

# How will Japanese Economic Woes Affect the U.S.

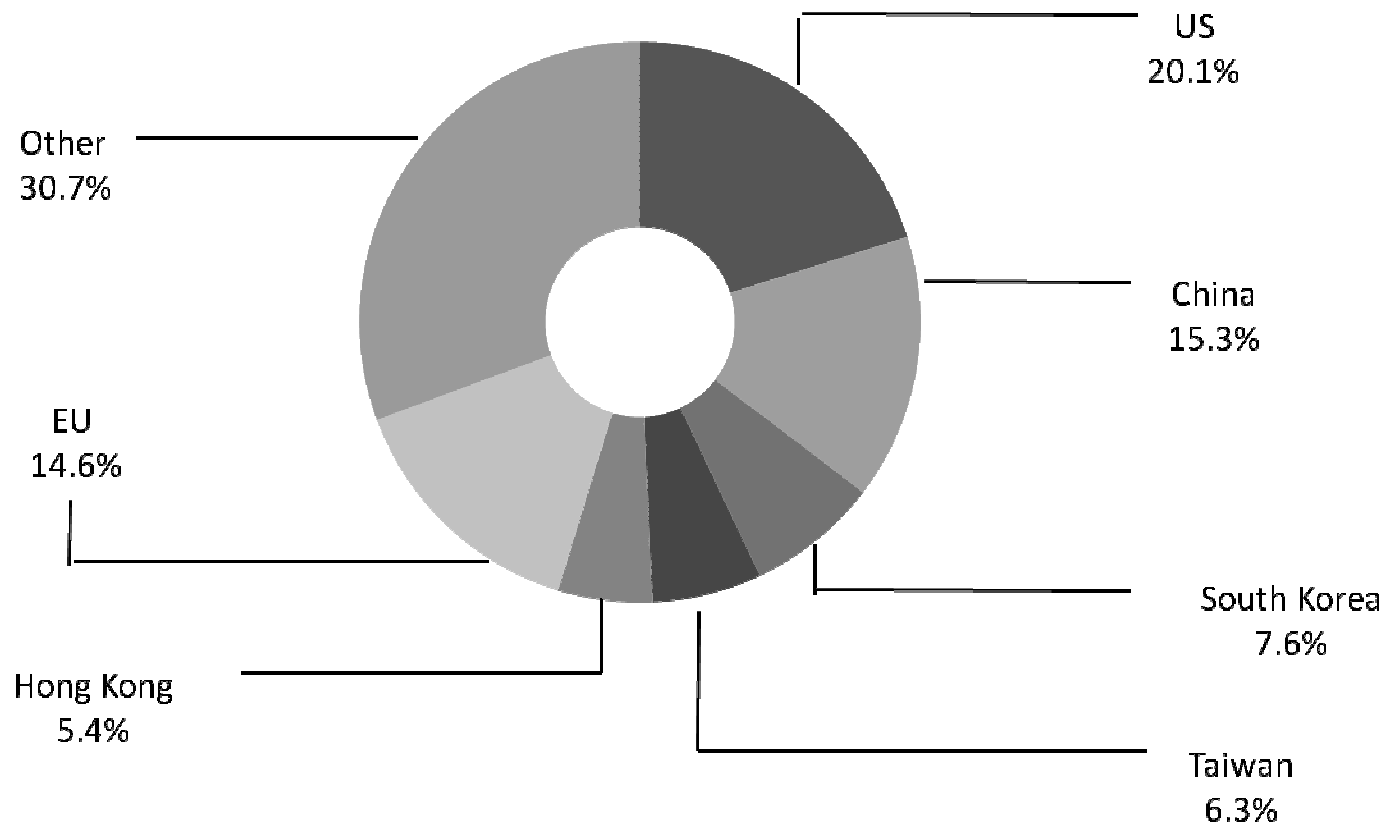
