

EBD/07/86

July 17, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Background Material on World Economic and Market Developments/
Financial Markets Update**

The attached package of charts and tables is intended to serve as background material for the discussion on World Economic and Market Developments and Financial Markets Update, scheduled for **Wednesday, July 18, 2007**. A brief list of issues on which Executive Directors may wish to comment is included at the front of the package. Tables and charts appear on pages 5–60.

It is not intended that this paper will be published on the Fund's external website.

Questions may be referred to Mr. Srinivasan (ext. 34589) and Mr. Faruquee (ext. 37332) in RES.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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Department Heads

Issues for Comment

The global economy expanded briskly during the first half of 2007. World growth is now projected at 5.2 percent for 2007, an upward revision of about one-quarter of a percentage point from the April 2007 WEO. The *United States* has continued to feel the effects of a still weak housing market, although other sectors showed signs of renewed strength in the second quarter. The business expansions in the *euro area* and *Japan* have remained robust and are increasingly extending to household consumption, supported by solid employment growth. Moreover, most *emerging market economies* continue to grow at a rapid pace, driven by strong export earnings and often boosted by large capital inflows. Substantial upward revisions have been made to the growth forecasts for *China*, *India*, and *Russia*.

Average oil prices increased during the first half of 2007, reflecting strong demand and geopolitical uncertainties in an environment of limited spare capacity. Gasoline prices increased even more, owing to bottlenecks in refining capacity, while food prices have also risen. As a consequence, headline inflation rose in many countries, even though inflation expectations generally continue to be well-anchored and core inflation has remained stable. As global capacity constraints become more binding, however, underlying inflationary pressures could intensify.

Expectations of higher growth pushed up long-term yields in June, while volatility was boosted, from low levels, by corrections in various credit markets. The correction has been most severe in the U.S. subprime mortgage and related derivatives markets, owing to a previous relaxation of credit standards. There have also been similar concerns about credit quality in other markets, notably the leveraged loan market that finances mushrooming LBO activity. Elsewhere there appears to have been only a limited impact on risk appetite, with modest corrections in equity and emerging market bonds markets. There is also little evidence of an unwinding of carry trades.

Directors may want to consider the following questions for discussion.

1. Do Directors agree that the global expansion remains strong? Where do they see the balance of risks? Do rising long-term yields pose a risk to global growth prospects? How do they assess the prospects for a turnaround in the U.S. economy given the still weak housing market? Will the euro area and Japan continue to grow above trend?
2. How do Directors view the outlook for emerging markets? To what extent are rising capital inflows and rapid credit growth contributing to vulnerabilities in some countries, and how should policy respond?
3. How do Directors assess global inflation risks in light of recent increases in food and fuel prices? Do they agree with staff's view that further commodity price spikes remain a risk?
4. Are Directors concerned about an excessive relaxation of credit standards? Are recent corrections in credit markets a cause for concern, or are they a healthy warning against market complacency? Do asset prices appropriately reflect current risks, or is there insufficient discrimination across asset classes?

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Table 1. Forecasts of Real Growth in 2007 and 2008

	Projections for 2007 Growth				Projections for 2008 Growth			
	W2007 WEO 1/	S2007 WEO 2/	April Consensus 3/	Latest Consensus 4/	W2007 WEO 1/	S2007 WEO 2/	April Consensus 3/	Latest Consensus 4/
United States	2.2	2.0	2.3	2.1	2.8	2.8	2.9	2.8
Japan	2.3	2.6	2.2	2.5	1.9	2.0	2.2	2.2
Germany	1.8	2.6	2.1	2.7	1.9	2.4	2.1	2.4
France	2.0	2.3	2.0	2.1	2.4	2.4	2.0	2.2
United Kingdom	2.9	2.9	2.6	2.8	2.7	2.7	2.3	2.2
Italy	1.8	1.8	1.8	1.9	1.7	1.7	1.6	1.7
Canada	2.4	2.5	2.4	2.5	2.9	2.8	2.9	2.8
G-7	2.2	2.2	2.2	2.3	2.5	2.5	2.5	2.5
Euro area	2.3	2.6	2.4	2.7	2.3	2.5	2.2	2.3
China	10.0	11.2	10.0	10.5	9.5	10.5	9.6	9.9
Hong Kong SAR	5.5	5.5	5.3	5.4	5.0	5.2	5.0	5.1
India	8.4	9.0	8.0	8.4	7.8	8.4	7.7	8.0
Indonesia	6.0	6.0	6.0	6.1	6.3	6.3	6.0	6.1
Korea	4.4	4.4	4.4	4.5	4.4	4.4	4.9	5.0
Malaysia	5.5	5.5	5.6	5.7	5.8	5.8	5.8	5.9
Philippines	5.8	5.8	5.5	6.0	5.8	5.8	5.5	5.7
Singapore	5.5	7.4	5.5	6.2	5.7	5.8	5.9	6.0
Taiwan Province of China	4.2	3.9	4.1	4.2	4.3	4.3	4.6	4.7
Thailand	4.5	4.0	4.2	4.1	4.8	4.5	4.9	4.9
Weighted average 5/	8.5	9.2	8.4	8.8	8.1	8.8	8.2	8.4
Argentina	7.5	7.5	7.6	7.6	5.5	5.5	5.6	5.8
Brazil	4.4	4.4	4.2	4.3	4.2	4.2	4.1	4.3
Chile	5.2	5.8	5.2	5.8	5.1	5.3	5.1	5.2
Mexico	3.4	3.1	3.3	3.1	3.5	3.5	3.7	3.7
Venezuela	6.2	6.2	6.7	7.3	2.0	2.0	3.2	4.0
Colombia	5.5	6.1	5.6	5.8	4.5	4.5	4.8	4.9
Peru	6.0	7.0	6.8	7.1	5.5	6.0	5.9	6.0
Weighted average 5/	4.9	4.9	4.8	4.9	4.2	4.3	4.4	4.5
Czech Republic	4.8	5.4	5.0	5.4	4.3	4.7	4.7	4.8
Hungary	2.8	2.8	2.4	2.6	3.0	3.0	3.0	3.0
Poland	5.8	6.6	5.7	6.2	5.0	5.4	5.2	5.4
Turkey	5.0	5.0	4.6	4.7	6.0	6.0	5.7	5.5
Russia	6.4	7.0	6.3	6.8	5.9	6.8	6.0	6.3
South Africa	4.7	4.8	4.7	5.1	4.5	4.5	4.8	5.2
Egypt	6.7	6.7	6.4	6.7	6.6	6.6	6.0	6.7
Weighted average 5/	5.7	6.0	5.5	5.9	5.4	5.9	5.5	5.7
World 5/	4.9	5.2	4.9	5.0	4.9	5.2	4.9	5.1
World 6/	3.4	3.6	3.3	3.4	3.5	3.7	3.4	3.4

1/ World Economic Outlook, April 2007 Published.

2/ World Economic Outlook, Live data as of July 16, 2007.

3/ Consensus Forecasts, April 10, 2007; Asia Pacific Consensus Forecasts, April 10, 2007; Latin American Consensus Forecasts, April 10, 2007; and Eastern Europe Consensus Forecasts, March 19, 2007.

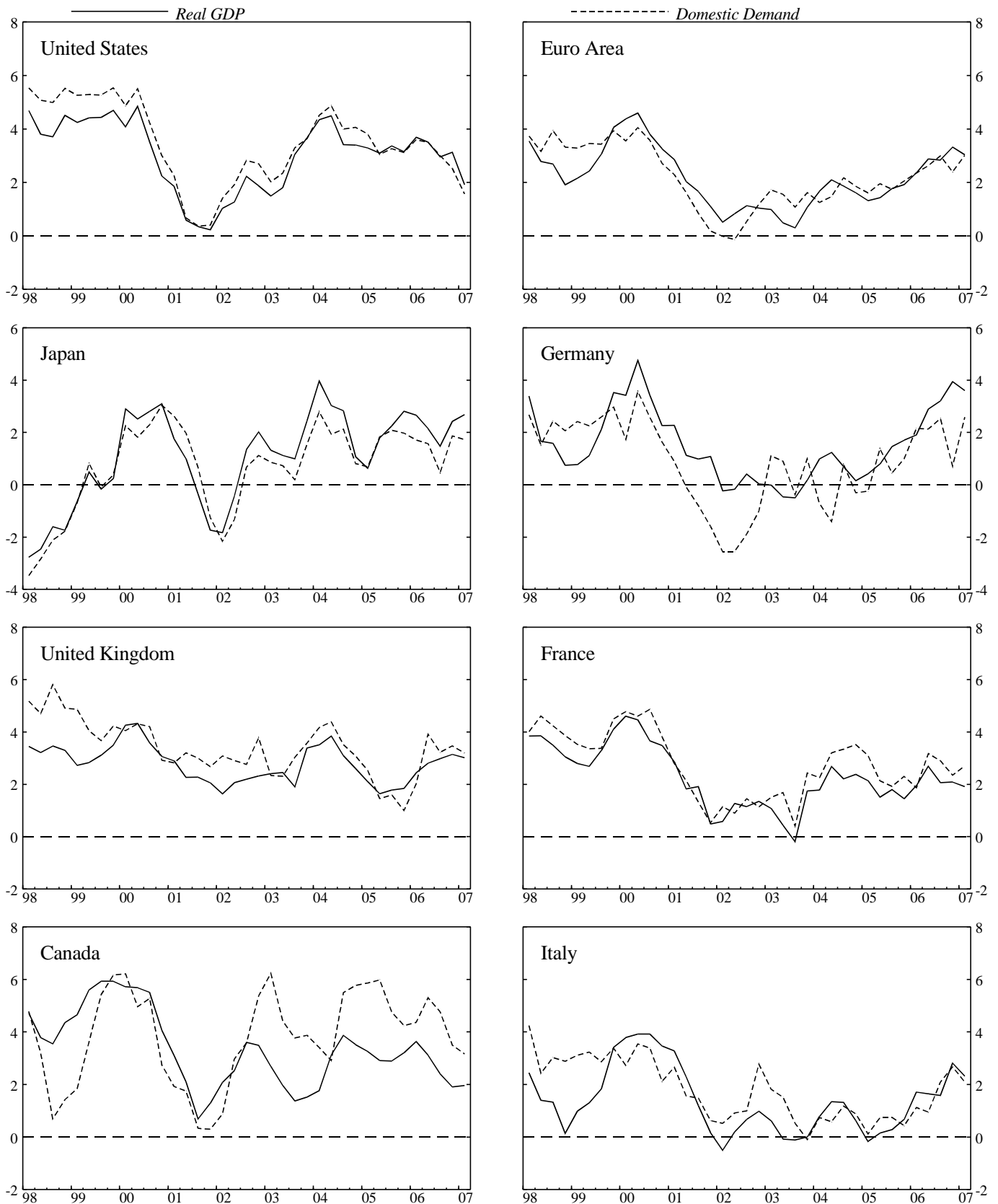
4/ Consensus Forecasts, July 9, 2007; Asia Pacific Consensus Forecasts, July 9, 2007; Latin American Consensus Forecasts, June 18, 2007; and Eastern Europe Consensus Forecasts, June 18, 2007.

5/ Based on purchasing-power-parity (PPP) weights.

6/ Based on market exchange rate weights.

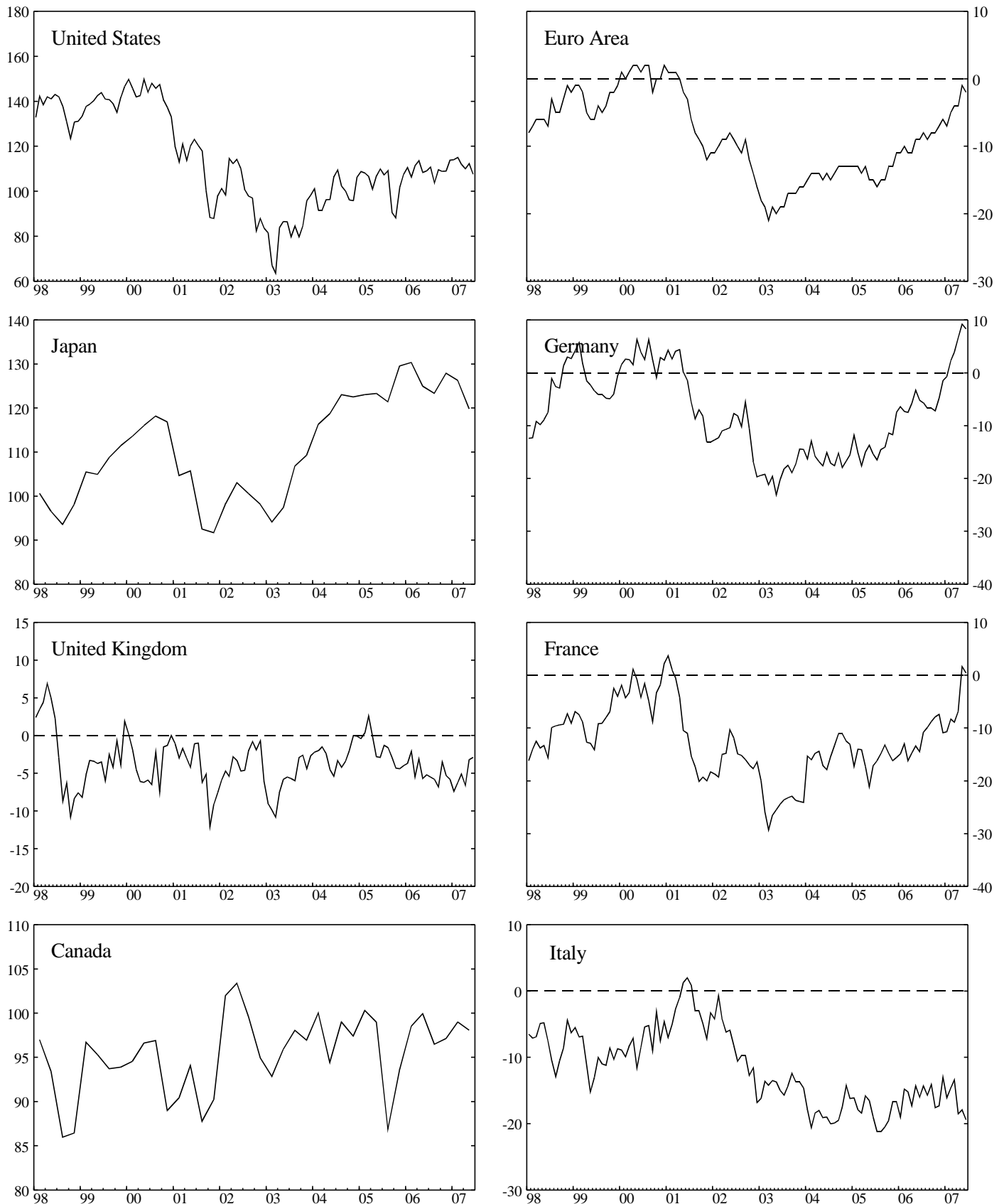
Major Industrial Countries

Chart 1. Major Industrial Countries: Real GDP and Domestic Demand
 First Quarter 1998 to First Quarter 2007
 (Percent change from a year earlier)



Source: Global Data Source.

Chart 2. Major Industrial Countries: Consumer Confidence 1/ 2/
January 1998 to June 2007

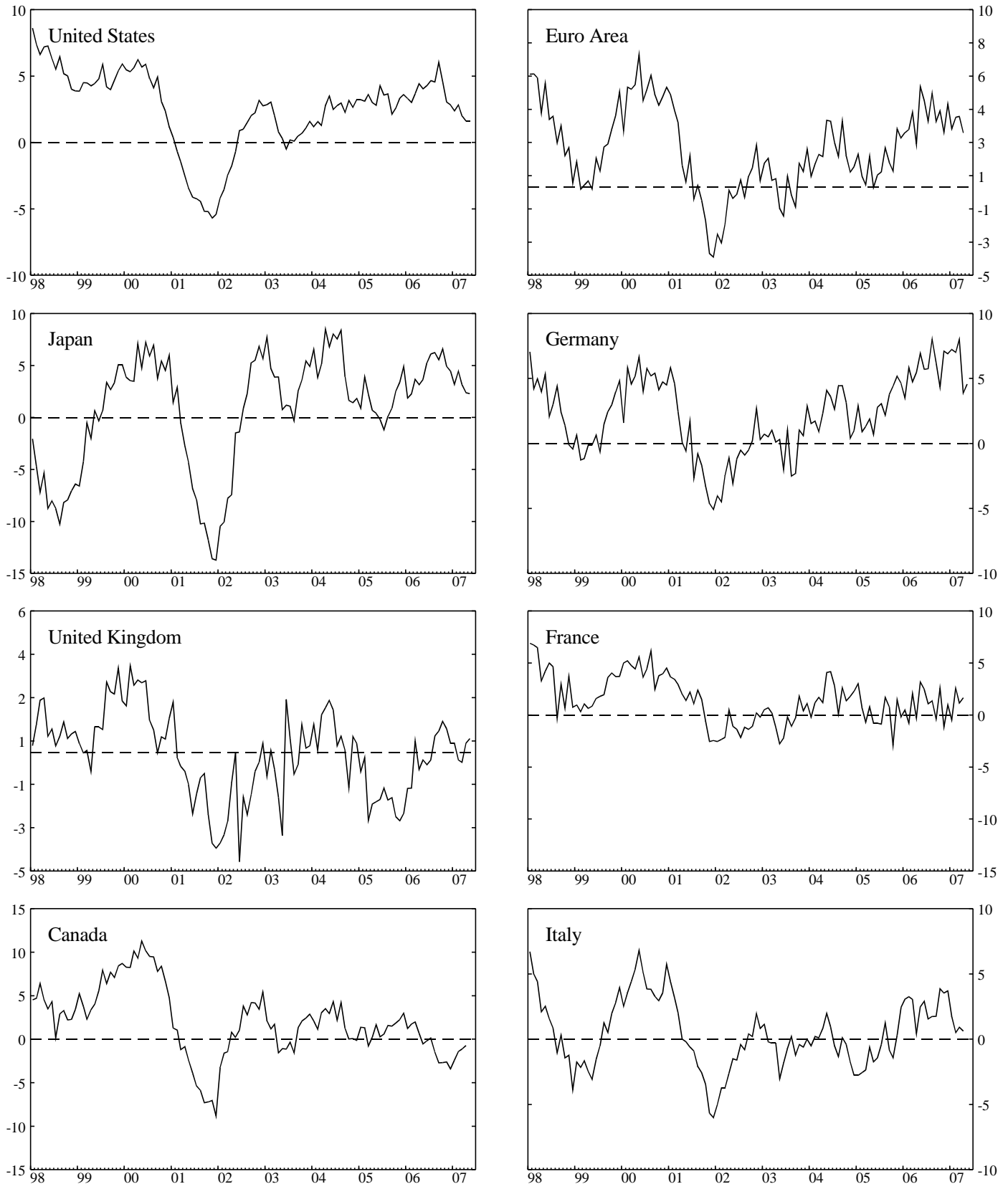


Source: Bloomberg L.P. and WEFA.

1/ Balance of opinion for the Euro Area, Germany, France, United Kingdom and Italy.

2/ Indices 2002=100 for the United States, Japan and Canada.

Chart 3. Major Industrial Countries: Industrial Production
January 1998 to June 2007
(Percent change from a year earlier)



Source: Global Data Source.

Chart 4. Major Industrial Countries: Business Confidence
January 1998 to June 2007
(Balance of Opinion)

