



World Economic Outlook

Transitions and Tensions

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United Nations, Project LINK Meetings, October 21, 2013

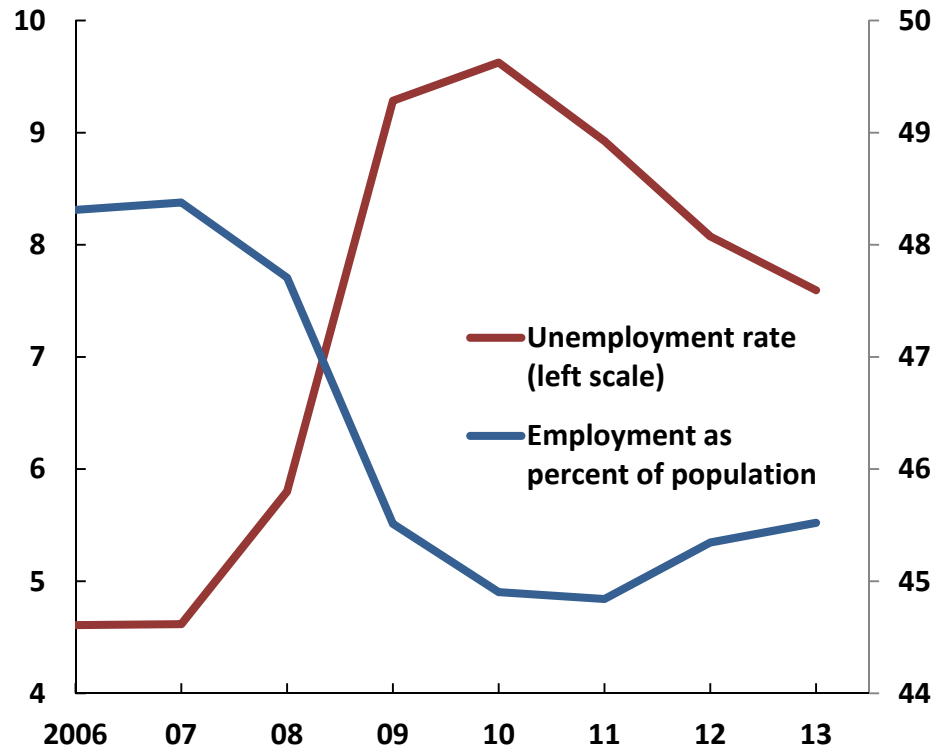
Global growth dynamics are in transition

Two new developments:

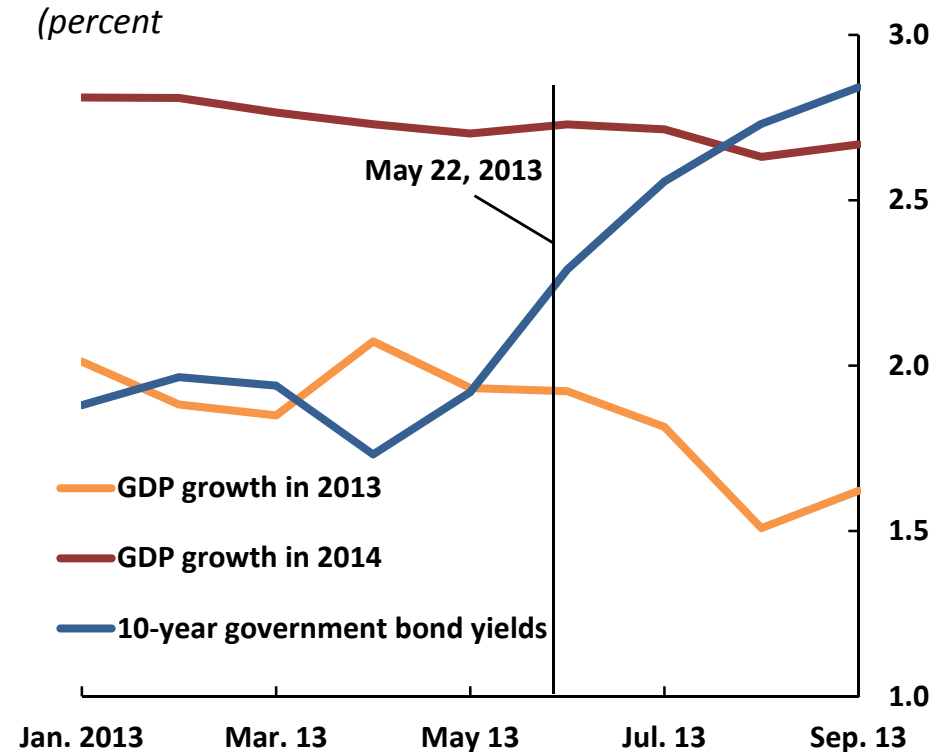
- **Markets anticipated a change in U.S. monetary policy**
- **Lower growth in emerging market economies, notably China**

Despite still ample slack in U.S. labor markets and downward revisions to real GDP growth, monetary conditions have tightened since May.

Unemployment Rate
(percent)



Government Bond Yields and GDP Growth From Consensus Forecast
(percent)

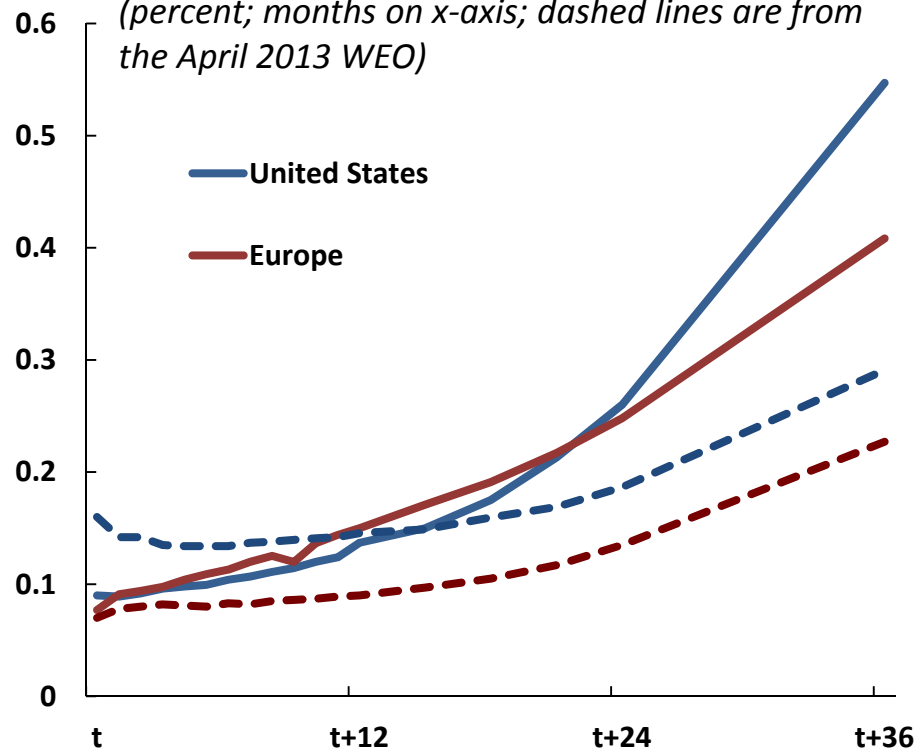


Sources: Bloomberg, L.P., *Consensus Forecast*; and IMF staff estimates.

Tighter U.S. monetary conditions have spilled over into the euro area and, to a lesser extent, Japan.

Policy Rate Expectations 1/

(percent; months on x-axis; dashed lines are from the April 2013 WEO)



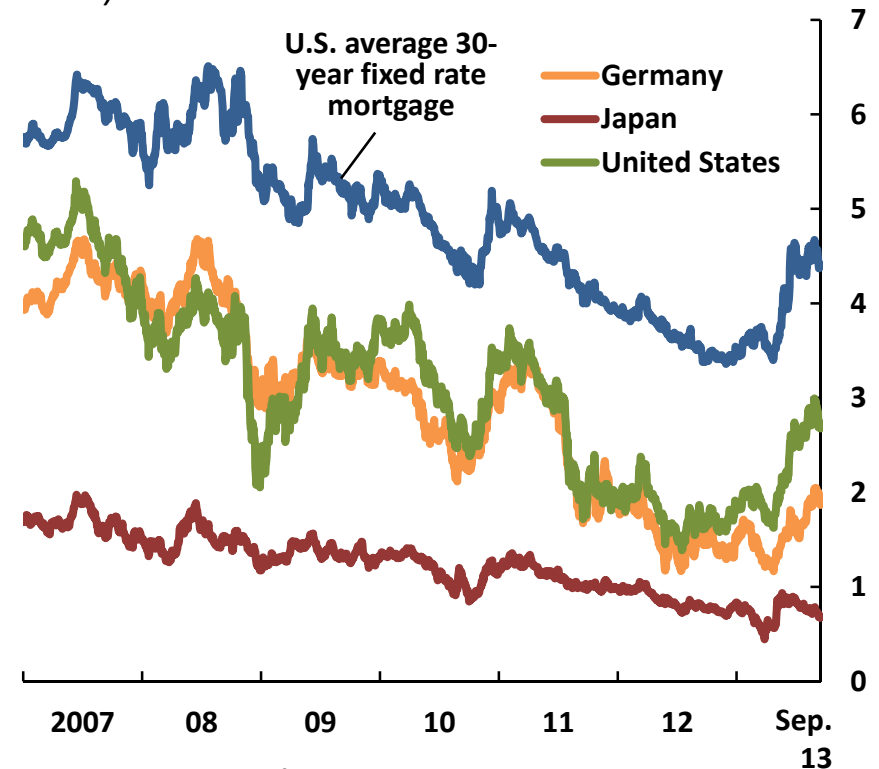
Source: Bloomberg, L.P.

