

# Action! Economics

## Global De-leveraging Driving the Downturn

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## Summary:

- U.S. downturn widely seen as real estate driven
- Global de-leveraging is the more general culprit
- Policy response is large relative to past downturns
- Response is small relative to de-leveraging forces
- De-leveraging is global, not local

### **Causal links, as generally perceived:**

U.S. real estate boom led to inevitable bust



Mortgage security values fell



Write-downs drained bank capital



Weakened banks quit lending



Lack of credit led to an economic contraction



U.S. contraction proved contagious globally

## Causal links as we see it:

Global investors undervalued risk starting in 1990s



Demand for risky securities outpaced sustainable levels



U.S. real estate reversal the “canary in the coal mine”



Global de-leveraging is pummeling asset values

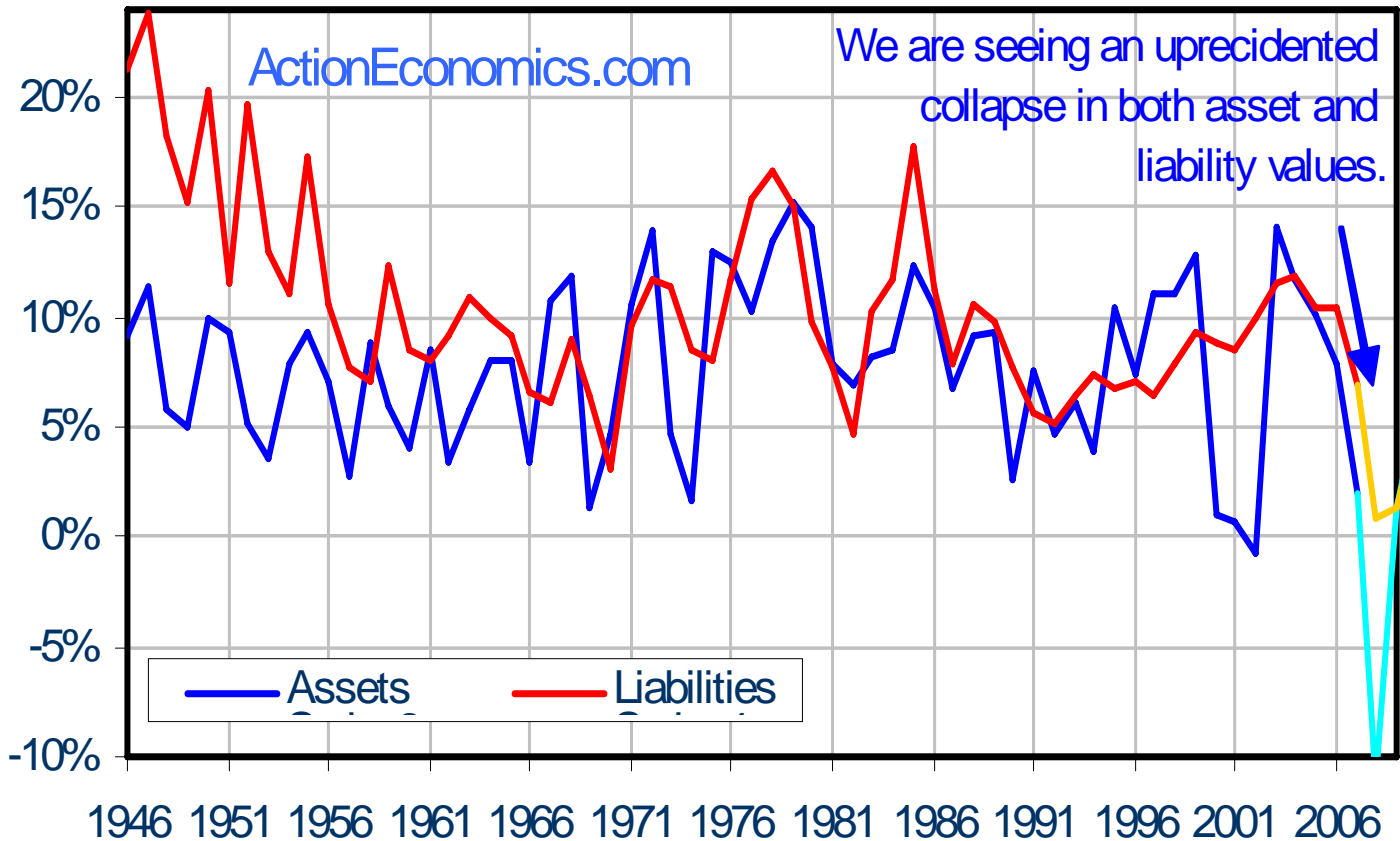


Global risk “revulsion” is contagious/self reinforcing



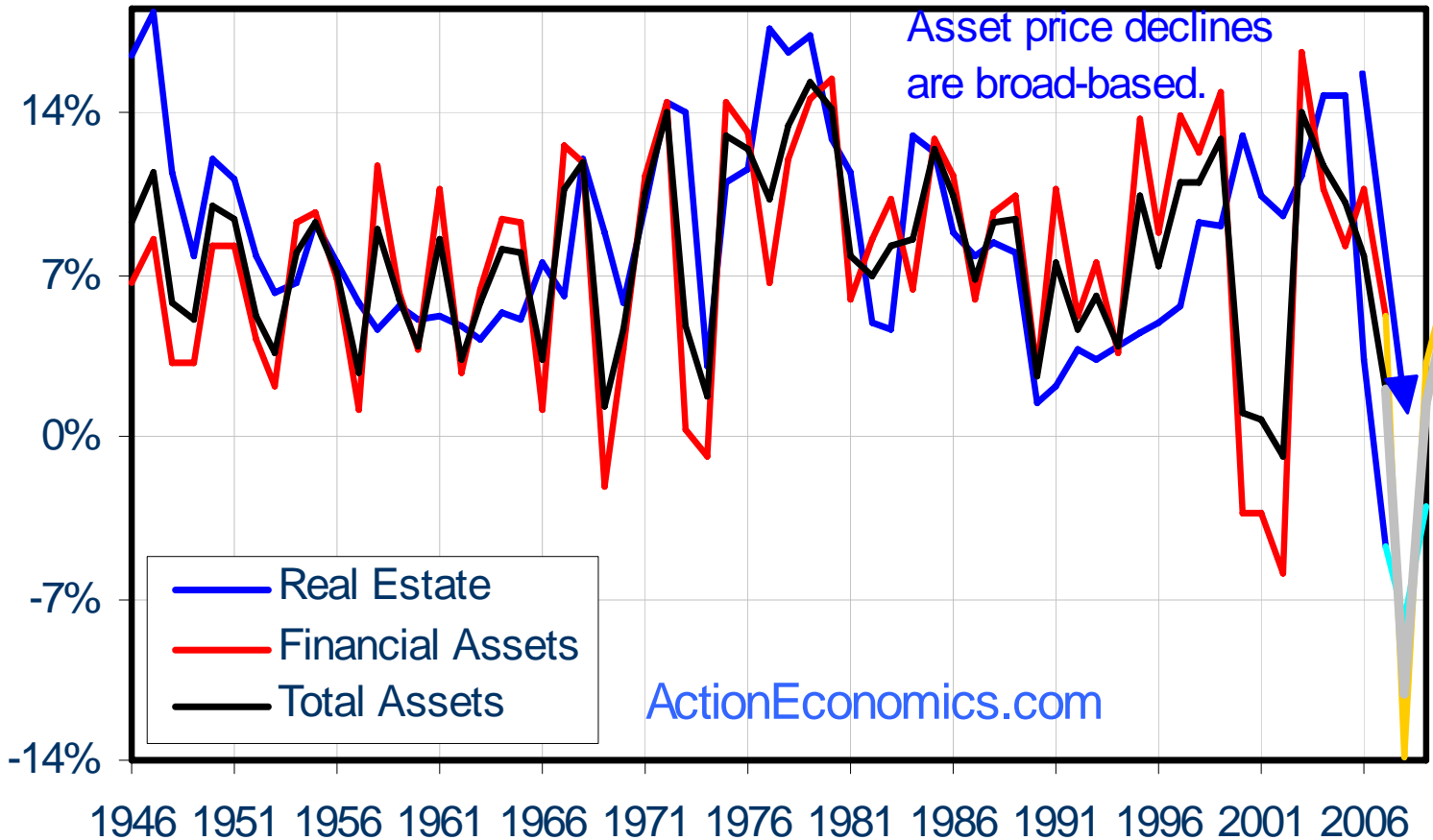
Forces from “paradox of thrift” dwarf policy response

