

# **Looking Beyond the Crisis: Pitfalls in a Post-Bubble World**

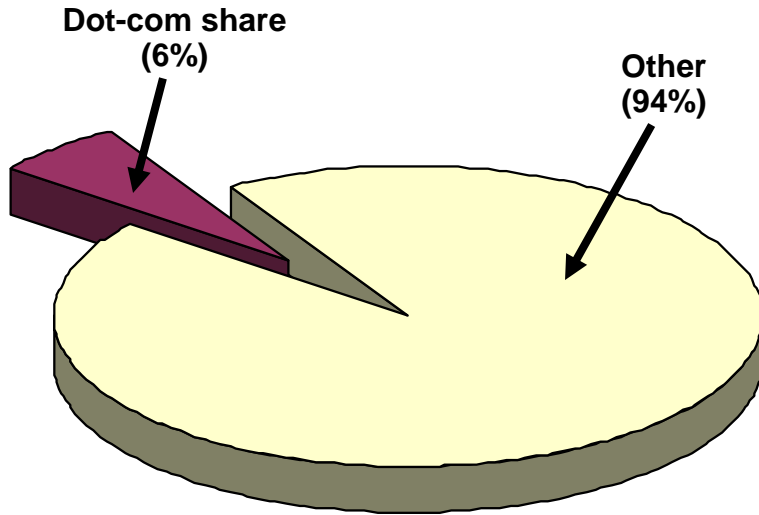
Stephen S. Roach  
Chairman  
Morgan Stanley Asia

