



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

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International Monetary Fund*











**Presentation at the London School of Economics**

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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
<b>2011 (SEP 2011)</b>	<b>4.0</b>	<b>1.5</b>	<b>1.6</b>	<b>-0.5</b>	<b>3.8</b>	<b>4.3</b>	<b>7.8</b>	<b>9.5</b>
2011 (APR 2011)	4.4	2.8	1.6	1.4	4.5	4.8	8.2	9.6
<b>2012 (SEP 2011)</b>	<b>4.0</b>	<b>1.8</b>	<b>1.1</b>	<b>2.3</b>	<b>3.6</b>	<b>4.1</b>	<b>7.5</b>	<b>9.0</b>
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:**

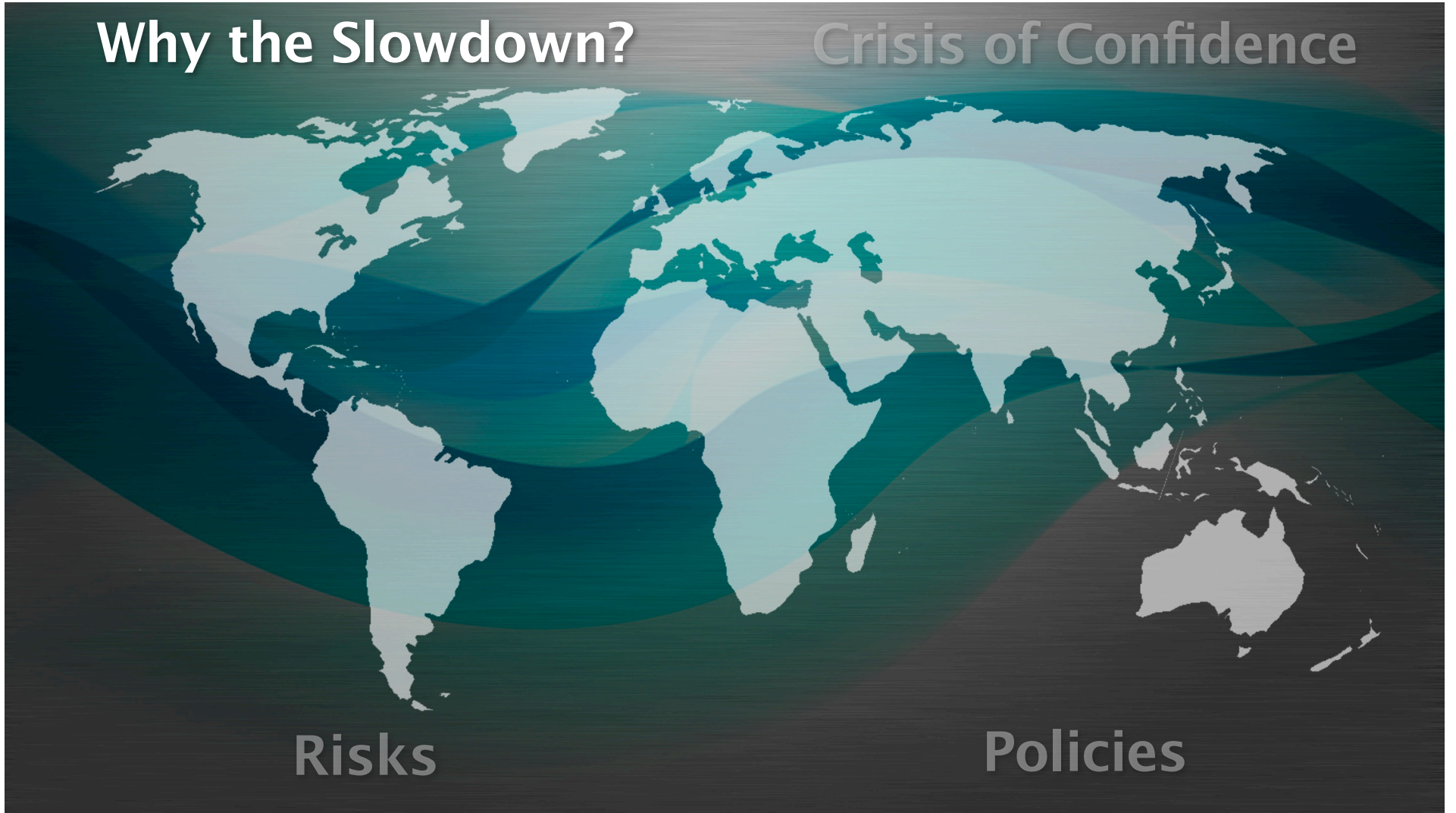
**This is where the risks are.**

**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.

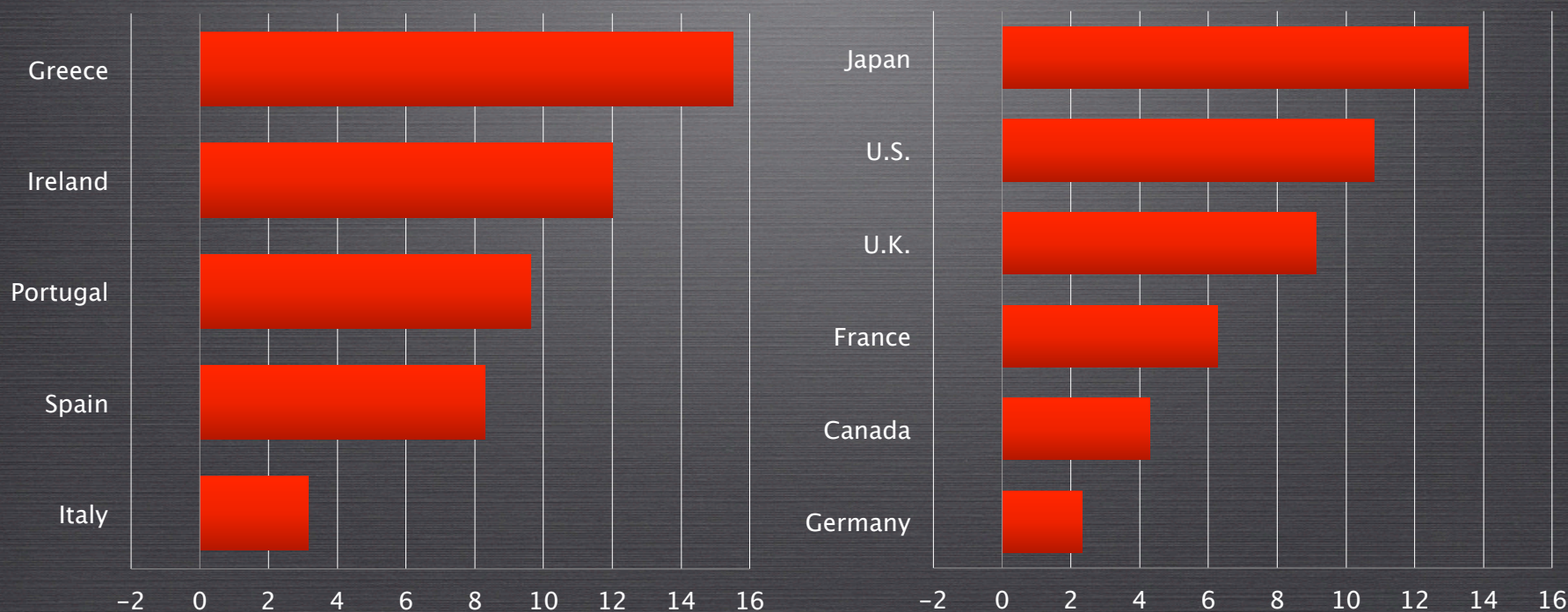
