Global Economic Setting

The world economy continues to be affected by the financial events in Asia in mid-1997. According to the International Monetary Fund (IMF), economic growth is expected to slow in 1998, particularly in Indonesia, Thailand and Korea.

Spillover effects — including less foreign money available for borrowing and higher interest rates on foreign borrowing — may inhibit economic activity in emerging markets outside Asia this year. However, the IMF expects growth in these emerging economies to continue.

While the outlook overall in Asia remains uncertain, the situation in many parts of Asia has stabilized and confidence may soon return to the region if the affected countries continue to pursue IMF programs. This would reduce the risk of further spillover to other countries and allow for a moderate pickup in global economic activity in 1999.

Among the G-8 summit partners, the most pronounced impact of Asian events is expected in Japan, where economic recovery was already faltering. Near-term prospects are weak, reflecting financial sector fragility and reduced foreign demand. As a result, the IMF expects little, if any, real growth in Japan in 1998. Boosting confidence and growth in Japan — particularly through financial sector restructuring and regulatory reform — is critical given Japan's importance in Asia and the world.

Events in Asia are expected to have only a modest impact on other G-8 countries. In Russia, downward pressure on the ruble following Asia's financial turbulence has subsided and official interest rates have fallen. Among the North American and European G-8 partners, the recent long-term interest rate decline is expected to support domestic demand, thereby offsetting the dampening effect of the Asian crisis on net exports. In countries that are net importers of commodities, declines in commodity prices will lead to trade gains, which will also boost domestic demand.

Reductions in export demand from Asia and declining commodity prices should reduce the risk of overheated economies in countries with high levels of resource use such as the United States and the United Kingdom. Monetary conditions in the United States and United Kingdom have been more expansionary than they would have been without the financial turbulence.

If the impact of events in Asia is less than expected, monetary authorities will have to watch out for developing inflation, to safeguard the low and stable inflation environment of recent years.