The global economy got off to a bumpy start this year buffeted by poor weather in the United States, financial market turbulence and the conflict in Ukraine. As a result, global growth projections for 2014 have been marked down from 3.2 percent in January to 2.8 percent now. Despite the early weakness, growth is expected to pick up speed as the year progresses and world GDP is projected to expand by 3.4 percent in 2015 and 3.5 percent in 2016 – broadly in line with earlier forecasts. When expressed in 2010 Purchasing Power Parity terms, global growth is projected to accelerate from 3.1 percent in 2013 to 3.4, 4.0, and 4.2 percent in each of 2014, 2015 and 2016.

High-income country recovery is underway

The bulk of the acceleration will come from high-income countries (notably the United States and the Euro Area). A reduced drag on growth from fiscal consolidation, improving labor market conditions and a steady release of pent-up demand in these countries are projected to overcome first quarter softness and lift high-income GDP growth to 1.9 percent in 2014, from 1.3 percent in 2013, and to 2.4 and 2.5 percent in 2015 and 2016.

Developing country growth to pick up slowly …

The outlook for developing countries is for flat growth in 2014. This marks the third year in a row of sub-5 percent growth and reflects a more challenging post-crisis global economic environment. The flat yearly profile masks an expected firming of activity during the course of 2014, with developing country growth reaching 5.4 and 5.5 percent in 2015 and 2016 — broadly in line with potential.

The outlook reflects countervailing forces. On the one hand, the high-income acceleration will supply an important tailwind, with their contribution to global growth expected to rise from less than 40 percent in 2013 to nearly 50 percent in 2015. As a result, high-income import demand is projected to accelerate from 1.9 percent growth last year to 4.2 percent in 2014 and as much as 5.0 percent in 2016, and developing country exports from 3.7 percent last year to 6.6 percent by 2016.

Developing country growth will not be more robust in part because most developing economies are already fully recovered from the crisis and growing at close to potential. Moreover, in the medium-term, global financial conditions will tighten. However, given substantial further credit easing in the Euro Area, when that tightening will occur has become less certain. Other factors arguing against a more buoyant acceleration include restructuring in China, a gradual move towards a more neutral policy stance in developing countries and, for commodity exporters, stable or even declining commodity prices.

Regional prospects vary

Supply-side bottlenecks will preclude stronger growth, particularly in East Asia and the Pacific; Latin America and the Caribbean; and Sub-Saharan Africa. Most economies in these regions have already completely recovered from the financial crisis and are growing at close to potential. Growth in East Asia is projected to slow modestly to 7.0 percent by 2016. Most countries in Latin America are operating at full capacity, but strengthening output in Argentina, Brazil and Mexico is projected to lift regional growth from a weak 1.9 percent this year to around 3.5 percent in 2016. In Sub-Saharan Africa GDP growth is projected to gradually firm toward 5.1 percent in 2016 from a broadly flat 4.7 percent in 2014.

In Europe and Central Asia, outturns will be affected by the conflict in Ukraine. Growth for developing countries in the region is projected to drop from 3.6 percent in 2013 to 2.4 percent this year, before firming to 3.7 and 4.0 percent in 2015 and 2016. For the broader geographic region (including high-income countries such as Russia, Poland and other Baltic economies) growth is projected to gradually firm from a low of 1.7 percent in 2014 to 3.2 percent in 2016.

In the Middle East and North Africa, and in South Asia growth is expected to pick up more brusquely. In South Asia the acceleration is expected to be focused in India, as reforms are undertaken to ease supply side constraints, particularly in energy and infrastructure. Regional growth is projected to firm from 4.8 percent in 2013, to 5.3, 5.9 and 6.3 percent in 2014, 2015, and 2016, respectively. In the Middle East, the projected rebound is more gradual, from stagnation last year, to growth of 1.9, 3.6 and 3.5 percent in each of 2014, 2015 and 2016 reflecting rising oil output in Iran and Iraq, and a partial recovery in Egypt and Jordan from the conflict-generated lows of recent years.

Global risks have declined but prospects remain sensitive to financial market volatility
High-income country based risks to the global economy have been largely eliminated, reflecting the substantial restructuring that has already occurred in both Europe and the US — although more needs to be done. High-income challenges and risks are increasingly of a medium term nature including those related to fiscal sustainability challenges and an orderly exit from unconventional monetary policy (Europe, US and Japan), deflation risks (in Europe) and the need for structural reforms to boost productivity growth. Short-term risks are less pressing and more balanced than before.

Among developing countries, short-term risks have also become less pressing, partly because earlier downside risks have been realized over the past year without generating large upheavals, and because the economic adjustments over the past year have reduced vulnerabilities. In contrast, domestic price and wage pressures remain strong and current account deficits high in Brazil and Turkey. While supportive in the short term, the fall in developing country yields since April could exacerbate underlying vulnerabilities that persist in several economies if domestic credit and demand start to expand too rapidly in response to increased financial inflows. Heightened risks in one or more of these economies could spark contagion to other countries. The baseline assumes that tensions in Ukraine will persist this year without escalating further. However, if they escalate, they could deeply shake global confidence, generating a slowdown of 1 or more percentage points of GDP in developing countries.

