CES CYPRUS ECONOMIC SOCIETY

The Annual Economy Panel
Outlook and risks in a challenging world

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Global Economic and Financial Outlook—The Story Behind the Numbers

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Disclaimer: The presentation reflects my personal views and not necessarily the views of the Board or of the Bank of Cyprus

The Setting:
We live in a Rapidly Changing World

"Change is a constant in history. However, only once in several generations do we witness the gathering of forces such as globalization, technological advances and climate change exacerbated by the ageing of societies, high levels of debt and stagnant productivity growth to produce greater affluence coexisting with growing inequality and diminished opportunity. This has unleashed waves of disillusionment and resentments by many citizens in many countries against the established order—both domestically and internationally—and the "global elites" who have been in charge."

Hung Tran, *"Witness to Uncertainty: The Unravelling of the Postwar World Order,"* Amazon e-Book, January 2020

Outline

- **IMF October 2019 WEO Projections**
- **IMF January 2020 WEO Update Projections**
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- **IMF Staff (WEO) Policy Recommendations**
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  - **Analysis of Savings-Investment Balances-Potential Output Growth**
  - **Effectiveness of Monetary Policy and Financial Vulnerabilities and Risks**
  - **A New, More Active Role for Fiscal Policy**
- **Synthesis and Conclusions**

IMF WEO Oct 2019 Projections, in %
Synchronized Slowdown in 2019

	Real GDP Growth			Diff. from Prev. Year		Consumer Price Inflation		
	2018	2019	2020	2019	2020	2018	2019	2020
World Output	3,6	3,0	3,4	-0,6	0,4			
Adanced Economies	2,3	1,7	1,7	-0,6	0,0			
United States	2,9	2,4	2,1	-0,5	-0,3	2,4	1,8	2,3
Euro Area	1,9	1,2	1,4	-0,7	0,2	1,8	1,2	1,4
Germany	1,5	0,5	1,2	-1,0	0,7	1,9	1,5	1,7
France	1,7	1,2	1,3	-0,5	0,1	2,1	1,2	1,3
Italy	0,9	0,0	0,5	-0,9	0,5	1,2	0,7	1,0
Spain	2,6	2,2	1,8	-0,4	-0,4	1,7	0,7	1,0
Japan	0,8	0,9	0,5	0,1	-0,4	1,0	1,0	1,3
United Kingdom	1,4	1,2	1,4	-0,2	0,2	2,5	1,8	1,9
Emerging Market and Dev. Econonies	4,5	3,9	4,6	-0,6	0,7			
China	6,6	6,1	5,8	-0,5	-0,3	2,1	2,3	2,4
India	6,8	6,1	7,0	-0,7	0,9	3,4	3,4	4,1
Russia	2,3	1,1	1,9	-1,2	0,8	2,9	4,7	3,5
World growth/market exchange rates	3,1	2,5	2,7	-0,6	0,2			
World Trade (G&S)- Advanced Econ.								
Imports	3,0	1,2	2,7	-1,8	1,5			
Exports	3,1	0,9	2,5	-2,2	1,6			

IMF WEO January 2020 Update Projections, in %
Tentative Stabilization, Sluggish Recovery?

IMF WEO January 2020 Update: Real GDP Growth Projections, 2018-2021, in %

	Real GDP Growth					Diff. from October Projections		
	2018	2019	2020	2021		2019	2020	2021
World Output	3,6	2,9	3,3	3,4		-0,1	-0,1	-0,2
Adanced Economies	2,3	1,7	1,6	1,6		0,0	-0,1	0,0
United States	2,9	2,3	2,0	1,7		-0,1	-0,1	0,0
Euro Area	1,9	1,2	1,3	1,4		0,0	-0,1	0,0
Germany	1,5	0,5	1,1	1,4		0,0	-0,1	0,0
France	1,7	1,3	1,3	1,3		0,1	0,0	0,0
Italy	0,9	0,2	0,5	0,7		0,2	0,0	-0,1
Spain	2,6	2,0	1,6	1,6		-0,2	-0,2	-0,1
Japan	0,8	1,0	0,7	0,5		0,1	0,2	0,0
United Kingdom	1,4	1,3	1,4	1,5		0,1	0,0	0,0
Emerging Market and Dev. Econonies	4,5	3,7	4,4	4,6		-0,2	-0,2	-0,2
China	6,6	6,1	6,0	5,8		0,0	0,2	-0,1
India	6,8	4,8	5,8	6,5		-1,3	-1,2	-0,9
Russia	2,3	1,1	1,9	2,0		0,0	0,0	0,0
World growth/market exchange rates	3,1	2,4	2,7	2,8		-0,1	0,0	0,0
World Trade (G&S)- Advanced Econ.		1,3	2,2	3,1				

What Explains the Numbers? (1/4)

- **A synchronized slowdown in 2019. Advanced countries continue to slow toward their weaker long-term potential growth rate.**

- **This was due to a geographically broad-based, notable slowdown in industrial output, driven by three interrelated factors:**
  - **A sharp downturn in the global car industry, which started in 2018 and continued into 2019, due to disruptions on both the demand side (expiration of tax incentives in China) and supply side (new emission standards in the Euro Area (especially Germany) and China)**
    - **The car industry accounts for 5.5% of global output (gross output and intermediate consumption) and for 8% of global exports of goods.**
  - **Weak business confidence (more pronounced in the production of capital goods) due to an escalation of tensions between the US and China on trade and technology**
    - **US-China trade tensions estimated to reduce cumulatively global GDP by 0.8% by 2020 (reduced to 0.5% in the Jan WEO Update, after the signing of the US-China Phase One agreement on January 15, 2020)**
  - **A slowdown of demand in China due to a tightening of regulatory framework to rein on debt concerns and the macro impact of trade tensions**

- **Other factors contributing to the synchronized slowdown reflect :**
  - **The stressed conditions in several emerging market economies (Iran, Argentina, Turkey, Venezuela)**
  - **Geopolitical concerns (including a potential no-deal Brexit)**
  - **Continued structural forces in advanced economies, such as low productivity growth and ageing demographics**

- **As a result, the growth of global trade was projected to decline sharply in 2019**

What Explains the Numbers? (2/4)

