Global Financial Crisis: Tensions at G-20, IMF Meetings. No Economic Recovery in Sight

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Last weekend's meetings of the International Monetary Fund and the G-20 saw further calls for policies to stimulate global economic growth. There were no concrete measures advanced to implement such a program, however, amid deepening divisions among the major powers.

While the discussions were not characterised by the air of crisis that accompanied some recent meetings, they were nonetheless dominated by the realisation that there is no economic recovery in sight and, instead, a deepening trend of stagnation and slump.

Fears of an immediate financial crisis had receded somewhat, but there were growing concerns that the policies of "quantitative easing" pursued by the major central banks could produce one in the near future.

The G-20 communiqué claimed that while progress had been made, "much more is needed to fulfil our commitment to address the ongoing weakness in the global economy."

However, the official words were a thin cover for deepening conflicts that erupted during the discussions. The *Financial Times* reported that there had been an "acrimonious standoff" between Germany and the US over the question of hard commitments to stabilise the level of public debt.

In a shot at the austerity agenda being implemented in Europe, US Treasury Secretary Jack Lew said "stronger demand in Europe is critical to global growth." The reference to "global growth" is a smokescreen. The Obama administration wants some easing of the austerity agenda in Europe in order to benefit American exports, while it continues to cut spending at home.

Similar self-serving positions were reflected in Lew's pronouncements on trade issues. In a criticism of Germany and Japan, he said countries with large trade surpluses had to make a greater effort. "Much more needs to be done to promote effective global rebalancing, which requires stronger demand in surplus countries and continued progress towards greater exchange rate flexibility."

In a counter-attack, German Finance Minister Wolfgang Schäuble directed his fire against the US and Japan over their high levels of government debt. "Fiscal and financial sector adjustments remain crucial to regain lost credibility and strengthen confidence. International cooperation remains crucial. At the current juncture, it is particularly the responsibility of the advanced economies, including Japan and the US, to follow through with ambitious fiscal consolidation over the medium term to reduce public debt ratios which in several cases have reached unsustainable levels," he said.

Delaying the necessary adjustments, Schäuble insisted, would "further aggravate the risks for the prospects of a lasting and fundamentally sound global recovery." He warned that "nobody should expect that Europe will deliver high growth rates in the coming years."

As is the case with the US, the German position is motivated by its national interests. The German government is resisting US demands for greater stimulus because it fears this will mean the commitment of more funds and that further increases in debt could adversely impact on German banks, to the benefit of their US competitors.

Schäuble was joined in his criticisms by Swedish Finance Minister Anders Borg. "The unsustainable fiscal situation in the US and Japan is a source of concern and uncertainty. Credible medium-term fiscal plans should be promptly developed," he said.

On the other side, Australian Treasurer Wayne Swan lined up behind the US position, condemning the policy of "mindless austerity" being carried out in Europe.

In its semi-annual report on the world economy, the IMF advanced a positive outlook. While pointing to a "bumpy" road ahead and warning of a "three speed recovery"—the US and some economies on the mend, others doing well, and others, principally in Europe, in trouble—the IMF claimed that "global economic prospects have improved again."

Nobody took much notice, however, because similar hopes have been raised at each of the spring meetings over the past several years, only to see the eruption of a new financial crisis or markedly slower than predicted growth by the end of the year.

The IMF forecast was already being declared outdated as it was delivered, with evidence of a worsening economic position in the US and slower than expected growth in China.

The divergences over so-called fiscal consolidation and debt reduction were also reflected in discussions on quantitative easing—the policy initiated by the US Federal Reserve—in which the major banks undertake purchases in bond markets to increase the supply of money. The policy featured prominently both in the public statements by central bankers and finance ministers and in their private discussions, because of the Bank of Japan's recent decision to double the country's money supply over the next two years in a bid to overcome deflation.

The G-20 communiqué sought to paper over the differences. It reiterated its position of last February that countries should seek to move to market-determined rates for their currencies, "refrain from competitive devaluation" and not target exchange rates for competitive purposes.

Whatever the stated public positions, the effect of quantitative easing is to push down the value of the targeted currency. This is seen most clearly in the case of the Japanese yen, which has fallen by more than 20 percent in recent months.

While the Japanese escaped official criticism—Finance Minister Taro Aso was eager to tell reporters that Japan had met with no objections at the meeting—there are growing criticisms.

South Korean Finance Minister Hyun Oh Seok said the falling yen was a "concern" and called for an orderly exit from the loose monetary policy regime.

Chinese central bank head Zhou Xiachuan, warned: "It is necessary to re-evaluate the marginal benefits and costs of such policies after multiple rounds of monetary easing. Prolonged easing could exacerbate the financial vulnerabilities and affect the stability of the international monetary system."

German Bundesbank head Jens Weidmann, a member of the European Central Bank governing council, said: "It is clear that the longer an ultra-expansionary monetary policy is pursued, the more the risks increase."

Commenting on the fears about where quantitative easing was heading, IMF managing director Christine Lagarde said: "We certainly heard from the entire membership [of the IMF] that it is unconventional that central bankers … jumped into an unknown landscape."

One major concern is the effect of a withdrawal of the monetary stimulus on financial markets. Ending the bond-buying program could produce a sharp drop in the value of these financial assets, prompting a rush for the exits and a rise in interest rates that could spark a further financial crisis, this time embroiling the central banks themselves.

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