



The World Economy: How Did We Get Here and Where Are We Going?

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A Sharp Decrease in Growth

WEO Real GDP Growth Projections (percent change from a year earlier)

								
	WORLD	U.S.	EURO AREA	JAPAN	BRAZIL	RUSSIA	INDIA	CHINA
2011 (SEP 2011)	4.0	1.5	1.6	-0.5	3.8	4.3	7.8	9.5
2011 (APR 2011)	4.4	2.8	1.6	1.4	4.5	4.8	8.2	9.6
2012 (SEP 2011)	4.0	1.8	1.1	2.3	3.6	4.1	7.5	9.0
2012 (APR 2011)	4.5	2.9	1.8	2.1	4.1	4.5	7.8	9.5

Source: IMF, *World Economic Outlook*.

The Confluence of Two Factors

**Slower
Underlying
Growth:**

Balance sheet repairs.

**A Crisis of
Confidence:**

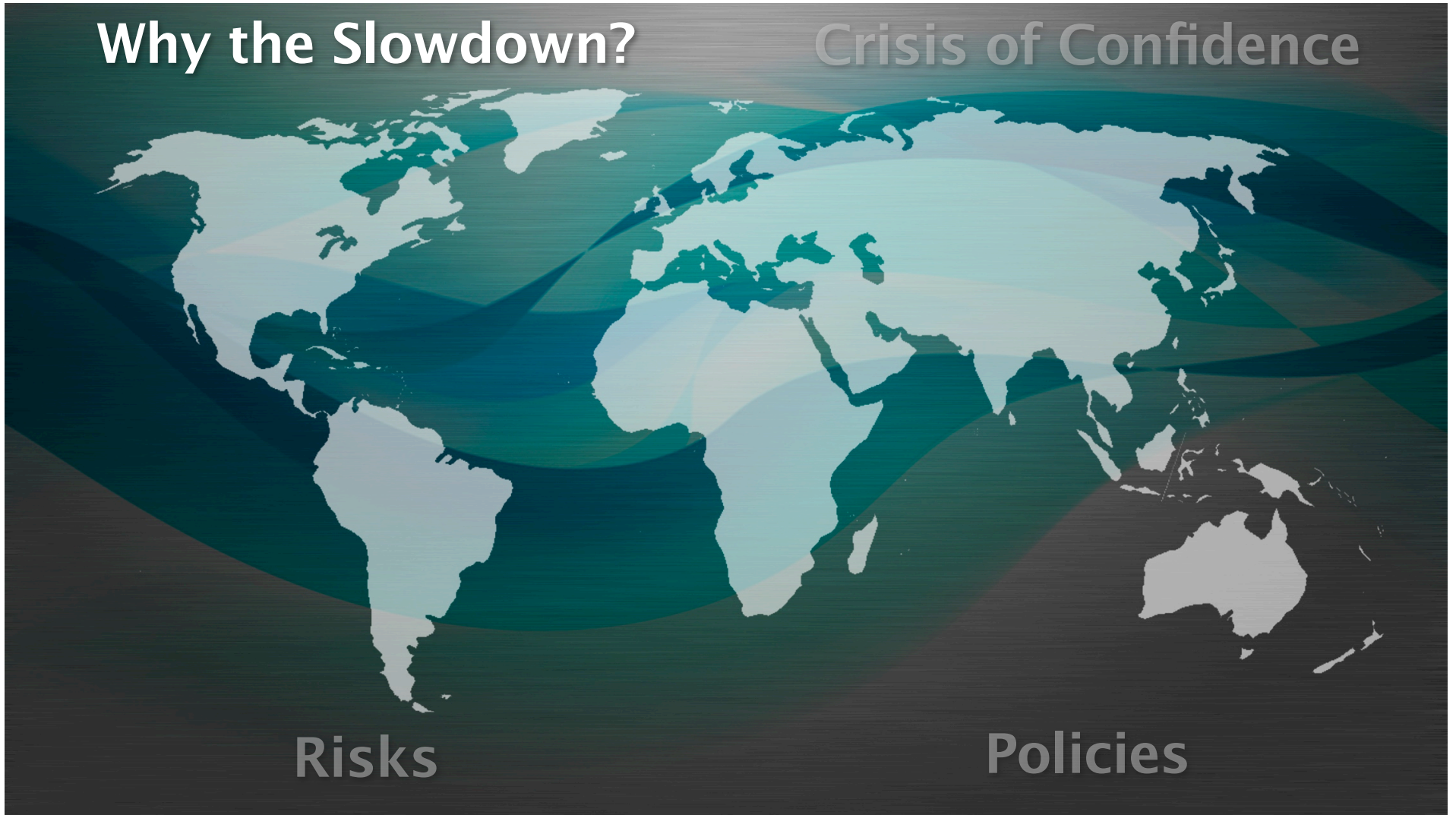
**Political uncertainty, and fiscal/financial
interactions.**

**Interacting
in Bad
Ways:**

This is where the risks are.

Why the Slowdown?

Crisis of Confidence



Risks

Policies

Why the Slow Down?

Failure of internal rebalancing: Balance sheet repairs at work.

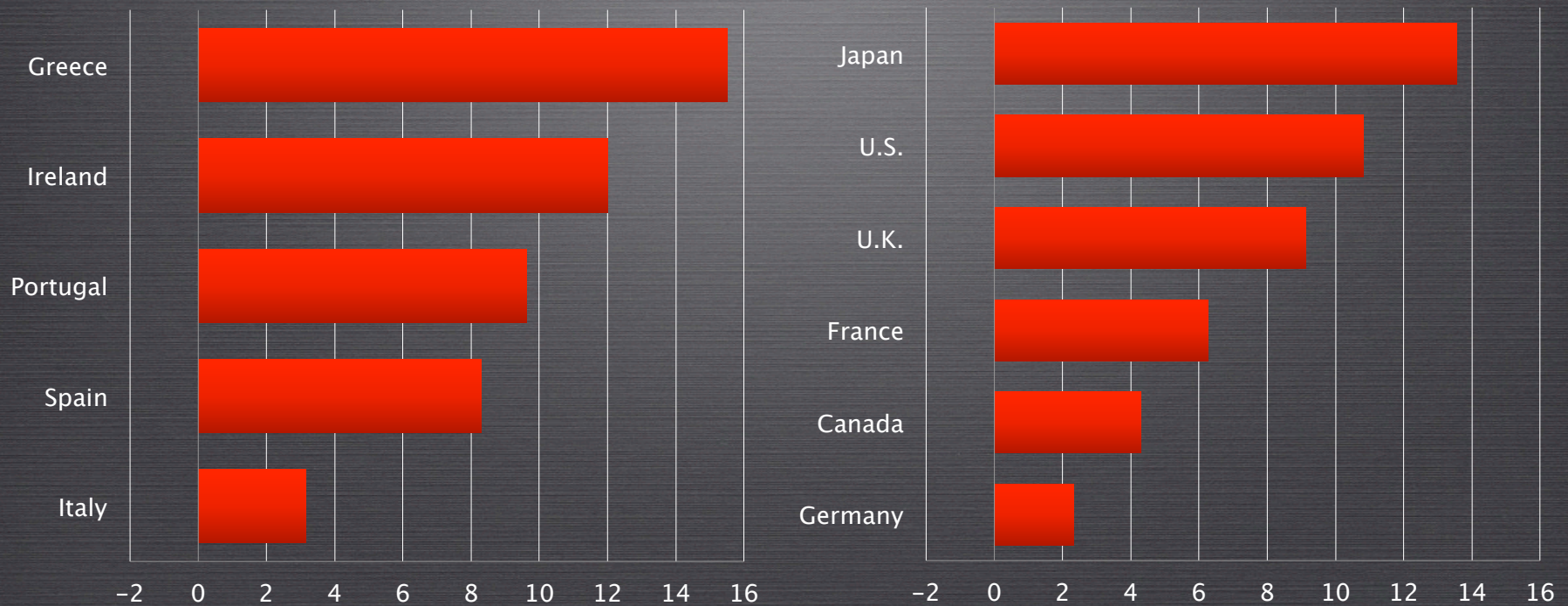
- **Fiscal consolidation.**
- **Weak domestic private demand.**

External rebalancing has stalled.

Fiscal Consolidation: Proceeding, But a Long Way to Go

Change in Cyclically-Adjusted Primary Balances (percent of GDP)

