



CENTRE for ECONOMIC
PERFORMANCE

Centre for Economic Performance 21st Birthday Lecture Series

The State of the World Economy

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The State of the World Economy

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Rebalancing and Recovery

- A (now) old theme: A strong recovery requires two rebalancing acts.
 - Internal: From public to private demand
 - External: From surplus to deficit countries
- Rebalancing happening slowly.
 - Private demand in Advanced Economies is weak
 - External rebalancing is slow
 - Limiting fiscal consolidation
- A weak recovery in Advanced Economies, stronger in Emerging Economies. Tensions: Capital flows, currency wars ?

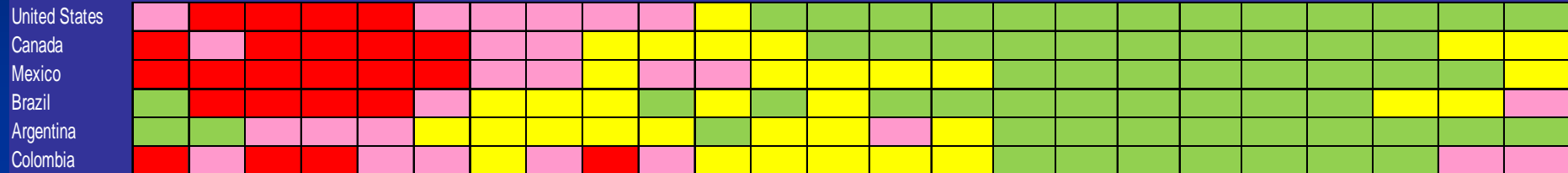
A World Heat Map

3

Assessing Growth Momentum

Sep-08 Oct-08 Nov-08 Dec-08 Jan-09 Feb-09 Mar-09 Apr-09 May-09 Jun-09 Jul-09 Aug-09 Sep-09 Oct-09 Nov-09 Dec-09 Jan-10 Feb-10 Mar-10 Apr-10 May-10 Jun-10 Jul-10 Aug-10

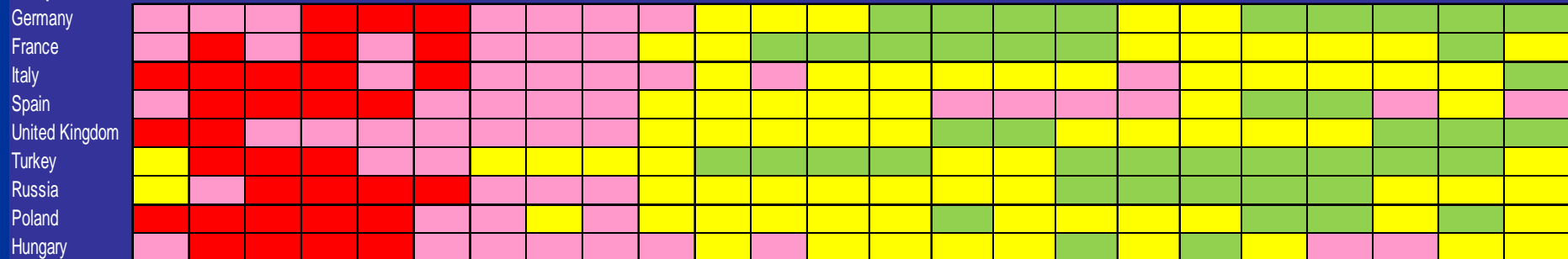
Western Hemisphere



Asia Pacific



Europe



Africa



Expansion and level at or above trend (mean)

Data not available



Expansion but level below trend (mean)

Moving sideways

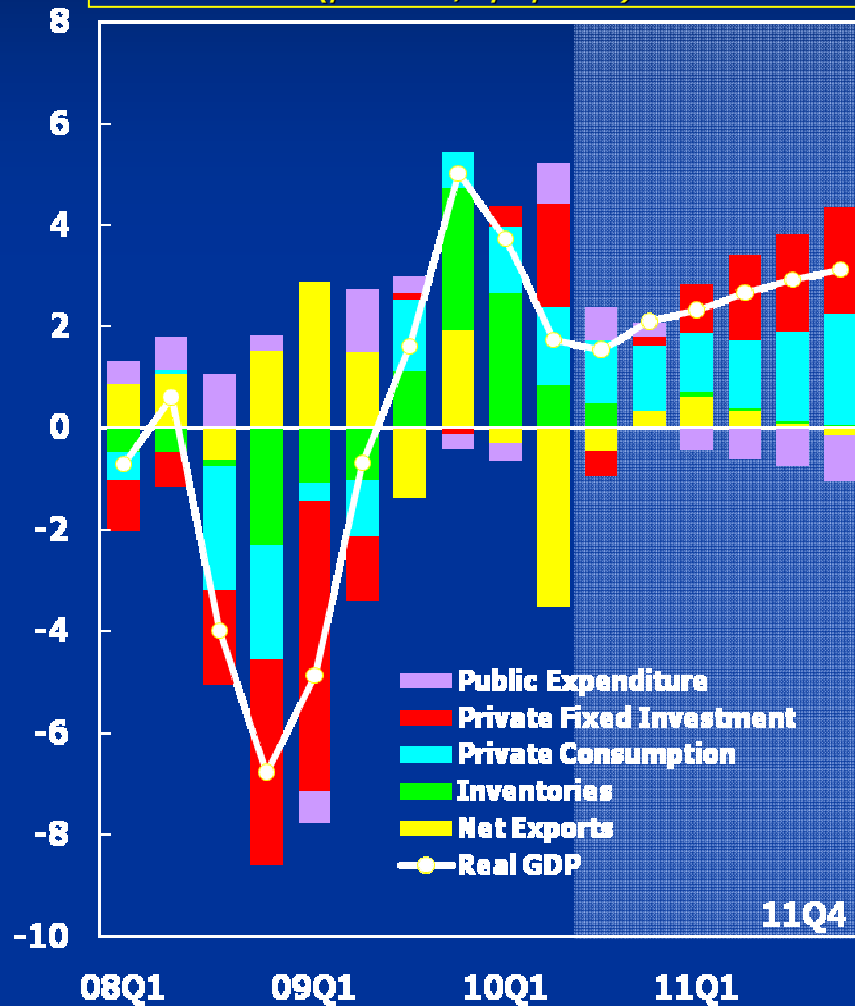


Contraction at a moderating rate

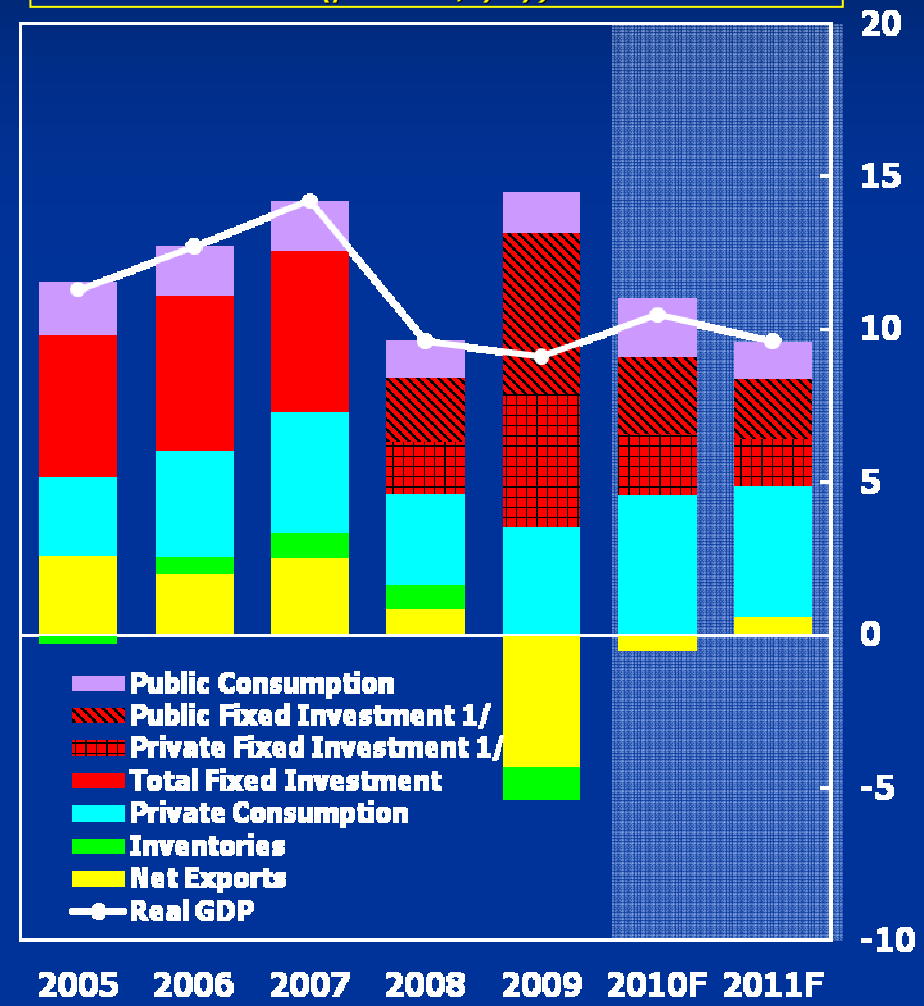
Contraction at a increasing rate

Limited Internal and External Rebalancing

**U.S. Real GDP
Growth Contributions**
(percent; qoq saar)



**China Real GDP
Growth Contributions**
(percent; yoy)



Sources: Haver Analytics; and IMF, World Economic Outlook.
1/ IMF staff estimates (not official data).

The Global Outlook

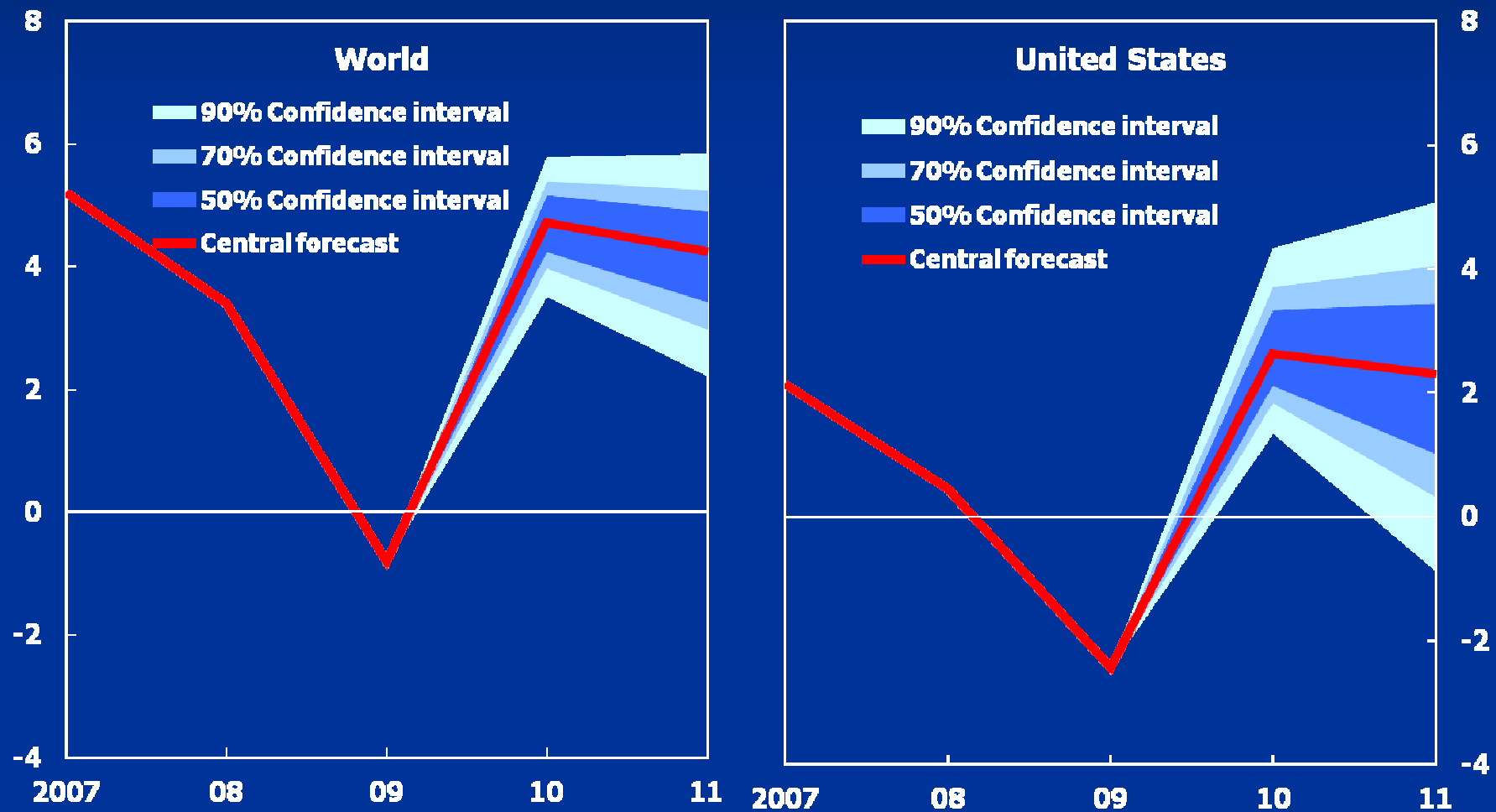
WEO Real GDP Growth Projections *(percent change from a year earlier)*