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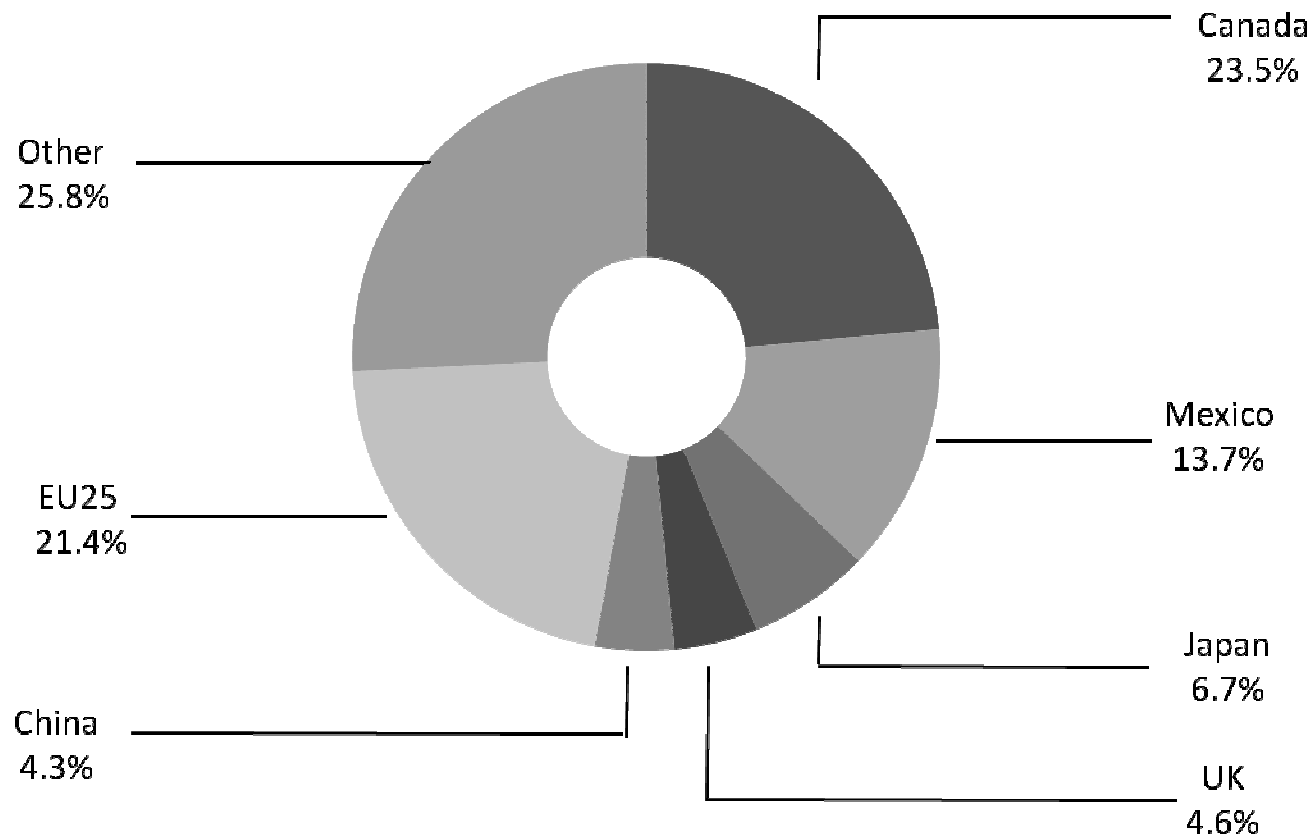
# U.S. Affects World Economy in Many Ways

