

# Are Foreigners Losing Their Interest in U.S. Investments?

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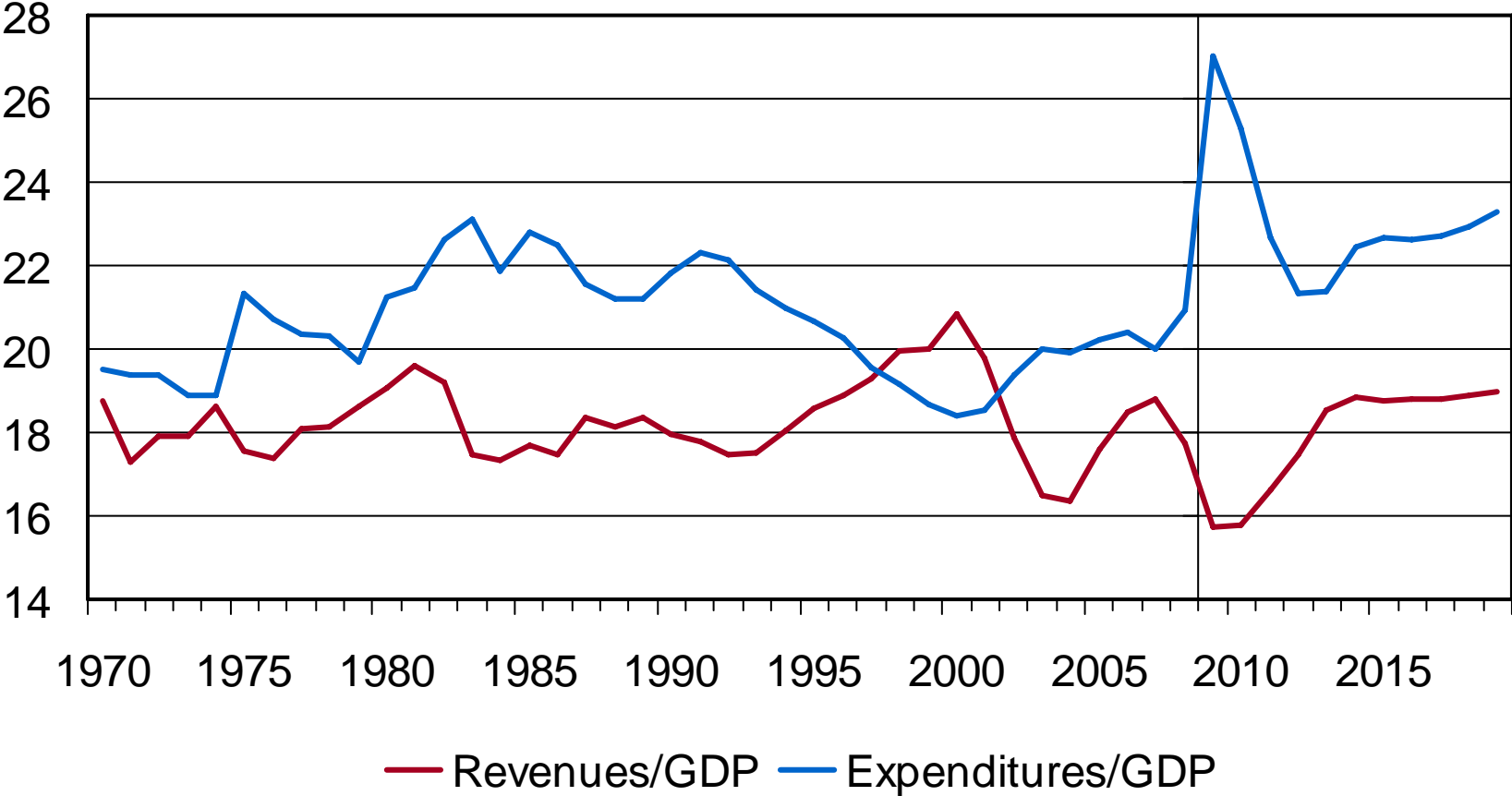
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INSIGHT

