

The U.S. Economy: Prospects and Policies

Marcello Estevão
International Monetary Fund

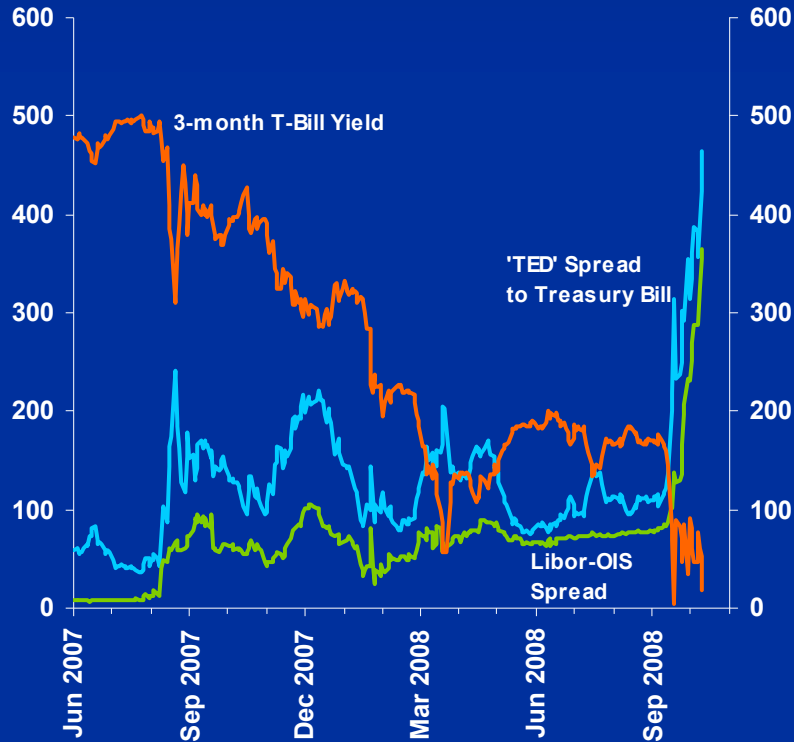
October 13, 2008

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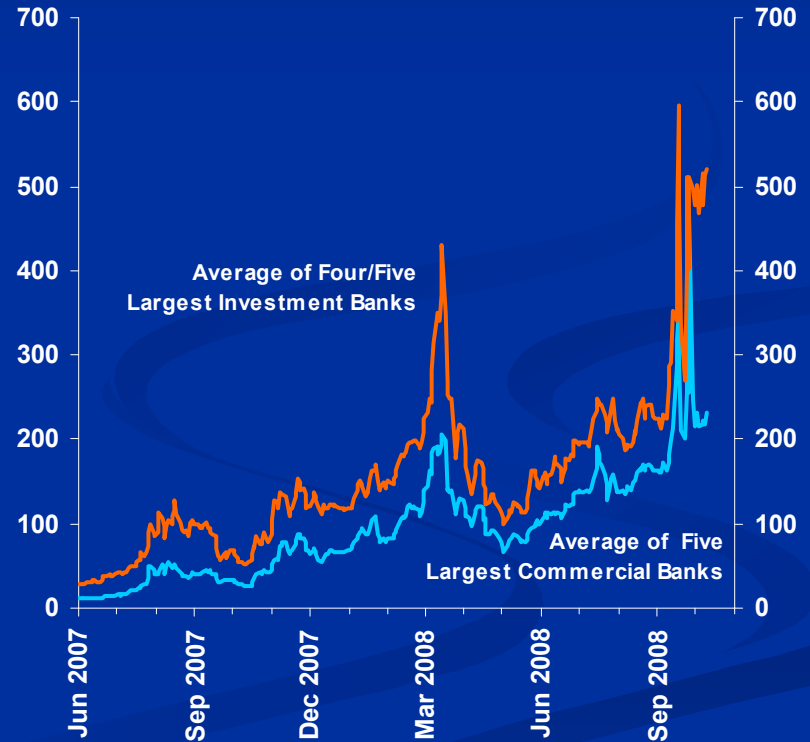


Financial markets in turmoil

Money Market Spreads & Treasury Yields
(basis points)

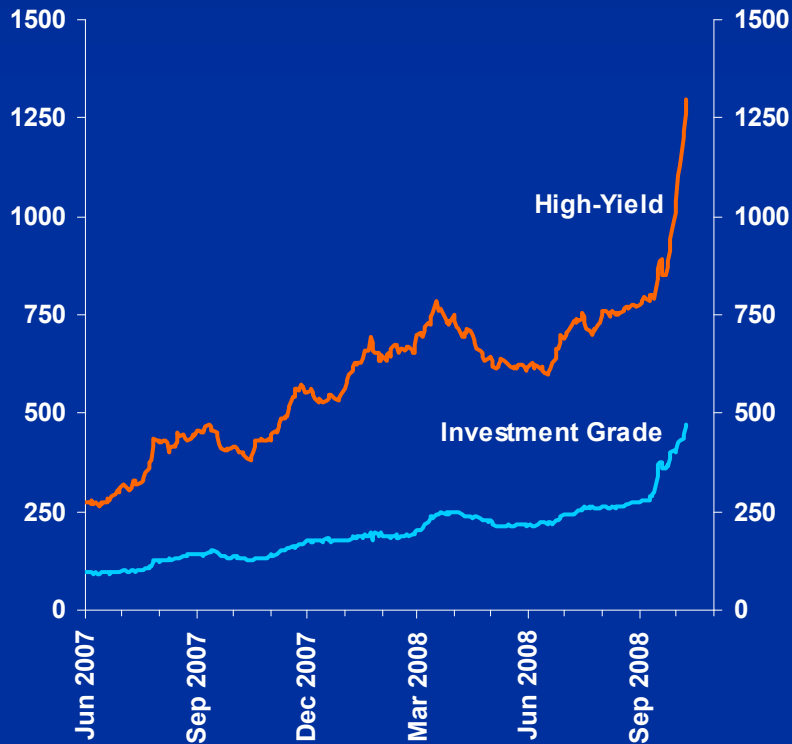


Cost of Insuring Against Default
(five-year CDS spreads; basis points)

