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GLOBAL MARKET COMMENT: GLOBAL SYNCHRONOUS SLOWDOWN

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The Global Synchronous Slowdown

In some ways, the current global downturn seems like a garden-variety slowdown: profits are shrinking, industrial production is falling, unemployment is rising, and consumers are growing cautious. While world economies have yet to officially fall into recession, what is particularly worrisome about these common markings is that they were largely set in motion by the investment bust in the United States. The knock-on effects of this bust have generated forces that are unusual for their global scope. The key issue for the global economy in the future is whether the next recovery, when it finally arrives, will correct the imbalances that the boom created in each economy, or whether continued reliance on the United States as the world's locomotive will merely paper over their existing stress points.

Synchronous global slowdowns are rare; the last one occurred in the early 1980s. In the postwar era, most downturns were caused by restrictive monetary policies by central banks in response to rising inflationary pressures. Domestic factors certainly introduced a distinct home-grown flavor to each global slowdown, but each was triggered by an exogenous systemic shock, such as the oil embargo 30 years ago. In the case of the current global downturn, its contours began to take shape over the late-1990s, as global economies and financial markets grew increasingly reliant on the United States. They depended on the United States to buy their exports, to advance their fledgling technology and telecom sectors, and to benefit from its seemingly ever-rising equity market. When America's high-growth machine began to sputter, imbalances in their economies began to emerge as well.

The Downside of Global Trade

This global slowdown is lethal for three reasons. First, global trade can cushion the effects of a downturn for one economy because exports usually increase, courtesy of lower exchange rates. During a synchronous global slowdown, however, this benefit is not available because most other economies are mired in the same slowdown and cannot absorb others' exports.

Second, global trade as a share of world GDP has steadily increased since 1990, reaching nearly 25% by the end of 2000, compared with only 19% during the 1990-91 recession (see Table A). Reliance on trade as the driver of growth carries risks that accelerate on the downside as well. This is currently playing out, as trade growth has sharply decelerated from 12.8% in 2000 to an estimated 1.4% in 2001. The impact of increased global trade is compounded because the United States—the largest consumer of imports—is leading this market downturn. The U.S. share of global imports grew from 14.9% in 1995 to a record 19.3% in 2000. In comparison, during the 1990 recession, the U.S. share of global imports was only 14.6%, and 13.8% during the 1981-82 recession.

Third, the effects of the bursting of the TMT bubble have been widespread as technology has become a global industry and as global investment in U.S. equities has exploded in recent years. By 2000, non-U.S. investors owned $1.7 trillion in U.S. equities, up from $398 billion in 1994, with most of the surge occurring from 1998 to 2000 when they poured $152 billion into U.S. equities (see Table B). These investors are now seeing their national wealth deteriorate as the U.S. equity market is in the midst of a steep decline. In addition, investors of almost every nationality have pushed up equity prices in their domestic markets, especially in the technology and telecom sectors, and in the process equities have become an increasingly vital component of their national wealth.

The global downturn has affected all regions, particularly those with a high dependence on exports and those with relatively weak domestic economies. For Europe, the softening of overseas markets has hit the region hard, because exports account for 15% of its GDP, which represents a greater international exposure than exists in either the United States or Japan. In addition, its domestic economy is subject to the risk that the bursting of its own TMT bubble will result in curtailed consumer spending. Further complicating matters, is that government authorities in Europe have been reluctant to stimulate the economy with fiscal or monetary measures. In Japan, weak international demand has not only limited the potential to increase exports, but it has also magnified the problems of its own liquidity trap and dysfunctional banking system, by putting the burden for recovery on domestic demand and consumer spending. Shrinking international capital flows have hurt all emerging economies, especially emerging Asia where exports account for about 40% of its GDP. The global slump in commodity prices, brought about by the sudden drop in global demand, has aggravated the highly leveraged Latin American economies and their currencies.

