



# International Monetary Fund

## Navigating the low global growth environment and prospects for monetary integration in the EAC

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# Presentation Outline

- 1) Global outlook and ongoing developments
- 2) Can flexible exchange rates play a buffering role in the face of global shocks?
- 3) Monetary integration: EMU lessons

# **Global outlook and ongoing developments**



# A subdued, complex recovery, with new tensions

## Complex set of economic forces continues to shape a subdued outlook

- Ongoing realignments: China rebalancing, commodity exporter adjustment, asynchronous monetary policy
- Persistent drivers: Weak productivity growth, demographics, low demand, low natural real interest rates
- Absent vigorous policy, there is a risk of falling further into a low-growth, deflationary trap

## But an overlay of political shocks becomes increasingly worrisome

- Brexit creates uncertainty about the eventual economic arrangements with Europe, way forward for EU
- Euro area institutions remain under stress; stalled reform efforts; weakened governments in some EU countries
- Refugee crisis remains unresolved, displaced persons impose costs, especially in Middle East and Africa
- Increasing tide of anti-trade, anti-immigration sentiment in the United States and Europe

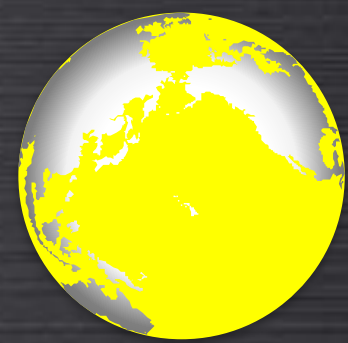
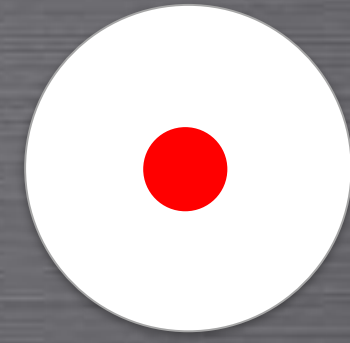
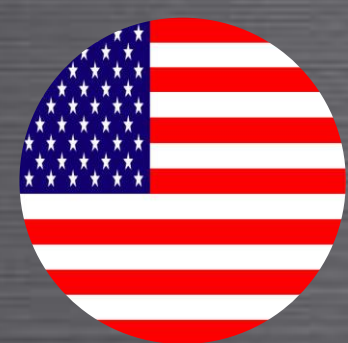
## Raising growth and enhancing stability look increasingly critical

- Overarching policy challenge: reinvigorate growth, ensure it is distributed more evenly, and make it durable
- Continue structural and tax reform, balance sheet repair, and improvements in the financial stability framework
- Time for a comprehensive, consistent, coordinated, as well as well-communicated macro policy approach



# Growth projections: Advanced economies

(percent change from a year earlier)



World

Advanced Economies

U.S.

U.K.

Japan

Euro Area

Germany

Canada

Other  
Advanced  
Asia

2015

3.2

2.1

2.6

2.2

0.5

2.0

1.5

1.1

2.1

2016

3.1

1.6

1.6

1.8

0.5

1.7

1.7

1.2

2.2

Revision  
from Jul.  
2016

0.0

-0.2

-0.6

0.1

0.2

0.1

0.1

-0.2

0.0

2017

3.4

1.8

2.2

1.1

0.6

1.5

1.4

1.9

2.5

Revision  
from Jul.  
2016

0.0

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-0.3

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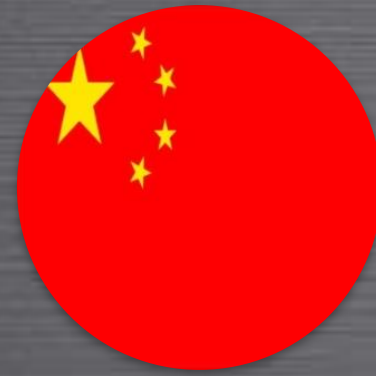
-0.1

Sources: IMF, *World Economic Outlook* October 2016; and IMF, *World Economic Outlook* July 2016 Update.



# Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)



World

Emerging  
Market and  
Developing  
Economies

China

India

Brazil

Russia

Commodity  
Exporting  
Economies

Sub-Saharan  
Africa

**2015**

3.2

4.0

6.9

7.6

-3.8

-3.7

0.8

3.4

**2016**

3.1

4.2

6.6

7.6

-3.3

-0.8

0.9

1.4

Revision from  
Jul. 2016

0.0

0.1

0.0

0.2

0.0

0.4

0.0

-0.2

**2017**

3.4

4.6

6.2

7.6

0.5

1.1

2.5

2.9

Revision from  
Jul. 2016

0.0

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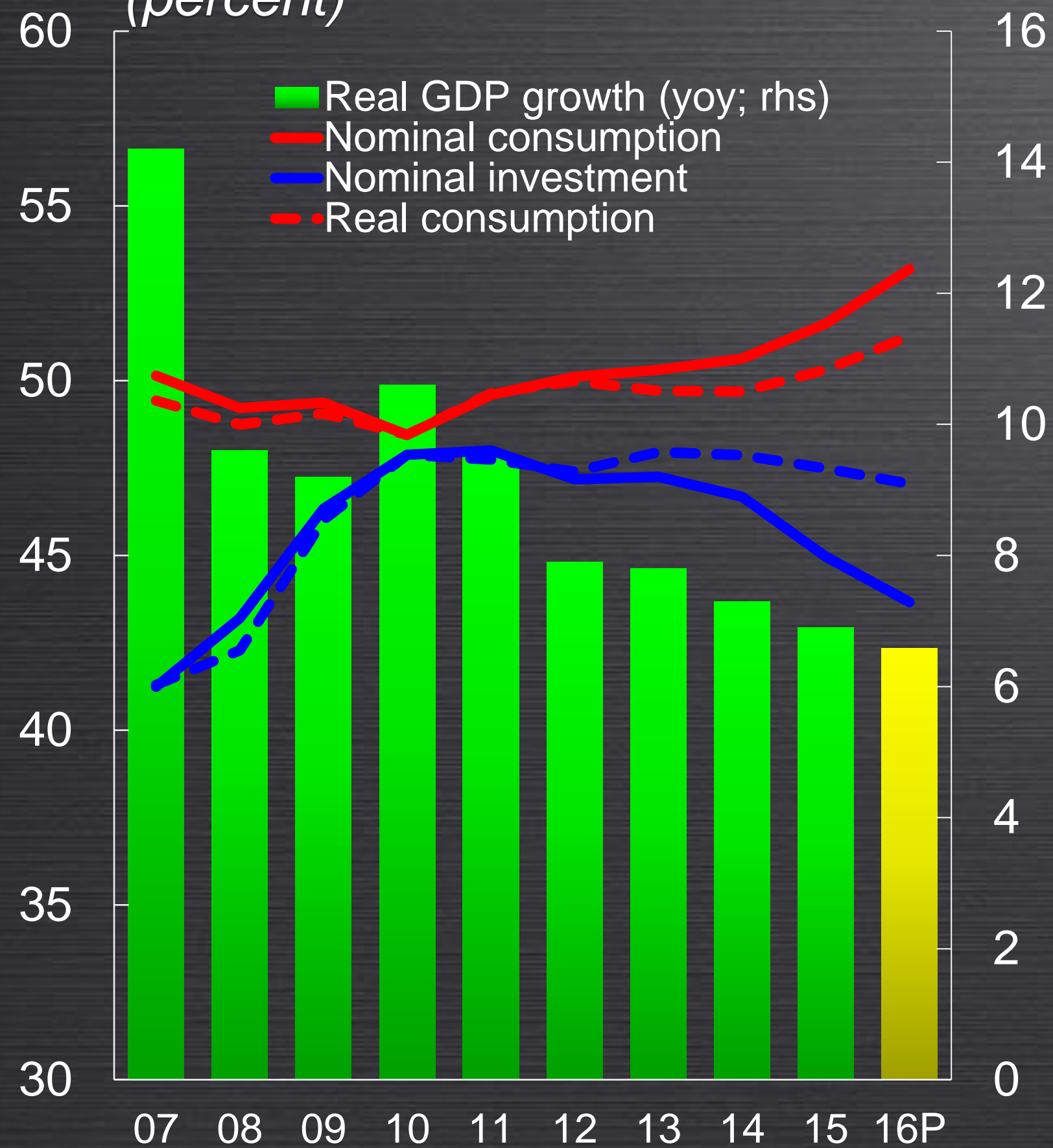
Sources: IMF, *World Economic Outlook* October 2016; and IMF, *World Economic Outlook* July 2016 Update.



# China: Slowing down and rebalancing

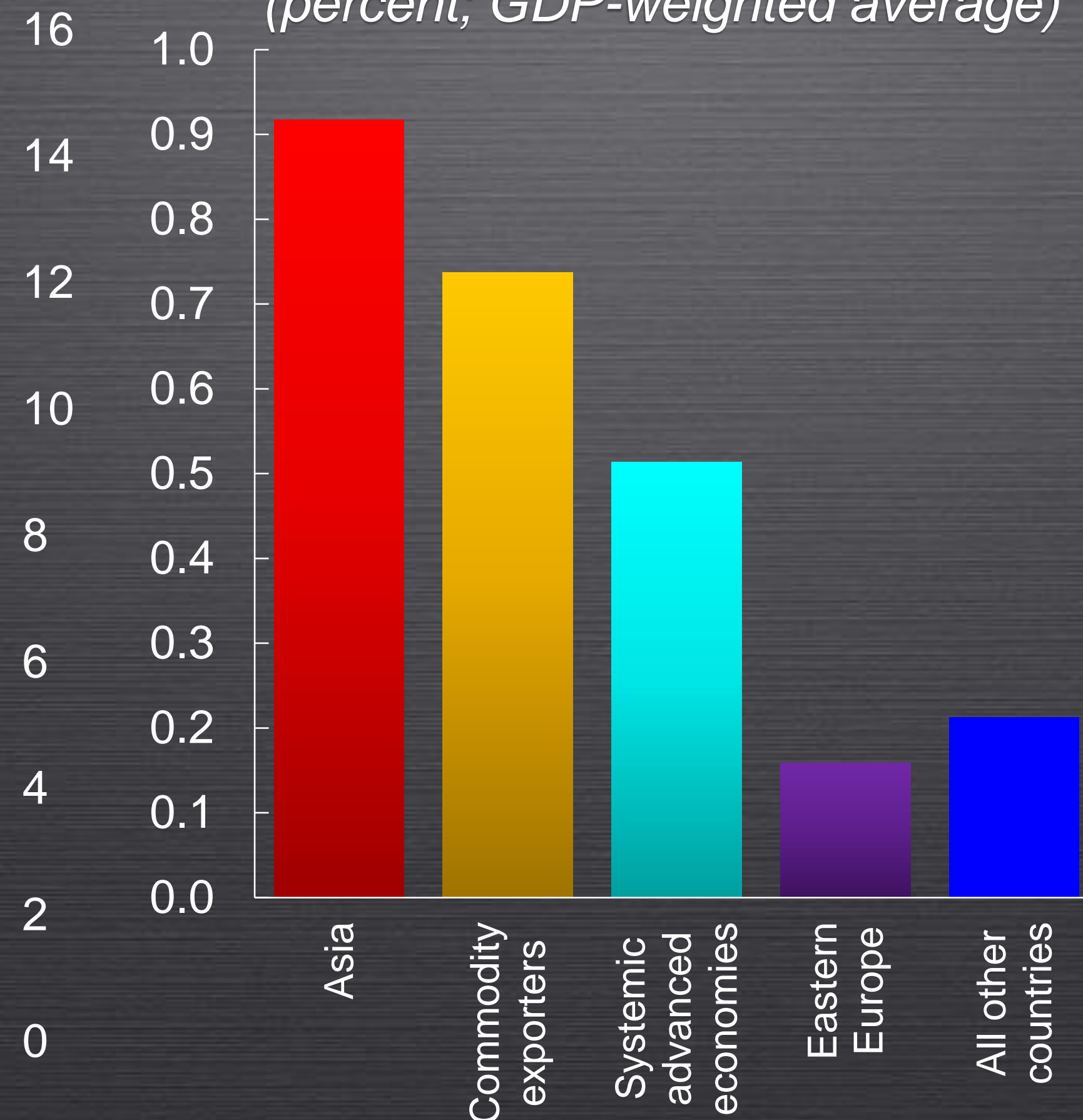
## Real GDP growth; consumption and investment shares

(percent)



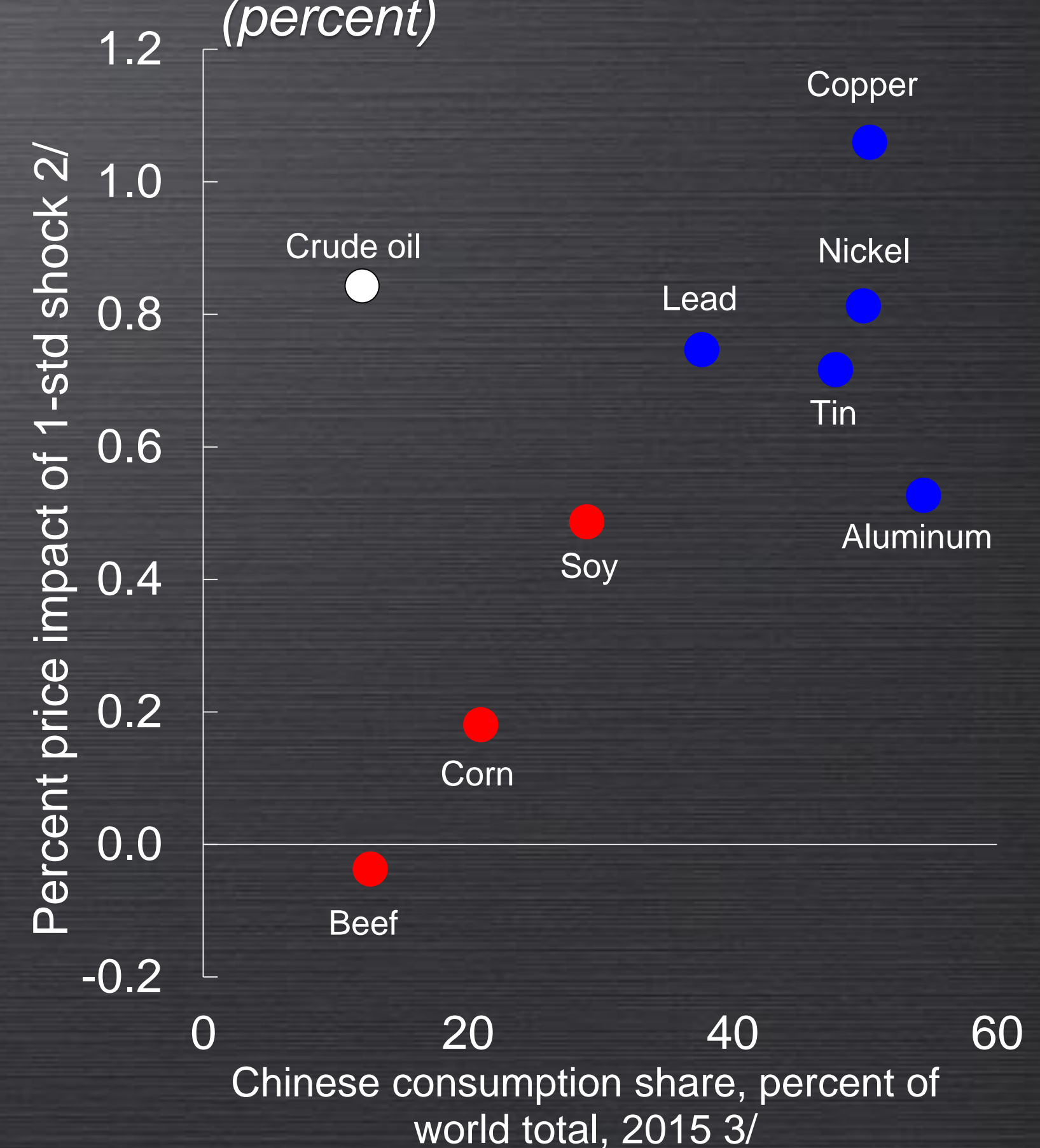
## Impact on exports of a 1 percent rise in China's demand after one year 1/

