

# Commentary

## When meetings matter — The World Bank and IMF Convene

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There are many reasons cited for this week's market turndown and risk pullback, including concerns about global growth, Ebola, turmoil in the Middle East, and excessive investor comfort from easy money. What has been less commented on is the role played by last weekend's IMF and World Bank Annual Meetings. Sometimes these meetings pass uneventfully, but sometimes bringing so many people together—policymakers and market people—creates a conversation that moves the consensus and as a result moves markets. It seems this year's was one of those occasions. As the meetings progressed, optimism about a G-20 growth agenda and infrastructure boom receded and concerns about growth outside of the United States began to dominate the discussion. The perception that policymakers—particularly European policymakers—were either unable or unwilling to act contributed to the gloom. Time will tell whether macro risk factors that markets have shrugged off over the past few years will now be a source of volatility going forward. But if that is the case, perhaps these meetings had something to do with it.

A few other thoughts on the meetings.

Markets are ahead of policymakers on European QE. Europe is divided on whether quantitative easing is needed, and if tried, whether it will be effective. While most market participants seem to expect the ECB to soon extend its program of quantitative easing to buying government bonds, current and ex-central bankers at presentations I attended signaled a greater degree of uncertainty. Part of the concern is whether the usual channels through which QE works—including a wealth effect on portfolios—will work as well in Europe's bank dominated system as it did in the United States, but the greater concern is gridlocked politics. This was highlighted by the public disagreement between ECB head Draghi and Bundesbank President Weidmann, as noted by several commentators. The risk is that the easing of policy comes late, and doesn't pack the punch that is needed to restore growth. We know from the U.S. experience that a potentially important channel for unconventional monetary policy comes from the forward guidance it provides that easy policy will be sustained. True, the ECB has some tools the Fed does not have (e.g., long-term fixed rate lending facilities) to signal that rates will stay low for a long time. Yet, at a time when policymakers elsewhere are increasingly focused on the challenge of exiting that guidance, the hesitancy of the ECB to clearly articulate its goals for and commitment to an expansion of its balance sheet and increased liquidity can only undermine the impact of current monetary policy.

The policy response to divergent monetary policies is starting to take shape. Much of the policy discussion tried to anticipate a world in which the Federal Reserve began to normalize policy while the Bank of Japan and ECB expanded their use of unconventional monetary policies. Exchange rates, particularly emerging market exchange rates, were seen as a source of future volatility. In this regard, I was

surprised I did not hear more about the risk of protectionism (in the United States for example if the dollar rises sharply) or capital controls (in emerging markets) if we have a normalization nightmare, following on the taper tantrum of last year. The continued criticism of the Fed by Indian central bank governor Rajan seems to have less to do with policy (the Fed's actions having supported global growth and its possible exit well communicated) as much as it may suggest preparation to resist the market pressures that will result.

The outlook is deteriorating for Russia and Ukraine. There is increasing anecdotal evidence that pressures on the Russian financial system are mounting and extending to non-sanctioned banks. The recent depreciation of the rouble and capital outflows have intensified concerns, and notwithstanding substantial central bank and government support it seems clear that Russia has dropped into recession. Most of the market forecasts still see positive growth this year, but I expect that to change after these meetings.

Meanwhile, I didn't need the meetings to tell me that the IMF's program for Ukraine is collapsing, a victim of continued Russian destabilization, a deep recession, and ridiculously optimistic initial IMF assumptions. What surprised me was the weak defense put up by the official community at these meetings. The IMF team that will go to Kiev in early November, after Parliamentary elections, has little choice but to positively conclude its review and disburse the roughly \$2.7 billion due Ukraine in December, given rising cash needs of the government heading into winter. But I suspect (and hope) that the review will acknowledge the large and growing financing needs of the country and the limits of the Fund's ability to meet these needs and introduce sustainable economic reform in the midst of a conflict. The Fund should signal that it may have to step back as soon as the next review (in March), and that bilateral support from the United States and European governments needs to fill the gap. That new package (with a private debt restructuring to extend maturities) needs to be in place by March, if not sooner.