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Center for Geoeconomic Studies

Global Economics Monthly
November 2016

Message From IMF Meetings: Not Our Fault!

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OVERVIEW

Bottom line: The Group of Twenty (G20) policymakers agree on the importance of stronger and more inclusive growth to address growing populism, but disagree on who—central banks, treasuries, or legislatures—should take the lead. This standoff all but guarantees that the global recovery will continue to disappoint.

Last month's International Monetary Fund (IMF) and World Bank meetings were sober affairs. The IMF repeated its call for all economic policy levers—monetary, fiscal, and structural—to boost growth. This move would reduce slack in the global economy and blunt rising discontent, primarily but not exclusively in the industrial world, where the slowdown in trade and changes in technology are having damaging effects on jobs and income. Addressing the root causes of inequality is at the core of the Fund's call for "inclusive" growth.

Few economists or policymakers disagree with the message of economic growth, and the Fund's management has been repeating it with increasing urgency throughout the year. Sadly, though, G20 and IMF meetings have yet to produce a policy package that would meet the Fund's lofty ambitions. The lack of (decisive) action at these latest meetings reflected a broad-based understanding that the IMF's calls would again go unheeded.

Still, there was something different about the most recent meetings; central bankers and finance ministers publicly sparred over who was to blame for anemic growth and who was responsible for providing additional policy stimulus to support demand. Out of this debate, a new impossible trinity, or policy "trilemma" has emerged, summarized by the following views:

More inclusive growth, less monetary support, and restrained fiscal policy cannot simultaneously be true.

- Growth needs to be inclusive: more growth, and more inclusive growth, is needed to maintain popular support for mainstream policies and governments.
- Monetary policy can't carry the full burden: with increased concern about the effectiveness of unorthodox monetary policies, a policy rebalance is needed to take the pressure off central banks to drive growth.
- Fiscal policy must remain restrained: fiscal authorities, already easing policies in response to recessionary pressures or elections, believe that they have limited room to add to demand. In addition, structural reform has stalled in many countries, raising concerns that any fiscal support will be short term.

Although each of these three views is controversial, together they represent the current dominant view of policymakers in the developed world. But these three aspirations—more inclusive growth, less monetary support, and restrained fiscal policy—cannot simultaneously be true. Consider each in turn.

INCLUSIVE GROWTH UNREALIZED

The concept of inclusive growth has led the policy debate for some time. Although it has no single definition, in the developed country context it usually signals a concern that low growth in the years following the great

recession, coupled with rising inequality, has resulted in some populations being left out of the recovery and has fed the populist backlash that many governments are now facing.

An added concern at this year's meetings was that anti-trade forces have reached a critical point and threaten a material rollback in globalization. Data suggesting a slowdown in trade flows, rising evidence of protectionism, and anti-trade sentiments in the U.S. presidential election attest to a broader turn in the global economy. Consequently, the debate at the meetings focused on how to maintain support for a globally integrated economy by addressing the dislocations produced by trade and technology. My colleague Ted Alden compellingly addresses these concerns. The backdrop of anti-trade sentiment also gave the discussion a distinctively political cast. The IMF has historically shied away from politics, but it choose to explicitly confront anti-trade rhetoric this year.

From this perspective, the global economic outlook is not promising. Although the forecast for developed country growth was unchanged for this year, the outlook for next year and beyond was once again lowered and, with mediocre growth forecasted, little additional progress is expected in reducing unemployment where large amounts of economic slack exist. Particularly in Europe, where growth is expected to average only around 1 percent, populist resentment is intensifying. An improved emerging market outlook provided a boost to growth, but even their forecasted recoveries are partly the result of countries such as Brazil and Russia coming out of recessions, rather than a strong recovery, and an array of political risks constrain optimism.

MONETARY POLICYMAKERS SEEK TO HAND OFF THE BATON

Central banks rightly are credited with being the primary source of policy stimulus in recent years, but questions are now being raised about whether central banks are nearing the limits of what unorthodox monetary policies can do. In part, this view reflects a reassessment of how asset purchase programs and negative interest rates stimulate demand. In addition, policymakers are increasingly concerned that persistent low or negative interest rates will have adverse side effects, including weakened bank profitability, for financial stability.

Central bankers (and the IMF) used the meetings to acknowledge these concerns and send a clear message that while they are not out of ammunition, they are being overstretched and should not be assumed to be able to continue being the first line of defense in dealing with shocks. This view is not uniformly held among central bankers. Janet Yellen, notably, has argued against the idea that the monetary policy toolkit is empty. I have expressed skepticism in the past as well that monetary policy is overstretched, but overall the message here was clear—fiscal authorities have to do more.

FISCAL POLICY CAN DO MORE

The IMF's ire is aimed at fiscal policymakers who are seen to have the space to expand policy, but are not yet doing more. Germany in particular has been criticized for adhering to a balanced budget rule despite large eurozone output gaps and a large current account surplus. German policymakers argue that a fiscal expansion would be irresponsible, though there were hints that some action, perhaps a tax cut, could be put in place ahead of Germany's elections next fall.

In my last monthly, I noted a quiet fiscal expansion that was taking place across most of the Group of Seven (G7) countries. If anything, recent developments (and statements by finance ministers at the meetings) suggests even more stimulus is now in progress. This reflects a range of motivations, including preelection spending (France, Germany), a reaction to Brexit (United Kingdom) and growing populist objections to austerity elsewhere (Italy), and evidence of faltering growth (Japan). Even in the United States, both candidates have offered proposals for increased spending, and though a divided Congress (which markets now expect to continue) is likely to put the brakes on such ideas, there would seem to be a bipartisan consensus to ease spending caps in fiscal year 2018, which would provide a modest fiscal boost.

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Still, the fiscal stimulus ahead is unlikely to produce a meaningful boost to growth, and absent supportive structural reforms—including labor market reforms that make mobility easier and retrain those displaced by technology—is unlikely to produce inclusive growth. Fiscal policy always has been a poor tool for fine-tuning growth support, and this appears to be no exception.

This is the heart of the trilemma. If monetary policy pulls back on the support that it has provided, or even stays where it is, and fiscal policy is restrained, aggregate demand will be insufficient to produce inclusive growth given the political and economic headwinds facing the global economy.

CONCLUSION

The IMF and World Bank annual meetings disappointed those hoping for more growth-supportive policies from the G20. Central bankers say they have done about all that they could. Fiscal authorities are hinting at additional stimulus, though largely for idiosyncratic reasons, not in a coordinated fashion and certainly not the kind that the IMF considers right. Structural policies are, in many respects, going backward. It is hard to see this as a recipe for addressing the loss of trust policymakers now face.

Central banks can and will continue to provide substantial stimulus, but fiscal policymakers need to do more. If G20 leaders are serious about providing inclusive growth, they should forsake restrained fiscal policies and instead adopt policies that might seem irresponsibly expansionary from a national perspective. That is the way to resolve the trilemma.

Looking Ahead: Kahn's take on the news on the horizon

Venezuela

A sweetening and repeated extensions of PDVSA's offer to swap its 2017 bonds allowed a deal to be completed, though with low participation, providing limited breathing space. A future default is still inevitable.

Deutsche Bank

Deutsche Bank remains under pressure, amid concerns about its weak balance sheet and the potential \$14 billion penalty from the U.S. Justice Department. Is it systemically important? The continuing deterioration of confidence could lead to further asset selloff and financial instability in Europe and beyond.

Renminbi

The renminbi (RMB) has officially joined the special drawing rights basket of the IMF. It is a largely symbolic move, though, along with the first offshore clearing center of RMB recently opened in the United States, it could signal a risky move to capital account liberalization.