

Global Economic Prospects

HIGHLIGHTS from CHAPTER 2: REGIONAL INTEGRATION AND SPILLOVERS¹ *Global Economic Prospects January 2016*

Key Points

- Most developing countries have strong economic linkages to major advanced markets in close proximity.
- Most of developing regions are more vulnerable to growth fluctuations in major economies than to growth fluctuations in regional emerging markets.
- Within-region economic ties are closest in Europe and Central Asia (ECA) and East Asia and the Pacific (EAP), and particularly pronounced in trade and remittance flows.
- Among the major emerging economies, economic fluctuations in Brazil, China, and Russia have the largest “spillover” effects on countries in their regions.

East Asia and Pacific (EAP). Countries in the EAP region are deeply integrated with the global economy and with each other. China has become the largest trading partner and source of foreign direct investment (FDI) for the region, although Japan remains one of the largest sources of FDI for several economies. Reflecting this integration, a growth slowdown in China could result in sizeable spillovers to many countries in the region. Slowdowns in Japan and other major advanced economies outside the region could also have sizeable spillovers.

Europe and Central Asia (ECA). The ECA region is one of the most open emerging and developing country regions, although there is wide heterogeneity. Because of this openness, and the presence of several large commodity exporters, ECA is more vulnerable to global growth shocks than to shocks originating from within the region. Within-region spillovers from Russia are sizable, especially in the eastern part of ECA, which is deeply integrated with Russia through trade and remittances. Spillovers from Turkey are smaller, and mostly local.

Latin America and Caribbean (LAC). The LAC region is less open to global trade and finance than other emerging and developing regions, although there is considerable within-region heterogeneity. Despite a multitude of regional trade agreements, regional economic linkages tend to be limited and largely confined to sub-regions. Growth shocks in Brazil have modest effects on growth in its South American neighbors, while those in Mexico have negligible spillovers.

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Middle East and North Africa (MENA). Most trade and financial ties of countries in the MENA region are with countries outside the region. Trade and financial flows between MENA countries are modest. As a result, within-region growth spillovers even from the largest developing countries in the region—including the Arab Republic of Egypt—and a large neighboring economy—Turkey—are small. In contrast, spillovers from G7 countries are considerably larger.

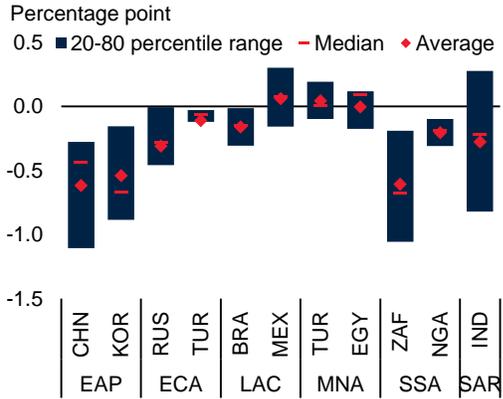
South Asia (SAR). The SAR region is one of the least integrated into the global economy; integration within the region is even more limited. Spillovers from a growth shock in India are modest for Sri Lanka and negligible for Pakistan, while those from large advanced countries are somewhat larger.

Sub-Saharan Africa (SSA). Over the past decade, regional integration in the SSA region has expanded. Though still low, within-region trade represents a growing share of the region’s trade. Cross-border financing flows within Sub-Saharan Africa have increased rapidly. Nevertheless, shocks to growth in Nigeria and South Africa appear to have no significant effects on growth in other countries in the region.

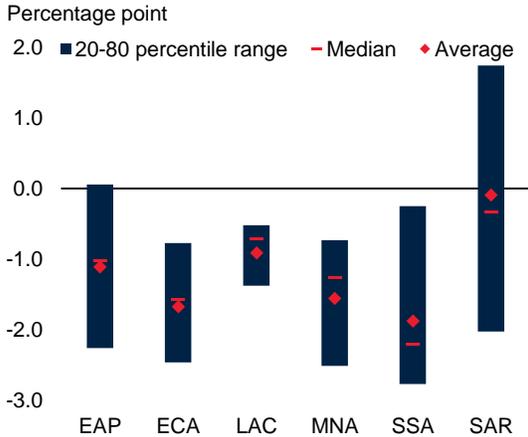
Figure 1. Spillovers from large emerging markets in each region

A growth decline in Russia has sizable spillovers in the ECA region due to strong within-region trade and remittance links. EAP is susceptible to a growth decline in China. Other within-region spillovers tend to be modest.

A. Impact on growth of a 1 percentage point decline in growth in large emerging markets within the region



B. Impact on growth of a 1 percentage point decline in G7 growth



(Download chart data to Excel)

Source: World Bank staff estimates.
 Notes: CHN = China; KOR = Republic of Korea; RUS = Russia; TUR = Turkey; BRA = Brazil; MEX = Mexico; TUR = Turkey; ZAF = South Africa; NGA = Nigeria; IND = India.
 Based on country-specific structural vector autoregressions (VARs) using the earliest possible data from 1998:Q1 to 2015:Q2 for 7 countries in EAP, 20 countries in ECA, 15 countries in LAC, 8 countries in MNA, 3 countries in SAR, and 4 countries in SSA. Estimation sample for the SSA region starts in 2007; results are statistically insignificant for spillovers from South Africa. Details of the model are provided in the January 2016 *Global Economic Prospects* (Boxes 2.1-2.6).