

World Economic and Financial Prospects

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The views expressed in this presentation are those of the author
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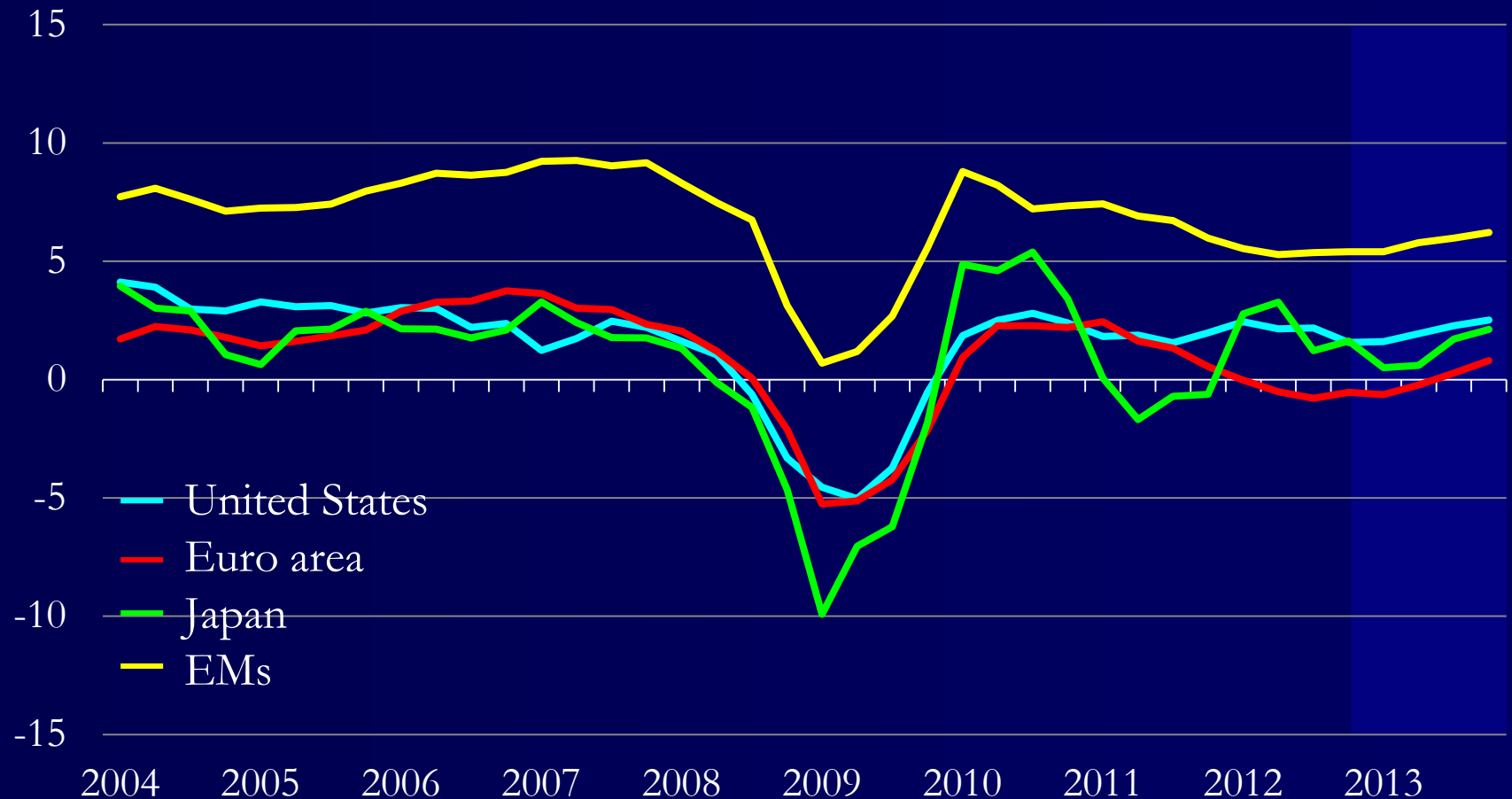
Structure of the presentation

- Developments in world economy and financial system
- Sources of uncertainty
- Actions to resolve Euro area crisis



Recovery has slowed down...

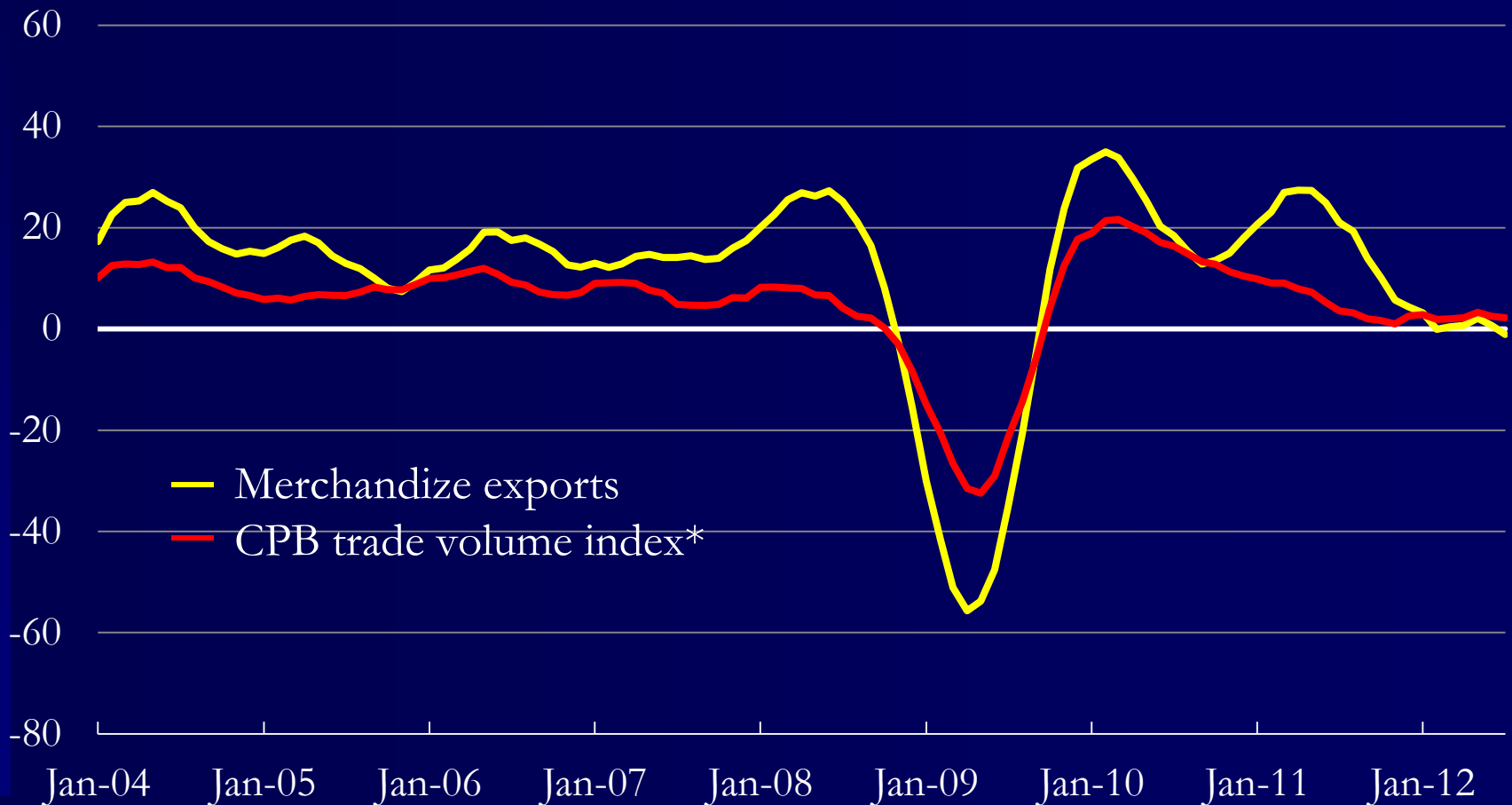
GDP Growth
(percent)



...and world trade growth has stalled.

Growth of Trade

(6 month moving average, annualized percent change)