Over the medium-term, macroeconomic policy needs to tighten …
While smooth adjustment to the normalization of monetary policy in high income countries remains the most likely scenario, markets remain skittish. Further episodes of volatility can be anticipated as markets speculate over the timing and magnitude of shifts in macro policy.

How well developing countries will be able to navigate further episodes of volatility will depend on the strength of domestic economies and the amount of policy space available to counter shocks. Today's easy global financial conditions provide a (short) window of opportunity to put domestic economies in order. Fiscal balances have deteriorated substantially since 2007 and, despite solid growth, debt levels have increased by 10 or more percent of GDP in more than half of developing countries.

In those middle-income countries that combine high inflation, and elevated current account deficits the need to tighten macro policy is clear—especially where real interest rates are close to zero. Elsewhere, the argument for a gradual tightening of policy is more prudential in nature. Many countries would be well advised to rebuild fiscal buffers by slowly reducing deficits, especially in a medium-term environment where debt-servicing costs are likely to rise, and, in the case of commodity exporters, government revenues are likely to weaken. While credit growth is slowing, domestic financial risks remain, notably in South Asia and developing Europe and Central Asia where non-performing loans are an ongoing concern.

… Medium-term growth will have to come from structural reforms
In a world where external financial conditions are expected to tighten and remain challenging, future growth must increasingly be driven by domestic efforts to boost productivity and competitiveness. Developing countries have shown their ability to prosper even as high-income country growth and imports weakened, but to continue to do so they will need to reinvigorate domestic reforms that have taken a backseat to fire-fighting and demand management in the post-crisis period.

Ambitious and advanced reform agendas in some countries (China, Mexico and the Philippines) and past reforms in others (Colombia and Peru) are enabling these countries to better navigate global financial headwinds.

The reform plans announced since November 2013 demonstrate China's commitment to improving resource allocation and increasing the role of market forces in the economy. But rebalancing the economy, while minimizing financial instability as credit growth slows and financial reforms are implemented is a formidable task. Growth in house prices has moderated as home sales and property construction have fallen, pointing to the real-estate market and associated lending as an area of growing concern. Any hard landing could have substantial spillovers within East Asia, and to commodity exporters.

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

	2012	2013e	2014f	2015f	2016f
Global Conditions					
World Trade Volume (GNFS)	2.7	2.6	4.1	5.2	5.4
Commodity Prices (USD terms)					
Non-oil commodities	-8.6	-7.2	-2.5	-0.6	0.1
Oil Price (US$ per barrel) [1]	105.0	104.1	102.8	99.3	98.1
International capital flows to developing countries (% of GDP) [2]					
Developing countries					
Net capital inflows	5.2	5.6	5.6	5.4	5.1
East Asia and Pacific	4.8	6.1	5.9	5.4	5.0
Europe and Central Asia	7.3	6.9	8.0	8.4	8.0
Latin America and Caribbean	5.4	5.9	5.8	5.8	5.5
Middle East and N. Africa	2.3	2.2	1.7	1.8	1.8
South Asia	5.6	3.9	4.5	4.5	4.4
Sub-Saharan Africa	6.4	5.8	5.2	5.3	5.4
Real GDP growth [3]					
World	**2.5**	**2.4**	**2.8**	**3.4**	**3.5**
Memo item: World (PPP weights) [4]	3.2	3.1	3.4	4.0	4.2
High income	**1.5**	**1.3**	**1.9**	**2.4**	**2.5**
Euro Area	-0.6	-0.4	1.1	1.8	1.9
Japan	1.4	1.5	1.3	1.3	1.5
United States	2.8	1.9	2.1	3.0	3.0
Developing countries	**4.8**	**4.8**	**4.8**	**5.4**	**5.5**
East Asia and Pacific	7.4	7.2	7.1	7.1	7.0
Europe and Central Asia	1.9	3.6	2.4	3.7	4.0
Latin America and Caribbean	2.6	2.4	1.9	2.9	3.5
Middle East and N. Africa	0.6	-0.1	1.9	3.6	3.5
South Asia	5.0	4.7	5.3	5.9	6.3
Sub-Saharan Africa	3.7	4.7	4.7	5.1	5.1

Source: World Bank.
Notes: PPP = purchasing power parity; e = estimate; f = forecast.
1. Simple average of Dubai, Brent and West Texas Intermediate.
2. This edition of Global Economic Prospects introduces a new methodology for measuring international capital flows based more closely on the definitions implemented in the sixth edition of the IMF's Balance of Payments Manual. Using this methodology, capital flows to developing countries are about 0.5 percentage points higher than those reported in earlier editions of GEP, which combined data from the earlier version 5 of the Balance of Payments and the World Bank's International Debt Statistics.
3. Aggregate growth rates calculated using constant 2010 dollars GDP weights.
4. Calculated using 2010 PPP weights.