FOREIGN POLICY ASSOCIATION
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US and GLOBAL ECONOMIC OUTLOOK

Featuring:

Theodore Roosevelt IV, Moderator -
Managing Director, Barclays Capital

Panelists:
Mark Chandler, Global Head of Currency Strategy of Brown Brothers Harriman.

Brian Fabbri, Chief Economist, Americas, BNP Paribas

Larry Kantor, Managing Director, Head of Research, Barclays Capital

THEODORE ROOSEVELT IV: And let me just introduce the three panelists who are here with us today. On my far left is Brian Fabbri who is the Chief US Economist for North America for BNP Paribas. To his right is Larry Kantor who is Chief of Research; Head of Research for Barclays and immediately to my left is Mark Chandler, Global Head of Currency Strategy of Brown Brothers Harriman. What's interesting about this group is that everyone one of them has had at least two graduate degrees; two of them have worked at the Federal Reserve so you have got considerable economic knowledge in this panel. We are going to break this at promptly 11:45 so everybody can get over to the Waldorf Astoria for lunch. Those of you that have luggage here, there is a green room which is out behind these two doors to the right. That room will be locked so if you want to put your luggage in their while you go to the Waldorf Astoria and have lunch, you may do so. So without any further delays Brian do you want to start off?

MR. BRIAN FABBRI: I would be delighted to. Thank you. Well I want to start off on a positive note. The world is recovering today, this quarter from probably what one will regard as the deepest and longest economic recession that we have had really since the great depression. The story I think is quite positive as we start to think about where we are relative to where we were. Financial markets have essentially recovered almost in all categories especially in the United States and especially in the corporate bond markets. There is one major exception, which I will talk about in a couple of minutes. And as a result we are likely to see GDP grow well 3 and ½ maybe 4% in the second half of this year. Largely it's a statistical thing. Businesses decided that they didn't need all of the inventories that they had at the end of last year so frankly without any new financing they just worked on their inventories. Production and trade dropped everywhere around the world and then consequently it has to start up. It did. I mean the auto industry is a great example of how this all worked.

Remember the auto industry stopped production in May and June and then all of a sudden it started it up in the end of July and consequently the numbers here but really everywhere looked like a steep decline in the first half of the year and now it's going to look like a relatively steep increase in terms of industrial production, in terms of economic trade, global economic trade and so on and everyone is participating around the world and to some degree in this pickup. Don't forget we also have lots of fiscal involuntary stimulus in place. The government as you knows created two fiscal stimulus packages. They provided some strength to consumer spending power, certainly in the spring of both of the past two years and consequently there is still some monies left in that fiscal stimulus package to be used but once its all gone certainly the Fed is responsible for creating all kinds of wonderful innovative strategies to avoid financial, really financial catastrophe.

But once this ends. The FED stops buying in December securities, most of the fiscal stimulus runs out then we start thinking about next year and that's really sort of the title of my theme. What happens next year? Not just here but to all of the advanced economies around the world. What happens? Where's the new stimulus to come from. Ordinarily we would have to think about the creation of jobs, the creation of income for consumers to spend and so on and frankly I think that's one of the problems that we will have. We'll not likely to see significant job creation over the next couple of years. It's that way almost every cycle. We've gone through the last two cycles when we used to and I remember writing these things and I am sure Larry did too. The jobless recovery in the 1990's and then last one was the job loss recovery in the 2002, 2003 experience so we really don't create lots of jobs when the economy starts to grow and I think that's going to be very present right now. Since consumption is 71% of GDP if we don't consume we are not growing very fast. If government stops stimulating I think that there's got to be something that takes its place or else government comes back and in deed it's my own view that I think we wind up with another fiscal stimulus package somewhere early next year. I think the Federal Reserve will continue to have to stimulate by buying more mortgage-backed securities and then they will all have to decide what to do about the commercial real estate that's looming.

We think it's a very big problem because commercial real estate, they can see rates arising, prices on real estate or commercial real estate are falling and it's sort of the same thing that happened in the residential markets only it's confined many to small and regional banks around the country so indeed there may be a lot of those banks going out. FDIC will have to step up and take the brunt of that. They will have to finance those buyouts or bailouts. And frankly we will be back in yet another situation. I guess my lack luster really the story boils down to this. We had a financial problem that we allowed ourselves to get into during most of the years of this decade.

We built up leverage to unprecedented proportions and we yet have not de-leveraged sufficiently. Until that de-leveraging really takes place it will continue to be a wait on GDP growth going forward. When we look at the rest of the world, Japan is in even bigger trouble. They are already in deflation; they are likely to stay in it. They don't really have the capacity for a lot of stimulus and have used up a lot of their personal savings wealth. Secondly Europe, we think Europe's just about ready to start tightening things again and we think it may even start by monetary policy measures before this year is over so therefore when you think about Europe, once again there potential for growth is even more limited than our own. They never really did manage a macro fiscal stimulus policy like we were able to produce and consequently their growth rates look really really fragile. I don't in fact our own views about Europe are they barely grow next year.

