

# Economic Outlook and Policy Priorities

**Rodolphe Blavy**

**Deputy Director, IMF Europe Office**



A world map composed of small white dots on a blue background, centered behind the title text.

# **The World Economic Outlook**

## **Legacies, Clouds, Uncertainties**

A world map rendered in a light blue, dotted style, centered on the Atlantic Ocean, serving as a background for the text.

## **Legacies from the crisis**

High public and/or private debt still affecting outlook

## **Clouds**

Low potential growth reflected in low demand today

## **Uncertainties**

Geopolitical; financial markets...

Country-specific factors

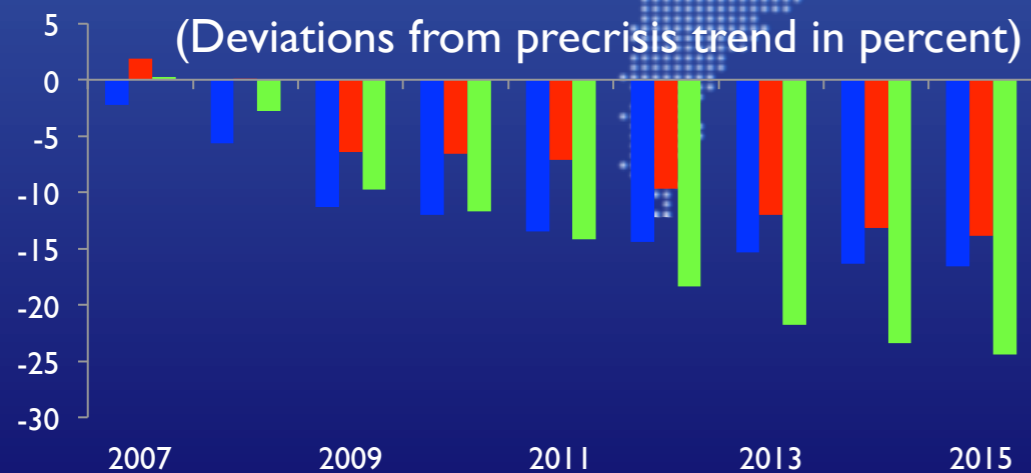
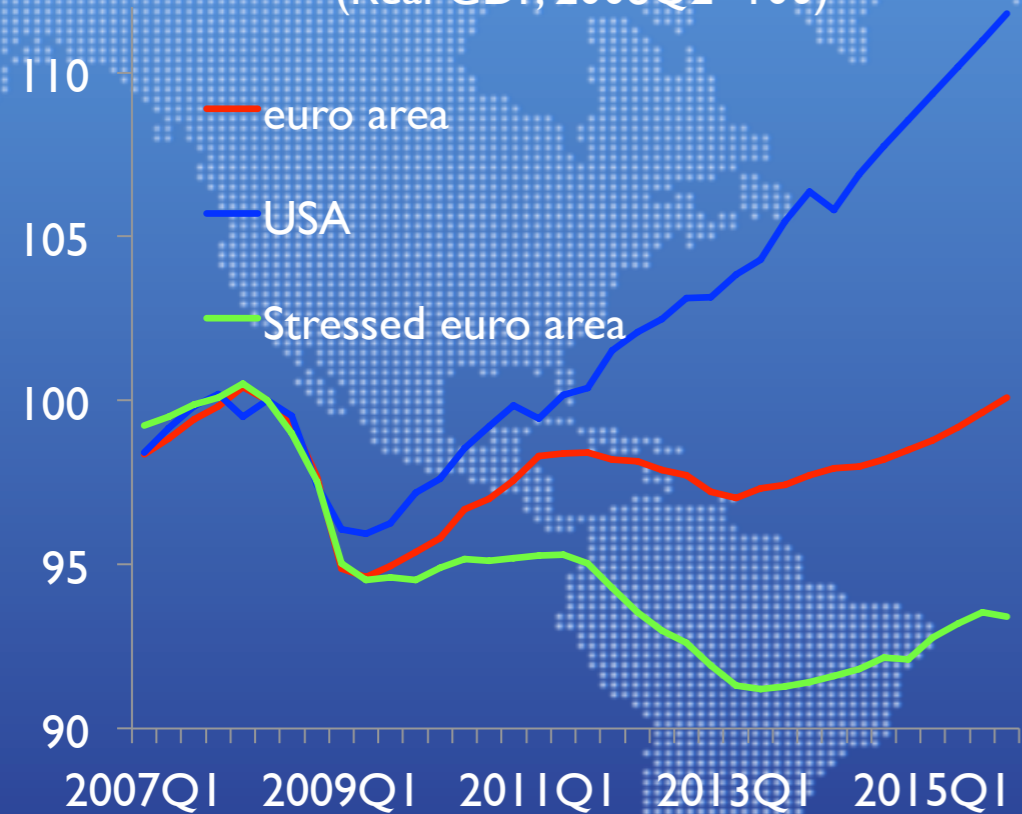
# Despite setbacks, a global recovery continues

- Global growth slowed more than expected in H1 2014
  - One-off factors in the U.S. economy; growth decelerated in Japan and stalled in the euro area, highlighting their more difficult recoveries
  - Growth also weaker in some major EMs: new factors (geopolitics), more persistent domestic demand weakness in some, and weaker AE demand
- 2014 forecast: 3.3 percent (↓ 0.4 pp vs. April WEO)
  - Key drivers for the recovery in AEs remain in place
  - Increasing heterogeneity in outlook
- 2015 forecast: 3.8 percent (↓ 0.2 pp vs. April WEO)

# Legacy effects from the crisis are expected to weigh more on aggregate demand and activity in the euro area

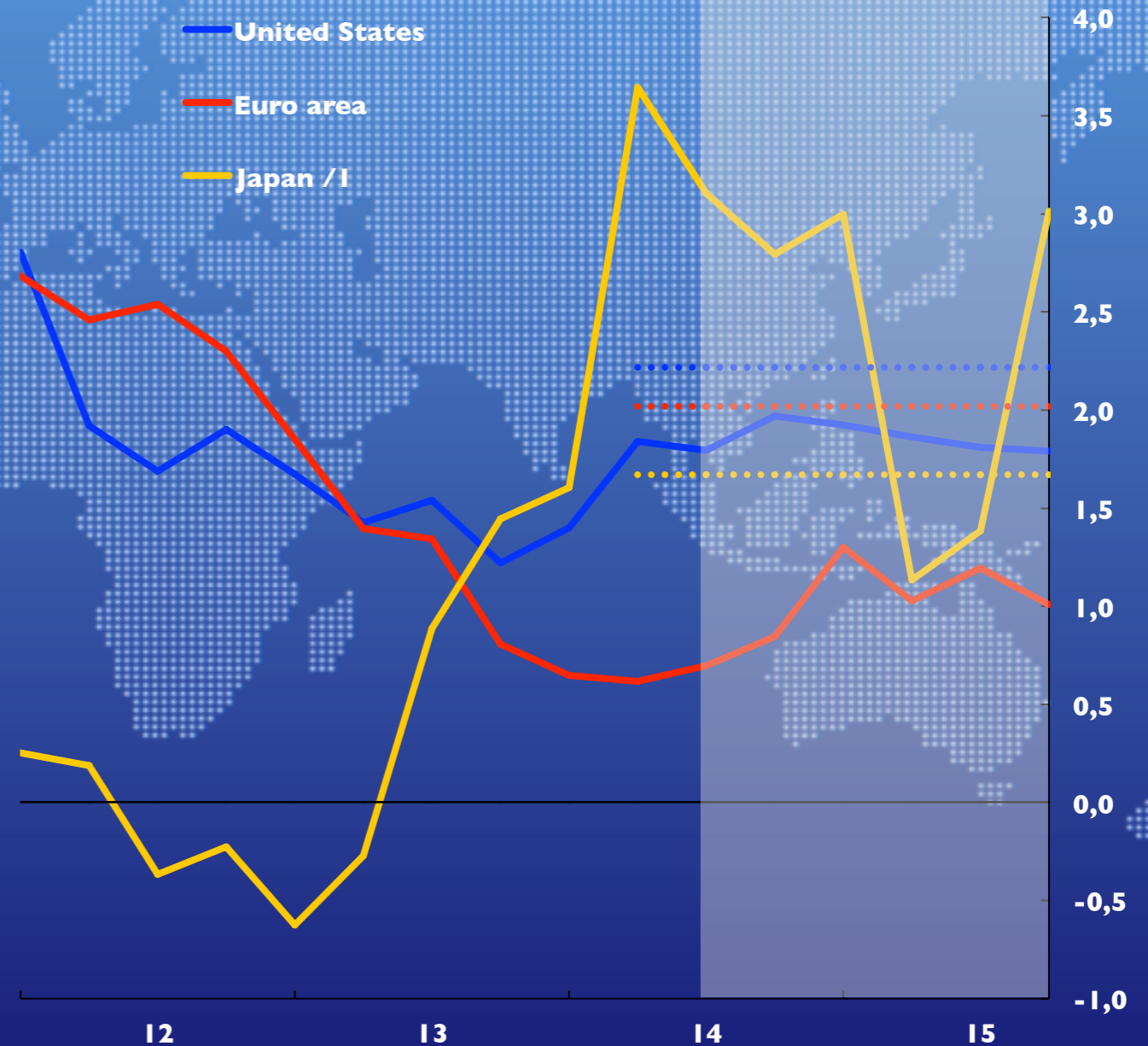
## Speed of Recovery and Output Loss Relative to Pre-crisis Trends

(Real GDP, 2008Q2=100)



## Headline Inflation

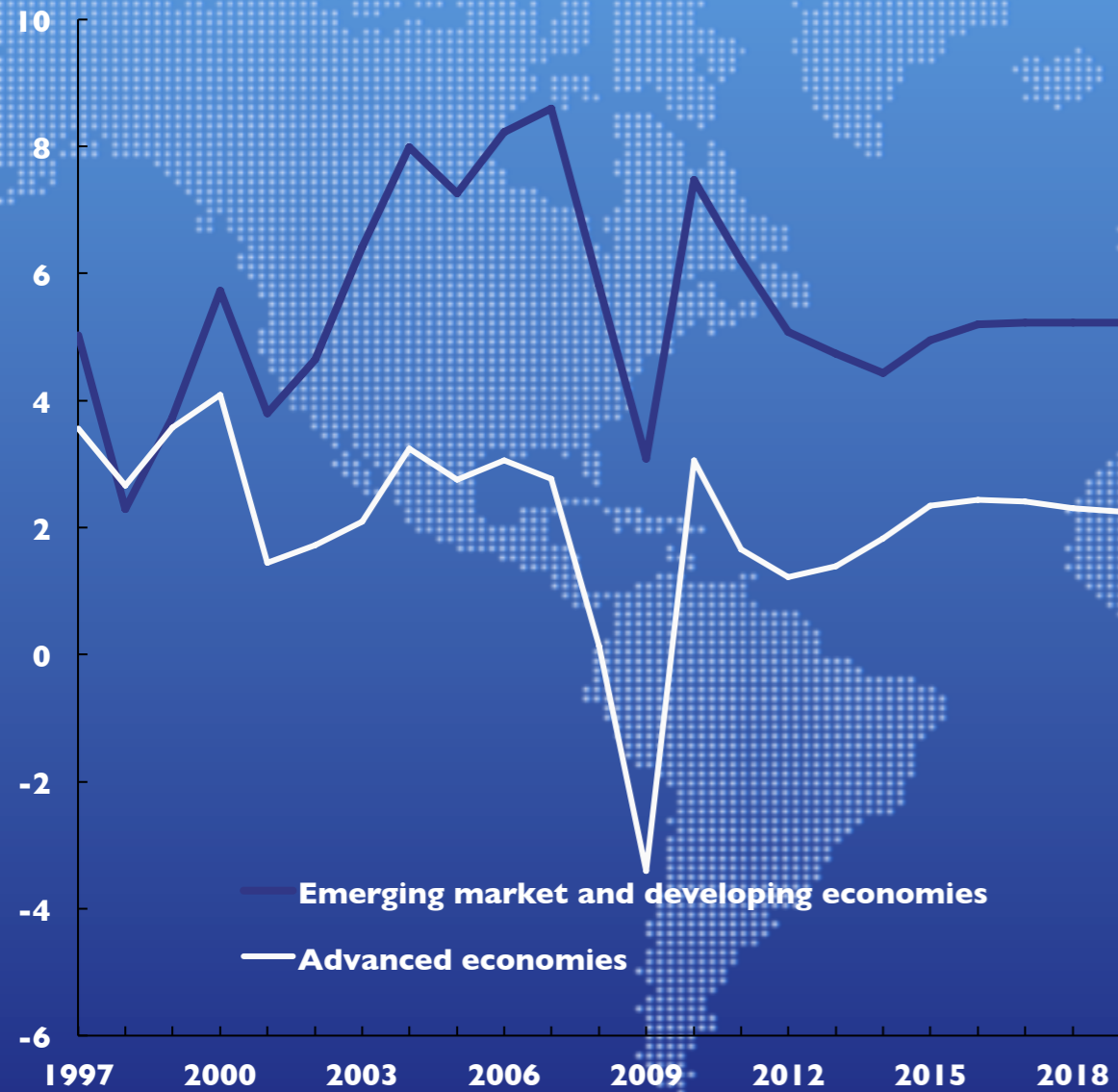
(year-over-year percent change; dashed lines are the six- to ten-year inflation expectation)



# Has the growth slowdown in emerging market economies bottomed out?

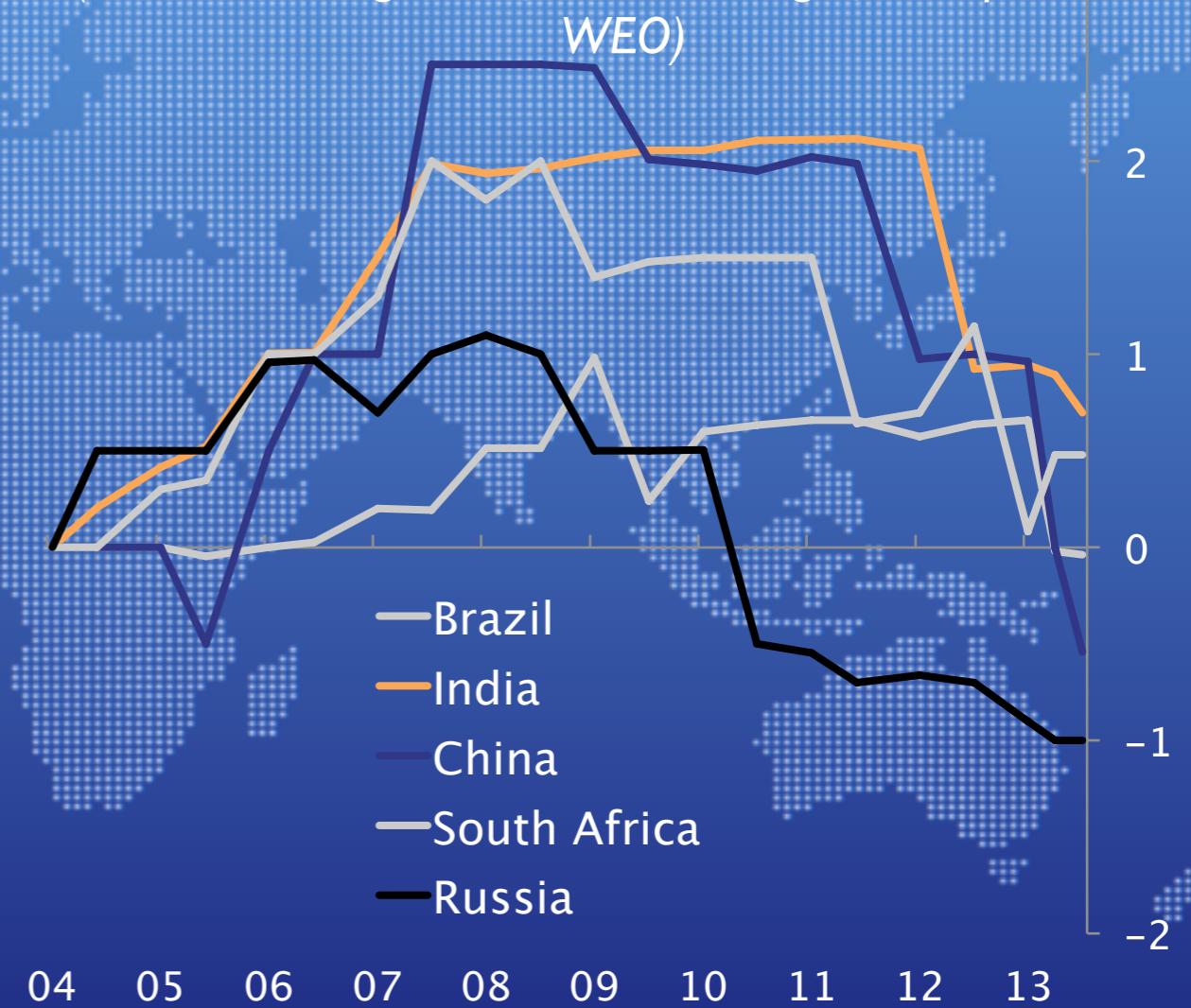
## Real GDP

(change in percent; based on PPP weights)