- U.S. impacts world economy more than does Japan due to the relative importance of the two economies
- The U.S. is still Japan's main export market while Japan is a relatively small market for the U.S.
- The U.S. economic slowdown has a major impact on international commodity prices
- Developments in U.S. financial markets have a major bearing on financial market developments in the rest of the world.
- A reduction in risk aversion can cause further appreciation of the Japanese yen.

## Japan: Main Destinations of Exports, 2007 (share of total)



## US: Main Destinations of Exports, 2007 (share of total)



# A Confluence of Negative Shocks

- The U.S. economy continues to be hit by a confluence of adverse shocks
- The worst housing market bust in the post-war period
- A credit crisis that Alan Greenspan describes as “a once or twice in a century event”
- A bear market in equities that has destroyed around U.S. \$3 trillion in U.S. household wealth
- The bursting of the commercial property market bubble
- A major international oil price shock

# Change in U.S. Housing Prices, Stocks, and Bonds

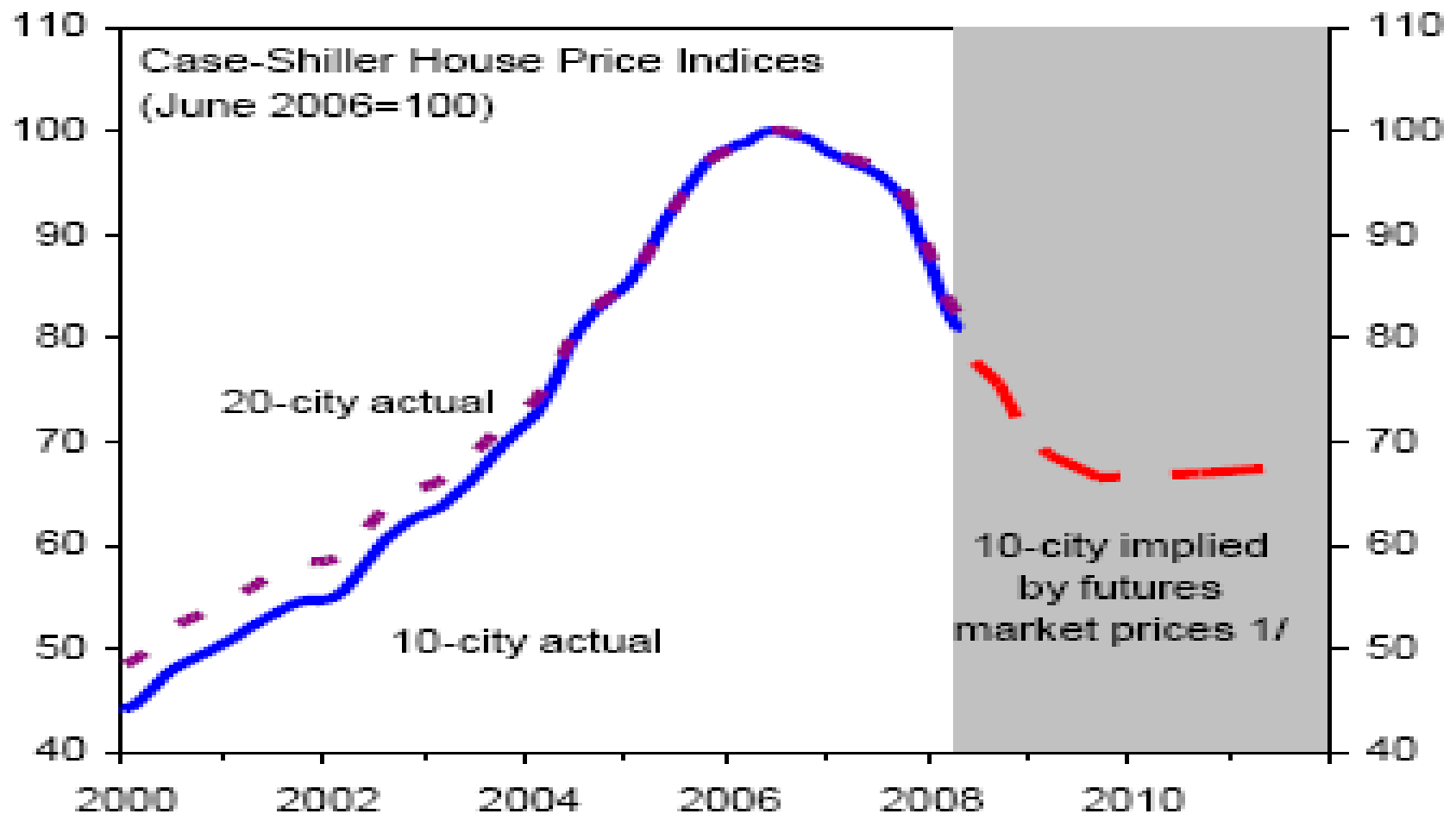


Source: PIMCO

# The U.S. Housing Market Shows no Signs of Stabilizing

- Over the past year, home prices as measured by the Case-Shiller Index fell by 16 percent
- Unsold housing inventories remain at close to record levels of around 11 months' supply
- Around one in three households will have negative equity in their homes by end-2008
- Foreclosure procedures initiated are running at an annual rate of 3 million units
- Private mortgage credit has all but dried up
- Around U.S. \$ 100 billion in option-ARMs reset over the next two years

## House Prices



Sources: Haver Analytics; Bloomberg, L.P.; and Fund staff calculations.

