

IMF fears European crisis poses risk of major recession

BY HOWARD SCHNEIDER

The global economy is slowing sharply and is at far greater risk of recession than was thought just months ago, with Europe's debt crisis creating "fertile ground" for a rapid collapse, the International Monetary Fund warned Tuesday.

In a sobering trio of reports on growth, public debt and financial stability, the agency described global trade and investment as waning and depicted the world as perhaps one shock away from a serious downturn. The epicenter of the economic turmoil remains the euro zone, where political leaders have not committed the money needed to prop up weakened governments and banks, thereby threatening to create a cycle of "self-perpetuating pessimism" that could undermine the recovery, the IMF said.

Whether the trigger is a government default in Greece, a bank failure or some other traumatic event, "the world could be plunged into another recession," said Olivier Blanchard, the IMF's economic counselor. "The world recovery, which was weak in the first place, is in danger of stalling."

The agency's latest forecasts suggest that the process may be underway. Projected worldwide economic growth for 2012 was trimmed to 3.25 percent from the 4 percent rate projected in September. China and India, which have become major engines of global growth, are predicted to cool to around 8.2 percent and 7 percent, respectively. The IMF projects that the euro zone will fall into recession and contract by about 0.5 percent this year.

IMF CONTINUED ON A16

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European Leaders Agree to New Measures to Enforce Budget Discipline

By **STEPHEN CASTLE**
and **JAMES KANTER**

BRUSSELS — All but two European Union countries agreed Monday to new and tougher measures to enforce budget discipline in the euro zone, but the bloc still showed few signs of producing a comprehensive solution for the sovereign debt crisis or a credible plan to revive fragile economies across Europe's weakened Mediterranean tier.

The meeting of 27 European Union heads of state and government here in Brussels was aimed at completing the text of a so-called fiscal compact for the 17 nations relying on or intending to join the euro zone — with only Britain and the Czech Republic opting not to adopt the measures.

After a meeting lasting seven hours, the leaders also issued a declaration calling for a new push to restart growth and combat joblessness across the Continent.

But a number of politicians and analysts said the pledge by the European leaders to create new jobs was mostly empty, and others complained that the proposed rules to keep deficits under control contained little to actually help nations with high borrowing costs.

The summit declaration also skirted the continuing problems

in Greece, where a second bailout is being held up by the inability of the government in Athens to complete a deal with private holders of Greek bonds over the losses they should accept.

Until Athens and its private-sector creditors can agree on a \$132 billion writedown on Greek government debt, the International Monetary Fund and the European Union are not prepared to sign off on a further bailout. Chancellor Angela Merkel of Germany said the Greek situation would not be addressed until after representatives of Greece's so-called troika of creditors — the European Union, the I.M.F. and the European Central Bank — report back on their investigation into what will be needed for Greece to manage its finances on its own.

Nicolas Sarkozy, the French president, told a news conference at the end of the summit that there would be a "definitive agreement" on the private sector's involvement in reducing Greek debt in coming days. After Monday night's summit meeting, informal talks continued between the Greek prime minister, Lucas Papademos, and European officials.

Despite the various other problems to deal with, an agreement on the fiscal compact could clear



PHILIPPE WOJAZER/REUTERS

President Nicolas Sarkozy of France, Chancellor Angela Merkel of Germany and Prime Minister Mario Monti of Italy before the European Union leaders meeting in Brussels on Monday.

the way for Germany to accept stronger efforts by the European Central Bank to support ailing countries and a more comprehensive bailout fund aimed at protecting Italy and Spain against the risk of default.

"It is an important step forward to a stability union," Mrs. Merkel told reporters. "For those looking at the union and the euro from the outside, it is a very important to show this commitment." Britain, which clashed openly with France and Germany

last month over the pact, did not give any ground Monday and was joined by the Czech Republic, which also elected to stay outside.

"We are not signing this treaty," David Cameron, the British prime minister, said. "We are not ratifying it. And it places no obligations" on the United Kingdom, he said.

He added: "Our national interest is that these countries get on and sort out the mess that is the euro."

Mr. Sarkozy sounded philosophical about the Britons' intransigence. "There are different degrees of integration and everyone is free to choose where they stand," he said.

While European leaders agreed to bring a permanent bailout fund into existence earlier than previously foreseen, they postponed any final decisions on its ultimate size and how it will be financed. The International Monetary Fund has been pressing Europe to commit enough money to provide a credible backstop that would insure that Italy and Spain could pay their bills and continue to finance their debts.