1/ Expectations are based on the federal funds rate for the United States, the sterling overnight interbank average rate for the United Kingdom, and the euro interbank offered forward rate for Europe; updated September 24, 2013.

2/ Interest rates are 10-year government bond yields unless noted otherwise.

Key Interest Rates 2/

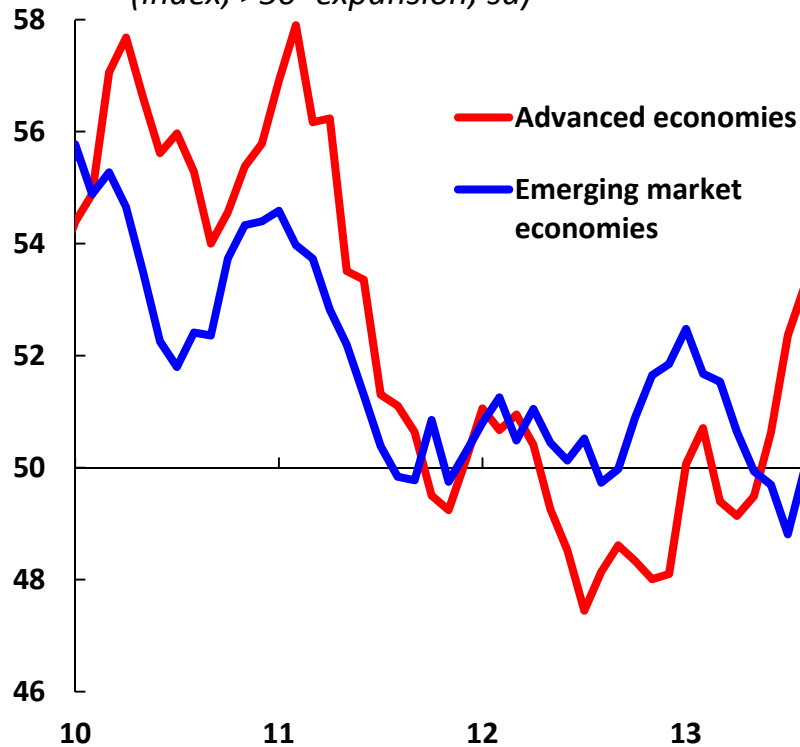
(percent)



EMEs slowing and AEs picking up

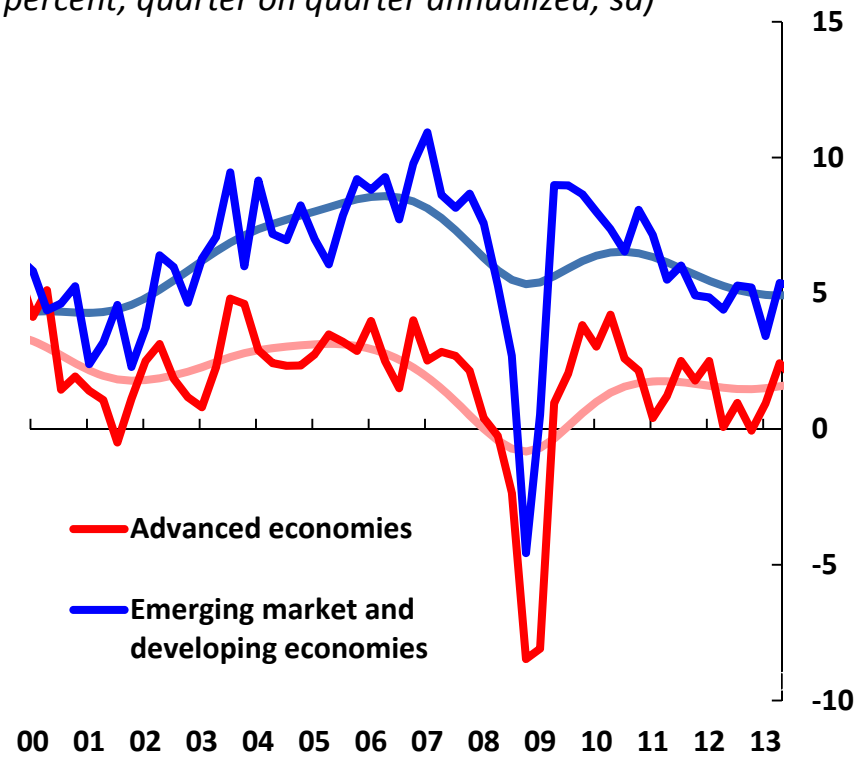
Manufacturing PMI

(index; >50=expansion; sa)



Real GDP Growth 1/

(percent; quarter on quarter annualized; sa)

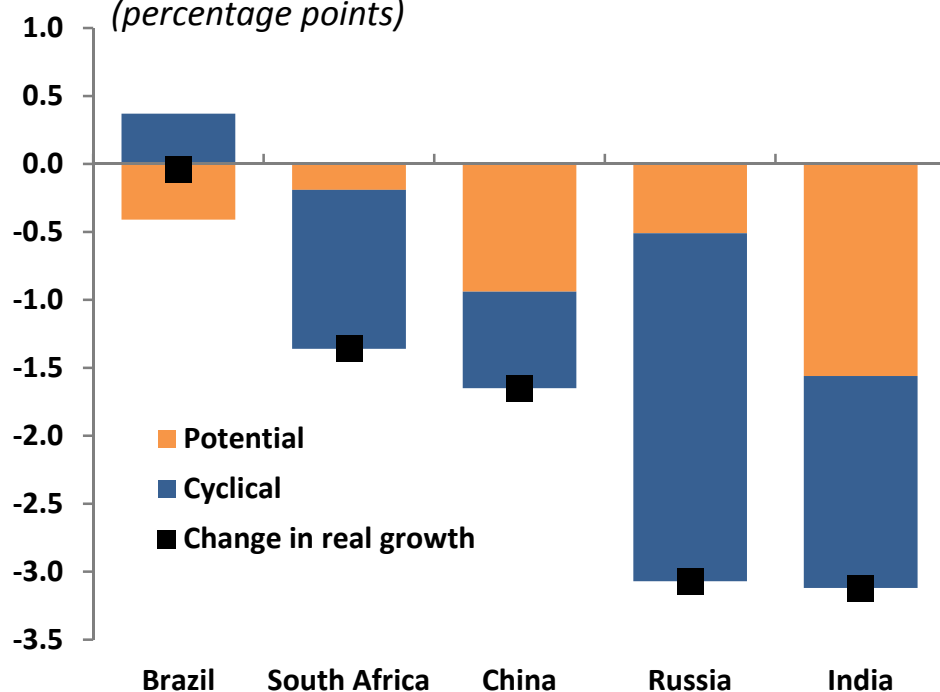


Sources: IMF, *World Economic Outlook*; and IMF, *Global Data Source*.
1/ Lighter shades indicate Hodrick-Prescott smoothed lines.

EM growth has declined for cyclical and structural reasons.

