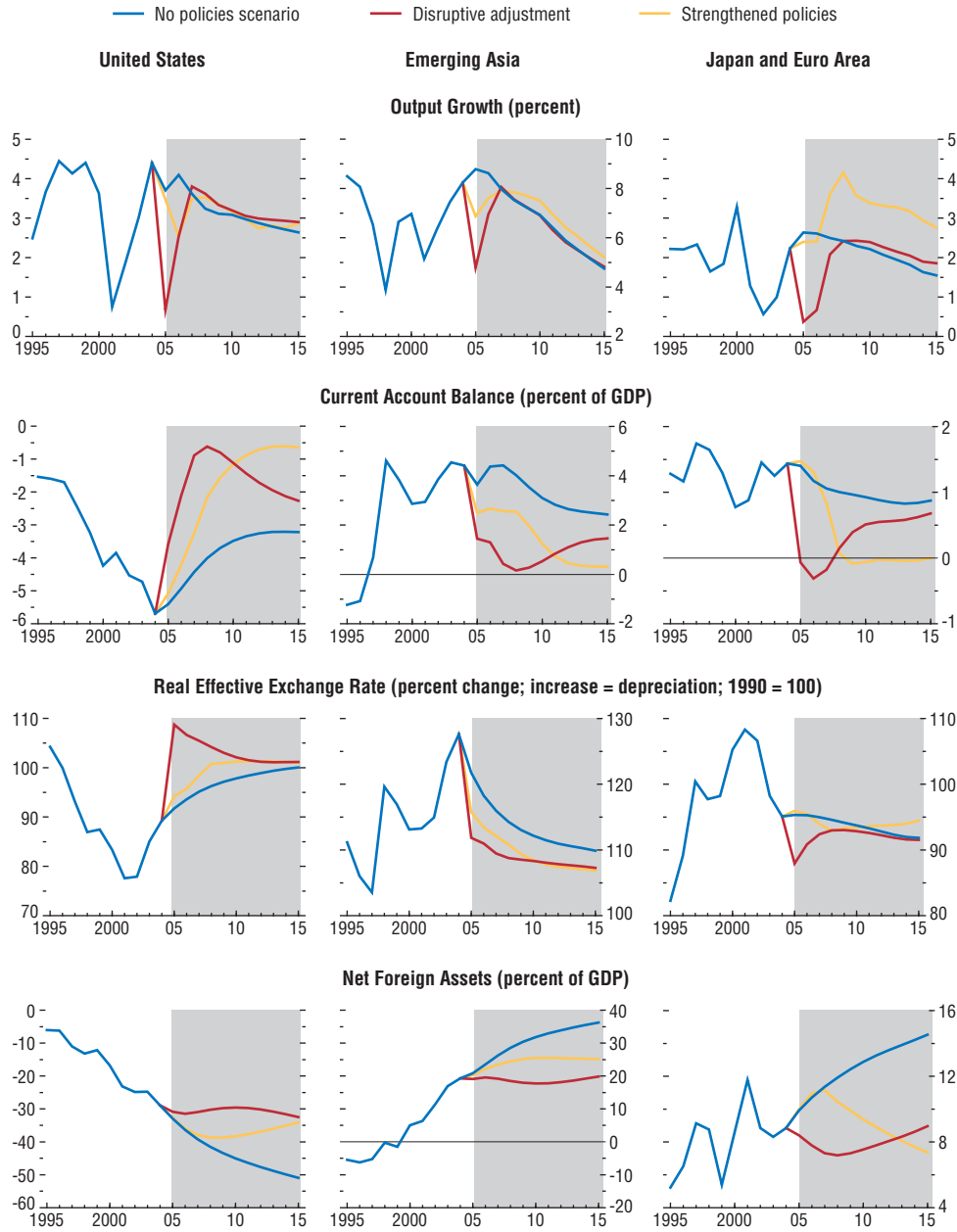


Figure 1.10. How Will Global Imbalances Adjust?¹

In the absence of policy adjustment, an orderly adjustment may take place, but only if investors are willing to hold substantially higher levels of U.S. assets (despite large capital losses) and if protectionist pressures are avoided. If these conditions are not met, there is a clear risk of a disruptive adjustment and a global recession. However, strengthened policies—along the lines described in the text—would sharply reduce imbalances, with a modest short-term slowdown offset by stronger medium-term growth.



Source: IMF staff estimates.

¹See Appendix 1.2, September 2005 *World Economic Outlook* for a detailed discussion of these projections. Since the no policies baseline includes significant short-term real appreciation in Asia through higher inflation, it may overestimate the adjustment in current accounts in the initial period.