- However, in contrast to the weak manufacturing and global trade, the service sector (which accounts for a much larger share of the global economy) continues to hold up across the globe, supporting employment and wage growth, as well as consumption growth in advanced economies
  - But there are some initial signs of a softening in the services sector in the US and the Euro Area
- At the same time, the announced monetary policy easing by major central banks has played a significant supporting role to growth by "appropriately" easing downside risks and preventing a de-anchoring of inflation expectations
  - The monetary stimulus is estimated to have raised GDP growth by 0.5% in both 2019 and 2020
- Investment growth remained weak
- There was a very large decline in FDI flows, but this was fundamentally a restructuring of the internal financial activities of multinational corporations induced by the US tax reforms (a repatriation of cash reinvested in US securities) with no impact on output

What Explains the Numbers? (3/4)

- On the inflation front, pressures have been muted
  - The broad synchronized global expansion from mid-2016 to mid-2018 helped narrow output gaps, particularly in advanced economies, but did not generate sustained core CPI inflation
  - Not surprisingly, as the global expansion has weakened, core inflation has fallen further below targets across advanced economies and below historical averages in EM and developing economies
  - Despite higher import tariffs in some countries, cost pressures have generally remained subdued

- Wage growth has edged up from modest levels as unemployment rates dropped further
  - After long declines, the share of labor income has been on a gentle upward trend since around 2014 in Japan, the U.K. and the US, and has increased in the Euro Area since 2018. But it's impact on prices has been mainly offset by a compression of profit margins.
  - A new IMF study has indicated that technology developments have been the main contributing factor to uneven growth rates and income inequality within several countries.
  - These rising inequalities have been one of the motivating factors of populist pressures.

- CPI inflation was projected to fall to 1.5% in 2019 in advanced economies, down from 2% in 2018

  - In the US, inflation is close to target. With the economy operating above potential, core CPI inflation is projected to average 2.6% in 2020-2021, above its medium-term value of 2.2% (the level consistent with the Fed's medium-term target of 2% for the PCE deflator).

  - In the Euro Area, headline inflation is expected to rise gradually from 1.2% in 2019 to 1.4% in 2020, remaining below the ECB target.

What Explains the Numbers? (4/4)

- Since the October WEO, some of the downside risks have receded with the announcement of the US-China Phase One trade deal and the lower likelihood of a no-deal Brexit.

- The January 2020 WEO Update takes a more positive tone amid high frequency indicators of a bottoming out of manufacturing output and trade growth.

- There are now tentative signs that global growth may be stabilizing, though at subdue levels.

- There are nonetheless marginal reductions in the projected 2020 growth for the global economy, advanced countries, the Euro Area and India, with higher growth in China. Net downside growth risks remain, though less so than in the October WEO.

- Business and investor confidence has improved, and has contributed to a renewed equity market boom and declines in credit spreads in the Euro Area following the resumption of ECB asset purchases in November.

IMF Staff (Oct WEO) Policy Recommendations

- The global economy remains at a delicate juncture. It is confronting a diverse set of headwinds.
- The foremost policy priority, in many countries, is to remove policy-induced uncertainty
- Policy missteps, such as a no-deal Brexit or a further deepening of trade disputes, could severely undermine sentiment and growth prospects, and may exhaust policy space for avoidable reasons.
- Multilateral cooperation is indispensable (on trade, technology, taxation, financial regulation and on climate change and migration)
- Fiscal policy can play a more active role, especially where room to ease monetary policy is limited.
- Monetary policy cannot be the only game in town
- In the US, where inflation is close to target, a combination of accommodative monetary policy, vigilant financial regulation and supervision, and a gradual fiscal consolidation path would help maintain the expansion and limit downside risks.
- In the Euro Area, in the face of stubbornly weak core inflation, fiscal policy needs to vary across countries depending on the extend of fiscal space. But there is significant fiscal space in Germany and the Netherlands. A synchronized fiscal response, albeit differentiated appropriately across member countries, can amplify the area-wide impact.
- In China, the overarching policy objective is to raise the sustainability and quality of growth, while navigating headwinds from trade tensions and weaker global demand.
- Across all economies, the priority is to take measures to boost potential output growth.

The True Nature of the US – China Trade Dispute (1/2)

- The Oct. 11 pause in the trade dispute and the a Phase One deal are a step in the right direction to calm tensions. Some of the fundaments US concerns remain unaddressed.

- But the trade dispute is not just about the bilateral trade balance, as Trump initially forcefully complained. Emphasis on this metric is analytically flawed.
- Instead, the US is appropriately concerned about other key issues and economic and trade violations by China:
  - China's preferential foreign investment regime
  - Forced technology transfers
  - Violations of protection of intellectual property rights
  - Chinese subsidies to SOEs and to exports, distorting competition
  - Cyber security issues and role of Chinese technology firms
- These issues are critical for the global trade regime and should be of concerned to all major countries, not just the US.

- A recent book by Michael Pillsbury, a leading US government China expert, provides an overview of how the Trump Administration and most analysts now consider China's strategy: "The Hundred-Year Marathon, China's Secret Strategy to Replace America as the Global Superpower." This is an excellent and well-documented book that reveals how Americans have been seduced into helping China achieve its 100-year strategy by 2049, the anniversary of Mao's revolution.

- China's new strategy:
  - Leveraging on its increased economic cloud, China has become very assertive in its international economic and other dealings
  - Expanded trade and investment relations with all countries, particularly in the energy and raw material areas (Belt and Roads Initiative)
  - But China is playing by its own rules, not established multilateral processes
  - Internally, enhanced ideological control and centralized economic and policy control by the regime, allowing no democratization or dissent
  - Would the strategy succeed? It depends on whether China's unique economic model would avoid the increasing distortions of central controls

- A new Cold War has begun between the US and China

The True Nature of the US – China Trade Dispute (2/2)

- But the US has also trade disputes with other countries:
  - the Canada and Mexico trade deals only last month approved by Congress;
  - Threats of US tariffs on the Euro Area over Airbus subsidies and tariffs on wine and car exports.
- But the recommended resort to multilateralism may not be so easy or feasible.
- The WTO framework is not considered effective and its reform is long overdue:
  - It focuses on consensus for new multilateral trade liberalization, and has induced instead a proliferation of Regional Trade Agreements (covering 1/3-1/2 of world trade);
  - 2/3 of WTO members are self-described as developing economies, enjoying deferential treatment;
  - Ineffective monitoring of enforcement of trade rules; and
  - A controversial dispute settlement framework (the US is objecting to appointing new judges of the Appellate Court, 2 out of 3 remaining judges (initially 7) retired last December, and only one left (a Chinese).

