

Economic Analysis

G20 | Hangzhou to put on a harmonious façade

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Leaders of the G20 will be meeting in Hangzhou on Sept 4-5 to discuss how to move “towards an innovative, invigorated, inter-connected and inclusive world economy”. The idyllic setting of this year’s G20 Summit should be conducive to cooperation. However, we expect a tepid outcome which looks good on paper but does not translate into actionable policies.

China’s agenda reflected by this year’s theme

On the *innovation* front, an encouraging development is the fact that bilateral talks between U.S. President Barack Obama and Chinese President Xi Jinping could result in the ratification of the Paris Climate Agreement by both parties. China will also push efforts for more coordination in global macroeconomic policy formulation. In particular, an *invigorated* global economy requires fiscal stimulus to iron out cyclical fluctuations that may hamper long-term growth. This is a theme that China already endorsed heavily at the G20 Finance Ministers Meeting in Shanghai earlier in the year, and will feature prominently again at the G20.

But perhaps the theme that warrants the most interest is that of *inter-connectivity*. Investment agreements could take the entire spotlight following from the collapse of the Doha Round on trade liberalization. China will use this as an opportunity to showcase progress with its flagship “One Belt, One Road” (OBOR) initiative. While OBOR is still in its infancy, the institutional framework is already in place, and it is by no means irrelevant. These include the AIIB (\$100B), BRICS Bank (\$100B), Silk Road Fund (\$40B), China-Latam Fund (\$10B) and China-Africa Fund (\$5B). The Summit would also be a good platform to revisit issues related to the World Bank’s voting reform, with support from other emerging nations under the G20.

This brings us to the point on *inclusiveness*. For the longest time, China has fought for a more equitable international financial system. We expect SDR inclusion to feature as part of the talks. The RMB will form part of the IMF’s SDR basket starting from October (Figure 1), and it is expected that the move will lead to \$42B of reserve assets being rebalanced into RMB. In fact, on August 31 the World Bank sold bonds backed by SDRs valued at around \$700M, a tip o’ the hat to RMB internationalization ahead of the G20 (Figure 2).

Things that won’t happen at the G20 Summit

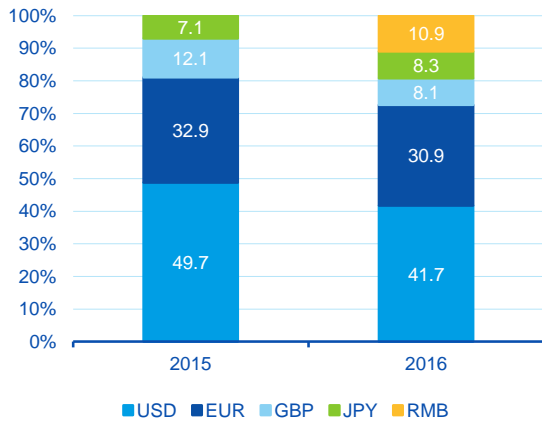
The outcomes of the Summit may prove ephemeral. Fiscal stimulus has been met with resistance at previous meetings, as developed and developing economies have little room to increase spending. Japan was the latest economy to announce fiscal expansion, but with new direct spending accounting for less than 1% of GDP in 2016, it won’t be meaningful enough to boost demand.

More importantly, advocating painful structural reforms seems contradictory given that China is not willing to compromise on its nominal growth target for 2020. Furthermore, while pressure has abated as of late, the world is still afflicted by the negative externalities associated with China’s PPI deflation. G20 leaders won’t agree to reforms unless China does more to address its own looming overcapacity concerns. This is especially true in the cases of coal and steel – hence the lack of progress on trade talks.

A final point on geopolitics and why the communiqué won’t disappoint

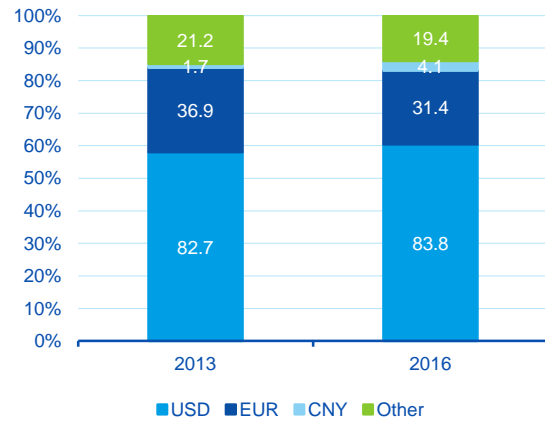
China will avoid addressing prickly issues related to its handling of territorial claims in the South China Sea. This means that the focus of the discussions will remain keenly on economic issues. At a superficial level at least, the communiqué should result in a series of outcomes that look good on paper. But strategic misalignments, particularly on the fiscal and structural fronts, will prevent these from translating into actionable policies.

Figure 1
Inclusion of RMB into the SDR basket...



Source: IMF and BBVA Research

Figure 2
... should boost share of RMB in global FX market



Source: BIS and BBVA Research

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