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IMF Sees European Recovery in 2010 Conditional on Further Policy Action, and Calls for Enhanced European Policy Coordination

The International Monetary Fund (IMF) today said that the severe economic downturn in Europe could end during the second half of 2010, followed by a gradual recovery, but that further policy actions, especially in the financial sector, will be essential to induce this recovery. In its Spring 2009 Regional Economic Outlook (REO) for Europe, the IMF notes economic activity is likely to contract most in emerging economies in the region this year, although activity may rebound slightly more in 2010 compared to the advanced economies of Europe.

For Europe's advanced countries, the IMF forecasts a 4 percent contraction in 2009. The advance countries are still expected to record negative growth in 2010, though at a more moderate rate of 0.4 percent. For Europe's emerging economies, the IMF projects a 4.9 percent decline in 2009, with a return to growth of 0.7 percent in 2010. Inflation is expected to fall to very low levels in many countries, but outright deflation is likely to be avoided, according to the IMF. The risks around this overall economic scenario, however, still remain tilted to the downside, it warns. With low inflation, consumers could regain confidence earlier, but continued weak global demand could lengthen and deepen the recession.

"The measures taken to counteract the deep recession in Europe have provided a good foundation for a gradual recovery, but further actions by policy makers, particularly in the financial sector, are needed to restore market trust and confidence, and accelerate the recovery," said Marek Belka, Director of the IMF's European Department. These actions include continued provision of liquidity and engagement in credit easing where necessary; credible loss recognition in the financial system; recapitalization of viable institutions by the private sector, but with public support if needed; and ring-fencing of impaired assets where they constitute a significant part of balance sheets, and preferably through a private sector managed bad-bank construction with government support and funding.

Macroeconomic policies are also needed to cushion the downturn. Fiscal policy needs to continue to support demand, combining rapid and extensive implementation of fiscal stimulus packages with a commitment to future fiscal consolidation. Monetary policy should be used to anchor inflation expectations solidly in positive territory, preempting deflationary risks.

"What is mostly needed is a robust approach to coordination, in particular on financial and regional macroeconomic stability," Belka said. "Europe is the most economically integrated market economy in the world, and yet the policies to address the crisis have been undertaken at the national level. Without a well-coordinated effort in these areas, neither fiscal nor monetary policy efforts will work as effectively as they must to make sure that Europe is as vibrant and prosperous after the crisis as it was before. Europe is facing the economic storm of a lifetime and it urgently needs to weatherproof its institutions," added Belka, who also called for improving the EU's financial stability framework, going beyond the recommendations suggested earlier in 2009 in the report by the High-Level Group of Financial Supervision in the EU, chaired by Jacques de Larosière.

Brief Summary of the Analytic Chapters in the 2009 Spring REO

Chapter 2 of the 2009 Spring REO, entitled *"Fiscal Policy in Advanced Economies: Effectiveness, Coordination, and Solvency Issues,"* concludes that while it is important for countries to support their economies in the face of an unprecedented slowdown, a clear and credible commitment to long-run fiscal discipline is now more essential than ever before: any loss of market confidence may lead to increases in long-term real interest rates and debt-service costs, partly offsetting the stimulus effects of measures taken to deal with the crisis and further adding to financing pressures. Any short-term fiscal action will have to be cast within a credible medium-term fiscal framework and envisage a fiscal correction as the crisis abates.

Chapter 3, entitled *"European Emerging Market in Crisis: Impact and Recovery,"* looks at the impact of the global financial crisis on emerging Europe and finds that for emerging market countries that became EU members, adherence to EU rules and institutions has helped to mitigate the impact of the crisis, although it has not shielded them completely. Also, the so called "EU halo effect"—or the phenomenon of lower bond spreads for New Member States in spite of rising vulnerabilities in some countries—has disappeared, while cross-country differences have increased. The chapter concludes that while the external environment and structural reform efforts will matter, the banking sector, which has played a central role in the run-up to the crisis, holds a key to the speed of recovery from the crisis. In the short term, bank recapitalizations seem unavoidable to prevent recessions from becoming protracted. In the medium term, recovery efforts will need to be supported by a strengthening of financial stability arrangements, including for cross-border activities, and the introduction of more forward-looking provisioning policies.

European Countries: Real GDP Growth and CPI Inflation, 2006–10
(Percent)

