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Global Economic Outlook 2009

Press Release

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EUCLID Global Economic Outlook Webcast

Good afternoon.

Please note that this press briefing is under embargo until October 2nd, noon GMT.

In accordance to a recent directive issued by Secretary General Syed Zahid Ali, EUCLID has prepared and is now broadcasting its annual Global Economic Outlook report.

As of September 30th 2008, the EUCLID faculty and research team would like to present the following reflections regarding the 2009 global outlook based on current patterns and taking into account the IMF World Economic Outlook and Global Financial Stability reports.

Trends that have emerged in 2008 are likely to continue in 2009, including the unwinding of the global credit bubble which has accelerated in the past weeks.

The overall health of the US economy, financial system and currency is of special concern due to its influence on other economic areas and on global financial stability.

For the United States, the EUCLID forecast is that of ongoing corrections of unsustainable economic fundamentals. The possible resolution of the immediate financial crisis will still require structural adjustments in 2009.

Real estate prices are likely to continue their decline due to a number of factors including public perception, increased foreclosures, rising unemployment and extreme cautiousness on the part of financial institutions. The widespread concern that asset values will continue to decline means that the pool of qualified buyers will be limited

in the foreseeable future. It is EUCLID's forecast that US real estate prices will decline by another 20% before a bottom is reached and that a rebound in real estate prices is very unlikely to take place in 2009.

Clearly, the pattern of US economic growth fueled by consumption driven by equity extraction, associated with a housing boom, rising property values and cheap energy, has come to an end. This pattern was also coupled with unsustainable budget, trade and current account deficits.

In this context, the policy response of the Federal Reserve System is constrained by mixed signals pertaining to inflation: inflationary pressure in most areas, especially food and energy, but also continuing asset deflation. In order to promote economic growth and to prevent deflation, the policy will in all likelihood be to maintain low interest rates throughout 2009. However, it is EUCLID's forecast that a modest rise of perhaps 0.25 or 0.50 percent is possible in 2009 without significant impact. Such a measure would be largely symbolic vis a vis the European Central Bank and to sustain the US dollar.

The commitment of the US Federal Reserve to stimulate growth while diminishing the relative weight of debt will in all likelihood result in the acceptance of higher inflation in 2009. By contrast, the European Central Bank is committed to controlling inflation, which indicates that the two central banks may be pursuing divergent policies. As a result, the value of the euro against the dollar is likely to remain relatively high, stabilizing around 1.60, with a possible peak at 1.75.

For the United States economy, 2009 is likely to be a year of difficult adjustments with a noticeable recession or slump. Taking into account the fact that finance and real-estate related sectors represent a large percentage of the real economy, the impact of this transitional period may be significant.

The monetary and fiscal options are very narrow with a risk of "stagflation" as pre-1970s conditions can be identified.

With weak demand and over capacity, the risk of deflation is also quite real, but the US authorities seem committed to take any measure to prevent this situation from developing. Moreover, the current real estate and credit deflation is more of a bubble correction than a systemic deflation.

Throughout 2009 and beyond, the structural imbalances of the US economy seem to have reached a point where painful corrections are needed, both in terms of public finances and balance of trade.

This situation will affect the economic outlook of the euro-zone where a mild recession can be expected. The level of economic adjustment will vary within the eurozone, with a more severe adjustment affecting Spain and the United Kingdom¹. Tensions in the EURO system are expected as participating countries such as France struggle with growing public deficits.

¹ The UK is here loosely considered part of the euro-zone economy.

India and China, together with other emerging economies, will also be affected by this global outlook since their economies are export oriented. However, the fundamentals of these economies are basically sound and this slowdown may actually be a healthy pause to avoid overheating.

At the international level, three factors are important and difficult to predict.

The first one has to do with geopolitical instability and the risk of open conflicts in the Caucasus and Iran.

The second one has to do with the supply chain and price of oil, but this last factor seems to be moderated by the end of speculation and decrease in demand. In spite of this favorable situation, it is EUCLID's forecast that the price of oil will remain high and stabilize above the \$100 mark by the last quarter of 2009.

The third factor has to do with the contrast between a gradual versus disorderly unwinding of the credit crisis and the risk of ripple effect throughout the system. It does seem clear that the notional value of credit derivatives must converge with the real value of the global GDP.² Massive and concerted government measures will be necessary to allow this correction to take place in a relatively orderly way.

In conclusion, we would like to refer to a somewhat prophetic speech by European Central Bank President Jean-Claude Trichet delivered in 2005. As Mr. Trichet, indicated:

A financial crisis can make it very difficult to maintain price stability. This is demonstrated by the fact that all major deflationary episodes in the world have been related to substantial falls in asset prices. Boom-bust cycles in asset prices do exist and can potentially harm the entire economy, especially via the effect on the financial system. Maintaining price stability in times of financial crises is a very difficult task.

It is EUCLID's assessment that 2009 will see the confirmed emergence of the EURO as primary reserve currency, with increase downward pressure on the US dollars. However, this trend may prove to result in further economic destabilization and needs to be closely monitored and controlled by the central banks.

It is also possible that the United States economy and US financial instruments may no longer be perceived as enjoying superior stability and oversight, thus leading to a possible transformation of international finance as well as continued growth in the emerging world of Islamic Finance which is not debt-based.

For further information, please visit www.euclid.int.

Thank you.

² Ref.: http://www.linkedin.com/answers/financial-markets/futures-markets/MKT_FUT/331320-6828686?browseCategory=MKT&goback=.avq_236100_20142303_0_*2.avq_240582_860466_0_*2

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