**External rebalancing has stalled.**



# Fiscal Consolidation: Proceeding, But a Long Way to Go

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

■ Total required adjustment by 2020 1/

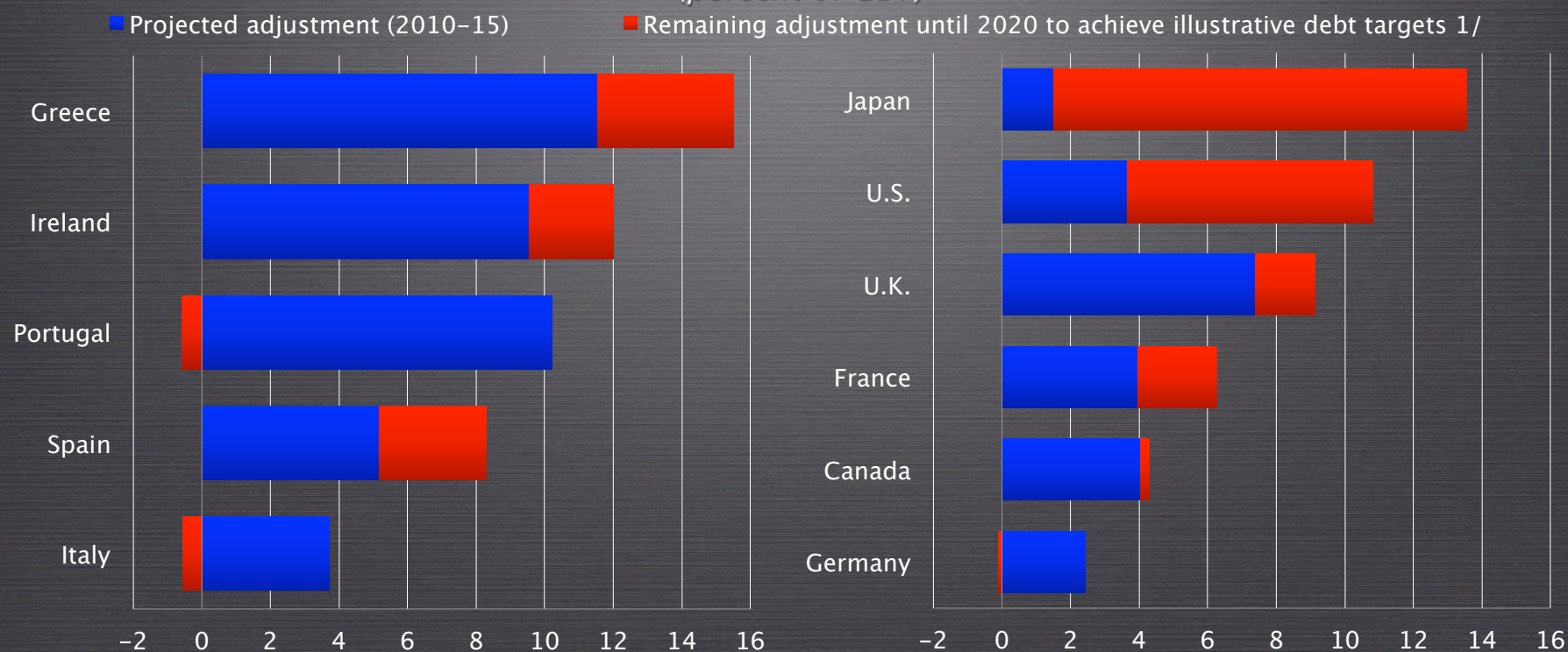


Source: IMF staff estimates.

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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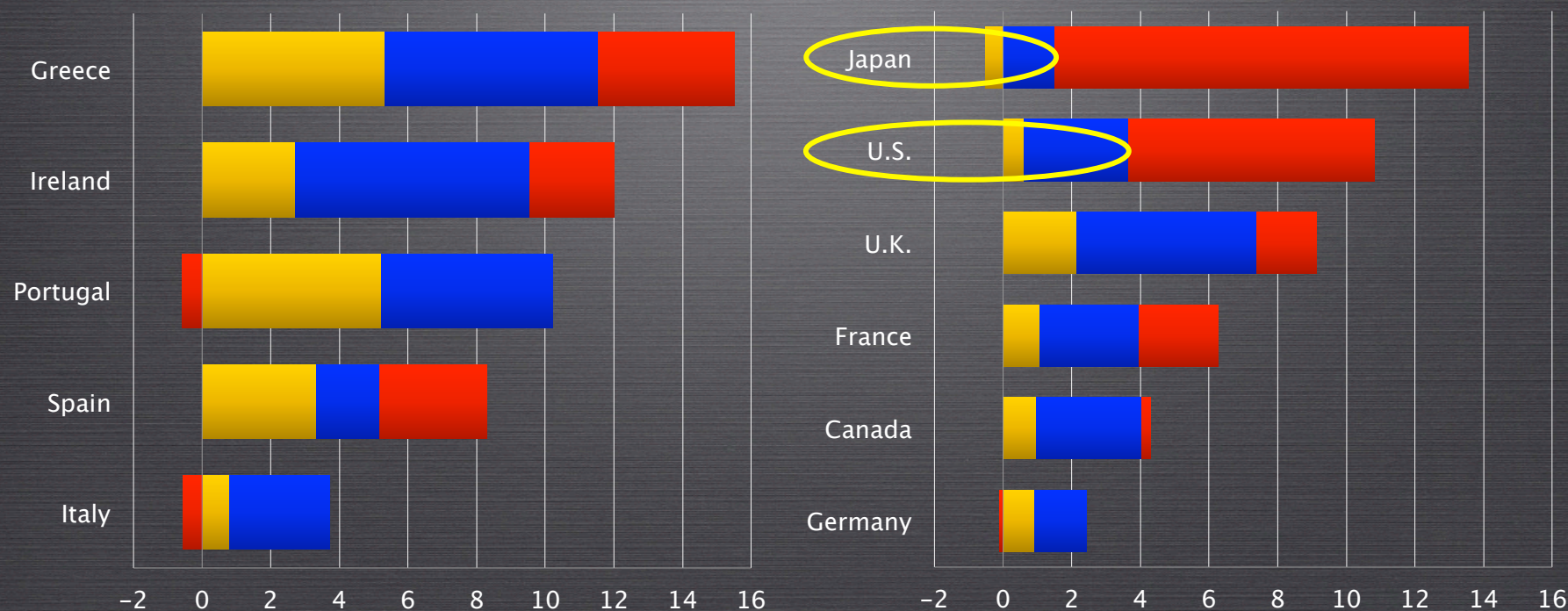
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# Fiscal Consolidation: Proceeding, But a Long Way to Go

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

■ Projected adjustment (2010-11)



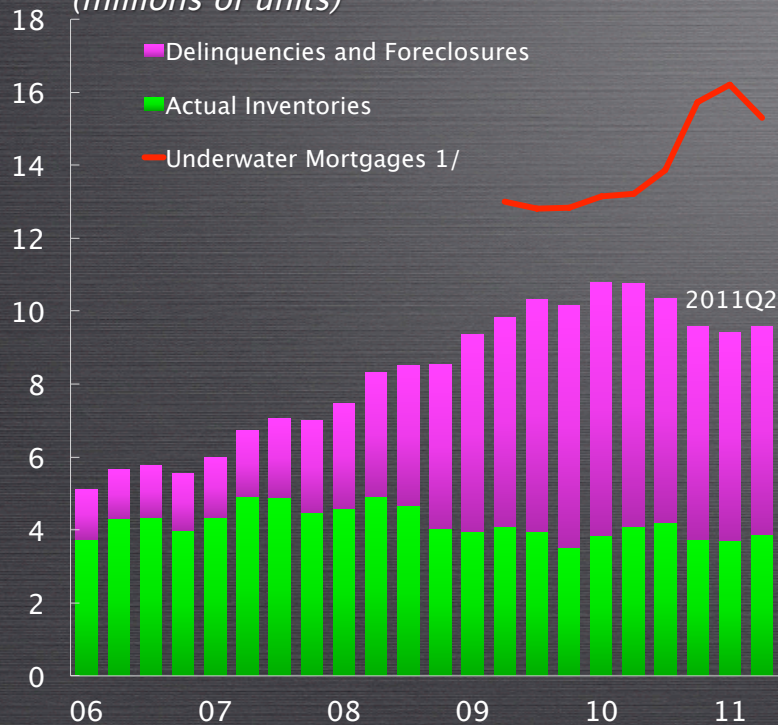
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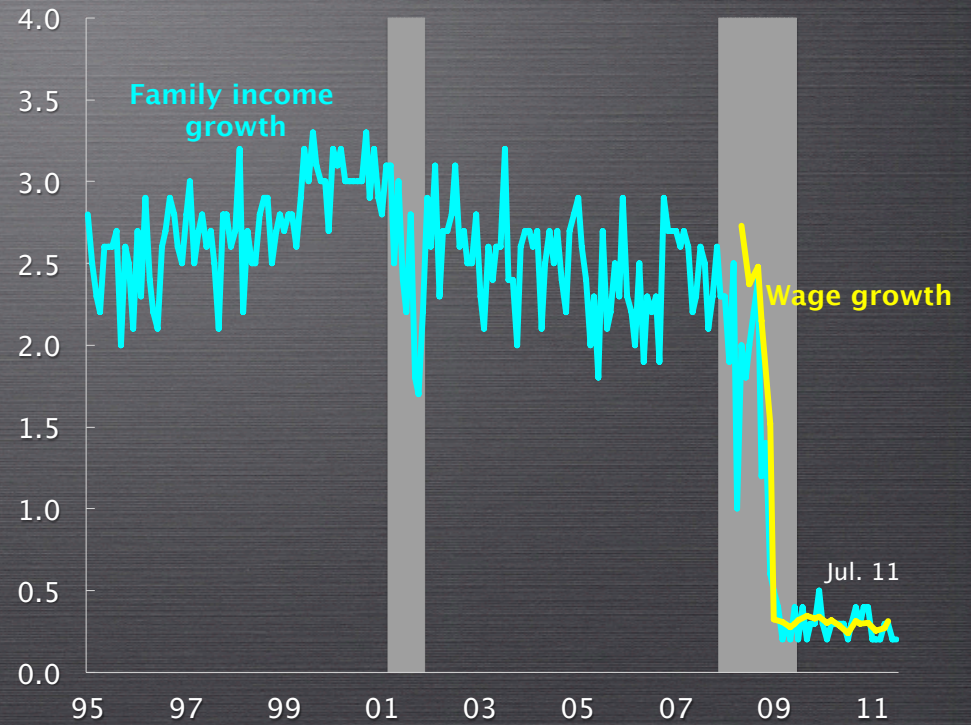


