took a toll on activity in emerging Europe in 2012. Exports decelerated, confidence suffered, and beleaguered western European banks decreased funding for their subsidiaries (Figure 2.4). Compounding these effects

Figure 2.4. Emerging Europe: A Gradual Recovery from 2012 Slowdown

Emerging Europe experienced a sharp growth slowdown in 2012, reflecting spillovers from the euro area crisis and domestic policy tightening in the largest economies. The share of nonperforming loans is high in parts of the region, and cross-border bank flows have abated.



Sources: Bank for International Settlements (BIS), Locational Banking Statistics; national statistics; Thomson Reuters Datastream; and IMF staff estimates.
Note: ALB = Albania; BGR = Bulgaria; BIH = Bosnia and Herzegovina; CDS = credit default swap; CEE = central and eastern Europe; HUN = Hungary; HRV = Croatia; MKD = FYR Macedonia; MNE = Montenegro; LTU = Lithuania; LVA = Latvia; POL = Poland; ROM = Romania; SRB = Serbia; TUR = Turkey. Euro area periphery includes Greece, Ireland, Italy, Portugal, and Spain.
[1]External position of BIS-reporting banks (from 43 countries) in the CEE, vis-à-vis all sectors.

were restrictive domestic policies—in Turkey to rein in the overheated economy and in Poland to address above-target inflation and a sizable fiscal deficit. As a result, growth in the region plunged from 5¼ percent in 2011 to 1½ percent in 2012. Several economies in southeastern Europe that had yet to fully emerge from the 2008–09 crisis fell back into recession.

Growth in emerging Europe is projected to pick up to 2¼ percent in 2013 and 2¾ percent in 2014 (Table 2.1), with positive impulses from improved financial market sentiment and easing external financing conditions resulting both from recent EU-wide policy decisions and from gradual recovery in the euro area. Economic activity should also benefit from monetary easing in the second half of 2012 and smaller drag from fiscal consolidation than during 2012. Nonetheless, various factors will constrain the recovery. Emerging Europe's principal export market, the euro area, will remain lackluster, only starting to grow in the second half of 2013. And the ongoing rebalancing of funding for the region's foreign banks from parent banks to local sources will continue to weigh on credit availability. Emerging Europe is also burdened by such crisis legacies as high nonperforming loan ratios and incomplete repair of public finances.

- Growth in Turkey is projected to accelerate to 3½ percent in 2013 and 3¾ percent in 2014—helped by recovering external demand and capital flows.
- Poland's growth will slow further to 1¼ percent in 2013 before picking up to 2¼ percent in 2014, on account of lackluster private consumption, fragile export demand from key trading partners in core Europe, and a further decline in EU-funded public investment.
- Southeastern Europe will see the most tepid recovery, reflecting to various degrees entrenched structural impediments and competitiveness problems, a continued rise in nonperforming loans, and challenging public finances.
- Hungary faces a difficult outlook due to high public and external debt, along with unconventional policies that have eroded confidence and investment.

Overall, annual average inflation is expected to remain moderate this year in most of emerging Europe. Elevated rates are projected only for Turkey (6½ percent) and Serbia (9½ percent), largely reflecting inflation inertia.

The balance of risks to the outlook is tilted to the downside, though less than in the October 2012

WEO, reflecting diminished crisis tail risks from the euro area. The key downside risk is prolonged stagnation in the euro area countries, given the strong economic linkages between them and the central and eastern European countries. In addition, domestic vulnerabilities and weaknesses relating to fiscal sustainability, the banking sector, or both—particularly in some countries in southeastern Europe and in Hungary—could exacerbate the impact of external shocks.

While keeping an eye on these risks, policymakers should continue to work off crisis legacies, addressing in particular high nonperforming loans and elevated fiscal deficits or public debt in several countries. In countries with flexible exchange rates, monetary policy should support the recovery. More fundamentally, many challenges that the 2003–08 boom had obscured have now resurfaced. Depending on the country, these challenges include high structural unemployment, low labor force participation, undersized tradables sectors, and incomplete transition agendas.

The United States and Canada: Growth Still Modest, but Brighter Spots Appearing

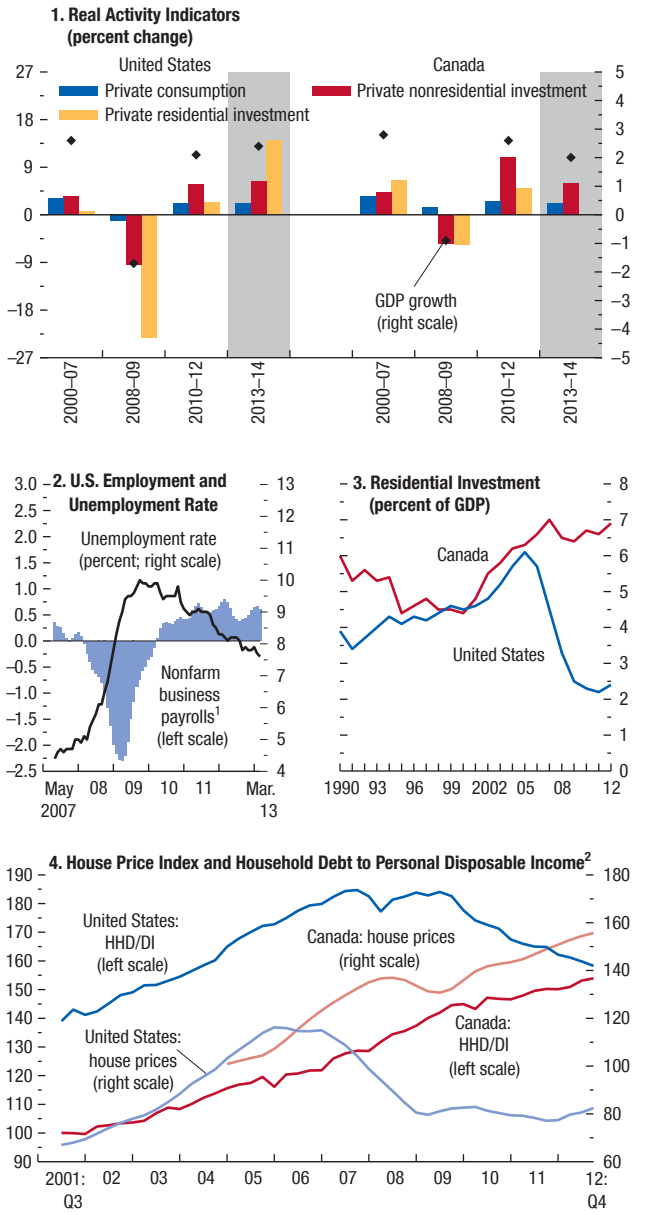
Recovery is proceeding in the United States as the housing market recovers and financial conditions remain supportive. The threat of a "fiscal cliff" was largely averted, but durable solutions to fiscal risks are needed.

Growth in the United States remained lackluster during 2012, reflecting significant legacy effects from the financial crisis, continued fiscal consolidation, a weak external environment, and temporary shocks, including the severe drought that affected farm activity and inventories and disruptions in the northeast following Superstorm Sandy. The fiscal cliff threat may also have played some role. But the recovery is beginning to show some bright spots. Credit growth has picked up, and bank lending conditions have been easing slowly from tight levels. Construction activity rebounded in 2012, albeit from low levels; house prices began to rise; and job creation picked up in the second half of the year, bringing the unemployment rate below 8 percent (Figure 2.5). Wage growth remained subdued, helping keep inflation pressure firmly in check.

The momentum in the housing market is likely to continue for the next few years, with residential investment recovering toward trend levels and

Figure 2.5. United States and Canada: Slow but Steady Recovery

Recovery is proceeding in the United States; the housing market is recovering and the threat of the "fiscal cliff" was largely averted, but durable solutions to remaining fiscal concerns are still needed. In Canada, the U.S. recovery will support growth, but high household debt and moderation in the housing sector are likely to weigh on private consumption and residential construction.



Sources: Haver Analytics; and IMF staff estimates.
[1]Moving quarterly absolute change; millions.
[2]HHD/DI = household debt to disposable income (percent)—for Canada includes only market liabilities; house prices: Case-Shiller Index (January 2005 = 100) for the United States; CREA House Price Index (2005 = 100, composite) for Canada.

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

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Advanced Economies	**1.2**	**1.2**	**2.2**	**2.0**	**1.7**	**2.0**	**–0.1**	**–0.1**	**–0.1**	**8.0**	**8.2**	**8.1**
United States	2.2	1.9	3.0	2.1	1.8	1.7	–3.0	–2.9	–3.0	8.1	7.7	7.5
Euro Area[4,5]	–0.6	–0.3	1.1	2.5	1.7	1.5	1.2	2.3	2.3	11.4	12.3	12.3
Japan	2.0	1.6	1.4	0.0	0.1	3.0	1.0	1.2	1.9	4.4	4.1	4.1
United Kingdom[4]	0.2	0.7	1.5	2.8	2.7	2.5	–3.5	–4.4	–4.3	8.0	7.8	7.8
Canada	1.8	1.5	2.4	1.5	1.5	1.8	–3.7	–3.5	–3.4	7.3	7.3	7.2
Other Advanced Economies[6]	1.8	2.5	3.4	2.0	2.1	2.4	4.6	3.5	3.4	4.6	4.7	4.6

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A6 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Based on Eurostat's harmonized index of consumer prices.
[5]Current account position corrected for reporting discrepancies in intra-area transactions.
[6]Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

stronger house prices helping to improve household balance sheets. Personal consumption will also be supported by continued, though moderate, job gains and low borrowing rates. At the same time, business investment will be supported by favorable financial conditions and strong profitability. The strengthening of private demand will more than offset the drag on growth from fiscal consolidation (projected to be 1¾ percent of GDP in 2013), which under the baseline scenario includes the sequester only during the current fiscal year, with the automatic spending cuts replaced by more back-loaded measures beginning in the last quarter of 2013. As a result, GDP growth is expected to pick up toward the end of 2013 and to accelerate from about 2 percent in 2013 to 3 percent in 2014 (Table 2.2).

The balance of risks is still on the downside, though less so than in the October 2012 WEO. On the external front, the main risk remains a worsening of the euro area debt crisis, which would affect the United States through both trade and financial channels, including higher risk aversion and a stronger U.S. dollar amid safe haven capital inflows.

On the domestic front, passage of the American Taxpayer Relief Act resolved the immediate threat of a fiscal cliff (Figure 2.6), but offered no durable solution to looming fiscal issues, including the need to raise the debt ceiling and the deep automatic budget cuts under sequester. The budget sequester, which went into effect March 1, is projected to subtract about 0.3 percentage point from GDP growth in 2013 if maintained until the end of this fiscal year (September 30, 2013) as assumed by the IMF staff. If the sequester continues into the next fiscal year, it could shave another 0.2 percentage point from GDP growth in 2013. Another risk is that further political entanglements over raising the debt ceiling or a lack of progress on medium-term consolidation plans could lead to a higher sovereign risk premium. Under such a scenario, also explored in Chapter 1, growth during 2015–16 would be 1½ to 2½ percentage points lower than in the baseline, with substantial negative spillovers to the rest of the world.

Developing a comprehensive medium-term deficit-reduction framework remains the top policy priority in the United States. Despite the progress made so far through discretionary spending caps and modest tax increases, a comprehensive plan is needed that includes entitlement reform and additional revenue-raising measures to put public debt on a sustainable footing. Such a comprehensive plan should place fiscal consolidation on a gradual path in the short term, in light of the fragile recovery and the limited room for monetary policy.

The output gap remains sizable, and is expected to keep inflation below 2 percent during 2013–14. Given the downside risks, the additional policy easing announced by the Federal Reserve in December 2012 is appropriate. Moreover, its conditional rate guidance further clarifies for market participants the future path of the federal funds rate. Although the IMF staff expect the first hike in policy rates to occur in early 2016, the policy tightening cycle may need to start earlier should upside risks to growth materialize.

Canadian growth slowed to about ¾ percent in the second half of 2012, with fiscal consolidation, tighter

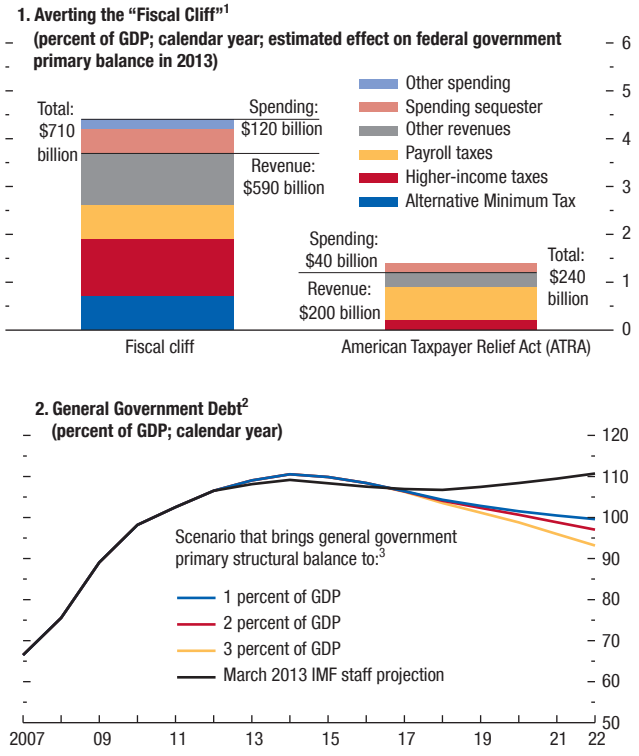
consumer credit, a cooling housing market, temporary disruptions in the energy sector, and an uncertain external environment weighing on economic activity. Economic growth is projected to be 1½ percent on average in 2013; business investment and net exports will benefit from the U.S. recovery, but high household debt and continued moderation of the housing sector will restrain domestic demand. Risks around the baseline scenario remain tilted to the downside, in particular from adverse fiscal outcomes in the United States, further turbulence in Europe, a decline in global commodity prices, and a less gradual unwinding of domestic imbalances. The main challenge for Canada's policymakers is to support growth in the short term while reducing the vulnerabilities that may arise from external shocks and domestic imbalances. Although fiscal consolidation is needed to rebuild fiscal space against future shocks, there is room to allow automatic stabilizers to operate fully if growth were to weaken further. The current monetary policy stance is appropriately accommodative, and the beginning of the monetary tightening cycle should be delayed until growth strengthens again.

Asia: Laying Foundations for Shared Prosperity

Economic performance was subdued in Asia during 2012, but growth is set to pick up gradually during 2013 on strengthening external demand and continued robust domestic demand (Figure 2.7). Private demand will be supported by accommodative monetary and, in some cases, fiscal policies; easy financial conditions; and resilient labor markets. Even as global tail risks recede, however, the risks and challenges emanating from within the region come more clearly into focus, including gradually increasing financial imbalances in some economies and the potential that any loss of confidence in regional economic policies could disrupt trade and investment. Policymakers must balance support for sustainable and more inclusive growth with the need to contain financial stability risks with adequate supervision.

