The Global Economic Outlook
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Director, Globalization & Monetary Policy Institute
Presentation to symposium on
“The Role of Southern New Mexico in the Economy”
NMSU, Las Cruces October 18, 2013
Overview

• Outlook for the global economy
• International trade
• Inflation
• Monetary policy
• Things to watch for in 2013:
  – Another flare up in Europe
  – Policy changes in Japan
  – Extent of malinvestment in China
The changing location of global economic activity
(Share of world total (percent))

2013 – the tipping point
The US and China
(Trillions of dollars)

If current growth differentials persist, China’s economy will be bigger than that of the US in 2019.
The global economy at the turn of the year

• Sluggish recovery in US
  – QE3

• Sovereign debt crisis in Europe
  – Incremental steps towards a stronger union
  – End of euro area recession

• Ongoing weakness in UK

• Growth slowdown in China
  – Fallout from Europe; overinvestment

• Major policy change in Japan
Global Purchasing Managers Indexes

Index

Above 50: Expansion
Below 50: Contraction

Services
Composite
Manufacturing

Last obs. Sep 2013
53.59
53.47
51.77

30 40 50 60 70

Industrial activity in OECD still not back to pre-crisis levels

Index, 2005=100

OECD Industrial Production

Last obs. Jul 2013 103.9
Global trade has recovered, but softened of late
The AE/EE dichotomy

Imports

Exports

Index, 2005=100

Emerging Economies

World

Advanced Economies

Last obs. Jul 2013

Imports

Exports

Index, 2005=100

Emerging Economies

World

Advanced Economies

Last obs. Jul 2013
Rebalancing of global financial flows

Note: 2012 and 2013 data based on national estimates and IMF projections.
Global inflation in check

Headline CPI

Percent, Year/year

- Emerging Economies
- World
- Advanced Economies

Last obs. Jul 2013

Emerging Economies:
- Jul 2013: 6.6%

World:
- Jul 2013: 3.6%

Advanced Economies:
- Jul 2013: 1.6%
Inflation in OECD economies likewise muted.

![Graph showing Headline Inflation and Core Inflation from 2000 to 2012. The graph indicates that inflation rates have generally decreased over this period, with a notable dip during the financial crisis of 2008. The last observation for Aug 2013 shows Headline Inflation at 1.61% and Core Inflation at 1.59%.]
...helped by abundant slack
Unemployment in euro area diverging from other advanced economies

![Graph showing unemployment rates for the euro area and other advanced economies over time. The graph includes lines for the euro area, U.S., U.K., Canada, and Japan. The y-axis represents the unemployment rate in percent, ranging from 0 to 12%. The x-axis represents years from 2000 to 2012. The graph shows that the unemployment rate in the euro area has been generally higher than in other advanced economies, with significant increases in 2009 and 2010.]

Aug 12.0
Jun 7.7
Aug 7.8
Sep 6.9
Aug 4.1
Government borrowing costs at historic lows
Equity values in euro area and Japan still languishing
Real value of U.S. dollar stable

Peak value: Feb 2002

Index, Jan. 2000=100

- Real Exchange Value of the U.S. Dollar
- U.S. Dollar vs. Major Currencies
- U.S. Dollar vs. Other Important Trading Partners
Central bank policy rates also at historic lows
Central bank balance sheets have grown

Note: June 2013 OECD GDP forecasts used for Q3 data.
General government net lending/borrowing remains high

Note: 2012 and 2013 data based on national estimates and IMF projections.
No stabilization of debt burdens
(General government gross debt as percentage of GDP)

Note: 2012 and 2013 data based on national estimates and IMF projections.
The global recovery will gain momentum only slowly

