GROUP OF TWENTY

G-20 Surveillance Note

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Prepared by Staff of the

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*Does not necessarily reflect the views of the IMF Executive Board

EXECUTIVE SUMMARY

There are tentative signs of stabilization in global growth. Amid softness in many parts of the world, global growth for 2019 was revised down in the April 2019 World Economic Outlook, partly reflecting idiosyncratic temporary factors and weakness in stressed economies. Against this backdrop, major central banks appropriately slowed the pace of monetary policy normalization, leading to an easing of financial conditions and some recovery of capital flows to emerging markets. Recent data releases suggest that growth may have firmed up in the first quarter. Going forward, the current forecast is for global growth to increase slightly from 3.3 percent this year to 3.6 percent in 2020.

The expected recovery comes with downside risks. In particular, questions remain about the strength of the recovery, as the impact of temporary setbacks and stresses could be felt for longer than expected. Trade tensions could persist or further escalate, and Brexit might end up being disorderly. Monetary and fiscal stimulus in China may delay the adjustment to more sustainable growth and add to risks in the medium term. Meanwhile, financial vulnerabilities continue to accumulate amid still-low interest rates in advanced economies, leaving many economies exposed to a sudden shift in financial conditions. Alongside, macroeconomic policy space to respond to shocks is limited in many G-20 economies.

The outlook remains wanting over the medium term. G-20 policymakers cannot be content with rates of GDP growth, which—in per capita terms—remain below historical averages for many countries, as aging and low productivity growth take their toll. At the same time, global imbalances persist, and continued inequality points to further room for sharing more widely the gains from trade and technological progress.

With the global economy remaining at a delicate juncture, the policy mix must be carefully calibrated. Policymakers should avoid any hastened removal of policy support. Monetary policy needs to stay accommodative until incoming data confirm inflationary pressures toward targets. Amid varying degrees of fiscal space, fiscal policy must balance the trade-offs between protecting the recovery and the most vulnerable and ensuring sustainability. Financial sector policy can help support stability by mitigating risks from high leverage in many sectors and vulnerabilities in non-bank financial institutions. Structural reforms should lay the foundation for stronger, more inclusive growth. Emerging market economies need to remain vigilant to reduce vulnerabilities to international capital flow volatility.

Should growth substantially disappoint, policymakers need to stand ready to act. Should downside risks materialize, a more accommodative policy mix would be warranted. This would include making use of conventional and unconventional monetary policy and fiscal stimulus—where space is available. Implementing structural reforms today will also help lift growth in the event of a downturn. Additional stimulus would be most effective if well-coordinated domestic policies are part of an internationally synchronized policy response.

Global cooperation can mitigate risks and support growth. Multilateral policies are necessary to help address global challenges. A key priority should be to create a more open, stable, and transparent trade system, including by durably resolving current trade tensions. International cooperation is also needed to reform the system for taxing multinational enterprises, complete post-crisis regulatory reforms, strengthen the global financial safety net, and mitigate and adapt to climate change.

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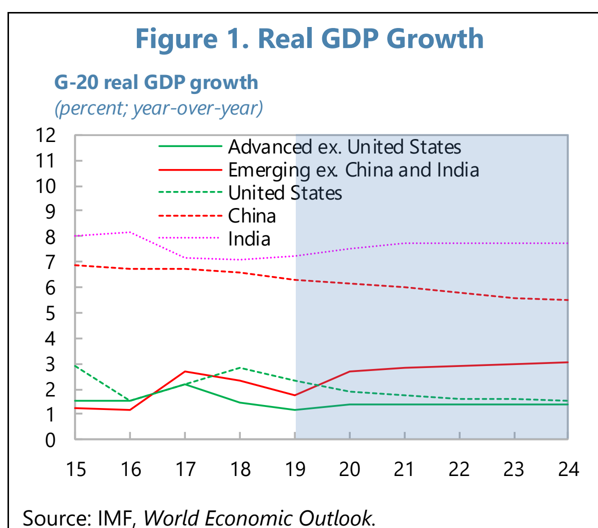
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

After a growth slowdown in late 2018 and early 2019, there are tentative signs that growth is no longer moderating. The unwinding of temporary factors, the continued monetary policy accommodation with associated easing of financial market conditions, and the policy stimulus in China should assist the return to somewhat stronger growth. However, for most G-20 economies, the strengthening of growth remains highly uncertain, with risks tilted to the downside, and the medium-term growth outlook is subdued.

A. Tentative Signs of Stabilization in Global Growth

1. **Global growth has slowed.** Following a deceleration of activity at the end of 2018, the global economy remained weak in early 2019. As a result, the April 2019 World Economic Outlook (WEO) revised down projections for global growth to 3.3 percent in 2019—0.4 percentage points lower than projected in the October 2018 WEO. The downgrade was broad-based across all income groups, with 70 percent of the global economy[1] now projected to see slower growth this year than last (Figure 1, Table 1). At the same time, output gaps are broadly closed in advanced G-20 economies and unemployment rates are at historic lows. Inflation pressures remain muted on continued weak growth and despite oil prices close to a six-month high (Figure 2).

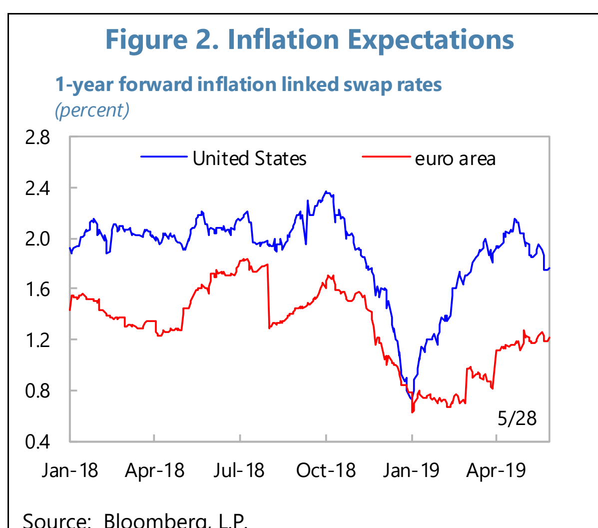
Figure 1. Real GDP Growth



Source: IMF, *World Economic Outlook*.

2. **The slowdown partly reflects country-specific temporary factors and the plight of stressed economies.** The weakness at the turn of the year was especially visible in the manufacturing sector and trade, with frequent disappointments in economic data releases (Figure 3). Idiosyncratic factors included a disruption in car manufacturing in *Germany*, protests in *France* that disrupted retail sales and weighed on consumer spending, and natural disasters in *Japan*. Trade tensions and the continued threat of a no-deal Brexit also held back growth. In *China*, ongoing progress on financial regulatory reforms helped rein in growth in shadow banking—though the sector remains large—but added to the drag on economic activity. Growth in *Brazil*, *Mexico*, *Russia*, and *South Africa* continued

Figure 2. Inflation Expectations



Source: Bloomberg, L.P.

[1] Based on purchasing power parity (PPP)-GDP.

to underperform on domestic challenges, and weakness in stressed emerging market economies weighed on growth (e.g., *Argentina* and *Turkey*).

