

GLOBAL ECONOMIC OUTLOOK – MARCH

Monetary and Statistics Department
External Economic Relations Division

2011

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The economic recovery continues, but uncertainty persists regarding the impacts of fiscal consolidation in some advanced economies. The new outlooks for **GDP** in all the countries under review except the USA have been revised slightly upwards. The euro area and Germany are expected to grow by 1.5%–1.7% and 2.0%–2.6% respectively this year, thanks largely to improved external demand and export growth. In the USA, GDP growth of between 2.1% and 3.7% is expected this year. GDP growth in China will remain below the 10% level.

According to the current forecasts for 2011, the **inflation** outlook is indicating a more than 2% rise in prices in the euro area and Germany. The inflation outlook in the USA is between 0.9% and 2.3%. Inflation in China should not exceed 4.6% this year.

The **leading indicators** in March are signalling faster economic growth in the USA and Germany. They are also indicating continued economic growth in the euro area, but at a lower level than in the USA. For China they are signalling a modest decline in its still strong GDP growth.

3M and 1Y EURIBOR rates started to rise slowly in mid-January 2011. Both rates jumped up after the ECB Governing Council meeting at the start of March and their growth halted. The market outlooks have been revised only slightly upwards. A similar trend could also be seen for the German ten-year government bond yield. The US interbank market showed a different pattern. **LIBOR dollar rates** remained flat and their expected growth based on market outlooks has thus been postponed again. The three-month rate has also seen quite a strong fall in growth. The ten-year government bond yield stopped rising in mid-February and even declined slightly. However, the outlook is still rising and even increased slightly at the three-month horizon.

In early March, the dollar-euro **exchange rate** was significantly affected by comments made by ECB representatives regarding rate increases in the euro area. On the other hand, economic growth in the USA is not as strong as expected and the Fed will continue to purchase bonds up to the end of June. The new Consensus Forecasts outlook therefore expects the euro to be stable against the dollar at the one-year horizon, at around USD 1.36/EUR. However, the dollar should appreciate against the Japanese yen (by 9%) and the Swiss franc (by 8%) according to the latest forecasts.

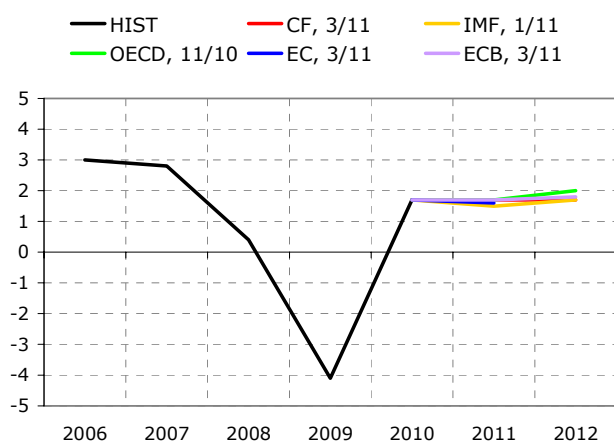
The price of **Brent crude oil** has been rising since September 2010. The growth accelerated in mid-February 2011 as the political situation in Libya deteriorated. Brent crude oil reached its highest price so far this year (USD 116 a barrel) in early March. Further growth was prevented only by reassuring comments made by Saudi representatives. The earthquake and subsequent nuclear accident in Japan led to a temporary drop in price, but demand for oil there can be expected to rise in the longer term. Market contracts are signalling a slight decline in oil prices in the future, but uncertainty regarding Saudi Arabia's spare capacity poses a risk. Prices of long-term **natural gas** contracts will be catching up with the past oil price growth throughout this year.

The non-energy commodity price index reached a long-term high in mid-February 2011. Since then, prices of most important commodities (most of all prices of wheat, rice, rubber and virtually all industrial metals) have dropped. According to the forecast, prices of **food commodities** will be flat until mid-2012 and then fall again. Prices of **industrial metals** should be flat over virtually the entire horizon.

II.1 GDP

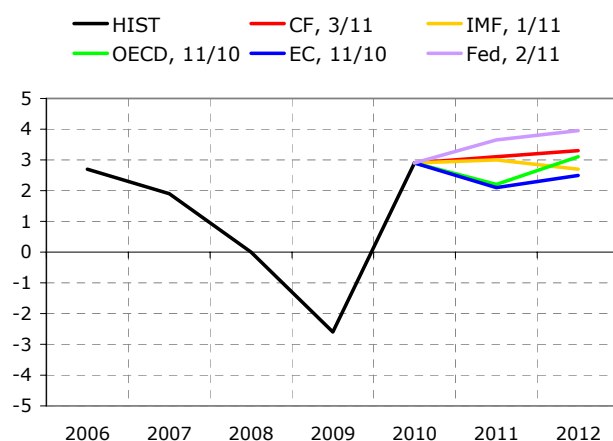
GDP growth in the euro area and Germany continues to be driven by net exports. The economic growth rate in the euro area will still be lower than before the crisis at the two-year horizon, but with a stable outlook. By contrast, GDP growth in Germany is expected to slow to about 2%, from 3.6% in 2010. A moderation in GDP growth compared to 2010 can also be expected in China in the two years ahead. Owing to the relatively wide range of the GDP growth estimates for the USA, the future course of the US economy is relatively unclear.

EURO AREA



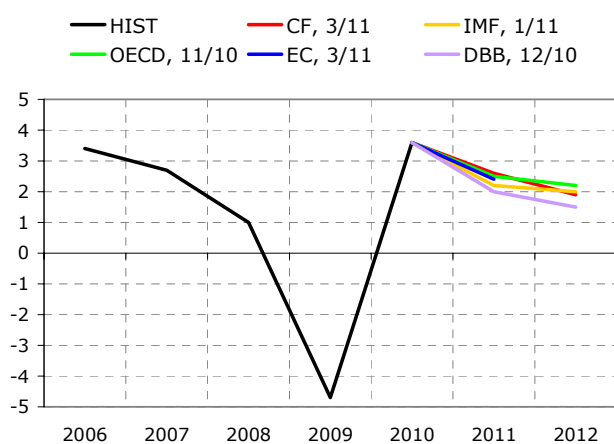
	HIST	CF	IMF	OECD	EC	ECB
2010	1.7					
2011		1.7	1.5	1.7	1.6	1.7
2012		1.7	1.7	2.0		1.8

USA



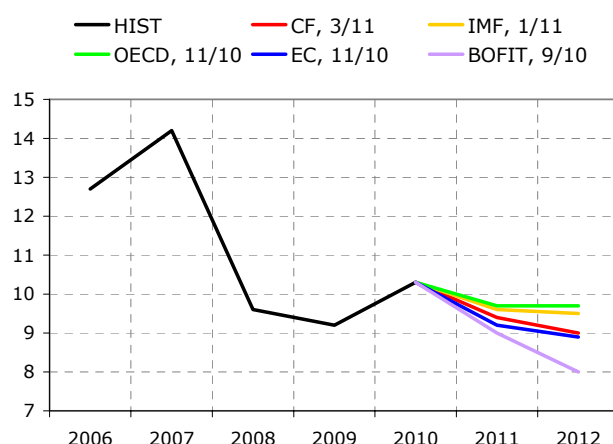
	HIST	CF	IMF	OECD	EC	Fed
2010	2.9					
2011		3.1	3.0	2.2	2.1	3.7
2012		3.3	2.7	3.1	2.5	4.0

