# FOREWORD

A typical foreword to the *World Economic Outlook* (WEO) highlights how data since the previous projection alter our baseline growth assumptions. It pays detailed attention to the most recent developments and interprets the implications for policies going forward. This WEO foreword—my last—will instead situate the current conjuncture in a broader historical context, the better to draw out lessons for the future.

The occasion justifies my unusual approach. This WEO is appearing shortly after the 10th anniversary of the Lehman Brothers collapse and, moreover, at a time of mounting uncertainties—not only over economic policies but also over the global framework of international relations within which policies are made.

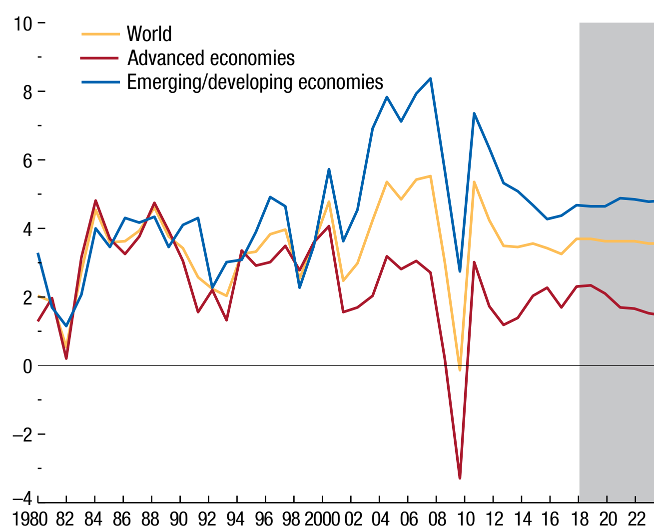
The decade since the global financial crisis of 2008–09 has indeed brought dramatic economic and political developments, a trend that seems unlikely to recede any time soon. How can policymakers guide their economies through the troubled waters ahead? How can they strengthen and modernize the post–World War II multilateral system, which supported an unparalleled 70 years of peace and prosperity? To answer, we must consider not only the impact of the crisis itself but also the years just before, when some key patterns that have defined the post-crisis period first emerged.

## The Precrisis Decade

It was in the period before the crisis when some of our current economic vulnerabilities first came to be. The chart tracks real global growth since 1980, along with the contributions of advanced economies and of emerging market and developing economies. After the Asian crisis (1997–98) and the collapse of the dot-com bubble (2000–01), the growth of emerging market and developing economies accelerated significantly while advanced economies, even though recovering, grew at rates below prior levels.

Two things stand out. First, advanced economies' growth has generally trended downward since the mid-2000s. This long-term decline stems from aging workforces and slower productivity growth, which coincide with falling economic dynamism and rising

**Figure 1. Real GDP Growth, by Country Group**
*(Year over year)*




Source: IMF, *World Economic Outlook*, October 2018.
Note: Grey area denotes projections.

market concentration. Notably, the longer-term future growth rates that the WEO projects for advanced economies are below current levels.

Second, the start of the new millennium brought a growth surge in emerging market and developing economies that decisively placed them ahead of advanced economies' growth. Rapid Chinese growth was responsible for some, but clearly not all, of this decoupling, because the pattern remains even after subtracting China's algebraic growth contribution (as well as India's, for that matter). The growth acceleration is a robust consequence of stronger policy frameworks in many emerging market and developing economies, including their embrace of more open trade. Because it also derives from the greater weight of these fast-growing economies in the world economy, their distinct growth advantage over advanced economies looks likely to continue unless advanced economies can meet their structural economic challenges.

The Asian crisis and the dot-com collapse—and intervening events like the forced bailout of Long-Term Capital Management (LTCM) in 1998, which avoided a possible systemic financial meltdown—illustrate

pointedly how balance-sheet weaknesses and asset-price bubbles can bring down financial institutions and entire economies. In his 1998 Henry L. Stimson Lecture at Yale University, Alexandre Lamfalussy wrote presciently of the US market turmoil that followed that year's Russian default: "If such developments can take place in the model market of the world, what is the practical value of recommending that emerging markets copy this model?"

Many emerging market and developing economies did draw and act on lessons from these crises, for example, by embracing inflation targeting, adopting more flexible exchange rate regimes, and implementing macroprudential policies—lessons well worth remembering today. Advanced economies, however, were more complacent, often viewing financial crises as problems to which only emerging market and developing economies were susceptible—notwithstanding the contradictory evidence from several near-misses, including LTCM. The result was the global financial crisis, which ended the mid-decade global boom. As a group, emerging market and developing economies generally weathered that crisis well, given its severity, and they have continued to grow more quickly than during the 1980s and 1990s.

## The Postcrisis Decade

World growth took a rarely precedented tumble in 2009, but all regions of the world experienced a bounce back in 2010–11, supported by vigorous countercyclical responses throughout the Group of Twenty countries. Many advanced economies reduced policy interest rates to the zero lower bound and began to experiment with unconventional monetary policies.

After 2010–11, however, a succession of shocks—the euro area crisis, reversals of fiscal stimulus in major economies, wobbles in Chinese growth, and falling commodity prices—all prevented continued strong and synchronized growth. Relatively favorable economic fundamentals in the United States made it likely that the Federal Reserve would be the first among major central banks to normalize monetary policy, and the dollar strengthened starting in the summer of 2014. Global markets were spooked a year later when China, feeling the resulting pressure on its heavily managed exchange rate, began to allow its currency to fall against the dollar. The tensions did not recede quickly. Within a month of the Federal Reserve's first interest-rate hike in nearly 10 years at the end of 2015, global financial markets swooned and commodity prices fell further. The 2016 global growth rate of 3.3 percent was the lowest since 2009.

