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I.M.F. Asks Rich Nations for Support

By **LANDON THOMAS Jr. and LIZ ALDERMAN** OCT. 7, 2014

WASHINGTON — The International Monetary Fund, showing heightened concern over a slowing world economy, said on Tuesday that cash-rich countries like Germany needed to step up large public investments to help keep the flagging global recovery on track.

The comments — from the fund’s managing director and its lead economist — reflect growing concerns within the I.M.F. that Germany, which recently passed China as the country with the largest trade surplus in the world, is not doing enough to spur growth in Europe.

At a news conference at the start of its semiannual meeting, an event that attracts financiers, policy makers and central bankers from around the globe, the fund’s top economists highlighted a shift in the global economy in which many major nations are failing to keep up with what is still a relatively modest recovery in the United States.

In an interview on Friday, Christine Lagarde, the managing director of the fund, said global growth risked being stuck in a rut for a long time. “If nothing gets done in a bold way, there is a risk of a new mediocre” level of growth for the global economy, she said.

And she took note that Germany could do more to stoke growth in Europe. “Given Germany’s current position, it could certainly spend more on infrastructure,” she said.

The fund’s growth worries were underscored on Tuesday when Germany said that orders for industrial goods in August shrank by the largest amount since 2009, plunging 4 percent on a month-over-month basis.

For investors, the warnings in the I.M.F. forecast and the report from

Germany helped send the broad stock market down sharply on Tuesday, with the Standard & Poor's 500-stock index falling 1.5 percent. The Dow Jones industrial average and the Nasdaq each fell about 1.6 percent.

The I.M.F. brought its estimate for global growth this year down to 3.3 percent from 3.7 percent and reduced its forecast for 2015 to 3.8 percent. The fund pointed to weaker growth in China, Europe, Japan and Latin America — Brazil in particular — as the main culprits behind the broad retrenchment.

Germany's growth forecast for 2014 was cut sharply to 1.4 percent from 1.9 percent.

Its estimate for United States growth in 2015, 3.1 percent, outpaces all major industrialized countries and exceeds as well a number of emerging markets, which in theory are supposed to grow at a substantially more rapid clip.

The assessment reflected a broad acceptance by global investors that, at least for the near future, the United States economy was set to advance ahead of many large economies, not just in terms of growth but also in corporate profitability and international competitiveness.

As a result, large investors and central banks have become aggressive purchasers of the dollar, betting that the currency will keep rising in value against the euro, the yen and the wobbly currencies of countries like Russia, Brazil and Turkey.

Economists have been warning for some time now that a situation in which the American economy becomes the prime engine for the global recovery brings with it significant risks by creating financial uncertainty in emerging markets as currencies weaken and capital flows reverse.

“At this stage, the question is, can the U.S. continue to power along while the rest of the world acts as a drag on global growth,” said Eswar Prasad, a professor of international finance at Cornell University and the author of a recent book on the dollar. “This is a very unbalanced recovery.”

Fund economists expect annual growth in the eurozone of just 0.8 percent, with inflation coming in at 0.9 percent — a figure that Ms. Lagarde raised pointed concerns about.

“We've been warning for over a year now about persistent low inflation, and frankly we faced a bit of denial — everyone said we don't need to think about it,” she said. “But now it's there.”

The fund unveiled this week a paper arguing that large-scale infrastructure investments, if properly undertaken, could bring relatively quick growth benefits — a message that seemed to be directed at deficit-obsessed eurozone governments, including Germany.

“Infrastructure investment, even if debt-financed, may well be justified,” Olivier Blanchard, the fund’s senior economist, said at the news conference on Tuesday.

And while he did not mention Germany by name, he left little doubt to whom he was broadly referring. “Eurozone countries should be ready to do more,” Mr. Blanchard said.

Mr. Blanchard pointed out that with interest rates at modern-day lows — Germany can borrow money for 10 years at below 1 percent — taking on extra debt to stimulate the economy need not be seen as profligacy.

He offered up a brief economic primer to underscore his point. “It is an irony of macroeconomics,” he said with a small smile, “that for countries with too much debt, sometimes the solution is to create more debt.”

Mr. Blanchard, who oversees economic research at the I.M.F., was behind the fund’s public recognition two years ago that heavy-handed austerity policies in Europe had a larger-than-expected impact on economic growth.

Now, it seems, the global watchdog seems to be going one step further by urging eurozone officials to relax their rigid austerity measures.

Both Ms. Lagarde and Mr. Blanchard also made it clear that they had their doubts about the two-year bull run in eurozone government bonds.

Ms. Lagarde, in the interview, said that there was a “disconnect between what’s happening in markets and, on the other hand, progress in the real economy.”

Mr. Blanchard said that the markets “were too complacent” and that policy makers should be especially watchful.

“The risk is there,” he cautioned.

The tough tone may well reflect a sense within the fund that this time around it needs to be more forceful in warning of financial trouble spots before it is too late.

The I.M.F. was criticized for not spotting the last financial crisis. It has responded by recently publishing a series of papers outlining how it might improve on its watchdog capabilities.

The fund has repeatedly cautioned that investors have become too reliant on very loose monetary policies on the part of global central banks to bolster their returns.

Wholesale purchases of bonds by monetary authorities have inflated equity and bond markets in countries around the world where investments were minimal and growth subpar, economists for the fund said in the report.

The warning echoes a rising chorus from economists and regulators who say that when the Federal Reserve in the United States starts raising interest rates — expected to begin in 2015 — so-called hot money flows that sought out high-yielding but risky returns in Europe and in emerging markets, including China, will head for safer shores.

A consequence could be a broad disruption in financial markets, similar to but greater in scope than the market spasm that hit markets in the developing world earlier this year.

Landon Thomas Jr. reported from Washington, and Liz Alderman from Paris.

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