III. TRANSFORMING THE REBOUND INTO RECOVERY

The economies of East Asia and the Pacific have rebounded sharply from the steep drop in activity in early 2009, thanks to fiscal and monetary stimulus, substantially improved global financial conditions, and an upturn in the inventory cycles. We are revising our projection for regional growth for 2009 up by 1.3 percentage points compared to our April forecast ("Battling the Forces of Global Recession" issued on April 6, 2009) even as our forecast for developed economies in 2009 are further downgraded. Real GDP in the G-3 is now projected to fall 3.5 percent in 2009 compared with a projected decline of only 0.4 percent a year ago and 3.1 percent in April, while projections of global trade volumes are now revised to show a contraction of 11.4 percent versus a drop of 2.1 percent forecast a year ago (Table 3).

Growth in the developed economies is projected to recover at a modest pace in 2010, as banks continue to deleverage, and high and rising unemployment subdues the recovery in private consumption. Global capital flows are likely to recover moderately from the lows of 2009 but will remain smaller than the record highs reached in 2007 as cross-border lending continues to suffer from international banks recognizing credit losses (now about half of the total projected) while inflows of foreign direct investment remain limited by large excess capacity.

East Asia may receive a larger share of these inflows because of a combination of investor expectations of stronger growth in the region than the rest of the world, the potential for currency appreciation and the growing liquidity and sophistication of the region's financial markets. Although limited availability of capital is a key risk, a surge in capital flows will create a separate set of challenges.

Premature withdrawal of fiscal and monetary stimulus is among the key concerns of policymakers in the region, just as it was on top of the agenda during the recent meeting of the G20 heads of state in Pittsburgh. Nonetheless, as growth recovers broadly and inflation pressures begin to materialize, monetary policy may need to be tightened sooner rather than later in East Asia, following the recent policy rate hikes by the central banks in Israel, Australia, and Norway. It is more likely that the monetary authorities in East Asia will move first by removing some of the support for liquidity in domestic and foreign currencies (similar to the reabsorption of foreign currency liquidity by the Korean authorities which they had extended to the market earlier), returning reserve requirements to pre-crisis levels (following up on the steps of Indonesia's central bank) and scaling back the scope for collateral eligible for accessing central bank facilities before hiking policy rates.

Table 3. Growth projections are revised up

(Percent change y-y unless indicated otherwise)

				Prev Forecasts	
				Dec'08	Apr'09
	2008	2009f	2010f	2009	2009
Developing East Asia	8.0	6.7	7.8	6.7	5.3
China	9.0	8.4	8.7	7.5	6.5
Indonesia	6.1	4.3	5.4	4.4	3.4
Malaysia	4.6	-2.3	4.1	3.7	-1.0
Philippines	3.8	1.4	3.1	3.0	1.9
Thailand	2.6	-2.7	3.5	3.6	-2.7
Vietnam	6.2	5.5	6.5	6.5	5.5
Cambodia	6.7	-2.2	4.2	4.9	-1.0
Lao PDR	7.3	6.4	7.5	6.0	5.0
Timor-Leste	12.8	7.4	8.0	1.4	1.0
Mongolia	8.9	0.5	3.0	7.5	2.7
Fiji	0.2	-0.3	1.8	1.1	2.4
Papua New Guinea	6.6	3.9	3.7	5.0	4.7
Memoranda:					
Developing East Asia					
Middle-income countries	8.1	6.9	7.9	6.8	5.4
Low-income countries	6.3	4.5	6.0	6.1	4.7
Excluding China					
Developing East Asia	4.7	1.1	4.5	4.1	1.1
Middle-income countries	4.5	0.7	4.3	3.8	0.7
G-3	0.3	-3.5	2.0	-0.4	-3.1
Global trade volumes	3.2	-11.4	4.0	-2.1	-6.0

Source: Datastream; DECPG; and World Bank staff estimates and projections. f=forecast

