T.RowePrice®
INVEST WITH CONFIDENCE

NEXT STOP FISCAL STIMULUS?

AUGUST 2016

Nikolaj Schmidt
Chief International Economist, T. Rowe Price

Without doubt, the policy space for the global central banks is shrinking. Interest rates can probably be cut further and asset purchases can be increased, but increasingly negative side effects will frustrate the stimulatory impact of further monetary easing. In part prompted by electoral promises, hopes are rising that fiscal authorities will pick up the baton. In my view, however, there is unlikely to be major fiscal support to growth unless there is a precipitous slowdown.

There are two main reasons for this. First, over the past 18 months fiscal policies have already turned from being a meaningful headwind to growth into a small tailwind. The most recent addition to this trend was the Japanese government's decision to postpone its planned sales tax increase to 2019. Second, policy initiatives during the global financial crisis have left most economies with very limited fiscal space. Confronted with an outlook of rising social expenditures from retiring baby boomers, many governments have decided to take a conservative approach to fiscal policy. As U.S. economists Carmen Reinhart and Kenneth Rogoff have shown, when debt levels are high, fiscal authorities tend to focus on debt reduction rather than growth support. In Japan, the government aims to raise the primary balance to zero by 2020. This requires additional fiscal tightening, not expansion.

Clearly, in tandem with disappointing growth outcomes, the commitment to the fiscal consolidation is likely to soften (as already exemplified by the delay in the sales tax increase). In Europe, the European Commission is still demanding plans for fiscal consolidation from the economies that are under the excessive deficit procedure. Granted, Spain and Portugal, despite continued violation of their fiscal targets, have been excused from financial fines. However, this has more to do with the need to support both countries through potentially turbulent election periods than an endorsement of their budget overruns; Spain and Portugal are still required to reduce their fiscal deficits.

The likelihood of a more supportive fiscal stance is greater in the U.S., where both major presidential candidates advocate an increase in spending. Realistically, however, the timing of this spending increase is likely to be 2018, and any proposal to increase spending will probably see significant reductions as it is pushed through a split Congress.

Overall, fiscal policy remains a marginal tailwind but is unlikely to turn into a material boost for growth.

FOR INVESTMENT PROFESSIONALS ONLY. NOT FOR FURTHER DISTRIBUTION.

Important Information

This material, including any statements, information, data and content contained within it and any materials, information, images, links, graphics or recording provided in conjunction with this material are being furnished by T. Rowe Price for general informational purposes only. The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price. The material does not constitute a distribution, an offer, an invitation, recommendation or solicitation to sell or buy any securities in any jurisdiction. The material has not been reviewed by any regulatory authority in any jurisdiction. The material does not constitute advice of any nature and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The views contained herein are as ofAugust 2016 and may have changed since that time.

Australia—Issued in Australia by T. Rowe Price International Ltd. (ABN 84 104 852 191), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. T. Rowe Price International Ltd. is exempt from the requirement to hold an Australian financial services licence in respect of the financial services it provides in Australia. T. Rowe Price International Ltd. is authorised and regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. For Wholesale Clients only.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA—Issued in the European Economic Area by T. Rowe Price International Ltd., 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Japan—Issued in Japan by T. Rowe Price International Ltd., Tokyo Branch (KLFB Registration No. 445 (Financial Instruments Service Provider), JIAA Membership No. 011-01162), located at GranTokyo South Tower 7F, 9-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-6607. This material is intended for use by Professional Investors only and may not be disseminated without the prior approval of T. Rowe Price International Ltd., Tokyo Branch.

Singapore—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH ("TRPSWISS"), Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

T. ROWE PRICE, INVEST WITH CONFIDENCE and the Bighorn Sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc. in the United States, European Union, and other countries. This material is intended for use only in select countries.