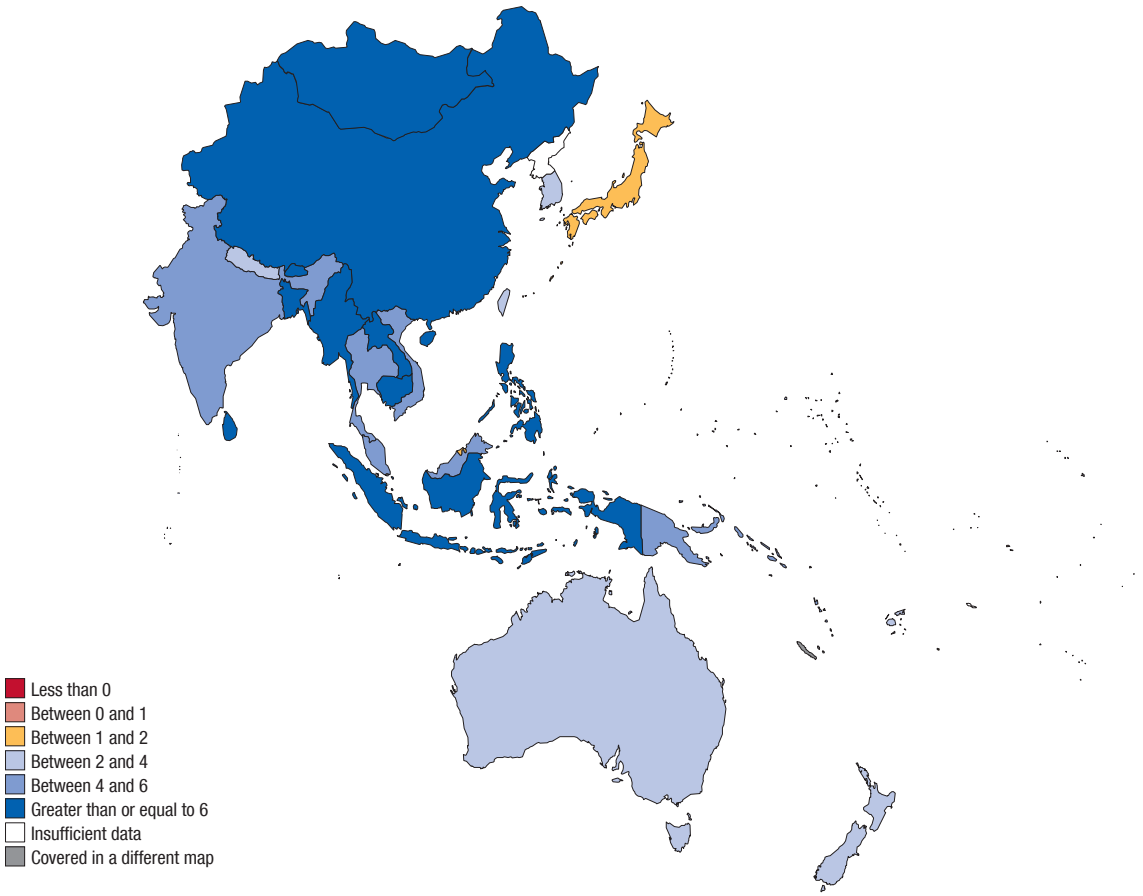
Economic activity had stabilized in Asia by the start of 2013. Growth slowed across the region in the middle of 2012 following a broad-based weakening of exports both within and outside Asia and implementation by China of policies aimed at moderating and better balancing growth (Figure 2.8). Exports have recently picked up across the region, reflecting firmer demand in China and the advanced economies (notably the United States).

Figure 2.6. United States: Fiscal Developments



Sources: Congressional Budget Office; and IMF staff estimates.
[1]Fiscal cliff refers to the sizable fiscal withdrawal—a combination of tax increases and spending cuts—that was scheduled to go into effect January 1, 2013. In particular, certain income tax provisions (enacted in 2001, 2003, and 2009), certain estate and gift provisions, provisions designed to limit the reach of the Alternative Minimum Tax, and certain tax credits (including bonus depreciation) were scheduled to expire. The extension of emergency unemployment benefits and a reduction in payroll taxes were also set to expire, and automatic enforcement procedures established by the Budget Control Act of 2011 (the "sequester") and reductions in Medicare payments to physicians were also scheduled to take effect. ATRA, signed into law on January 2, 2013, averted the fiscal cliff by significantly reducing the fiscal withdrawal. Other spending includes emergency unemployment benefits and Medicare payments to physicians. Other revenues include health care reform taxes and expiration of bonus depreciation and various tax credits if the fiscal cliff materialized. ATRA expanded the bonus depreciation and most other tax credits for fiscal year 2013 but maintained the health care reform taxes, postponed the sequester for two months, and allowed the payroll tax to rise. Higher-income taxes include interactions with the Alternative Minimum Tax: ATRA permanently extended 2001 and 2003 tax cuts for incomes below $400,000/$450,000 (single/joint filers). ATRA delayed the sequester for two months. The sequester took effect on March 1, 2013, and will remain in effect until the end of fiscal year 2013 (September 30, 2013).
[2]On the basis of *Government Finance Statistics Manual 2001*.
[3]The depicted scenarios assume a structural primary withdrawal of about 1 percent of GDP annually until the target general government primary structural balance is reached.

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



Source: IMF staff estimates.

For Asia as a whole, growth will pick up modestly to about 5¾ percent in 2013, largely as a result of recovering external demand and continued solid domestic demand (Table 2.3). Consumption and private investment will be supported by favorable labor market conditions—unemployment is at multiyear lows in several economies—and by relatively easy financial conditions. The latter reflect a combination of accommodative monetary policies; rapid credit growth, particularly in some members of the Association of Southeast Asian Nations (ASEAN); and continued robust capital inflows, which last year helped push stock prices up by 10 to 20 percent across most of the region.

Asian economies will also benefit from internal demand spillovers, particularly growing Chinese demand and the policy-led pickup in Japan. Indeed, for several economies, direct and indirect demand from China and Japan are almost as important as demand from the United States and Europe. This dynamic may be complicated, however, by the recent yen depreciation, which may put some of the region's exporters in more direct competition with Japanese firms in world markets, while others may benefit through supply-chain linkages with Japan. The ASEAN economies have become increasingly competitive in production of final consumer goods, which will contribute favorably to intraregional demand.

Inflation is expected to remain generally within central banks' targets (explicit or implicit). Reflecting the moderate acceleration of growth and a stable outlook for global food and commodity prices, headline inflation is expected to increase slightly to 4 percent in 2013, from 3½ percent in 2012.

- In Japan, growth is projected to be 1½ percent in 2013, moderately higher than in the October 2012 WEO as a result of new fiscal and monetary stimulus, despite a sharp contraction in the second

half of 2012. A sizable fiscal stimulus—about 1½ percent of GDP over two years—will boost growth by some 0.6 percentage point in 2013, and growth will be supported by a recovery in external demand and the substantial further monetary easing under the recently announced quantitative and qualitative framework in pursuit of the 2 percent inflation target.

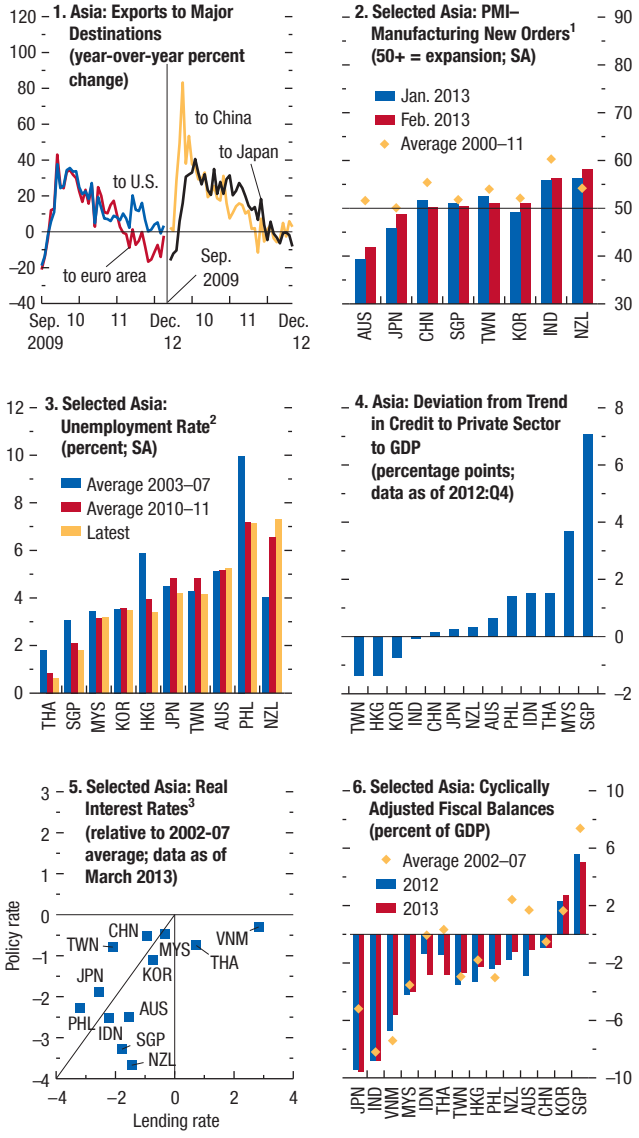
- China's growth is set to accelerate slightly to about 8 percent in 2013, reflecting continued robust domestic demand in both consumption and investment and renewed external demand. Inflation will pick up only modestly to an average of 3 percent in 2013.
- In Korea, improved exports should help spur private investment and help growth rebound to 2¾ percent. Inflation is rising but is expected to remain close to the lower bound of the target band.
- Growth will rise in India to 5¾ percent in 2013 as a result of improved external demand and recently implemented progrowth measures. Significant structural challenges will likely lower potential output over the medium term and also keep inflation elevated by regional standards.
- Growth in the ASEAN-5 economies will remain strong at 6 percent in 2013, reflecting resilient domestic demand. A large pipeline of projects under the Economic Transformation Plan will propel strong investment in Malaysia; robust remittance flows and low interest rates should continue to support private consumption and investment in the Philippines; and Indonesia will benefit from a recovery of commodity demand in China. In Thailand, growth is expected to return to a more normal pace after a V-shaped recovery driven by public reconstruction and other flood-related investment in 2012.

The potential impact of external risks on Asia remains considerable. In the event of a severe global slowdown, falling external demand would exert a powerful drag on Asia's most open economies, including through the second-round impact of lower investment and employment in export-oriented sectors. For example, in the scenario analyzed in Chapter 1 under which a reassessment of sovereign risks in advanced economies prompts further fiscal tightening and lower growth, growth in emerging Asia would be reduced by about 1 percentage point on average in 2015–16.

As global tail risks recede somewhat, risks and challenges to growth from within the region come more clearly into focus. Financial imbalances and asset prices

Figure 2.8. Asia: Stabilization, Recovery, and Accommodative Policies

With activity showing signs of stabilization, growth is expected to pick up gradually during 2013, as robust domestic demand is supported by favorable labor market conditions, easy financial conditions, and accommodative macroeconomic policies.



Sources: CEIC Data; Markit/Haver Analytics; and IMF staff estimates.
Note: AUS = Australia; CHN = China; HKG = Hong Kong SAR; IDN = Indonesia; IND = India; JPN = Japan; KOR = Korea; MYS = Malaysia; NZL = New Zealand; PHL = Philippines; SGP = Singapore; THA = Thailand; TWN = Taiwan Province of China; VNM = Vietnam. PMI = Purchasing Managers' Index; SA = seasonally adjusted.
[1]A reading above 50 percent indicates expansion; below 50 percent indicates contraction.
[2]Latest data as of March 2013 for the Philippines; February 2013 for Korea, Taiwan Province of China, and Hong Kong SAR; January 2013 for Japan and Thailand; 2012:Q4 for Singapore and Malaysia; and 2012:Q3 for Australia and New Zealand.
[3]A position above the 45-degree line indicates a larger lending cut, and below the line indicates a larger policy rate cut.

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

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Asia	**5.3**	**5.7**	**6.0**	**3.4**	**3.9**	**4.4**	**1.2**	**1.1**	**1.3**	**. . .**	**. . .**	**. . .**
Advanced Asia	**2.1**	**2.2**	**2.6**	**1.1**	**1.2**	**2.8**	**1.5**	**1.1**	**1.4**	**4.2**	**4.0**	**4.0**
Japan	2.0	1.6	1.4	0.0	0.1	3.0	1.0	1.2	1.9	4.4	4.1	4.1
Korea	2.0	2.8	3.9	2.2	2.4	2.9	3.7	2.7	2.4	3.3	3.3	3.3
Australia	3.6	3.0	3.3	1.8	2.5	2.5	–3.7	–5.5	–6.0	5.2	5.3	5.2
Taiwan Province of China	1.3	3.0	3.9	1.9	2.0	2.0	10.5	10.3	9.8	4.2	4.2	4.2
Hong Kong SAR	1.4	3.0	4.4	4.1	3.5	3.5	2.3	2.0	2.5	3.3	3.2	3.1
Singapore	1.3	2.0	5.1	4.6	4.0	3.4	18.6	16.9	17.2	2.0	2.0	2.1
New Zealand	2.5	2.7	2.6	1.1	1.4	2.2	–5.0	–5.8	–6.0	6.9	6.6	6.0
Developing Asia	**6.6**	**7.1**	**7.3**	**4.5**	**5.0**	**5.0**	**1.1**	**1.1**	**1.3**	**. . .**	**. . .**	**. . .**
China	7.8	8.0	8.2	2.6	3.0	3.0	2.6	2.6	2.9	4.1	4.1	4.1
India	4.0	5.7	6.2	9.3	10.8	10.7	–5.1	–4.9	–4.6	. . .	. . .	. . .
ASEAN-5	**6.1**	**5.9**	**5.5**	**3.9**	**4.5**	**4.5**	**0.8**	**0.6**	**0.4**	**. . .**	**. . .**	**. . .**
Indonesia	6.2	6.3	6.4	4.3	5.6	5.6	–2.8	–3.3	–3.3	6.2	6.1	6.0
Thailand	6.4	5.9	4.2	3.0	3.0	3.4	0.7	1.0	1.1	0.5	0.7	0.7
Malaysia	5.6	5.1	5.2	1.7	2.2	2.4	6.4	6.0	5.7	3.0	3.0	3.0
Philippines	6.6	6.0	5.5	3.1	3.1	3.2	2.9	2.4	2.0	7.0	7.0	7.0
Vietnam	5.0	5.2	5.2	9.1	8.8	8.0	7.4	7.9	6.3	4.5	4.5	4.5
Other Developing Asia[4]	**6.2**	**6.0**	**6.5**	**7.4**	**6.8**	**6.1**	**–1.6**	**–2.2**	**–2.2**	**. . .**	**. . .**	**. . .**
Memorandum												
Emerging Asia[5]	6.0	6.6	6.9	4.2	4.7	4.7	1.9	1.8	1.9	. . .	. . .	. . .

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

are building in a number of economies, fueled by rapid credit growth and easy financing conditions. In China, the use of more market-based financial instruments means that about half of financial intermediation now takes place outside traditional banking channels in less-well-supervised parts of the financial system, which leads to growing risks. In the scenario explored in Chapter 1 under which growth prospects for emerging markets are marked down and investment falls, Asia's output could be more than 2 percent below the baseline, and even lower if rising spreads lead to capital outflows. A number of other risks are more difficult to anticipate but could prove disruptive given Asia's highly integrated supply-chain network and growing dependence on regional demand and finance. These risks include disruptions to trade from territorial disputes, a loss of confidence in efforts to restore economic health in Japan, and stalled reforms and recovery in China.[1]

[1]For example, as highlighted in the IMF's *2012 Spillover Report* (IMF, 2012), a sharp rise in yields could lower growth in emerging Asia by about 2 percentage points.

