

After a slowdown in the first half of 2014, global growth is forecast to strengthen to 3.5 percent in the second half of 2014 and 3.8 percent in 2015. But growth is uneven and still weak overall and remains susceptible to many downside risks. Production disruptions or sharply higher global oil prices—due to geopolitical tensions—would reduce global growth, as would an unexpected tightening in financial conditions owing to higher-than-expected U.S. long-term interest rates or increased risk aversion. Over the medium term, protracted weak demand in advanced economies could result in lower growth everywhere, including, in part, through negative supply-side effects.

Global growth slowed more than expected from an annualized rate of 3.9 percent in the second half of 2013 to 2.7 percent in the first half of 2014. Although the downside surprise was mainly owing to temporary factors, particularly for the U.S. economy, it also reflected a weaker recovery in the euro area, as the region continued to overcome the legacies of the crisis, and in Japan, where the negative effects on demand of the consumption tax increase were greater than previously expected. Among emerging market and developing economies, growth in China picked up in the second quarter, responding to the measures deployed to boost activity after a weaker-than-expected first-quarter outturn. However, domestic demand remained weak in a few major economies, notably in Latin America. Geopolitical tensions related to the Russia-Ukraine situation and the Middle East dampened activity in those regions, but with limited broader spillovers so far.

Against this backdrop, advanced economies are expected to continue a slow recovery, with growth rising to 1.8 percent this year and to 2.3 percent in 2015 (Figure 2.1, panel 1). Growth in emerging market and developing economies will slow to 4.4 percent in 2014, before rising to 5.0 percent in 2015. The forecast is weaker than projected in the April 2014 *World Economic Outlook* (WEO), reflecting the negative growth surprises in the first half of the year, a more subdued pace of domestic demand growth in some emerging

markets, and stronger adverse effects of geopolitical tensions. Notwithstanding the recovery, growth is weak overall, and medium-term growth prospects have been marked down for many economies in the past several WEO reports (see Figure 1.15).

Downside risks to the forecast remain relevant. As elaborated in Chapter 1, escalation in geopolitical tensions is an immediate risk, as it could lead to sharply higher oil prices. This chapter's Spillover Feature finds that the consequences of a rise in the U.S. long-term interest rate depend on the drivers of the increase—for example, stronger U.S. growth versus tighter U.S. monetary policy due to higher-than-expected inflation—as well as on recipient countries' economic conditions and characteristics. And a protracted weak recovery in advanced economies would result in slower medium-term growth everywhere through weaker trade and productivity spillovers (Figure 2.1, panel 2). Thus, for more robust growth, many countries need policies to lift actual growth to its potential level and measures to raise potential growth itself.

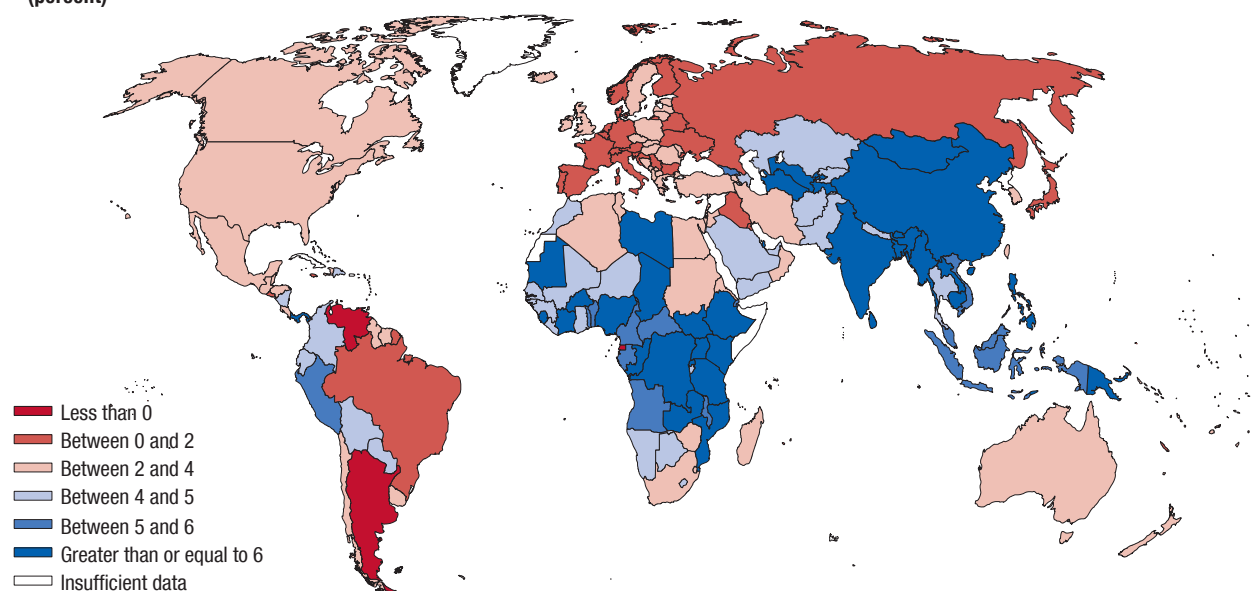
The United States and Canada: Recovery to Continue after Temporary Setback

Growth is now stronger in the United States and Canada after a slowdown in the first quarter of 2014. However, many downside risks, from both domestic and external sources, remain relevant. In the United States, monetary policy normalization should be gradual to sustain the recovery and avert negative domestic or global spillovers. Medium-term growth should be strengthened by upgrading infrastructure and human capital. In Canada, stronger exports and business investment are expected to translate into more balanced growth, but housing market risks should continue to be closely monitored.

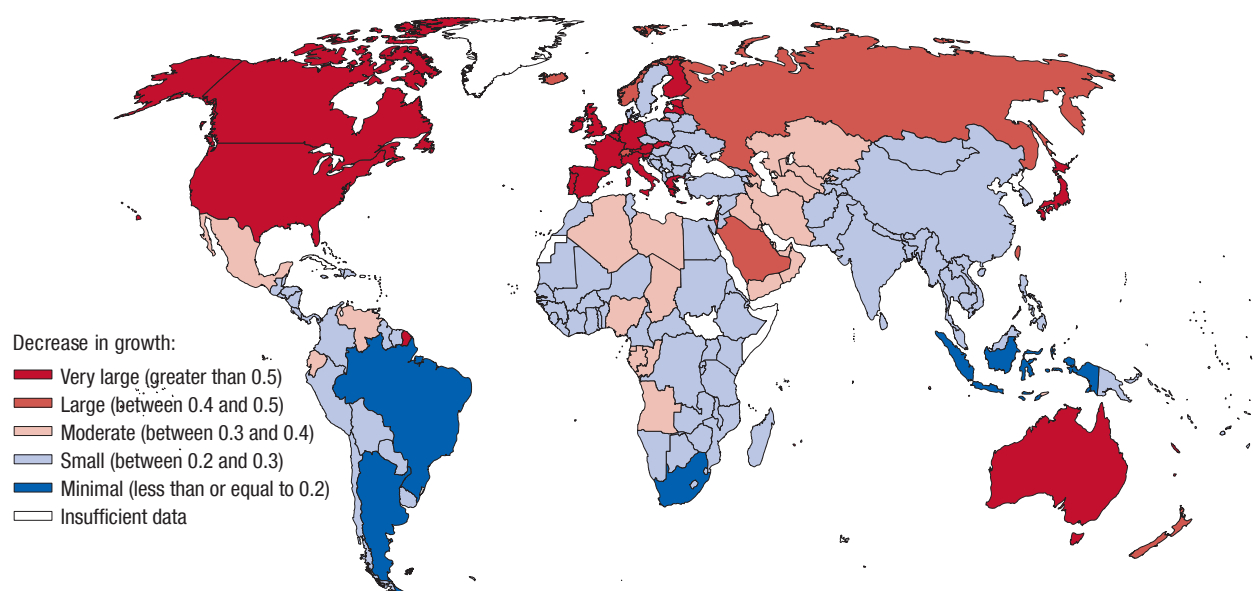
After a temporary setback in the first quarter of 2014, the U.S. economy has rebounded. Temporary constraints—an unusually harsh winter and a sharp correction to an earlier inventory buildup—have now receded. Growth reached an annualized 4.2 percent in

Figure 2.1. 2015 GDP Growth Forecasts and the Effects of a Plausible Downside Scenario

**1. 2015 GDP Growth Forecasts¹
(percent)**



**2. Effects of Secular Stagnation in Advanced Economies
(percentage point difference from baseline medium-term growth²)**



Source: IMF staff estimates.

¹Syria is excluded because of the uncertain political situation. The data for Argentina are officially reported data as revised in May 2014. On February 1, 2013, the IMF issued a declaration of censure, and in December 2013 called on Argentina to implement specified actions to address the quality of its official GDP data according to a specified timetable. On June 6, 2014, the Executive Board recognized the implementation of the specified actions it had called for by end-March 2014 and the initial steps taken by the Argentine authorities to remedy the inaccurate provision of data. The Executive Board will review this issue again as per the calendar specified in December 2013 and in line with the procedures set forth in the Fund's legal framework. The Zimbabwe dollar ceased circulating in early 2009. Data are based on IMF staff estimates of price and exchange rate developments in U.S. dollars. IMF staff estimates of U.S. dollar values may differ from authorities' estimates. Real GDP is in constant 2009 prices.

²Simulations are conducted using the IMF's Flexible System of Global Models, with 29 individual countries and eight regions (other European Union, other advanced economies, emerging Asia, newly industrialized Asia, Latin America, Middle East and North Africa, sub-Saharan Africa, oil exporters group). Countries not included in the model are allocated to the regions based on the WEO classification of fuel exporters, followed by geographical regional classifications. Medium-term growth is proxied by growth in 2017, which is the year with the peak effect for most advanced economies.

the second quarter.¹ Improving housing activity, stronger nonresidential investment, and steady payroll gains suggest that the rebound is becoming more sustainable (Figure 2.2). The unemployment and labor participation rates stood at 6.1 percent and 62.8 percent, respectively, in August.

Despite the recovery, price pressures remain contained, with consumer price index inflation at 1.7 percent in August and core personal consumption expenditure inflation—the Federal Reserve’s preferred measure of underlying inflation—at 1.5 percent in August. Price increases reflect higher energy and food costs, although increasing housing costs (rents and owner-equivalent rental costs) and the waning of the sequester-related compression of health care costs have also been factors in price conditions. Real wages have been flat, given still-substantial slack in the labor market.

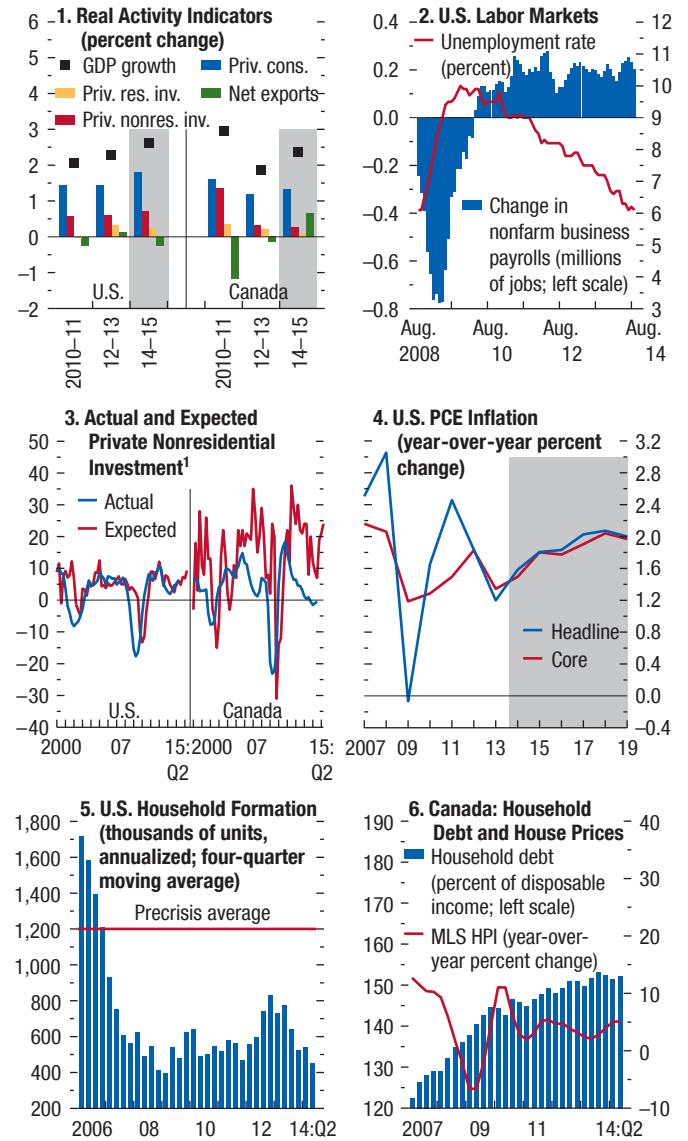
At about 3 percent, growth is projected to remain above potential for the rest of the year and into 2015. The strength is underpinned by an improving labor market, better household balance sheets, favorable financial conditions, a healthier housing market as household formation gradually returns to levels that are more closely aligned with demographic factors, higher nonresidential investment as firms finally upgrade aging capital stock, and a smaller fiscal drag.

However, medium-term prospects are generally subdued. Under current policies, potential growth is estimated at only about 2 percent, weighed down by population aging and lower productivity growth compared with that in previous decades.

The risks to the outlook are broadly balanced. On the downside, an unexpected rise in inflation due to lower-than-expected economic slack could increase interest rates more sharply or more quickly than currently expected. Or there could be a disorderly unwinding of the recent compression of volatility and term premiums in financial markets. Uncertainty about fiscal policy and associated political brinkmanship could return in early 2015. External risks include a sharper slowdown in emerging markets, including China, and sharply higher oil prices, given geopolitical tensions. On the upside, the nascent improvement in private investment could continue, boosting confidence regarding future economic prospects and raising growth. Further improvements in

Figure 2.2. The United States and Canada: Recovery to Continue after Temporary Setback

In the United States, the recovery is firming after a brief slowdown in the first quarter of 2014, as improvements in labor markets continue and private investment picks up. Wage and price pressures, however, remain subdued. Canada’s growth also slowed in the first quarter but has since rebounded strongly, with exports benefiting from the U.S. recovery and a weaker currency, while housing market risks call for continued vigilance.



Sources: Canadian Real Estate Association; Central Bank of Canada (BoC); Duke/*CFO Magazine* Global Business Outlook Survey; Haver Analytics; Statistics Canada; U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; and IMF staff estimates.

Note: Cons. = consumption; inv. = investment; MLS HPI = Multiple Listing Service Housing Price Index; nonres. = nonresidential; priv. = private; PCE = personal consumption expenditure; res. = residential.

¹Year-over-year percent change. Duke/*CFO Magazine* Global Business Outlook Survey and BoC Global Business Outlook Survey for expected (12-month-ahead) investment spending for the United States and Canada, respectively. For Canada, expected investment shows the balance of opinion measured as the percentage of firms expecting higher investment in machinery and equipment minus the percentage expecting lower investment.

¹Growth for the second quarter was revised to 4.6 percent after the WEO database was closed on September 19, 2014.

Table 2.1. 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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Advanced Economies	1.4	1.8	2.3	1.4	1.6	1.8	0.4	0.3	0.2	7.9	7.3	7.1
United States	2.2	2.2	3.1	1.5	2.0	2.1	-2.4	-2.5	-2.6	7.4	6.3	5.9
Euro Area ^{4,5}	-0.4	0.8	1.3	1.3	0.5	0.9	2.4	2.0	1.9	11.9	11.6	11.2
Japan	1.5	0.9	0.8	0.4	2.7	2.0	0.7	1.0	1.1	4.0	3.7	3.8
United Kingdom ⁴	1.7	3.2	2.7	2.6	1.6	1.8	-4.5	-4.2	-3.8	7.6	6.3	5.8
Canada	2.0	2.3	2.4	1.0	1.9	2.0	-3.2	-2.7	-2.5	7.1	7.0	6.9
Other Advanced Economies ⁶	2.3	2.9	3.1	1.5	1.6	2.2	5.5	5.1	4.8	4.5	4.5	4.4

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

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

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Based on Eurostat's harmonized index of consumer prices.

⁵Current account position corrected for reporting discrepancies in intra-area transactions.

⁶Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

mortgage credit availability for relatively lower-rated borrowers could stimulate a faster housing market recovery.

Policies should be geared toward keeping the recovery on course and achieving increased long-term growth. Monetary policy should manage the exit from zero interest rates in a manner that allows the economy to converge smoothly to full employment with stable prices while containing risks to financial instability, which, if they materialized, could have negative global spillovers. Financial stability concerns arising from a prolonged period of very low interest rates should be addressed with tightened supervision, stronger prudential norms, and strengthening of the macroprudential framework.

