World Economic Outlook

And Implications for the Pacific

April 2013

International Monetary Fund

Gradual pickup in growth is expected, with lower downside risks

Global growth and inflation prospects little changed, but policies have lowered major risks

- Emerging market and developing countries (EMDEs) generally coping well; in most advanced economies (AEs) shifting from public to private demand; Euro area recovery still stalled.
- US fiscal cliff avoided; action in Europe on banking/sovereign debt crisis; Japanese and Chinese measures to bolster demand.

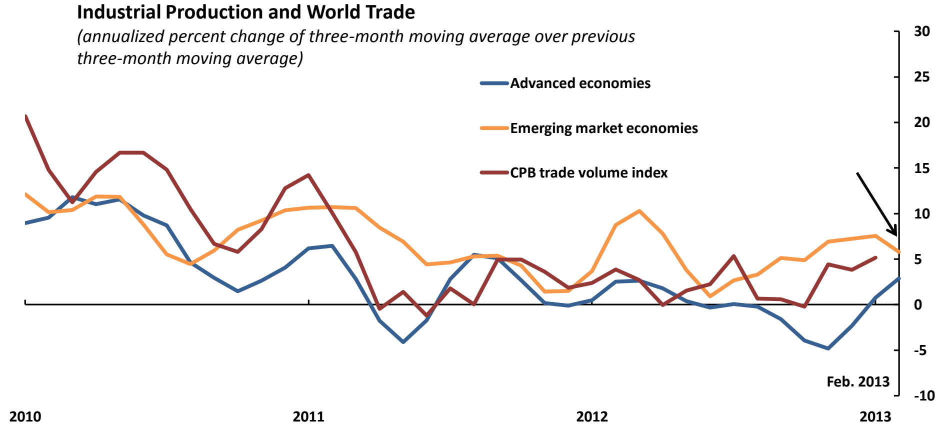
Implications for Pacific island countries

- External demand is unlikely to be a major source of growth, but also less risk of adverse shocks.
- Restoration of higher growth will depend on domestic policies and reforms.
- International experience points to key areas for strengthening performance.

Activity is beginning to recover after the slowdown in 2012

Industrial Production and World Trade

(annualized percent change of three-month moving average over previous three-month moving average)

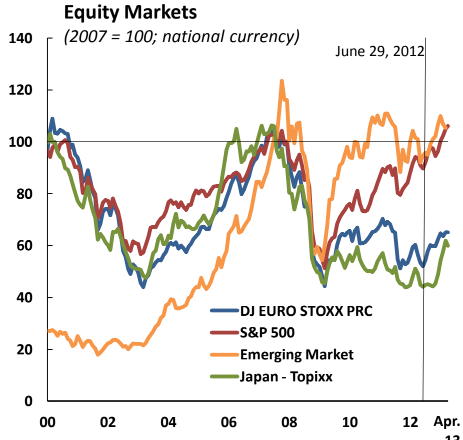


Source: Haver Analytics; Netherlands Bureau for Economic Policy Analysis for CPB trade volume index; and IMF staff calculations.

Financial conditions have also improved

Equity Markets

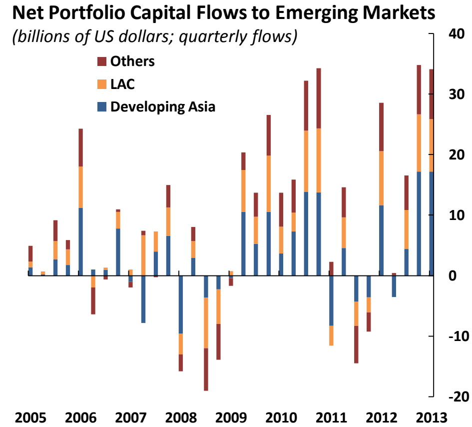
(2007 = 100; national currency)



Sources: Haver Analytics; EPFR Global; and IMF staff calculations.

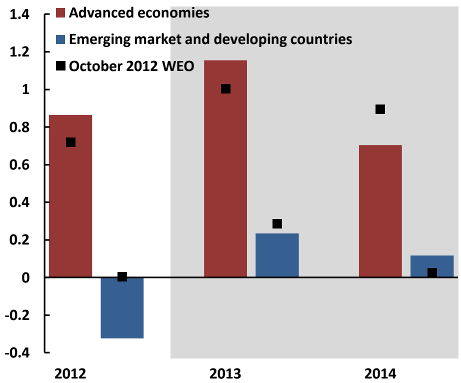
Net Portfolio Capital Flows to Emerging Markets

(billions of US dollars; quarterly flows)

