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Analysis: G20 doesn't even try to put brave face on debt mess

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By Alan Wheatley, China Economics Editor

BUSAN, South Korea (Reuters) - Finance ministers can usually be relied upon to put the best spin on whatever is happening to the global economy.

Not at this weekend's Group of 20 meeting in Busan.

The two days of talks were remarkable for ministers' candor about the extent of the Europe's debt crisis and the imperative of appeasing the bond market, which has compelled Greece to seek a bailout and is circling other strugglers.

"There is substantial concern about what's been occurring in Europe of late and the risks associated with that. That was reflected not only in the communique but in the discussions we had in the room together," Canadian Finance Minister Jim Flaherty said.

Financial markets used to live in thrall of the Group of Seven, the G20's predecessor as the premier global economic policy-making forum, in case it flagged currency intervention or some other initiative.

For now, at least, the tables are turned.

Held on the weekend of the French Open tennis championships, the Busan G20 was a straight-sets win for bond vigilantes.

"Those countries with serious fiscal challenges need to accelerate the pace of consolidation," read the key line in the communique.

CHANGING THEIR TUNE

Reinforcing the impression of a group on the back foot, ministers abandoned the idea of a universal levy on banks to pay for future bailouts after divisions proved irreconcilable.

And bank lobbying appeared to pay off as several ministers signaled that a lengthy phase-in for new capital rules, aimed at reducing the risk of a re-run of the 2007/08 global financial crisis, was now inevitable.

To be sure, the G20 said public finances had to be brought under control in a way that was growth-friendly and tailor-made for each country's needs.

At their previous meeting just six weeks earlier, ministers had also prescribed customized exit strategies. But they stressed then that countries dependent on fiscal stimulus for growth should maintain their policy support until the recovery was more entrenched and firmly driven by the private sector.

Meeting as the euro fell to a four-year low against the dollar, depressed by fears that Hungary could go the way of Greece, ministers ditched the option of continued stimulus.

Instead, they pledged merely to "stand ready to safeguard recovery" and stressed the "significant challenges" posed by recent market volatility.

"We are not out of the woods," said Egyptian Finance Minister Youssef Boutros-Ghali, who also heads the International Monetary Fund's policy-steering committee.

"The measures they have been required to implement are fairly tough. And there are in some areas doubts whether they are able to continue implementing such tough measures," he told Reuters.

GEITHNER ON THE LOSING SIDE

One reason why the talks were heated, in the words of a senior South Korean official, was a rearguard action fought by U.S. Treasury Secretary Timothy Geithner, who argued that restoring fiscal sustainability was a task for the medium term.

In a frank letter to his counterparts, Geithner warned that global growth would be sub-par if Europe -- especially Germany -- as well as China and Japan did not boost domestic demand to make up for the retrenchment forced upon overindebted U.S. consumers.

But he could take little comfort from events.

Japan elected a new prime minister, Naoto Kan, who is a fiscal conservative and has floated the idea of raising the national sales tax.

China reaffirmed its current policy stance, giving no hint that it was ready to stoke domestic demand by letting the yuan rise.

And Germany gave short shrift to the view, shared by the IMF, that growth would take a hit in the short term if rich economies cut their budget deficits without adjustments by emerging economies to reduce their reliance on exports.

"I made no bones about the fact that I share the IMF's underlying philosophy only in a very limited way," German Finance Minister Wolfgang Schaeuble said.

It is never good news when two of the world's biggest economies bicker. U.S. pressure on Germany to change its monetary policy was one of the factors that unnerved investors in the run-up to the 1987 stock market crash.

The only crumb of comfort for Washington, according to one U.S. official, is that Berlin will not start tightening its belt until 2011.

SETBACKS ALL ROUND

With Europe signing up for austerity, it is no wonder that pessimists such as U.S. economist Nouriel Roubini see the euro zone heading for stagnation if not recession.

And in the absence of a burst in private sector demand in current account surplus countries such as Germany and China, global economic imbalances could deteriorate again -- especially if a resurgent dollar undercuts the revival in U.S. exports.

The immediate test, though, will be whether bond traders will be convinced by the G20's promise of probity.

"Noble intentions by advanced economies to bring their budget deficits under control are rubbing up against the harsh reality of a weak and unstable recovery that might increase the need for further stimulus measures," said Eswar Prasad, a senior fellow at the Brookings Institution, a Washington think-tank.

Prasad, a trade professor at Cornell University and a former IMF economist, said the G20 had recognized the depth of the public debt morass and the consequent risk of global instability.

"But the communique is unlikely to give bond markets much confidence that budget deficits will be brought under control with anything approaching the alacrity with which they were run up during the height of the crisis," he said.

The G20 is grappling with complex issues. It is unrealistic to expect magic-bullet solutions from such a diverse group of rich and emerging economies. But it is tough to put a positive gloss on the Busan meeting.

And, in the end, ministers did not even try.

(Additional reporting by Gernot Heller, David Lawder, Louise Egan and David Milliken; editing by Myra MacDonald)

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