**Khazanah Megatrends Forum  
Kuala Lumpur, Malaysia  
October 20, 2008**

# Two Canaries in the Coal Mine

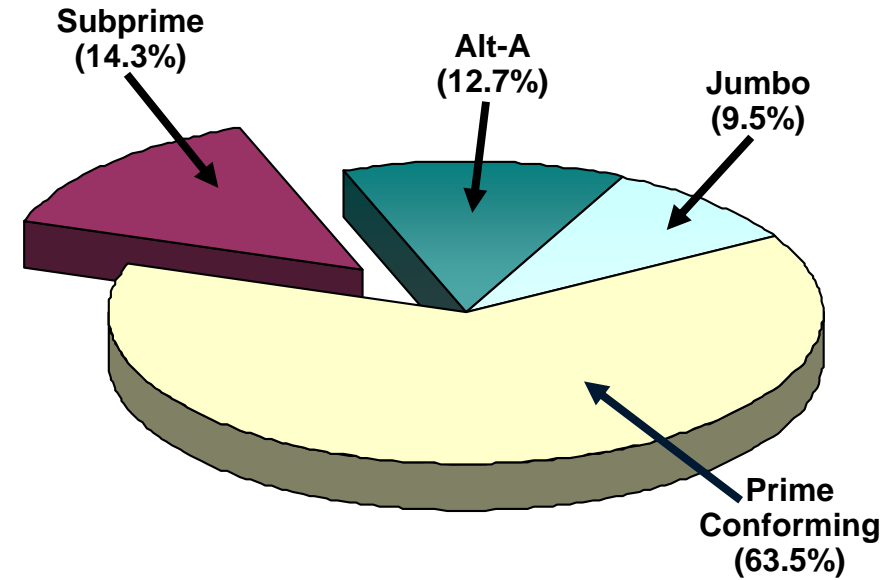
## Dot-Com Bubble

\$17.2 trillion total equity market cap: Year-End 1999



## Subprime Bubble

\$6.3 trillion total securitized mortgages: March 2007



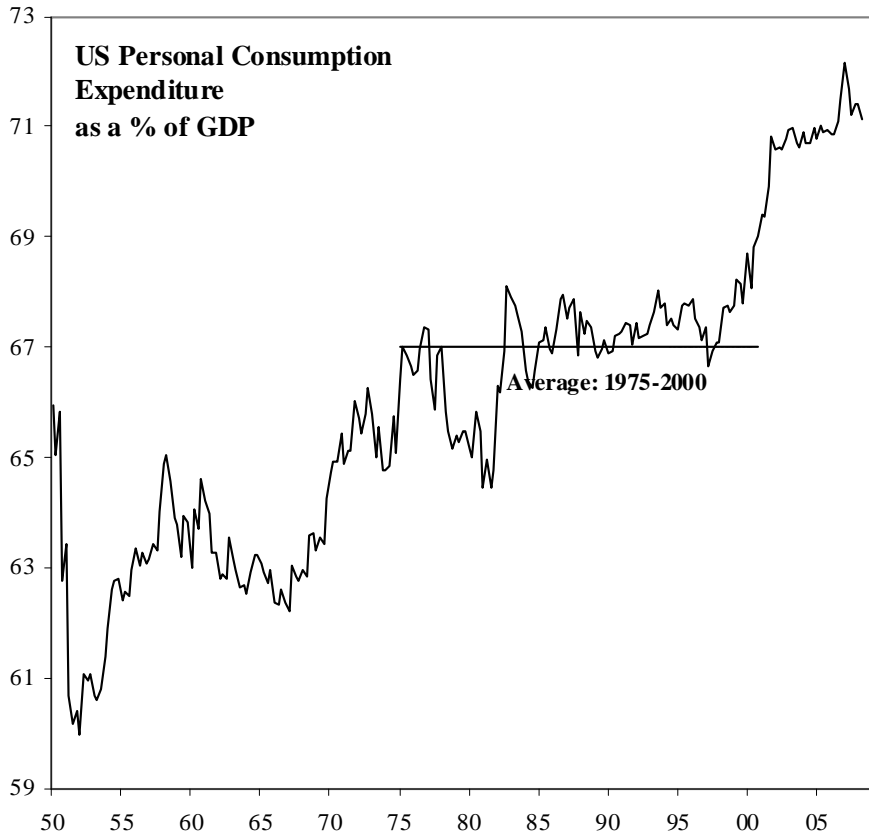
Source: Federal Reserve, FDIC, MBA, Morgan Stanley Research

# Taxonomy of a Crisis

IMPACTS	TRANSMISSION MECHANISM	OUTCOME
FIRST-ORDER	<b>CROSS-PRODUCT CONTAGION: DERIVATIVES AND STRUCTURED PRODUCTS</b>	<b>DE-RISKING DE-LEVERAGING</b>
SECOND-ORDER	<b>ASSET-DEPENDENT REAL ECONOMIES</b>	<b>CONSOLIDATION OF CONSUMPTION AND HOMEBUILDING</b>
THIRD-ORDER	<b>CROSS-BORDER LINKAGES: TRADE AND CAPITAL FLOWS</b>	<b>EXPORT AND VENDOR FINANCING RISKS</b>