1/ Illiquidity in market may lend a downward bias to prices implied by futures contracts.

# U.S. Housing Starts and Months Supply of Existing Homes

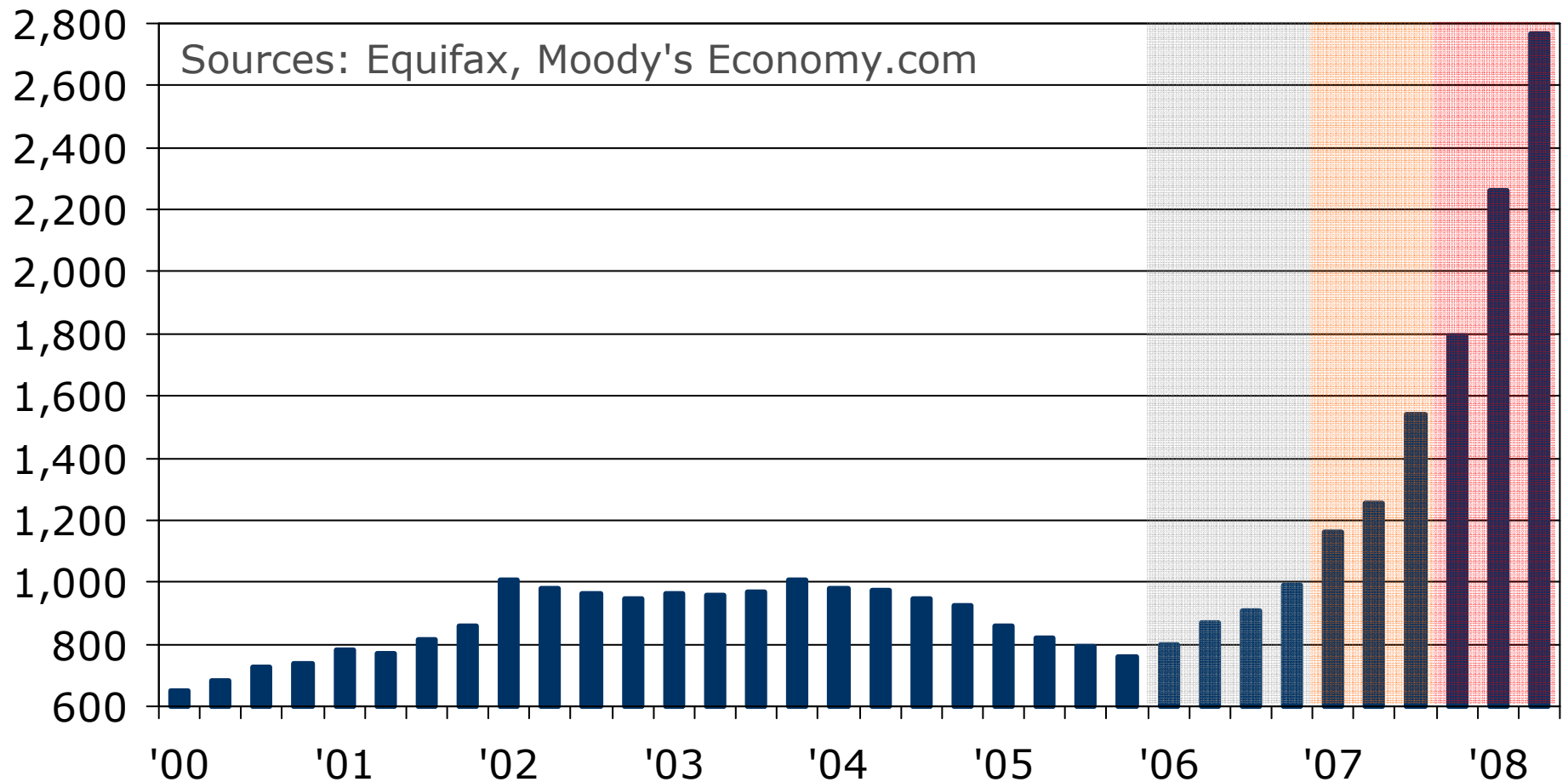
thousands,  
at annual rates

level, months supply at  
current sales rate



# Foreclosures Surge...

**First mortgage loan defaults, ths, SAAR**

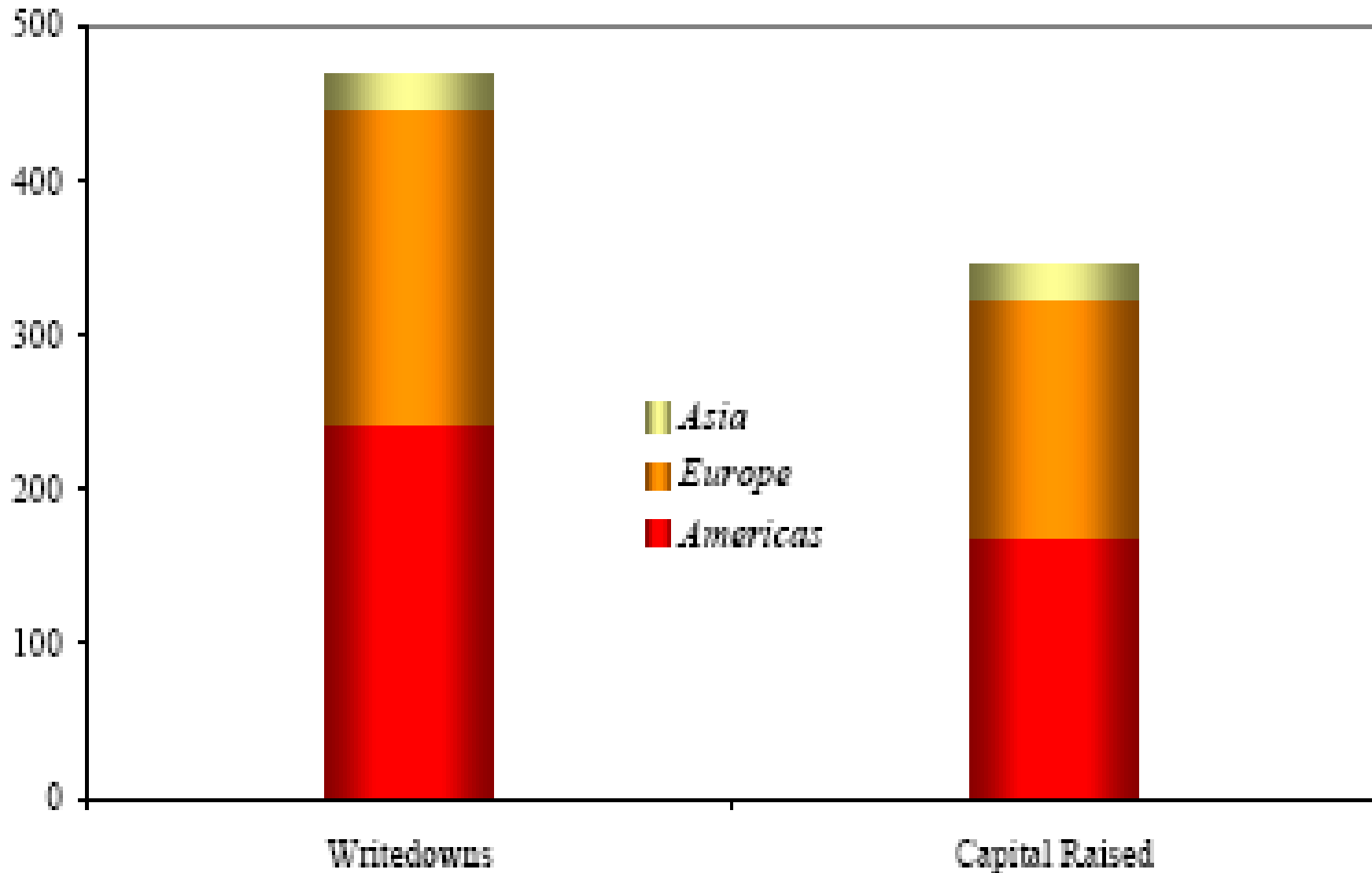


