

# The International Economy: Recent Developments and Outlook

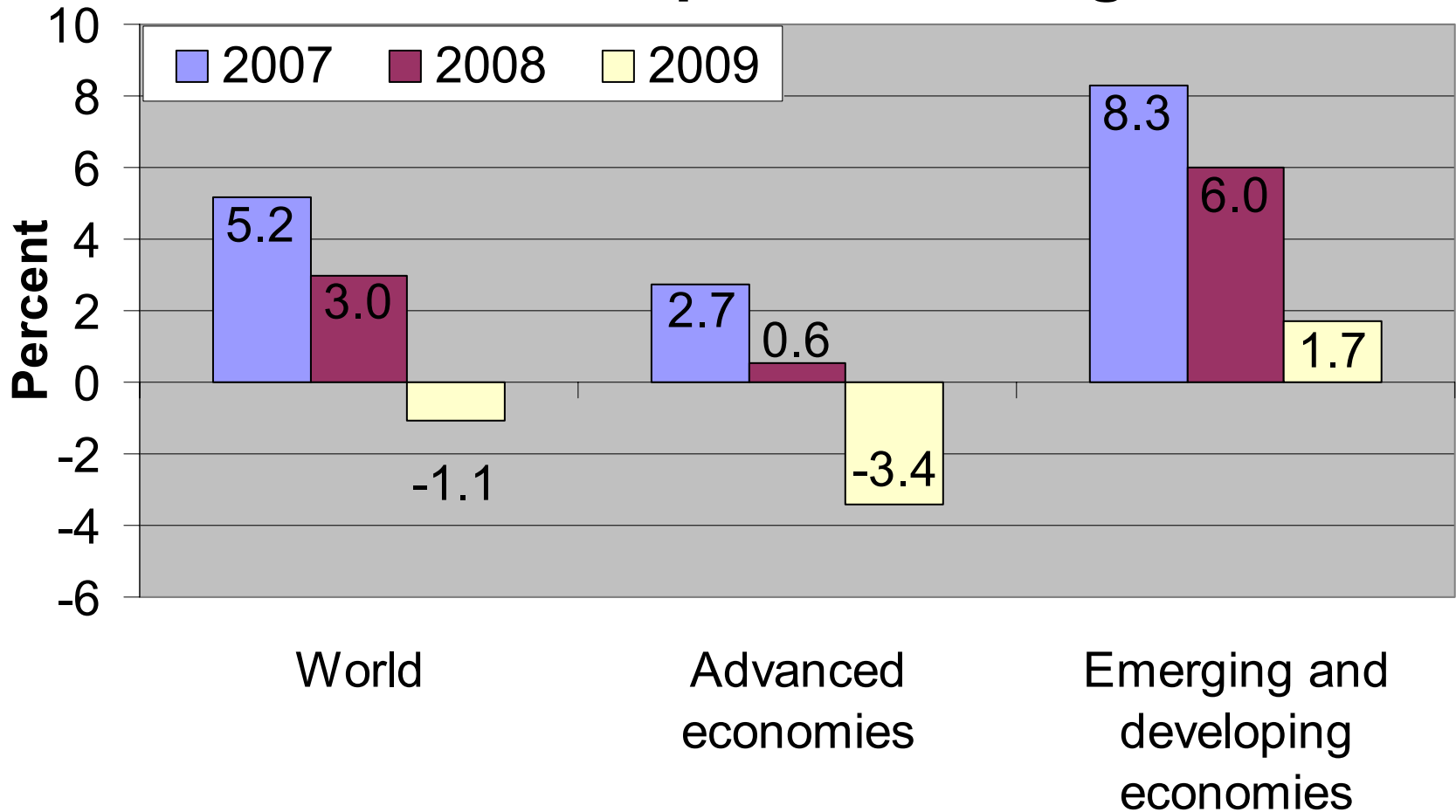
Presented to the Silicon Valley Roundtable of the  
National Association for Business Economics

by Anne Ramstetter Wenzel, M.A.

