

# NESDB Annual Academic Seminar

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## Monetary and Fiscal Policy in a Volatile Global Economy

*8 September 2016*

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- Weak and sporadic global recovery since 2009
  - US is the strongest world economy. But 4Q15, 1H16 growth averaged 1% annualized. Weakest US recovery since end of WWII.
  - 3 rounds of QE expanded Fed B/S by \$3.8trn but US GDP grew 2.5% or less. Stock prices however rose 225% since 2009 low
  - EU. After problems with Greece, then Brexit, then Italian banks.
  - \$11trn worth of bonds with negative yield, eroding confidence not boosting growth
  - Japan. Monetary policy reaching limit. 28trn yen fiscal stimulus package (public debt 250% of GDP). Fiscal stimulus strengthening the yen.

*Reaching the limits of QE... with few remaining options.*

- Large downgrades in forecasts: GDP growth rate of 2.4% over 10 years adds to 27% gain in GDP; 1.9% adds to 21%. Difference is \$1.1trn in GDP in 2016 dollars.
- Growth has disappointed because productivity has disappointed.
- Unemployment fell faster than expected. But inflation also lower than expected → lower natural unemployment rate

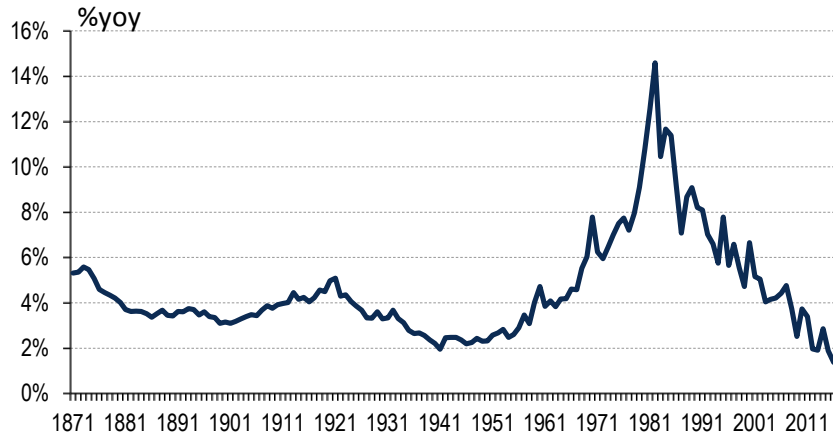
Long-run projections of output ( $y^*$ ), unemployment ( $u^*$ ), and the fed funds rate ( $r^*$ ) from the FOMC's June Summary of Economic Projections

	$y^*$	$u^*$	$r^*$
<b>2016</b>	1.8 – 2.0	4.7 – 5.0	3.0
<b>2015</b>	2.0 – 2.3	5.0 – 5.2	3.75
<b>2014</b>	2.1 – 2.3	5.2 – 5.5	3.75
<b>2013</b>	2.3 – 2.5	5.2 – 6.0	4.0
<b>2012</b>	2.3 – 2.5	5.2 – 6.0	4.25

Note: Values shown are central tendencies for  $y^*$  and  $u^*$ , and the median for  $r^*$ . Central tendencies are the range of projections submitted by FOMC participants, omitting the top three and bottom three values.

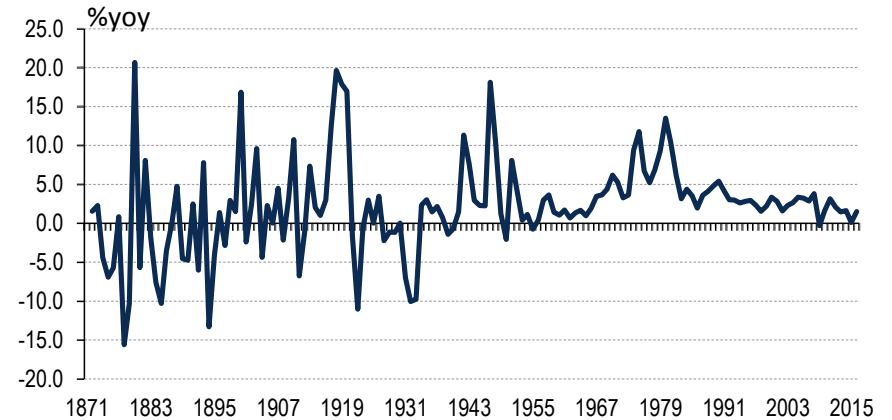
***Implying lower for longer policy rates and anemic growth?***

