Asia-Pacific
Economic Cooperation

2019/SOM1/FDM/007
Agenda Item: 3.4

World Economic and Financial Outlook

Purpose: Information
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APEC
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7-8 March 2019

WORLD ECONOMIC AND FINANCIAL OUTLOOK:
A WEAKENING GLOBAL EXPANSION

March 7, 2019

International Monetary Fund

Overview

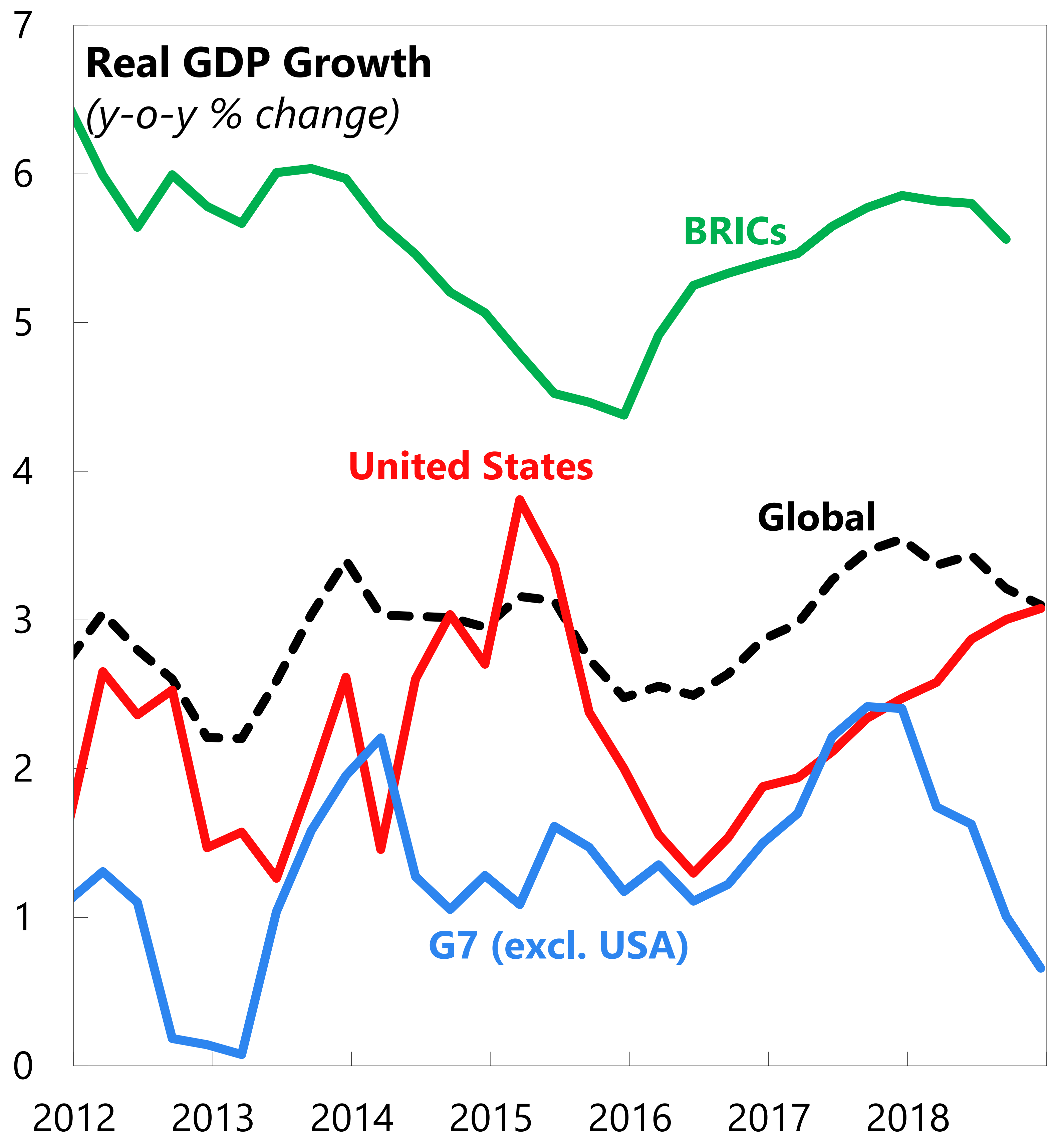
- Recent Developments
  - Momentum has weakened
  - Increase in financial market volatility in advanced economies
  - High frequency indicators suggest softer momentum will continue into 2019

- Outlook
  - Advanced economies: growth still above trend but declining, and expected to fall further into the medium term
  - Emerging markets and developing economies: slight weakening of growth in 2019, but with some growth pick up 2020-onwards. Notable differences in regional prospects

- Balance of Risks
  - Tilted to the downside in a context of high policy uncertainty

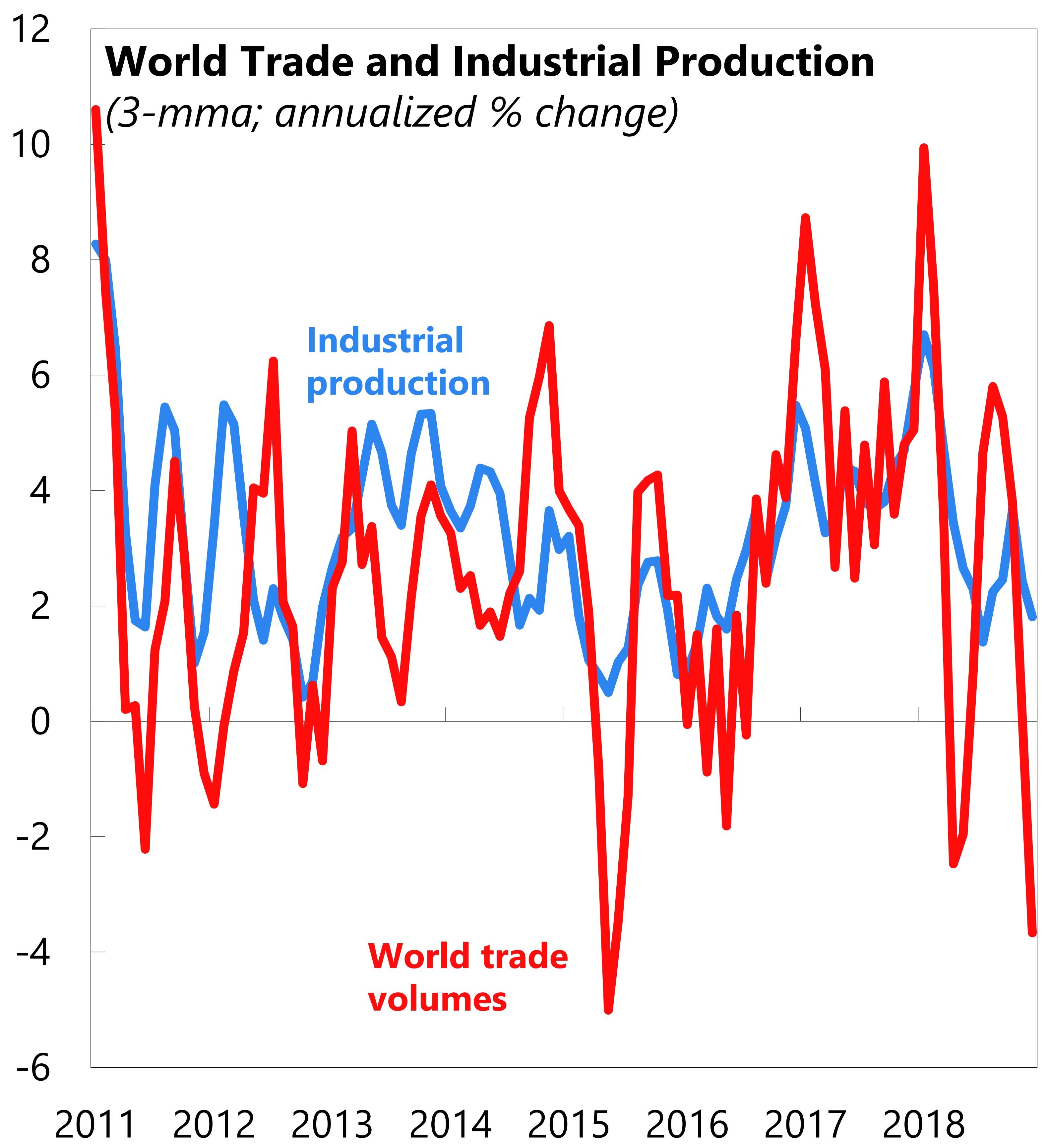
The weaker growth momentum is evident in trade and industrial production indicators

The global expansion weakened in the second half of 2018.



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Notes: BRIC = Brazil, Russia, India, and China. Global growth is the weighed average of real GDP growth in the G7 and BRIC economies.

The underlying momentum has weakened further with the end of import front-loading ahead of tariff hikes.