Where's the growth? Where's the good news? China. If you have a command based economy you just basically say here's the stimulus, here's the money, start building and basically building contractors and every one else went out and did it and then they flooded the banks with liquidity and unlike our own situation where banks basically held back, didn't use all the excess reserves, they went out and flooded the market with liquidity. Consequently China's growing in our judgment over nine percent and they really never fell into recession. But they now have another problem, too much liquidity in China, money growth, credit growth, everything is growing thirty, thirty-five percent and consequently even they may have to start thinking about taking something off the table. So China's definitely growing, it's helping out the emerging world and theirs a big separation in our view between what goes on in emerging market countries economies and advanced economies. The advanced ones are stuck in a rut. The emerging ones are growing pretty rapidly and that's where we think you ought to put your money.

MR. ROOSEVELT IV: Great. Larry?

MR. LARRY KANTOR: Okay. Well maybe we can make things interesting because I've got a different view than that.

MR. FABBRI: That's what makes economists.

MR. KANTOR: So we can you know have a nice discussion and hopefully get some audience participation and some Q & A. I mean the way we are looking at things is that we are in the midst of what I think will turn out to be once all the data and a classic V shaped recovery. What is interesting about it is that we've already pretty much seen it in Asia. The truth of the matter, the Asia story is kind of old because you know as Brian pointed out it's actually not that China is going to take some actions to slow things down, they already have. And in fact you can see it in the data that they've slowed things down. In our view that is a good thing.

And it's a good thing because I mean China doesn't release quarter on quarter GDP statistics so you have to kind of interpolate it but by our estimates and this is consistent with most people's estimates GDP growth is the second quarter was something like 16% at an annual rate and even for a country like China that is way above what they can do on a sustainable basis I would say by their definition they probably did go in recession because quarter on quarter growth slowed to as much as, as little as 5 or 6% which my China's standards is way below potent ional. They did unleash quite a bit of credit growth although it is important even to put that in context because unlike the rest of the world before the crisis hit, China was actually restraining credit growth so there was much more scope for growth.

Then when you also consider that China nobody would argue with this has massive infrastructure needs in terms of the needs to build highways and schools and electronic circuits and the like and no one would also doubt that they, that they don't have the where with all to spend this money so in our view the fact that the Chinese authorities are taking action at a relatively early stage to slow things down at a more sustainable rate is good because if they didn't do that they'd need a much more abrupt and I would think much more destructive policy tightening later down the road. But China's not the whole story. If you look at almost every country in Asia it looks like a V. Japan is a bit of a different story but when you are looking at Singapore, Hong Kong, Tai Wan across the board, Korea certainly, in fact Korea right now it looks like the V is pretty much complete. In other words they have regained all of the loss output and is we think on the verge of slowing to a more sustainable pace. The interesting thing is that no one is extrapolating this to the more developed countries like the United States and Countries in Europe.

If you look at where GDP growth is right now in countries like Germany and France, it looks like it's around it has a three handle or so 3 ½ percent of so. In countries like Germany and France that is actually above trend, that is a rapid rate of growth for those countries. And then of course we move to the U.S. although I agree with Brian, I don't think that growth is going to be strong on a sustained basis in most European Countries. But I do think it is happening in the U.S., which is a contentious point and I recognize that most people don't believe that this is the case. The first thing, one thing I want to talk about is a little bit about inventories because as Brian said that is a big part of this story. Brian referred to this as statistical.

I hear a lot of people say this is a technical thing. I don't know if it is, if it was statistical and if it was technical why wasn't everybody saying that on the downside? The truth of the matter is that inventories played a huge role in the decline of GDP. And it will play, it is playing actually it is forthcoming most if it, a big in the increase. And it always does, always. Go back and look at every single economic cycle and you will see that inventories play a very big role and by the way we are in the midst of the mother of all inventory cycles. This one is bigger than any of the others because we had a much bigger panic effect both on the part of demand and then the response of firms. When you get in a recession and this was a real recession firms go into survival mode and what they do following the collapse in demand is they cut output drastically.