Footprints of the Downturn

Tables C-F indicate the rarity of global slowdowns and their effects. The current period is the first time since the early 1980s when all major economies decelerated simultaneously. Unemployment is rising across the board, though the United Kingdom is holding up relatively well. Industrial production growth has been one of the most visible casualties of the slowdown, while business confidence has also dropped dramatically. Consumer confidence has kept the global economy from falling into a steeper recession, but it may be starting to crack under the pressures of rising unemployment and business retrenchment. The possibility that we are at the precipice of a full-blown global recession cannot be ignored. The good news is that most central banks are trying to reflate their economies, though their willingness and ability to do so is varied.

Are Equity Markets Discounting Its Full Effects?

Consensus analyst earnings estimates have been continually ratcheted down over this year, but still appear to be overly optimistic. As the table below shows, analysts expect earnings to contract in all developed markets but the United Kingdom and Japan in 2001, and to rebound sharply in 2002. If global markets are on the brink of a global recession, further downward earnings revisions will follow.

Earnings Growth Estimates (%)

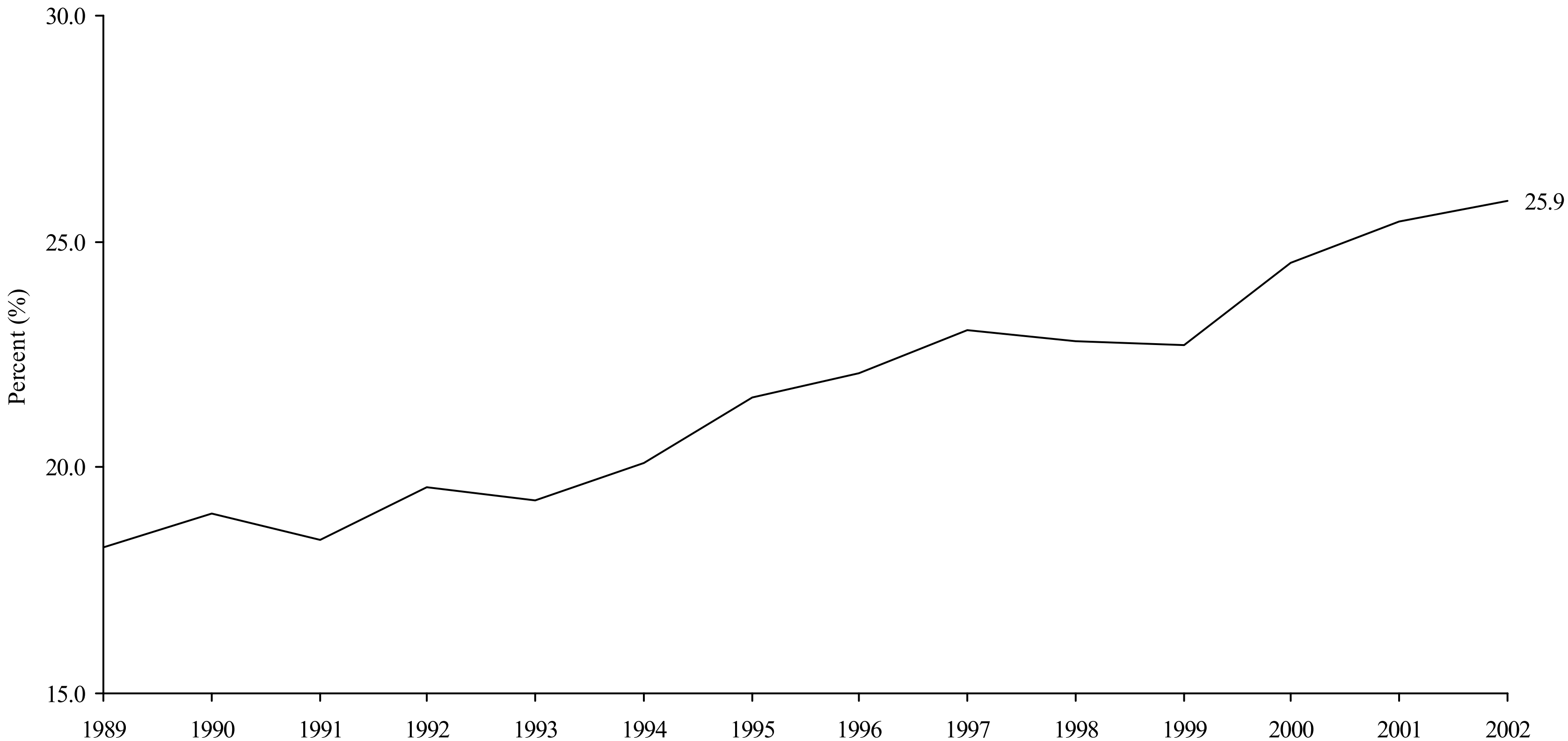
Index	2001	2002
FTSE World	-11.2	16.4
S&P 500	-14.8	17.2
FTSE U.K. 100	3.7	8.1
FTSE Europe ex U.K.	-13.4	17.2
Japan Topix	2.5	38.2
FTSE Pacific Basin	-11.1	33.0
FTSE Pacific ex Japan	-4.0	22.5