■ Total required adjustment by 2020 1/

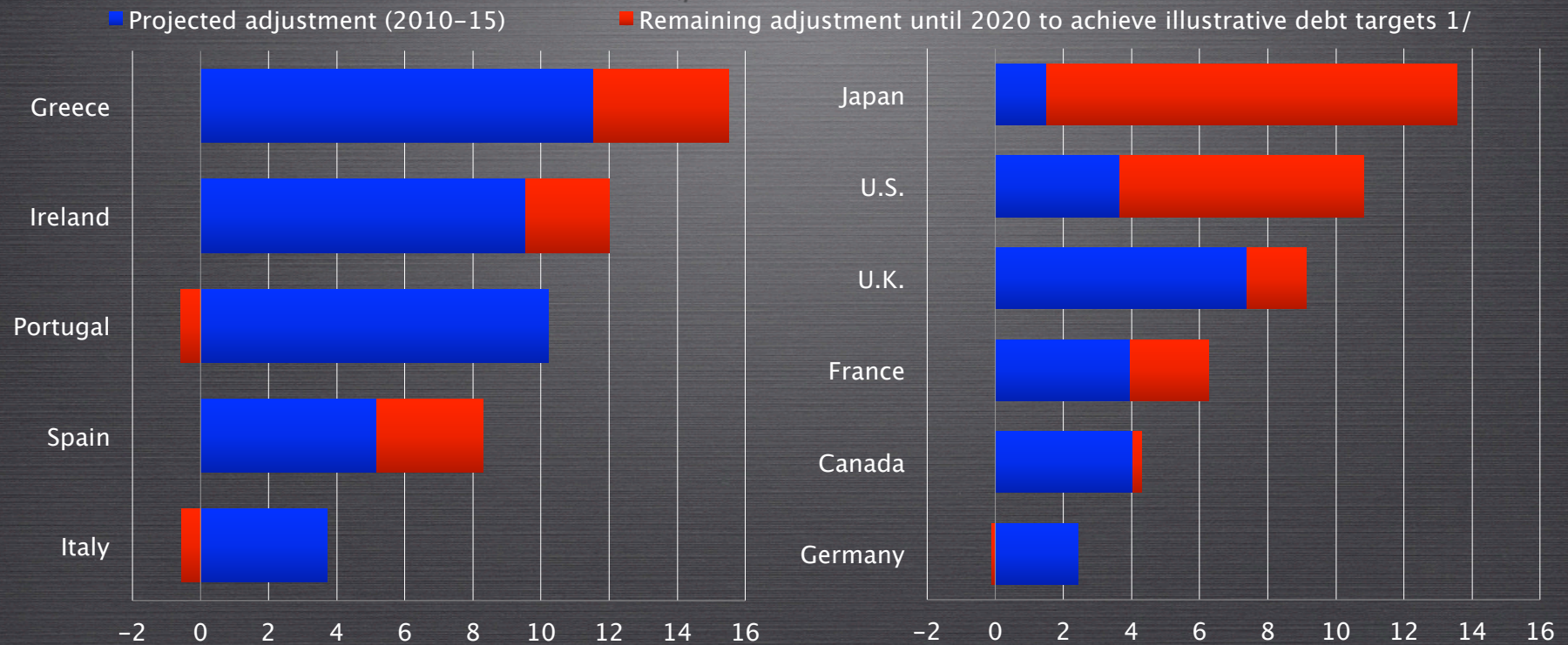


Source: IMF staff estimates.

1/ Total required adjustment to reduce the gross debt ratio to 60 percent by 2030 (net debt target of 80 percent for Japan). After 2020, the primary balance must be maintained constant at the prevailing level until 2030.

Fiscal Consolidation: Proceeding, But a Long Way to Go

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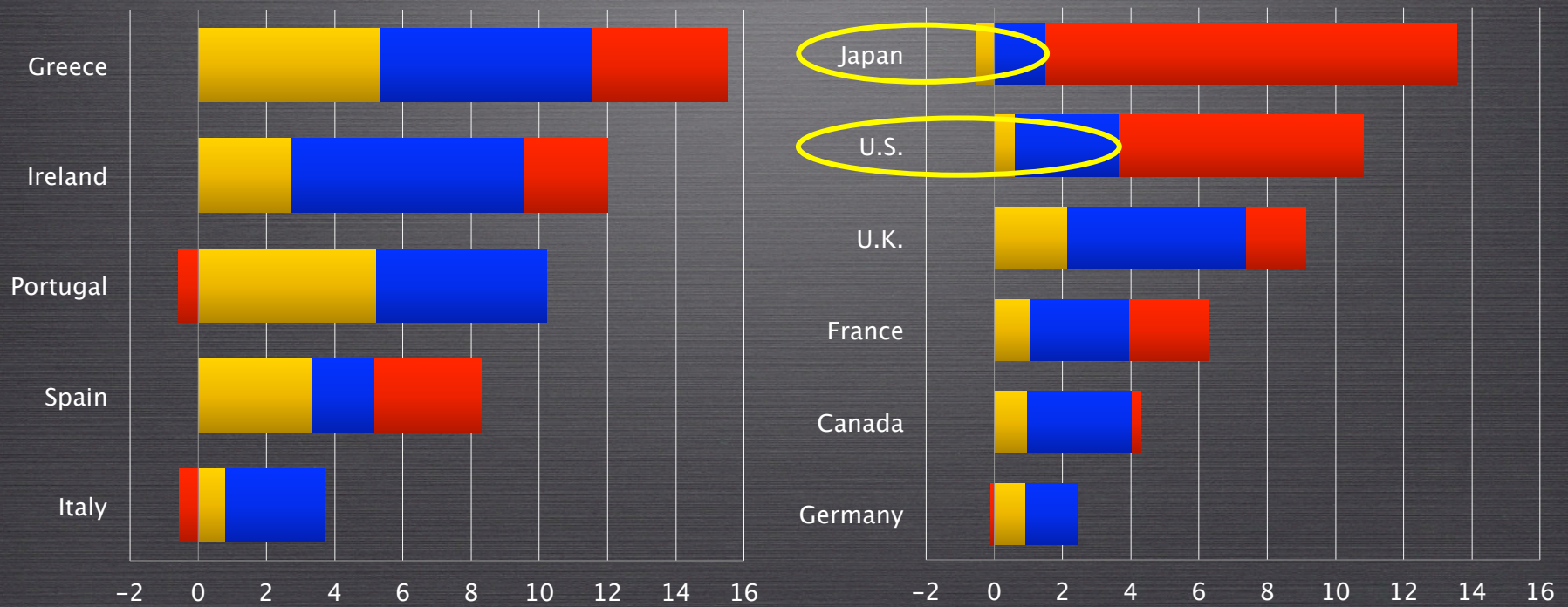
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Fiscal Consolidation: Proceeding, But a Long Way to Go

Change in Cyclically-Adjusted Primary Balances (percent of GDP)

■ Projected adjustment (2010-11)

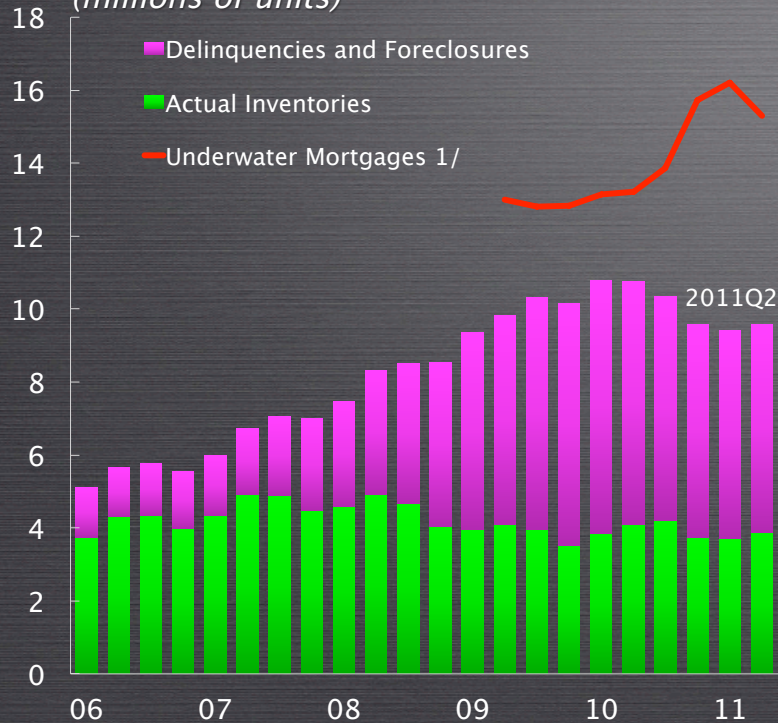


Source: IMF staff estimates.

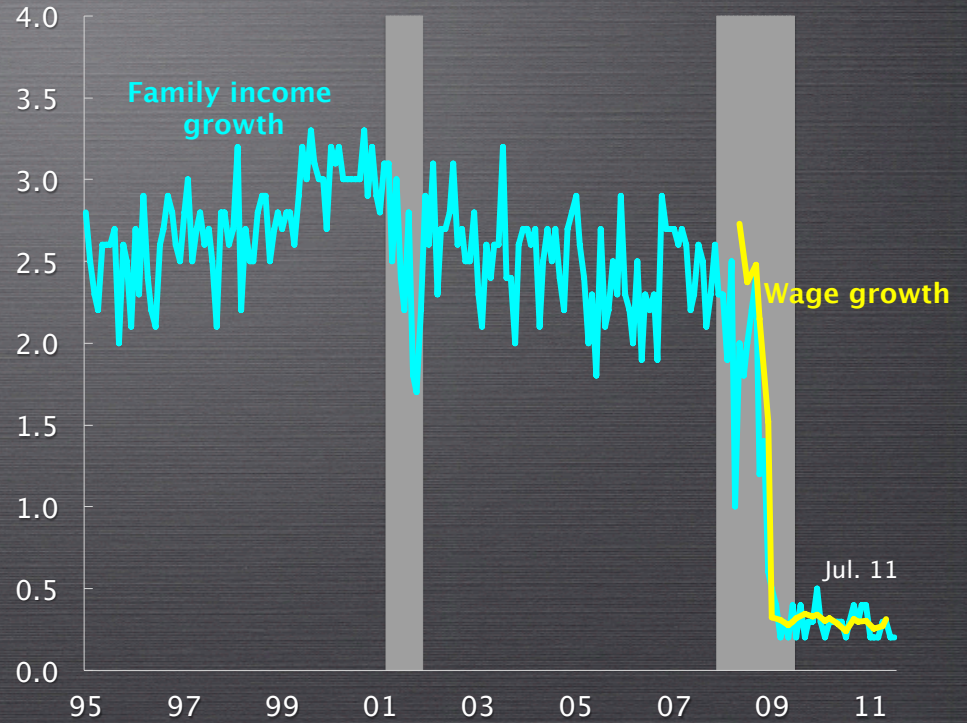
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Low Private Domestic Demand: Mechanical Brakes or Animal Spirits?

U.S. Housing Inventories and Foreclosures
(millions of units)



U.S. Expected Change in Income and Wages 2/ 3/
(percent; median; 3-month moving average)



Sources: University of Michigan, Survey of Consumers; New York Federal Reserve-ALP Panel; and IMF staff estimates.

