UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Fear of flying: Policy stances in a troubled world economy

UNCTAD

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Session 1 “Global Economy”

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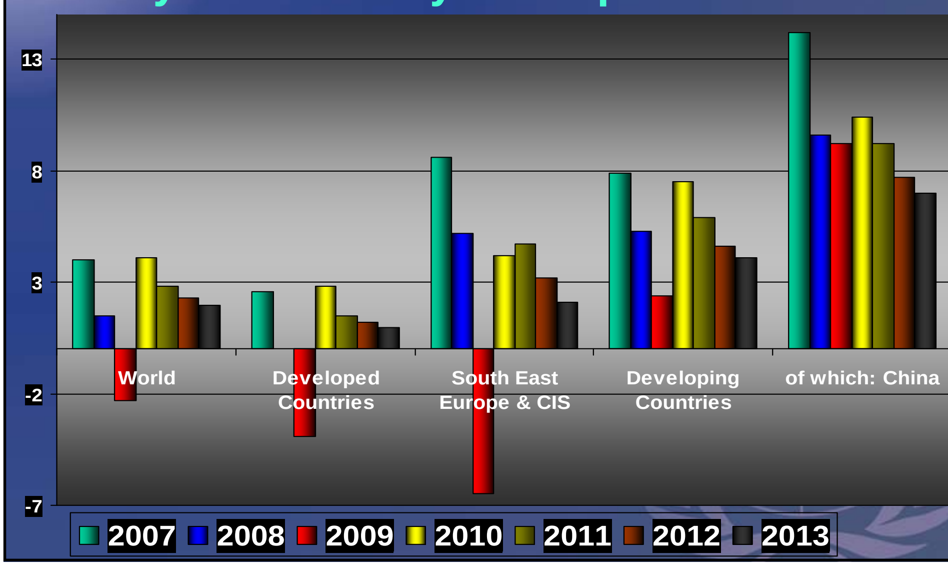
A weakening economic performance reflects inability to address systemic problems



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Global growth scenarios

- ***Scenario1 = Treading water:***
Continuation of slow and below-par recovery

- ***Scenario 2 = Unsustainable growth:***
Relatively faster growth through a renewal of debt-driven cycles

- ***Scenario 3 = Instability redux:***
Recovery derailed by chaotic unwinding of monetary impulses and financial shocks

- ***Scenario 4 = Coordinated recovery:***
Combined expansionary monetary and fiscal measures, income redistribution and financial regulation

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Main policy stances and adjustment patterns

- ***Policy action, constrained by the burden of debt (private or public) and perceived market response leans towards austerity measures***

- ***Export-led recovery strategies based on competitiveness and lower (wage) costs drive down global demand***

- ***Renewed poles of credit-driven spending on the back of asset appreciations***

- ***Ongoing vulnerability to the vagaries of capital flows, speculation and commodity price shocks***

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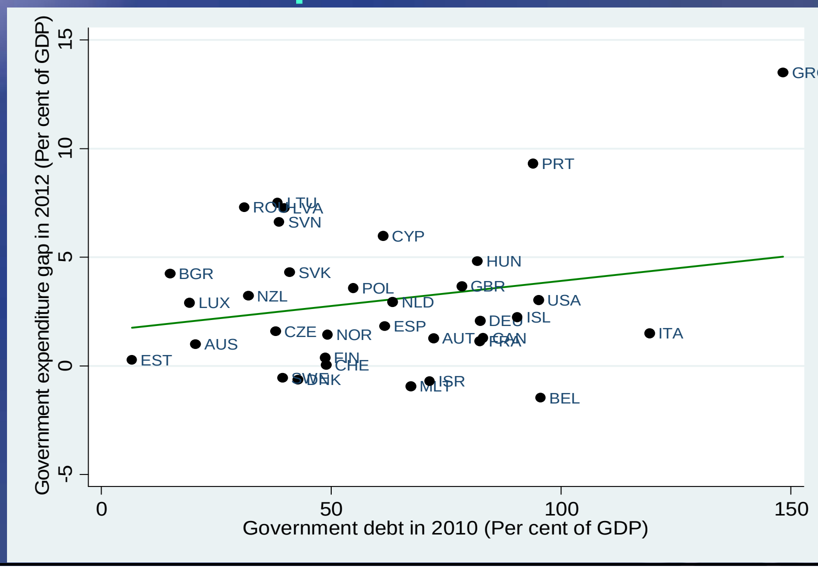
Fiscal stances: in developed countries austerity was the usual response to debt burdens