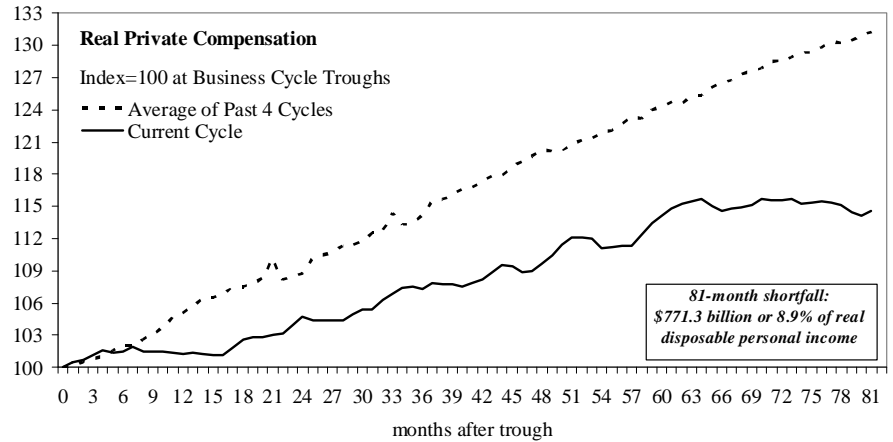
# American Consumer at Risk

## US Consumption Binge

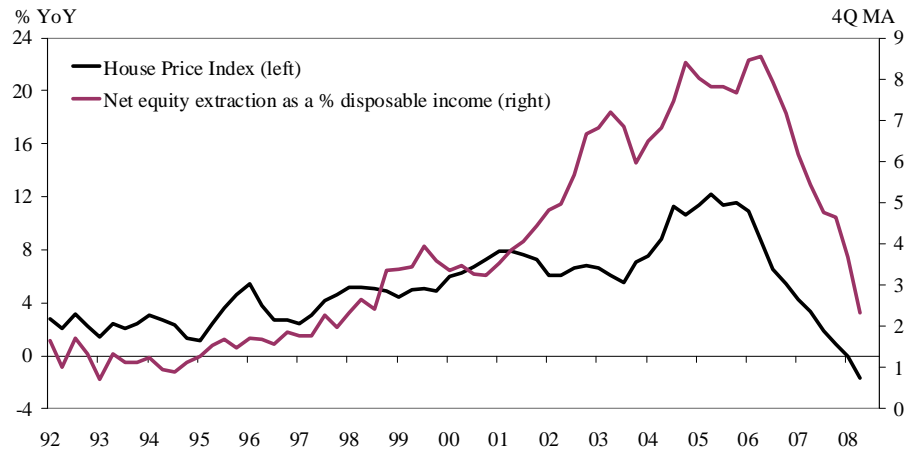


Source: National sources, Morgan Stanley Research

## Income Effects

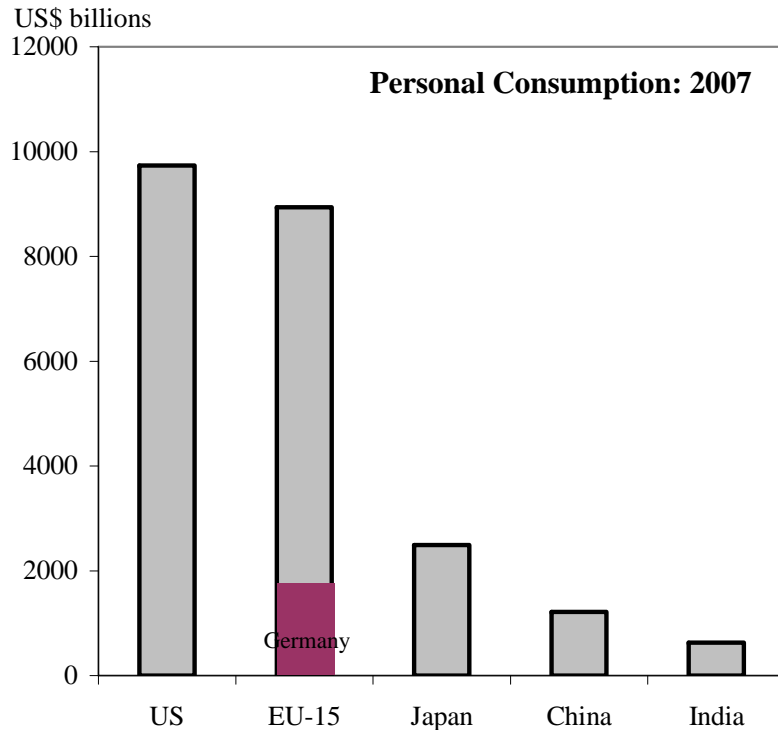