They want to get their inventories down to as low as possible. They cut payments to suppliers. They shut plants, they lay off employees and they did it big time. Then what happens is demand stabilizes at a low level, which actually happened around the turn of the year? It's still weak but it has grown a little bit but it's at low low levels but output just kept falling and as Brian says the auto sector is a great example of this where you know you get to a point where production is so far below spending that you've got to catch up. That's what starts it. It is not the consumer. The consumer never leads you out. It's when firms have to rebuild output, which cuts the layoffs and even causes hiring and so forth, and increase in hours. That's how the process started. That's what's happening this time. So now if you go back and look at the patterns of business cycles and in my view we haven't had a real recession in over twenty-five years. Brian talks about the jobless recovery and he's right. The last two recoveries had very little job growth and in some cases Brian noted job losses but my view, that's because they weren't real recessions. The last U.S. recession, so called recession in 2001 do you know we didn't even get to consecutive quarters of negative GDP and GDP was never negative year on year. Housing and autos the two most cyclical sectors in the economy never even went down in the last recession. This was a real old fashioned recession and we lost millions of jobs. The unemployment went up five percentage points or so in a year. That's what happens. It feels like the world is ending. And when that happens because employers are so drastic in cutting workers to rebuild output they got to bring workers back on. We will get the test of this pretty soon. If I am right, by the end of the year you should see net job growth before the end of this year and we are getting pretty close. There are only four more employment reports to go.

If job growth is still negative through the end of the year, especially if it is significantly negative then we are going to have a problem because the consumer is unlikely to come back if the labor market doesn't come back it will stay weak. Right now though and this is important you don't need strength in the consumer. Okay so if you take, if you look at the other thirty-percent of the economy it looks like it always looks after a big downturn. It looks exactly like a V. Okay even - - so we basically it fell almost 160 Billions dollars in real terms in the second quarter. What does that mean? What is that? Inventories are just the difference between spending and output so if spending is 100 and output's 20 inventory's 80 inventory's full by twenty.

How big is that? Just to get output back up to spending if spending doesn't increase at all you are talking about more than five and ½ percentage points of

GDP. Housing, what's going on in housing activity and this is maybe a word that is going to shock all of you. If growth returns it's booming. Single-family housing starts already are almost 40% above the bottom. Is that a great level? No. It is very very weak but it is just that we got to practically zero. That's what happens in big recessions and that's what's going on now. Trade okay for the first time in I don't know how many years trade is actually adding to growth mostly because of A, a very cheap dollar and B because the U.S. contrary to previous business cycles was the last out so we have got strong export growth and relatively weak import growth.

Even Cap X, which tends to lag the cycle, in fact in most recessions it declines for a year is going to turn positive judging by capital goods orders so the big negatives are over. This is important. Okay all these things for example residential construction had been subtracting a full percentage point from GDP growth on average every quarter for three years. As soon as the second half of this year you are going to see a positive, a positive growth. That is a very big swing. So you are going to see a V. You are probably going to see in the second half of this year somewhere between 4 and 5% U.S. GDP growth. That's and by the way that wouldn't be all that spectacular given how hard we fell before but it is going to feel a lot better.

I will just, let me end here because I don't want to over do my time here. What's the big risk to markets? I would venture to say that most of you would say that it is going to be that the recovery falters okay. You know it is not going to be as strong as you think. I think that those concerns are misplaced. This recovery is anything but fragile. It is spreading around the world. You've got the big inventory cycle. The Syrical sectors are coming back and there is tons of policy in the pipeline. That only rates about zero.

The FED still has another five hundred billion dollars or so of securities to buy. That's not the risk. The risk here is that when people recognize that this is a real recovery they are going to also realize that crisis settings for policy, which is where we are now, are no longer appropriate. And when that happens in conjunction with the FED not buying these securities anymore you are going to get a very sizeable rise in interest rates and that is going to make the going a lot tougher when it comes to financial markets. So I will just stop there.

MR. ROOSEVELT IV: Mark?

MR. MARK CHANDLER: It's hard to follow that. I guess I come from a little different perspective but I guess I can say that generally as far as the debate between two former Fed economists I am sort of in the middle or I should be I guess. I do believe what Larry was saying that we get a much strong recovery than people expect not just for the second half of this year, probably into the first half of next year. You know a lot of the fiscal stimulus is still in the pipeline. It still hasn't been spent and will be spent next year.

So I generally agree more bullish on the economy but what I would really like to do is talk about putting these things into a global context. As a currency strategist that is how I spend my time you know when you buy a bond or you buy a stock you could always sell it and buy another asset class but when you sell the currencies you have to stay in the currency universe. There is no such thing as getting out of the currency universe. And so what I would really like to do is just spend my few minutes here just explaining why I am despite all the pessimism about the US dollar, Central Banks diversifying reserves, we heard from the earlier panel that our model of what someone said is lay say far Capitalism is over. For me I don't know about this lay say fair Capitalism. It seems to me that we never had that in the United States. Canes rights a book in the 1930's saying the end of lay say fair so where are these people today saying this is the end of lay say fair just because the government is getting more involved in the economy. Before this recession hit there are different ways to measure the size of the government.