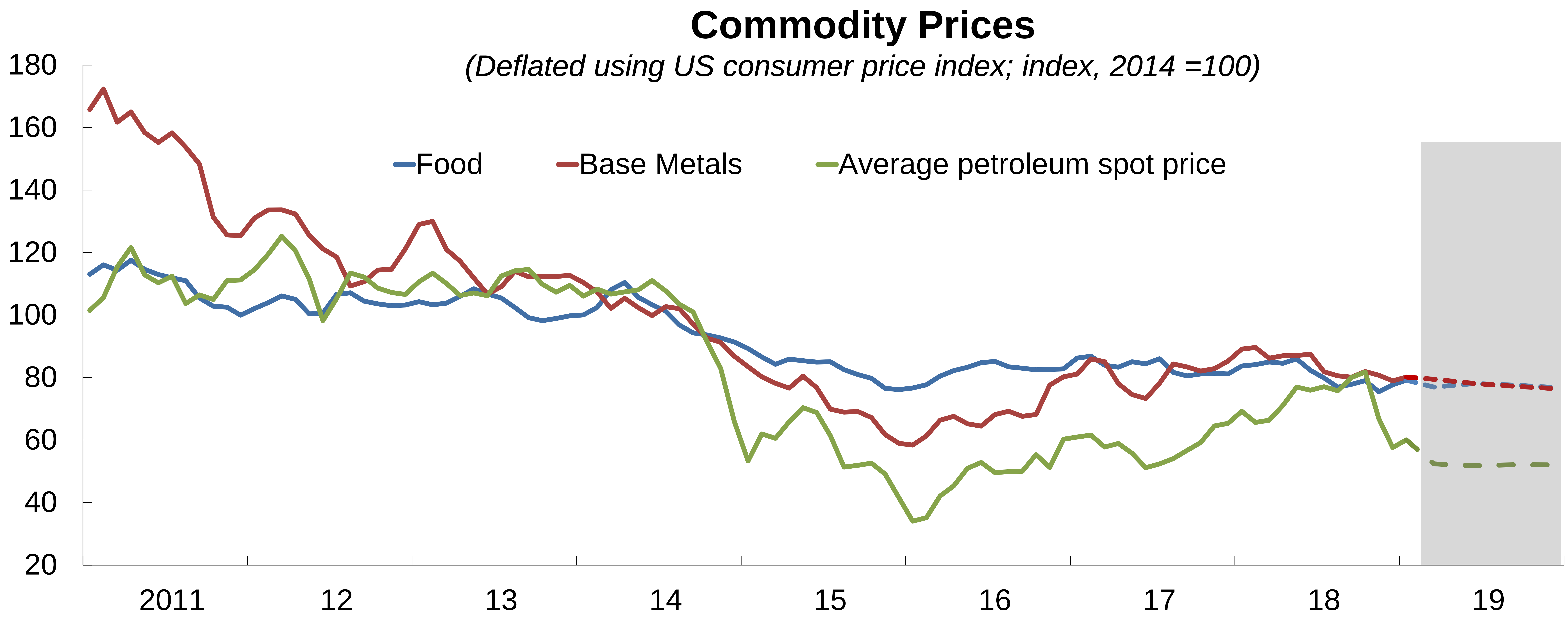


Sources: CPB Netherlands Bureau for Economic Policy Analysis; IMF, Global Data Source database; and IMF staff calculations.

The purchasing managers' indices show weakt new export orders.

Sources: J.P. Morgan; IHS Markit; and Haver Analytics.

Commodity prices have been volatile in recent months

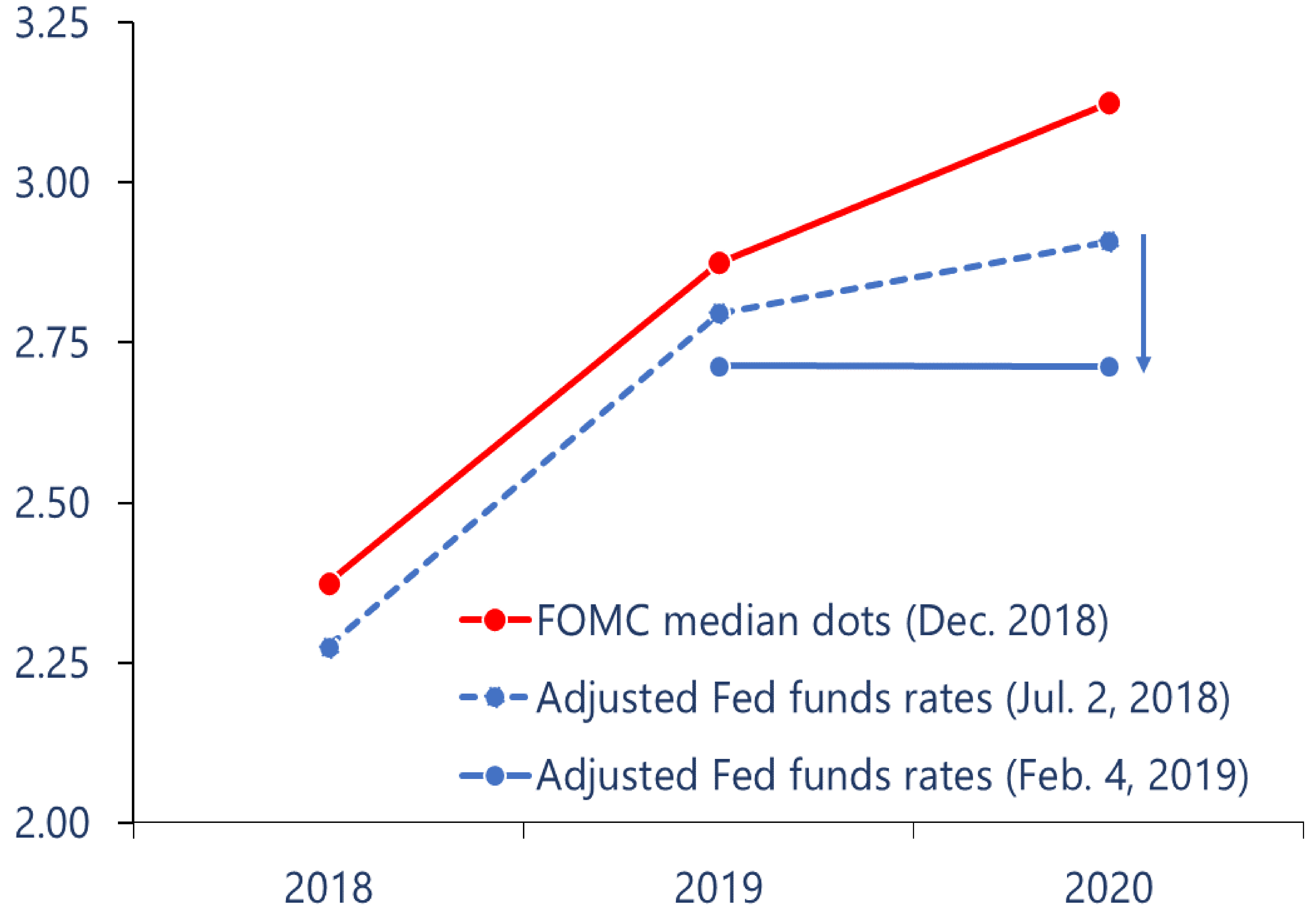


Sources: IMF, Primary Commodity Price System; and IMF staff estimates.

Investors Have a More Dovish Monetary Policy Outlook

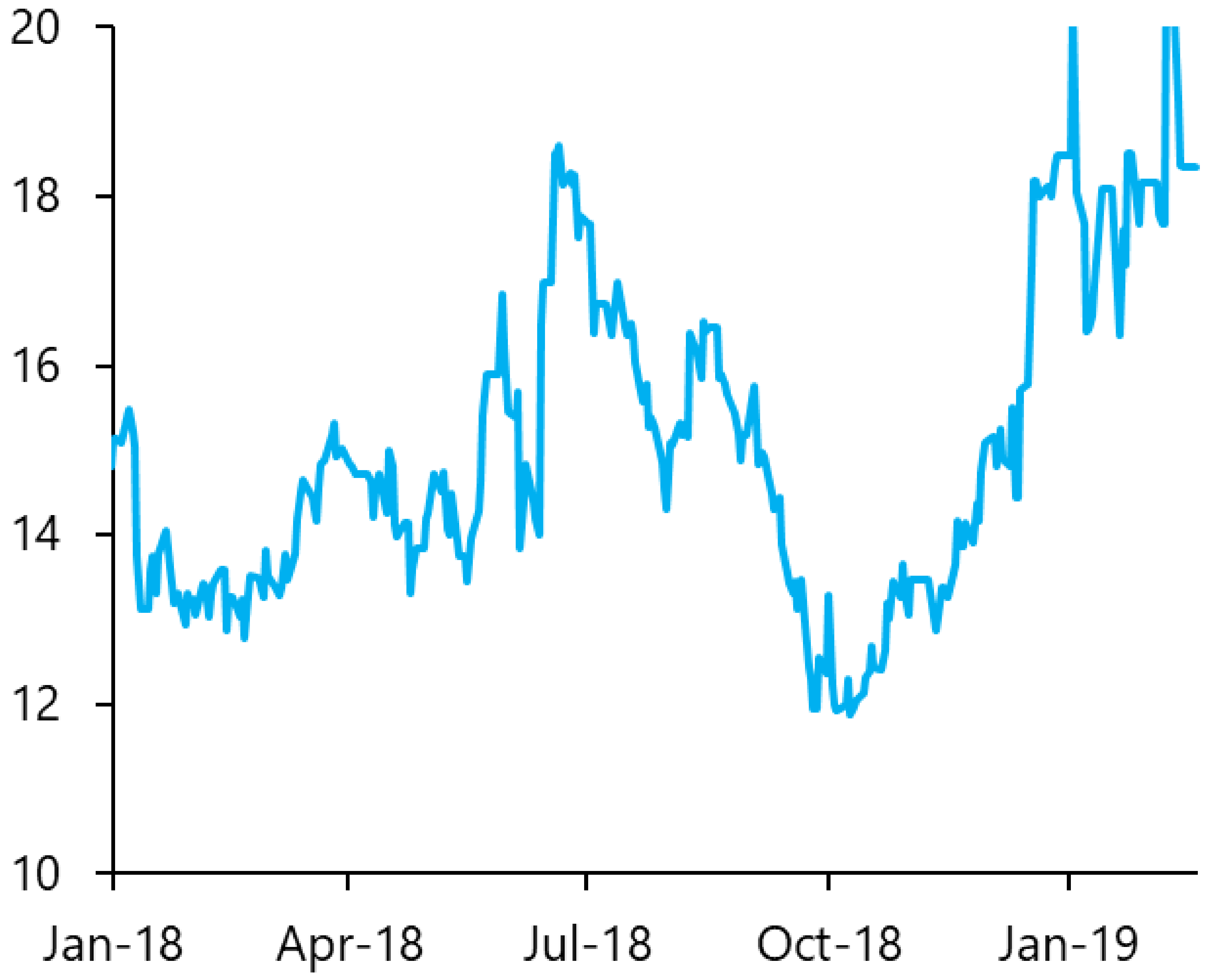
Investors are now pricing in a more dovish future rate path in the US …

Expected Fed Fund Rate versus FOMC Dots
(End-of-period, Percent)



