Action Economics!

The Anemic U.S. Recovery

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Review of Main Take-Aways from 2009:

•Downturn once viewed as U.S. real estate driven

•De-leveraging was the more general culprit

•De-leveraging was a global, not local, phenomenon

Causal links, as once 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

More likely Causal links:

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

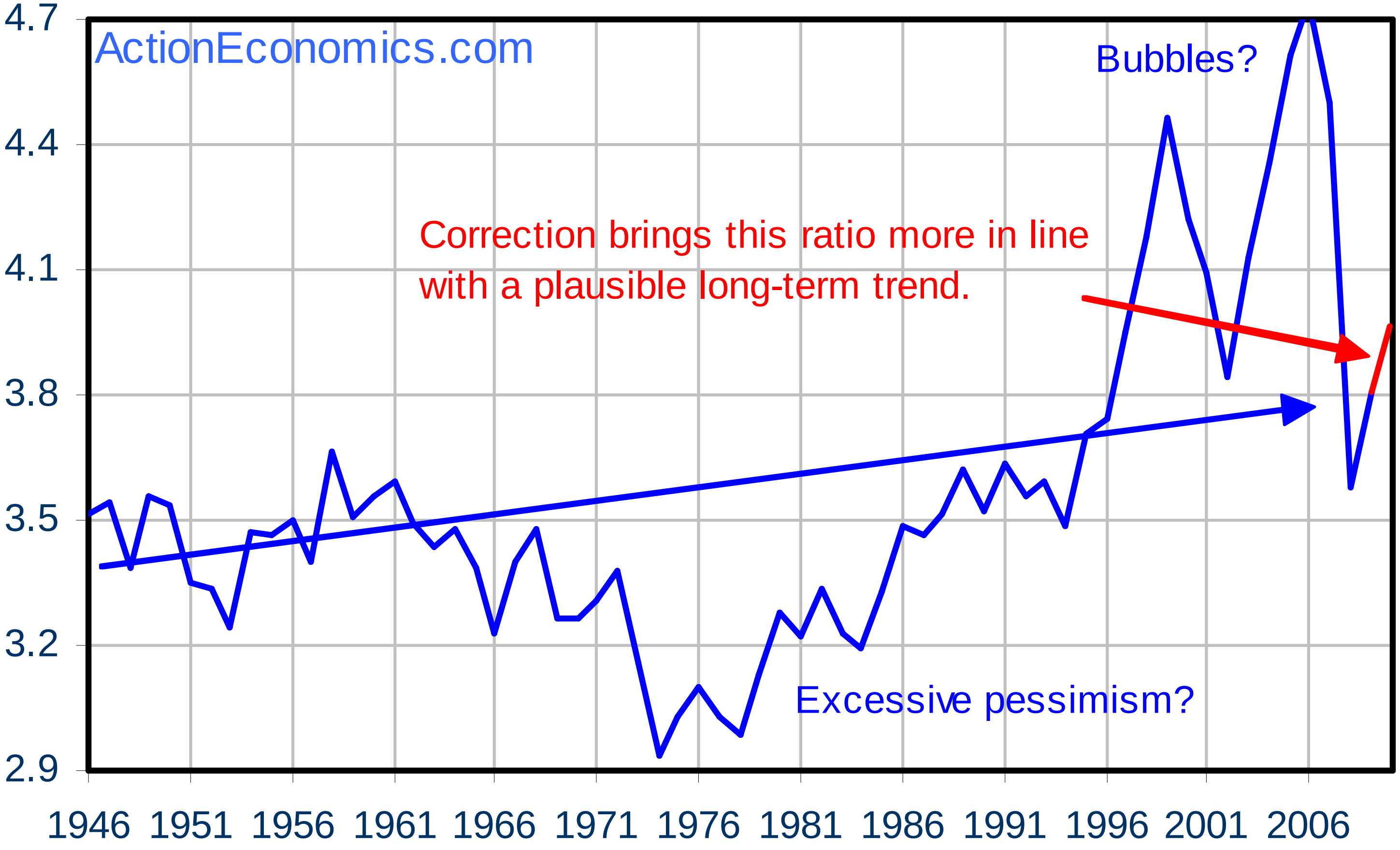
⇩

Global risk "revulsion" is contagious/self reinforcing

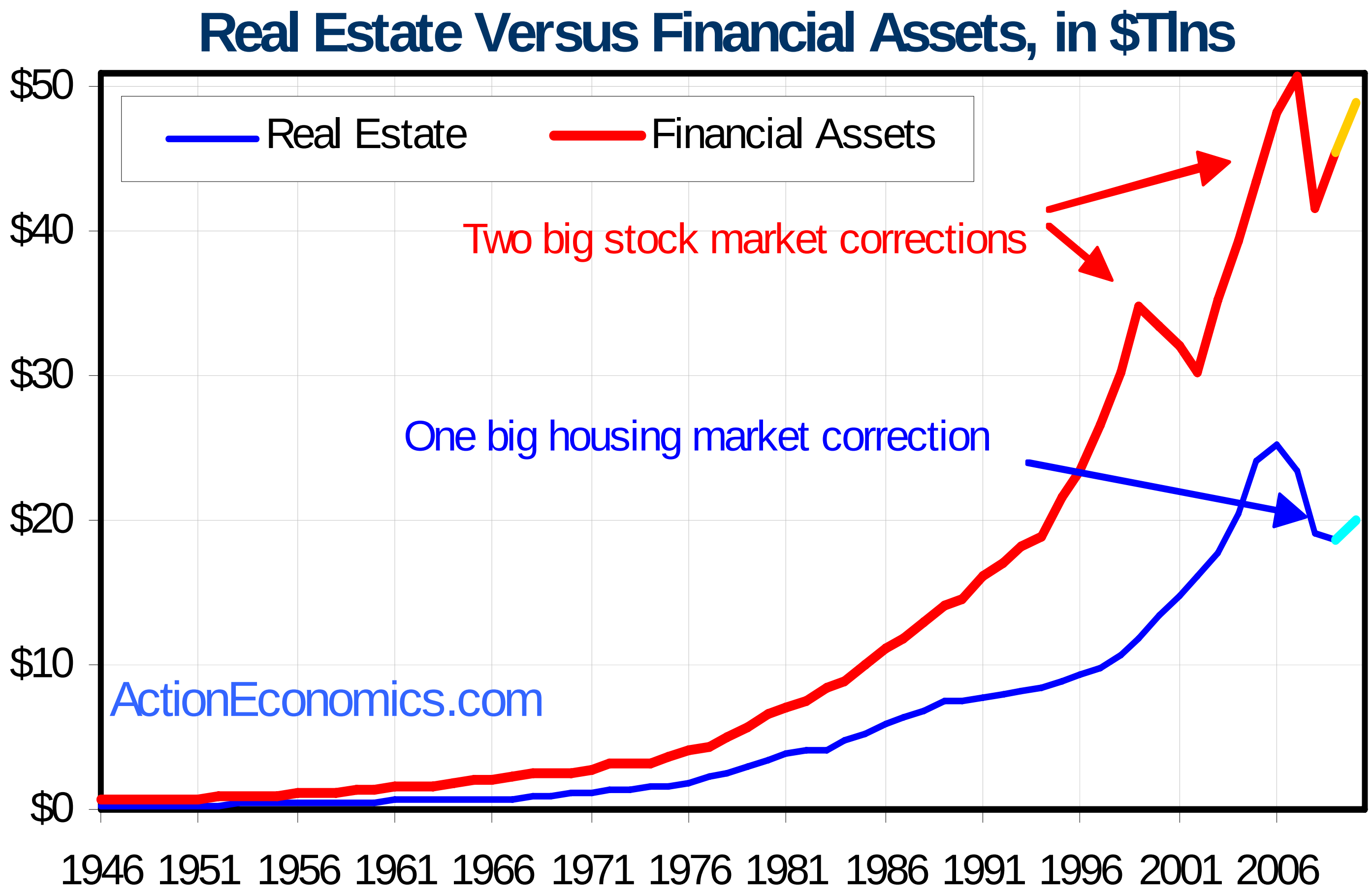
⇩

Forces from "paradox of thrift" dwarf policy response

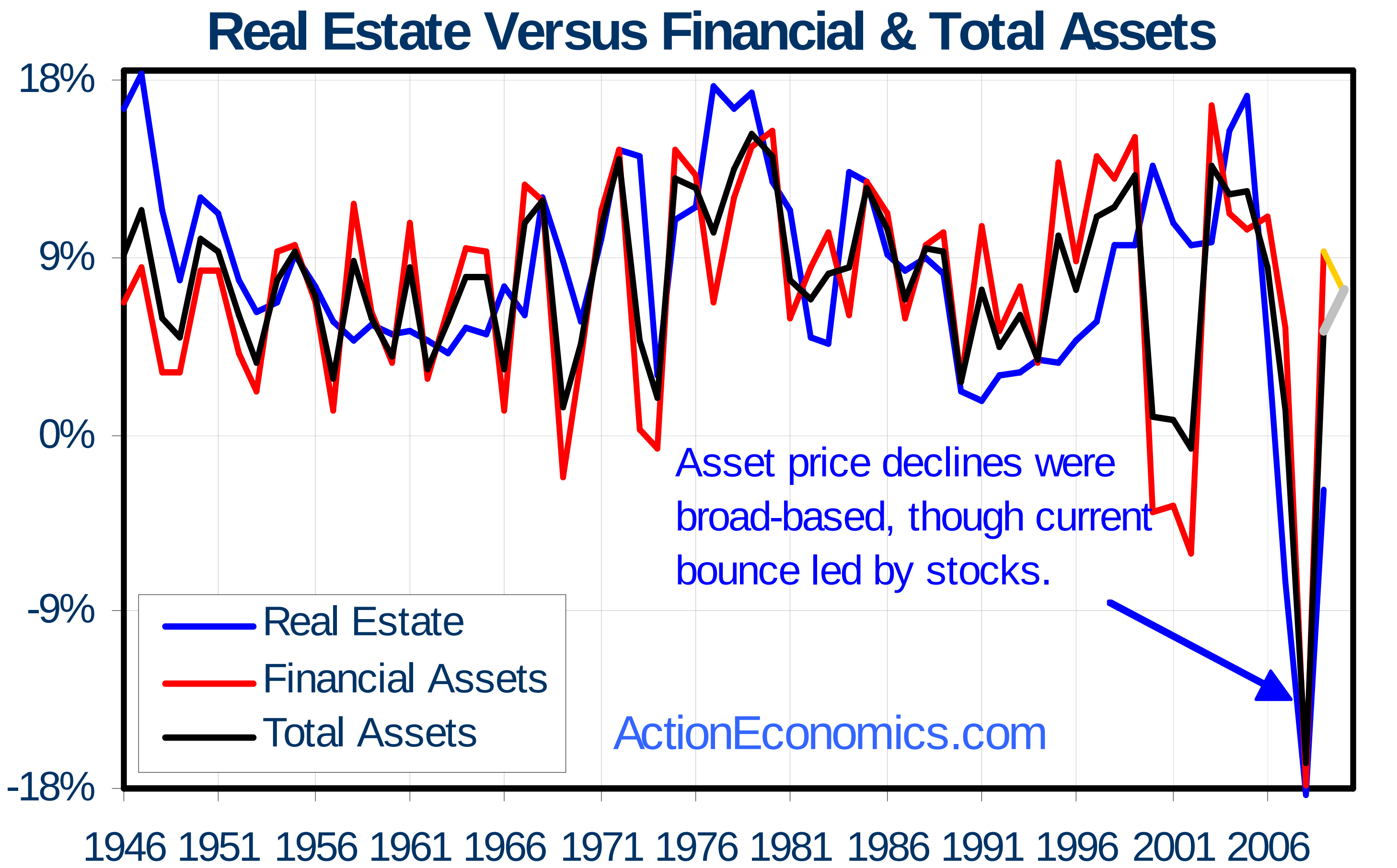
Ratio of Total U.S. Net Worth to Nominal GDP



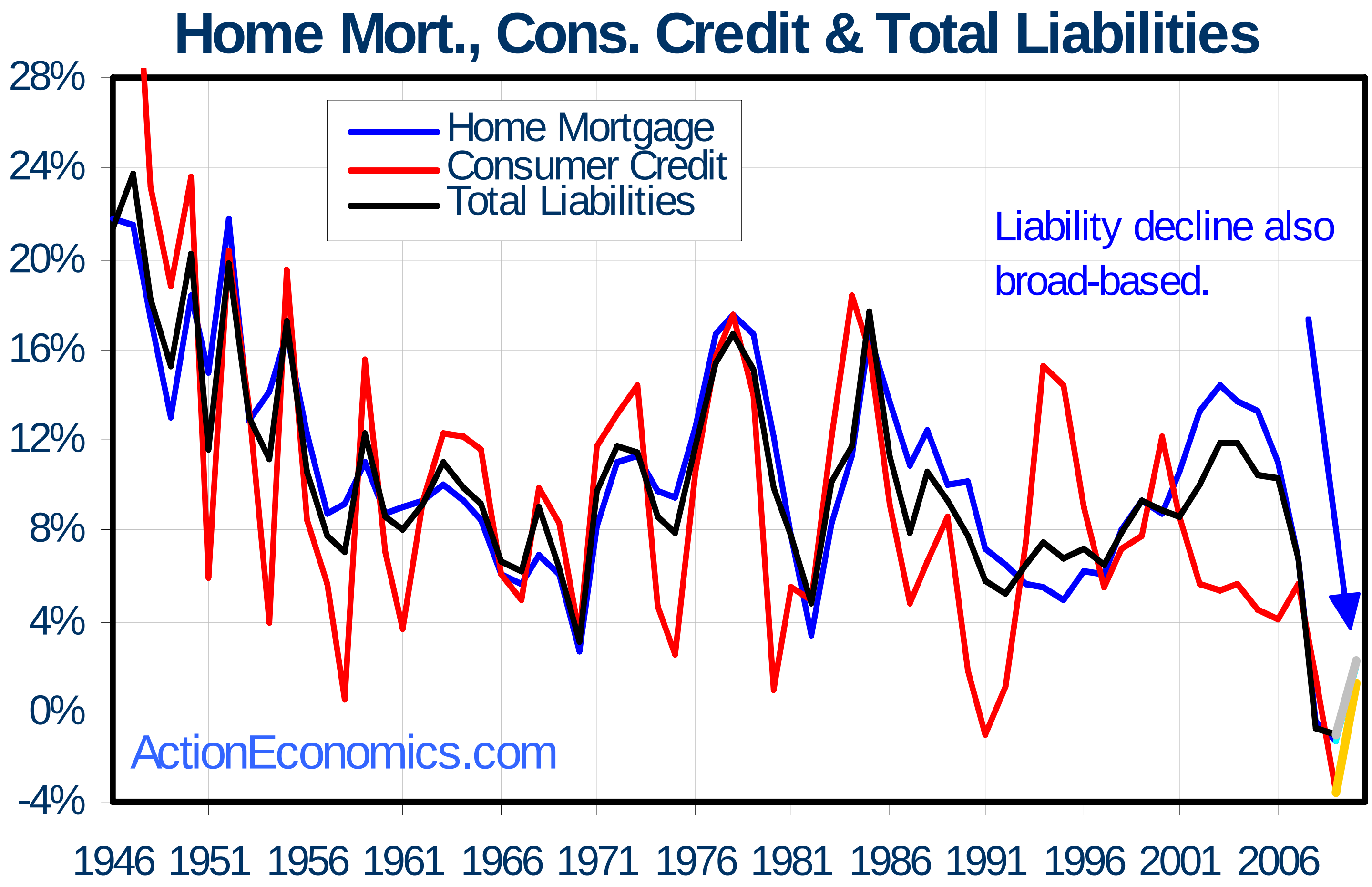
* U.S. net worth fell from $66 tln in Q3 of 2007 to $48 tln in Q1 of 2009.