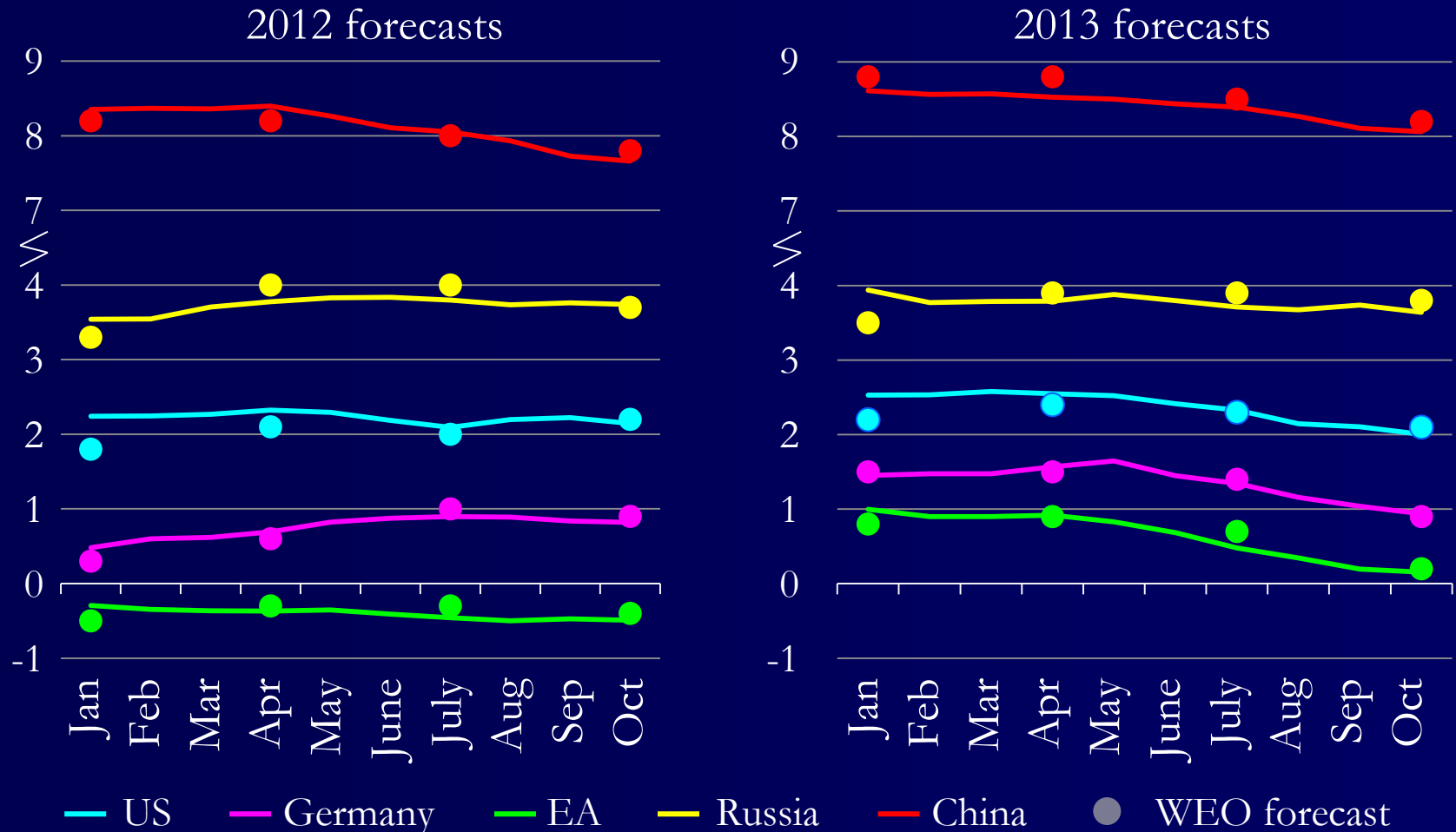
*Trade volume is calculated from the trade value deflated by CPB estimated price series



Forecasts are being revised down

Vintages of GDP Growth Consensus and WEO Forecasts

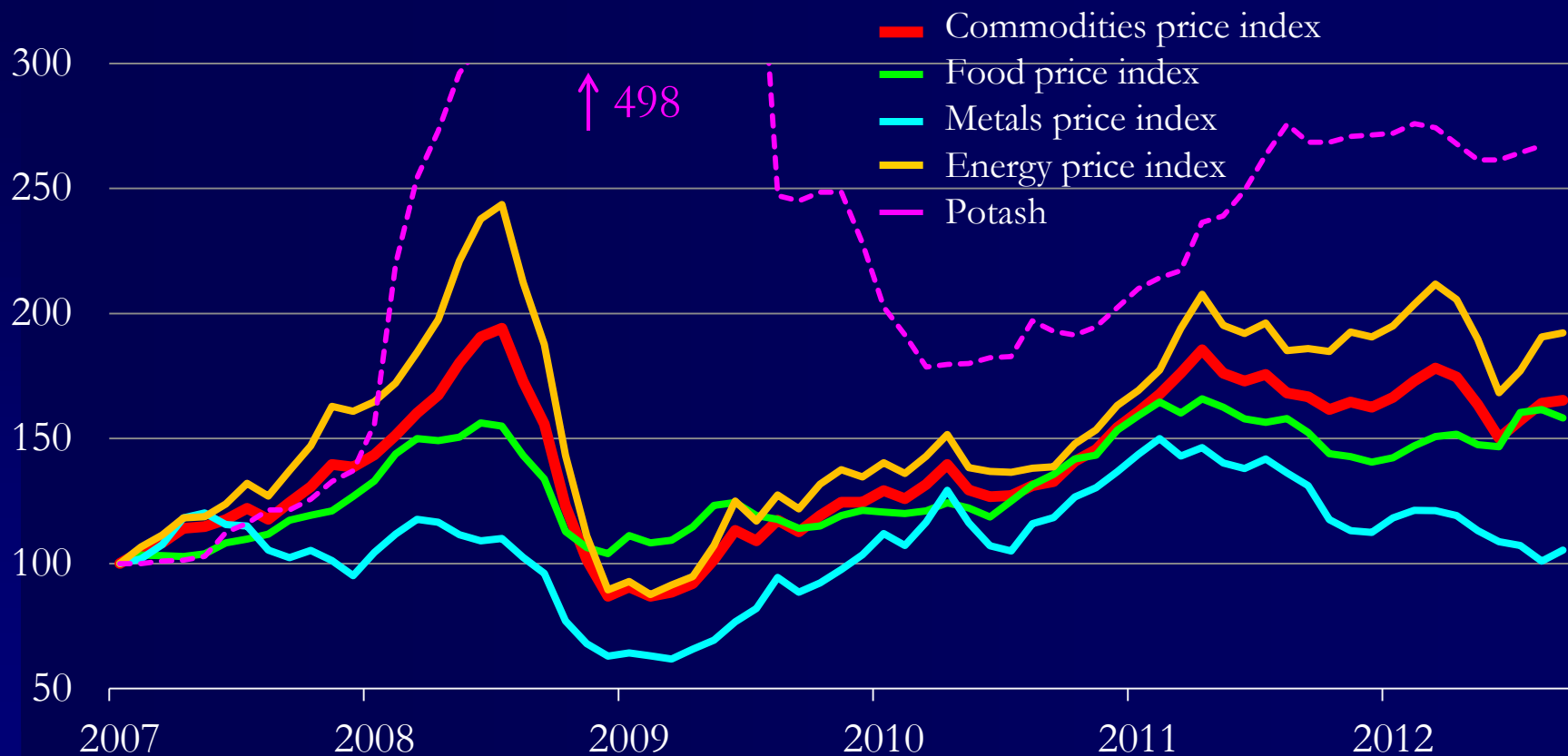
(percent)



Commodity prices seem to have stabilized

Commodities Price Indices

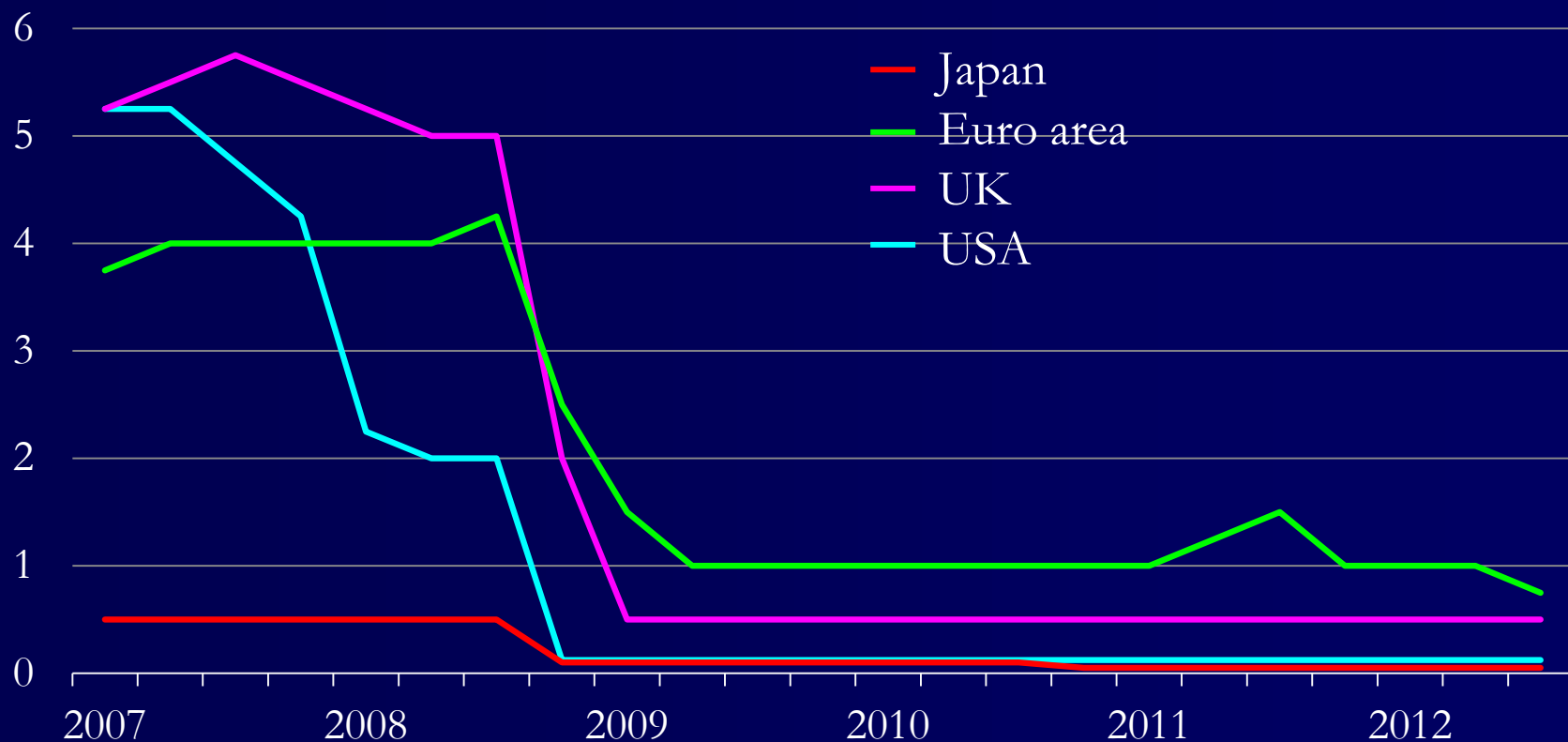
(Jan-2007=100)



Policy interest rates have been kept low...

