



# World Economic Outlook

*October 2013*

Jörg Decressin

Deputy Director

Research Department, IMF

## Global Growth Dynamics Are Changing

**Two new developments over the past 6 months:**

- **Markets anticipated a change in U.S. monetary policy—conditions tightened partly because activity is firming in the U.S., euro area**
- **Lower growth in emerging economies, notably China**



## Outline

- **Prospects for Advanced Economies**
- **Recent Developments and Implications for Emerging Economies**
- **Medium-term prospects for EM**
- **Risks**
- **Rebalancing within the euro area**
- **Policy implications**

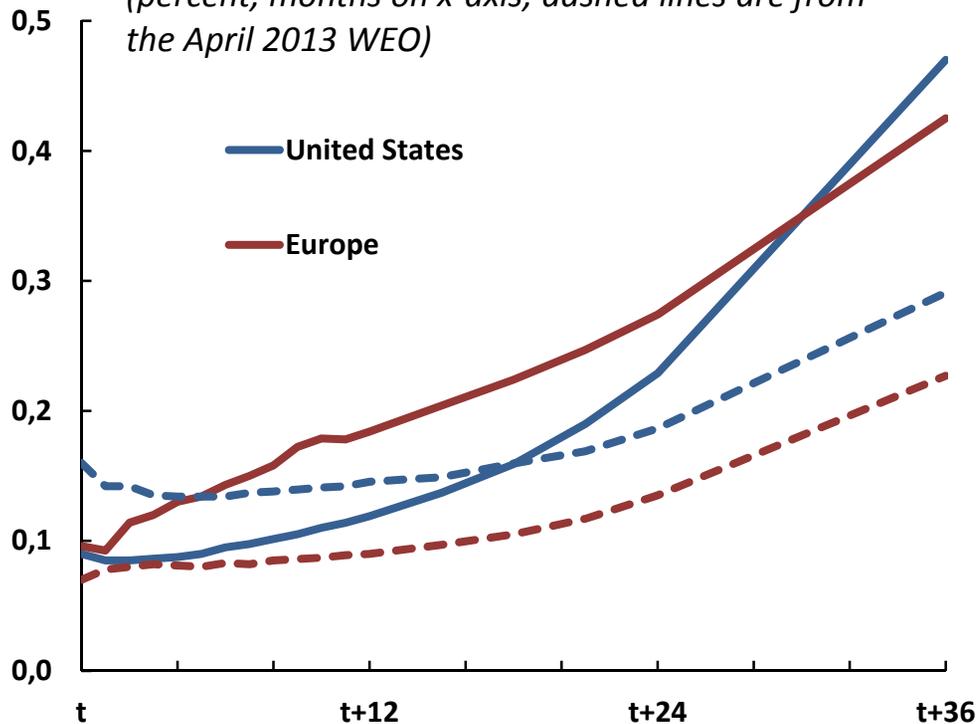
## Prospects for Advanced Economies

- **Tighter monetary conditions**
- **Much easier fiscal policy**
- **Higher growth in 2014**

# U.S. monetary conditions have tightened and this spilt over into the euro area and, to a lesser extent, Japan.

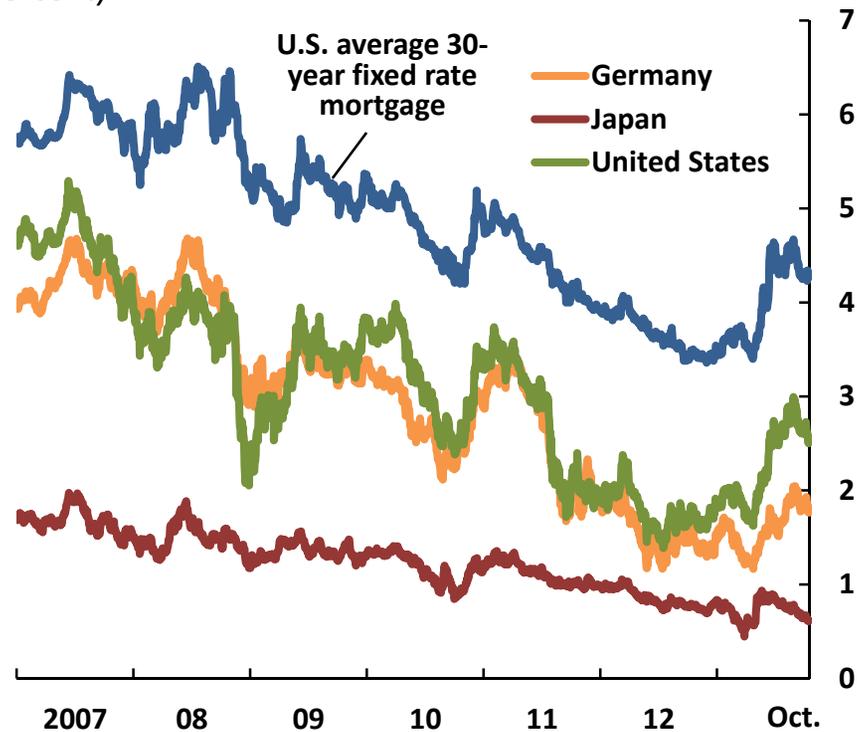
## Policy Rate Expectations 1/

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



## Key Interest Rates 2/

(percent)

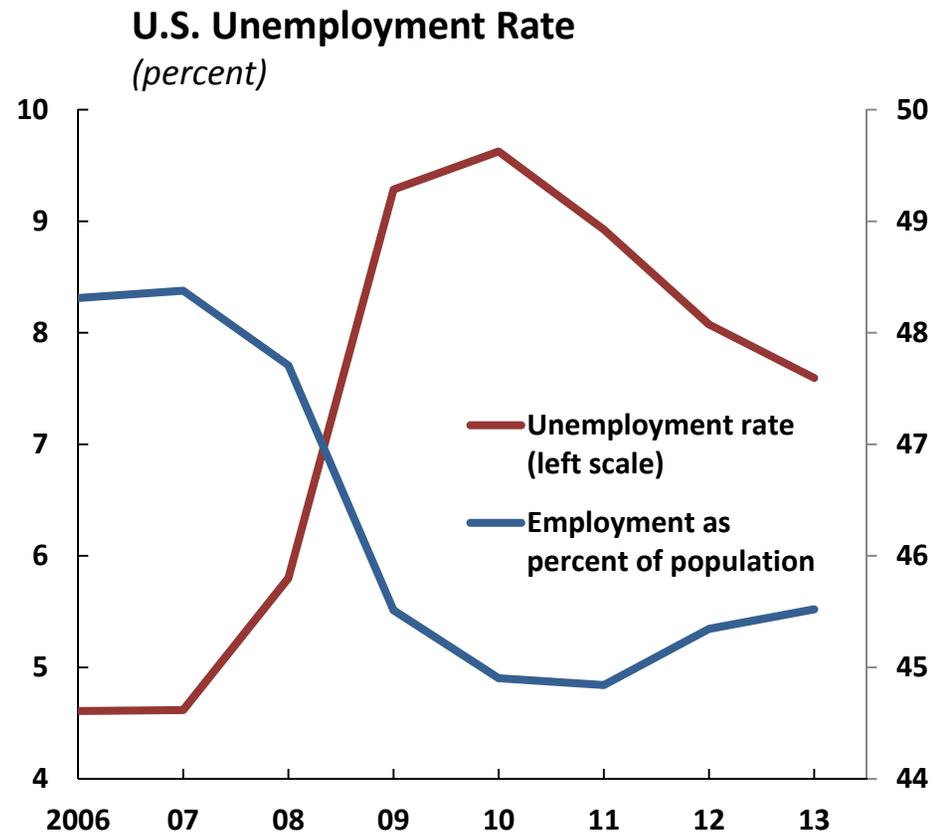
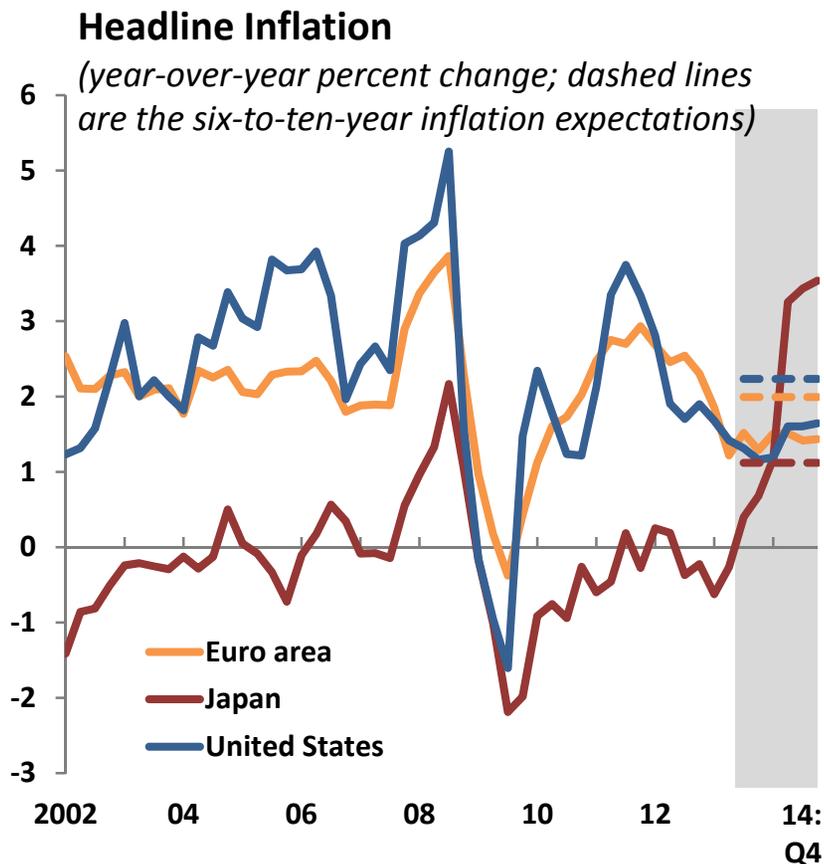


Source: Bloomberg, L.P.

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 October 24, 2013.

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

**Inflation pressures are very low and there is still ample slack.  
Monetary policy is assumed to stay very accommodative.**

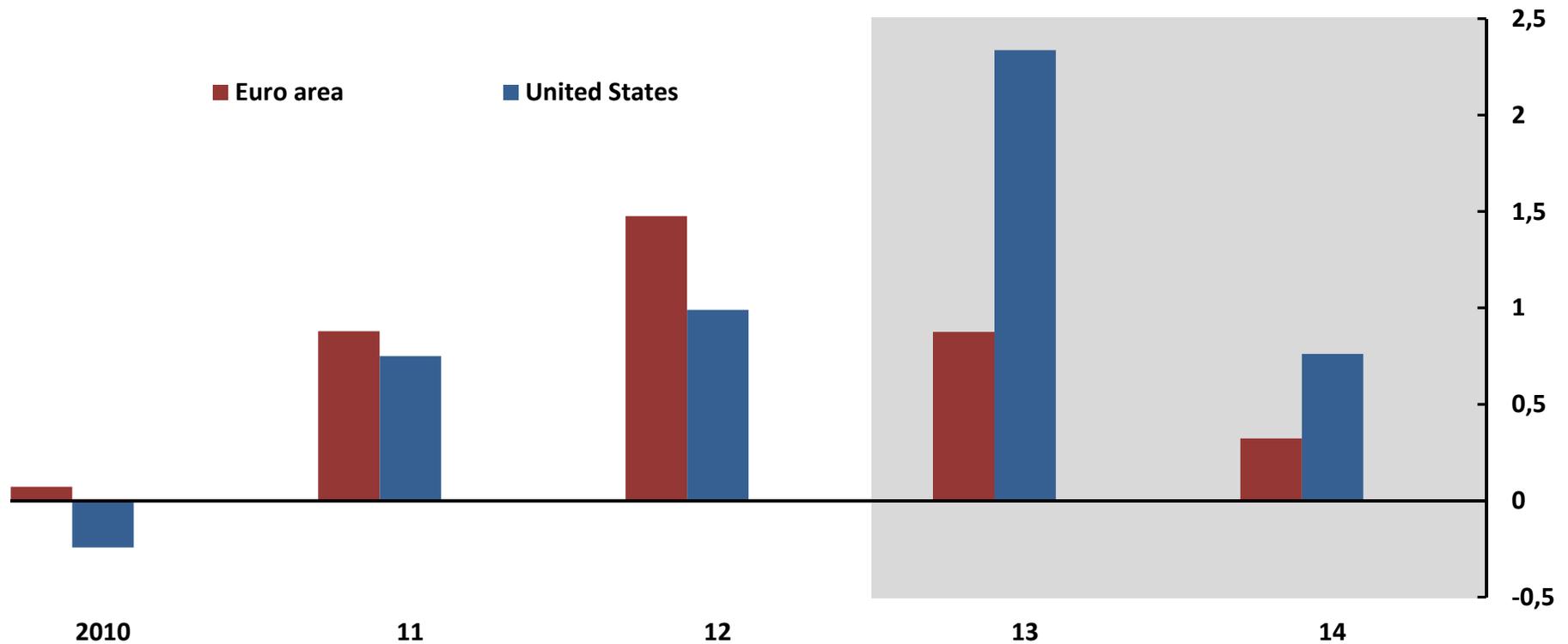


Sources: Consensus Forecast; and IMF staff estimates.

# AE fiscal policy will be less tight in 2014 (except in Japan).

## Fiscal Impulse

(Change in structural balance as percent of GDP)

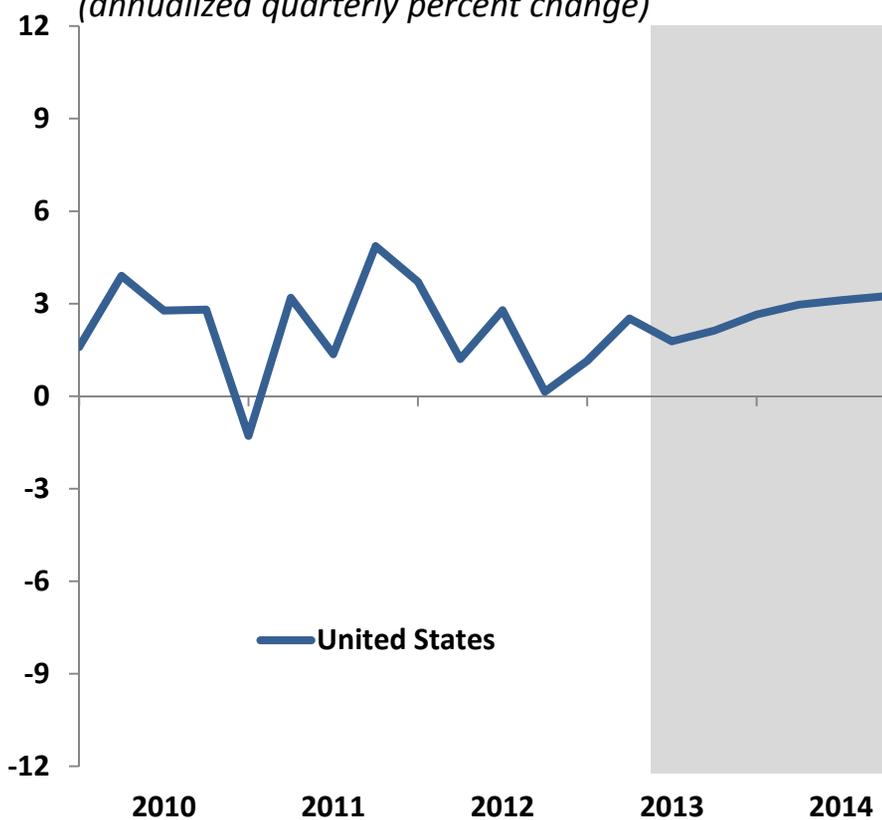


Source: IMF staff estimates.

