



International Monetary Fund



World Economic Outlook

Research Department, IMF

**Istanbul, Turkey
September 23, 2011**

Activity is under threat as demand rebalancing is not advancing.

Policy priorities are:

Rebalancing I

- From public to private demand in AEs, need:
- fiscal repair and support for recovery;
 - bank capital, housing markets;
 - vision for euro area

Rebalancing II

- From C/A surplus to C/A deficit countries, need:
- medium-term fiscal adjustment in key AE;
 - structural reforms and exchange rate flexibility in key EMs

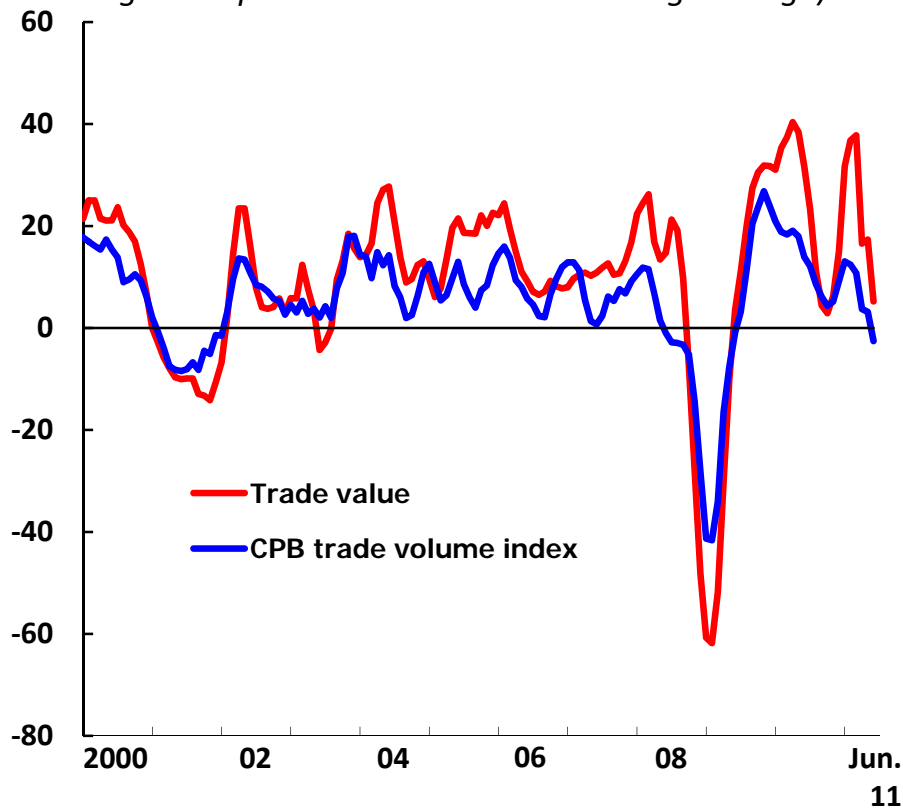
Reforms

- Stronger global financial system, need:
- financial regulation & macroprudential tools;
 - reform of global trade and financial system;

Global activity has slowed noticeably.

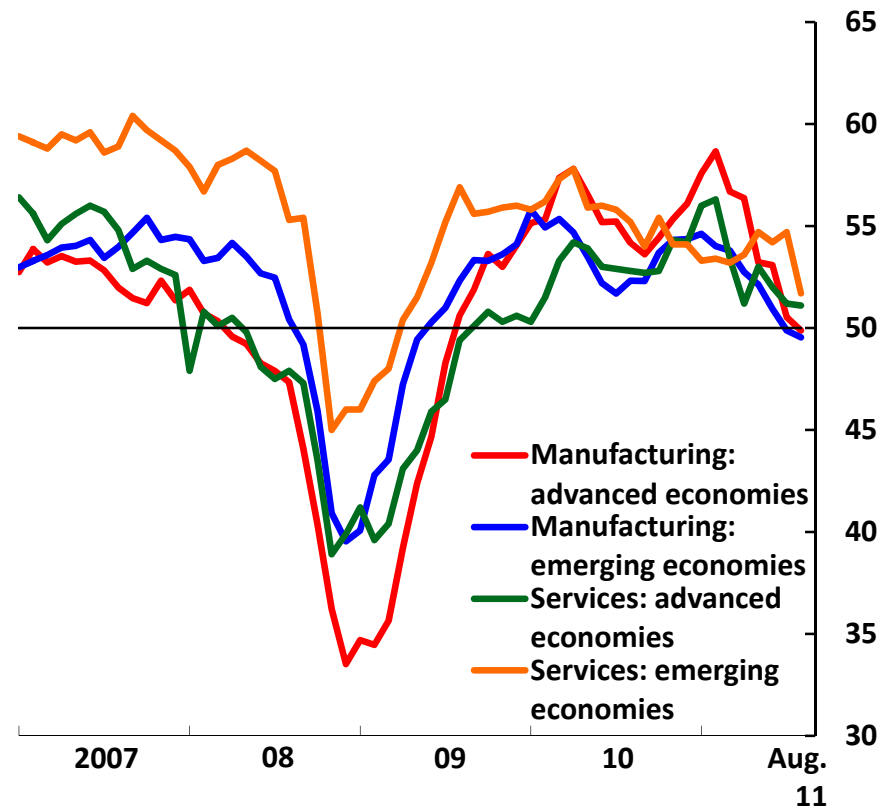
World Trade

(annualized percent change of three-month moving average over previous three-month moving average)



Purchasing Managers' Index (PMI)

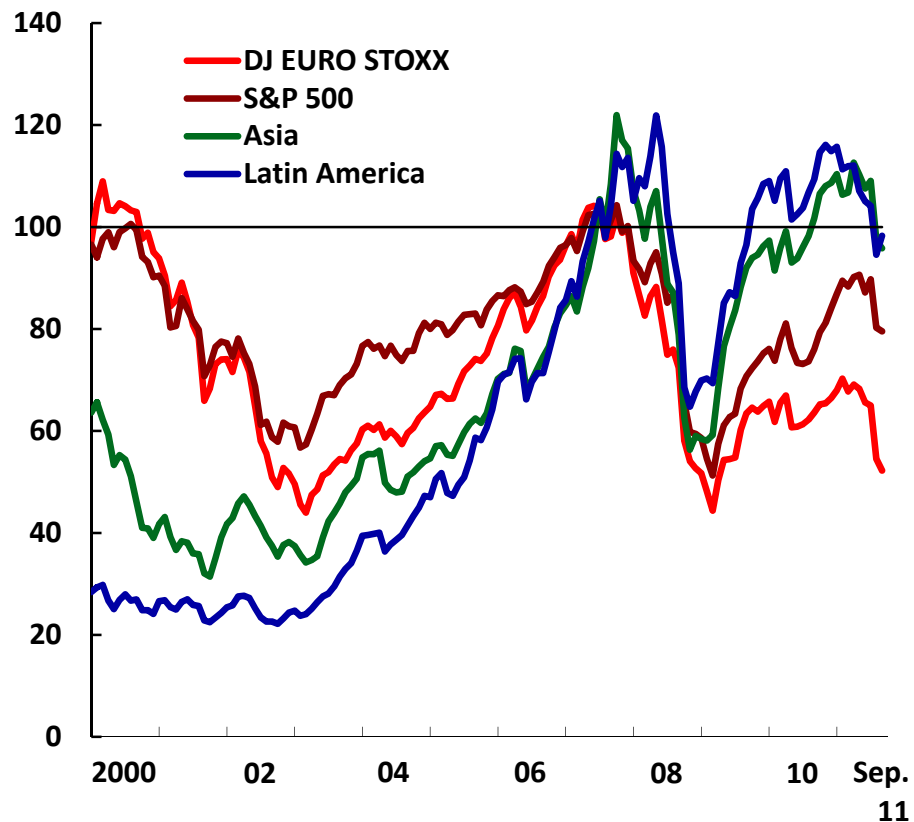
(index)



Equity markets have fallen sharply and volatility has increased drastically.

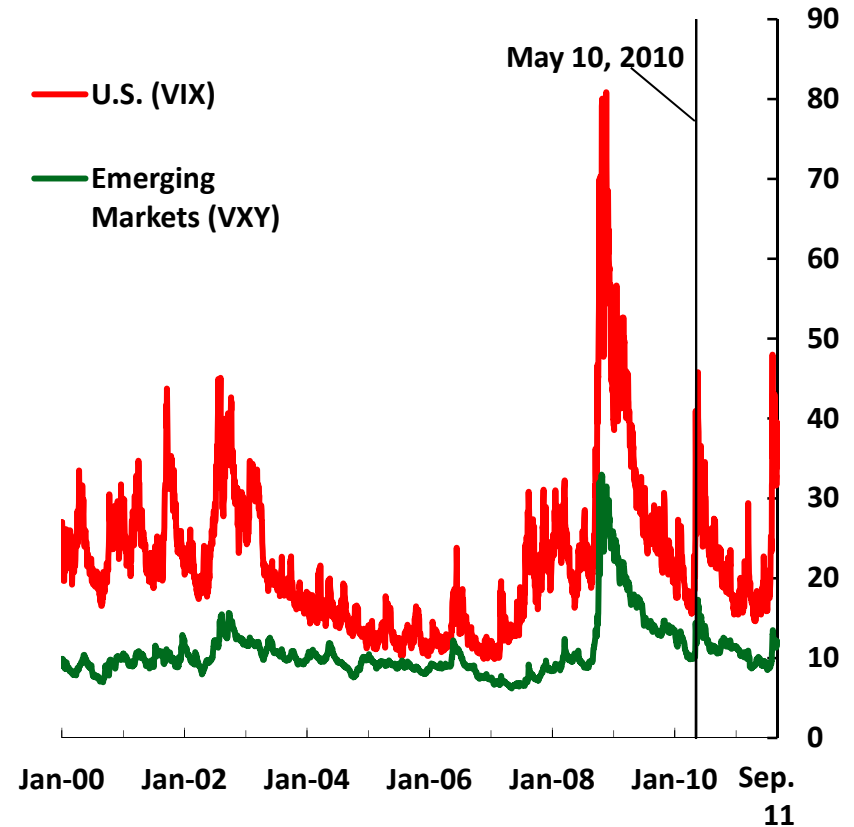
Equity Markets

(index; 2007=100; national currency)



Implied Volatility

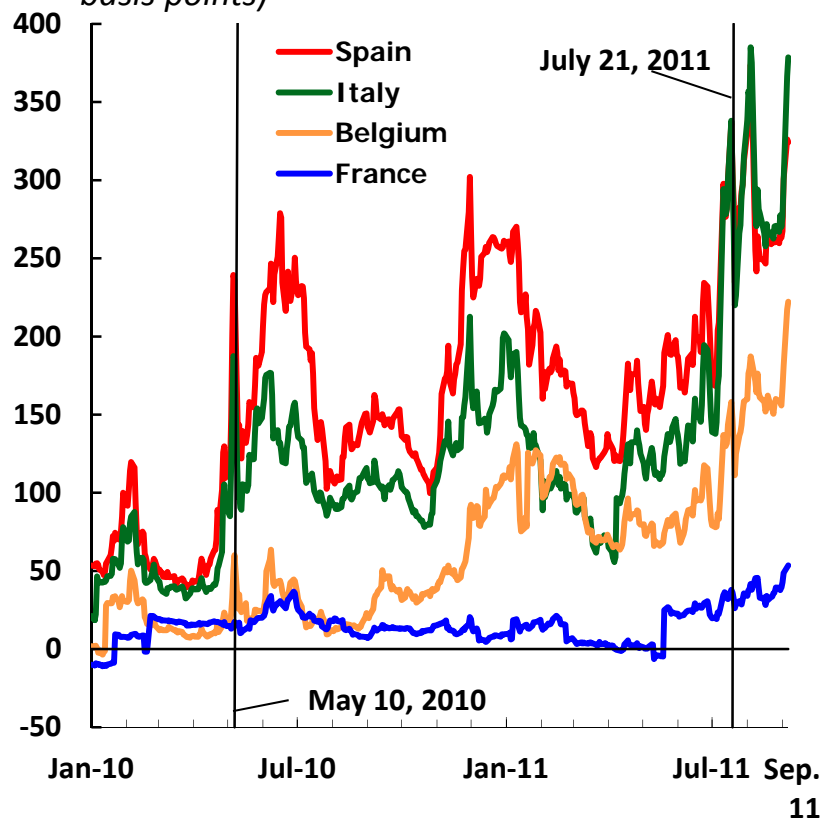
(percent)



Financial stability risks have increased dramatically, especially in the euro area.

