
Table of Contents

Foreword	ix
Acknowledgments	xi
Selected Abbreviations	xiii
Overview and Policy Messages: The Development Potential of Surging Capital Flows	1
The broad surge in private capital flows continues	2
Global growth has propelled the surge in capital flows, but serious risks remain	4
Capital flows are being transformed	5
Net official flows continue to decline	7
To ensure economic stability, developing countries must manage capital flows effectively	8
Multilateral cooperation is key to resolving global financial imbalances	10
Chapter 1 Prospects for the Global Economy	13
Summary of the outlook	13
Global growth	16
Regional outlooks	18
Commodity markets	22
Inflation, interest rates, and global imbalances	25
World trade	30
Risks	32
Avian influenza	36
Notes	39
References	41
Chapter 2 The Growth and Transformation of Private Capital Flows	43
Private debt market developments in 2005	45
Structural changes in emerging market debt	59
Prospects for private capital flows	71
<i>Annex: Commercial Debt Restructuring</i>	73
Developments in 2005 and the first quarter of 2006	73
Notes	75
References	75
Chapter 3 Supporting Development through Aid and Debt Relief	79
Recent trends and prospects for foreign aid	80
Debt relief: improving and maintaining debt sustainability	87

	The challenge ahead: accessing external capital, while maintaining debt sustainability	99
	<i>Annex: Debt Restructuring with Official Creditors</i>	100
	Notes	102
	References	103
Chapter 4	Financial Integration among Developing Countries	107
	The growth of South–South capital flows	108
	Foreign direct investment in the developing world	110
	South–South banking	117
	Developing-country stock exchanges	124
	Conclusion	127
	<i>Chapter 4 Annexes</i>	128
	Annex 1: Data on South–South capital flows	128
	Annex 2: Selected South–South M&A deals by southern multinationals in service sector, 2000–5	130
	Annex 3: Model of determinants of bank ownership	131
	Notes	131
	References	133
Chapter 5	Challenges in Managing Capital Flows	139
	Two booms in capital flows—what has changed?	141
	The effect of the recent influx of capital flows on domestic investment and asset prices	156
	Lessons and policy agenda	159
	<i>Annex: Capital Flows and Domestic Investment</i>	164
	Notes	166
	References	166
Statistical Appendix		171
Tables		
1	Net capital flows to developing countries, 1997–2005	3
2	Net private capital flows to developing countries by region, 1998–2005	4
1.1	The global outlook in summary	17
1.2	Estimated impact of three risk scenarios	34
1.3	Impact of a 400-basis-point increase in interest rates in selected developing countries	35
1.4	Impact of a further \$30 hike in oil prices in selected developing countries	35
1.5	Impact of a 15 percent fall in non-oil commodity	36
1.6	Impact of a widening of bird-bird flu	37
1.7	Possible economic impacts of flu pandemic	37
1.8	A breakdown of economic impacts of a potential human-to-human pandemic	38
2.1	Net private debt flows to developing countries, 2002–5	45
2.2	Gross market-based debt flows to developing countries, 2002–5	45
2.3	Gross cross-border loan flows, 2005	49
2.4	Countries' access to international capital markets by intermediaries, 2002–5	50
2.5	Asset allocation of major international pension funds, 2004	54
2.6	Net FDI flows to developing countries, 2000–5	55
2.7	Selected announced privatization and M&A deals in developing countries, 2005	57
2.8	International bonds and notes outstanding, by currency, 1999–2005	59