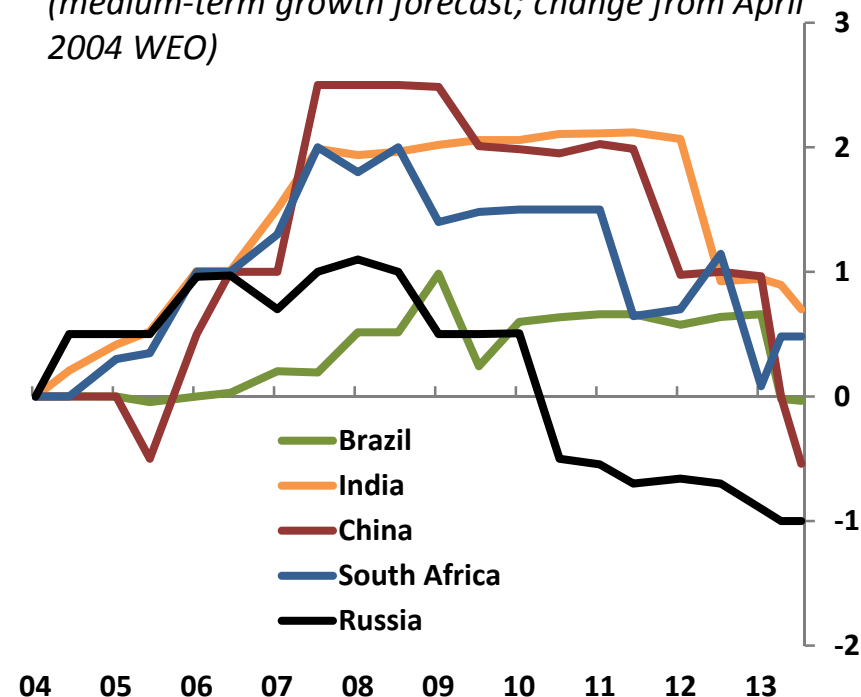
Decomposing the 2011-13 Slowdown 1/

(percentage points)



Long-term Expectations: Up and Down 2/

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



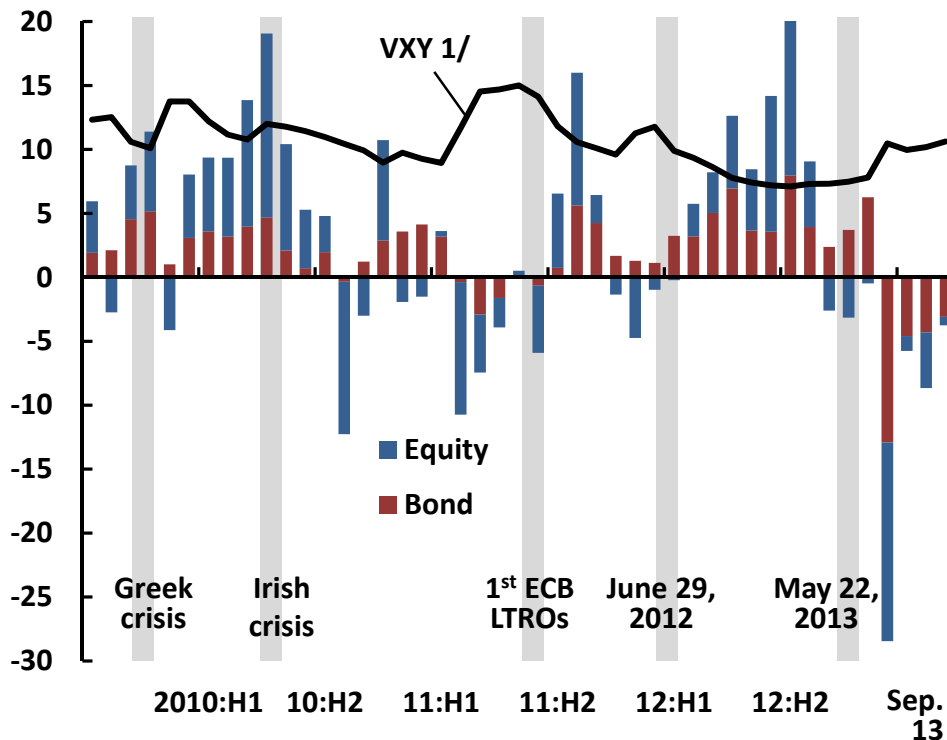
Source: IMF, *World Economic Outlook*.

1/ Cyclical component of growth calculated as the difference between real and potential growth. Potential growth estimated using multivariate filter (see Box 1.2 of the October 2013 WEO for details).

2/ 5-year ahead growth forecasts used as a proxy for longer term growth expectations. India's figures for the July 2013 update are in fiscal year terms.

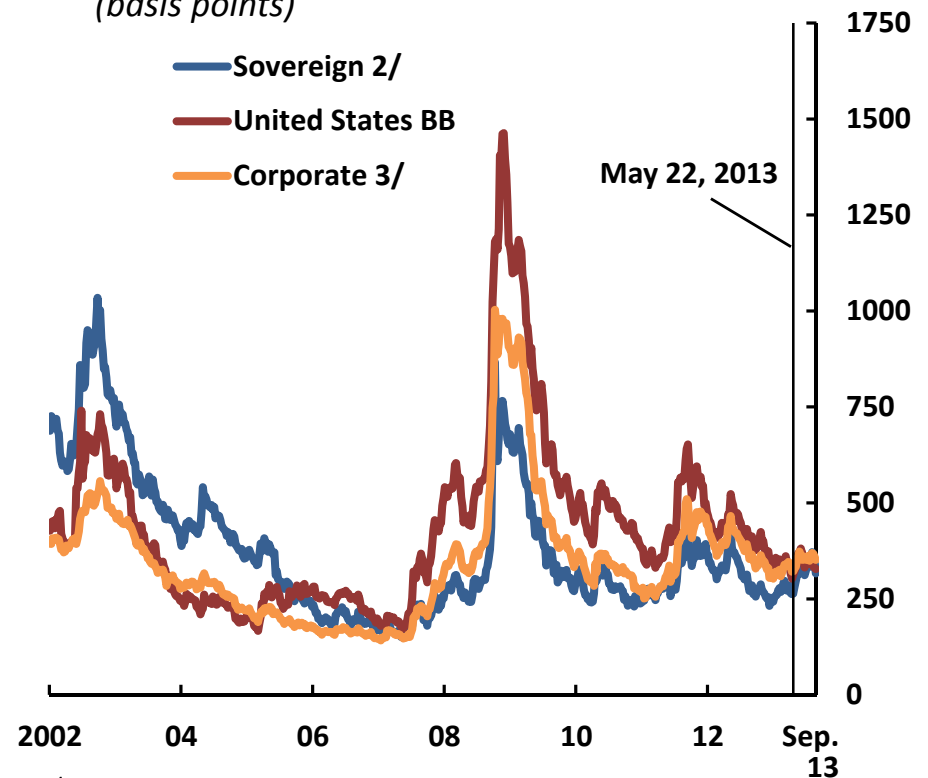
Tighter U.S. monetary conditions interacted with EM domestic weaknesses and led to tighter EM funding conditions.

Net Capital Flows to Emerging Markets Breakdown
(billions of U.S. dollars; monthly flows)



Sources: Bloomberg, L.P.; EPFR Global/Haver Analytics; and IMF staff calculations.
Note: ECB = European Central Bank; LTROs = longer-term refinancing operations.

Interest Rate Spreads
(basis points)

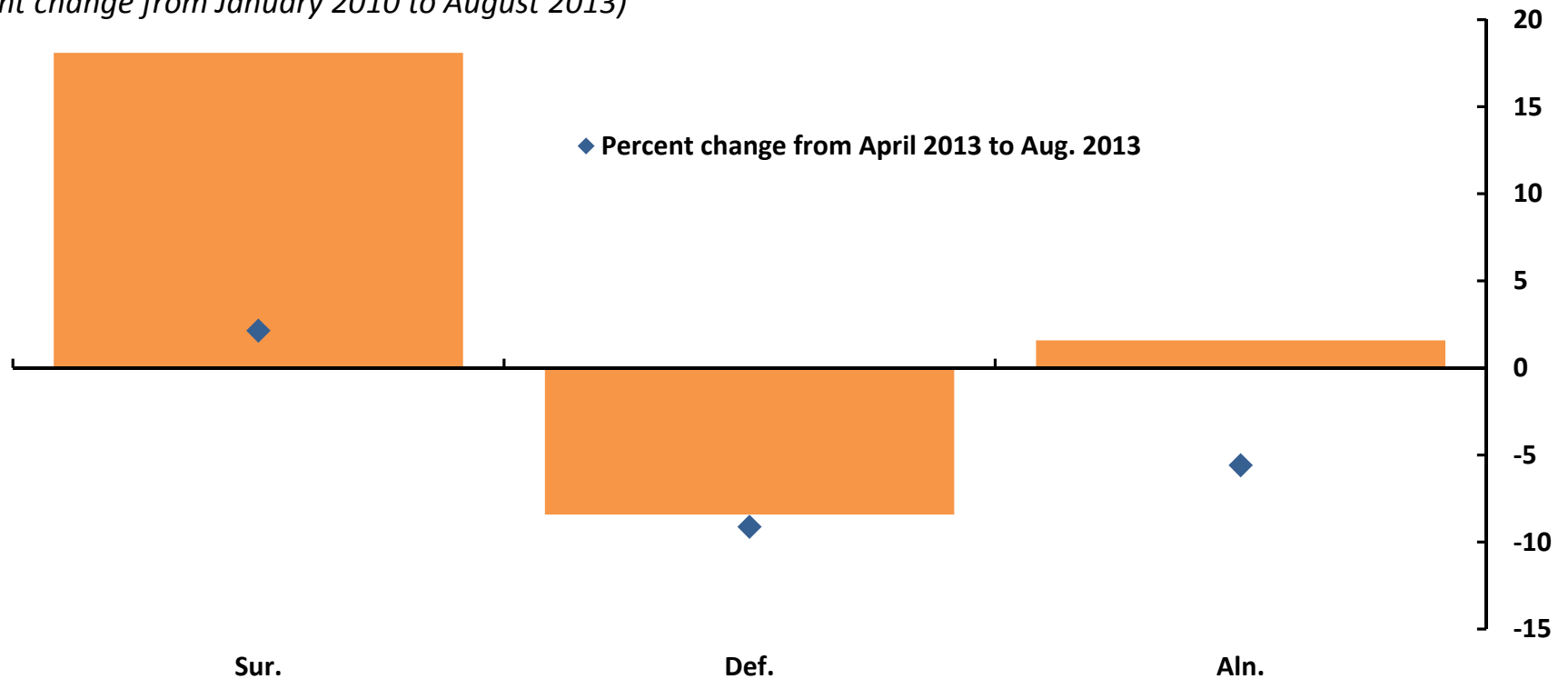


1/ JPMorgan emerging market volatility index.
2/ JPMorgan EMBI Global Index spread.
3/ JPMorgan CEMBI Broad Index spread.