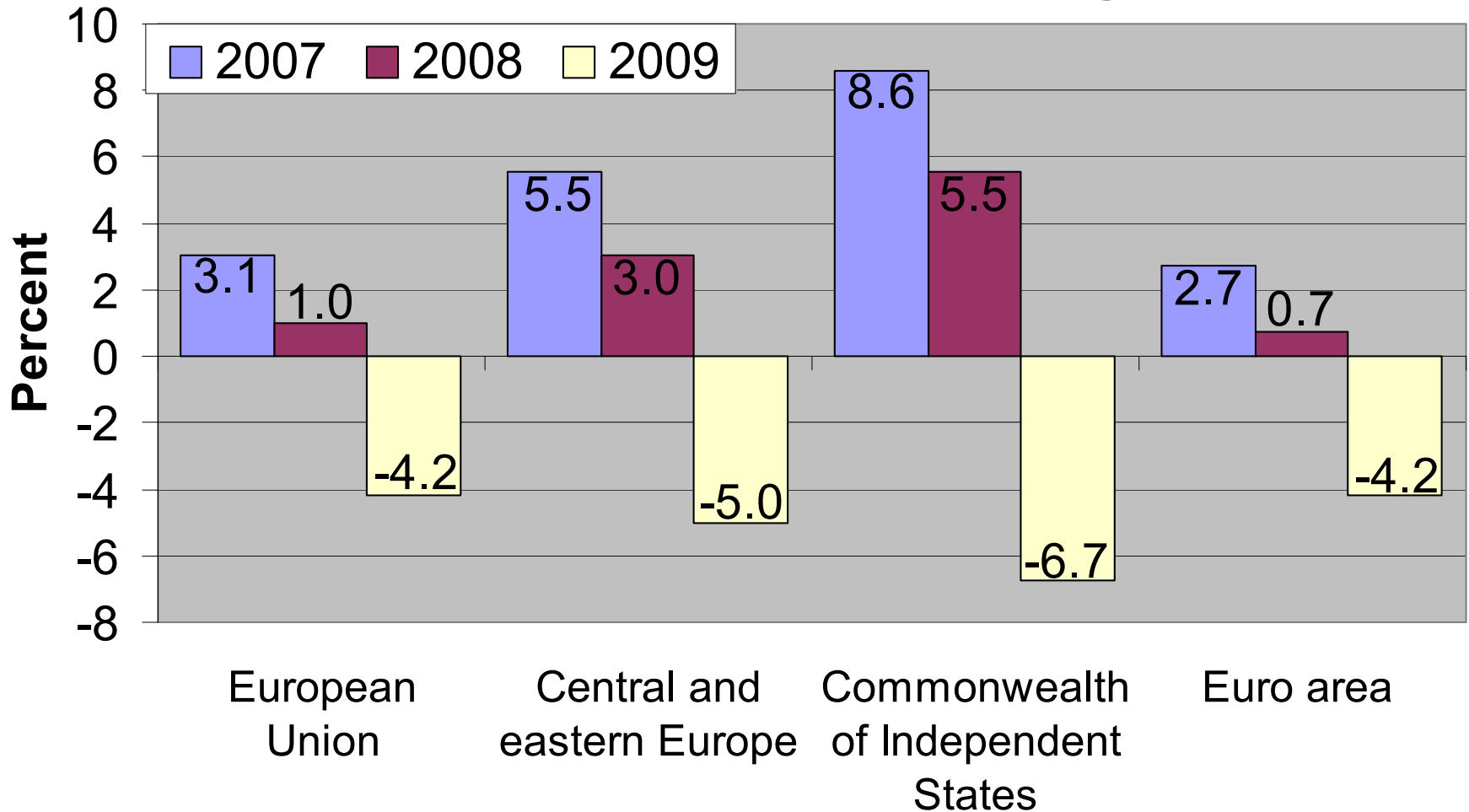
Econosystems

January 12, 2010

# GDP constant prices, annual percent change

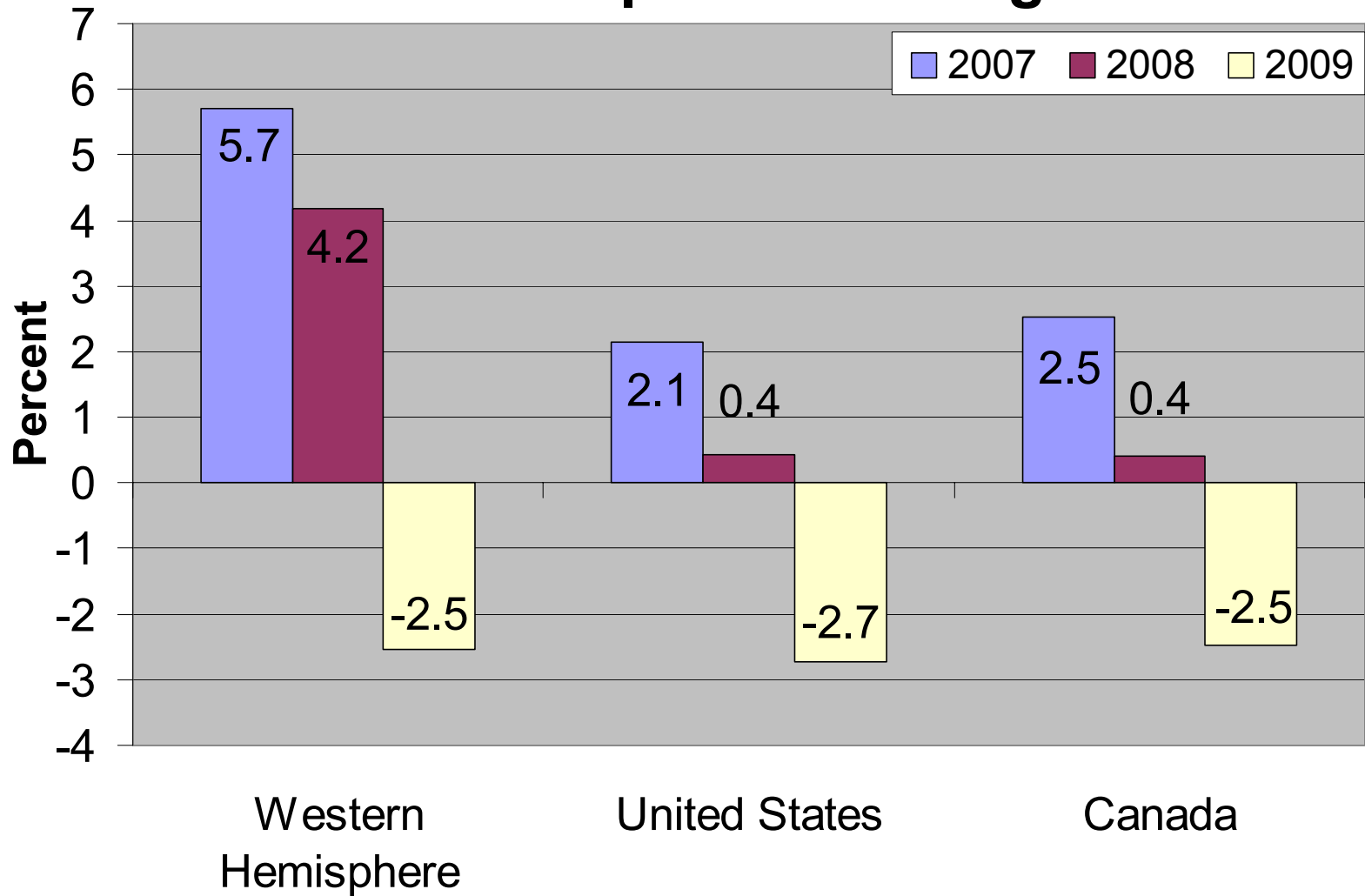


# GDP constant prices, annual percent change



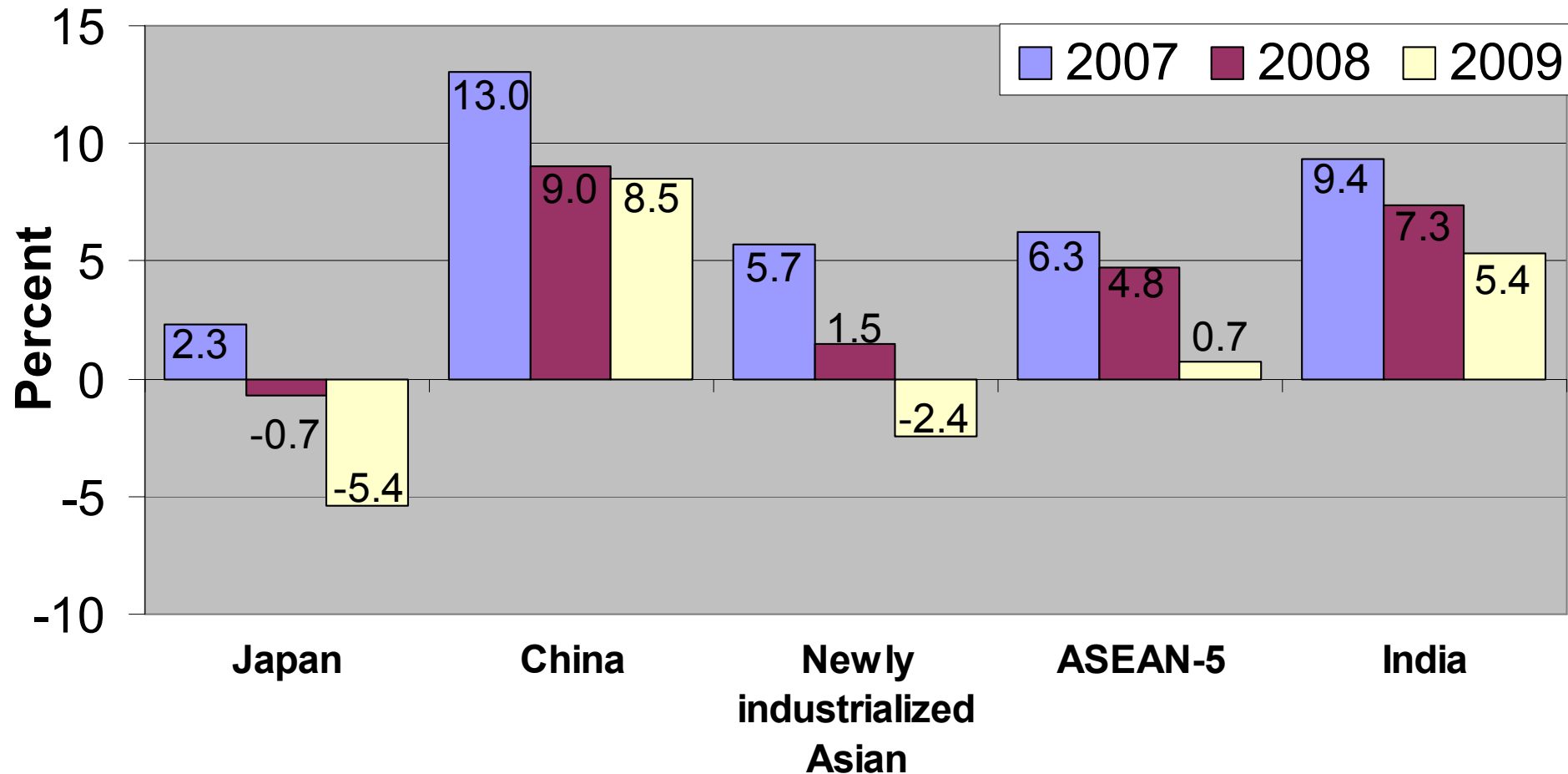
\*CIS includes a group of former Soviet Republics plus Mongolia.

# GDP constant prices, annual percent change



\*Western Hemisphere includes Central and South American countries.

