A reassuring diagnosis

FOR THE ACT SPRING PAPER, SPONSORED BY CITIGROUP, STANLEY FISCHER TOOK THE AUDIENCE ON A WHIRLWIND TOUR OF THE STATE OF THE GLOBAL ECONOMY. AND FOR AN ECONOMIST – SOMEONE WHO IS PAID TO WORRY – HE CAME UP WITH A REASSURING DIAGNOSIS. **PETER WILLIAMS** REPORTS.

It is hard to guess from media reports that the prospects for the global economy are actually quite decent, according to Stanley Fischer. The outlook is good and emerging markets in particular are doing well. 2004 was the best year for the global economy for 20 years. Though, as Mr Fischer noted, any time there has been an exceptional year, it is wise to predict that the numbers are not going to be so high in the following period.

The reason why many feel gloomy is because of 'well-appreciated risks' that cloud the outlook. These include high oil prices, rising short-term interest rates, US fiscal deficit, US current account deficit and the dollar, and European slowdown.

While oil hits all-time new highs of $60/barrel, in real terms in euros and sterling the price of oil is the same as it was in the mid 1980s. While that may be reassuring, Mr Fisher warns that every time there has been a spike in the price of oil, a recession has followed – apart from this time… yet. It has always been issues around disruption in supply that led to recession rather than price. The market does not expect the price of oil to come down below $40. At that price, the cost of oil reduces the purchasing power for countries and it is a cost factor for corporates, but it is not a major issue in the world economy.

Mr Fischer described the US fiscal deficits when measured as a percentage of GDP as 'exemplary'. Iraq war expenses will increase that measure by one percentage point while social security reforms will add nothing to the deficit. Further out, Mr Fischer warned that in 2014 healthcare costs are set to explode increasing the fiscal deficit as a percentage of GDP by three to four percentage points. Mr Fischer remarked the prospect was: "Distinctly undesirable but it is a pity not a catastrophe."

In the more immediate future, US interest rates will probably go to 3.5-4%. Mr Fischer said; "The Fed is softening its language on gradualism because of concerns over inflation". While that may be understandable there is little or no comprehension on what is happening to long rates. As Mr Fisher put it: "Even Alan Greenspan is baffled about what is happening at the long end."

The current account deficit Mr Fischer described as not sustainable. He said: "Often we are not so good at saying when the unsustainable actually will stop." Two events will make the unsustainable stop. The US grows more slowly than its trading partners or the dollar depreciates – the latter has started to happen. The current account deficit makes the US a good place to invest for outsiders because it is cheap and the perception is that the investment is likely to appreciate.

On Europe Mr Fischer noted that in the last quarter of 2004, Germany, Netherlands, Italy and Switzerland all experienced negative growth. Responding to a question on Europe at the end of his talk, Mr Fischer said he had a 'mental reservation' about Europe. He said: "You look at European growth figures and you think there may be something happening that we don't understand."

China and Japan are getting on well economically. Mr Fischer declared that today's China/Japan situation was reminiscent of the late 19th/early 20th century in Europe. He said: "The offshore economy is first to develop and then the mainland with its great talent and people develops and becomes bigger."

On the emerging economies Mr Fischer described the key figures – 'the electrocardiogram of the economies' – as in the best shape for a decade. He said: "They have made fundamental changes that make them a good place to invest". One of the most significant changes is the flexible exchange rates that now operates in many of these emerging economies. Many of the crisis and collapse we have seen in the past was as a result of fixed rates. With that fundamental altered similar crisis are less likely. Even though the emerging economies are growing strongly, Mr Fischer noted that these economies represented a small proportion of the overall global economy.

A GOOD PICTURE Overall Mr Fischer does see risks but some of those are exaggerated. He concluded: "It is a good picture relative to what we might have expected seven years ago."

Stanley Fischer is Vice Chairman of Citigroup. He is a former International Monetary Fund director and has recently been appointed as Governor of the Bank of Israel.