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UPDATE 1-IMF says clean up banks to tackle dire world crisis

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* Economic crisis dire, risk of unrest and war - IMF

* Recovery depends on cleaning up bank balance sheets

(Recasts, adds quotes, details, background)

By Jonathan Lynn

GENEVA, March 23 (Reuters) - The world is in a dire economic crisis, but no recovery is possible until the financial sector is cleaned up, the head of the International Monetary Fund said on Monday.

The crisis will push millions into poverty and unemployment, risking social unrest and even war, and urgent action is required, IMF Managing Director Dominique Strauss-Kahn said.

"Bluntly the situation is dire," he told a meeting on the crisis at the International Labour Organisation, a United Nations agency representing unions, employers and governments that studies labour issues.

Strauss-Kahn was talking less than two weeks before a summit of the G20 leading nations on April 2 to tackle the crisis.

As the crisis spills over into developing countries, millions of people will be pushed back into poverty and hardship, Strauss-Kahn said.

"All this will affect dramatically unemployment and beyond unemployment for many countries it will be at the roots of social unrest, some threat to democracy, and may be for some cases it can also end in war," he said.

REVERSAL

Strauss-Kahn confirmed that the IMF would shortly update its economic forecasts to show the world economy contracting by between 0.5 and 1.0 percent this year -- the first reversal in more than 50 years of sustained growth.

Developed countries would shrink by a post-war record of about 3 percent, he said.

But the IMF still believed recovery was possible in 2010 provided bold policies were followed.

Firstly this involves boosting demand, but monetary policy -- moving interest rates -- has reached its limits, even with the unconventional tools central banks are using, he said.

That is why the IMF had called for governments around the world to pump money in the economy to the tune of 2 percent of gross domestic product, he said.

He noted that this did not mean that all countries should provide this fiscal stimulus, as some were in too fragile a financial position to increase spending.

But so far those countries that could afford it had pumped in about 1.6-1.7 percent of world GDP.

"I do believe there is still some room to go further in some countries, but taking it all round it's not that bad," Strauss-Kahn said, adding this showed that international coordination was working well.

But the prerequisite for success was the restoration of a healthy financial sector, he said.

Although bailing out banks was politically unpopular, businesses and households could not survive without a working banking system, he said.

The IMF's experience of 122 banking crises around the world had taught it that economic recovery was impossible until banks were cleaned up, whether this was done quickly or slowly.

"You can put in as much stimulus as you want. It will just melt in the sun as snow if at the same time you are not able to have a generally smaller financial sector than before but a healthy financial sector at work," he said.

Despite the need for many countries to run huge deficits, emerging countries must not ignore the importance of rebuilding confidence in order to attract private capital in a globalised world, he said. (Reporting by Jonathan Lynn; Editing by xxx)

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