Germany backed away from a suggestion that it wanted the government in Athens to cede temporarily control over tax and spending decisions to a new, all-powerful, budget commissioner before it can secure further bailouts. Italy won its battle to restrict the scope of the fiscal compact, which calls for making it easier to impose sanctions against countries that break European Union budget rules. The text said the compact would make it harder to block sanctions against countries that exceed annual deficit targets but that the same tough system would not apply to nations with excessive overall debt, like Italy.

The compact will come into force in those nations that agree to its terms once 12 euro zone nations have ratified it. That would prevent the project being held up if one or two nations hold referendums on the deal.

Still, impatience with the German focus on belt-tightening loomed large over the summit meeting.

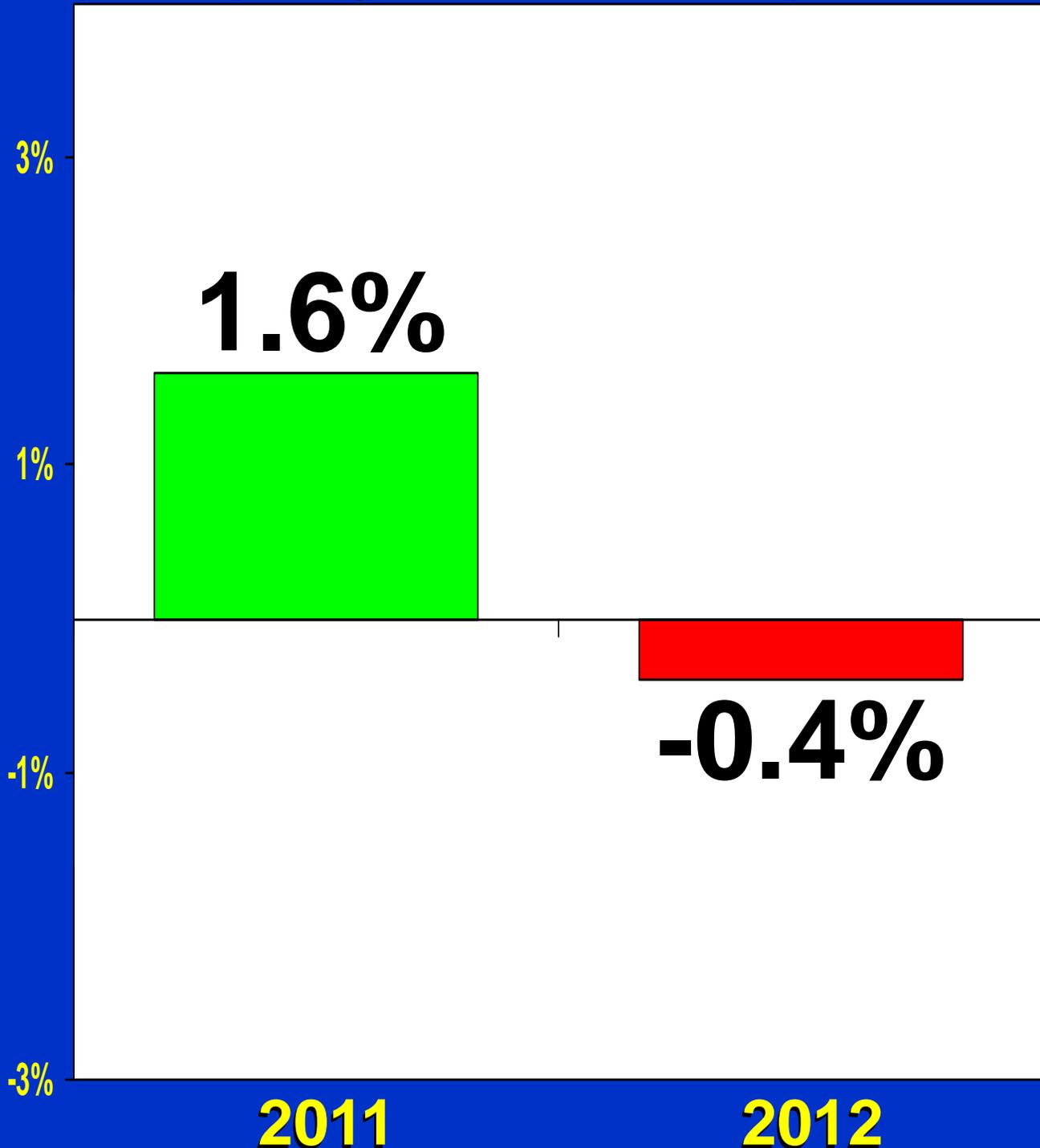
"You don't have to be an economics professor to know that if you have zero growth you are not going to sort things out," said Martin Schulz, the president of the European Parliament. Critics of austerity point to Greece, which is being strangled by a vicious cycle of deficit cutting, declining tax revenues and more budget cutting, while making little if any progress on its overall budget deficit.

