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Merkel cautious on guarantees

EU warned about unrealistic pledges

Soros hits out over austerity dangers

By Chris Giles in Davos, Quentin Peel in Berlin and Ralph Atkins in Frankfurt

Angela Merkel, the German chancellor, spelt out her determination yesterday to overcome the eurozone crisis, but warned Europeans against demanding excessive guarantees from Berlin that it could not fulfil.

In a forthright opening speech to the World Economic Forum in Davos, Ms Merkel said Europe could recover the confidence of global markets only if its weaker economies boosted growth and competitiveness with structural reforms as well as ensuring their debts were sustainable.

Germany was prepared to show its solidarity, but "what we don't want is to promise something we will not be able to fulfil".

In response to International Monetary Fund calls this week for bigger firewalls to protect European sovereign debt from speculative attacks, Ms Merkel questioned whether demands to double or treble the eurozone rescue funds would be credible.

"If Germany promises something that cannot be delivered if the markets attack it hard, then Europe would be left with a wide open flank," she said. Part of the answer was to build solidarity through closer European integration, rather than simply to rely on Germany to guarantee the debts of weaker eurozone economies. But individual countries must also act to boost their competitiveness, and ensure their debts were sustainable.

Ms Merkel's uncompromising message – matched by other German participants in Davos – has caused some dismay among other WEF delegates. Some had hoped that Berlin, particularly with its economic strength, would be more open to greater financing of the necessary adjustment process in the eurozone or to that role being played by the European Central Bank.

Speaking to journalists at the forum, George Soros, the financier, blamed Germany for many of the eurozone's woes.

"The austerity that Germany wants to impose will push Europe into a deflationary spiral," he said. "The fact that an unsustainable target is being imposed creates a very dangerous political dynamic. Instead of pulling countries together, it will drive them to mutual recrimination."

To counter such criticisms, Ms Merkel said: "It's not only austerity measures, but also structural reforms that lead to more jobs." She pleaded for patience for the results to be seen of reforms she said were happening in Portugal, Ireland and Italy.

But the contrast between the double-dip recessions predicted or being experienced in southern Europe and continued German economic success was shown yesterday as the country's businesses reported growing confidence.

The Ifo survey of German companies rose faster than expected to a measure of 108.3 earlier this month from 107.3 in December – propelled higher by their expectations of growth prospects rather than the current situation.

The findings suggest Germany could avoid a recession, and support the Bundesbank's view that, after a bleak winter, its economy will rebound later this year.

On Tuesday, the IMF cut its forecast for German growth this year from 1.3 per cent to 0.3 per cent and said it expected 1.5 per cent growth in 2013. But Jens Weidmann, the Bundesbank president, said the IMF was being too pessimistic.

Hans-Werner Sinn, president of the Ifo institute in Munich, said: "The German economy has started the new year with élan."

The Bundesbank expects 0.6 per cent growth this year and 1.8 per cent in 2013. Last year, Germany's economy grew by 3 per cent – twice as fast as the eurozone overall and the US.

Follow WEF coverage at www.ft.com/davos

Japan reveals first annual trade deficit in three decades

By Mure Dickie in Tokyo

Japan recorded its first annual trade deficit in three decades in 2011, according to data released yesterday.

Perhaps the most surprising thing about the Y2.49tn deficit unveiled by the government yesterday could be that it was not bigger.

Last year, after all, saw a huge earthquake and tsunami batter north-east Japan, widespread supply chain disruption for exporters from extreme flooding in Thailand, the rise of the yen to nominal record highs and a nuclear crisis that caused power shortages and sent fuel imports rocketing.

Given such factors, plus weak global demand, a 2.7 per cent year-on-year fall in exports to Y65.55tn and a 12 per cent rise in imports to Y68.05tn looks almost admirable.

But the deficit – the first for a full calendar year since 1980 – has inevitably fuelled doubts about Japan's ability to maintain the trade surpluses on which it has long relied as a vital driver of economic growth. Such concerns are heightened by the knowledge that a switch to chronic trade deficits would make it more difficult domestically to finance a gross state debt already equivalent to two times gross domestic product.

