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PRESS CONFERENCE ON GLOBAL ECONOMIC OUTLOOK

The marked slowdown in the pace of the global economy started with the slowdown in the United States economy, Professor Lawrence Klein, Nobel laureate and head of an expert group called Project LINK, told correspondents at a Headquarters press conference yesterday morning.

While he would not characterize the United States' situation in stronger terms, the United States economy, the primary mover of the global economy in the last decade, was definitely in a slowdown, Professor Klein continued. Based on the forecasts of the Expert Group on the World Economic Outlook, world economic growth in 2001 was expected to slow to some 2.4 per cent from 4 per cent in 2000.

Professor Klein was joined by Jozef van Brabant, Chief of the Economic Assessment Outlook Branch at the Department of Economic and Social Affairs, and Professor Peter Pauly of the University of Toronto. Mr. van Brabant explained that Project LINK was a network of economic researchers from more than 60 countries who met twice a year to forecast world economic growth.

The project was jointly managed by the Department of Economic and Social Affairs and the University of Toronto, and was meeting in New York for a three-day session this week to prepare its outlook for the world economy in 2001 and 2002.

In an effort to stabilize the world economy, credit terms were being eased around the world, Professor Klein continued. "One country after another is trying to lower interest rates", he said. The United States had experienced three credit easings in 2001 alone, and additional lowering of credit terms was expected. While discussion of fiscal stimuli was taking place in the United States Congress and Administration, it was a political issue and its outcome was at uncertain.

While Europe, especially Western Europe, was also trying to meet the slowdown by lowering interest rates, its growth profile was not yet as low as that of the United States, Professor Klein continued. Asian economies had been recovering well from the financial crisis of 1997 and 1998, but one Asian country after another was now experiencing a degree of export difficulty that was associated to some extent with the weakening United States economy.

In North America, Mexico's economy, which had been doing very well, was also experiencing export problems, Professor Klein added. Canada had lowered its economic expectations for 2001 for similar reasons and was following the United States in terms of monetary easing.

It was unfortunate that Japan's economy -- the second largest in terms of size of production -- had not been able to help ease the slowdown, Professor Klein added. Japan's long-standing recessionary problems had led to a strong global dependence on the United States economy, Professor Klein added. Part of the problem was associated with high-energy costs. High oil prices were generally not friendly to the United States economy.

The expert group, which was in the middle of its deliberations, was discussing how far the United States slowdown would go, whether it would enter a

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period of recovery, and whether 2002 and 2003 would be better years for the world economy.

Professor Peter Pauly of the University of Toronto said that the world economy faced three challenges. The first was that the attempt to engineer a "soft landing" given that the brisk pace of the United States economy in late 1990s had slowed. While it was expected that the United States slowdown would not be long-lived, there were nevertheless questions surrounding a possible turnaround. Secondly, there were obvious signs of spillover to other countries, particularly the countries of the North American Free Trade Association (NAFTA) and those of East Asia, reflecting the high degree of trade and production integration between these economies.

The third concern was that there was no sign at the moment of significant strength elsewhere in the world economy to make up for the United States slowdown, he added. A resumption of economic growth in Japan in the short or medium term was not expected. European economic performance -- while solid -- was not sufficient to counteract the global effect of the United States slowdown.

All in all, this was a challenging time after many favourable years, he said. The present slowdown called for decisive policy action to turn what might otherwise be a prolonged growth reduction into a short-lived experience. Decisive monetary policy action both in the United States and in Europe was needed, as was fundamental structural change in Japan.

The danger of a recession in the United States spreading to the rest of the world economy was mentioned only at the end of Project LINK's report, Mr. van Brabant explained. There was, however, the problem of a current account deficit in the United States -- some 4.5 per cent of gross domestic product (GDP) (about \$450 billion) -- which had been financed by capital inflows largely from Western Europe and motivated by a very strong dollar. While profit expectations had declined, the dollar had held up well against the euro and had strengthened against the yen.

Any sharp reduction in the current account deficit in the short term would have to come through reduced consumption, and, hence, reduced import demand, in the United States, he continued. This could lead to a recession.

A correspondent asked whether the unprecedented expansion in the United States economy could be followed by an unprecedented downturn, and what changes in monetary policy were being suggested. Professor Klein explained that, historically, in the United States economy, expansions were much longer than contractions, although that was not true of the Great Depression of the 1930s. Generally speaking, the trend was a long growth spurt, followed by a sharp downturn, followed by revival. In the current case, the slowdown would probably not last long. The recovery, however, might be gradual.

He added that it was necessary to separate the stock market from what was called the "real economy". The real economy was still undergoing great technological change, and this change would be part of the recovery in the United States. He did not, however, expect the stock market prices for high technology companies to return to the excesses of the last five years.

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Regarding monetary policy, he meant a policy by the Central Bank -- in this case, the United States' Federal Reserve Bank -- to make credit easier, Professor Klein continued. The experts expected that the Federal Reserve Bank's meeting in May would result in another lowering of interest rates. It was also possible that there could be a lowering of those rates before the May meeting. And any reduction from the May meeting might not be the last reduction. Congress was also debating a tax cut. While the size of that tax cut was not yet known, the result would undoubtedly be some fiscal easing.

"The United States is not presently in recession by usual definitions of that concept", he added. While it might feel like recession, the consensus forecast was that the United States economy would go through an upturn.

Mr. van Brabant said that the European Central Bank had raised interest rates in early October last year and had not changed those rates subsequently. He expected that Central Bank -- perhaps, by Thursday of this week -- to lower its policy interest rates and to put less emphasis on inflation-fighting and more on output support in Europe, particularly since the German economy was not expected to do as well as previous economic forecasts had predicted.