## UST 10Y yield record low



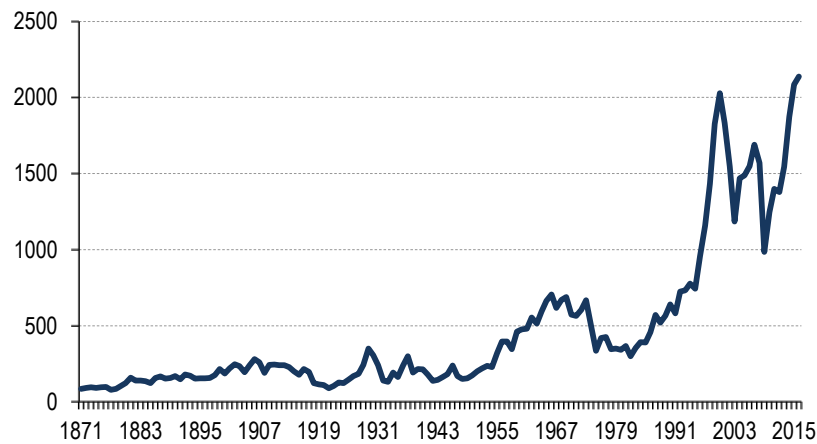
Source: US Treasuries, Robert Shiller, "Irrational Exuberance"

## Inflation down and not volatile



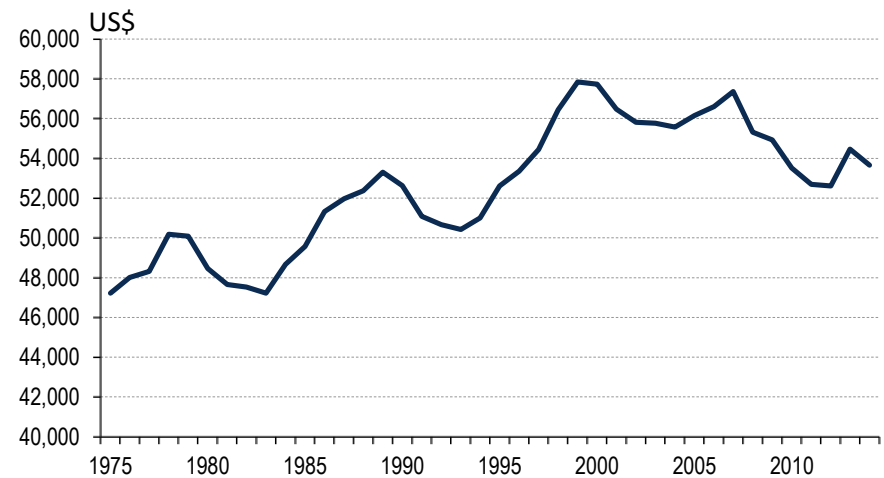
Source: Robert Shiller, "Irrational Exuberance"

## Real S&P500 Index



4 Source: Robert Shiller, "Irrational Exuberance"

## US: Median real income

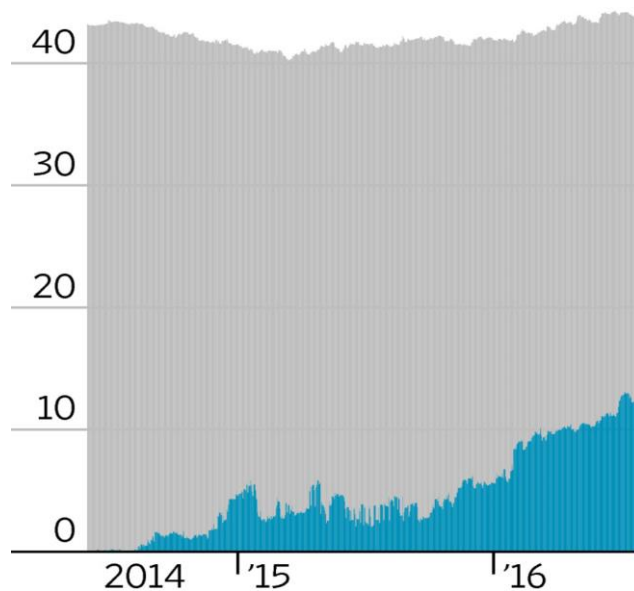


Source: US Census Bureau

## Below Zero

Debt with negative rates has increased globally.

