

RGE GLOBAL ECONOMIC OUTLOOK SEPTEMBER 2010 UPDATE



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* Report current as of September 10, 2010.

September 10, 2010

Global Overview: September 2010 Outlook Update

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By Nouriel Roubini, Christian Menegatti and the RGE Macroeconomic Team

- The global recovery is much weaker than consensus expected. While 2010 has followed our script of a “Year of Two Halves,” signs of deterioration in the U.S. and global outlooks have prompted us to upgrade the probability of a double dip to 40%.
- We maintain a central scenario that entails a sluggish, U-shaped recovery in much of the advanced world, with risks of L-shaped recoveries looming over Japan and the eurozone.
- The recovery continues to be stronger in emerging markets, though these economies will still feel the slowdown. Absent another financial shock and a severe double dip, emerging markets with healthy balance sheets will grow at rates close to potential.

Region	Real GDP(% chg,y/y)			CPI (% chg,y/y)		
	2009	2010	2011	2009	2010	2011
U.S.	-2.4	2.5	1.5	-0.3	1.5	0.9
Japan	-5.2	2.6	1.5	-0.7	-1.3	-0.4
Eurozone	-4.1	1.6	1.2	0.3	1.5	1.6
UK	-4.9	1.6	1.5	2.2	3.1	2.5
G7	-3.4	2.4	1.5	0.1	1.2	1.0
Advanced Economies¹	-3.3	2.2	1.5	0.2	1.3	1.2
Asia Pacific²	3.9	7.3	6.1	1.0	3.6	3.4
Emerging Asia³	6.2	8.5	7.2	1.3	4.7	4.2
Latin America⁴	-2.0	5.6	4.1	6.1	9.1	8.4
Emerging Europe⁵	-5.4	3.7	3.7	6.8	5.8	6.2
MENA⁶	2.4	4.5	4.8	5.3	5.3	6.0
BRICs	5.4	8.5	7.5	2.2	5.0	4.7
World	-0.6	4.1	3.4	1.6	3.2	3.0

¹ Includes U.S., Canada, Japan, UK, Eurozone, Sweden, Denmark, Australia, New Zealand, Israel

² Includes Japan, Australia, New Zealand, China, India, Hong Kong, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Vietnam, South Korea, Taiwan and Thailand

³ Includes Asia Pacific excluding Japan, Australia, New Zealand.

⁴ Includes Brazil, Argentina, Mexico, Chile, Peru, Colombia and Venezuela

⁵ Includes Czech Republic, Hungary, Slovakia, Poland, Romania, Bulgaria, Turkey, Russia

⁶ Includes Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, United Arab Emirates, Syria, Jordan, Lebanon, Morocco, Tunisia, Algeria, Libya and Israel

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Since [RGE's July 2010 Global Economic Outlook update](#), it has grown clearer that the multispeed global recovery is much weaker than consensus expected. While 2010 so far has followed the script of our "[Year of Two Halves](#)," signs of deterioration in the [U.S.](#) and [global outlooks](#) have prompted us to increase the probability we assign to a double dip (now at 40%). We maintain, however, our central scenario for below-trend global growth (to which we assign an over 50% probability) in 2010 and 2011, with 2011 significantly weaker than 2010.

Our forecasts for global growth remain roughly unchanged at 4.1% for 2010 and 3.4% for 2011, well below the 4.5% global growth average of 2004-08. We expect advanced economies to grow 2.2% in 2010 and to slow to 1.5% in 2011. Our emerging markets aggregate will register strong 6.9% growth in 2010 and slower 6% growth in 2011. Overall, 2011 will be weaker as base effects dissipate, fiscal stimulus effects wane and several countries (notably in the eurozone) implement fiscal austerity measures.

The four main themes RGE has stressed since the beginning of the year have played out precisely as we projected:

1. **Multispeed global recovery**, with developed economies (DEs) following an anemic/subpar/below-trend "U" rather than the "V" foreseen by optimists. As we warned, the hard slog of deleveraging private and public debts will take years. In emerging markets (EMs), however, we foresaw a V-shaped recovery given their higher potential growth and—with few exceptions—the absence of high private and public debt and leverage.
2. **A "Year of Two Halves,"** as the tailwinds of H1 become headwinds in H2 and 2011 (i.e., fiscal stimulus turns into fiscal drag as austerity sets in, inventory adjustment ends, base effects disappear and tax policies that stole demand from the future—cash for clunkers, investment tax credits, homebuyers' tax credits—disappear).
3. **The risk of a double-dip recession** or L-shaped recovery rising for the U.S., Japan and the periphery of the eurozone (EZ).
4. **Less room for policy response**, as monetary and fiscal tools and bailouts of financial institutions lose their effectiveness on the real economy or become counterproductive.

