

## CHAPTER 1

# GLOBAL OUTLOOK

Weak Momentum, Heightened Risks



*Global growth in 2019 has been downgraded to 2.6 percent, 0.3 percentage point below previous forecasts, reflecting weaker-than-expected international trade and investment at the start of the year. Growth is projected to gradually rise to 2.8 percent by 2021, predicated on continued benign global financing conditions, as well as a modest recovery in emerging market and developing economies (EMDEs) previously affected by financial market pressure. However, EMDE growth remains constrained by subdued investment, which is dampening prospects and impeding progress toward achieving development goals. Risks are also firmly on the downside, in part reflecting the possibility of destabilizing policy developments, including a further escalation of trade tensions between major economies; renewed financial turmoil in EMDEs; and sharper-than-expected slowdowns in major economies. It is therefore urgent for EMDEs to reinforce policy buffers and build resilience to possible negative shocks, and to implement reforms that promote private investment and improve public sector efficiency. Efforts to strengthen access to markets and technology while boosting the quality of infrastructure and governance should be prioritized and be implemented through cost-effective and private-sector-led solutions. Structural reforms aimed at improving the business climate would also boost growth prospects. Well-designed social safety nets and active labor market policies are key to managing risks and protecting vulnerable groups.*

## Summary

Global economic activity continued to soften at the start of 2019, with trade and manufacturing showing signs of marked weakness (Figures 1.1.A and B). Heightened policy uncertainty, including a recent re-escalation of trade tensions between major economies, has been accompanied by a deceleration in global investment and a decline in confidence (Figure 1.1.C). Activity in major advanced economies—particularly in the Euro Area—as well as in some large emerging market and developing economies (EMDEs) has been weaker than previously expected. Recent high-frequency indicators suggest this period of weakness may be receding; however, global activity remains subdued.

Amid low global inflation and a deterioration of the growth outlook, the prospect that the U.S. Federal Reserve and other major central banks will tighten monetary policy in the near term has faded, leading to an easing in global financing conditions and a recovery of capital flows to EMDEs. However, weakening external demand has weighed on export growth across EMDE regions. Although demand for industrial commodities has generally softened, prices have

partially recovered because of tightening supply conditions. EMDE growth momentum continues to be generally subdued, as slowing global trade and persistent policy uncertainty in key economies are only partially offset by recent improvements in external financing conditions.

Global growth in 2019 has been downgraded to 2.6 percent—0.3 percentage point below previous projections—reflecting the broad-based weakness observed during the first half of the year, including a further deceleration in investment amid rising trade tensions. In particular, global trade growth in 2019 has been revised down a full percentage point, to 2.6 percent—slightly below the pace observed during the 2015-16 trade slowdown, and the weakest since the global financial crisis.

As recent softness abates, global growth is projected to edge up to 2.7 percent in 2020 and to 2.8 percent in 2021. Slowing activity in advanced economies and China is expected to be accompanied by a modest cyclical recovery in major commodity exporters and in a number of EMDEs affected by recent pressure related to varying degrees of financial market stress or idiosyncratic headwinds such as sanctions (Figure 1.1.D).

EMDE growth is projected to pick up from a four-year low of 4 percent in 2019—0.3 percentage point below previous projections—to 4.6 percent in 2020-21. This recovery is predicated on the waning impact of earlier

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Note: This chapter was prepared by Carlos Arteta, Patrick Kirby, and Marc Stocker, with contributions from Ekaterine Vashakmadze and Collette M. Wheeler. Additional inputs were provided by John Baffes, Csilla Lakatos, Peter Nagle, Franz Ulrich Ruch, and Rudi Steinbach. Research assistance was provided by Liu Cui, Ishita Dugar, Claudia Marchini, Julia R.R. Norfleet, and Jinxin Wu.

**TABLE 1.1 Real GDP<sup>1</sup>**

(Percent change from previous year)

Percentage point differences  
from January 2019 projections

	2016	2017	2018e	2019f	2020f	2021f	2019f	2020f	2021f
<b>World</b>	<b>2.6</b>	<b>3.1</b>	<b>3.0</b>	<b>2.6</b>	<b>2.7</b>	<b>2.8</b>	<b>-0.3</b>	<b>-0.1</b>	<b>0.0</b>
<b>Advanced economies</b>	<b>1.7</b>	<b>2.3</b>	<b>2.1</b>	<b>1.7</b>	<b>1.5</b>	<b>1.5</b>	<b>-0.3</b>	<b>-0.1</b>	<b>0.0</b>
United States	1.6	2.2	2.9	2.5	1.7	1.6	0.0	0.0	0.0
Euro Area	2.0	2.4	1.8	1.2	1.4	1.3	-0.4	-0.1	0.0
Japan	0.6	1.9	0.8	0.8	0.7	0.6	-0.1	0.0	0.0
<b>Emerging market and developing economies</b>	<b>4.1</b>	<b>4.5</b>	<b>4.3</b>	<b>4.0</b>	<b>4.6</b>	<b>4.6</b>	<b>-0.3</b>	<b>0.0</b>	<b>0.0</b>
Commodity-exporting EMDEs	1.5	2.1	2.2	2.1	3.1	3.0	-0.4	0.1	0.0
Other EMDEs	6.0	6.1	5.8	5.2	5.5	5.5	-0.3	-0.1	-0.1
Other EMDEs excluding China	5.1	5.4	4.9	4.2	4.8	5.0	-0.5	-0.1	-0.1
East Asia and Pacific	6.3	6.5	6.3	5.9	5.9	5.8	-0.1	-0.1	0.0
China	6.7	6.8	6.6	6.2	6.1	6.0	0.0	-0.1	0.0
Indonesia	5.0	5.1	5.2	5.2	5.3	5.3	0.0	0.0	0.0
Thailand	3.4	4.0	4.1	3.5	3.6	3.7	-0.3	-0.3	-0.2
Europe and Central Asia	1.9	4.1	3.1	1.6	2.7	2.9	-0.7	0.0	0.0
Russia	0.3	1.6	2.3	1.2	1.8	1.8	-0.3	0.0	0.0
Turkey	3.2	7.4	2.6	-1.0	3.0	4.0	-2.6	0.0	-0.2
Poland	3.1	4.8	5.1	4.0	3.6	3.3	0.0	0.0	0.0
Latin America and the Caribbean	-0.3	1.7	1.6	1.7	2.5	2.7	-0.4	-0.2	0.0
Brazil	-3.3	1.1	1.1	1.5	2.5	2.3	-0.7	0.1	-0.1
Mexico	2.9	2.1	2.0	1.7	2.0	2.4	-0.3	-0.4	0.0
Argentina	-2.1	2.7	-2.5	-1.2	2.2	3.2	0.5	-0.5	0.1
Middle East and North Africa	5.1	1.2	1.4	1.3	3.2	2.7	-0.6	0.5	0.0
Saudi Arabia	1.7	-0.7	2.2	1.7	3.1	2.3	-0.4	0.9	0.1
Iran	13.4	3.8	-1.9	-4.5	0.9	1.0	-0.9	-0.2	-0.1
Egypt <sup>2</sup>	4.3	4.2	5.3	5.5	5.8	6.0	-0.1	0.0	0.0
South Asia	8.1	6.7	7.0	6.9	7.0	7.1	-0.2	-0.1	0.0
India <sup>3</sup>	8.2	7.2	7.2	7.5	7.5	7.5	0.0	0.0	0.0
Pakistan <sup>2</sup>	4.6	5.4	5.8	3.4	2.7	4.0	-0.3	-1.5	-0.8
Bangladesh <sup>2</sup>	7.1	7.3	7.9	7.3	7.4	7.3	0.3	0.6	0.5
Sub-Saharan Africa	1.3	2.6	2.5	2.9	3.3	3.5	-0.5	-0.3	-0.2
Nigeria	-1.6	0.8	1.9	2.1	2.2	2.4	-0.1	-0.2	0.0
South Africa	0.6	1.4	0.8	1.1	1.5	1.7	-0.2	-0.2	-0.1
Angola	-2.6	-0.1	-1.7	1.0	2.9	2.8	-1.9	0.3	0.0
<b>Memorandum items:</b>									
<b>Real GDP<sup>1</sup></b>									
High-income countries	1.7	2.3	2.1	1.8	1.6	1.6	-0.2	-0.1	0.0
Developing countries	4.4	4.8	4.6	4.2	4.7	4.8	-0.3	-0.1	0.0
Low-income countries	4.8	5.6	5.6	5.4	6.0	6.1	-0.5	-0.2	-0.2
BRICS	4.6	5.3	5.4	5.1	5.3	5.3	-0.1	0.0	0.0
World (2010 PPP weights)	3.3	3.7	3.7	3.3	3.5	3.6	-0.3	-0.1	0.0
<b>World trade volume<sup>4</sup></b>	<b>2.8</b>	<b>5.5</b>	<b>4.1</b>	<b>2.6</b>	<b>3.1</b>	<b>3.2</b>	<b>-1.0</b>	<b>-0.4</b>	<b>-0.2</b>
<b>Commodity prices<sup>5</sup></b>									
Oil price	-15.6	23.3	29.4	-3.4	-1.5	0.7	-0.5	-1.5	0.7
Non-energy commodity price index	-2.8	5.5	1.7	-2.1	-0.1	1.4	-3.1	-1.3	0.2

Source: World Bank.

Notes: PPP = purchasing power parity; e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. Country classifications and lists of emerging market and developing economies (EMDEs) are presented in Table 1.2. BRICS include: Brazil, Russia, India, China, and South Africa. Due to lack of data, the World Bank has ceased producing a growth forecast for Venezuela and has removed Venezuela from all growth aggregates in which it was previously included.

1. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights.

2. GDP growth values are on a fiscal year basis. Aggregates that include these countries are calculated using data compiled on a calendar year basis. Pakistan's growth rates are based on GDP at factor cost. The column labeled 2019 refers to FY2018/19.

3. The column labeled 2018 refers to FY2018/19.

4. World trade volume of goods and non-factor services.

5. Oil is the simple average of Brent, Dubai, and West Texas Intermediate. The non-energy index is comprised of the weighted average of 39 commodities (7 metals, 5 fertilizers, 27 agricultural commodities). For additional details, please see <http://www.worldbank.org/en/research/commodity-markets>.

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financial pressure currently weighing on activity in some large EMDEs, and on more benign global financing conditions than previously expected. It also assumes no further escalation in trade restrictions between major economies and stability in commodity prices. Despite this projected recovery, per capita growth in a large number of EMDEs will remain insufficient to narrow income gaps with advanced economies—including in Sub-Saharan Africa, a region with a high concentration of poverty (Figure 1.1.E).

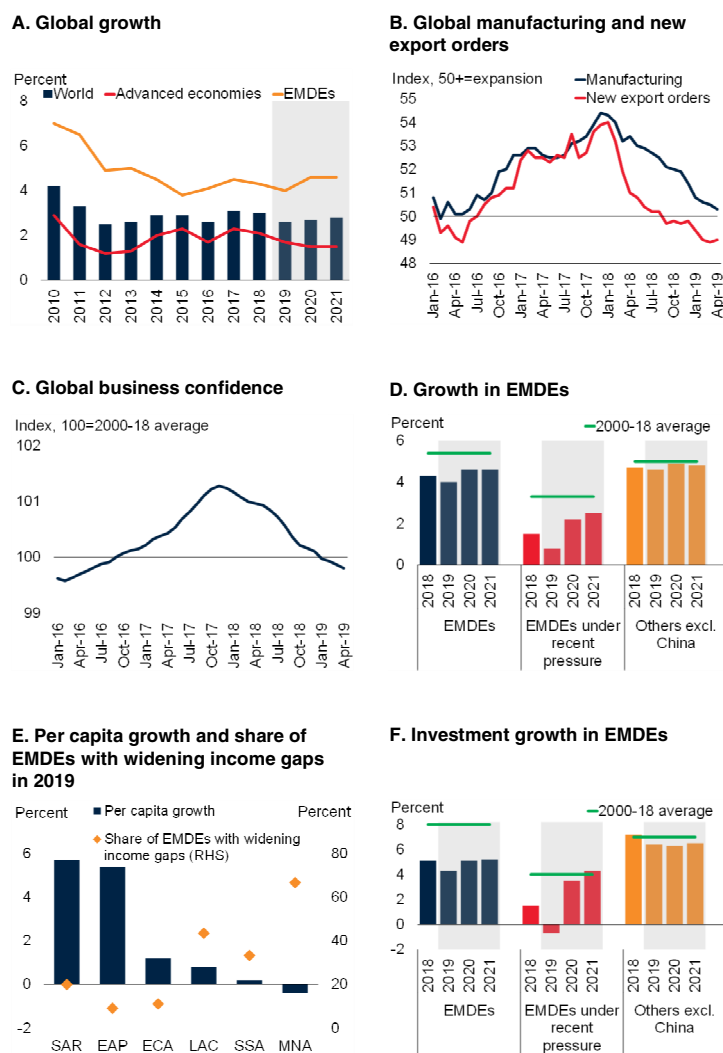
Moreover, EMDE investment growth will remain soft, particularly in commodity exporters and countries affected by recent pressures (Figure 1.1.F). Factors contributing to the weak pace of EMDE investment growth include elevated debt levels, limited fiscal space, lack of clarity about policy direction, and inadequate business climates. Subdued investment will weigh on EMDE growth prospects directly through slower capital deepening and indirectly through its dampening impact on productivity, which will make achieving the Sustainable Development Goals more difficult.

Amid a low probability of substantial near-term policy improvements in major economies, risks remain firmly on the downside (Figure 1.2.A). Confidence and investment could be markedly impacted by a sudden rise in policy uncertainty—triggered, for instance, by substantial new trade barriers between major economies resulting in cascading trade costs and a lack of clarity about future trading rules (Figure 1.2.B). If this rise is persistent, the impact on global investment and activity could be severe. An increase in uncertainty could also be related to a heightened possibility of a disorderly exit of the United Kingdom from the European Union (EU). Similarly, a sustained dissipation of these uncertainties—for instance, due to a comprehensive resolution of trade tensions between the United States and China—could significantly buttress global growth prospects. The potential gains associated with such a resolution highlight the large opportunity costs that additional trade tensions would entail.

A weakening of financial market sentiment could lead to sudden increases in risk premiums and be amplified by high and rising debt levels, corporate sector vulnerabilities, and increasing refinancing

**FIGURE 1.1 Global growth prospects**

*Global growth softened further in the first half of the year, as trade and manufacturing decelerated. Amid heightened policy uncertainty, confidence has declined. A more dovish stance by major central banks has led to some easing in financing conditions. After weakness in 2019, EMDE growth is expected to recover in 2020-21, as headwinds in key economies fade. In many EMDEs, this recovery will not be enough to narrow per capita income gaps with advanced economies. Subdued investment will continue to weigh on EMDE growth prospects.*

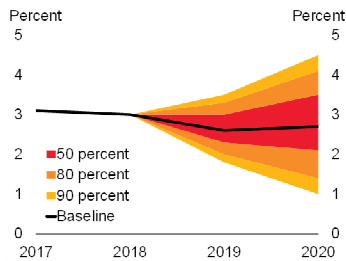


Source: Haver Analytics, J.P. Morgan, Organisation for Economic Co-operation and Development, World Bank.  
 Note: EMDEs = emerging market and developing economies.  
 A.D.F. Shaded areas indicate forecasts. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Data for 2018 are estimates.  
 B. Manufacturing and new export orders are measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Black horizontal line indicates expansionary threshold. Last observation is April 2019.  
 C. Average business confidence across major advanced economies and EMDEs, including Brazil, Canada, France, Germany, Italy, Japan, Russia, Turkey, the United Kingdom, and the United States. Last observation is April 2019.  
 D.F. EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia).  
 E. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa. Countries with widening income gaps are those with per capita GDP growth at least 0.1 percentage point lower than advanced-economy per capita GDP growth.  
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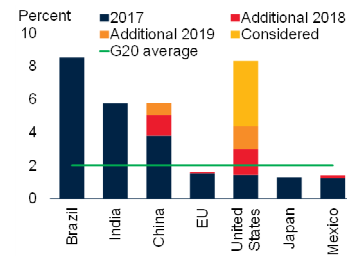
## FIGURE 1.2 Global risks and policy challenges

*Downside risks continue to dominate. A further escalation of trade tensions involving major economies could lead to a sharp increase in trade barriers and weigh on confidence and investment. The risk of financial stress in EMDEs could be exacerbated by increasing debt-refinancing needs. A sharp deceleration in major economies would have large spillover effects for EMDEs and increase the probability of a marked global downturn. Rising public debt levels are reducing the effectiveness of fiscal policy in EMDEs. Structural reforms, such as improvements in institutional quality, can help boost growth and reduce poverty.*

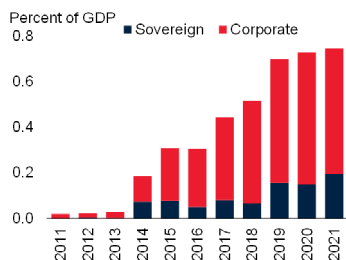
### A. Probability distribution around global growth forecasts



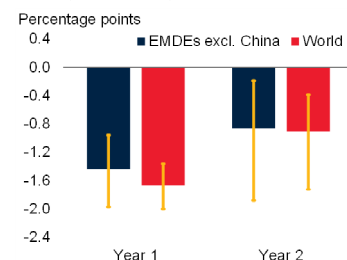
### B. Average import tariffs in G20 countries



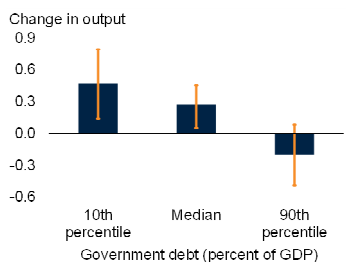
### C. International bond redemptions in EMDEs



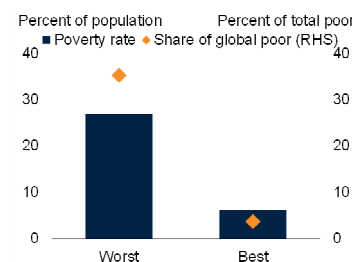
### D. Impact of 1 percentage point growth slowdown in the United States, Euro Area, and China



### E. Fiscal multipliers in EMDEs



### F. Poverty, by regulatory quality



Source: Bloomberg; Dealogic; International Monetary Fund; World Bank.

A. The fan chart shows the forecast distribution of global growth using time-varying estimates of the standard deviation and skewness extracted from the forecast distribution of three underlying risk factors: Oil price futures, S&P 500 equity price futures, and term spread forecasts. Each of the risk factor's weight is derived from the model described in Ohnsorge, Stocker, and Some (2016). Values for 2019 are computed from the forecast distribution of 6-month-ahead oil price futures, S&P 500 equity price futures, and term spread forecasts. Values for 2020 are based on 18-month-ahead forecast distributions. Last observation is May 21, 2019.

B. Blue bars are the trade-weighted averages for 2017 tariffs. "Considered" reflects announcements of possible tariffs as of May 23, 2019, including an additional 25 percent tariff on U.S. imports from China not subject to 2018 tariff hikes and on selected U.S. imports of motor vehicles and parts.

C. Data are as of May 22, 2019.

D. Bars are impulse responses to a 1 percentage point decline in the United States, Euro Area, and China. Yellow lines are 16-84 percent confidence intervals. Based on the vector autoregression model in World Bank (2016). Sample includes 22 advanced economies and 19 EMDEs.

E. Bars are the median conditional fiscal multipliers after two years. Fiscal multipliers are the cumulative change in output relative to cumulative change in government consumption to a 1-unit government consumption shock. Orange lines are 16-84 percent confidence bands.

F. Poverty rate is the unweighted average in each group. "Best" indicates quartile of EMDEs with the strongest regulatory quality (2017 or for year with latest poverty data); "Worst" indicates the weakest regulatory quality. The back data for regulatory quality are from the World Governance Indicators.

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pressures in many EMDEs (Figure 1.2.C). The risk of a sharper-than-expected deceleration in major economies—such as the Euro Area, the United States, or China—would result in considerably weaker global and EMDE growth (Figure 1.2.D). Meanwhile, climate change poses ever-growing risks to various EMDE regions.

Moderating global activity and heightened downside risks highlight the need for policymakers in advanced economies and EMDEs to reinforce policy buffers against possible negative shocks, and to shore up both short-term and long-term growth prospects.

For advanced economies, the associated challenges include the appropriate use of automatic fiscal stabilizers and discretionary spending, when feasible, as well as clear and credible monetary policy guidance that reduces the risk of abrupt market adjustments. Productivity-enhancing reforms are also crucial to deal with slowing labor force growth.

In EMDEs, policymakers need to use the opportunity provided by still benign financing conditions to rebuild fiscal and monetary policy buffers to confront future shocks. Even if borrowing costs are currently low, countries with constrained fiscal positions may find that rising debt levels limit the effectiveness of public spending and make them more vulnerable to crises (Box 1.1; Figure 1.2.E). Amid adverse debt dynamics and narrowing fiscal space, authorities need to urgently strengthen domestic resource mobilization, prioritize growth-enhancing spending, and improve debt management and transparency.

While growth prospects are subdued, there is a substantial upside potential from the implementation of structural reforms that improve the business climate and encourage job creation. Increased public sector efficiency and measures to foster private sector investments will be key to meet large infrastructure needs in electricity, transport, water supply and sanitation, and climate change prevention and mitigation. Estimates of the infrastructure spending required to meet the Sustainable Development Goals in those areas by 2030 range between 4.5 to 8.2 percent of EMDE



GDP, depending on policy choices. Improving access to reliable and affordable electricity, enhancing the quality of logistics and transport infrastructure, leveraging digital technologies, and improving institutional quality could help unlock a large untapped growth potential and contribute to poverty alleviation (Figure 1.2.F).

Raising agricultural productivity could also help boost development opportunities and increase resilience to extreme weather events in regions with large exposed populations. Strengthening the role of social safety nets and active labor market policies is also key to manage risks and promote access to productive employment.

Finally, amid soft growth prospects and heightened risks, both advanced economies and EMDEs need to be prepared to undertake coordinated policy action in the event of a severe global slowdown that threatens to inflict major economic losses and set back progress on poverty alleviation. International coordination would magnify the effectiveness of available fiscal and monetary policy buffers. International financial institutions and the G20 can play an important role in fostering such coordination.

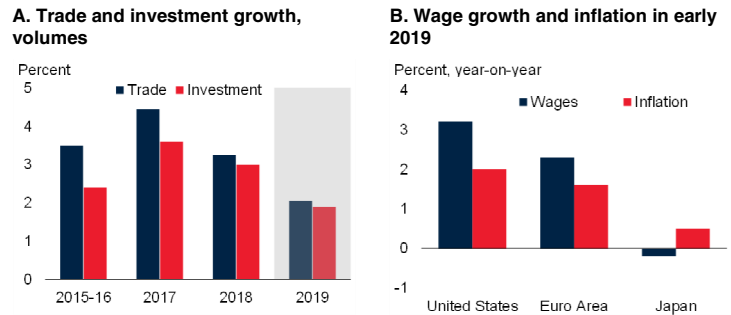
## Major economies: Recent developments and outlook

*Activity in advanced economies is slowing, especially in the Euro Area, in part due to weakening exports and investment. Amid subdued inflation and decelerating activity, major central banks have signaled a more dovish stance. In the United States, the effects of recent fiscal stimulus are waning. In China, growth appears to be stabilizing following weakness at the start of the year, but it faces heightened risks.*

Recent data for advanced economies point to decelerating activity, especially in the Euro Area. Investment has lost momentum and trade growth has declined markedly (Figure 1.3.A). Private consumption has so far been resilient, however, supported by ongoing job creation and higher real wages (Figure 1.3.B). In response to subdued inflation and decelerating activity, monetary policy has become more accommodative.