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2010	3.6					
2011		2.6	2.2	2.5	2.4	2.0
2012		1.9	2.0	2.2		1.5

CHINA



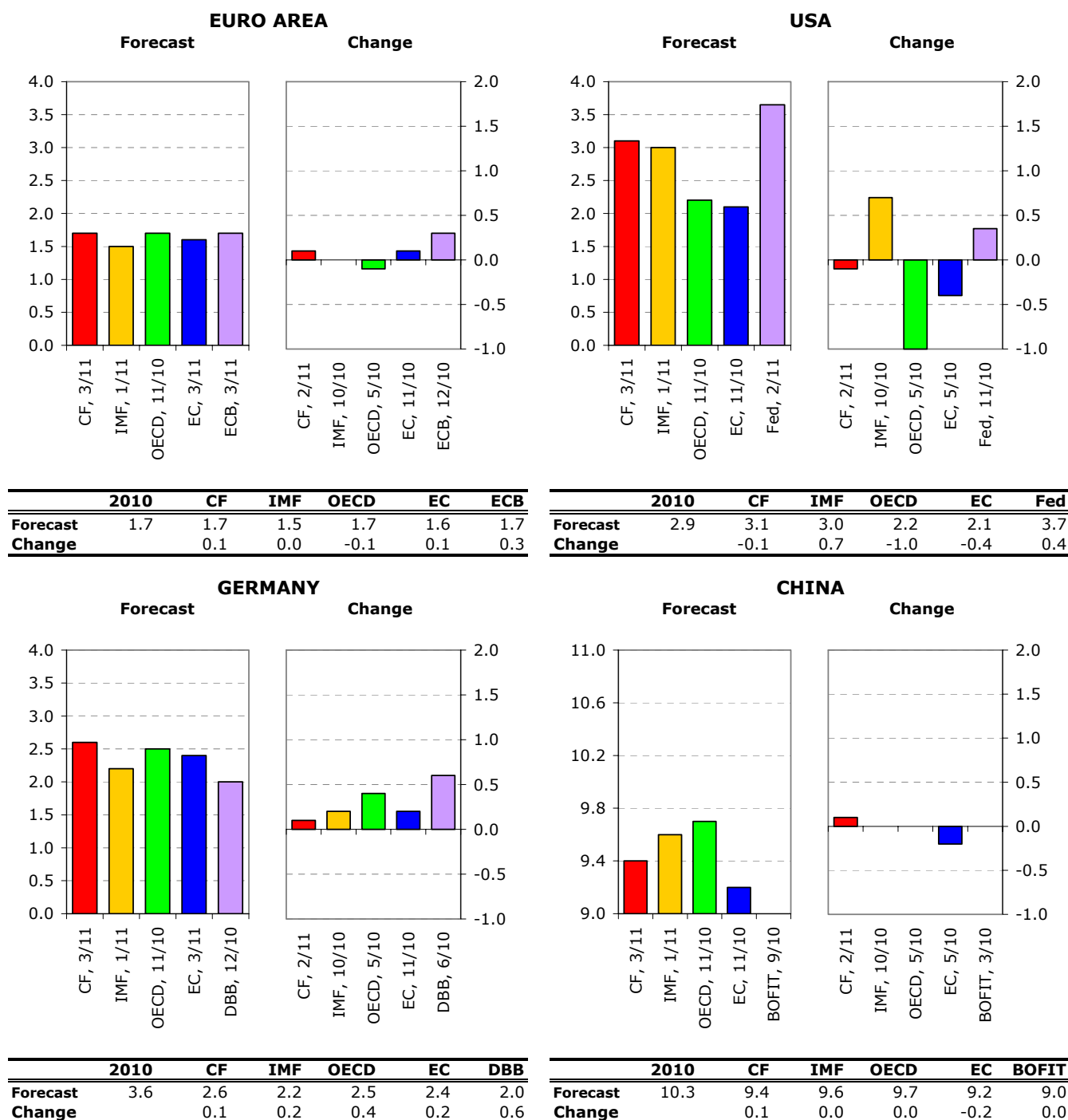
	HIST	CF	IMF	OECD	EC	BOFIT
2010	10.3					
2011		9.4	9.6	9.7	9.2	9.0
2012		9.0	9.5	9.7	8.9	8.0

Note: Legend shows latest forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. The 2010 figure is preliminary. [Cut-off date for data: 18 March 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.2 GDP forecast comparison and change from the previous forecast

Based on the current outlooks for 2011 (see the March CF, EC and ECB forecasts), the estimates of GDP growth in the euro area and Germany have been revised upwards. By contrast, expected growth in the US economy has been lowered slightly, mainly because of a decline in personal consumption. The outlook for GDP growth in China has improved somewhat.



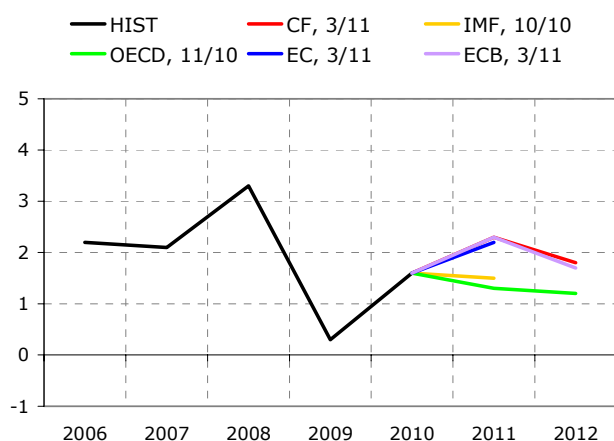
Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. The 2010 figure is preliminary. [Cut-off date for data: 18 March 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.3 Inflation

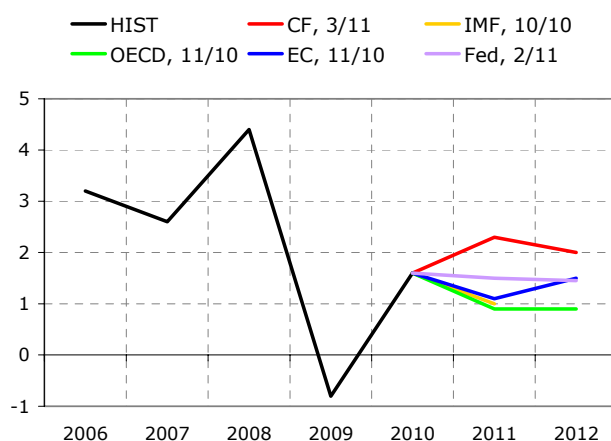
The inflation outlook for the euro area has been revised upwards for 2011. According to the March CF and ECB forecasts, inflation in the euro area should reach 2.3% this year. Inflation in Germany is also expected to exceed the 2% level this year. In the longer term, inflation in the euro area and Germany should return below the ECB's target level. The inflation outlooks for the USA and China remain within a wide range.

