

# Between Tardy Recovery and Protracted Malaise

## The painful adjustment to global rebalancing



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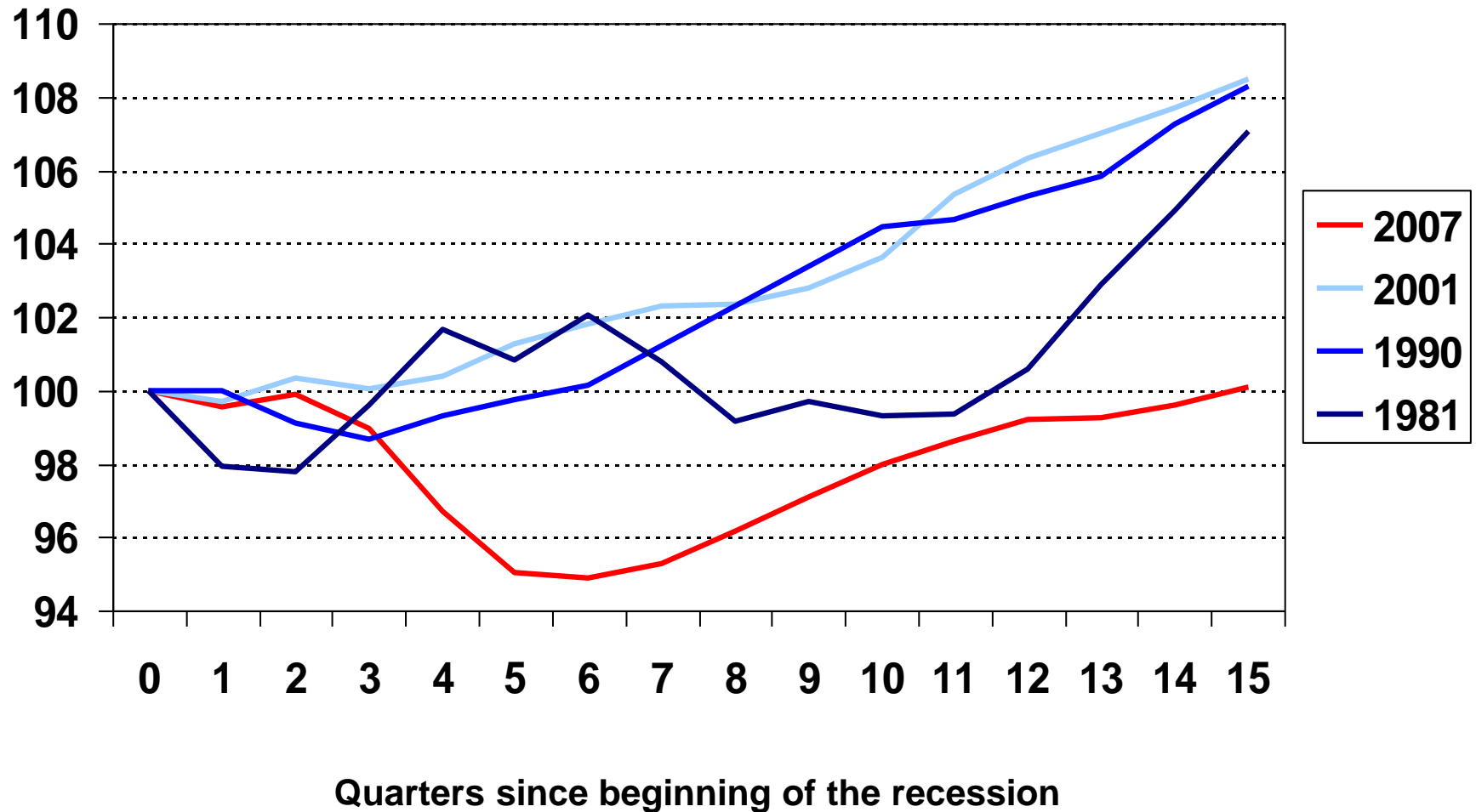
# Between Tardy Recovery and Protracted Malaise

## The painful adjustment to global rebalancing

- The U.S. Outlook: between short-term and long-term challenges
- The European Outlook: chickens come home to roost
- The Rest of the World: codependant or decoupled?