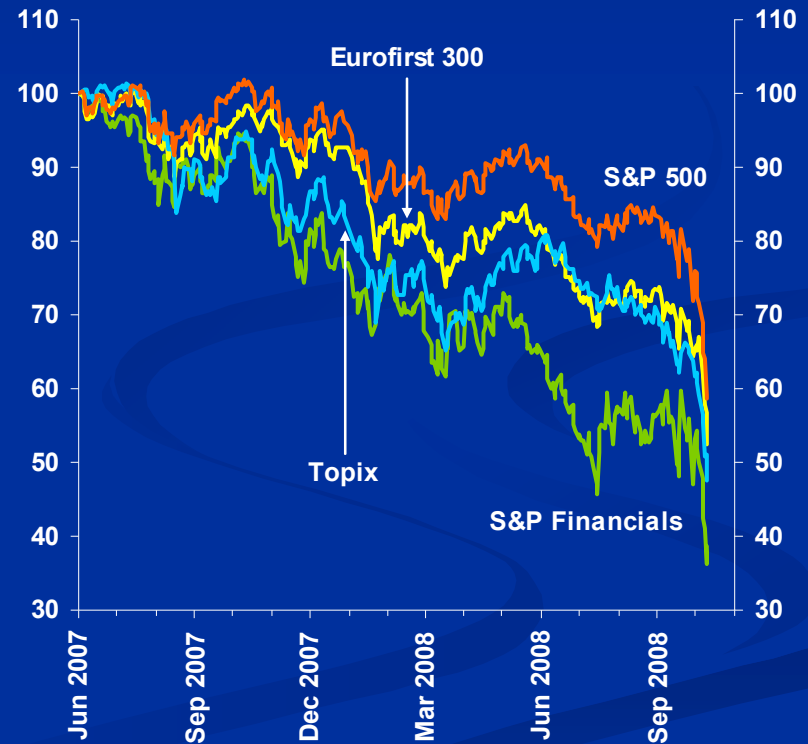


Financial markets in turmoil (cont'd.)

Investment Grade and High Yield Spreads
(basis points)

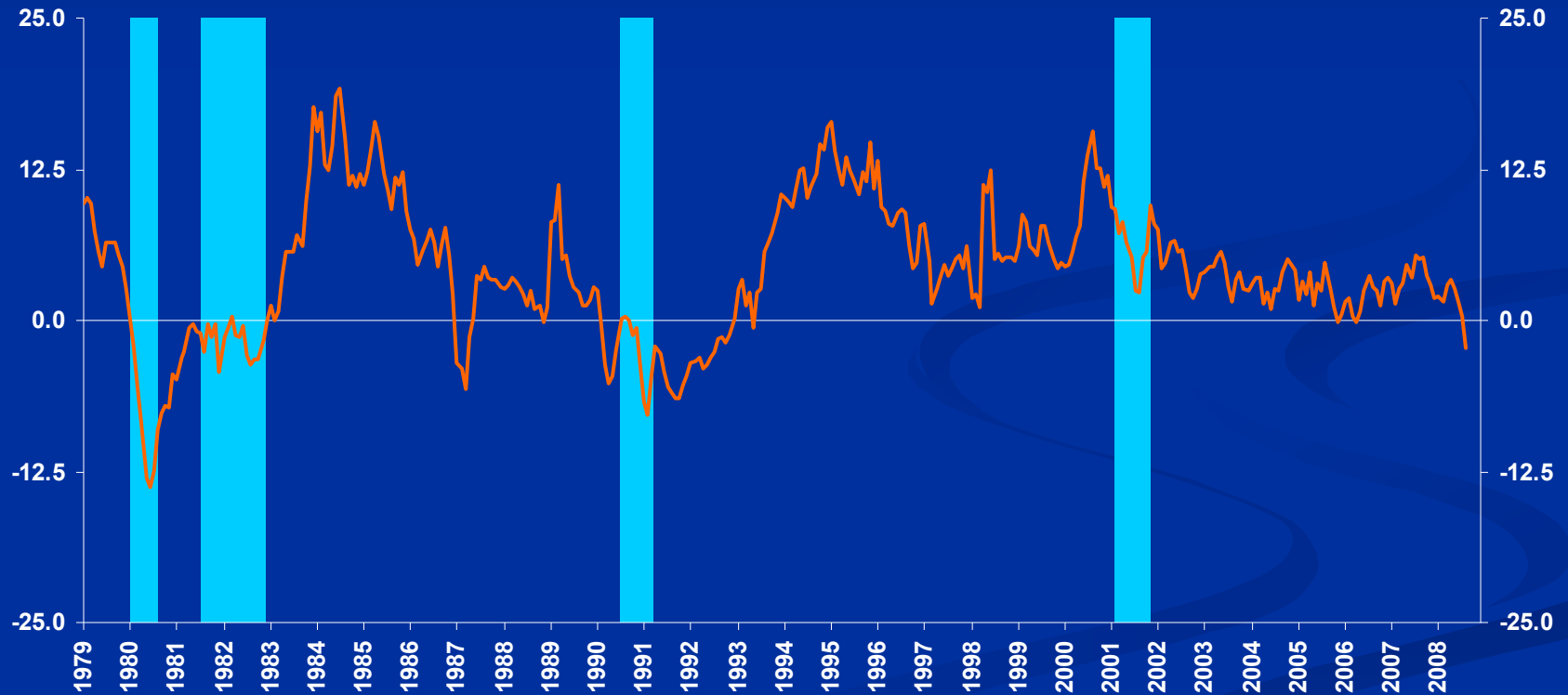


Equity Markets
(index, June 1, 2008=100)



Consumer credit starting to shrink

Real Consumer Credit Growth
(3-month percent change, annual rate)