Governments in the region plan to continue implementing already announced fiscal stimulus packages until the recovery is on firmer footing. Moreover, some governments have announced additional stimulus measures, including in Thailand and Singapore. The Thai government is boosting spending with a second stimulus package equivalent to 16 percent of GDP to be spent over 2010-2012 to largely alleviate critical transportation bottlenecks. About a third of the package will be within the central government budget, and the rest off-budget. In Singapore, the government decided to extend for six months the Jobs Credit Scheme, a key and successful part of its stimulus program that was set to expire this year. Balancing between projections for ongoing recovery and concerns that activity may weaken again, the government is reducing the amount of subsidy under the program that encourages new hiring, but is keeping it operational to allow for more rapid response in case of economic weakness. Other governments have drafted budgets that allow for discretionary increases should economic activity weaken. This is the case in Indonesia, where the government targets the 2010 deficit to narrow to 1.6 percent of GDP from 2.2 percent in 2008, but the budget authorizes the government to enact new spending and boost the deficit to 2 percent of GDP should the recovery of growth sputter.

The low-income countries will remain under pressure to support domestic demand. Some, including Lao PDR, are planning to sustain large fiscal deficits to be financed from government deposits and the domestic banks. Other countries, such as Mongolia, are set to carry out somewhat tighter fiscal policy under the IMF-supported program. The continued need to mobilize resources from the multilateral institutions to help the most vulnerable remains a priority, as emphasized by the recent Leaders' G-20 summit held in Pittsburgh.

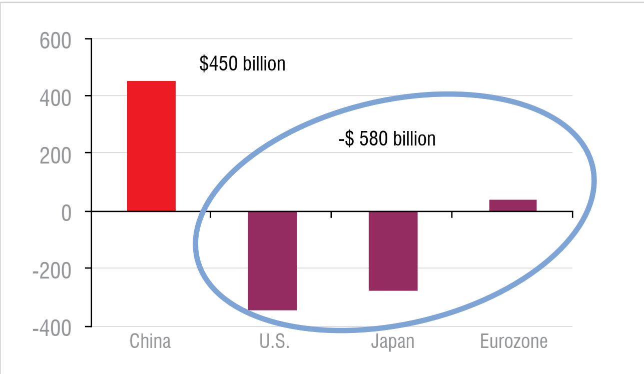
The authorities in the region are aware that the limits of what fiscal policy could accomplish in stimulating domestic demand will be reached faster unless investors are reassured that exit strategies will be put in place to unwind the stimulus when recovery sets in more firmly. Such strategies will be more credible if supported by robust medium-term fiscal and debt frameworks. Coordinated withdrawal of stimulus, much like the coordinated introduction of the extraordinary fiscal support will be important, as emphasized at the recent leaders' summit of the G20.

Helped by large and timely fiscal and monetary support and on the basis of strong fundamentals before the crisis, growth in developing East Asia is projected to reach 6.7 percent in 2009, the same pace of expansion we forecast a year ago. But the composition of growth is expected to be fundamentally different from what we projected a year ago, however. On the expenditure side, the contribution of net exports turned substantially more negative in China after several years of increasingly stronger boost to output, and the contribution of private investment is also negative in almost all countries. Government spending, by contrast, whether on consumption or investment, has contributed more than expected earlier as stimulus spending was either accelerated or augmented. There are substantial differences across countries as well. Growth in China is now stronger than we projected both a year ago and in April 2009, but we have revised down by about 6 percentage points compared with a year ago the growth projections for two middle-income countries (Thailand and Malaysia) and by about 7 percentage points growth for two low-income countries (Cambodia and Mongolia).

Thanks to China, East Asia remains the fastest growing developing region in the world. Although China's economy accounts for less than a tenth of the global economy, the increase in China's GDP in 2009 will offset three-fourths of the decline in G3's GDP. This number underlies China's markedly increased global role, but also reveals the limits to what China alone can do, because this year's outcome was achieved through a huge monetary and fiscal stimulus that the authorities will find neither prudent nor necessary to sustain for an extended period of time. Take China out of the equation, however, and the remainder of the region is set to expand at a slower pace than the Middle East and North Africa, South Asia, and only modestly faster than Sub-Saharan Africa (Table 4). This reflects the openness of East Asia and the fast transmission of shocks through production networks serving the U.S., Japan and other global markets.

