

Number PB03-2

April 2003

International Economics Policy Briefs

Global Economic Prospects: Through the Fog of Uncertainty

Michael Mussa

Michael Mussa, senior fellow, served as economic counselor and director of the research department at the International Monetary Fund from 1991 to 2001. He served as a member of the US Council of Economic Advisers from August 1986 to September 1988 and was a faculty member of the Graduate School of Business of the University of Chicago (1976–91) and the department of economics at the University of Rochester (1971–76). He is the author of Argentina and the Fund: From Triumph to Tragedy (2002). He has written extensively on international economics, macroeconomics, monetary economics, and municipal finance.

© Institute for International Economics. All rights reserved.

The global economic recovery lost considerable momentum in late 2002 and appears likely to remain sluggish through the first half of 2003 before accelerating again late this year and in 2004. The escalation of world oil prices and uncertainties surrounding the economic effects of the US-led invasion of Iraq are key factors contributing to the current slowdown and clouding near-term economic prospects. While the risks of ongoing military operations—especially

the level of casualties and longer-term political consequences—are still difficult to assess, the most likely scenario is a rapid removal of the present Iraqi regime without enduring damage to Iraq's economic infrastructure. This should be followed by bounce-back in consumer and business confidence and in financial market sentiment and by a de-escalation of world oil prices—all contributing to a strengthening of growth in the second half of this year and beyond.

The escalation of world oil prices and uncertainties surrounding the economic effects of the US-led invasion of Iraq are key factors contributing to the current slowdown and clouding near-term economic prospects.

Overall, real GDP growth for this year, on a fourth quarter to fourth quarter (Q4/Q4) basis, should probably run at about last year's estimated pace of 3¼ percent—about ½ percent below global potential. Global growth on a year-over-year basis will be ¼ percent stronger than last year's estimated 2¾ percent result. This reflects an estimate of somewhat stronger performance of developing and transition countries for 2003—attributable largely to a partial recovery of Latin America from a disastrous year in 2002.

Table 1 Summary of global growth prospects (annual percentage real GDP growth rates)

Country or region	Year-over-year			Q4/Q4		
	2002	2003	2004	2002	2003	2004
Industrial countries	1¾	1¾	2½	2½	2	3
Developing and transition countries	4	4½	5	4	4 ½	5¼
World (WEO weights)	2¾	3	3¾	3¾	3¾	4

WEO = IMF's *World Economic Outlook*.

As in most recent years, the performance of the US economy will be particularly important for the global result both because of the relative size of the US economy and its influence on economic outcomes elsewhere. (The US economy accounts for 22 percent of world GDP on a WEO weighting scheme using PPP-based exchange rates and for over 30 percent of world GDP valued at current market exchange rates.) Evidence of continued strong productivity growth, together with a growing population of working age, suggests that the

Global growth on a year-over-year basis will be ¼ percent stronger than last year's estimated 2¾ percent result.

potential US GDP growth is about 3¾ percent. A variety of offsetting positive and negative short-term influences suggest that actual real GDP growth will run slightly below potential this year—as it did last year.

The economy of Western Europe is nearly as large as that of the United States. In the context of a general global recovery, its performance last year was particularly disappointing. Indeed, real GDP growth Q4/Q4 in the euro area barely reached 1 percent, leaving actual growth well below potential. Moreover, an important part of real GDP growth in the euro area was due to gains in net exports rather than to rising domestic demand—indicating that the euro area was sucking demand from the rest of the world in a period of global economic weakness. The German economy was particularly weak. For 2003, prospects appear modestly better. Assuming some pick-up in the second half, real GDP growth

Q4/Q4 in Western Europe should reach 1½ percent—a result that would still be below potential. This expectation of improvement, however, is based mainly on the faith in the general forces of global recovery and on lower oil prices. Economic policy in Western Europe is doing little, if anything, to improve growth performance.

The export-led recovery of the Japanese economy appears now to be petering out, despite 2½ percent real GDP growth during 2002. With recent indicators pointing to a slowdown in early 2003 and economic policy effectively paralyzed, growth this year is projected to reach about 1 percent Q4/Q4, and this also depends primarily on the general forces likely to propel a reacceleration of global growth.