(percent; GDP-weighted average)



## Futures-price response to China industrial-production news surprise

(percent)



Sources: Blagrove and Vesperoni (2016); IMF, *World Economic Outlook*; Kolerus, N'Diaye and Saborowski (2016); U.S. Department of Agriculture; World Bureau of Metal Statistics; and IMF staff calculations.

1/ Asia include HKG, IDN, KOR, PHL, SGP, THA. Commodity exporters include AUS, BRA, CHL, COL, RUS, ZAF. Eastern Europe includes CZE, EST, HUN, LTU, LVA, POL, SVK, SVN, TUR. Systemic advanced economies include DEU, JPN, USA. All other countries include ARG, AUT, BEL, CAN, CHE, DNK, ESP, FIN, FRA, GBR, GRC, IRL, ISL, ISR, ITA, LUX, MEX, NLD, NOR, NZL, PRT, SWE.

2/ 1-std = one standard deviation.

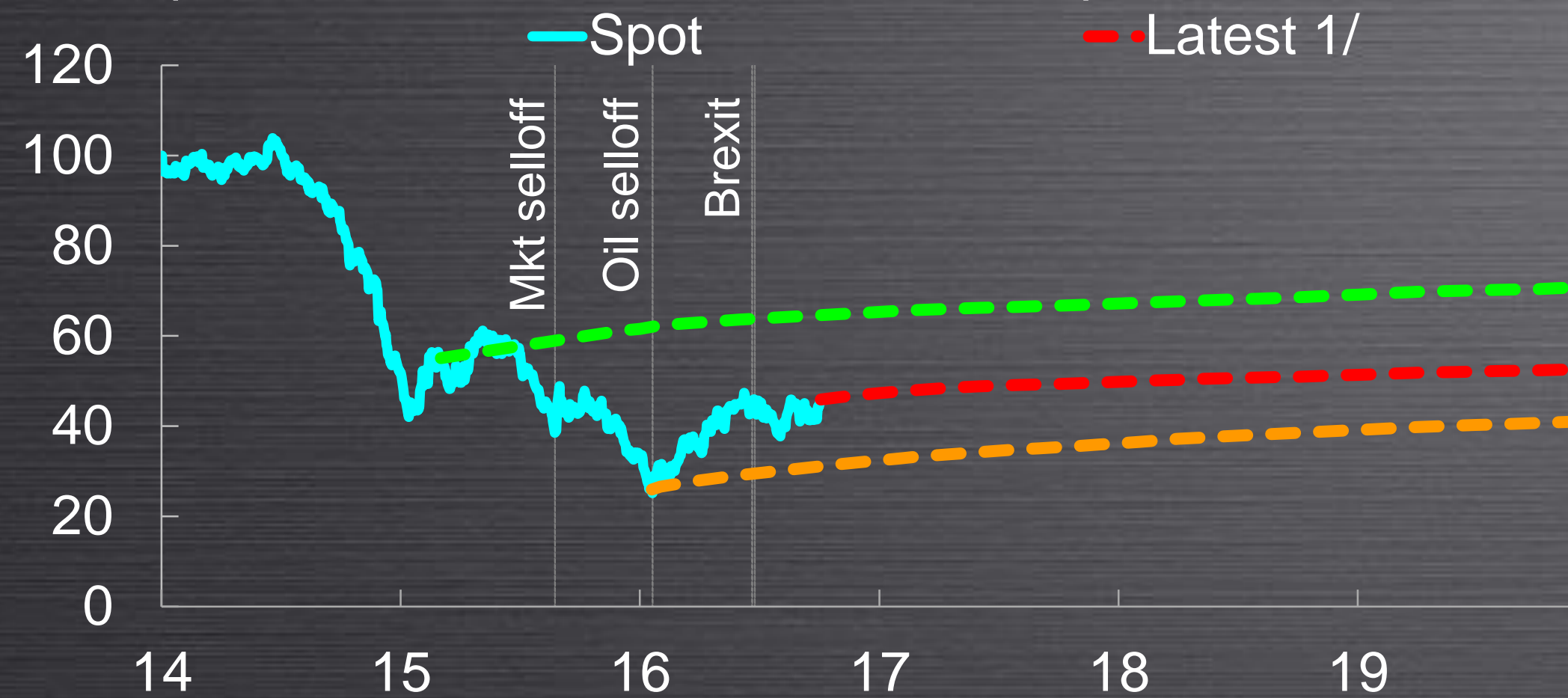
3/ The consumption share data for crude oil is as of 2014.



# Modest recovery in most commodity prices

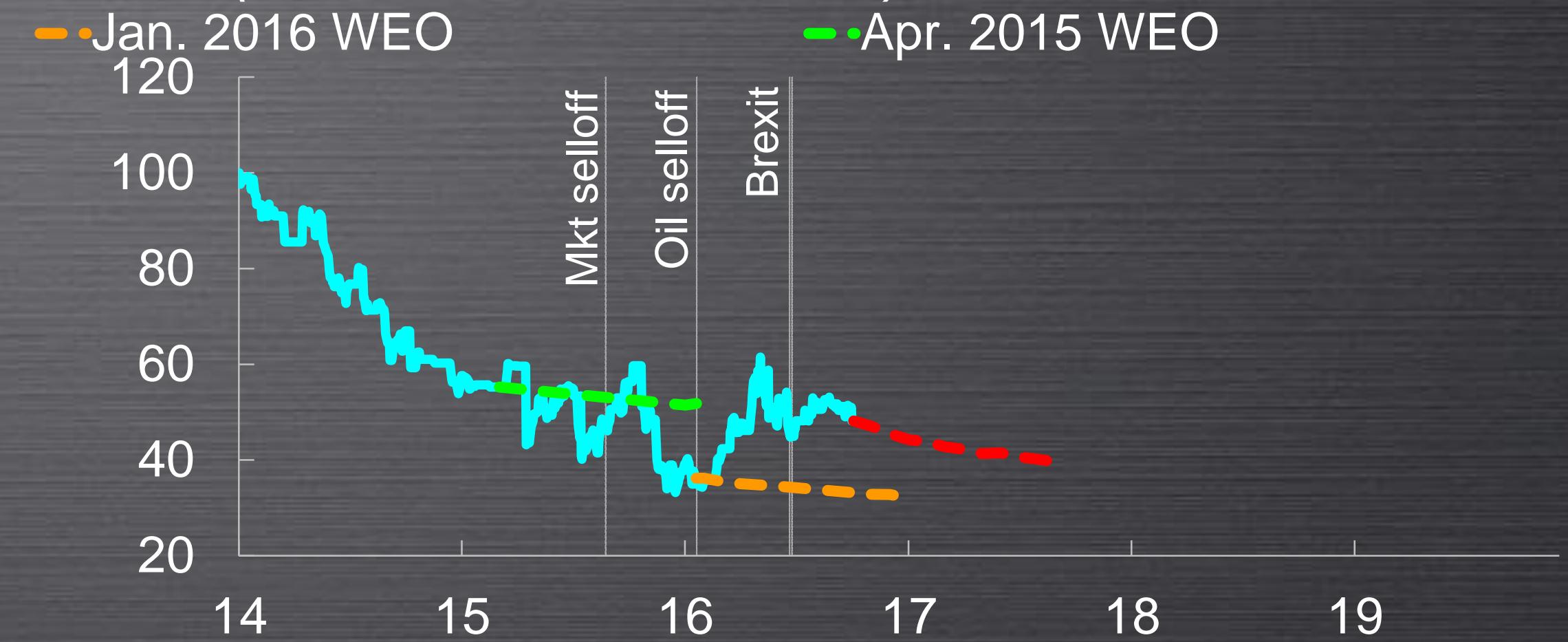
## Oil: Spot and futures prices

(index; Jan. 2014=100; Brent)



## Iron Ore: Spot and futures prices

(index; Jan. 2014=100)



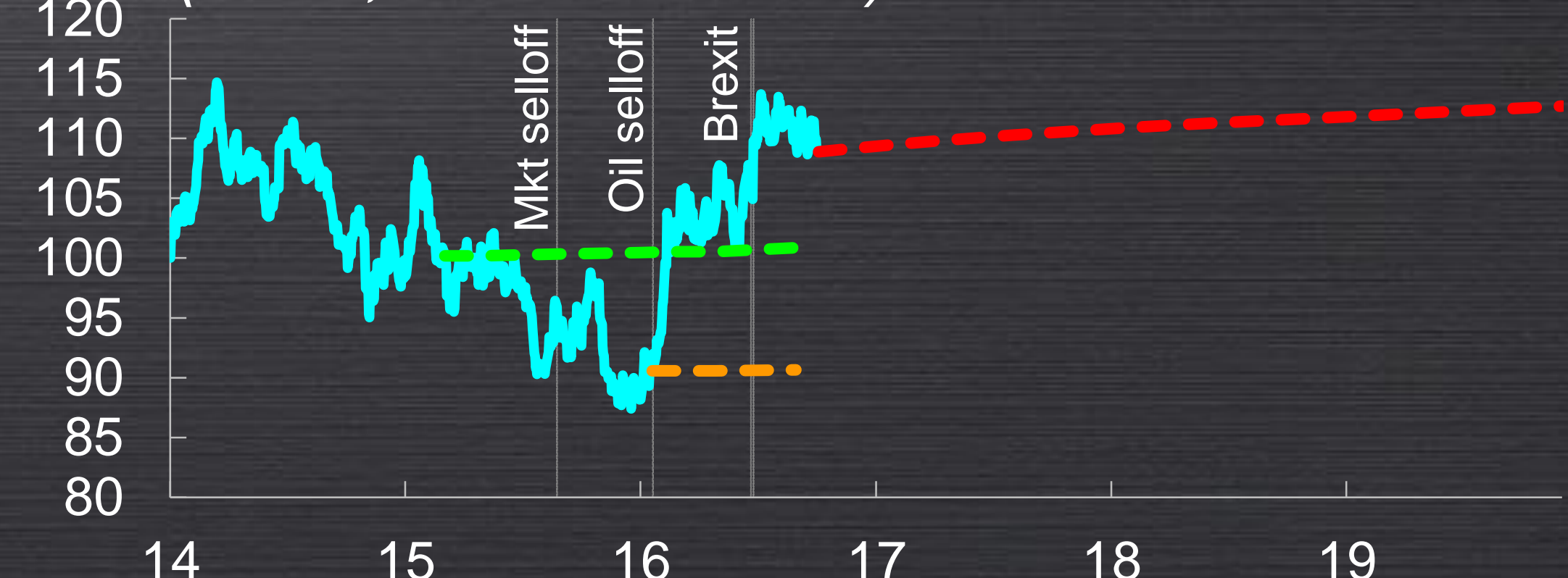
## Copper: Spot and futures prices

(index; Jan. 2014=100)



## Gold: Spot and futures prices

(index; Jan. 2014=100)



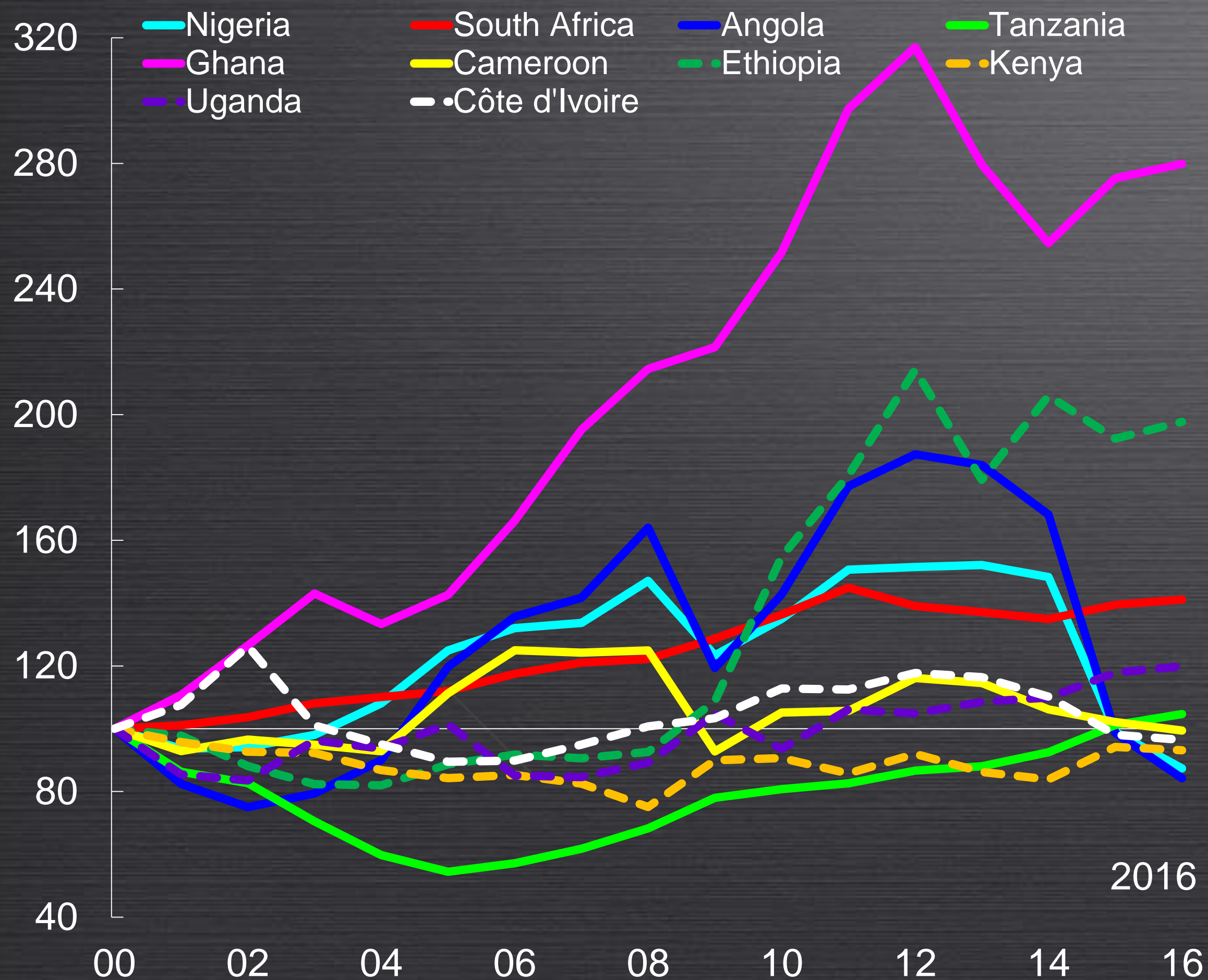
Sources: Bloomberg, L.P.; and IMF staff calculations.  
1/ As of October 3, 2016.