Key EMs are under pressure but exchange rates have acted as a buffer and reduced or reversed previous overvaluations.

Real Effective Exchange Rates

(percent change from January 2010 to August 2013)



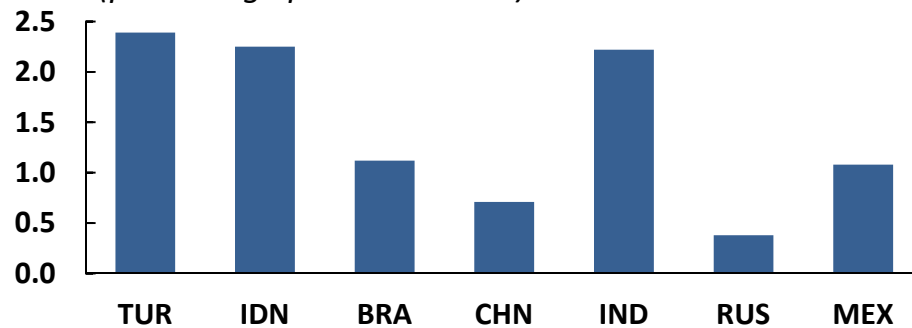
Sources: Haver Analytics; IMF, *World Economic Outlook*, April 2013 and IMF staff calculations.

Note: Aln. = aligned emerging market economies, including India, Mexico, Poland, Russia, Saudi Arabia; Def. = deficit emerging market economies, including Brazil, Indonesia, South Africa, Turkey; Sur. = surplus emerging market economies, including China, Malaysia, Thailand.

Exchange rate depreciation, however, will not forestall lower growth— extent of slowing depends on policy room.

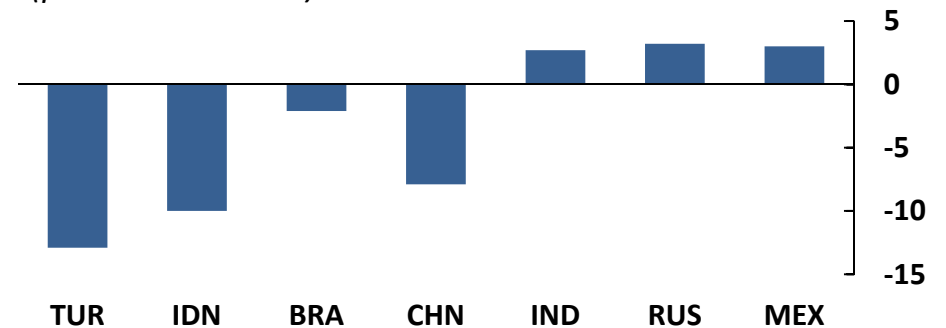
Market Interest Rates

(percentage point deviation)



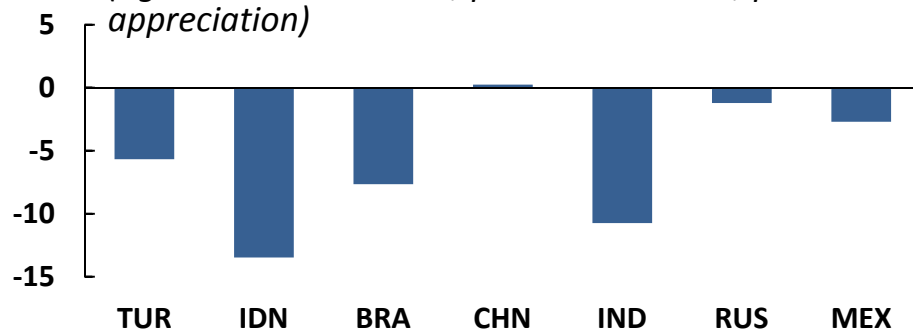
Equity Prices

(percent deviation)



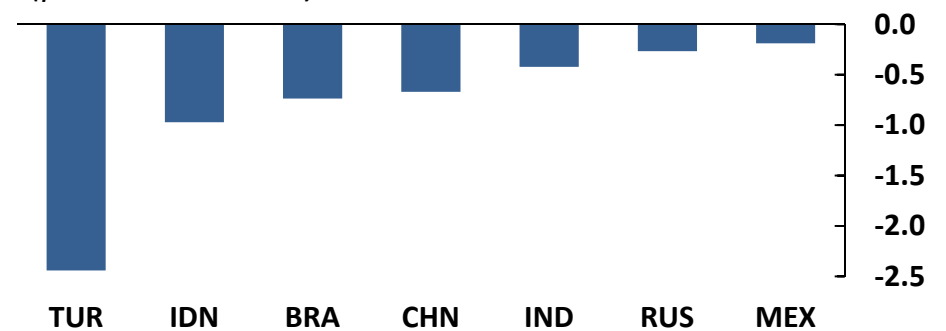
Bilateral Exchange Rate

(against the U.S. dollar; percent deviation; positive = appreciation)



Real GDP

(percent deviation)



Source: IMF staff estimates.

Note: BRA = Brazil; CHN = China; IDN = Indonesia; IND = India; MEX = Mexico; RUS = Russia; TUR = Turkey.

Assumptions underlying the forecast









AE monetary policy: U.S. tapers gradually, keeps rates on hold until 2016; euro area and Japan stay very accommodative

AE Fiscal policy: Less tightening in U.S. & euro area; more in Japan.

EM: tightening of external financing conditions is largely a one off

The WEO forecast has been revised down, mainly on account of emerging economies.

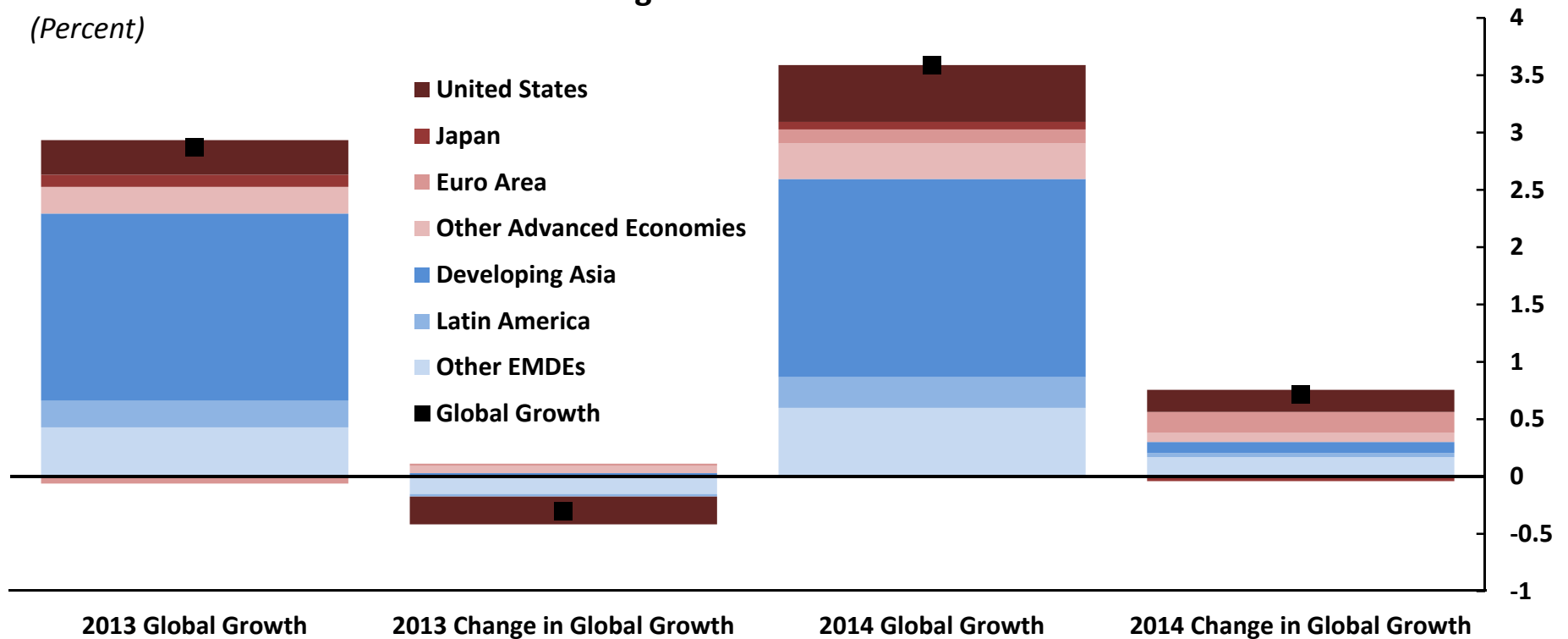
WEO Real GDP Growth Projections (percent change from a year earlier)