	U.S.	Euro Area	Japan	Brazil	Russia	China
2010 (Oct. 2010)	2.6	1.7	2.8	7.5	4.0	10.5
2010 (Jul. 2010)	3.3	1.0	2.4	7.1	4.3	10.5
2010 (Jan. 2010)	2.7	1.0	1.7	4.7	3.6	10.0
2011 (Oct. 2010)	2.3	1.5	1.5	4.1	4.3	9.6
2011 (Jul. 2010)	2.9	1.3	1.8	4.2	4.1	9.6
2011 (Jan. 2010)	2.4	1.6	2.2	3.7	3.4	9.7

Source: IMF, World Economic Outlook.

Prospects for a Double Dip?

Prospects for GDP Growth (annual percent change)



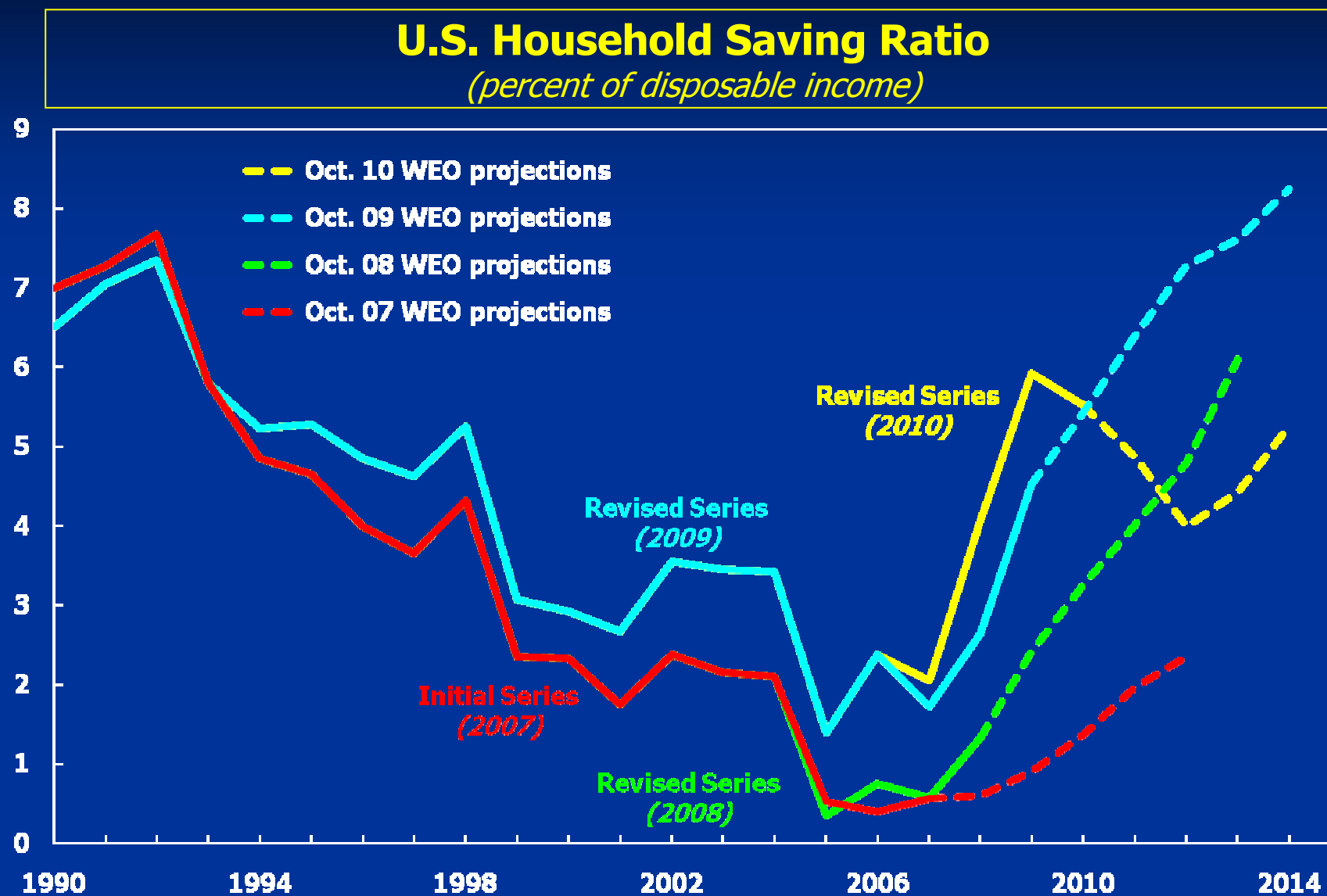
Sources: IMF, World Economic Outlook and staff estimates.

United States: Uncertainty

- Saving behavior of U.S. consumers.
- Poor prospects of residential investment.
- Non residential investment. Profits or sales?

Uncertainty about U.S. Saving

8

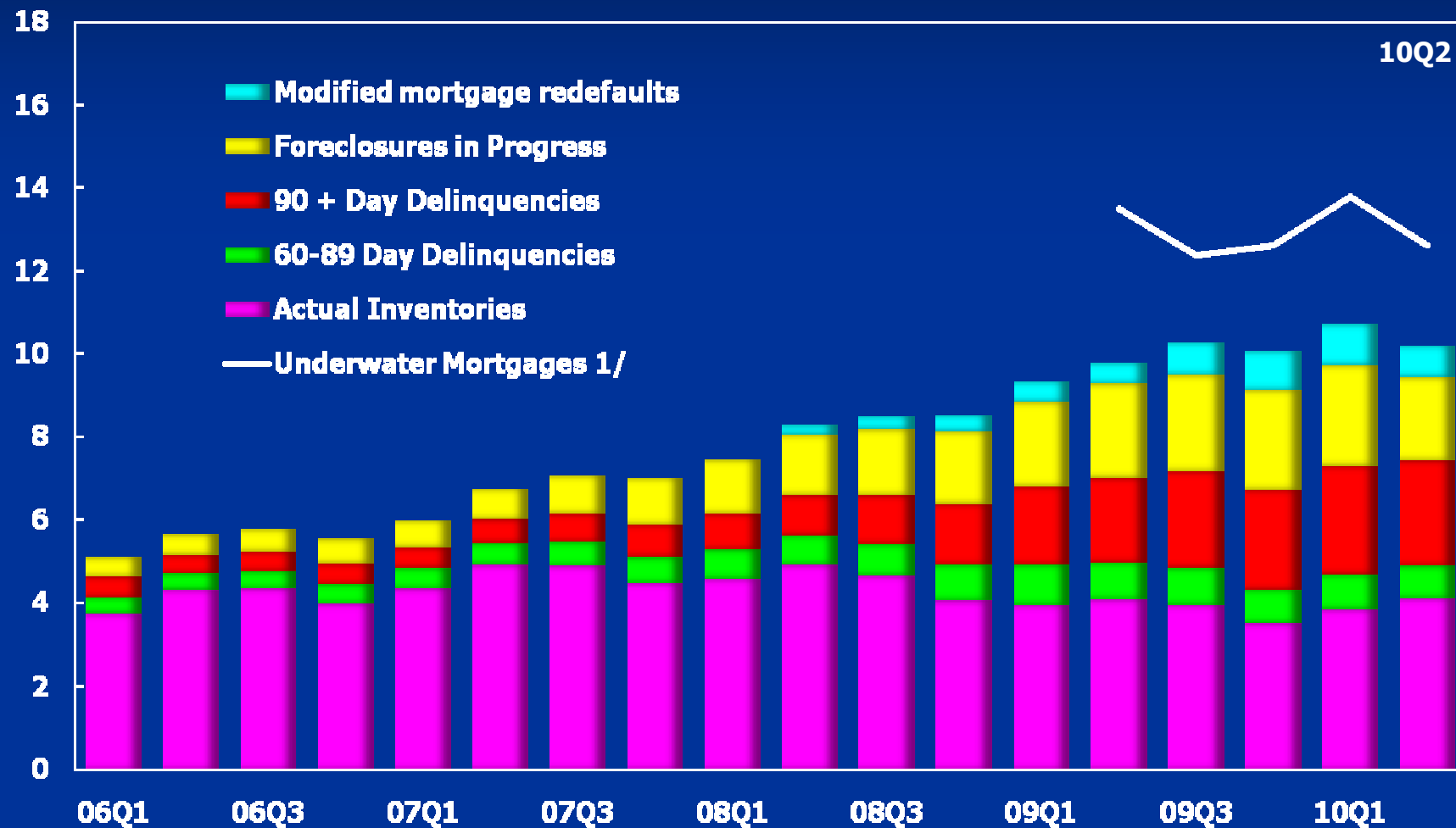


Sources: U.S. Bureau of Economic Analysis and IMF, World Economic Outlook.

Prospects for U.S. Housing Investment

U.S. Housing Inventories and Foreclosures

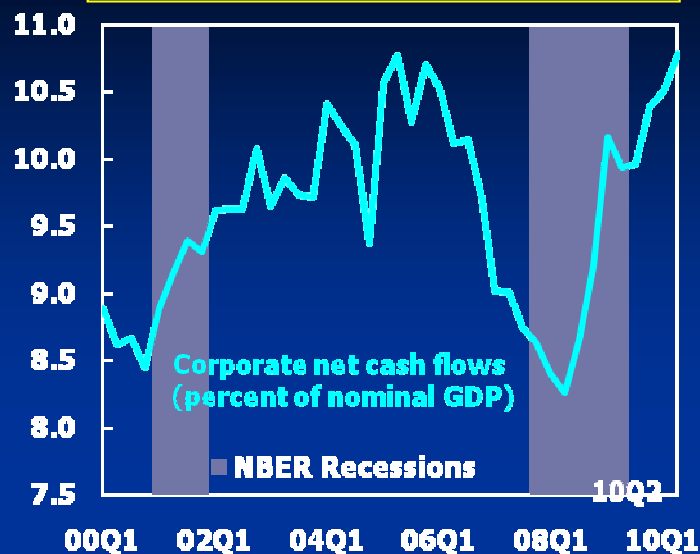
(millions of units)



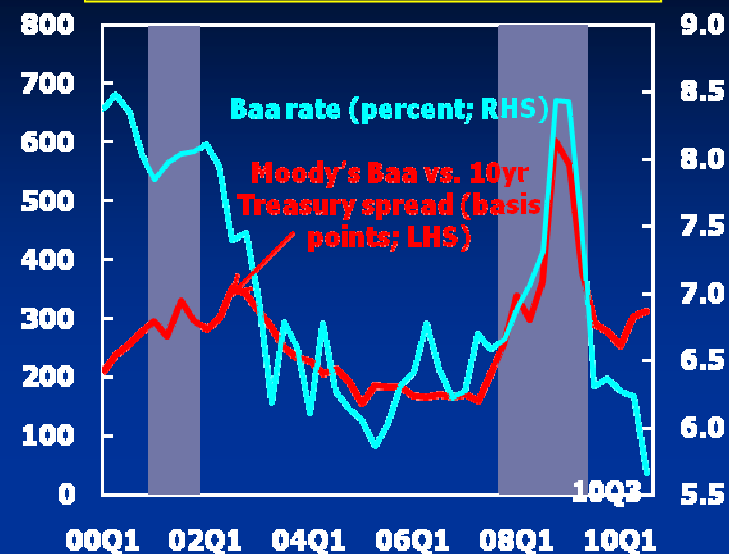
Sources: MCM staff estimates, Haver Analytics.

