Group of Seven meeting calls a "ceasefire" but interest rate "war" not over

Nick Beams
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If you cannot resolve a major difference, then try to pretend, at least in public, that it does not exist. That seems to have been the decision of Group of Seven finance ministers as they met in Washington last weekend.

After 10 days of escalating conflicts over the refusal of the European Central Bank (ECB) to cut official interest rates in line with the US and Japan, the G7 ministers simply by-passed the issue in their communiqué on the talks.

The communiqué endorsed US monetary policy—the 2 percentage point cut in rates by the Federal Reserve Board so far this year—and included the now almost standard call for reform of the Japanese economy, but said nothing about monetary policy in Europe.

And, in order to try to put the best face on a bad situation, it contained a remarkably upbeat assessment of the world economy. While the International Monetary Fund had cut its estimate for world growth by a full percentage point, and indicated that there were significant “downside” risks, the G7 statement claimed that although growth had slowed, the foundations for economic expansion were “sound” and the prospects for “improving the world standard of living ... compelling.”

But the differences, which saw US treasury secretary Paul O'Neill declare he was “mystified” by European attitudes and the IMF chief economist, Michael Mussa, state that Europe had to be “part of the solution and not part of the problem”, have not gone away.

The *Financial Times* noted that the “Atlantic proved too broad to bridge” and the G7 meeting ended with a “civilised disagreement on how to deal with the slowdown of the global economy.”

How long civility will last is another question, for as the *FT* also pointed out, while a “ceasefire” had been declared, in order not to reveal the divisions among the world's major economic powers, “the war is far from over.”

The main target of the attacks, ECB president Wim Duisenberg, added to the confusion when he said the G7 communiqué included the statement: “We understand different countries will approach these policies in different ways. We respect these differences and it is not our intent to give directions to each other.”

Duisenberg said that was a statement he “very much appreciated.” But in fact it did not appear in the final communiqué. Apparently, it had been circulated at the drafting stage but then withdrawn.

The G7 ministers were assisted in their efforts to cover over policy differences by figures published on the eve of the meeting showing that the US economy had grown at an annual rate of 2 percent in the first quarter, twice as fast as most predictions.

US treasury secretary Paul O'Neill said the figure was “nothing but good news” and that it showed the economy was “wonderfully resilient.”

But elsewhere there was caution over the meaning of the figures. IMF executive director Horst Kohler warned it was too soon to say the world economy was out of danger. “We are not in a very nice world, even with the first-quarter growth figures,” he said.

And in an editorial entitled “Hold the champagne” the *Financial Times* said there was something about figures which “does not quite ring true.”

“What is happening in the US does not feel like a temporary phenomenon. Profitability is falling. Job losses have not been confined to the technology sector but have recently spread to the likes of Procter & Gamble, the consumer goods company, and 3M, the conglomerate. Business and consumer confidence are still falling at a rapid rate. Could the US recovery still falter?"

While the first quarter was a pleasant surprise the second quarter could be "grimmer."

"And it is easy to forget that over its 10-year expansion, the US has built up an internal imbalance—a huge excess of investment over savings—of which the counterpart is an enormous current account deficit. Advocates of the short, sharp slowdown theory have to explain what will happen to these. An orderly adjustment is feasible but the IMF this week repeated its concern about the possibility of a disorderly correction, possibly involving disruptive shifts in world currencies."

Even as the G7 ministers were meeting, new figures were being released which showed the continuing downturn in the global economy. The German government has revised its growth forecast for the year from 2.75 percent to about 2 percent.

Figures from Japan indicate a slide into recession. Industrial production fell by 2.1 percent in March, double the expected figure. In the first quarter of this year production fell by 3.7 percent, the first decline for seven quarters. Further evidence of deflationary pressures was seen in consumer prices which fell by 0.8 percent in March, the 20th consecutive month of declines.

While the US economy has not yet slipped into recession, the sharp decline in its growth rate—from almost 5 percent to just 2 percent—is already having a marked impact on the global economy. In the latter half of the 1990s high growth rates in the US provided markets for the economies of East Asia in the aftermath of the financial crisis of 1997-98. But in February imports into the US fell by 4.4 percent.

Under the impact of a contracting US market, the IMF estimates that growth in the South-East Asian economies of Indonesia, Thailand, Malaysia and the Philippines will slow from a combined rate of 5 percent to 3.4 percent this year.

The slowdown in the richer economies of Korea, Taiwan, Singapore and Hong Kong will be even more marked. The collective decline for this group is expected to be from 8.2 percent last year to 3.8 percent this year.

This contraction, in turn, has implications for the US economy and the other major industrialised nations.

In the early 1990s, when the major capitalist countries were experiencing slower growth, the expansion of the East Asian economies—the so-called "Asian miracle"—provided an important buffer for the world economy by providing export markets. According to the US magazine *BusinessWeek*: "As their growth accelerated, their trade deficit with the industrialised nations soared from $6.1 billion in 1990 to more than $100 billion in 1993 and $138 billion in 1995."

It has been estimated that in the first half of the 1990s, expansion of the East Asian economies provided as much as one third of the increase in world economic growth. But having become completely dependent on an expanding US market in the aftermath of the "Asian financial crisis," these countries are in no position to repeat that role. On the contrary, a continued downturn in the US threatens to drag them towards recession as well.