Policymakers in the region must rebuild room for macroeconomic policy maneuvering while containing financial stability risks. Asian central banks have adopted an accommodative monetary policy stance, reducing policy rates or keeping them low during 2012 in the face of uncertain growth prospects and generally low and stable inflation. This stance has served them well, but the direction of future monetary policy action will diverge within the region. In emerging Asia, macroprudential measures will have to play an important role in those economies in which credit growth remains too rapid and threatens financial stability, especially if accompanied by persistently strong capital inflows. In China, financial sector reform should be accelerated to contain risks related to the rapid growth in total credit and to prevent a further buildup of excess capacity. In addition, the China Banking Regulatory Commission has recently announced steps to strengthen the supervision of banks' off-balance-sheet activities. The adoption of a new quantitative and qualitative monetary easing framework in Japan is welcome. For it to be successful and achieve 2 percent inflation within two years, easing must be accompanied by ambitious

growth and fiscal reforms to ensure a sustained recovery and reduce fiscal risks.

Country circumstances will also determine the appropriate pace of fiscal consolidation, including the need for demand rebalancing and the adequacy of policy room. For some economies with large external surpluses and low public debt, it may be appropriate to use fiscal measures to support domestic demand. More generally, structural deficits are higher than before the crisis and fiscal room needs to be rebuilt. Automatic stabilizers should be the first line of defense if growth disappoints.

The key medium-term priority is to sustain economic growth and make it more inclusive. Again, the policy agenda diverges among individual countries within the region and includes economic rebalancing, strengthening private investment, reform of goods and labor markets, improving tax and spending policies, and addressing rapid demographic shifts. Asian policymakers should also undertake coordinated and collective action to deepen regional trade integration.

Latin America and the Caribbean: Higher Growth Supported by Easy Financing Conditions

Output growth moderated somewhat in Latin America and the Caribbean during 2012, but domestic demand remains strong and external current account deficits have widened further, even with high commodity prices. Growth is projected to increase to 3½ percent in 2013, supported by a pickup in external demand, favorable financing conditions, and the impact of earlier policy easing in some countries (Figure 2.9). Policymakers in Latin America need to strengthen fiscal buffers, contain the buildup of financial vulnerabilities, and move forward with growth-enhancing reforms. In the Caribbean, the policy challenges are more pressing because growth continues to be held back by high debt levels and weak competitiveness.

Real GDP growth in the LAC region declined to 3 percent in 2012, from 4½ percent in 2011, reflecting a slowdown in external demand and, in some cases, the impact of domestic factors. The deceleration was particularly pronounced in Brazil, the region's largest economy, where large policy stimulus failed to spur private investment. The slowdown in Brazil spilled over to its regional trading partners, especially Argentina, Paraguay, and Uruguay. In Argentina, widespread import and exchange controls also affected business confidence and investment. In most of the other financially integrated economies (Chile, Mexico, Peru), growth remained strong, gradually moderating toward potential (Figure 2.10). Economic activity in Central America was also resilient, expanding by an average of 4¾ percent in 2012. However, in much of the Caribbean the recovery remained constrained by high debt levels and weak tourism receipts.

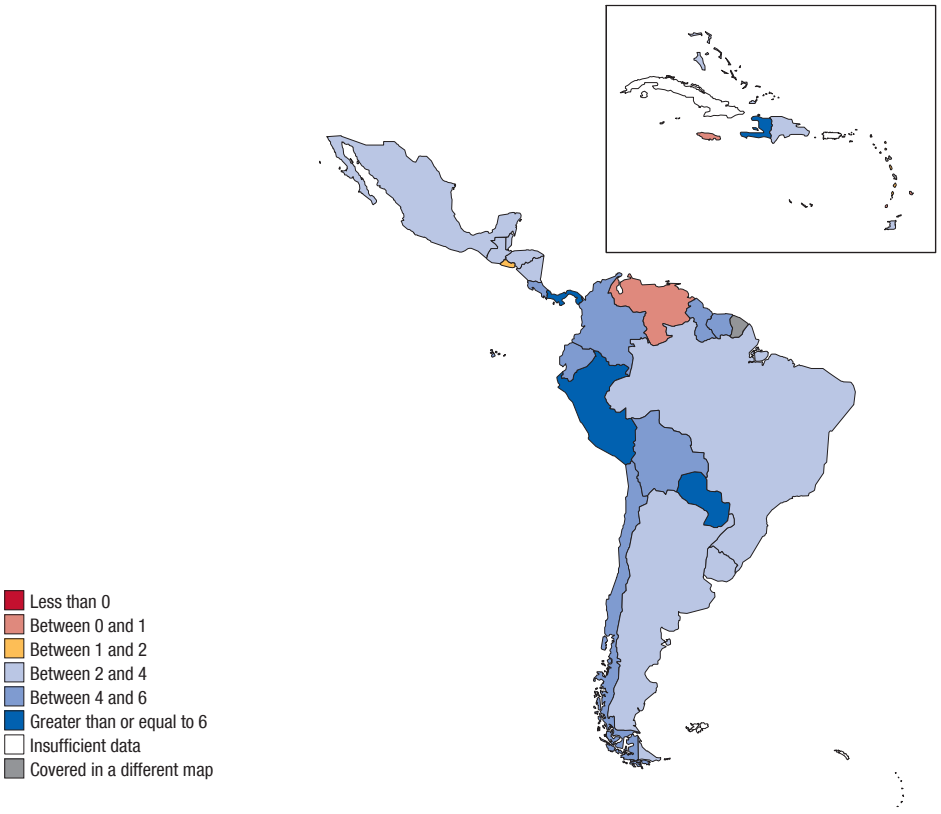
Despite the moderation in growth, domestic demand remained robust in most of Latin America, supported by easy financing conditions and high commodity prices. External current account deficits increased to 3 percent of GDP on average for the larger financially integrated economies in 2012 (from 1¼ percent in 2010).[2] Meanwhile, inflation in these economies remained generally well anchored, although it stayed above the midpoint of the inflation target in some cases (including Brazil and Uruguay). Capital inflows have been strong, and the pickup in portfolio flows in the second half of 2012 pushed up equity prices and local currencies. Bank credit growth and bond issuance remained strong in many countries, and household and corporate debt increased.

Against this backdrop, real GDP growth in the LAC region is projected to increase to 3½ percent in 2013 (Table 2.4):

- In Brazil, growth will strengthen to 3 percent, from less than 1 percent in 2012, reflecting the lagged impact of domestic policy easing and measures targeted at boosting private investment. However, supply constraints could limit the pace of growth in the near term. Activity in other commodity-exporting countries is expected to remain strong. A notable exception is Venezuela, where growth is projected to decelerate sharply as the pace of fiscal spending declines. Private consumption growth in Venezuela is also expected to decline in the near term following the recent currency devaluation and tightening of exchange controls.
- In Mexico, growth is expected to be close to potential, at 3½ percent in both 2013 and 2014, with domestic demand underpinned by sustained business and consumer confidence and resilient exports. High capacity utilization suggests that the recovery in investment will continue, and sustained employment growth and favorable credit conditions should support consumption.
- Most Central American economies are projected to expand in line with potential (by about 4½ percent), supported by strengthening in exports and remit-

[2]This group includes Chile, Colombia, Mexico, Peru, and Uruguay.

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



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

tances, although fiscal consolidation may dampen demand in some cases.

- The recovery will continue in much of the Caribbean, with a gradual pickup in tourism flows. However, high debt levels and weak competitiveness will continue to constrain growth.

The downside risks to the near-term outlook for the LAC region have diminished, as policy actions in the United States and the euro area have contained the immediate threats to global growth. However, as long as the repair of the euro area financial sector is incomplete, subsidiaries of European banks in the region remain vulnerable to potential deleveraging. Meanwhile, the reacceleration of growth in China should help support commodity prices and the region's exports. Domestic demand growth may be higher than projected, supported by strong capital inflows and easy financing conditions, particularly if slippages occur in the implementation of fiscal consolidation plans.

In the medium term, however, downside risks continue to dominate. The main risks remain the potential reversal of easy external financing conditions and favorable commodity prices. As illustrated in the risk scenarios in Chapter 1, the region would be seriously affected by a sharp slowdown in emerging market economies, particularly in China. Specifically, a 10 percent decline in private investment in the BRICS (Brazil, Russia, India, China, South Africa) could reduce output in Latin America by more than 1 percentage point during 2013–14 through its effect on demand for commodities and other exports. A combination of lower investment and capital outflows would reduce output in the region by more than 2 percentage points relative to the baseline. In addition, lingering uncertainty about the medium-term fiscal outlook for the advanced economies could result in heightened risk aversion and an increase in sovereign spreads, with negative implications for global growth.

Debt levels and fiscal deficits in many countries remain higher than before the crisis. With output gaps closed in most of the region, policymakers should take advantage of the relatively favorable economic conditions to proceed with fiscal consolidation. Fiscal prudence would also help mitigate the widening of the current accounts and the appreciation of real exchange rates. Fiscal consolidation efforts should protect much-needed public investment and education spending. If downside risks to the outlook were to materialize, monetary policy should act as the first line of defense in countries with well-anchored inflation expectations.

Large and potentially volatile capital flows continue to present a challenge for the region. Policies need to be geared toward limiting the buildup of financial and corporate sector vulnerabilities in an environment of cheap and readily available external financing. Exchange rate flexibility should continue to be used to buffer shocks and discourage speculative capital flows. Also critical will be strong prudential regulation and supervision, focused on identifying vulnerabilities and limiting systemic risks, as well as adequate capitalization and loan loss provisioning in economies that have recently experienced rapid credit growth.

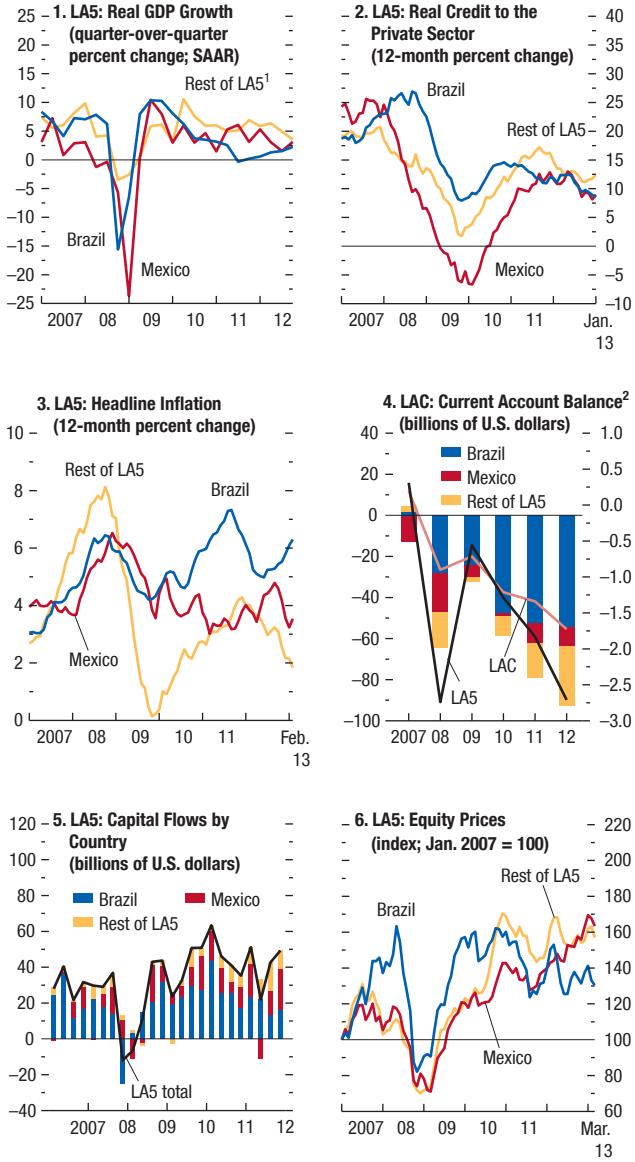
The key challenge for the medium term remains boosting productivity and competitiveness. High growth rates in Latin America in recent years have been supported by an increase in labor utilization and rapid credit growth, which are likely to moderate. To maintain high rates of potential output growth, the region needs to invest more in infrastructure and human capital, improve the business and regulatory environment, and diversify exports. Increasing competitiveness is also critical for the Caribbean, where higher growth would also help alleviate the high debt burden.

Middle East and North Africa: Narrowing Differences in a Two-Speed Region

Economic performance across the Middle East and North Africa was again mixed in 2012. Although most of the region's oil-exporting countries grew at healthy rates, economic growth remained sluggish in the oil importers—many of which are undergoing political transitions. In 2013, these differences are expected to narrow because of a scaling back of hydrocarbon production among oil exporters and a mild economic recovery among oil importers. Many countries face the immediate challenge of reestablishing or maintaining macroeconomic stability amid political uncertainty and social unrest, but the

Figure 2.10. Latin America: Growth Supported by Easy Financing Conditions

Output growth moderated in much of the region, with Brazil observing the sharpest slowdown. Domestic demand and bank credit continue to grow at a fast pace; inflation has generally been contained, but current account deficits continue to widen. Capital flows remain buoyant, with a recent pickup in portfolio flows leading to a strengthening of both currencies and equity markets.



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: LAC = Latin America and the Caribbean. LA5 includes Brazil, Chile, Colombia, Mexico, and Peru. Rest of LA5 refers to simple average for Chile, Colombia, and Peru (unless noted otherwise). SAAR = seasonally adjusted annualized rate.
[1]For Colombia, growth is averaged over four quarters.
[2]Rest of LA5: total for Chile, Colombia, Peru. LA5: simple average; percent of GDP, right scale. LAC: percent of GDP, right scale.

Table 2.4. Selected Western Hemisphere Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
North America	**2.3**	**2.0**	**2.9**	**2.2**	**2.0**	**1.9**	**–3.0**	**–2.8**	**–2.9**	**. . .**	**. . .**	**. . .**
United States	2.2	1.9	3.0	2.1	1.8	1.7	–3.0	–2.9	–3.0	8.1	7.7	7.5
Canada	1.8	1.5	2.4	1.5	1.5	1.8	–3.7	–3.5	–3.4	7.3	7.3	7.2
Mexico	3.9	3.4	3.4	4.1	3.7	3.2	–0.8	–1.0	–1.0	4.8	4.8	4.5
South America[4]	**2.6**	**3.4**	**4.1**	**6.8**	**7.2**	**6.7**	**–1.7**	**–1.6**	**–2.1**	**. . .**	**. . .**	**. . .**
Brazil	0.9	3.0	4.0	5.4	6.1	4.7	–2.3	–2.4	–3.2	5.5	6.0	6.5
Argentina[5]	1.9	2.8	3.5	10.0	9.8	10.1	0.1	–0.1	–0.5	7.2	7.1	6.8
Colombia	4.0	4.1	4.5	3.2	2.2	3.0	–3.4	–3.4	–2.9	10.4	10.3	10.0
Venezuela	5.5	0.1	2.3	21.1	27.3	27.6	2.9	6.2	7.7	7.8	7.8	7.8
Peru	6.3	6.3	6.1	3.7	2.1	2.3	–3.6	–3.5	–3.4	6.8	6.8	6.8
Chile	5.5	4.9	4.6	3.0	2.1	3.0	–3.5	–4.0	–3.6	6.5	6.5	6.6
Ecuador	5.0	4.4	3.9	5.1	4.7	4.1	–0.5	–1.3	–1.5	5.3	5.8	6.0
Bolivia	5.2	4.8	5.0	4.5	4.6	4.3	7.5	4.8	3.5	5.4	5.4	5.3
Uruguay	3.8	3.8	4.0	8.1	7.3	7.2	–3.4	–2.9	–2.5	6.1	6.5	7.0
Paraguay	–1.2	11.0	4.6	3.8	3.6	5.0	–2.0	–2.4	–2.9	5.8	5.4	5.5
Central America[6]	**4.8**	**4.4**	**4.1**	**4.5**	**4.6**	**4.7**	**–6.6**	**–6.6**	**–6.3**	**. . .**	**. . .**	**. . .**
Caribbean[7]	**2.4**	**2.2**	**3.0**	**5.1**	**5.1**	**4.6**	**–4.5**	**–3.3**	**–2.4**	**. . .**	**. . .**	**. . .**
Memorandum												
Latin America and the Caribbean[8]	3.0	3.4	3.9	6.0	6.1	5.7	–1.7	–1.7	–2.0	. . .	. . .	. . .
Eastern Caribbean Currency Union[9]	0.0	1.2	2.2	3.0	3.1	2.6	–17.8	–18.3	–18.0	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country.

