IMF cuts US growth forecast, warns of global slump

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The International Monetary Fund's biennial World Economic Outlook report, issued Wednesday, forecasts a US recession that will drag the global economy down with it.

The report, issued in advance of this weekend's spring meetings in Washington of the IMF and World Bank, together with a conference of the Group of Seven industrialized nations' finance ministers, paints a far more dire picture of the state of the world economy than those put forward by government and central bank officials in the US and Europe.

It states that financial problems which erupted last August in the US subprime mortgage market "spread quickly and unpredictably" and caused "extensive damage." It describes the resulting financial crisis as the biggest since the Great Depression.

The IMF predicts that the US economy will grow by only 0.5 percent in 2008, a reduction of 1 percent from its previous US growth projection, made in January, and estimates the US economy will not recover in 2009, growing by only 0.6 percent.

Translated into fourth-quarter-to-fourth-quarter terms, the IMF projects that the US economy will contract by 0.7 percent this year and grow by only 1.6 percent in 2009. This stands in stark contrast to US growth projections by the US Federal Reserve Board, which predicts that US growth with recover in the second half of this year and rise to 2.5 percent to 3.0 percent in 2009.

The report sees a 25 percent chance that world economic growth could fall below 3 percent this year and next, which it says is "equivalent to a global recession."

"Economic growth has nearly stalled," said Simon Johnson, the IMF's chief economist, at a Washington press conference.

In its report, the IMF trims its projection for growth in the eurozone countries from 1.6 percent to 1.4 percent this year, and predicts a further slowdown to 1.2 percent in 2009.

Japan is expected to grow 1.4 percent this year, down from its 2007 pace of 2.1 percent, and see only a 1.5 percent growth next year.

China's growth projection is slashed 0.7 percentage point to 9.3 percent for 2008, and India is expected to grow 7.9 percent, down from an earlier forecast of 8.4 percent.

The IMF projects overall global growth for 2008 at 3.7 percent, down from an earlier estimate of 4.2 percent, and lower by 1.3 percentage points from the 5 percent global growth rate in 2007.

In a separate Global Financial Stability Report, the IMF states that world banks and financial institutions face potential losses of nearly $1 trillion as a result of the bursting of the US housing and credit bubbles. The report says that banks will suffer more than half of the estimated $945 billion losses, with the rest hitting insurance companies, pension funds and other investment firms.

Jaime Caruana, the head of monetary affairs and capital markets at the IMF, said, "The deterioration in credit has moved up and across the entire spectrum." Alluding to the epidemic of speculation on borrowed funds that led to the crisis, he said there had been a "collective failure to appreciate the extent of leverage in the financial system."

Acknowledging the potentially catastrophic implications of the credit collapse, Malcolm Knight, the general manager of the Bank for International Settlements, often referred to as the central bankers' central bank, told the *Wall Street Journal* that the current turmoil is "probably the most serious financial turbulence in the advanced countries since the Second World War."

Dominque Strauss-Kahn, the IMF managing director, told a press conference on Thursday that the current financial turmoil posed the greatest financial crisis since the 1930s, and called for coordinated intervention by governments around the world. He echoed a call made last week by the Institute of International Finance, an association representing big banks, which said there was a "growing case" for government intervention.

Strauss-Kahn directly broached the issue of direct government bailouts of the banks with public funds, saying, "With respect to the banks, if capital buffers cannot be repaired quickly enough by the private sector, use of public money can be examined."

He dismissed assertions that the credit crisis could be largely restricted to the US, saying, "The crisis is global. The so-called decoupling theory is totally misleading," He added that so-called developing countries such as China and India would be affected.

The US has already moved in the direction of using taxpayer

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money to bail out the banks and investment houses. Last month, the Federal Reserve Board engineered the rescue of the investment bank Bear Stearns, guaranteeing $29 billion of its failing mortgage-backed assets as part of a takeover of the bankrupt investment house by JPMorgan Chase.

At the same time, the Fed opened up its discount window to provide loans to other investment banks, the first time such a measure had been taken since the banking collapse of the 1930s. In effect, the Fed signaled that it would step in to prevent the failure of any major banking firm, with the cost to be paid ultimately by US taxpayers.

Since last August, the Fed had pumped $300 billion into the US banking system. According to an April 11 article on the *Wall Street Journal* web site, the Fed is currently considering contingency plans for expanding its ability to lend money to the banks. These include direct infusions of public funds onto the Fed's balance sheet from the US Treasury.

These emergency measures have not, however, resolved the underlying crisis of solvency in the financial system, and inter-bank loan rates remain extraordinarily high as banks demand premiums to lend to their counterparts, while their ability to extend credit is reduced by the massive losses they incur from bad bets on subprime mortgage-backed securities and other high-risk investments.

At the same time, the hundreds of billions of cash pumped into the US financial system by the Fed further undermines the value of the US dollar, which hit new lows this week against the euro and the Chinese currency. The cash infusions and dollar crisis, in turn, fuel rampant inflation in commodity prices. This week, oil futures hit a new high of $112 per barrel.

The Fed's unprecedented measures have provoked dissent from some within the financial elite who fear an uncontrolled eruption of inflation and a full-scale crisis of the dollar. In an extraordinary speech delivered Tuesday before the Economic Club of New York, former Fed Chairman Paul Volcker chided current Fed Chairman Ben Bernanke for going to "the very edge" of the central bank's legal authority, and criticized bank executives and government regulators for creating "a demonstratively fragile financial system that has produced unimaginable wealth for some while repeatedly risking a cascading breakdown of the system as a whole."

He said the decision of the Fed to extend credit to investment firms should be followed by new rules to bring these institutions under the regulatory control of the US central bank, something Bernanke and the Bush administration have opposed.

Asked whether he still predicted a dollar crisis, Volcker said, "You don't have to predict it. We're in it."

The credit crunch is increasingly impacting the so-called "real economy," producing a spreading slowdown in economic activity, which, in turn, exacerbates the financial crisis.

Last week, the US Labor Department reported a net loss of 80,000 jobs in March, the third consecutive monthly job loss, bringing the total job loss for the three months to 232,000. The official unemployment rate jumped from 4.8 percent to 5.1 percent.

Minutes from the March 18 meeting of Fed policy makers, released this week, recorded the fears of "many participants" that "a protracted and severe economic downturn could not be ruled out."

The Financial Stability Forum, a body representing financial ministers and regulators from around the world, presented a report Friday to the Group of Seven financial ministers meeting calling for more disclosure and better risk management by financial institutions and a greater exchange of information between central bankers and regulators. It recommended requiring institutions to hold more capital and maintain larger cash reserves, but proposed no significant increase in government supervision of the banks.

The report is expected to be approved by the G7, but this is little more than window dressing meant to conceal sharp divisions among the member states. While the Fed has dramatically cut its target short-term interest rate since September, bringing it down from 5.25 percent to 2.25 percent, the European Central Bank has held its rate steady at 4 percent, and again this week refused to follow the Fed's lead and reduce the eurozone rate. The divergence in policy has intensified the dollar crisis, as speculators and investors shift their holdings from dollars to euros.

On Wednesday, the US responded to the IMF economic growth report by publicly disavowing its projections for the US economy as "unduly pessimistic." US Treasury spokesmen also rejected Strauss-Kahn's call for government intervention on a global level to deal with the financial crisis.

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