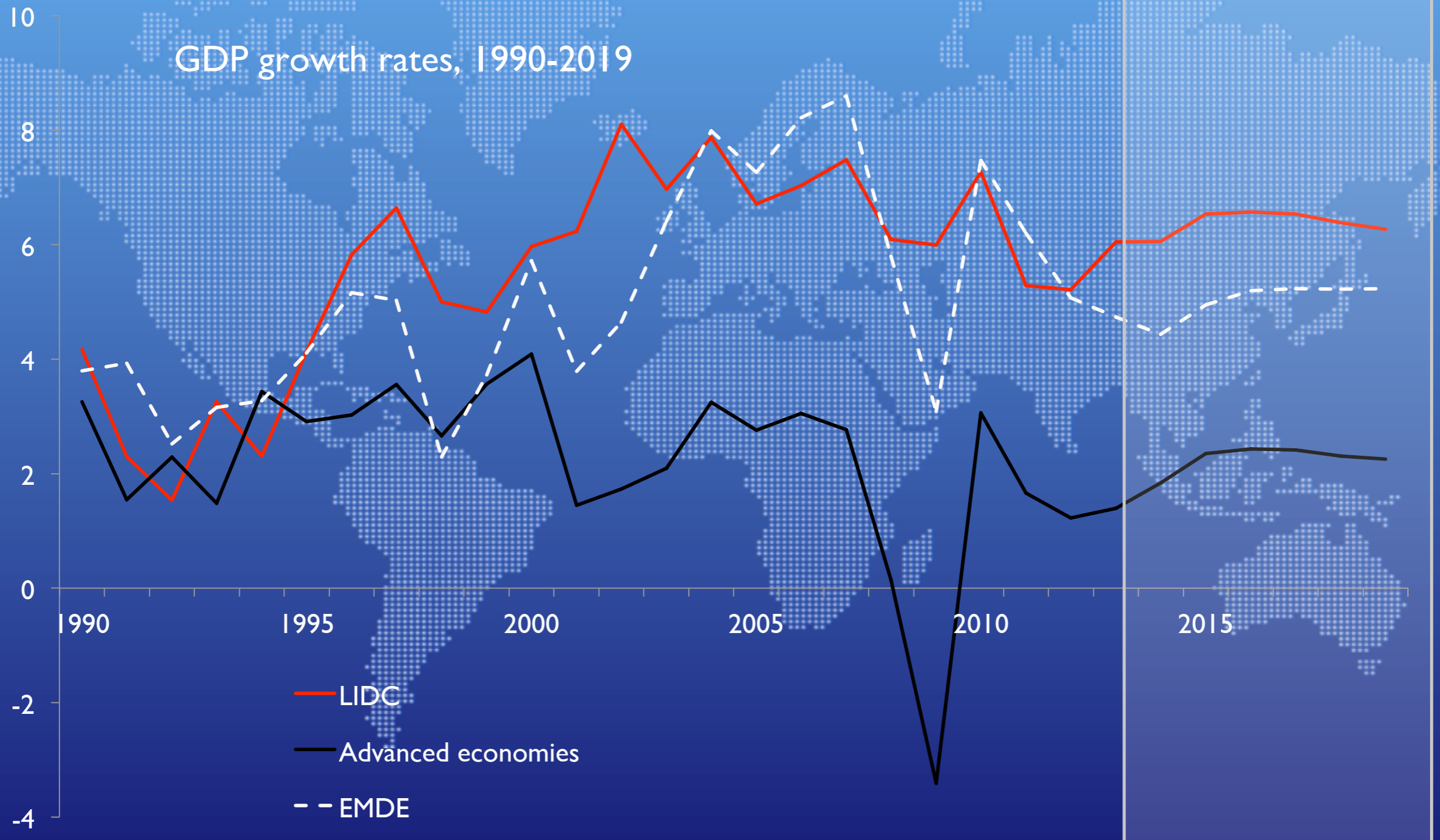


## Long-term Expectations: Up and Down 2/

(medium-term growth forecast; change from April 2004 WEO)



# LIDCs: sustaining high growth?



# Key factors supporting the recovery

## In advanced economies:

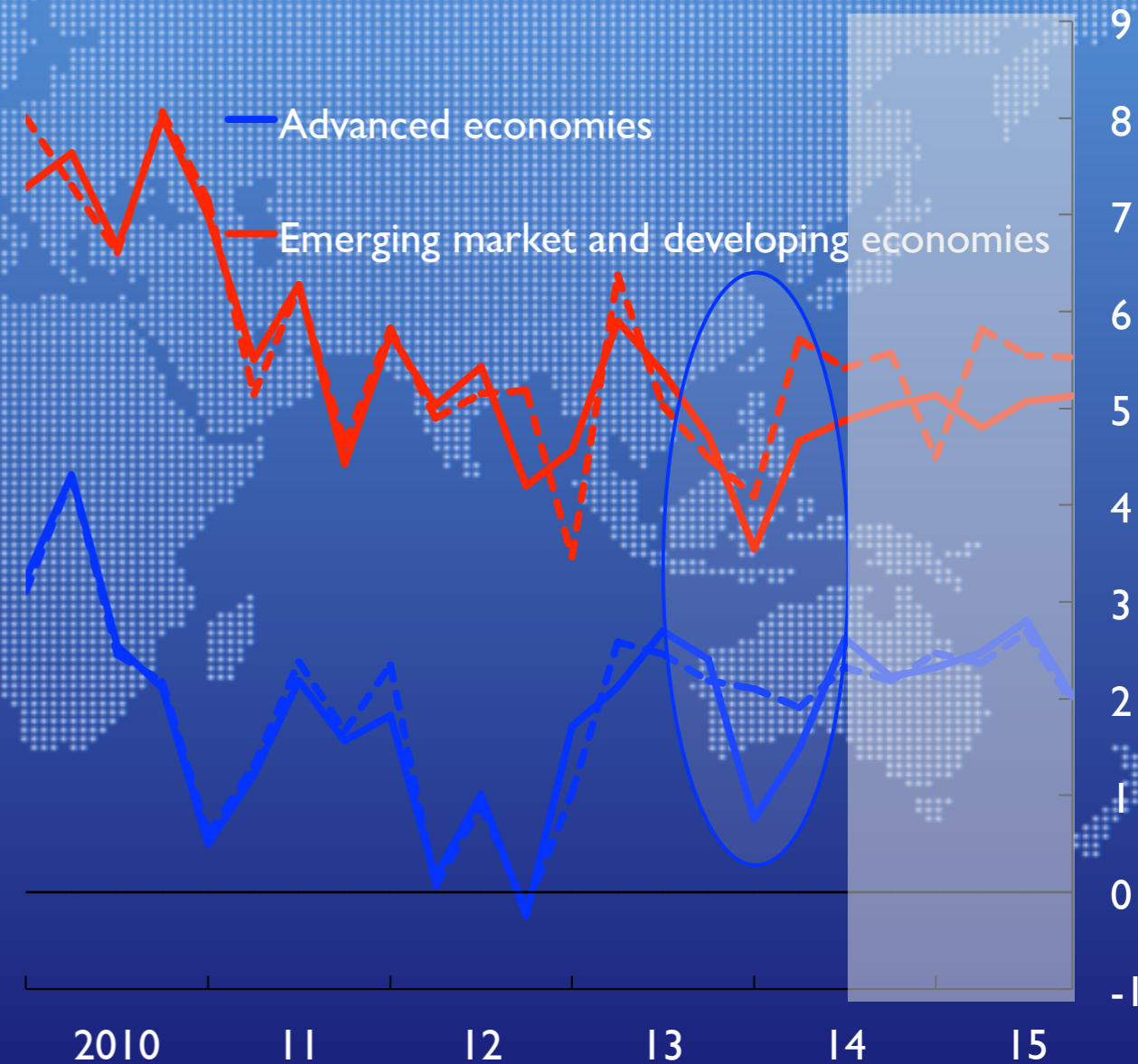
- *Monetary policy very accommodative*
- *Financial market conditions supportive*
- *Moderate fiscal consolidation in 2014-15*

## Emerging and developing economies:

- *Higher external demand in AEs and still-favorable financial conditions*
- *Gradual lifting of structural impediments to growth in some economies*
- *Recovery in economies affected by geopolitical tensions or domestic strife*

## GDP Growth

(annualized quarterly percent change; dashed lines are from April 2014 WEO)





# The outlook is thus for a continued recovery, but the pace is weak and uneven...

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



**World**



**U.S.**



**Euro  
Area**



**Japan**



**Brazil**



**Russia**



**India**



**China**

**2014  
(October  
2014)**

**3.3**

**2.2**

**0.8**

**0.9**

**0.3**

**0.2**

**5.6**

**7.4**

**2014  
(April  
2014)**

**3.6**

**2.8**

**0.8**

**1.4**

**1.8**

**1.3**

**5.4**

**7.5**

**2015  
(October)**

**3.8**

**3.1**

**1.3**

**0.8**

**1.4**

**0.5**

**6.4**

**7.1**

**2015  
(April  
2014)**

**4.0**

**3.0**

**1.3**

**1.0**

**2.7**

**2.3**

**6.4**

**7.3**

Source: IMF, World Economic Outlook.

# Downside risks have increased

- Geopolitical tensions.
- Financial market correction: Higher equity prices, risk spread compression, and very low price volatility could reverse
- Stagnation risks in advanced economies; low inflation in the euro area;
- Lower potential growth
  - *declines in potential output in some EMs*
  - *Expectations of lower potential growth can slow investment today*

# Confirmed by more recent developments

- A financial market correction. (-)
- Considerably lower oil prices. (+)
- Further sign of weakness in activity. (-) and inflation (-)

# Policies

## **Advanced economies: demand and supply**

Demand support to the recovery

Boost to public investment

Structural reform to boost potential output (country specific)

## **Emerging and developing economies**

Address vulnerabilities

Increase potential output (country specific)

# The projected pick-up in growth may again fail to materialize or fall short of expectations. Raising actual and potential growth remains a priority

## Advanced economies

- Avoid premature monetary policy tightening
- Fiscal adjustment attuned in pace and composition to supporting both the recovery and long-term growth
- Complete financial regulatory reforms
- Develop and strengthen macroprudential measures

## EMDEs

- Manage financial volatility and contain external vulnerability
- Allow exchange rate to adjust to external shocks
- Scope for macroeconomic policies to support growth is limited in economies with external vulnerabilities

## All

- Structural reforms to raise productivity and potential output, make growth more sustainable
- Public investment if conditions are right: boost demand in the short term, help to raise potential growth in the long term

# The View on Europe

Strong policy actions helped move euro area from crisis to recovery

But recovery still weak and fragile

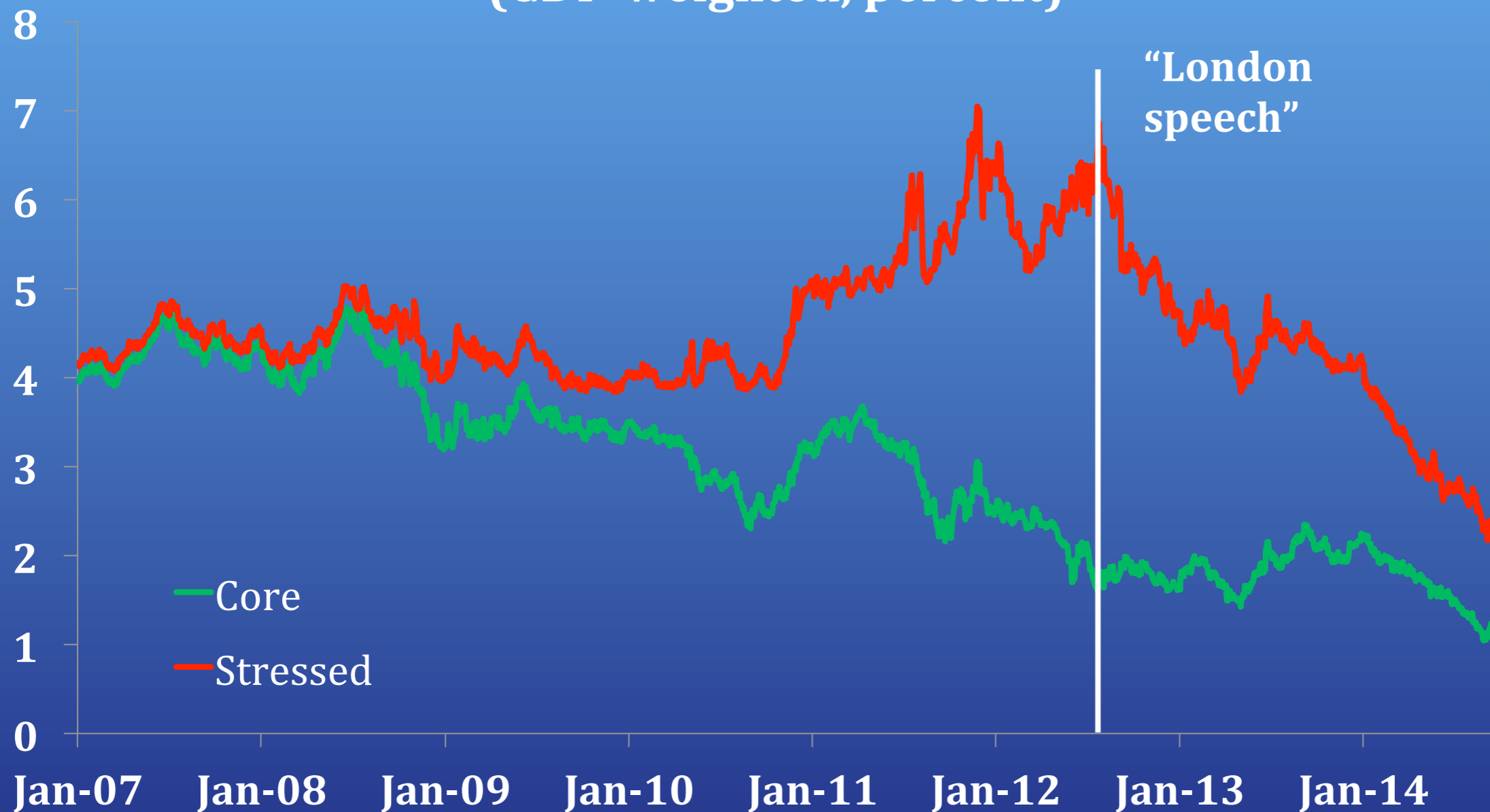
- Geo-political risks
- “Lowflation”
- Growth too low to bring down debt and unemployment

Policy agenda: Strengthening the recovery

- Supporting demand and mending balance sheets
- Rebalancing and growth policies

# Dramatic decline in sovereign yields

Euro Area: 10-year Sovereign Yields  
(GDP-weighted, percent)



Sources: Haver Analytics, Bloomberg, and IMF staff calculations.

From crisis to recovery

# Strong policy actions have helped

Fiscal consolidation and structural reforms at national levels

Banks repairing balance sheets

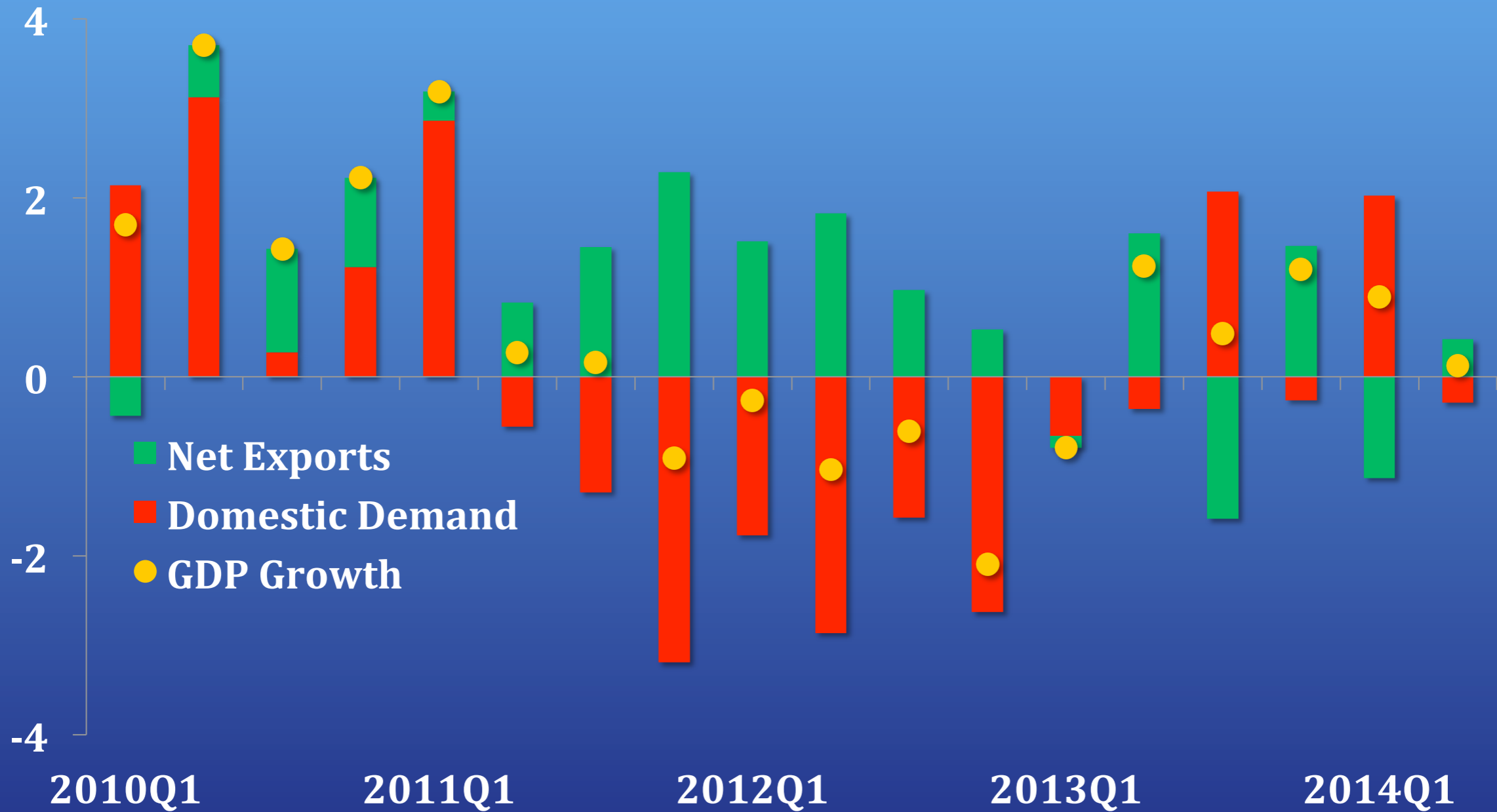
At EU level:

- Firewall against market turmoil
- Accommodative monetary stance
- Comprehensive assessment of large banks
- Progress toward banking union
- Refinements to fiscal governance



# A fragile recovery

Euro Area: GDP Growth and Contributions  
(annualized Q/Q)

