The Global Economic Outlook:
Looking Beyond the U.S. Soft Landing

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Presented by:
Sara Johnson
Managing Director,
Global Macroeconomics
The World’s Economic Expansion Continues
Regional Growth Patterns

- World growth remains above trend
- U.S. growth picking up, but housing still declining
- Western Europe’s better performance won’t last
- Japan on slow, steady growth path
- Robust growth in Emerging Asia and Europe; China’s investment boom continues
- Other emerging markets supported by high commodity prices and expanding world trade
The Fastest Growth Is in Emerging Markets

(Real GDP, percent change)

- NAFTA
- Other Americas
- Western Europe
- Emerging Europe
- Japan
- Other Asia
- Mideast-N. Africa

2006 2007 2008 2009
Output Gaps Show Little Spare Capacity: Deviation of Actual GDP from Potential GDP

(Percent of potential real GDP)

Source: OECD
Consumer Price Inflation Is Low in Most Regions

(Percent change)

- NAFTA
- Other Americas
- Western Europe
- Emerging Europe
- Japan
- Other Asia
- Mideast-N. Africa

2006 2007 2008 2009

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Industrial Materials Prices Remain Strong

(Global Insight Indexes, 2002:1=1.0)

- All Materials
- Nonferrous Metals
Is Excess Global Liquidity a Problem?

- Legacy of expansionary monetary policies
- Aggravated by financial innovation, easy credit
- Low Japanese interest rates spawned carry trade
- High saving rates and limited investment options in Asia and the Middle East
- Speculative behavior contributing to asset bubbles
Global Stock Markets Are Rising; China’s Gains Are Exceptional

(Percent change, local currencies)

- China (SSEA)
- Eurozone (FTSE Euro 100)
- Emerging Markets (MSCI)
- United Kingdom (FTSE 100)
- World, Developed (MSCI)
- United States (S&P 500)
- Canada (S&P TSX)
- Japan (Nikkei 225)

2006 vs. 2007 YTD through June 20
Most Policy Interest Rates Are Rising

(Percent)

1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009

U.S.  Eurozone  Canada  Japan  U.K.
The U.S. Economy Is Resilient

- The worst is over for real GDP growth
- Business investment back on track
- Inventory correction progressing
- Bright outlook for exports
- Consumer spending healthy, but likely to slow
- Housing markets will start to recover in 2008

A soft landing despite housing market turbulence
U.S. Economic Growth Is Picking Up

(Annual percent change, 2000 dollars) (Percent)

Real GDP Growth
Unemployment Rate
Long-Term Interest Rates Are Edging Upward

Graph showing the trend of Federal Funds, 10-Year Treasury, and 30-Year Mortgage Rate from 1990 to 2010.
A Hard Landing for Housing Markets

- Easy credit and speculation fueled price bubbles
- Affordability deteriorated, reducing demand
- Prices are falling, mortgage foreclosures rising
- Builders are cutting production
- Credit availability is tightening
- Home-building, sales, and prices will fall further
Home Prices Will Decline in 2007 and 2008

A 5% price decline would reduce housing wealth by $1.0 trillion. With a wealth effect of .06, consumption would be cut by $60 billion, or 0.6%.
Cycles in the Single-Family Housing Market

(Millions of units)

(Millions of units)


Housing Starts  Home Sales
Cross-Currents Affecting Consumer Spending

**Positive Forces**
- Steady Job Growth
- Accelerating Wages
- Moderating Inflation

**Negative Forces**
- Declining Home Sales
- Declining Housing Wealth
- Heavy Debt Burdens
- Negative Saving Rate
Consumer Spending Will Shift to Services

(Please provide data on the graph, such as percent change and current dollars for 2006, 2007, and 2008.)