# De-leveraging is Intensifying the Credit Crisis

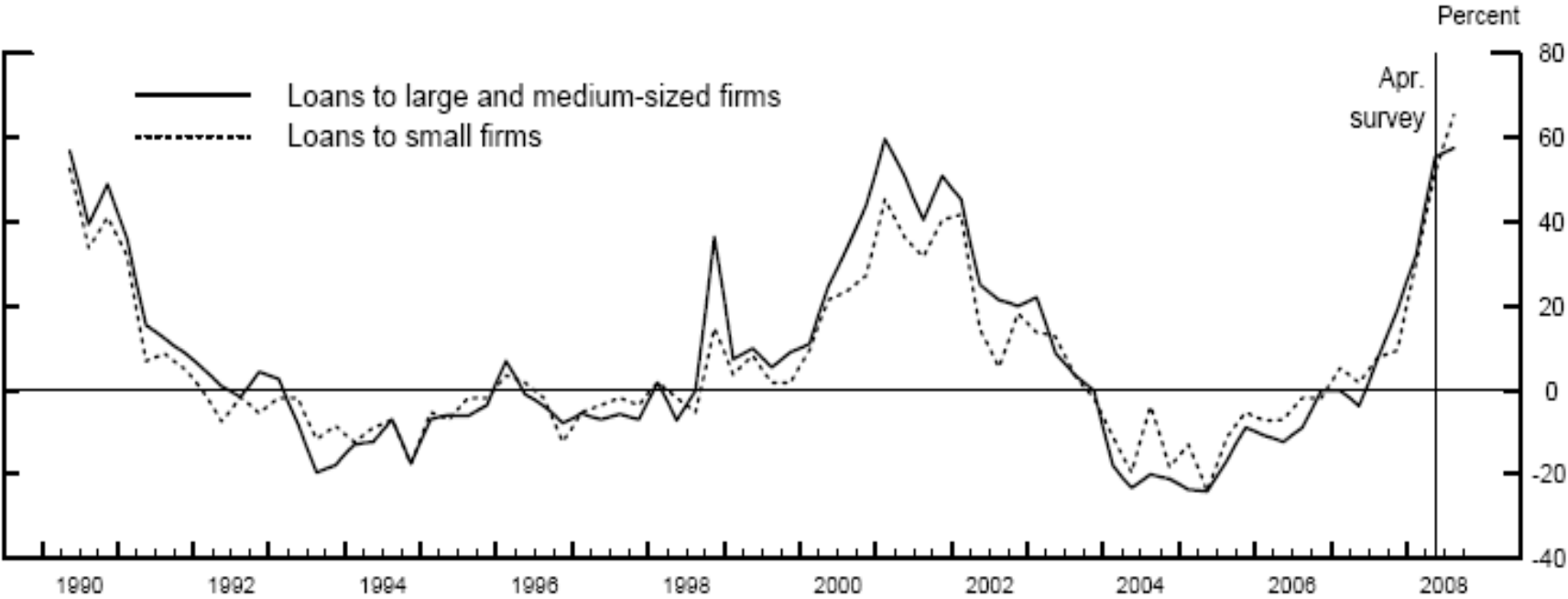
- The global banking system has acknowledged U.S. \$ 500 billion in loan losses and raised only U.S. \$ 350 billion in new capital
- Bank lending standards have been tightened across the board
- Default rates are rising in many areas of non sub-prime mortgage related lending
- Interest rate spreads have widened again thereby offsetting the Federal Reserve's monetary easing
- The inter-bank market continues to be dysfunctional
- Corporate Issuance has plummeted
- Bank credit is now contracting at the fastest pace in 40 years

