IMF report: Threat of a financial crisis hangs over slowing global economy

Nick Beams
11 April 2023

The world economy is nowhere near a return to pre-COVID growth rates and is under the continual threat that a major financial crisis can rapidly upend whatever limited expansion there may be. That is the situation laid out in the *World Economic Outlook* (WEO) report of the International Monetary Fund released yesterday.

In his blog post on the report, IMF chief economist Pierre-Olivier Gourinchas started by trying to put the best face on a worsening situation. The global economy's "gradual recovery" from the pandemic and the effects of the Ukraine war was "on track," supply chain disruptions were unwinding, the disruption in food and energy markets was receding and inflation was starting to move back to targets.

But it was all downhill from there. The IMF forecast "feeble and uneven" global growth of just 2.8 percent this year, compared to the 3.4 percent last year with the major economies expanding by only 1.3 percent. It forecast a slow rise until the growth rate reached 3 percent five years out "the lowest medium-term forecast in decades."

The outlook could be much worse because this "baseline forecast" assumed that the "recent financial sectors stresses are contained" – a prospect that is far from guaranteed.

In his foreword to the report, Gourinchas warned that while there was the appearance of a gradual recovery "below the surface, however, turbulence is building, and the situation is quite fragile, as the recent bout of banking instability reminded us."

Inflation, he said, was "much stickier than anticipated even a few months ago," downside risks dominated and "the fog around the world economic outlook has thickened." This is the result of the turn in central bank policy from the near-zero interest rate regime, initiated after the global financial crisis of 2008, to interest rate hikes.

He said it was "worrisome" that the "sharp policy tightening" of the past 12 months was starting to have "serious side effects for the financial sector" because it "triggered sizable losses on long-term fixed income assets."

In a telling sentence he continued: "The stability of any financial system hinges on its ability to absorb losses without recourse to taxpayers' money."

By this measure the global financial system is heading for bankruptcy. While government funds were not directly used, massive financial resources had to be mobilised both in the British pension fund and bond market crisis of September last year and the collapse of Silicon Valley Bank and Signature Bank last month.

"The financial instability last fall in the gilt market in the United Kingdom and the recent banking turbulence in the Unites States with the collapse of a few regional banks," Gourinchas wrote, "illustrates that significant vulnerabilities exist both among the banks and nonbank financial institutions. In both cases the authorities took quick and strong action and have been able to contain the spread of the crisis so far. Yet the financial system may well be tested again."

In an interview with the *Financial Times*, he referred to events leading to the global financial crisis of 2008.

"We can all remember the long time between the failure of an individual institution, whether it was Bear Stearns or Countrywide. Every time, this was treated like an isolated incident, until it wasn't."

The IMF report pointed to the connection between financial crises and the underlying real economy. "Risks to the outlook are heavily skewed to the downside, with the chances of a hard landing having risen sharply."

Financial sector stress could "amplify and contagion could take hold," weakening the real economy "through a sharp deterioration in financing conditions." At the same time, "core inflation could turn out to be more persistent than anticipated requiring even more monetary tightening."

Despite the turmoil it is causing in financial markets, the IMF is insisting that the central bank interest rate increases continue as the key component of the so-called fight against inflation – in reality a program aimed at suppressing the wages struggles of the working class.

Gourinchas acknowledged that wage rises were not the cause of inflation – he could hardly do otherwise given the vast array of data which underscores this fact – and noted that "corporate margins have surged in recent years."

"Nominal wage inflation," he wrote, "continues to lag far behind price inflation, implying a steep and unprecedented decline in real wages."

But while it is never publicly acknowledged, the IMF, as with all the other global capitalist institutions, maintains a firm focus on the class struggle and Gourinchas noted that given the "tightness" of the labour market this was not likely to continue.

He did not make direct reference to it, but fear of the growing upsurge by the working class is the driving force behind the monetary tightening regime of the world's major central banks.

But as has already been seen, the interest hikes have provoked major financial turmoil, with the prospect of more to come.

The global economy, the IMF said, was entering a "perilous phase" in which economic growth remained low by historical standards while inflation had "not yet decisively turned the corner," in which it put the probability of a "severe downside scenario" at 15 percent.

The appropriate course of action, he said, depended on the state of the financial system. So long as it remained stable, monetary policy should continue on the present tightening regime but should a "systemic financial crisis loom large" then a "careful timely recalibration of policy will be needed to safeguard both the financial system and economic activity."

In essence, what this economic jargon means is that while there should be no let up in the war against the working class – systemic crises always mean a worsening of its position as 2008 so clearly demonstrated – the monetary taps should be turned on to prop up the banks and the myriad of non-bank financial institutions.

The longer term outlook is also being hit by the rise of geo-political tensions, building up for some time but accelerating with the Ukraine war, which have led to what the IMF calls geo-economic fragmentation, the effects of which it devotes a chapter in its latest WEO report.

Summarising the results of that analysis in his foreword, Gourinchas warned that some of the recent slowdown may reflect "ominous forces," including the scarring impact of the pandemic, rising trade tensions, less direct investment and a slowed pace of innovation and technology development across fragmented "blocs."

"A fragmented world is unlikely to achieve progress for all or to allow us to tackle global challenges such as climate change or pandemic preparedness. We must avoid that path at all costs," he wrote.

But from avoiding this path, the ruling capitalist oligarchies and financial elites, for which the IMF is one of the key representatives, is laying it down, a fact of economic and political life underscored in its latest WEO report.