Forging agreement on a credible medium-term fiscal consolidation plan is a high priority, with steps to lower the growth of health care costs, reform social security, and increase revenues. Identifying specific measures for fiscal savings in future years would help relax the near-term budget envelope and allow increased funding for efforts aimed at raising labor force participation, encouraging innovation, strengthening productivity, and tackling poverty and long-term unemployment. Supply-side measures to raise potential growth through stepped-up infrastructure investments, better educational outcomes, improvements to the tax structure, and development of a skilled labor force, including through immigration reform, should also be considered.

Canada's growth slowed in the first quarter of 2014 but has since rebounded. The economy is expected to grow at 2.3 percent and 2.4 percent in 2014 and 2015, respectively (Table 2.1, Figure 2.1). Exports should

benefit from the U.S. recovery and a weaker currency, which in turn would stimulate investment. However, more protracted weakness in external demand could hamper the momentum in exports and investment, while high household debt and a still-overvalued housing market remain important domestic vulnerabilities.

The slack in the economy, well-anchored inflation expectations, and downside risks to the outlook imply that the current accommodative monetary policy remains appropriate. Fiscal consolidation, while exerting only a modest drag on near-term growth, needs to proceed at the provincial level, where fiscal room is limited. Domestic vulnerabilities associated with the housing market and the household sector call for continued vigilance and may require additional macroprudential measures.

Europe

Advanced Europe: At Different Stages of Recovery

Advanced Europe is experiencing a multispeed recovery. Growth is still weak in the euro area, with lingering risks of more protracted low growth and low inflation. Elsewhere in Europe, housing market risks are emerging in some advanced economies. In the euro area, the priority is to strengthen the recovery, raise inflation, and lift medium-term growth through a mix of accommodative monetary policy, strengthening bank and corporate balance sheets, completing the banking union, and implementing structural reforms. Advanced European economies outside the euro area should mitigate financial sector vulnerabilities from the housing market.

Advanced Europe has begun to recover, but the recovery is still slow and tentative in the euro area. The euro area stagnated in the second quarter of 2014, with investment surprising on the downside in several large economies. Financial markets have remained resilient, with spreads at precrisis lows and lower bank funding costs. However, the legacies of the crisis—inadequate demand, high debt, and unemployment—continue to pose challenges to robust and sustained growth:

- Output and investment remain well below precrisis levels. Growth is weak and uneven across countries.
- Low inflation—well below the European Central Bank’s (ECB’s) price stability objective—is ubiquitous, reflecting persistent slack. Inflation expectations have declined.
- Balance sheets remain impaired, partly because of high debt and unemployment. Financial fragmentation persists, and firms in stressed economies face borrowing constraints. The ECB’s comprehensive assessment is prompting banks to strengthen balance sheets, but this effort is still a work in progress.
- Notwithstanding progress on reforms, deep-seated obstacles to productivity and competitiveness remain. Moreover, the adjustment of relative prices and external imbalances has been asymmetric, with persistent current account surpluses in creditor countries.

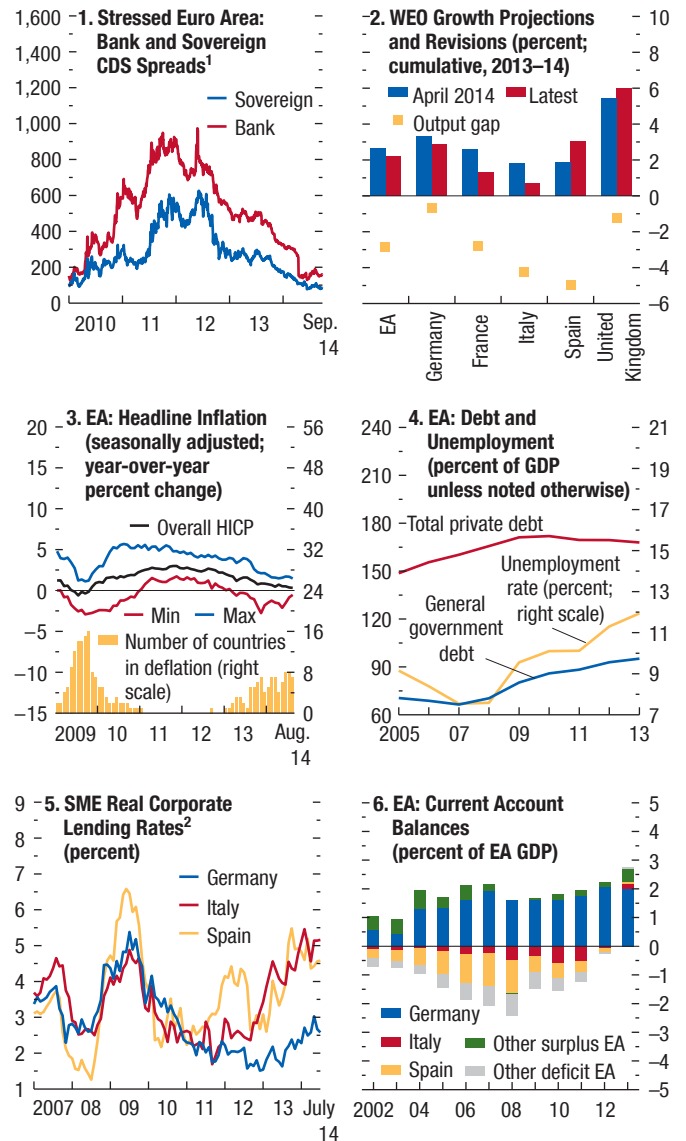
The outlook is for a modest recovery and subdued inflation. Growth—predicated on continued improvements in lending conditions and resilient external demand—is expected to average about 0.8 percent in 2014 and 1.3 percent in 2015. The forecast is weaker for both years compared with the April 2014 WEO (Figure 2.3). Over the medium term, growth is expected to hover around 1½ percent. Within this weak outlook, prospects are uneven across the region—stronger in Germany and Spain, weaker in France and Italy. Inflation will average about 0.5 percent in 2014 and is expected to remain well below the ECB’s medium-term price stability objective in the foreseeable future owing to persistent slack over the medium term.

Growth is stronger in other advanced European economies (Table 2.2), but not without concerns:

- The United Kingdom’s economy is expected to continue to grow strongly. Demand is becoming more balanced, with stronger business investment. But despite rapid employment growth, some slack

Figure 2.3. Advanced Europe: At Different Stages of Recovery

Financial markets remain generally resilient as a fragile recovery gets under way in the euro area. However, inflation remains low, reflecting large output gaps for most euro area countries. Stubbornly high unemployment rates, large debt, and persistent financial fragmentation continue to provide headwinds to growth. Current account balances have improved, but with persistent surpluses in creditor economies.



Sources: Bloomberg, L.P.; European Central Bank; Eurostat; Haver Analytics; IMF, World Economic Outlook database; and IMF staff estimates.
 Note: Euro area (EA) = Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Portugal, Slovak Republic, Slovenia, Spain. CDS = credit default swap; HICP = harmonized index of consumer prices; SME = small and medium enterprise.
¹Bank and sovereign five-year CDS spreads in basis points are weighted by total assets and general government gross debt, respectively. Data are through September 22, 2014. All stressed euro area countries are included, except Greece.
²Monetary and financial institutions’ lending to corporations under €1 million, one to five years.

Table 2.2. 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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Europe	0.5	1.5	1.9	2.0	1.3	1.6	2.0	1.7	1.7	...	...	...
Advanced Europe	0.1	1.3	1.6	1.5	0.7	1.1	2.6	2.2	2.2	10.7	10.2	9.8
Euro Area ^{4,5}	-0.4	0.8	1.3	1.3	0.5	0.9	2.4	2.0	1.9	11.9	11.6	11.2
Germany	0.5	1.4	1.5	1.6	0.9	1.2	7.0	6.2	5.8	5.3	5.3	5.3
France	0.3	0.4	1.0	1.0	0.7	0.9	-1.3	-1.4	-1.0	10.3	10.0	10.0
Italy	-1.9	-0.2	0.8	1.3	0.1	0.5	1.0	1.2	1.2	12.2	12.6	12.0
Spain	-1.2	1.3	1.7	1.5	0.0	0.6	0.8	0.1	0.4	26.1	24.6	23.5
Netherlands	-0.7	0.6	1.4	2.6	0.5	0.7	10.2	9.9	9.6	6.7	7.3	6.9
Belgium	0.2	1.0	1.4	1.2	0.7	1.0	-1.9	-1.3	-1.0	8.4	8.5	8.4
Austria	0.3	1.0	1.9	2.1	1.7	1.7	2.7	3.0	3.2	4.9	5.0	4.9
Greece	-3.9	0.6	2.9	-0.9	-0.8	0.3	0.7	0.7	0.1	27.3	25.8	23.8
Portugal	-1.4	1.0	1.5	0.4	0.0	1.1	0.5	0.6	0.8	16.2	14.2	13.5
Finland	-1.2	-0.2	0.9	2.2	1.2	1.5	-0.9	-0.6	-0.5	8.2	8.5	8.3
Ireland	0.2	3.6	3.0	0.5	0.6	0.9	4.4	3.3	2.4	13.0	11.2	10.5
Slovak Republic	0.9	2.4	2.7	1.5	0.1	1.3	2.1	1.9	2.2	14.2	13.9	13.2
Slovenia	-1.0	1.4	1.4	1.8	0.5	1.0	6.8	5.9	5.8	10.1	9.9	9.5
Luxembourg	2.1	2.7	1.9	1.7	1.1	2.1	5.2	5.1	4.0	6.9	7.1	6.9
Latvia	4.1	2.7	3.2	0.0	0.7	1.6	-0.8	-0.1	-1.5	11.9	10.3	9.7
Estonia	1.6	1.2	2.5	3.2	0.8	1.4	-1.4	-2.2	-2.4	8.6	7.0	7.0
Cyprus	-5.4	-3.2	0.4	0.4	0.0	0.7	-1.9	-1.1	-0.8	15.9	16.6	16.1
Malta	2.9	2.2	2.2	1.0	1.0	1.2	0.9	0.3	0.3	6.4	6.0	6.1
United Kingdom ⁵	1.7	3.2	2.7	2.6	1.6	1.8	-4.5	-4.2	-3.8	7.6	6.3	5.8
Switzerland	1.9	1.3	1.6	-0.2	0.1	0.2	16.0	13.0	12.5	3.2	3.4	3.3
Sweden	1.6	2.1	2.7	0.0	0.1	1.4	6.2	5.7	6.1	8.0	8.0	7.8
Norway	0.6	1.8	1.9	2.1	2.0	2.0	11.2	10.6	10.2	3.5	3.7	3.8
Czech Republic	-0.9	2.5	2.5	1.4	0.6	1.9	-1.4	-0.2	-0.3	7.0	6.4	6.0
Denmark	0.4	1.5	1.8	0.8	0.6	1.6	7.3	7.1	7.0	7.0	6.9	6.6
Iceland	3.3	2.9	3.0	3.9	2.5	3.3	3.9	2.1	2.3	4.4	4.0	3.5
San Marino	-3.2	0.0	2.2	1.3	1.0	1.2	...	...	...	8.0	8.2	7.8
Emerging and Developing Europe⁶	2.8	2.7	2.9	4.2	4.0	3.8	-3.9	-3.2	-3.5	...	...	...
Turkey	4.0	3.0	3.0	7.5	9.0	7.0	-7.9	-5.8	-6.0	9.0	9.5	9.9
Poland	1.6	3.2	3.3	0.9	0.1	0.8	-1.4	-1.5	-2.1	10.3	9.5	9.5
Romania	3.5	2.4	2.5	4.0	1.5	2.9	-1.1	-1.2	-1.8	7.3	7.2	7.1
Hungary	1.1	2.8	2.3	1.7	0.3	2.3	3.0	2.5	2.0	10.3	8.2	7.8
Bulgaria ⁵	0.9	1.4	2.0	0.4	-1.2	0.7	1.9	-0.2	-2.3	13.0	12.5	11.9
Serbia	2.5	-0.5	1.0	7.7	2.3	3.4	-6.5	-6.1	-5.1	21.0	21.6	21.8
Croatia	-0.9	-0.8	0.5	2.2	-0.3	0.2	0.9	2.2	2.2	16.6	16.8	17.1
Lithuania ⁵	3.3	3.0	3.3	1.2	0.3	1.3	1.5	0.9	0.1	11.8	11.0	10.7

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

¹Movements 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.

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

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

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

⁶Includes Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, and Montenegro.

remains in the labor market, and labor productivity growth has been low. Inflation remains below the 2 percent target. House prices, however, have increased by 10 percent across the country—in London, more than double that—and household debt, at 140 percent of gross disposable income, remains high.

- The outlook in Sweden is for rising growth, driven by strong household demand and investment. Inflation is low, in part because of increasing services sector productivity. However, higher unemployment among vulnerable groups, especially at the lower end of the wage distribution, is a concern.

- Growth is expected to continue in Switzerland, although at a more modest pace, reflecting the recent softening in consumption and construction investment. Inflation is forecast to remain close to zero. Medium-term challenges include an aging population.

For the euro area, risks surrounding the growth projection are tilted to the downside. Specifically, the risk of protracted slow growth and persistently low inflation is high. And should the risk materialize, the effects would reverberate throughout Europe. There are also risks associated with reform fatigue and larger-than-expected bank recapitalization needs. Elsewhere in Europe, including in the United Kingdom, risks are more balanced. However, the United Kingdom, as well as Sweden and Switzerland, faces financial stability risks arising from housing and mortgage markets. For the entire region, negative external developments—such as lower growth in trading partners, an abrupt tightening of global financial conditions, and economic disruptions and sharply higher oil prices owing to geopolitical reasons, including from the Russia-Ukraine situation—are another major source of risk.

Policy efforts should focus on strengthening the recovery while ensuring financial stability. In this context, monetary and fiscal policies need to respond to divergent growth and inflation prospects:

- For the euro area, the priority is to achieve strong above-trend growth and raise inflation, implying maintenance of accommodative monetary policy. Despite strong actions already taken in June and September of this year, if the inflation outlook does not improve and inflation expectations fail to increase, the ECB should be willing to do more, including the purchase of sovereign assets. Fiscal policy, which is only slightly contractionary in 2014–15 for the euro area as a whole, should not be tightened further in the event of negative growth surprises. Over the medium term, public debt in some countries needs to be reduced to more sustainable levels. For Germany, there remains a strong case for an increase in public investment, for example, for the upgrade and maintenance of transportation infrastructure.
- In the United Kingdom, given weak price and wage pressures, monetary policy should stay accommodative for now, but it may need to be tightened quickly if inflation rises. Interest rate increases could also be considered if macroprudential tools prove

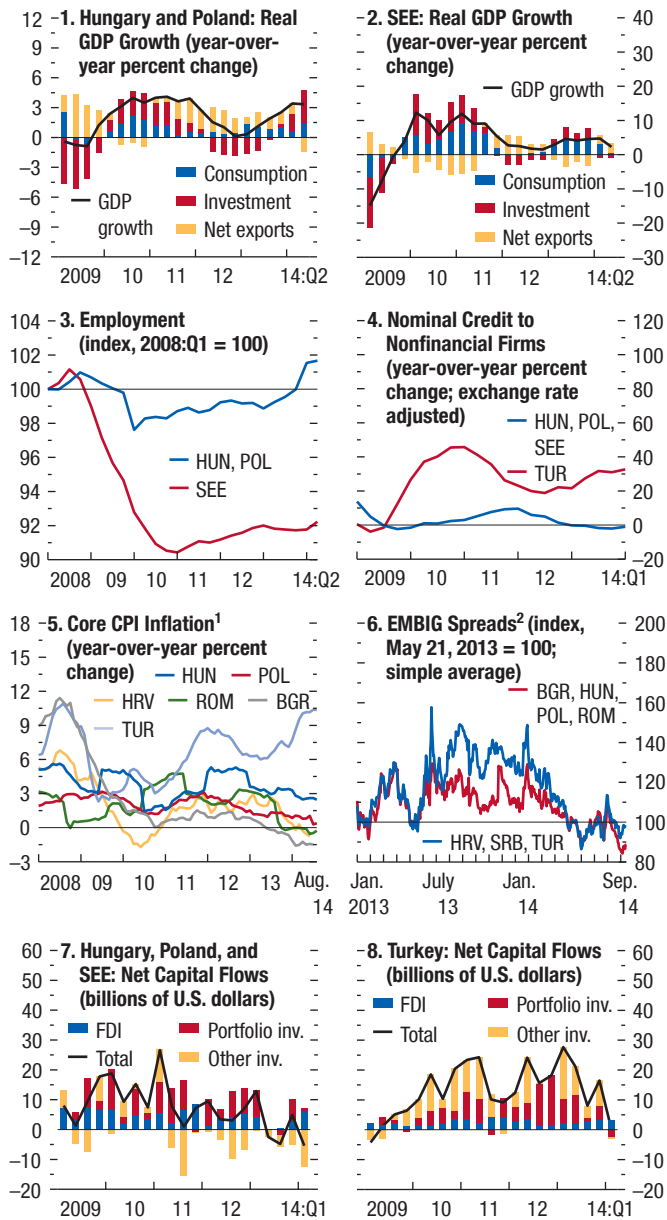
insufficient to contain financial stability risks (see next paragraph), with careful consideration given to the trade-off between damage to the real economy and the ultimate costs of financial vulnerabilities. This also holds for Sweden, where, absent effective action to reduce financial stability concerns, monetary policy will have to continue to balance price and financial stability risks. Large medium-term and contingent liabilities related to Sweden's large financial sector call for fiscal consolidation.

