



The Knowledge to Decide

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Channel News Asia Prime Time Morning
23 December 2008

Health of the global economy in 2009

Synopsis

The world economic crisis could put 25 million people out of work and the recession is likely to continue for much of 2009. Group Managing Director of Spire Research and Consulting, Leon Perera, shares his views on the outlook for the global economy in 2009.

Unemployment

"Certainly unemployment is inching up. All of the major economies are either in recession or in very slow growth. The unemployment level in the US, which is the biggest economy in the world, is close to seven percent and that is a very high level. The big recessions in the 1980s saw unemployment levels at about nine percent so we're quite close to that.

We expect some reversal of the unemployment trend and some recovery in the economy in the second half [of 2009] if the fiscal package in the US works. In any case, even if there is continued slowdown in the developed economies, we feel that Asia will be less affected so unemployment will not be as horrendous in most of the Asian countries as what we're seeing in the US.

Recovery of the economy

The expectation and hope is sometime in the second half of next year... It really hinges on firstly, whether unemployment can be reversed and I think, the incoming Obama administration correctly senses that. It's targeting the safeguarding or creation of 3 million jobs with their fiscal stimulus plan. Once we can bring down the unemployment rate, then the prospects for encouraging banks to resume lending and companies to resume investing are much stronger. There are many healthy banks and companies in the world, particularly in Asia and Japan, that are sitting on large piles of cash. A lot hinges on whether we can get that virtuous cycle of confidence going again.

Inflation as an economic threat

We feel that, on balance, inflation will still be present next year. If you look at consumer pricing around the world, it will probably still be above the ten or 15 year trend line. But it would not be as high as it was this year. I don't think we will see the kinds of highs in commodity prices next year as we saw this year, particularly in terms of agri-food... That was a big cause of the inflation.

But we do see some upsides in the commodity prices – energy prices, metal prices, non-food agri. We feel that those will go up next year. Even though we have a weak demand and weak economy, inflation will still remain above average next year.

We don't feel there will be a steep inflation. But nevertheless, the fact of the matter is that we are still not over some fundamental supply-demand imbalances in terms of commodities. Commodities are very unlike stocks and shares or investment instruments – there is a core underlying demand for commodities; they need to be consumed.

If you look at the other side of the inflation equation, there are constraints on supply. There are long lead times to bring a new supply of commodities onto the market. The current low prices have led to under-investment. So, on balance, we feel that this basic supply-demand imbalance in commodities will re-assert itself next year and in the medium-term, going forward. Probably not steep inflation, but relatively high inflation compared to the last 15 years or so.

State of US economy and Japan

Japan's export performance has been disastrous. Business confidence in Japan among the big international companies as well as the SMEs is really at very low levels. That tells us something about the weak state of global demand in the US – Japan exports a lot to the US.

But I think crucially it also tells us about the high level of the yen. The yen is basically too strong. Right now it is at 90 yen to the US dollar. And that is actually a big cause of Japan's export weakness. I think the focus of policymakers right now, rather than the interest rates, should be the exchange rate. Open market operations, for example, or the loosening of monetary policy in order to weaken the level of the yen to the US dollar and other major currencies.

Bank of Japan's close-to-zero key policy rate

The interest rate policy will not succeed – interest rates are already very low. The markets have discounted further lowering of the interest rate. Historically, it has not worked very well in Japan. In this sense it is very unlike Europe or America or other economies where interest rates are at a very much higher level. So

essentially we see this as quite futile. The focus should be the exchange rate at this stage.

China's timid rate cuts

What the China authorities are trying to do is leave room for further rate cuts. China is bracing itself for more bad news as we go through the Christmas season and into January. They're trying not to cut rates too aggressively so that they can manage some kind of soft landing for the economy. That is a wise move at this stage – everyone is expecting more bad news, particularly in the south of China where there is a lot of exporting to the US and to the developed countries.

Europe's interest rates

The European Central Bank is historically more conservative than the US Fed so we do expect some trimming of the rates next year but this will not occur aggressively, in large sweeps or quickly.”