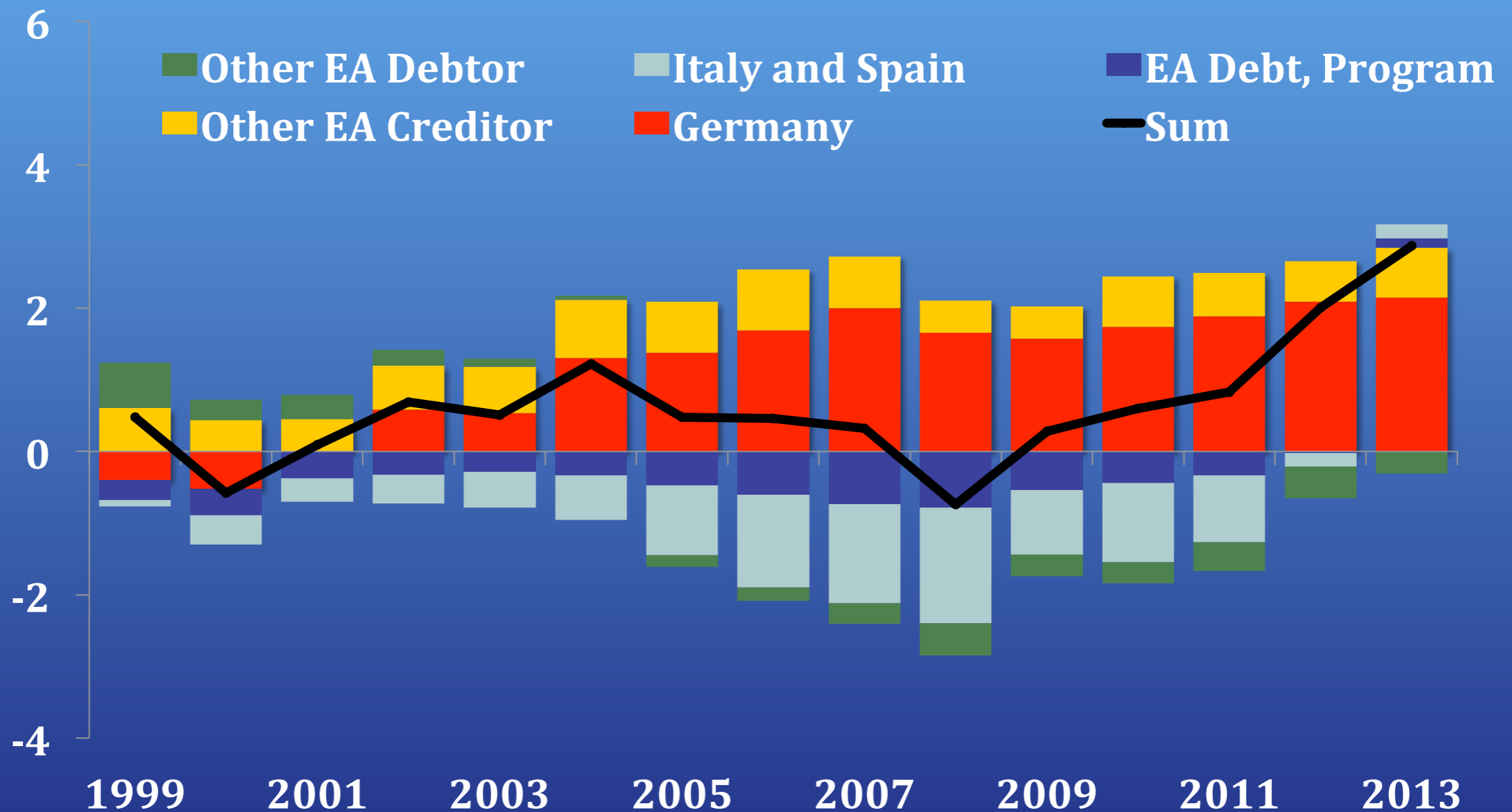


Source: Haver Analytics, Eurostat and IMF staff calculations.

A weak and fragile recovery

# An unbalanced rebalancing

Regional composition of the euro area current account  
(percent of euro area GDP)

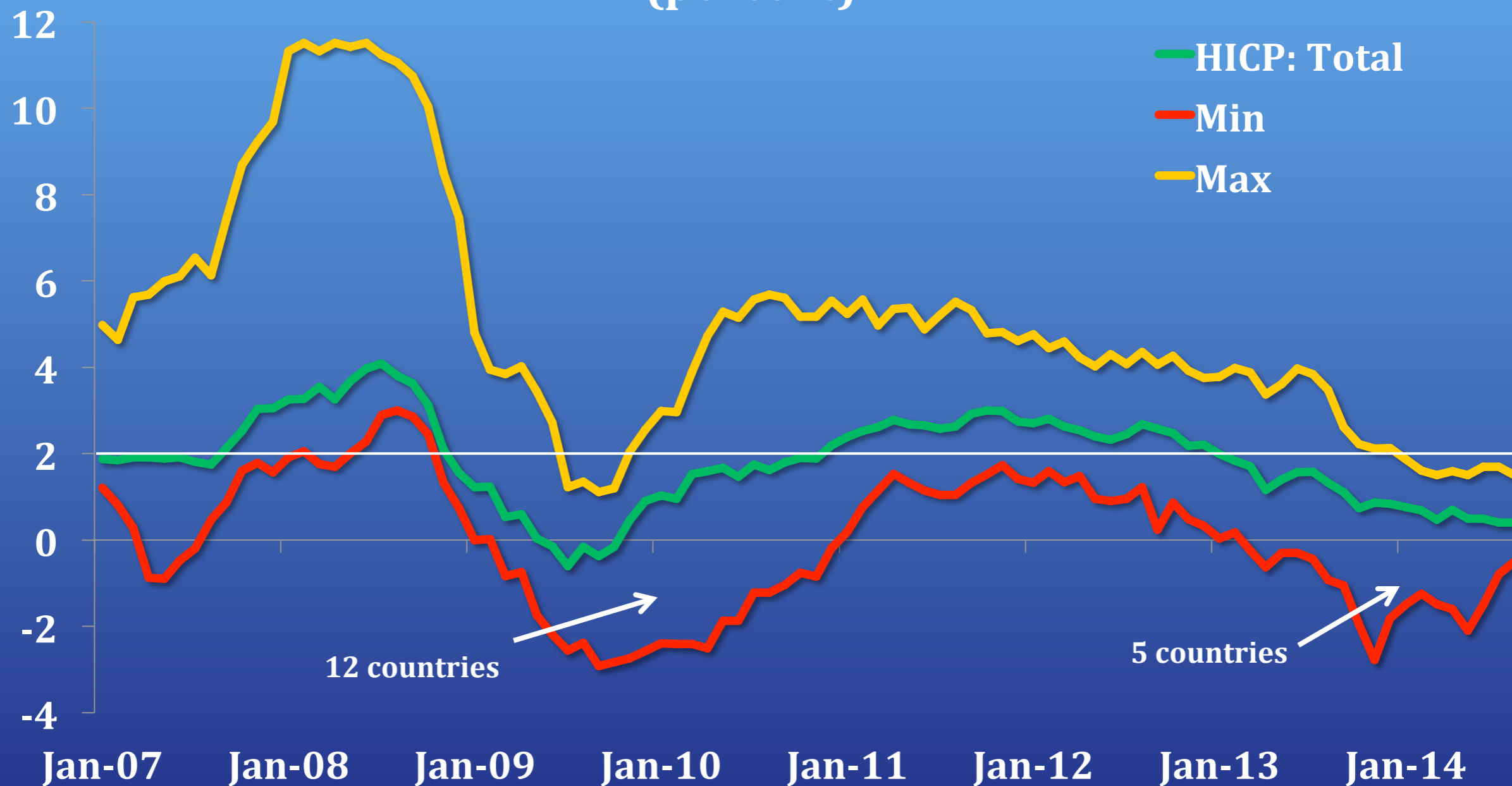


Source: IMF WEO and IMF staff calculations.

A weak and fragile recovery

# Inflation is worryingly low

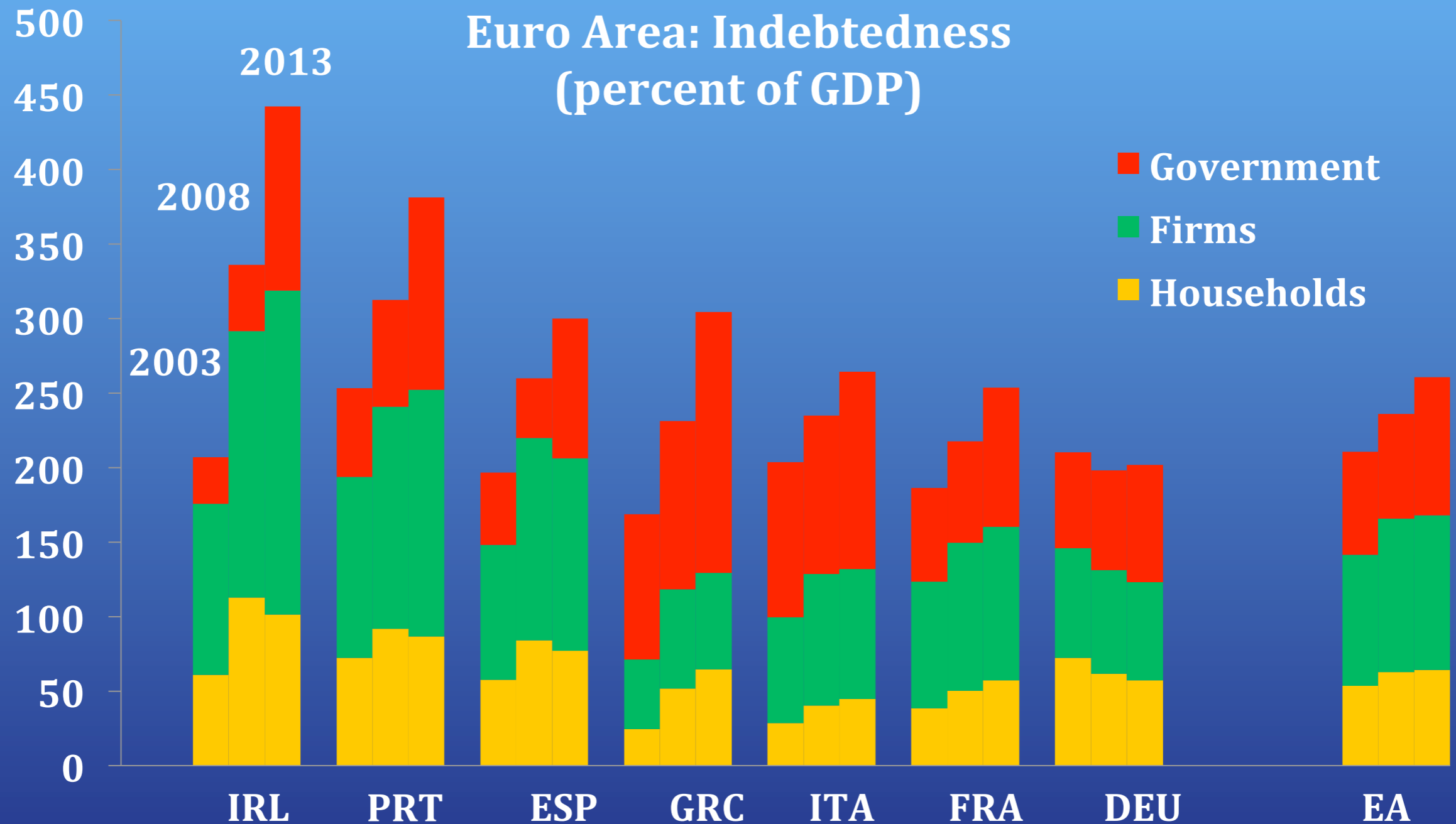
## Euro Area: Annual Inflation (percent)



Source: Eurostat and IMF staff calculations.

A weak and fragile recovery

# Medium-term risk: high debt—low growth trap?

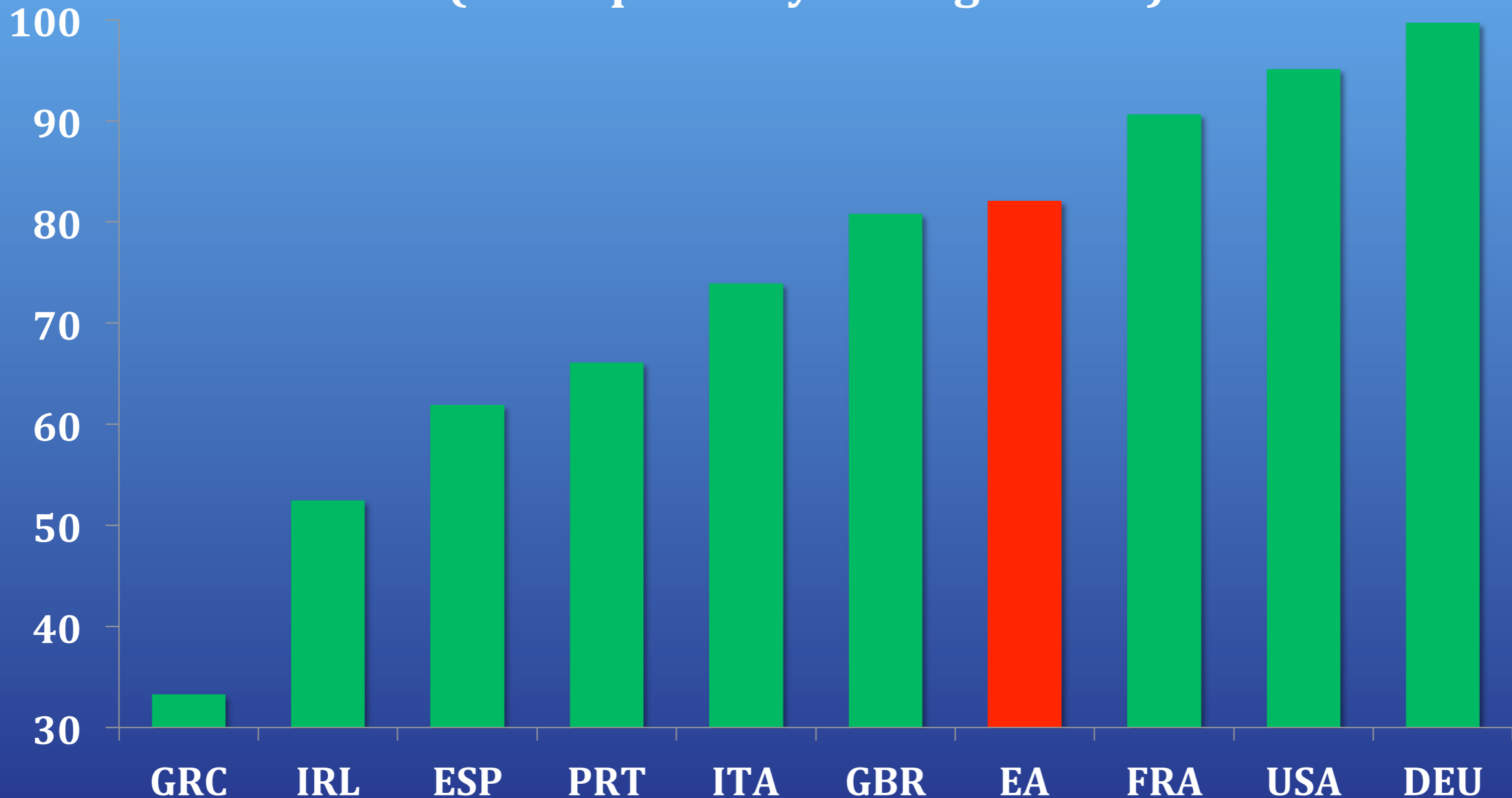


Source: Eurostat, ECB and IMF staff calculations.

## High debt—low growth trap?

# Low investment, low potential growth

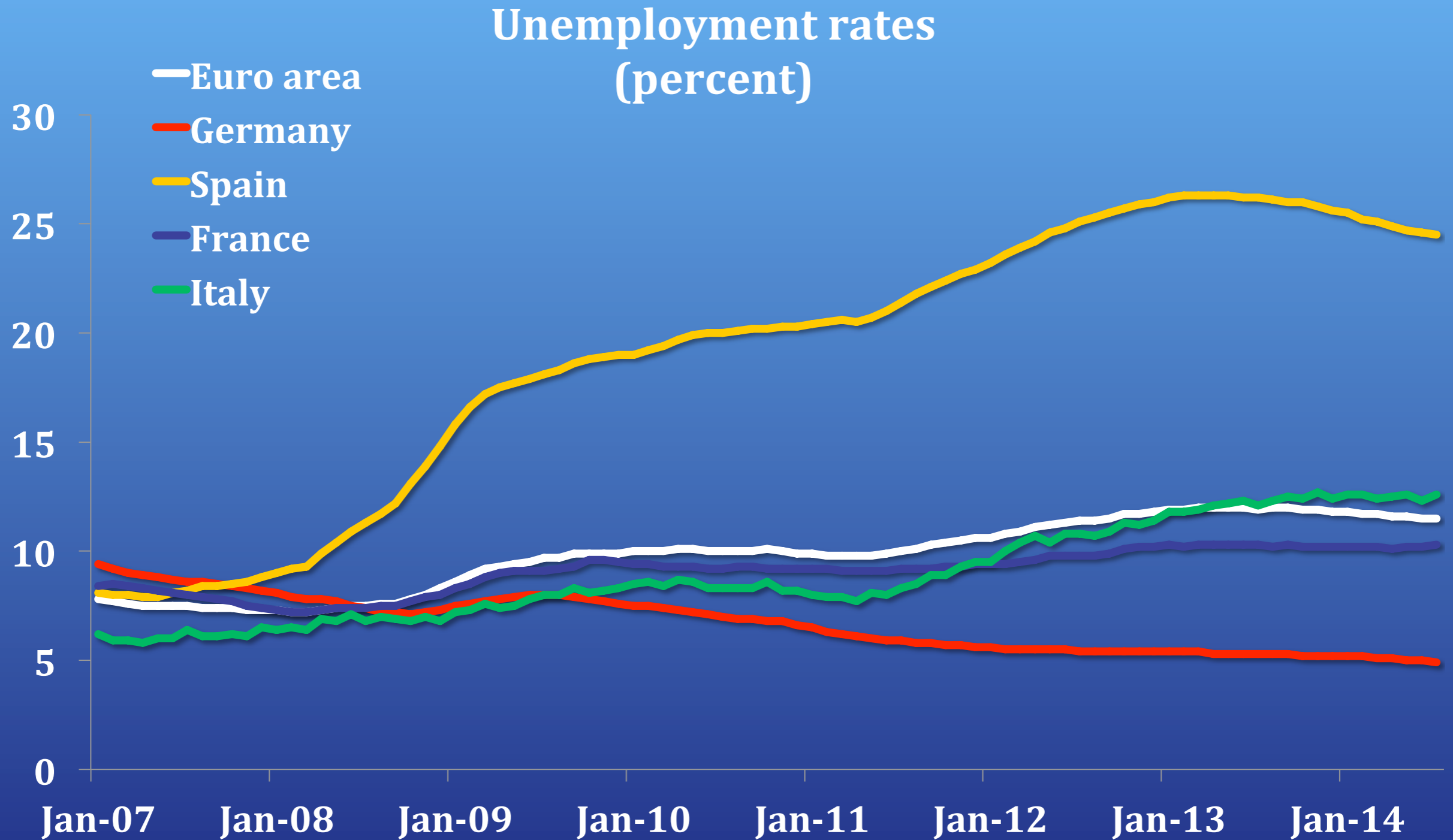
Euro Area: Investment Recovery to Date  
(2007 quarterly average = 100)



Source: World Economic Outlook and IMF staff calculations.

