

FOREIGN NEWS REVIEW

Forecasts of deeper global recession ahead

Signs of a likely global recession in the early part of 1988 have been signalled from various quarters of both the developed and developing world. Looking at the global economy, at the beginning of December, leading economic experts warned in Washington that the world economy faced the prospects of collapse not equaled since the Great Depression of the 1930s, if the major nations failed to take action. They called for quick and drastic steps to cut the US trade deficit, and equivalent surpluses in Western Europe and Asia.

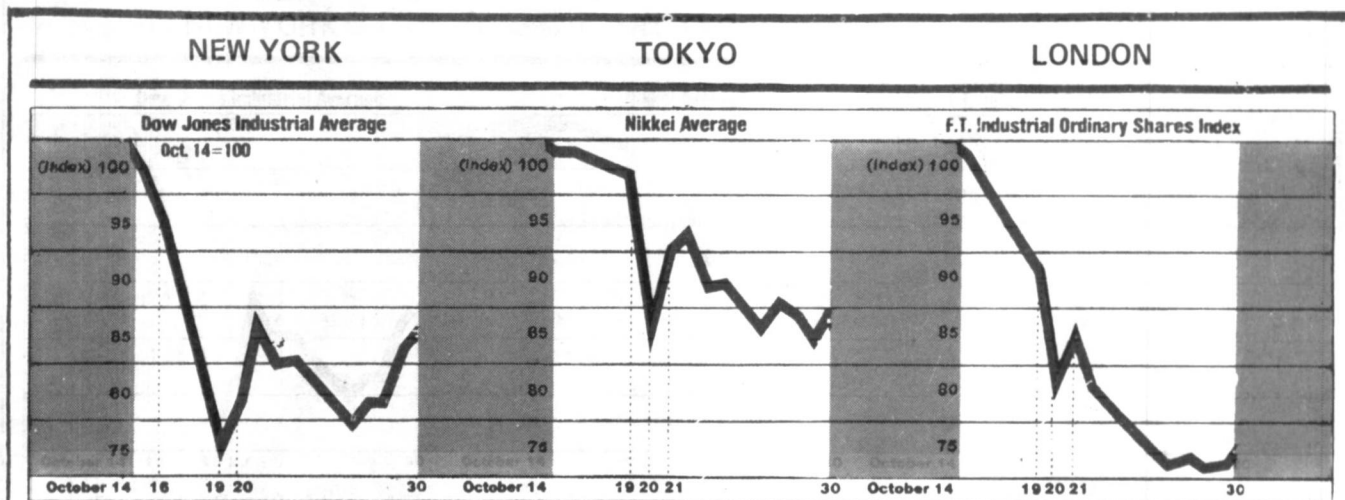
The prospects of such a collapse they said, was the signal given by the October crash in stock markets around the world and an earlier plunge of the American bond market. The economist's conclusions were contained in a

report issued by the Institute for International Economics, Washington. Specially, the economists warned, a new meeting of finance ministers and central bankers of the Group of Seven major industrialized nations, which is widely expected to take place next month, would be futile and even counterproductive "unless more decisive action is taken to correct existing imbalances at their roots".

In the EEC the European Commission's experts responsible for drawing up economic forecasts have revised their growth estimates for 1988. The EEC's economists who were predicting a 2.5 per cent economic growth for the 12 member nations of the European Community, have now suggested that since the crash of "Black Monday" (Oct.19) the EEC countries

would be lucky to reach a growth level of 1.5 percent next year. They warn that another fall in the US dollar's value, even without a recession in the US, could push Western Europe into a recession. They also indicated that European Governments were not taking sufficient steps to avert a recession.

Most analysts, in Europe are still seriously wondering if the U.S. has deflated its economy enough to create room for a shift of resources from consumption to exports. The budget cuts are minimal and monetary policy is loose. But the latest trade figures represent a pre-crash economy. By January with the postcrash devaluation of the dollar and the growing American dislike for imports, the U.S. economy will present another picture. A prominent analyst at a London bank predicts that the deflationary impact will be greater in the U.S. This would suggest higher interest rates and a further fall in stock markets. The major stock markets are expected to fall bet-



The crash suffered by the world stock markets following the October 19 Black Monday plunge was most deeply felt on Wall Street where it shattered much of the entrenched sense of financial security in the US. A look at the three major stock markets shows how inter-related global financial markets are. Severe jolts were felt throughout the world's global financial markets when investors wary of the massive Trade and Budget deficits of the US, and the weakening dollar began a major sell-off. The New York Dow Jones average declined a record 508 points or 22.6 percent in one day; while in London and Tokyo investors sold a staggering amount of stocks. During the week of the crash, the Dow Jones and Financial Times indexes fell below their year-high levels by 31.6 percent and 36.1 percent, respectively.

London's free fall began on Black Monday when blue chip stocks crashed and on Tuesday the rest followed. But turnover in London, unlike New York, was not high; though the index dropped 250 points or 22 percent over the two days. In Tokyo it was only on October 20 when investors learnt of the Wall Street crash that everyone rushed to sell and the index fell 15 percent. In this period the farthest the Nikkei Average fell below its 1987 high was 17.8 percent and by the week's end, the Nikkei Average had rebounded a strong 4.2 percent reflecting the Tokyo market's resilience.