								
	World	U.S.	Euro Area	Japan	Brazil	Russia	India	China
2013 (Oct. 2013)	2.9	1.6	-0.4	2.0	2.5	1.5	3.8	7.6
2013 (Jul. 2013)	3.1	1.7	-0.6	2.0	2.5	2.5	5.6	7.8
2014 (Oct. 2013)	3.6	2.6	1.0	1.2	2.5	3.0	5.1	7.3
2014 (Jul. 2013)	3.8	2.7	0.9	1.2	3.2	3.3	6.3	7.7

Global growth impulses to be increasingly driven by advanced economies

Contributors to Global Growth and Changes in Global Growth

(Percent)

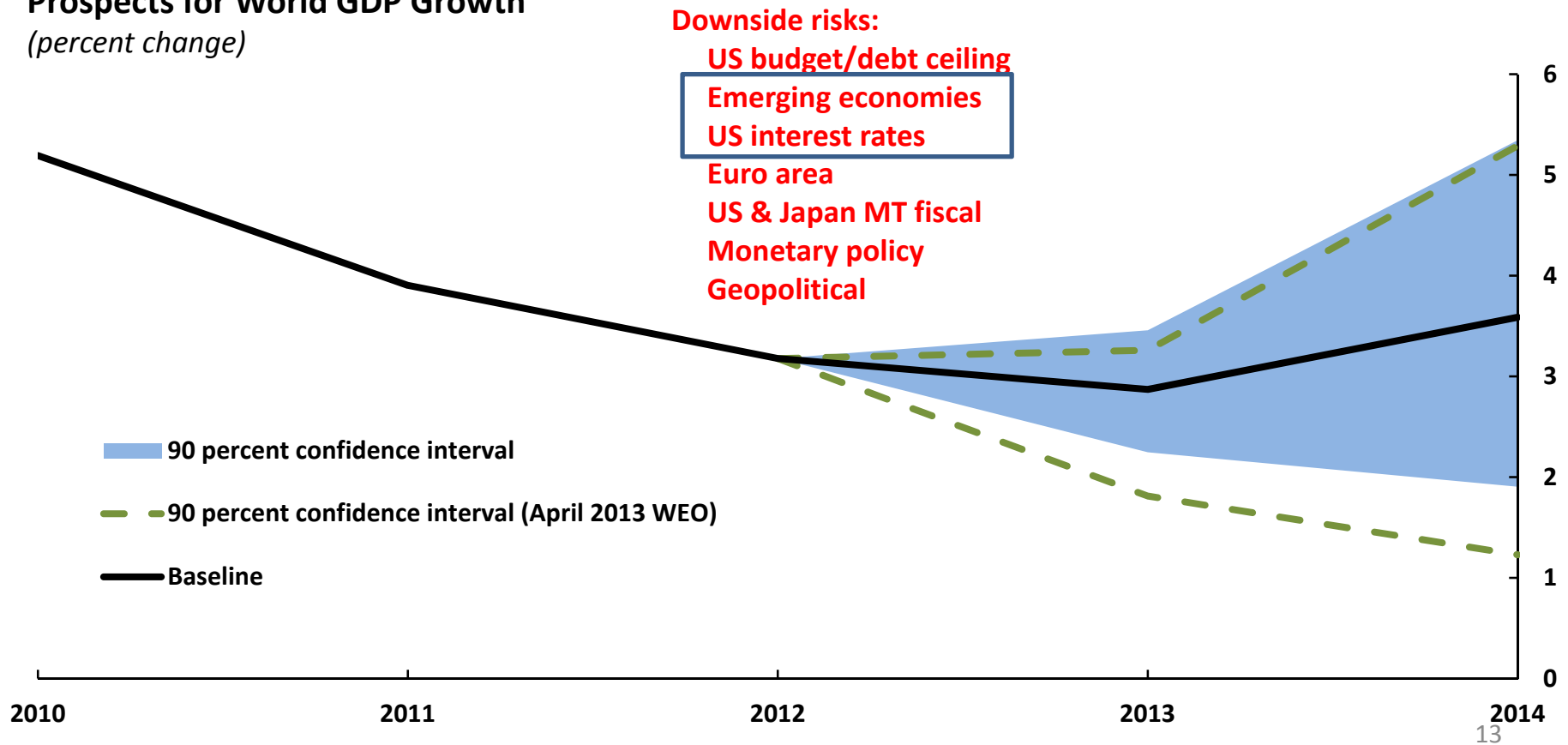


Source: IMF staff estimates.

Note: EMDEs = Emerging Market and Developing Economies.

Near-term risks remain on the downside. Market risk indicators do not point to a large change in risks.

Prospects for World GDP Growth
(percent change)



Source: Consensus Forecasts; and IMF staff estimates.

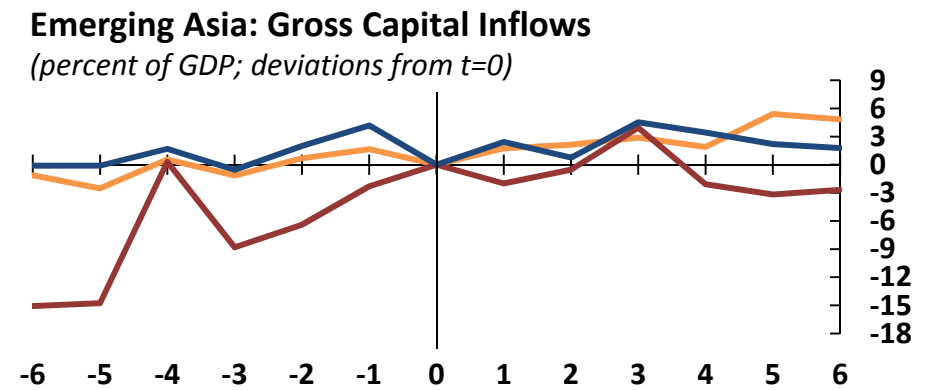
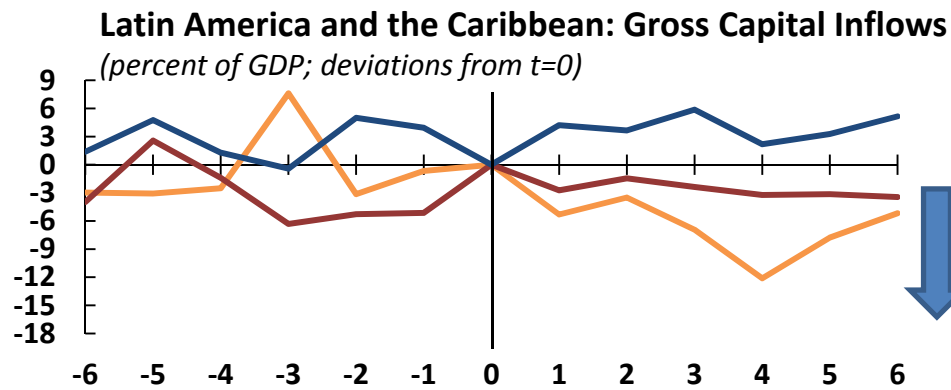
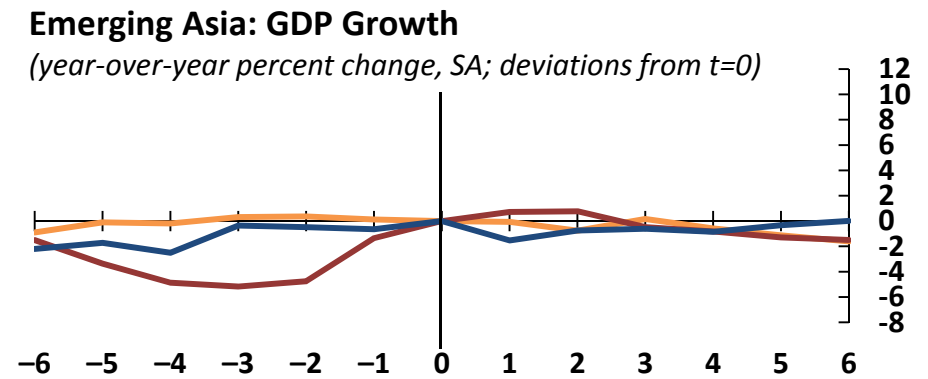
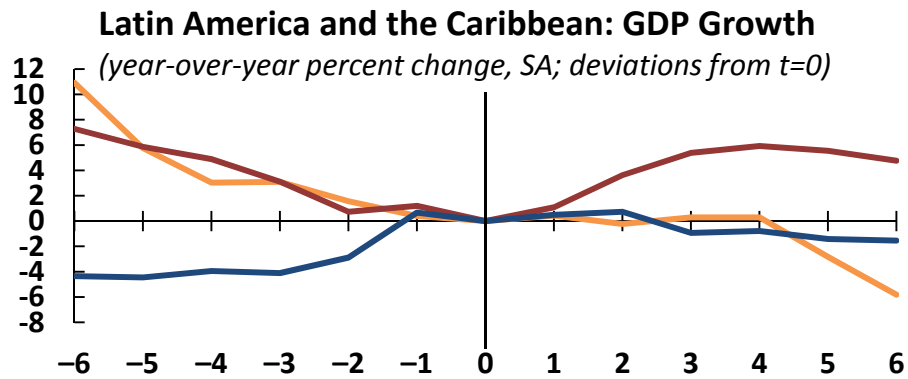
Risks from higher interest rates in advanced economies for emerging economies

