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As FY2013 came to a close, financial conditions had improved, but the road to a comprehensive and robust global recovery was expected to remain bumpy. Policy actions during the year addressed the gravest short-term risks, but growth prospects were little changed by the end of April 2013, and the global economy was evolving at different speeds—in various parts of the world improved financial conditions had not translated evenly into growth or other factors were acting as brakes.

Decisive policy actions had successfully defused the two most immediate threats to the global recovery. One, strong actions by European policymakers had helped avert major risks of a tail event in the euro area. Two, U.S. policymakers had been able to avoid the fiscal cliff. In both instances, however, durable solutions would be needed to combat underlying risks. At the same time, Japan had adopted more expansionary macroeconomic policies, including ambitious changes to the monetary policy framework. Also, policy easing in key emerging market economies helped support internal demand.

Financial stability had strengthened, with the decline in market and liquidity risks. Market volatility had subsided and asset prices rallied, posting strong gains in both advanced and emerging market economies from mid-2012. Nevertheless, confidence remained fragile, and markets tended to move ahead of the real economy. In this regard, the recovery remained unbalanced—moving at “three speeds”—and global growth prospects were little changed, highlighting key factors still weighing on growth.

TURNING THE CORNER AT DIFFERENT SPEEDS

World growth hit a trough at about 2¼ percent in the second quarter of 2012, but picked up steam in the second half of the year, reaching 2¾ percent, and in early 2013, leading indicators pointed to a further acceleration of activity. In the April 2013 *World Economic Outlook*, real GDP growth was forecast to reach 3¾ percent in 2013, rising to 4 percent in 2014. However, these global averages masked considerable variations between and even within groups of countries.

In the advanced economies, in particular, the recovery was expected to proceed at different speeds, with the United States in the lead. Private demand in the United States had shown signs of strength, although the larger-than-expected fiscal adjustment was expected to keep real GDP growth at about 2 percent in 2013. The euro area was projected to remain in recession in 2013, with many economies facing continued fiscal adjustment, competitiveness problems, persistent differences or fragmentation in financial conditions, and deleveraging pressures stemming from private sector debt overhang, including in the banking sector. Japan, by contrast, would see a fiscal- and monetary-stimulus-driven rebound in 2013. Overall growth for advanced economies in 2013 was forecast to be 1¼ percent—no better than in 2012—although growth was expected to continue to gain momentum, reaching 2¼ percent in 2014.

In emerging market economies and developing countries, the expansion of output was projected to become more broad based and accelerate steadily. After decelerating to 5.1 percent in 2012, activity was expected to reach 5.3 percent in 2013, before rebounding to 5.7 percent in 2014. The return to stronger growth was driven by resilient consumer demand, macroeconomic policy on hold, and exports reviving as the advanced economies recovered. However, some economies in the Middle East and North Africa were continuing to struggle with difficult internal transitions. In contrast, the prospects for many dynamic low-income countries appeared stronger thanks largely to sound policy frameworks and earlier structural reforms.

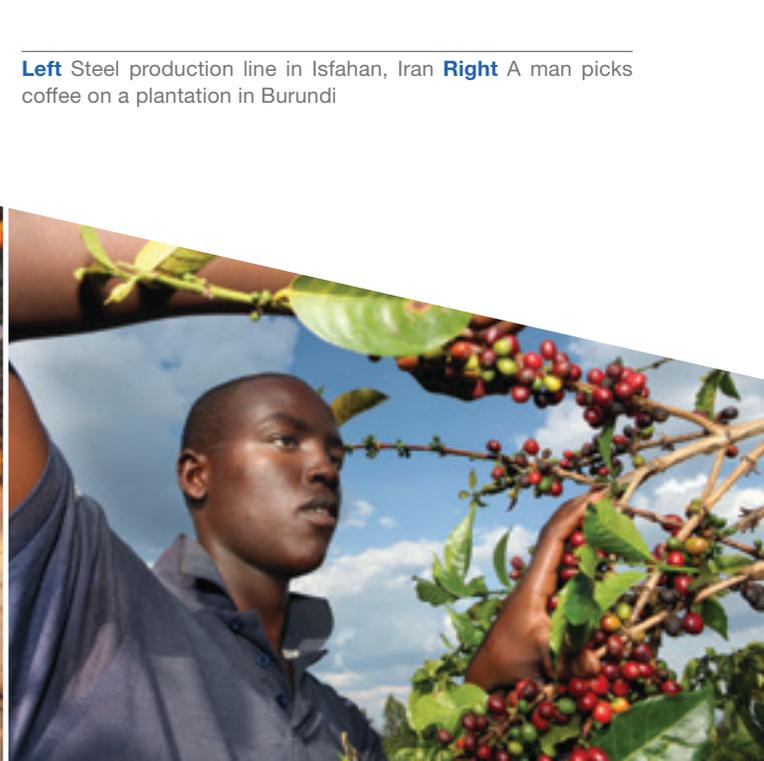
Although policy actions had helped ease near-term risks, old and new dangers still clouded the outlook. In the euro area, the most immediate risks stemmed from incomplete or stalled delivery of reform commitments, at both the euro area and national levels. In the United States, near-term risks pertained to the possible sharper fiscal contraction if the budget sequester were not reversed soon. Moreover, failure to raise the U.S. debt ceiling by later in 2013 would be very damaging to global economic and financial stability. Over the medium term, in Japan as well as the United States, risks related to the absence of credible medium-term fiscal consolidation plans. Other relevant risks concerned limited policy space, high private sector debt, and persistently weak activity. For example, larger or more persistent adverse effects of public and private deleveraging, entrenched fragmentation, and delayed structural reforms could lead to stagnation in the euro area. There was also growing concern regarding the potential complications from easy and unconventional monetary policy in many advanced economies, as well as rising challenges to domestic financial stability in many emerging market economies and developing countries.

