Concerns in G7 over "imbalances" in world economy

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Concerns that the growing US balance of trade deficit and consequent international indebtedness could spark a financial crisis at some point were behind the demands voiced at the G7 finance ministers meeting held last weekend that Japan take action to boost its economic growth rate.

In a joint communiqué issued in Tokyo after the summit the G7 ministers and central bankers said that while there were good prospects for non-inflationary expansion there was also a need to secure “a more balanced pattern” in the world economy.

This is a reference to the continuing stagnation of the Japanese economy, which US officials say is partly responsible for the rising American trade gap. The communiqué noted that while US economic growth remained strong, and there were signs of increased growth in Europe, in Japan “a sustained recovery remains to be established.”

Leading the criticism of Japan was the US Treasury Secretary Lawrence Summers who told Japanese Prime Minister Obuchi a growth rate higher than the official 1 percent target had to be aimed at and the administration had to be more aggressive in the deregulation of the Japanese economy.

“A willingness to accept as adequate growth in the 1 percent range is to establish a pattern in which global growth may not be fully balanced,” he said. “It is to run the risk that, if there are fluctuations, growth would again be negative.”

But there are definite limits on the actions of the Japanese government. Continued efforts over the past decade to stimulate the economy by expanding government spending have meant that the budget deficit is running at around 10 percent of gross domestic product. Japan's gross public debt is now estimated to be around 128 percent of GDP, up from 69 percent in 1990, making it the most indebted government of the major capitalist countries.

While the official G7 communiqué expressed confidence in the prospects for economic growth and low inflation, there were indications that concern is growing over how long the boom in the US economy can continue.

Bundesbank president Ernst Welteke noted that since the warning by US Federal Reserve chairman Alan Greenspan about “irrational exuberance” in December 1996, the stock market had risen by 70 percent.

Japan's Finance Minister Kiichi Miyazawa said the market had ignored the warning and that he had told Greenspan that the current rise in the market was a bubble. Speaking on a Japanese TV chat show, the Finance Minister was even more forthcoming. He said that Greenspan was concerned that the flood of imports into the US was not sustainable. Wealth was being generated not through the production of goods and services but through the rise of the stock market.

“At this point what is troubling Mr Greenspan is that the money is going into imports, and this may be good for the people of the world but for the American economy it cannot continue for long,” he said.

While US officials maintain that the current account deficit can be handled in the short term, there are concerns that it must eventually be wound back. Those concerns would have been heightened by the latest trade, which showed that the trade deficit for November widened to a record $26.5 billion, up almost $1 billion from October, and considerably greater than market expectations.

The US is now running a trade gap of more than $300 billion a year—larger in terms of its percentage of gross domestic product than at any time in history. So far, the trade gap has not provoked a fall in the dollar because of the inflow of foreign capital into financial markets. As markets rise and increased spending is generated through the so-called “wealth effect” of rising stocks, imports increase and the trade gap widens still further, creating the need for a further capital inflow. But there is growing recognition that this “virtuous financial circle” cannot continue indefinitely.

A report in the latest issue of the British magazine *The Economist* notes that over the past five years American households and firms have increased their indebtedness to a record 132 percent of GDP. While much of this borrowing is being used to finance investment in hi-tech equipment a considerable portion is being used to finance share buy-backs by major companies—a procedure aimed at maintaining stock prices. During the last two years, the article notes, non-financial corporations increased their debts by $900 billion while retiring $400 billion worth of equity.

The Economist also pointed to the growing dependence of the US on foreign investors, pointing out that it is even more vulnerable than Japan to a debt crisis.

“America is already the world biggest foreign debtor, with net foreign liabilities of $1.5 trillion, around 20 percent of GDP. As a credit-fuelled spending binge has sucked in more imports, America's current account deficit has widened to about 4 percent of GDP. If it remained at this level, America's net foreign debt would rise to more than 50 percent of GDP within 10 years.

“This leaves the American economy dependent on foreigners' willingness to hold more and more dollar-denominated assets. But there is surely a limit to this. If foreigners' appetite for dollars dries up, the currency will fall. America would then need to offer progressively higher interest rates to convince foreigners to put a growing share of their wealth into dollar securities. Higher interest rates, and hence lower share prices, would be a blow to American debtors.”

Apart from concerns about the international position of the US dollar, there is also evidence that the much-vaunted profitability of US corporations may rest on increasingly unstable foundations. Gains from venture capital investments and stock portfolios form a significant part of increased bank profits reported over the past week.

The most graphic example was Chase Manhattan. Some 44 percent of its fourth quarter earnings came from its private equity arm, while the bank's entire corporate lending operations contributed just 8 percent to the overall result.

Microsoft reported that of its $640 million increase in profits for the year $436 million was generated by equity investments and only $204 million from operating income. America Online reported a quarterly net profit of $271 million, but $111 million of this came from an increase in the value of its investment in the Internet company Sandpiper Network. What this points to is that not only is consumer spending being fuelled by the rise in the market, but company profits as well.