One way to do it is expenditures as a percentage of GDP. Before this recession hit the U.S. Government expenditures percentage of GDP was 33%. The government was already consuming a third of GDP before this crisis hit. So it looks like the role of government is going to increase on a semi permanent basis though not as big as it looks like right. But Europe is at 50% of GDP and that's the other thing that I guess that strikes me is that we can look at our own navels and chassis ourselves for the light regulatory environment for Federal Reserve keeping rates to low for too long and yet many other countries in the world have been hit by a deeper economic downturn than the United States. Their banks are even more leveraged than ours.

Look at European Banks. Look at the UK Banks for example. UK Banks assets were four times GDP. Four times GDP to the UK. US Bank assets and that's with our eight thousand banks less than 1 times GDP. Size matters. That means that we can easier to absorb these problems. Think about those UK Banks a five percent draw on an asset value, which is about what Bear Sterns experienced before they closed down their funds. Five percent a loss of UK Banking assets cost them twenty percent of GDP. It is amazing these numbers. We are nowhere close to that. The story I like to tell people about why I am optimistic to the I would say the durability dollar, durability of the United States economy within the world economy, a story about these two boys being chased by a tiger.

One of the boys stops and puts on a pair of gym shoes. And he friend says what are you doing? You can't outrun a tiger by putting on running shoes. And his friend says I don't have to outrun the tiger. I just have to outrun you. And the point is that as bad as it looks in the United States right now I just think that the United States has the most has the best chances emerging from this crisis stronger than other countries. I think we will emerge from this crisis like we emerged from the great depression from World War II stronger than when we went into it. The reason we are going to be stronger is partly because their economic system is more flexible.

I know many of you are thinking the flexibility of the labor markets but how I experienced the flexibility of capital markets, excuse me of labor markets my boss can fire me for any reason or any bad reason. I am hired at will. That's the flexibility of labor markets. My father was a plumber. This was before they became drain surgeons okay. He was able to support a family of six; one man's blue-collar income could support a family of six in the 1960's and the 1970's. You can't do that anymore. The problem is not that these people who don't have income, jobs or assets, these - - loans were pulling a fast one on Wall Street. The problem is that our means haven't kept pace with the American Dream.

The American Dream is not having more shoes like my wife does to Imelda Marcos comes over to the house of Mari Shoes. The American Dream is having a house, having kids that go to college. That American Dream as TIA Kraft knows and you look at their website and it tells you how much it costs to send a kid to college today. It's beyond the range of most Americans. The Family income in the U.S., the median family income is not much more than $50,000. How do you spend a quarter of a million to send a kid to college? The problem is, here's how I see the problem. My father had an income that was kept pace with inflation or productivity. That was decoupled at the time of the early 1970's so out of all the goods and services the US produces one of the things we produce very well, we can turn a necessity into a virtue.

And what we did is after the early 70's when male's income no longer kept pace with inflation and productivity we sent women into the work force and that's a good thing right? The family is working more hours. That is how the families began making ends meet. Then adolescent children began working at an earlier age. That still wasn't enough to make ends meet. How did we make ends meet? Credit card. And so the American consumer, American household, American worker was at a disadvantage in this crisis. This is why Studs Turcel, his book the Great Depression wasn't called the Great Depression. It was called Hard Times because for most people it wasn't a depression it was just more hard times. The same thing with this crisis. Yes there is a lot of Americans that are out of work.

Now most Americans, most Americans in the work force are employed. Most people are making their mortgage payments. For me the crisis is one of a systematic problem of wages not keeping pace with inflation or productivity. That is because our employers are soci-economical elite since America of course doesn't have classes have been so; this is part of the problem. This is what is happening and this is why I am positive on the economy like Larry. I think what's happens is our employer's have been ruthless. As much as they cut production they've cut workers even quicker. So what this means is productivity has gone up. You know that our jobs are not being lost to China. China is loosing American jobs as well. Most major industrialized countries are loosing manufacturing jobs. This is a good thing because people are being replaced by machines, technology, and productivity. And I think about the, you know when I was younger I used to want a secretary to remind me when my anniversary is, do my typing, right. Where have all the secretaries gone? They have gone to Puerto Rico or China. No they have been replaced by Bill Gates Microsoft Office Suites. What about Bank Tellers?

All these Bank Tellers, we don't have as many Bank Tellers in New York or in any of the major financial centers anymore. Where did they all go? Did they go to China? They have been replaced by ATM machines. This is a good thing. It makes me optimistic about the United States is that the dollar, we have survived this crisis and the dollar today is an important in the world economy as it was twenty years ago. Many people talk about the Chinese. You know we are getting ready for this G20 meeting and say well the Chinese are talking about SDR's they are forming the International Monetary Regime. We know, we know very well when our politicians are lying in the United States right because their lips move right?

