

A faint, light blue world map is visible in the background of the top section of the slide, centered behind the text.

A recovery at risk

Households and companies
in the United States and in Europe:
spenders or savers?

01 | 18 | 2010

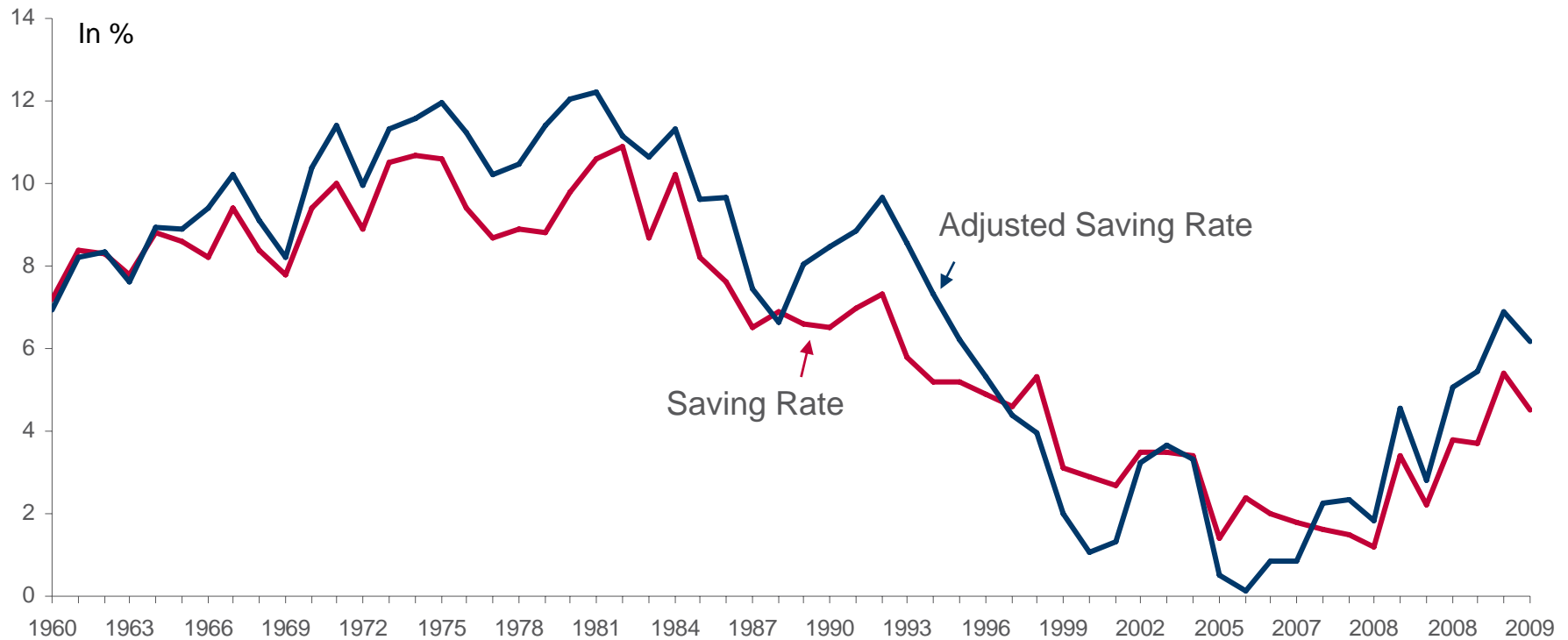
- *Dean BAKER,*
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Washington

Key Factors Limiting Growth in the U.S.

1. Saving rate is rising back to normal levels
2. Housing wealth is likely to decline further
3. Demographics are hugely tilted towards savings
4. High unemployment will deter consumption
5. Excess capacity will restrain investment
6. Over-valued currencies create uncertainty

