



## Global risks getting worse, IMF warns



IMF managing director Christine Lagarde

Kevin Lamarque/Reuters

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The International Monetary Fund cut its forecast for global economic growth and predicted “severe” repercussions if Europe fails to contain its debt crisis or if U.S. policy makers reach an impasse over a fiscal plan.

The world economy will expand 4% this year and next, the IMF said Tuesday, compared with June forecasts of 4.3% in 2011 and of 4.5% in 2012. The U.S. growth projection for 2011 was lowered to 1.5% this year from 2.5% in June.

“Global activity has weakened and become more uneven, confidence has fallen sharply recently, and downside risks are growing,” the IMF said in its World Economic Outlook report today. In Europe “leaders must stand by their commitments to do whatever it takes to preserve trust in national policies and the euro” while in the U.S. “deep political divisions leave the course of U.S. policy highly uncertain.”

IMF chief Christine Lagarde last week urged global policy makers to find “collective resolve” as investors worry Greece may default and European banks will be forced to take losses on bonds sold by the region’s most indebted countries. Under an alternative to its growth scenario, the institution predicts the U.S. and Europe could fall back into recession.

The Washington-based IMF said it based its forecasts of a “modest pickup of activity” in advanced economies and of “robust growth” in emerging counterparts on the premise that European policy makers implement the measures to reinforce their bailout mechanism agreed on in July.

It also assumed that volatility in financial markets doesn’t worsen and that U.S. authorities agree on a fiscal plan that both supports the economy and outlines fiscal consolidation over the medium term.

“Key drivers of stronger activity over the near term include the rebound of activity in Japan, the drop in oil and food prices, and

solid demand growth in key emerging market economies,” the IMF said.

The IMF predicts growth of 6.4% in developing economies this year and 6.1% next year, down from 6.6% and 6.4% forecast in June.

Richer nations will grow 1.6% this year instead of the 2.2% expected in June, and 1.9% next year instead of 2.6%, the IMF said.

Japan was the only Group of Seven economy revised higher for this year, with the IMF now seeing a 0.5% contraction, compared with a 0.7% decline seen in June. Growth in 2012 should reach 2.3%, a 0.6 percentage point less than in June.

In the euro area, where the IMF cut its prediction to 1.6% from 2% this year and to 1.1% from 1.7% next year, injecting capital into banks and restructuring or closing down others is “essential,” the IMF said.

The European Central Bank should lower interest rates if risks to growth persist, the IMF also said. The ECB’s current benchmark rate is 1.5%.

In its downside scenario, the IMF assumes that banks need to absorb losses resulting in a 10% decrease of their capital as a result of “major financial turbulence in the euro area, combined with a downscaling of expectations for U.S. medium-term growth prospects and real-estate-related financial stress in emerging Asia.”

In the U.S., where the IMF now sees expansion of 1.8% next year as the housing market also weighs on the recovery, the fiscal plan is a priority, the IMF said. The Federal Reserve should also stand ready to “deploy new unconventional support for the economy.”

The IMF urged emerging economies to roll back fiscal deficits and to continue raising interest rates, though situations vary across countries. It said that China’s currency remains “substantially undervalued.”

The IMF now assumes oil at US\$103.20 a barrel in 2011, based on the average prices of U.K. Brent, Dubai and West Texas Intermediate crudes, compared with US\$106.30 in June.

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