But some how when politicians in other countries speak we take them at face value. So the Chinese talk about changing moving onto the dollar. But here's what they are have done. In the middle of last year, I should say in June, the end of June of last year the Chinese reserve which they don't tell us how they are allocated by currency but the US treasury data showed that the Chinese owned roughly out of their reserves about 27 percent of them were in US Treasury. At the end of June of this year about 6 percent of them were in Treasuries. There is no evidence whatsoever from the INF data which is the most authoritative source that central banks have diversified their reserves out of the dollar.

Roughly speaking the dollar is 2/3rd of the reserves today, it was 2/3rds of the reserves in the early 1990's before they run up to the Euro Zone. The Euro back in 1999 when the Euro was born people were writing at the time that the Euro was going to replace the dollar. The Euro today is slightly bigger than the sum of its parts. Its parts are the Acue, the Due mark and the French - -. Not only is the dollar the world's key reserve currency but it's also a very important invoicing currency. When China buys iron ore from Australia they pay US dollars. Not only at commodities some energy the hydrocarbons, precious metals, industrial metals, food and fibers all quoted in dollars but many countries, look at Italy for example, they have the Euro.

Fifty-one percent of Italy exports are involved in US dollars. The bulk of South Korea, Taiwan, Malaysia and Singapore's exports are invoiced in dollars. I think that's right for China and India, excuse me, China, Japan, India, Russia to say that there is not much of an alternative for their reserves. They have to many of them because they so rely on exports. Look at what happened earlier this week in Pakistan. They said they had roughly 17 Billion dollars in reserves. They said they'd like to move them but they don't have an alternative. Come on seriously? Any country, look at Canada, our biggest trading partner. Over half of their reserves are not in dollars. Something like twenty-six billion of their dollars, of their reserves, half of them are not in US dollars. Surely - - has a choice.

China might not have a choice and I say "too bad." They rely on exports. They export roughly 40% of their GDP. So does Germany export about 40% of GDP? What we've developed in the world is the imbalance. Can you imagine what is going to happen at this G20 meeting? Treasury Secretary Githner will tell the G20 something like this, which is sort of my fantasy. He will say you know you people have been complaining about over spending of the US consumer for a couple of decades now and here's the good news. The American consumer is pulling back. They are de-leveraging. I agree with Brian, the country as a whole is not de-leveraging because we are transferring the debt from the consumer sector, household sector, and government sector.

The country as a whole is not de-leveraging but the consumer as a whole is. You see this is what we are doing about the deficit. We are reigning in the American consumer and now we would like to hear what you people, what you Europeans, the other G20 members are going to do about the global imbalance? Merkle who is running for reelection is Germany who is going to be at the G20 Photo Opportunity, she's going to say something like I am sorry but Germany is committed to our export engine. We have rising unemployment. What else can we do? We export, that's what we Germans do. The Chinese are going to say the same thing. We have eight hundred million people in the rural communities living in abject poverty. We can't give up our export led machine. The global imbalance is going to change. Frankly I don't think they will and this is really my answer to some of the problems, some of the structural problems that Brian pointed out. I think it is the old classical political scientist answer for these problems and I think this is the most likely outcome. Muddle through. Thank you.

MR. ROOSEVFELT IV: Thank you. Just to go back to the Obama package looking at it very carefully along the CBO, 18% of the 800 Billion Dollars roughly went for infrastructure and from what I understand from congress today not one dollar of that portion of it has been spent. It may still come down the road over a distributed period of four or five years of course but not much really went for infrastructure in spite of the rhetoric.

MR. CHANDLER: I think that is a good point too because I think the same thing when it comes to Chinese data. We talk about how strong the Chinese economy is. Here is one of the things that they consider retail sales. They count retail sales as when the goods go from the factory to the store. That counts as retail sales. In the United States we only count retail sales when the consumer actually buys that goods. So I think that for me I say we have got to look at these numbers closely and I think that we've lost some faith here not simply because of our economic downturn. We've lost faith that Democratic Capitalism is a superior economic model to authoritarian Capitalism. Like China might have. Like Russia may have. I think that we have to really examine our own core values. Do we believe in democratic Capitalism? Does China have an advantage over us because they are authoritarian? I don't think so. Democracy we have to believe is both an ends and a means.

MR. ROOSEVELT IV: Great. Let me open up the audience. There are microphones on both sides and I will try and recognize you in the order at least that I see you. Yes ma'am?