All these calls have turned out to be accurate. At the beginning of the year, the consensus projected a V-shaped recovery—with growth well above potential—for several years, like typical post-war recoveries. Now, the V is not an option anymore, and the more bullish analysts have skulked into the U camp, struggling to explain how we will avoid a double dip. So, the "U" is the "new Size 6," our new measure of normalcy, to paraphrase "The Devil Wears Prada." Meanwhile, the risk of a double dip has risen to 40%.

Unfortunately, few bullets remain in the policy-making holster: A year ago, when the global economy was in free fall, the ammo dump brimmed with shells. Policy makers could push rates down to zero while massively

increasing base money through quantitative easing (QE); most advanced economies could run fiscal deficits of about 10% and backstop, ring-fence and bail out their financial systems. Now, however, we are facing a massive slowdown ahead and the looming risk of a double dip without the same policy options that we had a year ago. The Fed and other central banks may engage in more QE, but it will be less effective: U.S. banks now sit on US\$1 trillion in excess reserves and refuse to lend those funds due to credit supply and demand constraints. Why, then, would they lend the second trillion—after QE2—if they hold so tightly to the first? Monetary policy can deal with liquidity problems but not with the solvency problems of households, banks and the corporate sector. Massive constraints also hinder fiscal policy: In all the G20 countries but the U.S., the current preference is for austerity, rather than growth. Even in the U.S., given the current path of fiscal policy, there will be a fiscal drag in late H2 that will grow in 2011. Finally, on credit policy, banks are too big to fail but also too big to be saved or bailed out, especially in the smaller European countries where the sovereign is stretched or distressed. In effect, these countries lack the fiscal resources to credibly backstop—let alone bail out—their financial systems, and the markets know it.

As expected, the recovery has been multispeed, with emerging Asia and Latin America outperforming other regions. Unlike most DEs, most EMs have healthy balance sheets across all the sectors (government, financial, corporate, household and external). This allowed those economies to take full advantage of global restocking and pickup in global trade activity. In particular, Asian Tigers, Turkey and Brazil stand out as places where the recovery has resulted in growth well above potential.

With the global economy slowing, “decoupling” talk has come back in vogue. We have never been subscribers to the decoupling thesis. While we believe that EMs will have to adjust to a “new normal,” we do recognize an increased resiliency of key EMs that were able to engage in countercyclical policy in this cycle and whose stronger potential growth rates are boosting their role in the global economy. Absent another financial shock and a severe double dip, we expect EMs with healthy balance sheets to grow at close to potential rates (though growth rates might remain below the highs witnessed in 2003-07). In particular, this applies to those economies with good demographics, strong domestic demand and deep domestic financial markets like India, Turkey and Brazil, for example. However, if the U.S. slowdown were to become a double dip there would be several implications for global growth. We would likely see a sharp rebalancing of the global economy amid trade tensions (or trade wars, depending on the severity of the double dip) and deflationary pressures in DEs and possibly EMs. In this gloomy [scenario](#), global growth could fall into the 2-2.5% range in 2011.

Within DEs, 2010 started with the U.S. and Japan leading the recovery, initially outperforming other G4 economies while Europe lagged behind. By Q2 2010, the baton of growth had passed to Germany, where surprisingly strong export-led growth, driven by the ongoing recovery in global demand as well as a rebound in domestic economic activity, led us to a significant growth upgrade for 2010 to 3.5% from the previous 1.9%. For the EZ as a whole, our forecasts will move up from the previous 0.9% to 1.6%. These upgrades are largely

due to the strength of growth in H1 2010 and the carryover. The performance of the core and northern economies will help sustain EZ growth but at a more moderate pace upon the phasing out of the inventory cycle and other temporary bounce-back effects. Moreover, renewed weakness in the periphery will give rise to a multispeed recovery that introduces a tightening bias at the margin. A cooling external environment is bound to slow demand for European exports to more sustainable levels and feed into the EU production chain. Forward-looking survey indicators point to slowing activity underway—even for growth leader Germany—amid inventory adjustment, fiscal drag, base effects and slower global export growth, though at a more moderate pace than previously expected. On the other hand, the periphery is at serious double-dip risk because it is either still contracting (Spain, Ireland, Greece) or barely growing (Italy and Portugal). Consistent with our "Year of Two Halves" theme, we expect growth to slow substantially in H2 2010, as the strong growth in global trade activity (20%) in H1 does not repeat, and to slow further in 2011 when the austerity packages will be in full swing.

