The global economy is transitioning into what is likely to be a smoother and less volatile period. However, the recovery is uneven. For high-income countries, fiscal consolidation, high unemployment and still weak consumer and business confidence will continue to dampen growth this year, while growth in the developing world will be solid but weaker than during the pre-crisis boom period.

Financial conditions in advanced economies have improved … but growth remains sluggish

Financial market risk indicators, such as credit default swap rates, sovereign debt yields, and stock-market volatility indicators have all improved significantly since June 2012. Although the challenges faced by high-income countries to restore financial-sector health, reform institutions and get fiscal policy back onto a sustainable path persist, the likelihood that these challenges will provoke a major crisis has declined markedly. Despite this, real-side activity remains sluggish, especially in Europe, where it is being held back by weak confidence and continued banking sector and fiscal restructuring. The recovery is on more solid ground in the United States, where a fairly robust private sector recovery is being held back, but not extinguished by fiscal tightening. Meanwhile, in Japan, a dramatic relaxation of macroeconomic policy appears to have sparked an uptick in activity, at least over the short-term.

Global GDP is expected to expand about 2.2 percent this year and strengthen to 3.0 percent and 3.3 percent in 2014 and 2015. For high-income countries, growth this year will be a modest 1.2 percent, firming to 2.0 percent in 2014 and 2.3 percent by 2015. The Euro Area is now estimated to contract by 0.6 percent in 2013, compared with the previous forecast of 0.1 percent, and is projected to slowly improve to a modest 0.9 percent in 2014 and 1.5 percent in 2015.

In the developing world, growth is solid but muted …

The story for developing countries is, for the most part, rosier. Developing economies have more or less completely recovered from the 2008 crisis and less volatile external conditions are expected to yield a gradual acceleration of activity in developing regions.

Developing-country GDP is now projected to be around 5.1 percent in 2013, strengthening to 5.6 percent and 5.7 percent in 2014 and 2015, respectively. Growth in several middle income countries has been held back by supply bottlenecks and is unlikely to reach pre-crisis rates unless supply-side reforms are pursued vigorously. In China also, growth has slowed as authorities seek to rebalance the economy. Looking at broader region-wide trends, East Asia is expected to grow by 7.3 percent this year; developing Europe and Central Asia by 2.8 percent; Latin America by 3.3 percent; Middle East & North Africa (MENA) by 2.5 percent; South Asia by 5.2 percent and Sub-Saharan Africa by 4.9 percent.

However, developing countries are not a homogenous group, and policy prescriptions need to be tailored accordingly:

- Several fast growing economies in East Asia, Sub-Saharan Africa and a few in Latin America, are at risk of overheating. Tighter macroeconomic policy stances are warranted to reduce vulnerabilities in these economies.
- Weak growth in the face of capacity constraints in some economies, requires supply side structural policy reforms to boost potential growth, notably in Brazil, India, Russia, and South Africa. Large output gaps in developing Europe and in several MENA economies are a cause of concern. In the former, limited macroeconomic space necessitates reforms to improve competitiveness, while in the latter, an easing in political tensions and conflicts and urgent structural reforms are needed to boost growth, improve the business environment and create jobs.

- The remaining countries are doing fine. Output gaps in most developing economies are small, and appear to be closing and policy appears broadly to be on track.

Developing countries face new risks …

Even as the post-crisis risks from the high-income world have declined in importance, a new set of uncertainties and risks are emerging or gaining in stature. For instance, developing countries are increasingly concerned about:

- **The potential effects of the radical relaxation of both fiscal and monetary policy in Japan.** This could reduce developing countries' competitiveness in markets in which they directly compete with Japan, due to the 21 percent real-effective depreciation of the Yen since September 2012, and exacerbate overheating economies, particularly in East Asia, through increased capital flows.
- **A faster than expected decline in commodity prices.** Since early 2011, industrial commodity prices have been weakening, a process that appears to have intensified in 2013, despite signs that the global economy was gaining strength. Indeed, since their peak in early 2011, the price of metals and minerals are down 30 percent, and that of energy is down 14 percent. If commodity prices were to decline even faster than expected, commodity exporting developing countries could experience serious fiscal setbacks and weaker growth, although commodity importers would stand to gain.
- **Domestic challenges, including inflationary pressures and asset price bubbles, and weaker than pre-crisis growth rates.** Increasingly the problems facing developing countries are domestic and the solutions will have to be found locally. For the many countries operating at close to or even above full capacity, macroeconomic policy may need to be tightened, both to re-establish fiscal space that was used up in response to the crisis, but also to prevent inflationary pressures and asset bubbles from building up.
- **The challenges of the withdrawal of quantitative easing in the United States.** The withdrawal or unwinding of highly accommodative monetary policy stances in the US and other high income economies is raising the specter of higher borrowing costs for developing countries. Countries that have run up private and public-sector debt during the low-interest period could be particularly vulnerable, as would be countries with relatively weak domestic financial sectors, and elevated current account or government deficits.

Domestic solutions hold key to future growth …

Developing countries have navigated the crisis and the immediate post-crisis period very well. As the global economy moves into the new, more stable phase and as acute risks from high income economies diminish, developing countries will have to pay more attention to domestic challenges and look to domestic solutions to boost growth, competitiveness and employment. They will also have to keep a close eye on the nature of evolving external risks, including from shifts in commodity prices and the withdrawal of quantitative easing by high income economies over the medium term.

Overall, with the demand gaps opened up by the crisis largely filled, future growth will increasingly be determined by the success with which countries succeed in addressing supply-side bottlenecks, including gaps in physical, social, and regulatory infrastructure. To achieve higher growth on a sustained basis, all developing countries will need to redouble efforts to restore and preserve macroeconomic stability, improve governance, simplify regulations, opening up to trade and foreign investment and investing in infrastructure and human capital. For it is these policies that have underpinned the acceleration in developing country growth over the past 20 years and it is only through continued reform and progress that the strong productivity growth of the past 20 years can be maintained.

Table 1.1 The global outlook in summary
(percentage change from previous year, except interest rates and oil price)

	2011	2012	2013e	2014f	2015f
Global Conditions					
World Trade Volume (GNFS)	6.2	2.7	4.0	5.0	5.4
Commodity Prices (USD terms)					
Non-oil commodities	20.7	-9.5	-4.7	-1.1	-1.5
Oil Price (US$ per barrel) [1]	104.0	105.0	102.4	101.0	101.0
International capital flows to developing countries (% of GDP)					
Developing countries					
Net private and official inflows	5.2	5.0	4.7	4.4	4.3
Net private inflows (equity + debt)	5.0	4.9	4.7	4.4	4.3
East Asia and Pacific	5.7	4.6	4.2	3.9	3.8
Europe and Central Asia	5.5	5.7	6.5	6.1	6.0
Latin America and Caribbean	5.4	6.4	5.9	5.5	5.3
Middle East and N. Africa	1.3	1.4	1.1	1.4	1.7
South Asia	3.3	4.0	3.6	3.4	3.3
Sub-Saharan Africa	4.2	3.5	3.8	3.9	4.2
Real GDP growth [2]					
World	**2.8**	**2.3**	**2.2**	**3.0**	**3.3**
Memo item: World (PPP weights) [3]	3.8	2.9	3.1	3.8	4.1
High income	**1.7**	**1.3**	**1.2**	**2.0**	**2.3**
Euro Area	1.5	-0.5	-0.6	0.9	1.5
Japan	-0.5	2.0	1.4	1.4	1.3
United States	1.8	2.2	2.0	2.8	3.0
Developing countries	**6.0**	**5.0**	**5.1**	**5.6**	**5.7**
East Asia and Pacific	8.3	7.5	7.3	7.5	7.5
Europe and Central Asia	5.7	2.7	2.8	3.8	4.2
Latin America and Caribbean	4.4	3.0	3.3	3.9	3.8
Middle East and N. Africa	-2.2	3.5	2.5	3.5	4.2
South Asia	7.3	4.8	5.2	6.0	6.4
Sub-Saharan Africa	4.7	4.4	4.9	5.2	5.4

Source: World Bank.
Notes: PPP = purchasing power parity; e = estimate; f = forecast.
1. Simple average of Dubai, Brent and West Texas Intermediate.
2. Aggregate growth rates calculated using constant 2005 dollars GDP weights.
3. Calculated using 2005 PPP weights.