Source: I/B/E/S International, Inc.

Table A

GLOBAL TRADE SHARE OF GDP

1989-2002



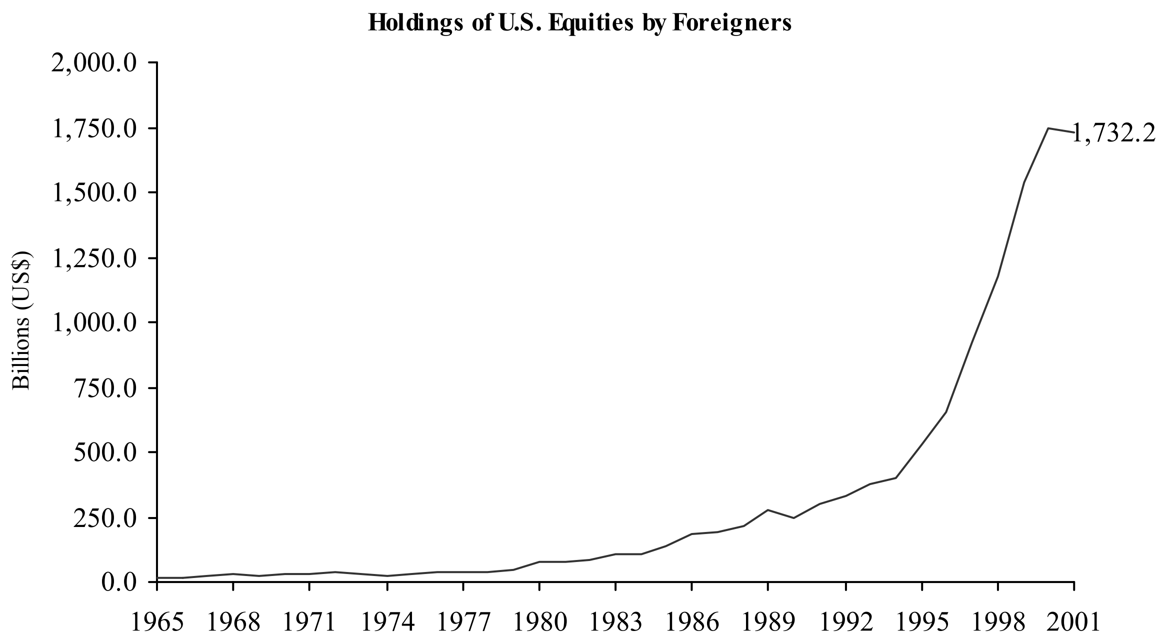
Source: International Monetary Fund.

