Post-Bubble Global Trends

AAPA Webinar

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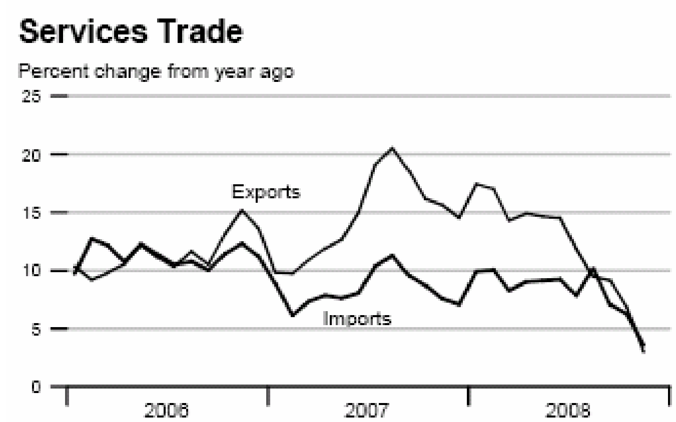
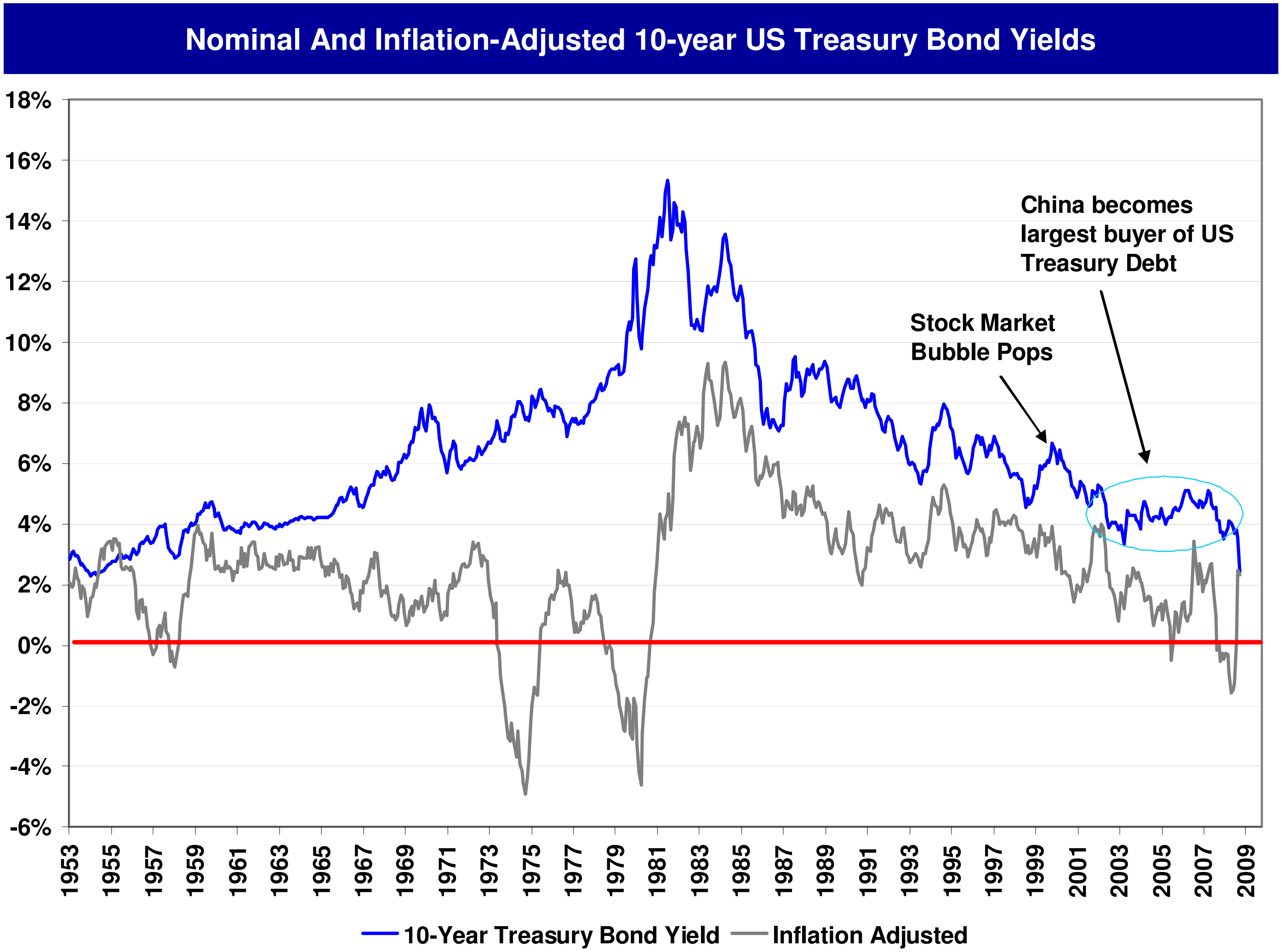
Takeaways

- The world economy is circling the drain
  - World is wealthier but too much capital often pursues the same growth expectations
  - Low cost of capital and too much leverage produced the twin bubbles
  - Poor policymaker judgment turned a bad situation into a catastrophe
  - The whole world is de-leveraging, which directly affects global trade
- Global New Deal Revival
  - At best consumer spending is on hold while wealth is rebuilt
  - Resource rich countries are suffering from falling income
  - Debt-Deflation cycle is a substantial risk given inventory overhang
  - Government spending is the near term engine of recovery
  - Global bank bailouts are a threat to global trade
- No “all clear” until 2012
  - Central banks will have to withdraw money pumped into the global economy
  - 2009 Economic Recovery Act may not have long term effects
  - Globalization is unlikely to reverse - long term drivers of trade growth remain intact through the next decade
  - US non-service export growth should be more aligned with import growth



Source: Federal Reserve of St Louis, US Department of Commerce

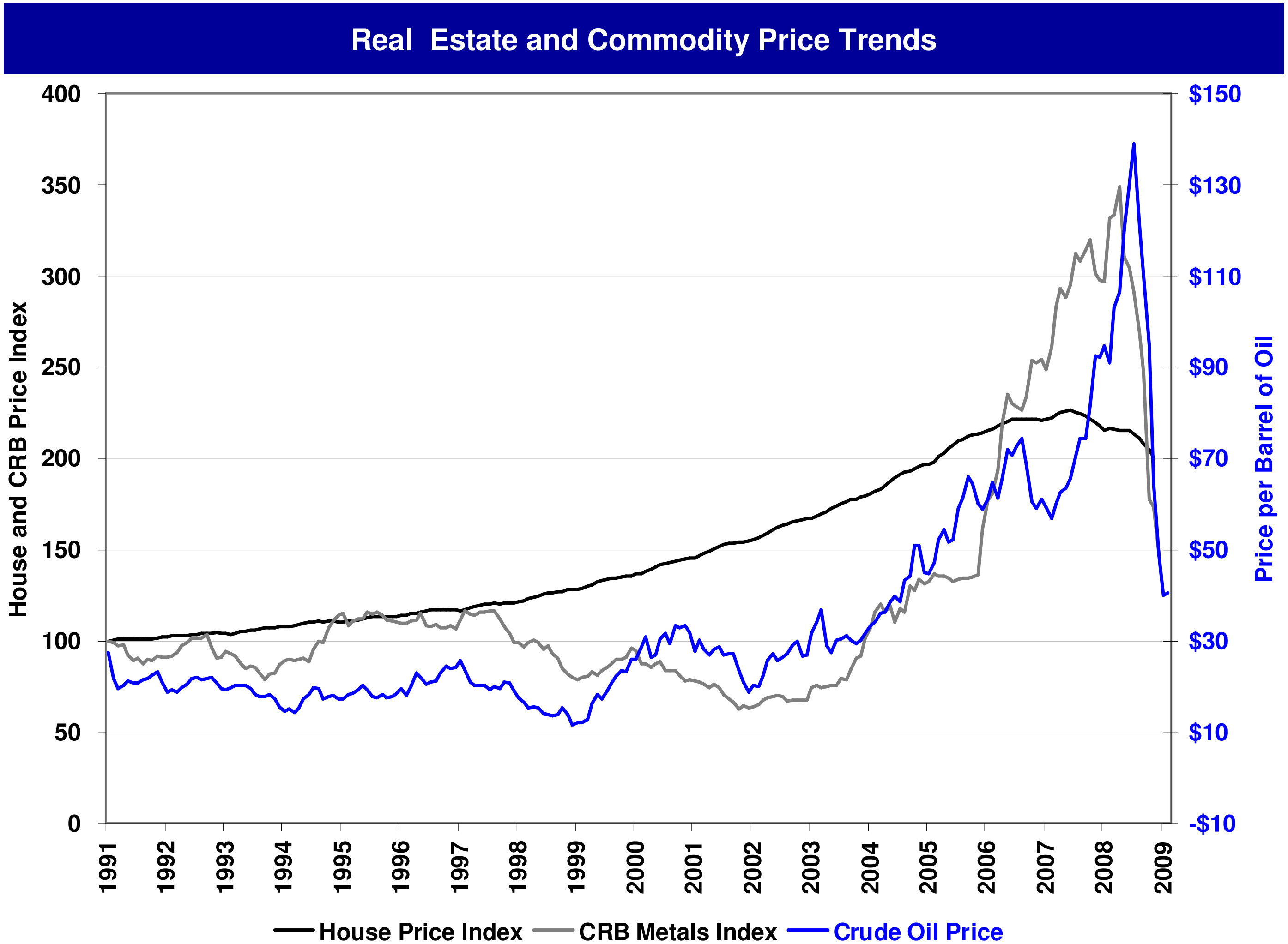
The Cost of Capital Declined Substantially



