

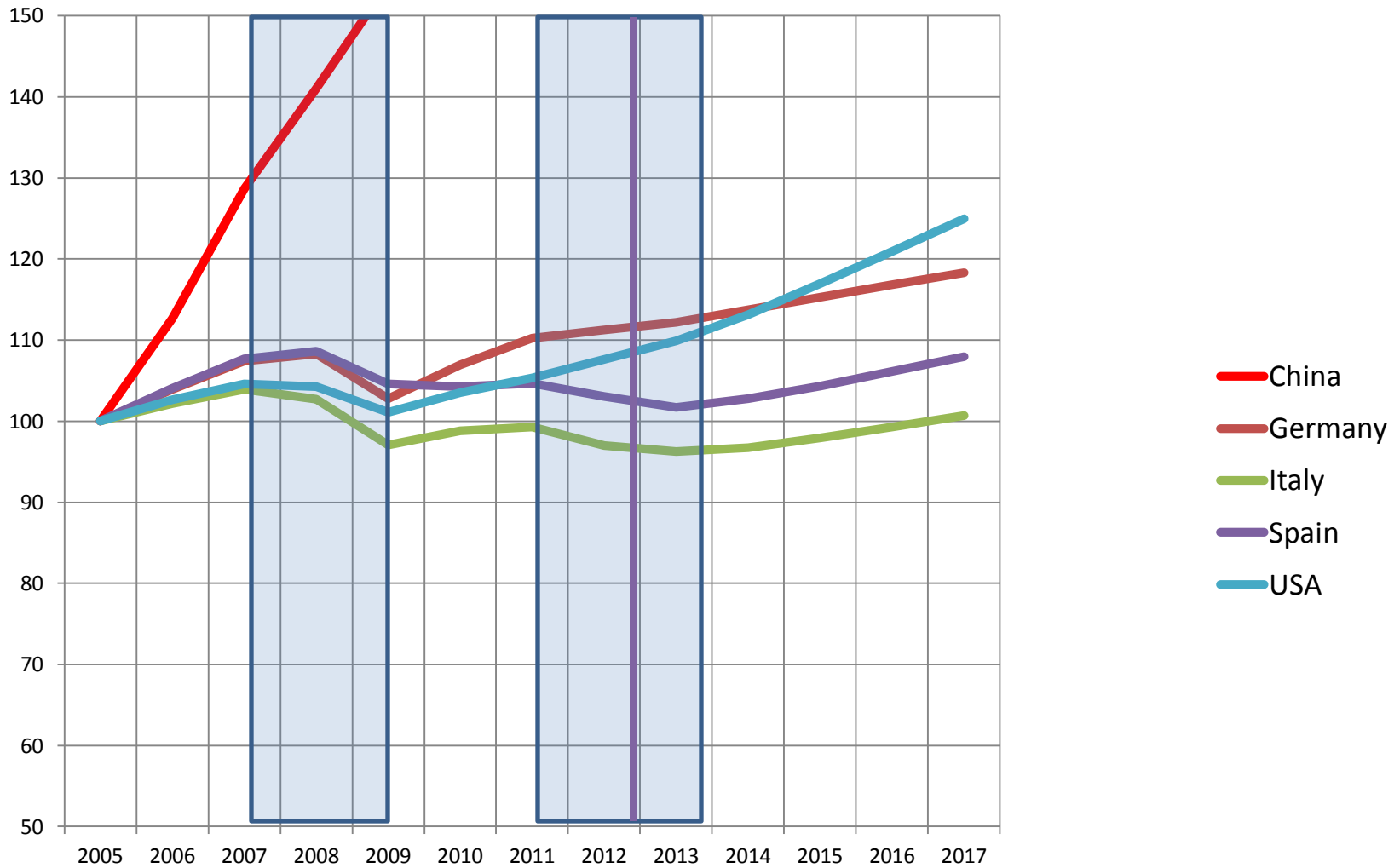
GLOBAL ECONOMIC WORRIES AND PRUDENT ASSET MANAGEMENT

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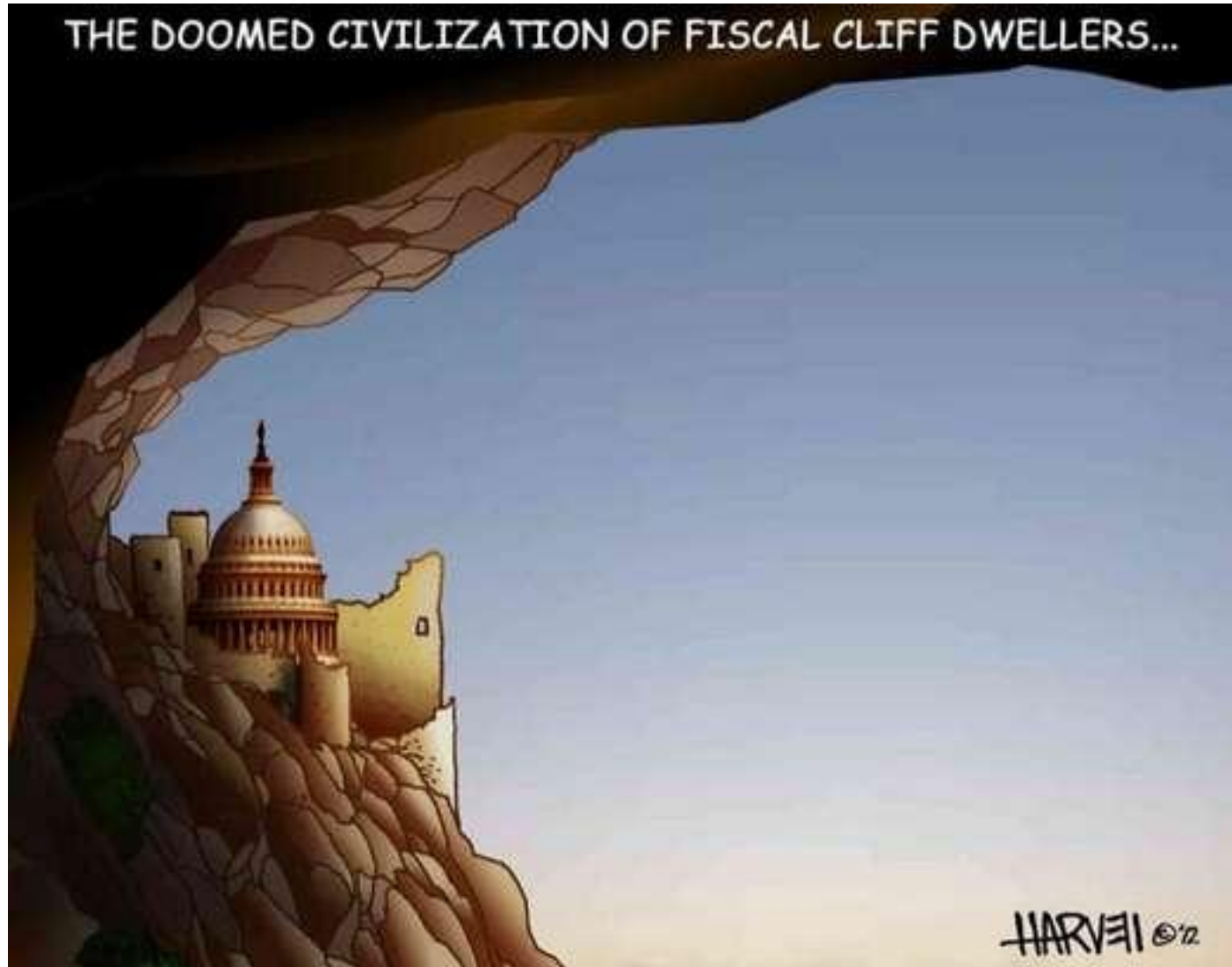
IMF: Real GDP (2005 = 100)