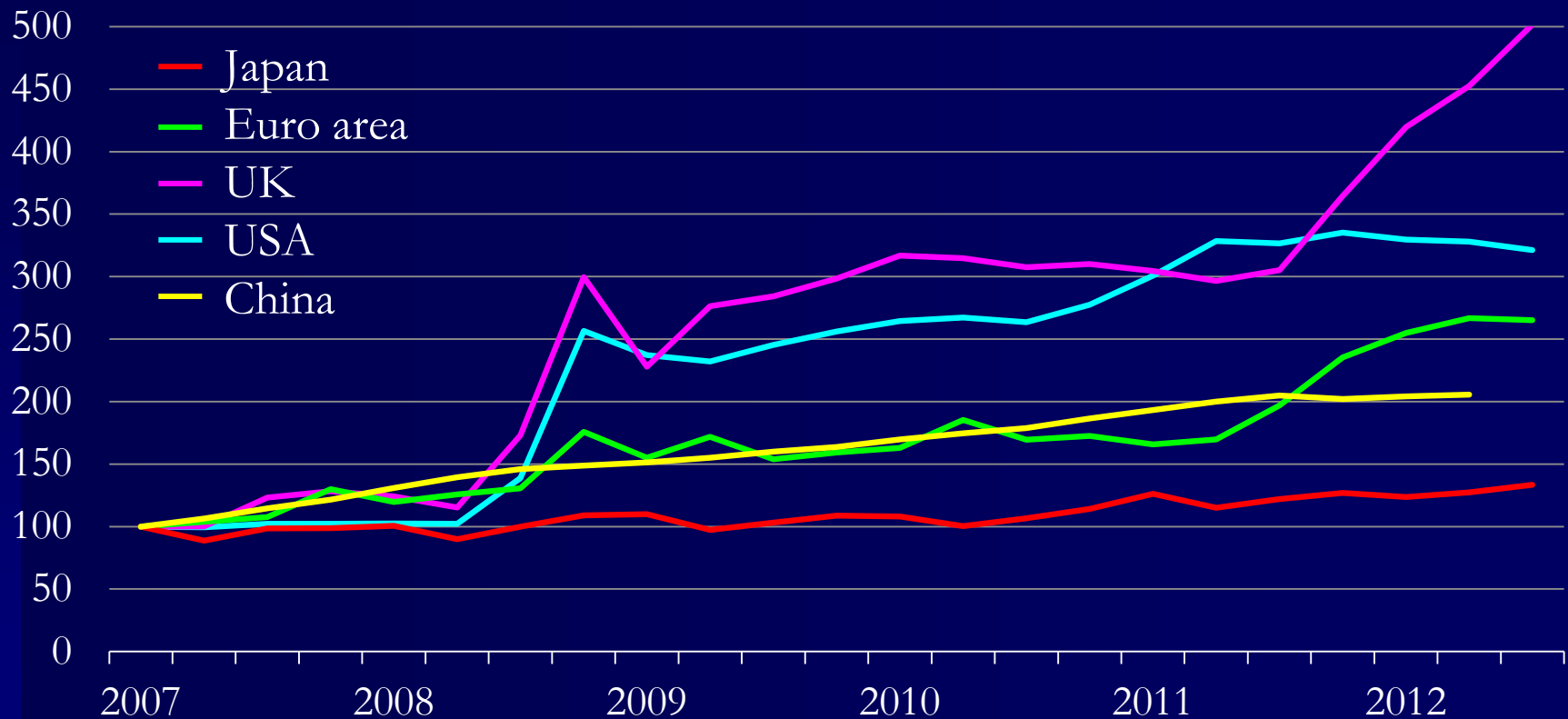
Central Bank Policy Rates

(percent)



... and central banks' balance sheets have been expanded.

Central banks balance sheet
(index, 2007Q1=100)



But there is still no sign of inflation

10-year inflation break-even rates
(percent)



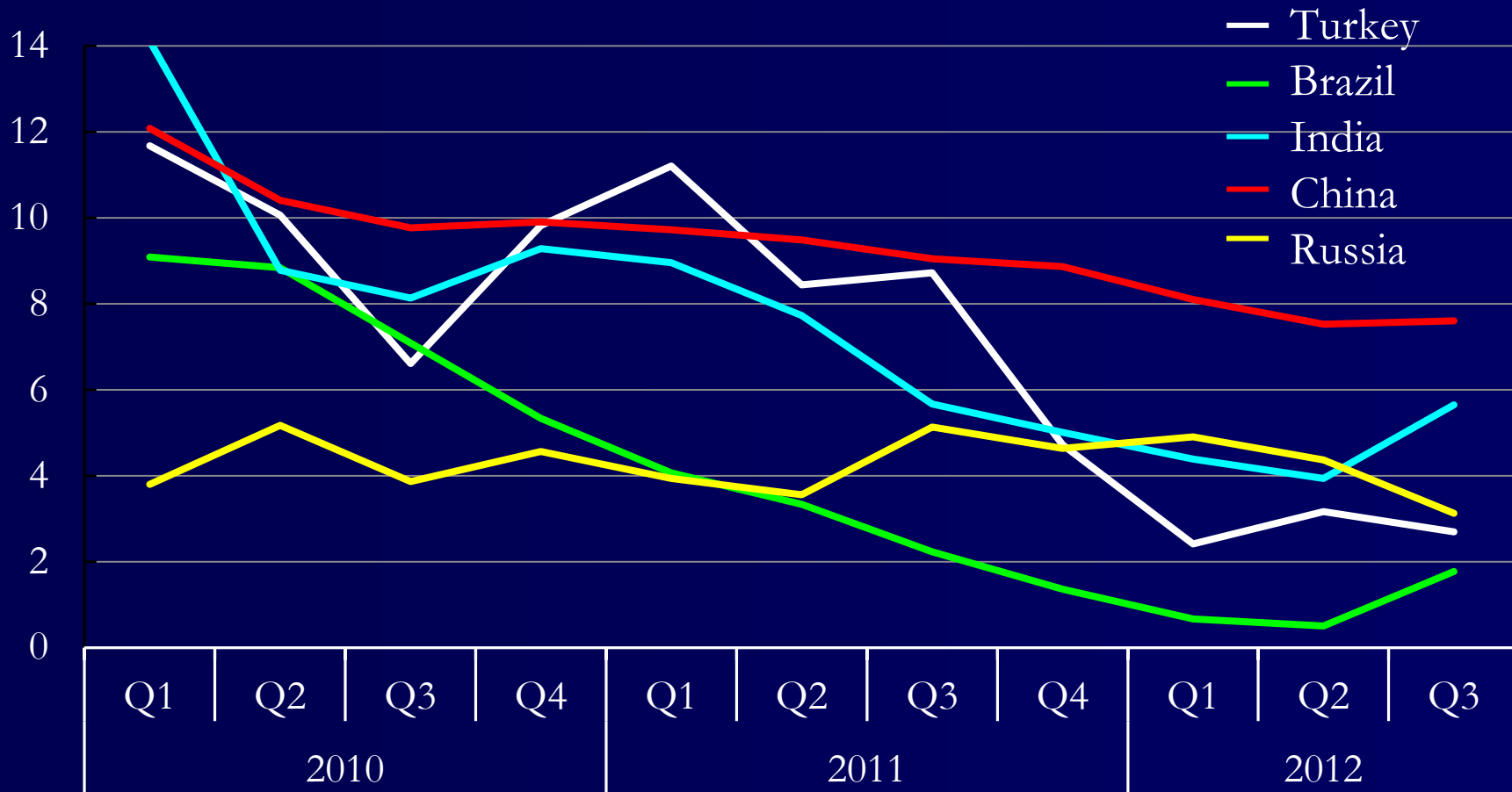
UK
Euro area
USA
Japan

Note: Starting June 2009 Japan reflects 5 –year breakeven rate

Source: Bloomberg

The boom in Emerging Markets may be over...