Stronger private sector balance sheets and financial sector reforms are needed to foster financial stability. In the euro area, bank recapitalization, lower corporate debt (in part through improved national solvency frameworks), and an effective common fiscal backstop to complete the banking union would help reduce financial fragmentation and restart credit flows. Financial sector vulnerabilities should be tackled in other advanced European economies: this implies continued strengthening of bank capital, but also effective and/or tighter macroprudential measures (Sweden, Switzerland). Macroprudential tightening may also be needed in the United Kingdom if recent measures prove insufficient to contain financial stability risks. The financial sector reform agenda in advanced Europe should be completed, including with respect to reforms dealing with large and systemically important banks and those to enhance cross-border resolution mechanisms.

Structural reforms are key to meeting medium-term challenges to growth. Greater labor and product market flexibility in debtor economies and higher infrastructure and private investment in creditor economies would raise productivity, employment, and growth and would also support greater rebalancing in the euro area. Lower hiring costs and more effective training programs would help reduce high youth unemployment rates. Capital markets need to be developed to fund small and medium firms. Longer-term challenges include simplifying the region's complicated fiscal framework and strengthening its enforcement. In Sweden and the United Kingdom, housing supply-side measures are crucial to safeguard housing affordability and mitigate financial stability risks. Labor market reforms would accelerate and sustain the transition of vulnerable groups into employment in Sweden. In Switzerland, the resolution of uncertainty related to future immigration policy would support growth.

Figure 2.4. Emerging and Developing Europe: Domestic Demand Taking Hold

Prospects remain uneven in emerging and developing Europe, with strong growth and improving employment in Hungary and Poland, but continued weakness in southeastern Europe. Financial conditions are still broadly supportive, but credit growth remains weak except in Turkey.



Sources: Bloomberg, L.P.; European Bank for Reconstruction and Development; Haver Analytics; and IMF staff calculations.

Note: Southeastern Europe (SEE) includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, FYR Macedonia, Montenegro, Romania, and Serbia, wherever data are available. All country group aggregates are weighted by GDP valued at purchasing power parity as a share of group GDP unless noted otherwise. Data labels in the figure use International Organization for Standardization country codes. CPI = consumer price index; EMBIG = J.P. Morgan Emerging Markets Bond Index Global; FDI = foreign direct investment; inv. = investment.

¹Data through August 2014 except in the cases of Bulgaria (July 2014) and Croatia (June 2014).

²Data through September 22, 2014.

Emerging and Developing Europe: Domestic Demand Taking Hold

Growth in emerging and developing Europe is also uneven, although domestic demand is strengthening in many countries in the region. With downside risks remaining, monetary and exchange rate policies should be used to support demand and manage the risks from market volatility, while fiscal policy should focus on rebuilding buffers. Enhancing debt resolution frameworks and advancing labor market reforms remain priorities for most countries in the region.

Economic recovery in emerging and developing Europe continued to be uneven, with growth remaining strong or accelerating in Hungary, Poland, and Turkey in 2013 and into the first half of 2014, but slowing in southeastern Europe. Financial market developments were also mixed although still broadly supportive (Figure 2.4). Corporate sector credit remained weak outside Turkey, partly reflecting the burden on the financial system from high levels of nonperforming loans. The region has thus far been resilient to the geopolitical tensions in Russia and Ukraine.

Inflation declined in most economies in the region, reflecting lower food and energy prices, as well as disinflation pressure from the euro area, particularly for economies that peg their currencies to the euro. Bosnia and Herzegovina, Bulgaria, Croatia, and Montenegro fell into deflation with persistent economic slack.

Growth is forecast to reach 2.7 percent in 2014 and 2.9 percent in 2015. The forecast entails an upward revision to growth in 2014 of 0.4 percentage point relative to the April 2014 WEO projections, mainly reflecting the stronger-than-expected outturn so far this year in some economies, and is unchanged for 2015.²

- Growth in Hungary and Poland is projected to rise, reaching 2.8 percent and 3.2 percent, respectively, in 2014, supported by rising investment and declining unemployment in Poland and significant monetary easing and higher public spending in Hungary. In 2015, growth will average 3.3 percent in Poland but slow to 2.3 percent in Hungary with the projected tightening in fiscal and monetary conditions.

²Note that the global and regional growth rates reported in the April 2014 WEO have been recalculated using the revised purchasing-power-parity weights (see note 1 of Chapter 1) to make them comparable to the figures in the current WEO report.

- Turkey's growth is expected to average 3 percent in 2014–15, down from 4 percent in 2013. In 2014, private consumption is projected to moderate, and government spending and investment will be the main drivers of growth, although net exports will also contribute. In 2015, growth will rotate toward private consumption and investment owing to the lagged effect of recent monetary easing.
- Southeastern Europe is projected to experience slower growth in 2014, in part because of severe floods in May that particularly affected Bosnia and Herzegovina and Serbia, before picking up in 2015 on reconstruction spending, rebuilding of flood-damaged areas, and in some countries, employment growth.

Inflation is expected to average about 3.8–4.0 percent during 2014–15. However, in a number of economies, inflation is likely to be much lower either because of imported disinflation (Bulgaria) or persistent economic slack (Croatia). In Turkey, inflation projections have been revised upward as a result of high food prices, the lagged effects of exchange rate depreciation, and a monetary policy stance that is inconsistent with the authorities' inflation target.

A return of market turbulence and a weaker euro area recovery continue to be the main risks to the outlook. Given the large stock of external private debt in many countries, as well as significant foreign-exchange-linked domestic debt in some, the region is also susceptible to other adverse shocks. These risks are somewhat mitigated by recent ECB policy actions to ease monetary conditions further, which could raise confidence and domestic demand more than currently expected.

As the recovery continues, and with most countries set to pursue fiscal consolidation to rebuild fiscal balances that deteriorated during the global crisis, monetary and exchange rate policies should be used flexibly—at different rates given differences in policy space and underlying vulnerabilities—to respond to changing market and economic conditions.

Enhancing private sector debt resolution frameworks, including through voluntary debt restructuring, would help tackle high levels of nonperforming loans and support credit growth. Reforming labor markets by reducing redundancy payments and addressing duality, enhancing the business climate, and improving competitiveness is crucial for many countries to increase potential growth. For Turkey, policies should aim to reestablish a nominal anchor and tighten the fiscal stance while promoting national saving and competitiveness.

Asia and Pacific: Steady Growth Ahead

The region's growth cooled somewhat in early 2014 but is now broadly on track for a rebound in the second half of the year. Growth will be driven by a bounce back in domestic demand, and for some, by stronger external demand. Downside risks stem from a sharp tightening in global financial conditions, as well as from protracted weak growth in advanced economies. A homegrown concern arises from a sharp slowdown in the real estate sector, especially in China. Under the baseline projections, fiscal consolidation should proceed gradually, and monetary tightening should start or continue where slack is negligible and inflation is high or rising. Structural reforms remain crucial for raising medium-term growth.

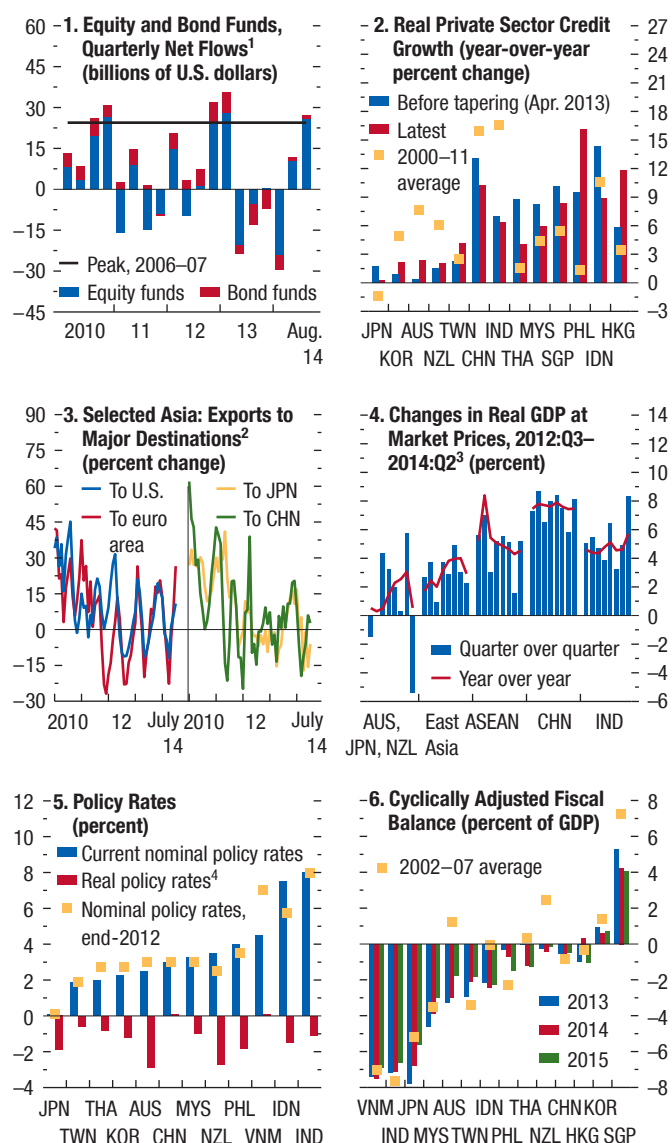
Growth slowed across most of the Asia and Pacific region in the first quarter of 2014 as export growth declined and domestic demand cooled in China (Figure 2.5). For some countries, the slowdown also reflected idiosyncratic factors (for example, political tensions in Thailand). However, activity picked up in most of the region's economies in the second quarter, including in China, on new measures to support activity. In India, growth increased in the second quarter on rising business confidence and stronger manufacturing activity since the election. Japan experienced a strong first-quarter growth outturn—reflecting, mostly, a stronger-than-expected rise in consumption ahead of the consumption tax hike—offset, however, by a somewhat sharper-than- envisaged slowdown in the second quarter, again driven by a sharp contraction in consumption.

Financial conditions have remained broadly supportive across the region, with strong credit growth, rising equity and bond fund flows in the second quarter of 2014, and stronger asset prices—reaching all-time highs in some cases.

The region's near-term outlook remains strong, predicated on a continuing global recovery. Growth is forecast to remain at 5.5 percent in 2014, rising to 5.6 percent in 2015—slightly weaker for both years compared with the April 2014 WEO forecast (Table 2.3). The downward revisions partly reflect the weaker first-quarter outturn. Growth is expected to be driven by domestic demand, given still-favorable financial conditions and healthy labor markets, but export growth is also expected to remain strong given the projected rebound in advanced economies and China. The macroeconomic policy stance across most economies is

Figure 2.5. Asia and Pacific: Steady Growth Ahead

Growth momentum cooled in early 2014 in the Asia and Pacific region, but recent data point to a rebound in the second half of the year. Exports should pick up on the back of stronger demand from advanced economies. Domestic demand is also expected to remain robust, helped by favorable financial conditions, healthy labor markets, and broadly accommodative policies.



Sources: CEIC; Haver Analytics; and IMF staff estimates.
 Note: ASEAN = Association of Southeast Asian Nations (Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam). East Asia = China, Hong Kong SAR, Korea, Taiwan Province of China. Data labels in the figure use International Organization for Standardization country codes.
¹Data include exchange-traded fund flows and mutual fund flows for ASEAN, Australia, east Asia, India, and New Zealand.
²Selected Asia includes Japan, Malaysia, Philippines, Singapore, Thailand, and east Asia. Vietnam is excluded due to a data lag. Annualized three-month moving average, seasonally adjusted.
³Quarter-over-quarter data are seasonally adjusted at an annual rate. East Asia excludes China. India's GDP is at factor cost.
⁴Deviation from 2002–07 average; percentage points.

also expected to remain broadly supportive. Inflation is forecast to remain generally low and stable.

- In China, growth will remain strong at 7.4 percent in 2014 on recent measures—higher infrastructure spending, support for small and medium enterprises, and social housing—and improved net exports. Growth is projected to moderate to a more sustainable rate of 7.1 percent in 2015 as slower credit growth through both the banking and nonbanking sectors slows investment and the moderation in real estate sector activity continues.
- In Japan, the sharp economic contraction in the second quarter induced by the consumption tax increase is expected to be short lived, with a moderate pace of recovery returning thereafter. GDP growth for 2014–15 is projected to average about 0.8–0.9 percent.
- Growth in India is expected to rise to 5.6 percent in 2014 and pick up further to 6.4 percent in 2015 as both exports and investment increase.
- Growth in Australia, Korea, and New Zealand is expected to be driven mainly by exports. In Korea, growth should rise from 3.7 percent this year to 4.0 percent in 2015, led by exports and investment. Australia's growth is forecast at 2.8–2.9 percent in 2014–15, with a pickup in exports offsetting waning mining investment. New Zealand is expected to benefit from reconstruction spending and export recovery, with average growth above 3 percent in 2014–15.
- The Association of Southeast Asian Nations–5 (ASEAN-5) economies are expected to grow steadily, except Thailand, where a sharp slowdown driven by political tensions this year should be followed by a rebound next year. Growth in Indonesia is expected to pick up moderately in 2015 owing to improved investor sentiment in the postelection period. Growth in Malaysia and the Philippines is forecast to remain strong in 2014–15, helped by favorable external demand and broadly accommodative policies and financial conditions.
- For the rest of developing Asia, growth should remain broadly robust, despite rising vulnerabilities associated with high fiscal and current account deficits in some countries. Given their relatively limited exposure to global financial markets, these economies were less affected by last year's tightening in financial conditions and are expected to benefit from stronger global and regional growth via stronger trade, remittances,

Table 2.3. Selected Asian and Pacific 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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Asia	5.5	5.5	5.6	3.8	3.7	3.7	1.4	1.4	1.5	...	...	...
Advanced Asia	2.1	2.1	2.2	1.1	2.3	2.3	1.9	2.1	2.1	4.0	3.8	3.9
Japan	1.5	0.9	0.8	0.4	2.7	2.0	0.7	1.0	1.1	4.0	3.7	3.8
Korea	3.0	3.7	4.0	1.3	1.6	2.4	6.1	5.8	5.8	3.1	3.1	3.1
Australia	2.3	2.8	2.9	2.4	2.7	2.6	-3.3	-3.7	-3.8	5.7	6.2	6.1
Taiwan Province of China	2.1	3.5	3.8	0.8	1.4	2.0	11.7	11.9	11.3	4.2	4.0	4.0
Hong Kong SAR	2.9	3.0	3.3	4.3	3.9	3.8	1.9	2.1	2.2	3.1	3.1	3.1
Singapore	3.9	3.0	3.0	2.4	1.4	2.5	18.3	17.6	16.6	1.9	2.0	2.1
New Zealand	2.8	3.6	2.8	1.1	1.6	2.0	-3.4	-4.2	-6.0	6.2	5.7	5.2
Emerging and Developing Asia	6.6	6.5	6.6	4.7	4.1	4.2	1.0	1.0	1.1	...	...	...
China	7.7	7.4	7.1	2.6	2.3	2.5	1.9	1.8	2.0	4.1	4.1	4.1
India	5.0	5.6	6.4	9.5	7.8	7.5	-1.7	-2.1	-2.2	...	...	...
ASEAN-5	5.2	4.7	5.4	4.6	4.6	5.0	0.0	0.7	0.6	...	...	...
Indonesia	5.8	5.2	5.5	6.4	6.0	6.7	-3.3	-3.2	-2.9	6.3	6.1	5.8
Thailand	2.9	1.0	4.6	2.2	2.1	2.0	-0.6	2.9	2.1	0.7	0.7	0.8
Malaysia	4.7	5.9	5.2	2.1	2.9	4.1	3.9	4.3	4.2	3.1	3.0	3.0
Philippines	7.2	6.2	6.3	2.9	4.5	3.9	3.5	3.2	2.6	7.1	6.9	6.8
Vietnam	5.4	5.5	5.6	6.6	5.2	5.2	5.6	4.1	3.4	4.4	4.4	4.4
Other Emerging and Developing Asia⁴	6.4	6.7	7.0	6.7	6.3	6.2	-2.6	-1.8	-1.1	...	...	...
<i>Memorandum</i>												
Emerging Asia ⁵	6.6	6.5	6.6	4.6	4.0	4.1	1.1	1.1	1.2	...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

¹Movements 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.

