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Global Update

World Economic Outlook: IMF 22nd April 2010

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The IMF in its latest World Economic Outlook has forecast global growth at 4.2% for 2010. However, for this to fructify fiscal stimulus for 2010 should be fully implemented. *This is in contrast to the Indian approach of phased withdrawal of the stimulus package.*

Some of the salient highlights are:

- The world economy is recovering from the global crisis better than expected, but the revival would be at different speeds in different parts of the world. World economic activity contracted by 0.6% last year as world trade slumped and credit froze.
  - Among the advanced economies, the United States is off to a better start than Europe and Japan.
  - Among emerging and developing economies, emerging Asia is leading the recovery, while many emerging European and some Commonwealth of Independent States economies are lagging behind.
  - China's growth is forecast at 10% in 2010, **with India also at a rapid 8.8%**. Sub-Saharan Africa has weathered the crisis well and its recovery is expected to be stronger than in previous global downturns. In the depth of the crisis last year.
- The recovery has been facilitated by both fiscal and monetary policy across all countries. Inflation expectations have generally remained well anchored, testifying to the credibility of accommodative monetary and fiscal policies as well as public support for financial repair.
- Together with real and financial activity, cross-border financial flows from advanced to emerging economies have picked up, primarily reflecting a recovery from deep retrenchment in 2008. Both equity and bond flows have accelerated since the end of 2008, although syndicated loan issuance remains below pre-crisis levels.
- Achieving strong, sustained, and balanced growth would require more fiscal consolidation in advanced countries, exchange rate adjustments, and a rebalancing of demand across the world.
- A key concern is that room for policy maneuvers in many advanced economies has either been exhausted or become much more limited. Moreover, sovereign risks in advanced economies could undermine financial stability gains and extend the crisis. The rapid increase in public debt and deterioration of fiscal balance sheets could be transmitted back to banking systems or across borders.
  - These problems underscore the need for policy action to sustain the recovery of the global economy and financial system. Given the still fragile recovery, fiscal stimulus planned for 2010 should be fully implemented, except in economies that face large increases in risk premiums.

Latest IMF projections

The world economy is recovering better than expected, but at varying speeds for different regions.

(percent change unless otherwise noted)

			Projections		Difference from January 2010 WEO projections	
	2008	2009	2010	2011	2010	2011
World Output	**3.0**	**-0.6**	**4.2**	**4.3**	**0.3**	**0.0**
Advanced Economies	0.5	-3.2	2.3	2.4	0.2	0.0
United States	0.4	-2.4	3.1	2.6	0.4	0.2
Euro Area	0.6	-4.1	1.0	1.5	0.0	-0.1
Germany	1.2	-5.0	1.2	1.7	-0.3	-0.2
France	0.3	-2.2	1.5	1.8	0.1	0.1
Italy	-1.3	-5.0	0.8	1.2	-0.2	-0.1
Spain	0.9	-3.6	-0.4	0.9	0.2	0.0
Japan	-1.2	-5.2	1.9	2.0	0.2	-0.2
United Kingdom	0.5	-4.9	1.3	2.5	0.0	-0.2
Canada	0.4	-2.6	3.1	3.2	0.5	-0.4
Other Advanced Economies	1.7	-1.1	3.7	3.9	0.4	0.3
Newly Industrialized Asian Economies	1.8	-0.9	5.2	4.9	0.4	0.2
Emerging and Developing Economies	6.1	2.4	6.3	6.5	0.3	0.2
Central and Eastern Europe	3.0	-3.7	2.8	3.4	0.8	-0.3
Commonwealth of Independent States	5.5	-6.6	4.0	3.6	0.2	-0.4
Russia	5.6	-7.9	4.0	3.3	0.4	-0.1
Excluding Russia	5.3	-3.5	3.9	4.5	-0.4	-0.6
Developing Asia	7.9	6.6	8.7	8.7	0.3	0.3
China	9.6	8.7	10.0	9.9	0.0	0.2
India	7.3	5.7	8.8	8.4	1.1	0.6
ASEAN-5[1]	4.7	1.7	5.4	5.6	0.7	0.3
Middle East and North Africa	5.1	2.4	4.5	4.8	0.0	0.1
Sub-Saharan Africa	5.5	2.1	4.7	5.9	0.4	0.4
Western Hemisphere	4.3	-1.8	4.0	4.0	0.3	0.2
Brazil	5.1	-0.2	5.5	4.1	0.8	0.4
Mexico	1.5	-6.5	4.2	4.5	0.2	-0.2

Source: IMF, World Economic Outlook, October 2009.
[1]Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

In the light of the present situation, Greece in particular, some of the more pressing problems that have to be addressed are:

1. Reducing sovereign risk. The key task ahead is to reduce sovereign vulnerabilities. In many advanced economies, there is a pressing need to design and communicate credible medium-term fiscal consolidation strategies. These should include clear time frames to bring down gross debt-to-GDP ratios over the medium term as well as contingency measures if the deterioration in public finances is greater than expected. Most advanced economies should embark on fiscal consolidation in 2011.
2. Unwinding the stimulus. Given the large amount of public debt that has been accumulated during this recession, in many advanced economies stimulus exit policies need to emphasize fiscal consolidation and financial sector repair. This will allow monetary policy to remain accommodative without leading to inflation pressure or financial market instabilities.
3. Combating unemployment. As high unemployment persists in advanced economies, a major concern is that temporary joblessness will turn into long-term unemployment. Beyond pursuing macroeconomic policies that support recovery in the near term and financial sector policies that restore banking sector health (and credit supply to employment-intensive sectors), specific labor market policies could also help limit damage to the labor market.
4. Buttressing financial stability. Policymakers need to try to ensure that the next stage of the financial sector deleveraging process unfolds smoothly and results in a safer and competitive financial system. Resolution of nonviable institutions and restructuring of those firms with a commercial future is the key. *Starting securitization on a safer basis is also essential to support credit, particularly for households and small and medium-size enterprises. The RBI's recent guidelines on securitization should be looked at as being in sync with what the IMF has spoken of.*
5. Agreeing to regulatory reform agenda. There must be agreement on the reform agenda for financial regulation. The direction of reform is clear—higher quantity and quality of capital and better liquidity risk management.
6. Tackling global imbalances. The world's ability to sustain high growth over the medium term depends on rebalancing global demand. This means economies that had excessive external deficits before the crisis need to consolidate their public finances to limit damage to growth and demand. Concurrently, economies that ran big current account surpluses will need to increase domestic demand to sustain growth. As currencies of economies with excessive deficits depreciate, those of surplus economies must logically appreciate. Rebalancing also needs to be supported with financial sector reform and structural policies in both surplus and deficit economies.

View on Asia

Although the downturn in many Asian economies in late 2008 was steeper than expected, recovery came quickly and was just as sharp. Output growth in 2009 in almost all Asian economies was stronger with Japan a notable exception. A V-shaped recovery points to an overall slowdown that was more moderate than in other regions. The recovery has also been more balanced in Asia than elsewhere, with output growth in most economies supported by both external and domestic demand. And even though macroeconomic stimulus was substantial, private demand also gained traction in many economies. Four factors have supported Asia's recovery.

1. Rapid normalization of trade following the financial dislocation in late 2008 greatly benefited the export-oriented economies in the region.
2. The bottoming out of the inventory cycle, both domestically and in major trading partners such as the United States is boosting industrial production and exports.
3. A resumption of capital inflows into the region has created abundant liquidity in many economies.
4. Domestic demand has been resilient, with strong public and private components in many of the region's economies. Low public debt levels allowed many Asian economies to implement strong and timely countercyclical policy responses to the crisis—IMF estimates that fiscal stimulus added 1¾ percentage points to Asia's growth in 2009. Monetary loosening also eased financial conditions across the region—through cuts in policy interest rates and, measures to increase liquidity.

China-India view

In both China and India, strong domestic demand will support the recovery. In China, GDP growth exceeded the government's 8% target in 2009 and is expected to be close to 10% in both 2010 and 2011. What has been so far mainly a publicly driven growth path, built on infrastructure investment, is expected to turn toward stronger private consumption and investment. In India, growth is projected to be 8¾% in 2010 and 8½% in 2011, supported by rising private demand. Consumption will strengthen as the labor market improves, and investment is expected to be boosted by strong profitability, rising business confidence and favorable financing conditions.

Further, the strength in final domestic demand in India and especially China is expected to have positive spillovers for other Asian economies, particularly exporters of commodities and capital goods. Rebalancing away from external demand, however, is likely to entail different measures for different economies in the region. For example, boosting domestic consumption will be a priority in China, through improved access to finance for small enterprises and households and stronger corporate governance and social safety nets to reduce precautionary saving.

Greater exchange rate flexibility in many economies would also facilitate rebalancing by raising households' purchasing power and helping shift productive resources from the tradable to the non-tradable sector. Given the region's strong recovery, planning the speed and sequencing of the exit from stimulative macroeconomic policies must become a policy priority. Withdrawing accommodative policy stances is becoming an option in several economies, but the fragility of the recovery in major advanced economies suggests that there are risks from moving too swiftly in that direction. Persistent differences in domestic cyclical conditions within Asia also warrant different timing and sequencing in the exits from policy support.