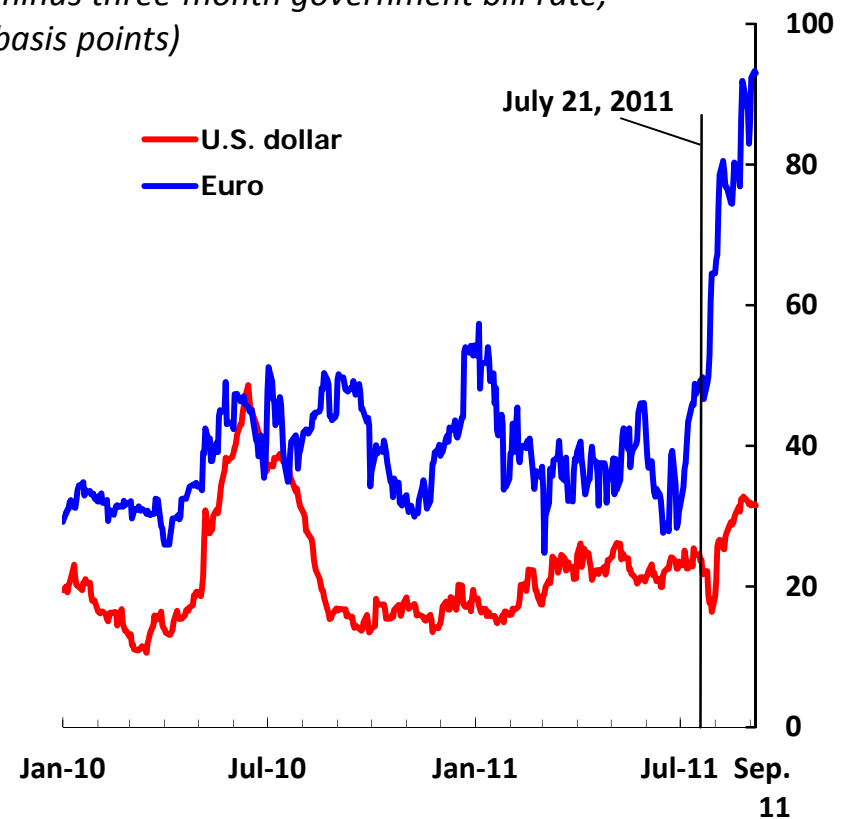
Government Bond Spreads

(two-year yield spreads over German bunds; basis points)

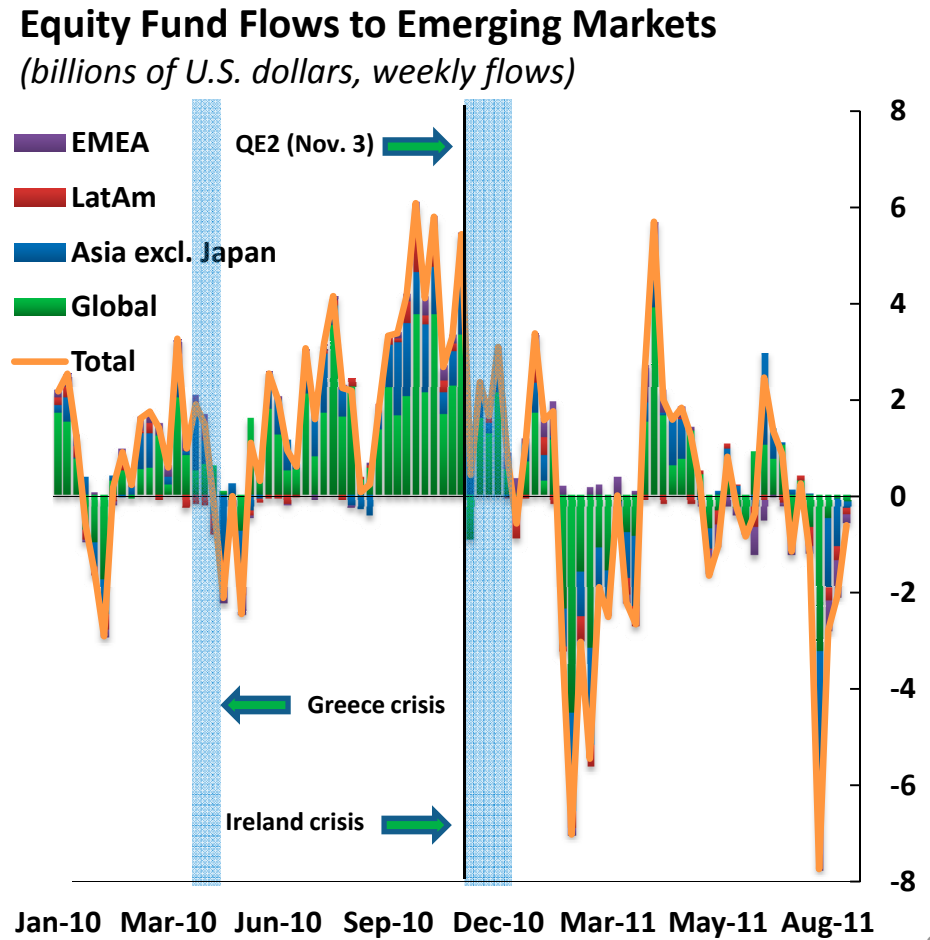
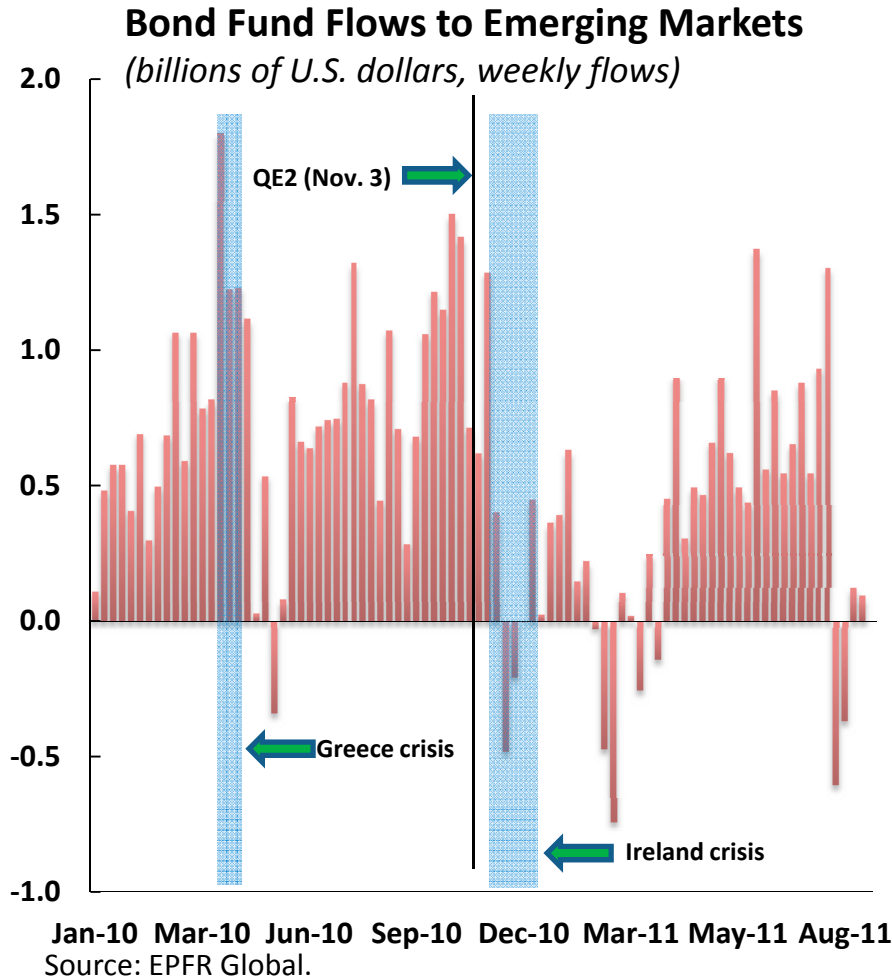


Interbank Spreads

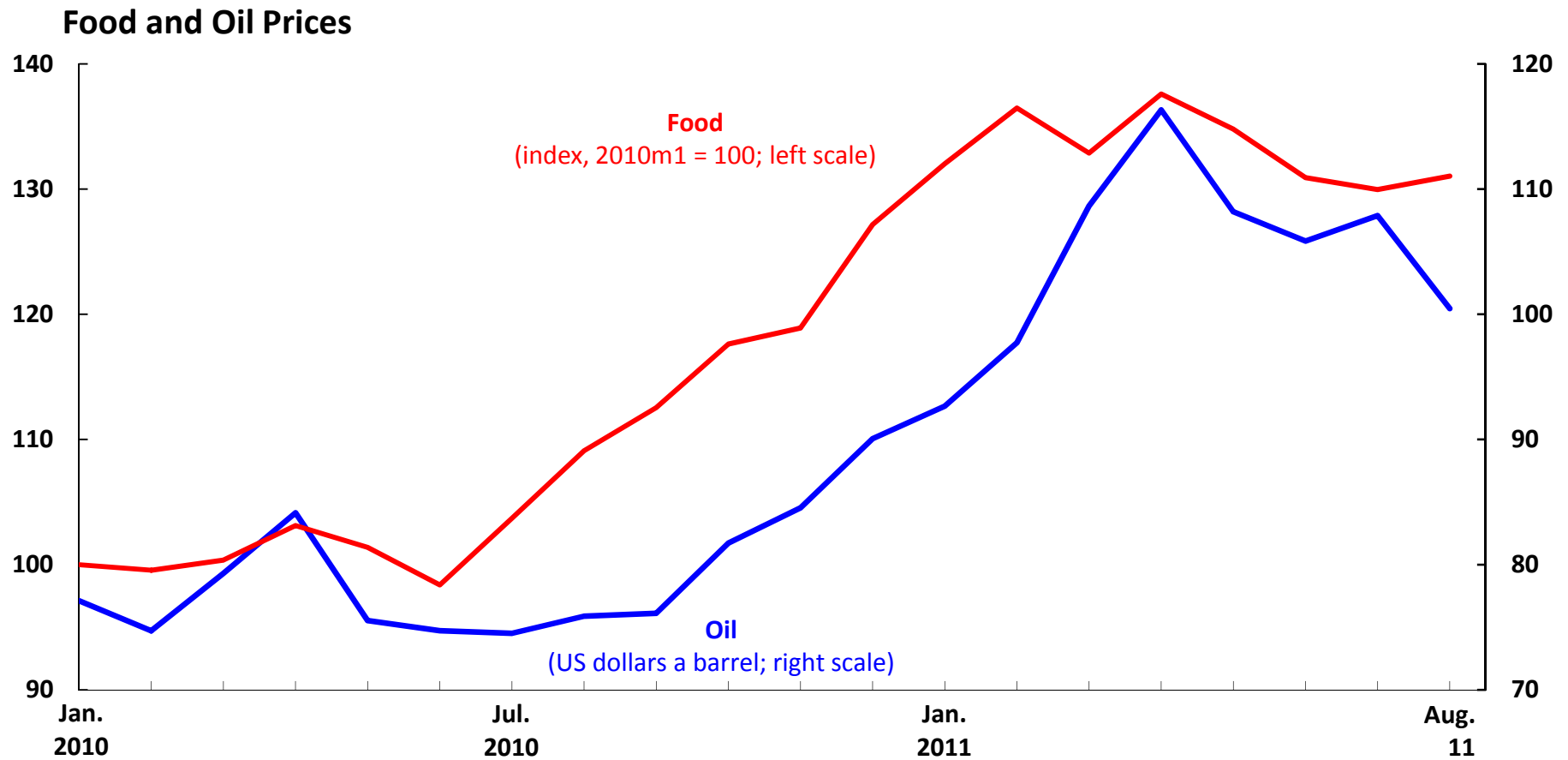
(three-month London interbank offered rate minus three-month government bill rate; basis points)