# A disappointing recovery: lagging GDP

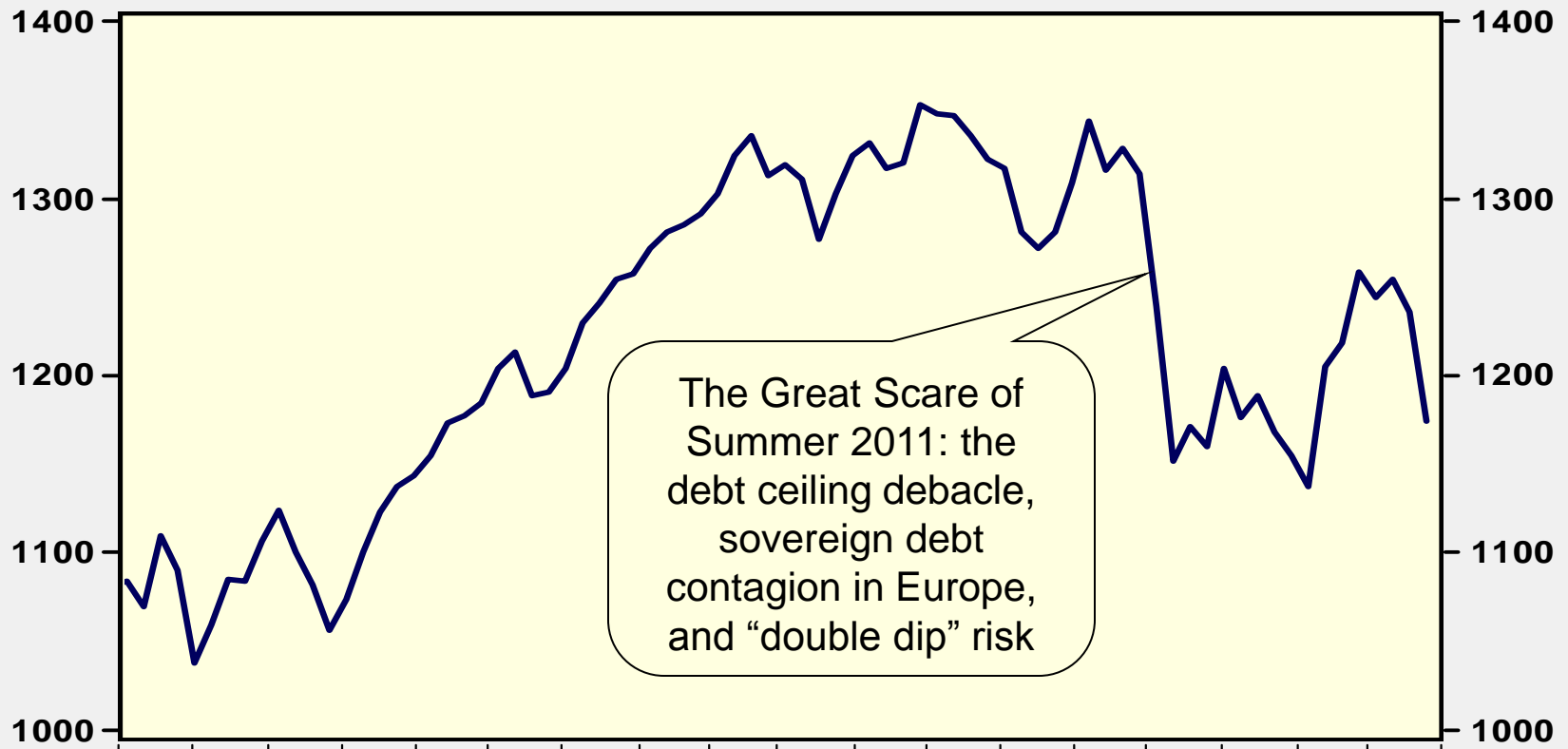
GDP at peak quarter = 100



# Summer 2011: a new crack in financial markets

Standard & Poor's 500 Stock Price Index

Avg, 1941-43=10



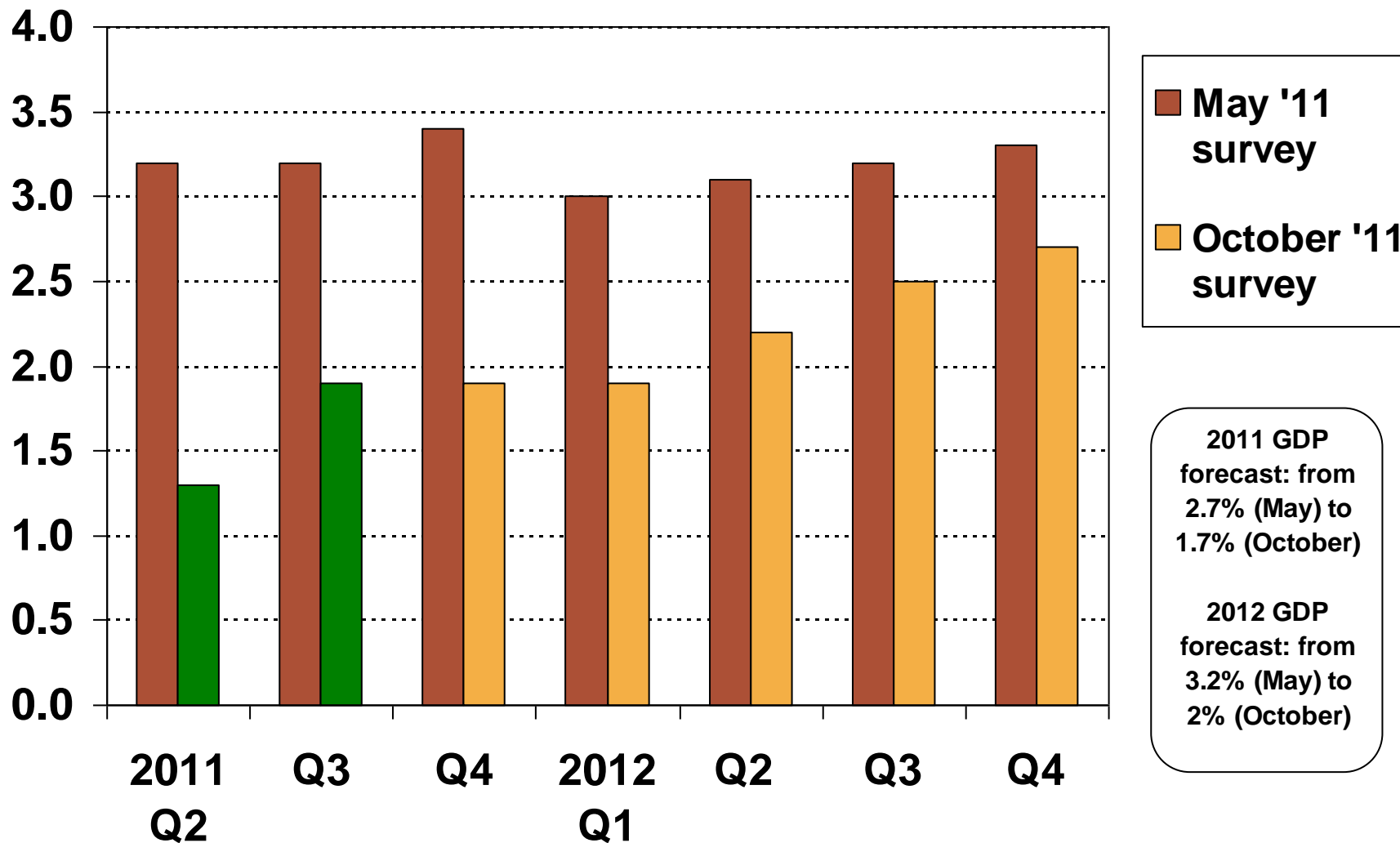
The Great Scare of Summer 2011: the debt ceiling debacle, sovereign debt contagion in Europe, and "double dip" risk