EURO AREA



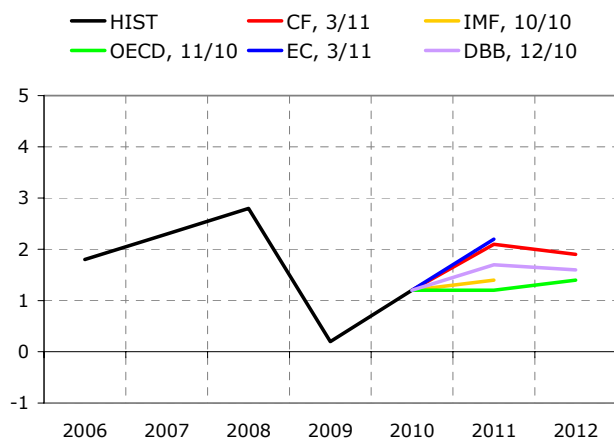
	HIST	CF	IMF	OECD	EC	ECB
2010	1.6					
2011		2.3	1.5	1.3	2.2	2.3
2012		1.8		1.2		1.7

USA



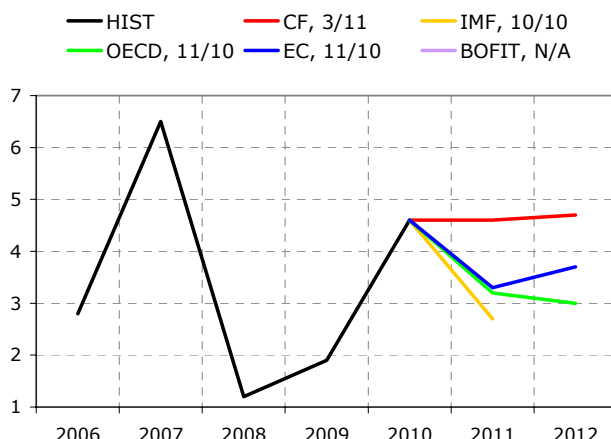
	HIST	CF	IMF	OECD	EC	Fed
2010	1.6					
2011		2.3	1.0	0.9	1.1	1.5
2012		2.0		0.9	1.5	1.5

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2010	1.2					
2011		2.1	1.4	1.2	2.2	1.7
2012		1.9		1.4		1.6

CHINA



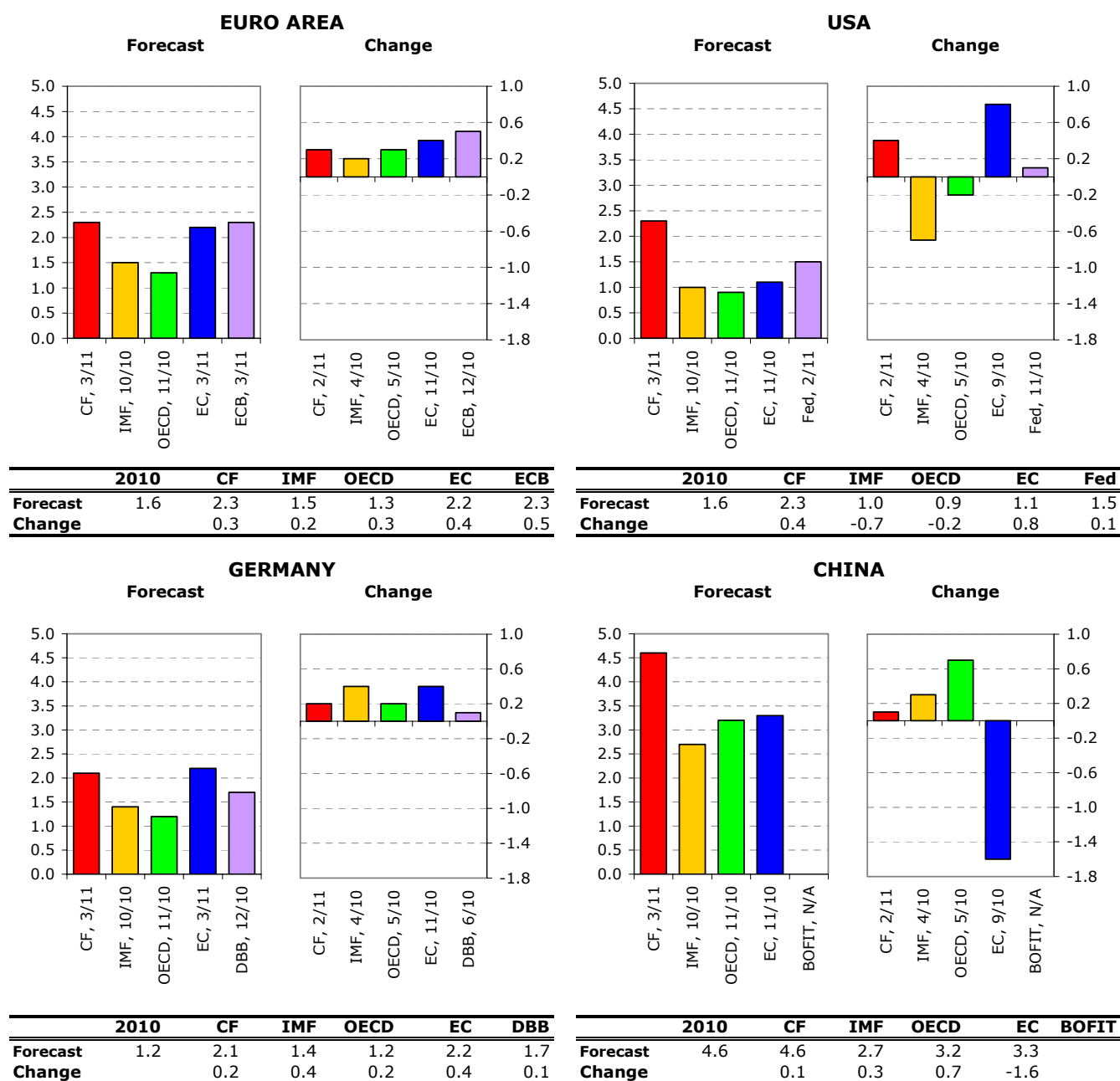
	HIST	CF	IMF	OECD	EC	BOFIT
2010	4.6					
2011		4.6	2.7	3.2	3.3	
2012		4.7		3.0	3.7	

Note: Legend shows latest forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. The 2010 figure is preliminary. [Cut-off date for data: 18 March 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.4 Inflation forecast comparison and change from the previous forecast

The higher inflation rates for 2011 in all the countries under review largely reflect the currently rising energy and commodity prices. Other risks include continued oil price growth as a result of the conflict in Libya and its potential spread to other Arab countries. The recovery in global economic activity can be regarded as another factor supporting future price growth. The changes in the forecasts for the USA still show no clear trend. According to the forecasts published this year, inflation in China in 2011 has been revised upwards.

