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The G20 Disappoints on Policy

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OVERVIEW

At the Group of Twenty (G20) Summit in Hangzhou, China, leaders called for governments to do more to support growth, but offered little in the way of new measures. Quietly, and away from the G20 spotlight, fiscal policy is becoming more expansionary, but current policies are unlikely to provide a meaningful boost to growth or soothe rising populist pressures.

FISCAL STANCES IN G20 COUNTRIES

Global growth is likely to remain anemic.

Last week's Hangzhou communique disappointed observers hoping for a growth-boosting package of fiscal and structural reforms. Aside from cementing previous agreements on climate and tax compliance, there were no real economic achievements. A coordinated fiscal stimulus package from G20 countries, like in 2009, will not occur this year. Nonetheless, a careful look at the data shows a shift across the G20 countries toward larger fiscal deficits and, in a few cases, toward a more expansionary spending policy. Japan, China, the periphery of Europe, and some emerging markets all display this shift. Even in the United States, the fiscal squeeze of recent years has begun to ease. However, additional fiscal stimulus seems unlikely. Many countries remain hamstrung by high debt levels and gridlocked politics, and other countries, such as Germany, continue to resist using available fiscal space to boost European activity above its trend rate. As a result, global growth is likely to remain anemic.

THE G20 CALL TO ACTION

Beginning in February, G20 finance ministers and central bank governors have called repeatedly for more aggressive growth-oriented policies in their communique:

> Over the last several years, the G20 has made important achievements to strengthen growth, investment and financial stability. We are taking actions to foster confidence and preserve and strengthen the recovery. We will use all policy tools—monetary, fiscal and structural—individually and collectively to achieve these goals. Monetary policies will continue to support economic activity and ensure price stability, consistent with central banks' mandates, but monetary policy alone cannot lead to balanced growth. Our fiscal strategies aim to support the economy and we will use fiscal policy flexibly to strengthen growth, job creation and confidence, while enhancing resilience and ensuring debt as a share of GDP is on a sustainable path.

This message has been reinforced by the International Monetary Fund (IMF) and other international organizations with increasing urgency and anxiety as the year has gone on, most recently in the IMF's report for the G20 summit. Observers have scrutinized each G20 statement for evidence of policies that would match the G20's words. Time and again, those wishing for growth-oriented policies have been disappointed. Still, looking across the G20, in most cases fiscal policy has been easing in practice (both compared to last year and to forecasts for 2016 made at the start of the year), in some cases substantially. This easing occurred through allowing larger deficits (Canada and the United States), reducing surpluses (Germany), or delaying planned deficit reduction (France, Italy, and Japan). The exceptions include Latin America and Russia, where domestic pressures are forcing consolidation. Although the weakening in fiscal policy has been the autonomous result of a

weaker global outlook (what economists call automatic stabilizers) in some cases, part of the loosening is the result of specific policies that will have a sustained impact.

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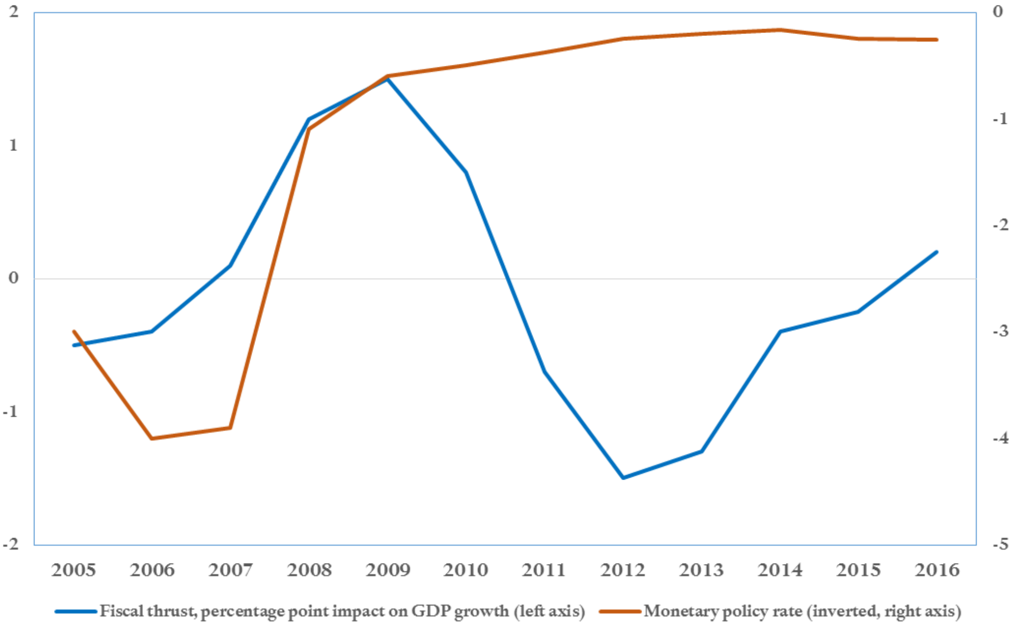
Notably, stimulus packages were announced this year in several countries. In March, Canada promised 3 percent of gross domestic product (GDP). In June, South Korea promised 1.2 percent of GDP. (My colleague Brad Setser has pointed out the limitations of the Korean effort.) In August, Japan announced a package of 6.7 percent of GDP, including loans. Japan's package is coupled with the long-expected decision to defer the planned hike in the consumption tax, both of which are expected to boost growth by 0.6 percent in 2017. This cumulatively represents a swing of more than 1 percent in Japan's fiscal position. Most important, China has introduced a substantial fiscal stimulus over the course of the year, which has provided tangible support to demand, though not enough to meaningfully reduce the external imbalances the country faces. These efforts include a loan-bond swap program for local governments to reduce debt costs, new infrastructure investment, and tax cuts. Although the Chinese government released new details of its plan after the summit, the plan does not appear to move fiscal policy beyond what was previously expected. The IMF argues that China's fiscal deficit, measured comprehensively, stands in excess of 10 percent, and urges caution going forward to contain financial risks, including the weak health of local governments. Others disagree with the IMF's assessment.