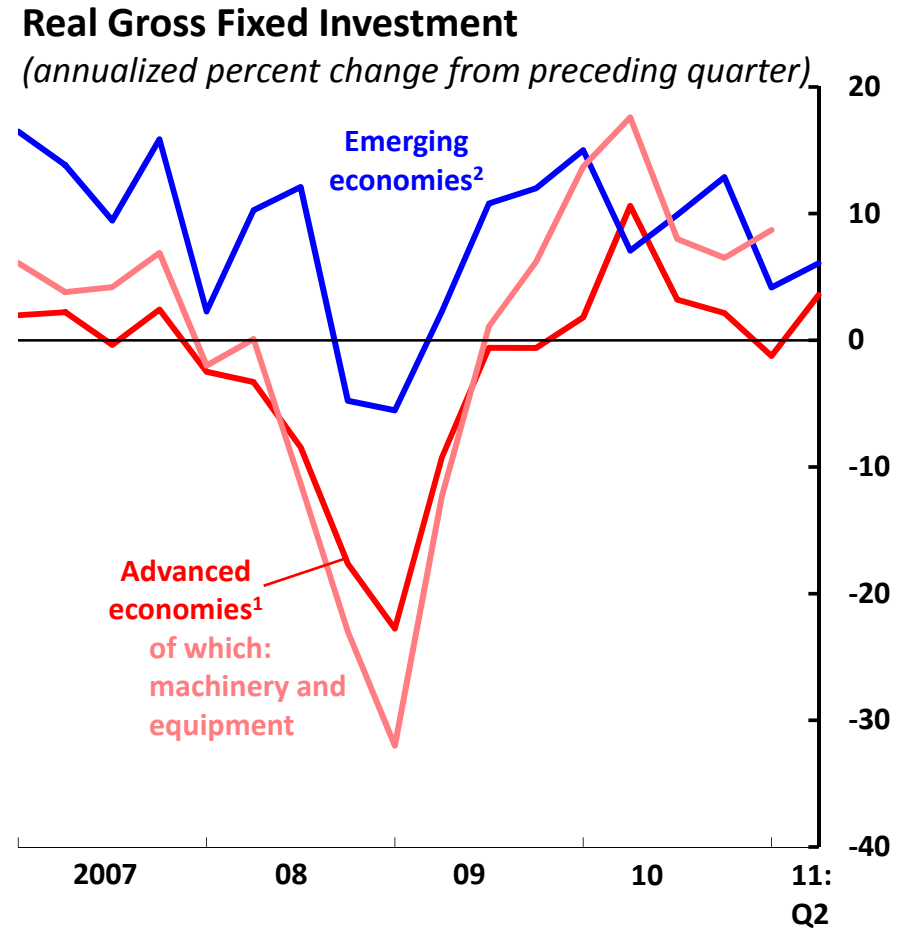
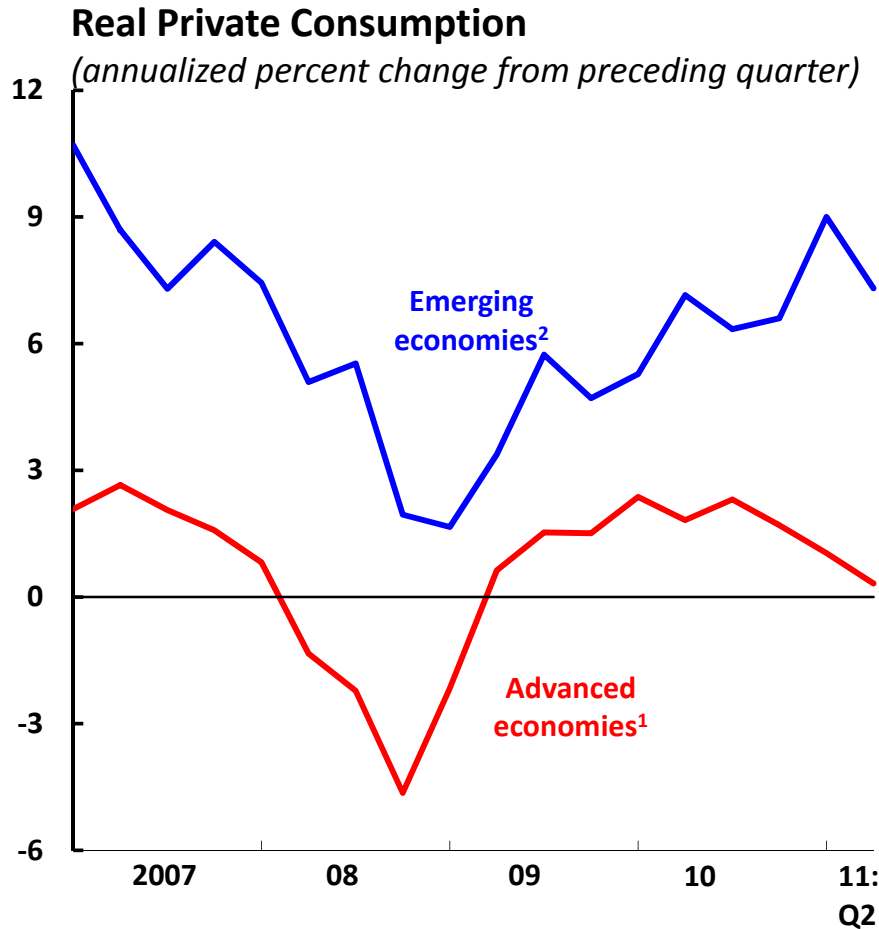
Capital flows to EM have turned negative.



Oil prices have retreated but are still above January 2011 levels.

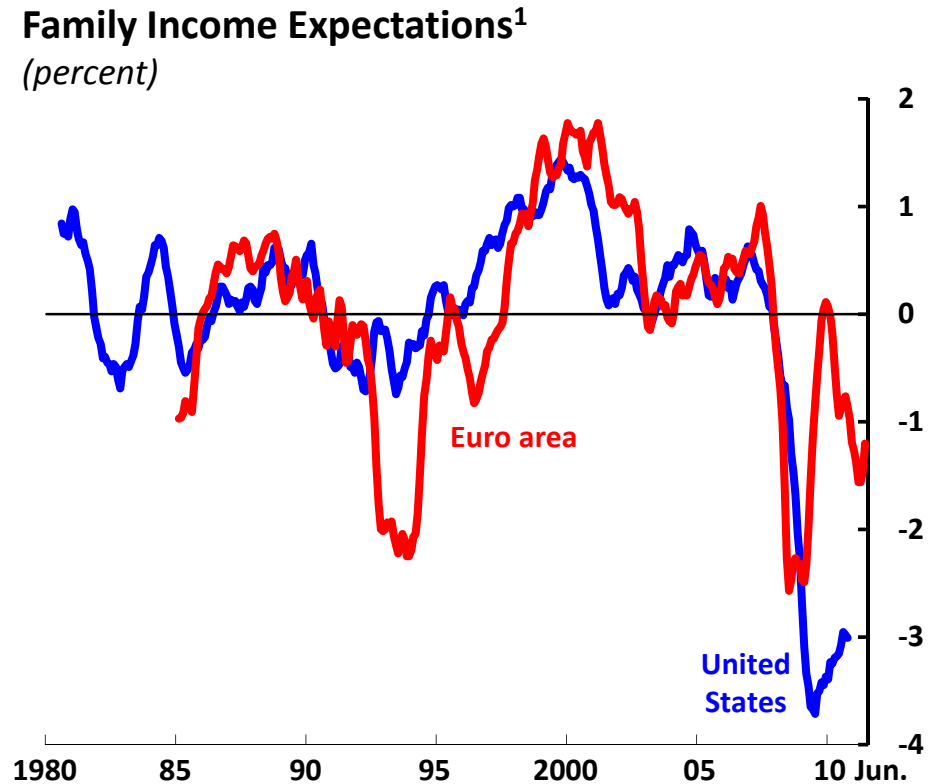
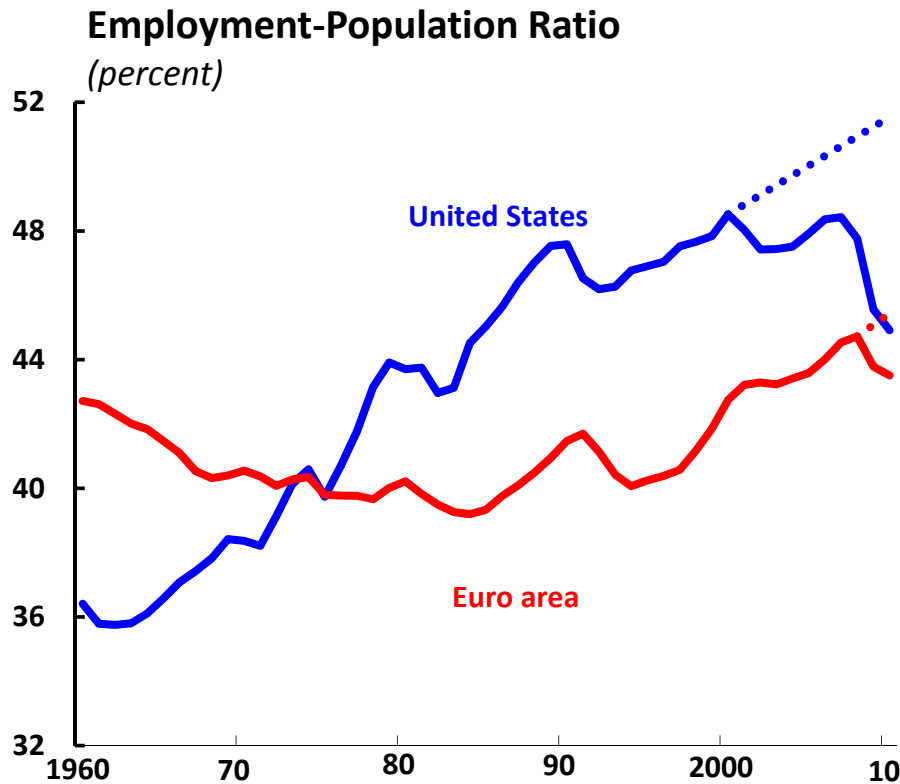


Consumption in advanced economies is struggling to recover from fiscal withdrawal, but M&E investment is still doing well.



¹Australia, Canada, Czech Republic, Denmark, euro area, Hong Kong SAR, Israel, Japan, Korea, New Zealand, Norway, Singapore, Sweden, Switzerland, Taiwan Province of China, United Kingdom, and United States.
²Argentina, Brazil, Bulgaria, Chile, China, Colombia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Romania, Russia, South Africa, Thailand, Turkey, Ukraine, and Venezuela.

Employment presents major challenges to recovery— U.S. in new territory.



¹U.S. data are from Reuters/University of Michigan Surveys of Consumers and represent the **11** difference between the percentage of people who think family income will go up and those who think it will go down. EU data are from the family financial situation index in the European Commission Business and Consumer Surveys. Both series are smoothed and harmonized.

WEO FORECAST AND RISKS

Key assumption underlying the baseline: financial recovery delayed but not derailed.