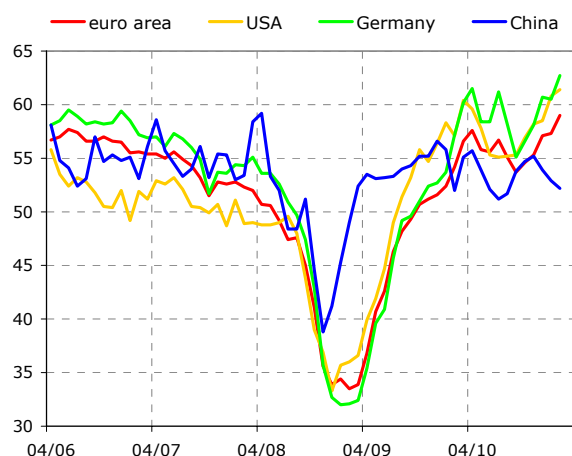


Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. The 2010 figure is preliminary. [Cut-off date for data: 18 March 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

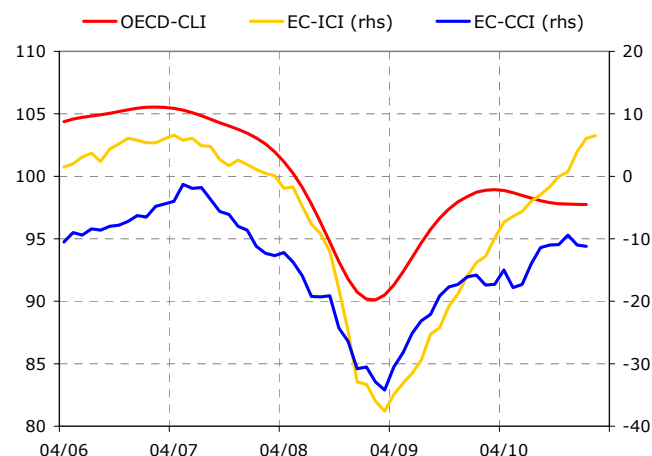
The PMI (Purchasing Managers' Index) leading indicators in March are signalling that industrial production growth will increase in the USA, the euro area and Germany and slow (but stay high) in China for the third time in a row at the start of this year. The other leading indicators (except consumer confidence) confirm the estimate of accelerating economic growth in the USA and the expectation that this growth will be at least twice as high in the USA this year as in the euro area. A further decline in consumer sentiment in the euro area reflects poor prospects of higher household consumption growth, due mainly to government expenditure cuts. The leading indicators for Germany suggest that private consumption will hinder GDP growth despite continuing buoyant growth in industry.

PMI IN MANUFACTURING



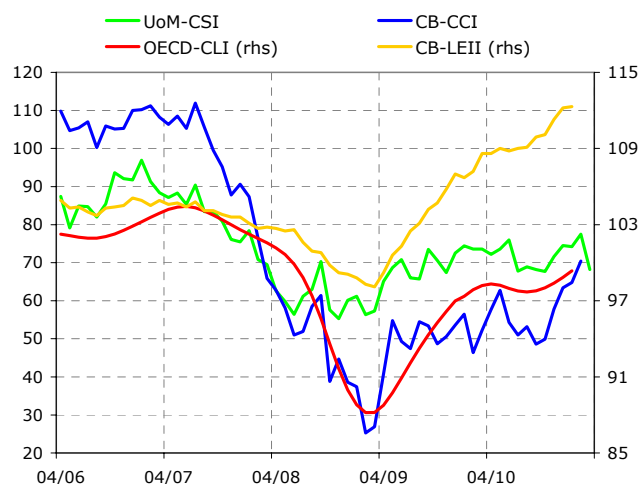
	EA	US	DE	CN
12/10	57.1	58.5	60.7	53.9
1/11	57.3	60.8	60.5	52.9
2/11	59.0	61.4	62.7	52.2

EURO AREA



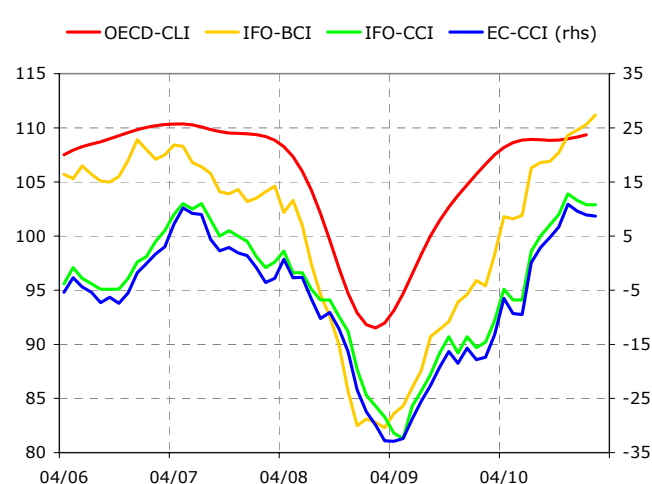
	OECD-CLI	EC-ICI	OECD-CCI
12/10	97.8	4.0	-11.0
1/11	97.7	6.1	-11.2
2/11		6.5	0.0

USA



	OECD-CLI	CB-LEII	UoM-CSI	CB-CCI
12/10	98.8	112.2	74.5	63.4
1/11	99.4	112.3	74.2	64.8
2/11			77.5	70.4

GERMANY



	OECD-CLI	IFO-BCI	IFO-CCI	EC-CCI
12/10	109.2	109.8	103.3	9.6
1/11	109.4	110.3	102.9	8.9
2/11		111.2	102.9	8.7

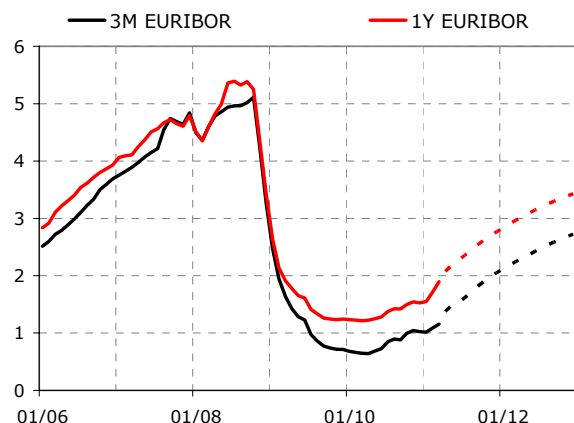
Note: OECD-CLI stands for OECD Composite Leading Indicator, EC-ICI (right-hand scale) for European Commission Industrial Confidence Indicator, EC-CCI (right-hand scale) for EC Consumer Confidence Indicator, CB-LEII for Conference Board Leading Economic Indicator Index, CB-CCI for CB Consumer Confidence Index, UoM-CSI for University of Michigan Consumer Sentiment Index, IFO-BCI for Institute for Economic Research – Business Climate Index, and IFO-CCI for IFO Consumer Confidence Index. [Cut-off date for data: 18 March 2011]

Source: CNB calculation using OECD, EC, IFO and UoM databases.