# Low Private Domestic Demand: Mechanical Brakes or Animal Spirits?

**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.

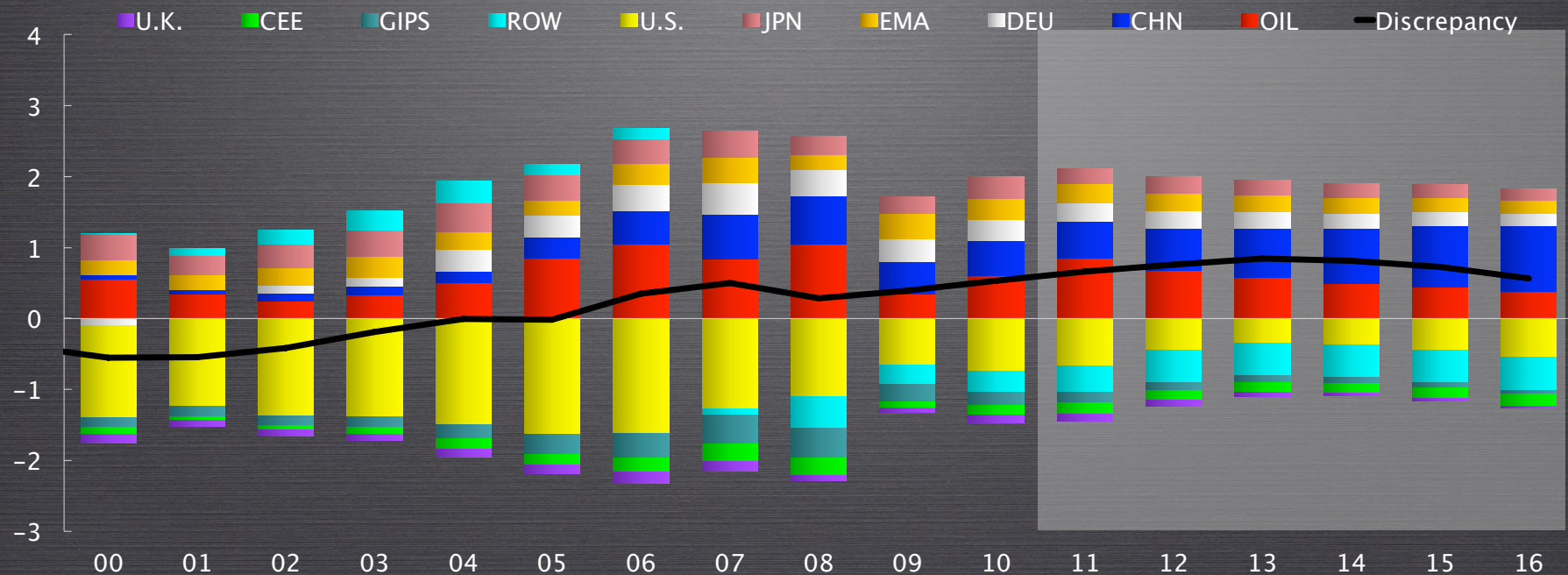
1/ Data from Zillow.com (single-family homes with mortgages in negative equity).

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.

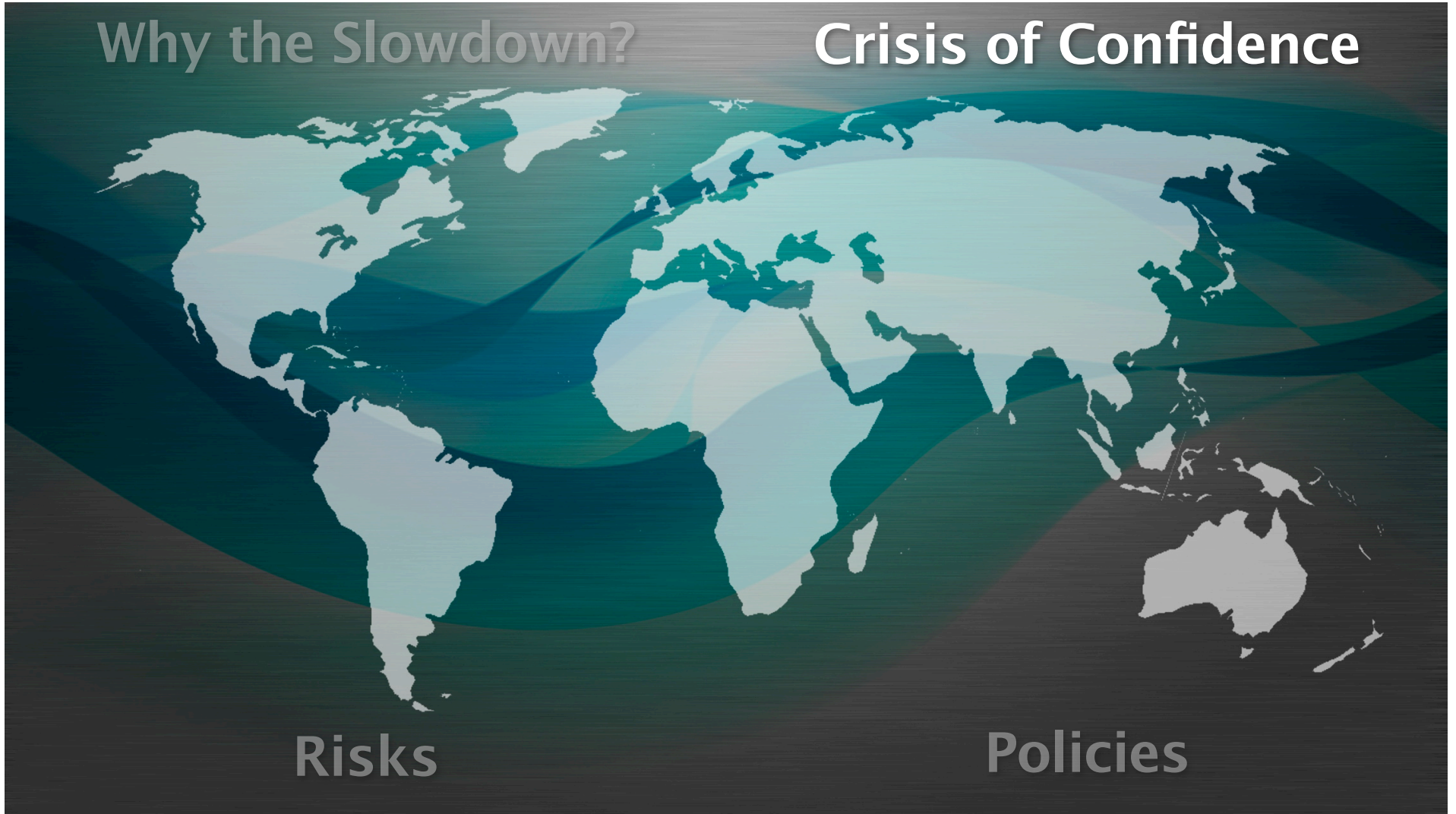


Why the Slowdown?

Crisis of Confidence

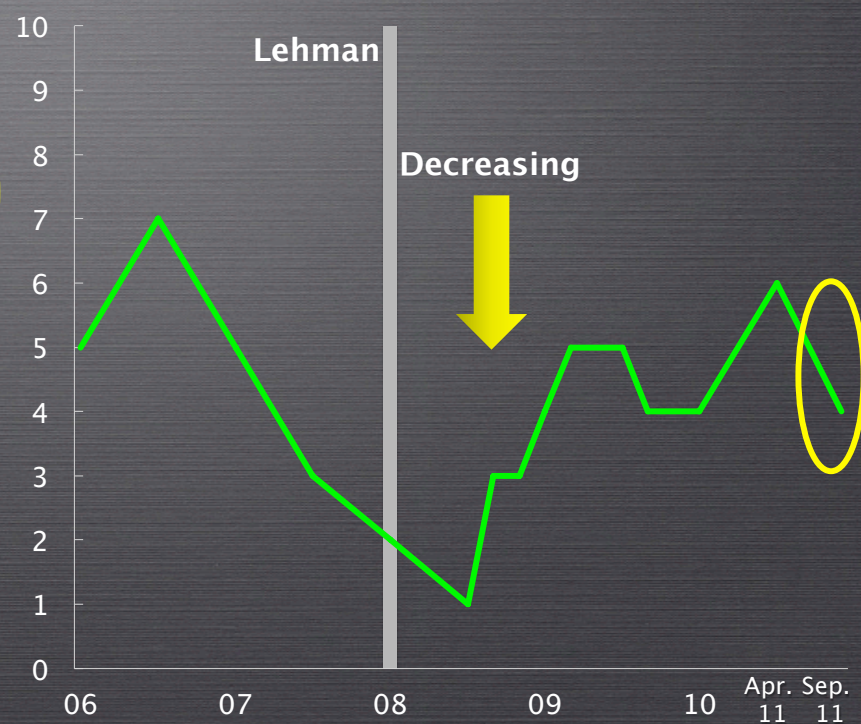
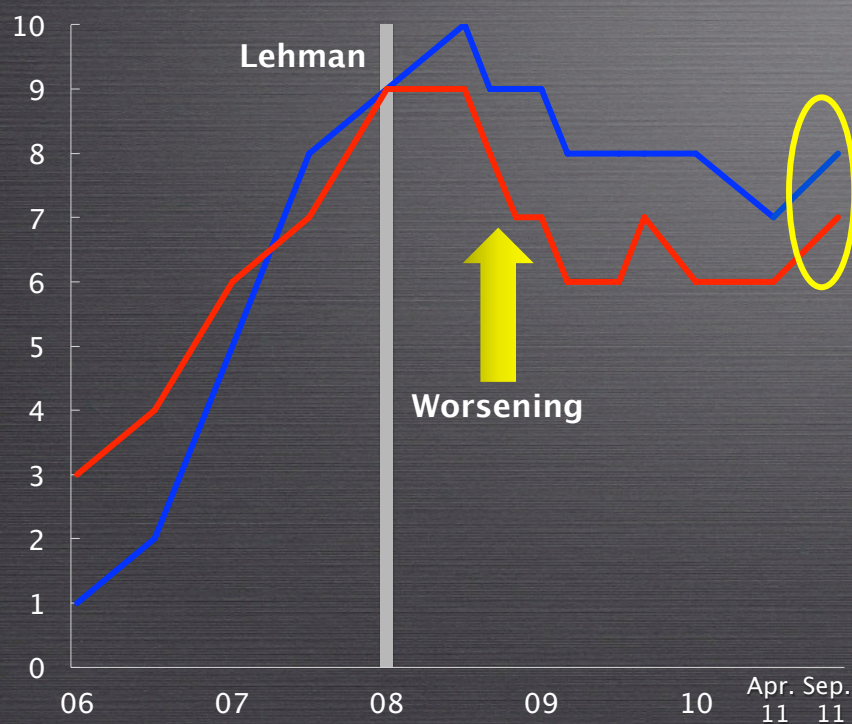
Risks

