

IMF/WB Meetings: Short-term optimism but important challenges ahead

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- **The IMF and the World Bank held their Spring Meetings in Washington, D.C. last week**
- **In our view, the two main takeaways of the meetings are:**
 - (1) **Global economic activity continues to grow at a solid and synchronized pace, but the likelihood of a deceleration or even a recession towards year 2020 has increased; and**
 - (2) **The balance of risks that could derail the global growth expansion cycle has worsened**
- **The possibility that central banks in advanced economies would have to be more aggressive in their monetary policy normalization processes is among the abovementioned risks**
- **In the meantime, protectionist policies -among other populism guidelines-, could foster higher inflationary pressures, exacerbating the speed and magnitude of the interest rate hiking cycles**
- **The IMF staff advises governments not to be complacent with the current wave of global growth and focus on strengthening structural sources of growth in the long run**

2018 Spring Annual Meetings. The International Monetary Fund (IMF) and the World Bank (WB) held their Spring Meetings in Washington, D.C., last week. The IMF and the WB gather their staff members with the member countries' delegates and representatives twice a year (spring and fall). Private sector investors, businessmen, and analysts -from Grupo Financiero Banorte among them-, also attend the meetings, and take advantage of the presence of so many world leaders to meet them either in one-on-one meetings or 'parallel' events. It is worth noting that while the meetings always take place in D.C., the Fall Meetings change venue every three years. For example, back in 2015 they took place in Lima, Peru and this year the meetings will be held in Bali, Indonesia. In this context, the last time (and the only time) that it has taken place in Mexico was back in 1952 in Mexico City.

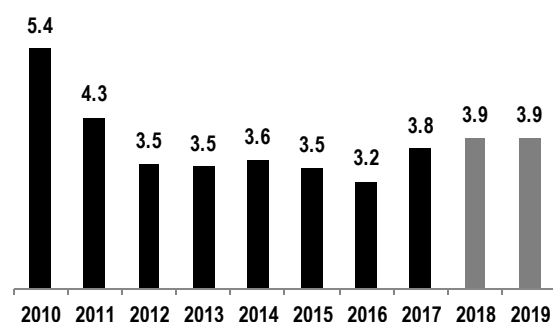
Geopolitical risks at the center of the debate. In our opinion, this time there were two very important takeaways: (1) There is more confidence on solid and synchronized global growth for the next two years. However, the likelihood of a global deceleration or even a recession by year 2020; and (2) the risks that could derail the expansionary phase of global growth have been increasing, particularly: (a) Tightening of financial conditions; (b) protectionism; and geopolitical risks in general. Even though these have been recurring topics since the 2016 Fall IMF/WB Annual Meetings, it is out take that this time they took a central role.

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Before we elaborate on the aforementioned topics, we want to highlight that we have never seen such a focus on the US economy in these meetings vis-à-vis the past meetings we have been attending for many years. Of course, it does not raise any flag per se just looking at the kind of president its population chose back in November 2016, in such a hegemonic country.

Solid and synchronized global growth. As we have mentioned earlier, the multilateral organizations, as well as central banks and some government ministries, along with global financial market participants have been concerned that we are experiencing the ninth year of GDP expansion globally while this positive phase of economic cycles have lasted between three and five years on average. In this context, the IMF did not revise its global GDP growth projections for 2018 and 2019. In fact, even though it did modify some country/regional forecasts, the overall estimation is for the world GDP to grow 3.9% in 2018 and 2019, which will be the highest growth rates the world would have observed since the global financial crisis in 2008-2009 (please see chart and table below). In addition, we perceived that the IMF staff is more confident that global growth is not only more solid, but that also is happening in almost every region and country in the world, with a very few exceptions such as Venezuela, Libya, and Yemen, which are struggling with particular problems.