The most recent GDP data from the U.S. clearly show that the "Year of Two Halves" commenced early, with growth in Q2 2010 slowing all the way to 1.6% (which is likely to be revised down to 1.2% given the latest real estate data), after nearly 4% growth in Q1. Since July and August data suggest that growth in Q3 will be lower than the anemic Q2, we are already in a growth recession, where growth in the 1% range feels like a recession even though technically it is not. Such low growth implies a weakening labor market, a larger fiscal deficit, lower home prices, larger losses for banks on loans and securities and stronger protectionist pressures.

Our baseline scenario projects real U.S. GDP growing at an average annualized pace of 0.9% in H2 2010, taking annual growth in 2010 to 2.5%. Growth in the sub-1% territory, significantly below potential, indicates an economy that is [approaching a dangerous "stall speed."](#) Such an unsustainable situation elevates the chances of a Japan-style stagnation and can bring about downside growth surprises (currently there is a large gap between the consensus forecast of 2.5% and ours of 1%) that can lead to further stock market corrections, further widening of credit and interbank spreads and further increases in volatility and risk aversion that could then tip the real economy—via wealth and cost of capital effects—into a double dip. We now attach a 40% probability to the double-dip scenario. In our baseline scenario, annual growth for 2011 looks weaker than 2010, at just 1.5%. In a double-dip scenario, 2011 would look very different. If a double dip were to occur, it would most likely be around Q1 2011, and we cannot discount the possibility of another contraction or quasi-zero growth in Q2 2011. A recovery would occur only in H2 and would be conditional on the timeliness and aggressiveness of the policy response. In this scenario, 2011 growth could be closer to 0.5%.

In the DEs, both Japan and the UK will also see a sharp slowdown in H2 2010. In Japan, growth will tumble to 0% in H2 2010, with a possible contraction in Q4 as fiscal stimulus measures expire and demand from China and Europe slows. We continue to see Japan in a deep U and at risk of a double dip as a result of low potential growth; terrible demographics given its aging population; public debt at 200% of GDP; lack of structural

reforms; weak and ineffective governments; entrenched and deepening deflation with low growth; and a strengthening yen that weakens competitiveness. Several other G10 countries, like Canada, Australia and several of the Nordic economies with stronger balance sheets and exposure to global demand, have performed more strongly than the G4 and should continue to be resilient, experiencing broad-based recoveries. The Nordic economies are experiencing a broad-based recovery with private consumption and exports driving the growth. While these are all relatively export-oriented economies, the strength of their balance sheets—with healthy banking sectors and strong public finances (particularly in comparison with the rest of Europe)—give them more policy room to steer their economies through a global slowdown.

In the emerging world, Asia will continue to outperform other regions, growing at 8.5% in 2010. Most Asian countries will grow above potential as the revival of global demand for business and consumer electronics boosted exports and industrial activity in H1 2010. In addition, strong capital inflows and loose fiscal and monetary policies led to quick recoveries in labor markets, consumption and capex. Yet inflection in high-frequency indicators suggests that growth began easing in Q3 and will slow further into Q4 2010/Q1 2011. Consumption, capex and intra-Asian trade will slow mildly compared to 2008-09, yet, because of structural ties to the U.S. and EU via exports, these factors will be insufficient to sustain the levels of growth seen in H1 2010. Growth should pick up by late Q2 2011 and trend a bit higher in H2 2011 toward what might be a "new normal" for Asian exports and capex. Base effects will slow emerging Asia's growth to 7.2% in 2011 with domestic-demand-driven economies outperforming export-dependent ones. We expect Chinese growth to slow to about an average 8% q/q pace in H2 from 10% in H1 as government spending and investment offset weaker demand from the G3. Chinese consumption will contribute about half of the 8.3% growth we forecast for 2011, slightly below China's new potential, but we remain concerned that adjustment and global rebalancing will be slow. India, with reviving investment and a strong consumption base, will outpace China in 2011 with growth of 8.4%. Despite strong macro fundamentals and balance sheets, Asia will remain vulnerable to global risk aversion via weaker capital inflows and credit market tightening hitting capex and sentiment. With inflation mostly supply-side driven, most central banks will slow/pause monetary tightening in late 2010/Q1 2011. With stretched fiscal and monetary policies, any additional policy stimulus in the event of a global double dip will be less effective compared to 2008-09.