* Both financial and real estate values fell this time, versus 2000 stock drop.

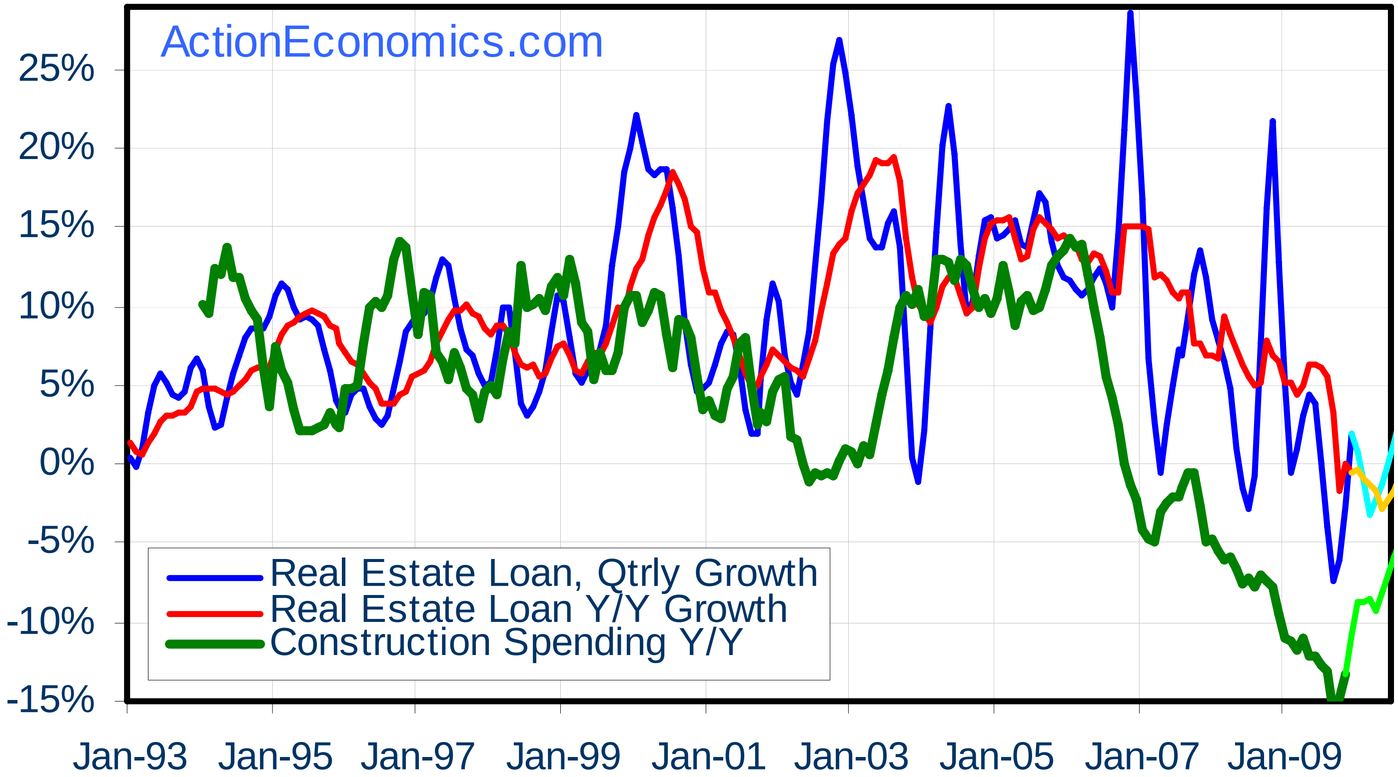


* Asset value collapse was across all categories, not just real estate.



* Credit market collapse across all categories, not just mortgages.

Y/Y & Qtrly Real Estate Loan Growth vs. Y/Y Construction Spending Growth



* Real estate lending only “chased” construction down, and didn’t “lead.”