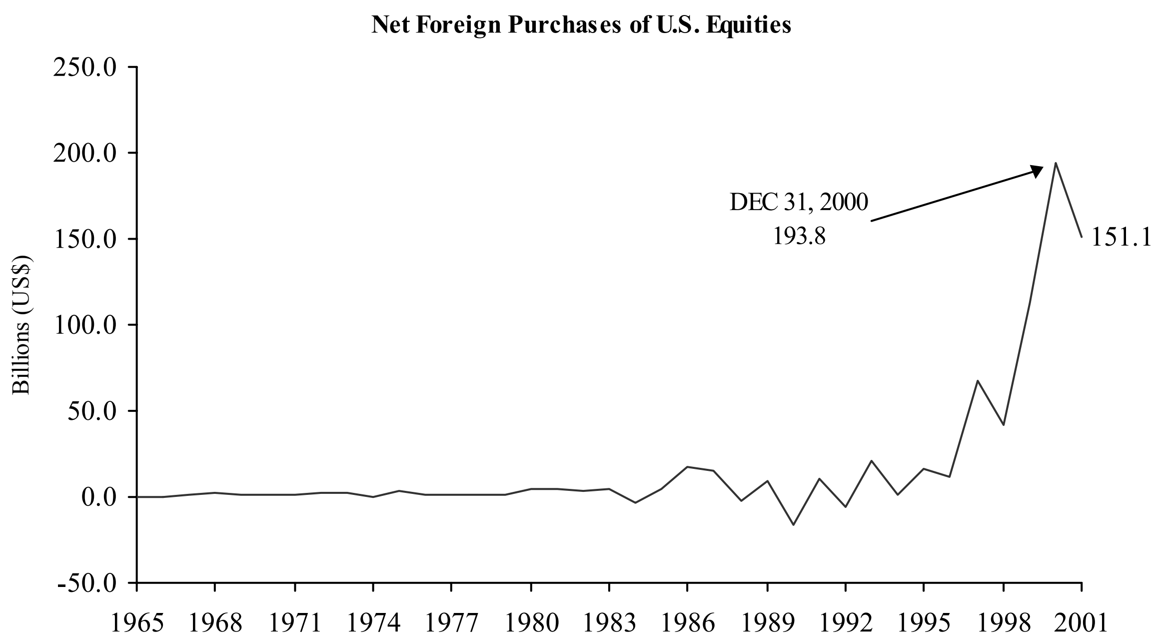
Notes: 2001 and 2002 data are projected. The graph represents world exports of goods and services as a percent of real GDP.