[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Tables A6 and A7 in the Statistical Appendix.

[2]Percent of GDP.

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

[4]Includes Guyana and Suriname.

[5]The data for Argentina are officially reported data. The IMF has, however, issued a declaration of censure and called on Argentina to adopt remedial measures to address the quality of the official GDP and CPI-GBA data. Alternative data sources have shown significantly lower real growth than the official data since 2008 and considerably higher inflation rates than the official data since 2007. In this context, the IMF is also using alternative estimates of GDP growth and CPI inflation for the surveillance of macroeconomic developments in Argentina.

[6]Central America comprises Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

[7]The Caribbean comprises Antigua and Barbuda, The Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

[8]Latin America and the Caribbean comprises Mexico and economies from the Caribbean, Central America, and South America.

[9]Eastern Caribbean Currency Union comprises Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines as well as Anguilla and Montserrat, which are not IMF members.

region must not lose sight of the medium-term challenge of diversifying their economies, creating more jobs, and generating more inclusive growth.

Growth in the MENA region was relatively robust at 4¾ percent in 2012, but is expected to weaken to about 3 percent in 2013 largely because of an expected slowdown among oil exporters (Figure 2.11; Table 2.5).[3]

Oil-Exporting Economies

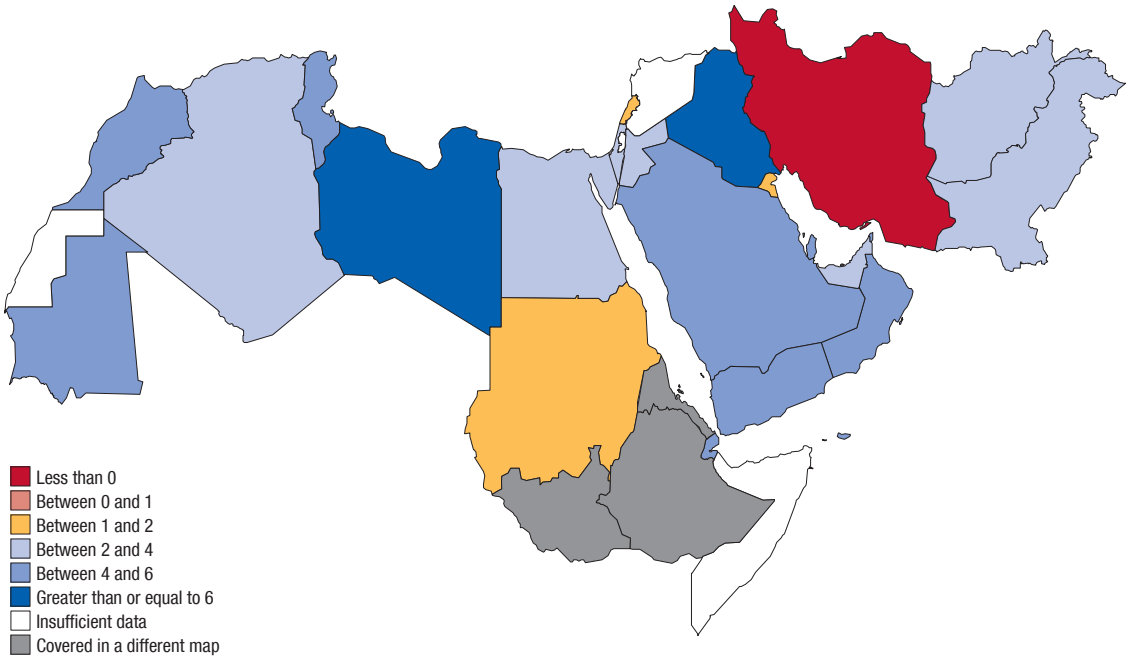
For MENA oil exporters, 2012 was a year of robust growth, which reached about 5¾ percent, driven largely by the almost complete restoration of Libya's oil production and strong expansions in the Gulf Cooperation Council countries. Economic growth is projected to fall to 3¼ percent in 2013 as oil production growth pauses against a backdrop of relatively weak global oil demand. Additional oil supplies from Iraq and Libya are expected to more than offset a decline in oil exports from Iran this year, while lower net demand for Saudi Arabian exports is expected to result in slightly reduced production. As a result, aggregate oil GDP is expected to stagnate in 2013, compared with growth of 4½ percent recorded in 2012.

Sustained high government spending will continue to support buoyant non-oil GDP growth, expected at 4¼ percent this year. Overall, growth in the oil exporters of the region is projected to strengthen to about 3¾ percent in 2014 on the back of rising non-oil GDP growth and resuming oil GDP growth.[4]

[3]Syria has been excluded from regional aggregates, including projections, since 2011 because of the ongoing civil war.

[4]Saudi Arabia recently revised its GDP data, which resulted in a significantly higher level of GDP and higher estimated growth rates in 2011 and 2012.

Figure 2.11. Middle East, North Africa, Afghanistan, and Pakistan: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: Includes Israel.

Inflation is expected to remain moderate in most oil-exporting countries because of decreasing food inflation, a benign global inflation environment, and lower increases in rents in some Gulf Cooperation Council countries. For Iran, some of these factors are envisaged to help reduce inflation in 2013. However, the macroeconomic environment is likely to remain difficult, given the sharp depreciation of the currency and adverse external conditions, which would sustain inflation at relatively high levels.

Risks to the near-term outlook for oil exporters center on the evolution of oil prices and global growth. Although fiscal and external balances are sensitive to fluctuations in oil prices, many countries have low public debt levels and would be able to draw on the reserves they have built up in the past to sustain aggregate demand in the event of a decline in oil prices. Nonetheless, a prolonged fall in oil prices brought about by lower global economic activity would result in fiscal deficits for most oil exporters. Indeed, the emerging market slowdown scenario described in Chapter 1 would place oil prices below the level required to balance the budget for most countries for many years, in the absence of a domestic policy response.

For oil exporters, increases in hard-to-reverse government expenditures such as wages should be contained to build resilience to a possible sustained decrease in the oil price. Capital expenditures can be sustained but need to be prioritized to ensure that the quality of public investment is not compromised. Fiscal consolidation is more pressing for some low-income oil exporters (particularly Yemen), which are already burdened by constrained fiscal positions. More broadly, countries need to continue their efforts to develop fiscal policy frameworks that mitigate the economic effects of oil price volatility and ensure the sustainable use of resource wealth.

To address their medium-term challenges, the oil exporters need to continue with reforms that increase the pace of economic diversification and support job creation. The former will require continued infrastructure investment and further improvements in the business climate, while the latter will require enhancing education and training, improving job placement services, and reviewing the incentives for working in the private relative to the public sector.

Oil-Importing Economies

Although growth in the MENA oil importers in 2012 was somewhat stronger than projected in the

Table 2.5. Selected Middle East and North African Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Middle East and North Africa	**4.8**	**3.1**	**3.7**	**10.7**	**9.6**	**9.0**	**12.5**	**10.8**	**8.9**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**5.7**	**3.2**	**3.7**	**11.3**	**10.0**	**8.5**	**16.6**	**14.3**	**12.0**	**. . .**	**. . .**	**. . .**
Iran	–1.9	–1.3	1.1	30.6	27.2	21.1	4.9	3.6	1.9	12.5	13.4	14.7
Saudi Arabia	6.8	4.4	4.2	2.9	3.7	3.6	24.4	19.2	16.1	. . .	. . .	. . .
Algeria	2.5	3.3	3.4	8.9	5.0	4.5	5.9	6.1	4.5	9.7	9.3	9.0
United Arab Emirates	3.9	3.1	3.6	0.7	1.6	1.9	8.2	8.4	7.9	. . .	. . .	. . .
Qatar	6.6	5.2	5.0	1.9	3.0	4.0	29.5	29.3	23.7	. . .	. . .	. . .
Kuwait	5.1	1.1	3.1	2.9	3.3	3.8	45.0	40.8	37.6	2.1	2.1	2.1
Iraq	8.4	9.0	8.4	6.1	4.3	5.5	7.0	3.6	2.9	. . .	. . .	. . .
Oil Importers[5]	**1.9**	**2.7**	**3.7**	**8.7**	**8.3**	**10.6**	**–7.7**	**–5.7**	**–4.9**	**. . .**	**. . .**	**. . .**
Egypt	2.2	2.0	3.3	8.6	8.2	13.7	–3.1	–2.1	–1.6	12.3	13.5	14.3
Morocco	3.0	4.5	4.8	1.3	2.5	2.5	–9.6	–7.0	–5.8	8.8	8.7	8.6
Tunisia	3.6	4.0	4.5	5.6	6.0	4.7	–8.0	–7.3	–6.6	18.9	16.7	16.0
Sudan	–4.4	1.2	2.6	35.5	28.4	29.4	–11.2	–6.9	–5.9	10.8	9.6	8.4
Lebanon	1.5	2.0	4.0	6.6	6.7	2.4	–16.1	–16.1	–14.6	. . .	. . .	. . .
Jordan	2.8	3.3	3.5	4.8	5.9	3.2	–18.1	–10.0	–9.1	12.2	12.2	12.2
Memorandum												
Middle East, North Africa, Afghanistan, and Pakistan	4.7	3.1	3.7	10.7	9.4	9.0	11.5	9.9	8.2	. . .	. . .	. . .
Pakistan	3.7	3.5	3.3	11.0	8.2	9.5	–2.0	–0.7	–0.8	7.7	9.2	10.7
Afghanistan	10.2	3.1	4.8	4.4	6.1	5.8	4.0	1.6	0.3	. . .	. . .	. . .
Maghreb[6]	15.3	6.1	5.0	5.9	4.1	4.1	6.3	5.5	3.6	. . .	. . .	. . .
Mashreq[7]	2.2	2.1	3.3	8.2	7.9	11.8	–6.1	–4.6	–4.1	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country.

[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.

[2]Percent of GDP.

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

[4]Includes Bahrain, Libya, Oman, and Yemen.

[5]Includes Djibouti and Mauritania. Excludes Syria.

[6]The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia.

[7]The Mashreq comprises Egypt, Jordan, and Lebanon. Excludes Syria.

October 2012 WEO, reaching about 2 percent, growth remains weighed down by a number of factors: continued political uncertainty and bouts of social unrest across the Arab countries in transition, significant regional spillovers from the escalating conflict in Syria, soft external demand from European trading partners, and persistently high commodity prices (particularly for food and fuel).[5] As a result, exports of goods and foreign direct investment (FDI) flows have declined; tourism arrivals remain below 2010 levels (including in Egypt and Lebanon); and unemployment has risen in many countries (Figure 2.12). At the same time, inflation has generally remained muted, reflecting tepid demand. Besides these broad trends, a few prominent country-specific factors have also played a role:

- Upside surprises to growth in 2012 were driven by a favorable agricultural harvest in Afghanistan, a tourism rebound in Tunisia, and higher-than-expected commodity revenues in Mauritania.
- In Egypt, the uncertainty generated by a protracted political transition has held back growth and led to an increase in fiscal and external imbalances.
- In Jordan, growth has been affected by the disruption of trading routes through Syria and strikes in the mining industry.
- In Morocco, an extended period of sound economic performance has been challenged by the deterioration of the situation in Europe; high oil and food prices and, in 2012, lower-than-average agriculture production; and heightening pressure on the public and external accounts.
- In Pakistan, high fiscal deficits and a difficult business climate are contributing to a sharp fall in private investment and growth.
- In Sudan, despite a significant pickup in agricultural activity, continued military skirmishes with neighboring South Sudan and the postsecession loss of

[5]The Arab countries in transition comprise Egypt, Jordan, Libya, Morocco, Tunisia, and Yemen.

oil production and exports led to a large decline in output in 2012.

The weak domestic and external environment will continue to pose challenges for MENA oil importers during 2013–14. Growth is projected to be 2¾ percent this year, a downward revision of ½ percentage point relative to the October 2012 WEO, owing to slower progress in political transitions and the protracted recovery in European trading partners. Nonetheless, assuming progress is made in the region's political and economic transitions, growth in oil importers could accelerate to 3¾ percent in 2014. Inflation is expected to rise during 2013–14, reflecting monetization of fiscal imbalances in several countries and cutbacks in commodity price subsidies, despite moderating commodity-import prices.

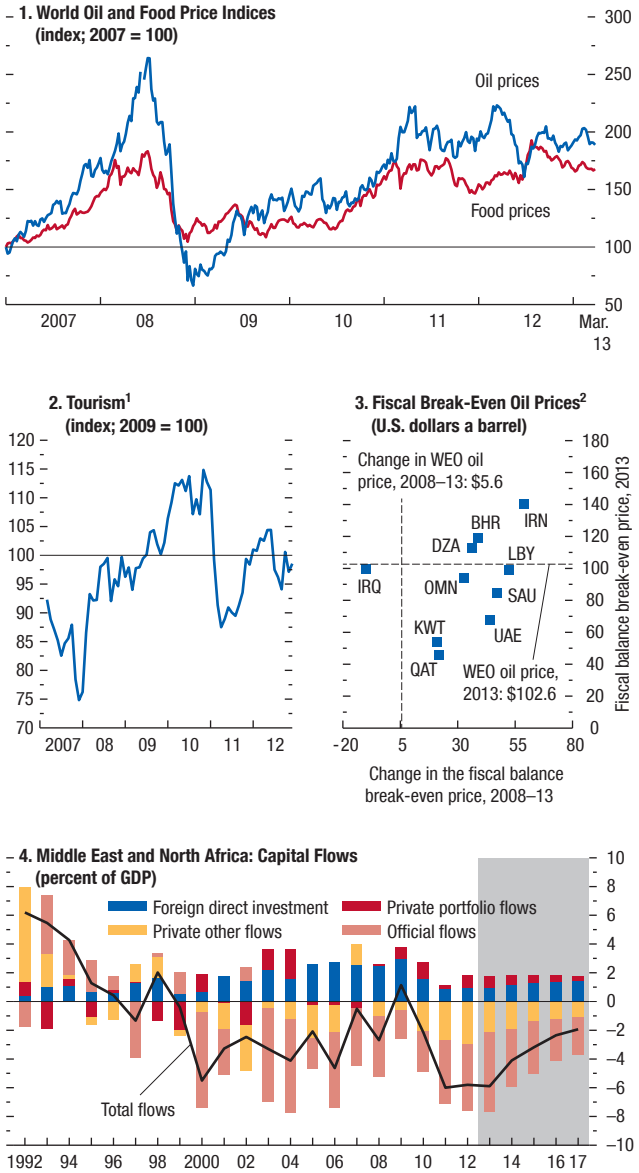
Downside risks remain elevated for oil importers, largely as the result of domestic and regional political instability and social unrest. Several governments in the region are transitional, and continued political instability could further delay policy action to maintain macroeconomic stability and aid the recovery. In addition, there is a risk that the conflict in Syria could spread to neighboring countries (Iraq, Jordan, Lebanon) and the broader subregion. In addition to the political risks, an increase in global food and fuel prices could reduce output and worsen the oil importers' already large fiscal and external deficits. A protracted period of slow European growth could further affect MENA oil importers' growth through economic linkages, including trade, tourism, remittances, and FDI. However, upside risks also exist from a potential "stabilization dividend" if reform momentum continues in Europe, a scenario analyzed in Chapter 1—this upside has the potential to boost activity, especially in the Maghreb (Algeria, Libya, Mauritania, Morocco, Tunisia).[6]

Since 2010, MENA oil importers have largely relied on their policy buffers to accommodate high fiscal and external current account deficits. However, use of these buffers has led to rising public debt (as a percentage of GDP) and a drawdown of international reserves. In recent months, some macroeconomic adjustment has taken place in several countries, in the form of greater exchange rate flexibility (Egypt, Tunisia) and reduced energy subsidies (Egypt, Jordan, Mauritania, Morocco,

[6]Annex 1.2 of the November 2012 *Regional Economic Outlook: Middle East and Central Asia* provides a detailed analysis of spillovers from Europe to the Maghreb and other MENA economies.