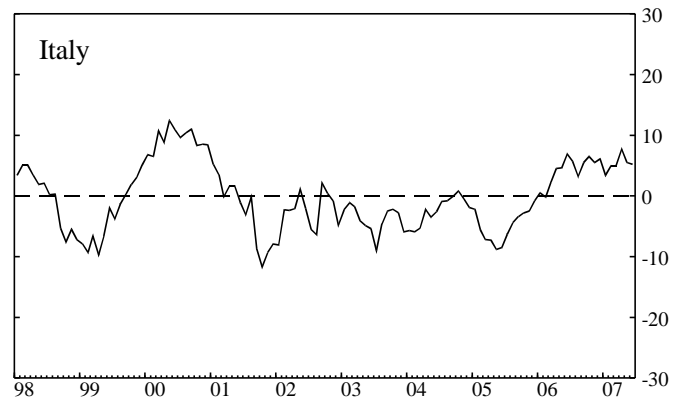
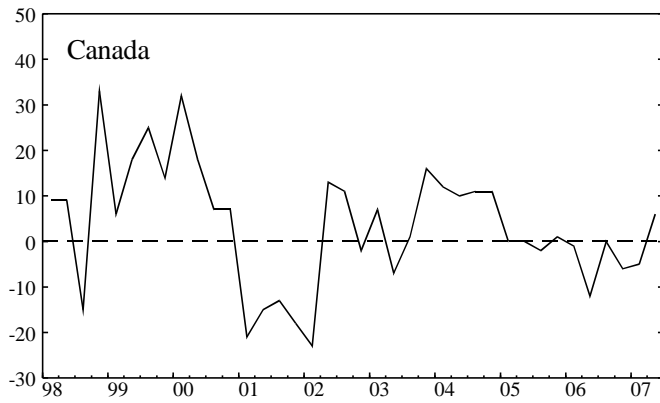
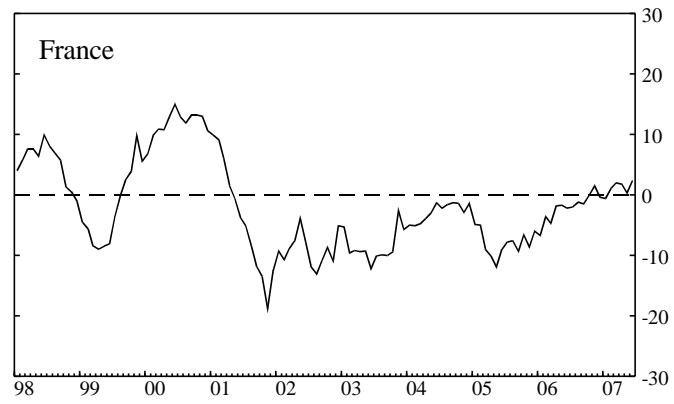
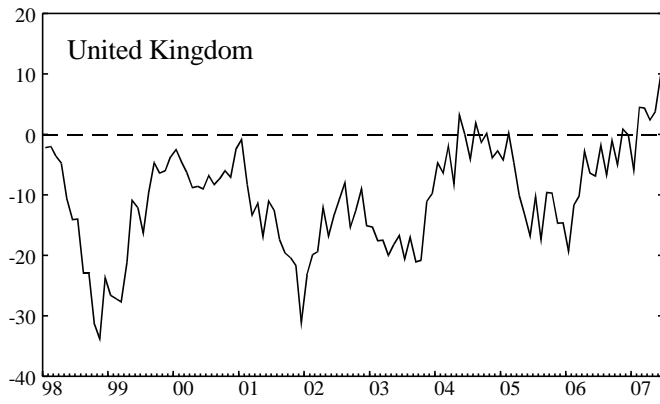
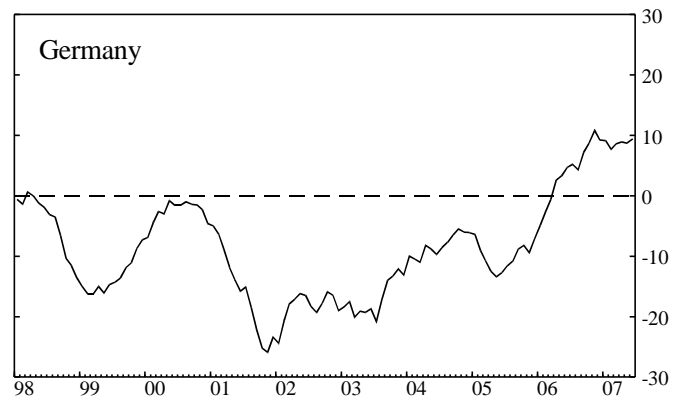
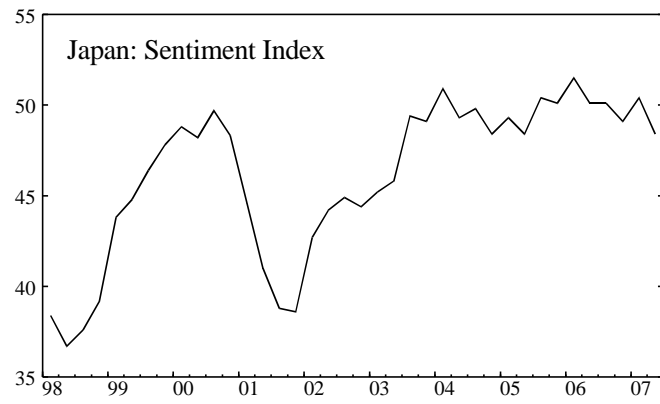
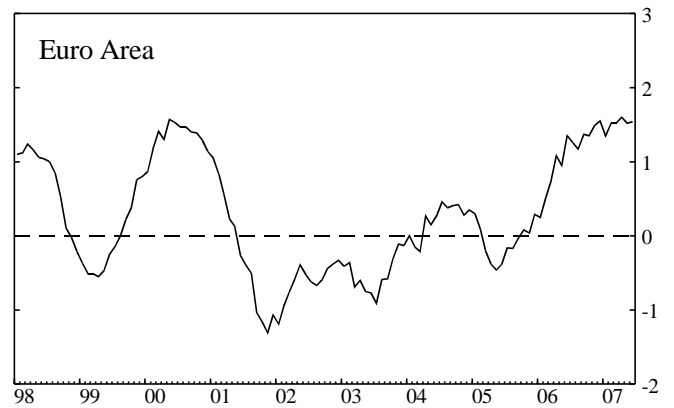
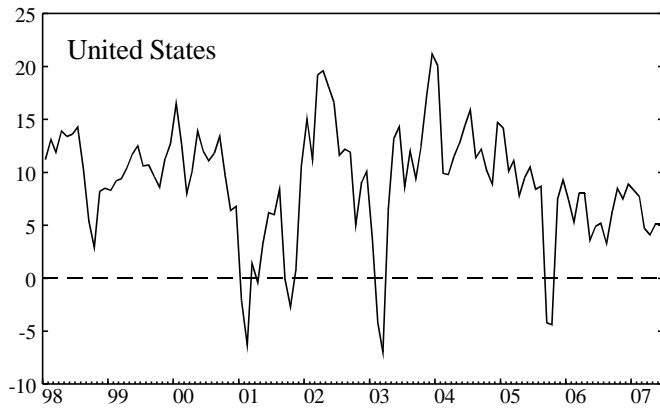
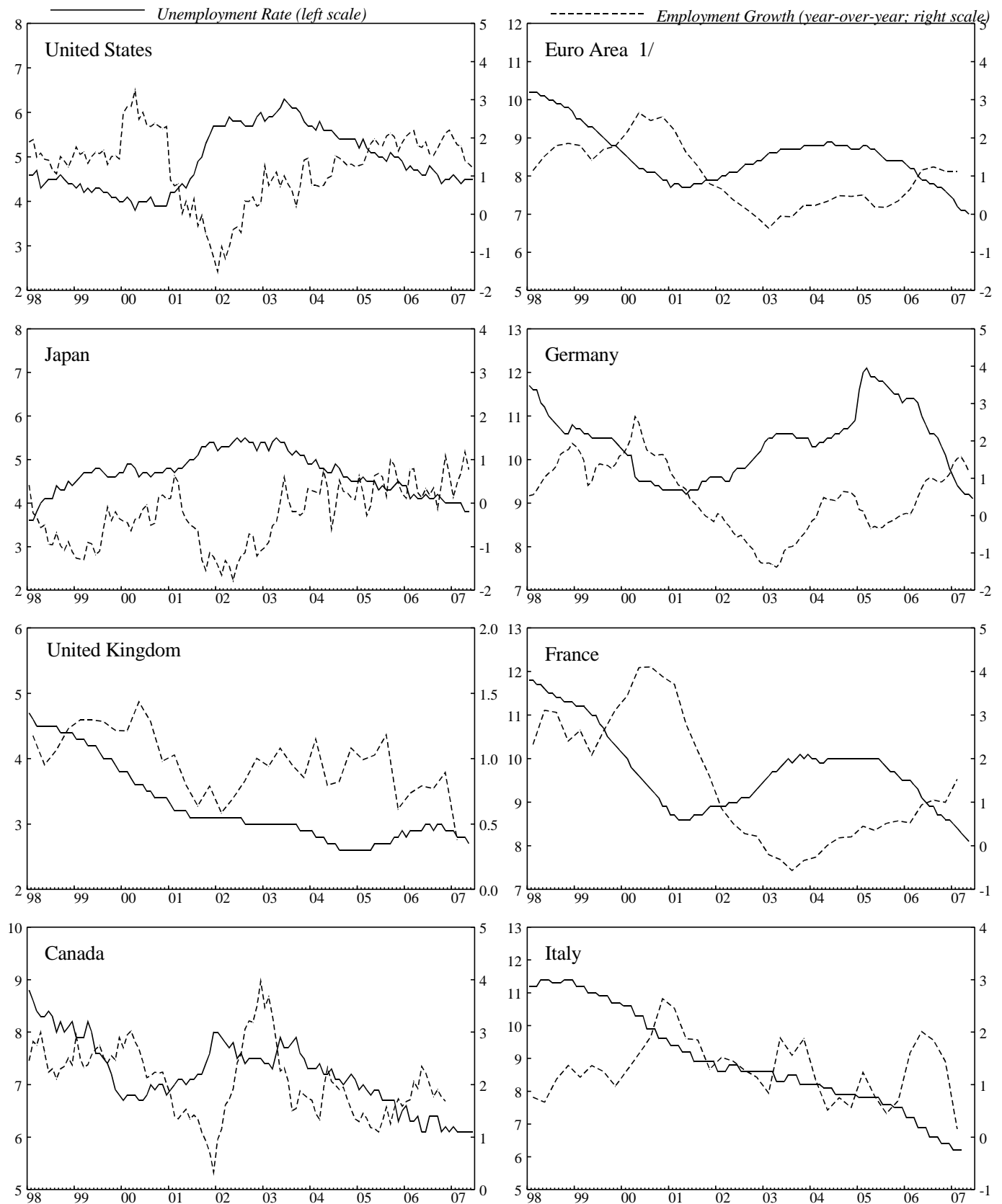


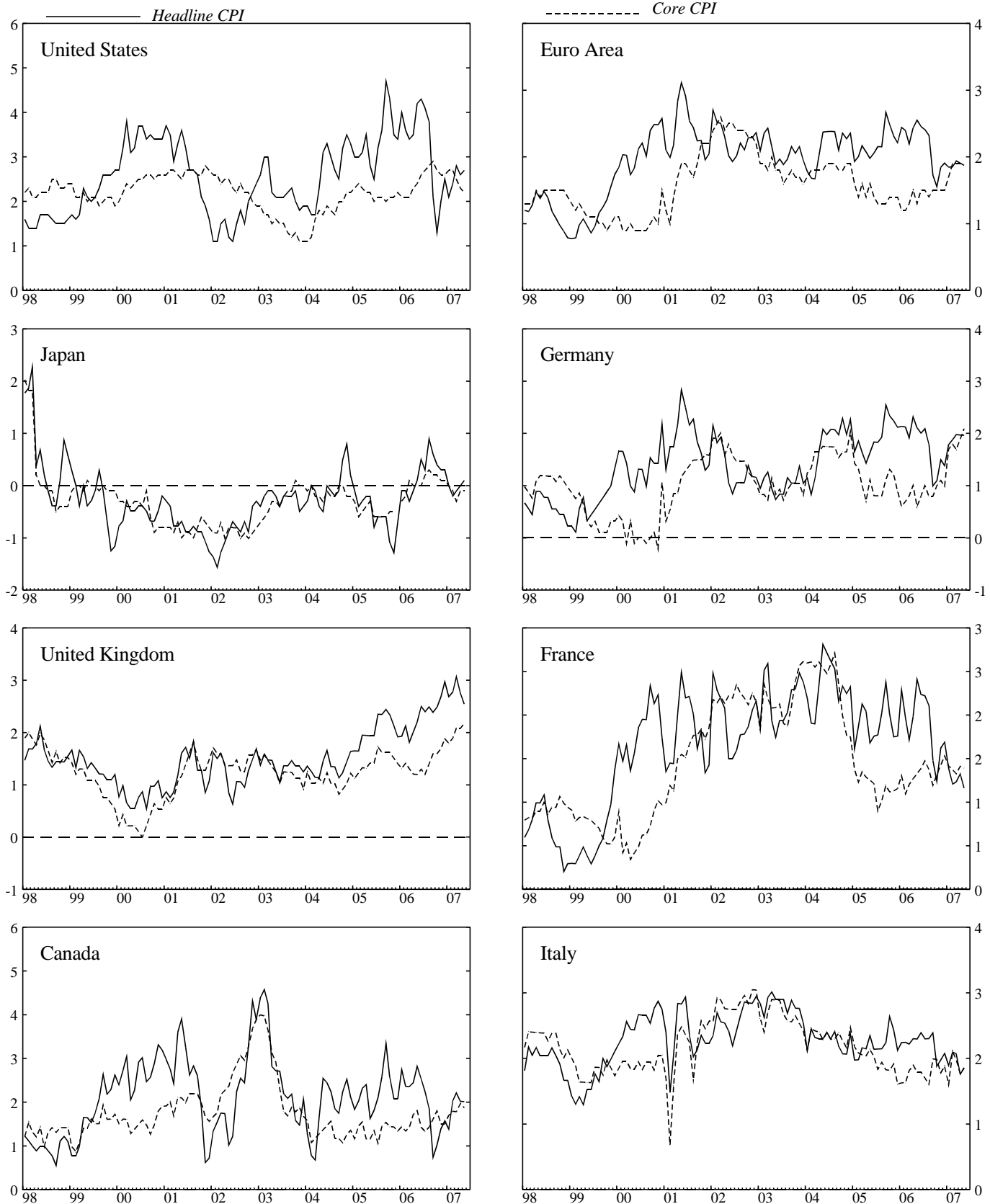
Chart 5. Major Industrial Countries: Unemployment Rate and Employment Growth
January 1998 to June 2007
(Percent)



Source: WEFA and Global Data Source.

1/ Employment growth for the Euro Area is a weighted average of Germany, France and Italy.

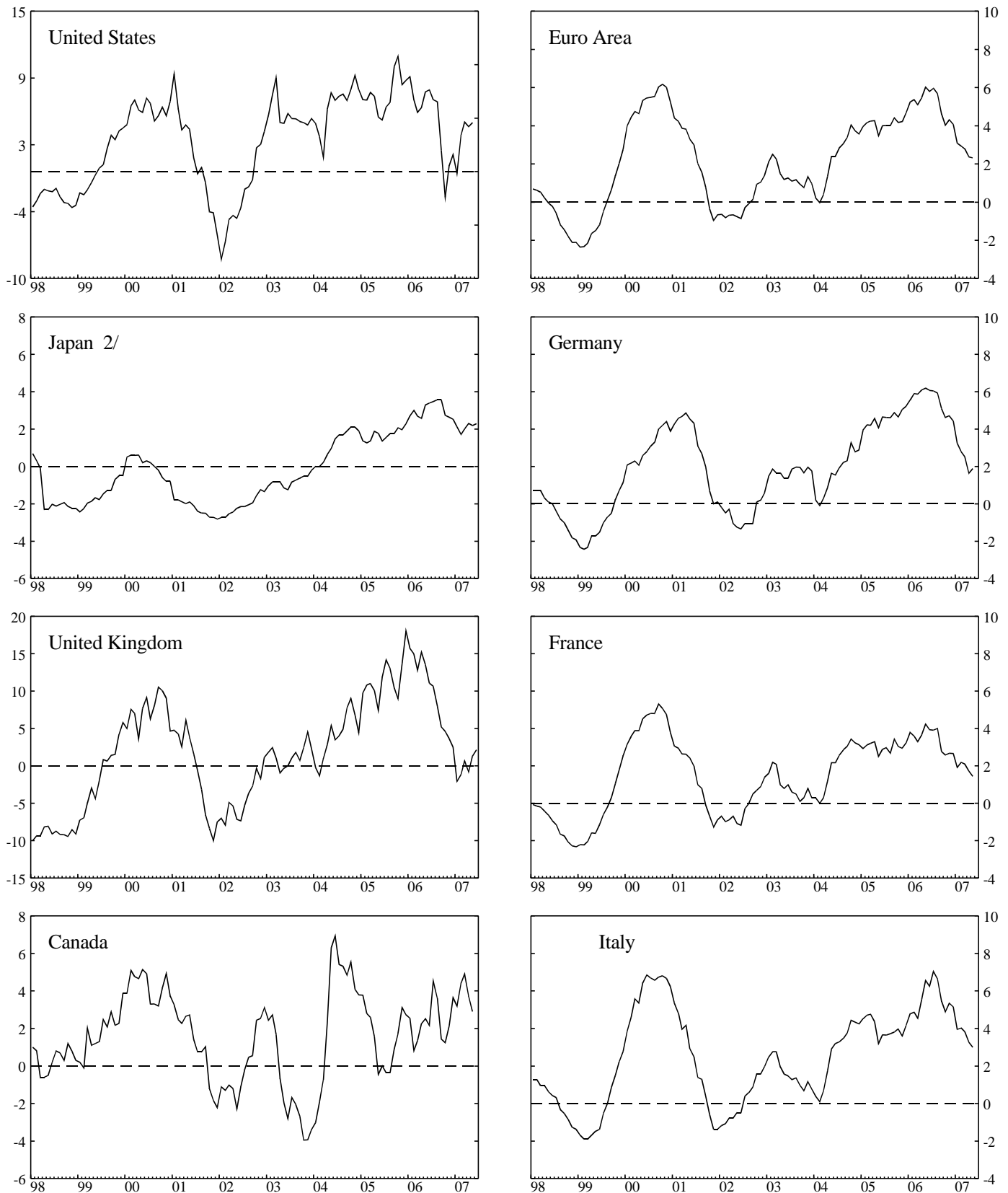
Chart 6. Major Industrial Countries: Consumer Prices 1/
January 1998 to June 2007
(Percent change from a year earlier)



Source: Global Data Source.

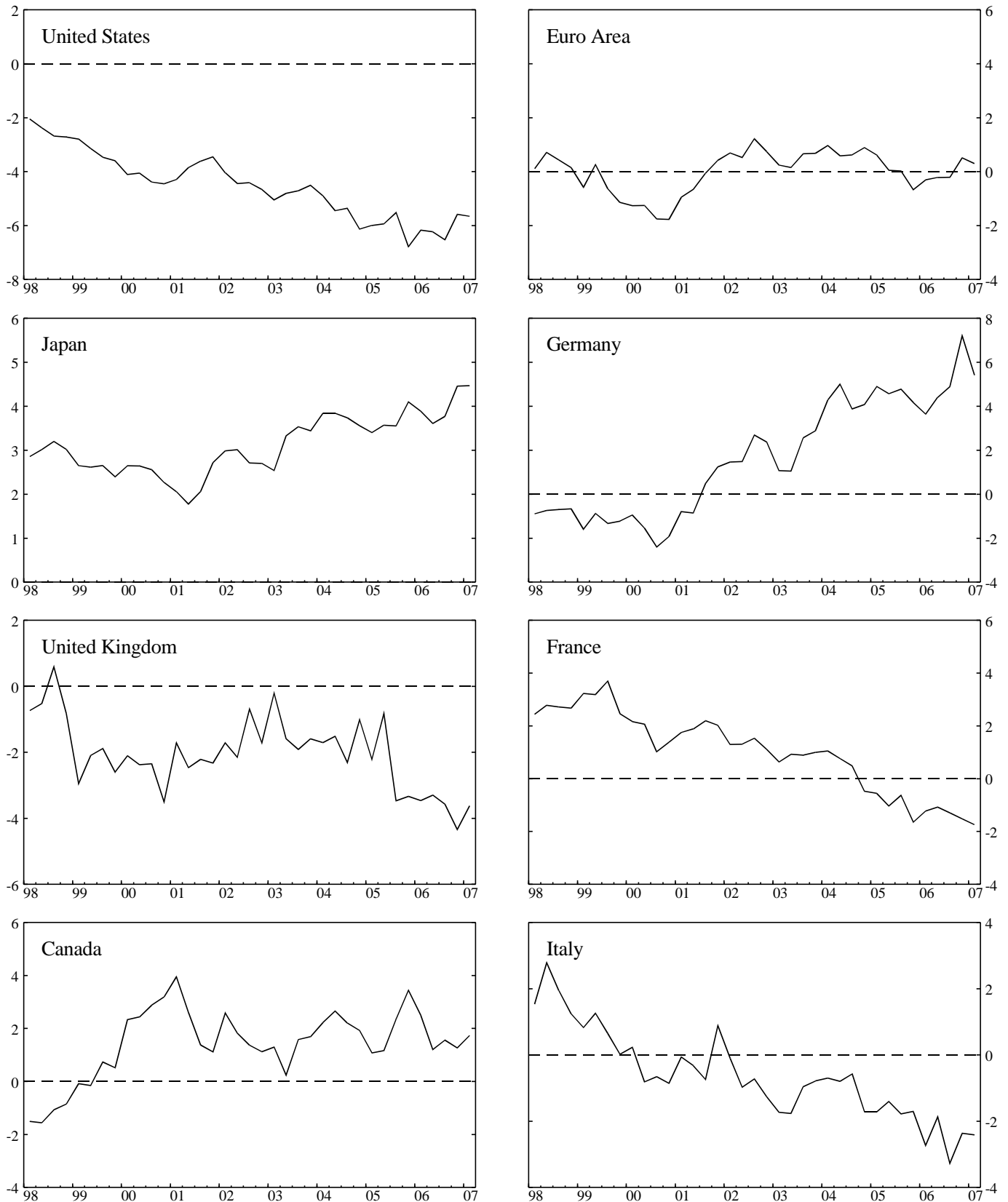
1/ Harmonized indices of consumer prices for the Euro Area, Germany, France, United Kingdom and Italy.

Chart 7. Major Industrial Countries: Producer Prices 1/
January 1998 to June 2007
(Percent change from a year earlier)



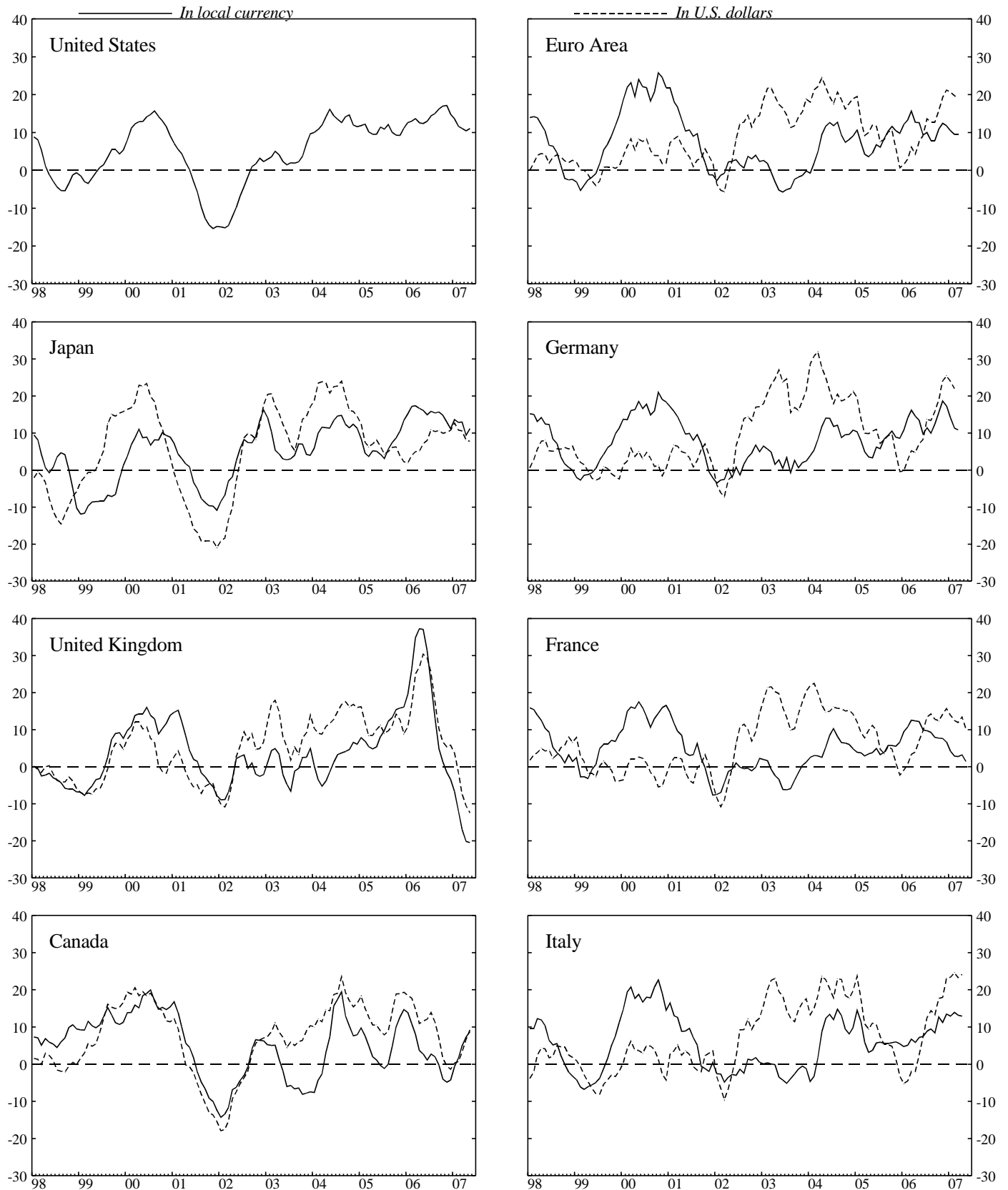
Source: WEFA and Eurostat.
1/ Scales differ across panels.
2/ Wholesale prices for Japan.

Chart 8. Major Industrial Countries: Current Account Balance
First Quarter 1998 to First Quarter 2007
(Percent of GDP)



Source: Global Data Source.

Chart 9. Major Industrial Countries: Exports 1/
January 1998 to June 2007
(Percent change from a year earlier)



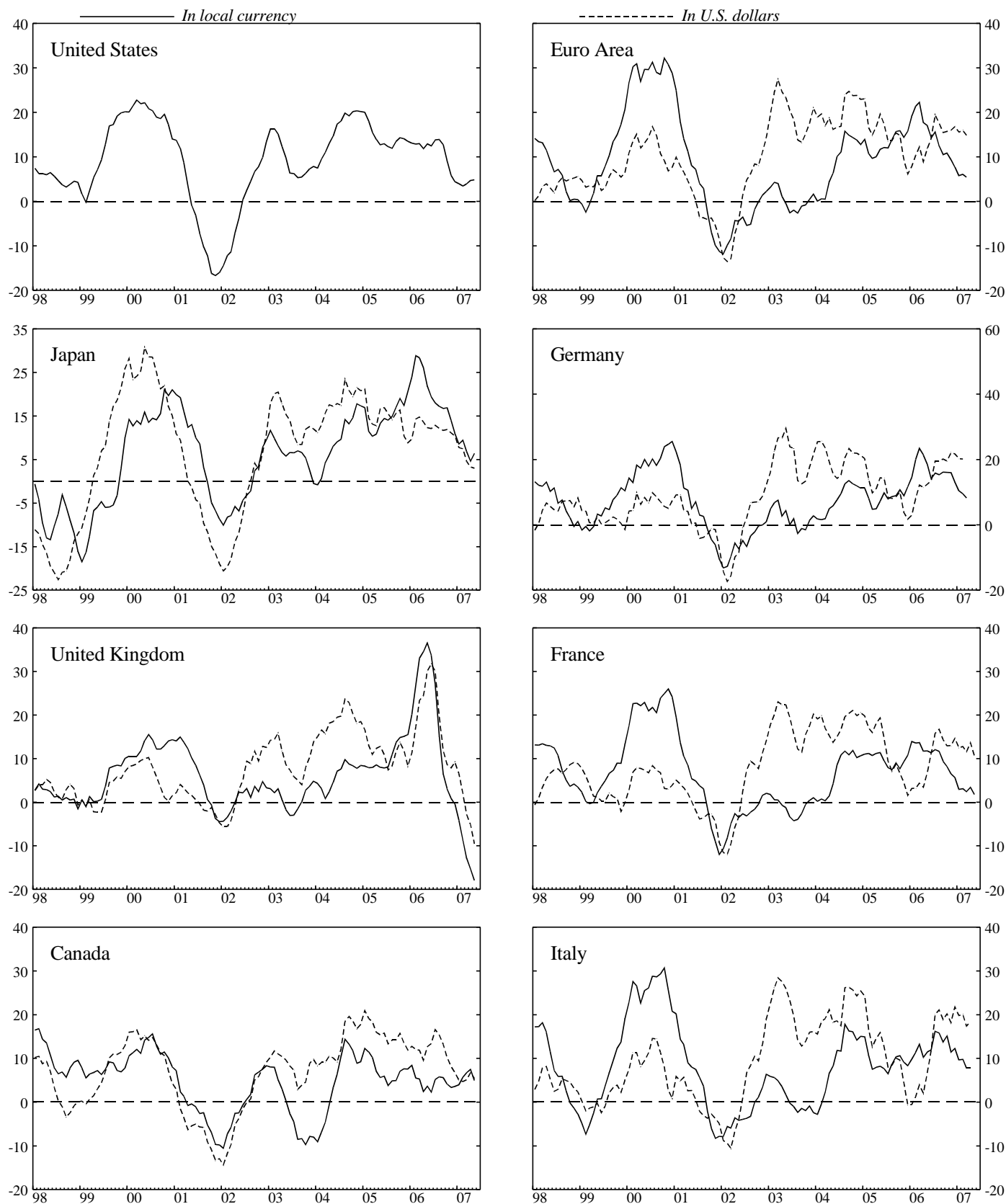
Source: WEFA.

