IMF revises down global growth projection

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Ten years after the global financial crisis, the *World Economic Outlook* (WEO) report issued by the International Monetary Fund this week makes clear the global economy is far removed from the growth path that existed in the years leading up to 2008.

In its two previous semi-annual reports, the IMF had pointed to synchronised global growth in 2017. While overall growth projections for 2018–19 remain above the levels for 2012–2016, synchronisation has largely petered out, with the outlook for the future on a downward trend.

Global growth is projected at 3.7 percent for 2018–19, some 0.2 percentage points lower than the forecast last April.

"The downward revision reflects surprises," the WEO stated. It referred to "suppressed activity in early 2018 in some major advanced economies, the negative effects of the trade measures implemented or approved between April and mid-September, as well as a weaker outlook for some key emerging markets and developing economies arising from country-specific factors, tightening financial conditions, geopolitical tensions and higher oil import bills."

The overall situation, the IMF assessed, was not going to improve as "growth in most advanced economies is expected to decline to potential rates well below the averages reached before the global financial crisis of a decade ago."

While the WEO predicted that global expansion would continue over the next two years, it would be much less synchronised than in 2017, which saw the biggest increase in growth since the rebound of 2010.

"A smaller share of countries, particularly among advanced economies" was expected to experience an acceleration of economic activity in 2018. The report noted that among the advanced economies, growth "disappointed" in the euro area and in the UK, with the latter experiencing lower growth than had been anticipated.

The only exception to this overall trend was the United States where growth was expected to remain elevated until 2020 as a result of what the IMF called a "sizable fiscal stimulus"—the massive corporate and personal income tax cuts enacted by the Trump administration, which have increased the US budget deficit.

But like a shot of adrenalin, the effects would not last. The pace of economic expansion was expected to slow "as the stimulus reverses and reinforces the effect of ongoing monetary tightening" flowing from the US Federal Reserve's moves to increase interest rates. Growth in the US was expected to fall to the somewhat anaemic level of 1.8 percent in 2020, with growth expected to further drop to 1.4 percent in later years.

The WEO noted that a "core element" in the upsurge in global growth and trade in 2017 was the pickup of investment in the advanced economies and an "end to investment contractions in some large, stressed commodity exporters." But this pace of expansion was expected to decline in 2018–19 compared to last year, "with a more notable decline in trade growth."

The report pointed to "rising trade tensions and policy uncertainty" which could lead firms to postpone or forgo capital spending and "hence slow down growth in investment and demand." High frequency data, such as the purchasing managers' indices, pointed to a "slowdown in international trade and industrial production." The IMF revised down its forecast for fixed investment growth in advanced economies by around 0.4 percentage points from its prediction of six months ago.

According to the WEO, the "balance of risks" to the global forecast has shifted to the downside in the context of "elevated policy uncertainty." Risks the IMF identified earlier, including rising trade barriers and a reversal of capital flows due to a tightening of monetary settings, "have become more pronounced or have partially materialized."

The report warned that "escalating trade tensions and the potential shift away from a multilateral rules-based trading system are key threats to the global outlook." In rather understated language, it said "a cooperative approach to reduce trade costs and resolve disagreements

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has so far proved elusive," with the US imposing tariffs on a variety of imports and its trading partners undertaking retaliatory action.

Having marked down its predictions for growth in emerging markets and developing economics by 0.2 and 0.4 percentage points respectively, the WEO said the main source for the revision was the "negative expected impact of the trade measures" on activity in China and other economies in emerging Asia.

With the protectionist rhetoric in the US now having turned to action, the report stressed that the escalation of trade tensions could reach a point where "systemic risk" to the global economy was a "distinct possibility without policy cooperation."

But there is no prospect for such cooperation because the eruption of trade conflicts is itself an expression of sharpening economic and geo-strategic rivalries.

The WEO instead concluded that tightening monetary conditions in the US, a stronger US dollar and a larger US current account deficit risk "aggravating trade tensions." This could lead to a faster tightening of global financing, with "negative implications for emerging market economies, especially those with weak external positions."

Financial risks had increased because an "extremely supportive financial environment" in the years since the financial crisis had rendered the global economy vulnerable to "sudden tightening of financial conditions." This was a reference to the ultra-low interest rate regime and the pumping of trillions of dollars into the financial system by the world's major central banks.

The report noted that measures of "equity valuations," such as the US stock market, appeared "stretched," leading investors to move into riskier assets in search of yield. "Across many economies, government and corporate debt is substantially higher than before the global financial crisis" and in "some emerging markets, there are concerns about rising contingent liabilities."

Under conditions of tightening interest rates and rising uncertainty, the IMF said the risk of contagion had increased and not only in emerging markets. The report cited the rise in yields (increased interest rates and lower bond prices) on Italian sovereign debt as "a case in point."

"A significant further decline in sovereign bond prices, with possible contagion effects, would impose valuation losses on investors, worsen public debt dynamics, and weaken bank balance sheets, reigniting concerns about sovereign-debt feed-back loops in the euro area," the WEO stated.

A chapter in the report outlined the economic impact of the global financial crisis. It drew out that the effects have been long lasting and extend well beyond the countries that experienced a banking crisis.

Some 91 countries, representing two-thirds of global economic output, experienced a contraction in 2009, making the crisis the biggest economic shock in the post-war period.

Comparing the fall in output with the pre-2008 trend, the IMF said 24 countries that experienced a banking crisis, 18 of which were high-income countries, were still showing a shortfall relative to the preceding trend. Relative to the pre-crisis trend, the average shortfall was around 10 percent, but in some cases it was between 20 and 40 percent.

The main reason for the fall in production was the collapse in investment, which was down by an average of 25 percent compared to the pre-crisis trend. And the fall in output would have been greater if not for the massive economic stimulus provided by China, equivalent to around 10 percent of its gross domestic product.

Writing on this aspect of the IMF report, *Financial Times* columnist Martin Wolf concluded: "'Never again' must be the watchword."

As the IMF survey makes clear, however, this remains nothing more than a pious hope. That is due to the increase in global indebtedness, the continued vulnerability of the world economy to financial shocks, and the ongoing breakdown of the international trading system, to name just some of the major trends.

The disease that struck the world capitalist economy a decade ago has not been cured, it has simply assumed more malignant forms.

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