# Challenging external conditions

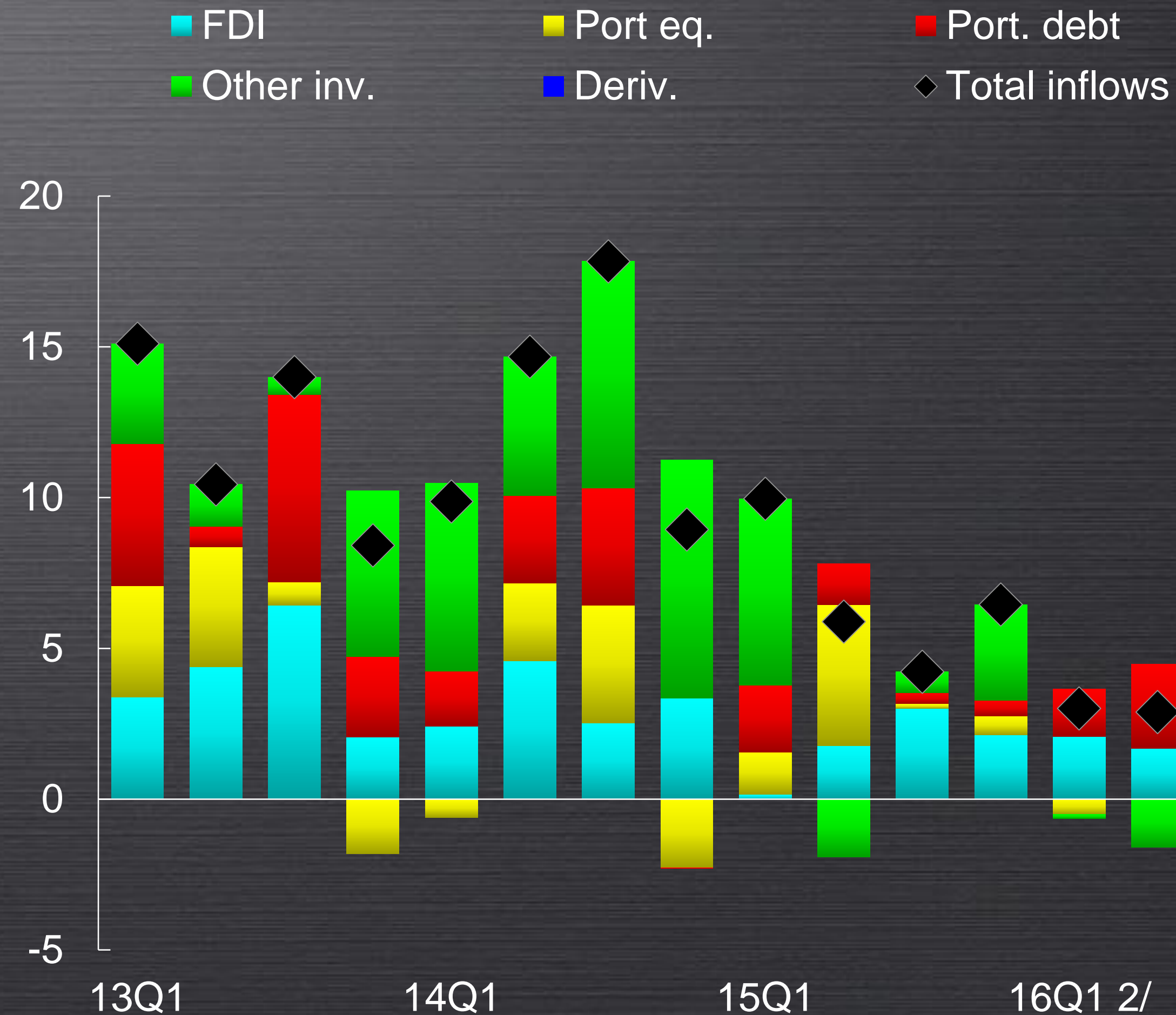
## Terms of trade

(index; 2000=100)



## Capital inflows 1/

(billions of U.S. dollars)



Sources: IMF, *World Economic Outlook*; IMF, *International Financial Statistics*; Haver Analytics; and IMF staff calculations.

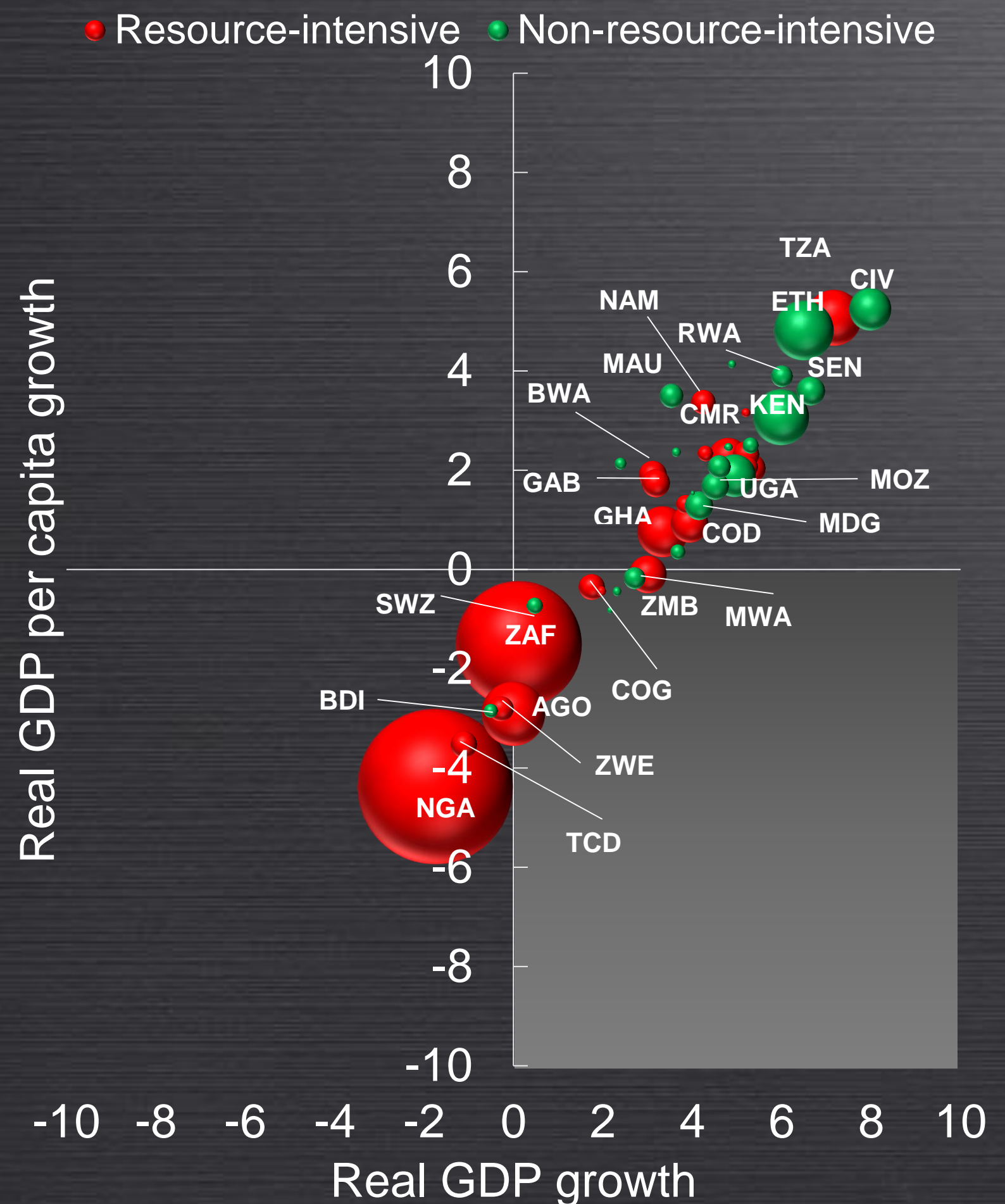
1/ Consists of Nigeria, South Africa, Tanzania and Uganda.

2/ 2016 Q2 consists of data from Nigeria, South Africa and Tanzania.

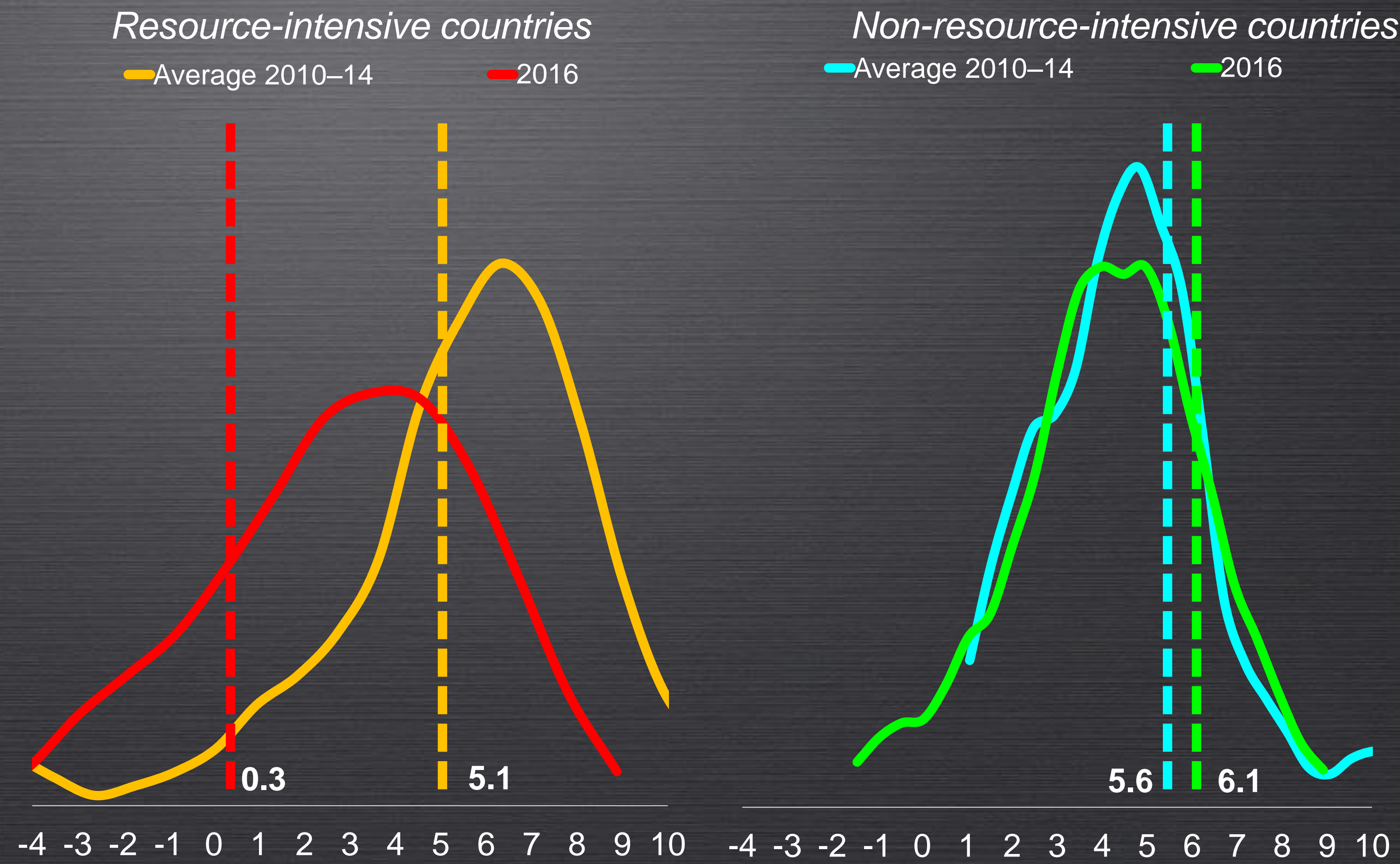


# Which are reflected in Sub-Saharan Africa's multispeed growth

Real GDP growth vs. real GDP per capita growth 1/  
(percent, 2016)



Evolution of real GDP growth during 2010-16 2/  
(Kernel density)



Sources: IMF, *World Economic Outlook* October 2016; October 2016 Regional Economic Outlook: Sub-Saharan Africa; and IMF staff calculations.

1/ Size of the bubble denotes weight in regional GDP. South Sudan and Equatorial Guinea not shown; these have real GDP growth and real GDP per capita growth of (-13, -17) and (-10, -12), respectively.