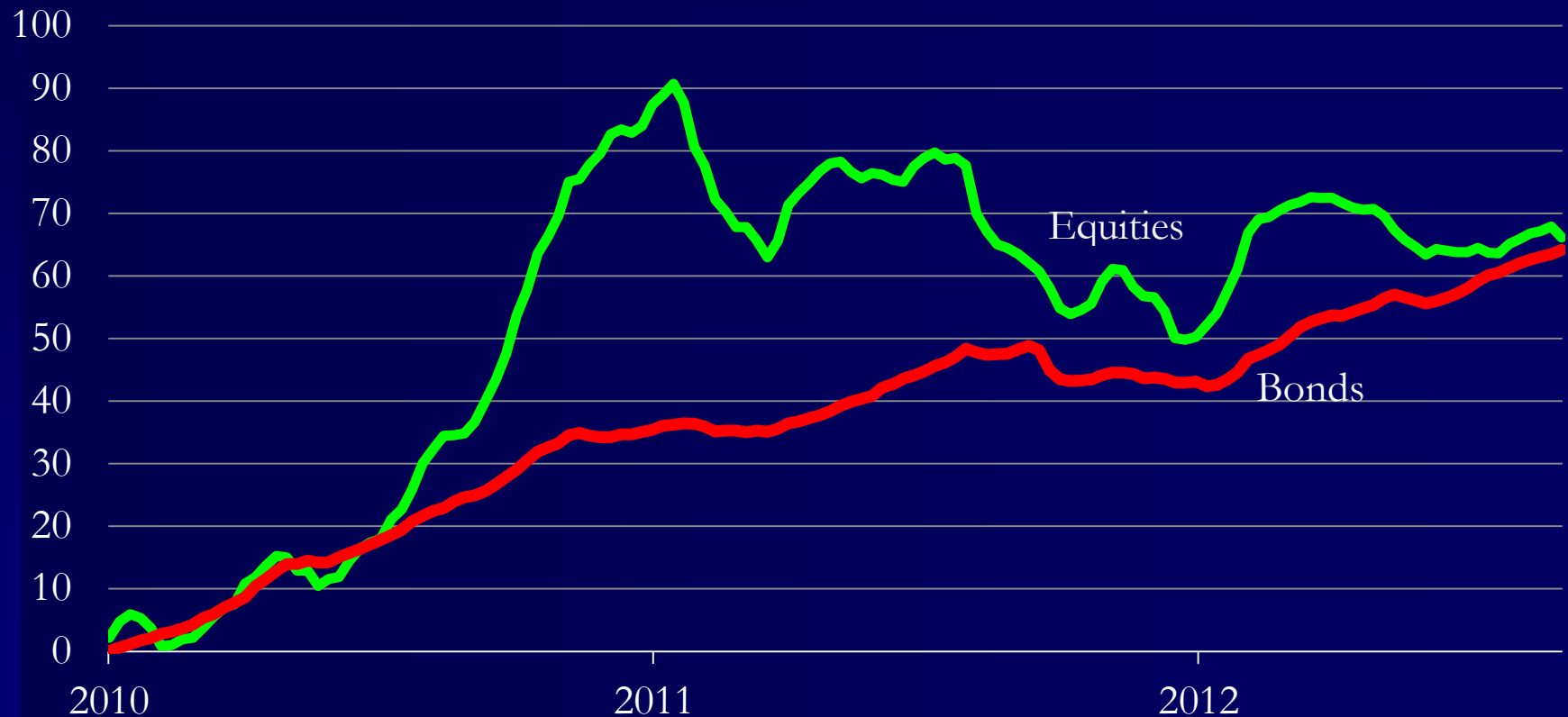
GDP Growth
(percent)



... but capital flows to EM bond markets remain strong.

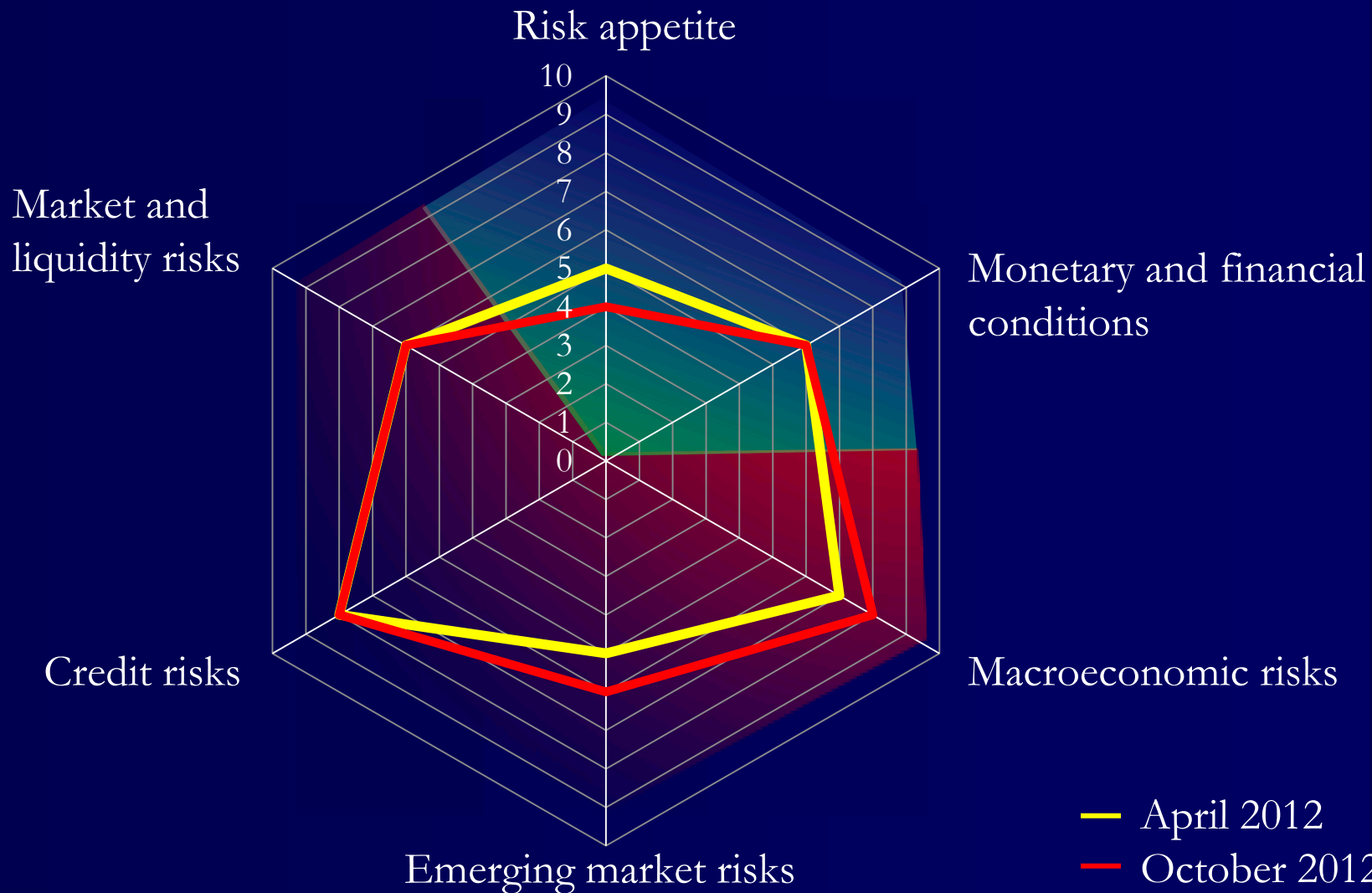
Cumulative Portfolio Flows to Emerging Market Mutual Funds

(In billions of U.S. dollars)



...and in worsening of many financial indicators.

Changes in Global Financial Stability Map since April 2012 GFSR



...and in worsening of many financial indicators.

Changes in Global Financial Stability Map since April 2012 GFSR

-
- The Global Financial Stability Map is a radar chart with six axes representing different risk categories. The scale on each axis ranges from 0 to 10. Two data series are plotted: April 2012 (green line) and October 2012 (red line). The chart shows a general shift towards higher risk levels in most categories by October 2012.
- Lower risk appetite among investors
 - Unchanged monetary and financial conditions
Tighter financial conditions offset by easier lending conditions
 - Higher macroeconomic risks from slower economic activity
 - Higher emerging market risks from inflation, corporate sector and liquidity
 - Unchanged but high credit risks
Banking sector deterioration offset by corporate sector improvement
 - Unchanged market and liquidity risk
Better liquidity and funding, and equity valuations offset by more cautious market positioning