# GDP growth forecasts for advanced economies are little changed: growth is moving up in U.S. and euro area.

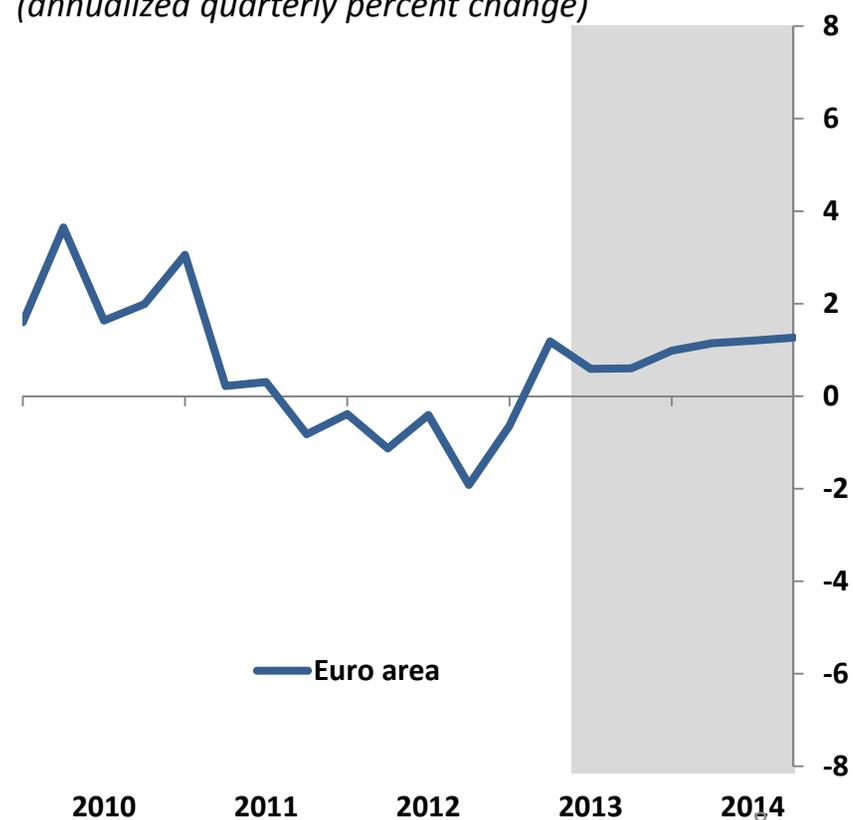
## 1. United States

(annualized quarterly percent change)



## 2. Euro Area

(annualized quarterly percent change)



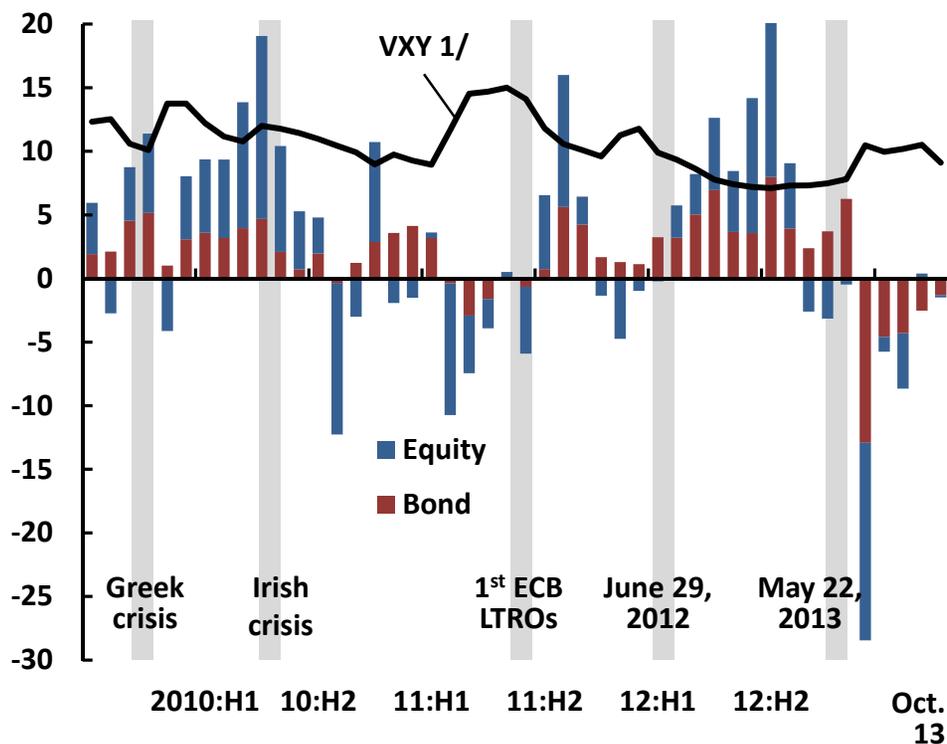
Sources: IMF staff estimates.

## Recent Developments and Implications for Emerging Economies

- **Tighter external funding conditions**
- **Lower potential growth**
- **More demand from advanced economies**
- **A modest cyclical uptick in 2014**

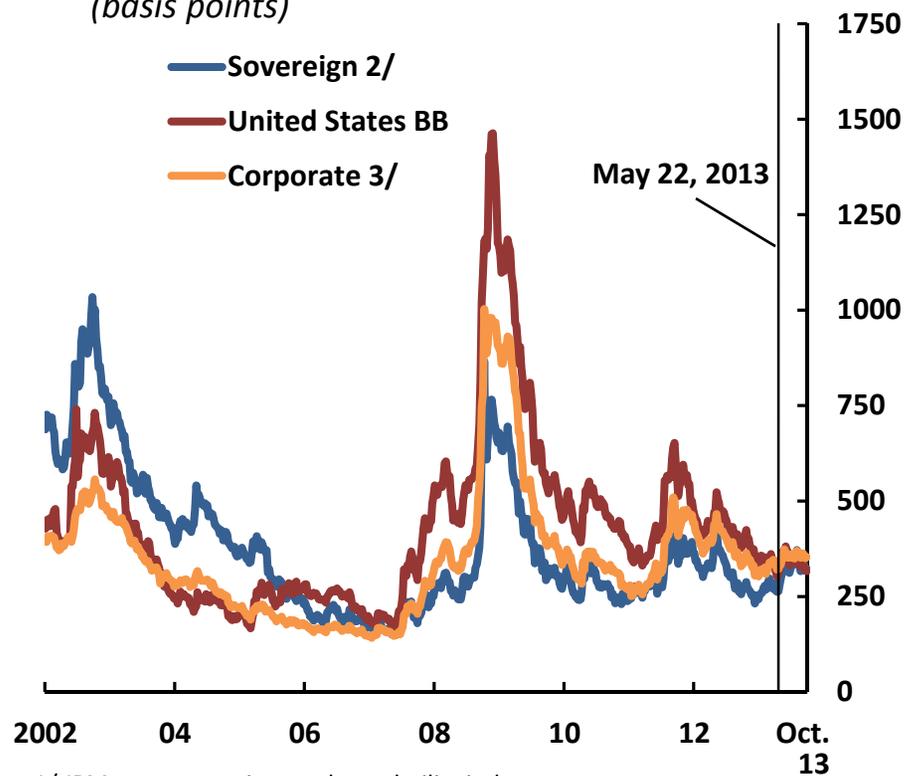
# Tighter U.S. monetary conditions interacted with EM domestic weaknesses and led to tighter EM funding conditions.

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



Source: 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)

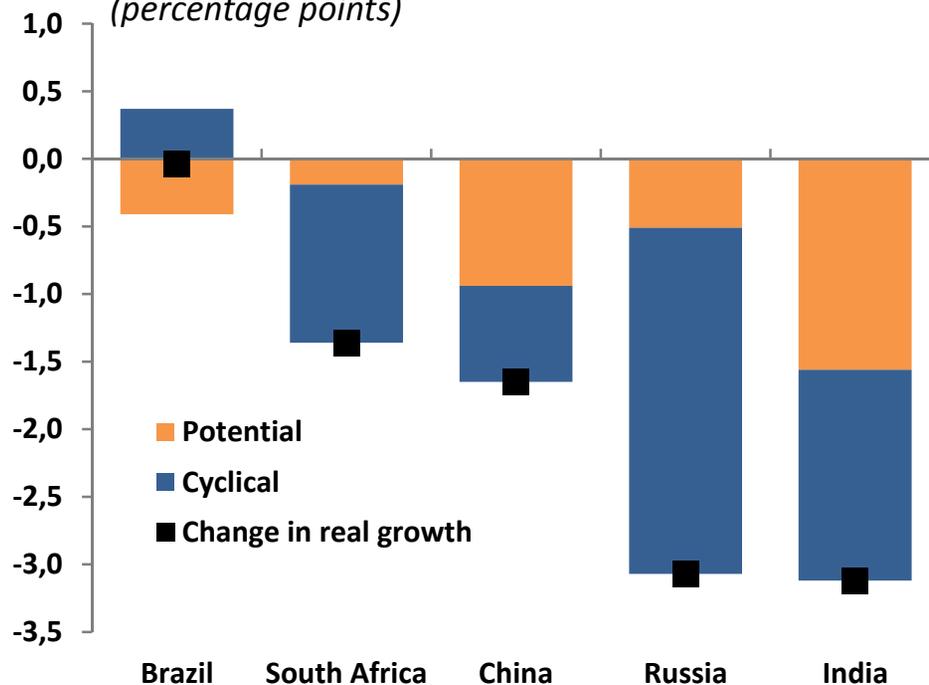


1/ JPMorgan emerging market volatility index.  
2/ JPMorgan EMBI Global Index spread.  
3/ JPMorgan CEMBI Broad Index spread.

# EM growth has declined for cyclical and structural reasons.

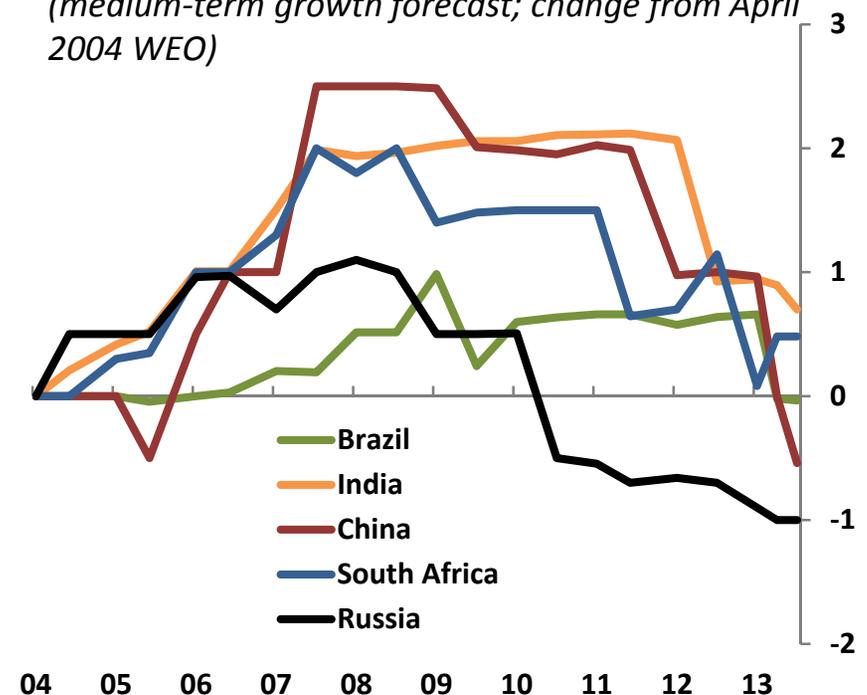
**Decomposing the 2011-13 Slowdown 1/**

(percentage points)



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

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



Source: IMF, *World Economic Outlook*.

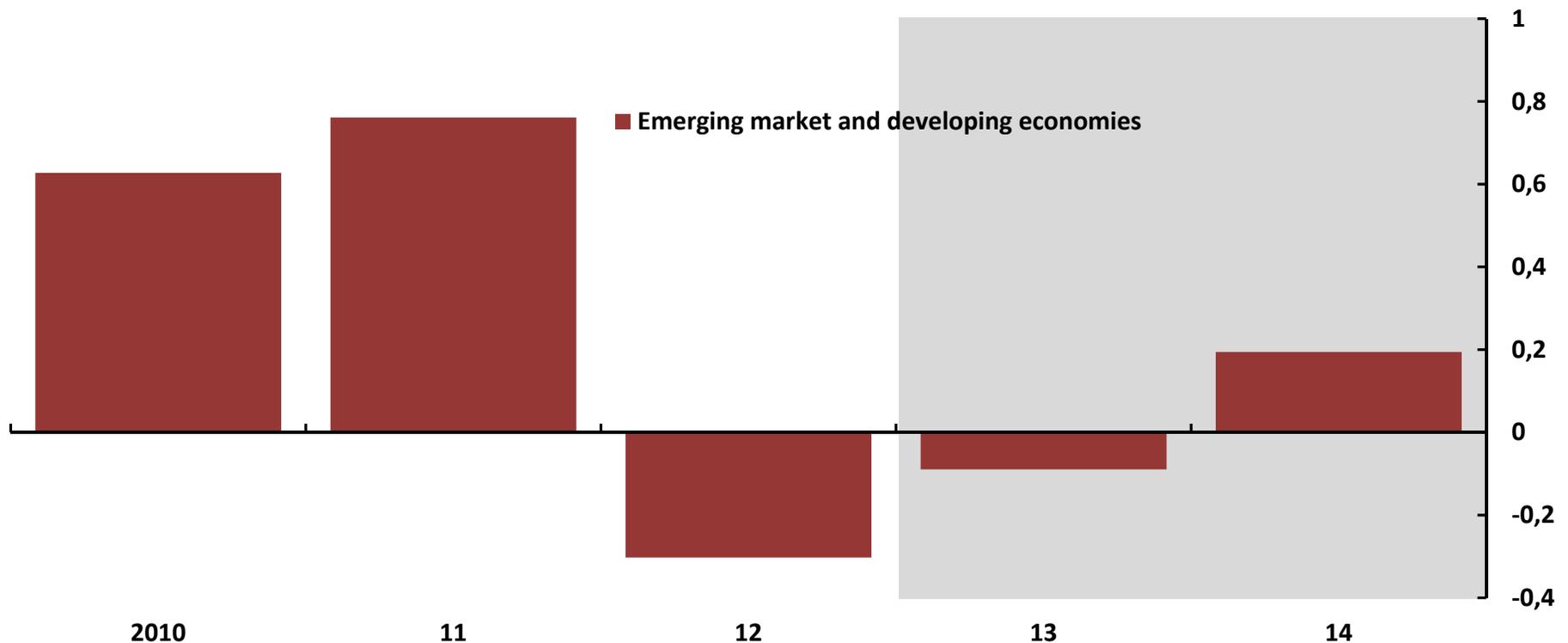
1/ Cyclical component of growth calculated as the difference between real and potential growth. Potential growth estimated using multivariate filter (see Box 1.2 of the October 2013 WEO for details).

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.

