

IMF EXECUTIVE BOARD DISCUSSION OF THE
OUTLOOK, APRIL 2009

The following remarks by the Acting Chair were made at the conclusion of the Executive Board's discussion of the World Economic Outlook on April 13, 2009.

Executive Directors noted that the global economy is in the grip of a severe recession inflicted by a massive financial crisis and an acute loss of confidence. The world economic outlook has worsened significantly since the October 2008 *World Economic Outlook*, as a dramatic escalation of the financial crisis has provoked an unprecedented contraction in global economic activity and trade. Shrinking activity, synchronized across countries, has added to pressure on balance sheets of financial institutions as asset values have continued to decline, discouraging lending to households and corporations. The adverse feedback between economic activity and the financial sector has thus intensified. While wide-ranging and often unorthodox policy responses have helped to diminish the most dangerous systemic risks, financial market stabilization is taking considerably longer than previously envisaged. Moreover, the crisis, which originated in the advanced economies, has now spread to emerging market economies. Emerging and developing economies are expected to face greatly curtailed access to external financing.

Against this backdrop, the *World Economic Outlook* projects that world output will contract by about 1.3 percent in 2009, which would represent by far the deepest post-World War II recession. Growth is expected to reemerge in 2010 but to be sluggish relative to past recoveries. Inflation pressures are projected to subside, and some advanced economies are expected to experience periods of consumer price declines. The IMF staff assesses the current outlook to be exceptionally uncertain and subject to considerable downside risks. A number of Directors

suggested that the recession could be more protracted, given the principal concern that policies may not succeed in arresting the adverse feedback between deteriorating financial conditions and weakening economies. A number of others, however, pointed to some tentative, encouraging signs in financial sector and real economy data, which could presage an earlier recovery. In light of these significant uncertainties and amid unprecedented circumstances, Directors underscored the need for balanced and nuanced assessments. Directors welcomed the efforts to closely integrate the conclusions of the *Global Financial Stability Report* and the *World Economic Outlook* analyses and stressed the need to reflect such integration in a coherent and consistent communication strategy for the public presentation of the documents.

Directors stressed that the grim and uncertain outlook calls for forceful action on the financial and macroeconomic policy fronts, with careful consideration of their cross-border implications. Directors also recognized that additional measures need to reflect varying country circumstances, the policies implemented to date, and medium-term policy objectives.

Directors agreed that the greatest policy priority at this juncture is financial sector restructuring, particularly to deal with distressed assets and to recapitalize weak but viable institutions. Directors welcomed the various initiatives announced in many advanced economies to address the serious difficulties in financial sectors. However, recognizing that market strains remain acute and that confidence is far from being restored, they stressed the need for firm policy implementation. An enduring solution

must be underpinned by credible loss recognition of impaired assets, supported with adequate funding and implemented in a transparent manner. Regarding recapitalization, Directors emphasized that efforts must be rooted in a careful evaluation of the long-term viability of institutions and that viable banks with insufficient capital should be recapitalized quickly. Nonviable financial institutions need to be resolved promptly through closures, mergers, or possibly a temporary period of public ownership until a private sector solution can be developed. Regarding financial sector policies in emerging economies, Directors were encouraged that some countries have taken steps to keep trade flowing and support credit to the corporate sector.

Turning to macroeconomic policies, Directors welcomed the concerted policy actions taken by many countries. They recommended that monetary policy needs to continue to respond to the deteriorating outlook. Although policy rates are already near the zero floor in many advanced economies, whatever policy room remains should be used quickly. At the same time, central bankers should underline their determination to avoid deflation by sustaining easy monetary conditions for as long as necessary. To this end, most Directors supported recourse to less conventional measures, including using the central bank's own balance sheet to support intermediation, especially in dislocated credit markets.

In view of the extent of the downturn and the limits to the effectiveness of monetary policy, Directors stressed that fiscal policy must continue to play a crucial part in providing short-term stimulus to the global economy. Considering that the room to provide fiscal support will be limited if credibility is eroded, Directors recognized that governments are facing a difficult balancing act of delivering short-term expansionary policies but also providing reassurance about medium-term prospects. However, this tension could be alleviated by focusing on temporary, high-impact stimulus measures that raise the economy's productive potential. Gov-

ernments should complement short-term initiatives with reforms to strengthen medium-term fiscal frameworks, particularly through credible actions to tackle the fiscal challenges posed by aging populations. Also, coordinated stimulus across countries with fiscal room will maximize benefits to the global economy. Accordingly, Directors welcomed the fact that many countries are contributing to fiscal expansion in 2009, and most Directors thought that continued fiscal support would be needed for 2010. Some Directors considered it premature to pursue further discretionary fiscal easing, pointing to uncertain fiscal policy lags and multipliers and the risk of such policies becoming procyclical once the recovery begins.

Directors expressed concern at the widening impact of the global financial crisis on emerging market economies, while recognizing the significant differences both across and within regions. Several Directors noted that many emerging markets are better positioned to weather the crisis than in earlier episodes of financial stress, owing to improved fundamentals and strengthened macroeconomic policy frameworks. Emerging European economies have, however, been hit hardest, reflecting some countries' large domestic and external imbalances. Directors also acknowledged that monetary policy actions to support activity may be complicated by the need to sustain external stability in the face of highly fragile financing flows in a number of emerging markets. To the extent that domestic central banks are unable to supply the needed foreign exchange, advanced economy central banks, the IMF, and other international agencies could play a useful role through their various credit lines and other facilities. Directors noted that the IMF is well equipped to support such efforts, including through the recent modernization of its lending toolkit, including the new Flexible Credit Line.

Looking further ahead, Directors observed that policymakers face important medium-term challenges. As financial regulation has proved ill equipped to address the risk concentrations and flawed incentives behind the financial innova-

tion boom, Directors generally agreed that the perimeter of regulation should be broadened to cover all systemically relevant institutions. Regarding macroeconomic policies, the significant ongoing expansion of central bank balance sheets and fiscal spending calls for careful consideration of exit strategies and orderly unwinding of outstanding positions as the situation improves. A number of Directors considered that central banks may need to adopt a broader macroprudential view, paying due attention to financial stability as well as price stability. Fiscal policymakers will need to bring down deficits and put public debt on a sustainable trajectory. Another challenge will be to sustain productivity growth as economies recover, which will depend on continued product and labor market reforms and integration into global markets. Low-income countries should undertake structural reforms to diversify sources of growth and improve resilience to economic shocks. Considering the weaker prospects for exports, Directors also noted that stronger consumption growth in east Asia could play a useful role in supporting output growth. Some Directors considered that this could be facilitated by more flexible exchange rate management. This, together with actions in advanced economies to rebuild effective financial intermediation and to strengthen saving in

deficit countries, should foster a successful rebalancing of the global economy. Careful attention to the size and composition of spending will be important, especially given the uncertainties regarding the pace of a return of output to trend as the recovery begins.

Directors agreed that international policy coordination and collaboration need to be strengthened. Cooperation is particularly pressing for financial policies, because of the major spillovers that domestic actions can have on other countries. The specific design of policies would appropriately vary from country to country, but policymakers should avoid policies—such as favoring domestic over foreign lending—that could lead to distortions. More generally, trade and financial protectionist pressures should be resisted. The G20 member countries' agreed moratorium over the next 12 months on introducing any new trade barriers is welcome. The stark collapse in world trade in the present crisis only heightens the importance of a rapid completion of the Doha Round to help open up markets and revitalize global growth prospects. Finally, strong support from bilateral and multilateral sources, including the IMF, could help limit the adverse economic and social fallout of the financial crisis in many emerging and developing economies.