Macroeconomic Outlook

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Global economic situation

- Global economy expanding again – pulled up by strong performance in Asian economies
- Recovery evident in financial markets, although conditions still difficult for borrowers
- Pace of recovery slow, mostly led by turn in inventory cycle
- Commodity demand increasing, boosting trade
- Lay-offs likely to continue in advanced economies - low demand, excess capacity, and tight credit
Global economic situation

1. Global:
   -1.1% (2009)
   3.1% (2010)

2. Advanced economies
   -3.4% (2009)
   1.3% (2010)
   US
   -2.7% (2009)
   1.5% (2010)

3. Emerging economies
   1.7% (2009)
   5.1% (2010)

Source: IMF

Global GDP Growth

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Global economic situation

Financial Stress

Source: IMF

Industriyal Production

Source: IMF

Advanced economies
USA
Western Europe
Japan
Emerging Asia
Emerging economies
World
Advanced economies

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Global economic situation

Commodity Prices

Source: IMF

World Trade

Source: IMF

Energy
Metals
Agricultural commodities
Food
Beverages

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Global economic situation

### Employment

- **Emerging economies**
- **World**
- **Advanced economies**

**Source:** IMF

### Headline Inflation

**Source:** IMF
Public policy

- Policy critical in cutting adverse feedback loop between financial and real sectors

- Monetary policy:
  - rise in output gap has reduced inflation
  - interest rates at zero bound, and central banks committed to keeping rates low
  - various measures used to ease financial conditions – “quantitative easing”
  - hard to unwind if markets remain illiquid
Output gaps

US – Output Gap

Euro area – Output Gap

% Output gap*

*Actual GDP growth – potential GDP growth

Source: IMF

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“Helicopter Ben!”
Monetary policy

Short-Term Interest Rates

Money Supply

Source: IMF

US
Euro area
Japan

Base money + reserves
Reserves
Base money

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Public policy

Logo

♦ Fiscal policy:

- provided major stimulus in both advanced and emerging economies

- expansion largest in advanced economies, estimated to boost G20 GDP by 1% in 2009

- public debt rising fast, especially in advanced economies (110% of GDP by 2014)

- fiscal deficits will contract as recovery improves cyclical components of budget
Fiscal policy

Fiscal Balance

% of GDP

1990 1990 2000 2010

Source: IMF

Public Debt

% of GDP

1990 1990 2000 2010

Source: IMF

Emerging economies
World
Advanced economies

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Public policy

- Financial policy:
  - most governments provided deposit and debt guarantees – low cost and easy to implement
  - programs to recapitalize financial institutions have typically met with public skepticism
  - G20 economies have put in less than 6% of GDP
  - capital remains short of that necessary to forestall further bank deleveraging – potential drag on recovery
Rebalancing world economy

- Sustained medium-term growth will require addressing supply-side disruptions due to crisis, i.e., growing output gaps – 3-5% of potential GDP

- Adjustments also required in global demand:
  - economies with export-led growth and current account surpluses (Asia) will need to increase domestic consumption
  - required to offset lower demand and higher savings rates in economies that have run current account deficits (US, UK, parts of Euro area)
Risks to sustained recovery

Key risk is that recovery stalls, and deflation becomes entrenched – could be triggered by too early exit from accommodative monetary policy

Other risks include:

- central banks have to tighten monetary policy by more than expected to deal with inflation
- large increases in public debt could unsettle global bond markets
- pressures for trade protection may build with increased unemployment
Short vs. medium-term objectives

- Need to map course between unwinding support policies too soon/leaving them in place too long

**Monetary Policy:**

- In advanced economies, central banks can afford to maintain liberal monetary policy for a while

- Once output gap narrows, and inflation becomes a concern, policy will need to be tightened

- Inflation-targeting perhaps too narrow - more emphasis on macro-prudential tools needed
Short vs. medium-term objectives

- *Fiscal Policy*:
  - stimulus needs to be sustained until economic recovery on firm footing
  - but need to address long-term fiscal balances at some point by committing to deficit reductions
  - long-term increase in debt will place pressure on interest rates as recovery occurs, possibly crowding-out private investment
  - may also eventually cause flight from bonds
Short vs. medium-term objectives

**Financial Policy:**

- restructuring financial firms is key for normal lending to resume, i.e., toxic asset cleanup
- exit strategies need to be clearly articulated
- three key financial reforms necessary:
  (a) perimeter of regulation needs broadening
  (b) counter-cyclical frameworks required
  (c) international regulatory convergence
Thank you

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