MS. ERICA KARP: I am Erica Karp with UBS. My question relates to the insidious dangers of protectionism and Mr. Chandler your comments regarding the intention of the Chinese authorities. From my standpoint making those comments is not helpful. In fact it probably instigates the kind of things that are counter the FPA's policy of informed discussion regarding Foreign Policy's so I think that maybe we should all be really open minded about what the intentions of the different authorities from around the world are. And so I think we should avoid using historic kind of quotes that are actually really exclusionary.

MR. CHANDLER: Did I say something wrong?

MS. KARP: Yes. From the Chinese Authorities.

MR. ROOSEVELT IV: Can we have the question?

MS. KARP: But the question relates to the challenges of protectionists leanings that we are seeing and it is very insidious. It might not be some of the dialogs that we are seeing at the G20. It might not be related to the tires, the thing that is going on right now between the US and China but more subtle, more about purchasing agreements into company, could you guys talk about your fears on the possibilities for protectionism really dampening the growth inordinately the way it did when we had smooth hauling and everything else after the recession. The protectionism is the question.

MR. KANTOR: Let me respond to that. This is one thing it is probably hard to find an economist anywhere that supports protectionism. I don't know if I've seen many and I doubt that you are going to get much argument that you know that protectionism is not a bad thing. I don't think anybody I mean you are welcome if you disagree but I think all of us think it is a bad thing. My - - gets nervous when you see tariffs slapped on and threats of retaliation and that kind of thing. My take on this is that peak of the risk of this really snowballing and culminating in something like a - - has actually gone down. In other words, that we have passed the peak.

And that's just because we are in a lot better shape economically whether you believe Brian's view of the world, mine, Marks or whatever then we were six months ago. I think everybody would agree we are in much better and it's when things are going down hard that protectionism is going to rear it's head most prominently because jobs are being lost and politically it is very attractive to come out and say we are not going to allow any more jobs to be lost to whomever, you know the Japanese or the Chinese or whoever. And that becomes a politically attractive thing so to me now that things are going better I think we are less vulnerable to that kind of thing really snowballing. The other thing is that you know look at China. You know their trade has gone down enormously because we can see more growth so you know I think charging them with currency manipulation and that kind of thing is not something that is not on the top of the agenda in Congress as much as it was maybe a while ago. So anyway to feel that way but to me the risk is lower.

MR. FABBRI: I certainly am sensitive to your view that certainly we do get the employment growth you think we will then it diminishes as an issue. If we don't get the employment you can read The Times today and you can find a whole rack of reasons why labor is going to challenge a variety of trade contracts with in particular in China because they feel either China has imported or exported I should say environmentally in pure products into the United States presumably under Cap in Trade should be taxed higher or because they've subsidized certain industries under all kinds of world trade agreements and they are violating those world trade agreements. I can see the issue continuing especially if the Chinese remain as adamant as they say they currently are about their currency. They basically say they want to maintain the stability of RMV relative to the dollar and clearly you know we have this massive imbalance. We've got about a two hundred and fifty billion dollar deficit with China and so usually you have and Mark knows a lot about this but usually you have currencies that just - - some of those massive imbalances. Well if the Chinese don't do that then it becomes a sticking point. A sore point and we have to go through other means. The other means of course are challenging them at the World Trade Organization levels or in the Court Systems or applying tariffs here and there. So Larry you are damn right. Nobody in our profession would ever say increasing tariffs is a good idea but politically it is going to be hot topic in the next twelve months.

MR. ROSSEVELT IV: Good. Ma'am.

MS. JOAN TRAVALET: I am Joan Travalet. I am the speechwriter on Wall Street. We will leave the name of the firm unmentioned but I essentially translate you guys into the mouths of businesses so ergo the financial crisis. I love economists. You really contribute to my falling asleep very well at night when I read you. But in the critique of what happened with the you know our recent financial debacle there has been, I have only seen maybe analyst of what, where was economics in this. We would like to blame Wall Street and it was and an analyst of where economists failed by a non-economist. Perhaps there was one economist who I think got what was happening. She happened to be a woman and I can't remember her name unfortunately and Peter Drucker the father of corporate management of course talks about us all having a problem with our own blinkard bias. The intellectual bias that we bring to our kind of structures. I have a good idea that the bias that Wall Street brings it structures my memos relying a great deal on modeling by economists and mathematicians. But has there been a critique and what do you think about critiquing your own discipline in the wake of what happened?

