

## Answer to Question

**Question:** Lately, the western media has speculated that the worst of the financial crisis is over and that the economies of some western countries are showing signs of economic recovery—the first green shoots, so to speak of. The media reports are often supported by economic experts and politicians who point to the buoyant stock markets, bank profits and the rise in the price of oil as evidence that the world economy has finally reached the bottom and is on the path of recovery. Hence the question arises is the western world really witnessing an economic revival or is it all media hype designed to instil confidence in the global financial system and prolong the crisis? And if this is the case, then why it is noticed such rise in the oil price, bank profits and buoyant stock markets?

**Answer:** It is wrong to exclusively look at the financial indicators such as the rise in the value of the stock markets or the rise in the value of commodities to determine the health of the economy. If one looked carefully at the level of corporate production, GDP, unemployment numbers, retail sales, corporate and consumer spending, number of foreclosures and bankruptcies including famous companies like General Motors..., and other economic indicators then there is not a single economy in the world that is showing a positive trend—when these indicators are considered as a whole.

Here is some indications showing this fact:

### 1-America

Take the US economy for example where the chorus about green shoots in the economy rings the loudest. US jobless rate up to 8.9% the highest in 26 Years. US GDP shrank by 6.1 per cent in the first quarter of this year. To cope with falling sales, businesses reduced their inventories the most since Second World War by \$103.7 billion in the first quarter of 2009 compared with \$25.8 billion in the fourth quarter of 2008. Business investment declined by 38 % at an annual rate. Exports of goods and services decreased 30 per cent in the first quarter of 2009, compared with a decrease of 23.6 % in the fourth quarter of 2008. Foreclosure filings rose in March 2009 to 341,180. This figure is up by 17% from February 2009 and 46% from March, 2008. Yet this despite the fact that US government has spent billions to shore up ailing banks and improve credit flows within the economy. The same can be said for other western economies.

### 2-Germany

in Germany the unemployment rate is 8.2% amidst the worst recession since world war. However, if it was not for the upcoming federal election and the change in the way the government reported the unemployment figures the jobless rate would be much higher. The Federal Labour Office said on 28/5/2009 that the seventh straight jobless rise was restrained by statistical changes and widespread use of shorter working hours. UniCredit economist Andreas Rees noted that the statistical changes to the jobs data were being phased in gradually so that June unemployment would also prove surprisingly positive. "There cannot be any doubt that further job cuts are in the pipeline," said Rees. "The labour market remains the Achilles heel of the German economy on its road to recovery." Furthermore, new data from the VDMA plant and equipment makers' association offered a stark reminder that German industry is still heavily exposed to weak global demand. German engineering orders fell in April by 58 % in real terms from the previous year, the biggest decline since records for the sector began, the VDMA said. Foreign

orders dropped 60 %, with the domestic intake down 52 %. The government expects Europe's largest economy to contract by a record 6 % this year, and some observers are even more pessimistic.

### **3-Europe**

European retail sales declined at a faster pace in May 2009 as rising unemployment prompted consumers to hold back spending, the Bloomberg purchasing managers index showed. "Consumers still face a lot of bad news from the labour market as unemployment will continue to rise," said Nick Kounis, chief European economist at Fortis Bank Nederland in Amsterdam. "Europe's unemployment rate rose to 8.9 % in March, the highest in more than three years. The rate will increase to 9.9 % next year and 11.5 % in 2010, the EU commission forecasts. The euro area economy may shrink 4 % this year, according to the European Commission, as exports decline and companies cut output and jobs.

### **4-Japan**

Japan's jobless rate hit the highest in five years at 5 % in April. In the reported month, 3.46 million people were without jobs, up 25.8 % from April last year, the Ministry of Internal Affairs and Communications said in a preliminary report. There were only 46 jobs available for every 100 jobseekers, making the ratio the worst since June 1999. The government also released the nation's core consumer price index (CPI) Friday, which showed a 0.1 % fall in April, compared to a year before. The core nationwide CPI, which excludes fresh food prices, fell in March for the first time in a year and a half, and remained in deflationary territory in April, reflecting falling petrol prices and weakening demand amid the global economic slump. Also households spent less in April, down by 1.3 % to 306,340 yen (\$3,175) from the same month a year before. Household spending figures are a key indicator of private consumption, which accounts for more than half of Japanese gross domestic product (GDP). Japan's GDP is shrinking at an annual rate of almost 10 per cent. The latest figures, for the period from January to March, showed the worst decline in Japan's economy since 1947. Glenn Maguire, Société Générale's chief Asia economist, said: "Generally, a 10 per cent contraction in growth is considered a depression. Japan has come terribly close to this, with the economy contracting by 9.7 per cent over the year. This point serves to highlight that Japan is the developed economy on which the financial crisis has had the most pernicious impact."