Analysis of Savings - Investment Balances, in % of GDP

National Accounts Identidy: (S-I)Public + (S-I)Private= Current Account Balance			
	2018	2019	2020
United States			
(S-I)Public=GG budget Balance	-5,7	-5,6	-5,5
(S-I)Private	3,3	3,1	3,0
CA Balance	-2,4	-2,5	-2,5
Euro Area			
(S-I)Public=GG budget Balance	-0,5	0,9	0,9
(S-I)Private	3,4	1,9	1,8
CA Balance	2,9	2,8	2,7
Germany			
(S-I)Public=GG budget Balance	1,9	1,1	1,0
(S-I)Private	5,4	5,9	5,6
CA Balance	7,3	7,0	6,6
China			
(S-I)Public=GG budget Balance	-4,8	-6,1	-6,3
(S-I)Private	5,2	7,1	7,2
CA Balance	0,4	1,0	0,9
Cyprus			
(S-I)Public=GG budget Balance	3,0	3,8	2,7
(S-I)Private	-7,4	-9,1	-7,7
CA Balance	-4,4	-5,3	-5,0
GG=General Government			

Analysis of Savings-Investment Balances—Potential Output Growth (1/2)

- **National accounts identity: (S-I)public + (S-I)private = External Current Account Balance**
- **The analysis of the sectoral savings and investment balances is very revealing as to which sectors are contributing to demand and growth**
- **In the US, the general government is running a large deficit, but the private sector has a surplus of savings and is accumulating assets. We have a glad of private savings, mainly corporate, which are not adequately channeled into productive investment, resulting in lowered potential output growth.**
- **In the Euro Area, and particularly in Germany and the Netherlands, both the general government and the private sector are net savers, with weak investment, accumulating assets from the rest of the world. The deficient domestic demand is offset by export demand for G & S to generate the observed weak total output growth. Ireland also has a very large current account surplus, but this is mainly the reflection of a channeling of profits of multinational firms through Ireland to benefit from the low tax regime.**
- **In China, the public sector is running huge deficits (especially if defined at the "social financing" level, with a deficit of 12.7% of GDP in 2019), while the private sector is a net saver. China has the largest savings and investment ratios in the world.**
  - **China is a state-controlled economy and the government sets targets for growth and uses the public budget at the central and local levels and the SOE operations to achieve them.**
- **In Cyprus, the government is a net saver but the private sector is dissaving on a large scale, spending too much on consumption (declining savings, despite the very high indebtedness) and little on investment.**
  - **Growth is slowing down toward potential output growth (of 2.3% over the medium term)**

Analysis of Savings-Investment Balances—Potential Output Growth (2/2)

- The key question is why is private investment in advanced economies so low and rising so slowly, despite the abundance of corporate own savings, improved tax regimes, easy bank lending conditions, low interest rates and low cost of capital in general?

- The is indeed a puzzle, it may reflect a combination of factors:
  - Very low expectations of future demand, as potential GDP growth over the medium-term is very low and declining (this is the well-known acceleration principle)
  - Policy uncertainty, particularly about the global trading system and the viability of the current network of global sub-suppliers
  - Lack of new investment ideas and new technological breakthroughs

- The sad reality is that growth in advanced economies is fueled mainly by consumption growth and the weak investment growth is contributing to even lower potential output growth rates in the future.

- The WEO assumes that actual real GDP growth for advanced countries would over the medium-term converge toward the declining potential output growth.
  - IMF estimates that potential output growth would
    - Slow from 2.0% in 2018 to 1.7% by 2024 in the US
    - Remain flat at 1.4% in the Euro Area
    - Decline from 6,6% in 2018 to 5.5% by 2024 in China

- This is very worrisome, and sooner or later something has to give in, as financial market distortions from excess savings and liquidity are mounting.

- This is where a new, more active role for fiscal policy assumes critical importance (to strengthen investment incentives and improve weak infrastructure), in addition to the recommended lowering of policy uncertainty.

Effectiveness of Monetary Policy and Financial Vulnerabilities and Risks (1/3)

- According to the IMF's Growth and Financial Stability Report (GFSR) of Oct 2019, about 70% of world economies (GDP weighted) have adopted a more accommodative monetary stance. This includes major central banks in the US, Euro Area, Japan and China
- The further easing of monetary policy by the ECB (more negative deposit rates and a resumption of QE) is controversial, criticized by current and former central bank officials.
- Main transmission channels of monetary policy are through:
  - lower borrowing costs for the private sector and governments
  - lower debt service costs for the rollover of the existing high debt, and
  - expectation by financial markets that interest rates (both ST and the yield curve over longer maturities) would stay low for longer
- Further easing is helping contain downside growth risks (equity and other financial markets have become addicted to low and declining interest rates) through improved sentiment that debt burdens are sustainable
- But central bank policies come at a major cost to:
  - Bank profitability
  - Distorted relative prices of financial assets
  - Stressed equity prices in the US and Japan (high P/E ratios relative to historical averages)
  - Negative government bond yields in many countries (for $15 trillion of assets)
  - Excessive debt levels by governments and the private sector in many advanced and EM countries and frontier economies
  - Elevated financial vulnerabilities, particularly for corporations (leveraged funding, including by zombie companies) and non-bank financial sectors (asset managers, pension funds and other institutional investors, and insurance companies)
  - Higher risk taking, including by the non-bank financial sector in more risky and less liquid assets (such as real estate and private equity)
- Policy recommendation by GFSR:
  - more macro prudential tools and enhanced disclosure requirements for non-bank financial sector and
  - more stress tests for banks

