

EconoFact Chats: Risks to 'Steady but Slow' Global Growth
Maurice Obstfeld, UC Berkeley
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Michael Klein

I'm Michael Klein, Executive Editor of EconoFact. A non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein

The week before we recorded this podcast, the IMF and The World Bank held their annual spring meeting in Washington. The twice per year meetings host government economic officials from across the world and offer an opportunity for setting a global economic agenda. This year the Managing Director of the IMF, Kristalina Georgieva, declared the theme of the meeting “Rebuild, Revive, Renew.” What has to be rebuilt, revived, and renewed? And how likely is it that these goals will be met? To discuss these themes and the state of the world economy more broadly, I am very pleased to welcome Maurice Obstfeld back to EconoFact Chats. Maury is particularly well placed to discuss these issues. He is widely recognized as one of the world's leading experts in international economics. Maury is a Senior Fellow at the Peterson Institute for International Economics and Professor of economics emeritus at Berkley. He has served as a member of President Obama's Council of Economic Advisors, and from 2015 to 2018 he served as Chief Economist at the International Monetary Fund. Maury welcome back to EconoFact chats.

Maurice Obstfeld

Thank you, Michael, it's a pleasure to be back.

Michael Klein

Maury before we discuss the topics covered in this springs' meeting, I'd like to ask you about the biannual meetings more generally. Who attends? What presentations take place? And how important are these meetings for policy making?

Maurice Obstfeld

The meetings are hosted by the IMF and The World Bank. The stars of the show are finance ministers, central bankers, development ministers, but also, leading academics, thinkers from think tanks, people from the financial sector, businesspeople. So it brings together a broad range of folks active in steering the world's economy, either from the policy angle, or through their business decisions.

Michael Klein

So that's a lot of people. To what extent do these meetings, like many conferences, come from discussions outside the formal agenda. You have, in one place for three days, some of the most influential economic policy makers and businesspeople in the world. I would imagine people take advantage of that to meet one on one, or in small groups outside of the scheduled sessions.

Maurice Obstfeld

Well, the Bank and the Fund arrange a number of scheduled sessions, as you said, on current topics. But there's also a wide range of activities more or less by institutions on the fringes – the Bretton Woods Committee, the Institute of International Finance, my think tank – The Peterson Institute. And then a lot of meetings on the fringes where there's more informal interaction. Where, say a policy maker from Spain can go to a leading think tank, such as Peterson or Brookings, and talk to their experts about their views on current issues. So all in all, it's sort of a buzzing beehive of informational exchange and conversation.

Michael Klein

So, what was the conversation this year, Maury? What is the state of the world as these meetings took place mid-April.

Maurice Obstfeld

Well, the state of the world is not great. There's been a surprisingly resilient recovery from the COVID pandemic, but it has left after-effects which are associated with slower growth in a number of countries or slower expected growth. And more worryingly, there is an upsurge in competition between large players in the world economy. Notably the US and China, but also between the US and Europe, and between Europe and China, which is leading to ever more fragmentation in the economic structure of the world. That structure is already fragmented politically as we saw most dramatically when Russia invaded Ukraine in 2022, and the fragmentation is only growing as a result of the war in Gaza.

Michael Klein

So, what was meant by the Managing Directors alliterative themes of “Rebuild, Revive, Renew”?

Maurice Obstfeld

Well, I think rebuilding is making up for some of the legacies of COVID, such as very very high public debts. A big theme of the fund has been the need to reduce those debts – not through sharp austerity but gradually over time, to put economies on more sound fiscal paths, consistent with debt sustainability. I think ‘renew’ is the need to rebuild some of the fissures in the world's economy and rebuild the cooperation through the multilateral institutions. Some of them, for example the World Trade Organization, are not faring very well at the moment. It's not dysfunctional, [but] certainly not functioning up to potential. And ‘revive’ is to basically boost the growth prospects of the world economy. The Fund views those as being fairly tepid into the medium-term. With such growth rates, especially the developing world, it's going to be hard to progress further on reducing poverty, or raising per capita incomes closer to rich country levels.

Michael Klein

So the projected growth is slow, but still the resilience of the economies in many countries has been striking. Inflation has fallen from its 2022 peak without major downturns, something that many commentators thought could not occur. But inflation rates are still above target. Do you think that the last mile of inflation, and bringing it down to 2% targets will be particularly hard to navigate? And achieving these targets will harden the so-called “soft landing”?