OECD forecasts for OECD area, unless noted otherwise

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<tr>
<td>Total</td>
<td>1.8</td>
<td>3.0</td>
<td>1.9</td>
<td>1.4</td>
<td>1.2</td>
<td>2.3</td>
<td>0.8</td>
<td>1.8</td>
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<td>U.S.</td>
<td>1.7</td>
<td>2.4</td>
<td>1.8</td>
<td>2.2</td>
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<td>2.8</td>
<td>1.7</td>
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<td>China</td>
<td>10.3</td>
<td>10.4</td>
<td>9.3</td>
<td>7.8</td>
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<td>1.9</td>
<td>1.5</td>
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<td>0.5</td>
<td>3.0</td>
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<td></td>
<td>0.8</td>
<td>-2.3</td>
<td>-2.0</td>
<td>-2.3</td>
<td>-2.9</td>
<td>-2.4</td>
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<td>6.5</td>
<td>8.3</td>
<td>7.9</td>
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<td>Total</td>
<td>2.5</td>
<td>1.9</td>
<td>2.6</td>
<td>2.1</td>
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<td>1.9</td>
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<td>-2.8</td>
<td>-7.7</td>
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<td><strong>World real trade growth</strong></td>
<td>4.9</td>
<td>12.7</td>
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<td>5.8</td>
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<td>3.7</td>
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<td>4.0</td>
<td>2.8</td>
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Things to watch for in 2013

• Europe
  – Resurgence of crisis; GREXIT, BRIXIT, FIXIT.....

• Japan
  – Public debt; Higher inflation target; central bank independence?

• China
  – Malinvestment

• Policy developments
  – End of inflation targeting?
  – Return of “currency wars” tensions?
From disunion to union to disunion
(10-year government interest rates)

Jan 1, 1999
Euro launched
Jan 1, 2001
Greece joins
Great Depressions

Unemployment Rate

Percent

U.S.
Great Depressions

Unemployment Rate

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<th>Year</th>
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<th>Greece</th>
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<tr>
<td>1940</td>
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Housing booms and busts
Residential investment as a share of GDP

Percent

15
13
11
9
7
5
3
1


U.S.
Housing booms and busts
Residential investment as a share of GDP

Percent


Arizona
Florida
U.S.

Nevada
Housing booms and busts
Residential investment as a share of GDP

Percent


Arizona
Spain
U.S.
Florida
Nevada
Ireland

Spain
Arizona
Florida
U.S.
“The laws of economics grind slowly, but they grind exceedingly fine”

- Euro area does not satisfy the criteria of an “optimum currency area”
- Implication: living with a “one-size-fits-all” monetary policy will create strains
- Illustrate with comparison to US monetary union
- How would individual US states conduct monetary policy if they were free to do so?
- Taylor Rule as guide
California: Implied Taylor rule rate

Percent

Taylor rule rate
California: Fed funds rate & Taylor rates
Euro area Taylor rule rate range

Percentage points

- Taylor rule rate range
- ECB policy rate
Variation in unemployment rates

U.S. unemployment range

Percentage points

1999 2001 2003 2005 2007 2009 2011 2013
Variation in unemployment rates

Percentage points

Euro area unemployment range
Variation in unemployment rates

Percentage points

- Euro area unemployment range
- U.S. unemployment range
Japan’s ever growing public debt

General government gross financial liabilities as a percentage of GDP
..against a background of continued stagnation

Average growth rate
1961-1973: 9.4%
1974-1991: 4.1%
1992-present: 0.8%
Fewer workers, lower prices
April 4, 2013

• Adoption of “quantitative and qualitative monetary easing” by Bank of Japan
• 2 percent inflation target to be attained in about two years
• Monetary base to double by end 2014
  – Main operating target for money market operations changed from the uncollateralized call rate to the monetary base
• No mention of exchange rate
A tsunami of ¥...

Note: June 2013 OECD GDP forecasts used for 2013 & 2014.
Breakeven inflation rate

- Dec 17
  - Japanese Elections
- Dec 20
  - BoJ ups Asset Purchase Program to ¥101 trillion
- Jan 22
  - BoJ adopts 2% inflation target

Feb 14
- Inflation “goal” of 1%
- Assets Purchase Program increases by ¥10 trillion to ¥65 trillion

April, September, October
BoJ Meetings:
- Increase Asset Purchase Program from ¥65 trillion to ¥91 trillion
Housing in China: A bubble?

Mortgage lending relative to GDP
Construction activity at historic high

Construction as a percent of GDP

Previous high: 6.4 percent in 1993
Conclusions

• Global economy will continue to grow in 2013
  – US expected to be one of the better performers
• “2013 will be a difficult year”
  – Real risks remain in Europe
• Monetary policymakers will venture further into unexplored territory to support global economic activity
  – “Inflation targeting” as a paradigm for monetary policy may become less popular