THE US ECONOMY

CONTEXT

When the real cost of money (and credit) is low:

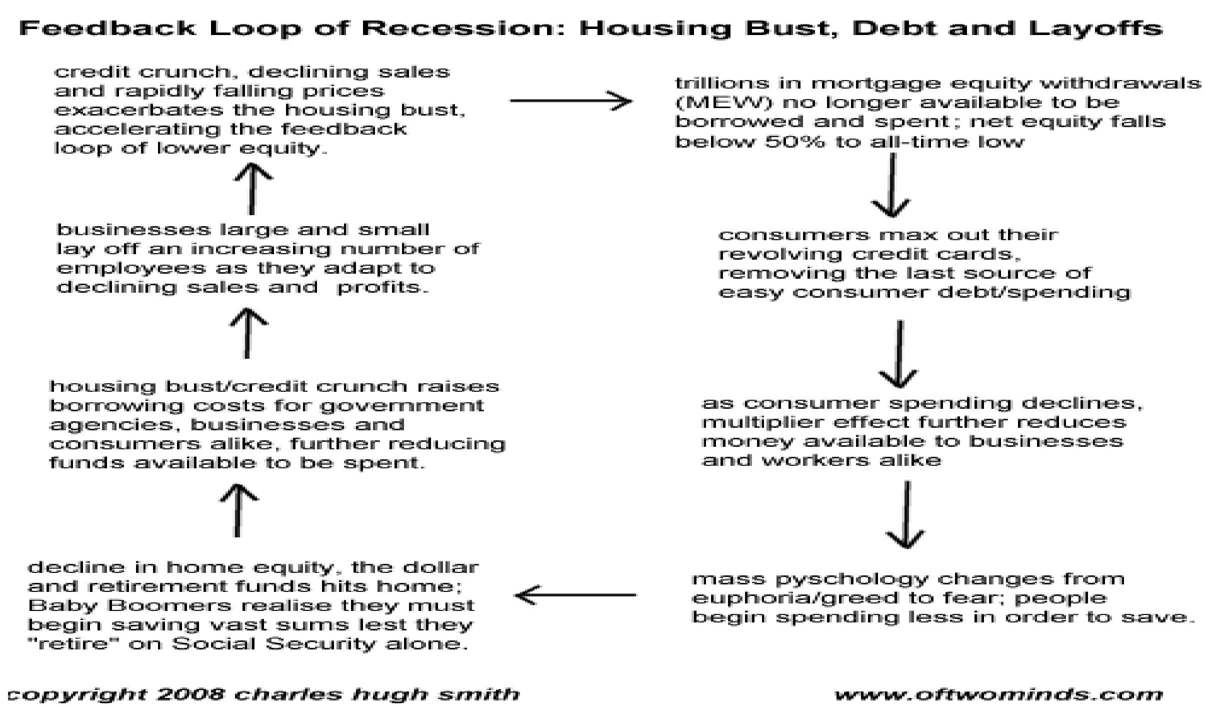
- Businesses and individuals are more likely to invest and spend.
- This climate promotes demand.
    - Demand promotes economic growth.
        - Economic growth promotes more employment.
        - Economic growth promotes higher wages.