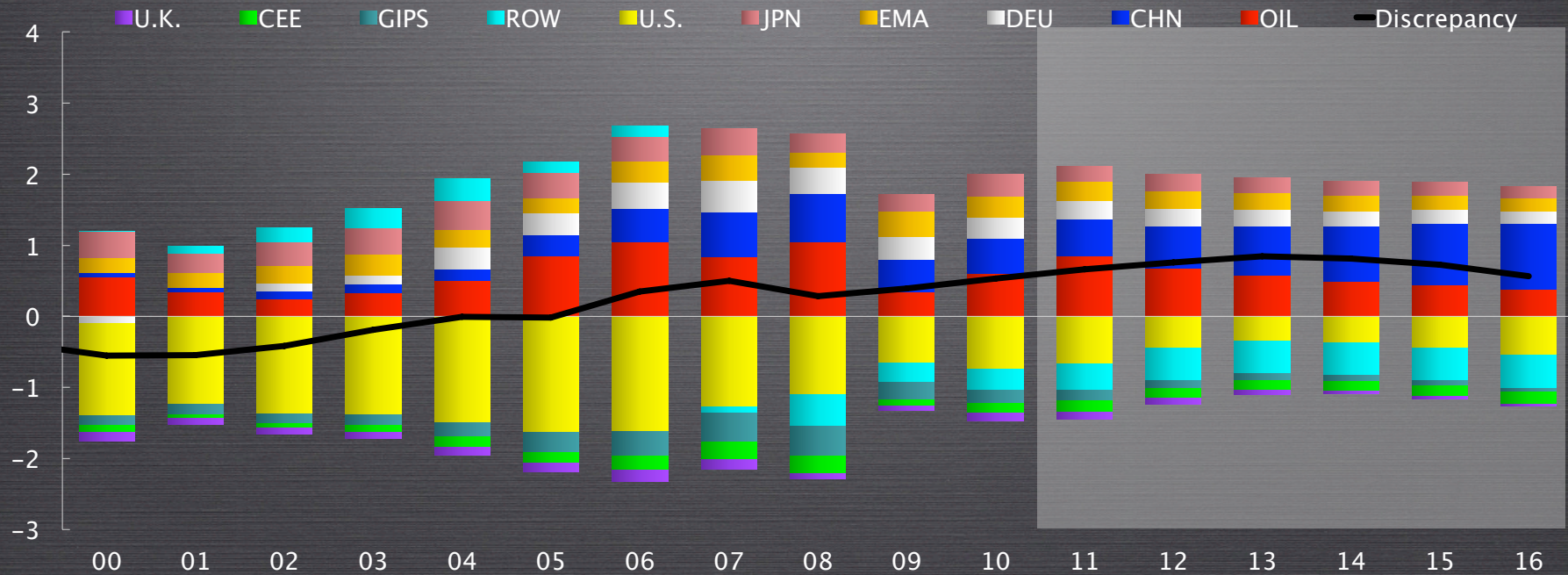
1/ Data from Zillow.com (single-family homes with mortgages in negative equity).

2/ Shaded bars indicate NBER-dated recessions.

3/ Median of point forecasts for year-ahead wage growth.

External Rebalancing Has Stalled

Global Imbalances 1/
(current account; percent of world GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

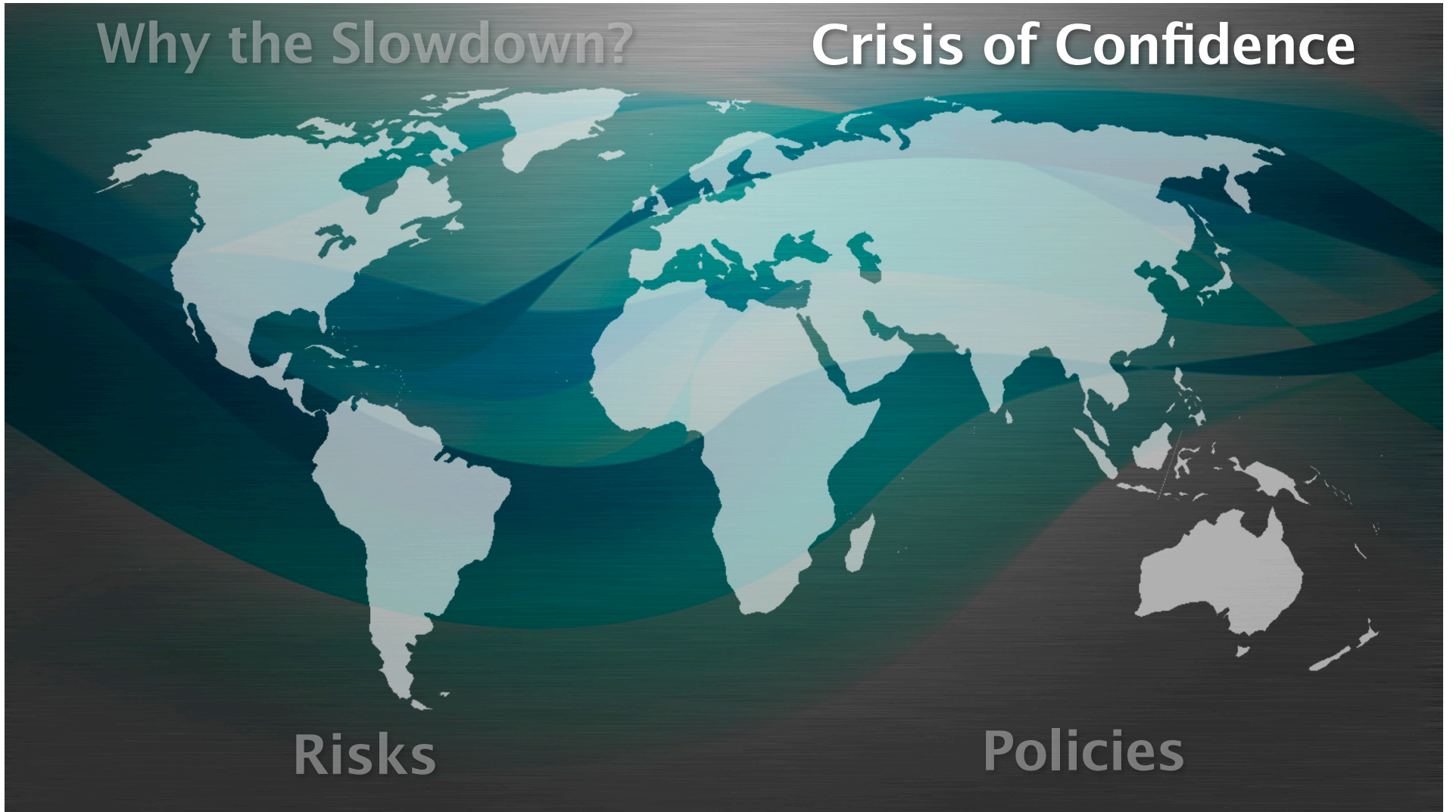
1/ CEE = Central European Economies; GIPS = Greece, Italy, Portugal, and Spain; ROW = Rest of World; EMA = Emerging Asia; OIL = Oil-exporting countries.

Why the Slowdown?

Crisis of Confidence

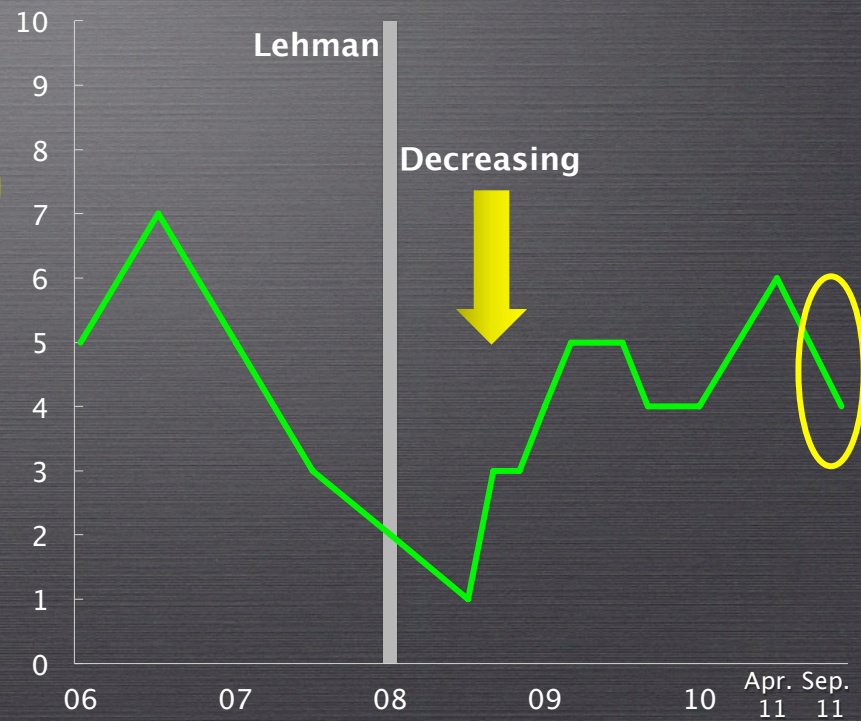
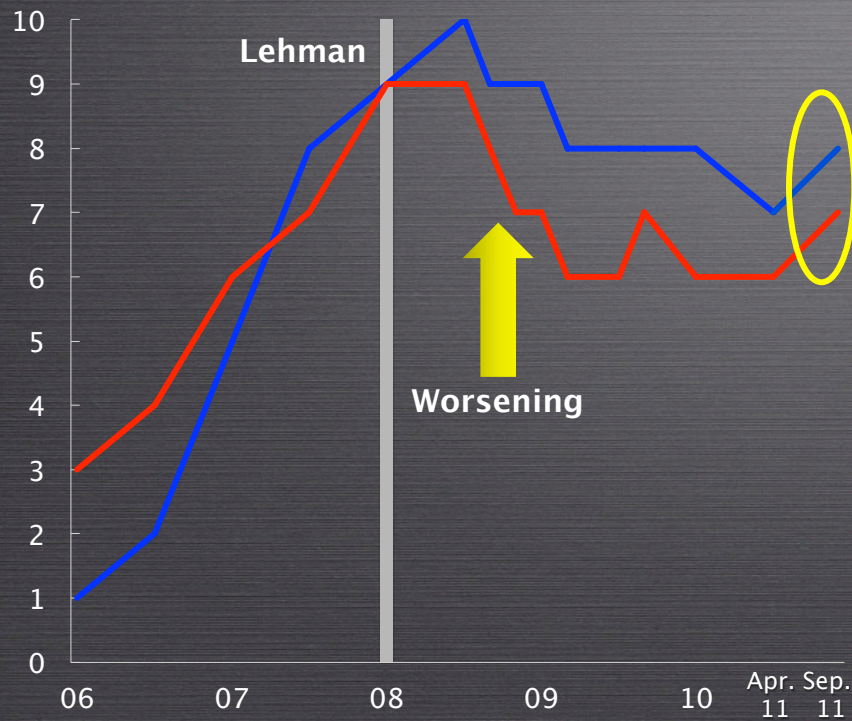
Risks