\$50 trillion  Positive-yielding debt  
 Negative-yielding debt

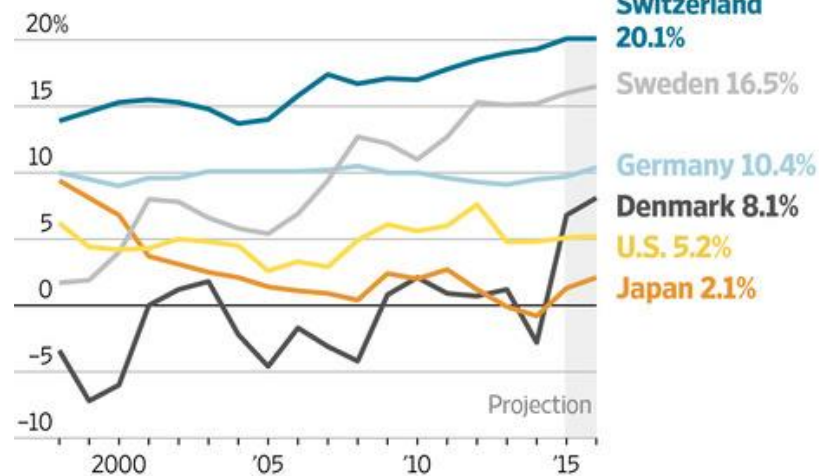


Source: Bank of America Merrill Lynch  
 THE WALL STREET JOURNAL.

## Unintended Effects

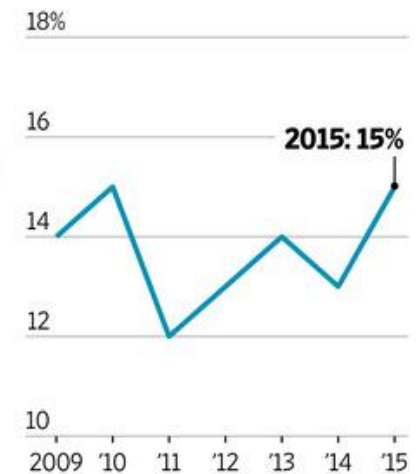
Consumers are saving more in many countries with low or negative rates, and companies also are holding on to cash.

### Household savings rates



Note: 2015 savings data are preliminary and 2016 data are projected. \*Europe, the Middle East and Africa  
 Sources: OECD (savings rates); Moody's Investors Service, company filings (cash)