Figure 45. The increase in China's GDP offset three-fourths of the decline in G3's GDP

(in billions of dollars, 2009)



Source: World Bank.

Table 4. Thanks to China, developing East Asia will remain the fastest growing world region

(Percent change y-y)

	2007	2008	2009f	2010f
Developing East Asia	11.4	8.0	6.7	7.8
Dev. East Asia excl. China	6.2	4.8	1.1	4.5
Europe and Central Asia	7.1	4.3	-6.1	1.9
Latin America and Caribbean	5.5	3.9	-2.5	3.0
Middle East and North Africa	5.3	5.8	3.0	3.4
South Asia	8.5	5.7	5.3	6.4
Sub-Saharan Africa	6.5	4.9	0.7	3.8
OECD countries	2.5	0.4	-3.2	1.7

Source: DECPG and World Bank staff estimates and projections.

China's economy will continue to influence substantially developments in the region in 2010. Real GDP growth is projected to strengthen modestly to 8.7 percent in 2010 from 8.4 percent in 2009, but the composition of growth is set to change significantly. Exports are projected to grow significantly after falling sharply in 2009, and real estate investment is bound to expand briskly. In 2010, the government stimulus is set to decline sharply. The authorities are committed not to withdraw any fiscal stimulus, but at the same time are mindful that substantial additional stimulus is also not warranted, given the strong growth prospects. Moreover, the extraordinary expansion in credit by the equivalent of 30 percent of GDP in 2009 could add to nonperforming loans (NPLs) in a repeat of the NPL accumulation during the 1990s. The government, as a result, may supplement the recently adopted measures to limit expansion in certain industries, including cement, steel and aluminum, with steps to slow rapid credit growth. This should also help address the authorities' growing concern about potential asset price bubbles.

Thailand and Malaysia are the region's middle-income countries worst hit by the crisis. In Thailand, a sharp decline in exports was the main cause for the economy to contract by 2.7 percent in 2009 amidst renewed political tensions. Prospects are for growth to recover in 2010 benefitting from inventory restocking and the pickup in demand for electronics and automobiles abroad. In Malaysia, the sharp drop in exports of oil, palm oil and electronics caused output to contract 2.3 percent this year.[11] The factors that battered the country on the downside are likely to support it as strongly on the upside, with increasing global demand, together with the positive effect from the second government stimulus package output projected to output to grow 4.1 percent in 2009.

Mongolia and Cambodia are the low-income countries hardest hit by the crisis. The collapse in copper prices hit Mongolia harder than the other major copper producers because of the country's particular combination of expansive fiscal and monetary policies, a fixed exchange rate and – at that time - an overheating financial sector. The government took strong actions to address the economic downturn from the start of 2009, supported by programs with the IMF, the World Bank, the ADB and Japan. These efforts have led to a stabilization of the external sector, the exchange rate and the budget, although nonperforming loans are still rising. Real GDP growth is projected to slow from nearly 9 percent in 2008 to 0.5 percent in 2009 before recovering modestly in 2010. The slowdown in economic activity in Cambodia is as sharp, with real GDP projected to contract 2 percent in 2009 after expanding nearly 7 percent in 2008. Exports of garments – which account for the bulk of shipments abroad and are almost all directed to the U.S. market - fell 26 percent in the first six months of 2009 from a year earlier. More worrisome than the decline in garment exports, however, is the loss in U.S. market share that indicates competitiveness challenges. The other key sectors of the economy were also negatively affected. Tourism arrivals declined and construction projects approved dropped one-fourth from a year before in the first half of the year. As in Mongolia, developments in the banking sector bear close watch. Very rapid growth

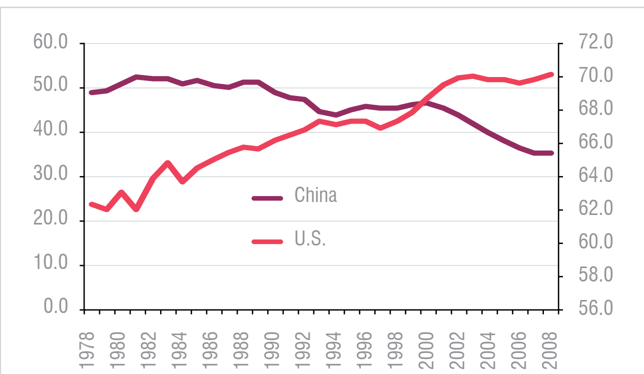
11 Malaysia's value added contribution to electronics exports is the highest in the region.

over 2005-2008 has slowed to a halt, while non-performing loans have increased during the first six months of 2009 and will be under further pressure because of economic weakness and the sharp downward correction in real estate prices.