Latin America's economic performance also surprised to the upside in H1 2010 as loose fiscal and monetary policy conditions had a stronger-than-expected impact on domestic demand, while a low base added momentum. External accounts showed resilience to the ongoing European sovereign crisis, as expected. Hard data, however, are now showing that Latin America's buoyant growth is cooling, in line with our overall assessment of a "Year of Two Halves." This is due to domestic policy conditions that have become tighter (with the exception of Argentina and Venezuela), vanishing base effects and sharper-than-expected slowdown in the U.S. This will contribute to regional growth consolidating toward more sustainable levels, a process we

believe will continue into 2011. While the risk of a deep European crisis has been set aside, at least for now, the risk of a double dip in the U.S. has certainly increased and is more pressing for the region. We are of the view that Latin American countries could manage a moderate double dip in the U.S., though some countries will likely fare better than others, given their strong fundamentals and sound balance sheets. Mexico would be the most vulnerable given its dependence on the U.S. In the event of a severe double dip, the resilience of several Latin American countries would be sorely tested. We now expect regional growth to be about 5.7% for 2010 (well above the 4.3% estimated potential) and anticipate a deceleration to 4.1% in 2011. Although the global recovery and solid commodity prices played an important role in H1 2010, differentiation in domestic demand dynamics will play a key role as external conditions become less benign.

Central Europe's recovery is proceeding at a much slower speed than that of other EM regions, such as emerging Asia and Latin America. Nevertheless, a stronger-than-expected Q2 performance in Germany, the region's main trading partner, fueled upward revisions. As the world economy cools off, Central Europe's export-oriented economies are expected to follow suit, although less export-dependent Poland, the region's biggest economy, should show greater resilience. We now forecast real GDP growth of 2.5% for Central Europe in 2010 and 2.8% in 2011. Notably, our 2011 growth forecasts for each of the CE-4 economies falls below consensus. The growth prospects in Central Europe (Czech Republic, Hungary, Poland, Slovakia) remain more upbeat than elsewhere in Eastern Europe, including the Baltics and Southeast Europe, where another year of regional economic contraction is expected in 2010. These economies are fragile. In Southeast Europe, vulnerabilities include hefty external debt levels, high levels of foreign-currency-denominated lending, ongoing fiscal deterioration and the significant presence of Greek banks.

Even before this summer's fires, Russian growth momentum disappointed, and RGE recently downgraded the Russian GDP growth forecast to 4.0% for 2010. Consumption, supported by social transfers and commodities exports, has been the main driver of growth, but investment continues to be lackluster. Moreover, even as growth slows, Russian policy makers now face a significant uptick in inflationary pressures due to past easing of policies. Rising global food prices, especially amid this summer's erratic weather, have merely exacerbated an ongoing inflationary trend. We hold to our view that the CIS, including Russia, will have growth of around 4%, but lingering financial vulnerabilities in Ukraine, Russia and Kazakhstan will restrain the domestic economy, particularly as global demand for commodities stabilizes. Aside from Russia and Azerbaijan, all countries in the CIS should show stronger growth in 2010.

Strong commodity demand has buoyed the Middle East and Africa in 2010, particularly economies like Egypt, Saudi Arabia, Kenya and Qatar where strong domestic demand was reinforced by government stimulus. In 2011, the economic divergence will be reinforced by the withdrawal of fiscal stimulus in the Maghreb, Levant and southern Africa as fiscal consolidation becomes a primary focus. In the Middle East and North Africa (MENA), we expect growth of 4.4% in 2010 and closer to 5% in 2011 as domestic credit is unlocked in the Gulf

Cooperation Council (GCC). Strong oil prices, government spending, global restocking and rising incomes pushed up growth in H1, but economic growth is stabilizing in H2 at a slightly slower pace that could continue into early 2011. Waning external demand, the threat of higher financing costs and constraints in local banking systems will keep growth below the 2004-08 trend as countries seek a new equilibrium after past overheating. Those countries with balance sheet constraints, including the United Arab Emirates and Kuwait, will continue to grow below trend. In Sub-Saharan Africa, aggregate growth of around 4% obscures regional differences. Risks of weaker-than-expected growth in South Africa—Sub-Saharan Africa's largest economy—threaten to offset strong growth in East African economies and in the oil exporters of West Africa. Upcoming elections in Nigeria could delay needed energy sector reform and exacerbate political uncertainties. Frontier markets in Sub-Saharan Africa will continue, like their CIS counterparts, to face financing constraints given the global competition for capital.

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United States: September 2010 Outlook Update

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By Christian Menegatti and Prajakta Bhide

- Signals of economic slowdown have grown more and more prevalent as the U.S. economy approaches stall speed.
- Risks of a negative feedback loop and a dreaded double dip are rising, now at 40%.
- With policy bullets limited, the focus should be on job creation with a temporary reduction in payroll taxes for both employers and employees.