### Cash as a percentage of revenues for EMEA\* nonfinancial companies

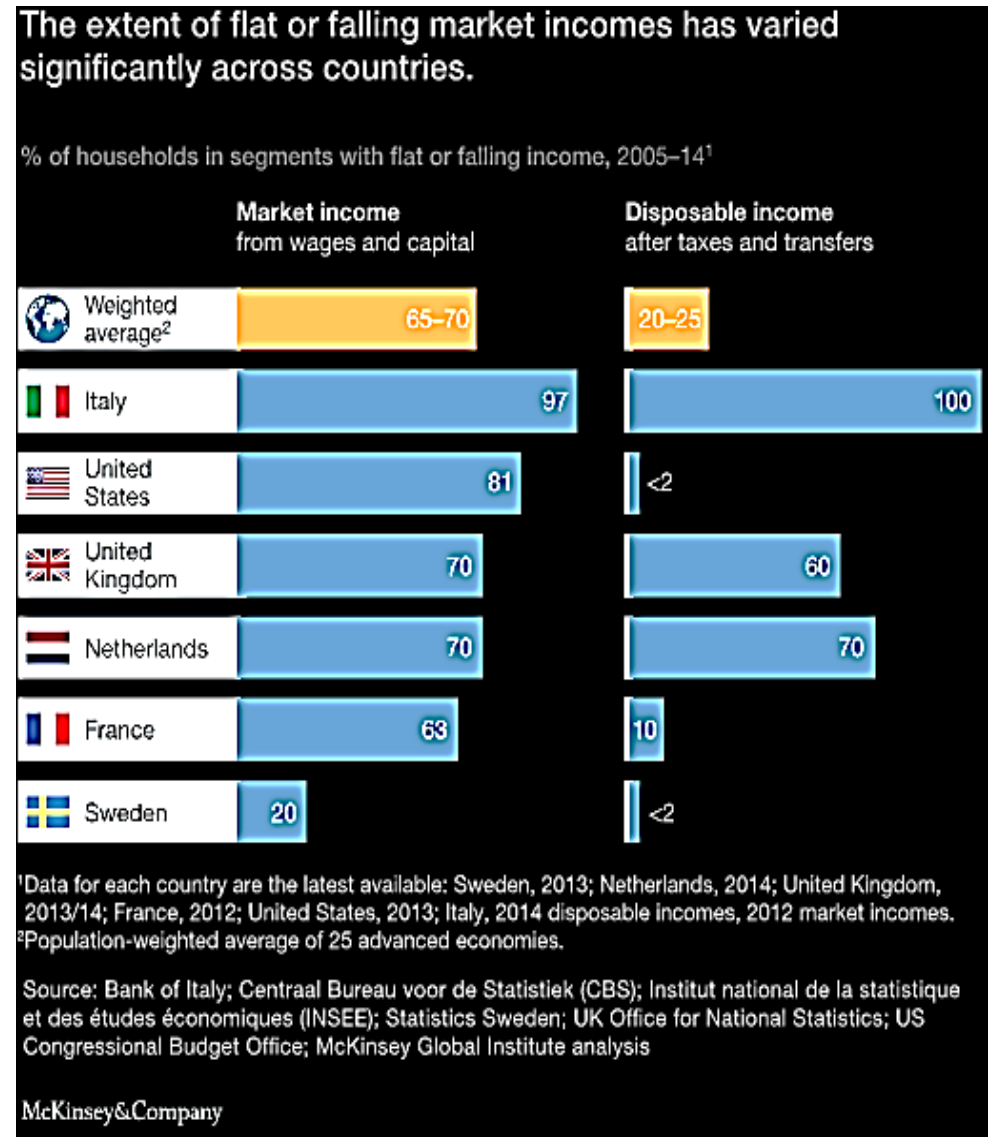


THE WALL STREET JOURNAL.

- Consumers are saving more in Germany and Japan, and in Denmark, Switzerland and Sweden, 3 non-eurozone countries with negative rates.
- Savings are at their highest since 1995
- In Japan, household savings began rising since 2014

## McKinsey Global Institute (August 2016):

- Real incomes of 65-70% of households (540-580mn) in 25 advanced economies were flat or fell during 2005-14.
- During 1993-2005, the figure was 2% or 2mn for the same 25 countries.
- 20-25% of household incomes still flat or falling incomes after govt transfers and lower taxes.
- Key factors: 2008 recession, aging, shrinking household, wages falling as % share of GDP.
- If low GDP growth continues, 70-80% of households could see flat or falling incomes in the next decade.



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Joseph Stiglitz (Bangkok Post 8 August 2016)

- In US: the bottom 90% saw income stagnate for 30 years. Median income for full-time male workers is lower in real terms than it was 42 years ago....
- During 1988 to 2008: big winners were the global 1%, the world's plutocrats and the middle class in EMs. Big losers who (gained little or none) were lower, middle and working classes in advanced countries.
- Free trade equalises wages of unskilled workers around the world. Trade in goods substitutes for movement of people. Eventually it would be as if Chinese workers migrate to the US and Europe until wage differences are eliminated.
- Governments gave generous bailouts for banks that caused the 2008 financial crisis reinforced the view that this failure was not economic misjudgments.

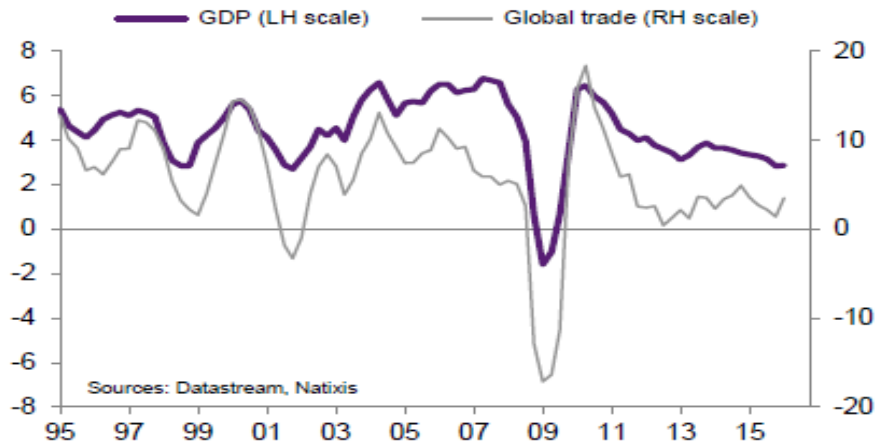
## Correlation: 10-Year government bond yields

2007-2016					
	<i>Thai</i>	<i>US</i>	<i>Jap</i>	<i>UK</i>	<i>Ger</i>
Thai	1.00				
US	0.73	1.00			
Jap	0.79	0.83	1.00		
UK	0.79	0.97	0.91	1.00	
Ger	0.81	0.89	0.97	0.96	1.00
2007-2009					
	<i>Thai</i>	<i>US</i>	<i>Jap</i>	<i>UK</i>	<i>Ger</i>
Thai	1.00				
US	0.57	1.00			
Jap	0.55	0.88	1.00		
UK	0.70	0.92	0.88	1.00	
Ger	0.77	0.83	0.83	0.96	1.00
2010-2016					
	<i>Thai</i>	<i>US</i>	<i>Jap</i>	<i>UK</i>	<i>Ger</i>
Thai	1.00				
US	0.53	1.00			
Jap	0.75	0.63	1.00		
UK	0.65	0.95	0.79	1.00	
Ger	0.72	0.77	0.94	0.89	1.00