1/ Three month moving average.

Chart 10. Major Industrial Countries: Imports 1/

January 1998 to June 2007

(Percent change from a year earlier)



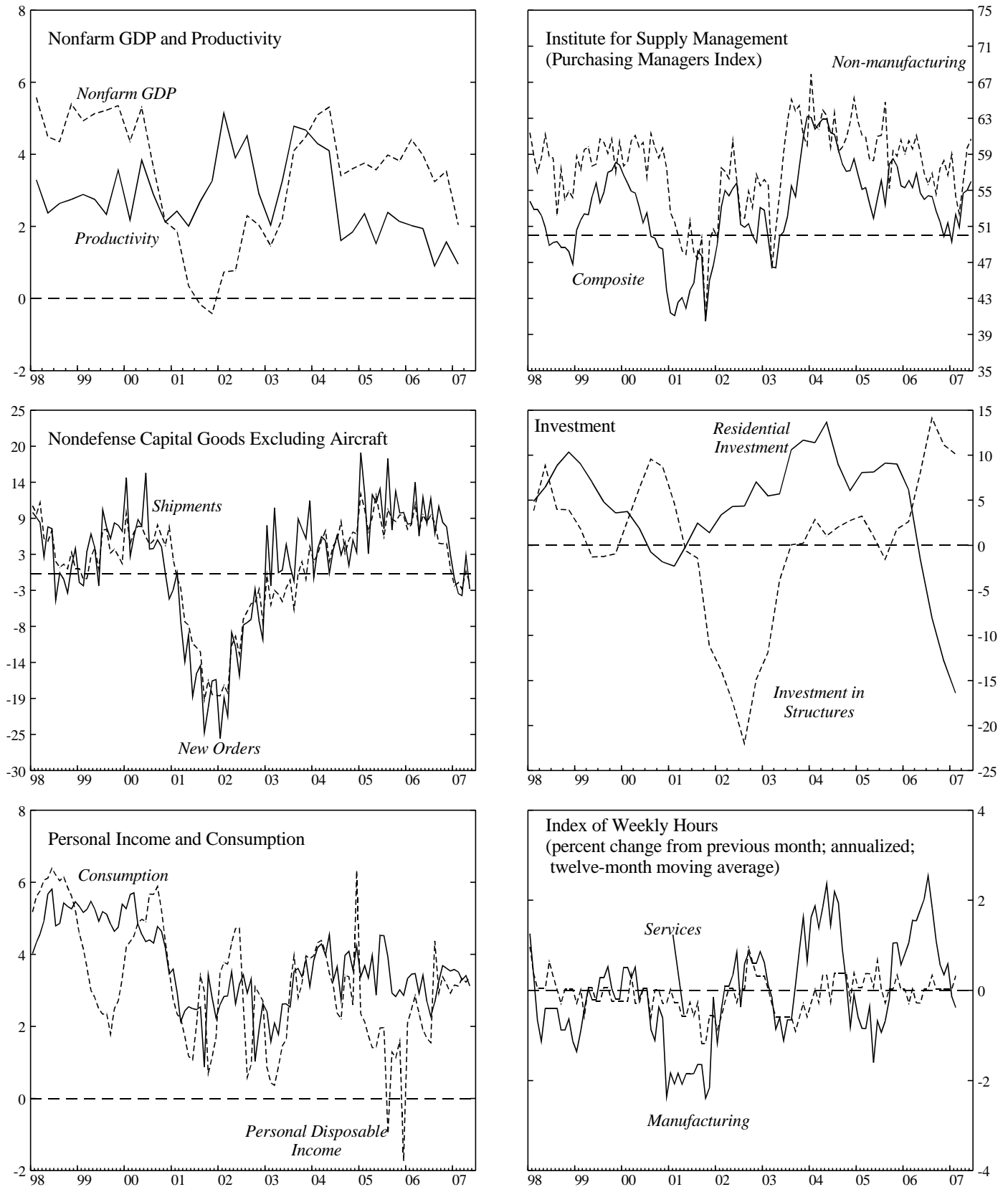
Source: WEFA.

1/ Three month moving average.

Chart 11. United States: Selected Economic Indicators

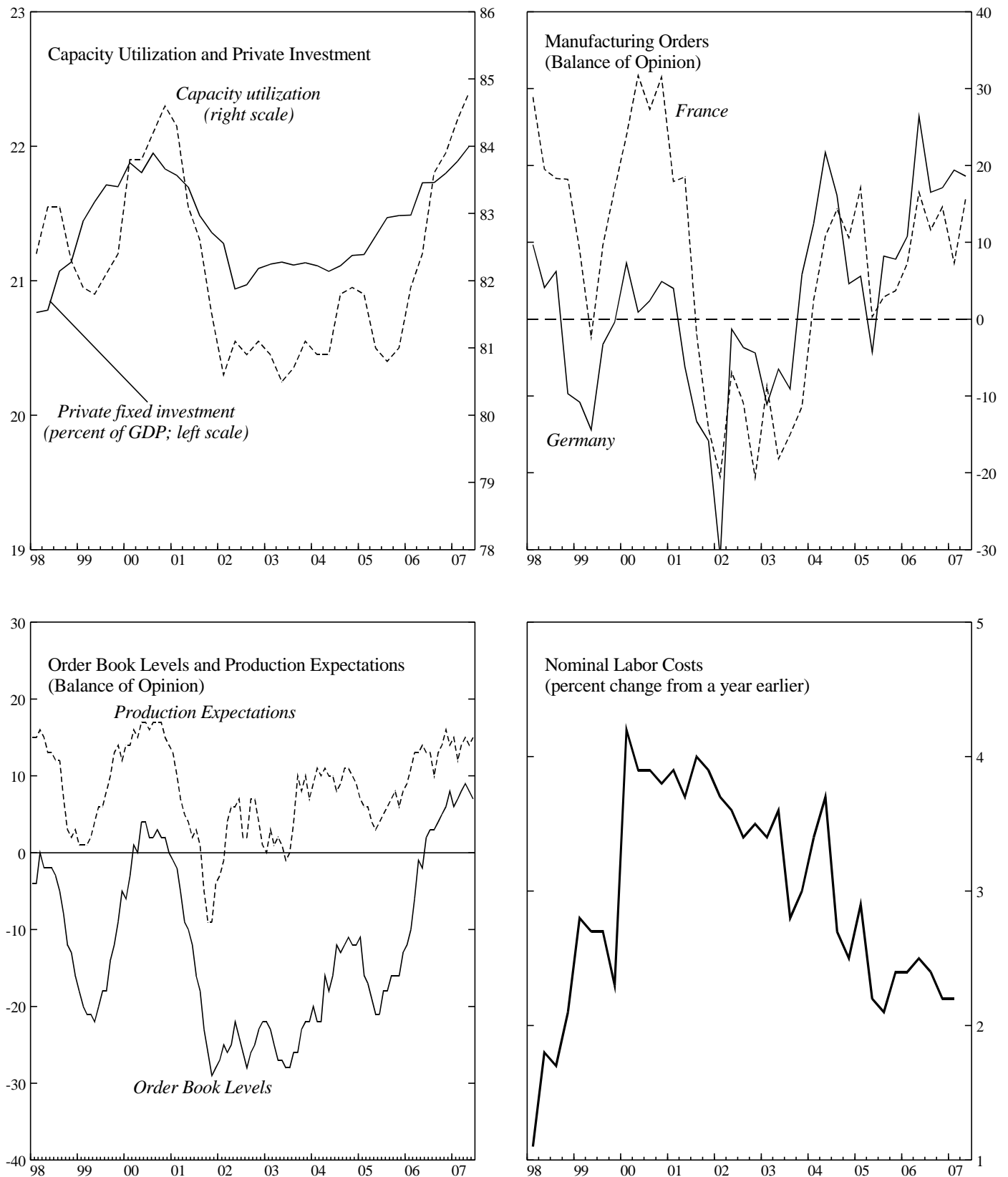
January 1998 to June 2007

(percent change from a year earlier)



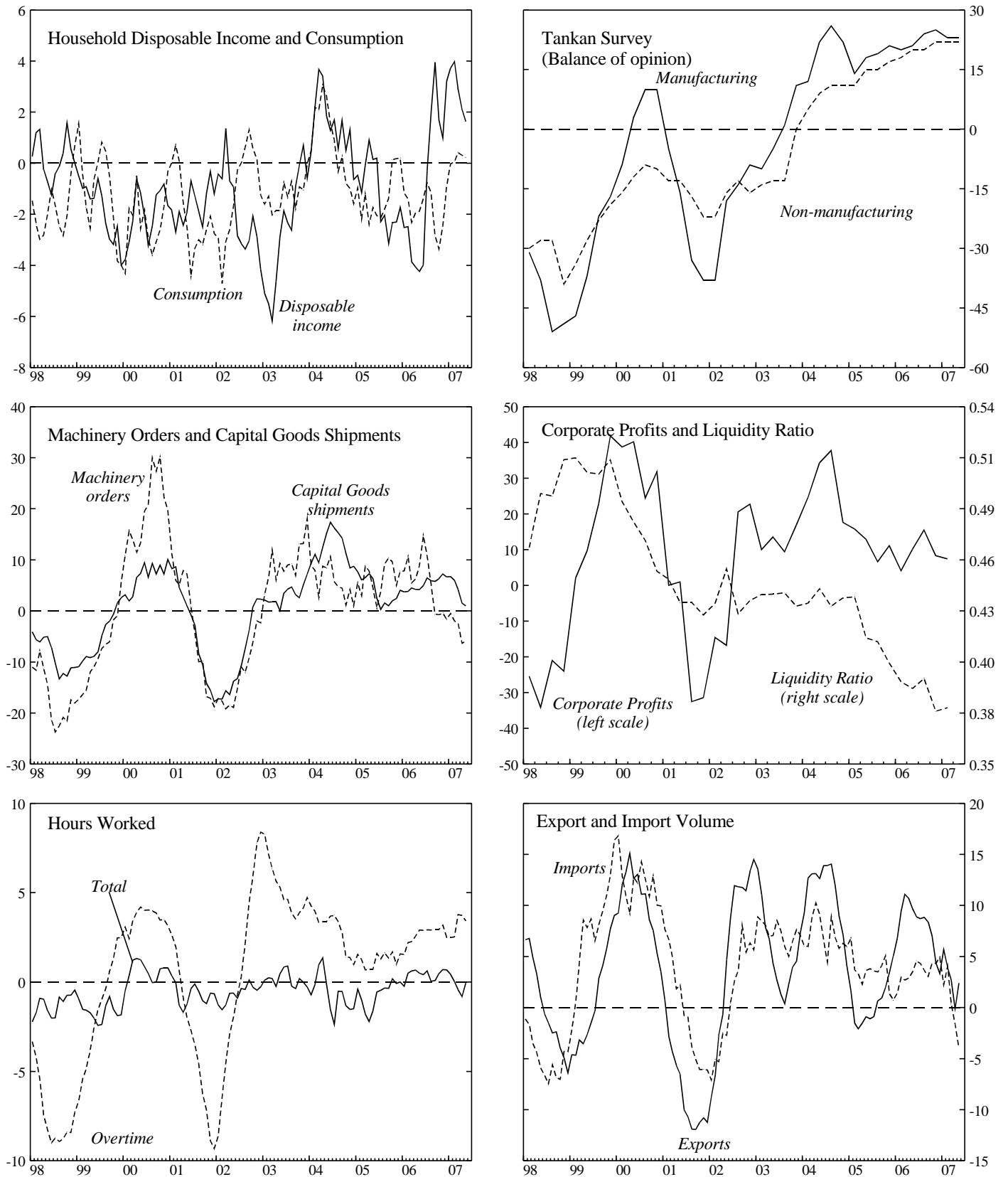
Source: WEFA and Bloomberg L.P.

Chart 12. Euro Area: Selected Economic Indicators
January 1998 to June 2007



Source: Eurostat and WEFA.

Chart 13. Japan: Selected Economic Indicators 1/
January 1998 to June 2007
(percent change from a year earlier)

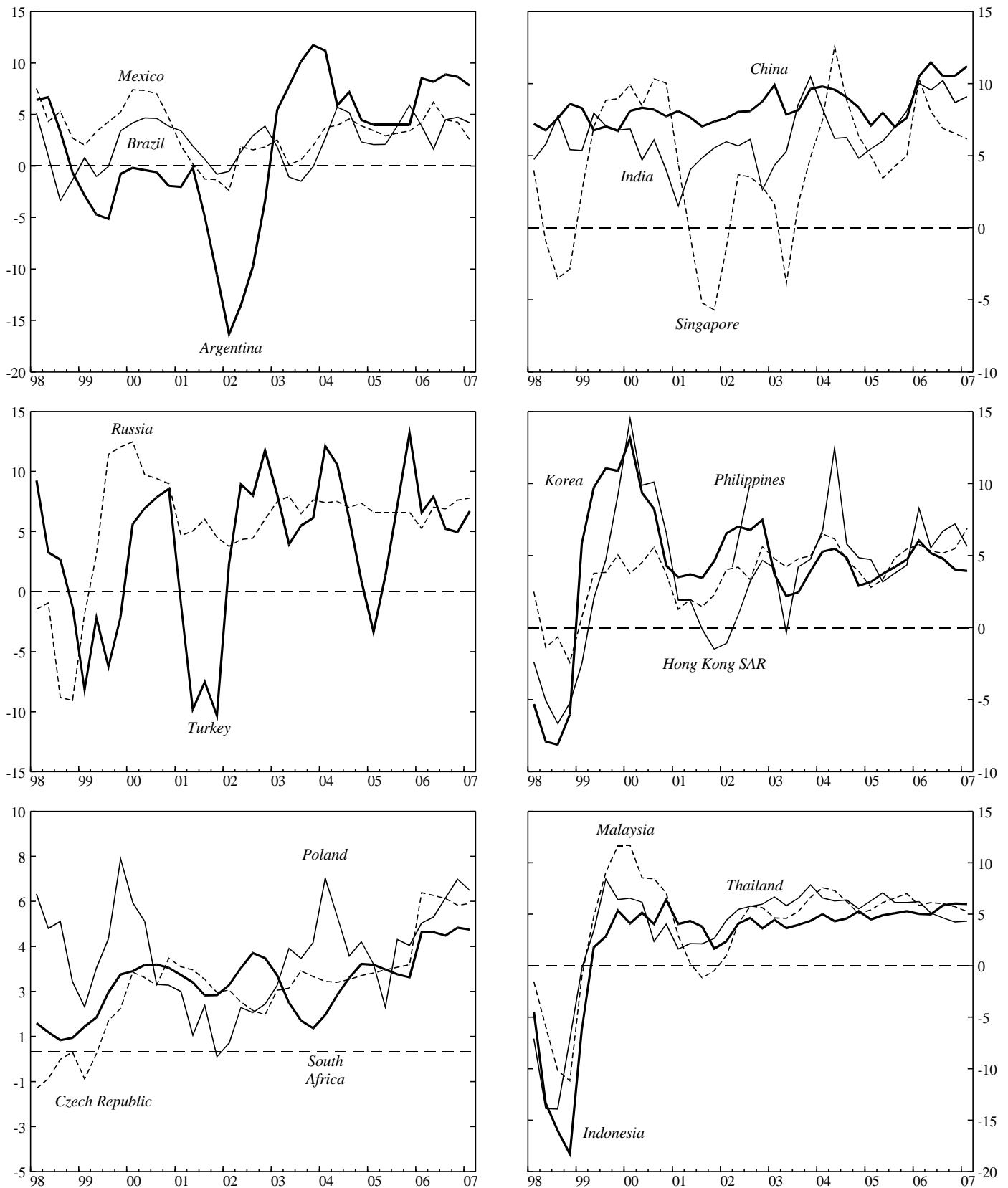


Source: WEFA.

1/ Three-month moving average for monthly series.

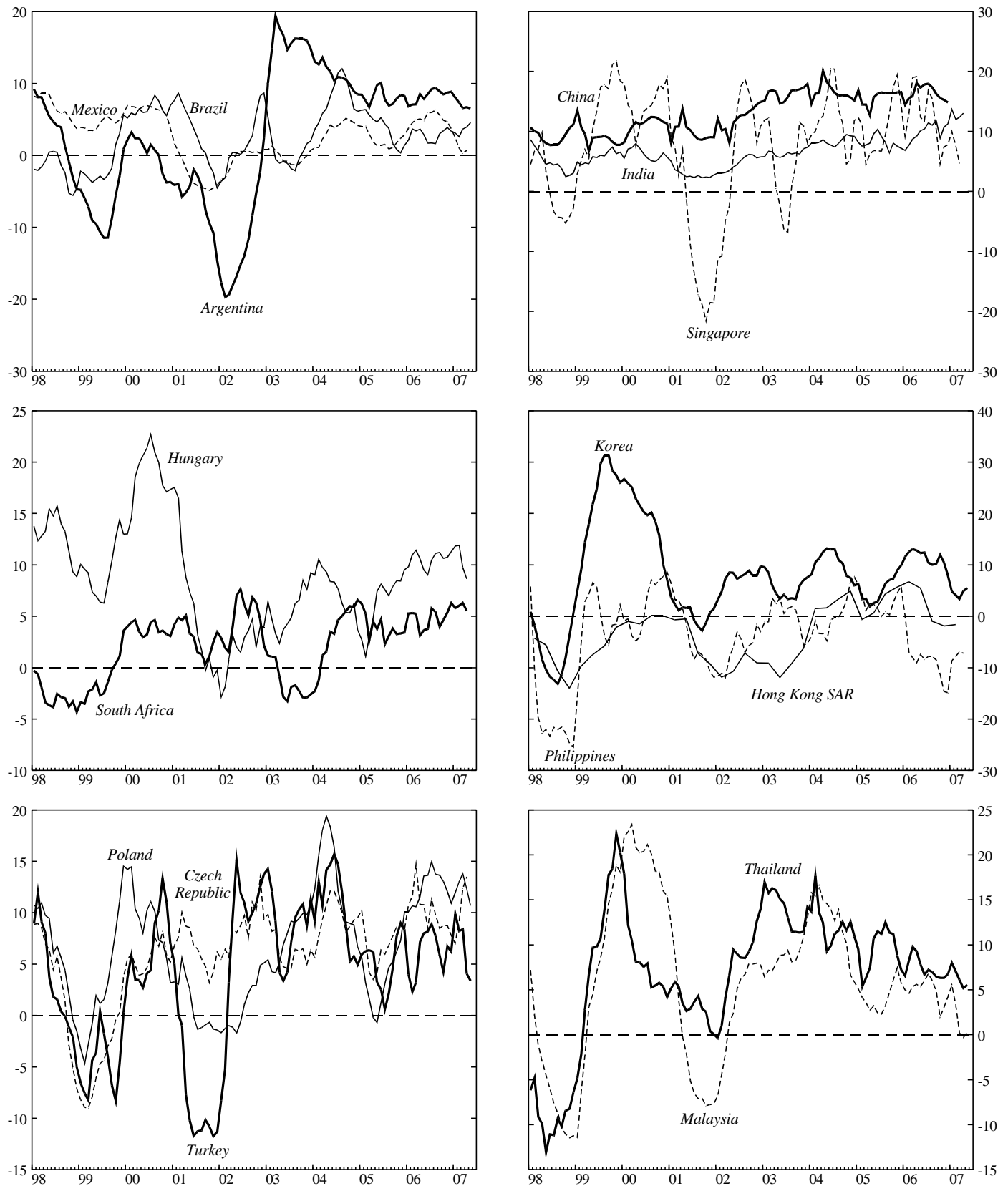
Selected Emerging Markets

Chart 14. Selected Emerging Markets: Real GDP 1/
 First Quarter 1998 to First Quarter 2007
 (percent change from a year earlier)



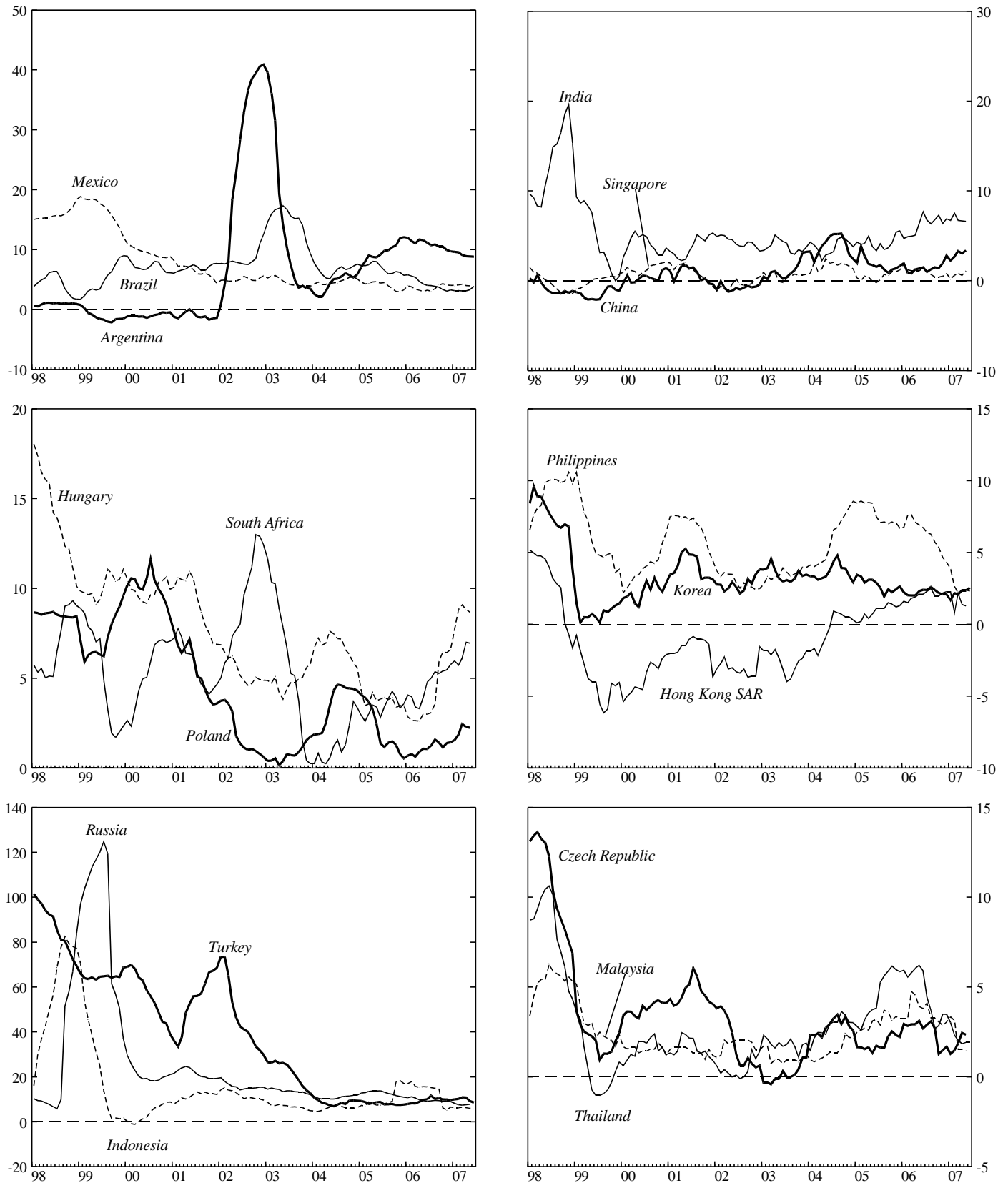
Source: IMF, World Economic Outlook and Global Data Source for Poland only.
 1/ Scales differ across panels.