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Other Emerging and Developing Asia comprises Bangladesh, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao P.D.R., Maldives, Marshall Islands, Micronesia, Mongolia, Myanmar, Nepal, Palau, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

⁵Emerging Asia comprises the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand, Vietnam) economies, China, and India.

and tourism. However, the small states of the Pacific will continue to underperform as a result of infrastructure gaps and competitiveness issues.

Inflation in the region is expected to remain stable at 3.7 percent during 2014–15, but with important differences across economies. In Japan, underlying inflation, excluding the effects of the consumption tax increase, has been rising. Medium-term inflation expectations have also been rising, although they remain below the Bank of Japan's 2 percent target. In India, with recent monetary tightening, disinflation should continue, but inflation overall will remain high at 7.8 percent in 2014, declining slightly to 7.5 percent in 2015. Inflation will also pick up in a few economies in which subsidy or tax reform is expected to be implemented or in which output is estimated to be above potential (Indonesia, Malaysia, Philippines).

The immediate risks to the outlook stem from a sharp tightening of global financial conditions—triggered, for instance, by greater volatility induced by U.S. monetary policy normalization or a spike in global risk aversion—which could lead to capital outflows, asset price declines, and higher domestic interest rates. This risk is more elevated in countries that depend to a greater extent on external financing (India, Indonesia) and in economies with a large foreign investment presence in domestic financial markets (Indonesia). In some economies, an additional risk stems from a sharp decline in house prices and housing activity (China, Hong Kong SAR, Singapore) or relates to elevated household leverage (Australia, Korea, Malaysia). Sharply higher oil prices due to an escalation of geopolitical tensions would also affect economic activity in the region.

Over the medium term, in addition to risks of spillovers from prolonged low growth in advanced economies, emerging Asia's potential growth, which has declined in the last few years, could weaken further, particularly if reform implementation is delayed.

Rebuilding policy space and implementing structural reforms for sustainable and stronger growth remain key policy priorities. With respect to fiscal policy, although policy space varies across the region and automatic stabilizers should be allowed to operate, fiscal consolidation is desirable across most of Asia and the Pacific. It is a priority where debt levels are relatively higher (Japan) or where there are contingent fiscal liabilities (Malaysia).

Under the baseline projections, monetary normalization should also proceed gradually in most of the region's economies, given that slack is negligible and in some cases inflation is still high (India) or expected to rise (Malaysia, Philippines). China needs to further bring down credit growth and local government borrowing to address financial stability risks while allowing the economy to transition to a slower and more sustainable pace of growth. As highlighted in the April 2014 *Regional Economic Outlook: Asia and Pacific*, macroprudential policies have been generally effective in containing financial stability risks and should remain part of the toolkit. Exchange rate flexibility should be the main shock absorber, but foreign exchange intervention can also help smooth volatility and address disorderly market conditions.

Structural reforms should continue to aim at lowering near-term vulnerabilities and bolstering medium-term growth. The agenda varies across the region but includes financial sector, state-owned enterprise, and local government reforms (China); fiscal reforms (India, Japan); banking sector reforms (Mongolia, Vietnam); product and labor market reforms (Japan, Korea); and improvement of investment conditions (India).

Latin America and the Caribbean: Still Losing Speed

Growth declined further in early 2014 across the region, reflecting a slowdown in external demand as well as weaker domestic momentum. A modest recovery is projected for 2015, yet risks remain tilted to the downside as many economies struggle to find new engines of sustainable growth in an environment of stagnant commodity prices and more binding supply bottlenecks. This situation

heightens the importance of preserving macroeconomic stability and implementing structural reforms to raise investment and productivity.

Growth in Latin America and the Caribbean continued to slow in early 2014, with data coming in even weaker than expected. External conditions played a role, as exports fell short of expectations in early 2014, and terms of trade deteriorated for some countries (Figure 2.6). However, domestic factors were also important in several economies as supply bottlenecks and policy uncertainty held back business confidence and investment. The resulting slowdown has increasingly spread to consumer spending amid signs that labor markets—although still quite tight—are starting to soften.

Overall, financial conditions are still supportive, with continued gains in equity prices and a narrowing of sovereign spreads since the beginning of the year, which have helped to reverse most of the financial market losses suffered after the mid-2013 turmoil. Domestic interest rates have also eased in most economies since April, but credit growth has continued to slow, notably in Brazil.

Growth in the region is expected to average 1.3 percent for 2014, the lowest rate since 2009 and 1.2 percentage points below the April 2014 WEO projection (Table 2.4). The downward revision partly reflects weaker-than-expected growth outturns for the first half of the year and domestic demand growth that is now expected to be slower than previously projected. Regional growth will pick up to 2.2 percent in 2015—again 0.7 percentage point weaker than previously projected—supported by improving exports and a recovery in investment. In particular, supply-side reforms undertaken by some countries, like Mexico, should start to pay off as an initial wait-and-see attitude among businesses gives way to higher capital spending.

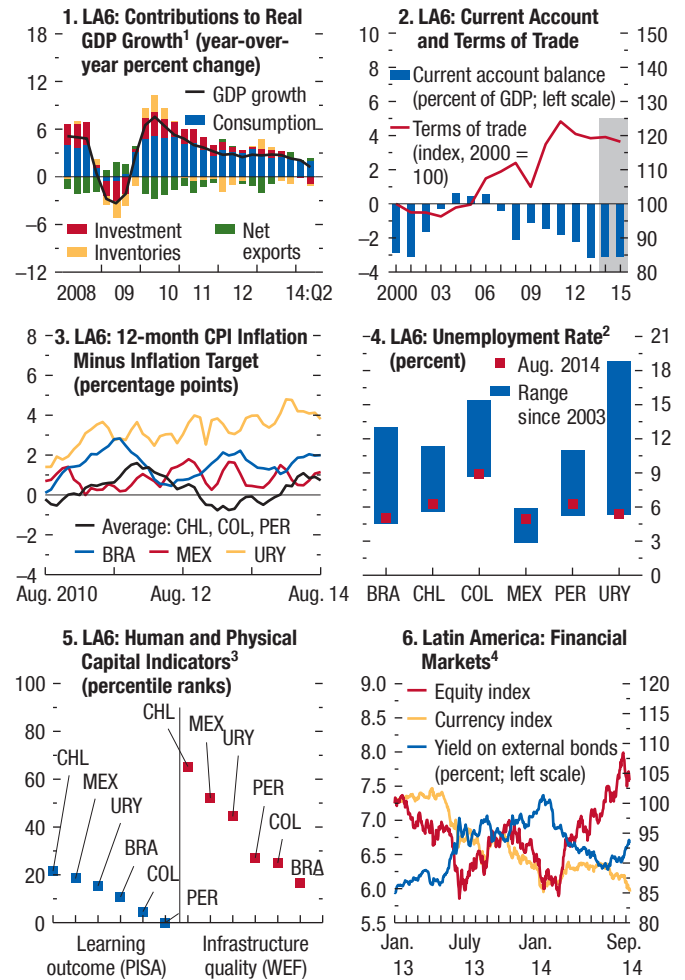
- In Brazil, output contracted during the first half of the year. Full-year growth in 2014 is now projected at 0.3 percent. Weak competitiveness, low business confidence, and tighter financial conditions (with interest rate hikes through April 2014) have constrained investment, and the ongoing moderation in employment and credit growth has been weighing on consumption. A moderate pickup in activity is expected for 2015, with growth rising to 1.4 percent as the political uncertainty surrounding this year's presidential election dissipates. Inflation is expected to

- remain in the upper part of the target range, reflecting inflation persistence, binding supply constraints, and pent-up pressure from administered prices.
- Mexico's economy is gathering pace, although not fast enough to offset fully the weakness in early 2014 that was driven by lower external demand and slower-than-expected construction activity. Growth is projected to average 2.4 percent in 2014 and reach 3.5 percent in 2015, helped by a firmer U.S. recovery, a rebound in domestic construction activity, and the gradual dividends from the ongoing reform of the energy and telecommunications sectors.
 - Sluggish growth in investment and durables consumption has resulted in an unexpected sharp slowdown in Chile and Peru this year. In Chile, recent monetary and fiscal easing and a weaker exchange rate should support a modest rebound. Peru's prospects should also improve as the impact of a temporary decline in metal production tapers off and supportive recent policy measures take effect. In Colombia, growth is expected to remain solid, led by strong construction activity.
 - Argentina is projected to remain in recession in 2014–15, amid rising macroeconomic imbalances and uncertainties related to the lingering standoff with holdout creditors. Inflation remains elevated, and the gap between the official and the informal exchange rates has been widening again in recent months. In Venezuela, severe policy distortions are expected to continue to constrain production, resulting in a sharp drop in activity and an inflation rate that now exceeds 60 percent.
 - Growth in Central America is projected to slow slightly to 3.8–3.9 percent in 2014–15 as country-specific domestic factors—including the closing of a large plant funded through foreign direct investment, which will affect export growth in Costa Rica—offset the positive effects from stronger U.S. activity.
 - In the Caribbean, long-standing competitiveness problems, high public debt, and significant financial fragilities will result in low growth in much of the region.

Around this subdued outlook, risks remain tilted somewhat to the downside. Activity in the region's commodity exporters might weaken with negative external demand shocks, such as a sharper-than-expected investment slowdown in China. An abrupt rise in U.S. interest rates could prompt a replay of the mid-2013 financial turmoil, which would tighten financial conditions and depress confidence further.

Figure 2.6. Latin America and the Caribbean: Still Losing Speed

Economic activity across Latin America and the Caribbean has continued to slow, reflecting less supportive external conditions and domestic policy uncertainties. Even so, spare capacity remains limited, as evidenced by above-target inflation, still-tight labor markets, and persistent external current account deficits. Meanwhile, financial markets have recovered from their January 2014 trough but remain vulnerable to new shocks.



Sources: Bloomberg, L.P.; Haver Analytics; IMF, International Financial Statistics database; national authorities; Organisation for Economic Co-operation and Development, 2012 *Programme for International Student Assessment (PISA)*; World Economic Forum (WEF), 2014–15 *Global Competitiveness Report*; and IMF staff estimates.

Note: CPI = consumer price index; LA6 = Brazil, Chile, Colombia, Mexico, Peru, Uruguay. Country group aggregates are weighted by purchasing-power-parity GDP as a share of group GDP unless noted otherwise. Data labels in the figure use International Organization for Standardization country codes.

¹Seasonally adjusted. Inventories include statistical discrepancies.

²Seasonally adjusted. Latest observation for Brazil is for April 2014.

³The scale reflects the percentile distribution for each respective survey; higher scores reflect higher performance.

⁴Yield on external bonds is J.P. Morgan Emerging Markets Bond Index Plus yield for Latin America. Equity index is MSCI Emerging Markets Latin America Index equity local net total return index. Currency index is Bloomberg J.P. Morgan Latin America Currency Index. The equity and currency indices are rebased to January 2, 2013 = 100. Data are through September 24, 2014.

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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
North America	2.1	2.2	3.1	1.7	2.2	2.3	-2.4	-2.5	-2.6	...	...	...
United States	2.2	2.2	3.1	1.5	2.0	2.1	-2.4	-2.5	-2.6	7.4	6.3	5.9
Canada	2.0	2.3	2.4	1.0	1.9	2.0	-3.2	-2.7	-2.5	7.1	7.0	6.9
Mexico	1.1	2.4	3.5	3.8	3.9	3.6	-2.1	-1.9	-2.0	4.9	4.8	4.5
South America⁴	3.2	0.7	1.6	8.5	...	...	-2.6	-2.5	-2.7	...	...	...
Brazil	2.5	0.3	1.4	6.2	6.3	5.9	-3.6	-3.5	-3.6	5.4	5.5	6.1
Argentina ^{5,6}	2.9	-1.7	-1.5	10.6	...	...	-0.8	-0.8	-1.1	7.1	8.8	9.0
Colombia	4.7	4.8	4.5	2.0	2.8	2.6	-3.3	-3.9	-3.8	9.7	9.3	9.0
Venezuela	1.3	-3.0	-1.0	40.6	64.3	62.9	5.0	7.6	6.4	7.5	8.0	10.4
Chile	4.2	2.0	3.3	1.8	4.4	3.2	-3.4	-1.8	-1.4	5.9	6.6	7.0
Peru	5.8	3.6	5.1	2.8	3.2	2.3	-4.5	-5.2	-5.0	7.5	6.0	6.0
Ecuador	4.5	4.0	4.0	2.7	3.1	3.0	-1.3	-0.8	-2.4	4.7	5.0	5.0
Uruguay	4.4	2.8	2.8	8.6	8.8	8.3	-5.6	-6.5	-6.4	6.6	6.8	6.9
Bolivia	6.8	5.2	5.0	5.7	6.0	5.3	3.3	2.6	2.8	6.4	6.3	6.2
Paraguay	13.6	4.0	4.5	2.7	4.8	5.0	2.1	1.0	-1.1	5.4	5.5	5.5
Central America⁷	4.2	3.8	3.9	4.2	3.6	4.2	-6.7	-6.3	-6.2	...	...	...
Caribbean⁸	3.2	3.8	3.3	5.1	4.1	4.4	-3.3	-2.7	-2.4	...	...	...
<i>Memorandum</i>												
Latin America and the Caribbean ⁹	2.7	1.3	2.2	7.1	...	...	-2.7	-2.5	-2.6	...	...	...
Excluding Argentina	2.7	1.7	2.6	6.7	8.0	7.5	-2.9	-2.7	-2.8	...	...	...
Eastern Caribbean Currency Union ¹⁰	0.6	0.9	1.7	0.9	1.3	1.7	-16.7	-16.4	-16.3	...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

¹Movements 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.

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Includes Guyana and Suriname. See note 6 regarding consumer prices.

⁵The data for Argentina are officially reported data as revised in May 2014. On February 1, 2013, the IMF issued a declaration of censure, and in December 2013 called on Argentina to implement specified actions to address the quality of its official GDP data according to a specified timetable. On June 6, 2014, the Executive Board recognized the implementation of the specified actions it had called for by end-March 2014 and the initial steps taken by the Argentine authorities to remedy the inaccurate provision of data. The Executive Board will review this issue again as per the calendar specified in December 2013 and in line with the procedures set forth in the Fund's legal framework.

⁶Consumer price data from January 2014 onwards reflect the new national CPI (IPCNU), which differs substantively from the preceding CPI (the CPI for the Greater Buenos Aires Area, CPI-GBA). Because of the differences in geographical coverage, weights, sampling, and methodology, the IPCNU data cannot be directly compared to the earlier CPI-GBA data. Because of this structural break in the data, staff forecasts for CPI inflation are not reported in the Fall 2014 *World Economic Outlook*. Following a declaration of censure by the IMF on February 1, 2013, the public release of a new national CPI by end-March 2014 was one of the specified actions in the IMF Executive Board's December 2013 decision calling on Argentina to address the quality of its official CPI data. On June 6, 2014, the Executive Board recognized the implementation of the specified actions it had called for by end-March 2014 and the initial steps taken by the Argentine authorities to remedy the inaccurate provision of data. The Executive Board will review this issue again as per the calendar specified in December 2013 and in line with the procedures set forth in the Fund's legal framework.

⁷Central America comprises Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

⁸The Caribbean comprises Antigua and Barbuda, The Bahamas, Barbados, Dominica, the Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

⁹Latin America and the Caribbean comprises Mexico and economies from the Caribbean, Central America, and South America. See also note 6.

¹⁰Eastern 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.

A sharp rise in oil prices would have an overall negative effect on the region's growth, despite benefiting a small number of net hydrocarbon exporters (notably Bolivia, Colombia, Ecuador, and Venezuela). Higher fuel prices could also intensify inflation or budgetary pressures (owing to large subsidies in some cases). Some Caribbean and Central American economies are particularly exposed, given large oil import needs and already-weak fiscal and external positions.

Over the medium term, another key risk for some economies in the region is a potential continuation

of weak investment if underlying competitiveness and structural issues are not adequately addressed. The effects on growth would be compounded by a prolonged stagnation in advanced economies.

The priority across most of the region is to maintain macroeconomic stability while stepping up efforts to boost potential growth. Still-tight labor markets, above-target inflation, and persistent current account deficits all point to limited resource slack. This situation argues against considering further fiscal expansion, notably in countries with weak public finances. Achiev-

ing the targets set under existing fiscal frameworks through high-quality measures is critical to preserving the credibility of those frameworks, avoiding a further erosion of fiscal positions, and supporting disinflation.