Table B

FOREIGN PURCHASES AND OWNERSHIP OF U.S. EQUITIES

January 1, 1965 - June 30, 2001





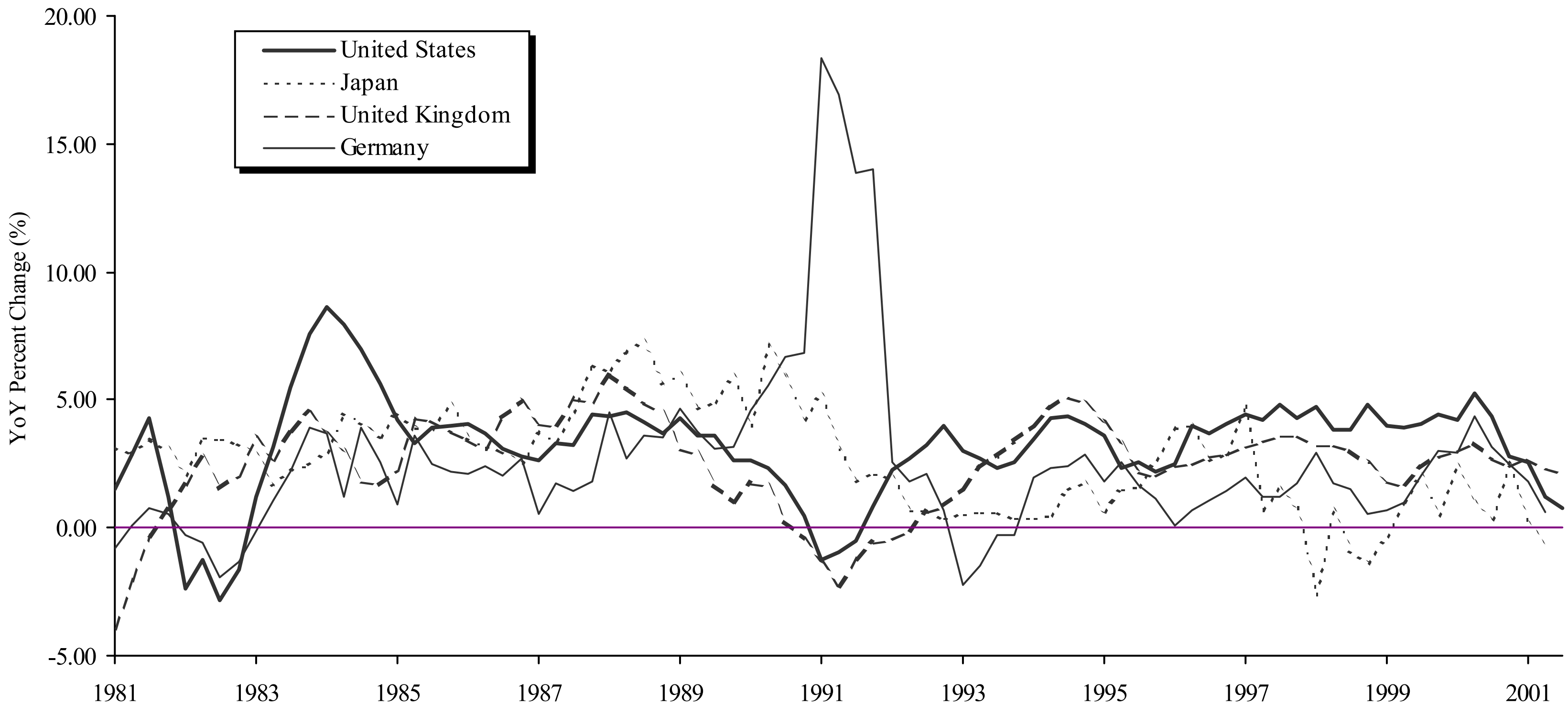
Source: Federal Rerserve.

Note: Foreign purchases figure for 2001 is annualized.