Policies



Global Financial Stability Is Worsening

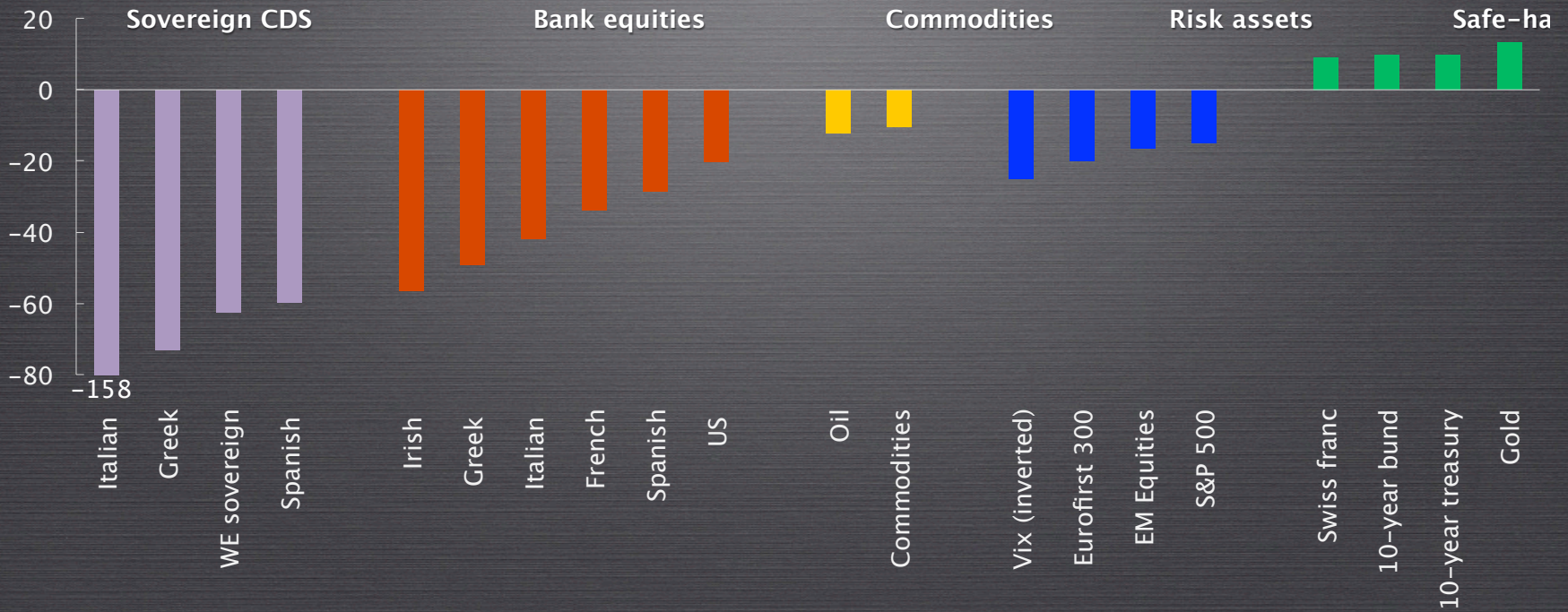
Credit Strain and Market & Liquidity Strain Indicators Risk Appetite



Source: IMF staff estimates.

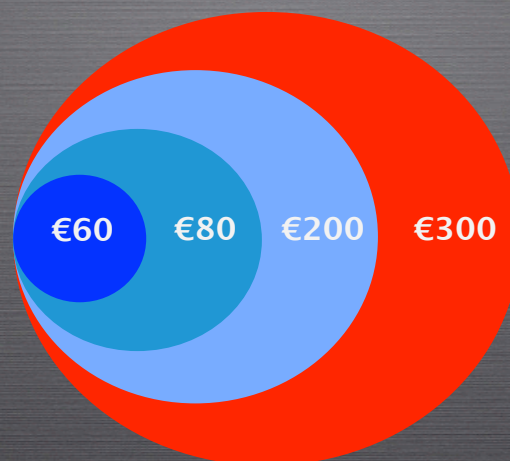
Prompting a Flight to Safe Assets

Asset Price Performance since April GFSR
(percent)



Sovereign Spillovers to the EU Banking System

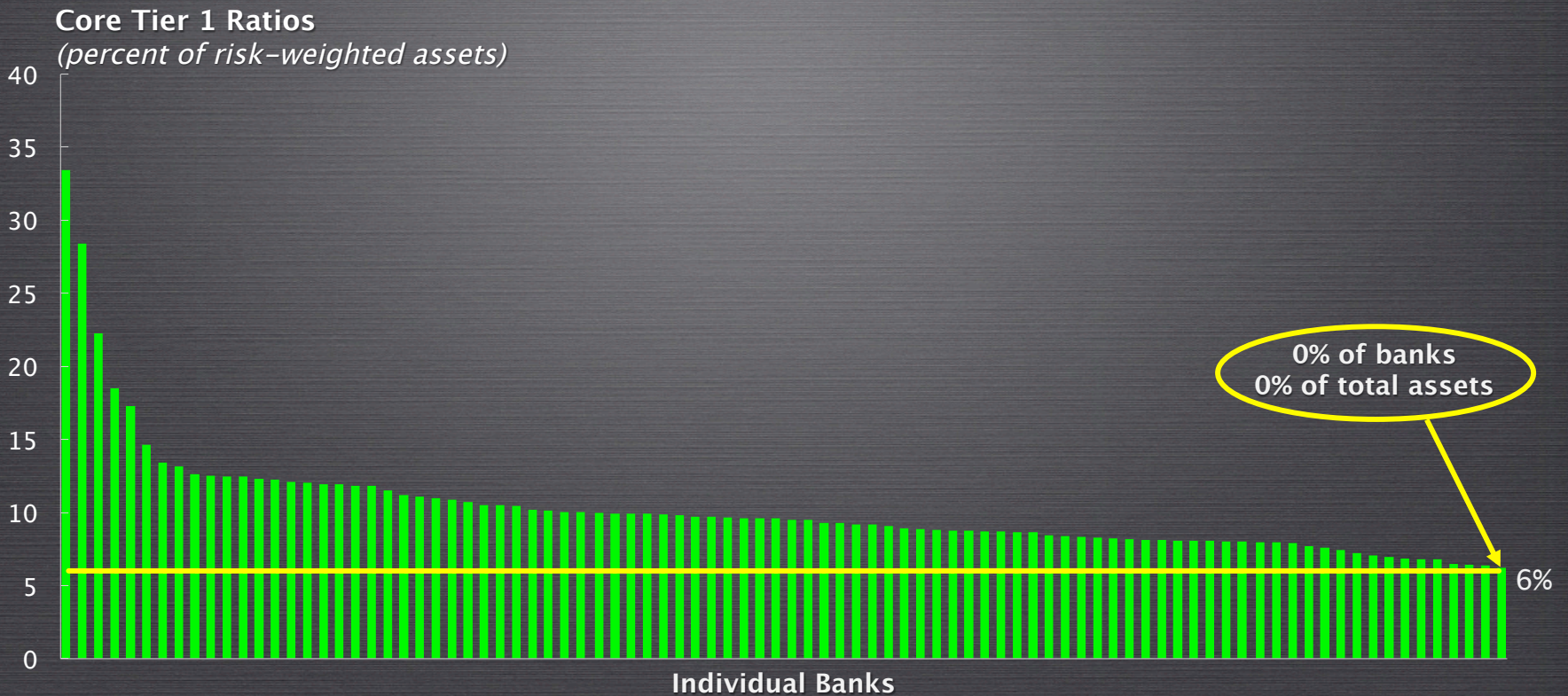
Cumulative Spillovers from High-Spread
Euro Area Sovereigns, 2010 Till Now
(billions of euros)



Spillovers from ...