Monetary policy, in turn, should be used to manage short-term fluctuations in growth. However, several central banks are currently facing a challenging combination of slowing growth and persistent price pressures, implying limited room to ease. Exchange rate flexibility remains essential not only to facilitate external adjustment, but also to discourage one-sided currency bets. Financial regulators should monitor private sector vulnerabilities closely and tighten prudential standards as necessary.

Structural reforms, to raise growth and its inclusiveness, should focus on creating the conditions for higher productivity and capital spending, including by addressing shortcomings in educational outcomes, infrastructure provision, and the business environment. Without such reforms, growth could well continue to disappoint relative to the high expectations created by the past decade and put at risk the important social advances the region has achieved.

Commonwealth of Independent States: Coping with Geopolitical Uncertainties

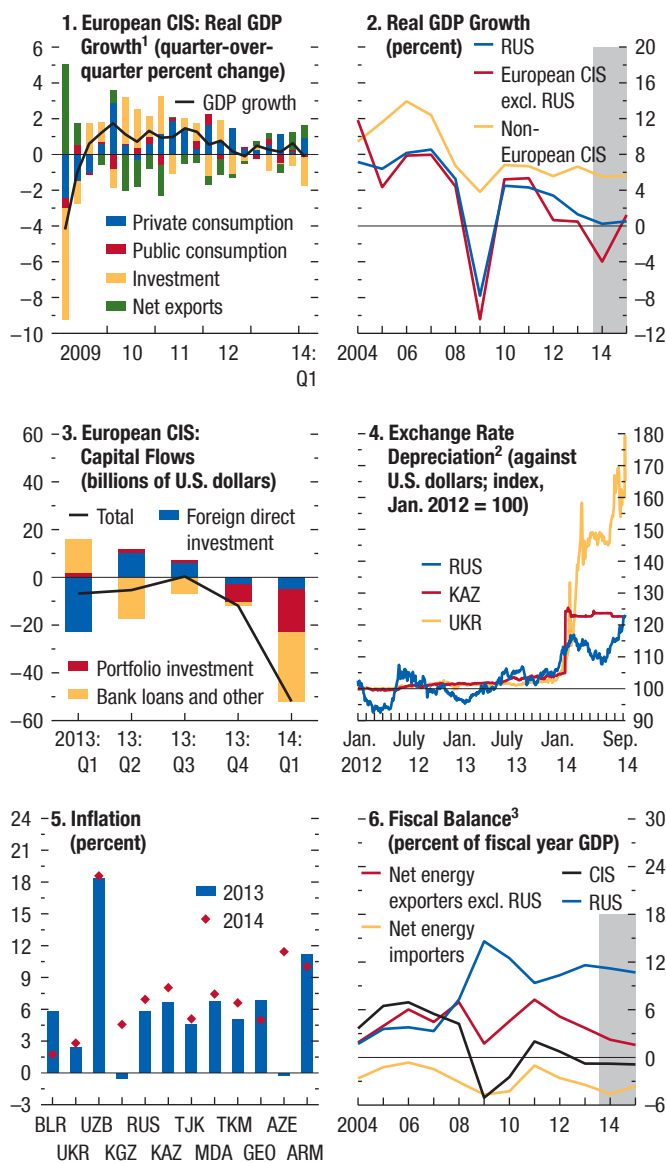
The Commonwealth of Independent States (CIS) economies are facing significant challenges given the fallout from ongoing geopolitical tensions, with investment contracting in Russia and conflict-hit Ukraine undergoing significant macroeconomic and structural adjustment. Policy priorities center on preserving macroeconomic stability in the near term and improving institutions and raising growth potential in the medium term.

The European CIS economies weakened sharply in the first half of 2014 (Figure 2.7). Investment dropped in Russia, where geopolitical tensions have further weakened already-subdued business confidence. Ukraine's crisis deepened further, with output contraction driven by falling industrial production and exports. Some economies in the Caucasus and Central Asia (CCA) slowed with weaker trade and remittance flows, given their economic ties to Russia.

Weaker activity has also reflected a worsening in financial conditions in the region: capital outflows intensified in Russia in the first half of 2014, putting pressure on the exchange rate and resulting in higher inflation, which induced policy rate hikes by the

Figure 2.7. Commonwealth of Independent States: Coping with Geopolitical Uncertainties

Growth in the Commonwealth of Independent States is subdued amid geopolitical tensions and a worsening of financial conditions. Inflation is forecast to remain high or even rise in the near term, in part reflecting pass-through from the recent exchange rate depreciations in many of the region's economies.



Sources: Bloomberg; Haver Analytics; and IMF staff estimates.
 Note: European CIS = Belarus, Moldova, Russia, Ukraine; non-European CIS = Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan. Net energy exporters excl. Russia = Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan; net energy importers = Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Tajikistan, Ukraine. Data labels in the figure use International Organization for Standardization country codes.
¹Moldova is excluded because of data unavailability.
²Data through September 22, 2014.
³Non-oil primary deficit for Russia, overall balance for net energy importers, and general government net lending/borrowing for both Commonwealth of Independent States (CIS) and net energy exporters excluding Russia.

Table 2.5. 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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Commonwealth of Independent States	2.2	0.8	1.6	6.4	7.9	7.9	0.6	1.9	2.1	...	...	...
Net Energy Exporters	2.3	1.3	1.5	6.7	7.3	7.1	1.8	2.7	2.8	...	...	...
Russia	1.3	0.2	0.5	6.8	7.4	7.3	1.6	2.7	3.1	5.5	5.6	6.5
Kazakhstan	6.0	4.6	4.7	5.8	6.9	6.1	-0.1	0.3	-0.7	5.2	5.2	5.2
Azerbaijan	5.8	4.5	4.3	2.4	2.8	3.0	17.0	14.6	10.4	6.0	6.0	6.0
Uzbekistan	8.0	7.0	6.5	11.2	10.0	11.2	0.1	0.1	0.5	...	...	...
Turkmenistan ⁴	10.2	10.1	11.5	6.8	5.0	5.5	-2.9	-1.9	-0.3	...	...	...
Net Energy Importers	1.2	-2.7	1.8	4.7	12.1	13.2	-9.0	-5.4	-5.1	...	...	...
Ukraine	0.0	-6.5	1.0	-0.3	11.4	14.0	-9.2	-2.5	-2.5	7.2	10.0	9.8
Belarus	0.9	0.9	1.5	18.3	18.6	16.9	-10.1	-8.5	-7.4	0.5	0.5	0.5
Georgia ⁴	3.2	5.0	5.0	-0.5	4.6	4.9	-5.9	-8.4	-7.9	16.1	...	...
Armenia	3.5	3.2	3.5	5.8	1.8	3.8	-8.0	-7.7	-7.3	18.5	18.0	17.9
Tajikistan	7.4	6.0	6.0	5.0	6.6	8.3	-1.4	-4.7	-3.6	...	...	...
Kyrgyz Republic	10.5	4.1	4.9	6.6	8.0	8.9	-14.8	-14.2	-14.8	7.6	7.6	7.5
Moldova	8.9	1.8	3.5	4.6	5.1	5.7	-4.8	-6.2	-7.3	5.1	6.0	5.8
<i>Memorandum</i>												
Caucasus and Central Asia ⁵	6.6	5.5	5.6	6.0	6.4	6.4	1.9	1.6	0.7	...	...	...
Low-Income CIS Countries ⁶	7.2	5.9	5.8	8.0	8.0	9.1	-3.1	-3.6	-3.3	...	...	...
Net Energy Exporters Excluding Russia	6.8	5.6	5.7	6.3	6.5	6.5	2.8	2.7	1.6	...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

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

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Georgia and Turkmenistan, which are not members of the Commonwealth of Independent States (CIS), are included in this group for reasons of geography and similarity in economic structure.

⁵Caucasus and Central Asia comprises Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.

⁶Low-Income CIS Countries comprise Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.

central bank. Since February of this year, Ukraine has experienced official reserve losses and exchange rate depreciation. With significant deposit withdrawals and loan quality deterioration, financial sector stress has risen. The depreciation of the Russian ruble has also exerted exchange rate pressure on the Kyrgyz Republic and Tajikistan, whereas in Kazakhstan, the currency was preemptively devalued.

Growth is projected to decline from 2.2 percent in 2013 to 0.8 percent this year, before recovering to 1.6 percent in 2015 as geopolitical tensions subside (Table 2.5). The forecast is significantly weaker for both years, compared with that in the April 2014 WEO, reflecting the ongoing crises and regional spillovers given Russia's role as a key regional trading partner.³

³Georgia and Turkmenistan are not members of the CIS, but they are included in this group because of their geographic proximity and similarity in economic structure.

- Russia's GDP is projected to remain flat in 2014 and recover modestly to grow by 0.5 percent in 2015 as investment contraction moderates and non-energy exports strengthen.
- In Ukraine, activity is projected to contract sharply this year, reflecting production disruptions from the ongoing conflict and the difficult macroeconomic situation.
- With weak external demand from Russia and structural limitations, Belarus's growth will remain subdued. Growth will also be modest in Moldova, owing to a slowdown in agriculture and spillovers from weaker activity in its main trading partners (European Union, Russia, Ukraine).
- In the CCA's oil and gas exporters, growth will decline in 2014–15 as high energy prices, large policy buffers, and diversified export markets only partly offset the effects of Russia's slowdown. Growth will decline in Kazakhstan in 2014–15, reflecting both weaker external demand and lower investor confidence due to increased regional tensions.

- Economic activity in most oil-importing economies in the CCA (Armenia, Kyrgyz Republic, Tajikistan) will also slow, given their close remittance and trade linkages with Russia and weakened investor sentiment, as well as relatively limited policy space.

Despite lower growth and declining food prices, average inflation in the region is forecast to rise from 6.4 percent in 2013 to 7.9 percent in 2014, reflecting pass-through from recent exchange rate depreciations. In Russia, inflation will likely rise above the target; in Belarus and Ukraine it is expected to exceed 10 percent. The February devaluation of the Kazakhstani tenge is expected to raise inflation but maintain it within the target range. In Uzbekistan, inflation will likely remain in the double digits, given continuing increases in administered prices and nominal depreciation.

Risks to growth are largely to the downside. An escalation of geopolitical tensions between Russia and Ukraine, resulting in a tightening of sanctions against Russia, could entail a serious setback for the region. Even without further escalation, prolonged uncertainty could erode confidence, accelerate capital outflows, put pressure on the exchange rate, and further weaken investment and growth in Russia, with adverse spillovers to the rest of the CIS via lower imports, remittances, and foreign direct investment.

With higher risks and worsening economic conditions, a key priority is to preserve macroeconomic stability. For Russia, monetary and financial policies should aim to anchor inflation expectations given recent depreciation, while recent steps to increase exchange rate flexibility should continue in order to facilitate adjustment to shocks, including from oil prices. Under an IMF-supported program, Ukraine is implementing economic and structural reforms to address long-standing structural weaknesses and macroeconomic imbalances. For Belarus, policies to halt wage increases and reduce directed lending and foreign exchange intervention would help safeguard macroeconomic stability. In Moldova, weaknesses in the banking system need to be addressed to ensure the stability of the financial sector.

In the CCA, monetary policies should be tightened if inflation pressure persists. Although a pause in fiscal consolidation is justifiable with slowing growth prospects in some economies (Armenia, Kazakhstan), gradual consolidation should be pursued over the medium term to place public debt on a sustainable

path. CCA economies also need structural reforms for strong and inclusive medium-term growth, specifically through improving the business climate and governance and increasing global and regional trade integration.

The Middle East, North Africa, Afghanistan, and Pakistan: Fragile Recovery

Economic activity in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region is projected to pick up in 2014–15, but the recovery will remain fragile. Political transitions in many countries and security problems, including from the recently intensified conflict in Iraq, pose downside risks. For many countries, fiscal consolidation is needed to rebuild buffers against unexpected shocks and preserve wealth for future generations. Achieving sustained, strong growth over the medium term will require structural reforms.

Oil-Exporting Economies

Activity in the Gulf Cooperation Council (GCC) economies accelerated slightly in the second half of 2013 and into 2014, driven by higher oil production and government spending. By contrast, although the Islamic Republic of Iran is showing signs of recovery, the pace of activity deteriorated in the non-GCC oil exporters, where security conditions remain challenging. The conflict in northern Iraq has started to affect non-oil growth in that country. Although most oil production is in the country's south and oil output levels have not been materially affected, the departure of skilled personnel will limit Iraq's ability to expand or, possibly, even maintain oil production. Ongoing political turmoil and security issues have disrupted oil production in Libya and undermined oil production in Yemen.

Average growth for the oil exporters is projected to edge up from 2.2 percent in 2013 to 2.5 percent in 2014 and to 3.9 percent in 2015. The forecast is 0.9 percentage point weaker for 2014–15, compared with that in the April 2014 WEO (Table 2.6):

- In the GCC countries, growth is projected to average about 4½ percent in 2014–15, with non-oil GDP growing by 6 percent and oil GDP rising by ½ percent. The latter mostly reflects the accommodation of oil supply disruptions elsewhere in a context of modest increases in global oil demand and rising supply in North America.

Table 2.6. 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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Middle East and North Africa	2.3	2.6	3.8	9.2	7.5	8.0	10.9	8.6	6.8	...	...	...
Oil Exporters⁴	2.2	2.5	3.9	9.5	6.8	7.3	14.8	11.6	9.8	...	...	...
Saudi Arabia	4.0	4.6	4.5	3.5	2.9	3.2	17.7	15.1	12.4	5.5	...	...
Iran	-1.9	1.5	2.2	34.7	19.8	20.0	7.5	4.2	1.7	10.4	11.6	12.2
United Arab Emirates	5.2	4.3	4.5	1.1	2.2	2.5	16.1	11.1	11.8	...	...	...
Algeria	2.8	3.8	4.0	3.3	3.2	4.0	0.4	-3.0	-2.9	9.8	10.8	11.3
Iraq	4.2	-2.7	1.5	1.9	4.7	6.2	-0.8	3.0	2.4	...	...	...
Qatar	6.5	6.5	7.7	3.1	3.4	3.5	30.9	27.1	23.2	...	...	...
Kuwait	-0.4	1.4	1.8	2.7	3.0	3.5	40.5	40.8	38.6	2.1	2.1	2.1
Oil Importers⁵	2.6	2.6	3.7	8.3	10.0	10.6	-6.2	-4.7	-5.9	...	...	...
Egypt	2.1	2.2	3.5	6.9	10.1	13.5	-2.7	-0.4	-4.0	13.0	13.4	13.9
Morocco	4.4	3.5	4.7	1.9	1.1	2.0	-7.6	-6.8	-5.8	9.2	9.1	9.0
Sudan	3.3	3.0	3.7	36.5	38.0	20.6	-8.6	-6.3	-6.3	14.8	13.6	13.3
Tunisia	2.3	2.8	3.7	6.1	5.7	5.0	-8.4	-7.7	-6.6	15.3	15.3	15.0
Jordan	2.9	3.5	4.0	5.6	3.0	2.6	-9.8	-10.0	-6.9	12.2	12.2	12.2
Lebanon	1.5	1.8	2.5	3.2	3.5	4.0	-12.9	-12.7	-12.3	...	...	...
<i>Memorandum</i>												
Middle East, North Africa, Afghanistan, and Pakistan	2.5	2.7	3.9	9.0	7.6	8.0	10.0	7.8	6.2	...	...	...
Pakistan	3.7	4.1	4.3	7.4	8.6	8.0	-1.1	-1.2	-1.3	6.2	6.7	6.5
Afghanistan	3.6	3.2	4.5	7.4	6.1	5.5	4.3	4.8	0.1	...	...	...
Israel ⁶	3.2	2.5	2.8	1.5	0.8	1.8	2.0	1.9	2.0	6.3	6.0	6.0
Maghreb ⁷	1.1	1.3	5.4	3.2	3.1	3.9	-0.8	-7.4	-6.8	...	...	...
Mashreq ⁸	2.1	2.3	3.5	6.5	9.1	12.0	-4.7	-3.0	-5.3	...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

¹Movements 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.

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Includes Bahrain, Libya, Oman, and Yemen.

⁵Includes Djibouti and Mauritania. Excludes Syria because of the uncertain political situation.

⁶Israel, which is not a member of the region, is included for reasons of geography. Note that Israel is not included in the regional aggregates.

⁷The Maghreb comprises Algeria, Libya, Mauritania, Morocco, and Tunisia.

⁸The Mashreq comprises Egypt, Jordan, and Lebanon. Syria is excluded because of the uncertain political situation.

- In the non-GCC oil exporters, growth is forecast to average only ¼ percent in 2014 given recent political shocks and deteriorating security. Growth is projected to recover to 3 percent in 2015, assuming a rebound in oil production in Iraq, Libya, and Yemen. These assumptions are, however, subject to significant uncertainty.