1/ Data from Zillow.com.

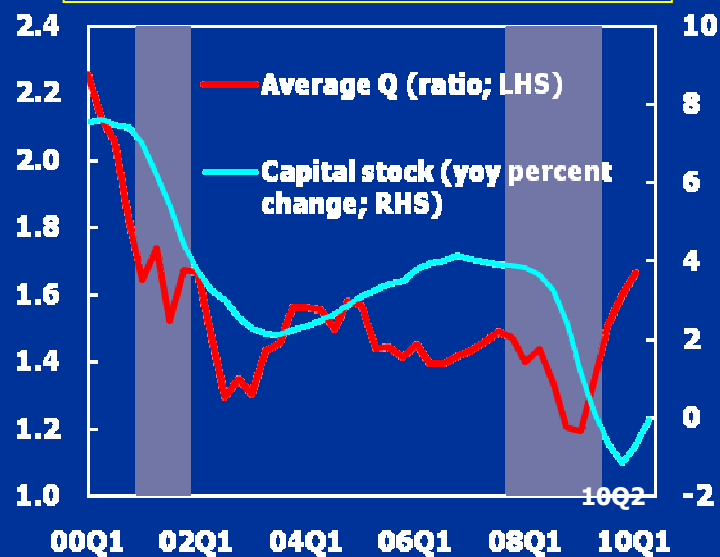
Corporate Net Cash Flows



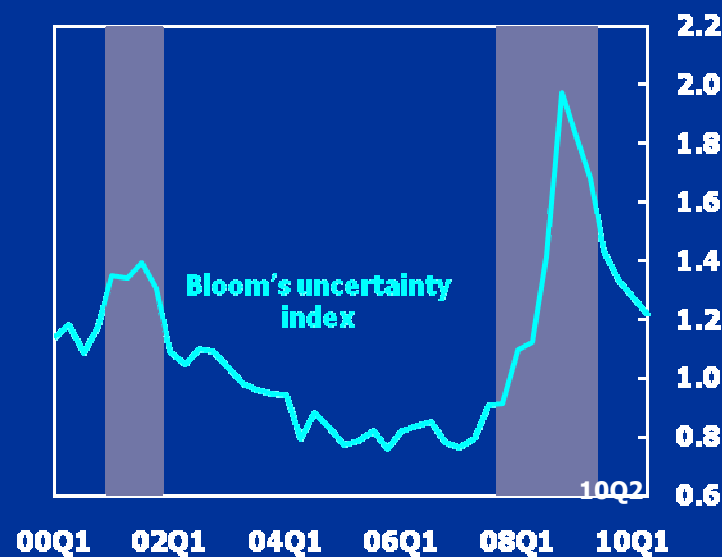
Corporate Spreads and Rates



Average Q and Capital Stock



Uncertainty Index

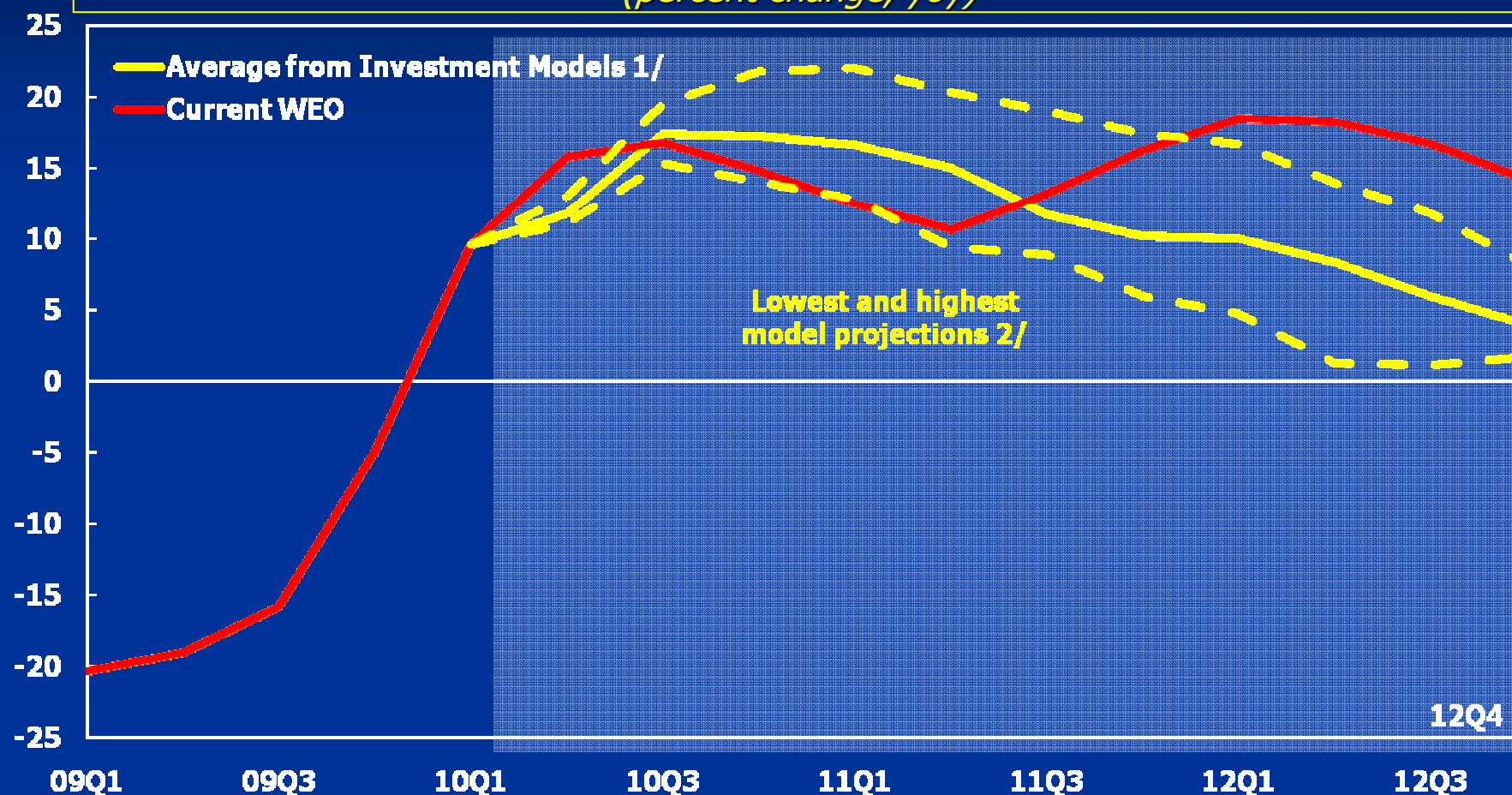


Sources: Haver Analytics and Bloomberg L.P.; IMF Staff Position Note, "Forecasting U.S. Investment" by Lee and Rabanal (2010); U.S. National Bureau of Economic Research.

Uncertainty about U.S. Investment

11

Equipment and Software Investment (percent change, yoy)



Sources: IMF, World Economic Outlook; IMF Staff Position Note, "Forecasting U.S. Investment" by Lee and Rabanal (2010).

1/ Accelerator Large VAR, Accelerator WEO, VECM1, and Tobin's Q models.

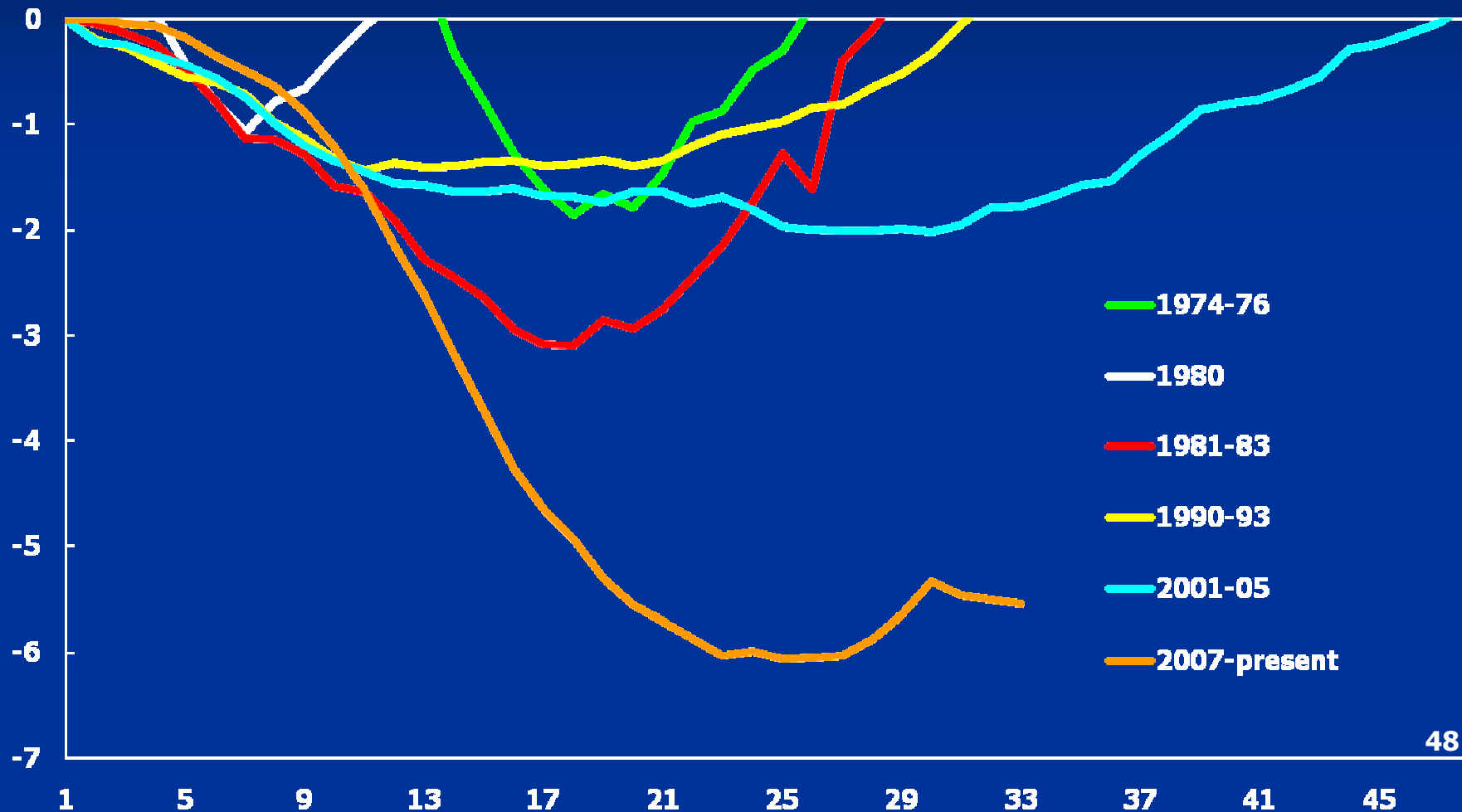
2/ Minimum and maximum values across the four forecasting models.

