OECD slashes growth forecast

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The Organisation for Economic Co-operation and Development, comprising the world's 30 largest economies, has added its voice to the predictions of a far-reaching global economic slowdown. In a preliminary report on the world economy, leaked last week, the OECD warned that growth for this year would be just 1 percent and only 1.2 percent in 2002. The predictions, which are not expected to change significantly when the OECD releases its final draft on November 2, contrast markedly with the figures of 2 percent growth for 2001 and 2.8 percent next year contained in the previous forecast published last May.

Just a year ago, the OECD was saying that "world economic prospects remain relatively bright." Then it said the US economy would be growing at a rate of 3.3 percent. Today, it is on the edge of recession.

As the *Financial Times* noted in an editorial last Saturday: "The message, broadly, is that we can say goodbye to the hopes of an early recovery in 2002. This had remained the orthodoxy until early summer, although the date of the turn was being increasingly postponed."

The editorial went on to point out that, even before the events of September 11, it is now clear the United States "was moving fairly quickly towards recession." "In the early part of the year many thought—and fervently hoped—that the US slowdown was mainly caused by a reduction of stocks and slowing investment that would soon be corrected. That hope now looks forlorn. For despite the steep reduction in official interest rates, businesses are reluctant to borrow even for their scaled-back investment plans."

The world economy was always going to suffer a reverse with the ending of the US financial boom, but the slowdown has been compounded by the contraction in other major regions.

German finance minister Hans Eichel warned last Thursday that growth would be just 0.75 percent this year, compared with a prediction of 2 percent in April and the 2.75 percent forecast at the start of the year. For 2002, Eichel said he expected a growth of "between 1 percent and 1.5 percent" compared with the government's earlier prediction of 2.25 percent.

Even these forecasts may have to be revised downwards, however, if the indications from Germany's leading measure of business confidence are anything to go by. The Ifo index dropped to 85 last month from a level of 89.5 in August, reaching its lowest point since 1993, and recording the largest single monthly fall since the world economic crisis of 1973. The fall was much larger than had been expected, giving rise to warnings that Germany, and possibly the whole eurozone, was entering a recession—two consecutive quarters of negative economic growth.

The extent of the German contraction is indicated by the fact that the country's machine tools industry, normally one of the last to be affected, is facing a decline of 2 percent next year. Only a year ago the industry was worried about the shortage of skilled workers to meet increased demand.

The building industry will be one of the hardest hit. Orders are expected to fall by 10 percent—double the previously forecast contraction—leading to a further drop in construction employment of 100,000.

One building industry official told the *Financial Times*: "The fall will take employment in construction below 1 million for the first time since Germany rose from the ashes of the Second World War. We can't release any figures for 2002, but we're expecting a clear further decline."

The head of Germany's employers' federation, Dieter Hundt, said he was "deeply worried" about the economy. The DGB trade union federation called for an economic stimulus package and for the European Central Bank to lower interest rates in order to prevent the economy entering a "deep recession." German unemployment is expected to rise to more than 3.9 million in 2002, well above a government target of 3.5 million.

The bad news from Germany has been compounded by the admission from the Japanese government that the economy is destined to contract in the financial year to April 2002. With most economists predicting a decline of at least 1 percent, the finance minister Masajuro Shiokawa set out the government's revised position last week. "I have tried my best to avoid negative growth but, given global conditions, it seems likely that the Japanese economy will contract," he said.

While Japan enters its fourth recession in 10 years, and Europe heads for severely reduced, if not negative growth, the key to the global economic outlook remains the situation in the US. Here the latest figures show a continuing downturn.

Last week, the US Federal Reserve reported that output from US industry declined for the 12th consecutive month in September, making it the longest continuous decline since October 1945. Output fell 1 percent in September, following a 0.7 percent decline in August. This was higher than had been forecast, with double digit percentage falls in the production of home electronics, clothing, computers, textiles, paper, metals, cars and trucks.

The severity of the decline is underscored by the fact that it has taken place amidst one of the most intense periods of interest rate cuts in post-war financial history—with nine reductions by the Fed since the start of the year.

The failure of the US and global economy to respond has brought calls for additional action. According to the *Financial Times*: "For policymakers, it is clear that a further stimulus will be needed, certainly in Europe, and probably also in the US. For investors, the message is sobering. Despite the big stimulus now in the pipeline, the adjustment will be longer and more painful than was generally expected." And even when "normal growth" did resume it would be far less than the recent past.

Others are warning that the action taken so far falls well short of what is needed. US economist James K. Galbraith said that the strikes on the World Trade Center were not merely a shock to a healthy system, "requiring only limited measures to restore confidence and stimulate spending.

"Household finances have been badly out of balance since 1997, as the household sector financed consumption above income by borrowing, largely against capital gains. But capital gains turned negative after April 2000. Once that happened, large cuts in consumer spending could be delayed but not avoided, absent major policy changes. What has happened since September 11 consolidates, advances in time, and also intensifies a decline that was already well under way."

According to Galbraith, there is "no chance that events will right themselves in a few weeks, or that we will be saved by such underlying factors as technology and productivity growth—as chairman Greenspan professes to believe—or by lower interest rates or the provisions of the recent tax act. Rather, we are in for an economic crisis; the sooner this is recognised and acted upon, the better."

Galbraith proposed an initial stimulus program up to three times as large as the spending measures so far announced. There was no danger, he wrote, of overdoing fiscal policy. On the contrary "the danger, at the moment, is collapse."