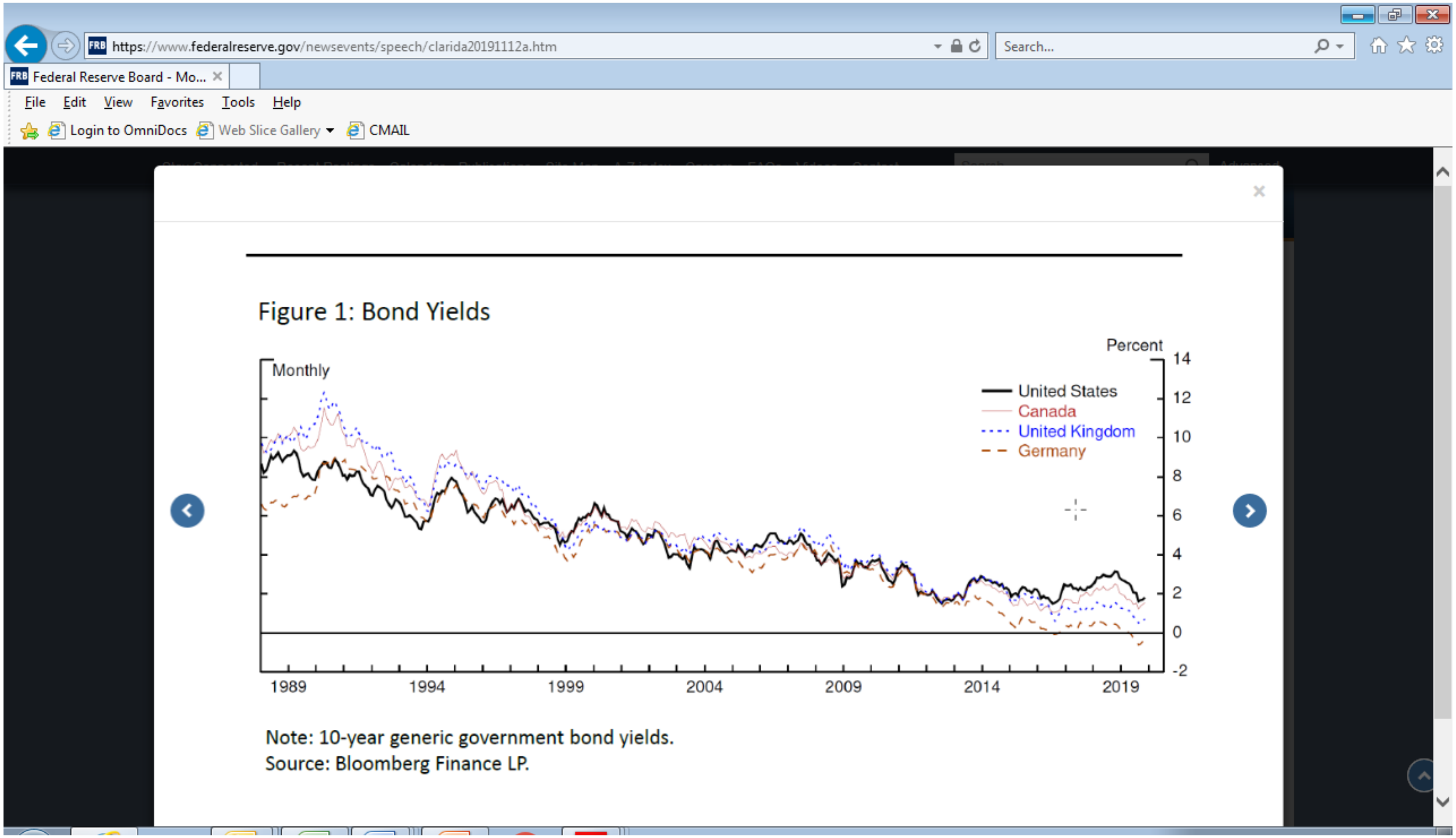
Effectiveness of Monetary Policy and Financial Vulnerabilities and Risks (2/3)

- In a speech on Nov 12, 2019, the Fed Vice Chair Richard Clarida pointed out that the success of inflation targeting and QE policies and the decline in the equilibrium real interest rate have brought about a fundamental change in the global financial landscape.
- Major nominal government bond yields have declined and become negative. Three contributing components:
- 1. Expected inflation has declined
  - Consequence of inflation targeting and reduced persistence of positive deviations of actual inflation from target
  - Inflation expectations anchored at a stable, low level
  - Variance of exogenous shocks to supply and demand may have declined
- 2. Expected real interest rate (r*) has declined
  - Due to "real" factors, beyond the control of central banks, such as reduced productivity growth worldwide
  - Changes in risk tolerance and regulations boosted savings and the demand for safe assets at a time when their supply declined due to QE policies
- 3. Term premium has declined and even become negative
  - Defined as a compensation for exposure to long-duration assets with interest rate and inflation volatility risk
  - Inflation volatility and its risk for investors has declined due to inflation targeting
  - Substantial central bank purchases under QE of long-duration bonds and other assets (in the US, Japan, Euro Area and the UK) which have reduced the risk of exposure to long-duration assets
  - Government bonds (as safer assets) have become a hedge against equity and other risks
    - The Bond-Stock Return Covariance is estimated to have changed from positive 0.2 in the 1970s and 1980s to negative 0.2 since the late 1990s. This covariance change may have reflected the change in the US monetary policy since 1979, initiated by then Fed Chairman Paul Volcker

Effectiveness of Monetary Policy and Financial Vulnerabilities and Risks (3/3)

- **The increasing financial market distortions and mounting financial vulnerabilities pose a major dilemma for policy makers:**
  - **Monetary policy effectiveness is diminishing, and further easing would exacerbate financial vulnerabilities and risks**
  - **At the same time, a sharp monetary policy tightening would unmask the accumulated financial vulnerabilities and cause a financial crisis**
  - **In addition, the policy room to respond to a new crisis or recession is minimal or nonexistent (normally a 4 percentage point reduction in policy interest rate is needed)**
  - **Central banks have effective tools to prevent persistent excess inflation above target**
  - **But persistent inflation shortfalls, such as those associated with the Effective Lower Bound (ELB) for policy interest rates, carry the risk of long-term inflation expectations becoming anchored below the stated central bank inflation targets.**
    - **This has already happened in the Euro Area. The ECB under President Lagarde has initiated a monetary policy review.**
    - **The Fed is considering options to address the Effective Lower Bound risks, including through a "makeup strategy" (compensating past inflation shortfalls with above-target future inflation)**

