The US Economic Crisis: Impact on Northeast Asia, Lessons from Japan

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The Oriental Economist Report

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Shorenstein Asia-Pacific Research Center

November 19, 2008
Impact on Northeast Asia

- Korea, Japan and China all very vulnerable
- Decoupling theory is wrong
- In this decade, Japan, Korea and China have all depended excessively on a rising trade surplus to drive growth
- Japan and Korea’s exports to China hinge on Chinese exports to the US
- US imports slowing
- No Obama protectionism
Japan
Forecast for Two Consecutive Years of Negative Growth
Demand Ultra-Dependent On Investment and Trade Surplus

- **Invest.**: Share of GDP = 16%, Share of GDP Growth = 36%
- **Trade Surplus**: Share of GDP = 4.3%, Share of GDP Growth = 41%
- **Household Consum.**: Share of GDP = 55%, Share of GDP Growth = 33%
Now Capex and Trade Surplus Detracting From Growth

Contribution to GDP Growth

-2.0% -1.5% -1.0% -0.5% 0.0% 0.5% 1.0% 1.5% 2.0%

2008-I 2008-II 2008-III

- Capex
- Trade Surplus
Wage Share of GDP Plunges

1980-2001 average
Income is Deficit-Financed

Total net disposable income

Govt tax cuts and transfer payments

Private income

Real Disp. Income as % of GDP


58% 59% 60% 61% 62% 63% 64% 65% 66% 67% 68% 69% 70% 71% 72% 73% 74%
Household Savings Rate Drops

Savings rate (% of disposable income)
Trade Surplus Hit Record % of GDP
(before pulling back)
Decoupling theory is wrong
Nikkei 225 Echoes S&P 500
This Decade: 70% Correlation Between US and Japanese GDP
Japanese Global Exports Mirror
US Global Imports

Yr-on-yr % growth

Japanese exports

US imports
Japanese Exports to China Mirror Chinese Exports to US

Anti-Japan boycott in China
Japanese Exports to Asia Mirror Asian Exports to US

Yr-on-Yr growth

97 98 99 00 01 02 03 04 05 06 07 08

Asian economic crisis

Japan exports to Asia  Asia exports to US
Japanese Exports to Asia Mirror

Chinese Exports to US

Yr-on-Yr growth

-30% -20% -10% 0% 10% 20% 30% 40% 50%

97 98 99 00 01 02 03 04 05 06 07 08

Japan exports to Asia
Asia exports to China
Capex Mirrors Exports Quarter Earlier

Yr-on-Yr growth, Exports

Yr-on-Yr growth, Capex

Exports (lagged)

Capex
Korea
Consumption Share Falling

Consumption % of real GDP

1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007
Culprit Is Low Personal Income

The constant dollar measure of disposable income shows a drastic decline, but the nominal won measure also shows a big decline.
Excess Reliance on Trade Surplus

Trade surplus as % of real GDP

Asian financial crisis

1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007
Unbalanced Growth

Black column shows the percentage of GDP; grey chart shows the % of GDP growth during 2002-07
Korean Exports to China Hinge on Chinese Exports to US

50% correlation between ROK exports to China and Chinese exports to US in 1994-2008; rises to 72% correlation in 2000-2008
Much Looser Link Between ROK Exports to China and China’s GDP

Smaller 32% correlation between ROK exports to China and Chinese GDP; falling to negligible 7% correlation in 2000-2008
China
Consumption Drops as % of GDP
(due to drop in household income as % of GDP)

Figure 2. Household consumption as percent of GDP, 1978-2006

One of Lowest Consumption Rates
(despite rapid rise in absolute terms)

![Graph showing consumption as a percentage of GDP against per capita GDP, with China marked as an outlier.](image-url)
Make up Demand Shortfall Via Capex
Make up Demand
Shortfall Via Trade Surplus

Figure 4. Net exports of goods and services, 1992-2007F

Renminbi Rises 22% vs. $
US Locomotive Hits Brake

• Japan, Korea, China can only run trade surplus of $100 billion or $200 billion or $300 billion if rest of the world combined runs equal deficit
• For most of this decade “rest of the world” has mostly meant USA
• Not anymore
US Imports Slowing

US Real Import growth year-on-year
US Trade Deficit Down 45%
Lessons for America From Japan

• Do Too Much Rather Than Too Little
• Move Too Soon Rather Than Too Late
America Is Not Japan: Three Differences

• Cause of the crisis
• Size of the crisis
• Response of Policymakers
Causes

- Japan: Deep-Seated Structural Flaws
- US: Policy Mistakes Driven By Ideology and Interests plus post-Lehman/AIG Investor Panic
- Better Parallel is not Japan’s Lost Decade But Asia 1997-98 (in causes, not severity)
Stock Market Bust

Japan since end of 1980s bubble; US since end of dot.com bubble. Data through Nov. 18
Stocks Gyrate More Wildly Than GDP
Japan real estate bubble dwarfs America's.
The Debt Load of Corporations

![Graph showing debt to operating profits ratio for Japan and USA over time](image)

- **Japan**
  - Peaks around 1998
  - Gradually decreases after 2002

- **USA**
  - More stable compared to Japan
  - Peaks around 1998
  - Stays relatively flat after 2002
Job Losses Less Than in 2001 Recession

% change in jobs since pre-recession peak

Months from employment peak

November forecast by 55 economists

Nov. 2007 onward
forecast
May 1990 onward
March 2001 onward
Aug. 1981 onward
No Credit Crunch Pre-Lehman
(just normal recession deceleration)
Strong Bank Balance Sheets

Ratio of Net Worth to Assets

NPLs Like Typical Recession

Delinquency rate (one month past due)

- All loans
- Mortgages on single-family homes
Banks Are Still Lending

Data through Nov. 5
Mortgage Foreclosures
Mostly Subprime (2008-II)

<table>
<thead>
<tr>
<th></th>
<th>% of Outstanding Loans</th>
<th>% of Total Foreclosures</th>
<th>foreclosure rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prime Fixed</td>
<td>65%</td>
<td>19%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Prime ARM</td>
<td>15%</td>
<td>23%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Subprime Fixed</td>
<td>6%</td>
<td>11%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Subprime ARM</td>
<td>6%</td>
<td>39%</td>
<td>17.1%</td>
</tr>
<tr>
<td>FHA &amp; VA</td>
<td>8%</td>
<td>7%</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

Total foreclosure rate: 2.47%

ARM = Adjustable rate mortgage
FHA & VA = loans financed by Federal Housing Authority and Veterans Agency
Household Wealth Still Strong

Data for end of period; data through June 2008
Corporate Net Worth Strong

Ratio of net worth to financial liabilities
Post-Lehman Panic in Commercial Paper

Total CP outstanding ($ mil.)

Lehman collapse
Post-Lehman Panic in Bond Market

Interest Rate Spread

- Baa bond
- Aaa bond
- 10-year Treasury

Lehman bankruptcy
Policy Response

- **Japan**: Years of Cover-up, Denial, Support of Zombies, Mismanaged Macroeconomic Policy
- **US**: Fiscal and monetary stimulus, rapid write-down of assets, allowing big institutions to fail, government bailout, correcting deregulatory excess, new efforts when some efforts prove insufficient or ineffective
Outcome?

• Depends on Policy: Republicans Like Feldstein and Democrats Like Summers Urging Big Fiscal Stimulus (2% of GDP for 2-3 years) and Some Kind of Mortgage Refinance to stop foreclosure-price cycle

• Probably recession not quite as bad as 1980-82 when US suffered zero growth for three years and unemployment hit 11%