Inflation is expected to remain contained in most countries, particularly in the GCC, in light of softening global food prices and pegged exchange rates. Inflation will remain high in many non-GCC countries, however, reflecting production disruptions and other idiosyncratic factors, such as a recent fuel price increase in Yemen.

The major risk to oil exporters arises from unexpected oil market developments. An immediate risk relates to disruptions to oil production (relative to

baseline projections) owing to escalating geopolitical tensions, particularly in Iraq, Libya, and Yemen. Activity in these countries could contract in response to such disruptions, should they materialize. As discussed in Chapter 1, such disruptions could also lead to higher oil prices and lower global growth, but they could boost oil revenues for other oil exporters in the region. There are also risks that oil prices could turn out to be lower than expected because of increased oil supply or lower demand. On the supply side, Libya's oil production could recover earlier than expected, the sanctions-related restrictions on the Islamic Republic of Iran's oil exports could be relaxed, or U.S. oil output could continue to surprise on the upside. On the demand side, energy demand in emerging markets could be weaker if downside risks to activity in these

economies should materialize. Protracted stagnation in advanced economies (see Figure 2.1) would have similar effects.

A key priority for most oil-exporting economies in the region is to shore up weakening fiscal balances, which reflect stalled progress in withdrawing fiscal stimulus implemented by the GCC countries during the Great Recession and oil production shocks in the non-GCC countries. The overall fiscal balance is projected to decline from 2 percent of GDP in 2014 to 1 percent in 2015. Fiscal surpluses are too low in most GCC countries to enable them to save an equitable share of oil wealth for future generations and are expected to vanish by 2017 (Figure 2.8). All non-GCC oil exporters are running fiscal deficits despite reliance on nonrenewable resources as the main revenue source. Fiscal consolidation is thus needed in most oil-exporting countries in the region over the medium term, to build buffers against future shocks and ensure that future generations can also benefit from their oil wealth. However, in some non-GCC countries, the need for consolidation is more immediate, given weaker fiscal positions after recent oil production declines. Fiscal consolidation should importantly include phasing out costly and inefficient energy subsidies and replacing them with targeted social safety nets, as well as raising non-oil revenue. These efforts should be supported with strengthened budget processes to control spending.

Structural reforms can help diversify the region's economies away from oil, raise productivity, and encourage firms in the region to expand into the tradables sector. Continued effort is needed to promote GCC nationals' employment in the private sector. Non-GCC countries urgently need to improve security and the business environment.

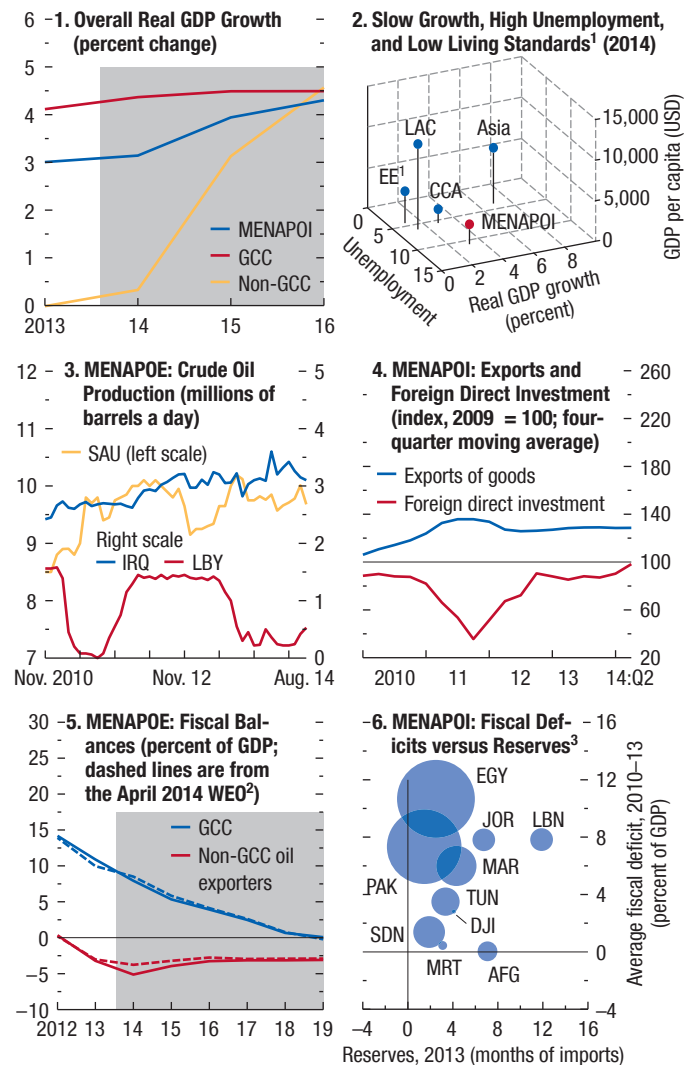
Oil-Importing Economies

Economic activity in the MENAP oil importers has remained lackluster given deep-rooted inefficiencies in economic structures, regional conflicts, and continued sociopolitical tensions. However, confidence has begun to improve, and exports are picking up with higher demand from trading partners. Some structural reforms are slowly nurturing competitiveness and foreign direct investment through lower production costs.

Growth in MENAP oil importers is projected to rise from 2.6 percent in 2014 to 3.7 percent in 2015—

Figure 2.8. The Middle East, North Africa, Afghanistan, and Pakistan: Fragile Recovery

Despite strong activity in the GCC economies, the recovery in the MENAP region as a whole has been fragile, owing to ongoing political transitions and recently intensified conflicts. Fiscal balances in oil exporters have weakened and are projected to deteriorate over the near and medium term. In oil importers, external and fiscal vulnerabilities remain significant.



Sources: Haver Analytics; International Energy Agency; national authorities; and IMF staff estimates.
 Note: CCA = Caucasus and Central Asia; EE = Emerging Europe excluding Russia and Ukraine; Gulf Cooperation Council (GCC) = Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates; LAC = Latin America and the Caribbean; Middle East, North Africa, Afghanistan, and Pakistan (MENAP) oil exporters (MENAPOE) = Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, Yemen; MENAP oil importers (MENAPOI) = Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Sudan, Syria, Tunisia. Data labels in the figure use International Organization for Standardization country codes. Data from 2011 onward exclude Syria.
¹The vertical axis shows each region's 2014 GDP per capita in U.S. dollars.
²April 2014 WEO data have been revised using the current purchasing-power-parity (PPP) GDP weighted according to the International Comparison Program.
³The size of each country's bubble is relative to its 2013 PPP GDP.

broadly similar to the April 2014 WEO projections for 2014, and 0.5 percentage point weaker for 2015. Growth is expected to be driven by rising external demand from Europe and the GCC countries and some recovery in domestic demand as confidence improves and political transitions evolve. However, growth is still too weak to tackle persistently high unemployment, especially among the young, and widespread socioeconomic inequities.

- In Morocco, the ongoing implementation of structural reforms is beginning to bear fruit, and growth is expected to pick up in 2015. Private investment is expected to strengthen with increased confidence, rising tourism receipts, and stronger export performance.
- Growth is also strengthening in Pakistan, reflecting in part the positive effects of energy reforms, although large fiscal and external vulnerabilities still remain.
- In Tunisia, progress in the political transition is leading to increased donor support. However, growth remains timid, and rising external imbalances have continued to put pressure on the exchange rate. Important steps are being taken to reduce banking sector fragilities, a key constraint on stronger and more inclusive growth.
- Egypt's presidential election and substantial GCC financing have restored some confidence and stabilized growth. However, continued reforms and additional external financing are critical to securing macroeconomic stability, generating inclusive growth, and creating jobs.
- In Jordan, recent reforms have stabilized growth and macroeconomic balances, but prospects are weighed down by adverse regional spillovers. Beyond the crisis in Syria, spotty gas flows from Egypt have required expensive alternative-energy imports. An escalated conflict in Iraq could jeopardize trade and confidence.
- In Lebanon, the political impasse and spillovers from the Syrian conflict have dampened confidence and activity. The presence of a larger number of refugees (one-quarter of the population) is affecting security, fueling high unemployment and poverty, and stressing already-weak public finances.

The recovery is vulnerable to setbacks in political transitions and intensified social and security tensions, including through their effects on oil prices, refugee movements, and trade disruption. Lower-than-expected growth in emerging markets, Europe, or the GCC

could slow tourism, exports, and remittances. Countries with limited exchange rate flexibility could face higher domestic interest rates when global monetary conditions tighten, although limited integration in international capital markets provides some monetary policy autonomy.

Structural reforms will help raise medium-term growth, create jobs, and improve living standards and equity. Business climate and governance reforms, better access to finance, and greater trade integration (particularly in higher-value-added products) are critical to lower firms' operating costs and increase employment opportunities. Labor market and education system reforms will help raise human capital and productivity—for example, by better aligning education and vocational training with private sector needs. Domestic reform efforts can also be bolstered by the international community through financing, access to key export markets, technical assistance, and policy advice.

Macroeconomic and financial policies should support the growth- and job-enhancing policy agenda. Fiscal consolidation is needed to instill confidence and restore public debt sustainability over the medium term. But it can be done at a measured pace, where financing allows. The ongoing reorientation of spending toward well-targeted social safety nets, infrastructure, education, and health care—all key to raising growth and jobs—could be supported through enhanced implementation capacity and restrained increases in spending on public sector wages. As growth improves, equity and business confidence can be boosted by broadening the tax base, increasing income tax progressivity, implementing subsidy reforms, and expanding targeted social safety nets.

Sub-Saharan Africa: Maintaining Speed

Economic activity in sub-Saharan Africa has continued to grow robustly—on the back of supportive external demand conditions and strong growth in public and private investment—and the outlook is expected to remain favorable for the lion's share of the region's countries. However, beyond the severe humanitarian implications, the ongoing outbreak of the Ebola virus is exacting a heavy economic toll in Guinea, Liberia, and Sierra Leone. Domestic risks also include a rapid buildup of fiscal vulnerabilities in a few countries and an intensification of security threats. Those risks could be compounded if global financing conditions were to tighten faster than anticipated and if emerging markets should slow down markedly, especially

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		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Sub-Saharan Africa	5.1	5.1	5.8	6.6	6.7	7.0	-2.4	-2.6	-3.2	...	...	...
Oil Exporters⁴	5.7	6.1	7.0	7.8	7.6	8.1	3.7	3.3	1.8	...	...	...
Nigeria	5.4	7.0	7.3	8.5	8.3	8.7	4.0	3.7	2.2	...	...	...
Angola	6.8	3.9	5.9	8.8	7.3	7.3	5.5	4.1	2.0	...	...	...
Gabon	5.6	5.1	5.4	0.5	4.7	2.5	12.1	12.2	6.0	...	...	...
Chad	3.9	9.6	6.7	0.2	2.8	3.1	-9.5	-7.2	-7.1	...	...	...
Republic of Congo	3.3	6.0	7.5	4.6	2.2	2.3	-3.4	-3.2	-3.2	...	...	...
Middle-Income Countries⁵	3.5	3.0	3.6	5.7	6.4	6.3	-5.4	-5.2	-5.0	...	...	...
South Africa	1.9	1.4	2.3	5.8	6.3	5.8	-5.8	-5.7	-5.6	24.7	25.2	25.0
Ghana	7.1	4.5	4.7	11.7	15.7	16.8	-11.9	-9.9	-8.5	...	...	...
Côte d'Ivoire	8.7	8.5	7.9	2.6	0.6	2.6	-2.1	-3.0	-3.1	...	...	...
Cameroon	5.5	5.1	5.2	2.1	3.2	2.6	-3.7	-3.5	-3.4	...	...	...
Zambia	6.7	6.5	7.2	7.0	8.0	7.8	0.7	1.9	2.3	...	...	...
Senegal	3.5	4.5	4.6	0.7	-0.5	1.5	-10.4	-9.8	-9.4	...	...	...
Low-Income Countries⁶	6.1	6.3	6.6	5.7	5.7	5.9	-11.7	-12.4	-12.3	...	...	...
Ethiopia	9.7	8.2	8.5	8.1	7.7	9.1	-6.0	-7.1	-7.3	...	...	...
Kenya	4.6	5.3	6.2	5.7	7.3	6.0	-8.7	-8.0	-8.1	...	...	...
Tanzania	7.0	7.2	7.0	7.9	5.9	4.9	-13.8	-13.7	-13.1	...	...	...
Uganda	5.8	5.9	6.3	5.0	5.5	5.9	-8.5	-10.4	-10.5	...	...	...
Madagascar	2.4	3.0	4.0	5.8	7.3	6.6	-5.4	-4.3	-4.0	...	...	...
Democratic Republic of the Congo	8.5	8.6	8.5	0.8	2.4	4.1	-10.2	-9.3	-9.2	...	...	...
<i>Memorandum</i>												
Sub-Saharan Africa Excluding South Sudan	4.9	5.2	5.7	6.6	6.8	6.9	-2.5	-2.6	-3.2	...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

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

²Percent of GDP.

³Percent. National definitions of unemployment may differ.

⁴Includes Equatorial Guinea and South Sudan.

⁵Includes Botswana, Cabo Verde, Lesotho, Mauritius, Namibia, Seychelles, and Swaziland.

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

in countries that depend on private external financing or on exports of natural resources. Consequently, for the vast majority of countries, sustaining high growth to foster employment creation and inclusive growth while preserving macroeconomic stability remains the key consideration. In the few countries where macroeconomic imbalances have emerged, they need to be addressed.

Growth in sub-Saharan Africa was buoyant at 5.1 percent in 2013, and activity remained strong in the first half of 2014. This was driven mainly by domestic demand, both from high investment outlays and strong private consumption—especially in low-income countries—but export growth has also remained strong. Continued solid public and private investment spending resulted from infrastructure projects and investment in mining and energy production in

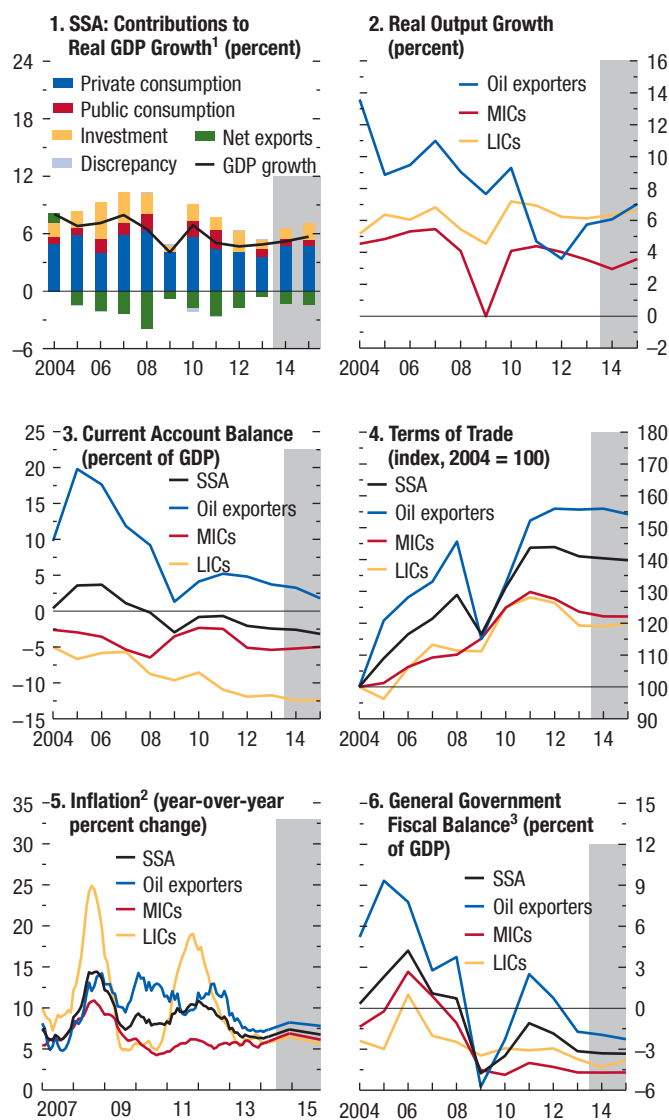
numerous countries; agricultural production recovered in some others.

Recent revisions to national accounts data suggest that some of the region's economies (Ghana, Nigeria) are far more diversified than previously thought—Nigeria's 2013 nominal GDP level has been revised upward by more than 80 percent, making it the largest economy in the region, with industry and services sectors representing a much larger share of the economy than previously estimated.

In many economies in the region, growth has also been supported by a further easing in external financial conditions since April 2014. Some economies have been able to tap capital markets at a heightened pace, and recent sovereign bond issuances in the Eurodollar market were largely oversubscribed, including maiden issuances in Kenya and Côte d'Ivoire. In fact, the "risk-

Figure 2.9. Sub-Saharan Africa: Maintaining Speed

Growth has remained strong in most economies of sub-Saharan Africa, driven by strong investment outlays and solid private consumption. However, fiscal vulnerabilities have been building up in a few countries.