Real GDP

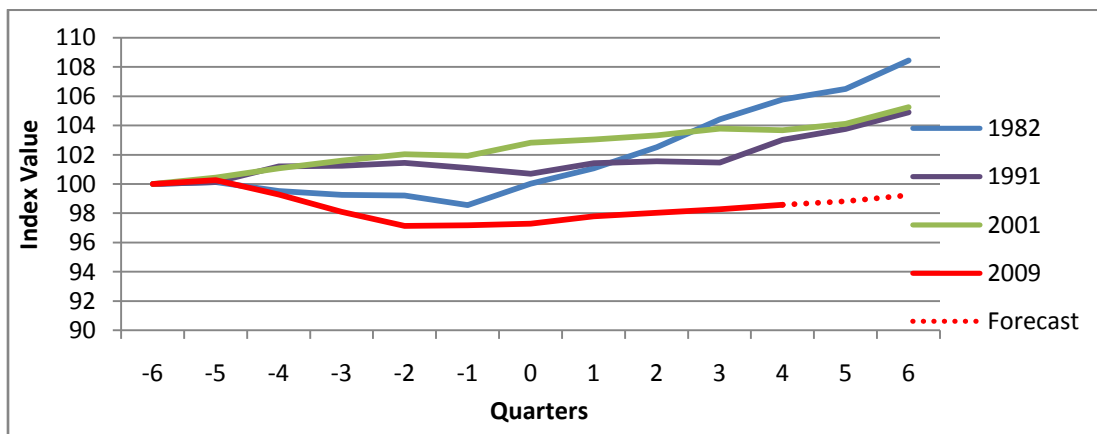
(% change v/y)

<u>2009</u>	<u>2010</u>	<u>2011</u>
<u>-2.4</u>	<u>2.5</u>	<u>1.5</u>
<u>CPI</u>		
(% change v/y)		
<u>2009</u>	<u>2010</u>	<u>2011</u>
<u>-0.3</u>	<u>1.5</u>	<u>0.9</u>

Outlook Update: Stalling and Falling?

Since the [beginning of 2010](#), we maintained that temporary factors would propel U.S. economic growth early in the year and that their effect would wane in H2. Headline growth would then converge with the anemic pace of final sales. Dynamics have largely followed that script: Indeed, the growth slowdown expected for H2 2010 materialized even earlier than we had expected. Growth registered an anemic 1.6% in Q2 2010, with final sales down to a pathetic 1%. The economy is [approaching a dangerous "stall speed"](#) and, with the exception of net exports, in Q3 2010 every component of demand looks even worse than in Q2.

Figure 1: Real Final Sales

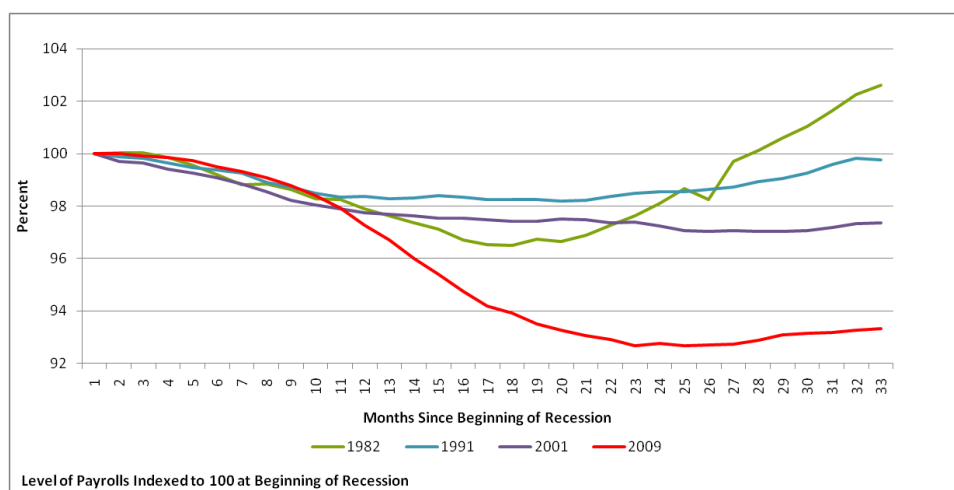


Level indexed to 100, six quarters prior to recession trough. Current recession trough assumed at Q3 2009.

Source: U.S. Bureau of Economic Analysis, RGE forecast

Consumer spending grew at an anemic pace in early 2010 and is off to a rockier start in Q3 2010. Weakness in core retail sales, especially auto sales, portends 1% growth in consumer spending in Q3 2010. Employment reports continue to highlight the [sluggish pace of the labor market recovery](#). New unemployment claims in Q3 have taken an upward turn, and the manufacturing sector has begun to signal a slowdown in hiring plans following the end of the restocking boom. This will weigh heavily on consumers throughout 2010, as debt reduction and balance sheet repair continues.

Figure 2: Private Payroll Growth Remains Sluggish



Source: U.S. Bureau of Labor Statistics

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Following the expiration of the first-time homebuyer tax credit, housing activity collapsed to record low levels. Over the course of 2010, we expect home prices to decline further, with no pickup before 2012, adding to the stress of households and the banking sector. We expect residential investment to contract by 9% in Q3 2010 after a 27.2% surge in Q2 2010. Underlying fundamentals suggest that investment will remain weak in 2011.

