

The International Economy: Recent Developments and Outlook

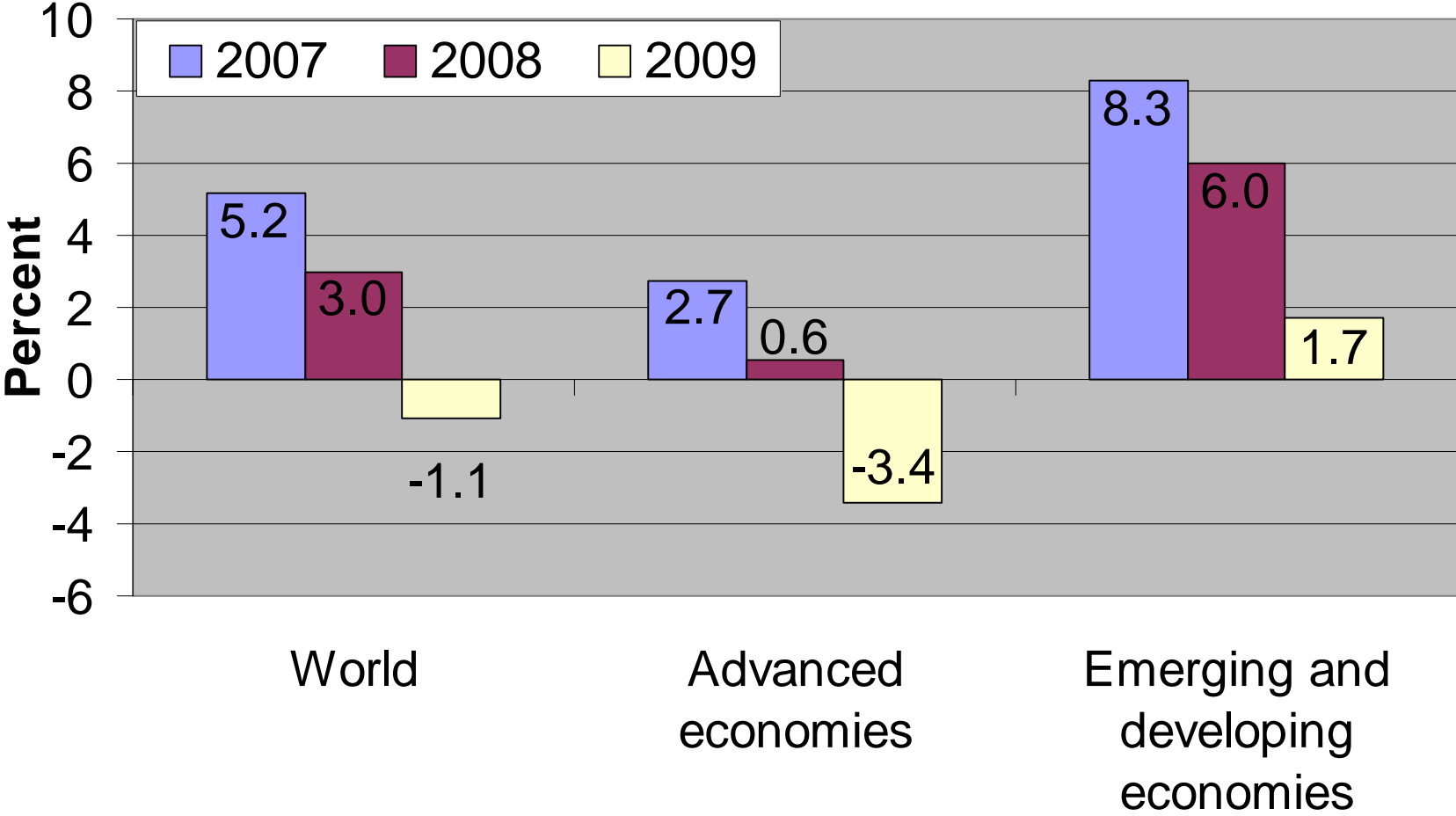
Presented to the Silicon Valley Roundtable of the
National Association for Business Economics

by Anne Ramstetter Wenzel, M.A.

