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IMF Welcomes Comprehensive European Response to Financial Crisis, Sees Major Downside Risks Averted, and Calls for Enhanced Coordination of Measures

The International Monetary Fund (IMF) today said that even though the global financial crisis will cause a sharp deceleration of economic activity, the comprehensive crisis management actions being undertaken should allow Europe to avoid a worse outcome. In its October 2008 Regional Economic Outlook for Europe (REO), the IMF projects activity in advanced European economies to stagnate in the near-term with growth expected at 1.3% in 2008 and 0.2% in 2009. While these projections were finalized before the crisis reached systemic proportions in early October, they remain broadly valid, even though some of the downside risks have materialized.[1] In particular, emerging European economies are now likely to grow at a somewhat slower pace than the 4.3% in 2009 anticipated in the report.

The IMF's baseline scenario for Europe's economic outlook relies on successful containment of the financial crisis. "Times are no doubt extraordinarily uncertain, but we are now seeing the concerted response that demonstrates policymakers' awareness that the global crisis needs a global response. For Europe, this crisis provides a catalyst for improved cross-border coordination, and we encourage European leaders to follow up with bold steps on their recent commitment to concerted and coordinated action, to resolve this crisis swiftly," said Alessandro Leipold, Acting Director of the IMF's European Department.

Policies will also need to nurture the economic recovery. The IMF projects inflation to drop to levels below central bank objectives in most of Europe's advanced economies in 2009. "With upside risks to inflation rapidly dissipating, the recent concerted easing of monetary policy was appropriate and there is scope for further easing going forward. Meanwhile, the provisions of the Stability and Growth Pact—which incorporate greater flexibility than is often thought—will allow fiscal policy to cushion the downturn," said Leipold.

[1] The data cutoff point for the report was September 16, 2008. The text of the report does not reflect events in financial markets or policy actions that took place after October 1, 2008.

For their part, Europe's emerging markets are also feeling the strain. They will need to respond quickly to any shortfall in capital flows that may arise, including by using reserves and strong fiscal positions when such buffers exist. Contingency plans should be drawn up to deal with hard landings or to mitigate the adverse effects from the crisis on banks and firms. And, Leipold noted, "The Fund of course stands ready to help as needed."

Analytic Chapters in the October 2008 REO

Chapter 2 of the October 2008 REO, entitled "Europe: Coping with High Commodity Prices," concludes that advanced economies in Europe are better positioned than emerging economies to head off second-round effects on inflation from the surge in commodity prices, seen earlier this year. Improved labor market flexibility, strong monetary policy credibility and the weak outlook for activity in advanced countries should limit the pass-through of commodity price shocks to core inflation. Appropriate policy responses to commodity price increases depend on the source of the price pressures, the credibility of policymakers, and the degree of labor market flexibility.

Chapter 3, entitled "The European Credit Cycle: Diverging Patterns," looks at financial system cycles and their impact on real activity across Europe. The financial sector can amplify business cycle fluctuations, as well as the impact of monetary policy shocks and asset price movements on real activity. Cross-border ownership of assets further bolsters this mechanism. The chapter finds that emerging economies are likely to be more vulnerable than advanced economies to the current downturn in the credit cycle, though with large differences among countries. The introduction of a countercyclical element in prudential regulation could substantially reduce the volatility of investment, particularly in financially integrated economies. Financial integration, therefore, remains essential to foster smooth adjustments within Europe.

Chapter 4, entitled "Cross-Border Labor Flows in New Member States: Patterns and Challenges," concludes that the flow of labor across EU's New Member States has been a key feature in their convergence process. Labor mobility has significant advantages: it speeds up convergence, boosts economy-wide capital-labor ratios, supports aggregate demand through remittances, and may help augment skills through the reintegration of returning migrants in domestic labor markets. Restricting labor mobility would not be the answer to overheating pressures; policies to improve overall labor mobilization are a better avenue.

