AGENDA

1. Introduction: the need for global rebalancing
2. The labor market: jobs, wages and salaries
3. The households' balance sheet
4. Housing
5. The banking sector
6. Conclusion: the economic outlook
**U.S. AND CHINA BEFORE THE “GREAT CORRECTION”**

- **The U.S.**
  - GDP growth between 2.5% and 3% between 2004 and 2007
  - Consumption accounted for 70% of GDP
- **China**
  - GDP growth between 15% and 20% between 2000 and 2008
  - Consumption accounted for 35% of GDP
- **China**: a development strategy based on (cheap) exports
- **U.S.**: a consumption-driven economy based on credit

- **The fundamental global imbalance: excess saving in Asia, excess consumption in the U.S.**
- **Economic fundamentals will not change overnight, but global rebalancing requires a greater domestic demand in China, and deleveraging in the U.S.**

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**THE DYNAMICS OF GLOBAL REBALANCING**

- **Deleveraging in the United States**
  - It requires a higher saving rate
  - Possibly it stems from paying off our debts, not defaulting on our mortgages!
  - Private deleveraging cannot be offset by government re-leveraging
- **Increasing final demand in China**
  - The current strategy is focused on public investment
  - Building a social safety net might help to increase consumption and reduce saving
- **International uncertainty**
  - Dollar is the world’s safe haven
  - There is no alternative to the greenback as a world reserve currency
  - Other Asian countries believe in strategic importance of deep pockets of dollar reserves
  - Demographics drive global maturity mismatches between risk-free and low risk assets, and more risky investments
PERSONAL CONSUMPTION: CONTRIBUTIONS TO GDP GROWTH, 2000-2010

A DISAPPOINTING RECOVERY

- By historical standards, growth has been a disappointment in this recovery
- A lackluster recovery is not a surprise, following a financial crisis
- 2H 2009 – 1H 2010: temporary factors contributed to macroeconomic performance, but no self-generating momentum was created
- The adjustment is structural, not cyclical
- A sobering realization: many jobs will not come back in their original form and sector
- “A number of [FOMC] participants reported that business contacts again indicated that uncertainty about future taxes, regulations, and health-care costs made them reluctant to expand their workforces.” [FOMC Minutes, August 10, 2010]
A DISAPPOINTING RECOVERY: LAGGING PAYROLL JOBS CREATION

GDP at peak quarter = 100

Job market did not fully recover until 1Q'05 (16 quarters)

SYMPTOMS OF STRUCTURAL IMBALANCE IN THE LABOR FORCE

- Mismatch of skills: the “Beveridge curve”
- Length of unemployment
- Length of unemployment benefits
- Benefit and income replacement ratio
- Wage flexibility
- Labor force mobility
- Survey of job separation

The Beveridge Curve
JOBS AND INCOME LOSSES

HOURLY EARNINGS

Avg Hourly Earnings: Private Service-Producing
% Change: Year to Year 3A, 5yr

Avg Hourly Earnings: Manufacturing
% Change: Year 16 Year 3A, 5yr

Sources: Bureau of Labor Statistics /Haver Analytics

Adolfo L. Laurenti, Deputy Chief Economist
Mesirow Financial

24th Annual Economic Outlook Symposium – December 3, 2010
“A TALE OF TWO CHRISTMASES”

- 2007 Survey of Consumer Finance
  - Income growth weak or negative for the middle class
  - Income (both level and growth) higher with college degree

- High-income families are recovering faster, and doing better thanks to larger increases in their salaries and bonuses

- Low- and middle-income families suffers persisting headwinds:
  - higher unemployment
  - small or no salary increases
  - uncertainty about unemployment benefits
  - underwater mortgages
  - reduced access to credit

Households’ Balance Sheet

Households & Nonprofit Organizations: Net Worth

Source: Federal Reserve Board /Haver Analytics
**HOUSEHOLDS’ ASSETS**

- **Households & Nonprofit Organizations: Total Assets**
  - NSA, Bil. $: 82500
  - NSA, Bil. $: 75000
  - NSA, Bil. $: 82500
  - NSA, Bil. $: 75000

- **Households & Nonprofit Org: Assets: Owner-occupied Real Estate**
  - NSA, Bil. $: 24000
  - NSA, Bil. $: 20000

- **Peak-to-trough:** -21%, or $16.8 trillion
- **Real estate:** -$6 trillion and still flat