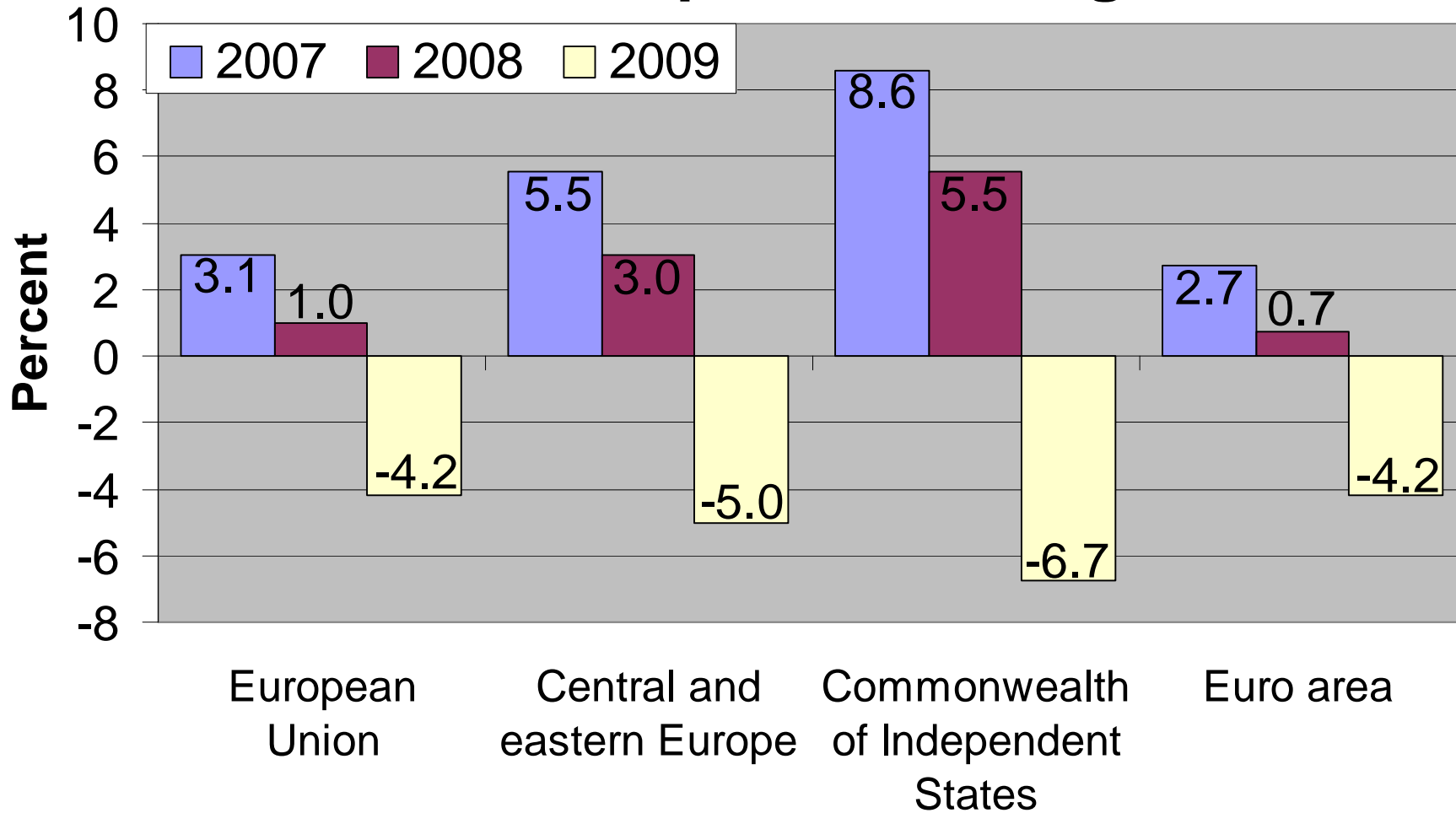
Econosystems

January 12, 2010

GDP constant prices, annual percent change

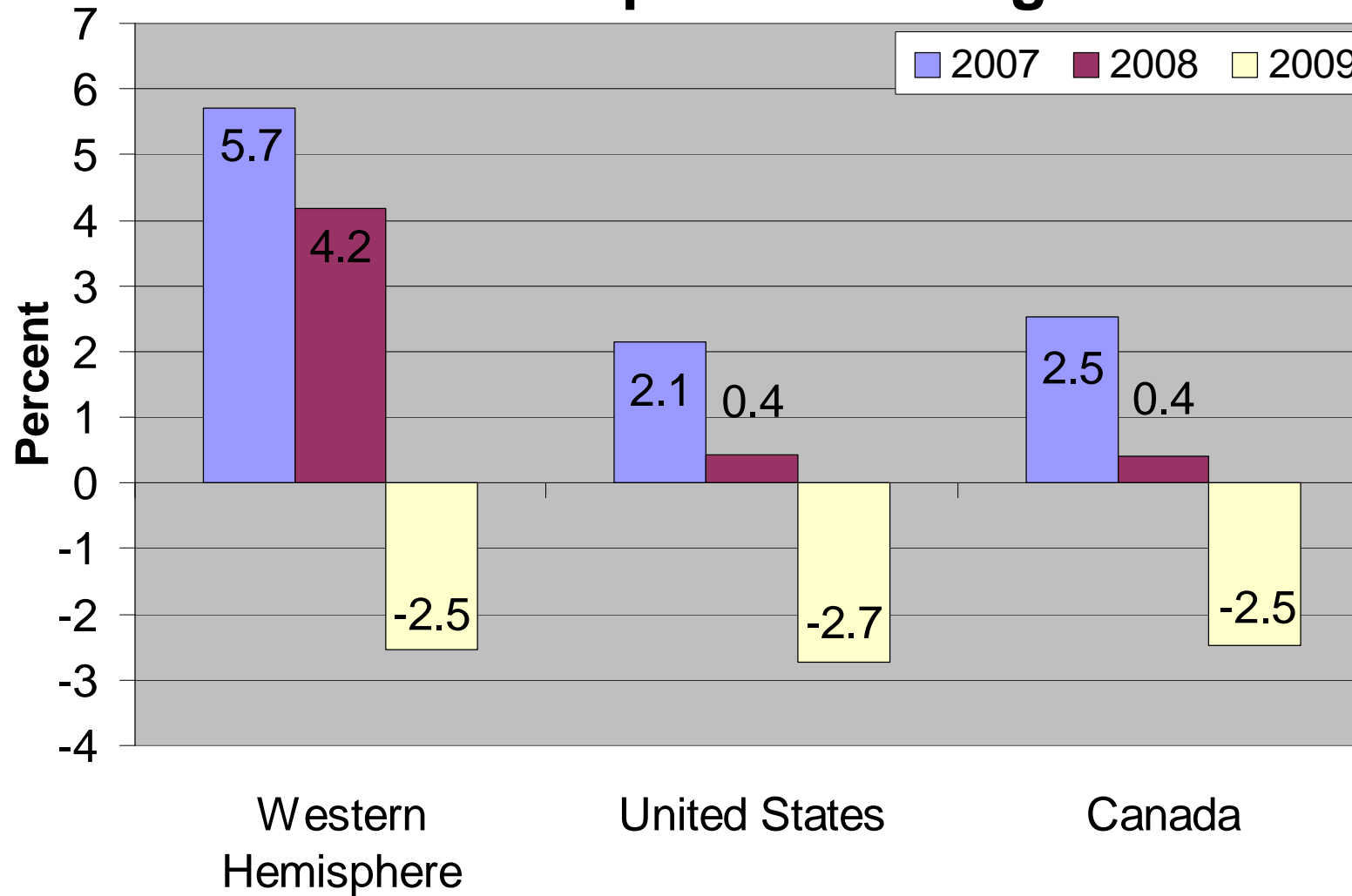


GDP constant prices, annual percent change



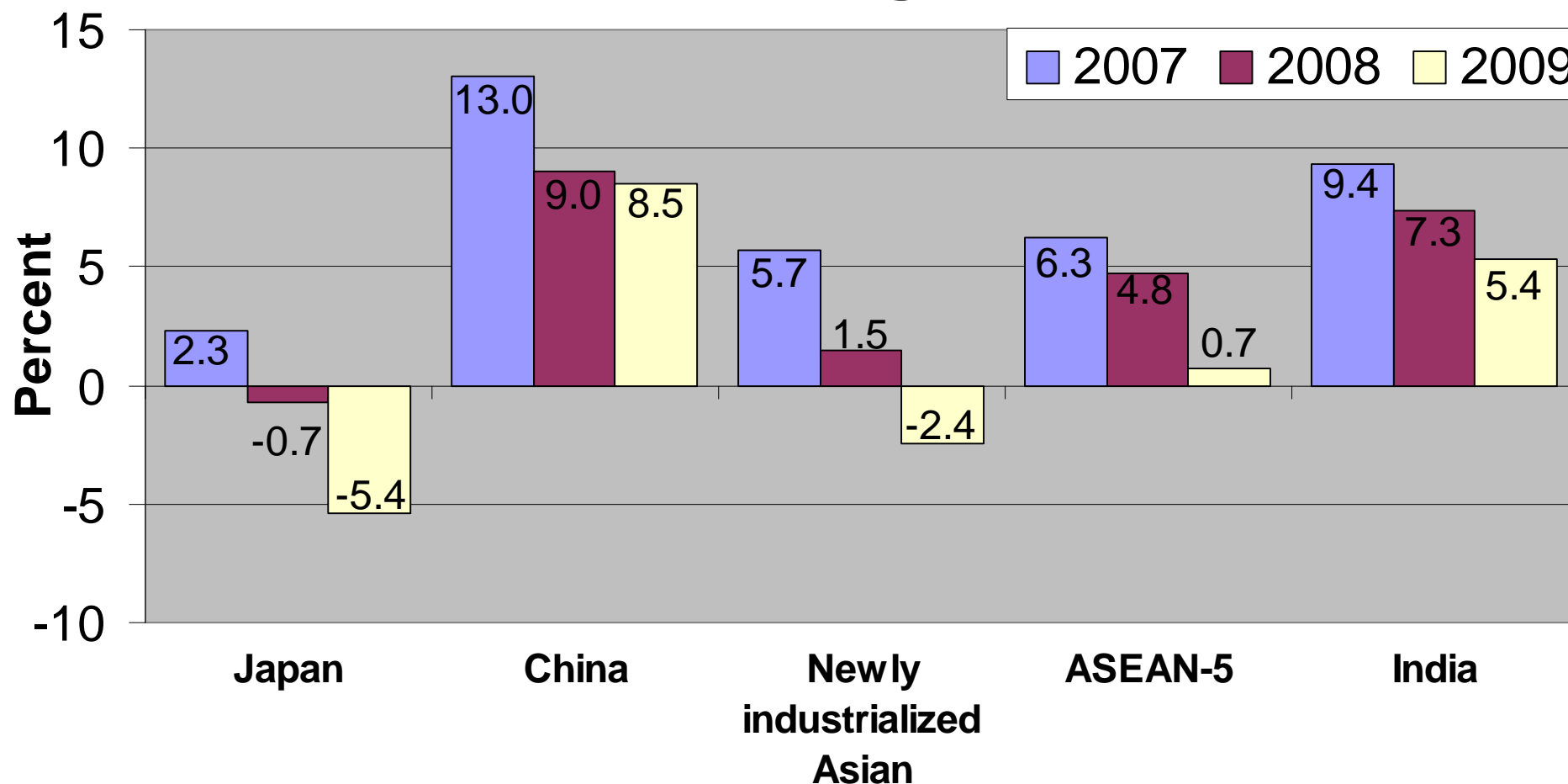
*CIS includes a group of former Soviet Republics plus Mongolia.

GDP constant prices, annual percent change



*Western Hemisphere includes Central and South American countries.

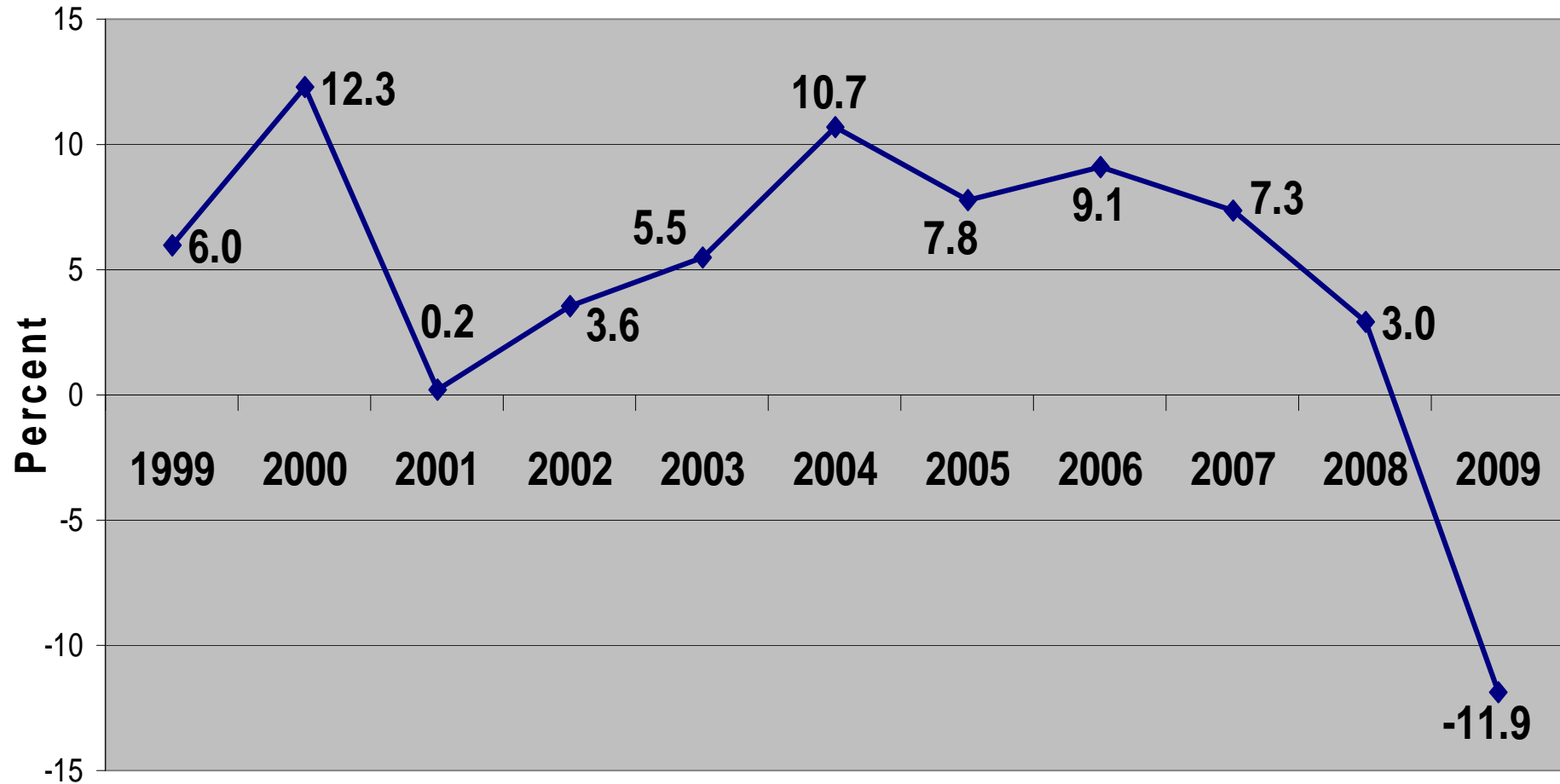
GDP constant prices, annual percent change