## Wealth Effects



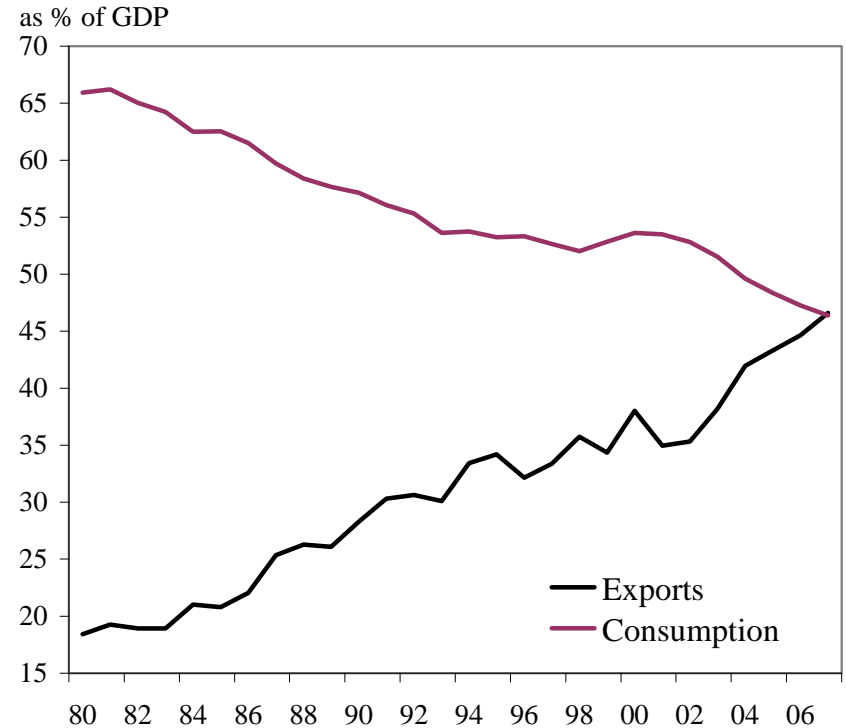
# Decoupling Dreams

## The Global Consumer



Source: National Sources, UN, Morgan Stanley Research

## Export-Led Developing Asia

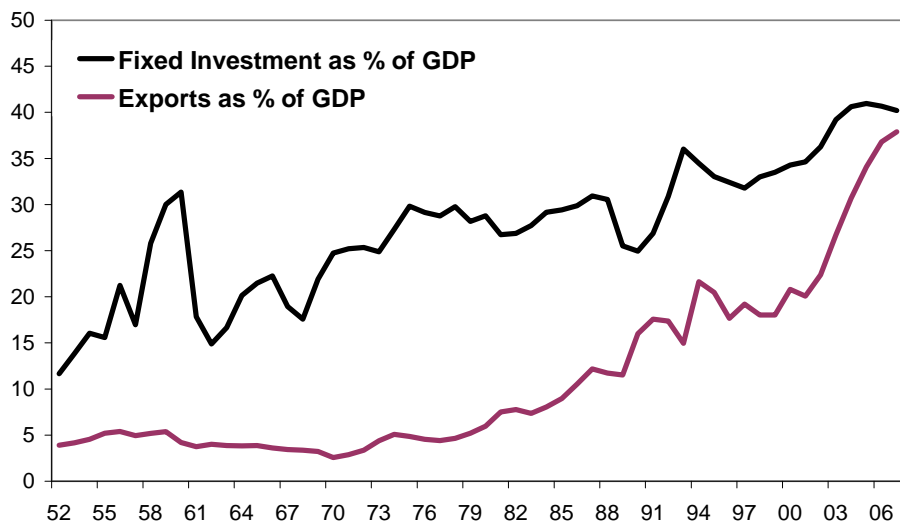