Looking to developing countries, Asia was the strongest performing region last year, and, again led by China and India, should turn in a respectable performance in 2003, with Q4/Q4 growth for the region as a whole of 4½ percent. Latin America should show substantial improvement in this year's growth, up to 3 percent Q4/Q4, after a miserable year in 2002. The situations in individual Latin American countries, however, will again differ considerably, depending mainly on domestic economic and noneconomic developments. In particular, while important progress in restoring market confidence by the Lula administration has significantly improved Brazil's near-term prospects, the situation remains uncertain.

Most of Central and Eastern Europe should maintain moderately good growth. But, Turkey faces major uncertainties arising from developments associated with Iraq and from the need to sustain and improve market confidence to deal with the challenges of a very large public debt. For the countries of the Middle East, war in Iraq is also a key uncertainty. Higher oil prices are a boost for the oil exporters, but (beyond Iraq itself) military conflict has important negatives for several

countries. For Africa, the oil-exporting countries should see some benefit from higher world oil prices, and some other commodity exporters are also benefiting from higher commodity prices, including gold. As always, countries experiencing intense political difficulties and/or civil wars tend to suffer economically as well.

Before turning to somewhat greater detail about economic forces likely to shape developments in different countries and regions of the world economy, it is useful to consider the global economic uncertainties arising from the war in Iraq.

Assessing the Potential Economic Effects of War in Iraq

As the likelihood of war in Iraq escalated through mid-March, world oil prices shot up to nearly \$40 per barrel, global equity markets plummeted, and indices of consumer sentiment fell sharply in both the United States and Western Europe. With the actual onset of hostilities, early success in securing Iraq's southern oil fields (with only minimal damage) and hopes for a very short war induced both a sharp drop in world oil prices (to well under \$30 per barrel) and a substantial recovery in global equity markets. Then, as hopes for a sudden, virtually bloodless victory faded, oil prices recovered to around \$30 per barrel and equity prices retreated but remained above their pre-war lows. Markets appear now to anticipate substantial hostilities lasting for several more weeks—even though the ultimate outcome of the war is not seriously in doubt.

While it goes on, media attention throughout much of the world will likely remain focused on the war in Iraq. The economic significance of the war, however, is not well measured by this intense media focus. Specifically, while short-term damage to Iraq's economy from the war will be substantial, Iraq's real GDP amounts to no more than about one-tenth of 1 percent of world real GDP (of about \$45 trillion evaluated at WEO exchange rates). Adverse economic effects of the war on some of Iraq's neighbors could also be significant, but here too the implications for world GDP are small.

As in the Gulf War of 1990–91, the principal impact of the present Iraq situation on the world economy will come through the effect on world oil and energy prices. Indeed, since in the summer of 2002, world oil prices appear to have embodied a premium of about \$4 to \$5 per barrel (above a baseline price of \$22 to \$24 per barrel) because of concerns about the Iraq situation. The world oil price hit \$30 per barrel in November and December as supplies from Venezuela were cut by the strike against President Chavez. More recently, a colder-than-normal winter

in the United States has contributed to a reduction of commercial oil inventories to very low levels and put further upward pressure on world oil prices.

Oil futures prices provide a guide to how oil-market professionals expect that the world oil price is likely to evolve over coming months and years. With Iraq's southern oil fields now secure and little apparent danger to oil production elsewhere in the Gulf, oil futures markets now anticipate that prices will fall back to near-baseline levels by this summer.

*As in the Gulf War of 1990–91,
the principal impact of the present Iraq
situation on the world economy will
come through the effect on world oil
and energy prices.*

Based on the actual evolution of world oil prices since mid-2002 and on oil futures prices looking forward, it now appears that from mid-2002 through mid-2003, world oil prices will run, on average, about \$5 per barrel above the \$22 to \$24 per barrel baseline. This implies an increased cost to oil consumers and an increased return to oil producers, of about \$150 billion over this 12-month period.

In the short run, this transfer from consumers to producers tends to depress global aggregate demand, probably by about \$75 billion. With a multiplier effect of about 2, the depressive effect on global output (reflected primarily in year-over-year real GDP growth for 2003) should be about \$150 billion or about half of 1 percent of world GDP (aggregated at market exchange rates because oil is priced at market exchange rates). Of this negative shock, perhaps two-thirds should be attributed to developments related to Iraq, implying that the negative effect through world oil prices of the Iraq situation amounts to about one-third of 1 percent of world GDP.

