

# The economic and financial outlook

Anton Brender

Roma, December 2009

Money does not perform. People do.

**DEXIA**  
Asset Management

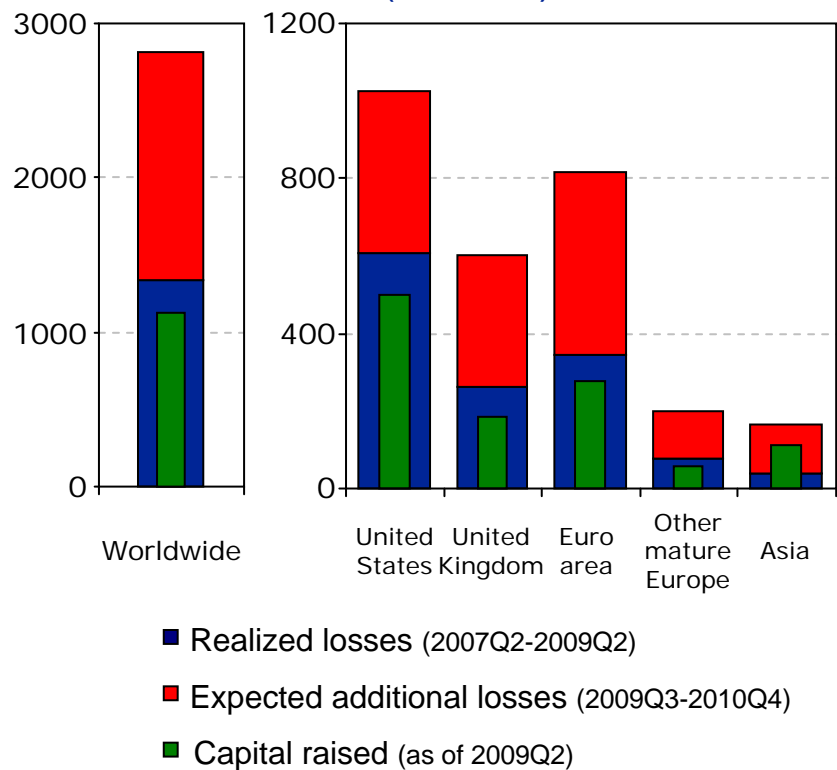
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# **The global picture**

## The start of a slow recovery

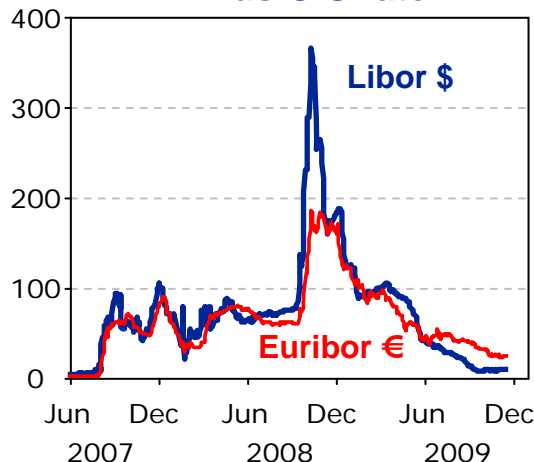
# Although banks' balance sheets may not yet be fully cleaned, tensions on money and credit markets have eased further

## Banks write-downs or loss provisions (\$ billion)

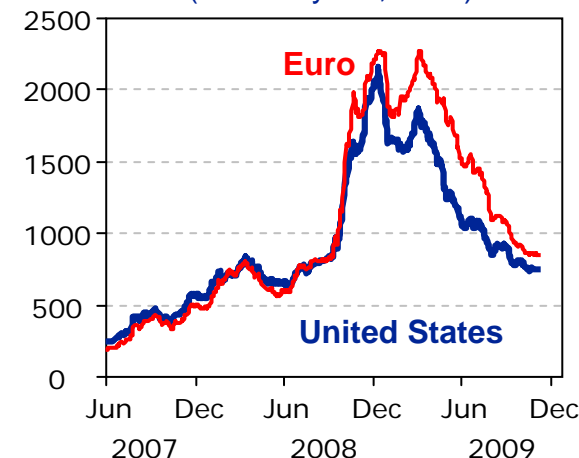


## Risk premia (basis points)

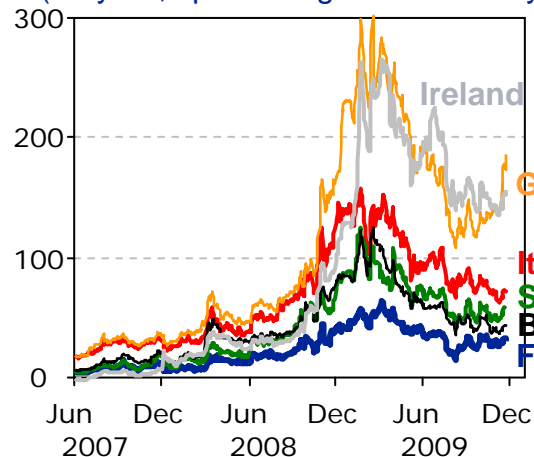
### 3-month interbank rate minus OIS rate



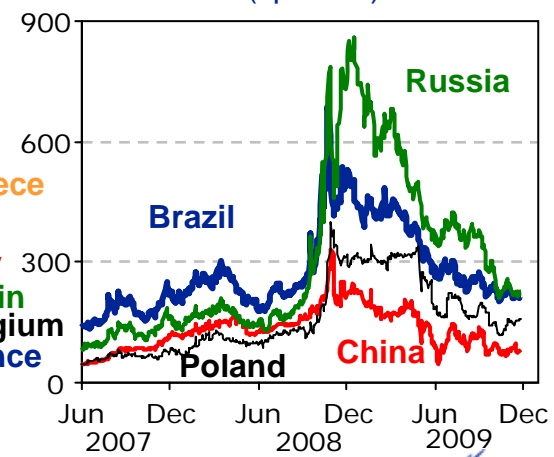
### High yield bonds (Merrill Lynch, OAS)



### Public bonds (10-year, spreads against Germany)

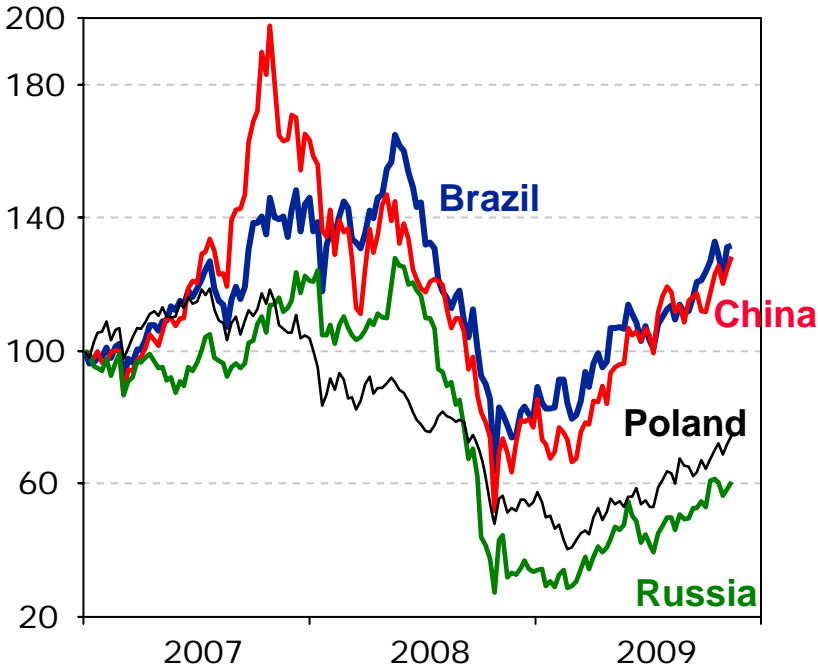
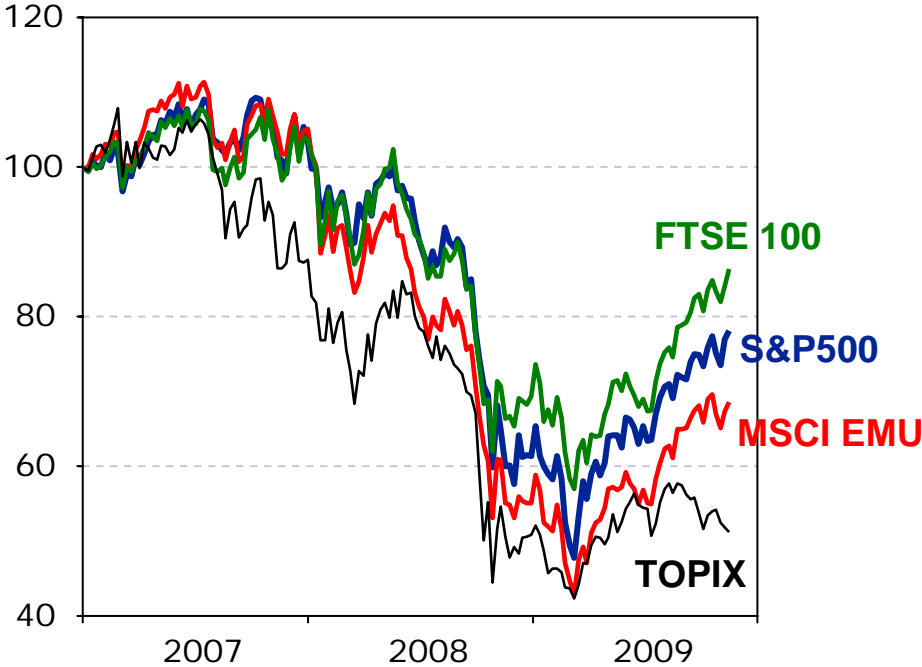


### EMBI+ (spreads)



# Stock markets have bounced back

## Stock market indices\* (2007 = 100)

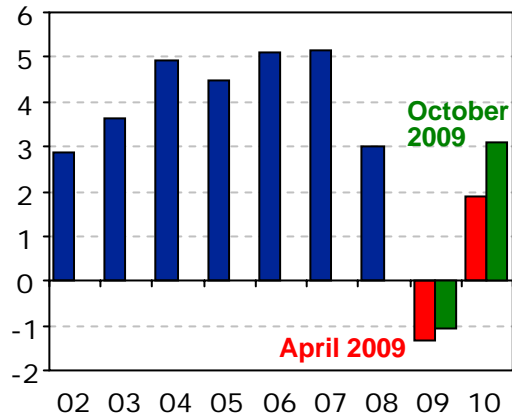


(\*) MSCI indices, unless otherwise specified.

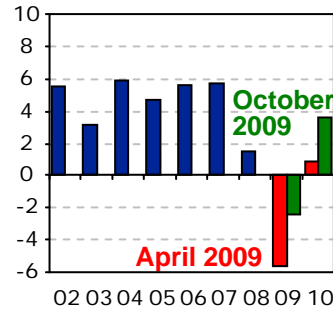
# For the first time since the beginning of the crisis, the IMF has revised *upwards* its growth forecasts

## IMF GDP growth forecasts (% year on year)

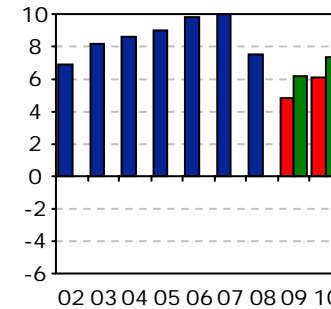
World



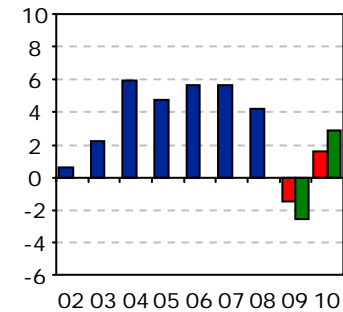
Newly Industrialized Asian Countries



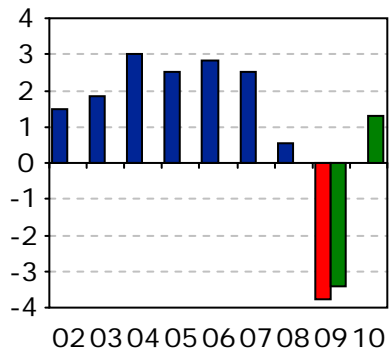
Developing Asia



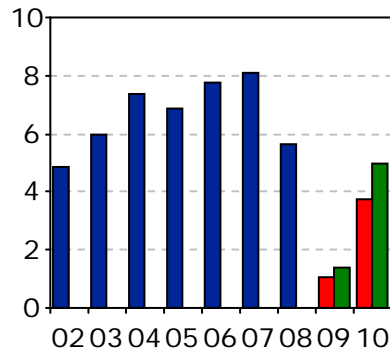
Latin America



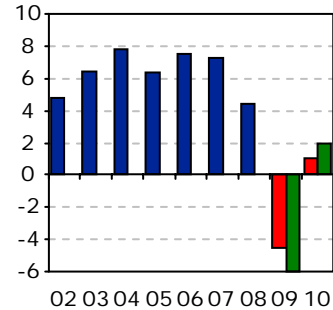
Developed countries



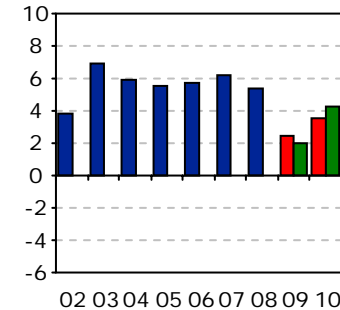
Emerging countries



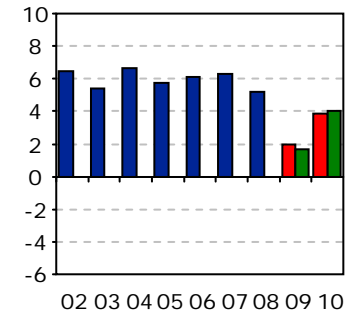
Central and Eastern Europe & CIS\*



Middle East

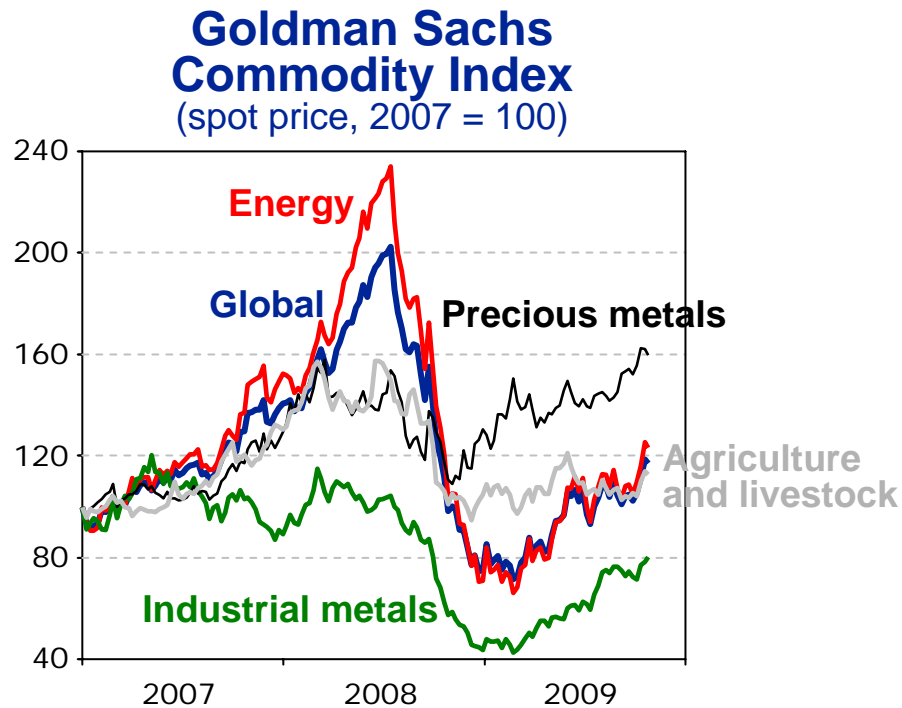


Africa

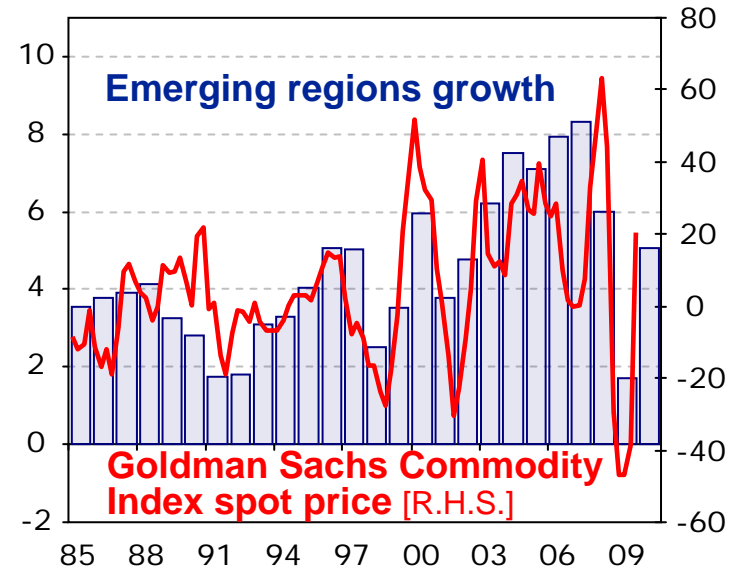


(\* ) Commonwealth of Independent States

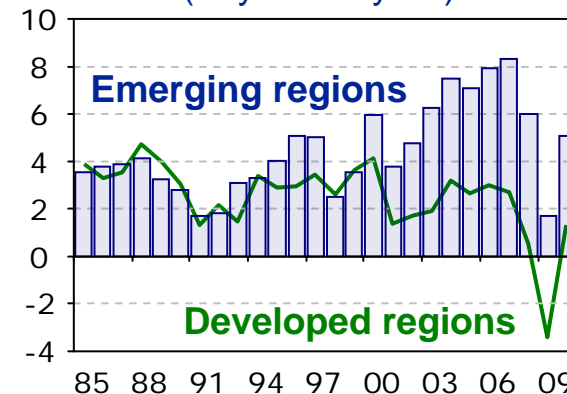
# The rise in commodity prices is another sign of confidence in the ending of the global recession



## Commodity prices and growth (% year on year)



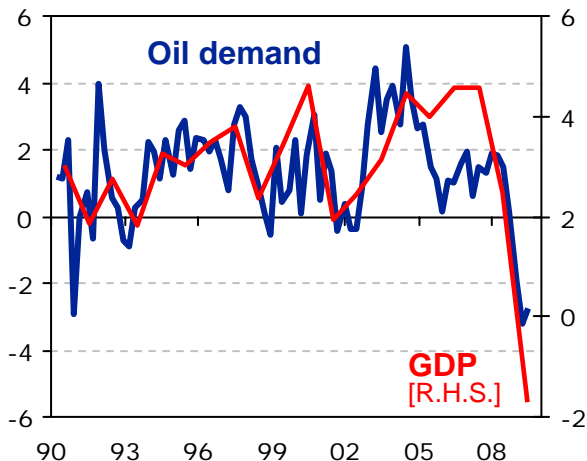
## World growth (% year on year)



# Another jump in oil price could however endanger the ongoing recovery

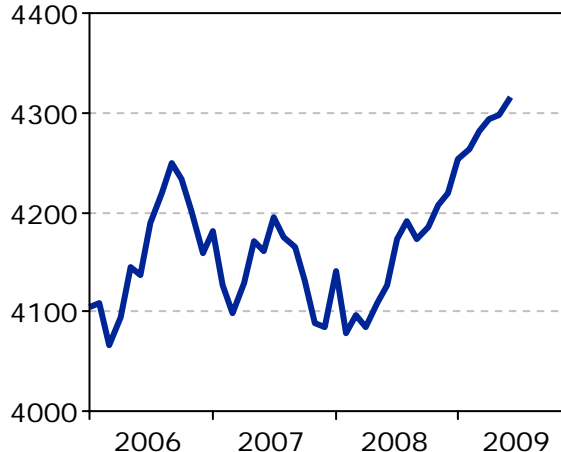
### World oil demand and GDP

(% year on year)