# EM fiscal policies are staying broadly neutral; for some this is fine; others need fiscal adjustment.

## Fiscal Impulse

(Change in structural balance as percent of GDP)

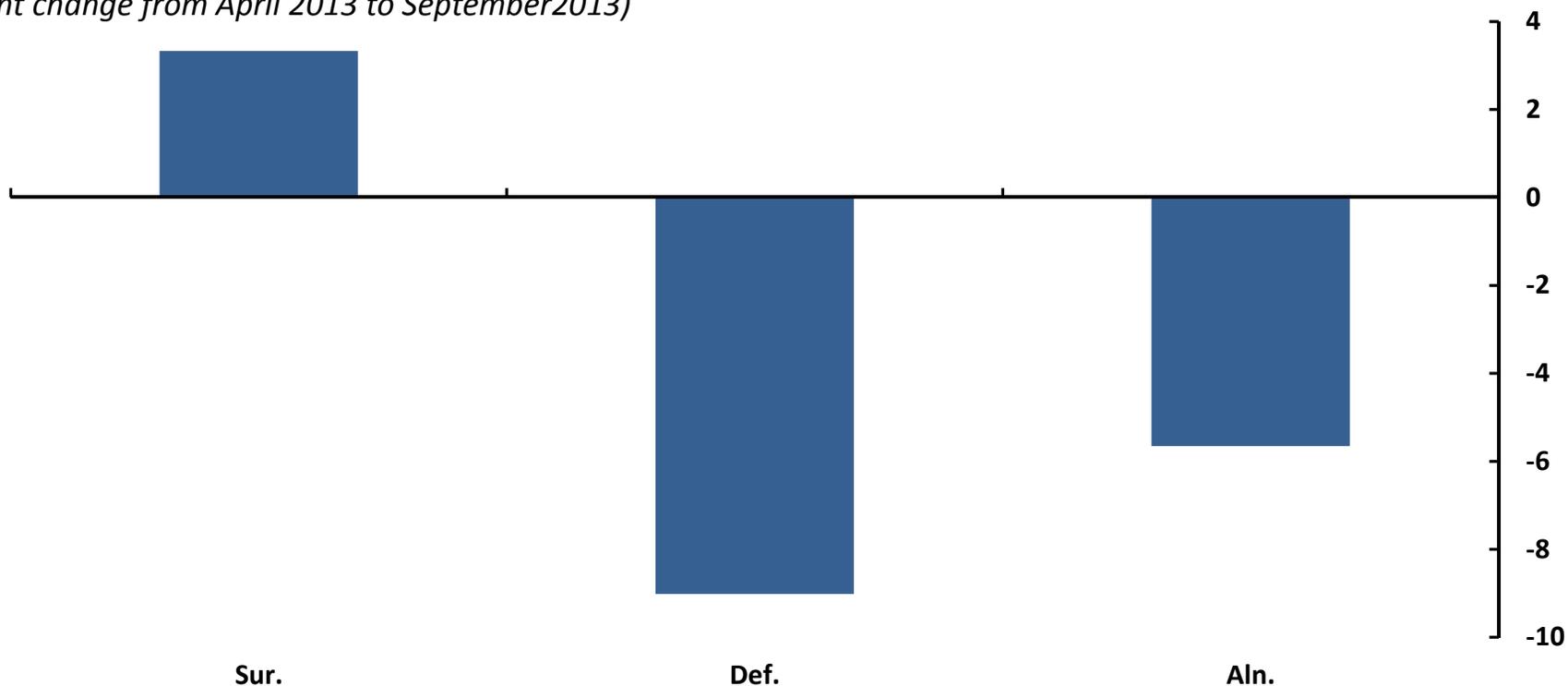


Source: IMF staff estimates.

# 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 April 2013 to September 2013)



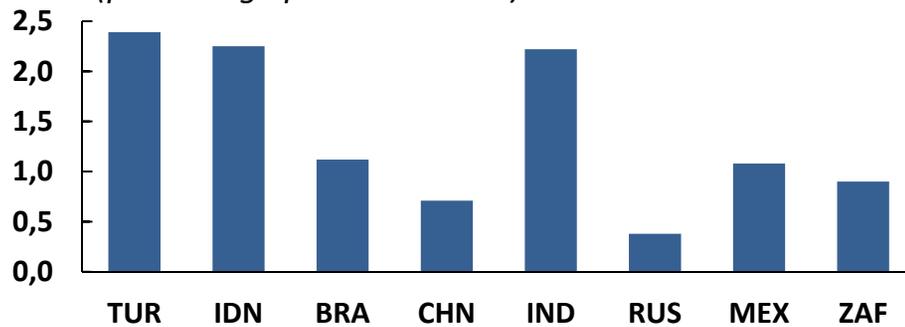
Sources: Haver Analytics; IMF, *World Economic Outlook*, April 2013 and IMF staff calculations.

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.

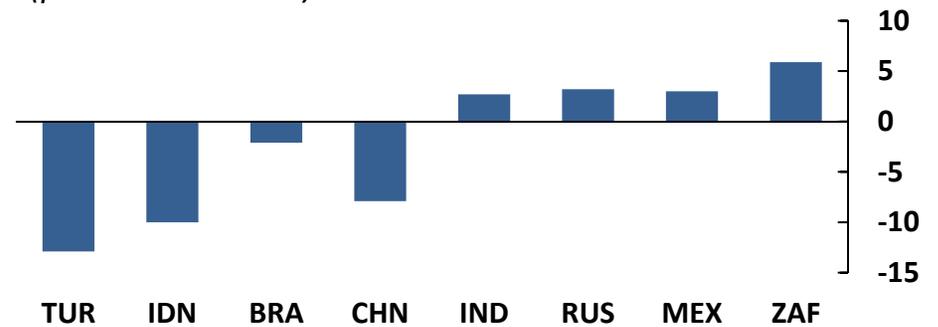
## Market Interest Rates

(percentage point deviation)



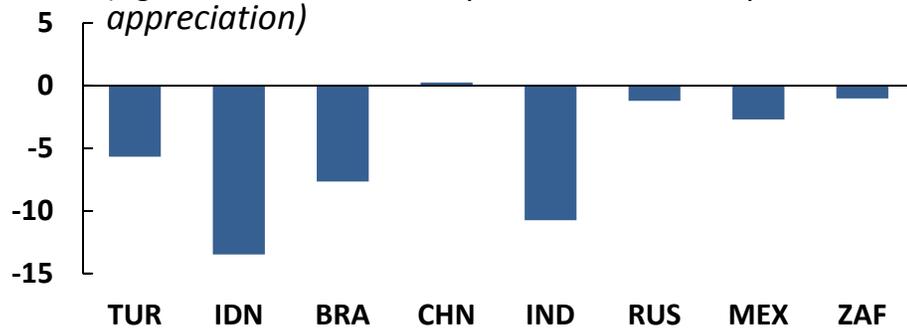
## Equity Prices

(percent deviation)



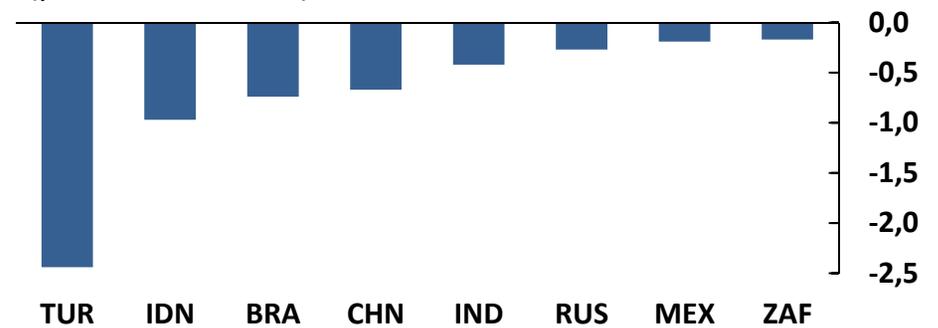
## Bilateral Exchange Rate

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



## Real GDP

(percent deviation)

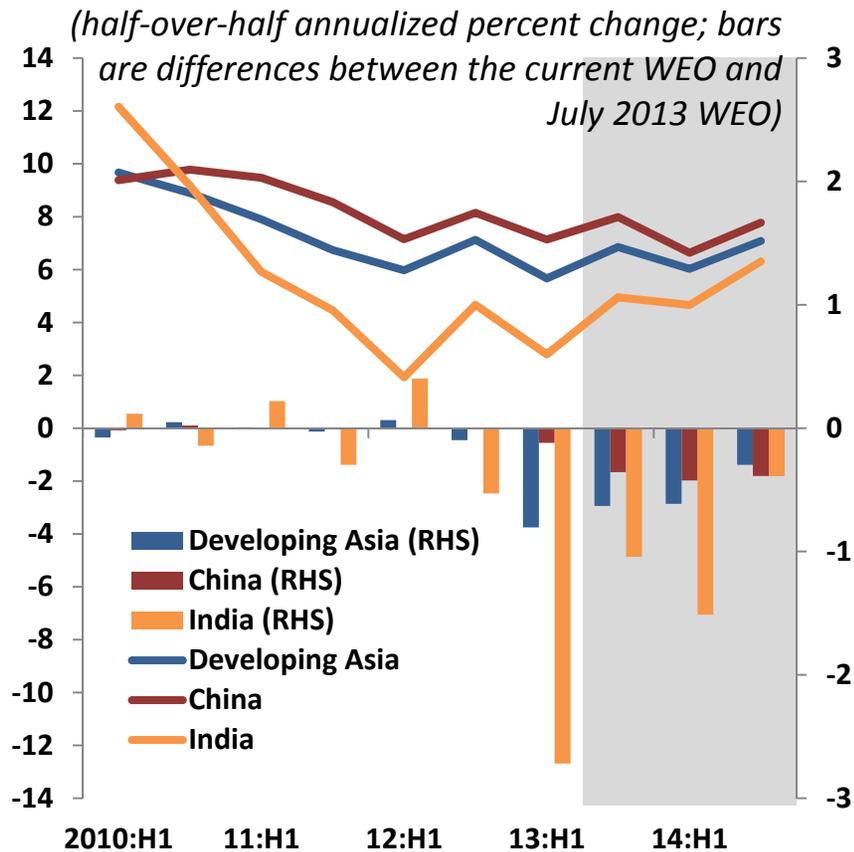


Source: IMF staff estimates.

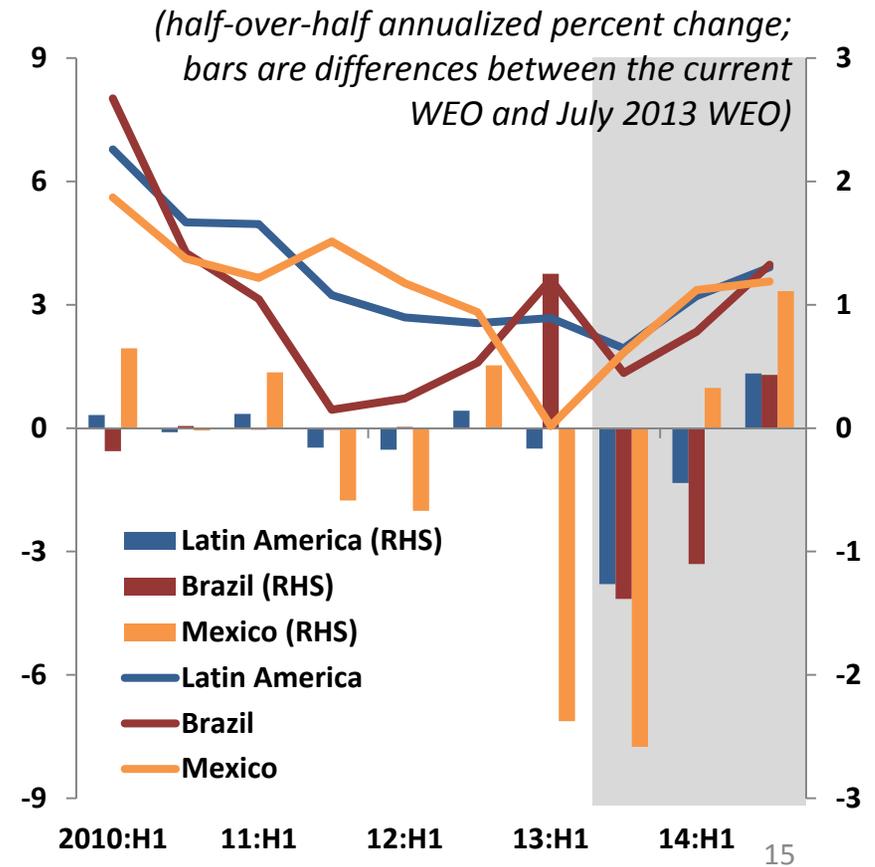
Note: BRA = Brazil; CHN = China; IDN = Indonesia; IND = India; MEX = Mexico; RUS = Russia; TUR = Turkey; ZAF = South Africa.

# EM growth forecasts have been marked down. But growth is still expected to move up modestly in 2014.

## 3. Developing Asia



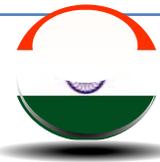
## 4. Latin America and the Caribbean



Sources: IMF staff estimates.

Overall, the WEO forecast has been revised down because of lower growth in emerging economies. In South Africa, activity has been in line with earlier projections: no revision.

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

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

## Five-Year-Ahead EM Forecasts: Less growth than during pre-crisis period but not far from historical averages, except China, Russia.

**Five-Year-Ahead Forecast Growth and Average Growth from 1998-2013 in the BRICS**  
(percentage points)

<b>Economy</b>	<b>Average Growth (1998 – 2013)</b>	<b>Average Growth (2004 – 2008)</b>	<b>Five-Year-Ahead Forecast Growth</b>
<b>Brazil</b>	2.9	4.8	3.5
<b>China</b>	9.6	11.6	7.0
<b>India</b>	6.9	8.0	6.7
<b>Russia</b>	4.4	7.1	3.5
<b>South Africa</b>	3.2	4.9	3.5
<b>Low Income Countries</b>	6.2	8.1	5.7

Source: IMF staff calculations.

Note: Five-year-ahead forecast growth is from the October 2013 WEO (estimate for 2018 growth; for India, shown on a fiscal year basis).

**There are many near-term risks. 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, as reform fatigue sets in  
Japan policy implementation is incomplete**

**US potential growth disappoints  
US monetary conditions tighten more than assumed in the WEO forecast  
Fiscal accidents in AEs or failure to lift the debt ceiling in the US**

# Risks from higher interest rates in advanced economies for emerging economies

**Depends on reason for interest rate hikes:**

**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**

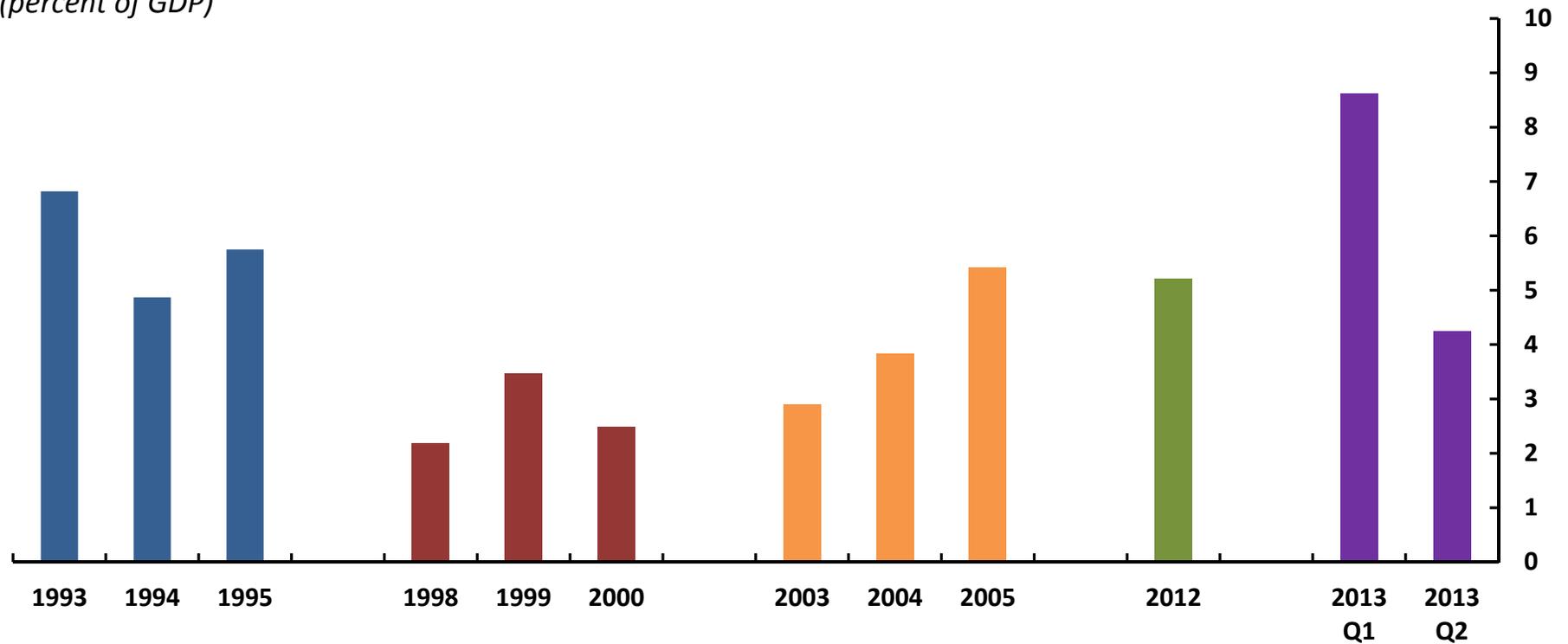
**The WEO forecast assumptions are for benign monetary conditions  
and thus subject to downside risks.**

