Small uptick in growth but major downside risks remain, says IMF

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The International Monetary Fund (IMF) has forecast an increase in the growth rate for the world economy from 3.1 percent in 2016 to 3.5 percent this year and 3.6 percent in 2018.

In the opening section of its *World Economic Outlook*, prepared for the organisation's Spring meeting in Washington over the weekend, the IMF says buoyant financial markets and a "cyclical recovery" underway in trade and manufacturing have brought about the improvement of economic prospects.

The use of the term "cyclical recovery" is significant, for, as Leon Trotsky once explained, such a term refers to the operation of the business cycle, which goes through ups and downs for as long as capitalism continues to exist. Trotsky likened this cycle to breathing, which continues right up until a person dies.

As far as the longer-term outlook is concerned, however, the IMF report makes clear that none of the underlying problems that have beset the world economy since the eruption of the global financial crisis in 2008 has been resolved.

The report is titled "Gaining Momentum?" The question mark is significant because, as IMF economic counselor Maurice Obstfeld commented in a blog, while there are "upside possibilities," the world economy faces "headwinds."

According to the IMF report, "binding structural impediments continue to hold back a stronger recovery, and the balance of risks remains tilted to the downside, especially over the medium term."

There are "persistent structural problems," including low productivity growth and high income inequality, which are leading to increased pressures for "inward looking policies" in advanced countries.

No details are directly given but the reference is to the growth of protectionism, expressed in the Trump administration's "America First" agenda, Britain's exit from the European Union and the rise of right-wing economic nationalist movements in Europe and elsewhere.

Such an "inward shift" in policies could pose a downside risk, with "lower global growth caused by reduced trade and cross-border investment flows."

In his foreword to the report, Obstfeld points to the turn to protectionism "leading to trade warfare" with "zero-sum" policy approaches that "could undermine international trading relationships, along with multilateral co-operation more generally."

Among other "downside risks," the report also points to the possibility of faster than expected interest rate rises in the US, which "could trigger a more rapid tightening in global financial conditions and a sharp dollar appreciation, with adverse repercussions for vulnerable economies."

The main concern here is for corporations in emerging market economies that hold dollar-denominated debt.

The IMF's *Global Financial Stability Report* (*GFSR*), also released yesterday, expands on these themes. What emerges from its survey is that no part of the world is free from the possibility of financial turbulence, with the risks once again on the increase in the United States.

Overall, the IMF says, financial stability has improved since its assessment in October last year, with a rise in US markets and elsewhere on the back of stronger growth expectations and higher commodity prices.

But the IMF warns that "new threats to financial stability" are emerging from "elevated political and policy uncertainty around the world." In the US, if anticipated policy changes, including on tax and

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financial deregulation, are less benign than expected, then "risk premiums and volatility could rise sharply, undermining financial stability."

The report repeats the warnings running through all the IMF reports and surveys of the recent period that a shift toward protectionism in advanced economies "could reduce global growth and trade, impede capital flows, and dampen market sentiment." It states: "In Europe, political tensions combined with a lack of progress on structural challenges in the banking system and high debt levels could reignite financial stability concerns."

The IMF says markets so far have taken a relatively benign view of these risks, "suggesting the potential for a swift repricing of assets in the event of policy disappointment." In other words, an unexpected shock to the system could have major financial consequences.

Financial Times commentator Martin Sandbu noted while the IMF warnings on the European banking system are not new, "it is significant that even with upgraded growth forecasts, the fund warns that even an undisturbed recovery will not generate enough profits to make the problems go away by themselves."

One of the most significant aspects of the *GFSR* is its focus on the position of US corporations in relation to any increase in interest rates. According to one measure, the ability of companies to cover interest payments is at its weakest since the 2008 financial crisis.

The Trump administration's position is that its policy of lower taxes for corporations will lead to greater corporate investment and labour hiring, promoting economic growth. But if the administration's policies turn out to be economically "unproductive," this would lead to increased budget deficits and inflation, pushing up interest rates and leading to a higher value for the dollar, the *GFSR* says.

That would not only lead to problems for emerging market economies but could have a significant impact in the United States.

According to the IMF, US corporations have taken on $7.8 trillion in additional debt and other liabilities since 2010 and "corporate credit fundamentals have started to weaken, creating conditions that have historically preceded a credit cycle downturn."

Companies with almost $4 trillion in assets, comprising 22 percent of total assets, are vulnerable to a sharp rise in interest rates.

Already companies with 10 percent of US corporate assets are not able to meet interest payments out of their current earnings. Most of these companies are in the energy sector and had been adversely affected by the fall in commodity prices. However, the IMF notes that "the proportion of challenged firms" has broadened to include real estate and utilities.

The IMF also repeats its warnings about credit growth in the Chinese economy, which increased in 2016. Last year an IMF paper noted that credit growth in China averaged around 20 percent a year between 2009 and 2015, much higher than the growth of gross domestic product (around 7 percent) and higher than the previous trend.

This signifies that in order to achieve the same level of growth as previously a larger injection of credit is necessary. As this process cannot continually indefinitely, the fear is that it can only end in a major financial crisis in the world's second largest economy.

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