WASHINGTON—Christine Lagarde, managing director of the International Monetary Fund, said the world economy is marked by “a high degree of instability” even though prospects for global growth are better than they were a few months ago.

In an interview with The Wall Street Journal, Ms. Lagarde said the IMF, which marked down its 2012 forecast for global growth in January to 3.3%, has now marked it up to reflect improving conditions in the world economy. But she said the new forecast, to be released next week, remains more pessimistic than the one it made last September, which predicted 4% growth.

Europe remains the biggest single risk to the global economy, the former French finance minister said.

The euro-zone has taken all the right steps, she said, referring to reforms in Italy and Spain, lending by the European Central Bank and the recent agreement to enlarge the Continent’s emergency-rescue fund. “It has done it in a fragmented, piecemeal and, sometimes, too slow way. But if you compile it all together, they have done an awful lot.”

Spain and Italy, she added, “are moving now fast enough in terms of reforms. It’s a question of keeping at it. It’s one thing to pass legislation, but you really have to make sure that it is implemented on the ground. There, clearly the jury is still out.”

The interview, as well as a speech at the Brookings Institution, came as Ms. Lagarde—using a cane because of surgery to repair an injured knee—prepares for next week’s gathering of finance leaders.
ministers and central bankers at the IMF.

Ms. Lagarde noted the decline in China’s current-account surplus, the broadest measure of its trade balance. Some of that welcome development reflects weaker demand for Chinese exports because of slower growth around the world. But some reflects the long-sought increase in domestic consumption in China, which she described as “a step in the right direction.”

China’s current-account surplus has gone from 10% of gross domestic product a few years ago, to around 3%. The IMF expects China’s current-account surplus to fall to 3% from around 10% a few years ago. As the world economy recovers, the IMF expects China’s surplus to be between 4% or 5% of GDP, substantially smaller than the 7% it previously forecast.

Ms. Lagarde said, however, that it is too early to conclude that China’s currency is no longer, as the IMF has put it, “substantially undervalued.” The U.S. and others have accused China of holding the value of its currency down to make its exports more attractive.

To prepare for unwelcome turns in the global economy, the IMF had been trying to raise enough money from member countries to boost its lending capacity by $500 billion. But that has proved impossible, and the IMF is now scaling back the target by more than $100 billion, officials said. "The needs now may not be quite as large as we had estimated earlier this year," Ms. Lagarde confirmed in a speech later in the day, noting reduced global risks and the aggressiveness of the European Central Bank.

Euro-zone economies have said they would commit up to $200 billion. The U.S. isn’t chipping in, preferring to keep pressure on Europe to boost its own defenses.

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