Source: IMF, Morgan Stanley Research

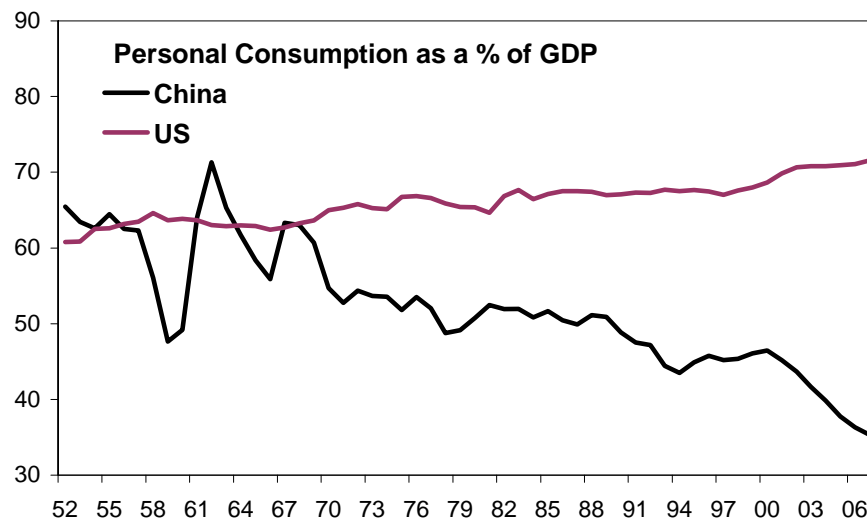
# China: Beneath the Surface

*“Unstable, unbalanced, uncoordinated, and unsustainable.”*  
— Premier Wen Jiabao, March 16, 2007