U.S. Recovery? Output versus Employment

12

U.S. Nonfarm Employment during Recessions

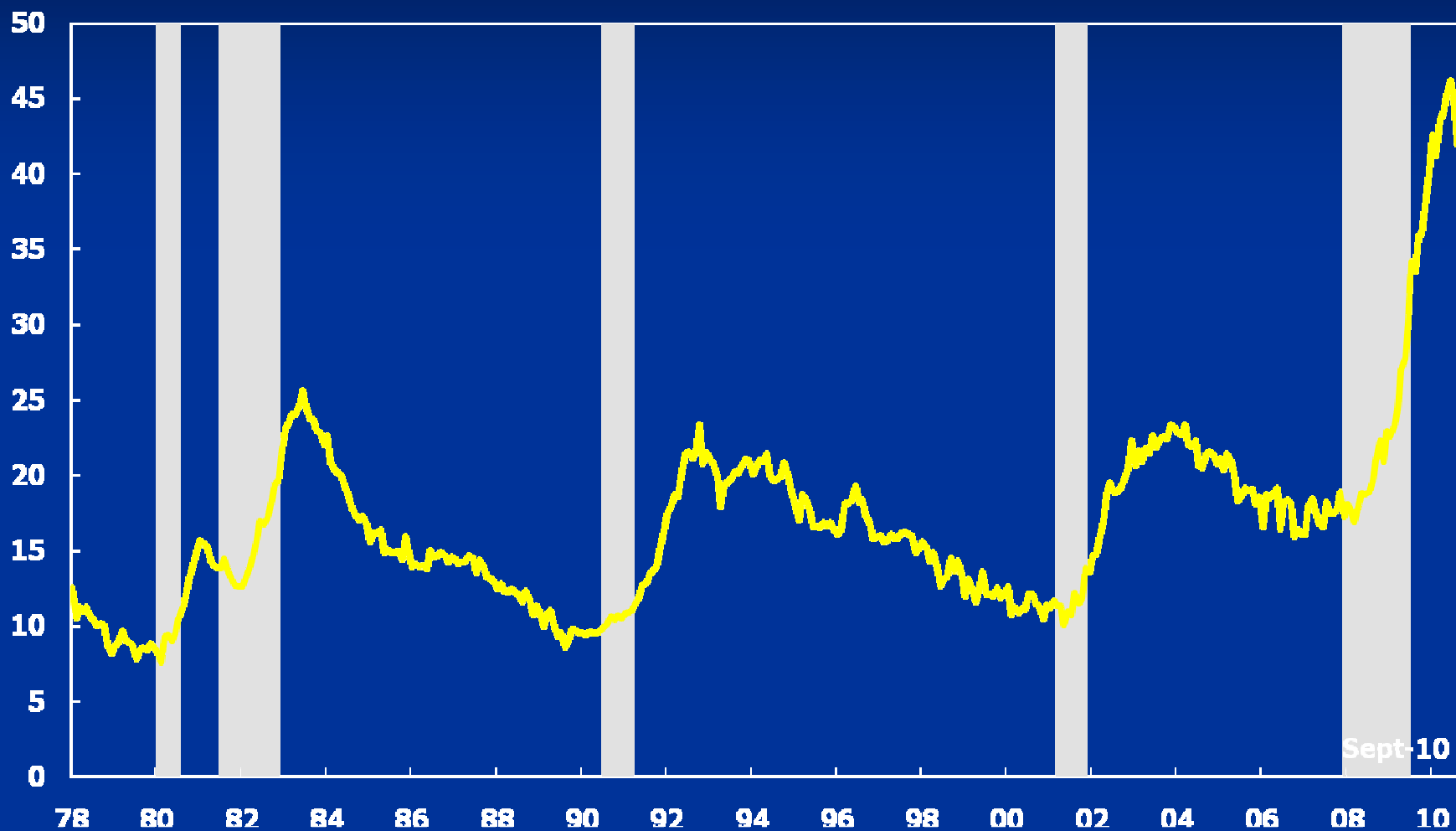
(percent change from start of each recession; months from peak on x-axis)



Sources: U.S. Bureau of Labor Statistics, and National Bureau of Economic Research.

48

U.S. Long-Term Unemployment (percent of total)



Sources: IMF Working Paper, "The Human Cost of Recessions: Assessing It, Reducing it" by Dao and Loungani (2010); Haver Analytics, and U.S. National Bureau of Economic Research.

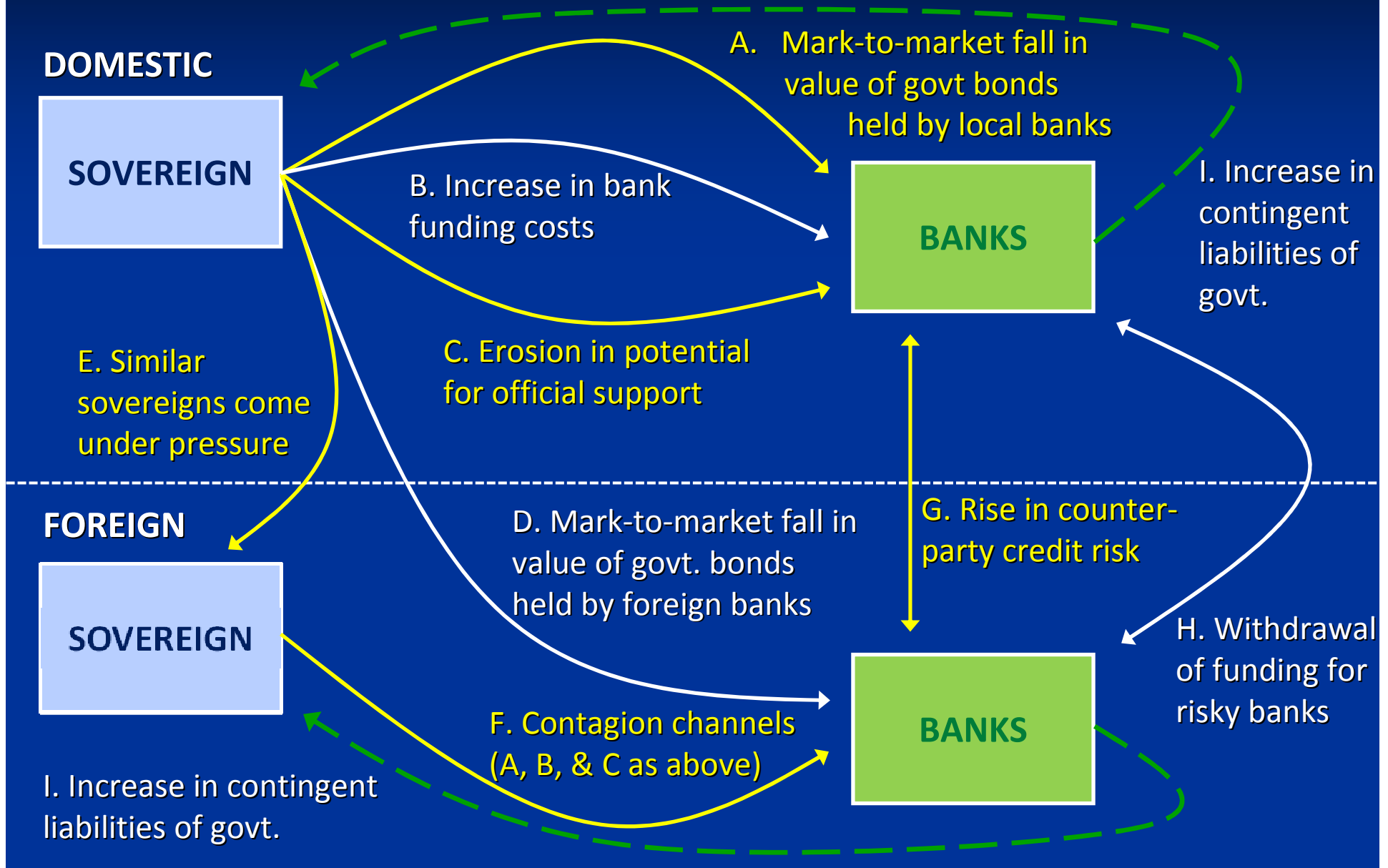
Europe: Mixed News

14

- Financial. Interacting Sovereign and Financial risks.
- The mechanisms in place. Collateral at ECB. EFSF and Standbys for new issues if needed.
- Real: Better than forecast, in particular in Germany.
A new German expansion?