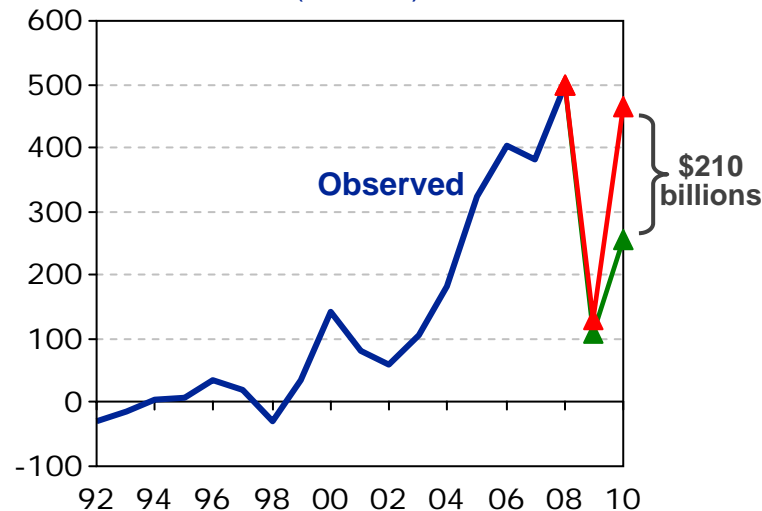
### OECD crude oil and petroleum stocks

(million barrels)

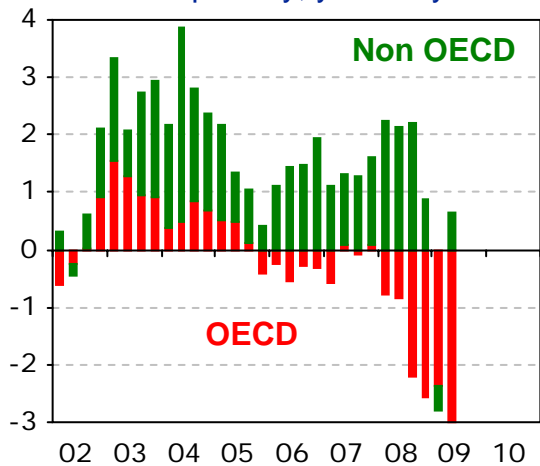


### OPEC and Russia's current account

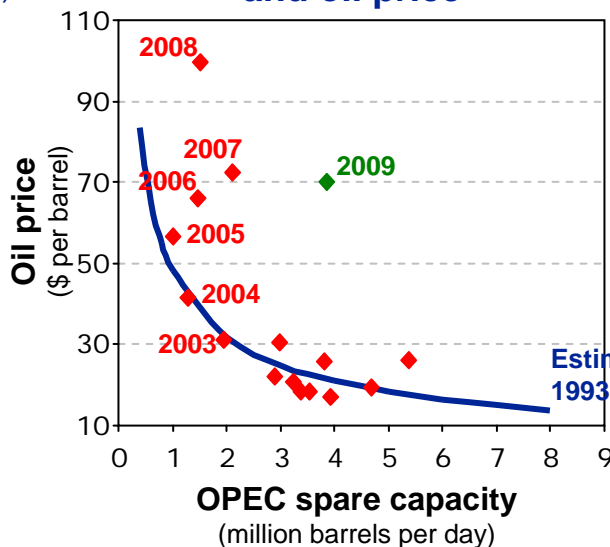
(\$ billion)



### World oil demand (million barrels per day, year on year change)

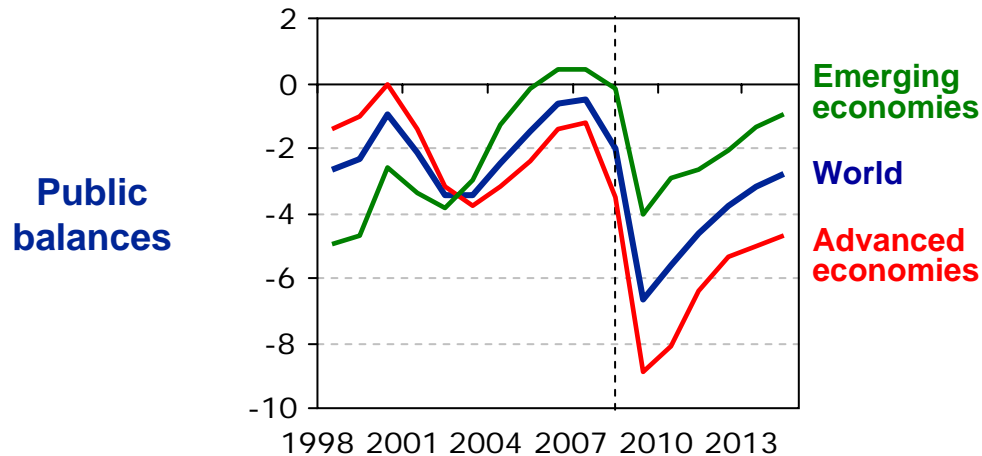


### OPEC spare capacity and oil price

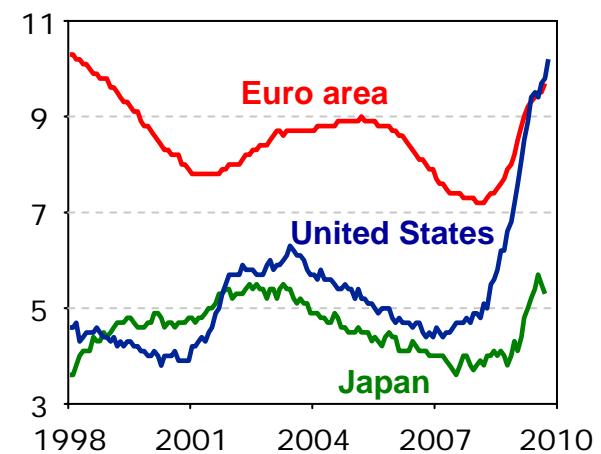
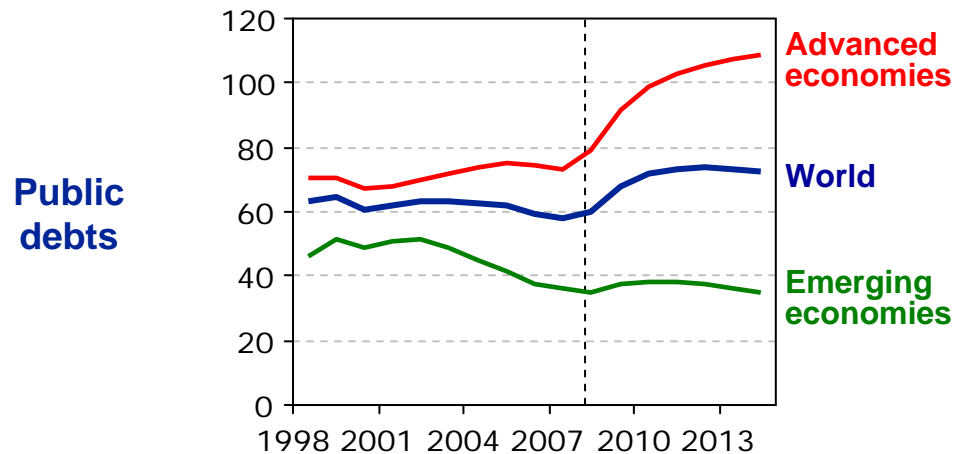
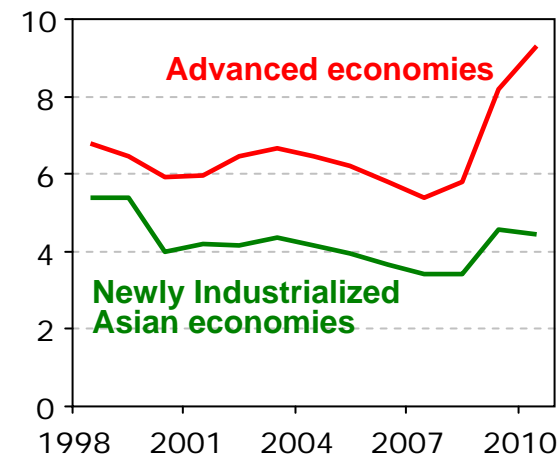


# In any case, the consequences of the crisis will be long to erase... especially for the developed economies

## Public deficits and debts (% of GDP)



## Unemployment rates (%)





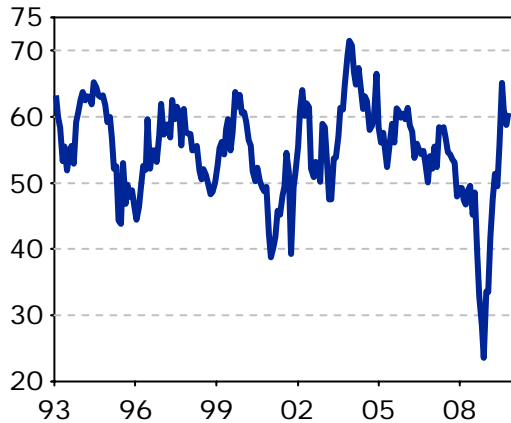
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## **United States**

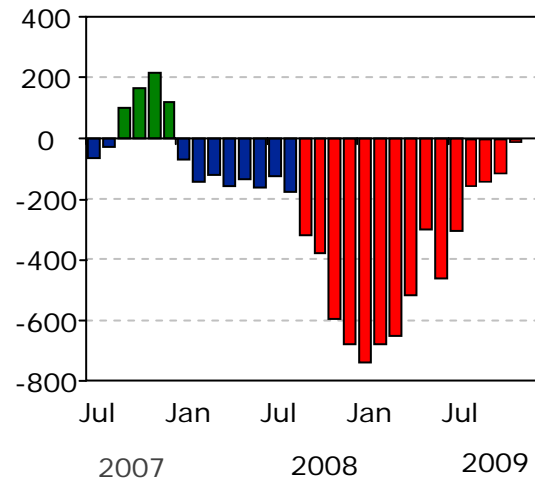
Bouncing back... but burdened with a heavy legacy!

# The worst is over... ... but the present is far from bright!

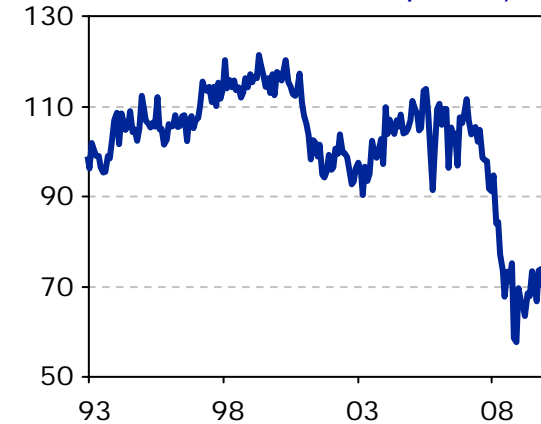
### Manufacturing ISM index (new orders component)



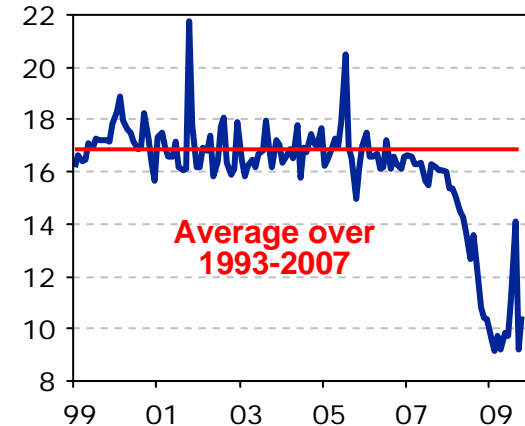
### Non farm payrolls (month on month change, thousands)



### Consumer confidence (Michigan index, current situation component)

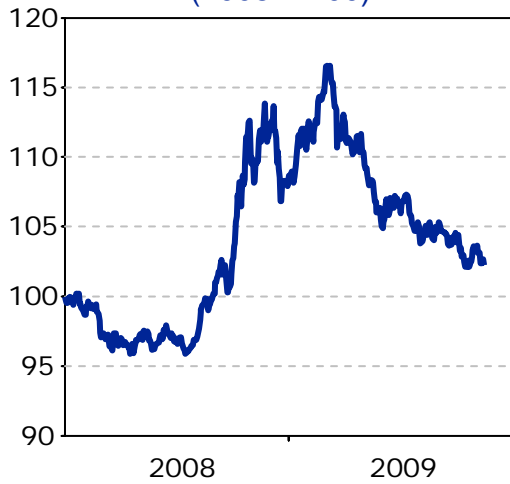


### Auto sales (millions at annual rate)

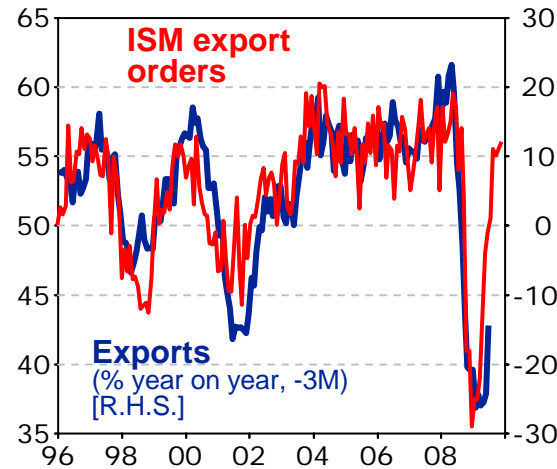


# In the coming quarters, exports should support growth

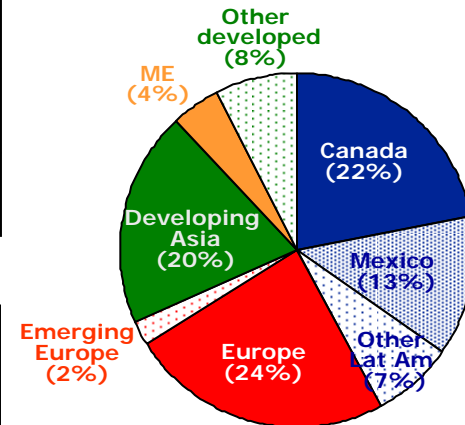
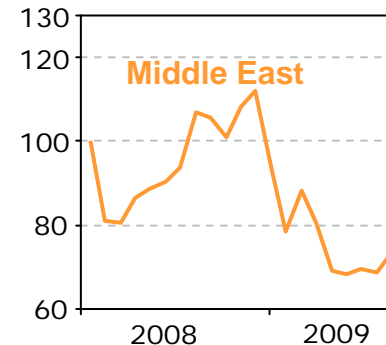
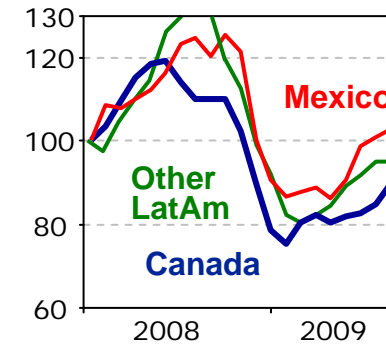
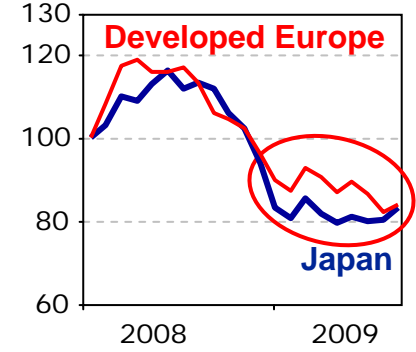
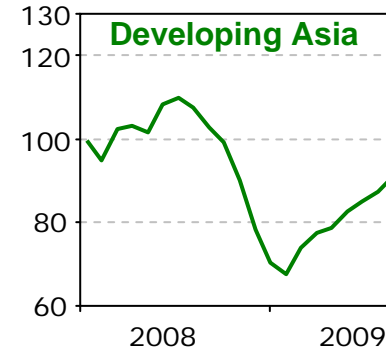
**Effective exchange rate**  
(2008 = 100)



**Export orders**



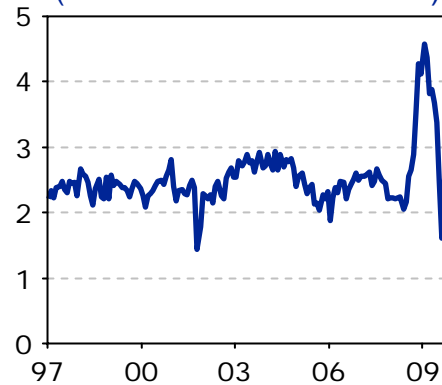
**US exports by destination**  
(2008 = 100)



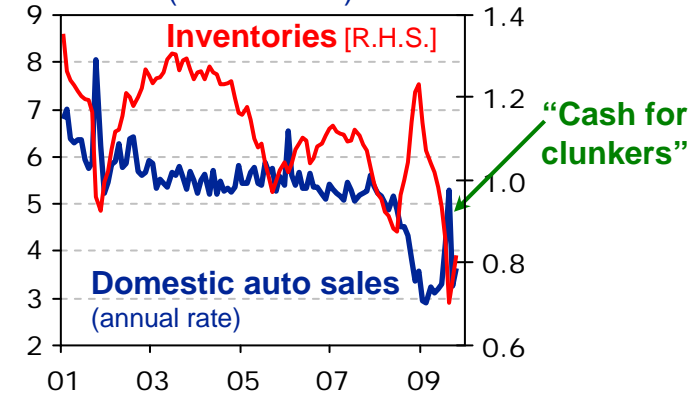
# The moderation in inventory liquidation will – temporarily – boost activity

## Automobile industry

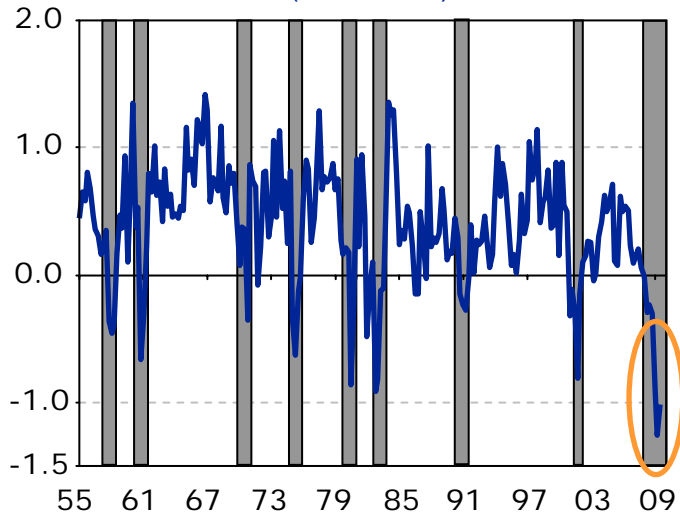
**Inventories to sales ratio**  
(in months of current sales)



**Inventories and sales**  
(million units)



**Change in inventories**  
(% of GDP)

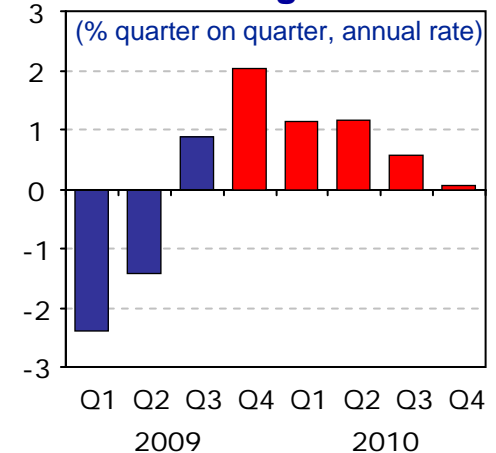


## Whole economy

**Inventories to sales ratio**  
(in months of current sales)

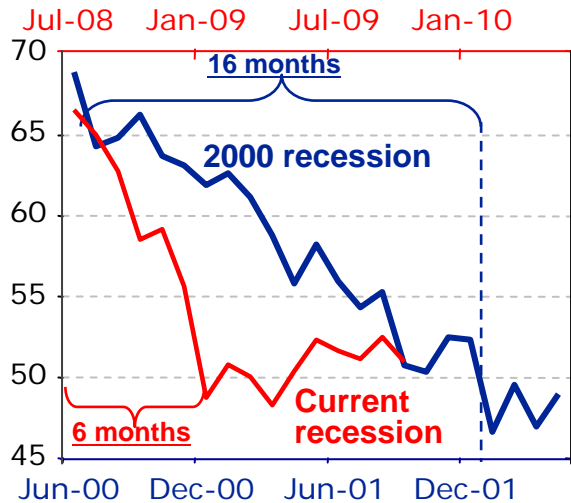


**Contribution of inventories to GDP growth**  
(% quarter on quarter, annual rate)



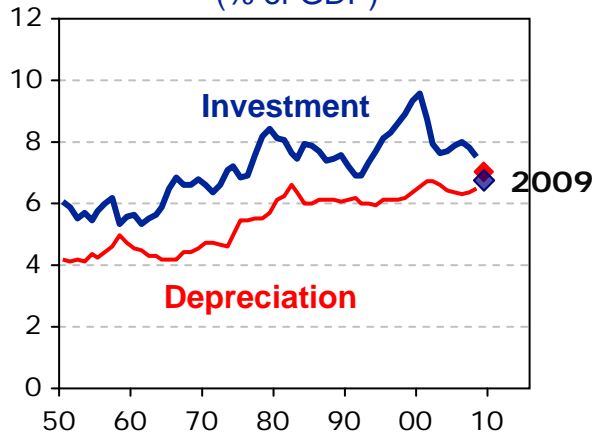
# A (modest) resumption of growth in equipment investment is likely...