- **Since 2001 US and European interest rates have been at their lowest levels in four decades, driven down by Asian purchases of debt to peg exchange rates**
- **Japanese interest rates have been even lower since the late 1990s**

Source: Federal Reserve of St Louis, US Department of Labor, Moffatt & Nichol

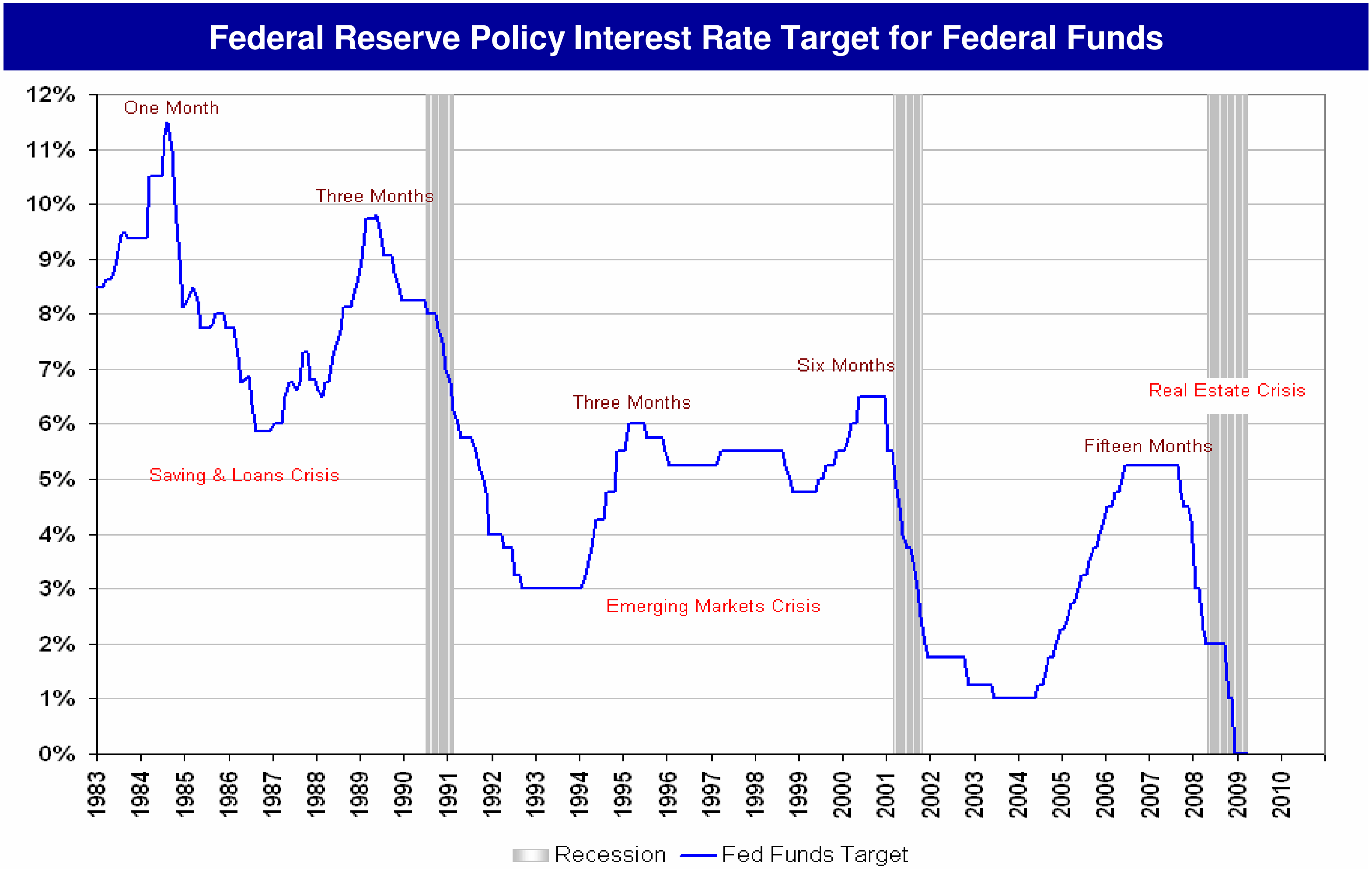
The Twin Bubbles: Commodities and Real Estate



- Mistrust of equities and a low cost of capital spawned speculation in “alternative asset” classes
- China’s growth was priced in too soon… Olympics created a deadline

Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Moffatt & Nichol

Unusual Coincidence Of Policy Errors

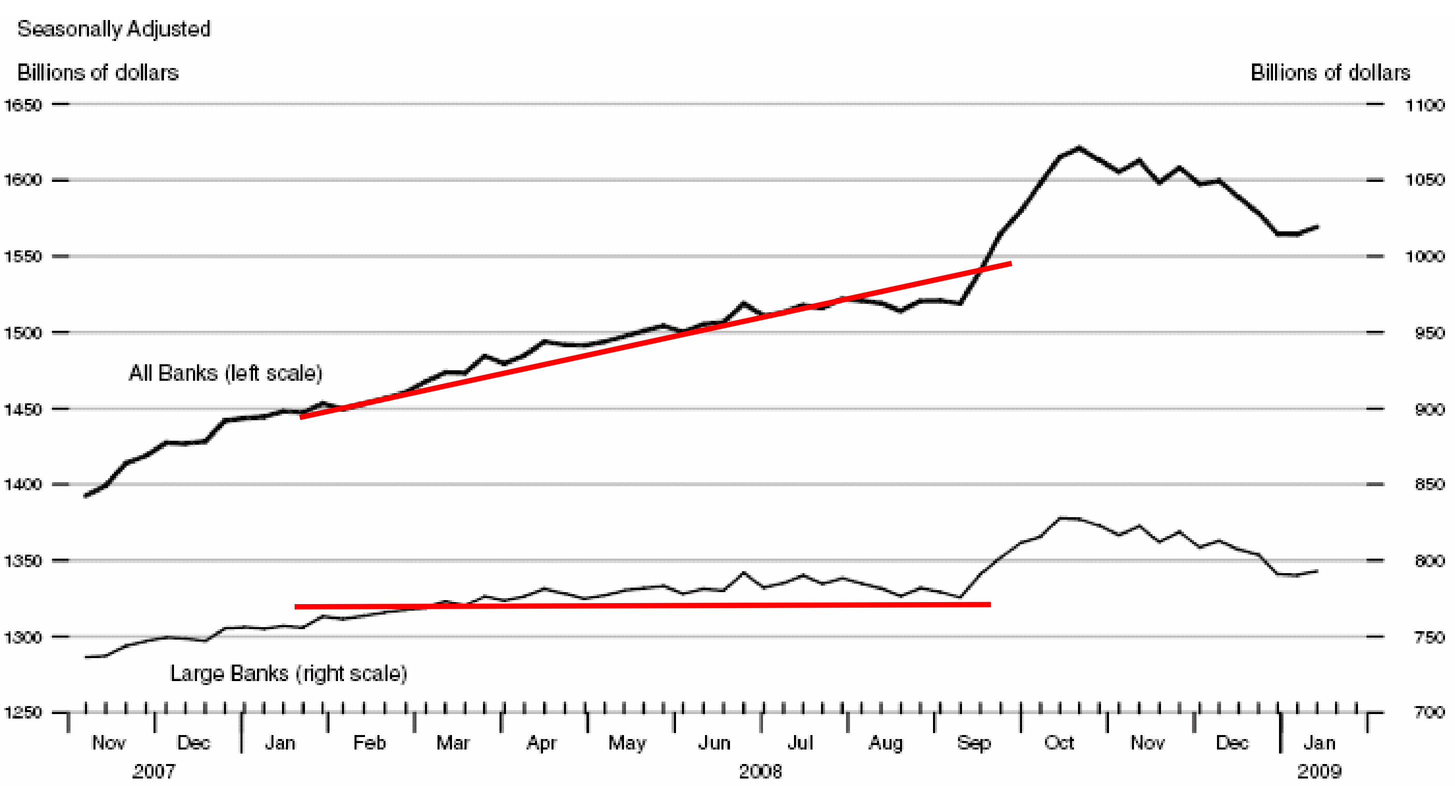


- **Letting Lehman fail in September shredded what little confidence remained**
- **FDIC Commissioner Sheila Bair's solution was ignored in favor of handing money to banks**
- **European Central Bank was raising its policy rate target… while the EU economy was already in recession**
- **The first stimulus in Q2 2008 was too little, too late**

Source: Federal Reserve, National Bureau of Economic Analysis, Moffatt & Nichol

Small Banks Have Been Doing The Heavy-lifting

Commercial and Industrial Loans

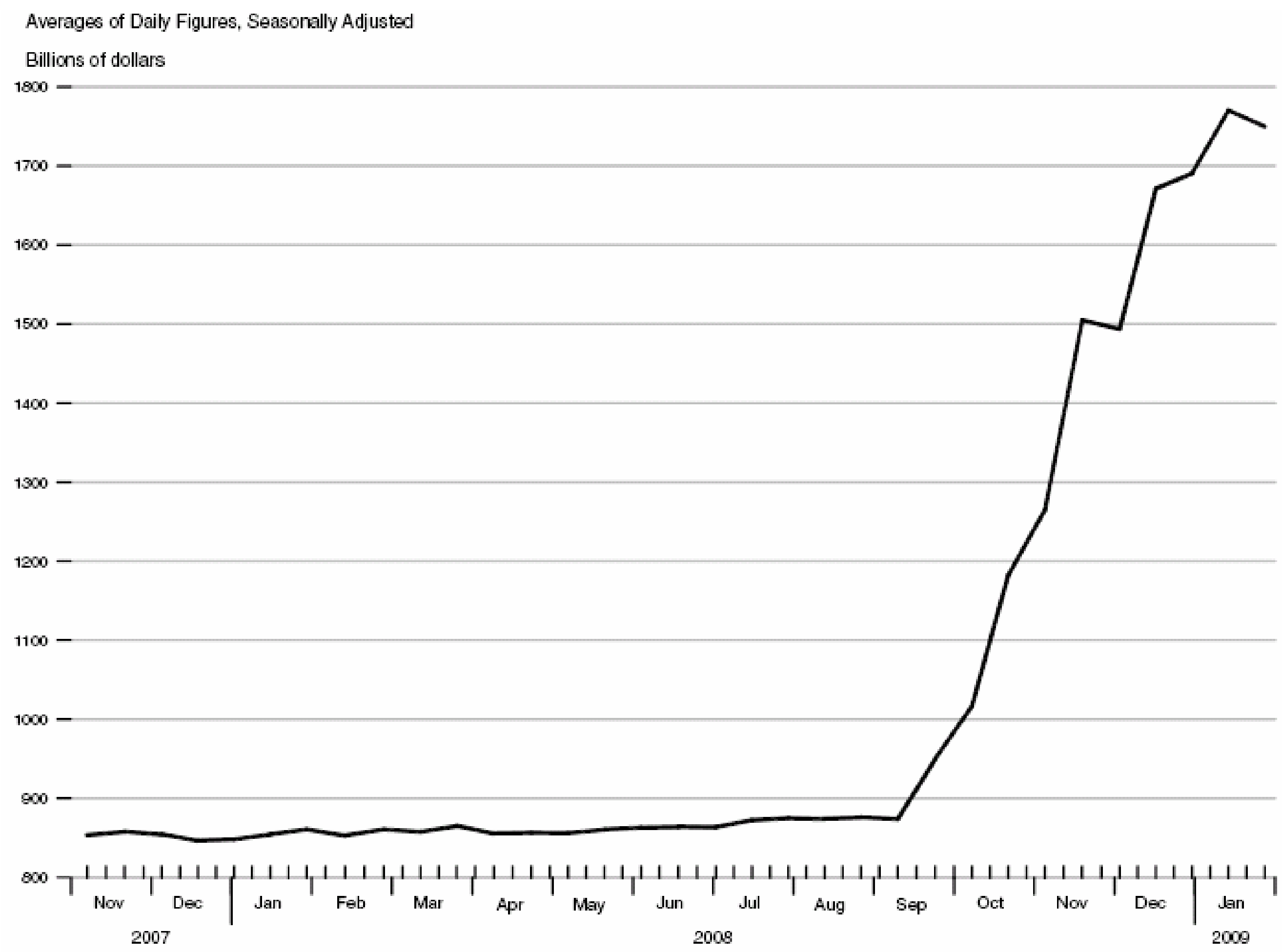


- Despite lower the Fed Funds rate, lending stagnated as large banks wrote down assets
- State and regional banks, savings & loans and credit unions propped the economy up and may have to continue to do so
- Foreign trade finance remains mostly unsupported by large banks

Source: St Louis Federal Reserve, Moffatt & Nichol

The Fed Is Making A Dramatic Effort Now

Adjusted Monetary Base

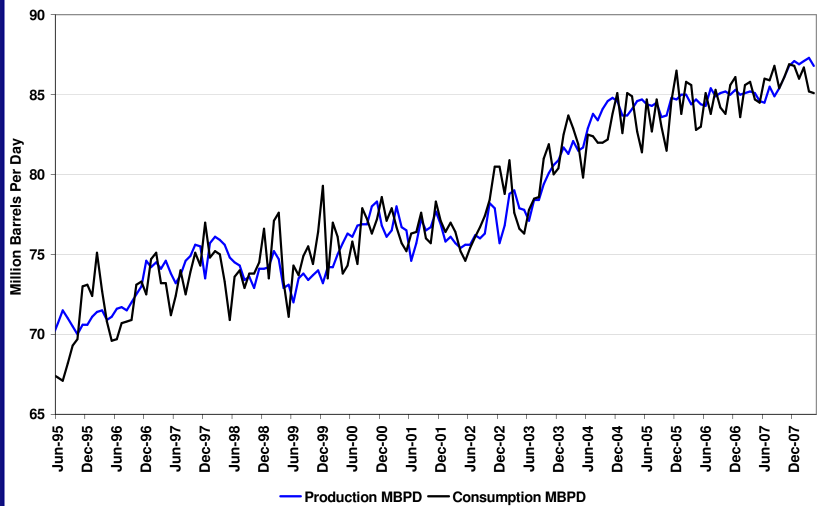


- **0% Fed Funds interest rate target and a doubling of the Fed's balance sheet have not reversed downward momentum in the economy**
- **We are in a "liquidity trap"**

