FOREWORD

The dynamics that were emerging at the time of the October 2013 *World Economic Outlook* are becoming more visible:

The recovery then starting to take hold in advanced economies is becoming broader. Fiscal consolidation is slowing, and investors are less worried about debt sustainability. Banks are gradually becoming stronger. Although we are far short of a full recovery, the normalization of monetary policy—both conventional and unconventional—is now on the agenda.

These dynamics imply a changing environment for emerging market and developing economies. Stronger growth in advanced economies implies increased demand for their exports. The normalization of monetary policy, however, implies tighter financial conditions and a tougher financial environment. Investors will be less forgiving, and macroeconomic weaknesses will become more costly.

Acute risks have decreased, but risks have not disappeared. In the United States, the recovery seems solidly grounded. In Japan, Abenomics still needs to translate into stronger domestic private demand for the recovery to be sustained. Adjustment in the south of Europe cannot be taken for granted, especially if Euro wide inflation is low. As discussed in the April 2014 *Global Financial Stability Report,* financial reform is incomplete, and the financial system remains at risk. Geopolitical risks have arisen, although they have not yet had global macroeconomic repercussions.

Looking ahead, the focus must increasingly turn to the supply side:

Potential growth in many advanced economies is very low. This is bad on its own, but it also makes fiscal adjustment more difficult. In this context, measures to increase potential growth are becoming more important—from rethinking the shape of labor market institutions, to increasing competition and productivity in a number of nontradables sectors, to rethinking the size of the government, to examining the role of public investment.

Although the evidence is not yet clear, potential growth in many emerging market economies also appears to have decreased. In some countries, such as China, this may be in part a desirable byproduct of more balanced growth. In others, there is clearly scope for some structural reforms to improve the outcome.

Finally, as the effects of the financial crisis slowly diminish, another trend may come to dominate the scene, namely, increased income inequality. Though inequality has always been perceived to be a central issue, until recently it was not believed to have major implications for macroeconomic developments. This belief is increasingly called into question. How inequality affects both the macroeconomy and the design of macroeconomic policy will likely be increasingly important items on our agenda.

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