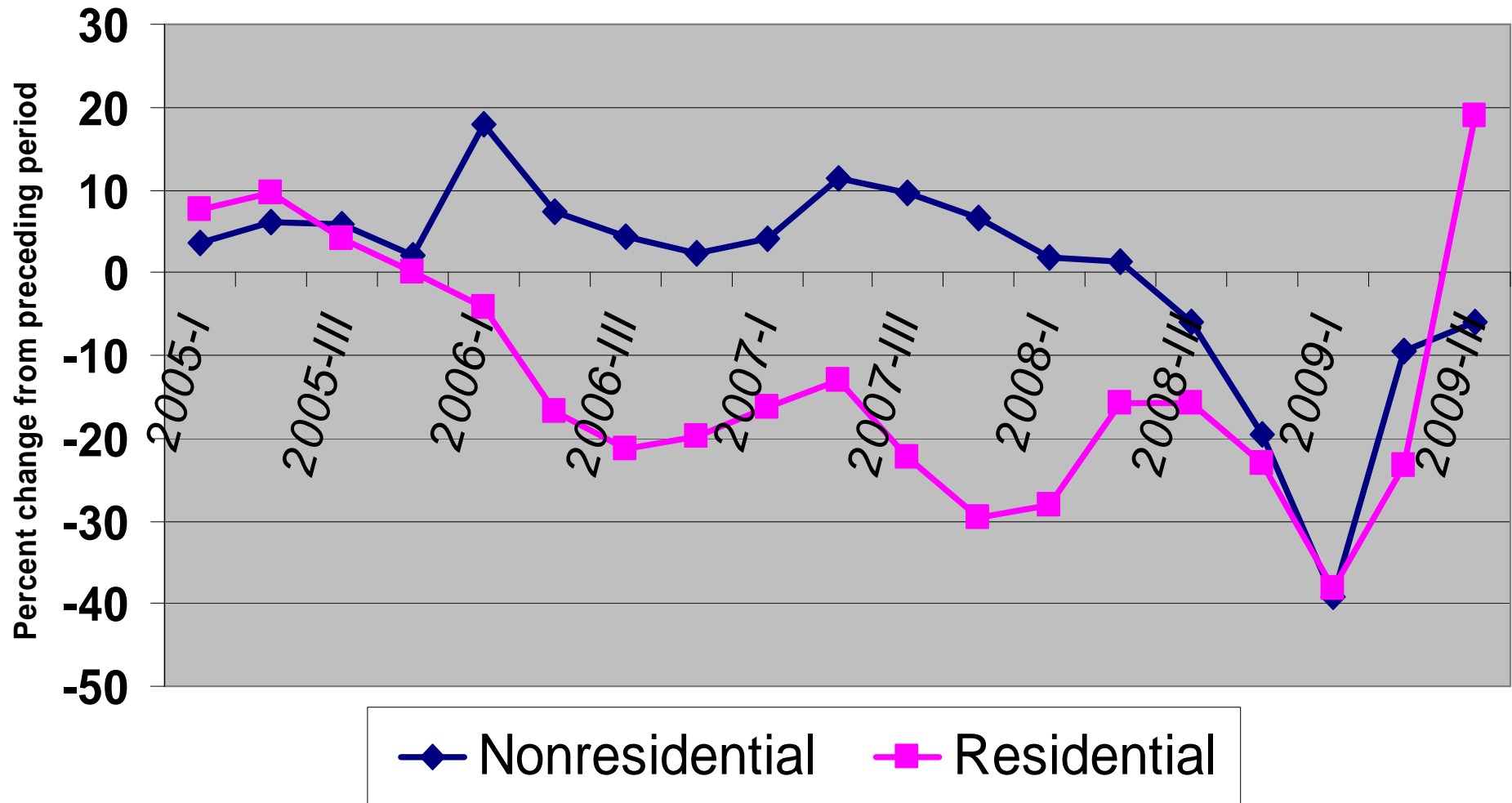
Association of Southeast Asian Nations-5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

NIC Includes Hong Kong, So. Korea, Singapore, and Taiwan.

World Trade Volumes, Goods and Services, annual percent change



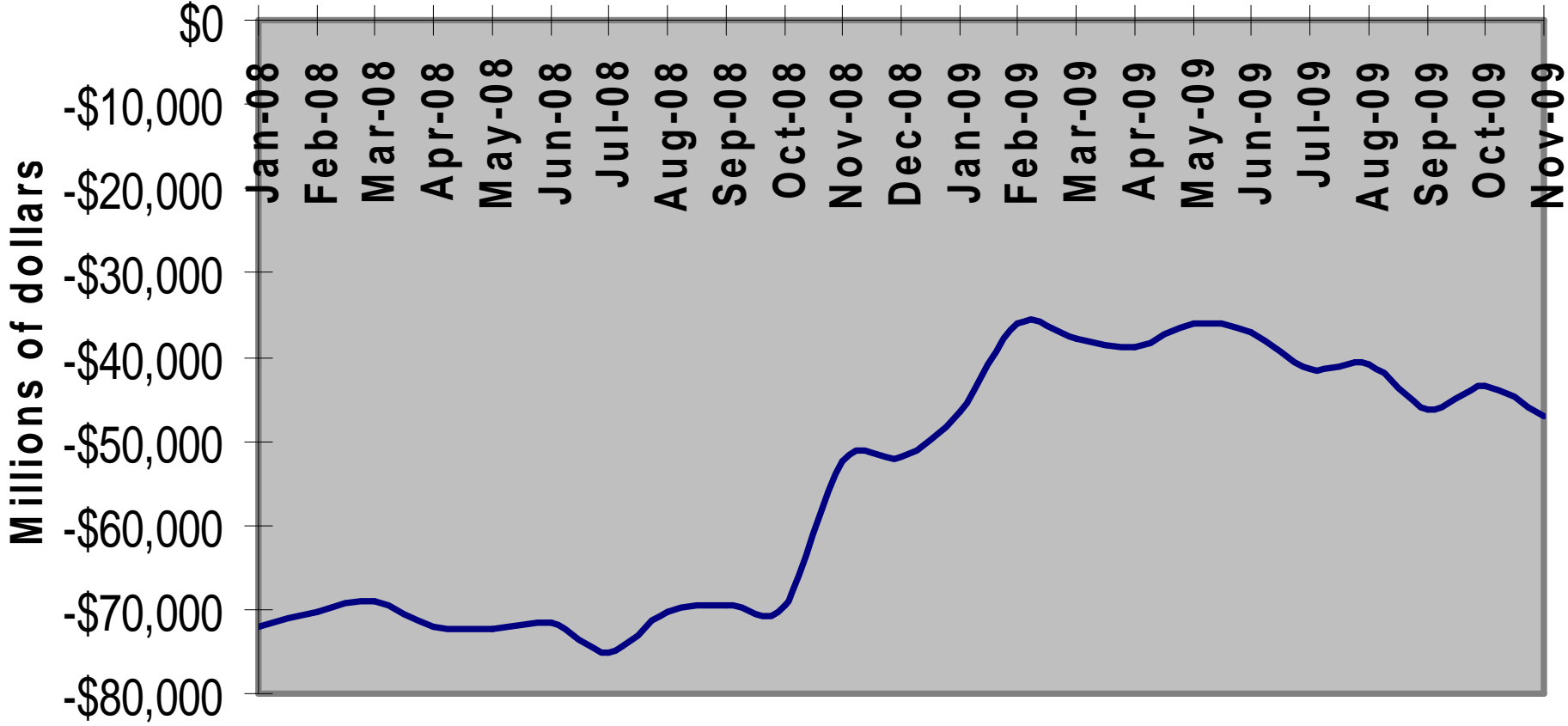
U.S. Gross Private Domestic Investment, Constant Dollar Seasonally Adjusted Annual Rate