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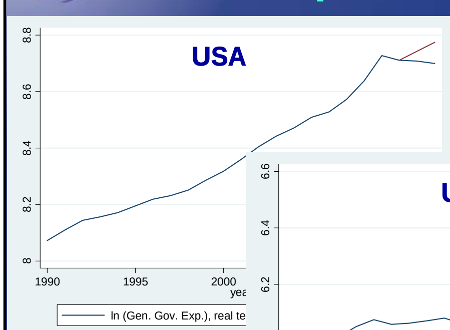
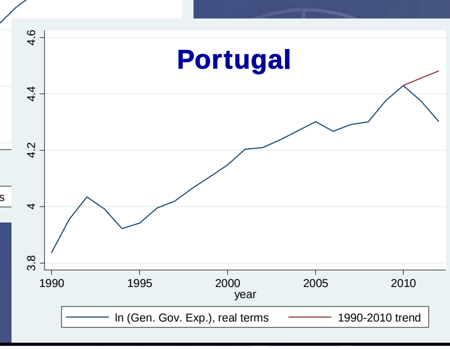
Government spending gaps: examples





The impact on aggregate demand can be considerable

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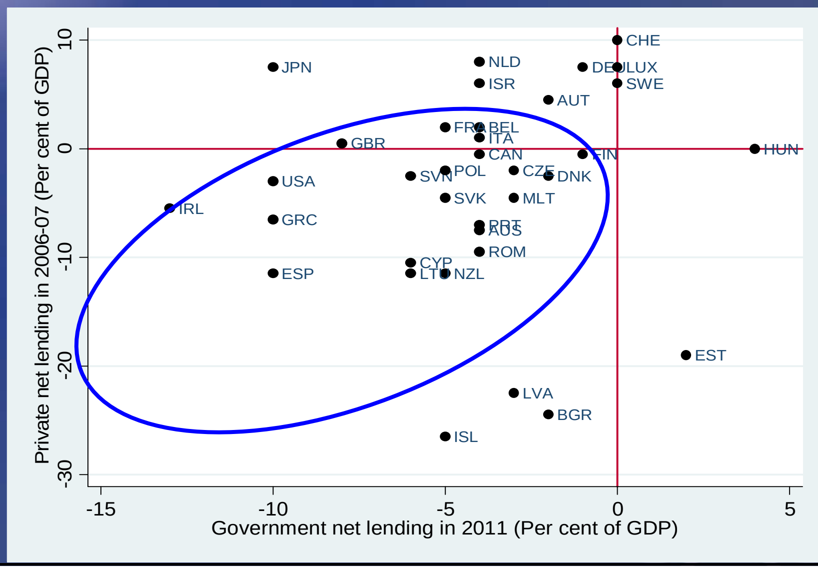
… while public debt often reflected faults in private sector behaviour



