

## FOREWORD

What strikes me as I write this is the complexity of the forces shaping macroeconomic evolutions around the world and the resulting difficulty of distilling a simple bottom line. Let me develop and expand.

Two deep forces are shaping these evolutions over the medium term:

Legacies of both the financial and the euro area crises are still visible in many countries. To varying degrees, weak banks and high levels of debt—public, corporate, or household—still weigh on spending and growth. Low growth, in turn, makes deleveraging a slow process.

Potential output growth has declined. As shown in Chapter 3, potential growth in advanced economies was already declining before the crisis. Aging, together with a slowdown in total productivity, has been at work. The crisis made it worse, with the large decrease in investment leading to even lower capital growth. As we exit from the crisis, and as suggested by Chapter 4, capital growth will recover, but aging and weak productivity growth will continue to weigh. The effects are even more pronounced in emerging markets, where aging, lower capital accumulation, and lower productivity growth are combining to significantly lower potential growth in the future. More subdued prospects lead, in turn, to lower spending and lower growth today.

On top of these two underlying forces, the current scene is dominated by two factors that both have major distributional implications, namely, the decline in the price of oil and large exchange rate movements.

The sharp decline in the price of oil came as a surprise. Many explanations have been offered after the fact, the most convincing of which focus on the steady increase in supply from nonconventional sources combined with a change in strategy by OPEC (the Organization of the Petroleum Exporting Countries). Most of these explanations suggest that the decline will likely be long lasting.

The price declines have effected a large reallocation of real income from oil exporters to oil importers.

The early evidence suggests that in oil importers from the United States, to the euro area, to China, and to India, the increase in real income is increasing spending. Oil exporters have cut spending but to a smaller extent: many have substantial financial reserves and are in a position to reduce spending slowly.

Exchange rate movements have been unusually large. Among major currencies, the dollar has seen a major appreciation and the euro and the yen a major depreciation. These movements clearly reflect major differences in monetary policy, with the United States expecting to exit the zero lower bound this year, but with no such prospects for the euro area or Japan. Given that these differences have been clear for some time, the surprise here may be how long it took for these exchange rate movements to occur. To the extent that both the euro area and Japan were at risk of another relapse, the euro and yen depreciations will help. To some extent, the United States has the policy room to offset the adverse effects of the dollar appreciation. Thus, this adjustment of exchange rates must be seen, on net, as good news for the world economy.

Now, put these four forces together. Some countries suffer from legacies, others do not. Some countries suffer from lower potential growth, others do not. Some countries gain from the decrease in the price of oil, others lose. Some countries' currencies move with the dollar, others move with the euro and the yen. Add to this a couple of idiosyncratic developments, such as the economic troubles in Russia or the weakness of Brazil. It is no surprise that the assessment must be granular. On net, our baseline forecasts are that advanced economies will do better this year than last year, that emerging markets and low-income countries will slow down relative to last year, and that, as a result, global growth will be roughly the same as last year. But these aggregate numbers do not do justice to the diversity of underlying evolutions.

Moving from the baseline to the risks, have they increased? I see macroeconomic risks as having slightly decreased. The major risk last year—namely, a recession in the euro area—has decreased, as has the risk of deflation. But financial and geopolitical

risks have increased. Large movements in relative prices, whether exchange rates or the price of oil, create losers and winners. Energy companies and oil-producing countries face both tougher conditions and higher risks. So do non-U.S. companies and governments that have borrowed in dollars. If large exchange rate movements were to continue, they could both create further financial risks and reignite talk of currency wars. A Greek crisis cannot be ruled out, an event that would surely unsettle financial markets. Turmoil continues in Ukraine and in the Middle East, although so far without systemic economic implications.

Finally, given the diversity of situations, it is obvious that policy advice must be country specific. Even so, some general principles continue to hold. Measures to sustain growth both in the short and the longer term continue to be of the essence. With

the introduction of quantitative easing in the euro area, monetary policy in advanced economies has largely accomplished what it can. Fiscal room exists in some countries but is limited; the decrease in the price of oil has created an opportunity to decrease energy subsidies and replace them with better-targeted programs. The case for more infrastructure investment that we made in the previous *World Economic Outlook* remains. And while structural reforms cannot do miracles, they can increase the level of output and increase growth for some time. The proper menu differs by country. Given the short-term political costs associated with many of these reforms, the challenge will be to choose carefully among them.

Olivier Blanchard  
*Economic Counsellor*