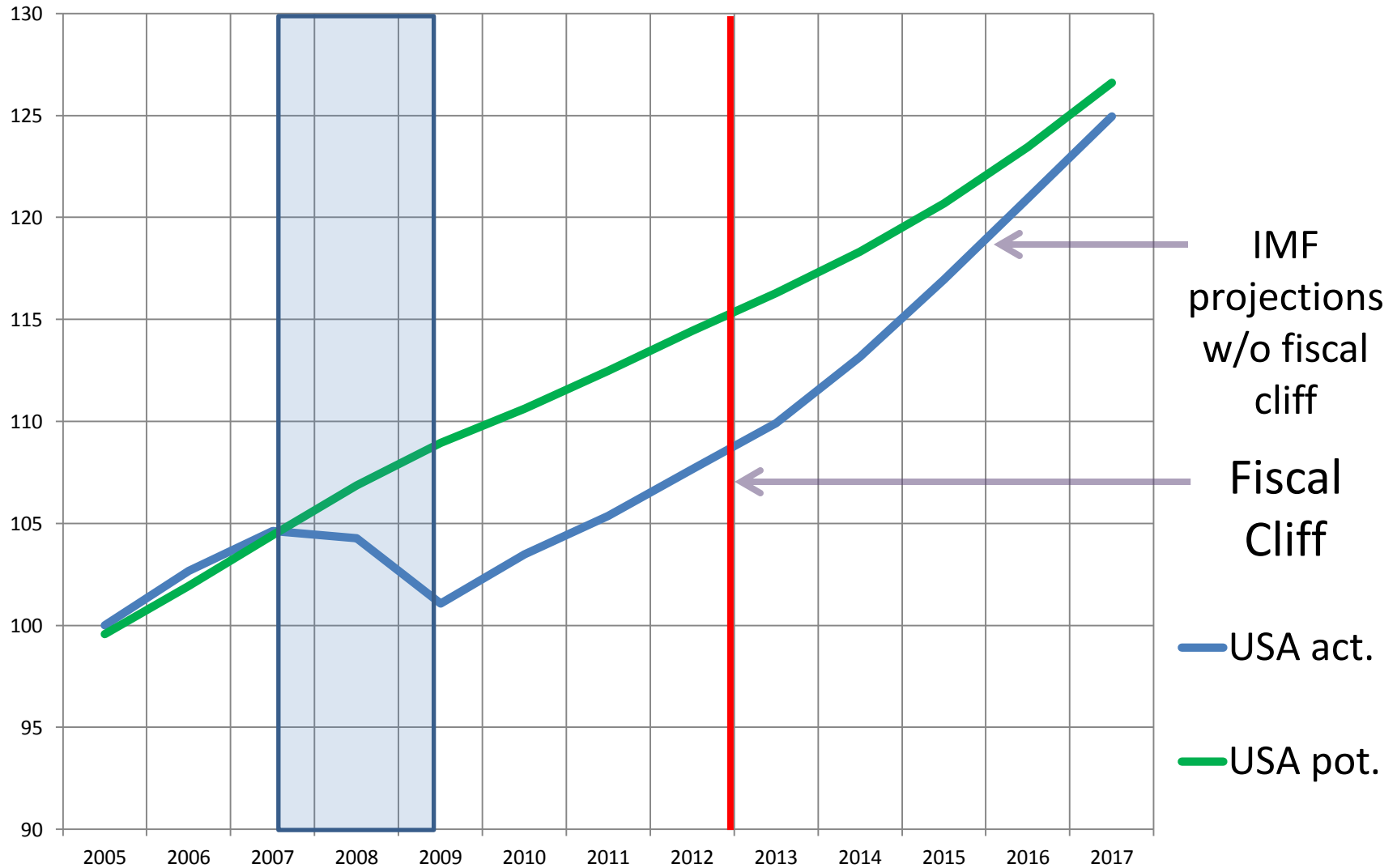
Worries

- U.S. recovery and the “fiscal cliff”
- China economic slowdown and structural imbalances
- EU austerity economics and recession
- Euro issues
 - Short-run stabilization
 - Long-run fiscal harmonization

U.S. recovery and the “fiscal cliff”



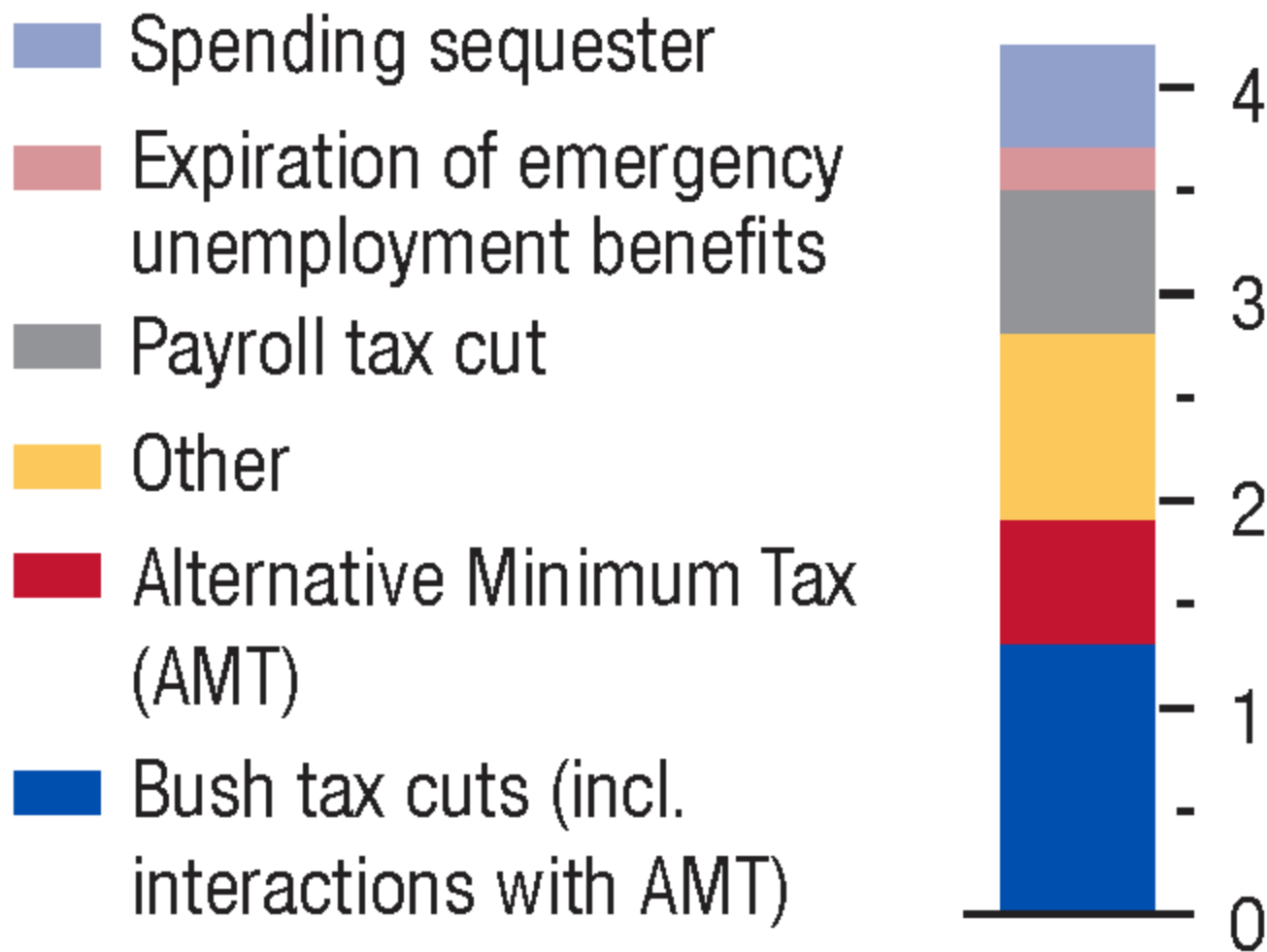
USA: Actual & Potential Real GDP



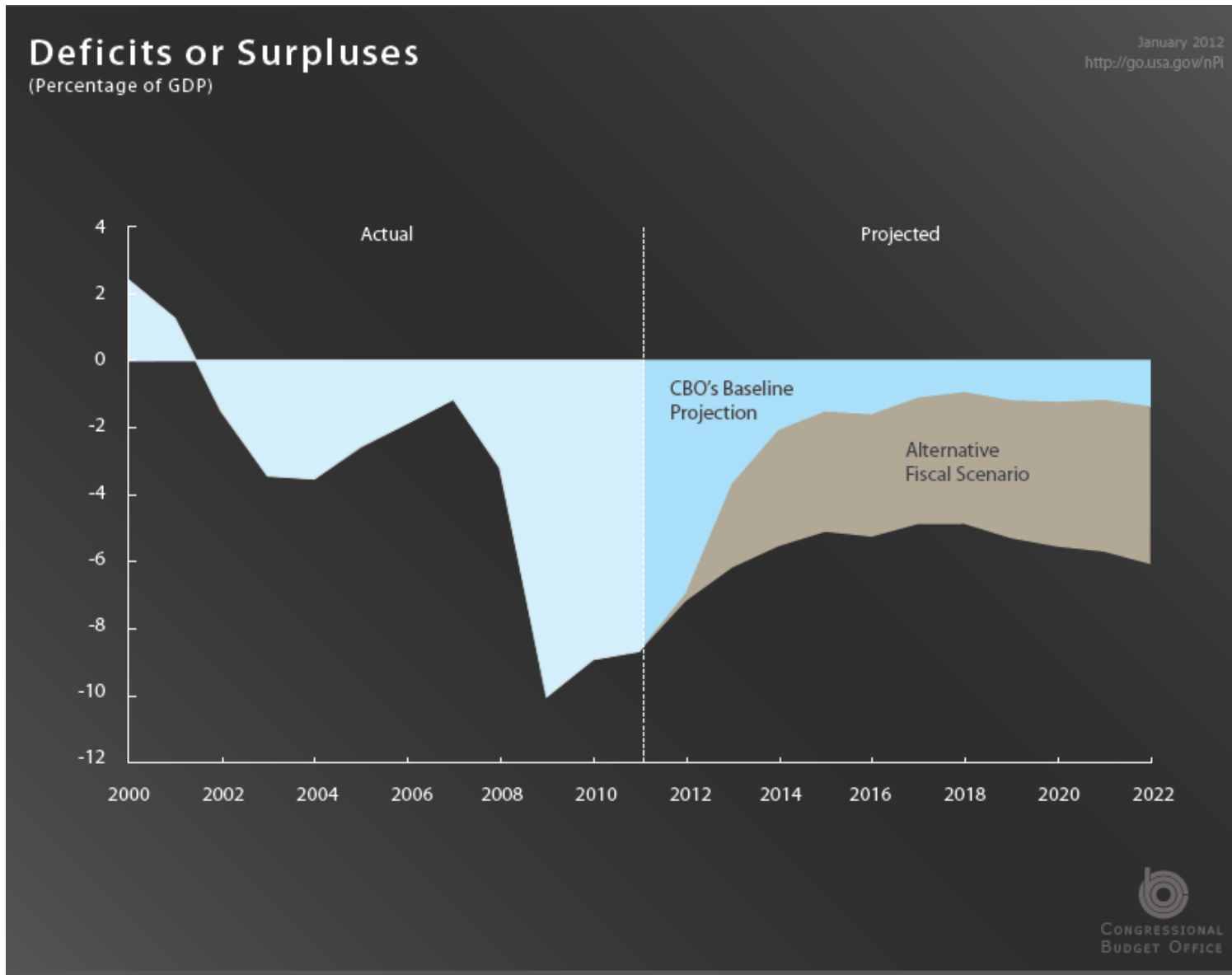
The “Fiscal Cliff” in the U.S.