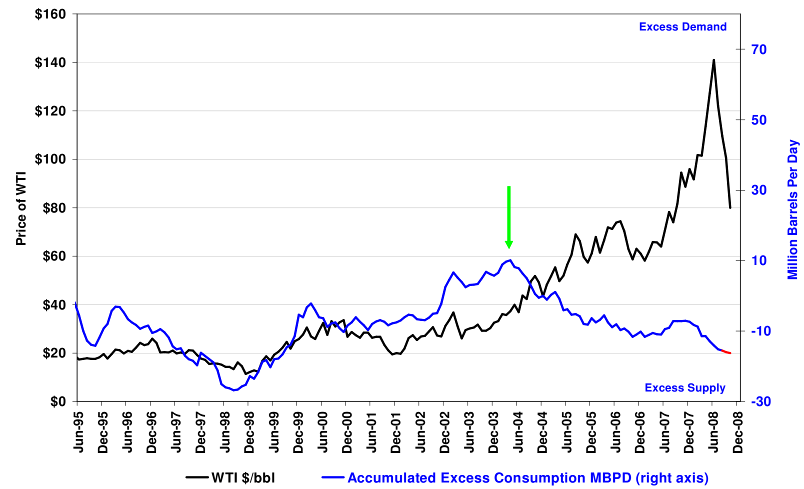
Source: St Louis Federal Reserve, Moffatt & Nichol

Global Oil Production Has Exceeded Consumption

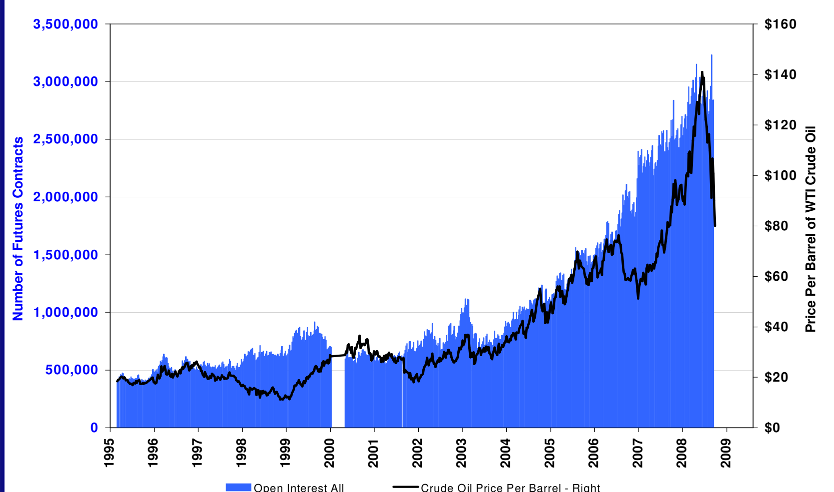
Global Oil Production Kept Pace With Consumption



Oil Prices Deviated From The Global Supply/Demand Balance



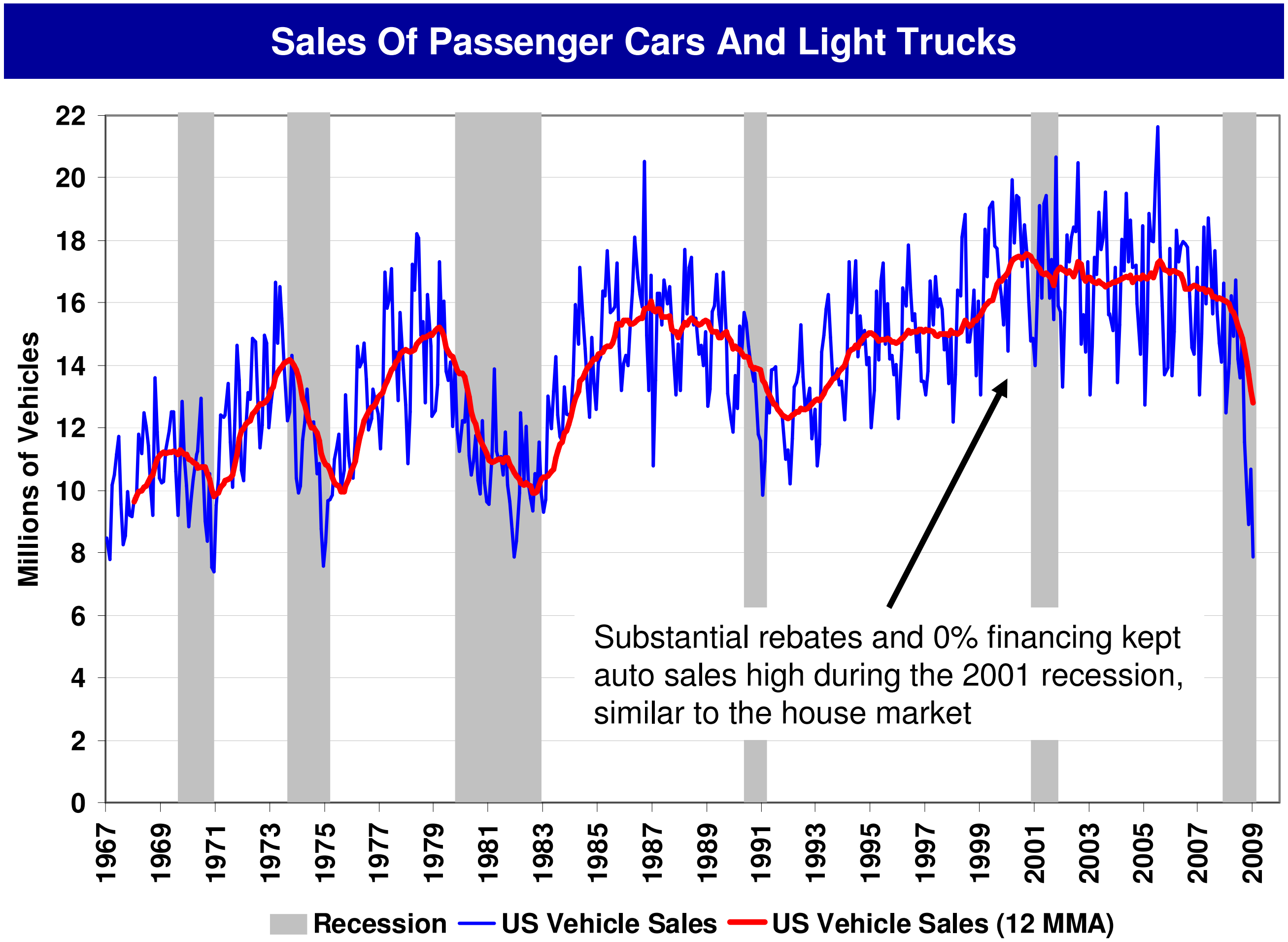
Oil Speculation Ahead of Oil Price Trends Since 2004



- World oil consumption has grown despite declining in industrialized nations.
- Globally oil production has exceeded consumption since 2004.
- High oil prices are more likely driven by financial capital flows than supply/demand fundamentals
- Oil prices are expected to remain in the $50-$80 per barrel range over the next 10 years

Source: International Energy Agency, Commodity Futures Trading Commission, Moffatt & Nichol