- Greek sovereign
- Irish & Portuguese sovereign
- Belgian, Spanish & Italian sovereign
- High-spread euro area banking sector

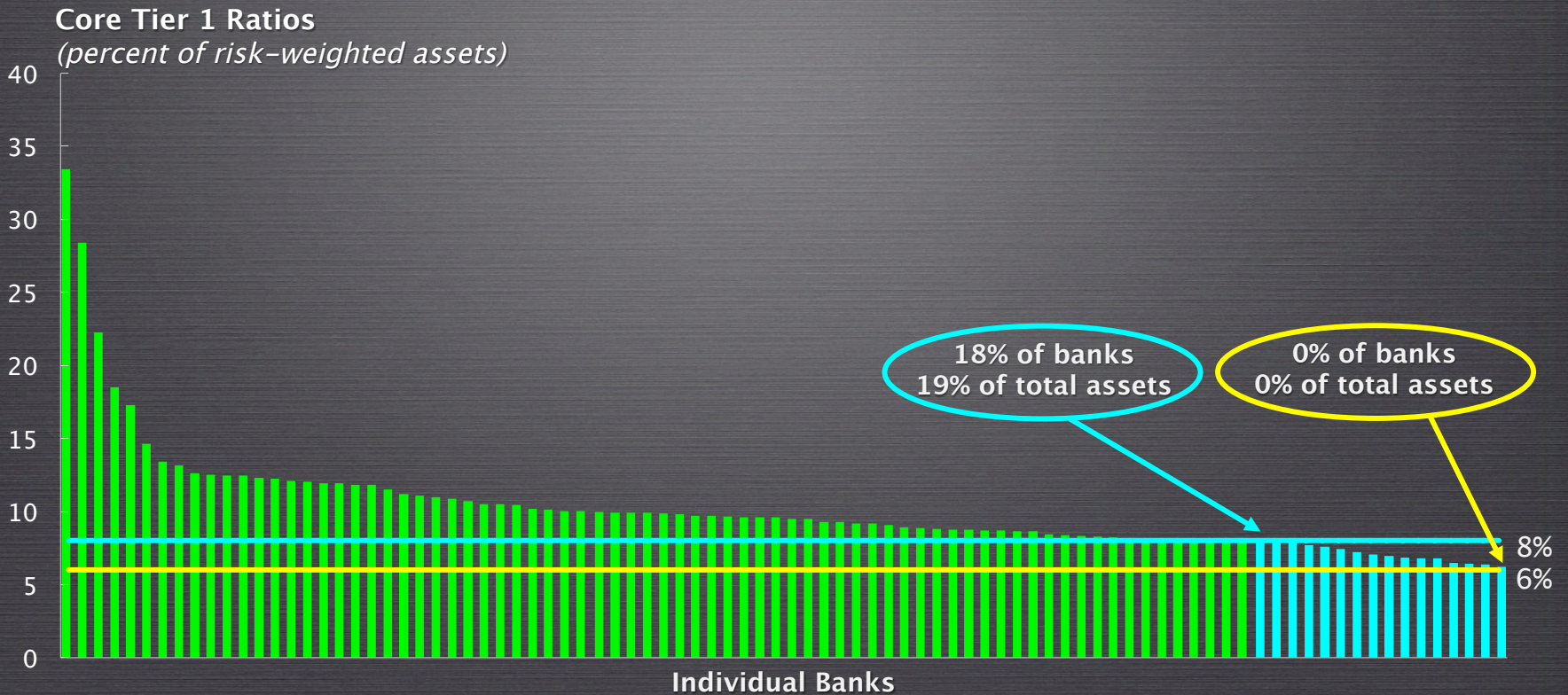
EU Bank Capital: Current Situation



Sources: European Banking Authority; and IMF staff estimates.

Note: Includes core Tier 1 capital at end-2010, actual equity raising from January to April 2011, and commitments made by April 2011 for equity rais and government support.

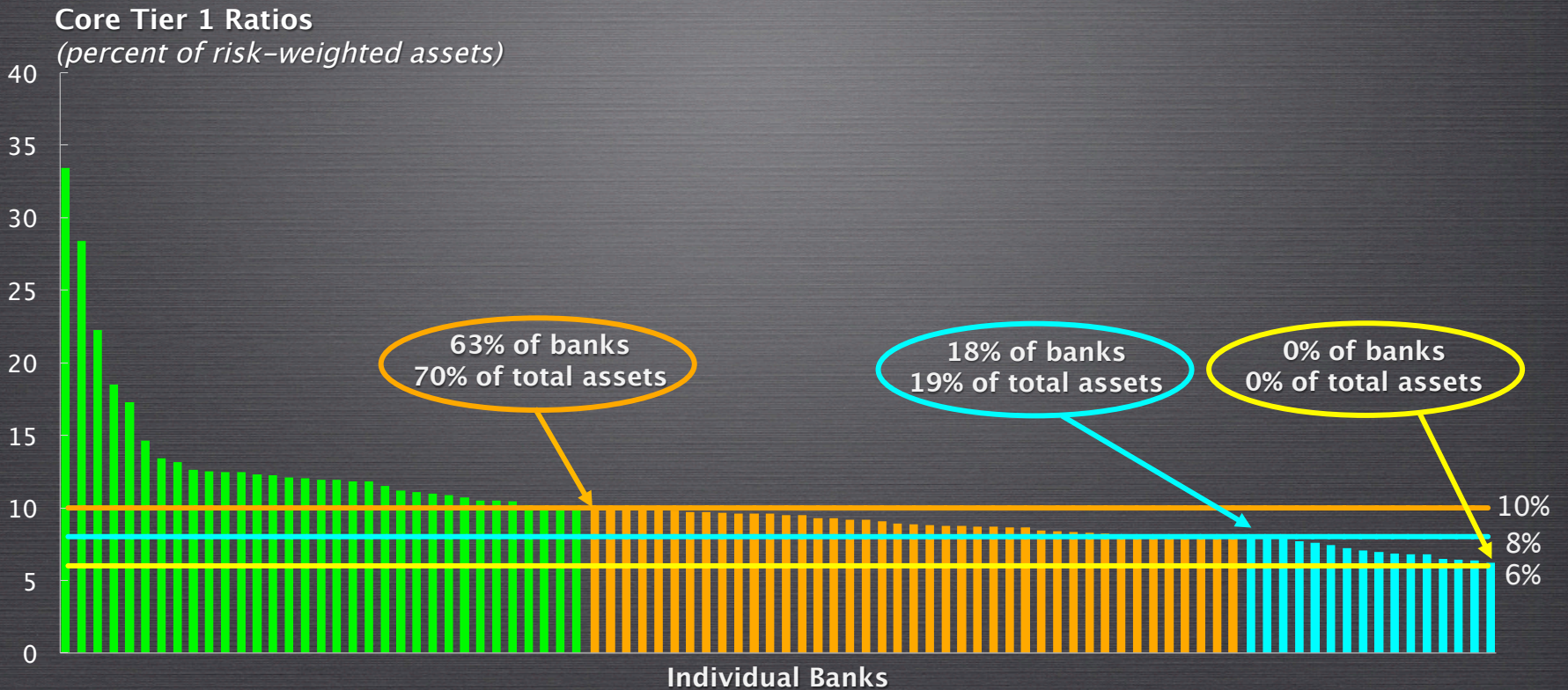
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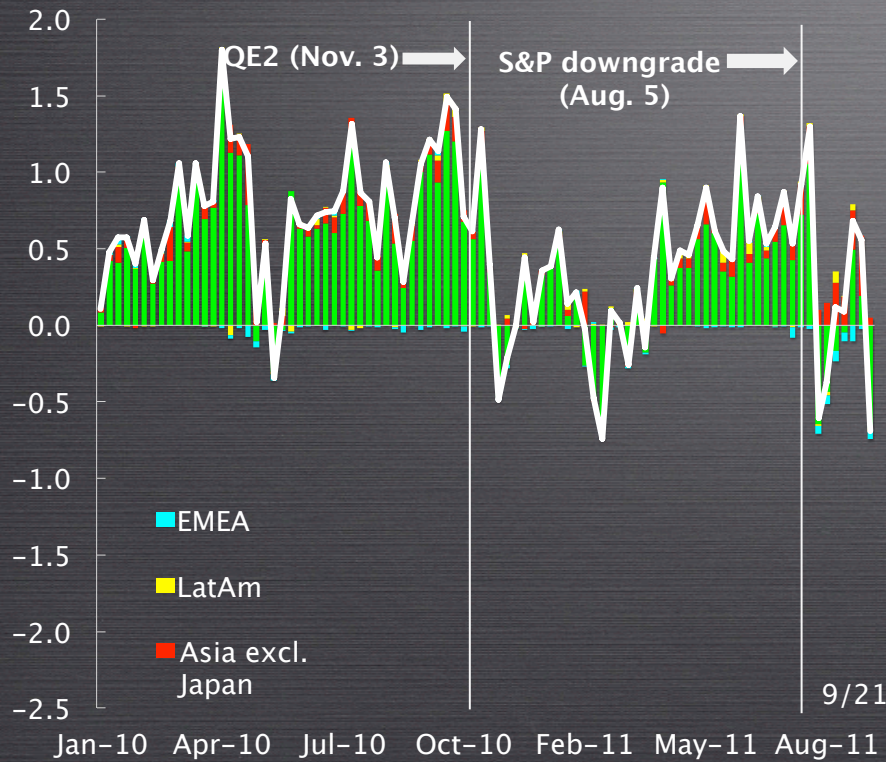
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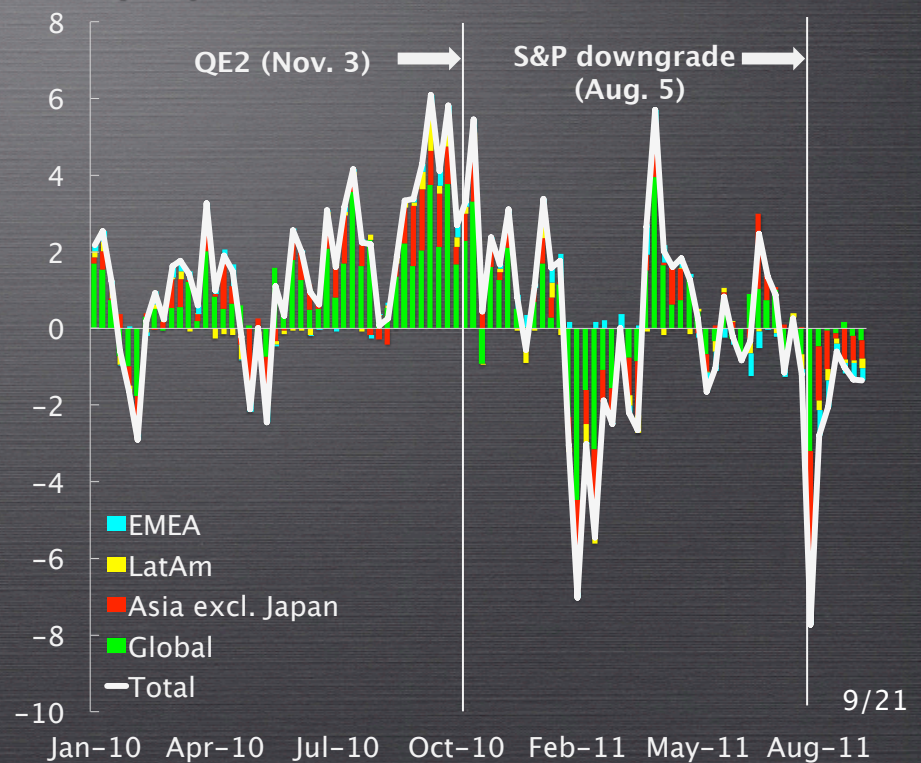
Capital Flows to EMs: Volatility Dominates

