Am 18. und 19. März 2004 findet in der britischen Botschaft in Berlin die diesjährige »CESifo International Spring Conference« statt. Am ersten Tag werden die wirtschaftlichen Perspektiven wichtiger Weltregionen im Frühjahr 2004 behandelt. Im Mittelpunkt des zweiten Tages steht die konjunkturelle Entwicklung in bedeutenden Branchen der europäischen Industrie. Jim O'Neill von Goldman Sachs wird einer der Referenten sein.

Nähere Informationen zur Konferenz finden Sie unter www.cesifo.de/isc. Oder wenden Sie sich an Dr. Hans Günther Vieweg, managing director, Tel.: +49(0)89/9224-1362.

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Economic Outlook: 2004 Global recovery – 2005 the US Loses Steam

As 2004, many forecasters including ourselves are getting more optimistic about the outlook for the world economy. Our forecast for 2004 is above that of many, around 4.5% with the US once more leading the way close to 4.5% according to our projection. At the same time, many, also including ourselves continue to warn about the dangers of the US balance of payments, the current account deficit and now the »twin« deficit problem of the current account and fiscal deficits.

To some extent, the strong recovery for 2004 is almost baked in the cake, and the real question is the sustainability. We believe that beyond 2004 it is difficult to be so optimistic unless the US current account and fiscal deficits are brought under control. Over the past twelve months, strong US growth has been achieved by aggressive monetary policy, significant fiscal easing and the benefits of a weaker dollar. Over time, these stimulative effects will wear off, and unless the same stimuli can be repeated US growth will weaken once more, and the world economy will become more vulnerable.

The key to maintaining our optimism is that US, and other G7 policymakers, need to ensure that global financial conditions do not tighten much. Other policymakers including the Chinese have an important role to play here. In order that global financial conditions don't tighten, this means that US interest rates cannot rise much from their current low levels, or certainly not until other countries have developed much stronger domestic demand led growth.

To maintain low interest rates, the US will need to tighten fiscal policy after the election almost irrelevant of the winner. In such circumstances the value of the dollar will almost definitely need to decline further. Other nations will have to introduce policies to offset the impact of a weaker dollar rather than to try and stop its decline.

Recent trade data suggests to an optimist that the US current account deficit could be stabilising at around 5% of GDP, and in this regard is a hopeful sign. It could be the case that this is just a temporary stabilisation before the strength of US demand sucks in higher imports and leads to fresh deterioration. Even assuming the optimistic scenario, however, a current account balance of 5% of GDP is very problematic. Attracting such capital flows is no longer so attractive for the US especially given the desirability of China, India and elsewhere to US companies. If the current account deficit does not actually soon fall, as opposed to merely stabilise, then the US will see its net external liabilities rise beyond 40% of GDP by 2006. This would create a growing burden for the US in terms of debt financing, and the persistence of a current account deficit close to 5% and a rising debt burden would eventually result in a complete halt to foreign capital inflows.

To reduce this threat, further dollar weakness is not only desirable, it is almost unavoidable. The question really is how much and how soon.

Linked to this challenge is of course the issue of Asian central bank intervention and the incredible growth of Asian foreign exchange reserves. At the time of writing, Asian central bank foreign exchange reserves are about to cross the $2.0 trillion barrier, yes 2 trillion. Japan's foreign exchange reserves now approximate $700.0bn. South Korea has reserves of $155.0bn, Taiwan more than $200.0bn. Even India has reserves in excess of $100.0bn. At some stage, these nations are going to develop sufficient self-confidence that they will reduce their degree of intervention or possibly even stop completely. At some time before the decade is over, some Asian countries will probably move away from using the dollar as the basis for their foreign exchange management policies. It could be that by 2010, Asian countries will manage their foreign exchange policies with an Asian benchmark or at least on a basket basis.

If this latter move were to happen quickly, and Asian currencies float, this could in turn represent a major challenge to the US bonds market, and in turn, to US consumers who would suddenly find their debt servicing burden rise sharply. If such circumstances were to appear, the US demand-led consumption for the world economy would rapidly disappear.

Consequently while the 2004 economic outlook looks sanguine, it is not without risks; and without fresh economic policies, the costs of 2004 success could be borne in later years. To avoid this nasty eventuality, the dollar must decline further and steadily. US fiscal policy needs to be tightened, and other nations need to find more flexible policies to offset dollar weakness. In Europe, the recently enforced flexibility of the Stability Pact needs to be consolidated and changed into something more sensible. It is important also that the ECB tries once more to re-interpret its inflation target, perhaps shifting to a symmetric target around its 2% goal as opposed to »just below«. European authorities may have to deal with a weak dollar for a long time.