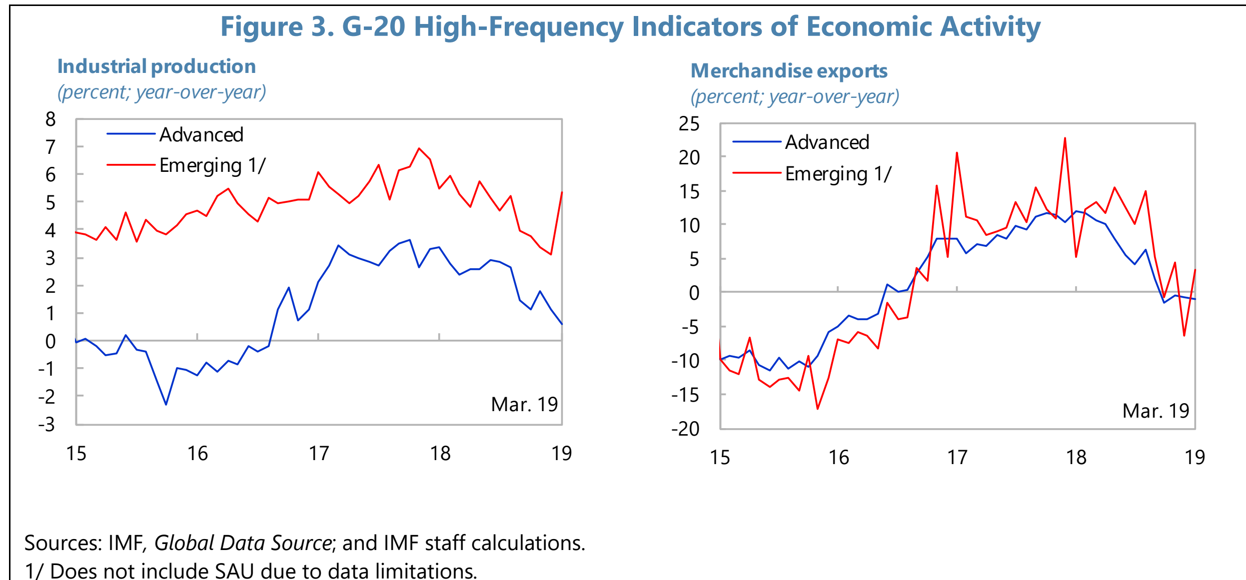
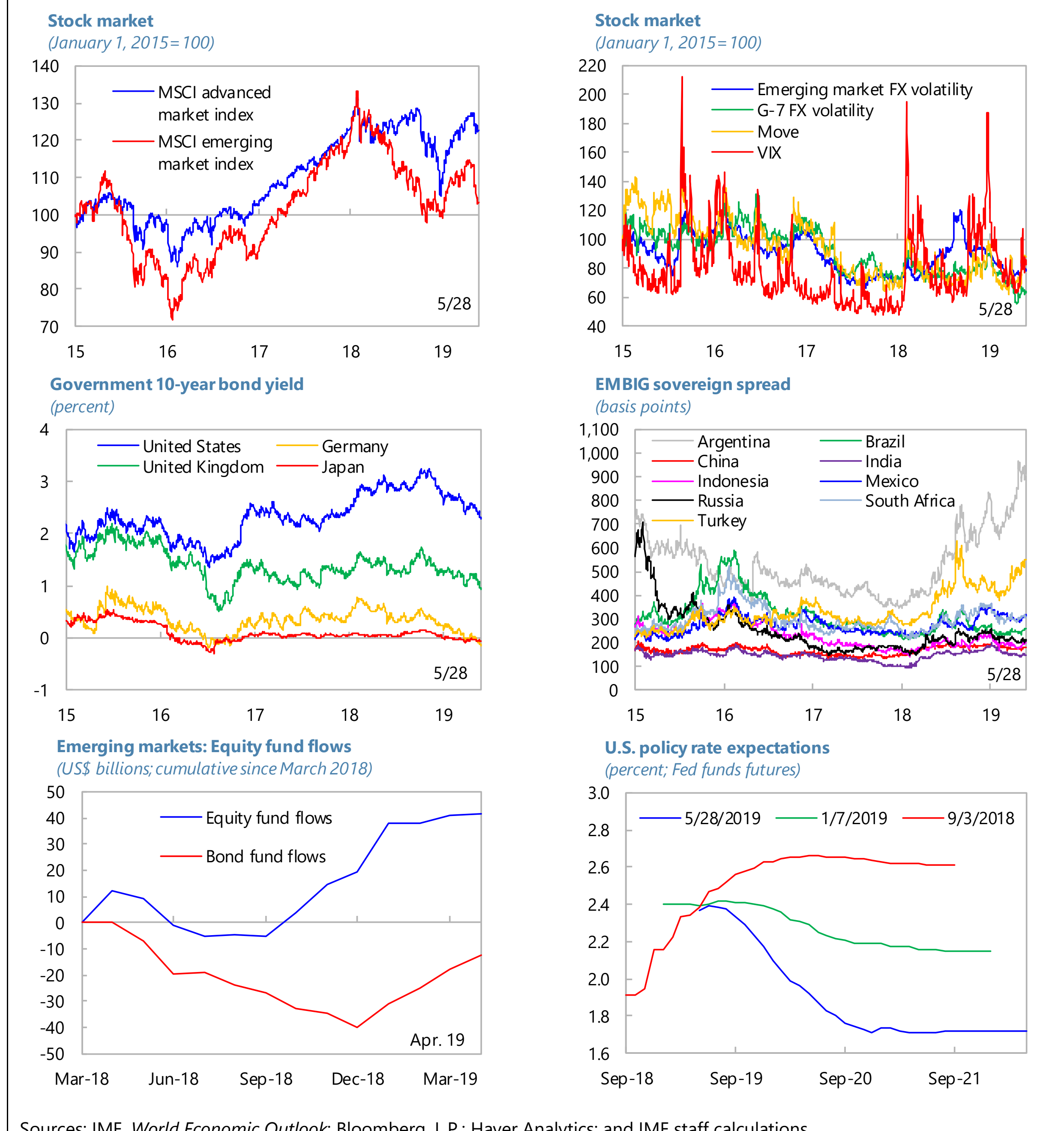


Figure 3. G-20 High-Frequency Indicators of Economic Activity

Sources: IMF, *Global Data Source*; and IMF staff calculations.
1/ Does not include SAU due to data limitations.

3. In response to the slowdown and subdued inflation, major central banks appropriately slowed the pace of monetary policy normalization, supporting an easing of financial conditions. The *United States* Federal Reserve slowed the pace of monetary policy normalization. The *European* Central Bank (ECB) announced a new round of targeted bank financing and stated its expectation that key ECB interest rates will remain at present levels at least through 2019. In response, financial conditions eased, and portfolio flows to many emerging markets strengthened (Figure 4). Long-term yields in advanced economies dropped as investors reassessed the outlook, and both *German* and *Japanese* 10-year yields again hover around zero. On the back of ongoing trade tensions and negative growth impacts from financial regulatory tightening, the *Chinese* authorities eased monetary policy alongside fiscal policy stimulus to provide temporary support for economic activity.