## New orders of capital goods (\$ billion, non defense ex aircrafts)

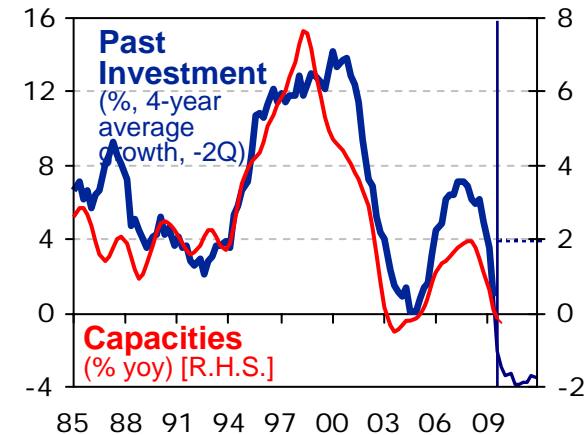


- With the actual low rate of growth of investment and a 4% increase in industrial production.
- ..... Assuming past investment would have grown as at the end of the 80's (around 4%).

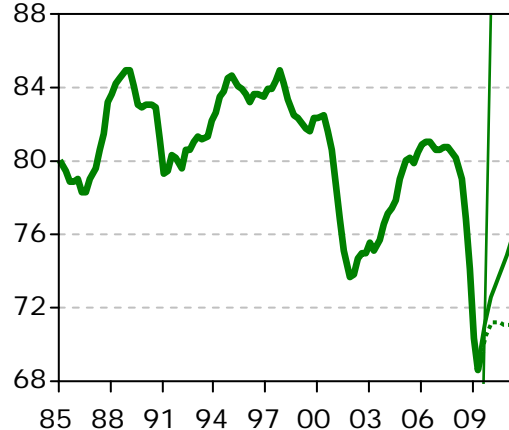
## Investment and capital depreciation (% of GDP)



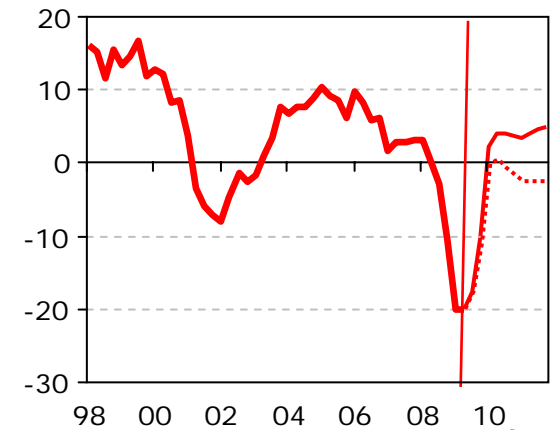
## Investment and production capacities



## Capacity Utilization Rate (%)

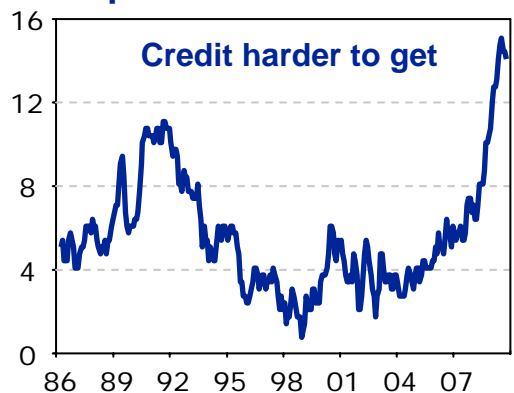


## Equipment investment (% year on year)

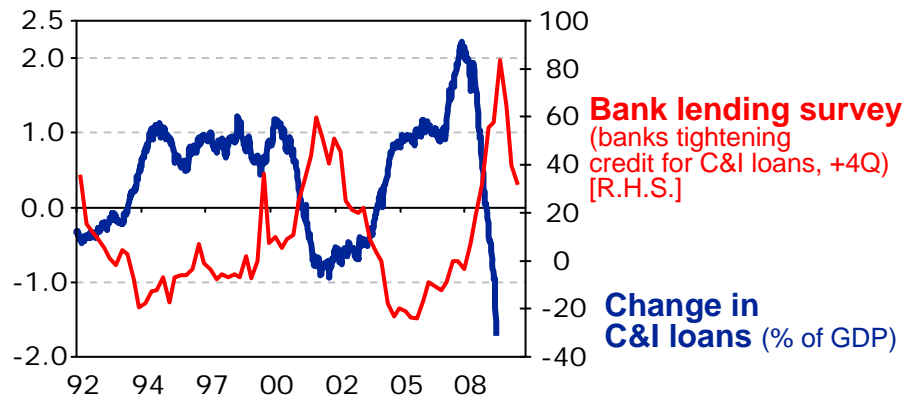


# ... despite borrowing conditions far from having normalized, especially for small firms

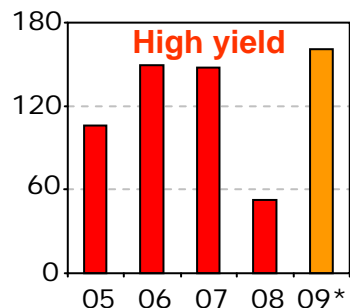
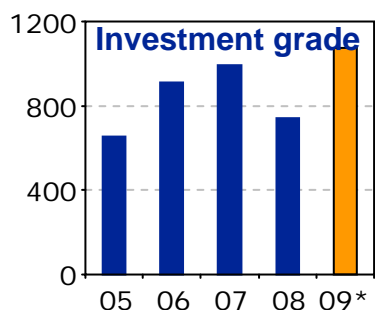
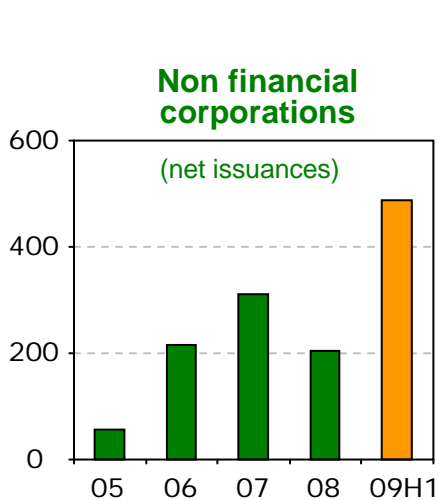
National Federation of Independent Business survey



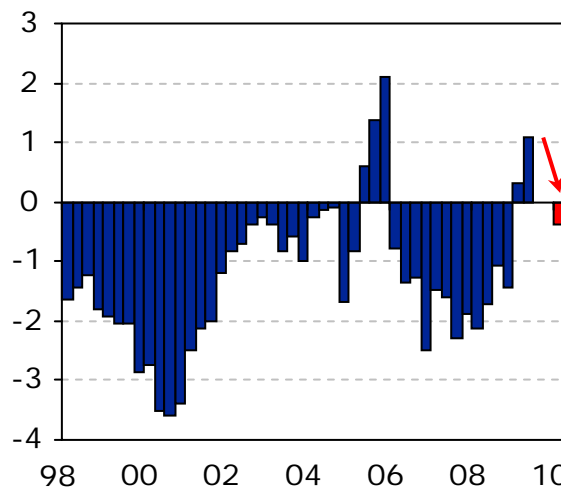
Credit conditions and commercial and industrial loans



Corporate bonds issuances (\$ billion, annual rate)



Nonfinancial corporate financial surplus or deficit (% of GDP)

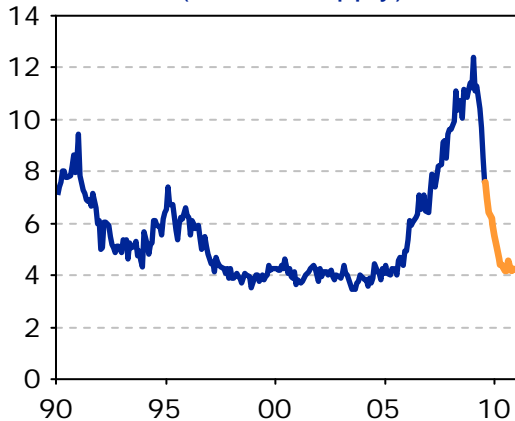


➔ Assuming a modest recovery of business capital expenditures, the non financial corporations financing gap should be easily financed.

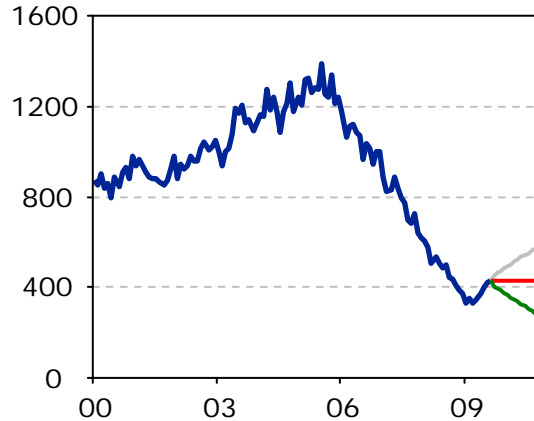
(\*) 9 months for 2009.

# Residential investment should also firm, but will be of only small help to GDP

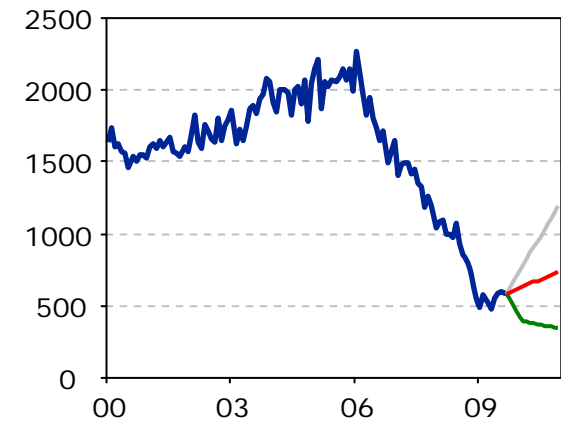
**New houses for sale to houses sold**  
(months supply)



**New home sales**  
(thousands of units, annual rate)



**Housing starts**  
(thousands of units, annual rate)

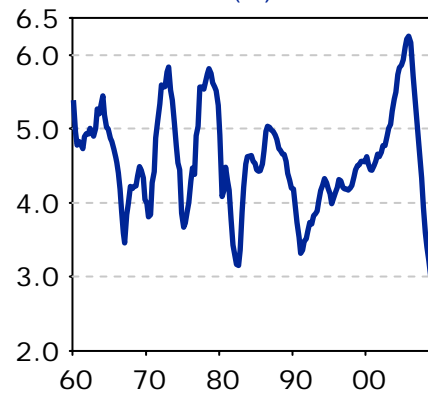


## Residential investment

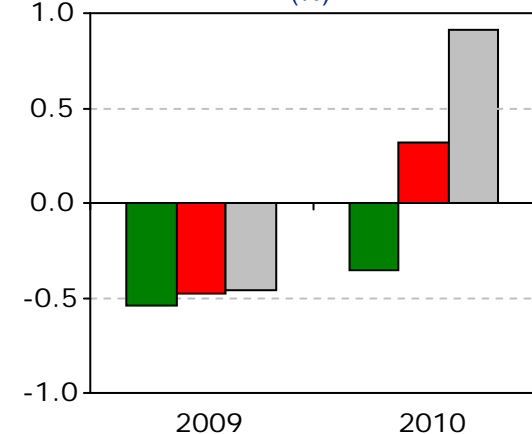
**% year on year**



**Share of GDP**  
(%)

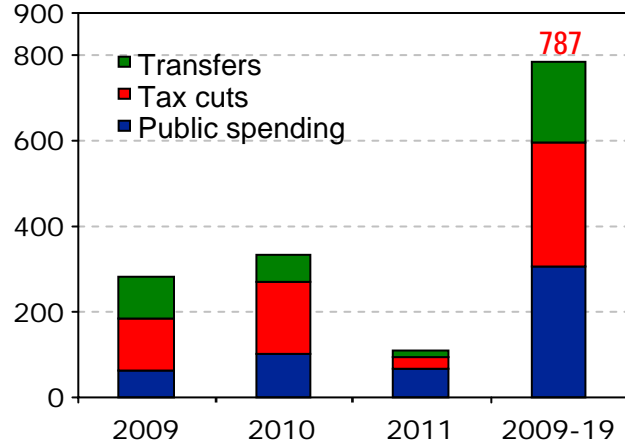


**Contribution to GDP**  
(%)



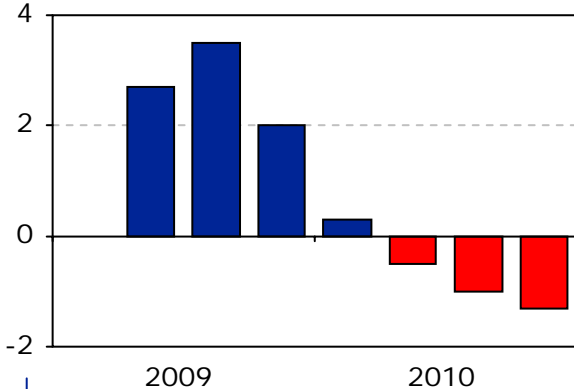
# The effect of the “Obama plan” will fade...

“Obama” plan (ARRA\*)  
(\$ billion)



(\*) American Recovery and Reinvestment Act

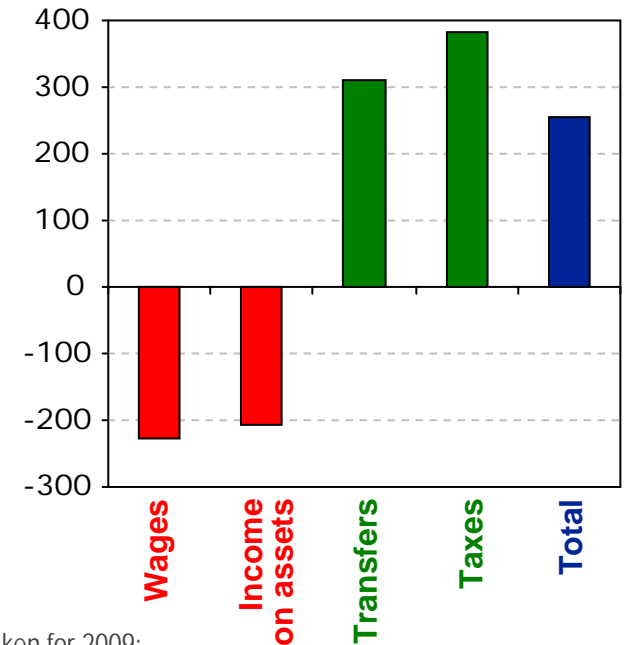
Estimated contribution  
of the ARRA to growth  
(% quarter on quarter, annual rate)



Disposable income  
versus wages  
(2006 = 100)



Change in  
disposable income  
(\$ billion, Oct. 2009 / Oct. 2008)



Measures taken for 2009:

- \$35 bn in tax refunds;
- \$40 bn in tax reductions;
- one-time \$250 checks sent to Social Security recipients (\$14 bn);
- cost of living adjustment for Social Security recipients (\$36 bn).

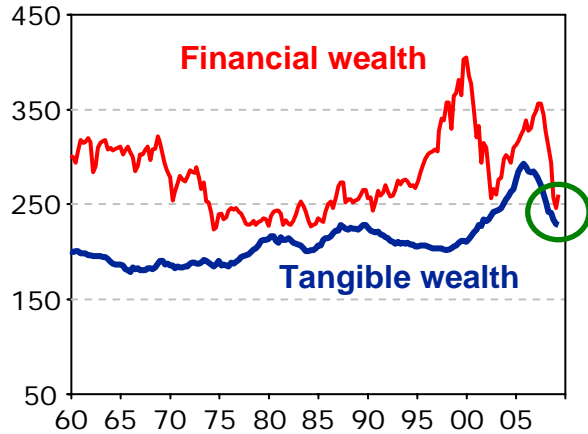
Together, these measures will increase households' disposable income by \$125 bn (or a 1% rise in income).



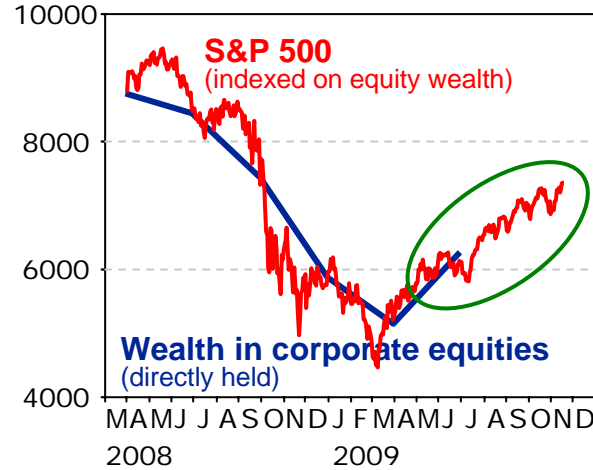
# ... but if sustained, the recent rise in household wealth will provide a significant offset

## Household wealth

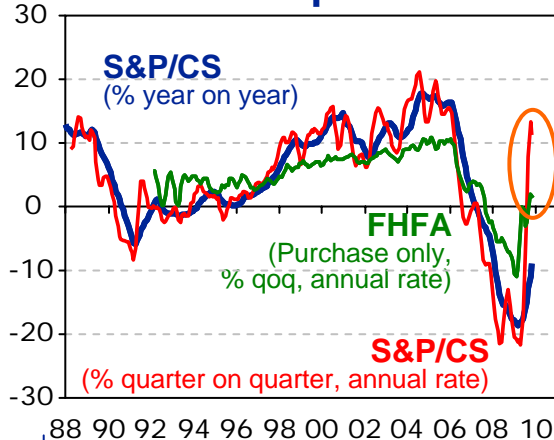
**Household wealth**  
(% of disposable income)



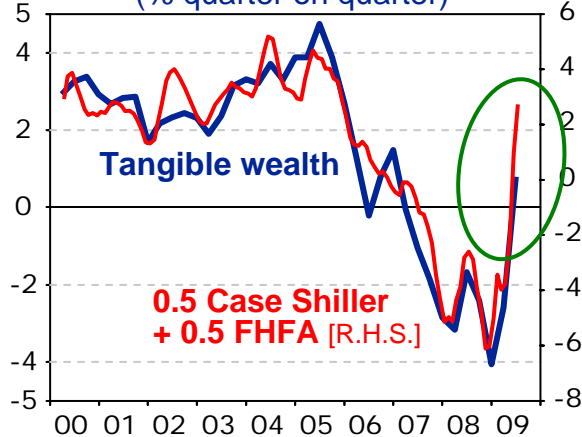
**Equity wealth**  
(\$ billion)



**Home prices**



**Real estate wealth**  
(% quarter on quarter)



**Effect on consumption of the rise in household wealth**  
(\$ billion, Q3/Q2 2009)

Equity shares (with an S&P at 1050):

- directly held + 800
- indirectly held + 800

Real estate:

+ 500

**Total wealth change + 2 100**

**Effect on consumption** + 105  
(with a propensity to consume wealth equal to 0.05)

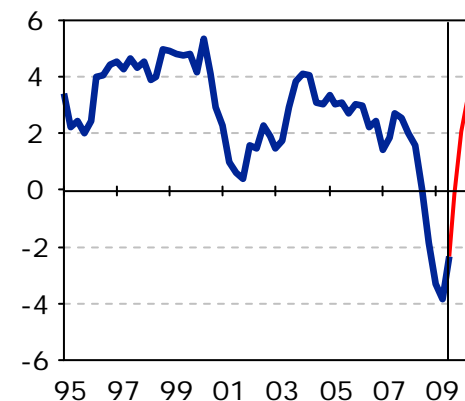
**Effect on consumption + 1.0%**

# All in all, GDP growth could well reach close to 3% next year

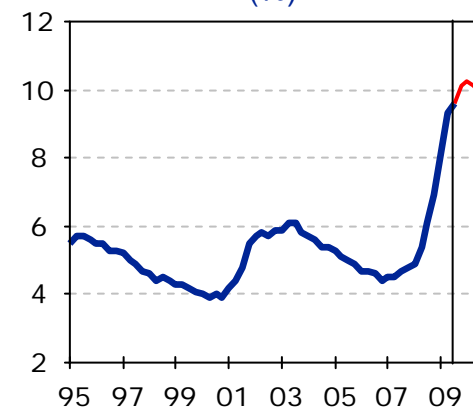
## GDP growth in the United States

(% quarter on quarter annual rate)	Q4 08	Q1 09	Q2 09	Q3 09	2005	2006	2007	2008	2009	2010
<b>Consumption</b>	-3.1	0.6	-0.9	2.9	3.4	2.9	2.7	-0.2	-0.5	1.8
<b>Investment</b>	-21.0	-38.7	-12.3	1.1	6.5	2.3	-2.2	-5.5	-18.3	2.3
- Residential	-23.2	-38.2	-23.2	19.5	6.2	-7.3	-18.5	-22.9	-20.0	10.9
- Equipment	-25.9	-36.4	-4.9	2.3	8.5	7.4	2.6	-2.6	-17.6	2.7
- Structures	-7.2	-43.6	-17.3	-15.2	1.5	9.2	14.9	10.3	-18.3	-6.4
<b>Inventory changes (\$ billion)</b>	-37.4	-113.9	-160.2	-133.0	49.9	59.4	19.5	-25.9	-117.2	42.0
<b>Government</b>	1.2	-2.6	6.7	3.1	0.3	1.4	1.7	3.1	2.1	1.1
<b>External balance (\$ billion)</b>	-471	-387	-330	-358	-723	-729	-648	-494	-356	-378
- Exports	1568	1435	1420	1476	1305	1422	1546	1629	1458	1591
- Imports	2039	1821	1750	1834	2028	2151	2194	2124	1814	1970
<b>GDP</b>	<b>-5.4</b>	<b>-6.4</b>	<b>-0.7</b>	<b>2.8</b>	<b>3.1</b>	<b>2.7</b>	<b>2.1</b>	<b>0.4</b>	<b>-2.4</b>	<b>2.8</b>