### FIGURE 1.3 Advanced economies

*Trade and investment in advanced economies have lost momentum. In contrast, rising real wages are supporting consumption in most countries.*



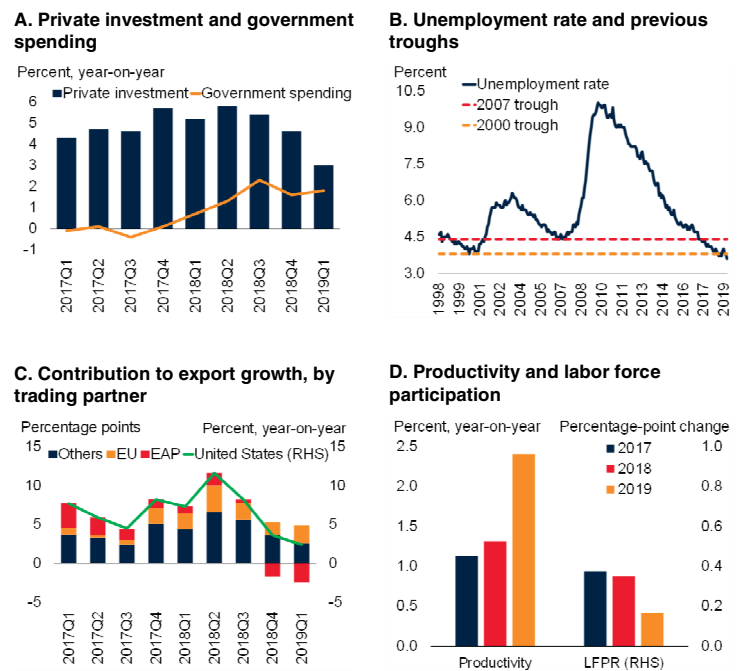
Source: Haver Analytics, World Bank.

A. Trade calculated as the average of imports and exports of goods and services. Shaded area indicates forecasts.  
 B. Last observation is April 2019 for U.S. wages and Consumer Price Index, and Euro Area Harmonized Index of Consumer Prices; March 2019 for Japan wages and Consumer Price Index; and 2018Q4 for Euro Area wages. Wages are average hourly earnings of private nonfarm employees for the United States, average monthly earnings for Japan, and nominal hourly wages and salaries for the Euro Area.

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### FIGURE 1.4 United States

*U.S. activity is still being bolstered by government spending and corporate tax cuts, but the boost is fading. Unemployment recently reached its lowest level in nearly five decades. Amid heightened trade tensions, exports have slowed, especially those to Europe and Asia. Rising productivity and labor force participation are supporting activity.*



Source: Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, Haver Analytics, U.S. Census Bureau, World Bank.

A. Government spending is government consumption and investment spending. Last observation is 2019Q1.

B. Data for civilian unemployment rate are seasonally adjusted. Last observation is April 2019.

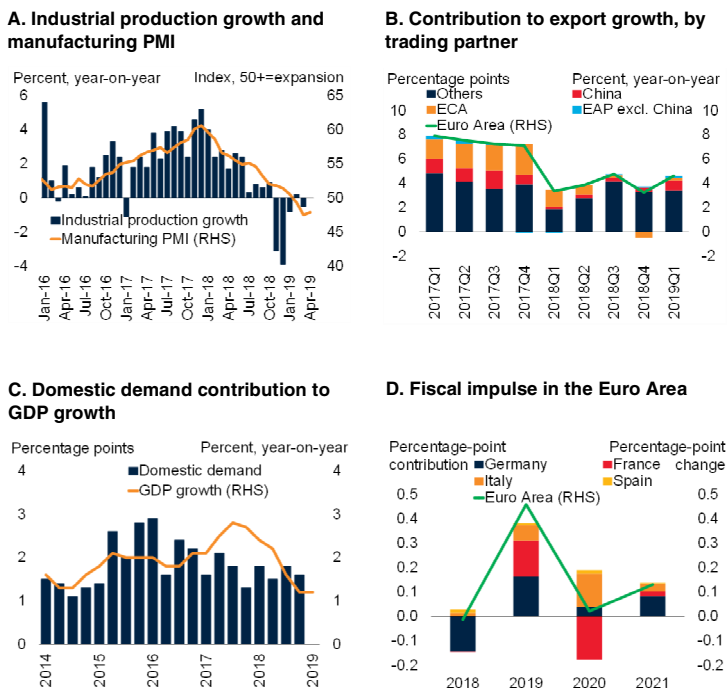
C. EU = European Union, EAP = East Asia and Pacific. Last observation is 2019Q1.

D. LFPR = Labor force participation rate. LFPR refers to civilian labor force participation rate of people aged 25 to 54 years. Data for 2019 are Q1 for Productivity and April for LFPR.

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## FIGURE 1.5 Euro Area

Euro Area economic conditions have deteriorated rapidly since early 2018, particularly in manufacturing and industrial activity. Exports have fallen sharply. Domestic demand has also slowed, but to a lesser degree. Fiscal policy is expected to be modestly stimulative in coming years.



Source: Eurostat, Haver Analytics, International Monetary Fund, World Bank.

A. PMI = Purchasing Managers' Index. Readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is April 2019 for PMI and March 2019 for industrial production.

B. ECA = Europe and Central Asia, EAP = East Asia and Pacific. Data are seasonally and working day adjusted. Last observation is 2019Q1.

C. Final domestic demand is GDP less net exports of goods and services, less changes in inventories. Last observation is 2019Q1 for GDP growth and 2018Q4 for consumption and investment.

D. Changes versus previous year. A positive (negative) number indicates expansionary (contractionary) fiscal policy. Country contributions are calculated using nominal GDP weights. Fiscal impulse indicates the change in cyclically adjusted primary balance, namely the estimate of the fiscal balance that would apply under current policies if output were equal to potential. Data on the general government cyclically adjusted primary balance are published in the April 2019 edition of the *Fiscal Monitor* (IMF 2019).

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Aggregate activity in advanced economies is expected to decelerate over the forecast horizon.

### United States

Growth in the United States remains solid. The Tax Cuts and Jobs Act of late 2017 and the Bipartisan Budget Act of early 2018 are supporting near-term growth, but their contribution is diminishing (Barro and Furman 2018; Figure 1.4.A). Unemployment is at its lowest level in nearly five decades, and inflation is hovering slightly below the 2-percent target

(Figure 1.4.B). Export growth has slowed further, with an especially acute deceleration in goods going to the European Union and the East Asia and Pacific region (Figure 1.4.C). By raising costs on a variety of goods, recent tariff increases have so far modestly weighed on U.S. real incomes (Fajgelbaum et al. 2019; Amiti et al. 2019). In light of muted inflation, heightened risks from the external environment, and unresolved policy issues, the Federal Reserve has signaled a more gradual pace of tightening.

U.S. growth is expected to slow to 2.5 percent in 2019 and further decelerate to 1.7 percent in 2020 and 1.6 percent in 2021, as the effects of recent fiscal stimulus wane. These projections are unchanged from the previous forecast due to offsetting factors. On the one hand, recent tariff increases and associated retaliatory actions are expected to weigh on activity. On the other, growth is being supported by more accommodative monetary policy than previously assumed and by sustained increases in productivity growth and labor force participation (Figure 1.4.D). A continuation of these positive structural trends could result in higher medium- and long-term growth than currently predicted. In contrast, further increases in trade restrictions or policy uncertainty could hinder activity.

### Euro Area

Economic conditions in the Euro Area have deteriorated rapidly since mid-2018, particularly in the manufacturing sector (Figure 1.5.A). This slowdown mainly reflects a decline in exports, especially to China and the Europe and Central Asia region (Figure 1.5.B). Domestic demand has also softened, albeit to a lesser degree, as it remains buoyed by declining unemployment and solid real wage growth (Figure 1.5.C).

In response to slowing activity, Germany, France, and Italy have announced plans for limited tax cuts and spending increases, equivalent to a combined 0.2 percent of Euro Area GDP per year during 2019-21 (Figure 1.5.D). In addition, the European Central Bank (ECB) has announced it will provide banks with additional low-cost credit, starting in September. Core inflation remains



around 1 percent, and the ECB is not expected to begin raising its main refinancing rate above zero until at least 2020.

Growth is projected to slow from 1.8 percent in 2018 to 1.2 percent in 2019 and to edge up to an average of 1.4 percent in 2020-21. Relative to previous projections, this represents a downgrade of 0.4 percentage point in 2019 and 0.1 percentage point in 2020, reflecting weakness in trade and domestic demand that will not be fully offset by more accommodative fiscal and monetary policy support.

### Japan

Activity in Japan benefited from government support in the first half of 2019, as well as a rebound following natural disasters last year, but remains lackluster. Trade—particularly exports to China—has been especially weak. A value-added tax (VAT) hike in October is likely to dampen activity further. Nonetheless, unemployment is low, labor force participation continues to climb, and the services sector remains relatively healthy.

Growth in 2019 is expected to be 0.8 percent, down from previous projections due to weaker-than-expected external demand. A variety of fiscal measures are expected to soften the near-term impact of the VAT hike toward the end of the year. With the economy at close to full employment and potential output constrained by low labor force growth, capacity constraints will slow activity to a projected 0.7 percent in 2020 and 0.6 percent in 2021.

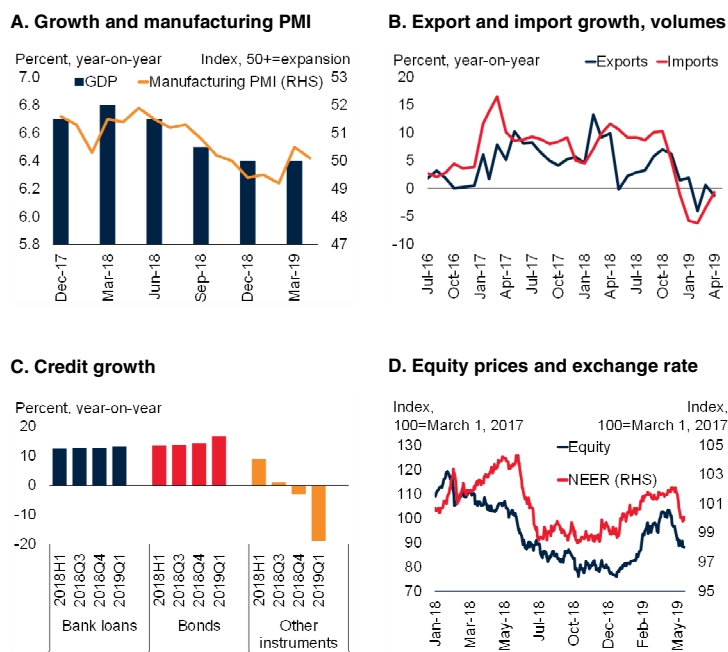
### China

Following several quarters of broad-based deceleration, growth appears to be stabilizing (Figure 1.6.A). Trade flows have been weak, however, weighed down by softness in manufacturing output, trade tensions with the United States, and lackluster global growth (Figure 1.6.B).

Recent activity has been supported by monetary and fiscal stimulus. Bank credit and bond issuance have picked up, but other non-bank lending has moderated due to regulatory tightening (Figure 1.6.C). Equity prices and the renminbi, which

**FIGURE 1.6 China**

*Following several quarters of broad-based deceleration, growth appears to be stabilizing. However, trade flows remain weak. Bank credit is stable and bond issuance has picked up, but other non-bank lending has moderated due to regulatory tightening. Equity prices, which recovered in early 2019 thanks in part to stimulus measures, have faced downward pressures amid the recent re-escalation of trade tensions.*



Source: Haver Analytics, World Bank.  
 A. Purchasing Managers' Index (PMI) readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is April 2019 for manufacturing PMI and 2019Q1 for GDP.  
 B. Figure shows 3-month moving averages. Data include only goods. Export and import volumes are calculated as export and import values deflated by export and import price deflators. Export and import indices for some missing values and for April 2019 are estimates. Last observation is April 2019.  
 C. Figure shows average of monthly data for periods indicated. Bonds include local government special bonds and net financing of corporate bonds. Other instruments include entrusted loans and trust loans. Last observation is March 2019.  
 D. NEER = nominal effective exchange rate. An increase in the NEER denotes an appreciation. Equity index is represented by the Shanghai Stock Exchange Composite. Last observation is May 20, 2019 for equity prices and May 21, 2019 for NEER.  
[Click here to download data and charts.](#)

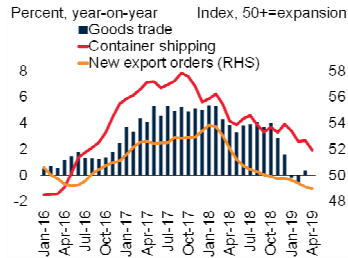
rebounded in early 2019 partly due to policy support measures, have faced downward pressures amid the recent re-escalation of trade tensions (Figure 1.6.D). Consumer price inflation has picked up but remains below target.

Growth is projected to decelerate from 6.6 percent in 2018 to 6.2 percent in 2019, primarily reflecting softening manufacturing activity and trade. The recent increase in tariffs on trade with the United States is projected to weigh on growth in 2020, which has been revised down to 6.1 percent. This outlook is predicated on no further escalation of trade disputes with the United States.

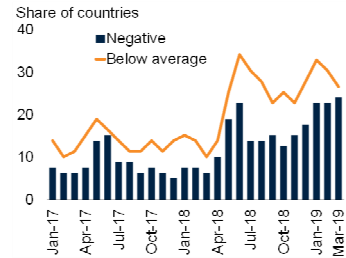
**FIGURE 1.7 Global trade**

Global goods trade growth weakened substantially in late 2018 and early 2019. While trade in Asia was markedly affected, the slowdown in industrial activity was widespread across countries. The softness reflected in part slowing demand for capital goods amid elevated trade policy uncertainty. Exports in most EMDE regions are expected to decelerate this year. Global trade growth is projected to slow to 2.6 percent this year, the weakest pace since the global financial crisis.

**A. Goods trade volume, container shipping, and export orders**



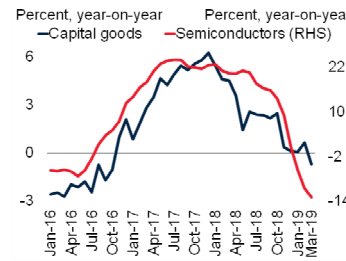
**B. Share of countries with negative or below-average industrial production growth**



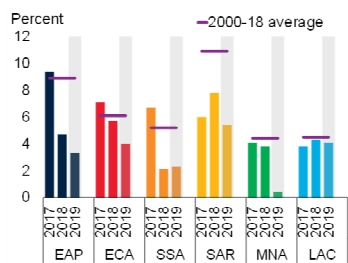
**C. Nominal merchandise import growth in China and export growth in Asia**



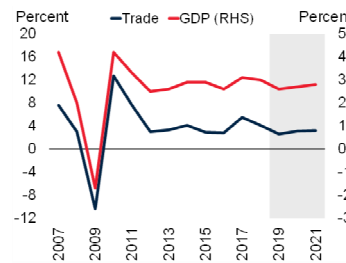
**D. Capital goods production and semiconductor sales growth**



**E. Export volume growth, by region**



**F. Global GDP and trade growth**



Source: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; Institute of Shipping Economics and Logistics; Semiconductor Industry Association; World Bank.

A. Data are 3-month moving averages. New export orders measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is March 2019 for goods trade and April 2019 for container shipping and new export orders.

B. Share of countries for which industrial production growth (3-month on 3-month change) was negative or below their 2012-17 average for two consecutive quarters. Sample includes 39 EMDEs and 29 advanced economies. Last observation is March 2019.

C. Import and export data are merchandise imports and exports in U.S. dollars, respectively, and is expressed as 3-month moving averages. "Asia" comprises Bangladesh, India, Indonesia, Japan, Malaysia, Mongolia, Pakistan, Philippines, Republic of Korea, Singapore, Sri Lanka, Thailand, and Vietnam. Last observation is March 2019 for Asia exports and April 2019 for China imports.

D. Capital goods index weighted by gross domestic product at constant 2010 U.S. dollars. Sample includes the G20 countries for capital goods for which data are available. Semiconductor index is 3-month moving averages of global billings by semiconductor equipment manufacturers, including front-end and final manufacturing equipment. Last observation is March 2019.

E.F. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Shaded area indicates forecasts.

E. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

F. Trade is the average of export and import volumes.

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It also assumes that policy actions partly mitigate domestic and external headwinds to activity (SCPRC 2019).

**Global trends**

Global trade has weakened amid slowing investment growth and elevated trade policy uncertainty. As the short-term growth outlook has softened, international financing conditions have eased, providing a respite to countries with large external financing needs. Industrial commodity prices have partially recovered, with weaker demand offset by supply cuts.

**Global trade**

Global industrial activity and goods trade have lost considerable momentum in 2019. Goods trade growth and new export orders fell to levels comparable to those prevailing at the start of 2016, when concerns about the global economy were elevated (Figure 1.7.A). The deceleration was broad-based—the share of countries with industrial production in technical recession has tripled since the start of 2018, reaching nearly 25 percent in early 2019 (Figure 1.7.B). Trade in Asia—which contains major, tightly interconnected, global manufacturing hubs—was particularly affected, although recent indicators suggest some stabilization (Figure 1.7.C).

Weakness in global trade was concentrated in heavily traded capital goods, including electronic components such as semiconductors (Figure 1.7.D). These products are deeply embedded in international production networks and illustrate the links between global investment and trade (Bussière et al. 2013; Buelens and Tirpák 2017). Increased tariffs by the United States and retaliatory actions by China and other trading partners that were implemented last year have affected bilateral trade flows and prices of the targeted products; however, they resulted in limited effects on aggregate trade volumes and activity in these countries (Constantinescu, Mattoo, and Ruta 2019; Fajgelbaum et al. 2019). Nevertheless, the increase in tariffs by the United States and China that were announced in May represents a substantial re-escalation in trade tensions and are likely to have more severe effects. Beyond economic losses for the affected exporters,

### BOX 1.1 Debt: No free lunch

*“[In the United States], if the future is like the past, this implies that debt rollovers, that is the issuance of debt without a later increase in taxes, may well be feasible. Put bluntly, public debt may have no fiscal cost.” Olivier Blanchard (2019)*

*“High debt levels make it more difficult for governments to respond aggressively to shocks.” Kenneth Rogoff (2019)*

*Government debt has risen substantially in emerging market and developing economies (EMDEs), by an average of 15 percentage points of GDP since 2007 to 51 percent of GDP in 2018. The current environment of low global interest rates and weak growth may appear to mitigate concerns about elevated debt levels. Considering currently subdued investment, additional government borrowing might also appear to be an attractive option for financing growth-enhancing initiatives such as investment in human and physical capital. However, history suggests caution: the cost of rolling over debt can increase sharply during periods of financial stress and result in financial crises; high debt levels can limit the ability of governments to provide fiscal stimulus during downturns; and high debt can weigh on investment and long-term growth, especially at a time when investment momentum is already weak. Hence, EMDEs need to strike a careful balance between taking advantage of low interest rates and avoiding the potentially adverse consequences of excessive debt accumulation.*

#### Introduction

Government debt has risen sharply in advanced economies, reaching levels not seen in the past six decades. Yet, low interest rates and subpar growth have led to an intense debate about whether the rapid increase in debt is reason for concern.<sup>1</sup> Some argue that countries, especially those that issue reserve currencies, should take advantage of low interest rates to borrow more to finance priority expenditures. Others caution that high debt weighs on long-term growth, by increasing the risk of crises, limiting the scope for countercyclical fiscal stimulus, and dampening private investment.

Although the focus of this debate has been mainly on advanced economies, many EMDEs have also borrowed heavily and their hard-won cuts in public debt ratios prior to the global financial crisis have largely been reversed. The tradeoffs EMDEs face are even starker, in light of their history of severe debt crises and their more pressing current spending needs to achieve development goals and improve living standards.

This box seeks to provide a basis for assessing the merits of additional debt accumulation in EMDEs by addressing two specific questions. First, how has EMDE debt evolved

since 2000? Second, what are the benefits and costs associated with rapid debt accumulation?

#### Evolution of EMDE debt since 2000

**Pre-crisis improvements in fiscal positions.** Prior to the global financial crisis, rapid growth helped narrow fiscal deficits and reduce government debt ratios, especially in EMDEs (Figure 1.1.1.A and B; Kose, Kurlat, et al. 2017). In addition to robust growth, debt relief in the Multilateral Debt Relief Initiative (MDRI) and the Highly Indebted Poor Countries initiative (HIPC) contributed to the decline in debt in low-income countries (LICs) and lower middle-income countries. Fiscal deficits that reached 3 percent of GDP in EMDEs, on average, in 2001 turned into fiscal surpluses amounting to 0.7 percent of GDP, on average, by 2007. Over the same period, EMDE government debt fell by 13 percentage points of GDP to 36 percent of GDP.

**Post-crisis debt accumulation.** EMDE fiscal positions have weakened partly because of sharp growth slowdowns that pushed government debt up by an average of 15 percentage points to 51 percent of GDP by 2018. This deterioration was broad-based—by 2018, government debt was 10 or more percentage points of GDP higher than in 2007 in about 60 percent of EMDEs, with commodity exporters, which account for almost two-thirds of EMDEs, being hit the hardest (World Bank 2015, 2018a). In LICs, government debt rose by 14 percentage points of GDP, to 46 percent of GDP in 2018 after falling to a trough of 32 percent of GDP in 2012.

**Post-crisis shifts in debt composition.** In many EMDEs, financing of debt has shifted toward higher-risk sources,

Note: This box was prepared by M. Ayhan Kose, Franziska Ohnsorge, and Naotaka Sugawara.

<sup>1</sup> Blanchard (2019), Blanchard and Summers (2019), Furman and Summers (2019), and Krugman (2019) provide reasons for additional borrowing in advanced economies, and the United States in particular, whereas Auerbach, Gale, and Krupkin (2019), Mazza (2019), Riedl (2019), and CRFB (2019) caution against adding to debt, citing in particular the example of the United States. For a detailed discussion of these issues, see Kose, Ohnsorge, and Sugawara (forthcoming).

### BOX 1.1 Debt: No free lunch (continued)

including debt held by nonresidents, issued on non-concessional terms, or at shorter maturity (Figure 1.1.1.C). Debt held by nonresidents accounted for about 50 percent of government debt in the median EMDE in 2018, making these countries more vulnerable to a deterioration in global investor sentiment. As a result, sovereign ratings have been downgraded for many EMDEs, and 40 percent of LICs are now classified as at high risk of debt distress (World Bank 2019a). The composition of LIC debt has become increasingly non-concessional as they have accessed capital markets and borrowed from non-Paris Club creditors (World Bank 2018a, 2019a).

#### Simultaneous buildup of private and public sector debt.

Whereas the private sector has deleveraged in most advanced economies since the crisis, private sector debt has risen in EMDEs in tandem with mounting government debt. As a result, total debt in EMDEs has risen to 169 percent of GDP, on average, in 2018, from 98 percent of GDP in 2007 and its highest level in two decades (Borensztein and Ye 2018; World Bank 2018b). Even in EMDEs excluding China, where corporate debt has soared post-crisis, total debt has risen to a near-record 107 percent of GDP in 2018. Although the increase in EMDE private debt partly reflects growth-enhancing financial deepening, elevated private debt represents a fiscal risk. Past experience illustrates that private sector debt may shift onto government balance sheets during financial crises as governments provide support to private institutions in difficulty (Kose, Ohnsorge, and Sugawara 2018; World Bank 2017a). For example, government debt rose by more than 30 percentage points of GDP in Indonesia and Thailand during the Asian financial crisis in the late 1990s (Figure 1.1.1.D; World Bank 2015, 2017a).

