

IMF remains upbeat on global economy but trade conflicts sound a jarring note

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The International Monetary Fund has stuck to its forecasts for an upswing in global growth over the next two years, despite signs the world economy may already be slowing and the threat of disruption caused by a developing trade war.

Introducing the IMF's *World Economic Outlook*, which predicts growth of 3.9 percent for both 2018 and 2019, the fund's chief economist, Maurice Obstfeld, struck a sombre tone, somewhat at variance with that of the official report.

"The world economy continues to show broad-based momentum," he began. "Against that positive background the prospect of a similarly broad-based conflict over trade presents a jarring picture."

Obstfeld noted that it seemed "paradoxical" that major economies were "flirting with trade war" at a time of economic expansion, "especially when that expansion is so reliant on investment and trade."

While maintaining its upbeat assessment for the immediate period, the IMF pointed to longer-term downward pressures on growth, leading to a more "sobering" assessment.

"Advanced economies—facing ageing populations, falling rates of labour force participation and low productivity growth—will likely not regain soon the per capita growth rates they enjoyed before the global financial crisis," Obstfeld said.

In other words, the present situation, which has seen cuts in the real living standards of workers in all the major economies, is as good as it gets.

The report also noted that risks to medium-term growth arising from easy financial conditions remain well above historical norms and financial conditions in the United States could tighten faster than expected.

With global debt levels at an all-time high of \$164 trillion—an increase of 40 percent since the 2008 global

financial crisis—the normalisation of monetary policies and accompanying increase in interest rates could pose repayment problems in countries facing lower growth rates over the medium term. Three quarters of the increase in global private debt comes from China, as a result of its efforts to boost its economy since 2008.

Trade conflicts were another threat. "Recent import restrictions announced by the United States, announced retaliatory actions by China, and potential retaliation by other countries raise concerns in this regard and threaten to damage global activity and sentiment," the report stated.

That conflict worsened virtually as Obstfeld was delivering his remarks. The US Federal Communications Commission decided in a 5–0 vote on Tuesday to ban federal funds being spent on any telecom company deemed a threat to national security. The measure is aimed at further restricting the already limited access of the Chinese telecom giant Huawei to the US market. The move followed the Commerce Department's decision this week to impose a seven-year ban on firms dealing with another Chinese telecom company, ZTE.

China stepped up its response to the threatened US tariff measures, covering up to \$150 billion worth of exports, by announcing a 178 percent tariff on US sorghum exports that took effect yesterday.

One key factor boosting the IMF's short-term growth forecasts is the cut in corporate and personal income taxes in the US. The expected uptick in US growth was responsible for one-third of the upgrade increase in IMF predictions over last October's forecast.

But US tax policies will not raise living standards for the mass of the population. In fact, the IMF stated, they are "expected to exacerbate income polarisation."

The Trump administration claims that massive tax

cuts, which will add hundreds of billions of dollars to the budget deficit, will stimulate the economy by providing an incentive for investment. But this claim is rapidly being blown apart. Most of the money will be spent to finance share buybacks and boost stock values.

The *Financial Times* reported this week that US companies are “expected to shower investors with a record amount of share buybacks in the current earnings seasons, as corporate investors take advantage of major tax cuts... to increase their repurchases programs.”

According to a JPMorgan analysis, US companies will buy back about \$800 billion of their stock this year, up from \$525 billion in 2017.

There is also doubt over the IMF’s predictions for a short-term upturn, particularly because Europe slowed down in the first quarter of this year after experiencing the fastest rise for a decade during 2017.

According to a report in the *Wall Street Journal*: “Industrial production [in the euro zone] fell for the third straight month in February, its longest slide since 2012, and there have also been signs of unexpected weakness in surveys of purchasing managers at manufacturers and service providers, measures of retail sales, and barometers of confidence among households and businesses. The region’s biggest economy, Germany, recorded a surprising drop in industrial production in February compared with January.”

This assessment is reflected in a “tracking index” compiled by the Brookings Institution and the *Financial Times*. The newspaper reported: “Momentum in the global economy has peaked and risks ranging from higher inflation to trade disputes and debt appear likely to taint prospects for 2018.”

Eswar Prasad of the Brookings Institution said: “The world economy’s growth momentum remains strong but is levelling off as the winds of trade war, geopolitical risks, domestic political fractures and debt-related risks loom, with financial markets already reflecting mounting vulnerabilities.”

With major tax cuts, the US was “engaged in a perilous macroeconomic experiment,” Prasad said. The increase in the budget deficit resulting from the handout to corporations could force a significant rise in interest rates.

There are also fears that so-called emerging market economies will be impacted by rising interest rates in

the advanced countries, as concerns grow over rising debt and the threat of capital flight.

Obstfeld addressed this danger in a press conference question-and-answer session. “Debts throughout the world are very high, and lots of debts are denominated in dollars,” he said. “And if dollar costs rise, this could be a strain on countries’ sovereign financial institutions.”

In other words, not only will companies be threatened, but major government bodies as well.

Obstfeld also pointed to the latest data on Europe. He said there were indications of “softness” in March, after the deadline for IMF forecasts had closed.

The major topic in the Q&A session was the trade conflicts. The first questioner asked about the IMF’s definition of the trade war and how close it was.

Obstfeld replied that he did not have a formal definition of trade war, but that it is “certainly the case that the first shots have been fired” and negotiations were taking place largely on a bilateral basis.

After referring to the US Smoot-Hawley Act of June 1930, which was “devastating for the global economy,” he continued: “I think if we get into a cycle of very widespread actions and counteractions, we would begin to see significant economic effects, and that would be, whether you want to call it a trade war or not, very worrisome.”

In his prepared remarks, Obstfeld called for strengthening of the existing multilateral system “rather than risk bilateral fragmentation of international trade,” adding, “Global interdependence will only continue to grow; and unless countries face it in a spirit of collaboration—not conflict—the world economy cannot prosper.”

All the trends of development are pointing to the latter, however, rather than the former.



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