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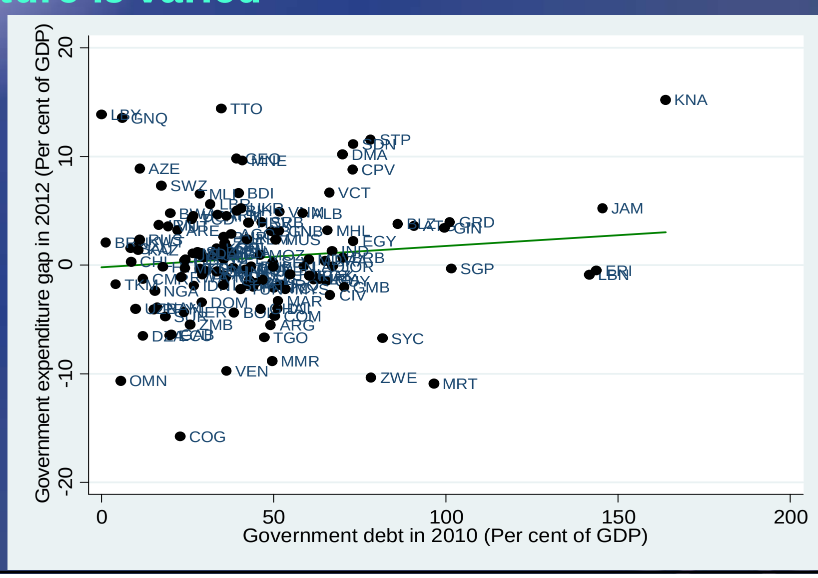
In developing and transition economies the picture is varied



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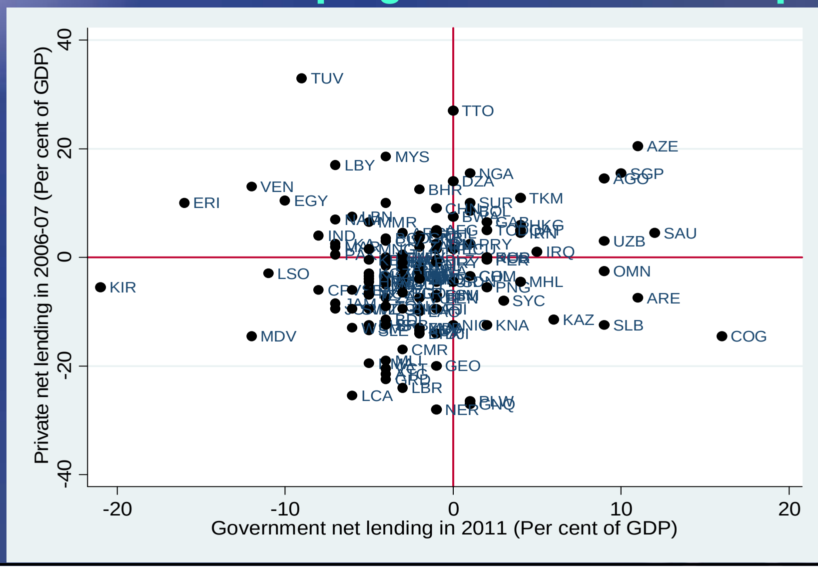
Interactions between public and private sector balances in developing countries are complex



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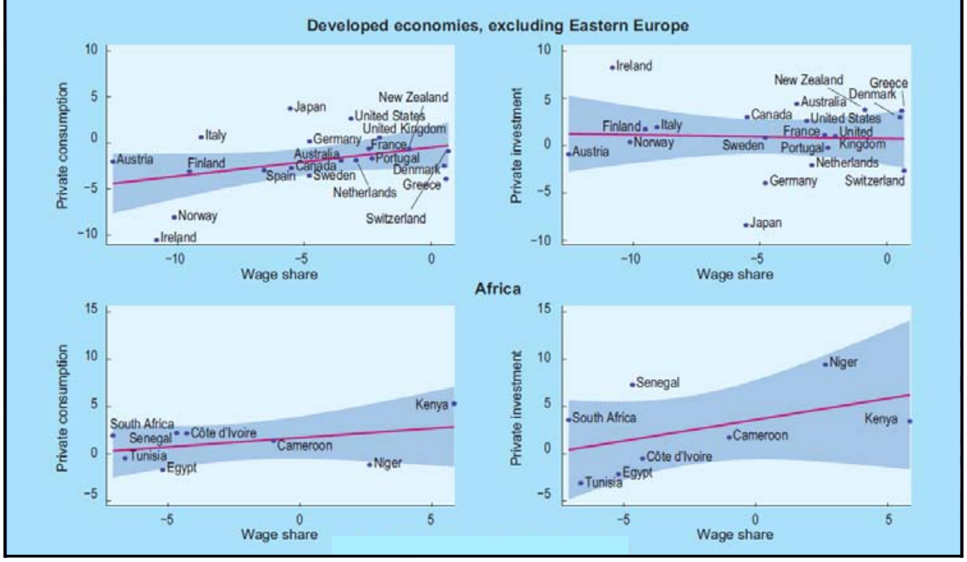
With demand falling on the back of austerity, to seek export competitiveness may backfire