High debt—low growth trap?

# High unemployment, low potential growth



Source: Eurostat and IMF staff calculations.

High debt—low growth trap?

# Addressing risk of low growth, high debt

- Monetary policy: ECB has taken action, willing to do more if needed
- Mending balance sheets: Comprehensive Assessment and completing Banking Union
- Fiscal policy: allow automatic stabilizers to operate, use flexibility incorporated in fiscal framework

Policy agenda: Supporting demand, mending balance sheets

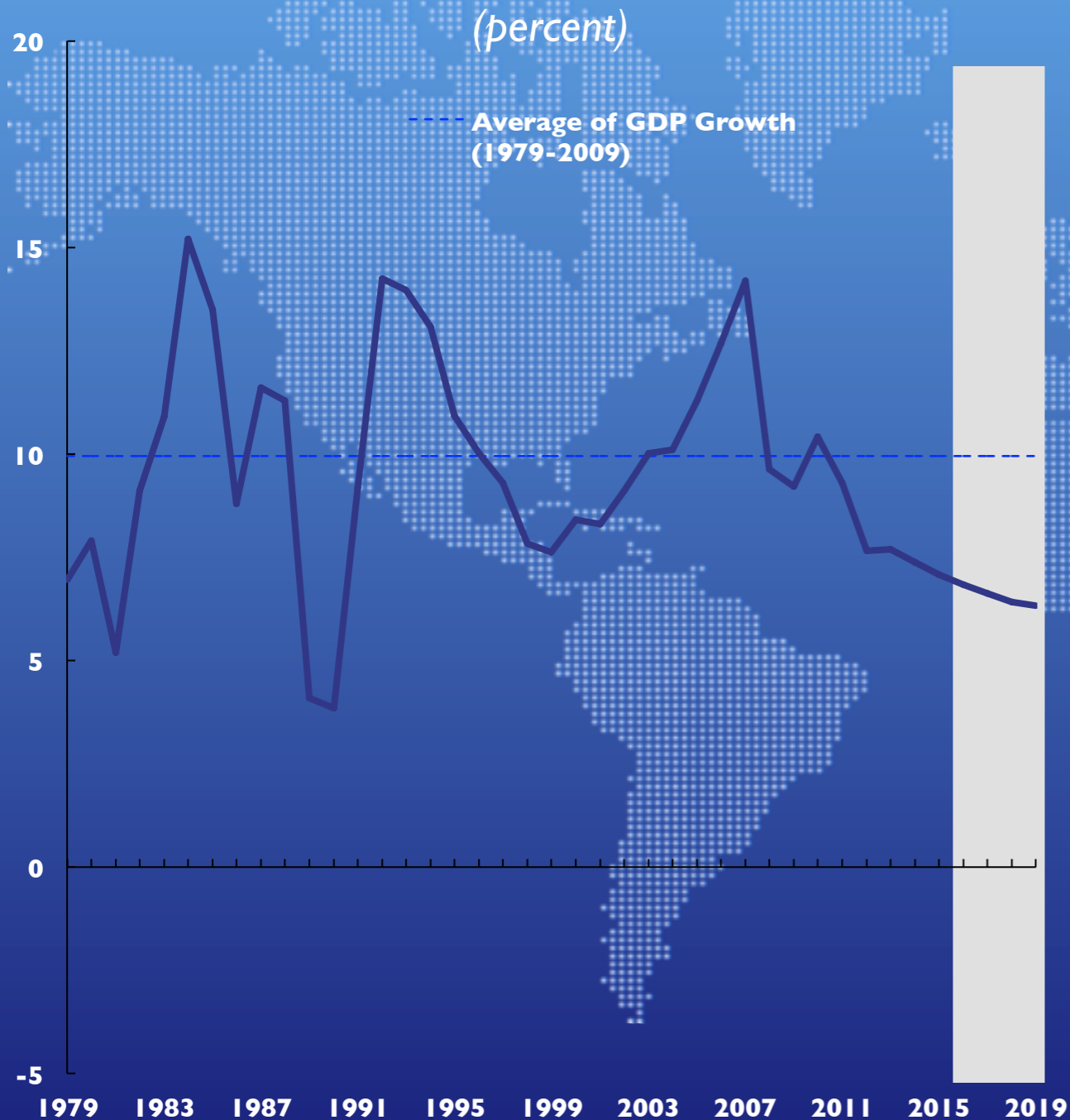
The image features a blue background with a dotted world map. A central teal band contains the text "Thank you" in a bold, black, sans-serif font. The map is composed of small white dots forming the outlines of continents. The teal band is a solid, medium-width horizontal strip.

**Thank you**

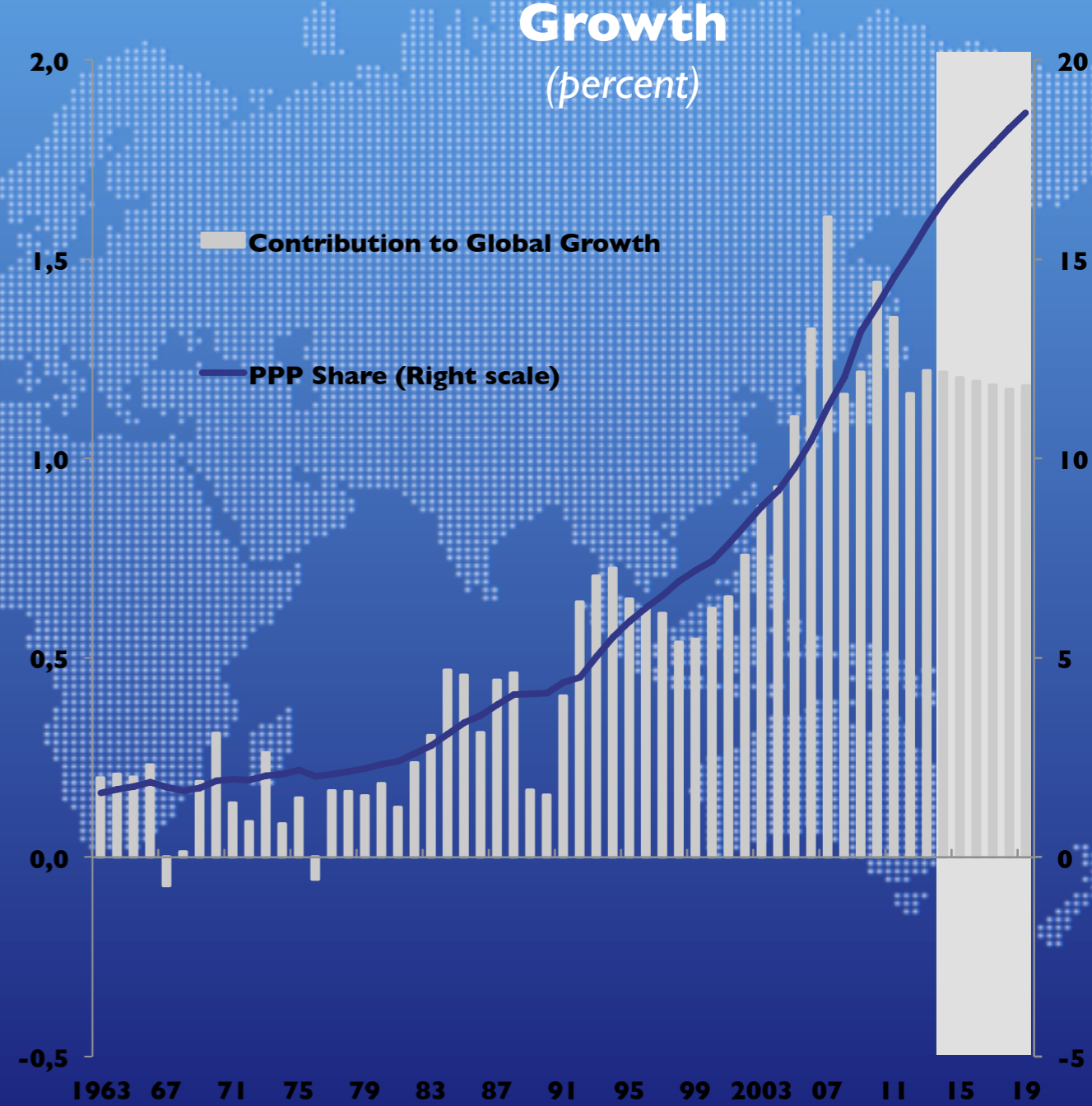


# Growth in China expected to moderate, but contribution to global growth remains broadly unchanged. A hard landing would have a major commodity market impact

## China GDP Growth



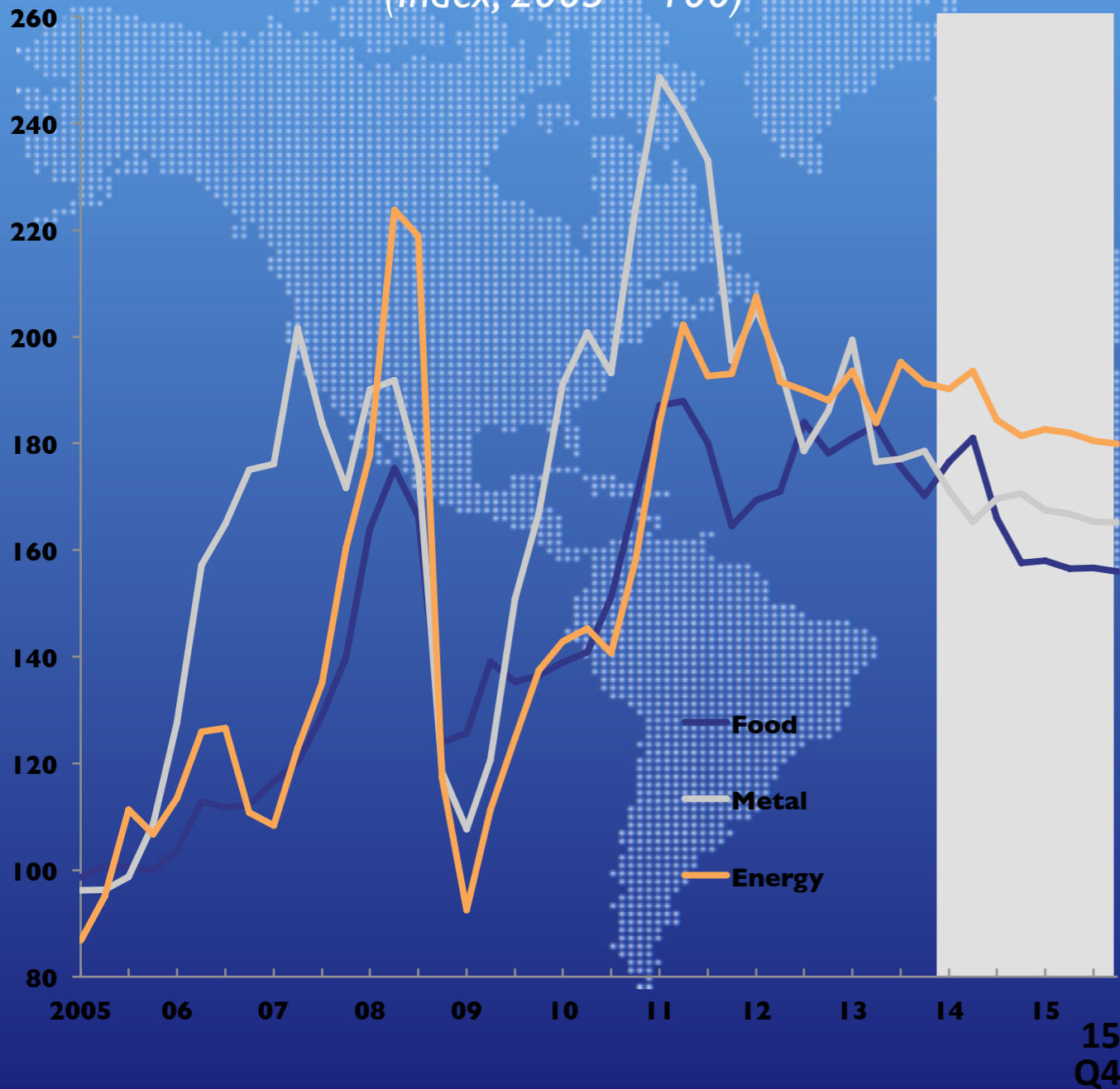
## China Contribution to Global GDP Growth



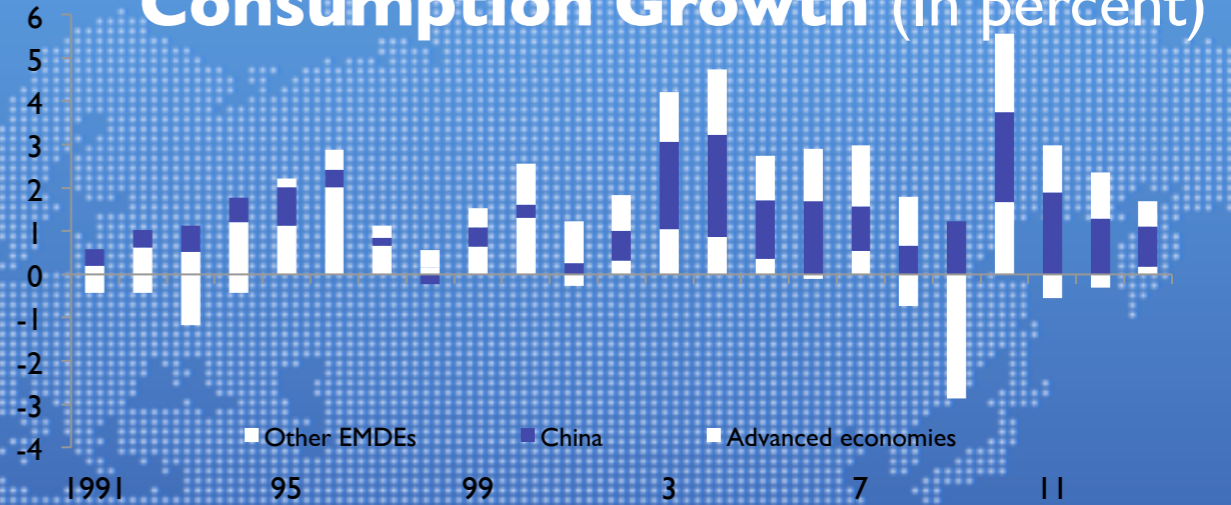
# Downside risks to commodity prices from weak demand and supply response to high prices in the past

## Commodity Prices

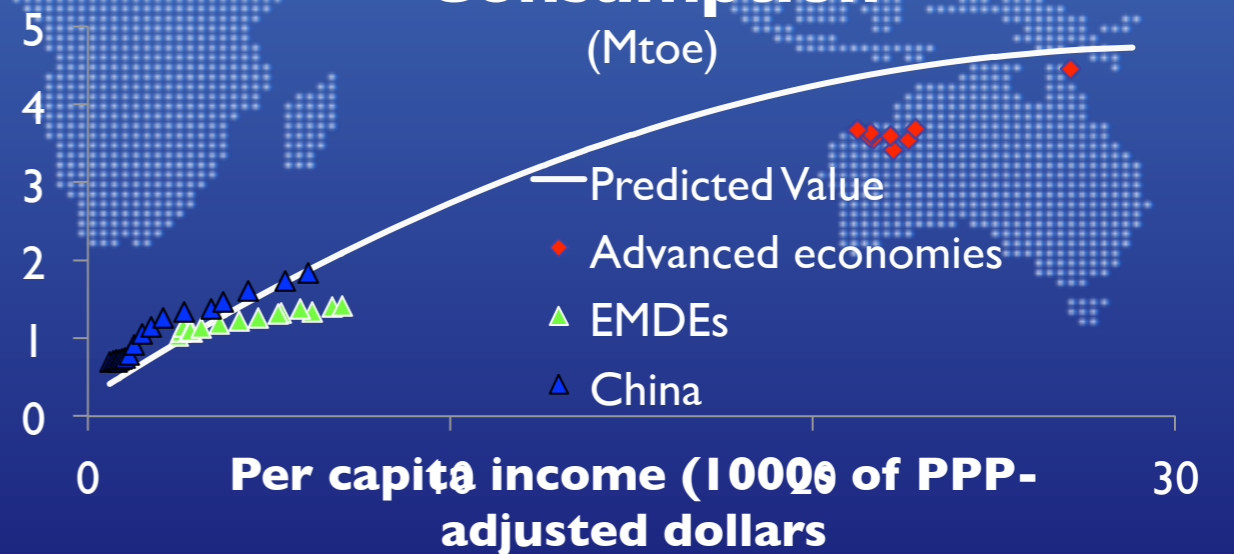
(Index; 2005 = 100)



