MARKET COMMENTARY

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International Monetary Fund reduces its forecasts once again

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It was predictable – after the economic statistics of recent weeks the GDP forecasts for next year would be lower than last time around, three months ago. And it is also a safe bet that the next forecast, early next year, will be reduced yet again.

For the IMF, the worst is still ahead of us. As of October 11, they expect the following: in 2023, the world's real GDP will exceed its 2022 level by only 2.7% while consumer price inflation will average 6.5%, after 8.8% y/y in 2022. Since labor markets are mostly tight in the rich part of the world and close to full employment, the main central banks will continue to tighten policies and to raise interest rates. They are pushed to do this by public opinion because there seems to be no other way to get inflation under control, even at the expense of another recession.

To increase the supply of energy and bring down inflation this way is not an approach that is discussed much – it takes too long or is not, on closer inspection, an attractive alternative: keep nuclear power plants running longer than planned, or lignite coal mines? Start fracking in places like Lower Saxony? Even more wind turbines in people's back yards? More subsidies for solar, wind and storage facilities? End the sanctions against Russia? One could argue that those high inflation rates by themselves will be enough to reduce overall demand and inflation, as mass incomes rise at a slower pace than the price level, but who can be sure? The risk is that the world is suddenly faced with new wage-price spirals after all, which would then require even stricter monetary policies.

Actually, there is almost no evidence of such self-enforcing spirals yet: in the U.S. as well as in the euro area, long-term inflation expectations are still only modestly above the 2% targets, and workers' wage demands remain quite modest so far, in spite of their strong negotiating power in the present full employment environment. No one knows why this is so. What happened to labor unions? Do they still exist, especially in America?

In other words, rising policy rates are not really needed to bring down inflation – weakening economies will do the job in any case. At this point I have to concede an important argument of those who favor more restrictive monetary policies: what is wrong about seizing the moment in order to "normalize" things and gain some room for manoeuver in case the world economy does indeed go into a free fall, perhaps as a result of another financial crisis? Some time in the future central banks want to be able to cut interest rates again and stimulate demand. If rates are near zero already, consumers and business are not much impressed by a cut to minus 1%. The action would be more effective if the starting point were at, say, 4%.

Another argument carries some weight as well: compared to the "natural interest rate" policy rates remain quite low. R*, the natural rate, is the product of target inflation (2%) and trend productivity (1 to 1 ¼%), i.e. somewhat above 3%. Policy rates should fluctuate around this level. In the U.S., the Fed Funds Rate is presently at 3.25%, and market participants expect that it will rise to a peak of about 4 ½% sometime next year while the ECB has raised its main refinancing rate from its low of zero to just 1 ¼% and thus continues to pursue a very expansionary policy. However, the bank has clearly indicated that it is determined to change that at the coming policy meetings this year and next – this would have the positive side effect of reducing the rate gap vis-à-vis the Funds rate and thus stop the inflationary depreciation of the euro. Perhaps.

the new IMF numbers (and CO_2 emissions)

% y/y

	∅ 2000/09	∅ 2010/19	2020	2021	2022	2023
world						
real GDP	3.9	3.7	-3.0	6.0	3.2	2.7
CO_2 emissions	2.5	1.4	-5.9	5.6	-	-
prices*)	4.2	3.6	3.2	4.7	8.8	6.5
US						
real GDP	1.9	2.2	-3.4	5.7	1.6	1.0
CO_2 emissions	-0.5	-0.6	-11.2	6.3	-	-
prices*)	2.6	1.8	1.2	4.7	8.1	3.5
China						
real GDP	10.3	7.7	2.2	8.1	3.2	4.4
CO_2 emissions	8.9	2.5	1.1	5.5	-	-
prices*)	1.8	2.6	2.4	0.9	2.2	2.2
euro area						
real GDP	1.4	1.4	-6.1	5.2	3.1	0.5
CO_2 emissions	-0.6	-1.3	-13.8	6.3	-	-
prices*)	2.1	1.4	0.3	2.6	8.3	5.7
Germany						
real GDP	0.7	2.0	-3.7	2.6	1.5	-0.3
CO_2 emissions	-1.3	-1.0	-11.7	4.7	-	-
prices*)	1.6	1.4	0.4	3.2	8.5	7.2
France						
real GDP	1.5	1.4	-7.9	6.8	2.5	0.7
CO_2 emissions	-0.8	-1.7	-16.0	8.7	-	-
prices*)	1.9	1.3	0.5	2.1	5.8	4.6
Italy						
real GDP	0.5	0.3	-9.0	6.6	3.2	-0.2
CO_2 emissions	-0.9	-1.7	-13.6	9.6	-	-
prices*)	2.3	1.3	-0.1	1.9	8.7	5.2
Japan						
real GDP	0.4	1.2	-4.6	1.7	1.7	1.6
CO_2 emissions	-0.7	0.0	-8.2	2.3	-	-
prices*)	-0.3	0.5	0.0	-0.2	2.0	1.4

*) consumer prices
sources: IMF World Economic Outlook Oct. 2022, BP Statistical Review of World Energy June 2022 ©UR

Another question is why the IMF and almost everybody else keeps talking about an imminent global recession even though real GDP is supposed to increase by 2.7% y/y in 2023. Increase, not decrease! A recession is therefore not an actual decline of GDP but a significant deviation from trend. This had been 3.8% from the beginning of the century to 2019, with a slight downward tendency. A recession when growth slows from 3.8% to 2.7%? I would argue that a recession is when unemployment rises significantly (that's not what the IMF anticipates) and real GDP change is actually negative on a wholeyear basis. The latter is the case for only two major economies, Germany and Italy – where labor markets are not yet, and will not be in distress, though. A strange global recession indeed.

Finally, a remark about the effects of the global economic slowdown on the environment. It is my impression, based on recent statistics, that the emission of climate killer CO_2 stagnates or starts to fall once the world economy grows at rates of 3% or less. So 2.7% is good news in this respect, if not good enough to come near the 2015 Paris target path. Very high energy prices, meanwhile, are a strong supporting factor, perhaps also the insight that the capacity expansion of renewables must be accelerated a lot to end the world's addiction to fossil fuels.

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About Wermuth Asset Management

Wermuth Asset Management (WAM) is a Family Office which also acts as a BAFIN-regulated investment consultant.

The company specializes in climate impact investments across all asset classes, with a focus on EU "exponential organizations" as defined by Singularity University, i.e., companies which solve a major problem of humanity profitably and can grow exponentially. Through private equity, listed assets, infrastructure and real assets, the company invests through its own funds and third-party funds. WAM adheres to the UN Principles of Responsible Investing (UNPRI) and UN Compact and is a member of the Institutional Investor Group on Climate Change (IIGCC), the Global Impact Investing Network (GIIN) and the Divest-Invest Movement.

Jochen Wermuth founded WAM in 1999. He is a German climate impact investor who served on the steering committee of "Europeans for Divest Invest". As of June 2017, he is also a member of the investment strategy committee for the EUR 24 billion German Sovereign Wealth Fund (KENFO).