MR. CHANDLER: I will just jump in here quickly. I am sure that Larry has a lot of points on this one. But there were a few firms on Wall Street that actually did predict recession including my own a couple of years before we actually got there. The housing crisis looked very bad to me and it's sort of a sticking point that I wanted to bring up with Larry anyway. Housing clearly as Larry said is coming back in a percentage wise big way. There are two parts to the housing issue. One is the activity itself of building new homes. We are building new homes right now. The other part is the finance. Our government has socialized the housing mortgage market totally, totally. And so therefore from my perspective when I was looking at housing being totally over built relative to anything like demand and realizing that risk was just being transferred from issuer, from lenders to principally somewhere out of this country which a lot of that did happen. You knew that there was a financial calamity and then when I learned that there was going to be more fraud in the origination of mortgages and I did learn that relatively early I knew we were headed for not just another economic problem but a really big financial problem and indeed so people did know that. Now I can the people that Larry and I know who have big models and use big models basically didn't see it coming even after we'd made presentations to these people and they believed in their models for a longer period until it actually happened and then of course the big model producers in government basically then saw the light. But they didn't because of the models.

MR. CHANDLER: I'd say that maybe I can give you a comparison. I have two watches, one watch my grandfather gave me. It's a nice hand crafted watch, it doesn't work but it's still right twice a day. My wristwatch I set five minutes fast. It's never on time, it's never accurate but it's more reliable.

MR. KANTOR: I don't know if that answers your question.

MR. CHANDLER: It's a nice anecdote.

MR. KANTOR: Just to and I am sorry we don't have any women economists here so you may not want to listen to anything we say at all but just to answer your question, Paul Krugmen actually in the Sunday New York Times Magazine did write an article I think specifically on the idea that economists got this wrong. And I did not forecast how bad things would get. I actually don't know anybody who forecast that it would get this bad except people that had been saying it for twenty years. I don't want to mention any names but people that are now touting out as the guy who predicted the financial crisis have been saying this, talking about a clock being right twice a day, a broken clock so I don't know anybody really who thought it would get this bad. Now to me it wasn't maybe you are probably right that the ability of economists to forecast things and control things is probably exaggerated and I don't think that when things are going really well they give to much credit to policy makers like former Fed Chairman and when things get bad they probably blame them too much also. In other words there's a business cycle out there and it's always been there. It moderated for a while and there were reasons for that such as a productivity boom associated with technology, the fact that communism broke down all these low cost suppliers come in which really was never, policy makers didn't create that. They got a lot of credit but they probably didn't deserve it in the first place. And then when it fell apart they got to much blame but to me all the proposals I see going around now to try and prevent what happened from happening again and not addressing the issue. You know whether it's higher bank capital ratios limiting bank compensation obviously I have an axe on that one or preventing certain bank activities is the wrong way to go and is not going to prevent this from happening and that's because financial services industry uniquely dependent on confidence more than any other business so you go out and buy a stereo or it's nice to have some confidence in whoever sells it to you but you don't have to have it because you have the thing. When you put your money and sometimes it's your savings in a financial institution what do you get? You get an electronic entry or something and if you loose confidence in the institution what are you going to do? You are going to pull your money out. That's what happened in September although it was on the whole sale rather than the retail. Everybody pulled their money out and then the system collapses. You need something to address. My own view is you need to extend insurance beyond just retail deposit and banks should be paying for that like they did to the FDIC and they should be risk adjusted just like car insurance. Let the banks do what they want but if they want to take riskier activities or leverage more they have to pay a higher insurance rate deposits, then you won't have that, you will not have that or you could even have the insurance authority refuse to give insurance if the bank or financial institution whether it's an insurance company, to me the focus ought to be on that because unless you are going to drive capital ratio's to one to one which nobody's talking about which I think would have very severe impact on the ability of the economy to grow you're still going to have this problem and we've had it for hundreds of years. This isn't a new problem. We had this in the late 19th Century on a number of occasions. Investor confidence goes. That's what happened and that's why nobody forecasted it. You know if that happens it's over. Right, I don't care how strong the financial institution is if everybody pulls their money out whether it's Brian's institution, my institution, Mark's institution it doesn't matter. If nobody has confidence in that institution as a financial services institution that institution can't continue. That won't survive.

MR. ROOSEVELT IV: Great. I am going to do something a little bit different. There are three people that want to ask questions. I would like you to compose your questions succinctly, simultaneously well not simultaneously but sequentially and then we will try and answer all three questions.

MR. MARTIN CHARWATT: I am Martin Charwatt from World Affairs Council of the Mid Hudson Valley. My question deals with China. China seems to be investing huge amounts of money export related industries at a time when exports are caving. What do you foresee as the result of these investments?

MALE VOICE 1: I will take the question.

MR. ROOSEVELT IV: We will run down each question and then we will.

MS. POLAND KIRSHENBAUM: I am Poland Kirshenbaum, Chapman Associates. My question has to do with Social Security. About a year and a half ago I had the opportunity to question a Senator Hagle who was then Chairman of the Senate Finance Committee about the deficit. The difference between the intake from Social Security and what they were paying out. End of fiscal 2007 there was a six hundred and fifty billion dollar surplus. We had a four hundred and fifty billion deficit at the same time so if you balance it out, we already had a trillion dollar deficit at that point. The question is what are you foreseeing for the impact of the Social Security numbers this coming year and what impact will that have on interest rates and your forecasting?