To this effect, one should add a small allowance for the direct negative impact of the war on Iraq and on its neighbors, and a somewhat larger allowance for the broader economic effects of the recent deterioration of consumer sentiment and world equity values apparently associated with the war. All told, this suggests that a plausible estimate of the negative impact of the Iraq war on world GDP for 2003 should amount to about half of 1 percent of GDP—or about \$200 billion (taking into account some positive effects of the war on government purchases primarily in the United States). If the war

should last, with continuing high levels of casualties, through May and beyond, the adverse impact on consumer and business sentiment, on equity values, and possibly on oil prices, however, could become significantly larger, and, correspondingly, world real GDP would be more adversely affected.

The Americas

As in most recent years, the behavior of the US economy last year told much of the story of the behavior of the world economy. During 2002, US real GDP grew by 3 percent Q4/Q4, versus my year-ago forecast of 4 percent growth. As expected, consumer spending and residential investment remained strong, and both inventory investment and government purchases made sizeable contributions to real GDP growth. Recovery of business investment in equipment and software,

As in most recent years, the behavior of the US economy last year told much of the story of the behavior of the world economy. During 2002, US real GDP grew by 3 percent Q4/Q4, versus my year-ago forecast of 4 percent growth.

however, was somewhat disappointing, while investment in nonresidential structures continued to decline sharply. Deterioration in US real net exports continued at a somewhat faster pace than (I had) anticipated.

On the positive side, US productivity growth was quite strong, suggesting that potential real GDP growth for the US economy remains somewhat above 3 percent per year. Normally in an economic recovery, the pattern is for actual GDP growth to somewhat outpace potential as economic slack is gradually eliminated. Expansionary monetary and fiscal policies should be expected to aid in achieving this result during 2003 and 2004.

Other short-term factors, however, point to US growth somewhat below potential during 2003. In particular, recent data relevant to growth during the first quarter and forward-looking indicators for growth in the second quarter suggest that real GDP growth will run at no more than about a 2 percent rate during the first half of the year. After that, assuming that the war in Iraq is successfully concluded, recovery of business and consumer

confidence and lower oil prices should contribute to an acceleration of real GDP growth to about a 4 percent annual rate. This suggests a Q4/Q4 growth forecast of 2¾ percent and a year-over-year forecast of 2¼ percent. As business investment strengthens further, the acceleration in the second half should continue into next year, leaving growth for 2004 between 3½ and 4 percent.

For the main components of US GDP, it may be expected that personal consumption will continue to grow but less proportionately than total GDP as the boosts from tax cuts and mortgage refinancings begin to peter out. Residential investment will probably show little or no further advance, but a continued very easy stance of US monetary policy (in the face of growth continuing below potential) should imply no dramatic turndown in the housing sector. Business investment in equipment and software should continue to gather pace (especially in the second half), reinforced by replacement demand for relatively short-lived capital equipment, and inventory investment should make a further modest contribution to GDP growth. Investment in nonresidential structures should make a much smaller negative contribution to GDP growth; and less of a negative is a positive. Despite pressures on budgets of state and local governments, government purchases should show additional modest gains (reflecting increased federal spending on defense and homeland security). The weakening of the US dollar (and some pay back for the exceptionally bad result in the fourth quarter of 2002) should help cut the negative contribution of real net exports to real GDP growth during 2003 to only half its negative contribution for 2002.

Concerning US macroeconomic policies, the Federal Reserve is likely to maintain a very accommodative stance and may even cut the federal funds rate further if the economy continues to look weak. At some point, once the recovery begins to regain forward momentum, the Federal Reserve will need to start to reverse its extraordinarily easy posture, but I would expect this late this year at the earliest. Meanwhile, the weakening of the foreign exchange value of the US dollar over the past year is providing some additional easing of overall monetary conditions. For fiscal policy, it now appears that President Bush may get only part of his proposed tax cuts through the Congress. In any event, the economic effect of these tax cuts is likely to be felt more in 2004 than in 2003—perhaps not an entirely undesired outcome from a political perspective.

For the past four years, Canada has had the strongest growing G-7 economy, and it appears likely to repeat that performance in 2003. Indeed, the strong performance of the Canadian economy

led the Bank of Canada to begin tightening monetary policy during 2002, when all other G-7 countries were continuing to ease. With evidence now of some pick up of inflationary pressures, and with no more than limited remaining margins of slack, some further monetary tightening is probably on the agenda. This suggests that real GDP growth in Canada during 2003 will not much exceed the 3 percent now projected for the United States, and Canadian real GDP growth for 2004 will probably continue at about a 3¼ percent rate.