— April 2012
— October 2012

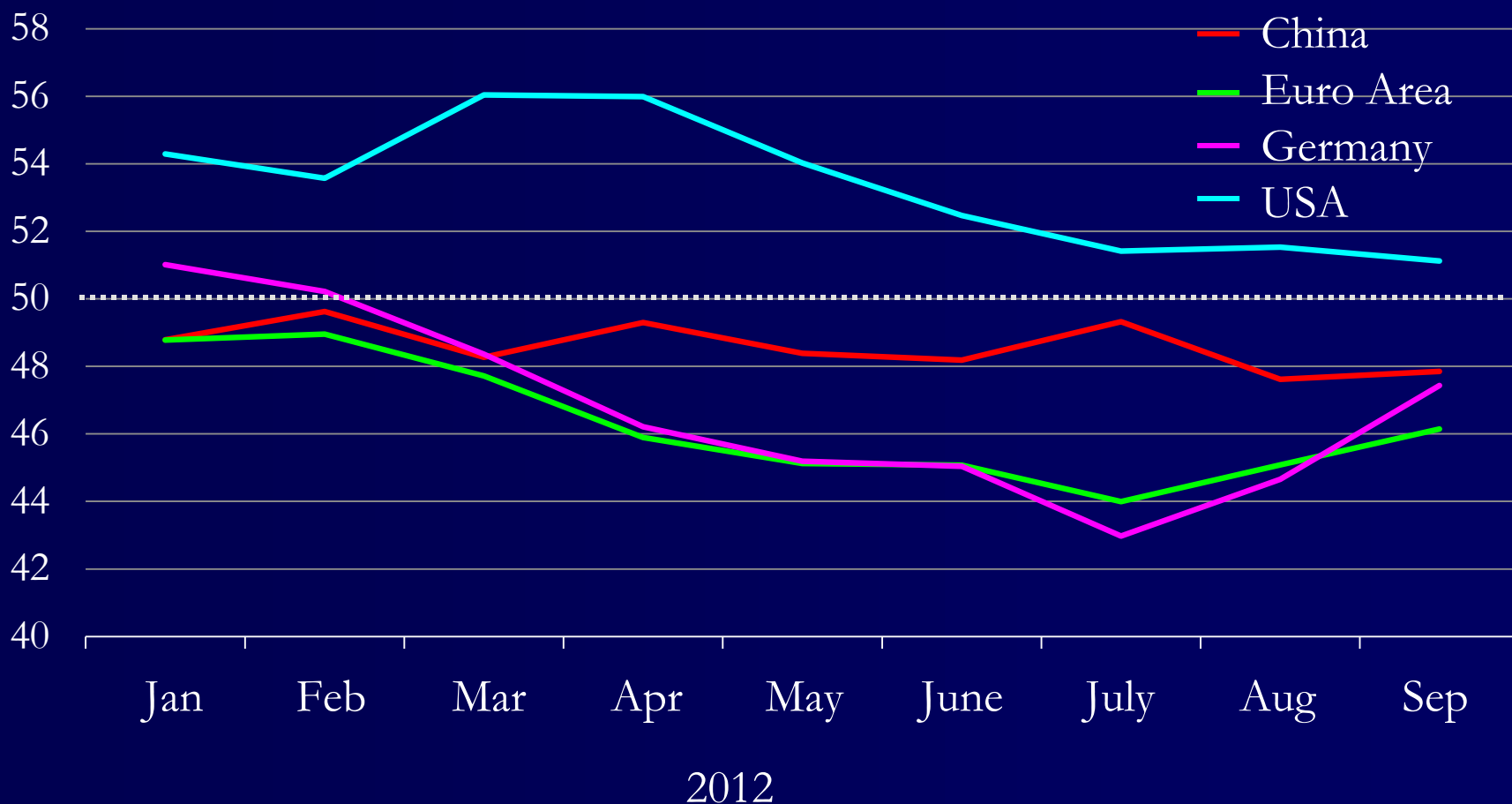
Challenges remain as before

- Recovery is weak
- US faces the fiscal cliff
- Europe is slow to resolve eurozone crisis
- Emerging markets may face hard landing



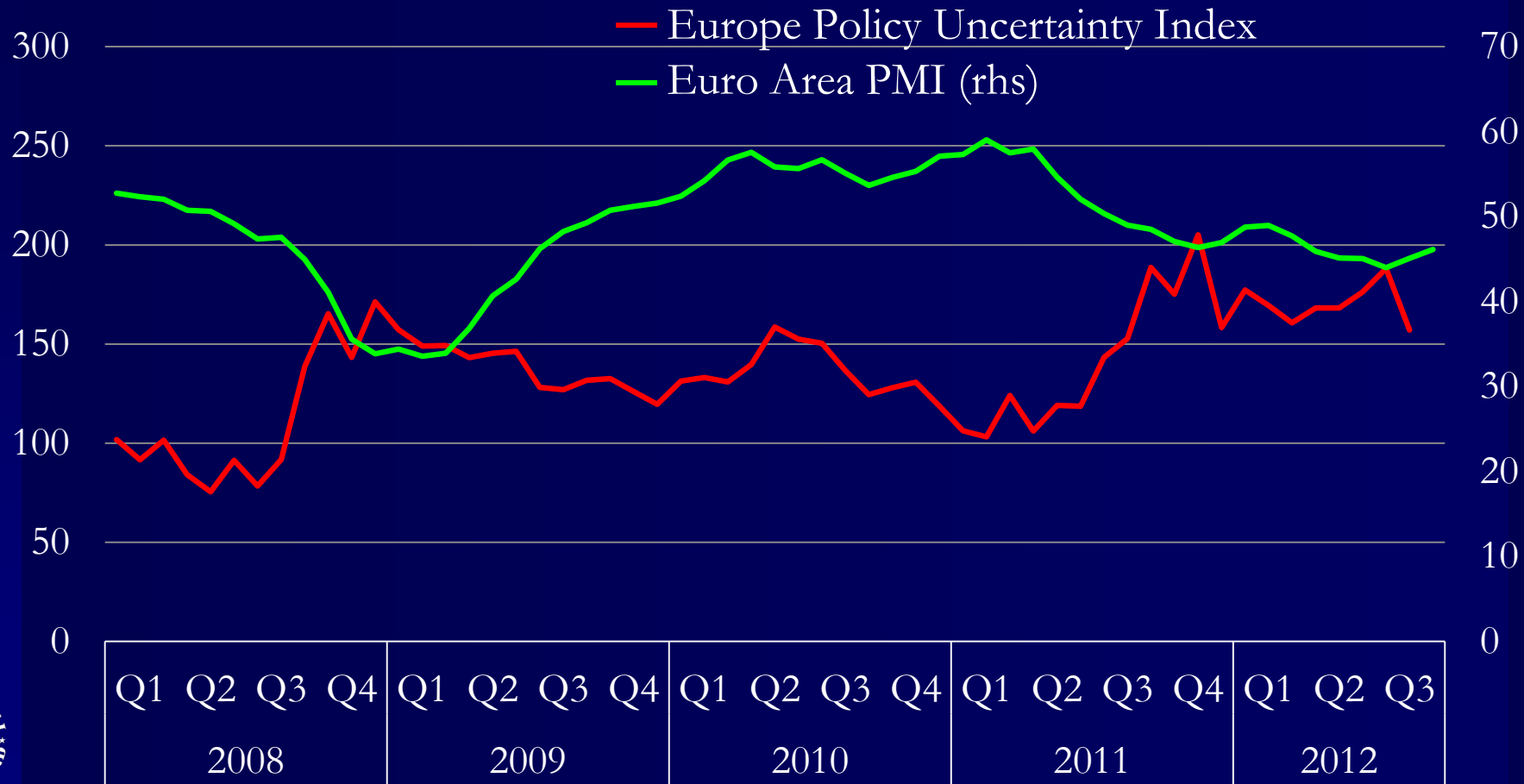
Business confidence is weak

Purchasing Manager Index
(points)



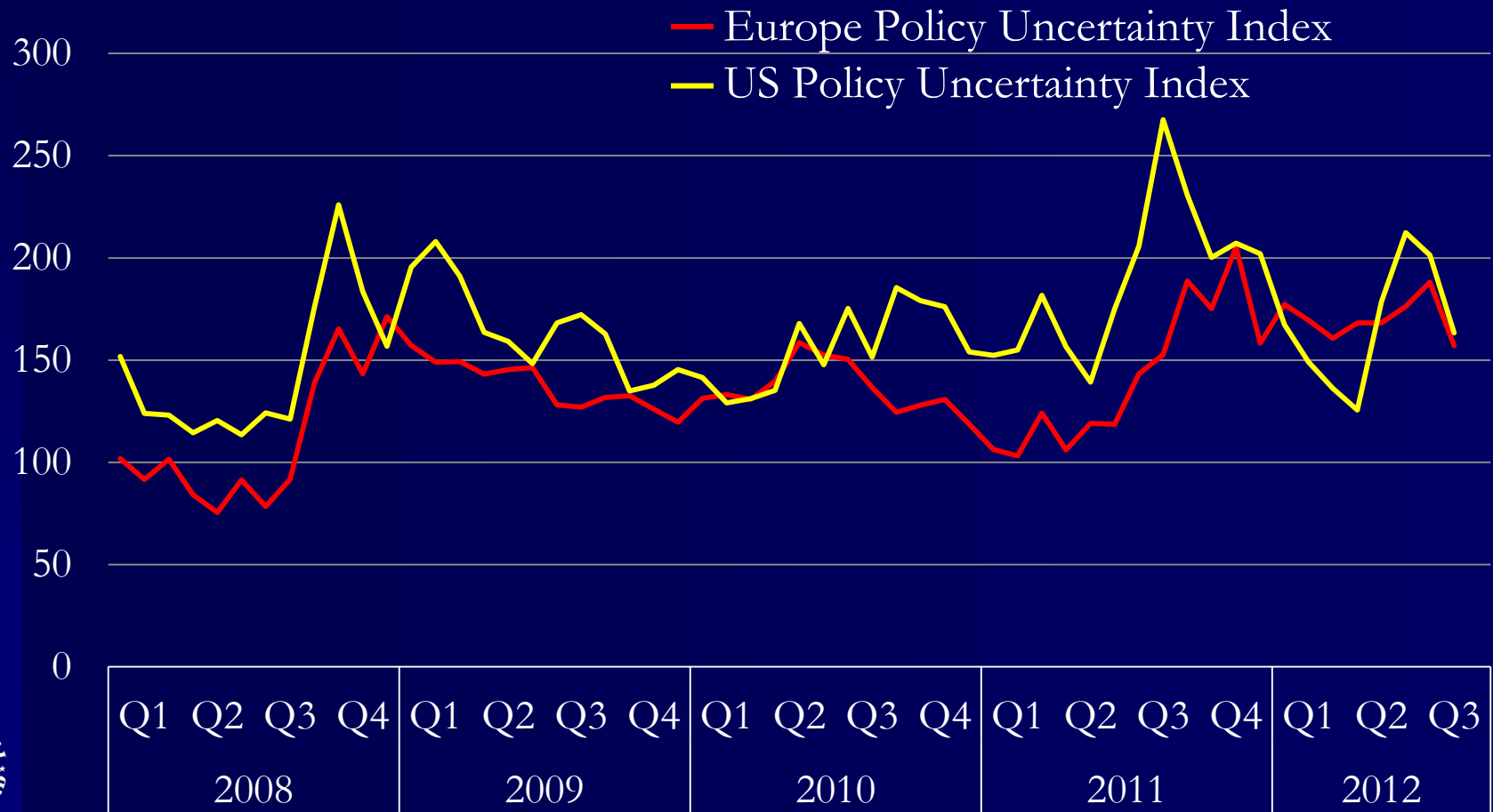
Confidence in Europe is directly related to uncertainty...