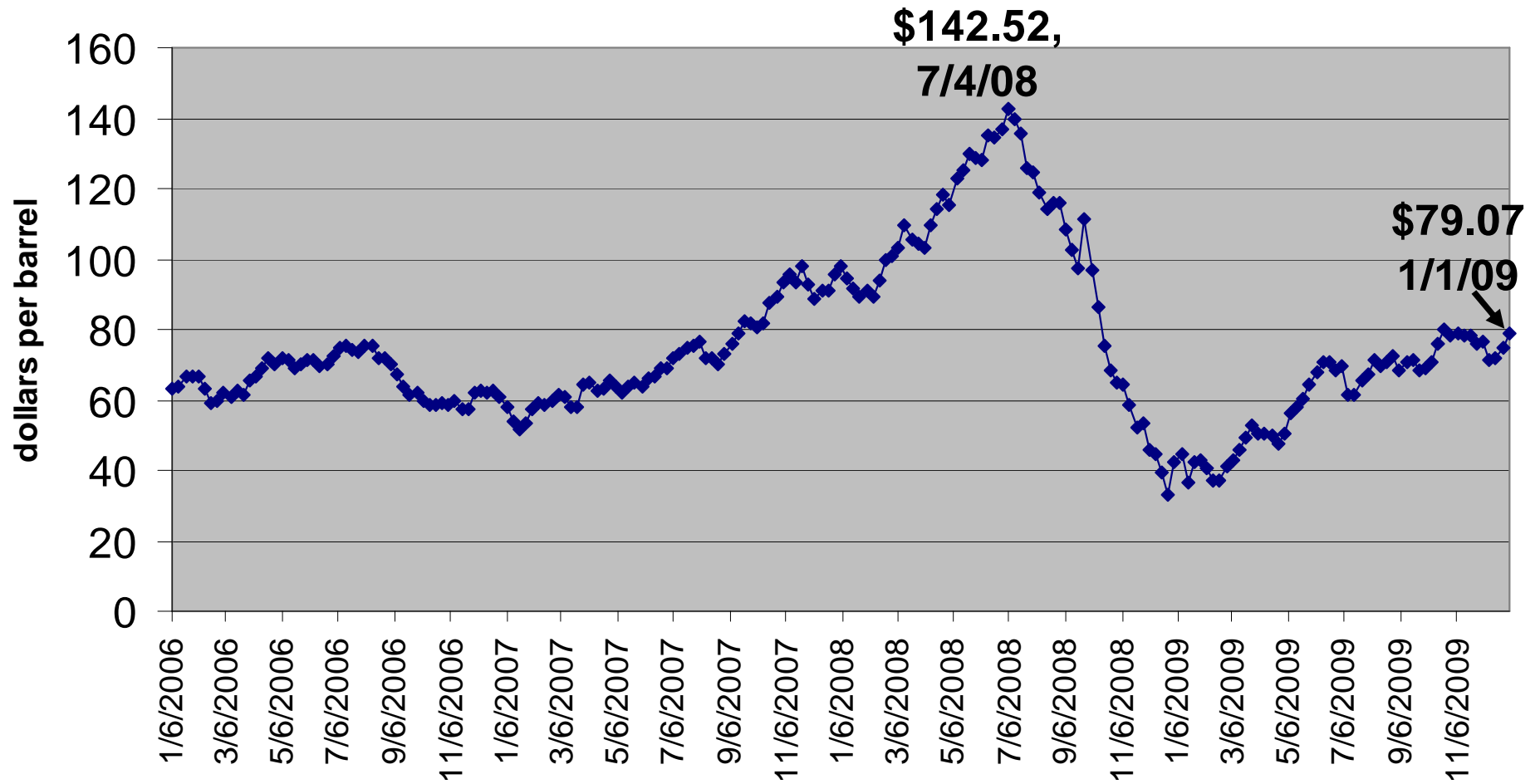
U.S Residential Investment

- Fell from a peak of \$813.3 billion current dollars in the first quarter of 2006 (seasonally adjusted annual rate) to a low of \$345.9 billion in the 2nd quarter of 2009.
- Residential investment increased in the 3rd quarter of 2009 to \$358.8 billion (SAAR, current dollars).
 - The 19% increase in residential investment for 3rd Quarter 2009 was from a historical low 2nd quarter low (compared to \$346.7 current dollars 1997 Q1).
 - Constant 2005 dollar data reported from 1995. Current residential investment levels lowest in past 15 yrs.

