



Turbulent Times: The US Economic Outlook for 2009 and Beyond

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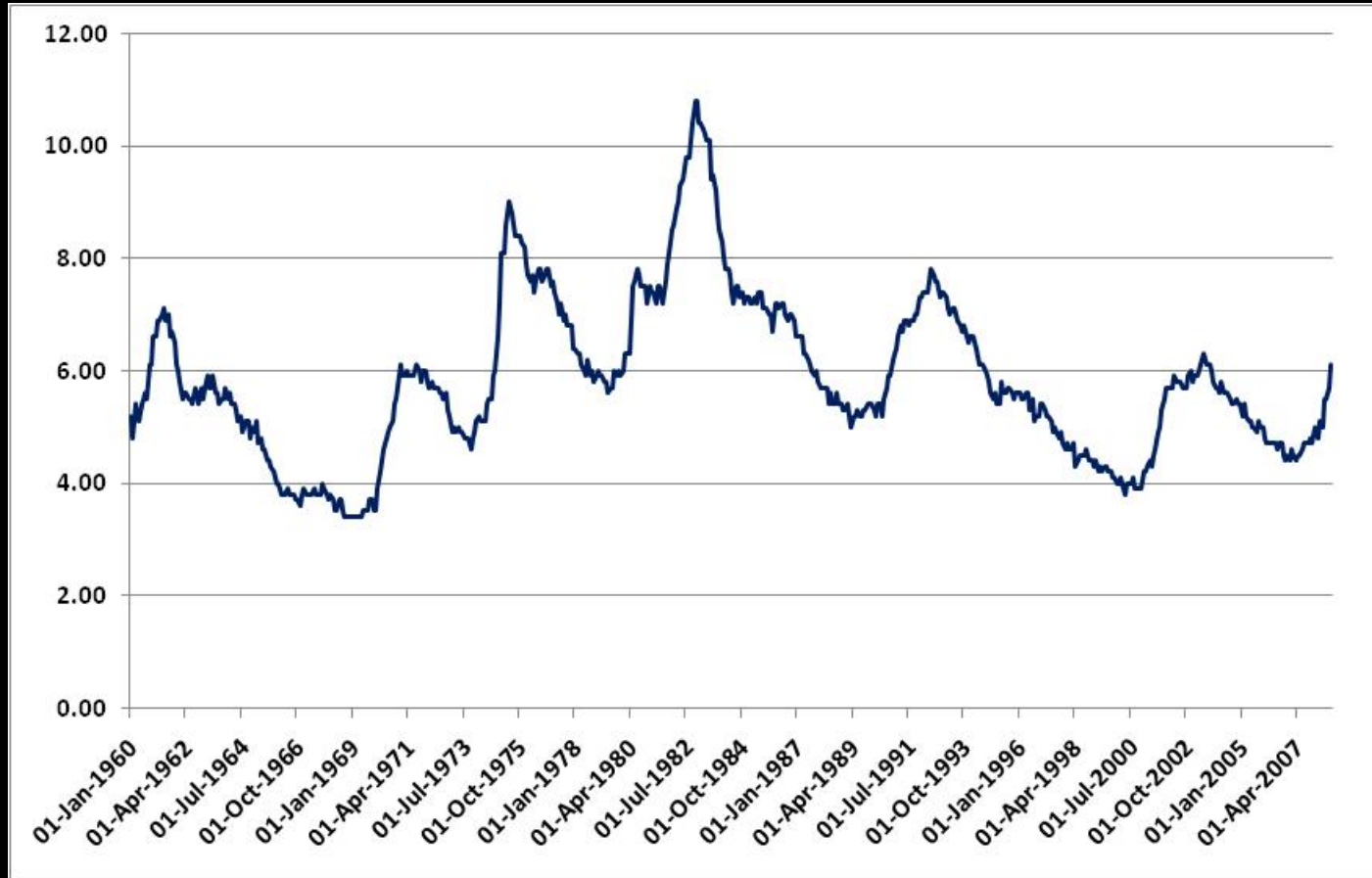