IV.1 Outlook for short-term and long-term interest rates: Euro area

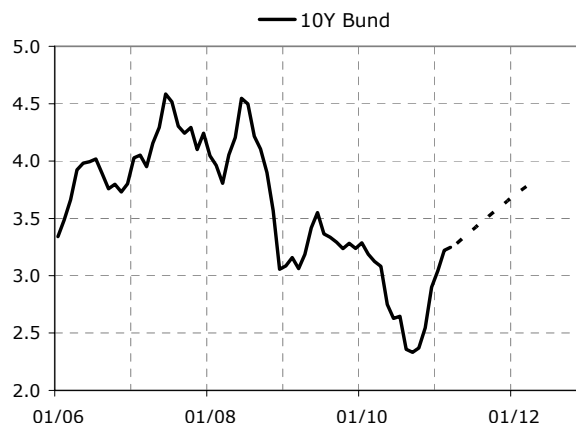
3M and 1Y EURIBOR rates started to rise slowly in mid-January (with the 1Y rate rising faster). Both rates jumped up after the ECB Governing Council meeting at the start of March (by 0.08 and 0.17 percentage point respectively) and their growth halted. The market outlooks have been revised only slightly upwards. A similar trend could also be seen for the German ten-year government bond yield. However, the outlook for this yield has been revised upwards by more than that for interbank market rates, especially at the start and at the end of the forecast.

EURIBOR



	02/11	03/11	06/11	12/11	06/12	12/12
3M EURIBOR	1.09	1.15	1.53	2.05	2.42	2.72
1Y EURIBOR	1.71	1.89	2.26	2.76	3.14	3.43

GOVERNMENT BOND YIELD



	02/11	03/11	06/11	12/11	06/12	12/12
10Y Bund	3.22	3.25	3.38	3.65		

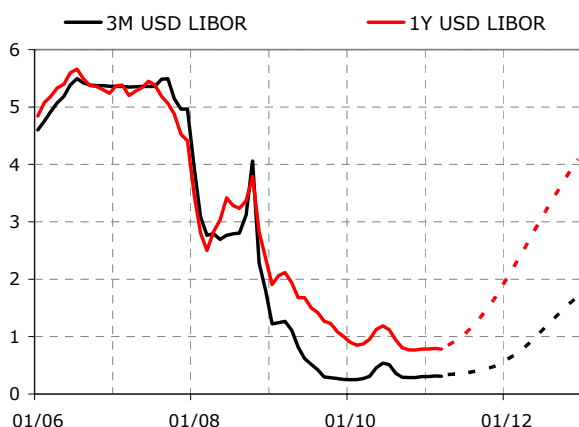
Note: Forecast for EURIBOR rates is based on rates implied by interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizon). Forecast for German government bond yield (10Y Bund) is derived from CF forecast. Dashed line represents outlook. [Cut-off date for data: 14 March 2011]

Sources: Thomson Reuters (Datastream), Bloomberg, CNB calculations.

IV.2 Outlook for short-term and long-term interest rates: USA

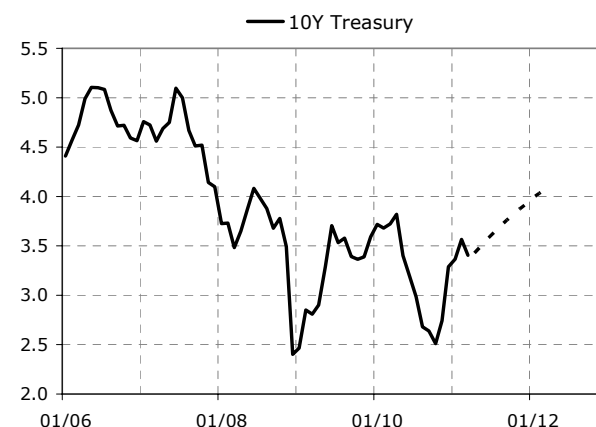
LIBOR dollar rates remained flat (at 0.3% for 3M and 0.8% for 1Y). Their expected growth based on market outlooks has thus been postponed again. The three-month rate has also seen quite a strong fall in growth. The ten-year government bond yield stopped rising in mid-February and even declined slightly. However, the CF03 outlook is still rising and even increased slightly compared to CF02 at the three-month horizon.

USD LIBOR



	02/11	03/11	06/11	12/11	06/12	12/12
3M USD LIBOR	0.31	0.31	0.35	0.53	1.05	1.70
1Y USD LIBOR	0.79	0.78	0.99	1.81	2.99	4.09

GOVERNMENT BOND YIELD



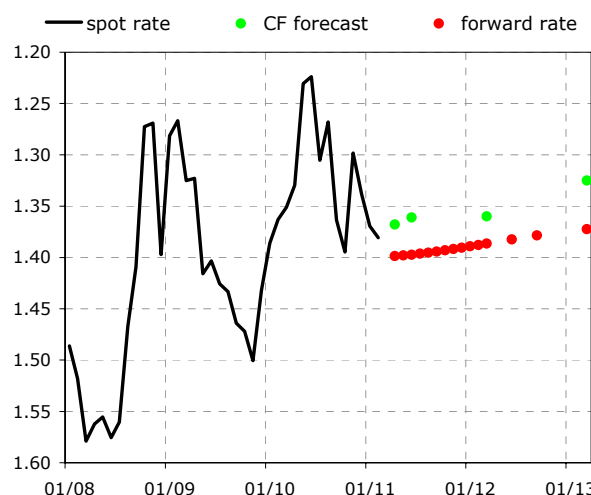
	02/11	03/11	06/11	12/11	06/12	12/12
10Y Treasury	3.57	3.40	3.57	3.93		

Note: Forecast for 3M and 1Y USD LIBOR rates is based on rates implied by London interbank market yield curve (USD LIBOR rates are used up to 3M, 3M FRA rates up to 15M, and adjusted IRS rates for longer horizon). Forecast for US government bond yield (10Y Treasury) is derived from CF forecast. Dashed line represents outlook. [Cut-off date for data: 14 March 2011]

Sources: Thomson Reuters (Datastream), Bloomberg, CNB calculations.

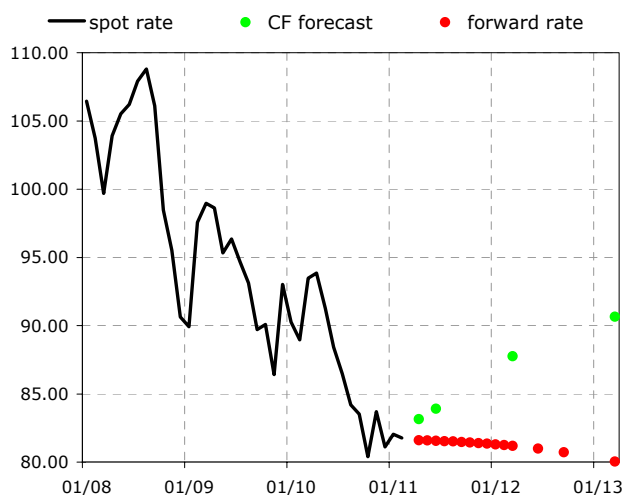
The US dollar weakened further against the euro in early March, when the rate reached the October 2010 level (USD 1.39 to the euro). The March Consensus Forecasts outlook expects a weaker dollar than the previous forecast, stable at around USD 1.36 to the euro. At the two-year horizon, however, the dollar is expected to firm by 3%. The dollar-sterling rate outlook saw no major changes; the dollar is expected to be 2% weaker at the start of 2013. By contrast, the dollar is expected to appreciate against the Japanese yen and the Swiss franc (by 11% and 13% respectively at the two-year horizon). The outlook for the Japanese economy was further aggravated by the earthquake and subsequent tsunami; the reconstruction costs will put an additional burden on this highly indebted economy. Given the positive interest rate differential of USD vis-à-vis JPY and CHF, by contrast, the forward rate is indicating depreciation of the dollar.