U.S. Trade Balance, Customs Basis Seasonally Adjusted

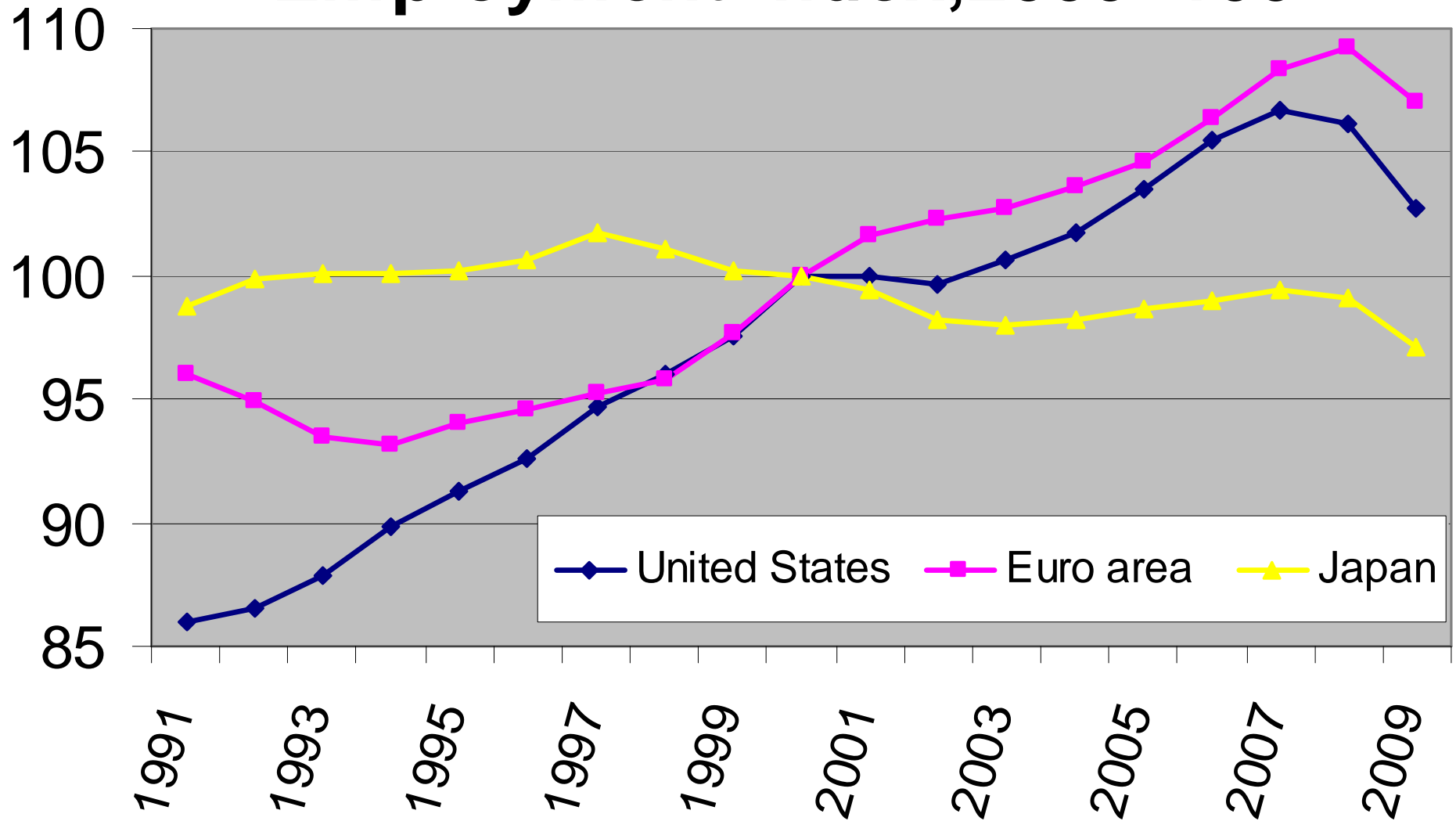


Crude Oil Weekly Spot Prices, WTI

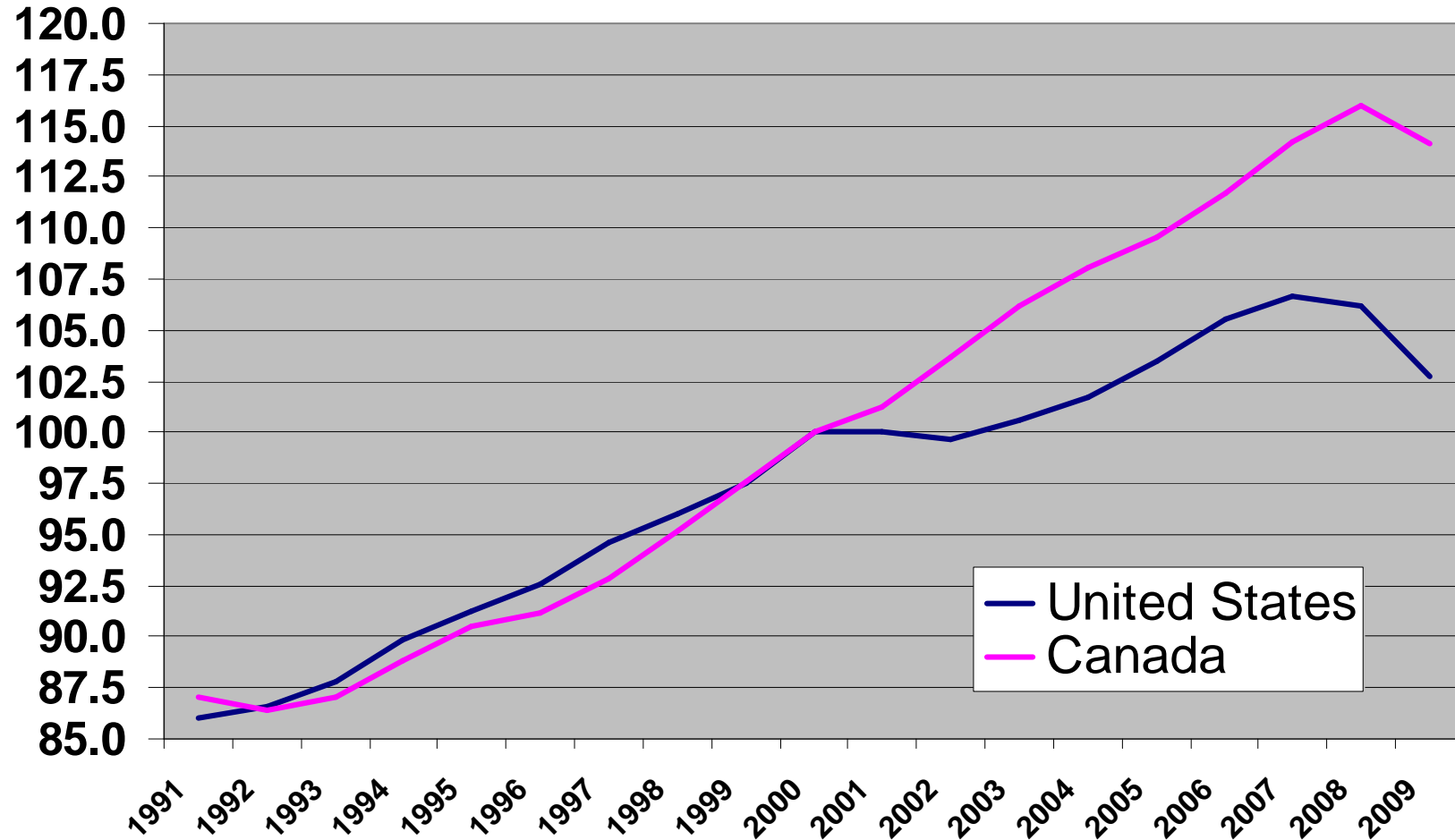


Euro Area, US & Japan

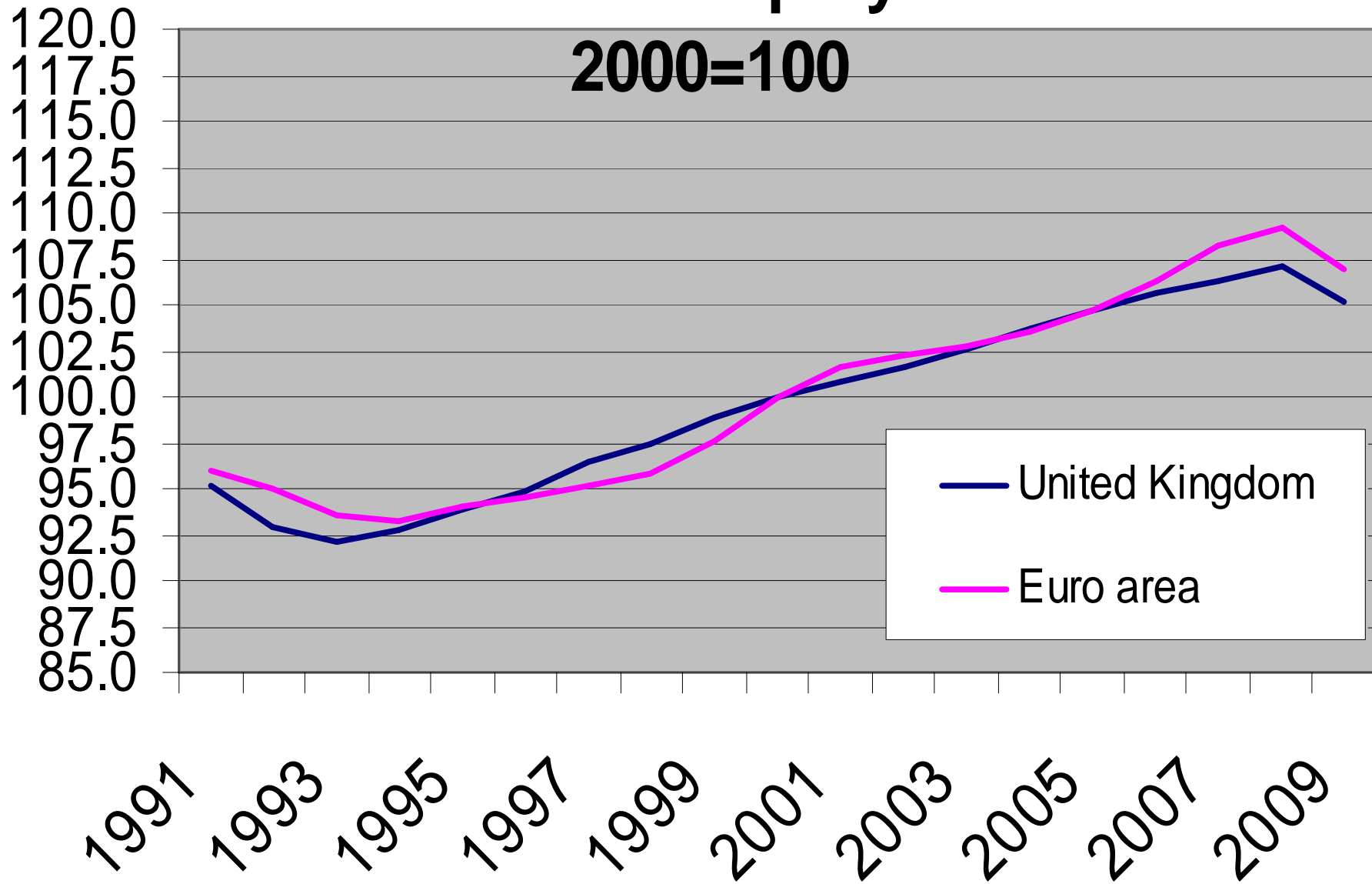
Employment Index, 2000=100