Policy Uncertainty Index and Purchasing Manager Index
(points)



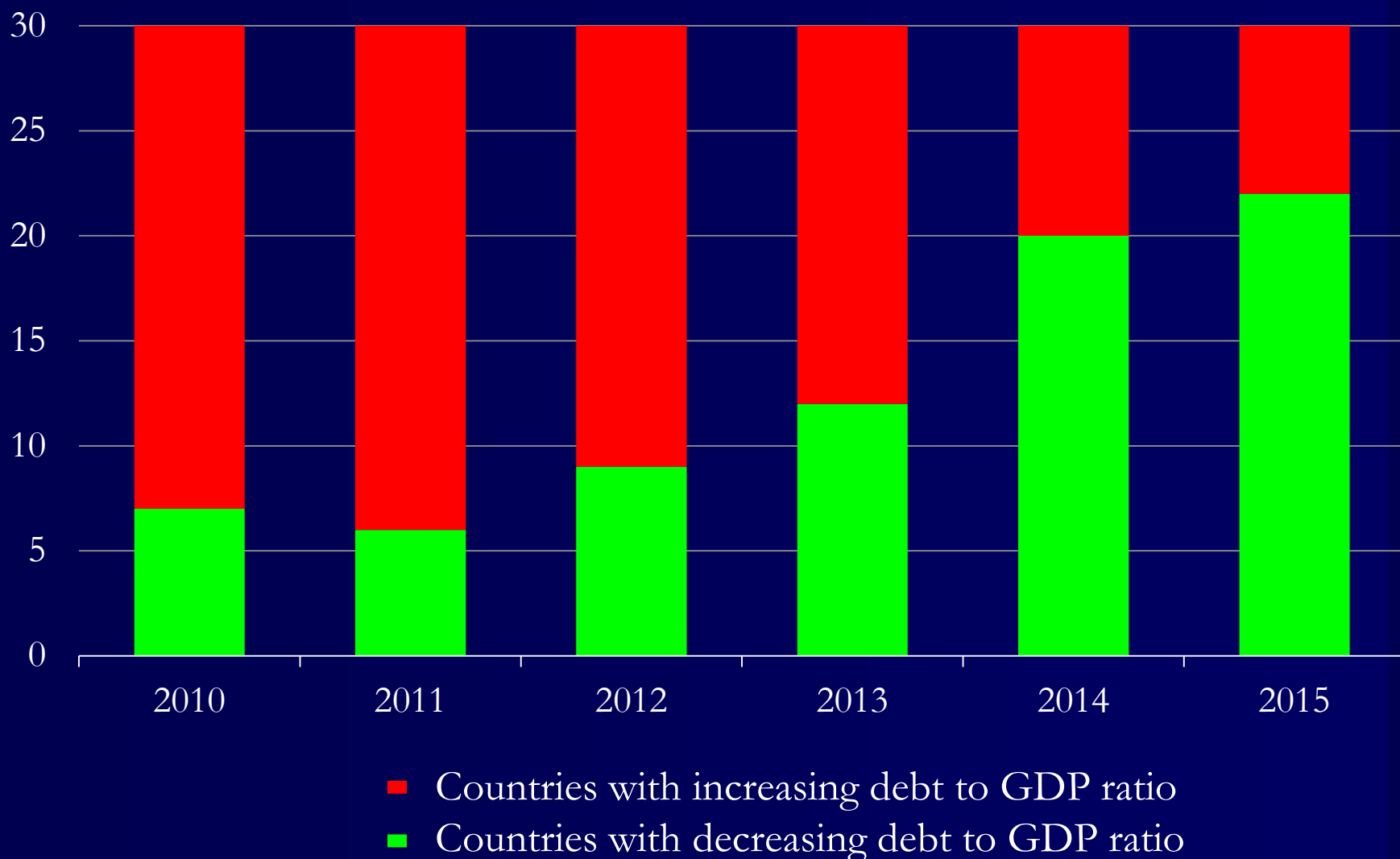
...and uncertainty about the outlook is high in the US too

Policy Uncertainty Indices
(points)



Debt reduction is expected to gain traction in 2014...

Advanced economies with Increasing/Decreasing Gross Debt to GDP



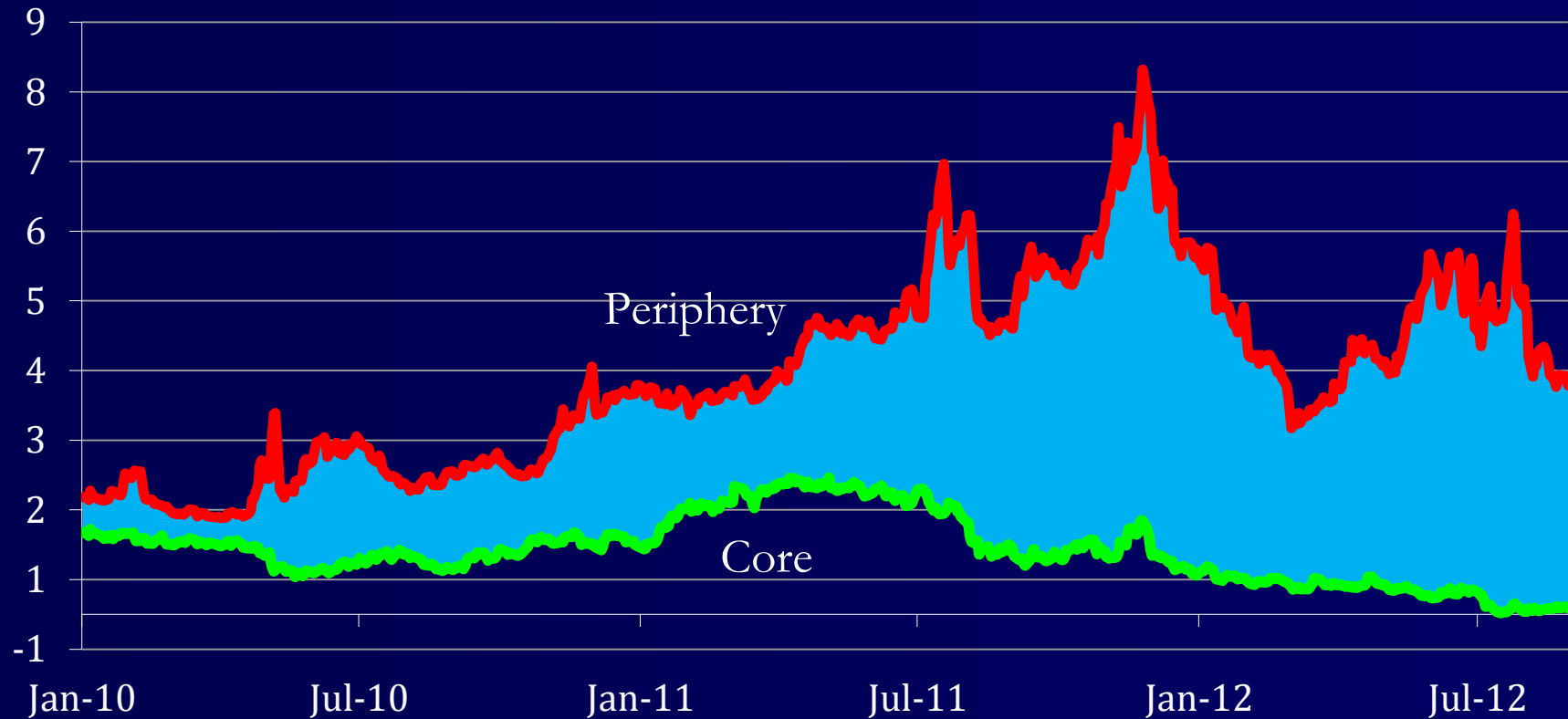
...but there is still work for fiscal policy.

- US and Japan lack credible medium-term fiscal strategies
- European Union should show flexibility on Stability and Growth Pact
 - Focus should be on structural not headline deficits
- Where fiscal policy can support demand it should do so



Financial disintegration continues in the Euro area...