## China's Growth Leaders



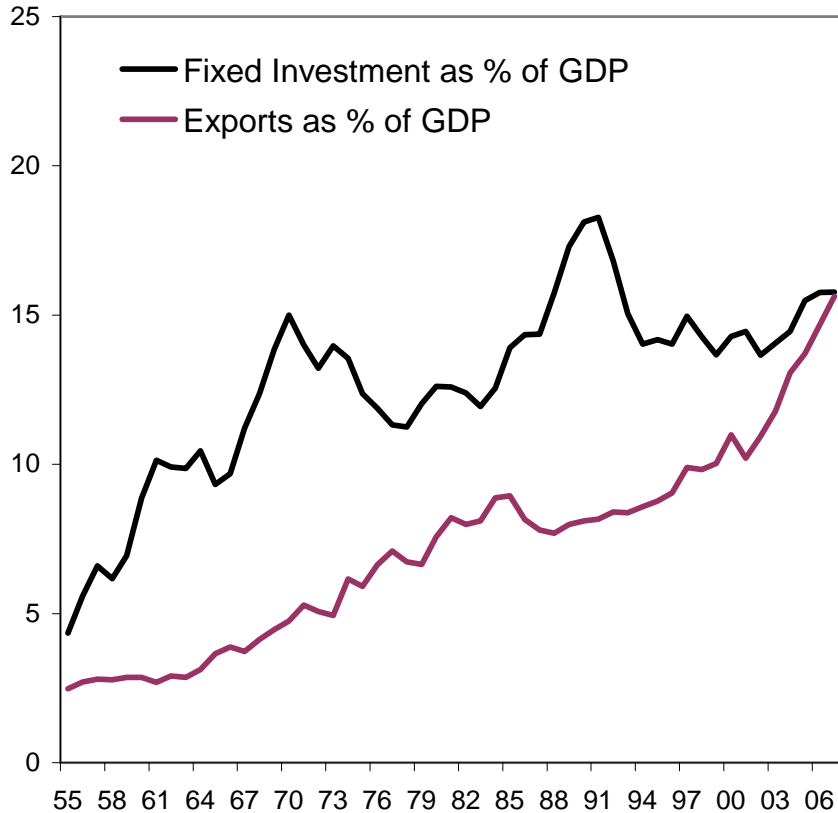
## China's Growth Laggard



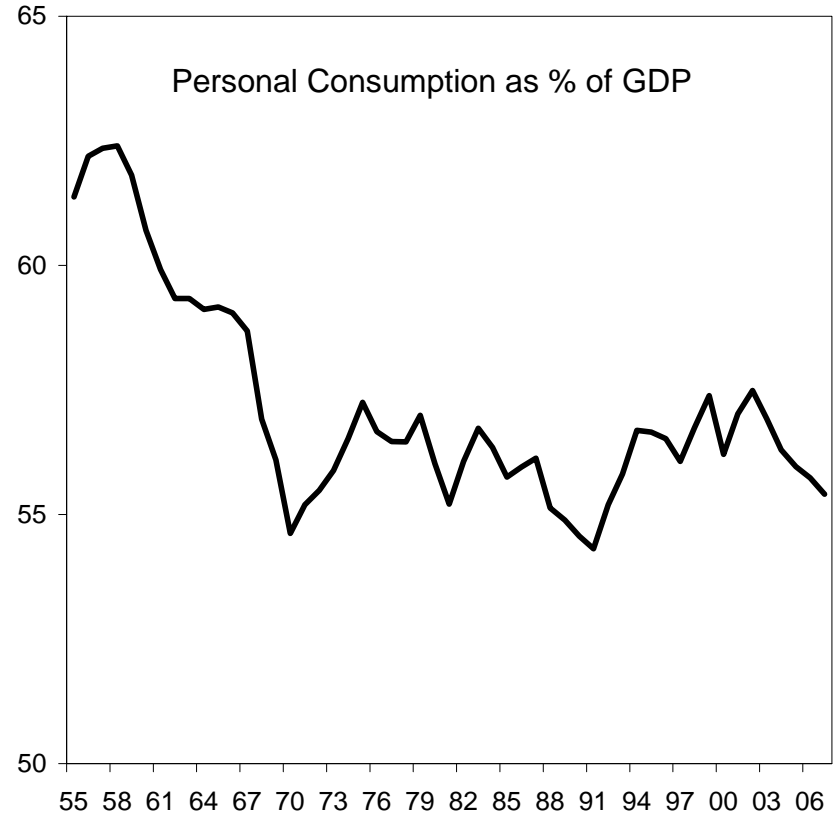
Source: National sources, Morgan Stanley Research