Policies



# Global Financial Stability Is Worsening

Credit Strain and Market & Liquidity Strain Indicators Risk Appetite

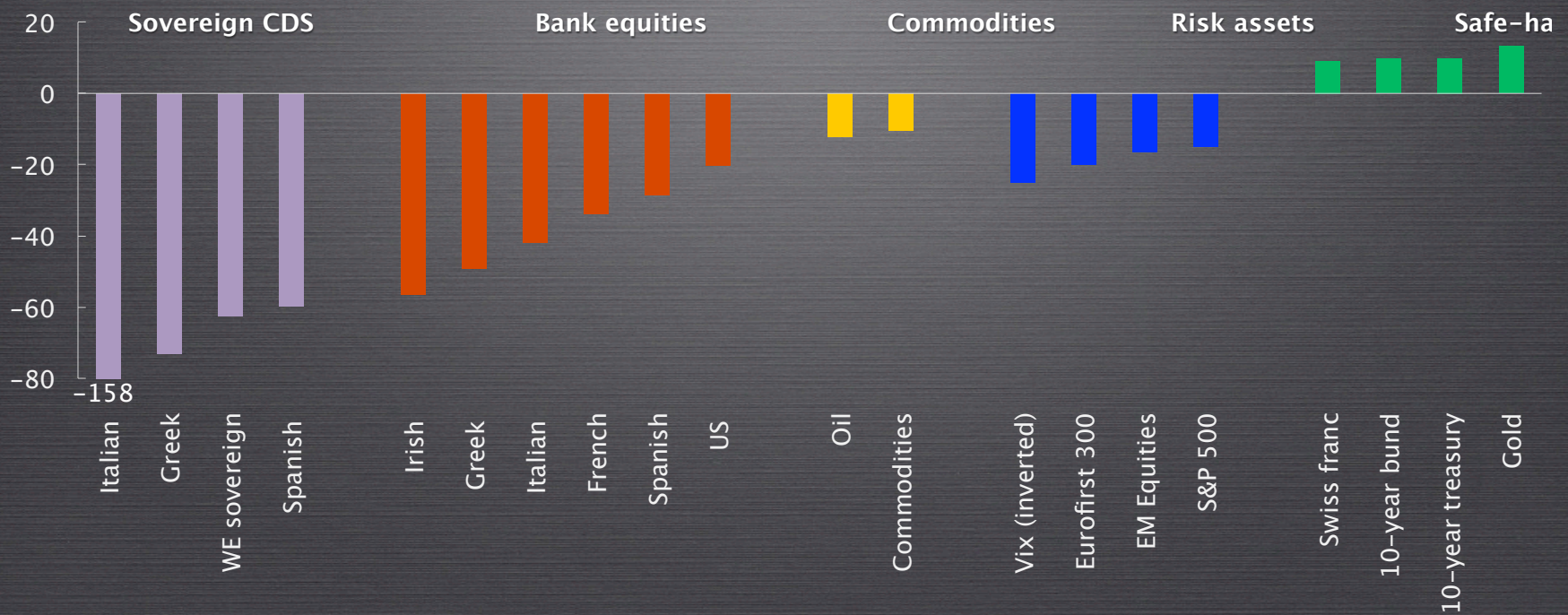


Source: IMF staff estimates.



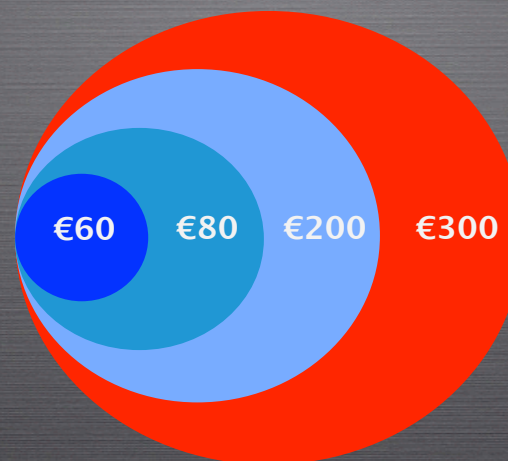
# Prompting a Flight to Safe Assets

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)