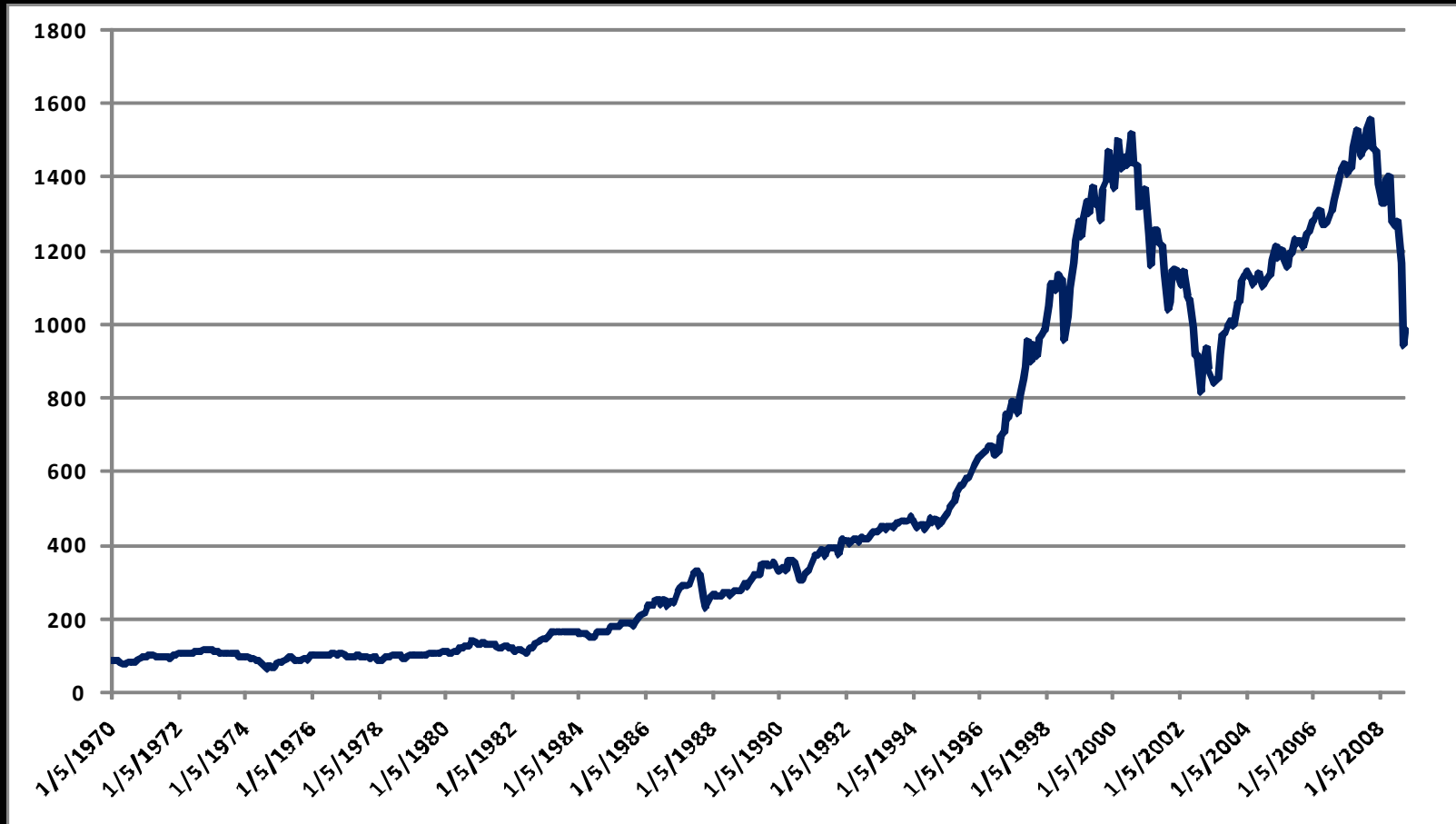
Supply Side Fundamentals

- Usually, the growth of supply in the economy drives income and returns.
 - Say: Supply creates its own demand.
 - Friedman: Money is a veil.
- After a difficult period in the 70's and 80's, the U.S. economy has had strong supply fundamentals for 15-20 years:
 - Solid real GDP growth
 - Strong underlying growth in productivity
 - Low unemployment rates
 - Robust stock market
 - Rapid rise in the stock of wealth