Why rates in AEs would be higher matters:

- **Higher-than-expected growth → good for the world**
- **Tighter policy stance → not good for the world**
- **Higher-than-expected inflation → bad for the world**
- **Worse fiscal positions → ugly for the world**
- **Other? Depends.**

EM growth and capital flows do not necessarily fall much when U.S. policy rates rise because of stronger U.S. growth.

— February 1994 — June 1999 — June 2004

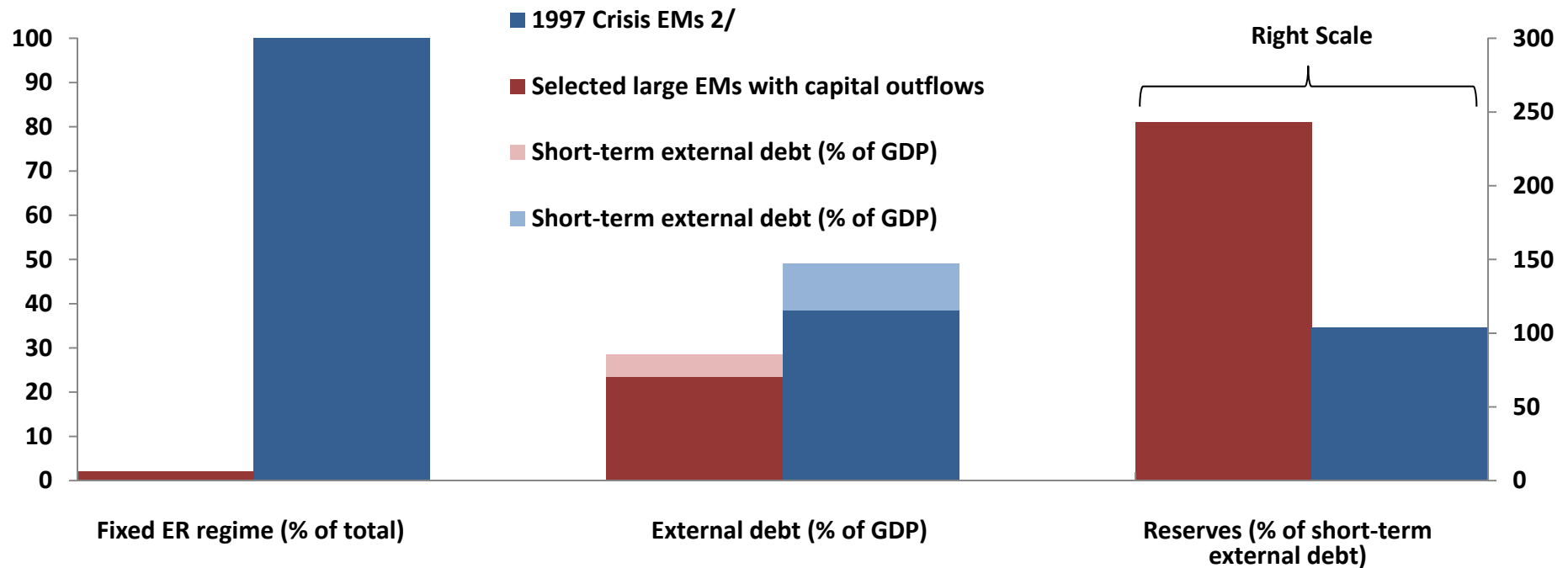


Source: IMF staff estimates.

EMs are now more resilient than in 1997. However, vulnerabilities have built up in some.

(initial conditions)

Key EMs Under Pressure Today vs. 1997 Asian Financial Crisis EMs
(percent)



Source: IMF, *World Economic Outlook*, April 2013.

1/ Brazil, Indonesia, India, Turkey, and South Africa. Data shown for 2012.

2/ Indonesia, Korea, Thailand, Malaysia, and Philippines. Data shown for 1996.

Over the medium term, a plausible downside scenario is one of several, limited disappointments and much lower global growth.

Tighter external funding conditions for EM
Less potential growth in EM, notably China
Lower commodities prices

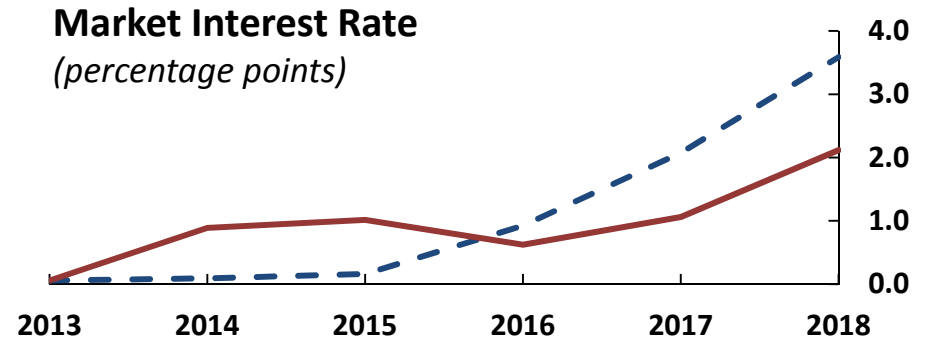
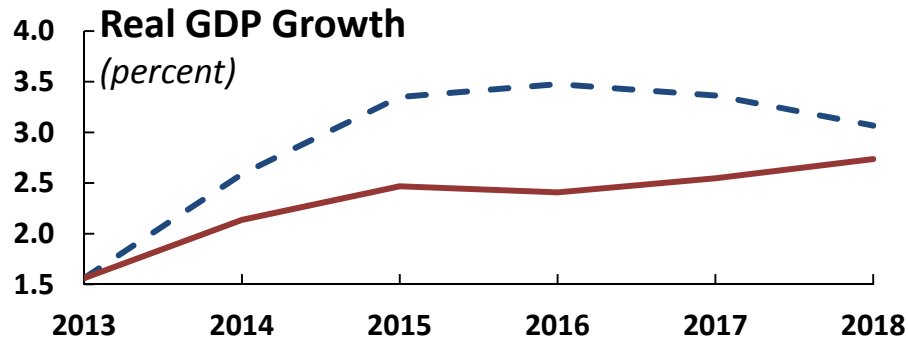
Euro area investment stalls, notably in periphery
Japan policy implementation is incomplete

US potential growth disappoints
US monetary conditions tighten more than assumed in the WEO forecast
Fiscal accidents in AEs