3.1	Net ODA disbursements, 1990–2005	80	
3.2	ODA and debt relief grants in 2005	81	
3.3	Main components of bilateral ODA, 1990–2005	81	
3.4	Net ODA disbursements to the ten largest recipient countries	83	
3.5	Donors' shares of ODA in 2005, projected 2010	84	
3.6	General government financial balances in 2004, projected 2005–7	85*	
3.7	ODA as a percentage of fiscal expenditures and revenues in 2004, projected 2006	85	
3.8	Debt relief grants provided by DAC donor countries, by income and region of beneficiary, 1990–2005	87	
3.9	Debt-service reductions to be provided by the MDRI	92	
3.10	Donors' commitment to refinance IDA for debt relief provided under the MDRI, selected years	93	
3.11	Net present value of external debt relative to GNI and exports, 2004	94	
3.12	Credit ratings for decision-point HIPCs	97	
3.13	Average annual real GDP growth, 1990–2005	97	
3.14	Indicators of external position of the 29 decision-point HIPCs, 1990–2005	99	
4.1	South–South FDI as a share of global FDI, 1999–2003	111	
4.2	Regional FDI by multinationals from selected countries	112	
4.3	Selected southern multinationals in the oil-and-gas sector, 2004	113	
4.4	South–South cross-border syndicated lending, 1985–2005	119	
4.5	Source of foreign bank assets, by region	120	
4.6	Performance indicators for northern and southern foreign banks, selected aggregates, 2000–4	123	
4.7	Stock exchanges in selected developing countries, December 2005	125	
5.1	Ratio of short-term debt to total debt in major borrowing countries, 1996–2004	144	
5.2	Profile of external financial policy for developing countries considered relatively open to capital movements	149	
5.3	Current account aggregated by region, 1997–2005	150	
5.4	Sources of reserve accumulation, 1997–2005	151	
5.5	Changes in central bank balance sheets, 2001–5	153	
5.6	Foreign currency reserves and foreign assets as shares of total central bank assets in countries with high reserve accumulations, 2005	154	
5.7	Investment performance during the surge in capital flows, 2002–4	158	
5.8	Indicators of overheating in selected developing countries, 2002–4	160	
5.9	Stock market performance in emerging markets, 2002–5	161	
5A.1	Domestic investment and private capital flows	165	

Figures

1	Financial flows to developing countries, 1997–2005	2
2	Benchmark spreads for emerging markets, 2001–6	4
3	Capital outflows by private entities in the developing world, 1981–2005	5
4	Net official lending and foreign aid grants to developing countries, 1980–2005	7
5	Net official lending, 1997–2005	7
1.1	Industrial production remains robust	16
1.2	Inflation in high-income countries	16
1.3	Developing-country growth remains robust	18
1.4	Regional growth trends	19
1.5	An end to the trend rise in oil prices?	22

1.6	Higher prices slow oil demand	23
1.7	A disappointing supply response	23
1.8	Spare production capacity remains low	24
1.9	Commodity prices	24
1.10	Moderate increases in inflation	25
1.11	Flattening yield curve	26
1.12	Changes in real effective exchange rate	26
1.13	Developing countries' current-account balances	27
1.14	Increased aid helped finance oil costs in 2004	27
1.15	Reserves in some countries are falling rapidly or worrisomely low	28
1.16	Tensions associated with fast growth, the case of Turkey	28
1.17	Global imbalances	29
1.18	Interest rate spreads support the dollar	29
1.19	Funding the U.S. current account deficit	30
1.20	Healthy growth in world trade	30
1.21	Regional increases in market share	31
1.22	Increased product range explains most of Chinese export growth	32
1.23	Exports of developing countries have diversified	32
2.1	Net private debt flows to developing countries, 1991–2005	43
2.2	Emerging market bond issuers by type, 2002–5	48
2.3	Average spreads on new bond issues, 2001–5	48
2.4	Bond market financing by risk category, 2002–5	48
2.5	Concentration in bond and bank financing, 1993–2003	51
2.6	Comparative cost of bond and bank financing, June 2004–December 2005	51
2.7	Bank financing raised for core activities, 2002–5	52
2.8	Bank credit for high-risk borrowers: rising rates but longer maturities, 2001–5	52
2.9	IPO activities in emerging market countries 2001–5	54
2.10	Investment climate and FDI	55
2.11	The concentration of FDI, 1995–2005	56
2.12	Euro-denominated international bond issues, by region, 1999–2005	60
2.13	Yields on U.S. and German 10-year government bonds, 1999–2005	60
2.14	Comparison of euro-denominated and U.S. dollar-denominated emerging market sovereign bond issues	61
2.15	The global credit derivatives market in notional terms, 2001–5	62
2.16	Credit derivative participants, 2004	64
2.17	Five-year CDS and ASW spreads for selected countries, 2002–5	65
2.18	Trends in domestic debt securities in emerging markets, by region, 1997–2005	66
2.19	The size of the domestic bond market in selected countries	66
2.20	Bond market profile in selected countries, September 2005	67
2.21	Performance of local-currency bonds (ELMI+) against major indexes, 2002–5	69
2.22	Returns vs. volatility of selected bond indexes, 2000–5	69
3.1	Net ODA to developing countries, 1990–2005	81
3.2	Bilateral ODA loans and grants, 1990–2005	82
3.3	Share of total ODA allocated to LDCs and other low-income countries, 1990–2004	82
3.4	Net ODA as a percentage of GNI in DAC donor countries, 1990–2005 and projected 2006–10	85
3.5	Debt-service payments and HIPC debt-service reduction for 28 “decision point” HIPCs	89
3.6	Debt-service reduction provided by the HIPC Initiative to 25 decision-point countries	89
3.7	Debt service paid by 25 decision-point HIPCs, 2000 versus 2005	89