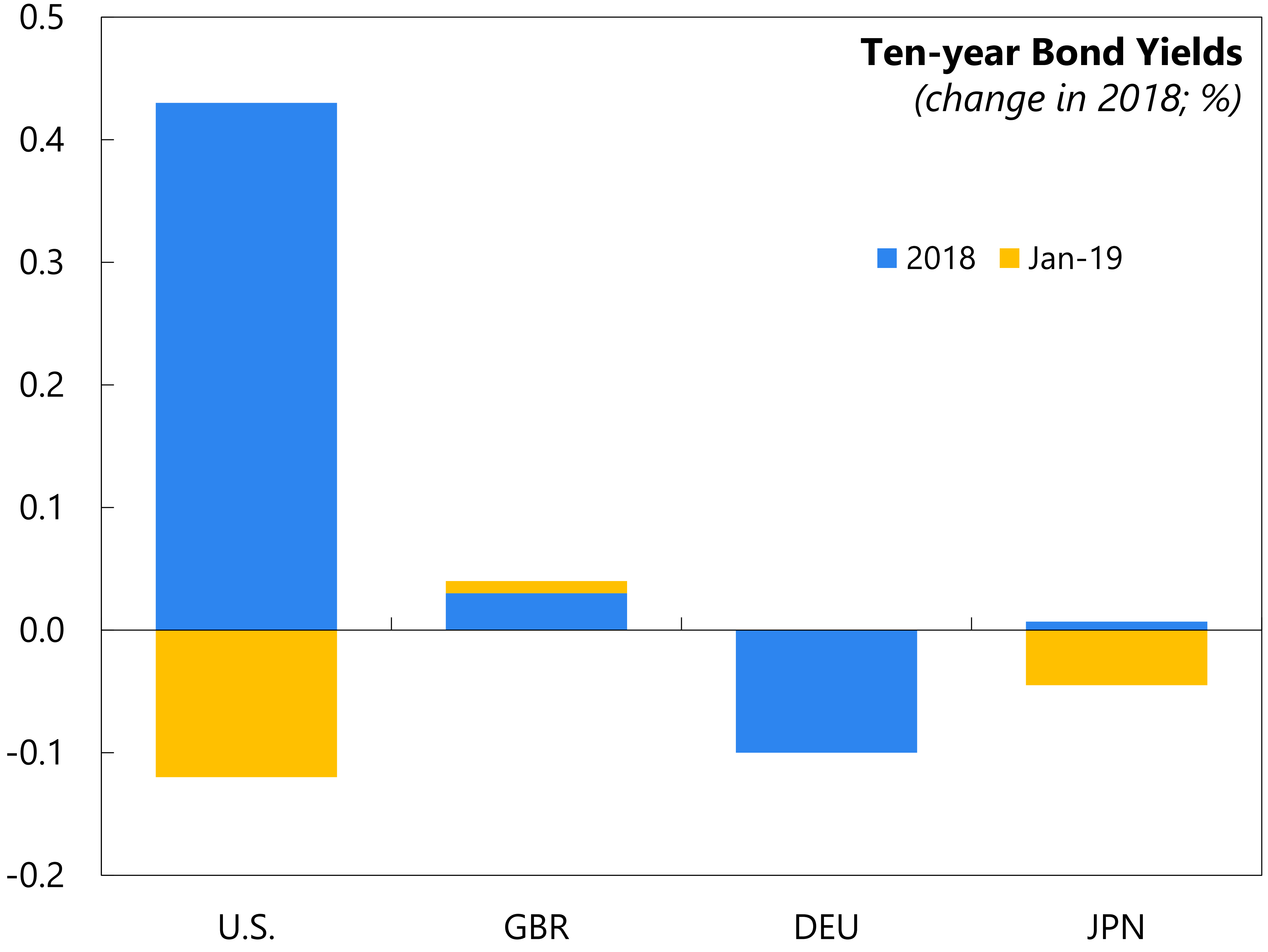
… as well as for the euro area

Expected Number of Months to First ECB Hike



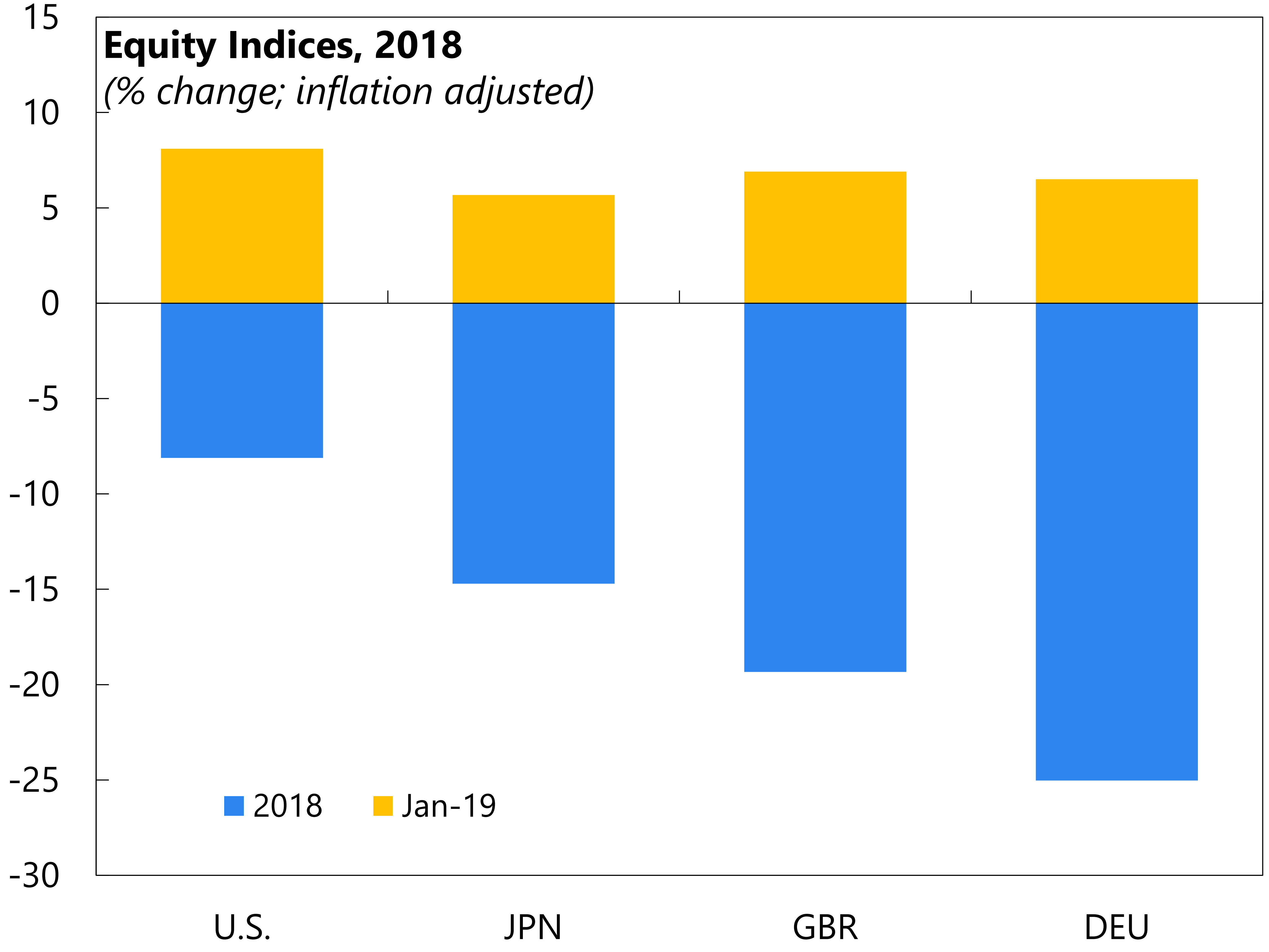
After tightening in 2018, financial conditions in advanced economies have eased somewhat in early 2019

Long-term sovereign bond yields have declined in 2019 reflecting a more dovish US monetary policy stance…



Sources: Haver Analytics; and IMF staff calculations.

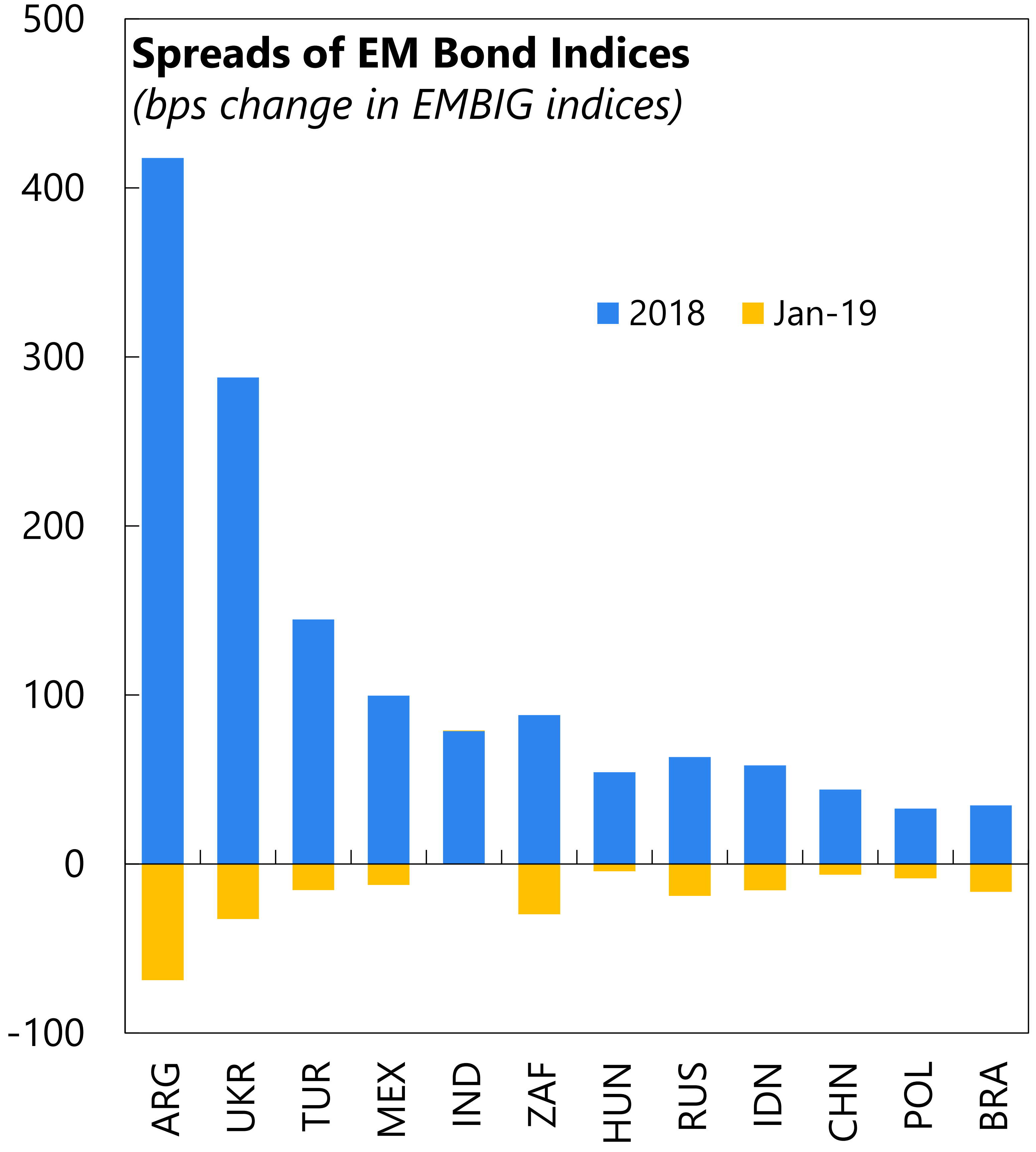
…and equity prices have increased following a sharp decline in late 2018 despite expectations of slower global growth.