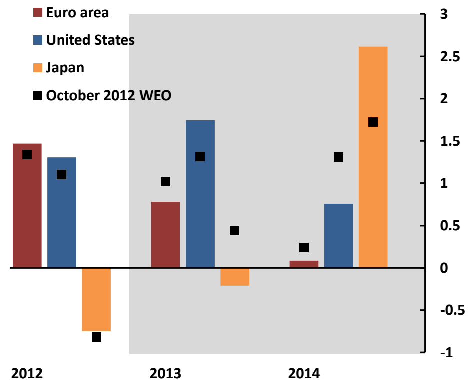


AE fiscal policy will remain tight in 2013, except in Japan, and monetary policy will be supportive
EM fiscal and monetary policy will be close to neutral

Fiscal Impulse
(Change in structural balance as percent of GDP)



Fiscal Impulse
(Change in structural balance as percent of GDP)

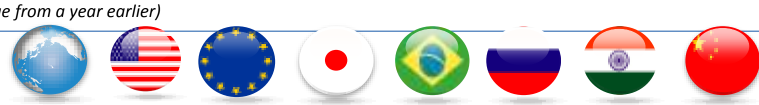


Source: IMF staff estimates.

5

The outlook is still weak and uncertain: forecasts have been revised down

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



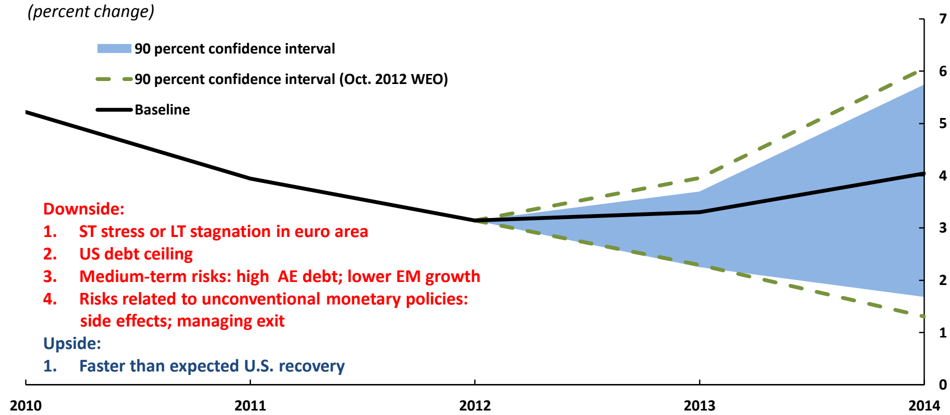
	World	U.S.	Euro Area	Japan	Brazil	Russia	India	China
2013 (April 2013)	3.3	1.9	-0.3	1.6	3.0	3.4	5.7	8.0
2013 (Jan. 2013)	3.5	2.0	-0.2	1.2	3.5	3.7	5.9	8.2
2014 (April 2013)	4.0	3.0	1.1	1.4	4.0	3.8	6.2	8.2
2014 (Jan. 2013)	4.1	3.0	1.0	0.7	4.0	3.8	6.4	8.5

Source: IMF, World Economic Outlook.

8

Many risks remain, even if the economy is in a better place; market risks indicators do not point to large decrease in risks

Prospects for World GDP Growth
(percent change)



Source: Consensus Forecasts; Bloomberg L.P.; and IMF staff estimates.

What to do? Work on medium-term policies and don't overburden monetary policy!

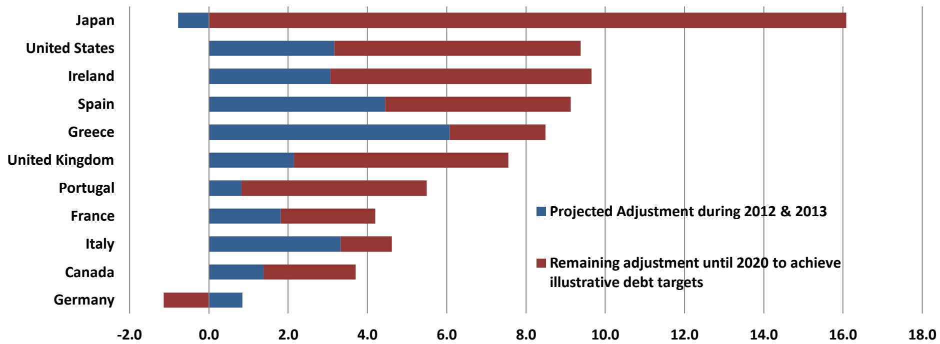
Euro area
- Accommodative monetary policy (2014 inflation < < 2% !!) and working on better pass through
- Restructuring weak banks, with help of ESM if needed
- Stronger EMU: banking union and capital market integration
- More entitlement reform and more structural reform

