ANNEX

IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, SEPTEMBER 2013

The following remarks were made by the Acting Chair at the conclusion of the Executive Board's discussion of the World Economic Outlook, Global Financial Stability Report, *and* Fiscal Monitor *on September 23, 2013.*

Executive Directors broadly shared the staff's assessment of the state of the global economy and financial markets, risks, and key policy recommendations. They observed, in particular, that global growth remains subdued and that uncertainty and downside risks dominate the outlook. The recovery in the United States and Japan has gained ground and the euro area is pulling out of recession, while growth in many emerging market economies has slowed. Directors underscored that policymakers in all economies have a shared responsibility to sustain balanced growth while continuing to build resilience.

Directors stressed that changing growth dynamics, combined with the anticipation of the start of the normalization of U.S. monetary policy, pose new policy challenges, particularly in emerging market economies. Many of these countries have recently experienced increased capital outflows, currency depreciation, lower equity prices, and higher sovereign risk premiums. In addition, external financial conditions have generally tightened and the fiscal space has narrowed, while risks of interest rate and exchange rate overshooting have increased. In this regard, Directors took note of the U.S. Federal Reserve's guidance that monetary policy normalization will occur in the context of stronger U.S. growth and employment that, in turn, should be beneficial for global growth.

Directors noted that global growth is expected to improve modestly in the near term. Activity in advanced economies is accelerating as fiscal consolidation eases and monetary conditions remain accommodative. In the euro area, policy actions have reduced tail risks and stabilized financial markets, but growth remains fragile, given persistently high unemployment, financial fragmentation, and weak credit developments. Growth in emerging market economies, which continues to account for the bulk of global growth, remains driven by solid consumption and, in a historical perspective, still supportive fiscal, monetary, and financial conditions. However, lingering supply side bottlenecks in infrastructure, labor markets, and regulatory and financial systems could have lowered potential output for many of these economies. Growth in low-income countries remains robust, supported by enhanced policy frameworks, although less favorable commodity prices and external financing may weaken their fiscal positions.

Directors expressed concern that multiple vulnerabilities may have raised the risk of a prolonged period of lower global growth. They noted that important legacy risks are still present in advanced economies. These include unfinished financial sector reforms in the euro area, impaired monetary policy transmission and corporate debt overhang in some of its economies, and high levels of government debt and related fiscal and financial risks in many other advanced economies, including Japan and the United States.

Directors noted that downside risks to growth in emerging market economies have become more prominent, reflecting risks of further asset repricing in anticipation of the normalization of U.S. monetary policy as well as rising domestic vulnerabilities in some countries. Fiscal vulnerabilities are increasing as policy buffers are used, potential output declines, and public contingent liabilities build up. Nevertheless, Directors noted that, in general, these economies are in a stronger position now than in the past to withstand the looming turbulence, with improved fundamentals and policy frameworks, more flexible exchange rates, and higher international reserve buffers.

Directors underscored the need for credible policy actions to forestall downside risks and address old challenges decisively. In the euro area, priorities continue to be—building on recent progress—bank balance sheet repair, a comprehensive assessment of, and measures to reduce, corporate debt overhang in some countries, and completion of a full-fledged banking union, with an effective common backstop. Directors underscored that, while the fiscal adjustment path is currently appropriate for the euro area as a whole, the speed and composition of fiscal consolidation in each country would need to take into account cyclical considerations, debt levels, and financing conditions. In Japan and the United States, Directors emphasized the importance of carefully pacing fiscal adjustment and placing government debt on a sustainable track, anchored in a medium-term plan that includes durable tax and entitlement reforms. Promptly lifting the debt ceiling is also a priority in the United States. More generally, Directors agreed that there is scope for broader tax reforms to improve efficiency and fairness, and for strengthening cooperation on international taxation. In most advanced economies, a sustained focus on structural reforms over the medium term remains crucial to reduce rigidities in labor and product markets, enhance competitiveness, and boost potential output.

Directors agreed that monetary conditions need to stay accommodative in major advanced economies. In the United States, it is important that monetary policy respond gradually to changing prospects for growth, inflation, and financial stability, accompanied by clear, well-timed communication about the policy direction and strategy. Directors also emphasized the need to address structural liquidity weaknesses and vulnerabilities in the shadow banking system, which would help reduce financial market volatility during the transition to higher interest rates.

Directors noted that policy priorities and options differ across emerging market economies, depending on the degree of economic slack, the nature of vulnerabilities, and available policy buffers. They pointed to the role of exchange rates as a shock absorber and the need to guard against excessive volatility, while macroprudential measures should be used to mitigate financial stability risks. A few Directors took the view that exploring policy options beyond the traditional toolkit could be useful, anchored in credible monetary policy frameworks. Directors emphasized the importance of prudential oversight and regulation to contain any further buildup of foreign currency mismatches and risks stemming from shadow banking activities in key emerging markets.

Directors noted that, in emerging market economies where inflation is low and expectations are firmly anchored, monetary policy should be used as the first line of defense if downside risks materialize. They stressed the need to rebuild fiscal buffers, unless growth deteriorates significantly. In countries with high debt, fiscal consolidation remains a high priority, taking advantage of still favorable cyclical conditions. Further structural reforms are also essential to boost potential growth, including improving infrastructure, productivity, and the investment climate. Low-income countries need to step up revenue mobilization, including from natural resources, to rebuild their fiscal buffers and support higher priority public spending.

Directors concurred that a further narrowing of global imbalances would help maintain more sustainable and stable global growth. They observed that the recent exchange rate depreciations have facilitated some rebalancing in many deficit emerging market economies. However, further efforts are needed to increase national saving and boost productivity and competitiveness in many countries, including Brazil, India, Russia, and South Africa. For the United States, gradual progress on fiscal deficit reduction through a comprehensive plan for medium-term consolidation would help support global rebalancing. In surplus countries, priorities include measures to promote more consumption-based growth in China and structural reforms and medium-term fiscal consolidation in Japan. Directors were of the view that further external rebalancing within the euro area requires deeper structural reforms, including sustained efforts to raise investment in Germany.