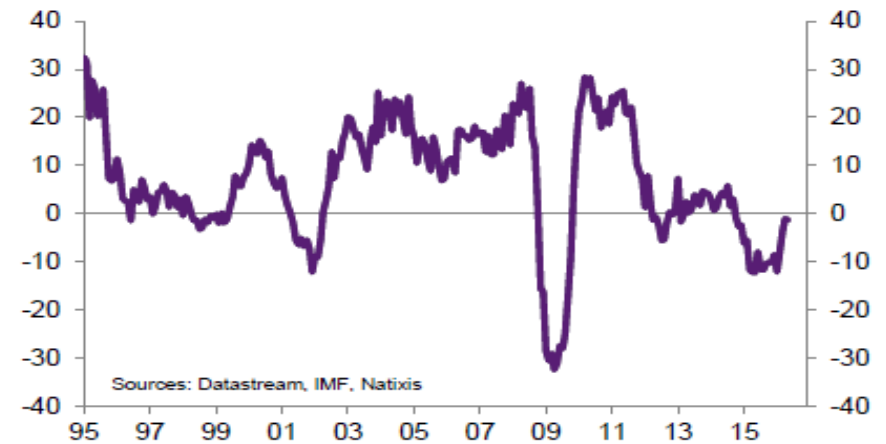


# Global trade: De-segmentation of value chains (Natixis)

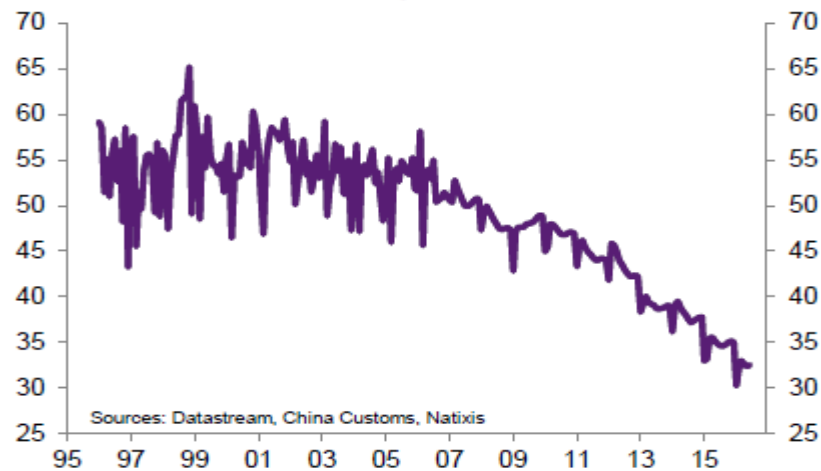
**Chart 1A**  
World: Real GDP growth and global trade in volume terms (Y/Y as %)