MS. ZOE BLACKWOOD: Zoe Blackwood. I am a student at - - College at the University of New York. The question is what advice or insight can you show with the younger people in the audience with emerging Global - - and Economic leaders about how we can prepare for our futures twenty years from now. You hinted at perhaps expecting to fully fund our own retirement. If you can elaborate on those two points I would really appreciate it.

MALE VOICE 1: Should we each take one? Do you want to do the last one and I will do China and you can do Social Security? Is that right?

[laughter]

MALE VOICE 1: Let's start with Social Security then. Take a note if you want. No I think the idea behind something, you know we have been ramping up Social Security payments and we have been delaying the payout and frankly I mean even Greenspan was involved in the commission years ago to increase the tax on Social Security. Clearly it looks like that's the only couple of options left to the government. Raise the taxes that are you don't have to raise the tax rates so much just allow the tax like it exists for medical insurance let the tax rate go up along with all of your income instead of capping it out at ninety five thousand dollars or whatever it is. So it increases the tax flow, that's number one. Number two clearly we are going to push out retirement age for people that wind up with lets say 100% of their social security benefit. Maybe winds up coming to you at 72 instead of 67 or whatever it is. I think that's inevitability. It's just going to happen later and people are going to work longer and businesses are going to have to maintain employment of older people for longer periods of time. I mean that is the humane way of basically dealing with it and I think that these issues are basically on the cusp of being decided by Congress. You know maybe not know because there is a bigger issue at stake but that has to happen very very shortly. Will it be the solution? The real problem is really health care insurance and social security insurance. They can solve the social security problem with more taxation and delay payments. It's health insurance; Medicaid is really the big big animal that they have to solve.

MALE VOICE 2: I agree with everything. I think they are also going to do means test. If you have a certain amount of wealth I wouldn't count on Social Security checks. But China from if you look at the fiscal package which is the only one bigger than the US one relative to GDP and in China they actually have focused on export related industries. It was focused on infrastructure and the Chinese government actually for a long time has wanted to reduce their dependence on exports and increase domestic demand so if - -.

MALE VOICE 3: They failed.

MALE VOICE 2: Well in, that's actually not true in the sense they spend a lot on exports but domestic demand definitely improved the economy so it depends on how you define improvement. There's no doubt that the big burst of spending you are seeing from the government is actually not export industries. It's on building highways and roads and schools and infrastructure like electronic circuits so I think that's changing. You maybe upset that it's not happening fast enough or that they are not allowing enough flexibility in the exchange rates of other - - but it is underway. It is just a matter of whether you think it's fast enough.

MALE VOICE 3: My question he asked was about what young people should do thinking about careers for the future. I'd say a lot of these job losses on Wall Street I think are going to be semi-permanent losses. Wall Street, I have some numbers in the 1950's up to the 80's Wall Street accounted for about ten percent of corporate profits. The bubble or during the bubble phase it reached 34% of Corporate profits. That is not sustainable. In terms of wages, in the 1950's through most of the 80's Wall Street wages were about 3% of all wages and they got up to 7%. Again that's not going to be sustainable.

The U.S. is again I am optimistic. I think the U.S. previously in the global division of labor specialize in finance I think we are more likely than other countries can redefine ourselves and find a Global Division of Labor and probably be less financed so I guess I would think that maybe the answer to your question is one about economics and critical analyst of our profession. I'd say part of the problem it seems to me is that we study economics in a vacuum. Economics is not about mathematical equations and formulas. I learned I did not take an economics course until I was in graduate school. The economics I learned previous prior to graduate school studying history.

A social content an historical social context for these things, for economics, for business. I would think also that we have to think about potential employers of our skills. Mark Twain once said let your education, excuse me, don't let your schooling interfere with your education. I say the same thing for us today that don't think that an employer who is going to buy your labor power for 8 hours or 10 hours a day is going to be the sole define of who you are. You will find that a lot of MBA students are leaving Wall Street and going to NGO's. So I think that we want to think about how to make the world better and it turns out that if you just go after money, if that's what young people want to go after money I'd say that it would leave a very short sided solution. The best thing to do I think is find something that you do that you enjoy doing. By enjoying doing it you give yourself a lot of practice at doing it and you naturally get better at it because you like to do it and you are willing to practice. And with that practice and getting good at something comes all those rewards that you might really be looking for. Money, status, prestige, and soul mates. Right? Everything can come with finding what you like to do. Its not so much the economy is going to dictate that. You should look to your skills inventory and think about what really motivates you.

MR. ROOSEVELT IV: Great. Join me in thanking our panel.

[applause]

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