Table C

REAL GDP GROWTH IN DEVELOPED COUNTRIES

April 1, 1980 - September 30, 2001



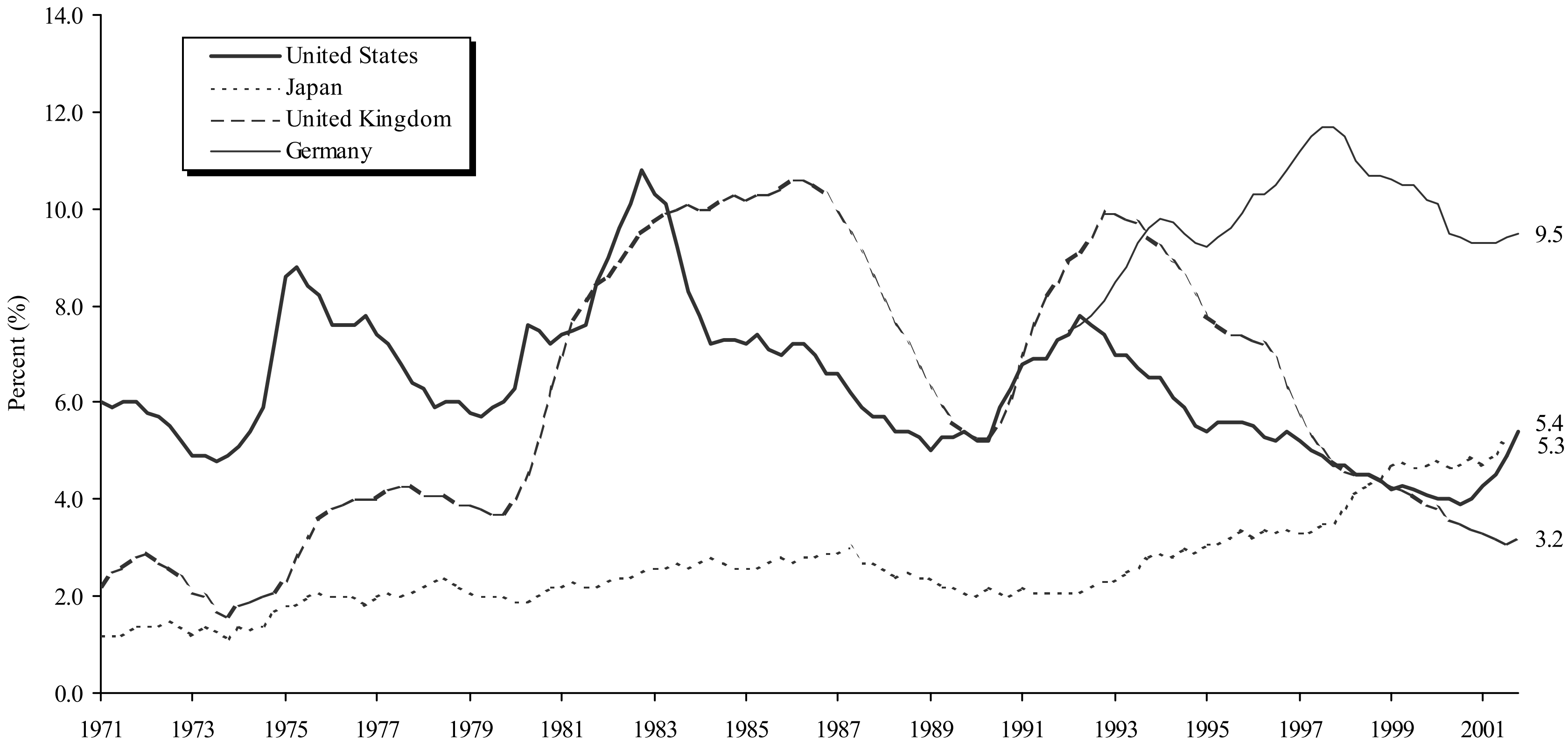
Source: Datastream International.

Notes: Real GDP data are in local currency. Japanese and German GDP data are through June 30, 2001. In the United States over the last five quarters, year-over-year GDP growth has decelerated 4.4 percentage points, from 5.2% to 0.8%. German GDP growth fell 3.7 percentage points for the year-ended June 2001, from 4.3% to 0.6%. Japanese GDP growth is down 3.2 percentage points over only two quarters, from 2.5% as of year-end 2000 to -0.7% as of June 2001. U.K. GDP growth is down only 1.1 percentage points from 3.3% as of June 2000 to 2.2% as of September 2001.