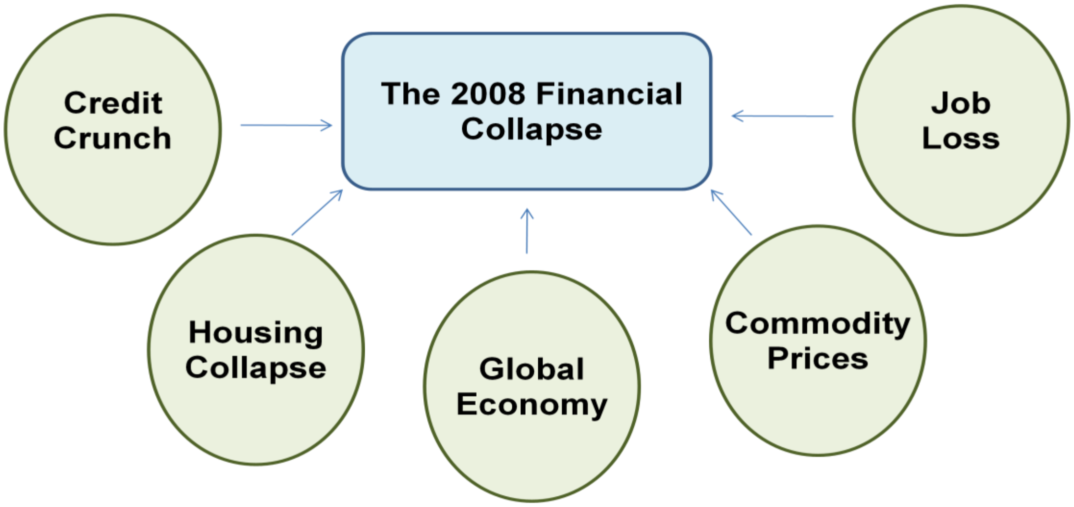
When the real cost of money (and credit) is too low:

- Demand can begin to outstrip productive capacity.
- When demand increases the supply can become inadequate.
    - Concern about the value of money and credit (the cost) in the future may increase.
        - This may produce higher prices (inflation).

The goal is to find the right balance between the cost of money and supply and demand — the right balance of economic growth.

THE RECENT SITUATION





The Great Recession ranks as the worst slowdown that the US has suffered in decades. Not surprisingly, this economic meltdown has affected US residents in a variety of ways.

The recession has certainly altered the spending habits of US consumers. In a recent poll, 62% of respondents said they had cut back on their spending since the start of the recession. Only 6% said they were spending more. An additional 30% said they were spending the same.

The recession has also changed the way many people work. According to the survey, 32% of US residents say that they either are or have been unemployed because of the recession. At the same time, 28% say they have had their work hours reduced, while 12% have had to take unpaid leave. An additional 11% of workers have had to switch to a part-time work schedule, while 23% have had to take a pay cut. Finally, 6% of respondents say they are now under-employed.

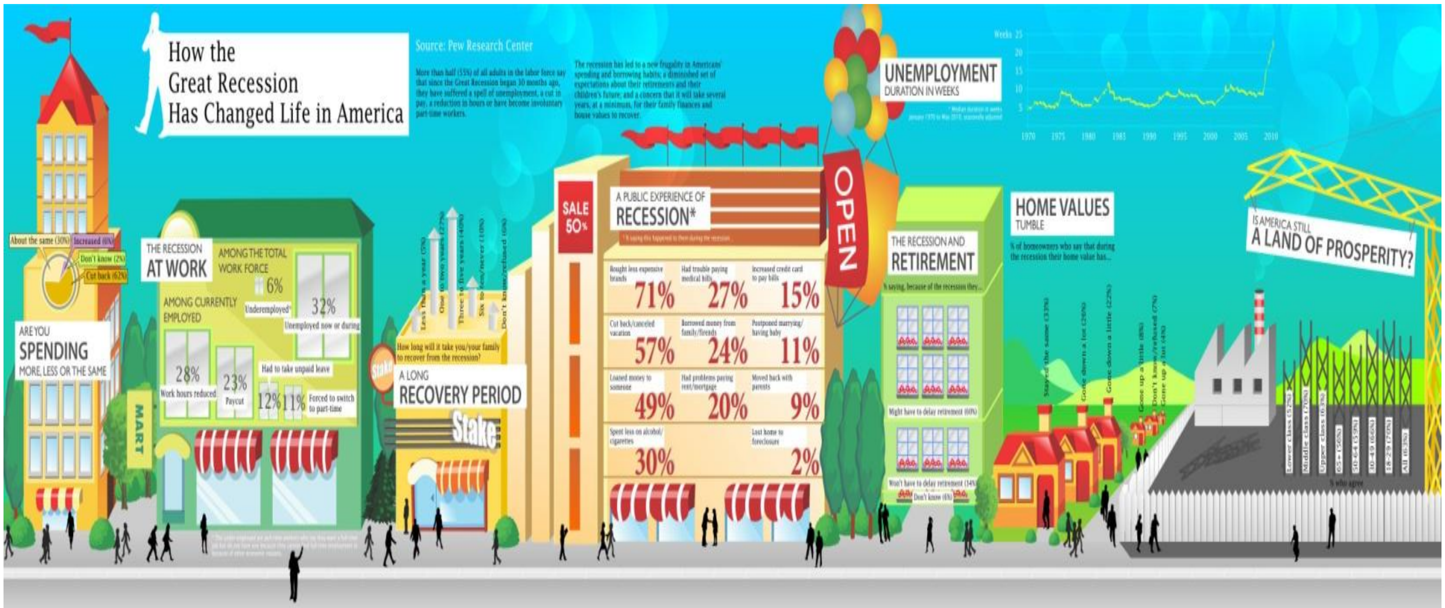
How long do families think it will take them to recover from the Great Recession? There is a wide variety here, too. A total of 5% of US families say it will take them less than a year to recover, while 27% estimate that it will take them a year or two to bounce back. For other families, the recession has had a much larger impact. A total of 40% estimate that it will take them three to five years to fully recover, while 10% predict that it will take six to 10 years. Also included in this last group are those families who say they will never recover from the effects of the Great Recession.