Source: Financial Times /Haver Analytics

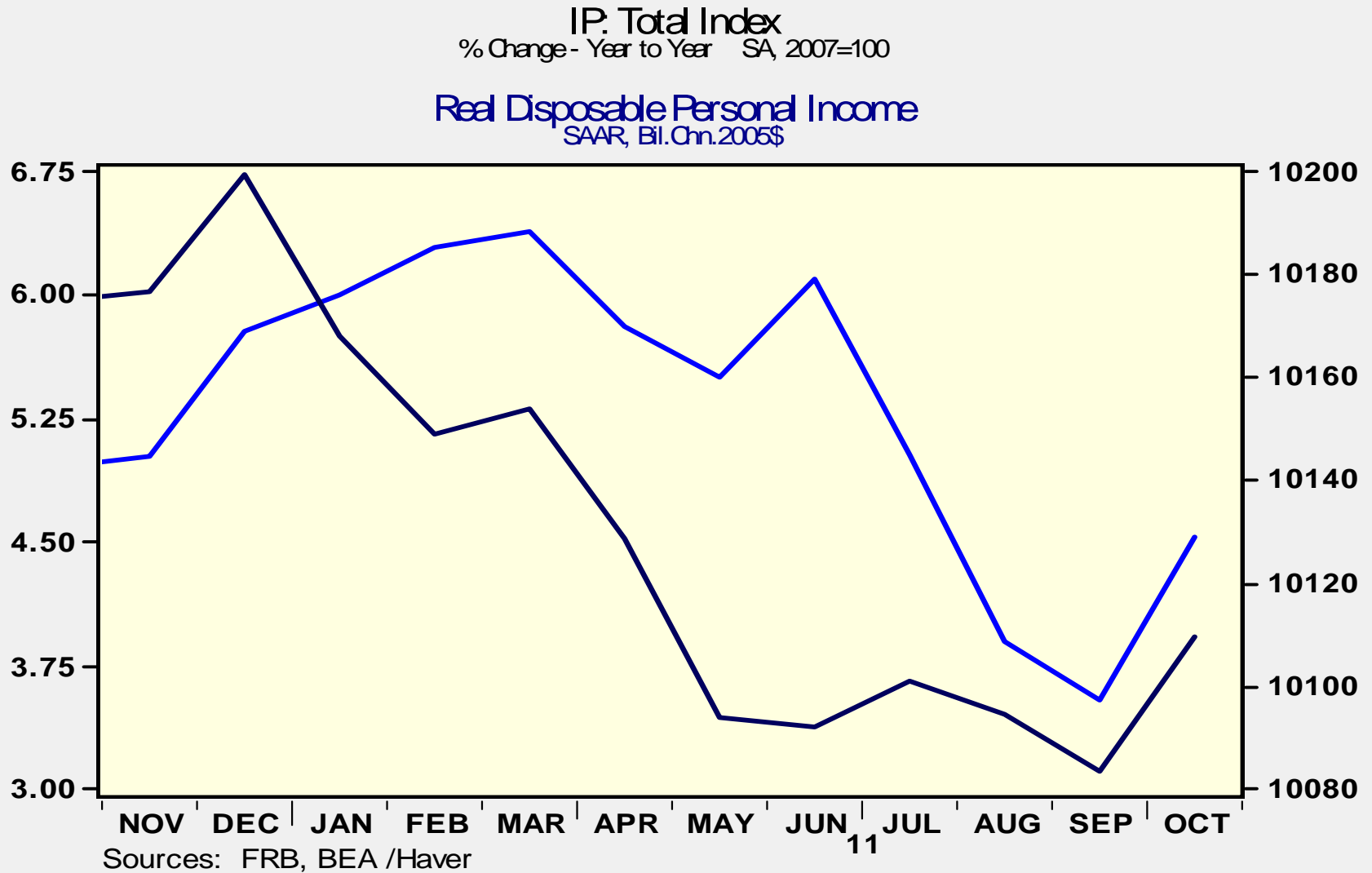
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# Blue Chip Economic Forecast Consensus: GDP Growth

