

US jobs data underscore downbeat IMF assessment of world economy

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US job creation slowed markedly last month, underscoring a downbeat assessment of the world economy issued by International Monetary Fund managing director Christine Lagarde in the lead-up to the IMF-World Bank annual meeting to be held in Lima, Peru, next weekend.

The US Department of Labor reported that jobs growth in September was 142,000, well below the forecast increase of 201,000. This is some two-fifths below the average increase over the past 12 months. The August figure was also revised down from 173,000 to 136,000.

The impact of deepening global recessionary trends and falling commodity prices on the US economy were seen in the figures for the mining industry, which showed that it had shed 10,300 jobs. Manufacturing employment was also down by 9,000 for the month.

The figures are particularly significant because jobs growth in the US has been held up as a “bright spot” for the global economy. Speaking to the *Financial Times* Michael Feroli, an economist with JP Morgan pointed to the significance of the result for US economic growth. “We’ve already taken down our third-quarter GDP [gross domestic product] forecasts, but it raises some questions about the fourth quarter and whether growth momentum is weakening into year-end,” he said.

In a major speech earlier this week at the Council of the Americas, Lagarde issued what has become a virtually ritualist call in recent years for governments and policymakers to take action to help bring about global economic recovery, warning that the world is at a “difficult and complex conjuncture.”

She noted that projections by the IMF for global growth, to be issued next week, will predict slower growth this year than last, “with only a modest acceleration expected in 2016.” The last remark can be taken with a large grain of salt because for the past four years the IMF has had to revise down its earlier forecasts.

Lagarde pointed to two major transitions taking place in the global economy, both with immediate negative consequences—the move by China to a less investment-oriented economy, which is impacting on commodity prices, and the move by the US Federal Reserve to increase interest rates for the first time in a decade.

“The prospect of rising interest rates in the United States and

China’s slowdown are contributing to uncertainty and higher market volatility,” she said. “There has been a sharp deceleration in the growth of global trade. And the rapid drop in commodity prices is posing problems for resource-based economies.”

On previous occasions Lagarde has urged the Fed not to begin its move to normalisation of interest rates, at present near zero, lest this cause problems for emerging market economies. IMF figures show that in the past decade the corporate debt of non-financial companies in large emerging market economies has more than quadrupled, rising from \$4 trillion in 2004 to \$18 trillion in 2018.

“Rising US interest rates and a stronger dollar could reveal currency mismatch, leading to corporate default—and a vicious cycle between corporates, banks and sovereigns,” she warned. That is, default by a major corporation could embroil both a country’s banking system and ultimately its government.

Lagarde was referring to a situation where a rise in US interest rates leads to a further increase in the value of the US dollar, meaning that companies which have taken out dollar-denominated loans face an increasing real debt burden because of the fall in the value of the currencies of their respective countries. The numbers involved are not small.

According to the Institute of International Finance (IIF), a private organisation of banks and finance houses which gathers data on financial flows, currency depreciation has increased corporate debt in Brazil by an amount equivalent to 7.3 percent of gross domestic product and 6.2 percent in Turkey.

Lagarde said that “action is required now” by policymakers in managing the transition in the world economy and that “proactive policy management by everyone is now more important than ever.”

However an examination of her suggestions as to where such “proactive management” should occur makes clear why this latest appeal will produce no improvement any more than similar urgings in the past.

Lagarde called for the incorporation of “spillover risks” in any decision on monetary policy. This is directed to the US Fed to take account of the global impact of its decisions when deciding on an increase in interest rates. In fact, the Fed did precisely that when it kept interest rates on hold in September,

citing economic problems in China and global financial turbulence.

This decision led to increased financial turmoil because of fears of the impact of the China slowdown and that, because the Fed felt unable to increase rates by even 0.25 percent, its inaction pointed to a more serious financial situation than previously thought. The decision met with opposition from within the Fed itself and financial institutions.

On Europe, Lagarde said there was a need to tackle nonperforming loans in the euro area to boost credit to companies and households. Such calls, however, ignore the reasons why such actions have not been taken in the seven years since the eruption of the global financial crisis in 2008. A major factor has been the belief by European banks that if they actually address the level of nonperforming loans and bad debts on their books, then their financial position will be weakened and they will be placed in a worse position relative to powerful American banks. Hence they have sought to cover up their real position.

The third area of action had to be the use of “macroprudential tools” in emerging markets to address corporate leverage and foreign debt. This refers to increased regulation by banking and financial authorities to try to contain dangerous financial practices. Firstly, such measures are all but useless in the case of major financial movements and secondly any increased macroprudential regulation now is very much a case of closing the stable door after the horse has bolted.

The IIF has revealed that, according to its data, emerging markets (EMs) are already being impacted by a sea change and will be hit by an outflow of capital for the first time since the 1980s.

It said that combined with increased outflows from residents, net capital outflows would be \$540 billion this year, following an inflow of \$32 billion in 2014.

According to IIF chief economist Charles Collyns: “Flows to EMs have weakened sharply in volatile market conditions and a jump in risk aversion. We now project overall negative flows for the first time since the emerging market concept was ... devised in the late 1980s.”

Lagarde emphasized the need for “skillful and savvy” policymaking given the interconnected nature of many of the issues involved and that “increased international cooperation is more urgent and essential than ever before.”

Here too, the course of events is moving in the opposite direction. There was a degree of international collaboration in the first meetings of the G-20 group of nations following the financial crisis of 2008. Participants pledged not to allow the world economy to fall into a Depression like that of the 1930s, and to eschew the protectionist measures that characterized that decade. But that approach has largely gone by the board, as can be seen by the increased use of interest rate cuts and currency devaluations as each major economy seeks to improve its position in global markets.

These conflicts are certain to be intensified in the coming period as recessionary trends take a firmer grip. The world’s third largest economy, Japan, is on the brink of what is known as a technical recession—two consecutive quarters of negative growth—following a contraction at an annualized rate of 1.2 percent in the second quarter. The second largest, China, is slowing rapidly with the official purchasing managers index coming in at 49.8 for the month of September. A figure of below 50 indicates a contraction.

Another unofficial index published the same day showed Chinese manufacturing is facing its worst conditions since March 2009. Last month the Chinese government halved the sales tax on small cars in an effort to boost demand. But most industry observers doubted it would have much effect in the face of poor consumer sentiment and economic uncertainty.

The intended scenario is that as manufacturing and investment decline, China will transition to a more service-oriented economy. But there are considerable doubts over whether this can be realized. Financial services accounted for 20 percent of China’s growth in the first half of the year. However, following the stock market crisis in June and July that figure will not be repeated.

The contribution to GDP growth from other service sectors is falling. In the first half of the year wholesale, retail, and catering services accounted for 9 percent of GDP growth, compared to 14 percent the year before. An article in the *Financial Times* noted that with the contribution of financial services set to decline, “growth may come crashing back down in the third quarter.”

The discussion and deliberations at the IMF-World Bank meeting will do nothing to reverse the recessionary trends which increasingly are coming to dominate the world economy and which, as the jobs data show, are now having a significant impact on the US real economy.



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