OECD cuts growth forecast

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7 May 2001

Like the International Monetary Fund, the Organisation for Economic Co-operation and Development (OECD), which encompasses the 30 richest capitalist nations, has sharply revised down its predictions for economic growth from the forecast of six months ago.

Growth in OECD region is predicted to be only 2 percent this year, half the rate achieved last year, while "the long-running reduction in area-wide unemployment is projected to come to an end."

Just six months ago, the OECD was predicting a growth rate for the US economy of 3.5 percent. Now the forecast has been halved to 1.7 percent. Last November, the OECD was warning that interest rates in both the US and Europe might have to be increased. But in its latest report it endorses the cuts undertaken by the US Federal Reserve Board and calls on the European Central Bank to reduce rates by half a percentage point as a precaution against slower growth in the US.

While its central projection is "relatively optimistic"—a recovery should take place next year—the OECD does caution that "the risks to the outlook are clearly on the downside." And a reading of its *Economic Outlook* makes clear that serious problems for the world economy could result if things do not turn out as hoped for.

Noting that a "significant stock market correction" has taken place in the US, it warns that if "prices were to decline substantially further", either as a result of a more severe than expected decline in earnings or simply because of "overshooting", aggregate demand in the US economy would be "hit harder."

Such a development, it continues, might seem more of a risk in the US than elsewhere but "it could spill over to other regions through share price declines, or, more generally, through a deterioration in confidence."

The two main risks to the OECD region, and consequently to the world economy as a whole, are centred in the US and Japan. In the US the main danger is that "rising household indebtedness and debt servicing obligations may prompt consumer retrenchment"—that is, the credit-based spending increases of the past five years come to an end—while in Japan key problems are in the banking sector and its "abundance of bad loans."

Overall, it warns, "business investment could be weaker to the extent that the recent investment boom has created excess capacity or that debt levels have become high."

The OECD says that while the reduction in US economic activity was anticipated, the "pace at which it occurred has exceeded most expectations" and if "downward momentum in the economy persists, larger reduction in interest rates may be required."

Since the report was issued this warning has been underscored by the latest US unemployment figures which showed a sharp increase in the jobless level to 4.5 percent.

The most serious problem area for the world economy, at least in the view of the OECD, continues to be Japan.

"The Japanese economy," it states, "is faltering and at the risk of entering a downward spiral. Last year's pick-up in activity has faded, with the achievement of self-sustaining growth forestalled by the inadequate pace of corporate restructuring and the renewed build-up of financial sector problems. Weakening external demand is now exacerbating the situation."

With the budget deficit of the Japanese government now running at around 10 percent of gross domestic product and the total public debt around 130 percent of GDP, the OECD report points out that "the scope for traditional macroeconomic policies to provide additional stimulus is rather limited."

The present level of "fiscal stimulus" should be

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maintained, at least for this year, but the “start of consolidation”—that is, public debt reduction—“cannot be delayed much longer.” With interest rates already at or close to zero, the scope for monetary policy is also limited.

Accordingly the report goes on to state that policy in Japan should be directed to tackling the “underlying structural problems”—the removal of bad loans from the banking and financial system. Such a program, however, would bring an escalation of bankruptcies in Japan and a sharp rise in unemployment.

Without going into details, the OECD does acknowledge that such “restructuring” would bring “further costs in the near term” but holds out the hope that “improvements in confidence could partly offset negative effects.” Not surprisingly, however, it fails to spell out how an agenda of increased corporate and financial bankruptcies and rising unemployment could supposedly bring about increased “confidence”.

Moreover, restructuring of the Japanese financial system, which is one of the central demands of international financial bodies, is very much a two-edged sword. If the liquidation of bad loans were to go ahead, this would mean that banks and financial institutions would to be forced to officially recognise the erosion of their asset and capital base that has taken place.

Such a readjustment could lead them in turn to withdraw funds invested elsewhere in the world. It is estimated, for example, that some 10 percent of all US government securities are held in Japanese hands. If this money were pulled out to repair bank balance sheets at home, it could tip the US from slower growth into outright recession.

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