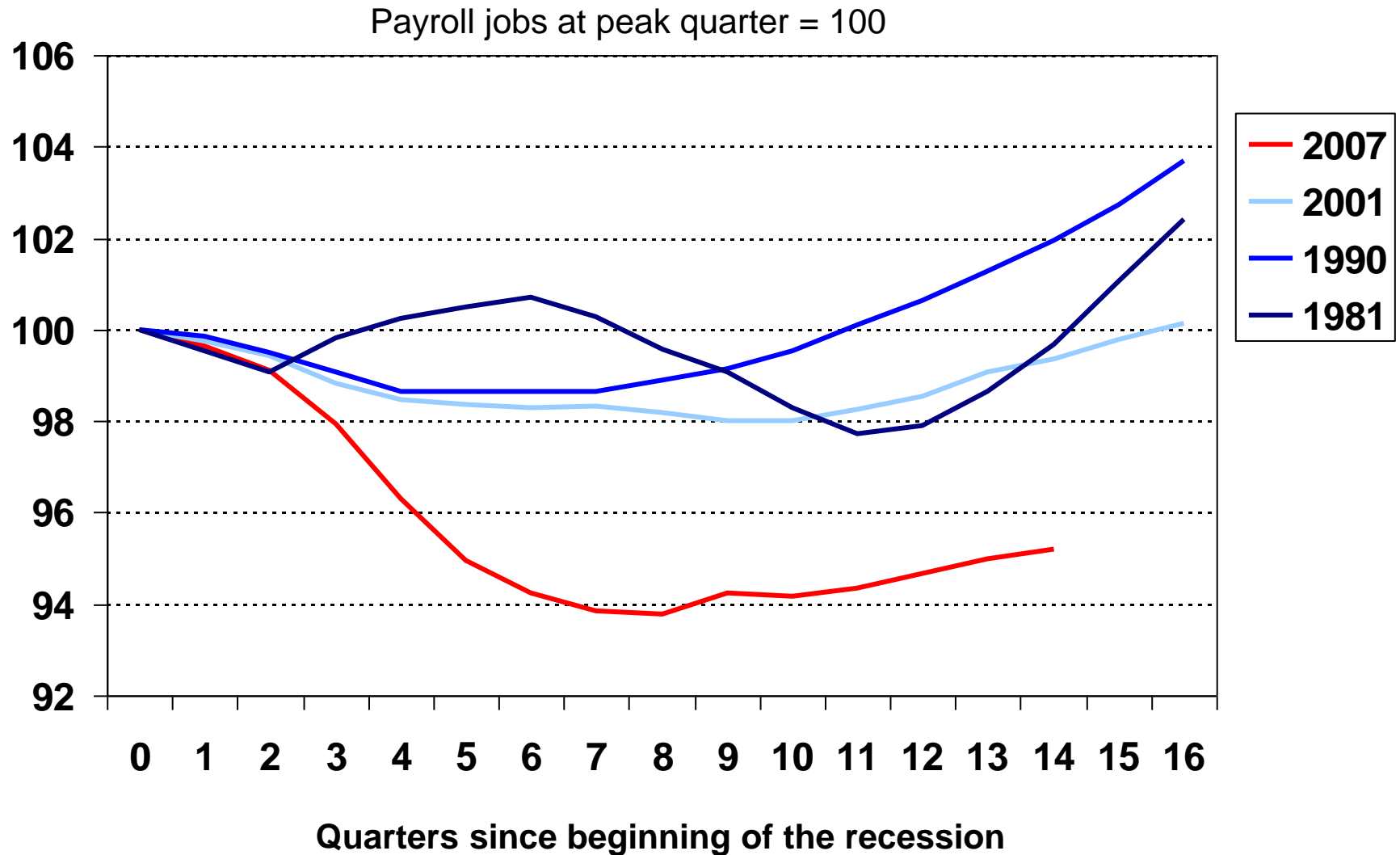
Percent change in real GDP, q-o-q saar



# Short term: signs that the outlook is improving



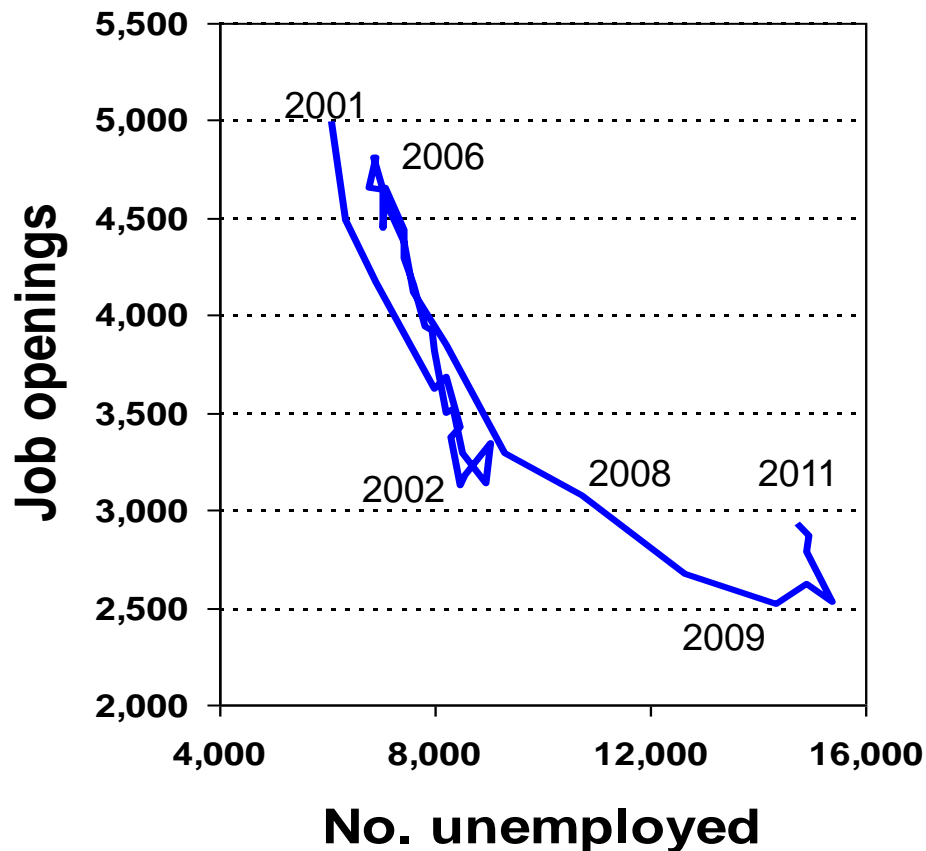
# Long term: structural challenges in labor markets



# 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

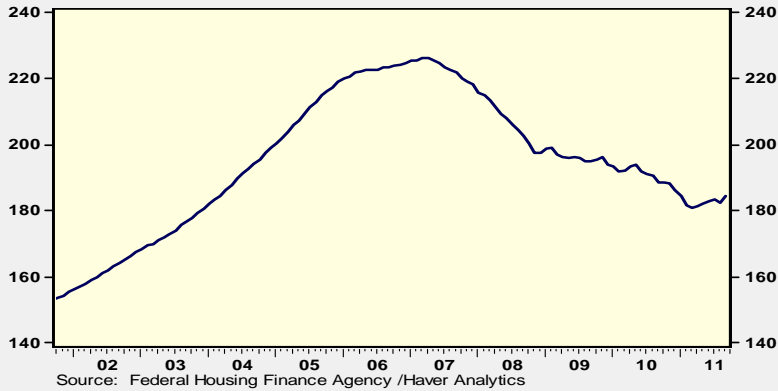
## The Beveridge Curve





# Long term: structural challenges in housing

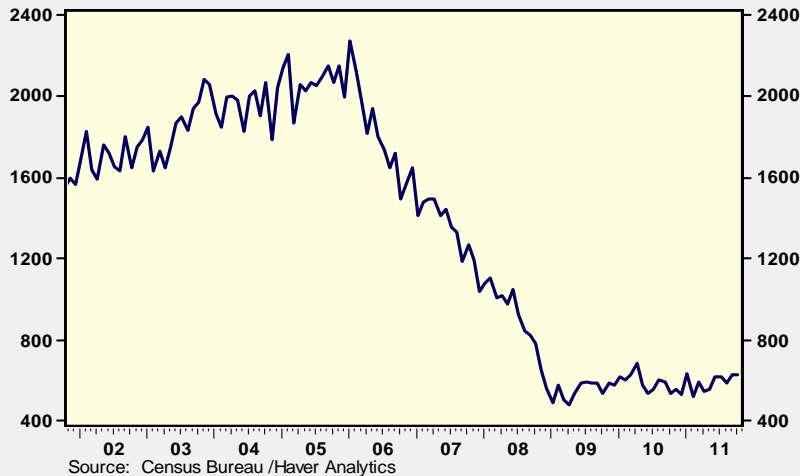
FHFA House Price Index: Purchase Only, United States  
SA, Jan-91=100



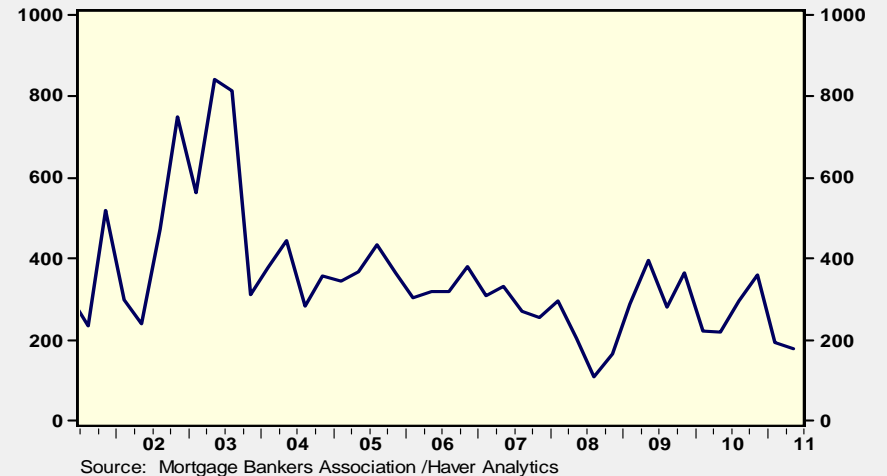
Total Home Sales (new plus existing units)  
(thous)