In response to a question on the United States economy, Professor Klein said that immediate action was needed to stimulate the United States economy.

Asked whether the prognosis for developing countries and countries with economies in transition was doubly awful, Professor Klein said that, while basic commodity prices were not falling, they were also not moving upward very quickly. Oil and gas prices were quite strong, which had been extremely helpful to Russia and to oil-exporting nations. There was now less concern for the economic situation of Russia than there had been since the end of the cold war. Russia had made significant gains as a result of high-energy prices. China, in his opinion, was doing also quite well. While India had been doing well, it would probably not do as well as projected, because of recent earthquake damage and weather conditions. Sub-Saharan Africa, with its long-standing problems of a poor manufacturing base and HIV/AIDS, was not doing well. Mexico, which had been doing well, would now almost need the United States to recover for it to get back on track.

Professor Pauly said that the spillover effects of the weakening United States economy had so far been localized to South Asia and Mexico. In other parts of the world, including Latin America, the effects had been relatively modest. International lending rates had also come down quite significantly.

Asked if the experts' forecast of 3 per cent growth in 2002 was predicated on the United States Federal Reserve Bank lowering interest rates to 3 per cent, Professor Klein said that, indeed the Federal Reserve must keep easing interest rates. Whether interest rates should fall to 4 per cent or to 3 per cent was not the right question to ask. A broader view was needed, not just a particular numerical target. The outcome of any changes would depend on how interest rate reductions were mixed with tax easing.

Responding to a question asking which countries were in the stickiest situations economically, Professor Pauly said that the effects on GDP for the countries that relied most heavily on information technology exports to North America, including Thailand and Malaysia, could be quite significant. Some 46 per

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cent of Malaysia's exports, for example, were based on information and communications technology exports to Japan and the United States.

Asked if the United States Administration should do anything other than take monetary and fiscal measures to get its economy running at a faster pace again, Professor Klein said that, in the last 10 years, there had been a very low household saving rate in the United States. While some Asian countries had average household savings rates of around 10 to 20 per cent of income, Americans saved between zero and 4 per cent of their household income. The United States Administration should stimulate personal saving. To some extent, the tax cut was aimed at that.

Asked what had started the current economic crisis, Professor Pauly said that it was caused by two things. The first was the rapid fall in asset prices in the high-tech industry, and the beginning of a weeding-out process of the "dot com" industries. The second was the slight overreaction on the part of the Federal Reserve Bank last year in raising interest rates a notch above what would have been prudent with the benefit of hindsight. In the short term, the United States economy had been growing way above potential for at least two years. It was not necessarily a bad sign to have a slow-down in growth. The challenge was to smoothly return to strong growth over a short period of time.

Responding to a question on whether the International Monetary Fund (IMF) was obsolete, Mr. van Brabant said that countries with ready access to private financial markets did not need public sector finance. However, many countries had no access to private financial markets -- or could only access them at exorbitant rates. For those countries, it was useful to have something like the IMF, which could provide funding relatively quickly. While the IMF had made mistakes, in the case of Mexico, for example, it had managed to mobilize resources on a scale that the private sector would not have been willing to. There was also a role for the IMF in giving policy advice. However, one could not expect an official institution to be infallible.

Given the number of economic outlooks available today, how was Project LINK's report different? a correspondent asked. Mr. van Brabant said that unlike the reports of the IMF or the Organisation for Economic Cooperation and Development (OECD) -- which were made in-house using one specific model -- Project LINK was a combination of 79 national and regional models that were run independently by national and regional centres. The coordination of those models was done by Project LINK at the United Nations. Project LINK was a unique undertaking.

On a question of Japan's economy, Professor Pauly said that Japan's problem was not cyclical, but a fundamental structural problem that had been visible for some 10 years. The Bank of Japan followed a zero interest-rate policy. A number of structural reforms to eliminate bad debts present in the financial sector -- in particular, in housing and real estate -- were needed to eliminate protection of unproductive industries in Japan. While Japan's economy was characterized by a high degree of productivity in a large number of tradable industries, that was coupled with low productivity in agricultural, in the public sector, and in the retail trade. Japan would have trouble mobilizing its resources as long as these rigidities remained in place.

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Professor Klein said that a feature of the United States expansion was a flexible labour market. When people were downsized by technological progress, they could find jobs somewhere else. That had not been the experience in Japan. He felt that Japan's commitment to lifetime employment should be reconsidered. Another issue was immigration. Japan was a very homogenous population. In the United States, immigration had done much to relieve labour market bottlenecks. While some very good things had come from Japan, namely, efficient cars, it was having trouble moving on to the next thing.

In response to a question on the role of the United States Federal Reserve, Professor Klein said that the Federal Reserve had engineered a slowdown. It did not want the United States economy to continue to grow at 4 or 5 per cent. It looks as though it "put on the brakes" for too long and too hard. The Federal Reserve consisted of a mixture of people with different opinions. They had implemented a compromise solution, and it looked now as if they overdid it. However, some action by the Federal Reserve had been necessary -- 5 per cent growth could not be sustained.

Asked about globalization and the economic slowdown, Professor Klein explained that when the United States stock market plummeted in recent months, this had been felt around the world. That was a manifestation of globalization.

Mr. van Brabant said that European economies, in particular Germany, were indirectly affected by the United States slowdown to a greater extent than was immediately obvious. Globalization did -- indeed -- matter.

Asked whether oil revenues would be likely to increase worldwide, Professor Klein said that, while oil prices would fluctuate, revenues would probably rise. It depended on how prices were adjusted for inflation. Oil was a scarce resource and the world needed it to run the global economic engine. So it was a good commodity for the countries that had it.

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