## Primary Energy Consumption: Contribution to World Consumption Growth (In percent)



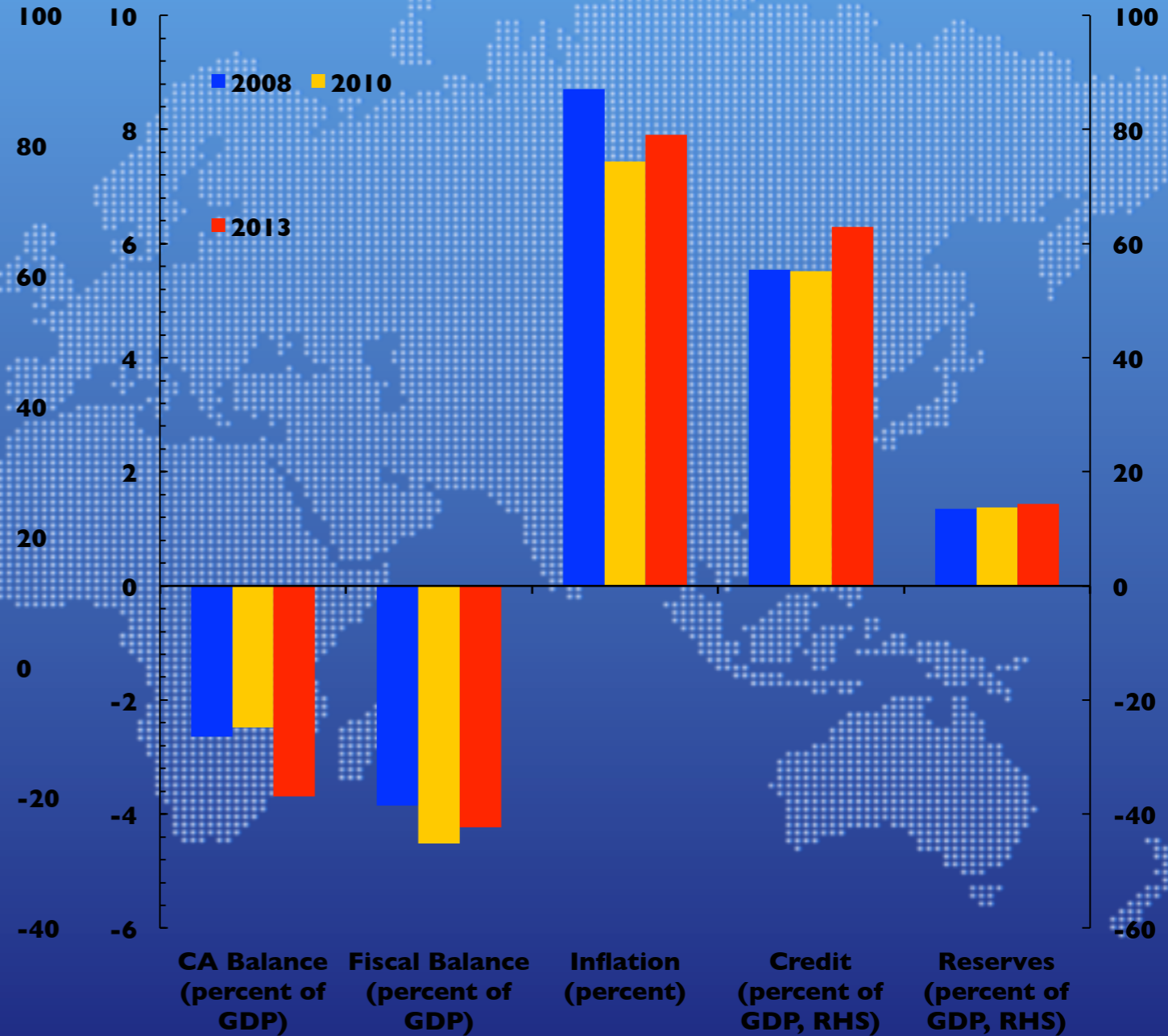
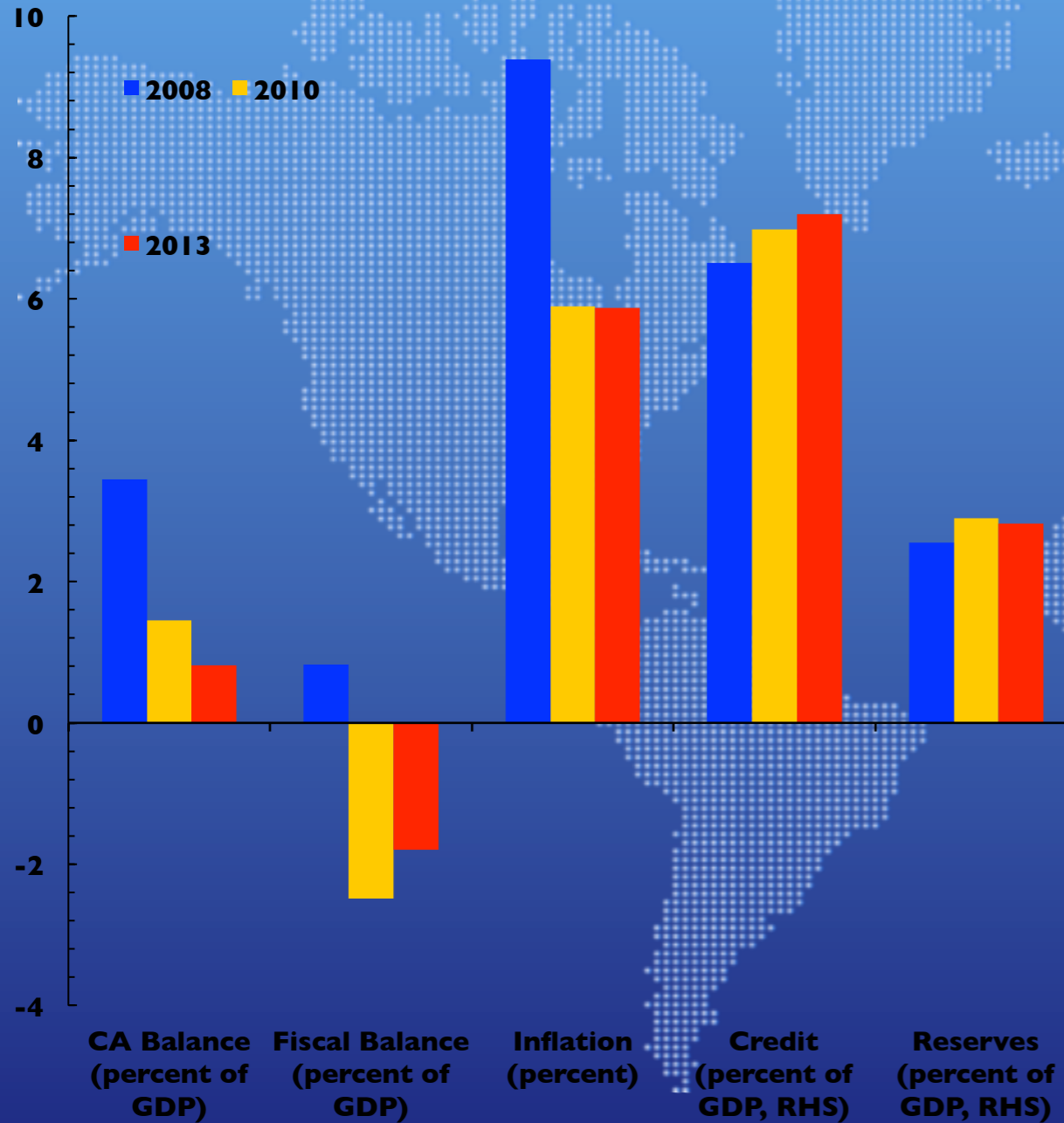
## Actual and Predicted Energy Consumption



# In some EMs current account and fiscal balances have weakened. But vulnerabilities appear manageable in general

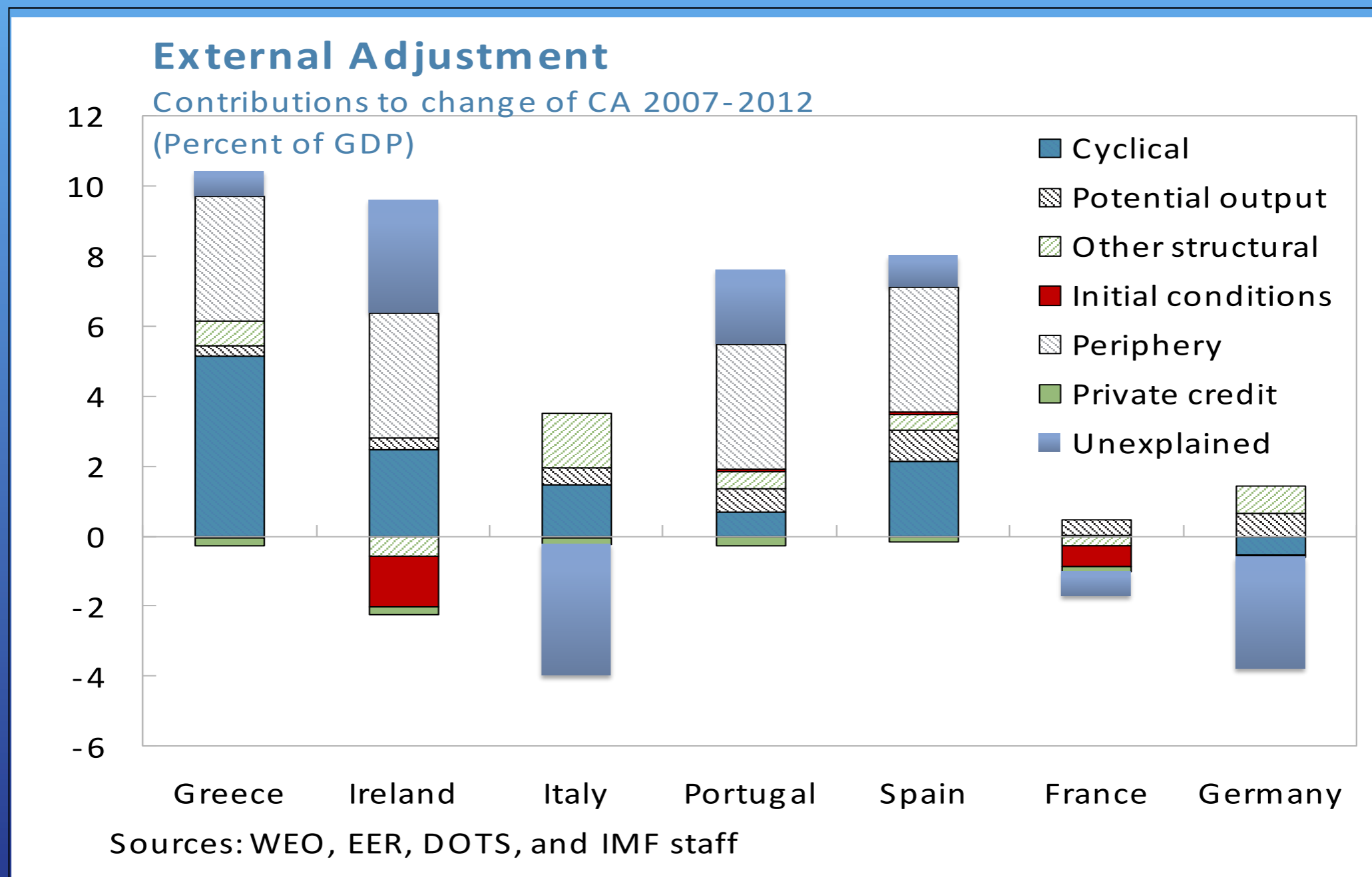
## All EMs

## Some Major EMs I/



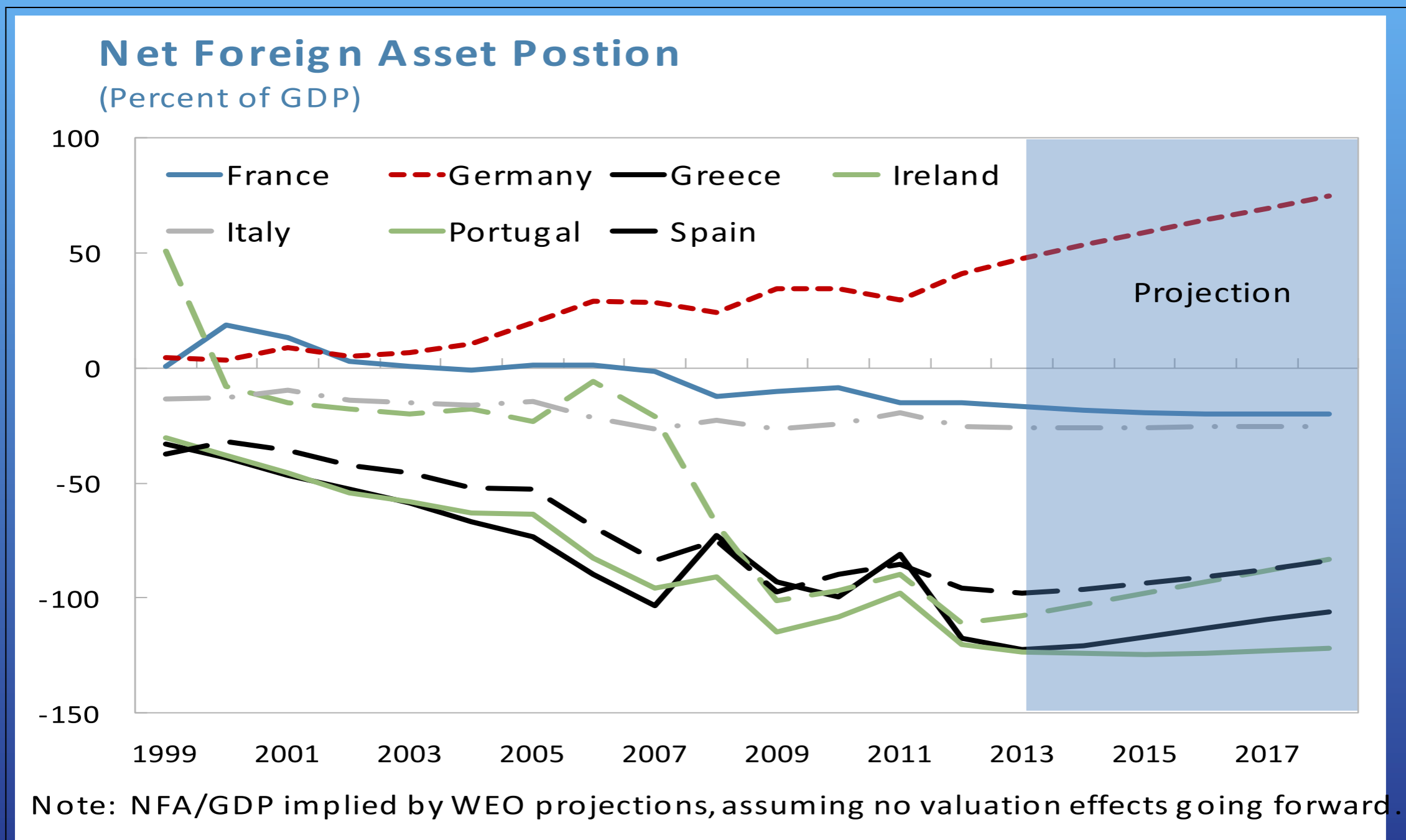
I/ Brazil, Indonesia, India, Turkey, and South Africa.

# Explaining the current account reversal



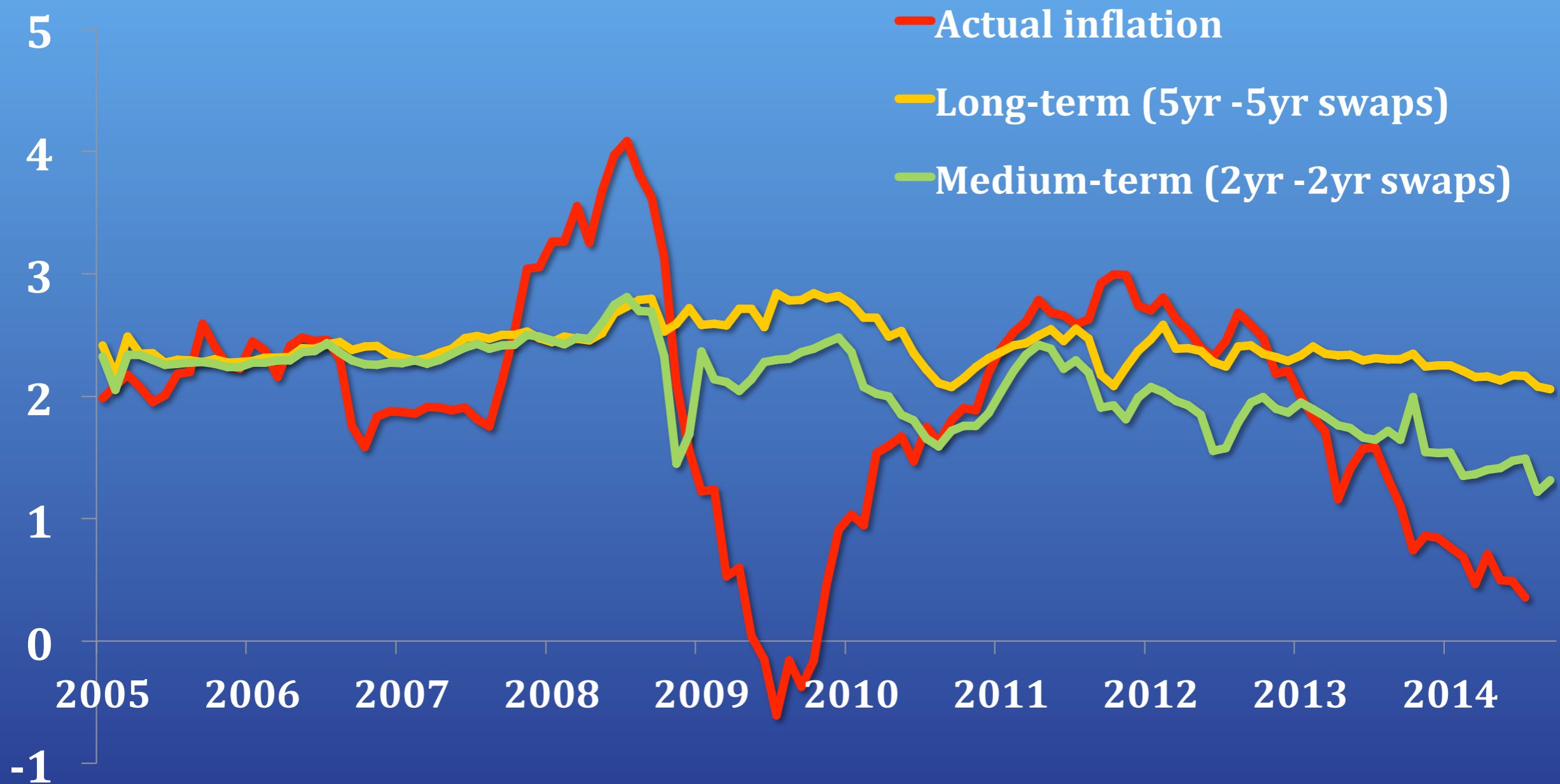
The policy agenda: rebalancing and growth policies