Figure 4. Financial Conditions

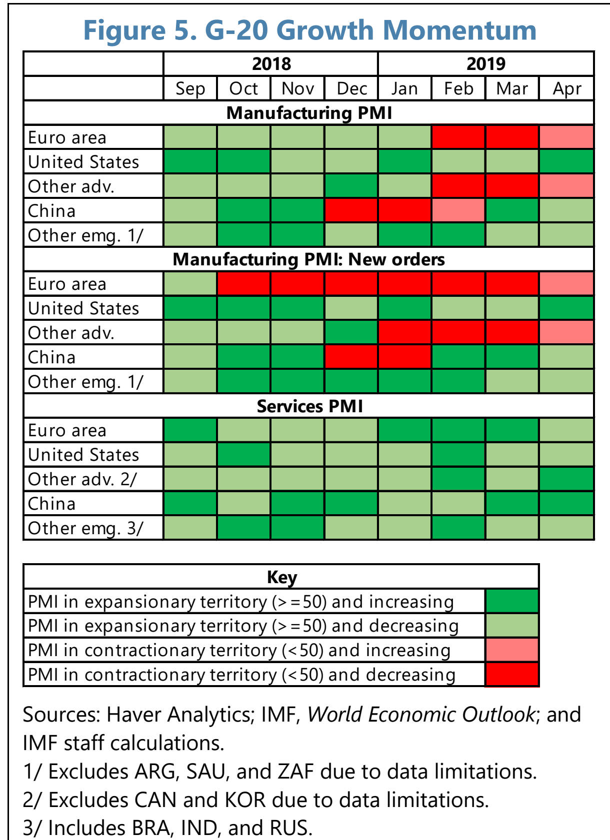


Sources: IMF, *World Economic Outlook*; Bloomberg, L.P.; Haver Analytics; and IMF staff calculations.

4. Incoming data suggest that the slowdown may have bottomed out, with some firming of economic activity expected to continue and growth projected to stabilize at slightly higher levels in 2020. Supported by policy actions, recent high-frequency data indicate that developments are broadly consistent with the April WEO projections and point to stabilization in a number of G-20 advanced and emerging markets (e.g., *China*, *euro area*, *United Kingdom,* and *United States*) (Figure 5). At the same time, significant uncertainties remain.

- *Advanced economies.* First-quarter growth surprised on the upside in the *United States* and the *euro area* (including *Germany*), with exports helping to narrow the *United States* trade deficit in February and March to its lowest level since mid-2018 and *Germany's* industrial production increasing slightly in March after a period of sustained decline. However, at least part of the unexpected growth is attributable to temporary factors (e.g., inventories in the *United States*), and the level of manufacturing activity remains weak.
- *Emerging market economies.* After a strong showing in March, high frequency indicators in *China* surprised on the downside in April on weak domestic and external demand, suggesting the turnaround remains fragile. While the rest of *emerging Asia* and *Latin America* mostly surprised on the downside in the first quarter on weak investment and exports, recent manufacturing indicators point to a tentative rebound (except in *India)*.

Figure 5. G-20 Growth Momentum



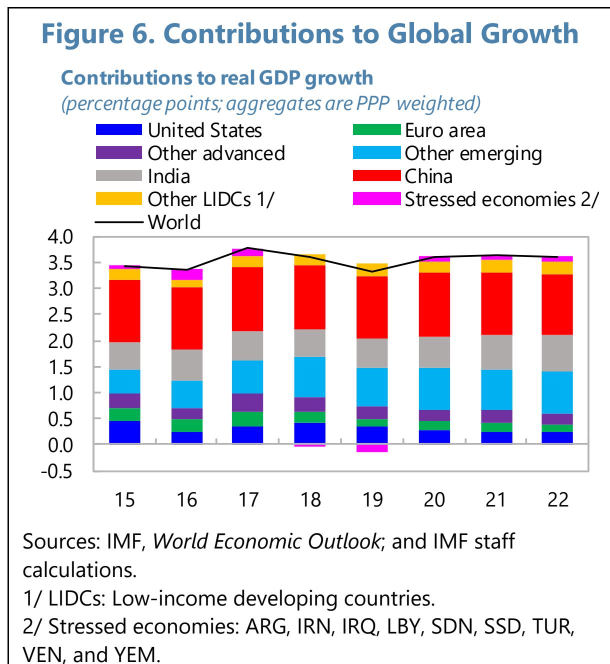
Sources: Haver Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Excludes ARG, SAU, and ZAF due to data limitations.
2/ Excludes CAN and KOR due to data limitations.
3/ Includes BRA, IND, and RUS.

B. The Expected Recovery Comes with Downside Risks

5. Questions remain about the strength and sources of the projected recovery. Notably, uncertainty surrounding the projected pick-up remains uncomfortably large.

- *Temporary setbacks could linger, and new ones might emerge.* Some of the idiosyncratic factors that held back growth could prove more protracted than projected, and the recent pickup in oil prices may create additional headwinds. Furthermore, the pickup in global growth from this year to next relies to an important extent on the predicted strengthening in stressed economies (e.g., *Argentina* and *Turkey*), which remains highly uncertain, and some easing of strains in countries affected by conflict and geopolitical tensions (Figure 6).

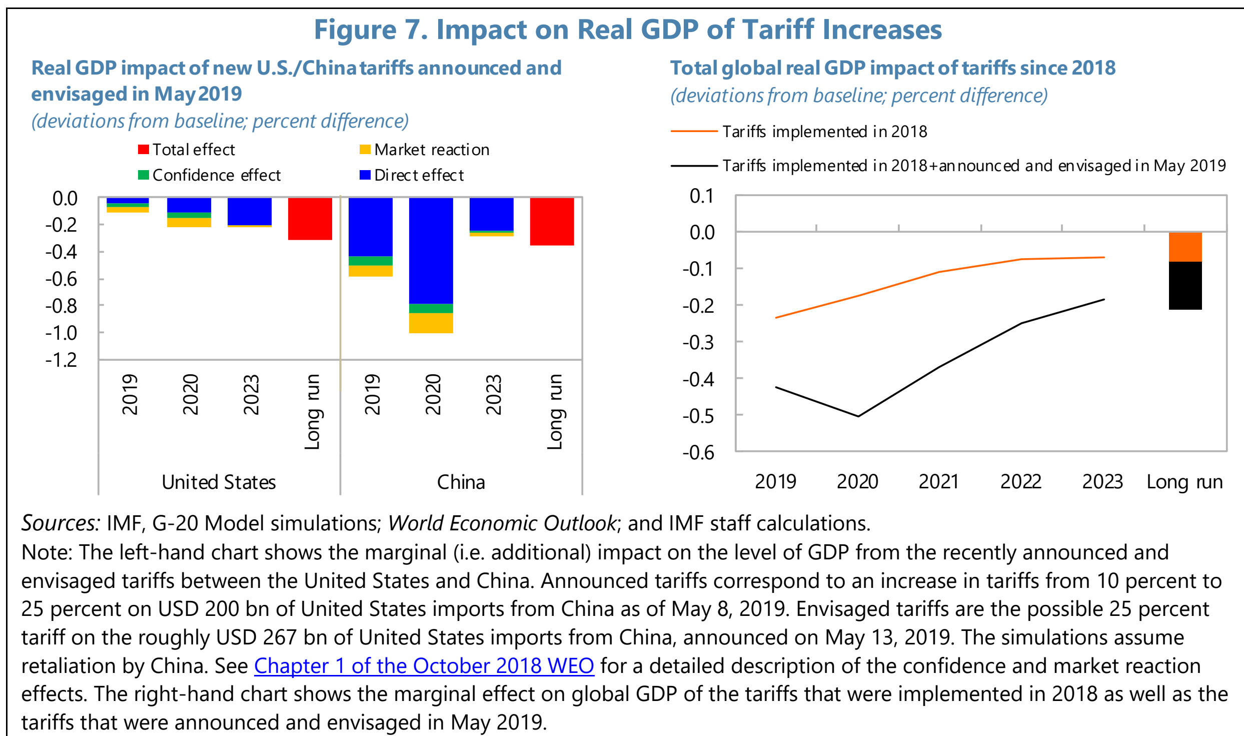
Figure 6. Contributions to Global Growth



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ LIDCs: Low-income developing countries.
2/ Stressed economies: ARG, IRN, IRQ, LBY, SDN, SSD, TUR, VEN, and YEM.