3.8	Debt-service reduction to be provided by the MDRI, 2006–45	92
3.9	Debt-service reduction to be provided to 18 completion-point HIPCs under the MDRI, 2006–45	92
3.10	Donors' commitment to refinance IDA for debt relief provided under the MDRI, 2006–45	93
3.11	Debt burdens in 18 completion-point HIPCs, before and after the HIPC and MDRI debt relief	94
3.12	Net official lending to 27 decision-point HIPCs as a percent of GDP, 1990–2004	96
4.1	South–South capital flows by type, 2005	108
4.2	Growing openness of developing countries to trade and capital flows, 1995–2005	110
4.3	South–South FDI in infrastructure and by region, 1998–2003	113
4.4	Cross-border lending to all countries by banks in developing countries, 2000–5	120
4.5	South–South foreign bank entry in developing countries, by country income level	121
4.6	Developing-country firms shift away from ADRs	126
5.1	Distribution of private capital flows across developing countries, 2002–4	142
5.2	Composition of financial flows to developing countries, 1992–7 and 2002–5	143
5.3	Ratio of foreign exchange reserves to short-term debt, by region	143
5.4	Changes in exchange rate flexibility, 1991–2004	145
5.5	Frequency distribution of daily percentage changes in exchange rates for selected developing countries, 1993–6 vs. 2003–5	146
5.6	Movements in real effective exchange rates in East Asia and Latin America, 1993–2005	147
5.7	Real exchange rates for selected countries that receive higher-than-average private capital inflows as a ratio to GDP, 1994–7 and 2002–5	147
5.8	Current-account balance, developing countries, 1990–2005	150
5.9	Value of oil imports, oil-importing countries, 2001–5	150
5.10	Foreign exchange reserves, by region, 1995–2005	153
5.11	Foreign exchange reserves as a share of trade, 1970–2003	153
5.12	Currency composition of developing countries' foreign exchange reserves, 2000 and 2005	156
5.13	Market capitalization	160
5.14	Turnover on world stock exchanges, 2004	160
5.15	Ratios of debt to equity in selected countries, 1996–2004	161
Boxes		
1	International migrant remittances	3
2.1	The emerging bond market enters the mainstream	46
2.2	Strong performance of emerging stock markets in 2005	53
2.3	Growing FDI in China's banking sector	57
2.4	Accession to the European Union and FDI	58
2.5	Credit default swaps	63
2.6	The role of multilateral development banks in developing local-currency bond markets	68
3.1	The Integrated Framework for Trade-Related Technical Assistance	84
3.2	The HIPC Initiative	88
3.3	The Paris Club	90
3.4	The MDRI	91
3.5	The DSF for low-income countries	95

4.1	Developing countries as aid donors	109	
4.2	South-South FDI and trade	111	
4.3	The World Bank Group and South-South flows	116	
4.4	Determinants of South-South foreign bank entry	122	
5.1	Preconditions for capital-account liberalization	148	
5.2	Capital flows are procyclical with respect to non-oil commodity markets	152	
5.3	Central bank debt in China	155	
5.4	Optimizing allocations in reserve portfolios	157	
5.5	Investment and private capital flows	159	