#### Debt: How much is too much?

Several strands of literature have attempted to identify how much debt is “too much”—a threshold level of debt below which it is sustainable or not harmful to growth (Kose, Ohnsorge, and Sugawara forthcoming). For example, one strand of the literature has estimated the sustainable level of debt in advanced economies if fiscal deficits remain consistent with past performance or if sovereign bond yields move consistent with past movements. Some studies have identified debt thresholds above which the likelihood of a financial crisis increases. A third strand of the literature has explored the debt levels above which debt burdens become detrimental to long-term growth.<sup>2</sup>

<sup>2</sup>For studies on the sustainable level of debt, see Ghosh et al. (2013) and Greenlaw et al. (2013). For studies that examine debt as an early

In a nutshell, the empirical evidence suggests that the optimal level of debt depends on a wide range of trade-offs. This in part reflects a broader theoretical challenge in the literature. The basic insight from theory is that debt increases output in the short-run but reduces it in the long-run (Elmendorf and Mankiw 1999). Debt can be beneficial in the short-run to smooth macroeconomic fluctuations and, in the long-run, to finance long-term investments that yield a higher rate of return than the cost of debt. However, elevated debt levels can lead to sustainability challenges, increase vulnerability to crises, erode the size and effectiveness of fiscal expansion, and weigh on investment and growth (Figure 1.1.1.E and F).

When weighing benefits against cost of debt, political-economy forces may tilt the scale towards underestimating the cost of borrowing while overestimating its benefits. Disagreements over spending preferences or short-lived government tenures generate incentives to expand government spending envelopes, financed by debt (Alesina and Tabellini 1990; Drazen 2000; Aguiar and Amador 2011). Especially ahead of elections, the absence of full information may create a conflict of incentives that encourages political incumbents to employ debt-financed fiscal stimulus to improve short-term growth prospects (Shi and Svensson 2006; Aidt, Veiga, and Veiga 2011). As a result, government expenditures, public debt and deficits tend to increase statistically significantly albeit modestly around elections (Philips 2016). Such political cycles in budget pressures tend to be stronger in countries with weaker fiscal transparency (Alt and Lassen 2006 a,b; Klomp and De Haan 2011), without balanced-budget requirements (Alt and Rose 2009; Cioffi, Messina, and Tommasino 2012) and with poorer governance (Shi and Svensson 2006; Streb, Lema, and Torrens 2009).

#### Benefits of debt

Additional debt accumulation by EMDEs could be justified because of their need to invest in growth-enhancing projects, such as infrastructure, health and education, and to protect vulnerable groups. During periods of weak growth, it may also be appropriate to employ expansionary fiscal policy to stimulate activity.

warning indicator, see Manasse and Roubini (2009) and Kraay and Nehru (2006). For a discussion of safe debt thresholds, see Reinhart, Rogoff, and Savastano (2003). Some studies report that higher debt is associated with lower growth when government debt is larger than 80-100 percent of GDP (Reinhart and Rogoff 2010; Cecchetti, Mohanty, and Zampolli 2011; Baum, Checherita-Westphal, and Rorher 2013). That said, others found no such effects (Panizza and Presbitero 2014).

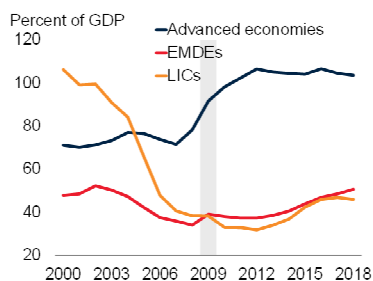


**BOX 1.1 Debt: No free lunch (continued)**

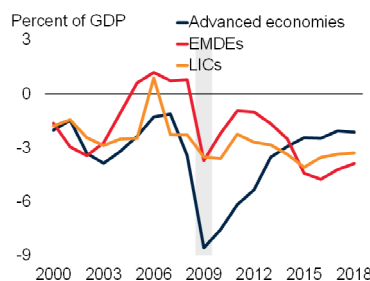
**FIGURE 1.1.1 Government debt, deficits, and multipliers**

Government debt has risen from pre-crisis levels, and fiscal balances have deteriorated. It has shifted toward financing sources that are more vulnerable to exchange rate and interest rate risks, as well as changes in global investor sentiment. Higher debt levels are associated with larger interest payments and they tend to render fiscal policy less effective.

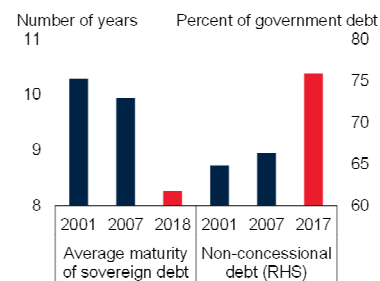
**A. Government debt**



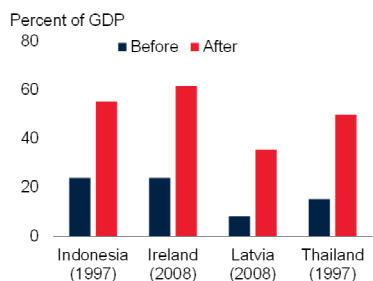
**B. Fiscal balance**



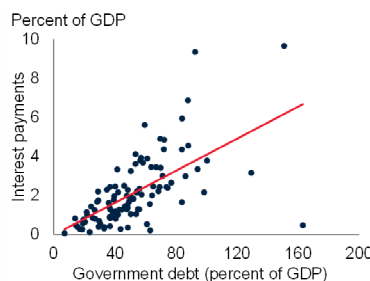
**C. Average maturity and share of non-concessional debt**



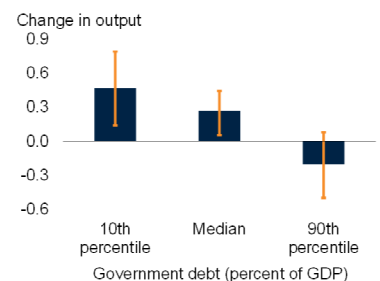
**D. Government debt during past banking crises**



**E. Government debt and interest payments in EMDEs, 2018**



**F. Fiscal multipliers after 2 years**



Source: Huidrom et al. (2019); International Monetary Fund; Kose, Kurlat, et al. (2017, data available at <http://www.worldbank.org/en/research/brief/fiscal-space>); Laeven and Valencia (2018).

A.B. Averages computed with current U.S. dollar GDP as a weight.

A. Sample includes 37 advanced economies, 151 EMDEs, and 32 LICs.

B. Sample includes 38 advanced economies, 154 EMDEs, and 32 LICs.

C. Median of up to 65 EMDEs for average maturity and 122 EMDEs for non-concessional debt, though the sample size varies by year.

D. "Before" and "after" denote, respectively, one year before and after the onset of banking crisis, as shown by numbers below the corresponding country names, taken from Laeven and Valencia (2018). Indonesia refers to central government debt only.

E. General government gross debt on the horizontal axis and interest payments on the vertical axis. Sample includes 104 EMDEs, excluding small states as defined by the World Bank.

F. Bars show the conditional fiscal multipliers for different levels of government debt after two years. Fiscal multipliers are defined as cumulative change in output relative to cumulative change in government consumption in response to a 1-unit government consumption shock. They are based on estimates from the interacted panel vector autoregression model, where model coefficients are conditioned only on government debt. Values shown on the x-axis correspond to the 10th to 90th percentiles in the sample. Bars represent the median, and vertical lines are the 16-84 percent confidence bands.

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**Promoting long-term growth.** Government investment in physical and human capital can provide an important foundation for stronger growth over the long-term. These investments have taken on greater urgency in light of the expected slowdown in potential growth—the rate of growth an economy can sustain at full employment and capacity—over the next decade (World Bank 2018c). In EMDEs, in particular, potential growth is expected to slow by 0.5 percentage point to 4.3 percent during 2018-27, well below the average rate of 6.7 percent during 2002-07.

Moreover, EMDEs have large investment needs to meet the Sustainable Development Goals (SDGs): low- and middle-income countries face aggregate investment needs of \$1.5–\$2.7 trillion per year—equivalent to 4.5–8.2 percent of GDP—between 2015 and 2030 to meet infrastructure-related SDGs, depending on policy choices (Rozenberg and Fay 2019). Infrastructure investment can have particularly large growth benefits if it connects isolated communities with input and output markets, allows companies to realize economies of scale by

### BOX 1.1 Debt: No free lunch (*continued*)

increasing market size, and increases competitive pressures (Égert, Kozluk and Sutherland 2009; Calderón and Servén 2010). To the extent that debt-financed investment spending stems the slowdown in potential growth, it also helps preserve the revenues required to service this debt (Fatas et al. 2018).<sup>3</sup>

**Stabilizing short-term macroeconomic fluctuations.** Temporary debt accumulation also plays an important role to stabilize short-term macroeconomic fluctuations. During recessions, borrowing for government spending or tax cuts can provide the necessary fiscal stimulus to support activity (World Bank 2015; Yared 2019; Figure 1.1.1.F). A large literature has estimated the output effects (fiscal multipliers) of additional government spending or tax cuts (Huidrom et al. 2016, 2019; Ramey 2019). The estimates vary widely—from a 1.1-dollar output decline to a 3.8-dollar output increase for every dollar of additional government spending or reduced revenues—depending on the cyclical position of the economy; structural country characteristics, including the coherence of fiscal frameworks; and the fiscal instrument employed. Broadly speaking, output effects tend to be larger during recessions than expansions, and larger for advanced economies than for EMDEs (Kraay 2012, 2014). In EMDEs, lack of fiscal space has often constrained fiscal policy during recessions, but there is some evidence that fiscal policy has become less procyclical during the 2000s (Frankel, Vegh, and Vuletin 2013).

#### *Costs associated with debt*

The main arguments against heavy borrowing, which may outweigh the benefits of borrowing in some countries, are that rollover costs can increase sharply during periods of financial stress and perhaps even trigger a financial crisis; and high debt levels can limit the size and effectiveness of fiscal stimulus during downturns. In addition, they can constrain growth by crowding out productivity-enhancing private investment over the long term, especially if the costs of debt outweigh its benefits.

**Deteriorating debt sustainability.** During the post-crisis period, the cost of government borrowing has been historically low, for both advanced economies and EMDEs (Figure 1.1.2.A and B). Looking ahead, demographic shifts and slowing productivity growth are expected to contribute to a further secular decline in both real interest

rates in advanced economies, continuing this multi-year trend (Holston, Laubach, and Williams 2017). However, an increase in global borrowing cost, for example because of a decline in global savings rates, could test the sustainability of high debt in some countries (Henderson 2019; Rogoff 2019).

The recent discussion on debt has focused on the differential between interest rates and nominal GDP growth. If interest rates (the cost of capital) are below nominal output growth (the presumed rate of return on capital), then the real burden of the debt declines over time because the rate of return on debt-financed investment is more than sufficient to service the debt. However, the interest rate-growth differential has to be weighed against the accumulation of new debt—the primary fiscal deficit. If, every year, primary deficits add more to the debt than is repaid on past debt (even if high rates of return are more than sufficient to service the debt), then the debt stock will be on a rising trajectory.<sup>4</sup>

During 1990-2018, the interest-rate-growth differential has been negative in just over half (57 percent) of country-year pairs (54 percent of country-year pairs among 36 advanced economies and 60 percent of country-year pairs among 63 EMDEs). However, even in about one-quarter of these instances, the differential was not large enough to offset the increase in debt from primary balances and maintain the government debt ratio on a stable or declining path. As a result, during 1990-2018, primary balances, long-term interest rates and nominal GDP growth have been such that debt has been on a steadily rising trajectory about half of the time—in 44 percent of country-year pairs among 34 advanced economies and 49 percent of country-year pairs among 62 EMDEs.

**Increasing vulnerability to financial crises.** Higher spending on debt service implies some combination of further borrowing, or increased taxes, or less spending on critical government functions (Figure 1.1.1.E; Debrun and Kinda 2016). The challenge of mounting borrowing is that a growing debt-to-GDP ratio could erode investor confidence, requiring a government to pay a rising risk premium on its debt. Eventually, these pressures can culminate in a debt crisis if investors fear that the accumulation of government debt is no longer sustainable (Henderson 2019; Rogoff 2019; Blanchard 2019).

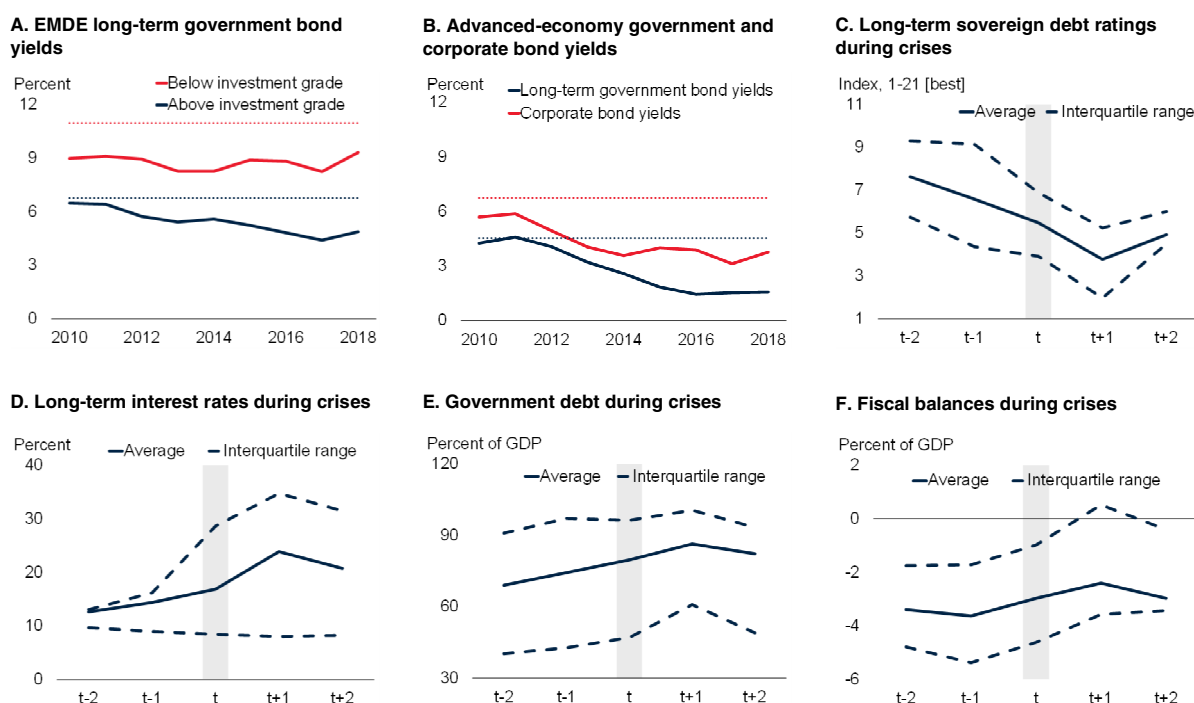
<sup>3</sup>In EMDEs, debt can also play an important role in financial deepening by establishing a safe asset for use as collateral and as benchmark for non-government debt (Hauner 2009; World Bank and IMF 2001).

<sup>4</sup>The balance between these two forces is captured in the sustainability gap, defined as the difference between the primary balance and the debt stabilizing primary balance at specific interest rates and growth rates (Kose, Kurlat, et al. 2017).



**BOX 1.1 Debt: No free lunch (continued)****FIGURE 1.1.2 Borrowing costs and fiscal positions**

*Borrowing costs in advanced economies and EMDEs have been historically low since the global financial crisis, despite a slight increase in 2018. However, the spread between investment and non-investment grade borrowing cost has widened in 2018. Financial stress events, especially sovereign debt crises, worsen debt dynamics, lead to credit downgrades, and tend to be associated with higher borrowing costs.*



Source: Bloomberg; Kose, Kurlat, et al. (2017, data available at <http://www.worldbank.org/en/research/brief/fiscal-space>); Laeven and Valencia (2018).

A. Average long-term government bond yields (with maturity of 10 years or close) for EMDEs with long-term foreign-currency sovereign ratings below investment grades and above investment grades in each year. Dotted lines show averages over 2002-07. Sample includes 61 EMDEs.

B. Average long-term government bond yields (with maturity of 10 years) for 36 advanced economies, and corporate bond yields computed as simple averages of U.S. high yield, U.S. investment grade, Euro high yield, and Euro investment grade corporate bond yields.

C.-F. Simple averages, as well as interquartile ranges, based on balanced samples. Crises refer to debt crises, as defined in Laeven and Valencia (2018). When there are multiple crises identified within five years, the one with the lowest real GDP growth is counted as an event. Sample includes 16 crisis episodes (Panels C and E), 11 episodes (Panel D), and 21 episodes (Panel F).

C. The sovereign ratings are converted to a numerical scale ranging from 1 to 21 (higher = better rating).

D. Long-term interest rates refer to nominal 10-year government bond yields, or bond yields with similar maturities.

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For reserve currency-issuing advanced economies, like the United States, it has been argued that such a spike in risk premia is unlikely, since these countries are often viewed as safe havens during periods of market turbulence (Furman and Summers 2019; Krugman 2014). For EMDEs, however, this risk is more acute. History has shown that EMDE borrowing costs tend to rise sharply during episodes of financial stress, and higher debt servicing costs can cause debt dynamics to deteriorate (Figure 1.1.2.C to F). A recent example is the case of Argentina, where its five-year U.S. dollar-denominated sovereign bond yields more than doubled during 2018 to over 11 percent in early September. Indeed, every decade since the 1970s has

witnessed debt crises in EMDEs, often combined with banking or currency crises (Kose and Terrones 2015; Laeven and Valencia 2018).

**Constraining government action during downturns.** High debt constrains governments' ability to respond to downturns, in part because debt service crowds out other important government spending needs, including growth-enhancing public investment or social safety nets (Obstfeld 2013; Reinhart and Rogoff 2010; Romer and Romer 2018). This was also the case during the global financial crisis: fiscal stimulus during 2008-09 was considerably smaller in countries with high debt than in those with low

### BOX 1.1 Debt: No free lunch (continued)

government debt (World Bank 2015). Moreover, weak fiscal positions tend to be associated with deeper and longer recessions, a situation that worsens if the private sector also falls into distress and its debt migrates to government balance sheets.

**Reducing the effectiveness of fiscal policy.** High government debt tends to render fiscal policy less effective (Figure 1.1.1.F). High government debt can reduce the size of fiscal multipliers through two channels. First, when a government with a high level of debt implements fiscal stimulus, consumers expect that tax increases will soon follow (Sutherland 1997). This expectation leads consumers to cut consumption and save more (the “Ricardian” reaction to government dis-saving). Second, when the level of debt is higher, fiscal stimulus can increase creditors’ concerns about sovereign credit risk. This raises sovereign bond yields and, hence, borrowing costs across the whole economy (Corsetti et al. 2013). This, in turn, crowds out private investment and consumption, reducing the size of the fiscal multiplier (“interest rate channel”). Indeed, empirical evidence suggests that, regardless of the time horizon considered, fiscal multipliers are smaller when government debt is higher (Figure 1.1.1.F; Huidrom et al. 2016, 2019). Similarly, evidence points to less effective monetary policy in the presence of high debt because of poorly anchored inflation expectations in high-debt countries (Kose et al. 2019).

**Slowing investment and growth.** High and rising government debt may eventually raise long-term interest rates (Rubin, Orszag, and Sinai 2004; Laubach 2009). High debt could also create uncertainty about macroeconomic and policy prospects, including the possibility that governments may need to resort to distortionary taxation to rein in debt and deficits (IMF 2018; Kumar and Woo 2010). Higher interest rates and uncertainty would tend to crowd out productivity-enhancing private investment and weigh on output growth.<sup>5</sup> The empirical evidence for the association between debt and growth is, however, mixed (Panizza and Presbitero 2014).

### Conclusion

EMDE governments need to put in place frameworks that help them strike a careful balance between taking

advantage of the present low interest rate environment and avoiding the risks posed by excessive debt accumulation. For countries with sound fiscal positions and with frameworks that help ensure long-term sustainability, the balance may tip toward debt-financed spending to boost growth prospects if the cyclical position is appropriate. But for those countries with constrained fiscal positions, alternative policies exist to expand the fiscal resources needed to finance growth-friendly policies.

These alternatives include better spending and tax policies, in an improved institutional environment. Spending can be shifted toward areas that lay the foundation of future growth, including education and health spending as well as climate-smart investment to strengthen economic resilience. Government revenue bases can be broadened by removing special exemptions and strengthening tax administration (Gaspar, Ralyea, and Ture 2019; IMF 2019; World Bank 2017b). Business climates and institutions can be strengthened to support vibrant private sector growth that can yield productivity gains and expand the revenue base.

Greater debt transparency and better debt management can mitigate some of the costs associated with debt buildups and some of the political-economy pressures for rapid debt accumulation. The buildup in LIC debt has not been accompanied by necessary improvements in the quality of debt management. Better debt management and transparency can help reduce borrowing costs, enhance debt sustainability, and dampen fiscal risks. For example, a sound debt management system would keep short-term and foreign currency exposures to prudent levels. Greater transparency—as well as institutional constraints on fiscal policy, including robust fiscal rules, and better governance—can mitigate some of the political-economy forces that are biased towards rapid debt accumulation.<sup>6</sup> Over time, improved debt management and transparency would help foster macroeconomic stability.

Regardless of the desired level of debt, prudent debt management favors debt contracted on terms that preserve macroeconomic and financial resilience—preferably at longer maturities, at fixed (and favorable) interest rates, are denominated in local currency and transparently disclosed. A debt composition that is less vulnerable to market disruptions reduces the likelihood that a decline in market

<sup>5</sup> Auerbach, Gale, and Krupkin (2019); Gale and Orszag (2003); Croce et al. (2018); Huang, Pagano, and Panizza (2017); and Panizza, Huang, and Varghese (2018).

<sup>6</sup> Alt and Lassen (2006 a,b); Klomp and De Haan (2011); Alt and Rose (2009); Cioffi, Messina, and Tommasino (2012); Shi and Svensson (2006); and Streb, Lema, and Torrens (2009).

**BOX 1.1 Debt: No free lunch (continued)**

sentiment, sharp depreciations, or interest rate spikes erode debt sustainability. This is particularly important in EMDEs, which tend to suffer sharp capital flow stops or reversals during times of financial stress.

EMDEs should avoid the temptation of the “this-time-is-different” syndrome in the current period of low interest rates (Reinhart and Rogoff 2009). Even if the cost of debt is currently low, the historical record suggests that it could

increase sharply during periods of financial stress, as some EMDEs have painfully learned once again in recent years. Excessive debt burdens may make governments more vulnerable to crises, limit the size and effectiveness of fiscal stimulus during future cyclical downturns, and weigh on investment and longer-term growth. As the long history of financial crises in EMDEs has repeatedly shown, debt cannot be treated as a free lunch.

these new tariffs are contributing to heightened policy uncertainty, which is expected to dent confidence and investment.

As demand from major economies continues to moderate, export growth is expected to decelerate across EMDE regions in 2019. An exception is Sub-Saharan Africa, where export growth is expected to recover modestly from supply disruptions in key commodity-producing sectors in 2018 (Figure 1.7.E). The weakness in export growth this year is projected to be particularly pronounced in the Middle East and North Africa, reflecting oil production cuts in OPEC countries and U.S. sanctions on the Islamic Republic of Iran. Overall, export growth in 2019 is expected to be below historical averages in more than 80 percent of EMDEs.

In all, global trade growth is projected to weaken from 4.1 percent in 2018 to 2.6 percent this year—a full percentage point below previous forecasts, slightly below the pace observed during the 2015-16 trade slowdown, and the weakest since the global financial crisis (Figure 1.7.F). As the weakness in manufacturing abates, global trade is expected to stabilize to an average of 3.2 percent in 2020-21. This assumes no further escalation in trade tensions between major economies; new stimulus measures implemented in China and, to a lesser degree, the Euro Area; and firming domestic demand in some EMDEs. However, global trade is projected to be weaker than previously envisaged over the forecast horizon. This reflects a softer outlook for global investment and evidence of a lower income elasticity of trade.

The post-crisis decline in the income elasticity of trade reflects slower value chain integration and trade liberalization (UNCTAD 2018).