Investment in equipment played a key role in driving growth in final sales in H1 2010. As borrowing conditions improved and the inventory cycle boosted activity, firms replaced outdated capital and proceeded with outlays put on hold during the course of the recession, causing investment to grow at an average pace of over 20%. Durable goods orders data have shown a marked slowdown in Q3 2010, and we project investment in equipment and software to moderate to around 10%. We also expect a modest contraction in investment in nonresidential structures.

We don't expect the large drag from net exports witnessed in Q2 2010 to continue for the remainder of the year. However, with commodity prices still relatively elevated and the global economy set to cool in coming quarters, net exports' contribution to growth will be insignificant.

Government spending will turn neutral at best in the remainder of 2010 and weigh on growth in 2011. Sharper-than-expected retrenchment at the state and local government levels could lead to a fiscal drag even before the end of 2010.

Our baseline scenario projects real GDP growing at an average annualized pace of 0.9% in H2 2010, taking annual growth in 2010 to 2.5%. Growth in sub-1% territory—significantly below potential—indicates the U.S. economy is dangerously close to an unsustainable stall speed, elevating the chances of a double dip to 40%. In 2011, fiscal spending will begin to drag on growth, base effects will disappear, the labor market will remain weak and home prices will weaken further. We see annual growth in 2011 at close to an abysmal 1.5% in our baseline scenario, worse than 2010.

In a double-dip scenario, 2011 would look very different. If a double dip were to occur, it would most likely hit in Q1 2011, and the following quarter could bring another contraction or near-zero growth. A recovery would occur only in H2 and would be conditional on the timeliness and aggressiveness of the policy response. In this scenario, 2011 growth could be closer to 0.5%.

How We Differ From Consensus: Consensus Still Lagging Behind

[Downward revisions to consensus forecasts](#), bringing them closer to our projections, have been the order of the day in the last few months. Although markets might be a bit ahead of consensus, their 2.5% projection for H2 2010 still seems behind the curve. Looking beyond to 2011, however, our projection for 1.5% yearly growth stands in stark contrast to a consensus forecast of 2.8% and the optimism that [policy makers recently expressed](#). The historically important drivers of economic upswings—consumer spending, residential

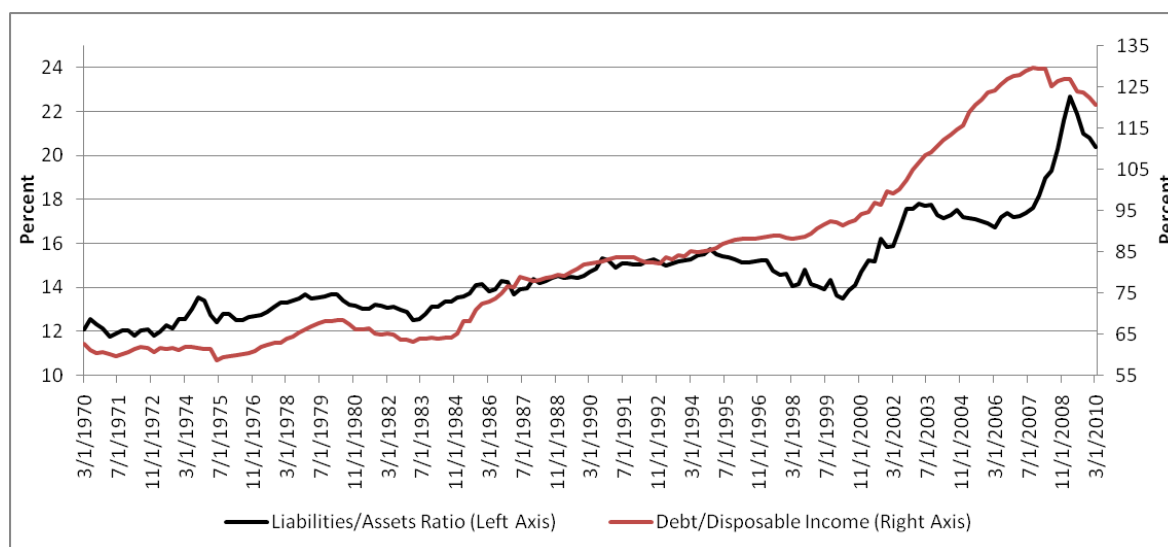
investment and net exports—seem in no position to take over the reins and boost growth in 2011 as the temporary drivers of growth fade away.