## Growth in Household Assets & Liabilities



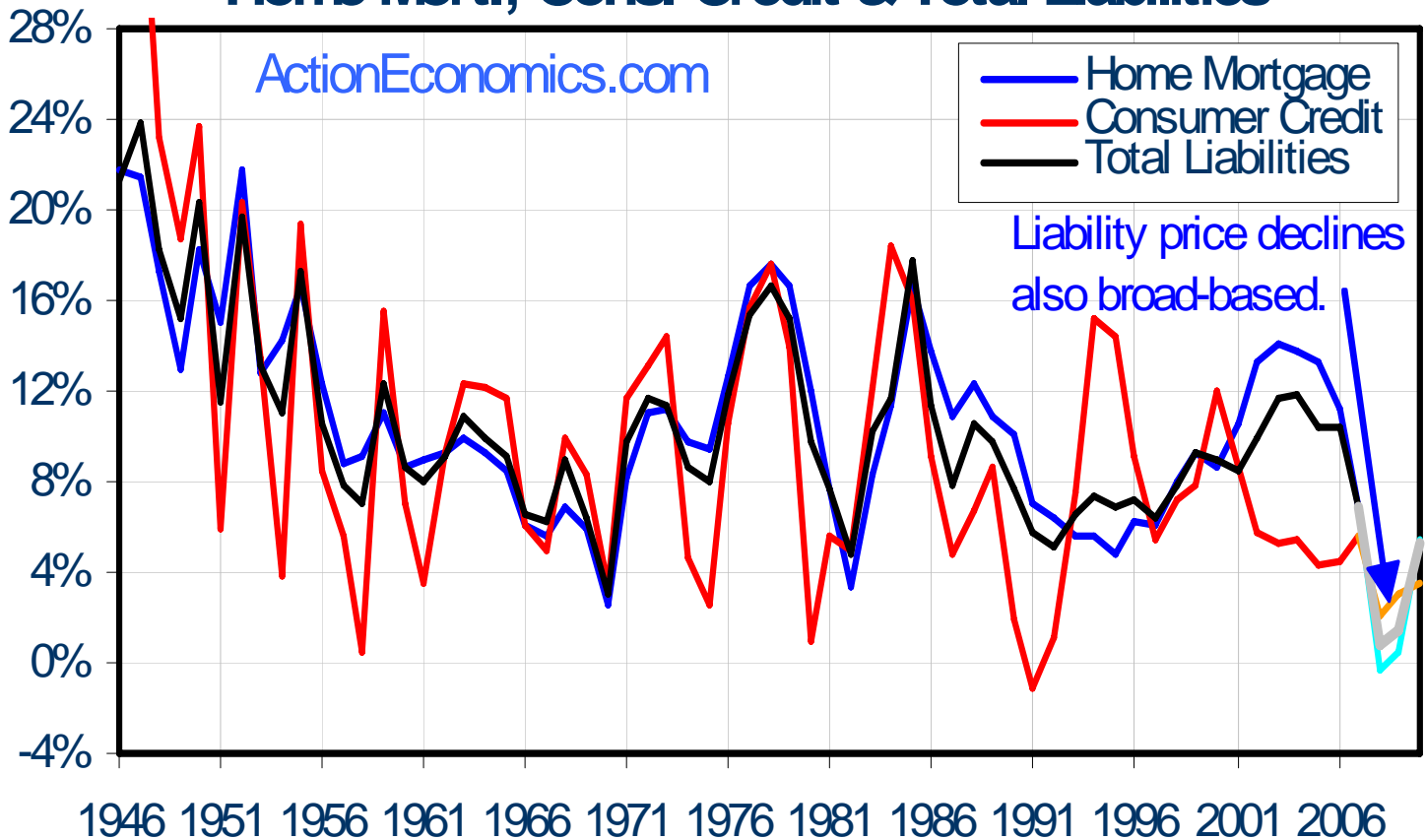
\* Out-performance of asset and liability growth since 1996 ending abruptly.

## Real Estate Versus Financial & Total Assets



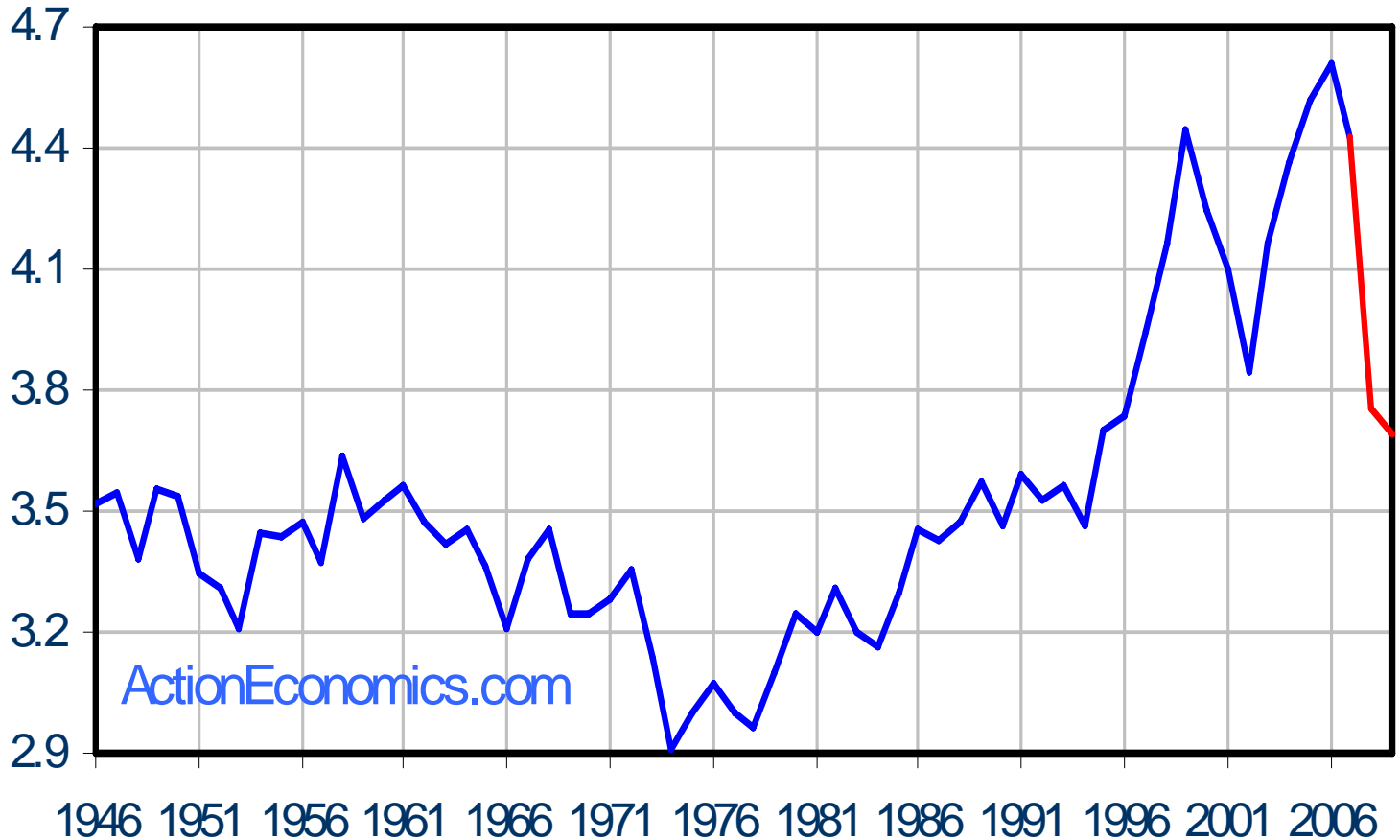
\* Reversal of asset out-performance is spread across asset classes.

