

# 2018 IMF/WB Fall Annual Meetings – Growth boost fading, heightened risks

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- The IMF/World Bank Fall annual meetings took place last week in Bali, Indonesia
- Global growth still solid, but slowing down and in a less synchronized way
- Geopolitical risks and the removal of monetary stimulus in advanced economies are heightening risks in many parts of the world
- Rising geopolitical risks have gone beyond populist rhetoric, towards protectionism, anti-migration actions, and separatism, are now questioning the very fundamental aspects that have ruled the world economy for a long time
- A complex combination of monetary restriction, protectionism, and other country-specific issues are increasing the risk of a global deceleration
- Higher crude oil prices are also becoming part of the complexities the world is currently experiencing
- A very important risk is that if a global crisis strikes, the world does not seem to be prepared to tackle it
- Unfortunately, all the above mentioned issues are 'distracting' the world to focus on much more important goals such as climate change, the impact of the technological revolution, economic development, and income-inequality reduction
- We perceived optimism about Mexico, but with rising concerns
- All in all, the main message we extracted is to expect higher volatility levels ahead

Document for distribution among the general public

**IMF/WB Fall meeting 2018.** Last week, the island of Bali, Indonesia, hosted the International Monetary Fund (IMF) and World Bank (WB) annual Fall meetings. As you might know, Spring meetings always take place in Washington, DC. However, even though the Fall meetings usually take place on DC as well, they switch to some other city around the world every three years. Three years ago, the Fall meetings took place in Lima, Peru, while Tokyo and Istanbul hosted the meetings six and nine years ago, respectively. Amid a 90 degrees Fahrenheit, quite humid weather, more than ten thousand government officials, journalists, members of academia, and the private sector gathered to discuss the current state of the world economy. In our view, the main message of the meeting was that geopolitical risks, particularly protectionist actions, are finally taking a toll on global growth, which is experiencing a quite complicated environment with the removal of monetary stimulus in advanced economies, higher crude oil prices, and other country-specific issues.



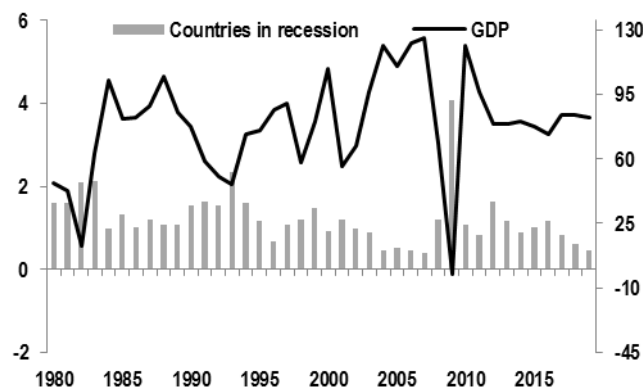
**Solid growth, but at a slower pace and less synchronized.** The IMF/WB meetings kicked off with the publication of the *World Economic Outlook* (WEO) update. In this context, the IMF staff revised its global growth forecasts for years 2018 and 2019 downwards to 3.7% (for both years), from 3.9% earlier this year. The most important forecast revisions for both years took place in emerging economies, while growth projections in advanced economies were just marginally lowered for next year (please see the table below on the left). On the other hand, with these revisions the number of countries facing a recession this year increased to seven, from six in the last WEO update in July 2018, as South Africa incorporated into the list of countries with at least two quarters with growth rates in negative territory (please see chart below on the right). All in all, the forecast revisions were not significant (20 bps), but jointly with the recent stock market selloff, we believe these are warning signals that the growth boost the world economy had been experiencing in the past few years might start to cool off, more so with the increasingly complex geopolitical environment and central banks in advanced economies unwinding their once ultra-lax monetary policies.