	Real GDP Growth					CPI Inflation				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Europe 1/ 2/	**4.1**	**3.9**	**1.8**	**-4.2**	**-0.1**	**3.6**	**3.6**	**5.7**	**2.9**	**2.5**
Advanced European economies 1/	3.1	2.9	0.9	-4.0	-0.4	2.2	2.1	3.4	0.5	0.7
Emerging European economies 1/ 2/	7.2	6.8	4.3	-4.9	0.7	7.8	7.8	12.0	9.2	7.1
European Union 1/	3.4	3.1	1.1	-4.0	-0.3	2.3	2.4	3.7	0.8	0.8
Euro area	2.9	2.7	0.9	-4.2	-0.4	2.2	2.1	3.3	0.4	0.6
Austria	3.4	3.1	1.8	-3.0	0.2	1.7	2.2	3.2	0.5	1.3
Belgium	3.0	2.6	1.1	-3.8	0.3	2.3	1.8	4.5	0.5	1.0
Cyprus	4.1	4.4	3.7	0.3	2.1	2.2	2.2	4.4	0.9	2.4
Finland	4.9	4.2	0.9	-5.2	-1.2	1.3	1.6	3.9	1.0	1.1
France	2.4	2.1	0.7	-3.0	0.4	1.9	1.6	3.2	0.5	1.0
Germany	3.0	2.5	1.3	-5.6	-1.0	1.8	2.3	2.8	0.1	-0.4
Greece	4.5	4.0	2.9	-0.2	-0.6	3.3	3.0	4.2	1.6	2.1
Ireland	5.7	6.0	-2.3	-8.0	-3.0	2.7	2.9	3.1	-0.6	1.0
Italy	2.0	1.6	-1.0	-4.4	-0.4	2.2	2.0	3.5	0.7	0.6
Luxembourg	6.4	5.2	0.7	-4.8	-0.2	2.7	2.3	3.4	0.2	1.8
Malta	3.2	3.6	1.6	-1.5	1.1	2.6	0.7	4.7	1.8	1.7
Netherlands	3.4	3.5	2.0	-4.8	-0.7	1.7	1.6	2.2	0.3	1.1
Portugal	1.4	1.9	0.0	-4.1	-0.5	3.0	2.4	2.6	0.3	1.0
Slovak Republic	8.5	10.4	6.4	-2.1	1.9	4.3	1.9	3.9	1.7	2.3
Slovenia	5.9	6.8	3.5	-2.7	1.4	2.5	3.6	5.7	0.5	1.5
Spain	3.9	3.7	1.2	-3.0	-0.7	3.6	2.8	4.1	0.0	0.9
Other EU advanced economies										
Denmark	3.3	1.6	-1.1	-4.0	0.4	1.9	1.7	3.4	-0.3	0.0
Sweden	4.2	2.6	-0.2	-4.3	0.2	1.5	1.7	3.3	-0.2	0.0
United Kingdom	2.8	3.0	0.7	-4.1	-0.4	2.3	2.3	3.6	1.5	0.8
New EU countries 1/	6.6	5.9	4.0	-2.9	0.2	3.2	4.3	6.5	3.0	2.3
Bulgaria	6.3	6.2	6.0	-2.0	-1.0	7.4	7.6	12.0	3.7	1.3
Czech Republic	6.8	6.0	3.2	-3.5	0.1	2.5	2.9	6.3	1.0	1.6
Hungary	4.0	1.1	0.6	-3.3	-0.4	3.9	7.9	6.1	3.8	2.8
Poland	6.2	6.7	4.8	-0.7	1.3	1.0	2.5	4.2	2.1	2.6
Romania	7.9	6.2	7.1	-4.1	0.0	6.6	4.8	7.8	5.9	3.9
Estonia	10.4	6.3	-3.6	-10.0	-1.0	4.4	6.6	10.4	0.8	-1.3
Latvia	12.2	10.0	-4.6	-12.0	-2.0	6.6	10.1	15.3	3.3	-3.5
Lithuania	7.8	8.9	3.0	-10.0	-3.0	3.8	5.8	11.1	5.1	0.6
Non-EU advanced economies										
Iceland	4.5	5.5	0.3	-10.6	-0.2	6.8	5.0	12.4	10.6	2.4
Israel	5.2	5.4	3.9	-1.7	0.3	2.1	0.5	4.7	1.4	0.8
Norway	2.3	3.1	2.0	-1.7	0.3	2.3	0.7	3.8	1.5	1.9
Switzerland	3.4	3.3	1.6	-3.0	-0.3	1.0	0.7	2.4	-0.6	-0.3
Other emerging economies										
Albania	5.5	6.3	6.8	0.4	2.0	2.4	2.9	3.4	1.5	2.2
Belarus	10.0	8.6	10.0	-4.3	1.6	7.0	8.4	14.8	12.6	6.0
Bosnia and Herzegovina	6.9	6.8	5.5	-3.0	0.5	6.1	1.5	7.4	2.1	2.3
Croatia	4.7	5.5	2.4	-3.5	0.3	3.2	2.9	6.1	2.5	2.8
Macedonia, FYR	4.0	5.9	5.0	-2.0	1.0	3.2	2.3	8.3	1.0	3.0
Moldova	4.8	4.0	7.2	-3.4	0.0	12.7	12.4	12.7	2.6	4.7
Montenegro	8.6	10.7	7.5	-2.7	-2.0	2.1	3.5	9.0	1.7	-0.2
Russia	7.7	8.1	5.6	-6.0	0.5	9.7	9.0	14.1	12.9	9.9
Serbia	5.2	6.9	5.4	-2.0	0.0	12.7	6.5	11.7	10.0	8.2
Turkey	6.9	4.7	1.1	-5.1	1.5	9.6	8.8	10.4	6.9	6.8
Ukraine	7.3	7.9	2.1	-8.0	1.0	9.0	12.8	25.2	16.8	10.0

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