In Australia the stockmarket dropped 25 percent; and in Singapore 21 percent. The Hongkong Stock market closed. The financial crash of 1987 is not expected to end in economic slump, but already economists foresee recession by mid 1988.

ween 10 and 20 per cent before there is any stabilisation.

But apart from what happens to the dollar and stock markets, the present mood portends serious worries about the ensuing recession both in the U.S. and Europe, and possibilities in the rise in unemployment. The European Commission experts responsible for drawing up economic forecasts for the EEC have prepared new estimates in the background of the October crash and the dollar's devaluation.

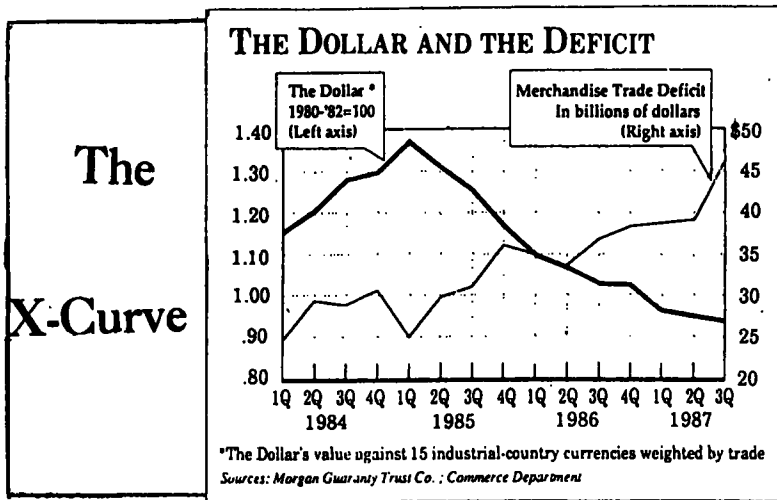
Meanwhile Japan's Institute of Developing Economies predicted that lower exports and upward pressure on the currencies of newly industrialising countries such as South Korea, Taiwan, Singapore, Thailand and the Philippines would slow down economic growth in these countries in 1988. The Institute forecasts that the economic growth of these countries would slow in 1988 as the US economy on which their exports largely depend, is expected to slow somewhat. It is said the U.S. would also press these countries harder to let their currencies appreciate.

The Institute's economic outlook report said newly industrialized Asian countries, led by South Korea and Taiwan have achieved high export-led economic growth in 1987, supported by the economic expansion in the U.S. and other advanced industrial nations and the steep appreciation of the yen. The higher yen made their products cheaper in Japan and more competitive against Japanese products in the U.S.

But the Institute said their economic growth rates will slow in 1988 as the U.S. economy, on which their exports largely depend, slows down.

Again a leading Indonesian economist predicted from Jakarta that the main industrial economies would experience recession starting in the second quarter of 1988. The impact would be felt in Indonesia three months later, mainly through falling demand and declining prices for primary commodities, he warned.

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The US trade deficit was expected to move up nearly \$ 20 billion ahead of last year's \$ 157 bn and exceed \$ 175 bn in 1987 according to all indications. This news, states the Asian Wall Street Journal, will incite the J-curvers to call for a still lower dollar. The theory, is that a lower dollar balances trade by making imports expensive and exports cheaper. In other words, the path to riches is buy high, sell low, well, after the initial dip the theory goes, you make it up on volume. Hence the curve that is supposed to look like a J. The Asian Wall Street Journal. It plotted a few weeks ago and it appeared more as an X-curve.

mer Economic Minister turned advisor to President Suharto, was quoted as saying that Indonesia should immediately cut its strong reliance on primary commodities to ease the impact of the recession.

This was a clear signal for primary producers in the entire region, including Sri Lanka.

UNCTAD's "Trade and Development Report, 1987" released recently, has also warned of a danger that deflationary forces will overwhelm present inadequate growth-revival efforts of the major economic powers, cause stock markets to decline and sweep the world economy into recession.

The Report notes the failure of two key price drops of oil and the dollar - to fulfill expectations of stimulating growth. It has found that their net impact has been contractionary and as a result the pace of global expansion slowed to 2.8 per cent in 1986 from 3.0 per cent in 1985.

Continued weakness from the low levels of 1986 was foreseen for 1987. Output growth for the world economy, and the growth of the volume of world trade is expected to continue its deceleration. Forecasts are that the terms of trade of developing countries would continue to worsen despite the

partial recovery of oil prices from their 1986 levels. Dollar prices of commodities are expected to lag behind those of manufactures, in part because of the depressive effect of the slow pace of world economic growth, and partly because the lower dollar prices of commodities are not being passed on to consumers in some of the market developed countries, and hence are not triggering rise in demand.

The UNCTAD study sees no other *deus ex machina* that can reverse the present sluggish trends characterized by weakening of demand in developing countries and virtual cessation of commercial bank lending to developing countries, which are nevertheless continuing to pay them large sums in debt service, mostly at the expense of domestic investment; and a significant escalation of tensions on the trade front as the struggle grows more intense for shares of shrinking markets. "It is difficult to see," this study emphasizes "how bilateralism - and, for that matter, mercantilism - can be avoided if the pace of world economic activity does not revive sufficiently to allow business and national economies to realize their growth potential. Warns UNCTAD "while the situation is bad, worse may be yet to come".