Maurice Obstfeld

Well, the US has proven quite resilient in terms of real growth and employment. Less so, I think, other advanced economies, though perhaps that will improve in coming quarters. And the lower and middle-income countries, I think, remain more challenged to varying degrees. Particularly the low-income countries where, as a result of the pandemic, many more people were driven below the poverty line. Inflation has come down sharply from its heights, but in some places, it remains stubborn, notably the United States. We saw in the latest release on quarterly GDP growth from the Commerce Department that growth in the first quarter was below expectations. Below 2%. Inflation as measured by the PCE Index was much higher than expected. So, I think that's an indication that it might be a tougher haul to get inflation back to 2% in the United States. Of course, what happens in the US through the Fed's actions has a huge effect worldwide because of the dollar's importance in the world economy.

Michael Klein

In fact we talked about that on a prior podcast, and you've written quite a bit about the role of the dollar. Can you briefly describe what the role of the dollar is, and why it's so important, even though the world is no longer on the Bretton Woods System of having exchange rates fixed to the value of the US dollar.

Maurice Obstfeld

Yeah. The dollar serves as the prevalent reserve currency, vehicle currency, in the foreign exchange market. Nearly 90% of transactions actually go through the dollar. It's an invoice currency for international trade, equal to none. So effectively the dollar is an international money, an international medium of exchange, store of value, and unit of account. Only the Euro comes anywhere close in terms of reserve holdings and invoicing, but even the Euro is primarily of regional importance. One implication is that with some much trade being denominated in dollars, and with so many transactions in financial markets depending on the dollar, what the Fed does to interest rates, and to the dollar via interest rates has a global effect. A strong dollar tends to be deflationary globally. A weak dollar tends to boost the world economy. Lately, as markets have concluded that Fed interest rate cuts are more distant than they had previously expected, the dollar has strengthened very sharply. And a number of countries, particularly in Asia, are discussing measures to strengthen their currencies because they fear that the depreciation of their currencies against the dollar will revive inflation. So, we have Japan and Korea talking about joint intervention, with the US. We have Indonesia raising interest rates and also discussing intervention. So, the dollar is really a currency of international concern. In fact, even in the US in political circles, there's been more discussion of action to weaken the dollar. Not for the benefit of foreign countries but for the benefit of the US. And of course, you and I wrote a blog post in 2019 on that topic, "Should the US weaken the dollar?" We discussed the motivations and the drawbacks of doing that. So, that blog could become very relevant again.

Michael Klein

So, we'll repost it. The metaphor we used was 'the tail wagging the dog'

Maurice Obstfeld

That's exactly right.

Michael Klein

And also, we have a podcast with Linda Goldberg from March in which we discuss the role of the dollar as well.

Maurice Obstfeld

I think all of that is coming back into the center frame of the discussion now.

Michael Klein

Pierre-Olivier Gourinchas...the Director of Research at the IMF, a successor to you there, wrote in a blog on the eve of the spring meetings that “the pandemic period left little scarring in the United States, but more scarring in low-income countries.” What did Pierre-Olivier mean by ‘scarring’ and what are its longer run effects on economies?

Maurice Obstfeld

Well, I think, first and foremost, debt build-up. Countries accumulated debts to deal with the pandemic, interest rates are higher, so the servicing costs of those debts are greater. That squeezes budgets, and makes it harder to provide essential services and goods. And those government support expenditures are more necessary than ever, in light of other elements of scarring. Students missed school and their accumulation of human capital, thereby, was hampered. Investment fell, and so capital stocks were depleted. A number of low-income countries now are at or near a situation of debt distress. Some are actively renegotiating with creditors, or at least trying to renegotiate. And so, these legacies of the pandemic are a lot of what’s behind the slower medium-term growth that the IMF is forecasting for these countries.

Michael Klein

In fact, the IMF identifies government debt as one of the key challenges facing countries. What happens if countries don’t meet this challenge? How likely is it that the debt will come down without extraordinary efforts?

Maurice Obstfeld

You know, to start, we need efforts. And if we look at the dysfunction in the United States, even efforts are not forthcoming in the near-term now. The US is in a privileged position because of the dollar’s status, and the centrality of US financial markets. Nobody thinks the US is going to face a situation where international capital markets refuse to lend to it. But that’s not the case for many other countries, particularly the low-income countries. Even middle-income countries, while they are on a much firmer basis now than in years past, could conceivably get into trouble. And what you see in those situations is basically a spike in borrowing rates as your markets begin to suspect the imminence of some sort of default. Or in the case where the government’s debt is denominated in [inaudible] currency, which is increasingly the case in middle income developing countries, markets begin to worry about a surge in inflation. If the government can’t raise the tax revenue to fund its expenditures, or reduce expenditures in line with its tax revenue, and markets won’t lend to it, then the next recourse is to the printing press, and that means higher inflation.