**THE DYNAMICS OF REBALANCING: DEBT ACCUMULATION & DELEVERAGING**

- **Households & Nonprofit Organizations: Total Liabilities**
  - NSA Bil. $: 15000
  - NSA Bil. $: 15000

- **Households & Nonprofit Organizations: Liabilities: Home Mortgages**
  - NSA Bil. $: 10000
  - NSA Bil. $: 7500

- **Stage:**
  - **Stage I**
  - **Stage II**
  - **Stage III**
  - **Stage IV**

Sources: Federal Reserve Board / Haver Analytics
**SAVING RATES: A TREND REVERSAL**

![Graph showing personal saving rate trend reversal](image)

*Source: Bureau of Economic Analysis/Haver Analytics*

**REVOLVING CREDIT CONTINUES TO CONTRACT**

![Graph showing revolving credit contraction trend](image)

*Source: Author's analysis*
HOUSEHOLD DEBT: 2007 SURVEY OF CONSUMER FINANCES

- Leverage ratio [sum of the debt to sum of the assets] is 15% -- but as low as 8% for top income percentile, and as high as 25% for the middle class
- 77% of families carry debt of one sort or another
  - 49% mortgage
  - 47% installment loans
  - 46% credit card
- Incidence of credit card and installment loans higher for middle class

HOUSEHOLDS' BALANCE SHEET AND CONSUMER FINANCES: 2007 SNAPSHOT

- 2007 Survey of Consumer Finance
  - 68.6% of families owns a primary residence
    [since 2007, homeownership fell to 66.7%]
  - 52.6% of families own retirement accounts
  - 51.1% of families own stock holdings, directly or indirectly
- Stocks represent 57% of financial assets for top income percentile, 39% of bottom income percentile
- Home represents 19% of financial assets for top income percentile, 47% for bottom income percentile
HOME PRICES: THE QUEST FOR STABILIZATION

FHFA House Price Index: Purchase Only, United States

% Change - Year to Year   SA, Jan-91=100

Source: Federal Housing Finance Administration / Haver Analytics

HOME SALES: NO MOMENTUM FROM TAX CREDITS

Total Homes Sales (new + existing) (thous)

Source: Haver Analytics
The banking sector: healing, slowly

- One major hurdle to resume hiring by small and medium-size businesses: banks unwillingness to extend credit
- Over-concentration of non-performing loans (mostly commercial real estate) still on balance sheets
- Unprecedented liquidity stress on banks' balance sheets is abating
- Banks are still being pulled in opposite directions:
  - Rebuilding capital, increasing reserves, loss provisions and charge-offs
  - Increasing lending – and not just to prime borrowers
- Lack of trust in the European banking stress test
- Persistent uncertainty about the new regulatory framework
THE OUTLOOK: THE 2010 SCORECARD

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<th>2009</th>
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<th>2011</th>
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<tr>
<td>Real GDP</td>
<td>-2.6</td>
<td>2.7</td>
<td>2.6</td>
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<tr>
<td>Personal Consumption</td>
<td>-1.2</td>
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<td>Industrial Production</td>
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<td>Unemployment Rate (year average)</td>
<td>9.3</td>
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<td>Housing Starts (million unit)</td>
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<td>0.59</td>
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<td>Auto Sales (cars + light trucks)</td>
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<td>11.9</td>
<td>13.2</td>
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<tr>
<td>Consumer Price Index</td>
<td>-0.3</td>
<td>1.6</td>
<td>1.6</td>
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<tr>
<td>Fed Funds (year-end)</td>
<td>0.05</td>
<td>0.20</td>
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<td>10-year T-Note yield (year-end)</td>
<td>3.85</td>
<td>2.50</td>
<td>3.10</td>
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Source: Haver Analytics/Mesirow Financial

SUMMARY

- The good news: financial markets and the economy are stabilizing; we do not anticipate a double dip
- The bad news: it will not be a quick transition. It will take time to restore "normal" operating conditions for the economy and, more crucially, to create jobs
- In 2010 and 2011 we’ll see some growth, but sub-par by historical standard; short-term, transitory factors will prevail on long-term, sustainable drivers
- 2011 and beyond: the economy will reaccelerate, but new risks will emerge: interest rates “normalization” (i.e. hikes by the Fed), tax increases (expiration of the Bush tax cuts), persistently elevated unemployment (“natural” rate at 6.5%?)
- The 2009 fiscal stimulus does look like a missed opportunity; the 2010 mini-stimulus is only marginally better and expected to be ineffective