**IMF: GDP forecasts**  
%, annual rate

	2018			2019		
	Current	Previous	Change (pp)	Current	Previous	Change (pp)
<b>Global</b>	3.7	3.9	-0.2	3.7	3.9	-0.2
<b>Advanced Economies</b>	2.4	2.4	0.0	2.1	2.2	-0.1
US	2.9	2.9	0.0	2.5	2.7	-0.2
Eurozone	2.0	2.2	-0.2	1.9	1.9	0.0
<b>Emerging Economies</b>	4.7	4.9	-0.2	4.7	5.1	-0.4
Argentina	-2.6	2.0	-4.6	-1.6	3.2	-4.8
Brazil	1.4	1.8	-0.4	2.4	2.5	-0.1
China	6.6	6.6	0.0	6.2	6.4	-0.2
Mexico	2.2	2.3	-0.1	2.5	2.7	-0.2
S. Africa	0.8	1.5	-0.7	1.4	1.7	-0.3
Turkey	3.5	4.4	-0.9	0.4	4.0	-3.6

Source: World Economic Outlook, October 2018, IMF  
Note: Previous figures refer to estimates in the July 2018 WEO revision except Argentina and Turkey (April 2018)

**GDP and number of countries facing a recession**  
%, annual rate      Number of countries

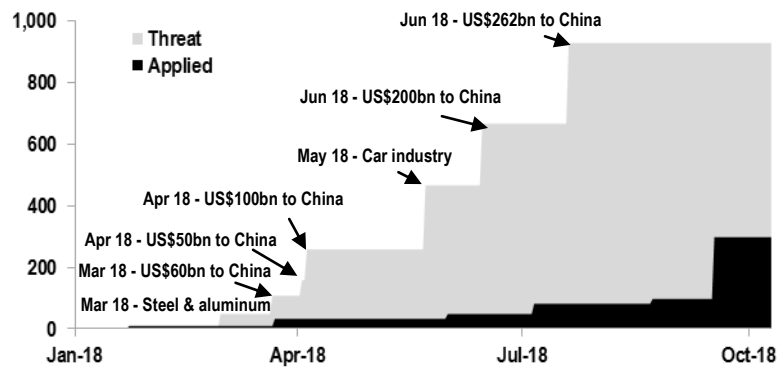


Source: IMF

**Rising geopolitical risks have gone beyond populist rhetoric.** US president Trump has gone from threatening to impose tariffs to imposing them, first to steel and aluminum globally, and then to a plethora of goods imported from China (please see chart below). Even though the recent positive news from NAFTA renegotiation (*i.e.* USMCA) provided with some relief to trade tensions, at least in North America, the uncertainty that this actions as well as the very unfortunate comments about the FOMC hiking cycle has increased global investors' concerns. On the other side of the Atlantic, *Brexit* is becoming a reality, slowing down the UK economy, and populist proponents in Italy not only won the most recent elections, but have not been able to convince market participants that their fiscal plans are sustainable in the long run. In this context, the main issue of the heightened geopolitical noise these days is that it is questioning the very foundations of the world economy, decreasing the market participants' capacity to assess investments, creating suboptimal capital allocations and therefore, curtailing projected global growth prospects.