- Recreation Services
- Medical Care & Products
- Computers & Software
- Transportation Services
- Food & Beverages
- Vehicles & Parts
- Apparel
- Home Furnishings
Business Fixed Investment: Cycles in Equipment and Structures Have Diverged

(Year-over-year percent change, 2000 dollars)
Growth in Business Equipment Investment

(Percent change, 2000 dollars)

- Total
- Information Technology
- Industrial Equipment
- Transport Equipment
- Other Equipment

- 2006
- 2007
- 2008
- 2009
Real Export and Import Growth Patterns Reflect the Business Cycle and Exchange Rates

(Year-over-year percent change)

- Real Exports
- Real Imports

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A Record U.S. Current Account Deficit in 2006

The graph shows the current account deficit (in billions of dollars) and as a percent of GDP from 1980 to 2016.

Key points:
- The current account deficit peaked in 2006.
- The deficit as a percent of GDP also reached a record high in 2006.
The U.S. Dollar Will Depreciate Further

(Real Trade-Weighted Dollar Index, 2000=1.0)

Industrial Countries  -  Developing Countries
U.S. Employment Growth Is Slowing, as Manufacturing and Construction Cut Jobs

(Year-over-year percent change)

- Total
- Manufacturing
- Construction
- Leisure & Hospitality
The West and South Lead in Employment Growth

[Map showing employment growth across the United States with different shades indicating the growth rates.]
Federal Policy as the 2008 Election Approaches

- Federal minimum wage increase enacted
- Energy and environmental initiatives
  - Higher auto fuel-economy standards
  - Renewable fuels mandates
- Tax decisions postponed
- Harsher rhetoric on trade policy
- Push for immigration reform
  - Favors immigrants with job skills, education
  - Guest worker program for low-skilled jobs
  - Citizenship path for illegal immigrants
Canada’s Economy Faces Headwinds

- Canada’s economy is operating near full capacity
- Trade and fiscal balances remain in surplus
- The Canadian dollar has soared, hurting exports
- Business investment is decelerating
- Consumer spending remains strong
- Core inflation has risen to 2.5%
- The Bank of Canada will soon raise its policy rate
Canada’s Economic Growth Is Near Its Potential

(Percents change)


Real GDP Industrial Production
## Canada’s Real Economic Growth by Sector

(Percent change)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>2.8</td>
<td>2.4</td>
<td>2.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Consumption</td>
<td>4.2</td>
<td>3.6</td>
<td>3.1</td>
<td>2.6</td>
</tr>
<tr>
<td>Residential Investment</td>
<td>2.1</td>
<td>-0.2</td>
<td>1.1</td>
<td>2.7</td>
</tr>
<tr>
<td>Business Fixed Investment</td>
<td>9.9</td>
<td>5.4</td>
<td>4.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>3.3</td>
<td>2.8</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Exports</td>
<td>0.7</td>
<td>1.5</td>
<td>4.0</td>
<td>5.6</td>
</tr>
<tr>
<td>Imports</td>
<td>5.0</td>
<td>2.9</td>
<td>4.3</td>
<td>4.9</td>
</tr>
</tbody>
</table>
Western Provinces Lead Canada’s Growth

(Percent change, real GDP)

- British Columbia
- Alberta
- Saskatchewan
- Manitoba
- Ontario
- Quebec
- New Brunswick
- Nova Scotia
- PEI
- Newfoundland

2006 vs 2007
Eurozone Growing, But Challenges Remain

- Growth led by investment and exports
- Rising employment will boost consumer spending
- But a strong euro and tightening fiscal and monetary policies will slow momentum
- Overheated housing markets pose risks — Spain
- Limits on long-term growth
- A North/South competitiveness divide
Home Prices Bubbles Pose Risks

(Cumulative percent change, 1997-2007 Q1)

South Africa: 350%
Ireland: 250%
U.K.: 200%
Spain: 175%
Australia: 150%
France: 125%
U.S.: 100%
Italy: 75%
Canada: 60%
Japan: 50%
Hong Kong: 0%

Source: The Economist, June 9, 2007
Real GDP Growth Rates Vary Across Europe

France Germany Italy Spain Sweden U.K.

