

IMF April 2013 World Economic Outlook: Hopes, Realities and Surveys

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In its April 2013 World Economic Outlook (WEO), the IMF sees a stabilization of economic activity in advanced economies and a pickup in growth in emerging market and developing economies. Subtitled “Hopes, Realities and Surveys,” the report states that after a slowdown in 2012, financial conditions have eased and global market confidence has improved. In advanced economies, two main tail risks to the global recovery could be averted: the danger of a euro area break-up and of a sharp fiscal contraction in the U.S.A. However, the road to recovery remains bumpy, and prospects remain divergent: What was a two-speed recovery, i.e. strong economic growth in developing economies but weak economic performance in advanced economies, is now becoming a three-speed recovery. Emerging and developing economies are still growing strongly, the U.S.A. is performing better than forecast, but the euro area is still experiencing negative growth.

World output is projected to increase by 3.3% in 2013 and 4% in 2014, while euro area growth is forecast to contract by 0.3% in 2013 and to increase by 1.1% in 2014. The analogous projections for Central, Eastern and Southeastern European (CESEE) countries are +2.2% (2013) and +2.8% (2014). Growth in the U.S.A. is forecast to be 1.9% in 2013 and 3% in 2014.

Since the October 2012 WEO, acute crisis risks in the euro area have diminished, inflation pressure has moderated and confidence in the viability of monetary union has increased. However, financial conditions remain vulnerable: The highly fragmented transmission of monetary policy and the weak credit intermediation in the euro area periphery are still hindering recovery. Domestic rebalancing from the public to the private sector is being held back by deleveraging, tight credit conditions and economic uncertainty. Events in Cyprus could lead to even more sustained financial market fragmentation. Hence, the main short-term risks now evolve around balance sheet weaknesses, financial fragmentation and insufficient progress toward a stronger economic and monetary union. However, the IMF recognizes that some institutional progress has been made in creating a roadmap for a banking union in the EU.

The WEO stresses that healthy banks are important to support recovery: Completing bank recapitalization and dealing with nonperforming assets are considered the crucial conditions in this regard. The IMF’s policy advice for the euro area hence focuses on further progress on banking union, including bank resolution and deposit protection, fiscal integration and on arresting the decline in demand. Given moderating inflation pressure, monetary policy should remain very accommodative.

Emerging Europe has experienced a sharp growth slowdown in 2012, reflecting spillovers from the euro area crisis and domestic policy tightening in the largest economies. Southeastern Europe is forecast to experience the most tepid recovery. Given the strong economic linkages between the euro area and the CESEE countries, prolonged stagnation in the euro area countries represents the key downside risk: Emerging Europe’s principal export market, the euro area, will remain weak, starting to grow only in the second half of 2013. The distorted credit transmission represents a further obstacle to the more robust revival of economic activity in the euro area’s periphery. However, growth in emerging Europe is projected to pick up in 2012 and 2013, with positive impulses from improved financial market sentiment and easing external financing conditions.