Last year, as expected, the economic recovery in Mexico lagged somewhat behind that in the United States, with Mexican real GDP registering

While important progress in restoring market confidence by the Lula administration has significantly improved Brazil's near-term prospects, the situation remains uncertain.

only a 1 percent year-over-year gain. But, growth did pick up to nearly 2 percent in the second half. The depreciation of the Mexican peso (relative to a generally weakening US dollar) should help support the Mexican economy this year, and will probably more than offset the economic impact of some recent tightening in Mexican monetary policy. Real GDP may be expected to grow 3 percent this year, followed by 4½ percent growth in 2004 as the US economy also accelerates.

For Latin America as a whole, 2002 was a very poor year—because of disastrous outcomes in Argentina, Uruguay, and Venezuela and lackluster performances elsewhere in the region. This year should see a marked improvement in growth—from minus 1½ percent to plus 2½ percent on a year-over-year basis. Although economic activity will remain well below its 1998 peak, the Argentine economy (where recovery began last summer) should rebound from minus 11 percent growth in 2002 to plus 5 percent growth for 2003. Uruguay, where real GDP also fell about 11 percent last year, will not experience a repeat disaster this year—although the problems of a large public debt remain unresolved. Only in Venezuela is this year's drop in real GDP likely to match or exceed last year's 9 percent decline.

In Brazil, the Lula administration has so far enjoyed remarkable success, both in establishing domestic support for a credible economic policy

program and in reassuring international capital markets—as reflected in a precipitous drop in the spreads on Brazilian government debt in international bond markets. Short-term domestic interest rates, however, have had to be raised substantially (from 18 percent to 26.5 percent) to combat the surge of inflation resulting from last year's exchange rate depreciation and the large injections of liquidity needed to keep domestic interest rates down before the elections. On balance, concerns about the possible need for a debt restructuring have clearly receded. But, remaining concerns in this area, together with the restrictive effects of tighter monetary policy and an austere fiscal policy, point to a cautious (but above consensus) forecast for real GDP growth of 2¼ percent for 2003 and 3 percent for 2004.

Elsewhere in Latin America, Chile's growth rate may be expected to pick up to 3½ percent from 2 percent in 2002, as the effects of monetary easing spur domestic demand and as growth in the region picks up. For Peru, in contrast, there will probably be some slowing from last year's 5 percent growth. The smaller economies of South and Central America should generally expect moderately stronger growth in 2003 and some further pick up in 2004.

Europe

While not a disaster like much of Latin America, last year's economic performance of Western Europe, especially the euro area, was quite disappointing. Real GDP growth in the euro area was only 1¼ percent Q4/Q4 and two-thirds of 1 percent year-over-year. This is well below the area's potential growth rate of about 2¼ percent. Moreover, with the current account balance of the euro area showing substantial improvement last year, it is clear that growth of domestic demand fell meaningfully short of the meager growth of real GDP. At a time when global growth was falling short of potential due to weakness of global demand growth, the euro area was both sucking demand out of the rest of the world economy and falling well short of its own growth potential. Inadequate response of economic policy, particularly monetary policy, during both 2001 and 2002 was an important reason the disappointingly sluggish growth of demand in the euro area—probably accounting for a shortfall of about one percentage point of GDP by the end of last year.

Looking to this year and next, growth in the euro area is likely to pick up somewhat. After a sluggish first half, the normal forces of cyclical recovery, aided by lower oil prices, should strengthen growth in the second half, yielding Q4/Q4 real GDP growth

of about 1¼ percent—the same as last year. Growth of domestic demand, however, should be somewhat stronger than last year, offsetting the effect of the strengthening of the euro that will tend to depress output growth relative to demand growth. To overcome this depressive factor and provide a boost to demand and output growth, some further easing of short-term interest rates by the European Central Bank (ECB) is both likely and desirable. This will help set the stage for demand and output growth during 2004 that is in line with the euro area's potential.