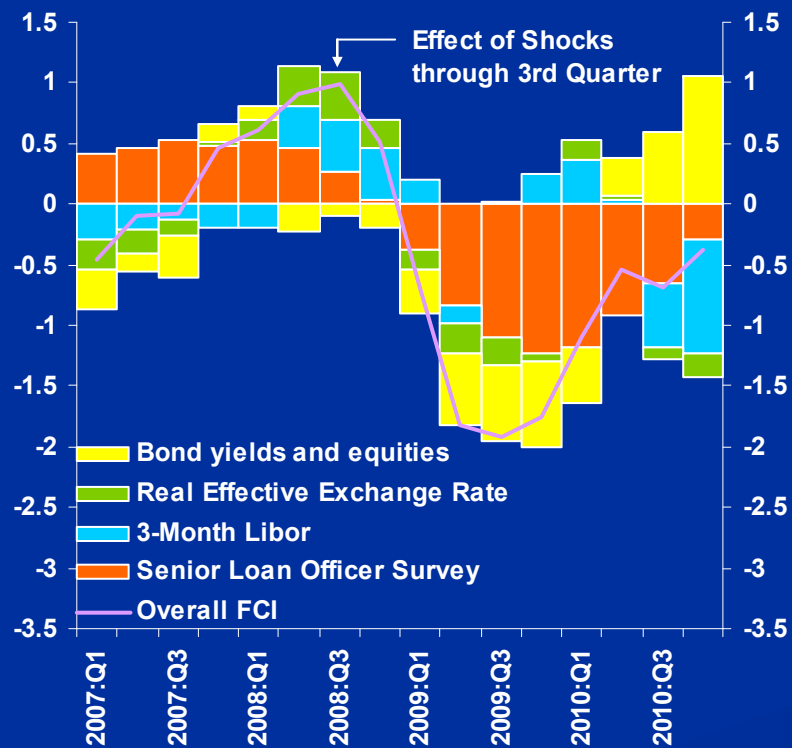


Substantial and long-lasting implications for the real economy

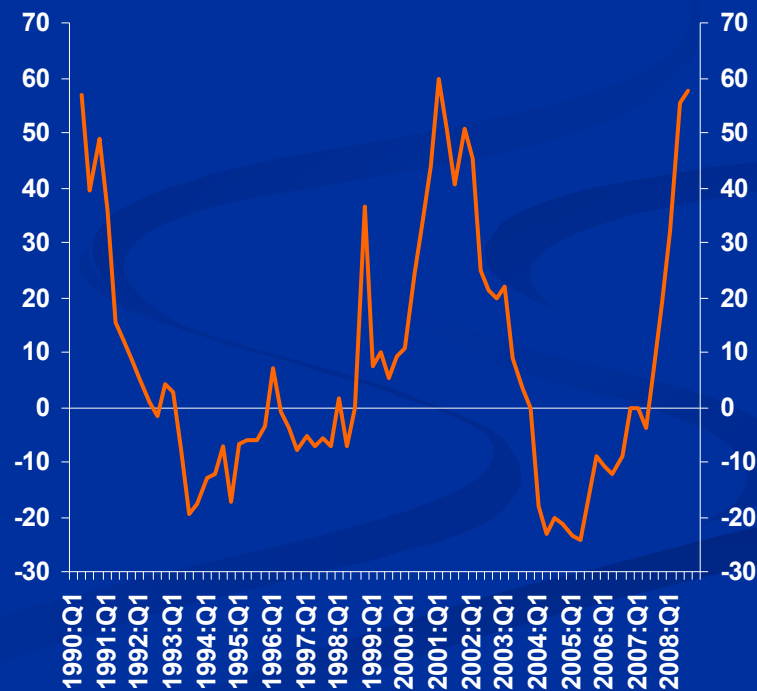
Shocks to date have long-lasting effects

Further shocks are likely

Financial Conditions and Growth
(percentage points of real y/y GDP growth)

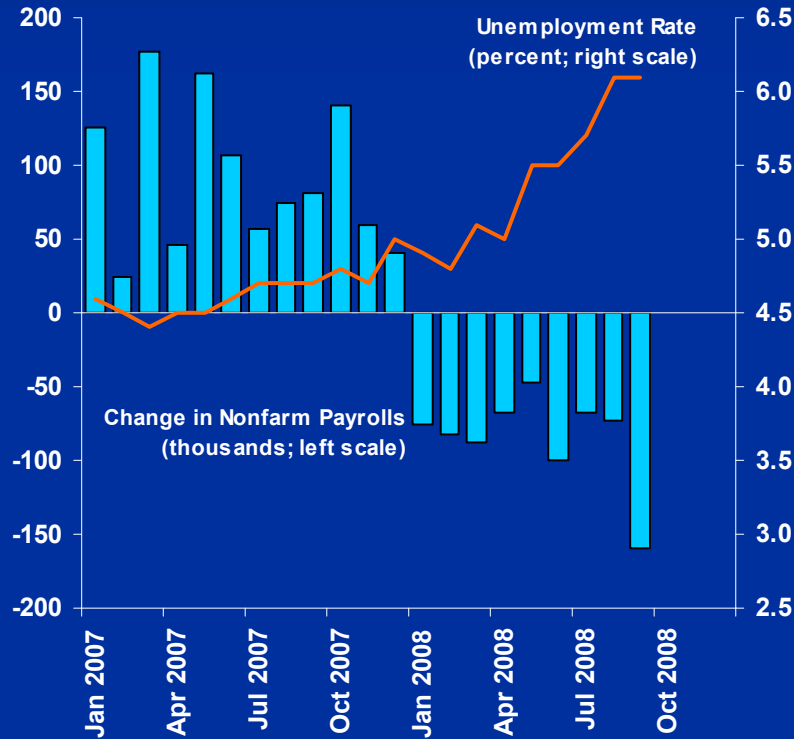


Senior Loan Officer Survey
(net percentage of domestic respondents tightening standards for C+I loans to large and medium firms)