Chart 15. Selected Emerging Markets: Industrial Production 1/
January 1998 to June 2007
(percent change from a year earlier)



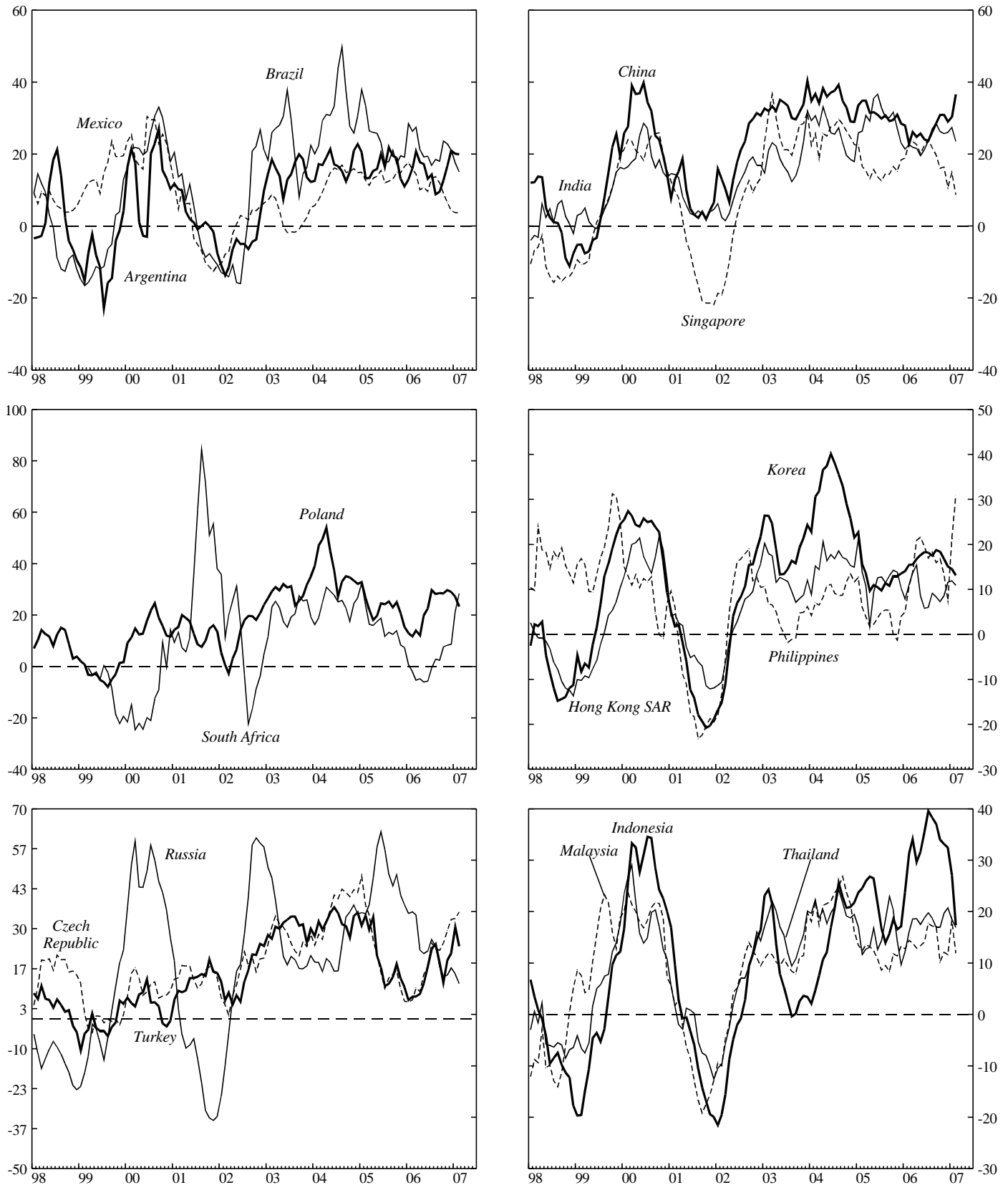
Source: WEFA and Global Data Source.
1/ Scales differ across panels.

Chart 16. Selected Emerging Markets: Consumer Prices 1/
January 1998 to June 2007
(percent change from a year earlier)



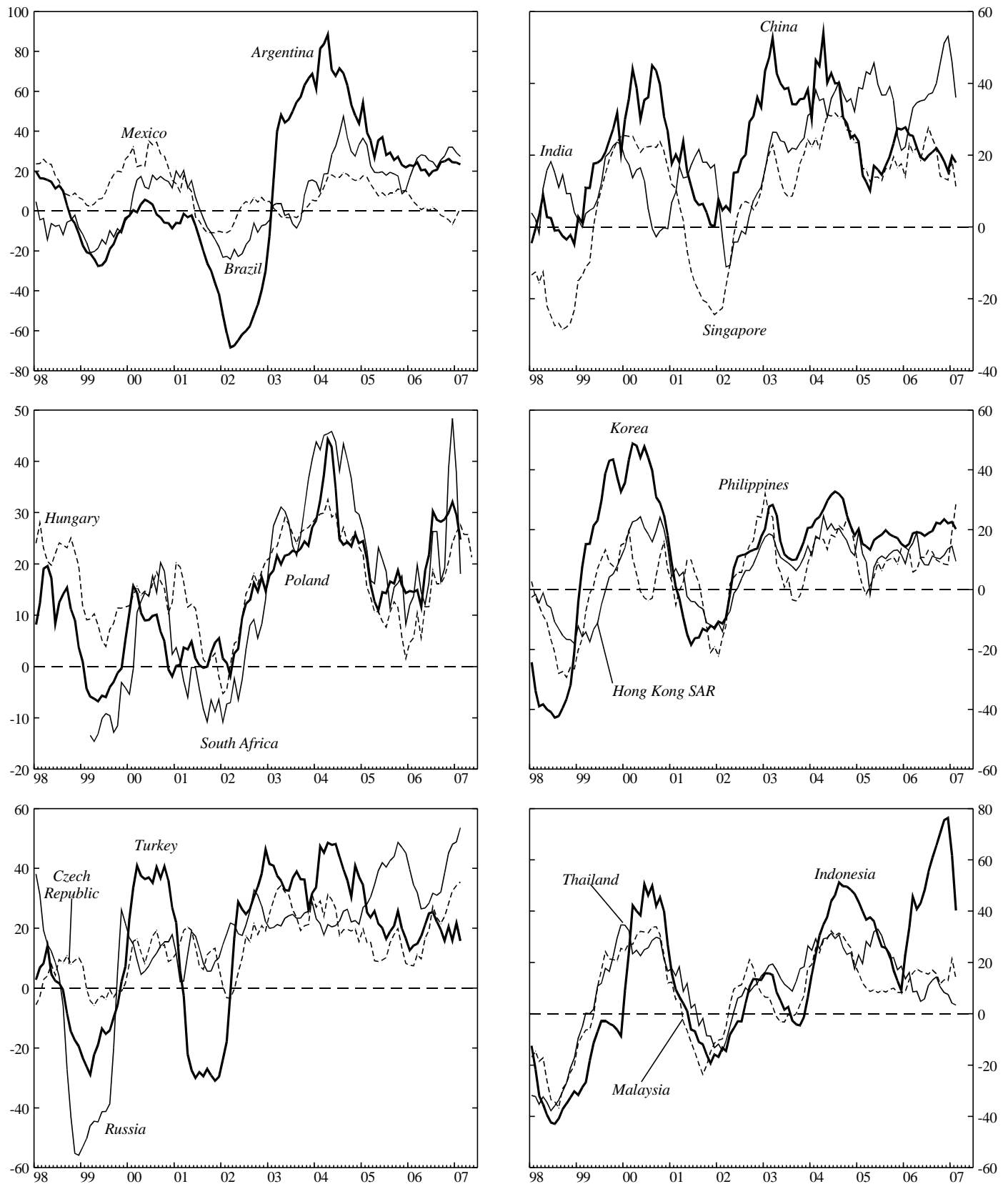
Source: Global Data Source.
1/ Scales differ across panels.

Chart 17. Selected Emerging Markets: Exports in U.S. Dollars 1/
 January 1998 to June 2007
 (percent change from a year earlier)



Source: WEFA and Global Data Source.
 1/ Scales differ across panels. Three-month moving average.

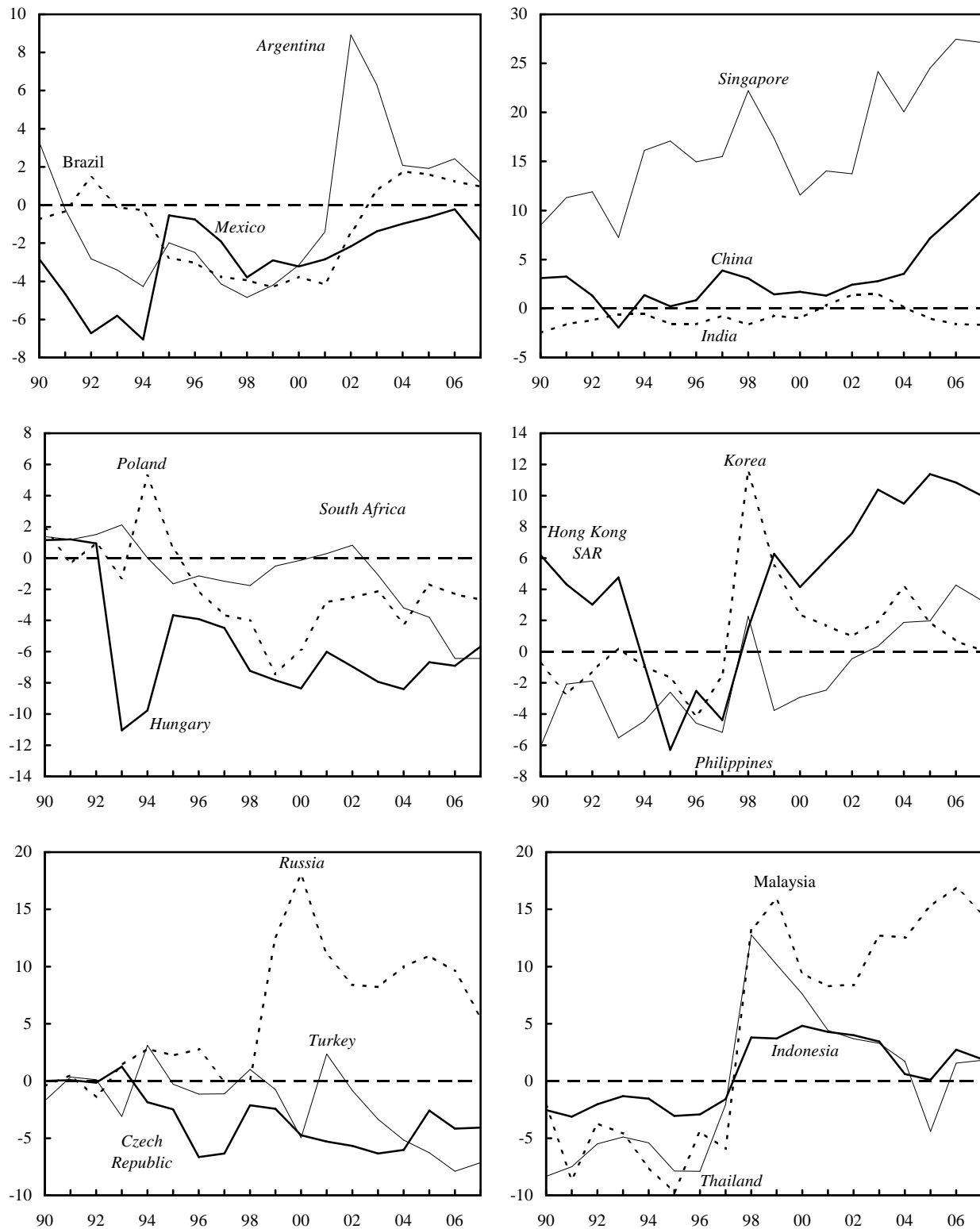
Chart 18. Selected Emerging Markets: Imports in U.S. Dollars 1/
January 1998 to June 2007
(percent change from a year earlier)



Source: WEFA and Global Data Source.

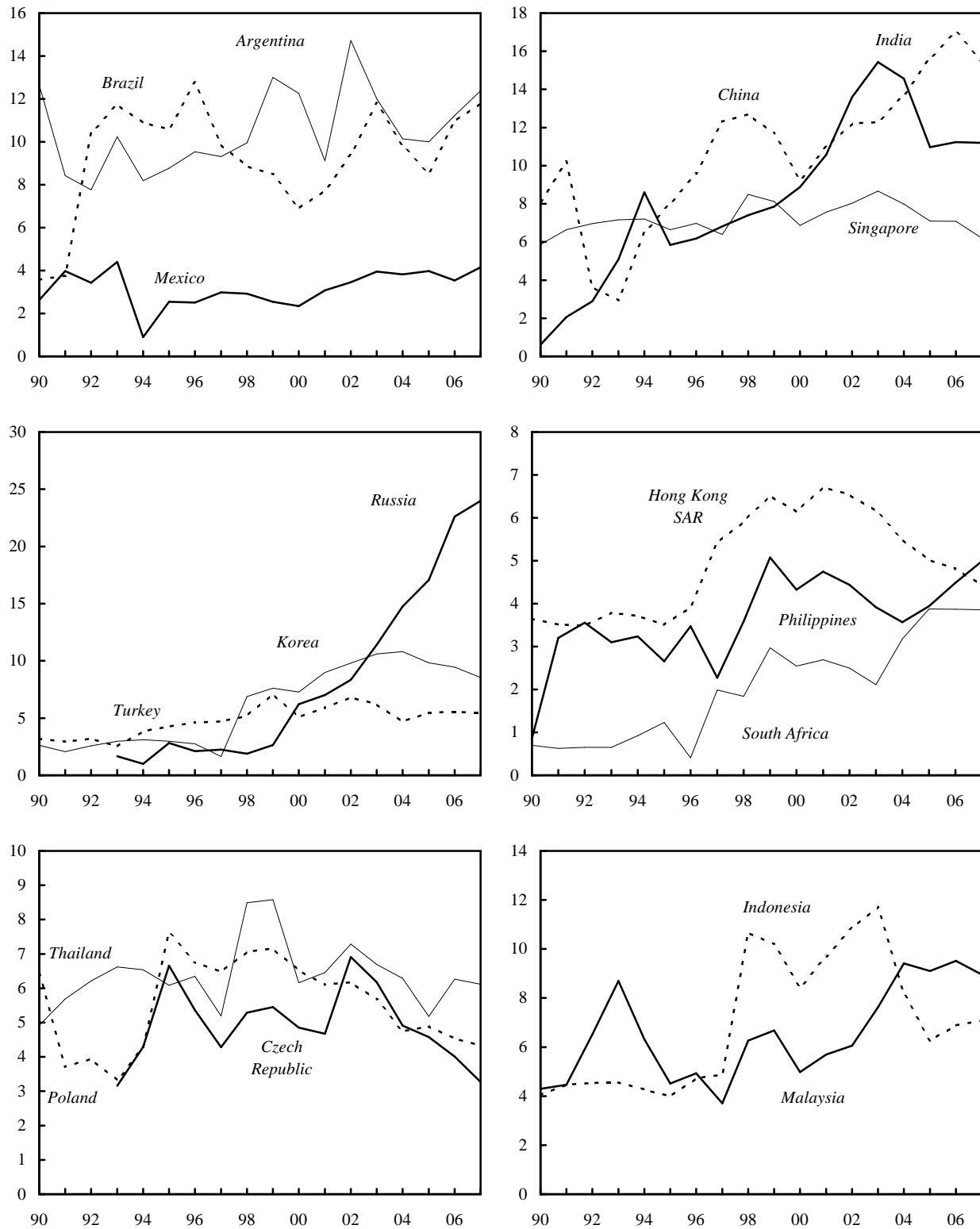
1/ Scales differ across panels. Three-month moving average.

Chart 19. Current Account 1/
1990 to 2007
(In percent of GDP)



Source: IMF, World Economic Outlook.
1/ Scales differ across panels.

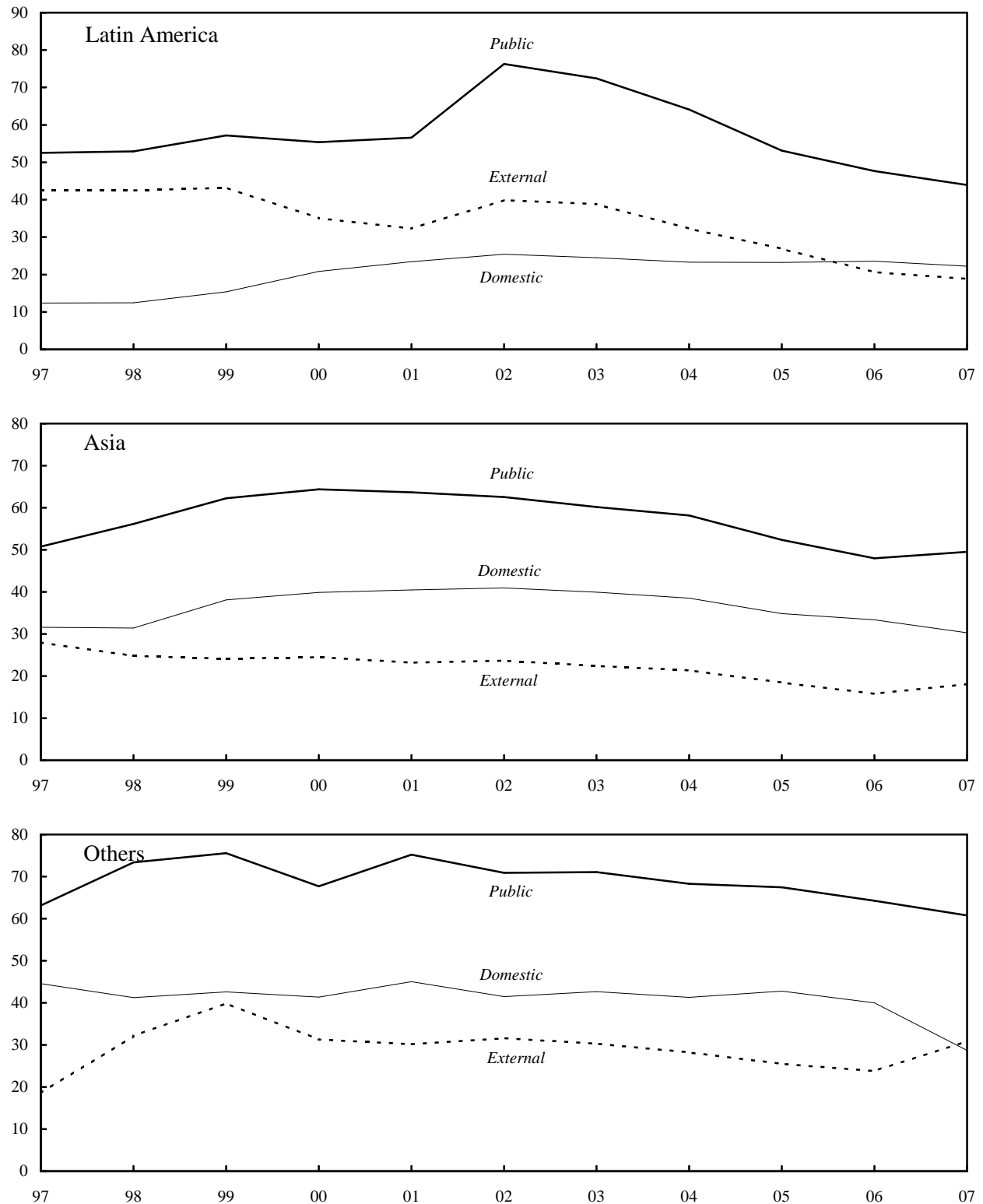
Chart 20. Foreign Exchange Reserves 1/
1990 to 2007
(In month of imports)



Source: IMF, International Financial Statistics and World Economic Outlook.

1/ Scales differ across panels.

Chart 21. Public Debt to GDP Ratios 1/ 2/
1997 to 2007
(In percent of GDP)



Source: IMF Staff estimates.

1/ Scales differ across panels.

2/ Latin America: Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela.

Asia: China, India, Indonesia, Pakistan, Philippines, and Thailand.

Others: Egypt, Hungary, Lebanon, Poland, Russia, South Africa, Turkey, and Ukraine.

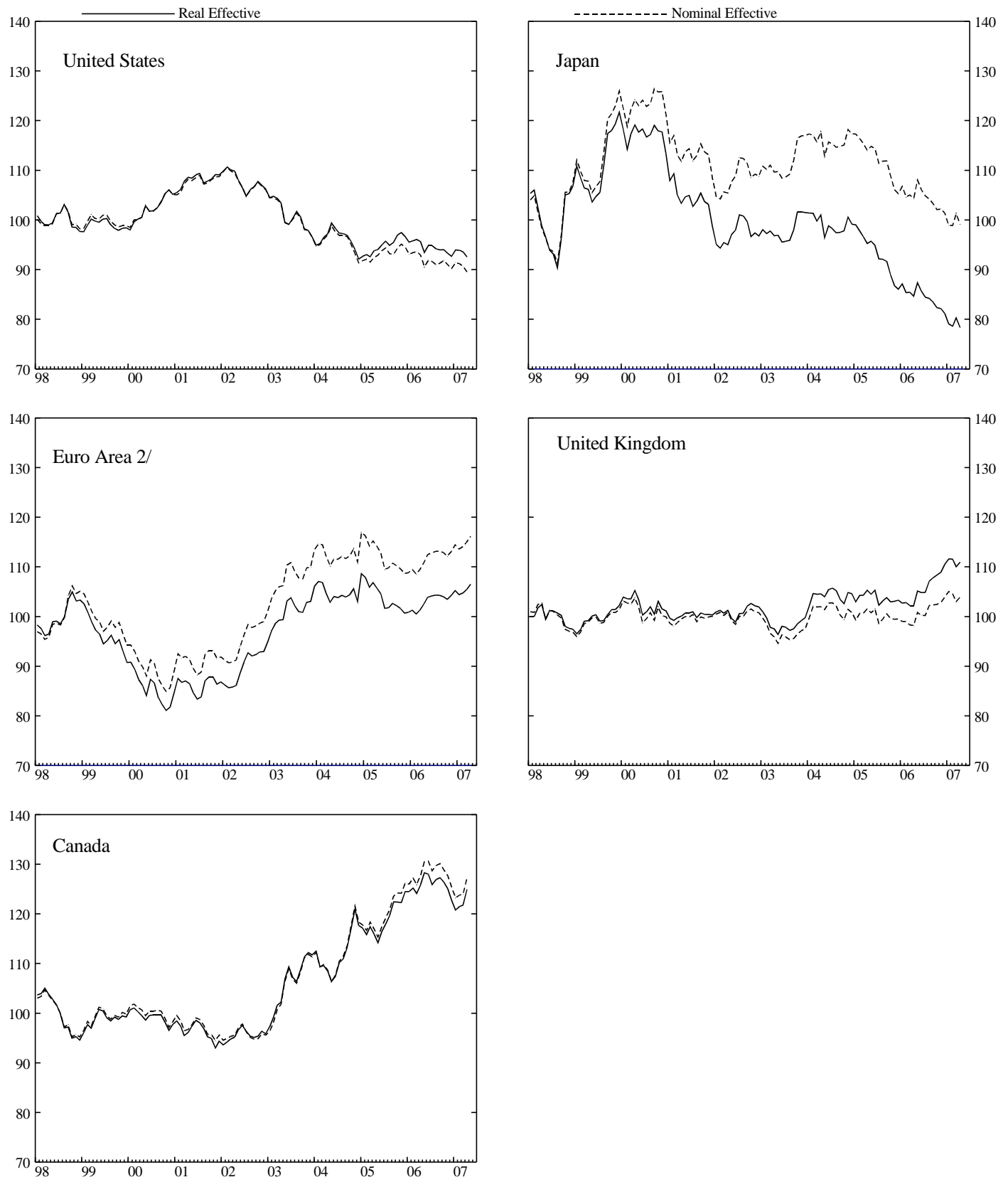
Financial Markets

Chart 22. Selected Industrial Countries: Bilateral Exchange Rates 1/
 January 1998 to July 2007
 (per U.S. dollar; inverted scale)



Source: Bloomberg L.P. and staff estimates.
 1/ Scales differ across panels.