Fiscal policy in the euro area will be broadly neutral, with moderately expansionary policies in France and Italy slightly more than offsetting the more cautious policy in Germany. In view of medium- and longer-term fiscal challenges, this overall stance of fiscal policy is appropriate; fiscal expansion is not the desirable means to boost euro area growth in the near term. Nevertheless, the Stability and Growth Pact needs a serious rethinking. With fiscal offset coefficients of euro area countries generally in the range of 60 to 80 percent, any slowdown of growth below potential tends to be reflected, with a factor of 60 to 80 percent, in a deterioration of the budget balance. The result is that unless countries typically maintain substantial room above the 3 percent ceiling on the budget deficit, the strictures of the Stability and Growth

The euro area's largest economy, Germany, has also been its most sluggish for the past two years, and it is likely to repeat that honor in 2003.

Pact can interfere significantly with the normal and desirable operation of the automatic stabilizers. On the other hand, the effect of the Pact has clearly not been to persuade countries to maintain budget surpluses or very small deficits most of the time in order to allow room for the automatic stabilizers during periods of sluggishness.

The euro area's largest economy, Germany, has also been its most sluggish for the past two years, and it is likely to repeat that honor in 2003. This sluggishness partly reflects the character of the present global economic slowdown, which is concentrated in manufacturing and capital goods that make up a relatively large share of the German economy. It is also partly the consequence of the

overvaluation of the deutsche mark relative to other euro area currencies at the time when the euro was introduced in 1999. The absence of much progress in addressing key structural problems of the German economy, including those of the former East Germany, is another contributing factor. The first of these difficulties will be helped by a general economic recovery that can be strengthened somewhat by more appropriate policies of the ECB. The latter two difficulties will take more time to fix.

The French economy has been growing modestly faster than the euro area average for each of the last four years, and this pattern seems likely to be sustained, by a quarter of 1 percent margin, in 2003 and 2004, with French Q4/Q4 growth rates of 1½ percent and 2½ percent, respectively. (French pride may be enhanced by a half percentage advantage over projections for Germany's growth—although the comparison with projected US growth is less flattering.) As with the rest of the euro area, the French economy is expected to be quite sluggish in the first half of this year (reflecting higher oil prices and general global sluggishness) and then pick up momentum in the second half. The same pattern is likely to apply to the Italian economy (the euro area's third largest), with growth rates that are perhaps slightly lower than those for the French economy.

For the past two years, the economy of the United Kingdom has outperformed that of the euro area, and this is likely to be true again in 2003 with Q4/Q4 growth projected at 2 percent (essentially unchanged from Q4/Q4 growth for 2002). The recent depreciation of the sterling, however, should help promote a modest change in the pattern of growth, with less strength in consumption and residential construction and less weakness in manufacturing and fixed investment. A moderately expansive fiscal policy and modest monetary easing should help keep the UK economy growing at near potential, although the recent up tick in retail inflation and the weakness of the sterling may well limit the latitude for further monetary easing. A generally stronger global (and European) economy should help boost the United Kingdom's economic growth rate modestly upward for 2004.

For Central and Eastern Europe, 2002 was a pretty good year, with Turkey turning in more than 7 percent growth and Russia and most of the rest of the former Soviet Union growing 4 percent or better. Poland was the one country in the region where growth was distinctly sluggish (only about 1¼ percent year-over-year), although growth for the Czech Republic was also somewhat disappointing.

For 2003, the surge in world oil prices will help sustain good growth rates in Russia and the

other energy-exporting former Soviet republics. Elsewhere, higher oil prices will be a negative factor but will probably not derail generally good growth in most cases. Indeed, Poland and the Czech Republic can reasonably expect some modest rebound from their weak performances in 2002. All of this assumes that referenda scheduled in EU candidate countries go smoothly—as negative surprises would undoubtedly have economic and financial consequences.

The big question mark in the region is Turkey. With the expectation of a large bilateral support package from the United States, financial-market conditions and sentiment for Turkey strengthened early this year; domestic interest rates and

For 2003, the consensus forecast envisions virtually no growth of the Japanese economy during the year, leaving year-over-year growth at about half of 1 percent.

international interest rate spreads declined, and the Turkish equity markets and the Turkish lira strengthened. With the collapse of prospects for a large US bilateral package, conditions in Turkish financial markets have turned ugly. Equity values have plunged. Domestic interest rates and international interest rate spreads have shot up. And, the lira has collapsed to new lows. Higher domestic interest rates and international spreads and the weaker lira (which affects the domestic value of Turkey's foreign-currency-linked debt) have reignited concerns about the sustainability of Turkey's public debt dynamics. Indeed, despite passage of a budget that promises to maintain a huge primary fiscal surplus of 6½ percent of GDP, there can be little doubt that Turkey's public debt dynamics are not stable unless there is some significant improvement in financial market conditions. Such improvement may come as the present panic subsides—especially if economic spillover effects from the war in Iraq are limited and concerns about Turkey's possible direct involvement in Iraq prove unfounded. However, there remains a risk of a major financial crisis in Turkey, which would obviously have substantial negative implications for Turkey's economic growth.