Looking beyond next year, East Asia has the potential to sustain high growth rates even in a more slowly growing global economy, but such an outcome will require substantial policy efforts. Until recently, some of the economies in the region strived to achieve rapid growth by imitating the earlier policies in Japan, Taiwan (China) and Korea of relying on export-led manufacturing growth, often without full regard for the costs and distortions incurred in the process. At the heart of these policies were undervalued exchange rates, accompanied with government measures to encourage the rapid build-up of manufacturing capacity for export, while boosting domestic saving, depressing household consumption and limiting competition, both domestic and foreign, in the nontradeable sectors. Favorable tax, customs and credit policies benefitting large export-oriented companies have been essential, as have been efforts to create the necessary facilitating infrastructure and conditions for attracting foreign investors in export-oriented sectors.

Figure 46. Domestically unbalanced: private consumption in the U.S. and China

(In percent of GDP)



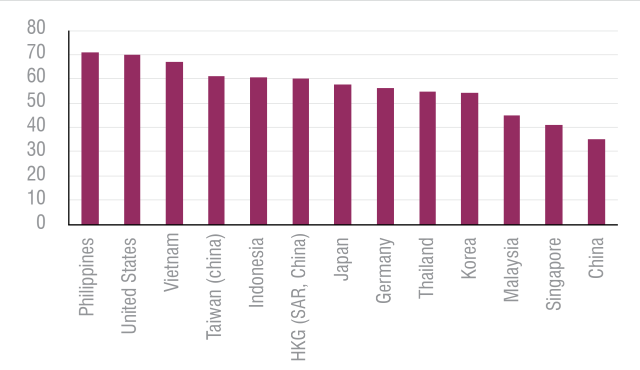
Source: Datastream and BEA.

First among the countries in developing East Asia, the authorities in China began to recognize that the investment-heavy, industry-led pattern of export-led manufacturing growth pursued over the last three decades has led to unsustainable domestic and external imbalances (Figure 46). The Chinese authorities remain committed to rebalancing growth as the key objective in its 11th five-year plan by giving greater attention to domestic sources of growth, increasing the role of services and consumption, improving energy efficiency, encouraging environmental sustainability, and reducing urban-rural inequalities. In this context, further reform of energy prices is one of the government's priorities, and carrying it forward will bring more starkly into focus the important question of reforming other relative prices, including interest rates and the exchange rate. The current crisis arguably slowed progress in rebalancing, as the authorities focused on limiting the slowdown in growth by implementing the 4 trillion RMB infrastructure-dominated fiscal stimulus package and effectively re-pegging the currency to the U.S. dollar. Nonetheless, senior Chinese leaders have stressed that the crisis makes rebalancing more urgent and important. Several measures to support private consumption have been undertaken thus far this year, including tax breaks for automobile purchases and subsidies for electronics sales, increases in pensions, the rolling out of a rural pension program, and the start of an important health reform program. These measures are helping sustain growth in private consumption in 2009 at a pace little changed from last year, modestly boosting the share of consumption in GDP. Nonetheless, significantly more efforts will be needed towards rebalancing, particularly in the area of removing the distortions that have kept growth in services, wages and private consumption lower than growth in overall GDP.