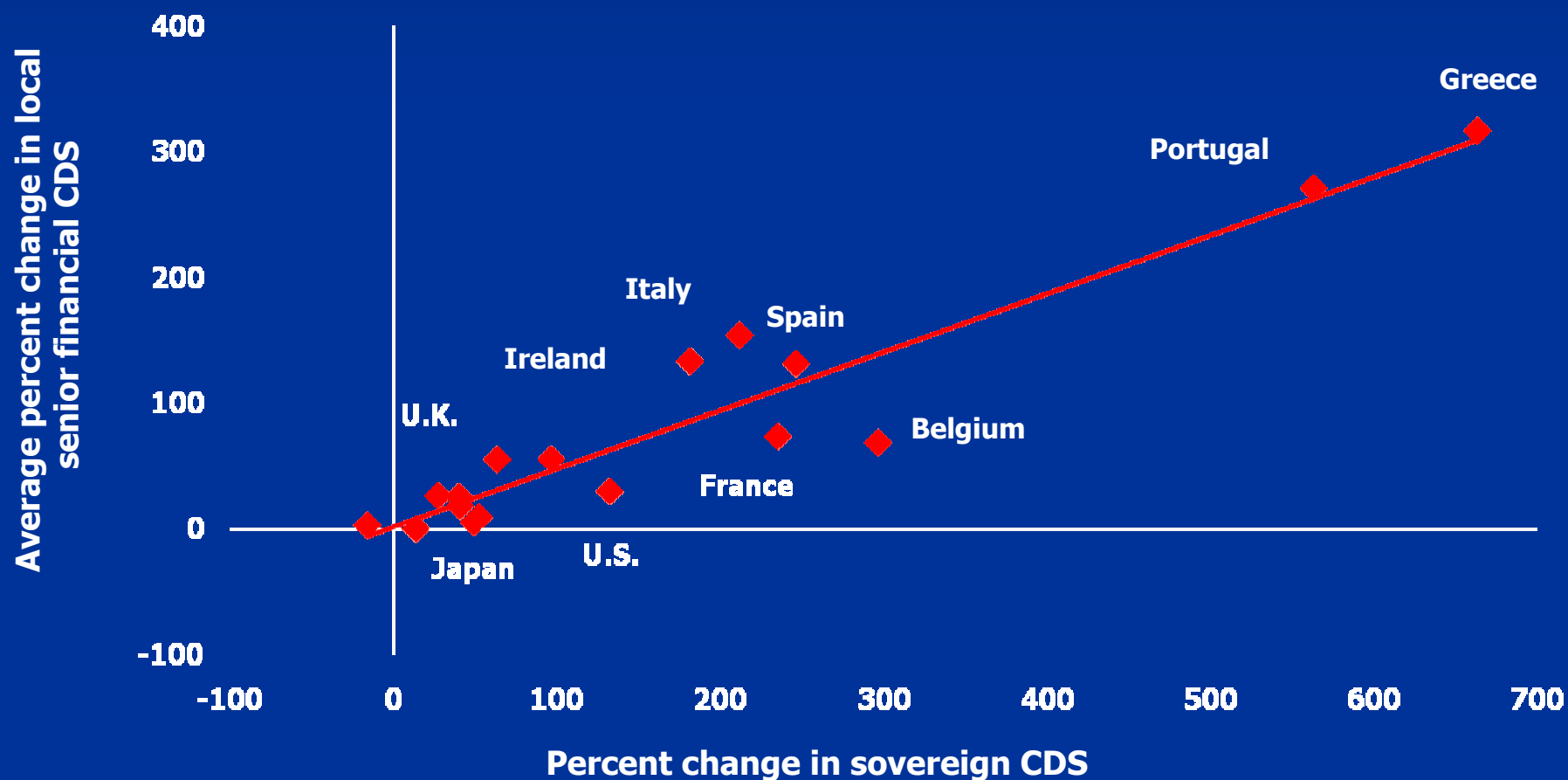
Europe: Sovereign and Financial Risks

15

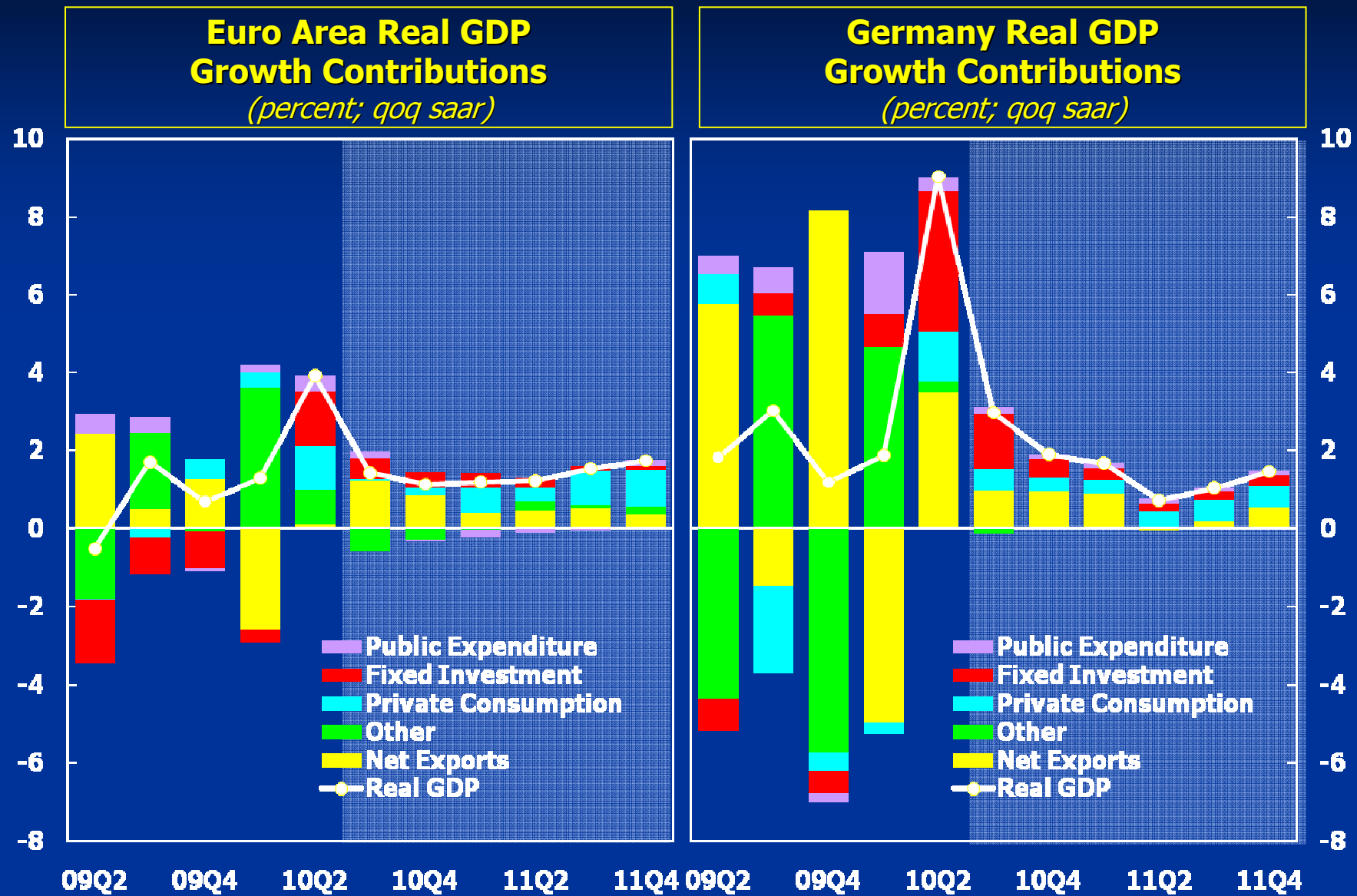


Sovereign and Financial Spreads

Change in Sovereign and Financial CDS Spreads
End-September 2009 to September 2010
(percent)



Is Germany Getting Ahead?



Source: IMF, World Economic Outlook.

Fiscal Consolidation: At What Pace?

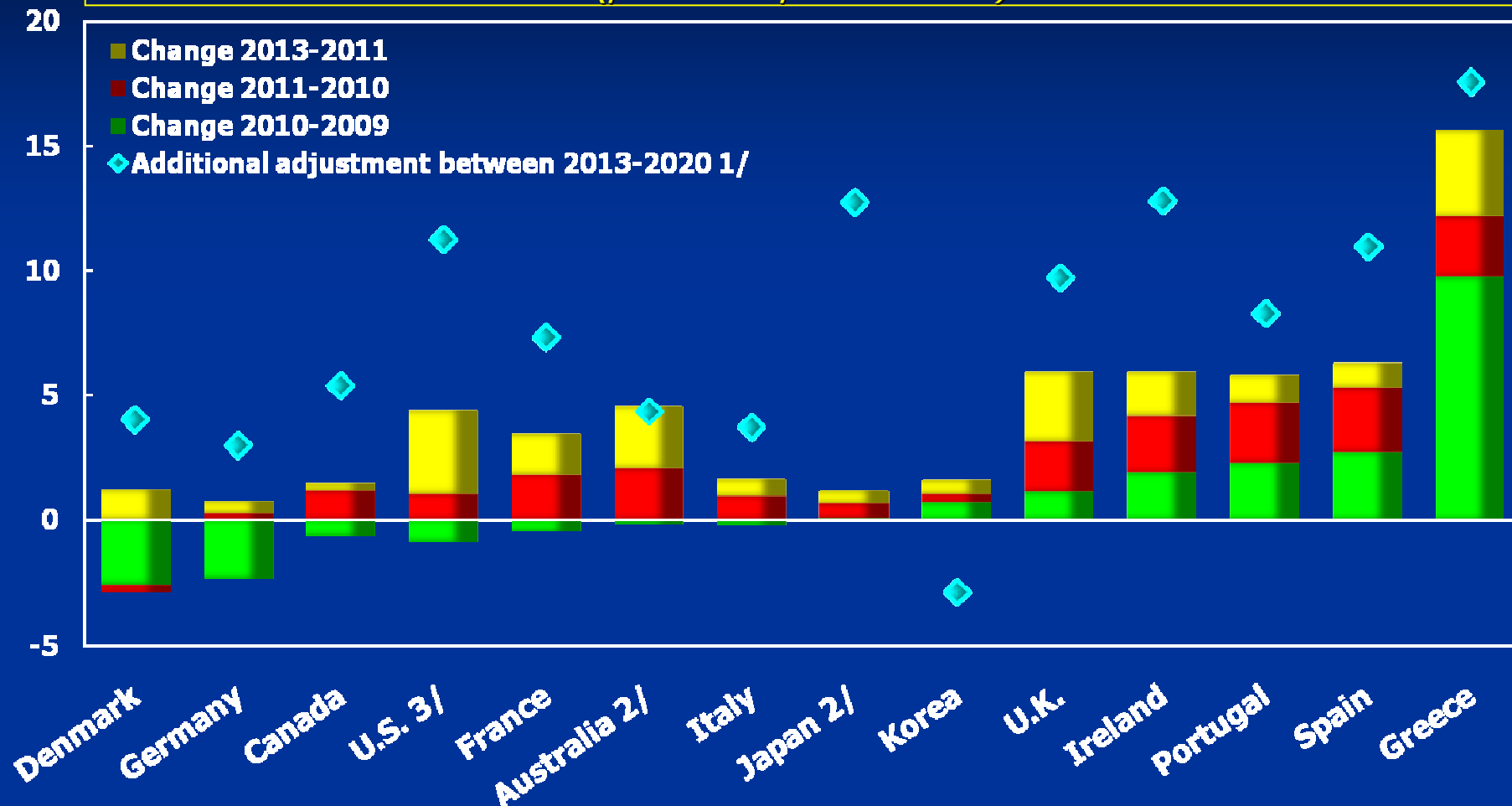
Fund line:

- Medium-term credible plan for debt stabilization.
Use rules, increased age of retirement, replacement rules...
- Then, have more room for profile of adjustment.
Variation across countries.
- Current plans broadly appropriate given forecasts.
Adjustment if things turn out worse.
- Actual state of play. Not enough on MT anchoring.

The Pace of Fiscal Consolidation

19

Projected Change in Cyclically Adjusted Primary Balances (percent of potential GDP)



Source: IMF staff estimates based on 2010 October WEO.

1/ In percent of GDP; distance from yellow bar reflects required additional fiscal adjustment relative to 2010-13; adjustment to be sustained between 2020-30 to reduce public debt to prudent levels.

2/ Structural primary balance.

3/ Excluding financial sector support recorded above the line.