Risks: Looking for an Upside

Our forecast for 1% growth in consumer spending in H2 2010 is a key source of potential upside risk. Revised estimates show the household savings rate increased faster than earlier estimated, reaching a peak of 7.2% in Q2 2009. The stabilization in household net worth may offer some respite, though the debt-to-disposable-income ratio remains high. Recent labor market data have shown a slight uptick in income growth, which will be the key driver of sustainable growth in consumer spending. However, unless there is substantial improvement in the labor market, the increase in income will be too small to alleviate household budget constraints.

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Figure 3: Household Balance Sheets



Source: Federal Reserve Flow of Funds

Another possible source of upside risk to our forecasts is the policy response. While the Obama administration's new proposals for infrastructure and investment tax breaks are unlikely to gain any traction in Congress at the moment, an economy flirting with sub-1% growth may change that. Well-targeted further stimulus could provide a much-needed kick-start to labor market improvement. Meanwhile, if the Obama administration were to extend the investment tax break into 2011, that may lead to a slight upside risk to our forecast for investment.

For additional sources of upside surprise, we look overseas. Trade was a large drag on growth in Q2 2010 and, for now, we remain skeptical of the U.S. economy's ability to export its way out of the economic slump. However, stronger-than-expected growth in emerging markets and resilient demand from the eurozone due to continued strength in the German economy could lead to improvement in the U.S. trade balance.

On the opposite end of the spectrum, downside risks remain high. Stall speed growth in H2 2010 could lead to a weakening labor market, a more sharply declining housing sector, faltering stock prices, widening credit and interbank spreads and increasing risk aversion. This could lead to a negative feedback loop conducive to a double dip.

Policy Implications: Focus on Job Creation, Not Capex

Our scenario for sub-1% growth in H2 2010 suggests [pressure will mount on the Fed to step in and provide more monetary stimulus](#). Recent insights into the FOMC discussions have indicated significant internal division regarding the future growth trajectory, clouding predictions for the trigger for further accommodation. As long as the economy does not tip into outright negative growth and inflation expectations remain in positive territory, the monetary policy response might be muted. Having said this, the problems facing the U.S. economy involve excess leverage and insolvency, not liquidity. The policy response that would most help the economy in the case of another severe downturn—massive purchases of risky private sector assets rather than riskless Treasuries—is difficult to implement and politically unfeasible.

On the fiscal policy side, the political gridlock in Congress and the upcoming midterm elections will hold back any concerted efforts toward additional stimulus for the time being. However, calls for more fiscal stimulus in 2011 will gain more traction as growth slows and concerns regarding the fiscal deficit move to the back burner.

In our view, the administration's current proposal to extend the investment tax credit is very much in the spirit of the homebuyer tax credit and the "cash for clunkers" initiative of 2009. At best, it may provide a small, temporary boost to investment. Even in the small business sector, the number of firms reporting financing constraints as the key impediment to capex plans is relatively small. Rather, with capacity utilization still well below pre-recession levels, firms have no reason to boost capex, especially given the woeful final sales figures. It comes as no surprise that corporates are hoarding cash.

As discussed in a [previous RGE Analysis](#), the policy focus should be directly on job creation. While the allocation of funds toward rebuilding infrastructure could boost jobs (and contribute to a few tenths of a percentage point of growth per year for a couple of years), a more effective form of stimulus would be a temporary reduction of the payroll tax for two years for both employers and employees. This would have a positive effect on hiring and income generation and could spark a much-needed positive feedback loop for a

sustainable boost to final demand. The impact on the deficit could be limited if this reduction of payroll taxes were partly financed through the expiration of some of the Bush administration tax cuts.

Given our views on growth, the key question for us is whether the appropriate policy measures will be implemented in a timely manner. Remaining behind the curve on policy may amount to a highly detrimental mistake.

