US-led global recession

A Chinese perspective on America's Economic Crisis

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It's time to take seriously a US-led global recession

I think it is time that we should take a serious look at the possibility that the US is going to take us down towards a worldwide recession in one or two year's time.

It is well known that the US is the world's biggest economy, taking up about 30 per cent of global GDP, but it is now also the world's biggest debtor country. According to the most authoritative person on this subject, the US Comptroller General David Walker, who audits the federal government's books, the tab for the long-term promises the US Government has made to creditors, retirees, veterans and the poor amounts to US$43,000 billion, US$145,000 per US citizen, or US$350,000 for every full-time worker.

And this figure does not even take into account all the personal debts such as credit card bills and mortgages. With a low interest rate of 1 per cent running for the past three years in a row, savings plummeted to just 1.8 per cent last year, below 1 per cent since January and at zero in the latest estimate from the Bureau of Economic Analysis. In 2000, household debt broke 18 per cent of disposable income for the first time in 20 years. Credit card debt alone averages US$7,200 per household.

The US Government indebtedness is financed this way: The US now runs a trade deficit roughly 6.5 per cent of its GDP and the gap is widened every day. Its citizens are spending ever more on foreign goods, and with the US dollar as the international currency, the US Government just prints money to finance the deficit. And with this money, central banks in the surplus countries purchase most of the US Treasury bonds as currency reserve.

By now, Japan is the largest creditor of the US Government, and the Chinese mainland has been a fervent buyer for the last few years. As for Hong Kong, most if not all of our reserves are in US dollar denominated assets. The US Government in turn uses this foreign borrowed money to finance as much as 90 per cent of the federal deficit which stood at US$412 billion last year. The federal deficit is expected to be running at about US$2 billion a day at the moment.

Put it simply, the Americans have been living way beyond their means for much too long. On top of this, the Bush Administration is cutting tax at least three times while fighting an expensive war in Iraq, which has already cost the country US$700 billion, and currently progressing at US$5.6 billion per month. Now the US economy is dependent on the central banks of Japan, China and other nations to invest in US Treasuries and keep American interest rates down. The low rates keep American consumers snapping up imported goods.

Any economist worth his salt knows that this situation is unsustainable. This includes the country's economic guru driver Alan Greenspan, who recently warned his countrymen that the federal budget deficit would hamper the nation's ability to absorb possible shocks from the soaring trade deficit and the housing boom. Now he may have to add two more worries: soaring oil prices and cyclones.

The US is now clearly in huge trouble, economically, socially, politically, and internationally. The Bush Administration bungled big in cyclone Katrina's aftermath in New Orleans, and then a minor rerun from Rita in Houston, and this will trigger the general outburst of people's dissatisfaction with the government, leading to great internal turmoil lasting for many years. In all likelihood, long-term interest rates are going to rise, and the greatest property bubble the world has witnessed is going to burst in the next one to two years.

The countdown is in progress, and there is no way that anybody can do anything to reverse it either by short-term measures such as fiscal and monetary policy, or through long-term reform of tax policy, entitlement programmes and even the entire federal budget. This is as inevitable as gravity, and it will take place under a new and inexperienced chairman of the Federal Reserve Board. I do not want to sound alarmist, but I see very bad omens.

To make things simple, let us just examine some key economic issues raised by some economists:

What if the dollar plummets? Do stocks follow? How about pensions?

What if interest rates soar? How would all the new homeowners, who stretched to buy with adjustable and interest-only loans, cover their mortgages?

How would consumers with record credit-card debt make their payments? Would they stop buying? Stop taking vacations? What will happen if they go bankrupt? New rules going into effect later this year make it harder on such debtors.

How would a government, which depends on the taxes of a strong economy to operate, keep all its promises?

To us, the good news is that when the country is in deep trouble, the US will not have the energy to pick on China. Even when it is necessary to start another war to divert people's attention, it would pick one much smaller in size and weaker in strength, like Iran. This will provide a much more amicable environment for China to make good use of its "period of strategic opportunity" till 2020 for the country to pass through a turbulent zone between per capita income of US$1,000-3,000.

But in the short term, now the US not only sneezes, and all symptoms indicate that it is going to suffer from a SARS-like trouble, the whole world should take extra precaution not to get infected. One thing is for sure, some time in the not too distant future, every central bank and institutional investor is going to dump US dollar and US Treasury bonds. Once, when a country like South Korea dumps the dollar, the still unsold US Treasuries in the asset column of Asian central banks – US$2,000 billion according to some estimates – will collapse. The cheapened dollar will cause a sudden jump in the US inflation, which forces the Fed to jack up interest rates. A giant leap in inflation will cause a severe recession, or perhaps a depression, in the US. These countries' exports to America will dry up, which in turn will spread the global economic downturn like wildfire.

After the stampede, everybody is going to get hurt, not least the central bank of China, and the Hong Kong Monetary Authority, which are major US creditors and with the US as their number one export market. The recent currency reform of the RMB is most timely, and it is about time we should do something about the Hong Kong dollar. At the same time, China should make extra efforts to rekindle internal consumption, and diversify its market really fast before the great US bubble bursts.