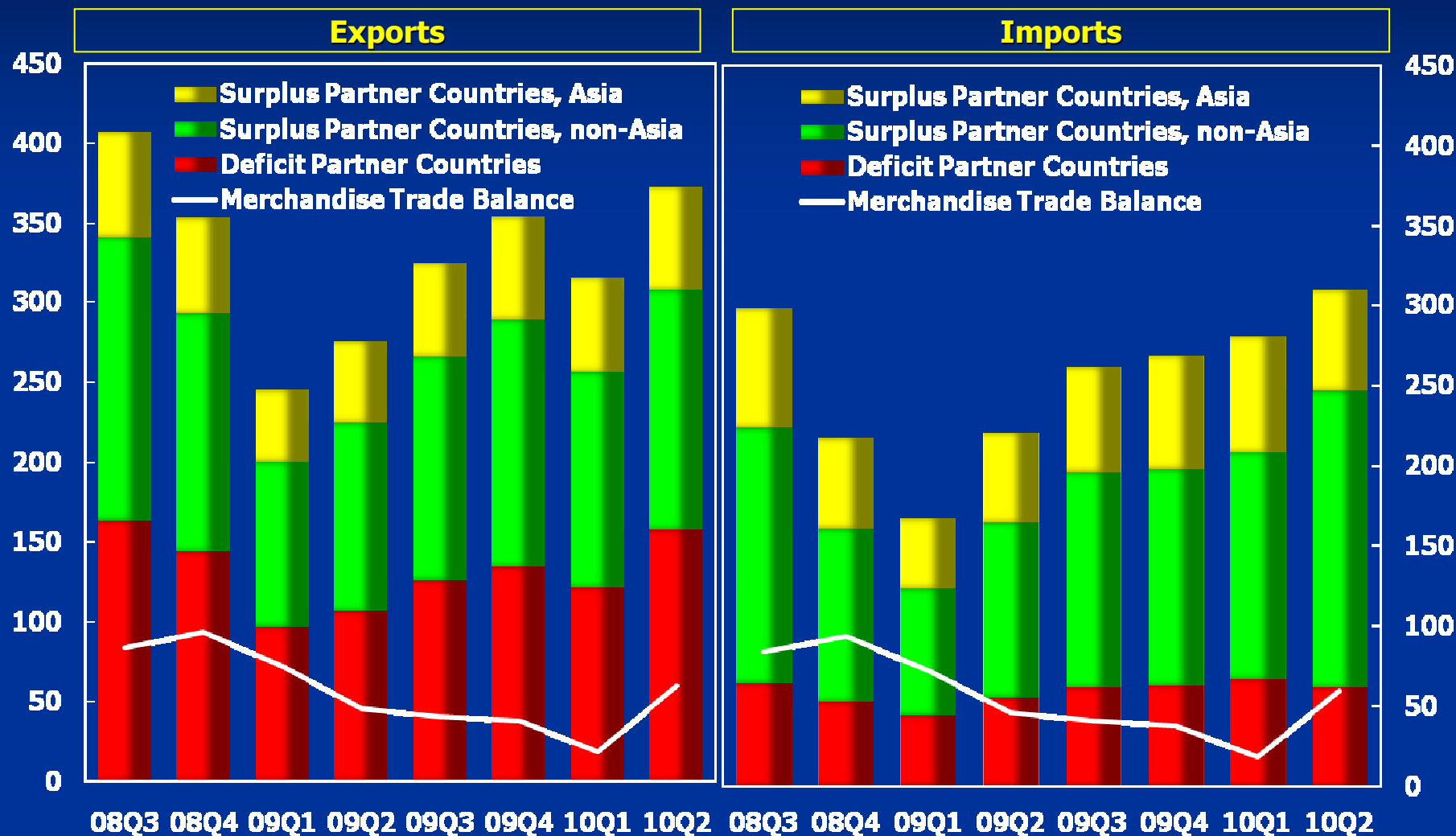
Emerging Market Economies

- Need to rebalance towards domestic demand.
Short term: To compensate for lower exports.
Medium term: To increase consumption and investment.
- Face large capital flows (with volatility). Largely fundamentals. Partly interest rate/carry trade.
- Not yet at 2007 levels. More portfolio rather than bank flows. Likely to increase over time.
- State of play. Large reserve accumulation. Limited appreciation. Increasing use of capital controls/macro prudential tools.

The Decrease in China's Trade Surplus

21

China Trade Balance with Deficit and Surplus Partner Countries 1/ (billions of U.S. dollars)

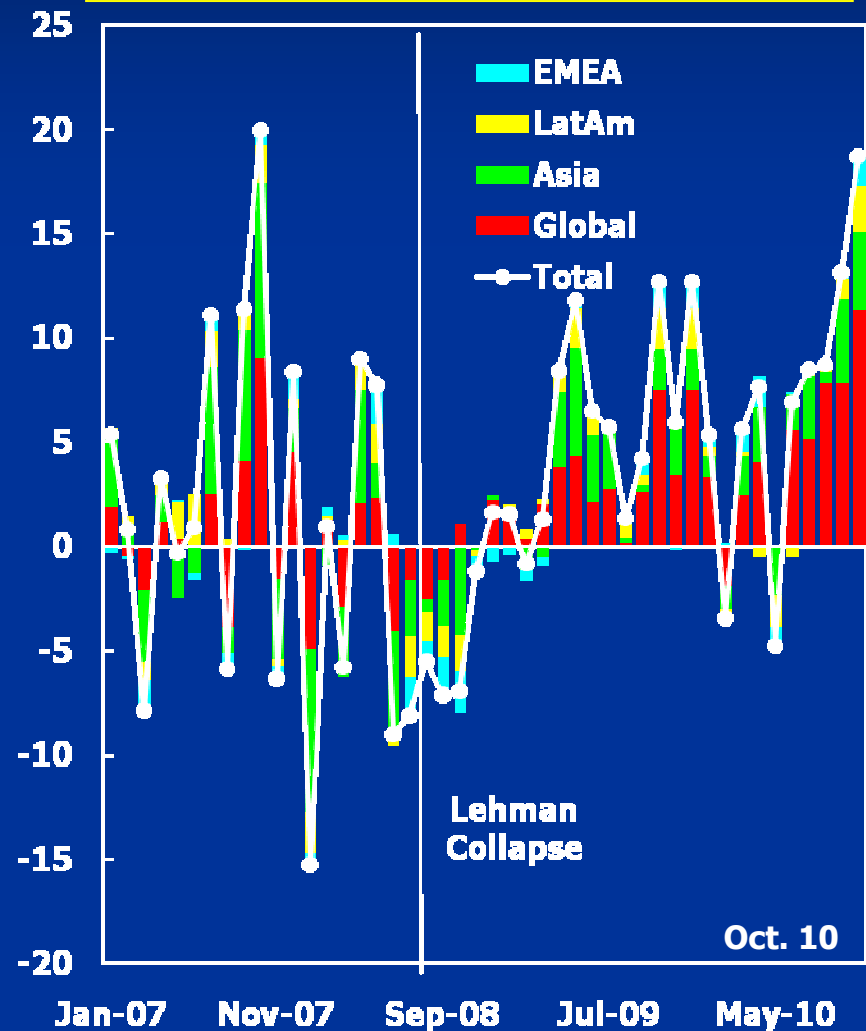


Source: IMF, Direction of Trade Statistics (DOTS).

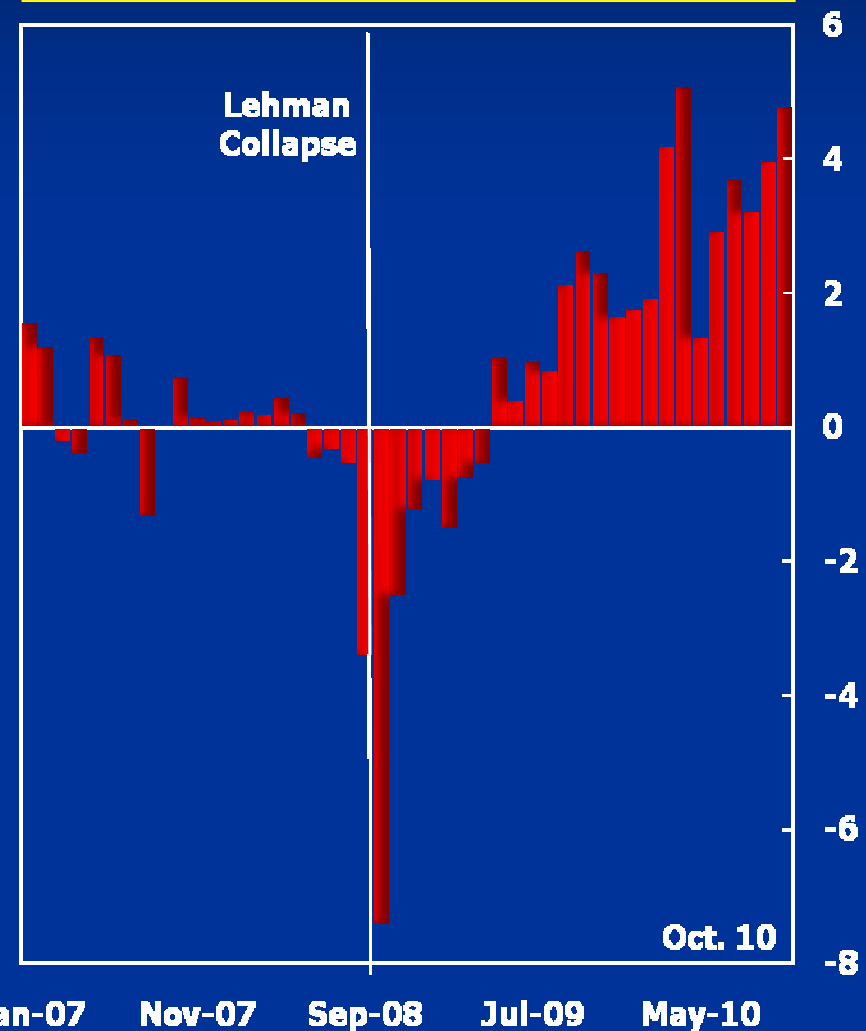
1/ Designation of surplus or deficit partner countries based on average current account balance between 2001 and 2008 applied to DOTS partner groups.

Increasing Capital Flows

Net Monthly Flows to Emerging Market Equity Funds
(billions of U.S. dollars)



Net Monthly Flows to Emerging Market Bond Funds
(billions of U.S. dollars)



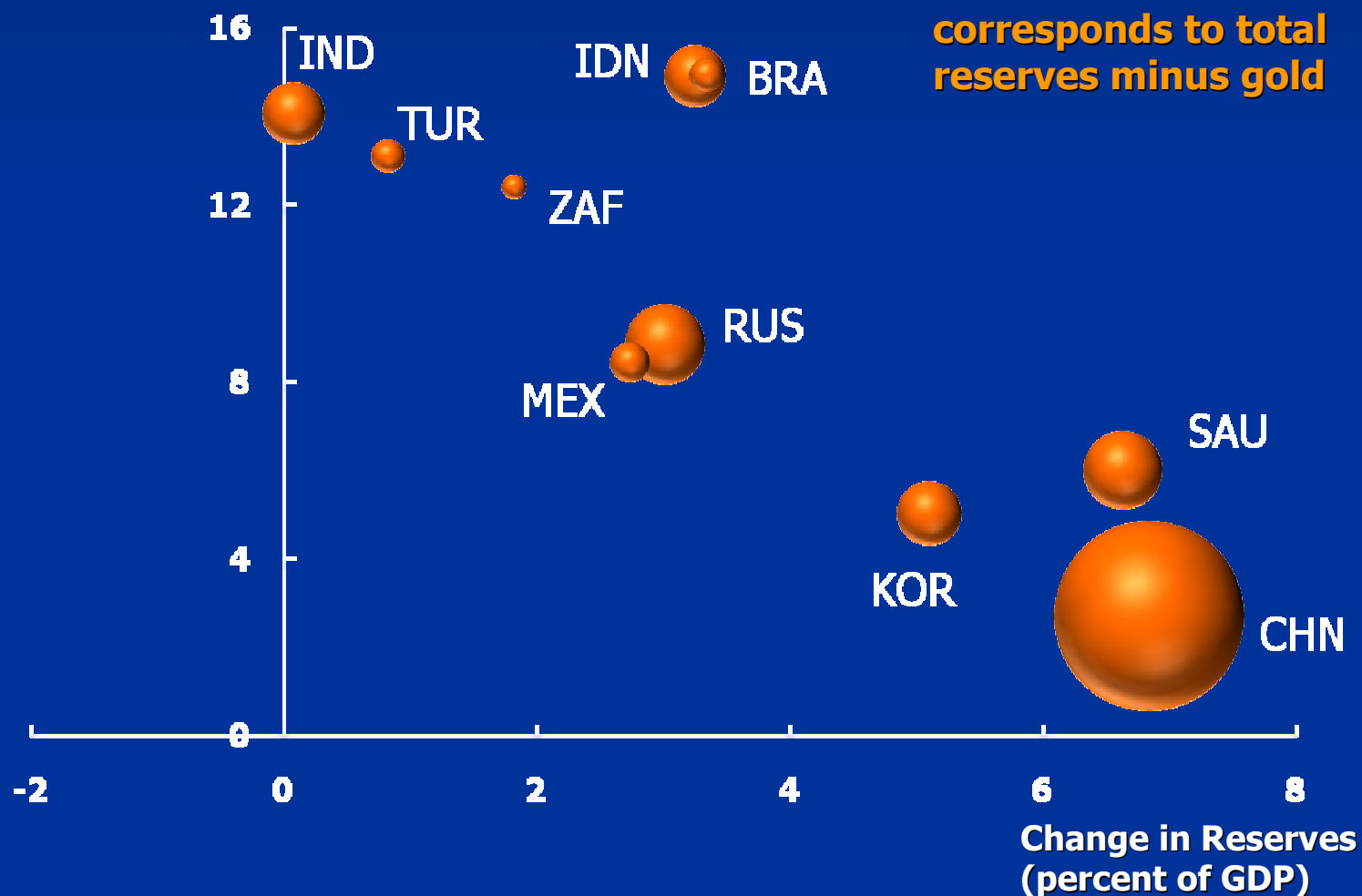
Appreciation versus Reserve accumulation