US\$ per Euro



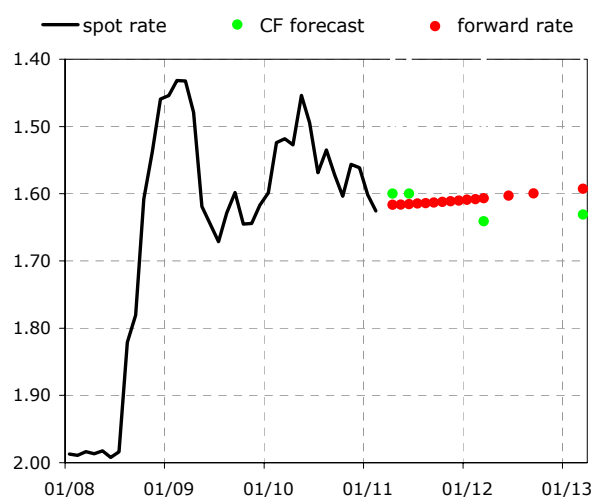
	14/3/11	04/11	06/11	03/12	03/13
spot rate	1.399				
CF forecast		1.368	1.361	1.360	1.325
forward rate		1.399	1.397	1.387	1.372

Yen per US\$



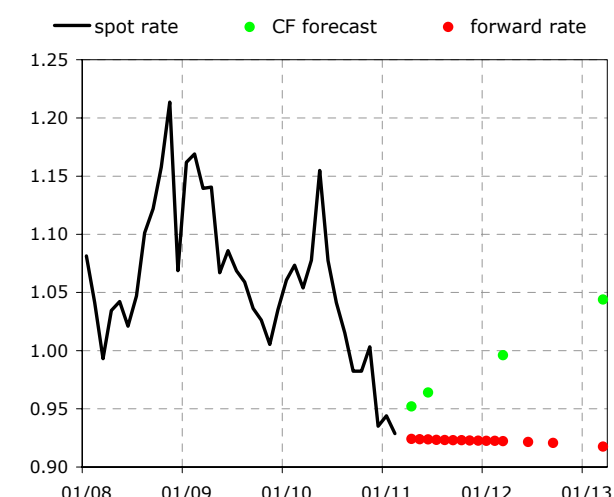
	14/3/11	04/11	06/11	03/12	03/13
spot rate	81.63				
CF forecast		83.15	83.91	87.76	90.65
forward rate		81.61	81.57	81.20	80.04

US\$ per UK£



	14/3/11	04/11	06/11	03/12	03/13
spot rate	1.617				
CF forecast		1.600	1.600	1.641	1.631
forward rate		1.617	1.615	1.607	1.593

Swfr per US\$



	14/3/11	04/11	06/11	03/12	03/13
spot rate	0.924				
CF forecast		0.952	0.964	0.996	1.044
forward rate		0.924	0.924	0.922	0.918

Note: Increase in currency pair represents appreciation of US dollar; data as of the last day of the month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibilities for securing future exchange rate. [Cut-off date for data: 14 March 2011]

Source: CNB calculation using Bloomberg and Consensus Forecasts databases.

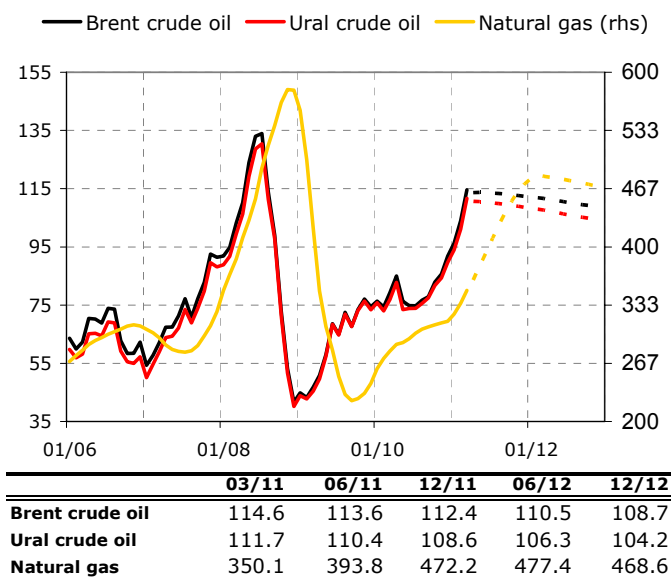
VI.1 Oil and natural gas

An upward trend in world oil prices has been visible since September 2010. The growth accelerated in mid-February 2011 as the armed conflict in Libya escalated. Brent crude oil reached its highest price so far this year (USD 116 a barrel) in early March, then corrected slightly following Saudi Arabia's announcement that it would cover the shortfall in Libya's production. The problems at Japanese nuclear power stations led to a temporary drop in price, but in the longer term the difficulties in Japan's energy sector could mean higher oil imports into Japan. Futures-based market outlooks expect a slight decline in oil prices, but uncertainty surrounding Saudi Arabia's spare capacity remains a risk. According to a Goldman Sachs study, Saudi Arabia has raised its production considerably and has little room to increase it further.

Note: Oil prices in USD/barrel are taken from listings on London-based ICE Futures Europe international exchange. Prices of Russian natural gas at border with Germany in USD/1000 cubic m are calculated using IMF data. Future oil prices are derived from oil futures. Dashed line represents outlook. [Cut-off date for data: 14 March 2011].

Source: Bloomberg, IMF, CNB calculations.

OUTLOOK FOR PRICES OF OIL AND NATURAL GAS



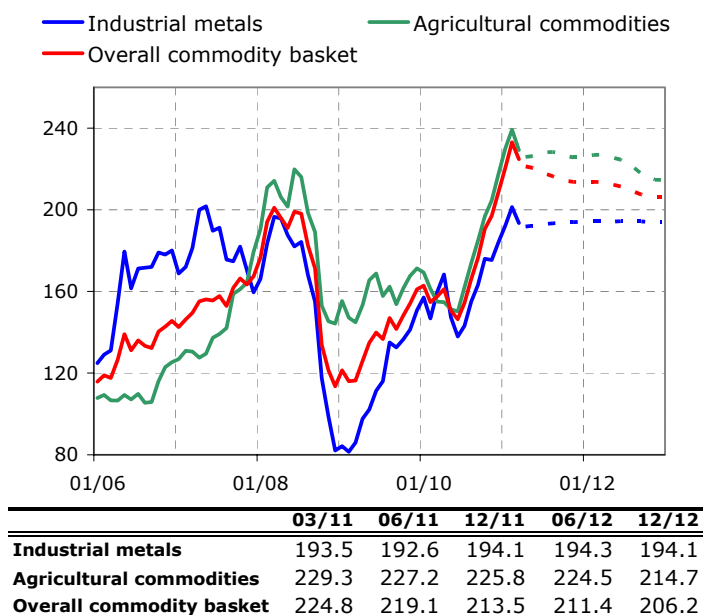
VI.2 Other commodities

The non-energy commodity price index reached a long-term high in mid-February 2011. Since then, however, prices of most important commodities have dropped.