Other developing East Asian countries are also likely to explore ways for extracting more growth from domestic demand while recognizing that developing countries will need to increase integration with global goods and service markets to sustain convergence with high-income economies. Observers point out that Vietnam faces challenges not very different from those faced by China, given the similarity of growth models pursued thus far. Malaysia and Thailand are striving to avoid the middle income trap, including by focusing on improving education and skills, tackling infrastructure bottlenecks, and enhancing competition in

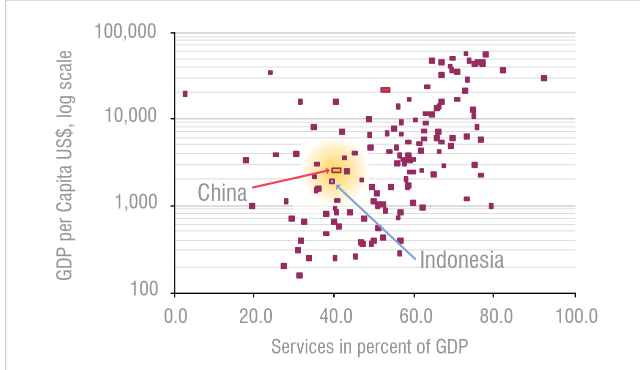
Figure 47. Not all countries have subdued private consumption as in China

(Private consumption, in percent of GDP, 2008)



Source: Datastream and national authorities.

Figure 48. The service sector is much smaller in China and Indonesia than in countries at similar income levels



Source: Datastream, Haver and World Bank staff estimates.

both the manufacturing and the service sectors. Malaysia's recent measures and announcements to liberalize the service sector and promote private investment, research and development and new niche areas are important first steps in this regard but would have greater impact if followed by further reforms in the regulatory framework.

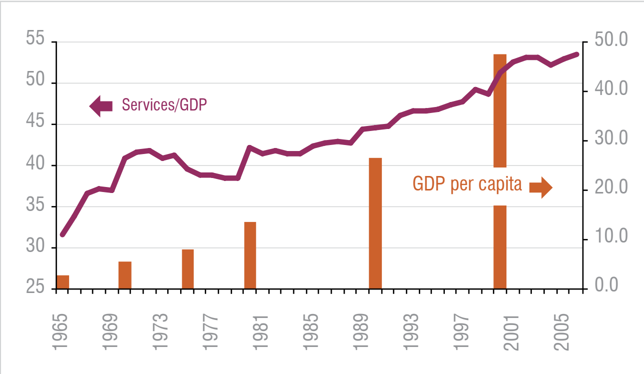
In contrast to these countries, the authorities in the Philippines and some of the low-income countries face a different challenge. In the Philippines, the level of household consumption relative to income is similar to that in the U.S. and is much higher than in other countries in the region, fueled by strong inflows of remittances (Figure 47). Capital-intensive production of goods and services, meanwhile, is predominantly inward-oriented and the value-added of exports is lower than in the other middle-income countries in the region. Transforming the economy by increasing its outward orientation will remain an important challenge for the government (see below).

East Asia's process of regional integration – that followed the global integration of most countries – has been a powerful driver of growth in the region. Although advanced, the process of regional integration could be deepened substantially further by addressing behind-the-border trade facilitation problems, tackling the liberalization of the services sector, including the financial sector (see below), and facilitating intra-regional migration. Harmonizing infrastructure and improving policy transparency are also important avenues for the authorities to explore. Global and regional production networks, along with the rapid rise in intra-regional trade in parts and components, have further room for growth and improvement, although some point out that higher energy prices in the future and concerns about climate change may lead to a rethink of the level of specialization and intra-industry trade which may place limits on economies of scale in manufacturing. Moving up the value-added chain in production networks will give growth a new impetus, as the benefits of new technology and innovation spread more broadly throughout the countries in the region.

The service sector – underdeveloped in many East Asian countries due to the bias in favor of merchandise tradeables – holds enormous potential for the region. Removing barriers to the development of the service sector needs to be pursued with sufficient urgency in countries such as China, Malaysia, Korea and Thailand where the need for finding new sources of growth is becoming crucial given the likelihood that import demand in developed countries is set to remain weak and where the limits of traditional growth strategies as vehicles of reaching high income status are being tested. Efforts need to include the reduction and elimination of tax incentives in favor of export-oriented manufacturing, opening up the service sector to more competition, including from foreign investors, and helping improve the access to finance for small- and medium-size enterprises. Easing restrictions to internal migration in China and advancing reforms to limit preferential treatment of different classes of citizens in other countries should offer substantial scope for increasing urban employment, raising household incomes, and allowing for better use of agglomeration