# Will Rising U.S. Debt Hurt the Attractiveness of Dollar Assets?

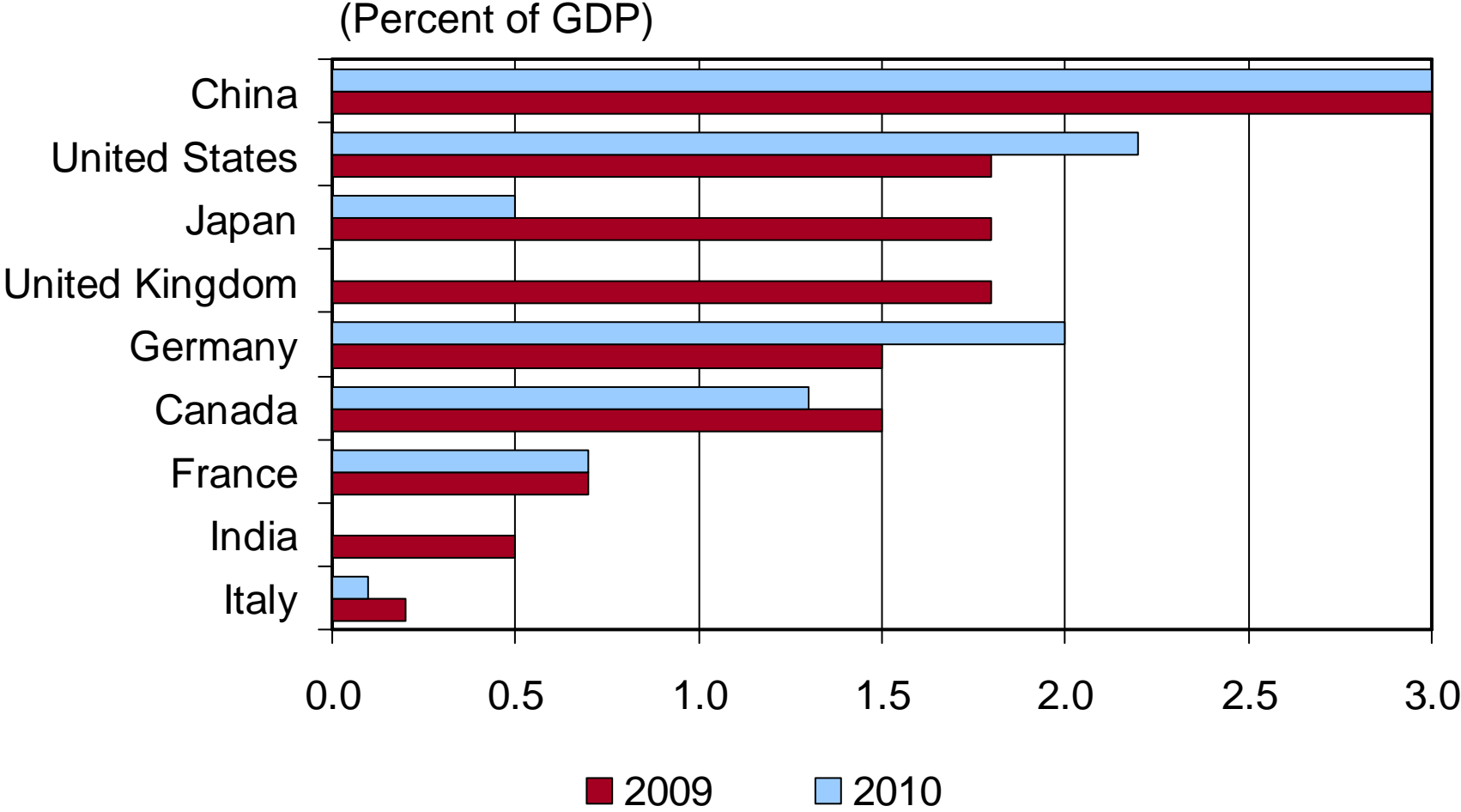
- Rising U.S. debt is not sustainable ...
- ... But the big increase in the U.S. deficit is temporary
- Longer-term fiscal sustainability will depend on how the entitlement programs (especially Medicare) are tackled
- In the near-term there is no substitute for the dollar as the premier reserve currency ... “the best looking horse in the glue factory”
- However, over time, other currencies will rise in importance
- Believe it or not, there are still some longer-term positives for the dollar ...
- ... And inflation is less of a threat than a “lost decade”
- China wants it both ways: reduced vulnerability to the dollar and a weak RMB
- Bottom line: the dollar will weaken but not collapse
- Bottom line: U.S. investments are still attractive

# U.S. Fiscal Stimulus and Financial Rescue Programs Will Push Federal Spending to Nearly 30% of GDP

(Percent of GDP, fiscal years, unified budget)