Looking at food commodities, prices of wheat and rice recorded the largest declines (of 20% and 16% respectively). Prices of maize, soy and sugar fell less markedly. By contrast, prices of coffee and beef increased. As regards other agricultural commodities, the price of cotton rose, but the price of rubber fell quite sharply. According to the outlook, the food commodity price index will be flat until mid-2012 and then fall again.

Prices of most industrial metals (except aluminium) have also declined since mid-February (by 5%–10%), but prices of precious metals have risen. No further drop in the industrial metal price index is expected over the outlook horizon.

OUTLOOK FOR OTHER COMMODITY PRICES



Note: Chart shows indices, year 2005 = 100. Dashed line represents outlook. [Cut-off date for data: 14 March 2011].

Source: Bloomberg, outlooks based on futures.

A LOOK BACK AT THE IIF SPRING MEMBERSHIP MEETING

The Spring Membership Meeting of the Institute of International Finance (IIF)¹ took place on 2–4 March this year in the Indian capital New Delhi. A large proportion of the presentations by financial experts and politicians alike naturally focused on economic developments in the host country. Much attention was also given to the recent political events in the Middle East and North Africa. However, the most heated debate concerned the planned Basel III regulation of banks and financial institutions.

1 Economic developments in India (Inside India)

India is the world's largest democracy. Both the government sector and the private sector are involved in most economic activities. The government sector is managed using five-year plans (the current 11th five-year plan started in April 2007 and will end in March 2012). A large part of the government sector deals with investment in infrastructure, but a sharp rise in the share of private investment (including PPP – Public Private Partnerships) is expected in this area in the future.

Potential real economic growth is estimated at between 8% and 9% annually. The optimal inflation rate is between 4% and 5%. The saving and investment rates are well above 30%. Roughly 58% of workers are employed in agriculture, which, however, only accounts for around 14% of GDP. Its share is falling amid strong growth in services and industry. Investment is going mainly into energy production (resource diversification) and water supply. Investment in education is regarded as insufficient, as its share is lower than in other developing countries. Despite strong nominal economic growth, the government is running deficits. Besides investing, it spends massively on subsidies (mainly for fuels, food and fertilisers). These subsidies are to decrease gradually (which could cause major problems given the current high prices of oil and agricultural commodities). At the same time, less efficient indirect subsidies (lower prices for some groups of the population) are to be gradually replaced by direct subsidies (direct transfers to subsidised groups, but single market prices). The government is putting great emphasis on reducing poverty. Construction of smaller towns is the preferred development strategy, but energy and communications infrastructures as well as "law and order" need to be introduced there. At its current level, government debt is not a problem, as the investment should give work to a large number of young people, who will repay the debt from their future taxes. India does not have a population ageing problem (more than 50% of the population is younger than 25 years) and new jobs are what the economy currently needs the most. Legislation must be improved so that start-ups have better access to the labour force.

The monetary policy stance is fairly loose, as the central bank (Reserve Bank of India) is focusing on core inflation, which is being reduced by falling prices of goods. Wages (which are closely linked with food prices) and inflation expectations are also being monitored as potential sources of inflation pressures. The persisting high prices of food are of course regarded as a big problem, as food accounts for a large part of the consumer basket, and the rising oil intensity of GDP is increasing the vulnerability of the economy, which weathered the recent financial and economic crisis with minimal losses. However, monetary policy will respond to the second-round effects. The central bank does not see the government deficits as a problem. On the contrary, the problem lies in the availability of easy money, which mostly ends up in developing countries regardless

¹ The IIF (www.iif.com) is a global association of financial institutions (mainly large ones) created in 1983 in response to the international debt crisis. Members include most of the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms.

of where it is generated. Exchange rate policy is based on “smoothed” floating. The high volatility of the US dollar, which is forcing firms to hedge against foreign exchange risk, is the main negative phenomenon for the economy.

2 Political and economic situation in the Middle East and North Africa (MENA²)

Most countries in this region have the following in common: a large government sector and a relatively small business sector, low productivity and competitiveness, high dependence on rent, and weak institutions facilitating corruption at government level. Economic growth in these countries was flat between 1980 and 2002, leading to low employment growth in the private sector and above all to rising unemployment among young people. Some economic growth occurred after 2002, but unemployment remained high and the proceeds were distributed not among the general public but only among limited elites. In several countries this has ultimately led to demonstrations demanding fundamental reforms of the political system.

From the point of view of advanced countries, the developments in MENA countries are important mainly because the latter produce oil and receive private investment. Reforms replacing autocratic systems with democratic ones are therefore being welcomed. However, the road to a new system will be long and difficult. The social and political reforms in these countries will take about two years to complete. Only then can we expect economic reforms to be launched. Pakistan-style economic reforms are unlikely, as the reforms in Pakistan were enforced by the IMF. However, most of the MENA countries have sufficient foreign exchange reserves and do not need IMF assistance. They may need it later on, when weak growth, high inflation and trade deficits eat up these reserves. On the positive side, the protests are not directed against the USA and Israel or against capitalist market principles, nor are they motivated by religion. The sole aim is to eliminate corruption and reform autocratic systems into democratic ones. However, it is unclear whether democracy will ultimately take hold in all these countries. There is a risk of nationalism and temporary economic deterioration. The final outcome will depend on the social, historical and cultural conditions in each country.

3 Regulation of the banking sector

Leading representatives of the private banking sector led heated debates on the proposed regulations (Basel III and Dodd-Frank). The vast majority of previous financial crises had originated in emerging market economies. However, the recent crisis started in the advanced world. Even so, the findings from the resolution of previous crises could still be useful now. A team of IIF economists is actively analysing past crises and participating in discussions on the proposed regulatory schemes. The conference participants agreed that any form of regulation (capital and liquidity requirements) should be applied globally, as the financial industry is also global. Legislation must therefore be harmonised internationally. The expected benefits of increased regulation (in terms of banking sector efficiency and stability) should be in balance with the expected costs (a higher price of capital, higher interest rates, lower availability of credit, higher bank costs and lower banking sector profits, and a negative impact on global growth). Banks should carry on an active dialogue with regulators in designing the new global banking architecture. Global convergence of accounting principles is a necessary condition. It is also essential for the regulation to apply effectively to shadow

² *Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Saudi Arabia, Syria, Tunisia, United Arab Emirates and Yemen.* Countries that have been experiencing political unrest are indicated in italics.

banks,³ which will increasingly come into existence as banks respond to the stricter regulation by attempting to move some activities beyond its reach. Global coordination of macroeconomic policies may also be necessary. The new regulation will mean a considerable shock to the banking system, a shock that banks will have to cope with for a whole decade. The opinion was also expressed in the debate that different types of institutions require different regulation. Otherwise, all institutions would be on the same side of the market at the moment of a shock. This would limit the scope for a market solution to a crisis. The “too big to fail” phenomenon should be eliminated and the system should allow any bank to fail. The importance of “cocos”⁴ in financing banks’ capital was frequently mentioned. Amy Friend presented a brief comparison between Dodd-Frank and Basel III from the position of the US regulator.