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

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

# Gross capital Inflows to emerging markets have been high but not extraordinarily high.

**Gross Capital Inflows to Emerging Markets**  
*(percent of GDP)*

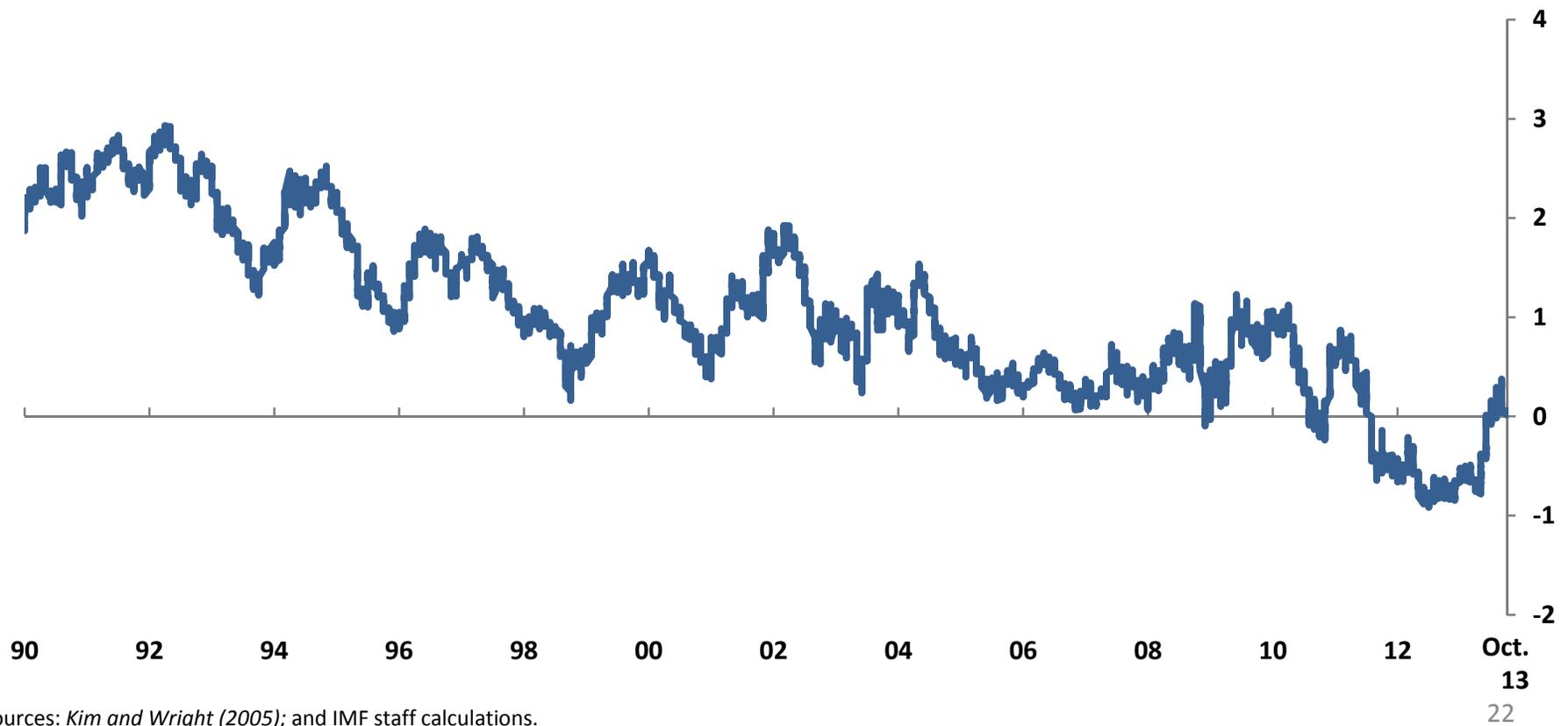


Source: IMF staff calculations.

Note: 2013 Q2 is based on only a subset of the countries due to non-availability of data.

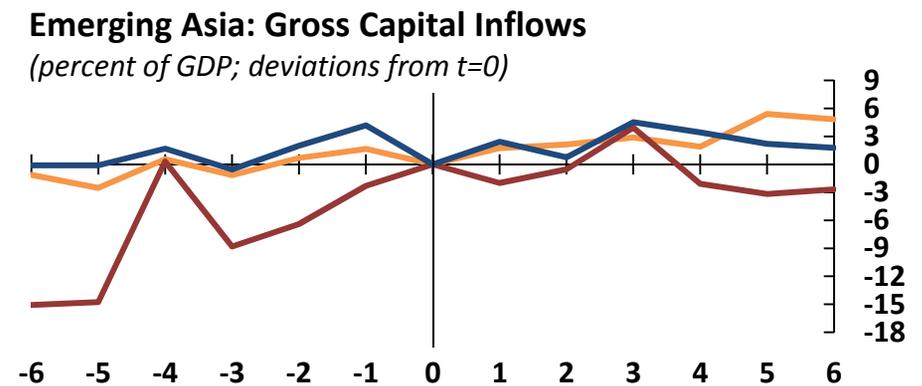
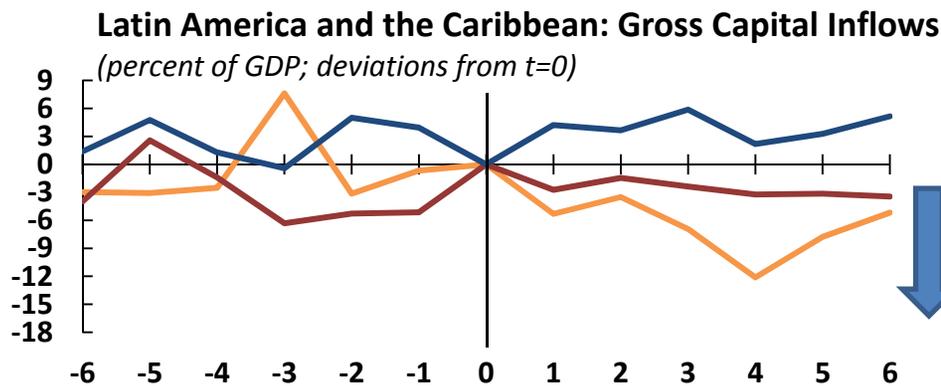
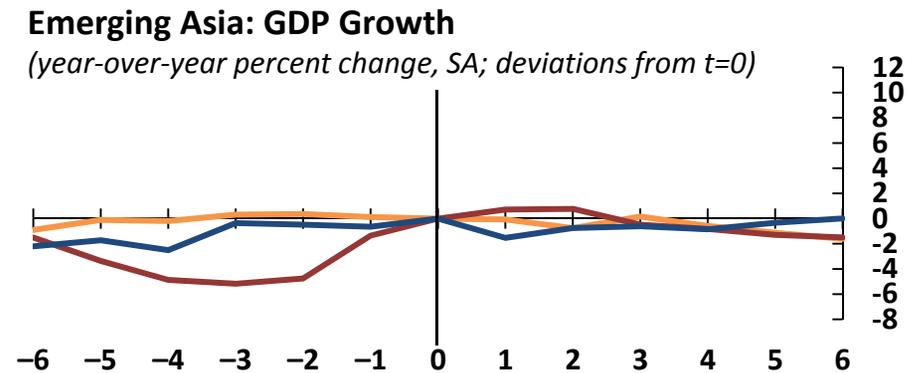
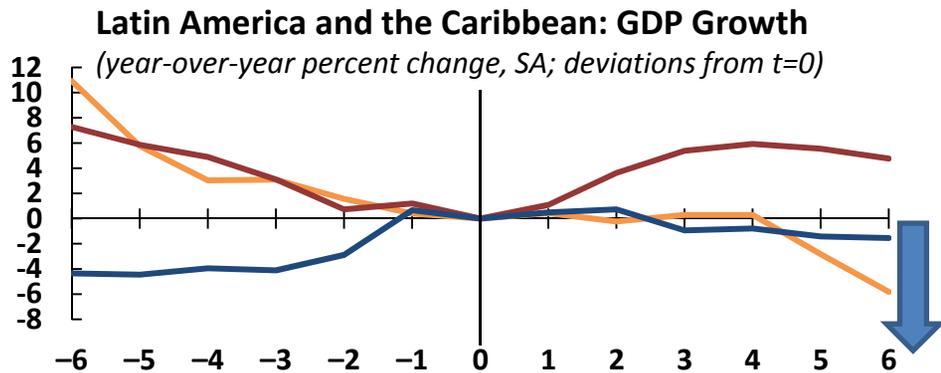
But the U.S. 10-year term premium is very low and could surprise on the upside.

U.S. Term Premium on 10-year Zero Coupon Bond



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

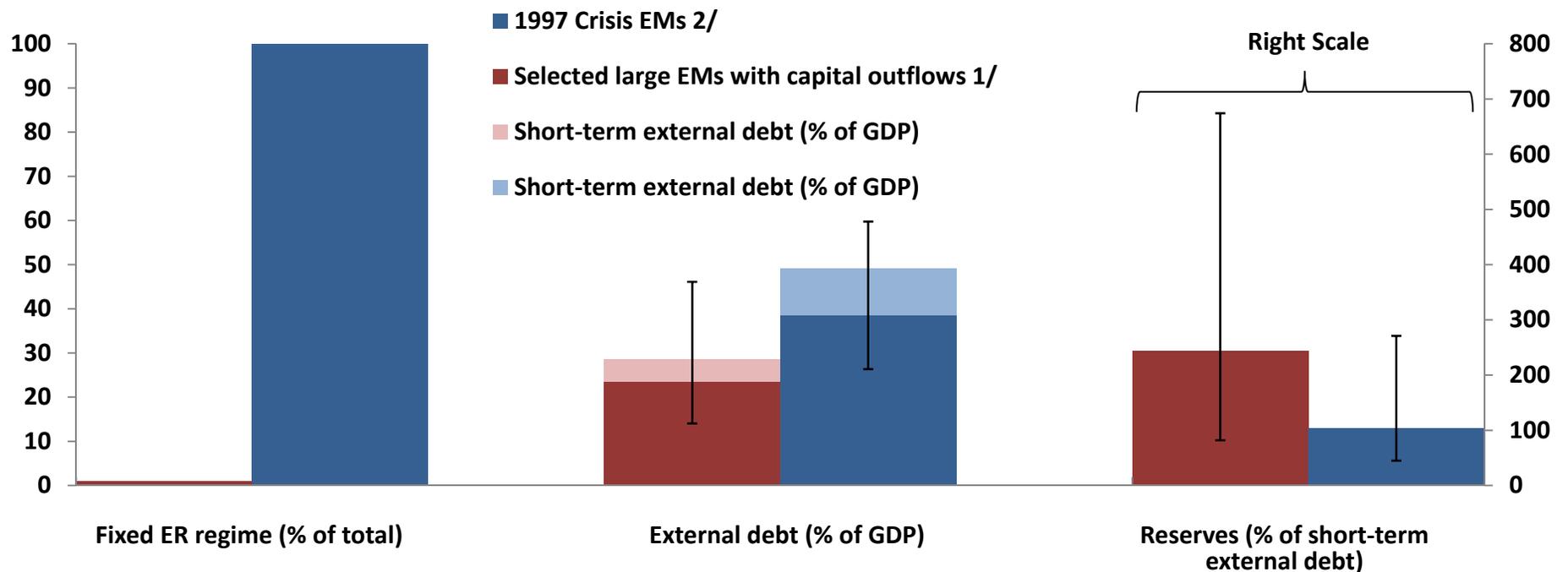
— February 1994    — June 1999    — June 2004



Source: IMF staff estimates.

# EMs are now more resilient than in 1997. Some vulnerabilities have built up. *(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.

## Policies

**Euro area: banking union; structural reforms; gradual fiscal adjustment**

**Japan: work on all 3 arrows of Abenomics**

**US: address ST fiscal challenges; easy monetary policy; MT fiscal adjustment & entitlement reforms**

**China: advance rebalancing and reform shadow banking**

**India: improve fiscal policy and remove structural bottlenecks**

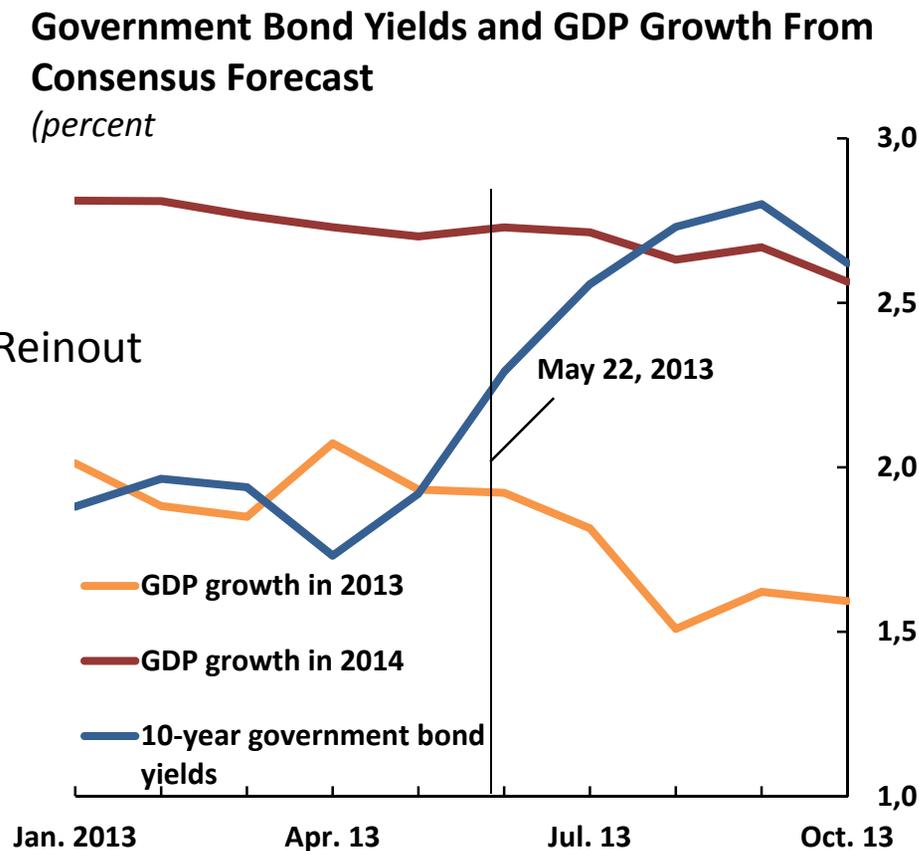
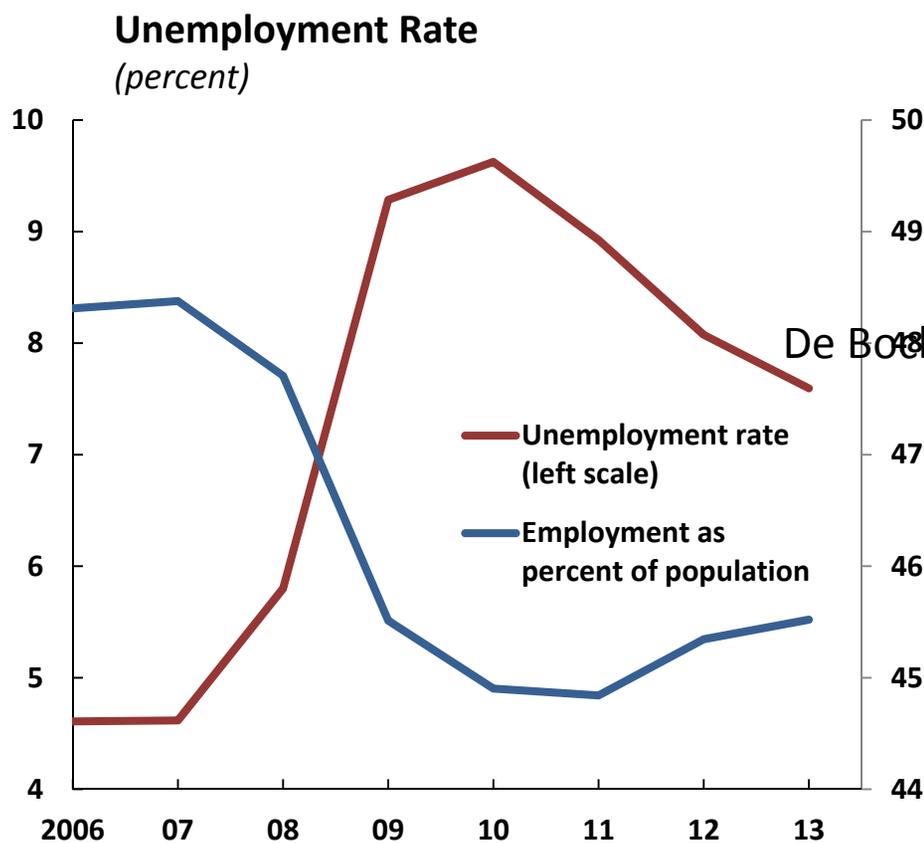
**Brazil: raise domestic saving and foster private investment**

