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SPEECH

Fix the Roof While the Window of Opportunity is Open: Three Priorities for the Global Economy

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Good afternoon—ńgh ōn!

I would like to thank the Asia Global Institute and the University of Hong Kong for welcoming me back to this great city.

Like others, I am always struck by Hong Kong SAR's unique flavor. Think of the incredible ingenuity and energy of its people. And think of their ability not just to *adapt* to change, but to actively *shape* their future.

Hong Kong's transformation—from manufacturing powerhouse, to global trade engine, to world-class financial center—reflects its unique commitment to **openness**, to combining home-grown talent with fresh ideas and expertise from across the world.

Of course, greater economic openness increases one's sensitivity to shifting trends.

Hong Kongers are keenly aware that economic history never moves in a straight line but in cycles. And they know that when the economy is moving—up or down—policymakers cannot afford to stand still.

This is also the story of our global economy.

The world is currently experiencing a strong **upswing** that holds the promise of higher incomes and living standards. Delivering on this promise is critical, not just here in Asia but around the world.

I have been calling on *all* governments to use the current growth momentum for much-needed policy actions and reforms, especially in labor markets and service sectors.

In other words, fix the roof while the sun is still shining.

These reforms are often politically difficult, but they are more effective and easier to implement when economies are moving *up*, not *down*.

Some governments have taken action, but more needs to be done.

The window of opportunity is open. Yet there is ***new urgency*** **because uncertainties have significantly increased**—from trade tensions, to rising financial and fiscal risks, to more uncertain geopolitics.

How can we sustain the current upswing in the face of these rising risks? And how can we foster long-term growth that benefits all?

These are the issues that Finance Ministers and Central Bank Governors will discuss next week at the IMF and World Bank's Spring Meetings.

And they are the issues that I would like to talk about today.

State of the Global Economy

The good news is that the economic picture is mostly bright—the sun is still shining.

We see global momentum—driven by stronger investment, a rebound in trade, and favorable financial conditions—which is encouraging companies and households to increase their spending.

That is why the IMF in January projected **3.9 percent** global growth for 2018 and 2019, and as you will see from our forecast next week, **we continue to be optimistic**.

Advanced economies are expected to grow above their medium-term potential this year and next. In **Europe**, for example, the upswing is now more widely spread across the region.

The **United States** is already at full employment, and growth will likely accelerate further due to expansionary fiscal policy.

Meanwhile, here in Asia the outlook remains bright—which is good for everyone, because this region contributes close to **two-thirds** of global growth.

Japan's economy continues to grow strongly, and Asian emerging markets—led by **China** and **India**—are driven by rising exports and higher domestic consumption.

Challenges remain in some other **emerging and developing countries**—including in **sub-Saharan Africa**—though commodity exporters are experiencing a modest upswing.

So yes, the current global picture is bright.

But we can see **darker clouds looming**.

The reality is that the momentum expected for 2018 and 2019 will **eventually slow**.

It will slow because of fading fiscal stimulus, including in the U.S. and China; and because of rising interest rates and tighter financial conditions as major central banks normalize monetary policy.

Add to this the issue of aging populations and weak productivity, and you have a **challenging medium-term** outlook, especially in the advanced world.

What can policymakers do? I see **three priorities** that can make a difference.

Three Priorities for the Global Economy

1. Steer Clear of Protectionism

First—governments need to **steer clear of protectionism** in *all its forms*.

History shows that import restrictions hurt everyone, especially poorer consumers.

Not only do they lead to more expensive products and more limited choices, but they also prevent trade from playing its essential role in boosting productivity and spreading new technologies.[1] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn1)

As a result, even protected industries eventually suffer as they become less dynamic than their foreign competitors.

And yet, discussions about trade restrictions are often bound up with the concept of trade deficits and surpluses. Some people argue that these imbalances indicate **unfair** trade practices.

Yes, there *are* unfair practices—which must be eliminated—and which *can* leave their mark on trade balances between two countries.

But in general, these bilateral imbalances are a snapshot of the division of labor across economies, including global value chains.

For example, a country that focuses on assembling smartphones will tend to have bilateral trade deficits with countries that produce the components, and surpluses with countries that buy the finished devices.

More importantly, unfair trade practices have little impact on a **country's overall trade deficit** with the rest of the world. That imbalance is driven by the fact that a country spends above its income.

The best way to address these macroeconomic imbalances is *not* to impose tariffs, but to use policies that affect the economy as a whole, such as fiscal tools or structural reforms.

The United States, for example, could help tackle excessive global imbalances by curbing gradually the dynamics of public spending and by increasing revenue—which would help reduce future fiscal deficits.