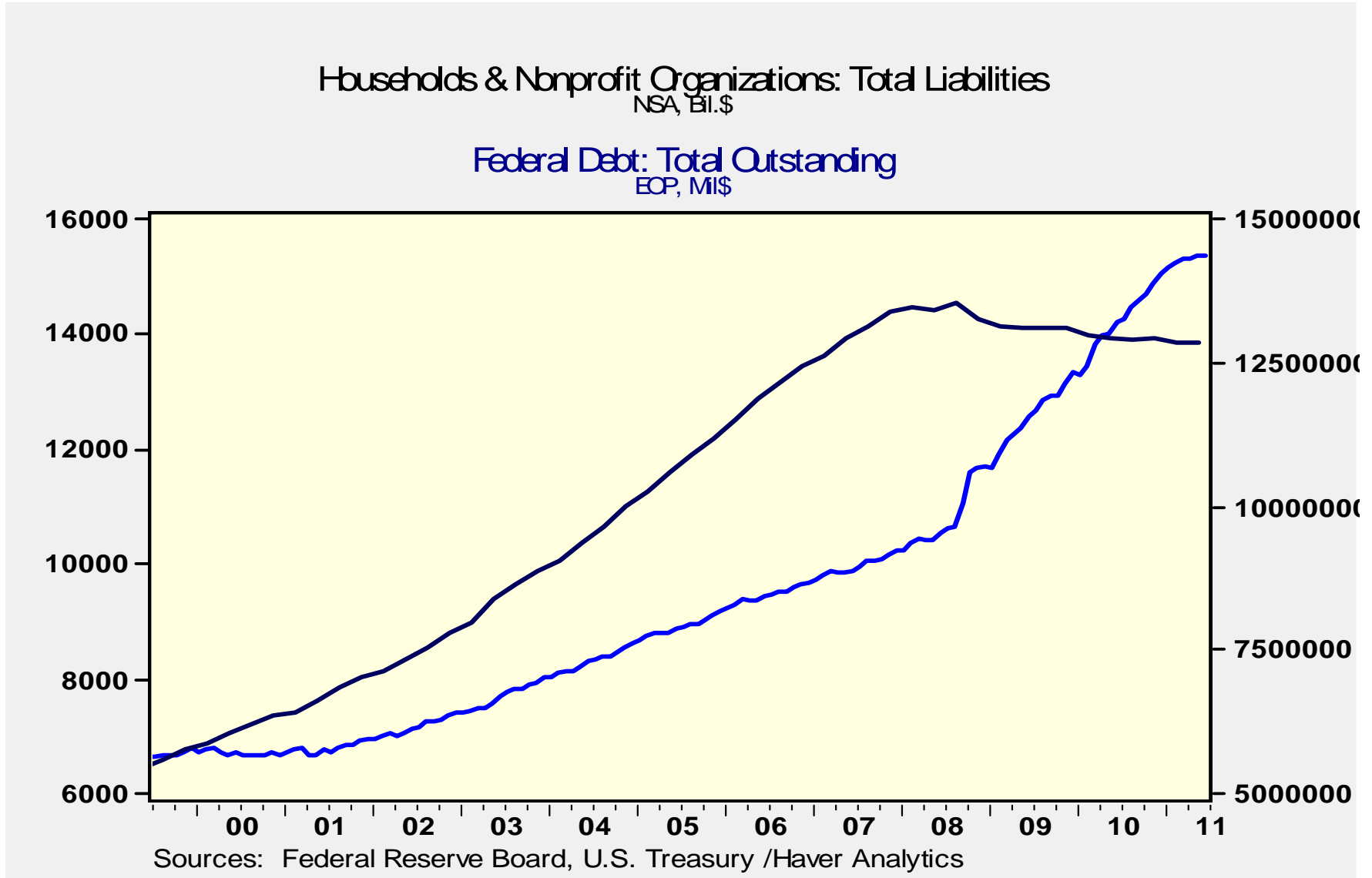
Housing Starts  
SAAR, Thous.Units



Mortgage Originations: 1-4 Family, Refinance  
Bl.\$



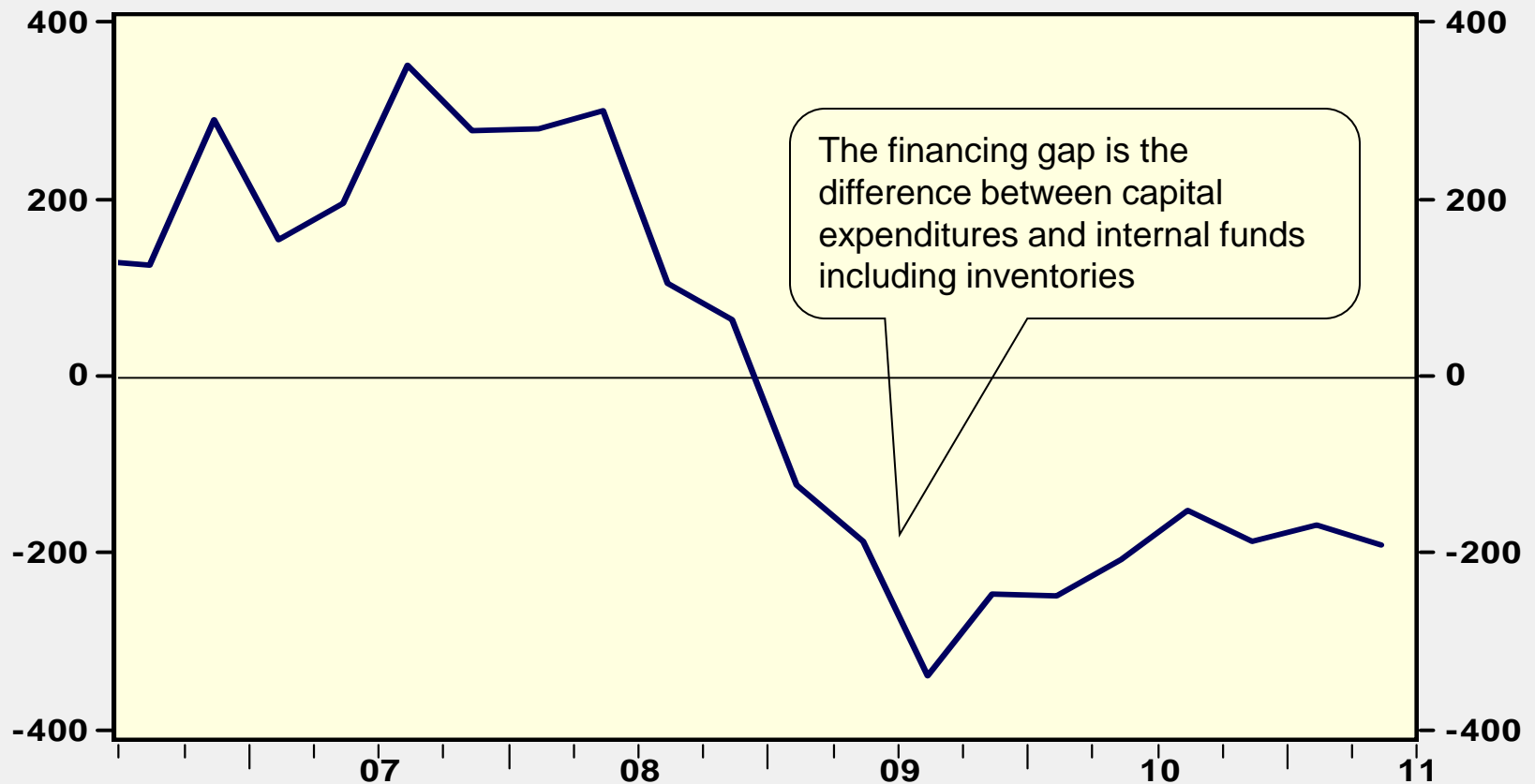
# Long term: structural challenges in deleveraging