While the global trade growth forecast assumes that new tariffs imposed continue to apply throughout the forecast horizon, trade relations between the United States and China remain fragile and could deteriorate further. Meanwhile, trade agreements that recently entered into force, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the EU-Japan Economic Partnership Agreement, could help boost trade and foster deeper integration between signatory countries. The recently signed, but yet to be ratified, United States-Mexico-Canada Agreement (USMCA) could impact trade in agricultural products, automobiles, textiles and apparel; however, it is expected to have limited effects on economic activity (Chepeliev, Tyner and van der Mensbrugghe 2018; Burfisher, Lambert, and Matheson 2019). Potential tariffs on U.S. imports from Mexico announced in late May—not included in baseline forecasts—could weigh on North American trade.

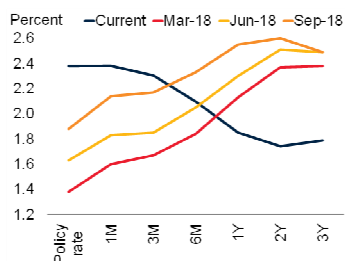
**Financial markets**

Amid signs of deterioration in global economic prospects and persistently low inflation, major central banks have adopted more accommodative monetary policy stances for the near term. The U.S. Federal Reserve has placed its tightening cycle on hold, while the European Central Bank has delayed the end of its negative interest rate

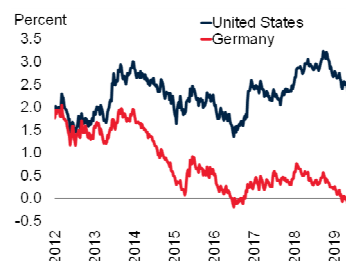
## FIGURE 1.8 Global finance

Major central banks have adopted a more dovish stance as a response to low inflation and deteriorating growth prospects. As a result, advanced-economy bond yields have fallen, and the share of debt trading at negative interest rates has increased. Search for yield has supported a recovery in EMDE portfolio flows, a compression of bond spreads, and robust bond issuances; however, renewed trade tensions are weighing on risk appetite.

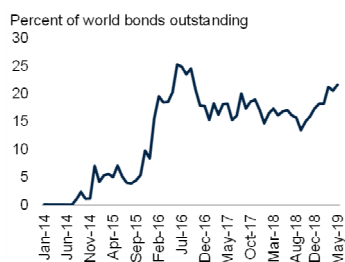
### A. Federal funds rate expectations



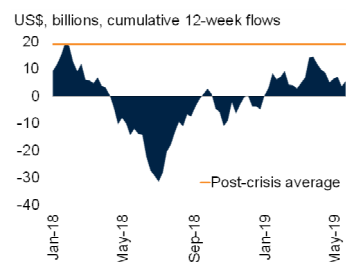
### B. U.S. and German 10-year government bond yields



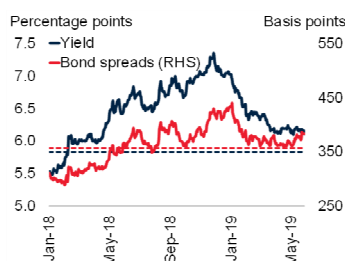
### C. Share of bonds trading with negative interest rates



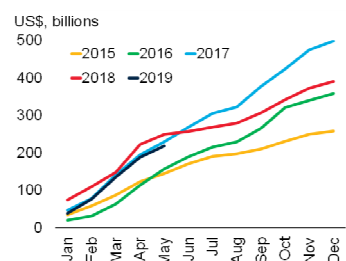
### D. EMDE portfolio flows



### E. EMDE bond yields and spreads



### F. EMDE international bond issuances



Source: Bloomberg, Dealogic, Institute of International Finance, J.P. Morgan, World Bank.

A. Last observation is May 23, 2019.

B. Figure shows weekly data. Last observation is May 23, 2019.

C. Last observation is May 2019, which includes data through May 23, 2019.

D. Cumulative weekly flows since January 1, 2018. Equity flows include Brazil, India, Indonesia, Pakistan, Philippines, Qatar, Sri Lanka, South Africa, Thailand, Turkey, and Vietnam. Debt flows include Hungary, India, Indonesia, Mexico, Poland, South Africa, Thailand, and Turkey. Post-crisis average over January 1, 2010, to December 29, 2017. Last observation is May 23, 2019.

E. Bond yields are computed summing the J.P. Moran Emerging Market Bond Index (EMBI) spread and the U.S. 10-year bond yield. Dashed lines represent post-crisis average over period January 1, 2010, to December 31, 2018. Last observation is May 23, 2019.

F. Figure shows cumulative sum. Last observation is May 2019, which is estimated using month-to-date volume as of May 23, 2019.

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policy and implemented new measures to stimulate credit and activity. Shifting market expectations about monetary policies contributed

to a drop in long-term yields—to their lowest levels since mid-2017 in the United States, and to below zero in Germany for the first time since late 2016 (Figures 1.8.A and B).

In this context, the share of bonds yielding negative market interest rates increased to its highest level since end-2017, reaching more than 20 percent globally and around 40 percent in Europe and Japan (Figure 1.8.C). While bank profitability does not appear to have been unduly affected so far, a long-lasting period of negative interest rate policies in the Euro Area and Japan could eventually pose challenges for bank profitability and financial intermediation (Arteta et al. 2016).

As long-term yields in advanced economies have eased, external financing conditions for EMDEs have improved, supporting a recovery in portfolio flows into EMDEs following persistent net outflows over most of 2018 (Figure 1.8.D). Notwithstanding recent reversals related to trade policy uncertainty, equity market valuations have risen, and aggregate EMDE sovereign bond spreads have dropped about 50 basis points since the start of 2019 (Figure 1.8.E). International debt issuance has been robust this year, as many borrowers have taken advantage of more favorable market conditions to meet growing refinancing needs (Figure 1.8.F). Some easing of external financing pressures, combined with moderating inflation, allowed many EMDE central banks to cut interest rates, or put their tightening cycles on hold.

Gains in both equity and bond portfolio flows this year may be partly offset by subdued bank-related flows, including in trade finance amid the deceleration in global trade (BIS 2014). Foreign direct investment (FDI) trends remain mixed, with a rebound in flows to China, and some Latin American countries, including Brazil, offset by weak flows in Europe and Central Asia, Middle East and North Africa, and Sub-Saharan Africa.

Global financing conditions are expected to remain supportive in the near term and tighten only gradually later in the forecast period. This assumes that monetary policy accommodation in major advanced economies will be gradually

removed, but at a slower pace than previously expected. The eventual rise of advanced-economy yields would, however, have a negative effect on capital flows to EMDEs. In Sub-Saharan Africa, persistent governance and regulatory impediments on investment, together with relatively subdued growth prospects, are expected to continue to weigh on FDI flows (Laudicina, Peterson, and McCaffrey 2018). Policy uncertainty, geopolitical risks, and security concerns could also continue to adversely impact EMDE capital inflows (World Bank 2018d).

### Commodity markets

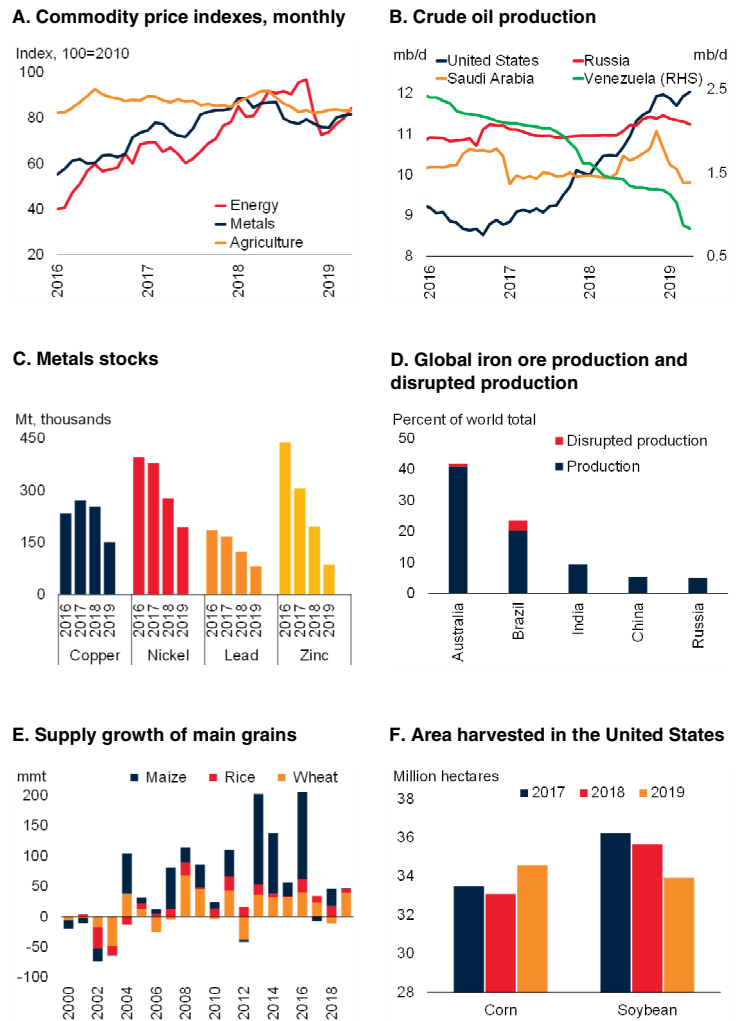
Prices of most industrial commodities picked up in the first half of 2019, but remained well below peak values from last year, while agricultural prices were mostly flat (Figure 1.9.A). Supply constraints and production cuts have supported prices since the start of the year; however, heightened trade tensions have recently weighed on prices of some commodities, particularly metals. Price forecasts for the year as a whole have been downgraded due to weaker-than-expected global growth.

Crude oil prices recovered over the first half of the year, averaging \$64 per barrel (bbl), supported by production cuts among OPEC and its non-OPEC partners, as well as the United States’ decision to terminate waivers for its sanctions on Iran. Saudi Arabia has contributed the most to the fall in supply, reducing output by 1 million barrels per day (mb/d) relative to late-2018 levels, while the Russian Federation has cut production by 0.2 mb/d (Figure 1.9.B). In contrast, production in the United States has continued to grow, and the country maintained its position as the world’s largest oil producer. Venezuela’s crude oil output has dropped further, to about 0.8 mb/d by mid-2019, from 1.4 mb/d in 2018 (IEA 2019).

Oil prices are expected to average \$66/bbl in 2019 and \$65/bbl in 2020, a slight downward revision relative to January reflecting softening global activity. The outlook remains highly uncertain and dependent on policy decisions, particularly whether the production cuts among OPEC and its partners will be extended into the second half of 2019. However, the supply cuts by OPEC

### FIGURE 1.9 Commodity markets

Most industrial commodity prices have recovered in 2019 following notable declines late last year. Against a backdrop of weaker global growth and growing U.S. production, crude oil prices have been supported by production cuts, mostly in Saudi Arabia, and the United States’ decision to terminate waivers for its sanctions on Iran. Amid low inventories, metals prices have been supported by supply disruptions, notably in iron ore production in Brazil. Agricultural supply continues to rise, with U.S. farmers reducing plantings of soybeans in favor of corn.



Source: Bloomberg, International Energy Agency, London Metals Exchange, Vale S.A., U.S. Department of Agriculture, World Bank, World Steel Association.  
 A. Indexes are based on nominal U.S. dollars. Last observation is April 2019.  
 B. Last observation is April 2019.  
 C. Last observation is April 19, 2019.  
 D. Red bars show the percent of disrupted iron ore production that has occurred in 2019 so far. In Australia, the disrupted production has resulted from adverse weather events. In Brazil, production has been restricted following the Vale mining disaster.  
 E. Supply is the sum of beginning stocks and production. Years represent crop seasons (for example, 2018 refers to 2018-19 crop season). Data reflect the May 10, 2019 USDA update.  
 F. Data for 2019 are estimates and as of May 9, 2019.  
[Click here to download data and charts.](#)

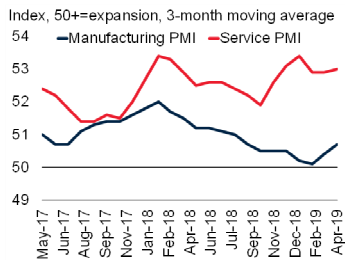
members have resulted in substantial spare production capacity, which lessens the likelihood of spikes in oil prices in the near term.



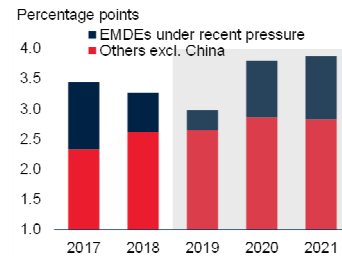
## FIGURE 1.10 Activity in EMDEs

EMDEs experienced broad-based weakness in manufacturing at the start of 2019, followed by some recent signs of stabilization. Growth in countries recently affected by financial stress or sanctions has been particularly subdued, weighing on aggregate EMDE growth. In those countries, export growth has slowed and import compression is underway due to weak domestic demand—particularly investment. In other EMDEs, growth is generally near potential. In many countries, especially commodity exporters, activity has been weaker than previously expected.

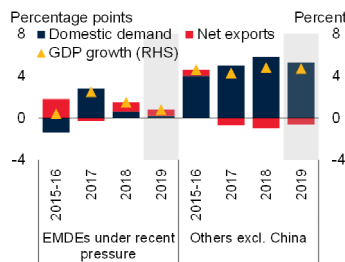
### A. Manufacturing and services PMIs



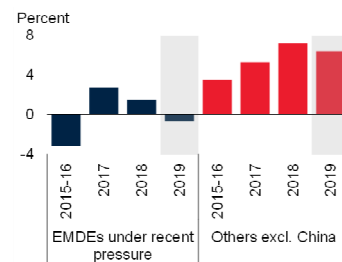
### B. Contribution to EMDE growth excluding China



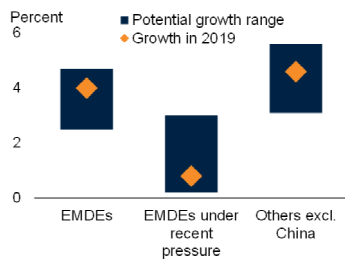
### C. Contribution to growth



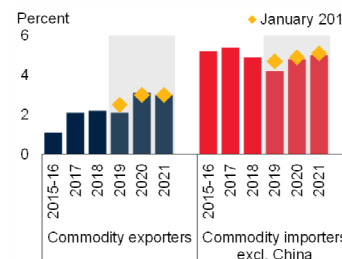
### D. Investment growth



### E. Projected and potential growth in 2019



### F. Growth



Source: Haver Analytics, International Monetary Fund, J.P. Morgan, Organisation for Economic Co-operation and Development, World Bank.

A. Horizontal line is the expansionary threshold for the Purchasing Managers' Index (PMI). Last observation is April 2019.

B.-E. EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia). "Others excl. China" is EMDEs excluding China and EMDEs under pressure.

B.-F. Aggregate growth rates are based on constant 2010 U.S. dollar GDP weights. Shaded areas indicate forecasts.

C. Domestic demand includes government consumption, private consumption, and gross capital formation, which includes the changes in inventories. Net exports are export minus import volumes. C.D.F. Data for 2015-16 are simple averages. Data for 2018 are estimates.

E. Potential growth estimates based on eight different methodologies (production function approach; multivariate filter; three univariate filters, including Hodrick-Prescott filter, Christiano-Fitzgerald filter, and Butterworth filter; IMF *World Economic Outlook*; and OECD *Economic Outlook and Long-Term Baseline Projections*), as in the January 2018 *Global Economic Prospects* report. Blue bars show minimum-maximum range of potential growth. Orange diamonds show average projected growth.

F. Yellow diamonds are projections from the January 2019 *Global Economic Prospects* report.

[Click here to download data and charts.](#)

Supply bottlenecks for metals such as copper, nickel, lead, and zinc supported prices in the first half of 2019, which was accompanied by sharp declines in inventories (Figure 1.9.C). Iron ore prices rose sharply at the start of the year due to temporary mine closures following the Vale mining disaster in Brazil and weather-related disruptions in Australia (Figure 1.9.D). More recently, however, the re-escalation of trade tensions have contributed to declining prices for most base metals. Overall, metals prices are expected to decline slightly in 2019 and 2020, a downward revision relative to the January forecast reflecting a weaker outlook for global metals demand.

Agricultural prices were stable, on average, in the first half of 2019, amid high stock levels and favorable crop conditions for the fourth consecutive year (Figure 1.9.E). Wheat prices, which had risen relative to other agricultural prices, fell sharply on positive supply news, particularly in Europe and Russia. Soybean prices also dropped amid rising trade tensions and the spread of African Swine Fever to pig populations in China, which are a key source of demand. In response to weaker soybean prices, U.S. farmers reduced plantings of soybeans and increased plantings of corn (Figure 1.9.F; World Bank 2018e). Agricultural prices are expected to decline in 2019 and stabilize in 2020.

## Emerging market and developing economies: Recent developments and outlook

*EMDE activity has been weaker than expected amid softening external demand and investment. As a result, EMDE growth is expected to slow further, to 4 percent this year, before regaining some strength in 2020-21. This forecast depends on a rebound in the large EMDEs that have been recently affected by financial market pressures. In Sub-Saharan Africa, where extreme poverty is increasingly concentrated, per capita income growth remains insufficient to lead to substantial poverty alleviation.*



## Recent developments

EMDEs experienced broad-based weakness in manufacturing and exports at the start of the year, followed by some recent signs of stabilization (Figure 1.10.A). Activity in the services sector has remained resilient, reflecting continued growth in consumer spending.

Countries that experienced recent pressures related to varying degrees of financial market stress or idiosyncratic headwinds such as sanctions—a group that includes many commodity exporters—have faced a particularly sharp deceleration in activity this year (Figure 1.10.B).<sup>1</sup> Private consumption growth appears stable, but it remains weak. Investment growth has moderated further as policy uncertainty persists, dampening imports (Figures 1.10.C and D). Economic slack remains elevated in many countries in this group.

In EMDEs that did not suffer recent pressures—a group that includes many commodity importers as well as the more diversified commodity exporters—growth is stable or moderating. Activity in these countries is being restrained by a combination of capacity constraints and softening external demand. As a result, exports and domestic demand are decelerating in tandem, with private consumption still resilient but investment growth remaining subdued (Special Focus 1.1). Import growth is slowing as well, partly due to the high import content of many capital goods. Economic slack in this group of countries is generally limited, and growth is near its potential in many cases (Figure 1.10.E).

### *Commodity-exporting EMDEs*

Growth in commodity exporters has been weaker than expected and remains lackluster (Figure 1.10.F). Notwithstanding a modest recovery from its 2015 low, investment growth in commodity exporters remains weak and below its long-term

average. Notably, investment has deteriorated substantially in Argentina, where confidence and public spending retreated after severe financial stress, and Iran, where economic sanctions are weighing heavily on capital spending (Special Focus 1.1).

Slower-than-expected mining and oil production, combined with domestic policy uncertainties, has delayed the recovery in activity in some of the largest commodity exporters in Sub-Saharan Africa (Angola, Nigeria, South Africa; World Bank 2019b). Amid oil production cuts agreed by OPEC members and some key non-OPEC producers, growth in Saudi Arabia and Russia is moderating, while sanctions or political crises are expected to lead to sharp contractions in other oil exporters (Iran, Sudan; World Bank 2019c and 2019d).

Conditions are improving or stable elsewhere. Momentum in Brazil is gradually firming, although at a slower pace than previously expected. Rising commodity prices this year, along with improving business confidence, have helped lift investment and private consumption in some large economies. In several commodity exporters in East Asia and Pacific and Latin America, where earlier terms-of-trade shocks were less acute, growth is stable or only gradually decelerating from high levels (Chile, Malaysia, Peru; World Bank 2019e).

### *Commodity-importing EMDEs*

Growth in commodity importers continues to decelerate, reflecting moderating external demand, increasing capacity constraints, and the lingering effects of financial stress in some countries—most notably Turkey. Among European EMDEs, slowing activity is particularly pronounced in economies with close ties to the Euro Area or facing ongoing domestic challenges (Belarus, Serbia, Turkey). In some countries, diminishing slack is putting a lid on growth (Hungary, Poland).

In Asia, activity is gradually decelerating but remains robust, with output in many countries expanding at a rate of 6-7 percent (Bangladesh, Cambodia, China, India, the Philippines,

<sup>1</sup> EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia).

### BOX 1.2 Short-term growth prospects for LICs

*Growth in low-income countries (LICs) is projected to remain robust in 2019, at 5.4 percent. It is, however, more moderate than previously forecast, as weaker external demand has been accompanied by devastating extreme weather events and by a normalization of agricultural production in some large economies. Growth is projected to rise to 6.0 percent in 2020 and 6.1 percent in 2021, as domestic demand continues to strengthen and as increased oil and metals production supports activity among industrial-commodity exporters. These growth rates are, however, insufficient to markedly reduce poverty, particularly in LICs affected by fragility, conflict, and violence. Risks to the outlook include slower-than-expected growth in major trading partners, a resumption in the tightening of international financial conditions, adverse weather, and health crises.*

#### Recent growth and prospects for 2019

**Economic activity.** Growth has remained robust in LICs, but lost some momentum. It is projected to decelerate to 5.4 percent in 2019—from 5.6 percent 2018—and is below previous forecasts (Figure 1.2.1.A). The downward revision reflects, in part, unexpectedly weak external demand from major trading partners, extreme weather events that dampened activity in several countries, as well as an earlier-than-expected normalization of agricultural production in some large LICs (Uganda, Tanzania) after strong recoveries from drought in previous years.

In non-resource-intensive LICs, growth has been supported by robust construction activity related to investment in infrastructure (Rwanda, Senegal) and rapidly growing services sectors amid continued urbanization (Ethiopia, Uganda). On the demand side, growth reflects strong household consumption supported by solid harvests (Benin, Burkina Faso) and expansionary monetary policy (The Gambia, Uganda), as well as sustained public investment (Comoros, The Gambia, Madagascar, Nepal, Uganda). Among some exporters of industrial commodities, growth has strengthened—despite weaker external demand—as oil and mining production has continued to benefit from investment in new capacity (Chad, Democratic Republic of Congo, Guinea).

However, several economies are facing severe strains. Output in Zimbabwe is expected to contract in 2019 with a sharp rise in inflation reducing real incomes and foreign exchange shortages constraining activity. The Southern and East African region was hit by two devastating tropical cyclones—Idai and Kenneth—in March and April 2019 that took a heavy human toll and caused severe damage to social and economic infrastructure in the Comoros, Malawi, Zimbabwe and, in particular, Mozambique. In this country, cyclone Idai in particular damaged a significant part of the port city of Beira and its surrounding area—affecting one of Mozambique’s key export terminals.

Note: This box was prepared by Rudi Steinbach. Research assistance was provided by Maria Hazel Macadangang and Mengyi Li.

**Progress in poverty reduction.** Despite declines in poverty rates over the past decade, more than 40 percent of the population in LICs still live in extreme poverty, and continued progress in poverty reduction in these countries remains challenging. The poverty headcount is rising in economies affected by fragility, conflict, and violence. In countries where progress is being made in reducing poverty, economic growth is concentrated in urban areas, yielding little benefit to the rural poor.