> 'For our company, the work is gradually coming back now'
>
> **Yoshinori Mito, Machinery plant president**

With politicians struggling to agree on how to balance the government books, reliance on potentially fickle foreign investors for deficit funding could be perilous.

Exporters have been issuing increasingly urgent warnings that the rise of the yen – which climbed 17 per cent against the euro in the latter half of last year – will accelerate an industrial hollowing-out that threatens hallowed postwar traditions of monozukuri, the art of making things.

Yoshinori Mito, president of precision parts maker Sanyo Machinery Works in the western city of Osaka, says that like many small and medium sized enterprises (SMEs) in the export sector it was hit hard by supply chain disruption in the first half of 2011.

Mr Mito's company's focus on hard-to-make, high-precision parts means it is still largely shielded from the competition from China and South Korea that is threatening many SMEs but the strong yen is a real burden. "We want action as soon as possible on the currency," he says.

Yesterday's data suggest that it would be too soon to write off Japan Inc as unable to compete. The nation recorded a 2011 surplus of Y4.1tn with the US, for example, while staying in the black in trade with Asia as a whole and with the European Union.

Before the March 11 earthquake and tsunami, trade was still in overall surplus. The big deficits are with resource producing regions led by the Middle East.

"The main reason for Japan's trade deficit is not that Japanese products are less competitive but that import prices have risen because of stubbornly high energy prices," economists at Nomura wrote in a recent research note.

Japan has needed to buy more fuel. Meltdowns at tsunami-crippled Fukushima Daiichi nuclear plant have created a crisis of confidence in atomic power that has left all but five of Japan's 54 commercial reactors offline. This has increased reliance on thermal power stations.

Imports of liquefied natural gas rose 12 per cent in volume in 2011, costing the nation Y4.77tn – 38 per cent more than the previous year. With no clear road-map for restarting shut-down reactors, such imports are likely to continue, dragging down GDP growth for some time.

Still, Goldman Sachs economist Chiwoong Lee says gradual recovery in the global economy and the fading impact of last year's disaster will help restore Japan to trade surplus by the second half of the fiscal year to March 2012.

"We do not expect the trade deficit to persist even if Japan's export competitiveness declines," Mr Lee wrote in a research note.

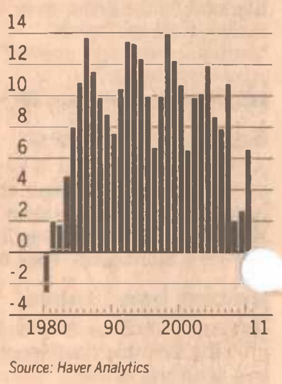
Mr Mito of Sanyo Machinery Works is optimistic that recovery will continue but notes that the economic environment remains fragile. Growing international tensions over Iran's nuclear programme, for example, could lead to higher oil costs that would further suppress growth, he says.

"For our company, the work is gradually coming back now [and] if there are no new external factors, then that should continue," Mr Mito says.

"But there is a lot of uncertainty."

A dip or a blip?

Japan trade balance (¥tn)



Source: Haver Analytics

IMF takes tougher stance over level of Greece's debt

Borrowing

Fund is pushing Athens and creditors to take measures to reach a sustainable target, writes Alan Beattie

The often taciturn International Monetary Fund has had a lot to say this week about the eurozone debt crisis. Christine Lagarde, its managing director, urged the eurozone on Monday to create a much bigger rescue fund for its troubled governments, holding out the prospect that the fund might seek to increase its own firepower in return.

Yesterday, she argued that if Greece's private creditors did not accept a big enough writedown, the European Central Bank might have to take a reduction in its own Greek debt holdings. "The balance between the participation of the private and the public sector is a concerning question," Ms Lagarde said.