# The nonfinancial corporate sector: healthy balance sheet

## Nonfarm Nonfinancial Corporate Business: Financing Gap

SAAR, BI.\$



Source: Federal Reserve Board /Haver Analytics

# The Outlook: The 2011-2012 Scorecard

	2010	2011	2012
Real GDP	3.0	1.7	1.9
Personal Consumption	2.0	2.3	1.8
Industrial Production	5.3	4.0	2.4
Unemployment Rate (year average)	9.6	9.0	8.9
Housing Starts (million unit)	0.59	0.67	0.88
Auto Sales (cars + light trucks)	11.6	12.7	13.5
Consumer Price Index	1.6	3.2	2.0
Fed Funds (year-end)	0.18	0.10	0.10
10-year T-Note yield (year-end)	3.30	2.15	2.30

Source: Haver Analytics/Mesirow Financial

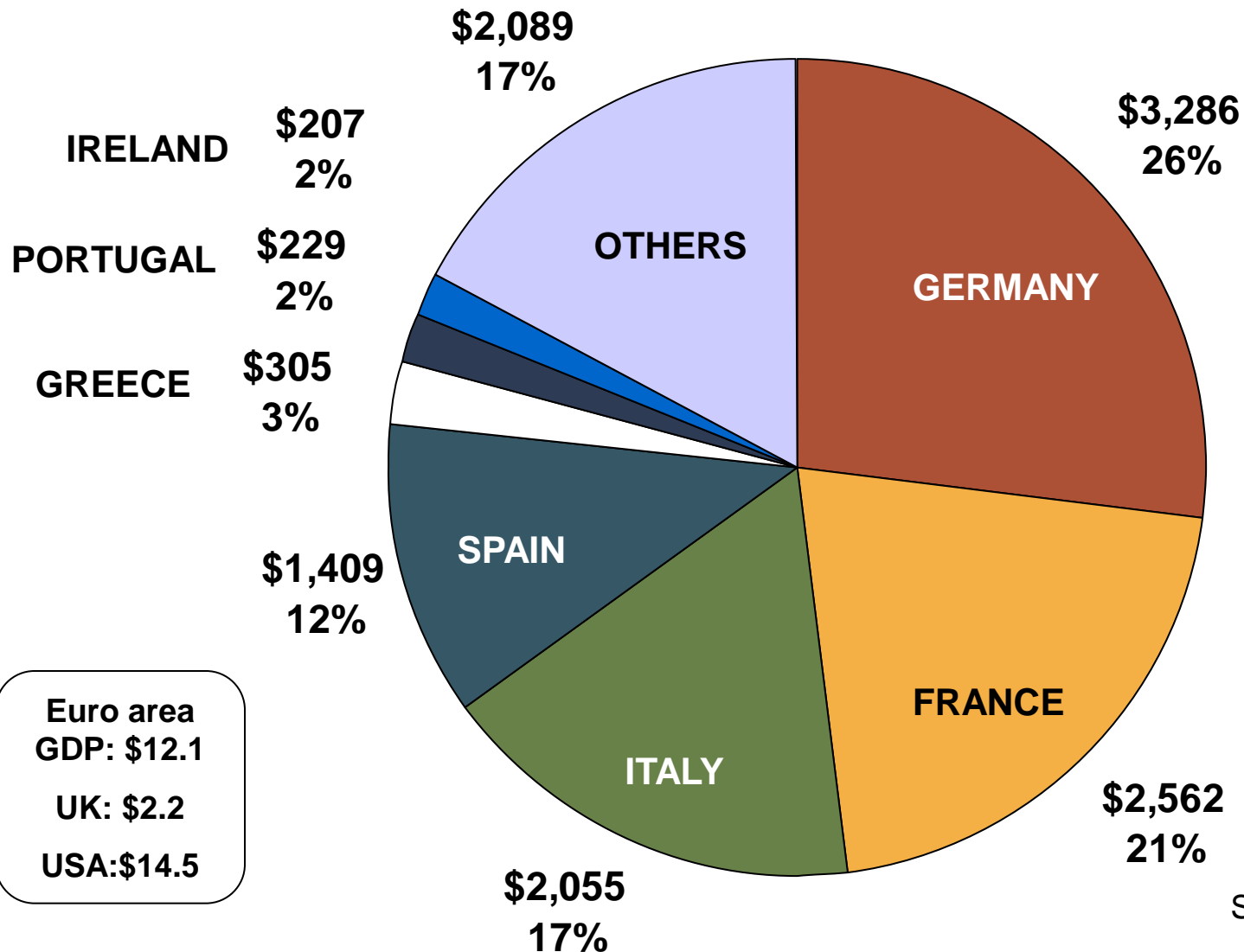
# Contributions to GDP growth in 2011 and 2012

	Y	C	I				G	NX
	GDP	Cons	Equip	Comm Struct	Resid Constr	Inv	Fed + Local	Trade
1Q   11	0.4	1.5	0.7	-0.4	-0.1	0.3	-1.2	-0.3
2Q	1.3	0.5	0.5	0.5	0.1	-0.3	-0.2	0.2
3Q	2.0	1.6	1.2	0.3	0.0	-1.4	0.0	0.5
4Q	2.2	1.8	0.5	0.1	0.1	-0.2	-0.1	0.1
1Q   12	1.4	1.1	0.8	0.0	0.1	-0.2	-0.3	0.0
2Q	2.1	0.9	0.7	0.1	0.1	0.9	-0.4	0.0
3Q	2.2	1.3	0.6	0.1	0.2	0.2	-0.3	0.2
4Q	2.6	1.6	0.7	0.1	0.3	0.2	-0.2	0.1
1Q   13	2.9	1.6	0.7	0.1	0.3	0.1	-0.2	0.2
2Q	3.4	1.9	0.5	0.1	0.5	0.3	-0.1	0.2

- Pent-up demand will support consumption
- Another solid year for business spending
- By 2013, a comeback for construction
- The downside risk: Europe