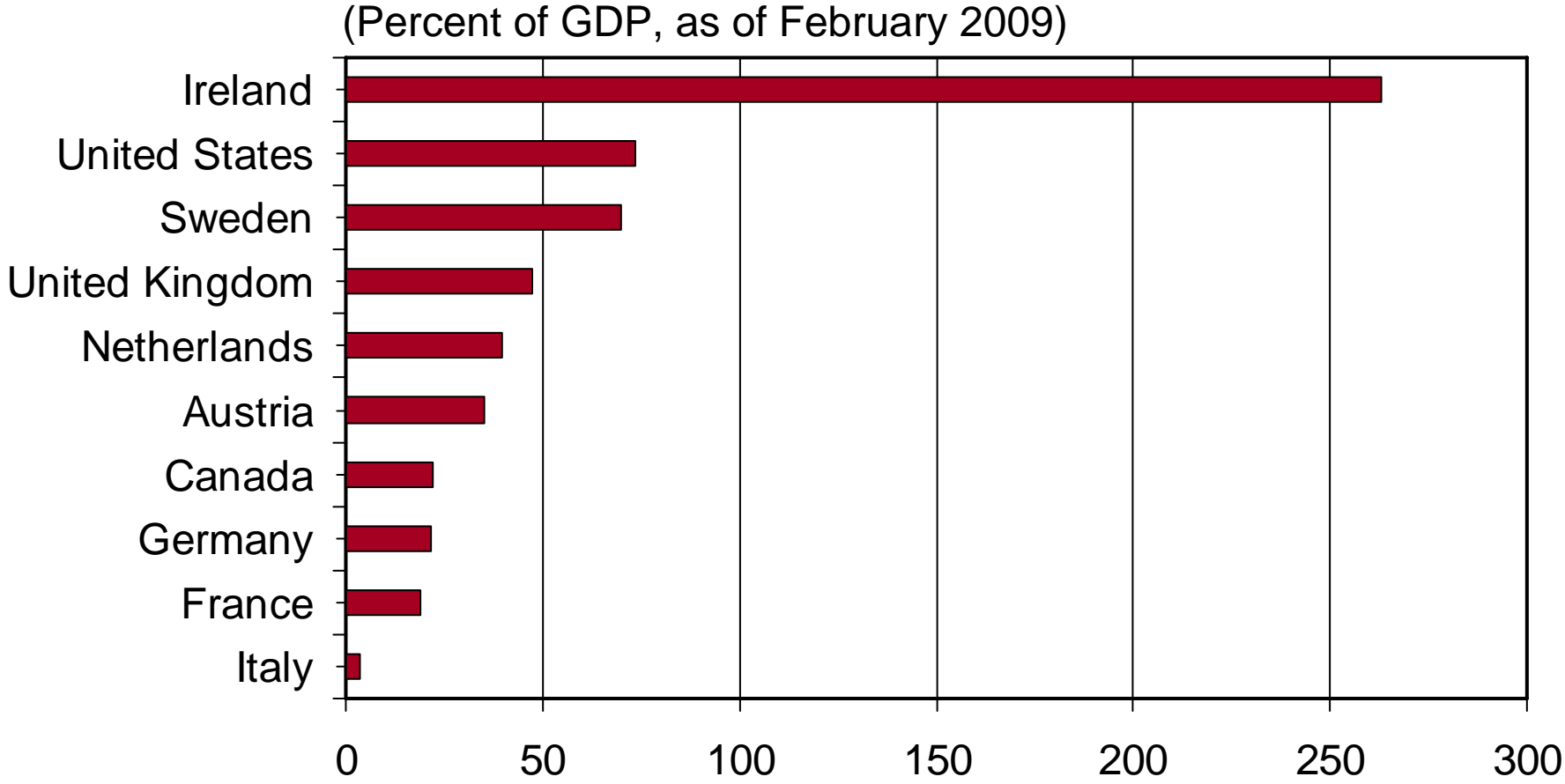


# Fiscal Stimulus in 2009 and 2010: Not Nearly Enough



Source: International Monetary Fund, IHS Global Insight

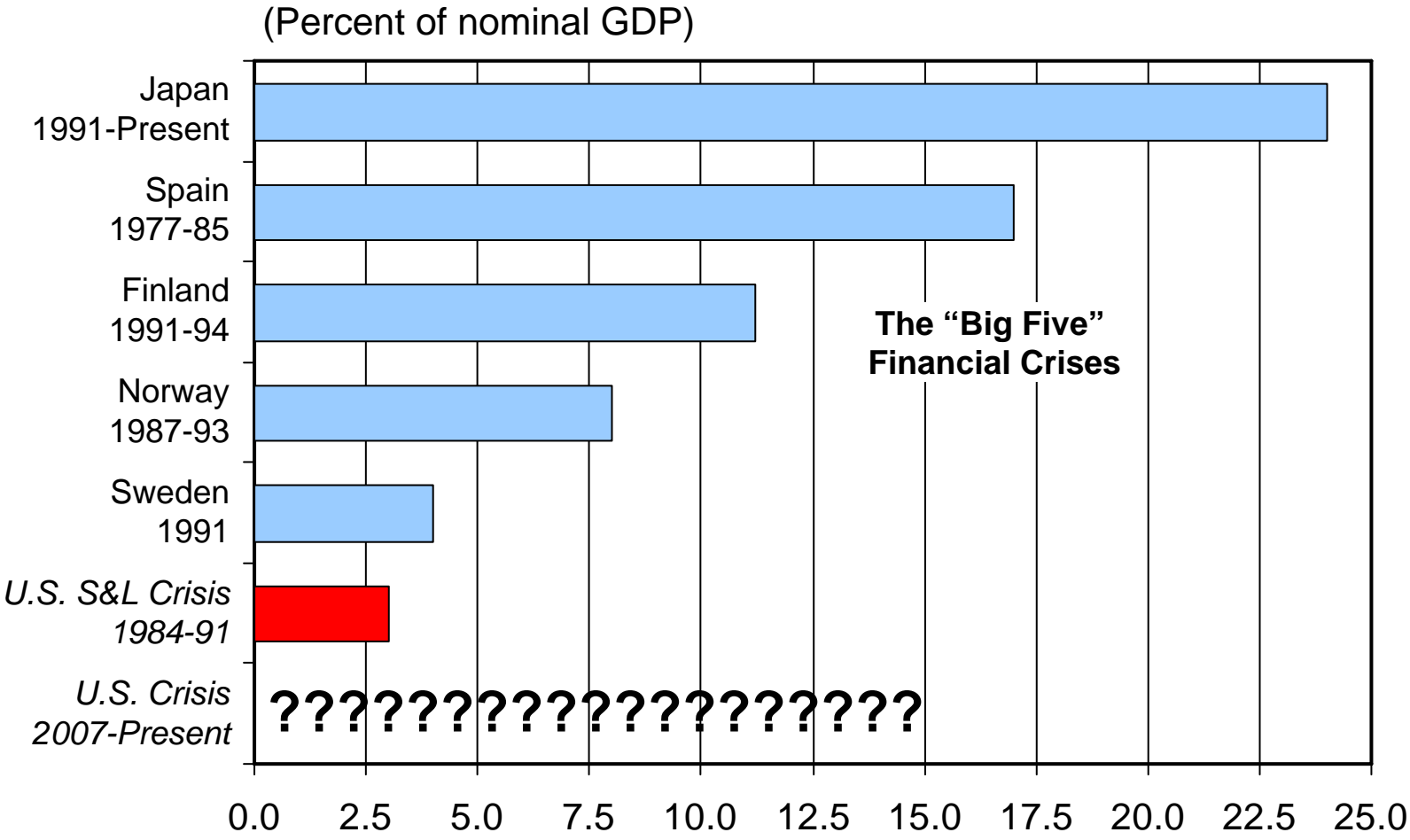
# Financial Sector Support Programs\*



\* Includes: Capital injection, purchase of assets and lending by treasury, central bank support provided by treasury backing, liquidity provision and other support by central bank, and guarantees.