**Chart 1B**  
World excl. Russia and OPEC: Exports in value terms (Y/Y as %)



**Chart 5**  
China: Share of processed exports as % of total exports



**Chart 9**  
World: Real GDP and manufacturing production (1995:1 = 100)



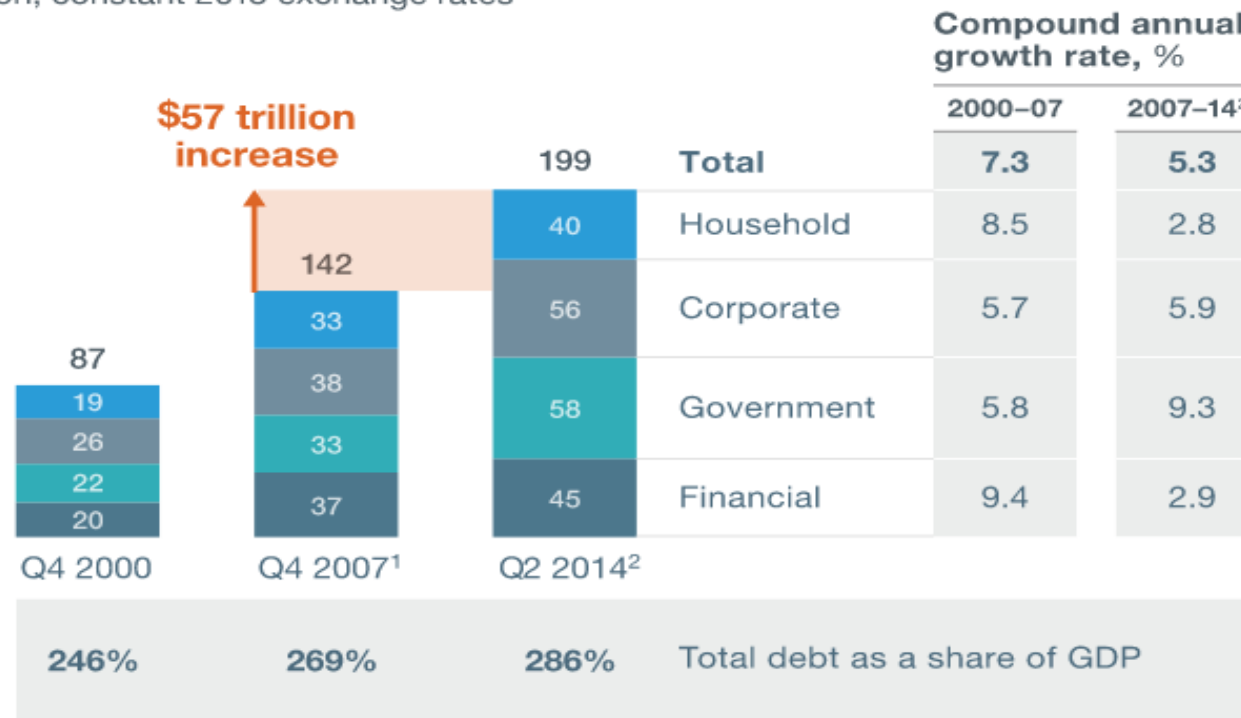
## G20 Joint Communiqué highlights

- 4-5 Sept Hangzhou G20 summit tries to revive global growth, outlook of which IMF is expected to again downgrade in October
- “growth must be shored up” but “refrain from competitive devaluations”
- “Our growth, to be strong, sustainable and balanced, must also be inclusive.”
- “use all policy tools – monetary, fiscal and structural ....monetary policy alone cannot lead to balanced growth”
- “making tax policy and public expenditure more growth-friendly .. by prioritizing high-quality investment”
- opposition to protectionism on trade and investment in all its forms.

***But short on substance....except for  
“a Global Forum on steel excess capacity, to be facilitated by the OECD”***

**Since the Great Recession, global debt has increased by \$57 trillion, outpacing world GDP growth.**

**Global stock of debt outstanding,**  
\$ trillion, constant 2013 exchange rates

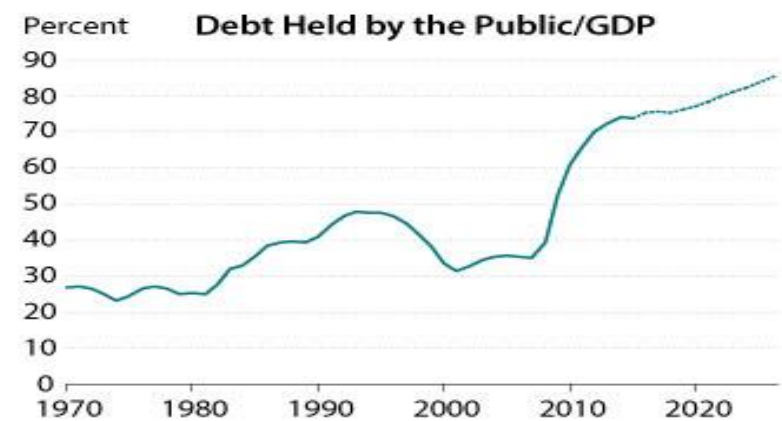
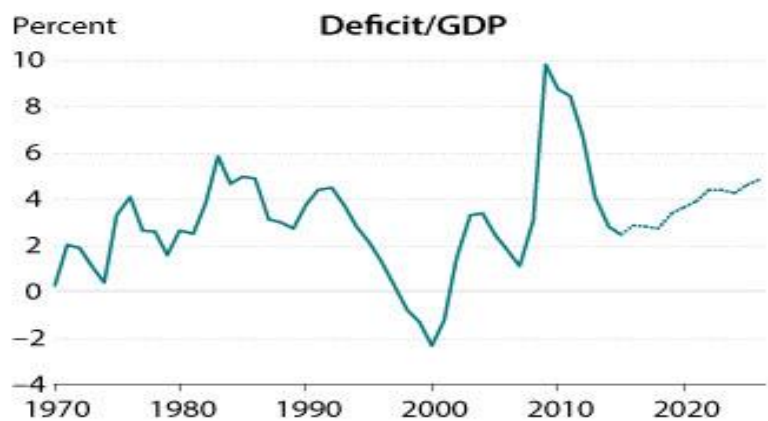
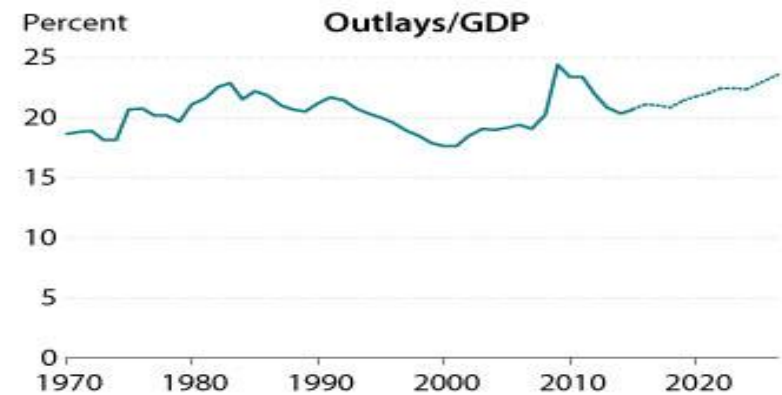
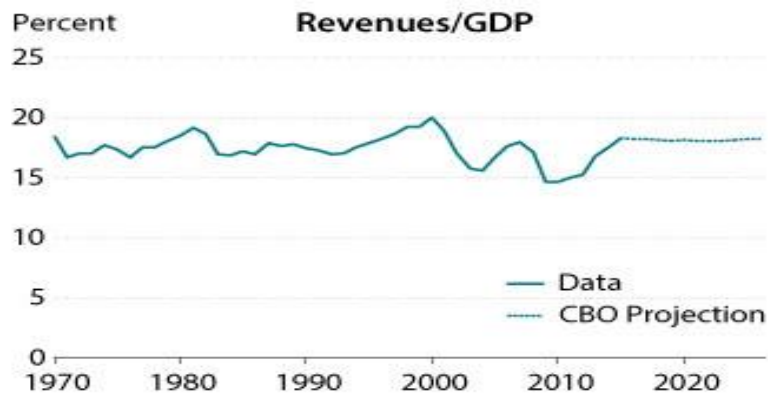