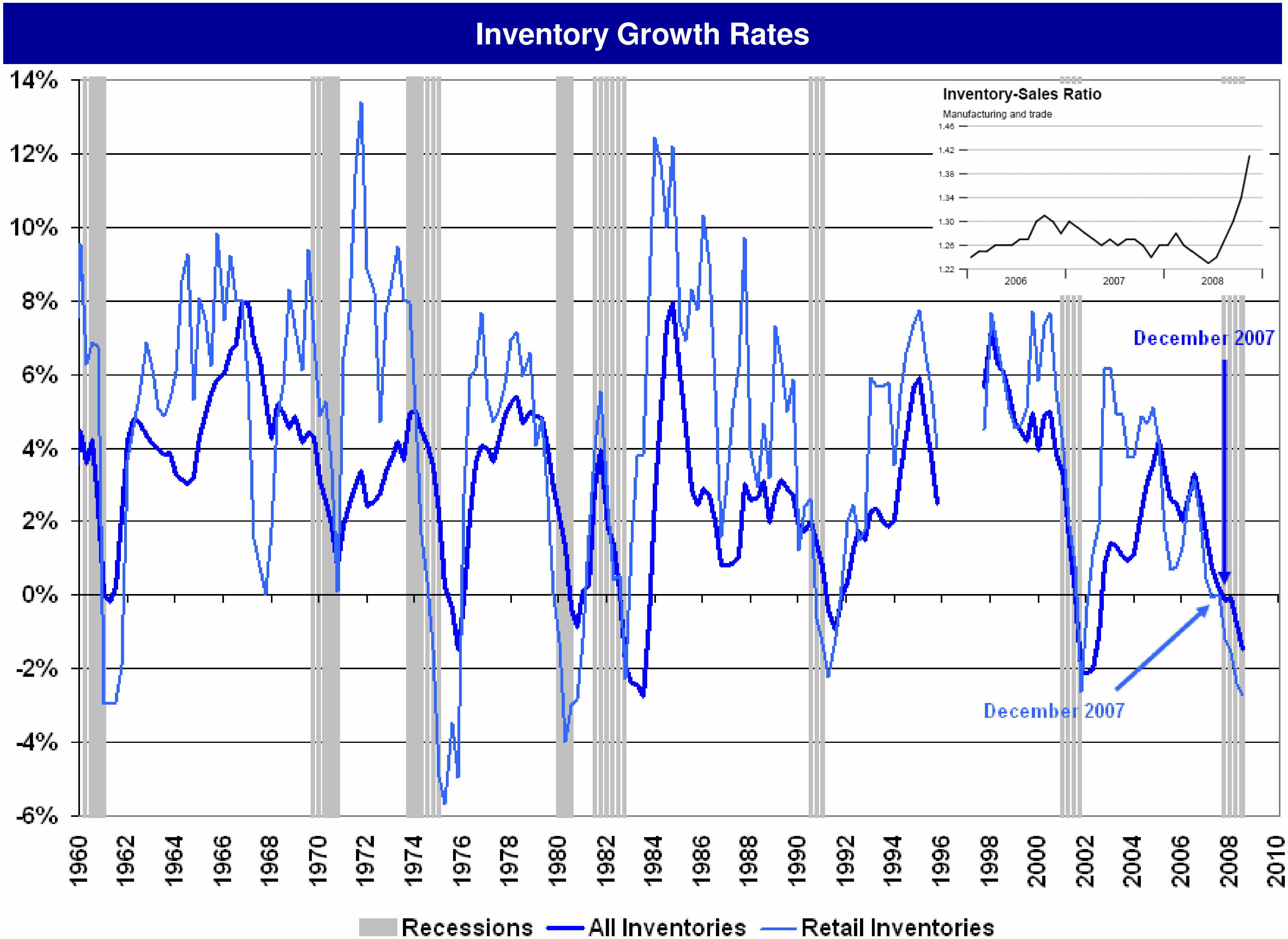
US Auto Sales At A 24-year Low



- **2001-2007 was the first economic expansion period where auto sales declined**
- **Vehicle sales declined despite manufacturer rebates and 0% financing**
- **Wars and subsequent speculative bubble in oil prices are to blame**
- **Outlook is more uncertain than when the Chrysler Loan Guarantee Act of 1980 was passed**

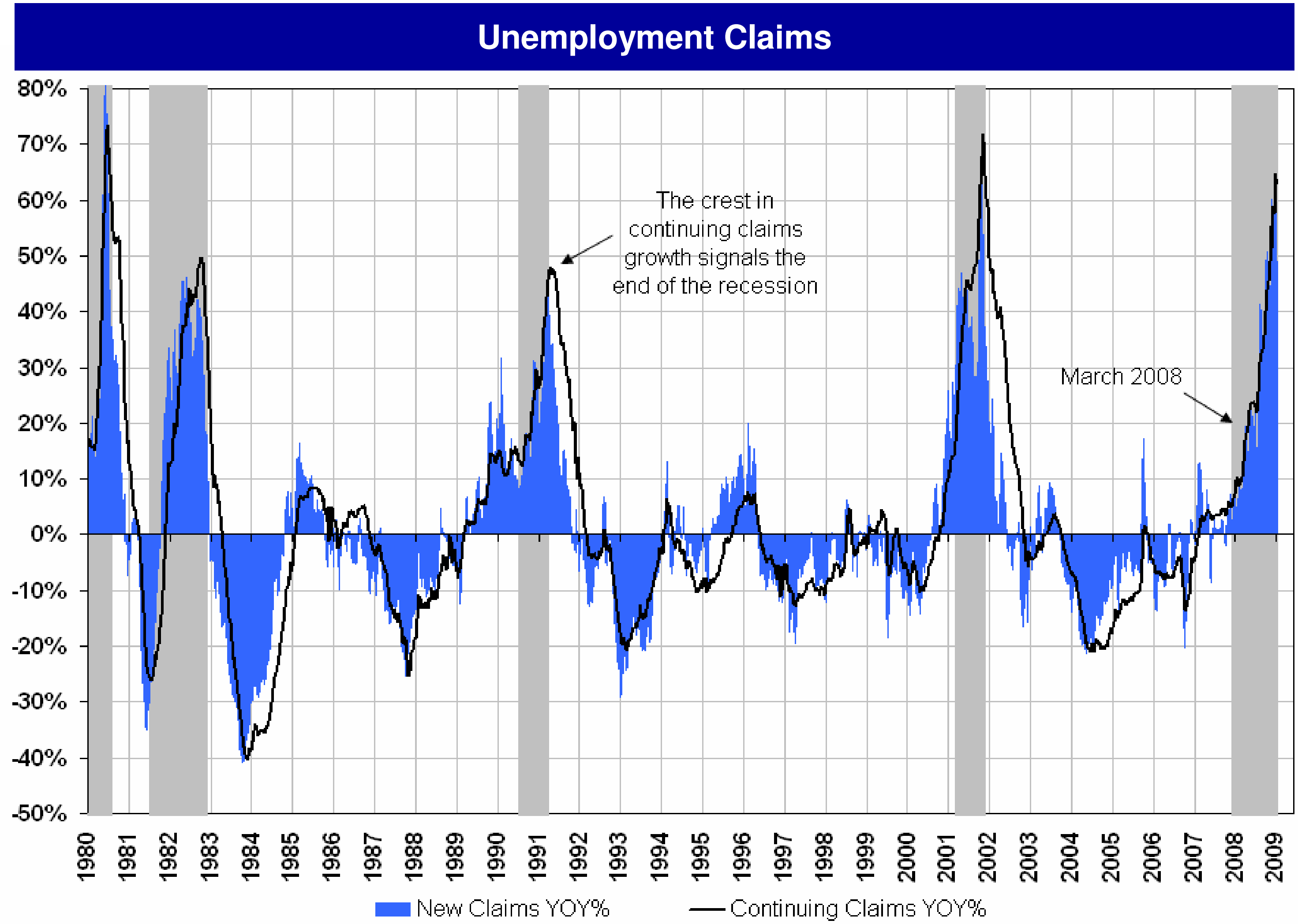
Source: Wards Automotive, Department of Commerce, NBER, Moffatt & Nichol

