Sustaining momentum in uncertain times

The world economy is currently witnessing a strong upswing. Mitsuhiro Furusawa considers policy priorities to maintain momentum

www.worldcommercereview.com

The world economy is currently witnessing a strong upswing and a broad-based acceleration not seen since the global financial crisis. Yet, as the IMF warned back in April, there were risks looming on the horizon that could derail this recovery. Some of these risks are now closer than we had anticipated, injecting new urgency on policy actions to sustain the momentum and resilience of the global economy.

These are the issues I would like to cover:

The global economy – stronger, broader momentum

Let me start with the outlook. The global economy has gained momentum, driven by stronger investment, a rebound in trade, and favourable financial conditions. The recovery is also broad-based: 120 countries saw stronger growth last year, accounting for three-quarter of world GDP.

Our latest forecast in April therefore projected the global economy to grow by 3.9 percent in 2018 and 2019 – 0.2 percent higher than our forecast last October. This acceleration is driven by both advanced countries and emerging and developing economies.

Advanced economies are projected to grow above medium-term potential this year and next. In the United States, which is already at full employment, expansionary fiscal policy will boost growth further to 2.9 percent this year and 2.7 percent in 2019.

Japan's economy is also growing, despite a soft patch earlier in the year. And emerging Asia will continue grow strongly, at about 6.5 percent in both 2018 and 2019 – led by China and India.

www.worldcommercereview.com

In advanced Europe our April *Regional Economic Outlook* projected growth at 2.3 percent this year. Since then however, weaker than expected growth earlier in the year and several emerging risks point to a possible downward revision. Nonetheless, growth remains solid and well above potential.

At the same time, emerging Europe will see sustained momentum in 2018 and 2019, albeit at a slower pace than last year. Importantly, the momentum is widely spread across the region, with all European countries growing for the first time since the global financial crisis.

Challenges, however, remain in other emerging and developing countries, including in sub-Saharan Africa and the Middle East, even as commodity exporters experience a modest upswing.

www.worldcommercereview.com

We need a renewed spirit of dialogue and cooperation to avoid protectionism, sustain the global upswing, and make it more inclusive

So, the overall picture for the global economy is bright – for now. But there are risks and uncertainties clouding the horizon.

Rising risks and uncertain prospects

For one thing, the momentum projected for 2018 and 2019 is temporary. It is expected to fade as fiscal stimulus unwinds in countries such as the United States and China. It will also fade as interest rates rise and financial conditions tighten with monetary policy normalization by major central banks.

Yet there are other vulnerabilities building up that can further threaten this momentum. I can see three such risks. The first is the risk of high debt. Based on the analysis in our April *Fiscal Monitor*, global debt – both public and private – has reached at an all-time peak of US$164 trillion. This is equivalent to 225 percent of global GDP.

Global debt is now 40 percent higher than its level in 2007, when it stood at about US$116 trillion. Private debt has been a major driver of this buildup, accounting for up two thirds of total debt.

Yet public debt dynamics are also worrisome, especially in advanced economies. At 105 percent of GDP, public debt is at levels not seen since the Second World War.

In emerging and middle-income economies as well, public debt has increased to levels seen only during the 1980s' debt crisis. Yet at almost 50 percent of GDP in 2017, this debt is projected to rise even further in coming years.

And for many low-income countries, debt burdens will become unsustainable if recent trends continue. Close to 40 percent of these countries are at risk for high debt distress – leaving them with fewer resources to achieve development goals, as governments spend more on debt service than on infrastructure, health, or education.

www.worldcommercereview.com

www.worldcommercereview.com

These high levels of debt are at the root of rising financial vulnerabilities – the second source of risk.

High debt burdens leave governments, companies and households more exposed to sudden tightening of financial conditions. Such potential shift could trigger market corrections, debt sustainability concerns, and capital flow reversals in emerging market economies.