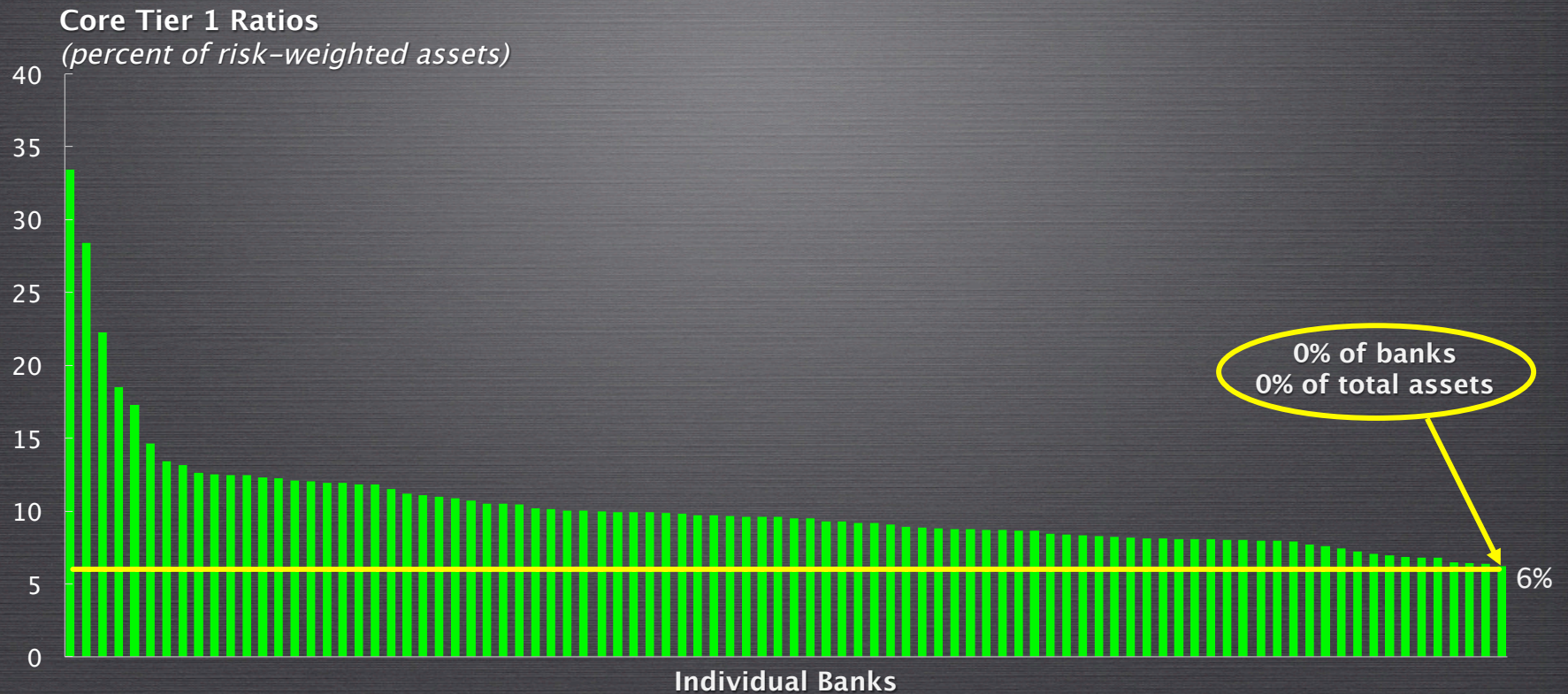


*Spillovers from ...*

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



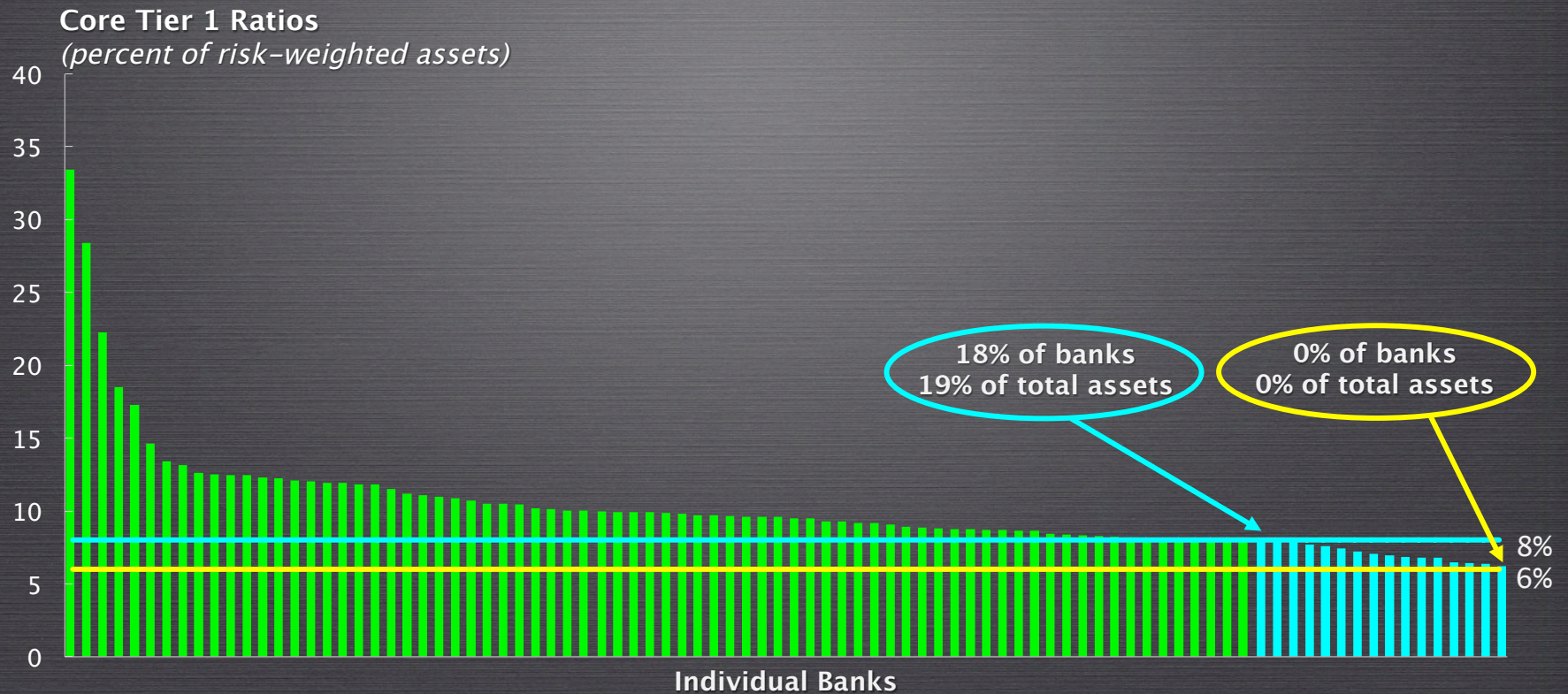
# EU Bank Capital: Current Situation



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 raises and government support.

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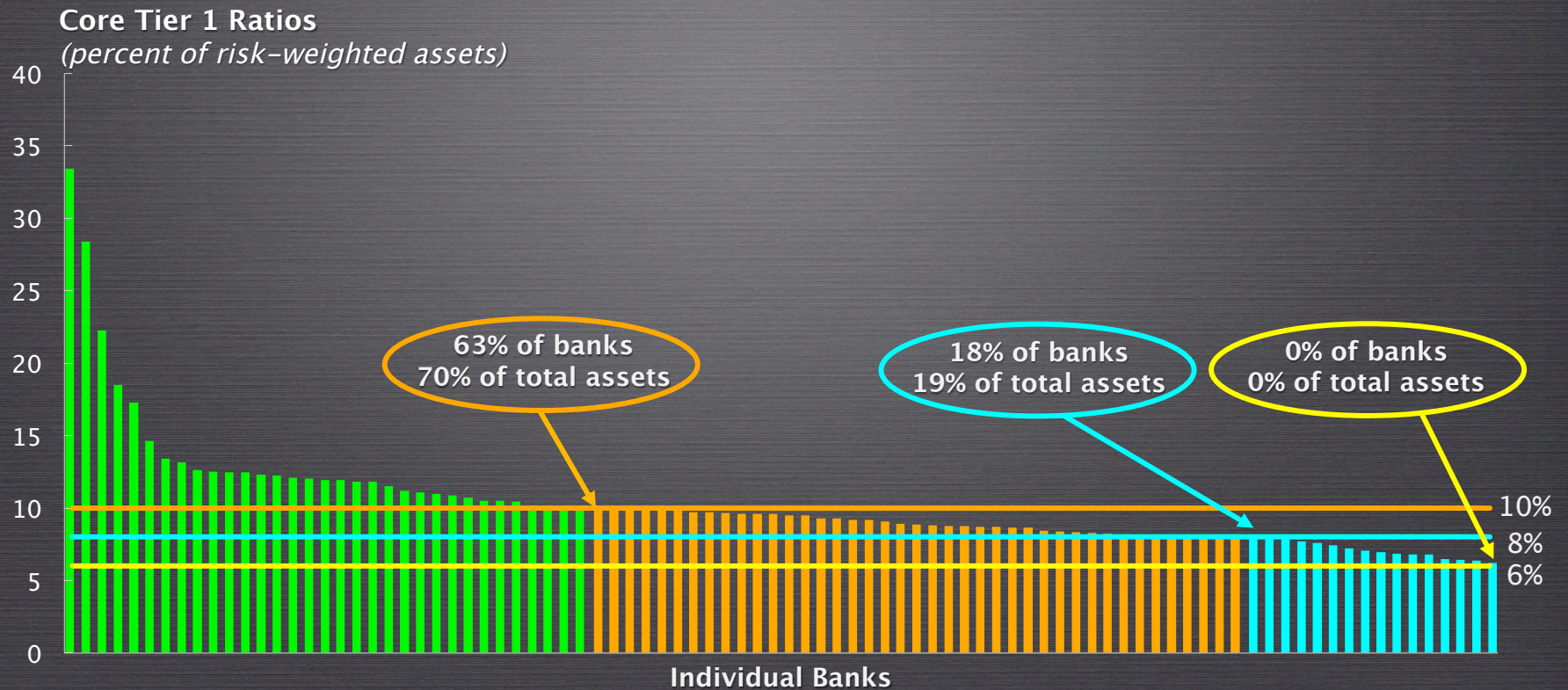


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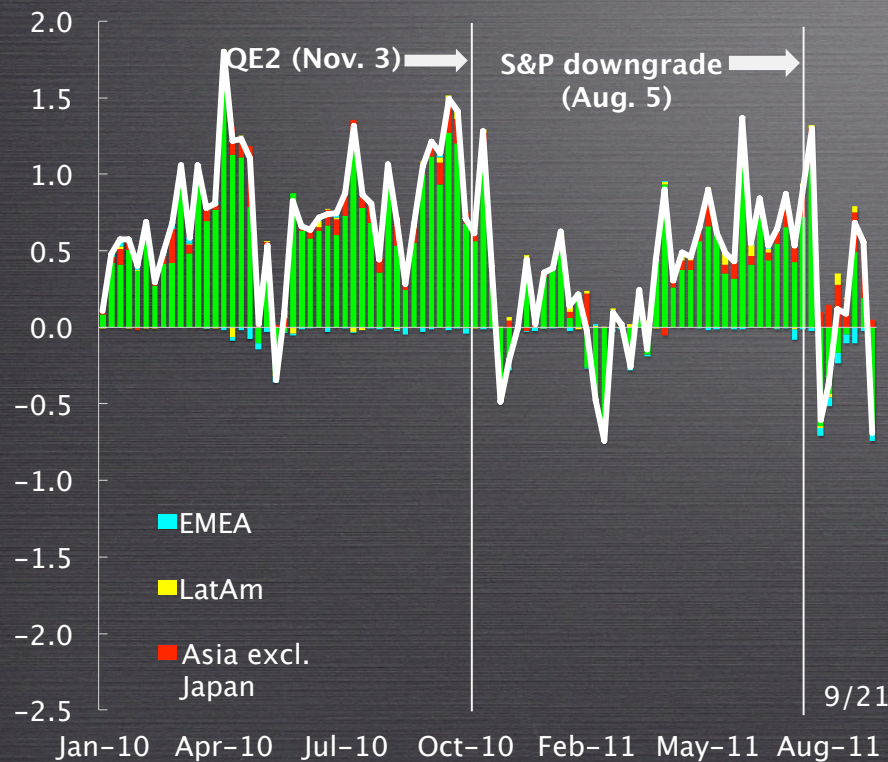
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# Capital Flows to EMs: Volatility Dominates

