IMF/WB Spring meetings 2015 raised more questions than answers

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- **IMF/World Bank's Spring meetings took place this past week in Washington, DC**
- **In our view, discussions focused on four topics:**

  (1) Slow global growth;

  (2) A less pessimistic outlook for oil prices;

  (3) U.S. Fed monetary policy normalization; and

  (4) The complex situation in Greece
- **The IMF revised its estimates of potential GDP for most countries, particularly those that benefited from the super commodity cycle**
- **On US Fed monetary policy normalization, discussions revolved around the impact of adverse weather conditions explaining weak economic data in 1Q15**
- **Meanwhile, Greece's situation has deteriorated significantly, especially given the potential difficulties to face upcoming debt payments, while medium-term outlook remains challenging**
- **As it has been the case in recent international events, Mexico is still perceived as one of the top emerging economies, despite low levels of growth**
- **On Mexican monetary policy, although there is a widespread perception that the central bank will wait for the Fed to act, there are some doubts on how Banxico will achieve this, particularly given the gaps between both central banks' meetings**
- **In sum, we believe that discussions were fruitful in order to generate scenarios of what might happen ahead, but there is still too much uncertainty around both cyclical events (Fed, Greece), and structural once (low levels of global growth)**

IMF/World Bank's spring meetings. Last week, we attended IMF/World Bank's spring meetings in Washington, DC. In our view, discussions focused on four topics: (1) Slow global growth; (2) a less pessimistic outlook for oil prices; (3) monetary policy normalization in the U.S.; and (4) the complex situation in Greece. In this context, a great variety of arguments and analysis were presented, but we believe that few answers came out of such discussions.

Slow global growth. While the IMF staff made adjustments to their GDP growth forecasts in several countries in their updated version of the *World Economic Outlook* (as shown in the table below), global growth remained at 3.5% for 2015. Notwithstanding, the IMF revised down its estimates of potential GDP for most countries, particularly those that benefited from the super commodity cycle. The new estimates place potential growth of these countries at levels observed before the super-cycle mentioned above. To explain this behavior, we highlight two competing theories: (1) Former Treasury Secretary Larry Summers' *secular stagnation* –on the structural side-, and (2) on the cyclical side, former IMF chief economist Kenneth Rogoff's *This time is different*. Mr. Rogoff argues that the fact that global growth has been low for many years does not mean that there has been a structural change, as Mr. Summers suggests. For Mr. Rogoff, the difference in this latest crisis with respect to others in recent decades, is that this was also a banking and financial crisis. In this context, there is empirical evidence that such crises last longer (about 8 years on average). Judging by Mexico's own experience in the crisis of 1994-1995, when the economy took a long time to recover, we tend to argue in favor of Mr. Rogoff theory.

Growth forecast
% yoy

	April 2015		January 2015	
	2015	**2016**	**2015**	**2016**
Global	3.5	3.8	3.5	3.7
Advanced economies	2.4	2.4	2.4	2.4
United States	3.1	3.1	3.6	3.3
Eurozone	1.5	1.6	1.2	1.4
Germany	1.6	1.7	1.3	1.5
France	1.2	1.5	0.9	1.3
Italy	0.5	1.1	0.4	0.8
Japan	1.0	1.2	0.6	0.8
Emerging economies	4.3	4.7	4.3	4.7
China	6.8	6.3	6.8	6.3
Brazil	-1.0	1.0	0.3	1.5
Mexico	3.0	3.3	3.2	3.5

Source: WEO 2015

A less pessimistic outlook for oil prices. Along with US Fed's normalization process, an important issue discussed was the outlook for oil prices. In our view, the perception is that oil prices will no longer remain below 40dpb. In fact, recent forecasts hover around 60dpb in a scenario where the U.S. has reached an agreement with Iran which would add between 1.0 and 1.3 million barrels per day to global oil supply. Nevertheless, this has not impacted on prices given the expectation that the lifting of sanctions imposed to Iran will be carried out over an extended period, allowing production coming from shale fields to decline first.

