IMF EXECUTIVE BOARD DISCUSSION OF THE OUTLOOK, OCTOBER 2016

The following remarks were made by the Chair at the conclusion of the Executive Board's discussion of the Fiscal Monitor, Global Financial Stability Report, *and* World Economic Outlook *on September 23, 2016.*

Executive Directors broadly shared the assessment of global economic prospects and risks. They observed that global growth is likely to remain modest this year, world trade growth is declining, and low inflation persists in many advanced economies. On the upside, commodity prices have firmed up, and financial market volatility following the U.K. vote to leave the European Union has generally been contained. Directors noted that, while global growth is expected to pick up somewhat next year, downside risks and uncertainty are elevated. The potential for another setback cannot be ruled out. Directors urged policymakers to employ all policy levers—individually and collectively—and enhance global cooperation, to avoid further growth disappointments, strengthen the foundations of the recovery, revive global trade, and ensure that the benefits of globalization are shared more broadly.

Directors noted that growth in advanced economies is projected to weaken this year and edge up slightly next year. Nevertheless, the overall outlook continues to be weighed down by remaining crisis legacy issues, persistently low inflation, weak demand, continued large external imbalances in some countries, low labor productivity growth, and population aging. At the same time, the full macroeconomic implications of the U.K. vote have yet to unfold. In emerging market and developing countries, growth is expected to strengthen gradually, on the back of improved external financing conditions, rising commodity prices, and a gradual stabilization in key economies currently in recession. Many countries have made steady progress in strengthening policy frameworks and resilience to shocks, and market sentiment has recently improved. Notwithstanding these positive developments, emerging market and developing economies remain exposed to spillovers from subdued growth in advanced economies, developments in China during its transition toward more sustainable growth, and volatility in capital flows and exchange rates, while domestic challenges remain to be addressed. Globally, concerns are growing about political discontent, income inequality, and populist policies, threatening to derail globalization.

Directors observed that, while financial markets have shown resilience to a number of shocks in the past six months, medium-term risks are rising. In advanced economies where weak growth calls for continued accommodative monetary policy, a prolonged period of low growth and low interest rates could add to banks' structural profitability challenges and put at risk the solvency of many life insurance companies and pension funds. These risks and challenges could, in turn, further weaken economic activity and financial stability more broadly. In many emerging market economies, high corporate leverage and the growing complexity of financial products continue to pose challenges.

Against this backdrop, Directors emphasized the urgent need for comprehensive, clearly articulated strategies—combining structural, macroeconomic, and financial policies—to lift actual and potential output, manage vulnerabilities, and enhance resilience. They recognized that the optimal policy mix will vary according to country contexts and the particular priorities. Directors also stressed that intensified multilateral cooperation is crucial to sustain global growth and improvements in living standards. Specifically, concerted efforts are needed to promote strong, sustainable, balanced, and inclusive growth; facilitate cross-border trade and investment flows; implement effective banking resolution frameworks; reduce policy uncertainty, including through clear communication; and sustain progress on global rebalancing. Strong global safety nets are also vital to deal with shocks, including those stemming from refugee flows, climate events, and domestic strife.

Directors broadly concurred that, in most advanced economies, policy action will need to continue to support demand in the short term and boost productivity and potential output in the medium term. Continued monetary accommodation remains appropriate to lift inflation expectations, while being mindful of negative side effects, but monetary policy alone would not be sufficient for closing output gaps and achieving balanced and sustainable growth. Growth-friendly fiscal policy is therefore essential, calibrated to the amount of space available in each country while ensuring long-term debt sustainability, anchored in a credible medium-term framework. Sustained efforts to repair bank and corporate balance sheets would help improve the transmission of monetary policy to real activity, and proactive use of macroprudential policies would safeguard financial stability. Structural reforms need to be prioritized depending on country circumstances, with a focus on raising labor force participation rates, enhancing the efficiency of the labor market, reducing barriers to entry, and encouraging research and development. In the corporate sector, reforms should focus on eliminating debt overhangs, facilitating restructuring, and further improving governance.

Directors acknowledged that circumstances and challenges in emerging market and developing countries vary depending on their level of development and cyclical position. To achieve the common objective of converging to higher levels of income, structural reforms should focus on facilitating technology diffusion and job creation, and enhancing human capital. Directors encouraged taking advantage of the current relatively benign external financial conditions to press ahead with needed corporate deleveraging, through a comprehensive approach, where warranted. This should be complemented by continued efforts to strengthen financial sector oversight, upgrade regulatory and supervisory frameworks, and improve corporate governance practices. Directors stressed that a smooth adjustment in China's corporate and financial sectors is crucial for sustaining growth and stability in China and elsewhere.

Directors stressed the need for financial institutions, particularly in advanced economies, to adapt their business models to new realities and evolving regulatory standards. Greater vigilance by regulators and improved data collection on nonbank financial institutions are essential to preserve their financial health and monitor their role in monetary policy transmission. Policymakers can help reduce uncertainty by completing the regulatory reform agenda, without significantly increasing overall capital requirements, while preserving the integrity of a robust capital framework. Directors broadly agreed that, in countries facing a private sector debt overhang or where the financial system is seriously impaired but fiscal space is available, well-targeted fiscal measures—with the support of strong insolvency and bankruptcy procedures and safeguards to limit moral hazard—could help facilitate private debt restructuring. Many emerging market countries should continue to enhance resilience, including by curbing excessive private debt build-up and strengthening the government balance sheet in upturns.

Directors underscored that policy priorities in low-income countries are to address near-term macroeconomic challenges and make progress toward their Sustainable Development Goals. In commodity-dependent economies, building fiscal buffers will require increasing the contribution of the non-commodity sector to tax revenue, together with spending rationalization. For countries less dependent on commodities, countercyclical macroeconomic policies should be adopted where growth remains robust, and debt management practices strengthened to lower the impact of potential shifts in capital flows. More broadly, achieving robust, sustainable, and inclusive growth requires sustained efforts to diversify the economy, broaden the revenue base, improve the efficiency of government spending, and enhance financial deepening.