Sources: Haver Analytics; and IMF staff calculations.

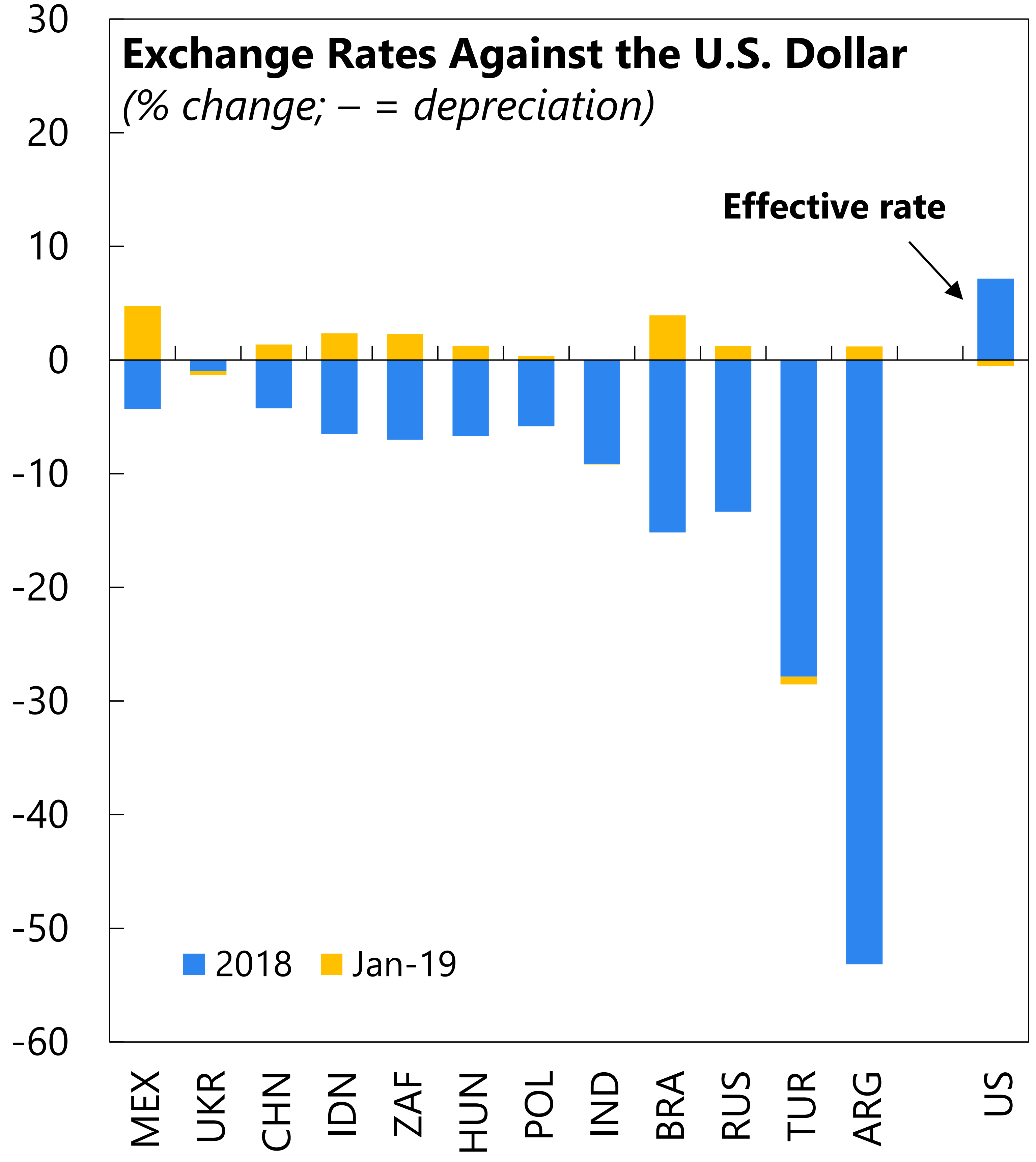
Also in EMEs, financial conditions tightened sharply in 2018, but have eased somewhat in 2019

Sovereign borrowing costs increased in 2018, albeit to varying degrees across markets…



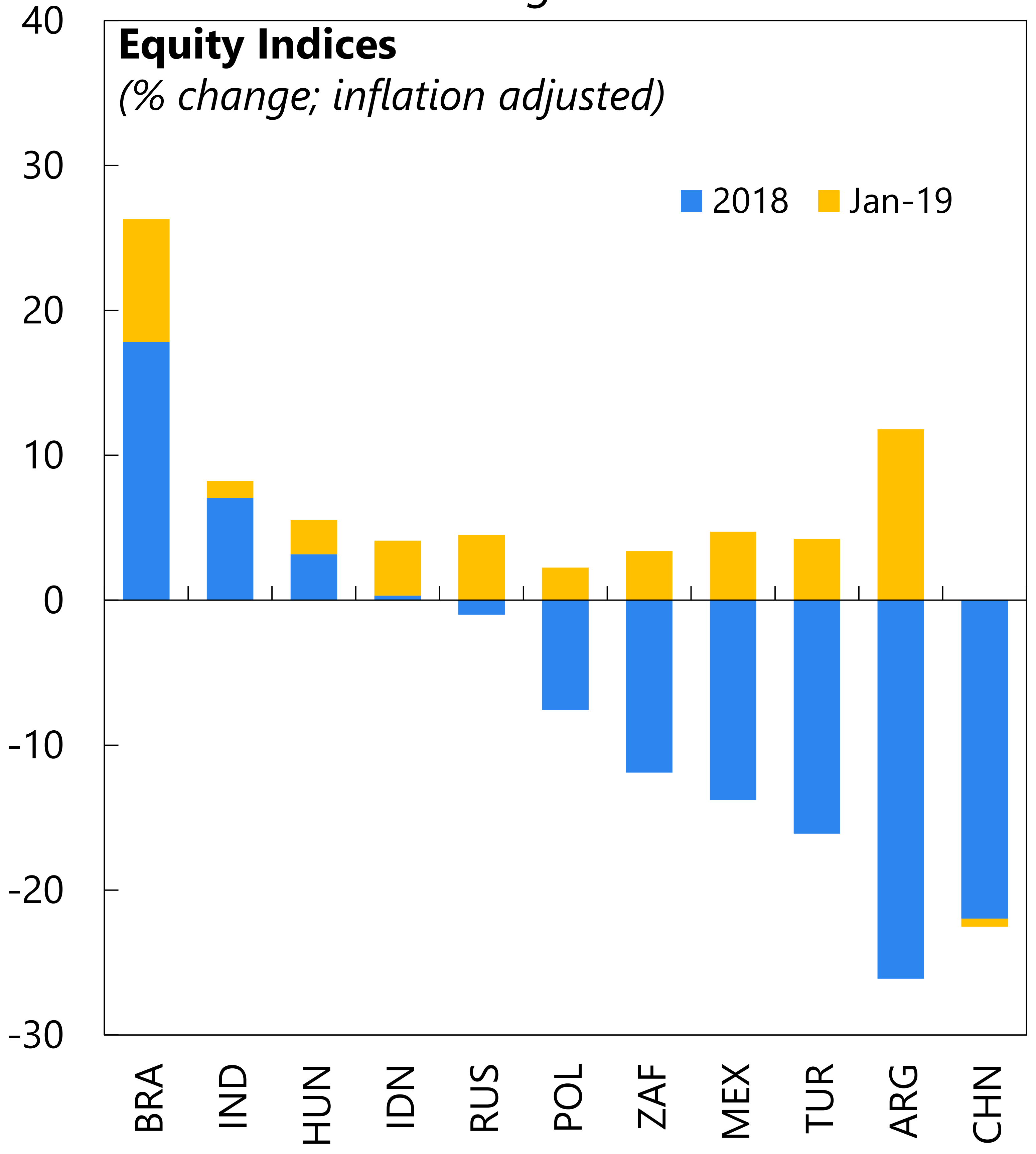
Sources: Bloomberg Finance L.P and IMF staff calculations.

… with several EM currencies depreciating beyond U.S. dollar effective appreciation…



Sources: Bloomberg Finance L.P ; Haver Analytics; and IMF staff calculations.

… and equity prices declining from historical highs.