- *Trade tensions could continue or escalate further.* The additional tariffs imposed by the *United States* and *China* are likely to dampen trade and weigh on confidence and financial market sentiment, adversely impacting investment, productivity, and growth. Simulations show that the recently announced and envisaged tariffs could reduce global GDP by 0.3 percent in 2020 (Figure 7). Considering also the impact of tariffs imposed in 2018, global GDP is likely to be lower by 0.5 percent next year. The impact would be felt not only in the countries directly involved, but also in many countries linked through global value chains and cross-border investments. The further deterioration of trade integration would be particularly problematic at a time when investment is already weak in many G-20 economies.[2]
- *Brexit could turn out disorderly.* The *European Union* has extended Britain's exit deadline until October 2019. However, prolonged uncertainty regarding the ultimate agreement, the exit process, and conditions post-Brexit could worsen confidence and stress financial markets.
- *China's adjustment to more sustainable growth remains uncertain.* While macroeconomic stimulus is supporting growth in the immediate term, necessary efforts to rebalance the economy will also impact growth going forward.

Figure 7. Impact on Real GDP of Tariff Increases



Sources: IMF, G-20 Model simulations; *World Economic Outlook*; and IMF staff calculations.
Note: The left-hand chart shows the marginal (i.e. additional) impact on the level of GDP from the recently announced and envisaged tariffs between the United States and China. Announced tariffs correspond to an increase in tariffs from 10 percent to 25 percent on USD 200 bn of United States imports from China as of May 8, 2019. Envisaged tariffs are the possible 25 percent tariff on the roughly USD 267 bn of United States imports from China, announced on May 13, 2019. The simulations assume retaliation by China. See Chapter 1 of the October 2018 WEO for a detailed description of the confidence and market reaction effects. The right-hand chart shows the marginal effect on global GDP of the tariffs that were implemented in 2018 as well as the tariffs that were announced and envisaged in May 2019.

6. Accommodative monetary policies mean that financial vulnerabilities continue to accumulate. Vulnerabilities in the corporate sector exceed global financial crisis levels in a number of systemically important countries. In the *United States*, the corporate debt-to-GDP ratio is at historical highs and increasingly skewed toward lower-rated issuers, leaving the composition of debt riskier. In

[2] See IMF, *World Economic Outlook*, Chapters 3 and 4, April 2019.

the *euro area*, corporate debt has increased markedly in a number of countries, with vulnerabilities largely tied to small and medium-sized enterprises.[3] In *China,* corporate vulnerabilities remain elevated. Against this backdrop, a sudden shift in financial conditions could lead to stress (e.g., where there are foreign-currency mismatches) and trigger capital flow reversals—especially from vulnerable emerging markets.

7. Risks related to non-bank financial institutions create new challenges. In the *United States*, non-bank financial institutions,[4] particularly those invested in less liquid assets, experienced larger redemptions during the recent market turbulence. In the *euro area*, liquidity mismatches in certain investment funds have risen. While regulatory tightening in *China* has helped slow overall shadow credit growth, non-bank financial institutions continue to pose an important risk, as leverage in the broker-dealer sector has risen and liquidity mismatches have become more prevalent.

8. At the same time, macroeconomic policy space to respond to shocks is more limited than in the past.

- *Many G-20 countries have significantly less conventional monetary policy space than before the global financial crisis (Figure 8).* In the *euro area,* the policy rate continues to be negative, but the ECB has well-established balance sheet operations and bank liquidity facilities that can be used to further ease financing conditions if necessary. While policy rates are still above zero in some countries (e.g., *Australia*, *Canada*, *South Korea*, and the *United States*), staff analysis suggests that the neutral real rate has also declined,[5] requiring lower nominal rates than previously needed for a given degree of monetary accommodation. Policy rates remain notably higher in most emerging market economies. However, depending on country-specific circumstances, they must carefully balance the need to stimulate their domestic economies with the need to stem capital outflows in the event that global financial conditions tighten again.
- *Fiscal policy space, while differing across countries, is often constrained by high or rising public debt (Figure 9)*. Only a few G-20 economies have "substantial" fiscal space at present levels of output gaps (*Australia*, *Germany*, and *South Korea*).[6] More countries have "some" fiscal space (*Canada*, *China*, *Indonesia*, *Japan[7], Mexico*, *Russia*, *Saudi Arabia*, *Turkey*, *United Kingdom*, and *United States*), but a number of both advanced and emerging G-20 economies are facing more binding constraints on fiscal space (*France*, *Italy*, *Spain*, *India*, *Argentina*, *Brazil*, and *South Africa*)—often against a backdrop of high public debt and, in some cases, sizable risk premia.

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[3] See IMF, *Global Financial Stability Report,* April 2019.

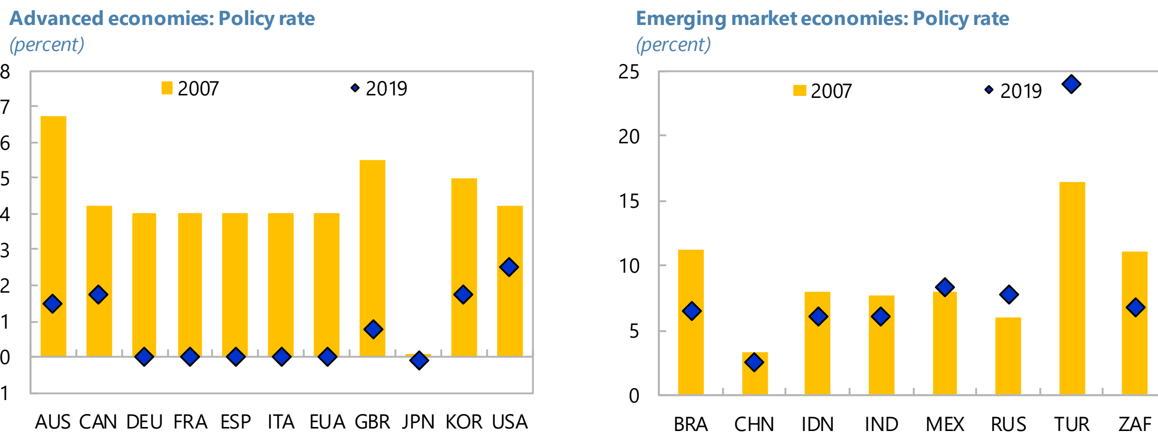
[4] Non-bank financial institutions include institutions such as investment funds, money market funds, trusts, and broker-dealers. Insurers are excluded.

[5] See IMF 2018 *G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth*.

[6] Based on the IMF's assessments, as reported in IMF 2018 *G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth*.