- The U.S. since the beginning of the financial crisis in 2007 has been running large government deficits due to lower revenues, higher short-term social support, spending to stimulate recovery: 8.2% of GDP in 2012.
- The country also faces serious long-run structural deficits due to an inadequate tax base for growing health and social security programs
- The “Fiscal Cliff” is the result of a political impasse that on 1 January 2013 raises income tax rates to 1990’s levels and lowers government spending
 - Bad short-run impact on recovery
 - Reasonable magnitude for needed long-run structural adjustment, but with arbitrary unbalanced fiscal impacts

6. Composition of the U.S. Fiscal Cliff (percent of GDP; 2013)



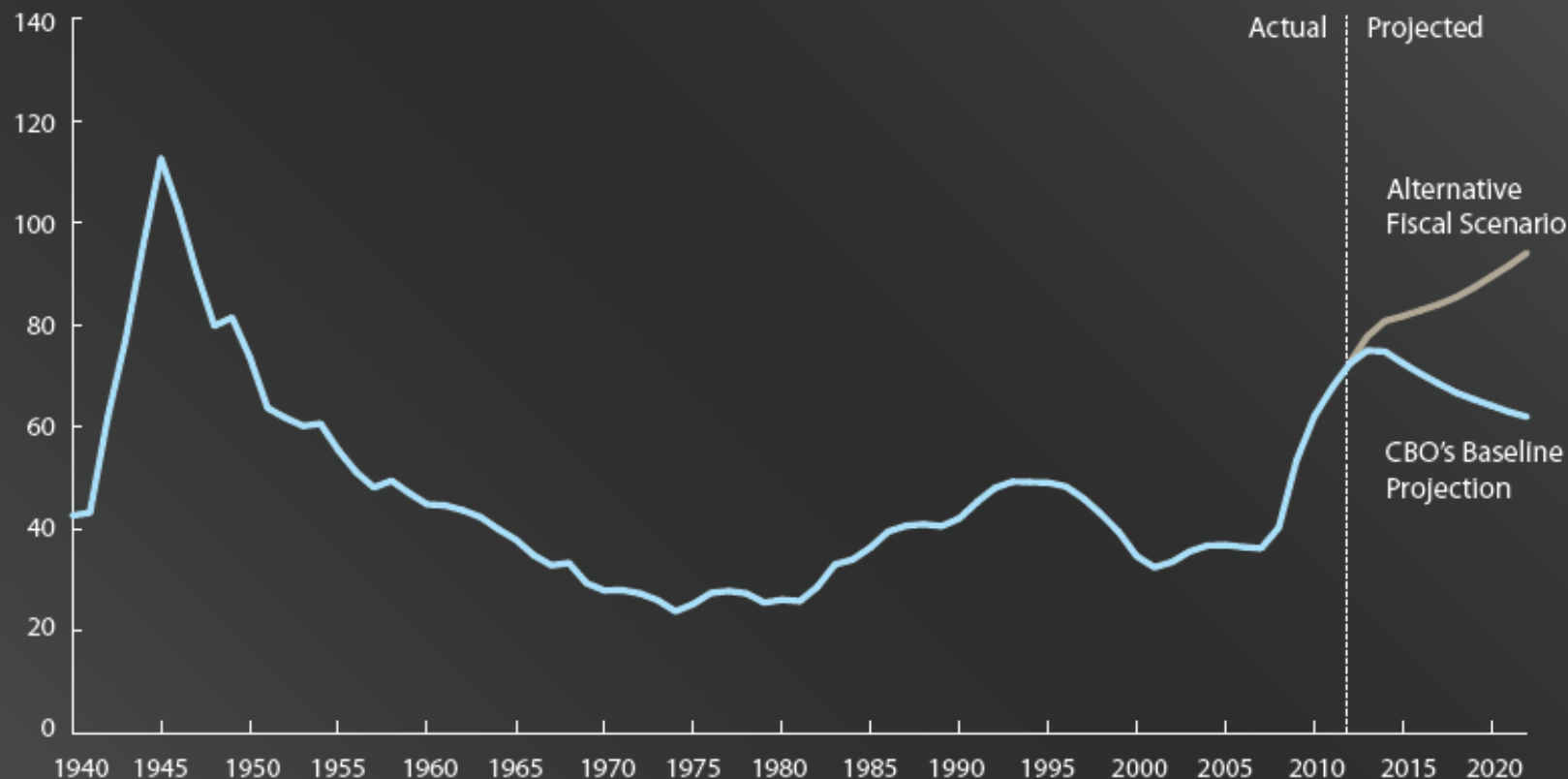
U.S. Government Deficit



Federal Debt Held by the Public, Historically and As Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of GDP)

January 2012
<http://go.usa.gov/nPi>



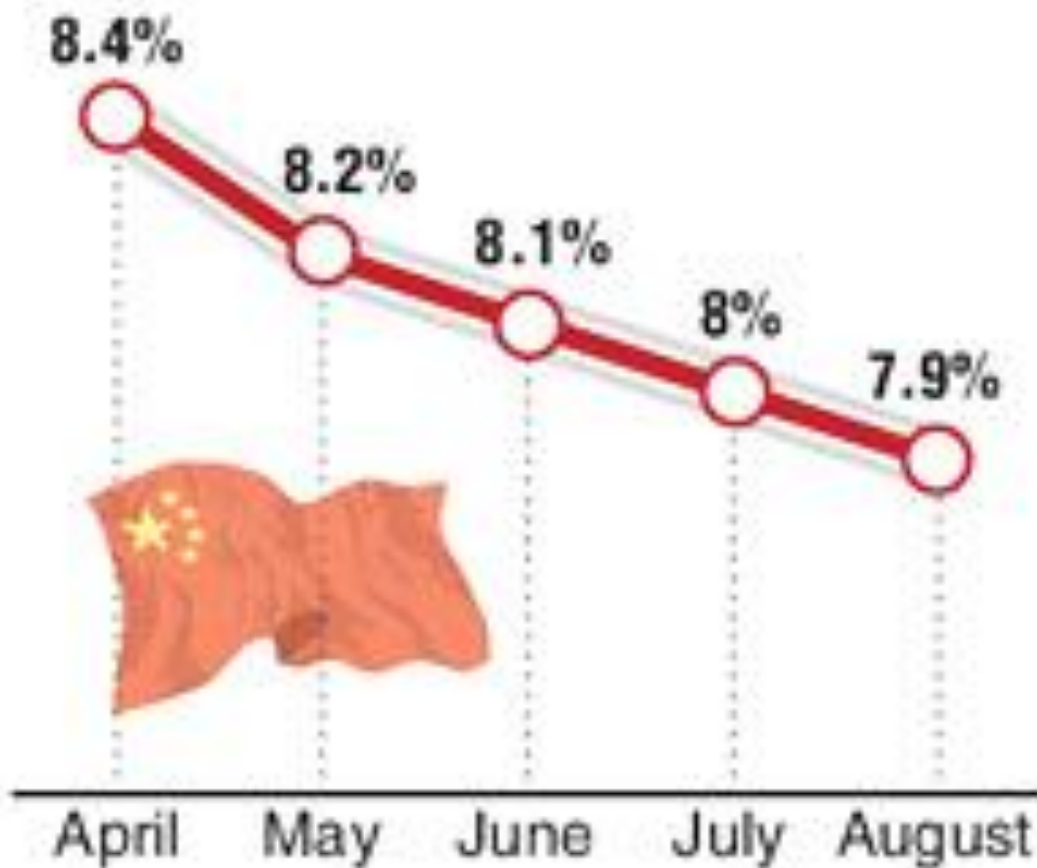
With modest deficits anticipated for much of the 10-year projection period of CBO's current-law baseline, debt held by the public recedes as a percentage of GDP. However, if some of the changes specified in current law did not occur and certain current policies were continued instead, debt held by the public would rise to 94 percent of GDP by the end of 2022, the highest figure since just after World War II.