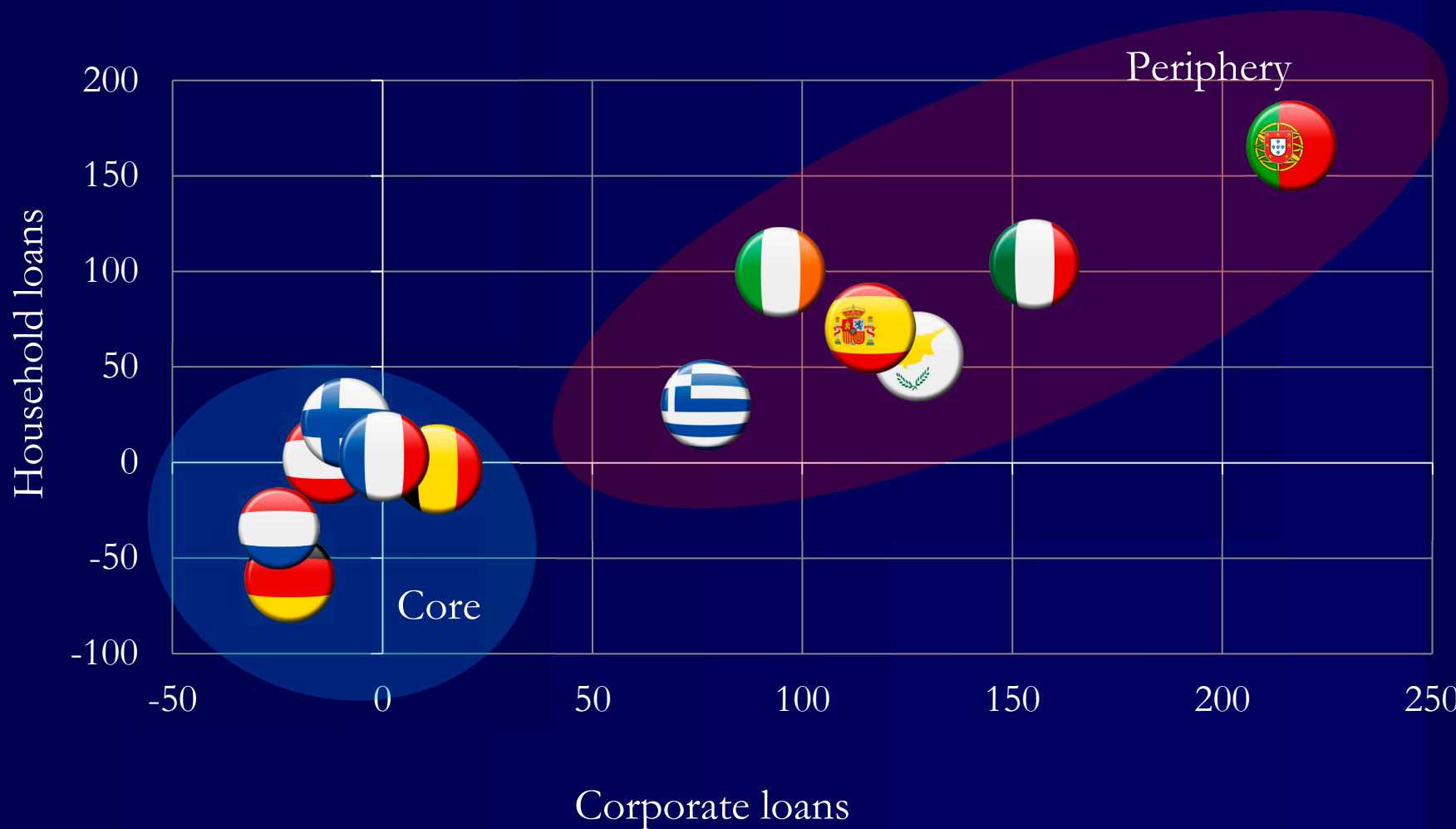
European 2-year Sovereign Bond Yields
(percent)



...and easy money is not reaching periphery...

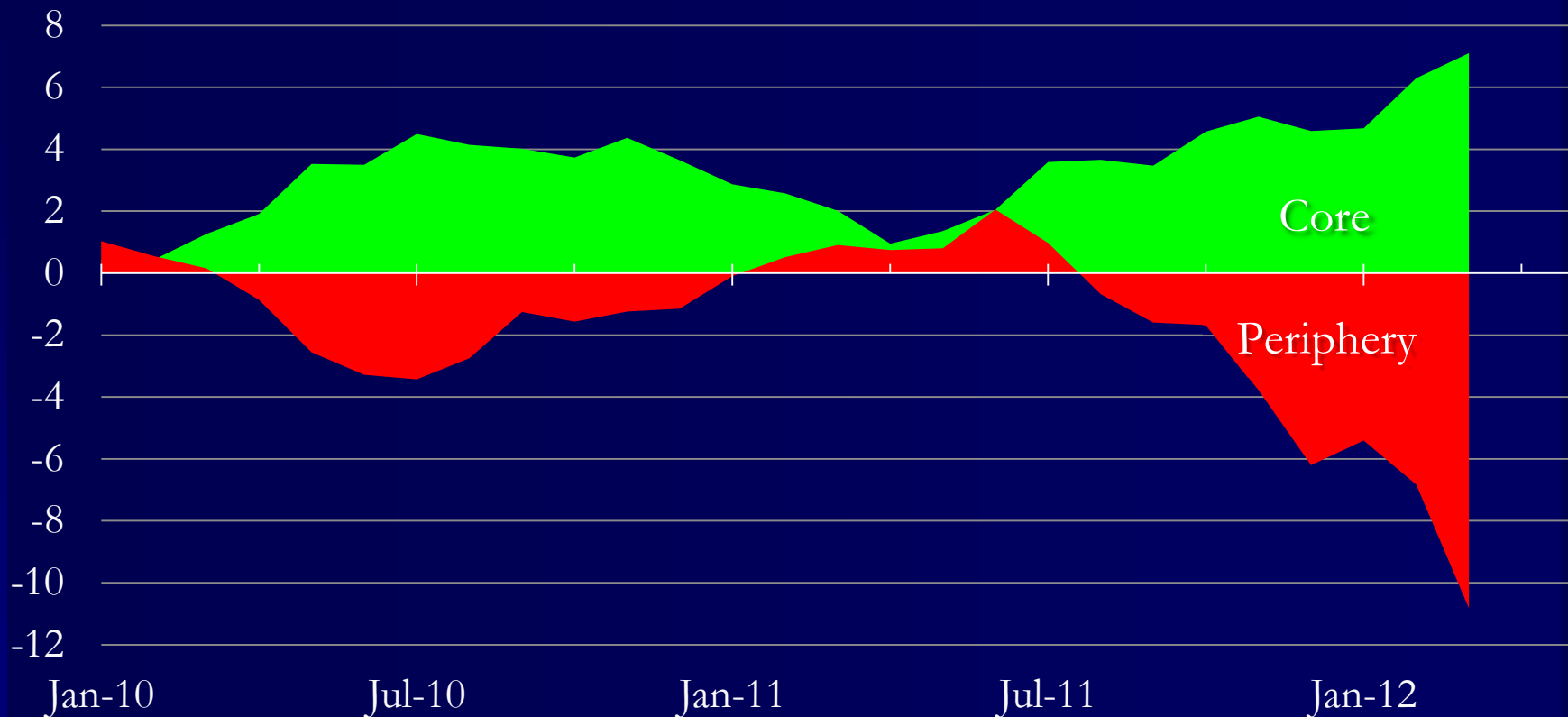
Change in Interest Rate on New Bank Loans

(Basis points; December 2009 to July 2012)



...which faces large private capital outflows.

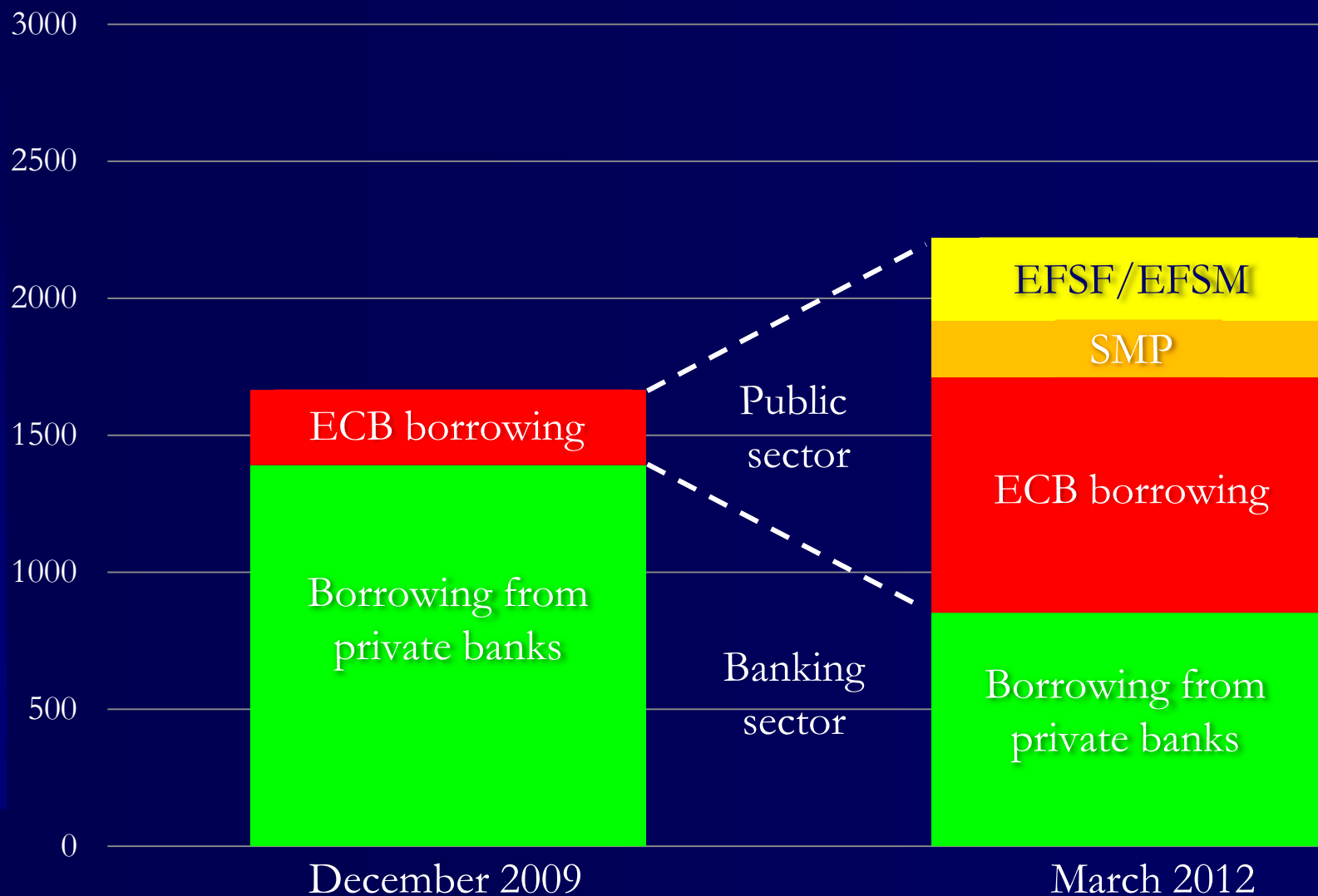
Portfolio and Other Investment Capital Flows Excluding Central Banks
(Cumulative from December 2009, in percent of GDP)



