The Global Economic Outlook and the Role of the IMF
Remarks at seminar on Global Capital Markets and Smaller Economies
16 February, 2001 – Kingston, Jamaica

- Glad to be here. I have been asked to address two subjects briefly here this morning:
    - The outlook for the world economy, which is of course an important determinant of the economic outlook for small states
    - The role of the IMF, especially in our smaller member economies

World economy

- The outlook is clearly weaker, led by the sharp US slowdown and weak Japan

- IMF forecast 4.2 percent growth last September. Now looks more than 3.5 percent.

- Much depends on US. If slowdown there is unexpectedly sharp, world growth could be lower still. But we are still a long way from global recession: in previous slowdowns growth hit 1 percent in 1982, 1.5 percent in 1991 and 2.5 percent in 1998.

- **US** growth slowed last year as consumer spending and company profits hit by:
    - Higher energy prices
    - Tighter credit conditions
    - Falling share prices
    - Weaker private sector confidence

- Some slowdown was inevitable, as activity was unsustainably strong. We expect very little growth in H1, but a pick-up later in the year.

- But clear risk of a sharper slowdown, given length of upswing and wealth effect.

- Aggressive rate cuts by Fed therefore welcome. A tax cut could help, but fiscal policy should have a long term focus. Monetary policy should do most of the easing, although could be difficult if weakening capital inflows to US push dollar down.

- **Japan** showing renewed weakness.

- Confidence remains depressed. Banks hurt by falling share prices. Outlook for industry clouded by US-led downturn in global electronics market.

- Limited room for manoeuver to cut interest rates should be taken. Fiscal losseing should only be last resort to avoid outright recession.

- Aggressive structural reform – especially banks and corporates – still essential.

- **European** growth slowed H2 last year, but remains relatively robust for now.
- Business confidence weakening. Exports will be hit by US and stronger euro.
- Inflation restrained by stronger euro, lower energy prices and wage restraint.
- So nor urgent need for rate cuts, but scope if activity weakens or euro rises too far.
- With structural unemployment at 8 per cent, need for structural reform as ever.
- What about **emerging markets**? Much depends on the US. Given that uncertainty, need for prudent macro policies and structural reform is as great as ever.
- In capital markets, Fed cuts and greater confidence have allowed Argentina and Turkey back. Emerging market debt issues rebounded in January after a dry period.
- Pronounced slowdown or mild recession, combined with Fed easing, should be OK for emerging market finance. A deeper recession would be more problematic.
- **Asia** most vulnerable to global slowdown, through trade links to US and Japan.
- Markets have weakened following post-crisis recoveries. US slowdown, weak electronics markets and equity volatility all pose threats.
- Corporate and financial restructuring too slow (eg Korea). Also political worries.
- **Latin America** also vulnerable to US slowdown, but more trade with Europe.
- Focus naturally on **Argentina.** Tentative signs of growth and confidence. Benefits more than most from lower dollar and US rates. Program implementation vital.
- **Mexico** grew around 7.5 percent in 2000. Modest slowdown welcome and likely.
- Growth in **Brazil** accelerated in H2 and domestic demand is expected to stay strong. Current account deficit 4.5 percent of GDP, but more than financed by FDI for now.
- Picture mixed elsewhere: **Chile** strong, **Peru** weakening, **Colombia** strong but set to weaken, **Venezuela** weaker because of oil prices, **Ecuador** suffering from oil, weak banks and lack of confidence.
- Elsewhere, growth in **Russia** likely around 4 percent in face of stronger ruble and weaker oil prices. Markets stabilized in **Turkey**, but fiscal and banking concerns.
- **Overall:** Slowdown but don't panic. Most policymakers have room to manoeuver.

Role of the Fund

- Small economies are valued part of Fund membership – approx 40 out of 183 have populations less than 1.5 million.

- We know many small states share difficult development challenges:
  - Remoteness and isolation
  - Relative openness
  - Susceptibility to natural disasters and environemtnal change
  - Limited scope for diversification
  - Greater poverty and income inequality
  - Limited institutional capacity

- These mean volatile incomes. Private markets also see small states as more risky.

- Fund keen to help where we can, through surveillance, lending and TA. Objective is to promote good policies that will deliver sustainable growth in living standards.

- Article IV key to national **surveillance**. More than half small states on annual consultations. Most others – including most in APD – on 24 month cycle. But there are interim staff visits and they can request move to annual cycle.

- Several small states – including Jamaica – have staff-monitored programs, through which there is a close policy dialogue between the Fund and the member.

- Bilateral discussion supplemented by discussions with regional authorities of monetary unions (Eastern Caribbean, West Africa and Central Africa).

- Policy advice from the Fund is important in helping developing countries – including small states – attract and make good use of aid and debt relief.

- Fund endeavouring to promote transparency in policy and data. It is uneconomic for many investors to research small states properly, so transparency can help reduce investror overreaction and adverse shocks.

- Fund promotes orderly current and capital market opening. Good for small states.

- Like all member countries, small states sometimes face balance of payments problems and are entitled to the Fund's **financial assistance** to tackle them.

- Small states have used a wide variety of lending windows. Half are PRGF eligible and some have made use of emergency assistance and Compensatory Financing Facility.

- Facilities have been rationalized and modernized in recent review.
- Fund provides wide range of **technical assistance** through its Fiscal Affairs, Monetary and Exchange Affairs, Statistics and Legal departments. IMF Institute also offers courses to government and central bank officials.
- There is now gradual shift in TA from transition countries to poorer members.
- TA especially valuable to small states because many lack administrative capacity.
- Some access TA through regional institutions like Eastern Caribbean Central Bank.
- Regional assistance to small states in South Pacific has benefited from establishment of regional center in Fiji in 1993, together with UNDP, supported by AsDB, Australia and New Zealand.
- Hope to have similar success with new regional TA center in Caribbean.
- In addition to working directly with and for small states, Fund also does important work in encouraging industrial countries to be good global economic cictzens:
    - More aid
    - Opening markets
    - Debt relief
    - Pursuing sound policies that do not disrupt smaller economies