

# goodbye monetary policy, here comes fiscal policy? bond report

**Investment Strategy &  
Portfolio Expertise**

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This report highlights our key takeaways from the 2016 Annual Meetings of IMF/World Bank and IIF and related meetings in Washington DC.

- ▶ The global economy is stuck in low gear, with investment and trade still weak
- ▶ A modest acceleration is expected in 2017, supported by a comeback of EMs.
- ▶ The general consensus in Washington was that monetary policy has been pretty much exhausted, at least in advanced economies.
- ▶ A shift towards targeted fiscal stimulus is welcomed, but effective leadership and poor fiscal fundamentals in many advanced economies act as constraints.
- ▶ The rise of populism (Trumpism, Brexit, Europe's refugee crisis) is a key risk factor for the global economic outlook, as it leads to uncertainty, obstructs policy making and hurts globalisation, global cooperation and global trade.

## **Background**

From 6-9 October, we participated in the 2016 Annual Meetings programme of IMF/World Bank and IIF and in related meetings from a couple of banks, rating agencies and asset managers. We also visited the Dutch Alternate Executive Director at the IMF. This report highlights the key takeaways from these meetings (around 30 in total). Views expressed in this report (including references to what has been stated by others) are those of the authors. The takeaways are broadly in line with our house view, although we should add that ABN AMRO still sees room for accommodative monetary policies in for instance the Eurozone, Japan and other parts of Asia.

## **Global growth prospects remain below trend, with some pick-up seen in 2017**

The general message arising from Washington is that global growth will remain below trend for the time being, although a moderate pick-up is expected next year thanks to a comeback of emerging markets. Growth is mainly driven by consumption, as investment growth is still weak (especially non-residential private capex), while world trade is stabilising at best. Main risks to the outlook stem from the rise of populism (particularly in advanced economies), which looks to be negative for globalisation including world trade and harms effective and powerful policy making. Other risks stem from the lack of room for stimulus policies in a wide range of countries and from high debt levels in various sectors in both advanced and emerging economies.

Larry Summers shared his ideas on 'secular stagnation', in his view not an excuse for fatalism. A global excess of savings over investment is the root cause for slow growth, low interest rates and low inflation. Still, addressing a lack in demand is easier than addressing a lack of supply. As a remedy, he favours more fiscal stimulus (particularly infrastructure spending), including in the US.



### **China less of a concern compared to the Spring 2016 and Autumn 2015 IMF meetings**

Risks stemming from China's transition and slowdown were much less in the spotlight than half a year ago. The consensus seems to be that, thanks to fresh stimulus measures and improved policy communication, China's economy has stabilised and hard landing concerns have eased. However, as Beijing takes more time to address serious imbalances (particularly ongoing strong credit growth outpacing nominal GDP growth), longer-term risks are rising. Still, the government has very sizeable buffers and in general a sharp correction is not expected in the coming years. In fact, China is already applying the broader policy mix, including fiscal stimulus, in an effort to manage the transformation, which is by itself the biggest contribution it can make to global growth. Other good news comes from the observation that credit growth to corporates seems to have started slowing, while household lending (still relatively low) is picking up instead. Still, the housing market is seen as increasingly overheated, particularly in the largest cities.

### **EMs show comeback, as China stabilises and Fed rate hike path remains very slow**

More in general, the picture for EMs has improved compared to half a year ago, thanks to China's stabilisation, the correction in commodity prices, the return of capital flows to EMs (although equity flows are still on the weak side) and ongoing fiscal and monetary easing (EMs in general have more room for policy support than AEs). There is not so much fear that EMs will be hit hard by a Fed rate hike in December, as the consensus view is that the Fed will continue with a very gradual hiking path. Emerging Asia particularly looks resilient, now that China has stabilised and a return in capital flows and policy easing compensate for weak global trade. Political risks and structural weaknesses continue to come to the fore in emerging markets, particularly in Latin America and Eastern Europe. However, regional growth in the latter two regions is also edging up next year, as the largest economies (Brazil and Russia) are gradually exiting recession.

### **Monetary policy in advanced economies is reaching exhaustion point ...**

The general impression is that monetary policy has been stretched too much, partly because there are constraints to an effective implementation of fiscal policy. Monetary policy can only be used as part of demand management, but is useless to address supply issues and when structural reforms are needed. Often the idea of monetary easing is to buy time for others to do what they have to do (e.g. fiscal stimulus, structural reforms), but this created time has not been used well so far.

Some stress that unconventional monetary policies are in place for too long now in for instance Japan and the Eurozone. Several speakers point to the consequences of negative rates/too low rates for financial stability (e.g. on banks, insurers, pension funds) and to the fact that – looking critically at the monetary transmission mechanism – negative rates may turn out to be counterproductive as savings seem to have risen in some cases. Moreover, as for instance Summers and Geithner pointed out, by leaving policy rates low for too long, there is hardly any policy space should we enter a crisis/recession again.

