

## Ed Hyman: We Are Not Japan

By Katie Southwick

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After the events last spring – the BP oil spill, increased deleveraging, and the sovereign debt crisis in Europe – the economy was suffering, said Ed Hyman, CEO of the NY-based consulting firm ISI Group. He spoke at GaveKal’s winter seminar in New York City last week.

“Reflecting on the things mentioned, the stock market began to go down, and with it, the economy,” he told seminar participants. “It looked like we lost.” The country appeared well down the path once followed by Japan – years of stagnant conditions in the wake of crisis.

What a difference six months can make. Despite that worrisome outlook earlier this year, Hyman provided an upbeat forecast of the US economy, arguing that we are in the midst of an economic recovery that will lead to expansion. We are demonstrating that we are not Japan, he said. Instead, Hyman predicted a quick recovery in the first quarter, with an increase in GDP, decrease in unemployment, rising bond yields, and increased S&P 500 earnings.

“I think this is a very special time,” said Hyman, explaining that two major factors are at work simultaneously that will have a positive effect on the economy. First, he pointed to quantitative easing, arguing that the success of QE2 can be measured in one way – by an increase in bond rates. Unlike other economists, who argue that success is measured by a decrease in bond rates, Hyman said rising bond rates point to the policy’s initial success. When QE1 was instituted last year, Hyman pointed out, bond yields increased from 2.5% to 4% in 12 weeks. “I know it is counterintuitive,” said Hyman, “but as the market goes up and people realize the economy is going to get better, the yields go up. They just don’t go up as much as they otherwise would if not for QE.”

Ultimately, Hyman believes that the more bond yields are increasing, the more it means that the economy is improving – “a reflection of strength, perceived and actual,” he termed it. He provided the following predictions for bond yields:

	2010	2011	2012
10-Year Bond Yield	3.0%	4.0%	4.5%



With an increase in bond prices, Hyman also lifted his GDP forecasts, proposing the following predictions, arguing that the growth in GDP was entering “recovery territory”:

	2010	2011	2012
Real GDP	2.5%	3.0%	3.0%
GDP Price Deflator	1.7%	1.5%	1.5%
Nominal GDP	4.2%	4.5%	4.5%

While GDP and bond yields are increasing, Hyman acknowledged that the one place where QE2 still needs to work through is the stock market. He noted that the last time the banks instituted QE, the stock market increased by 60%. Hyman provided these optimistic estimates of S&P 500 earnings:

	2010	2011	2012
S&P 500 EPS	\$84	\$93	\$100

In addition to quantitative easing, Hyman argued that a political move toward the center will also drive the economy into recovery. During times of economic crisis, we tend to elect leaders who enact anti-business policies and increase regulation. “The anti-business move – increased regulation – is one of the things that kept the Depression [of 1930s] going longer,” Hyman argued. This time around, however, Hyman believes that Obama wants to be re-elected, which he believes will cause him shift his policies closer to the center. He compared this year’s midterm election to the midterm elections of 1994, arguing that when Clinton’s policies shifted towards the center, the stock market rose by 30% over the next year.

“If we move to the center, it would be – or could be – a big plus for the stock market,” Hyman explained, forecasting positive growth over the next two years. Already, we have seen a stimulus package of 2%. “So I think Bernanke and Obama are trying to put in place a world policy that will make the next two years better than the consensus predictions, those being for 2% growth,” he continued. By 2012, Hyman predicts that GDP will increase by 2-3%, and he predicts that unemployment will decrease to 8.5%.

	2010	2011	2012
Unemployment Rate	9.5%	9.0%	8.5%
Payroll Employment	0.7%	1.0%	1.0%

Furthermore, Hyman expressed a positive outlook on auto sales, reporting a 39% annual increase in car sales during the first quarter. As a discretionary purchase, car sales are often delayed during recession, creating a pent-up demand for new vehicles. Once the economy begins to rebound, however, auto sales increase, signaling a shift to economic recovery.



Finally, Hyman concluded with a few words on inflation. He described Federal Reserve Chairman Ben Bernanke as an “inflation hawk,” citing a speech that Bernanke delivered in 2004 that stated “we have all learned by the past two decades that inflation is good.” Hyman also argued against the forecast of hyperinflation, comparing current inflationary conditions to historical data from Weimar Germany, a period notorious for its hyperinflation. “I can see getting inflation if, for example, the price of oil increases to \$200,” he stated, but he does not see a strong case for hyperinflation, as both wage values and currency values do not even approach those recorded during Weimar Germany.

Ultimately, Hyman assured his audience that the future of the US economy would not resemble the recent history of Japan. “We are demonstrating that we are not Japan, which has been a constant concern for all of us,” he argued. “Three months ago, we said, ‘Maybe we are Japan. We had a recovery, and we’re headed back down.’” Now, however, Hyman emphasizes the quickness with which a full recovery seems to be unfolding. “Recoveries? The recoveries are taking off. They are short,” he asserted. While recovery is also “the most dangerous part of the trip,” Hyman concluded that we are “on the verge of getting into expansion.”

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