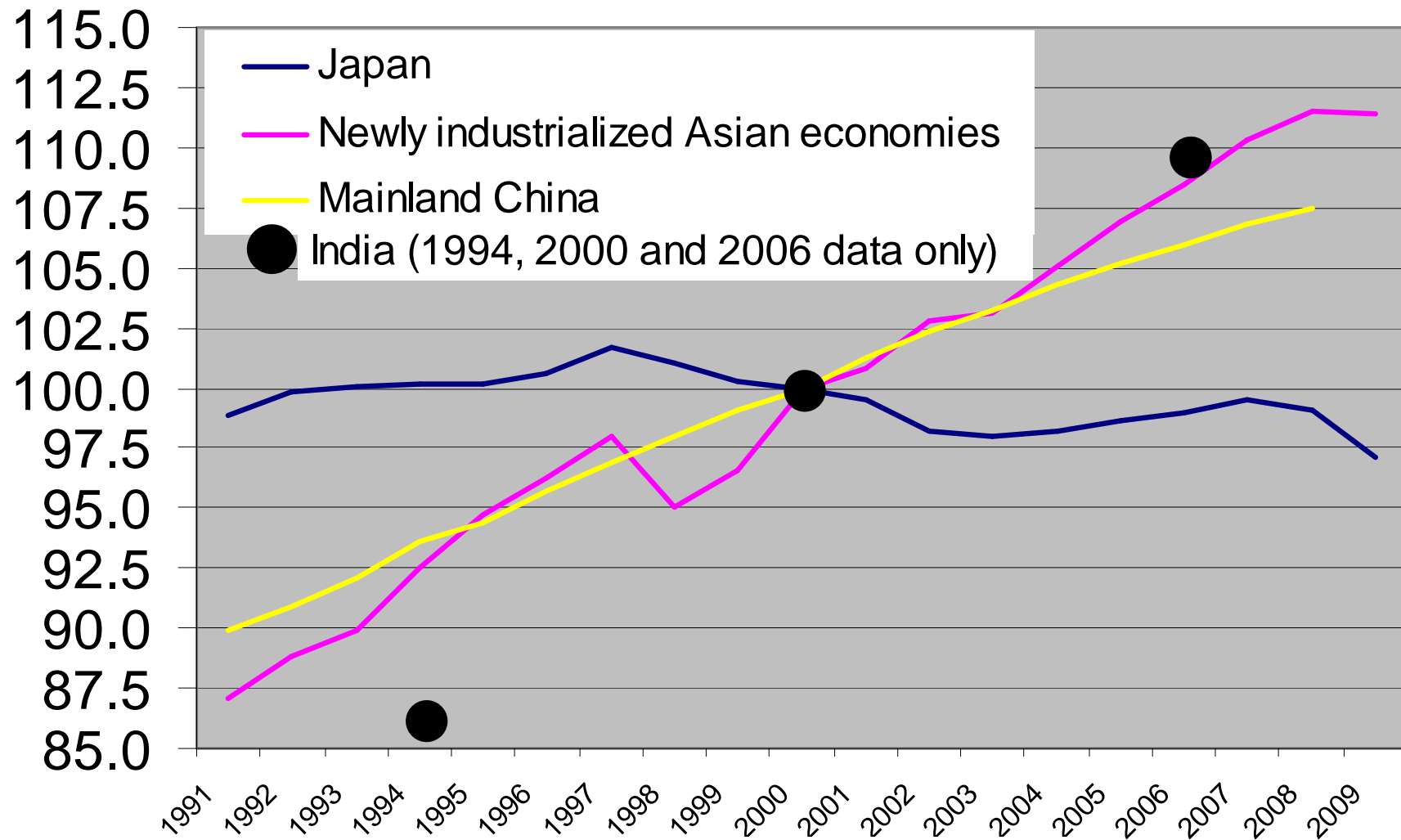
US & Canada Employment Index 2000=100



UK & Euro Area Employment Index

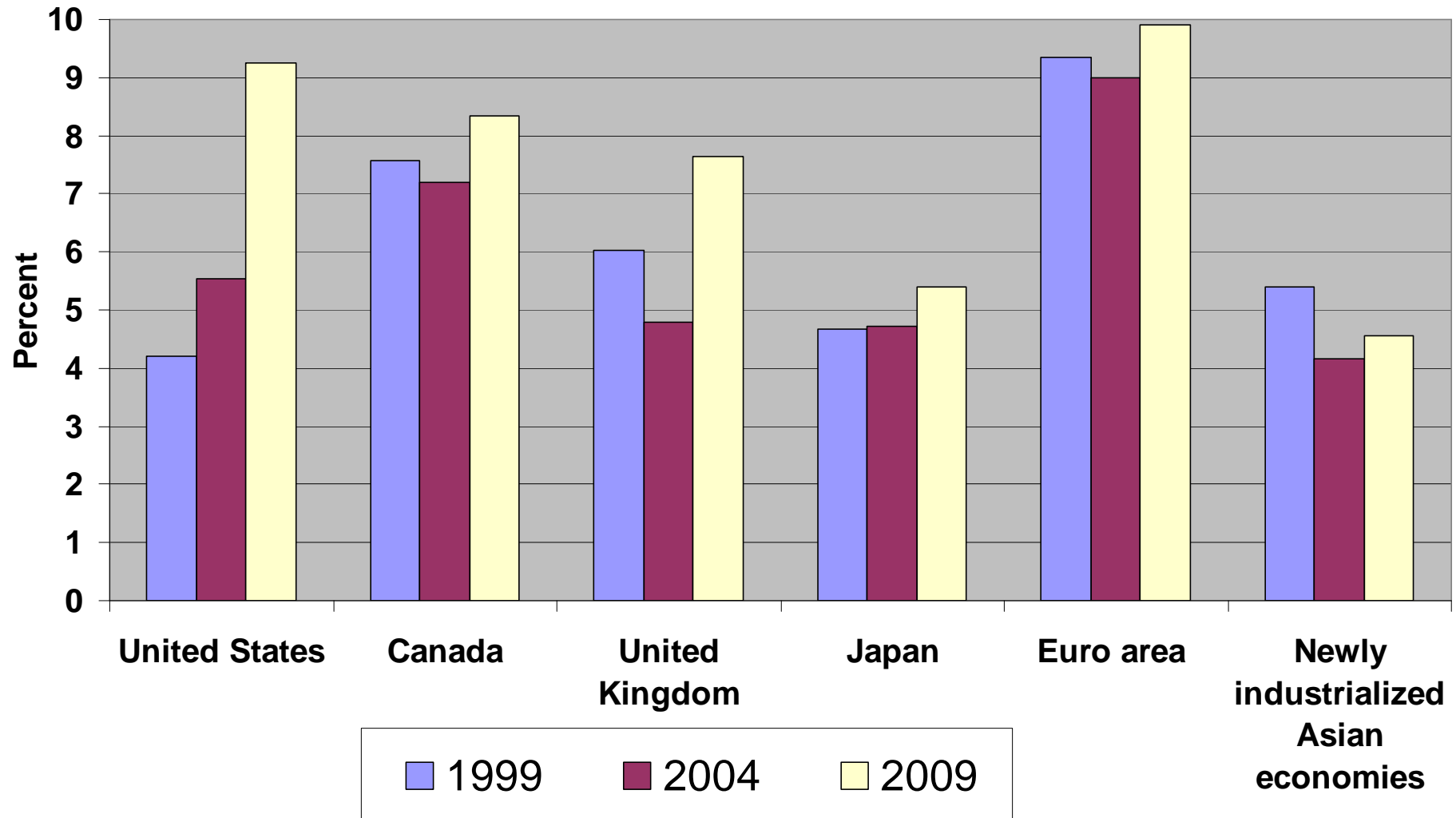


Employment Index, 2000=100



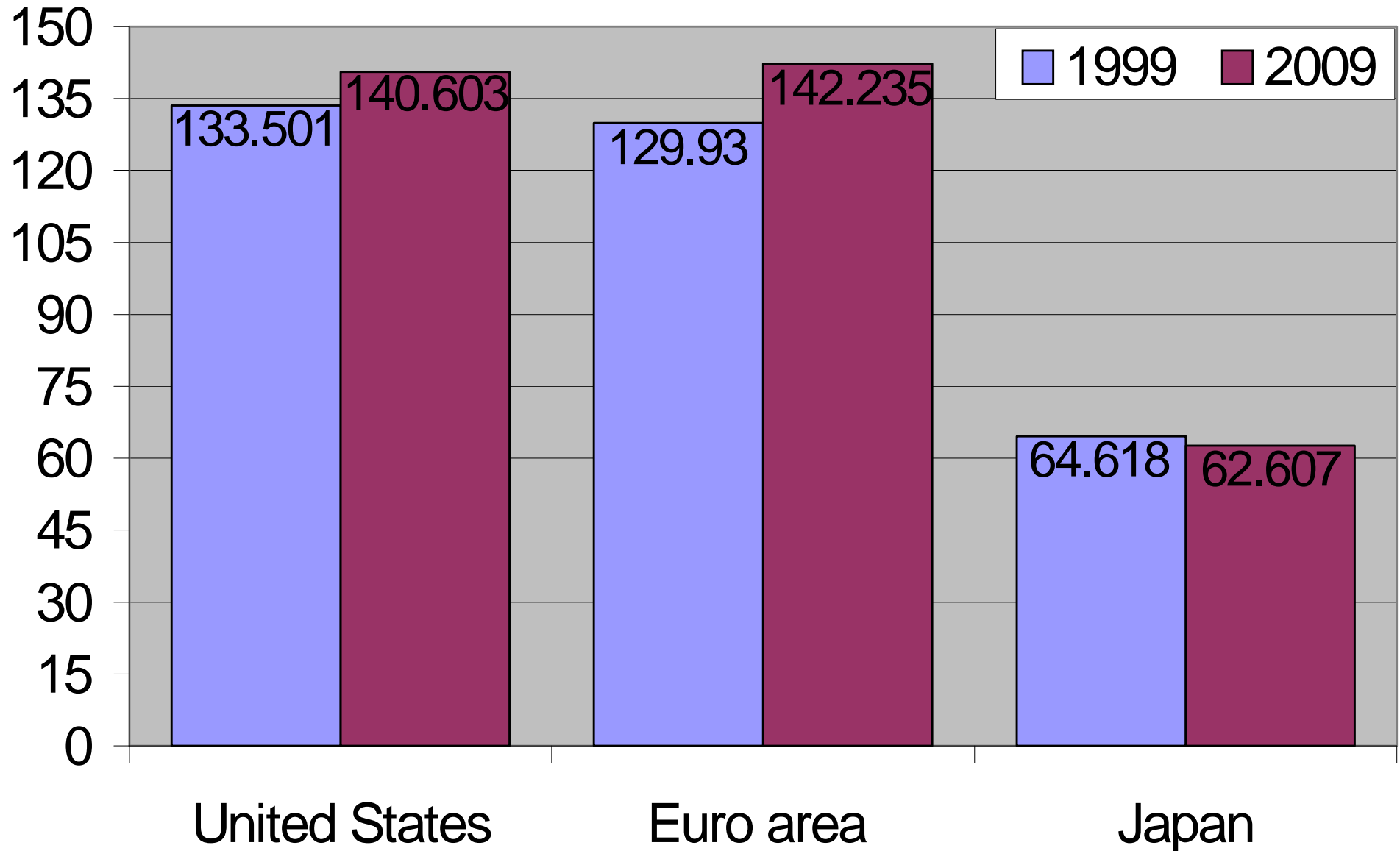
*NIC Includes Hong Kong, So. Korea, Singapore, and Taiwan.