2/ Dashed lines correspond to weighted average growth for each period.

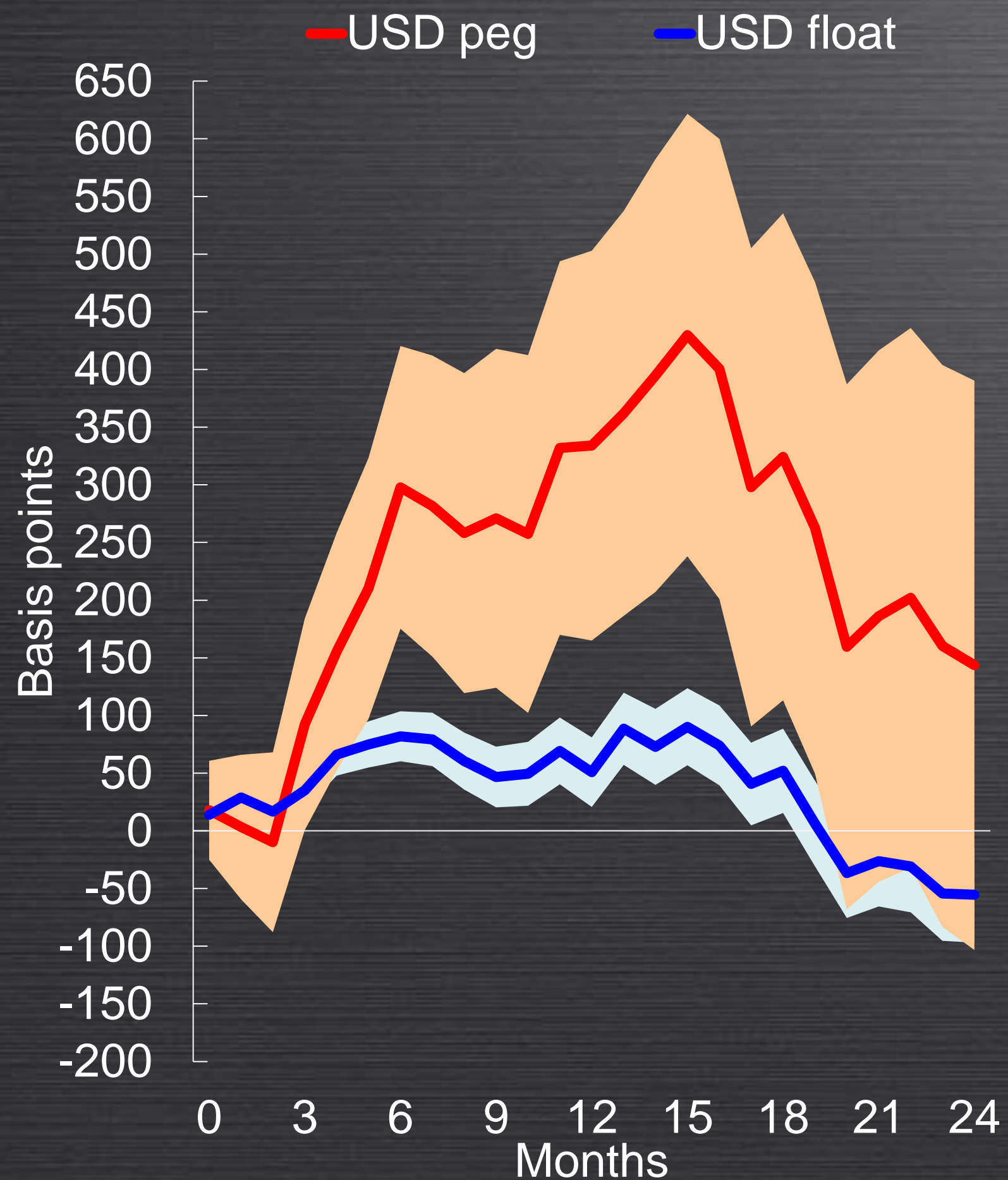


**Can flexible exchange rates play a buffering role  
in the face of global shocks?**

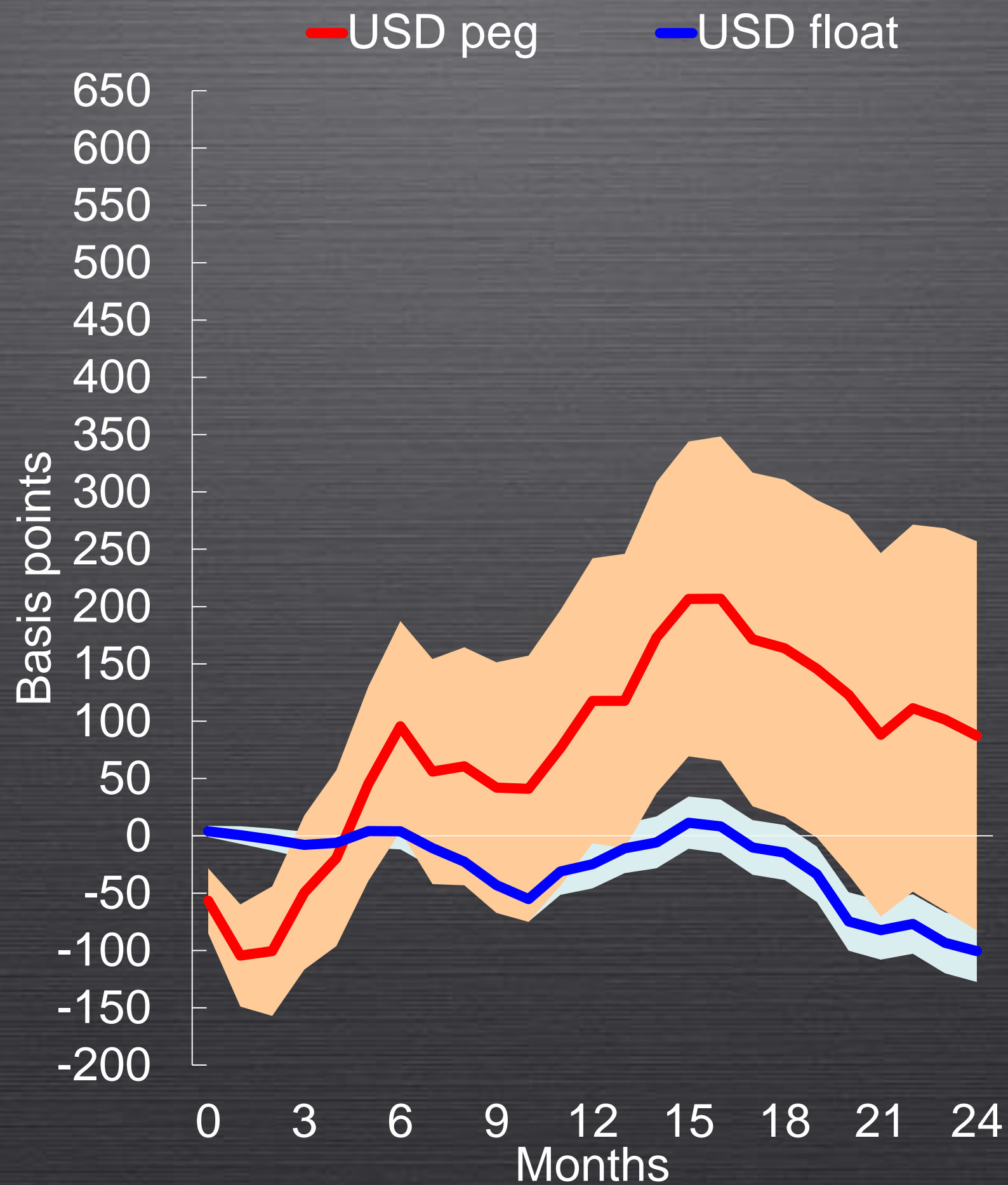


# Impact of US policy tightening

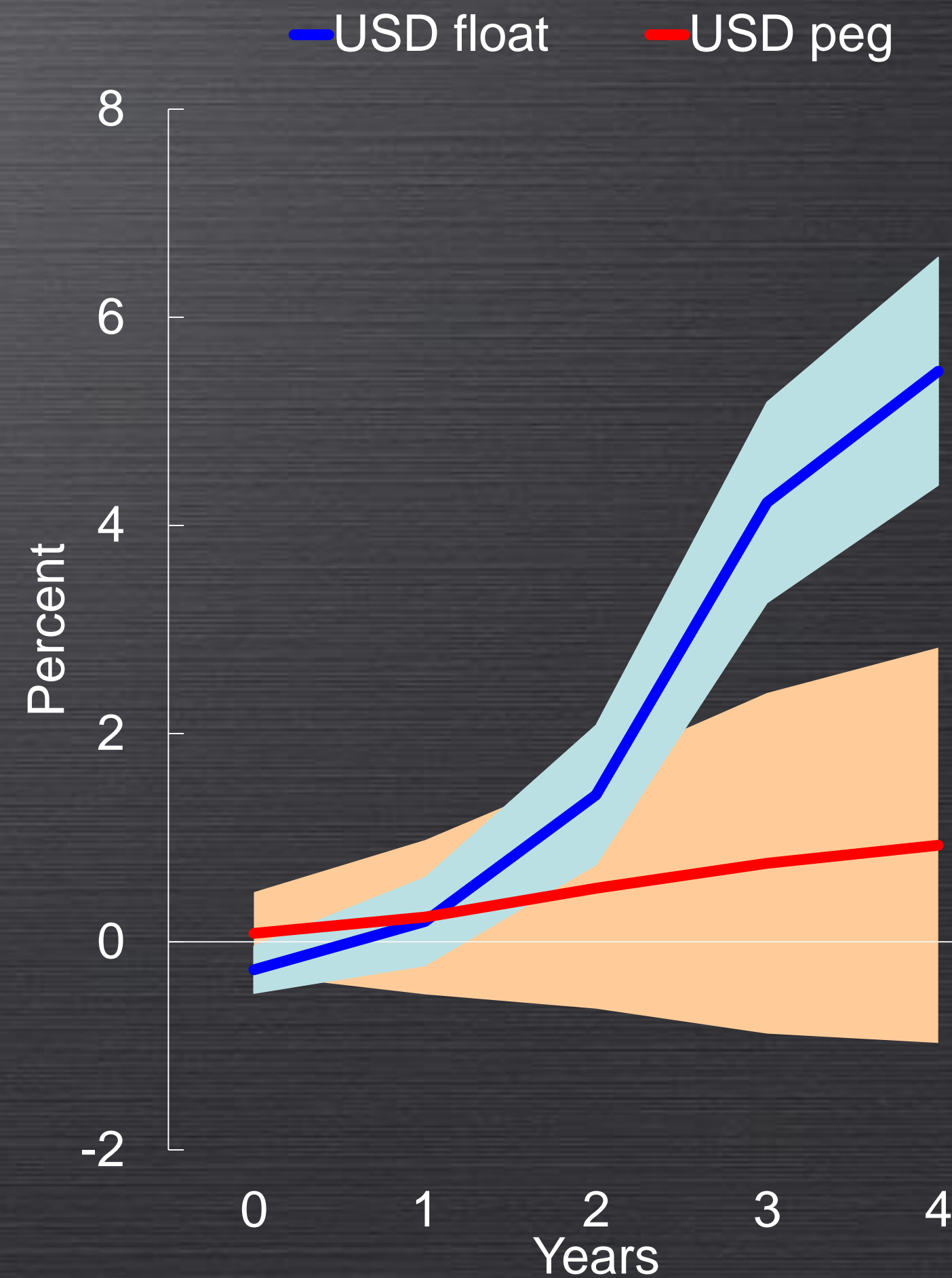
## 2-year yield



## 10-year yield



## Exchange rate (per USD)

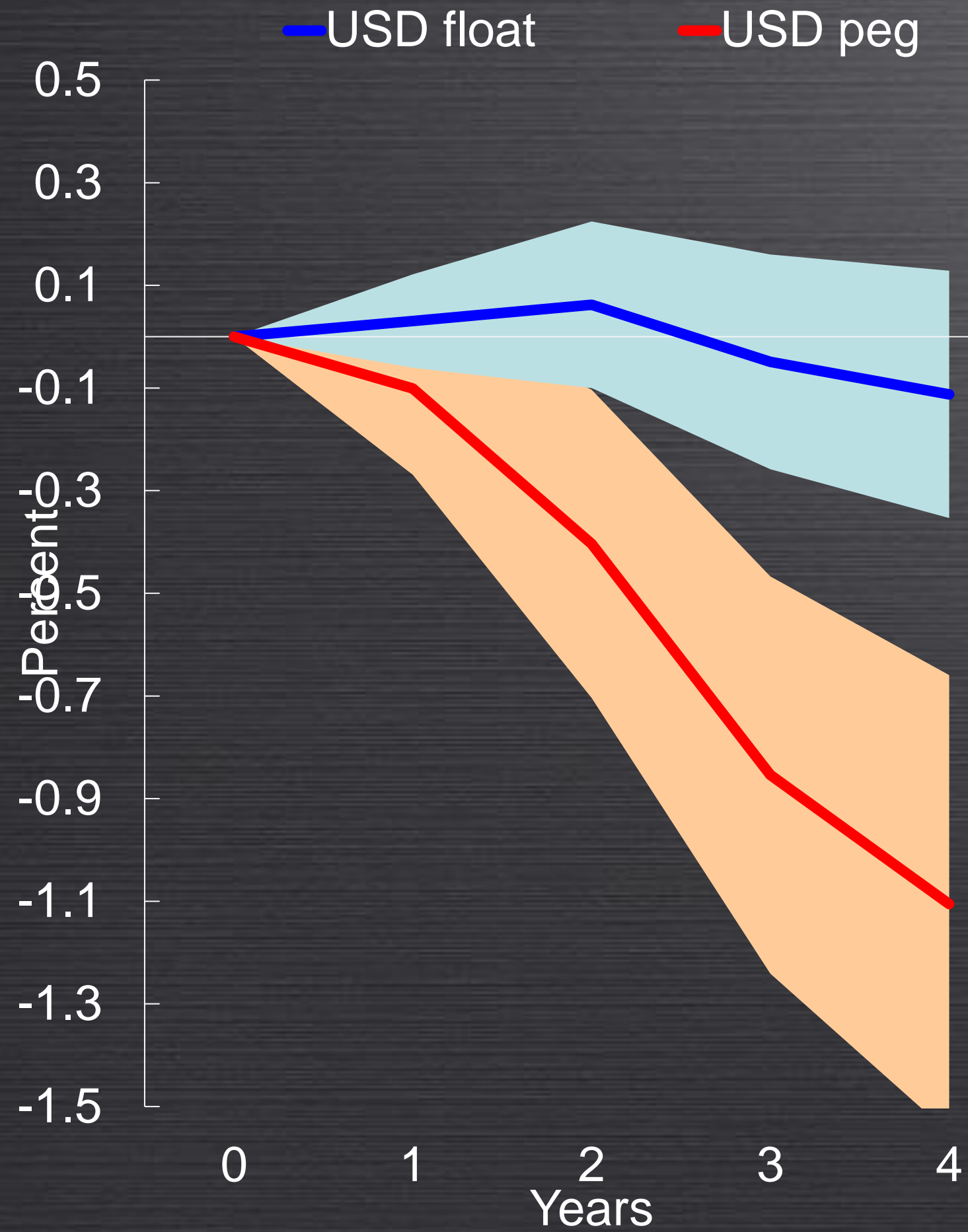


Sources: Obstfeld and Taylor (2016).

