Global Prospects and Policy Challenges : IMF

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International Monetary Fund's in its report "Global Prospects and Policy Challenges" prepared for G-20 meeting of finance ministers and central bank governors notes that global growth has continued to strengthen and growth rose in the second half of 2017, driven by remarkably strong investment and trade.

The momentum is broad-based—activity strengthened in most countries over the last year, with stronger-than-expected outcomes in the euro area, Japan and the United States, continued fast expansion in China, and improving conditions for commodity exporters. Despite the recent equity market turmoil, financial conditions remain supportive. Headline inflation is picking up, especially in the United States, but is still below target in many G-20 countries.

Recent Developments, Outlook and Risks

The positive momentum expected for 2018 and 2019 will eventually slow, implying a challenging medium-term outlook for many countries. Some cyclical forces will disappear: market interest rates are rising and financial conditions are likely to tighten as monetary policy normalizes; the U.S. tax reforms will subtract momentum when investment incentives expire; and China's transition is expected to resume as credit growth and fiscal stimulus slow.

At the same time, while the recovery in investments can add to potential growth, population aging and other factors continue to slow productivity growth in advanced economies. Prospects in emerging countries are generally more benign, but some face similar headwinds as the benefits of earlier reforms may have run their course. Commodity exporters need to continue adjustment and export diversification.

Short-term growth could surprise again on the upside, but downside risks are accumulating. The recent volatility illustrates the financial stability concerns from elevated market and liquidity risks, weakening credit quality, and high corporate leverage; with potential repercussions for short- and medium-term growth.

U.S. financial conditions could tighten faster than expected—for example, due to an adjustment in the anticipated path of monetary policy normalization or a sudden decompression of term premia. This could have spillovers to other economies, including a reversal of capital flows to emerging market economies.

Procyclical fiscal policy in the United States or other excess current account deficit countries, combined with persistent excess surpluses in others, would widen global imbalances. With inclusive growth remaining elusive in many countries and increasing anxiety about technological change and globalization, this could foster inward-looking policies, disrupting trade and investment. Climate change, geopolitical tensions, and cyber security pose additional global risks.

The report notes that growth is foreseen to fall gradually in China considering the anticipated withdrawal of fiscal stimulus and moderating credit impulse, while India should see growth picking up after two transitory shocks viz. demonetization and the implementation of GST.

Conclusions

Going ahead, the current macroeconomic situation offers a window of opportunity to push policies and reforms that protect the upswing and raise medium-term growth to the benefit of all.

- **Build buffers: The report suggests that** monetary accommodation should continue where inflation is weak, but a well communicated normalization should be pursued when inflation approaches central bank targets. In countries at or close to full employment (e.g., United States), fiscal policy should build buffers and expand aggregate supply, avoiding pro-cyclical stimulus while contributing to lower global imbalances. Excess surplus countries with fiscal space (e.g., Germany) should finance policies boosting potential.

- **Improve financial resilience:** Micro- and macro-prudential policies should be used to curb elevated leverage and contain financial market risks. In some advanced economies, balance sheet repair needs to continue. Emerging economies should monitor exposures to foreign-currency debt. Building on recent efforts, China should keep reining in credit growth and addressing financial risks.

- **Strengthen the potential for higher and more inclusive growth:** All countries have room for structural reforms and fiscal policies that raise productivity and enhance inclusiveness, including by increasing labor force participation, supporting those displaced by structural change, and investing in the young to enhance their job opportunities.

- **Foster cooperation:** Priority should be given to maintaining financial and regulatory reform momentum and avoiding backtracking on progress made, preserving an open multilateral trade system, collaborating to address the problems of excess external imbalances, the buildup of low income countries' debt, cyber security, and climate change.

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