Slowdown and Structural Imbalance in China



Pullback in Chinese growth

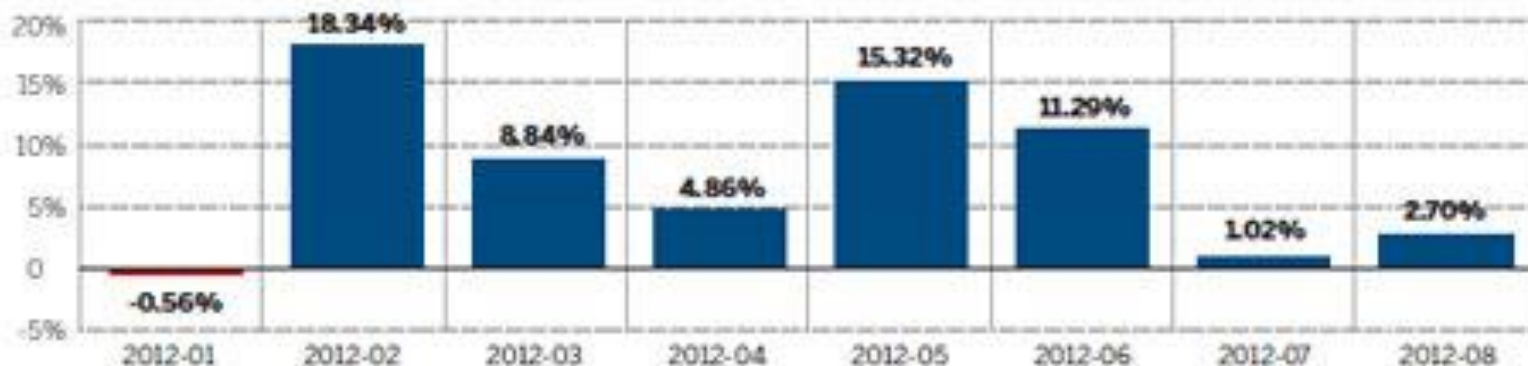
*Average estimate in China's
2012 GDP growth*