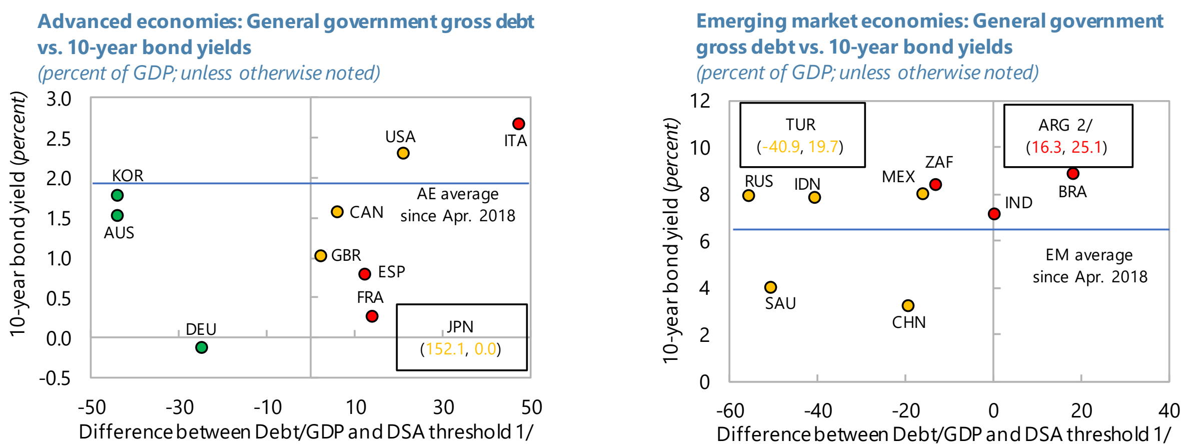
[7] Conditional on the adoption of a credible medium-term framework.

Figure 8. Monetary Policy Space



Sources: Haver Analytics; Bloomberg, L.P.; and IMF staff calculations.
Note: Spain is a permanent invitee. 2019 data as of May 28, 2019. The interest rate for the euro area (EUA) is the ECB main refinancing operations announcement rate.
1/ China 2012 average policy rate is used for 2007.

Figure 9. Fiscal Policy Space



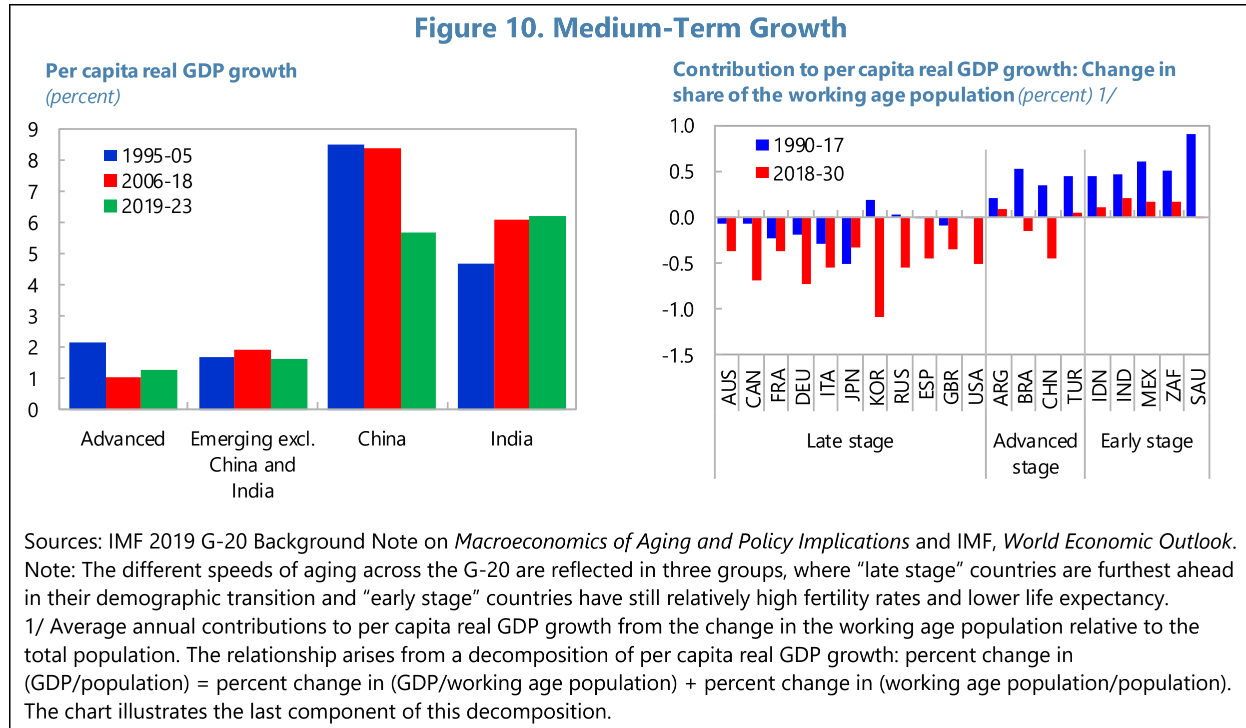
Sources: Haver Analytics; Bloomberg, L.P.; and IMF staff calculations.
Note: Spain is a permanent invitee. Color coding denotes (i) substantial fiscal space (green); (ii) some fiscal space (yellow); and (iii) limited fiscal space (red), where fiscal space is as reported in *IMF 2018 G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth*, published in October 2018. Individual country assessments may have changed since then.
1/ Debt Sustainability Analysis (DSA) thresholds for debt-to-GDP is 85 percent for advanced economies and 70 percent for emerging market economies.
2/ Bloomberg Argentina 10-year sovereign yield based on a set of bonds, as calculated by Bloomberg.

C. The Outlook Remains Wanting Over the Medium Term

9. G-20 policymakers cannot be content with the current weak trajectory for per capita GDP growth. Over the medium term, growth is projected to remain below historical averages for many countries, as aging populations and low productivity growth weigh on the outlook in G-20 advanced economies and certain emerging markets (Figure 10). Global growth is projected to remain stable at around 3.6 percent but will rely on weights shifting toward countries with relatively higher

growth rates (mainly G-20 emerging markets such as *China* and *India*). For some G-20 emerging economies, high levels of public debt and financing costs along with volatile commodity prices could weigh on medium-term growth prospects and convergence toward advanced economies by constraining fiscal space and limiting investment opportunities.

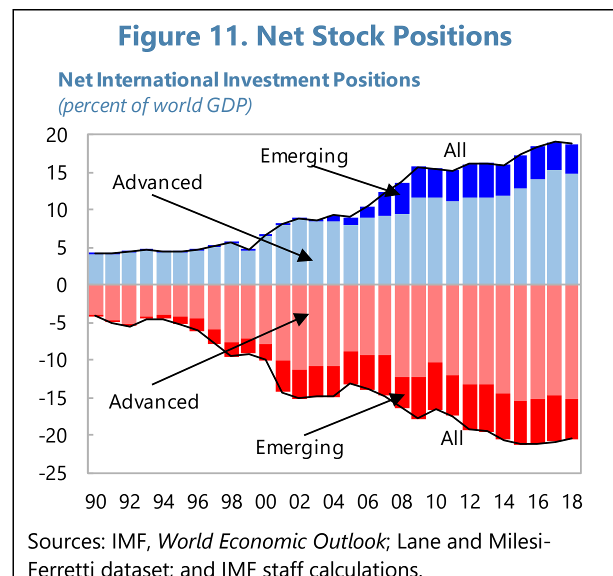
Figure 10. Medium-Term Growth



Sources: IMF 2019 G-20 Background Note on *Macroeconomics of Aging and Policy Implications* and IMF, *World Economic Outlook*.
Note: The different speeds of aging across the G-20 are reflected in three groups, where “late stage” countries are furthest ahead in their demographic transition and “early stage” countries have still relatively high fertility rates and lower life expectancy.
1/ Average annual contributions to per capita real GDP growth from the change in the working age population relative to the total population. The relationship arises from a decomposition of per capita real GDP growth: percent change in (GDP/population) = percent change in (GDP/working age population) + percent change in (working age population/population). The chart illustrates the last component of this decomposition.