Home values have also tumbled thanks to the Great Recession. According to the survey, 26% of US homeowners have seen the value of their residences fall significantly during the recession. Another 22% have seen their home values fall a little, while 33% say they have stayed the same. Only 8% of homeowners say their home values have gone up a little. An even smaller 4% say they have gone up a lot.

Consumers have taken steps to adjust to these troubling economic times. A large number – 71% – of consumers say they have purchased less expensive brands during the recession, while 15% have increased their credit card balances to pay bills. A total of 27% of consumers have struggled to pay medical bills. A large number, 57%, have cut back or canceled vacations, while 24% have borrowed from family members or friends. Some have even made big changes: 11% say they have postponed either getting married or having a baby thanks to the recession.

Others, 20%, have struggled to make their mortgage payments. An additional 30% have spent less on alcohol and cigarettes, while 2% have lost their homes. Many others, 60%, reported that they will have to delay the date of their retirement thanks to the recession.

What is surprising is that so many people still view the United States as a land of prosperity even after the Great Recession's impact: 52% of lower-class respondents said the United States was still a prosperous nation, while 70% of middle-class respondents agreed. A total of 63% of upper-class respondents said the same.



Monetary Policy Responses to 2008 Collapse

- The Fed lowered the discount rate (07/2007 - 5.25%, 12/2008 - 0.00%).
- The Fed bought debt of uncertain value from financial institutions, providing them money instead.
- Credit available again but increases in bank and financial institution lending were very slow to come.