# Bank Writedowns and Capital Raised

*(in billions of U.S. dollars)*



# Federal Reserve Senior Loan Officer Survey for Commercial and Industrial Lending



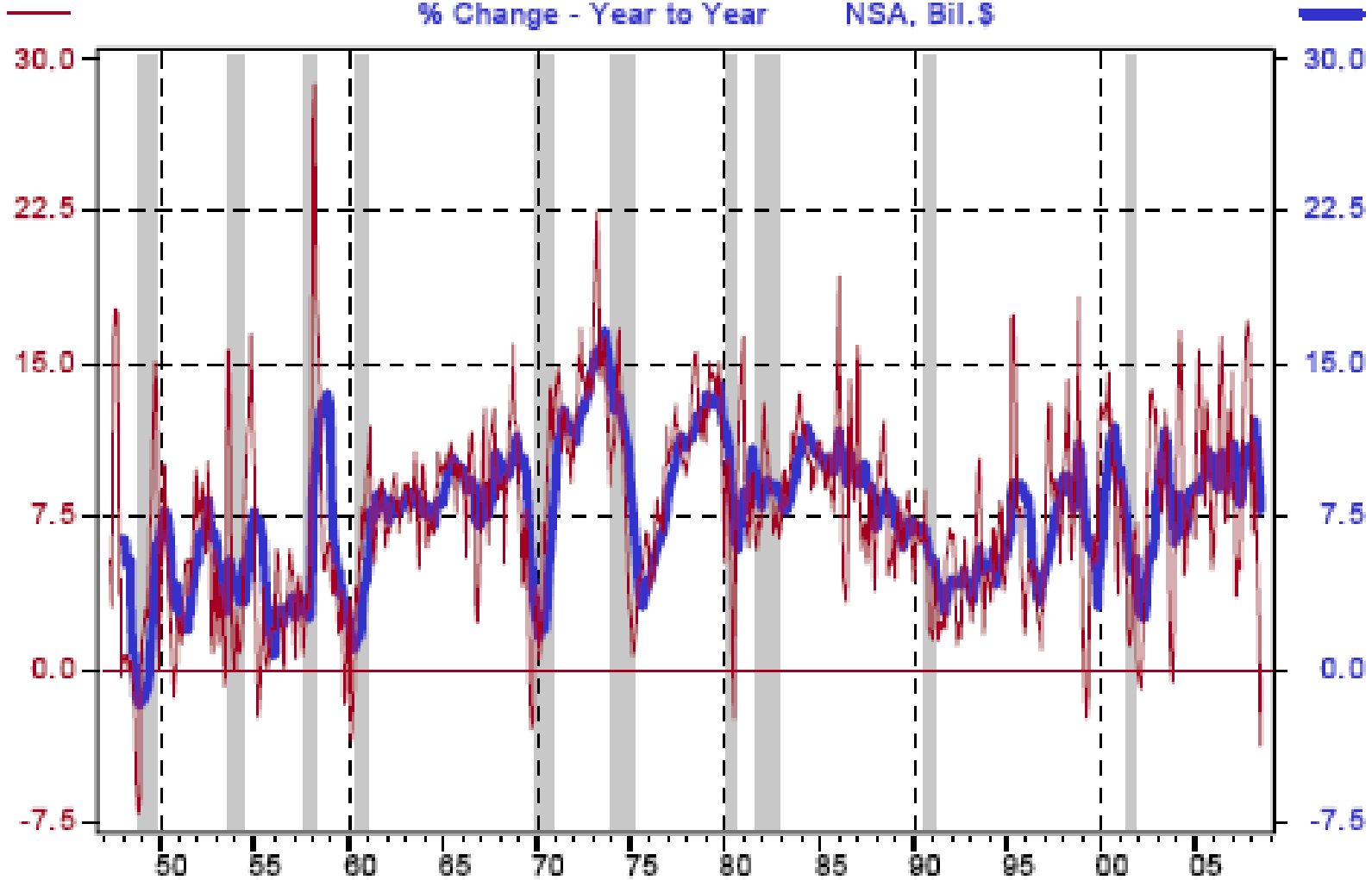
Source: Federal Reserve Senior Loan Officer Survey