### **5- World economy**

Perhaps the best indicator of the economic revival is the health of the world economy. According to The New York Times the economies of the developed world have had their worst quarterly showing in decades, the Organization for Economic Cooperation and Development (OECD) said on 25/5/2009, even as more signs emerged that the pace of the decline was easing. The combined gross domestic products of the 30 countries in the organization fell 2.1 % in the first quarter when compared with the previous quarter. If that preliminary estimate holds, it would be the largest drop since 1960, when the organization began collecting such data. The G.D.P. of member countries fell 2 % in the final quarter of 2008. The O.E.C.D. economies accounted for 71 % of world G.D.P. in 2007, according to the World Bank. Those economies shrank 4.2 % in the first quarter from a year earlier. The United States contributed 0.9 %age point of that decline, while Japan contributed 1 %age point, the 13 largest euro-zone countries 1.3 points, and the remaining member countries 1 point. China, which is not a member of the organization, is one of the few countries where the economy has continued to grow in the first quarter.

The increase noticed in the value of the stock markets, and some goods and services, can be attributed to three factors:

**First**, the US government bailed out AIG by giving it \$173 billion. AIG used more than \$90 billion of tax payers' money to pay money it owed (due to Credit Default Swap Contracts) to US and European banks. On March 15 2009, AIG revealed that through three separate types of transactions, Goldman received an aggregate \$12.9 billion, Merrill Lynch \$6.8 billion, Bank of America \$5.2 billion, Citigroup \$2.3 billion and Wachovia \$1.5 billion. Among European banks, SocGen was the biggest recipient at \$11.9 billion, Deutsche got \$11.8 billion, Barclays was paid \$8.5 billion and UBS of Switzerland got \$5 billion. Describing the importance of AIG payouts the Federal Reserve Chairman, Ben S. Bernanke said: "Here was a company [AIG] that made all kinds of unconscionable bets. Then, when those bets went wrong, they had a — we had a situation where the failure of that company would have brought down the financial system." Unable to give money directly to the banks for a fear of public backlash the Fed routed the money through AIG which eventually reached the banks. Subsequently, many of these banks posted profits (Bank of America (BAC) made \$4.2 billion, Citigroup \$1.6 billion, Goldman Sachs \$1.8bn and in Europe, Barclays Bank unveiled record full-year profits of £5.28 billion the 1st quarter of 2009) and the stock markets increased in value.

So this increase is not because of profit due to economic activities, but because of that money support which will not stay for long time.

**Secondly**: the US government early this year announced its stress test program for US banks designed to instil confidence in investors that the US banks were healthy and not too deeply leveraged. The stress tests were specifically crafted by US Treasury Secretary Timothy Geitner to give the impression that most of the troubled assets of banks can be erased from the balance sheet. On May 6 2009 the US government announced that some US banks such as JP Morgan and Goldman Sachs did not require government funds, whilst other banks such as Bank of America and Morgan and Stanley required some funds. In total, ten of America's top banks required just under \$75bn, which could be easily covered by the TARP fund which still has \$75 billion remaining—thereby reducing the need for the US government to ask congress for more funds. Subsequently, stock markets posted hefty gains and shares in US banks rose in value. Wells Fargo was up 8.5%, Morgan Stanley was up 0.9, Bank of America up 4% and Citigroup 7% respectively. However, despite the upbeat mood amongst investors, many experts have stated that the tests were fatally flawed. "The stress tests are, at best, a waste of time," said Mike Holland. "At worst, they're misleading and testing the wrong things. The idea of using some level of unemployment to say whether Citigroup is not as strong as JP Morgan to me is laughable. And therefore I will be glad when this process is over." "I would argue — as others have — that a lot of (banks') models have been badly flawed in the last few years anyway, which is why they're in the mess they're in," said Yra Harris, a currency trader with Praxis Trading. On May 4 2009 the International Monetary Fund estimated that U.S. financial institutions could suffer \$2.7 trillion in losses from the global credit crisis, nearly double its projection six months ago.

**Thirdly**: early this year both the US Federal Reserve and the Bank of England announced plans that they would embark upon on 'quantitative easing' or the creation of money to buy bad assets of banks, corporate bonds and other troubled financial assets. The increase in the money supply will inevitably lead to inflation and increase the price of goods of services. Already the Bank of England is concerned about

the high inflation in an economy that is suffering its worst economic downturn since the 1930s, In its statement the Bank of England (BoE) said there are 'promising signs' that the pace of Britain's downturn is slowing. But the BoE also said it has been taken aback by the stubbornly high level of inflation, which at 2.9 per cent is 'significantly' higher than its 2 per cent target. This explains why the prices of certain commodities (the price of oil has increased to more than \$58 a barrel from a low of \$36) have risen and how it is being misinterpreted as a sign of economic recovery. Furthermore, it should be noted that oil prices usually increase when the value of the dollar is very low. The increase is not due to an increase in demand for oil rather it is because the US actively manipulates the price of oil to prevent further erosion of the value to the value of the dollar.

Also when we know that according to The Impact of the Financial and Economic Crisis on Global Energy Investment prepared by the IEA in May 2009, the world electricity consumption dropped in 2009 for the first time since World War II— a clear signal that the world economy is very far from an economic revival.

For the aforementioned reasons the economic recovery in the West is premature. At best, western governments by pursuing a policy of low interest rates and quantitative easing are delaying an inevitable economic collapse. In fact it can be argued that by flooding barren economies with money manure, western governments are most likely to re-inflate collapsed commodity and currency bubbles, which will produce greater calamity than what the world is witnessing today.

6 Jumadah 2<sup>nd</sup> 1430

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