International Commentary — April 17, 2023

World Bank and IMF 2023 Spring Meetings Takeaways

Summary

Wells Fargo International Economics attended and participated in the 2023 Spring Meetings of the World Bank and International Monetary Fund to discuss global economic trends and themes. In this report, we summarize our key takeaways and highlight themes we discussed over the course of the week. These conversations focused on the health of the global economy, the direction of monetary policy as well as the possibility of additional sovereign debt defaults across the developing and emerging markets.

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World Bank and IMF 2023 Spring Meetings Themes and Takeaways

Global economic conditions have stabilized. Conversations lead us to believe consensus among the public and private sector is that global economic conditions have tentatively stabilized. A common theme was resilient activity in Europe and the United States, with strong consumer spending the key driver of this resilience. China's growth prospects are robust and contributing to positive global economic momentum; however, most argued the post-COVID rebound has fully matured. We agree global growth will be led by China this year, although we do not believe China's recovery has matured yet. Our counterargument centered around still rising domestic mobility, the property sector showing signs of recovery, and authorities' commitment to monetary and fiscal policy support. We note that our China GDP forecast (5.5%) is above consensus (5.3%) as well as above the IMF's latest forecast (5.2%).

Risks to the global economic outlook are heavily tilted to the downside. Official communications from the IMF as well as other conversations reinforce risks to the global economic outlook are significantly tilted towards slower growth. Banking sector challenges—particularly in the United States, not so much Europe—were cited as the primary rationale for a potential renewed downturn in global economic prospects. Most agreed that banking sector issues will likely push the U.S. economy into recession this year; however, those still forecasting a “soft landing” conceded that recession is now more likely amid a possible tightening of credit conditions and lending standards. We did not come across anyone from either the public or private sector that felt another Global Financial Crisis was imminent, although most noted the full extent of banking sector issues may not be known at this time.

Higher for longer. Few believed the Fed would ease monetary policy this year. While downside risks to growth are now present, our sense is that most believed inflation is still the Fed's priority and conditions will likely not be met to lower interest rates this year. This sentiment extended to most central banks. Conversations with the Bank of Canada suggested policymakers may have a high bar to start cutting rates in 2023. In the emerging markets, IMF economists noted that select central banks may have space to ease monetary policy, but should exercise caution when considering policy rate cuts. Based on conversations with Brazilian Central Bank and Chilean Central Bank policymakers, we believe both institutions will cut rates this year, but easing will be measured. Our forecast calls for 50 bps of Fed and Bank of Canada rate cuts in Q4-2023, a more dovish view than consensus. We remain vigilant in our forecast for less Brazilian Central Bank easing relative to consensus, and our discussions reinforced our view that the Chilean Central Bank will not deliver on the easing currently priced by markets.

Additional emerging market sovereign debt defaults are likely. Many of our conversations focused on this theme, and private sector colleagues expressed worry additional sovereign debt defaults would materialize. IMF officials shared these concerns, and indicated 60% of low-income developing countries (LIDC's) are either in debt distress or at high-risk of imminent debt distress, up from an average of 39% from 2009-2019 and 55% in 2020. LIDC's in Sub-Saharan Africa make up the majority of countries in debt distress, although the consensus was there is little risk of contagion and Fed monetary policy normalization efforts would not be disrupted. We also joined investor discussions focused on larger emerging market sovereigns at risk of default. Egypt and Pakistan were top of mind from an investor perspective, though with contrasting views on how systemic an Egypt or Pakistan default would be to broader emerging markets. All agreed Egypt would be more significant, and questioned authorities willingness to implement reforms to receive Fund and regional financial support. In Latin America, concerns around Argentina completing its IMF program were shared, and consensus view was that Argentina would struggle to avoid another sovereign default.

Evolving creditor composition will continue to delay sovereign debt restructuring efforts. By creditor composition, most public and private sector colleagues referred to China, and China's unwillingness to effectively participate in sovereign debt restructure efforts. The IMF's G20 Common Framework for debt restructuring has been largely unsuccessful, and most noted China's reluctance to participate in debt restructuring attempts as the primary, but not only, reason why the Common Framework has been ineffective. China is a majority holder of sovereign debt for countries across Africa, which makes China vital to any debt restructuring attempt. Sovereign debt advisory analysts highlighted the uncertainty of what China wants in return for debt restructuring, which should delay processes further. Opinions range from China wanting higher coupon rates to more influence/control over the process, possibly its own parallel architecture to negotiate with creditor nations.

Reshoring away from China is happening. Tariffs, geopolitical fragmentation, and supply chain diversification are driving reshoring back to the U.S. and regional economies. The U.S. can benefit; however, Mexico can be the primary beneficiary. Conversations with Mexican government officials suggested companies are engaging in nearshoring, although limited existing infrastructure is a challenge to these efforts. Nearshoring will need to take place in Southern Mexico due to geographical constraints in Northern Mexico, although completing manufacturing capabilities could take up to 10 years. All agreed diversifying away from China is a once-in-a-generation opportunity for Mexico, although most expressed concern over whether Mexico can capture this upside. Nearshoring is not evident in FDI data just yet, but according to government officials we spoke with, should be more apparent in the future as well as in labor market data and local demand for raw materials.

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