

IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, SEPTEMBER 2012

The following remarks were made by the Acting Chair at the conclusion of the Executive Board's discussion of the World Economic Outlook, Global Financial Stability Report, and Fiscal Monitor on September 14, 2012.

Executive Directors noted that the global economic recovery remains fragile and risks to the global financial system have increased. Growth has slowed recently both in advanced and in emerging market and developing economies, and the outlook remains subdued, largely because policies in major advanced economies have failed to instill lasting confidence. Directors emphasized that clear and credible policies in advanced economies, with improved policy coordination and communication, are of paramount importance to address immediate downside risks. In this regard, ongoing efforts at fiscal consolidation and structural reform, as well as recent policy initiatives in key advanced economies, should help improve financial stability, lower public debt over the medium term, spur growth, and contribute to strengthen market confidence.

Directors agreed that downside risks to the outlook remain considerable. Principal sources of near-term risk are the protracted crisis in the euro area and the “fiscal cliff” and impending “debt ceiling” in the United States. Geopolitical risks that could lead to a disruption of oil supply also remain a concern. Over the medium term, the elevated, though gradually declining, public debt in advanced economies could dampen investor confidence and destabilize global bond markets. Furthermore, stress in key regions could have large spillover effects given cross-border macro-financial and trade linkages.

Directors concurred that resolving the euro area crisis remains the most important policy priority. They welcomed the recent decisions by the European Central Bank to increase liquidity support and safeguard an appropriate monetary policy transmission, particularly through the Outright

Monetary Transactions program. They urged timely and accelerated implementation of these and other measures to strengthen the currency union and reduce financial fragmentation. In particular, Directors supported the establishment of a banking union with a unified financial stability framework, as well as further fiscal integration, recapitalization or restructuring of viable banks, and resolution of nonviable banks. It is also imperative to make the euro area firewall sufficiently flexible to help break the adverse feedback loop between sovereigns and banks.

Directors observed that most countries have made progress in reducing fiscal deficits, improving fiscal policy frameworks, and strengthening fiscal governance. Nevertheless, they noted that debt levels remain high and underscored the need for sustained medium-term fiscal consolidation to achieve debt sustainability. The United States and Japan, in particular, urgently need to adopt credible medium-term fiscal adjustment plans to reduce their debt to sustainable levels. Fiscal tightening should be executed in a manner that makes public finances growth friendly and efficient. Most Directors considered that in countries with fiscal space, near-term fiscal adjustment plans should be implemented flexibly, and automatic stabilizers should be allowed to operate fully, as economic conditions warrant. A few Directors, however, stressed the need to preserve the credibility of fiscal policy frameworks by strictly adhering to fiscal targets.

Directors reiterated that fiscal consolidation should be combined with accommodative monetary policies, while respecting the mandate of respective central banks, and with structural reforms to maintain growth and limit the negative social impact of deficit reduction. Most Directors supported further

easing of monetary policy to sustain growth, including through unconventional measures if necessary. In that regard, they underscored the importance of the recent announcements by the European Central Bank and the Federal Reserve. A number of Directors noted, however, that prolonged monetary easing could introduce economic and financial distortions, discourage fiscal consolidation, and spur destabilizing capital flows to other regions, while its effectiveness may be limited.

Directors called for faster progress with structural reform. The priorities are to strengthen the financial regulatory framework, improve bank balance sheets and financial health more generally, and reduce household debt. Many countries also need to improve their external competitiveness, which will require reforms to enhance labor and product market flexibility and efficiency. Social safety nets and reforms to reduce long-term unemployment should be strengthened in parallel with fiscal adjustment.

Directors welcomed the steady improvement in the economic performance of emerging market and developing economies, which reflected both good policies and fewer shocks. However, the recent slowdown of growth calls for determined action

to mitigate internal and external vulnerabilities, including the use of macroprudential policies as needed. Those countries with stable and low inflation could pause or reverse the monetary policy tightening of the past year to sustain growth. Those with relatively strong fiscal and external positions could also use their fiscal space prudently for this purpose. Others would have to continue to rebuild policy space needed to tackle shocks, with due regard for social and development needs in low-income countries.

Directors agreed that global imbalances and associated risks have diminished, mainly because of weaker demand in external-deficit advanced economies. Lasting resolution of these imbalances is in the self-interest of both deficit and surplus economies. For surplus economies, this will require structural reforms to boost investment and consumption, more market-determined exchange rates, and discontinuation of large-scale official reserve accumulation where appropriate. A few Directors nevertheless emphasized the importance of maintaining adequate reserve buffers against external shocks. Deficit economies will require stronger fiscal positions, higher saving rates, and lower consumption demand.