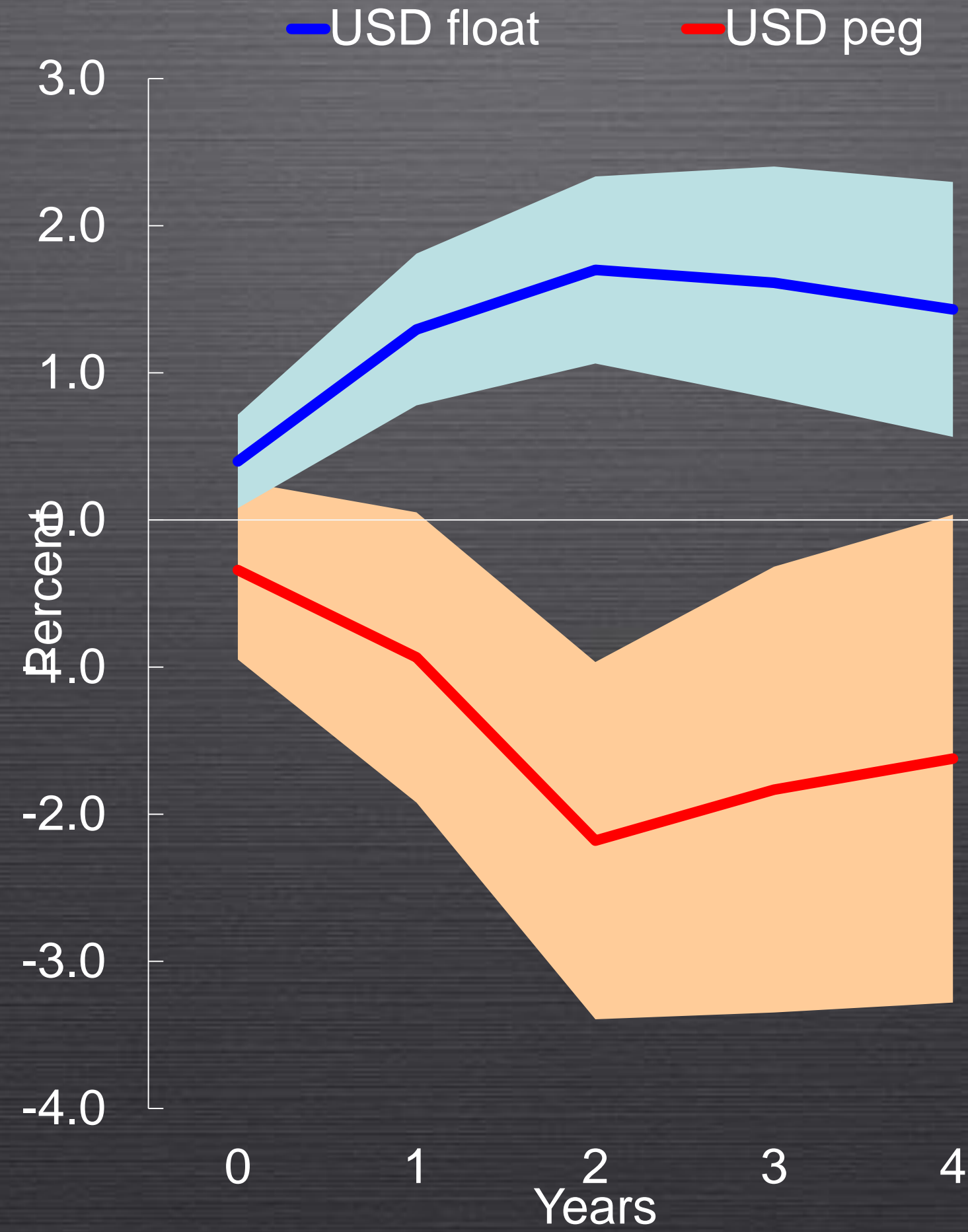


# Flexible exchange rates have a buffering role

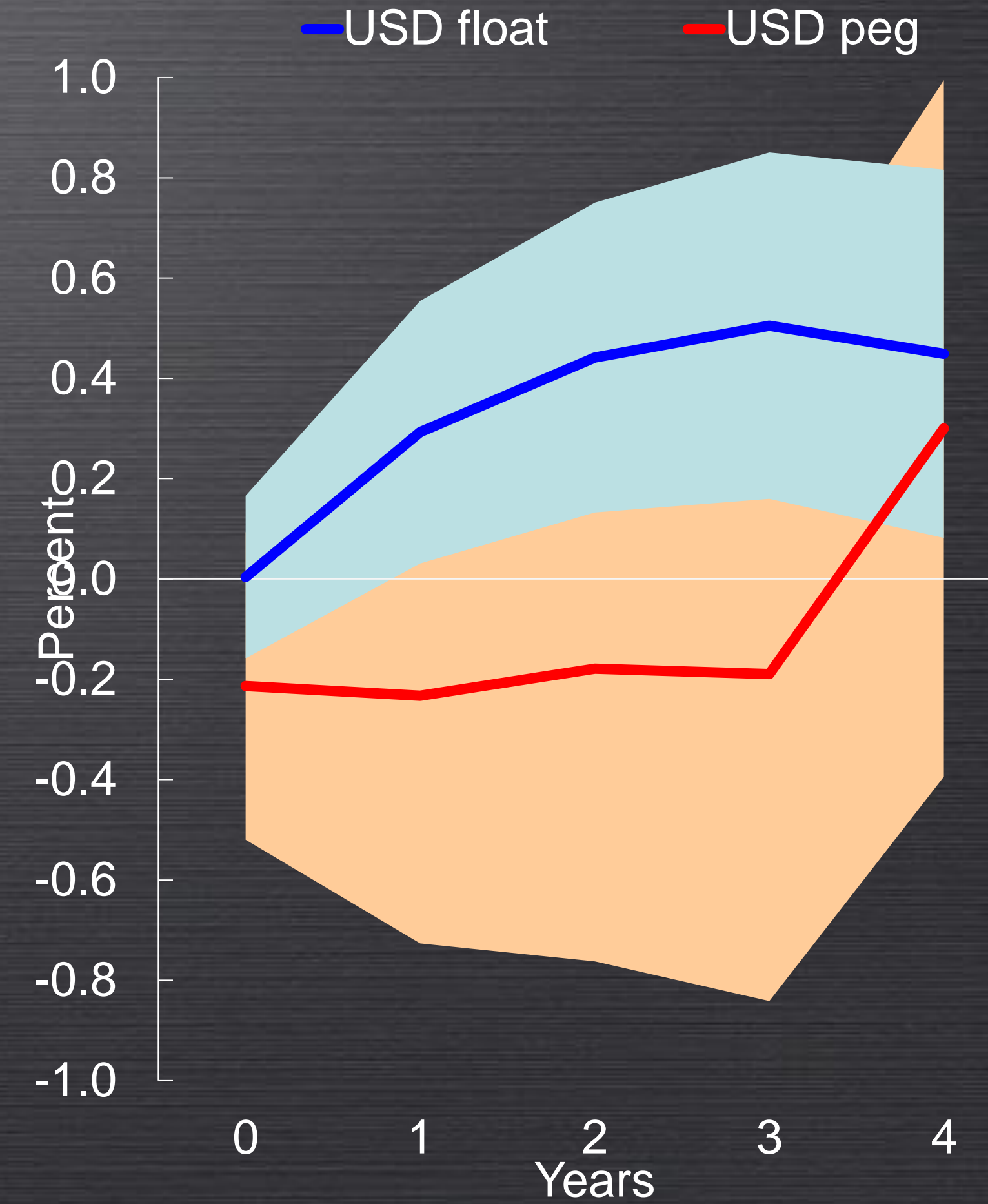
## Real GDP



## Real investment



## Real consumption

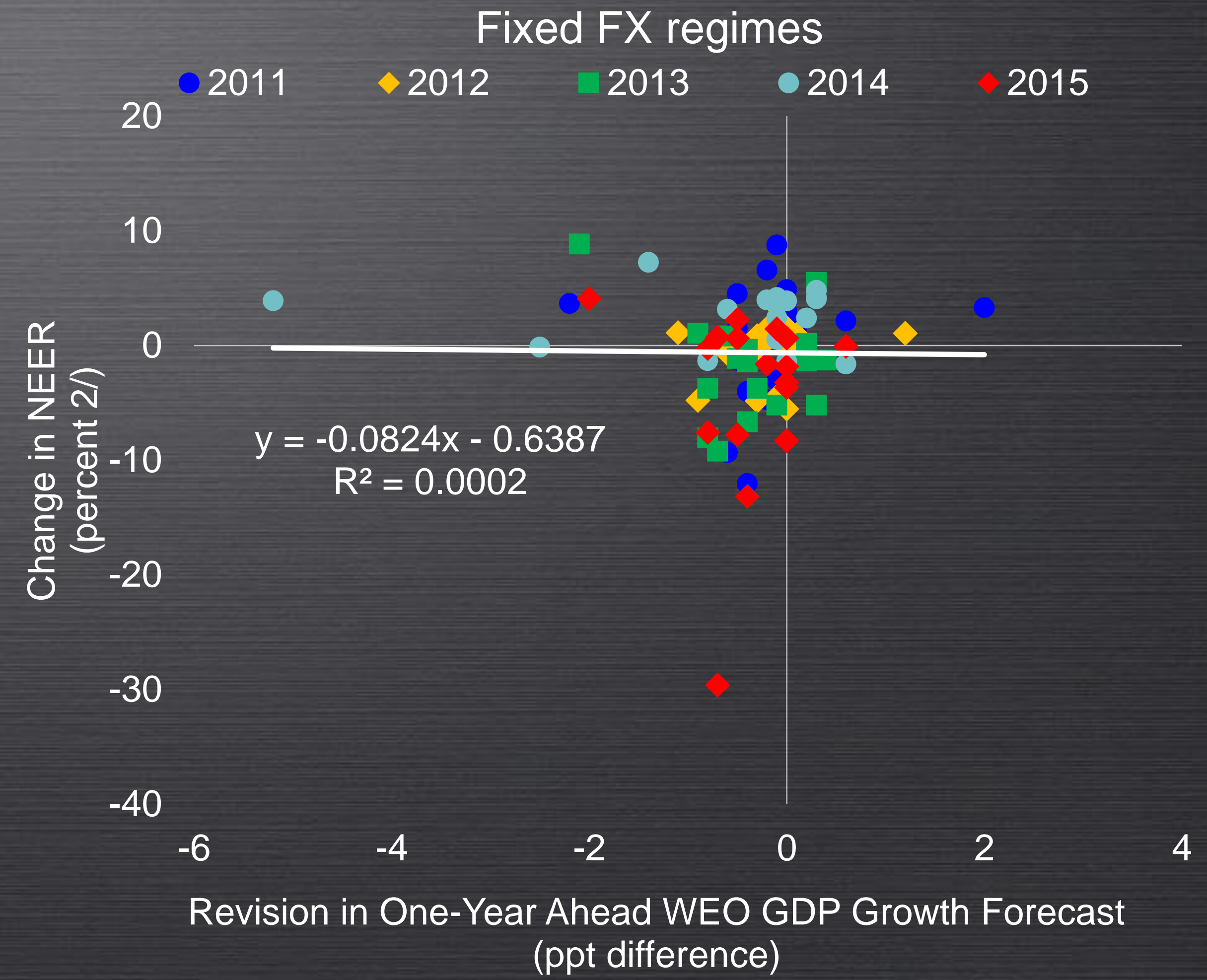
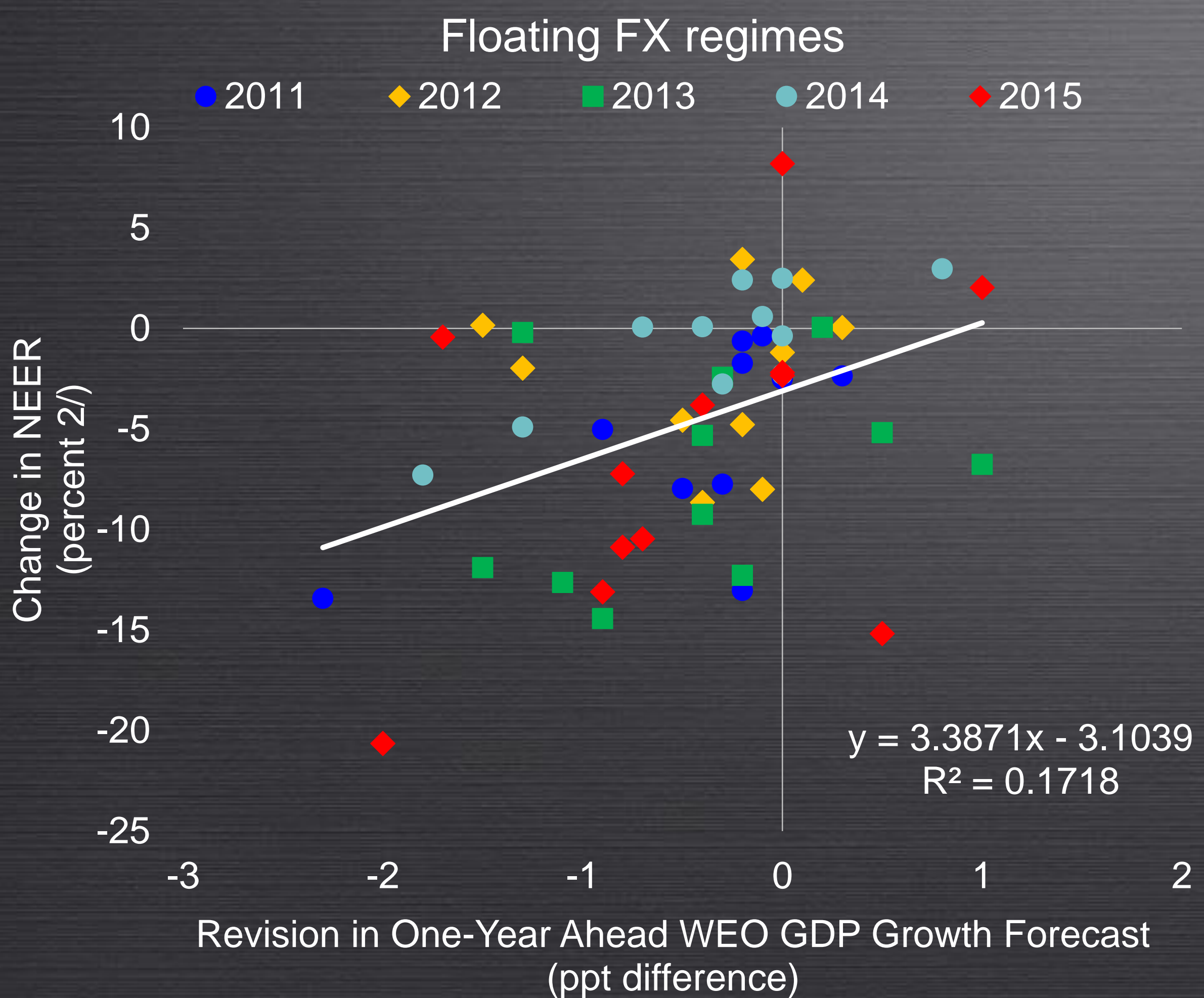


Sources: Obstfeld and Taylor (2016).



