Warnings of a US recession and global slowdown

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18 August 2006

Three commentaries published in the *Financial Times* over the past week have pointed to the increasing likelihood of a US recession that would have major implications for the global economy.

In an article published on August 10 under the title "The world must prepare for America's recession", New York University economist Nouriel Roubini warned that while the US Federal Reserve Board may have been hoping for a "soft landing" when it decided earlier this month to halt its cycle of interest rate rises, the decision has come too late and it now confronts a recession.

"The US recession will be triggered by three unstoppable forces: the housing slowdown; higher oil prices; and higher interest rates. The US consumer, already burdened with high debt and falling real wages, will be hard hit by these shocks," he wrote.

According to Roubini, the effects of the housing slump will be more severe than those that followed the collapse of the technology stocks bubble in 2000. This is because property comprises a much larger component of household wealth than technology stocks and about 30 percent of the increase in US employment since the recession of 2001 has been related to housing.

The latest US gross domestic product (GDP) figures were an "ominous signal" with consumption of durable goods falling, residential investment in "free fall", and inventories on the increase as production confronts falling sales. "Higher investment in equipment and software, expected to offset lower spending on housing and consumption, is instead falling."

While the Fed may try to counter the impact of a recession by cutting interest rates, "the housing and consumption slump will dominate any monetary easing."

Recession in US would have widespread international ramifications because "the room for monetary and fiscal easing is much more limited now than in 2001, when the Group of Seven industrialised countries slashed [interest] policy rates and eased fiscal policy. There are now serious limits to monetary easing as global inflation is up; and fiscal policy cannot be eased either as almost all G7 countries face serious fiscal imbalances.''

Similar predictions were made in a comment by Morgan Stanley chief economist Stephen Roach published on Monday. It would be a "serious mistake," he wrote, to extrapolate the world growth rate of 4.8 percent over the past three years into the future. "There is a much better chance that global growth has peaked and the boom is about to fizzle."

"The world's main growth engine, the US, is slowing. That is the verdict from the labour market, with job growth in the past four months running 35 percent below the average since early 2004. It is the verdict from the housing market, where an emerging downturn in residential construction activity is knocking at least 1 percentage point off the GDP growth trend of the past three years."

The changes in the US were critical for the global economy, which has become ever-more dependent on American consumption spending as the source of final demand. The gap left by a cutback in US consumption was unlikely to be filled. Even though economic growth in the eurozone was expected to be 2.5 percent this year—the highest since 2000—it was not likely to be sustained, and could fall back to below 1.5 percent next year. "The European economy is about to be hit with a 'triple whammy': a big tightening in fiscal policy, the delayed impact of monetary tightening and the drag of a stronger euro."

Increased growth in the Japanese economy could not

fill the gap left by a downturn in the US. While growth should exceed 2.5 percent this year, it could slow to less than 2 percent in 2007.

Neither would the "two dynamos" of Asia—China and India—be able to counter the trend in the major economies. With China facing the risk of an overheated economy, financial authorities face little choice but to introduce tightening measures.

There was likely to be a "moderation of China's growth beginning in 2007, with attendant reductions in its voracious appetite for commodities. That should spawn ripple effects in commodity producers such as Australia, Canada, Brazil and Africa." A Chinese slowdown would also impact on the major oil producers as well as on its Asian suppliers, such as Japan, Korea and Taiwan.

"There is a deeper meaning to the coming global slowdown," Roach concluded. "The global boom of the past four years was never sustainable. It was supported by the excesses of the liquidity cycle, which arose from emergency anti-deflationary actions of the world's big central banks. The ensuing vigour of global growth was dominated by the US consumer but America's binge came at the cost of a record drawdown of domestic savings funded by the capital inflows of a record US current account deficit. The boom was balanced precariously on unprecedented global imbalances. Excess liquidity bought time for a precarious world. As central banks move to normalise monetary policy, that time has run out."

In other words, the underlying instability of the global economy, which made its appearance in the Asian crisis of 1997-98 and the collapse of the stockmarket bubble of 2000-2001, having been alleviated by extraordinary loose monetary and credit-creation policies, may be about to make a reappearance.

In a comment also published on Monday, *Financial Times* columnist Wolfgang Munchau concluded that anyone who thought that Europe and Asia might take up the slack caused by a severe slowdown in US economic growth "might want to add that the tooth fairy should visit overnight and put piles of cash under the pillow." Far from the eurozone escaping from a US downturn, its impact might be even more serious than in America.

While it took five months for the US to recover from the recession of 2001, he noted, it was five years before the eurozone returned to pre-recession levels of economic growth. Japan and China could not act as a substitute either as both economies depend directly or indirectly on US consumer demand for economic growth.

The extent of that dependence is indicated by export figures. In 2005, 32 percent of China's merchandise exports went to the US, along with 23 percent of Japan's and 20 percent of the 10 countries of the Association of Southeast Asian Nations (ASEAN).

Over the past decade, the Asian economic growth rate has been higher than the US, but the share of the region's exports going to the US has remained the same. In other words, the economies of Asian region have become more dependent on consumption demand in the US. This means that far from being able to counter the impact of the slump in the US, they will be significantly impacted by it.