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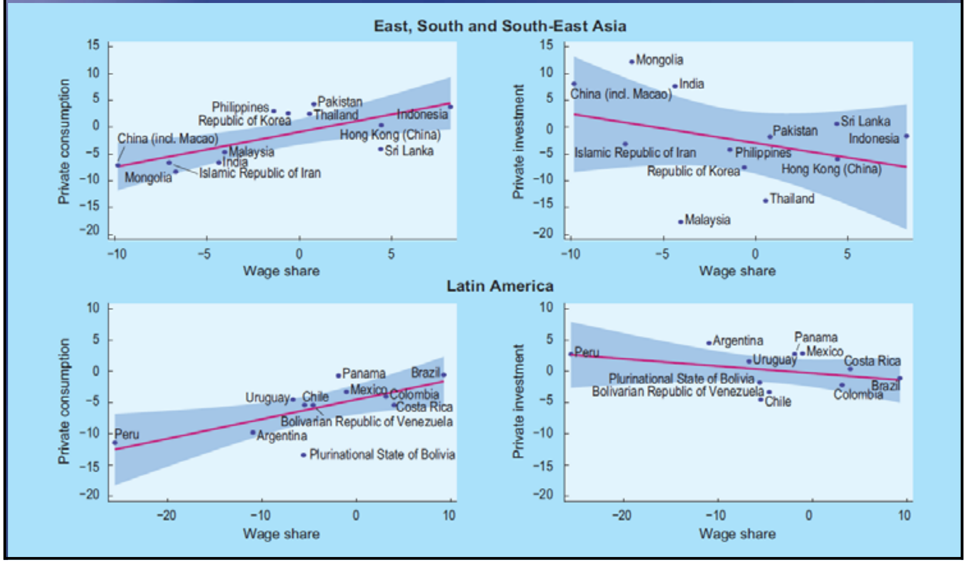
… since wage compression lowers consumption, discourages investment…



