The second major risk to the outlook involves the macroeconomic policy mix of the major industrial countries. With most of the major industrial economies currently operating close to the limits of productive capacity, a premature easing of monetary policy, unaccompanied by fiscal consolidation, could lead to higher inflation — necessitating more restrictive policies in the future.

Tightening fiscal policies in countries with large budget deficits would provide the monetary authorities with greater flexibility by directly countering inflationary pressures. Achieving tighter fiscal policy, and the concomitant reduction in domestic demand, will help not only to contain inflation, but also contribute to a reduction of external deficits. In addition, a reduction in government spending would ease the upward pressure on real interest rates, reduce the debt service burden of developing countries and aid in the financing of reconstruction in Eastern Europe.