(Percent change)

<table>
<thead>
<tr>
<th>Year</th>
<th>France</th>
<th>Germany</th>
<th>Italy</th>
<th>Spain</th>
<th>Sweden</th>
<th>U.K.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td></td>
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<td>2007</td>
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<td>2008</td>
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<tr>
<td>2009</td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>
Emerging Europe Is Attracting Investment

- Falling trade barriers, low costs, and privatization foster industrial development
- EU entry brings transfer payments and FDI
- Concerns: inflation, trade, and fiscal imbalances
- Poland: broadly based economic boom
- Turkey: high interest rates restrain growth
- CIS: rapid growth through oil and gas development
- Russia: increasing investment risks
Real GDP Growth in Emerging Europe

(Percent change)
Emerging Asia Is Powering Global Growth

- Momentum will shift from exports to domestic demand
- Monetary policies are generally tightening
- CPI inflation averages 3.5%, but varies widely
- High saving rates — Asia will remain an exporter of capital
- Intra-regional trade driven by vertical specialization
- Region’s stake in multilateral free trade accentuated
- Exchange rates across Asia will rise
Real GDP Growth in Asia/Pacific Economies

(Percent change)

Indonesia  Hong Kong  Malaysia  Singapore  Philippines  Vietnam

2006  2007  2008  2009

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China: A Runaway Locomotive?

- Monetary policy is still very stimulative
- Policy tightening has failed to cool investment boom
- Trade surplus creates financial and political pressures
- CPI inflation is tame, but real estate and stock prices have soared
- The major risk is a boom/bust cycle
- Structural forces hold back consumer spending
- The renminbi will appreciate 7–8% annually
## China’s Real Economic Growth by Sector

(Percent change)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>10.7</td>
<td>10.6</td>
<td>9.4</td>
<td>8.8</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>5.1</td>
<td>6.2</td>
<td>6.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Fixed Investment</td>
<td>15.3</td>
<td>12.7</td>
<td>11.5</td>
<td>10.5</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>8.1</td>
<td>8.0</td>
<td>8.4</td>
<td>9.5</td>
</tr>
<tr>
<td>Exports</td>
<td>17.4</td>
<td>15.3</td>
<td>11.3</td>
<td>10.7</td>
</tr>
<tr>
<td>Imports</td>
<td>16.3</td>
<td>15.0</td>
<td>15.6</td>
<td>11.9</td>
</tr>
<tr>
<td>Domestic Demand</td>
<td>9.9</td>
<td>10.2</td>
<td>11.5</td>
<td>9.4</td>
</tr>
</tbody>
</table>
### Foreign Direct Investment in China Is Moving Up the Value Chain

Distribution of Foreign-Invested Enterprise Output

(Percent of FIE overall industry value added)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Communications, Computing, &amp; Other Electronic Equip.</td>
<td>11.82</td>
<td>1</td>
<td>22.26</td>
<td>1</td>
<td>10.44</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>6.38</td>
<td>5</td>
<td>8.44</td>
<td>2</td>
<td>2.06</td>
</tr>
<tr>
<td>Electrical Machinery &amp; Equipment</td>
<td>5.35</td>
<td>7</td>
<td>6.63</td>
<td>3</td>
<td>1.28</td>
</tr>
<tr>
<td>Raw Chemical Materials &amp; Chemical Products</td>
<td>7.01</td>
<td>2</td>
<td>5.88</td>
<td>4</td>
<td>-1.14</td>
</tr>
<tr>
<td>Textile</td>
<td>6.28</td>
<td>6</td>
<td>4.09</td>
<td>5</td>
<td>-2.19</td>
</tr>
<tr>
<td>General Purpose Machinery</td>
<td>2.68</td>
<td>16</td>
<td>4.07</td>
<td>6</td>
<td>1.39</td>
</tr>
<tr>
<td>Production &amp; Supply of Electric Power &amp; Heat Power</td>
<td>6.80</td>
<td>3</td>
<td>4.03</td>
<td>7</td>
<td>-2.76</td>
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<tr>
<td>Processing of Food from Agricultural Products</td>
<td>4.54</td>
<td>8</td>
<td>3.78</td>
<td>8</td>
<td>-0.76</td>
</tr>
<tr>
<td>Apparel &amp; Footwear</td>
<td>6.43</td>
<td>4</td>
<td>3.29</td>
<td>9</td>
<td>-3.15</td>
</tr>
<tr>
<td>Metal Products</td>
<td>3.24</td>
<td>13</td>
<td>2.92</td>
<td>10</td>
<td>-0.33</td>
</tr>
</tbody>
</table>

