

The G-20 Agenda

As preparations for the next G-20 Summit (Seoul, November) gather momentum, there has been some progress since the last Summit – the Basle Committee on Banking Supervision constituted by the Bank for International Settlements has agreed on new norms for banks' capital adequacy standards (Basle III). These prescribe a significant increase in shareholders' funds, and have also increased the capital charge for market risk. The United States has enacted tighter and highly complex banking regulations, and the European Union is also well on the way to finalising financial reforms later this year. Neither of these may achieve the full extent of the reforms envisaged by the G-20, but very strong and powerful bank lobbies have been working hard, in Basle, Brussels, London, and Washington, to dilute the prescriptions (but more on the new regulations in a later article). There is also a question mark whether the cost of the new capital ratios and other regulations will be passed on to and borne entirely by the banks' customers – higher lending rates, for example, would, over the long term, affect global growth. One major unresolved issue is the convergence of accounting standards prescribed by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB): this is unlikely to be achieved in the current year, as originally targeted.

On the other hand, major problems and contradictions in the global economy are coming to the fore. Many of the conventional correlations seem to be breaking down. For example, loose monetary and fiscal policies are supposed to be inflationary. There is no sign of this in the U.S., Europe and Japan. Again, gold is supposed to be an inflation hedge and the conventional wisdom suggests that its price would go up in anticipation of high inflation. The gold price has been breaking new records, but the yields on inflation adjusted bonds in the U.S. for example, evidence few signs of inflation rising. The other major disconnect is that the substantial fiscal and monetary stimuli have, broadly speaking, failed to trigger sustained economic growth: to be sure, some economists, Paul Krugman for example, had predicted that, in the U.S., the fiscal stimulus would prove to be

inadequate. In the recently published Annual Outlook for 2011, the United Nations Conference on Trade and Development (UNCTAD) apprehends a contraction in the world economy in 2011, and worries that an exit from stimulative macro-economic policies in the developed countries may lead to a “deflationary spiral”. To be sure, some members of the G-20, China and India for example, seem to have been broadly unaffected by the diseases of the developed world.

Ominously, global imbalances (a code word for Chinese surpluses) have started widening again. As the yuan appreciation continues at a snail's pace, the Chinese surplus is a potential danger spot to global economic co-operation. As trade tensions rise, a bill providing for punitive tariffs on Chinese imports is making its way through the U.S. Congress; the European Union has also threatened increased tariffs on the import of car wheel rims from China. Given China's status as by far the world's largest market for light vehicles (China 15.6 mn, Japan 9.1 mn and U.S. 7.1 mn, estimates for 2010), its capacity to retaliate should not be underestimated: the European Union, for example, exported auto parts worth \$ 5 bn to China last year, besides a large number of cars.

In the U.S., unemployment stubbornly remains close to double digits, even as the number of those classified as being in “involuntary part-time” working, continues to rise, the latest number being 9 mn. And, Japan, now the third largest economy in the world, continues to be experiencing stagflation (“flation” preceded by “de”, not “in”) exacerbated by an appreciating yen. After six years, Japan intervened in the exchange market last week when the currency fell below JPY 83 to a dollar; it is also blaming China for fuelling yen appreciation through its purchases of yen bonds for its reserves. While the yen is back above 85 post-intervention, its longer term success is more questionable as the continued appreciation of the Swiss franc despite sizeable intervention, evidences – it has fallen below parity against the dollar. (Another interesting contradiction – Switzerland remains, with Germany, the fastest growing economy in Europe.)

The growth picture in the European Union is getting more confusing. The European Commission has recently revised its earlier forecast for growth in the current year, from 0.9% to 1.7% (eurozone) and 1.8% for the EU as a whole. On the other hand, latest data suggest stagnancy in factory output in the eurozone. And, the reputed ZEW economic research institute recently reported a sharp fall in its index of expectations for the economy; the index has now plunged into negative territory.

Lastly, as if the other problems were not enough, President Obama may find himself on a weak political wicket by the time of the Summit as poll after poll suggest a sharp set back to his Democratic Party in the mid-term elections later this year – in the U.S., the conservative right is making a strong come-back.

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