- 1. Euro area crisis does not run out of control.**
- 2. Global financial volatility does not escalate.**
- 3. No major tightening of bank lending conditions.**

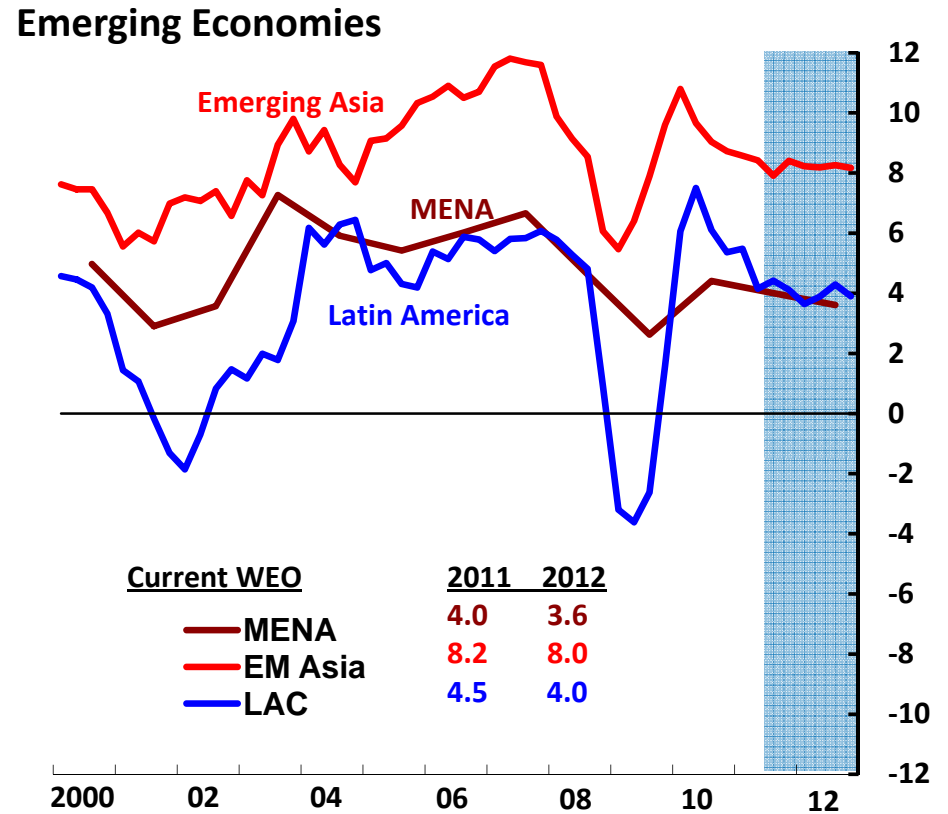
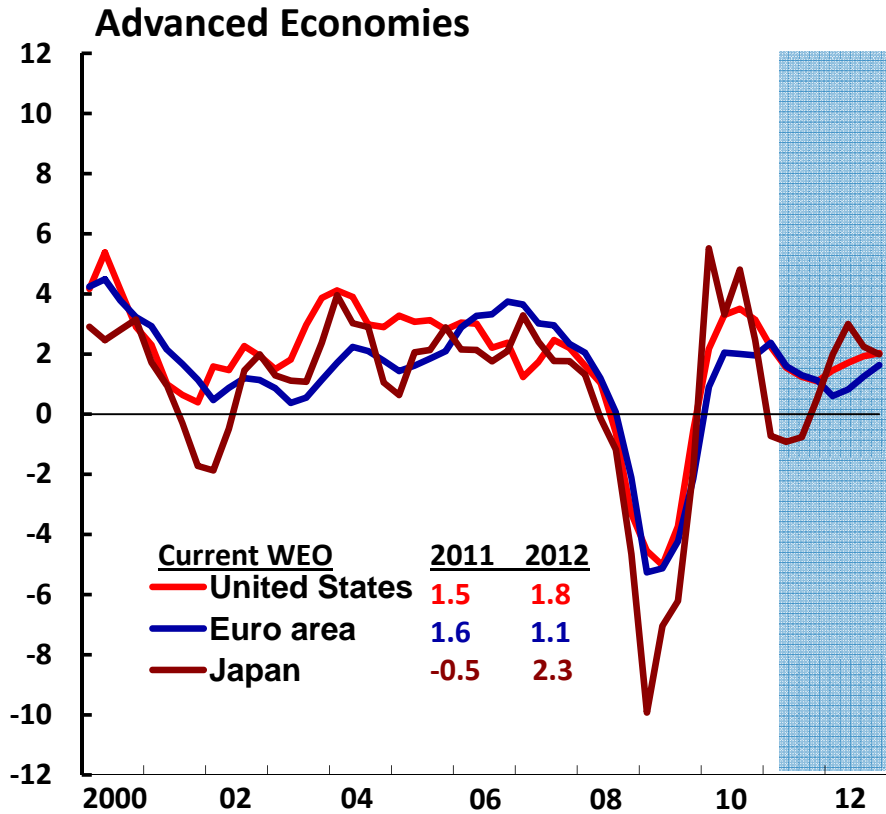
More uneven recovery:

> 6 percent growth in EM
 < 2 percent growth in AE
 = 4 percent global growth.

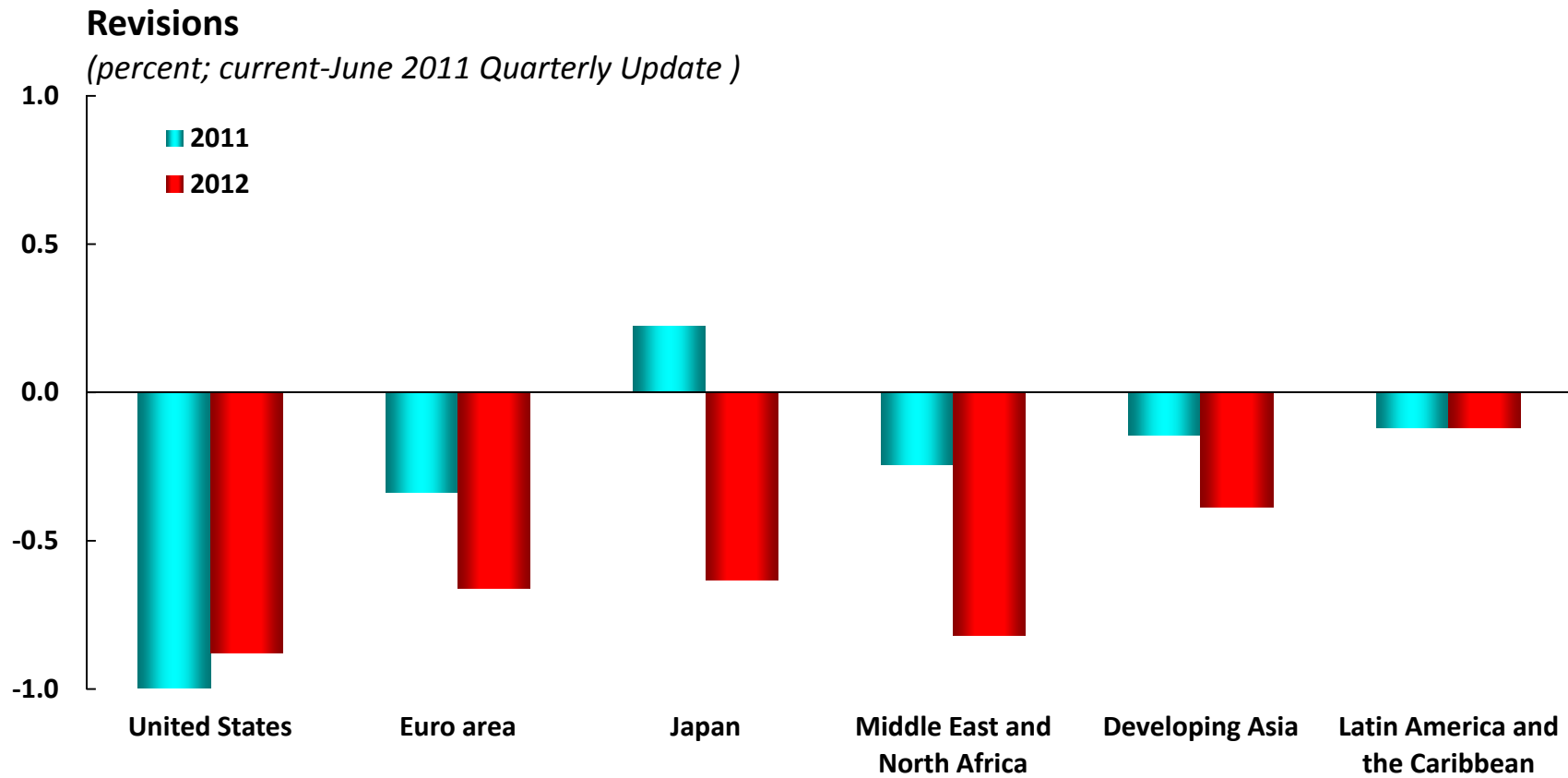
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Real GDP Growth

(percent change from a year earlier)

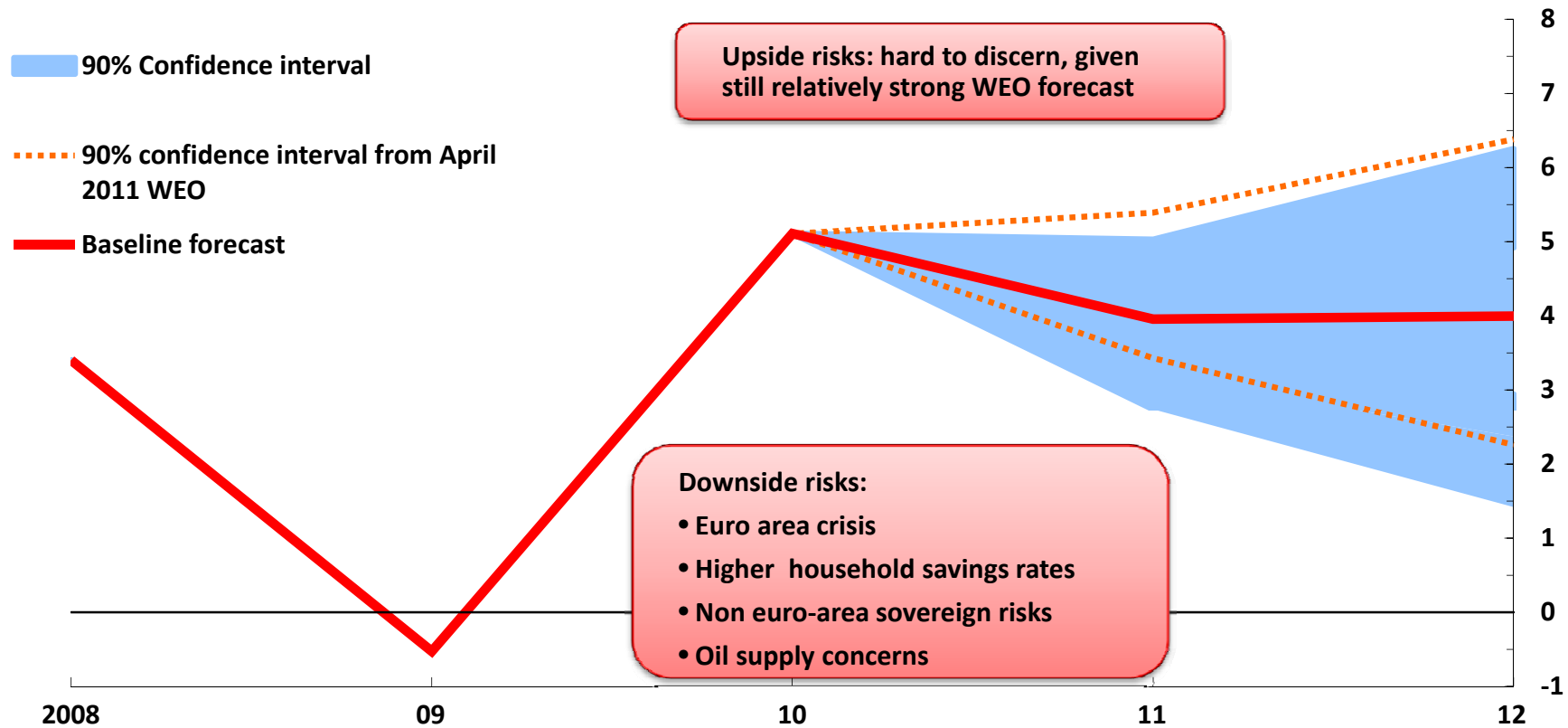


**Downward revisions are larger for AE than EM.
Various EM have policy space to counteract the slowdown.**



Downside risks have increased sharply. Risk for global growth < 2 percent are > 10 percent!

