

Societe Generale's Doomsday Scenario

Societe Generale recently published a white paper that purports to be a "worst-case-scenario" of economic predictions, but which ultimately makes a persuasive case for an economic meltdown akin to that experienced by Japan throughout its "lost decade" of the 1990's.

The report is primarily aimed at presenting its clients with practical financial guidance should this scenario prevail, but provides extensive historical and analytical comparisons to the current economy and Japan's lost decade. Among the striking comparisons and economic features of both the US and Japanese crises, these are the most compelling:

1. Ballooning public debt: "Debt is the main constraint on US GDP growth, but reducing the excessive debt burden is likely to stall economic activity." Lower government spending will limit consumption and GDP;
2. End of bear market rally: The rally was "fueled by restocking and fiscal stimulus". Normal consumer spending will be unable to pick up the slack;
3. Deflation is the real immediate risk, not inflation: "The printing of money by western economies has been used only to replace the credit destroyed";
4. Banking crisis;
5. Property bubble: the largest asset bubble in the nation's history spawned massive, artificial consumption which will likely not be replaced;
6. Corporate debt crisis;
7. High valuations going in;
8. Stock market crash;
9. Low interest rates.

The report makes some general observations:

1. Household deleveraging will reduce overvalued properties to a new "equilibrium". Output will also reach a new equilibrium, as "previous output was largely the product of a consumption bubble".
2. Assuming that the savings rate stabilizes at 7%, which is the current level, it will take consumers 9 years to reduce the debt/income levels to those seen in the 1980's.
3. If governments are unable to adequately service their massive debts, then the only option is default. In Dubai, this option appears to be already on the table, as its sovereign wealth arm announced a six month suspension of interest payments on its debt, [here](#).
4. Inflation, resulting from a devalued and weak dollar, could help ease excessive debt, as it is essentially inflated away, but would likely lead to stagflation, hyper-inflation and revaluation. Ultimately, the interest rate hikes needed to control inflation would hurt consumers as debt servicing costs would surge.
5. A growing transfer of wealth is occurring from advanced economies to emerging economies.
6. The bear scenario would lead to a deflationary spiral, as high unemployment and low consumption will drive prices ever lower. "A second round of home foreclosures in the

US would lead to further write-downs on bank balance sheets, and even more government public deficits as the debt transfers from financial institutions to the state through more rescue packages."

7. In the bear scenario, "avoiding depression is the focus here, though a long and arduous recession can be expected under this scenario."
8. The bear scenario would ultimately lead to: a) severely reduced household wealth, as equities and property markets are hammered; b) Long and short term interest rates would remain low, as central banks battle deflation; c) massive transfers of liabilities from households to governments; d) unemployment would reach record levels, which would further destabilize the economy and consumption; e) consumption would be effectively stalled for long periods, leading to an eradication of considerable excess global production capacity; f) Excessively high government debt will force advanced economies into a painful period of deleveraging and contraction, leading to sharply reduced levels of service and government budgets.

Although the report tempers its support for the bear scenario as a likely outcome, the stark contrast between Japan's economy of the 1990's and our own economy is striking, and makes this scenario at least plausible and realistic. The Societe Generale report clearly signals the risks to our economy, much the same way that many analysts noted the sharp rise in housing values and warned of housing's imminent collapse. The housing bubble was predictable, quantifiable, known and observable, yet it was ignored and even ridiculed because of the massive consumption bubble that it generated. The US economy and Wall Street's near-obsessive compulsion with short term goals and profits ensured that the housing bubble and the artificial consumption it generated were ignored to the detriment of the larger economy, while preserving historic profits for a very rich and limited few. Will we again ignore looming crisis and bury our heads in the sand for the benefit of a few?

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- [Societe General Report.PDF](#)