Financial problems still loom large as IMF downgrades global growth forecast

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The International Monetary Fund (IMF) has slightly revised down its forecast for global growth, largely on the back of worsening conditions in the euro zone and China. It has stated that a "full recovery toward prepandemic trends appears increasingly out of reach, especially in emerging market and developing economies."

The forecasts are contained in the latest *World Economic Outlook* report prepared for the October meeting of the IMF and the World Bank being held in Marrakech, Morocco.

In its latest projections, the IMF said global growth would slow from 3.5 percent in 2022 to 3 percent this year. It predicted a fall to 2.9 percent next year, a 0.1 percentage point decline for 2024 from its forecast in July. This is a trend it describes as "well below the historical average."

In his foreword to the report, IMF economic counsellor Pierre-Olivier Gourinchas said the global economy continued to recover slowly from the blows of the pandemic, the Ukraine war and the cost-of-living crisis and was displaying "remarkable" resilience.

But, he continued, growth remained slow and uneven and "the global economy is limping along."

Gourinchas noted that while some "extreme risks"—a reference to the US banking crisis—had moderated since April, the balance remained "tilted to the downside." He cited the real estate crisis in China, which has implications for the global economy.

As the executive summary of the report noted, "China's property sector crisis could deepen, with global spillovers, particularly for commodity exporters."

Gourinchas said IMF projections were increasingly consistent with a so-called "soft landing" scenario in which inflation comes down without a major economic downturn. But he noted important divergences were emerging. While the US had "surprised on the upside," euro area activity was revised downward. China faced "growing headwinds from its real estate crisis and weakening confidence."

On the policy front, he stated that central banks had to maintain a tight stance even as inflation was coming down. Fiscal policy had to support monetary strategy. By this is meant the necessity to cut government spending. Gourinchas pointed to the US as "most worrying" because the "fiscal stance has deteriorated substantially."

In an interview with Bloomberg, Vitor Gaspar, director of the IMF's Fiscal Affairs Department, said with current policies the US was on an "unsustainable fiscal path."

"US deficits are elevated and they're projected to be persistent," he said. "Under unchanged policies, debt dynamics in the US are very unfavourable."

And it is not just the US. The IMF said that overall fiscal policy should focus on "rebuilding financial buffers" that have been seriously eroded by the pandemic and the energy crisis.

Translating these prescriptions into the language of social reality, what this means is cutting government spending, not of course on the military, which is being increased everywhere, but on vital social spending affecting the lives of the broad mass of the population in areas such as health and education.

The *Global Financial Stability Report* was also somewhat downbeat.

In his foreword, IMF Financial Counsellor Tobias Adrian noted that sentiments in financial markets were different from the time of the last report in April. Then the US had just experienced three of its four largest bank failures in history. Now concerns about the

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banking sector had given way to “optimism about brisk disinflation and a soft landing for the global economy.”

“But such optimism,” he continued, “can unravel in the face of adverse shocks—like upside surprise inflation, financial stability concerns in China, and renewed concerns about debt sustainability—resulting in a sharp repricing of assets.”

As a result, financial risks remained elevated as was the case in April.

Furthermore, while “acute strains” in the banking sector had subsided, there were indications of “trouble elsewhere as higher interest rates are beginning to bite.”

The report pointed to some of those troubled areas, particularly commercial real estate. It has been hit both by the decline in demand for office space as a result of the pandemic with the increase in working from home, and higher interest rates.

It stated: “Given the size and concentration of commercial real estate (CRE) and its strong connection with the broader financial system and the real economy stress in that sector can have significant financial stability implications.”

CRE is of considerable significance, equating to 12 percent of GDP in Europe and 18 percent in the US.

“Concerns about the risk of a widening funding gap have emerged, as funding sources become less available for CRE borrowers, private equity fundraising activity has slowed sharply and the issuance of commercial mortgage-backed securities has gone tepid,” the report said.

Financial authorities let out a collective sigh of relief when the US bank failures of last March–April did not develop into something even more serious—not because of the operation of safety mechanisms within the financial system, but because US financial authorities bailed out all uninsured depositors. There is, however, a recognition that the underlying problems have not been solved.

As the executive summary of the report put it, under the heading Soft Landing or Abrupt Awakening: “While acute stress in the global banking system has subsided, a weak tail of banks remains in some countries. In addition, cracks in other sectors may also become apparent and could turn into worrisome fault lines. In the event of an abrupt tightening of financial conditions, adverse feedback loops could be triggered and again test the resilience of the financial system.”

In his forward, Adrian referred to the growing importance of nonbank financial intermediation (NBFI)—carried out by hedge funds and other financial organisations—over the past decade. This made “comprehensive systemic risk assessments of NBFI a financial stability policy priority.”

Such remarks are aimed at conveying the impression of a financial cop on the beat. But as the IMF and Adrian himself have acknowledged, financial regulators have only very patchy knowledge of the NBFI world and its intimate and often complex relations with the broader financial system.

The overall message from the latest IMF finance report is that the supposed guardians of the global system know that another crisis will strike but have no clear idea of how and when it will occur. But one thing is certain: it will have a major impact on the real economy which, as the economic outlook report made clear, is only “limping” along.

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