Foreign Direct Investment Is Still Concentrated in Coastal China

Source: Global Insight China Regional Service
Chinese Regional Wage Rates — Central China Will Attract More Development

(Average annual wage, US$, 2005)

Coastal

Hinterland

Western

Source: Global Insight China Regional Service

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India Will Sustain Rapid Growth

- Services and manufacturing are booming
- Foreign direct investment is rising
- Overheating is a risk— inflation, twin deficits
- Demographic trends are favorable
- Consumer spending and home-building are surging with the growth of urban middle-class populations
- But India has many competitive disadvantages


India’s Real Economic Growth by Sector

(Percent change)

<table>
<thead>
<tr>
<th></th>
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<tr>
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<td>9.4</td>
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<td>8.6</td>
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<td>10.3</td>
<td>5.5</td>
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<td>14.6</td>
<td>14.6</td>
<td>14.5</td>
<td>13.3</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>9.0</td>
<td>4.3</td>
<td>6.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Exports</td>
<td>8.6</td>
<td>12.6</td>
<td>15.2</td>
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<td>12.5</td>
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<td>Domestic Demand</td>
<td>9.8</td>
<td>9.3</td>
<td>8.3</td>
<td>8.4</td>
</tr>
</tbody>
</table>
Middle East and Africa Prosper Amid Instability

- Record trade and fiscal surpluses in 2006
- Positive economic reforms in the GCC — Saudi Arabia, U.A.E., Kuwait, Qatar, Bahrain, and Oman
- Public sector investments in energy, infrastructure
- Private sector investments in real estate, tourism, services, chemicals, other manufacturing, mining
- Political risks in Iran, Iraq, Lebanon, Morocco, and Algeria
Real GDP Growth in the Middle East and Africa

(Percent change)

Saudi Arabia  South Africa  Iran  UAE  Israel  Nigeria

2006  2007  2008  2009
Asia and North America Generate Two-Thirds of the Global Economy’s Growth

<table>
<thead>
<tr>
<th>Region</th>
<th>% of World Growth, 1996-2006</th>
<th>% of World Growth, 2006-16</th>
<th>% of World GDP in US$, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>36</td>
<td>27</td>
<td>32</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>30</td>
<td>39</td>
<td>24</td>
</tr>
<tr>
<td>China</td>
<td>12</td>
<td>17</td>
<td>5</td>
</tr>
<tr>
<td>Japan</td>
<td>5</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Western Europe</td>
<td>20</td>
<td>15</td>
<td>30</td>
</tr>
<tr>
<td>Emerging Europe</td>
<td>5</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Middle East &amp; Africa</td>
<td>5</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Other Americas</td>
<td>4</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>
Bottom Line

- Global economic growth remains strong
- Inflationary pressures will lead to higher rates
- The worst is over for the U.S. economy
- Emerging markets of Asia and Europe will experience the fastest growth
- Japan and the Eurozone have limited potential

The major global risk is a boom-bust cycle
Thank You!

Sara Johnson
Managing Director,
Global Macroeconomics
781-301-9115
sara.johnson@globalinsight.com