Unemployment Rates US, Canada, UK, Japan, Euro area, & NIC of Asia

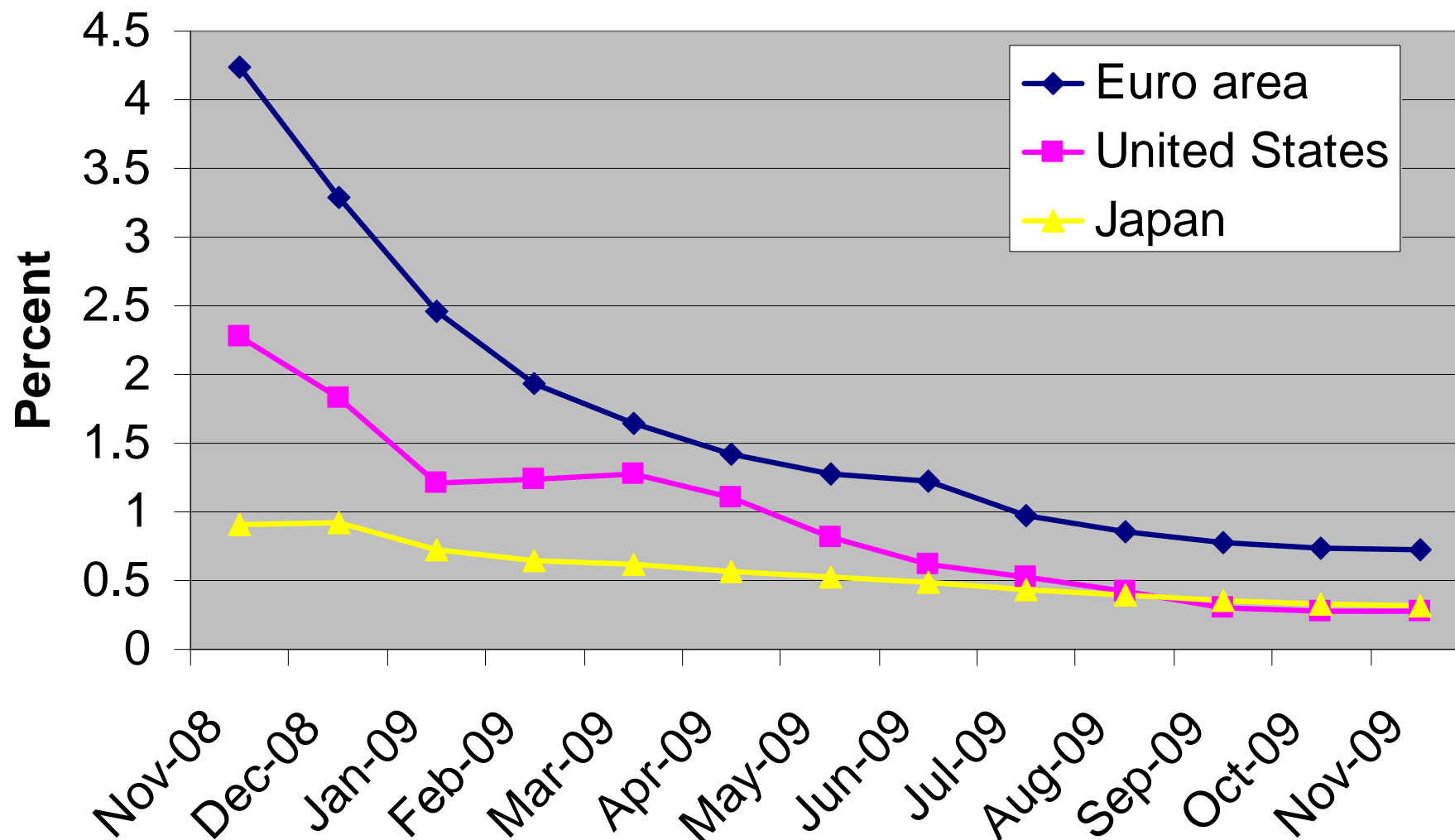


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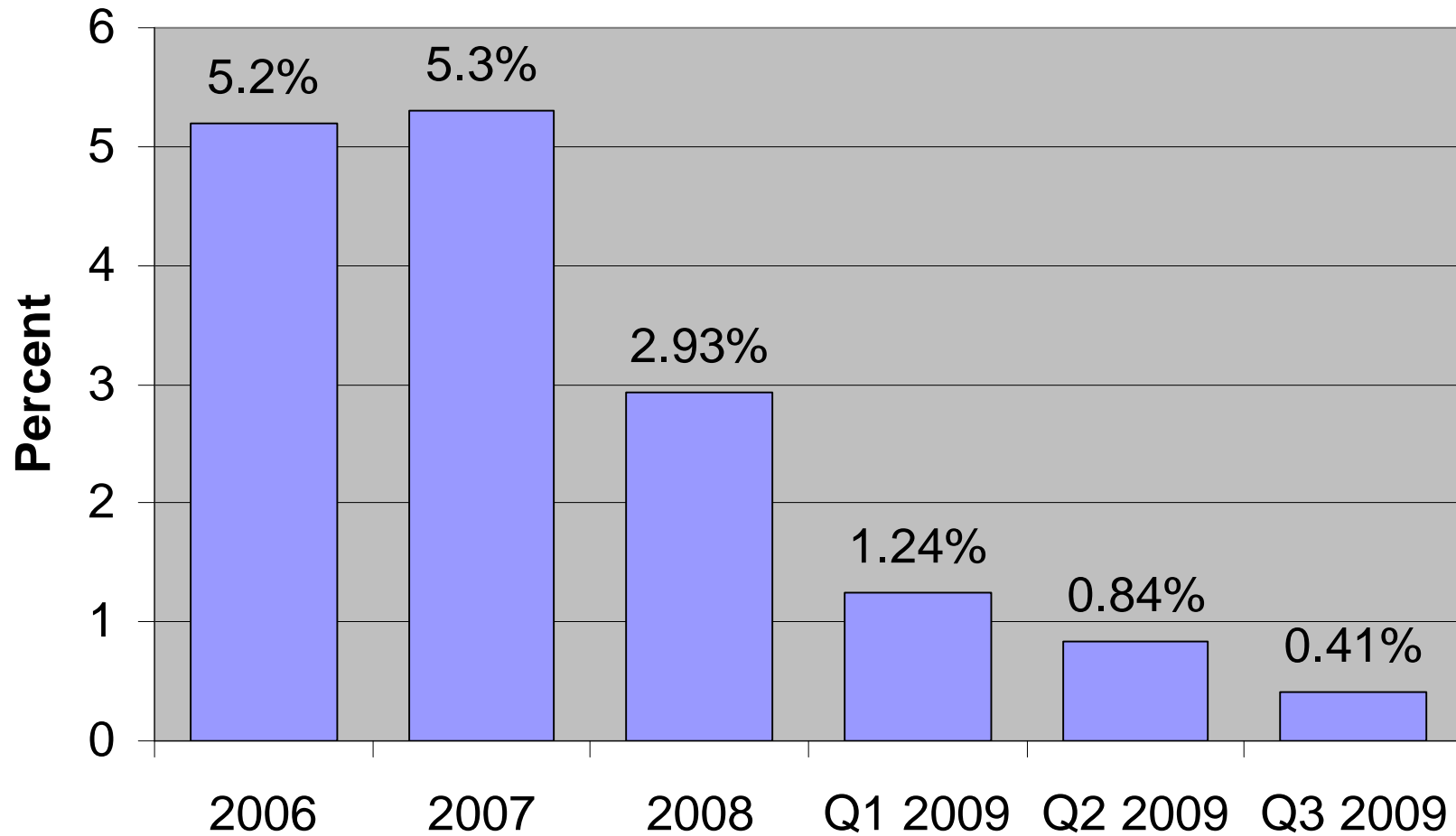
Euro area, US & Japan Employment in Millions



3-month LIBOR rates



3-month LIBOR, United States



John B. Taylor: Fear of Deflation led to a Looser monetary policy than economic conditions warranted:

Loose fitting

Federal funds rate, actual and counterfactual, (in percent)

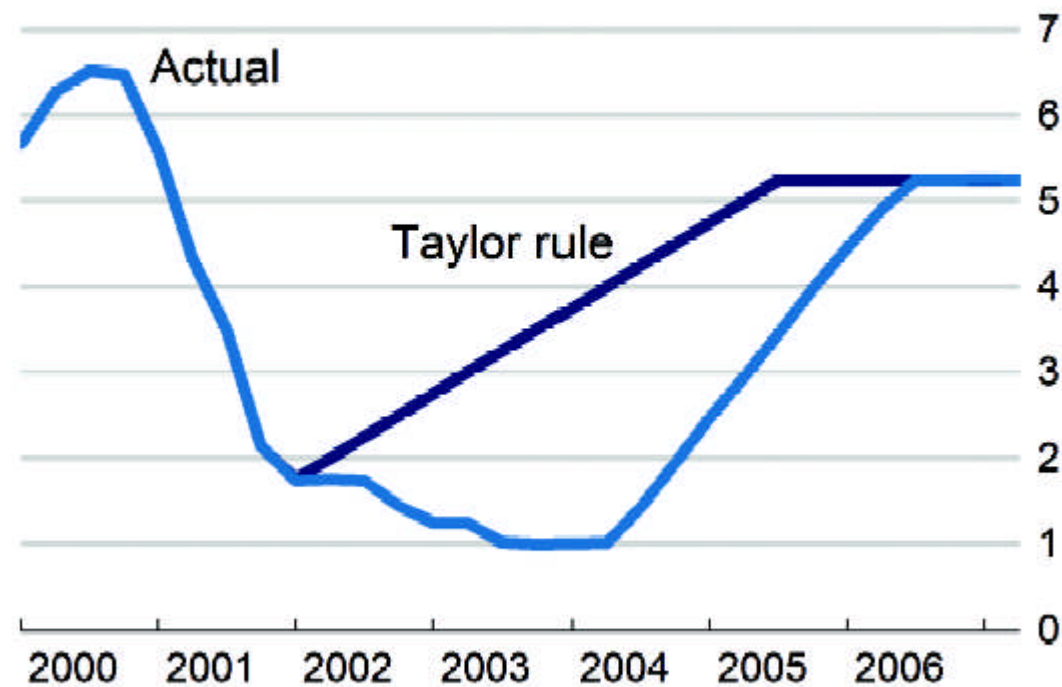


FIGURE 1. Chart from *The Economist*, October 18, 2007

John B. Taylor, *Getting off Track*

Figure 7 illustrates this using a measure that has since become the focus of many studies. That measure is the spread between the three-month London Inter-bank Offered Rate (Libor) and the three-month overnight index swap (OIS). The OIS is a measure of what the markets expect the federal funds rate to be over the three-month period comparable to the three-month Libor. Subtracting OIS from Libor effectively controls for expectations effects, which are a factor in all term loans, including the three-month Libor. The difference between Libor and OIS is thus due to things other than interest-rate expectations, such as risk and liquidity effects.

Source: *Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*, John B. Taylor, Hoover Institution Press Publication, 2009 p. 15.

The Credit Crisis Begins in 2007

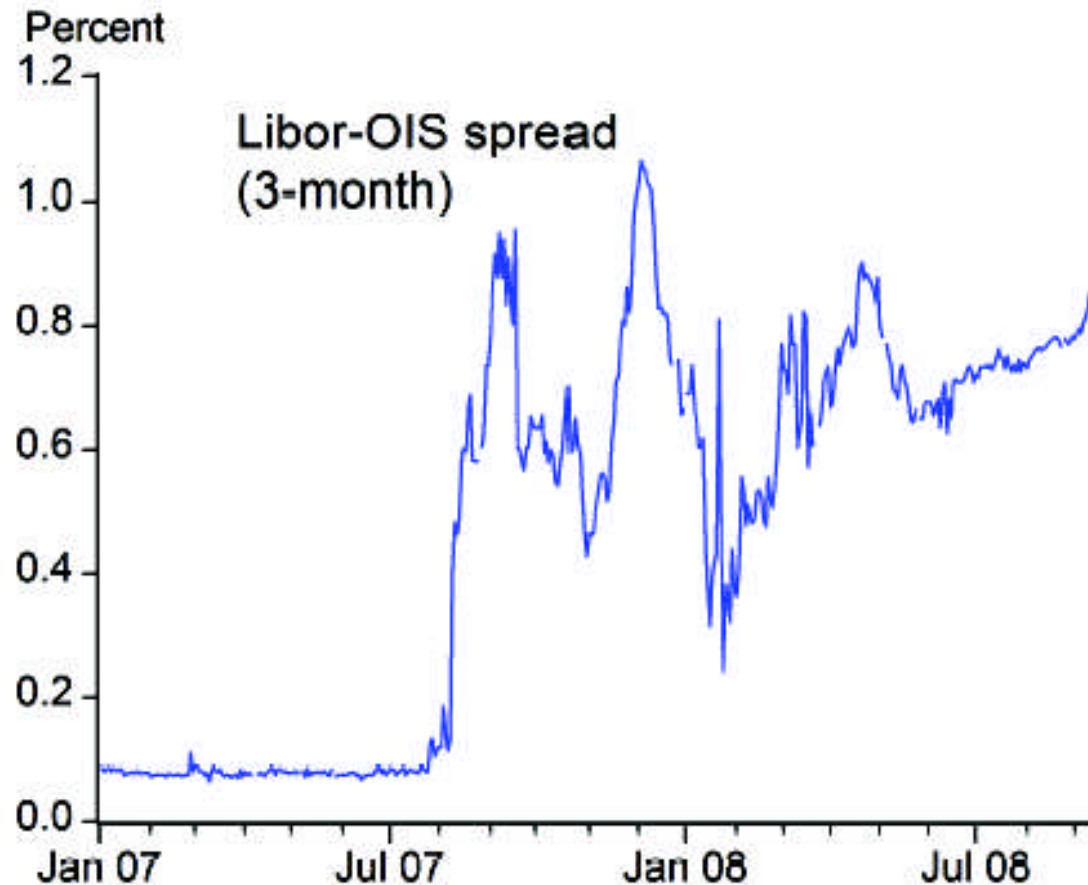


FIGURE 7. The Libor-OIS (overnight index swap) Spread during the First Year of Crisis

Source: [Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis](#), John B. Taylor, Hoover Institution Press Publication, 2009, p. 16.