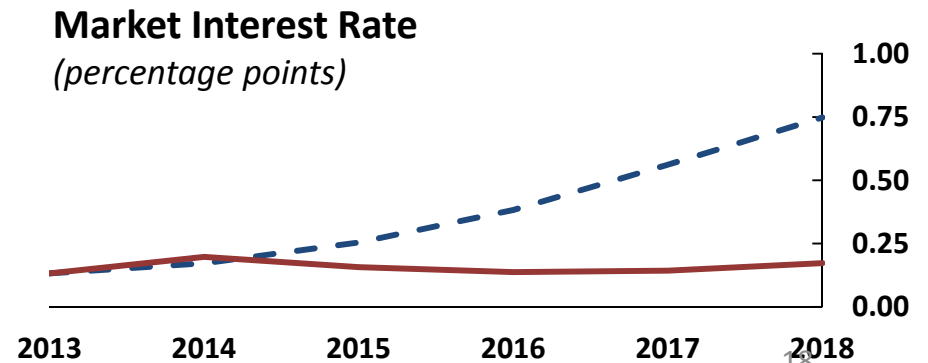
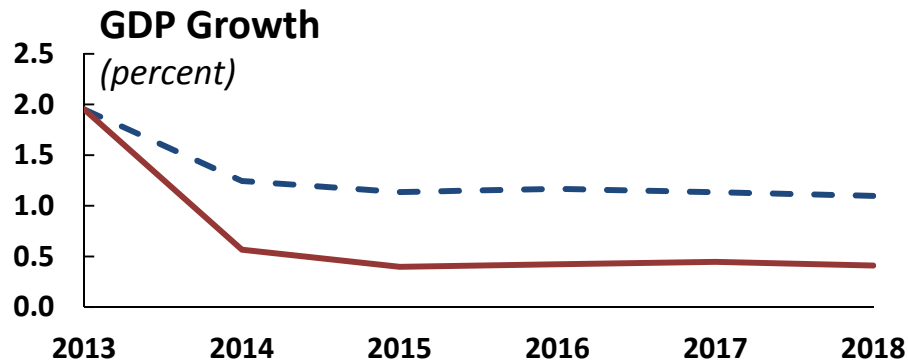
In the plausible downside scenario, U.S. policy rates stay close to the zero bound for many years.

--- WEO baseline
 — Plausible Downside Scenario

United States



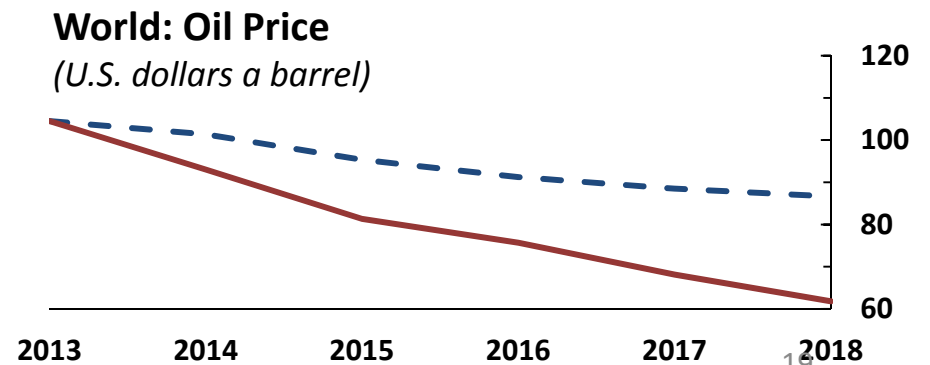
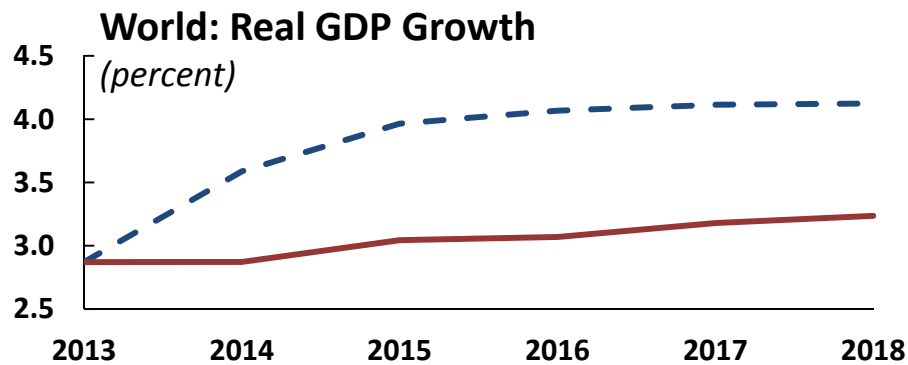
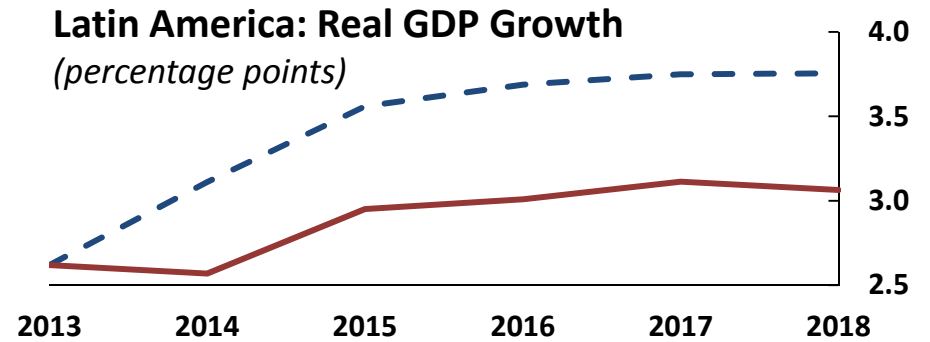
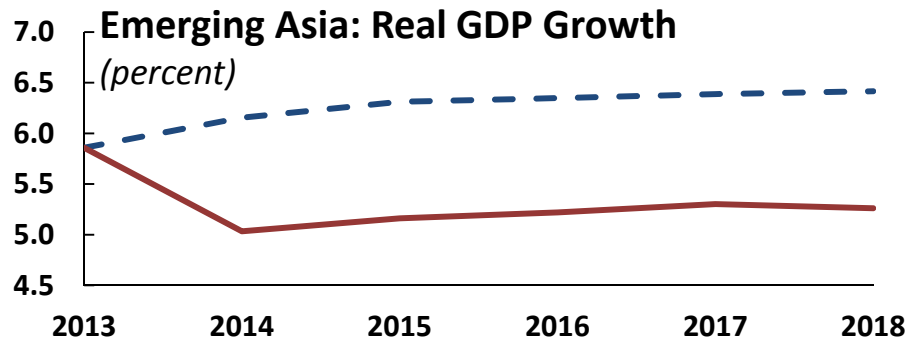
Japan



Source: IMF staff estimates.

EM are hit particularly hard and global growth averages 3 percent, rather than 4 percent.

--- WEO baseline
 — Plausible Downside Scenario



Source: IMF staff estimates.

Policies

adjustment

Japan: work on all 3 arrows of Abenomics

US: address ST fiscal challenges; easy monetary policy; careful calibration and effective

communication on timing of exit from asset purchases; MT fiscal adjustment &

China: advance rebalancing and reform shadow banking

India: improve fiscal policy and remove structural bottlenecks

Brazil: raise domestic saving and foster private investment

Russia: rebuild fiscal buffers and improve the investment climate

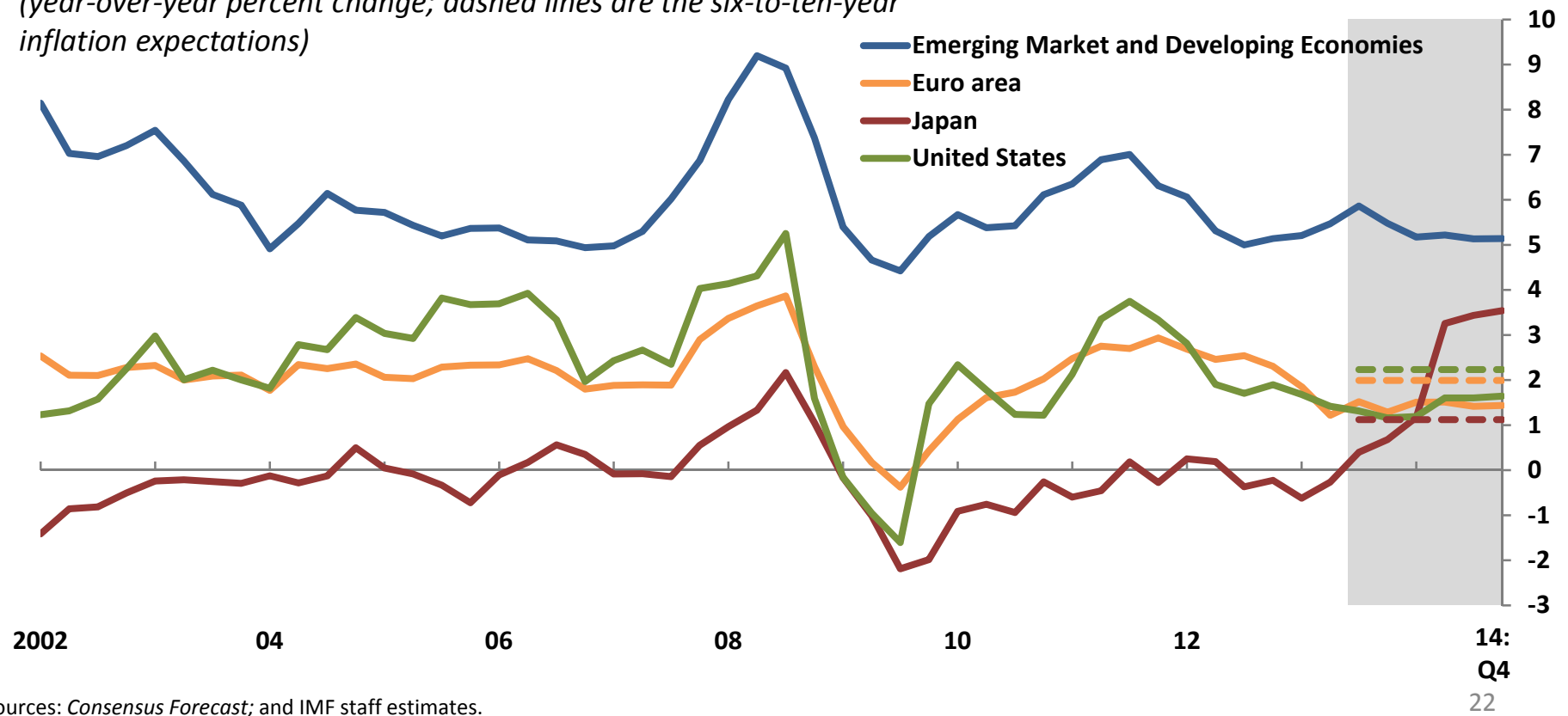
EMDC: (i) exchange rate buffer; (ii) monetary policy to keep inflation well anchored; cut rates if room exists; (iii) fiscal policy to be geared to MT objectives; stimulate only if major slowdown threatens; (iv) preserve financial stability; (v) structural reforms