### **... so the Washington consensus is that fiscal policy should now take over**

The hope that fiscal policy would be used more in the current circumstances was heard everywhere. In its latest Fiscal Monitor, the IMF mentions for instance Germany, China and South Korea as countries that have fiscal space. China already has provided substantial fiscal stimulus since mid-2015. However, the German officials we have heard in Washington (including Minister Schäuble) did not sound very enthusiastic about aggressive fiscal stimulus. They point to the fact that Germany's fiscal spending did already increase last year due to refugee related expenses. They also point to the low unemployment rate. Germany trusts the automatic stabilisers will do their job and regards itself as a role model for the eurozone in terms of having sound public finances. Moreover, one German official noted that if central banks would (finally) be successful in pushing inflation and interest rates up, much of the current 'fiscal space' would prove to be illusory. Weak leadership – for instance affected by rising populism – or weak public finance fundamentals can be constraints for an effective implementation of fiscal policy. Still, countries could also create a form of fiscal space by reprioritising towards growth-enhancing forms of spending (switch from public consumption to public investment).

### **Rise of populism is a threat to globalisation, global cooperation and global trade**

The rise of populism, mainly in Europe and the US, is seen as one of the key risk factors for the global economic outlook, as it leads to uncertainty, obstructs effective policy making and hurts globalisation, global cooperation and global trade. Brexit, the rise of Trump, the refugee crisis in Europe are all part of this broader trend. Notably, the IMF, considering itself a 'non-political' organisation, devoted a chapter in its latest WEO to this topic. The popularity of politicians like Trump is based on the fact that they give the ordinary people 'voice'. Their feeling of being 'losers' is based on reality and fed by side-effects of globalisation, the aftermath of the global financial crisis and new technology threatening many jobs. International financial institutions also suffer from a lack of

trust and should re-invent themselves. How we could benefit all from globalisation and the promotion of inclusive policies should be their focus. It should also be made clear that some issues cannot be solved without global cooperation. And it's not about convincing the elite, but the 'common people'.

### **US elections**

The US elections have been an obvious topic in various sessions. The establishment has no clue how to handle the Trump phenomenon and is totally unprepared for a Trump presidency. According to some, Trump would politicise the Fed. Trump could also drop NAFTA (president is in the lead with global trade), raise tariffs with Mexico to 35% and use the proceeds to pay for a "wall". According to exit polls, Clinton won the second presidential debate on Sunday 9 October and she solidified her lead in the polls. The debate was 'nasty', with the presidential candidates trading a range of personal insults. These kind of developments made Larry Summers observe that the style of failed Latin American governments (anger to the elite, desire for rapid action, authoritarian leadership, nationalism, restoring past 'greatness') now seem to have been exported to the US. He thought that after the latest scandal, there was a 25% probability that Trump would not even participate in the presidential elections.

### **Brexit an 'unfolding event', with increasing risk of hard Brexit**

The Washington meetings took place just after UK PM May surprised markets, by setting a deadline of end-Q1-2017 to trigger Article 50 (earlier than expected) and by making some comments which were interpreted by markets as an increasing probability of a 'hard Brexit'. Although the immediate economic impact of the UK Brexit vote in June turned out to be milder than expected, Brexit is a so-called 'unfolding event' with many open ends and uncertainties, both on the political and economic side. After May's announcements, markets have become more aware that Brexit will not be without economic pain (explaining the renewed pressure on sterling). Going forward, most of the participants expected quite a rough ride for the UK, if they would really go for a 'hard Brexit'. Meanwhile, the political fall-out of the Brexit vote has been quite limited so far, although going forward potential fall-out will also depend on the outcomes of the negotiation process between UK and EU.

### **The low productivity puzzle: an 'ill-understood phenomenon'**

In a special IMF meeting, the fact that US growth was clearly below historical trends was attributed to four specific factors: low labour participation, low productivity growth, low business/labour dynamics and low investment (these factors are obviously interdependent). What was probably most striking is that the experts were not really able to give a clear expla-

nation of the fall in productivity, something the IMF also had noted in the latest WEO ('ill-understood phenomenon'). Reference was made to an OECD study, showing that frontier firms are doing well in adopting new technologies, but there is not an appropriate transition into other firms. Also, there is a rising dispersity in terms of innovation within industries.

### **Global financial stability: are we safer now?**

In the IMF's Per Jacobsson Lecture, Tim Geithner evaluated the 2008 crisis instruments in the context of today. He sees no reason to assume we have become any better in detecting a crisis beforehand and strongly advises to be prepared, as crises will always come again. True, banks are clearly better capitalized now. Still, we should be aware the shadow banking will always and continuously erode such efforts. Also, there are now clearly less macro (Keynesian) tools available, as there is much less room now to cushion a blow to demand by fiscal policy. Moreover, current discussions to use 'fiscal space' would empty the macro toolkit further. In the US, many of the specific crisis programmes set up in 2008 have been stopped or unwound again. Talking from experience, Geithner urges to keep these tools at hand (again) to allow

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