Crisis worsens:

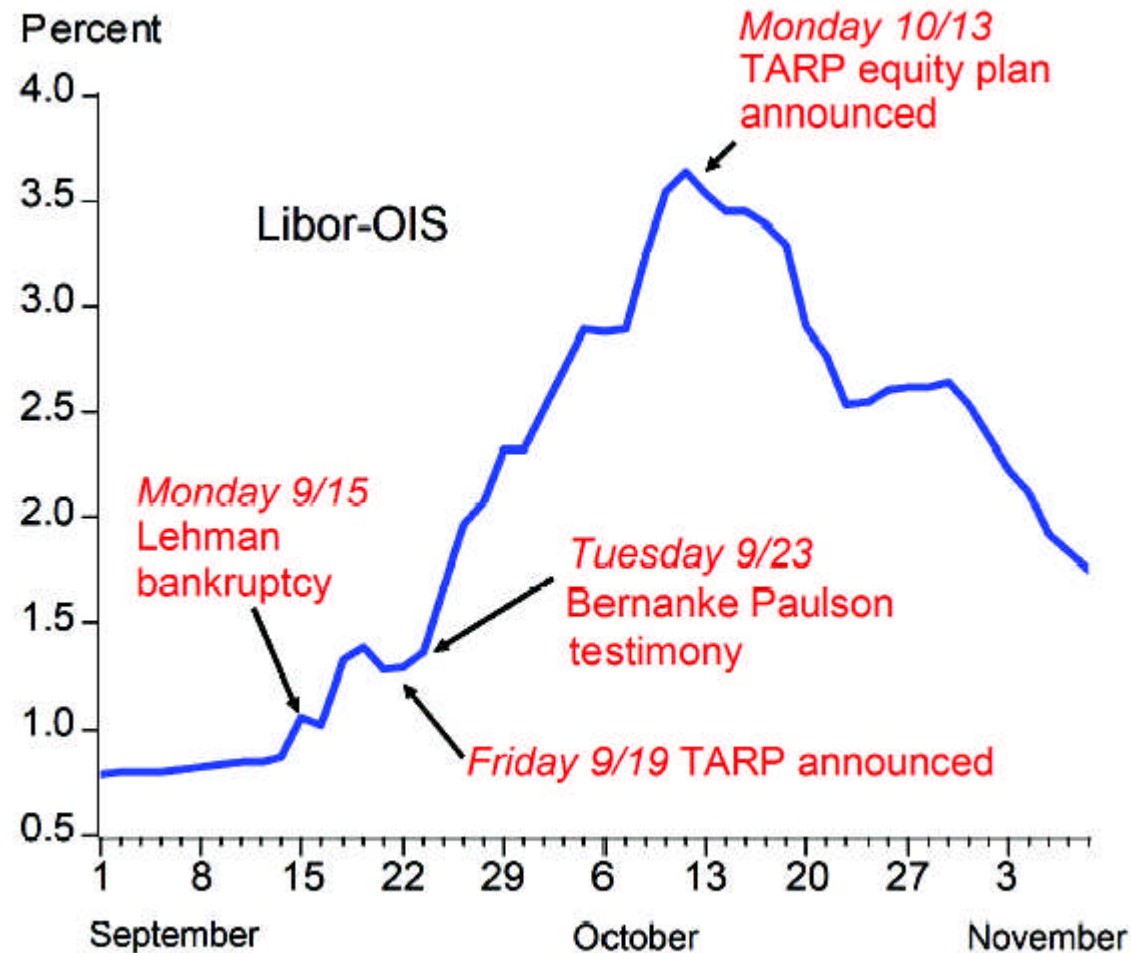


FIGURE 13. Event Study of the Worsening Crisis (2008)

Source: [Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis](#), John B. Taylor, Hoover Institution Press Publication, 2009, p. 27.

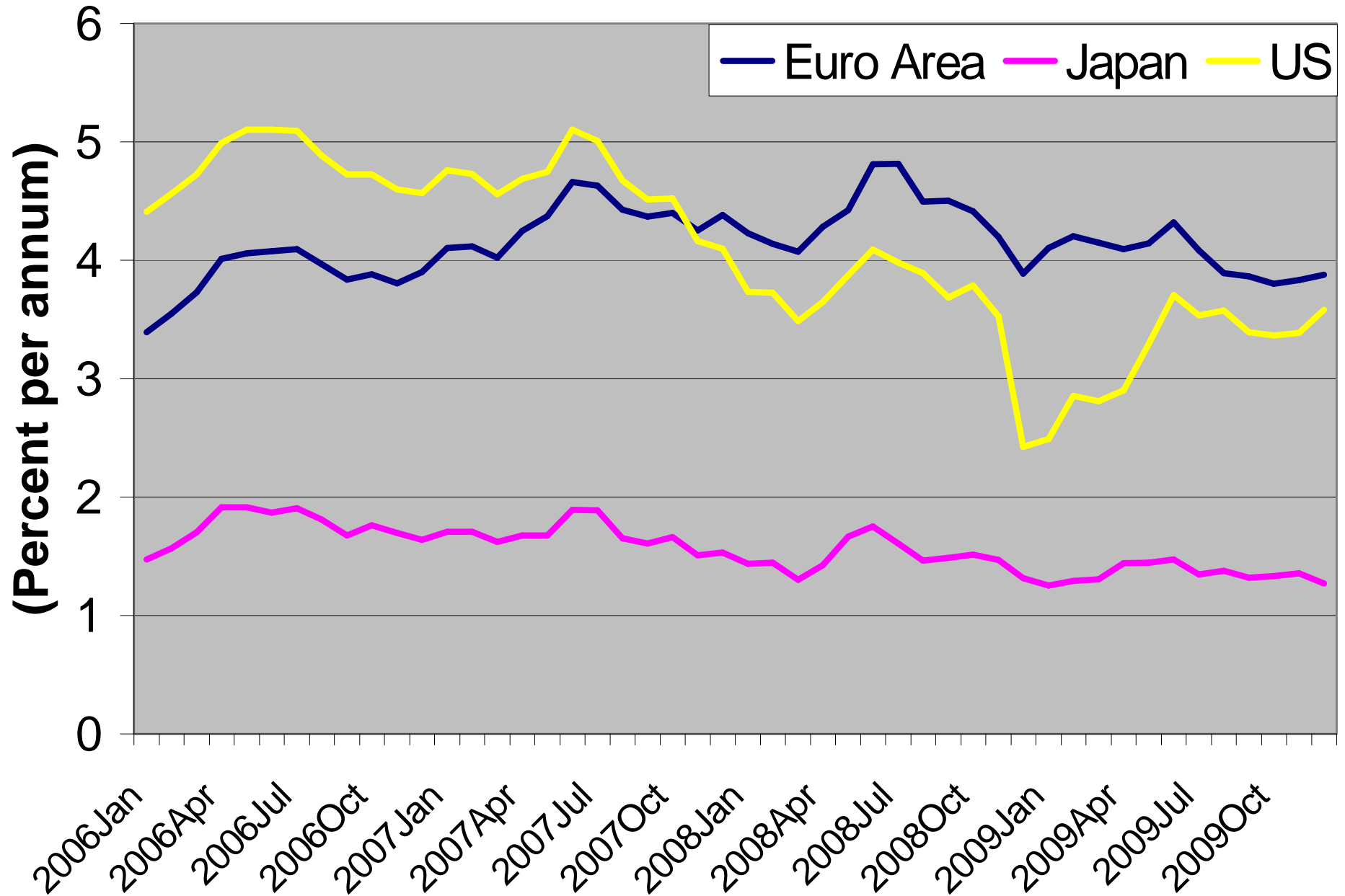
Defaults, bank failures and the financial market effects:

- Markets for some securities disappeared, had only the Federal Reserve as buyer.
 - The Federal Reserve's \$1.25 trillion program to buy Fannie Mae, Freddie Mac and Ginnie Mae MBS is scheduled to end 2010 1st Q.
- Access to capital markets disappeared for many businesses, developing countries.
 - Recession in US, W. Europe and Japan led to less direct investment, tourism and remittances to developing countries.

Financial markets recover, some normalcy resumes

- Six-month Treasury bonds yields 0.16% for the week ending January 8, 2010.
 - Core inflation 0% in November 2009
 - Core index up 1.7% from November 2008.
 - Six-month Treasury yielded:
 - 01/04/2008, 3.33%, annual core inflation ~ 2.5%
 - 01/05/2007, 5.09%, annual core inflation ~ 2.7%
- Long term interest rates are inching up towards 4% levels (3.85% 1/7/2010):

10-year Government Bond Yield



Careful Unwinding of Monetary Policy Needed
(M1 = \$1.7 trillion, M2 = \$8.4 trillion in Nov. 2009)

US Total, Required, and Excess Banks Reserves (millions of dollars)			
	Not seasonally adjusted		
	Reserves of depository institutions		
	Total	Required	Excess
Nov. 2000	\$ 38,739	\$ 37,536	\$ 1,203
Nov. 2006	42,286	40,597	1,689
Nov. 2007	42,653	40,960	1,693
Nov. 2008	609,284	50,248	559,036
Nov. 2009	1,139,924	62,636	1,077,288

Demand for loans is low

- General deleveraging is taking place
- Small business sales are slow:
 - The NFIB polls members on most pressing problem: Top problem, cited by 34%, was weak sales.
 - Interest rates and access to capital was a top problem for only 4% of respondents.
 - Only 18% planned capital expenditures in December 2009, down from 30% in Dec. 07.

Where do we go from here?

- The recovery is real, government supported.
- Government proposals are also creating uncertainty:
 - Environment policy, health care policy.
- Commercial real estate investment remains depressed nationally, despite pockets of strength.

IMF World Economic Outlook Summary

Real GDP percent change

	2009e	2010f
World	-1.1	3.1
U.S.	-2.7	1.5
Canada	-2.1	2.6
Mexico	-7.3	3.3
Euro Area	-4.2	0.3
EU	-4.2	0.5
Japan	-5.4	1.7
China	8.5	9.0
India	5.4	6.4
ASEAN-5	0.7	4.0

Growth forecast is weak:

- World GDP growth averaged 4% from 1997 through 2007, which included 2001 recession growth of 2.2%
- Unemployment and excess capacity are forecast through 2010.
 - The natural unemployment rate has likely increased to above 6%.
 - Long term unemployment, unneeded capital, will slow growth in potential GDP.

Upside risks exist:

- Stock markets have recovered, leading to more consumer spending, slight ratcheting down of the savings rate.
- Health Care reform is sure to pass, may not be as de-stabilizing as many fear.
- Environmental reform will reduce costs, not just increase costs.
- Growth should continue slowly unless an unforeseen positive shock takes place.

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