10. At the same time, global imbalances persist. Current account imbalances have narrowed during the past decade and rotated toward advanced economies, thereby reducing financing risks that are faced by many emerging market economies. Yet, their persistence has contributed to diverging net international investment positions (Figure 11), which, to the extent they reflect macroeconomic and financial vulnerabilities and policy distortions, can pose risk. For example, widening debtor positions in systemic economies could constrain growth if debt levels and associated service costs become too high to support new investment.

Figure 11. Net Stock Positions



Sources: IMF, *World Economic Outlook*; Lane and Milesi-Ferretti dataset; and IMF staff calculations.

11. Progress to reduce income inequality has been unsatisfactory. While some countries have seen a decline in inequality since the global financial crisis (e.g., *United Kingdom* and *China*), it remains

high and persistent.[8] *South Africa* remains among the most unequal countries in the world. More broadly, inequality is observed both across gender and age, and it is impacted by technological advances.

- *Despite significant progress in recent decades, labor markets across many G-20 economies remain divided along gender lines as well as age.* Female labor force participation remains lower than male participation, and gender wage gaps are high. Despite comprising about 50 percent of the working-age population, women only represent about 40 percent of the global labor force.[9] In emerging market economies especially, women tend to be overrepresented in the informal sector, leaving them in a more precarious employment situation than men. Youth unemployment remains a critical concern as well, with about 20 percent of youths in emerging market and developing economies neither employed, in school, nor in training.[10]
- *Gains from technological advancements have been spread unevenly.* For example, the adoption of new technologies has often favored high-skilled workers in occupations complementary to new technologies and low-wage service sector jobs, creating concerns about job and income polarization.[11] In addition, many jobs involving low- and middle-skill routine tasks are potentially being eliminated through increasing use of automation and artificial intelligence.

12. Rising corporate power may add to challenges related to sluggish investment, low productivity growth, and a falling labor income share. Market power has increased moderately across most advanced economies and throughout most industries. However, within industries, market power has been concentrated among a small fraction of productive and innovative firms. In some emerging markets (e.g., *South Africa*), rent seeking activity is prevalent. While not an imminent threat, if market power of these already powerful firms increases further, it could weaken investment, deter innovation, reduce labor income shares, and make it more difficult for monetary policy to stabilize output.

[8] As measured by the Gini coefficient. See IMF 2018 *G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth*.

[9] See K. Kochhar, S. Jain-Chandra, and M. Newiak (editors), 2017, "*Women, Work, and Economic Growth. Leveling the Playing Field*."

[10] See J. Ahn, Z. An, J. Bluedorn, G. Ciminelli, Z. Kóczán, D. Malacrino, D. Muhaj, and P. Neidlinger, 2019, "*Work in Progress: Improving Youth Labor Market Outcomes in Emerging Market and Developing Economies*, "IMF Staff Discussion Note No. SDN/19/02.

[11] See IMF 2018 G-20 Background Note on *Future of Work: Measurement and Policy Challenges*.

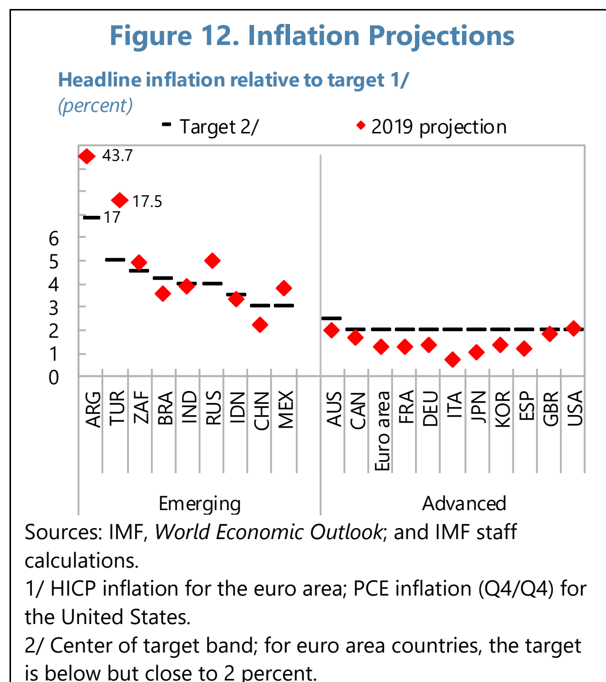
POLICIES

Amid closed output gaps in many economies and limited macroeconomic policy space, policymakers need to consider a carefully calibrated policy mix to protect the recovery and ensure sustainability, while raising medium-term prospects. To succeed, multilateral collaboration must be a key complement to national policies.

A. The Policy Mix Must be Carefully Calibrated

13. Monetary policy needs to stay accommodative until price pressures are firmly supported by incoming data. Monetary policy should aim at keeping inflation on track toward the central bank's target and inflation expectations anchored at that level. Given that inflation is below target in a majority of countries, an accommodative stance remains appropriate until inflation recovers (Figure 12).

Figure 12. Inflation Projections



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ HICP inflation for the euro area; PCE inflation (Q4/Q4) for the United States.
2/ Center of target band; for euro area countries, the target is below but close to 2 percent.

14. Fiscal policy must balance the trade-offs between supporting demand and ensuring sustainability. With public debt at or near historical peaks, unsatisfactory growth prospects, and still-high inequality, fiscal policy must balance the objectives of supporting the recovery and fostering inclusive growth, while ensuring debt sustainability. In some cases, expenditure reprioritization away from regressive spending (e.g., fuel subsidies) can help upgrade infrastructure and public service delivery in a budget-neutral way. In G-20 emerging market economies, where per capita GDP remains much below levels in advanced economies, a policy priority should include the building of a strong fiscal revenue base to support social spending and infrastructure investment.

- *In countries with limited fiscal space, fiscal consolidation should be calibrated to avoid harming near-term growth and to protect poor and vulnerable groups.* Efforts to reduce public debt and the implementation of structural and financial sector reforms, including by building buffers to mitigate vulnerabilities in the sovereign-financial nexus, are essential to secure growth and stability.
- *In countries with some or substantial fiscal space, fiscal policy should be guided by country-specific circumstances.* In countries with ample fiscal space, fiscal policy can be used to support inclusive and sustainable growth going forward. This would include the promotion of productive investment to raise potential growth. However, where public debt is high, and growth remains favorable, gradual fiscal consolidation should be pursued. In general, policymakers should bear

in mind that even with low interest rates, a sufficiently large public sector deficit could push up the debt-to-GDP ratio.

15. Financial sector policy can support stability by encouraging stronger balance sheets and mitigating risks from high leverage. Financial sector policies can enhance resilience against a potentially more volatile environment in global asset markets. For example, macroprudential tools, such as sector-specific and countercyclical capital buffers or more stringent rules on risk weights and provisioning, can strengthen balance sheets and address vulnerabilities proactively. These could be complemented by borrower-based tools to mitigate risks stemming from high debt vulnerabilities. Regulators should also strengthen macroprudential tools applying to non-bank financial institutions to contain vulnerabilities and avoid regulatory arbitrage, including by applying stress tests and lending standards more consistently across types of institutions.