(billions of U.S. dollars; weekly flows)

Bond Funds

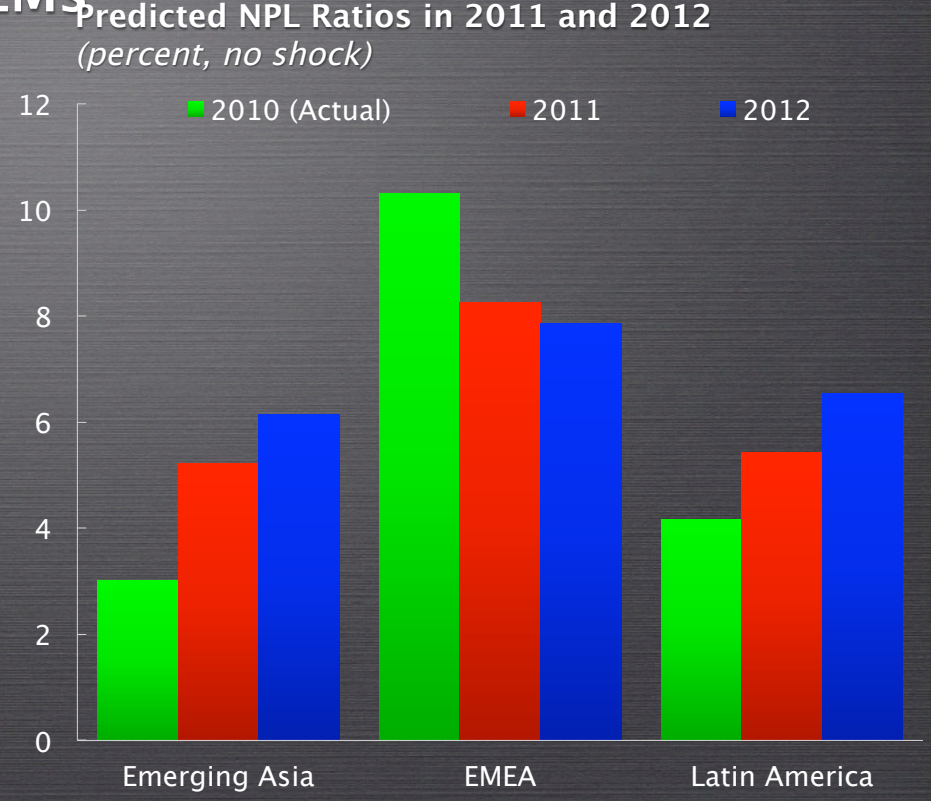
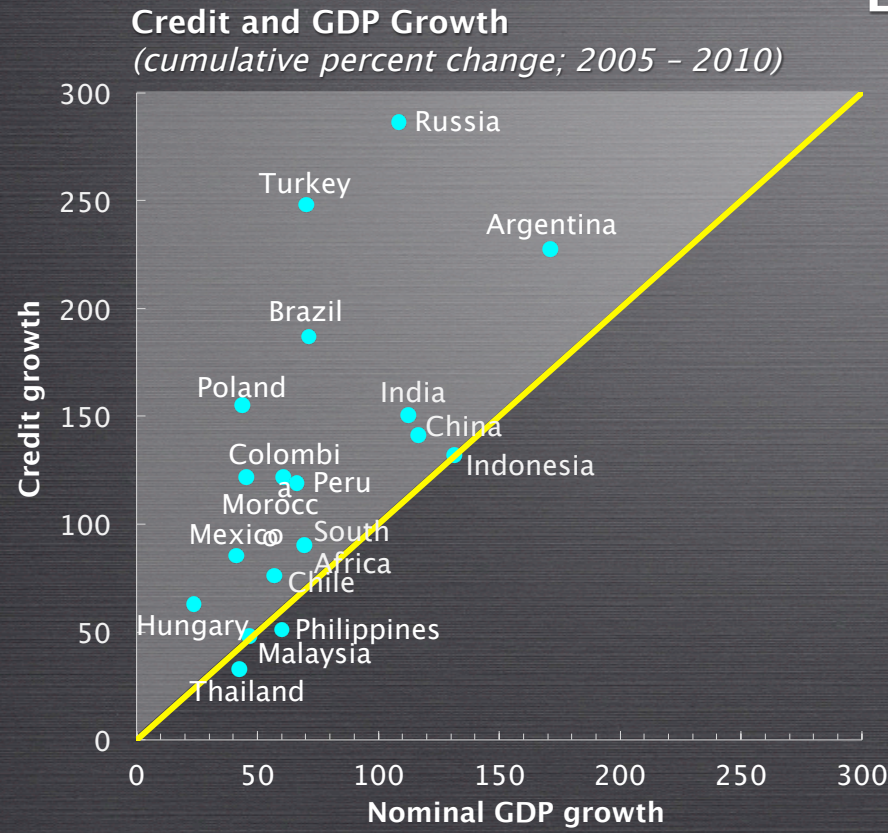


Equity Funds



Source: EPFR Global.

Rapid Credit Growth Can Lead to Rising Nonperforming Loans in EMS



Sources: IMF, *Global Data Source*; IMF, *International Financial Statistics*; and IMF staff estimates.

Why the Slowdown?