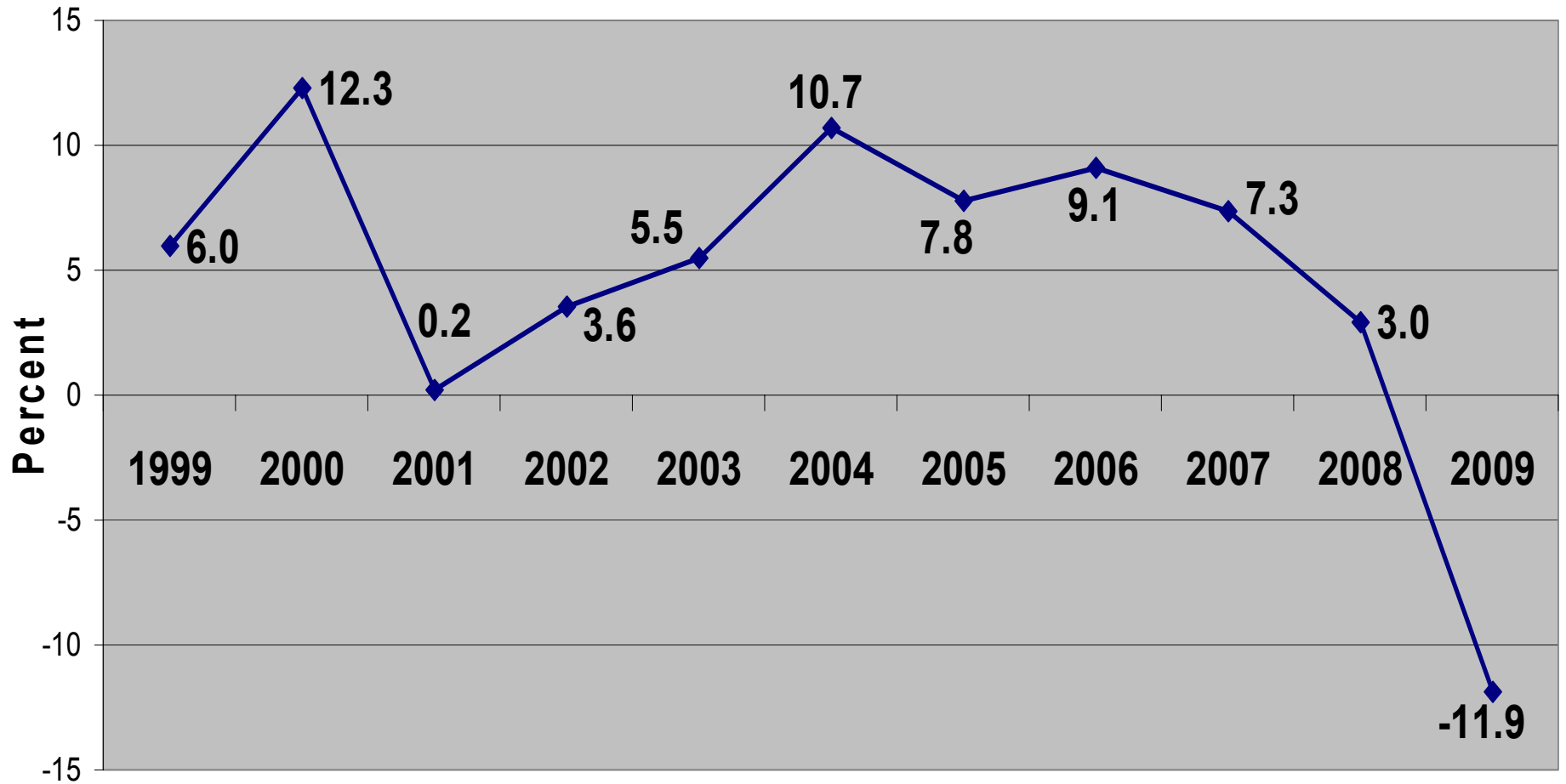
# GDP constant prices, annual percent change



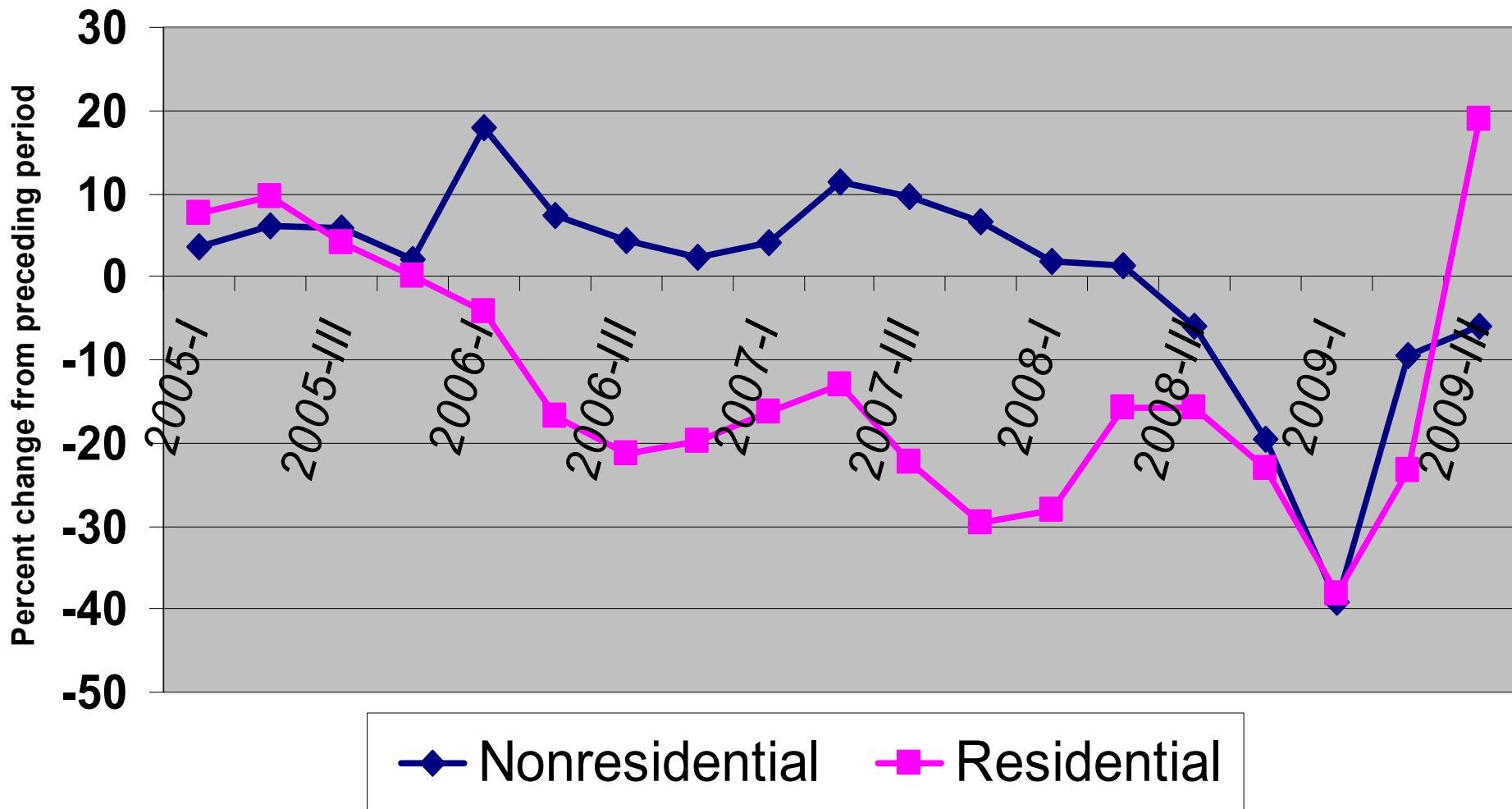
Association of Southeast Asian Nations-5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