Inventories Are Declining While The Inventories-Sales Ratio Rises



Source: US Department of Commerce, Moffatt & Nichol

Unemployment Is Driving The Economy Towards Deflation



- Consumers are struggling to pay their debts which is impacting retail sales
- Lower sales means falling prices and falling profits and layoffs, while China export-dependent China struggles
- The burden of debt gets worse creating a vicious debt-deflation cycle

Source: Bureau of Labor Statistics, Moffatt & Nichol

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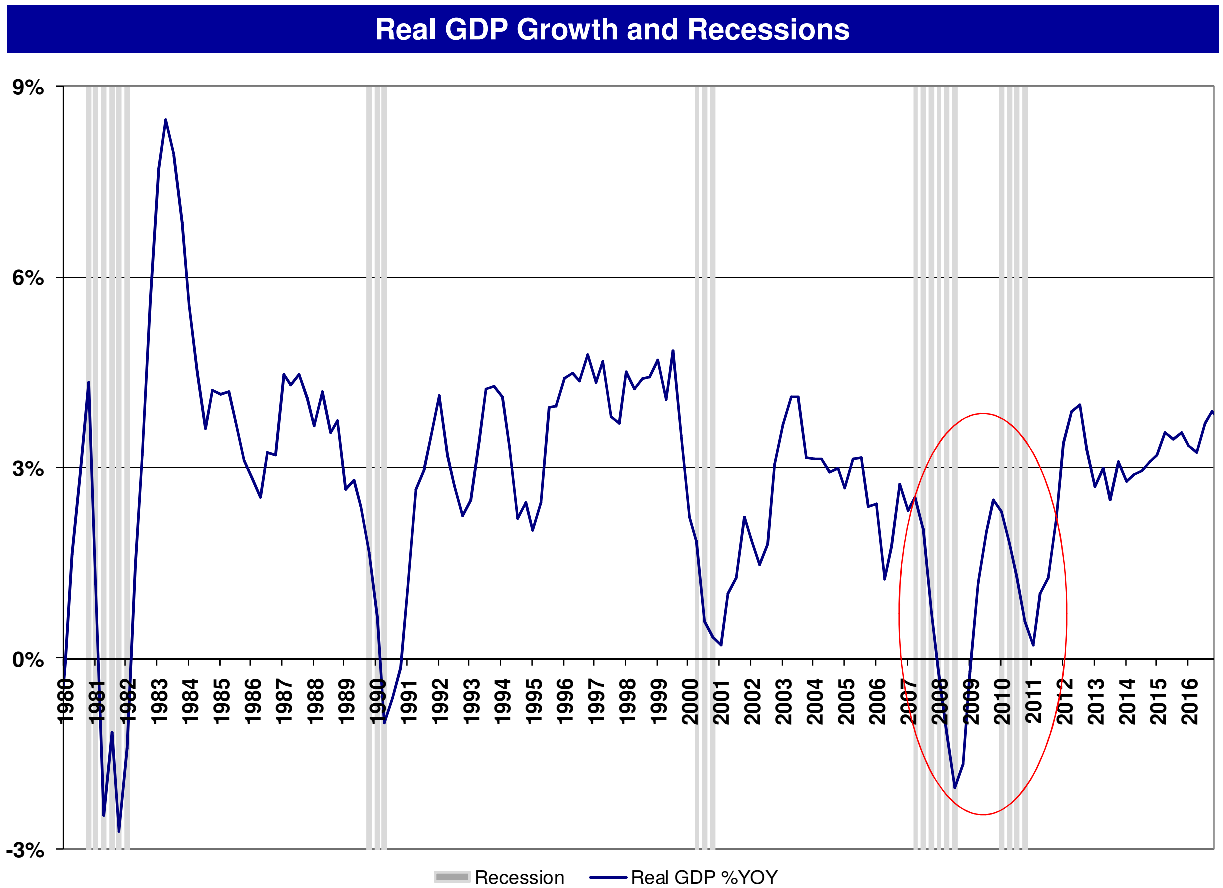
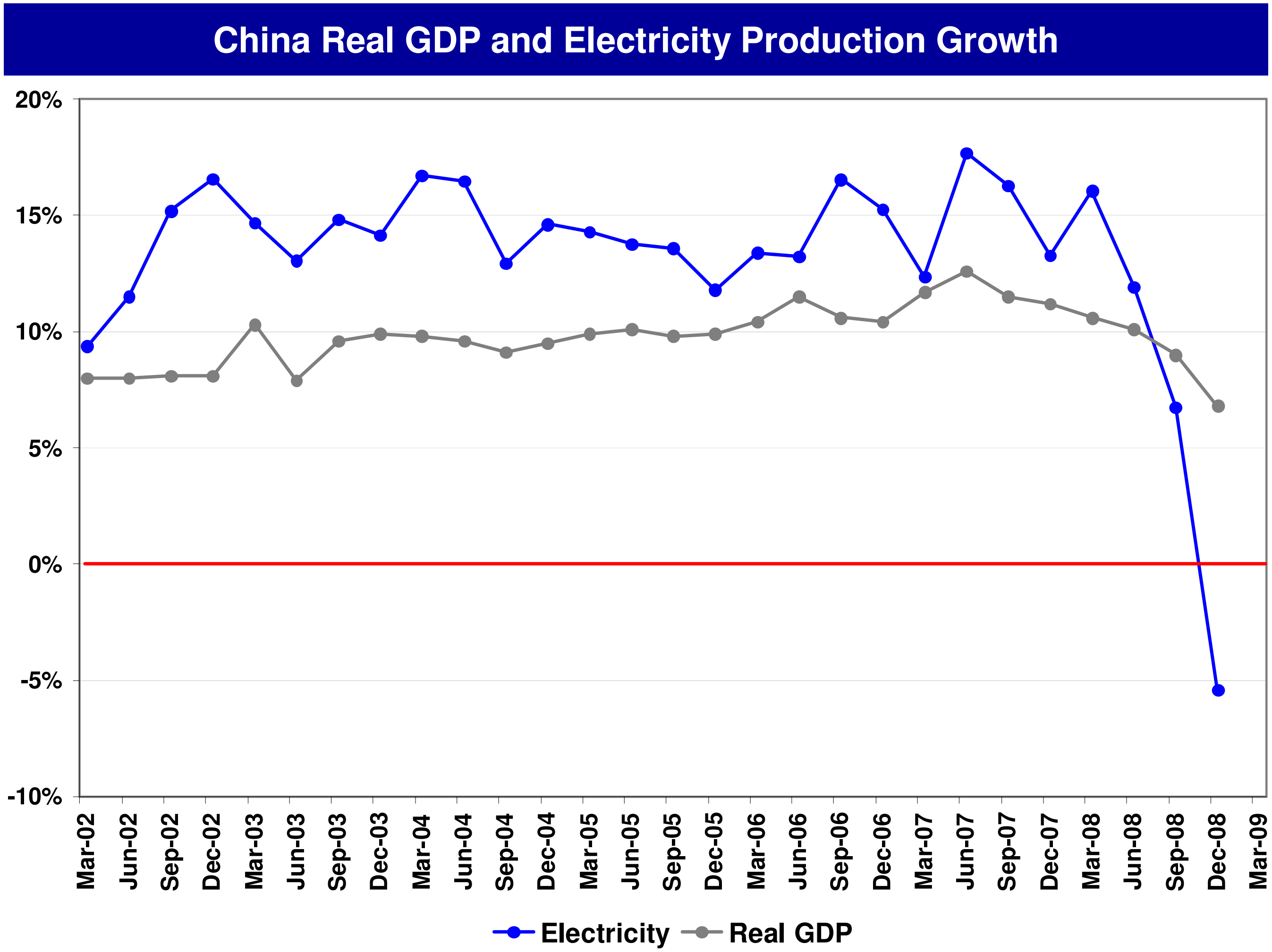
Look For "All Clear" In 2012