Source: IMF

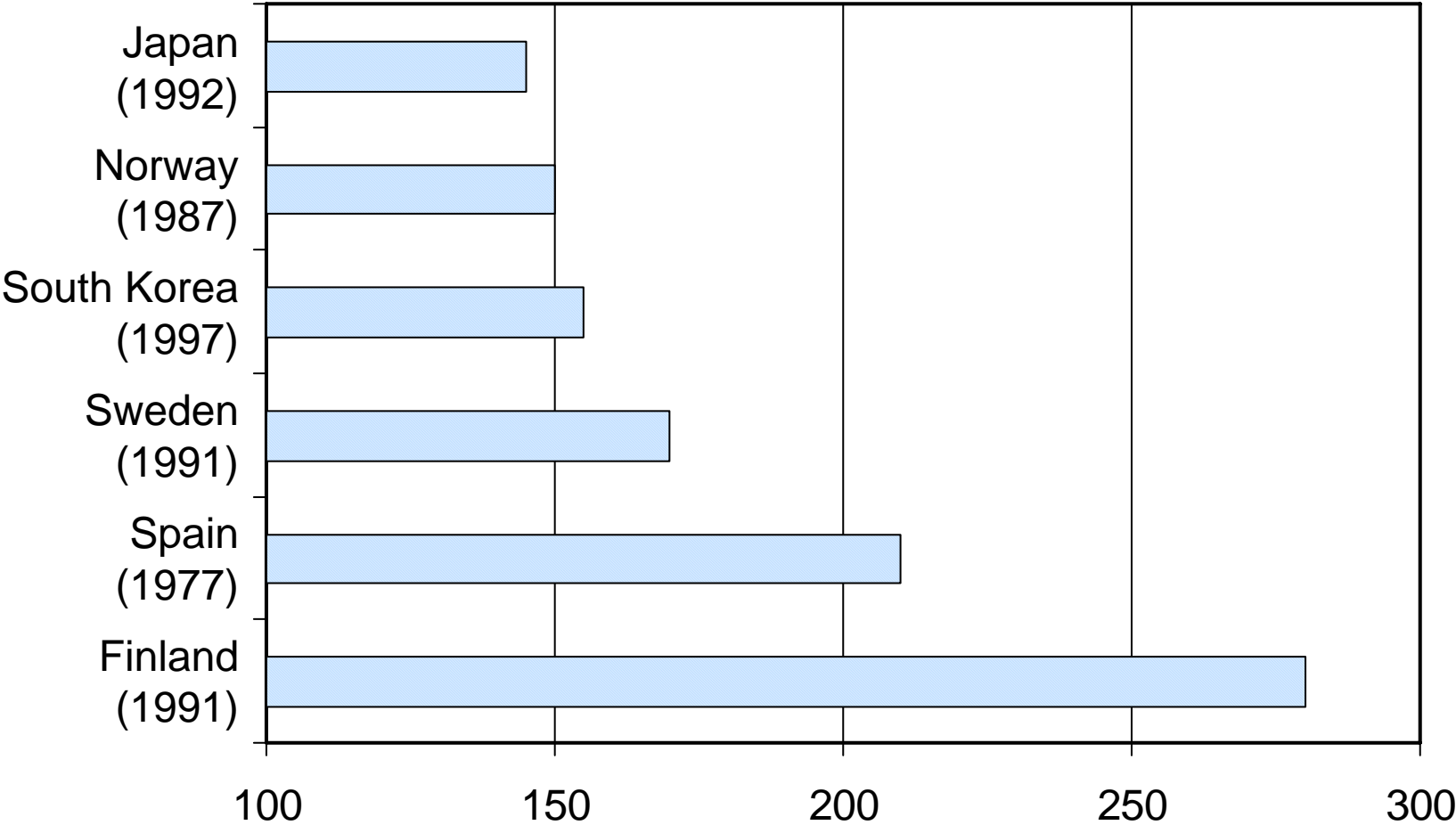
# Fiscal Costs of Major Post-War Banking Crises



Sources: IMF, Global Insight

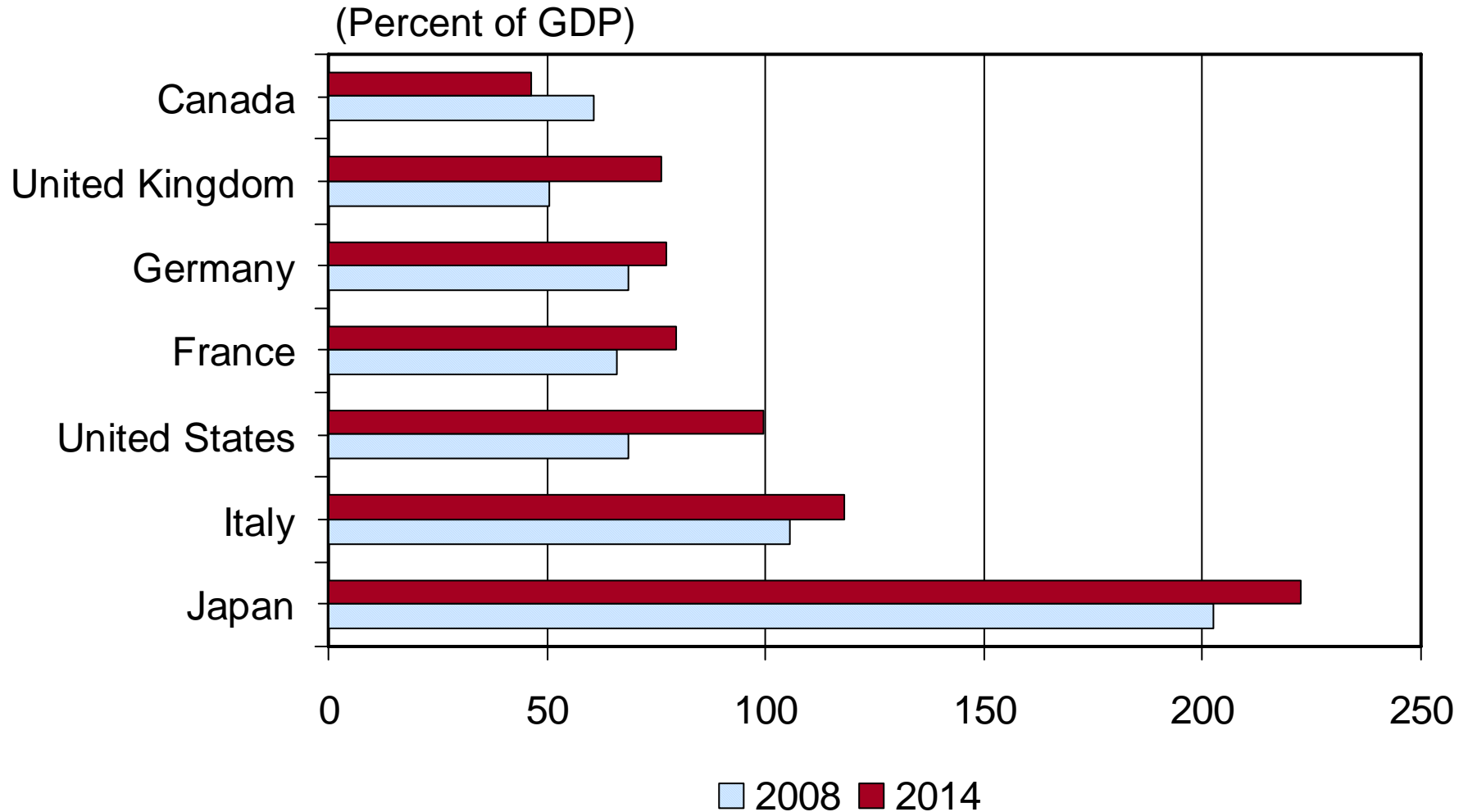
# Post Crisis Rise in Debt

(Cumulative rise in public debt in 3 yrs following banking crisis, index=100 in year of crisis)