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

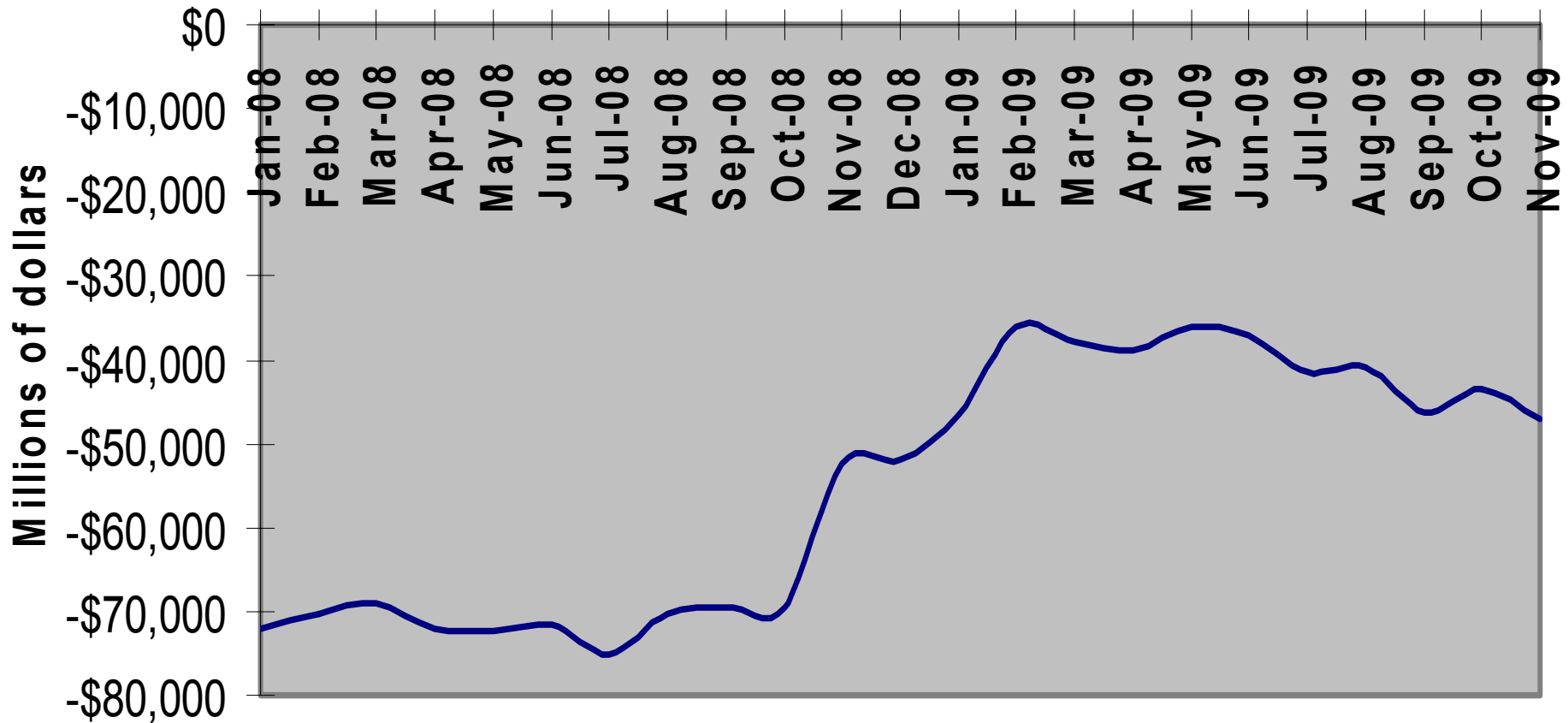


# U.S Residential Investment

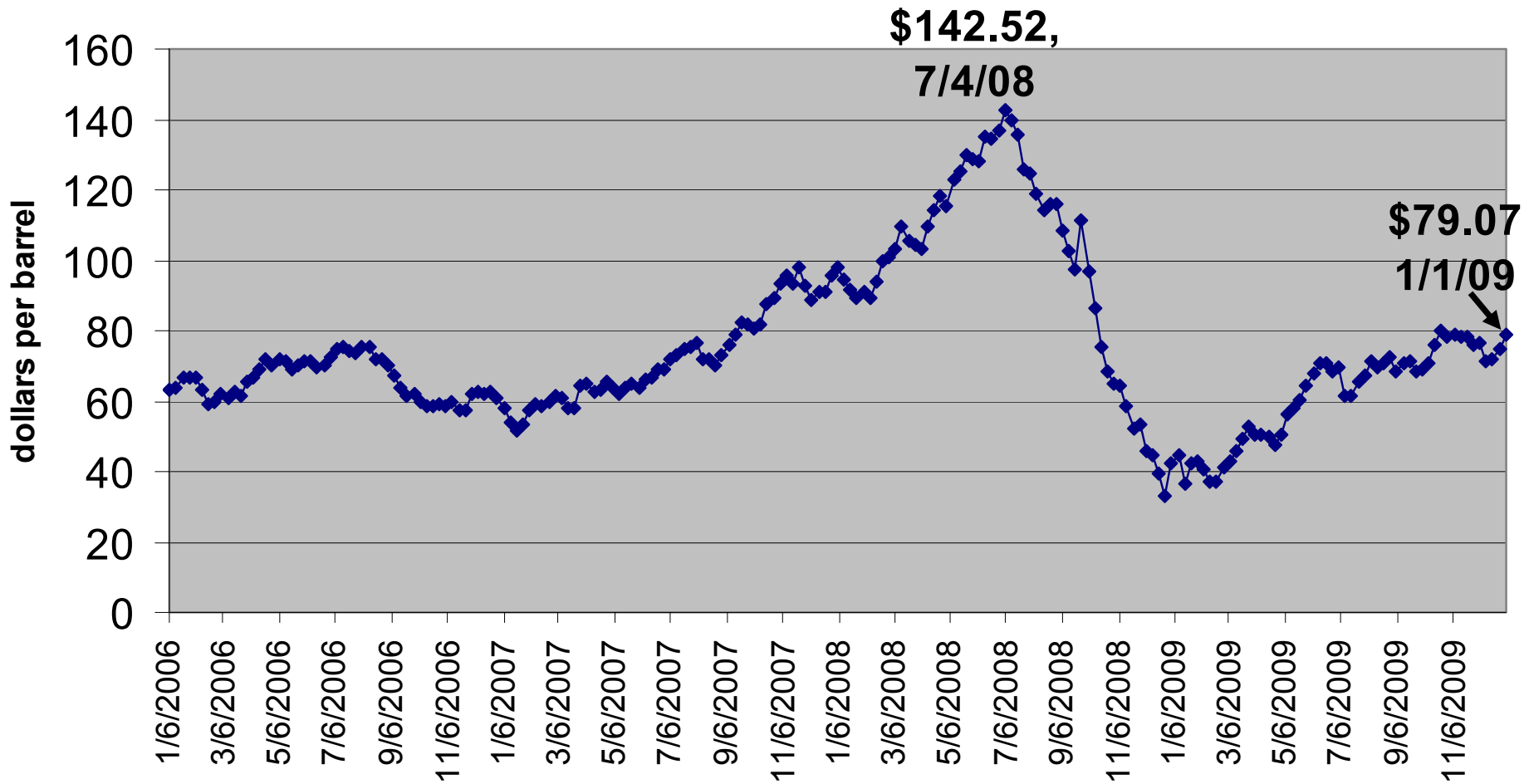
- Fell from a peak of \$813.3 billion current dollars in the first quarter of 2006 (seasonally adjusted annual rate) to a low of \$345.9 billion in the 2<sup>nd</sup> quarter of 2009.
- Residential investment increased in the 3<sup>rd</sup> quarter of 2009 to \$358.8 billion (SAAR, current dollars).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