- **Assuming the second stimulus begins to be deployed in Q2, expect recession to end in 2009-H1 but without the usual substantial recovery spike**
- **Deflation through the first half of 2009, then inflation will begin to rise, forcing the Fed to start tightening again, unless infrastructure investment has an immediate and significant impact on productivity**
- **Expect low growth through 2011; a mild recession is possible in late 2010/early 2011;**
- **After that we could have 7-8 years of strong growth**

Source: Department of Commerce, Moffatt & Nichol

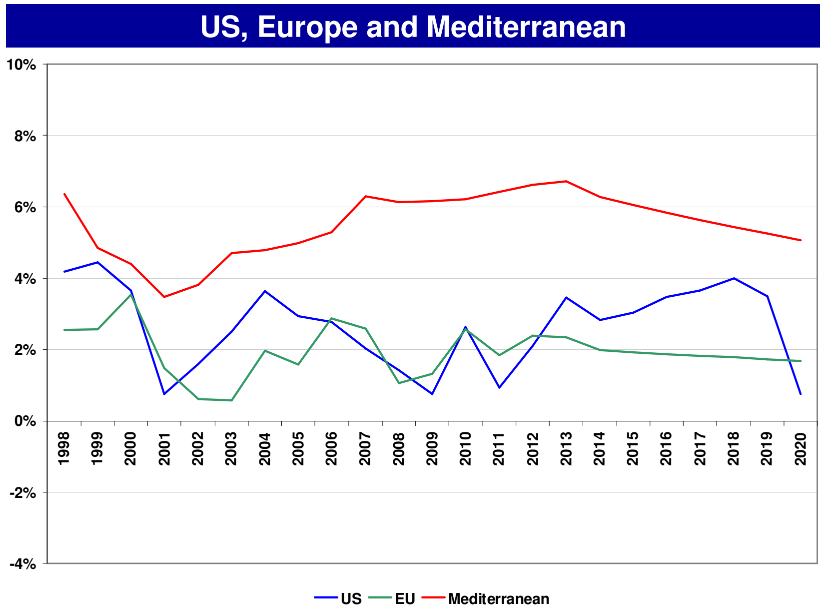
China Is Also Slowing Down Significantly

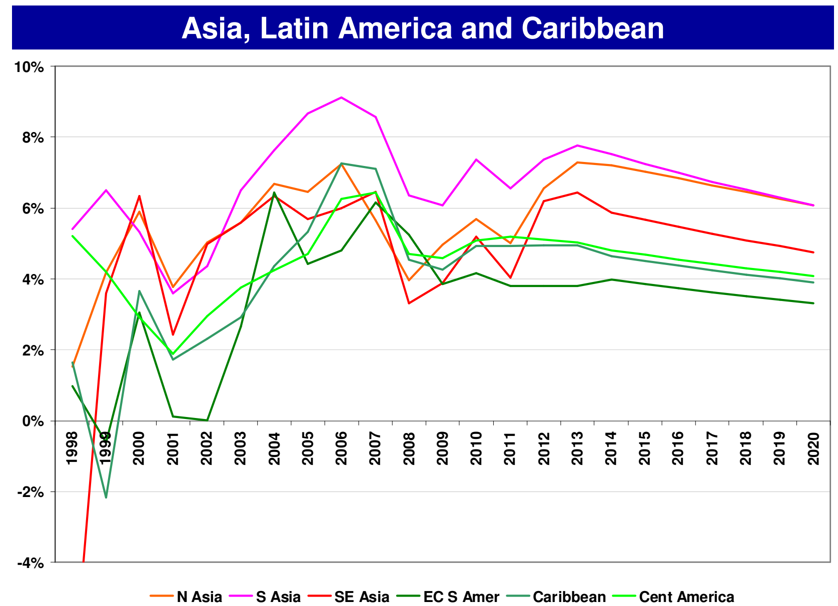


- **Some fundamental data on China's economy is out of line with official macroeconomic statistics**
- **Like the US, Europe and Japan, China is also deploying a fiscal stimulus containing significant investment in infrastructure**

Source: Bloomberg, Moffatt & Nichol

Economic Outlook for Major Trade Lanes



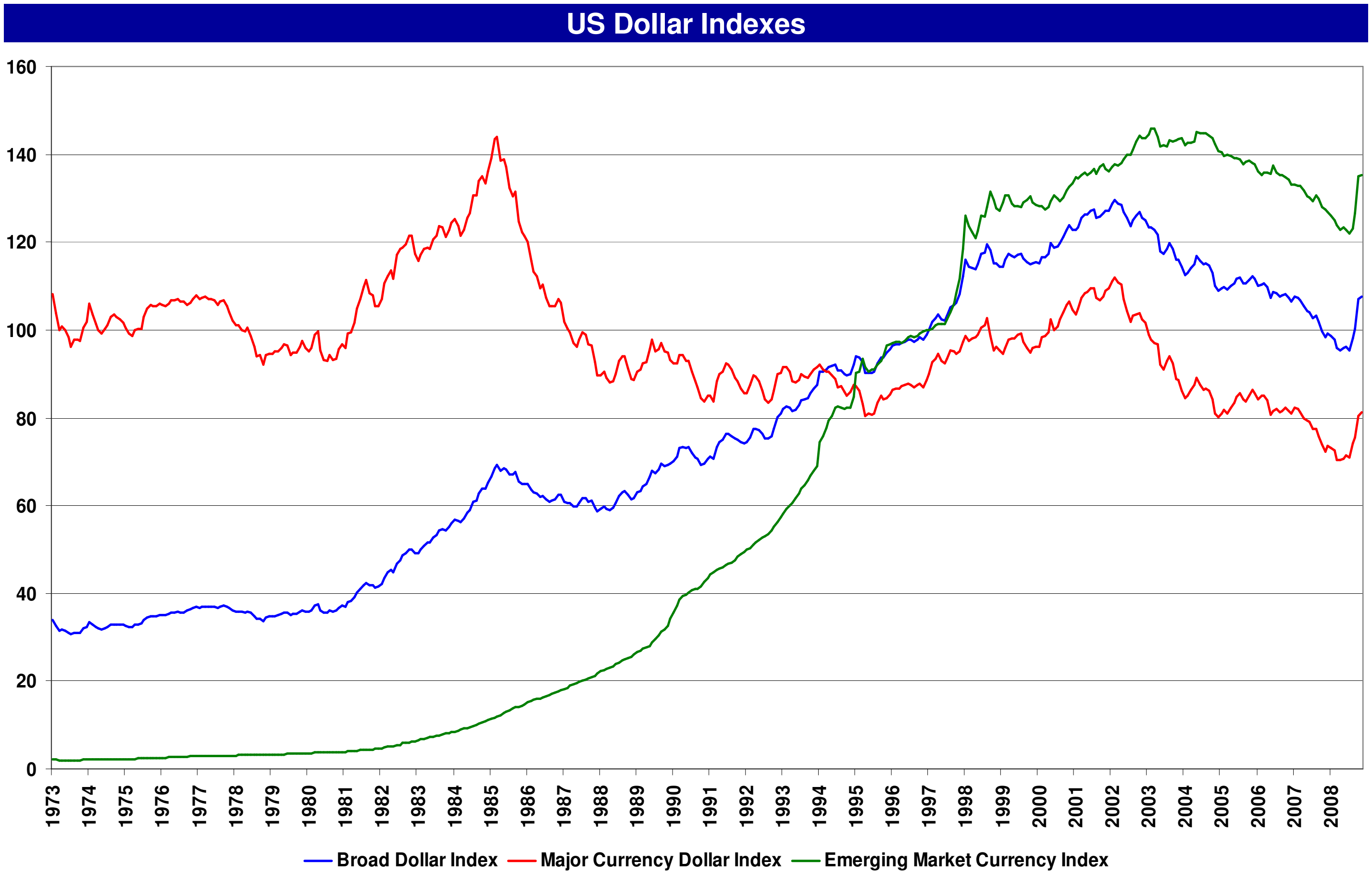


- **Near term is weak and mostly due to US and Europe**
- **Long term outlook is more robust due to Emerging Markets growing due to increasingly self-financed investment**
- **World trade patterns will change due to the changing relative size of emerging and mature economies over the forecast horizon**
- **Risks to this view:**
  - **Bank bailouts produce a “Smoot-Hawley” effect on international capital movement**
  - **Stability of the euro**
  - **Emerging Markets policies focus on developing a middle class**