Chart 23. Major Industrial Countries: Nominal and Real Effective Exchange Rates
January 1998 to June 2007
(Indices, 1998 = 100)

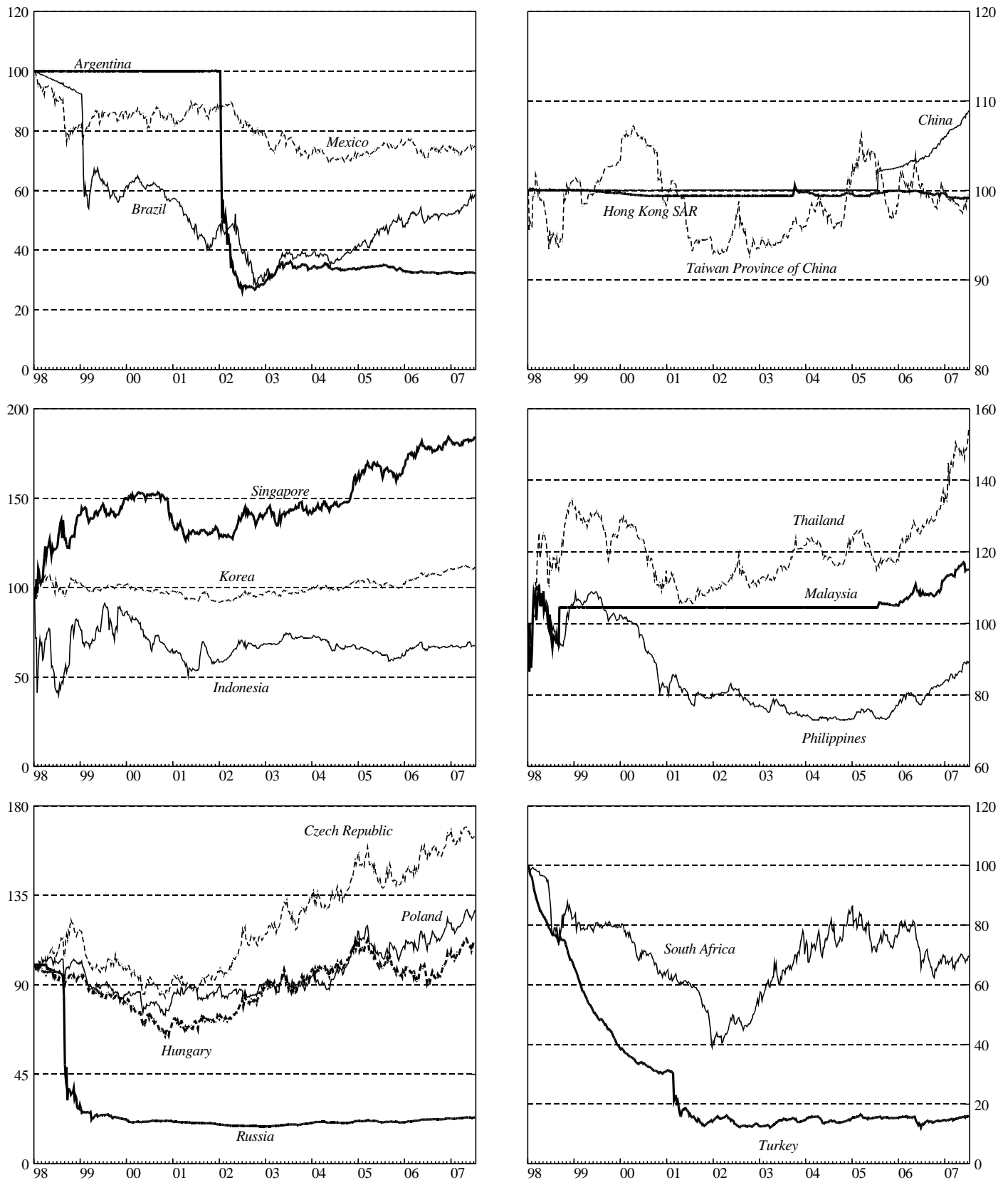


Source: INS and staff estimates.

1/ CPI based staff estimates.

2/ Data prior to January 1, 1999 are based on a weighted average of euro area currencies.

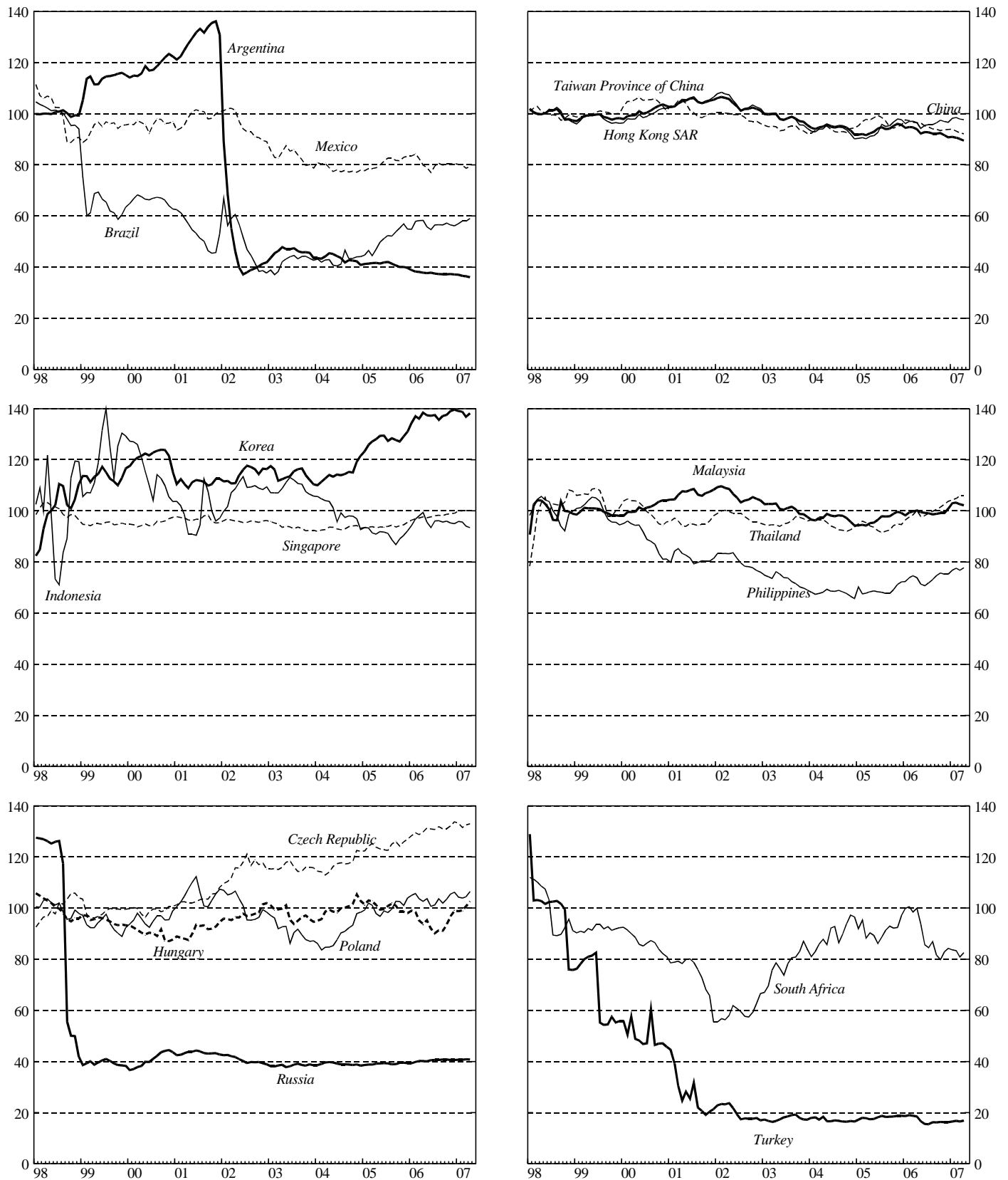
Chart 24. Selected Emerging Markets: Bilateral Exchange Rates 1/
 January 1998 to July 2007
 (Against U.S. dollar; Index, January 6, 1998 = 100)



Source: Bloomberg L.P.

1/ Increase indicates appreciation.

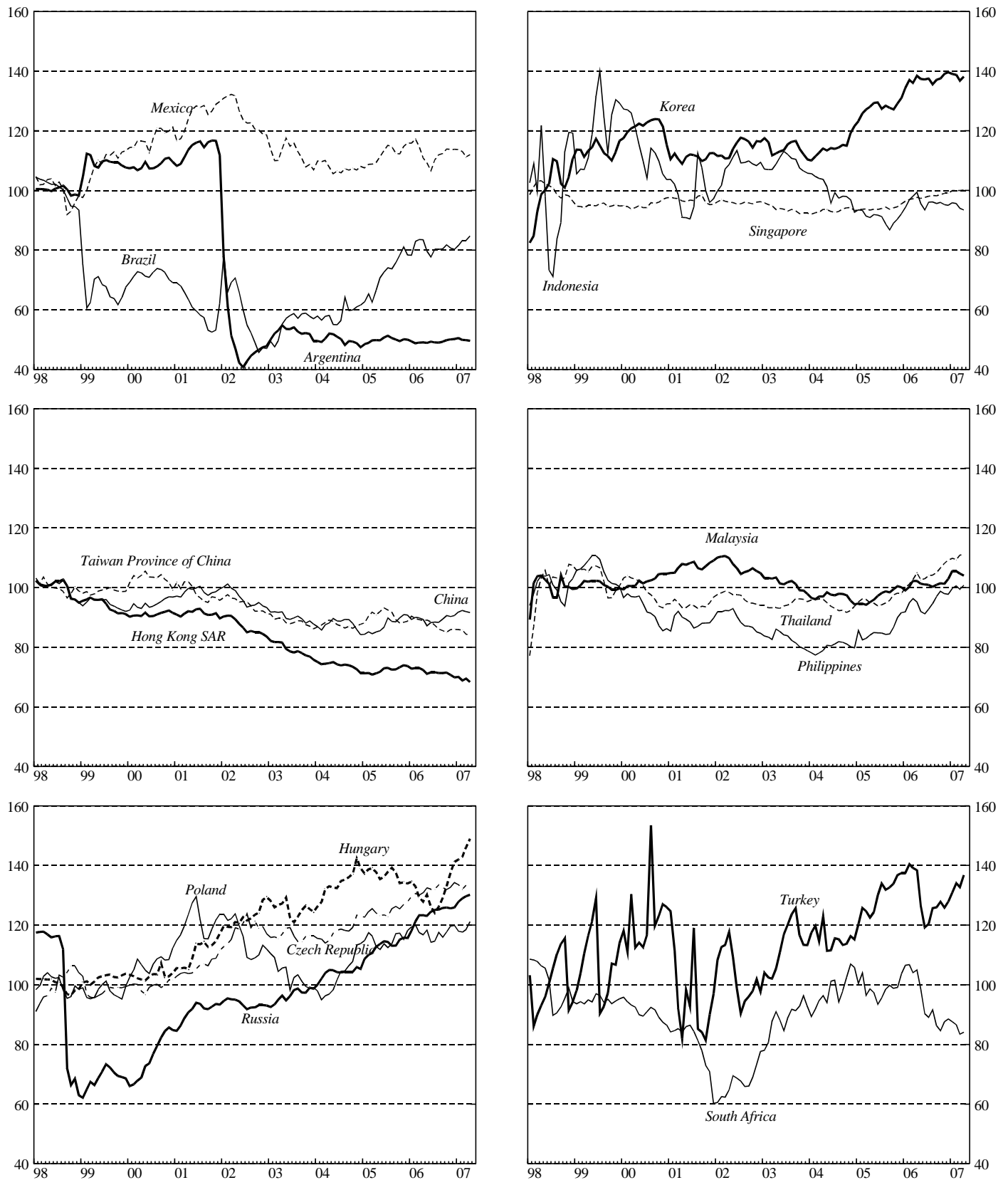
Chart 25. Selected Emerging Markets: Nominal Effective Exchange Rates
January 1998 to May 2007
(Index 1998 = 100)



Source: INS and staff estimates.

1/ Scales differ across panels.

Chart 26. Selected Emerging Markets: Real Effective Exchange Rates 1/2/
January 1998 to May 2007
(Index 1998 = 100)

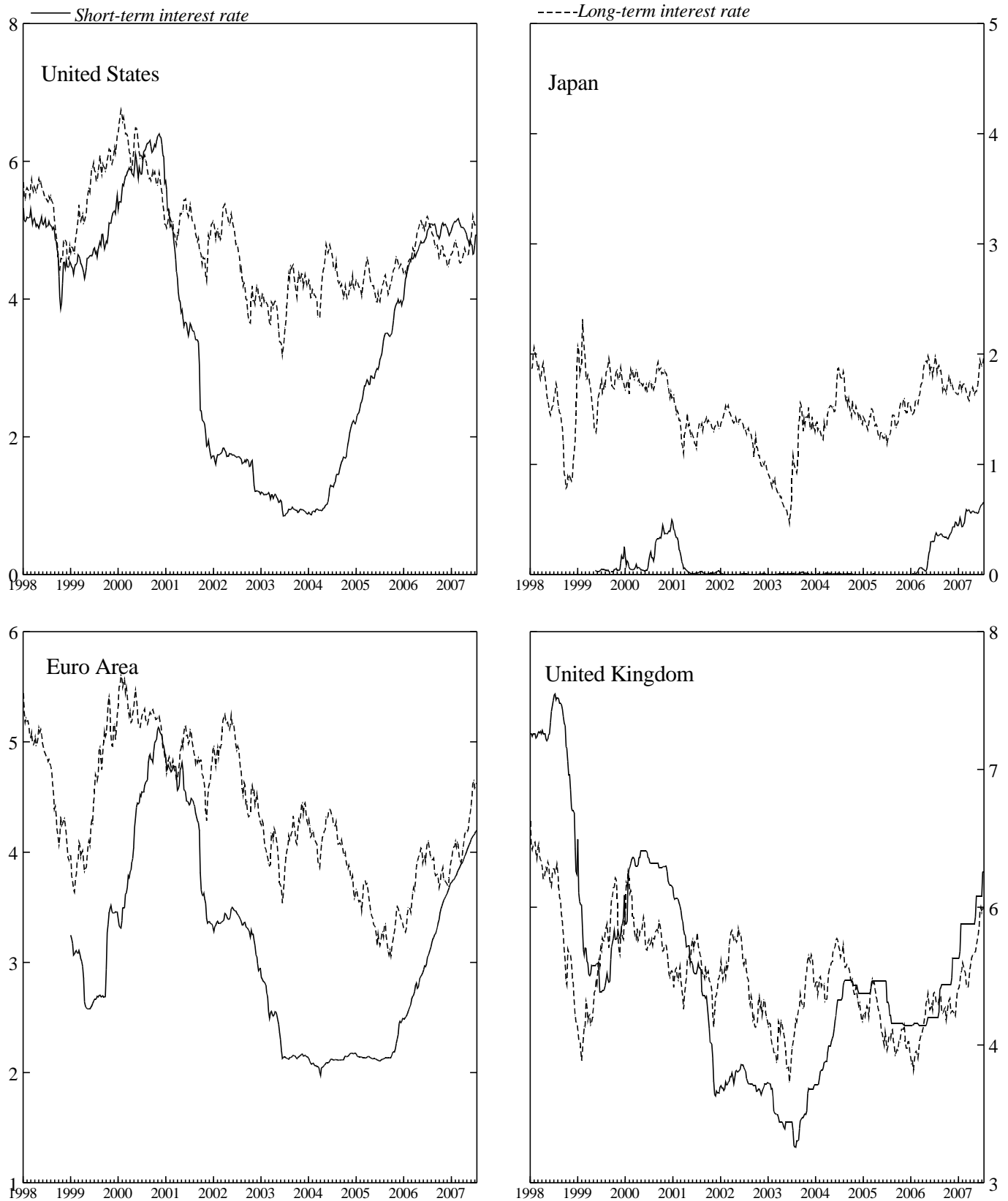


Source: INS and staff estimates.

1/ CPI based staff estimates.

2/ Scales differ across panels.

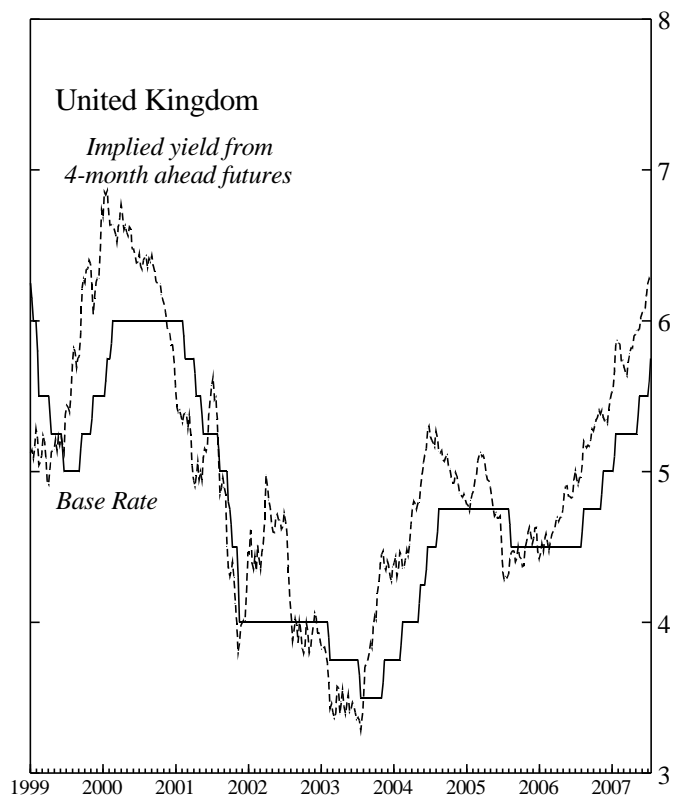
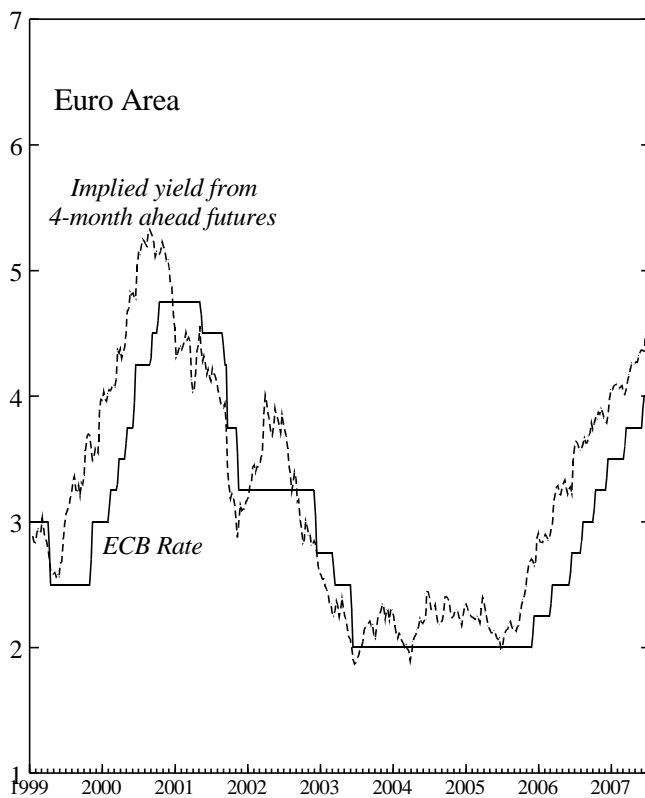
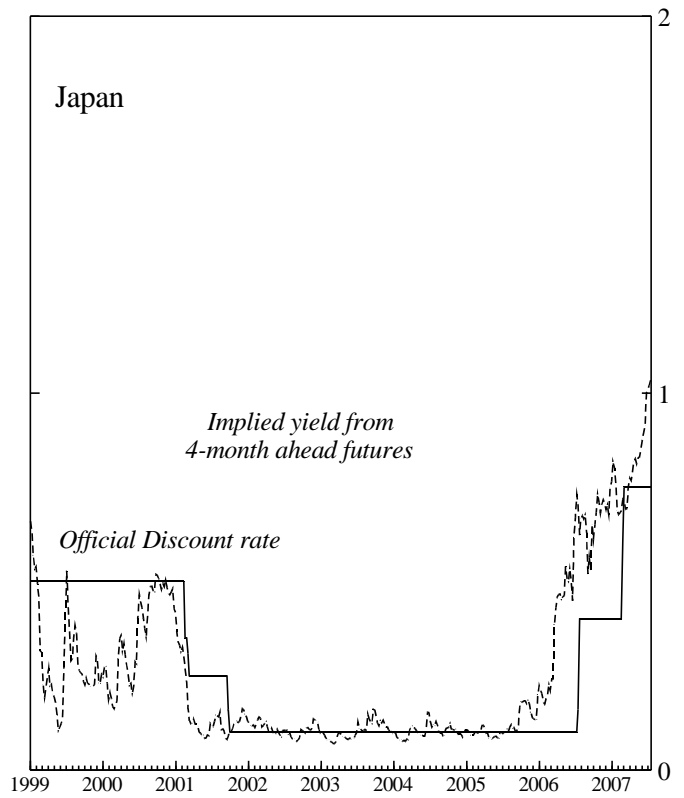
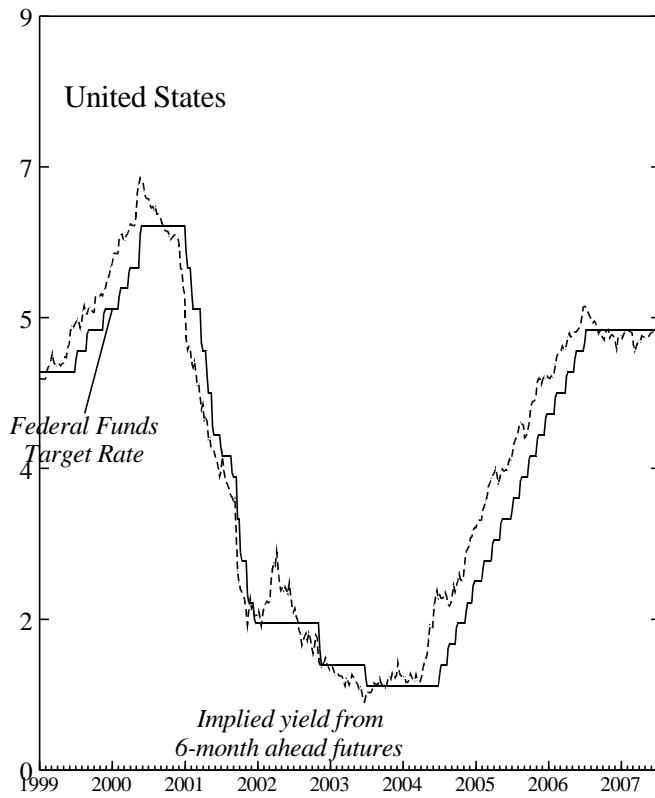
Chart 27. Major Industrial Countries: Short- and Long-Term Interest Rates 1/
January 1998 to July 2007
(In percent)



Source: Bloomberg L.P.