## Home Mort., Cons. Credit & Total Liabilities



\* Reversal of liability out-performance also spread across borrowing classes.

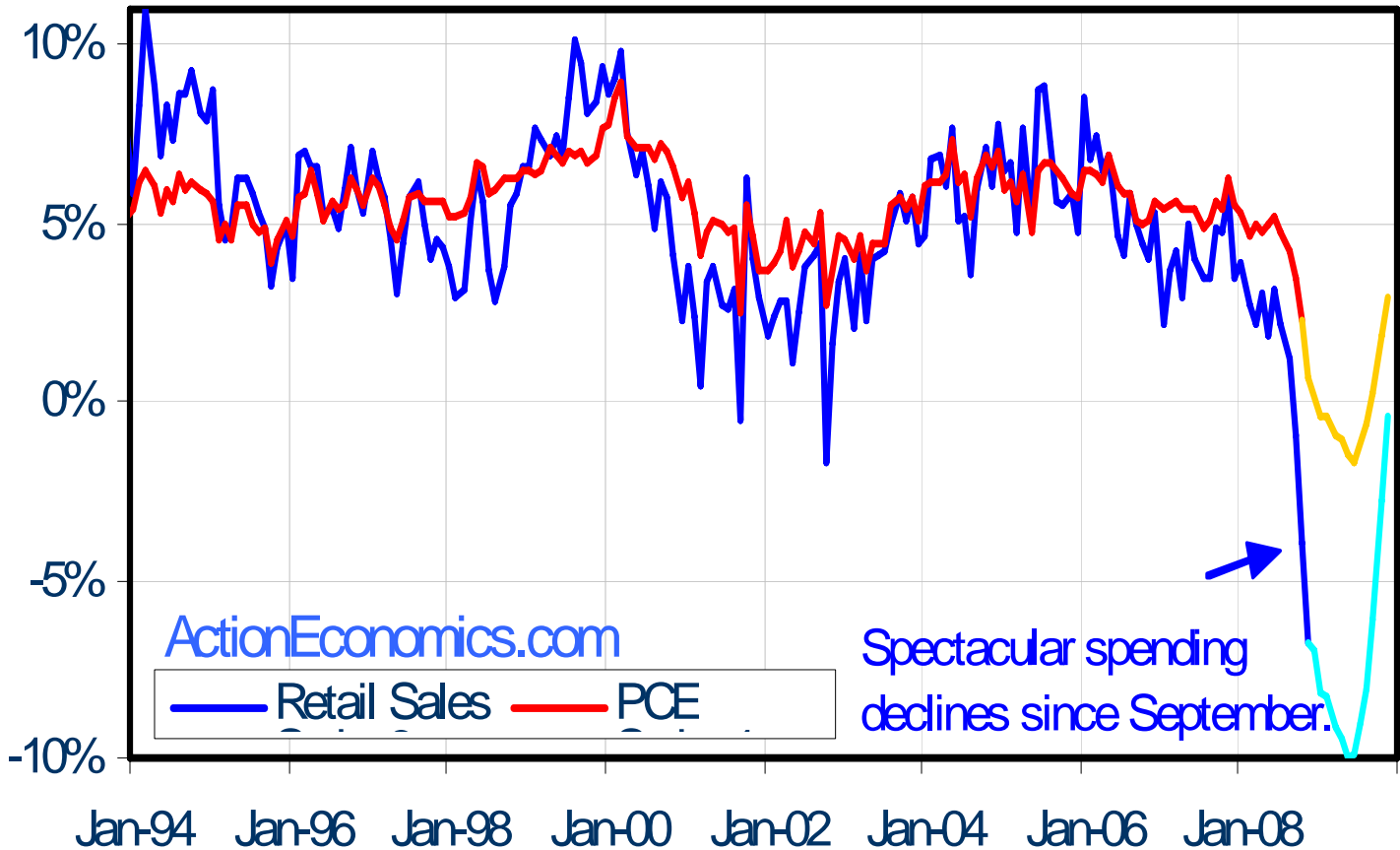
## Ratio of Total U.S. Net Worth to Nominal GDP



\* Out-performance, and correction, of net worth evident in ratio to GDP.