# U.S. Trade Balance, Customs Basis

## Seasonally Adjusted

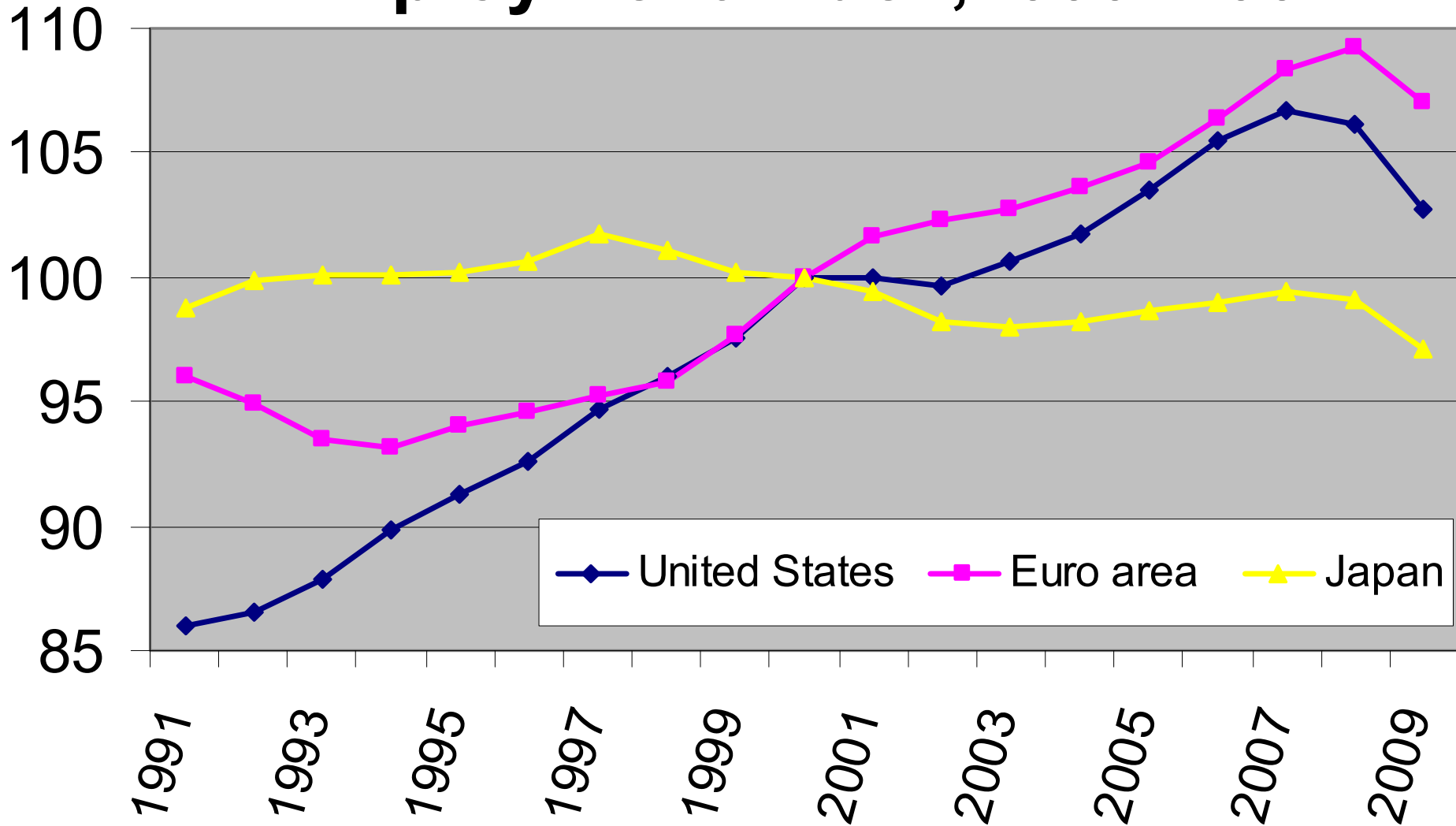


# Crude Oil Weekly Spot Prices, WTI

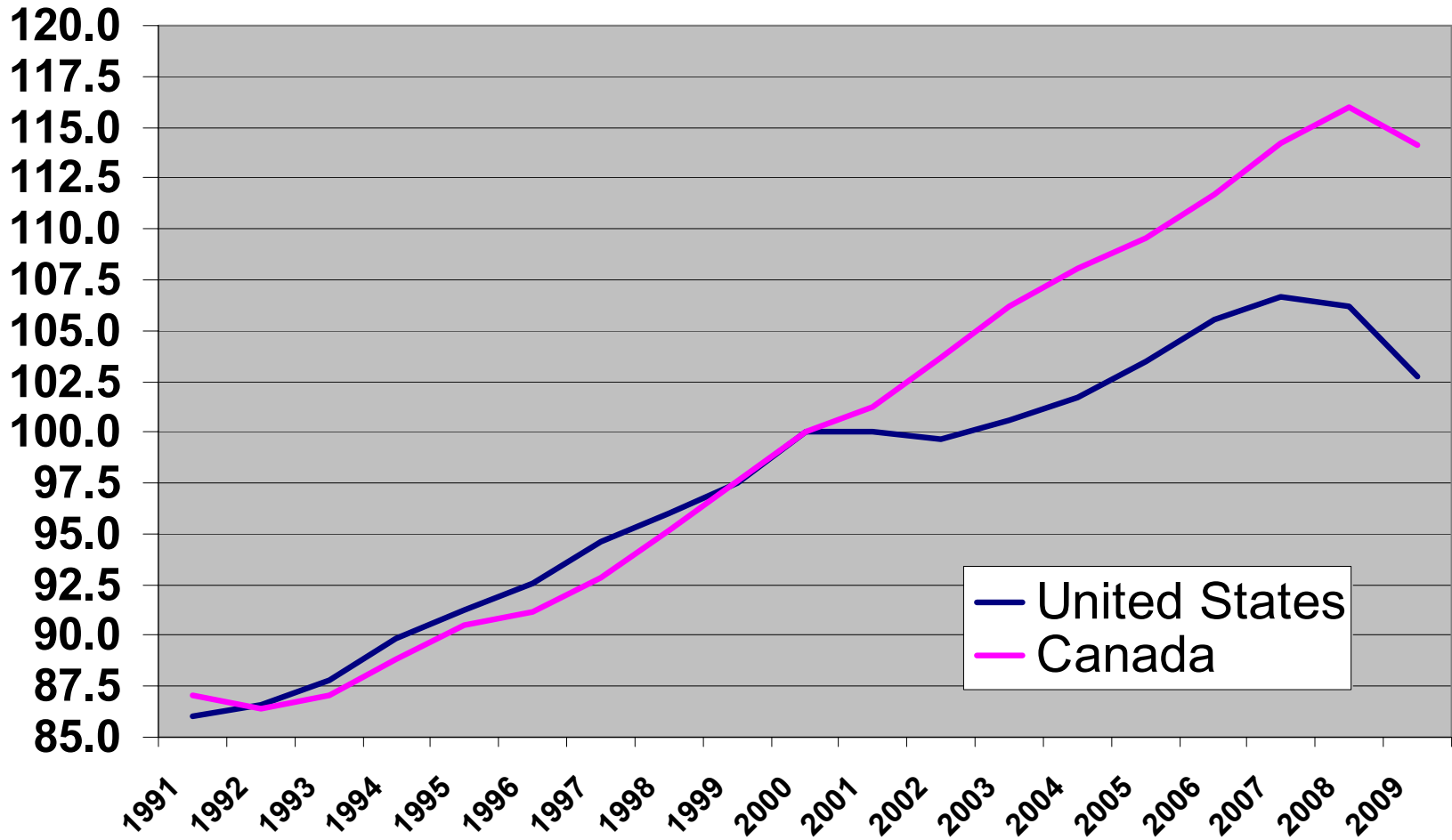


