INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 07/252
FOR IMMEDIATE RELEASE
November 12, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Regional Economic Outlook for Europe Sees Need for Financial Sector, Fiscal, and Structural Reforms to Tackle Financial Turbulence and Sustain Growth

The International Monetary Fund (IMF) today released its inaugural Regional Economic Outlook: Europe (REO), which sees growth easing moderately throughout Europe to an inflation-adjusted 3.2 percent in 2008 from 3.7 percent in 2007,[1] unless financial market turmoil fails to dissipate. Emerging Europe's growth is set to remain relatively robust at 5.7 percent in 2008.

Mr. Michael Deppler, Director of the IMF's European Department, emphasized the report's main findings:

"Financial turbulence has hit Europe at a time when growth was showing momentum. Sound policies, a favorable global environment, and increasing trade and financial integration have been yielding clear growth dividends for advanced economies and convergence benefits for emerging Europe. The outcome is a projected easing of growth in 2008, to a level that remains nonetheless fairly robust, but also heightened uncertainty and the risk that financial market turmoil—should it linger—may depress this outlook.

"A balanced policy response would consist of dealing up front with the financial market turmoil, while implementing fiscal consolidation and structural reforms, including in the financial sector, to address Europe's vulnerabilities, raise its medium-term growth performance, and deliver on the promise of convergence for Europe's emerging economies.

[1] Albania, Austria, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Euro Area, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Kosovo, Latvia, Lithuania, Luxembourg, Macedonia, FYR, Malta, Moldova, Montenegro, Netherlands, Norway, Poland, Portugal, Romania, Russia, San Marino, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom.

“Central banks will need to continue to be ready to assist financial markets. While their response to unsettled credit markets has been broadly effective so far, not all markets have returned to smooth functioning. Policymakers will also need to continuously assess the implications of the ongoing turbulence for real activity and inflation. For advanced economies, the balance of considerations currently argues for keeping the monetary stance unchanged. Many emerging economies, however, which have been less affected by the turbulence, are facing inflationary pressures and sizeable external imbalances. For these countries, a further tightening of monetary and fiscal policies will be essential.

“The ongoing financial turbulence has underscored the need for financial sector reform. It revealed that private and public prudential frameworks will need to do a better job at keeping up with financial innovation. Clearly, the tendency of new financial products to exploit gaps in prudential frameworks can prove problematic and must be guarded against. Nonetheless, financial innovation has been and will remain an important source of strengthened economic performance over the medium term. This calls for a two-pronged policy response policy to permit Europe to reap the benefits from financial innovation without incurring excessive risks. The upgrading of prudential arrangements, financial safety nets, and crisis resolution mechanisms needs to be matched with further financial sector reforms aimed at leveling the playing field for the various forms of financial intermediation and exploiting their synergies.

“In addition to addressing financial turbulence, fiscal consolidation and structural reforms need to remain priorities. Notwithstanding good economic performance, fiscal consolidation has been stalling, reflecting Europe’s tendency to squander the fiscal dividends of robust growth. There are compelling reasons to pursue fiscal consolidation. Europe’s aging population is putting upward pressure on public spending. Moreover, many advanced economies need to create more fiscal room to deal with eventual downturns. And, in emerging Europe, fiscal consolidation is important to alleviate convergence-related demand pressures and lessen risks posed by the rapid increase in private external indebtedness.

“Europe’s structural reforms have paid off, but on average, structural rigidities remain a weak spot and most of Europe’s advanced economies are still failing to make notable progress in closing the transatlantic divide in GDP per capita. Yet, as shown by its most successful performers, further steps to improve labor market flexibility and enhance competition are bound to pay off. To make convergence sustainable, emerging economies will need to focus on strengthening the contestability in domestic markets and improving the business environment.

“Effectively managing rapid financial deepening remains crucial for emerging Europe. In addition to adopting general fiscal restraint, it will be important to remove fiscal and other distortions that have contributed to the blistering pace of credit growth, strengthen prudential oversight, and promote a better understanding and disclosure of risks. Ensuring a smooth,

inevitable turnaround of the large external imbalances associated with convergence will require that resources flow without hindrance to productive investments in the tradables sector. To assist this process, policymakers need to make labor and capital markets more flexible and strengthen their financial systems. More broadly, all economies in emerging Europe can reap significant efficiency and resilience benefits from sustaining the development of their financial systems.

“In sum, Europe is facing unexpected uncertainty. To weather this episode well and to secure sustained medium-term growth, policymakers—in dealing with financial turbulence—should not lose sight of the need to make progress on the long-standing challenges of fiscal consolidation and structural reforms, including financial sector reforms.”

European Countries: Real GDP Growth, 2006–08

	Real GDP Growth		
	2006	2007	2008
Europe 1/	**3.8**	**3.7**	**3.2**
Advanced European economies 1/	2.9	2.7	2.2
Emerging European economies 1/, 2/	6.6	6.3	5.7
European Union 1/	3.2	3.0	2.5
Euro area	2.8	2.5	2.1
Austria	3.3	3.3	2.5
Belgium	3.0	2.6	1.9
Finland	5.0	4.3	3.0
France	2.0	1.9	2.0
Germany	2.9	2.4	2.0
Greece	4.3	3.9	3.6
Ireland	5.7	4.6	3.0
Italy	1.9	1.7	1.3
Luxembourg	6.2	5.4	4.2
Netherlands	3.0	2.6	2.5
Portugal	1.3	1.8	1.8
Slovenia	5.7	5.4	3.8
Spain	3.9	3.7	2.7
Other EU advanced economies			
Denmark	3.5	1.9	1.5
Sweden	4.2	3.6	2.8
United Kingdom	2.8	3.1	2.3
New EU countries 1/	6.4	6.1	5.2
Bulgaria	6.1	6.0	5.9
Cyprus	3.8	3.8	3.7
Czech Republic	6.4	5.6	4.6
Hungary	3.9	2.1	2.7
Malta	3.3	3.2	2.6
Poland	6.1	6.6	5.3
Romania	7.7	6.3	6.0
Slovak Republic	8.3	8.8	7.3
Estonia	11.2	8.0	6.0
Latvia	11.9	10.5	6.2
Lithuania	7.5	8.0	6.5
Non-EU advanced economies			
Iceland	2.6	2.1	-0.1
Israel	5.2	5.1	3.8
Norway	2.8	3.5	3.8
Switzerland	3.2	2.4	1.6
Other emerging economies			
Albania	5.0	6.0	6.0
Belarus	9.9	7.8	6.4
Bosnia and Herzegovina	6.0	5.8	6.5
Croatia	4.8	5.6	4.7
Macedonia, FYR	3.0	5.0	5.0
Moldova	4.0	5.0	5.0
Russia	6.7	7.0	6.5
Serbia	5.7	6.0	5.0
Turkey	6.1	5.0	5.3
Ukraine	7.1	6.7	5.4

Source: IMF, *World Economic Outlook*.
1/ Average weighted by purchasing power parity GDP.
2/ Montenegro has not yet been included in the World Economic Outlook database.