The IMF insists that it is not pushing for any particular combination of private and public financing. Although the IMF has to sign off on any new bail-out for Greece in which it takes part, fund officials say that, following its rules on lending to debt-laden countries, it takes largely a technocratic rather than a micro-managing role. Its task is to point out the size of Greece's external financing gap and then invite the private sector and the European authorities to work out their own ways to fill it.

Olivier Blanchard, the IMF's chief economist, reiterated on Tuesday that the IMF insisted merely that Greece and external creditors take steps to put the country on a realistic track to achieving a ratio of public debt to gross domestic product of 120 per cent by 2020. "How [Greece] does it is not for us to decide," he said.

If it looks like the fund is getting more assertive with the eurozone over the bloc's approach to the sovereign debt crisis, IMF experts say the real shift in the fund's position is its increasing pessimism over Greece's debt sustainability.

Initially, after the May 2010 Greek bail-out announcement, the IMF went out of its way to stick to the official line that no writedown of its external debt would be necessary.

In September 2010 a team led by Carlo Cottarelli, director of the IMF's fiscal affairs department, wrote a policy note entitled, Default in Today's Advanced Economies: Unnecessary, Undesirable, and Unlikely, which argued that even a negotiated voluntary restructuring was likely to do more harm than good. Noting that the difference between real interest rates and growth – a key determinant of a countries' ability to avoid default – was relatively low, even in Greece, the paper concluded that a 50 per cent writedown in Greek debt would only reduce by a fifth the fiscal tightening required to reach sustainability.

With the spreads on Greek bonds rising in 2011, and growth underperforming expectations, the IMF moved towards an increasingly pessimistic view of Greece's ability to grow its way out of its debt burden.

"The fund has got harsher because reality has got harsher and they are responding to it," says Ted Truman of the Peterson Institute think-tank in Washington. "Once you get into a debt restructuring situation, it pays to err on the side of doing too much rather than too little, because you don't want to have to do it twice".

The IMF's most recent assessment of Greece's debt sustainability, in December, was markedly downbeat. Officials involved in talks over Greece say the IMF has been taking a more pessimistic line on debt sustainability than the eurozone authorities, arguing that more official finance is needed to hit the 120 per cent debt to GDP target.

Gabriel Sterne, an economist at Exotix, a brokerage specialising in distressed debt, says the fund's December analysis was an implicit admission that it had been too lenient. "Just like in Argentina [10 years ago to the month], the fund has discovered that . . . a commitment to the unsustainable is an unsustainable commitment," he writes in a research note. "The IMF is making a serious attempt to free itself from the shackles of significant past policy mistakes."

Mr Sterne, a former IMF official, notes that the target ratio of 120 per cent of public debt to GDP by 2020 is a relatively recent development. In previous reviews of the bail-out, the fund was content to release funds even though the projected debt to GDP ratio was higher.

The future for the Greek rescue will depend on how much the IMF allows its debt sustainability calculations to be influenced by lobbying from the European authorities and private bondholders.

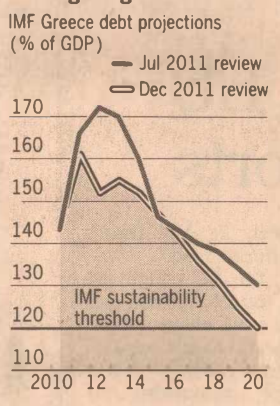
But the signs this week are that it is at least taking a tougher line than before.

Interactive graphic, www.ft.com/consequences

Free lunch: thousands queue in the square outside the Greek parliament in Athens yesterday to pick up onions, potatoes and other vegetables given away by farmers who set up stalls to distribute 25 tonnes of foodstuffs Reuters

Getting tougher

IMF Greece debt projections (% of GDP)



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UK data raise stagnation fear

By Norma Cohen in London

Britain's economy shrank in the fourth quarter of last year, adding to fears of economic stagnation and increasing the likelihood that the Bank of England may print more money to shore up an "arduous, long and uneven" recovery.

David Cameron, prime minister, said he was "disappointed" by the growth figures, which showed the economy contracting by 0.2 per cent in the quarter.