# Euro Area, US & Japan

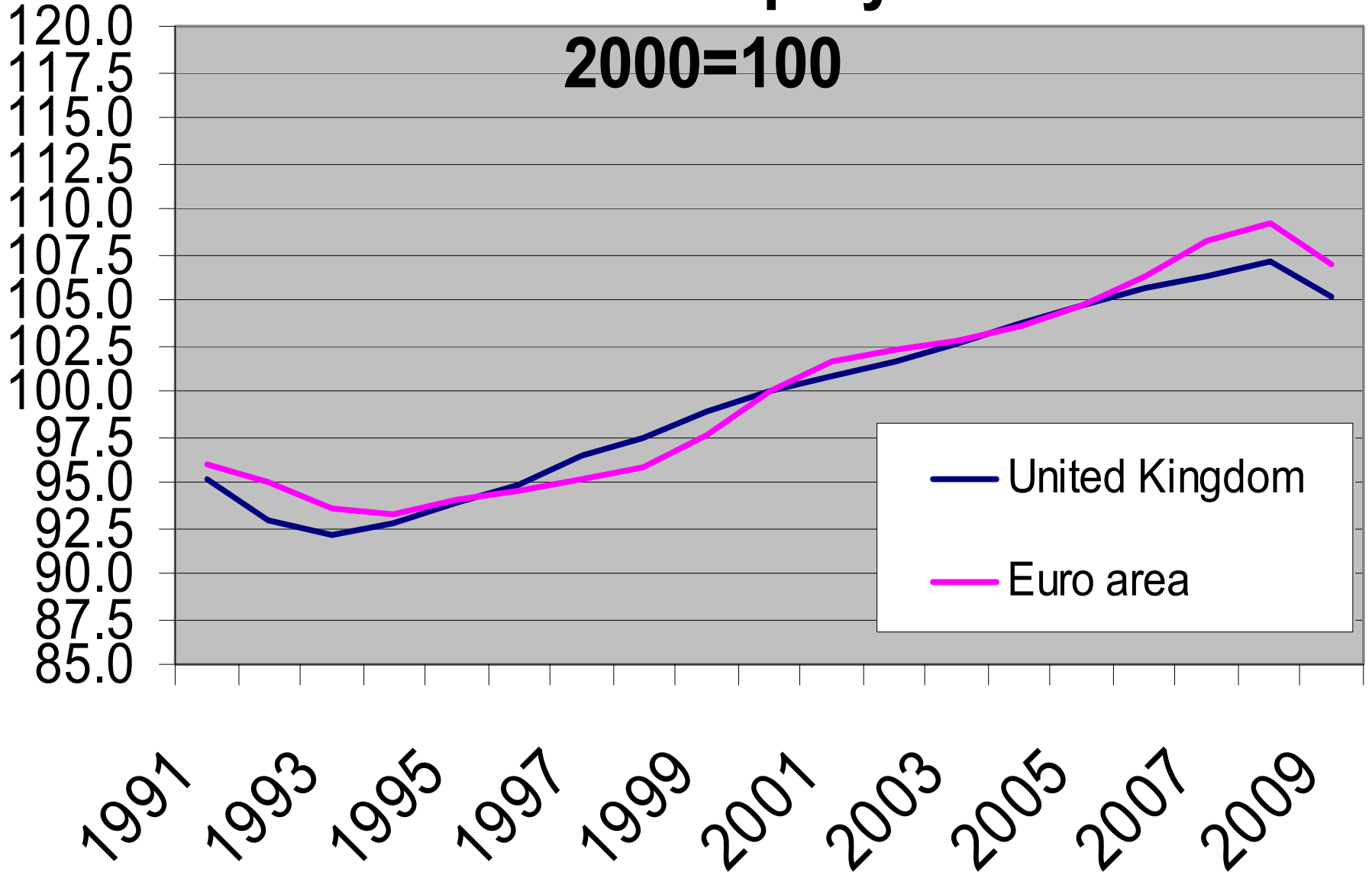
## Employment Index, 2000=100



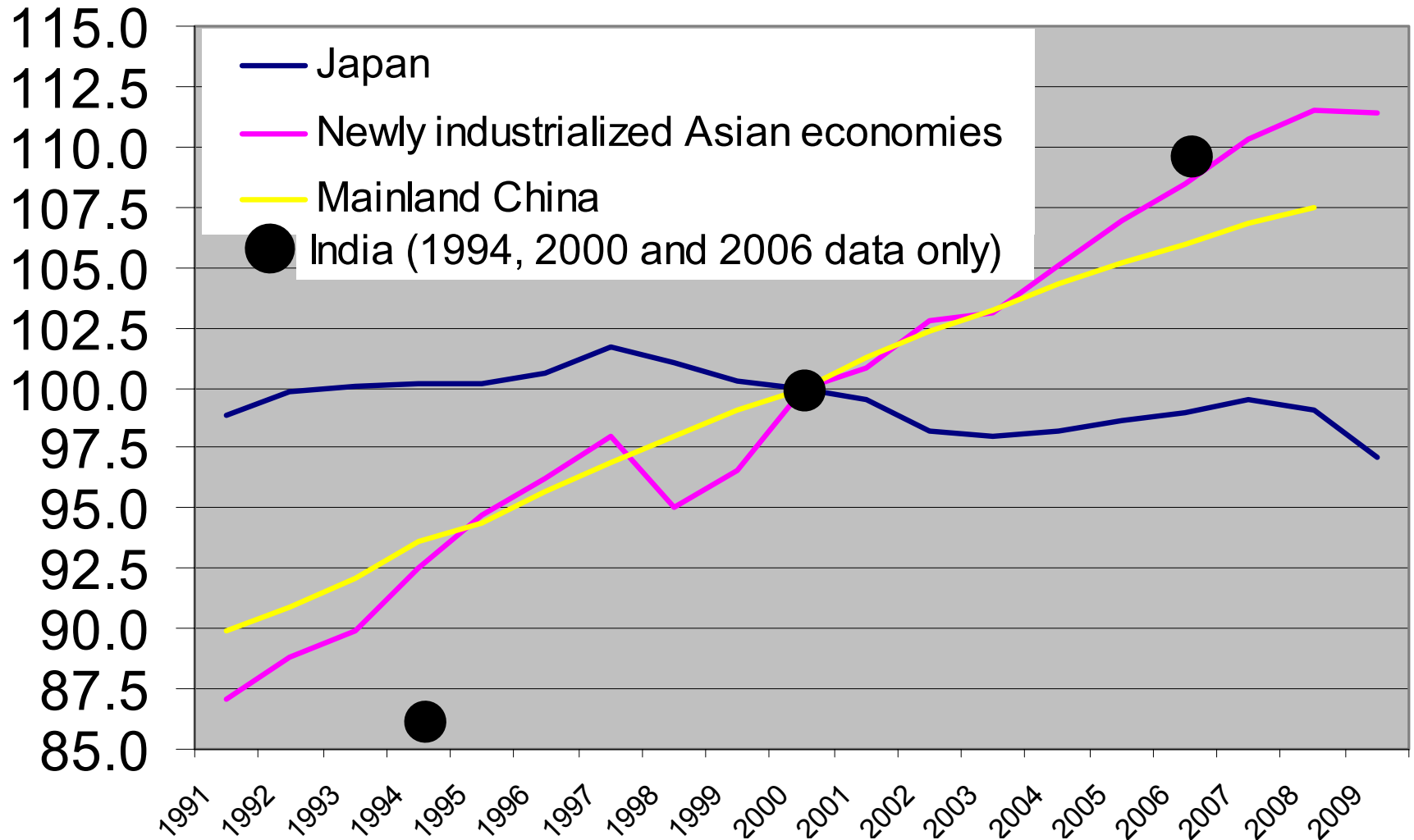
# US & Canada Employment Index 2000=100



# UK & Euro Area