# More evidence of flexible exchange rates as buffers

## Currency adjustments and growth forecast revisions in EMs 1/



Sources: IMF, *World Economic Outlook*; IMF; *Information Notice System*; and IMF staff calculations.  
 1/ 29 largest EM economies.  
 2/ Positive change in NEER denotes appreciation.

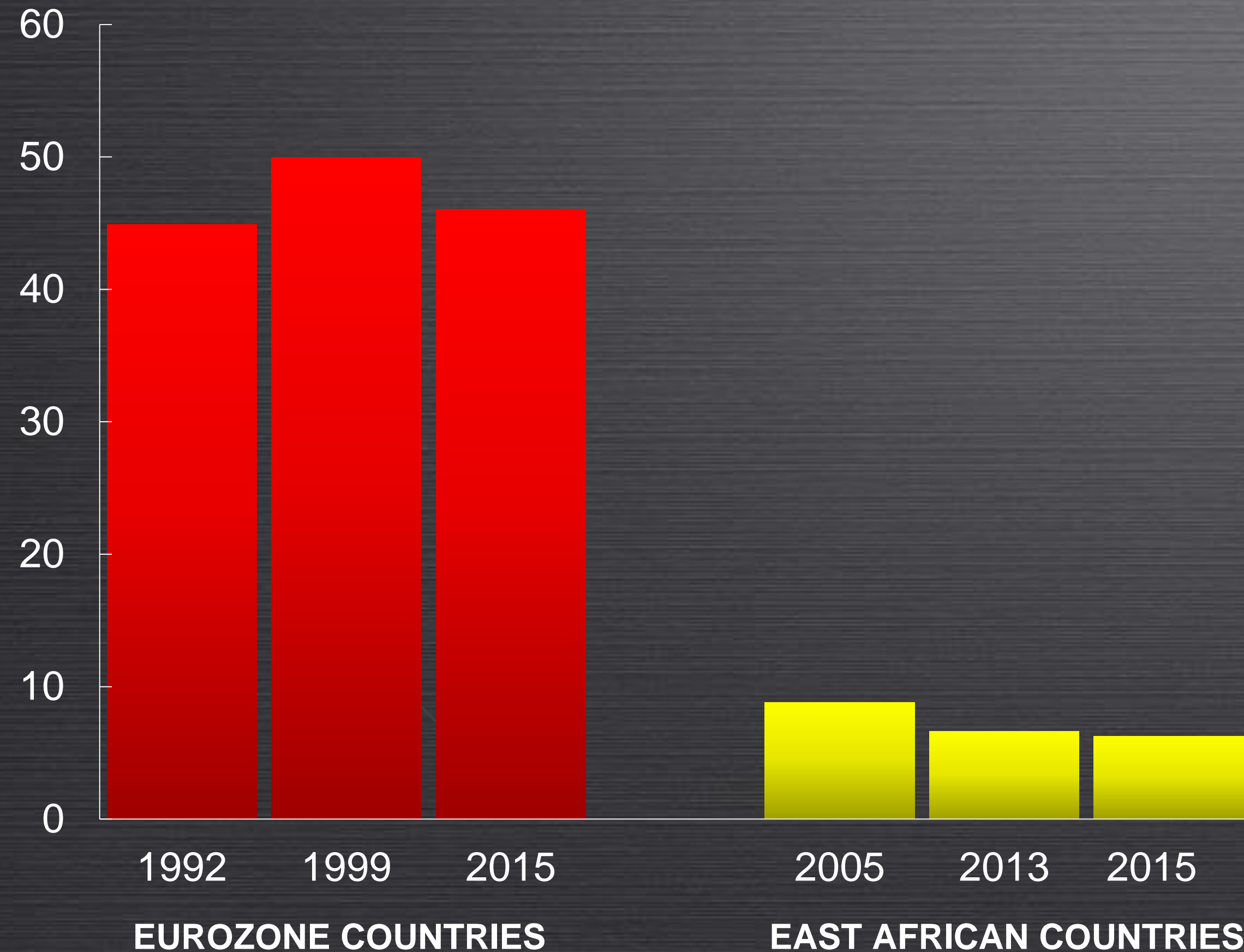


# **Monetary integration: EMU lessons**

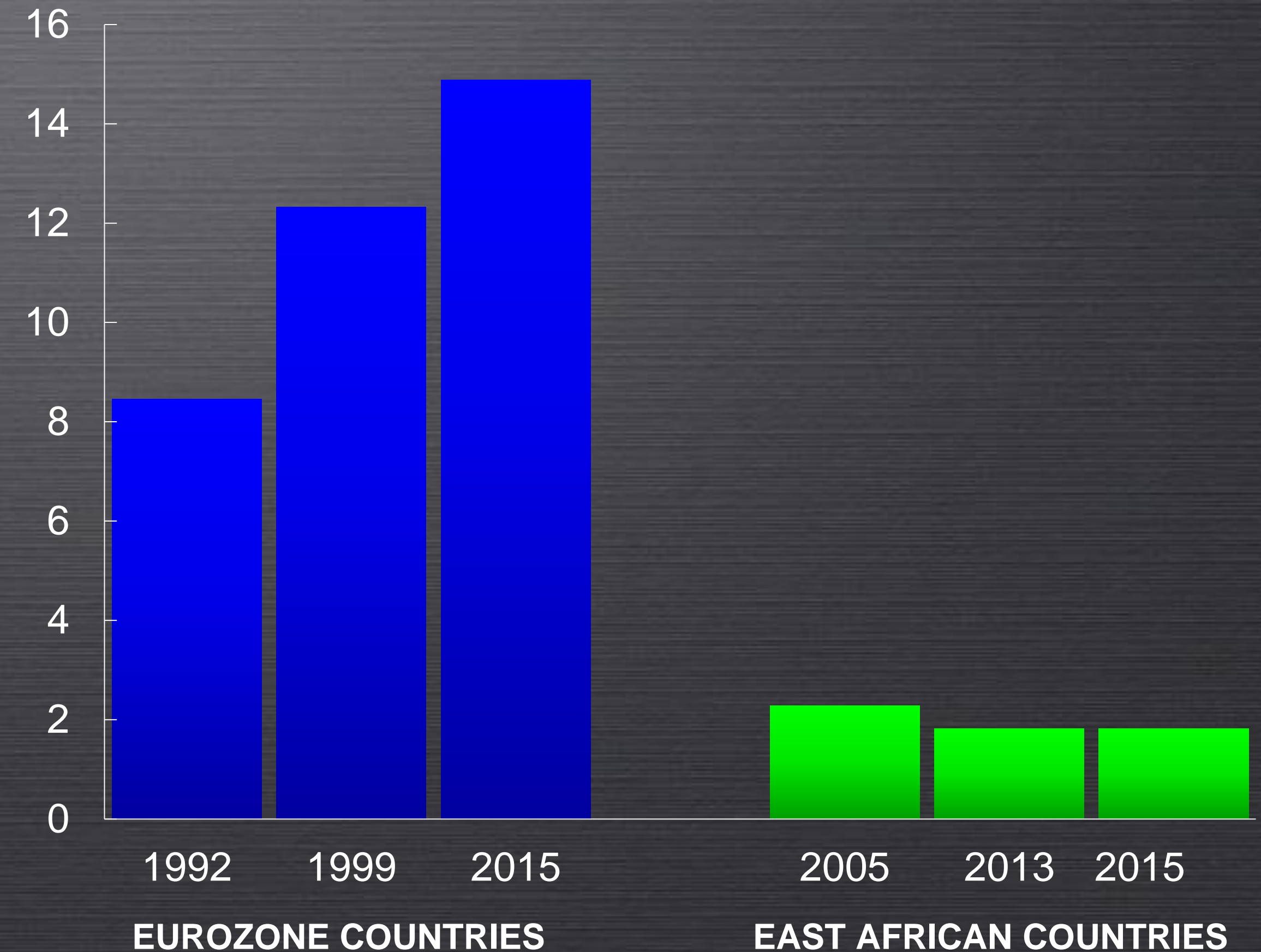


# Much larger intra-region trade integration in the Eurozone

**Intra-group imports as percentage of total group imports**  
(percent)



**Intra-group imports as percentage of group GDP**  
(percent)



Sources: IMF, *World Economic Outlook*; IMF, *International Financial Statistics*; and IMF staff calculations.

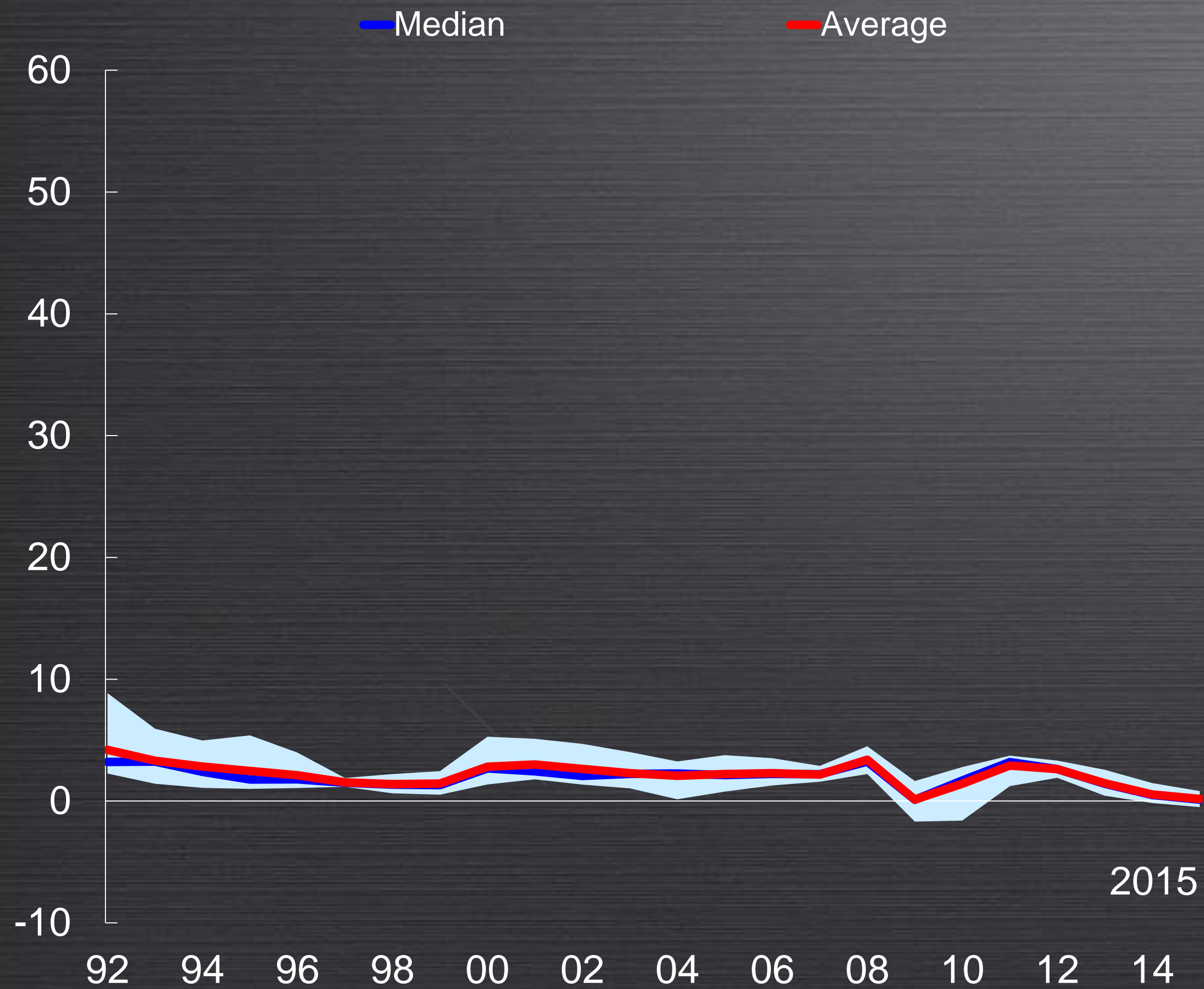
Note: Eurozone countries include Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain. East African countries include Burundi, Kenya, Rwanda, Tanzania and Uganda.