IMF Global growth forecasts (Apr-18)
% y/y



Source: *World Economic Outlook*, IMF (Apr 2018)

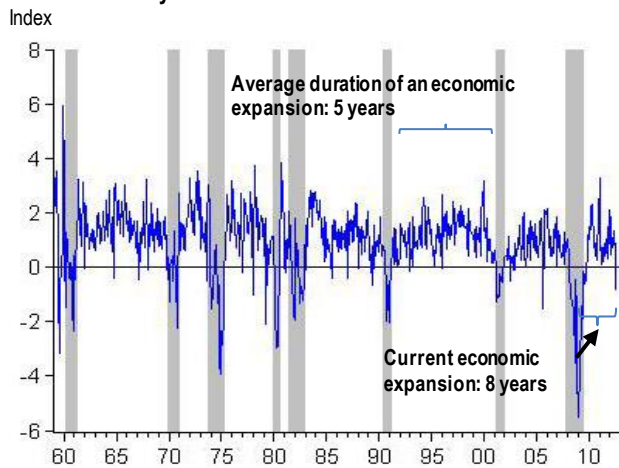
Economic growth forecasts
% y/y

	2017	Forecasts Apr 18		Forecasts Jan 18	
		2018	2019	2018	2019
Global	3.8	3.9	3.9	3.9	3.9
Advanced Economies	2.3	2.5	2.2	2.3	2.2
United States	2.3	2.9	2.7	2.7	2.5
Eurozone	2.3	2.4	2.0	2.2	2.0
Germany	2.5	2.5	2.0	2.3	2.0
France	1.8	2.1	2.0	1.9	1.9
Italy	1.5	1.5	1.1	1.4	1.1
United Kingdom	1.8	1.6	1.5	1.5	1.5
Japan	1.7	1.2	0.9	1.2	0.9
Emerging markets	4.8	4.9	5.1	4.9	5.0
China	6.9	6.6	6.4	6.6	6.4
Brazil	1.0	2.3	2.5	1.9	2.1
Mexico	2.0	2.3	3.0	2.3	3.0

Source: *World Economic Outlook*, IMF (Apr 2018)

Deceleration or even recession going forward. Despite this optimism, important risks that can derail the current economic expansion phase, as well as the "natural" behavior of economic cycles, where as we have commented, have historically averaged three to five years in the past (see graph below). On this last point, the staff of the IMF considers that the probability that the world will see a significant deceleration or even a recession after 2020 has increased significantly. Clearly, a shock generated by the increase of some of the risks mentioned at the beginning of the document (*i.e.* more aggressive rate hikes and geopolitical risks) could accelerate the start of a slowdown or recessive phase in the growth of some or some of the advanced economies and it is very likely that this will permeate global growth.

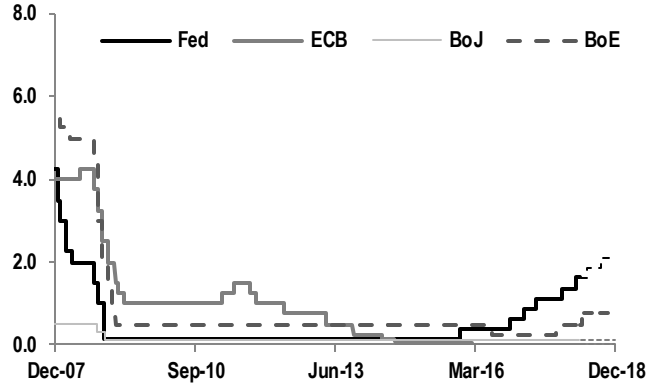
U.S. Business Cycle Indicator



Source: CREFC –Center of Research on Economic and Financial Cycles and Federal Reserve Bank of Atlanta