Figure 49. The share of services in GDP has risen along with incomes per capita in Korea */

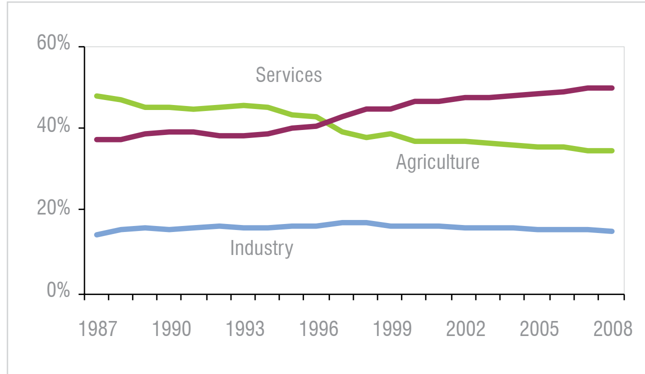
(In percent)



Source: WDI, OECD and Haver Analytics. Note: */GDP per capita is in current U.S. dollars relative to the U.S.

Figure 50. Philippines: service employment denominates

(In percent of total)



Source: Philippines growth brief prepared by Ulrich Lachler, World Bank, based on data from the national authorities.

economies. In Korea, the authorities are rightly concerned that labor productivity in the service sector – dominated by SMEs – has expanded by just about 1 percent a year this decade, six times slower than manufacturing productivity, largely due to the financial difficulties among SMEs in accessing finance, dealing with business regulation and labor market rigidities.

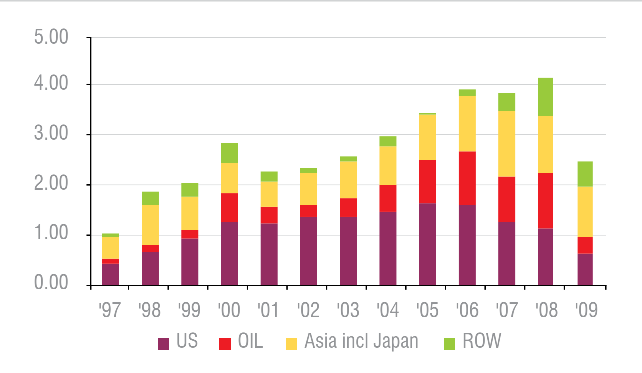
Consider the potential of the service sector for China. Value-added in services accounts for 40 percent of GDP, below the midpoint of the range for countries with broadly similar income per capita (25-75 percent) and the same as in Indonesia (a country with half of China's income per capita). Indeed, the share of value-added in services in China has risen modestly from 32 percent of GDP in 1960, when GDP per capita was substantially lower. In Korea, services accounted for about 40 percent of GDP in the mid-1970s when GDP per capita was the same as China's level today relative to the U.S. The share of services has risen to about 50 percent subsequently, measured in current prices. As emphasized above, development of the service sector in Korea has been restrained by policies geared toward export-led goods manufacturing and this is an important similarity with China. Nonetheless, services accounted for half of the increase in real GDP in Korea over the last 25 years, or a contribution equivalent to that of the rest of the economy. An ambitious agenda for developing the service sector in China, therefore, could help boost output, employment and living standards well beyond current projections.

In contrast to China and Indonesia, the service sector in the Philippines is large but that reflects a failure to boost economic activity more generally, rather than a mark of success in diversifying the structure of growth. The Philippines was the most developed country in developing Asia in the 1950s, but subpar rates of growth, coupled with policies protecting inefficient manufacturing based on excessively capital-intensive technology in the subsequent three decades, caused living standards to stagnate to levels that are now below all other middle-income countries in the region. Industry was unable to absorb the rapidly growing labor force, including migrants from the rural areas, leaving the service sector as the safety valve. Services account for 65 percent of GDP and nearly half of employment, but anecdotal evidence suggests that the bulk of the service sector simply masks severe urban underemployment with very low productivity. A ray of hope has been offered by the success of the Business Process Outsourcing (BPO) service sector, which in less than a decade has risen as a formidable global competitor to companies in India – still the preferred destination for BPO. More will need to be done to help the BPO boost employment from 1 percent of the total in the country, however, and policies to be pursued will also facilitate the emergence of other higher value-added and high productivity services and manufacturing.