**GDP growth**  
(% year on year)



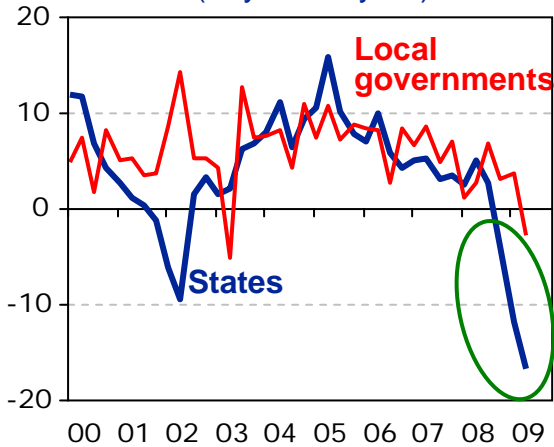
**Unemployment rate**  
(%)



**Still, many downside risks remain...**

# State and local governments are in a difficult financial situation

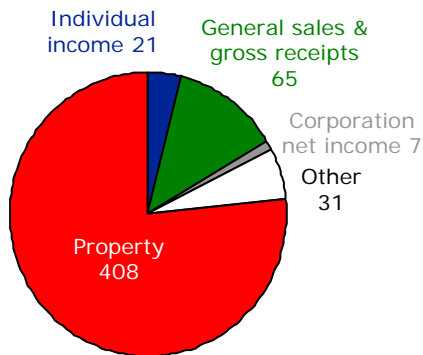
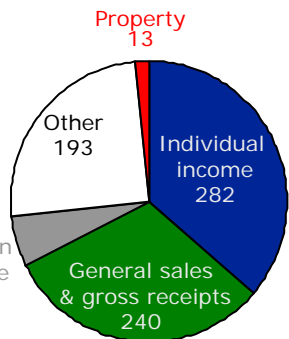
## State and local tax revenues (% year on year)



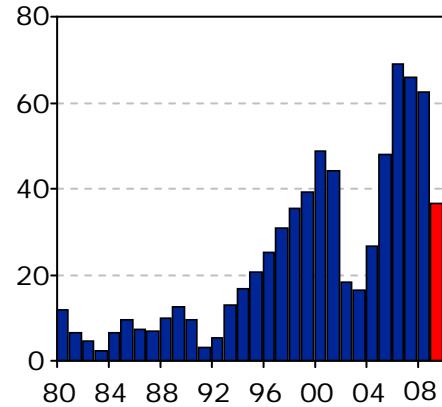
## 2008 tax revenues (\$ billion)

Total States = \$774

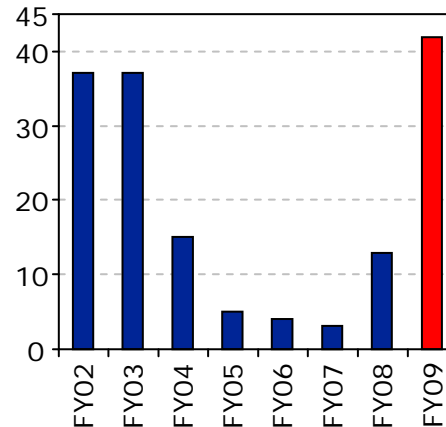
Total Local = \$532



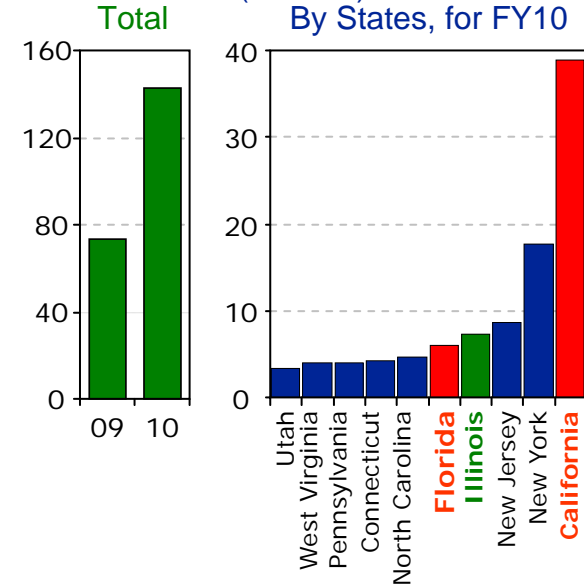
## Rainy day funds (\$ billion)



## Number of States taking corrective measures



## Budget gaps (\$ billion) By States, for FY10



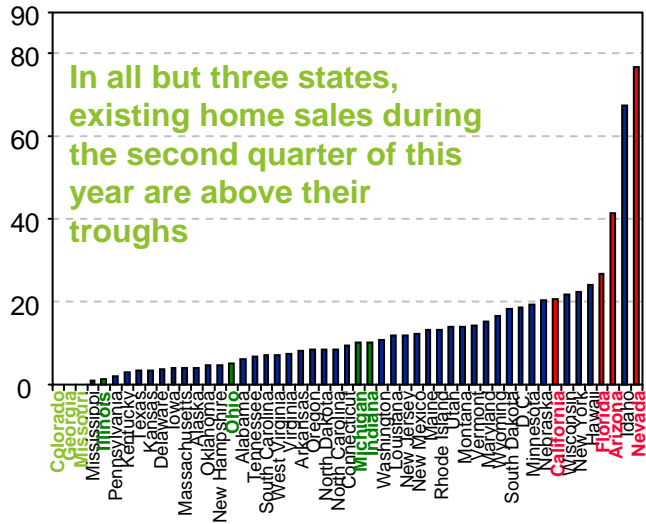
→ State and local governments' fiscal adjustments should not hinder a recovery, but could easily subtract 0.5% of GDP growth in 2010.

→ Part of this could be offset by more federal assistance.

# The rebound in home sales should be interpreted with caution

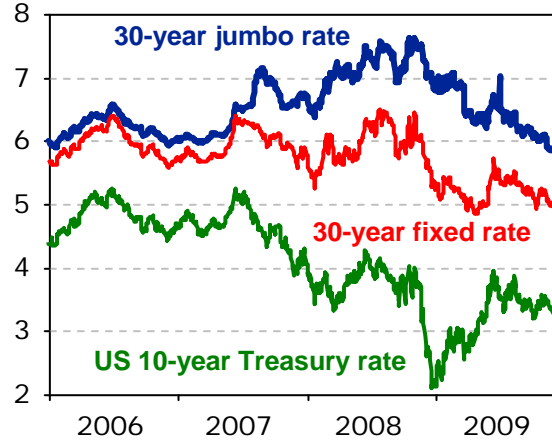
## Home sales

(2009Q2 level compared with trough level, %)

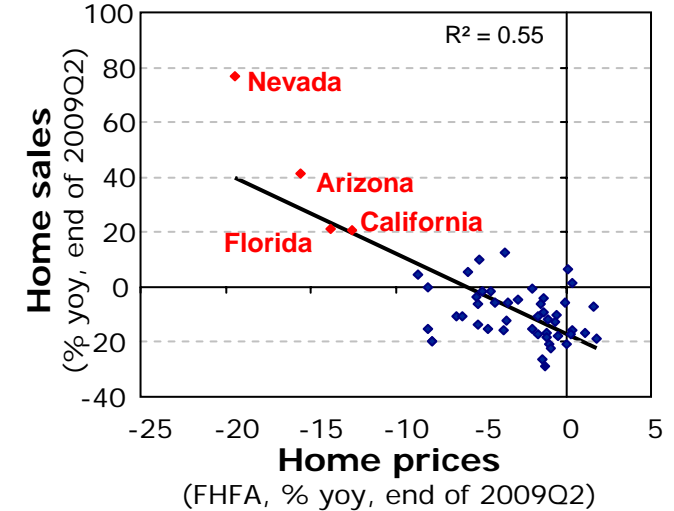


## Mortgage interest rate

(as given by Bankrate, %)

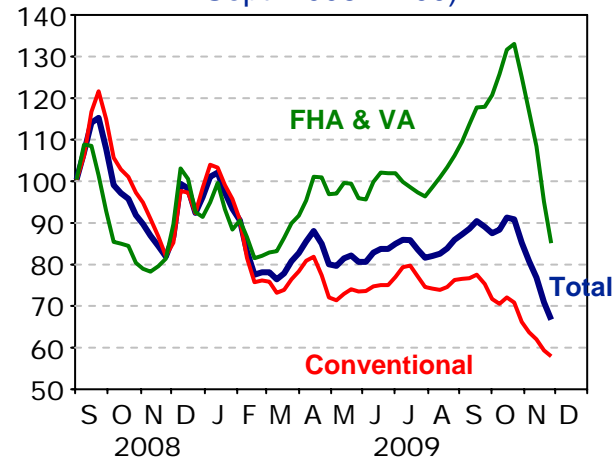


## Home prices and home sales



## New mortgage applications

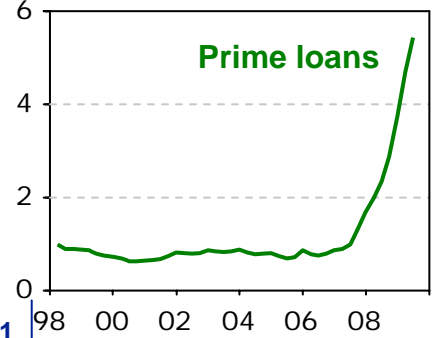
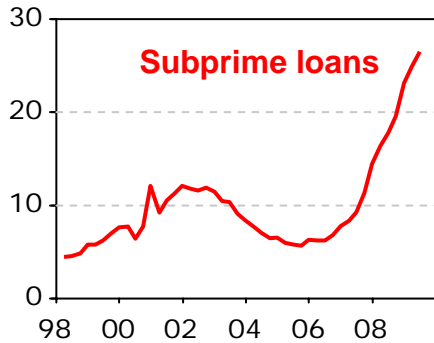
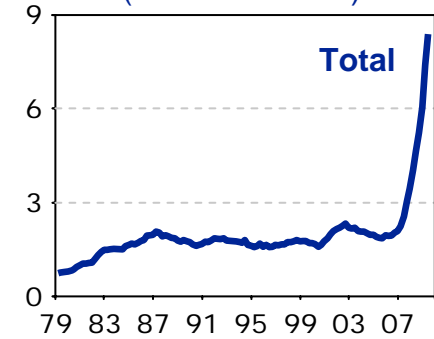
(purchase index, 2-week average, Sept. 2008 = 100)



# Foreclosures are likely to stay elevated for a while...

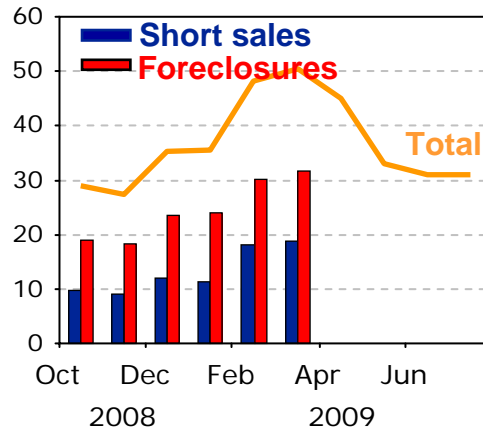
## Seriously delinquent mortgage loans

(% of total loans)



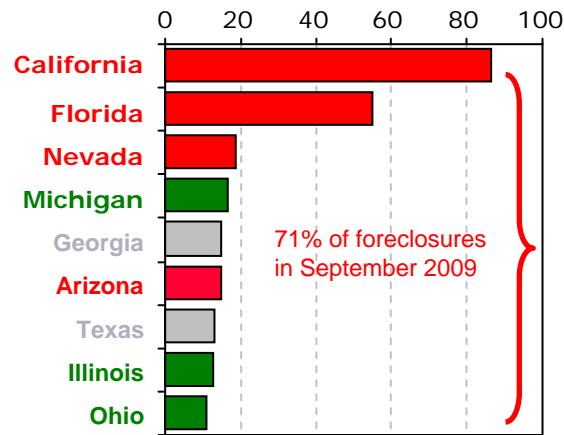
## Distressed sales

(% of total sales)



## Foreclosures by State

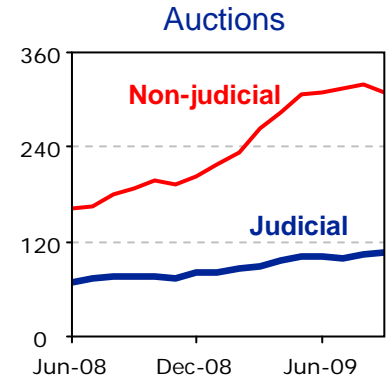
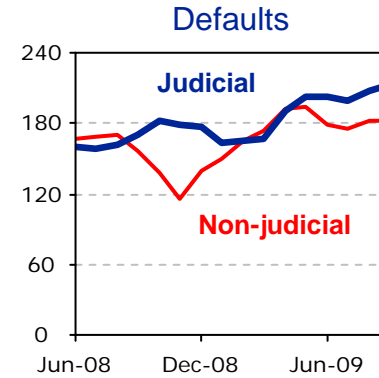
(thousands)



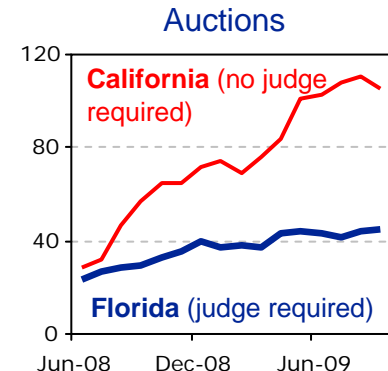
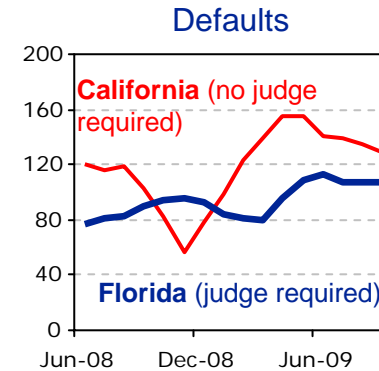
## Judges or no judges?

(thousands, over 3 months)

### United States

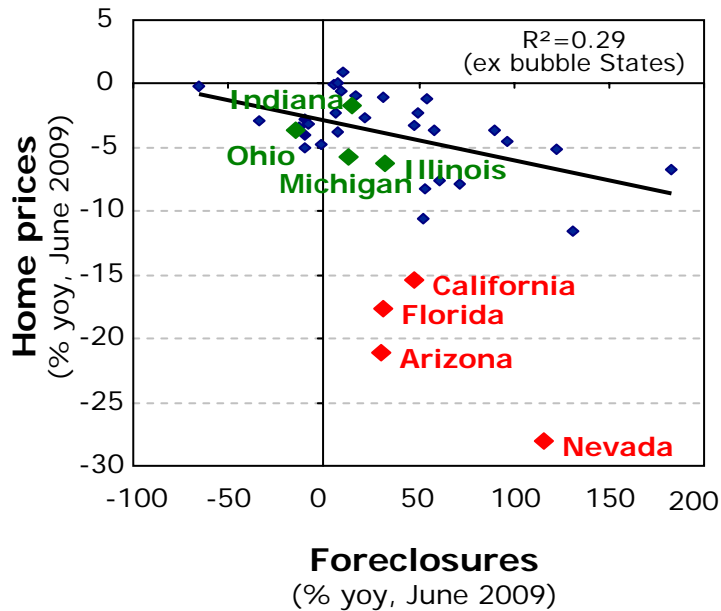


### California versus Florida

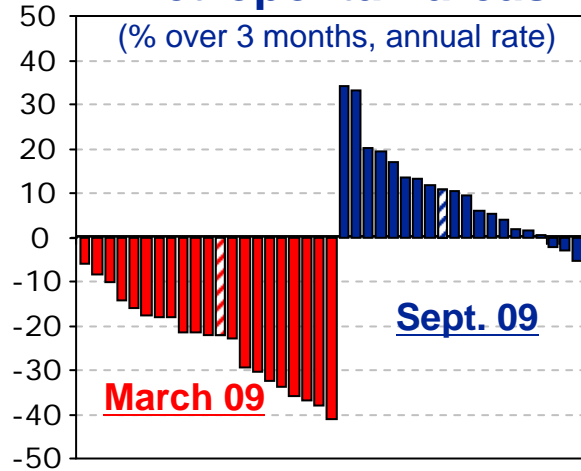


# ... and put pressure on home prices

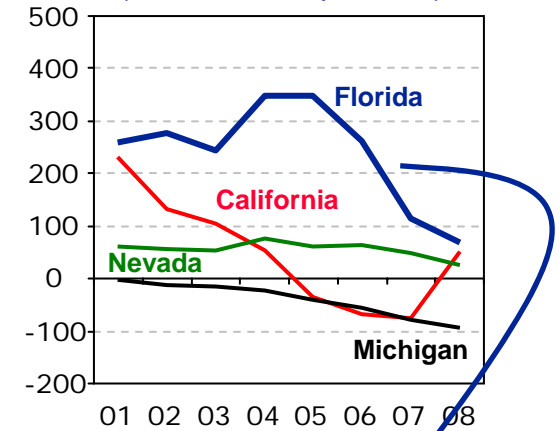
## Foreclosures and housing prices



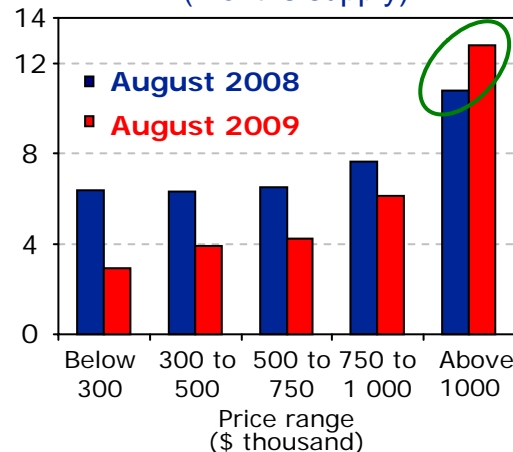
## Home prices by metropolitan areas



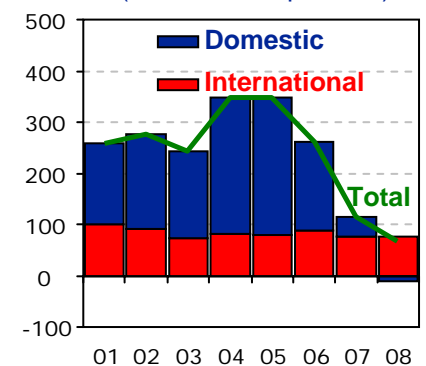
## Net migration by selected States



## Inventory to sales in California

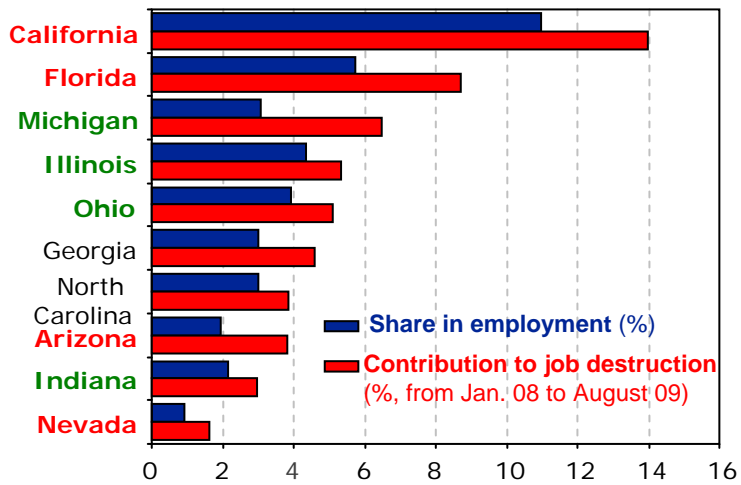


## Net migration in Florida



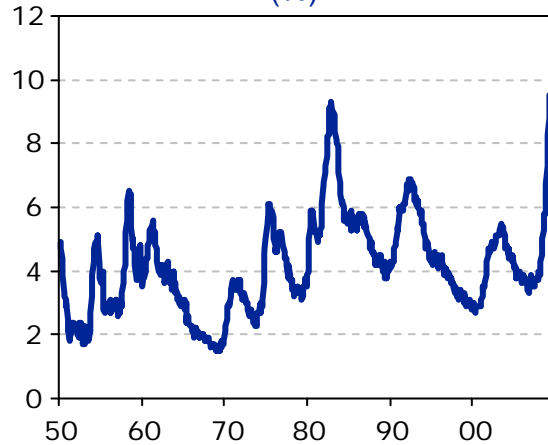
# The labor market will remain weak... ... for a considerable period of time!

