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Optimism After the G-20

By Andrew Balls

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There are normally good reasons to be skeptical about grand communiqués that governments put out following international economic meetings. Words are rarely matched with deeds. The ink is not dry on the paper before the back-pedaling begins. The main points of agreement can be on who else to blame.

However, there may be cause to be a little more optimistic on the recent output from the Group of 20 finance ministers and central bankers.

First, the right countries were represented at the meeting. There is plenty of scope for debating the precise lineup but, in contrast to the G-7, the systemically important emerging market economies are part of the group and thus part of the pledge. “We designated the G-20 to be the premier forum for our international economic cooperation,” the statement said. It is long overdue recognition of the reality of global growth and capital flows.

Second, the elements of the plan, if carried out, can credibly be expected to improve the quality of global growth compared with the uneven and unsustainable experience that culminated in the financial crisis and global recession. “We need to shift from public to private sources of demand, establish a pattern of growth across countries that is more sustainable and balanced, and reduce development imbalances,” the statement says. This will involve taking steps that might be sub-optimal from an economic standpoint (or plain politically unpopular) if taken in isolation but where there is true promise of mutual gains if taken collectively. That is the point of international policy coordination.

Third, there is a consultation and monitoring element that may in principle mean that countries make an effort to align their policies with their pledges. It is hard to see how there could ever be a system of enforcement. (The members of the Eurozone struggle with that and they share a currency.) Even so, the G-20 process as laid out will provide the forum for peer review with technical support from the International Monetary Fund at the regional and global level. The prospect of naming and shaming may have some impact but hopefully the collective responsibility embedded in the compact will be stronger.

It is encouraging that the focus is on maintaining interventions to promote a sustainable recovery and on credible frameworks for repairing public sector balance sheets in the medium term. Both are required: ongoing support and the avoidance of premature policy tightening at a time when big question marks over the sources of sustainable demand growth remain, and a credible plan for the restoration of sustainable fiscal balances over the cycle to avoid a loss of market confidence in the countries with the biggest increases in public sector borrowing.

In addition to contributing to coordination in the eventual exit from extraordinary policy measures – with ongoing focus on spillover effects across borders and

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currencies – the medium-term challenge lies in managing the adjustment away from global reliance on the U.S. consumer and U.S. reliance on global savings. This adjustment is inevitable over time but can happen at higher or lower levels of overall global economic growth depending on the success of countries in promoting domestic-led growth elsewhere. And in more or less orderly fashion.

You do not have to be a skeptic to point out that there was no mention of currencies in the G-20 communiqué and to highlight this as a glaring omission in the overall plan. For the G-20 to be credible as the premier forum for international coordination, that will have to change – in words, perhaps, but more importantly in deeds.

While there are policy challenges and costs of adjustment on all sides, it is clear that this adjustment will be aided by a U.S. dollar depreciation against Asian emerging market currencies and that adjustment toward domestic-led growth in those countries will be aided by currency appreciation. Ongoing appreciation of currencies that have borne the brunt of the dollar's decline in recent years, notably the euro, will do little to promote more balanced global growth.

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Mr. Balls is a managing director in the London office, a member of the Investment Committee and head of European portfolio management. (He leads PIMCO's European investment team, which is based in London and Munich, and manages European and global portfolios.) Mr. Balls was previously a global portfolio manager in Newport Beach and the firm's global strategist. Prior to joining PIMCO in 2006, he spent eight years at the Financial Times, most recently as editor of the U.S. Lex column and as chief economics correspondent in Washington, D.C. He has 11 years of investment and financial market experience and holds a bachelor's degree from Oxford and a master's degree from Harvard University. He was a lecturer in economics at Keble College, Oxford.

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