Source: 11 global investment banks

China

YEAR-ON-YEAR GROWTH IN EXPORTS



YEAR-ON-YEAR GROWTH IN IMPORTS



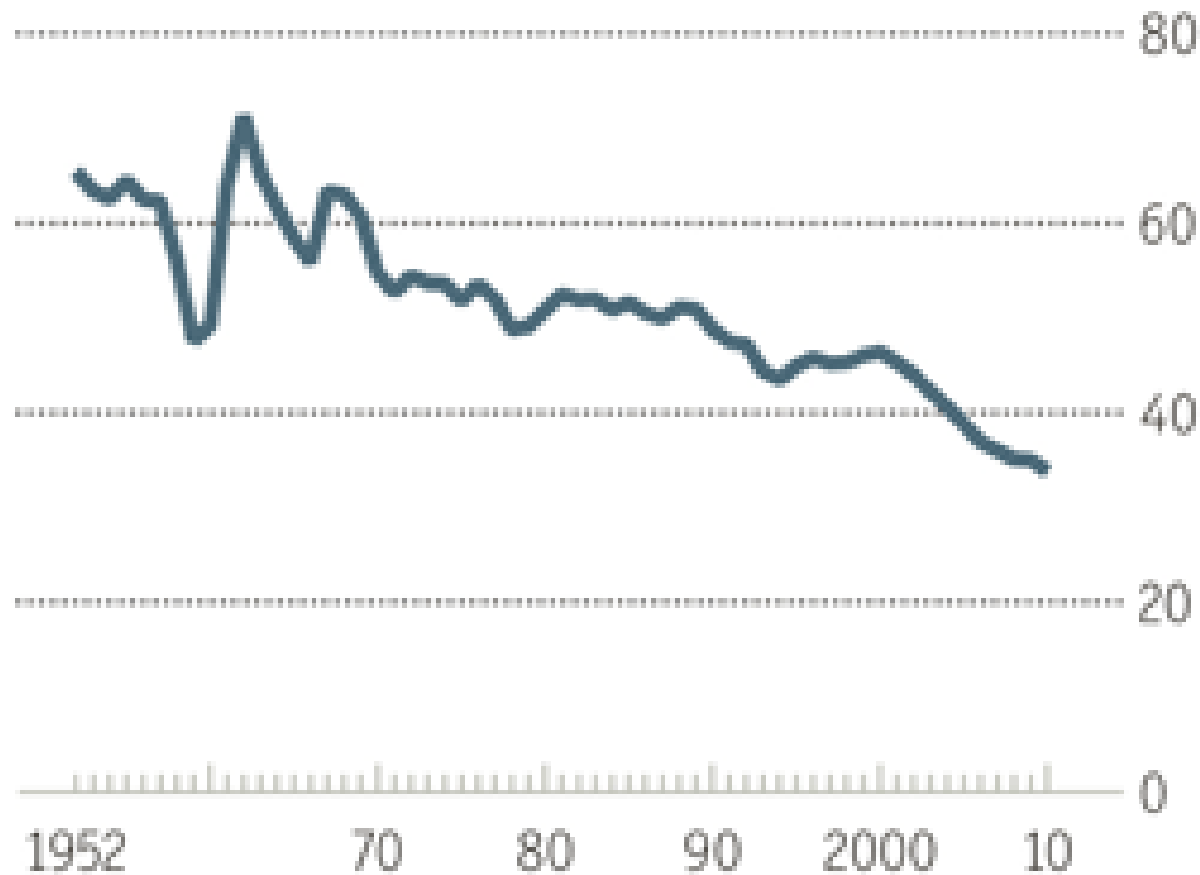
Source: Wind information

ZHANG YE / CHINA DAILY

Great fall of China

1

Chinese household consumption as % of GDP

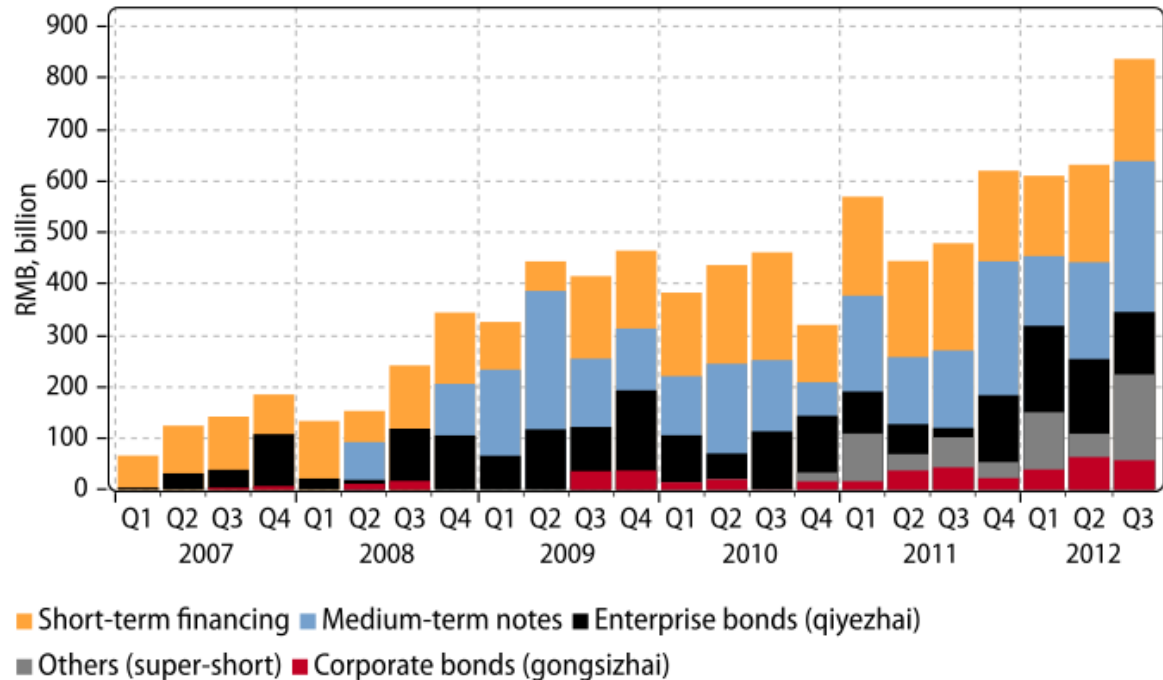


Source: CEIC

China

Corporate debt issuance surged to new highs in Q3

Bond sales by nonfinancial corporations, by type

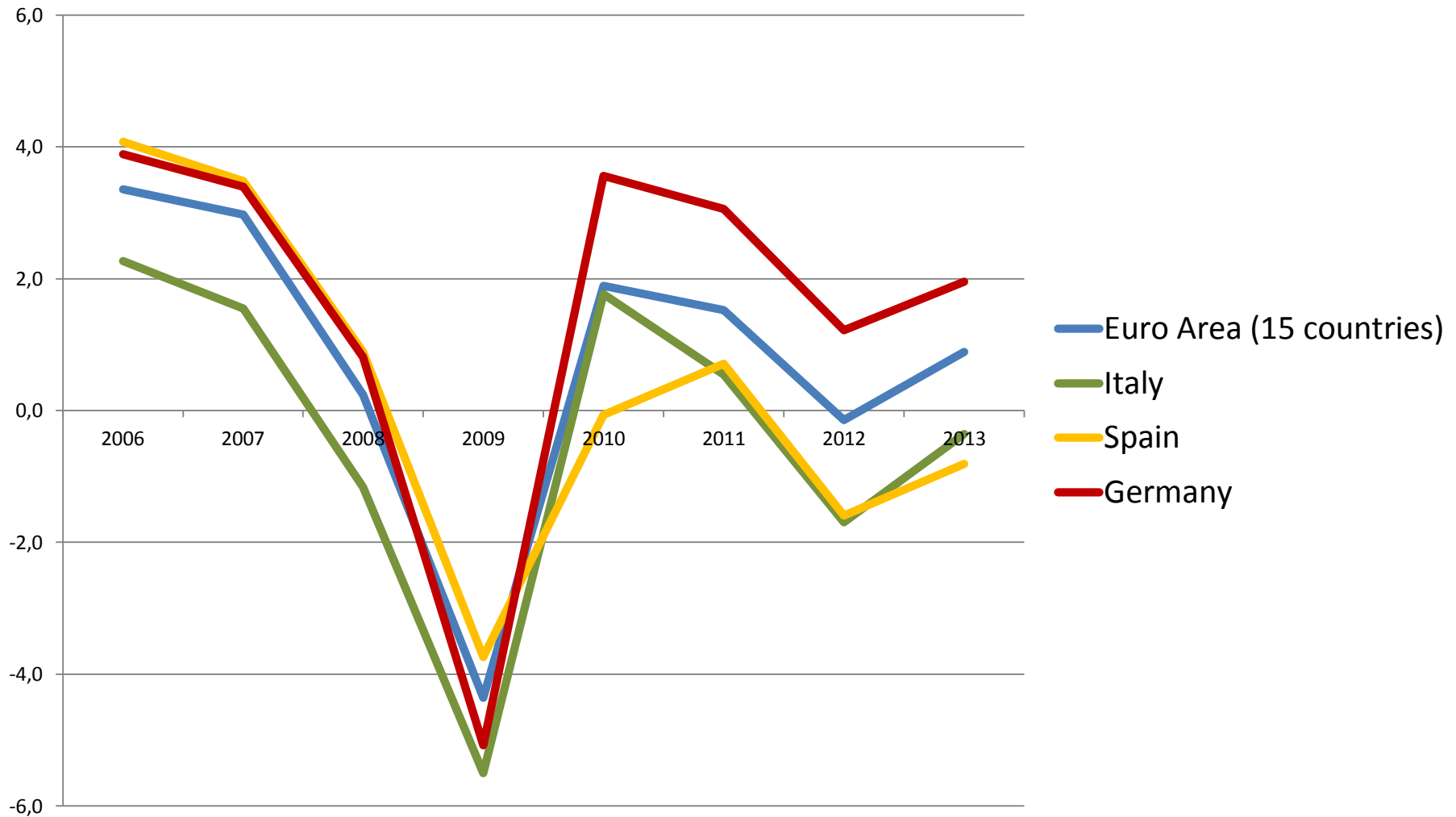


CEIC, GaveKal Data

EU Austerity and Recession

- A number of member states have chosen fiscal austerity as a response to declining revenues and rising costs of rolling over government and government-guaranteed debt
 - Iceland, Ireland, UK, Spain, Greece (involuntarily), Portugal and Italy (reluctantly)
- The EU, led by Germany, has resisted monetary loosening that could become inflationary, accepting slow growth and shrinking peripheral countries
- Can austerity work? Is recession worth it?

Real GDP Growth Rates



The Euro Crisis

STAR TRIBUNE
S&K

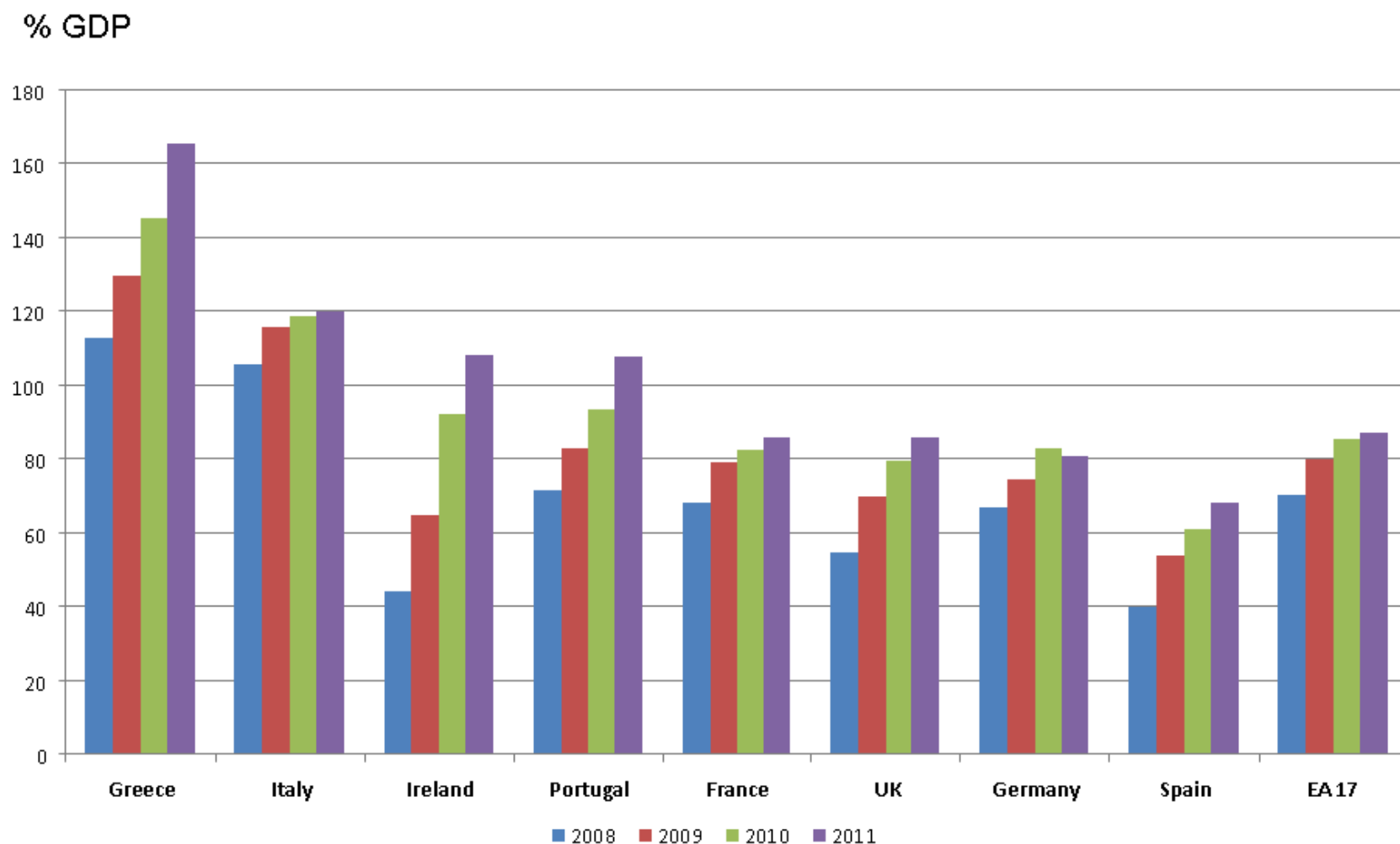


WORST MEDITERRANEAN CRUISE EVER!