### Bank Credit: All Commercial Banks

3-month %Change-ann SA, Bil.\$

### Bank Credit: All Commercial Banks

% Change - Year to Year NSA, Bil.\$



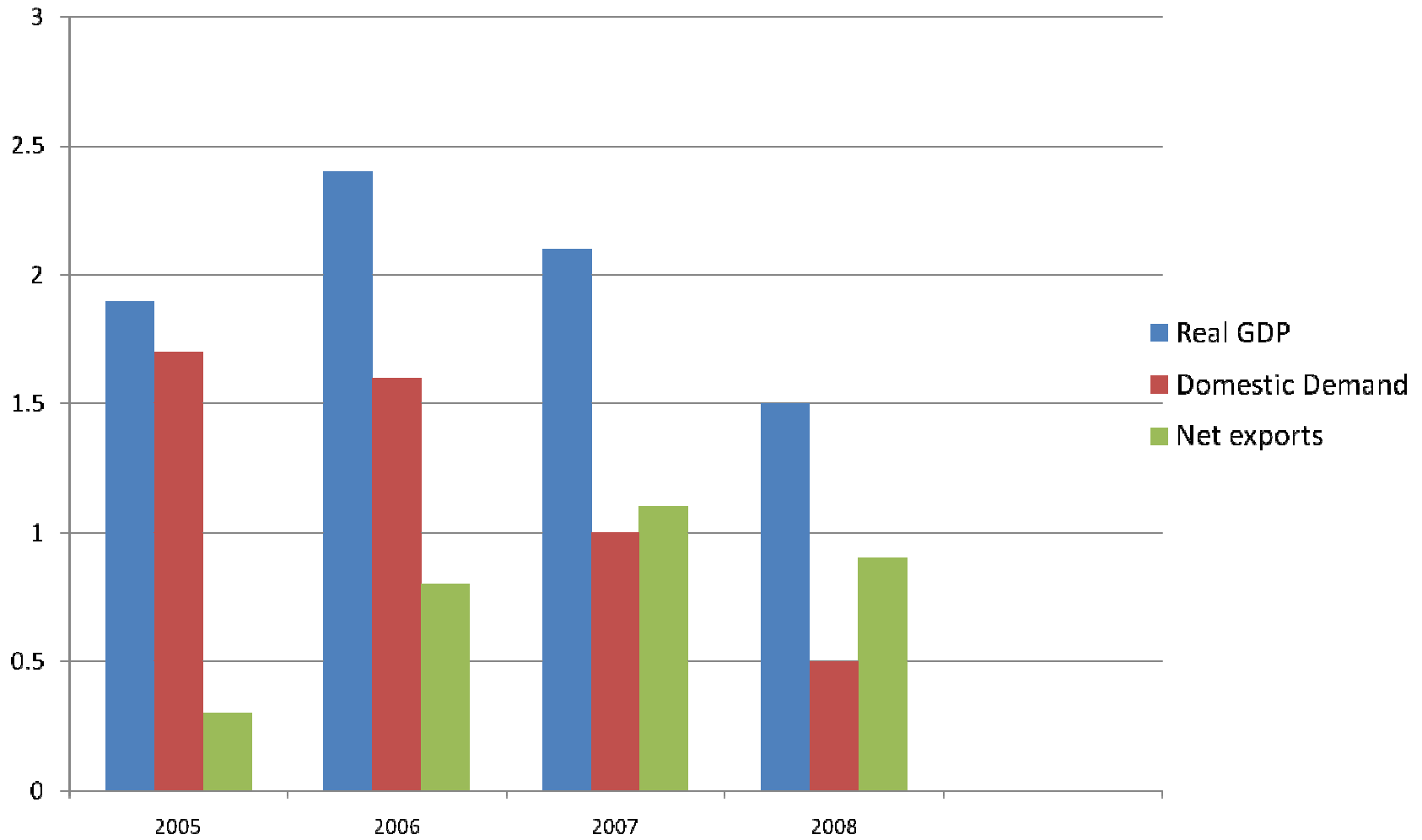
Source: Federal Reserve Board /Haver Analytics

# Japan is Highly Vulnerable to Global Crisis

- Japanese growth has depended importantly on robust exports
- A slowing U.S. economy will impact Japan and China
- Rising Risk Aversion will cause the Yen to appreciate
- Falling commodity prices could cause deflation to return in Japan
- Japan's financial system does not have a sub-prime problem
- Japan lacks monetary and fiscal instruments to deal until an economic slump.

# Japan

percent



## Japan: Growth of Exports and Imports