Figure 2.12. Middle East and North Africa: Narrowing Differences in a Two-Speed Region

Growth rates will converge somewhat as oil exporters scale back oil production and oil importers recover slightly.



Sources: Bloomberg, L.P.; Haver Analytics; IMF, *Regional Economic Outlook: Middle East and Central Asia* (November 2012); national authorities; United Nations World Tourism Organization, World Tourism Barometer; and IMF staff estimates.
[1]Index of tourism is calculated based on the simple average of tourist arrivals of Egypt, Jordan, Lebanon, Morocco, and Tunisia. Morocco is excluded in 2007 due to data limitations.
[2]DZA = Algeria; BHR = Bahrain; IRN = Iran; IRQ = Iraq; KWT = Kuwait; LBY = Libya; OMN = Oman; QAT = Qatar, SAU = Saudi Arabia; UAE = United Arab Emirates. For Yemen, the fiscal break-even price of oil is $215 a barrel.

Tunisia).[7] Further fiscal consolidation is needed and will require reductions in inefficient spending on generalized subsidies and increased expenditures on targeted social safety nets, as well as boosts to public investment. Mobilizing external official financing can assist in smoothing the adjustment, and greater exchange rate flexibility can help protect reserves and maintain competitiveness in the face of external and domestic shocks. At the same time, action is needed to formulate and implement a credible and bold agenda of institutional and regulatory reforms, which will enhance the business environment, bolster private sector activity, and create greater and more equal access to economic and employment opportunities.

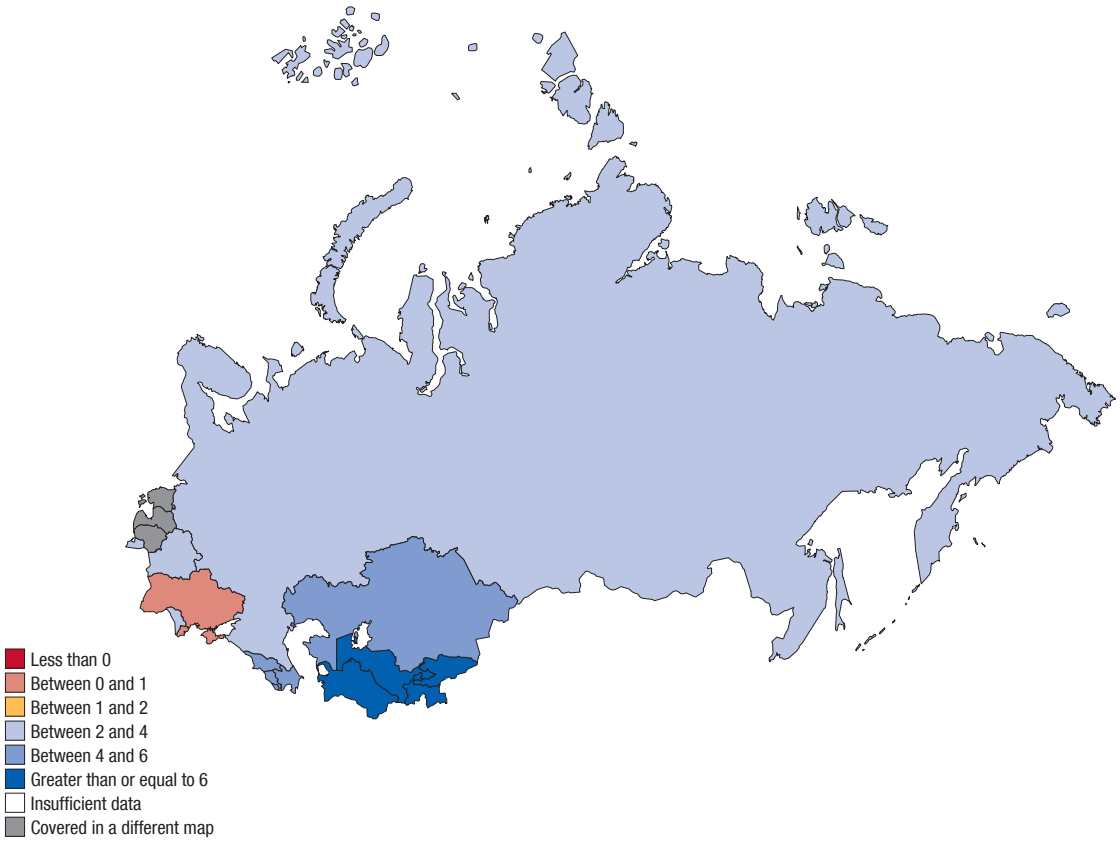
[7]See Appendix 1 of the April 2013 *Fiscal Monitor* for a more detailed discussion of energy subsidy reform.

Commonwealth of Independent States: An Improving but Vulnerable Outlook

Growth in the CIS is likely to pick up somewhat from its mediocre pace in 2012 as the external environment gradually improves and oil prices stabilize at high levels. Growth will be stronger in the Caucasus and central Asia than in the European CIS countries, underpinned by remittances and high commodity prices (Figure 2.13). Most countries in the region would benefit from structural policies to boost medium-term growth, but some, including Belarus and Ukraine, also have macroeconomic imbalances to address.

After a relatively strong start, activity decelerated in the CIS during the course of 2012, bringing growth down to 3½ percent for the year, from 4¾ percent in 2011 (Figure 2.14). The global slowdown affected exports across the region, although the impact was

Figure 2.13. Commonwealth of Independent States: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.
Note: Includes Georgia.

stronger in the European CIS countries than in the Caucasus and central Asia. Domestic demand also weakened, for varying reasons: in Russia because export prices for oil stopped rising, and in Ukraine because of higher interest rates used to defend the exchange rate. Georgia's economy slowed in the second half of the year because of uncertainties stemming from October's election and the ensuing political transition. Moldova's growth came to a halt in 2012, the result of a poor harvest, slowing trade, and stagnating remittances. Growth in the Kyrgyz Republic fell sharply, induced by shortfalls in gold production. A temporary decline in oil output accounted for the slowing of GDP growth in Kazakhstan.

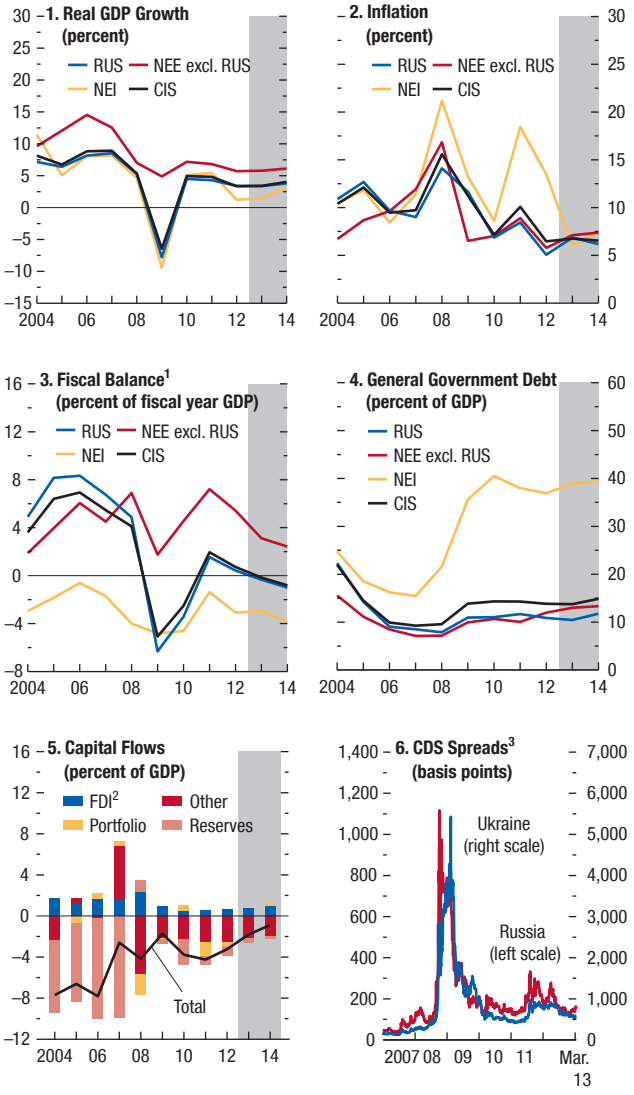
Growth in the CIS is projected to remain at 3½ percent in 2013 and pick up to 4 percent in 2014, underpinned by the gradual global recovery and stable commodity prices (Table 2.6). Improved financial conditions lend further support. Since the middle of 2012, the reduction in euro area tail risks has helped reduce credit default swap spreads in the region significantly and ease access to international capital markets. In the Caucasus and central Asia, growth is projected to remain near 6 percent during 2013–14, well in excess of the CIS regional aggregate. Growth will continue to be underpinned by healthy remittance flows from Russia and high commodity (energy and minerals) prices.

- Russia's growth is projected to remain at 3½ percent this year because the output gap is essentially closed and growth is running close to potential.
- In Ukraine, after nearly zero growth in 2012 because of deteriorating terms of trade, GDP growth is likely to remain subdued in 2013 under unchanged policies.
- Growth in Armenia will moderate to about 4¼ percent during 2013–14 compared with more than 7 percent in 2012, as a return to more normal weather conditions, a slowdown in credit expansion, and a continuation of fiscal consolidation bring the economy back toward trend growth.
- In Turkmenistan, growth during 2013–14 will be close to 8 percent, led by growing gas exports to China and public investment expenditures.

Inflation is expected to remain close to current levels in 2013. In Russia, it will average about 7 percent. In Ukraine, inflation is projected to remain at ½ percent in 2013. There is concern that premature policy loosening might impede disinflation in

Figure 2.14. Commonwealth of Independent States: An Improving Outlook with Vulnerability to Global Slowdown

Growth in the Commonwealth of Independent States (CIS) is likely to pick up modestly as the external environment gradually improves and oil prices stabilize at high levels. Rebuilding fiscal policy buffers remains a key priority for several CIS economies. The decline in euro area tail risks has helped reduce credit default swap (CDS) spreads in the region and eased access to international capital markets.



Sources: Thomson Reuters Datastream; and IMF staff estimates.
Note: Net energy exporters (NEE): Azerbaijan, Kazakhstan, Russia (RUS), Turkmenistan, Uzbekistan. Net energy importers (NEI): Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Tajikistan, Ukraine. NEE excl. RUS = net energy exporters excluding Russia.
[1]General government net lending/borrowing except for NEI, where it is the overall balance.
[2]FDI = foreign direct investment.
[3]Data from January 2007 through March 2013.

Table 2.6. Commonwealth of Independent States: Real GDP, Consumer Prices, Current Account Balance, and Unemployment
(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Commonwealth of Independent States (CIS)	**3.4**	**3.4**	**4.0**	**6.5**	**6.8**	**6.5**	**3.2**	**1.9**	**0.9**	**. . .**	**. . .**	**. . .**
Net Energy Exporters	**3.8**	**3.8**	**4.2**	**5.2**	**6.9**	**6.4**	**4.5**	**2.9**	**1.9**	**. . .**	**. . .**	**. . .**
Russia	3.4	3.4	3.8	5.1	6.9	6.2	4.0	2.5	1.6	6.0	5.5	5.5
Kazakhstan	5.0	5.5	5.6	5.1	7.2	6.4	4.6	4.0	2.2	5.4	5.3	5.3
Uzbekistan	8.0	7.0	6.5	12.1	10.9	11.0	2.7	3.5	4.2	0.2	0.2	0.2
Azerbaijan	2.2	4.1	5.8	1.1	3.4	6.7	20.3	10.6	6.0	6.0	6.0	6.0
Turkmenistan	11.0	7.7	7.9	4.9	5.6	5.5	1.7	2.5	2.8	. . .	. . .	. . .
Net Energy Importers	**1.2**	**1.5**	**3.2**	**13.5**	**6.0**	**7.5**	**–7.3**	**–7.3**	**–7.2**	**. . .**	**. . .**	**. . .**
Ukraine	0.2	0.0	2.8	0.6	0.5	4.7	–8.2	–7.9	–7.8	8.0	8.2	7.9
Belarus	1.5	2.1	2.6	59.2	20.5	15.5	–2.9	–5.2	–5.5	0.6	0.6	0.6
Georgia[4]	6.5	6.0	6.0	–0.9	1.0	4.6	–12.0	–10.0	–8.4	14.6	14.0	13.3
Armenia	7.2	4.3	4.1	2.5	4.2	4.0	–10.6	–9.6	–8.2	19.0	18.5	18.0
Tajikistan	7.5	7.0	6.0	5.8	7.7	7.0	–1.9	–2.2	–2.4	. . .	. . .	. . .
Kyrgyz Republic	–0.9	7.4	7.5	2.8	8.6	7.2	–12.7	–7.6	–6.1	7.7	7.6	7.6
Moldova	–0.8	4.0	4.0	4.7	4.6	5.0	–9.4	–10.0	–9.7	5.5	6.2	5.7
Memorandum												
Caucasus and Central Asia[5]	5.7	5.8	6.1	5.2	6.7	7.1	5.4	3.8	2.4	. . .	. . .	. . .
Low-Income CIS Countries[6]	6.5	6.4	6.1	7.5	8.0	8.4	–3.3	–2.1	–1.1	. . .	. . .	. . .
Net Energy Exporters Excluding Russia	5.7	5.8	6.1	5.8	7.1	7.4	7.1	5.1	3.3	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Georgia, which is not a member of the Commonwealth of Independent States, is included in this group for reasons of geography and similarity in economic structure.
[5]Includes Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
[6]Low-income CIS countries comprise Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.

Belarus. Inflation in Uzbekistan will likely remain in double digits in 2013, underpinned by higher administered prices.

The regional balance of risks to the outlook remains on the downside, reflecting the balance of risks at the global level. Under a number of scenarios, such as the emerging market investment slowdown and the euro area downside scenario explored in Chapter 1, lower oil prices would transmit adverse global developments to Russia and Kazakhstan, with secondary effects from the former throughout the CIS. Trade, FDI flows, and remittance linkages are additional key spillover channels from Russia to other CIS economies—for example, remittances from immigrants working in Russia are a key driver of economic activity in Armenia, the Kyrgyz Republic, and Tajikistan. As for financial system risks, bank balance sheets remain impaired in economies with sizable nonperforming loans (Kazakhstan, Tajikistan).

Rebuilding fiscal policy buffers remains a key priority for several CIS economies. Among the energy importers, reducing fiscal deficits will help ensure public debt sustainability (Kyrgyz Republic, Tajikistan) and help narrow large current account deficits (Georgia). Fiscal consolidation is also important for Azerbaijan, whose non-oil fiscal position is well above the long-term sustainable level.