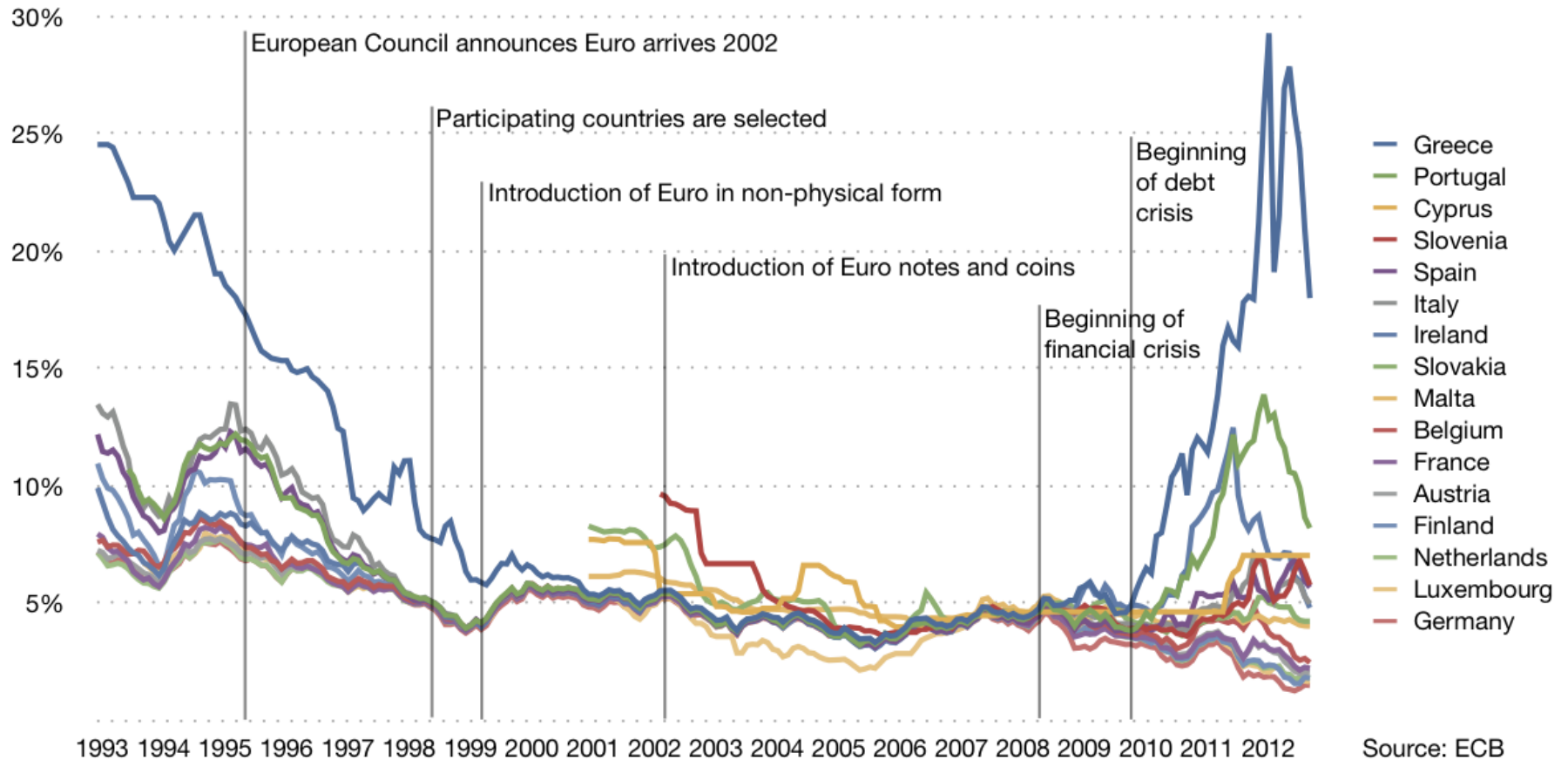
Stabilization



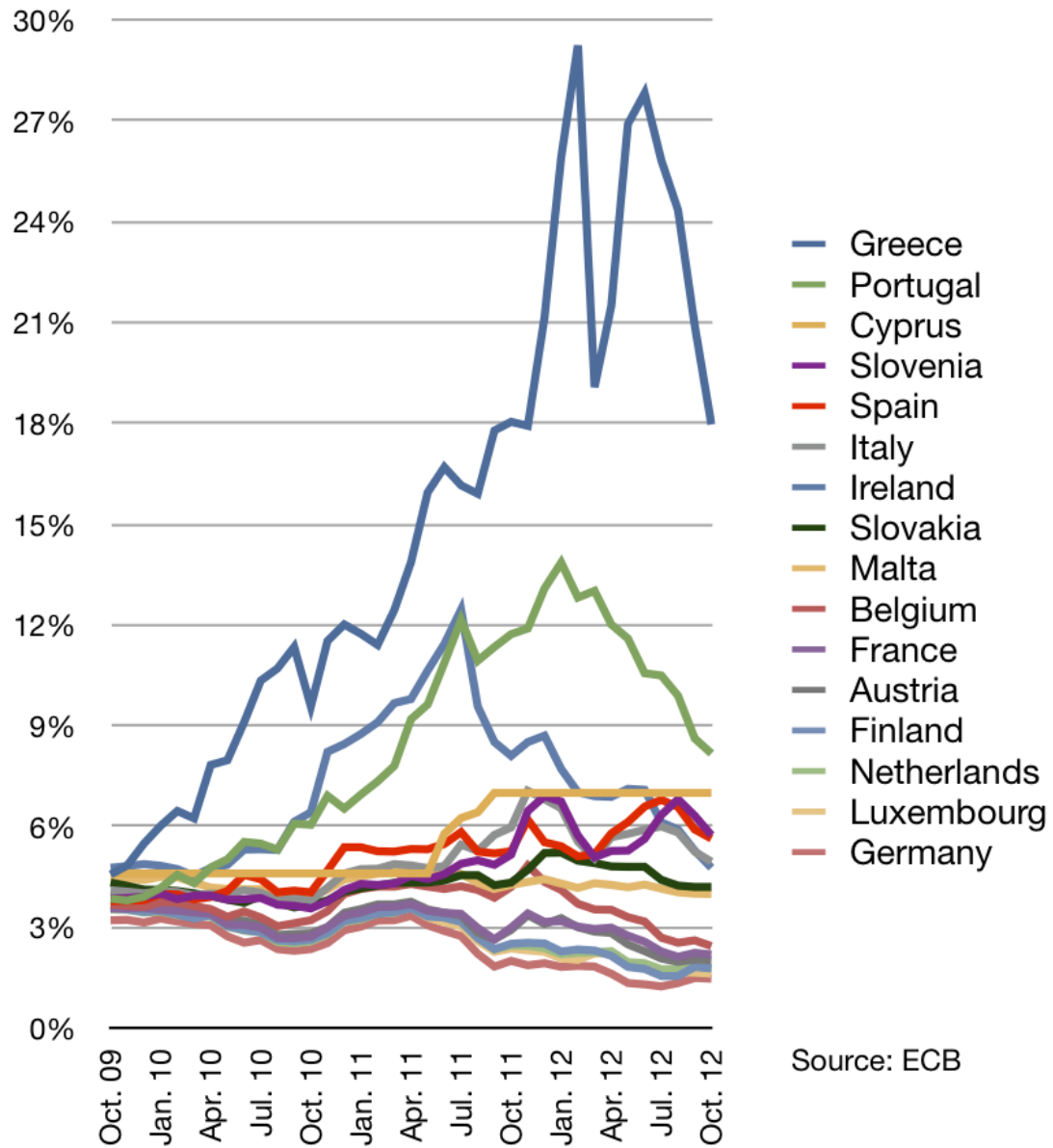
Debt to GDP Ratio for Selected European Countries