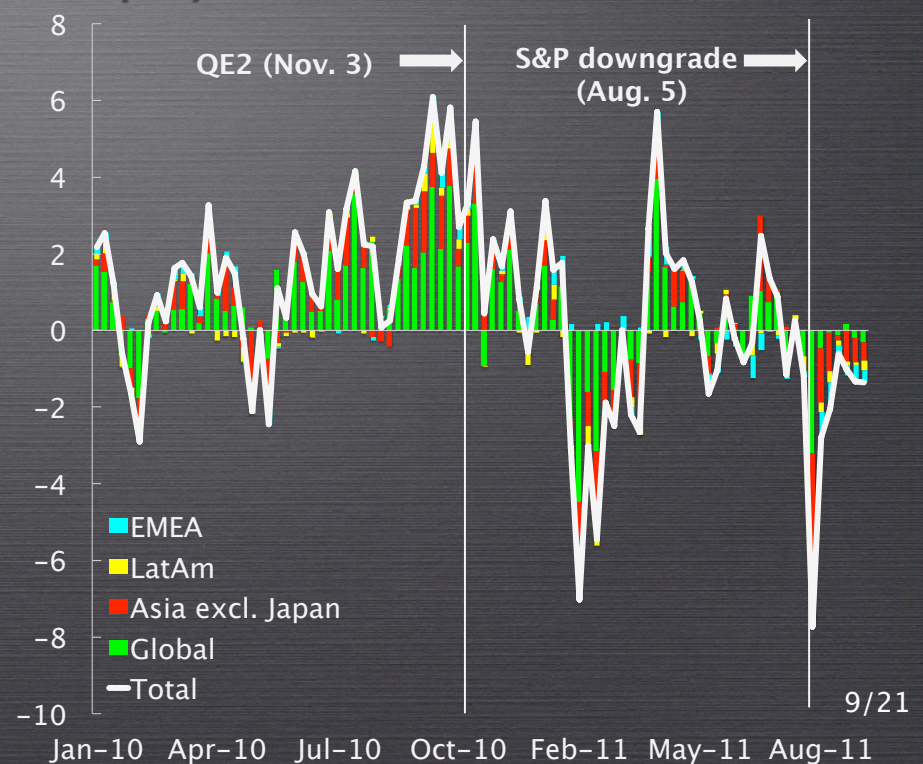
(billions of U.S. dollars; weekly flows)

## Bond Funds



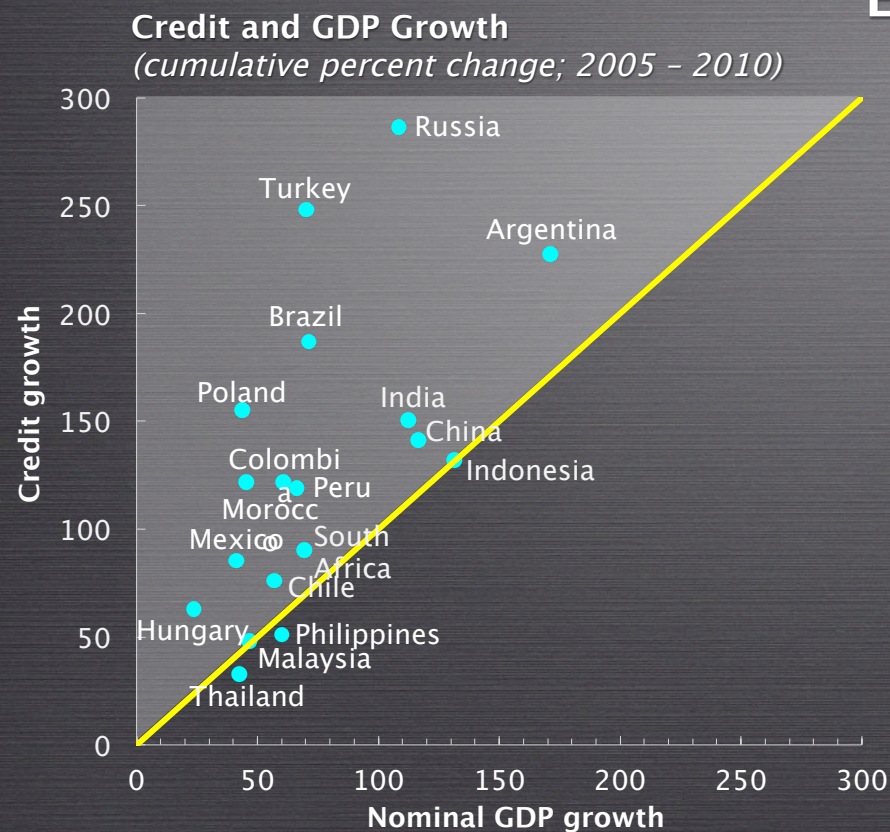
Source: EPFR Global.

## Equity Funds

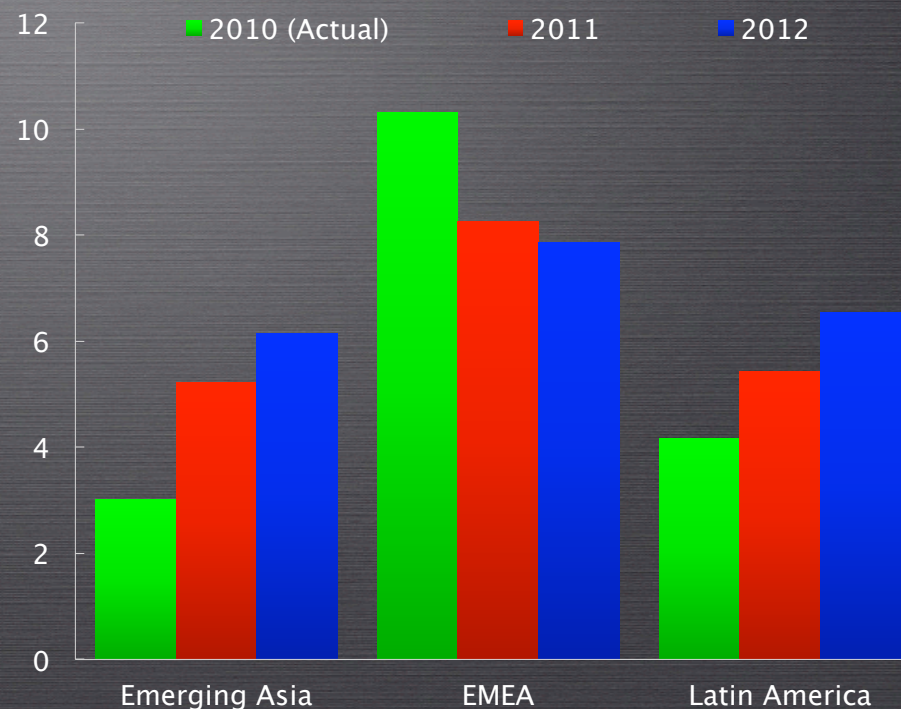




# Rapid Credit Growth Can Lead to Rising Nonperforming Loans in EMs



**Predicted NPL Ratios in 2011 and 2012**  
(percent, no shock)



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

Why the Slowdown?