Sources: Haver Analytics; IMF, International Financial Statistics database; and IMF staff estimates.

Note: LIC = low-income country (SSA); MIC = middle-income country (SSA); SSA = sub-Saharan Africa. Oil exporters refer only to SSA oil exporters. See Table 2.7 for country groupings and the Statistical Appendix for country group aggregation methodology.

¹Liberia, South Sudan, and Zimbabwe are excluded because of data limitations.

²Because of data limitations, Eritrea is excluded from LICs, Zimbabwe from LICs prior to December 2009, and South Sudan from oil exporters prior to June 2012.

³General government includes the central government, state governments, local governments, and social security funds.

on” mode has been broad based, with little discrimination based on domestic policies. Sovereign spreads have reverted to post-global-crisis lows across the board, regardless of countries’ fiscal positions—with the notable exception of those in Ghana. In this environment, currencies have generally stabilized after having weakened in 2013—except in Ghana—and some economies (in particular, Nigeria) that had used external reserves to defend the external value of their currencies in 2013 have been able to replenish these reserves. The Ghanaian cedi, however, has suffered from continued downward pressure, largely reflecting domestic policy slippages. Pressures on the Zambian kwacha were also substantial until May 2014, but the currency has since then recovered some of the lost ground.

This overall positive outlook is, however, overshadowed by the dire situation in Guinea, Liberia, and Sierra Leone, where the current Ebola outbreak is exacting a heavy human and economic toll. In addition, in contrast to robust activity in much of the region, growth in South Africa has remained lackluster, dragged down by protracted strikes, low business confidence, and tight electricity supply. The significant depreciation of the rand has so far resulted in only a limited amount of much-needed external adjustment.

The region’s growth is projected to accelerate further, rising from 5.1 percent in 2014 to 5.8 percent in 2015 (Table 2.7, Figure 2.9). The forecast is slightly weaker for 2014 compared to that in the April 2014 WEO, but slightly stronger for 2015. In many countries, activity will continue to benefit from the boost generated by infrastructure projects, the expansion of productive capacity, buoyant services sectors, a rebound in agricultural production, or combinations of those factors. In some middle-income countries and oil exporters, however, the picture is more mixed. In South Africa, a muted recovery is expected to take hold only in 2015, as improving labor relations allow inventory rebuilding and gradually stronger net exports to offset the drag from financial tightening.

Homegrown factors pose risks to the outlook for the region. Should the Ebola outbreak become more protracted or spread to more countries, it would have dramatic consequences for economic activity in the west African region. The security situation in several parts of sub-Saharan Africa remains fragile, including in the Central African Republic and South Sudan. Finally, the fiscal position is weakening in a few countries on the back of rising current expenditures.

On the external front, the region has become more sensitive to external real and financial shocks, given its increasing global linkages. Thus, a sudden reversal in risk premiums and volatility compression in global financial markets could severely affect sub-Saharan African countries reliant on external market funding. Lower growth in emerging market economies—notably China—also poses a protracted risk for the region, but especially for countries heavily reliant on commodity exports. Sharply higher oil prices would benefit the region's oil exporters but negatively affect its oil importers, especially since energy constraints faced by most countries in the region are related to a high cost of electricity, as generation often relies on fuel-based power plants.

For the vast majority of the countries in the region, sustaining high growth remains the key consideration to foster employment creation and inclusive growth. Policies should continue to emphasize growth-enhancing measures, including by boosting domestic revenue mobilization, supporting much-needed infrastructure investment, and improving the business climate. But as policymakers pursue development objectives, it will be important to pay heed to macroeconomic constraints, avoid overreliance on volatile capital flows, and prevent a permanent widening of the fiscal position. In the few countries where macroeconomic imbalances have become a source of concern, adjustment is necessary but will need to avoid adverse consequences for the poor and vulnerable groups.

Spillover Feature: Underlying Drivers of U.S. Yields Matter for Spillovers

The U.S. tapering announcement in May 2013 triggered a sharp repricing of risk and was followed by unusually high market volatility (Figure 2.SF.1). Yields in other advanced economies increased significantly, and emerging market economies were hit hard: local bond yields increased, equity prices declined, and currencies depreciated. The market turbulence that followed the taper talk was likely the side effect of an unanticipated policy turning point amid one-sided market positioning accompanied by very low implied volatility in option prices. Such market positioning has reemerged during recent months, but in a context in which the liftoff from the zero lower bound is more imminent than a year ago.

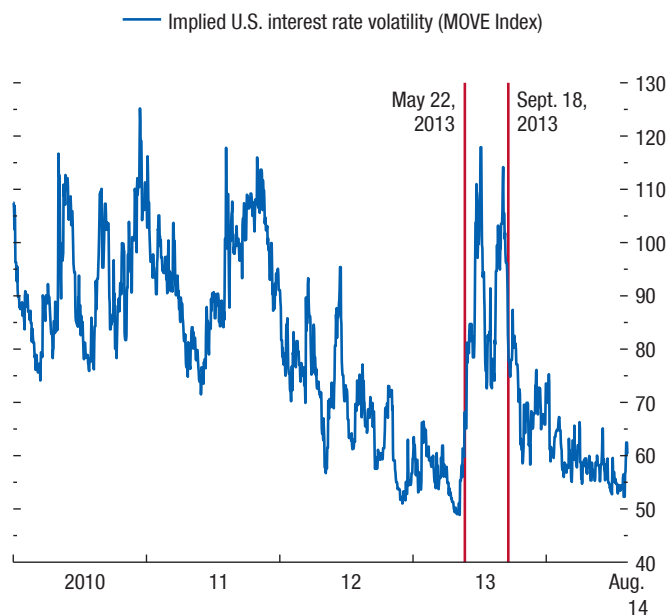
Given the prospects for tightening financial conditions, it is important, from a spillover perspective, to know what is driving the tightening, because this determines the nature of the spillover. Thus, this Spillover Feature examines the underlying drivers of U.S. yields, their recent behavior, and potential spillovers, building on the *2014 Spillover Report* (IMF 2014).¹ The analysis proceeds in two steps: (1) it separates the key drivers of U.S. yields into “real” and “money” shocks using a vector autoregression (VAR) with sign restrictions, and (2) it explores the implications of spillovers from the two shocks for different country groupings, using panel VARs. The intuition behind the identification scheme is simple: while positive (tightening) money shocks push yields up and depress stock prices, positive real shocks (better prospects/more risk appetite) increase both yields and stock prices.

The analysis suggests that spillover effects are different depending on the drivers of U.S. yields and recipient countries’ economic characteristics. Specifically, money shocks have adverse spillover effects abroad because they increase foreign yields significantly, which depresses economic activity. Spillovers to emerging market economies are stronger than those to small advanced economies. At the same time, real shocks have a generally positive spillover impact on recipient economies: higher economic activity in the United

The authors of this Spillover Feature are Troy Matheson, Emil Stavrev, and Sebastian Weber, with research assistance from Ava Yeabin Hong and Chanpheng Fizzarotti.

¹In light of the uneven recovery in advanced economies, see the *2014 Spillover Report* for a discussion of the implications of an asynchronous policy exit, with the United Kingdom and the United States exiting first, followed by the euro area and Japan.

Figure 2.SF.1. Implied Volatility
(Basis points)



Source: Bloomberg, L.P.

Note: MOVE = Merrill Option Volatility Expectations. Data are through August 11, 2014.

States spurs export growth, which is only partly offset by the higher yields in the recipient economies.

Underlying Drivers of U.S. Yields

To decompose U.S. yields into real and money shocks, a bivariate VAR with sign restriction, comprising bond yields ($R_{i,t}$) and the log stock market index ($S_{i,t}$), is used. Specifically:

$$R_{i,t} = \alpha_{i,0} + \alpha_{i,1}R_{i,t-1} + \alpha_{i,2}S_{i,t-1} + \varepsilon_{i,t}^R, \quad (2.SF.1)$$

$$S_{i,t} = \delta_{i,0} + \delta_{i,1}R_{i,t-1} + \delta_{i,2}S_{i,t-1} + \varepsilon_{i,t}^S, \quad (2.SF.2)$$

The parameters $\alpha_{i,0}$, $\alpha_{i,1}$, $\alpha_{i,2}$, $\delta_{i,0}$, $\delta_{i,1}$ and $\delta_{i,2}$ are reduced-form coefficients, and $\varepsilon_{i,t}^R$ and $\varepsilon_{i,t}^S$ are reduced-form shocks that are a linear combination of the structural shocks $MONEY_{i,t} \sim N(0,1)$ and $REAL_{i,t} \sim N(0,1)$. Matheson and Stavrev (forthcoming) offer a more detailed description of the methodology.

The contemporaneous sign restrictions used to identify the two shocks assume that positive economic news causes both long-term yields and equity prices to

rise, whereas tighter monetary policy causes long-term yields to rise and equity prices to fall. Hence, the sign restrictions imposed on the two variables in the VAR are as follows:²

	<i>R</i>	<i>S</i>
REAL	+	+
MONEY	+	-

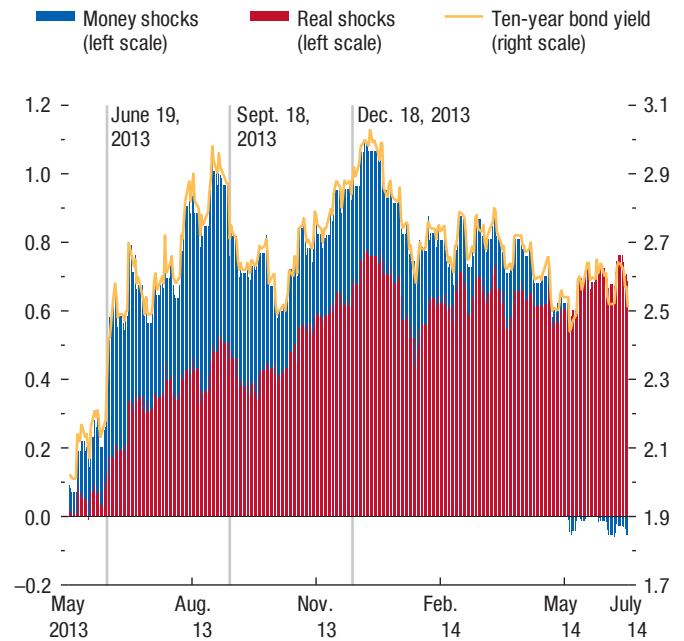
The data are daily over the period from January 2000 to mid-July 2014. The long-term bond yield (*R*) series is the 10-year U.S. Treasury bond yield at constant maturity, and the equity price (*S*) series is the (log) Standard & Poor’s 500 index. Through the use of long-term yields instead of short-term yields in the analysis, a broader concept of money shocks that encompasses both conventional and unconventional monetary policy shocks is considered. However, the identification is also consistent with exogenous shocks to the term premium, shifts in portfolio preferences away from bonds and equities toward higher demand for cash, and potential upward surprises in inflation unrelated to increased demand. At different times, different factors will be dominant.

The results from the decomposition highlight the changing roles of money and real shocks in regard to U.S. yield developments over the period May 2013–July 2014.³ Specifically, in the aftermath of the taper talk, higher yields were driven by money shocks, contributing about 60 percent of the total 100 basis point increase by the September “no taper” announcement. The subsequent actual taper announcement in December 2013 had little impact on yields because it was perceived by markets as confirmation of a better economic outlook. Starting in early 2014, yields

²The money and real shock decomposition is based on the model that provides the least distance to the pointwise median impulse response of all the models that fulfill the sign restrictions (Fry and Pagan 2011).

³Note that the real shocks from the bivariate VAR decomposition comprise both activity and “risk-on/-off” shocks, which could have potentially different spillover implications. To disentangle risk shocks, the U.S. nominal effective exchange rate has been added to the bivariate VAR. Although activity and risk shocks have the same impact on yields and stock prices, their impact on the exchange rate is different: the U.S. dollar appreciates (depreciates) as a result of stronger activity (risk) (for elaboration on the estimation, see IMF 2014). Preliminary results from this three-way decomposition suggest qualitatively similar results for the contribution of money shocks. Regarding real shocks, the results suggest that the activity component has remained broadly stable, whereas the risk-on contribution has increased since May 2014. Further analysis is needed to assess the spillover implications of activity and risk shocks.

Figure 2.SF.2. Drivers of U.S. Yields
(Basis points)



Sources: Bloomberg, L.P.; Haver Analytics; and IMF staff calculations. Note: Data are through July 10, 2014.

declined in line with the falling contribution from the money shock, whereas the contribution from real shocks remained broadly unchanged. Since mid-May 2014, money shocks have turned negative (easing in money conditions), offsetting the positive contribution of better economic news to U.S. yields. By mid-July 2014, real shocks accounted for the entire 60 basis point increase in U.S. long-term yields since May 2013 (Figure 2.SF.2).

Spillover Effects from Higher U.S. Yields

To assess the international transmission of the identified real and money shocks to U.S. yields, the dynamic effect of these external shocks (X_t) on other countries’ variables ($Y_{i,t}$) is obtained using a panel VAR model estimated with monthly data.⁴ Specifically:⁵

⁴A number of authors have assessed the role of U.S. shocks for other countries. See, for instance, Ehrmann, Fratzscher, and Rigobon 2011; Ehrmann and Fratzscher 2009; Fratzscher, Lo Duca, and Straub 2013; Chen, Mancini-Griffoli, and Sahay, forthcoming; Georgiadis, forthcoming; Kim 2001; Maćkowiak 2007; Miniane and Rogers 2007; and Mishra and others 2014.

⁵A caveat to this analysis is that coefficient estimates are held constant across the sample period. Spillovers may have been larger

$$Y_{i,t} = \sum_{l=1}^{12} A_l Y_{i,t-l} + \sum_{l=0}^{12} B_l X_{t-l} + \varepsilon_{i,t}, \quad (2.SF.3)$$

in which A_l and B_l represent reduced-form coefficient matrices. The dependent-variable vector includes the local-currency long-term sovereign bond yield ($R_{i,t}$), the annual change in the nominal effective exchange rate ($E_{i,t}$), and an activity measure ($Z_{i,t}$) alternatively described by the annual change in industrial production, the annual change in the stock price index, or the sum of equity and bond net-capital-inflow-to-GDP ratios:⁶

$$Y_{i,t} = (R_{i,t} \ E_{i,t} \ Z_{i,t}). \quad (2.SF.4)$$

The external shocks (X_t) are the U.S. money and real shock, respectively.⁷ Because the two shocks are orthogonal to each other, they are included separately in the estimation. All regressions include 12 lags.⁸ Confidence bands are based on bootstrapped standard errors.⁹

The analysis uses monthly data for the period from January 2000 to July 2014. Long-term local-currency sovereign bond yields are taken from Bloomberg, L.P., and the IMF's International Financial Statistics (IFS) database. The nominal effective exchange rate is based on data from the IMF's Information Notice System (INS), and the industrial production data are obtained from the IFS database and Haver Analytics.

The (unbalanced) panel includes a total of 29 economies: 6 small advanced economies (Australia, Canada, New Zealand, Norway, Sweden, Switzerland), 9 central and eastern European economies (Bulgaria,

Croatia, Czech Republic, Hungary, Israel, Poland, Romania, Slovak Republic, Turkey), 10 Asian economies (China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore, Thailand), 3 Latin American economies (Brazil, Colombia, Mexico), and South Africa. To minimize endogeneity concerns, larger advanced economies, such as Japan, the United Kingdom, and the euro area, are excluded from the spillover analysis (although even for these economies, it is likely that U.S. shocks dominate; see for elaboration Ehrmann, Fratzscher, and Rigobon 2011).

The results show that spillovers associated with a 25 basis point increase in the U.S. 10-year bond yield differ notably depending on whether the underlying driver is a real or a money shock (Figure 2.SF.3). In particular, money shocks are followed by increases in bond yields, a depreciation of the currency, capital outflows, and declines in stock markets and economic activity. The same yield increase due to better growth prospects (real shock) is followed by a limited response in bond yields, an appreciation of the currency, capital inflows, and higher stock market returns and economic activity. The response of the exchange rate is not immediately intuitive, given that better economic prospects in the United States may also cause higher capital inflows and an appreciation of the U.S. dollar. The fact that the other currencies appreciate (and capital flows to them) is explained by the dual character of the real shock (see note 4). Given the nature of the identification scheme, the real shock can capture both better economic news about the U.S. economy and increased risk appetite, which leads to a reallocation of assets from safe (U.S. bonds) to more risky (stocks and emerging market bonds) assets. If risk appetite dominates, the real shock causes capital to flow to emerging markets, appreciating their currencies and depressing their yields. However, whether risk motives or U.S. economic news dominates, industrial production rises in the United States and other economies.

