A SIMPLE VIEW OF OUR ECONOMIC PROSPECTS

(or how to rescue the world economy)

State of Balance Sheet	**Government**	**Banks**	**Corporations**	**Households**
Japan (1990)	Strong	Weak	Weak	Strong
Japan (today)	Weak	Strong	Strong	*Weak***
USA (today)	Weak	Weak	Strong	Weak
Europe (today)	Weak	Weak	Strong	Strong

An economy is made up of government , corporations and households. Banks, although part of the corporations landscape, play a special role in providing credit and facilitating the money multiplier that is so crucial to modern economies.

Everyone is worried about global economic prospects and investors are scouring every bit of the increasingly high-frequency data points to discern these prospects. Despite the torrent of data, there appears to be no clear consensus.

I thought it might be useful to assess, in a simple manner, the state of the balance sheets of these crucial economic components in each key economic zone. Rather than ask "**where is the economy headed?",** it is much more useful to ask "**what can we do about it**?". And the latter question very much depends on the balance sheet of the country/zone in question.

I find the results are quite revealing.

The most striking feature is the strength of corporate balance sheets all over the world. Where is the money? In the corporations!

Actually, that is why the developed world is stuck. If corporations do not invest and create jobs, households will not consume. If they do not consume, corporations will not invest.

The answer to our economic morass is, in fact, quite simple. **<u>Incentivise corporations to invest to renew their capital stock</u>**. Governments across the developed world should give their corporations fiscal and even monetary incentives to invest and renew their capital stock - new machines, new infrastructure, new IT equipment, new software and even new furniture. This investment wave will create jobs and income, which will drive consumption. Income and consumption taxes from rising employment and incomes will rise to offset the fiscal cost of capital investment tax incentives.

<u>We're wasting our time, energy and resources trying to rejuvenate the capital-challenged, overstretched and morally-bankrupt financial sector.</u>

The reason we cannot see this solution is because we have been brainwashed to believe that consumption drives GDP. We've got it backwards - there can be no consumption without income, no income without investment and no investment without savings. Where is the last remaining pool of savings? In the corporations!

****TODAY'S JAPAN HOUSEHOLD BALANCE SHEET IS WEAK?**

Japan in 1990 faced a situation where corporations were weakened by their debt loads and the banking system was technically bankrupt. Since corporations could not invest and banks could not provide credit, the government stepped in and used its balance sheet to sustain the economy. Throughout, households remained strong as most Japanese corporations did not retrench workers on a big scale and Japanese households had maintained a high savings rate despite the bubble economy of the 1980s.

After 20 years, although banks and corporations have rebuilt their balance sheets, the Japanese government is severely weakened. Meanwhile, the cost of hanging on to employees regardless of business circumstances has manifested itself in 20 years of poor job prospects for the younger Japanese.

For younger Japanese, unemployment is very high and incomes are much lower than their parents' generation, who have retired or are soon to be retired. As a result, Japanese household incomes have become weak.

In fact, far too many young Japanese adults are living off their parents when they should really have established their own households, assets and nest eggs. The parents' balance sheet is still shared by the adult children when they should actually have created their own clusters.

I would therefore argue that the "notional" balance sheet per household in Japan has now become weak.