### President Trump's tariffs and threats

US\$bn

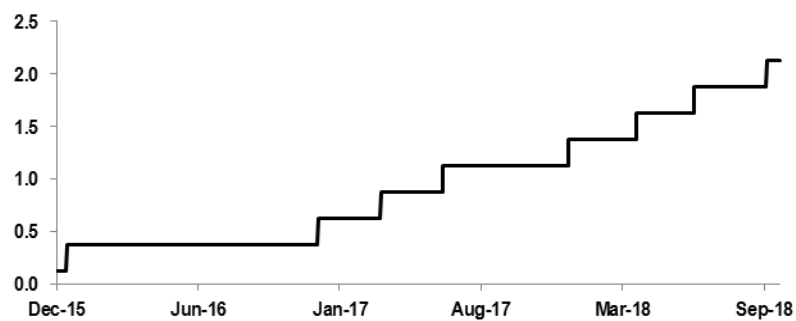


Source: Banorte and Peterson Institute

**Normalization of monetary policy, positive but up to what extent.** While the removal of monetary stimulus in advanced economies (AE) is a welcome development -meaning that things are going well and there is no longer needed to continue implementing emergency measures-, normalization of monetary policy can be harmful if it is not done carefully. This is even more important for emerging markets, in which a hiking cycle in AEs has always caused mayhem. As a result, even though the major normalizer among central banks, the US Fed, has carried out its hiking cycle in a quite gradual fashion, this is no longer the case. In fact, almost half of the 200-basis point (bp) interest rate increases -which begun back on December 2015-, has happened this year (please see chart below). In our view, the FOMC is accelerating the pace of normalization because of apparently rising inflationary pressures, as well as to have room to cut rates if a recession strike. Nevertheless, in this case, the preparation for a crisis might actually cause a crisis.

### Fed funds

%

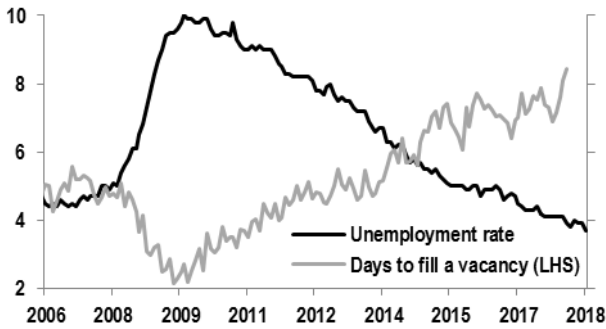


Source: Bloomberg

**Protectionism means slowdown.** The new wave of protectionism fostered by US president Trump could create a crisis self-fulfilling loop with the US Fed monetary normalization process happening at the same time. As tariffs are imposed on imports and anti-migration policies no longer allow US-based companies to attract talent from abroad -more so in a full-employment economy with such a tight labor market (chart below on the left)-, and some commodity prices -such as crude oil (chart below on the right)-, continue to increase -in part because the US exit from the Iran nuclear deal- inflationary pressures continue to rise and the FOMC will feel more compelled to either continue to hike rates or to increase the pace of hikes, of both.