ACHIEVING A FULL-SPEED GLOBAL ECONOMY

As FY2013 drew to an end, the imbalances in and risks to the global recovery underscored the need for a proactive policy stance. Policymakers faced a difficult balancing act in moving from financial stabilization to securing an enduring full-speed global economy. Unless policies addressed the lingering risks, global activity was likely to suffer periodic setbacks, and robust real growth—and much-needed jobs growth—might remain elusive. By the same token, a stronger-than-projected policy response could also foster a stronger recovery in activity.

In the advanced economies, there was no silver bullet to address concerns about demand and debt. Policymakers were advised to prudently use all available margins to stimulate demand and growth, complemented with structural policies to boost employment and competitiveness. A comprehensive approach on all fronts that managed well the underlying trade-offs would be needed to achieve a lasting and robust recovery.

More broadly, fiscal consolidation was essential given persistent high debt in many advanced economies. However, in the short term, tightening needed to be calibrated at a pace that preserved the recovery. The April 2013 *Fiscal Monitor* underscored that consolidation needed to be gradual, but sustained toward medium-term objectives, in the context of growth-friendly strategies suitable for each country. This underlined the urgency of formulating clear and credible plans, for example, in Japan and the United States to bring debt ratios down over the medium term. In countries where private demand had been chronically disappointing, policymakers were encouraged to consider smoothing the pace of consolidation, if they had room for maneuver and financing allowed.



Left Steel production line in Isfahan, Iran **Right** A man picks coffee on a plantation in Burundi

Monetary policy in advanced economies needed to remain accommodative to support activity as fiscal policy tightened, provided that long-term inflation expectations continued to stay well anchored. In this context, progress in repairing the financial sector was perceived as crucial, especially in light of the impaired credit transmission in the euro area. Policymakers were cautioned to be mindful of new and evolving financial stability risks from prolonged use of easy and unconventional monetary policies, including excessive risk taking and misallocation of resources, and advised to take appropriate macro-prudential measures, as needed, to mitigate these risks.

Notwithstanding progress to improve financial regulation at both the national and global levels, important work still lay ahead. The April 2013 *Global Financial Stability Report* underscored the need for further financial repair and action to complete the regulatory reform agenda, namely, the too-big-to-fail problem, nonbank financial institutions, and shadow banking. Prompt and consistent implementation of the reform agenda, including Basel III requirements, would be necessary for future financial stability and to strengthen the flow of credit to the real economy. Reversing financial fragmentation in the euro area, for example, was perceived as critical to supporting growth. Improved financial policies could also help the transmission of monetary policy.

In emerging market economies and developing countries, the key objectives were to strengthen policy buffers and guard against financial excesses. In this context, some tightening of policies over the medium term was considered appropriate. Where

financial stability was at risk, macroeconomic policy adjustment could be supported by prudential measures, and in some circumstances, capital flow management measures could also be useful. As soon as conditions permitted, policymakers were advised also to return fiscal balances to levels that provided ample room to handle future shocks. Where structural problems—such as infrastructure and labor market bottlenecks or regulatory gaps—held back growth, effort was required to remove these impediments. In many economies, especially low-income countries, efforts needed also to continue to improve the targeting of subsidy regimes, diversify the economy, and enhance social policies.

Developments over the course of the year provided reminders of the potential for spillovers, including policy-related ones, in the increasingly interconnected global economy. The likelihood of a bumpy recovery and the skewed macroeconomic policy mix in advanced economies could complicate policymaking elsewhere, particularly in emerging market economies. With short-term financial stability risks abating, bond and equity flows to emerging market economies had resurged, increasing upward pressure on their exchange rates and raising concerns of competitive devaluations. To address currency worries it was recommended that all economies pursue policies that would foster internal and external balance. In addition, concerted efforts continued to be required to further reduce global imbalances—including stronger domestic demand and exchange rate flexibility in surplus economies, and increased public saving and structural reforms to boost competitiveness in deficit economies.