IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, SEPTEMBER 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 September 20, 2010.*

Executive Directors observed that the global economic recovery is proceeding broadly as projected, despite disturbances in financial markets. The recovery is losing momentum temporarily during the second half of 2010 and will likely remain weak in the first half of 2011, as extraordinary policy stimulus is gradually withdrawn. Directors welcomed signs that financial conditions have begun to normalize, aided by policy coordination and announcements of a front-loading of fiscal adjustment in Europe. A more robust, self-sustaining global recovery will require progress in achieving both internal and global demand rebalancing, supported by healthy financial systems.

Directors noted that the observed asymmetry in growth performances will likely persist. In most advanced and a few emerging market economies, recoveries are proceeding at a sluggish pace, and large internal adjustments remain needed to achieve internal rebalancing from stimulus-led to private-sector-led growth. On the other hand, growth in many emerging market and developing economies continues to be vigorous, on the back of improved macroeconomic policy frameworks and a stronger financial footing. Downside risks to near-term global growth remain elevated and concentrated in advanced economies. These emanate from heightened uncertainty in financial markets, fragile real estate markets, continued household deleveraging, and persistently high unemployment. However, the probability of a sharp global slowdown, including stagnation or contraction in advanced economies, appears low.

Directors agreed that fiscal consolidation is a top priority in countries with relatively high public debt. They highlighted the urgency of adopting credible strategies for medium-term consolidation and debt stabilization, including through legislation where necessary. At the same time, policymakers should stand ready to act if global growth threatens to slow appreciably more than expected. In this regard, consideration could be given to postponing consolidation in countries with fiscal room and credibility to do so. In all but the most vulnerable countries, automatic stabilizers should be allowed to operate. Directors stressed that medium-term consolidation plans should be based on realistic growth projections and include reforms to limit rapidly escalating spending programs such as pension entitlements and public health care and tax incentives to boost the supply potential and discourage debt.

In light of subdued inflation pressures, Directors generally considered that monetary policy in most advanced economies should remain highly accommodative, including through unconventional measures if needed, and should be the first line of defense against any larger-than-projected weakening of activity as fiscal stimulus is being unwound. In emerging market economies with rising inflation or asset price pressures, monetary tightening has been broadly appropriate. For all economies, the implications of fiscal consolidation and developments in financial and asset markets for inflation would also need to be taken into account when setting monetary policy.

Directors underscored the urgent need for restoring financial sector health and making progress in regulatory reforms in a coordinated manner, especially among advanced economies. To enable an early exit from fiscal support as well as address legacy problems, priorities include restructuring and resolving weak financial institutions; implementing measures to shore up bank capital adequacy, liquidity, and stability of funding sources; and improving coordination of supervision to avoid rapid cross-border amplification of shocks. Further advancement toward building a stronger financial regulatory framework is crucial to underpin market confidence and enhance global financial stability.

Directors emphasized that medium-term growth prospects depend on progress in implementing structural policies to give forceful impetus to global demand rebalancing. In this regard, many emerging market economies would need to further reorient toward domestic demand, not only because import recovery in advanced economies will likely trail behind precrisis trends, but also to achieve balanced growth that addresses their own consumption and investment needs. For economies with excessive external surpluses, this would entail allowing further exchange rate flexibility and appreciation in response to sustained capital inflows, while safeguarding financial stability with macroprudential or other targeted measures. These measures should be complemented by structural reforms aimed at enhancing social safety nets and shifting toward optimal saving-investment patterns. Similarly, measures to boost net exports would be crucial for economies with excessive current account deficits. Continued fiscal adjustment and financial sector reforms that discourage excessive spending are also key.

Directors noted that structural policies that strengthen growth over the medium term would help support the required normalization of macroeconomic policies in advanced economies. Labor market policies, coupled with complementary product and services market reforms, should aim to promote competition and enhance growth and job creation, and with sufficient support for the unemployed.

Directors underscored the critical importance of continued policy effort and coordination at both the regional and global levels—as demonstrated during the global crisis and more recently during the European sovereign debt market turmoil. While policy requirements now differ considerably across countries, it is essential that countries continue to work together toward the common goal of achieving strong, sustained, and balanced growth over the medium term. Directors also emphasized the need to avoid negative spillovers as well as trade and investment protectionism.