There are both downside and upside risks to the outlook presented in this report. On the downside, the main risk is that private investment and consumption in developed countries remain very weak because of sizable excess capacity and high unemployment, keeping overall growth in the advanced economies dependent on sustaining for an extended period of time fiscal and monetary

Figure 51. Global imbalances have been reduced – but not by Asia

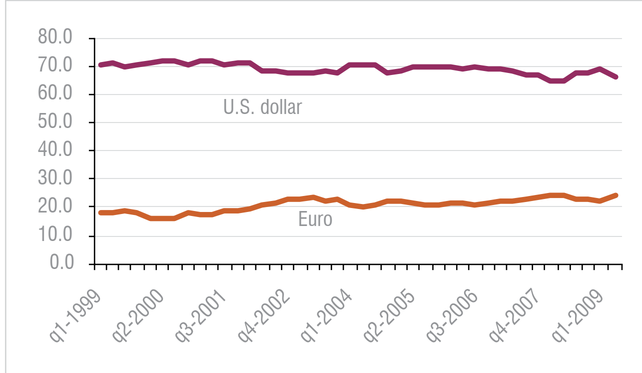
(absolute value of current account balances, in percent of global GDP)



Source: Datastream and national authorities.

Figure 52. The share of foreign exchange reserves denominated in dollars has eased only slowly

(In percent)



Source: IMF.

stimulus. The authorities, as a result, may face the unpalatable choice of whether to keep up the stimulus at greater risks to fiscal sustainability and developed country currencies, or withdraw it and risk a double dip in economic activity. Even if stimulus is sustained, the risk is that the crisis has triggered a more permanent shift to lower potential growth for the developed countries. Such economic developments will give rise to populist and protectionist sentiment in developed and developing countries alike. Finally, continued problems with financial institutions that have yet to realize more than half of likely losses could also trigger another round of financial instability.

The upside risks are substantial as well. A more robust recovery in the developed countries than currently expected could come before global imbalances are tackled more vigorously and financial regulation in advanced economies improved to rein in the excesses that led to the crisis. Such a recovery will likely put East Asia under strong pressure to return to the status quo ante of supporting manufacturing exports at any cost. The upside also carries with it the risk that East Asia's growth potential and much improved financial markets attract larger capital inflows than assumed under the baseline scenario, leading to new and larger asset price bubbles and complicating macroeconomic policies. Managing both the upside and the downside risks will be a challenge to any government. Rebalancing growth, together with advancing integration with global markets and retooling institutions to encourage innovation however, seems to be the key ingredient of any strategy to tackle the problems the next two years will bring to policymakers in the region.

The crisis accelerated the process of reducing global current account imbalances but it is unclear if progress will be sustained. The U.S. current account deficit peaked in 2006 at 6 percent of GDP (1.6 percent of global GDP) and was declining even before the crisis began, as the weak dollar helped slow growth in imports more than exports (Figure 51). Surpluses among the oil producers peaked in 2008 along with oil prices. The current account surplus in East Asia (developing East Asia, the NIEs and Japan), by contrast, has narrowed only modestly in 2009 from the 2008 peak. Continued dollar weakness, reflecting improved confidence in the rest of the world – notably in East Asia – and increased worries about the potential difficulties in reducing the U.S. fiscal deficits that are set to average 10 percent of GDP in the fiscal years 2009 and 2010, holds the potential of reducing imbalances further in the near term. A lot will depend, however, whether the dollar will weaken against a broader basket of currencies, notably the currencies of the countries with the largest surpluses.