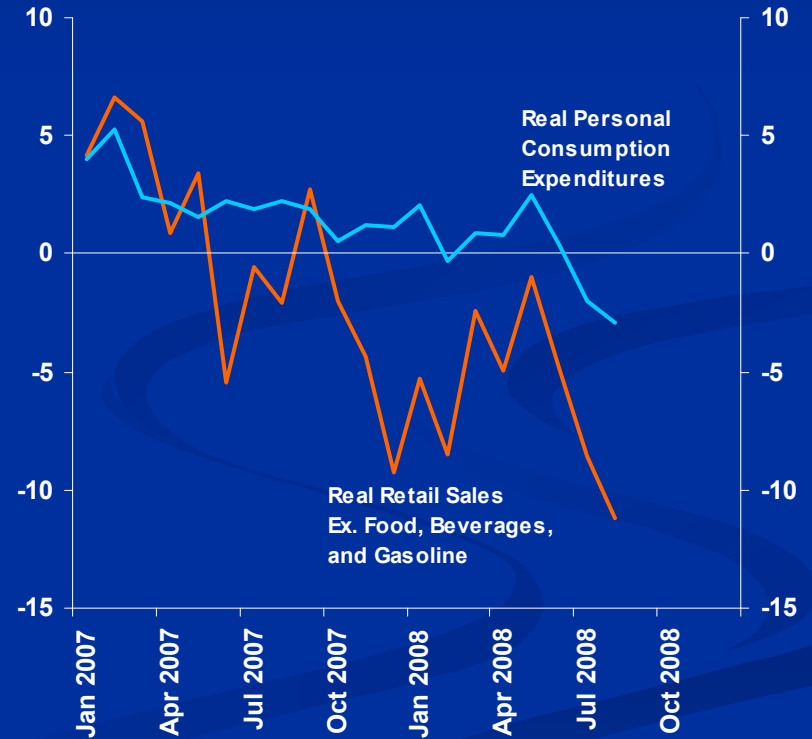


Activity indicators already softening

Labor Market

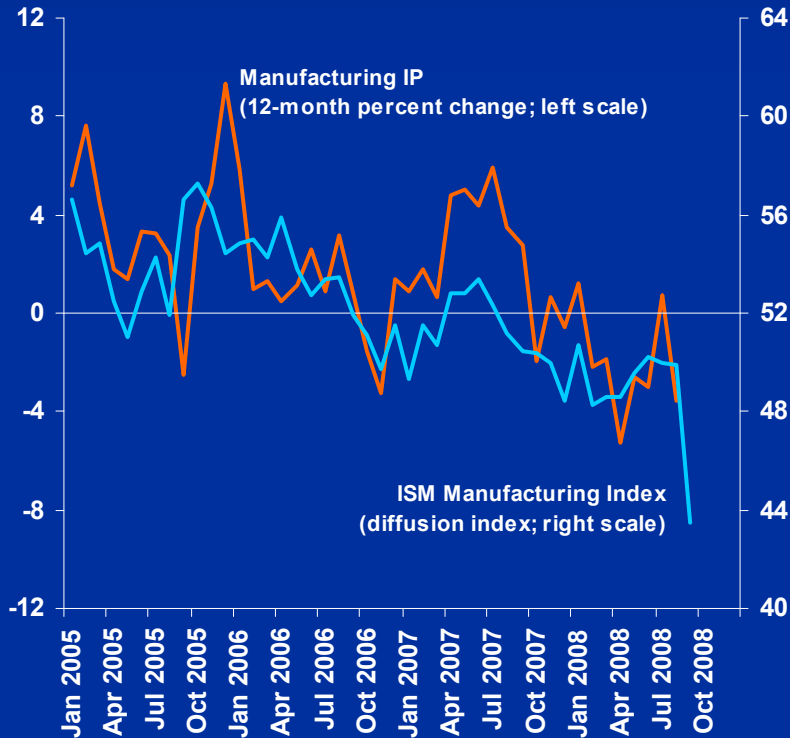


Consumption Indicators (3-month percent change, annual rate)

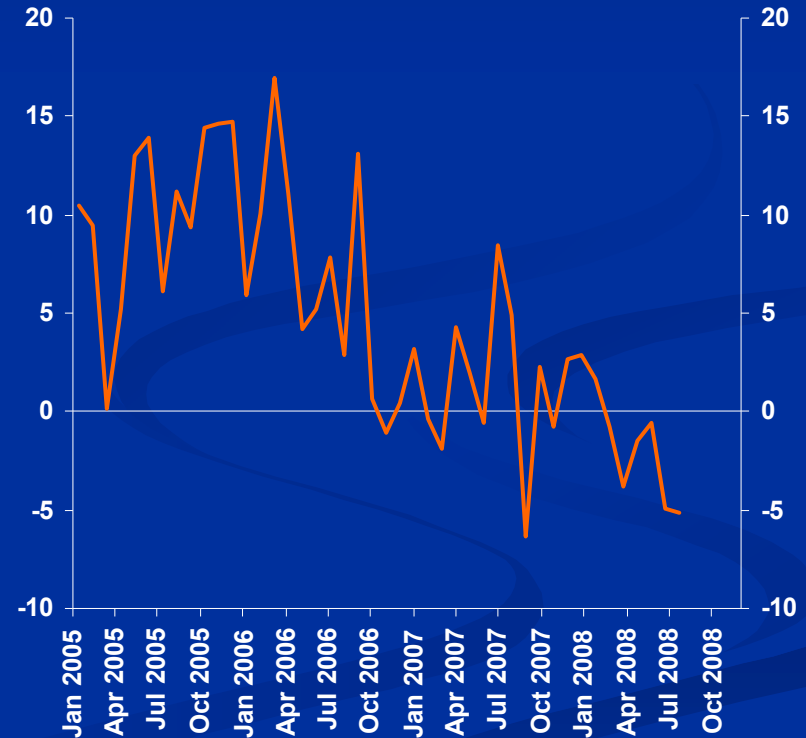


Activity indicators already softening (cont'd.)

