IMF hikes growth forecast and warns strong clouds

The International Monetary Fund (IMF) has raised its world economic growth forecast from 4 per cent to 4.5 per cent, reflecting the positive impact of economic activity in the first half of the year as much as it did the “strong clouds [that] have appeared on the horizon,” according to an official statement.

Offering comments on the release of the updated forecast, Olivier Blanchard, Chief Economist at the Fund, said, “While we remain cautiously optimistic about the pace of recovery, there are clear dangers and policy challenges ahead.”

In particular, there were concerns about how Europe would deal with fiscal and financial problems, the progress that advanced countries make with fiscal consolidation, and the efforts of emerging countries to rebalance their economies, Mr. Blanchard noted.

On the upside, the Fund report said, the numbers on economic activity for the first half of the year “have come in strong, indeed somewhat stronger than we had forecast”. These would give reasons to be more optimistic than the fund had been earlier, Mr. Blanchard added, referring to an April forecast for growth according to which world economic output was expected to expand at 4 per cent.

Specifically the Fund was cheered by the fact that the world economy expanded at an annualised rate of over 5 per cent in the first quarter of 2010 and that growth was stronger than expected in most countries, including the United States, Europe, Japan, Brazil, and India. “A good sign for the future,” according to the IMF was the finding that in most cases, such growth reflected stronger private demand.

Yet on the downside Mr. Blanchard cautioned that the strong clouds that had appeared on the horizon present “real dangers and serious policy challenges, and give reasons to be less optimistic than we were earlier”.

Clouds threaten global economy

The clouds started building over Greece, but quickly extended to Europe, Mr. Blanchard explained, underscoring that these clouds threatened to cover the entire global economy. He argued that worries about fiscal solvency in Greece got transmitted to fiscal solvency concerns elsewhere and this in turn led to doubts about “the solvency of banks… financial turbulence, disruptions in market financing and a freeze in the interbank market in Europe”.

Despite striking this ominous note for the future, the IMF still noted that its forecast for 2011 would remain broadly unchanged, at about 4.25 per cent. It added that both this and the 2010 growth rates however “hide a large difference between and within advanced and emerging and developing economies”.

In particular, the IMF forecasted growth for advanced countries at 2.6 per cent for 2010 and 2.4 per cent for 2011, emphasising that these low growth rates implied that high unemployment would remain a central issue.

In significant contrast however, the Fund’s growth projection for emerging and developing economies was 6.8 per cent in 2010 and 6.4 per cent in 2011, which included an upward revision of 0.5 per cent for 2010 and a downward revision of 0.1 per cent for 2011.

The IMF also called upon emerging countries such as India to deal with capital flows, expected to increase in the aftermath of the crisis in Europe, because such flows were “largely driven by good fundamentals, and likely to be long lasting.” Mr. Blanchard said that limiting their size through controls, or fighting their effect on the exchange rate through reserve accumulation, may prove “difficult and eventually self defeating”.

The Fund also recommended that emerging market countries focus on shifting from external to internal demand, as that would permit them to maintain growth in the face of lower exports to advanced countries, and to better satisfy domestic needs. This would require both structural reforms and exchange rate appreciations, the fund said.

DPA reports:

IMF said Asia's strong recovery from the global financial crisis continued in the first half of 2010, despite renewed tension in financial markets. "GDP growth forecast for Asia has been revised upward for 2010, from about 7% in the April WEO to about 7.5%," it added. The fund raised its 2010 forecast for China to 10.5% from 10% in April and for Japan to 2.4% from 1.9%. Its forecast for 2011 growth was unchanged at 4.3%, a decline from this year's rate. In a move that might fuel concern the recovery is fading, the fund lowered its 2011 growth forecast for China from 9.9% to 9.6%, for Japan from 2% to 1.8% and for Britain from 2.5% to 2.1%.

India's growth forecast for 2010 to 9.5%, stating that favourable financing conditions and robust corporate profits will accelerate economic expansion. The multilateral lender hiked its growth projection from the earlier estimate of 8.8% it made in April. Recently, PM Manmohan Singh had said the country's economy is expected to grow by 8.5% for the financial year ending March 31, 2011. In the last fiscal, the economy expanded 7.4%.

Collective growth for the 10 members of the Association of South-East Asian Nations was projected at 6.4 per cent in 2010 and 5.5 per cent next year.

A combination of exports and strong private domestic demand lent “continued buoyancy” to the region’s economic activity, according to a revised version of the IMF’s World Economic Outlook released in Hong Kong.

"But downside risks - including the recent turmoil in Europe - mean that Asian policymakers need to remain attuned to negative shocks."

The region also faces a real threat in the sharp rebound in capital flows that is likely to emerge as investors avoid Europe, the United States and Japan, where growth has been sluggish, for a burgeoning Asia. "Such huge inflow of capital can create instability," he warned. To manage such a problem, Asian nations could consider measures such as currency revaluation and even temporary capital controls, he suggested. Asia, he pointed out, needed to nurture a "second engine of growth" by boosting domestic investment and consumption.

It is a strategy that some nations in the region are already pursuing, as they try to strengthen their social safety nets to boost private consumption, and introduce more flexible exchange rates.

China, for instance, recently raised the minimum wages of workers in the hope of revving up domestic consumption, a move hailed by Mr Victor Fung, honorary chairman of Hong Kong's International Chamber of Commerce.

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