# How much rebalancing is needed?



The policy agenda: rebalancing and growth policies

# Addressing risk of “lowflation”

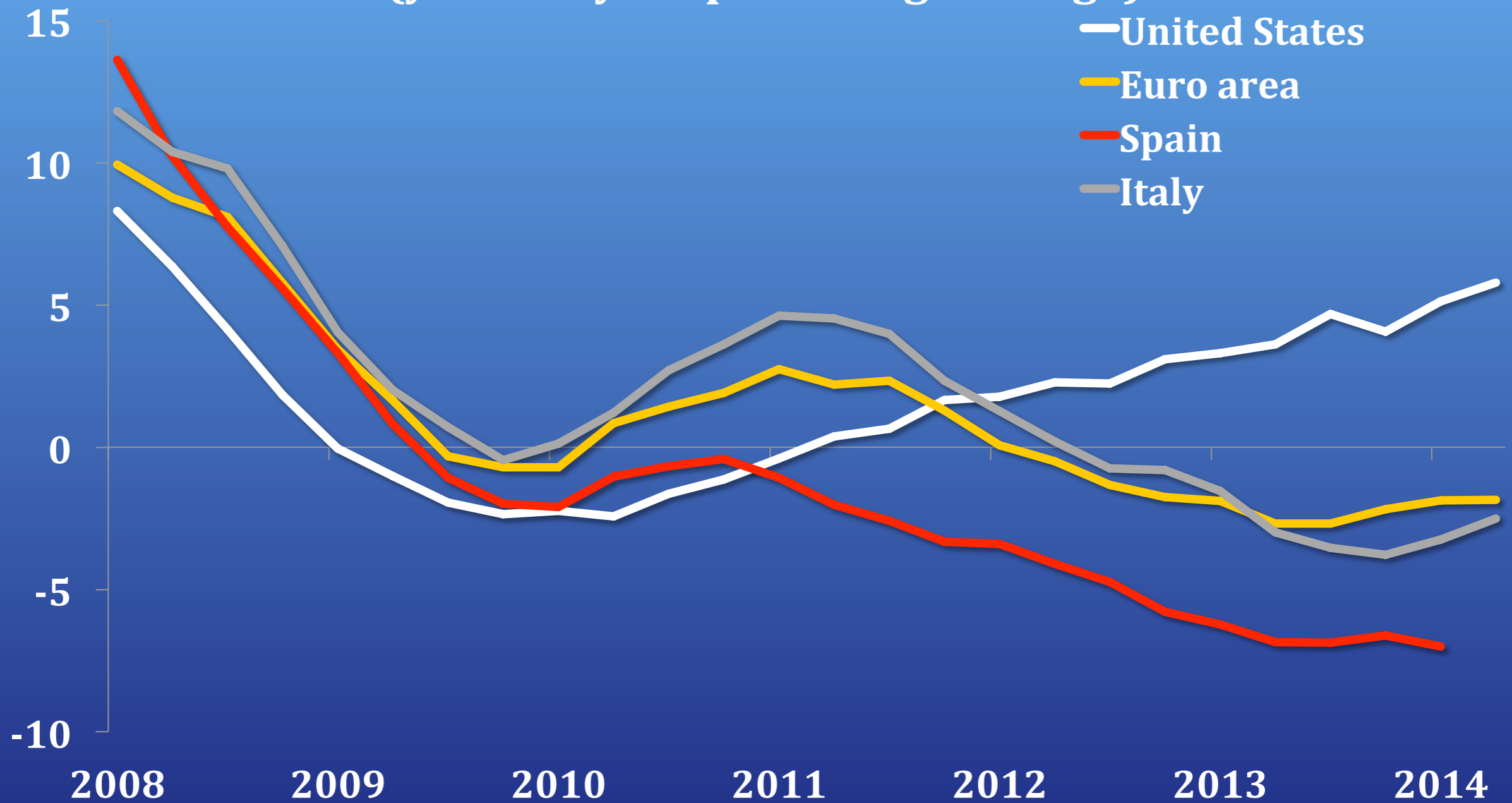


Sources: Haver Analytics, Bloomberg and IMF staff calculations.

Policy agenda: Supporting demand, mending balance sheets

# Mending balance sheets, restoring credit growth

## Non-Financial Firms and Households Credit Growth (year-on-year percentage change)

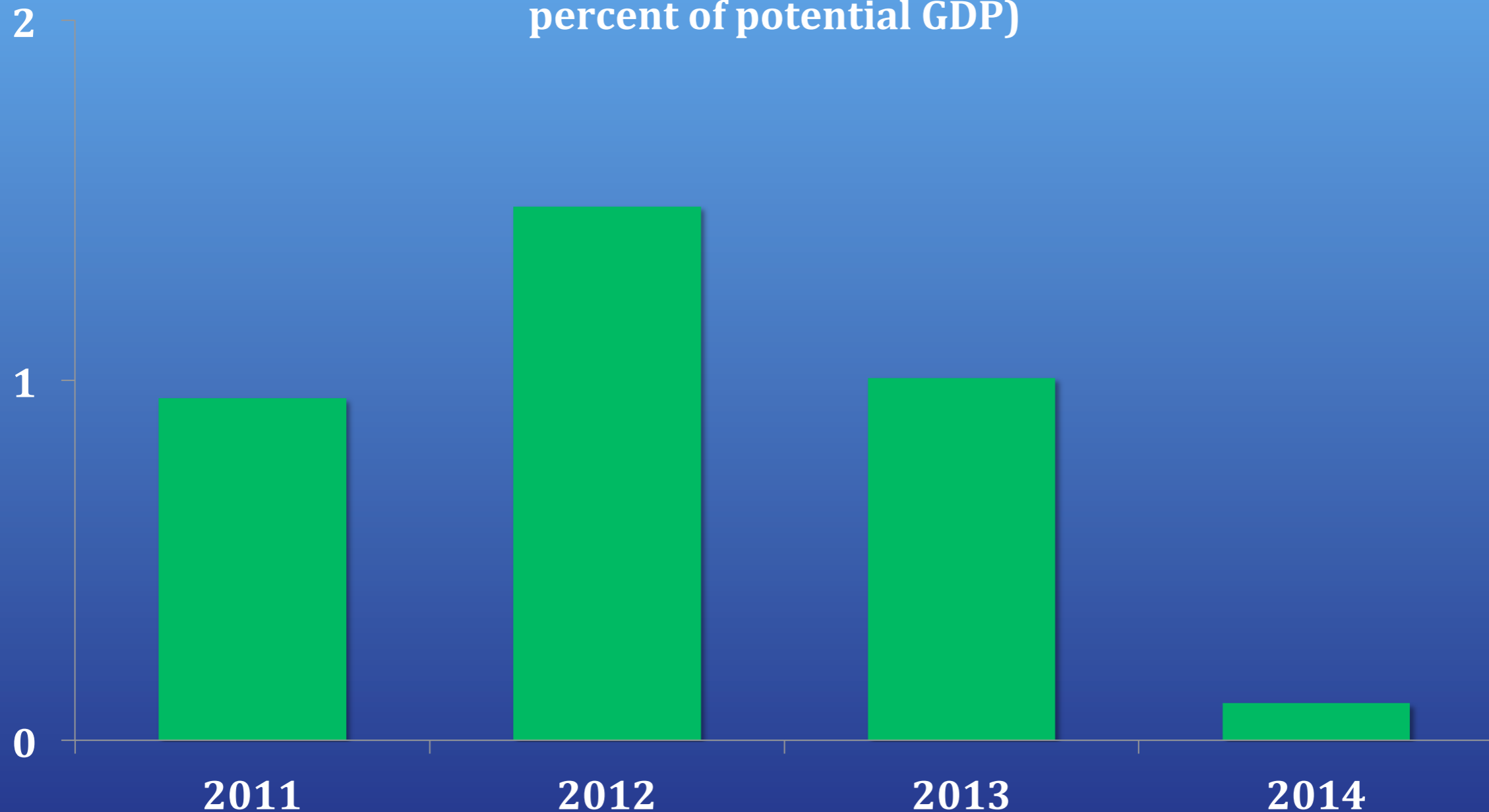


Source: World Economic Outlook and IMF staff calculations.

Policy agenda: Supporting demand, mending balance sheets

# Avoid additional fiscal drag

**Euro Area: Fiscal consolidation**  
(change in general government structural balance,  
percent of potential GDP)

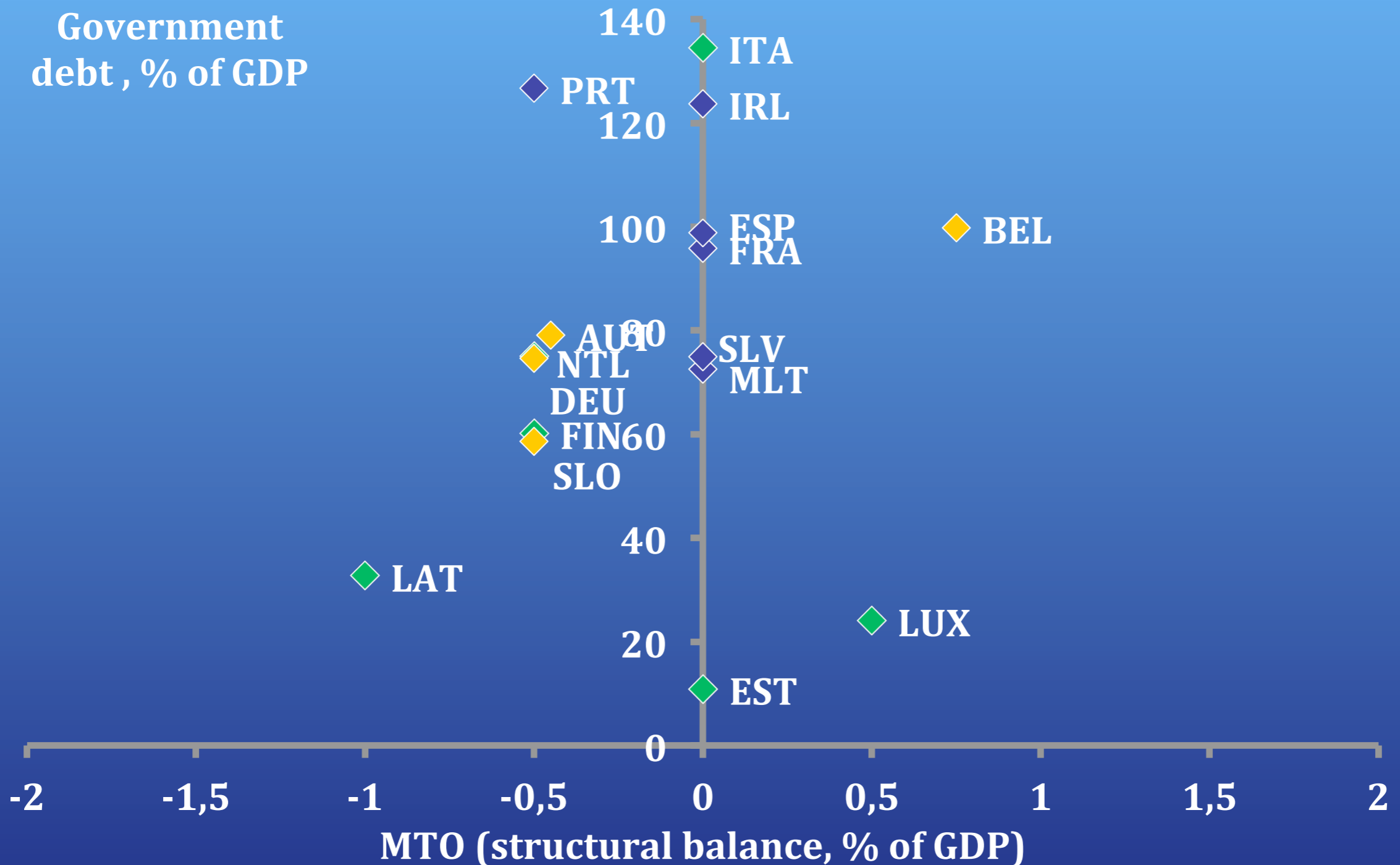


Source: IMF WEO and IMF staff calculations.

Policy agenda: Supporting demand, mending balance sheets



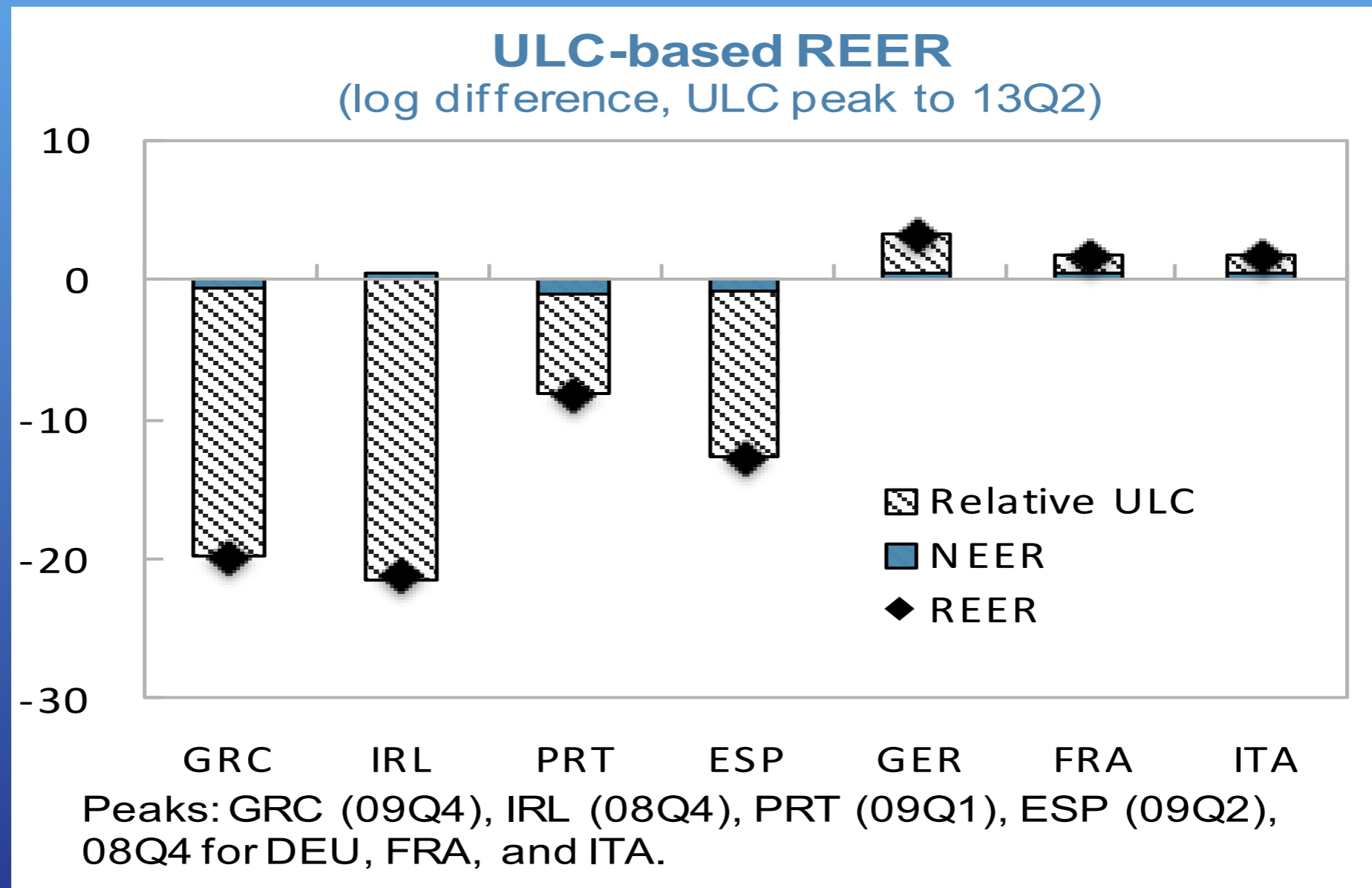
# Simplifying and strengthening fiscal governance



Sources: European Commission and IMF staff calculations.