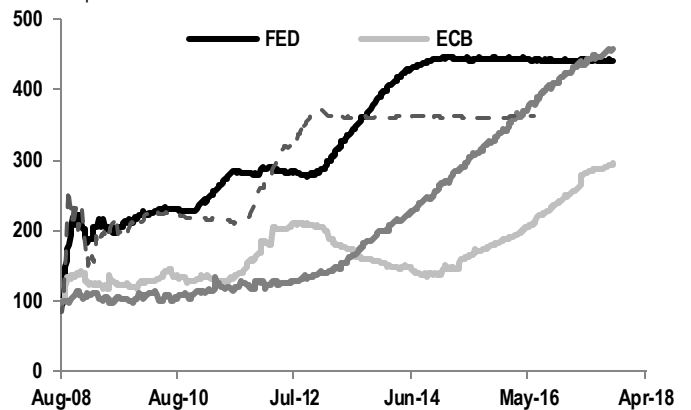
Tightening of financial conditions. It is well known that the normalization of monetary policies in advanced economies (AE) has already begun. The central banks of AEs diverged from monetary orthodoxy a few years ago by combining near-zero interest rates (please see chart on the left) with a significant liquidity injection via the implementation of quantitative easing policies (please see chart on the right), in order to mitigate the negative effects of the global financial crisis in 2008-2009. Even though so far the reduction of the monetary stimuli has been gradual, the recently approved tax reform in the US, the dollar weakness, as well as the recent increase in commodity prices could foster a more aggressive stance among central banks. This could definitely tighten global financial conditions. Moreover, the global wave of populist policies, particularly protectionism -mainly boosted by the US-, could not only engender inefficiencies that could hurt global growth, but could also increase inflationary pressures that could nurture a more violent hiking cycle.

Reference rates
%



Source: Bloomberg

Central bank's balance sheets
index september 2008=100



Source: Bloomberg

New FOMC composition and @realDonaldTrump. The world wants to know which phase of the US growth cycle we are currently experiencing, as well what is going to be the impact of the US tax reform and the potential protectionism measures on inflation. In this context, a recurrent related theme in DC was the new composition of the Federal Open Markets Committee (FOMC) of the Federal Reserve System (Fed). This became increasingly relevant given president Trump's tweet on the US interest rate hiking cycle (please see chart below on the right). More so that this *tweet* came out right after the US government made public its decision of not to call China a "currency manipulator". A number of analysts have seen this as a direct confrontation to the (de facto, not de jure like Mexico) autonomy of the US central bank. It is worth noting that we are still waiting for the legislative approval of Richard Clarida as Vice chairman of the Fed, and the nomination of Michelle Bowman to fill a vacant positions in the FOMC that overlooks community banking (please see table below on the right). Even though FOMC members need to go through legislative approval, there is an increasing perception that politicians in the US -particularly the president-, might influence their monetary policy decisions going forward.

Trump tweet on Russia, China and U.S. monetary policy

Member	Appointment	Votes in FOMC 2018
Jerome Powell	Chair	Yes
William Dudley*	Vicechair President of New York's Fed	Yes
Richard Clarida**	Candidate for Vicechair	No
Lael Brainard	Member of the board	Yes
Randal Quarles	Member of the board (banking regulation)	Yes
Michelle Bowman**	Candidate for member of the board (community banking)	No

Members of Regional Banks of Reserve

John Williams*	San Francisco's Fed President	Yes
Thomas Barkin	Richmond's Fed President	Yes
Raphael Bostic	Atlanta's Fed President	Yes
James Bullard	St. Louis' Fed President	No
Charles Evans	Chicago's Fed President	No
Esther George	Kansas City's Fed President	No
Eric Rosengren	Boston's Fed President	No

Source: Twitter.com

FOMC Composition



Donald J. Trump 
@realDonaldTrump

Russia and China are playing the Currency Devaluation game as the U.S. keeps raising interest rates. Not acceptable!