Manufacturing IP and ISM Manufacturing Index

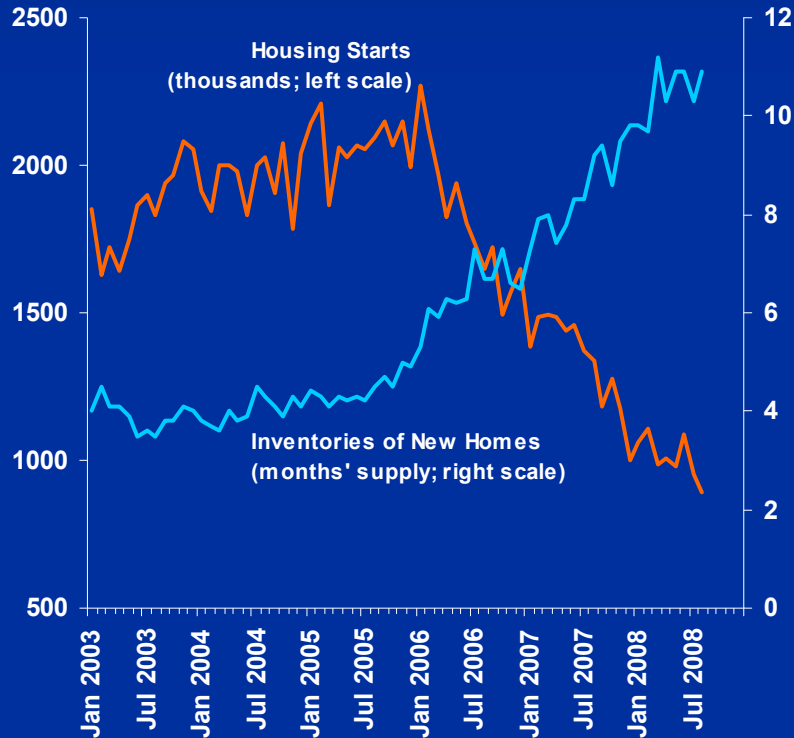


Durable Goods Orders
(12-Month Percent Change)