Crisis of Confidence

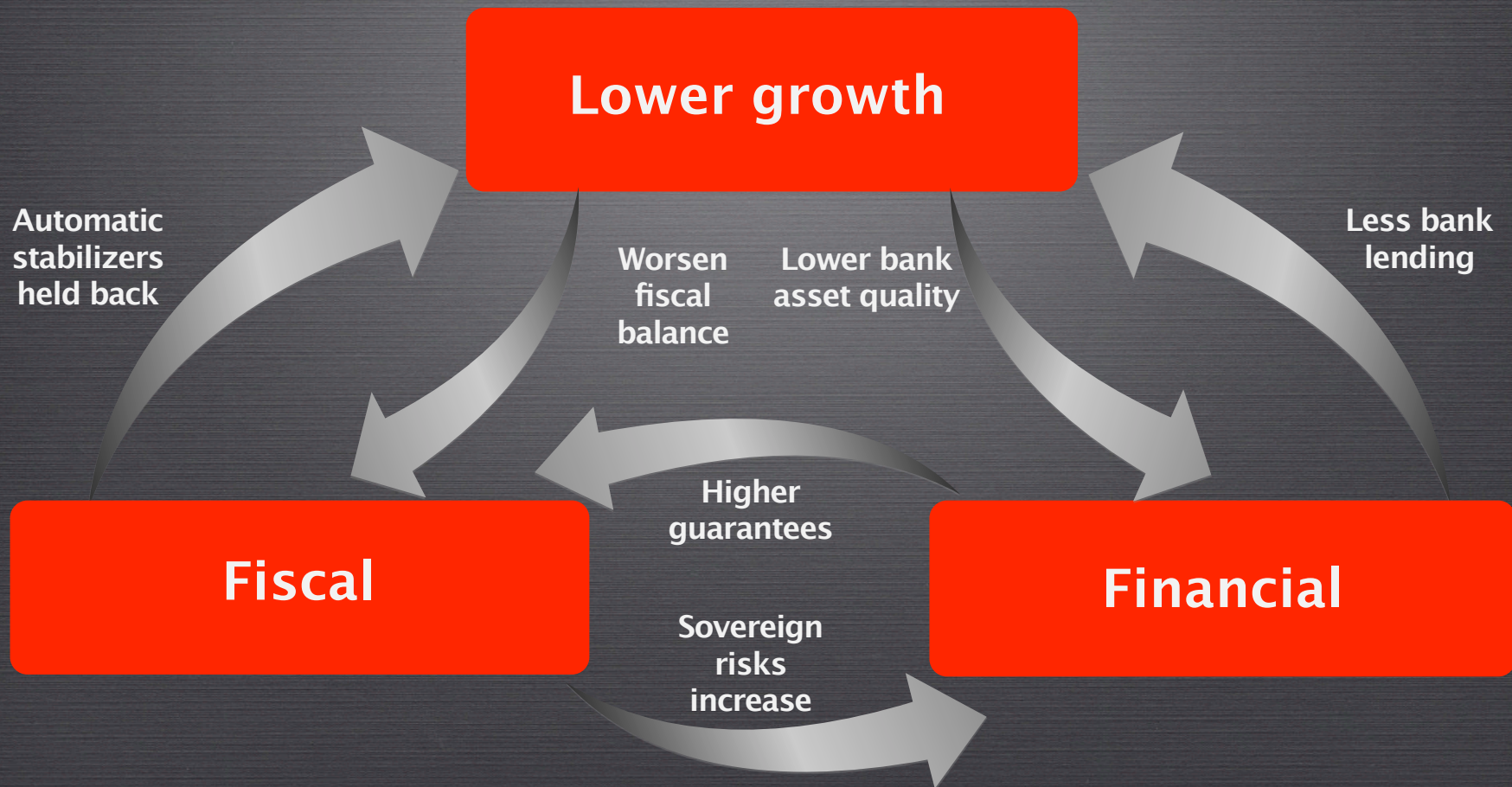
**Risks**

Policies

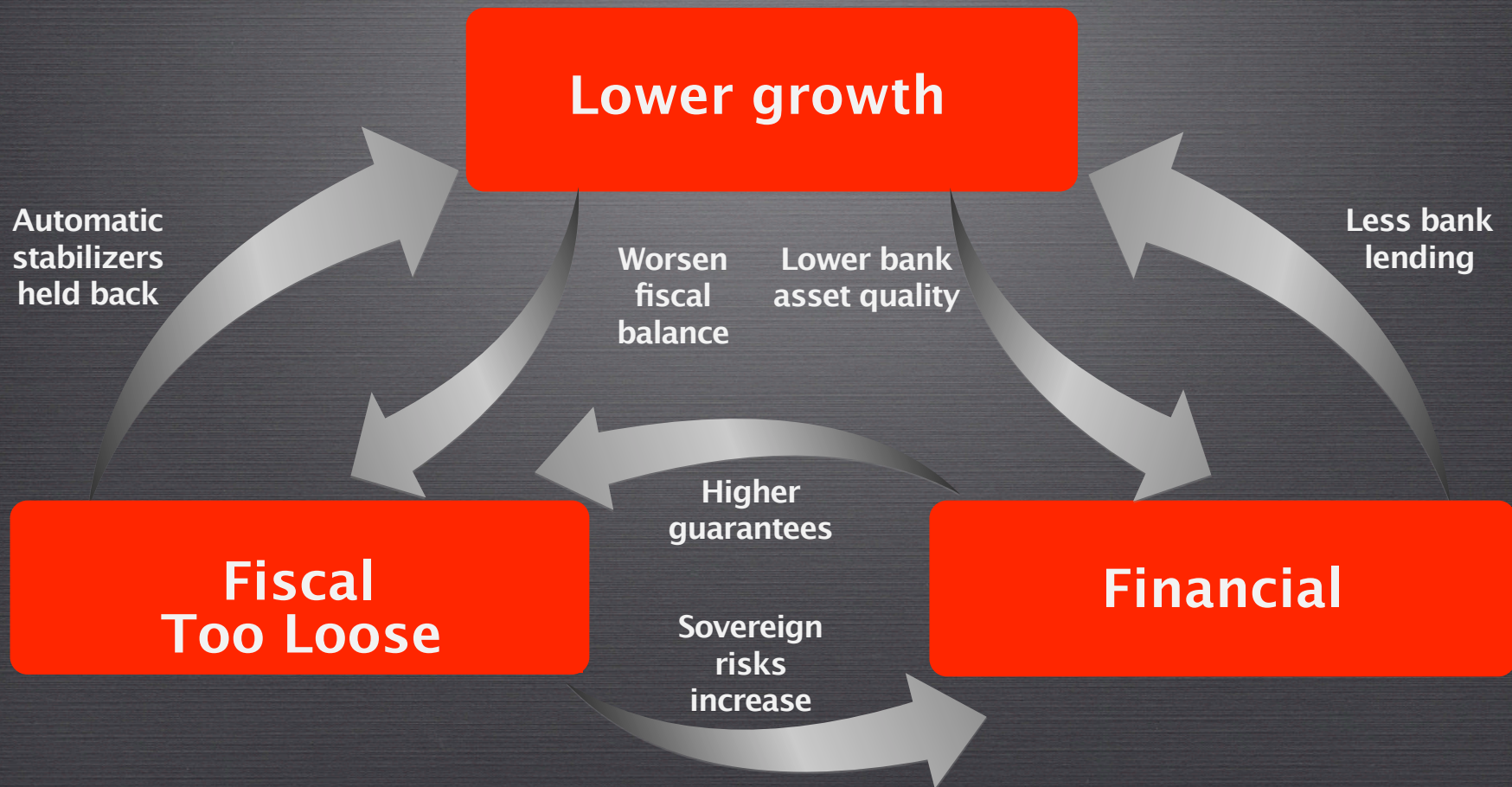




## Risks – Adverse Feedback Loops



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# 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

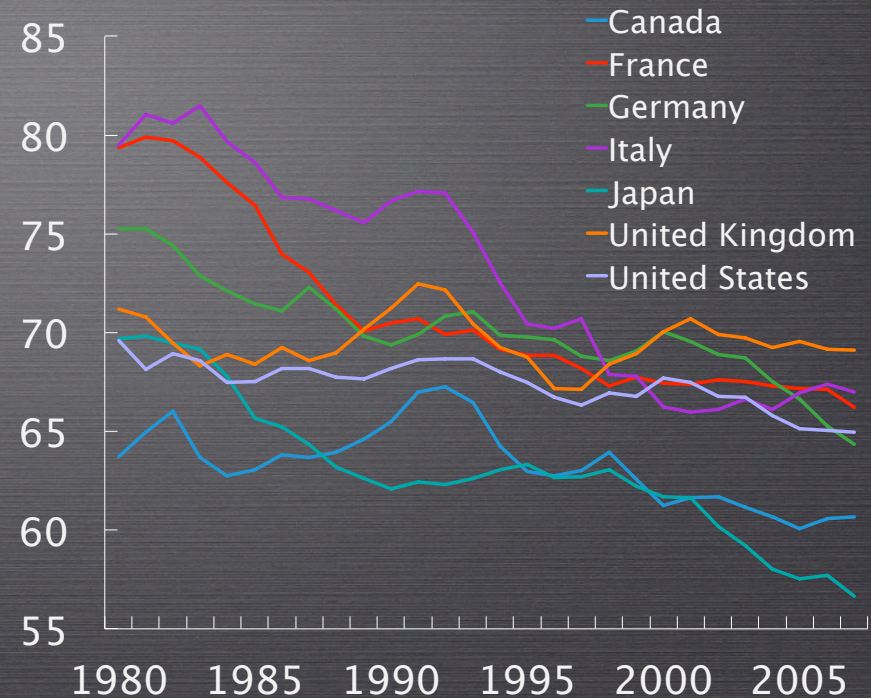
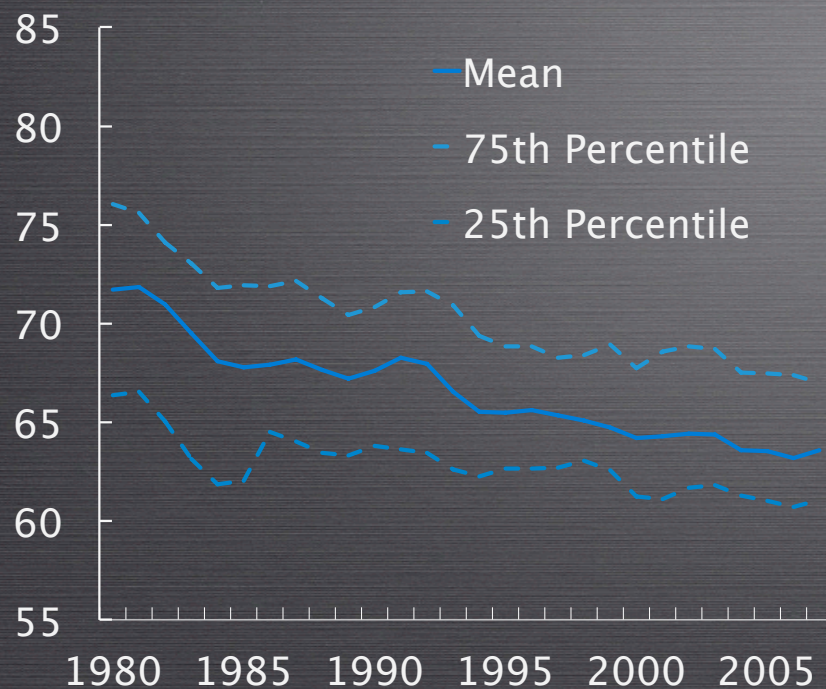
Unemployment Rate  
(percent; weighted by labor force)



Source: IMF, Global Data Source.