Asia

In 2002, Asia was the strongest-growing region of the world economy, as it has been for most of the past three decades. This will be true again in 2003 and 2004.

To the surprise of virtually all economic forecasters, Japan turned in respectable economic performance during 2002, after a dismal year during 2001. Specifically, Q4/Q4 growth for Japan in 2002 is now estimated at 2½ percent, well above the year-ago consensus forecast of only 1 percent growth. (On a year-over-year basis, growth is now estimated at a gain of about quarter of 1 percent versus a year-ago forecast of a drop of 1 percent.) Indeed, benefiting from the general global recovery, Japanese economic growth even exceeded my very optimistic year-ago forecast of 2 percent Q4/Q4 growth.

For 2003, the consensus forecast envisions virtually no growth of the Japanese economy during the year, leaving year-over-year growth at about half of 1 percent. Partly, this pessimism reflects the fact that the preliminary estimate for Q4 2002 Japanese GDP looks somewhat strong in light of other information about recent performance of the economy, and there may be either some revision to these results or a payback in terms of lower growth results for early 2003. While sharing concerns about the Japanese quarterly GDP data, I believe that the pessimism in the consensus forecast is (once again) overdone. Reflecting higher world oil prices and the relatively weak global economy, Japanese economic growth is likely to be quite weak, even possibly negative, in the first half. But, it is reasonable to expect a recovery in Japanese growth—along with growth in the rest of the world—during the second half. On a Q4/Q4 basis, the Japanese economy should grow 1 percent during 2003, rising to 2 percent growth during 2004.

To assist in this more-favorable-than-expected growth outcome, it is important that Japanese economic policy do its utmost to support growth. With a large budget deficit and a large and rapidly growing public debt, further fiscal expansion, especially through public works spending, is not useful. With short-term money rates virtually at zero, recent efforts and monetary easing have relied on quantitative expansion of the monetary base. Some believe that these efforts have been unsuccessful, and some have argued that they pose dangers—either of future inflation or of capital losses for the Bank of Japan. In my view, the record suggests that quantitative monetary

easing (with short-term rates near zero) is not very powerful, but it is not dangerous. More effort in this direction would probably be helpful. There should be no illusion, however, that Japan's longer-term problems with a massive public debt and large implicit public liabilities through commitments to support the elderly and deal with the probable costs of bailout of the financial system will be solved by short-term measures to stimulate the economy.

In the weighting scheme used in this discussion and in the IMF's *World Economic Outlook* to calculate global GDP growth (based on purchasing power parity exchange rates), China has a weight of 12.1 percent of the world total—second only to the

War-related activities may boost economic activity in some of the smaller Gulf states, but elsewhere the effect will generally be negative, especially for Iraq itself but also probably for Jordan, Syria, and Egypt.

weight (21.4 percent) assigned to the US economy. This implies that China's growth performance has an important influence on the global outcome.

For 2002, China's officially reported real GDP growth was 8 percent. On the WEO weighting basis, this accounted for nearly one-third of the total growth of the world economy. Questions have often been raised about the quality of Chinese GDP estimates, especially whether there is a systematic tendency to overestimate real GDP growth. But, taking the official data at face value, for 2003 and 2004, the Chinese economy appears set to continue its strong growth performance of recent years, with projected growth rates of 7½ percent for both years.

India also has a substantial weight (4.7 percent) in scheme for calculating global GDP growth. Last year, India's solid growth performance (5 percent year-over-year) made a meaningful contribution to global growth. A slight pickup in India's growth (to 5½ percent) may be expected this year, as fairly expansionary monetary and fiscal policies offset the impact of higher oil prices. Growth next year should continue to be strong (despite the hope of a more restrained fiscal policy), aided by lower world oil prices and a generally more buoyant global economy. Although India's relatively closed capital account allows the public debt to be financed at moderate interest rates, the size and rate of

increase of this debt is a matter of concern. At some point, but probably not during the next two years, the accumulating problems from persistently large fiscal deficits will presumably come home to roost.