**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**

# Supplementary Slides

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

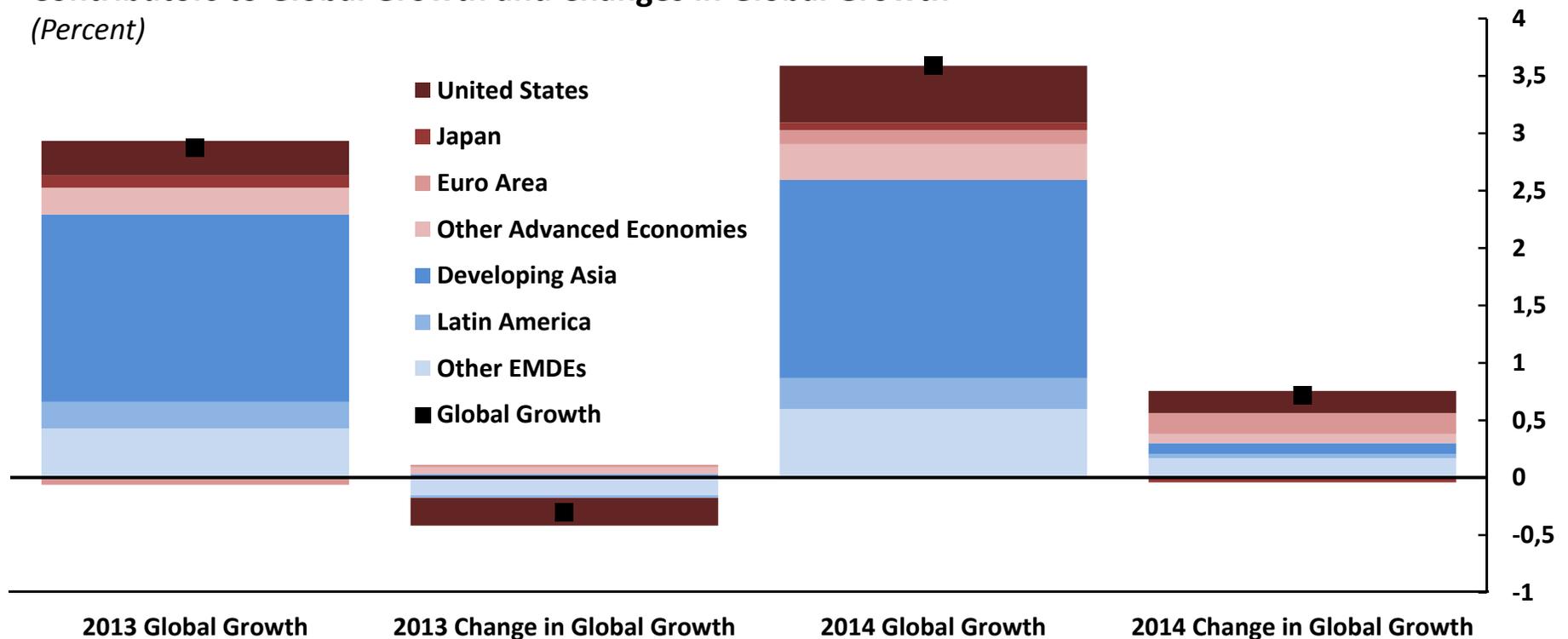


Sources: Bloomberg, L.P., *Consensus Forecast*; and IMF staff estimates.

# The WEO sees advanced economies making greater contributions to global growth, helped by more gradual fiscal adjustment.

## Contributors to Global Growth and Changes in Global Growth

(Percent)



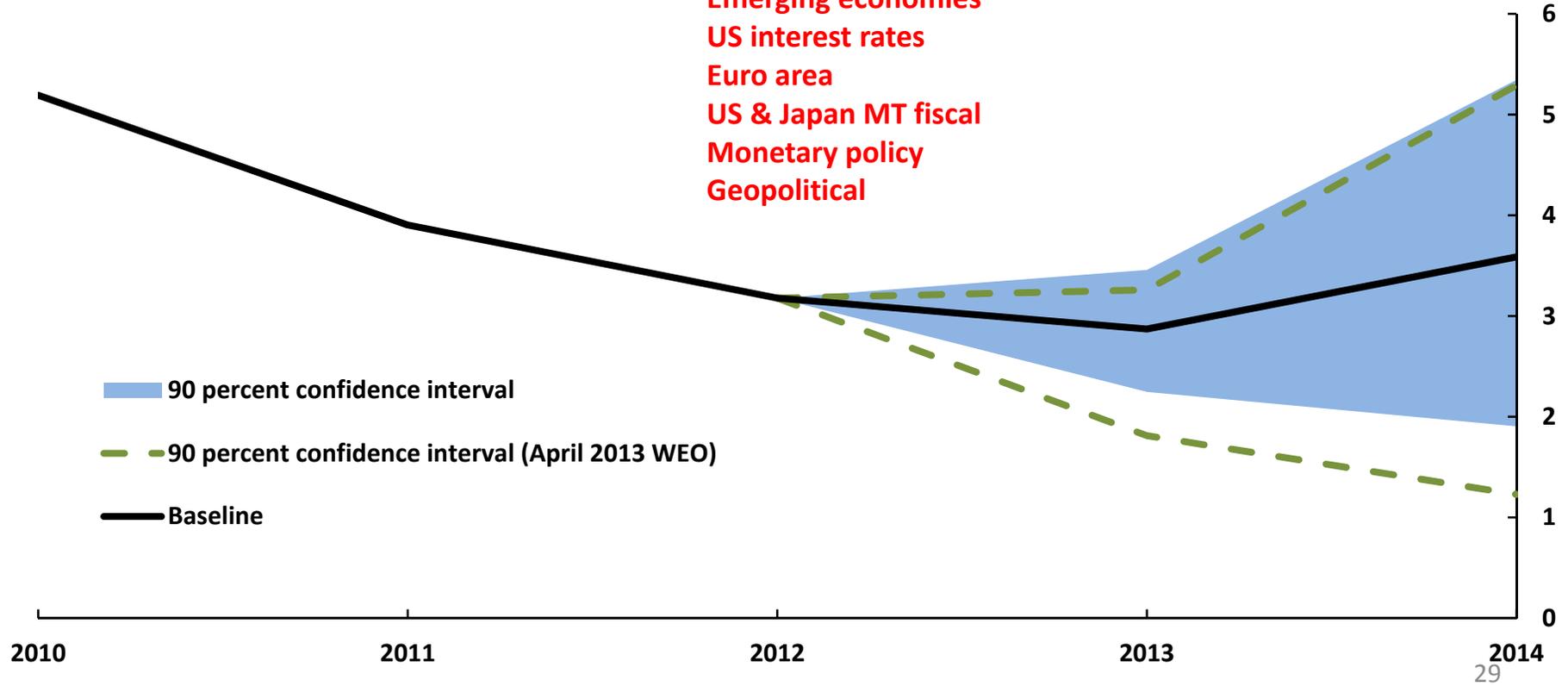
Source: IMF staff estimates.

Note: EMDEs = Emerging Market and Developing Economies.

# Risks to the WEO forecast remain on the downside. Market risks indicators do not point to a large change in risks.

Prospects for World GDP Growth  
(percent change)

**Downside risks:**  
Emerging economies  
US interest rates  
Euro area  
US & Japan MT fiscal  
Monetary policy  
Geopolitical

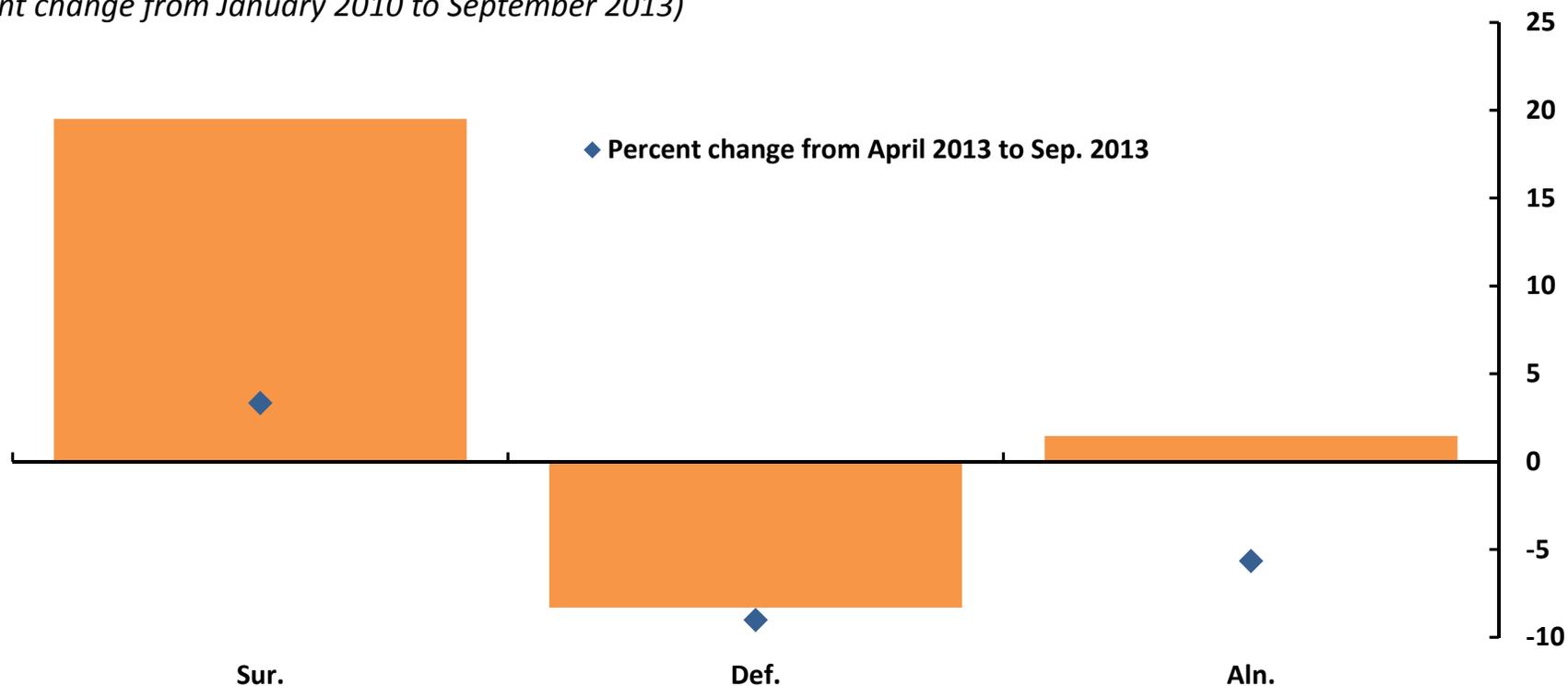


Source: Consensus Forecasts; and IMF staff estimates.

# 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 September 2013)



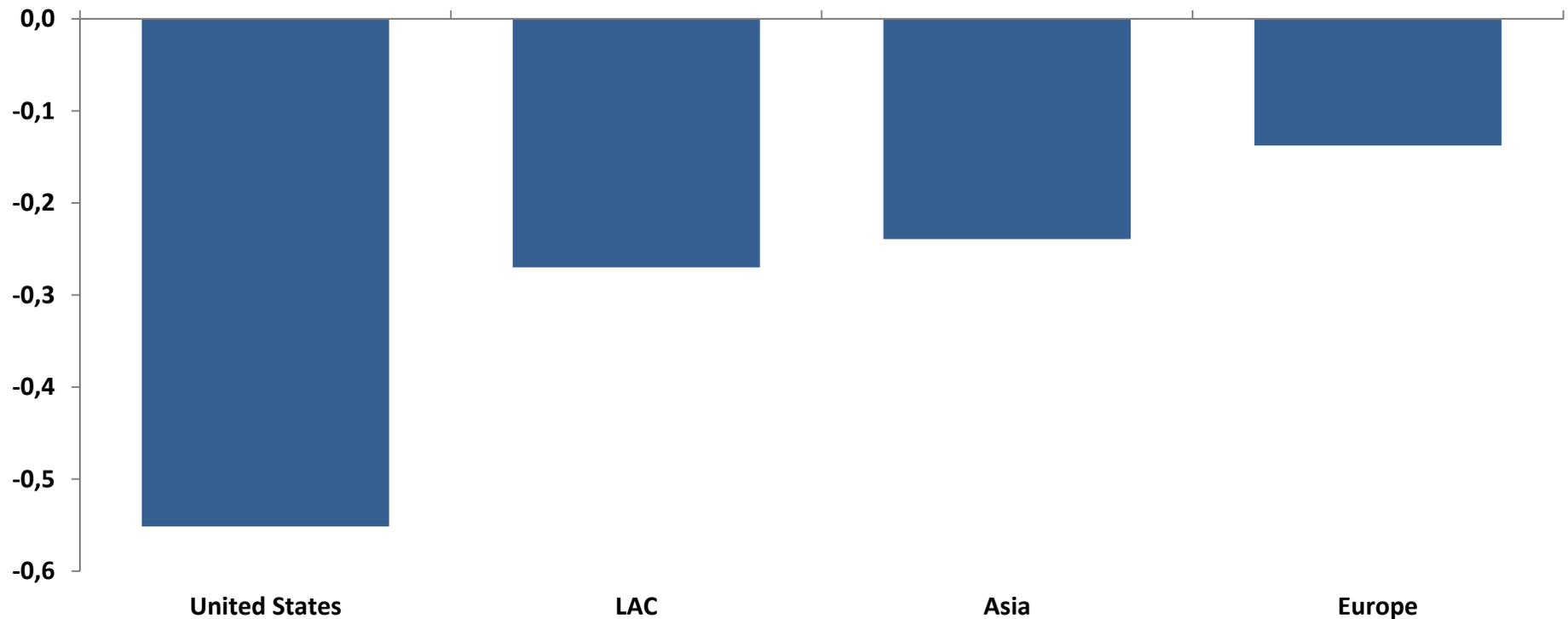
Sources: Haver Analytics; IMF, *World Economic Outlook*, April 2013 and IMF staff calculations.