Analysis in the April *Global Financial Stability Report* suggested that capital flows to emerging markets could decline by as much as US$60 billion in the event of tightened liquidity. This is about a quarter of total annual flows in 2010-17. In such a scenario, less creditworthy borrowers are expected to experience relatively larger capital outflows. In fact, during the recent bout of emerging market volatility, capital flow reversals have been larger in countries with relatively weaker fundamentals.

The third risk – and one that is dominating the public debate – is that of protectionism and the rise of inward-looking policies. The prospect of trade restrictions and counter-restrictions threatens to undermine confidence and derail global growth permanently.

In Europe, political uncertainty about Brexit and policy complacency, especially in countries with high public debt, risk diverting attention from the steps needed to strengthen the institutional underpinnings of the currency union.

If we add to these risks the challenges from aging populations and weak productivity growth, we can see a rather sobering medium-term outlook – especially in advanced economies.

This means that these countries will not regain the per capita growth rates they experienced before the global financial crisis. Economic inequality, debt concerns, and political polarization could get worse.

The bottom line is: there is momentum in the global economy, but risks and uncertainties to this momentum have risen. The window of opportunity may be narrowing. Policymakers need to act decisively to strengthen the resilience of the global economy and boost prospects for all.

Policy priorities to sustain global momentum

What does this mean in practice? It means three priorities: build policy buffers, step up structural reforms, and steer clear of protectionism. Let me elaborate on each in turn.

First, countries need to build policy buffers and create more space to act in the event of a downturn. This means reducing government deficits, strengthening fiscal frameworks, and placing debt on a downward path. Such policies should be done in a growth-friendly way through more efficient spending and progressive taxation.

Building policy space also calls for stronger financial policy tools. Increasing buffers in corporate and banking sectors can help strengthen financial stability. Corporate debt should be reduced, and capital and liquidity boosted where needed.

Next, countries need to step up structural reforms, especially in labour markets and service sectors. Our recent *World Economic Outlook* analysis shows that productivity levels in some service sectors – such as transportation, communications, and business services – can match those in manufacturing. A key feature of these sectors is their higher tradability.

This means that opening up service sectors can help boost productivity and long-run growth in many countries. It can also help prevent a relapse to disappointing medium-term growth in advanced economies, and enable emerging and developing economies to catch up to advanced economy income levels.

www.worldcommercereview.com

Yet unleashing the full benefits of the service sector requires action at the global level as well. We need to increase trade in services, where tariffs and barriers remain extremely high. This means that – as a third priority – countries must steer away from protectionism.

The intensification of trade tensions between major advanced and emerging economies is calling into question the international framework that has served the world well over the past several decades.

Yet each country can do more to promote sustainable trade and reduce excessive global imbalances. For example, the United States could gradually control the dynamics of public spending and increase revenue. This would help reduce fiscal deficits and contribute to lowering excessive global imbalances.

On the European side of the Atlantic, Germany could use its excessive savings to boost long-run growth by increasing investments in physical and digital infrastructure. At the same time, concerns about inequitable trade practices, including intellectual property rights, are legitimate. Yet, these concerns should be resolved within a strong and dependable rule-based multilateral framework – rather than risk bilateral fragmentation of international trade.

Of course, there is room to improve the current system. After all, the international framework is only as strong as its members' policies.

Each country has a responsibility to improve the trade system by addressing unfair trade practices and committing to a level playing field. This means stronger protection of intellectual property and reducing distortions from policies that favour state enterprises.

www.worldcommercereview.com

Beyond actions to preserve the international trade system, countries must also ensure that there are policies to help those who have suffered from dislocations, whether by trade or technological advances. Investment in education, training, and job-search assistance can help temper the public sentiment in many places of being left behind.

Conclusion

These are challenging times for policymakers. The IMF stands ready to support its members as they confront uncertainties and threats to the multilateral system – by offering analysis, advice, and a platform for dialogue and cooperation. We need a renewed spirit of dialogue and cooperation to avoid protectionism, sustain the global upswing, and make it more inclusive. ■

Mitsuhiro Furusawa is an IMF Deputy Managing Director

This article is based on a speech delivered at the Czech National Bank, Prague, June 28, 2018

www.worldcommercereview.com