The results also suggest that spillovers from money shocks appear, in general, smaller than effects in the United States, whereas those from real shocks appear larger (Figures 2.SF.3 and 2.SF.4). In particular, following an adverse money shock, industrial production in recipient countries falls on average about $\frac{3}{4}$ percent, whereas U.S. industrial production declines by about $\frac{1}{4}$ percent over the course of a year. This is in line with the panel results that interest rates in recipient economies increase by less than those in the United States after a money shock. The estimates are slightly

in the aftermath of the crisis. However, the number of available observations is insufficient to make testing this hypothesis empirically feasible.

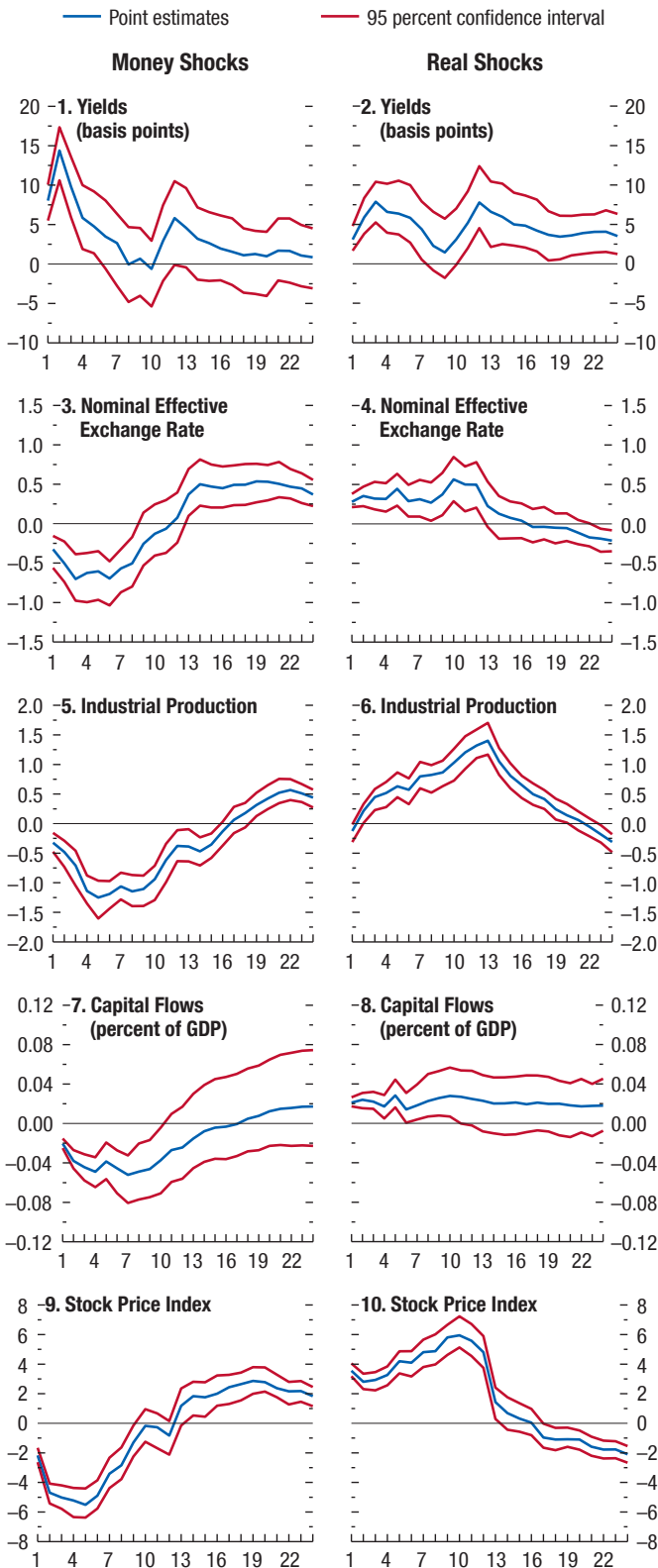
⁶This approach is preferred to a regression including all three activity measures at a time, which would severely reduce the degrees of freedom given two additional variables and 12 lags. Impulse-response functions are reported for yields, nominal effective exchange rate, and industrial production from the baseline specification and complemented by those for the annual change in the stock price index and the sum of the equity and bond net-capital-inflow-to-GDP ratios from the alternative specification. Data are taken from the IMF's International Financial Statistics database and from EPFR Global. Changing the specification to a log-level regression or a first-difference of the log-level regression affects the value of the point estimates somewhat but has no implications for the qualitative results.

⁷To convert the shocks, which are identified at daily frequency, to monthly frequency, the sum of the shocks in the respective month is taken.

⁸The optimal lag length varies depending on the test criteria (between 9 and 16 lags).

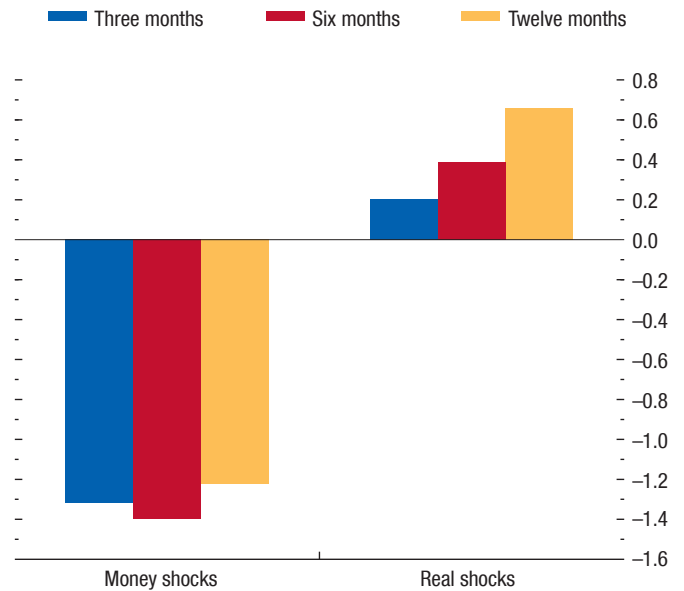
⁹Confidence bands allow for cross-equation correlation in the VAR structure. However, confidence bands are likely underestimating the uncertainty around the coefficient estimates because cross-sectional dependence across countries is not taken into account and an estimated variable is used as a regressor.

Figure 2.SF.3. Spillovers from U.S. Money and Real Shocks
(Year-over-year percent change, unless indicated otherwise; months on x-axis)



Source: IMF staff estimates.

Figure 2.SF.4. United States: Average Response of Industrial Production after Varying Intervals
(Year-over-year percent change)



Source: IMF staff estimates.

above those for conventional monetary policy spillovers, which range from a ratio of 1:3 to a ratio of 1:2 for the contraction in recipient-country output relative to U.S. output.¹⁰ At the same time, a positive real shock in the United States boosts industrial production there by a bit less than in recipient economies, likely reflecting the additional positive impact from higher risk appetite embedded in real shocks. The VAR literature based on quarterly data finds average responses to U.S. growth surprise shocks in the range from a ratio of 1:4 to a ratio of 1:2 and for some countries above a ratio of 1:1 (see the April 2014 *World Economic Outlook*).¹¹ However, the identification strategy underlying these estimates differs from the one used here, which comprises both growth surprise and risk-on components. The latter are generally associated with larger effects for emerging markets and thus may account for the higher spillover estimate.

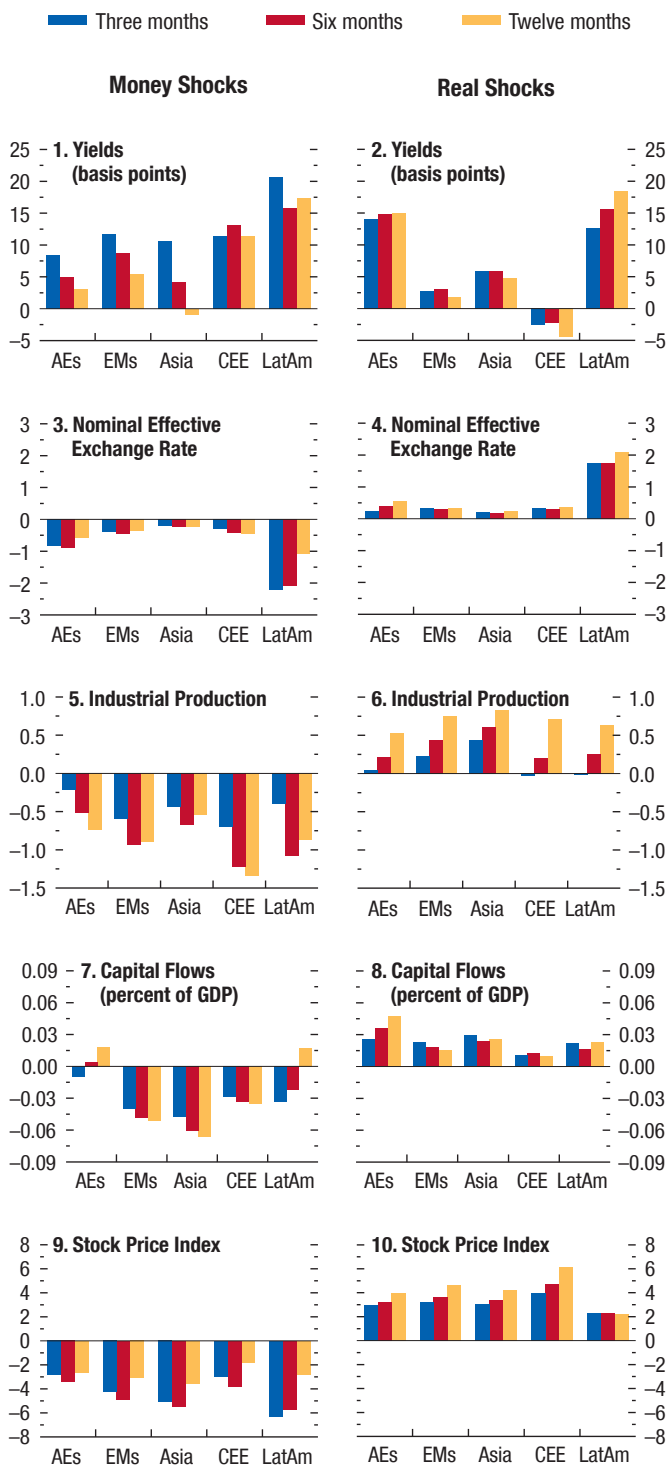
The average responses mask potential variation across countries, reflecting, for example, differing economic links with the United States or policy frameworks that can act

¹⁰See for instance Kim 2001, Mackowiak 2007, and Georgiadis, forthcoming.

¹¹These studies rely on sample periods extending often beyond the early 1980s. Growth correlations in the past decade have been significantly higher (see the October 2013 *World Economic Outlook*).

Figure 2.SF.5. Spillovers from U.S. Money and Real Shocks by Country Group

(Year-over-year percent change, unless indicated otherwise)



Source: IMF staff estimates.
 Note: AE = advanced economy; CEE = central and eastern Europe; EM = emerging market; LatAm = Latin America.

as shock absorbers or amplifiers. This aspect is further analyzed by contrasting two cases: first, splitting the sample into small advanced economies and emerging markets, and second, comparing the results for central and eastern European, Asian, and Latin American emerging markets. Figure 2.SF.5 shows the average response of bond yields, nominal effective exchange rates, industrial production, capital flows, and stock prices for the country groups in the first 3, 6, and 12 months following money and real shocks. Results for Latin America should be interpreted with care, because they rely on a small sample of only three economies for which data are available, mainly in the latter half of the sample period.

In response to a U.S. money shock, compared with those in advanced economies, yields in emerging market economies increase by more, exchange rates depreciate by less, capital outflows are larger, and output and stock prices contract by more. The differential responses likely reflect the higher risk associated with emerging market assets and the higher exchange rate flexibility and deeper financial markets in advanced economies. The response to a U.S. real shock is less differentiated across the two groups, with the notable exception of the yield response, which reflects, among other factors, the dual nature of the real shock (comprising a risk-on component that tends to depress bond yields in emerging markets).¹²

Activity in Asian economies tends to be less affected by U.S. money shocks relative to economies in central and eastern Europe and Latin America, despite higher capital outflows and larger stock market declines. However, economies in central and eastern Europe and Latin America experience larger currency depreciations and greater increases in bond yields. The tighter financial conditions in these economies prompt a larger decline in industrial production relative to that in economies in Asia. In response to a U.S. real shock, the difference between economies in Asia and those in central and eastern Europe is less pronounced (and mostly not statistically significant), with the exception of the reaction of stock market prices, which tend to rally more in central and eastern Europe than in Asia. The different impacts on central and eastern European and Asian economies from U.S. money and real shocks likely reflect, among other things, differences in fundamentals

¹²The stronger yield response in advanced economies compared with that in emerging markets following real shocks is consistent with real shocks capturing risk-on behavior, with emerging market bonds and equities generally considered more risky, whereas advanced economy bonds are viewed as safer assets.

(for example, relatively strong current account balances in Asian economies).¹³ In addition, central and eastern European economies tend to have greater participation of foreigners in local currency markets. This may explain the stronger equity price response and nonsignificant negative response of bond yields to a real shock, reflecting the risk-on aspect. Latin American economies' yields and nominal effective exchange rates are more responsive than those in economies in the other two regions, partly reflecting relatively open capital accounts and more flexible exchange rate regimes.

Conclusions

This analysis suggests that spillover effects differ depending on the underlying drivers of U.S. yields. A

faster recovery (real shock) in the United States has a positive impact on global growth by strengthening external sector performance and boosting confidence in recipient economies. At the same time, an unexpected tightening of financial conditions (adverse U.S. money shock) has negative spillover effects abroad as it pushes up foreign yields significantly, depressing economic activity.

The impact across countries varies depending on the strength of their economic links with the United States, their policy frameworks (which can act as shock absorbers or amplifiers), or both. Small advanced economies are less vulnerable to adverse U.S. money shocks than emerging market economies, reflecting, among other factors, their more flexible exchange rate regimes and deeper financial markets. Across emerging market economies, tightening financial conditions have a smaller impact on activity in Asian economies than in central and eastern European and Latin American economies, partly reflecting relatively strong external balances among Asian economies.

¹³On the role of fundamentals in spillovers, see IMF 2014 and the references therein.

References

- Chen, Jiaqian, Tommaso Mancini-Griffoli, and Ratna Sahay. Forthcoming. “Spillovers from U.S. Monetary Policy on Emerging Market Economies: Different This Time?” IMF Working Paper, International Monetary Fund, Washington.
- Ehrmann, Michael, and Marcel Fratzscher. 2009. “Global Financial Transmission of Monetary Policy Shock.” *Oxford Bulletin of Economics and Statistics* 71 (6): 739–59.
- , and Roberto Rigobon. 2011. “Stocks, Bonds, Money Markets and Exchange Rates: Measuring International Financial Transmission.” *Journal of Applied Econometrics* 26 (6): 948–74.
- Fratzscher, Marcel, Marco Lo Duca, and Roland Straub. 2013. “On the International Spillovers of US Quantitative Easing.” ECB Working Paper 1557, European Central Bank, Frankfurt.
- Fry, Renée, and Adrian Pagan. 2011. “Sign Restrictions in Structural Vector Autoregressions: A Critical Review.” *Journal of Economic Literature* 49 (4): 938–60.
- Georgiadis, Giorgio. Forthcoming. “Determinants of Global Spillovers from U.S. Monetary Policy.” ECB Working Paper, European Central Bank, Frankfurt.
- International Monetary Fund (IMF). 2014. *2014 Spillover Report*. Washington.
- Kim, Soyoung. 2001. “International Transmission of U.S. Monetary Policy Shocks: Evidence from VAR’s.” *Journal of Monetary Economics* 48 (2): 339–72.
- Maćkowiak, Bartosz. 2007. “External Shocks, U.S. Monetary Policy and Macroeconomic Fluctuations in Emerging Markets.” *Journal of Monetary Economics* 54 (8): 2512–20.
- Matheson, Troy, and Emil Stavrev. Forthcoming. “News and Monetary Shocks at a High Frequency: A Simple Approach.” IMF Working Paper, International Monetary Fund, Washington.
- Miniane, Jacques, and John H. Rogers. 2007. “Capital Controls and the International Transmission of U.S. Money Shocks.” *Journal of Money, Credit and Banking* 39 (5): 1003–35.
- Mishra, Prachi, Kenji Moriyama, Papa N’Diaye, and Lam Nguyen. 2014. “Impact of Fed Tapering Announcements on Emerging Markets.” IMF Working Paper 14/109, International Monetary Fund, Washington.