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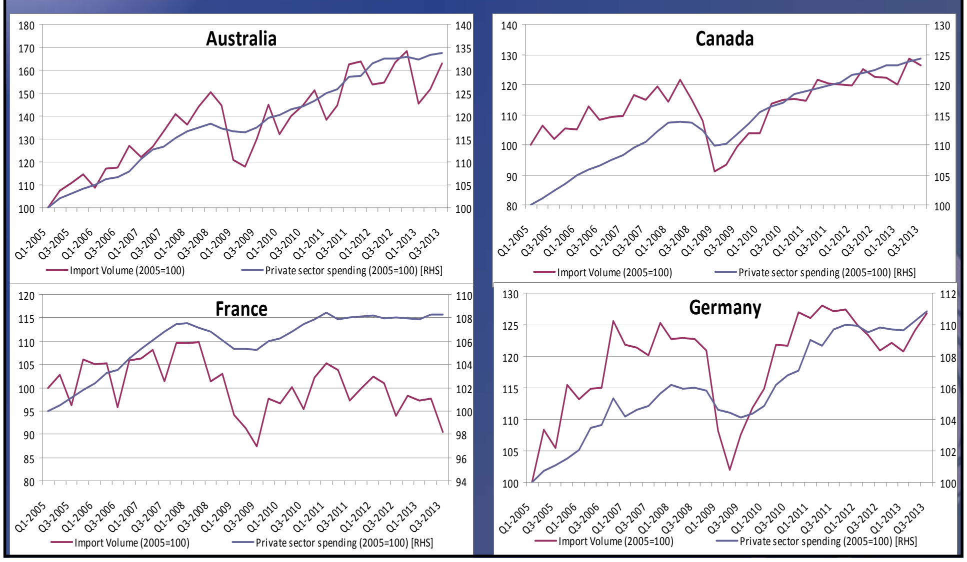
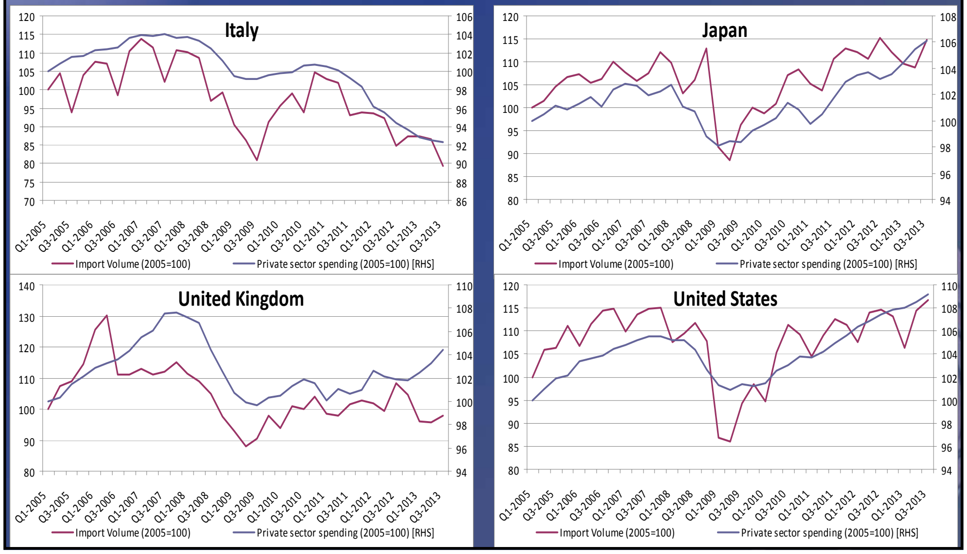
..and the deceleration of consumption and investment drives down imports…



… with detrimental impact on global demand and stability



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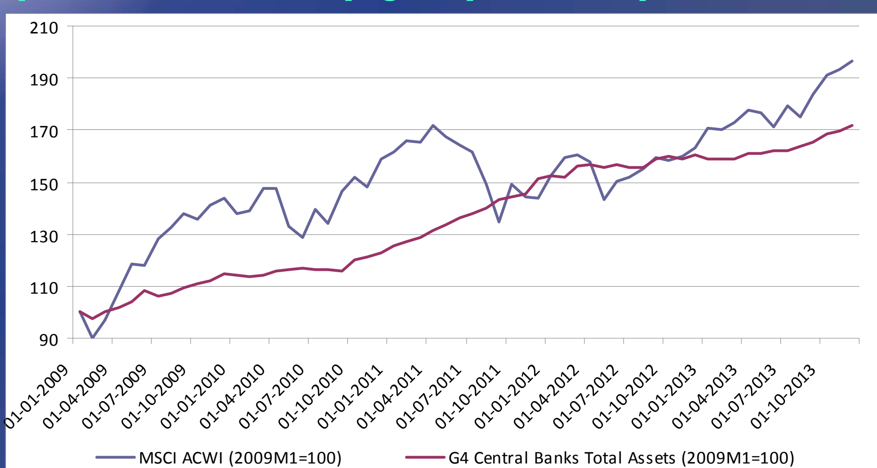
As austerity and export strategies fail, liquidity expansion is seen (again) as an option



The increase of G4 CB assets (from ~ 5 to usd 13 Tr.) has mostly served to fuel stock market bubbles