The region needs to spur structural reforms to lift its growth potential. In Russia and Kazakhstan, this means delivering on pledges to improve the business climate and diversify the economy. Gas sector reform is overdue in Ukraine. In the Kyrgyz Republic and Tajikistan, growth could be spurred by prudently financed and prioritized infrastructure investment. For Belarus, price liberalization, enterprise reform, and privatization should be priorities. In addition, European CIS countries need to maintain flexible exchange rates, and Belarus and Ukraine should address macroeconomic imbalances: Belarus needs to ensure further disinflation, and Ukraine should reduce the large current account and fiscal deficits. Further strengthening and development of institutions will help successfully implement the required policies in the region.

Sub-Saharan Africa: Strong Growth Continues

Sub-Saharan Africa is expected to continue growing at a strong pace during 2013–14, with both resource-rich and lower-income economies benefiting from robust domestic demand (Figure 2.15). The external environment is the main source of risks to growth, particularly for middle-income and mineral-exporting economies. Given the still-uncertain global environment, countries whose policy buffers are thin and where growth is strong should seek to rebuild fiscal positions without undermining productive investment.

Driven largely by domestic momentum in private consumption and investment, as well as exports, sub-Saharan Africa experienced robust growth in 2012, continuing a long trend of expansion only briefly interrupted in 2009 (Figure 2.16).[8] At 4¾ percent, regional GDP growth was slightly lower than forecast in the October 2012 WEO, reflecting mainly the impact of floods on oil and non-oil output in Nigeria and labor stoppages in South Africa.

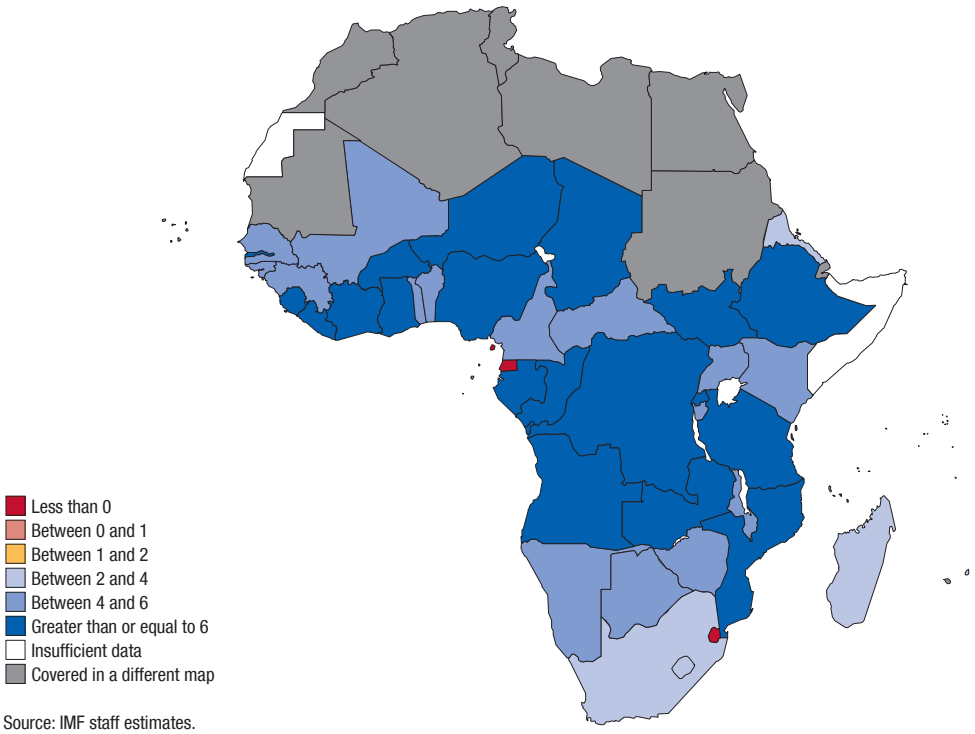
[8]Chapter 4 has an in-depth analysis of today's dynamic low-income countries and how they differ from previous generations of fast-growing economies.

Headline growth in sub-Saharan Africa in 2012 was visibly affected by the interruption of oil exports from South Sudan. Activity in Mali and Guinea-Bissau was adversely affected by civil conflict; in Mali, 400,000 people have been displaced, half of whom fled to neighboring countries. On the positive side, Angolan oil production strengthened, and Côte d'Ivoire experienced a sharp rebound in economic activity after the election-related disruptions of 2011.

Growth is projected to reach 5½ percent in 2013, only marginally lower than forecast in the October 2012 WEO (Table 2.7). The generally strong performance is based to a significant extent on ongoing investment in infrastructure and productive capacity, continuing robust consumption, and the activation of new capacity in extractive sectors. In Nigeria, the rebound from the floods and implementation of power sector reform will boost growth in 2013. Among middle-income countries, South Africa is forecast to grow at a muted 2¾ percent, owing to sluggish mining production and the weakness of demand in the euro area, its main export market.

In 2014, regional economic growth is projected to be about 6 percent. A main driver of growth in 2014 will be the strengthening of activity in South Africa

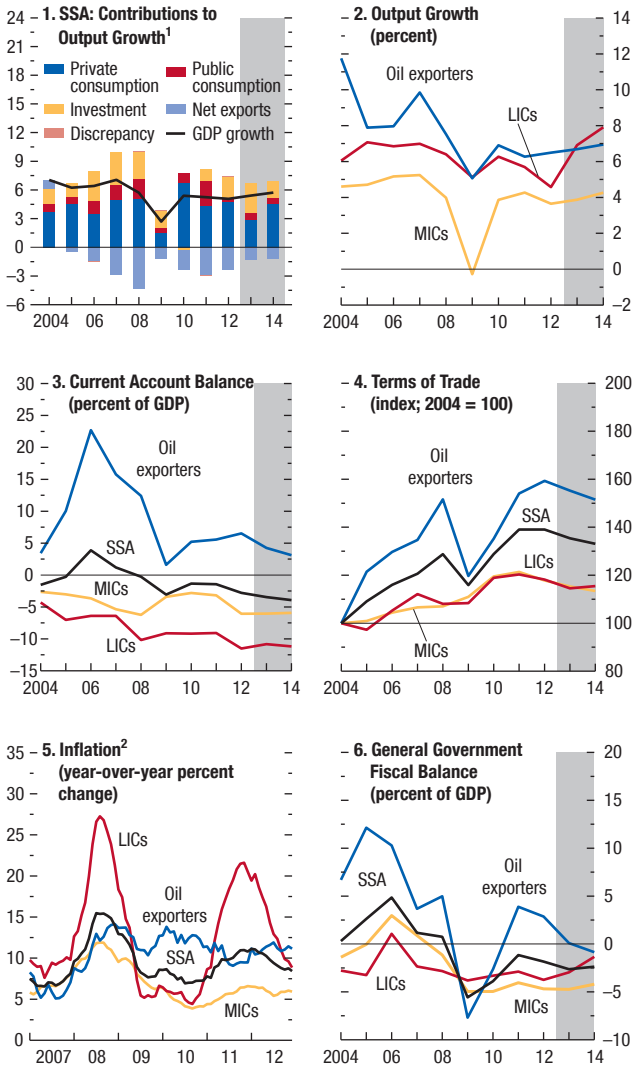
Figure 2.15. Sub-Saharan Africa: 2013 GDP Growth Forecasts
(Percent)



Source: IMF staff estimates.

Figure 2.16. Sub-Saharan Africa: Continued Resilience

Sub-Saharan Africa (SSA) is expected to continue growing at a strong pace during 2013–14 as a result of robust domestic demand. Some deterioration in the current account is expected resulting from projected declines in the terms of trade. Inflation has moderated. Fiscal buffers need to be strengthened in many of the region's economies.



Sources: Haver Analytics; IMF, International Financial Statistics database; and IMF staff estimates.
Note: LIC = low-income country (SSA); MIC = middle-income country (SSA).
[1]Liberia, South Sudan, and Zimbabwe are excluded due to data limitations.
[2]Due to data limitations, the following are excluded: Equatorial Guinea from oil exporters; Cameroon, Côte d'Ivoire, and Zambia from MICs; Burkina Faso, Central African Republic, Comoros, Democratic Republic of the Congo, Eritrea, The Gambia, Guinea, Mozambique, São Tomé and Príncipe, South Sudan, and Zimbabwe from LICs.

and other middle-income countries, predicated on improvements in the external environment. Similarly, some low-income and fragile countries are expected to do better, including those currently experiencing internal conflict.

Some deterioration is expected in the short term in the current account balances of a number of countries, largely on account of the expected decline in the terms of trade, especially among oil exporters. Among low-income countries, some of the investment that has been raising final demand should increase capacity in tradables sectors in the medium term.

Inflation in the region moderated from 10 percent at the end of 2011 to less than 8 percent at the end of 2012, a trend expected to continue, absent new fuel and food price shocks. The improvement in 2012 was particularly marked in eastern Africa, owing to monetary policy tightening and lower food prices associated with a recovery in local food production. Some temporary headwinds to these trends have been observed in countries reforming energy subsidies, where the price level has shown one-time increases (Nigeria), and in Malawi, which has experienced some pass-through from depreciation. In sub-Saharan Africa as a whole, inflation is projected to fall further to 7 percent in 2013.

The main risks to the outlook for sub-Saharan Africa stem from the external environment, although domestic security and political risks should not be discounted. At least two of the downside scenarios discussed in Chapter 1 would pose challenges for the region—the euro area downside scenario, under which sub-Saharan Africa's middle-income countries would be especially affected, and the reduction in investment in emerging market economies (including South Africa), which would weaken key commodity prices and hit mineral exporters. Countries that regulate the prices of food and fuel products would face budgetary pressure in the event of price shocks to these commodities. Relatively few elections are scheduled for 2013, but disruptions could occur in some cases; the security difficulties in the Sahel region also pose a threat to activity in affected countries.

The setting of macroeconomic policies is largely appropriate in a majority of countries in the region. In fast-growing countries in which policy buffers still need replenishing, country authorities should consider measures to strengthen fiscal positions, including by addressing inefficient and poorly targeted price subsi-

Table 2.7. Selected Sub-Saharan African Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment

(Annual percent change unless noted otherwise)

	Real GDP			Consumer Prices[1]			Current Account Balance[2]			Unemployment[3]		
		Projections			Projections			Projections			Projections	
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Sub-Saharan Africa	**4.8**	**5.6**	**6.1**	**9.1**	**7.2**	**6.3**	**–2.8**	**–3.5**	**–3.9**	**. . .**	**. . .**	**. . .**
Oil Exporters[4]	**6.5**	**6.7**	**6.9**	**10.9**	**9.5**	**7.6**	**6.5**	**4.2**	**3.1**	**. . .**	**. . .**	**. . .**
Nigeria	6.3	7.2	7.0	12.2	10.7	8.2	6.6	5.5	4.8	. . .	. . .	. . .
Angola	8.4	6.2	7.3	10.3	9.4	8.4	9.6	3.5	1.3	. . .	. . .	. . .
Equatorial Guinea	2.0	–2.1	–0.8	5.5	5.0	5.4	–14.7	–11.2	–11.9	. . .	. . .	. . .
Gabon	6.2	6.1	6.8	3.0	3.0	3.0	12.6	10.5	7.1	. . .	. . .	. . .
Republic of Congo	3.8	6.4	5.8	5.0	4.5	3.0	3.6	2.8	–0.1	. . .	. . .	. . .
Middle-Income Countries[5]	**3.6**	**3.9**	**4.3**	**5.6**	**5.7**	**5.3**	**–6.1**	**–6.1**	**–5.9**	**. . .**	**. . .**	**. . .**
South Africa	2.5	2.8	3.3	5.7	5.8	5.5	–6.3	–6.4	–6.5	25.2	25.7	25.9
Ghana	7.0	6.9	6.8	9.2	8.4	8.2	–12.6	–11.6	–10.1	. . .	. . .	. . .
Cameroon	4.7	5.4	5.5	3.0	3.0	2.5	–4.4	–3.5	–3.4	. . .	. . .	. . .
Côte d'Ivoire	9.8	8.0	8.0	1.3	3.1	2.5	–1.8	–2.7	–3.3	. . .	. . .	. . .
Botswana	3.8	4.1	4.2	7.5	7.2	6.9	4.9	3.9	3.3	. . .	. . .	. . .
Senegal	3.5	4.0	4.6	1.1	1.5	1.6	–9.8	–8.5	–7.8	. . .	. . .	. . .
Low-Income Countries[6]	**4.6**	**6.9**	**7.9**	**12.7**	**6.9**	**6.1**	**–11.5**	**–10.8**	**–11.2**	**. . .**	**. . .**	**. . .**
Ethiopia	7.0	6.5	6.5	22.8	8.3	9.6	–5.8	–7.5	–6.5	. . .	. . .	. . .
Kenya	4.7	5.8	6.2	9.4	5.2	5.0	–9.1	–7.4	–8.1	. . .	. . .	. . .
Tanzania	6.9	7.0	7.2	16.0	9.0	5.9	–15.8	–14.8	–13.3	. . .	. . .	. . .
Uganda	2.6	4.8	6.2	14.1	5.5	5.0	–10.9	–12.9	–14.8	. . .	. . .	. . .
Democratic Republic of the Congo	7.1	8.3	6.4	9.3	6.8	8.0	–12.4	–12.0	–13.3	. . .	. . .	. . .
Mozambique	7.5	8.4	8.0	2.1	5.4	5.6	–26.1	–25.4	–40.6	. . .	. . .	. . .
Memorandum												
Sub-Saharan Africa Excluding South Sudan	5.1	5.4	5.7	8.9	7.2	6.3	–2.8	–3.5	–4.1	. . .	. . .	. . .

Note: Data for some countries are based on fiscal years. Please refer to the country information section of the WEO online database on the IMF website (www.imf.org) for a complete listing of the reference periods for each country

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

[2]Percent of GDP.

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

[4]Includes Chad.

[5]Includes Cape Verde, Lesotho, Mauritius, Namibia, Seychelles, Swaziland, and Zambia.

[6]Includes Benin, Burkina Faso, Burundi, Central African Republic, Comoros, Eritrea, The Gambia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Niger, Rwanda, São Tomé and Príncipe, Sierra Leone, South Sudan, Togo, and Zimbabwe.

dies. Fiscal choices are more difficult where growth is weak, given the trade-offs between supporting economic activity and containing debt accumulation. In the event of a slowdown in growth, countries should let automatic stabilizers work and avoid a procyclical fiscal contraction. The success in reducing inflation has provided room for a gradual easing of the monetary policy stance in several countries. Policymakers should also strive to make growth more inclusive, including through reforms to promote economic diversification and employment, deepen the financial sector, and tackle infrastructure gaps.

Spillover Feature: Spillovers from Policy Uncertainty in the United States and Europe

A common view is that high uncertainty in general, and high policy uncertainty more specifically, has held back global investment and output growth in the past two years. Much of the policy uncertainty emanated from the United States, with the debt ceiling dispute in August 2011 and negotiations about the "fiscal cliff" in December 2012. Policy uncertainty has also been elevated in Europe, especially in the aftermath of Greek Prime Minister George Papandreou's call for a referendum on the Greek bailout plan (and his subsequent resignation) in November 2011, and during the negotiations about a pan-European crisis response through much of 2012. Policymakers and business leaders across the globe worry about the implications of such uncertainty in the United and States and Europe—the world's two largest economies.

Spillovers from policy uncertainty can occur through several channels. Trade can be affected if increased policy uncertainty adversely affects economic activity and import demand in the United States and Europe. Policy uncertainty could also raise global risk aversion, resulting in sharp corrections in financial markets and capital outflows from emerging markets.