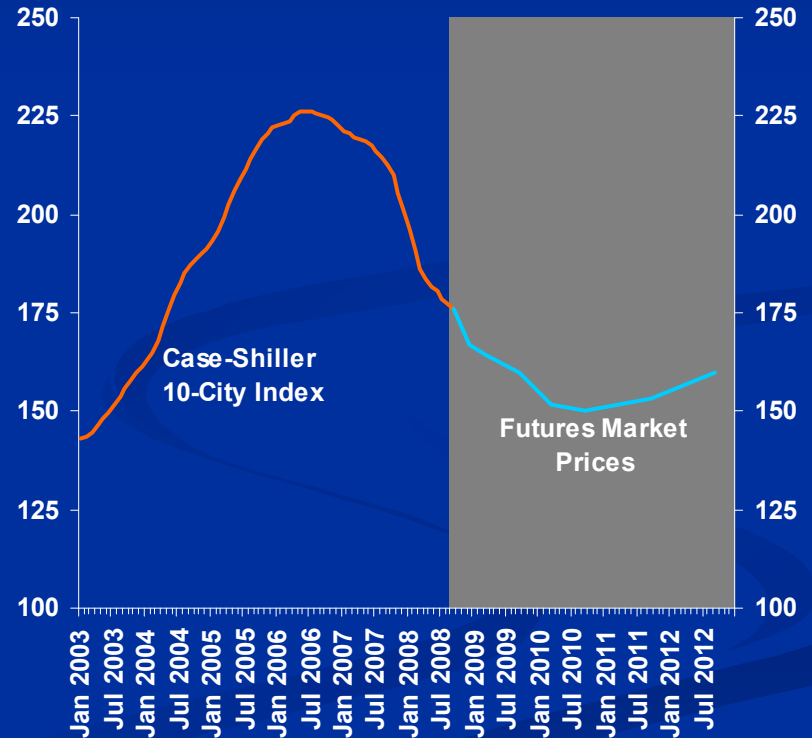


Housing still deteriorating

Housing Starts and New Home Inventories

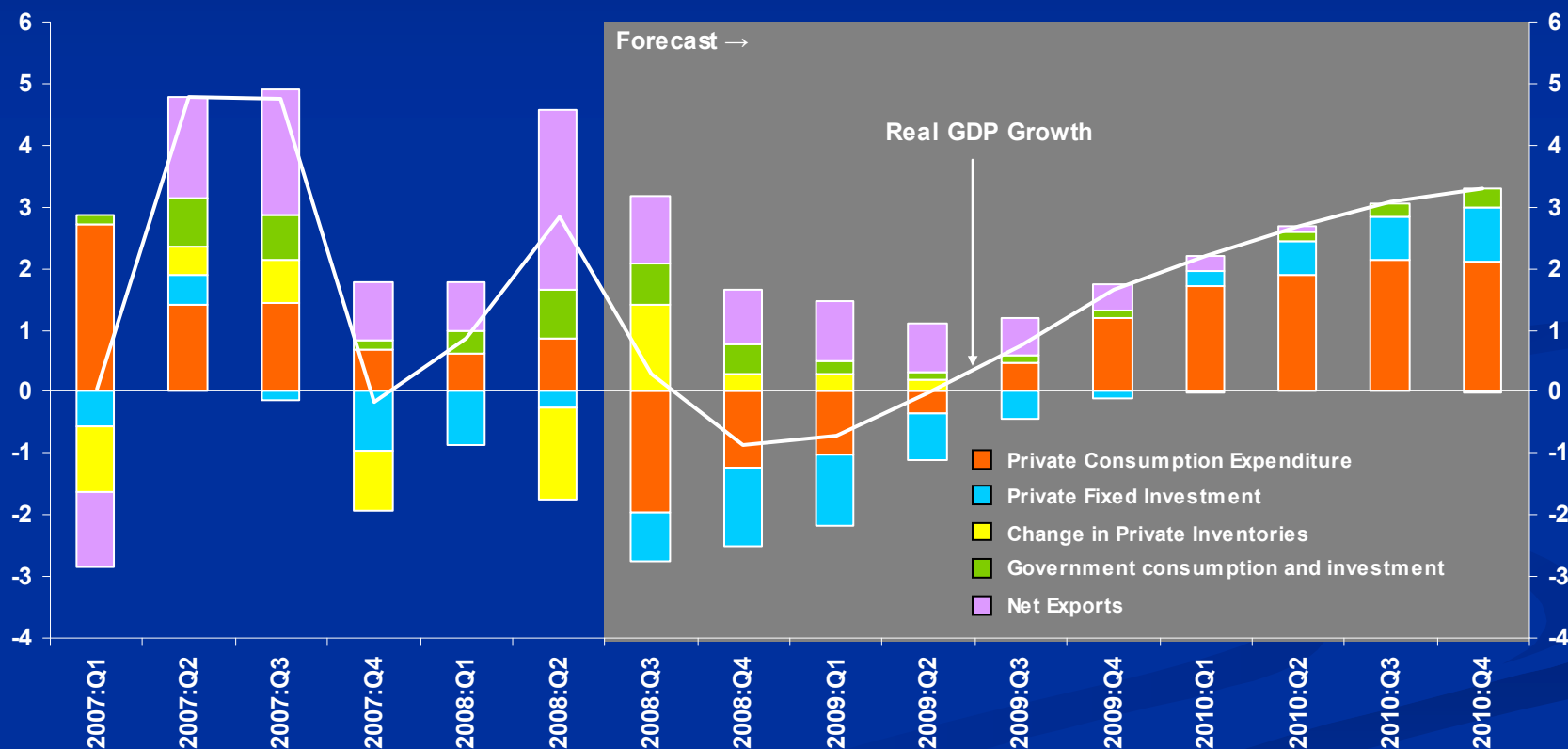


House Prices
(index, Jan. 2000=100)



Output declines in the next quarters and slow recovery probable

Contributions to Growth
(percentage points, annual rate)



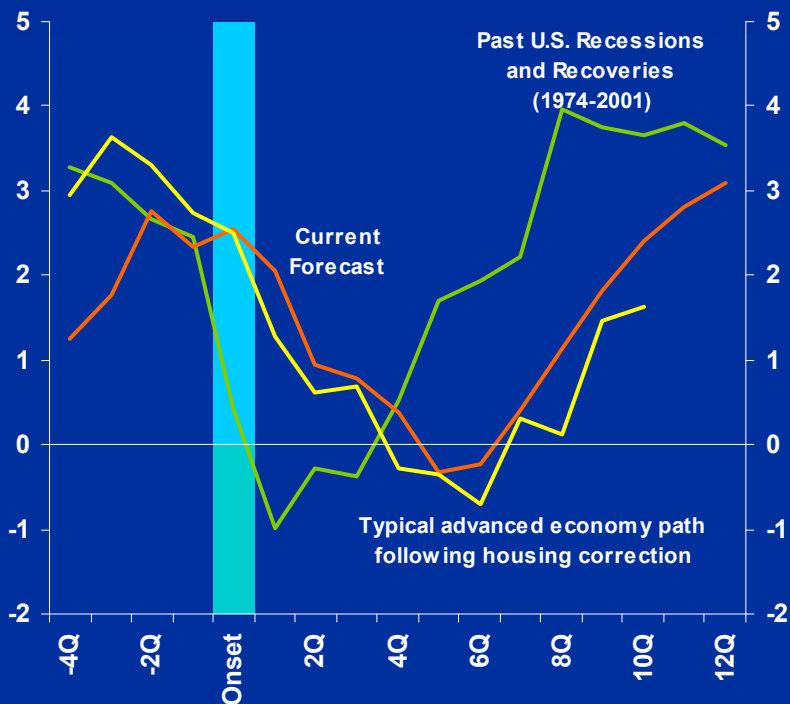
Output declines in the next quarters and slow recovery probable (cont'd.)

Real GDP Growth (percent change)

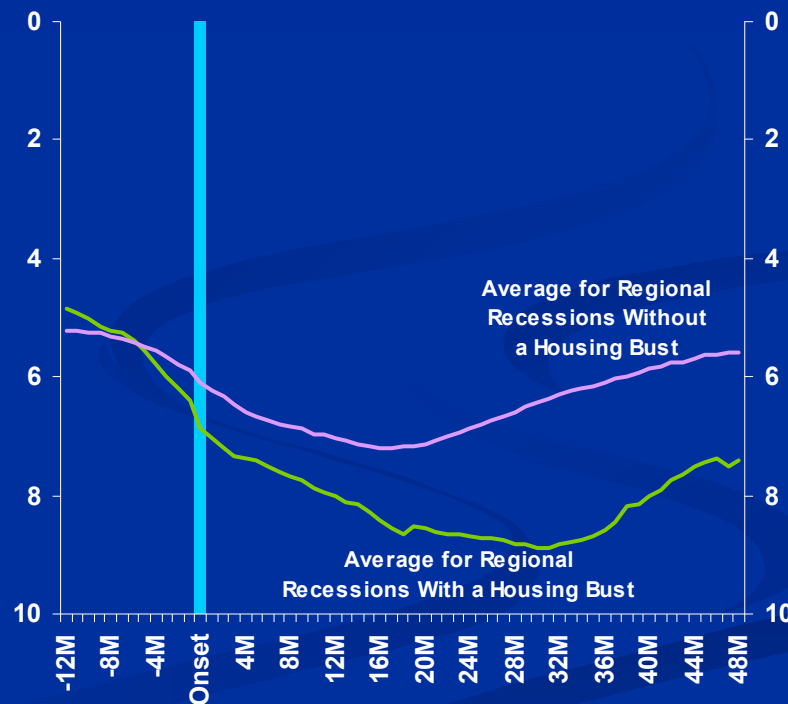
	2007	2008	2009	2010
Annual Average	2.0	1.6	0.1	2.0
Q4/Q4	2.3	0.7	0.4	2.8

Slow recovery reasonable given experience with housing busts

Real GDP in Downturns and Recoveries
(yr/yr percent change)