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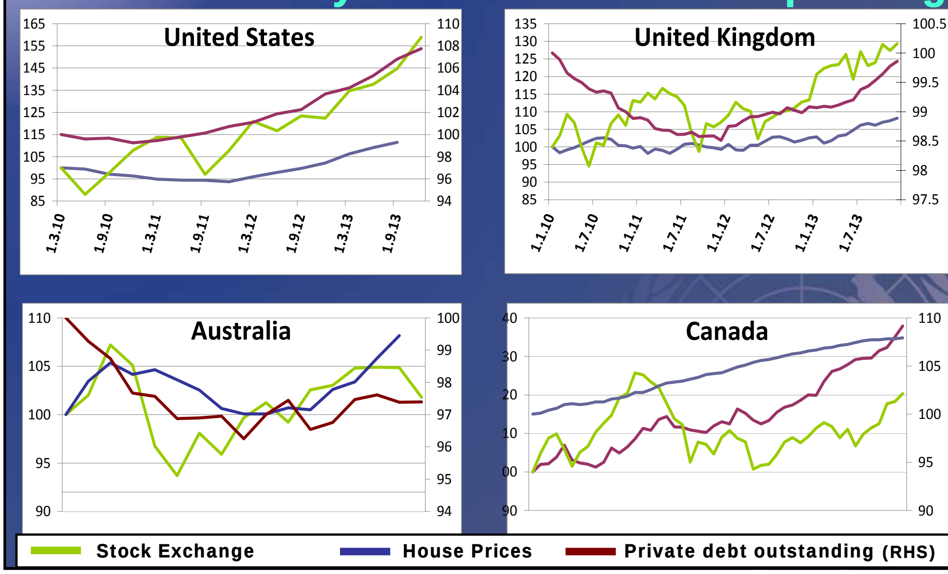
In some cases excess liquidity props up asset bubbles and may lead to debt-driven spending



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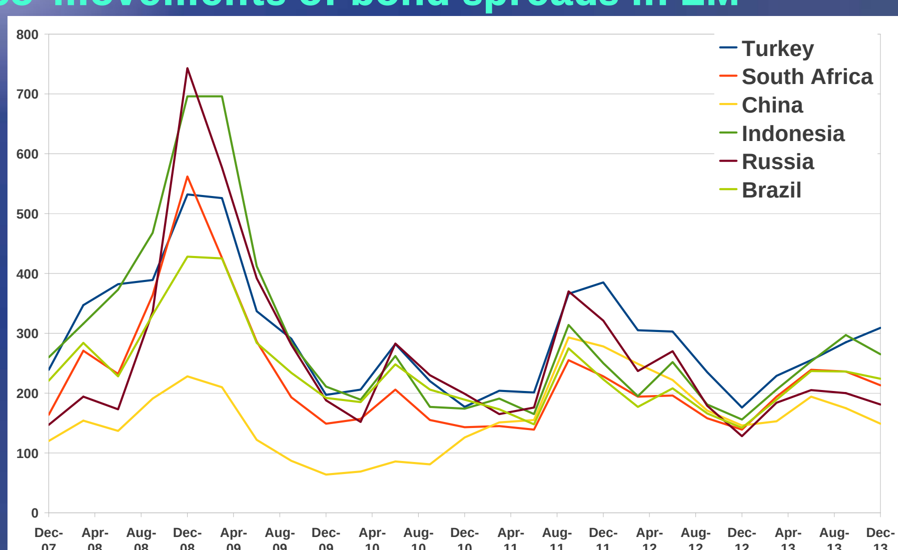
But excess global liquidity has caused erratic co-movements of bond spreads in EM