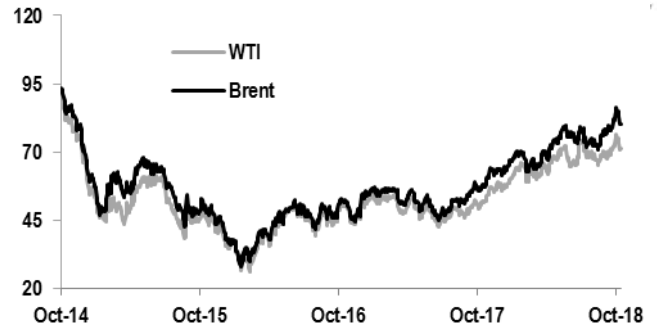


**Tight labor market in the US**  
%: days



Source: Bloomberg

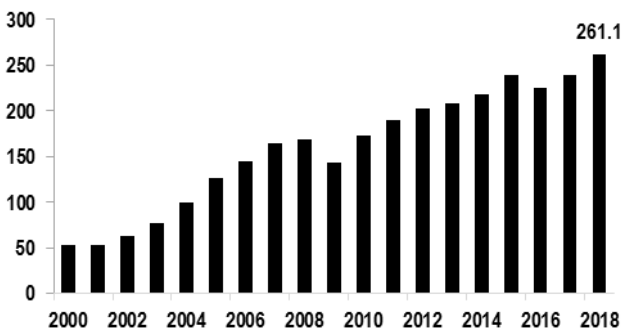
**Crude oil prices**  
US\$/BBL



Source: Bloomberg

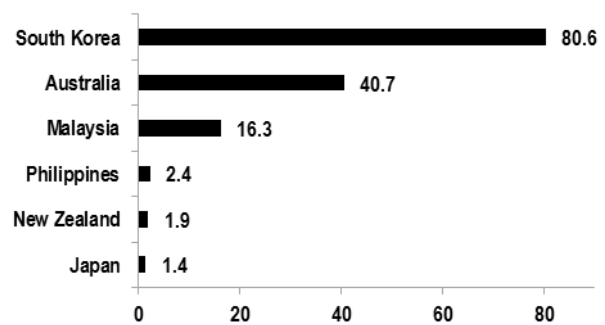
**It is not just about China.** The trade war the US initiated with China a few months ago has boosted trade between these two countries. While China has increased the imports of US soybeans, for example, China has accelerated the exports of all sorts of goods to avoid the tariffs before they are imposed. In fact, the US trade deficit with China is now at its all-time high (please see chart below on the left). However, as we all know, this is not sustainable. What is more, it will not have a negative impact on China alone. It will disrupt global supply chains, beginning with Asia. Recall that China's surplus with the US is in part, a result of deficits that China has with many Asian countries, as it is shown in the chart below on the right. Another issue to remember is that China is the most important trading partner of every single Asian country. So, you can now imagine the extent of the problem. In this context, while the Chinese government and the PBoC could implement certain policies to avert a major turndown, this would probably help China, and not necessarily create a regional boom.

**US Trade with China**  
US\$, billion



Source: Banorte with data from Census Bureau

**China deficit with main trade partners in Asia**  
US\$, billion

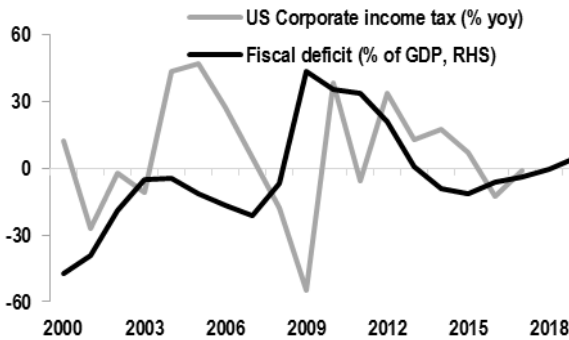


Source: Banorte with data from Bloomberg

**A tale of two fiscal deficits: US and Italy.** The US is experiencing its largest pro-cyclical budget deficit ever. Obviously, this has to do with the de facto reduction of corporate income tax back in December and, on the other hand, not having cut back spending (please see the chart below on the left). Moreover, the US Fed has been trimming its QE-legacy balance sheet. As a result, with more supply of US Treasuries -as the government must finance a higher deficit-, and lower demand -from the US Fed, at least-, yields have been increasing.

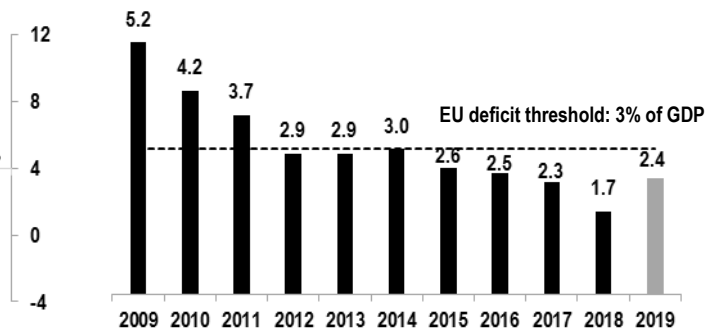
The yield of the 10-year US Treasury Note has been crossing the 3% psychological level in the past few months, causing some global portfolio rebalancing out of EMs. This is how a US dollar-printing country can get away with irresponsible public finance. In contrast, Italy -that does not have the US dollar printing legal capability-, has not been able to convince the investor community that the current proposed deficit increase does not mean they will soon surpass the Eurozone maximum deficit rule (chart below on the right). Having a Eurosceptic government has not helped.