U.S. Fed monetary policy normalization. Discussions on this issue focused on three aspects: (1) How relevant were adverse weather conditions to explain 1Q15 economic activity weakness. There was no prevailing opinion, so we will have to wait for 2Q15 data to be published, to assess if it really was the weather or there was some additional factors, including a structural ones. We are inclined to think that the weather had a significant impact, so we believe it is likely to see stronger data ahead; (2) the timing for US Fed's normalization cycle. In this regard, we believe that the opinion of FOMC members, market economists, as well as of IMF and World Bank's economists is divided. While much of the disagreement comes from each economist interpretation of recent weakness in US data (*i.e.* if it was weather related or not), the so called *real-money accounts* anticipate that the Fed will start its normalization process in June, hedge funds believe it will not be until December while none the investors we saw, expected a delay until 2016. In conclusion, data on 2Q15 will be relevant in order to assess the outlook. If they come on the positive side, then weather in fact affected economic activity and probably the Fed will start normalization in June. If data is still weak, the Fed will probably wait until September or December; and as for (3) the magnitude of the hikes and the terminal level of the Fed funds rate, the FOMC is expected to be very gradual, even with rate increases *"every other meeting"*. Nevertheless, once timing is worked out, the magnitude, the speed and the timing of each increase will be the most important source of global uncertainty.

The complex situation in Greece. The situation in Greece has deteriorated significantly in recent weeks and will still generate volatility in international financial markets at least until June, particularly between now and May 8-12, when there are significant debt payments (€1.4 and €0.8 thousand million, respectively). We perceive that whenever a short-term issue is resolved, concerns on the next issue arise, until a new short-term equilibrium is reached. Nevertheless, the medium-term outlook remains challenging as structural problems have not been tackled, in particular, amid political pressures coming within Greece, other Eurozone governments and the IMF. Nevertheless, the probability of Greece leaving the European Monetary Union is still relatively low.

Mexico: The best emerging economy, but no growth. As it has been the case in similar forums, Mexico is still perceived as one of the top emerging economies, despite the low levels of growth. Nevertheless, given the forecasted growth for Mexico vs. other emerging economies, the issue of low growth in Mexico is minimized. The IMF expects a 0.9% expansion in Latin America this year, while for Mexico they forecast 3% (Banorte-Ixe: 3.6%). In this regard, investors continue to view Mexico as *an example to follow*, not only because of macroeconomic stability but also because of structural reforms being implemented. Nevertheless, the question is why growth is still subdued. As for Mexico's monetary policy, we believe that speeches from Banxico's board members were fully in line with the idea of *waiting* for the Fed's normalization process, to raise rates in Mexico too.

Note that several investors commented that with low inflation in Mexico and sluggish growth, the central bank could delay hiking interest rates, even if the Fed begins its normalization process. In this regard, a member of the central bank said that once the Fed raises rates, the central bank will act quickly. Another issue discussed –but in a more informal way among analysts and investors-, was the gap of time between central bank meetings in both countries, particularly around the dates that the Fed is expected to move rates. For example, if the Fed hikes in its June 17 meeting, the next meeting for Banxico's board of governors will take place in July 23, *i.e.* five weeks later. A similar case occurs in September, when the Fed's meeting will take place on the 17th, while Banxico´s first meeting after this date is scheduled on October 15th, four weeks later. The explicit question from investors was whether the central bank would have to act calling an unscheduled meeting (intra-meeting). In this regard, we believe that while there is no doubt that the central bank has to act as quickly as possible, we believe that the economic situation in Mexico (low inflation and moderate growth), Banxico's credibility and the *Exchange Commission* toolkit, gives the central bank enough leeway to act on scheduled meetings.

More questions than answers, so high volatility episodes will continue in the coming months. In sum, we believe that the discussions that took place in the Annual IMF/World Bank Spring meetings were fruitful in order to generate scenarios of what might happen ahead, but there is still too much uncertainty around both cyclical events (Fed, Greece), and structural once (low levels of global growth).

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