U.S. Saving Rate has Risen Sharply, Still Below Trend

Saving as a Percent of Disposable Income



Source: Bureau of Economic Analysis and author's calculations

The Housing Bubble Has Only Partially Adjusted

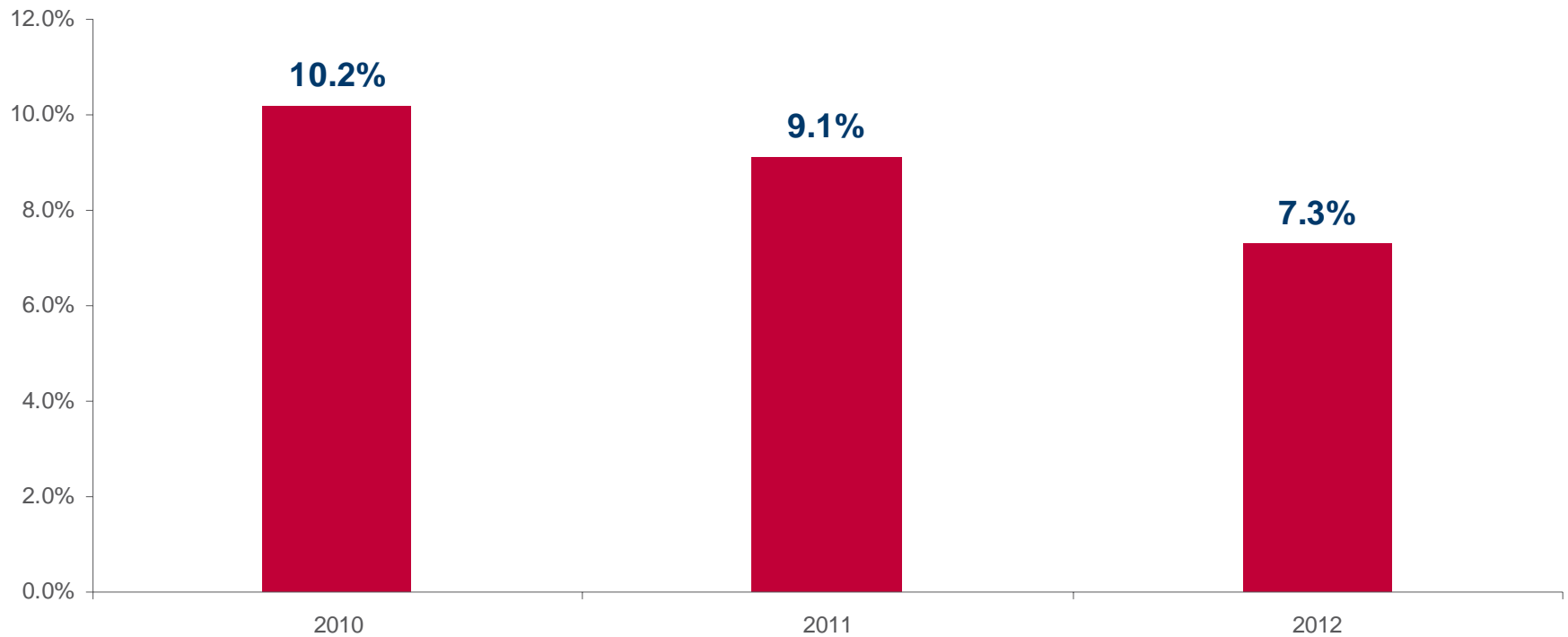
- Real house prices are still 15-20 percent above long-term trend
- Vacancy rates are at record levels
- Continued high unemployment
- Flood of foreclosures (2 million a year)
- Factors temporarily supporting house prices will be removed
 - Fed purchases of mortgage backed securities (March)
 - First-time homebuyers tax credit (April)
 - Tighter standards at Federal Housing Authority
 - Tighter standards at Fannie and Freddie

Demographics Tilted Toward Savings

- Baby boom cohort is in its peak saving years (ages 46-64)
- Defined benefit pensions are disappearing
- Most have little savings
 - Median 45-54 - @\$50,000
 - Median 55-64 - @ \$60,000
- Housing equity vanished with crash (Many underwater)
 - Median 45-54 - @\$30,000
 - Median 55-64 - @\$70,000
- Proposals to cut Social Security
- Seniors face large and growing health care expenses even with Medicare

Unemployment Will Remain High

Projected Unemployment Rate - Congressional Budget Office



Investment Will be Limited by Excess Capacity

- Retail, office, and hotels all hugely overbuilt in boom 2005-2008
- Capacity utilization in manufacturing 67.6 percent (Oct.) – near post-depression low

Dollar Remains Substantially Over-valued Against East Asian Currencies

- U.S. deficit with China is continuing to rise
- There is huge uncertainty over future exchange rates

A weak growth is expected in the US...

- U.S. economy likely to show weak growth for the next several years
- Possibility of further stimulus due to political pressure

The Prospects for Further Stimulus

Pro:

- Slow growth and high unemployment are bad news for the Democrats in 2010 congressional elections and 2012 presidential election
- Stimulus money can please key constituencies
- Stimulus money can also be tied to long-term goals (e.g. global warming, health care)

The Prospects for Further Stimulus

Con:

- Concerns over deficit/debt raise (unfounded) fears of declining future living standards and financial crises
 - projected debt/GDP ratio for 2019 is just 67.8 percent
 - low current interest rates suggest little fear in financial markets
 - real U.S. deficit story is health care
- Stimulus will result in wasteful spending:
bad news in the era of YouTube

The View of Europe from the United States

- Europe, especially France, is often held up as a model of failure (eurosclerosis)
 - myth of high unemployment
 - lack of dynamism in the economy
 - increasingly irrelevant with the rise of China and India

The View of Europe from the United States

- Less aggressive response to the economic crisis and therefore slower recovery
 - smaller stimulus packages
 - ECB less aggressive than Fed