Long-Term Interest Rates

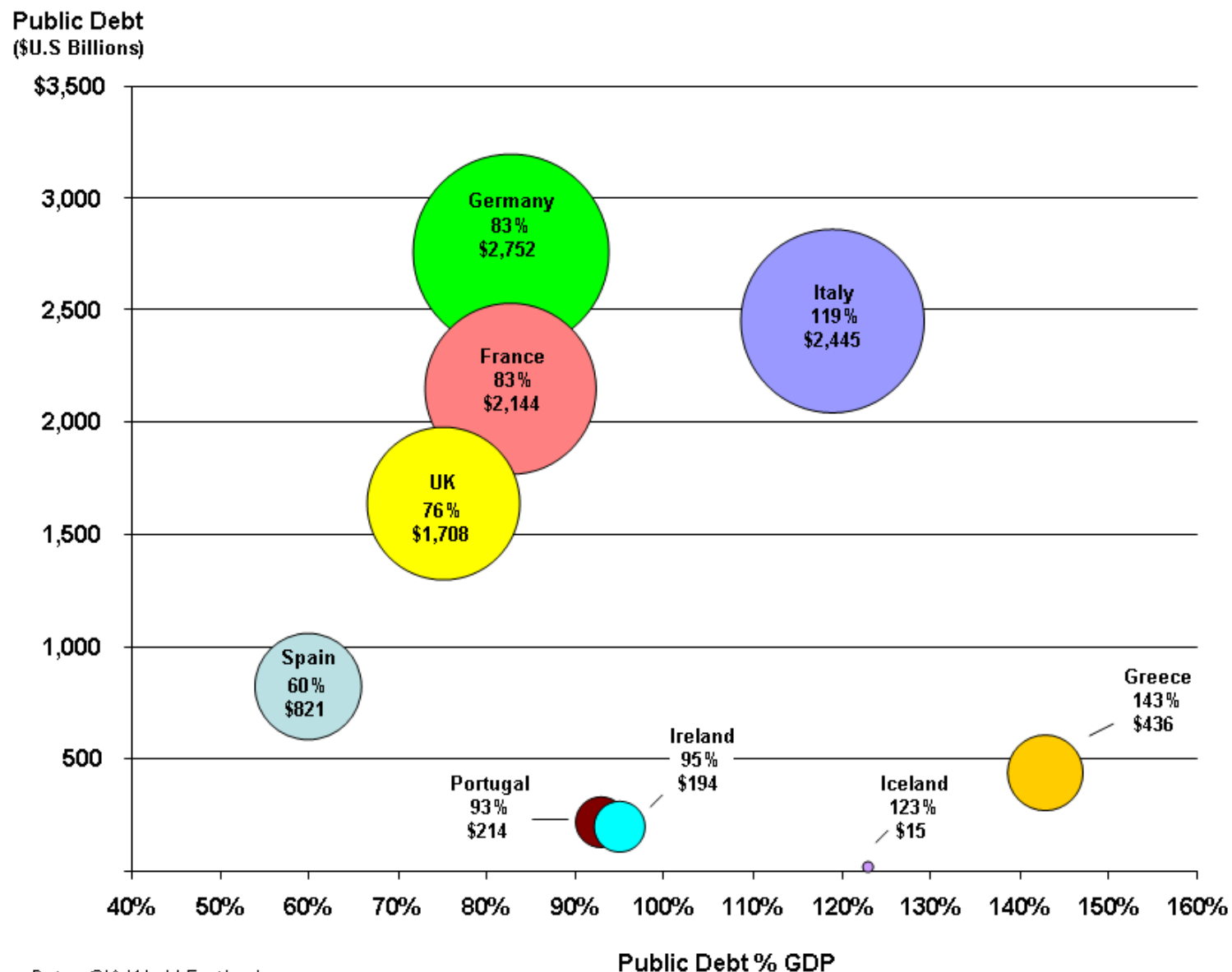


Long-term interest rates



Source: ECB

Public Debt and Debt to GDP - 2010

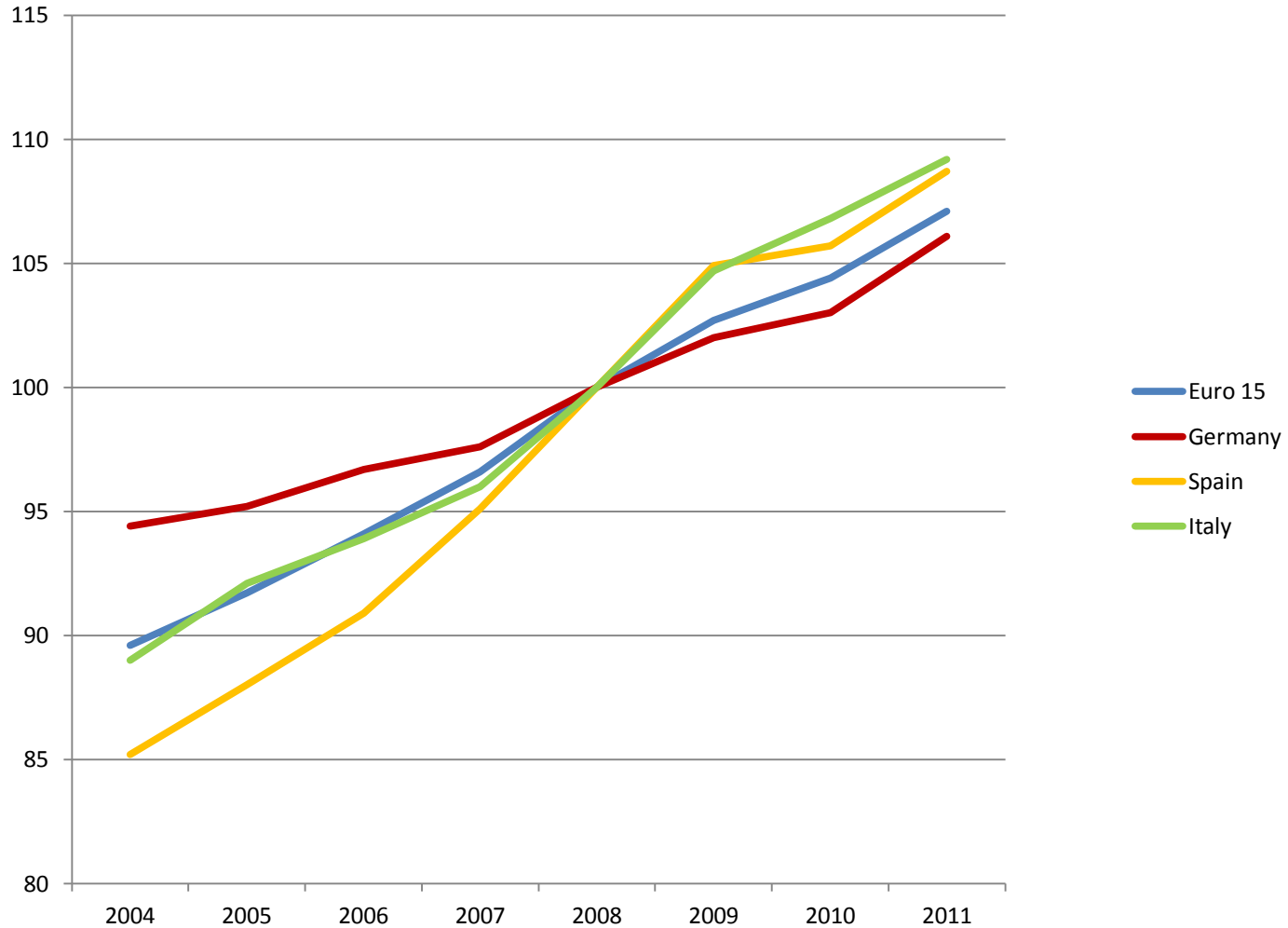


Source Data: CIA World Factbook

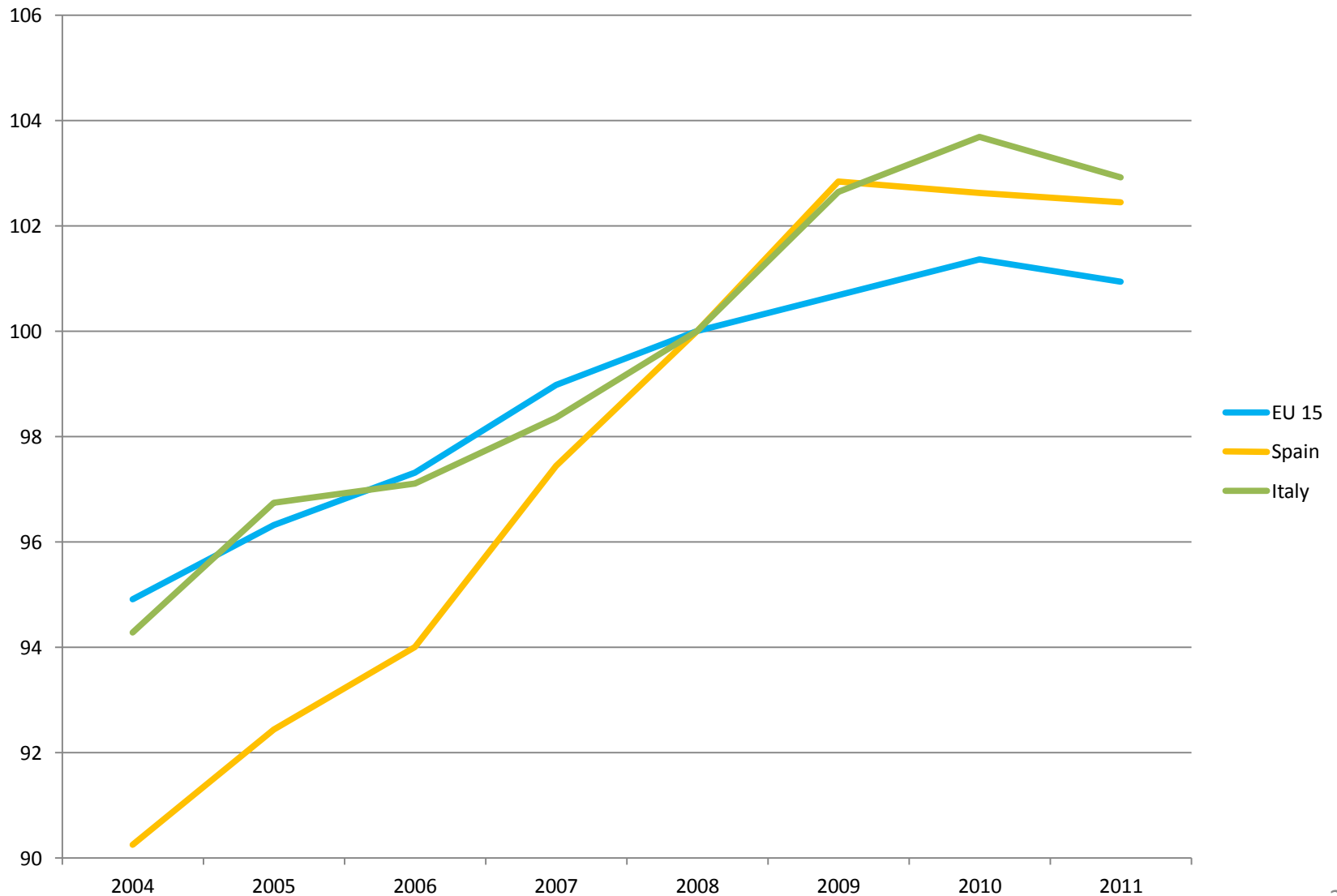
Structural and Survival Issues



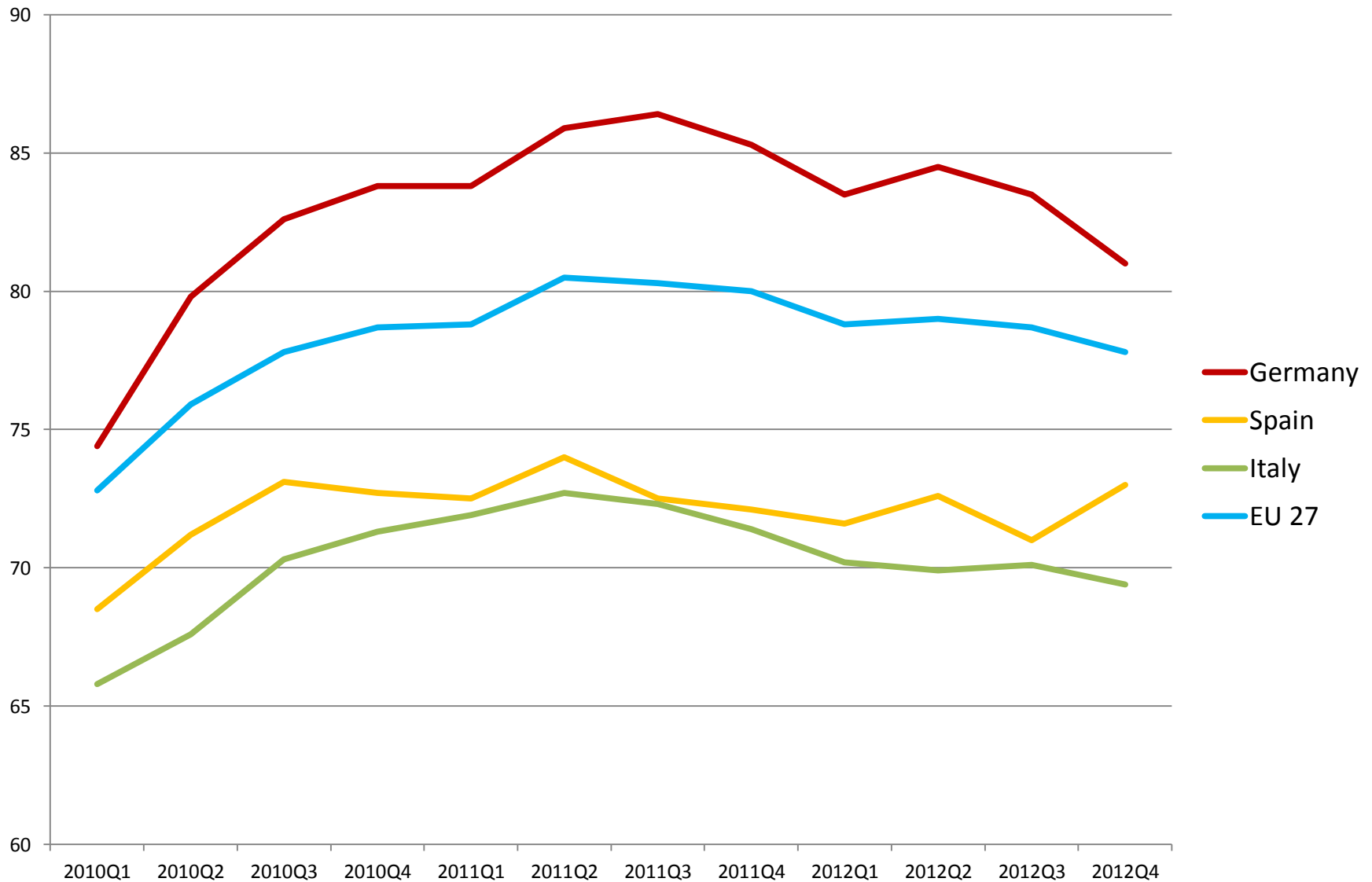
Nominal Unit Labor Costs



Unit Labor Costs Relative to Germany

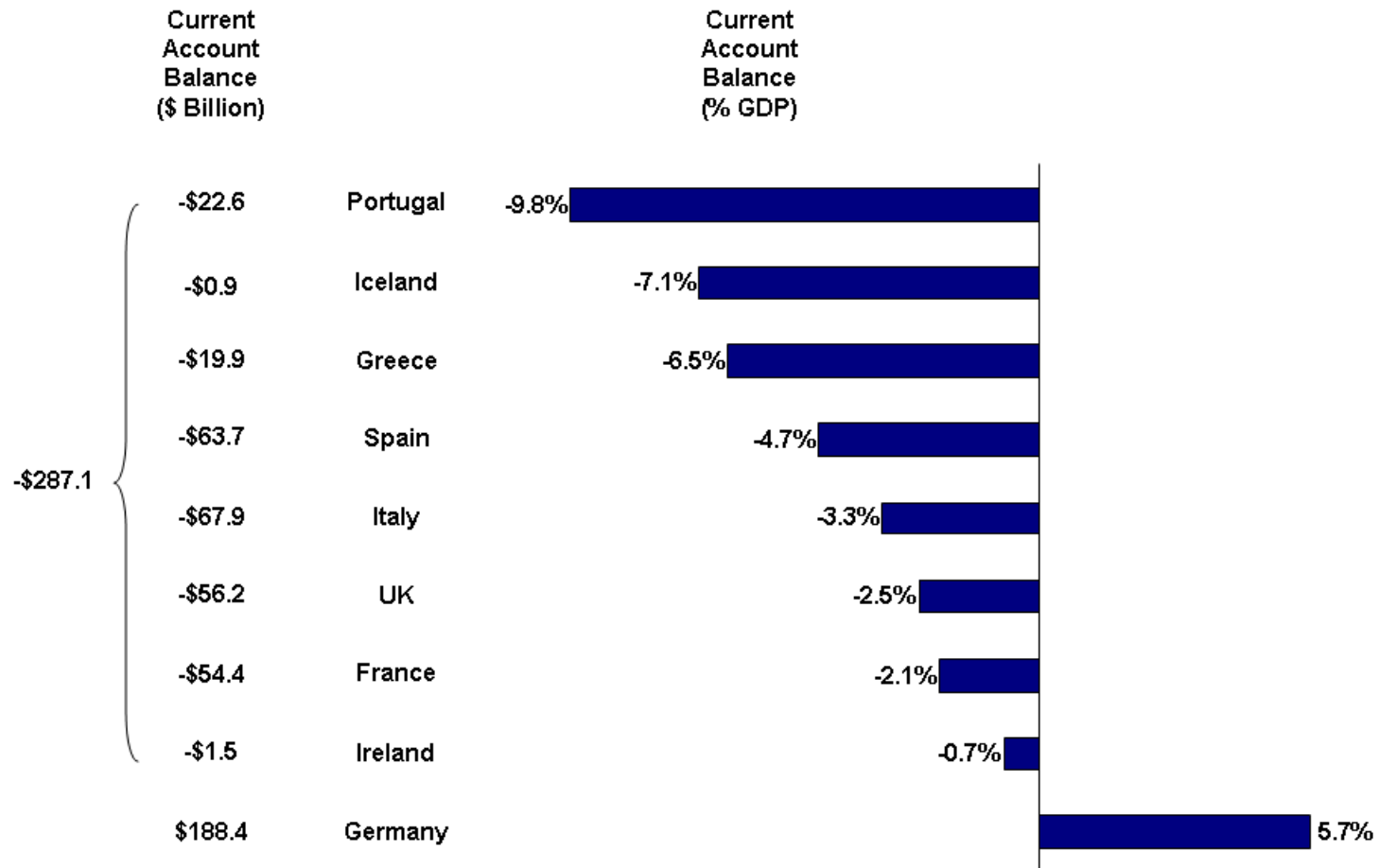


Manufacturing Capacity Utilization



Balance by Inflation or by Wage Cuts?

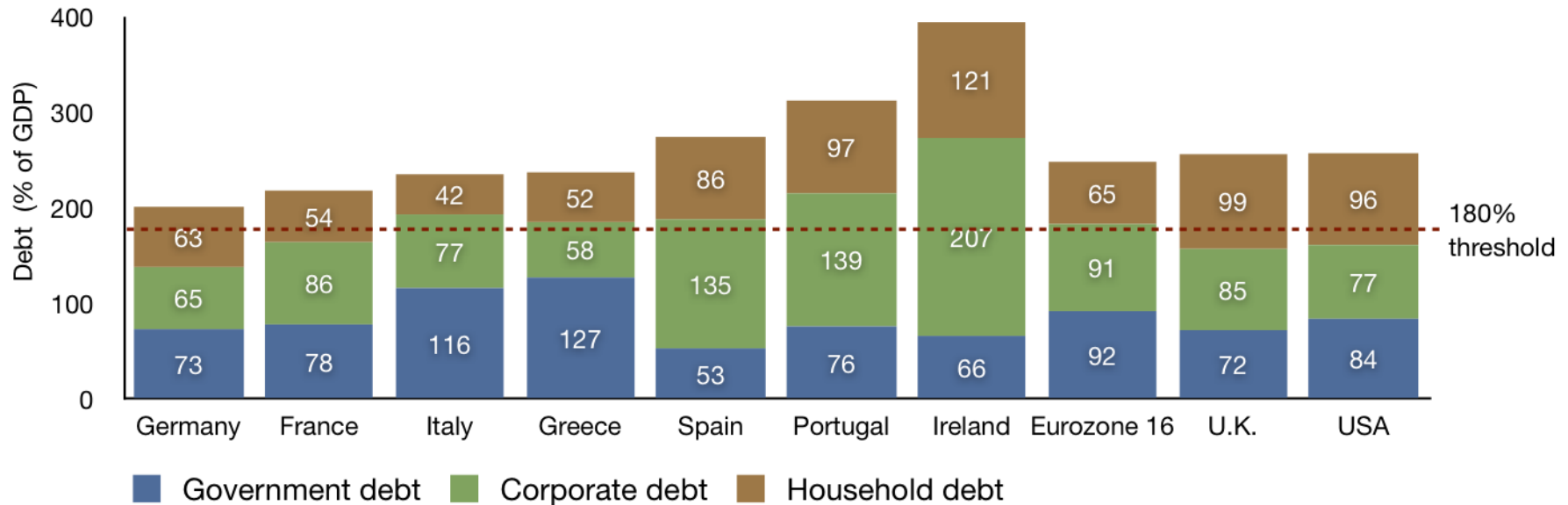
Current Account Balances - 2010



Source Data: CIA World Factbook

Necessary debt reduction and wealth tax to reach 180 percent of debt-to-GDP ratio

€ (billions)	523	727	845	134	998	221	340	6,121	1,252	8,243
wealth tax needed	11%	19%	24%	47%	56%	57%	113%*	34%	27%	26%



* Ireland's household financial assets are smaller than the required adjustment of debt levels.

Source: Eurostat, Federal Reserve, Thomson Reuters Datastream, BCG analysis.

Note: All data as of 2009.

Prudent Asset Management



← 30 Years →

Asset Management Objectives

- Move a person's real income from work to retirement years without risk relative to the economy in which the person lives
- As an alternative to defined benefit (risk on fund) and defined contribution (risk on person) systems, consider a defined SES system that guarantees a pensioner the same social status as in his working days

Implications

- Do not expect or seek real rates of return higher than the Italian real rate of growth per capita
- No unhedged diversification outside the local economy
 - stay in the Italian boat: even if not the fastest, it is going to take you home
- Beware of bankers and hedge funds selling derivatives
 - Fully insured long-run returns higher than the rate of growth per capita are too good to be true