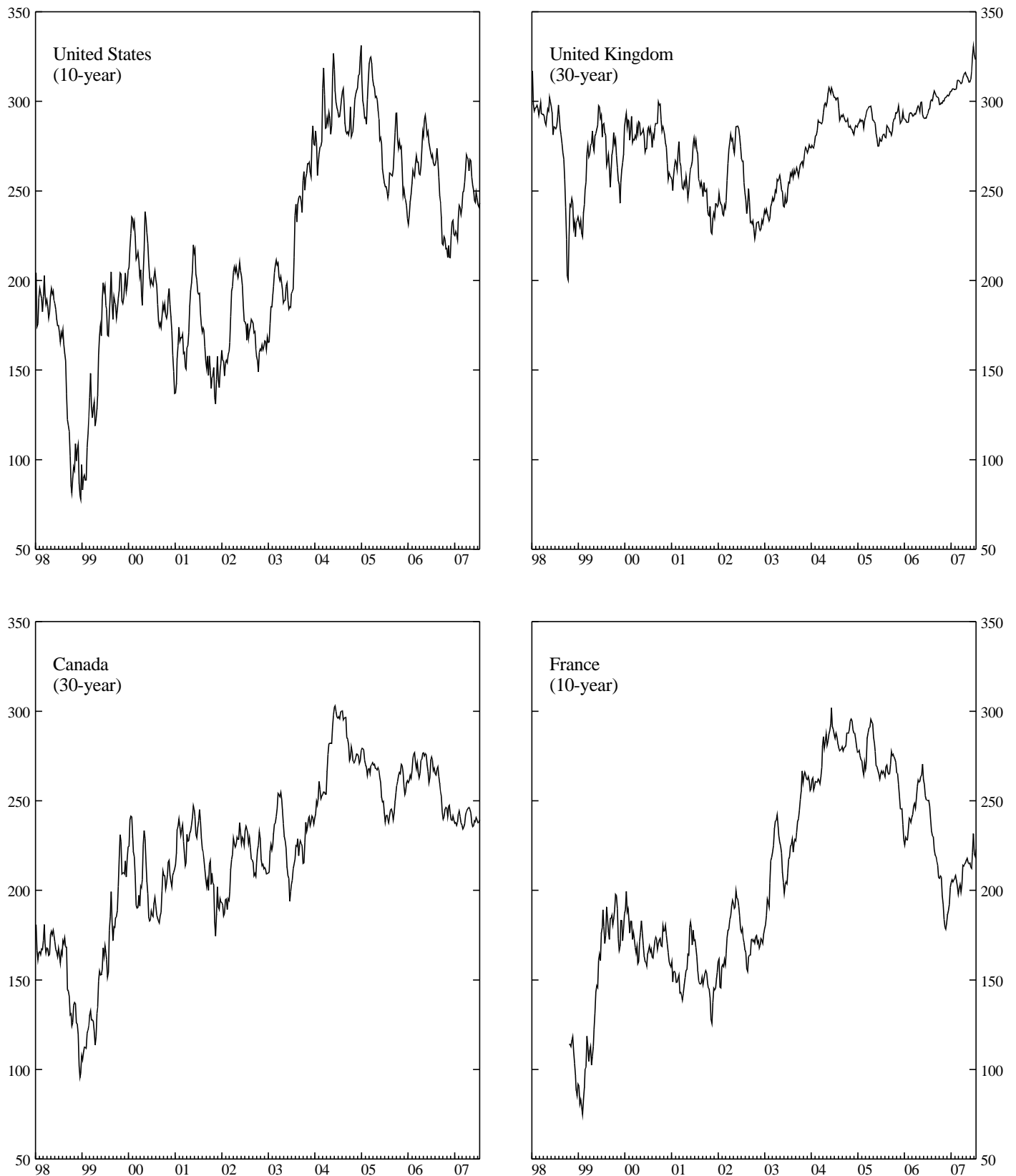
1/ Scales differ across panels.

Chart 28. Major Industrial Countries: Policy Interest Rate and Implied Yield from Futures
January 1999 to July 2007
(In percent)



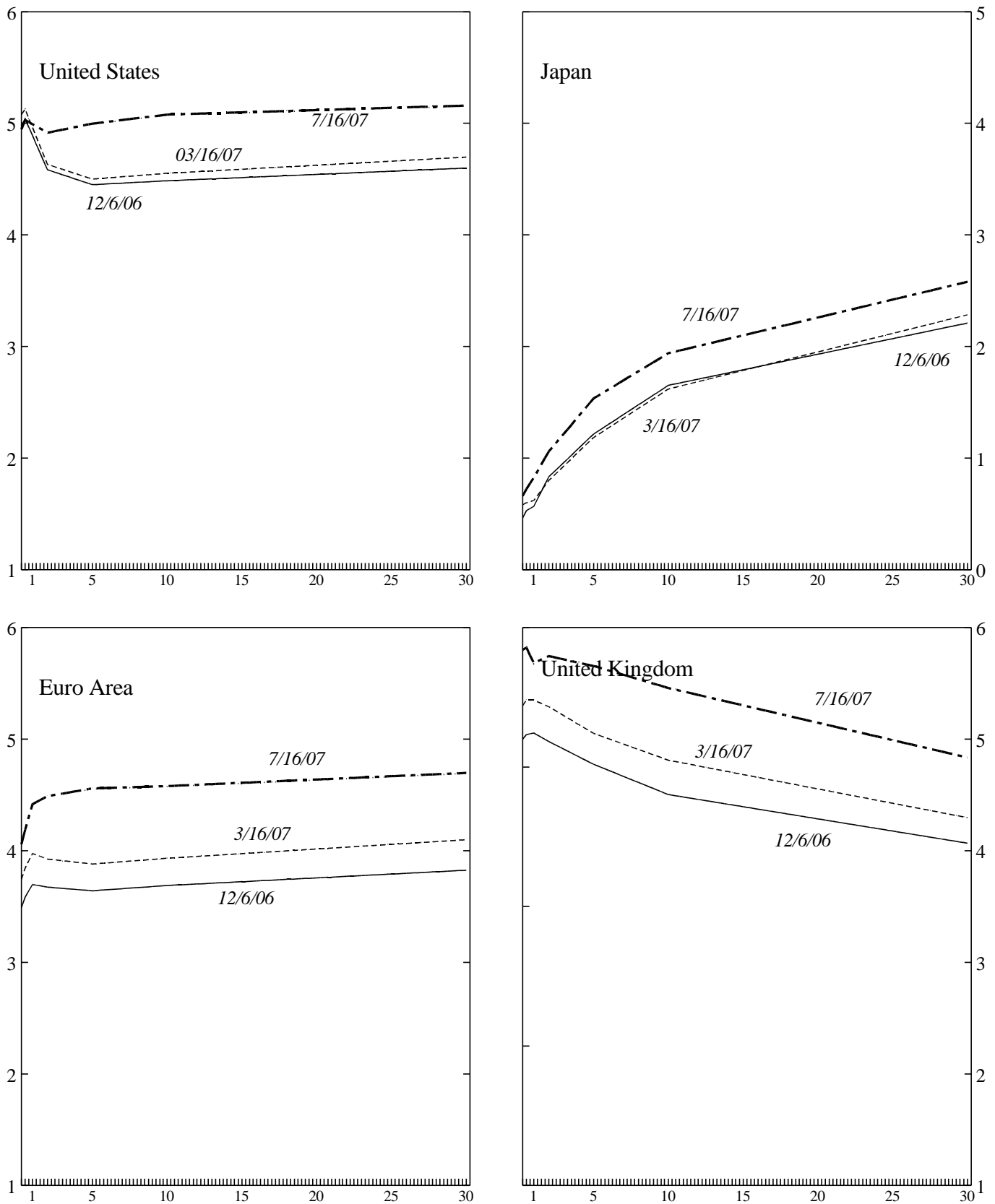
Source: Bloomberg L.P.

Chart 29. Yield Differential Between Nominal and Index-Linked Government Bonds
(In basis points)



Source: Bloomberg L.P.

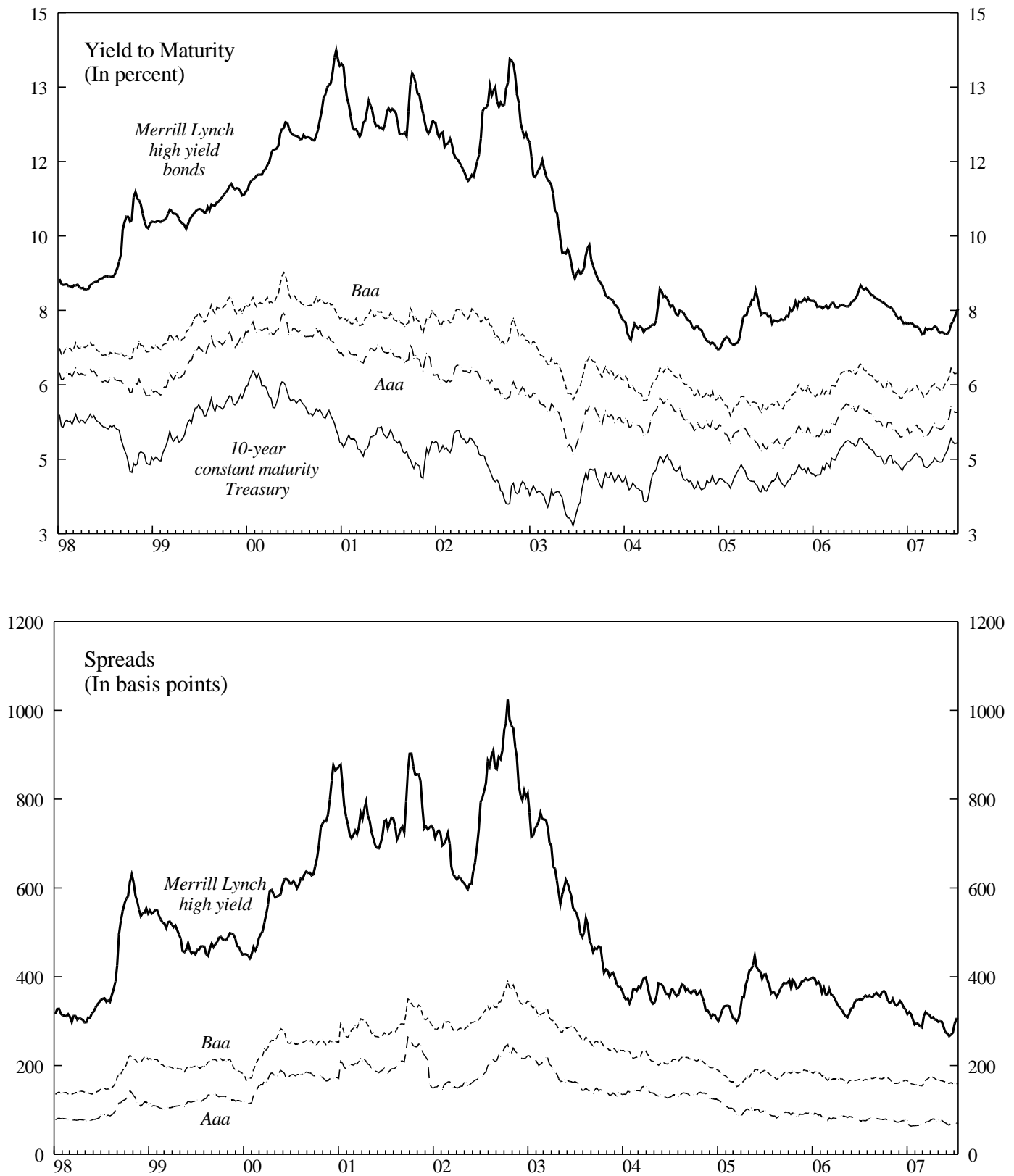
Chart 30. Major Industrial Countries: Yield Curves 1/
(In percent per annum)



Source: Bloomberg L.P.

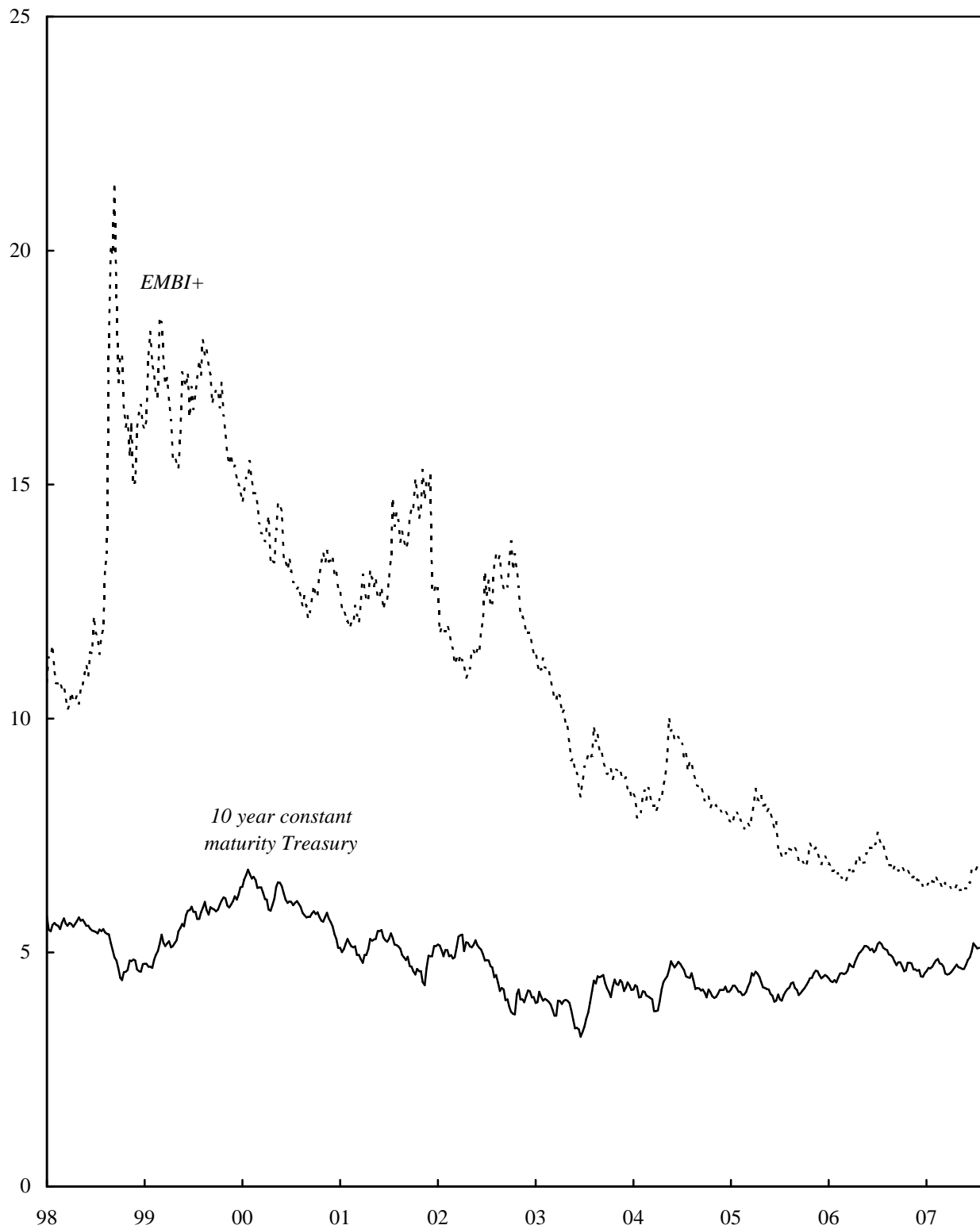
1/ Yields on treasury bills and government bonds of varying maturities.

Chart 31. U.S. Corporate Bond Yields and Spreads
January 1998 to July 2007



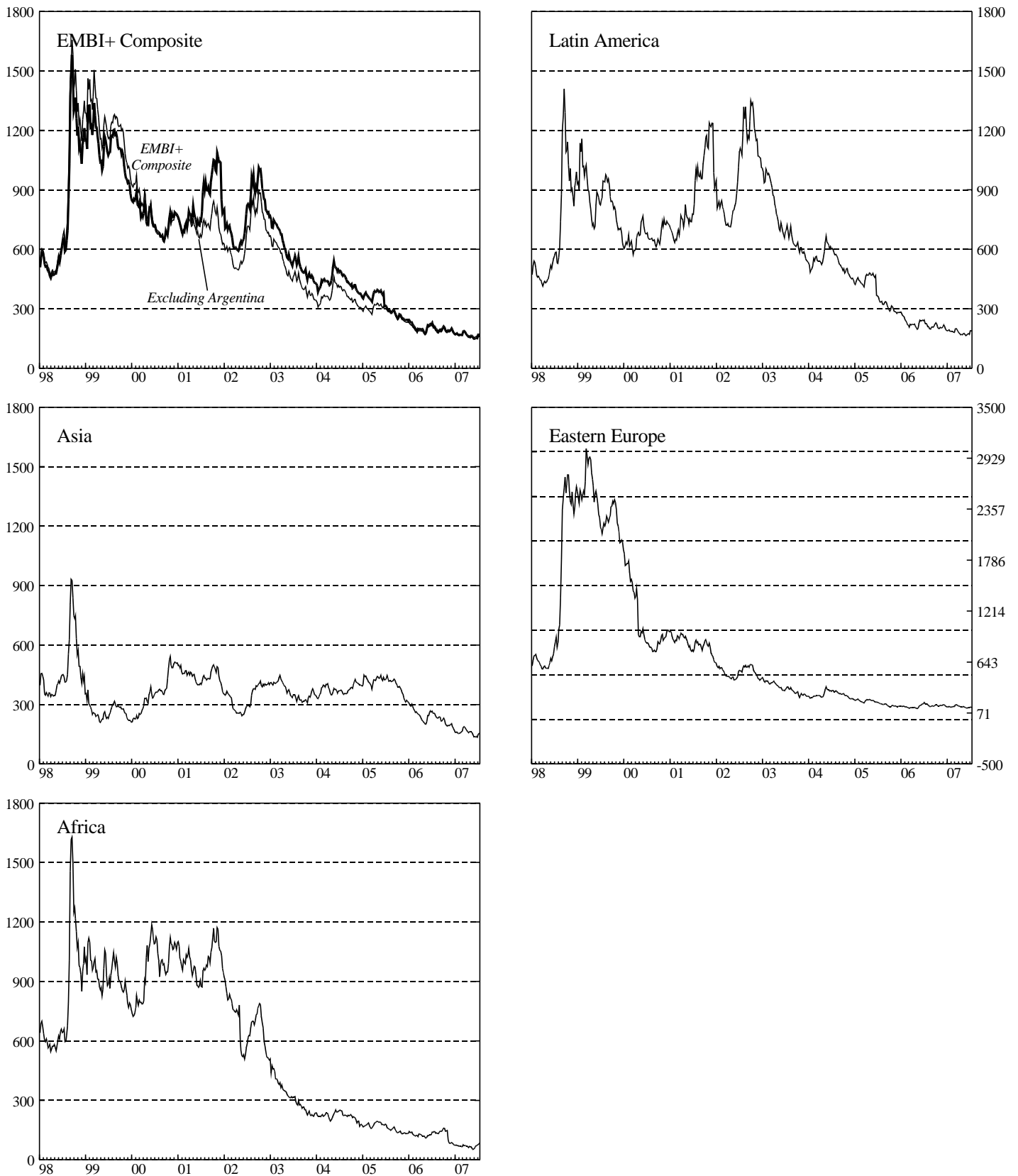
Source: Federal Reserve, Merrill Lynch and Bloomberg L.P.

Chart 32. EMBI+ and Treasury Yields
January 1998 to July 2007
(In percent)



Source: Bloomberg, L.P.

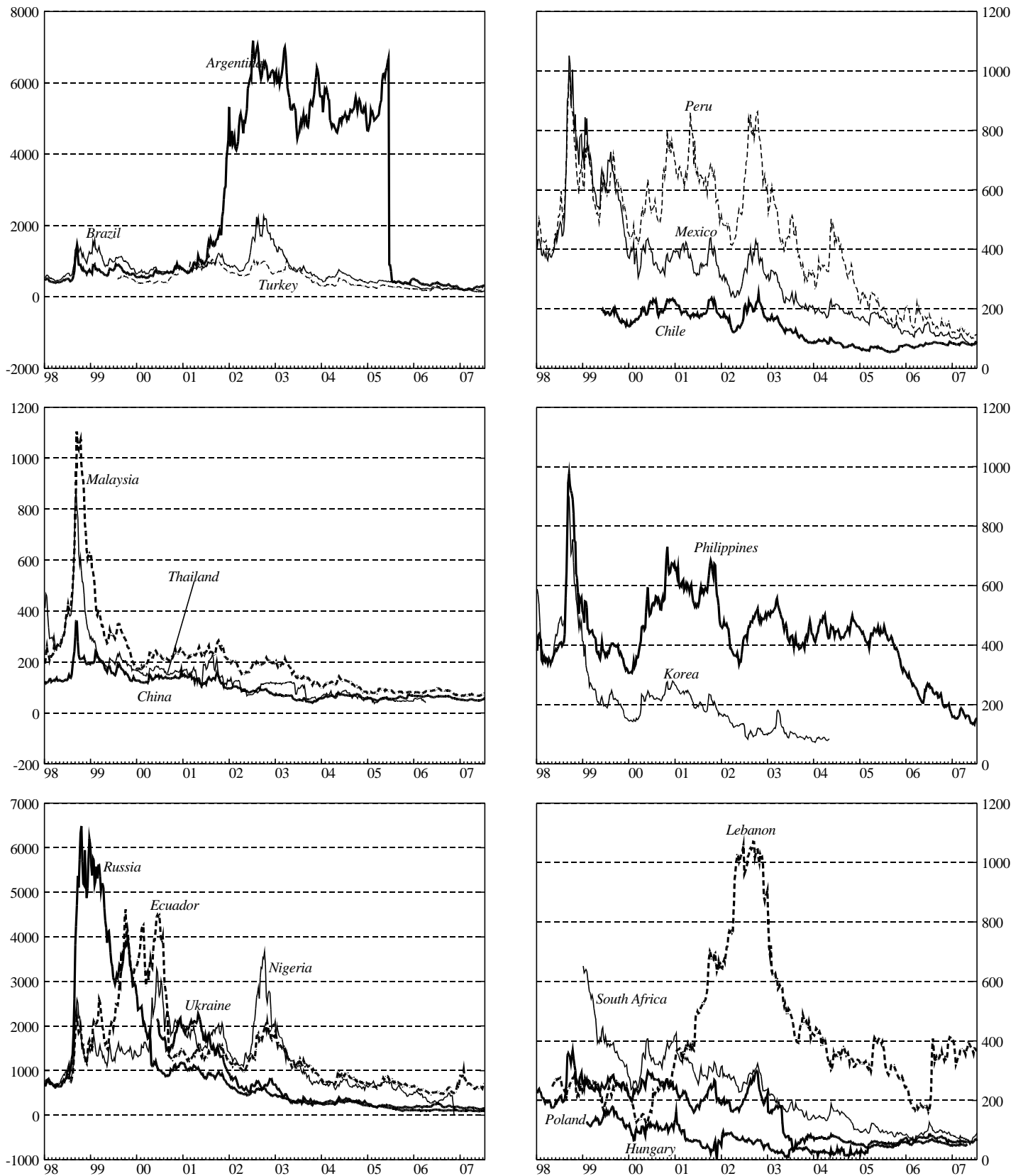
Chart 33. EMBI+ Regional Yield Spreads 1/
January 1998 to July 2007
(basis points)



Source: J.P. Morgan Chase.

1/ Latin America: Argentina, Brazil, Colombia, Ecuador, Mexico, Panama, Peru, and Venezuela. Asia: Korea and the Philippines. Eastern Europe: Bulgaria, Poland, Russia and Turkey, Ukraine. Africa: Morocco and Nigeria.

Chart 34. EMBI Global and EMBI+ Country Yield Spreads 1/ 2/
January 1998 to July 2007
(basis points)

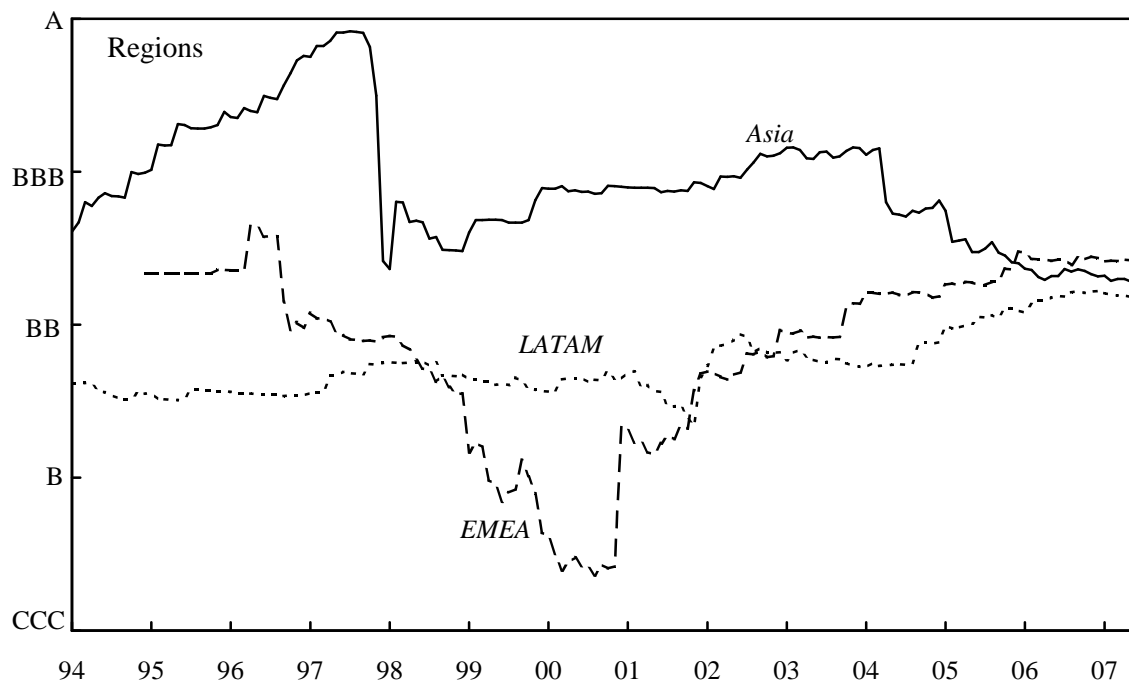


Source: J.P. Morgan Chase.