An IIF study that attempts to quantify the expected costs of Basel III was introduced in a special briefing. According to the IIF, the cost impact will be considerably greater than the BIS estimate or the slightly higher OECD estimate. Basel III will make loans either more expensive or less available. The euro area countries, which, according to an econometric estimate, are the most dependent on loans, will be the most affected. Smaller impacts can be expected on the USA and the emerging economies. Trillions (of euros/dollars) of additional capital will be needed, which will reduce banks’ profits. Phased introduction will have no dampening effect, since banks will want to obtain additional capital as soon as possible in a “race for capital”.

This discussion also included a presentation by a Standard & Poor’s representative. It might have come as a surprise to some to learn that agency ratings do not express the absolute probability of default, but only rank entities by relative creditworthiness. The probability of default fluctuates according to the current global economic situation.

4 The IIF global economic outlook

The global economy is currently facing three main challenges:

- there is a danger of economic overheating and inflation, especially in new market economies (high commodity prices, private capital inflows, high growth in loans and their share in GDP);
- advanced economies must cope with fiscal consolidation and exit strategies (widening spreads between German bond yields and yields on problem countries’ bonds, government deficits, and government debt-to-GDP ratios);
- bank financing and regulation is also a problem mainly of the advanced countries (capital adequacy of banks, ratio of deposits to bank assets, functioning of the interbank market, regulation of shadow banks).

IIF Chief Economist Philip Suttle presented his view on the economic cycle:

- the economy never looks great, except in hindsight. The outlook is always fragile and highly uncertain;

³ Financial institutions and banks that do not accept deposits and are therefore subject to less strict regulation (e.g. investment banks, money market funds, hedge funds and government-sponsored mortgage agencies). Like banks, they act as intermediaries between investors (e.g. pension funds) and debtors (mostly corporations).

⁴ Contingent convertible bonds – these are issued as bonds but are automatically converted into shares in order to increase a bank’s capital (Tier 1) if it gets into financial difficulties.

- the main risks in the initial recovery phase stem from the remnants of past imbalances. These risks disappear over time;
- economic policies are always backward-looking in the initial recovery phase. As the recovery gains momentum, the view needs to change. Markets generally fail to predict this change;
- new surpluses and imbalances created by the growing recovery are becoming a risk.

Mr Suttle stated that the global recovery had been going on for almost two years and was being driven by the emerging economies. Growth in global industry slowed in 2010, but signs of a return to recovery can be seen. The US economy is returning to sound growth, but problems from the past persist in construction and in the labour market. Confidence in Europe is strengthening, but fiscal deficits and banking sector problems remain. Inflation is accelerating worldwide, driven mainly by food and energy prices. Underlying this are low real rates in both advanced and emerging economies, where low unemployment is also playing a role. This may induce an excessive monetary policy reaction and give rise to a new recession.

Other current risks include high oil prices, which have preceded most past recessions. As the economy recovers, global imbalances will start to increase and, last but not least, the large government debt levels in the G7 countries will start to play a role as interest rates rise. We are in a phase where the recovery should gain momentum and economic policy stimuli should be gradually phased out. Unfortunately, it is likely that economic policy will remain easy for too long. This will lead to growing imbalances and end the economic expansion earlier than in the case of a timely change in economic policy stance and better economic policy coordination.

The following table summarises the outlook for global economic activity and inflation:

Table 1: Outlook for global economic activity and inflation

Country	Real GDP (y-o-y in %)			Inflation (y-o-y in %)		
	2010	2011	2012	2010	2011	2012
Advanced economies	2.5	2.2	2.3	1.5	1.5	1.4
USA	2.9	3.4	3.2	1.2	1.9	1.4
Euro area	1.7	1.5	1.6	2.0	1.6	1.8
Japan	4.0	1.2	1.6	0.1	-0.7	-0.1
Emerging economies	7.0	6.2	6.1	6.1	6.2	5.2
Latin America	6.1	4.5	4.4	8.1	8.7	6.7
Europe	4.1	3.7	3.5	6.8	7.1	6.0
Asia	9.1	8.2	8.0	5.0	4.8	4.2
Africa and Middle East	3.8	3.7	4.2	5.5	5.9	6.0
World, total	3.5	3.1	3.2	2.5	2.6	2.3

Source: IIF.

5 Interesting observations from the discussion

Some interesting ideas were expressed in the discussions on individual presentations. For example, it was said that the currently higher headline inflation is likely to be only temporary, since core inflation is low and a JPMorgan study proves that it is not true that headline inflation pulls core inflation; rather, it is core inflation that ultimately pulls headline inflation. Besides, unlike in the 1970s we are not seeing a price/wage spiral, which back then transformed supply shocks into a long period of elevated inflation. As

regards the elevated price level, however, we have never had such a long-lasting situation of a strong supply shock (oil, food) combined with extremely easy monetary policy. The high price level might therefore persist for a very long time.

As for global imbalances, a parallel was made between the relationship between Germany and the rest of the euro area in Europe and the relationship between China and the USA at the global level. China and Germany should consume more, while other countries should save more.

Regarding the currently low interest rates, the view was expressed that there is a risk of economic agents starting to make long-term decisions based on these low rates. In addition, monetary policy has only limited room for manoeuvre at such low interest rates. The message, then, is: "Don't miss exit".

Several discussants emphasised that we must not treat Eastern European countries as a whole. Similarly, the PIIGS⁵ are not a single entity either; each country has its own specific problems. The growing imbalances and local problems in the euro area must be solved at local level, not centrally. The current crisis is a consequence of risk underestimation, but also of an unwillingness to enforce rules.

A Greek participant pointed out the paradox that although Greece has made major reforms to its pension system and its public finances are sounder, market perceptions (as measured by CDS and spreads) are worse. It is estimated that the austerity measures in Greece will lead to a recession (mainly as a result of declining investment), the cumulative impact of which will be 10–20% of GDP over the next three years.

An IMF representative highlighted the growth in Europe, saying that it was a result not only of good policy, but also of economic integration. Integration is progressing rapidly but is not yet complete. There is a need to regain competitiveness, especially in protected sectors.

A possible recipe for reducing budget deficits in Europe is the approach of Switzerland, where a law saying that the budget deficit must be balanced throughout the economic cycle has been on the books since 2003.

⁵ Portugal, Ireland, Italy, Greece and Spain

BOFIT	Bank of Finland Institute for Economies in Transition
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBOT	Chicago Board of Trade
CF	Consensus Forecasts
CN	China
CNB	Czech National Bank
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
EC	European Commission
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EIU	The Economist Intelligence Unit database
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
CHF	Swiss franc
IFO	Institute for Economic Research
IFO-BCI	IFO – Business Climate Index
IFO-CCI	IFO – Consumer Confidence Index
IMF	International Monetary Fund
IRS	Interest rate swap
JPY	Japanese yen
LIBOR	London Interbank Offered Rate
N/A	not available
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
UoM	University of Michigan
UoM-CSI	University of Michigan Consumer Sentiment Index
US	United States
USD	US dollar