As a result, the overall fiscal thrust (that is, the net boost to demand adjusting for changes in the economic cycle) of the eurozone, Japan, United Kingdom, and United States (the so-called G4) has turned positive in 2016 for the first time since 2010.

Figure 1. G4 Policy Stance



Source: JP Morgan.

FISCAL EXPANSION, NOT POLICY COORDINATION

Encouraging other people to spend their money seems to be the only thing that G20 leaders are able to agree on.

Fiscal expansion's many supporters believe that monetary policy has become less effective in recent years with interest rates already at low or negative levels. Further, research by the IMF and others on the experience in Europe after the crisis in 2010 has argued that the impact of fiscal spending ("fiscal multipliers") is greater when interest rates are zero. In this regard, potentially high payoffs to greater infrastructure and public goods spending would appear to make a great deal of sense with rates low, a point reinforced by the IMF's recent call for a substantial new infrastructure spending effort. Some economists have explicitly linked these arguments to efforts to address the anxiety now seen across the industrial world, calling for a "responsible nationalism." However, it is worth emphasizing that a reorientation of spending, with the same overall deficit or surplus, could also address the need for more inclusive growth and assuage concerns of those who feel left behind by globalization. Others have gone further and called for fiscal expansion directly financed by central bank money creation ("helicopter money"). Although these arguments have broad or, in the case of helicopter money, growing appeal among economists, they have not seemed to affect the politics in major countries. On the surface, the fiscal policies of the major countries have hardened in recent years, making compromise more difficult.

From this perspective, recent fiscal moves do not appear to be a coordinated act or a stealth policy initiative representing a successful G20 process. In each of the cases above, domestic politics have driven policy decisions, and global debates have played a limited role. Regarding the weak global growth environment as a common factor, I have argued elsewhere that the growth environment should be differentiated from true policy coordination. A more important question, from a growth perspective, is whether it is enough. Again, it is hard to argue that the scope for fiscal policy is exhausted, and indeed the IMF and others maintain that the major surplus countries have the fiscal space to provide additional demand support. The problem: the most significant unused space in the G20 is in Germany, and aside from a proposed 3.7 percent increase in spending (some of which is associated with the migration crisis) and some tax cuts, there appears to be little political room for a change in fiscal policy ahead of fall 2017 elections.

These dynamics were on display in last week's G20 meeting. Germany was quick to put down talk of coordinated action, and China, though supportive of additional growth, was clear that it had done all it can. The United States made the case, as it has in the past, for the fuller use of available fiscal space, but its ability to contribute is stymied by domestic politics. Earlier today, U.S. Treasury Secretary Jack Lew claimed the debate between austerity and growth is over and signaled new fiscal measures would be coming, but it is reasonable to be skeptical about this claim. Encouraging other people to spend their money seems to be the only thing that G20 leaders are able to agree on.

WHAT HAPPENS NEXT YEAR

In the United States, Donald Trump and Hillary Clinton have both put forward expansionary spending proposals, though Trump's is far more so. But if the United States retains a divided government (as markets appear to expect), it is unlikely that either candidate would see his or her policies approved as president. Still,

it is reasonable to expect at least some easing of spending caps, which would allow U.S. policy to become expansionary.

In sum, fiscal policy has been responsive to events over the past year, and has provided support for growth in the face of substantial political and economic headwinds, including Brexit. But this easing was more the result of countries acting in their own interest than the result of coordinated action or a breakthrough at the G20. Further, there does not appear to be much more fiscal easing in the pipeline, nor even a reorientation that would address the populist concerns of the electorate. Those who want more aggressive fiscal support for inclusive growth will be disappointed by last week's meeting.

Looking Ahead: Kahn's take on the news on the horizon

Ukraine

One year after Ukraine's debt restructuring deal, investor confidence, rattled by continuing conflicts in the country's east, remains cautious and fragile. What is equally worrying is Ukraine's slow progress in implementing needed reforms, which has caused a delay in completing the second review of its IMF program and receiving the next tranche of aid. An IMF board meeting is scheduled for September 14.

Emerging Market Debt

Corporate debt in emerging markets will likely experience a negative net issuance of $21 billion in 2016, with $118 billion maturing after nearly a decade of rapid expansion. Although this deleveraging process soothes the anxiety about high debt, the repayment ability of some corporations is still in question. The process also reflects debt-issuing companies' rising concerns about investment profitability and the broader sluggish macroeconomic environment.

Venezuela

The crisis continues to deepen in Venezuela, underscored by a sharp recent deterioration in oil production, but the government is moving forward with a bond swap to make fall payments on state and energy-company debt. Still, default is a question of when, not if.