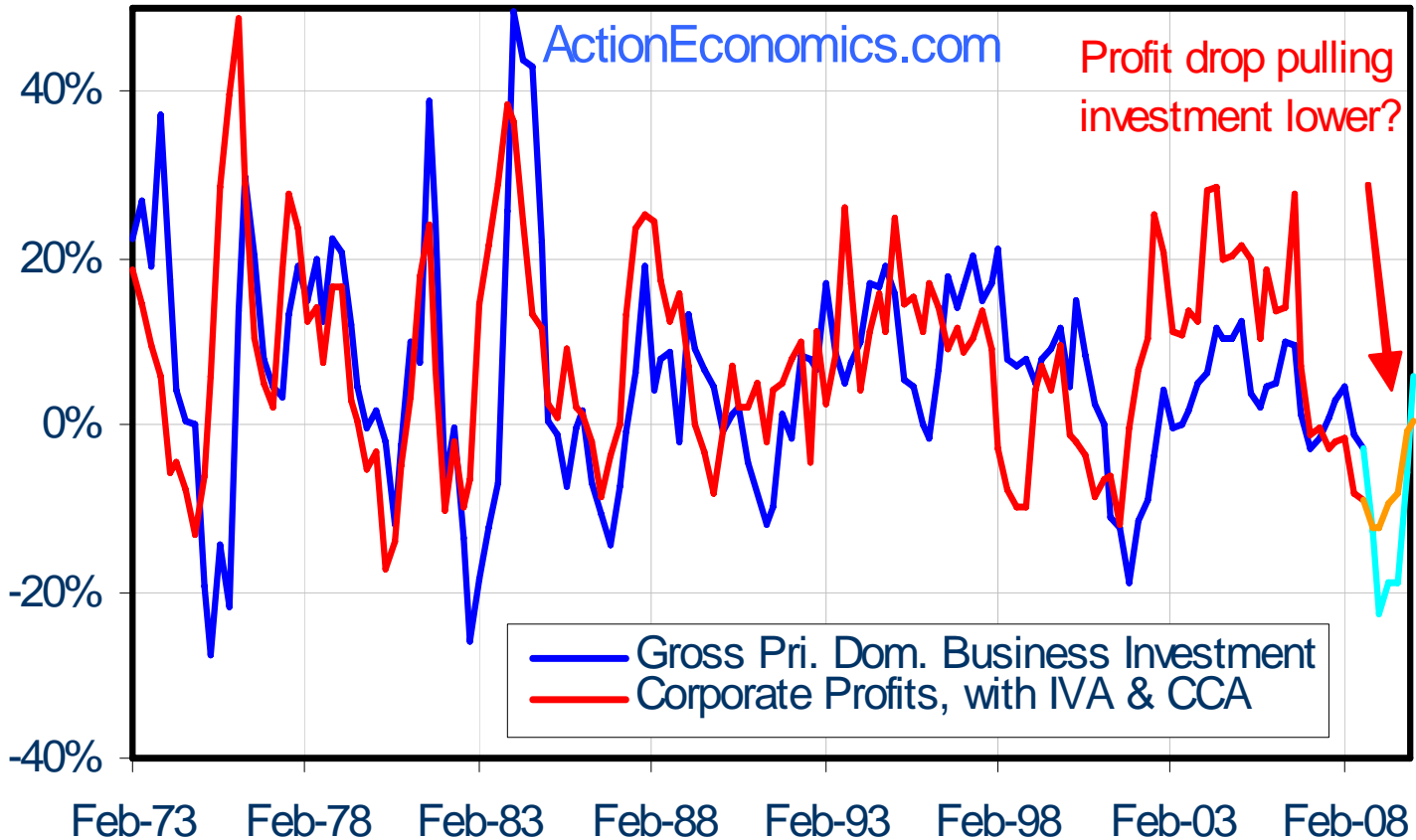


## Retail Sales & PCE, Y/Y Growth



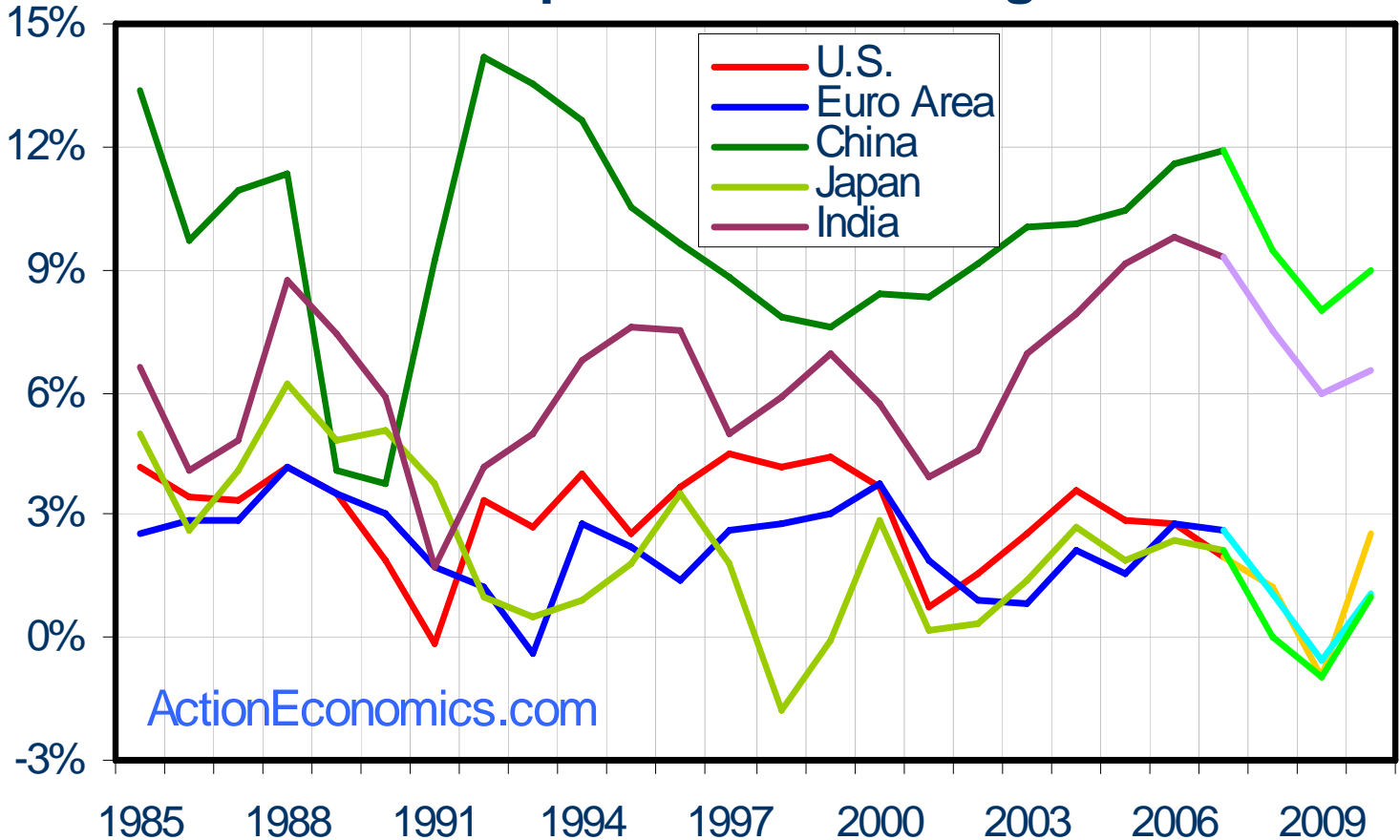
\* Collapse in willingness to leverage is pummeling consumer spending.