# Japan's Structural Imperatives

## Japan's Growth Pillars



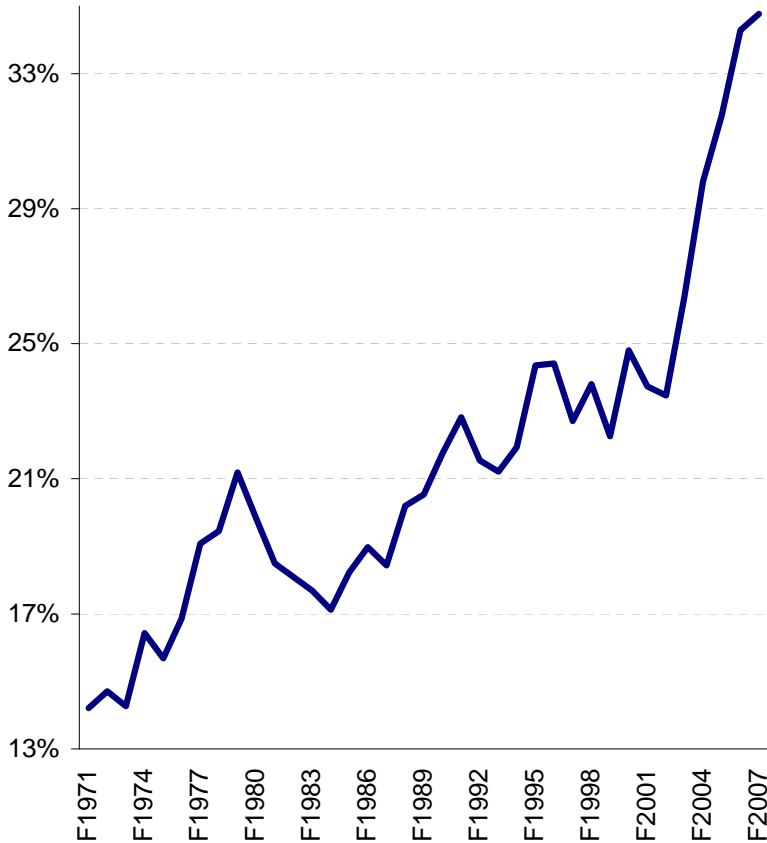
## Japan's Laggard



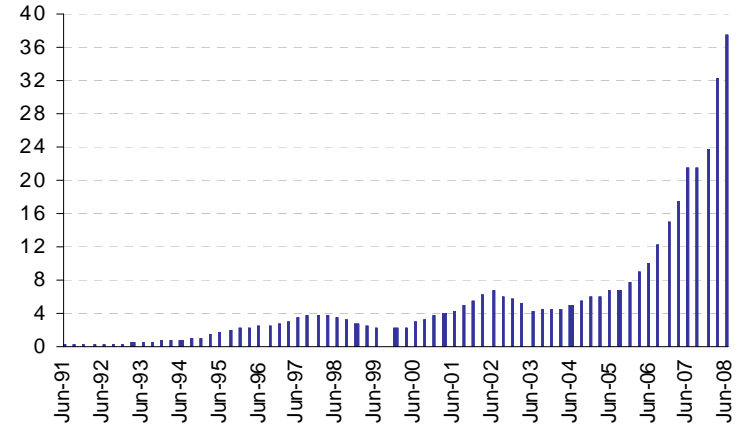
Source: CEIC, Morgan Stanley Research

# India's Improving Macro

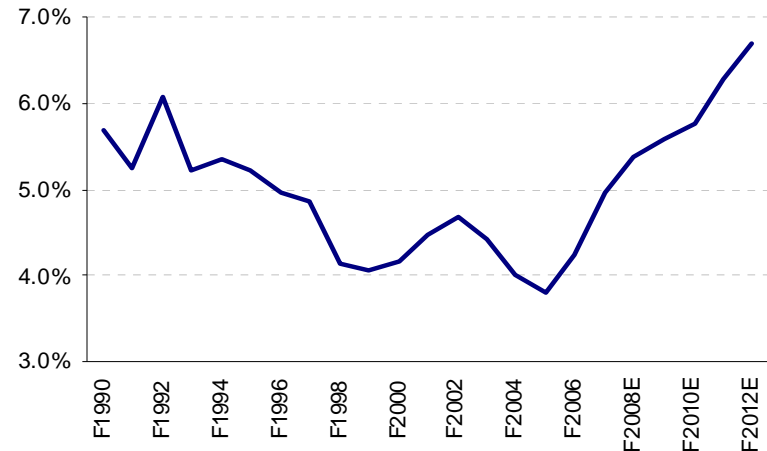
## Gross Domestic Savings as a % of GDP



## Gross FDI (4 Quarter Trailing) in US\$ Bn\*



## Infrastructure Investment as a % of GDP



Source: CSO, DIPP, RBI, Morgan Stanley Research, E= Morgan Stanley Research Estimates  
 \* Adjusted for US\$4.6Bn of Share Swaps and Round Tripping in FQ32007 for the Cairn IPO