16. In the *euro area*, completing the institutional architecture to strengthen resilience should remain a priority. Completing the banking union would help guard against adverse feedback loops from sovereign-financial linkages but requires a common deposit insurance scheme—which currently remains a national responsibility—and a common fiscal backstop to the Single Resolution Fund. Deeper capital market integration would improve private cross-border risk sharing. A central fiscal capacity for macroeconomic stabilization, contingent on compliance with the common fiscal rules to avoid moral hazard risks, would help countries better respond to shocks.

17. Emerging markets should prepare for potential volatility in international capital flows. The recurrent shifts in financial conditions have led to significant volatility in capital flows. To prepare for such episodes in the future, emerging market economies should aim at reducing excessive external liabilities and reliance on short-term debt and maintaining adequate fiscal buffers and foreign exchange reserves. The exchange rate should be used as a shock absorber and foreign exchange interventions be reserved to address disorderly market conditions. Capital flow management measures should not substitute for necessary macroeconomic adjustment. When warranted, they need to be transparent, temporary, and nondiscriminatory.

B. Meaningfully Lifting Medium-Term Prospects Require both Macro- and Micro-Level Policies

18. Structural reforms are needed to lay the foundation for stronger, more inclusive growth. While priorities vary according to country-specific needs, in most countries, ample opportunity remains for structural reforms to raise potential output, strengthen resilience, and make growth more sustainable and inclusive. Reforms to lift productivity growth are particularly relevant in light of aging populations in many countries and a need for growth dividends to be shared more widely across the population.

- *Advanced economies have scope to raise growth.* Depending on the country, labor market reforms should focus on boosting skills (e.g., *United Kingdom*), increasing flexibility, including by decentralizing wage bargaining to align wages with productivity (e.g., *Italy*), and offsetting the aging-induced decline in the labor force, including by promoting female labor force participation

(e.g., *Japan*). Product market reforms should help enhance productivity growth, including through measures to increase competition, particularly in services (e.g., *France*, *Germany*, *Italy*, and *Japan*), and strengthen incentives to innovate. This involves increasing spending on research and development and ensuring that competition policy frameworks facilitate the entry of new firms—which would also facilitate strong market competition going forward.

- *Emerging market economies should focus on promoting sustainable growth and, where relevant, absorbing a growing labor force.* In *China*, reforms should focus on facilitating the transition to more sustainable growth, including by increasing social spending and tackling barriers to labor mobility. Reducing the footprint of state-owned enterprises as well as barriers to entry in certain sectors would help enhance productivity growth. In *India*, reforms to hiring and dismissal regulations would help incentivize formal job creation and, combined with an increase in female labor force participation, would help absorb the country's large demographic dividend. In commodity exporters, economic diversification remains essential for sustained strong growth.

19. Fiscal policy and reforms can help ensure that economic gains benefit all citizens. Amid persistent inequality and continued technological change, increased focus on assuring that growth benefits all segments of society is essential. This would include adequate social spending, ensuring high-quality and accessible education, health, and social safety nets that protect vulnerable households and foster human development. While these policies require sustainable financing, they may also support growth both directly and indirectly through increased public support for growth-enhancing structural reforms. Strategies focused on better learning opportunities and improved job prospects for both women and the youth could have an important positive impact on growth.

20. Creditor and debtor countries should adjust to reduce excess international imbalances. If countries with stronger than warranted external positions make use of available fiscal space, this would not only help lift medium-term growth prospects but also support a narrowing of excess imbalances. Similarly, appropriately calibrated, growth-friendly fiscal consolidation in deficit countries would support sustainability and help strengthen their external positions.

C. Should Growth Substantially Disappoint, Policymakers Need to Stand Ready to Act

21. In the event downside risks materialize, and the slowdown turns out deeper and more protracted than under the baseline, a broad-based domestic policy effort is essential. Given the limited policy space in many economies, policymakers should take advantage of all policy levers and exploit complementarities in available tools.[12]

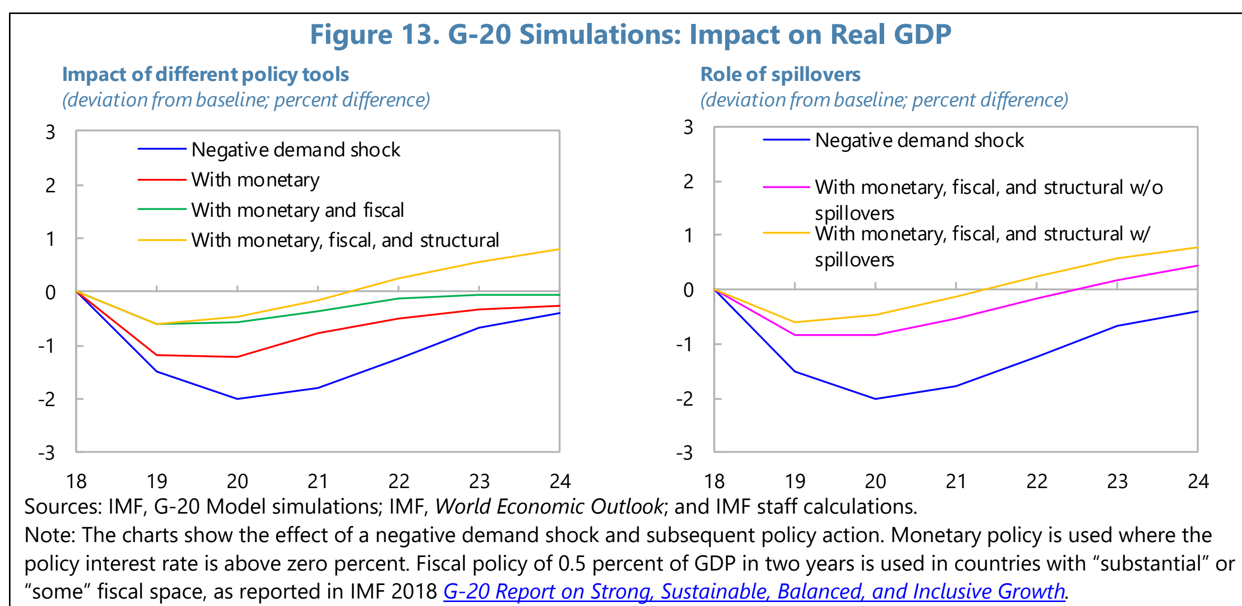
- *Monetary policy should ease decisively.* This would need to be clearly communicated and make use of the available conventional and unconventional policy space, including new or prolonged quantitative easing, depending on country circumstances. At the same time, maintaining

[12] See V. Gaspar, M. Obstfeld, and R. Sahay, "*Macroeconomic Management When Policy Space Is Constrained: A Comprehensive, Consistent, and Coordinated Approach to Economic Policy?*" IMF Staff Discussion Note No. SDN/16/09.

permissive financial conditions for longer can further stimulate the search for yield in risky assets and increase the importance of macroprudential policies.

