

*The following remarks were made by the Chair at the conclusion of the Executive Board's discussion of the World Economic Outlook, Global Financial Stability Report, and Fiscal Monitor on April 1, 2013.*

Executive Directors welcomed recent signs of improved global economic prospects and financial conditions. They noted that strong policy actions had averted the risks of a euro area breakup and a sharp fiscal contraction in the United States. Meanwhile, financial stability has generally strengthened, with a decline in market and liquidity risks. Activity in emerging market and developing economies has picked up and is expected to strengthen further this year, while low-income countries have achieved more robust growth with macroeconomic stability.

Directors stressed, however, that there is no room for complacency. They observed that the near-term outlook for key advanced economies remains clouded by lingering risks. In the euro area, the main downside risks include persistent financial fragmentation, balance-sheet weaknesses, and adjustment fatigue, as well as renewed financial strain in the periphery. In addition, uncertainties about fiscal policy in the United States and high and rising debt ratios in Japan continue to pose risks. These daunting challenges require further decisive actions to boost confidence.

Directors noted the continued presence of medium-term risks. These relate to high private sector debt and limited policy space in the euro area, the absence of strong fiscal consolidation plans in the United States and Japan, complications from easy and unconventional monetary policy in many advanced economies, and overinvestment and high asset prices in several emerging market and developing economies.

Against this background, Directors underscored that policies need to remain proactive. They generally agreed that, in advanced economies, policymakers should prudently use all available measures to stimulate demand and growth, complemented with structural policies to boost employment and competitiveness. In emerging market and developing economies, strengthening policy buffers and guarding against financial excesses are key objectives.

Directors welcomed the many important actions taken by the euro area authorities to restore market confidence and underscored the need to fully implement the measures recently announced. They highlighted that rapid progress toward a stronger and deeper economic and monetary union, including a banking union, is critical for financial stability. Directors also noted that growth prospects in the euro area would benefit from internal rebalancing within the union, including through reforms of labor and product markets.

Directors concurred that, for most advanced economies, fiscal consolidation should be gradual but sustained toward credible medium-term objectives, in the context of growth-friendly strategies that are suitable for each country. They underlined the urgency of formulating clear and credible plans in Japan and the United States to bring debt ratios down over the medium term. Directors considered it important that fiscal policies avoid procyclicality. In this regard, they generally supported focusing on structural balances and, if financing allows, letting automatic fiscal stabilizers operate fully, although a few Directors pointed to the practical difficulties of estimating structural balances. Most Directors noted that where private demand has been chronically disappointing and room for policy maneuvering exists, consideration should be given to smoothing the pace of consolidation. Directors urged faster progress on entitlement reforms in many advanced economies to tackle spending pressures related to pensions and health care expenditures.

Directors broadly agreed that monetary policy in advanced economies should remain accommodative to support activity as fiscal policy tightens, provided that long-term inflation expectations stay well anchored. In this context, it is important that central banks maintain operational independence and communicate monetary policy in a clear and transparent manner. In addition, progress in repairing the financial sector

is crucial, especially in light of the currently impaired credit transmission. Noting financial stability risks that could arise from prolonged use of easy and unconventional monetary policies, including excessive risk taking and misallocation of resources, Directors encouraged authorities to take appropriate measures to mitigate these risks and to pay due attention to spillover effects on emerging market economies. In addition, they encouraged central banks to prepare well in advance for a smooth and appropriately timed exit from these extraordinary policies.

Directors noted that considerable progress has been made to improve financial regulation at both the national and global levels, but that important work still lies ahead. An immediate priority is to complete the regulatory reform agenda, particularly with regard to the too-big-to-fail problem, nonbank financial institutions, and shadow banking. Prompt and consistent implementation of the reform agenda, including Basel III requirements—though challenging in the current environment—is necessary to underpin future financial stability.

Directors emphasized that the main macroeconomic policy challenges for emerging market and developing economies are to manage financial risks and buttress policy buffers. They shared the view that some tightening of policies would be warranted in many of these economies over the medium term, beginning with

monetary policy. Where financial stability is at risk, macroeconomic policy adjustment could be supported by prudential measures, and in certain circumstances, capital flow management measures may also be useful. Specifically, policymakers must remain vigilant to potential risks from sustained rapid credit growth, high asset prices, rising corporate leverage, and increasing foreign currency debt. Directors also considered it prudent to return fiscal balances, as soon as conditions permit, to levels that provide ample room to handle future shocks. Moreover, strengthened fiscal institutions would enhance the prospects for fiscal sustainability. In many economies, especially low-income countries, efforts must also continue to improve the targeting of subsidy regimes, diversify the economy, and enhance social policies.

Directors cautioned that the bumpy recovery and the macroeconomic policy mix in advanced economies could complicate policymaking elsewhere. They considered that the pursuit in all economies of policies that foster internal and external balance would help dispel concerns about competitive devaluations. In addition, concerted efforts continue to be required to further reduce global imbalances—notably and where applicable, stronger domestic demand and exchange rate flexibility in surplus economies and increased public saving and structural reforms to boost competitiveness in deficit economies.