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.

# 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)

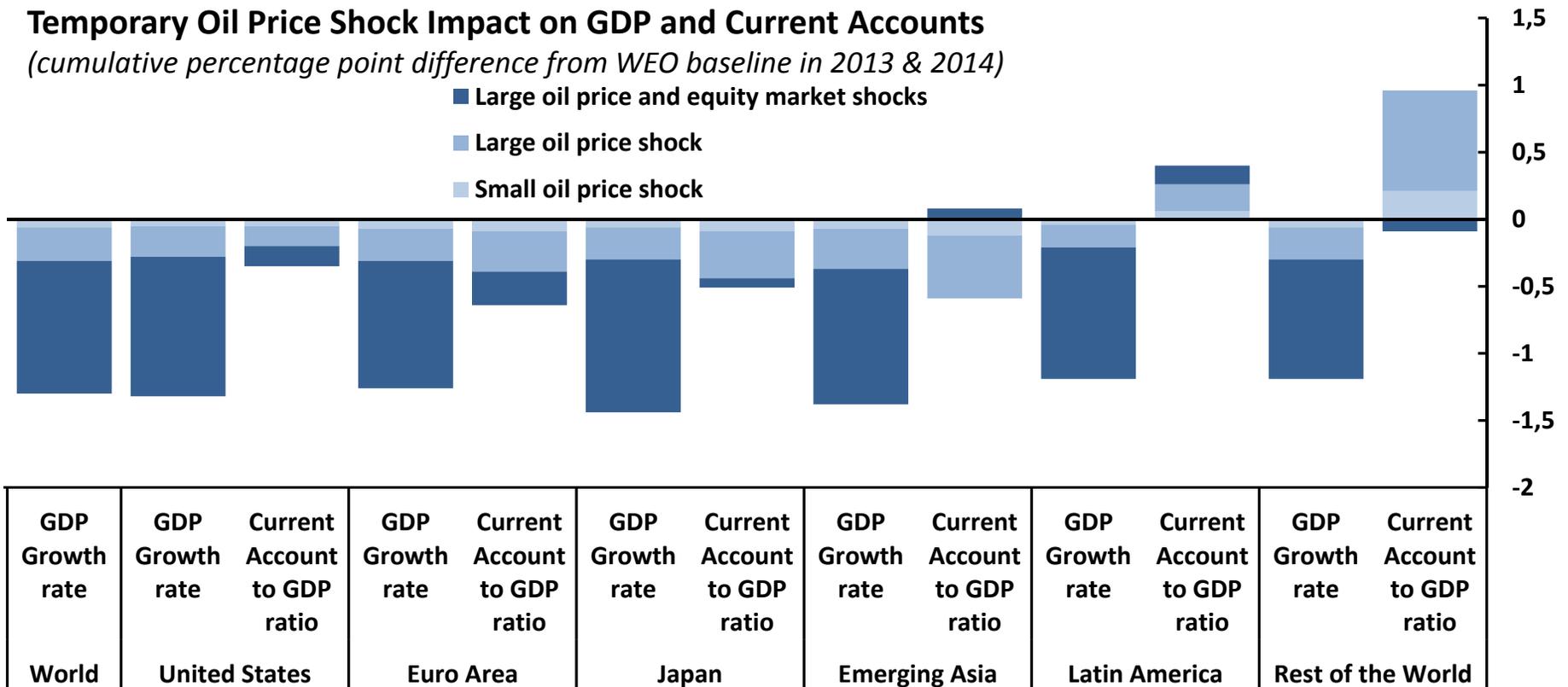


Source: IMF staff calculations.

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.

# Oil price shocks triggered by geopolitical events would mainly reduce growth via financial markets and confidence

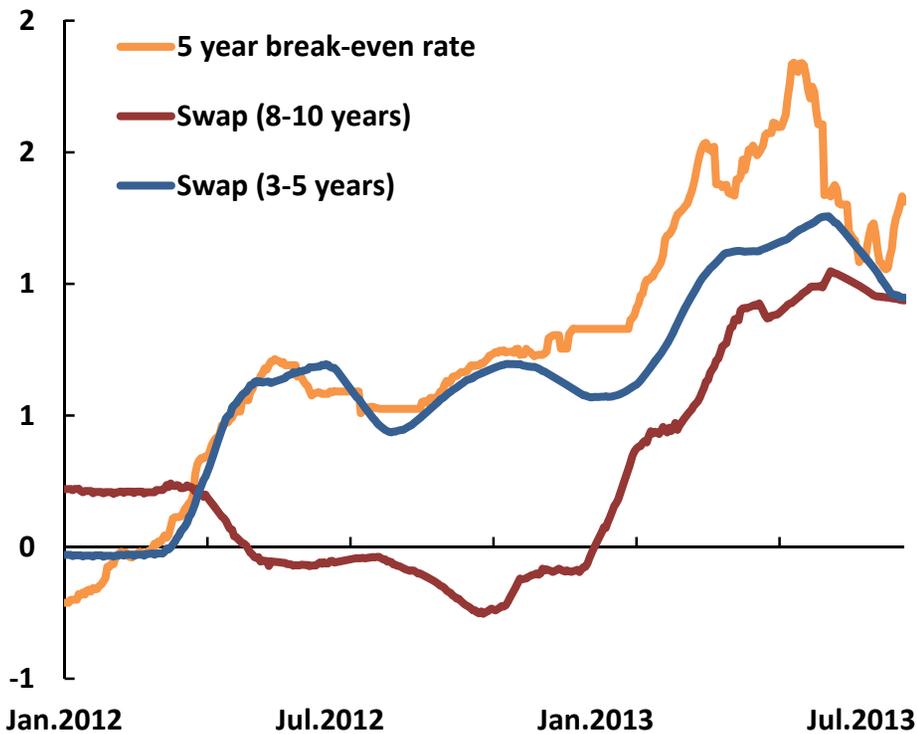
**Temporary Oil Price Shock Impact on GDP and Current Accounts**  
*(cumulative percentage point difference from WEO baseline in 2013 & 2014)*



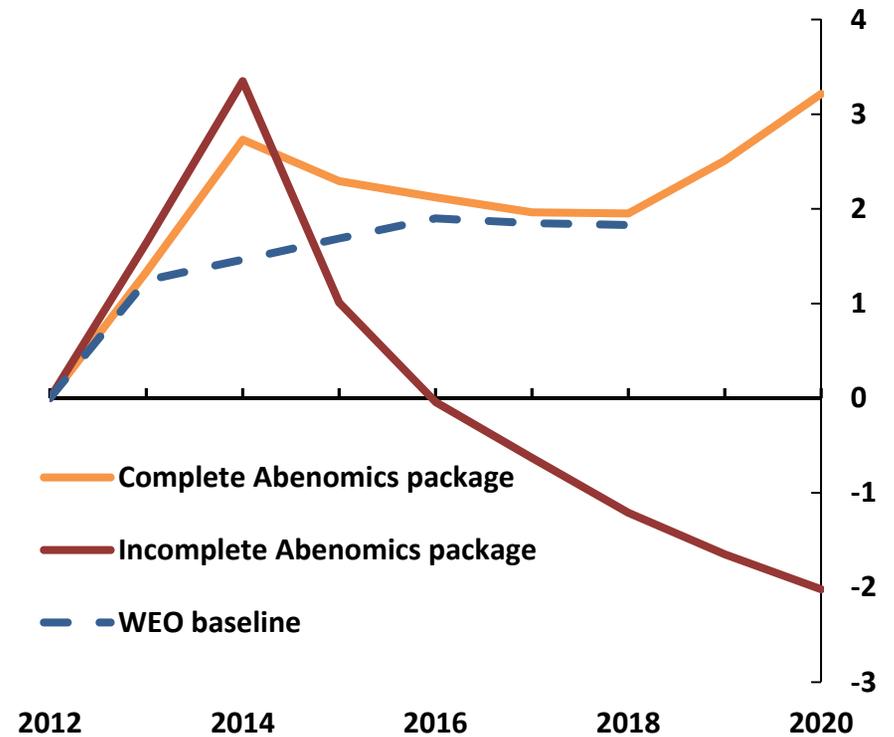
Source: IMF staff estimates.

# Abenomics: Risks after early success?

**Inflation Expectations 1/**  
(year-over-year percent change)



**Real GDP**  
(percent deviation from pre-Abenomics baseline)

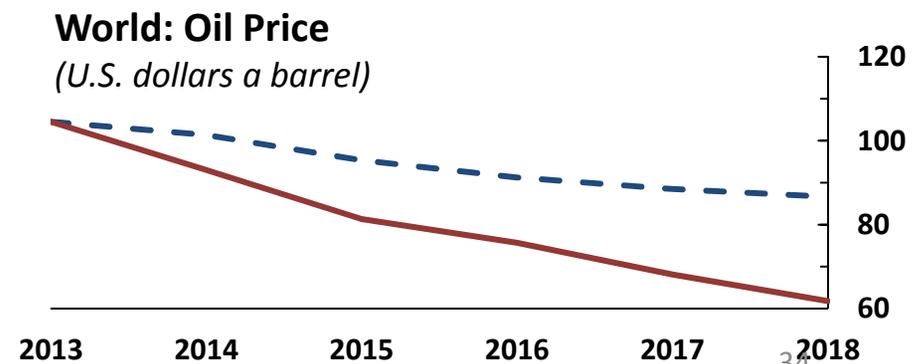
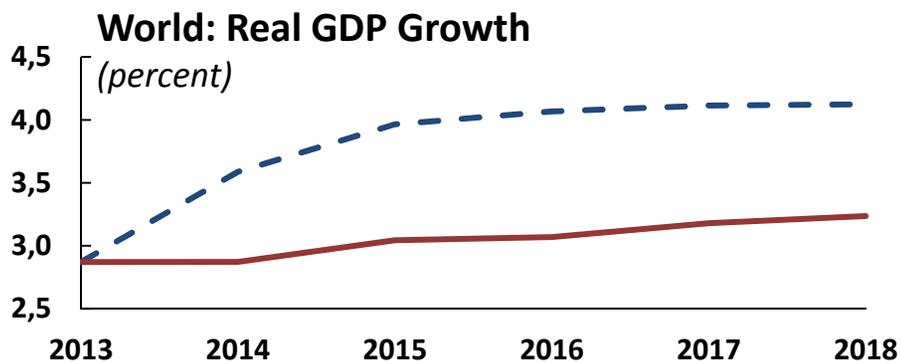
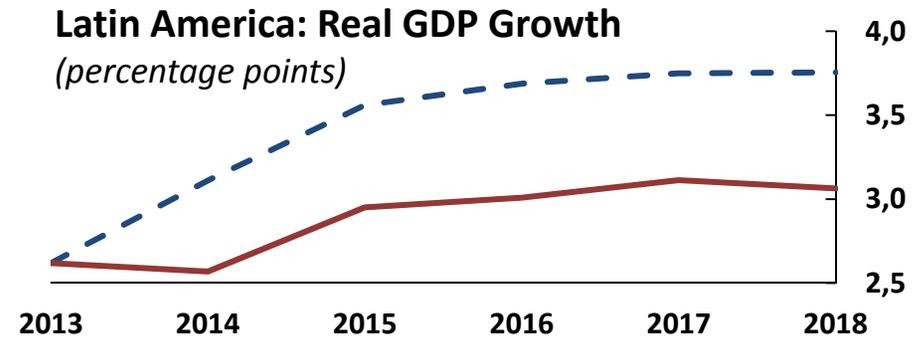
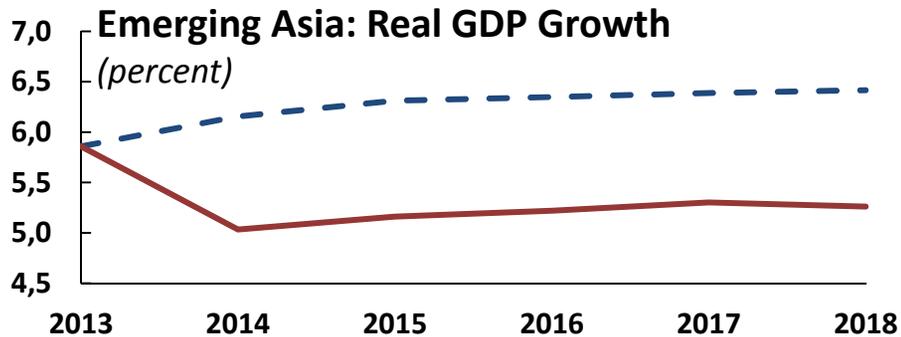


Sources: IMF staff calculations based on data from Bloomberg, L.P. and IMF staff estimates.

1/Estimated as a one-month moving average of implied consumer price index based on inflation swap bid and ask prices.

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

--- WEO baseline  
 — Plausible Downside Scenario



Source: IMF staff estimates.

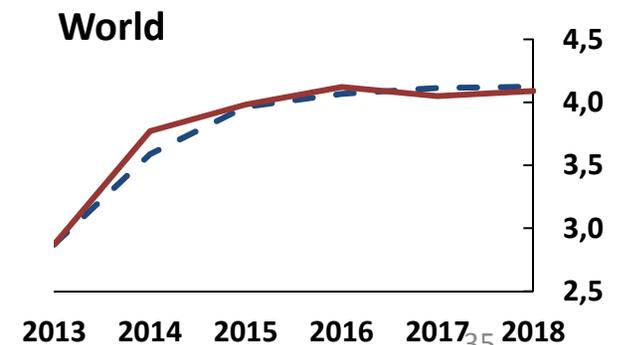
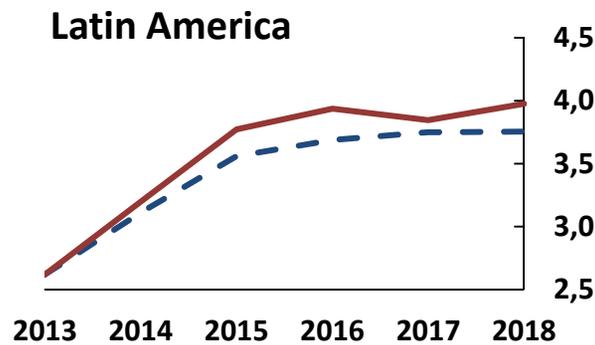
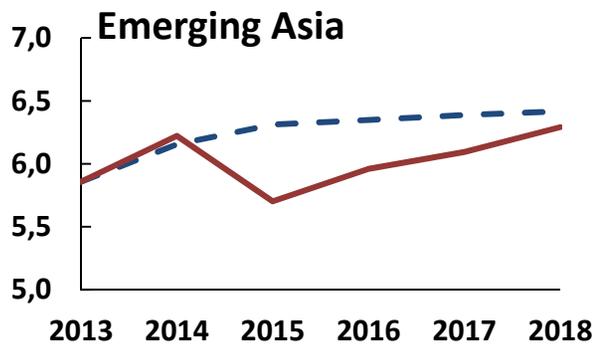
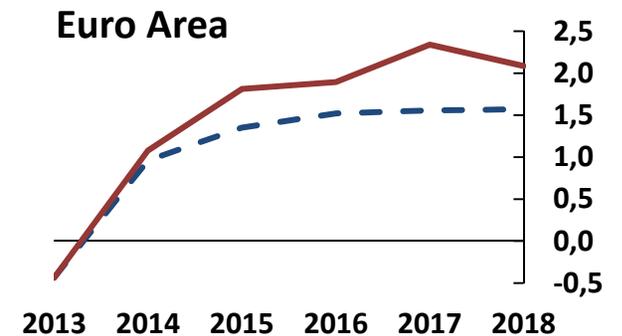
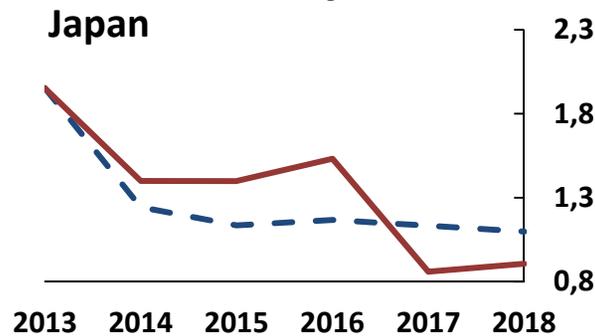
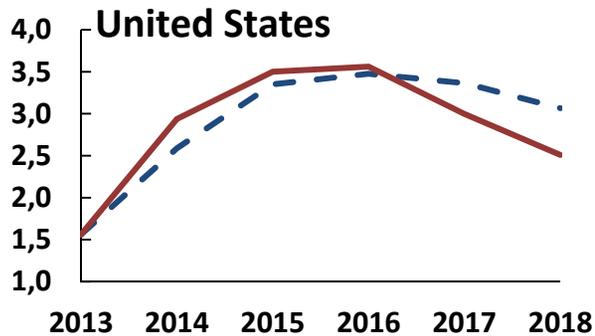
# Rebalancing scenario: a safer world but with similar growth rates