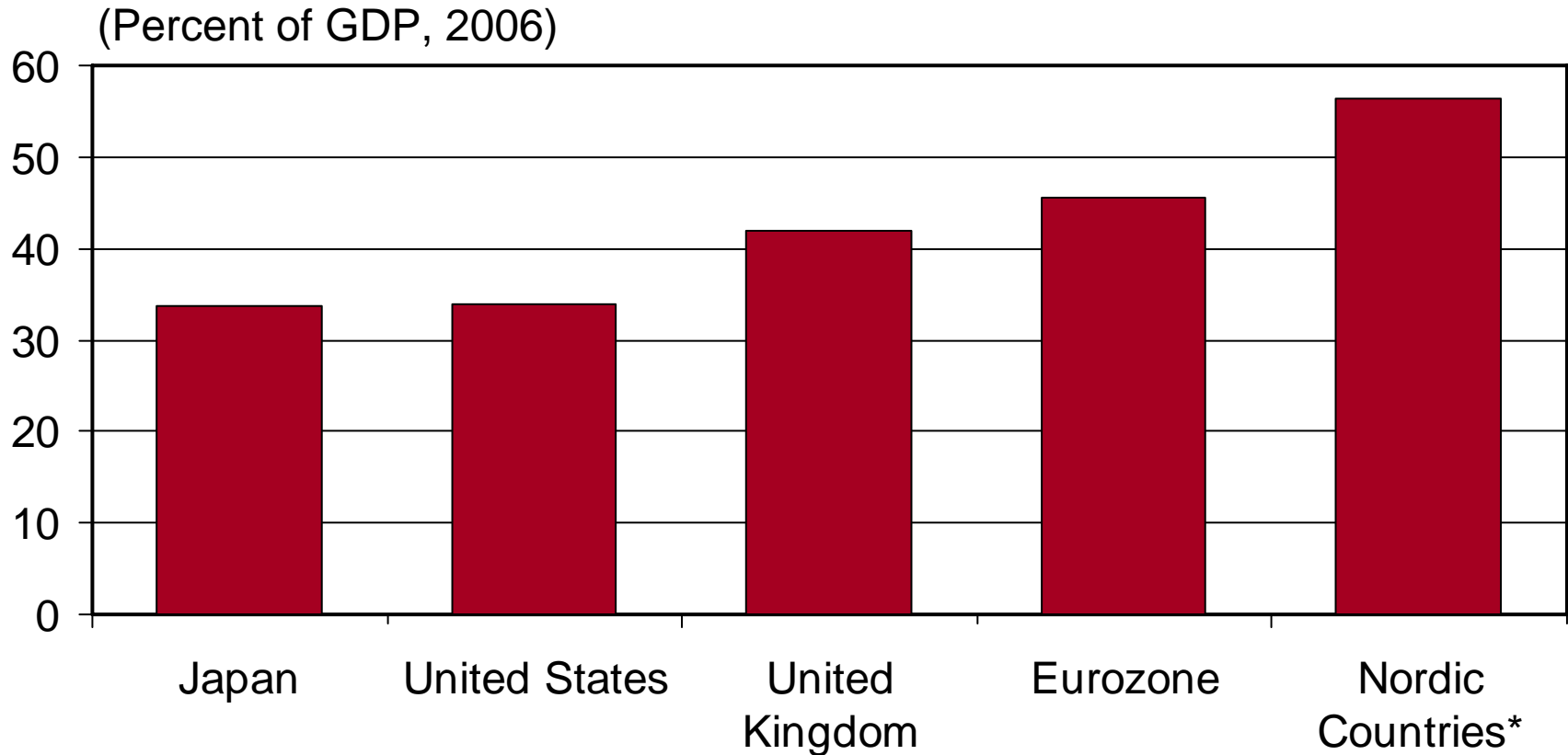
Source: Carmen M. Reinhart and Kenneth S. Rogoff, "The Aftermath of Financial Crises", *American Economic Review*, May 2009