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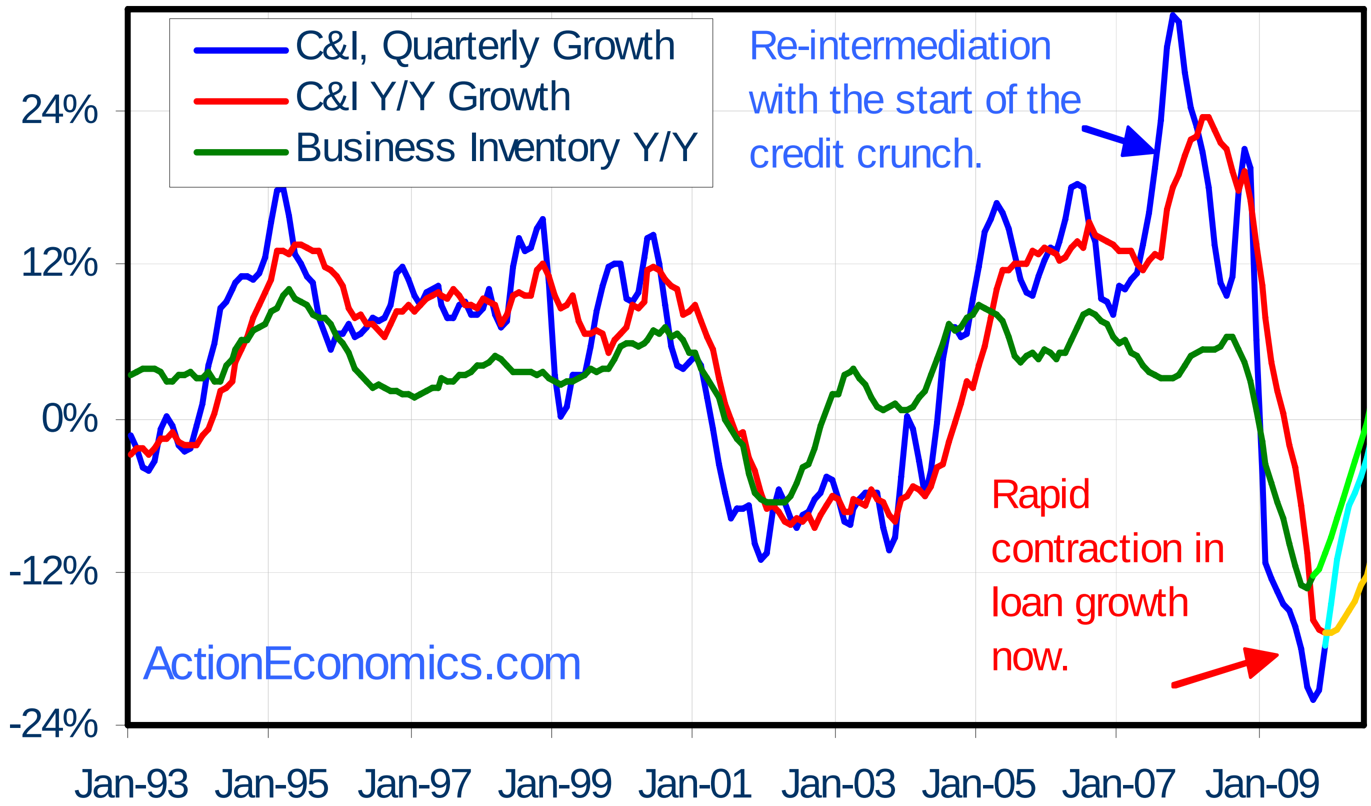
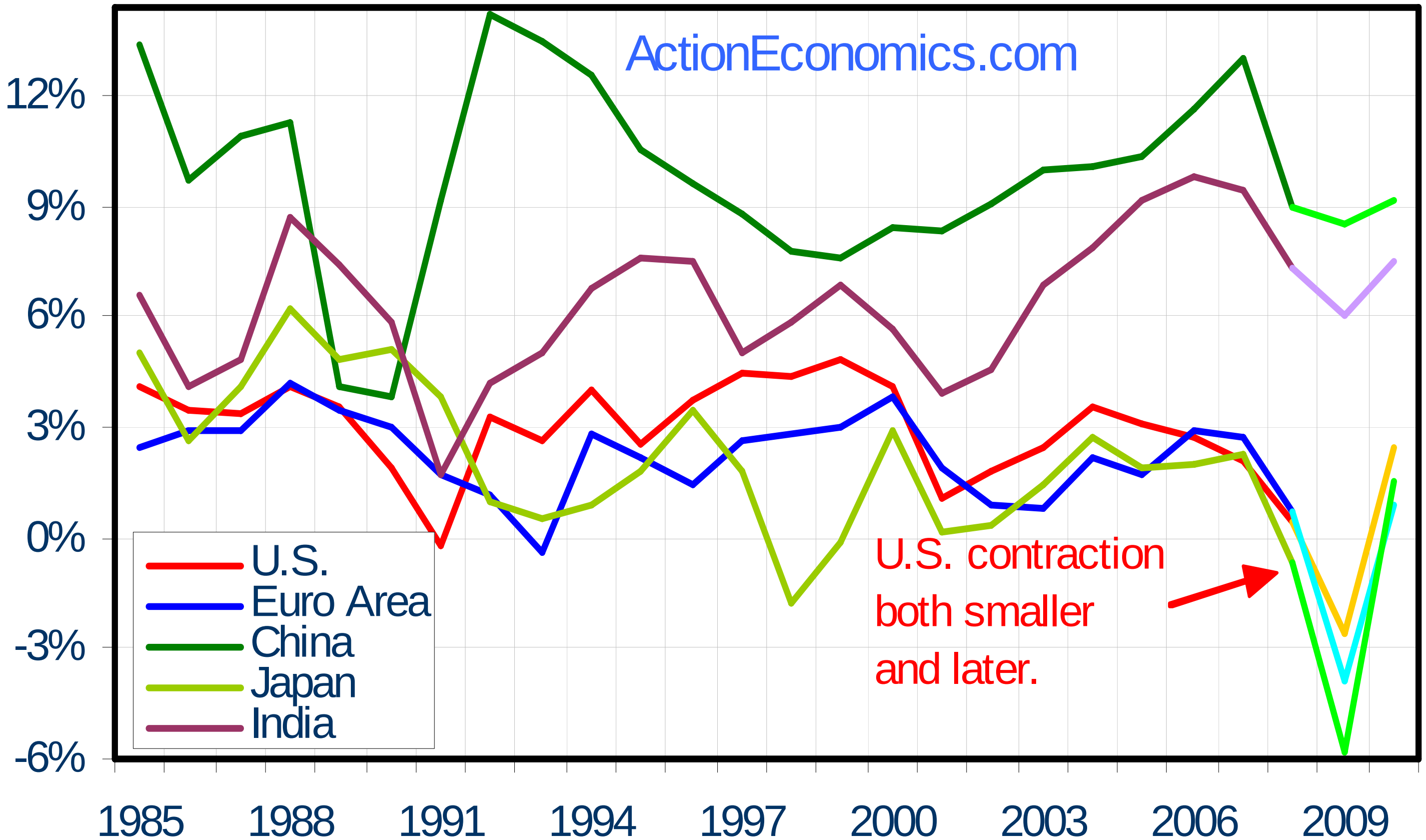
Y/Y & Qtrly C&I Loan Growth vs. Y/Y Business Inventory Growth



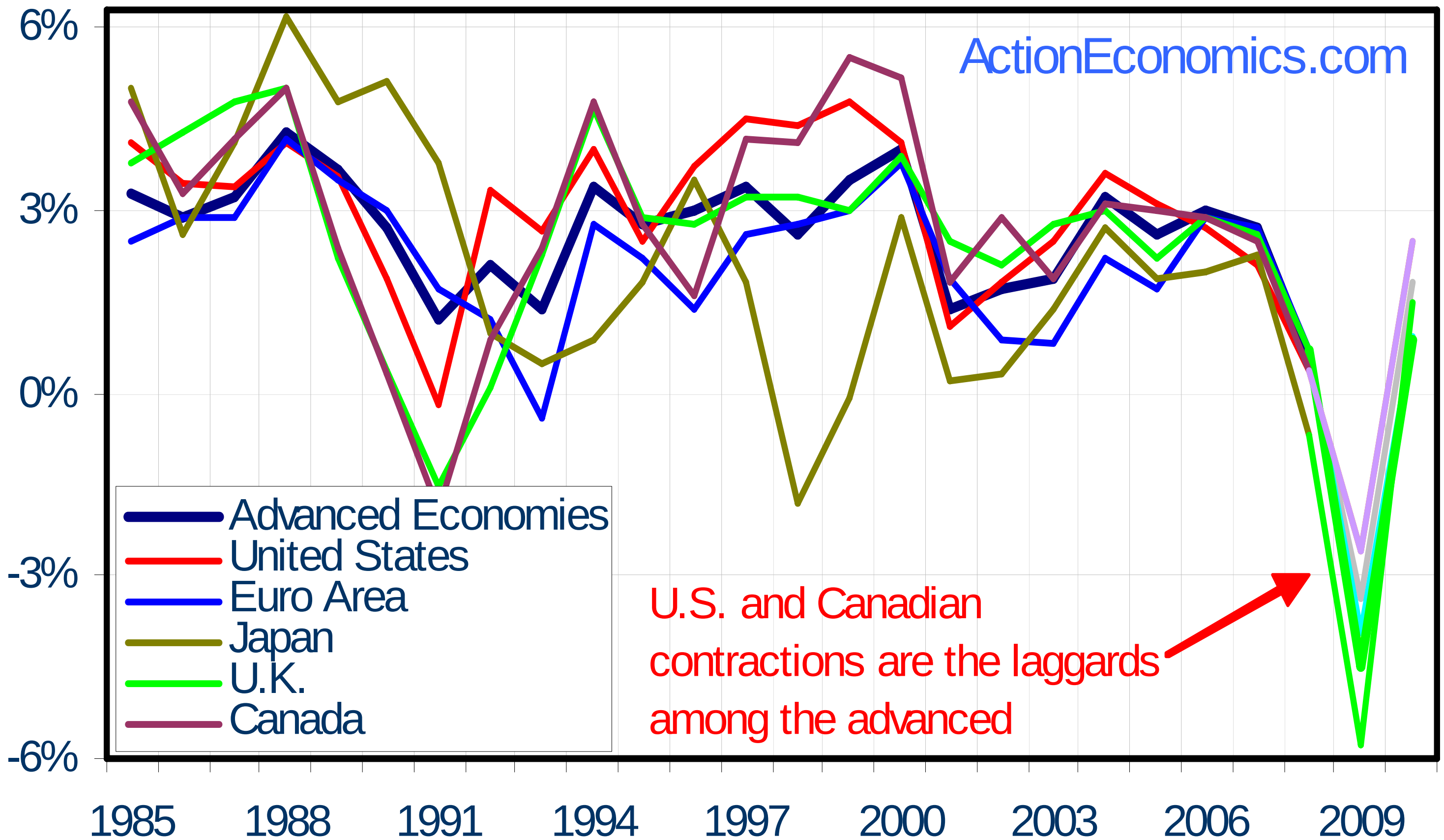
* C&I Loan growth also just “chased” inventories lower, and didn’t “lead.”