**US Corporate income tax revenues vs. Fiscal deficit**  
%



Source: CBO


**Italy's fiscal deficit**  
% of GDP



Source: IMF  
\*Proposed by the government

**The world might not be prepared for a crisis.** Back in years 2008 and 2009, the world was not prepared for a crisis. Needless to say, it was neither prepared for such a deep crisis. By degree of preparedness, we are here talking about the global institutions that should be the ones carrying out at least liquidity-provision mechanisms, namely, the IMF. The amounts the IMF was able to lend, and the lack of short-term and quick-giving liquidity-provision channels characterized the IMF at that time. Unfortunately, this has not changed much. Even though the IMF has tried to pursue reforms, the main member countries have not followed. Furthermore, the US and other countries have shifted to an inward focus, leaving very little hope that they could respond so quickly, coordinated, and with such resolve, as they did during the global financial crisis in year 2009.

**What about climate change and income inequality reduction?** Once thought to be a demon of the past, protectionism has returned, distracting the world from much more pressing issues, such as poverty fighting, income-inequality reduction, and climate change, among other quite relevant topics. Moreover, the US has even not just turned its back to some of these issues, but it is now going against them, such as the recently-approved tax reform, walking away from the Paris agreements, and waiving construction projects from EPA regulation, among other things. Even though the IMF/WB annual meetings are usually more focused on short- and some medium-term macroeconomic issues (vis-à-vis the WEF, for example), several participants highlighted that nationalist populism, protectionism and other geopolitical risks have distracted government officials and multilateral institutions from the abovementioned structural issues.



**Optimism about Mexico...** While most investors attending the meetings expressed a positive view about the Mexican economy, they also were quite explicit in terms of their concerns, particularly about three issues: (1) Pemex, the state-owned oil company; (2) the new airport of Mexico City; and (3) the potential loss of talented government officials if they cut their paycheck.

Investors were pleased that President Elect Lopez Obrador will appoint Jonathan Heath as Vice Governor of the central bank and are giving a full vote of confidence on the budget for fiscal year 2019 and ahead. In this context, it is worth noting that even though they have observed AMLO says different things about the same issues depending on the audience and on the day, he has been extremely consistent across audiences since he was candidate whenever he talks about fiscal responsibility. Investors also expressed that the closeness they have been able to achieve with Alfonso Romo -proposed to become the Chief of Staff of AMLO-, the two proposed Undersecretaries of Finance, Arturo Herrera and Gerardo Esquivel, as well as with Abel Hibert -market waiting for his appointment-, has helped them a great deal. Nevertheless, they were very vocal that they would become very concerned if any of the aforementioned -particularly Romo-, quits at some point in the future. While these are more medium-term concerns, there is no doubt investors are concerned about Pemex and the new airport.

**...but there are relevant concerns rising.** Investors believe the current administration did a great job saving Pemex, but as one of the investors put it: *"...while the patient was able to survive, it is not fully cured yet, and probably still belongs to the intensive care unit..."*, particularly referring to the handling of the debt, as well as to continue to improve their administrative processes and how to conduct the optimization of the oil output, that has proven to be extremely difficult, particularly changing the employees' production-maximization mindset. Several investors said that they have not met the new team at Pemex yet, and are really looking forward to it. On the new airport of Mexico City, investors raised the issue that it is not just another airport for them, but a very important signal about how respectful of contracts the new government is going to be, as well as in terms of acting in the best interests of the country, rather than just personal ideology. Finally, all investors told us that even though they were expecting significant changes in the upper positions at the Ministry of Finance -and other ministries as well-, they were not expecting loss of talent at the operational levels, as well as in the central bank, as it seems it has started to happen because of the proposed cut in government officials' wages. Investors even mentioned that one of the highlights of investing in Mexico in the past thirty years has been that they have always found quite talented government officials.



**All in all, prepare for higher volatility levels ahead.** Christine Lagarde, IMF Managing Director and Chairwoman has warned in the past two annual meetings that *"it seems that it is getting cloudy"*, then *"it is getting cloudy"*, and even though she did not say exactly this, the interpretation we give to her most recent comments is that *"it is beginning to rain"*. In our view, this is a way to summarize the potential outcome of the complex combination of geopolitical risks -particularly protectionism-, with country-specific issues, at a time when the peak of the cycle might have just happened, and central banks in AEs are removing monetary stimulus.

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