# World growth increasing but imbalances getting worse

**Nick Beams**
**23 September 2003**

The International Monetary Fund has maintained the forecast it made in April that world economic growth will increase by 3.2 percent this year and by 4.1 percent in 2004. The estimates were contained in its World Economic Outlook published last week at the commencement of the annual IMF/World Bank meetings being held in Dubai.

Releasing the report, chief economist Kenneth Rogoff said that "for the first time in a very long time" the IMF was "reasonably optimistic about a return to normal growth in the global economy or better." But the report itself and comments by Rogoff at a press conference point to the fact that far from returning to "normal" the world economy is characterised by significant imbalances.

In his prepared remarks, Rogoff emphasised that growth would not be "balanced." In the US and "emerging Asia" the question was how long the rebound could be sustained while "Europe is struggling to turn the corner." Japan's situation, while improving "remains clouded."

Rogoff said that while there had been an increase in Japanese growth of late "it would be premature ... to declare that Japan is out of the woods." Trade with China and "emerging Asia" had helped growth but "underlying problems with corporate and bank balance sheets, a soaring government debt, and entrenched deflationary expectations are all still major roadblocks" to sustained growth.

As far as Europe was concerned, the only positive news was elsewhere and "most Europeans who want to see an economic recovery will have to watch it on TV." Germany, Italy, and the Netherlands have all been in recession for the first half of the year, the gross domestic product (GDP) for the euro area declined in the second quarter of this year while "weak consumer confidence and fragile corporate balance sheets are leading problems."

The problems of the European economy were underscored in the body of the report. "For the third year in succession," it noted, "the German economy has stayed in a feeble state, contributing to the below average performance of the whole euro zone and threatening the prospects of a recovery."

Among the risks to the global economy, Rogoff pointed to the "disturbing pattern of global current account imbalances, which is likely to get worse before it gets better, with the United States continuing to absorb a large share of world savings, and Asia providing much of it."

As a result of its balance of payments deficit, currently running at around $500 billion, equivalent to about 5 percent of gross domestic product, the US needs an inflow of this amount from the rest of the world. During the finance bubble of the late 1990s, the prospect of higher rates of return in the American market was the chief factor in sustaining this inflow. But now the foreign investment in American equities has to a great extent dried up and much of the inflow comes from Asian central banks buying up US Treasury Notes and other government-backed debt in order to prevent a revaluation of their currencies against the greenback and thereby preserve their competitive edge in world markets.

According to the *Economist* Asian institutions now have around $1.66 trillion in foreign-exchange reserves, most of them in dollar assets. China is estimated to hold about $290 billion in US government debt, while Japanese monetary authorities spent $78 billion between January and August this year buying up US dollars in order to prevent the value of the yen increasing.

Asked about the effect of financial imbalances on the prospects of recovery for the global economy, Rogoff said they could have an impact over the next two to four years.

"It is a very serious problem overhanging the global economy. It is probably getting worse with the unbalanced recovery." At some point the US current account deficit, which the IMF does not see falling to below 4 percent of GDP until at least 2008, has to "unwind" and "when it does there will be a sharp drop in the dollar."

Answering a question on whether there might be a "whiff" of a financial bubble in the economic upturn, Rogoff returned to the question of global imbalances making it clear that the IMF views the growth of indebtedness as "one of the central risks in the global economy."

One of the concerns about the growth of the US current account deficit, he said, was that the "big borrowing" by the US from the rest of the world was no longer being used to finance high investment that would lead to increased growth in the future. In the aftermath of the bursting of the equity bubble, the current account deficit had come to represent dissaving, with the government and the private sector borrowing heavily from the rest of the world.

Some of these issues were also addressed in a comment by Columbia University economics professor Joseph Stiglitz published in the *Guardian* of September 17. Stiglitz pointed out that the growing financial imbalances in the US economy—both the balance of payments deficit and the increasing budget deficits being run up by the Bush administration—had to be of concern to the rest of the world.

If America continued to absorb vast amounts of the world's pool of savings this would eventually lead to a shortage of funds resulting in increased interest rates and reductions in investment and growth. There was also the danger that the US trade deficit could lead to global instability if investors changed their portfolio mix and moved away from US assets.

At the same time, he warned, the Bush administration, searching for others to blame, could turn to protectionism, even as it preached the virtues of free markets.

"Equally worrying—for America and the rest of the world—is the path on which it has embarked: deficits as far as the eye can see. In the long run, this policy bodes ill for the US and hence for the world."