# Expected Increases in Government Debt as a Result of The Financial Crisis



Source: IMF

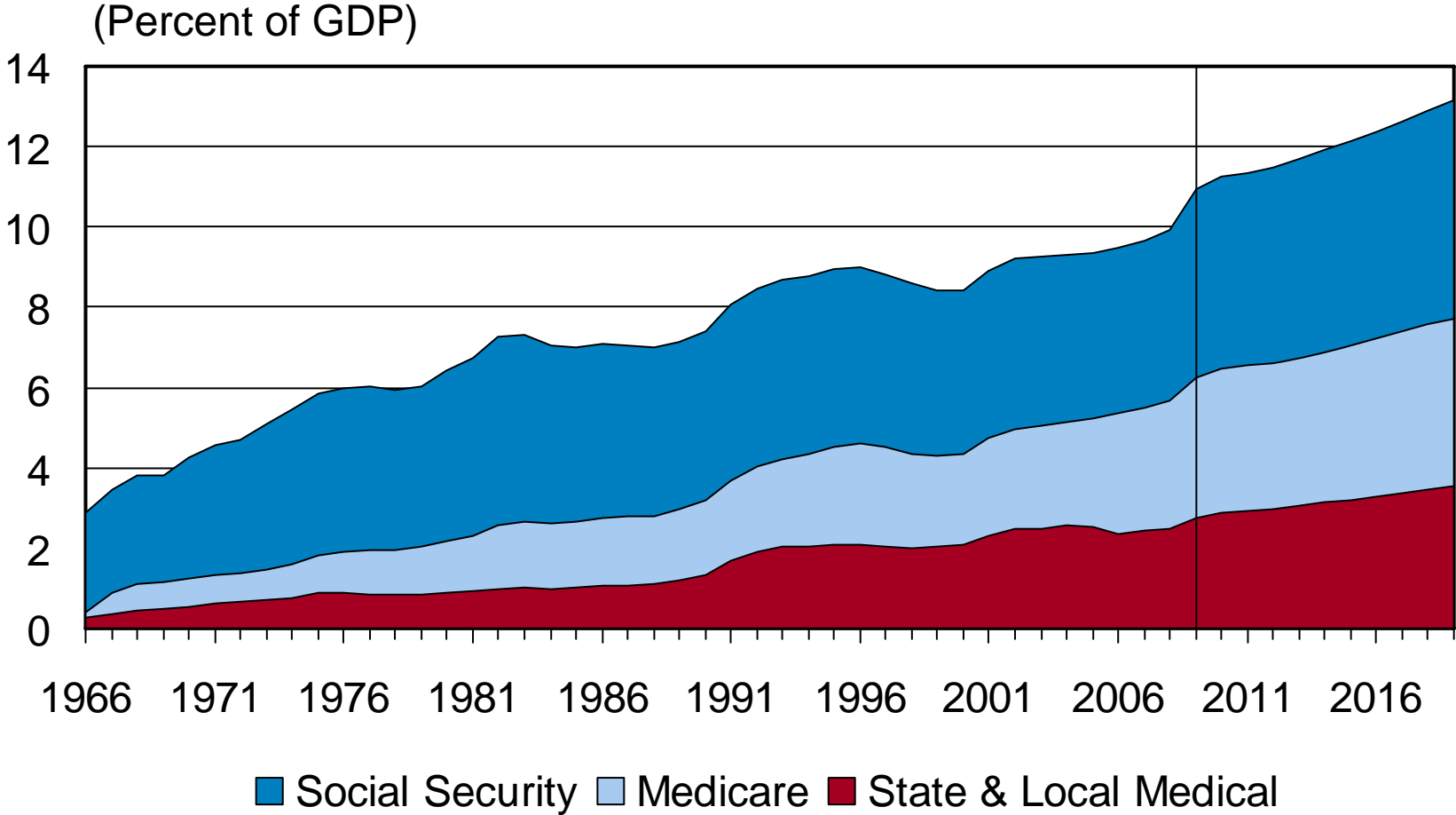
# The “Footprint” of Governments



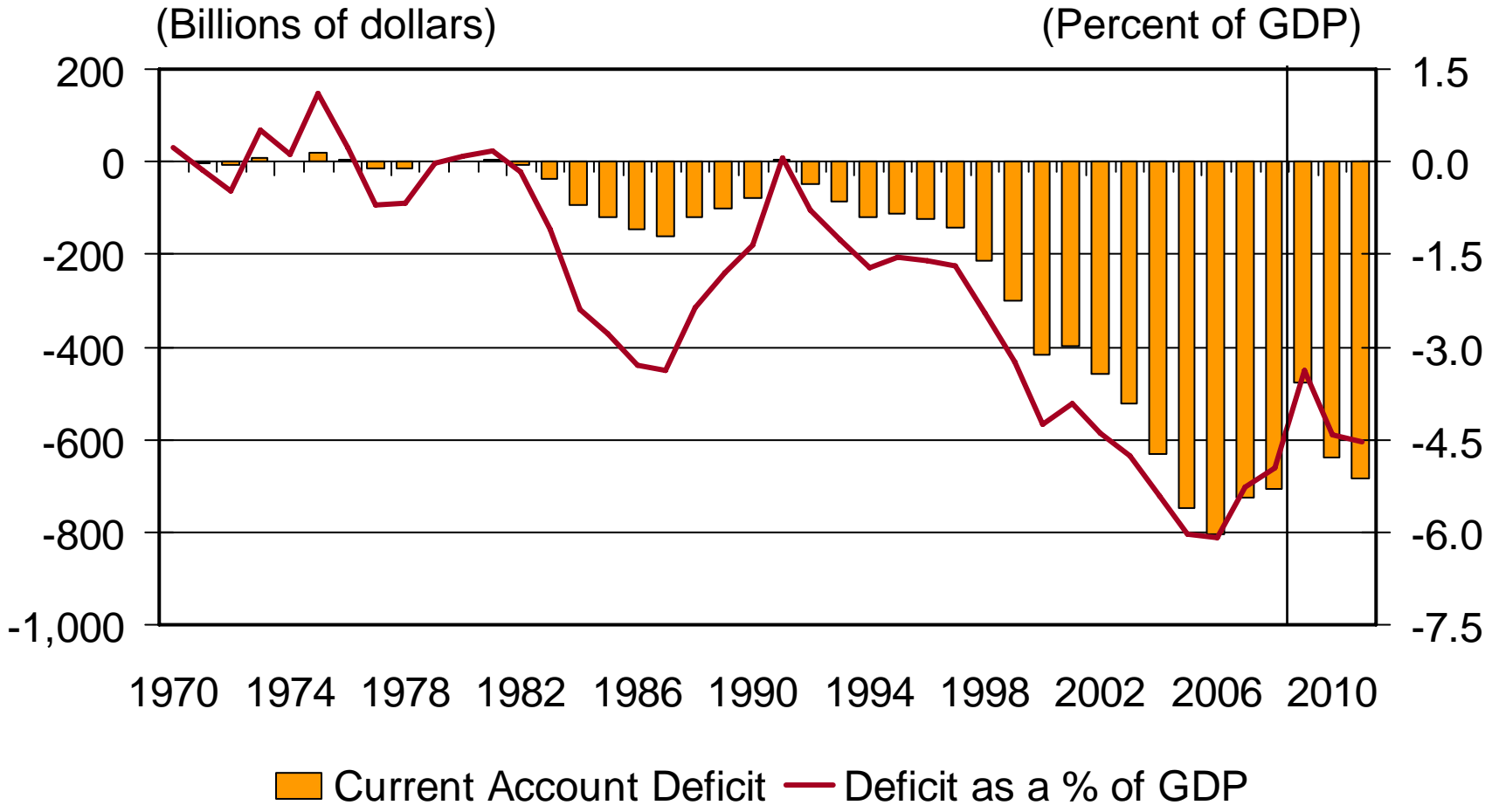
\* Unweighted average of Denmark, Finland, Norway, and Sweden

