HIGHLIGHTS from Special Focus 1.1:
Investment: Subdued Prospects, Strong Needs

Key Points

- *Investment growth in emerging market and developing economies (EMDE) is expected to be subdued and below historical averages, despite a recent modest cyclical recovery that coincided with a rebound in commodity prices.*
- *Weak investment is a concern because it will further dampen long-term per capita GDP convergence, slow capital accumulation, and make achieving Sustainable Development Goals more difficult.*
- *Depending on country circumstances, the use of appropriate fiscal policy and structural reforms could generate upside potential for investment.*

Evolution of EMDE investment growth: Post-crisis weakness. Following a prolonged, broad-based slowdown that began after the global financial crisis, investment growth in EMDEs reached a modest 4.7 percent in 2018 and is expected to slow to 3.9 percent in 2019 (Figure A). In more than half of EMDEs, investment growth has been below its long-term average since 2012. China accounted for a large portion of the EMDE investment slowdown after 2010, but commodity-exporting economies also contributed (Figure B). Between 2011-15, the investment growth slowdown in EMDEs was, in almost equal measure, a reflection of weakening domestic output growth, a sharp deterioration in terms of trade for commodity exporters, and elevated private debt burdens (Figure C). The subsequent moderate recovery of investment growth starting in 2016 largely reflected improving terms of trade for commodity exporters (Figure D).

Outlook for EMDE investment: Subdued. Investment growth is expected to advance slightly in 2020 and 2021, supported by a modest cyclical recovery in commodity exporters and easier financing conditions than in recent years, but remain subdued. The long-term prospects for investment growth remain weak, however, and have been persistently downgraded since 2010. The 10-year-ahead outlook for EMDE investment growth was 3.2 percent in early 2019, more than half a percentage point lower than projected in 2018 (Figure E).

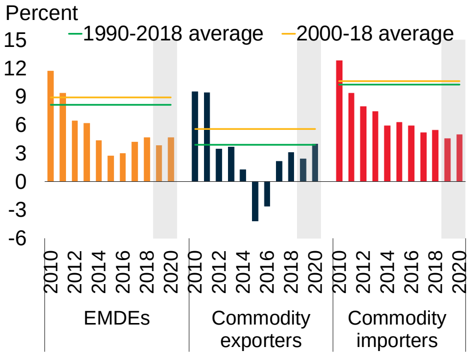
Long-term implications of weak EMDE investment. Decelerating investment growth during the post-crisis period has dampened the pace of convergence in per capita GDP between EMDEs and advanced economies and has slowed capital accumulation. Weak investment prospects raise concerns about EMDEs' ability to fulfill large infrastructure investment needs to meet the relevant Sustainable Development Goals, estimated at 4.5–8.2 percent of low and middle-income economies' combined GDP (Figure F).

Policy implications: Balance trade-offs. In light of elevated debt levels in EMDEs and lack of fiscal space, policymakers could support investment by reallocating resources to high quality projects, and by improving the efficiency of public investment management systems. Institutional reforms that improve the business climate, reduce labor and product market inefficiencies, and strengthen corporate governance could help create conducive conditions to attract investment. For commodity-exporting EMDEs, economic diversification may help reduce the vulnerability of private investment to commodity price changes.

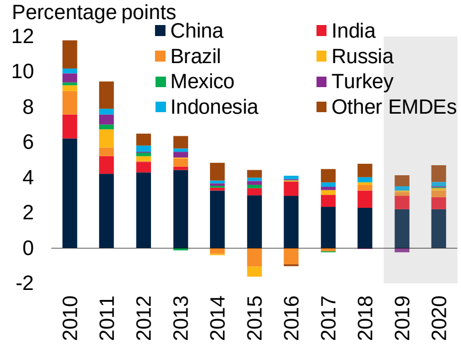
Figure 1. Investment growth in EMDEs

Notwithstanding a modest recovery since 2016, EMDE investment growth is subdued and below historical averages, reflecting trends in commodity prices, financial conditions, and domestic output growth. The sluggishness is expected to persist in the long term. Weak investment growth creates development challenges for EMDEs.