23

Foreign Reserves and Real Effective Exchange Rate

(change from end-June 2009 until end-June 2010)

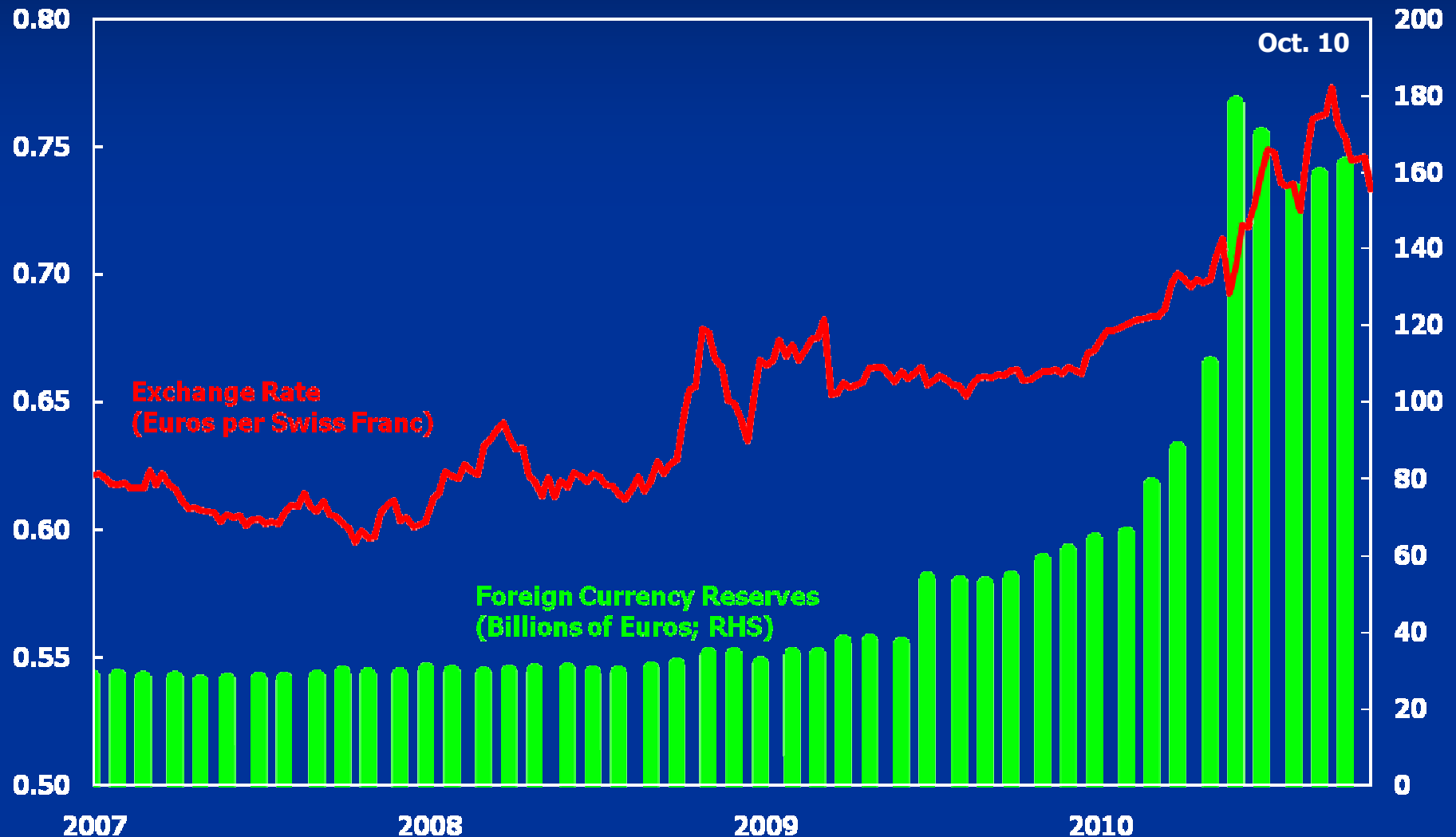
Change in Real Effective
Exchange Rate (percent)



Not Only EMs. Risk Aversion, Appreciation, and Reserve Accumulation in Switzerland.

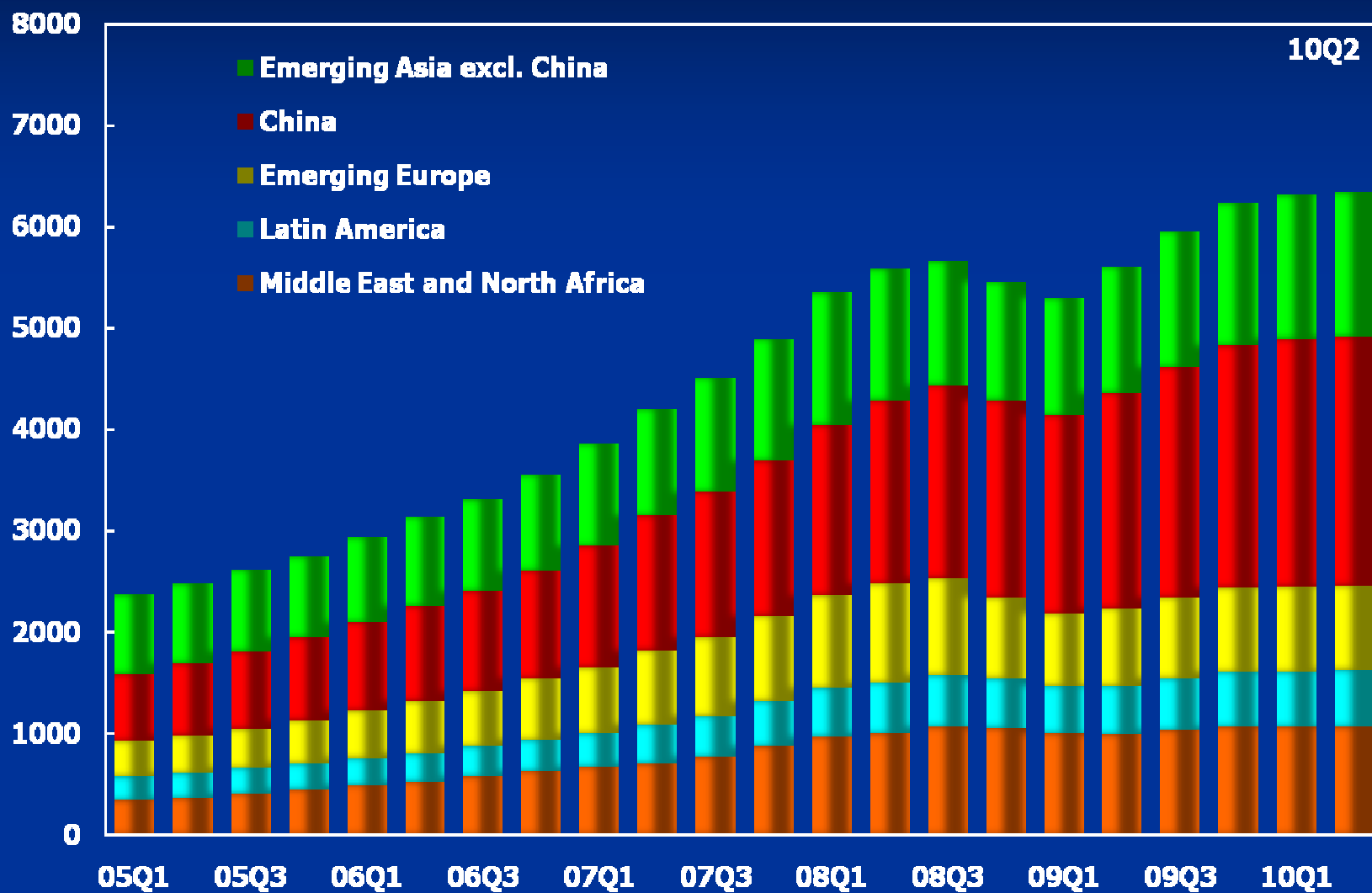
24

Switzerland: Exchange Rate and Foreign Reserves



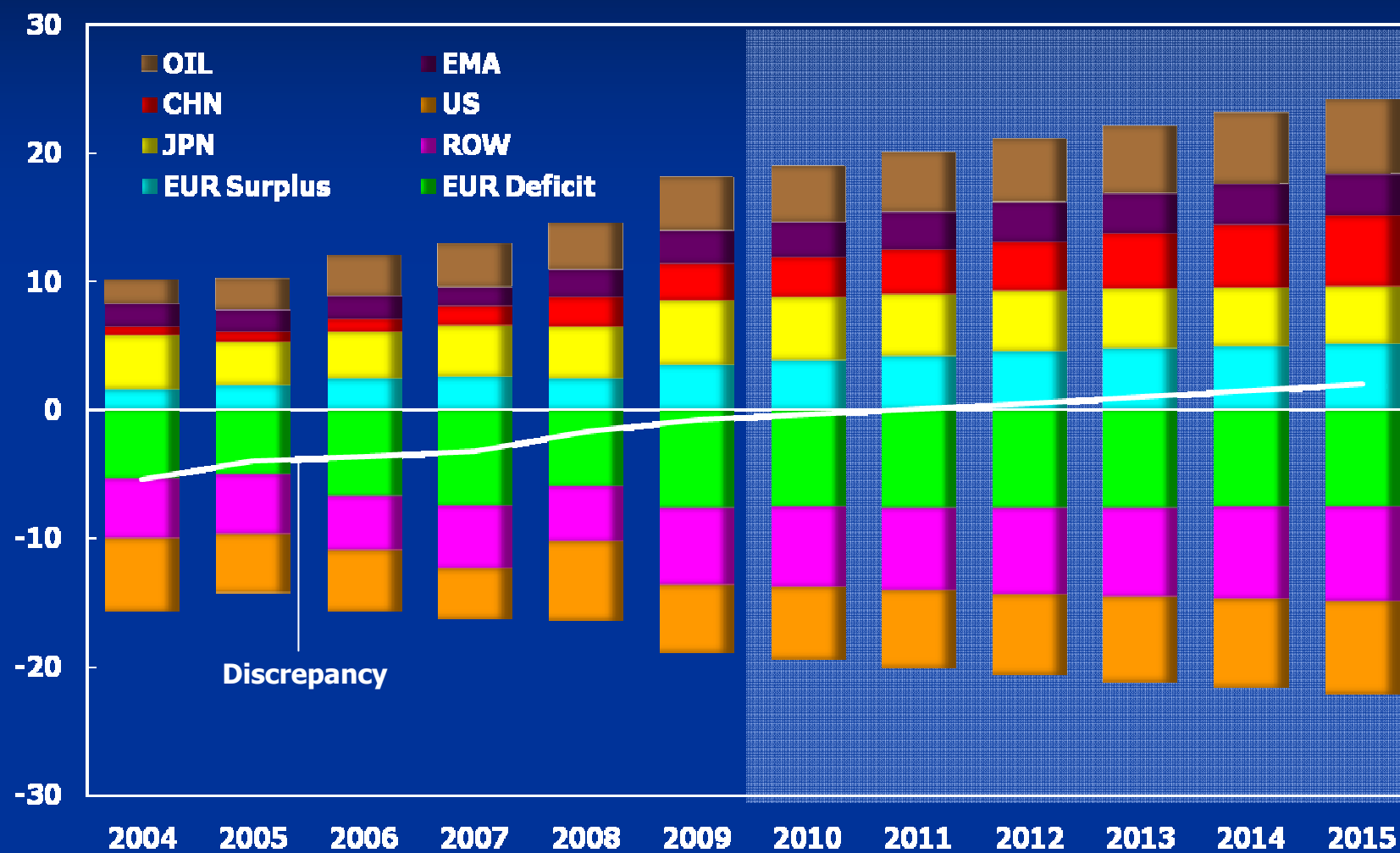
International Reserves

(billions of U.S. dollars)



Source: IMF, International Financial Statistics.

