

IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, SEPTEMBER 2015

The following remarks were made by the Chair at the conclusion of the Executive Board's discussion of the World Economic Outlook, Global Financial Stability Report, and Fiscal Monitor on September 21, 2015.

Executive Directors broadly shared the assessment of global economic prospects and risks. They noted that global growth remains modest and uneven across countries and regions, while financial market volatility has increased in recent months. Downside risks to the global outlook have risen, with emerging market and developing economies particularly exposed to the declining commodity prices and tighter global financial conditions. Directors observed that persistent weak growth in advanced economies and the fifth consecutive year of growth declines in emerging market economies reflect both country-specific developments and common forces of a medium- and long-term nature. Forceful policy action on all fronts, as well as enhanced international cooperation, has become more crucial than ever to reverse this trend and promote stronger, more balanced global growth.

Directors broadly concurred that, in advanced economies, the foundations for a modest recovery in 2015–16 are still intact, while financial stability has generally improved. They noted that a sustained recovery in the euro area, a return to positive growth in Japan, and continued robust activity in the United States are positive forces, although increased market volatility may pose financial stability challenges in the near term. Medium-term prospects remain subdued, reflecting unfavorable demographics, weak productivity growth, and high unemployment, as well as legacy issues from the crisis—including high indebtedness, low investment, and financial sector weakness. A key risk is a further decline of already-low growth that could turn into near stagnation, especially if slower growth in emerging market economies dampens global demand. In this context, persistent below-target inflation could become more entrenched.

Directors noted that the overall outlook for emerging market and developing economies is generally weakening, reflecting tighter global financial conditions, China's transition toward consumption-driven

sustainable growth, a weaker commodity market outlook, and geopolitical tensions. However, growth prospects differ considerably across countries. Emerging market economies are vulnerable to shifts in exchange rates and a reversal of capital flows. Meanwhile, further declines in commodity prices could weaken the outlook for commodity exporters. While China's transition and the ensuing slowdown have long been anticipated, a sharper-than-expected growth decline, if it materialized, could generate considerable spillovers and risks for other countries.

Directors acknowledged that the global financial outlook is clouded by increased emerging market vulnerabilities, legacy issues from the crisis in advanced economies, and concerns about weak market liquidity. They noted in particular high corporate leverage and foreign-currency exposures in emerging market economies, headwinds from balance sheet weaknesses in advanced economies, and remaining gaps in the euro area financial architecture. In the context of rising policy rates, the global financial system may see adjustment as financial conditions tighten and risk premiums rise from historically low levels. Directors recognized that interest rate normalization in the United States driven by robust activity will benefit the world economy and also reduce uncertainty—and hence should take place in a timely, data-dependent manner.

Directors underscored that raising both actual and potential output continues to be a policy priority, requiring mutually reinforcing measures for demand support and structural reforms. They concurred that the main policy recommendations are appropriate, although the right balance of policy mix will vary from country to country. A collective effort is needed to boost trade growth, avoid trade protectionist measures, refrain from competitive devaluations, and reduce the persistent global imbalances.

Directors agreed with the policy priorities for full employment and stable inflation in advanced

economies. Accommodative monetary policy remains essential, particularly in Japan and the euro area, while efforts should continue, where needed, to enhance policy transmission and address financial system risks through continued balance sheet repair and macro-prudential policies. Fiscal policy should remain prudent, yet flexible and growth friendly, anchored in sound medium-term strategies. Countries with fiscal space and sizable output gaps or significant current account surpluses should ease their fiscal stance in the near term, especially by increasing investment in high-quality, high-return infrastructure projects. Structural reforms should aim to strengthen labor force participation and trend employment, facilitate labor market adjustment, tackle legacy debt overhang, and lower barriers to entry in product markets, especially in services.

Directors recognized that emerging market and developing economies in general are now better prepared for the current, less favorable environment—with stronger fundamentals, buffers, and policy frameworks. Nevertheless, they face a difficult trade-off between supporting demand and reducing vulnerabilities. The scope for further easing macroeconomic policies varies considerably across countries, depending on the extent of economic slack and inflationary pressures and fiscal space, as well as external, financial, and fiscal vulnerabilities. Directors agreed that exchange rate flexibility, where feasible, in the context of a well-specified policy framework, can help absorb external shocks. They stressed that, in many countries, structural reforms are urgently needed to raise productivity and remove bottlenecks to production.

Directors concurred that, in a more difficult external environment, developments in low-income countries should be given particular attention. Many of these countries are commodity exporters whose initial conditions have already been strained, fiscal and external balances are deteriorating, and absorptive capacity is limited. Appropriate policy advice and adequate financial assistance from development partners, including the Fund, will be essential to support low-income countries in their adjustment efforts and advancement

toward the Sustainable Development Goals. Their priorities generally include economic diversification, domestic revenue mobilization, and financial sector deepening.

Directors highlighted the importance of preserving financial stability, safeguarding against market illiquidity, and maintaining confidence in policymaking. For advanced economies, priorities should include continued clear and effective communication of monetary policy intentions, and a comprehensive strategy to tackle nonperforming loans and complete the financial architecture in the euro area. Liquidity conditions, especially for nonbanks, should be closely monitored, and market structure solutions to liquidity shortages should be explored. Completing the global financial regulatory reform agenda requires further progress on implementation, finalization of outstanding reforms, and addressing emerging risks.

Directors emphasized the need to address both cyclical and structural challenges in emerging market economies. They agreed that policymakers should rely on micro- and macro-prudential tools to discourage the buildup of excessive leverage, strengthen provisioning by banks, and improve regulations on credit quality classification. Foreign-currency exposures warrant special attention and the reform of corporate insolvency regimes should continue. Rebalancing and deleveraging in China will require a careful pacing and sequencing of market-based reforms, a further strengthening of the financial system, and strong implementation of the reform agenda.

Directors noted that lower oil prices present both opportunities and challenges. In many oil-importing countries, lower oil prices have eased the burden on monetary policy and created some fiscal policy space. Exporters of oil and other commodities with worsening terms of trade will need to adjust public spending in the face of lower commodity-related revenue. These countries should also continue to upgrade their fiscal policy frameworks and provide a longer-term anchor to guide policy decisions. Reforms of energy subsidies and taxation remain an important priority for many countries.