<sup>1</sup>Figures do not sum to total, because of rounding.

<sup>2</sup>Q2 2014 data for advanced economies and China; Q4 2013 data for other developing countries.

Source: Bank for International Settlements; Haver Analytics; International Monetary Fund *World Economic Outlook*; national sources; McKinsey Global Institute analysis

- Deficits in 2009-13 from the financial crisis doubled US govt debt held by the public.
- CBO projects debt to reach 75.4% of GDP by end 2016 and 85.6% by 2026, very high for peacetime in US
- Mandatory expenditure – mainly Social Security and health care -- will average 11.3% of GDP in next 10 yrs.
- CBO expects interest rates to rise and the deficit would average 3% of GDP, high by historical standards.



SOURCE: Congressional Budget Office and author's calculations.

## Republican candidate Trump

- Americanism not Globalism: Build a wall, mass deportation, ban Muslim immigration temporarily
- China will be labelled as a currency manipulator
- Impose 35% tariff on Mexican goods and a 45% tariff on Chinese goods.
- Reject TPP and renegotiate NAFTA
- Will expand US military in South China Seas
- Doesn't believe in climate change: more drilling, more mining
- Cut taxes; corporate tax cut from 30% to 15%
- US public debt would rise by \$11trn over next 10 years

## Democrat candidate Clinton

- Adopts Sanders' policies such as free university education
- \$2trn in tax hikes on the rich but also \$2.2trn in infrastructure and education spending
- Anti-Wall Street and will tax capital gains
- 4% more tax on those earning >\$5mn - the "fair share surcharge".
- No longer supports TPP
- Criticizes China's human rights record and "dumps cheap steel in our markets"
- Strong support for renewable energy, solar plan, reduce oil consumption

# Public Debt to GDP of major economies: Room for fiscal policy limited?

- Apart from QE, the financial crisis caused OECD public debt to GDP to rise by over 20ppt of GDP from 2008 to 2010
- Initial Anglo-Saxon and Japanese fiscal stimulus was greater than that of Euro Area

## Public debt % of GDP

	2008	2009	2010	2011	2012	2013	2014	2015
France	79.3	91.4	95.7	99.3	109.3	112.6	115.1	116.1
Germany	69.9	77.5	86.2	85.5	88.5	85.9	83.9	79.8
Italy	118.9	132.4	131.1	124.0	142.2	145.5	147.2	147.4
Japan	171.1	188.7	193.3	209.5	216.5	224.6	229.6	232.5
Spain	48.0	63.3	68.4	78.8	92.6	104.0	108.5	111.5
Greece	122.5	138.3	157.3	179.9	167.5	186.0	188.7	188.2
United Kingdom	57.3	72.1	81.7	97.1	101.6	99.3	101.7	103.1
United States	72.6	85.8	94.6	98.8	102.1	104.3	106.2	106.5
Euro area (15 countries)	78.0	88.8	93.9	95.9	104.4	106.7	107.7	106.9
<b>OECD-Total</b>	<b>79.9</b>	<b>91.2</b>	<b>97.5</b>	<b>102.1</b>	<b>107.1</b>	<b>109.5</b>	<b>111.1</b>	<b>111.2</b>