## Real GDP Growth

(percent)

--- WEO baseline

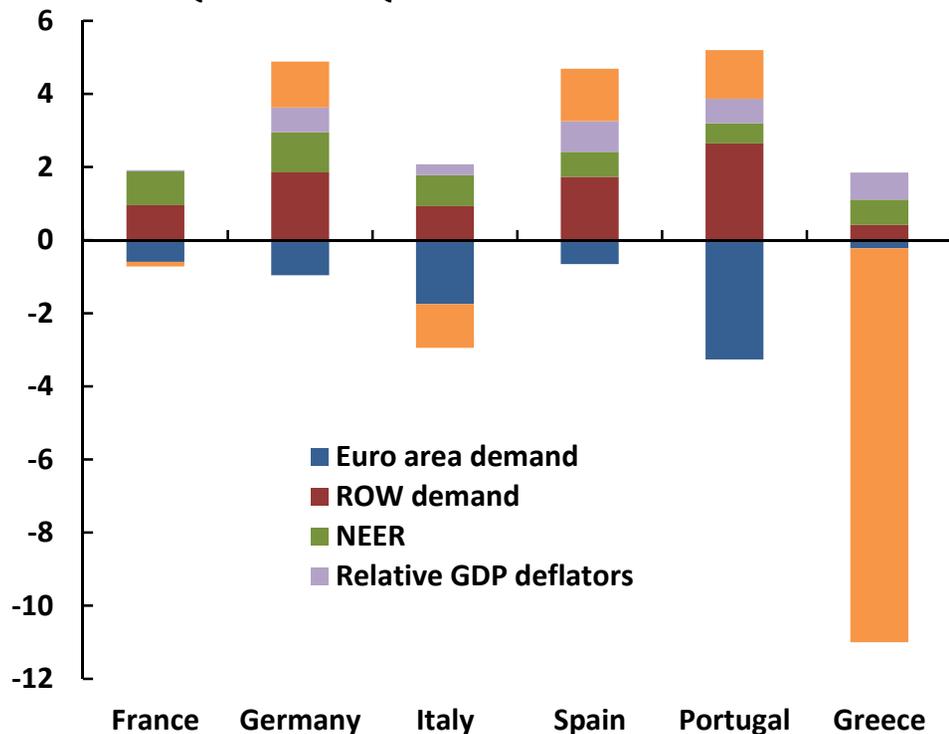
— Rebalancing Scenario



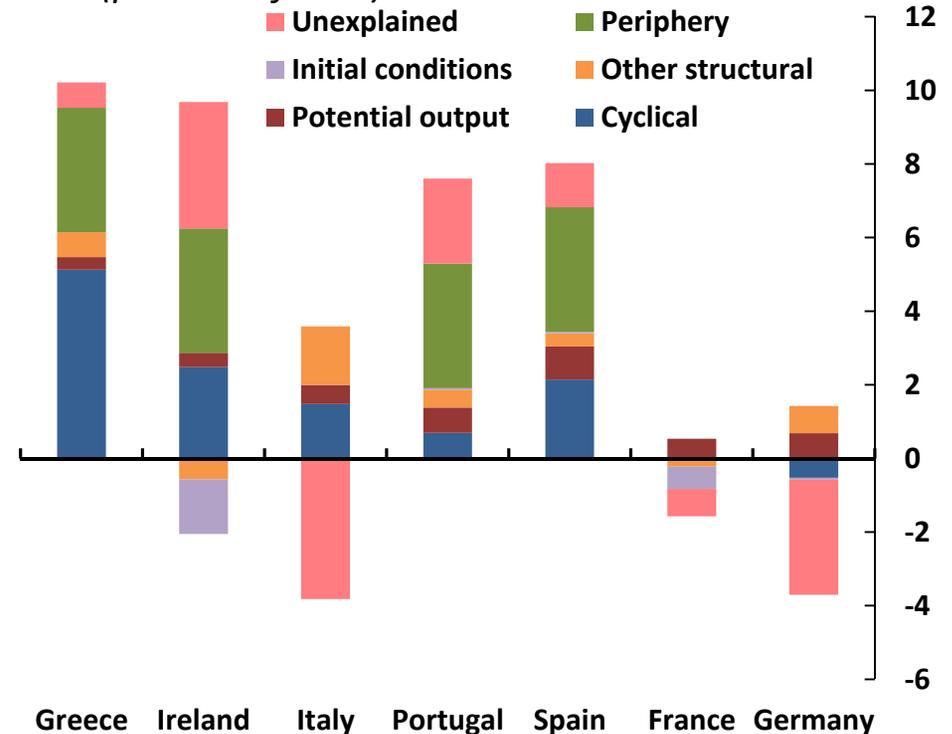
Source: IMF staff estimates.

# Export performance improved, except in Greece. There still is a long way to go in reducing large NFL positions.

**Cumulative Contributions to Export Performance 1/  
2008:Q3 – 2012:Q4**



**External Adjustment 2/  
(percent of GDP)**



Sources: Eurostat; Haver Analytics; IMF, *Direction of Trade Statistics*; and IMF staff calculations. 1/ IMF staff estimates are based on export regression analysis.

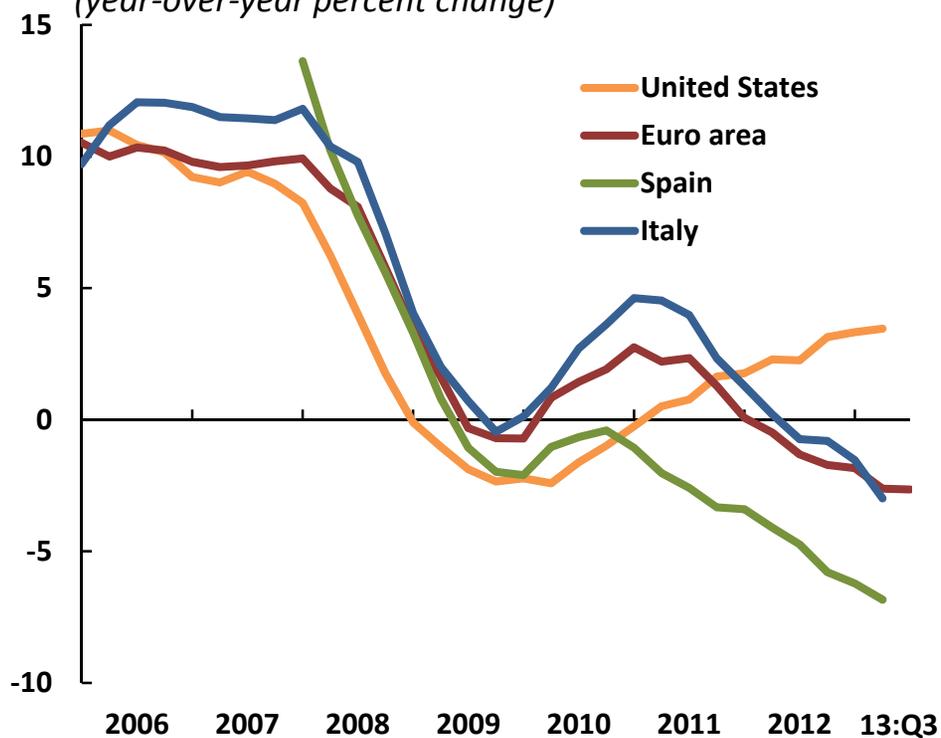
Note: ROW = rest of the world.

2/ Contributions to change in current account, 2007-12. IMF staff estimates are based on current account regression analysis.

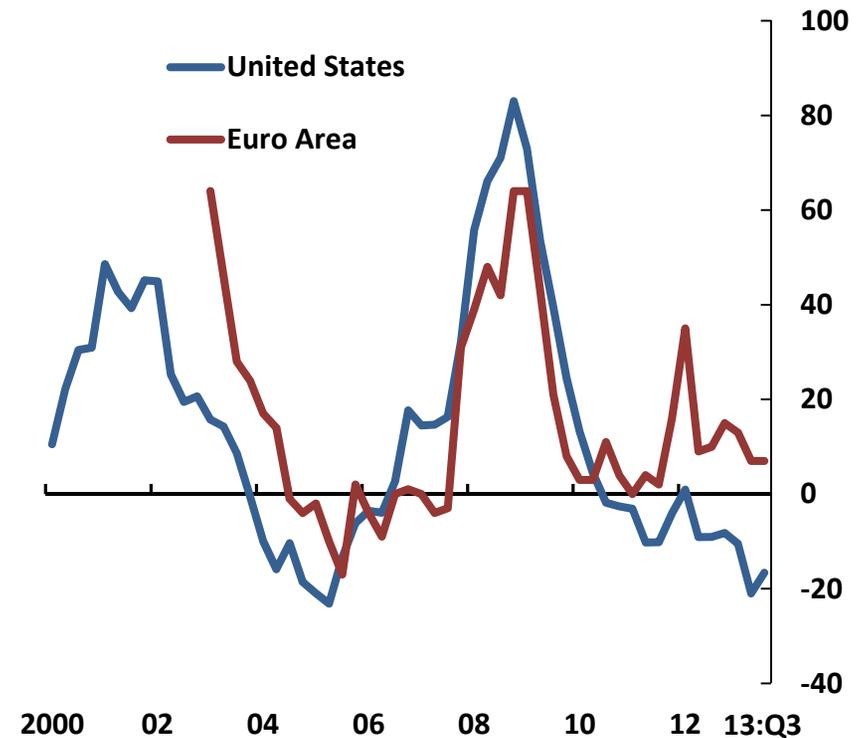
# Euro area credit conditions are still tight, while U.S. conditions continue to loosen.

**Nonfinancial Firm and Household Credit Growth 1/**

(year-over-year percent change)



**Bank Lending Conditions 2/**



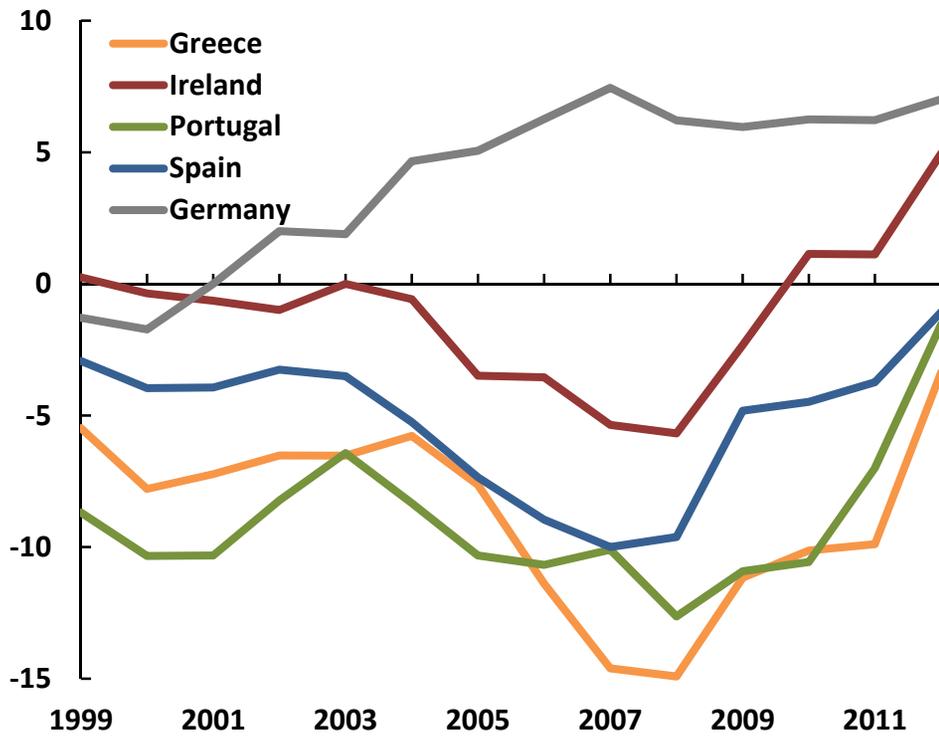
Sources: Bank of Italy; Bank of Spain; Haver Analytics.

1/ Flow of funds data are used for the euro area, Spain, and the United States. Italian bank loans to Italian residents are corrected for securitizations.

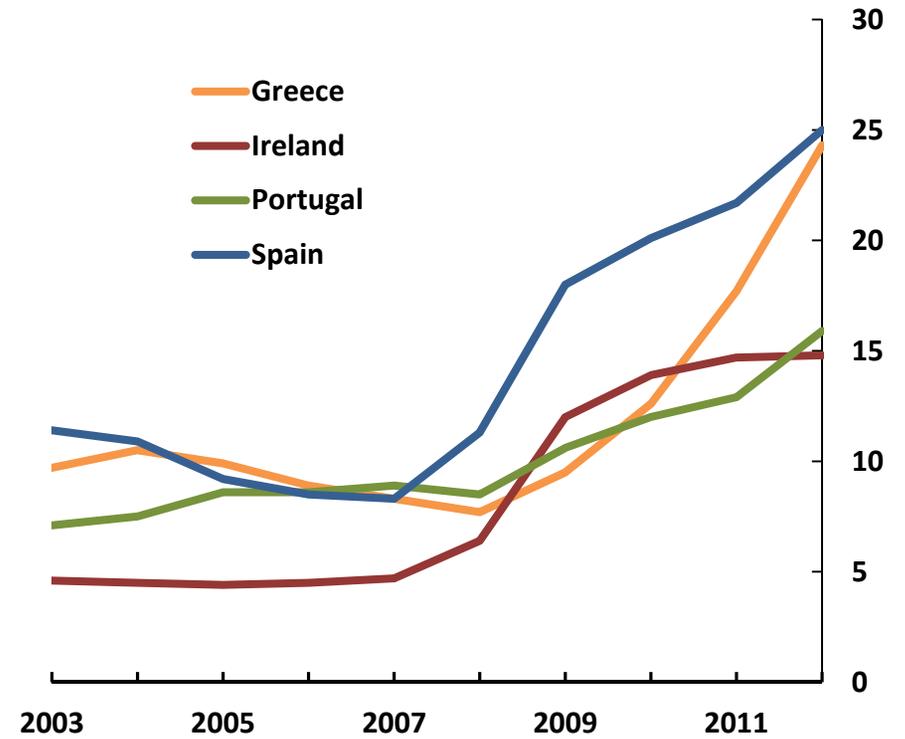
2/ Percent of respondents describing lending standards as tightening "considerably" or "somewhat" minus those indicating standards are easing "considerably" or "somewhat" over the previous three months. Survey of changes to credit standards for commercial and industrial and commercial real estate lending for the United States.<sup>37</sup>