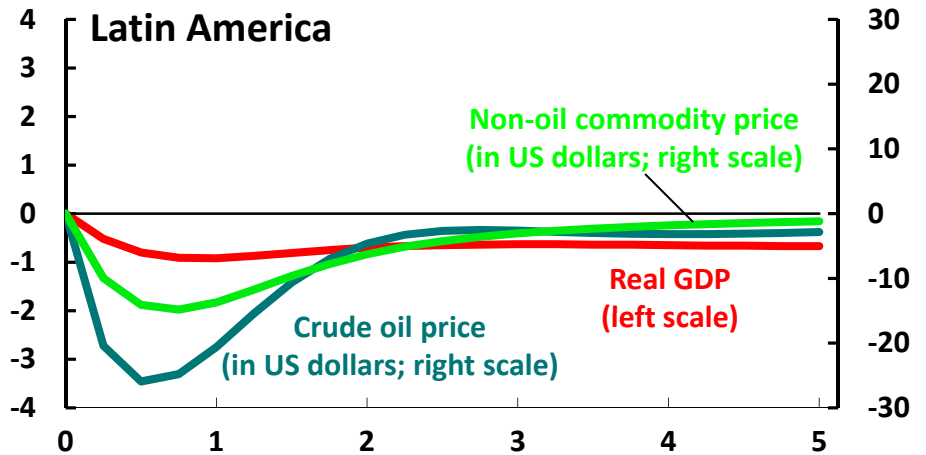
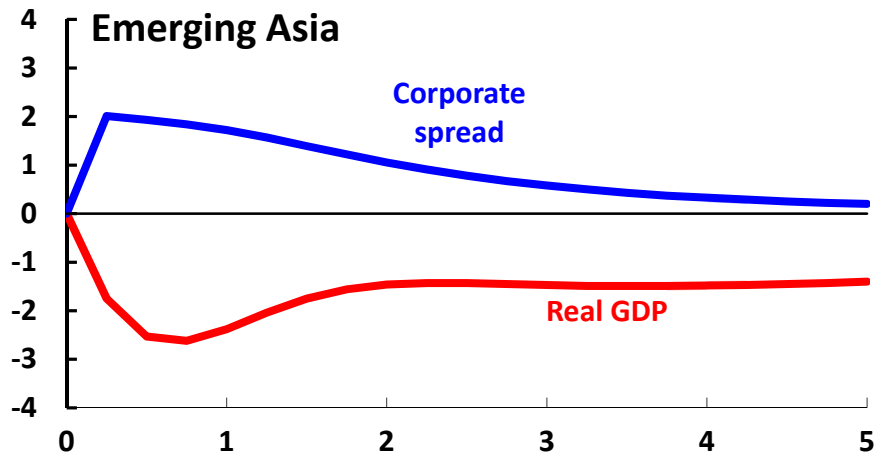
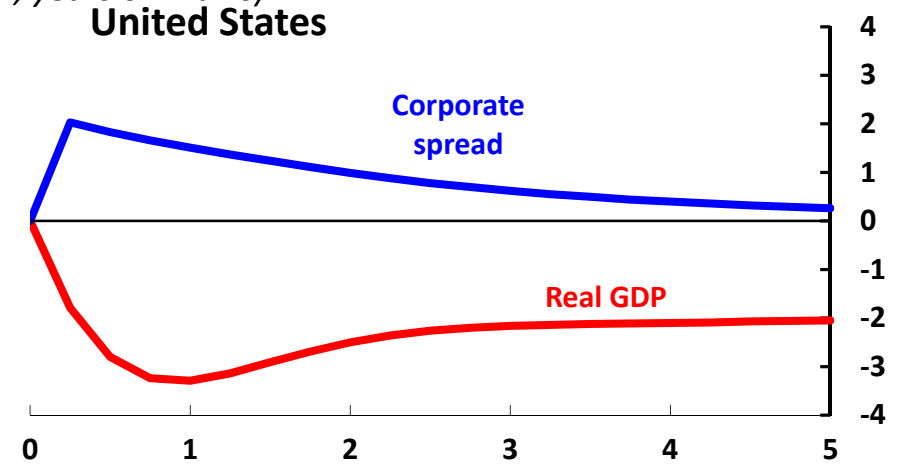
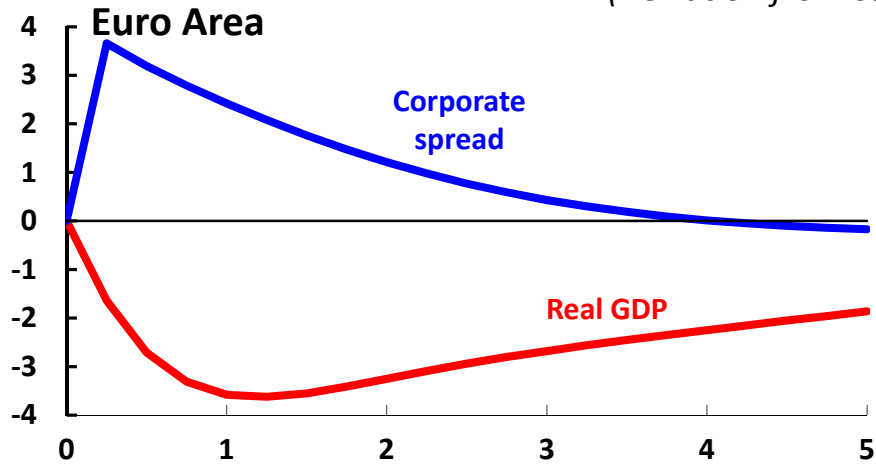
Prospects for World GDP Growth (percent change)



Downside scenarios point to potentially large output losses.

Downside Scenario

(Deviation from control; years on x-axis)

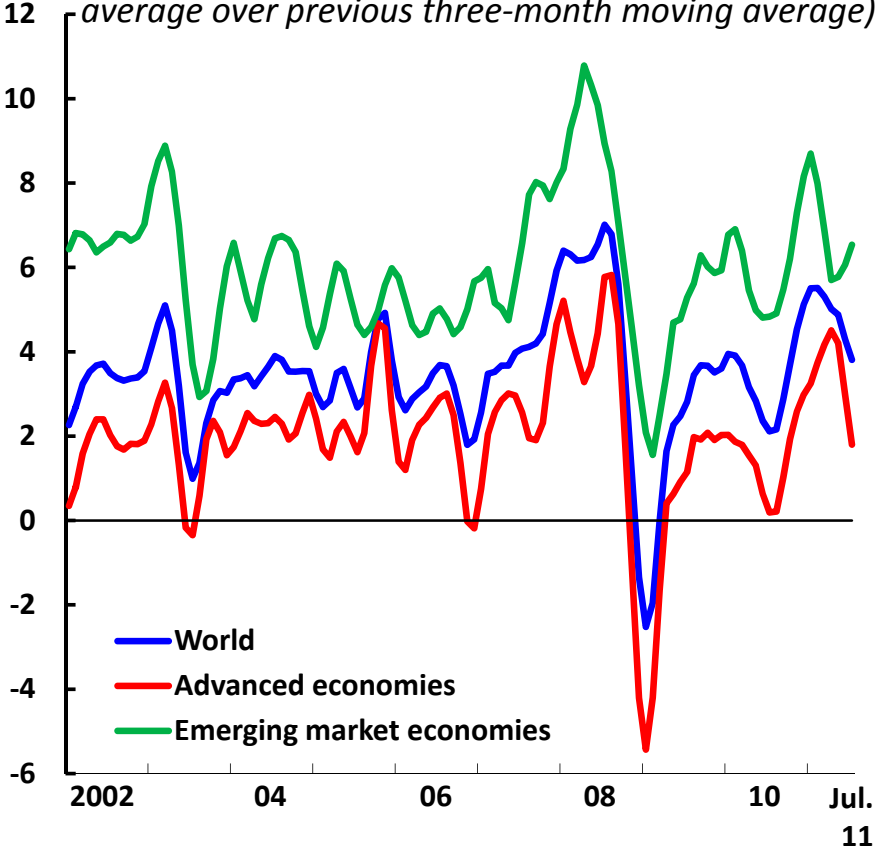


Policy Challenges

Inflation has begun to moderate.

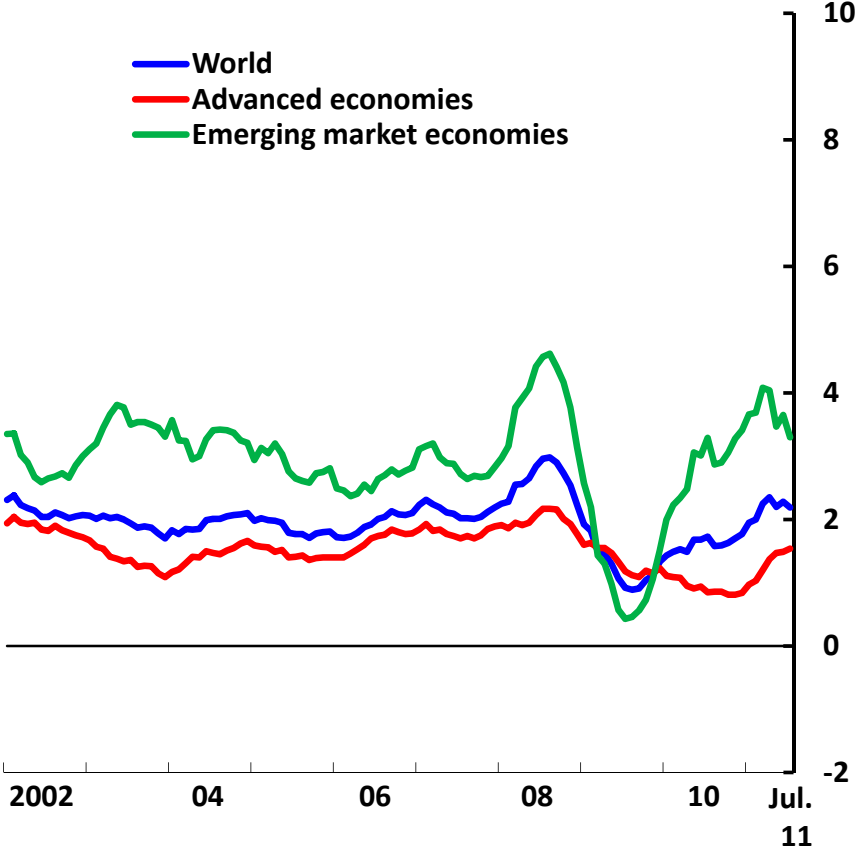
Headline Inflation

(Annualized percent change of three-month moving average over previous three-month moving average)



Core Inflation

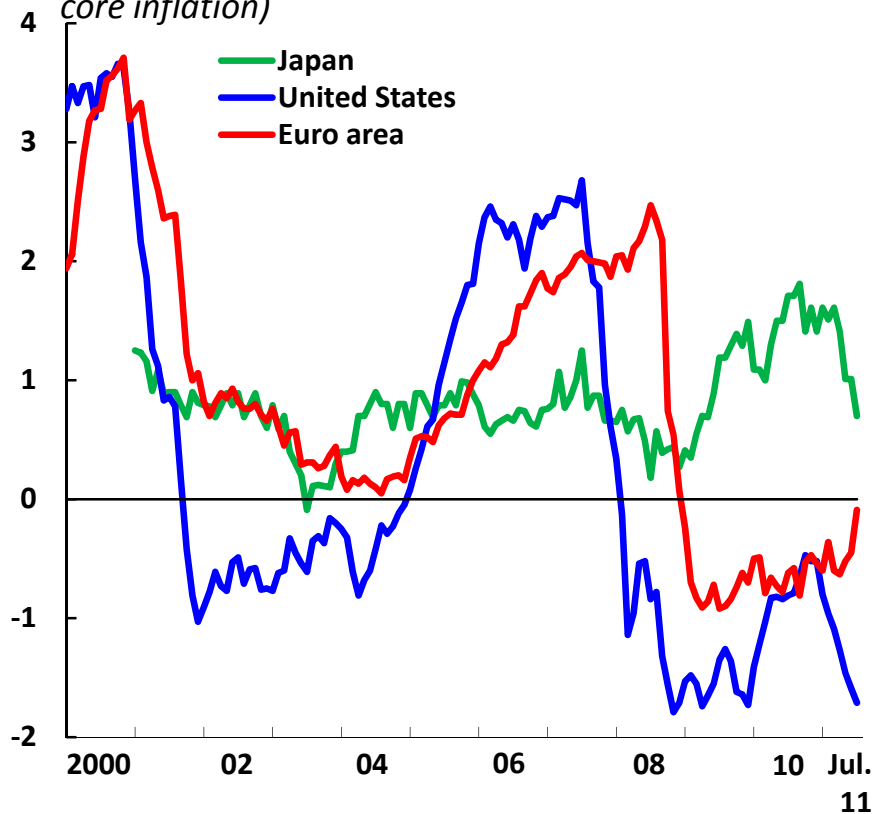
(Twelve-month change)



AE monetary policy can stay very accommodative; stand ready for more unconventional support.