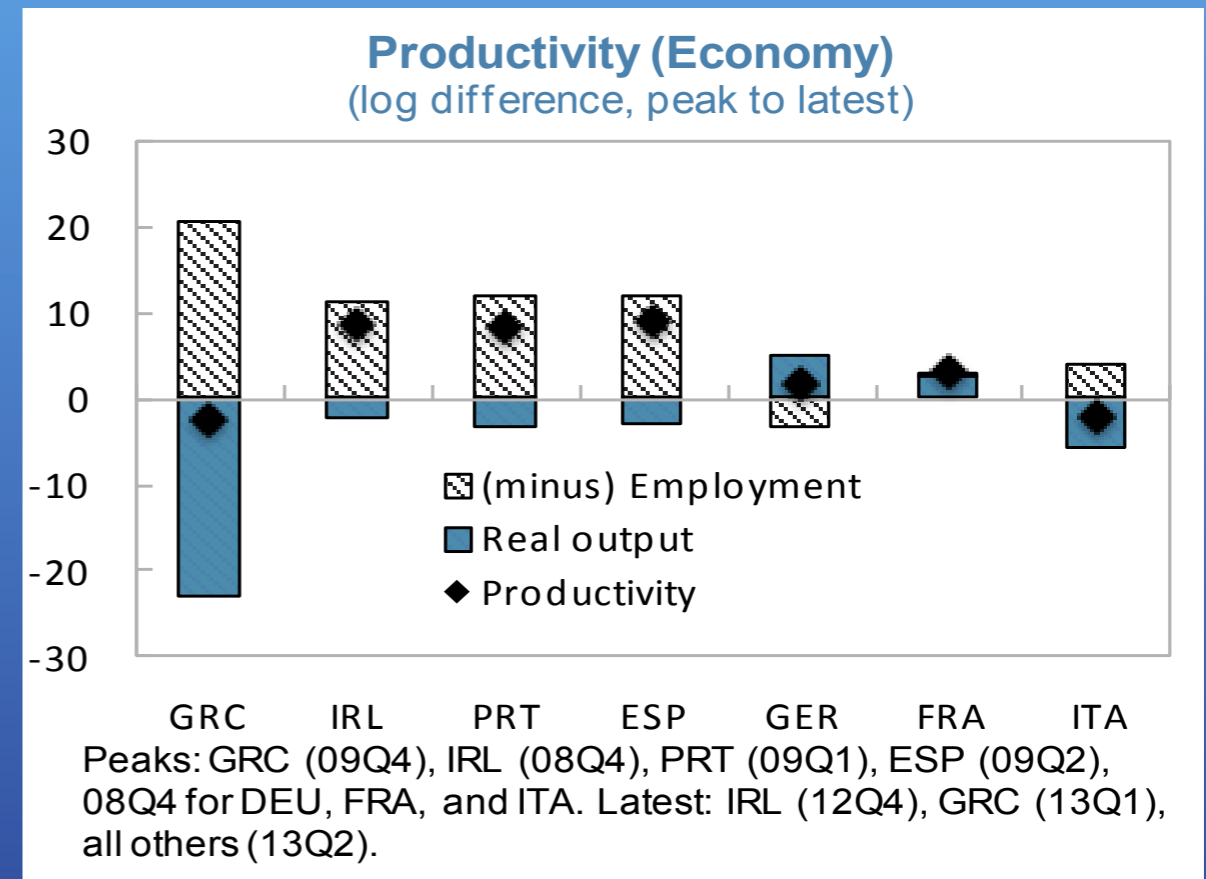
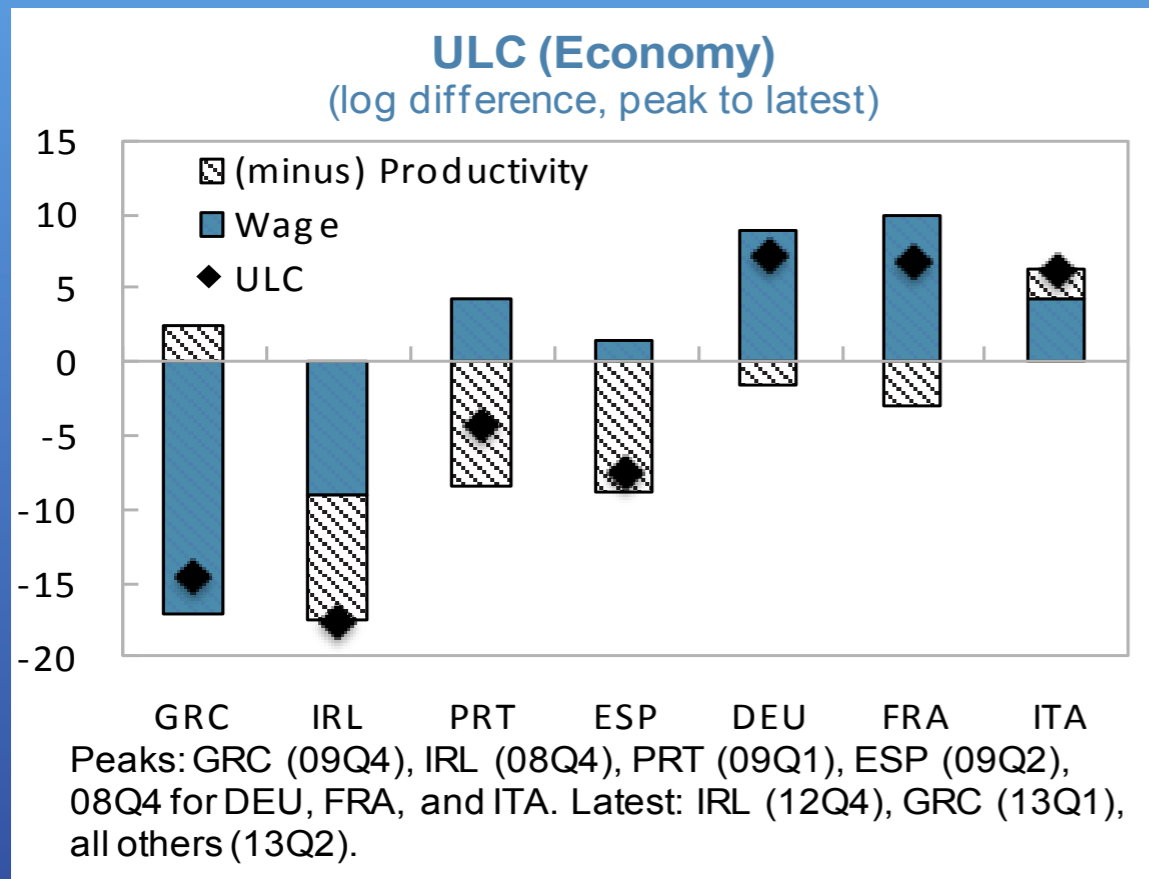
The policy agenda: supporting demand

# Relative price adjustments in deficit countries



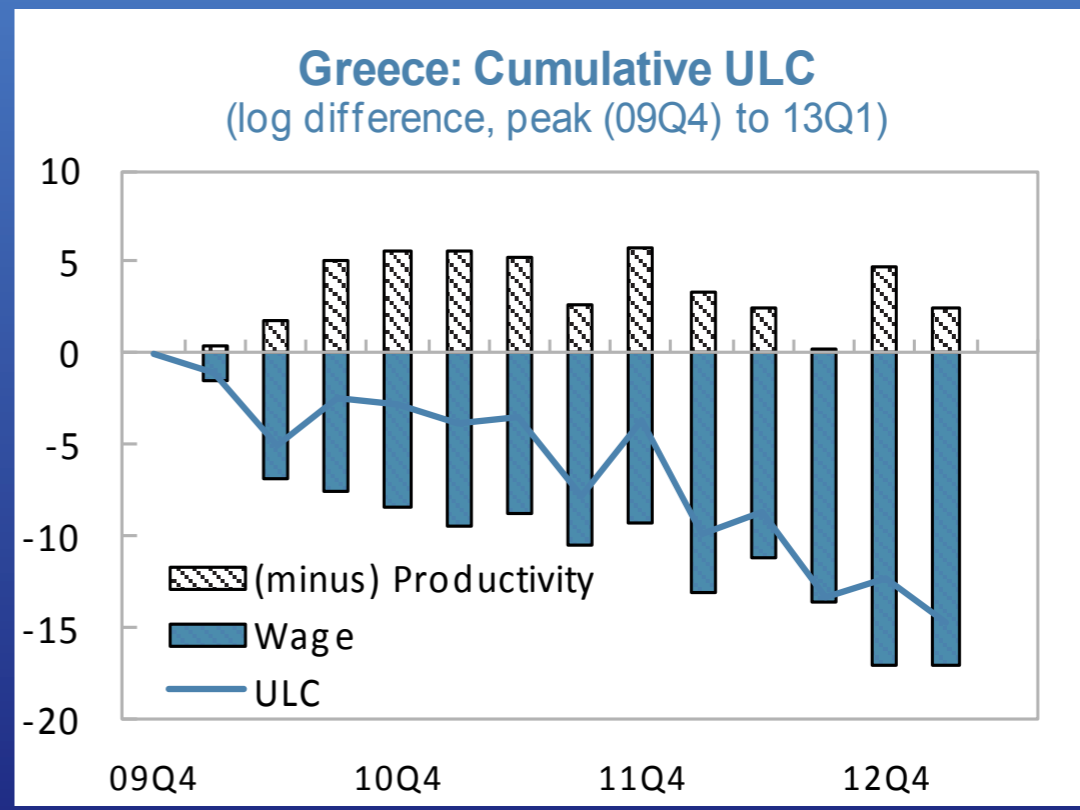
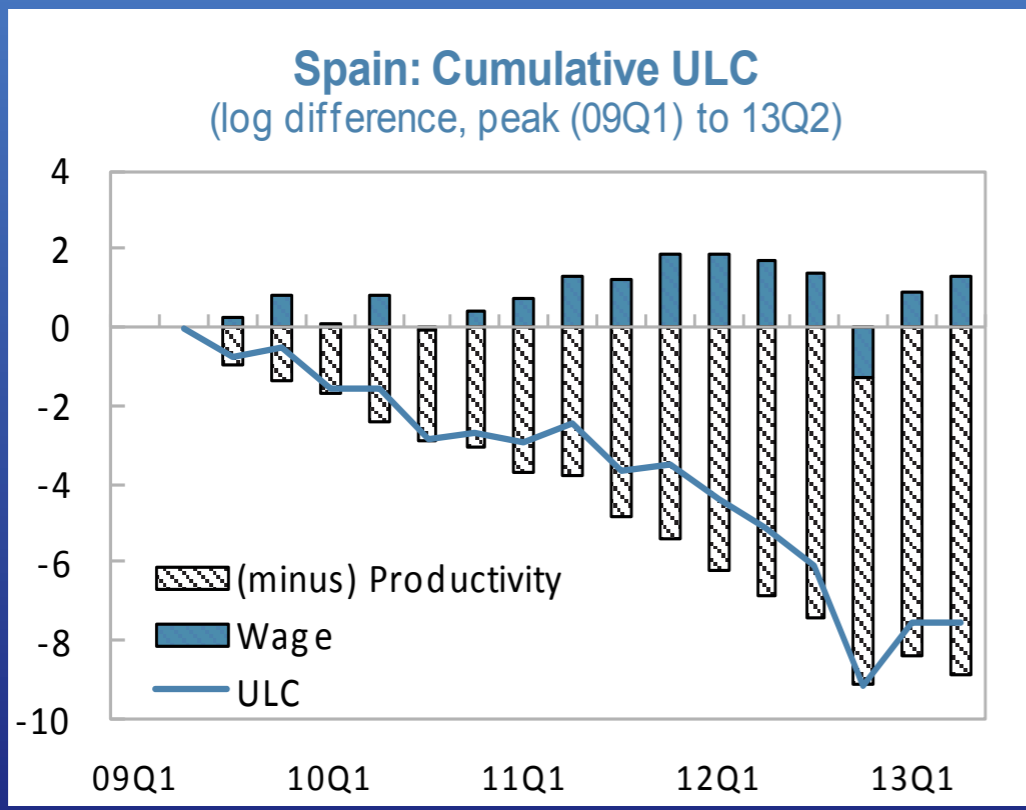
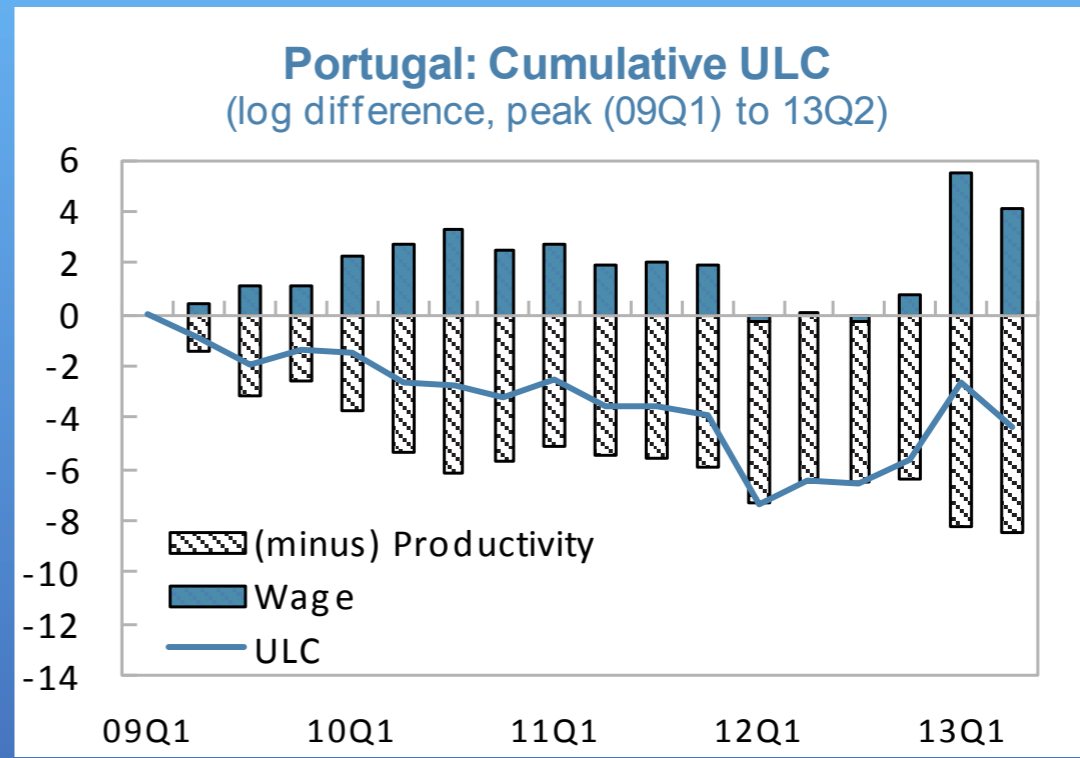
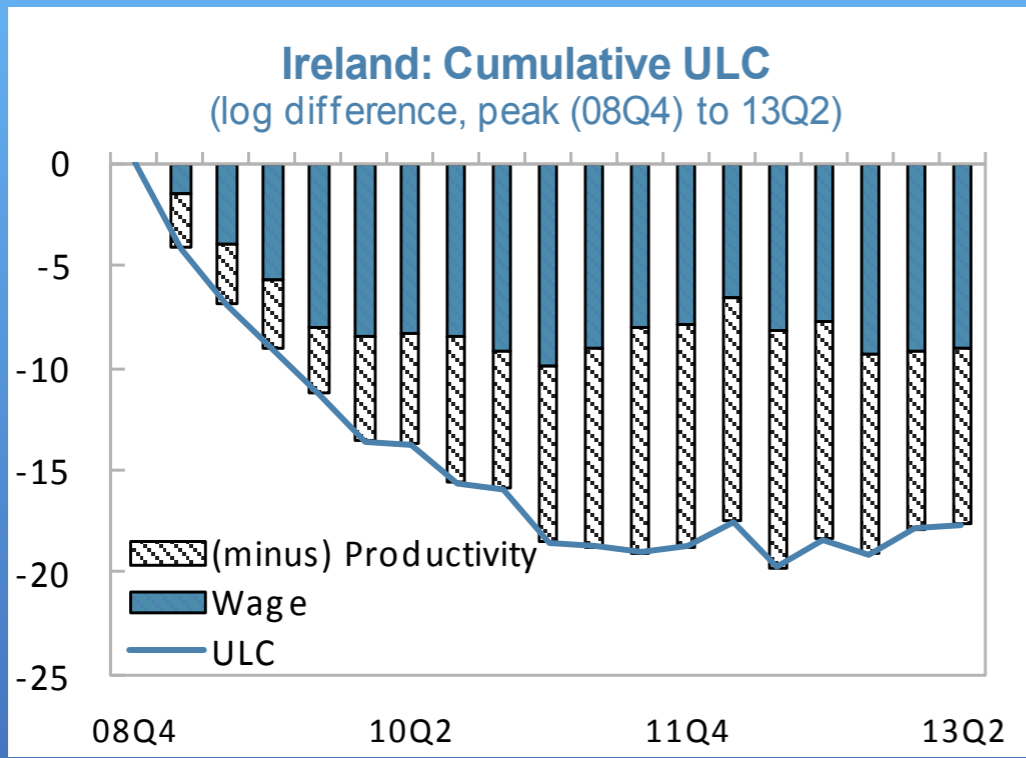
The policy agenda: rebalancing and growth policies

# But decline in unit labor cost reflects labor shedding



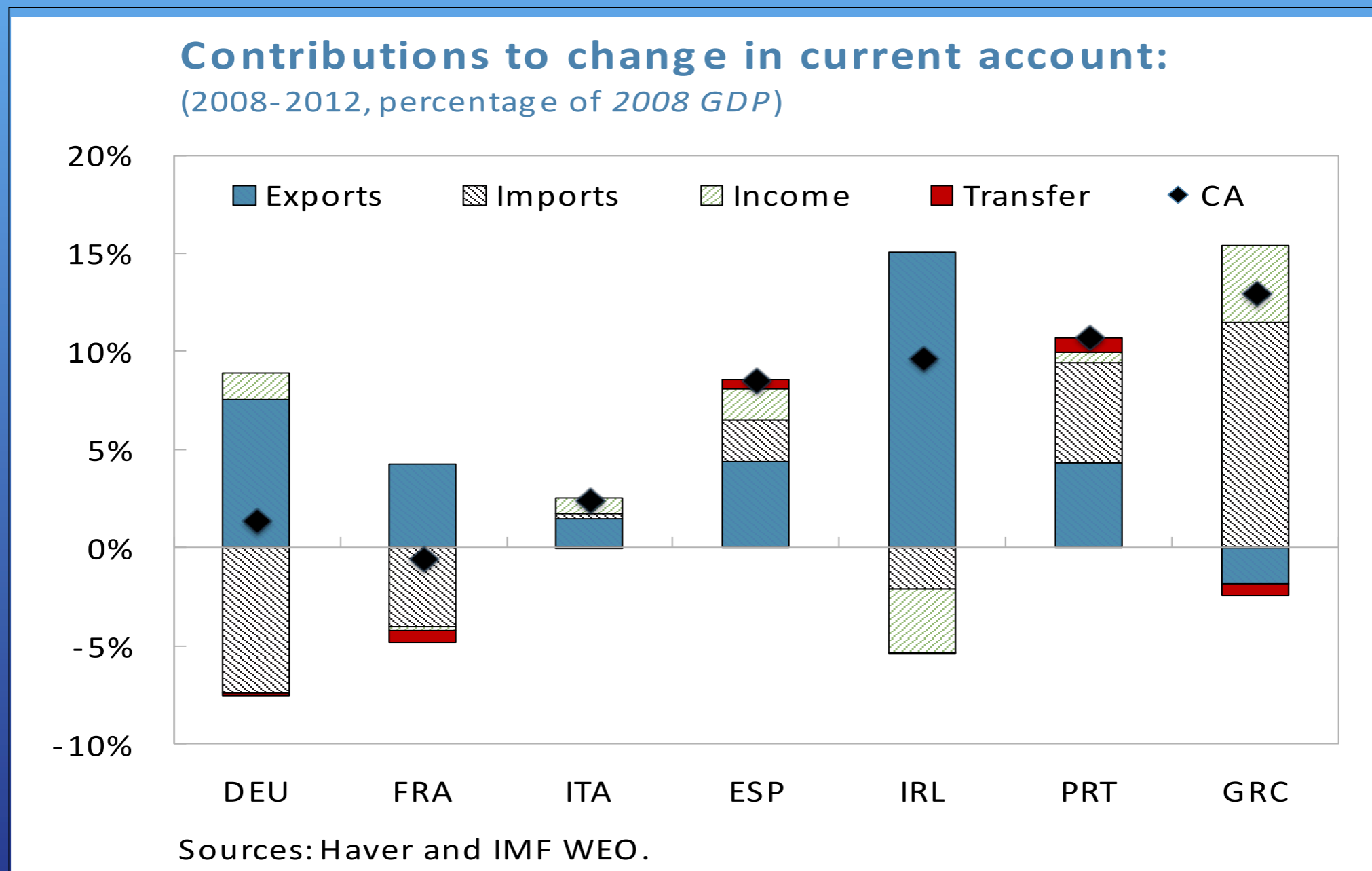
The policy agenda: rebalancing and growth policies

