IMF upgrades growth forecast but "vulnerabilities" remain

Nick Beams
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The International Monetary Fund has upgraded its forecast for global economic growth prompting claims, as articulated in the *Financial Times*, that "most advanced economies will emerge from the coronavirus with little lasting damage," thanks to the roll out of vaccines and the sharp increase in public spending and borrowing.

However, closer examination of the reports published for the spring meetings of the IMF and the World Bank being held this week reveals that the world economy as a whole, including the advanced countries, is far from attaining a post-pandemic equilibrium.

The IMF projected what it called a "strong recovery" for the global economy in 2021, upgrading its forecast for growth by 0.5 percentage points to 6 percent and predicting a 4.4 percent rise for 2022. But it warned that the "outlook presents daunting challenges related to the speed of recovery both across and within countries and the potential for persistent economic damage from the crisis."

It has estimated that the global economy suffered an "historic contraction" of 3.3 percent in 2020.

It reported that cumulative per capita income losses over 2020-2022, compared to pre-pandemic forecasts to be equivalent to 20 percent of 2019 per capita GDP for emerging markets and developing economies (excluding China) and 11 percent for advanced economies.

The impact of the pandemic has reversed poverty reduction with an additional 95 million people entering the ranks of the extremely poor in 2020 and 80 million more becoming undernourished.

The IMF noted that the main reason for its global growth upgrade was the forecast for increased output in the advanced economies, particularly for the United States where growth is expected to be 6.4 percent this year, a significant rise of 1.3 percent on previous projections.

Higher than expected growth was due to the easing of lockdowns in most regions for the second half to the year. However, it said that "high uncertainty" surrounded the global economic outlook primarily related to the pandemic.

"Further developments will depend on the path of the health crisis, including whether the new COVID-19 strains prove susceptible to the vaccines or whether they prolong the pandemic."

Demonstrating the indifference in ruling circles to the health and well-being of the population, the IMF significantly failed to point out that the easing of lockdowns and the lack of meaningful measures to deal with the pandemic—the main factors in increased growth and profits—have resulted in continuing surges in its spread and the development of new, more infectious and dangerous virus mutations.

On the issue of vaccine distribution, it made the pro forma statement that "first and foremost" countries had to work together to ensure widespread vaccinations around the world. Then, however, it had to immediately acknowledge this was not taking place, noting that vaccine access was "deeply iniquitous" with high-income countries with 16 percent of the world's population having pre-purchased 50 percent of the doses.

Pointing to "divergent recovery" paths, the IMF said they would likely create "wider gaps" in living standards across countries compared to pre-pandemic conditions.

Inequality will rise, not only between countries but within them. This is because "young workers and those with relatively lower skill remain more heavily affected, not only in advanced, but also emerging markets and developing economies."

In her blog post on the report, IMF chief economist Gita Gopinath noted that "because the crisis has accelerated the transformative forces of digitalization and automation, many of the jobs lost are unlikely to return, requiring worker reallocation across sectors—which often comes with severe earning penalties."

Reports on the financial situation pointed to the dangers of "financial vulnerabilities." The IMF estimated that without the $16 trillion worth of fiscal support by governments and the $10 trillion injected into the global financial system by central banks the impact of the pandemic on the global economy could have been three times larger.

The *Global Financial Stability Report*, said what it called "massive policy support" had led to an easing of financial conditions and kept risks at bay. But notable downside risks to future GDP growth remain.

It said the unprecedented financial support may have unintended consequences with "excessive risk taking" in markets contributing to "stretched valuations" and warning that "rising financial vulnerabilities" may become structural problems.

Equity markets had rallied strongly since the third quarter of 2020 and "are now trading at levels meaningfully higher than those suggested models based on fundamentals." In other words, the stock market boom bears little or no relation to the state of the underlying real economy and is the result of the trillions of dollars of ultra-cheap money injected into the financial system by the world's major central banks.

US government debt has increased, prompting a rise in long term interest rates as reflected in the rise in yield on the 10-year US Treasury bond from just over 0.5 percent last August to around 1.75 percent. As a result, concerns have been growing about the impact of these increases on the stability of the global financial system.

The IMF's financial report noted that while a rise in interest rates on the back of improving fundamentals may be welcome, "a rapid and persistent increase, especially in real rates, may result in a repricing of risk in markets and a sudden tightening in financial conditions.

"Such a tightening could interact with elevated financial vulnerabilities, with repercussions for confidence and endangering macro-financial stability, especially in emerging markets."

In other words, because the financial system, including the rapid expansion of corporate debt, has become so dependent on cheap money, even a small rise in interest rates, if it takes place rapidly, can have major consequences.

This issue was also raised by Gopinath in her blog. She warned that if interest rates rose further in the US in unexpected ways, "this could cause inflated asset valuations to unwind in a disorderly manner, financial conditions to tighten sharply, and recovery prospects to deteriorate, especially for some highly leveraged emerging markets and developing economies."

There are also rising concerns in the advanced economies as well, especially in Europe where the increased holdings of inflated government debt by major banks have revived fears of the re-emergence of the crisis which threatened the collapse of the euro in 2012.

The holdings by major banks of government debt created a situation where a vicious circle, dubbed a "doom loop," developed in which they mutually weakened each other. A rise in interest rates weakens the banks because it lowers the value of the government bonds they hold, while the government is in turn weakened by the problems of the banks.

Bank holdings of government debt declined somewhat after the crisis but are now on the rise again with the issuing of more debt by European governments in response to the pandemic, with total indebtedness now passing 100 percent of GDP for the first time.