U.S and Japan
- Medium-term fiscal plans and entitlement reform
- U.S. needs to durably address debt ceiling
- Japan needs a strong medium-term growth strategy
- Accommodative monetary policy, including BoJ reforms

EMDC
- Rebuild policy space
- Watch for legacies of past credit growth or ongoing expansions
- Structural reforms: to reaccelerate potential output, absorb inflowing capital productively, rebalance growth

Despite consolidation progress, a long way to go in key AE economies

Change in Cyclically-Adjusted Primary Balances
(percent of potential GDP)

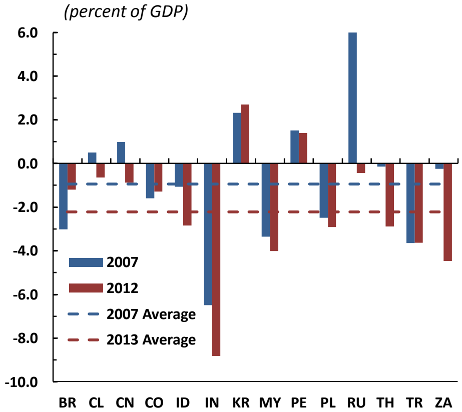


Source: IMF staff estimates.
Note: Total required adjustment to reduce the gross debt ratio to 60 percent by 2030 (net debt target of 80 percent for Japan). After 2020, the primary balance must be maintained constant at the prevailing level until 2030.

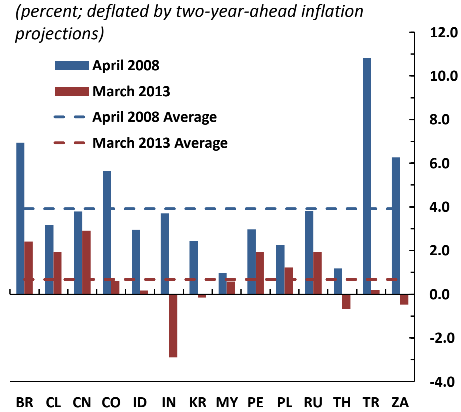
14

Many EM&DC need to rebuild fiscal and monetary policy room for maneuver over the medium term

General Government Structural Balance
(percent of GDP)



Real Policy Rates
(percent; deflated by two-year-ahead inflation projections)



BR: Brazil; CL: Chile; CN: China; CO: Colombia; ID: Indonesia; IN: India; KR: Korea; MX: Mexico; MY: Malaysia; PE: Peru; PH: Philippines; PL: Poland; RU: Russia; TH: Thailand; TR: Turkey; ZA: South Africa.

Implications for Pacific island countries

External conditions are likely to be more stable, but not a source of stimulus to Pacific economies

- Prospect of subdued demand, remittance income, likely to last through medium term, reflecting ongoing fiscal consolidation, rebuilding of balance sheets, and more stable commodity prices.

Impetus for stronger growth within the Pacific region will need to come from within

- Need to put in place policies and reforms that will bolster growth over medium term.
- Evidence points to importance of sound macro policies, privately financed investment, trade openness, financial access, political stability, education.

What is needed to strengthen performance?

Three very recent papers point to the kinds of policies and reforms needed in the Pacific island economies:

- IMF 2013 Spring WEO Chapter 4: "Breaking through the frontier: Can today's dynamic low-income countries make it?"
- Tumbarello and others, 2013, "Asia and Pacific small states: Raising potential growth and enhancing resilience to shocks." IMF
- Yang and others, 2013, "The Pacific speed of growth: how fast can it be and what determines it?" IMF Working Paper *forthcoming*

What factors help explain successful "take-offs"?

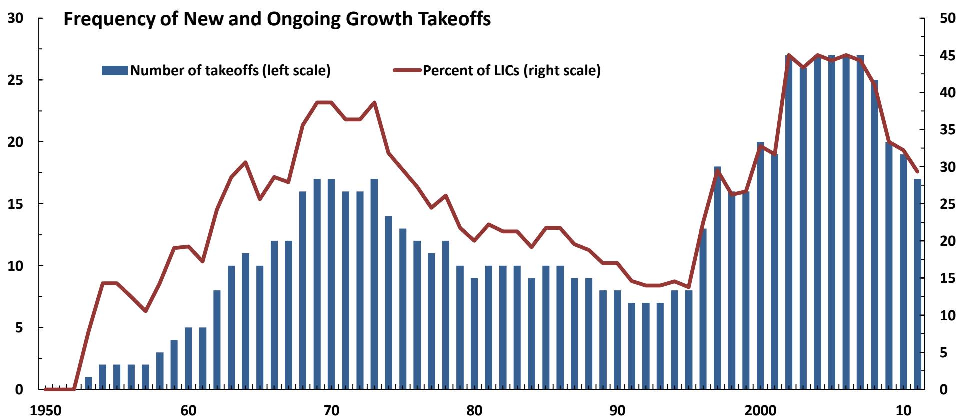
WEO Ch. 4 focuses on identifying key factors associated with economic "take-off" in low income countries (LICs)

