IMF: Credit Turmoil Could Cause Global Recession

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WASHINGTON -- The head of the International Monetary Fund Monday warned that an "earthquake" in credit markets may have been so severe the global economy tips into recession, ending a five-year boom.

"Over the past few months, we have lived through an earthquake in the credit markets," IMF Managing Director Rodrigo Rato told the IMF's 185 member countries.

"Like most earthquakes, it has been distant for most people: something they have to read about in the newspapers."

"But there is still a risk of aftershocks."

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Rato, who steps down at the end of October, said the full scale of the financial turmoil, which was sparked by rising defaults in the U. S. mortgage market, could not yet be gauged, but that it was large enough to raise a troubling question.

"The central question now is whether the global economy is at an inflection point," he said. "So far, it seems that growth will continue, although at a slower pace than in the past two years."

The IMF chief, speaking toward the close of a three-day annual meeting of the IMF and World Bank, said the credit market strains that burst into view in August had exposed weaknesses in the world's financial infrastructure that needed to be addressed.

Still, he said corporate balance sheets in developed countries were strong and labor markets generally

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healthy.

"For these reasons, we expect a slowdown in growth but not a recession in the United States, and a smaller slowdown in other advanced countries," Rato said. He added that emerging economies, led by fast-growing countries such as India and China, had become a source of stability.

TASKS AHEAD

Japan's Senior Vice Finance Minister, Otohiko Endo, called on the IMF to strengthen its monitoring of markets, saying it could have been more active in sounding the alarm earlier on emerging problems in the U.S. subprime mortgage market, which caters to borrowers with spotty credit.

"It is true the fund pointed out potential risks and rung the alarm in various reports issued before the summer," Endo told the meeting. "However, these reports did not attract much attention in the capitals or in the markets."

Developing countries have said that the rich nations which have long dominated the IMF have all too often ignored the institution's advice. At the same time, the fund's influence among emerging economies is waning as fewer of these countries find the need for its emergency loans.

Rato said recent market turbulence was a reminder that the good economic times may not last forever, saying that risks to economic growth had clearly risen in the past six months.

Further market disruptions and declines in home prices, which have already begun to slip in the United States, could lead to a global economic downturn. "If there is a downturn, other risks already present will loom larger," he said.

So far, movements in exchange rates have been orderly and in line with fundamentals, Rato added. He warned that an abrupt fall in the U.S. dollar, which has been trading at lifetime lows against the euro, could provoke a loss of confidence in dollar-denominated assets.

There was also a risk that the rise of other currencies, such as the euro, could hurt growth prospects in those regions, he said.

Rato also cautioned there was a risk emerging economies that have relied on external financing to fund large current account deficits could be tipped into crisis by a combination of reduced demand for their exports and tighter credit conditions.

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