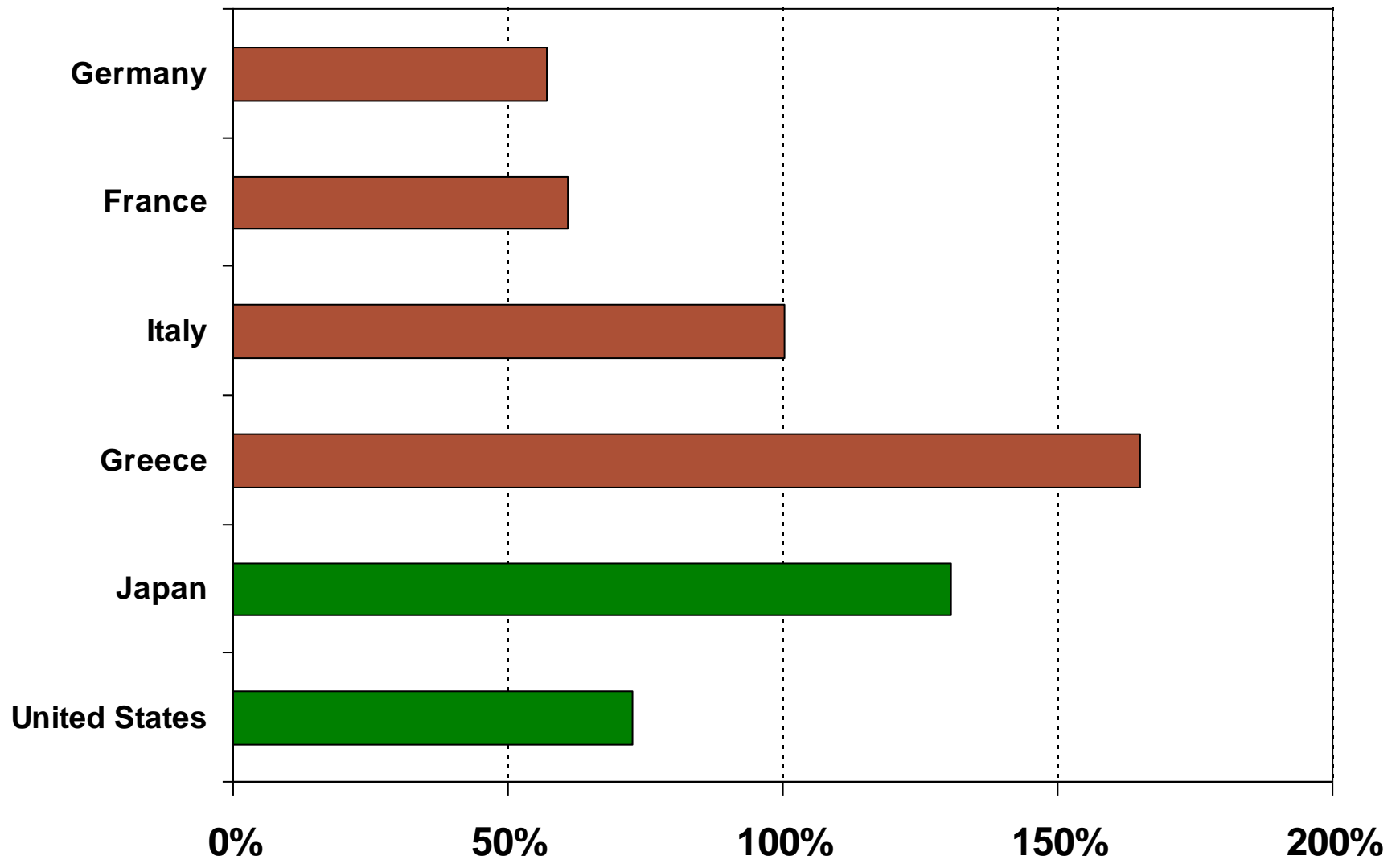
# Size and shares of Euro area GDP

In trillion of US dollar



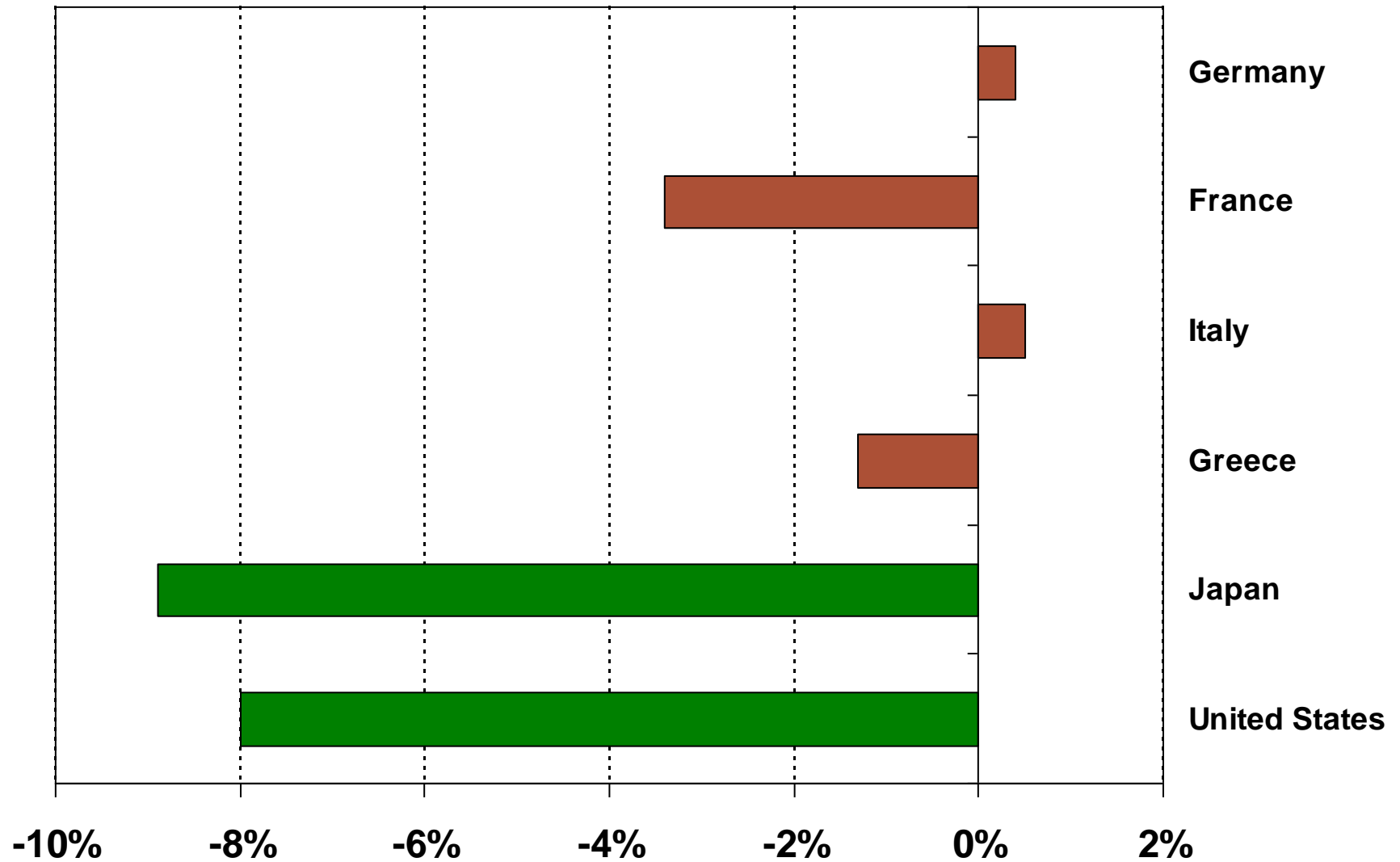
Source: IMF

# Net government debt-to-GDP ratio, 2011



Source: IMF

# Government Budget Balance-to-GDP Ratio, 2011



Source: IMF



# Europe: multiple, interlocking challenges

- Sovereign debt
  - A problem of **solvency**: Greece, eventually Italy
  - A problem of **liquidity**: France
- Banking sector balance sheet
- Growth
- Political credibility
- The future of the Euro

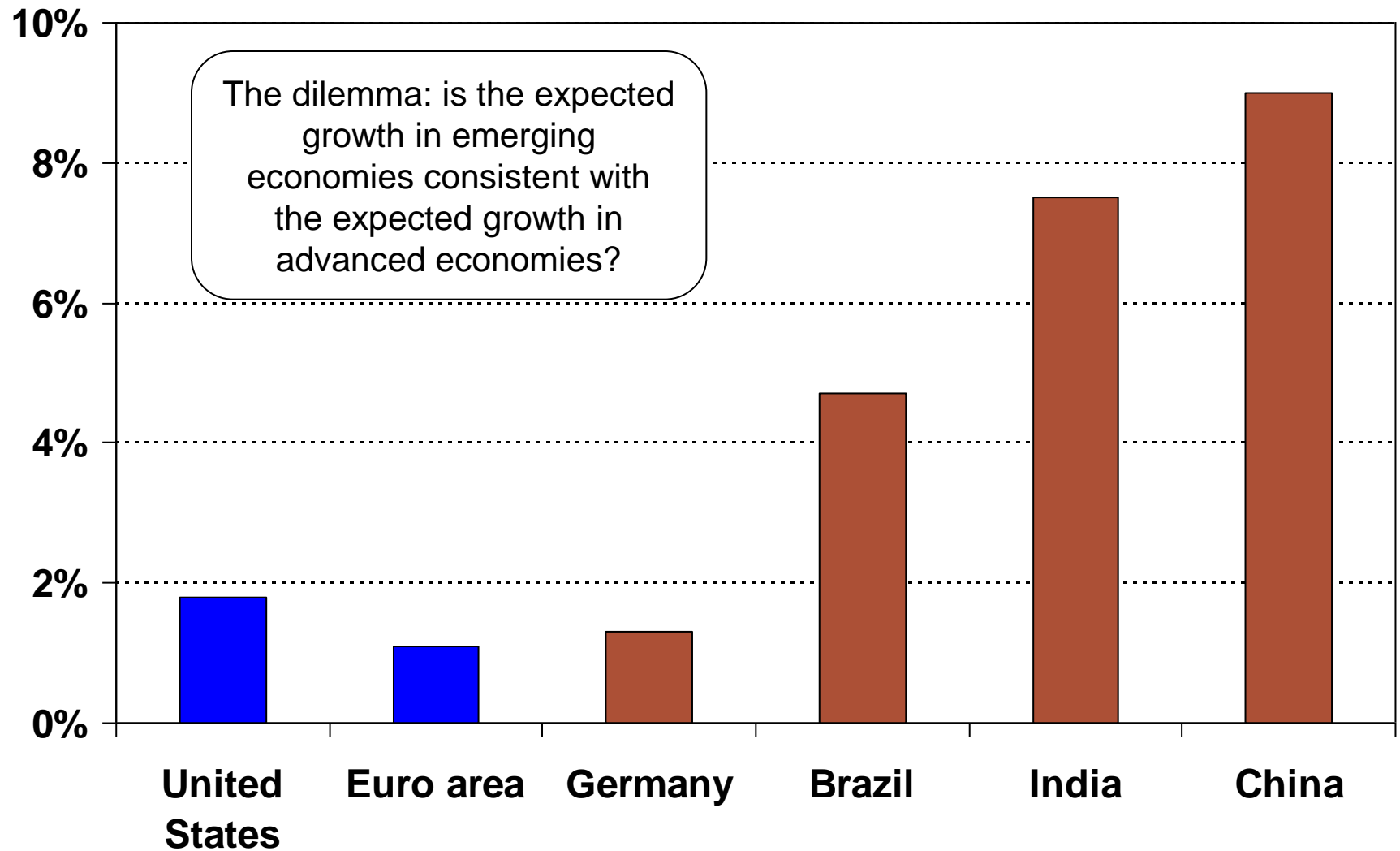
## Our expectation

- The Euro will survive because of the strong political, social, cultural and historical bonding that European countries share
- Euro area members will, eventually and slowly, converge toward greater fiscal integration
- The process will be painful and protracted over time, with recurring bouts of financial stress, persistently disappointing growth rates and a gradual structural reform with elevated social costs

# Why Europe matters for us

- Exports: to Europe, \$285b; to the Eurozone, \$176b (2010)
- Imports: from Europe, \$390b; from the Eurozone, \$247b (2010)
- U.S. Money Market Funds exposure: to Europe, \$675b; to Eurozone, \$380b (France \$200b)
- U.S. exposure to:
  - Greece: sovereign debt, \$2b; banks, \$2.6b, others, \$4b, derivatives, \$38b.
  - Italy: sovereign debt, \$14.8b; banks, \$16.1b, others, \$13.5b, derivatives, \$248b
  - France: sovereign debt, \$26b; banks, \$152b, others, \$67.8b, derivatives, \$396b

# GDP growth in 2012: IMF projections



# Summary

- 2012 will be a year of recovery for the U.S. economy
- Because of the structural nature of many of our current woes, the process of repairing the economic damage suffered since 2007 will be slower than desired
- The major downside risk for the U.S. (and the global outlook) is the complex crisis occurring in Europe
- In 2012, don't expect a collapse of the Euro, but don't expect a solution of the European problems, either – it will take years
- Emerging economies have been the driver for global growth: but how successful can they continue to be, if the advanced economies stall?



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