The significance of Japan's $60bn pledge

Summary

- **We read Japan's US$60bn pledge to the IMF to be of considerable significance.**
- **What is currently playing out is a ballet in which:**
  - **The non-European great powers are progressively going to put up the anti-speculation money; but**
  - **They will offer it no faster than they feel they have to, all the while demanding the maximum from the European's themselves.**
- **The various latest IMF *World Economic Outlook* pronouncements need to be read against that backdrop.**

Preamble

We regard the announcement by the Japanese that they have pledged US$60bn to the IMF to be of considerable significance.

We believe that the great bulk of analysis and commentary on the euro area approaches the issue at too low a level, i.e. at a sub-systemic level. And, by so doing, it is drawing the wrong conclusion.

Our view

In our view the right argument runs as follows:

1. The euro area has design flaws.
2. There are really only two (binary) outcomes:
   - fix these design flaws; or
   - see the countries picked off one by one – the weakest first.
3. Trying to limit break-up would be too huge a risk: a Europe in turmoil would be absolutely contrary to the interests of the whole world – Japan, China, the rest of Asia, the US, Canada etc. (From the US perspective, a disintegrating Europe would be to plunge the region back to the pre-Marshall Plan days and represent a fundamental failure of the post-WWII strategy).
4. At the same time, the major powers are deeply frustrated by the European failure initially to appreciate the seriousness of the situation; then to deal with it in a resolute way; and now to put up sufficient money.
5. The strategy of the major powers therefore (like that of the ECB) has to be two-pronged:
   - Put the Europeans under all possible pressure to implement the full range of fiscal and structural policies needed to make the euro area viable in the medium term; while
   - In return, making sure that there is sufficient money available from outside Europe to pre-empt any Gaderene-like speculative rush developing.
6. We wrote all throughout last year (in our Economic and Financial Market Forecasts) that we believed the surplus countries in particular would, if push came to shove, stump up the requisite funds. We became more confident in this view after speaking to one of Japan's special advisors to the Cabinet Office Government of Japan at the end of January this year.
7. Japan is pivotal in this process. It is highly likely, particularly given the signal that it is putting up more money than expected, that Japan is at the centre of the diplomatic effort to bring in other countries, including importantly China (with whom Japan is now cooperating closely over helping to establish the renminbi as an international reserve currency).

What is currently playing out therefore is a ballet in which the non-European great powers are progressively going to put up the anti-speculation money, but will offer it no faster than they feel they have to, all the while demanding the maximum from the European's themselves.

The various latest IMF *World Economic Outlook* pronouncements need to be read against that backdrop. ■

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