This Spillover Feature attempts to quantify the impact of U.S. and European policy uncertainty on other regions.[9] Specifically, it addresses the following questions: What do we mean by policy uncertainty? How well can we measure it? How has policy uncertainty in the United States and Europe evolved during the past several decades? And how large are the spillovers to economic activity in other regions?

The analysis suggests that sharp increases in U.S. and European policy uncertainty in the past have temporarily lowered investment and output in other regions to varying degrees. It points to the possibility that a marked decrease in policy uncertainty in the United States and Europe in the near term could help boost global investment and output.

Uncertainty and Economic Activity

The idea that uncertainty can adversely affect economic activity dates back to John Maynard Keynes (1936), who argued that investment is the most volatile component of aggregate activity because it is dependent on views about the future, which are most uncertain. The idea was formalized in a number of theoretical models, ranging from Bernanke (1983) to Bloom (2009). Temporary increases in uncertainty make it worthwhile to delay investment, because investment is impossible or costly to undo or change. Investment tends to recover once uncertainty dissipates, and can overshoot as a result of pent-up demand. The same holds true for consumption of durables, which is subject to the same forces.

Two critical challenges arise in trying to estimate the spillover effects of policy uncertainty. First, it is necessary to ensure that causality is not running in the opposite direction—that policy uncertainty in the United States and Europe is not being driven by developments in economic activity elsewhere. For the most part, this is a plausible assumption—spikes in policy uncertainty are often associated with domestic economic and political events, or with global geopolitical events that can be considered exogenous to most individual countries (Figure 2.SF.1). To the extent that specific events could result in reverse causality (for example, the Russian and Long-Term Capital Management crises in 1998 resulted in a spike in policy uncertainty), the analysis verifies that the results hold even when these events are excluded.

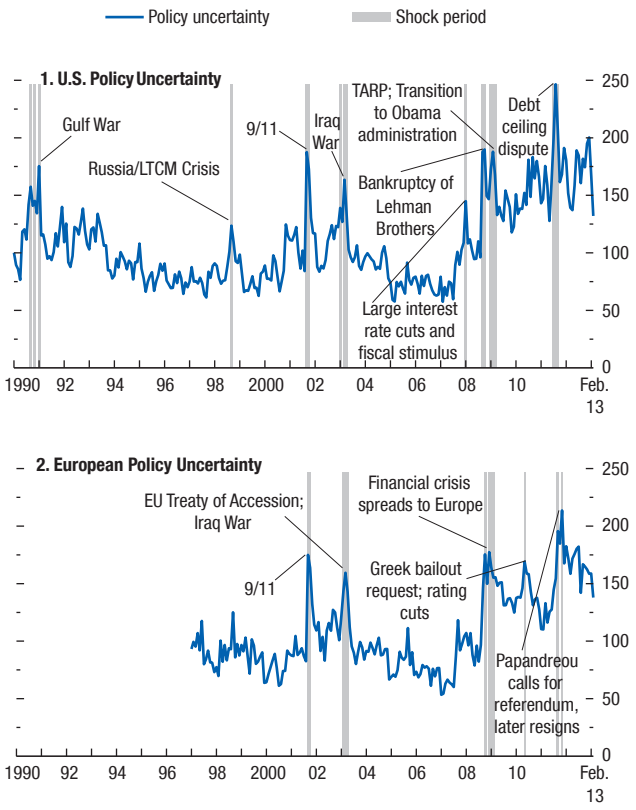
The second challenge is to avoid attributing to policy uncertainty the effects of other factors, such as more general economic uncertainty, shifts in consumer or business confidence, or fluctuations in economic activity. This challenge is addressed by controlling for such variables, which is important because these variables tend to move together—uncertainty tends to rise and confidence tends to fall during downturns in economic activity. This means that various measures of uncertainty could be picking up actual changes in

The main author of this feature is Abdul Abiad, with support from Nadia Lepeshko and Katherine Pan.

[9]A number of empirical studies have analyzed the effects of uncertainty on domestic economic activity, not on activity elsewhere. These include Bloom, Bond, and van Reenen (2007); Bloom (2009); Bekaert, Hodrick, and Zhang (2010); Baker, Bloom, and Davis (2012); and Box 1.3 of the October 2012 *World Economic Outlook*. One exception is Carrière-Swallow and Céspedes (forthcoming), who look at the effects of uncertainty (as measured by implied volatility in the U.S. stock market) on economic activity in a handful of emerging market economies. The analysis in this feature is similar in spirit to that in Carrière-Swallow and Céspedes (forthcoming), but it looks specifically at policy uncertainty and investigates its impact on all the regions of the world.

Figure 2.SF.1. Policy Uncertainty in the United States and Europe

Policy uncertainty tends to spike in response to identifiable economic, financial, and geopolitical events.



Sources: Baker, Bloom, and Davis (2012); and Haver Analytics.
Note: Uncertainty shocks are defined as periods during which detrended uncertainty is more than 1.65 standard deviations above its mean. LTCM = Long-Term Capital Management; TARP = Troubled Asset Relief Program.

economic prospects, not just the uncertainty surrounding economic prospects.

Measuring Economic Policy Uncertainty

The analysis starts with the measures of U.S. and European economic policy uncertainty constructed by Baker, Bloom, and Davis (2012). These measures use news-based indicators of policy-related economic uncertainty (the relative frequency of newspaper articles that refer to "uncertainty," "economy," and "policy"), the number of expiring tax provisions, and the dispersion in economists' forecasts about government spending and inflation levels.[10] These measures are combined to construct monthly indices of policy uncertainty dating back to 1985 for the United States and to 1997 for Europe.

This measure of economic policy uncertainty is not without issues. First, the news-based component is an indirect measure, and ascertaining whether it is measuring policy uncertainty properly is hard. Second, many expiring tax code provisions are regularly renewed and are unlikely to be a major source of uncertainty. Finally, the forecast dispersion components might rise because of other factors—inflation forecasts could become more dispersed because of uncertainty about oil or food prices, for example, and not because of uncertainty about monetary policy.

To address the first concern, Baker, Bloom, and Davis (2012) offer several "proof of concept" tests. For example, they construct a similar news-based measure for financial uncertainty by searching for news articles containing "uncertainty," "economy," and "stock market" and show that the constructed index tracks the Chicago Board Options Exchange Market Volatility Index (VIX) closely. They also note that their measure of policy uncertainty is highly correlated with other policy-uncertainty measures, such as those of Fernández-Villaverde and others (2011) and Born and Pfeifer (2011), which are constructed using very different methodologies.[11] With regard to the second and third issues, the results reported below are robust to excluding the tax-expiration and forecast-dispersion components of the

[10]The European measure relies only on a news-based indicator of policy-related economic uncertainty and the dispersion in economists' forecasts because data on expiring European tax provisions are not available.

[11]Fernández-Villaverde and others (2011) and Born and Pfeifer (2011) use time series methods to estimate the time-varying volatility of taxes and government spending.

policy-uncertainty measure and relying solely on the news-based measure of policy uncertainty.

The Evolution of U.S. and European Policy Uncertainty

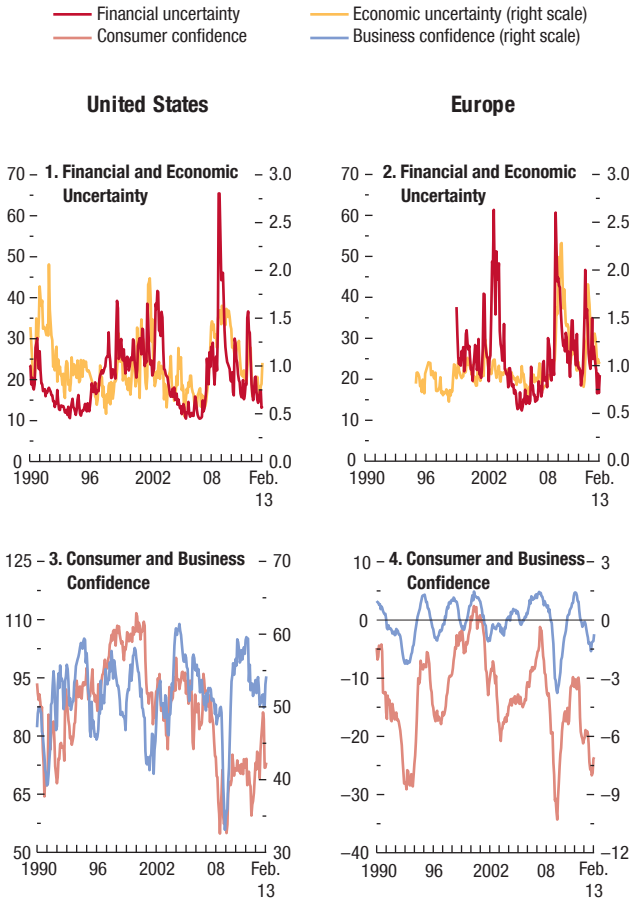
Policy uncertainty tends to spike in response to identifiable economic, financial, and geopolitical events (Figure 2.SF.1). Policy-uncertainty shocks, identified by vertical lines in Figure 2.SF.1, are defined as periods during which the Hodrick-Prescott detrended value of the index exceeds its mean by more than 1.65 standard deviations, following Carrière-Swallow and Céspedes (forthcoming). As noted by Baker, Bloom, and Davis (2012), many of the spikes in policy uncertainty are associated with identifiable events. For example, U.S. policy uncertainty spiked after the start of the Gulf War in August 1990, the September 11, 2001, terrorist attacks, and the run-up to the Iraq War in early 2003. More recent spikes in U.S. policy uncertainty have been associated with economic and financial events, including the recession-induced monetary and fiscal easing in January 2008, the bankruptcy of Lehman Brothers in September 2008, the debt ceiling dispute in August 2011, and the fiscal cliff negotiations in late 2012.

European policy uncertainty also spiked following the September 11 attacks and again in early 2003 with the signing of the EU Treaty of Accession (the single largest expansion of the European Union), which compounded the uncertainties from the Iraq War. Other events associated with high European policy uncertainty include the Greek bailout request in May 2010, the call in November 2011for a Greek referendum on the terms of the bailout, and discussions on the EU-wide policy response to the expanding crisis in 2012.

These events raised uncertainty about economic policies, but they also raised general financial and economic uncertainty and caused a drop in confidence—making it critical to control for these other correlates. Policy uncertainty tends to move with general economic uncertainty—whether measured by indicators of financial uncertainty (such as implied stock market volatilities) or of economic uncertainty (such as the dispersion of economists' GDP forecasts; Figure 2.SF.2, panels 1 and 2). There are divergences, however. Most notably, general economic uncertainty has retreated from its 2008 highs, whereas policy uncertainty has remained high and has even increased. The correlation between confidence indicators (Figure 2.SF.2,

Figure 2.SF.2. General Uncertainty and Confidence in the United States and Europe

Although policy uncertainty is correlated with measures of more general financial or economic uncertainty and with indicators of business or consumer confidence, there are divergences. In particular, policy uncertainty has remained high in recent years even as general financial and economic uncertainty has declined.



Sources: Bloomberg L.P; *Consensus Forecasts;* and Haver Analytics.
Note: Financial uncertainty is measured by the implied volatility of equity markets (Chicago Board Options Exchange Volatility Index), and economic uncertainty is measured by the dispersion of economists' forecasts.

panels 3 and 4) and policy uncertainty is also evident but imperfect, making it possible to include them as control variables in the analysis.

Spillovers from Policy Uncertainty

The policy-uncertainty shocks in the United States and Europe are used as regressors to explain output and investment behavior in other regions. The methodology resembles those of Cerra and Saxena (2008) and Romer and Romer (2010), among others. Specifically, real GDP growth and real investment growth (both measured in log differences) are used as regressors to explain their lagged values to capture the normal dynamics of the growth process, as well as on contemporaneous and lagged values of a dummy variable that is equal to 1 during the policy-uncertainty shocks described above and zero otherwise.[12,13] Including lags allows for the possibility that policy-uncertainty spillovers affect other economies with a delay. The specification also includes a full set of country dummies to account for differences in normal growth rates, but the inclusion of time dummies is precluded by the fact that the variable of interest is a global variable common across all countries.

The model is estimated by region, using seasonally adjusted quarterly data for 43 economies from 1990 to 2012, although the wide variation in the availability of quarterly GDP data means the sample is highly unbalanced.[14] The effects of U.S. and European policy-uncertainty shocks are estimated separately, given their high correlation; the estimated impacts should thus be considered an upper bound because each is likely picking up the effects of the other.

[12]Using the level of the policy uncertainty variable, or of a hybrid that interacts the 0–1 dummy with the level, produces similar results. Excluding policy uncertainty shocks whose origins are outside the United States or Europe also does not materially change the findings.

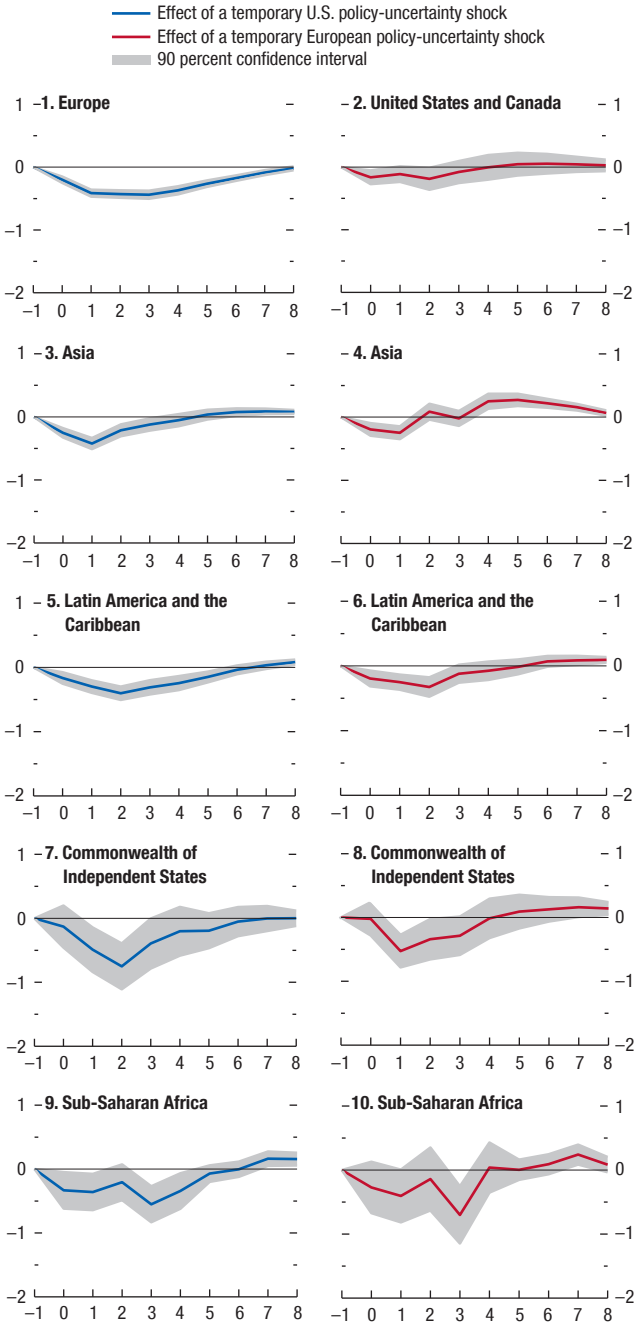
[13]The regression is estimated in changes (that is, growth rates) because of nonstationarity in the log levels of real GDP and real investment. The estimated responses from the regression are cumulated to recover the response of the level of output or investment to a policy-uncertainty shock. The standard errors of the impulse responses are calculated using the delta method.