Table D

UNEMPLOYMENT IN DEVELOPED COUNTRIES

March 31, 1971 - October 31, 2001



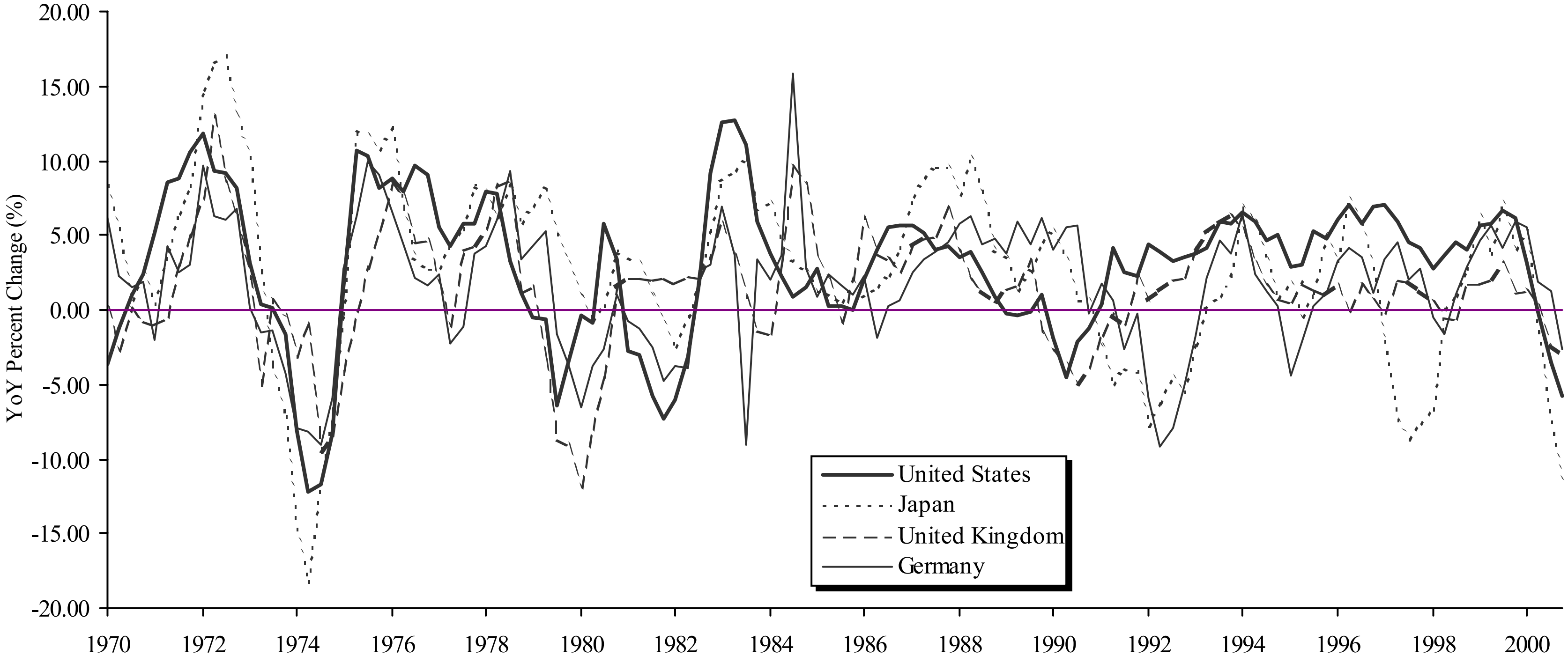
Source: Datastream International.

Notes: German unemployment data begin March 31, 1992. Japanese unemployment data are through September 30, 2001.

Table E

INDUSTRIAL PRODUCTION IN DEVELOPED COUNTRIES

January 1, 1970 - September 30, 2001



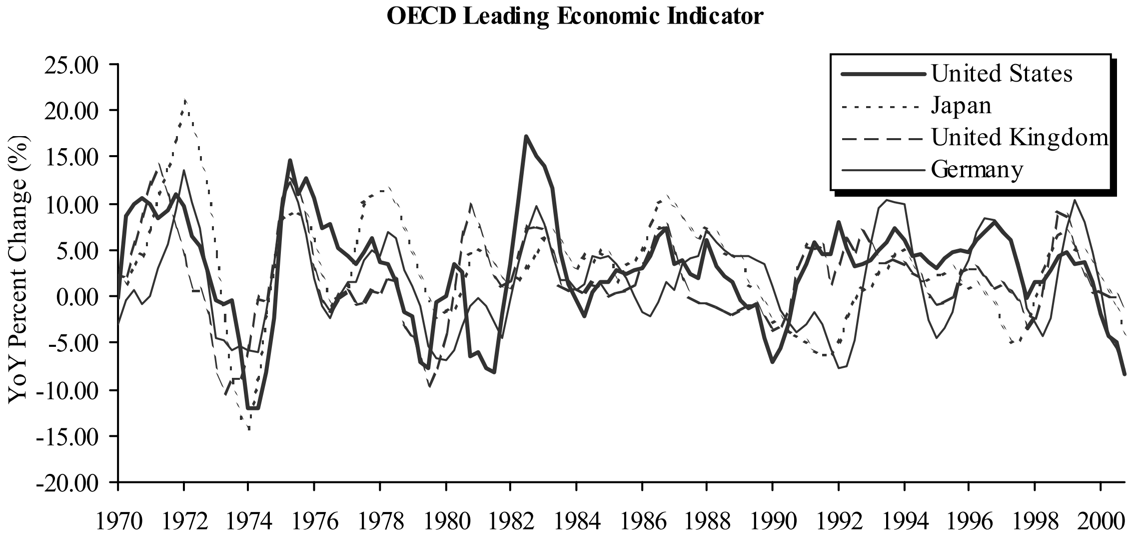
Source: Datastream International.