## Job losses by State

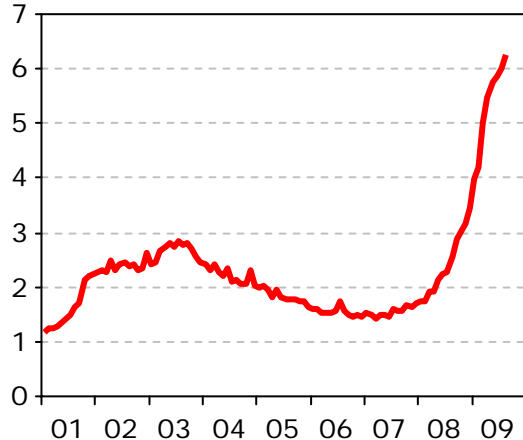


**Housing bubble** and **industrial Midwest States** have absorbed 50% of job losses, while accounting for 1/3 of employment

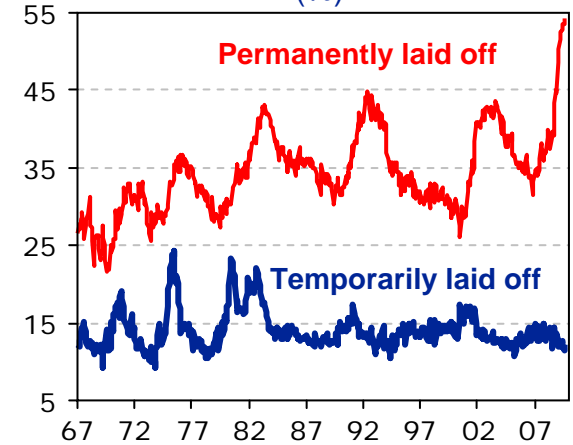
## Unemployment rate for men between the age 25 and 54 (%)



## Number of job seekers per job opening

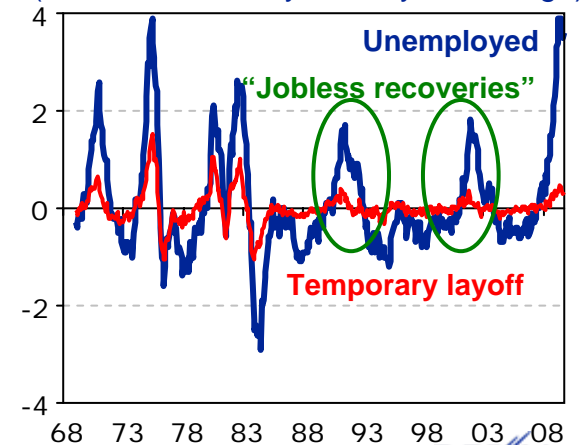


## Composition of unemployment (%)



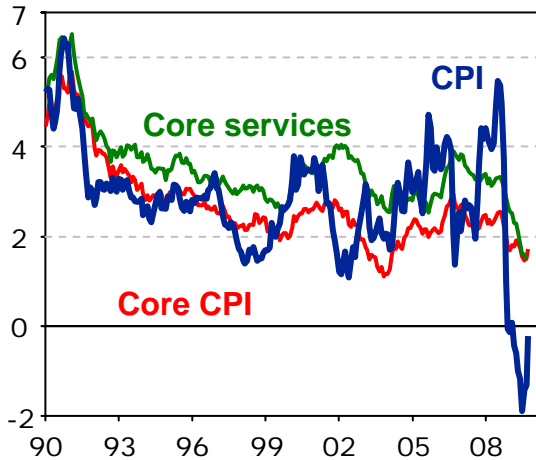
## Temporarily laid off and unemployed

(% of labor force, year on year change)

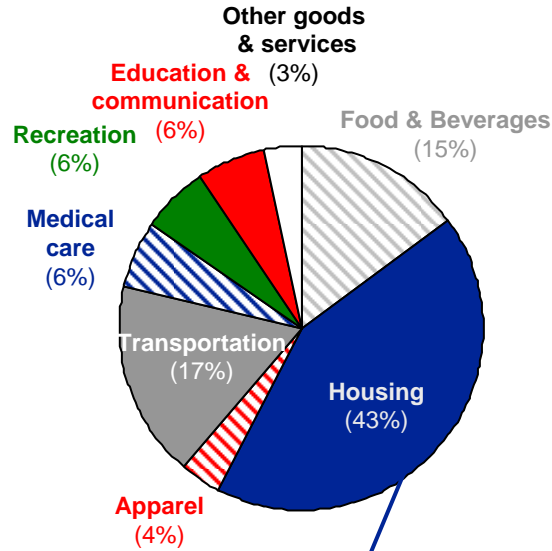


# In such a context, inflation should remain tame for a while

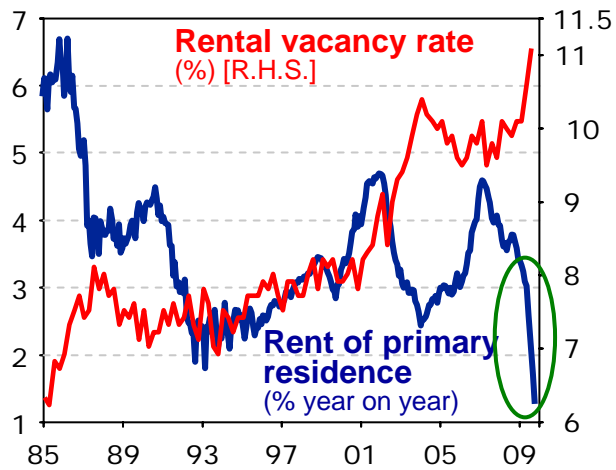
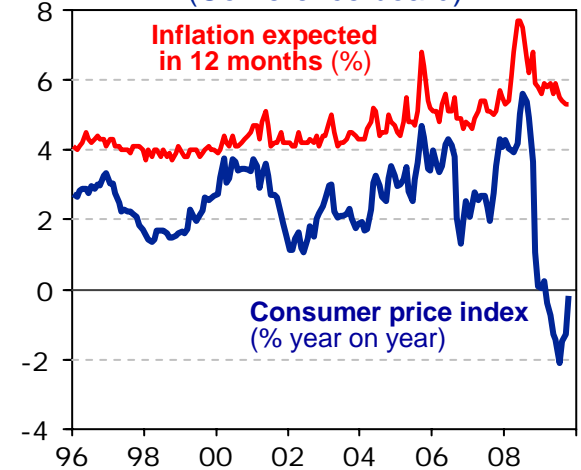
## Inflation in the US (% year on year)



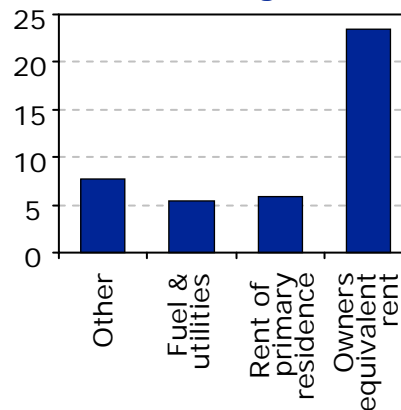
## Share of CPI



## Inflation expectations Households expectations (Conference board)



## Share of housing in the CPI



## TIPS (%)





## Conclusions

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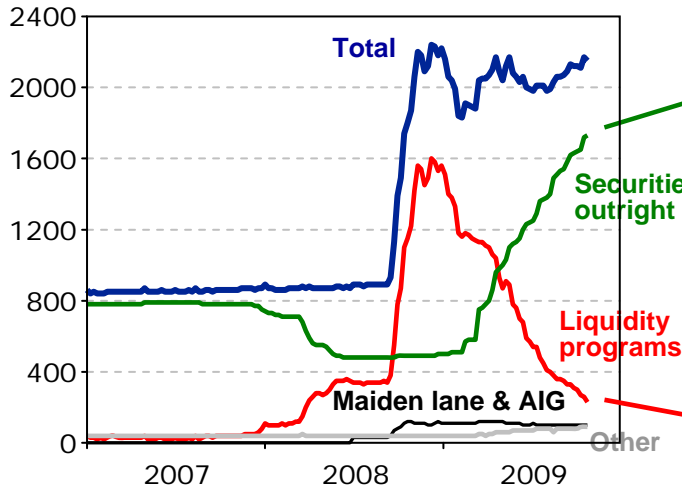
- After a deep recession, growth should be close to 3% in 2010, while unemployment stays elevated and inflation contained.
- The timely implementation of fiscal and monetary “exit strategies” is the policy challenge of the coming years.
- Short term rates will remain unchanged for a big part of next year, while long term rates move back to around 4.25%... in a more or less orderly manner.
- Despite its recent rise, the stock market is far from being overvalued.

# Addenda: the Fed liquidity programs are in a run-off mode, while the debt purchase program is close to an end

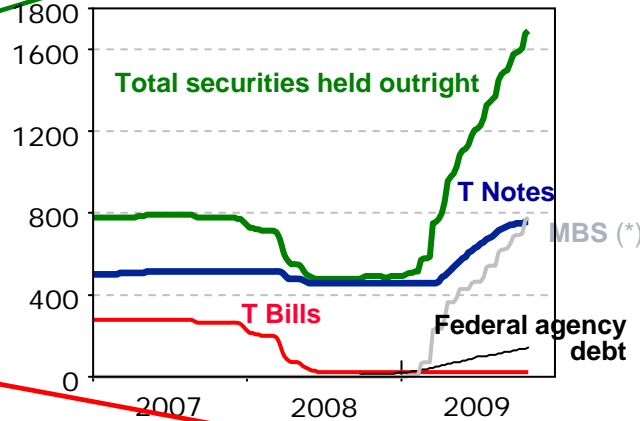
## Balance sheet of the Federal reserve

(\$ billion)

### Assets

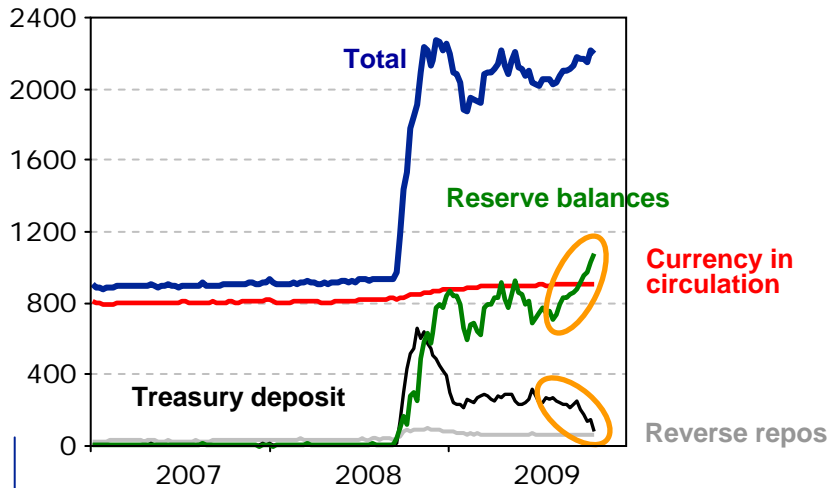


### Securities held outright

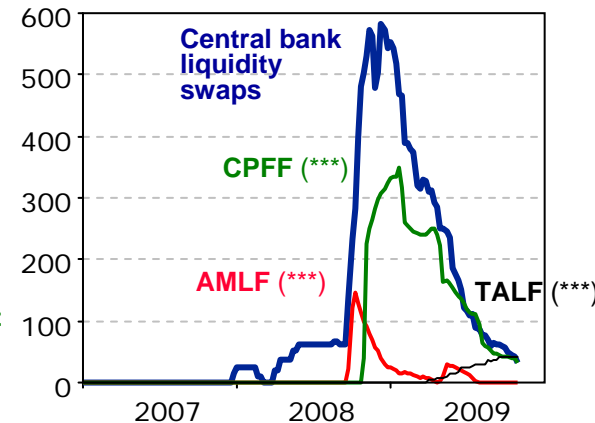
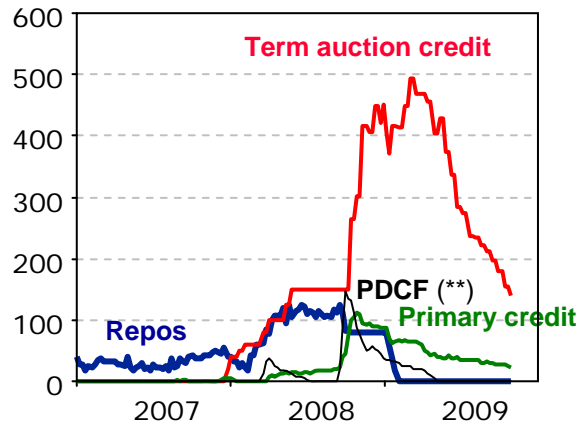


- (\*) MBS: Mortgage-Backed Securities
- (\*\*) PDCF: Primary Dealer Credit Facility
- (\*\*\*) CPFF: Commercial Paper Funding Facility
- AMLF: ABCP Money market mutual fund Liquidity Facility
- TALF: Treasury ABS Liquidity Facility

### Liabilities



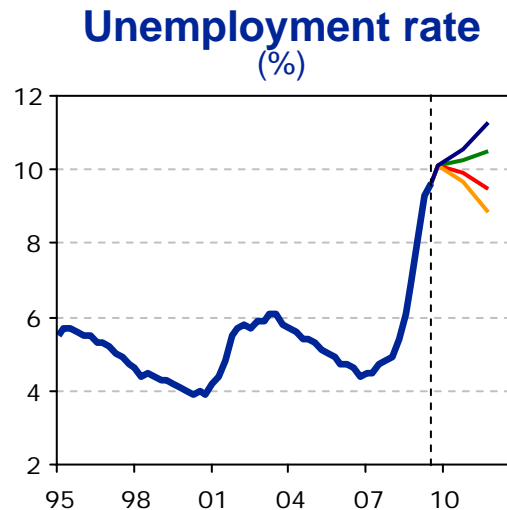
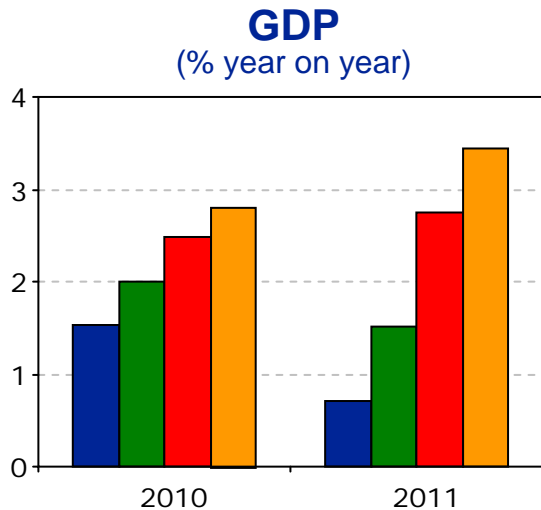
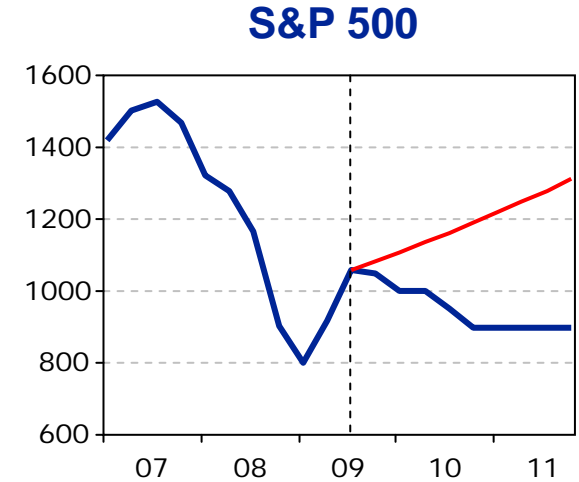
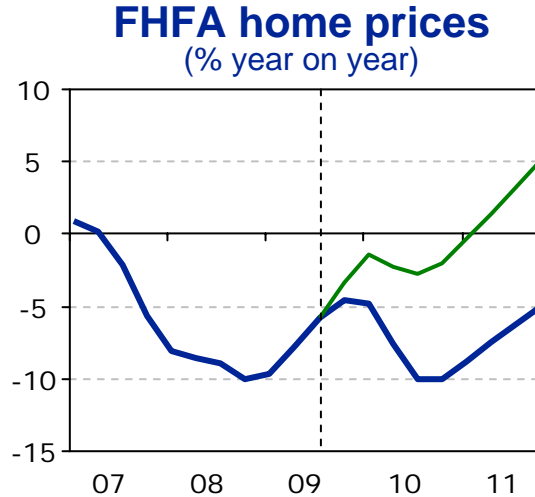
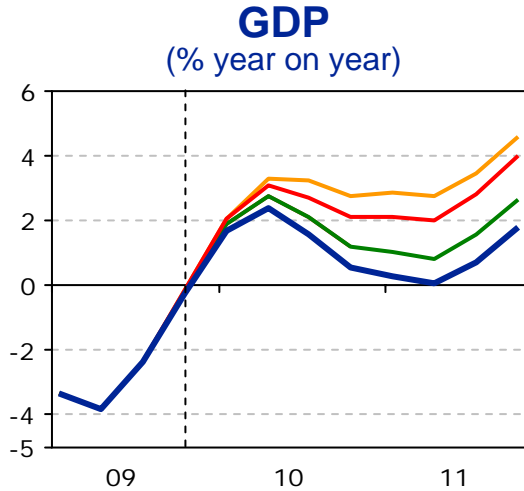
### Liquidity programs



Source: Thomson Datastream



# Addenda: much of the 2010-11 GDP outcome will depend on how asset prices behave in the coming quarters



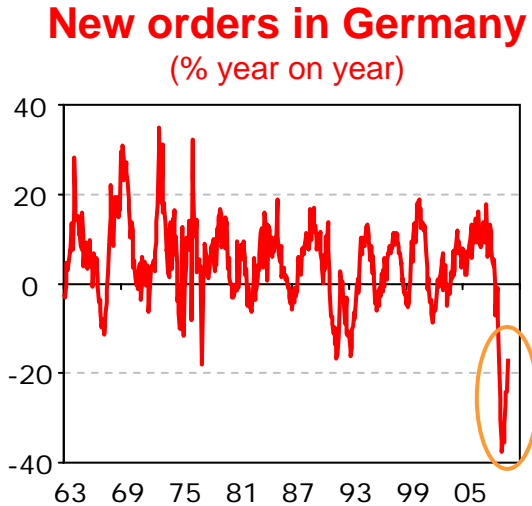
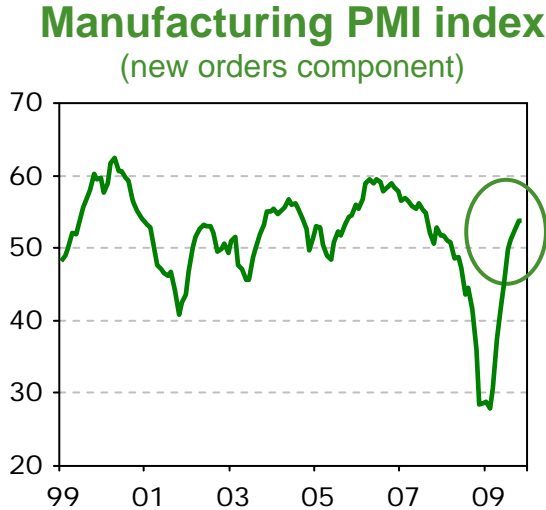
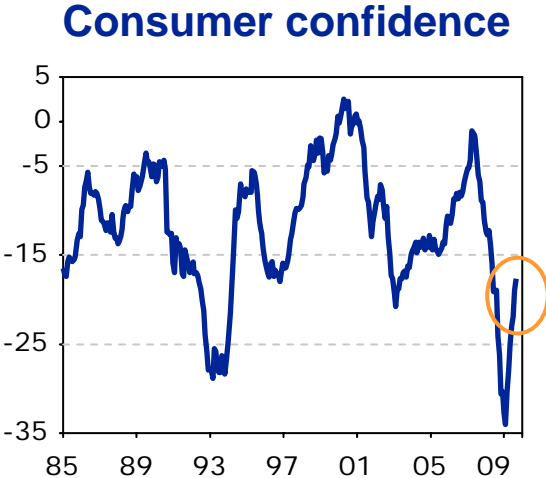
- World demand 1% lower than expected and weak asset prices.
- Some pick up in housing prices
- The S&P continues to climb
- Expected world growth and an additional 3% decline in the real effective exchange rate.