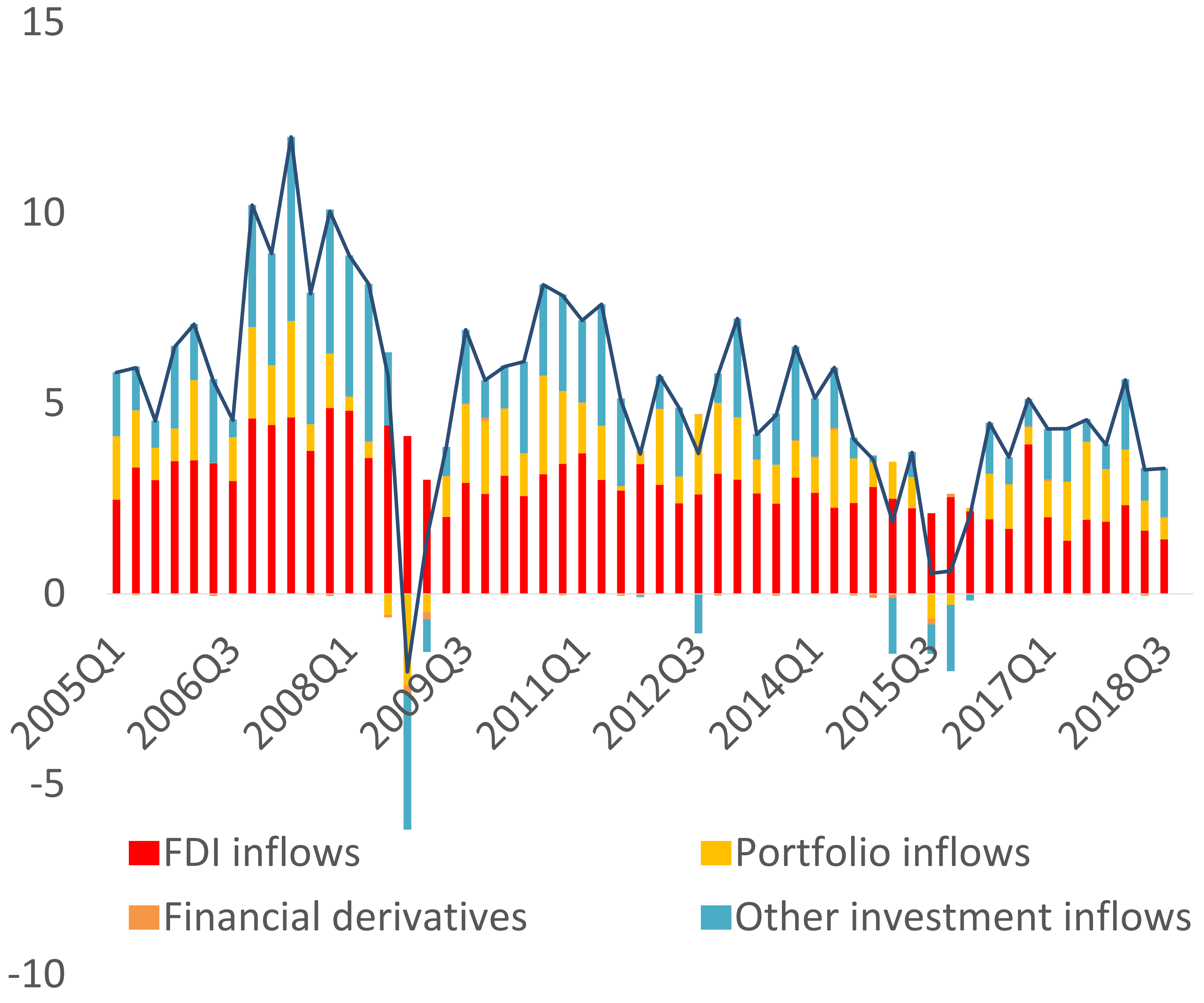


Sources: Bloomberg Finance L.P and IMF staff calculations.

Capital flows to EMs weakened in 2018 and resurged in 2019

Capital Inflows to Emerging Market Economies

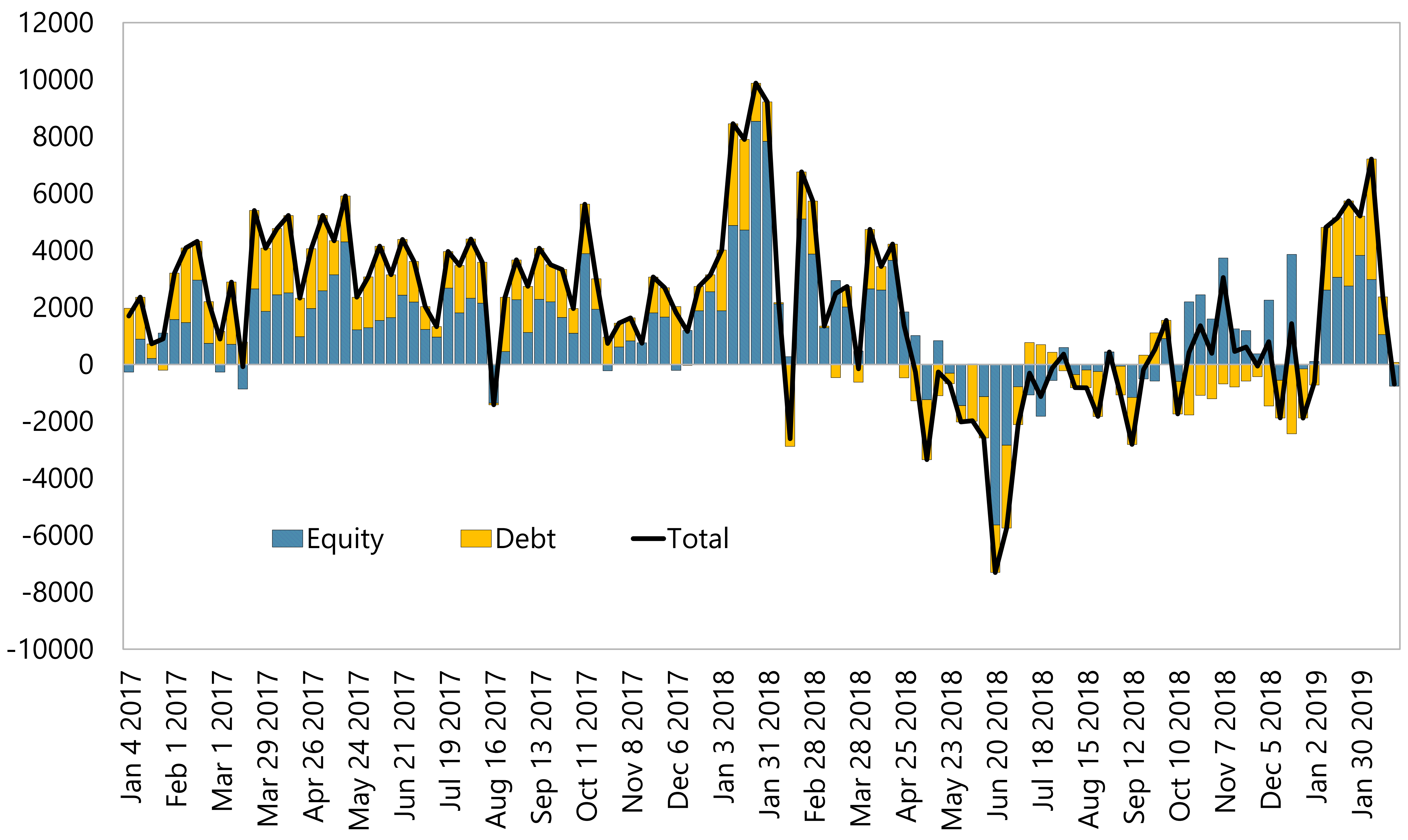
(percent of GDP)



Sources: Haver Analytics, and IMF staff estimates.

EPFR flows to Emerging Market Economies

(US$ Millions)

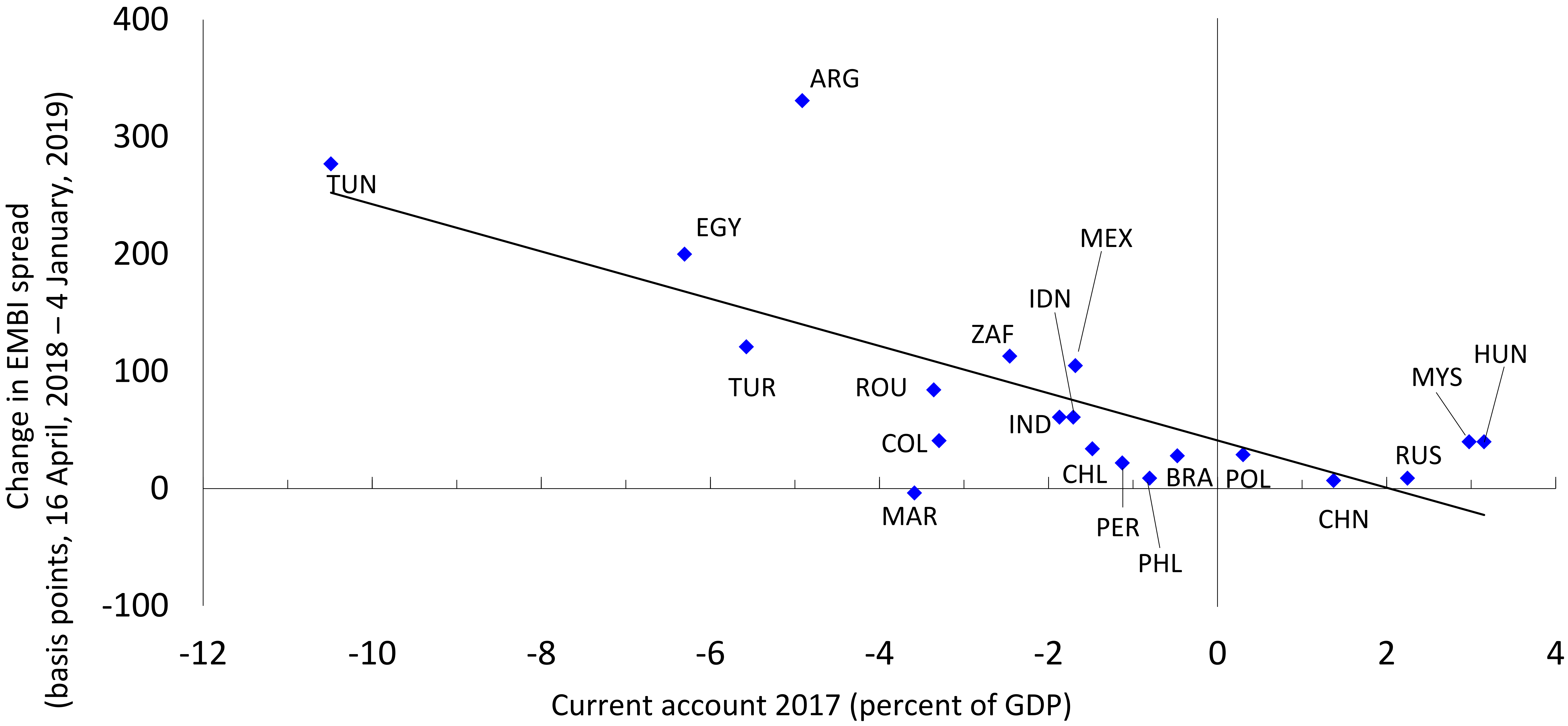


Sources: Haver Analytics.