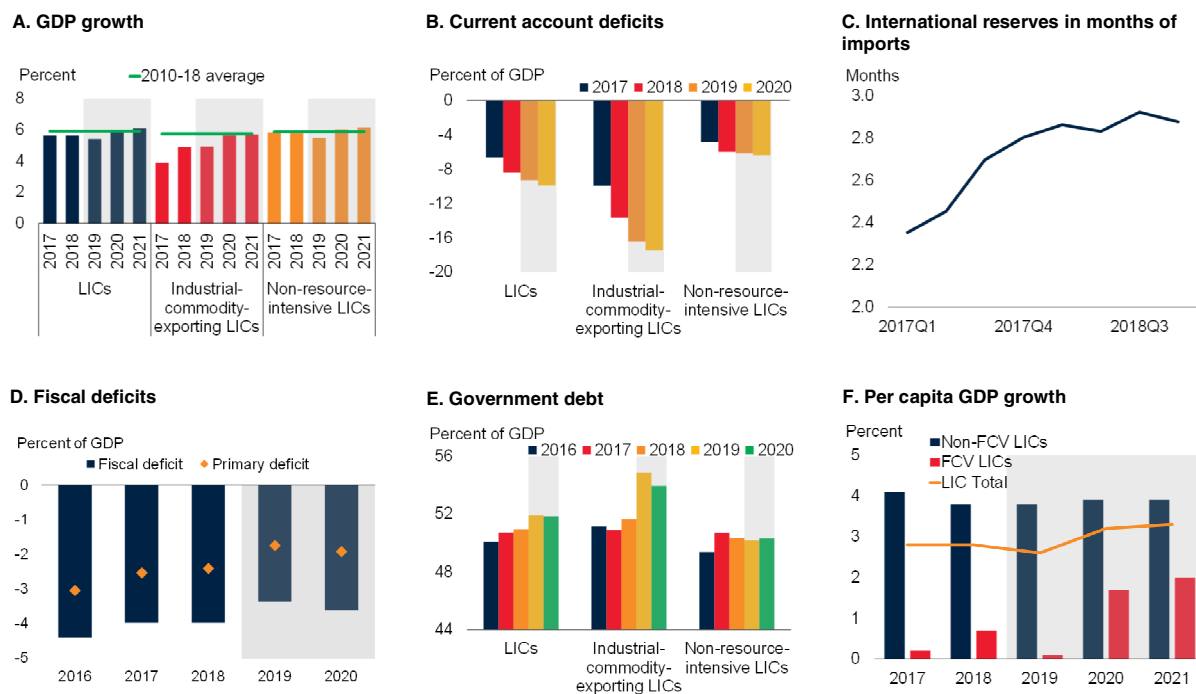
**External positions.** Current account deficits are widening in almost half of LICs, with the average deficit expected to increase to 9.3 percent of GDP in 2019 from 8.4 percent in 2018 (Figure 1.2.1.B). In some LICs (Afghanistan, Burundi, Guinea, Guinea-Bissau), widening external deficits reflect weaker external demand and slower export growth. Elsewhere (Mozambique, Nepal, Niger, Uganda), imports of capital goods related to large infrastructure investment projects have been contributing to larger deficits. The deficit in Mozambique will rise further during the cyclones’ aftermath by weaker agricultural exports and with elevated imports of aid and reconstruction materials. In a few LICs (Benin, Ethiopia), current account deficits are narrowing despite weak external demand because past investments in export-oriented industries are supporting stronger export growth. While FDI inflows have been largely sufficient to finance current accounts deficits—especially in countries with large infrastructure investment programs—they have weakened somewhat amid last year’s tighter external financing environment. This has contributed to a decline in LICs’ international reserves relative to their imports. They now stand further below the commonly recommended minimum of three months’ cover (Figure 1.2.1.C).

**Fiscal positions.** Fiscal deficits are gradually narrowing in LICs, with the average deficit expected to decline from 4 percent of GDP in 2018 to 3.4 percent in 2019 (Figure 1.2.1.D). Narrower deficits among many fast-growing LICs reflect fiscal consolidation (Benin, Ethiopia, Togo), as well as greater public spending efficiency and improved revenue collections (Benin, Togo). Among industrial-commodity-exporting LICs, rising government revenues related to increased oil and metals production (Chad),

**BOX 1.2 Short-term growth prospects for LICs (continued)**

**FIGURE 1.2.1 Short-term economic prospects for LICs**

Growth in LICs is projected to remain robust in 2019, at 5.4 percent, albeit more moderate than previously forecast. It is expected to rise to 6.0 percent in 2020 and 6.1 percent in 2021. Growth is being spurred by new oil and mining production capacity coming on stream among some large industrial-commodity exporters; public investment and strong agriculture performances should support growth in non-resource-intensive LICs. Per capita income growth will not be sufficient to markedly reduce poverty. Current account deficits are widening, amid weaker external demand and strong capital goods imports, while financing of these deficits has been under pressure. Fiscal deficits remain large, contributing to elevated government debts.



Source: Haver Analytics; International Monetary Fund, *World Economic Outlook*; World Bank; World Development Indicators.  
 Note: LICs = low-income countries. Industrial-commodity exporting countries include energy- and metal-exporting economies, and the sample includes 8 countries. Non-resource-intensive countries include agricultural-exporting countries and commodity importers, and the sample includes 22 countries.  
 A. Aggregate growth rates calculated using 2010 U.S. dollar GDP weights.  
 B,D,E. Simple averages of country groups.  
 C. Simple averages. Sample includes 23 countries.  
 F. FCV = fragility, conflict, and violence. FCV and Non-FCV LICs samples each include 14 countries. Weighted averages of country groups.  
[Click here to download data and charts.](#)

greater tax revenue mobilization (Sierra Leone), and fiscal consolidation (Tajikistan) are improving fiscal balances. However, in some LICs, fiscal deficits are widening, amid weak economic growth that weighs on government revenues (Liberia), election-related fiscal pressures (Mozambique), and scaled up public consumption and investment by a new government (Democratic Republic of Congo).

After increasing sharply in recent years, government debt ratios are elevated among LICs, with debt expected to reach 52 percent of GDP, on average, in 2019—a 15 percentage point increase since 2013 (Figure 1.2.1.E).

However, in some LICs, increased fiscal discipline and more effective revenue mobilization have begun to stabilize debt ratios. Among non-resource-intensive LICs, indebtedness has remained broadly unchanged, or even declined somewhat, in Benin, the Comoros, Ethiopia, Haiti, and The Gambia. Similarly, increases in debt appear to have come to a halt in some industrial-commodity exporters, where revenues have been lifted by increased resource production (Chad, Democratic Republic of Congo). Nevertheless, debt continues to rise in many countries, driven by strong public investment (Rwanda, Tanzania, Uganda) and larger current spending, in some cases related to elections (Burundi, Mozambique).

### BOX 1.2 Short-term growth prospects for LICs (*continued*)

In addition to elevated levels of debt, the composition of government debt has changed in recent years, as non-concessional and foreign-currency-denominated borrowing has increased amid greater access to international capital markets and increased non-resident participation in domestic debt markets (World Bank 2019a, 2019b).

While international financial conditions have eased in recent months, they are still tighter than in 2017, keeping debt-servicing costs elevated and making fiscal consolidation in countries with large debt burdens more challenging.

#### Outlook for 2020-21

**Economic growth.** Growth in LICs is expected to strengthen to 6.0 percent in 2020 and 6.1 percent in 2021. This projected pickup assumes that the recovery among oil and metals exporters will be bolstered by higher production as new capacity comes on stream, while domestic demand continues to strengthen (Chad, Democratic Republic of Congo, Guinea). In the Democratic Republic of Congo—the largest industrial commodity-exporting LIC and the country estimated to have the most cobalt reserves in the world—mining production accounts for more than 80 percent of exports and 25 percent of government revenues. Mining production is expected to increase by around 10 percent a year over the forecast horizon, driven by strong growth in cobalt demand from the expanding global electric vehicle industry (Alves Dias et al. 2018; Campbell 2019).

Growth is also expected to remain robust in several non-resource-intensive LICs. In particularly fast-growing LICs (Rwanda, Uganda, and Tanzania), expansions will be supported by public investment in infrastructure and continued strong agricultural growth. Similarly, agricultural production in Malawi is assumed to recover as the Fall Armyworm infestation of recent years recedes. Reconstruction efforts in the cyclone-affected countries in Southern and East Africa—the Comoros, Malawi, Mozambique, and Zimbabwe—are also expected to support activity over the next two years. In Afghanistan, greater political stability following an assumed peaceful transition after the upcoming election in July is expected to improve the business environment and deliver a growth spurt. Improved political stability is also expected to support the outlook for Guinea-Bissau and Zimbabwe. While growth in Ethiopia is expected to remain strong, it will be held back by a tighter fiscal stance, as the government continues its efforts to stabilize public debt.

**Prospects for per capita income convergence.** The growth recovery will help lift per capita GDP growth in LICs from 2.6 percent in 2019 to 3.2 percent in 2020 and 3.3 percent in 2021 (Figure 1.2.1.F). However, among LICs affected by fragility, conflict, and violence—which host about 56 percent of the LIC poor and 43 percent of the LIC population—prospects for convergence to middle-income country income levels are limited, as per capita income growth is expected to be significantly lower, averaging 1.9 percent in 2020-21. For these economies, growth is thus expected to remain insufficient to significantly reduce poverty rates, and the number of people in LICs living in extreme poverty (below the international poverty line for income of \$1.90 per day) is expected to remain elevated.

**Risks.** Risks to the economic outlook for LICs are predominantly on the downside. Slower-than-expected growth in major economies—China, the United States, and the Euro Area—could set back LIC growth. These three countries account for 31 percent of LIC exports, 41 percent of LIC FDI, and 23 percent of remittances to LICs, leaving LICs highly exposed to developments in their economies. A slowdown in China would hit industrial-commodity-exporting LICs particularly hard, as China accounts for more than one-half of global metals demand (World Bank 2016 and 2018b).

Unexpected shifts in investor sentiment, or in economic developments or policies in major economies, could lead to a re-tightening of financial conditions. The impact would be amplified in LICs with larger debt burdens, weaker macroeconomic fundamentals, or elevated political risks. The disruptions to capital inflows and sharp currency depreciations that could result from a sudden deterioration in market sentiment would raise debt-servicing costs further—especially on debt denominated in foreign currency—and undermine fiscal consolidation efforts while constraining critical poverty-reducing expenditures.

Many LICs are vulnerable to weather-related shocks as climate change increases the frequency of extreme weather events such as tropical storms, floods, heatwaves, and severe and prolonged drought episodes. Crop damage events caused by a greater incidence of insect pests (e.g., the Fall Armyworm) could become more severe as warmer conditions fuel their population growth and metabolic rates (Deutsch et al 2018). In the average LIC, agriculture accounts for 29 percent of GDP. LICs that are most highly dependent on agricultural activity are most at risk

**BOX 1.2 Short-term growth prospects for LICs (continued)****TABLE 1.2.1 Low-income country forecasts<sup>a</sup>**

(Real GDP growth at market prices in percent, unless indicated otherwise)

Percentage point differences  
from January 2019 projections

	2016	2017	2018e	2019f	2020f	2021f	2019e	2020f	2021f
<b>Low Income Country, GDP<sup>b</sup></b>	<b>4.8</b>	<b>5.6</b>	<b>5.6</b>	<b>5.4</b>	<b>6.0</b>	<b>6.1</b>	<b>-0.5</b>	<b>-0.2</b>	<b>-0.2</b>
Afghanistan	2.3	2.7	1.0	2.4	3.2	3.6	-0.3	0.0	0.4
Benin	4.0	5.8	6.5	6.5	6.5	6.5	0.3	0.0	-0.1
Burkina Faso	5.9	6.3	6.8	6.0	6.0	6.0	0.0	0.0	0.0
Burundi	-0.6	0.5	1.6	1.8	2.1	2.0	-0.5	-0.4	-0.8
Chad	-6.3	-3.0	2.6	3.4	5.6	4.8	-1.2	-0.5	-0.1
Comoros	2.2	2.7	2.8	3.1	3.2	3.2	0.0	0.1	0.1
Congo, Dem. Rep.	2.4	3.7	5.8	5.9	6.5	6.8	1.3	1.0	0.9
Ethiopia <sup>c</sup>	7.6	10.2	7.9	7.9	8.2	8.2	-0.9	-0.7	-0.7
Gambia, The	0.4	4.6	6.6	5.4	5.2	5.0	0.0	0.0	-0.2
Guinea	10.5	10.6	5.8	5.9	6.0	6.0	0.0	0.0	0.0
Guinea-Bissau	6.3	5.9	3.8	4.3	4.8	5.5	0.1	0.4	1.0
Haiti <sup>c</sup>	1.5	1.2	1.5	0.4	1.6	1.3	-1.9	-0.8	-1.2
Liberia	-1.6	2.5	1.2	0.4	1.6	1.3	-4.1	-3.2	-3.5
Madagascar	4.2	4.3	5.2	5.2	5.3	5.1	-0.2	0.0	-0.2
Malawi	2.5	4.0	3.5	4.5	4.7	5.1	0.2	-0.6	-0.4
Mali	5.8	5.3	4.9	5.0	4.9	4.8	0.0	0.0	0.0
Mozambique	3.8	3.7	3.3	2.0	3.5	4.2	-1.5	-0.6	0.1
Nepal <sup>c</sup>	0.6	8.2	6.7	7.1	6.4	6.5	1.2	0.4	0.5
Niger	4.9	4.9	5.2	6.5	6.0	5.6	0.0	0.0	0.0
Rwanda	6.0	6.1	8.6	7.8	8.0	7.5	0.0	0.0	-0.5
Senegal	6.2	7.2	6.8	6.8	7.0	7.0	0.2	0.2	0.1
Sierra Leone	6.4	3.8	3.7	5.4	5.4	5.2	0.3	-0.9	-1.1
Tajikistan	6.9	7.1	7.3	6.0	6.0	6.0	0.0	0.0	0.0
Tanzania	6.9	6.8	6.0	5.4	5.7	6.1	-1.4	-1.3	-0.9
Togo	5.2	4.3	4.9	5.0	5.2	5.1	0.2	0.1	0.0
Uganda <sup>c</sup>	4.6	3.9	5.9	6.1	6.5	5.8	0.1	0.1	-0.7
Zimbabwe	0.8	4.7	3.5	-3.1	3.5	4.9	-6.8	-0.5	0.9

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. Central African Republic, Democratic People's Republic of Korea, Somalia, Syria, and Yemen are not forecast due to data limitations.

b. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

c. GDP growth based on fiscal year data. For Nepal, the year 2019 refers to FY2018/19.

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of increases in poverty rates as a result of these factors (World Bank 2019a).

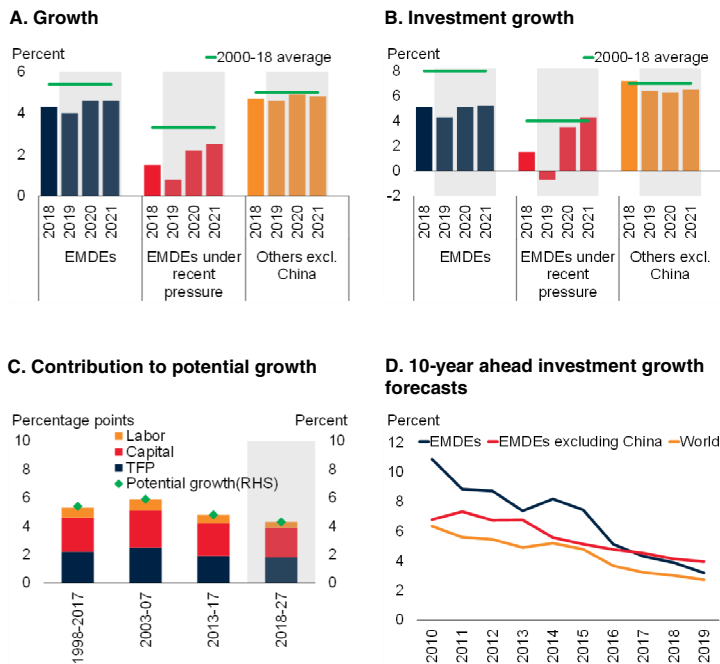
Health crises remain a constant concern among LICs. The latest Ebola epidemic in the northeastern Democratic

Republic of Congo has been ongoing since mid-2018 and could weigh heavily on activity in the country and the sub-region, especially if it were to spread to major urban centers and to neighboring countries (Burundi, Rwanda, South Sudan, Tanzania, Uganda).



## FIGURE 1.11 EMDE growth prospects

Following a further deceleration in 2019, growth in EMDEs is expected to recover in 2020-21, as headwinds are assumed to dissipate in a number of key economies. However, investment growth will remain subdued. In the longer run, productivity and demographic trends point to weakening growth potential across EMDEs, further weighing on investment prospects.



Source: Consensus Economics, J.P. Morgan, Penn World Tables, World Bank.

A.-C. Aggregate growth rates are calculated using constant 2010 U.S. dollar GDP weights. Shaded areas indicate forecasts.

A.B. EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia).

C. TFP = total factor productivity. Sample includes 50 EMDEs. Potential growth estimates are based on production function approach. For further details on potential growth estimates, refer to the January 2018 edition of the *Global Economic Prospects* report.

D. 10-year-ahead forecasts surveyed in indicated year. Constant 2010 U.S. dollar investment-weighted averages. Sample includes 23 advanced economies and 20 EMDEs (indicated by † in Table SF1.1.1). For 2010-18, the average of four projections during the year is shown; for 2019, the average of two projections during the first half of the year is shown.

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Vietnam), despite moderating export growth. In India, growth remains solid, supported by improved confidence, slowing inflation, and still robust investment (World Bank 2019e, 2019f). Other economies continue to benefit from pan-Asian infrastructure investments and expanding intra-regional trade (Bhutan, Cambodia, Vietnam). Activity is weaker in countries where policy uncertainty continues to discourage private investment (Mexico, Sri Lanka), and in countries that have tightened fiscal and monetary policies to reduce fiscal and current account deficits (Haiti, Pakistan, Tunisia).

### Low-income countries

Growth remains robust in low-income countries (LICs; Box 1.2; Special Focus 2.1); however, it has lost some momentum amid weaker external demand from major trading partners and extreme weather events. Among non-resource-intensive countries, rising consumption growth and sustained public investment in infrastructure are supporting activity, offset by a modest slowdown in agricultural output (Uganda, Tanzania). Growth among exporters of industrial commodities has generally firmed due to investment in new resource production capacity (Chad, Democratic Republic of Congo, Guinea). In contrast, the Comoros, Malawi, Zimbabwe, and particularly Mozambique are facing severe strains after two devastating tropical cyclones—Idai and Kenneth—hit Southern and East Africa in March and April, taking a heavy human toll and causing severe economic damage. Current account deficits across LICs have widened, on average, due to strong capital goods imports related to public investment projects and slower export growth among some metals exporters (Guinea, Nepal, Niger). Strong public investment spending has, in part, kept fiscal deficits elevated; however, they have narrowed in some countries amid continued fiscal consolidation and improved revenue collection (Benin, Ethiopia, Sierra Leone).

### Outlook

#### Growth outlook

EMDE growth is expected to slow from 4.3 percent in 2018 to 4 percent this year—0.3 percentage point lower than previously projected, with notable heterogeneity across regions (Box 1.3; Chapter 2). Almost 40 percent of EMDEs are expected to decelerate in 2019 relative to last year. Moreover, forecasts for 2019 growth have been downgraded for more than 40 percent of countries. For many countries, a substantial part of the forecast downgrade is attributable to continued weakness in investment, which remains well below historical averages.

Growth in EMDEs facing the lingering impact of earlier financial stress (Argentina, Brazil, Nigeria, South Africa, Turkey) and idiosyncratic head-



### BOX 1.3 Regional perspectives: Recent developments and outlook

*Growth in all EMDE regions has been weaker than expected amid softening external demand and, in some countries, persistent domestic headwinds. Activity in the East Asia and Pacific and South Asia regions remains buoyant, while growth in other EMDE regions is expected to recover in 2020-21.*

**East Asia and Pacific.** Growth in the region is projected to slow from 6.3 percent in 2018 to 5.9 percent in 2019-20, and to ease further to 5.8 percent in 2021. This will mark the first time since the 1997-98 Asian financial crisis that EAP growth dropped below 6 percent. In China, growth is expected to decelerate from 6.6 percent in 2018 to 6.2 percent in 2019, and gradually decline to 6.0 percent by 2021, reflecting softening manufacturing activity and trade amid domestic and external headwinds. In the rest of the region growth is also expected to moderate to 5.1 percent in 2019, before rebounding modestly to 5.2 percent in 2020-21, as global trade stabilizes. Risks to regional growth remain tilted to the downside and have intensified with the re-escalation of trade tensions. They include a sharper-than-expected slowdown in major economies, including China; an intensification of global trade tensions; and an abrupt change in global financing conditions and investor sentiment.

**Europe and Central Asia.** Growth in the region is projected to fall sharply from 3.1 percent in 2018 to 1.6 percent in 2019. The slowdown partly reflects a sharp weakening of activity in Turkey, which fell into recession in the wake of acute financial market stress in 2018. Regional growth is projected to pick up in 2020-21 as Turkey recovers and Russian strengthens. Excluding these economies, the rest of the region is expected to moderate. In particular, growth in Central Europe is projected to soften as economies grapple with the slowdown in the Euro Area and binding domestic capacity constraints. Key external risks to the region include spillovers from weaker-than-expected activity in the Euro Area and from escalation of global policy uncertainty, particularly in relation to trade tensions and the United Kingdom's exit from the European Union. Renewed financial pressures in Turkey could also disrupt regional growth.

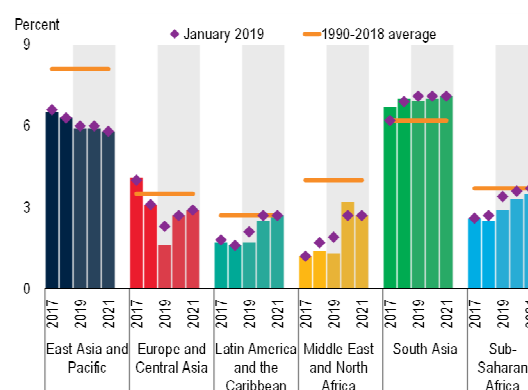
**Latin America and the Caribbean.** Growth in the region is expected to be subdued in 2019, at 1.7 percent, reflecting challenging conditions in several of the largest economies. Gradually building momentum in Brazil and a recovery in Argentina are projected to contribute to a pickup in

Note: This box was prepared by Patrick Kirby, with contributions from Rudi Steinbach, Temel Taskin, Ekaterine Vashakmadze, Dana Vorisek, Collette Wheeler, and Lei Ye. Research assistance was provided by Hazel Macadangang.

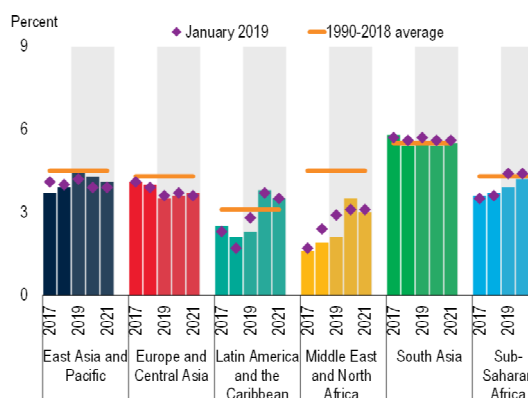
### FIGURE 1.3.1 Regional growth

*Growth in all EMDE regions has been weaker than expected, hindered by a combination of policy uncertainties, weak external demand, and the lingering impact of past financial stress. Activity is expected to recover in 2020-21.*

#### A. Regional growth, weighted average



#### B. Regional growth, unweighted average



Source: World Bank.

A.B. Bars denote latest forecast; diamonds correspond to January 2019 forecasts in the *Global Economic Prospects* report. Average for 1990-2018 is constructed depending on data availability. For Europe and Central Asia, the long-term average uses data for 1995-2018 to exclude the immediate aftermath of the collapse of the Soviet Union.

A. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Since largest economies account for about 50 percent of GDP in some regions, weighted averages predominantly reflect the developments in the largest economies in each region.

B. Unweighted average regional growth is used to ensure broad reflection of regional trends across all countries in the region.

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### BOX 1.3 Regional perspectives: Recent developments and outlook (*continued*)

regional growth to 2.5 percent in 2020 and 2.7 percent in 2021. Financial conditions in the region have eased markedly since early 2019. Despite soft global trade, regional export growth has picked up, boosted by trade diversion in response to bilateral tariffs by the United States and China, and by solid growth in the United States. As these effects wane and global trade decelerates further, export growth in the region is projected to slow. Risks to the growth outlook remain tilted to the downside. Sharper-than-projected slowdowns in the United States and China could have negative spillovers on regional growth through trade, financial, and commodity market channels. Adverse market responses to weak fiscal conditions and disruptions from natural disasters are other important risks. The crisis in Venezuela also presents risks.