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# **Euro area**

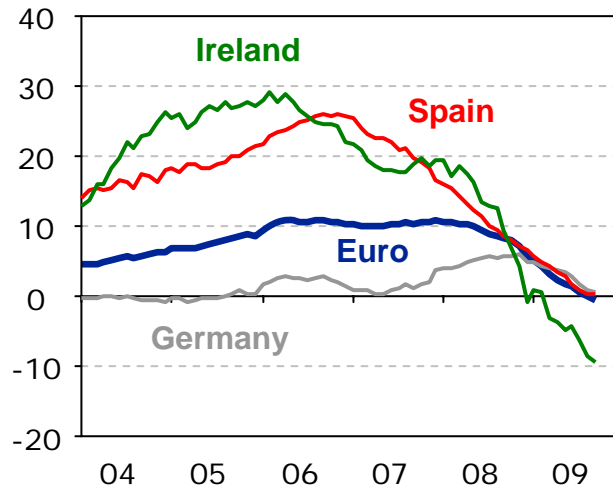
## Growing... with the rest of the world

# As the United States, the Euro area has been severely hit

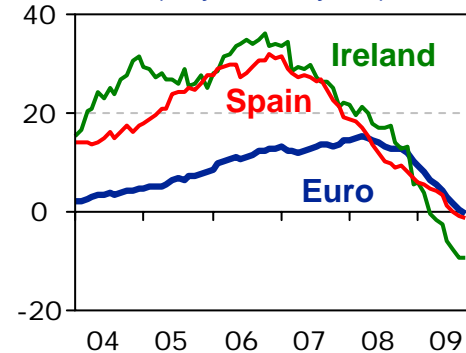


# In a few European countries – Ireland and Spain in particular – credit growth faltered...

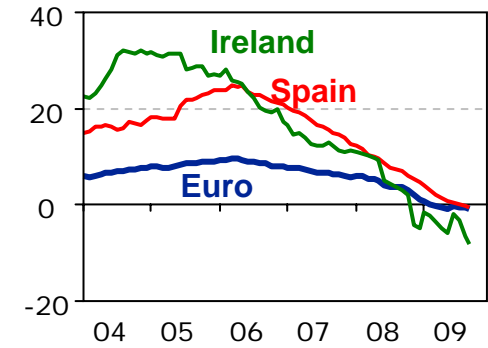
**Credit to the private sector**  
(% year on year)



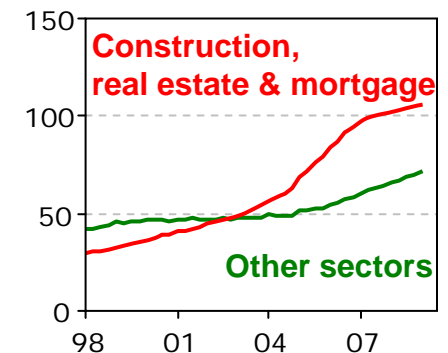
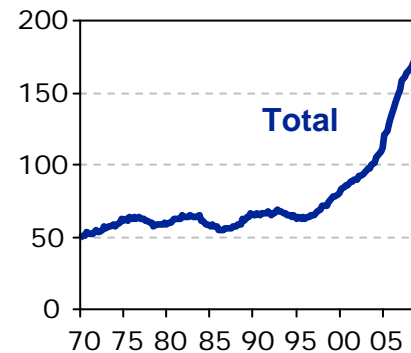
**Loans to non financial corporations**  
(% year on year)



**Loans to households**  
(% year on year)



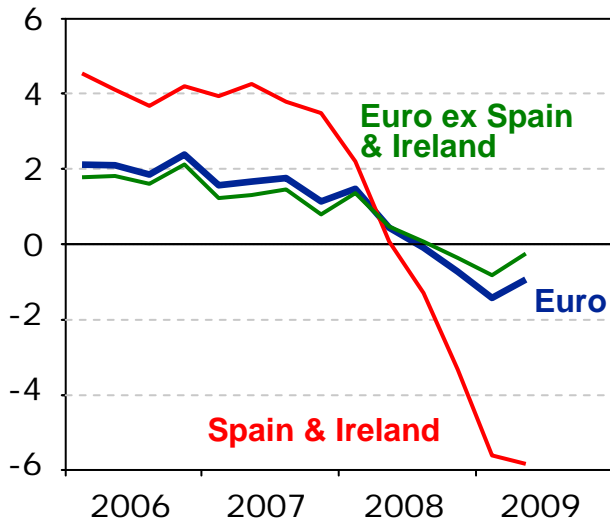
**Lending to the private sector in Spain**  
(% of GDP)



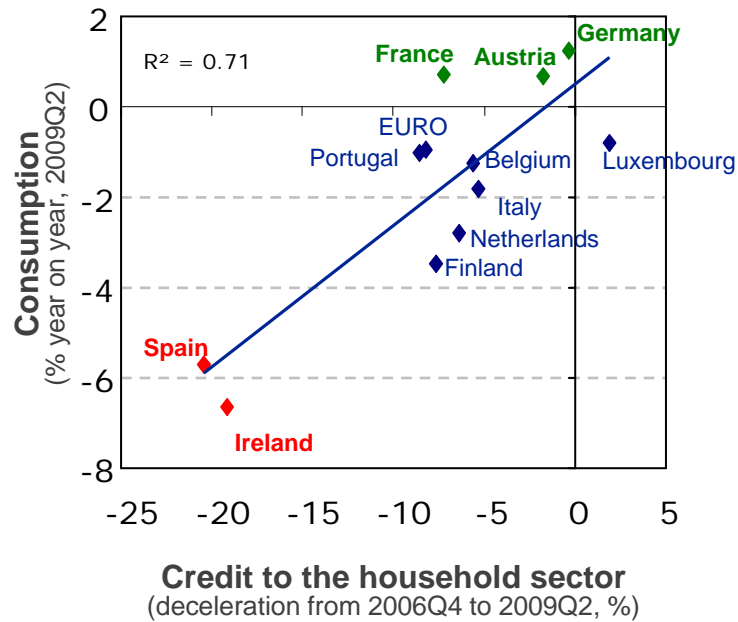
In Spain, 50% of corporate lending was for construction and real estate companies at mid-2007.

# ... and consumption was choked

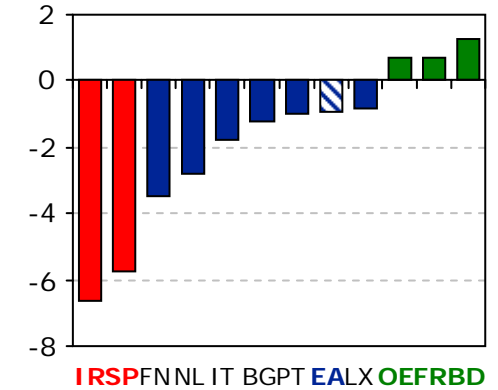
### Consumption (% year on year)



### Credit and consumption

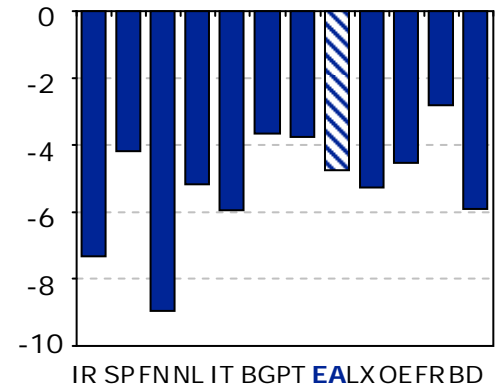


### Consumption (% year on year, 2009Q2)



### GDP

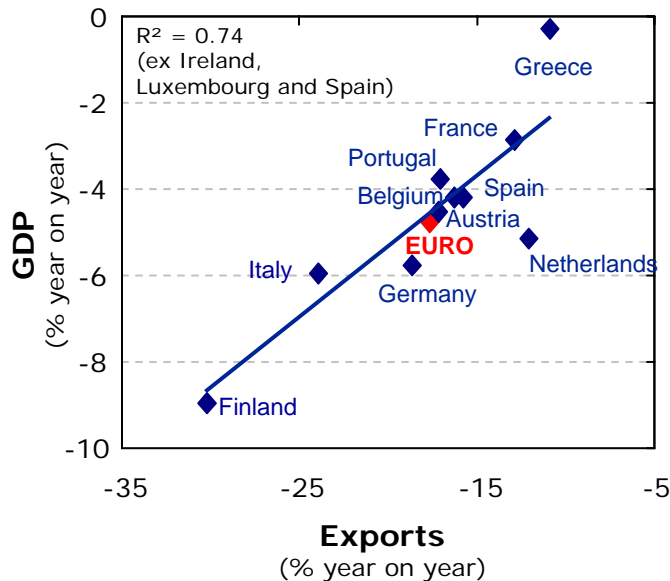
### (% year on year, 2009Q2)



# But in most countries, the collapse of foreign demand was the trigger of the downturn

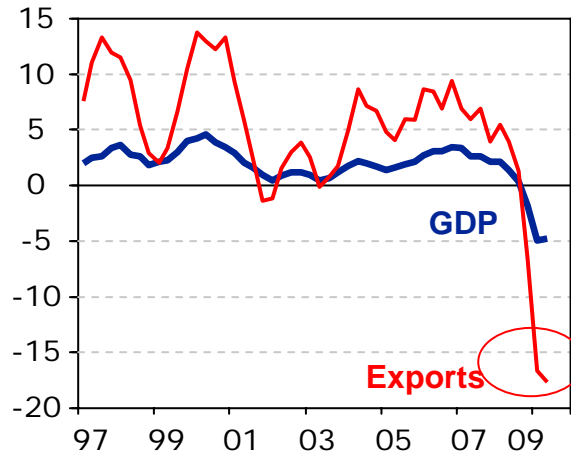
## Exports and GDP

(% year on year, 2009Q2)



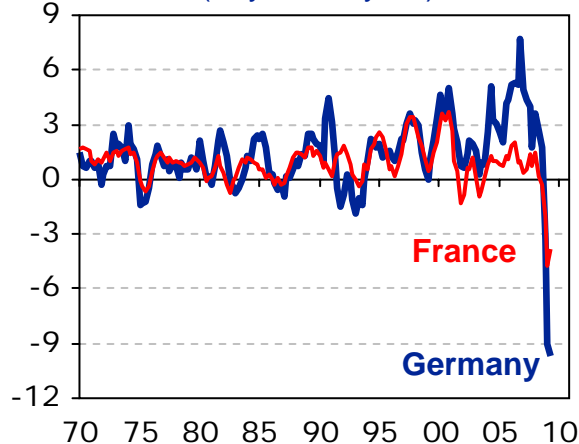
## GDP growth and exports

(% year on year)



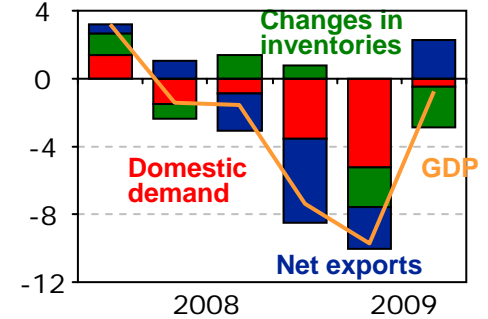
## Contribution of exports to growth

(% year on year)

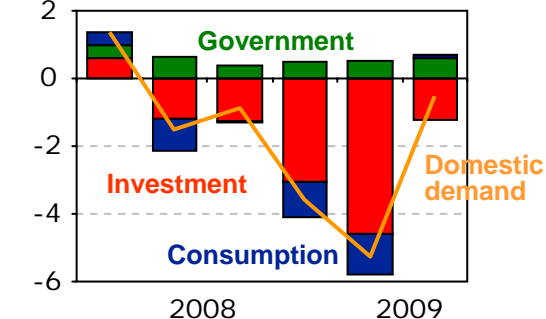


## Contribution to GDP growth

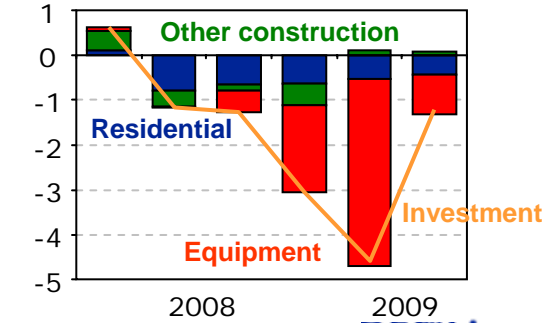
(% quarter on quarter, annual rate)



## Domestic demand



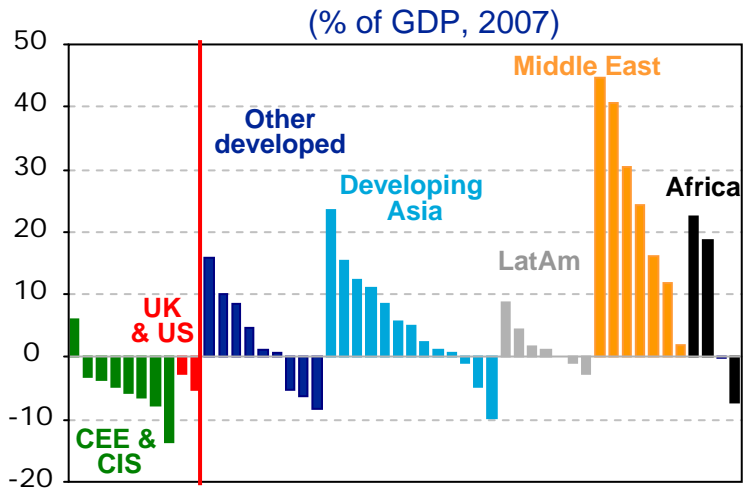
## Gross fixed capital formation





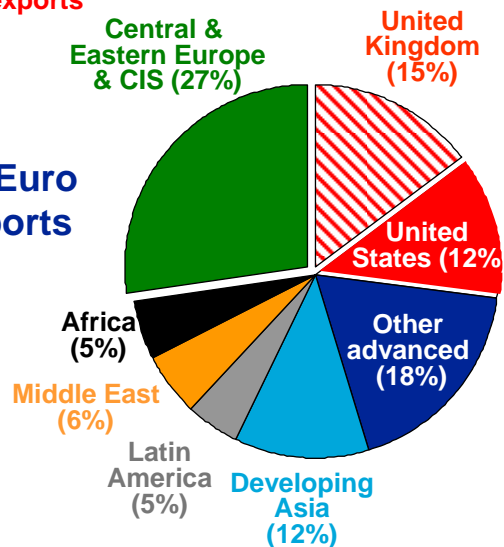
# Many of our trading partners have been dramatically affected by the financial turmoil

