Global Economic Prospects

South Asia

June 2014
Andrew Burns
Main Messages

• 2014 Global forecast has been downgraded, mainly reflecting one-off factors

• Financing conditions have eased temporarily, but are expected to tighten once again—carrying with them risks

• Medium-term outlook is for growth to remain flat in 2014 and to rise moderately in 2014 and 2015.

• Growth in South Asia has been disappointing, and although vulnerabilities are declining they remain

• Inflation, fiscal sustainability and the pace of structural reform are central challenges
First quarter GDP data in high-income countries was mixed.

Percent quarterly GDP growth, annualized pace

Euro Area: Stable but weak growth

Japan: Sharp uptick in advance of April VAT hike

United States: Weather sharply lowered growth

Despite first quarter, business confidence in high-income countries remains strong

Purchasing Managers, indexes (50 or more indicates expansion)

Developing countries

- Real data still positive for most countries, but confidence measures have weakened—perhaps because of Ukraine

- Financial turmoil has eased, borrowing costs are up, but remain low

- Forecast is for modest pickup in growth

- Growth has been disappointing in some regions
First quarter growth in most developing countries about the same as 2013Q4

Industrial production growth, 3m/3m saar

Regional industrial production appears to be stabilizing

South Asian Industrial production growth, 3m/3m saar

Financial conditions have loosened since January in contrast to earlier expectations

- Most developing countries not affected by turmoil
- Capital flows have recovered
- Developing country yields have returned to fall levels, and are actually 55 basis points lower than before the crisis
- Market remains volatile, in part because rising rates will change portfolio decisions
- Vulnerabilities have declined but remain
Rather than rising further, developing country borrowing have declined

Yields on sovereign debt, basis points

Capital inflows declined abruptly in February, but recovered in March & April.

Gross capital flows, billions USD

Source: World Bank, Dealogic.
Gross capital flows to South Asia have also recovered

Gross capital flows, $ billions

- Equity issuance
- Bond issuance
- Syndicated bank lending

Source: World Bank and Dealologic
Local currency valuations of stock markets have recovered from last summer.

Source: World Bank and Dealogic
Tailwinds to support growth

• High-income acceleration will double their contribution to global import demand growth

• Growth impact of eventual tightening of financial conditions has been postponed

• Commodity prices are stable or falling (good for importers, modest headwind for exporters)
Contribution of high-income countries to global trade growth will more than double.

Contribution to annual growth of global trade

Contributions of imports from group to growth of global trade volumes

- Developing
- High-income

Commodity prices are critical to region and expected to remain stable or decline.

USD price of internationally traded commodities, index 2010=100

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<th></th>
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Outlook

- Projected pick up in growth to be led by high-income countries
- Developing-country growth in line with underlying potential
- Regional growth shows strengthening or stability going forward
- Slower growth in middle-income countries may reflect weaker than thought potential
A gradual pick up in growth, led by high-income countries

Regional Outlook

• Medium-term outlook for the region is for growth to remain flat in 2014 and pick up moderately in 2015 and 2015.

• Growth is projected to remain weak in South Africa, owing to tight monetary policy, tense labor relations, and electricity constraints.

• Excluding South Africa, outlook is for growth to remain robust in the rest of the region, with FDI flows in the natural resources sector, public investment in infrastructure, expansion in agriculture, and firming external demand as key drivers of growth.

• Mozambique’s GDP is projected to grow faster than the regional average, supported by strong investment and production in the coal sector.

Source: World Bank
Despite slowdown, South Asia continues to outperform developing country average.
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Risks

- Today’s loose financial conditions could regenerate vulnerabilities (longer term they will tighten, increasing weaker financial flows, higher capital costs).
  - Fiscal conditions have deteriorated
  - External financing requirements have risen
- A key near term risk for the region is weak monsoon rains due to El Nino weather conditions.
- Longer term growth has to come from structural reforms: improving education quality; health and infrastructure.
Financial vulnerabilities have declined but remain

Source: World Bank
Partly as a result, developing country debt to GDP ratios have been rising.

Fiscal deficits have declined but remain high

General government balance, % of GDP

Source: World Bank
Inflation in India has eased somewhat, but remains high.

Source: World Bank, Haver, national sources.
Stressed loans (including restructured loans) are more than 10 percent of total loans in four South Asian countries

Source: IMF and World Bank estimates based on national sources

**Stressed loans as percent of total loans (H2 2013)**

- **Restructured loans**
- **Non-performing loans**

Source: IMF and World Bank estimates based on national sources
Structural policies will be key for sustaining stronger growth.

Source: World Bank
Decomposing potential output

GDP and potential growth, and contributions to potential, percent

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Investment growth in India slowed sharply since 2012, dragging down the investment rate (as % of GDP) and overall GDP growth.

Note: Investment excludes acquisition of valuables such as gold.
Decomposing potential output

GDP and potential growth, and contributions to potential, percent

Concluding remarks

• Downgrade in 2014 growth mainly explained by weak first quarter and situation in Ukraine

• Looser than expected financial conditions now could mean faster tightening in the future

• Developing country growth has disappointed for 3 years running – reinforcing the need to focus on structural policies to speed growth

• Vulnerabilities have declined but remain, macro cushions should be gradually rebuilt
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THE WORLD BANK