Emerging Portfolio Fund Research (EPFR) database

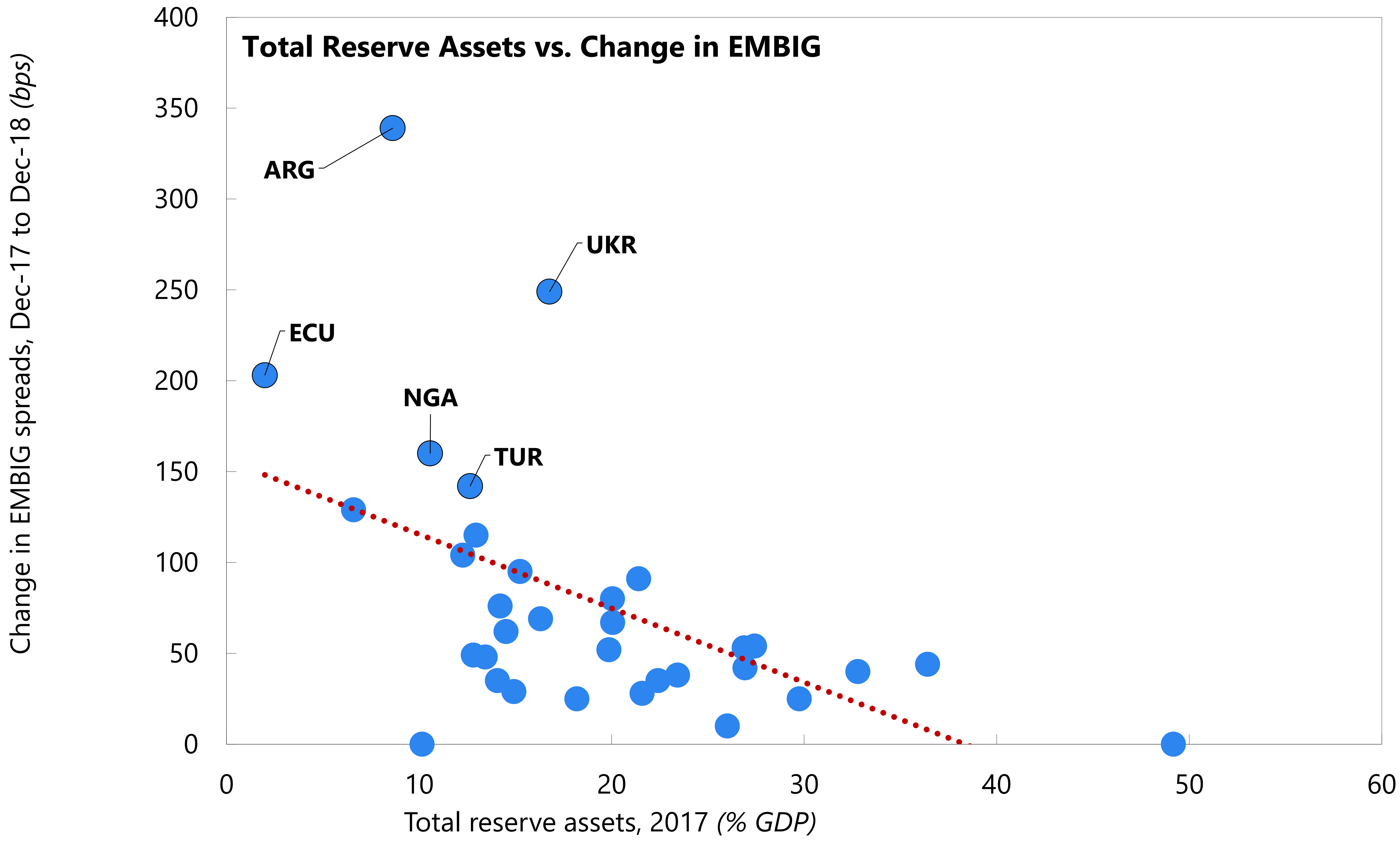
Investors are differentiating across EMs: spreads widened more in economies with higher external financing needs…

EM: Current Account Balance and Change in EMBI Spreads



Source: IMF staff calculations.

… and lower reserves



Sources: IMF, World Economic Outlook database; Thomson Reuters Datastream; and IMF staff calculations.

Forces shaping the outlook

Advanced economies | **Emerging market and developing economies**

near term…

Advanced economies

- Discussions on trade barriers, policy uncertainty
- Financial market volatility
- Global effects of US fiscal policy changes
- Generally accommodative monetary policy

Emerging market and developing economies

- Discussions on trade barriers, policy uncertainty
- Volatile oil prices: diverging prospects for fuel exporters vs importers
- Localized financial market pressures
- Idiosyncratic factors – political uncertainty, conflict

…medium term

Advanced economies

- Lower growth, reflecting
  - Demographic headwinds
  - Lackluster productivity growth

Emerging market and developing economies

- Group aggregate: pickup in growth after 2019 (stressed economies recovering); heterogeneity in regional prospects
- 45 EMDEs, accounting for 10 percent of global GDP (PPP), falling further behind AE income levels over projection horizon

Growth projections: Advanced economies

(percent change from a year earlier)

	World	Advanced Economies	U.S.	U.K.	Japan	Euro Area	Germany	Canada	Other Advanced Asia
2018	**3.7**	**2.3**	**2.9**	**1.4**	**0.9**	**1.8**	**1.5**	**2.1**	**3.1**
2019	**3.5**	**2.0**	**2.5**	**1.5**	**1.1**	**1.6**	**1.3**	**1.9**	**2.6**
Revision from Oct. 2018	–0.2	–0.1	0.0	0.0	0.2	-0.3	–0.6	-0.1	0.0
2020	**3.6**	**1.7**	**1.8**	**1.6**	**0.5**	**1.7**	**1.6**	**1.9**	**2.6**
Revision from Oct. 2018	–0.1	0.0	0.0	0.1	0.2	0.0	0.0	0.1	0.0

Sources: IMF, *World Economic Outlook Update* January 2019; and IMF, *World Economic Outlook* October 2018.

Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)

	Emerging Market and Developing Economies	China	India	Brazil	Russia	ASEAN-5	Fuel Exporting Economies	Low Income Developing Economies	LAC	APEC	Emerging & Developing Asia
2018	**4.6**	**6.6**	**7.3**	**1.3**	**1.7**	**5.2**	**1.1**	**4.6**	**1.1**	**4.1**	**6.5**
2019	**4.5**	**6.2**	**7.5**	**2.5**	**1.6**	**5.1**	**1.6**	**5.1**	**2.0**	**3.9**	**6.3**
Revision from Oct. 2018	–0.2	0.0	0.1	0.1	-0.2	-0.1	–0.3	–0.1	-0.2	0.0	0.0
2020	**4.9**	**6.2**	**7.7**	**2.2**	**1.7**	**5.2**	**2.1**	**5.1**	**2.5**	**3.8**	**6.4**
Revision from Oct. 2018	0.0	0.0	0.0	–0.1	-0.1	0.0	-0.1	–0.2	-0.2	0.0	0.0

Sources: IMF, *World Economic Outlook Update* January 2019; and IMF, *World Economic Outlook* October 2018.

Risks: tilted to the downside

- Potential for upside surprises has receded, downside risks have become more pronounced
- Trade tensions
  - Escalation could severely dent business confidence, harm financial market sentiment and increase volatility, slow investment and trade
- Financial conditions
  - Could tighten sharply (range of triggers: trade actions, hard Brexit, higher political and policy uncertainty, faster-than-envisaged China slowdown….)
  - Sudden tightening would expose financial vulnerabilities accumulated over years of very low interest rates
- Other factors
  - Geopolitical strains
  - Declining trust in mainstream political parties, regional and national institutions
  - Climate shocks

Trade tensions

Failure to resolve differences and a resulting increase in tariff barriers would lead to

- higher costs of imported intermediate and capital goods
- higher consumer prices

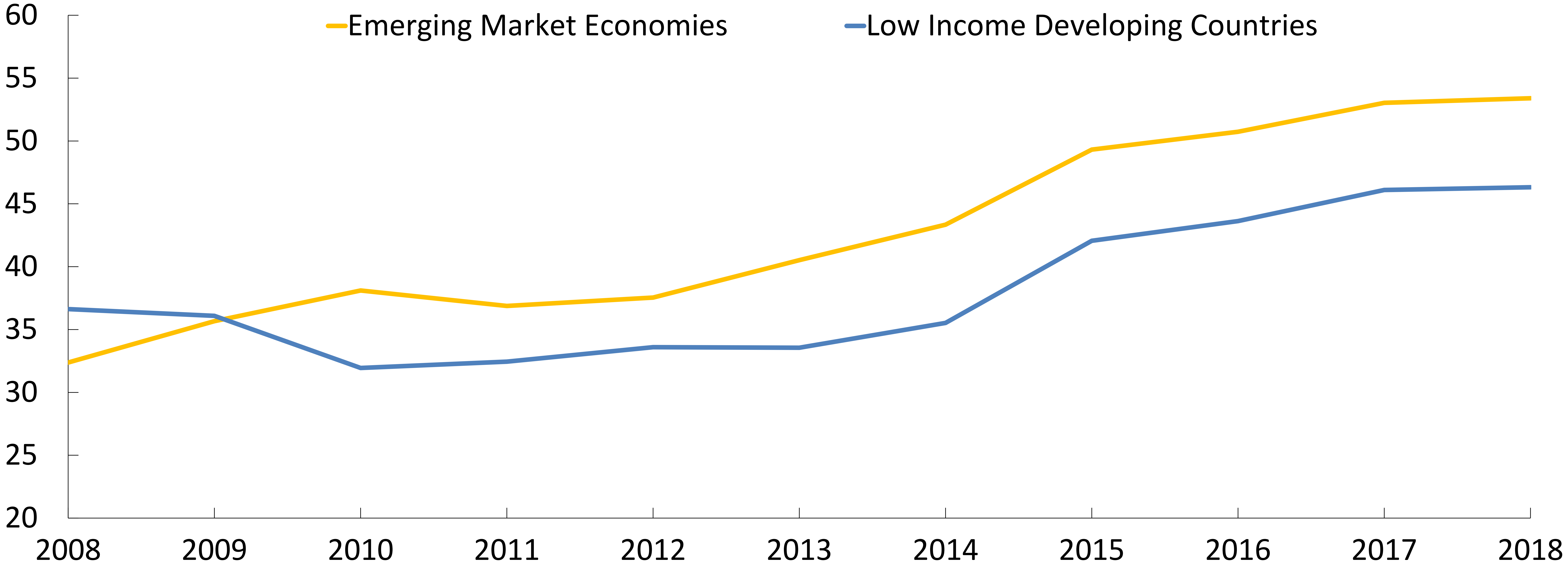
Beyond these direct impacts, higher trade policy uncertainty and concerns over escalation and retaliation would

- lower business investment
- disrupt supply chains
- slow productivity growth

The resulting depressed outlook for corporate profitability could dent financial market sentiment and further dampen growth (Scenario Box 1, October 2018 WEO).