## Current account balances of the 50 biggest economies ex Euro area countries

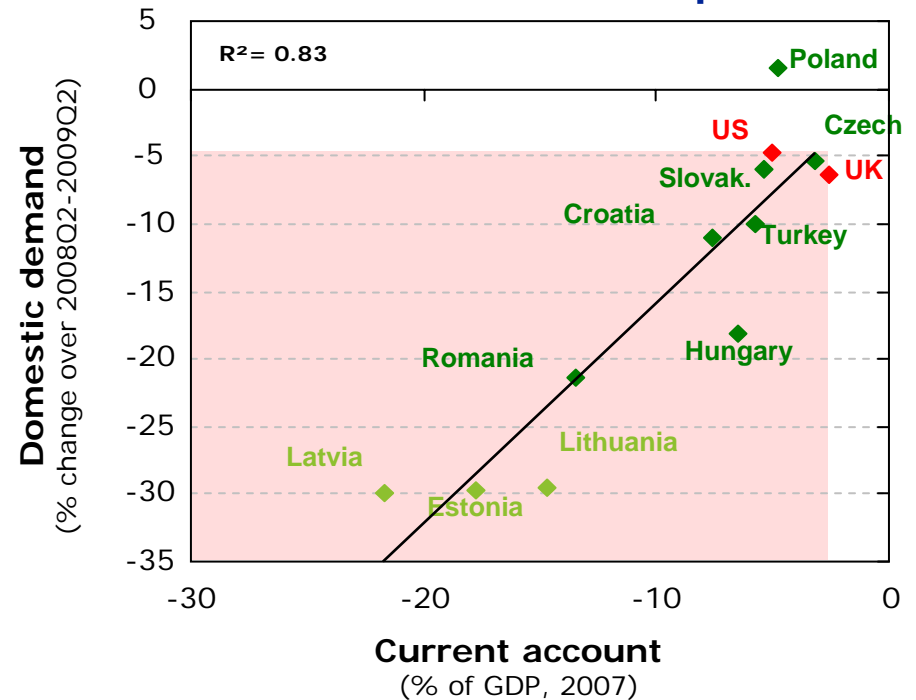


More than 50% of our exports

### Shares in Euro area's exports (2008)

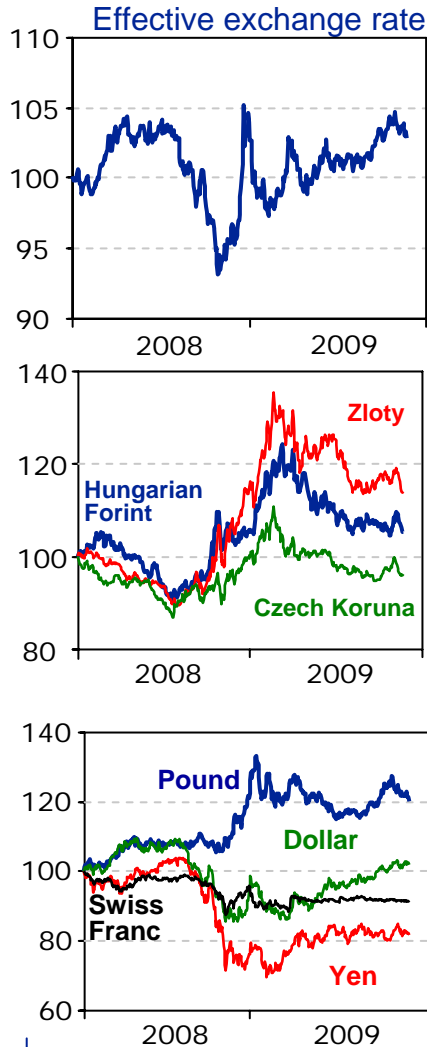


## Current account balance & domestic demand in Central and Eastern Europe

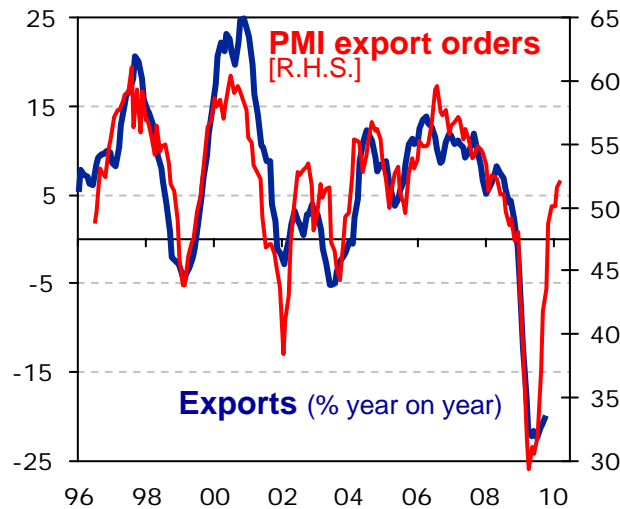


# Despite the recent appreciation of the euro, a modest rebound of our exports seems to be in the pipeline

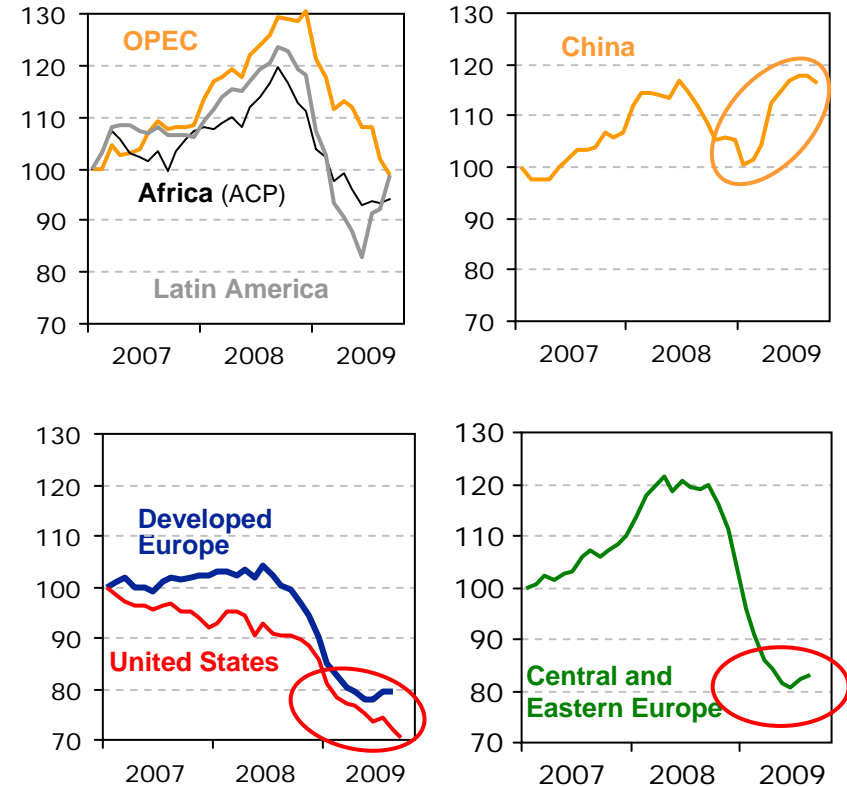
## Euro exchange rate



## Extra euro area exports

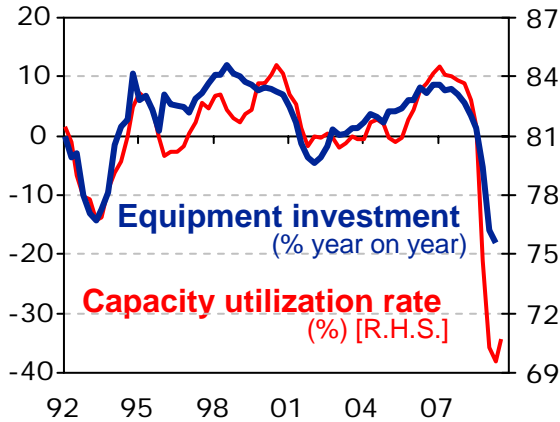


## Euro area exports by destination (2007 = 100, in euros)

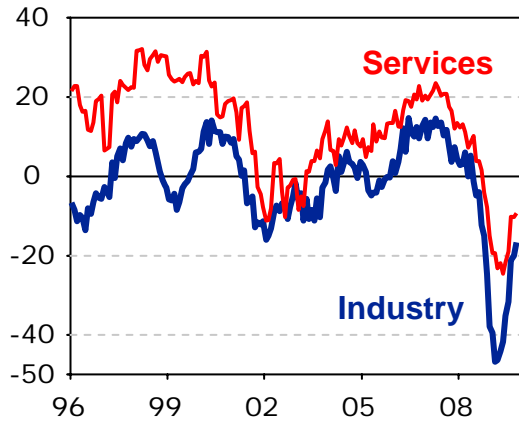


# Some recovery in business investment is also likely...

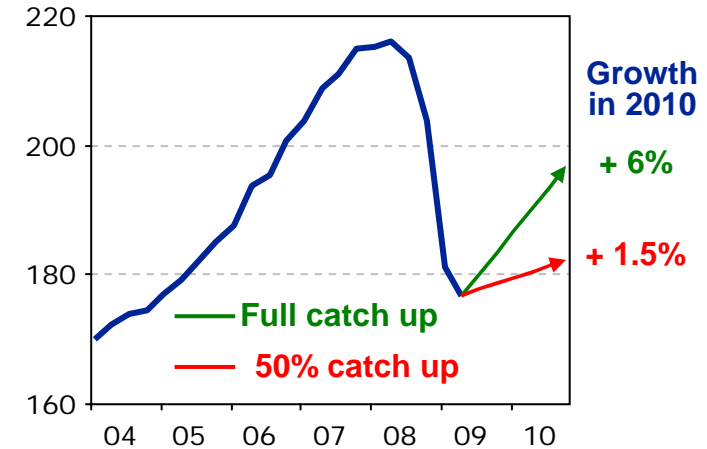
## Capacity utilization rate



## Recent evolution in demand (European Commission survey)

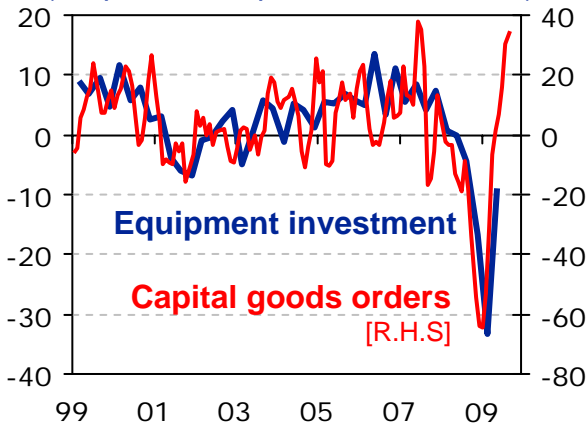


## Equipment investment (in billions of 2000 euros, quarterly)

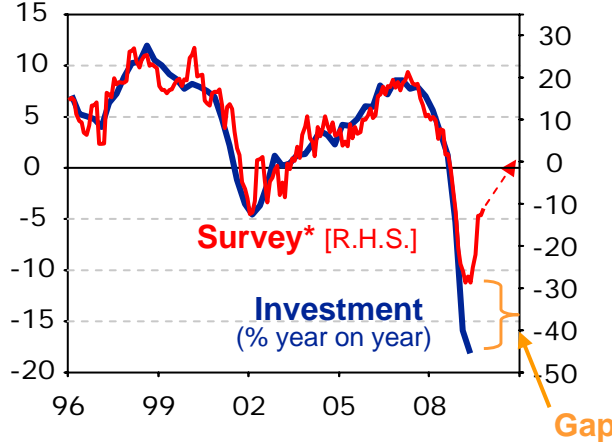


## Capital goods orders

(% quarter on quarter, annual rate)



## Evolution in demand and investment



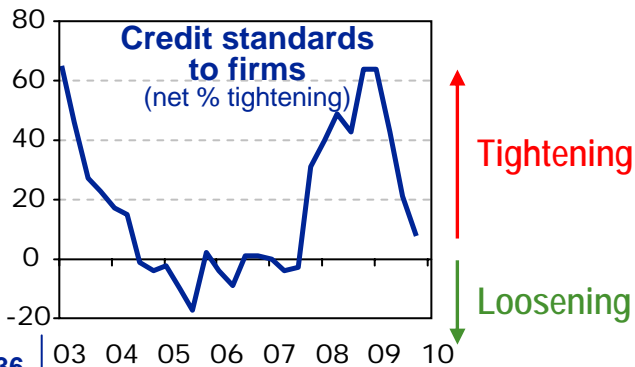
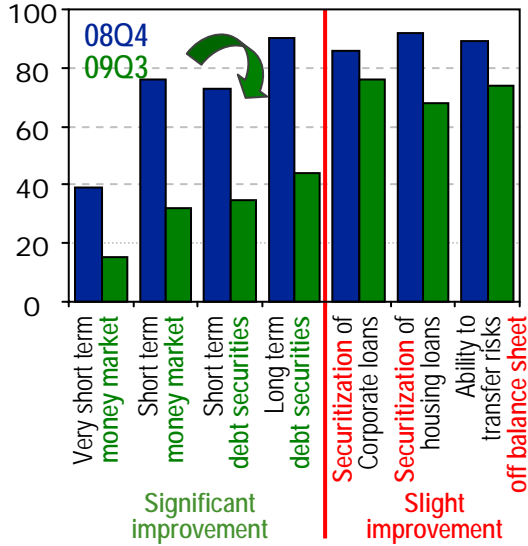
(\*) Survey composite:  
0.25 x industry production trend +  
0.75 x services recent evolution in demand

# ... even if access to bank credit remains difficult, especially for Spanish smaller firms

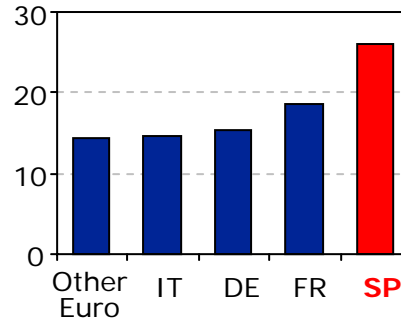
## Bank lending survey

### Access to wholesale funding

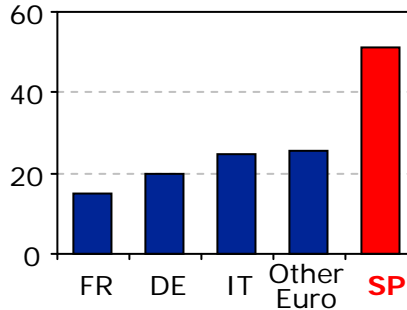
(% of banks reporting hampered market access)



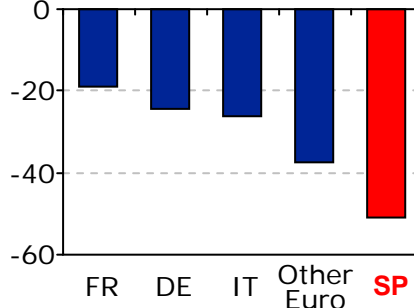
## Credit conditions for small and medium enterprises



% saying access to finance is currently the most pressing problem



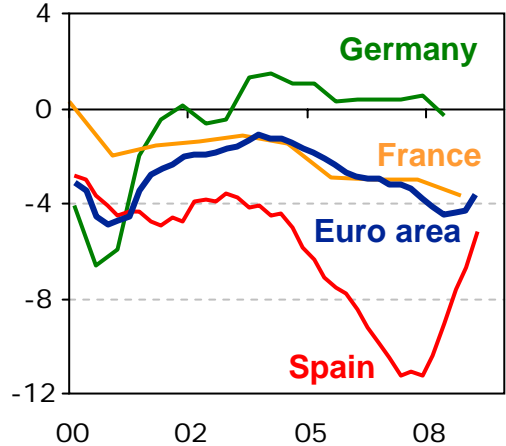
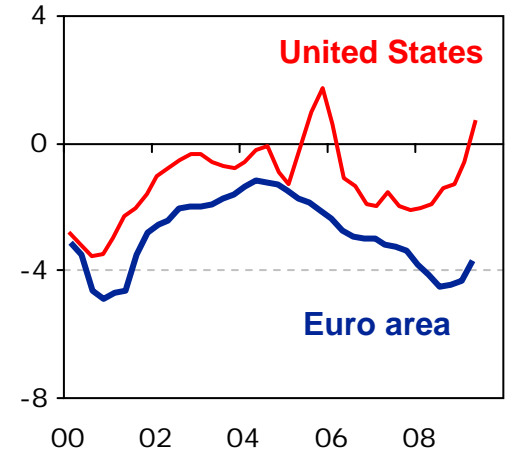
% firms saying they only got part of the bank loan they applied for or their loan was rejected



Net % saying the availability of bank loans has deteriorated (-) over the past 6 months

## Net lending or borrowing of non financial corporations

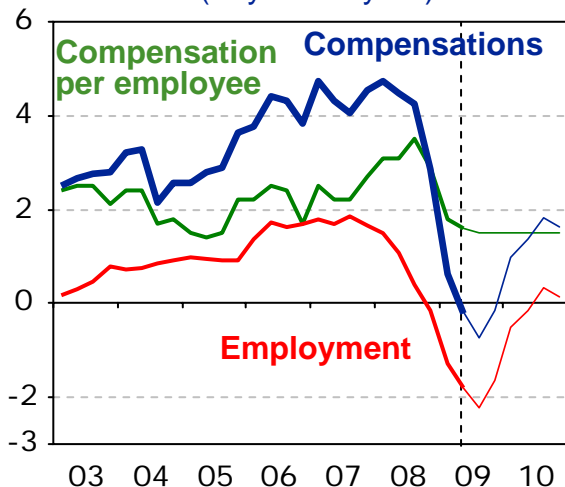
(% of GDP)



# The headwind of a rising household saving rate should progressively fade...

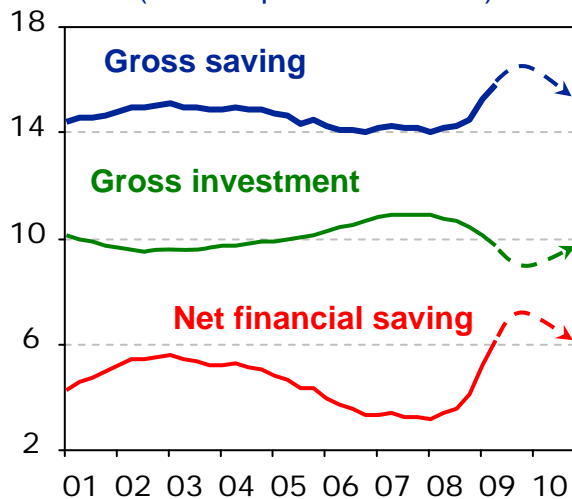
## Compensations

(% year on year)

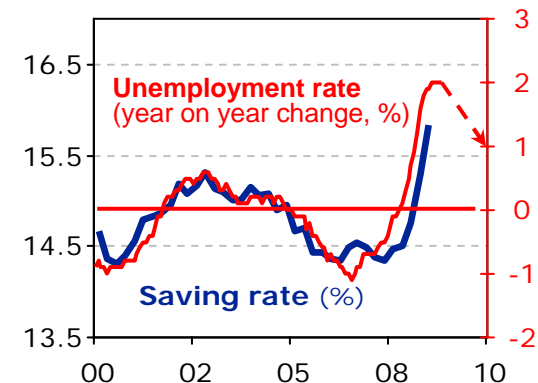


## Households saving

(% of disposable income)

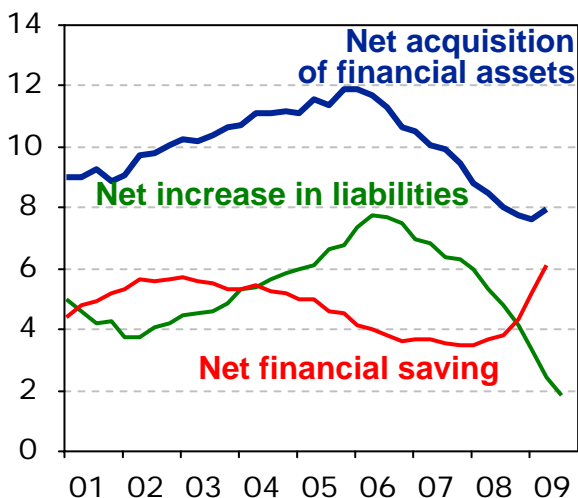
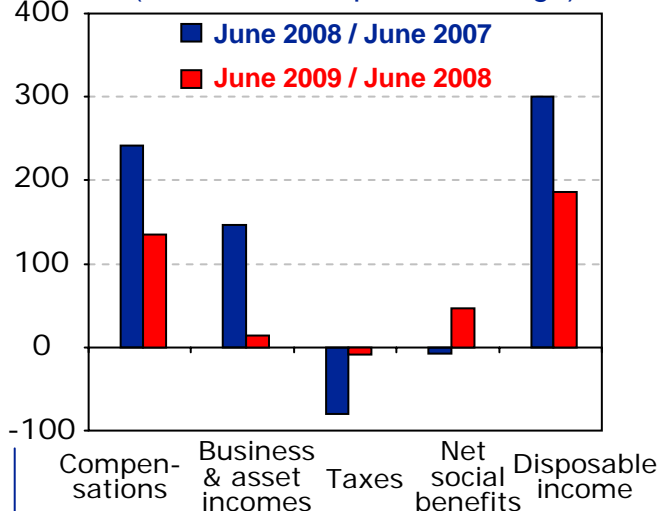


## Gross saving rate and the labor market

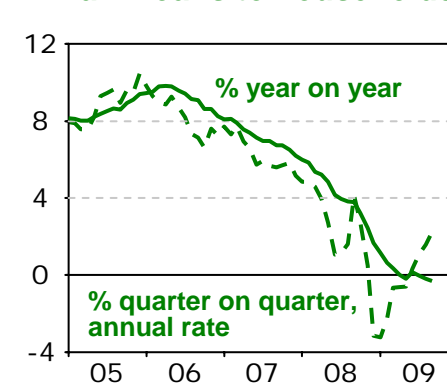


## Change in disposable income

(euro billion, 4-quarter average)

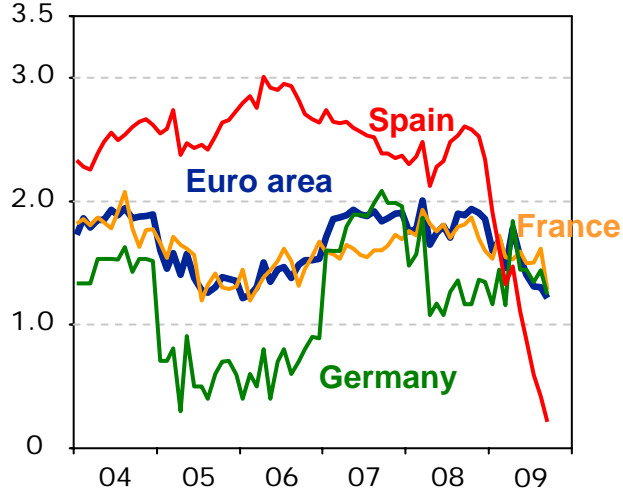


## Bank loans to households

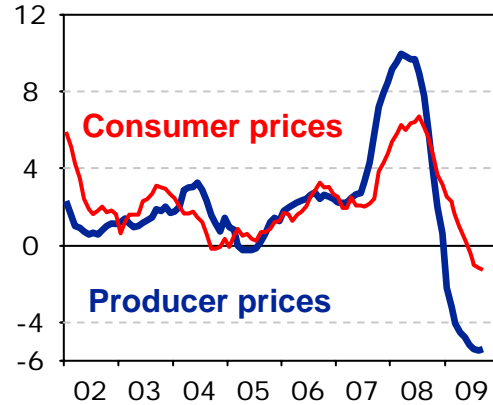


# ... while inflation remains contained

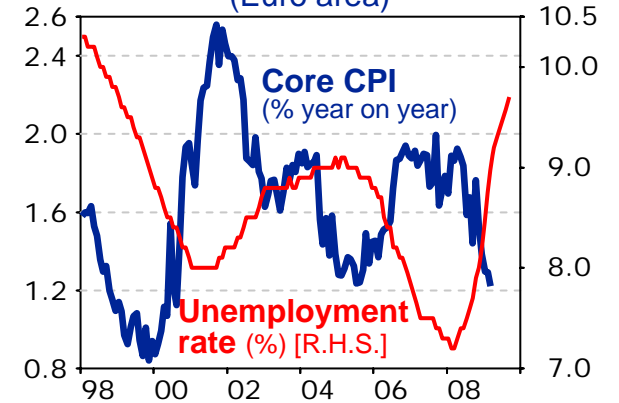
**Core consumer prices**  
(% year on year)



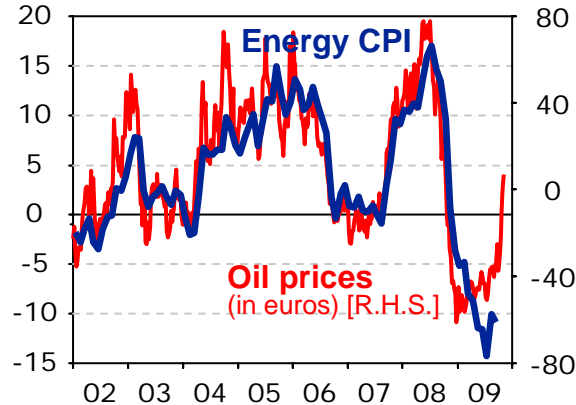
**Food prices**  
(% year on year, Euro area)



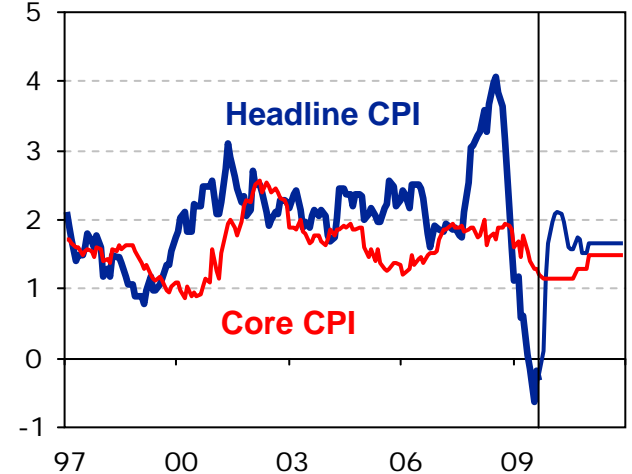
**Core consumer prices and unemployment rate**  
(Euro area)