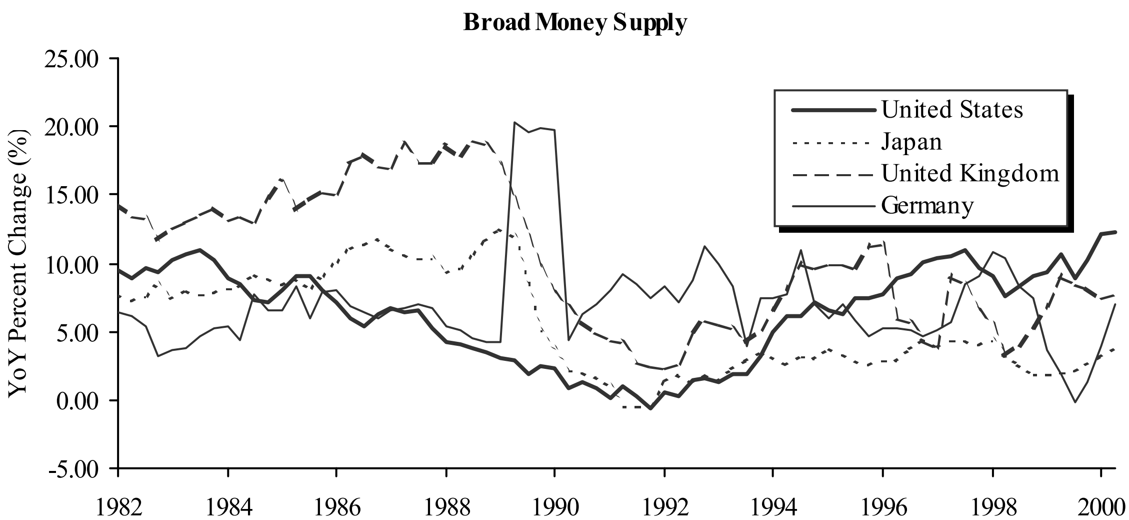
Notes: In the United States, the current drop has far outpaced all downturns since at least the third quarter 1982, plunging an astounding 12.5 percentage points over the last five quarters (from 6.7% as of June 2000 to -5.8% as of September 2001). In Germany, industrial production shrank 8.5 percentage points over the last year (from 5.9% as of September 2000 to -2.6% as of September 2001). Japanese industrial production is down 16.8 percentage points over three quarters (from 5.3% at year-end 2000 to -11.5% as of September 2001). U.K. industrial production is down 6.1 percentage points over five quarters (from 3.1% as of June 2000 to -3.0% as of September 2001).

Table F

OECD LEADING ECONOMIC INDICATOR AND BROAD MONEY SUPPLY IN DEVELOPED COUNTRIES

January 1, 1970 - September 30, 2001





Source: Datastream International.

Notes: Money supply data are in local currency and begin September 30, 1982. Money supply data are in nominal terms. Japan money supply data are not seasonally adjusted. Money supply are defined as follows: United States, M3; Japan, M2 + CD; U.K., M4; and Germany, M3. The U.S. Federal Reserve has cut interest rates from 6.5% to 2.0%; the Bank of England, from 6.0% to 4.0%; and the European Central Bank, from 4.75% to 3.25%. Year-over-year broad money supply growth in the United States increased from 8.9% as of year-end 2000 to 12.3% as of September 2001. Through September 2001, broad money supply growth increased from 1.9% as of June 2000 to 3.7% in Japan, from 3.2% as of September 1999 to 7.8% in the United Kingdom, and from -0.2% as of year-end 2000 to 7.1% in Germany.