Source: International Monetary Fund, US Department of Commerce, Moffatt & Nichol

Foreign Exchange

- **USD is approaching Fair Value against major currencies and is expected to stay there**
- **USD will lose value against emerging markets currencies over the next 10 years assuming they develop a middle class and inflation is controlled**



Source: Federal Reserve, Moffatt & Nichol

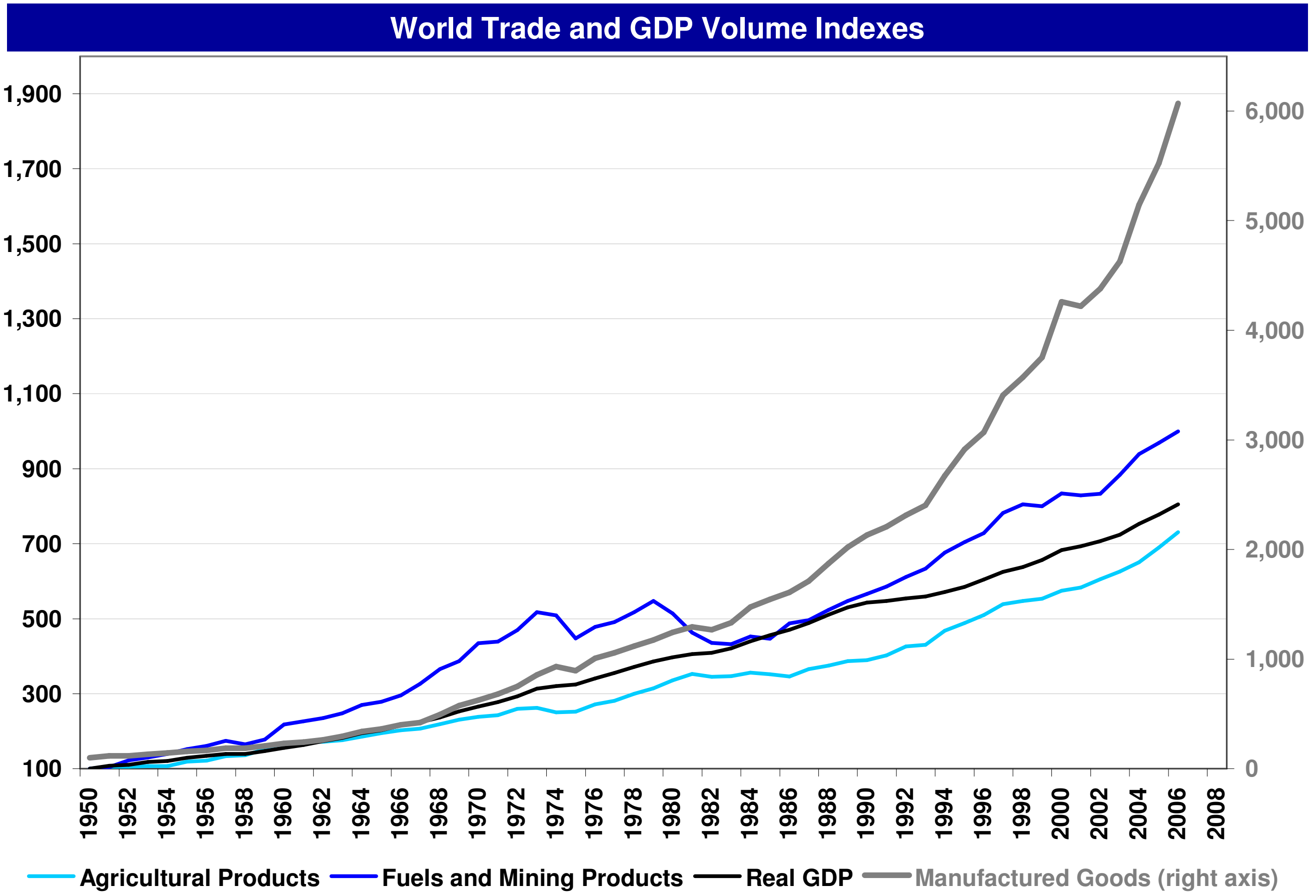
Loaded TEU Forecast Summary - US

	2007				2007-2013 CAGR			2007-2020 CAGR		
	Imports	Exports	Total	Share	Imports	Exports	Total	Imports	Exports	Total
North Asia	11,542,916	4,355,308	15,898,225	55.1%	4.8%	7.5%	5.6%	6.8%	7.1%	6.9%
SE Asia	1,600,483	788,903	2,389,386	8.3%	5.4%	7.0%	6.0%	7.4%	6.3%	7.1%
South Asia	575,977	298,761	874,738	3.0%	7.6%	8.4%	7.9%	8.4%	8.3%	8.4%
Europe	1,701,699	1,477,121	3,178,820	11.0%	2.9%	4.1%	3.5%	3.3%	3.2%	3.2%
Mediterranean	852,215	687,011	1,539,226	5.3%	3.3%	7.9%	5.5%	4.5%	6.9%	5.6%
Middle East	38,080	260,027	298,108	1.0%	4.3%	9.1%	8.5%	7.0%	7.3%	7.3%
WC S America	282,773	206,014	488,787	1.7%	3.0%	7.8%	5.2%	4.1%	4.1%	4.1%
EC S America	417,802	313,498	731,300	2.5%	3.6%	4.1%	3.8%	5.3%	3.9%	4.7%
Cent Am/Carib	943,474	1,743,340	2,686,815	9.3%	2.7%	5.0%	4.2%	3.7%	4.4%	4.2%
NAFTA	62,943	56,000	118,943	0.4%	3.2%	11.2%	7.3%	4.9%	10.7%	8.1%
Australia/NZ	130,936	200,732	331,668	1.1%	3.6%	3.2%	3.4%	5.9%	3.1%	4.3%
Africa	69,562	166,293	235,855	0.8%	3.3%	11.9%	9.7%	4.5%	11.6%	10.0%
Other	30,951	62,598	93,549	0.3%	3.2%	1.9%	2.3%	5.3%	2.5%	3.5%
Total	**18,249,813**	**10,615,606**	**28,865,420**	**100.0%**	**4.6%**	**6.6%**	**5.3%**	**6.3%**	**6.1%**	**6.3%**

- **Long term loaded container volume growth forecasts are more conservative than in 2007:**
  - **Lower growth in 2008-2009 than previously expected**
  - **Slower offshoring pace and trade agreement progress over the next four years**
  - **US is pulling the global economy with it as it circles the drain**
- **There are more reasons why volume growth could overshoot than undershoot the forecasts, such as**
  - **Stronger growth in 2011 than anticipated due to further policy stimulus**
  - **Infrastructure investment generates strong productivity gains**

Source: PIERS, Moffatt & Nichol

Global Commodities Trade Has Lagged Manufactured Trade



- **Manufactured goods and non-agricultural products trade have grown faster than GDP.**
- **Agricultural products trade has lagged GDP and other trade in other products.**
- **The gap between manufactured goods and other products trade is expected to narrow.**
- **The outlook for bulk commodities depends on expectations for manufactured goods trade.**

CAGRs Period	Manufactured Goods	Agricultural Products	Fuels and Mining Products	Real GDP
1950-2006	7.6%	3.6%	4.2%	3.8%
1980-2006	6.3%	3.0%	2.6%	2.8%
1995-2006	6.9%	3.7%	3.2%	3.0%

Source: World Trade Organization, World Bank, Moffatt & Nichol

Summary

- The world economy is circling the drain – policymakers failed to contain the damage after speculative bubbles

- Global New Deal Revival – government spending, not consumers, will drive growth

- In 2012, “All clear” for 8 Years – until then relatively low trade volume growth

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