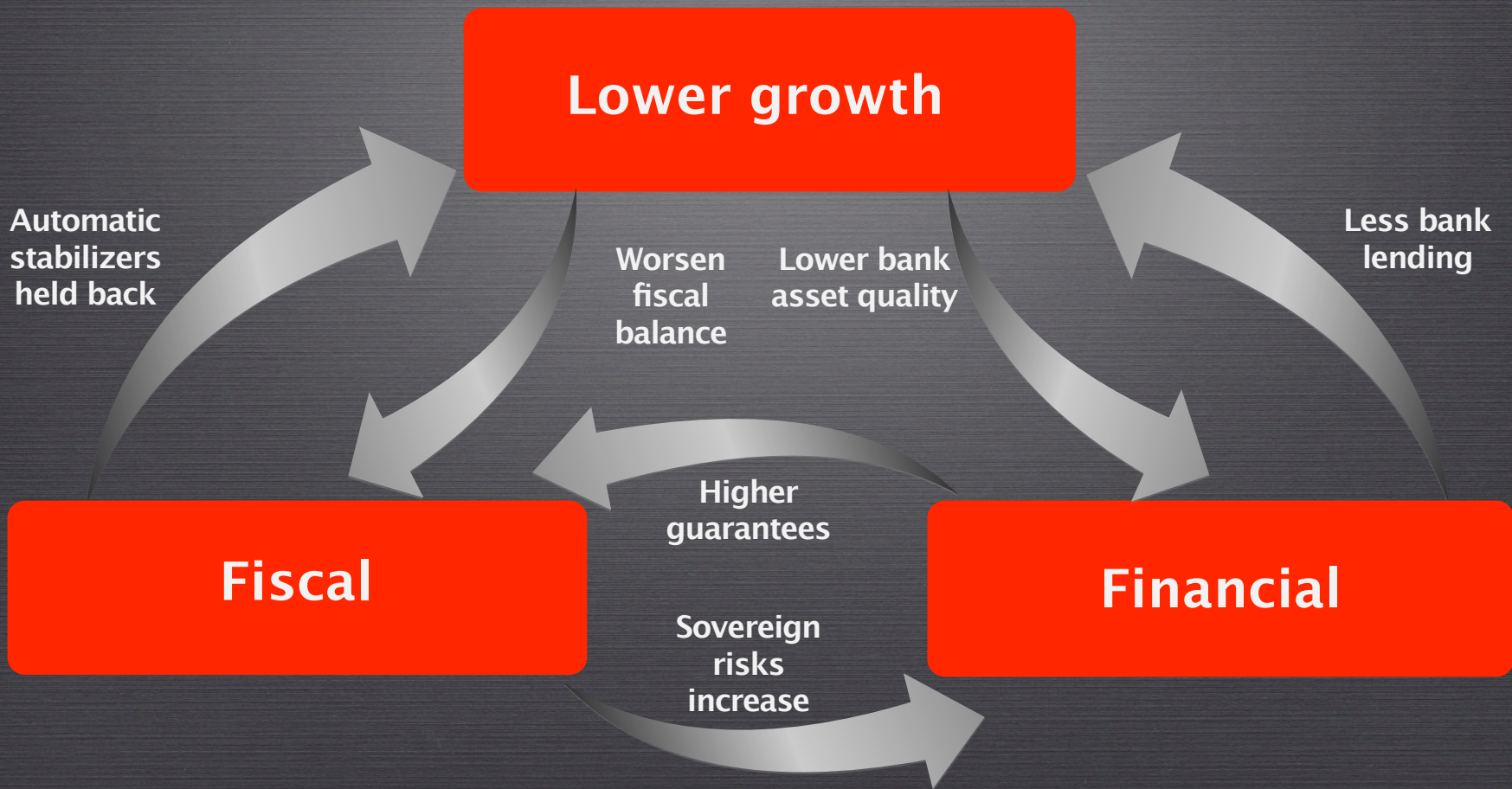
Crisis of Confidence

Risks

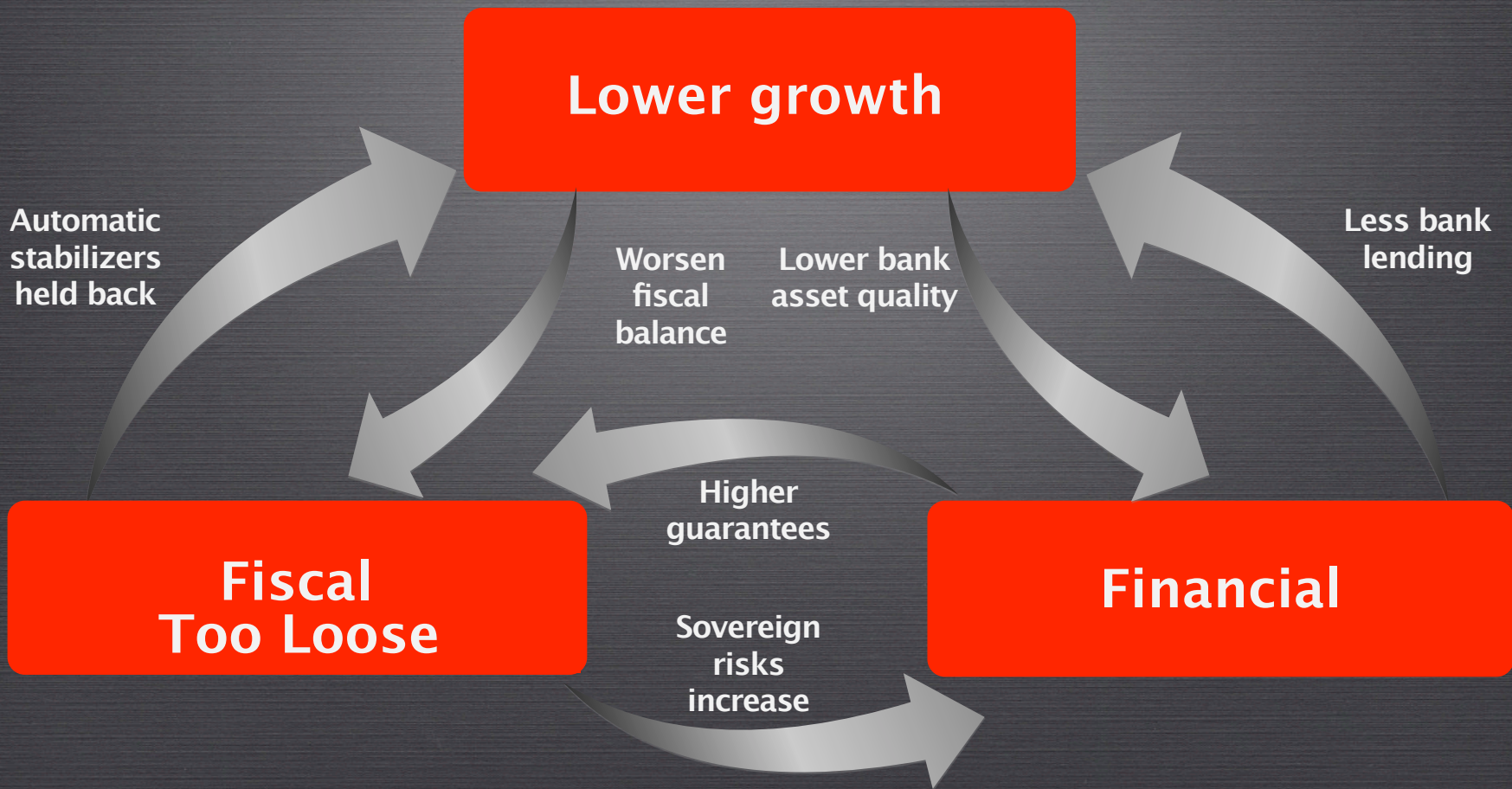
Policies



Risks – Adverse Feedback Loops



Risks – Adverse Feedback Loops



World Economy Facing Severe Downside Risks

A Global “Paradox of Thrift”

- Households, firms, and governments reduce demand, with many advanced economies unable to lower policy rates further.

Household and Public Debt Sustainability in the U.S.

- Continued low growth without fiscal consolidation could raise risk premia and U.S. bond yields, with adverse effects on public debt sustainability.

Sovereign Debt and Funding Pressures in Euro area

- Funding costs and low growth risk undermining fiscal sustainability and raise already high pressure on banks. Wholesale funding markets and deleveraging could trigger further large spillovers to real economy.

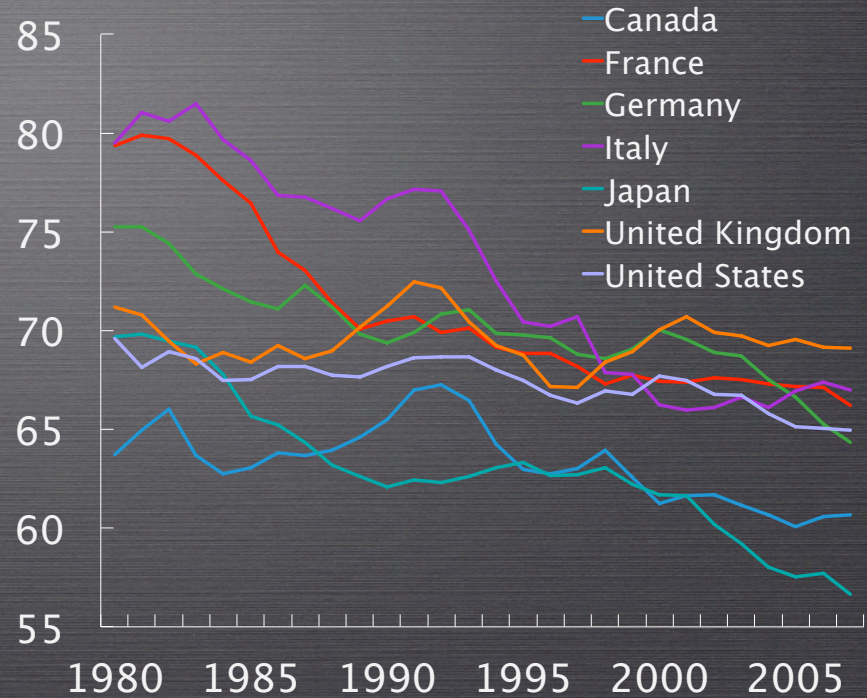
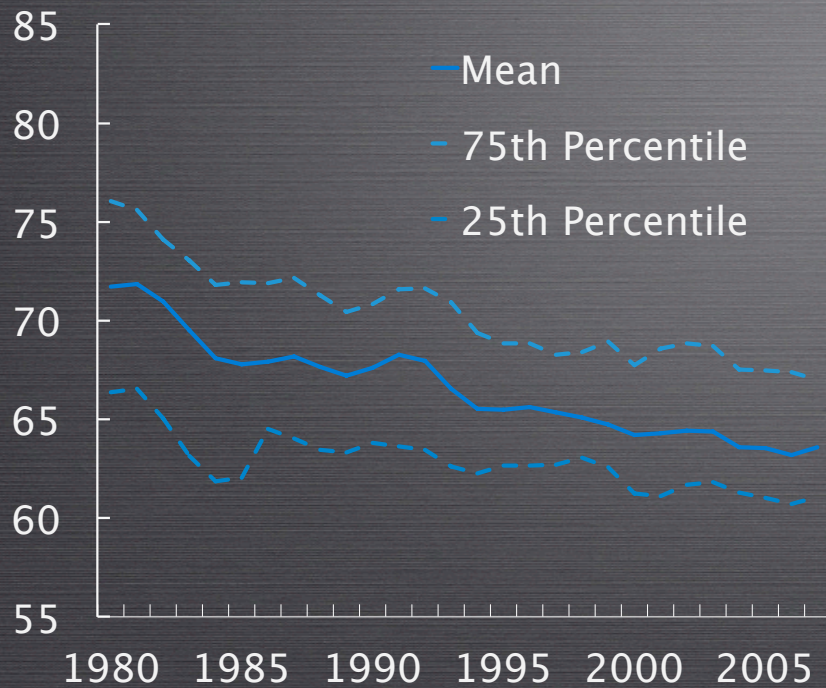
High unemployment with Limited Policy Space

Unemployment Rate
(percent; weighted by labor force)



Source: IMF, Global Data Source.