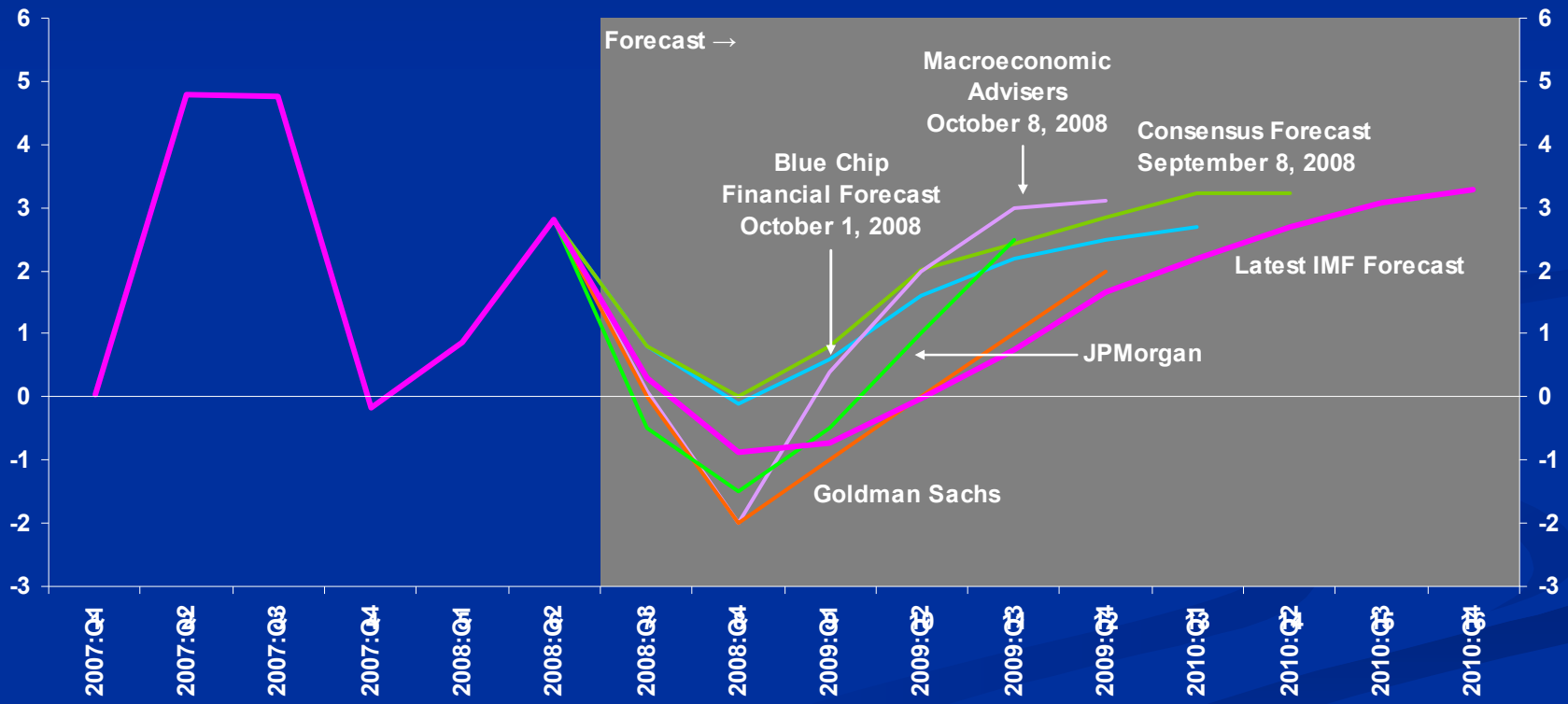


Recoveries from U.S. Regional Housing Busts
(unemployment rate; percent)



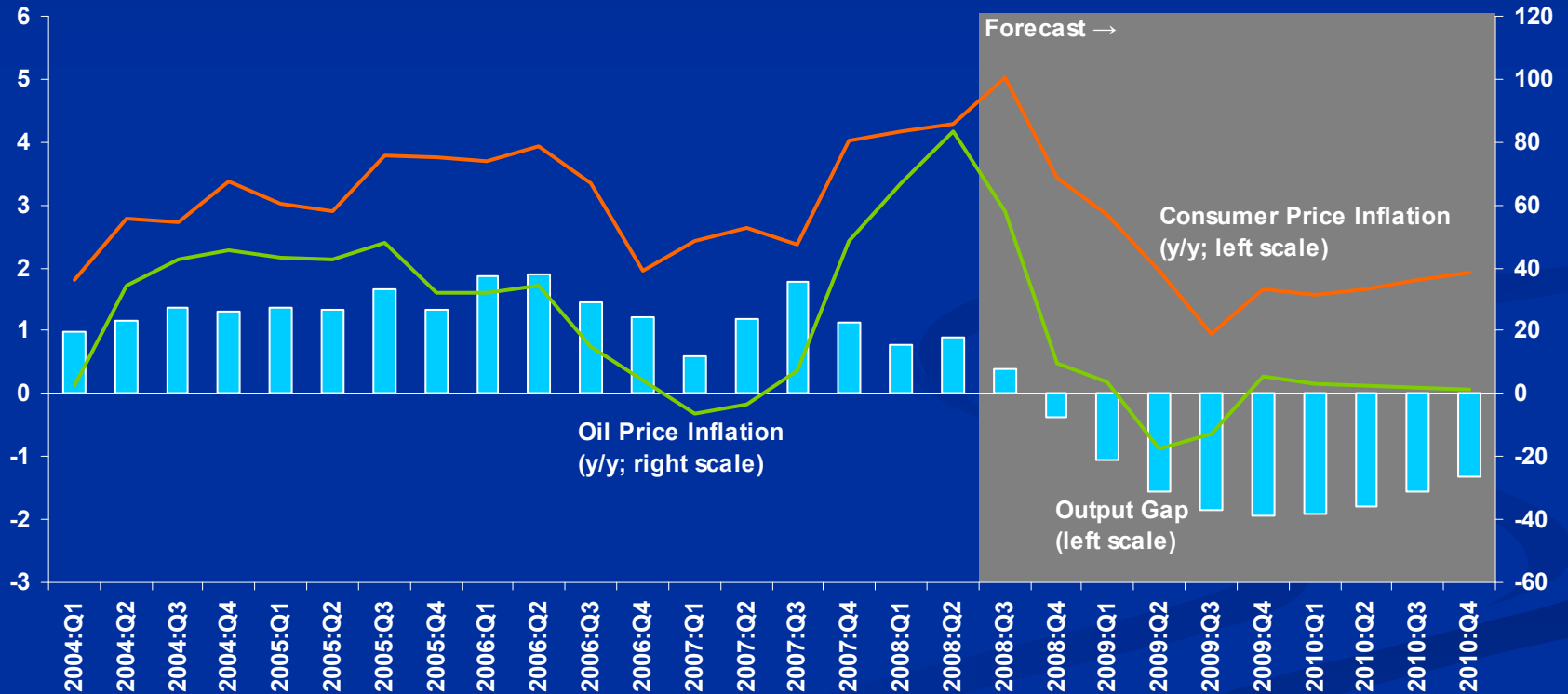
Many analysts pessimistic

Forecast Comparisons
(percent change, a.r.)