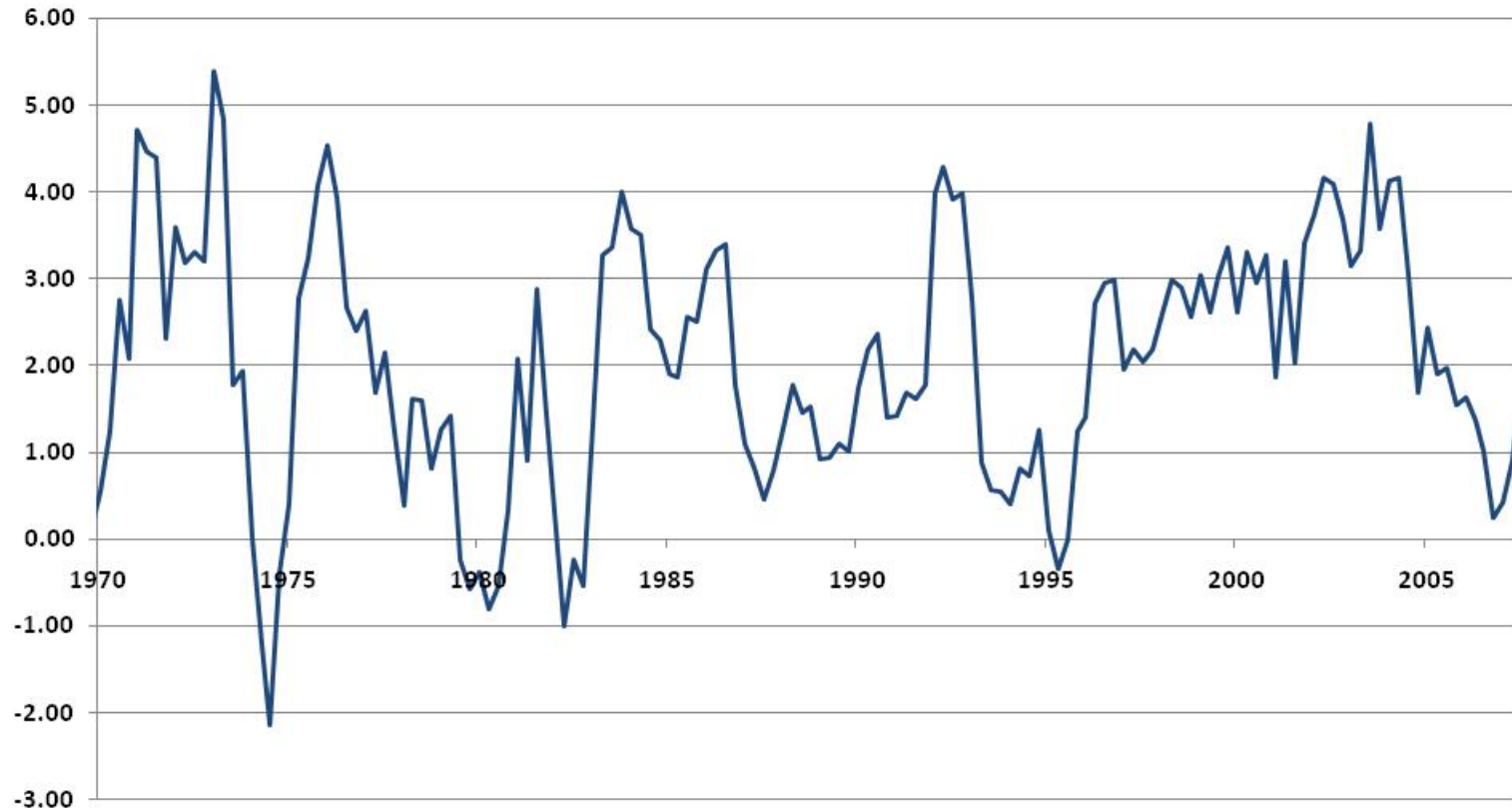
Unemployment Rate 1960-2008



S&P 500 Average 1970-2008



Labor Productivity 1970-2008



12-month Rolling Average



Long Term Fundamentals

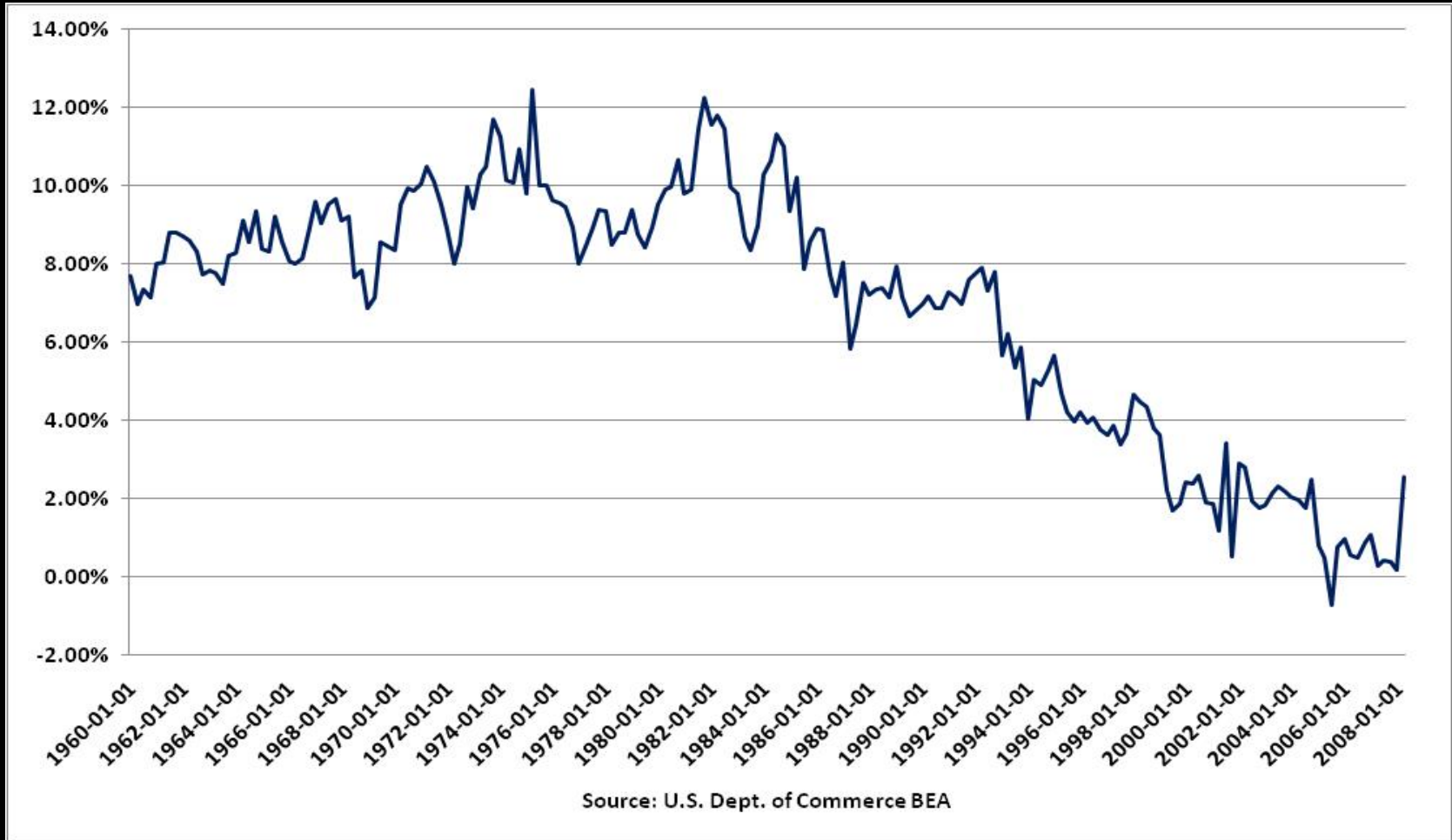
- Potential growth rate increased as US firms led the development of the new economy:
 - information technology
 - telecommunications
 - connectivity
 - global value creation
- US firms remain well-positioned to lead in these sectors:
 - rewards to innovate are high
 - capital markets broad and deep
 - labor markets flexible
 - regulations not excessive
 - skilled workers and immigrants

An Unsustainable Economy?

