Address by Murilo Portugal
Deputy Managing Director of the International Monetary Fund
At the 2007 High-Level Segment of ECOSOC
Geneva, July 2, 2007

Mr. President, Excellencies, Ladies and Gentlemen,

It is a great honor to address the ECOSOC and to have the opportunity to share with such a distinguished audience the IMF's view on current developments and prospects for the world economy.

Our assessment and baseline scenario are that times continue to be good for the global economy. There continues to be solid growth in the Euro area and Japan, a vigorous pace of expansion in emerging market countries, particularly in China and India, and we expect a strengthening of growth in the United States in the second half of the year. With these, we are forecasting global growth to top 5 percent again in 2007. This would be the fifth consecutive year of strong growth, and indeed the strongest five-year span for the global economy since the 1970s. Let me go in some more elaboration on developments in key advanced and emerging market economies that have underpinned this robust global expansion.

After a year-long slowdown in growth, the U.S. economy is expected to regain momentum gradually as the drag from the housing correction and the softness in the business sector dissipate. Growth in the first quarter of 2007 was weak at 0.6 percent, as "headwinds" from inventories and residential investment offset continued strong consumption. Going forward, higher gasoline prices may weigh on consumption in the near term, but the drag from weakness in the housing sector is expected to diminish. The rates of decline in house prices and housing starts appear to be moderating. The recent firming of indicators of business activity and investment is encouraging. We expect a stronger second half and that the economy will continue to gain momentum going into 2008. Inflation has moderated somewhat, bringing core inflation down to the top of the Fed's comfort zone, but vigilance is still needed in view of tight labor markets and recent increases in food and energy prices.

In the *Euro area*, growth has been stronger than expected. GDP expanded by 2.4 percent in the first quarter, driven by strong investment and net exports, although consumption spending slowed, in part reflecting the effects of the German VAT increase.

The Euro area economy's forward momentum looks solid and growth is expected to remain above potential through 2008. Slowing house price inflation in some countries suggests the possibility of weaker residential construction going forward. Labor markets continue to evolve favorably, with the Euro area wide unemployment rate falling to a record low. Recent moderate wage developments and rising productivity augur well for anchoring inflation expectations, and we expect inflation to remain consistent with the ECB's objective of "below but close to" 2 percent. Monetary policy has been tightened, with policy rates increasing to 4 percent, but with the area's growth projected to remain close to or above potential, further tightening may be needed, depending on how much the supply-side of the economy has improved.

Growth in *Japan* continues at a healthy pace. GDP grew by 3.3 percent in the first quarter, reflecting buoyant business investment and strengthening private consumption. Solid confidence amidst strong profits in the business sector and continued employment growth should underpin a further expansion of the economy. Consumption indicators point to a continued up-trend, and our projections for 2007 GDP growth are being revised higher. Japan's consumer price inflation continues to hover around zero, and monetary policy remains appropriately accommodative in the very low inflation environment. The return to a neutral monetary stance should proceed in tandem with improved inflation prospects.

Emerging markets and developing countries are expected to continue to grow strongly in 2007, drawing continued support from favorable financial conditions and, in many cases, from strong commodity prices, as well as, strengthened macroeconomic management and continued reform efforts.

In ***China***, GDP growth re-accelerated to an annual pace of more than 11 percent in the first quarter of 2007, led by buoyant investment and exports. In ***India***, GDP growth expanded by 9.1 percent in the first quarter of 2007—the fastest pace in 18 years, driven by a robust manufacturing sector and a pickup in agriculture. For both countries, growth looks likely to continue to be stronger than anticipated and further monetary policy tightening may be needed.

It is encouraging that growth prospects also remain strong, broadly across all groups of emerging market and developing countries. Growth remains strong in most of emerging Asia and emerging Europe, has gained further momentum in Latin America, and continues to be buoyant in Sub-Saharan Africa. Against this background, overheating and asset price inflation in some emerging market countries are a rising concern, although central banks have generally been quick in recognizing the problem and in taking remedial action.

Let me now elaborate on how we see the risks to this baseline scenario going forward, which we see as tilted to the downside. There are a number of downside risks, but let me focus on three key ones:

- First, inflation pressures remain a concern, in both advanced and emerging market countries. As we are in the fifth year of this global expansion, output gaps are closing in many countries. Rates of capacity utilization are high, and well above their long-term averages, and labor markets are tightening. Thus, the influence of increasingly global markets may have less restraining influence on inflation, as suggested by the firming prices of manufactured imports from many emerging markets. At the same time, agricultural commodity prices have soared, reflecting strong demand growth, pushing up food price inflation. A renewed surge in energy prices also remains a risk, with continuing limited spare capacity and geopolitical tensions in important producing areas. The recent rise in global long-term bond yields reflects many of these concerns as well as an improved growth outlook. Longer-term inflation expectations seem well anchored—owing to the market's confidence that central banks will maintain firm control over inflation. But these risks underscore the need for continued vigilance against inflation pressures.

- Second, the recent noticeable rise in long-term interest rates and spreads and last February turmoil remind us to guard against any complacency about global financial sector risks. Problems in the U.S. subprime mortgage sector are real and some "ripple effects" may still be felt from strains in the mortgage market. The surge in leveraged buyouts in the United States and Europe—financed by leveraged loans with lax covenants—draw some uncomfortable parallels with that situation. Finally, there remain pockets of financial vulnerability within the emerging markets universe. Notably, strong private sector flows into emerging Europe have fuelled rapid domestic credit growth, thus creating some vulnerabilities for corporations and banks. Again, vigilance against these risks is called for.

- Third, continued large global current account imbalances leave open risks of a possible disorderly unwinding—a low-probability but a high-cost event—and of rising protectionist pressures. The apparent collapse of efforts to advance the Doha round is deeply disappointing. As a positive note, I should mention that the IMF conducted a first multilateral consultation addressing the issue of resolving global imbalances in a manner that is supportive of global growth, and that the participant countries have provided a useful roadmap of policies that could help to significantly reduce the risks attached to global imbalances. The key now is implementation.

In sum, I would conclude by saying that the global outlook remains favorable, but risks remain of unwelcome surprises. There is no room for policymakers to relax their efforts both to sustain a stable macroeconomic environment and to advance reforms that would underpin continued strong global growth over the medium term.

Thank you.