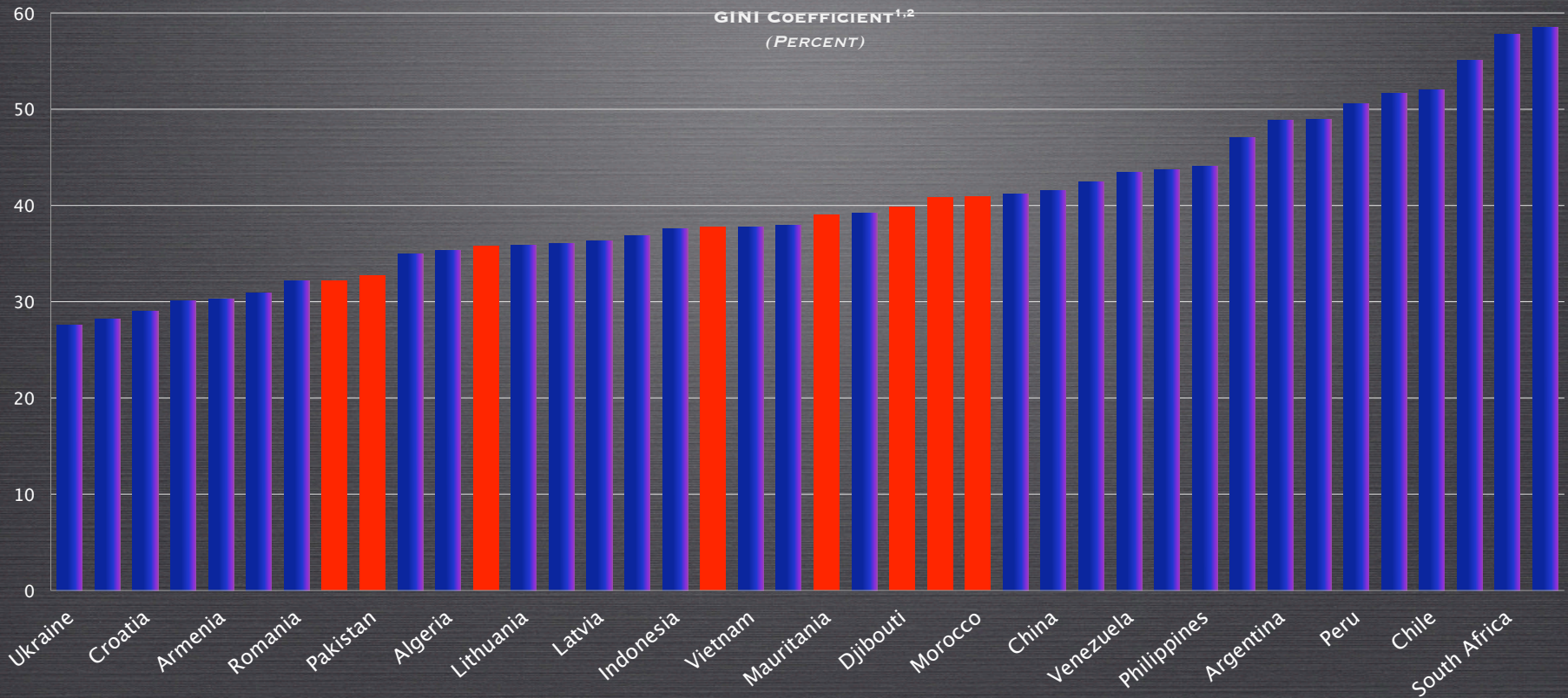
Declining Share of Labor in Income likely to Persist



Source: OECD.

Note: Left-hand panel reports mean and inter-quartile range for all advanced economies. Right-hand panel shows country-specific data for seven selected economies.

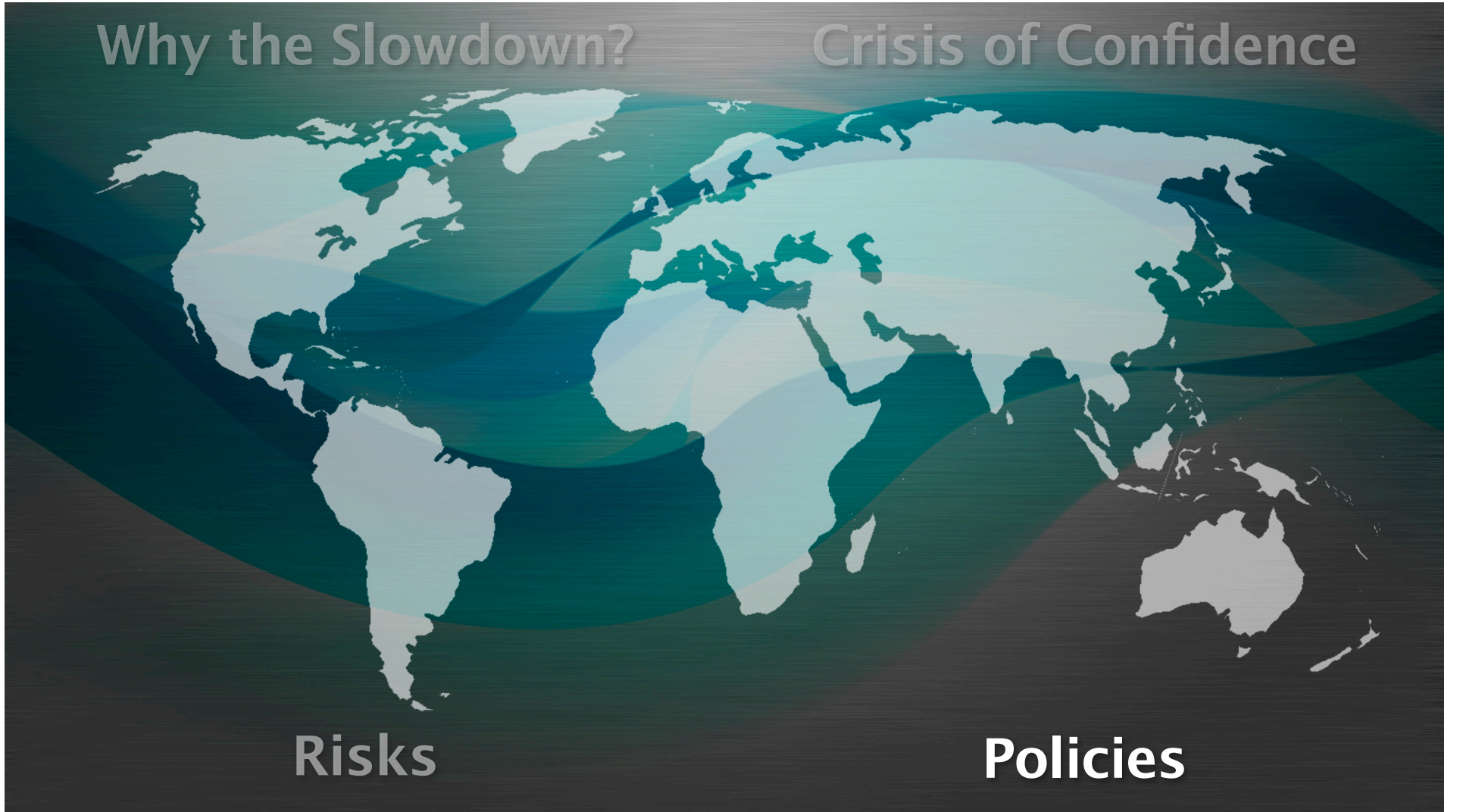
Against a Backdrop of High Income Inequality in Many Countries



SOURCE: WORLD BANK, *WORLD DEVELOPMENT INDICATORS*, 2011.
¹GINI COEFFICIENT IS A MEASURE OF INCOME INEQUALITY, WITH A LOWER VALUE ASSOCIATED WITH HIGHER INCOME EQUALITY.
²MOST RECENT DATA AVAILABLE.

Why the Slowdown?

Crisis of Confidence



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Need for Collective Action

To Preserve Stability and Sustainable Global Growth

Restoring Confidence

- Global economy entering a danger zone
- Decisive action needed to safeguard stability and prevent a crisis from deepening

Sustainable and Balanced Growth

- Path to recovery has narrowed but still within reach
- Medium-term consolidation, structural reform, and rebalancing are necessary complements to short-term action

Urgent and Collaborative Action Required

Restore Sound Public Finances

Sovereign Balance Sheet Repair	Principles	<ul style="list-style-type: none">• Credible medium-term plans and frameworks• No one-size-fits-all: size and speed of adjustment varies
	Achieving Credibility	<ul style="list-style-type: none">• Entitlement reforms necessary, not sufficient• Well-designed rules and institutions key• But no substitute for political will
	Concretely	<ul style="list-style-type: none">• For most, plans and frameworks help afford greater flexibility through more “back-loaded” timing• For most, let automatic stabilizers operate

Monetary Policy

Advanced Economies

- Keep policy rates low (or lower if room allows and risks warrant)
- Deal with undesirable side effects through macro-prudential policies
- Be ready to use unconventional measures (e.g., QE, SMP)

Emerging Market Economies

- Tighten if needed, but be ready to shift
- Complement with macro-prudential/capital flow measures where needed

Better Target Financial and Structural Policies

Advanced Economies

Private Sector Balance Sheet Repair

U.S. Households

- Mortgage debt

European Banks

- Adequate capital buffers; sources: private/national/EFSF
- Restructure/resolve where necessary

Advanced Economies

Better target structural reforms for growth

U.S. and Europe

- Tackle high unemployment
- Better align reform plans with OECD's priorities for growth
- Enhance supply potential

Better Target Financial and Structural Policies

Emerging Market Economies

Contain Vulnerabilities and Enhance Resilience

Beyond Fiscal and Monetary Policies

- Prudential (macro and micro)
- Structural financial reform

Low-Income Countries

Remain resilient and supportive of sustainable growth

Macro and structural policies

- Continue advancing structural reforms, medium-term public investment frameworks
- Rebuild policy buffers mostly exhausted in previous crisis

Tackling Global Imbalances

Global Growth and Stability

External Rebalancing

- In U.S., more external demand to sustain growth
- In EM Asia, shift towards internal demand, assisted by structural adjustments, large gaps in social safety net, financial restrictions, and undervalued exchange rates. These take time, movement is essential
- Beneficial from domestic and multilateral perspective

THANK YOU