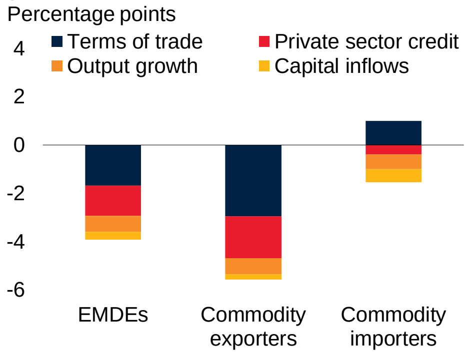
A. Investment growth



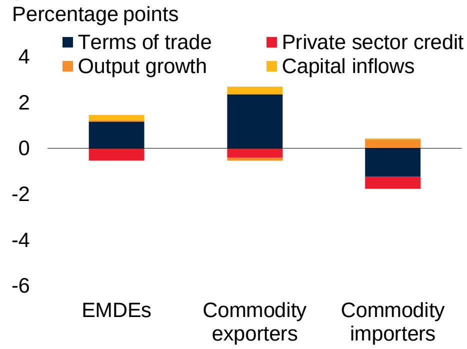
B. Country contribution to EMDE investment growth



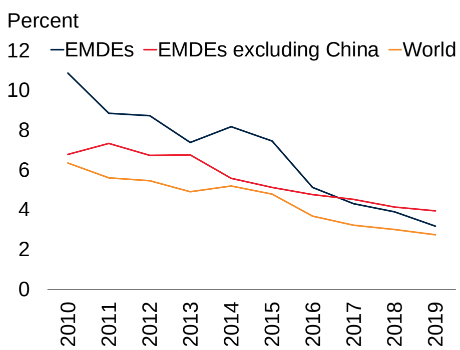
C. Predicted change in EMDE investment growth, 2011-15



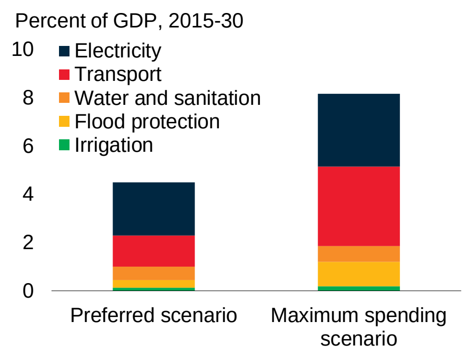
D. Predicted change in EMDE investment growth, 2015-18



E. Long-term investment growth forecasts



F. Spending needs in infrastructure sectors related to SDGs



Source: Consensus Economics, Haver Analytics, Oxford Economics, Rozenberg and Fay (2019), World Bank.

A. B. Investment refers to real gross fixed capital formation (public and private combined). 2010 investment-weighted averages. Sample includes 65 EMDEs. Shaded areas indicate forecasts. C.D. Unweighted averages for 56 EMDEs. Charts show change in contribution of each explanatory variable to predicted investment growth (defined as coefficient estimate times the realization of the variable), based on the regression specification in first column of Annex Table SF1.1.1.1. For presentational clarity, the charts show only the four explanatory variables with the largest contributions to the predicted change in investment growth. E. 10-year-ahead forecasts surveyed in indicated year. Constant 2010 U.S. dollar investment-weighted averages. Sample includes 23 advanced economies and 20 EMDEs. 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. F. Bars show average annual spending needs during 2015-30. "Preferred scenario" is constructed using ambitious goals and high spending efficiency, and "maximum spending scenario" using ambitious goals and low spending efficiency. Country sample includes low- and middle-income countries. Country sample includes low- and middle-income countries, as defined by the World Bank. The technical appendix of Rozenberg and Fay (2019) provides information on the country sample.