World Output Growth: The Big Five



* No tendency for the U.S. to have “led” the world economy downward.

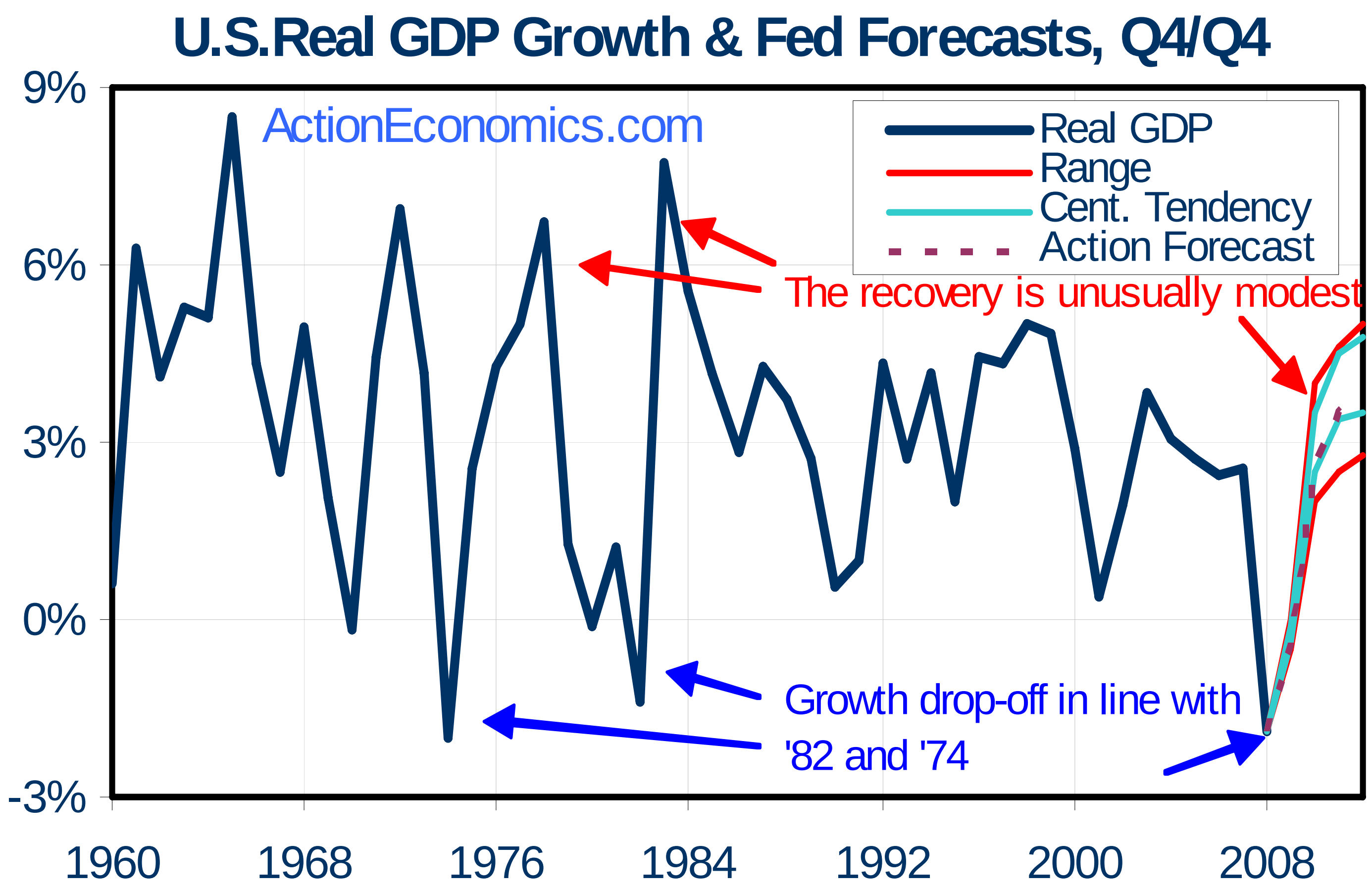
Output Growth: Major Advanced Economies



* The U.S. actually seemed to “chase” the industrialized economies down.

Going Forward: The drivers for 2010

- Recovery on a slow trajectory from a June trough
- All GDP components to underperform… but housing!
- Pace of expansion hinges on businesses, not consumers
- Highly stimulative policy a mixed blessing
- Yields to rise, curve to flatten, spreads to narrow



* An unusually modest recovery, given current Fed forecasts, and our own.