The other developing countries of Asia together account for 8.7 percent of the total weight in the WEO scheme for calculating global GDP growth. Although performances were somewhat mixed, by and large these countries' economies performed quite well in 2002, with year-over-year growth of 4½ percent. The star was Korea with 6 percent year-over-year growth, while Hong Kong and Singapore managed only 2¼ percent growth. In general in these economies, growth was slowing toward the end of last year and appears to be relatively sluggish early this year. The general slowdown in growth of global manufacturing is clearly a factor, and higher world oil prices are also hurting—especially for Korea which has a particularly heavy oil import bill. Hence, for 2003, growth for these economies appears likely to be below the outcome for 2002—down half a percentage point to 4 percent (but well below the 7 percent that I forecast a year ago). For next year, an acceleration to 5 percent growth is projected, based on generally stronger growth in the world economy and lower oil prices.

Both Australia and New Zealand had good years in 2002, recording year-over-year growth of just below and just above 4 percent, respectively. In both cases, a slowdown is expected for 2003, with year-over-year growth running about 3 percent. This is consistent with the slowdown that was occurring in both economies toward the end of last year and appears likely to continue into the early part of this year. For New Zealand, the slowdown to about 3 percent growth is likely to persist into 2004 as this appears to be the potential growth rate (or slightly above the potential growth rate) of the economy, and margins of slack are already small. For Australia there is probably greater room for a modest rebound of growth toward 4 percent in 2004—spurred by rising global growth.

The Middle East and Africa

The Middle East region had a poor year in 2002. The Israeli economy shrank about 1 percent; Saudi Arabia's economic growth was negligible (despite higher oil prices that do not directly affect the volume of output); and Egypt's economy grew only sluggishly. This year, the outcome is likely to be worse because of the war in Iraq and its economic spillover effects. War-related activities may boost economic activity in some of the smaller Gulf states, but elsewhere the effect will generally be negative, especially for Iraq itself but also probably

for Jordan, Syria, and Egypt. For 2004, economic prospects look much better—assuming that the war in Iraq has a successful conclusion and aftermath.

African economies generally had a decent year in 2002, although Nigeria's economy performed rather poorly and Côte d'Ivoire experienced severe politically related economic difficulties. With some help from higher gold prices, South Africa's economy (the largest by far in sub-Saharan Africa)

registered moderate 3 percent growth. Oil-exporting countries (aside from Nigeria) generally benefited from higher world oil prices, and the exporters of some other primary products also benefited from stronger prices. For 2003, the prospects look much the same as last year—with the outcome critically dependent, as usual, on the severity of political and social difficulties in several countries.

Table 2 Global growth prospects: Assessment as of April 2, 2003 (annualized percentage real GDP growth rates)

Country or region	Year-over-year			Q4/Q4		
	2002	2003	2004	2002	2003	2004
Industrial countries	1¾	1¾	2½	2½	2	3
United States	2½	2¼	3¾	3	2¾	3¾
Japan	¼	1½	1½	2½	1	2
Western Europe	1	1¼	2¼	1½	1½	2¼
United Kingdom	1½	2	2½	2	2¼	2½
Euro area	¾	1	2	1¼	1¼	2¼
Germany	¼	¾	1¾	¾	1	1¾
France	¼	1¼	2¼	1¾	1½	2½
Italy	½	1¼	2¼	1	1½	2¼
Developing and transition countries	4	4½	5	4	4½	5¼
Asia	6½	6	6¼			
China	8	7½	7½			
India	5	5 ½	5½			
Others	4¾	4	5			
Latin America	-1½	2¼	3¾			
Argentina	-11	5	4			
Brazil	1½	2¼	3			
Mexico	1	3	4½			
Central and Eastern Europe	4¾	3½	4¼			
Middle East	1½	½	3			
Africa	3	3	3			
World (WEO weights)	2¾	3	3¾	3¾	3¾	4

The views expressed in this publication are those of the author. This publication is part of the overall program of the Institute, as endorsed by its Board of Directors, but does not necessarily reflect the views of individual members of the Board or the Advisory Committee.