[14]The regional definitions follow those used in Chapter 2. No spillover estimates are provided for the Middle East and North Africa because of a lack of quarterly GDP data. Because the quarterly data for sub-Saharan Africa include only Botswana and South Africa, the estimates should be considered to reflect spillover effects only on the region's open middle-income economies.

Figure 2.SF.3. Effect of a U.S. or European Policy-Uncertainty Shock on Real GDP in Other Regions

(Quarters on x-axis, percent change in real GDP on y-axis)

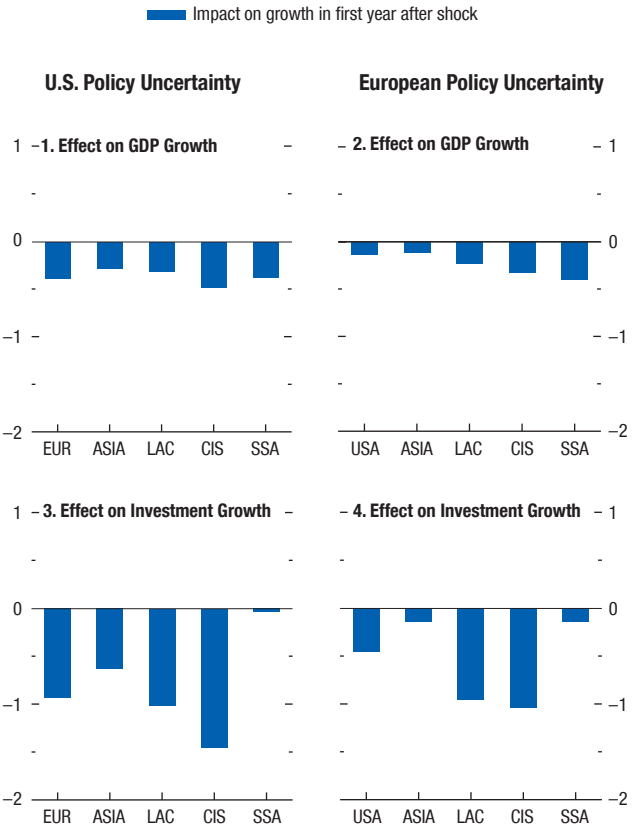
Policy-uncertainty shocks in the United States and Europe have a negative effect on real activity in other regions, with the magnitude, persistence, and statistical significance differing across regions. In general, the effect of U.S. policy-uncertainty shocks tends to be slightly bigger and more persistent than that of European policy-uncertainty shocks, and U.S. shocks affect Europe more than vice versa.



Source: IMF staff calculations.
Note: Policy-uncertainty shocks are defined as periods during which detrended uncertainty is more than 1.65 standard deviations above its mean.

Figure 2.SF.4. Growth Impact of U.S. and European Policy-Uncertainty Shocks
(Percentage points)

U.S. policy-uncertainty shocks tend to reduce GDP growth in other regions by 0.2 to 0.5 percentage point. European policy-uncertainty shocks have a smaller impact. U.S. policy-uncertainty shocks affect Europe more than vice versa.



Source: IMF staff calculations.
Note: CIS = Commonwealth of Independent States; EUR = Europe; LAC = Latin America and the Caribbean; SSA = sub-Saharan Africa; USA = United States.

Figure 2.SF.3 shows the estimated impact of a large but temporary policy-uncertainty shock—similar in magnitude to the shocks highlighted in Figure 2.SF.1—on real GDP of economies in various regions. The impulse responses are shown for an eight-quarter horizon, with the 90 percent confidence bands around the estimates shaded in gray. The impact on annual growth is significant. U.S. policy-uncertainty shocks temporarily reduce GDP growth in other regions by up to ½ percentage point in the year after the shock (Figure 2.SF.4, panel 1). European policy-uncertainty shocks temporarily reduce GDP growth in other regions by a smaller amount (Figure 2.SF.4, panel 2).[15]

One of the ways that policy uncertainty affects economic activity in other regions is by reducing investment. Figure 2.SF.5 shows the results of a similar exercise in which real investment is the dependent variable. Significant declines in investment result in all regions, except sub-Saharan Africa, with the biggest decline in the Commonwealth of Independent States (CIS).[16] The effect of European policy-uncertainty shocks tends to be similar or slightly smaller than that of U.S. shocks (Figure 2.SF.4, panels 3 and 4). In addition, European shocks tend to have a smaller effect on the United States than vice versa.

The Mechanics of Policy-Uncertainty Spillovers

The analysis addresses the possibility that the policy-uncertainty measure is picking up the effects of other variables by controlling for general uncertainty, declining confidence, or a decline in U.S. or European economic activity. Note that the results can be interpreted in two ways:

- One possibility is that the additional control variable—for example, general economic uncertainty—affects U.S. or European policy uncertainty as well as economic activity in other countries. In this case, adding the control variable improves the estimate of the spillover effects from policy uncertainty.

[15]We do not estimate the impact on domestic activity in the United States and Europe because they are much more subject to the endogeneity problem—policy uncertainty is affected by domestic activity. But for purposes of comparison, Baker, Bloom, and Davis (2012) use a vector-autoregression-based approach and find that an increase in U.S. policy uncertainty of the size that occurred between 2006 and 2011 would reduce U.S. output by up to 3.2 percent, and private investment by 16 percent.

[16]If only South Africa is used in the SSA sample (that is, if Botswana is excluded), the decline in investment is larger.

- A second possibility is that the control variable is a mediating variable through which policy uncertainty is actually conveyed—for example, higher policy uncertainty increases general uncertainty, which, in turn, affects activity elsewhere. In this case, adding the control variable nets out any effect of policy uncertainty that was conveyed through this mediating variable, resulting in an underestimation of the overall spillover effects.

The likeliest scenario is that both interpretations are valid—that is, policy uncertainty affects and is affected by the control variables (general uncertainty, confidence, and activity). As a result, the true magnitude of spillover effects from policy uncertainty is most likely somewhere between the baseline effect reported in Figures 2.SF.3 and 2.SF.5 and the effects estimated when using the control variables shown in Figure 2.SF.6.

In addition to showing the peak effect on real GDP and real investment, Figure 2.SF.6 shows the peak effect on real consumption. The dark-blue bars show the peak effect when there are no control variables other than policy uncertainty: these are the minimum values of the impulse response functions shown in Figures 2.SF.3 and 2.SF.5. The red bars show the peak effect of policy uncertainty when financial-uncertainty shocks—as measured by the VXO—are added as a control in the regression.[17] For the most part, the magnitude of the policy-uncertainty effect is broadly similar to the baseline. The same holds true in regressions that control for business confidence or the level of the stock market (Figure 2.SF.6, yellow and gray bars).

The pink bars in Figure 2.SF.6 show that controlling for import growth in the United States or Europe reduces the estimated effect of policy uncertainty in some, but not all, regions.[18] One interpretation is that U.S. or European policy uncertainty could negatively affect domestic activity, which affects activity elsewhere via lower import demand. The reduction in the impact of policy uncertainty would then indicate the strength of this particular transmission channel. For the CIS, for example, the effects of European policy uncertainty are diminished, but the effects of U.S. policy uncertainty are not. Under this interpretation, European policy uncertainty affects the CIS primarily via trade

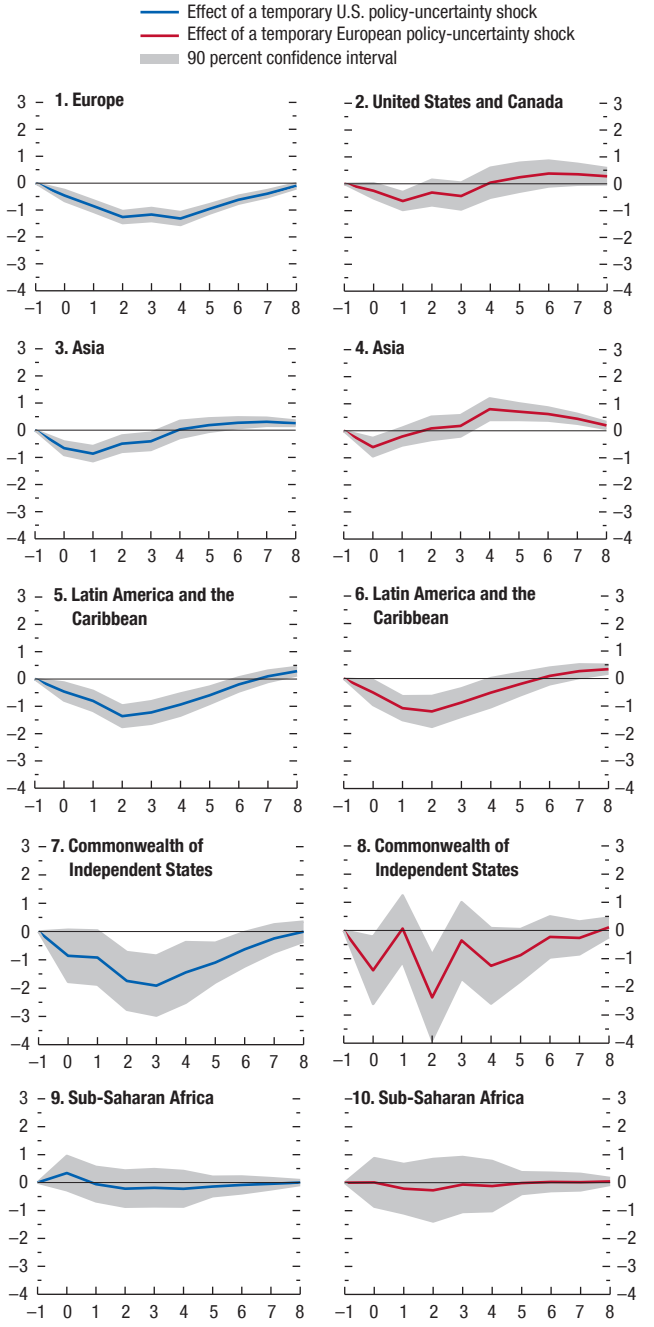
[17]The Chicago Board Options Exchange S&P 100 Volatility Index (VXO) is a measure of implied stock market volatility similar to (and very highly correlated with) the more widely recognized VIX, but it has longer time coverage, going back to 1985.

[18]Controlling for U.S. and European GDP growth instead of import growth produces similar results.

Figure 2.SF.5. Effect of a U.S. or European Policy-Uncertainty Shock on Real Investment in Other Regions

(Quarters on x-axis, percent change in real investment on y-axis)

One way policy-uncertainty shocks in the United States and Europe affect real activity in other regions is through declining investment. As with output, the magnitude, persistence, and statistical significance of the effects differ across regions. The effect of U.S. policy-uncertainty shocks tends to be slightly bigger and more persistent than that of European policy-uncertainty shocks, and U.S. shocks affect Europe more than vice versa.

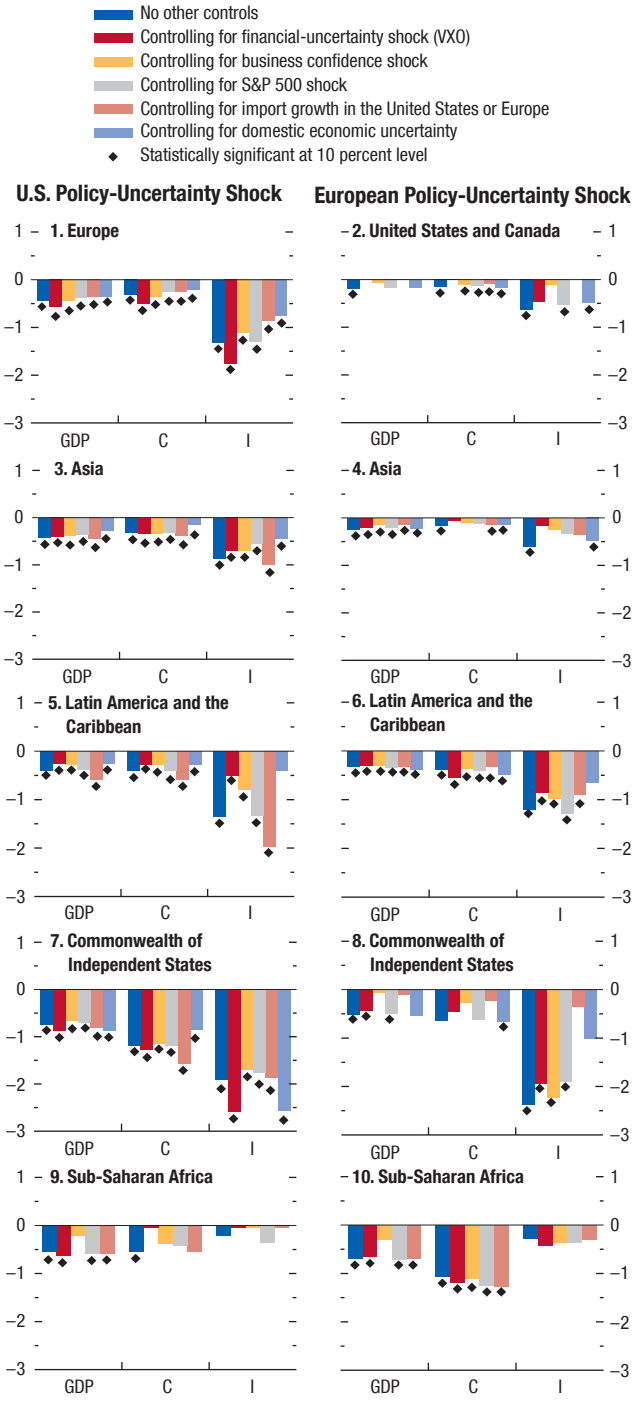


Source: IMF staff calculations.

Note: Policy-uncertainty shocks are defined as periods during which detrended uncertainty is more than 1.65 standard deviations above its mean. If only South Africa is used in the SSA sample (that is, if Botswana is excluded), the decline in investment is larger.

Figure 2.SF.6. Peak Effect of a U.S. or European Policy-Uncertainty Shock on Real GDP, Consumption, and Investment in Other Regions

The impact of policy-uncertainty shocks on economic activity tends to be attenuated, but is often still significant, when additional controls are added.



Source: IMF staff calculations.
Note: C = consumption; I = investment; VXO = Chicago Board Options Exchange S&P 100 Volatility Index.

channels, but U.S. policy uncertainty is transmitted through other channels.

A similar exercise can measure the extent to which the spillover effects of U.S. and European policy uncertainty are transmitted by raising uncertainty in other economies (measured by forecast dispersion). The spillover effects of policy uncertainty are reduced in some cases, but not in others (Figure 2.SF.6, light-blue bars), suggesting that increased uncertainty can be another channel of transmission. In most regions, policy uncertainty seems to reduce investment at least partly through its effect on higher domestic uncertainty.

Conclusion

This analysis documents significant spillover effects from policy uncertainty in the United States and Europe to other regions. It finds that sharp spikes in U.S. policy uncertainty can temporarily lower investment and output in other regions. The spillover effects from European policy uncertainty tend to be slightly smaller and less persistent and tend to have smaller effects on U.S. activity than vice versa.

Policy uncertainty has remained high in the United States and Europe since the Great Recession—even as more general uncertainty has receded and various measures of consumer and business confidence have recovered. The evidence presented here hints at the possibility that elevated policy uncertainty may have contributed to the serial disappointments and downward revisions in investment and output growth observed throughout the same period. It is futile to attempt to disentangle the effects of policy uncertainty from other variables, but suggestive evidence indicates that a reduction in policy uncertainty in the United States and Europe in the near term may give an added fillip to global investment and output.

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