IMF update underlines speed of slide into global recession

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The International Monetary Fund (IMF) sharply revised its estimates for global growth downwards last Thursday, predicting a simultaneous recession in the US, Japan and major European economies for the first time since the institution was established in 1945. The IMF cut its previous projection of 3 percent for the world growth rate in 2009 to 2.2 percent, with an overall contraction in the advanced economies of 0.3 percent.

The new assessment is an update to the IMF's World Economic Outlook (WEO) issued just last month—a sign both of the speed with which the world economic crisis is unfolding and the inability of governments and global institutions to comprehend, let alone stop, the rapid slowdown. The IMF summed up the bleak outlook, stating: "Prospects for global growth have deteriorated over the past month, as financial sector deleveraging has continued and producer and consumer confidence have fallen."

The IMF stated in April that global growth of less than 3 percent was "equivalent to a global recession". Last week, however, IMF chief economist Olivier Blanchard played down the latest figures, saying that he did not view the 3 percent level as a "useful" definition. He urged coordinated international action, saying that if that happened, "the forecast we have may be on the pessimistic side."

There is no doubt that the rapidity of the economic slowdown and the intractability of the financial crisis have caught the IMF by surprise. Warnings that the global economy is either in recession, or is rapidly sliding into one, are now commonplace. A full-blown economic depression is also being quietly discussed. At a meeting of the World Economic Forum in Dubai, one senior monetary official told Reuters: "There is a real possibility of a real, deep, international depression." He described the crisis as "the worst in 100 years."

The IMF warned that all of the major economies would contract in 2009, commenting: "The US economy will suffer, as households respond to depreciating real assets and tightening financial conditions. Growth in the euro area will be hard hit by tightening financial conditions and falling confidence. In Japan, the support to growth from net exports is expected to decline."

The IMF estimated that the US economy would shrink by 0.3 percent, Japan by 0.2 percent and the UK by 1.3 percent. Across the euro zone, it foreshadowed negative growth of 0.7 percent with Germany contracting by 0.8 percent, France by 0.5 percent and Italy by 0.6 percent. The IMF's predictions were underscored by last week's interest rate cuts by the European Central Bank of 0.5 percent and by the Bank of England of a huge 1.5 percent.

One of the most significant indicators of the slide into recession is the slowing of world trade. The IMF update estimated that the growth in international trade volume in goods and services would fall from 7.2 percent in 2007 to 4.6 percent in 2008 and 2.1 percent in 2009. Imports by advanced economies were predicted to shrink in 2009 by 0.1 percent impacting heavily on cheap labour platforms that are reliant on exports.

While growth rates for emerging and developing economies are expected to remain positive, the IMF cut its overall 2009 estimate from 6.1 percent in its October report to 5.1 percent. "Among the most affected are commodity exporters, given that commodity price projections have been marked down sharply, and countries with acute external financing and liquidity problems," it warned.

The IMF was more positive in describing the economies in East Asia, including China, as "typically more robust". But its 2009 estimate of 8.5 percent for China is little more than an optimistic stab in the dark. Chinese manufacturing hubs are already confronting dramatic

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declines in overseas orders and a wave of factory closures and job losses.

China's growth rate has already dropped from 12.7 percent in the second quarter of 2007 to 9 percent in the third quarter of this year. According to last Friday's *New York Times*, "[A]nalysts are forecasting the worst growth in more than a decade, with the economy expected to expand as little as 5.8 percent in the fourth quarter this year." In a bid to arrest the slowdown, Beijing yesterday announced a massive $585 billion stimulus package over the next two years.

The IMF also expressed fears about the stability of the international financial system, despite the trillions of dollars allocated by US and European governments to rescue packages. In comments to the *Wall Street Journal*, IMF chief economist Blanchard warned there could still be additional "land mines" in either advanced or emerging economies. "So it's quite conceivable that we could see a flare-up of the financial crisis," he said.

The IMF update presented a gloomy picture of financial markets, pointing to the exceptionally high interest rate spreads that indicate a drying up of credit. "Markets have entered a vicious cycle of asset deleveraging, price declines and investor redemptions. Credit spreads spiked to distressed levels, and major equity indices dropped by about 25 percent in October," it stated.

The situation for so-called emerging economies was far worse, with the value of shares and currencies plunging as foreign investors pulled out of the markets. The IMF noted that the credit spreads for the sovereign debt of more than a third of countries in the benchmark EMBIG index were over 1,000 basis points. In other words, those countries pay a premium of 10 percent on any loans—if they are available at all.

Increasingly countries are being forced to queue up for emergency IMF loans. Last week the IMF formally approved bailout packages for Ukraine of $16.4 billion and Hungary of $15.7 billion. Iceland is due to follow with a $2.1 billion loan. The list of countries is rapidly growing, particularly in Eastern Europe which relied heavily on cheap foreign loans to finance everything from businesses to home loans.

Latvia has been the latest to indicate it may require IMF assistance. Premier Ivars Godmanis announced the half-nationalisation of Parex banka, the country's second largest bank, on Saturday in a bid to halt the flight of foreign investment. Swedish banks in particular are heavily exposed to debt in the Baltic countries, causing a recent IMF report to warn of a possible financial crisis in Sweden as well.

Serbia, Belarus and Pakistan have all been in talks with the IMF over emergency loans. The *International Herald Tribune* noted on Friday that Turkey, until recently regarded as a success story, might be forced to seek assistance. "Turkish corporations gorged on easy foreign debt," the article explained, leaving them saddled with debt obligations that far surpass their dollar assets. UBS estimates the mismatch to be $73 billion."

The IMF's $250 billion store of funds is rapidly depleting. Alongside around $50 billion already committed, the IMF announced last month that it had set aside $100 billion to provide lines of credit to some of the larger emerging countries such as South Korea and Brazil. Well aware that the IMF's resources are under strain, British Prime Minister Gordon Brown has appealed to China and Gulf states such as Saudi Arabia to increase their commitments.

The leaders of G-20 group of large economies are due to meet in Washington on Saturday to confront the global financial turmoil and economic downturn. Amid calls, particularly from Europe, for a new international financial architecture, IMF managing director Dominique Strauss-Kahn warned in the *Financial Times* last week: "Expectations should not be oversold... A lot of people are talking about a Bretton Woods 2. The words sound nice but we are not going to create a new international treaty."

The latest IMF report underlines the fact that those responsible for the world economy are yet to come to terms with the scope and intensity of the worst economic crisis since the Great Depression and are struggling to formulate any response. Recession invariably leads to companies and countries seeking to defend their own portion of a shrinking pie. Far from reaching a new agreement, the Washington summit is likely be dominated by bitter haggling as world leaders each seek to solve their own problems at the expense of their rivals.

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