Growth Estimates Revised Down Ahead of IMF-World Bank Meetings

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The annual meetings of the International Monetary Fund (IMF) and the World Bank starting in Washington on Friday take place following downward revisions in global economic growth by both organisations.

Such reductions have been a regular occurrence since the eruption of the global financial crisis in 2008. The difference this year is the recognition that lower growth, and outright stagnation in some cases, is becoming a permanent condition.

In its *World Economic Outlook* issued yesterday, the IMF cut its forecast for global growth in 2014 to 3.3 percent, a reduction of 0.4 percentage points from April and 0.1 percentage points down on an update issued in July.

According to the IMF, there is no prospect of an upturn in the period ahead. "Demand shortfalls in advanced economies, together with the erosion of potential output, could lead to sustained global economic weakness over a five-year period," it stated.

While not predicting this prolonged slump will necessarily take place, the IMF warned that it is the biggest risk to the world economy over the medium term.

IMF chief economist Olivier Blanchard pointed to a feedback loop pushing in the direction of protracted low growth. "Potential growth rates are being revised downward and these worsened prospects are in turn affecting confidence, demand and growth today," he said.

With growth forecasts for the eurozone being revised down, the IMF estimated that the risk of recession in the region doubled from around 20 percent in April to nearly 40 percent just six months later. It said the probability of a slide into deflation was 30 percent.

A World Bank analysis, issued earlier this week on the prospects for East Asia and the Asia Pacific, sharply lowered its estimate for world economic growth as well as for the all-important Chinese economy.

The bank said global growth for this year would be 2.6 percent, a marginal increase from 2.4 percent last year, and well below the estimate of 3 percent growth predicted in April. (The differences between the two growth figures arise from the different methods used to reduce currency values to a common measure.)

Growth in China would fall over the next three years—7.4 percent this year as compared to a previous estimate of 7.6 percent. It would then decline to 7.2 percent and 7.1 percent for the years 2015 and 2016 respectively, as opposed to a previous forecast of 7.5 percent for

both years.

For the Asia Pacific region as a whole, excluding China, the World Bank said growth would bottom out at 4.8 percent this year before recovering to 5.3 percent in 2015–2016. But this forecast is based on the assumption that exports from the region will increase as a result of a “gradual recovery” in high-income countries and an “orderly normalization” of monetary policy in the US as the Federal Reserve winds back its financial stimulus program.

Yet, the report warned that weaker-than-expected recovery in world trade, an abrupt rise in global interest rates or increased global political tensions could not be ruled out, all of which would “pose risks” to the regional outlook.

The bank said a “key downside risk” was a slower than expected recovery in high-income countries, noting the threat of deflation and continued anaemic growth in the euro region. Falling inflation had already raised real interest rates and further downward movements could “unleash a pernicious debt-deflation cycle.”

It remained “unclear,” the bank stated, to what extent recent measures announced by the European Central Bank (ECB), based on financial asset purchases, would boost activity, while in Japan investment and export growth “remain tentative.”

One of the biggest threats to growth in the Asia-Pacific region was the potential flow-on effect from a tightening of monetary policy in the US and “an abrupt rise in interest rates cannot be discounted.” Returning monetary policy to a more normal state “will be complex” since it has “remained extraordinarily expansionary over an unusually extended period of time.”

Nothing like what has happened in the past six years has been seen in the history of global capitalism and no one is sure what the outcome of the reduction of central bank intervention could be.

The World Bank pointed to a number of dangers, including abrupt market reactions, increased volatility and the overshooting of interest rates. Moreover, in conditions where the monetary policy in major reserve currency countries is diverging—the US Fed is tightening monetary policies, while the ECB and the Bank of Japan continue a loose regime—there is the risk of “disorderly exchange rate and interest rate movements.” Adjustment to a new equilibrium could be “disruptive.”

A rapid rise in interest rates would impact heavily on a number of countries in the East Asia Pacific region because debt levels have increased markedly since 2008 and debt-service ratios are already at “historically elevated levels.” Problems could also arise if there is a sharp reduction in capital flows.

In a speech delivered to Washington’s Georgetown University last week previewing the *World Economic Outlook*, IMF managing director Christine Lagarde pointed to “grey clouds” hanging over the world economy. Economic recovery had been “disappointing … brittle, uneven and beset by risks.”

The global economy was weaker than envisaged six months ago, with only a modest pickup foreseen for 2015 as “the outlook for potential growth has been pared down.”

The weakness is centred in the major capitalist economies. Lagarde pointed out that emerging and developing economies accounted for more than 80 percent of world growth since 2008.

Six years after the eruption of the financial crisis there was continued weakness in the world economy, countries were still dealing with its legacies and there were "serious clouds on the horizon." One of them was "low growth for a long time," as falling expectations of growth potential led to present-day cuts in both investment and consumption.

There were financial "clouds" as well.

> "There is concern that financial sector excesses may be building up, especially in advanced economies. Asset valuations are at an all-time high; spreads [the difference between the rates of return on the riskiest and safest assets] and volatilities are at an all-time low."

Another worry was the "migration of new market and liquidity risks to the 'shadows' of the financial world," that is, to the less regulated and nonbank sector. In the US, Lagarde noted, "shadow banking is now considerably larger than the traditional banking system" and China, at 25–35 percent, has the fifth largest shadow banking sector in the world. She warned that the longer the present easy money policies continued, the greater the risk of fuelling financial excess.

Whether Lagarde recognised it or not, her speech was actually an impeachment of all the would-be guardians of the global economy and financial system, herself included. It was an acknowledgement that, after the most severe crisis since the Great Depression, not only is there no "recovery" but the policies pursued over the past six years are creating the conditions for another crisis.

Lagarde concluded her speech by invoking the colours of the university, grey and blue. There are some "grey clouds," she said, but "aiming higher, trying harder and doing it together, we can gain new momentum and bring the 'blue' skies."

There could hardly be a clearer indictment of the entire global capitalist order. With the livelihood of billions of people in the balance, those supposedly in charge of economic policies can offer nothing but incantations akin to those of a rather desperate college basketball coach.

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