Fiscal Policy Responses to 2008 Collapse

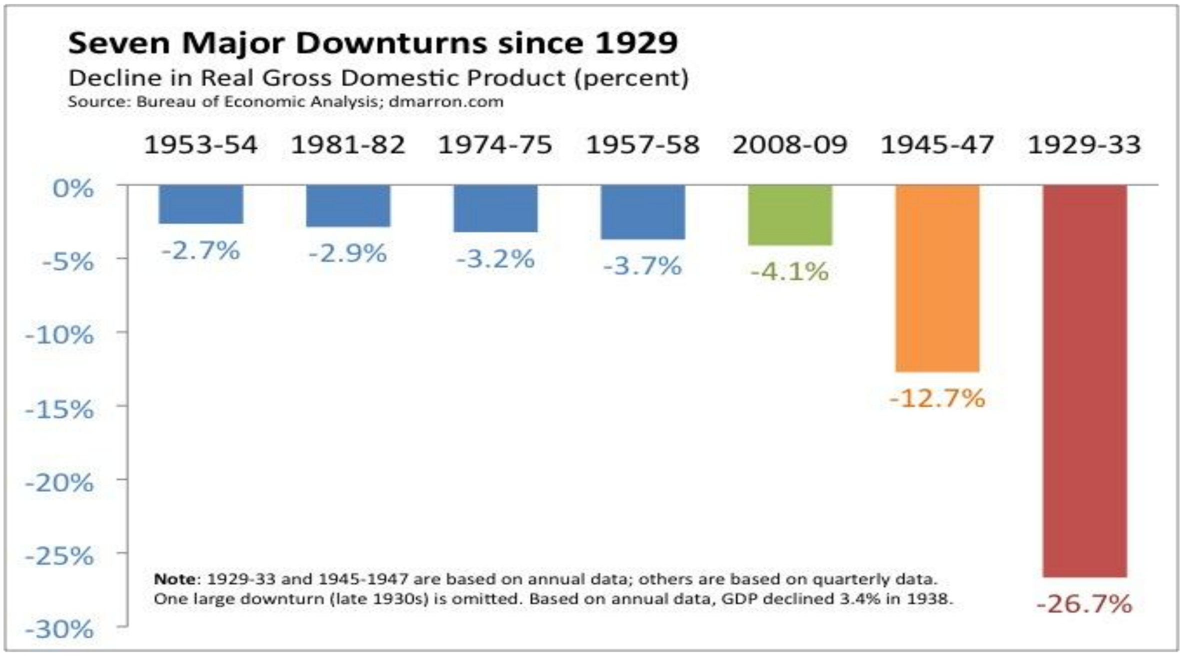
- Rebirth in Keynesian economics and the use of fiscal policy.
- Government bought bad debt.
- Government extended unemployment benefits.
- Government initiated job creation programs.
- Government enacted certain tax rebates.
- Government approved financial transfers to states.
- Targeted spending bailed out or federalized financial institutions and automakers but national deficit skyrocketed.

How Successful Were the Interventions?

- Belief that government should intervene.
- Global institutions involved and cooperative.

- Both monetary and fiscal policy options available.
- Clear that the aggressive use of both limited the impact of the collapse.
- The situation did not turn into another "Great Depression" but it is still not healthy.

FINANCIAL CRISES IN COMPARISON … THIS TIME IS DIFFERENT



Historical Financial Crisis Facts

- real housing prices decline 35% over 6 years
- real equity prices fall 56% over 3.4 years
- unemployment rate rises 7% over 4.8 years
- real GDP per capita falls 9.3% over 1.9 years
- real government debt rises 86% over the first 3 years

How does the current US cycle compare?

The US's current experience is your "garden-variety severe financial crisis." However labor markets are performing better than in previous episodes.

Financial Crises Facts

	Historical Average	Current U.S. Cycle
Real Housing Prices	-35.5%	-38.0%
Real Equity Prices	-55.9%	-53.4%
Unemployment Rate	7.0%	5.7%
Real GDP per Capita	-9.3%	-6.4%
Real Government Debt	86.0%	78.0%

When we compare the Great Recession not to other US cycles but to the Big 5 financial crises and the US Great Depression (thanks to US Treasury for adding that to the graph), the current cycle actually compares pretty favorably. This is likely due to the coordinated global response to the immediate crises in late 2008 and early 2009.

While the initial path of both the global and US economies in 2008 and 2009 effectively matched the early years of the Great Depression – or worse – the strong policy response employed by nearly all major economies – both monetary and fiscal – helped stop the economic free fall. Given the history of post WWII recessions in the US, the current level of job loss and slow recovery to date make the current cycle the clear outlier.