Employment Index

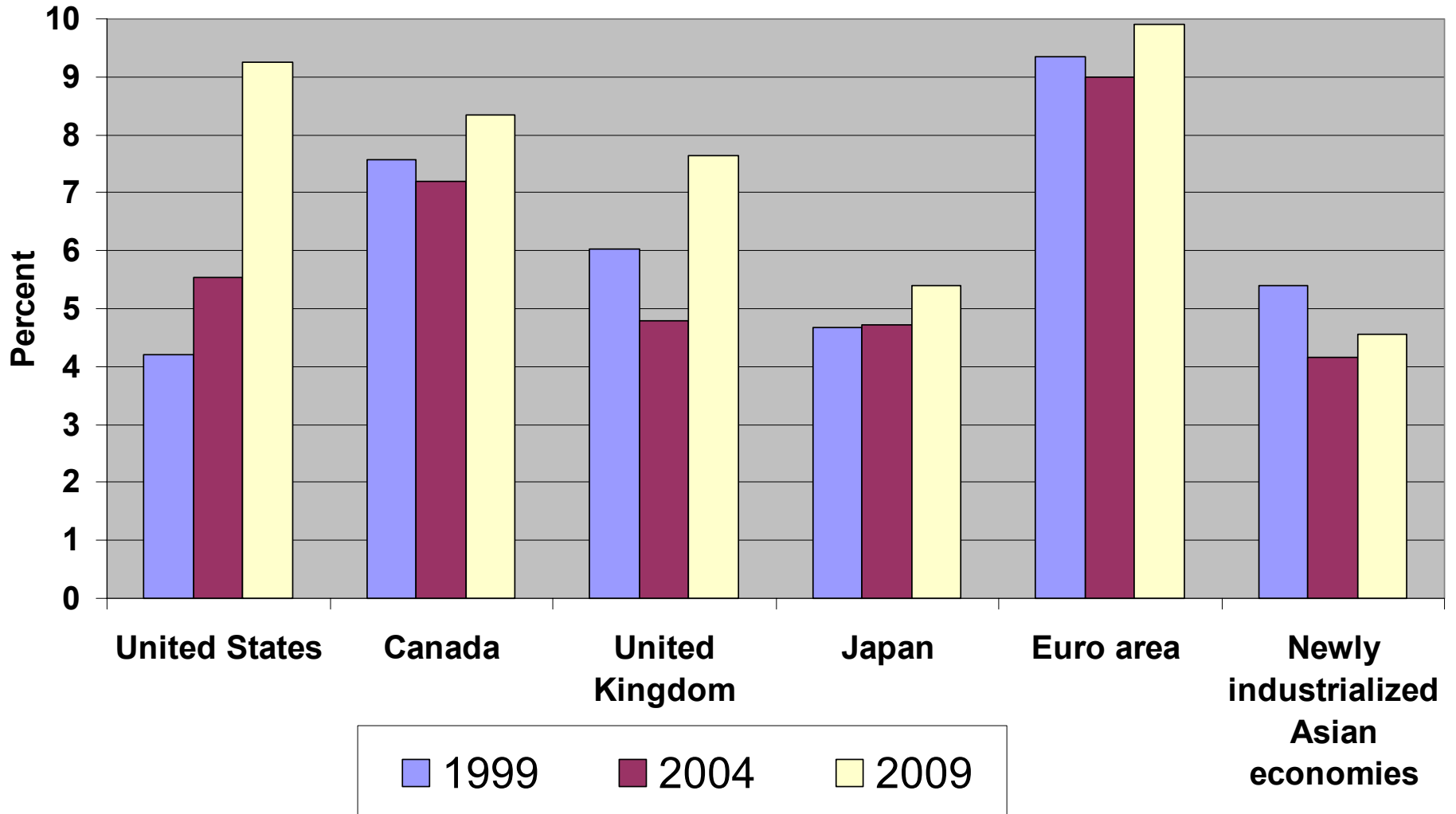


# Employment Index, 2000=100



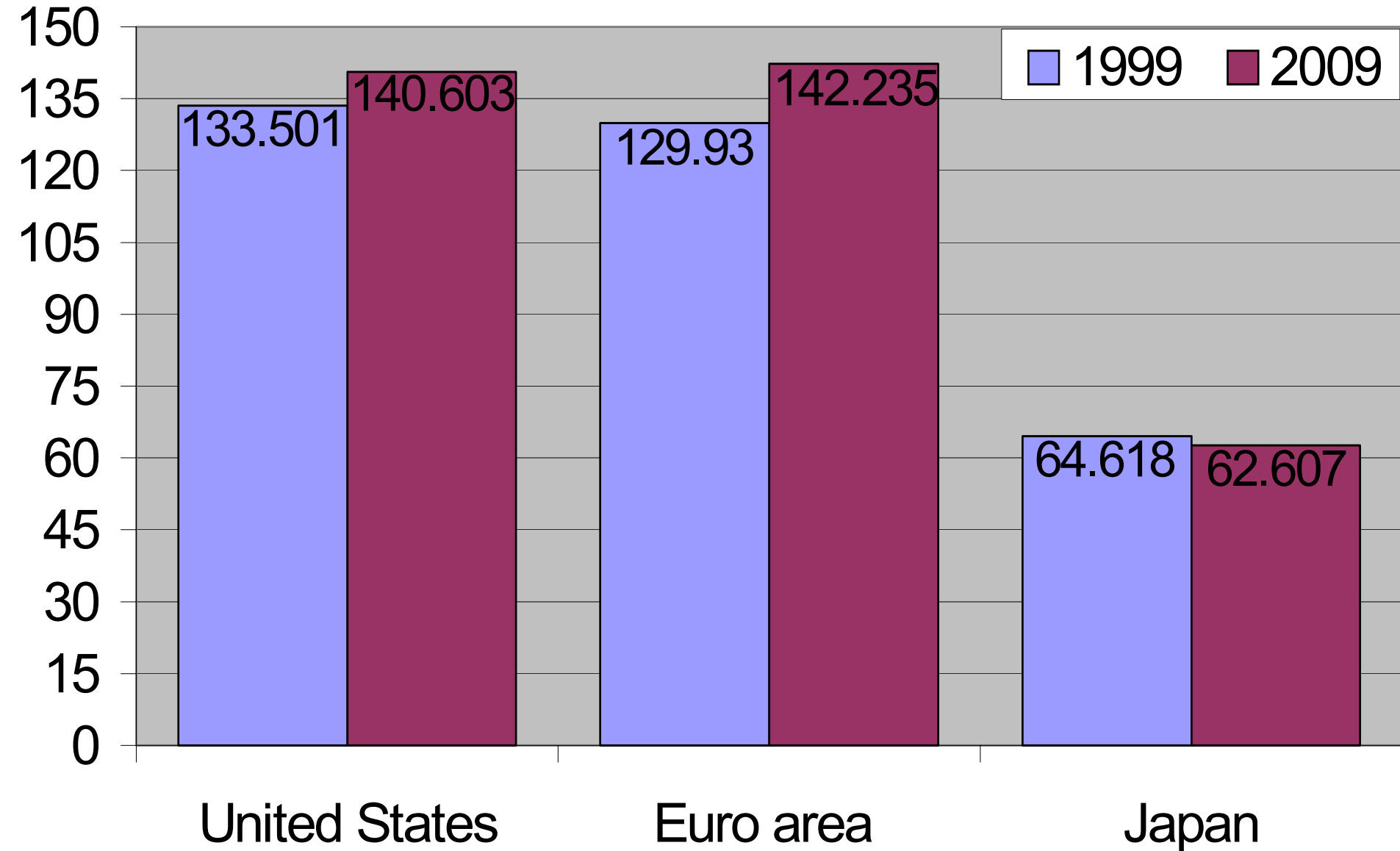
\*NIC Includes Hong Kong, So. Korea, Singapore, and Taiwan.

