IMF's reduced growth prediction could be too optimistic

By Nick Beams
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The International Monetary Fund has stuck by its pre-September 11 forecast of 2.6 percent growth for the world economy in 2001 in the hope that the economic stimulus delivered by central banks and governments in the wake of the terrorist attack will prevent a global recession.

But in delivering its latest *World Economic Outlook* report, IMF chief economist Kenneth Rogoff admitted that the forecast, itself a sharp reduction from the 3.7 percent growth prediction of last April, may not be met because of the fallout from the terrorist attack which was having "a negative effect on activity now in many regions of the globe."

Behind the scenes there are fears that growth could well drop below official predictions. While the IMF forecast for the US economy is 1.3 percent growth, Rogoff told a press briefing that a recession in the US was a "done deal". However, he then withdrew his remarks at the end of the news conference saying they reflected his "much greater experience at lecturing in my Harvard classroom than giving conferences of this sort."

The IMF also retained its forecast for 2002 but Rogoff conceded that "global growth is likely to be rather lower than the 3.5 percent presently projected" as the "downside risks" set out in the body of the fund's *World Economic Outlook* had increased.

Rogoff acknowledged that even before September 11 "macroeconomic developments over the past six months already pointed to weaker growth in just about every region of the globe, both this year and next, than we anticipated in April. Among other factors, this synchronised slowdown has reflected stronger than expected global linkages, which have been particularly evident in Europe; the continued weakness in the IT sector; the deteriorating situation in Japan; and worsening financing conditions for emerging markets."

In the body of its report, the IMF noted that "there is no major region providing support to global activity." "This has increased the vulnerability of the global economy to shocks and heightened the risk of a self-reinforcing downturn whose consequences could prove difficult to predict."

The IMF forecasts will probably be regarded as too optimistic by many private economic forecasters. In its latest assessment of the global economy, the investment firm Morgan Stanley Dean Witter (MSDW) revised its forecast downwards from 2.1 percent to 1.8 percent, well below the 2.5 percent considered to mark the onset of global recession.

According to MSDW chief economist Stephen Roach, before September 11 the firm's economists had already judged that the world economy was in a "synchronous recession." Now "the downturn looks considerably deeper and longer than we ever suspected."

Even with the lowered forecast, Roach wrote, the risks remained "largely on the downside" and "if the verdict ultimately falls at the lower end of our new risk range, it would qualify as the worst global recession of the post-World War II era—both deeper and longer than the contractions of the mid-1970s and early 1980s."

According to MSDW, Japan and the US are already in recession and Europe could soon enter one. For the industrial world as a whole the growth of gross domestic product is estimated to be about 1 percent, representing one third of the trend growth of around 3.1 percent since 1982.

The MSDW forecast does not hold out the prospect for a rapid rebound—the so-called V-shaped recovery being predicted in some quarters on the basis of the facile argument that because the downturn is more rapid, the upswing will be steeper as well. This is because the US economy is “still facing powerful structural headwinds—excess capacity, an overextended consumer, and a massive current account deficit.” Moreover, the underlying trend in productivity growth could fall short of that experienced in recent years.

Overall, according to this analysis, the effects of the September 11 shock will be deflationary rather than inflationary, with the global economy facing a deflationary shock “likely to be more serious than that which occurred in late 1998 in the depths of the Asian financial crisis.”

These assessments are echoed in other forecasts. In an analysis of Asia, the market advisory firm IMA said more than half the region’s markets have “little ability to counter a major external shock.” In Japan, it said, there was “no prospect of resilience in the corporate, finance and government sectors” in the short term. “The risk is that Japan moves from its position of having a much diminished positive influence on the region to having a strongly negative impact.”

According to Richard Jerram, the chief economist for ING Barings, the Japanese economy is likely to contract by almost 2 percent this year. “The recession is spreading from the manufacturing sector across the service sector, through the damage to labour demand and profits.”

The Economist Intelligence Unit has predicted that growth in the Asia-Pacific region will slow to 1.3 percent in 2001, a third of last year’s rate. The region is not only being hit by cuts in export markets in the US and Japan, but also by the slowdown in capital inflows.

Throughout this year, analysis of the US economy has shown that it has only been kept out of recession—defined as two consecutive quarters of negative growth—by continuing high levels of consumer spending. This set of circumstances seems to have come to an end.

The Conference Board, a New York-based research group, announced on Tuesday that its index of consumer confidence for September had fallen to 97.6—its lowest level since January 1996—from 114 in August. This was the biggest single monthly fall for 11 years. Since its level of 142.5 just one year ago the index has fallen by almost 40 percent.

Even before the terrorist attack there were indications that consumer spending would start to decline as layoffs increased and the stock market continued to fall. Household income and debt figures also point in the same direction.

The latest figures from the US Bureau of the Census show that in the year 2000—before the downturn had got underway—household incomes remained stagnant. Median household income was $42,148, marginally below the level for 1999. This stagnation reversed the trend of the preceding period when real household income rose by 2.8 percent in 1999, 3.6 percent in 1998 and 2.1 percent in 1997. Lower wages played a central role, with the earnings of full-time year-round workers falling by 1 percent for males and increasing by only 0.5 percent for females.

Increased consumer spending has been financed by debt, with the household debt burden growing from 87 percent of disposable income in 1990 to more than 100 percent in each of the last four quarters. Some of the debt growth is a reflection of the increases in the value of shareholdings. But this trend has now gone into reverse.

Since the second quarter of 2000, household net worth has fallen by 4.3 percent, much of the decline due to the fall in equity values. From their peak of $9.41 trillion in the first quarter of 2000, stocks held by individuals had fallen by $3.11 trillion—a decline of 33.1 percent—to the end of the first quarter of 2001. The latest slide in the market, which has seen the biggest point fall in a week since the Depression of the 1930s, will further cut household wealth, leading to reductions in spending and accelerating the recessionary trends in the US and globally.