1/ EMBI Global: Chile, China, Hungary, Lebanon, Malaysia, Philippines, South Africa, Thailand and Ukraine.

2/ EMBI+: Argentina, Brazil, Ecuador, Korea, Mexico, Nigeria, Peru, Poland, Russia and Turkey.

Chart 35. Credit Ratings 1/
January 1994 to June 2007



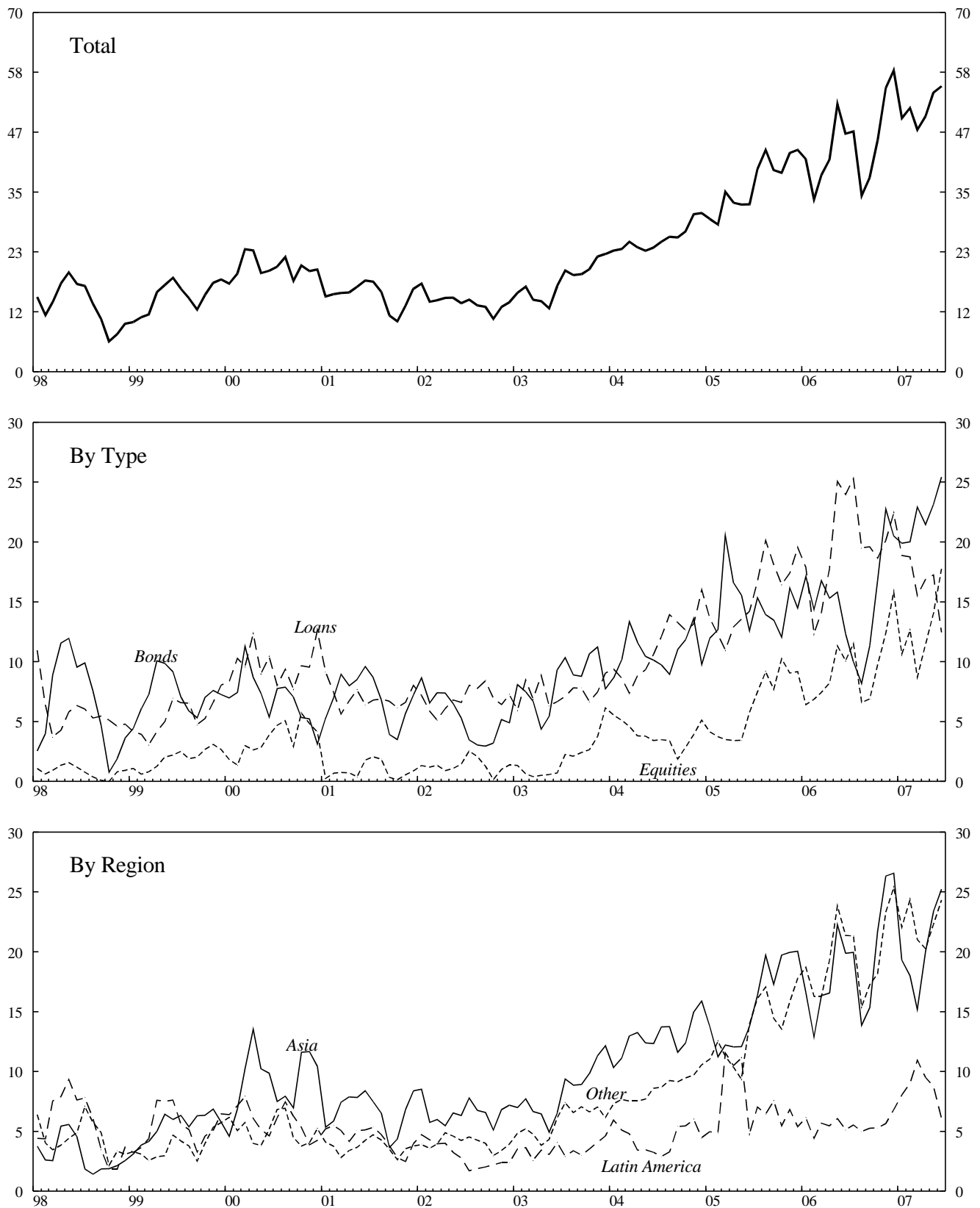
Source: J.P. Morgan Chase, Moody's, Standard & Poor's, and IMF staff estimates.

1/ Asia: Asian region.

LATAM: Latin American region.

EMEA: European, Middle Eastern, and African region.

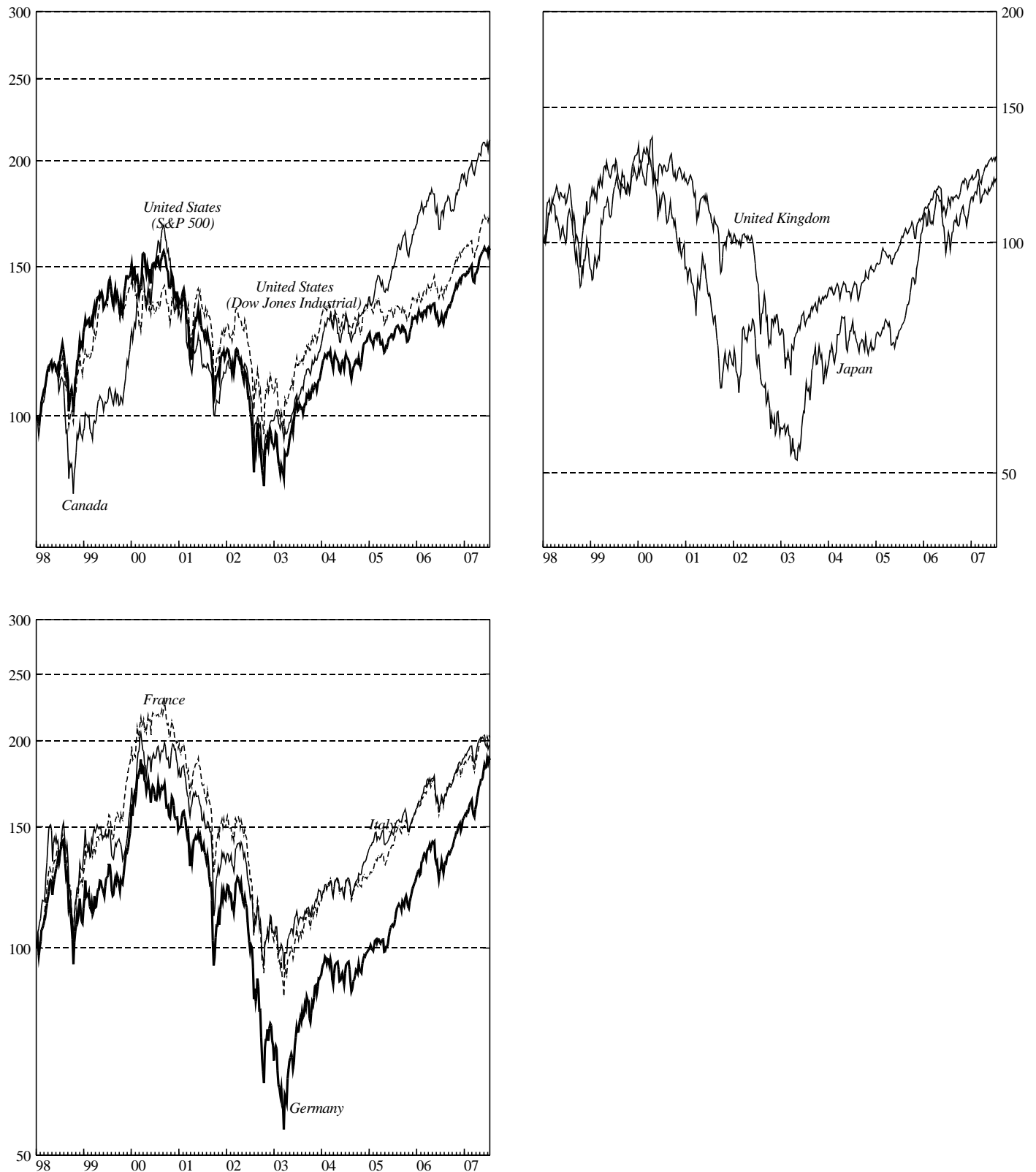
Chart 36. Emerging Markets: Monthly Gross Capital Flows 1/
 January 1998 to June 2007
 (In billions of U.S. dollars)



Source: Capital Data.

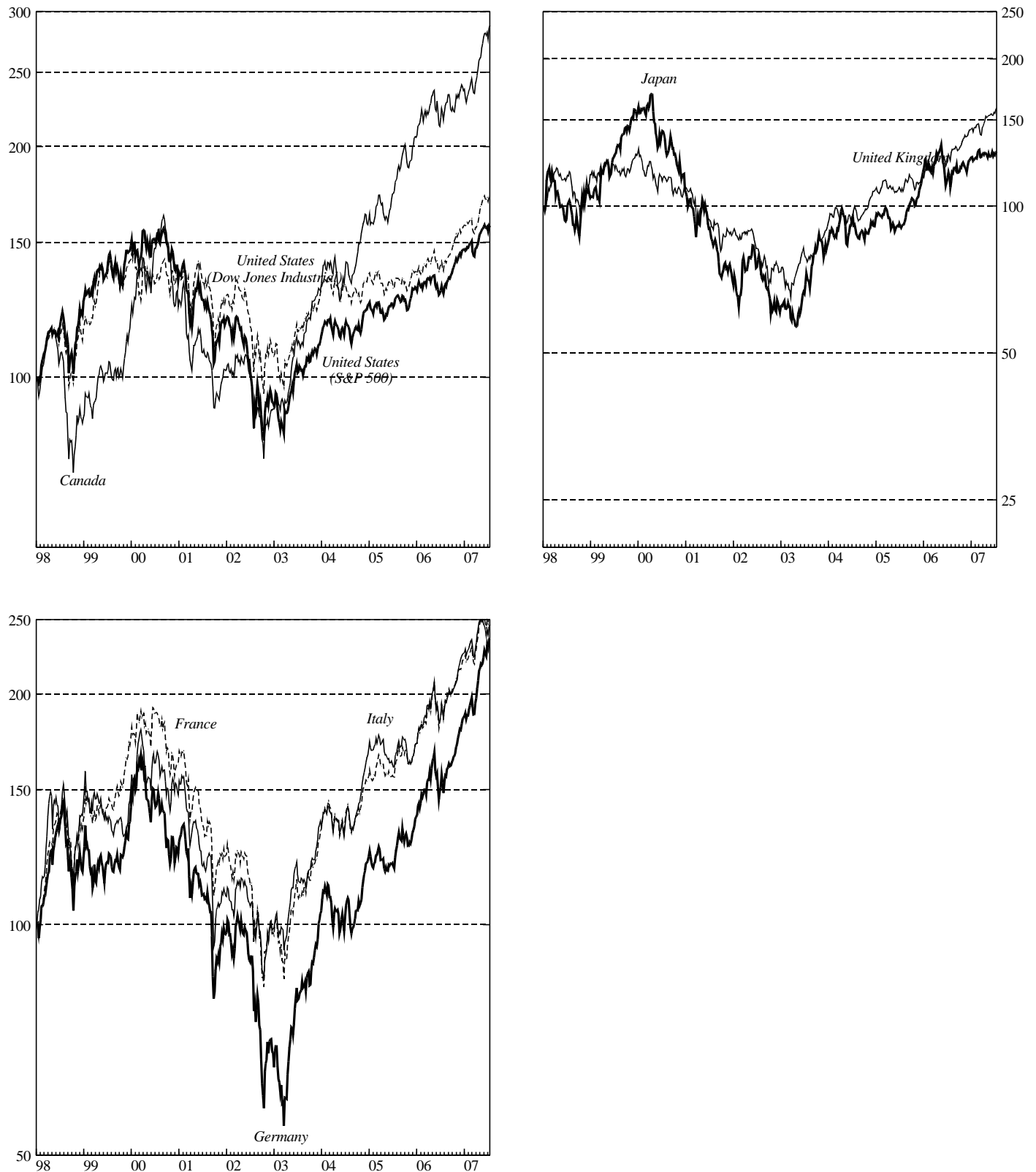
1/ Three-period moving average of actual flows. Scaling differs across panels.

Chart 37. Selected Industrial Countries: Equity Indices 1/
 January 1998 to July 2007
 (Local currency indices; January 1, 1998 = 100; logarithmic scale)



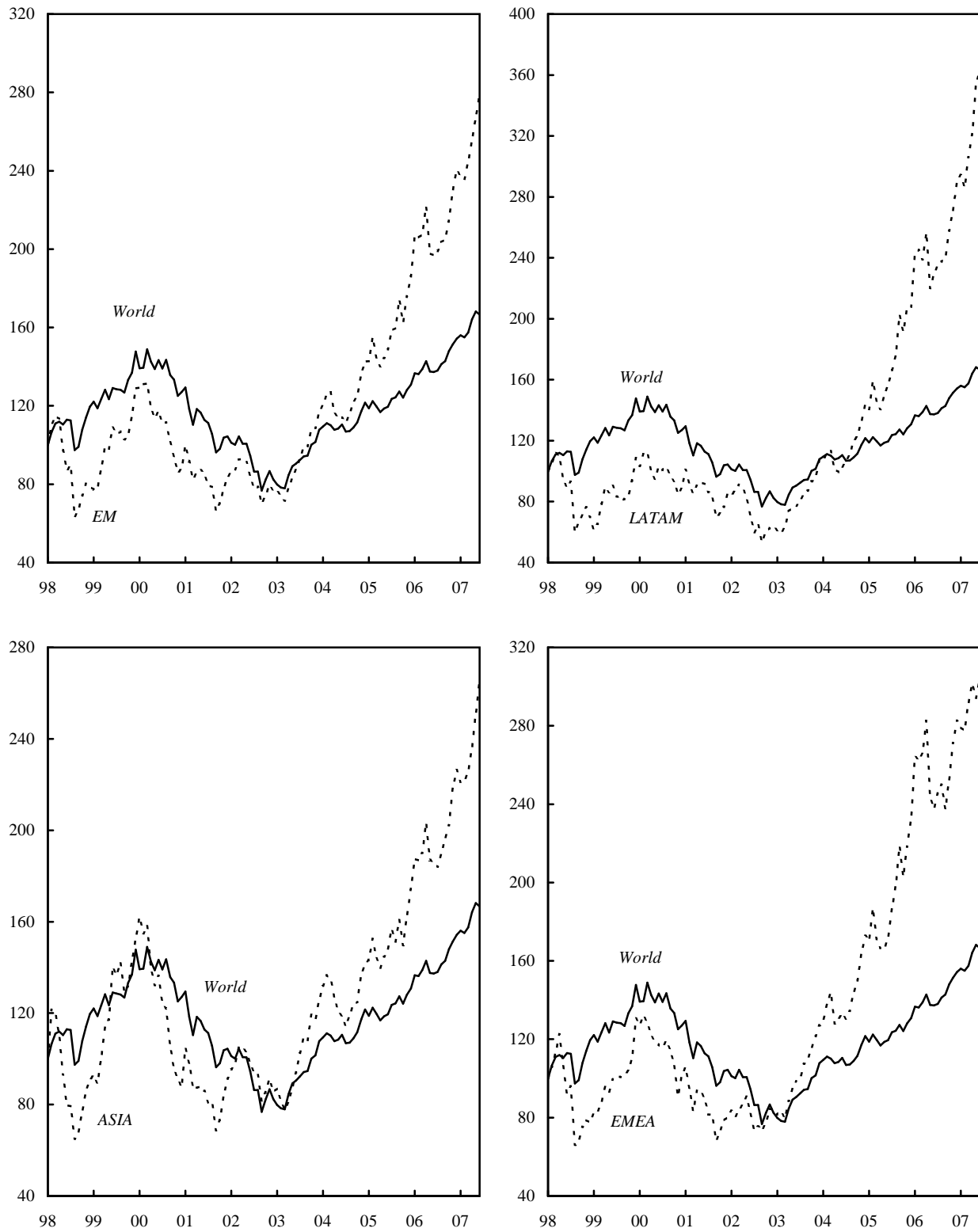
Source: Bloomberg L.P.
 1/ Scales differ across panels.

Chart 38. Selected Industrial Countries: Equity Indices 1/
 January 1998 to July 2007
 (U.S. dollar indices; January 1, 1998 = 100; logarithmic scale)



Source: Bloomberg L.P.
 1/ Scales differ across panels.

Chart 39. MSCI Equity Index 1/ 2/
January 1998 to July 2007
(Indices, 1998 = 100)



Source: Bloomberg, L.P.

1/ Scales differ across panels.

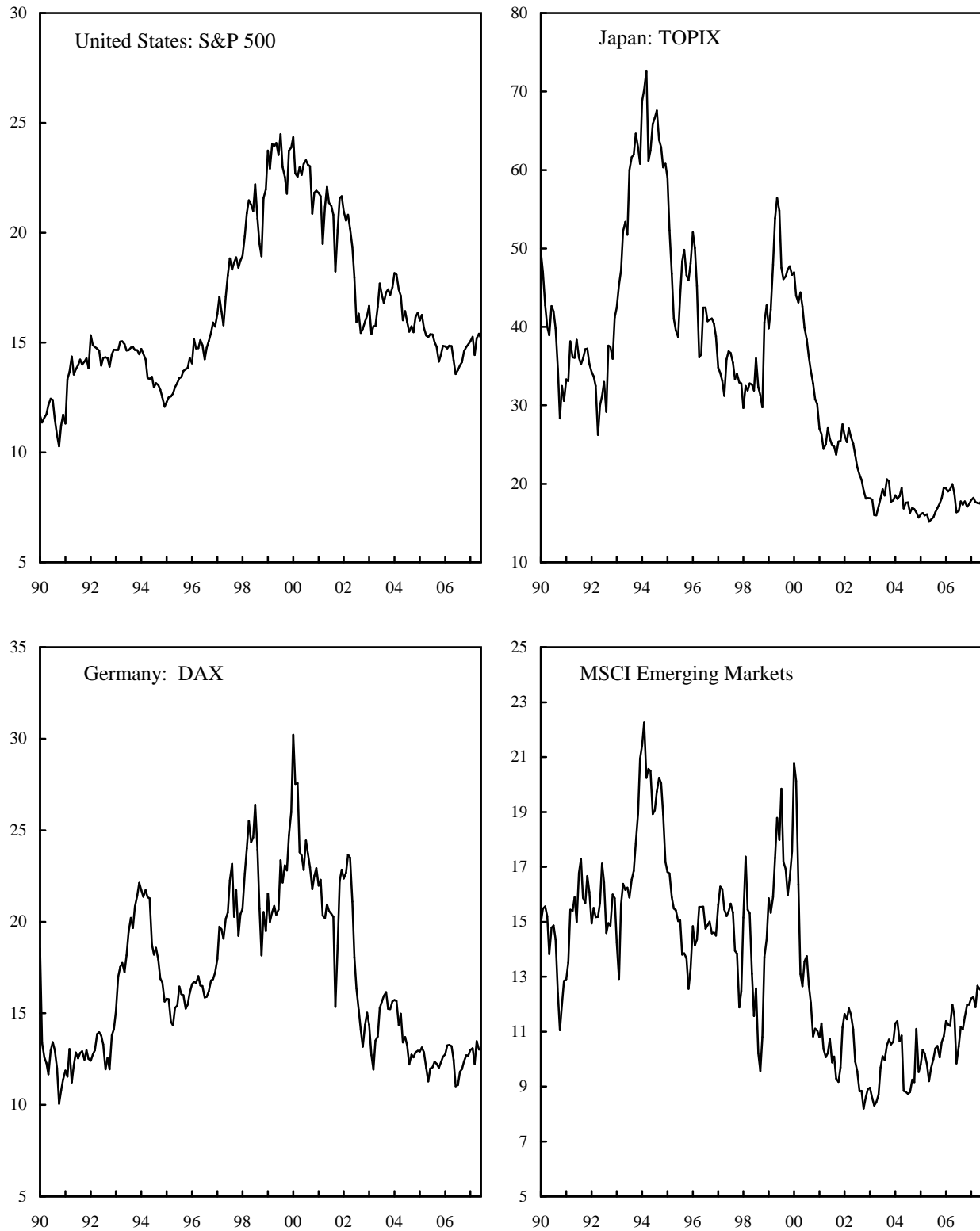
2/ EM: Emerging Market region.

LATAM: Latin America region.

ASIA: Asia region.

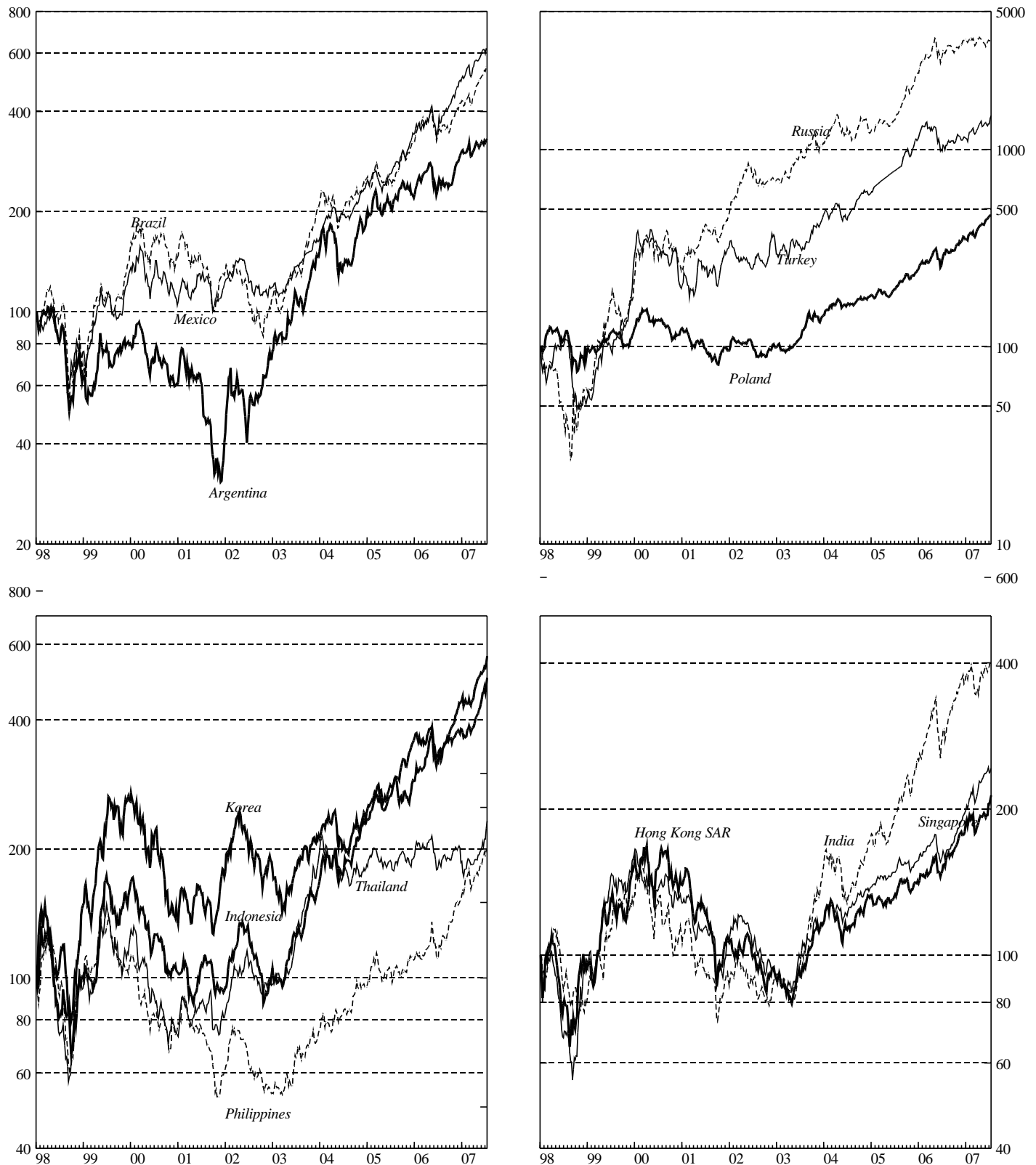
EMEA: European, Middle Eastern, and African region.

