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## From AI to deglobalisation: key takeaways from the IMF annual meetings

There is strong consensus around near-term resilience in most of the global economy and a struggling China. The USD is not under threat of displacement, but fragmentation is likely to be amplified by China's emergence in EV production.

### Key Takeaways

- Resilience and fragmentation were the major themes at this year's IMF annual meetings.
- It was however not just a case of 'US exceptionalism'. Aside from China – which presenters sometimes competed to be the most pessimistic on – resilience was remarked on all the way across the DM-EM spectrum.
- 'Higher for longer' dominated central bank communications and was judged to be a key component contributing to the recent rise in yields.
- Fiscal largesse (primarily the US's) was also a prominent topic – one that was not discussed at the IMF Spring meetings. Bond vigilantes may eventually force a government adjustment, but few thought governments would self-correct.
- Deglobalisation pressures and reshoring were also top of mind. The dollar's position is not under threat, but trade flows and shifting production locations were thought to be evidence of fragmentation. China's success in electric vehicle manufacturing is regarded as good for the environment but expected to be the next front in global trade tensions.
- AI's potential impact on productivity and geopolitical tensions was explored, with experts urging caution in implementation and integration and an immediate boost to productivity considered unlikely.

*emerging markets at the International Monetary Fund (IMF) annual meetings. Several presentations were conducted under 'Chatham House rules'; hence, full attribution is not provided in all instances.*

### A sombre start

The host country, Morocco, suffered a 6.8 magnitude earthquake in the Atlas Mountains one month ahead of the IMF annual meetings; it is estimated to have killed around 3,000 people, with more than 5,000 injured. And just before the start of the annual meetings, Hamas attacked Israel – a stark reminder of the political fault lines that are never far from the surface.

Appropriately, resilience and fragmentation were the major themes cutting across almost all presentations.

### The global economy has shown surprising resilience

US economic resilience was widely remarked: the ballast from excess savings, and the ability of corporates to term out their loans were repeatedly cited as key reasons why the US had absorbed the Fed's rate hikes thus far.

It was however not just a case of 'US exceptionalism'. Excluding China – which most were downbeat on – resilience was remarked on across the spectrum, from developed (DM) to emerging markets (EMs).

### 'Higher for longer' and the return of the bond vigilantes

The full effects of monetary tightening are yet to be felt, allowing central banks to keep rates where they are as the remnants of excess inflation are purged.

*This Insight summarises three days of conference presentations and discussions on the global economy and*



Indeed, with such a similar message coming from central bank governors, a common quip was that macro presentations could simply be recycled by switching country names.

'Higher for longer' typically blurred into an expectation that real equilibrium interest rates ( $r^*$ ) had shifted higher, with a combination of governors and former Federal Reserve officials simultaneously noting the uncertainty of  $r^*$  and saying they thought it had shifted to around 1% or more, up from around 0% before the pandemic.

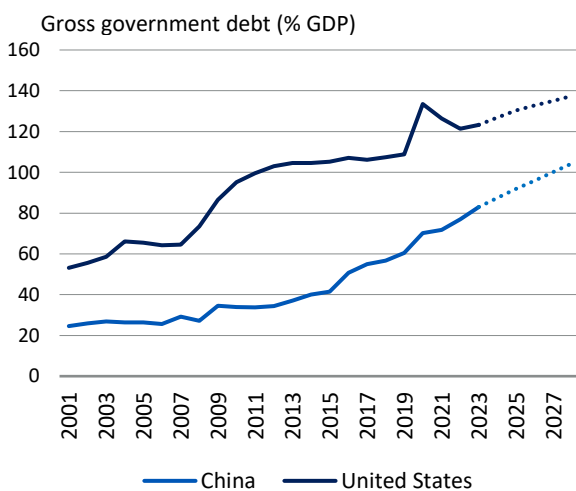
The higher level of  $r^*$  coincided with the emerging business of after-the-fact rationalisation for the spike in US 10-year yields. One former Fed official broke down the steady-state 10-year as reflecting:

- i.  $r^*$  at 1%, itself a reflection of the approaching 'chronic' US fiscal deficits;
- ii. the Fed's asymmetric flexible average inflation targeting regime (FAIT) – where misses are made up, but overshoots are let slide – and a more challenging picture for global supply, which could mean inflation averages 2.5%;
- iii. And a term premia of 1%, which may be unusual by recent history, but is not when considered over a longer time frame. Indeed, if ZLB events are more unusual, and geopolitical drivers (national security and the green transition) keep fiscal policy loose, the compensation required for holding debt could be even higher.

### Hey big spender

The IMF showcased its new debt database: 50% of global debt is accounted for by the US and China, and expectations that these two countries would stop the climb of debt/GDP were very low, but for very different reasons.

**Figure 1: US and China to drive global debt higher**



Source: IMF, abrdn (October 2023)

Nobody thought that US politics would be able to rein in fiscal spending while political disfunction and gridlock were so entrenched. Some presenters thought that the bond market would *eventually* impose some fiscal prudence, but this was not thought likely any time soon. The IMF did however expect that higher rates would curtail the build-up of private sector debt.

China's upward march in debt, was not due to lack of prudence. Instead, a supply-side biased policy mix which weakens the nominal backdrop was combining with lower trend growth. Moreover, the end of its real estate-driven growth model, a need to bring debt onto the central government balance sheet and growing geopolitical tensions were thought to be difficult headwinds to overcome.