Guy Verhofstadt, leader of the centrist liberal and democrat group, and a former prime minister of Belgium, took a similar stand.

"The new agreement consolidates fiscal discipline but omits completely to address the other side of the coin — that of solidarity and investment that will create jobs and growth," Mr. Verhofstadt said. "E.U. leaders should act instead of producing more paper."

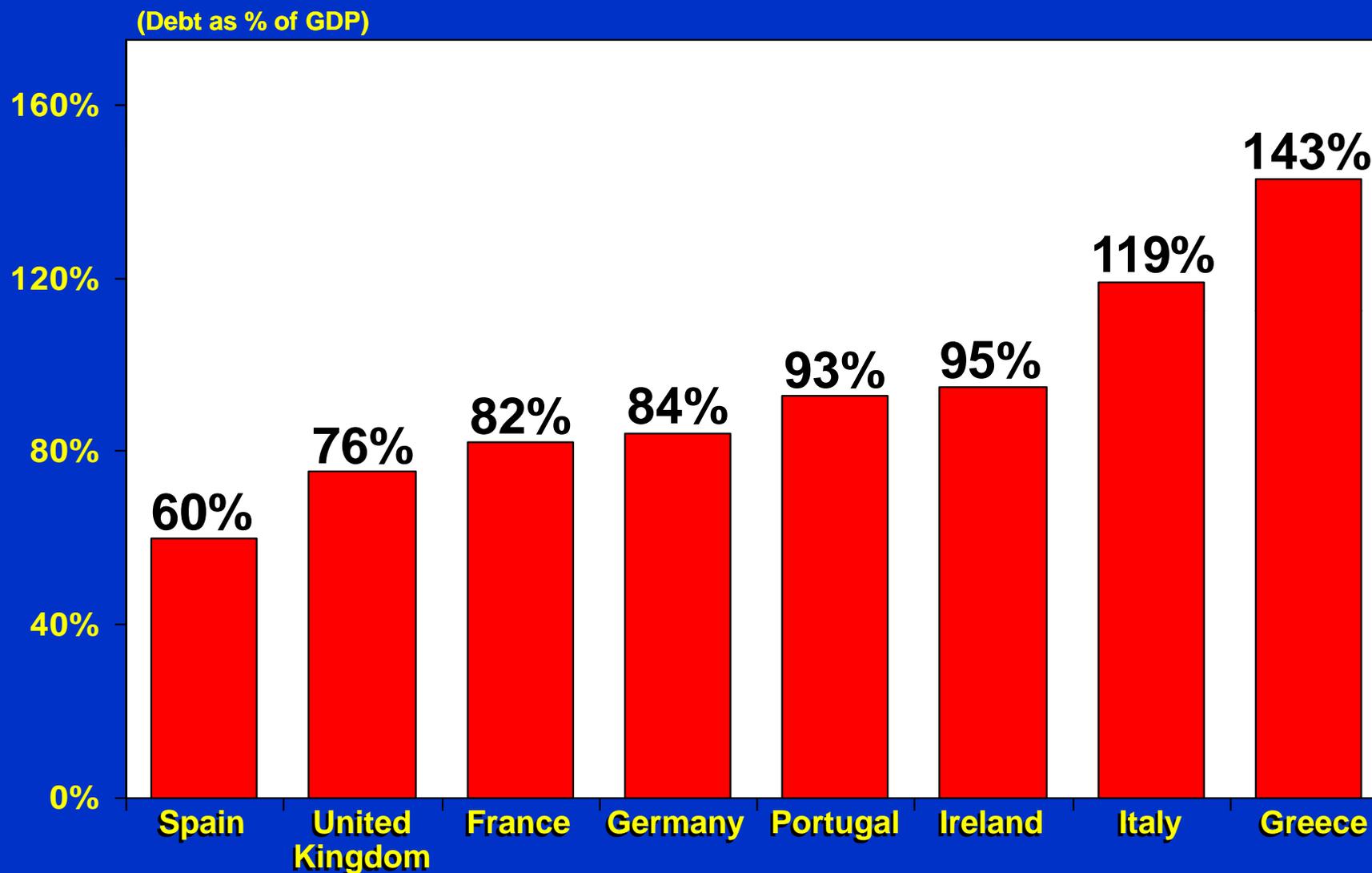
Eurozone Economy Slowing

(Estimated percent growth of real GDP, annual rate)