Germany, which is facing an aging population, could use its excess savings to boost its growth potential—including through investments in physical and digital infrastructure.

So, what can policymakers do about unfair practices?

Each country has a responsibility to *improve* the trade system by looking at its *own* practices and by committing to a level playing field where everyone follows the rules.

This includes better protecting intellectual property, and reducing the distortions of policies that favor state enterprises. It also means trading by the rules—the WTO rules that all 164 members agreed upon.

We can *all* do more—but we cannot do it alone.

Remember: the *multilateral* trade system has transformed our world over the past generation. It helped reduce by half the proportion of the global population living in extreme poverty.[2] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn2) It has reduced the cost of living, and has created millions of new jobs with higher wages.

But that system of rules and shared responsibility is now in danger of being torn apart. This would be an inexcusable, collective policy failure.

So let us redouble our efforts to *reduce* trade barriers and *resolve* disagreements without using exceptional measures.

Let us work together to build on forward-looking trade initiatives, including the recent agreement between Japan and the European Union, the new African Continental Free Trade Area, and the so-called TPP-11.

And let us also ensure that policies help those affected by dislocations, whether from trade or technological advances. Consider the benefits of scaling up investment in training and social safety nets—so that workers can upgrade their skills and transition to higher-quality jobs.

In all these efforts, we at the IMF are supporting our members through analysis and advice and by offering a platform for dialogue and cooperation.

This is what we were set up to do. Our experience over more than seven decades shows that when countries work together, global challenges become more manageable.

We need that spirit of cooperation to avoid protectionism—and to sustain the global upswing.

2. Guard against Fiscal and Financial Risk

We also need to **guard against fiscal and financial risks**. This is my second priority.

Here, numbers tell the story.

New IMF analysis[3] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn3) shows that, after a decade of easy financial conditions, global debt—both public and private—has reached an **all-time high of $164 trillion**.

Compared to its 2007 level, this debt is now **40 percent** higher, with China alone accounting for just over 40 percent of that increase.

A major driver of this buildup is the **private sector**, which makes up **two thirds** of the total debt level. But that is not the whole story.

Public debt in advanced economies is at levels[4] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn4) not seen since the Second World War. And if recent trends continue, many **low-income** countries will face unsustainable debt burdens.

High debt in low-income countries could jeopardize development goals as governments spend *more* on debt service and *less* on infrastructure, health, and education.

The bottom line is that high debt burdens have left governments, companies, and households **more vulnerable** to a sudden tightening of financial conditions. This potential shift could prompt market corrections, debt sustainability concerns, and capital flow reversals in emerging markets.

So, we must use the current window of opportunity to prepare for the challenges ahead.

This is about creating more room to act when the next downturn inevitably comes—or as the economists like to say, it is about "building **policy buffers**."

What does that mean specifically?

For many economies, it means reducing government deficits, strengthening fiscal frameworks, and placing public debt on a gradual downward path. This should be done in a *growth-friendly* way through more efficient spending and progressive taxation.

It also calls for more exchange rate flexibility to cope with volatile capital flows, especially in emerging and developing countries.

These efforts help reduce the severity and duration of recessions.

For example, a recent study[5] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn5) shows that the decline in output after a financial crisis is less than 1 percent in a country with adequate fiscal and monetary buffers, but almost **10 percent** in a country with no buffers.

So, using macroeconomic tools is critical. But it is not enough.

Strengthening *financial* stability by increasing buffers in **corporate and banking sectors** is key, especially in large emerging markets such as China and India.

This means reducing corporate debt and bolstering bank capital and liquidity where needed. It also means implementing policies to address booming housing markets, including here in Hong Kong.

New IMF analysis[6] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn6) shows that housing markets in major cities across the world are increasingly moving in tandem—which could amplify the financial and macroeconomic shocks coming from any one country.

That is why we need **global buffers** as well.

For one thing, we must keep our financial systems safe by avoiding a rollback of the regulatory framework put in place since the global financial crisis to boost capital and liquidity buffers.

And the international regulatory framework needs to keep pace with the rapidly evolving fintech landscape to head off new risks while harnessing the potential.

Most importantly, we want a **strong global financial safety net**. Here the IMF plays a central role in helping countries to better cope with capital flow volatility in times of distress.

Together these policy actions will help sustain the current upswing.

But it is also essential to foster longer-term growth that is more **sustainable** and more **widely shared**. That is my third priority.

3. Foster Long-term Growth that Benefits Everyone

Fostering stronger and more inclusive growth is a key challenge.

If, as projected, *advanced economies* return to disappointing medium-term growth, this would worsen economic inequality, debt concerns, and political polarization.