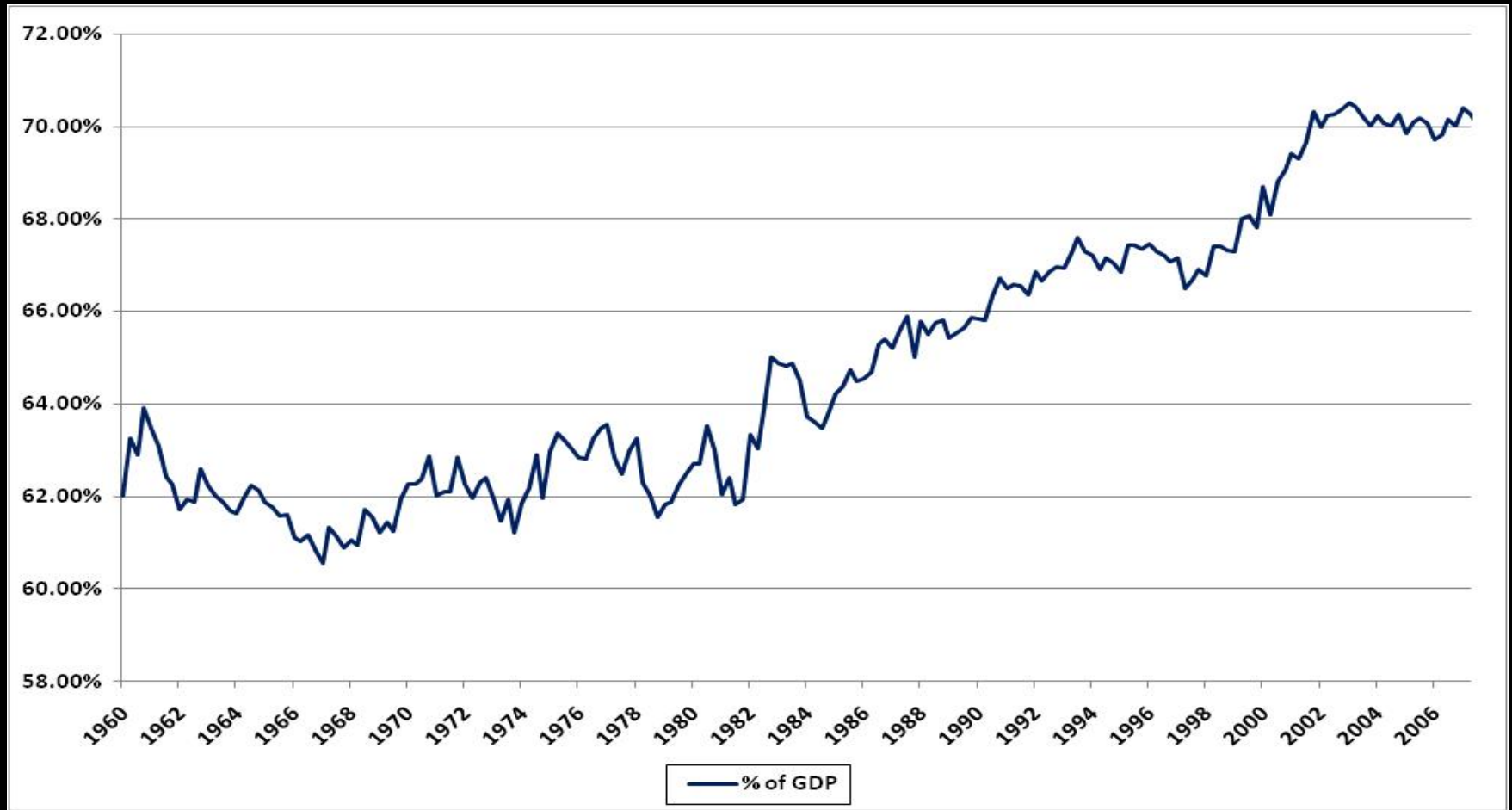
- Perhaps easy credit enabled demand to pull supply above true underlying potential for an extended period of time:
 - Negative personal savings rate
 - Surge in consumption relative to GDP
 - Federal budget deficits
 - Large current account deficits