European Countries: Real GDP Growth and CPI Inflation, 2006–09
(Percent)

	Real GDP Growth				CPI Inflation			
	2006	2007	2008	2009	2006	2007	2008	2009
Europe 1/ 2/	**4.1**	**3.9**	**2.6**	**1.4**	**3.6**	**3.6**	**5.8**	**4.2**
Advanced European economies 1/	3.0	2.8	1.3	0.2	2.2	2.1	3.5	2.2
Emerging European economies 1/ 2/	7.0	6.8	5.7	4.3	7.5	7.5	11.5	9.2
European Union 1/	3.3	3.1	1.7	0.6	2.3	2.4	3.9	2.4
Euro area	2.8	2.6	1.3	0.2	2.2	2.1	3.5	1.9
Austria	3.4	3.1	2.0	0.8	1.7	2.2	3.5	2.3
Belgium	2.9	2.8	1.4	0.2	2.3	1.8	4.6	2.8
Cyprus	4.0	4.4	3.4	2.8	2.2	2.2	4.6	3.5
Finland	4.9	4.5	2.5	1.6	1.3	1.6	3.9	2.5
France	2.2	2.2	0.8	0.2	1.9	1.6	3.4	1.6
Germany	3.0	2.5	1.8	0.0	1.8	2.3	2.9	1.4
Greece	4.2	4.0	3.2	2.0	3.3	3.0	4.4	3.1
Ireland	5.7	6.0	-1.8	-0.6	2.7	2.9	3.5	2.4
Italy	1.8	1.5	-0.1	-0.2	2.2	2.0	3.4	1.9
Luxembourg	6.1	4.5	2.3	1.8	2.7	2.3	3.7	1.8
Malta	3.1	3.7	2.8	2.3	2.6	0.7	3.7	2.2
Netherlands	3.4	3.5	2.3	1.0	1.7	1.6	2.9	2.6
Portugal	1.4	1.9	0.6	0.1	3.0	2.4	3.2	2.0
Slovenia	5.7	6.1	4.3	3.7	2.5	3.6	5.9	3.3
Spain	3.9	3.7	1.4	-0.2	3.6	2.8	4.5	2.6
Other EU advanced economies								
Denmark	3.9	1.7	1.0	0.5	1.9	1.7	3.4	2.8
Sweden	4.1	2.7	1.2	1.4	1.5	1.7	3.4	2.8
United Kingdom	2.8	3.0	1.0	-0.1	2.3	2.3	3.8	2.9
New EU countries 1/	6.6	6.3	5.0	3.5	3.3	4.1	6.4	4.4
Bulgaria	6.3	6.2	6.3	4.2	7.4	7.6	12.2	7.0
Czech Republic	6.8	6.6	4.0	3.4	2.5	2.8	6.7	3.4
Hungary	3.9	1.3	1.9	2.3	3.9	7.9	6.3	4.1
Poland	6.2	6.6	5.2	3.8	1.0	2.5	4.0	3.3
Romania	7.9	6.0	8.6	4.8	6.6	4.8	8.2	6.6
Slovak Republic	8.5	10.4	7.4	5.6	4.3	1.9	3.9	3.6
Estonia	10.4	6.3	-1.5	0.5	4.4	6.6	10.2	5.1
Latvia	12.2	10.3	-0.9	-2.2	6.5	10.1	15.9	10.6
Lithuania	7.9	8.9	3.9	0.7	3.8	5.8	11.3	6.2
Non-EU advanced economies								
Iceland	4.4	4.9	0.3	-3.1	6.8	5.0	12.1	11.2
Israel	5.2	5.4	4.3	2.8	2.1	0.5	4.8	3.3
Norway	2.5	3.7	2.5	1.2	2.3	0.8	3.2	2.7
Switzerland	3.4	3.3	1.7	0.7	1.0	0.7	2.6	1.5
Other emerging economies								
Albania	5.4	6.0	6.1	6.3	2.4	2.9	4.0	3.0
Belarus	10.0	8.2	9.2	8.0	7.0	8.4	15.3	9.6
Bosnia and Herzegovina	6.9	6.8	5.5	5.0	6.1	1.5	8.5	5.2
Croatia	4.8	5.6	3.8	3.7	3.2	2.9	7.0	4.9
Macedonia, FYR	4.0	5.0	5.5	5.0	3.2	2.3	8.5	3.0
Moldova	4.8	4.0	6.5	6.5	12.7	12.4	13.7	9.7
Montenegro	8.6	9.7	7.5	5.0	2.1	3.5	9.2	5.2
Russia	7.4	8.1	7.0	5.5	9.7	9.0	14.0	12.0
Serbia	5.6	7.1	6.0	6.0	12.7	6.8	10.7	7.5
Turkey	6.9	4.6	3.5	3.0	9.6	8.8	10.5	8.4
Ukraine	7.3	7.6	6.4	2.5	9.1	12.8	25.3	18.8

Source: IMF, *World Economic Outlook*.
1/ Average weighted by PPP GDP.
2/ Montenegro is excluded from the aggregate calculations.