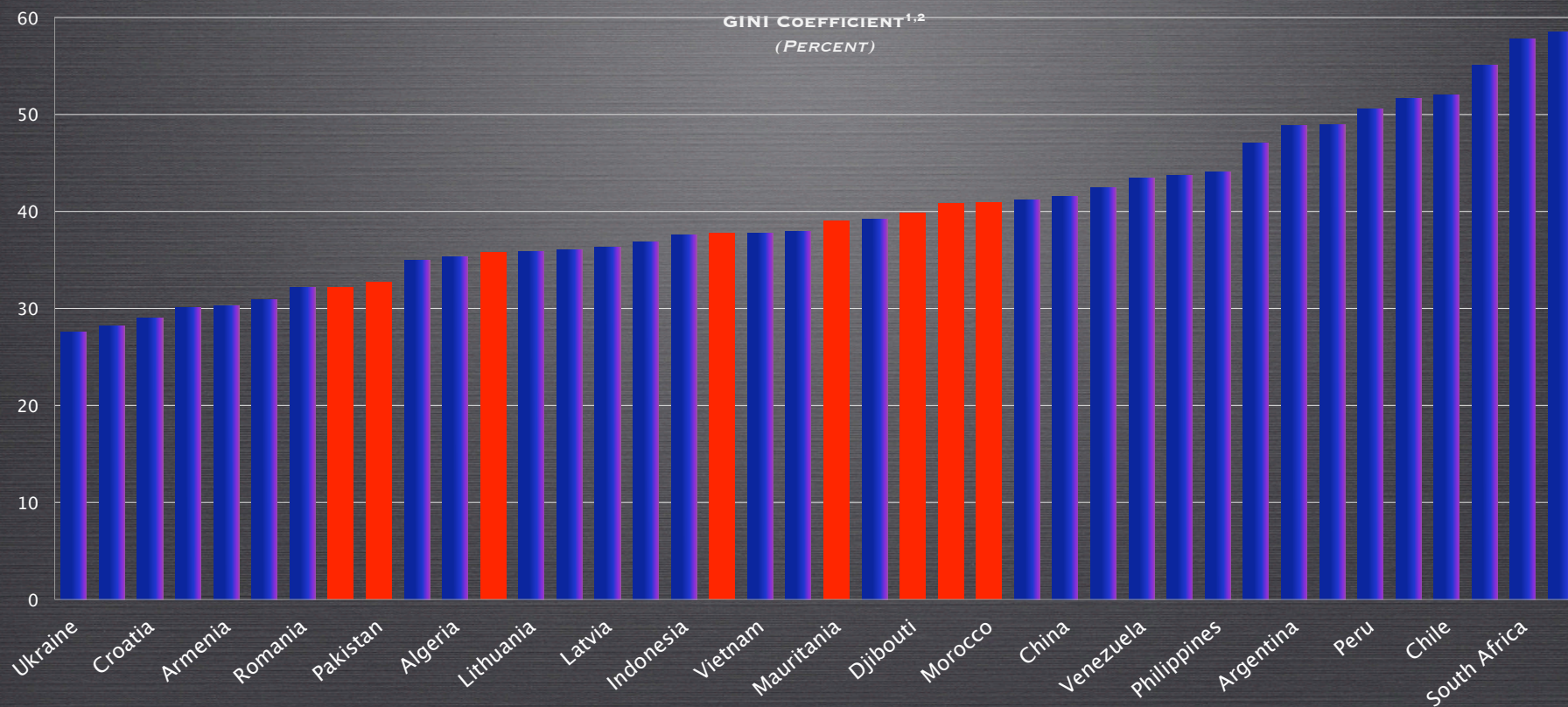
## Declining Share of Labor in Income likely to Persist



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.

<sup>1</sup>GINI COEFFICIENT IS A MEASURE OF INCOME INEQUALITY, WITH A LOWER VALUE ASSOCIATED WITH HIGHER INCOME EQUALITY.

<sup>2</sup>MOST RECENT DATA AVAILABLE.

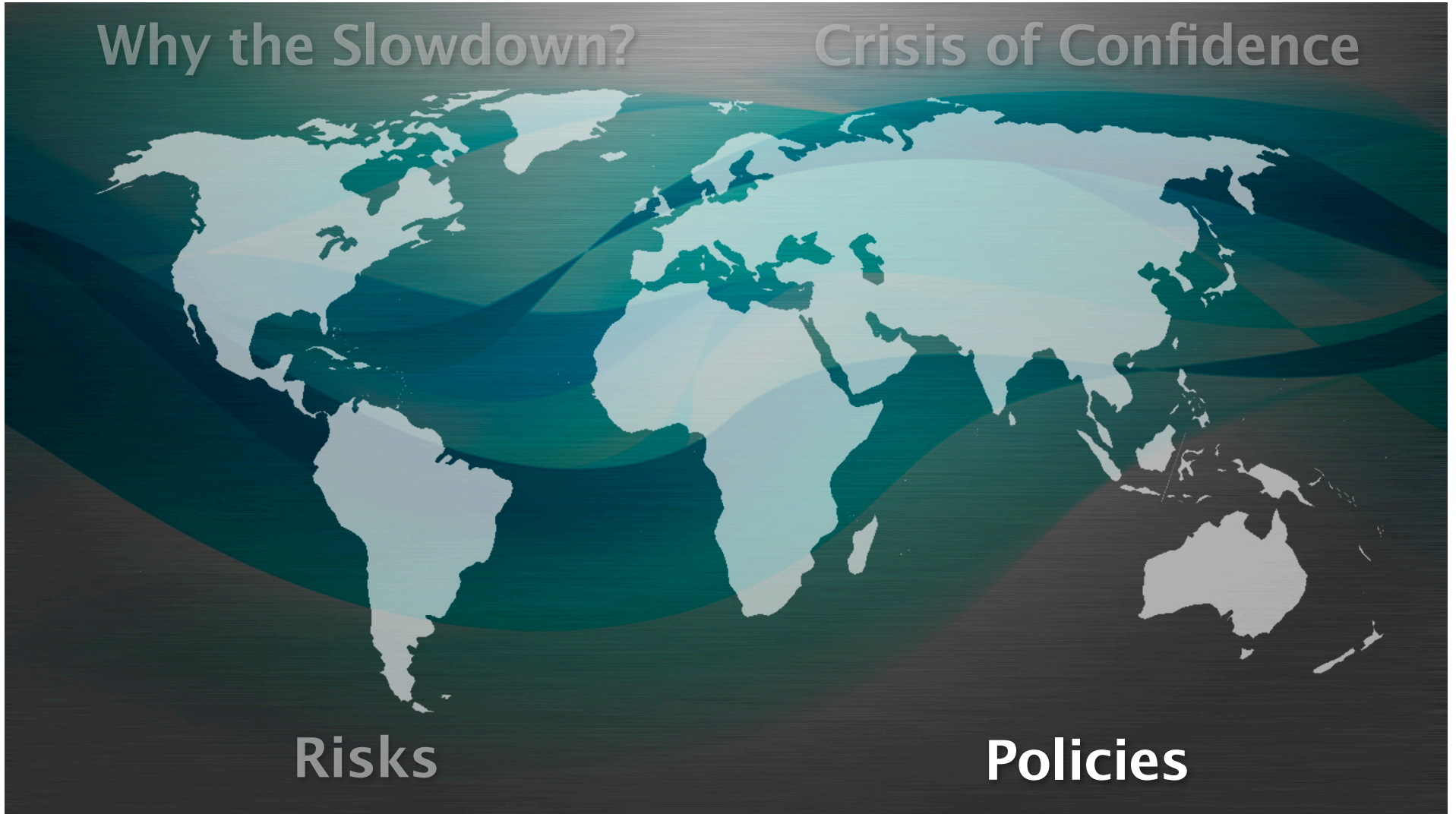


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# Need for Collective Action

## 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

- Credible medium-term plans and frameworks
- No one-size-fits-all: size and speed of adjustment varies

### Achieving Credibility

- Entitlement reforms necessary, not sufficient
- Well-designed rules and institutions key
- But no substitute for political will

### Concretely

- 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  
Vulnerabili  
ties 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