**Energy prices**  
(% year on year, Euro area)



**Consumer prices**  
(% year on year, Euro area)

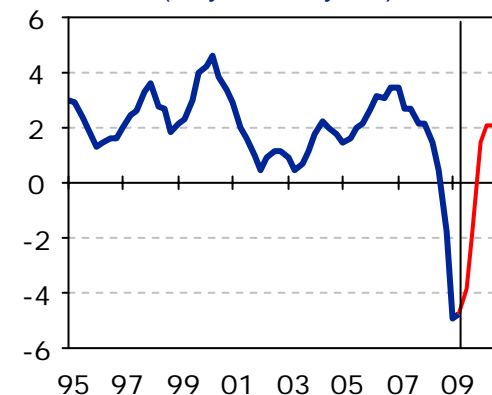


# All in all, growth could pick up to close to 2% in 2010

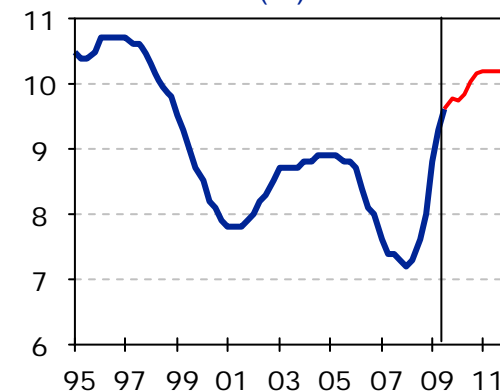
## GDP growth in the Euro area

(% quarter on quarter annual rate)	Q308	Q408	Q109	Q209	2005	2006	2007	2008	2009	2010
<b>Consumption</b>	0.0	-1.8	-2.1	0.3	1.9	2.1	1.6	0.3	-0.8	0.6
<b>Investment</b>	-5.7	-13.3	-19.8	-6.0	3.4	5.8	4.8	-0.6	-9.7	-0.6
- Housing	-11.2	-11.4	-9.9	-7.9	3.3	6.0	1.4	-4.6	-9.3	-5.2
- Equipment	-4.3	-17.2	-37.0	-9.7	4.8	7.3	7.8	1.3	-14.7	4.0
- Structures	-2.7	-6.9	13.0	2.8	0.9	2.7	2.6	-0.2	0.3	-4.5
<b>Change in inventories (contribution)</b>	1.6	1.1	-2.2	-2.5	-0.1	0.1	-0.1	0.1	-0.8	0.7
<b>Government</b>	2.1	2.4	2.6	3.0	1.6	2.0	2.2	2.1	2.7	2.4
<b>External balance (contribution)</b>	-2.2	-4.8	-2.4	2.3	-0.2	0.1	0.4	0.0	-1.0	0.4
- Exports	-3.8	-25.3	-32.0	-6.0	5.3	8.5	6.1	1.0	-13.2	8.0
- Imports	1.1	-17.1	-27.9	-11.3	6.0	8.4	5.2	1.0	-11.4	7.2
<b>GDP</b>	<b>-1.5</b>	<b>-7.1</b>	<b>-9.6</b>	<b>-0.7</b>	<b>1.8</b>	<b>3.1</b>	<b>2.7</b>	<b>0.6</b>	<b>-3.8</b>	<b>1.8</b>

**GDP growth**  
(% year on year)



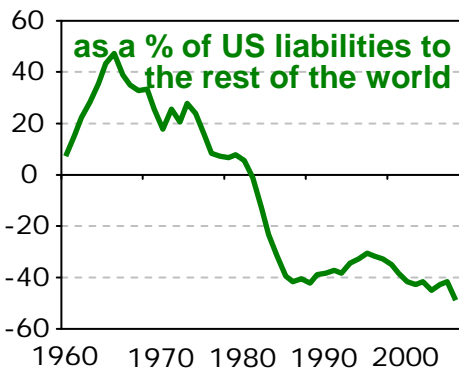
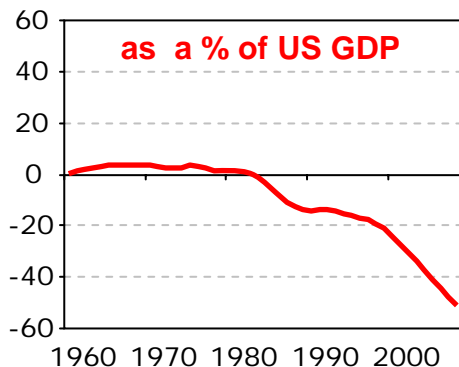
**Unemployment rate**  
(%)



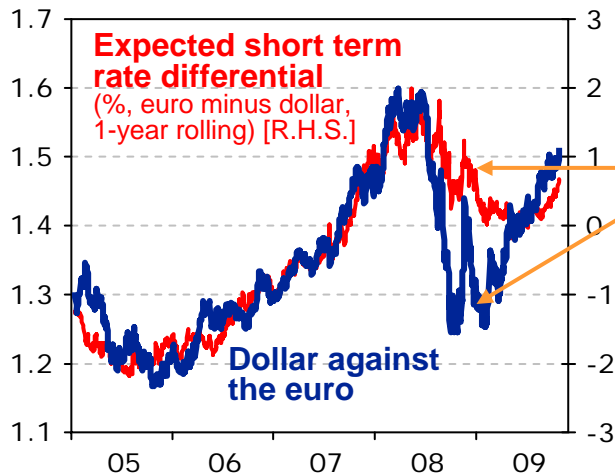
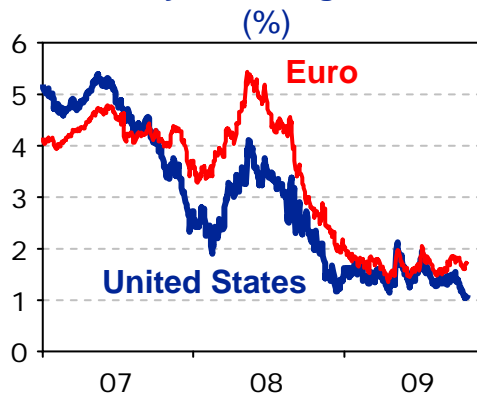
# A sharp increase in the euro exchange rate would of course put such an “export led” recovery at risk...

## Expected interest rates differential and euro/dollar exchange rate

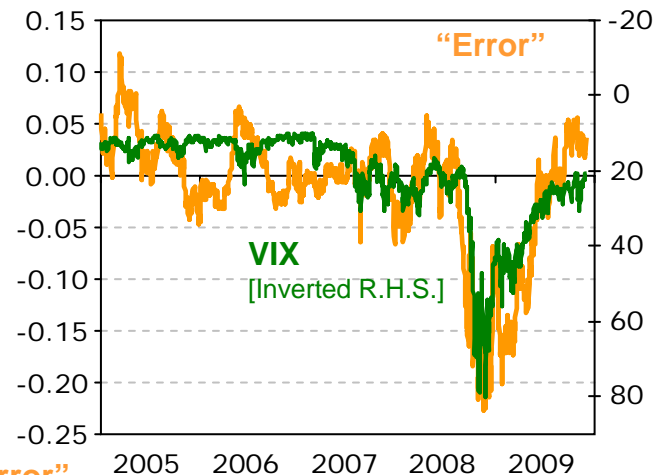
**Cumulated US current account**



**3-month interest rates expected at a 1-year rolling horizon (%)**



**Error & VIX**

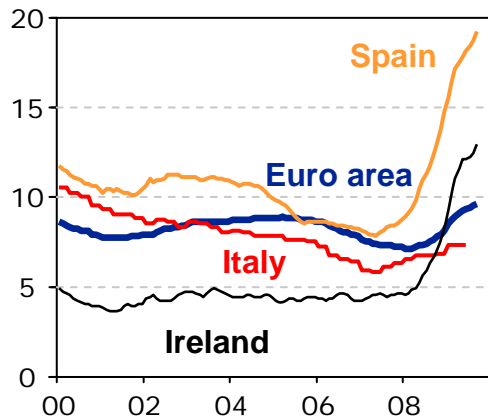
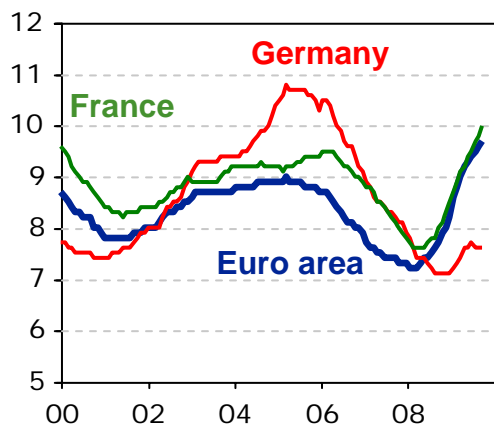


Up to now, at least, the recent depreciation of the dollar against the euro seems to have been driven mainly by the general fall in risk aversion.

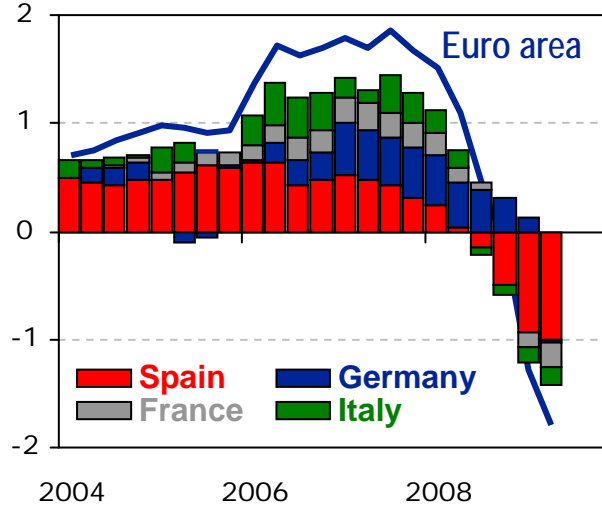


# ... the more so since labor hoarding makes the labor market vulnerable to any new shock

## Unemployment rate (%)

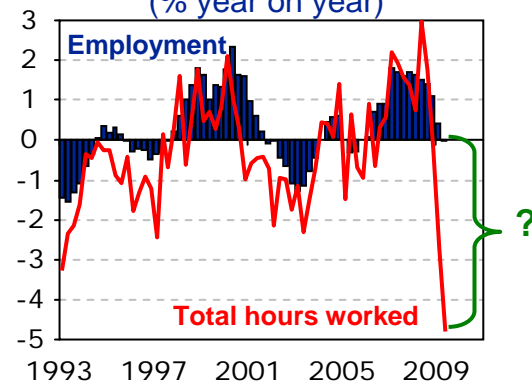


## Contribution to employment growth (% year on year)



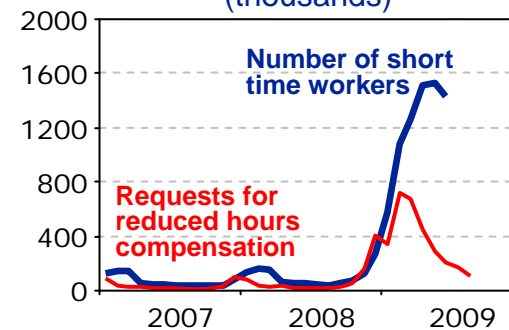
## Labor market in Germany

### Hours worked (% year on year)



The short time allowance program and some additional labor "hoarding" have helped to avoid a 2% rise in the German unemployment rate.

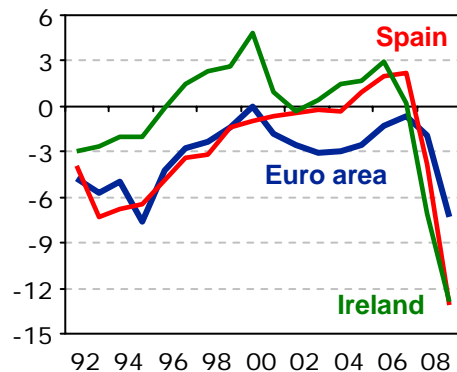
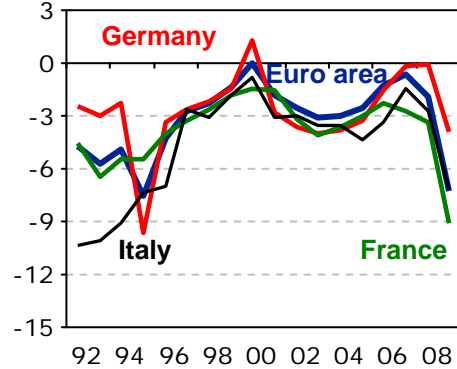
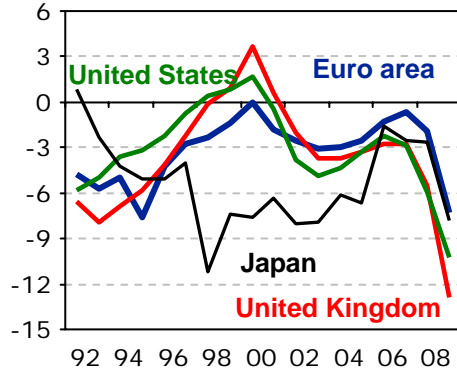
### Short time workers (thousands)



# This also pleads in favor of a cautious withdrawal of the fiscal stimulus

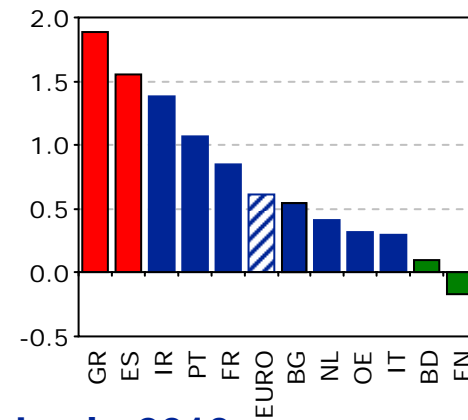
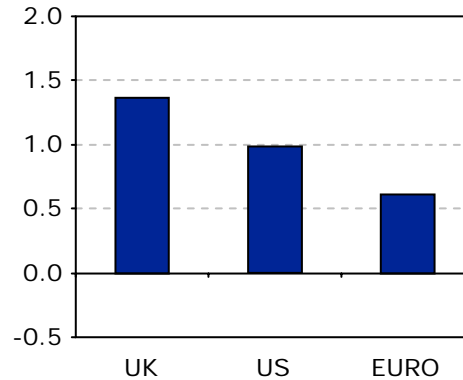
## Government balance

(% of GDP)



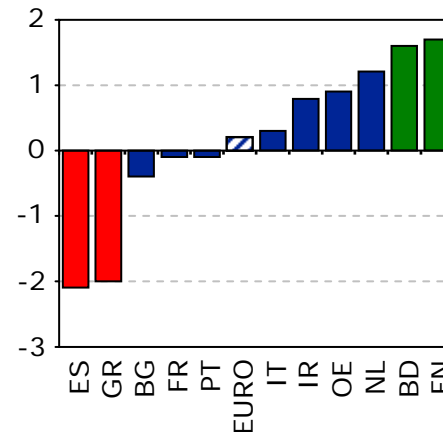
## Annual restriction needed over 2010-15 to stabilize the public debt to GDP ratio by 2015

(change in structural primary balance, % of GDP)



## Fiscal impulse in 2010

(change in structural primary deficit, % of GDP)



Sources: European Commission, Dexia-AM

## Conclusions

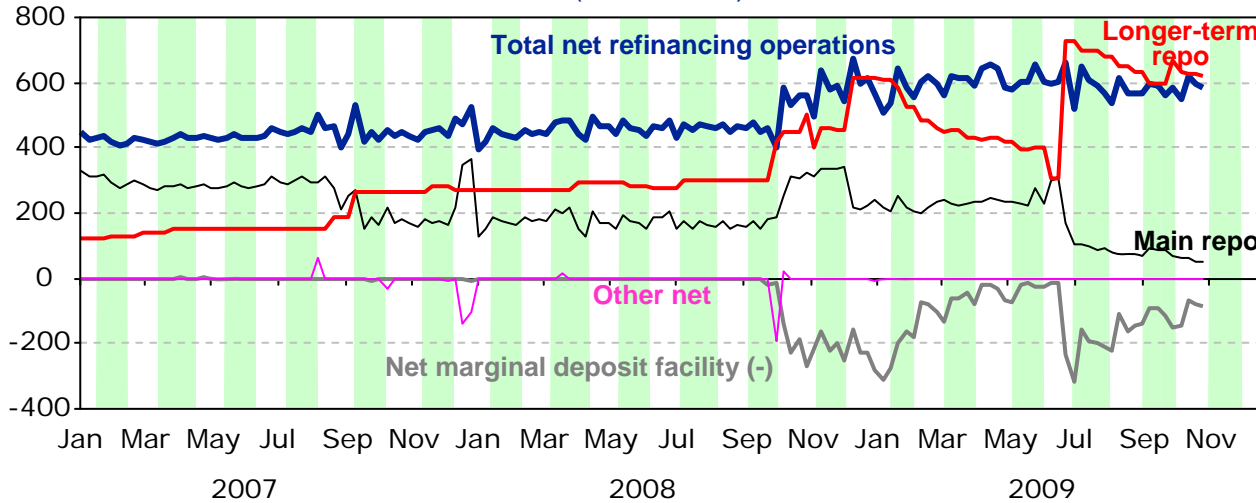
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- After a deep recession, growth should be close to 2% in 2010, while unemployment stays elevated and inflation contained.
- The timely implementation of fiscal and monetary “exit strategies” is particularly challenging.
- Short term rates will remain unchanged for a big part of next year, while long term rates move back to around 4%.
- Despite its rebound, the stock market is far from being overvalued.

# Addenda: ECB policy and the money market

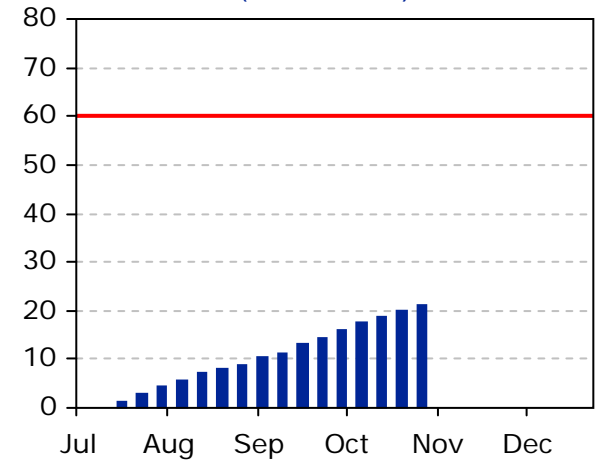
## Refinancing operations

(euro billion)



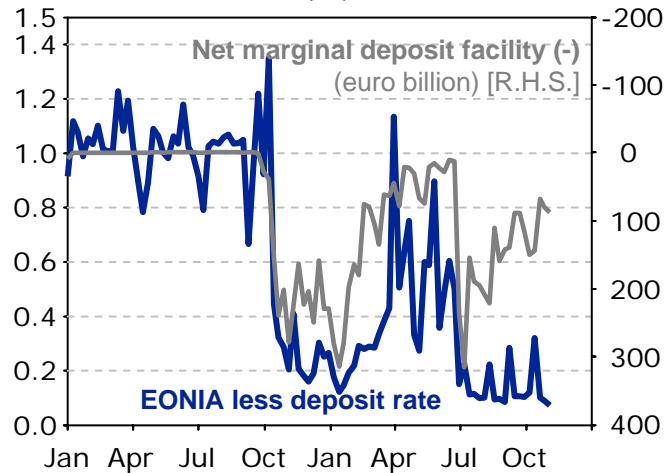
## Purchases of covered bonds

(euro billion)



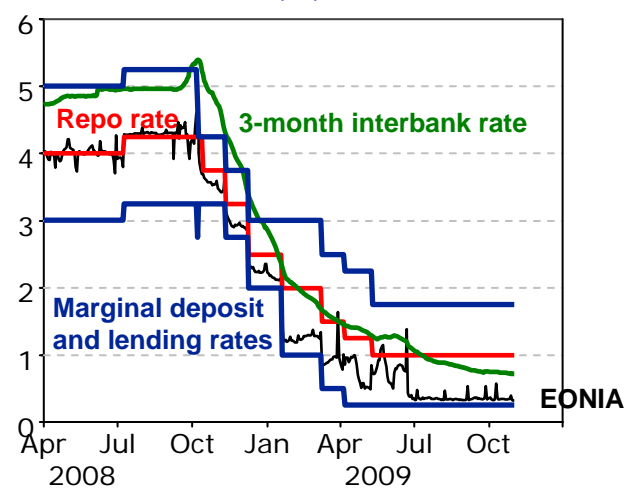
## Excess reserves and EONIA

(%)



## EMU policy rates

(%)



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