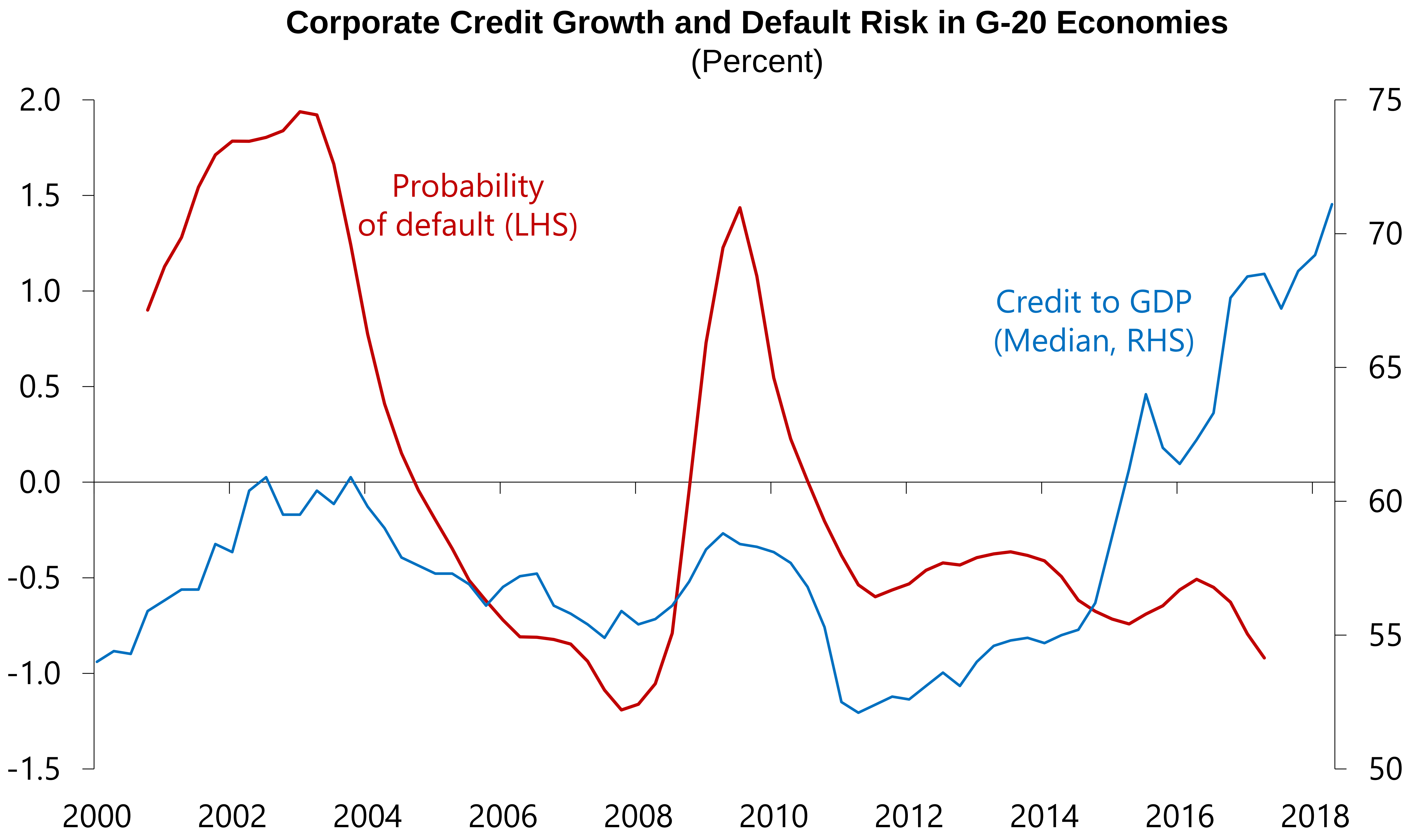
Sudden tightening of financial conditions could expose vulnerabilities related to higher debt in EMDEs

Median general government debt / GDP ratio by group of economies



Source: IMF WEO Database

Markets seem to be increasingly complacent about rising corporate debt

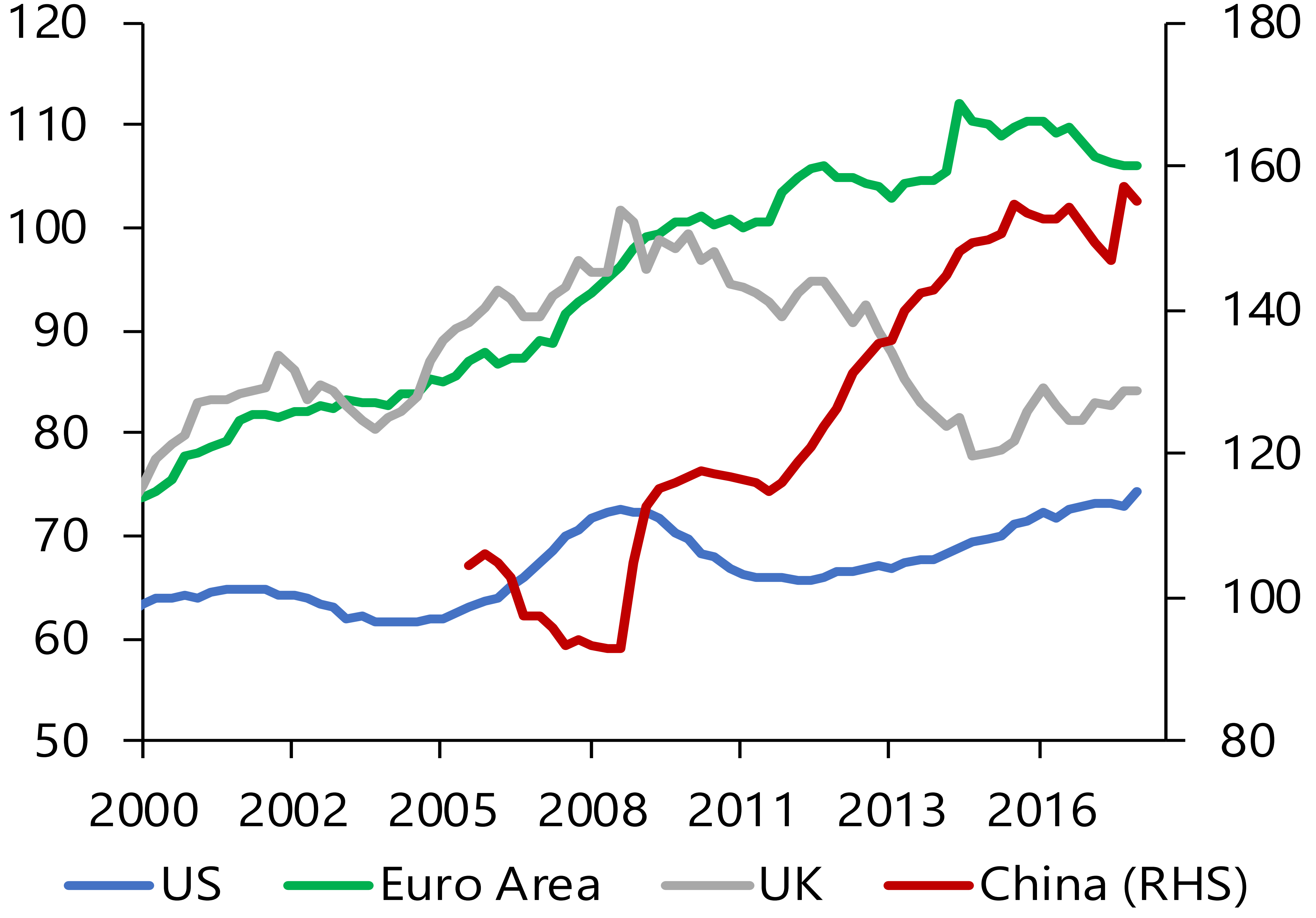


Source: October 2017 GFSR

Lower Profitability Could Worsen Debt Vulnerabilities

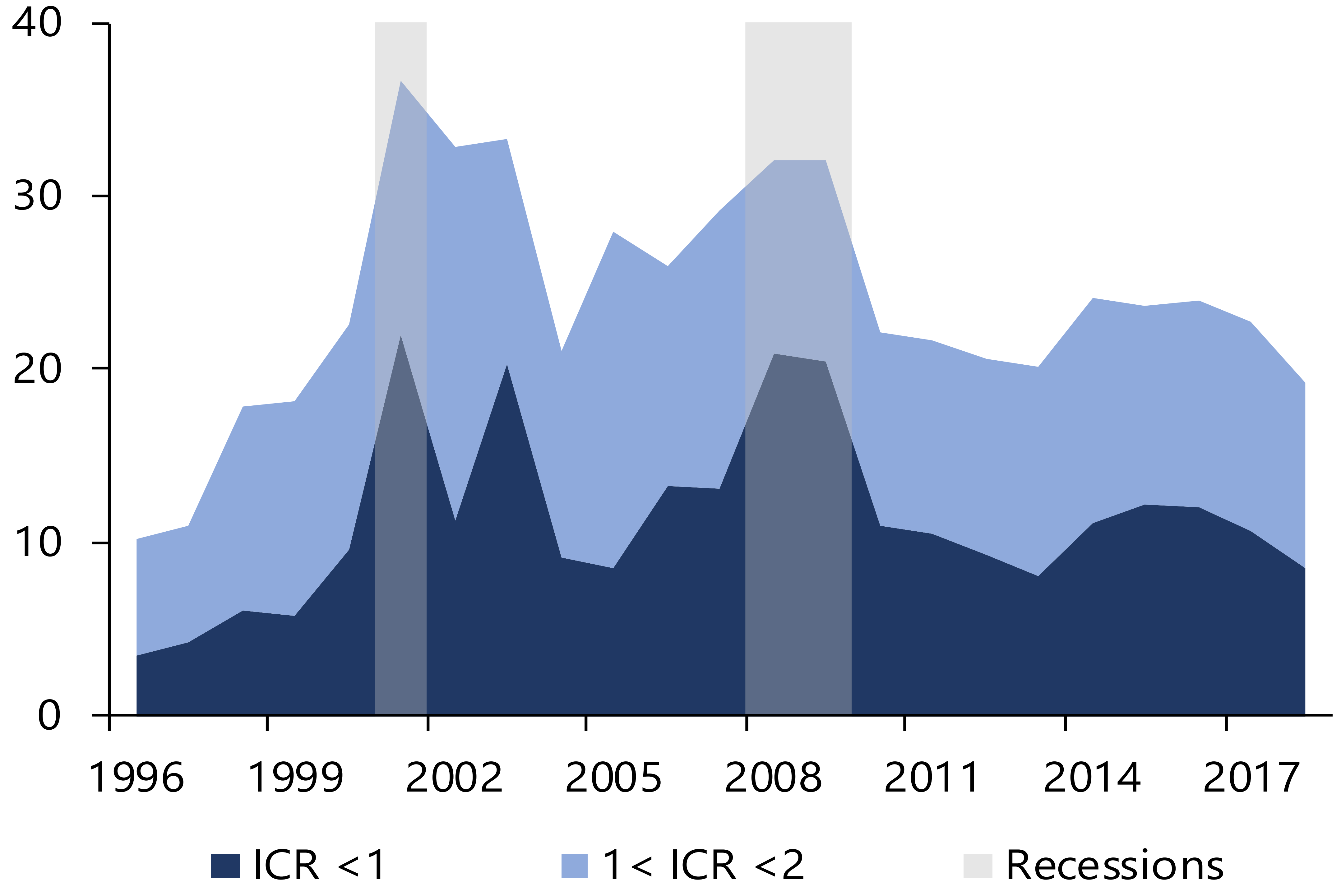
Corporate debt levels have increased globally …