Economic optimism began to return midway through 2016, despite any effects from the surprise outcome of the UK Brexit referendum in June. Late that year, manufacturing activity surged and growth picked up broadly around the world, leading to the most evenly balanced global upswing since 2010. Global trade, which had grown unusually slowly during 2012–16, also rebounded as investment began to recover. As of the April 2018 WEO, we projected global growth to rise to 3.9 percent in both 2018 and 2019, and for the first time in a while, assessed short-term risks to our growth forecast to be evenly balanced between potential positive and negative surprises.

Now, in October 2018, the outlook is one of less balanced and more tentative expansion than we hoped for last April. Growth in the United States remains exceptionally robust for now, powered by a procyclical fiscal expansion that may, however, weigh on US and global growth later. But we have downgraded near-term growth prospects for the euro area, Korea, and the United Kingdom. Our reassessment is more dramatic for emerging markets as a group, where we see growth easing in Latin America (notably Argentina, Brazil, Mexico), the Middle East (notably Iran), and emerging Europe (notably Turkey). Our 2019 growth projection for China is also lower than in April, given the latest round of US tariffs on Chinese imports, as are our projections for India. Owing to these changes, our international growth projections for both this year and next are downgraded to 3.7 percent, 0.2 percentage point below our last assessments and the same rate achieved in 2017. At the global level, recent data show weakening in trade, manufacturing, and investment. Overall, world economic growth is still solid compared with earlier this decade, but it appears to have plateaued.

These more moderate growth numbers and the weaker incoming data that underpin them owe, in part, to a sharp rise in policy uncertainty over the past year—a development yet to be reflected in advanced economy financial markets but evident in news-based uncertainty measures. Uncertainty over trade policy is prominent in the wake of US actions (or threatened actions) on several fronts, the responses by its trading partners, and a general weakening of multilateral consultation on trade issues. The possible failure of Brexit negotiations poses another risk. Amid the trade uncertainties, financial conditions are tightening for emerging market and developing economies as they

adjust to progressive interest rate hikes by the Federal Reserve and an impending end of asset purchases by the European Central Bank. Compared with 10 years ago, many of these economies have higher levels of corporate and sovereign debt, leaving them more vulnerable. With geopolitical tensions also relevant in several regions, we judge that, even for the near future, the possibility of unpleasant surprises outweighs the likelihood of unforeseen good news.

## Policy Challenges

Perhaps the biggest secular challenge for many advanced economies centers on the slow growth of workers' incomes, perceptions of lower social mobility, and, in some countries, inadequate policy responses to structural economic change. Not only has the trend in long-term advanced economy growth been downward; in many countries, the more meager gains have gone primarily to the relatively well-off. In the United States, for example, median real household income was about the same in 2016 as in 1999. This pattern clearly predates the global financial crisis and the euro area crisis. But the crises themselves, along with aspects of the policy response, further soured the public mood. Such discontent in turn helped give rise to current tensions over trade policy as well as a broader skepticism toward centrist policies and leaders, who have traditionally supported global cooperation as the proper response to shared challenges.

Policymakers must take a long-term perspective to address this malaise. Inclusive fiscal policies, educational investments, and ensuring access to adequate health care can reduce inequality and are key priorities. So too are more secure social safety nets that can help workers adjust to a range of structural shocks, whether from globalization, technological change, or (in some countries) climate change. Policies to promote labor force participation and the economic inclusion of women and youth are especially important. Structural reform priorities differ by country, but in general, addressing them will raise output and growth over the medium term. That said, due consideration must be given to those who are already disadvantaged but might lose out further. Support for research and development and basic and applied scientific research offers the promise of raising growth rates, as many studies have shown. These policy priorities are also relevant to emerging market and developing economies.

Most countries also need to build fiscal buffers to make room for policy responses to the next recession when it comes and to reduce the long-term tax costs of servicing high public debts. Several emerging market and developing economies must undertake fiscal reforms to ensure the sustainability of public finances and improve market sentiment. Global and national actions have buttressed financial stability since the crisis, but the work remains incomplete in several respects, including, for example, safeguarding the nonbank financial sector and resolution in insolvency, especially for systemically important international banks, where a cooperative global framework is urgently needed. Some financial oversight measures that grew out of the crisis could be simplified, but a wholesale rollback would risk future instability. Even piecemeal deregulation must be cautious and carefully considered, because a sequence of smaller actions could eventually weaken the system enough to leave it fragile. Indeed, precisely because monetary policy will need to remain accommodative where inflation is below target levels and will need to proceed cautiously elsewhere, effective macro- and microprudential levers must remain available.

The growing weight of emerging market and developing economies in the global economy means that advanced economies internalize fewer of the global gains from their own support of multilateral cooperation. They perceive the leakage of benefits to other countries to be relatively larger now than in the past, compared with their own benefits. This change may tempt some to retreat into an imagined self-sufficiency. But economic interdependence is greater than ever—through trade, finance, knowledge spillovers, migration, and environmental impacts, to name a few channels—and that makes cooperation in areas of common concern more important than ever too, including for advanced economies.

Multilateralism must evolve so that every country views it to be in its self-interest, even in a multipolar world. But that will require *domestic* political support for an internationally collaborative approach. Inclusive policies that ensure a broad sharing of the gains from economic growth are not only desirable in their own right; they can also help convince citizens that international cooperation works for them. I am proud that during my tenure, the IMF has increasingly championed such policies while supporting multilateral solutions to global challenges. Without more inclusive policies, multilateralism cannot survive. And without multilateralism, the world will be a poorer and more dangerous place.

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