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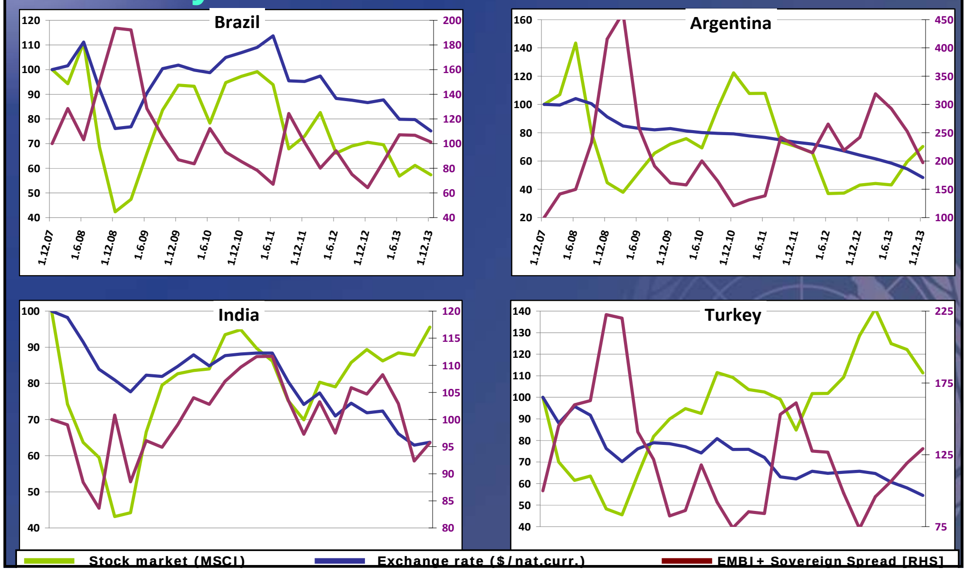
Liquidity expansions have triggered greater instability and exacerbated vulnerabilities…



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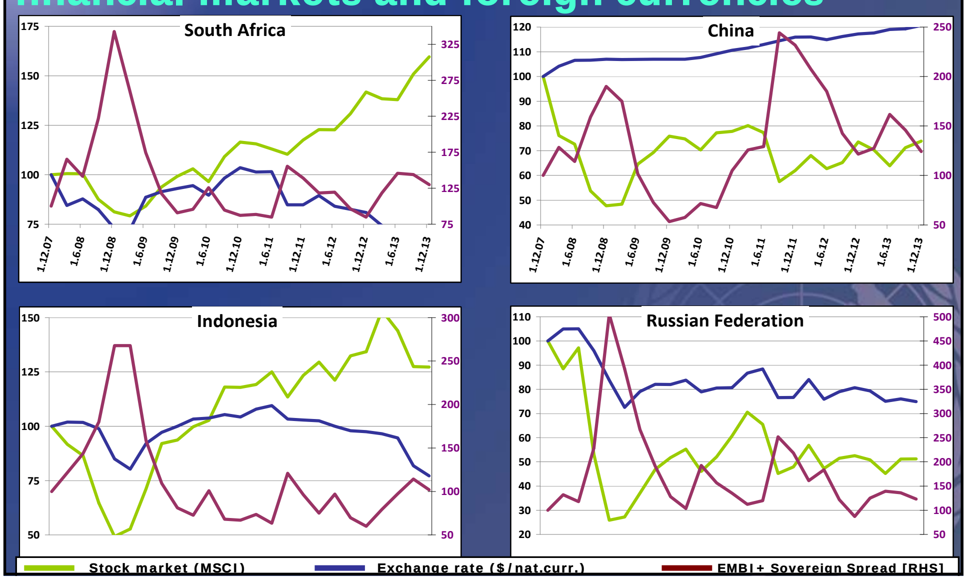
… in so far as countries depend on foreign financial markets and foreign currencies



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In sum, a sustained recovery is held back by:

- ***Over-reliance on monetary policy:*** In so far as the pressure towards downsizing of the state prevails, macroeconomic policies will be inconsistent and back-fire
- ***Financialization:*** In a global economy centred on productive activities, a profit-investment nexus may generate centrifugal forces through expansion of aggregate demand. But in a financialized global economy profit-seeking is mostly centripetal through asset price movements
- ***US-centric 'international' payments system:*** In so far as global finance depends on the US dollar there can mostly be two kinds of response: mercantilism (to gain $ by exports), or stagnation (demand contraction)