

IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, APRIL 2010

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 7, 2010.

Executive Directors noted that the global recovery has been better than expected, driven by highly accommodative macroeconomic policies in response to the deep downturn. However, activity has been picking up unevenly across countries and regions. The recovery under way in major advanced economies is expected to be sluggish compared with recoveries in emerging and developing economies and with recoveries after previous recessions. Among emerging and developing economies, Asia is leading the recovery, whereas a number of eastern European and Commonwealth of Independent States economies are lagging behind.

Directors observed that although a variety of risks have receded, the growth outlook remains unusually uncertain, and near-term risks are generally to the downside. First, as public debt is growing in many advanced economies, room for policy maneuvers has either been largely exhausted or is much more limited, leaving the fragile recoveries exposed to new shocks. Second, heightened concerns about sovereign risks, though unlikely to be widespread across major advanced economies, are dampening investor confidence and threatening financial stability. Third, bank exposures to real estate and household indebtedness continue to pose downside risks, mainly in the United States and parts of Europe.

Directors stressed that the key policy task ahead is to ensure a smooth transition of demand from government to the private sector and from economies with excessive external deficits to those with excessive surpluses. For most advanced economies, it will be important to fully implement the planned fiscal stimulus and maintain supportive monetary policies for this year, while repairing the financial sector and reforming prudential policies and frame-

works. Given relatively weak growth prospects in advanced economies, the challenge for some emerging economies is to absorb rising capital inflows and nurture domestic demand without triggering a new boom-bust cycle. Continued strengthening of prudential policies is also in order. While the timing of exit depends on individual country circumstances, international policy coordination is critical to minimizing negative spillovers and to sustaining strong, balanced growth.

Directors underscored that addressing fiscal fragilities is a top priority. In many advanced and some emerging and developing economies where the economic slowdown and stimulus measures have pushed debts and deficits to very high levels, there is a pressing need to design and communicate credible medium-term fiscal consolidation strategies. Such strategies should include clear timelines to bring down gross debt-to-GDP ratios to more prudent levels, as well as concrete measures to raise potential output over the medium term. If macroeconomic developments proceed as expected, most advanced economies should embark on fiscal consolidation in 2011. For economies facing large increases in risk premiums, consolidation needs to begin now. Entitlement reforms that do not detract from demand in the short term should be implemented without delay, contributing to long-term fiscal sustainability.

Directors considered that the key challenges facing monetary policymakers are when and how to unwind accommodative conditions. Still-low levels of capital utilization and well-anchored inflation expectations are expected to keep inflation in check in most economies. In major advanced economies, monetary policy can remain accommodative as fiscal consolidation progresses, provided inflation

pressure remains subdued. This can be achieved even as central banks begin to withdraw the emergency support provided to financial sectors. Major emerging and some advanced economies will likely continue to lead the tightening cycle, as they are expected to experience faster recoveries and renewed capital flows.

Directors noted that in emerging economies with excessive surpluses, monetary tightening should be supported with nominal effective exchange rate appreciation as excess demand pressures build. In cases where monetary tightening risks attracting more capital inflows, leading to exchange rate appreciation and undermining competitiveness, specific macroprudential measures should be considered. Other measures that can be taken include fiscal tightening to ease pressure on interest rates, some buildup of reserves, or easing of controls on capital outflows. Temporary controls on capital inflows—carefully designed to avoid creating new distortions and minimize implementation costs—could play a complementary role, and, in the view of some Directors, should be used only in exceptional circumstances.

Directors observed that the response of unemployment to the sharp declines in output during the crisis has been markedly different across the advanced economies, depending in part on factors such as the magnitude of the output decline, financial stress, and house price busts. Given the

expected sluggish recovery in output and the lingering effects of financial stress, unemployment rates are likely to remain high through 2011 in many advanced economies. Preventing temporary joblessness from turning into long-term unemployment requires, first, appropriately supportive macroeconomic policies; second, sound restructuring of the banking system that would help restore credit for employment-intensive sectors; and, third, appropriate labor market policies, notably adequate unemployment benefits and education and training.

Directors highlighted the urgency of rebalancing global demand, supported by appropriately sequenced financial sector and structural reforms. Economies with excessive external deficits before the crisis need to consolidate their public finances in ways that limit damage to growth and demand and encourage private savings. Economies with excessive current account surpluses need to increase domestic demand further as excessive-deficit economies scale back their imports in response to lower expectations about future income. In this context, Directors took note of the IMF staff's findings that reversing current account surpluses does not necessarily entail lower output growth and that appropriate macroeconomic and structural policies—particularly those aimed at promoting resource reallocation and higher-value-added industries—could help offset the contractionary effects of a real exchange rate appreciation.