# Maastricht criteria: Inflation

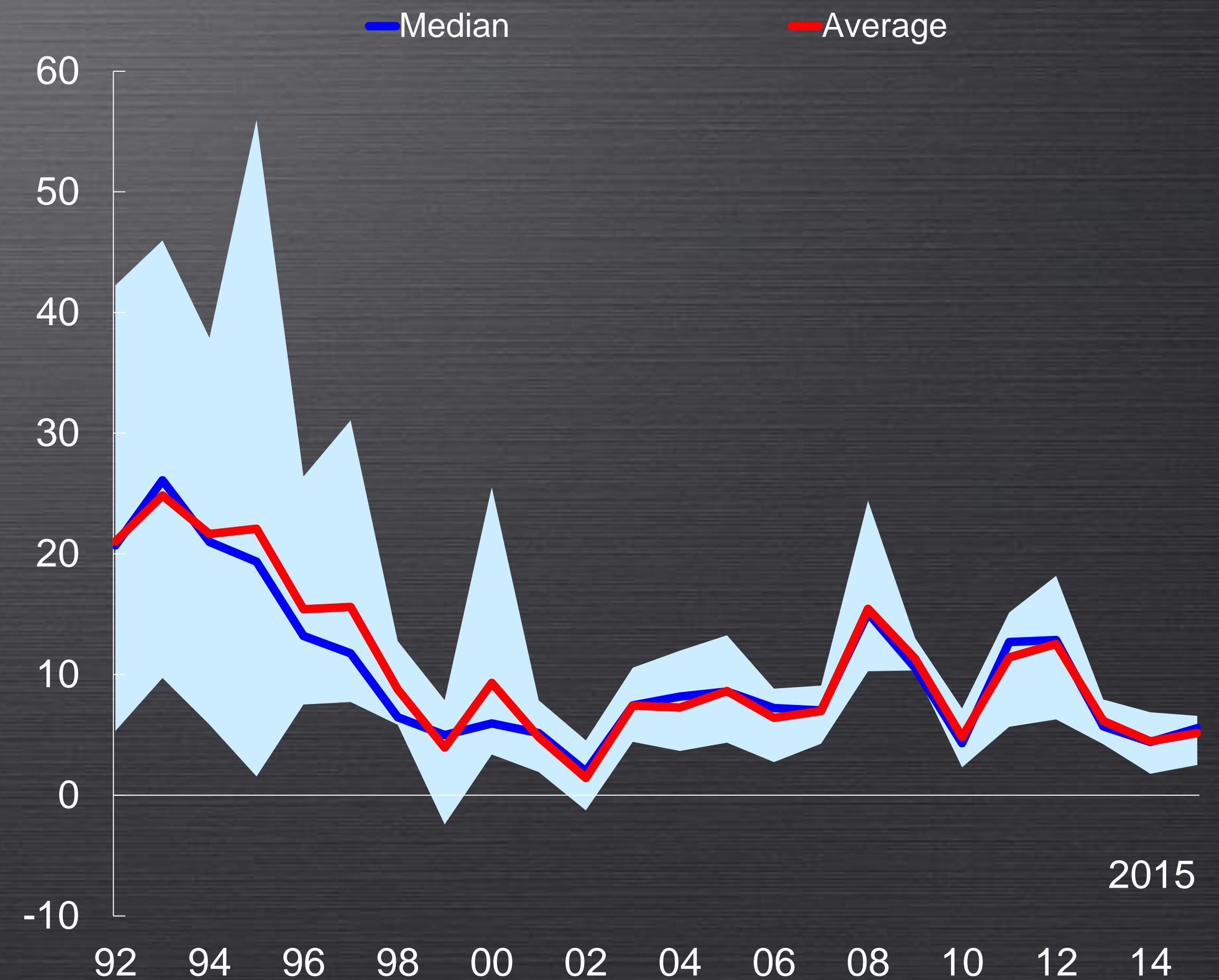
## Euro Area - 11

(percent; year over year)



## East African Community

(percent; year over year)



Source: IMF, *World Economic Outlook*.

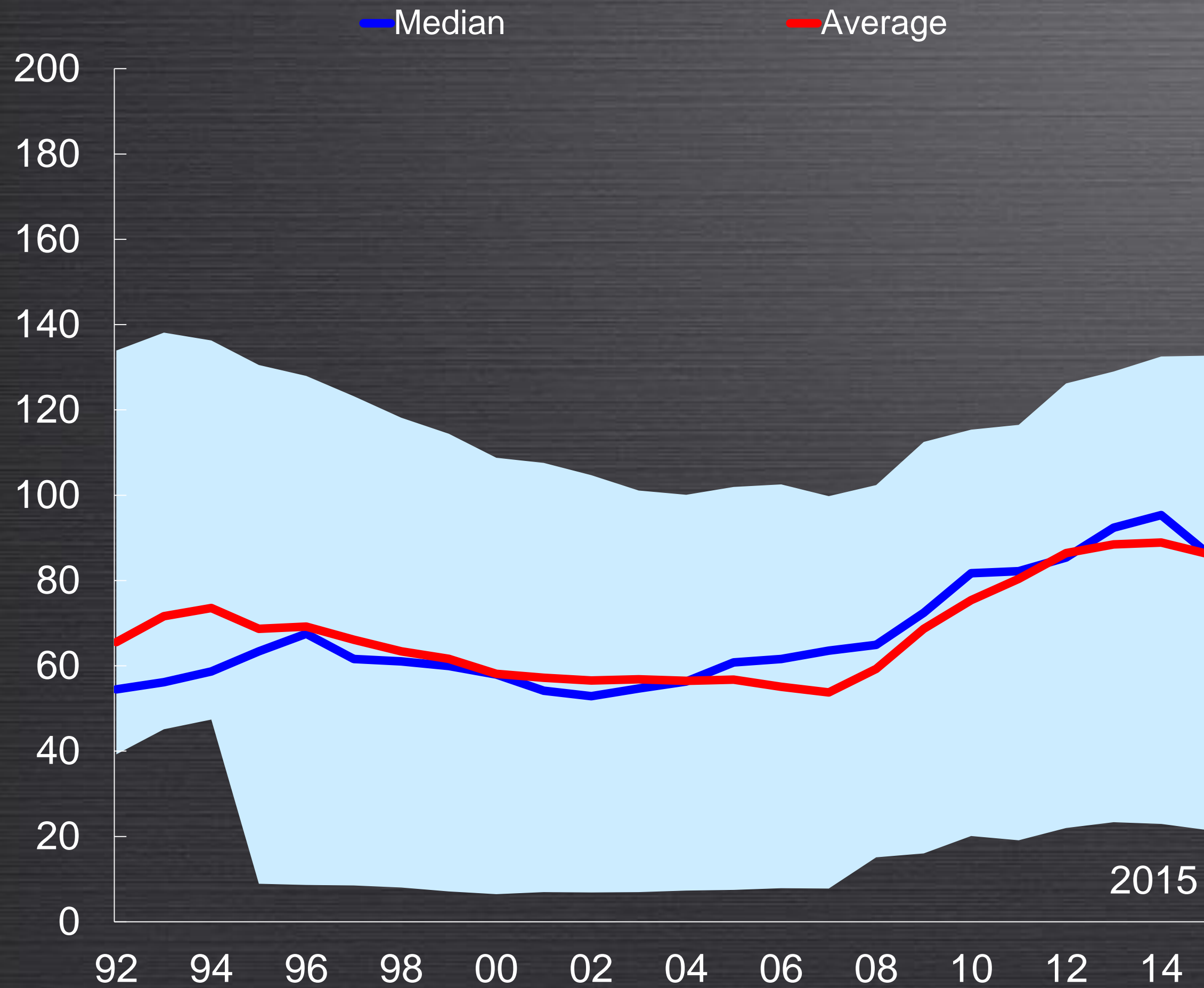
Note: Eurozone covers the 11 countries that adopted the Euro in 1999 (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain)



# Maastricht criteria: Debt

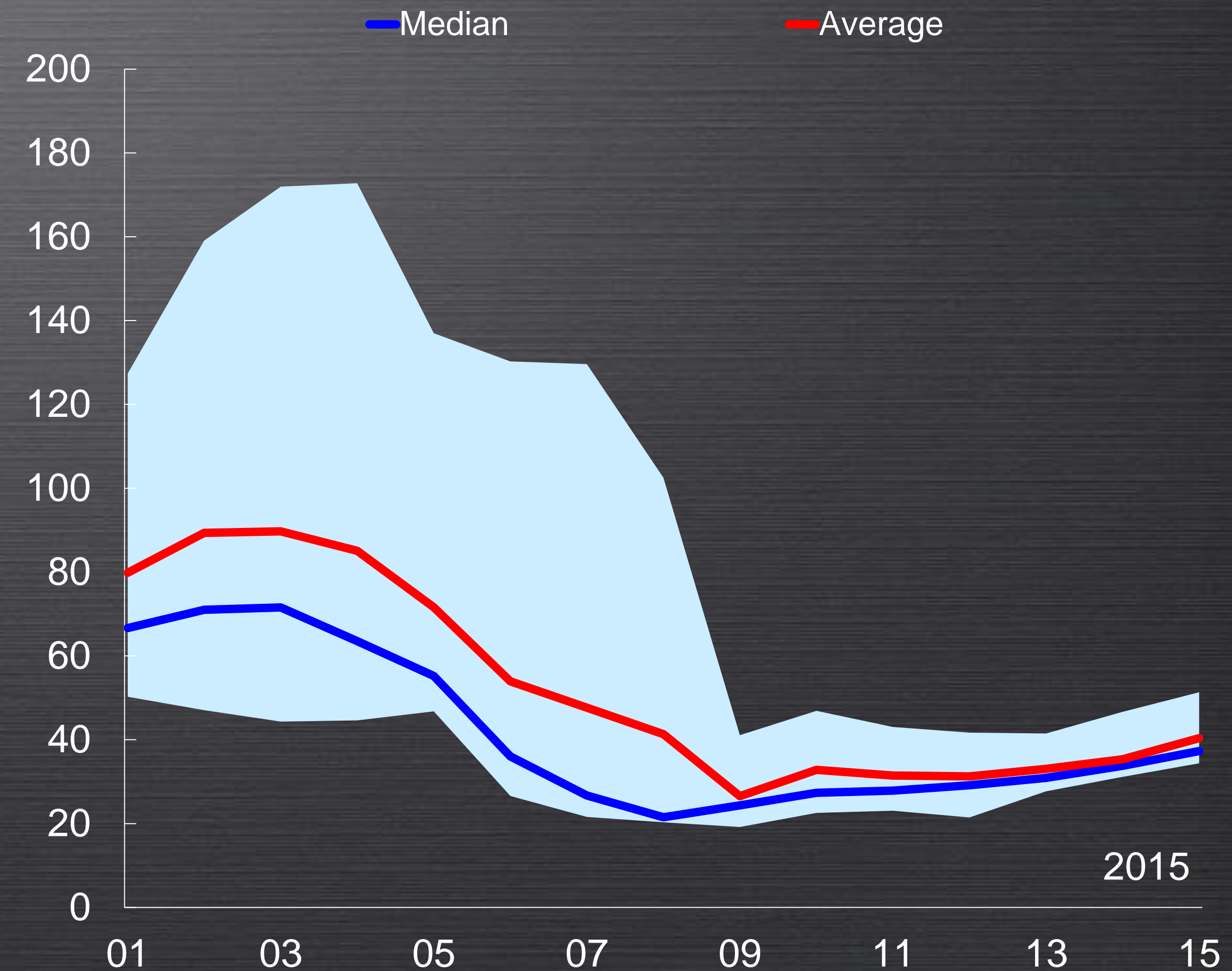
## Euro Area - 11

(percent of GDP)



## East African Community

(percent of GDP)



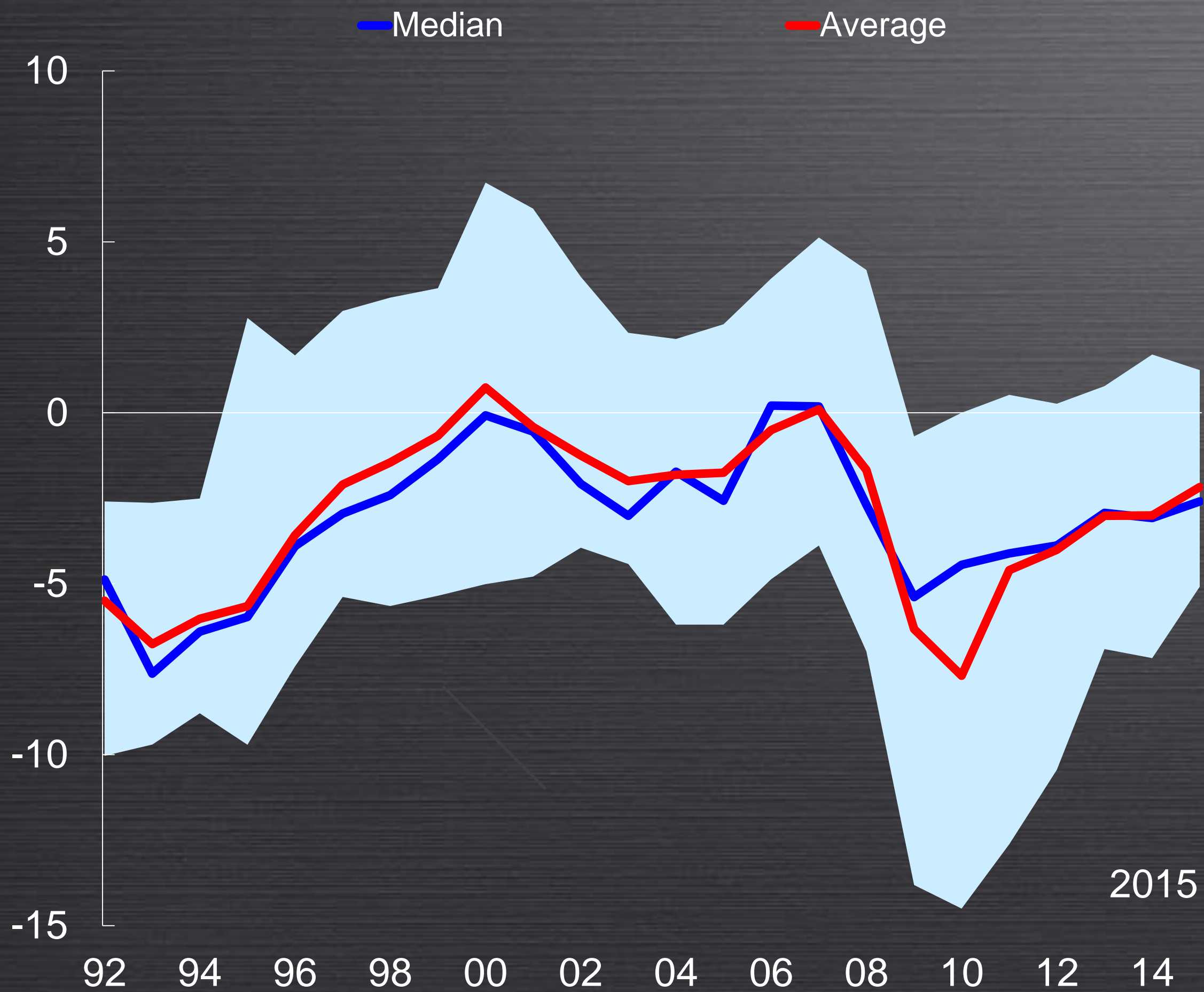
Source: IMF, *World Economic Outlook*.