At the same time, more than **40** *emerging and developing countries* are projected to grow *more slowly* in per capita terms than advanced economies.

This means slower improvements in living standards and a widening income gap between those countries and the advanced world.

As I said earlier, the window of opportunity is open. But to boost productivity and potential growth, countries need to step up economic reforms and policy actions.

Let me touch on two potential game-changers:

(i) First, unlock the potential of the service sector, especially in developing economies.

In moving from an *agriculture*-based to a *service*-based economy, many of these countries are bypassing a traditional industrialization phase.

This raises concerns that countries could get stuck at lower-productivity levels, with little chance of catching up to advanced economy incomes.

Our **latest research[7]** (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn7) shows, however, that some service sectors—led by transportation, communications, and business services—can match the productivity levels of manufacturing.

This is critical for countries such as the Philippines, Colombia, and Ghana where employment and output are shifting from agricultural production to higher-value services.

It is also important for the economic wellbeing of millions of women, who often account for the majority of service industry workers.

Unlocking this potential is not an easy task. It requires **more public investment in education, training, and job-search assistance**. It also means opening service sectors to **more competition**.

At the global level, there is work to be done as well. We need to *increase* trade in services, including e-commerce, by reducing barriers in this area—which are still extremely high.

(ii) The second potential game-changer is the digital transformation of government.[8] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn8)

When it comes to cutting-edge technologies and systems, public sectors can lead the way—and we are seeing great examples here in Asia:

- In India, citizens receive subsidies and welfare payments directly into their bank accounts, which are linked to unique biometric identifiers.
- In Australia, tax authorities collect information on wages in real time, which gives them immediate insight into the state of the economy.
- And here in Hong Kong, bank customers will soon be able to use their mobile phone numbers and email addresses to transfer money or make retail purchases, thanks to a new, government-funded payment system.[9] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn9)

These initiatives are just the beginning. Governments across the world are now also looking at ways of generating efficiency gains.

For example, one recent study[10] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn10) estimates that almost **20 percent** of public revenues worldwide, or about **$5 trillion**, go missing each year, because of tax noncompliance and misdirected government payments.

By using new tools—such as big data analysis—governments can *reduce* these leakages, which are often directly related to corruption and tax evasion. Reducing leakages would enable countries to *increase* priority spending.

The bottom line is that digital government can deliver public services more efficiently and more effectively, and help improve people's lives.[11] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn11)

Think about it: more households in **developing countries** now have access to digital technology—such as the internet and smartphones—than have access to clean water and secondary education.[12] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftn12)

What huge potential for digital interaction! But also, what a reminder that we need to leverage technology effectively to make broader development progress.

Conclusion

Let me conclude. **This generation of policymakers is facing a stark choice**:

They can simply copy the policies of the past, which have delivered mixed results—raising living standards substantially, but leaving too many behind.

Or they can paint a **new economic landscape**—where open trade is fairer and more collaborative; where financial systems are safer and more supportive of economic growth; and where the digital revolution benefits not just the fortunate few but *all* people.

As the great artist Henri Matisse once said: "*Creativity takes courage*."

We certainly need more courage—in the halls of government, in company conference rooms, and in our hearts and minds.

Thank you.

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[1] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref1) April 2018 World Economic Outlook, Chapter 4.

[2] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref2) From 1990-2010. World Bank figures: World Development Indicators.

[3] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref3) April 2018 Fiscal Monitor, Chapter 1; global debt of $164 trillion in 2016.

[4] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref4) In advanced economies, public debt as a proportion of GDP was at 105 percent on average in 2017.

[5] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref5) Romer, C. D., and D. H. Romer. 2018. "Phillips Lecture—Why Some Times Are Different: Macroeconomic Policy and the Aftermath of Financial Crises." *Economica* 85 (337): 1–40.

[6] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref6) April 2018 Global Financial Stability Report, Chapter 3.

[7] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref7) April 2018 World Economic Outlook, Chapter 3.

[8] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref8) April 2018 Fiscal Monitor, Chapter 2.

[9] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref9) The Hong Kong Monetary Authority is creating a so-called Faster Payment System, to be launched in

September 2018.

[10] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref10) McKinsey research (https://www.mckinsey.com/industries/public-sector/our-insights/the-trillion-dollar-prize-plugging-government-revenue-leaks-with-advanced-analytics).

[11] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref11) Gupta, Sanjeev, Michael Keen, Alpa Shah, and Geneviève Verdier, *Digital Revolutions in Public Finance*, International Monetary Fund, 2017.

[12] (file:///C:/Users/PWang/OTmp/FINAL_MD_Curtain_Raiser_Speech_Hong_Kong.docx#_ftnref12) World Bank data.

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