4/16/18, 7:31 AM

21.5K Retweets 97.5K Likes



Source: Federal Reserve

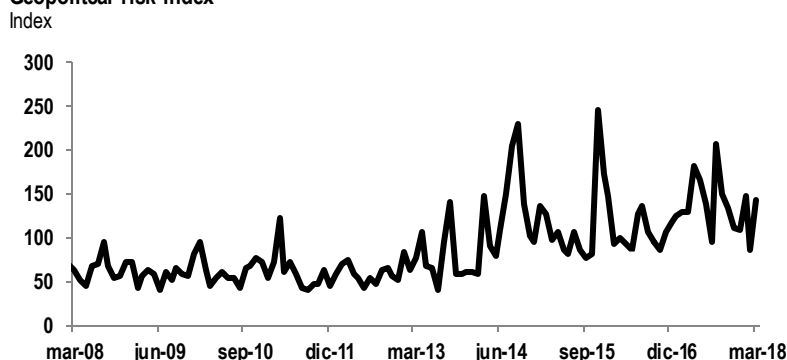
*Dudley will be retiring in May from New York's Fed –with permanent vote at the FOMC-, and will be replaced by John Williams, current president at San Francisco's Fed

**Pending confirmation

Central bank communication and financial stability as a target. In order to improve the market participants' interpretation of the central bank's monetary policy intentions, as well as to defend its autonomy, several FOMC members as well as noted economists have pointed that the Fed -as well as other central banks-, might change their communication to focus more on targets and thresholds, rather than on a particular set of words in the 'forward guidance' tool. This also hopes to mitigate the influence of politicians in monetary policy decision-making process. On the other hand, we noticed a debate that has been gaining ground lately: The divergence between the reference rate that clears markets in the real economy (r^*) and the equilibrium interest rate that clears financial markets in a healthy way (right now the usual assumption is that they are equal). We just wanted to highlight this interesting issue. However, we do not know about any consensus view at the moment.

Geopolitical risks *in crescendo*. In the aftermath of 2008 economic crisis, we saw economic risks at the center of discussions. Nevertheless, 10 years after the crisis, geopolitical risks have become key to assess the outlook of a country and the world, as can be seen in the next graph. In the meetings we held or that we had the opportunity to attend, three issues were addressed mainly: (1) The opening of sources of conflict by the US government has increased the probability of committing a political error that could have serious consequences at the global level ; (2) it was recommended that governments not be complacent with the current wave of growth and that they focus their batteries on strengthening the structural sources of long-term growth, because not doing so can increase the popularity of populist politicians among the population; and (3) there has been an increased risk that leaders who propose populist policies will come to power and that these will cause setbacks in the approval and implementation of structural reforms, as well as the erosion of institutions.

Geopolitical risk index



Source: *World Economic Outlook*, IMF (Apr 2018)

Protectionism: A risk to the outlook in the medium term. Although the short-term scenario is encouraging, as we have already mentioned, the recent temptation to take protectionist measures by some advanced economies in particular could have a negative impact on the global economic outlook. Among others, an increase in tariff and non-tariff measures on trade could damage market sentiment, as well as cause a disruption in global supply chains, reducing levels of productivity and investment globally. Additionally, greater protectionism tends to have a negative impact on consumer welfare levels. That said, it is also true that there are countries that have to keep moving forward in terms of economic opening, as is the case in China.

Opening sources of conflict also might give way to policy mistakes. As we have already mentioned, most of the meetings revolved around the analysis of the risks that the decisions taken by the administration of President Trump in the United States could entail. In particular, in the context of a meeting with political analysts, the political outlook for the year was discussed taking into account November's mid-term election, which is considered as an endorsement of the current administration. The majority of the attendees to the meeting (51%) considered that the Republicans could lose the majority in the House of Representatives, but they will keep it in the Senate.

Additionally, given that it is an election year, it is not expected that Congress will pass any type of relevant legislation, *i.e.* almost no progress will be made in terms of infrastructure program or legislation in terms of arms control.

We particularly highlight comments on how the White House currently works. In this context, to the moderator's question about when they estimated that the present government could be "*stabilized*" -*i.e.* when we could see more order in the decisions, less turnover of personnel, among others-, analysts agreed that this is how President Trump likes to work. This is an environment in which the drama around the decisions is his way of doing politics. Nevertheless, it is thought that up until now difficult situations have been self-inflicted and that they have not yet had to manage a true crisis situation, either at a domestic or global level, which poses a risk to the outlook.

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