Global growth is projected to accelerate to 3.2 percent this year, up from 2.4 percent in 2013, firming further to 3.4 and 3.5 percent in 2015 and 2016, respectively. Much of the initial acceleration will reflect a pick-up in high-income country growth, which after years of extreme weakness and outright recessions, appear to be finally emerging from the global financial crisis.

Among the three major high-income economies (the United States, the Euro Area and Japan), the recovery is most advanced in the US, with GDP expanding for 10 quarters now. In the Euro Area, growth turned positive in the second quarter of 2013. However, headline growth slowed in the third quarter and a similar hesitancy can be expected in coming quarters before the recovery gains a more solid footing. In Japan, large doses of fiscal and monetary stimulus have sparked a strong cyclical upturn, but sustaining this will require structural reforms. Growth in high-income economies is expected to rise to 2.2 percent in 2014 (from 1.3 percent in 2013), increasing to 2.4 percent for each of 2015 and 2016.

Growth is firming in developing countries …

Although developing country growth in 2013 was relatively weak, at an estimated 4.8 percent, it has been firming in recent months – partly reflecting strengthening growth in high-income countries, but also a recovery from earlier weakness in large middle-income countries, such as India and China. Overall, growth in developing countries is projected to come in at 5.3 percent this year and 5.5 and 5.7 percent in 2015 and 2016, respectively. Although these growth rates are about 2.2 percentage points lower than they were during the pre-crisis boom period, the slower growth is not a cause for concern. For the most part, the stronger growth during 2003-07 reflected a cyclically unsustainable boom. Only one half of a percentage point of the slower growth expected between 2013-2016 is due to slower potential growth in developing countries.

Looking at regional trends, growth will be flat in East Asia & Pacific, at 7.2 percent this year (7.1 percent for each of 2015 and 2016). Output in developing Europe & Central Asia is projected to slowly firm from 3.4 percent in 2013, to 3.5 percent this year – rising gradually to 3.8 percent in 2016. GDP growth in Latin America & the Caribbean is projected to be a more modest 2.9 percent this year, strengthening to 3.7 percent in 2016. Output in the Middle East & North Africa continues to be held back by social and political strife. Although growth in the region is projected to accelerate from 2.8 percent this year to 3.6 percent in 2016, the acceleration will not be robust enough to cut significantly into underlying unemployment and spare capacity. Activity in South Asia should pick up from a modest 4.6 percent growth in 2013, rising to 5.7 percent this year and 6.3 and 6.7 percent in 2015 and 2016, respectively. Growth in Sub-Saharan Africa is also expected to firm, by 5.3 percent in 2014, rising to 5.5 in 2016, bolstered by continued strong investment flows.

… but prospects will be sensitive to market reactions to QE withdrawal

This year sees the start of the withdrawal of quantitative easing in the United States. The most likely scenario is for the taper to follow a relatively orderly trajectory, and for global interest rates to rise only slowly – reaching 3.6 percent only by mid-2016. The impact of an orderly tightening of financial conditions on developing-country investment and growth is expected to be modest, with capital flows to developing countries projected to ease from about 4.6 percent of developing country GDP in 2013 to 4.1 percent in 2016, as investors take advantage of higher yields in high-income countries.

So far, market reactions to the announcement and the first few days of the taper have been subdued. However, if markets react sharply as the process evolves, the impacts on developing countries, notably middle-income countries and those with financial vulnerabilities, could be much more marked. Should markets push up long-term interest rates much more quickly, they could provoke a rapid and disorderly adjustment in portfolios. In such a scenario, flows to developing countries could weaken sharply, as they did in the summer of 2013. Private capital inflows to developing countries could decline by 50 percent or more for several months, causing middle-income countries' GDP to fall relative to the baseline by as much as 1.2 percent. Economies with large current account deficits, and those that have experienced significant increases in bank lending over the past few years of low interest rates would be most at risk in such a scenario.

Strengthening trade will provide an important tailwind

While tighter financial conditions will act as a headwind for developing countries, stronger demand in high-income countries should have the opposite effect. Over the past several years, global trade has been subdued – both because of weak overall demand in high-income countries, but also because of changes in the composition of demand away from import sensitive categories of demand like investment and toward less trade creating government spending. As investment and consumer demand in high-income countries picks up, global trade (and developing country exports) is expected to accelerate, rising by 4.6 percent this year before strengthening further to 5.1 percent in 2016.