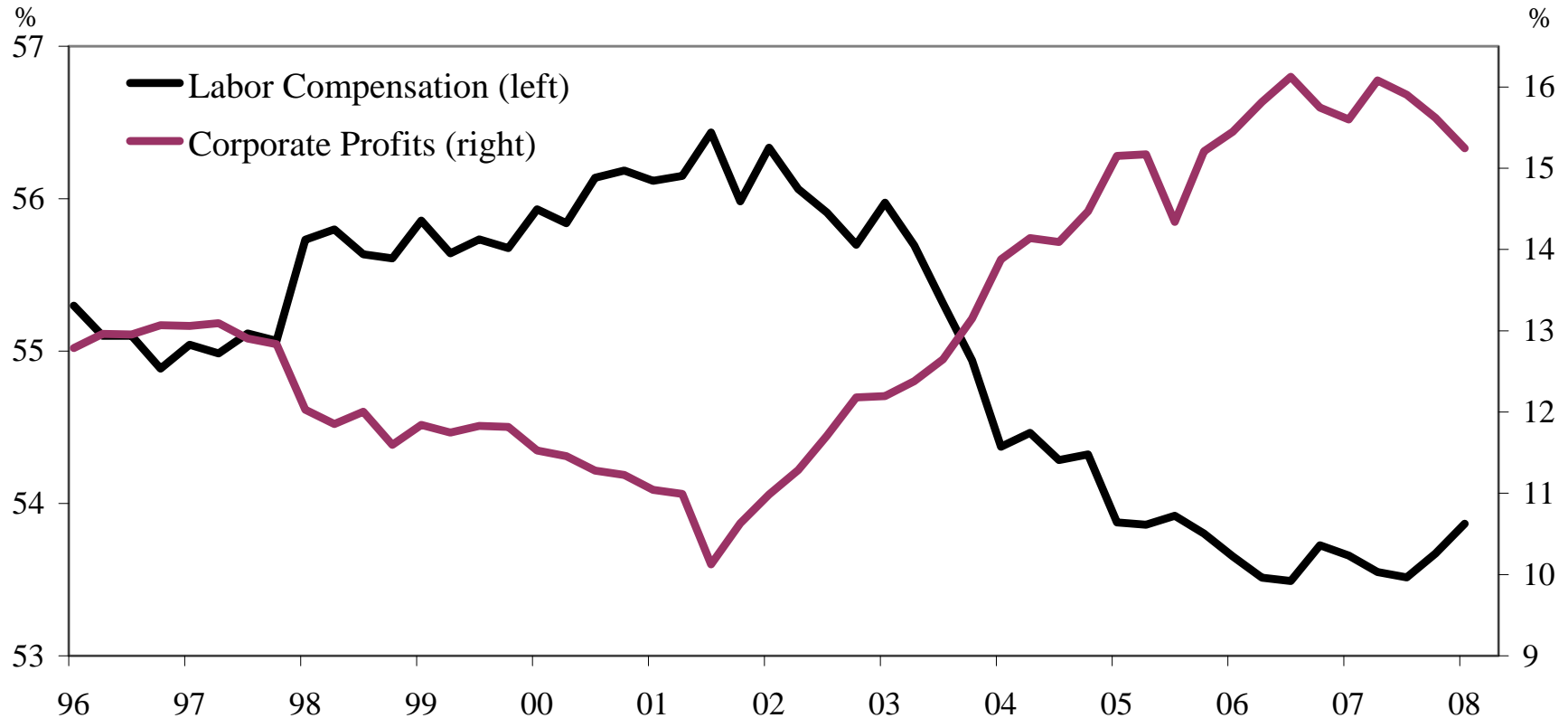
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# Backlash Against Globalization

Shares of National Income: G7+ Economies



\* G7+ includes the US, Japan, EMU, UK, and Canada.

Source: National sources, Morgan Stanley Research

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# From Globalization to Localization?

## Globalization

Trade Liberalization  
Low Inflation  
Low Interest Rates  
Strong Corporate Profits  
Dollar: Soft Landing

## Localization

Protectionism  
Rising Inflation  
Rising Interest Rates  
Margin Compression  
Dollar: Hard Landing

# A Brief History of the World

## Shifting Mix of Global GDP

	Western Europe	FSU	United States	Japan	China	India
1500	17.9%	3.4%	0.3%	3.1%	25.0%	24.5%
1600	20.0	3.5	0.2	2.9	29.1	22.5
1700	22.5	4.4	0.1	4.1	22.3	24.4
<b>1820</b>	<b>23.6</b>	<b>5.4</b>	<b>1.8</b>	<b>3.0</b>	<b>32.9</b>	<b>16.0</b>
1870	33.6	7.6	8.9	2.3	17.2	12.2
1913	33.5	8.6	19.1	2.6	8.9	7.6
1950	26.3	9.6	27.3	3.0	4.5	4.1
<b>1973</b>	<b>25.7</b>	<b>9.4</b>	<b>22.0</b>	<b>7.7</b>	<b>4.6</b>	<b>3.1</b>
1998	20.6	3.4	21.9	7.6	11.5	5.0
<b>2006e</b>	<b>19.0</b>	<b>3.8</b>	<b>19.7</b>	<b>6.3</b>	<b>15.1</b>	<b>6.3</b>

Note: Based on 1990 International (PPP) Dollars; FSU is Former Soviet Union.

Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2001); IMF, Morgan Stanley Research

# Disclosures

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