## Y/Y Growth: Investment vs Profits

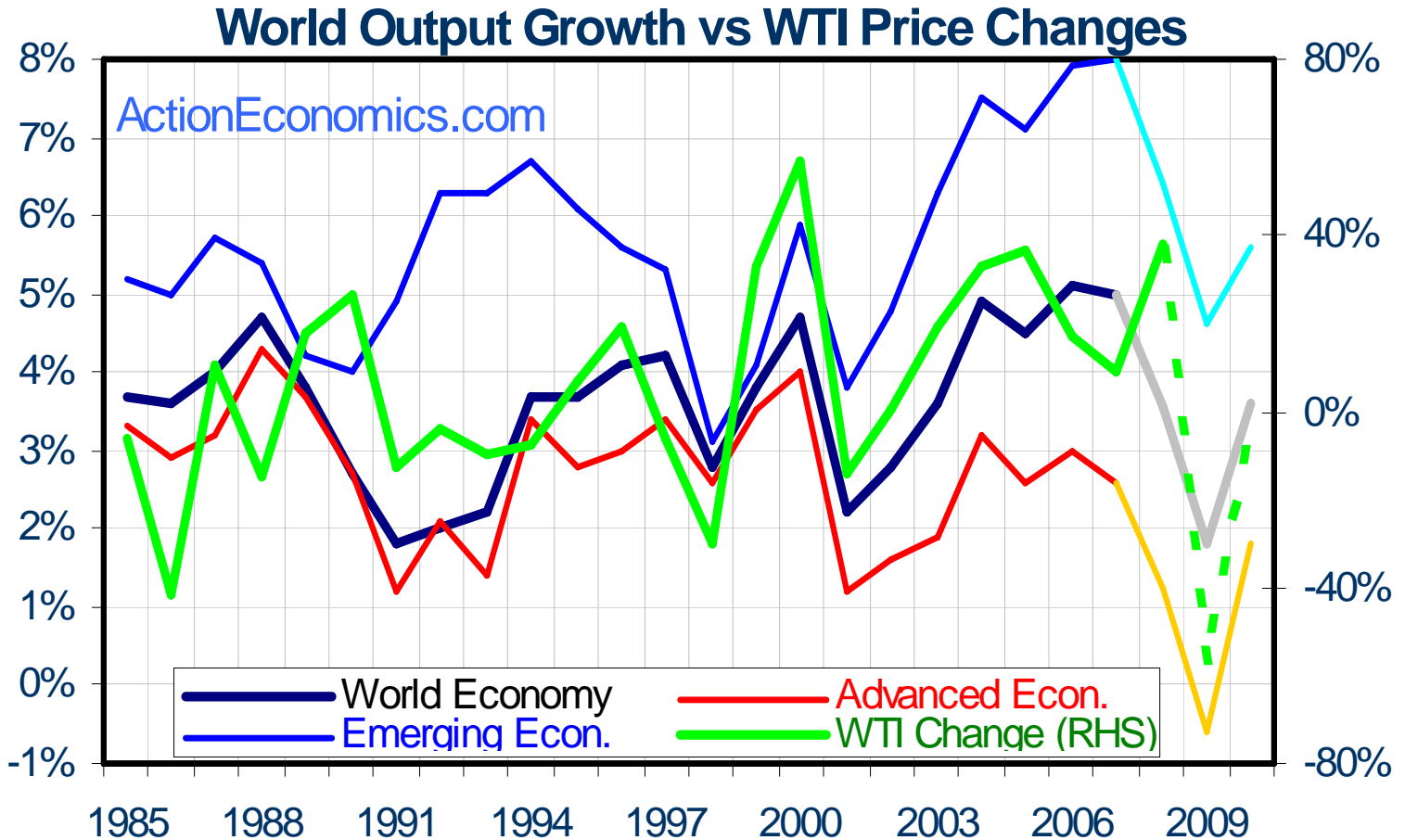


\* Collapse in leverage is now also impacting business investment.

## World Output Growth: The Big Five



\* Contraction is global, and potentially larger in emerging economies.



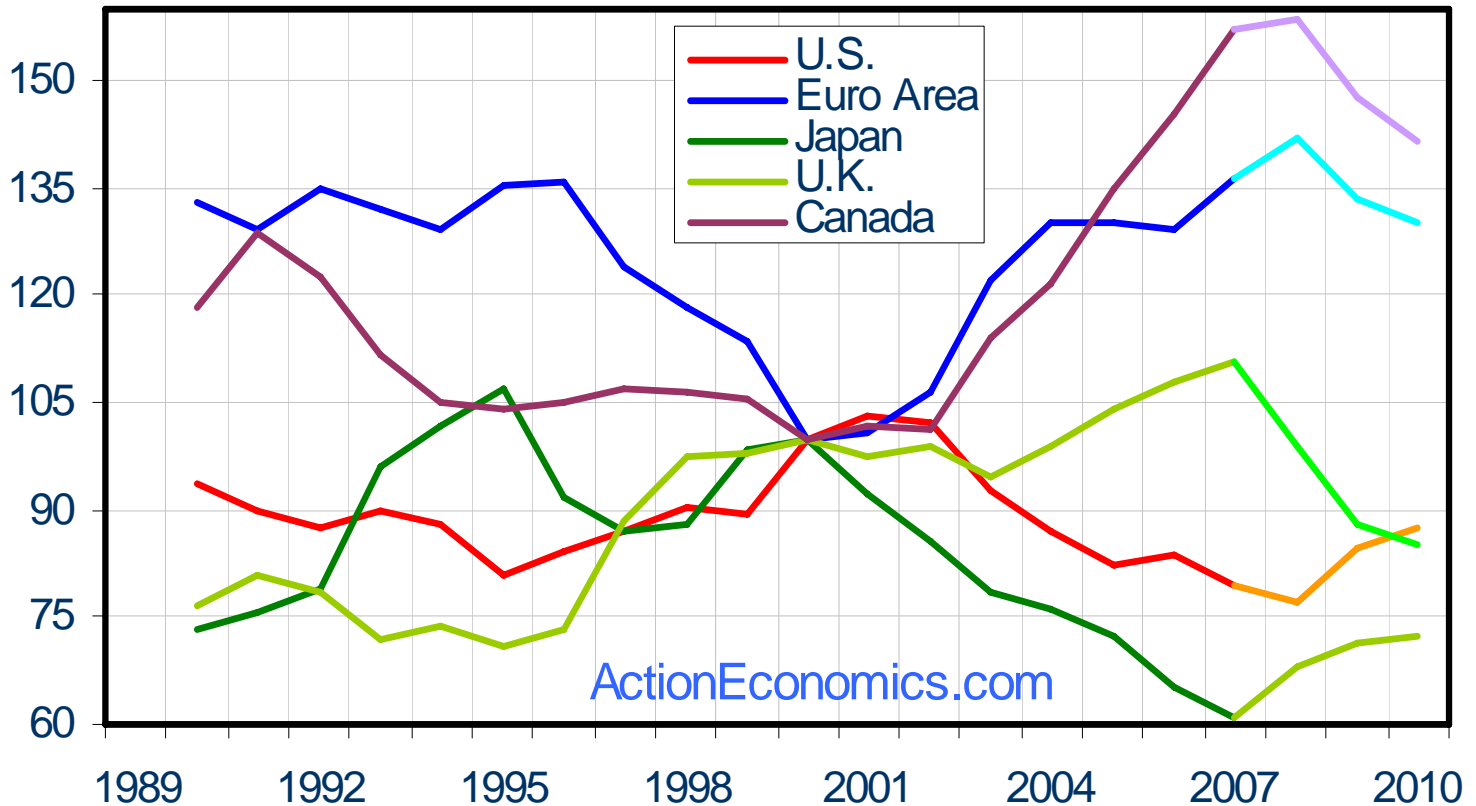
\* Collapse in world growth likely gauged “real time” by oil price freefall.

