Markets up, but financial crisis far from over

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The stabilization of currency markets and the rise in share market values over the past month have generated a new mood of optimism among officials of the major global financial institutions. But the expressions of confidence are in marked contrast to the increased signs of world recession.

Speaking in Melbourne, where he addressed a meeting on the restructuring of the global financial system, International Monetary Fund deputy managing director Stanley Fischer said the worst of the Asian crisis was over. Economies would start growing again from early next year, he said. Following the Russian crisis in late September there had been an air of 'doom and gloom' over the world economy, but with the interest rate cuts in the United States and Europe and the expenditure cuts initiated by the Brazil government there was now less pessimism. World Bank president James Wolfensohn echoed Fischer's assessment. He said the Asian economies had 'turned the corner'.

However, these optimistic forecasts have been contradicted by statistics from Singapore which show that the island economy has entered its first recession since the mid-1980s and that it could contract by as much as 1 percent next year. Announcing the figures, the Ministry of Trade and Industry said that business expectations for the next six months remained weak. The problems of the Asian region were 'likely to take a protracted period to work themselves out'.

While the IMF officials are trying to put the best gloss on the situation, there is some recognition in the world financial press that none of the deep-rooted problems that produced the turmoil in September and early October have been resolved.

The British magazine *The Economist* described the statement issued earlier this month by the G7 powers, on strengthening 'the financial architecture for the global market place of the next millennium', as 'transparent hype'.

'The statement,' it declared, 'was not a list of actions but yet another version of the agenda for ponderous deliberation that governments have been wheeling out since the peso crisis of 1995, if not before. A central theme in this endlessly recirculated list of talking-points ... is the need for greater disclosure and 'transparency'. A transparent rendering of this statement would read, in full, as follows: 'We still haven't quite worked out what to do."

Under the headline 'From Panic to Euphoria,' the US magazine *BusinessWeek* raised concerns in an editorial published this week that the rapid rise in share values on Wall Street--the Dow Jones has risen by 17 percent in the last month--could be the prelude to another crash. 'There is plenty of information to show that the soaring equity market is swinging away from fundamental realities,' it declared. 'The truth is that enormous uncertainties in the global economy remain unresolved. The calm that appears to have settled over the credit markets may actually turn out to be the eye of yet another storm. No one knows.'

What was known, the editorial continued, was:

* 'a deflationary recession still grips 40 percent of the world's economy';
* while the depression-like fall of gross domestic product in Korea and Thailand may have bottomed out, neither country had recovered;
* Brazil was 'set to plunge into recession';
* Japan remained in recession;
* Chinese regional investment trusts are going bankrupt with 'billions in hidden foreign debt they may default on';
* and Russia was 'heading down the path of hyperinflation'.

The editorial warned that with profit rates now falling, the stock market was 'levitating on analysts' hot air', and 'earnings estimates on Wall Street could turn out to be as sound as advice from psychic hotlines'.

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The London-based *Financial Times* has published similar, although less colourfully worded, warnings. In an editorial on November 7 it pointed out that while the upturn in the markets was similar to the aftermath of the 1987 crash, when financial authorities also pursued expansionary policies, there were 'important differences, notably in the deflationary environment that now prevails'.

'It is striking that business confidence in the developed world is eroding very rapidly and that the cold wind now extends beyond those companies directly exposed to Asia--to the likes, even, of retailers Marks and Spencer,' the editorial stated.

Further signs of deflation

Evidence of the deflationary global tendencies can be seen in some of the major corporate announcements of the past weeks. The Dutch-based Philips group, Europe's largest consumer electronics group, announced plans to close around one-third of its factories worldwide over the next four years in a bid to lift profits, saying that it had 'built too big a production capacity for requirements'.

The Philips' announcement was quickly followed by a decision of Siemens, Germany's largest engineering and electronics group, to sell off all its businesses involved in loss-making semiconductor activities. The restructuring, one of the biggest in German corporate history, involves firms worth $10.3 billion and employing 60,000 workers.

The Siemens move to hive off semiconductor operations is the result of a worldwide depression in the prices of memory chips. World prices for dynamic random access memory (D-Ram) devices fell 60 percent in the year to the end of September, following a 75 percent price fall in 1997 and an 45 percent fall in 1996.

While the signs of recession in Europe and the US are growing, the Japanese economy shows no signs of an upturn. Indeed conditions appear to be worsening. This month steel makers have warned of falling profits and outright losses because of falling demand in both the auto and construction industry.

Warning of a 13 percent drop, Nippon Steel said that despite the stimulus flowing from the government's stimulus package, the business environment would 'remain grim' because 'the prospects for the world economy remain unclear'. Kobe Steel, which forecast a 26 yen billion ($200 million) loss, said the business environment was becoming 'increasingly difficult' and that in addition to the Asian slump 'it is feared the economies of the United States and Europe are slowing down'.

And in a sign of the contraction in the auto industry, Mitsubishi, Japan's fourth largest carmaker, said it would make another loss this year. It will lay off 1,000 workers in the United States and close two domestic truck plants.

On top of the worsening figures from the manufacturing industry, unprecedented events in Japanese financial markets point to further turbulence. With the bank discount rate already at 0.25 percent it had been thought that Japanese interest rates could not go much lower. But last week major US and European banks operating in Japan began to impose negative interest rates on yen deposits. This signified that the depositors were sufficiently concerned about the state of the Japanese banking system to incur a financial penalty for placing their funds in non-Japanese banks.

Commenting on this situation, one London banker quoted by the *Financial Times* said: 'The fact that people are willing to accept negative interest rates in yen is an alarming reflection on the state of the Japanese economy.' And not only on the Japanese economy--the second largest in the world. It is a clear indication that the crisis which gripped world financial markets in September is far from being played out.

See Also:
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