**Middle East and North Africa.** Growth in the region is projected to remain subdued in 2019, at 1.3 percent. Activity in oil exporters has slowed due to weak oil sector output and the effects of intensified U.S. sanctions on Iran, despite an easing of the fiscal stance and positive prospects for non-oil sectors in some countries. Many oil importers continue to benefit from business climate reforms and resilient tourism activity. Regional growth is projected to pick up to around 3 percent in 2020-21, supported by capital investment and policy reforms. Risks to the outlook are tilted to the downside, including geopolitical tensions, reform setbacks, and a further escalation of global trade tensions.

**South Asia.** The region continued to enjoy solid economic activity in 2018, posting 7 percent GDP growth due to robust domestic demand. Pakistan was a notable exception, with a broad-based weakening of domestic demand against the backdrop of tightening policies aimed at addressing the country's macroeconomic imbalances. Regional growth is projected to remain close to 7 percent over the forecast horizon, as it benefits from strong private consumption and investment. The main risks to the outlook include a re-escalation of political uncertainty and regional tensions, financial sector weakness due to nonperforming assets, fiscal challenges, and a sharper-than-expected weakening of growth in major economies.

**Sub-Saharan Africa.** The recovery in the region has disappointed, with weakening external demand, supply disruptions, and elevated policy uncertainty weighing on activity in major economies. Growth in the region is projected to pick up from 2.5 percent in 2018 to 2.9 percent this year and an average of 3.4 percent in 2020-21, as domestic demand gathers pace and oil production recovers in large exporting economies. However, this expected recovery is significantly slower than previously projected, reflecting persistent headwinds in major economies, and it is largely insufficient to make progress in poverty reduction. Downside risks to the outlook include weaker-than-expected external demand, lower commodity prices, renewed stress in global financial markets, fiscal slippages, political uncertainty, armed conflicts, and adverse weather conditions.

winds such as sanctions (Iran, Russia) is expected to remain subdued this year (Figure 1.11.A). Projections for 2019 were revised down in most of these countries, with particularly sizable downgrades for Brazil, Mexico, and Turkey. Forecasts for countries facing oil production cuts this year (Bahrain, Russia, Saudi Arabia, and United Arab Emirates) were also downgraded. In contrast, growth in EMDEs that did not face recent pressures is expected to remain solid.

EMDE growth is projected to firm to 4.6 percent in 2020-21, in line with previous forecasts. This assumes a waning drag from earlier financial pressures in some large countries, that global financing conditions remain generally benign, and that global trade growth stabilizes. In Argentina

and Turkey, the impact of severe financial market turmoil is expected to diminish over the forecast horizon as investor confidence returns (World Bank 2019c). In Brazil, Russia, and South Africa, headwinds associated with elevated policy uncertainty are also expected to moderate. In Iran, the impact of U.S. sanctions is projected to peak this year, with growth resuming in 2020 (World Bank 2019d).

In EMDEs that did not suffer recent pressures, growth is expected to remain stable in 2020-21. Resilient domestic demand and still favorable global financing conditions should largely offset the negative impact of decelerating exports. However, there are some large divergences. Growth in India and Indonesia is expected to

remain steady and above EMDE averages, while capacity constraints and the projected deceleration in the Euro Area will slow activity in Poland and Hungary.

EMDE investment growth is expected to decelerate in 2019, primarily because of contractions in countries affected by recent pressures (Figure 1.11.B). While investment growth is projected to recover somewhat in 2020-21, it is expected to remain below long-term averages, reflecting elevated debt levels, limited fiscal space, lack of clarity about policy direction, and inadequate business climates (Special Focus 1.1).

Growth in LICs is expected to recover to an average of 6.1 percent in 2020-21, from 5.4 percent in 2019 (Box 1.2). In non-resource-intensive countries, the pickup assumes stronger private investment amid improving business environments (Rwanda, Uganda), continued robust public infrastructure spending, solid agricultural output (The Gambia, Malawi, Tanzania), and greater political stability (Afghanistan, Guinea-Bissau, Zimbabwe). Among exporters of industrial commodities, the recovery is predicated on rising oil and mining production amid continued investment in new capacity (Chad, Democratic Republic of the Congo, Guinea), and on stronger domestic demand. Despite the pickup in growth, LICs' prospects for progression to middle-income status will be challenged by a greater incidence of fragility; a heavy reliance on agriculture, which is vulnerable to climate change and extreme weather events; and the fact that many are land-locked, limiting the scope of involvement in global trade (Special Focus 2.1).

Over the medium term, challenges associated with demographics, productivity, and investment point to weakening growth potential in EMDEs (Figure 1.11.C; World Bank 2018c). Slowing labor force growth will be most pronounced in key economies in East Asia and Pacific and in Europe and Central Asia, while it is projected to be broadly neutral for growth in Latin America and the Caribbean, in the Middle East and North Africa, and in South Asia, and to remain supportive in Sub-Saharan Africa. Many of the drivers of the productivity

slowdown seen across EMDEs in the post-crisis period are likely to persist, notwithstanding the promise of new technologies. Over the next decade, investment is expected to remain subdued, which will exacerbate the decline in potential growth directly through slower capital deepening and indirectly through its dampening impact on productivity (Figure 1.11.D).

### *Per capita income growth and poverty*

Sustained per capita income growth has historically been the main driver of global poverty reduction (World Bank 2018f). Softening growth in EMDEs since the global financial crisis has been associated with a slower pace of global poverty reduction, as well as an increased concentration of extreme poverty in Sub-Saharan Africa. While extreme poverty has fallen substantially in some regions, such as East Asia and Pacific, addressing broader measures of poverty still remains an acute challenge (World Bank 2019f).

Near-term growth prospects will be insufficient to result in significant progress toward global poverty alleviation, with per capita income growth this year remaining below its long-term average in more than half of EMDEs. In about a third of EMDEs, per capita growth in 2019 will be below that of advanced economies, resulting in widening income gaps.<sup>2</sup> These EMDEs are mainly in commodity-reliant regions such as Sub-Saharan Africa, Latin America and the Caribbean, and the Middle East and North Africa (Figure 1.12.A).

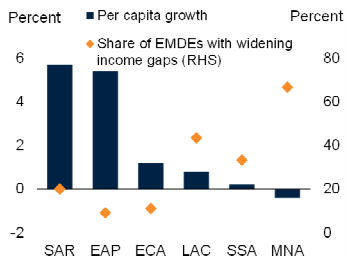
There are significant differences within regions, however. In the case of Sub-Saharan Africa, per capita growth is weak in the largest three economies (Nigeria, South Africa, and Angola), in some metals exporters, and in countries affected by fragility, conflict, and violence. In contrast, some non-resource-intensive countries in the region are experiencing solid per capita income growth rates (Côte d'Ivoire, Ethiopia, Rwanda, Senegal).

<sup>2</sup>Median per capita income growth is also expected to be weak, as the correlation between median household income growth and per capita GDP growth is 0.75 for those countries for which household income data are available.

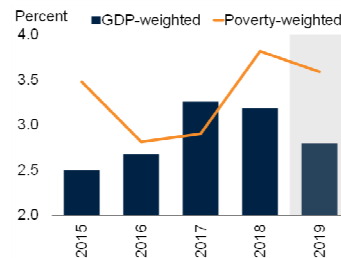
## FIGURE 1.12 EMDE per capita income growth and poverty

Weakening growth this year suggests that, in many EMDEs, per capita income gaps with advanced economies will continue to widen. Per capita income in countries with the largest number of extreme poor is expected to grow at a somewhat faster clip than other EMDEs, but at less than half the pace needed to reduce global extreme poverty to 3 percent by 2030.

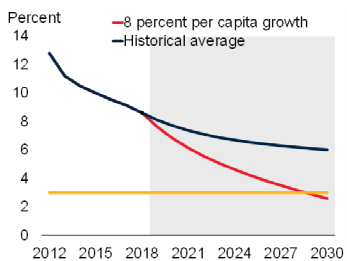
**A. GDP per capita growth and share of EMDEs with widening income gaps, 2019**



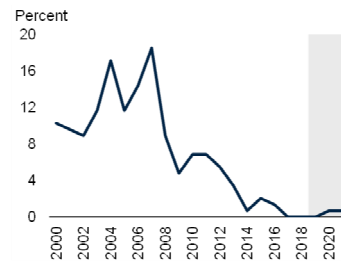
**B. Per capita growth in EMDEs**



**C. Extreme poverty scenarios**



**D. Share of EMDEs with per capita growth at or above 8 percent per annum**



Source: World Bank.

A. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Countries with a widening income gap are those with per capita GDP growth of at least 0.1 percentage point lower than advanced-economy per capita GDP growth.

B.-D. Shaded areas indicate forecasts.

B. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights ("GDP-weighted") or number of extreme poor living at or below \$1.90 a day ("poverty-weighted"). The poverty-weighted estimate of per capita GDP growth excludes countries for which poverty head counts are not available. Sample includes 104 EMDEs for poverty-weighted and 117 EMDEs for GDP-weighted per capita growth.

C. Data for 2016-18 are estimates. The blue line shows the poverty rate assuming that income per capita of the bottom 40 percent of the income distribution grows at the historical average from 2005-15; the red line shows this but assuming a rate of 8 percent per year. The yellow horizontal line indicates the 3 percent extreme poverty rate goal set for 2030. See World Bank (2018f) for details.

D. Share of EMDEs that reach or exceed 8 percent GDP per capita growth. Sample includes 146 EMDEs.

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Aggregate per capita income in countries with the largest numbers of extreme poor is expected to grow at a somewhat faster clip than that of other EMDEs over the forecast horizon (Figure 1.12.B). That pace will nevertheless remain well below what is needed to achieve poverty alleviation goals. To reduce global extreme poverty to 3 percent by 2030, income per capita growth in countries where extreme poverty concentrates would need to

be sustained at about 8 percent per year (Special Focus 2.1; Figure 1.12.C). This is more than twice the rates projected over the next two years—and only a small and declining proportion of EMDEs have achieved such growth in any given year since the global financial crisis (Figure 1.12.D).

## Risks to the outlook

*Risks continue to be tilted to the downside. A further escalation in trade tensions and rising policy uncertainties could weigh on investment and contribute to financial market volatility. New financial stress episodes in EMDEs could be amplified by rising debt levels, corporate sector vulnerabilities, and increasing refinancing pressures. Sharper-than-expected slowdowns in major economies could have substantial spillover effects for EMDEs. These risks are compounded in some regions by the possibility of intensifying conflict and by the increased frequency of extreme weather events.*

Baseline forecasts point to a deceleration of global growth from 3 percent in 2018 to 2.6 percent this year—0.3 percentage point below previous projections, amid a more broad-based slowdown in manufacturing activity and trade than previously anticipated. More accommodative monetary policy stances in major advanced economies, new fiscal stimulus measures in China, and the diminishing effect of financial pressures in some major EMDEs are assumed to help stabilize activity and prevent a further deterioration in global growth. On balance, global growth is predicted to edge up to a slightly weaker-than-expected 2.7 percent in 2020 and to 2.8 percent in 2021.

There is considerable uncertainty surrounding global growth projections, and risks to the global outlook continue to be firmly tilted to the downside (Figure 1.13.A). Intensifying policy and political uncertainty, including a further escalation of trade disputes between major economies, could weigh on sentiment and dampen investment and trade. Relative to the baseline assumption of no additional escalation going forward, a renewed deterioration in trade relations could therefore result in substantially lower global growth. The potentially large adverse effects associated with



such escalation highlight the opportunity costs of the absence of a comprehensive trade deal between the United States and China. A mutually beneficial resolution of trade disputes between the world's two largest economies would lead to a sustained dissipation of global policy uncertainty, support confidence and investment, and bolster the near- and long-term global growth outlook.

A renewed deterioration of EMDE financial market sentiment could be amplified by high levels of debt and spread through financial sector exposure to sovereign risk. A sharper-than-expected deceleration of activity in systemically large economies—such as China, the Euro Area, and the United States—could also have broad-ranging repercussions for EMDEs. The probability of growth in 2020 being at least 1 percentage-point below current projections is estimated at close to 20 percent (Figure 1.13.B). Such slowdown would be comparable to the 2001 global downturn.

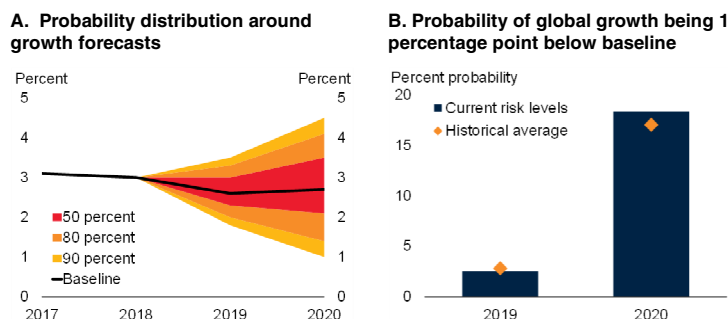
### Renewed trade tensions and policy uncertainty

Rising policy uncertainty in major advanced economies and EMDEs has already contributed to weakening confidence and delayed investment plans (Figure 1.14.A). An intensification of such uncertainties—including a sharp escalation in trade tensions between the United States and China, a disorderly exit of the United Kingdom from the EU, and more fractious political landscapes after elections in major economies—could contribute to a continued deterioration in global activity, with particularly significant consequences for trade and investment. For instance, a sustained increase of 10 percent in an index of U.S. economic policy uncertainty could, after one year, reduce EMDE output growth by 0.2 percentage point and EMDE investment growth by 0.6 percentage point (World Bank 2017c).

Trade relations between the United States and several of its major trading partners remain fragile and could deteriorate further, leading to a proliferation of new tariffs and other trade barriers with broad-ranging consequences. An increase in U.S. tariffs on all remaining imports from China,

### FIGURE 1.13 Balance of risks

*The balance of risks to global growth remains tilted to the downside. The probability of global growth being 1 percentage point below forecast in 2020 is close to 20 percent.*



Source: Bloomberg, World Bank.

A.B. The fan chart shows the forecast distribution of global growth using time-varying estimates of the standard deviation and skewness extracted from the forecast distribution of three underlying risk factors: oil price futures, the S&P 500 equity price futures, and term spread forecasts. Each of the risk factor's weight is derived from the model described in Ohnsorge, Stocker, and Some (2016). Values for 2019 are computed from the forecast distribution of 6-month-ahead oil price futures, S&P 500 equity price futures, and term spread forecasts. Values for 2020 are based on 18-month-ahead forecast distributions. Last observation is May 21, 2019.

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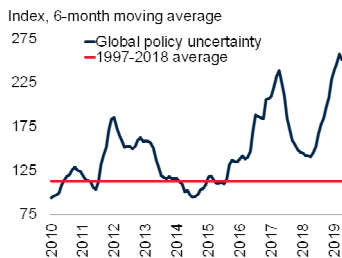
and retaliatory responses by China, would result in significant economic losses for exporters of the targeted products and lead to cascading trade costs to other sectors. While some countries could benefit from trade diversion in the short run, adverse effects from weakening growth and rising policy uncertainties involving the world's two largest economies would have predominantly negative repercussions (Freund et al. 2018). In addition, the risk of higher tariffs on U.S. imports of automobiles and parts remains elevated, and could cause severe disruptions to tightly integrated global value chains (GVCs; Figure 1.14.B).

The complex and discretionary nature of tariff measures and a lack of clarity about future trading rules could also be a notable barrier to firms' decisions to invest and export. In particular, U.S. policy uncertainty is found to significantly erode growth and investment prospects across EMDEs (Kose, Lakatos, et al. 2017). In the presence of GVCs, protectionist measures have widespread adverse implications not only on targeted sectors and countries but also on downstream industries and other trading partners (Bellora and Fontagne 2019; Blanchard, Bown, and Johnson 2016). If all proposed tariff increases were to be implemented, the average U.S. tariff rate would increase to levels not seen since the late 1960s and substantially

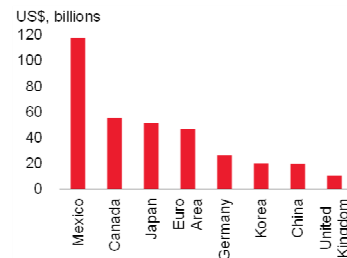
## FIGURE 1.14 Risk of renewed trade tensions and policy uncertainty

Global policy uncertainty is close to record highs, reflecting increased risks of further escalation in trade tensions and rising political uncertainty. Additional U.S. tariff hikes, including in the automobile sector, could significantly disrupt tightly-integrated value chains and raise average U.S. tariffs substantially above those of most G20 countries. Amid increasingly divided political landscapes, elections in countries accounting for more than a third of global GDP could contribute to unpredictable policy changes.

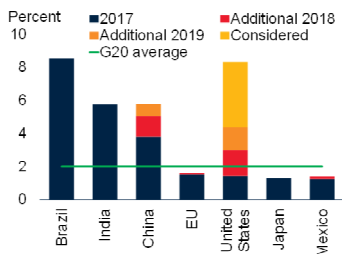
### A. Global policy uncertainty



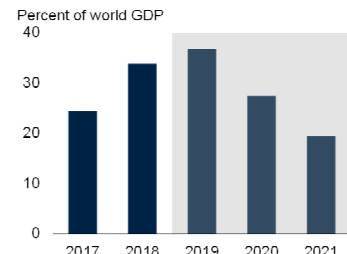
### B. U.S. auto imports, by economy



### C. Average import tariffs in G20 countries



### D. Share of global GDP accounted for by countries with general elections



Source: Baker, Bloom, and Davis (2016); Election Guide; Haver Analytics; International Foundation for Electoral Systems; National Sources; Peterson Institute for International Economics; U.S. Census Bureau; World Bank.

A. The global policy uncertainty index is computed by Baker, Bloom, and Davis (2016), and is based on the frequency of words in domestic newspapers mentioning geopolitical tensions, including military, nuclear, war, and terrorism. Last observation is April 2019.

B. Data are as of May 23, 2019.

C. Blue bars are the trade-weighted averages for 2017 tariffs. "Considered" reflects announcements of possible tariffs as of May 23, 2019, including an additional 25 percent tariff on U.S. imports from China not subject to 2018 tariff hikes and on U.S. imports of motor vehicles and parts from non-North American trading partners.

D. Bars represent the share of global GDP accounted for by countries that held or are expected to hold general elections in the years 2017-21. Sample includes 33 advanced economies and 142 EMDEs. Share calculated using constant 2010 U.S. dollars GDP. Shaded area indicates forecasts.

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surpass the average tariff among G20 countries (Figure 1.14.C).

Intensifying trade tensions involving major economies could increase the likelihood of global escalation in protectionist measures. An escalation of tariffs up to legally allowed bound rates could translate into a decline in global trade flows amounting to 9 percent, similar to the drop observed during the global financial crisis (Kutlina-Dimitrova and Lakatos 2017; Devarajan et al.

2018). This could eventually jeopardize progress in international cooperation and undermine past gains from the multilateral trading system.

A no-deal Brexit from the EU could have a severe impact on the United Kingdom and, to a lesser extent, on its European trading partners, in the event of large disruptions and delays at border crossings (Crowley, Exton and Han 2019; Graziano, Handley, and Limão 2018). It could also be a source of financial stability risks if it leads to an abrupt interruption in financial relationships and cross-border financial flows (Bank of England 2018). While actions have been taken to mitigate some of these risks, including regulatory agreements to avoid disruption in the derivatives markets, significant financial market stress in a no-deal event is still possible (ECB 2018). In addition, the United Kingdom accounts for a large share of cross-border lending to some EMDEs, which could be negatively impacted by a sudden retrenchment.

More generally, increasingly divided political landscapes in key countries and rising support for more inward-looking policies could contribute to heightened policy uncertainty and geopolitical risks over time. Countries holding general or parliamentary elections this year account for 35 percent of global GDP (Figure 1.14.D). These include major advanced economies (all EU member states, Canada) and EMDEs (Argentina, India, Indonesia, South Africa).

## Financial stress episodes

Renewed episodes of substantial financial market stress could have increasingly pronounced and widespread effects, in view of rising levels of indebtedness (Figure 1.15.A). Such episodes could be triggered or amplified by several factors.

First, an increase in corporate default rates amid slowing activity in major economies could lead to a rapid deterioration in financial market sentiment, a re-pricing of risks, and a spike in bond spreads for more vulnerable borrowers. The share of lower-rated corporate bond issuers has increased substantially in both advanced economies and EMDEs in recent years, indicating a drop in the quality of outstanding bond stocks



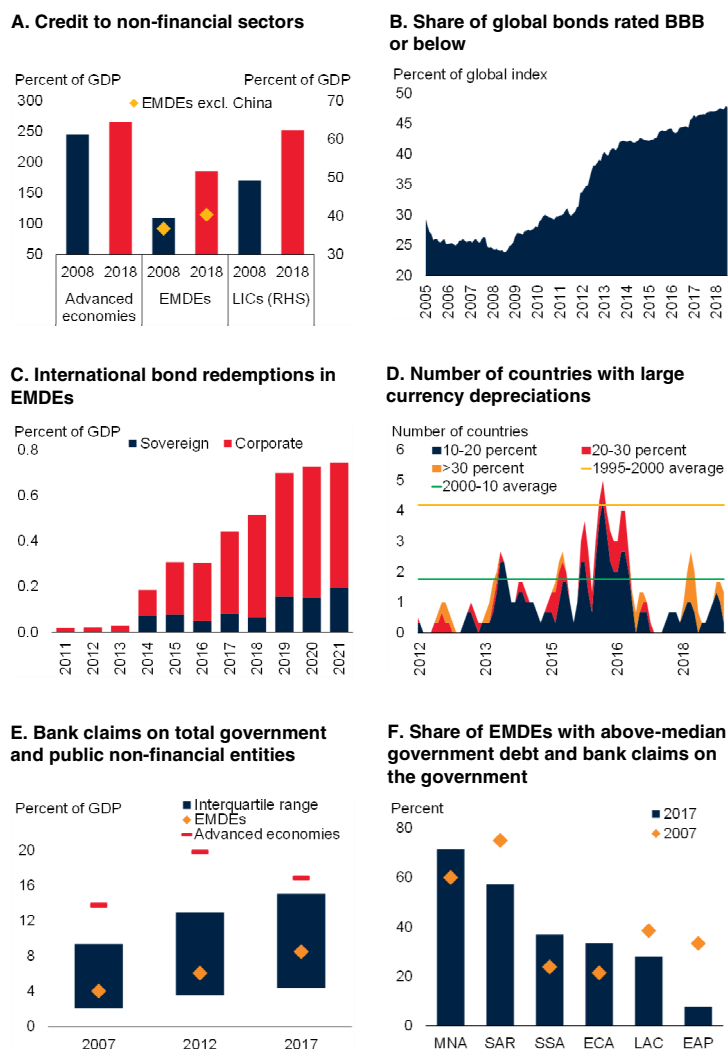
(Figure 1.15.B). A broad-based loss of investment-grade status could potentially trigger sudden pullbacks by investors (BIS 2019). Both corporate and sovereign borrowers could come under stress, especially given low interest coverage and large volumes of bond refinancing scheduled in coming years (Figure 1.15.C). A substantial re-escalation of trade tensions involving major economies could amplify this risk by dampening financial market sentiment, global trade, and investment prospects.

Second, shifting expectations about monetary policy across major economies could lead to disruptions in capital flows to EMDEs, particularly if accompanied by an appreciation of the U.S. dollar. This could be prompted, for instance, by markets repricing the possibility of additional U.S. interest hikes in the next couple of years, in contrast to current market expectations of interest rate cuts later this year and in 2020. While the risk of an abrupt increase in U.S. long-term yields has abated amid concerns about slowing activity, a faster-than-expected acceleration in U.S. wage growth or signs of an unexpected pickup in global growth could contribute to a sudden tightening of borrowing conditions. Reduced confidence in central banks' ability to deliver price stability, or perceived threats to their independence, could also contribute to greater financial and macroeconomic volatility (Berger, de Haan and Eijffinger 2001; Draghi 2018; Tucker 2018).