## U.S. Petroleum Imports, SA, \$Blns



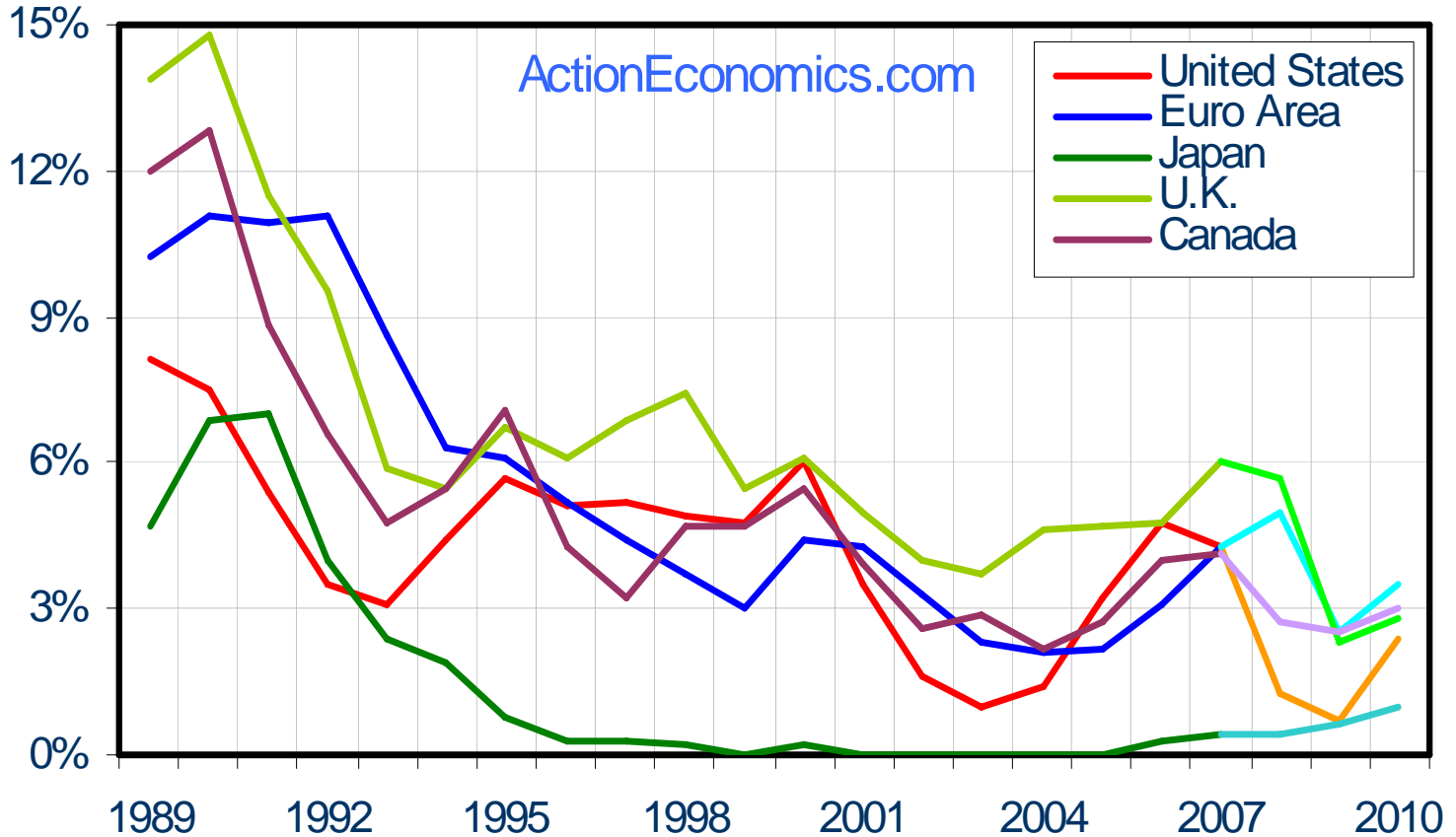
\* De-leveraging now greatest among those dependent on petro-dollars.

## IMF "Real" Exchange Rate Indexes



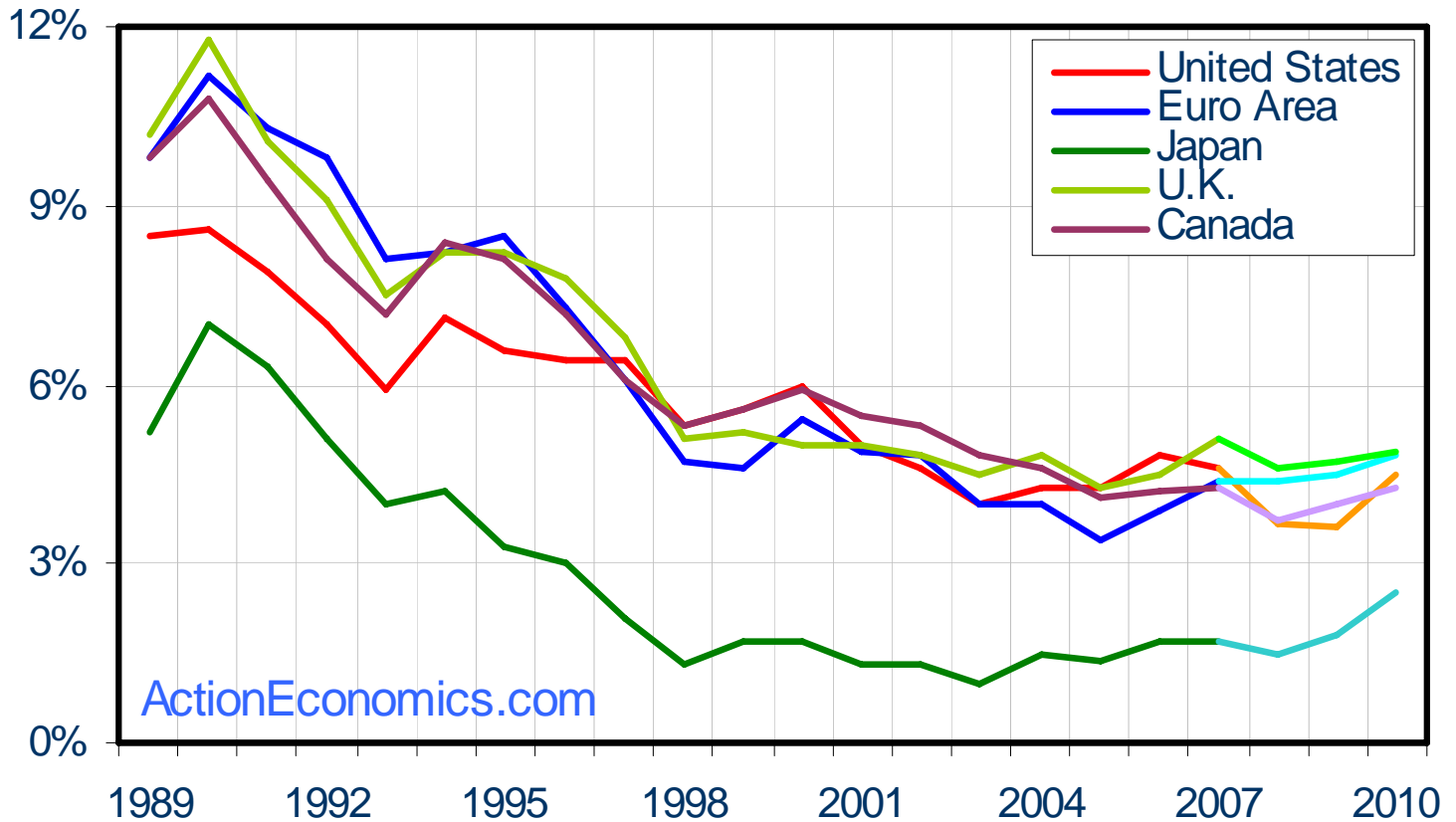
\* Winners from petro-leveraging are now losers from de-leveraging.

