

The global impact of policy action in the world's top five economies

Lunchtalk, Bruegel, 16 September 2013

IMF officials presented their new [2013 Spillover Report](#) and [2013 External sector Report](#)

David Robinson: External Report 2013:

- Global current account divergences continued to narrow in 2012: as a consequence of contributions from all major players in the world (smaller surpluses in surplus countries and smaller deficits deficit countries)
- Lower current accounts have implied lower capital flows and less reserve accumulation (with almost no reserve accumulation in China for the first time in 7 years)
 - Switzerland exchange rate policy led to a large accumulation of international reserves by the Swiss National Bank
- Capital flows to emerging markets have been volatile, especially debt creating flows (non-FDI)
- There's higher capital flow volatility in the financial centers but larger exchange rate volatility in emerging markets
- External imbalances have narrowed slightly during the first two quarters of 2013
- Steven Phillips: this is a work in progress (methodologically speaking)
- Policy responses have shaped the evolution of external positions and contributed to capital flow volatility

Isabelle Mateos y Lago: Spillover Report 2013

Focused on the 5 biggest economies: China, Japan, US, UK, and the euro area

The US is clearly in the center of the spillover model, with the biggest economy, the largest financial system and having control over the international currency, therefore its relative weight is of course much heavier; a simulated financial crisis in China would a larger impact in the global economy through the US (financial linkages) than directly (trade linkages).

- EA stress avoided
 - On average we estimate that the reduced stress in the EA increased the global output with respect to the counterfactual (EA meltdown) is between 1.5 and 3 percentage points
- US fiscal cliff
 - The partial avoidance of the fiscal cliff (sequester) increased global GDP by an estimated 0.5 to 1.7 percentage points with respect to the counterfactual (full blown fiscal cliff)
- Unconventional monetary policy (US, UK, Japan)
 - Unknown counterfactual
 - Estimated benefit for the world by 1.2 percentage points of GDP (through lower borrowing costs)
 - Japanese QE could have had a negative effect in the rest of the world through a weaker yen, at least in the short run. This result is based on the initial markets' reaction on the days of the announcements, so it is a short term negative effect. We still think it is a positive policy on the long term. Our Japanese counterparts have asked us to state that explicitly. Last year we showed that the yen was overvalued; therefore, what we have seen so far is taken as a correction, not a competitive devaluation.

- UMP exit
 - FED tapering: mean reversion in local currency government bond yields
 - Three scenarios:
 - Smooth exit: +1% world GDP
 - Exit with a term premium shock: negligible impact on world GDP, overreaction on long term rates, tightening in financial conditions for most of the world, positive for Mexico, Canada, US, negative for everyone else
 - Exit with term premium shock but no higher growth: -1% in world GDP, very negative for the US and rest of North America
- Impact from incomplete policies: Prolonged slowdown in the EA: -0.9% global GDP
- Impact of sovereign debt stress: -2% of global GDP (200 base points on Japanese CDSs)
- Combined policy action synergies (of the big 5): the coordination of fiscal policies of the five major economies in the world could lead to an increase in the total world output of 3%

Authors' answers to questions from the audience

- The IMF has continue to improve its current account model in their annual External Sector report. The G35 model takes into account both gross and net flows when assessing current accounts, exchange rates and debt sustainability issues, among many others. Much of the action in their simulations is now based on changes in the asset prices (bond yields and exchange rates). The IMF current account (CA) analysis is not only based on CA regressions. The IMF has managed to *modernize its CA model using financial variables, FX intervention, capital controls, VIX*. The concept of cyclically adjusted CA replaces the standard CA measure in most of the analysis: The concept of a cyclically adjusted CA is a tricky one. The idea is not to point out countries that increase their current account balance when they enter in recession as a result of contraction in local demand and depreciation of their exchange rate. We don't see countercyclical monetary policy as a beggar thy neighbour policy, or at least there is no strong evidence of that. With respect to the fit, we have despite the improvements, this is still a work in process; in some countries there is an important part of the movements in CA that is still unexplained in the context of our model.
- Regarding the robustness of the results, the IMF has addressed these questions through many different models obtaining very similar results, as many different models point in the same direction we would say that these results are quite robust. Of course our models do not fit that well for all countries; Saudi Arabia was mentioned as one of those countries where the IMF's models do not fit too well, as it is an oil dependent economy.

Event notes by Carlos de Sousa