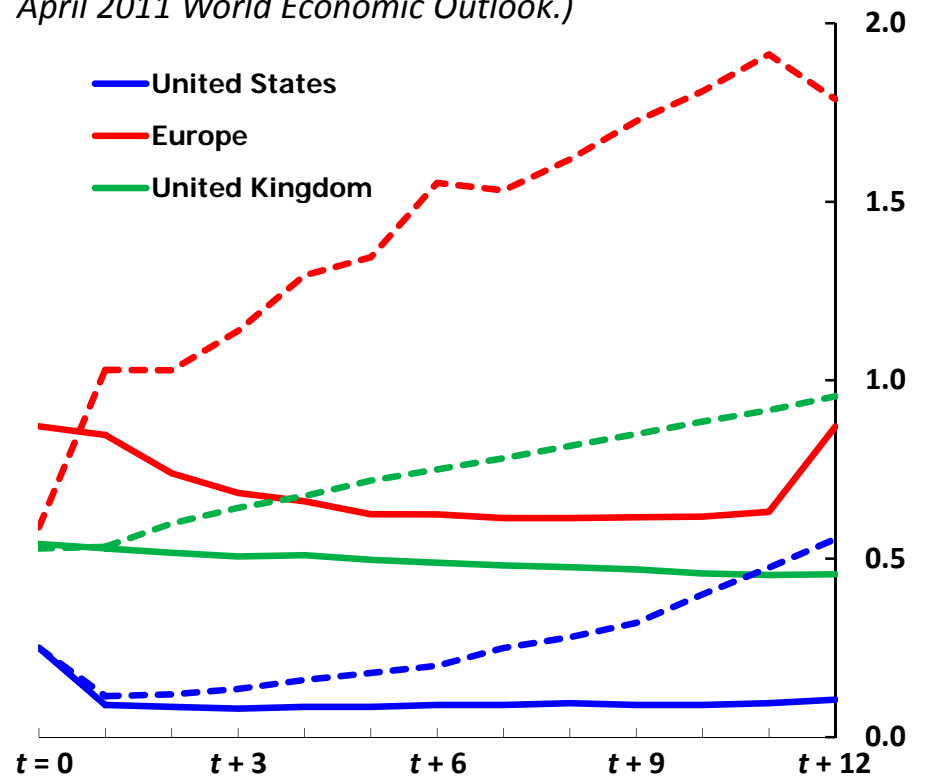
Real Short-Term Interest Rates

(percent; three-month treasury bill, relative to core inflation)

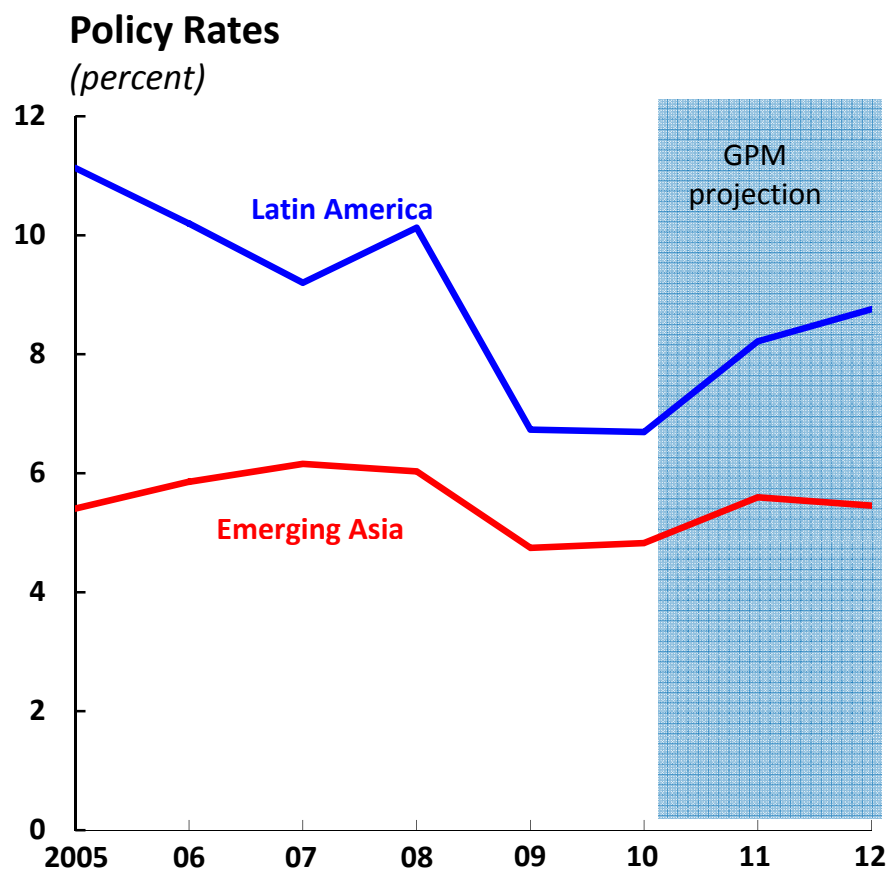


Policy Rate Expectations

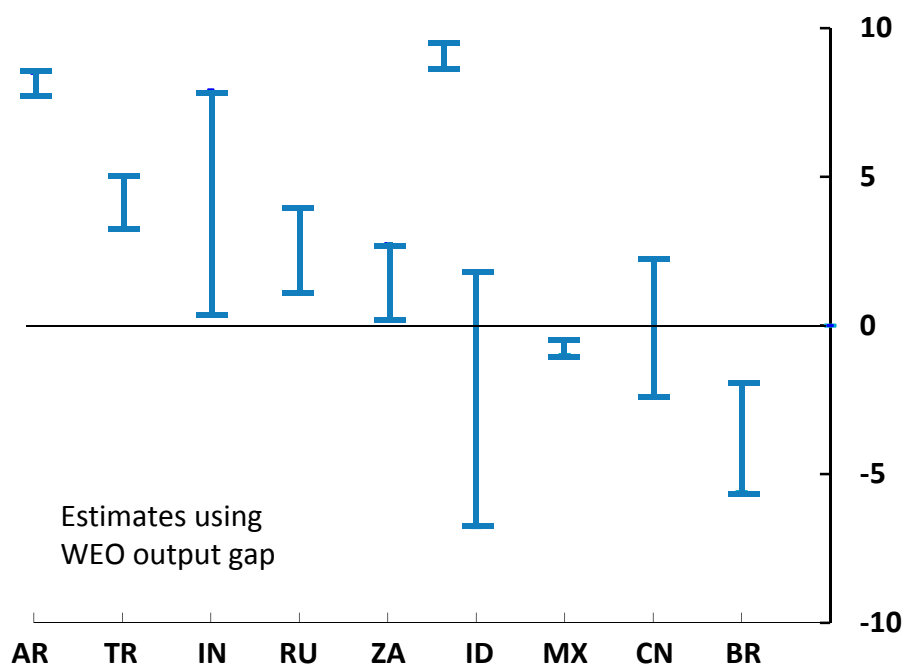
(percent; months on x-axis; dashed lines are from the April 2011 World Economic Outlook.)



EM still need to tighten but a number of them can “wait and see” before normalizing further.



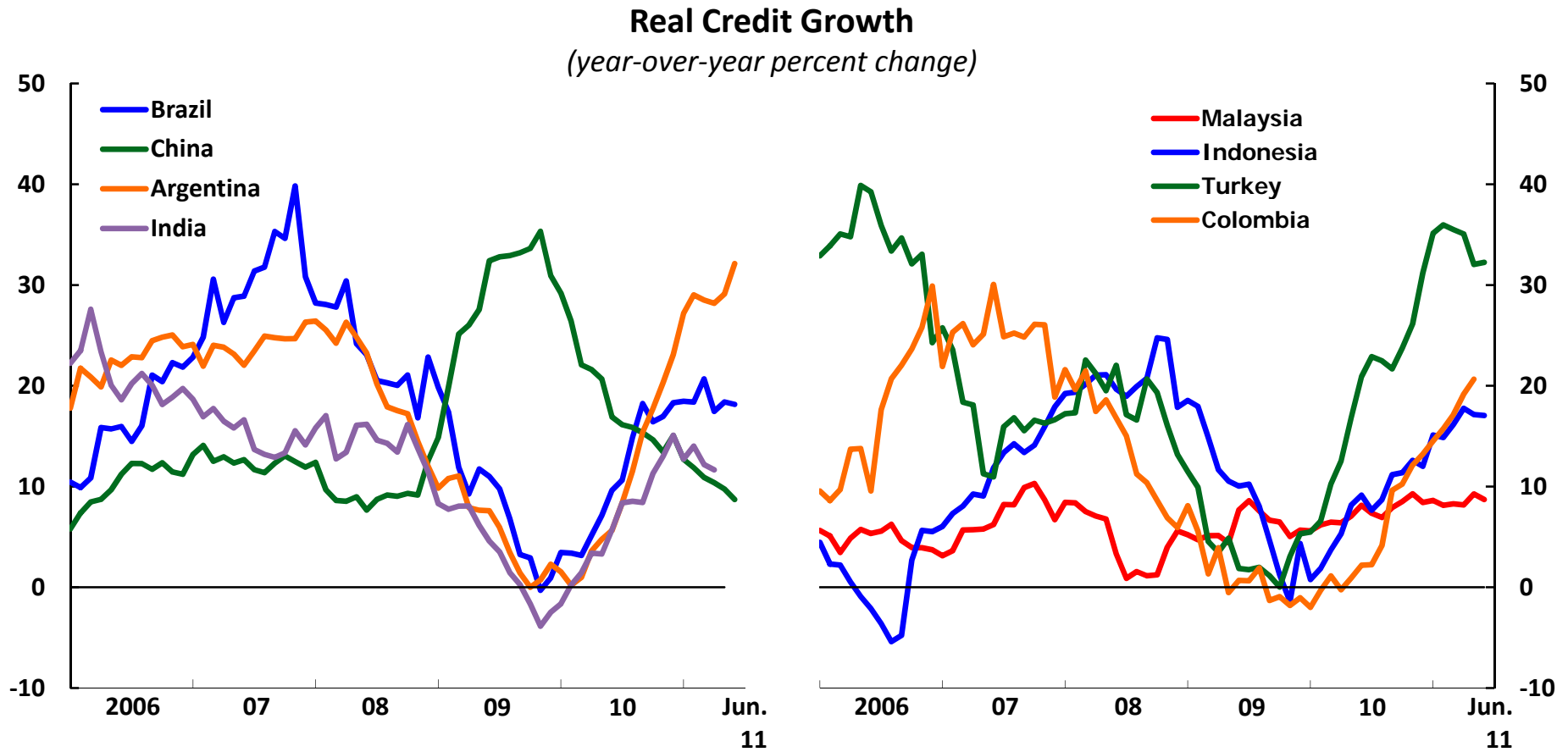
Summary of Taylor Deviations^{1,2}



¹AR: Argentina; BR: Brazil; CN: China; ID: Indonesia; IN: India; MX: Mexico; RU: Russia; TR: Turkey; ZA: South Africa.

²Taylor rule in the form of $i = \text{infl} + r^* + 0.5(\text{infl} - \text{infl}^*) + 0.5(\text{ygap})$. i is the policy rate (prescribed); infl is actual inflation, core inflation, and two-year WEO projected inflation; r^* is the equilibrium real rate = 2; infl^* is 2 percent for advanced economies and 4 percent for emerging economies; ygap is the output gap (WEO) and output relative to the precrisis trend in percent.

