

World economy like a “house of cards”

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27 September 2002

The International Monetary Fund meeting to be held in Washington over the weekend takes place amid what is arguably developing into the most serious crisis of the global capitalist economy in the post-war era. It is not just that growth rates have been revised down, following claims of a recovery earlier this year. There is also a growing sense that a series of financial and economic problems are coming together.

The growth figures in themselves are bad enough. According to the IMF's *World Economic Report*, world growth for 2002 is projected at just 2.8 percent, barely above the 2.5 percent level considered by many economists to be bordering on recession. Moreover, the growth estimate for 2003 has been marked down to 3.7 percent, compared to the 4 percent that was predicted last April.

Summing up the report, the Reuters correspondent said it had painted “a picture of a global economy stacked precariously like a house of cards, waiting for a hit from just one more morsel of economic misery to bring on a global recession”.

Even more significant than the overall outlook are the growth predictions for the major capitalist economies. US growth is predicted to be 2.2 percent for 2002 and 2.6 percent next year, compared to the prediction five months ago of 3.4 percent.

For the euro zone the growth rate prediction for this year is just 0.9 percent and 2.3 percent next year, with no marked increase likely in the near future. According to IMF economic director Kenneth Rogoff: “The main short-term concern in Europe is that domestic demand is extremely weak and insufficient to fuel the recovery.”

The Japanese economy is in an even worse state. Growth for this year is projected to be minus 0.5 percent, rising to 1.1 percent next year. Having passed through a decade of stagnation, there is no guarantee, according to Rogoff, against a similar bad decade in the

absence of a determined effort to “address the nation's core economic problems, the need for profound bank and corporate restructuring, together with decisive steps to finally end a period of deflation unprecedented among industrialised countries since World War II.”

But Rogoff's remarks could well be seen simply as a case of “rounding up the usual suspects” for no one, either in the IMF or the Japanese government, has a viable plan for resolving the country's worsening economic problems.

Indeed, if the events of the past two weeks are anything to go by the situation is becoming more desperate. Ten days ago the Bank of Japan (BoJ) announced that it intended to buy shares from major banks in order to try to sustain their asset base. This proposal—unprecedented in the history of central banking—was widely criticised as dangerous. Now it appears that it may have been a ploy to pressure the Japanese government to intervene itself—a desperate attempt by the BoJ for someone to take seriously its warnings of the need for decisive restructuring of the banking and financial system.

From the standpoint of the stability of the world economy as a whole, it is hard to know which of the two alternatives is the more serious—the BoJ share bailout plan, or the fact that it feels the need to resort to “shock therapy” proposals to force the government's hand.

The problems confronting the world economy go beyond the low levels of growth and Japanese deflation—serious as they are in themselves.

The Japanese financial disaster was regarded as the exception. But it may turn out to be the rule, for there is a growing fear that the continued slide in world stock markets and the heavy involvement of banks and other financial institutions with companies that have incurred heavy losses—especially in the telecommunications and high-tech industries—could lead to a major financial

crisis.

In an editorial published on September 26, entitled “The bear starts to show its teeth”, the *Financial Times* pointed out that two significant rallies in the stock market—the first in the immediate aftermath of September 11 last year and the second in the late (northern) summer—have proved to be “false dawns”.

The editorial pointed out that the longer the bear market continued the more serious became its consequences for the workings of the economy and the financial system. One of the greatest problems concerned life insurance companies that gave guarantees to investors based on what were believed to be conservative assumptions about equity returns but which may not be met if markets keep falling. “It will be a disaster for everyone,” the editorial concluded, “if the insurance sector produces its own Barings or Long-Term Capital Management.”

Across the Atlantic, the *Wall Street Journal* has also been warning of the flow-on effects for US banks from the losses incurred in European telecom companies. Following an announcement by J.P. Morgan Chase that it would need \$1.4 billion to cover “soured loans”, an article in the WSJ noted that because of the practice of syndication, in which banks sell their loans to other banks and big investors in order to spread the risk, the problems could extend across the financial sector.

“[W]hile syndication has helped shield individual banks from trouble, it also means when problems arise, they quickly cascade across the balance sheets of other banks. What frustrates investors now is that no one knows for sure all of the loans that tripped up J.P. Morgan—and which other banks could be left holding the bag.”

The worsening situation is starting to create policy dilemmas for those in charge of regulating the economy.

This week the US Federal Reserve decided to leave the federal funds rate stationary even while it pointed to “considerable uncertainty” as to the extent and timing of the “expected pickup in production and employment” and while warning that risks were “weighted mainly towards conditions that may generate weakness”.

In something of a departure from the norm, the decision was not unanimous, with two members of the Federal Open Market Committee calling for an interest

rate cut.

While the deliberations have not been made public, one can surmise that one consideration was that with a base rate of only 1.75 percent, a further cut would not leave much in reserve in the event that a major cut is needed if even more serious problems emerge.

No doubt the IMF meeting will try to put the best face on a worsening situation and issue a reassuring communiqué, even as the problems are discussed behind closed doors. But no policy decisions will be put on the table to halt the gathering crisis.

As the *Financial Times* commentator Gerard Baker pointed out, labelling the IMF meeting as a “gathering of incompetents,” it was a “delusion” to believe that “the people gathering in Washington have the inclination, let alone the ability, to control global economic activity”.

An editorial published in the *Guardian* warned that “the world economy is looking increasingly vulnerable to something really nasty happening”. America could move back into recession at any time, Japan was still locked into an asset price deflation “that is showing no signs of ending and which the government has no policy to deal with” while the Europe Union was “in no mood to help out by unilaterally stimulating growth”.

In the face of this situation, the only policy it could come up with was a European interest rate cut. But the deepening problems of the world economy—to which the editorial itself pointed—have gone well beyond anything that could be resolved by so-called fine tuning.



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