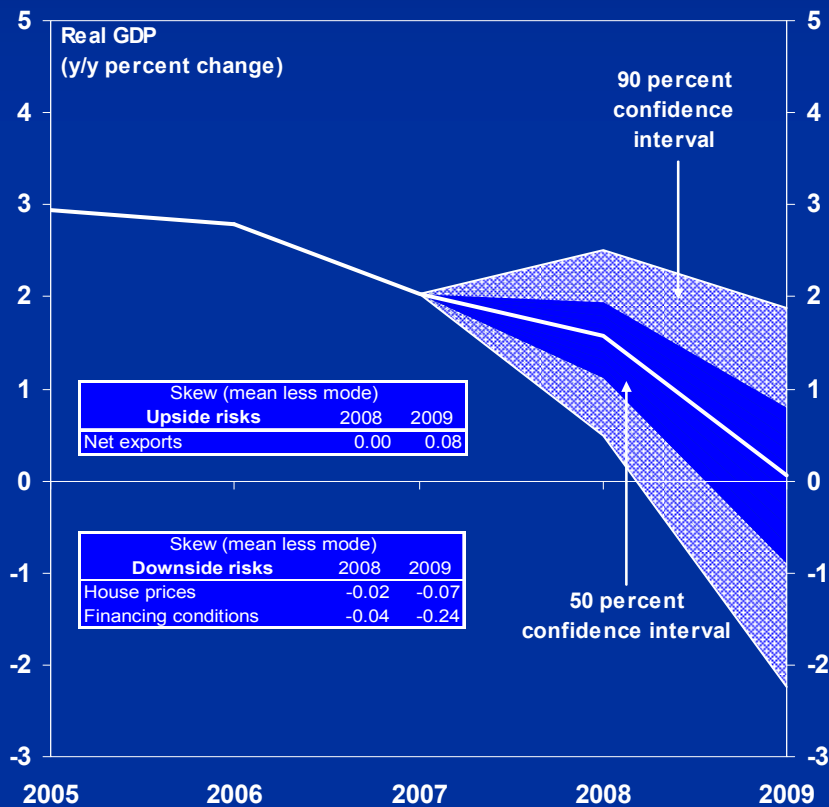
Inflation unlikely to be a problem

Consumer and Oil Price Inflation and Output Gap
(percent)

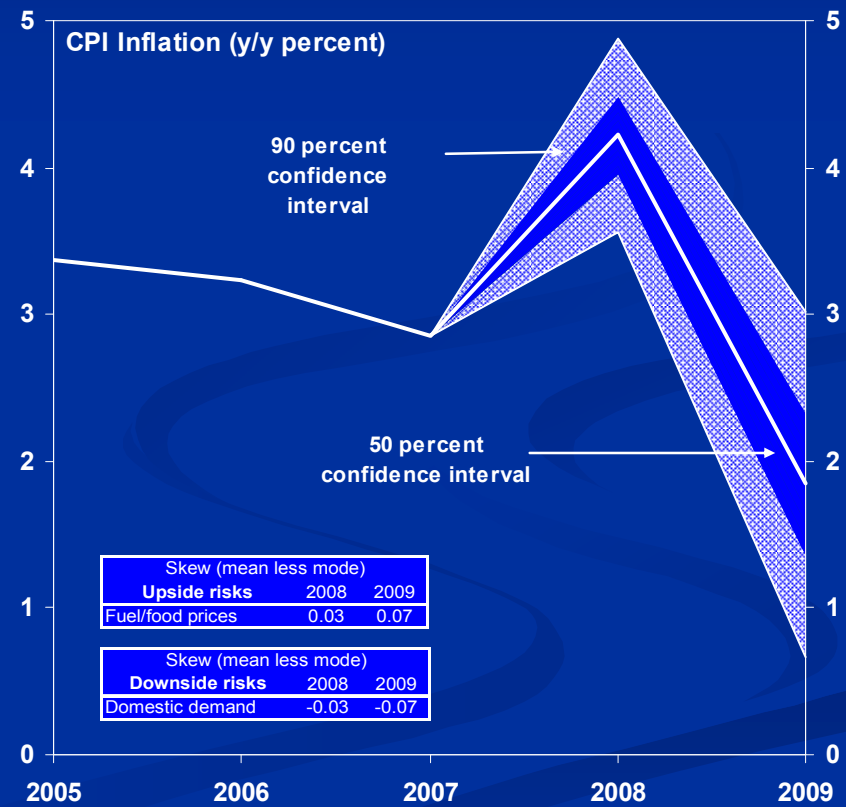


Large risks to the forecast

Growth Risks to the Downside



Inflation Risks Balanced



Policy Messages

- U.S. authorities have acted promptly and decisively.
- RECAPITALIZE BANKS! Do it directly and soon using authority provided by EESA.
- Avoid paying inflated prices for bank assets.
- Best information versus timeliness: U.K. model can be useful.

Policy Messages (cont'd.)

- In the meantime, more liquidity facilities (and, possibly, wider guarantees).
- Recapitalization/Liquidity/Guarantees enacted simultaneously.
- Further interest-rate cuts may be warranted. Fed should tighten once recovery begins.
- Further fiscal stimulus, if needed, targeted to the housing and financial sectors, but other measures (e.g., state aid, infrastructure investment) could be useful.

Policy messages (cont'd.)

- Entitlement reform is key to LT fiscal sustainability, while achievement of MT aims hindered by nontransparent budgeting.
- The Treasury blueprint provides a useful starting point for financial regulatory reform, but gaps should be addressed.
- In particular, need for (i) medium-term plan for GSEs; (ii) rules to mitigate procyclicality of banks' balance sheets; and (iii) better clarification of systemic supervisor's role.