But currency appreciation cannot be a goal in itself. Allowing currencies in the region to strengthen, but by no more than differential labor productivity growth in the tradeable sectors, will help rebalance the economy gradually and improve living standards without endangering competitiveness. Most authorities in the region nonetheless worry that appreciation will stymie the potential recovery in exports in the short term, while encouraging capital inflows that would bring instability to financial systems and exert further upward pressure on currencies. The authorities in many East Asian countries, moreover, are concerned about losing competitiveness against China, should they allow their currencies to strengthen at a time when China has effectively re-pegged the renminbi to the weakening dollar since mid-2008. Some observers have suggested that if such concerns persist, countries in the region may consider intervening jointly to appreciate their currencies against the dollar in a move similar to the Louvre Accord signed in 1987 to stem the depreciation of the U.S. dollar.[12] The likelihood of such a development does not appear high at present, however.

Over the longer term, the likely sustained shift in global economic power to East Asia, notably to China, will play an increasingly larger role in shaping the available options of reserve currencies. The firming multi-polarity in the world economic order in the aftermath of the recent global crisis has led some to question the role of the U.S. dollar as the world's predominant reserve currency. The dollar's share of global foreign exchange reserves was trending modestly down before the global financial crisis intensified with the failure of Lehman Brothers, but demand for short-term U.S. government bonds surged at the height of the crisis even as their yields fell essentially to zero. A renewed shift away from the dollar has been evident again from the start of 2009, supported by returning confidence in the rest of the world and concerns that U.S. fiscal deficits of about 10 percent of GDP in 2009 and 2010 and government debt up by about 25 percent of GDP by 2011 will dampen prospects for the U.S. currency (Figure 52).

What options are there for global reserve currencies in the future? Demand for the euro as a reserve currency may increase somewhat further over the medium term, but observers note that the currency's position will be limited as long as the eurozone lacks a single euro-bond market and a single eurozone finance authority. Officials from the BRIC countries have recently proposed a greater role for both the SDR and their own currencies. The general IMF SDR allocation in August injected the equivalent of $250 billion into the global economy and gave rise to much of the discussion about using the synthetic currency as an alternative reserve currency. The allocation amounted to just 3 percent of global foreign exchange reserves, however. There may be a role for the SDR in a global reserve system, but it must be supported by improved governance arrangements, along the lines articulated at the recent G20 Summit in Pittsburgh. The Chinese authorities, meanwhile, have begun work to encourage the use of the renminbi in trade settlements with trading partners, and promoting its financial centers, including Hong Kong (SAR China), with the ultimate goal of making the currency convertible and elevating it to global reserve currency status. Such ambitions are underpinned by the likelihood that even with slower growth than recorded in recent years, China's GDP is likely to exceed that of the U.S. in about 25 years – and Japan's perhaps in as few as five.[13] All in all, these factors make it more likely that a multi-polar reserve currency world will emerge over the longer term and, if supplemented with stronger global economic cooperation as pledged at the G20 Summit in Pittsburgh, could ultimately limit the need for countries to hold ever larger foreign exchange reserves to self insure against unfavorable external shocks.[14]

The November G20 Summit in Pittsburgh acknowledged the need to sustain strong policy responses until a durable recovery is secured, and stressed yet again the need for continued policy coordination and consultation to tackle global imbalances and improve regulatory frameworks that are understood to be among the primary causes of the crisis. The authorities in the region are mindful of the risks of a premature withdrawal of stimulus before recovery of private investment is on a sound footing. Some governments in the region will have the fiscal space to sustain fiscal stimulus until the transition from a rebound to a recovery is ensured, while others will be more fiscally constrained. Nonetheless, even those with ample room for fiscal maneuver are aware

12 The signing of the Louvre Accord by the G-7 (other than Italy) followed the Plaza Accord in 1985 which aimed to weaken the dollar against the DM and the Japanese yen.

13 Assuming real GDP growth in China exceeds that in the U.S. by 5.5 percentage points, for example, 8 percent growth in China and 2.5 percent real GDP growth in the U.S.

14 Also see the discussion in Mansoor Dailami and Paul Masson, 2009, The Multipolar International Monetary System, manuscript.

that fiscal and monetary policy alone cannot ensure a return to the levels of production that prevailed before the crisis if, as it seems likely, developed countries will recover only slowly.