Fed Vice Chair Richard Clarida



Fed Vice Chair Richard Clarida

https://www.federalreserve.gov/newsevents/speech/clarida20191112a.htm

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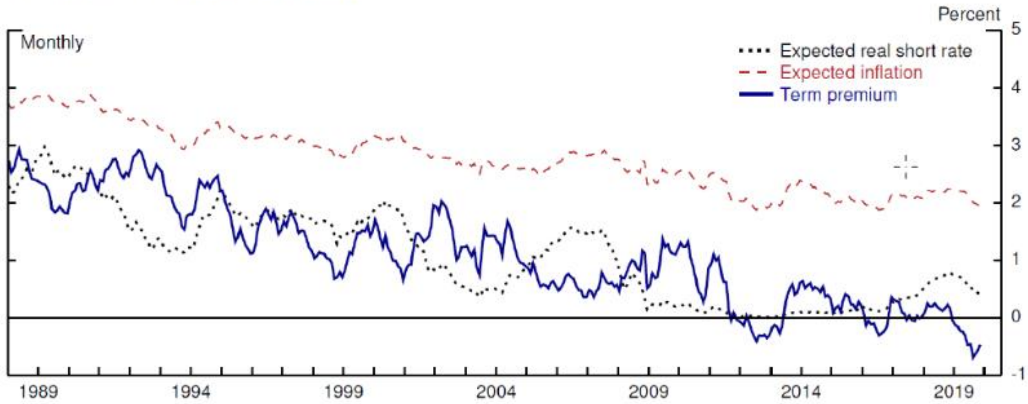
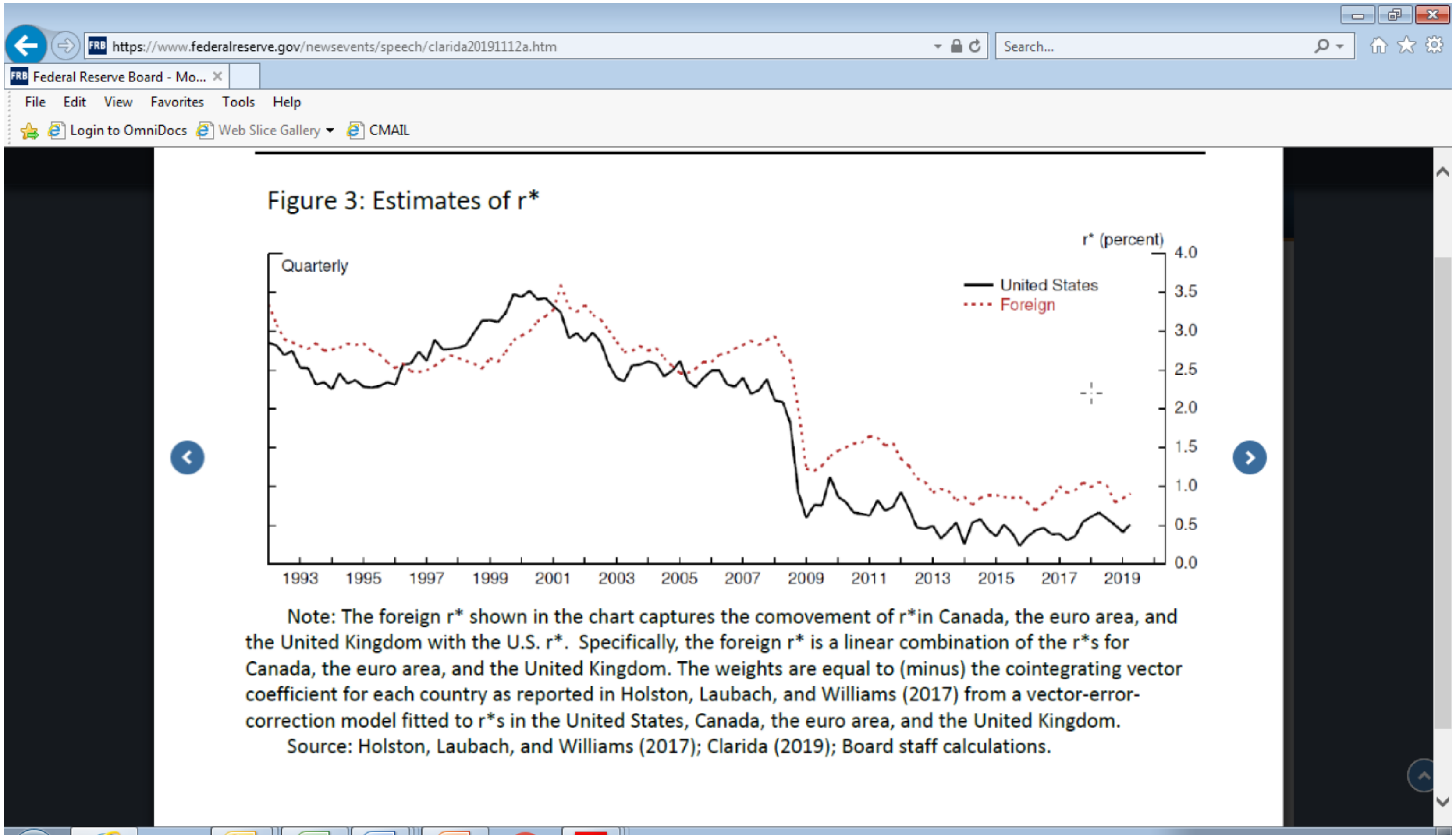
Figure 2: Yield Decomposition



Note: Decomposition of the 10-year zero-coupon U.S. Treasury yield based on the model presented in Kim, Walsh, and Wei (2019).

Source: Federal Reserve Bank of New York; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters; Wolters Kluwer Legal and Regulatory Solutions U.S., Blue Chip Financial Forecasts; Board staff calculations.