Net Foreign Assets (percent of world GDP)



Source: IMF staff estimates.

Currency Wars?

27

- External rebalancing is needed. Simulation.
- Capital flows and appreciation are part of the adjustment process.
- Capital flows/appreciation can be excessive. Irrational investors, disruptions from fast adjustments in e , inability of domestic financial system to absorb large flows.
- Slow adjustment of e , carry trade and capital flows.
- What if one country pegs?
- Policy implications
 - Use of macro prudential tools/capital controls
 - Limits on quantitative easing.

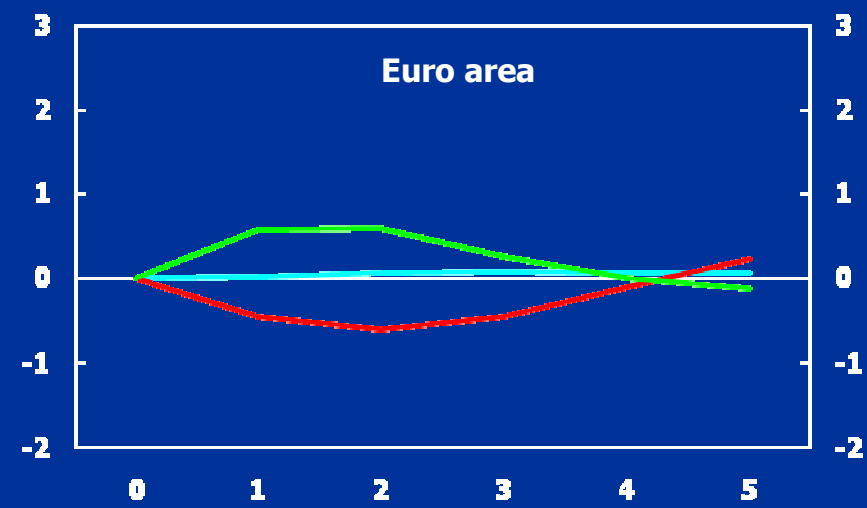
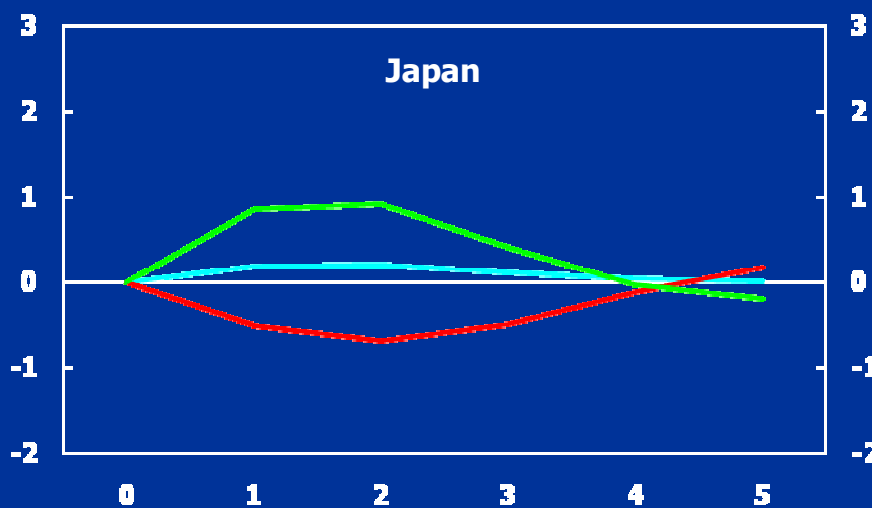
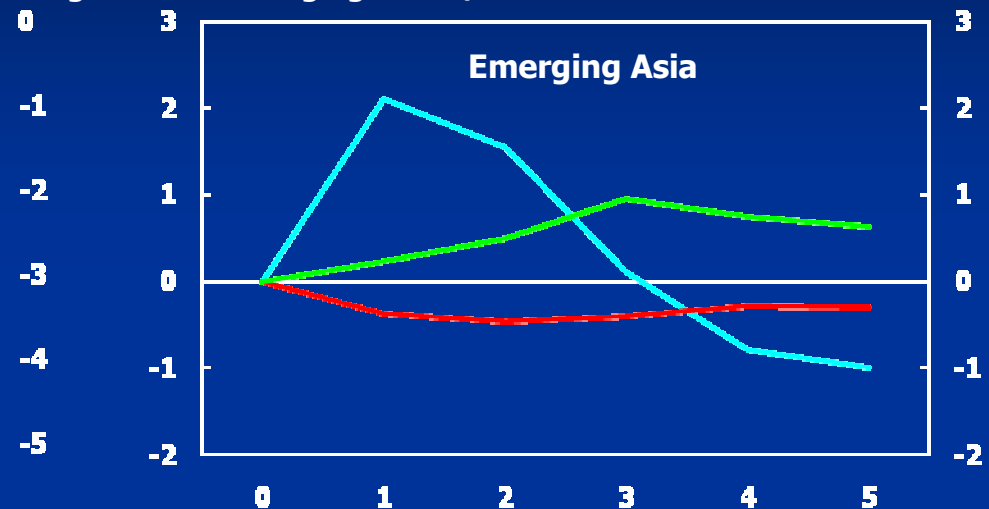
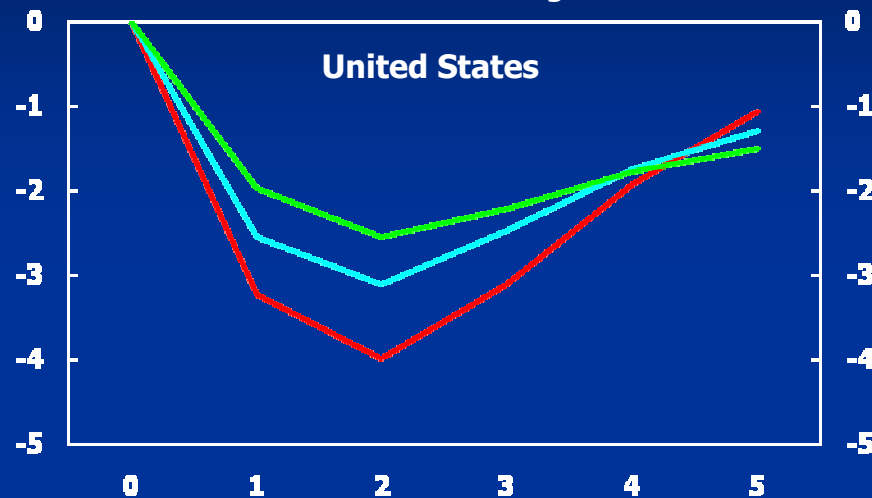
How Much Can External Rebalancing Help?

28

Real GDP

(percent deviation from baseline)

- Increase in US Saving Rate 1/
- Increase in US Saving Rate and Decrease in Emerging Asia Saving Rate 1/
- Increase in US Saving Rate and Real Exchange Rate in Emerging Asia 2/



1/ Limited exchange rate flexibility (crawling peg) in Emerging Asia.

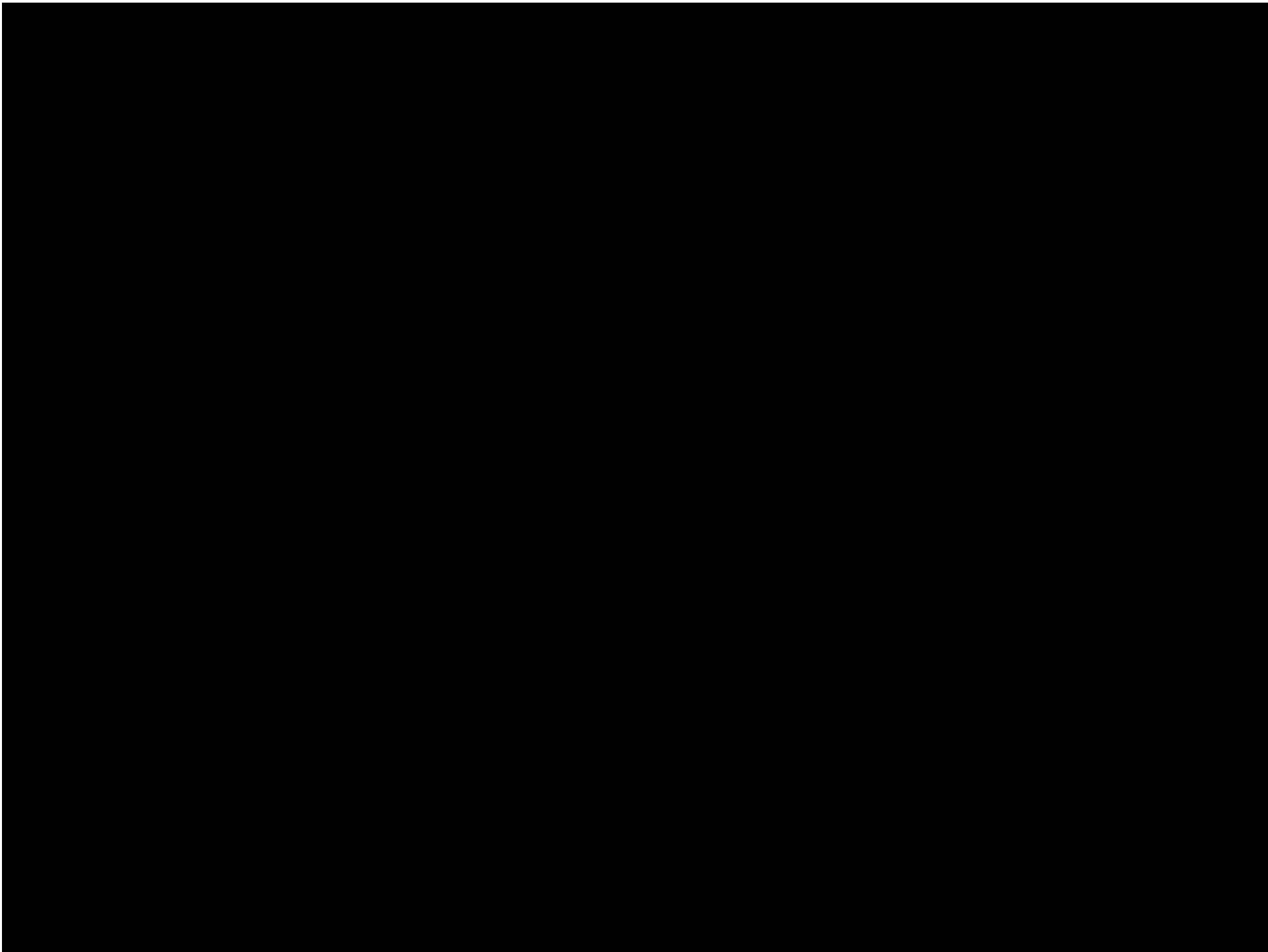
2/ Floating exchange rate in Emerging Asia, following large initial appreciation.

Policy Challenges

29

Key directions:

- Financial repairs and reforms (to sustain private domestic demand in Advanced Economies, and reduce downside risks).
- Fiscal consolidation in Advanced Economies (to reduce fiscal stimulus as private demand increases).
- Rebalancing towards domestic demand in Emerging Economies. Managing the “currency wars.”





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