Michael Klein

Which is what we've actually seen in a range of countries. Countries resorting to the printing press and having high inflation at a point that actually hurts economic growth, right?

Maurice Obstfeld

Yeah. To be fair, this is less prevalent across countries than it was 25 years ago. Many more countries have instituted independent central banks, and those central banks are run by much more skilled personnel. But we can certainly see the cases where this doesn't work. Look at Argentina. Look at Zimbabwe. Look at Turkey until very recently was heading to uncontrolled inflation. They've gotten that more under control, but the situation there is not fully satisfactory yet. So, I think the danger continues to loom, that in extremis, more countries might fall into inflationary traps because of their unbalanced fiscal situations.

Michael Klein

When the spring and fall meetings occur, in April and October, the IMF publishes its World Economic Outlook. And the most recent issue speaks of a surprisingly resilient world economy, and the prospects over the next few years of steady but slow growth, despite efforts to continue to bring inflation to the target levels that we were talking about. An article in Bloomberg calls this recovery 'milquetoast.' It says it's not really that steady or strong. Is this a fair characterization or should we think about the world economy being surprisingly resilient?

Maurice Obstfeld

Back in the fall of 2022 when the Fed was still raising interest rates without a clear end in sight, and other countries were doing the same, it really looked like we might have a global recession. And it's been a bit of a miracle that inflation has come down as much as it has, without more of a hit to growth. I think that is a great success for central bankers. It also is a success for markets because in many cases supply chains readjusted, and eased up more quickly than you would have expected. So this more elastic supply response is also a large part of the success story. There have been mild recessions here and there. Germany, Japan, the UK could be pointed to. But not the huge decline in activity such as we saw in the early 1980s when the Fed decided to take on inflation under Paul Volcker. So, from that perspective we should be very happy with the outcome, and not decry the achievement. That being said, growth is subdued. The projected growth rate of the IMF, the global growth rate of 3.2% is not high by previous standards. Inflation remains above central bank targets in a number of countries, notably in the US, and I've already pointed to the central importance of the US' inflation challenge. So, we're not in a perfect place yet by any means, but you know, we shouldn't ignore the fact that things could have been a lot worse. It's partially a testament to what central banks achieved over the last couple of decades in bringing global inflation down, and keeping it moderate, and building up a stock of credibility.

Michael Klein

Maury, what do you see as the main risk factors facing the world that could derail the projected by the IMF, slow but steady growth?

Maurice Obstfeld

Well, I think that the three most obvious factors are geopolitics, climate, and health. The risk of epidemics or pandemics, and the threat of the last of these is underscored by the discovery of H5N1 virus DNA in US cattle herd. Before COVID, experts thought that the most likely cause of a global pandemic would be some mutation of avian flu, such as struck the world in 1918 and 1919. The fact that we had a coronavirus instead came as something of a surprise, but the flu threat is definitely out there. Climate is degrading at a rapid rate, leading to extreme weather events. And of course, as we saw in the last couple of weeks, all-out war could break out in the Middle East. And there are other areas of concern such as East Asia. So those are the big threats. Aside from those, some sort of financial crisis could derail the global economy. We had events last year with Silicon Valley Bank, and Credit Suisse. So that threat is always there, and I think financial regulators need to remain vigilant. We are in an environment now of, I think, frothy financial markets. Whether it's bitcoin, or tight corporate spreads, or elevated equity prices. Even though the S&P has come down from its recent all-time highs, the FTSE has just reached all time highs. So, these valuations are, at the best, questionable in terms of the growth prospects ahead of us, and the interest rate prospects ahead of us. You know, maybe productivity growth due to AI will come and save us, but that's not a sure thing. A number of economists are skeptical.

Michael Klein

Well, a lot to be concerned about. I guess as always, but maybe especially now. Maury, thank you very much for joining me today and offering your perspective on where we are right now through the lens of the spring meetings. As always, I enjoy speaking with you, even if it is dire.

Maurice Obstfeld

It's always a pleasure Michael!

Michael Klein

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