Public funding is replacing private cross-border flows

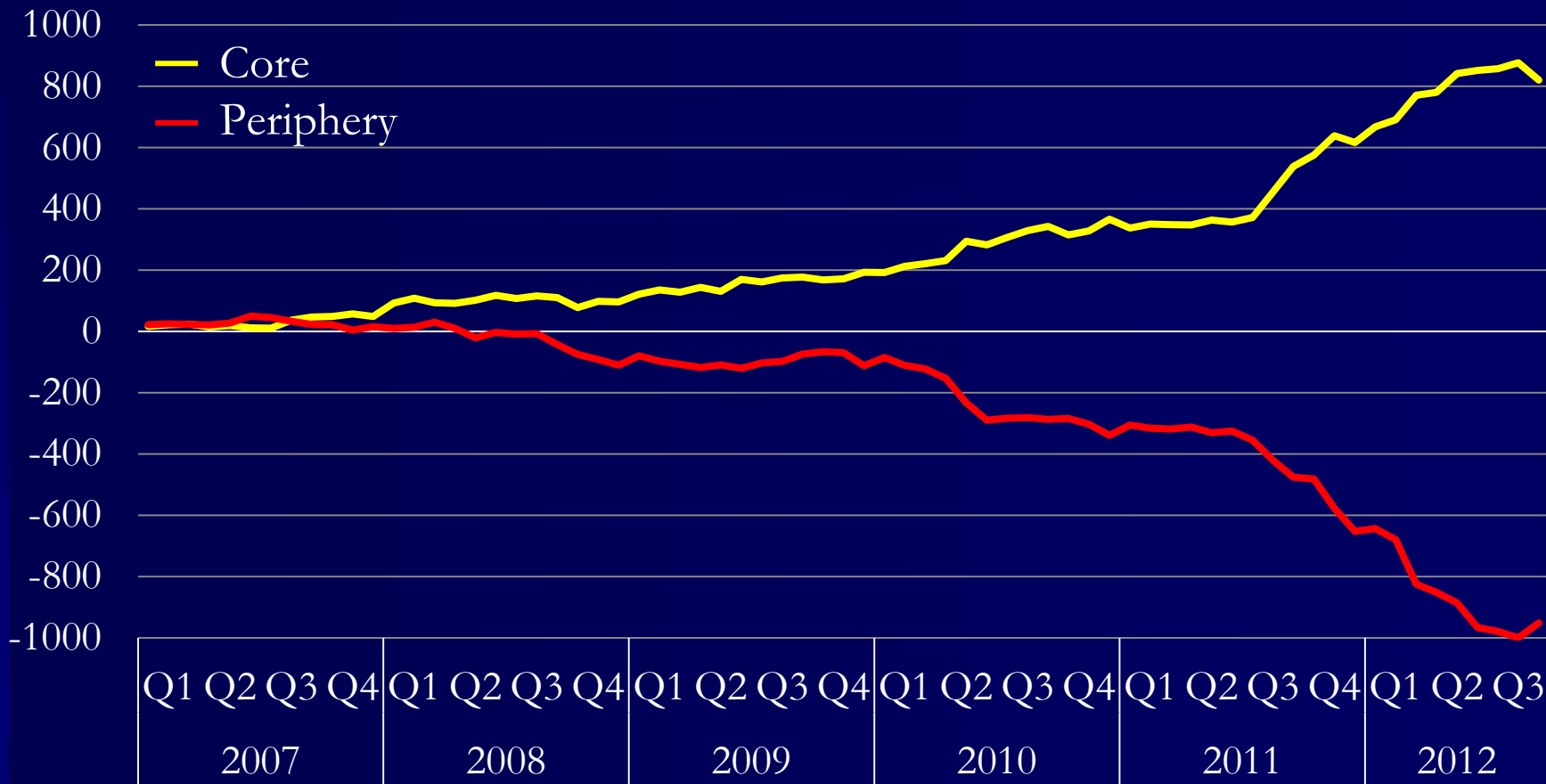
Euro area exposures to Greece, Italy, Portugal and Spain

(billions of euros)



...and this is reflected in TARGET2 balances.

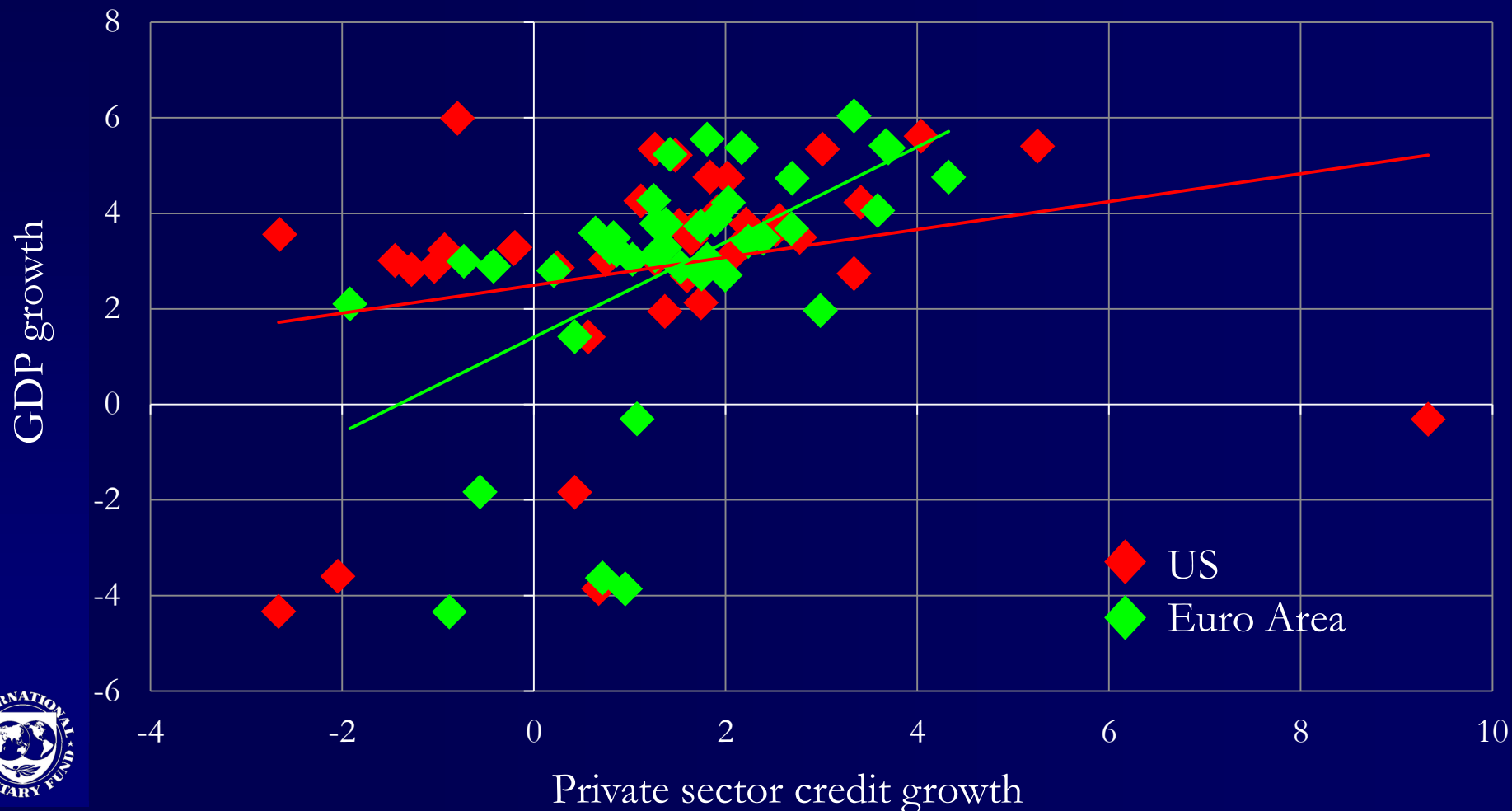
Net balance with Eurosystem
(EUR billion)



Bank credit is vital for Euro area growth

2002Q1-2011Q4

(percent change y/y)



Euro Area has made progress, but not yet enough

Actions since June 2012

OMT*

- Vital to repair monetary transmission mechanism and support sovereigns
- Activation depends on ESM/EFSF***

ESM**

- Ratified and effective
- Increases resources available to support banks directly

Banking Union

- In principle common regulation and supervision by 2013
- Needs to be complemented by common bank resolution and deposit insurance

Fiscal Union

- Embryonic only in ESM/EFSF
- Framework of fiscal rules
- Needs to be some common bond issuance

Clear thought and steadfast implementation needed to reassure markets

* Outright Monetary Transactions

** European Stability Mechanism

***European Financial Stability Facility



Thank you