The (relative) good news was that government debt/GDP was expected to fall outside of the US and China, so there is some risk of being too US-centric when considering the pressures on yields and  $r^*$ . Moreover, the IMF thought the capacity to bear the debt burden in both countries was 'immense'.

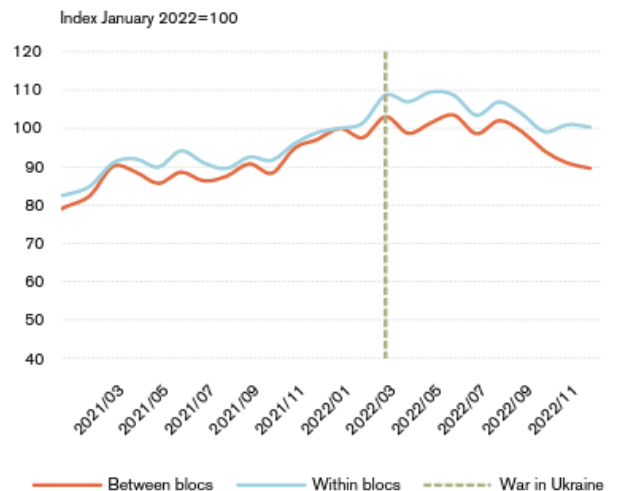
### Along the reshore

Deglobalisation was often thought to be overstated, or at least on some key aspects.

Capital flows were still moving from 'outside the circle of trust' to 'inside the circle of trust', an indication that capital movements had not yet deglobalized.

On the other hand, the World Trade Organisation (WTO) presented work that showed trade flows being slightly stronger between politically aligned countries (as proxied by voting records at the UN) than between these blocs, a weak indication of fragmentation within trade flows.

**Figure 2: Trade within hypothetical geopolitical blocs has been stronger than between blocs**



Source: WTO, abrdn (October 2023)



Some thought that greenfield investment in China was little changed, with FDI weakness instead capturing profit remittance.

Few (if any) thought there was a credible challenge to the US dollar's crown. And some questioned whether a multipolar world would really resolve key issues around liquidity provision and capital flow pressures for EMs.

One or two thought that the weaponization of the USD could eventually take the shine off, but even China – who would arguably be most concerned about sanction risk – was seemingly still acquiring US assets. Parking official reserves in Treasuries may no longer be standard practice, but state actors provided another route to recycle trade balances, pivoting from USTs to agency bonds.

Mexico and (to a lesser extent) the host country Morocco were held up as examples of beneficiaries of reshoring. One Mexican official noted that private sector investment had not been this strong for 25 years, another reason why rates would need to be held high.

The IMF mission chief for Morocco noted the benefits it was accruing from its hard-won macro stability, which allowed it to leverage off its proximity to the Eurozone – the port of Tangiers is reportedly booming.

### **Electric vehicles could be the next stage in global trade tensions**

China's electrification was simultaneously welcomed and feared.

On the one hand, China has made substantial progress in greening the automobile fleet. The push into renewables is positive in terms of both domestic energy production, which could help to give China an advantage by lowering the carbon intensity of its production, and the potential for other countries to gain a positive spillover from the subsidies aimed at solar and other renewables.

Subsidies supporting electric vehicles (EVs) could (in theory) also create a positive externality. But the potential for cheap Chinese EVs to flood the European Union (EU) market was thought to be the next flash point in global trade tensions.

EU automakers are torn between wanting to access the Chinese market and fearing unfair competition on home soil. The EU assessment on China EV subsidies is therefore key to assessing how the EU's China trade policy will evolve: there is a non-trivial risk that EU tariffs placed on imports from China lead to retaliation.

An EU pivot to protectionism could also sound the death knell for the WTO, which is put under the most pressure

from fragmentation since non-discrimination is its core principle. Fundamentally this would be inconsistent with the global trading system operating under spheres of trust.

### **Other multilateral institutions could be reformed**

Other multilateral institutions are at least moving up the policy priority list. The US Treasury is seemingly motivated to push through development bank reform, with expanded quotas (but no changes to voting shares) – one route that the World Bank can use to expand its development lending.

It was also reported that working groups between the US Treasury and China are being set up, which should encourage dialogue and could reduce the risks of a tailspin in US-China relations. One working group will be between the Treasury and China's Ministry of Finance, while another will be between the Treasury (but roping in the Fed when needed) and the People's Bank of China (PBOC).

These groups did not however imply a return to the ambitious (and rarely delivered) joint-statements that were a common feature of the Strategic Economic Dialogue and its replacement, the Strategic and Economic Dialogue (yes, the 'and' was a key distinction as US administrations changed).

### **AI to the rescue?**

One of the largest US banks reported that they were expecting AI to boost the productivity of their developers by around 30%, with efficiency gains also being reaped across client servicing (call centres, for example).

But academic experts sounded a note of caution. For a start, AI is nowhere near to 'thinking' by itself. It is unable to think beyond pre-defined parameters and current systems effectively optimise one task.

An immediate boost to firm productivity also seemed optimistic. For businesses, the key challenge is less on the coding side and more on the implementation/integration side – with a lack of talent on the latter.

Implementation risk was underappreciated: firms would need to be highly cognisant of the potential to embed discriminatory features, such as race.

How AI would be used also matters. One Harvard study cited implied that an overreliance on GPT for producing outputs could be detrimental, but gains were seen when it was used for the initial phases of work.

Fears of mass job losses were generally thought to be exaggerated, but the impact on labour markets still adds another dimension to pressures on globalisation.

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