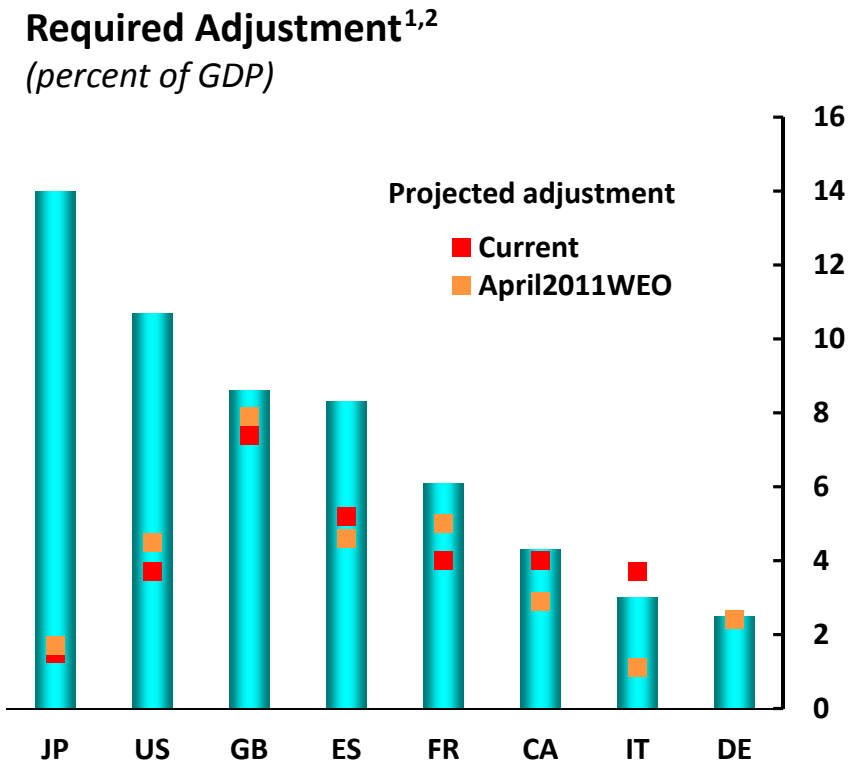
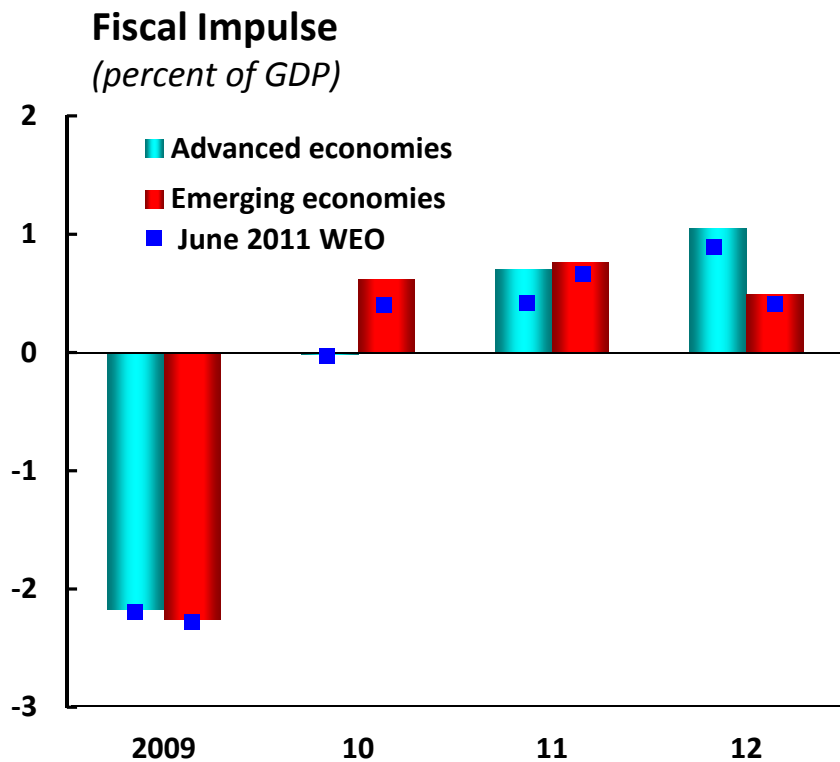
Real credit growth is still high in a number of EM— watch for prudential risks.



Fiscal withdrawal has been larger than expected in 2011.

AE: MT consolidation → room for ST support.

EM: continue to consolidate, room for support if growth slows.



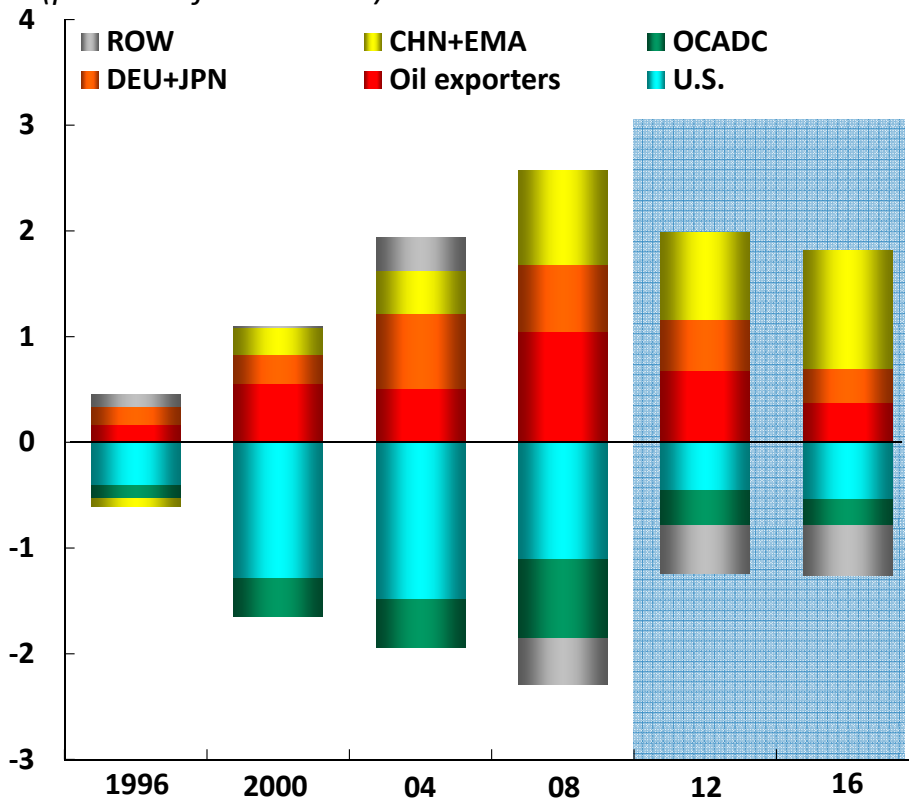
Sources: IMF, *Fiscal Monitor*; and IMF staff calculations.

¹ CA: Canada, FR: France, DE: Germany, IT: Italy, JP: Japan, ES: Spain, GB: United Kingdom, US: United States.

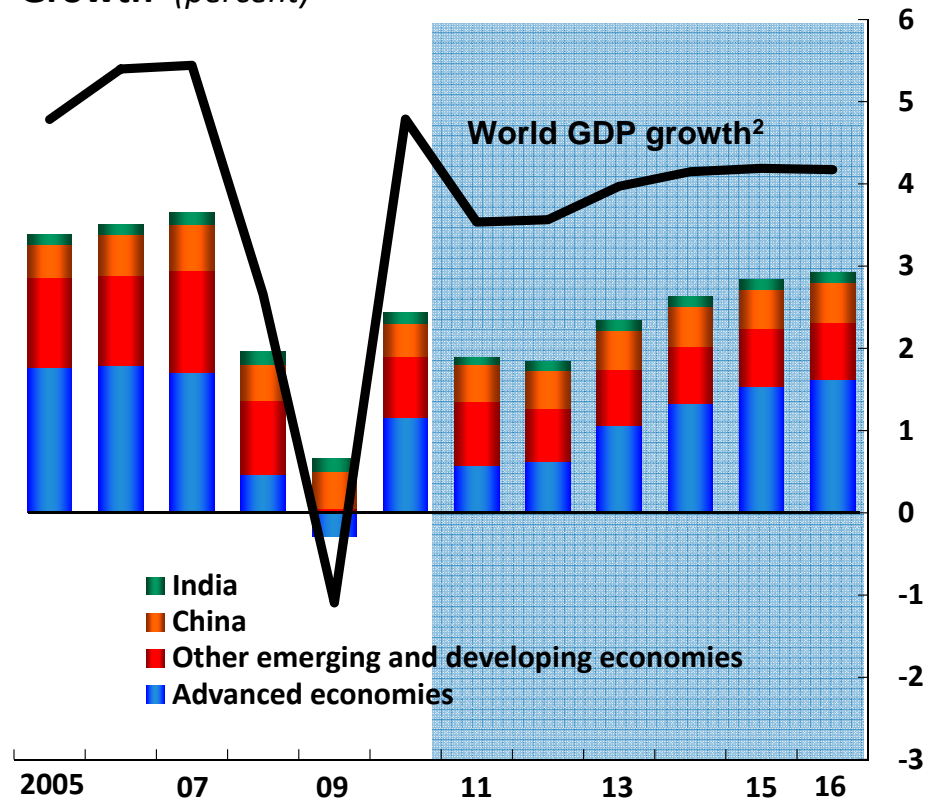
² Cyclically adjusted primary balance adjustment needed to the debt ratio to 60 percent in 2030, except for Japan.

Global demand rebalancing is stuck—EM not making up for less AE consumption. **Structural reforms are needed.**

Global Imbalances¹
(percent of world GDP)



Country Contributions to Global Consumption Growth¹ (percent)

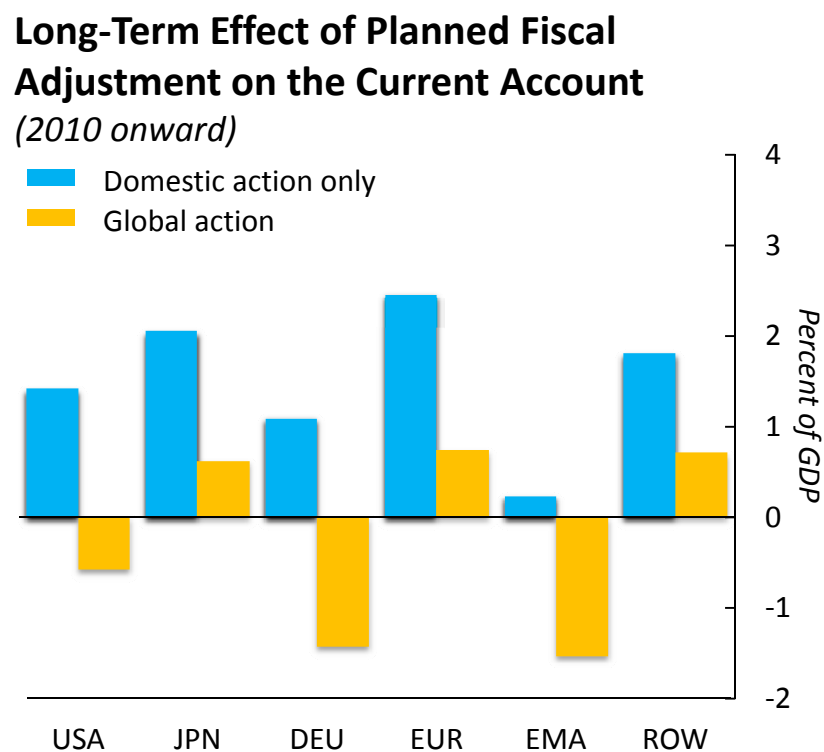
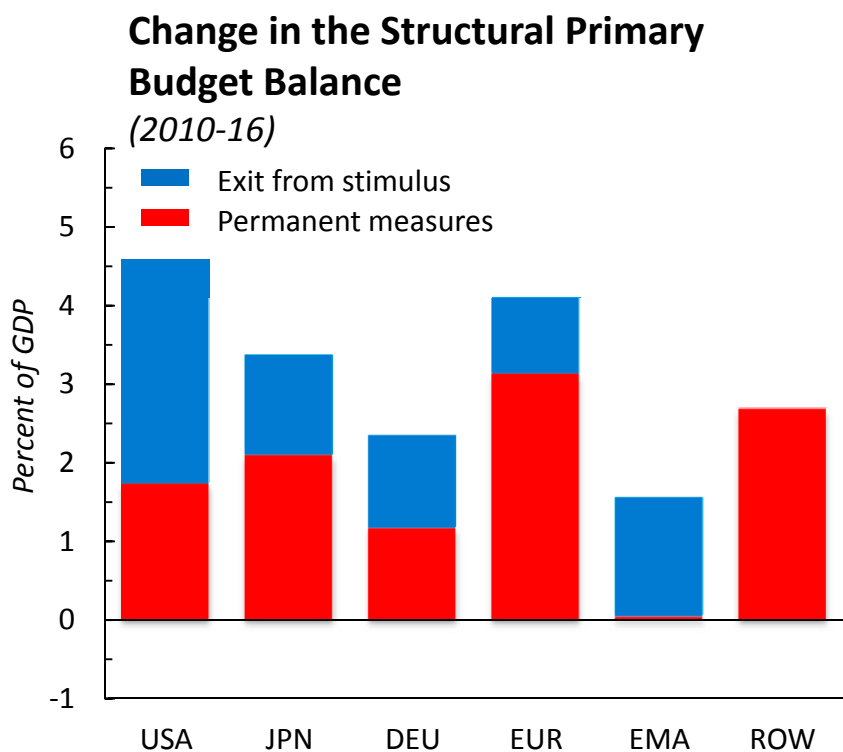