Fed Vice Chair Richard Clarida



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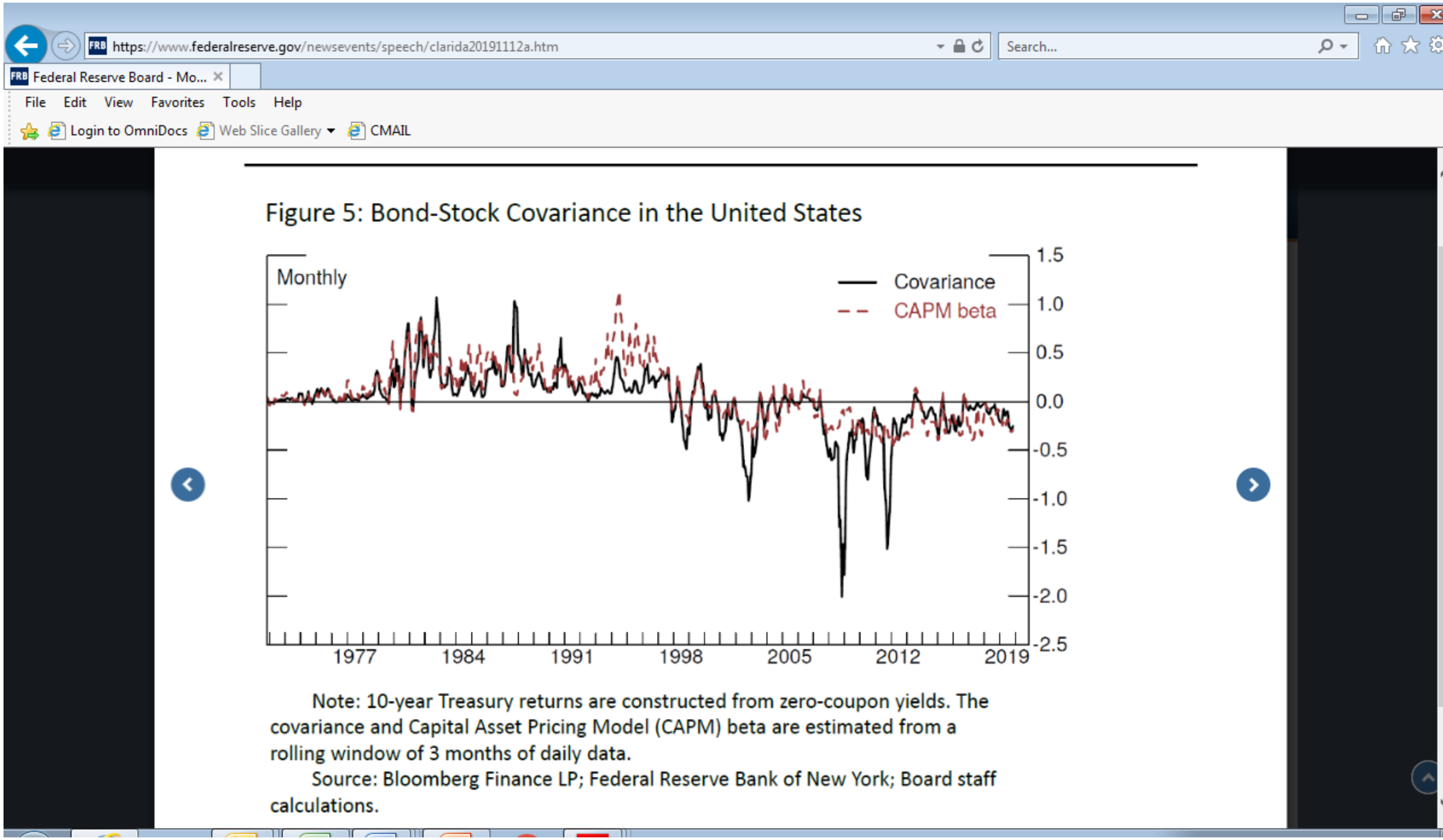
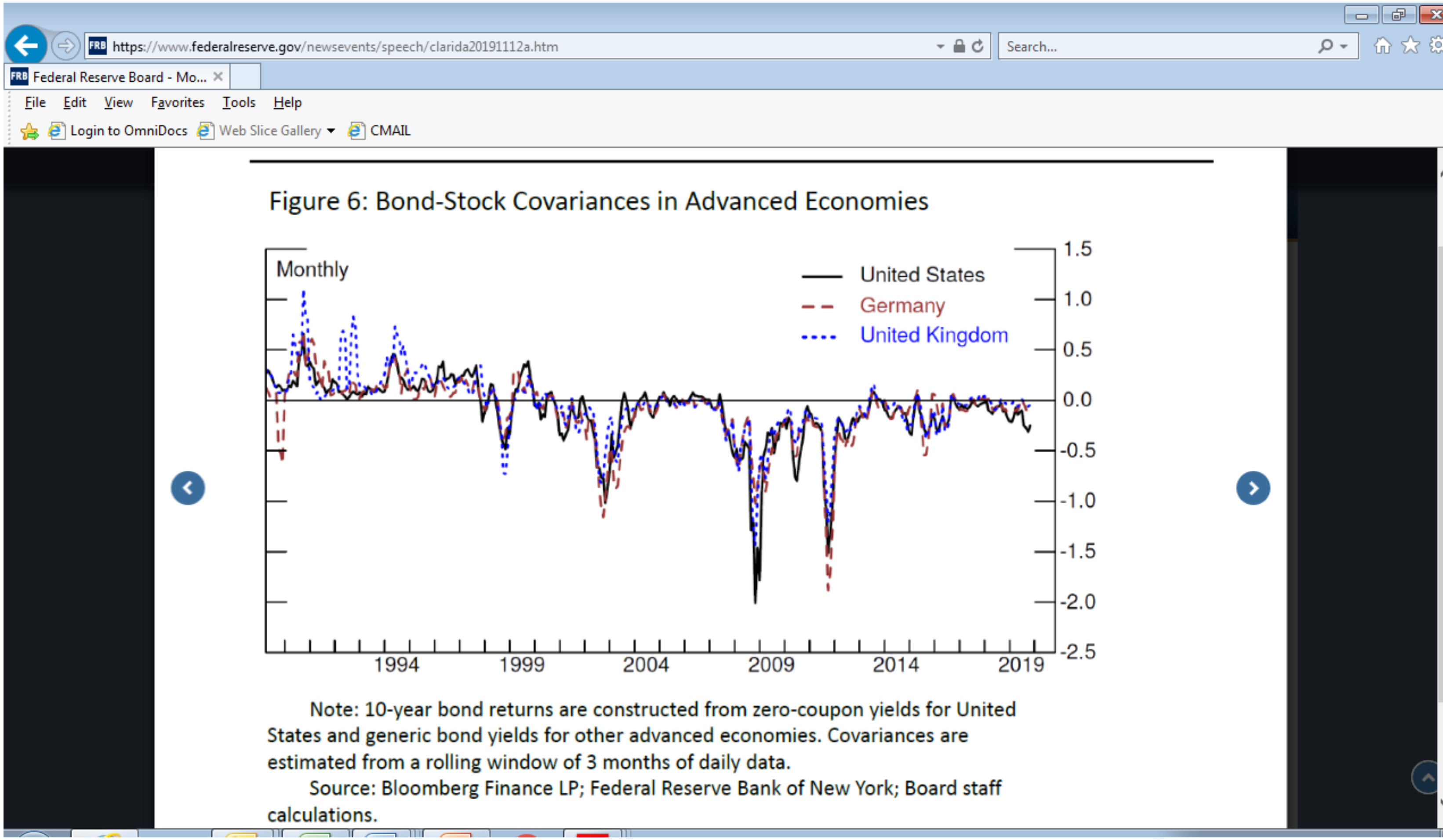
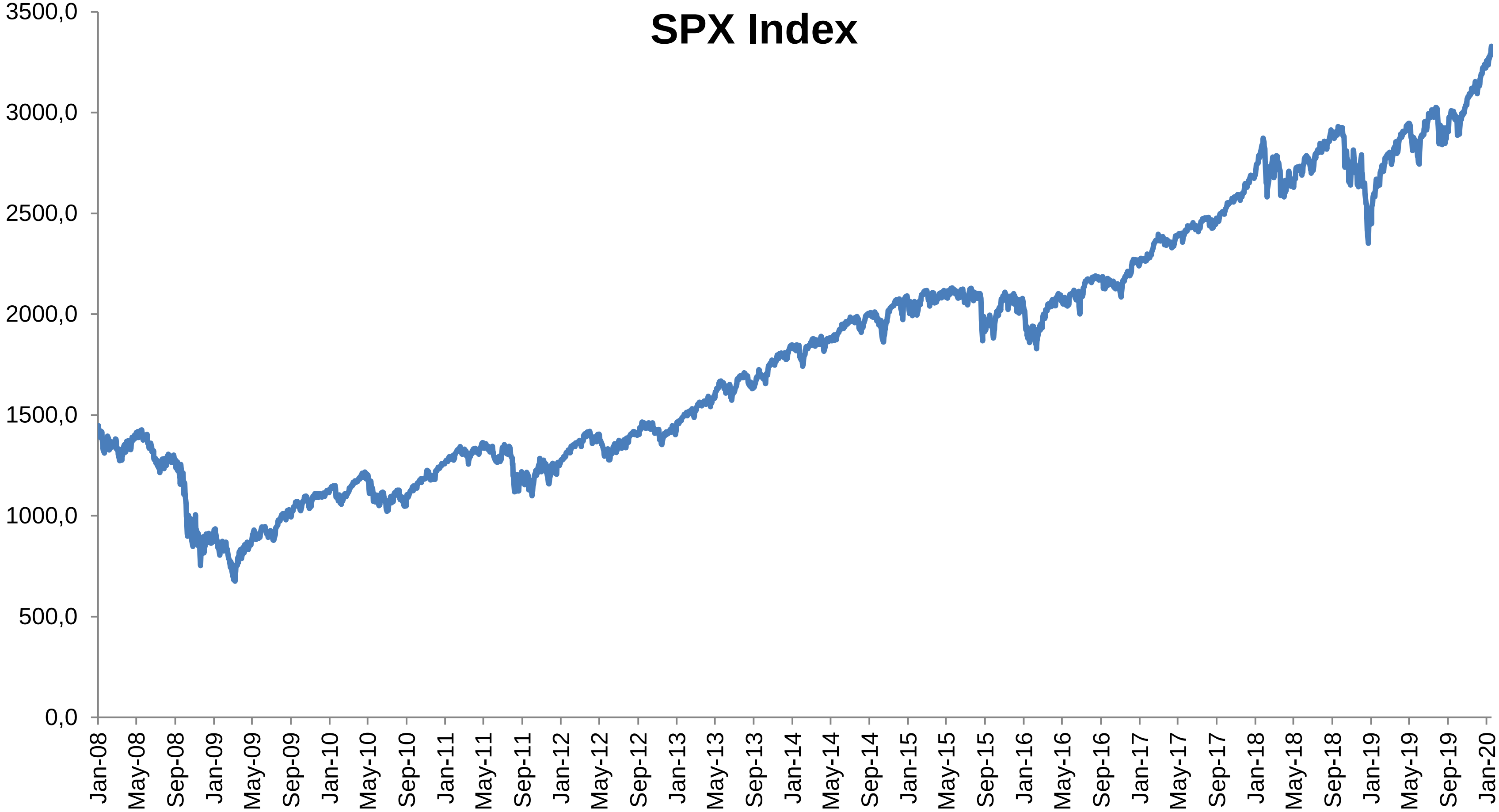