Source: OECD

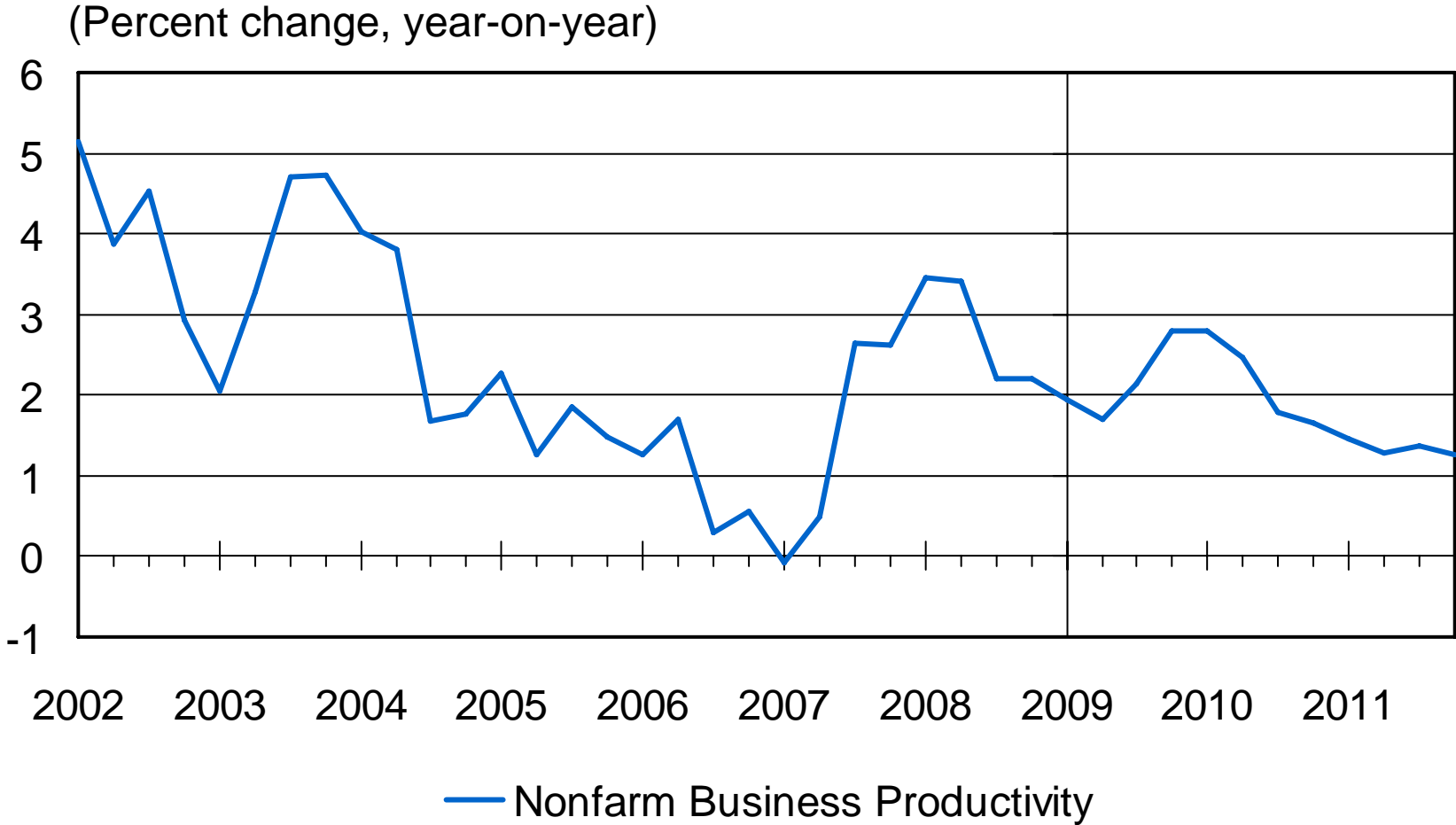
# U.S. Government Spending on Social Security and Health Care Will Take a Rising Share of GDP