- What distinguishes successful take-offs from failure to take off?
- Are take-offs since 1990s different from pre-90s?
- Examine 29 LIC take-offs since 1990 and 41 pre-1990 (mainly mid-60s-70s). Compare take-off conditions/features with non-take-offs and with pre- and post-1990

Findings

- Economic structure not very important, though resource-based economies have done relatively well in recent period
- Global conditions matter—higher global growth, lower interest rates, stronger terms-of-trade help

Low income countries are in a second wave of growth takeoffs



Sources: IMF staff calculations

What factors help explain successful “take-offs”?

- Export growth is a driver—more rapid export growth is associated with take-offs
- Investment is a key factor—take-off countries have significantly higher investment rates than others, as well as high national savings rates to finance much of it.
- Ample credit is not critical to initiation of take-off, but rising credit/GDP accompanies sustained takeoff.
- Socio-economic & institutional factors also matter for take-off, especially in the more recent period: education, business environment, income equality, and limited government executive power all are associated with take-off.

Differences between pre- and post-1990 take-offs

- Post-1990 take-offs have typically been longer and stronger than pre-1990s.
- Financing of investment has been significantly different, with important consequences.

What factors help explain successful “take-offs”?

- In post-1990 period, FDI has played a key role in financing investment. So take-off countries experienced large declines in public and external debt ratios as take-off proceeded.
- In pre-1990s, debt financing played a key role, leading to average doubling of public and external debt/GDP ratios.
- One third of pre-1990s take-offs ended with currency, debt or banking crises.

Comments

- Association is not the same as causality, but story rings true.
- Important lessons for development strategies—no silver bullets, but sound, sustainable policies and institutional arrangement, promoting private investment, education and inclusiveness should generally work.
- PICS not included in the study, so need to take a closer look their cases

Are Pacific Islands different from the others?

IMF *Small States* paper and *Pacific Speed of Growth* paper consider factors explaining low growth in Pacific Island economies and the policy implications

Both papers focus on comparisons between Pacific Island countries (PICs) and other low income small states.

Both papers identify a number of important factors that may account for the relatively low growth experienced in PICs as compared with other small states:

- Geographic isolation is a key factor. PICs are much further away from major markets than most small states. *Pacific Speed* estimates that this explains 1½ percentage points of slower growth on average in PICs than in other small states.
- Trade openness. More export-oriented economies grow faster. PICs are less open, generally, than other small states, hindering growth.

Are Pacific Islands different from the others?

- Investment. Higher investment/GDP ratios raise growth. PICs have typically had significantly lower rates of investment than their peers, hindering growth.
- Political stability. Political stability, as measured by the World Bank index, raises growth, and on average has benefited PICs compared with peers elsewhere. Political instability in Fiji has harmed its growth performance.
- Aid. Aid dependence appears to harm growth. Exactly why is not clear. Possibly because aid leads to moral hazard—recipients may do less to reform. Possibly because aid is mostly directed at providing higher or more equitable living standards rather than promoting growth. Possibly because aid may raise real exchange rate, undermining external competitiveness.

Policy implications

Global economic environment is looking more supportive, but will not lift growth significantly in PICs

Experience in other LICs and more specifically in similarly small states points towards key policy areas for promoting growth:

- Reducing the isolation handicap. Better, lower cost transport infrastructure; better access to major external markets; regional trade integration.
- Investment. Promote private investment, especially FDI, through reduced regulatory impediments, tax and other distortions favoring debt vs. equity investment; facilitate business startups; change unhelpful labor and land use laws.
- Exports. Promote development of export industries, through trade policies, infrastructure assistance, and investment policies, education and training.

Policy implications

- Macroeconomic policies. Adopt sound, transparent fiscal and monetary policy frameworks and strategies that will stabilize expectations and promote investor confidence. Fiscal policy should help promote high private savings and investment rates, complemented with public infrastructure investment, and spending on education and training. Monetary and central banking policies focused on low inflation, external competitiveness and a sound, efficient banking system.
- Social infrastructure. Strengthen democratic institutions and the rule of law. Adopt policies to promote a productive, flexible labor force, through education, health care, and equity of opportunity.

Vinaka