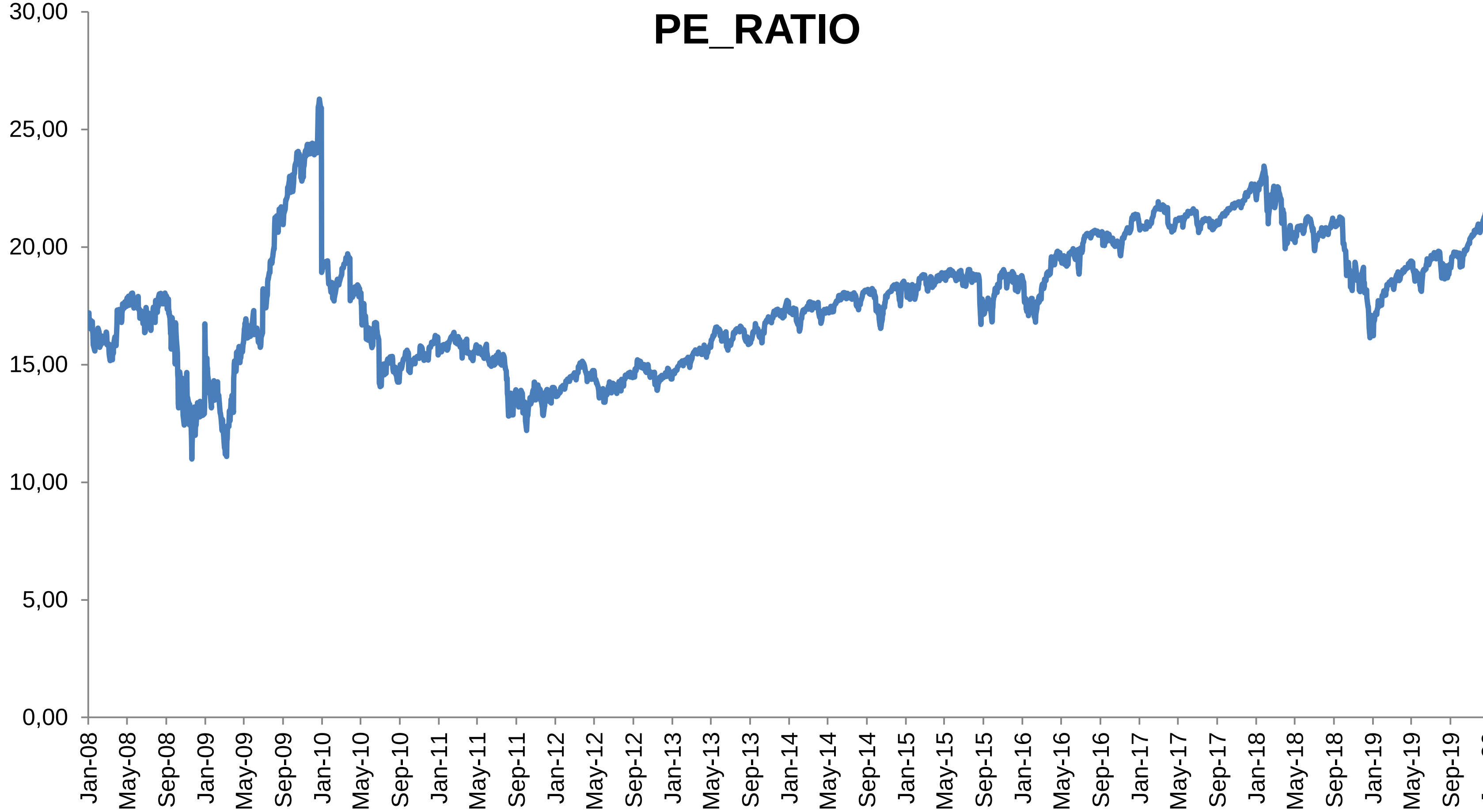
Fed Vice Chair Richard Clarida



S&P Index - A Ten Year Bull Market



S&P P/E Ratio – It Remains Below Past Peaks



Latest Major Government Bond Yields

Region	2 Year	5 Year	10 Year	30 Year
United States	1,56	1,62	1,82	2,28
United Kingdom	0,42	0,43	0,65	1,19
Germany	-0,60	-0,52	-0,22	0,29
France	-0,57	-0,34	0,03	0,86
Italy	-0,03	0,68	1,35	2,41
Spain	-0,37	-0,09	0,44	1,35
Portugal	-0,38	0,02	0,48	1,30
Ireland		-0,28	0,04	0,88
Greece		0,45	1,39	
Japan	-0,14	-0,11	-0,01	0,46
Russia (USD)	1,99	2,19	2,92	3,70
Cyprus	-0,13	0,07	0,53	1,52

Latest Cyprus Government Bond Yields

ISIN	Last Price	Yld	Yld %	5d Chg bps	Coupon	Maturity
XS1227247191	109,18	↓	-0,13%	-1	3,88%	5/6/2022
XS1457553367	113,44	↓	-0,08%	-1	3,75%	7/26/2023
XS1637276848	112,14	↓	0,01%	-1	2,75%	6/27/2024
XS1314321941	122,98	↓	0,24%	-2	4,25%	11/4/2025
XS1883942648	115,39	↓	0,55%	-3	2,38%	9/25/2028
XS2105095777	99,15		0,71%		0,63%	1/21/2030
XS1956050923	123,04	↓	0,99%	-4	2,75%	2/26/2034
XS2105097393	99,48		1,28%		1,25%	1/21/2040
XS1989383788	128,48	↓	1,54%	-4	2,75%	5/3/2049

A New, More Active Role for Fiscal Policy

- **Calls for a more active role for fiscal policy have been escalated in recent months by central banks (especially the ECB), the IMF and policy analysts and think tanks**

- **For three reasons:**
  - **The reaching of the limits of what monetary policy can do, especially in the Euro Area**
  - **Interest rates expected to remain low for (much) longer, reducing the risk of public debt rollovers or new borrowing causing significantly higher borrowing costs**
  - **Substantially improved interest rate-growth debt dynamics (r<g)**

- **Larry Summers and Olivier Blanchard argue that Secular Stagnation is a significant thread to advanced countries and that fiscal policy should be reintroduced as a major stabilization tool**
  - **Blanchard: "With the interest rates lower than nominal growth rates, the cost of high public debt is not as onerous as earlier thought, and there may be no fiscal costs"**
- **There is significant scope and need for fiscal expansion through growth-enhancing spending, including through Public-Private Partnerships (PPP) for infrastructure and other spending in several countries.**
- **Such scope is more feasible and more necessary in surplus countries such as Germany, which was actually close to recession in Q2 and Q3 in 2019**
  - **This would be good both for Germany and the Euro Area as a whole**
  - **Germany has been the main beneficiary from membership in the Euro Area**
    - **It has benefitted from a stable exchange rate and avoided appreciation despite its sizable external current account surpluses**
    - **The negative yields on its bonds (due in part to QE and the shift to safe assets, boosted in part by the concerns raised by the Euro Area sovereign debt crisis) has resulted in cumulative benefits in the form of reduced budget debt service costs of the order of 11% of GDP in recent years.**

Impact on Cyprus

- **The global economic and financial outlook and the ECB monetary policy would affect the Cypriot economy as follows:**

- **Positively:**
  - **Government cost of borrowing, yields at record low levels**
  - **Domestic borrowers from low bank lending rates**

- **Negatively:**
  - **Bank depositors, low or negative deposit rates**
  - **Banks, given their excess liquid assets, negative ECB deposit rates, low bond yields and low interest rate margins**
  - **Pensioners, pension funds and investors from the distorted asset prices and the extremely low yields on bond holdings**
  - **Export demand, tourist arrivals and revenue from tourism**

Synthesis and Conclusions

- Last October, there were major concerns about an imminent recession in major advanced countries and possibly also a major equity market correction.
- These concerns have eased since then, with no recession projected but recovery in 2020 tentative
- US economy is currently fairly resilient, but Euro Area much weaker, with stubbornly low inflation
- But, as concluded at the January 2020 AEA annual meeting, the developed world is stuck with low growth, low inflation and low interest rates for years to come.
- Even worse, with Investment, growth in advanced countries is projected to slow further over the medium term toward lower potential output growth.
- Economists are divided as to whether the slow growth is due to flagging supply (low productivity growth) or weak demand (secular stagnation, with excess savings)? Probably both. They all agree on the policy response: more fiscal stimulus on productive investment.
- Low interest rates for longer, but
  - Easy monetary policy is reaching the limits of its effectiveness, and is
  - Exacerbating financial vulnerabilities
  - Distorting asset prices, giving rise to stressed/overvalued equity prices
    - But US equity prices sustained by the ongoing growth (and expected company earnings) due in large part to buoyant consumer demand and the recently declining policy uncertainty over trade issues
  - A financial crisis is likely over the medium term if these trends remain unchanged
- To ease the monetary policy burden and facilitate a boost to output growth, there is an increasing consensus and Increased calls for a more active role for fiscal policy through growth-enhancing spending, particularly for countries with fiscal space such as Germany.

Global Economic and Financial Outlook—The Story Behind the Numbers

Presentation at the CES Annual Economy Panel, January 28, 20209

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Disclaimer: The presentation reflects my personal views and not necessarily the views of the Board or of the Bank of Cyprus