Note: Eurozone covers the 11 countries that adopted the Euro in 1999 (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain)

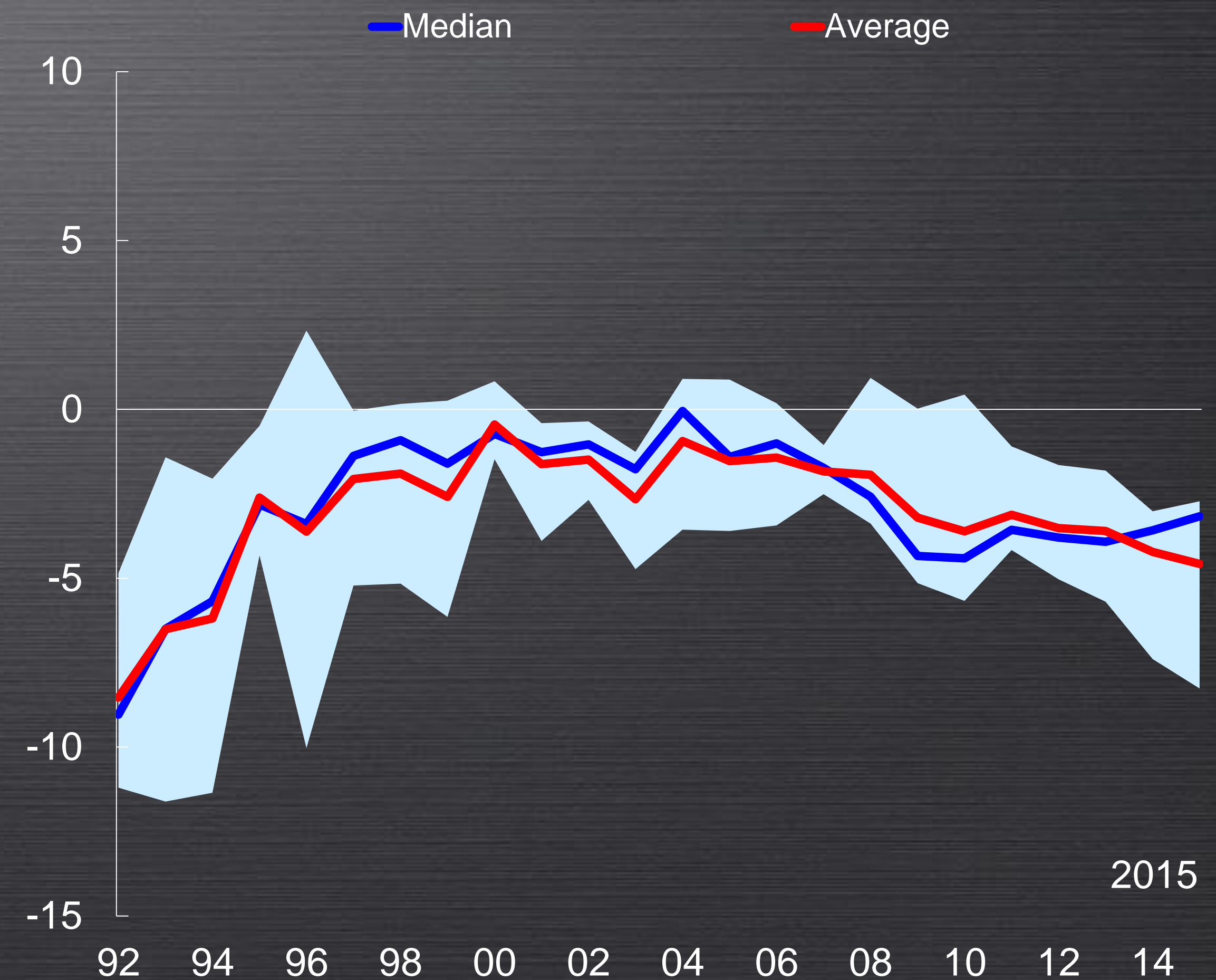


# Maastricht criteria: Fiscal Balance

**Euro Area - 11**  
(percent of GDP 1/)



**East African Community**  
(percent of GDP)



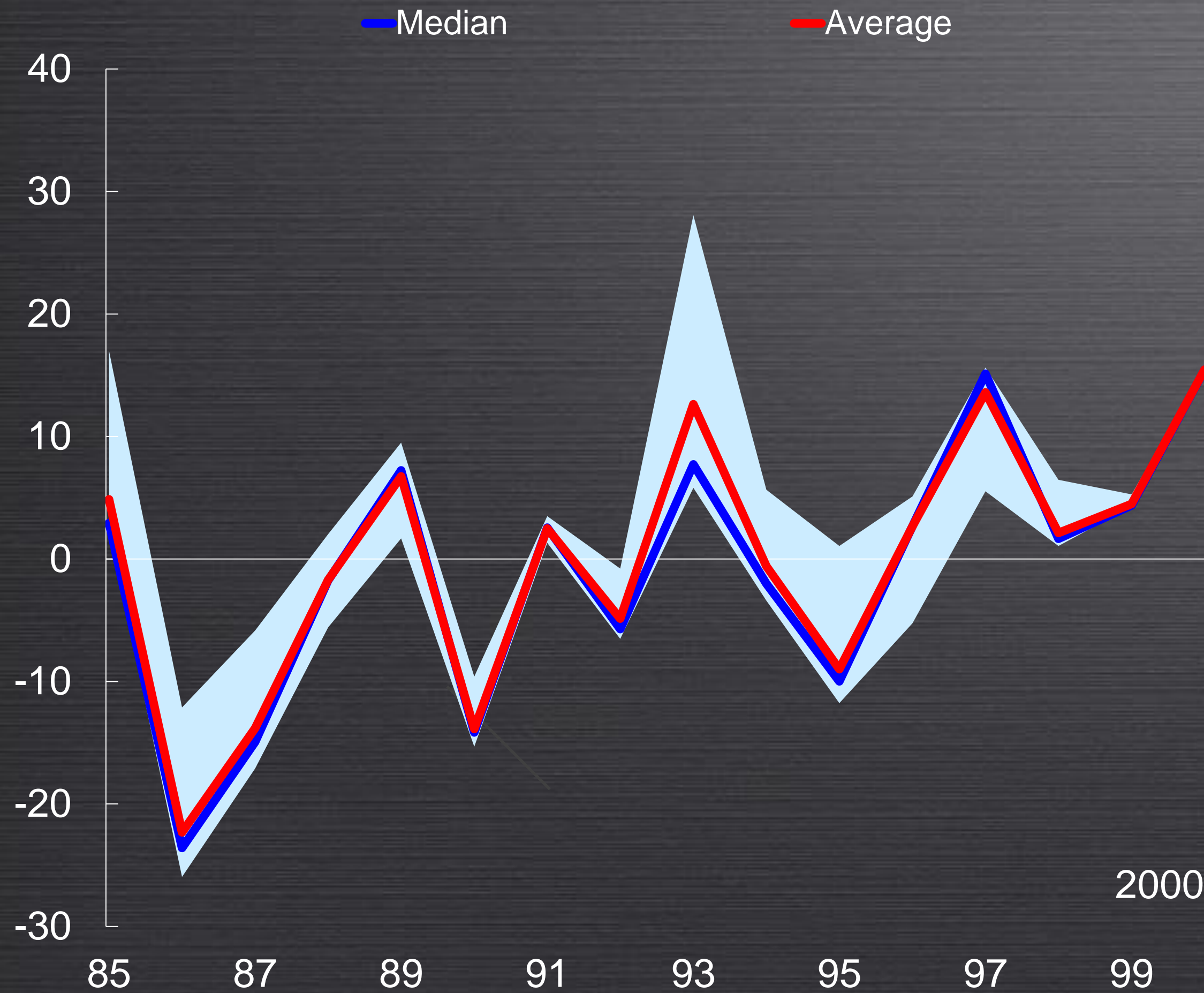
Source: IMF, *World Economic Outlook*.

1/ The minimum fiscal balance in 2010 is -32.1 percent (for Ireland) but it is not shown.

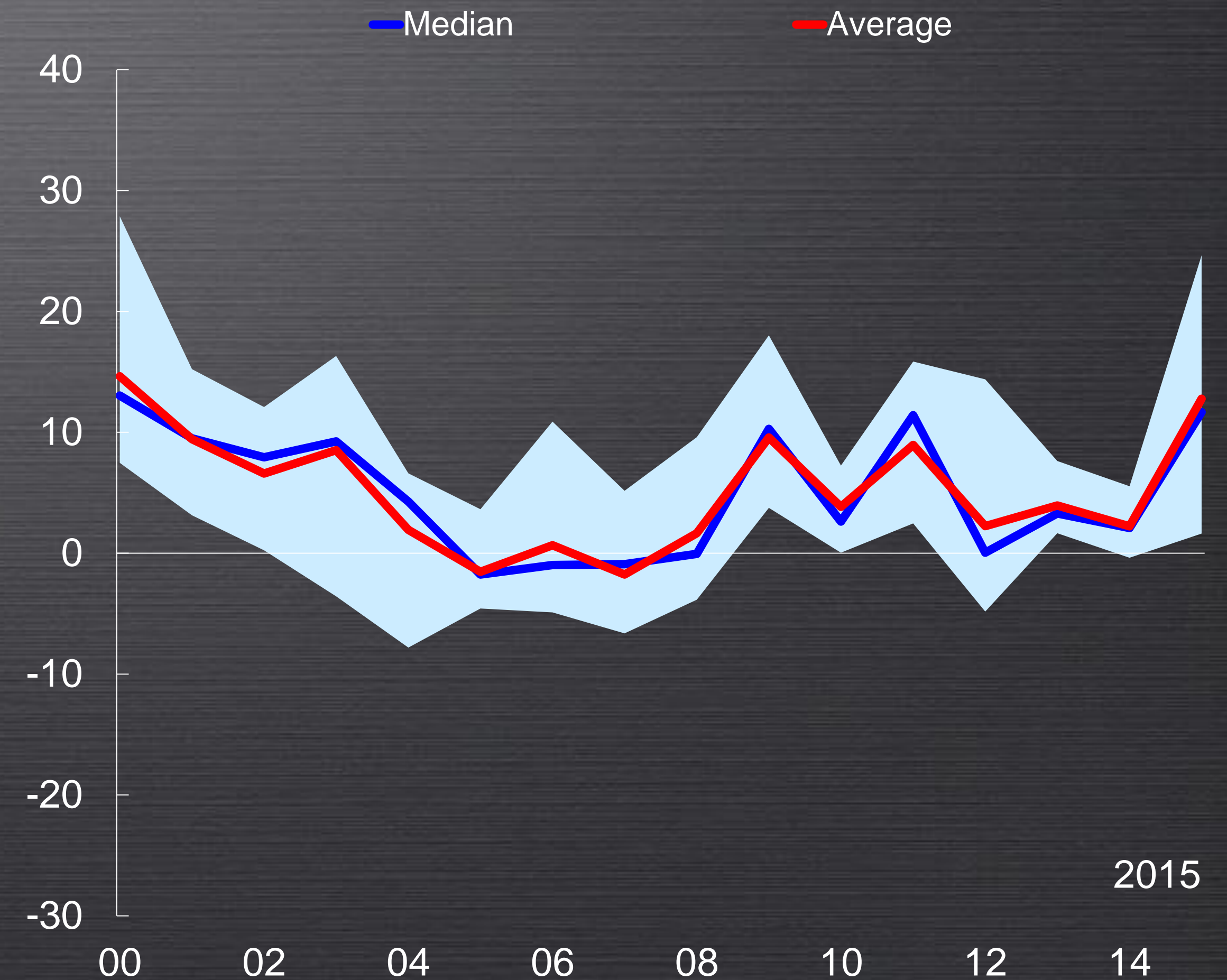


# Maastricht criteria: Exchange Rates

**Euro Area - 11**  
(percent; year over year)



**East African Community**  
(percent; year over year)



Source: IMF, *World Economic Outlook*.

Note: Exchange rate changes measured using national currency units per U.S. dollar, period average. Eurozone covers the 11 countries that adopted the Euro in 1999 (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain).



# Optimum currency area criteria: lessons from Eurozone

- 1) Factor mobility (Mundell, 1961)
- 2) Intra-area trade (McKinnon, 1963)
- 3) Fiscal union (Kenen, 1969)
- 4) Banking union (CEPR report, 1991)

I will take up 3 and 4, which are more dependent on institutional engineering (and closely inter-related)



## Eurozone conflicts over fiscal policy

- A default by one member could endanger system stability
- Lack of monetary independence and self-fulfilling debt crises
- How to avoid “transfer union”?
- Solution: System-wide rules on debts, deficits
- Fiscal policy cannot counteract negative asymmetric shocks
- Collective action clauses to limit bailout incentives
- But these are not credible given absence of a true banking union (see next slide)
- Possibility of fiscal transfers still enters through backdoor of ECB operations, TARGET imbalances
- Exceptional Liquidity Authority (ELA): a discretionary dodge



## Need for true banking union

- Maastricht Treaty did not flesh out ECB's LOLR role, left supervision in the hands of national authorities
- CEPR (1991) made a largely "microeconomic" critique
- But the macroeconomic implications have become evident
- But as bank systems expanded, micro distortions became macro-significant and could threaten sovereign solvency
- "Doom loop" of bank-sovereign interdependence
- This remains even with current SSM and SRM
- Is critical for "law of one price" of EZ deposits: contrasting cases of Greece (capital controls), Puerto Rico
- Resolution authority needs to be backed by some adequate, centralized fiscal capacity; current BRRD faces challenges