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

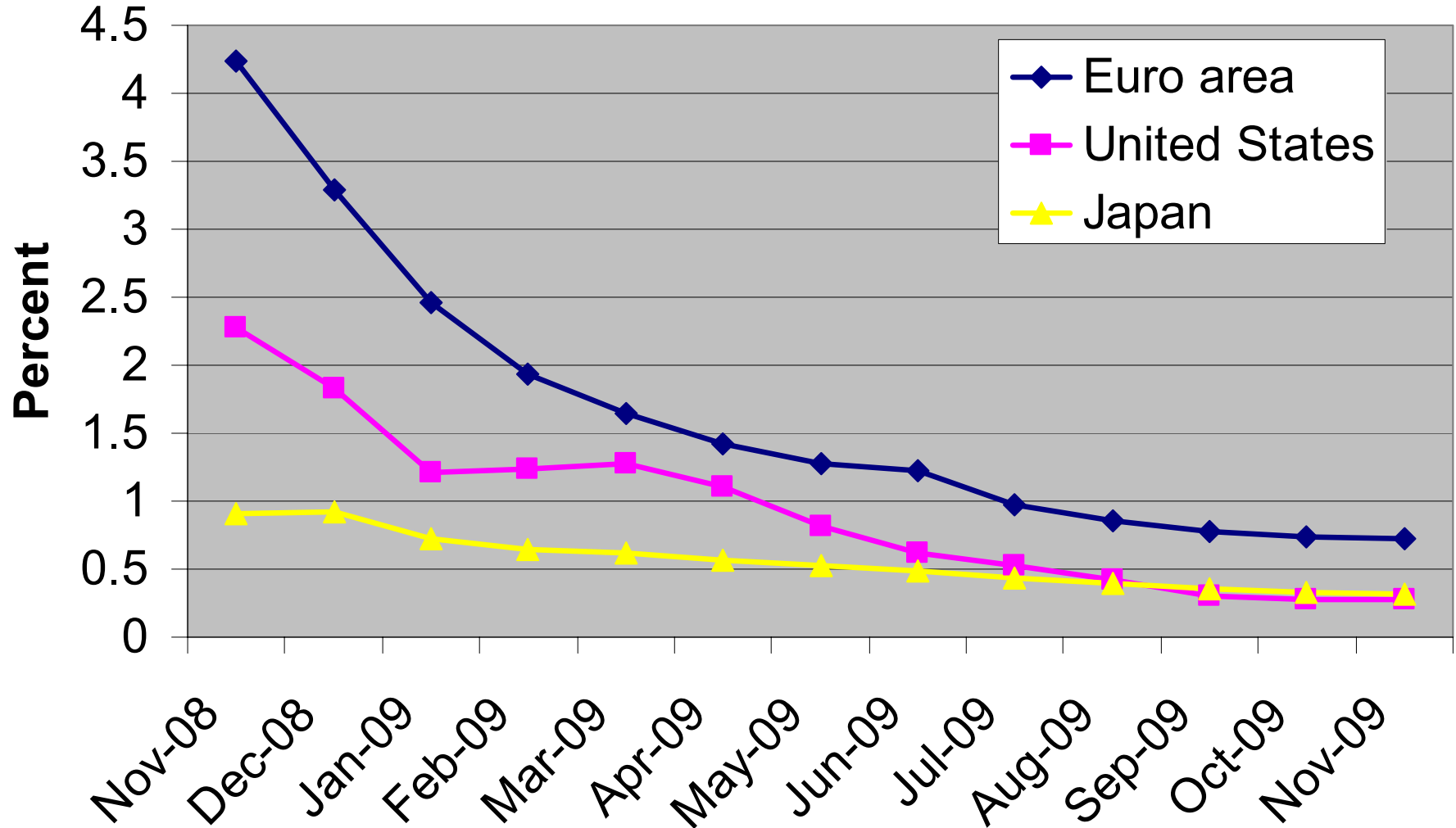


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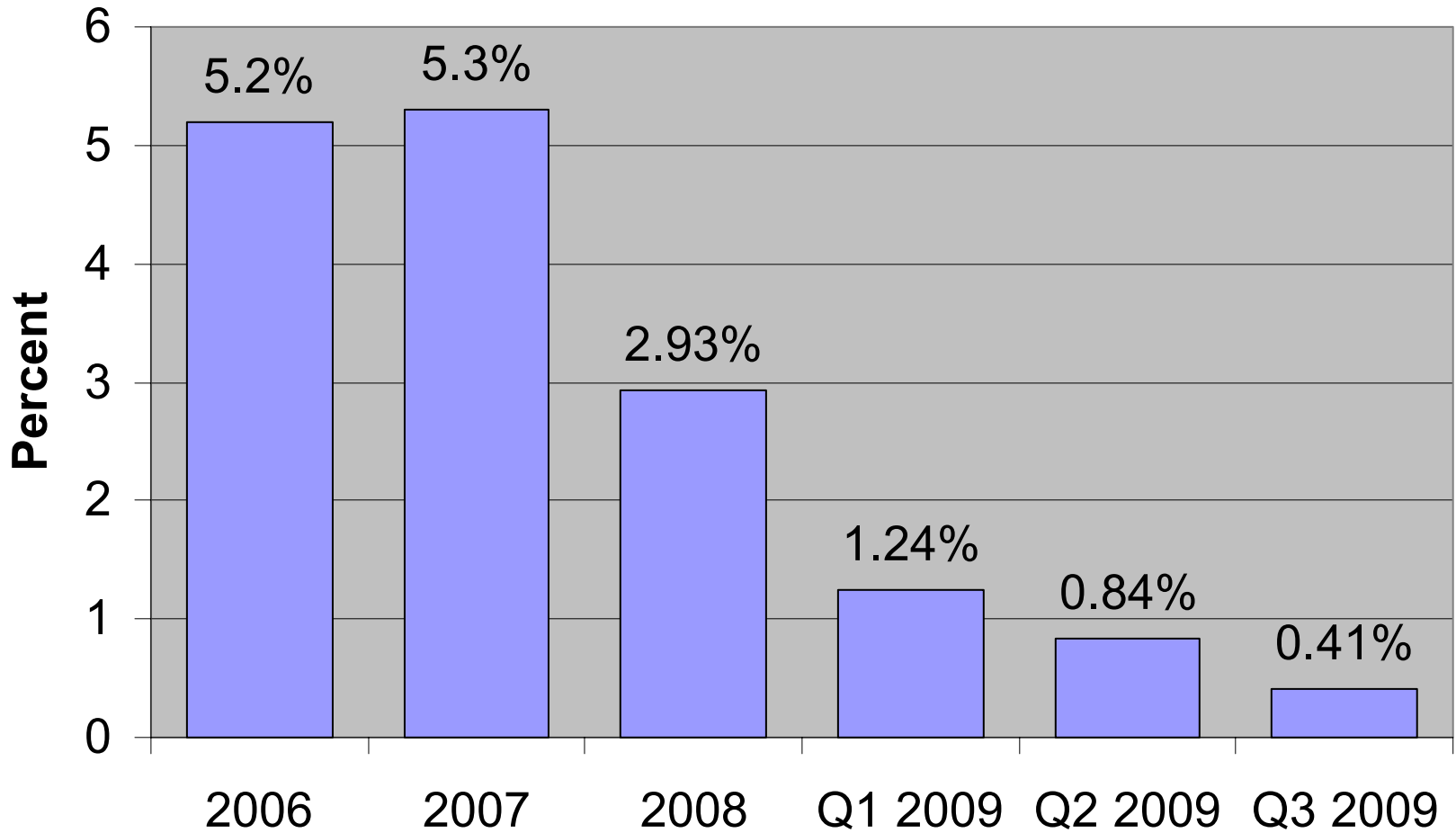
# Euro area, US & Japan Employment in Millions



# 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)

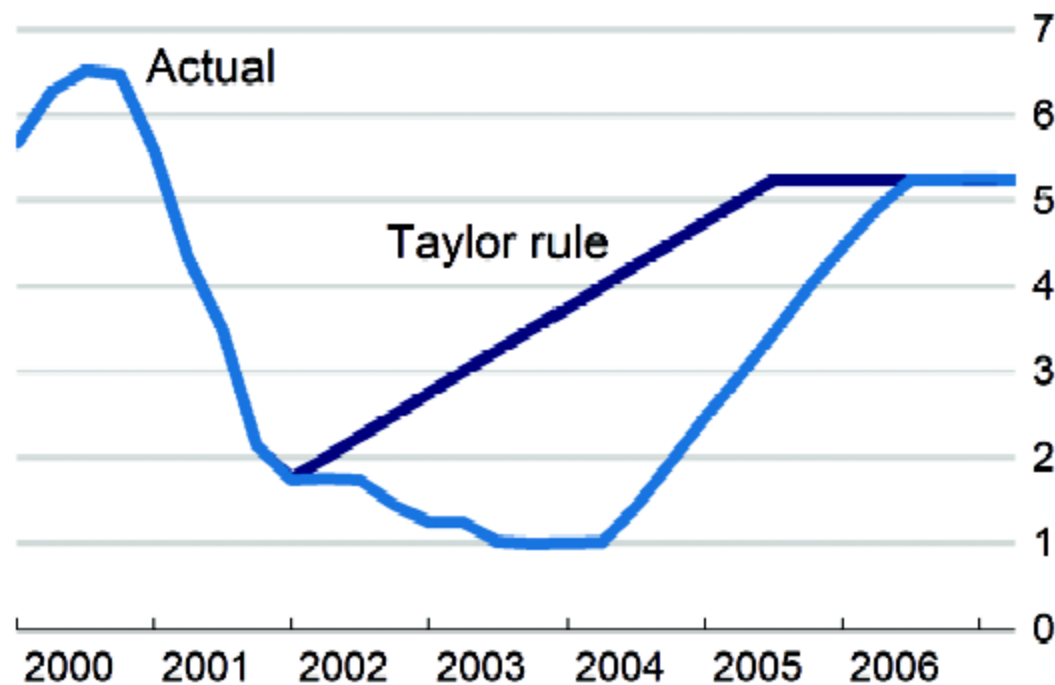


FIGURE 1. Chart from *The Economist*, October 18, 2007

# 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

[See figure 7 in chapter 2 of \*Getting off Track\*](#)

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:

See Figure 13 in chapter 3 of *Getting Off Track*

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**.

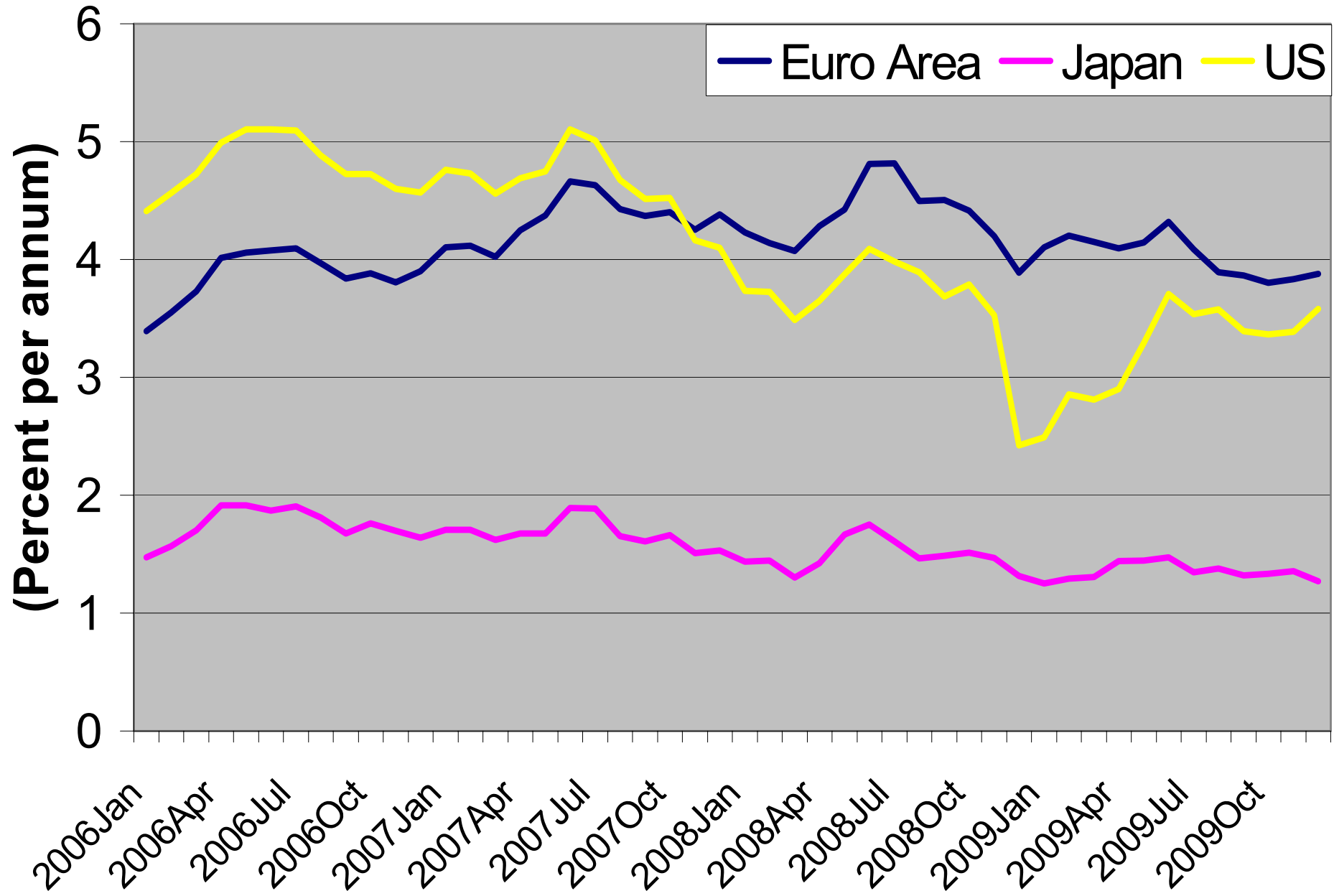
# Defaults, bank failures and the financial market effects:

- 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

- BUT, 6-month Treasury bonds yield 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)

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

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