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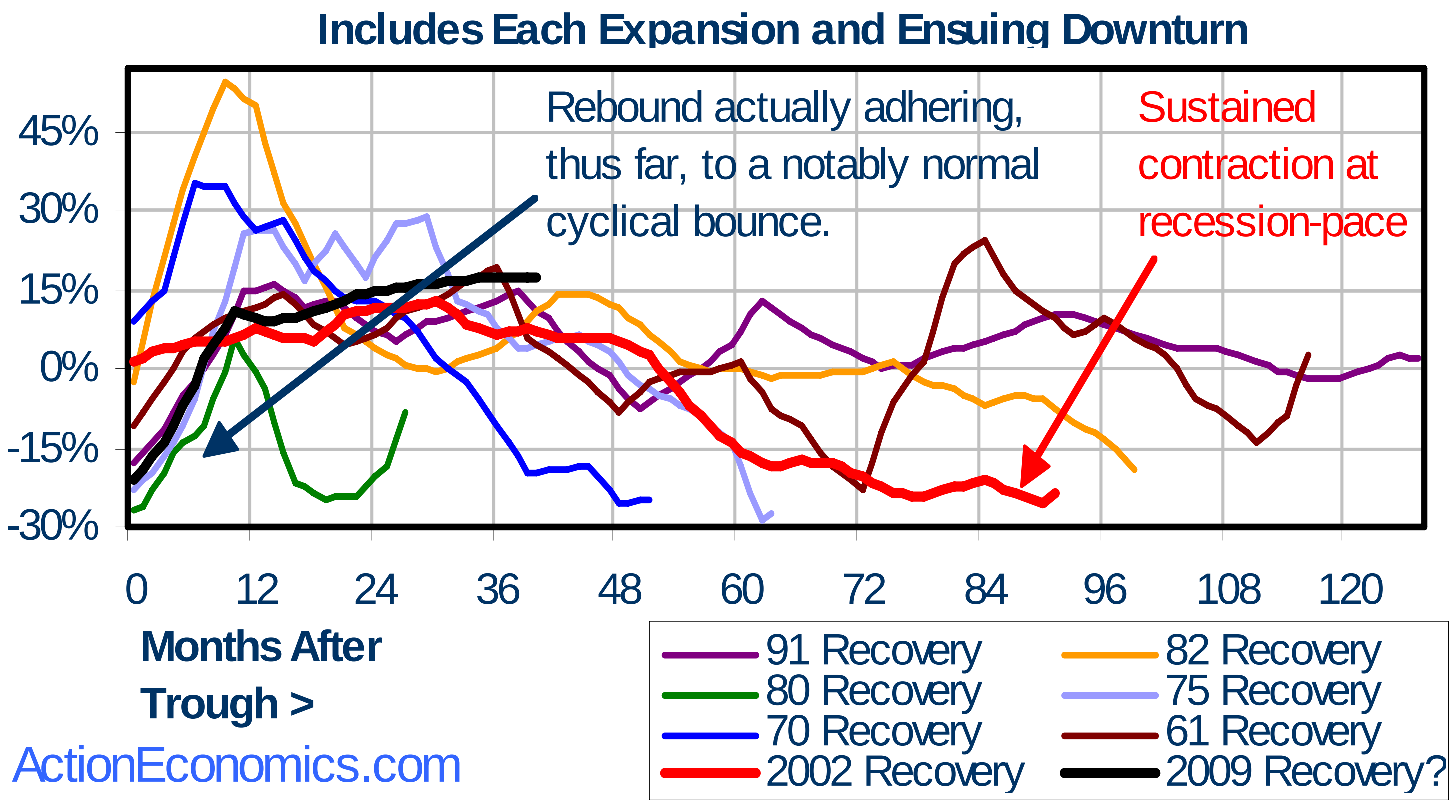
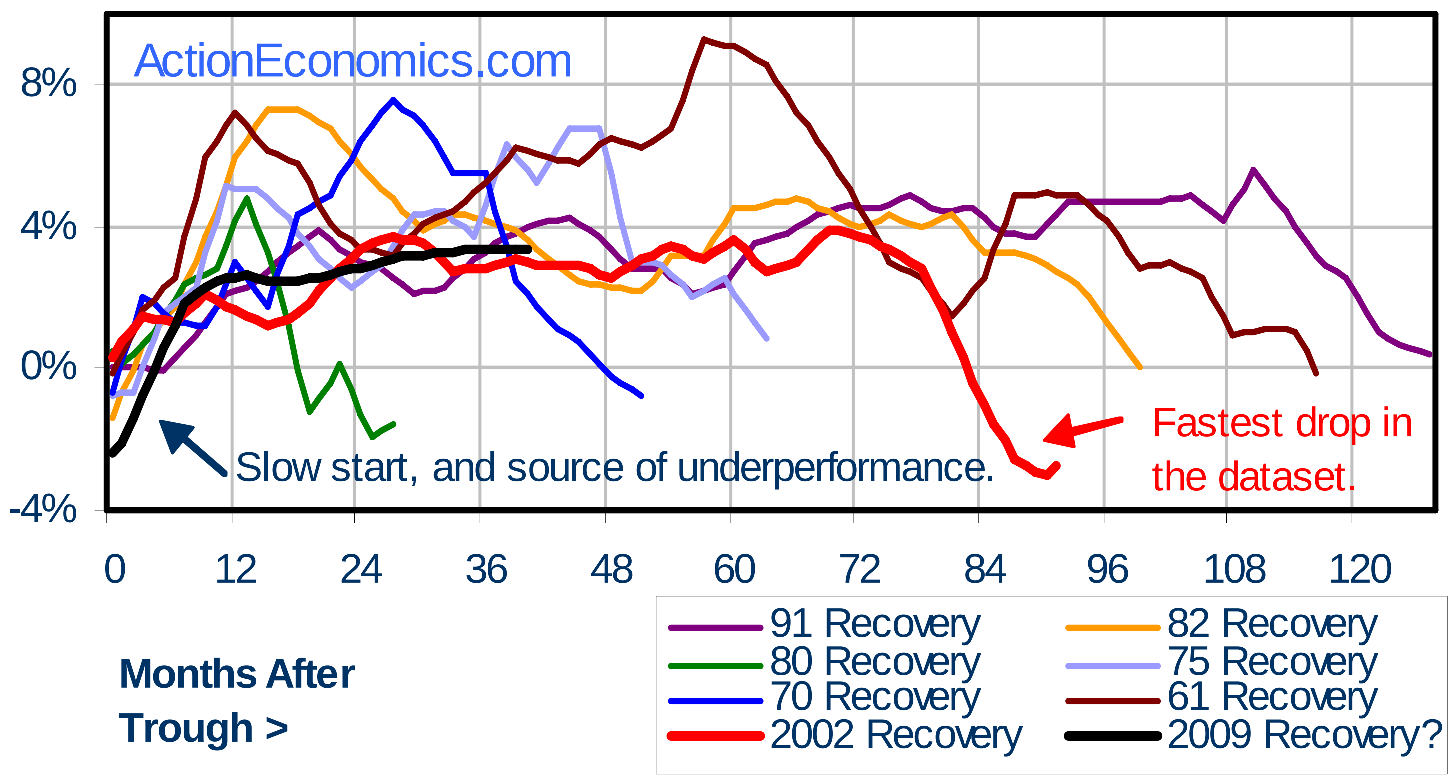
Y/Y Real Residential Investment Growth in the Last Seven Cycles



* Housing in the “ball park” of a normal cyclical rebound.

Y/Y Real GDP "Ex-Housing" Growth in the Last Seven Cycles

Includes Each Expansion and Ensuing Downturn



* GDP “ex-housing” is tracking a notably anemic expansion thus far.

