IMF concerned over inflation and push for higher wages

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The International Monetary Fund has warned of growing inflationary pressures in the global economy, making clear its greatest concern is that rising prices will lead to a push for higher wages.

The warnings are contained in the latest projections in the Fund's twice-yearly *World Economic Outlook* report prepared for the IMF-World Bank meetings being held in Washington this week and in comments by IMF chief economist Gita Gopinath.

In a blog post, Gopinath said the global recovery from the pandemic continued but it was being "hobbled" by the spread of the Delta variant. "Health risks abound, holding back a full return to normalcy. Pandemic outbreaks in critical links of global supply chains have resulted in longer than expected supply disruptions, feeding inflation in many countries. Overall risks to economic prospects have increased and policy trade-offs have become more complex," she wrote.

These trade-offs refer to the monetary policy of the US Fed and other major central banks. On the one hand, rising inflation leads to a push for a tighter monetary policy but, on the other, it threatens to destabilise financial markets, which have become ever more dependent on the inflow of cheap money, and to bring about a recession.

"Monetary policy," Gopinath commented, "will need to walk a fine line between tackling inflation and financial risks and supporting the economic recovery.

"While monetary policy can generally look through transitory increases in inflation, central banks should be prepared to act quickly if the risks of rising inflation become more material in this uncharted economic recovery."

She elaborated further on this issue in comments made to the *Financial Times*, saying central banks should act if there were signs that companies, households and workers started to expect higher inflation to continue, with energy prices of particular concern.

"What [central banks] have to watch out for is the second-round effects [with] these increases in energy prices feeding into wages and then feeding into core prices. That's where you have to be very, very vigilant," she said.

The IMF report insisted that central banks should act to curb inflation—and by implication the push for higher wages—through the tightening of monetary policy even if employment was still weak.

"A spiral of doubt could hold back private investment and lead to precisely the slower employment recovery central banks seek to avoid when holding off on policy tightening," it stated.

Gopinath's blog post also pointed to a "great vaccine divide" and a "dangerous divergence" in economic prospects. While aggregate output for advanced economies was expected to reach its pre-pandemic path by 2022, emerging market and developing economies (excluding China) would remain 5.5 percent below pre-pandemic projections in 2024.

While almost 60 percent of the adult population in advanced countries were fully vaccinated, about 96 percent of the population in low-income countries were unvaccinated.

According to Gopinath, if COVID-19 were to have an impact into the medium-term "it could reduce global GDP by a cumulative $5.3 trillion over the next five years relative to our current projections."

She called for the stepping up of efforts to ensure equitable vaccine access for every country in order to secure better economic prospects for all.

However, there is no sign of this taking place.

In its financial stability report, the IMF warned that financial markets and emerging economies were vulnerable to a sudden increase in borrowing costs if central banks needed to lift interest rates because of rising inflation.

It said an abrupt and sustained rise in interest rates from low levels, particularly in the US, “could trigger a tightening of global financial conditions” that would interact with existing financial vulnerabilities and lead to a “sharp fall in asset valuations.”

The IMF-World Bank meeting—a virtual gathering due to the pandemic—began in unprecedented circumstances with the very real prospect of the fund’s managing director, Kristalina Georgieva, being removed from her post as proceedings were about to begin.

Georgieva was under examination by the IMF’s executive board. An investigation by the US law firm WilmerHale claimed during her time as a senior executive at the World Bank, prior to her appointment as the fund’s chief in 2019, she manipulated data to lift China’s rating in the bank’s 2018 *Doing Business* report.

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Georgieva rejected the findings and her supporters, including former World Bank chief economist Joseph Stiglitz, denounced the WilmerHale findings as a “hatchet job.” International economist Jeffrey Sachs said she had been targeted because she was “not a sworn enemy of Beijing.”

Within the IMF, Georgieva received support from European countries led by France which had played the central role in securing her IMF appointment in 2019.

Faced with a prospect of another conflict with Europe the US, the fund’s largest shareholder decided to back down, at least for the present.

On Monday, after a series of eight long meetings, stretching over a week, the 24-member IMF executive board issued a statement saying it had “full confidence” in her ability to carry out her duties as managing director.

However, according to a report in the FT, citing people briefed on the discussions, the decision was close. While the executive board statement expressed confidence in Georgieva it left open the possibility for future moves against her. It stated that the evidence presented “did not conclusively demonstrate” that she had played an “improper” role in lifting China’s ranking in the *Doing Business* report.

While forced to back down, the US has made it clear that so far as it is concerned the conflict is not over.

In a phone call to Georgieva on Monday, US Treasury Secretary Janet Yellen said the WilmerHale report had raised “legitimate issues and concerns” but that “absent further direct evidence with regard to the role of the managing director there is not the basis for a change in IMF leadership.”

Yellen effectively put Georgieva on notice. She said the US Treasury would “monitor, follow up closely, evaluate any new facts or findings” and that the issue highlighted the “need for shareholders to be vigilant in defending the integrity of both the bank and the fund.”

The issue was never about a few points in the *Doing Business* report but centred on China’s increasing role in global institutions which is seen by the US as undermining its dominance. At present the US is the dominant shareholder in the fund holding more than 16 percent while China, the world’s second largest economy and rapidly approaching the size of the US, holds around 6 percent.

Across the entire political establishment, there is vociferous opposition in the US to any move to increase China’s influence in the IMF and other global institutions. It was summed up in a recent editorial in the *Wall Street Journal* in which it said China’s economic rise would give it more sway in global bodies such as the IMF and the World Bank, but China had “the habit of turning these institutions to serve the interests of the Communist Party.”