# External balances improved in the periphery and unemployment rose.

**Current Account**  
(percent of GDP)



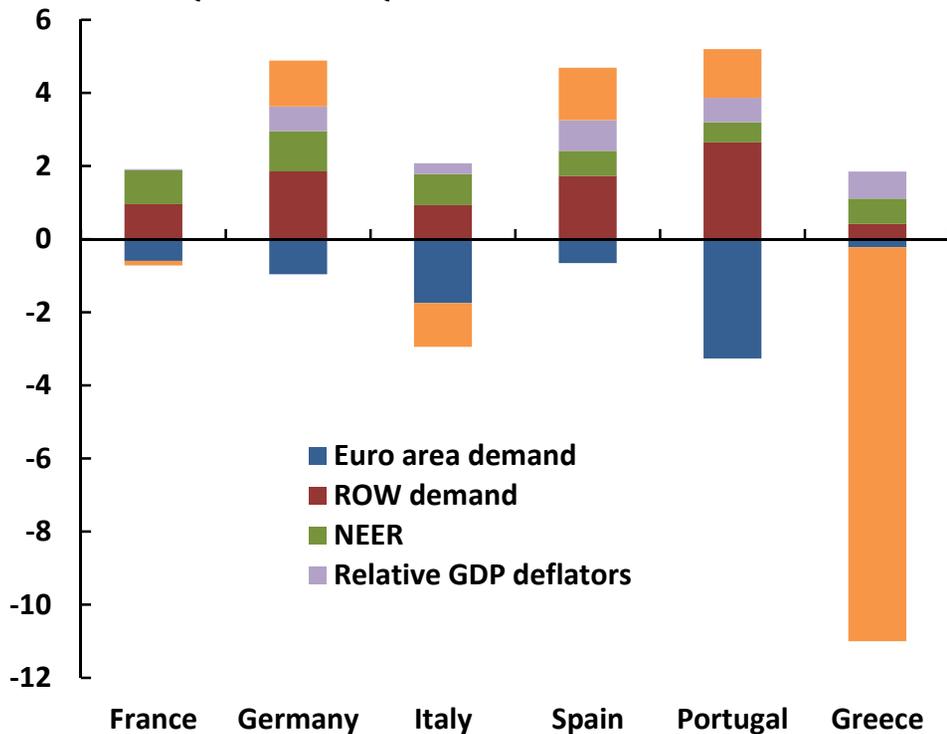
**Unemployment Rates**  
(percent)



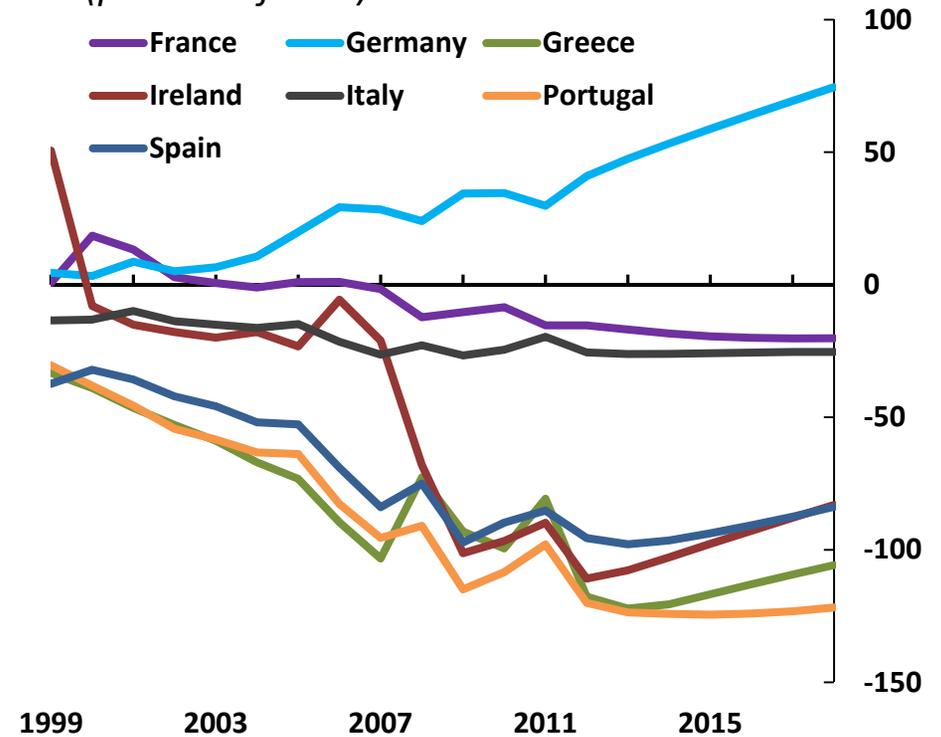
Sources: Eurostat; Haver Analytics; and IMF staff calculations.

# Export performance improved, except in Greece. There still is a long way to go in reducing large NFL positions.

**Cumulative Contributions to Export Performance 1/  
2008:Q3 – 2012:Q4**



**Net Foreign Asset Position 2/  
(percent of GDP)**

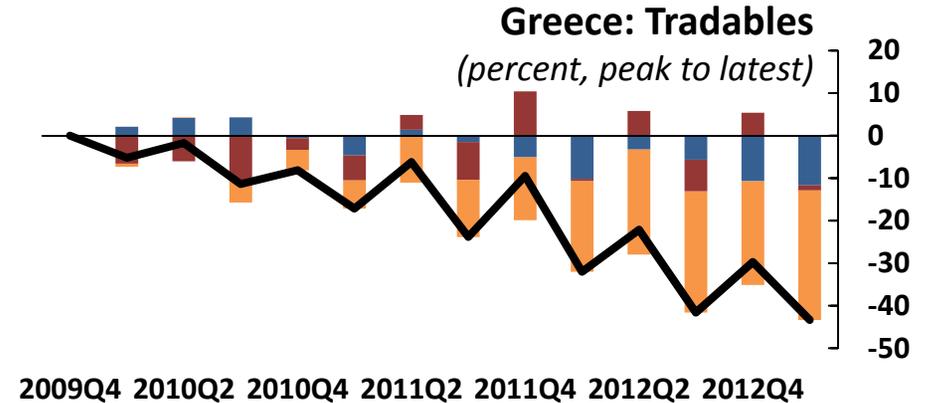
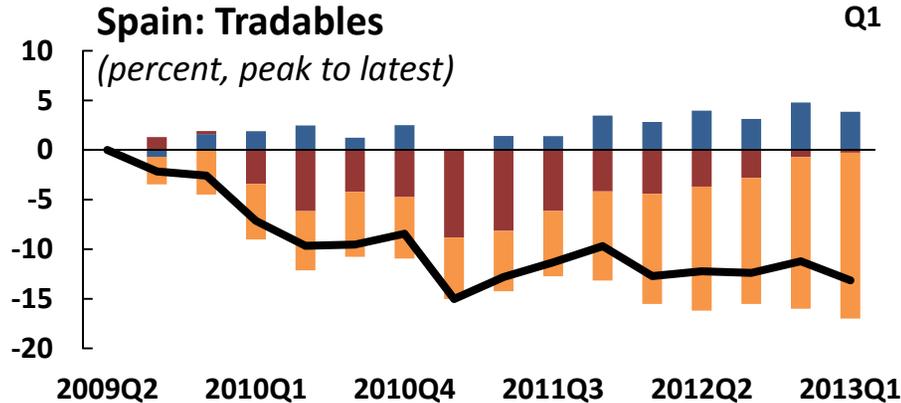
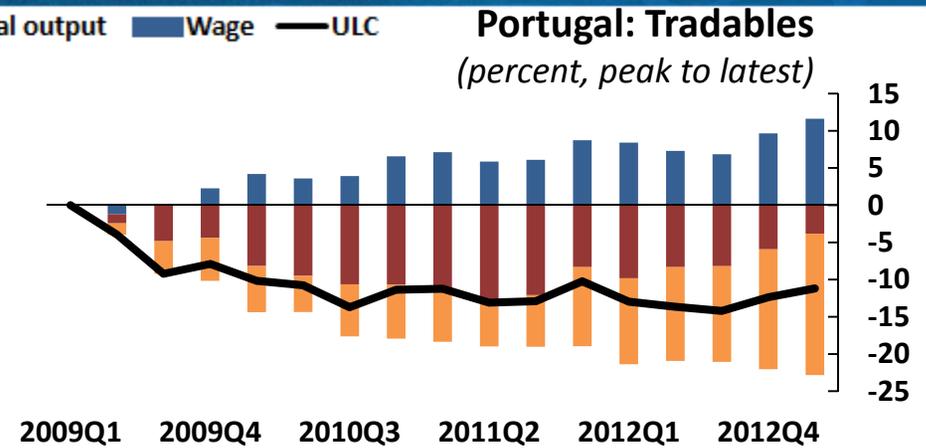
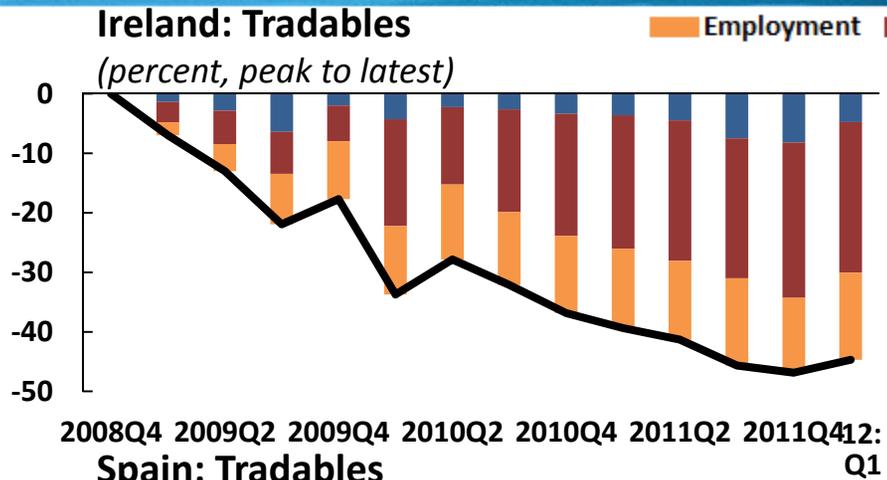


Sources: Eurostat; Haver Analytics; IMF, *Direction of Trade Statistics*; and IMF staff calculations.  
Note: ROW = rest of the world.

1/ IMF staff estimates are based on export regression analysis.

2/ Net foreign asset position in percent of GDP implied by WEO projections, assuming no future valuation effects.

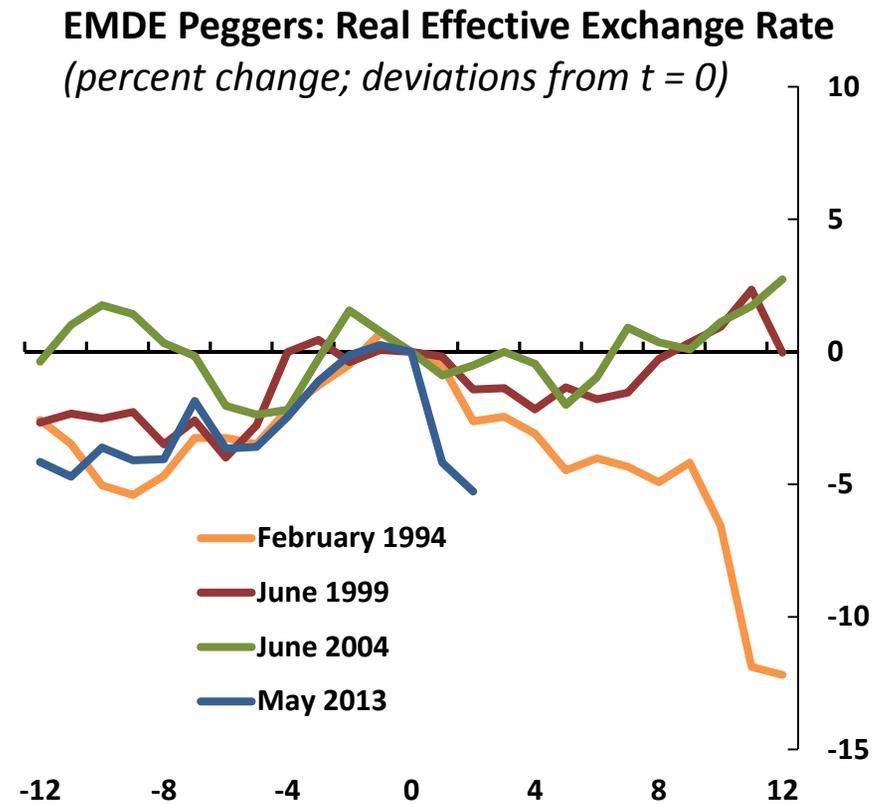
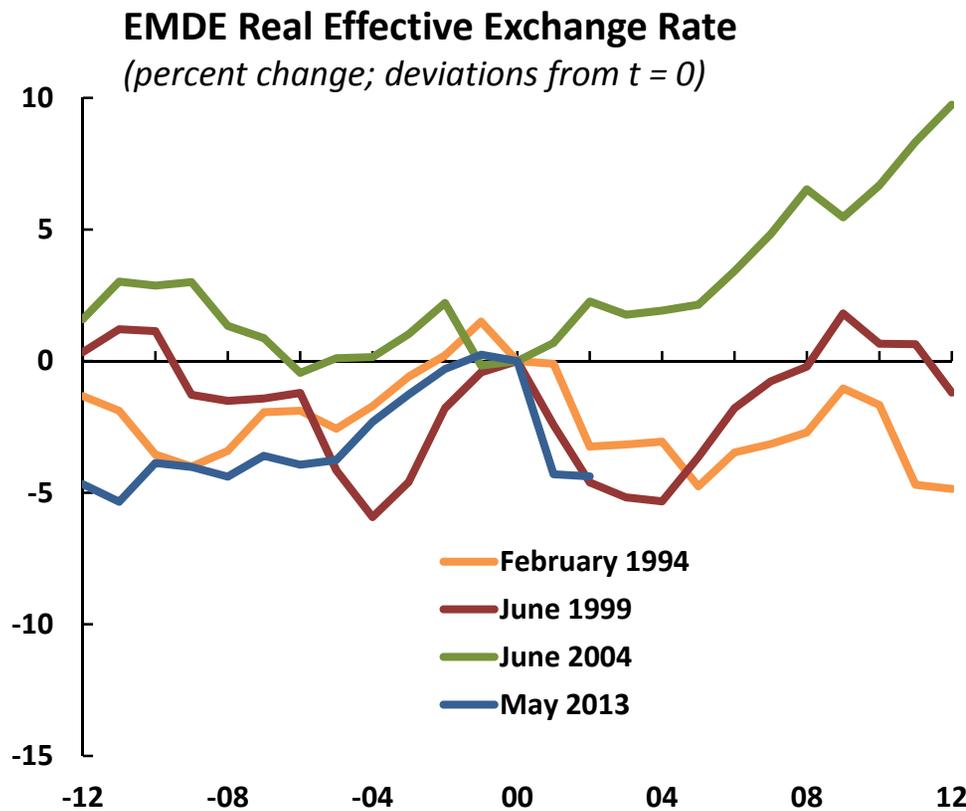
# As less productive workers were fired, unit labor costs declined. Wages fell modestly in Ireland and Greece.



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Note: Tradables sector include manufacturing (industry, excluding construction for Greece). Peaks are 2009:Q4 for Greece, 2008:Q4 for Ireland, 2009:Q1 for Portugal, and 2009:Q2 for Spain (based on ULCs). Latest is 2013:Q1. For real output, negative sign indicates increase in real output.

# Exchange rate pegs may be more vulnerable to U.S. monetary policy tightening.



Source: IMF staff calculations.

Note: EMDE = emerging market and developing economy. The x-axis shows the numbers of months away from time  $t = 0$ ;  $t = 0$  is February 1994, June 1999, June 2004 and May 2013.

## Euro Area Rebalancing

- **Current accounts in the periphery moved from large deficits into surplus, mainly because of low demand**
- **Exports are growing but tradable sectors are still shrinking. There still is a long way to go to reduce large NFL positions**
- **ULC in periphery slowed relative to core but mostly because of cutbacks in employment. Tradable sectors are shrinking.**