¹ CHN+EMA: China, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan Province of China, and Thailand; DEU+JPN: Germany and Japan; OCADC: Bulgaria, Croatia, Czech Republic, Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Turkey, and United Kingdom; ROW: rest of the world; US: United States.

¹ Based on GDP at 2007 market exchange rates.

² Based on 2007 PPP weights.

Rebalancing and Fiscal Policy: Contributions Under Current Plans



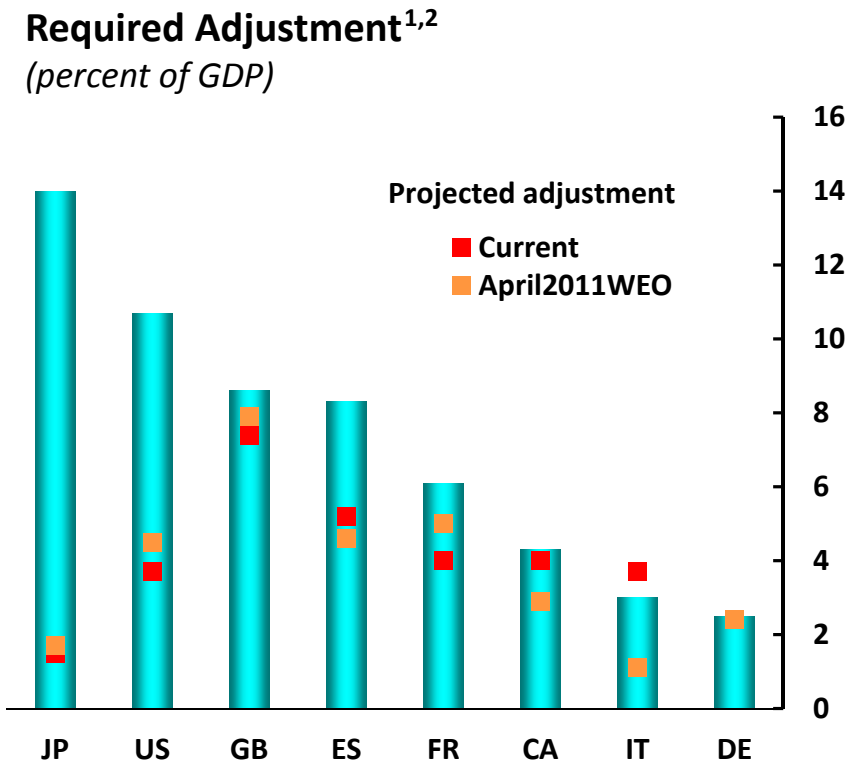
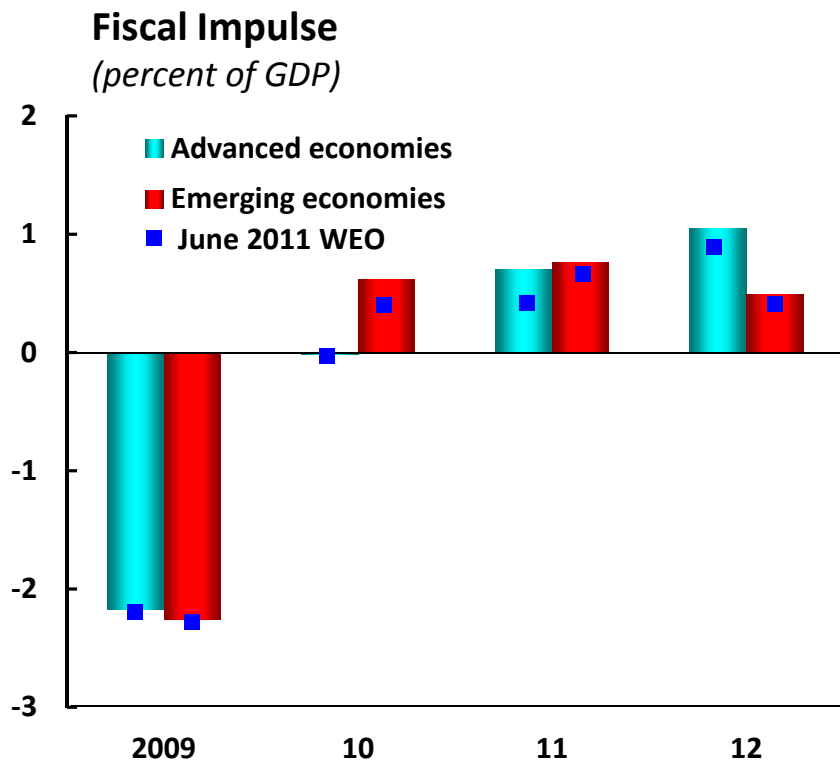
Source: IMF staff calculations, GIMF simulations.

Note: DEU: Germany; EMA: emerging Asia; EUR: euro area excluding Germany; JPN: Japan; ROW: rest of the world; USA: United States.

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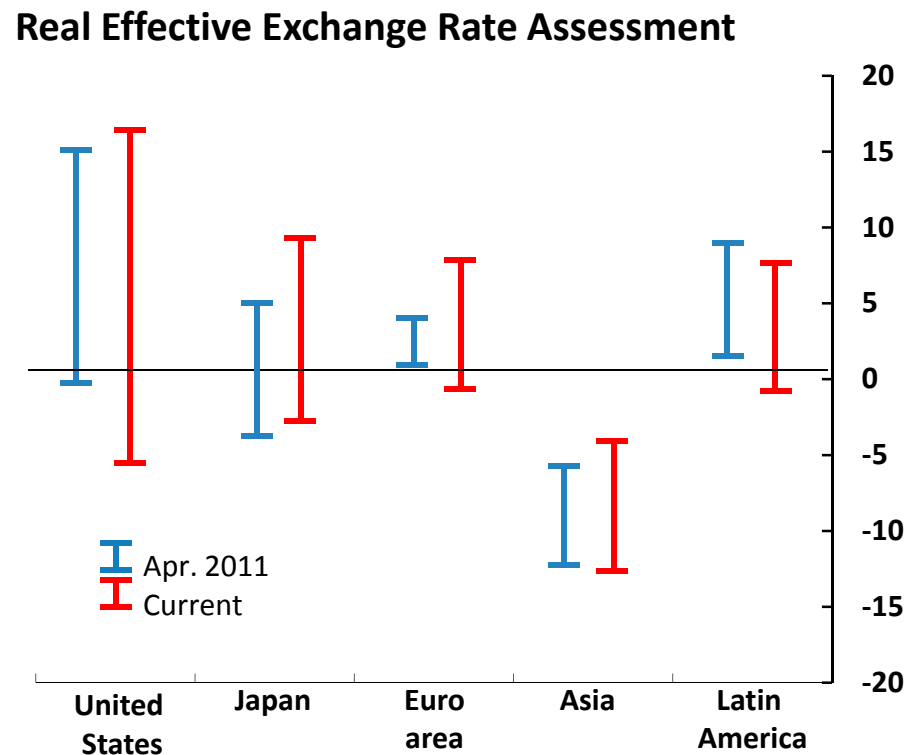
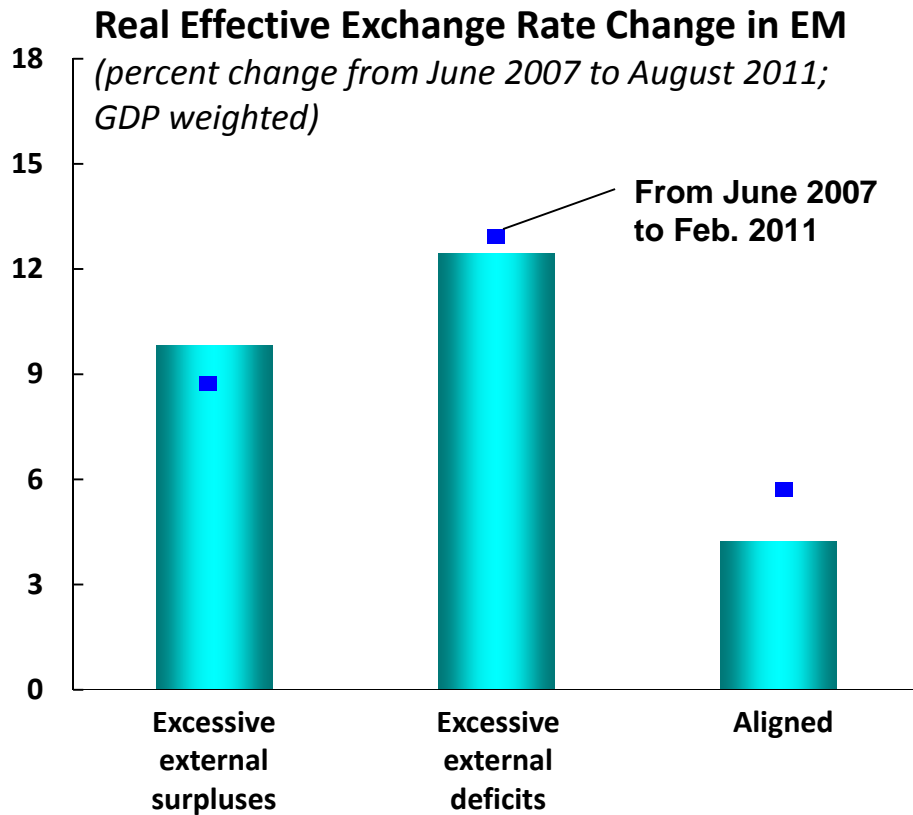


Sources: IMF, *Fiscal Monitor*; and IMF staff calculations.

¹ CA: Canada, FR: France, DE: Germany, IT: Italy, JP: Japan, ES: Spain, GB: United Kingdom, US: United States.

² Cyclically adjusted primary balance adjustment needed to the debt ratio to 60 percent in 2030, except for Japan.

More and better balanced exchange rate adjustment is needed.



There remains a path to recovery but time is running out

Advanced economies: supportive monetary policy; credible medium-term fiscal consolidation and short-term support; **strengthened euro area crisis management framework; bank capital buffers (incl. from EFSF).**

Emerging and developing economies: structural reforms and currency appreciation in key surplus economies; policies to avert build-up of financial vulnerabilities; social safety nets.

Other (regulatory, IMS, etc): enhance IMF surveillance and strengthen global financial safety net; reform global financial system; trade.