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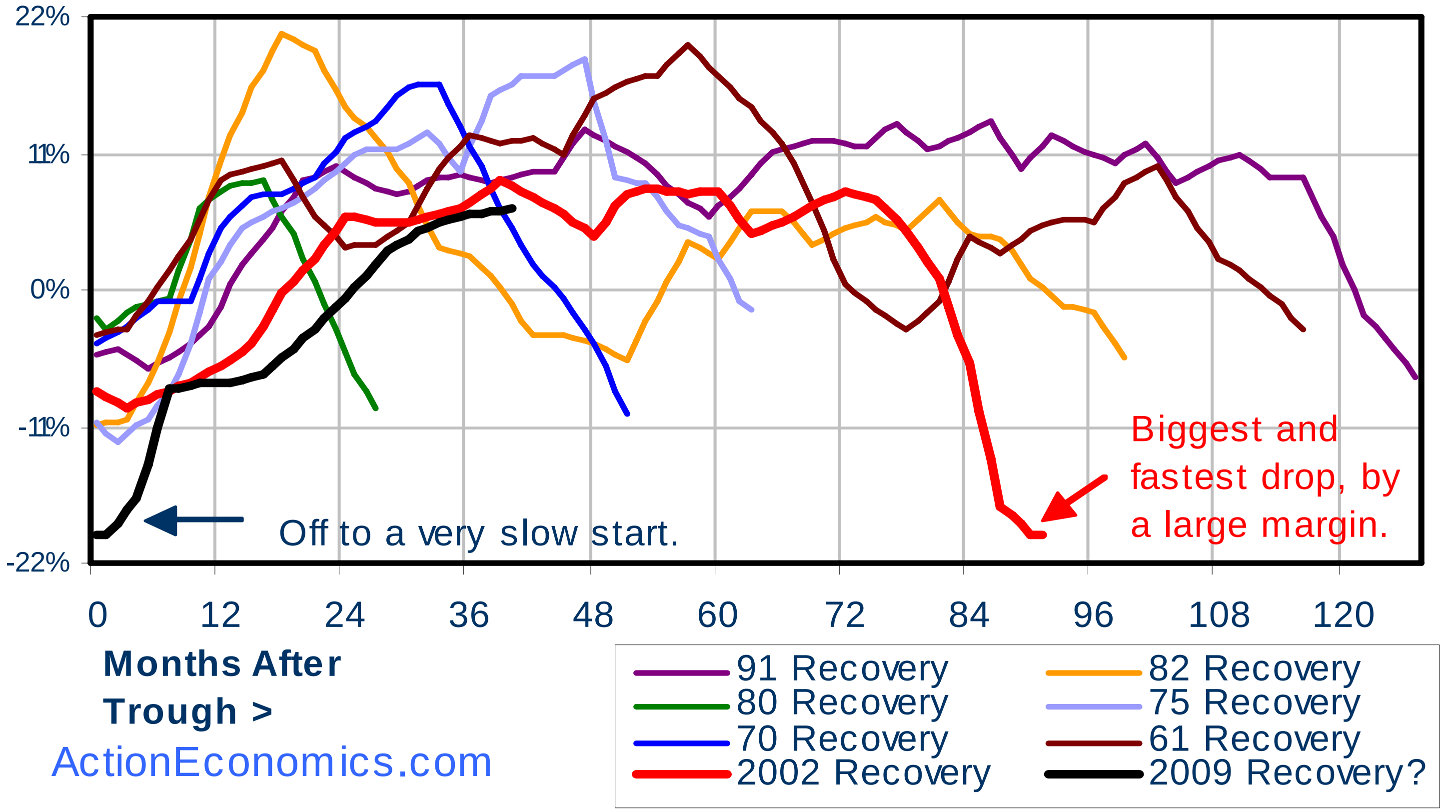
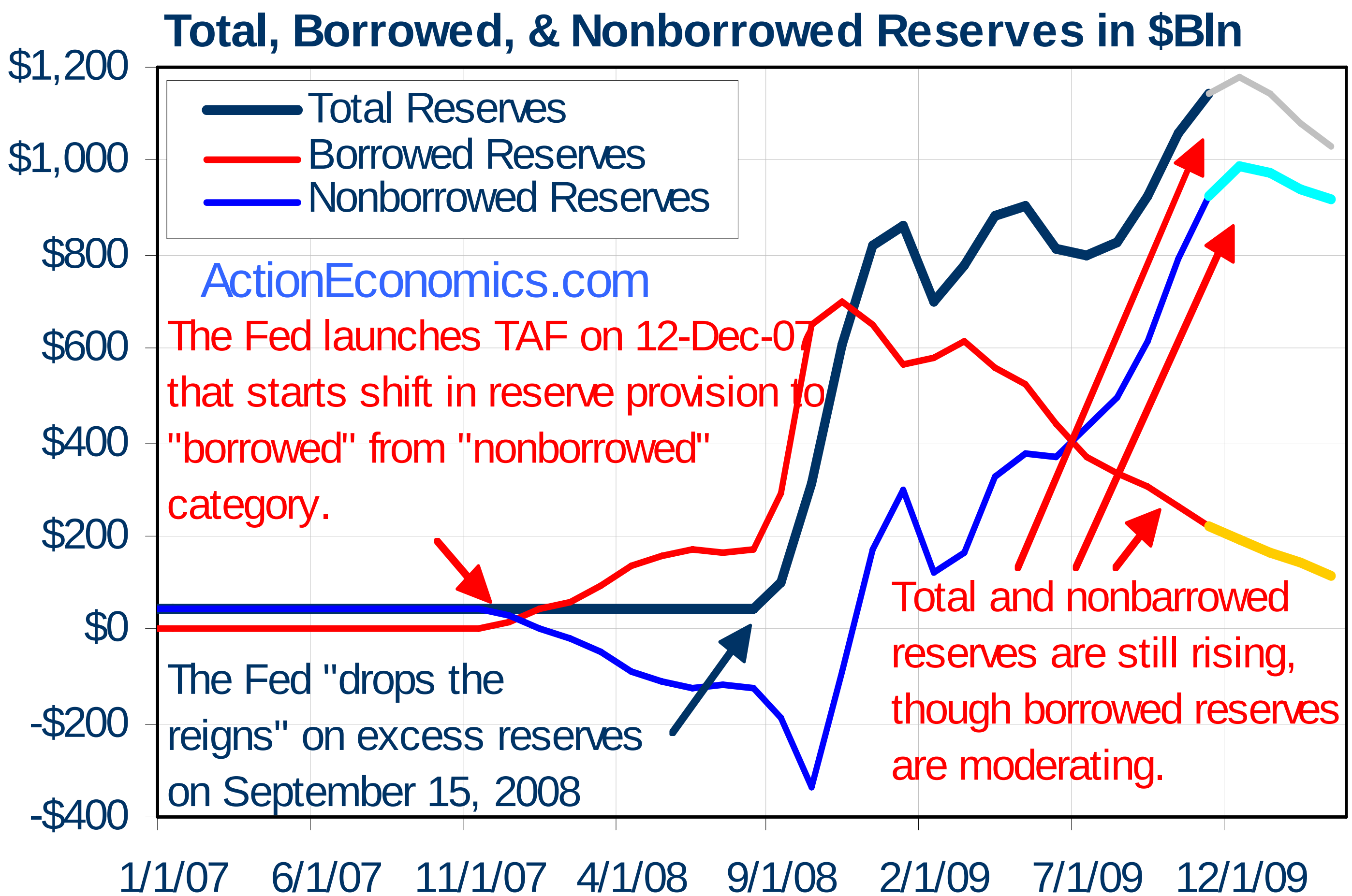
Y/Y Real Business Fixed Investment Growth in the Last Seven Cycles