The contribution of the external sector to developing country incomes and demand will continue to be tempered by weaker commodity prices. Between their early-2011 peaks and recent lows in November 2013, the real prices of energy and food have declined by 9 and 13 percent, respectively, while those of metals and minerals have fallen by 30 percent. These downward pressures on commodity prices are expected to persist, in part reflecting the coming onstream of additional supply. In general, price risks remain weighted to the downside in commodity markets.

Prospects for developing countries are varied, with supply-side constraints a central policy challenge in East Asia & the Pacific (excluding China) and Latin America & the Caribbean, keeping growth broadly in line with potential. GDP in China is projected to stay flat in 2014 at 7.7 percent, slowing to 7.5 percent for the next two years, reflecting deleveraging and less reliance on policy-induced investment.

In Sub-Saharan Africa, continued robust investment in resource and infrastructure sectors is projected to lift growth in the medium term, despite the negative income effects of lower commodity prices. Developing Europe, with its close trade and financial ties to the Euro Area, is expected to benefit from the recovery in high-income Europe, although the slowdown in Russia (now classified as a high-income country) creates a new uncertainty for developing Central Asia.

Growth in South Asia appears to be recovering and is projected to slowly accelerate, mainly reflecting stronger growth in India, and a gradual implementation of structural reforms throughout the region. Prospects for developing countries in the Middle East remain poor, reflecting continued social and political tensions that have sapped macroeconomic strength and exacerbated the severe structural challenges inherited from the period prior to the Arab Spring.

Rebalancing, retrenchment and reforms will prove much harder to deliver than stimulus

Developing countries responded to the global financial crisis by deploying fiscal and monetary stimulus. However, with public sector and current account deficits some 3 or more percent of GDP higher in most countries, the scope for such reactions has declined greatly.

Given the risks that developing countries are facing, policy makers need to give thought now to how they would respond to a significant tightening of global financing conditions. Countries with adequate policy buffers and investor confidence may be able to rely on market mechanisms, counter-cyclical macroeconomic and prudential policies to deal with a decline in flows. In other cases, where the scope for maneuvering is more limited, countries may be forced to tighten fiscal policy to reduce financing needs or raise interest rates to incite additional inflows. Where adequate foreign reserves exist, these can be used to moderate the pace of exchange rate adjustments, while a loosening of capital inflow regulations and incentives for foreign direct investment might help smooth adjustment. Finally, by improving the longer term outlook, credible reform agendas can go a long way towards boosting investor and market confidence. This could set in motion a virtuous cycle of stronger investment, including foreign investment, and output growth over the medium term.

	2012	2013e	2014f	2015f	2016f
Global Conditions					
World Trade Volume (GNFS)	2.4	3.1	4.6	5.1	5.1
Commodity Prices (USD terms)					
Non-oil commodities	-8.6	-7.2	-2.6	-0.2	0.1
Oil Price (US$ per barrel) [1]	105.0	104.1	103.5	99.8	98.6
International capital flows to developing countries (% of GDP)					
Developing countries					
Net private and official inflows	5.1	4.7	4.3	4.3	4.2
Net private inflows (equity + debt)	5.0	4.6	4.2	4.2	4.1
East Asia and Pacific	4.7	4.4	4.0	3.9	3.7
Europe and Central Asia	7.8	6.6	6.0	6.2	6.3
Latin America and Caribbean	5.7	5.3	5.0	5.1	4.9
Middle East and N. Africa	2.1	1.5	1.1	1.6	1.7
South Asia	4.1	3.7	3.6	3.7	3.9
Sub-Saharan Africa	4.8	5.3	4.3	4.2	4.1
Real GDP growth [2]					
World	**2.5**	**2.4**	**3.2**	**3.4**	**3.5**
Memo item: World (PPP weights) [3]	2.9	2.9	3.7	3.9	4.0
High income	**1.5**	**1.3**	**2.2**	**2.4**	**2.4**
Euro Area	-0.6	-0.4	1.1	1.4	1.5
Japan	1.9	1.7	1.4	1.2	1.3
United States	2.7	1.8	2.8	2.9	3.0
Developing countries	**4.8**	**4.8**	**5.3**	**5.5**	**5.7**
East Asia and Pacific	7.4	7.2	7.2	7.1	7.1
Europe and Central Asia	2.0	3.4	3.5	3.7	3.8
Latin America and Caribbean	2.6	2.5	2.9	3.2	3.7
Middle East and N. Africa	1.5	-0.1	2.8	3.3	3.6
South Asia	4.2	4.6	5.7	6.3	6.7
Sub-Saharan Africa	3.5	4.7	5.3	5.4	5.5

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 2010 dollars GDP weights.
3. Calculated using 2010 PPP weights.