Chart 40. Forward-Looking Price/Earning Ratios 1/
January 1990 to June 2007



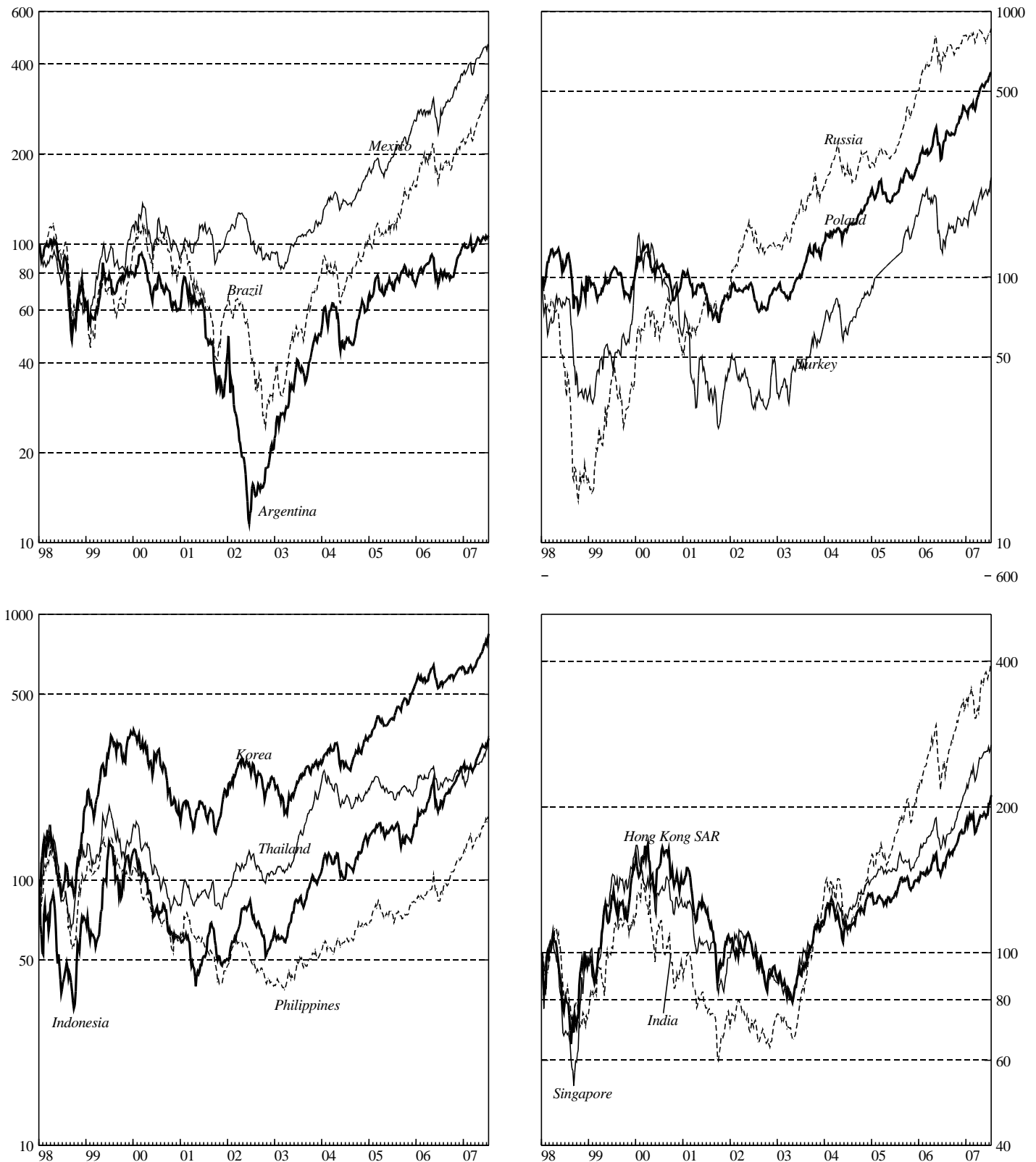
Source: I/B/E/S International.
1/ Scales differ across panels.

Chart 41. Selected Emerging Markets: Equity Indices 1/
 January 1998 to July 2007
 (Local currency indices; January 1, 1998 = 100; logarithmic scale)



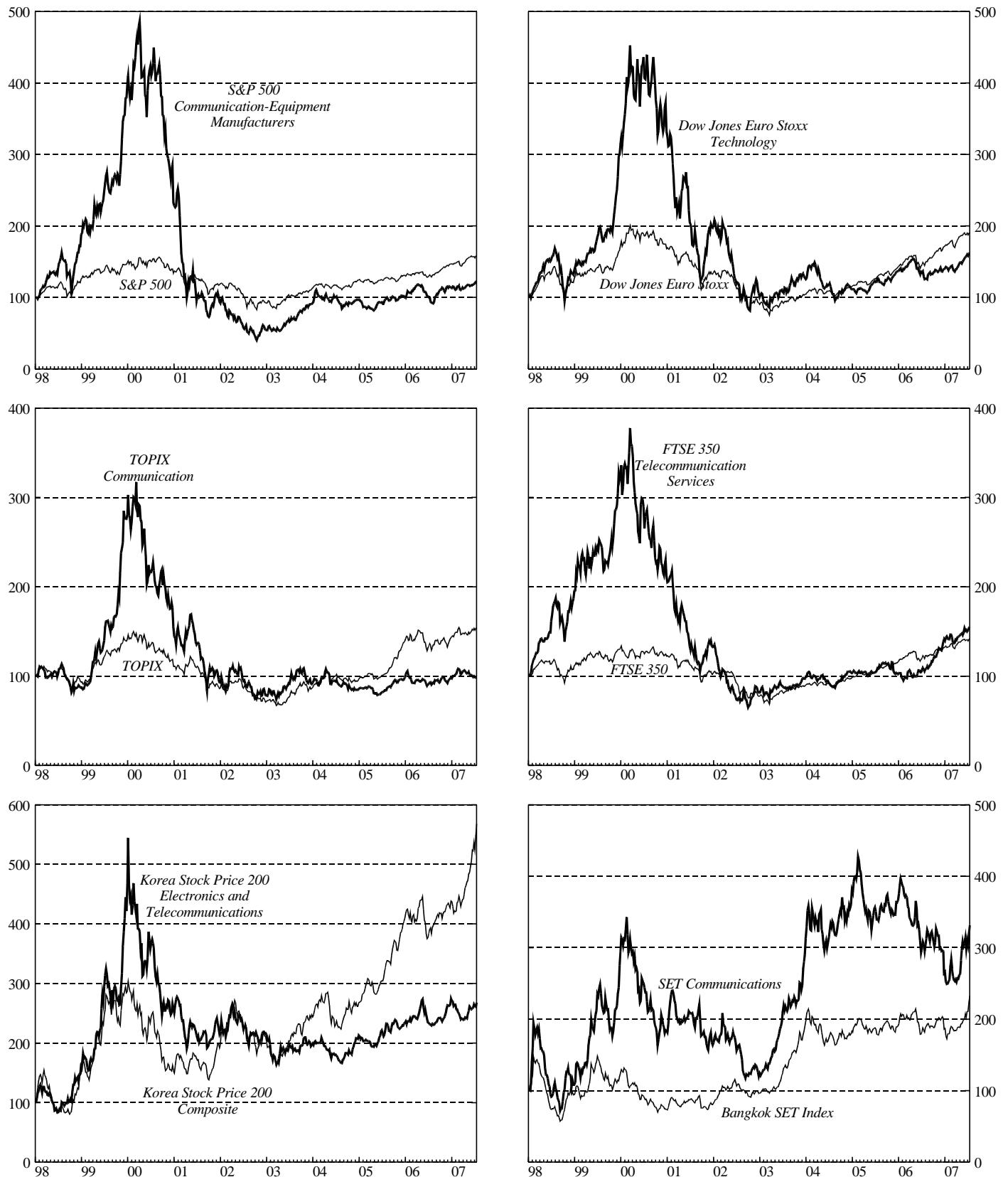
Source: Bloomberg L.P.
 1/ Scales differ across panels.

Chart 42. Selected Emerging Markets: Equity Indices 1/
 January 1998 to July 2007
 (U.S. dollar indices; January 1, 1998 = 100; logarithmic scale)



Source: Bloomberg L.P.
 1/ Scales differ across panels.

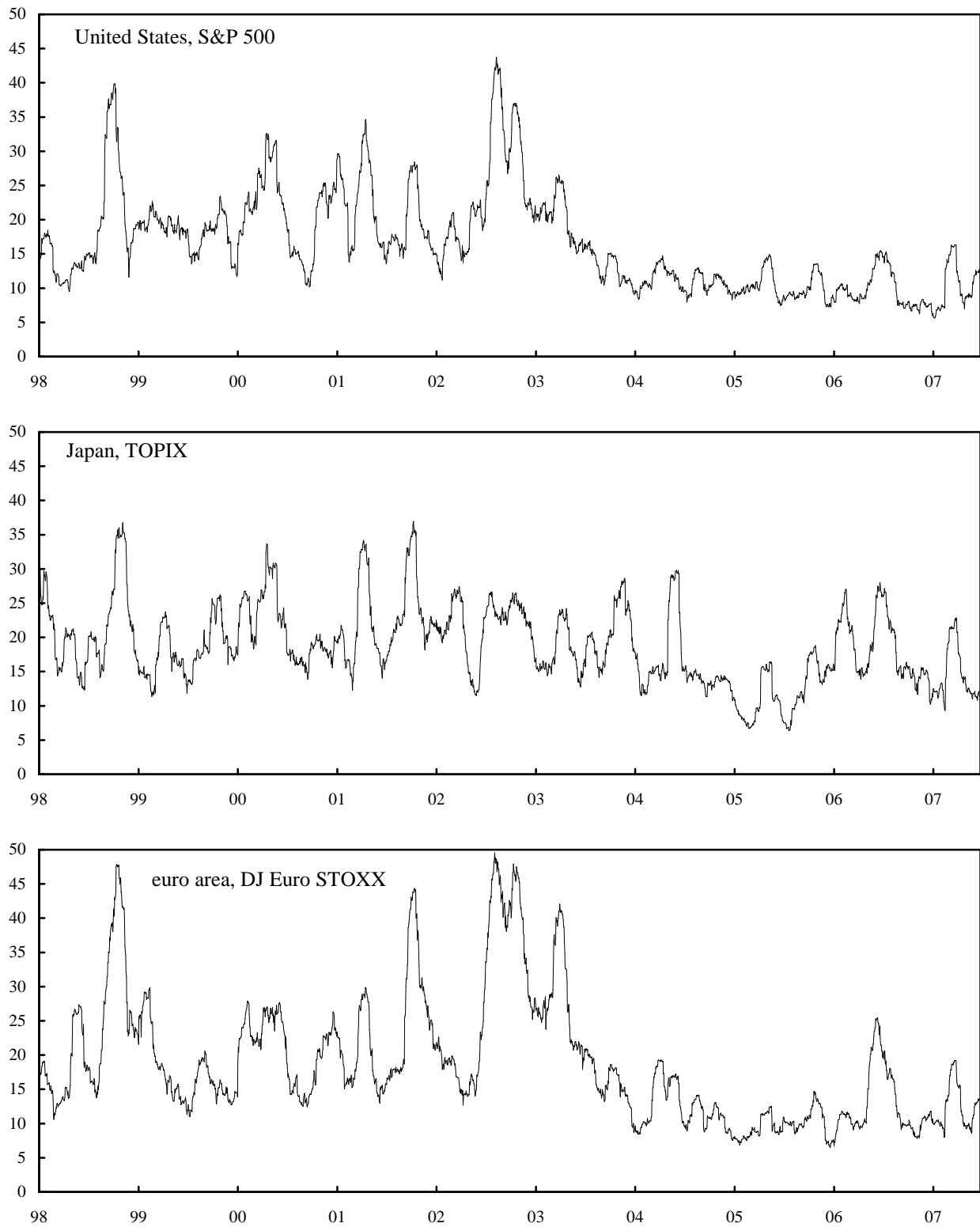
Chart 43. Technology Equity Indices 1/
January 1998 to July 2007
(Local currency indices; January 1, 1998 = 100)



Source: Bloomberg L.P.

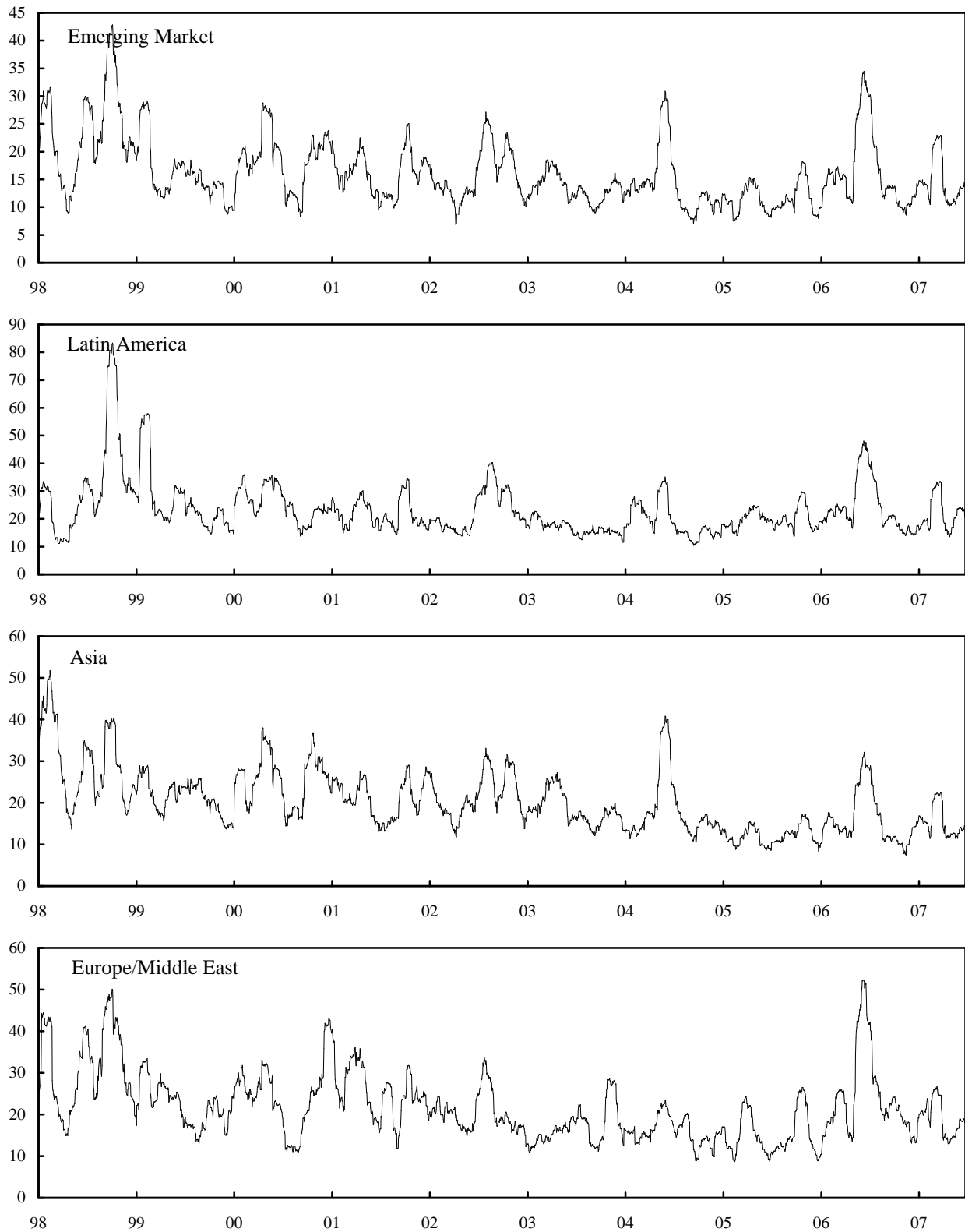
1/ Scales differ across panels.

Chart 44. Industrial Equity Volatility
January 1998 to July 2007
(In percent)



Source: Bloomberg, L.P.

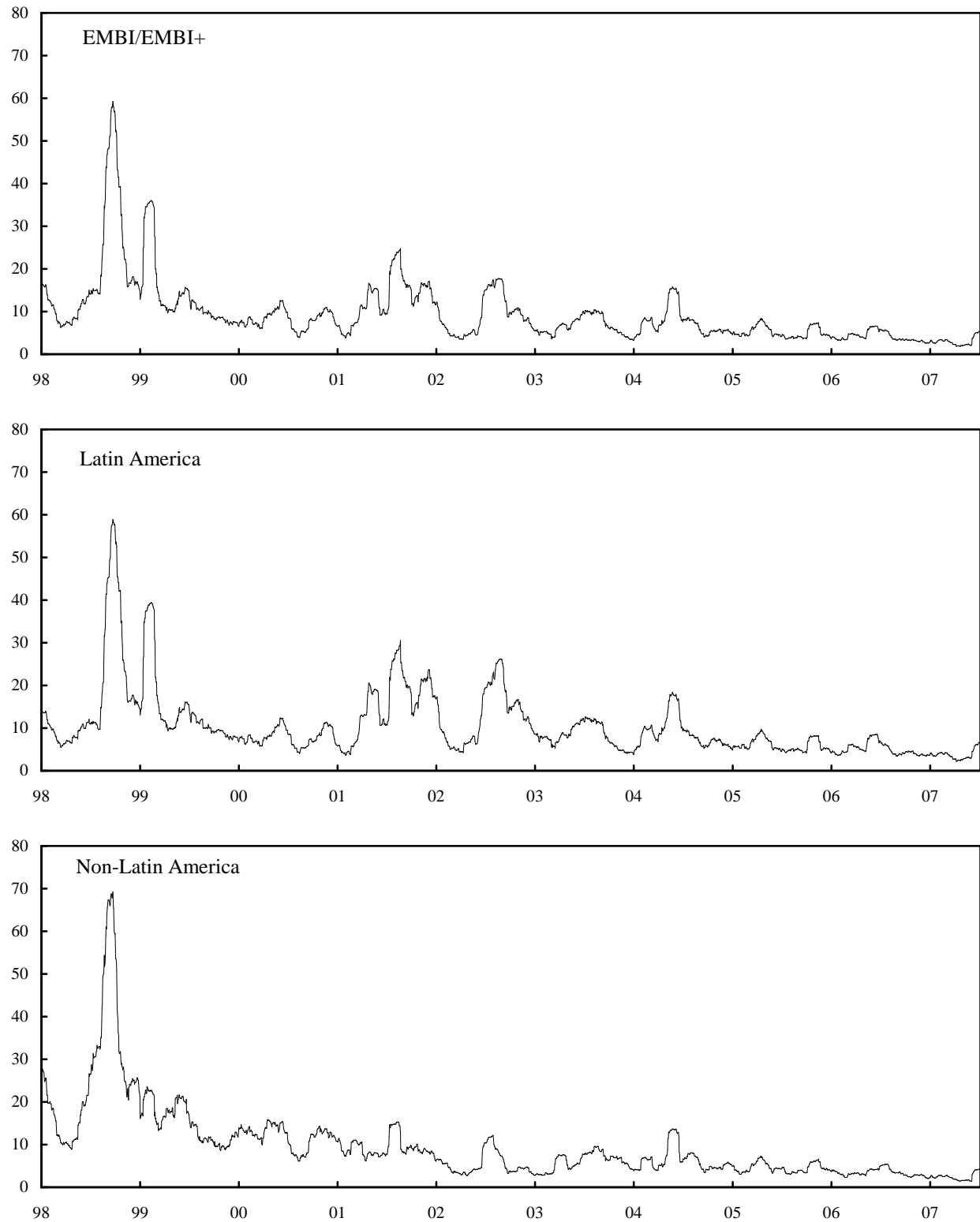
Chart 45. Emerging Market Equity Volatility 1/
January 1998 to July 2007
(In percent)



Source: Morgan Stanley Capital International.

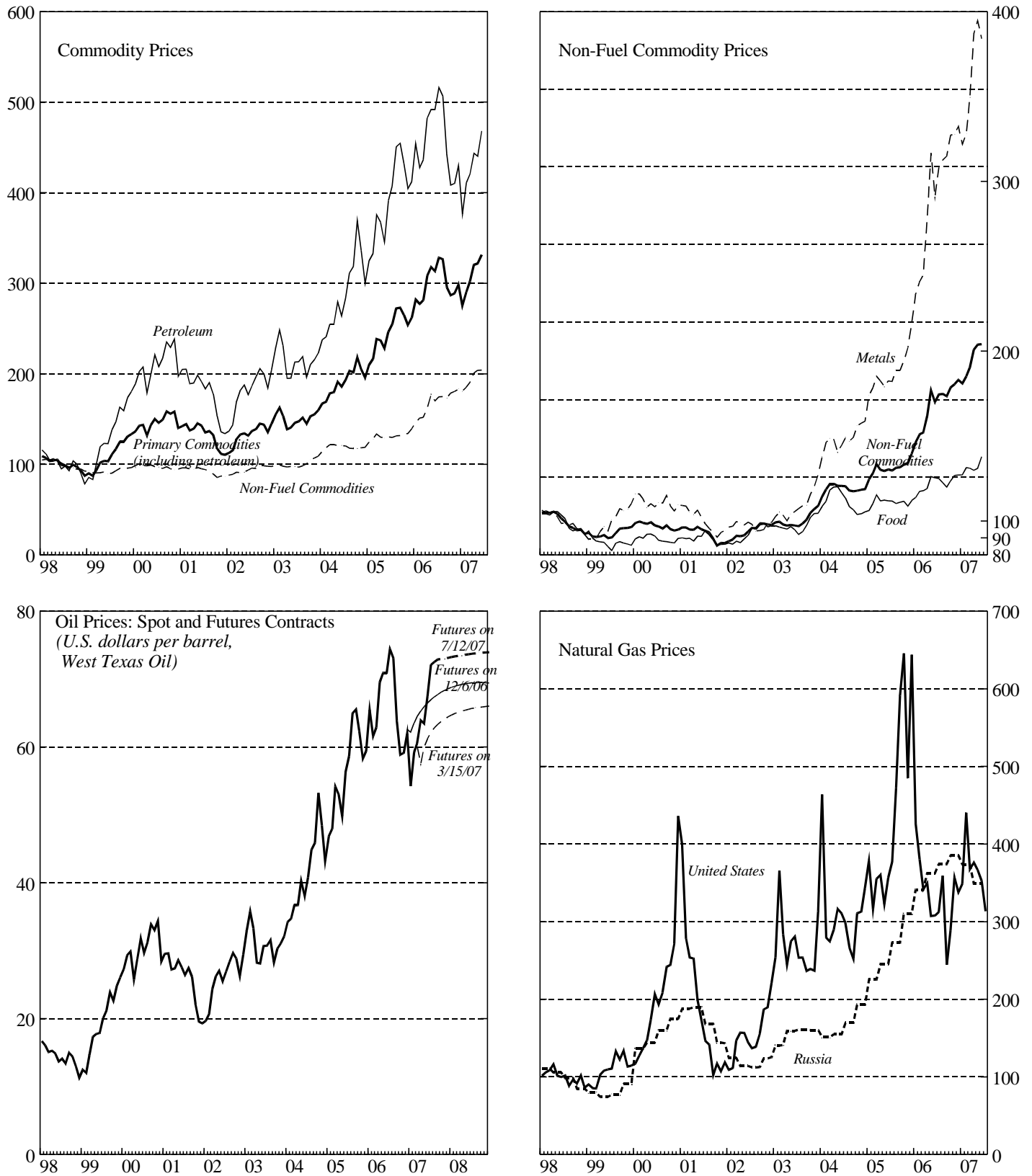
1/ Scales differ across panels.

Chart 46. Emerging Market Debt Volatility
January 1998 to July 2007
(In percent)



Source: J.P. Morgan Chase.

Chart 47. Commodity Prices 1/
January 1998 to July 2007
(Indices of prices in U.S. dollars, 1998=100)



Source: Research Department and Bloomberg, L.P.
1/ Scales differ across panels.