## Short-Term Yields, Advanced Countries



\* Weakening currencies also in countries with the biggest policy rate cuts.

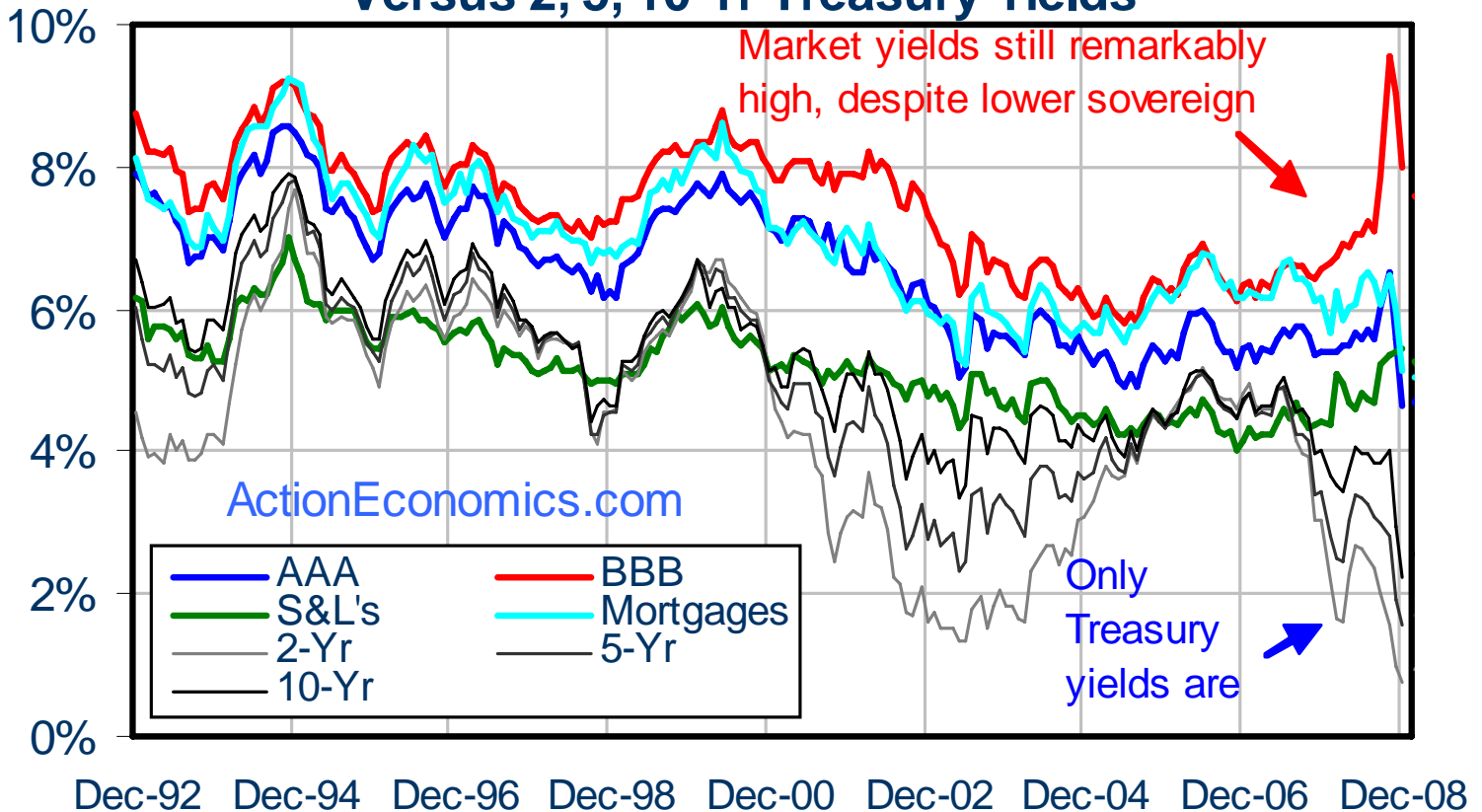
## Long-Term Yields, Advanced Countries



\* Longer-term yields only modestly responding to falling short term rates.