Third, large currency depreciations in EMDEs could amplify credit default risks. Although such events have become less frequent over time, they can still be triggered by shifts in U.S. monetary policy expectations, sharp commodity price movements, or concerns about debt sustainability or domestic policy uncertainties (Figure 1.15.D). Rising foreign ownership of local-currency bonds, and sizable shares of local-currency lending originating from foreign banks, have helped reduce immediate currency risks in some countries. However, foreign participation in local-currency debt markets can also amplify the transmission of external financing shocks to domestic borrowing conditions if liquidity dries up as investor risk sentiment deteriorates (Agur et al. 2018). A lack of central bank independence and rigid currency regimes also make it more

**FIGURE 1.15 Risk of renewed financial stress**

*Elevated global debt levels and declining credit quality increase the likelihood of financial stress episodes in EMDEs, which could be amplified by mounting refinancing needs and the possibility of dislocating currency depreciations. Growing interconnections between financial sector and sovereign risks make banks in EMDEs increasingly vulnerable to distress of their sovereigns—and vice versa.*



Source: Bank for International Settlements; Dealogic; International Monetary Fund; Kose, Kurlat, et al. (2017); World Bank.

A. Aggregates are calculated using debt and GDP in U.S. dollars. Aggregates of advanced economies and EMDEs are based on 27 countries and 16 countries, respectively, and data for 2018 are for the third quarter. Data for 2018 in low-income countries (LICs) are for the latest available quarter and sample includes 22 LICs. Total credit is measured as total credit to general government and non-financial private sector for advanced economies and EMDEs and a sum of general government debt and domestic claims on the private sector for LICs.

B. Last observation is July 2018.

C. Sovereign bonds include central government and state and local authorities. Data are as of May 22, 2019.

D. Figure shows 3-month moving averages. Depreciations are defined as negative quarterly changes in the effective exchange rate. The sample is comprised of 138 EMDEs. Last observation is December 2018.

E. Data published in the October 2018 edition of the World Bank *Macro Financial Review*.

F. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa. Blue bars indicate the share of EMDEs within each region for which general government debt and total bank claims are simultaneously above the EMDE median of the respective indicators. The EMDE median statistic for 2007 and 2017 is 34.6 and 50.7 percent for general government debt and 4.1 and 8.5 percent for bank claims on government. Sample includes 147 EMDEs.

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difficult to adjust to sharp exchange rate movements, amplifying fluctuations in domestic prices and activity in the affected countries (Special Focus 1.2; Ha, Kose, and Ohnsorge 2019). Renewed financial stress in large EMDEs, such as Argentina or Turkey, could lead to significant contagion effects if accompanied by heightened investor risk aversion and portfolio relocations among broad asset classes.

Fourth, government guarantees to the financial system, alongside large bank holdings of government debt, can create self-reinforcing feedback effects between the banking sector and sovereign risks (Dell’Ariccia et al. 2018). This sovereign-bank nexus has become more pronounced in EMDEs since the global financial crisis (Figure 1.15.E). The share of countries with both elevated public debt levels and high banking sector exposure is particularly elevated in the Middle East and North Africa and South Asia (Figure 1.15.F). In Eastern Europe and Central Asia, as well as in East Asia and Pacific, a greater source of vulnerability is the level of private sector debt, and the risk that rising corporate defaults could weaken bank balance sheets. Public sector balance sheets would be eroded if the government were to support the banking sector—that is, if contingent liabilities become actual liabilities—in episodes of stress.

### Sharper-than-expected slowdowns in major economies

Around 80 percent of advanced economies—including major European countries, Japan, and the United States—are expected to register slowing growth in 2019 (Figure 1.16.A). China’s deceleration and rebalancing toward domestic consumption and services is also expected to continue. For all of these economies, however, downside risks have intensified.

In the Euro Area, the risk of a markedly sharper-than-expected slowdown has risen on the back of significant growth disappointments since mid-2018, decelerating global trade, and elevated policy uncertainty. A further deceleration could trigger renewed financial stress in more vulnerable countries, leading to slower investment, higher unemployment, and renewed concerns about

banking sector health. Negative interest rate policies could weaken bank profitability over time and erode financial stability (Arteta et al. 2016).

In the United States, activity could be negatively affected by weaker-than-expected confidence and investment amid trade tensions with major trading partners. Deteriorating creditworthiness in the corporate sector could amplify negative shocks. A recession is unlikely in the short term, but the probability could increase as the effects of fiscal stimulus dissipate and trade policy uncertainty persists. Three of the last four U.S. recessions were triggered by financial shocks, which revealed underlying balance sheet weaknesses and led to a sudden retrenchment of activity, accentuated by the government’s inability to agree on the implementation of countercyclical fiscal measures.

China faces both external risks associated with threats of rising U.S. tariffs and domestic risks related to high corporate indebtedness in sectors with deteriorating profitability. The total stock of non-financial-sector debt is above levels seen at the peak of previous credit booms in other major EMDEs. The materialization of these risks could have significant adverse repercussions on activity. Although the authorities hold policy levers to mitigate such repercussions in the near term, continued fiscal and monetary stimulus could become ineffective over time while adding further leverage to private and public sectors. Providing stimulus through highly indebted state-owned enterprises (SOEs) may eventually undermine economy-wide productivity growth.

A combined deterioration in the outlook for the United States, the Euro Area, and China—which together accounted for about 50 percent of global GDP and almost two-thirds of global growth in 2018—would have major spillover effects for EMDEs through trade, financial, commodity, and confidence channels (Figure 1.16.B). The growing use of GVCs could contribute to the propagation of shocks across countries (Duval et al. 2016). A 1-percentage-point growth shock for these three economies would curtail global growth by 1.7 percentage points and EMDE growth (excluding China) by 1.4 percentage points after one year (Figure 1.16.C).

A pronounced slowdown in the Euro Area would most severely affect countries in Central and Eastern Europe and North Africa, because of tight trade, remittance, and banking system linkages (World Bank 2016). Financial markets in Latin America could also be adversely affected by deleveraging and de-risking measures among weakened Euro Area banks. A substantial deceleration in China would lower commodity prices worldwide, with a widespread effect on commodity exporters (Figure 1.16.D). Exposure to risks in the United States is particularly pronounced for Latin America and the Caribbean, since the United States is the single largest export destination for more than half of the countries in the region. In addition, U.S. capital markets supply a substantial share of portfolio flows to many EMDEs and a drying up of these markets would cause equity values and exchange rates to weaken significantly.

### Region-specific downside risks

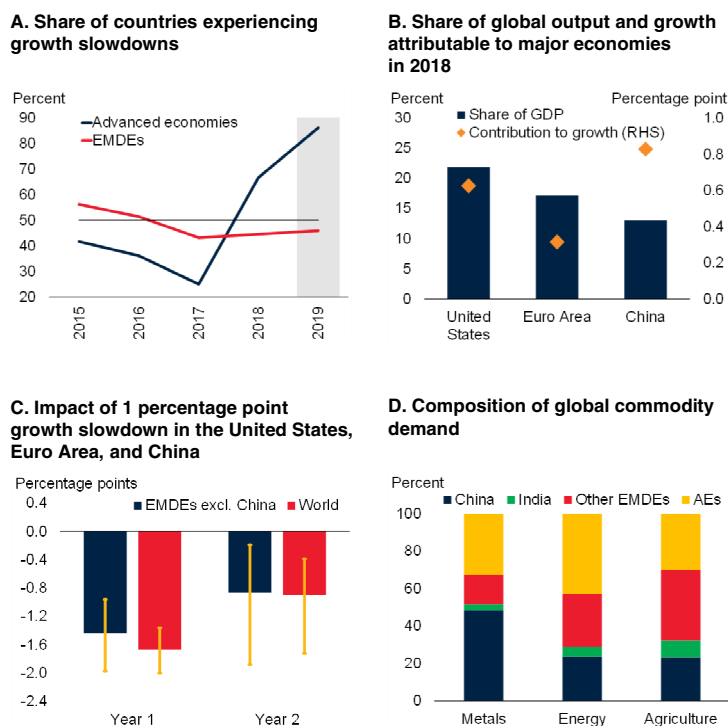
In addition to global risks, a variety of region-specific risks could dampen growth (Box 1.3; Chapter 2). Many countries remain vulnerable to financial turmoil. Further declines in trade, whether caused by slowing manufacturing activity or increased trade barriers, would impact regions that are heavily invested in value chains, such as the manufacturing hubs in East Asia and Central Europe. A significant decline in commodity prices would weigh on activity in regions with a large number of commodity exporters, which account for half of the world’s poor.

Renewed conflict in various parts of the world—the Korean Peninsula, the Middle East and North Africa, South Asia, the South China Sea, Sub-Saharan Africa, or Ukraine—could severely disrupt regional activity. Skirmishes between India and Pakistan in February are a reminder that latent geopolitical tensions can flare up at any time.

Climate change is contributing to a multitude of risks for more exposed EMDE regions (IPCC 2018). More extensive droughts and extreme heat are causing more frequent harvest failures and desertification. Rapidly spreading forest and grassland fires increasingly threaten built-up areas and resource-based industries. Cyclones of unprec-

**FIGURE 1.16 Risk of sharp slowdowns in major economies**

*A sharper-than-expected downturn in the United States, Euro Area, or China would have major spillover effects, with a slowdown in China having a disproportionate impact on commodity exporters.*



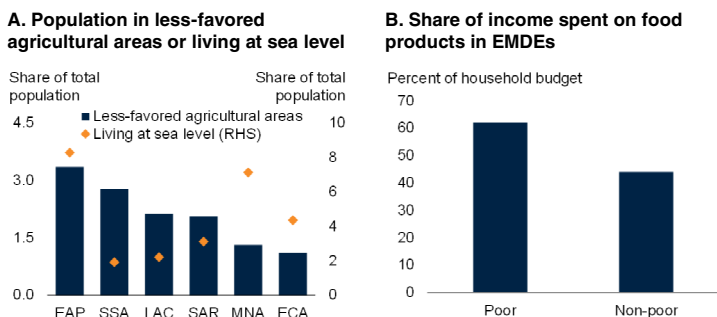
Source: World Bank.  
 A. Growth slowdowns are declines of at least 0.1 percentage point change in growth. Sample includes 36 advanced economies and 146 EMDEs.  
 B. Figure is calculated using constant 2010 U.S. dollar GDP. Major economies includes China, the Euro Area, and the United States.  
 C. Bars are the impulse response to a 1 percentage point decline in the United States, Euro Area, and China. Yellow error lines are the 16-84 percent confidence intervals. Based on the vector autoregression model presented in World Bank (2016). The sample includes 22 advanced economies and 19 EMDEs.  
 D. AEs = advanced economies. Figure shows 2010-17 average. Sample for energy and metals includes 18 advanced economies and 33 "other" EMDEs. Agriculture includes 14 advanced economies and 117 "other" EMDEs.  
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edented power have already caused catastrophic floods in agricultural plains and heavily populated river deltas and mudslides in mountainous regions. Rising sea levels threaten low-lying islands and coastal regions.

Due to their location and topography, small island developing states are particularly vulnerable to extreme weather events, which is exacerbated by limited infrastructure and a lack of financial resources (World Bank 2017d). Countries with large populations working on agricultural lands with difficult terrain, poor soil quality, or limited rainfall, including many in Sub-Saharan Africa

## FIGURE 1.17 Climate risks and poverty

In several EMDE regions, populations in vulnerable rural and sea level areas are particularly exposed to climate risks. The extreme poor are more susceptible to food price shocks.



Source: Barbier and Hochard (2018); Laborde, Lakatos, and Martin (2019); World Bank.

A. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa. Less-favored agricultural areas are agricultural lands constrained by difficult terrain, poor soil quality, limited rainfall, or with limited access to markets. "Sea level" identifies areas where elevation is below 5 meters. Data are from 2010.

B. Simple averages across 31 countries. For further details, refer to Laborde, Lakatos, and Martin (2019).

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and South Asia, face growing risks from changing weather patterns (Figure 1.17.A). Poor people are disproportionately affected by climate change as they tend to live in riskier areas such as lower terrain in flood plain areas or on steep, eroded, and unstable hillsides. They also depend heavily on agriculture for income, and lack the savings and access to borrowing that can help them cope with disasters (Hallegatte et al. 2016; World Bank 2019g). The poor also spend higher shares of their income on food, making them more vulnerable to food price spikes that follow local harvest failures (Figure 1.17.B; Laborde, Lakatos, and Martin 2019).

## Policy challenges

### Challenges in advanced economies

*Many advanced economies have limited fiscal or monetary policy space to respond to a severe downturn. Low policy rates leave little room for further conventional monetary loosening. Elevated debt tends to limit the magnitude and effectiveness of fiscal stimulus. Coordinated policy action may be needed in the event of a severe slowdown. Policies to boost investment and productivity would bolster long-term growth prospects, and over time help restore space for effective macroeconomic policy.*

### Monetary and financial policies

With the notable exception of the United States, the room for conventional monetary policy easing is limited in most advanced economies, as policy rates remain at or near zero (Figure 1.18.A). Indeed, central banks have responded to recent weakness in growth principally by providing additional forward guidance, making inexpensive credit available to banks, and adjusting their balance sheets.

After the financial crisis, such unconventional policies were a necessary complement to central banks' conventional policy rate cuts amid weak aggregate demand and declining neutral interest rates (Christensen and Rudebusch 2019). Now, given the lack of conventional policy space in most advanced economies, central banks may again be forced to respond to a negative shock mostly or entirely with unconventional policies. It is not clear that they will be as effective as conventional policies in such a scenario. There is evidence of decreasing returns to scale in quantitative easing (Figure 1.18.B; Reza, Santor, and Suchanek 2015). Over time, negative interest rates can also pose problems for bank profitability, and hence for the availability of bank credit (Arteta et al. 2016). The effectiveness of forward guidance may be significantly reduced in the presence of borrowing constraints and uninsurable risks (McKay, Nakamura, and Steinsson 2016). Furthermore, any perceived loss of central bank independence could substantially reduce the effectiveness of monetary policy. Maintaining clear and credible monetary policy is key for macroeconomic and financial stability.

Protracted periods of low interest rates could encourage excessive risk taking which, combined with declining creditworthiness, may result in financial instability (Figure 1.18.C). Rigorous macroprudential monitoring and regulation is essential to prevent such outcomes.

### Fiscal policy

Even though public debt is high and rising in most advanced economies, many governments can borrow money at near-zero or negative rates. Persistently low borrowing costs provide credit-



worthy countries with additional fiscal space—they can sustain small deficits without increasing debt-to-GDP ratios (Figure 1.18.D; Blanchard 2019; Rachel and Summers 2019; Kose, Kurlat, et al. 2017).

Fiscal space may, however, be eroded by a sudden fall in nominal growth or rise in borrowing costs. Moreover, even in the present low-interest-rate environment, many advanced economies have deficits that would put the ratio of government debt to GDP on a persistent upward path, a trend that is exacerbated by weak potential growth.

The debt-to-GDP ratio that is sustainable varies considerably by country and over time. A persistently rising debt ratio exposes public finances to the risk of a sharp rise in borrowing costs. It also reduces policymakers’ ability to respond to a slowdown with deficit spending, both because there is less room for additional borrowing and because stimulus tends to be less effective when countries have weak fiscal positions (Huidrom et al. 2019).

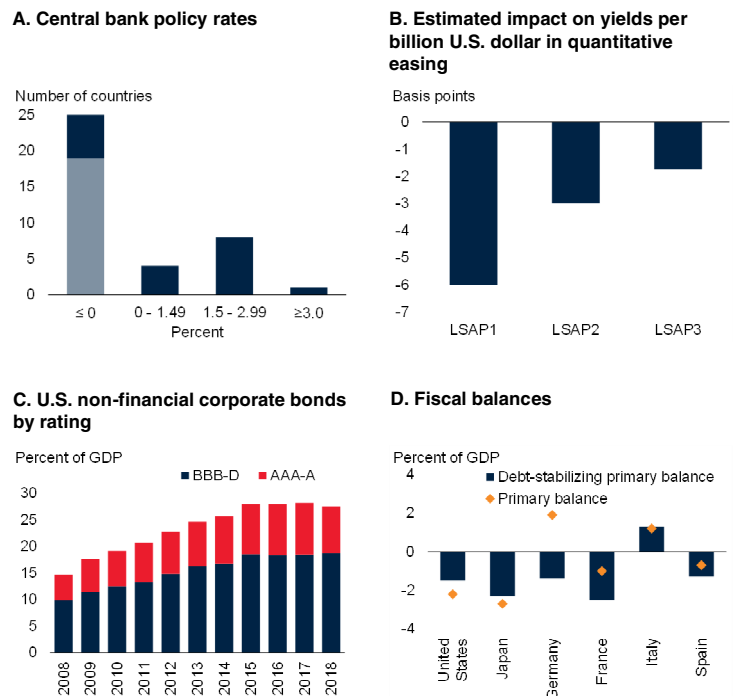
A severe slowdown in activity may require a strong, timely, and well-coordinated response, reminiscent to that undertaken during the global financial crisis. Simultaneous fiscal expansion can speed the recovery from crisis, as the positive impact of fiscal stimulus in one country spills over into its neighbors, thus magnifying the impact of limited fiscal space.

*Structural policies*

Expectations for long-term growth in advanced economies have fallen sharply in recent years due to a combination of demographic headwinds, weak productivity, and slowing investment (Figure 1.19.A; World Bank 2018c, 2018b). On the fiscal front, the prospect of slower growth implies less fiscal space to respond to shocks since government revenues will be reduced, and the primary balance needed to stabilize debt will be increased (Figure 1.19.B). For monetary policy, weak long-term investment growth lowers the underlying demand for funds, reducing equilibrium interest rates and providing less space for conventional monetary policy to respond to an economic slowdown (Laubach and Williams 2016).

**FIGURE 1.18 Monetary and fiscal policies in advanced economies**

*Policy rates in most advanced economies remain at or near zero, limiting the conventional response to a downturn. Unconventional responses may exhibit diminishing returns. A rising share of lower-rated corporate debt calls for macroprudential vigilance. Many economies have deficits well in excess of debt-stabilizing levels.*



Source: Bloomberg; European Central Bank; Haver Analytics; Krishnamurthy and Vissing-Jorgensen (2013); Kose, Kurlat, et al. (2017, data available at <http://www.worldbank.org/en/research/brief/fiscal-space>); National Sources; World Bank.

A. Sample includes 37 advanced economies. Light blue area indicates Euro Area countries. Last observation is April 2019.

B. Estimates from Krishnamurthy and Vissing-Jorgensen (2013). LSAP = Large-Scale Asset Purchase. LSAP1: December 2008–March 2010; LSAP2: November 2010–June 2011; LSAP3 = Maturity Extension Program (MEP): September 2011–December 2012.

C. Data are calculated using the ICE (Intercontinental Exchange) Merrill Lynch investment-grade and high-yield bond indexes, excluding cash and the issues of financial firms, as of the last trading day of December for each year shown. Face values as percentage of U.S. nominal GDP.

D. The debt-stabilizing primary balance is the primary balance needed to stabilize debt at its current level and is calculated as  $(\frac{1+\gamma}{i-\gamma})d^*$ , where  $i$  is the nominal long-term interest rate,  $\gamma$  is nominal GDP growth, and  $d^*$  is the target debt ratio in percent of GDP. The nominal long-term interest rate is the country ten-year treasury bond yield at the cut-off date; nominal GDP growth is the seasonally adjusted year-on-year percentage change of GDP in local currency in 2018; the target debt ratio is the 2018 level of debt for each country.

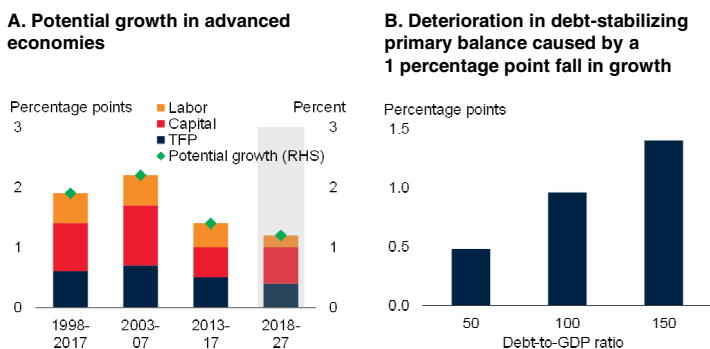
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Governments can promote stronger long-term activity, and restore policy space, by pursuing growth-enhancing structural reforms that improve the business climate, build physical and human capital, promote labor market flexibility, encourage labor force participation, and foster the adoption of new technologies. A free, fair, and rules-based global trade system boosts global potential by allowing capital to flow to its most productive locale, lowering costs for both



## FIGURE 1.19 Structural policies in advanced economies

Declining labor force growth and weak productivity are reducing long-term growth expectations. Weak growth magnifies the burden of previously issued debt, eroding fiscal space.



Source: Haver Analytics; Kose, Kurlat, et al. (2017, data available at <http://www.worldbank.org/en/research/brief/fiscal-space>); Organisation for Economic Co-operation and Development; World Bank. A. TFP = total factor productivity growth. Figure shows potential growth estimates based on production function approach. For further details on potential growth estimates, refer to the January 2018 edition of the *Global Economic Prospects* report. Aggregates calculated using constant 2010 U.S. dollar GDP weights. Sample includes 30 advanced economies. Shaded area indicates forecasts. B. The debt-stabilizing primary balance is the primary balance needed to stabilize debt at its current level and is calculated as  $\left(\frac{i-\gamma}{1+\gamma}\right) d^*$ , where  $i$  is the nominal long-term interest rate,  $\gamma$  is nominal GDP growth, and  $d^*$  is the target debt ratio in percent of GDP. Calculations assume a country with 2 percent interest rates and nominal growth falling from 4 to 3 percent.

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businesses and consumers. By allowing economies to produce the goods and services in which they have a comparative advantage, such a system encourages the efficient use of resources and the growth of real incomes.

### Challenges in emerging market and developing economies

*EMDEs need to reinforce macroeconomic frameworks to improve resilience to shocks, particularly in countries with high debt levels. Given limited fiscal space and large investment needs to meet critical development goals, policymakers need to ensure that public spending is cost effective and growth enhancing and that policy environments are conducive to private-sector-led solutions. Structural reforms aimed at bolstering the business climate could also significantly bolster prospects. Improving access to reliable and affordable infrastructure, leveraging productivity-enhancing technologies, and buttressing institutional quality can help remove key bottlenecks to activity. Building resilience to extreme weather events, and boosting agricultural productivity is also a key priority in countries with large and poor rural populations. China's main policy challenges are to*

*manage disruptions associated with heightened trade tensions and to gradually shift to a more balanced and sustainable growth path and support an orderly deleveraging process.*

### Policy challenges in China

In response to trade tensions with the United States, as well as softening exports and domestic demand, authorities have provided monetary and fiscal support, while stepping up structural reform efforts. Monetary policy loosening has mainly taken the form of cuts to bank reserve requirements. On the fiscal front, the authorities have reduced value added and social security tax rates, and boosted public investment spending by increasing the ability of local governments to issue bonds. The business environment is likely to benefit from new laws protecting foreign investors and strengthening intellectual property rights. The authorities' commitment to macroeconomic stability and structural reforms was reaffirmed in March (SCPRC 2019).

China's immediate policy challenge is to manage disruptions caused by trade tensions with the United States without exacerbating domestic vulnerabilities. In the longer term, the country's key challenge is to continue its gradual shift to more balanced growth, while reducing the financial stability risks stemming from high levels of corporate debt (World Bank 2019e). Continued reforms toward more sustainable growth need to be combined with efforts to improve the business environment, support innovation, strengthen intellectual property rights, enhance competition and financial discipline, reduce barriers to entry, boost productivity, and foster household consumption (World Bank 2018g). These reforms would also contribute to achieving a comprehensive resolution of trade disputes with the United States and bolster China's growth prospects.