Thank you

But inflation pressures are very low. Thus, our WEO assumes that monetary policy stays very accommodative in advanced economies.

Global aggregates: Headline Inflation

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

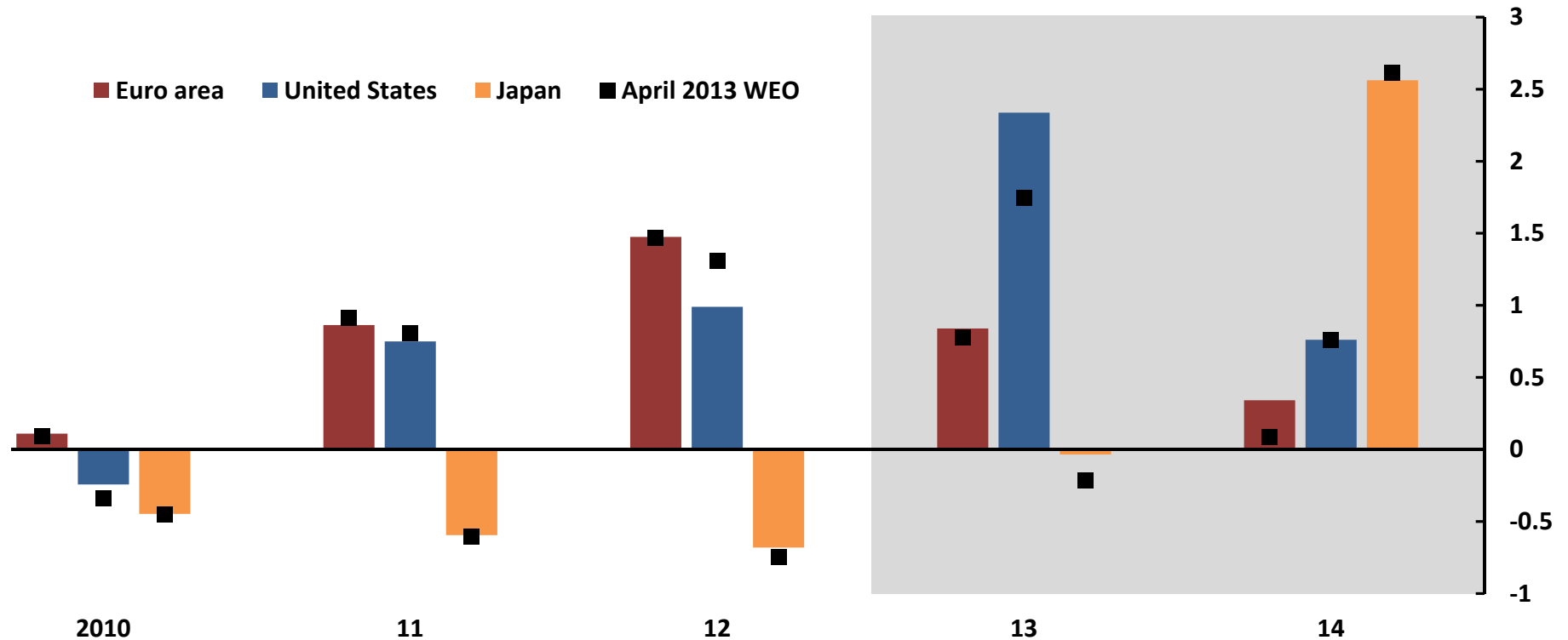


Sources: Consensus Forecast; and IMF staff estimates.

AE fiscal policy will be less tight in 2014, except in Japan.

Fiscal Impulse

(Change in structural balance as percent of GDP)



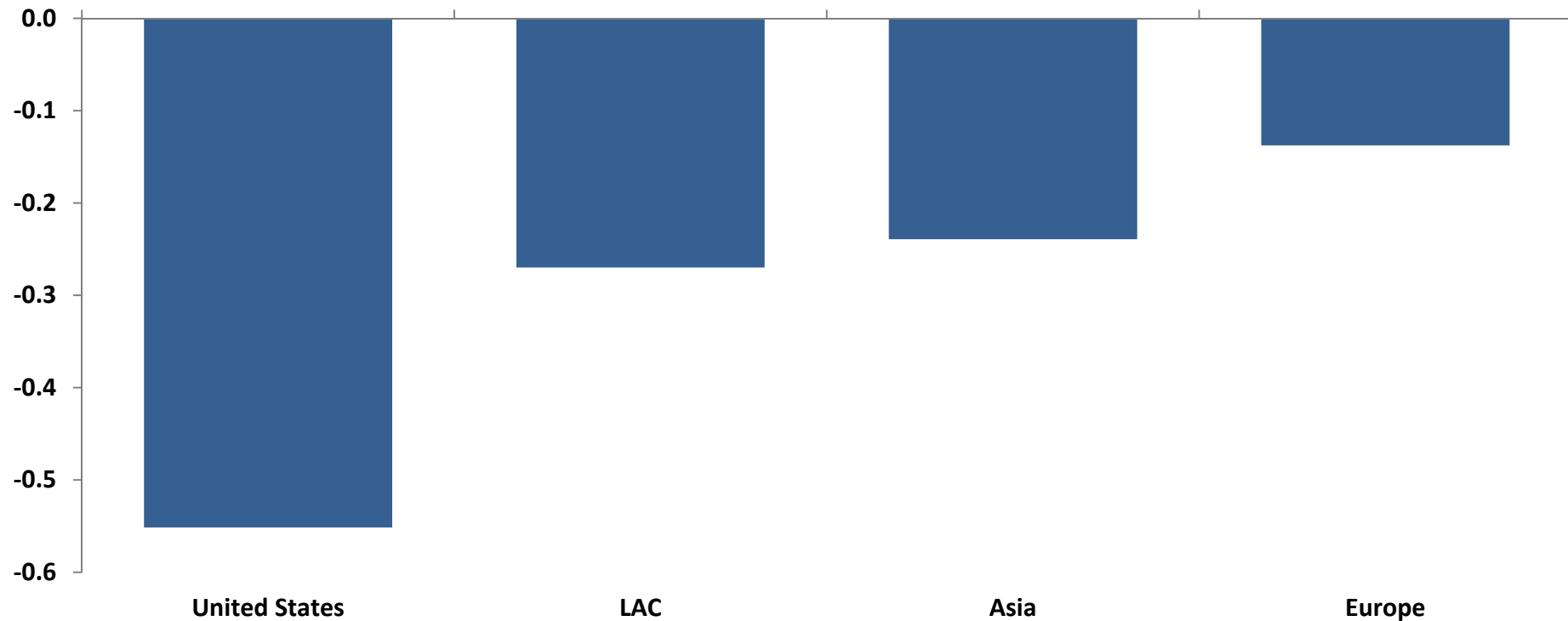
Source: IMF staff estimates.

Spillovers:

(effects of a US monetary policy shock) 1/

Econometric Evidence

(peak effect of 100 basis point increase in U.S. policy interest rate; percent)



Source: IMF staff calculations.

1/ U.S. monetary policy shock defined as a surprise change in monetary policy rates that is not a response to inflation or economic conditions, and is taken from Romer and Romer (2004). See October 2013 WEO Chapter 3 for details.