# Current Account Deficit: Plunging With Oil Prices



# Productivity: No Cyclical Collapse

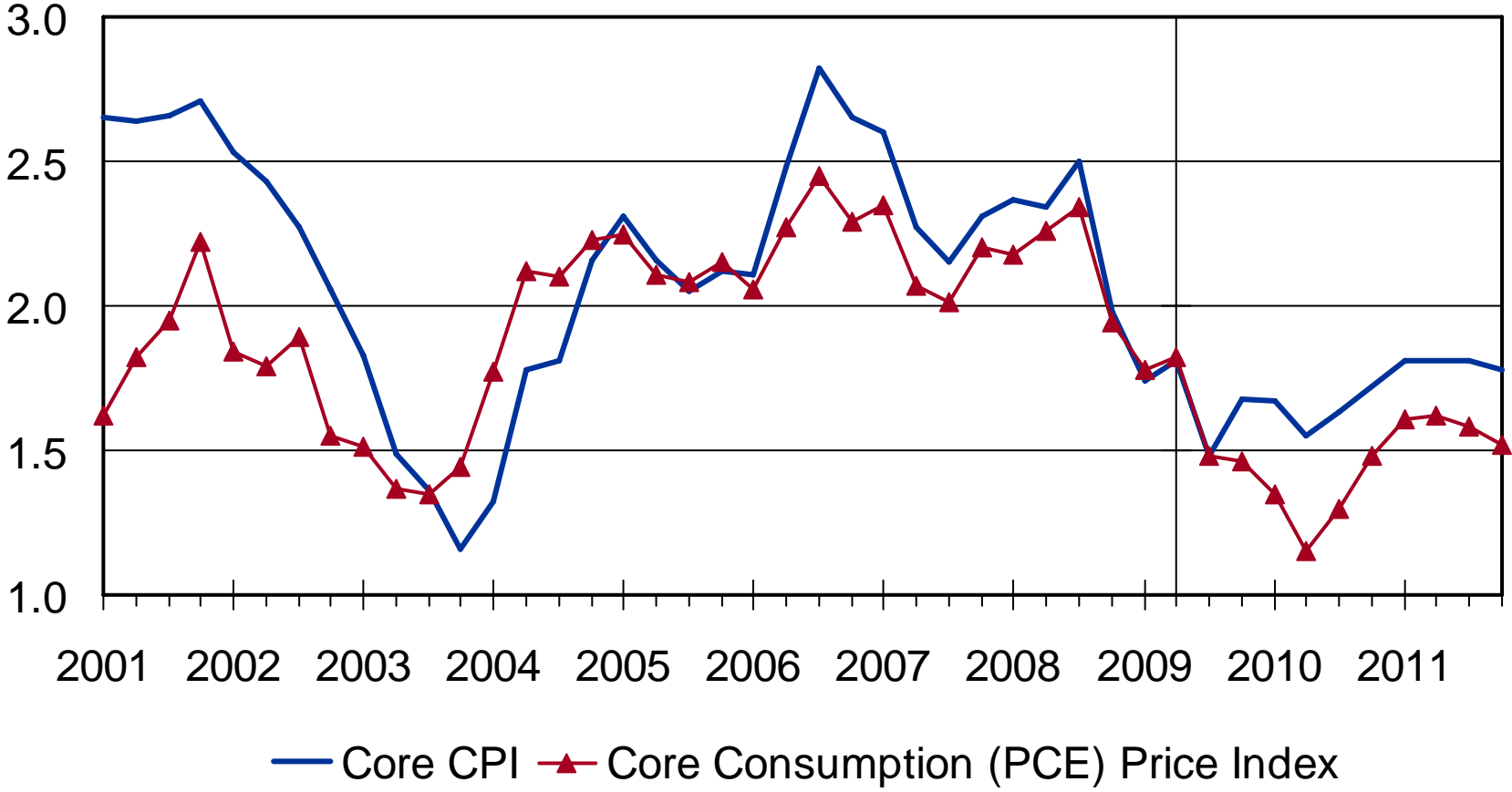


# Which Is the Bigger Risk: a “Lost Decade” or Inflation?

- Output gaps are historically large
- The de-leveraging process is deflationary
- The large increases in debt and collapsing currencies didn't trigger an inflationary surge in the Nordic countries in the 1990s – quite the contrary, inflation remained in the 1% to 1.5% range
- The very high levels of government debt and long periods of near-zero interest rates have been accompanied by deflation in Japan
- The large rise in U.S. debt after WWII and the purchases of U.S. government bonds by the Fed did not result in an increase in inflation
- A bigger risk is premature policy tightening – especially in Europe

# Core Consumer Inflation Falling

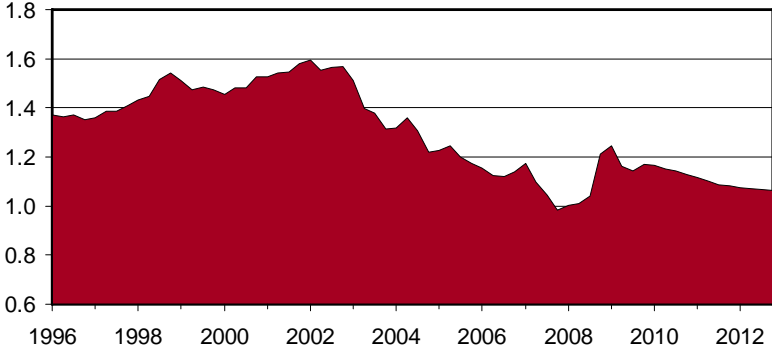
(Ex-food and energy, percent change from a year earlier)



# U.S. Dollar Exchange Rates

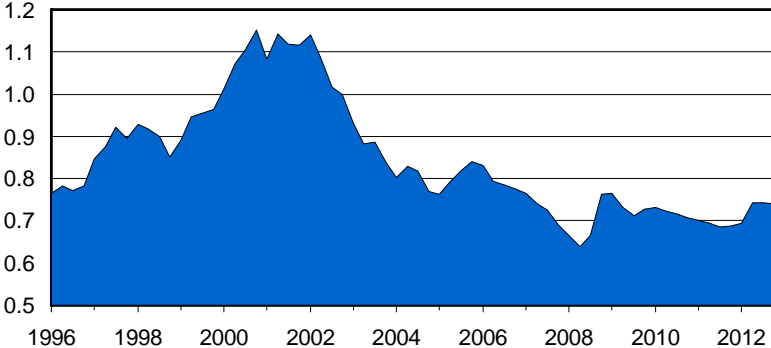
## Canadian Dollar

(Canadian dollars per U.S. dollar, quarterly averages)



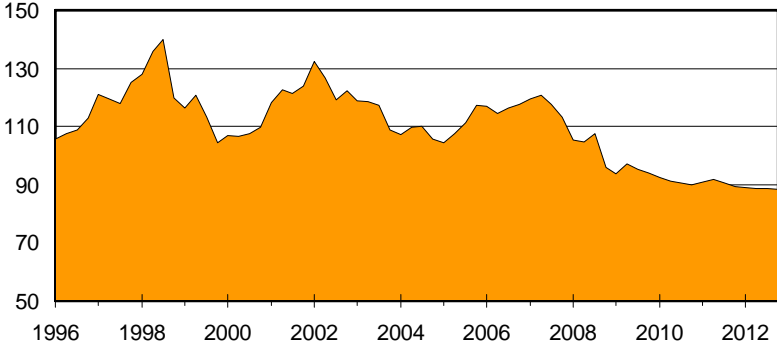
## Euro

(Euro per U.S. dollar, quarterly averages)



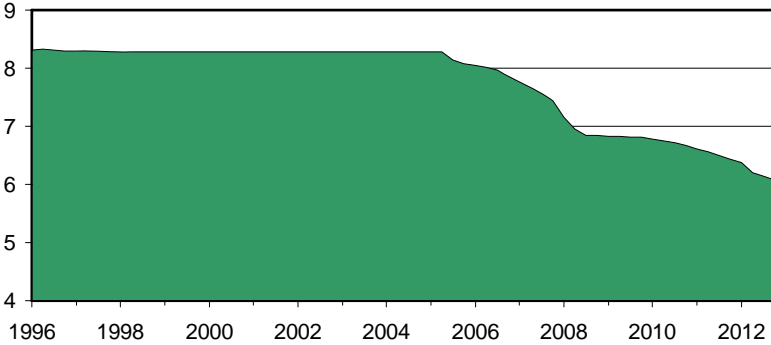
## Japanese Yen

(Yen per U.S. dollar, quarterly averages)



## Chinese Renminbi

(Yuan per U.S. dollar, quarterly averages)



# What Could Diminish Investors' Appetite for Dollar Assets

- Lack of a credible plan for deficit reduction – especially for the medium- to long-term
- A rise in inflation and expectations of inflation
- Continued unbalanced growth in the global economy – back to the future
- A “crisis of confidence”

# Thank you!

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