Including Each Expansion and Ensuing Downturn

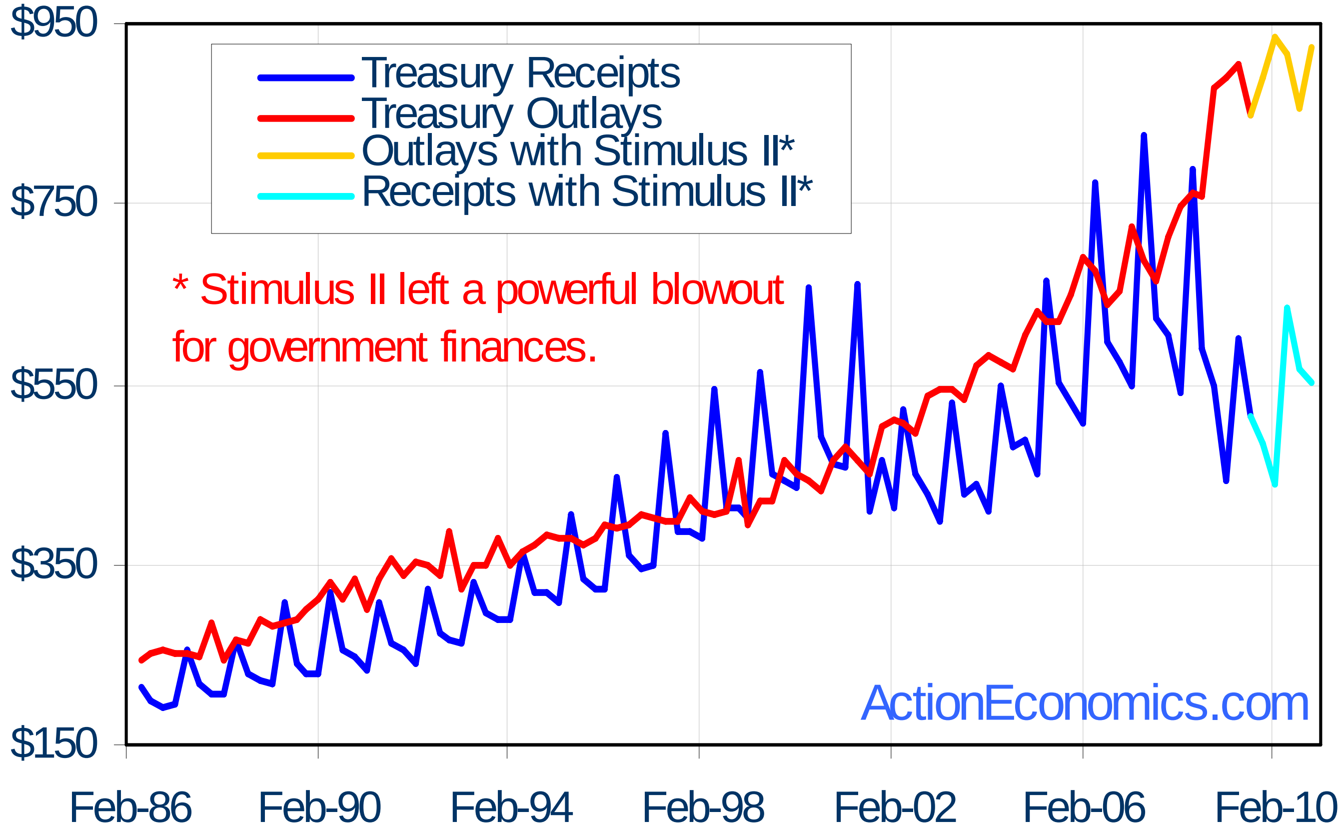


* Remarkably weak business fixed investment is the main culprit.

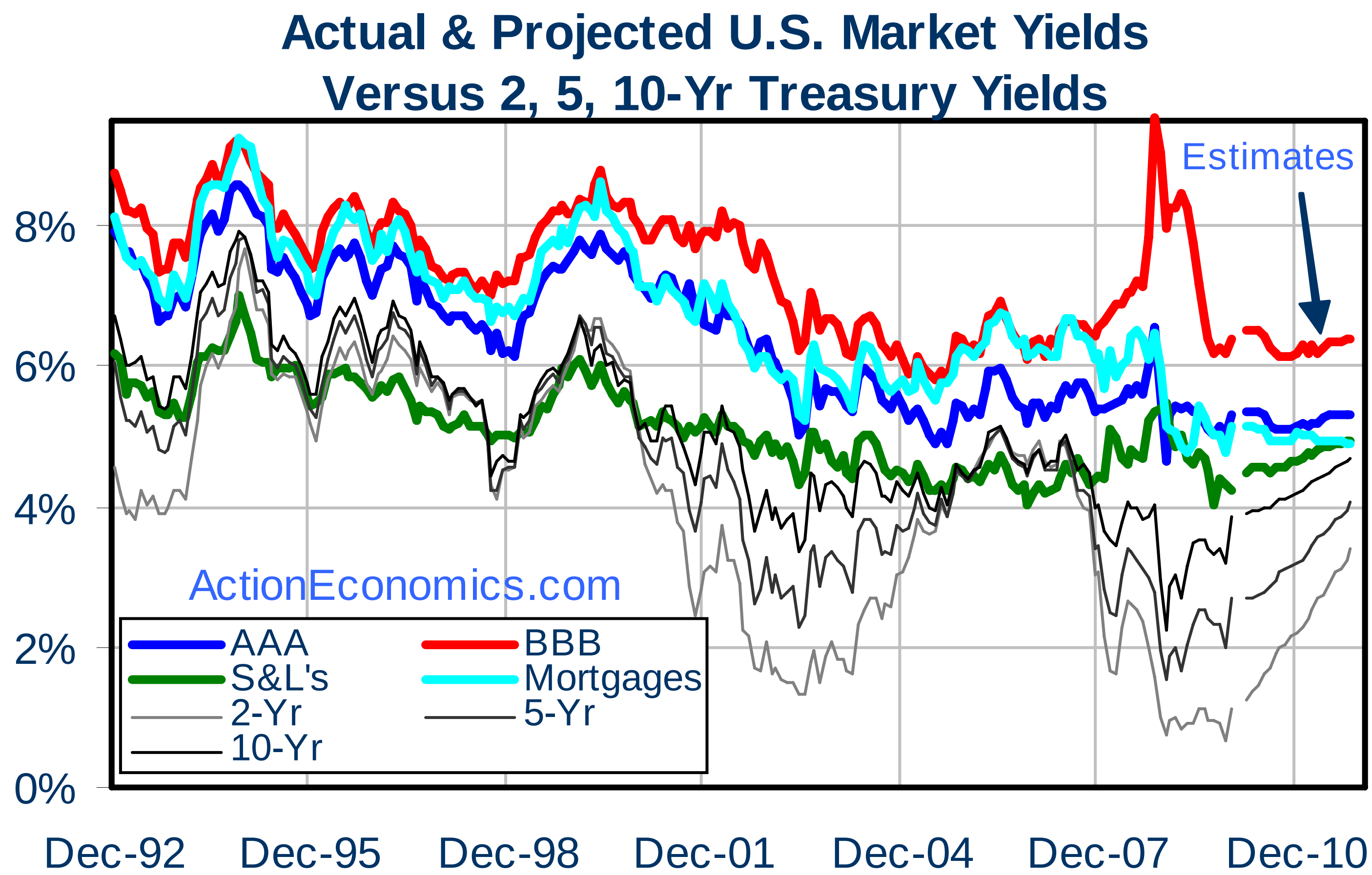


* The Fed’s balance sheet is frighteningly large. Will they exit on time?

U.S. Treasury Receipts & Outlays. Bln$



* The Treasury's balance sheet is hopeless. Can Congress recover?



* Sovereign yields to rise, curve to flatten, spreads to narrow.

Summary:

- Downturn due to de-leveraging, not housing
- De-leveraging was a global, not local, phenomenon
- Recovery on a slow trajectory from a June trough
- All GDP components underperforming but housing!
- Pace of expansion hinges on business, not consumers
- Highly stimulative policy a mixed blessing
- Yields to rise, curve to flatten, spreads to narrow