Source: Blue Chip Economic Indicators, January 10, 2012

European Debt as Percent of GDP



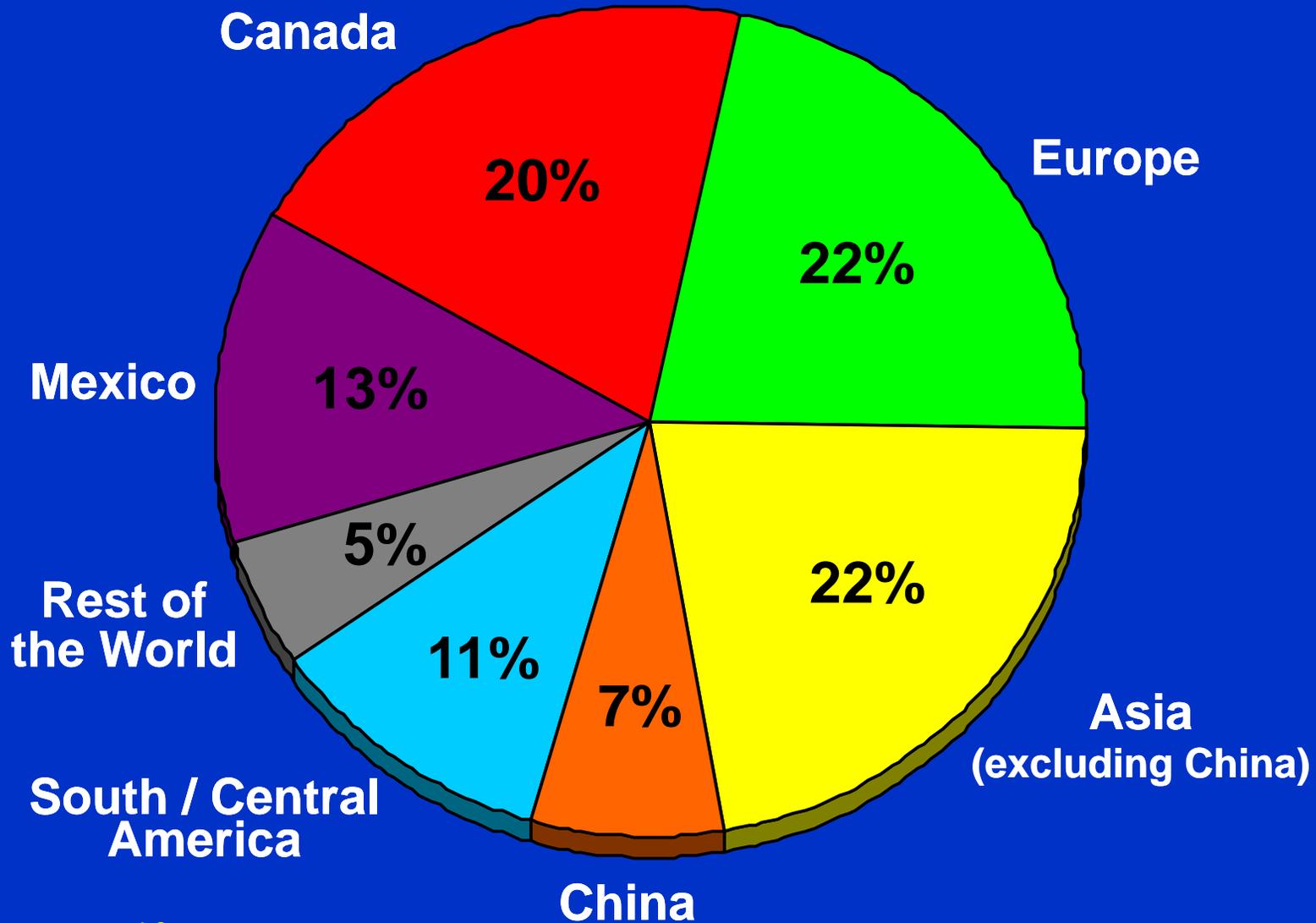
Source: IMF 2010 gross debt figures

Economist Blinder on Threat to U.S. from European Debt / Financial Crisis

“My rough outlook for [U.S.] GDP growth in calendar year 2012 is about 2.5 percent.... The biggest threat to the economy is financial contagion from Europe.... [I]f we get a worse case scenario, a European financial blow up that looked somewhat like Lehman brothers ... I think almost all, if not all, of that putative 2.5 percent growth could just evaporate in a worldwide recession.”

**– Former Vice Chairman of Federal Reserve Alan S. Blinder
Testimony before Senate Budget Committee
January 26, 2012**

Who's Buying U.S. Exports



Source: Department of Commerce
Note: Totals for 2010