- *Where fiscal space is available, new fiscal stimulus can support growth*. Countries with "substantial" or "some" fiscal space should make use of it to help offset the impact of negative shocks. Where some fiscal stimulus is recommended also in the baseline, this could imply an acceleration or expansion of already planned measures. In countries where fiscal policy is constrained and on a consolidation path, its pace would have to slow to ensure adequate support for near-term demand, to the extent that this does not threaten debt sustainability. That said, countries should remain vigilant regarding high risk premia (e.g., *Argentina*, *Italy*, and *Turkey*).
- *Structural reforms are a necessity in many countries, but some measures will be most effective when supported by strong demand*. For example, while lowering product market entry barriers has been shown to boost output, positive impacts of labor market reforms would appear quicker when accompanied by strong demand—which, in the context of a downturn, puts a premium on supportive demand policies.[13]
- *This strongly suggests that a broad-based approach will make for more effective support*. Further monetary easing would not only lower borrowing costs for the private sector but also help to reduce the crowding out of private investment from fiscal expansion (Figure 13). Together, the more supportive macroeconomic policy mix would make necessary structural reforms more effective in the short term.

Figure 13. G-20 Simulations: Impact on Real GDP



Sources: IMF, G-20 Model simulations; IMF, *World Economic Outlook*; and IMF staff calculations.
Note: The charts show the effect of a negative demand shock and subsequent policy action. Monetary policy is used where the policy interest rate is above zero percent. Fiscal policy of 0.5 percent of GDP in two years is used in countries with "substantial" or "some" fiscal space, as reported in IMF 2018 *G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth*.

22. A globally synchronized push toward broad-based domestic policy would make it even more effective. Simulation results illustrate that the impact would be amplified if well-coordinated domestic policies are part of an internationally synchronized policy response, which takes into account country-specific circumstances. Not only would spillovers from synchronized action reduce the extent

[13] See IMF, *World Economic Outlook*, Chapter 3, April 2016.

of policy leakage, joint efforts would likely also come with significant positive confidence effects, thereby further boosting investment and growth.

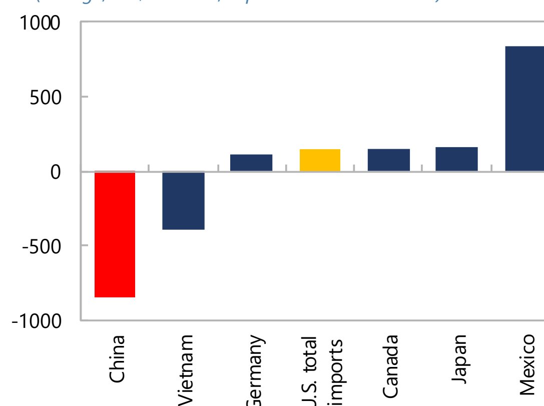
D. Global Cooperation Can Mitigate Risks and Support Growth

23. Multilateral policies are needed for the G-20 to reap its full growth potential. Many of today's challenges are global and can only be met in a renewed multilateral setting that makes growth more inclusive and sustainable. A new multilateralism can complement strong national action through globally cooperative efforts in favor of a more level playing field across borders and a commitment to work together on broader global challenges.

24. A key priority should be to create a more open, more stable, more transparent rules-based trade system. International cooperation is needed to durably de-escalate and resolve the current trade tensions. There is strong evidence that, while trade diversion might narrowly benefit some, the *United States*, *China*, and the global economy overall lose from the recently imposed trade restrictions. Heightened uncertainty and tighter financial conditions also add to the economic costs that arise from distorting well-established global value chains. At the same time, bilateral tariffs, quotas, or other managed trade arrangements have little or no impact on aggregate trade balances, as they will only lead to trade diversion and a costly distortion of existing bilateral trade flows without changing aggregate trade balances (Figure 14). Instead policymakers should reverse trade restrictions and take strong multilateral action to make the international trade system more open and transparent. The rules-based multilateral trade system should be modernized to capture the increasing importance of e-commerce and trade in services, strengthen rules in areas such as subsidies and technology transfer, and assure continued enforceability of WTO commitments through a revamped WTO dispute settlement system.

Figure 14. Impact of Tariffs on U.S. Imports

United States imports: $16 billion list
(change; US$ millions; Sep-Nov 2018 over 2017)



Sources: U.S. Census Bureau; and IMF staff calculations.

25. But the need for international cooperation goes well beyond trade. There is an urgent need for a cooperative multilateral approach to reform the current system of international corporate taxation to address tax competition and reign in prevalent profit shifting by multinationals. Additionally, multilateral efforts are essential to complete post-crisis financial regulatory reforms, improve debt transparency, tackle illicit financial flows, and ensure the adequacy of the global financial safety net. Stronger joint action is critical to confront broader challenges, including climate change, demographic shifts, and tensions caused by conflict and migration.[14]

[14] See IMF, 2019, "*Fiscal Policies for Paris Climate Strategies—from Principle to Practice*." For a strategy to foster international cooperation see IMF, 2019, "*Corporate Taxation in the Global Economy*."

Table 1. Real GDP Growth

(percent change)

	Year over Year		Projections (Apr. 2019)		Deviations (from Jan. 2019)	
	2017	2018	2019	2020	2019	2020
World	**3.8**	**3.6**	**3.3**	**3.6**	**-0.2**	**0.0**
Advanced economies	2.4	2.2	1.8	1.7	-0.2	0.0
Euro area	2.4	1.8	1.3	1.5	-0.3	-0.2
Emerging market and developing countries	4.8	4.5	4.4	4.8	-0.1	-0.1
G-20 1/	3.9	3.8	3.5	3.7	-0.1	0.0
Advanced G-20 2/	2.2	2.1	1.7	1.6	-0.3	0.0
Emerging G-20 3/	5.4	5.2	4.9	5.2	-0.1	-0.1
Argentina	2.7	-2.5	-1.2	2.2	0.5	-0.5
Australia	2.4	2.8	2.1	2.8	-0.6	0.2
Brazil	1.1	1.1	2.1	2.5	-0.4	0.3
Canada	3.0	1.8	1.5	1.9	-0.4	0.0
China	6.8	6.6	6.3	6.1	0.1	-0.1
France	2.2	1.5	1.3	1.4	-0.2	-0.2
Germany	2.5	1.5	0.8	1.4	-0.5	-0.2
India 4/	7.2	7.1	7.3	7.5	-0.2	-0.2
Indonesia	5.1	5.2	5.2	5.2	0.1	0.0
Italy	1.6	0.9	0.1	0.9	-0.5	0.0
Japan	1.9	0.8	1.0	0.5	-0.1	0.0
Korea	3.1	2.7	2.6	2.8	0.0	0.1
Mexico	2.1	2.0	1.6	1.9	-0.5	-0.3
Russia	1.6	2.3	1.6	1.7	0.0	0.0
Saudi Arabia	-0.7	2.2	1.8	2.1	0.0	0.0
South Africa	1.4	0.8	1.2	1.5	-0.2	-0.2
Spain 5/	3.0	2.5	2.1	1.9	-0.1	0.0
Turkey	7.4	2.6	-2.5	2.5	0.0	1.0
United Kingdom	1.8	1.4	1.2	1.4	-0.3	-0.2
United States	2.2	2.9	2.3	1.9	-0.2	0.1
European Union	2.7	2.1	1.6	1.7	-0.3	-0.1

Source: IMF, *World Economic Outlook*, April 2019.
1/ G-20 aggregates exclude the European Union.
2/ Includes Australia, Canada, France, Germany, Italy, Japan, Korea, United Kingdom, and United States.
3/ Includes Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, and Turkey.
4/ India's real GDP growth rates are calculated as per national accounts, with base year 2011/12.
5/ Spain is a permanent invitee.