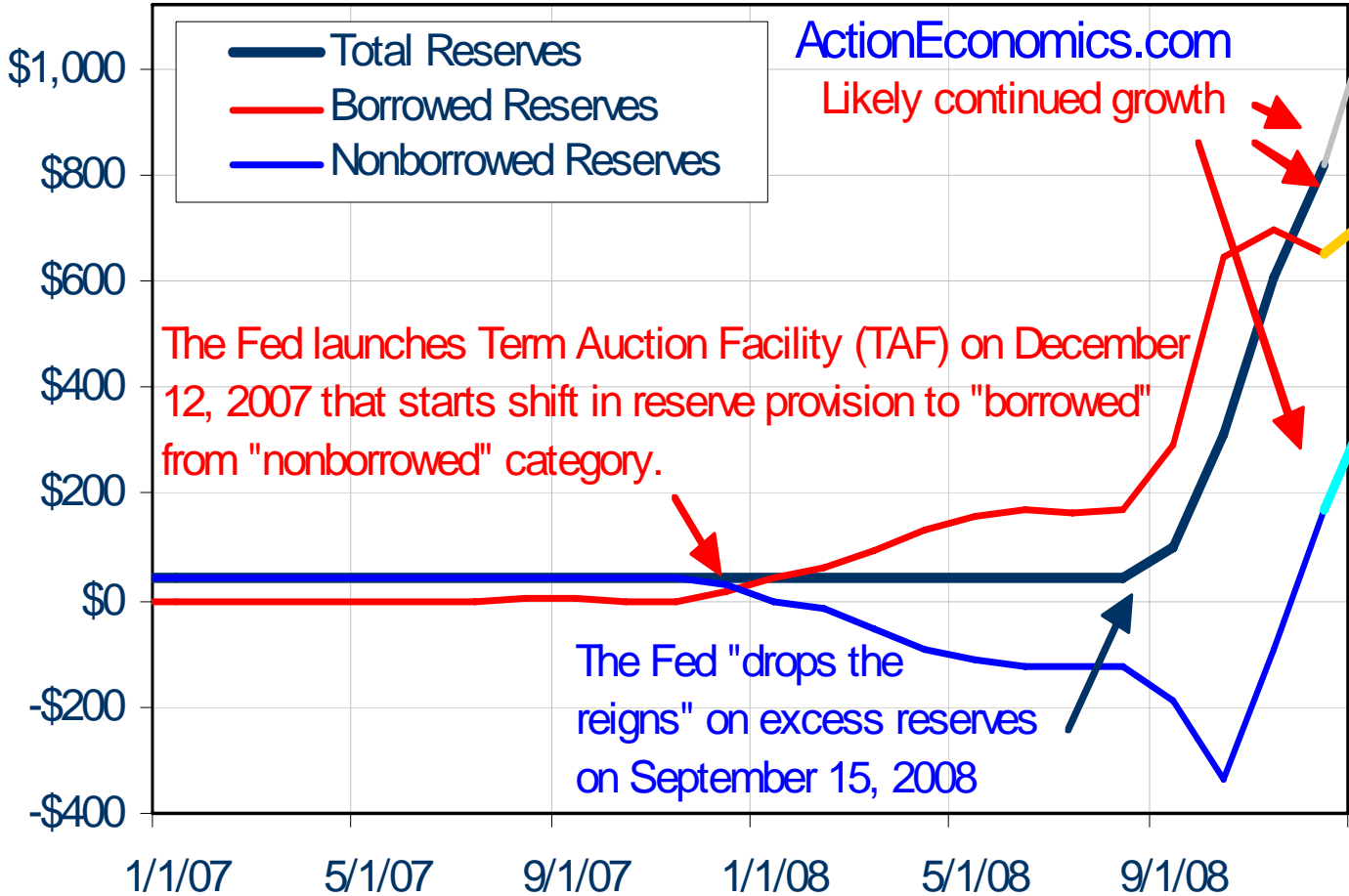


## Actual & Projected U.S. Market Yields Versus 2, 5, 10-Yr Treasury Yields



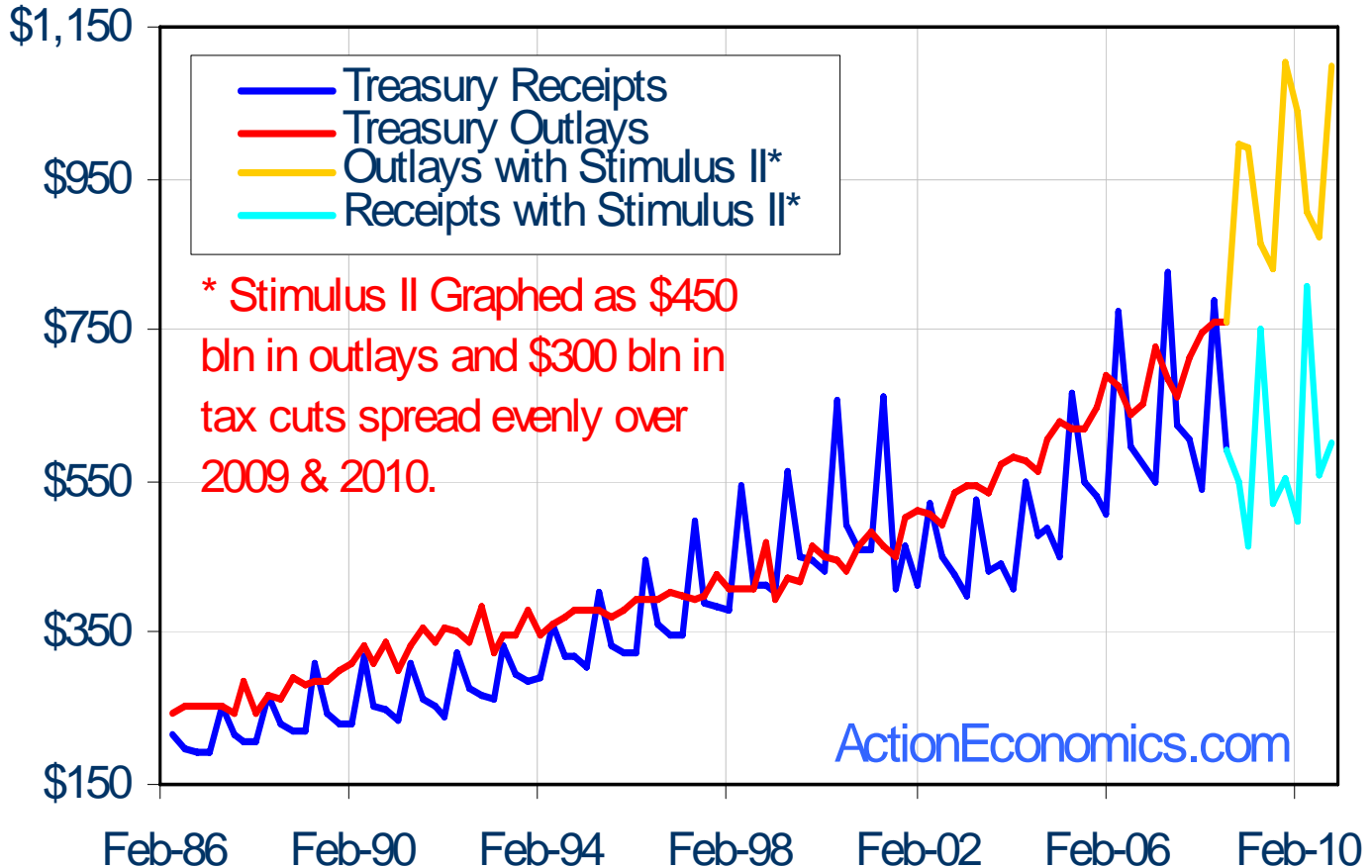
\* Most market yields are rising, not falling, with monetary easing.

## Total, Borrowed, and Nonborrowed Reserves in \$Bln



\* The Fed is buying assets for reserves, to offset "de-leveraging" sales.

## U.S. Treasury Receipts & Outlays. Bln\$



\* Obama administration preparing spending explosion & tax collapse to fill void.

| Relative Magnitudes of Various Wealth/Output Measures, \$Tns               |                         |                 |
|--|-------------------------|-----------------|
| Action Economics, LLC  |                         |                 |
| Monthly and total Impacts:   | Monthly*<br>Peak Impact | Total<br>Impact |
| Wealth Bust (vs 8% trend): 2008  | -\$1.41 (08-Q4)         | -\$11.2         |
| Wealth Boom (vs 8% trend): 2003-2006                                       | \$0.65 (04-Q4)          | \$6.9           |
| House Price Bust (vs 8% trend): 2006-2008                                  | -\$0.35 (08-Q3)         | -\$4.2          |
| House Price Boom (vs 8% trend): 2002-2005                                  | \$0.16 (05-Q2)          | \$3.3           |
| Mortgage Bust (vs 8% trend): 2008  | -\$0.25 (08-Q4)         | \$1.3           |
| Mortgage Boom (vs 8% trend): 2002-2007                                     | \$0.16 (06-Q2)          | \$2.1           |
| FY09-10 Fiscal Stimulus Program??  | \$0.03 (09-Apr?)        | \$0.8           |
| FY08 Fiscal Stimulus Rebate Checks   | \$0.05 (08-May)         | \$0.1           |
| <b>Levels (as of Q3-08)</b>  |                         |                 |
| U.S. GDP level   | +0.02 to -0.02          | \$14.5          |
| U.S. Household Assets  | +0.71 to -1.53          | \$71.1          |
| U.S. Household Liabilities   | +0.58 to -0.11          | \$14.6          |
| U.S. Household Mortgages   | +0.39 to -0.08          | \$10.6          |
| <b>* Peak monthly impact is estimated as 1/3 of peak quarterly impact.</b> |                         |                 |

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