During 2011 as a whole, UK gross domestic product increased by 0.9 per cent, less than half the 2.1 per cent growth rate in 2010. Ed Miliband, Labour opposition leader, accused the coalition government of "smug complacency" and said it was running out of "excuses" for the economy's poor performance.

Although economists are generally not forecasting a double-dip recession, they are pessimistic on growth prospects. "Even if the UK does avoid recession, there appears little scope for a meaningful recovery during the first half of 2012," said Allan Monks, economist at JPMorgan.

The fourth quarter contraction announced yesterday followed growth of 0.6 per cent in the third quarter of 2011. The data showed that services, the nation's single largest sector, was flat for the quarter.

Sir Mervyn King, Bank governor, signalled this week that the Bank was likely to continue printing money for some time as he warned of another difficult year for a country suffering a "debt hangover".

> 0.2%
>
> **The amount which the UK economy contracted by**

"After the steepest downturn in output since the 1930s, . . . the path of recovery is likely to be arduous, long and uneven," he said.

The Bank governor's warnings coincided with official figures this week showing that the UK's public sector net debt for the first time exceeded £1tn.

The outlook for public borrowing further ahead is clouded by weaker economic forecasts, which could reduce tax revenues. The International Monetary Fund has lowered its prediction for the UK growth in 2012 to 0.6 per cent.

Separately, new data showed bank lending to British industry fell sharply in December. Sentiment among UK manufacturers has deteriorated, the CBI business lobby reported, as "confidence was hit by stagnant output, falling demand and concerns over exports". A CBI survey found domestic and export orders fell for the first time in two years.

Sir Mervyn said the efforts of banks and households to pay back some of their debts would hinder growth. Rising equity prices and falling inflation "does not mean 2012 will be an easy year", the Bank governor said. After inflation, wages had endured their longest period of stagnation since the 1920s, he added.

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India debars space scientist

Corruption inquiry claims senior scalp

By James Fontanella-Khan and James Lamont in New Delhi

India's wave of corruption scandals claimed its most respected casualty yesterday when the country's senior space scientist said he had been banned from government employment.

Madhavan Nair, former head of the Indian Space Research Organisation, has denounced an investigation into his conduct at the agency and launched a stinging attack on Isro's management, warning that it was being wrecked.

Mr Nair, who supervised 25 space missions, is credited with helping to transform the space programme into a showcase for India's high-tech abilities. His efforts propelled India into a regional space race with China and Japan and earned him international recognition.

He is now president of the Paris-based International Academy of Astronautics, a role usually filled by US scientists, and chairs several government research committees.

The fallout from the inquiry puts in jeopardy a highly prestigious programme at the heart of New Delhi's claims to be a rising superpower.

India has in the past two years signed agreements with leading powers, including the US, Russia and France, to boost its activities in space. The programme is a source of immense national pride: exploring space was a dream of Jawaharlal Nehru, India's first prime minister.

Mr Nair, 68, faces allegations he was involved in the underpriced leasing of space spectrum to the private sector. Those allegations have been under investigation by a panel set up by Manmohan Singh, the prime minister, after the state auditor estimated that improper dealings cost the exchequer Rs20bn ($400m).

Mr Nair, who retired from the agency in 2009, has denied any wrongdoing. He said yesterday that the space programme was "grinding to a halt" and had failed to advance any significant initiative over the past two years because of incompetent leadership.

He complained that he had been given no opportunity to defend himself in the inquiry. No criminal charges have been laid and are unlikely to be, given high security surrounding the space programme.

"Even in an autocratic or military regime an opportunity would have been given to the person who has been blacklisted," he said.

Isro declined to comment on the investigation into its allocation of satellite-based spectrum in 2005, without a bidding process, to Devas Multimedia.

Bangalore-based Devas paid the agency $130m for about 60 MHz of the S-band frequency, which provides high-speed mobile internet.

"This attack against [Mr Nair] is politically motivated and will hurt India's entire space programme," a space expert said.