The opening of China's financial system to international investors—as illustrated by the country's inclusion in various global bond and equity benchmark indexes—will require prudent management. Slowing growth in the working-age population is becoming an increasing drag on

long-term growth; however, this could be offset by productivity-enhancing investments in health, education, and research and development (World Bank 2018c).

*EMDE monetary and financial policies*

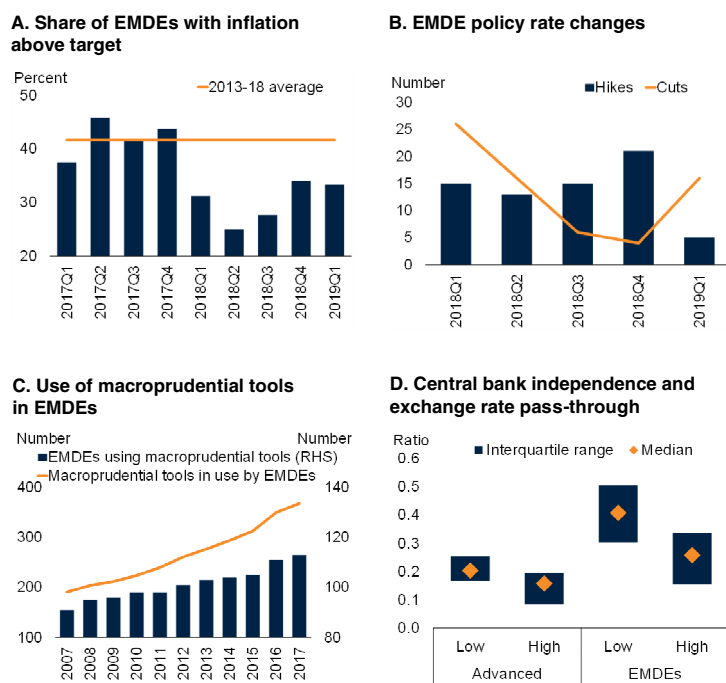
The waning impact of previous currency depreciations and of the 2017-18 rebound in energy prices has helped tame inflation in early 2019 (Figure 1.20.A). Monetary policy tightening has, therefore, paused in many EMDEs, and some have eased their policy stance (Figure 1.20.B). However, underlying inflationary pressures are still present in many countries and recent oil price increases are expected to add to these pressures. In addition, while external financing conditions have eased somewhat, the currently benign market sentiment could change abruptly. This could reignite short-term capital outflows and force procyclical monetary policy tightening.

The most vulnerable EMDEs tend to be highly indebted, to have borrowed extensively in foreign currencies, or to rely on short-term capital inflows to finance their current accounts. Sharp depreciations that accompany short-term capital outflows are often contractionary, particularly in countries with elevated foreign-currency-denominated debt, as they both increase debt burdens and reduce the value of collateral on corporate balance sheets (Korinek 2018; Serena and Sousa 2018). The adverse impact of these disruptions can be amplified further by tight linkages between sovereign and private sector risks.

Central banks and regulators need to bolster policy frameworks in order to confront future shocks, particularly in countries where rising public and private debt-to-GDP ratios are increasing exposure to currency, interest rates, or debt-rollover risks. The resilience of banking and corporate sectors can be enhanced by implementing macroprudential policies that prevent the buildup of systemic risk. Since the global financial crisis, EMDEs have significantly increased the number and coverage of macroprudential measures, such as countercyclical capital buffers and limits on foreign-currency borrowing (Figure 1.20.C; Cerutti, Claessens, and Laeven 2017). Shoring up central bank

**FIGURE 1.20 EMDE monetary policy**

*Moderating inflation in EMDEs led some central banks to ease policy rates in the first half of 2019. Since the global financial crisis, there has been a substantial increase in the number and coverage of macroprudential measures across EMDEs. Greater central bank independence and transparency would help reduce the impact of currency movements on domestic inflation.*



Source: Cerutti, Claessens, and Laeven (2018); Haver Analytics; World Bank.  
 A. The 2013-18 average is 41.7 percent. Last observation is 2019Q1, which includes available data through May 22, 2019. Unbalanced sample includes 48 EMDEs with announced inflation targets.  
 B. Unbalanced sample includes 70 EMDEs and excludes Argentina and Venezuela. Last observation is 2019Q1, which reflects available data up to May 22, 2019.  
 C. Data is based on the 2018 update of Cerutti, Claessens, and Laeven (2017). Sample includes 155 EMDEs.  
 D. Exchange rate pass-through after one year driven by a monetary policy shock. Estimated from factor-augmented vector autoregression models for 26 EMDEs over 1998-2017. A positive pass-through means that a currency depreciation associated with an easing of monetary policy leading to higher inflation after one year. Bars show the interquartile range and markers represent the median across countries. The central bank independence index is computed by Dincer and Eichengreen (2014). Low and high central bank independence are defined as below or above the sample average.  
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independence and transparency could also help boost confidence and enhance the policy room to maneuver. This can be particularly effective in limiting the impact of currency depreciations on inflation (Figure 1.20.D; Carrière-Swallow et al. 2017; Eichler and Littke 2018; Special Focus 1.2). In turn, this reinforces the shock-absorbing capacity of market-driven exchange rate movements.

In LICs, monetary policy transmission channels are often weaker than in other EMDEs as financial markets are less deep. This underscores the need

for LIC central banks to provide a credible anchor in order to maintain price stability (Ha, Kose, and Ohnsorge 2019).

### *EMDE fiscal policy*

Fiscal deficits and debt levels are rising in many EMDEs, increasing their vulnerability to tighter financing conditions and potentially constraining their capacity to implement countercyclical fiscal policy and growth-enhancing investments. Generally benign external financing conditions in recent years have allowed EMDE sovereigns and firms to notably increase the amount of debt issued on international bond markets (Figure 1.21.A; Fuertes and Serena 2018; Serena and Moreno 2016). However, rising debt is often associated with growing external vulnerabilities—a majority of countries that recently experienced pressures had deficits in excess of 4 percent of GDP (Figure 1.21.B).

Looking forward, EMDEs need to strike a balance between taking advantage of current low interest rates and the potentially adverse consequences of excessive debt accumulation (Box 1.1). Countries with sound fiscal positions and with fiscal frameworks that help ensure long-term sustainability can borrow at low interest rates to support growth-enhancing investments. However, countries with constrained fiscal positions should prioritize measures to reduce fiscal deficits, lengthen the maturity of existing debt, improve the quality of spending, and raise tax collection and compliance, particularly in LICs (World Bank 2019a).

In countries where sovereign default risks are high, undertaking fiscal consolidation to address long-term debt sustainability can help restore market confidence, and increase the space for future policy actions (Figure 1.21.C; Ilzetzki, Mendoza, and Végh. 2013; Aizenman et al. 2019). Just as stronger bank balance sheets reduce the risk of financial sector problems affecting the sovereign, a stronger government balance sheet can help reduce the risk that domestic banks are affected by sovereign distress.

While restoring fiscal space is an important priority, EMDE governments can minimize the

negative consequences of tighter budgets by preserving growth-enhancing spending and implementing tax reforms that support investment and revenue mobilization (Ramey 2019). Such reforms may include broadening the tax base, eliminating loopholes and unnecessary preferences (for example, avoiding base erosion and profit shifting), and strengthening tax administration and collection to reduce avoidance or evasion (OECD 2017). Improving the effectiveness and efficiency of public spending can help governments provide important services without sacrificing fiscal space (Herrera and Ouedraogo 2018).

Restoring fiscal space ensures that EMDE policymakers are able to act should downside risks materialize. Government stimulus tends to elicit a weaker demand response when fiscal space is narrow and government debt is elevated (Figure 1.21.D; Brinca et al. 2016; Hagedorn, Manovskii, Mitman 2019; Huidrom et al. 2019). The introduction or improvement of fiscal stabilizers can also help smooth the business cycle (Amra, Hanusch, and Jooste 2019).

### *EMDE structural policies*

Unless countered by comprehensive structural reforms, adverse demographic trends in an increasing number of countries, and weak productivity growth, are likely to result in a further deterioration in EMDE growth potential over the next decade (Figure 1.22.A). Weakening external demand from major economies and elevated trade policy uncertainty also highlight the need to address the most pressing impediments to domestic and regional growth and to renew commitments to trade liberalization. An improved multilateral rules-based trading system remains the first line of defense against protectionist tendencies and could yield previously untapped development opportunities for many EMDEs.

The implementation of structural reforms to improve the business climate and foster private investment and job creation would substantially bolster the growth outlook. This is particularly important given current fiscal constraints and large investment needs (Special Focus 1.1). Estimates of

the infrastructure spending required to meet the Sustainable Development Goals by 2030 range between 4.5 to 8.2 percent of EMDE GDP, depending on policy choices and the quality and quantity of infrastructure services (Rozenberg and Fay 2019). Business climates and institutions can be strengthened to support productivity and unlock private investments to meet future needs.

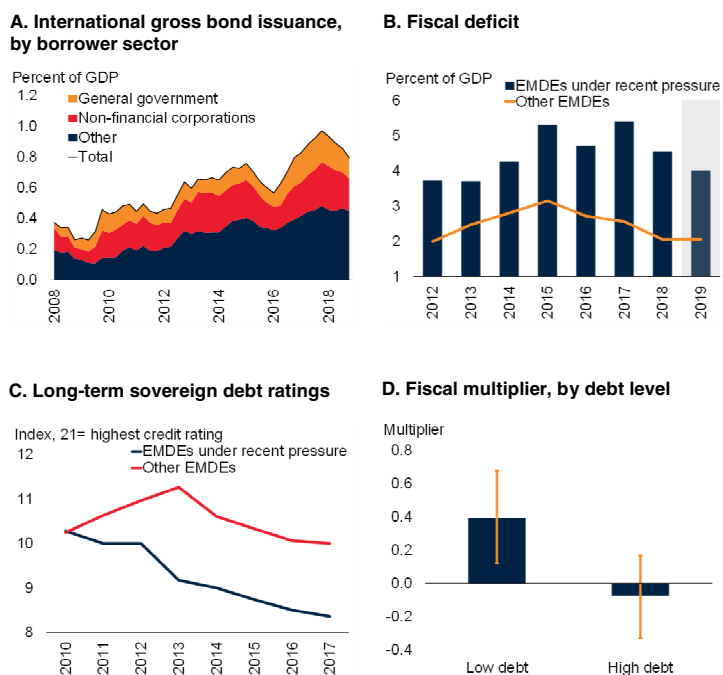
Key priorities include increasing access to reliable and affordable electricity, improving transport services, leveraging digital technologies, and improving business climates. Raising agricultural productivity could substantially boost development opportunities in countries with large rural populations, as well as increase the resilience of the rural sector to extreme weather events. Effective social safety nets and active labor market policies are also key to manage economic, social, and environmental risks.

**Access to electricity.** Limited access to electricity is a drag on economic activity in many EMDEs—particularly in LICs, as electricity infrastructure is either inadequate or plagued by frequent outages (Andersen and Dalgaard 2013; Blimpo and Cosgrove-Davies 2019; Special Focus 2.1). Policymakers in the affected countries should prioritize critical investment to ensure reliable, cost-effective, and sustainable power generation. Policy actions need to achieve both access to affordable electricity for the poor, as well as adequate profitability for power utilities. Such reforms include reviewing costly and regressive energy subsidies, minimizing losses in transmission and distribution, and ensuring payment of electricity bills (Kojima and Trimble 2016). Small-grid solutions and renewable energy may also expand access to electricity (World Bank 2018h). Moreover, operation and maintenance—an often-neglected component of effective power generation—need to be budgeted with a reliable source of funding (Rozenberg and Fay 2019).

**Logistics and transportation.** Inefficient logistics and inadequate transport infrastructure are key growth bottlenecks in many EMDEs, raising the cost of doing business and reducing the potential for domestic and international integration. Reform priorities include the removal of

**FIGURE 1.21 EMDE fiscal policy**

*Low borrowing costs and ample availability of credit have allowed governments to borrow heavily on international markets. Fiscal deficits are declining, but persist at elevated levels in many countries, especially those that have recently faced financial pressures. Government stimulus tends to be less effective when debt is high.*



Source: Bank for International Settlements; Huidrom et al. (2019); International Monetary Fund; J.P. Morgan; Kose, Kurlat, et al. (2017, data available at <http://www.worldbank.org/en/research/brief/fiscal-space>); World Bank.

A. Figure shows 4-quarter moving averages of gross-bond issuance. "Other" includes central banks and public and private financial institutions. Last observation is 2018Q4.  
 B. Shaded area indicates forecasts.  
 B. C. EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia).  
 C. Sovereign ratings are converted to a numerical scale ranking from 1 to 21, as estimated by Kose, Kurlat, et al. (2017). A higher ranking indicates a better rating (in other words, less likely to have a sovereign default episode).  
 D. Figure shows fiscal multipliers 2 years from impact based on estimates from the IPVAR model of Huidrom et al. (2019). An economy is considered to have low debt when government debt is below 40 percent of GDP and high debt when it exceeds 60 percent of GDP. Orange lines represent 16-84 percent confidence bands.

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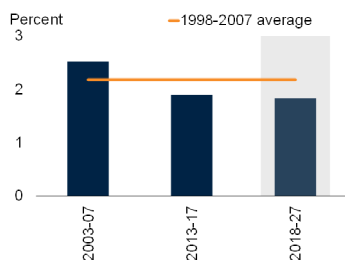
regulatory barriers such as impediments to entry in trucking, brokerage, terminal and warehousing operations; as well as greater reliance on market mechanisms and private sector participation (World Bank 2018i). Mobility and market access can also be bolstered by prioritizing cost-effective transport infrastructures. Appropriate land-use planning and urbanization policies can substantially reduce the cost of meeting transport needs, while minimizing carbon footprints (Rozenberg and Fay 2019; Figure 1.22.B).



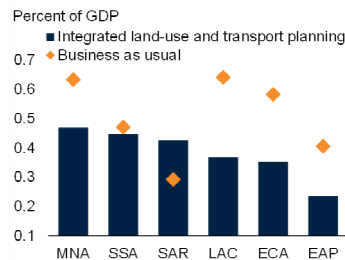
## FIGURE 1.22 EMDE structural policies

Productivity growth is lackluster in EMDEs. Investment needs in transport are large but costs can be reduced with appropriate land-use planning in most regions. Upgrading economic complexity and government effectiveness closer to advanced-economy levels could yield large growth dividends, particularly in Sub-Saharan Africa. Weak governance and unfavorable business climates are also associated with significantly higher poverty rates, highlighting the importance of structural reforms that bolster the business climate in EMDEs.

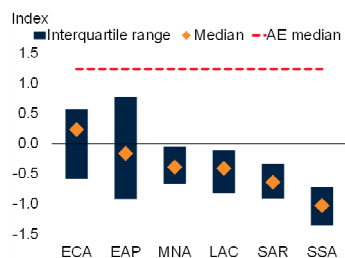
### A. Total factor productivity growth in EMDEs



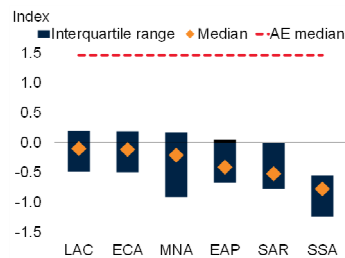
### B. Investment needs in urban transport to meet Sustainable Development Goals



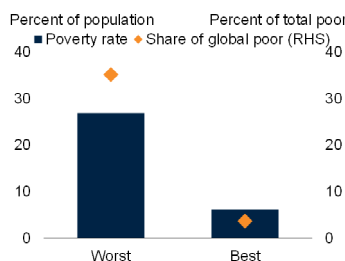
### C. Economic Complexity Index, 2014-16



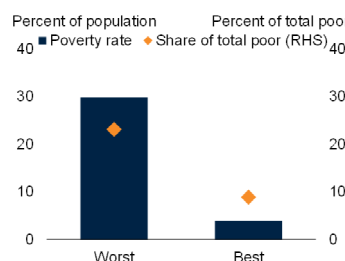
### D. Government effectiveness, 2014-16



### E. Poverty, by regulatory quality



### F. Poverty, by Ease of Doing Business



Source: Observatory of Economic Complexity, Penn World Tables, Rozenberg and Fay (2019), World Bank.

Note: TFP = Total factor productivity. AE = Advanced economies, EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

A. Shaded area indicates forecasts. GDP-weighted averages of production function-based potential TFP growth estimates. Sample includes 50 EMDEs.

B. Figure shows estimates from Rozenberg and Fay (2019). Data cover the years 2015 to 2030.

C. The Economic Complexity Index (ECI) measures the relative knowledge intensity of exports. Higher values indicate higher degree of economic complexity. Sample includes 96 EMDEs and 31 AEs.

D. The indicator reflects the perceptions of the quality of public services, the quality of civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Higher values indicate better quality. Sample includes 150 EMDEs and 36 AEs.

E. The poverty rate is an unweighted average in each group. "Best" indicates quartile of EMDEs with the strongest regulatory quality (based on data for year with latest poverty data). "Worst" indicates quartile of EMDEs with the weakest regulatory quality. The back data for regulatory quality has been taken from the World Governance Indicators. The data is for 2017.

F. The poverty rate is an unweighted average in each group. "Best" indicates quartile of EMDEs with the highest 2019 Ease of Doing Business score (above 67.5). "Worst" indicates quartile of EMDEs with the lowest 2019 Ease of Doing Business score (below 51.6).

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Improved cross-border connectivity can also help foster intraregional trade and diversification, as well as encourage higher domestic value-added content in production. This may particularly help Sub-Saharan Africa—which, together with South Asia, has considerably lower export complexity than other EMDE regions and significantly higher intraregional trade costs (Figure 1.22.C; UNECA 2018).

**Digital technologies.** More widespread adoption of digital technologies, including in the delivery of financial and public sector services, could further boost productivity by helping spread innovation and improving both private sector and government efficiency (Baldwin 2019). In countries with large informal sectors, widespread adoption of these digital technologies could help expand tax bases through the fiscalization of informal sector transactions. New technologies are more likely to be adopted successfully if policies are in place to mitigate the costs of adjustment for both workers and firms, and if market failures are addressed (World Bank 2019h). Policy measures that prioritize investment in human capital are needed to ensure that digital technologies promote inclusive growth. Digital technologies are also expected to further contribute to the reduction of trade costs and an increase in trade flows (WTO 2018). However, the spread of digital technologies will also likely affect the composition of trade by increasing the services value-added component, changing patterns of comparative advantage, and affecting the complexity and length of global value chains.

**Governance and business climate.** Better institutional quality—such as control of corruption and rent-seeking, fair application of the rule of law, protection of property rights, and political stability—is associated with more innovation, increased financial access, and stronger investment growth (Berkowitz, Lin, and Ma 2015). Governance reforms can lead to sizable productivity gains, particularly in countries furthest away from best practices, many of which are in Sub-Saharan Africa (Bhattacharyya 2009; Cusolito and Maloney 2018; Acemoglu, Johnson, and Robinson 2005; Figure 1.22.D). Improving the business climate by simplifying tax and



regulatory requirements and ensuring clarity and predictability for investors is another effective way to support private investment and productivity. Better governance and business climates can also help reduce the likelihood of corruption, informality, and extreme poverty (Demenet et al. 2016; Djankov et al. 2018; Lawless 2013; Paunov 2016; Figures 1.22.E and F).

**Agricultural productivity, climate risks, and poverty.** The effects of climate change are becoming increasingly visible. The poor are disproportionately affected by climate risks as they tend to live in more vulnerable areas, depend on income sources such as agriculture that are often susceptible to climate shocks, and lack the savings and access to borrowing that can help them cope with natural disasters (World Bank 2019g). Many EMDEs in Sub-Saharan Africa and South Asia have large agricultural sectors that are subject to extreme weather events and other environmental stresses. Agriculture accounts for at least a third of

GDP in most LICs, and climate risks are presenting severe challenges in many of them (Special Focus 2.1).

Productivity-enhancing measures in the agricultural sector—including improved irrigation, better access to markets, effective use of fertilizers and new technologies—could benefit the two-thirds of the global poor who earn their livelihood from farming (World Bank Forthcoming). Improved institutions and policy buffers can enhance resilience to climate change, as they provide the resources needed to support victims of extreme events. Investment in climate-smart infrastructure, combined with appropriate land-use planning, can help mitigate those risks. Effective social safety nets and productive inclusion programs also have an important role to play in protecting the most vulnerable, acting as a countercyclical buffer during economic downturns, and facilitating transitions to productive employment.

**TABLE 1.2 Emerging market and developing economies<sup>1</sup>**

Commodity exporters <sup>2</sup>		Commodity importers <sup>3</sup>	
Albania*	Madagascar	Afghanistan	Panama
Algeria*	Malawi	Antigua and Barbuda	Philippines
Angola*	Malaysia*	Bahamas, The	Poland
Argentina	Mali	Bangladesh	Romania
Armenia	Mauritania	Barbados	Samoa
Azerbaijan*	Mongolia	Belarus	Serbia
Bahrain*	Morocco	Bhutan	Seychelles
Belize	Mozambique	Bosnia and Herzegovina	Solomon Islands
Benin	Myanmar*	Bulgaria	Sri Lanka
Bolivia*	Namibia	Cabo Verde	St. Kitts and Nevis
Botswana	Nicaragua	Cambodia	St. Lucia
Brazil	Niger	China	St. Vincent and the Grenadines
Burkina Faso	Nigeria*	Comoros	Thailand
Burundi	Oman*	Croatia	Tonga
Cameroon*	Papua New Guinea	Djibouti	Tunisia
Chad*	Paraguay	Dominica	Turkey
Chile	Peru	Dominican Republic	Tuvalu
Colombia*	Qatar*	Egypt	Vanuatu
Congo, Dem. Rep.	Russia*	El Salvador	Vietnam
Congo, Rep.*	Rwanda	Eritrea	
Costa Rica	Saudi Arabia*	Eswatini	
Côte d'Ivoire	Senegal	Fiji	
Ecuador*	Sierra Leone	Georgia	
Equatorial Guinea*	South Africa	Grenada	
Ethiopia	Sudan*	Haiti	
Gabon*	Suriname	Hungary	
Gambia, The	Tajikistan	India	
Ghana*	Tanzania	Jamaica	
Guatemala	Timor-Leste*	Jordan	
Guinea	Togo	Kiribati	
Guinea-Bissau	Trinidad and Tobago*	Lebanon	
Guyana	Turkmenistan*	Lesotho	
Honduras	Uganda	Maldives	
Indonesia*	Ukraine	Marshall Islands	
Iran*	United Arab Emirates*	Mauritius	
Iraq*	Uruguay	Mexico	
Kazakhstan*	Uzbekistan	Micronesia, Fed. Sts.	
Kenya	West Bank and Gaza	Moldova, Rep.	
Kosovo	Zambia	Montenegro	
Kuwait*	Zimbabwe	Nepal	
Kyrgyz Republic		North Macedonia	
Lao PDR		Pakistan	
Liberia		Palau	

\* Energy exporters.

1. Emerging market and developing economies (EMDEs) include all those that are not classified as advanced economies and for which a forecast is published for this report. Dependent territories are excluded. Advanced economies include Australia; Austria; Belgium; Canada; Cyprus; the Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hong Kong SAR, China; Iceland; Ireland; Israel; Italy; Japan; the Republic of Korea; Latvia; Lithuania; Luxembourg; Malta; Netherlands; New Zealand; Norway; Portugal; Singapore; the Slovak Republic; Slovenia; Spain; Sweden; Switzerland; the United Kingdom; and the United States.

2. An economy is defined as commodity exporter when, on average in 2012-14, either (i) total commodities exports accounted for 30 percent or more of total goods exports or (ii) exports of any single commodity accounted for 20 percent or more of total goods exports. Economies for which these thresholds were met as a result of re-exports were excluded. When data were not available, judgment was used. This taxonomy results in the classification of some well-diversified economies as importers, even if they are exporters of certain commodities (e.g., Mexico).

3. Commodity importers are all EMDEs that are not classified as commodity exporters.

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