Personal Savings/Disposable Income 1960-2008



Consumption/GDP 1960-2008

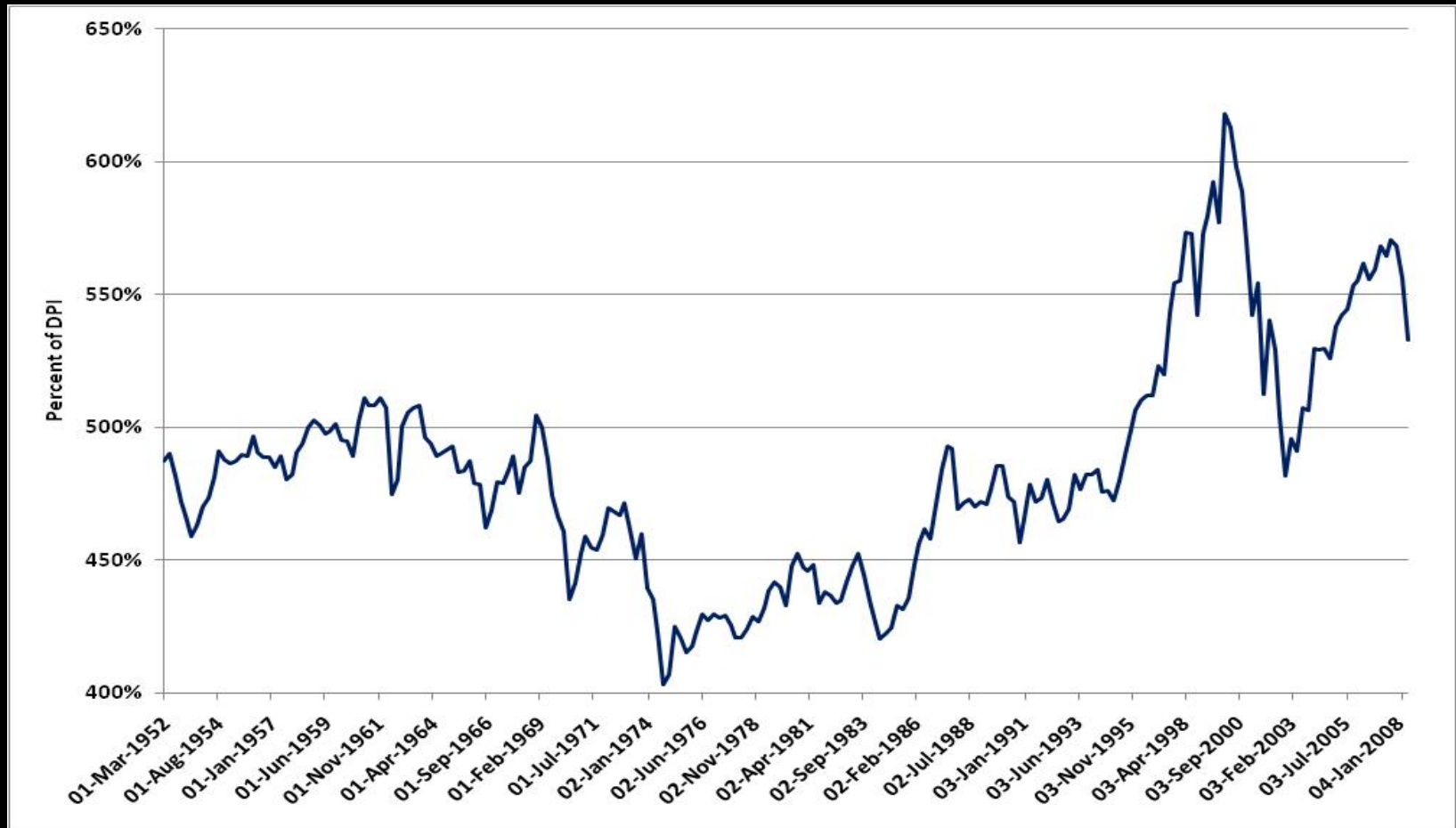




Reconciliation 1990-2005

- Unexpectedly high returns on assets and labor effort:
 - New economy companies and real estate appreciation
 - Higher productivity = higher real income
- Confident households with higher than expected wealth borrow against expected future income, which was rising
- Growth without accelerating inflation
- Norway and North Sea oil?

Household Net Worth/Income 1952-2008





Reconciliation post-2005

- New economy supply factors continued...
 - Technology still boosts productivity
 - US firms still lead tech sector
 - US assets still attractive
- ..but lax credit amplified demand...
 - Irresponsible mortgage lending caused housing market bubble and ensuing financial market chaos



Reconciliation post-2005

- Housing bubble and bust...
- ...caused decline in value of ubiquitous mortgage backed securities...
- ...which, combined with high leverage of financial institutions, is at the root of an ongoing credit crisis.
 - Investment banks decimated
 - Fannie and Freddie nationalized
 - Consolidation of traditional banks
 - Severe disruption in credit markets: loss of confidence and liquidity & some insolvency



Current Risks

- Fed balancing act: avoid a Great Depression or Japan scenario
 - Restore confidence and liquidity now
 - Worry about inflation and dollar later
- Policymakers will be busy....
 - Fiscal stimulus needed, but difficult
 - Financial market regulation and oversight must change—reduce conflicts
 - Bailout mania: Who's next? Why?
- ...hopefully not too busy



Turning Point Forecast

- Stock Market: January 2009 (Obama team in place will reduce uncertainty)
- GDP: June 2009 (time needed to reverse paradox of thrift)
- Unemployment: January 2010 (unemployment follows output as firms boost productivity)



Questions?