# A closer look



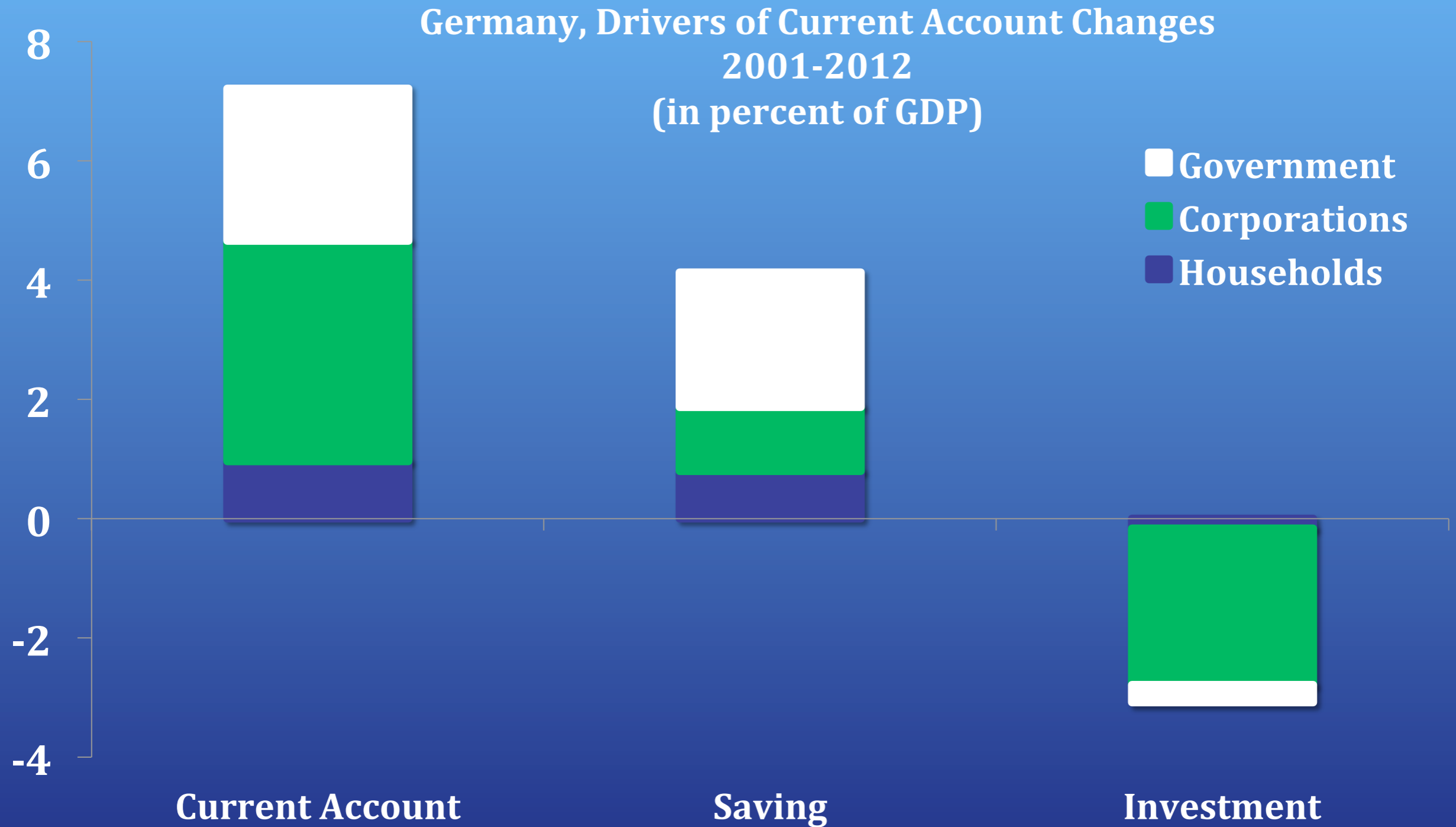
The policy agenda: rebalancing and growth policies

# Explaining the current account reversal



The policy agenda: rebalancing and growth policies

# German surplus reflects high savings, low investment

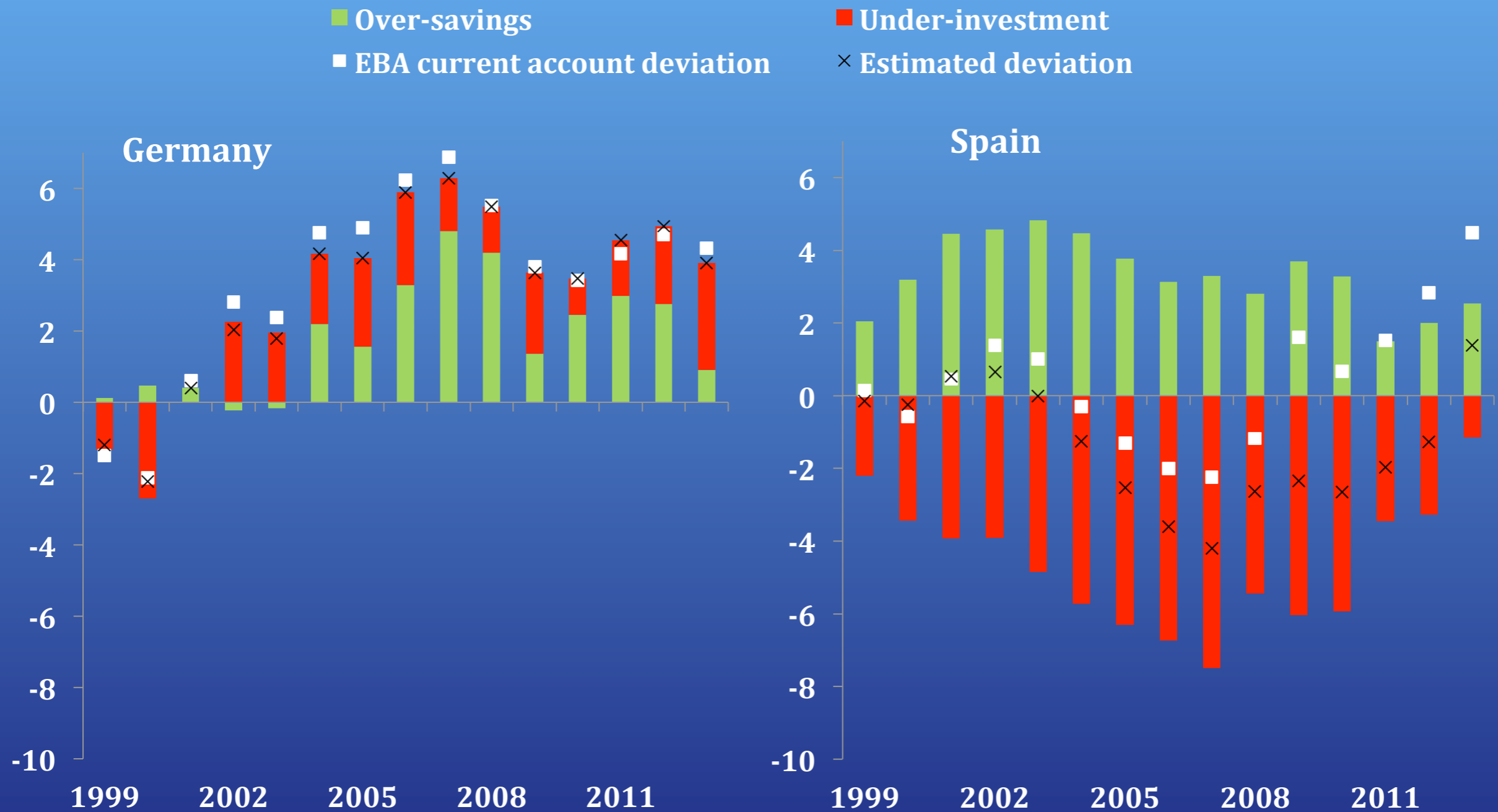


Sources: Eurostat and IMF staff calculations.

The policy agenda: rebalancing and growth policies

# Over-investment in Spain, under-investment in Germany

## Estimated current account imbalances (in percent of GDP)



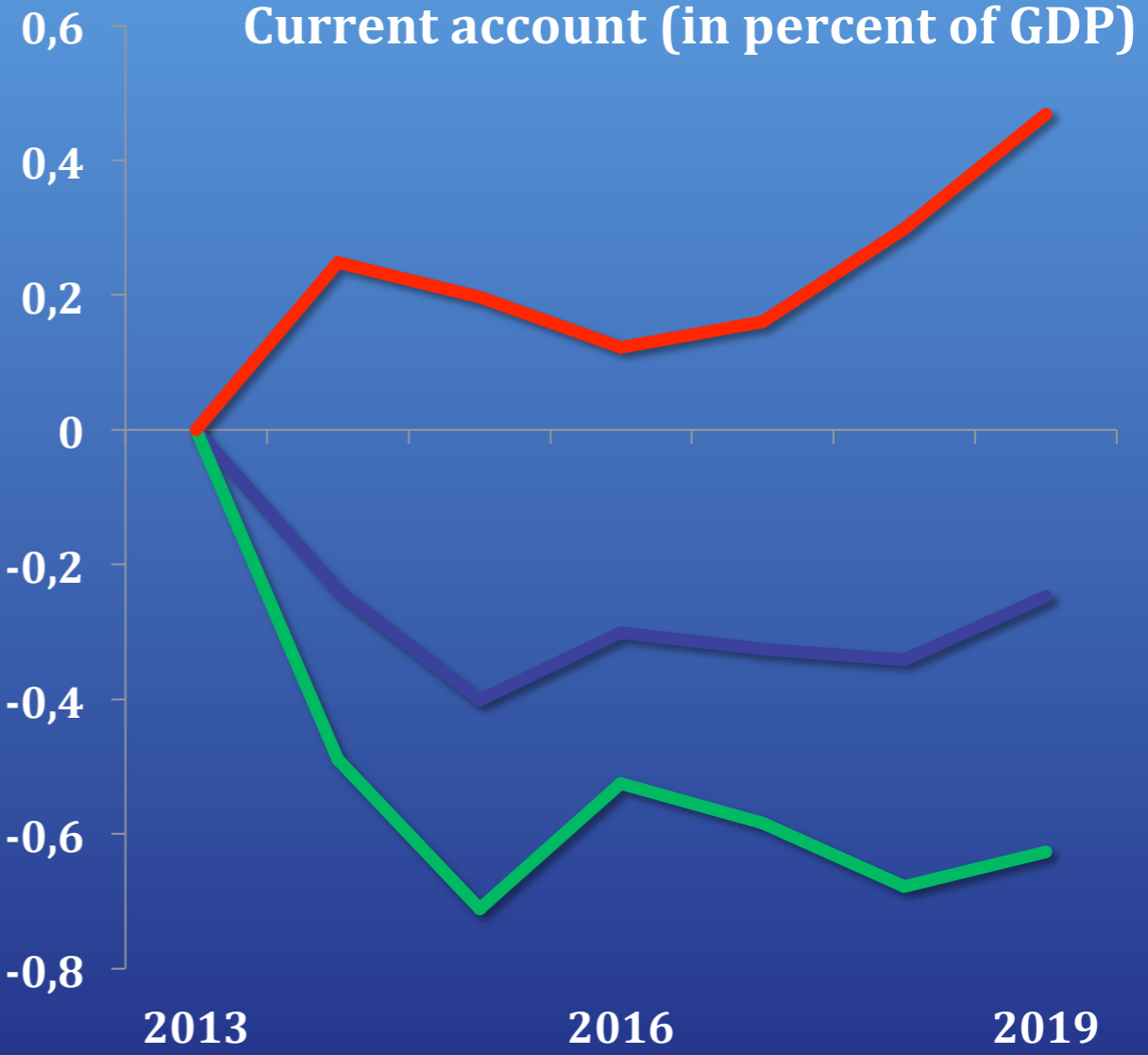
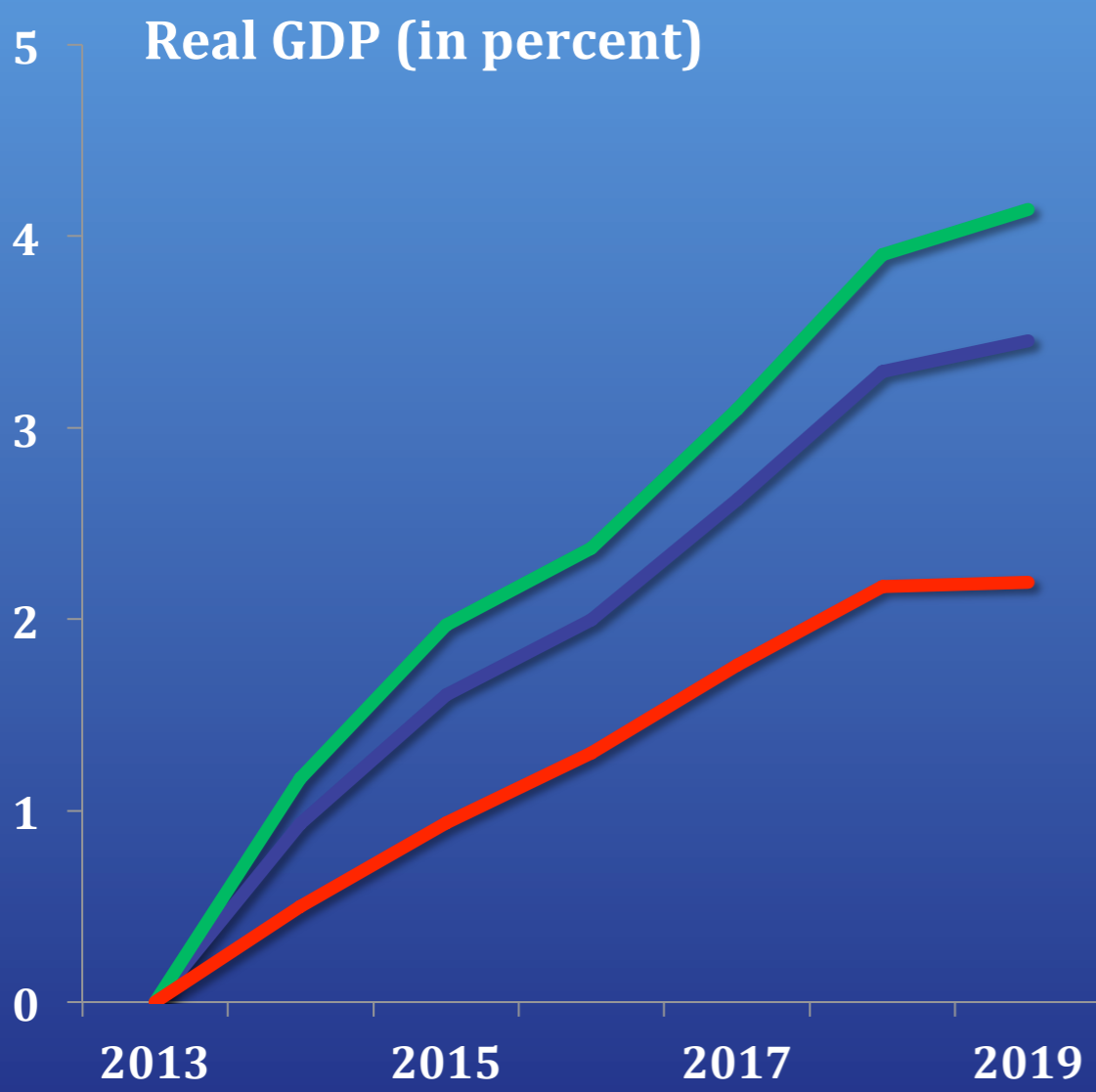
Sources: IMF External Balance Assessment and IMF staff calculations.

The policy agenda: rebalancing and growth policies

# Benefits from euro area rebalancing

## Deviation from baseline

— Euro Area    — Core EA Economies    — Stressed EA Economies



Sources: IMF staff calculations.

The policy agenda: rebalancing and growth policies



# Policies for rebalancing

Reduce excessive current account surpluses:

- Higher infrastructure investment
- Increase productivity and competition, in particular in service sectors

Enhancing competitiveness in deficit countries and Italy:

- Improve functioning of labor markets, remove downward rigidities
- Improve employment among the youth, including better ALMP
- Enhance competition in the product market, reduce costs in regulated network sectors
- Improve business environment and reduce red tape

Continued progress on Euro Area and EU policies:

- Complete the Banking Union, to help internal and external rebalancing
- Stronger governance framework (Macroeconomic Imbalance Procedure, European Semester and national reform agendas)
- Deepening capital markets

The policy agenda: rebalancing and growth policies