When Will This Crisis Hit Bottom?

By Noboru HATAKEYAMA

When the global economic crisis will hit bottom is the question most frequently asked nowadays. There are at least four answers to this question.

The first answer is that since this crisis is the outcome of a business cycle, it will bottom out within a few years. However, this time, there have been many cases that have happened for the first time ever or for the first time in many, many years. For example, Japan's industrial production index nosedived 8.1% last November as compared with the previous month. It was the largest decline in the history of this statistical record, which is 55 years old. Last December, the value of the yen went up to ¥87.10 per US dollar at one point, which was the highest in 13 years since 1995 when the rate hit a record high ¥79.75 yen. If the yen rate breaks through this level, it will surely be another historic record.

Therefore this crisis does not look like a cyclical phenomenon that comes and goes every five years or so.

The second answer is that since this crisis requires us to implement structural adjustment of national economies across the world, it will not be over until after structural problems have been resolved. Those problems in the US economy include excessive private consumption relying on debts and the twin deficits of fiscal and current accounts. Before the Lehman Brothers collapse, there was excessive liquidity in the US monetary market which could find nowhere to go except for subprime loans.

In the case of Japan's economy, the yen rate had remained too low in recent years although it was not intended by its monetary authorities. Because of this low yen rate, for example, Japan's exports increased more than 10% in 2006 and 2007 with the yen averaging ¥117 and ¥118 per dollar in these two years respectively.

Many Asian countries, including China, depend too much on exports, especially to the US market. China relied on the Untied States for 37.5% of its exports in 2007.

Structural problems have to be adjusted. People do know a necessity to do so theoretically. However, people did not change their lifestyle or policies practically from inside. Then outside power started working in the form of an economic crisis, which is sort of an explosion of the magma of structural problems left intact for many years in the past.

Therefore, until after structural problems have been resolved, the crisis will not disappear.

We have already seen drastic changes in problems as mentioned above. Due to the burst of bubbles, US personal savings started increasing, with their rate going up from less than 1% in the second quarter of 2005 to 2.6% in the first quarter of 2008, reducing the personal consumption ratio in turn. Of course, excessive liquidity has disappeared because of banks' lost confidence in customers after the burst. Reflecting the increased value of the yen and decreased demand for goods and services from the rest of the world due to this crisis, Japan's exports declined for five months in sequence until last December (the latest data available), when exports shrank as much as 35.0% from the same month in 2007.

As are shown in the figures above, if we sliced off the bubble-caused flab from the economies of developed countries, what we can expect would be very modest growth, if any, for each economy. The reason why OECD members were able to enjoy 2.8% economic growth on average for three years between 2004 and 2007 was just thanks to the US economic bubble. Therefore, even when the world economy comes back to normal, the growth rate enjoyed in the bubble economy will not return.

The third answer is as follows. Since this crisis is telling us that economic demand in developed countries has been saturated, recovery will not come until and unless innovative technologies for goods and services are developed, especially in developed countries or new markets in developing countries. Those new goods and services will include those useful to battle global aging and global warming.

The fourth answer is that since this crisis originated from the presumption of US home prices going up forever, we have to go back to basics – analyzing the housing market in quest of clues to finding out when to recover. The S&P/Case-Shiller Home Price Indices started declining in January 2007 in terms of the 10-City Composite index. Although the pace of decline then was only 0.5%, I think this was the beginning of the burst of the US economic bubble since the home price indices continued to record minus growth from then on, with the size of decline for each month steadily expanding until last October (the latest data) when a drop of 19.1% was recorded. It took 22 months for the pace of fall to reach roughly 20%. It is said that another 20% decline will occur. It will take another 22 months from last November. Then, in October next year, this crisis will hit bottom. JS

Noboru Hatakeyama is chairman/CEO, Japan Economic Foundation. Before then he was chairman/CEO, JETRO. A former senior trade official, he undertook many trade issues, including the Uruguay round of GATT talks. He is known as a pioneer of debate on FTAs involving Japan.