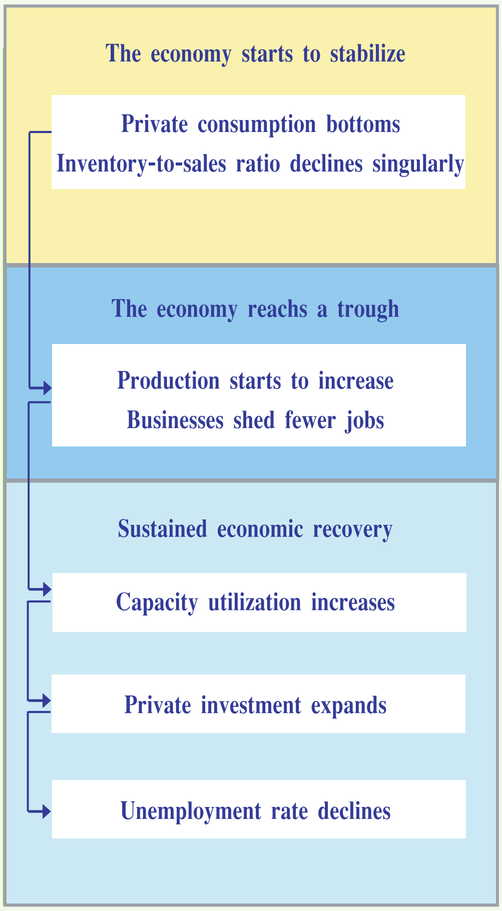
Prospects for a global economic rebound

As the current global economic recession originated from the economic and financial crisis in the US, the world's largest economy by purchasing power and the world's largest net importer, the prospects of a global economic recovery crucially depends on the US economic rebound. This article analyses the prospects for such an outcome as well as what should become of the Euro area, Japan and Asia going forward.

Key indicators for US economic rebound

A pattern from the past seven US recessions[1/] during 1960 to 2005 indicates that sustained economic recoveries can be characterized by a firm rebound in private consumption and private investment combined with employment growth. The common sequence of a sustained recovery path is as follows: (1) the economy starts to stabilize when private consumption bottoms and inventory-to-sales ratio continues to decline; (2) the economy reaches the trough and businesses start to increase production and shed fewer jobs in anticipation of a subsequent improvement in domestic demand and; (3) an increase in capacity utilization induces an expansion in business investment as well as hiring. These improvements support private consumption and lead to sustained economic recovery.



Several of the latest financial and economic indicators in May 2009 have started to exhibit signs of impending stabilization, mainly on the back of the fiscal stimulus and measures toassist the financial sector. This improvement indicates that the US recession may be entering its late phase. In addition, recent financial indicators show signs of improvement; for instance, the bond yield spreads which continue to fall to levels before Lehman Brothers' bankruptcy. Private consumption also may be close to bottoming out through continued improvement in retail sales and persistent decline in inventory to sales over several successive months.

The production and employment indicators have begun to level off. Industrial production has declined at a slower rate for 4 consecutive months from the peak of -7.7 per cent in January 2009. The number of job losses in the non-farm sector declines gradually

[1/] Comprises (1) Recession during 1960-61 (2) Oil Price Crisis during 1969-70 (3) Stagflation during 1973-75 (4) Second Oil Price Crisis (5) Saving and Loans Crisis during 1981-82 (6) Financial Crisis during 1990-91 and (7) Dot Com Crisis in 2001 from the peak of 741,000 jobs lost in January 2009 to 467,000 in June 2009. This employment condition will support a revival of personal income and can help arrest the fall in private consumption.

Despite encouraging signs of stabilization, primarily due to the fiscal stimulus which would raise average US GDP growth rate during 2010-2014 by 0.8-1.0 percentage point according to the Congressional Budget Office, output between 2009-10 is still projected to be around 7.0 per cent below potential. This negative output gap implies that the fiscal thrust alone may not be sufficient to put the economy on a firm recovery path in a timely manner.

Furthermore, an important hindrance to the recovery process is capacity utilization which at 68.3 percent in May 2009 has been at the lowest level since 1957. Moreover, tight credit condition and unresolved financial institution problems can inhibit the recovery of private investment.

In summary, the upturn in consumption, production and employment in the non-farm sector suggests that the US economy will likely approach a stabilizing phase and therefore contract at a diminishing rate on a year-on-year basis in the following period. However, the high rate of unemployment and historically low capacity utilization, coupled with the delay in the resolution of financial institution problems, are major obstacles to private investment and consequently to the US recovery prospects.

The recovery prospects of other major economies

The Euro area faces comparably severe financial stress as the US does, but it has been less aggressive in addressing the problems. There are also limitations in employing fiscal stimulus programs. Besides, the unemployment rate has been high. It is therefore expected that these factors would cause European recovery to lag that in the US.

For Japan, even though consumer confidence has improved and production has become more stable, public debt is elevated and domestic demand continues to be weak. Therefore, Japan's recovery would likely lag that in the US as well.

Even though the Asian economies have not suffered direct financial losses from this global crisis and governments have implemented the financial measures and extensive fiscal stimulus to support growth, the Asian economies will expand at a lower rate than pre-crisis average, as they are highly export-dependent and reliant on major industrialized economies. An exception is China, which is expected to grow significantly from investment and consumption upswing on account of the effective economic stimulus packages. However, the Chinese economy would not be able to replace the US as a main global growth driver during the subsequent recovery period.

In summary, the US economy has started to show stabilizing signs but risks to the prospects of recovery remain high and it will take time for the US economy to recover fully. The Euro area and Japan are expected to rebound at a slower pace compared to the US while the rest of Asia will likely expand gradually going forward.