Corporate Debt Trends, by Region
(Percent of GDP)



… this may strain corporate debt repayment capacity should profits decline

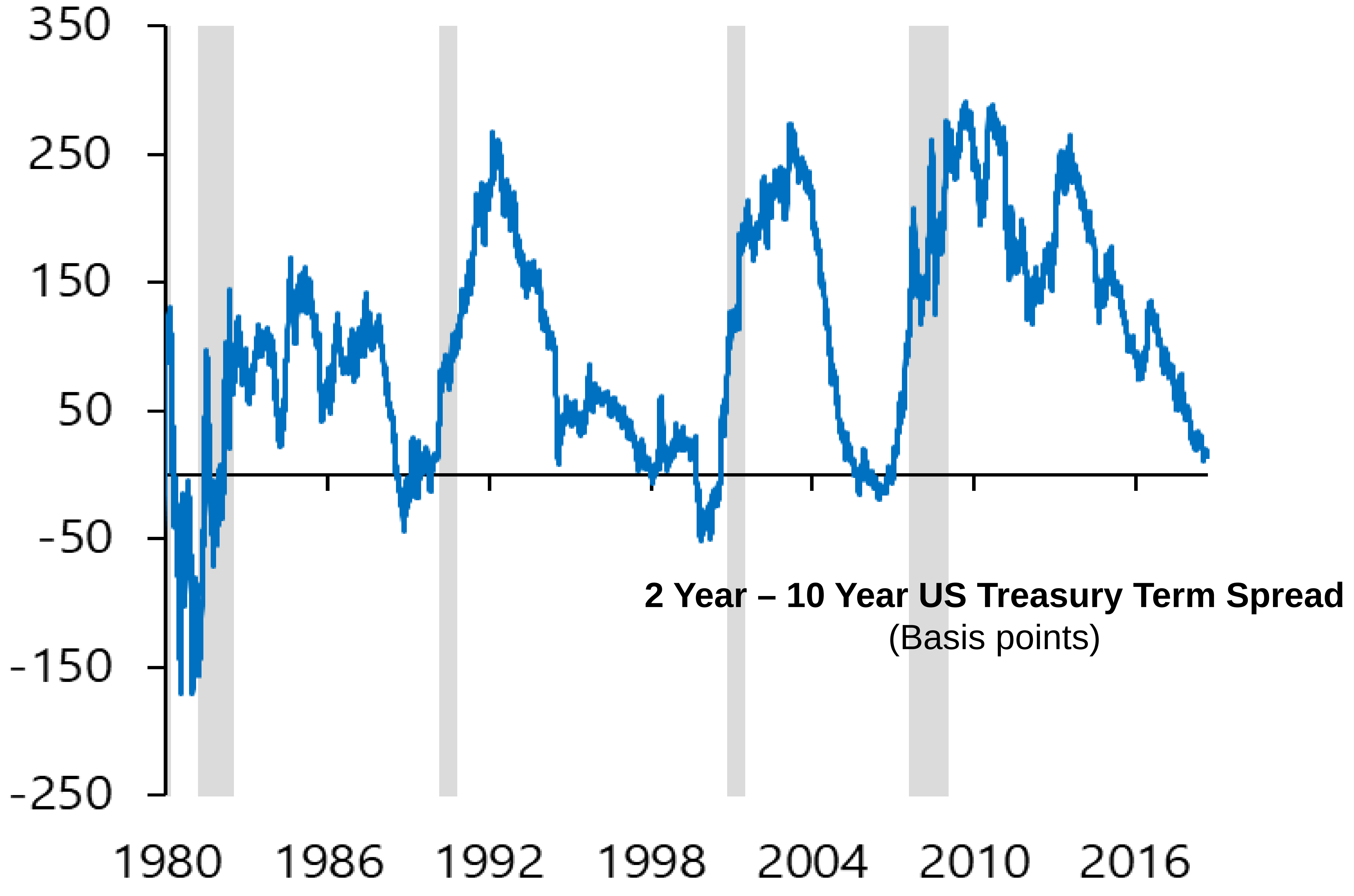
Weak Tail of US Companies by Interest Coverage Ratio*
(Share of US companies with ICR<2, Percent of total debt)



*ICR = Ratio of Earnings Before Interest and Taxes to Interest Expense

What Does a Flatter US Yield Curve Tell Us?

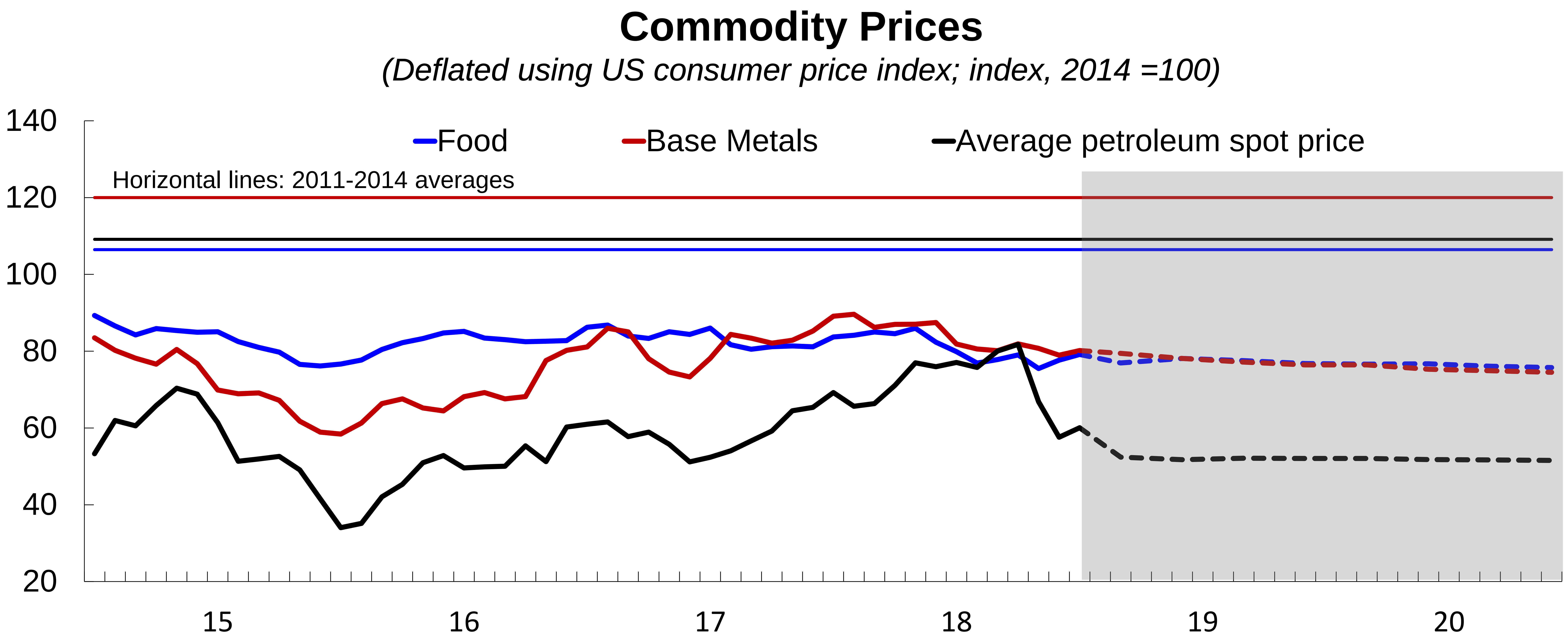
A tightening of term spreads tends to occur later in the cycle …



Note: Shaded areas depict recessionary periods

Source: October 2018 GFSR

Commodity prices expected to settle at levels well below past averages



Sources: IMF, Primary Commodity Price System; and IMF staff estimates.

Political uncertainty looms ahead.

Upcoming Elections in 2019 in Asia and WH

March
Micronesia
Thailand
Tuvalu

April
Indonesia
Maldives
Solomon Islands

May
Australia
India
Panama
Philippines

July
Guatemala
Japan
Nauru

October
Argentina
Bolivia
Canada
Haiti
New Zealand
Uruguay

November
Hong Kong
Marshall Islands

December
Dominica
Kiribati

Policy priorities: implement reforms to lift potential growth, contain vulnerabilities

Shared priorities

- Resolve cooperatively and quickly trade disagreements and the resulting policy uncertainty
- Adopt measures to boost potential output growth while enhancing inclusiveness
- Strengthen fiscal and financial buffers in an environment of high debt burdens and risk of tighter financial conditions

Advanced economies

- Monetary policy: support closing of output gaps where needed; gradually normalize where inflation is rising toward target; ensure inflation expectations remain anchored
- Orient fiscal policy more toward medium-term goals
  - Start rebuilding buffers where needed
  - Shift budget composition to lifting potential growth and enhancing inclusiveness (infrastructure, workforce skills, participation rates)
- Structural reform policies

Emerging market and developing economies

- Priorities differ based on diverse cyclical positions and economy-specific vulnerabilities
- Bolster financial resilience, including via strengthening macroprudential frameworks
- Strengthen fiscal positions where needed (particularly LIDCs, commodity-dependent economies), focusing on revenue mobilization, limiting recurrent expenditure, and curbing poorly-targeted subsidies
- Promote economic diversification (commodity exporters, countries particularly vulnerable to climate events) – judicious macro management, improving access to credit, investing in infrastructure and workforce skills