Source: OECD

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Sample of 45 developing and developed countries. Findings:

- Strong positive association between SME development and growth but this relationship is not robust to controlling for simultaneity bias.
- Relationship between SMEs and economic growth becomes statistically insignificant when controlling for endogeneity.
- Thus, while a prosperous SME sector is a characteristic of flourishing economies, we cannot reject the view that SMEs do not cause growth.
- SMEs do not benefit the incomes of the poor and a significant relationship between SMEs and poverty reduction.

***Conclusion: No empirical support for directly subsidizing SME development to accelerate growth and reduce poverty.***

Source: "SMEs growth and poverty" Thorsten Beck, Asli Demirgüç-Kunt, Ross Levine, NBER working paper, March 2005

Main finding based on data from 51 countries during 1981-2003

- Income inequality has risen but average incomes have also risen
- Trade liberalization and export growth are associated with lower income inequality
- Increased financial openness is associated with higher inequality
- But biggest contributor to inequality is technological change especially markedly in developing countries.
- FDI and technological progress both appear to increase the premium on higher skills and higher returns to capital.

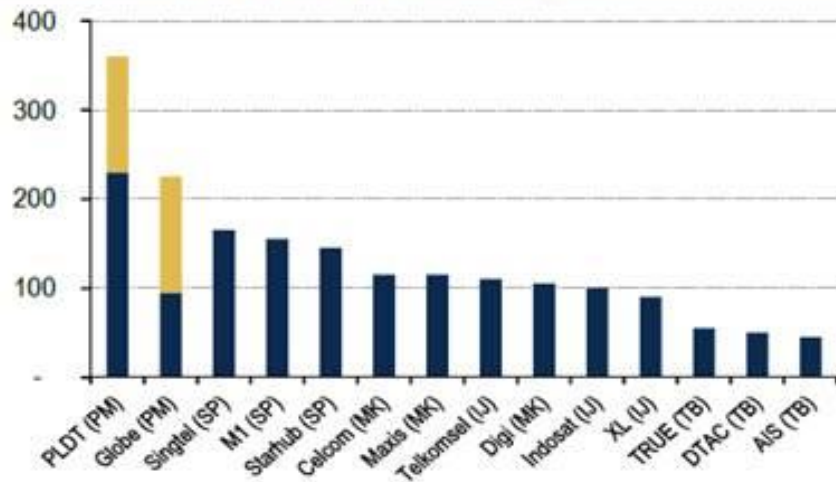
***“Export growth is associated with a rise in the income shares of the bottom 4 quintiles and a decrease in the share of the richest quintile.... financial globalization and technological progress are shown to benefit mainly the richest 20% of the population”.***

Source: “Rising Income Inequality: Technology, or Trade and Financial Globalization?” IMF Economic Review 2013



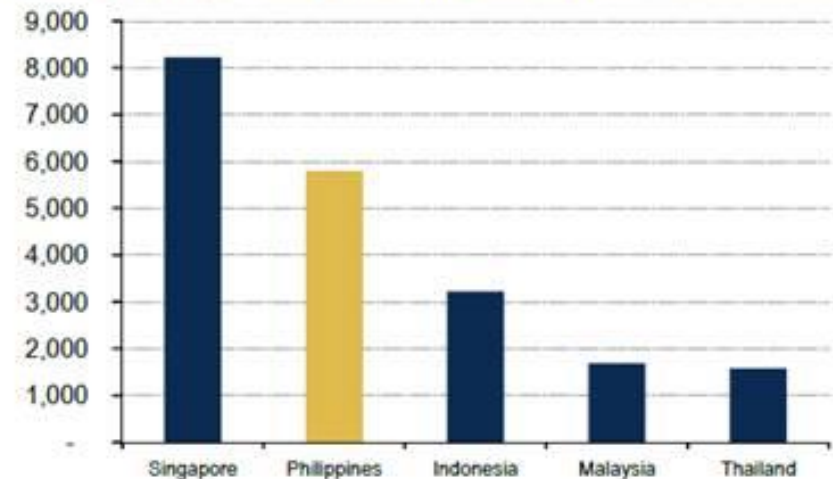
G20: “making tax policy and public expenditure more growth-friendly .. by prioritizing high-quality investment”

Chart 6: ASEAN Telcos' spectrum holdings (MHz)



Source: BofAML Global Equity Research, PEP Estimates

Chart 5: ASEAN Cell Tower Density (subscriber/cell tower)



Source: TowerXchange