RGE Forecast Tables

PREVIOUS FORECASTS		COUNTRY	CURRENT FORECASTS					
Real GDP (% chg, y/y)			Real GDP (% chg, y/y)			CPI (% chg, y/y)		
2010	2011		2009	2010	2011	2009	2010	2011
2.6	2.1	U.S.	-2.4	2.5	1.5	-0.3	1.5	0.9
3.3	2.5	Canada	-2.5	3.0	2.2	1.7	1.8	1.9
2.2	1.7	Japan	-5.2	2.6	1.5	-0.7	-1.3	-0.4
1.1	1.1	United Kingdom	-4.9	1.6	1.5	2.2	3.1	2.5
0.9	0.7	Eurozone	-4.1	1.6	1.2	0.3	1.5	1.6
1.9	1.3	Germany	-4.7	3.5	1.9	0.2	1.1	1.5
1.2	1	France	-2.6	1.5	1.2	0.1	1.4	1.5
0.7	0.7	Italy	-5	0.9	0.7	0.8	1.5	1.7
-0.5	-0.2	Spain	-3.7	-0.3	0.3	-0.2	1.6	1.8
0.2	1.5	Ireland	-7.1	0.2	1.5	-1.7	-1.4	0.5
-3.5	-3	Greece	-2.0	-4.0	-3.0	1.3	4.8	2.5
0.5	-0.5	Portugal	-2.6	1.1	-0.5	-0.9	1.4	1.8
1	1.2	Finland	-8	2.6	2.2	0	1.1	2
1.8	1.4	Switzerland	-1.9	2.5	1.8	-0.5	0.6	0.8
1.3	1.2	Denmark	-4.7	1.9	1.5	1.3	2	1.9
2.9	2.2	Sweden	-5.1	4.2	2.4	-0.3	1	1.7
1.5	1.9	Norway	-1.6	1.5	1.9	2.1	2.2	1.5
2.5	2	New Zealand	-0.5	2.6	2.8	2.1	2.4	2.6
3.2	2.9	Australia	1.2	3.4	2.9	1.8	3	3.2
10	8.3	China	9.1	9.8	8.3	-0.7	3	3.5
8.6	8.5	India* * Refers to fiscal year and wholesale price index	7.4	8.5	8.4	3.8	9.0	5.6
4.8	4.5	Hong Kong	-2.7	5.5	4.3	0.5	2.4	2.6
5.8	5.8	Indonesia	4.5	5.7	5.8	4.9	6	6.9
6.9	4.5	Malaysia	-1.7	6.2	4.4	0.6	1.6	2
4.4	4.3	Pakistan	4.1	1.5	2.9	11.7	19.9	11.7
3.7	2.8	Philippines	1.1	7.1	4.6	3.2	4.7	5.2
13.5	4.4	Singapore	-1.3	14.6	4	0.6	2.8	2.6

6.8	6.3	Sri Lanka	3.5	6.2	6.7	3.4	6.1	6.8
6.3	6.9	Vietnam	5.3	6.3	6.7	6.9	8.7	8.7
6.1	3.9	South Korea	0.2	5.9	4.2	2.8	2.8	2.9
6.8	4	Taiwan	-1.9	8.3	4.0	-0.9	1.2	1.4
5.1	3	Thailand	-2.2	7.6	4.8	-0.7	0.8	1.5
5.8	4	Turkey	-4.7	6.5	4.0	6.3	8.7	6.7
4.7	4	Russia	-7.9	4.0	4.5	11.7	6.7	8.4
1.6	1.9	Czech Republic	-4.1	2.0	1.9	1.1	1.4	2
-0.3	2	Hungary	-6.3	0.0	1.8	4.2	4.5	3
2.8	2.8	Slovakia	-4.7	4.0	3.0	1.6	1.3	2.4
3	2.9	Poland	1.7	3.2	3.4	3.5	2.7	2.6
-1.8	1.5	Romania	-7.1	-2.3	1.0	5.6	6.2	5.0
-0.7	1.8	Bulgaria	-5.0	-0.8	1.8	2.5	2.7	3.0
3.5	4	Kazakhstan	1.5	5.0	4.0	7.3	7.1	8.5
3	3.5	Ukraine	-15	5.0	3.5	15.9	8.0	10.0
3.5	3.3	Israel	0.7	3.5	3.3	3.3	2.2	2.6
5.5	5.8	Egypt	4.7	5.5	5.8	16.2	11.9	9.5
3.8	4	Saudi Arabia	0.1	3.8	4.0	5.0	5.4	5.2
2.6	2.9	U.A.E.	1.3	2.6	2.9	1.1	2.5	3
3	3.5	South Africa	-1.8	3	3.5	7.1	4.5	3.5
7	4.5	Brazil	-0.2	7.5	4.6	4.3	5.2	4.7
6.5	3.7	Argentina	0.9	8	4.5	15	30	30
4	3.2	Mexico	-6.5	4.2	3.2	3.6	4.5	3.9
4.7	5.5	Chile	-1.5	5.3	6.1	-1.4	3.6	3
6.8	6.2	Peru	0.9	7.8	6.2	0.2	2.9	2.6
3.8	4.3	Colombia	0.8	3.8	4.3	2.0	3.3	3.8
-4.4	0.8	Venezuela	-3.3	-2.4	1.5	26.9	33	30

PREVIOUS FORECASTS			CURRENT FORECASTS					
Real GDP (% chg, y/y)			Real GDP (% chg, y/y)			CPI (% chg, y/y)		
2010	2011	AGGREGATE	2009	2010	2011	2009	2010	2011
2.2	1.7	G7	-3.4	2.4	1.5	0.1	1.2	1
1.9	1.6	Advanced Economies ¹	-3.3	2.2	1.5	0.2	1.3	1.2

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-	-	Emerging and Frontier Markets ²	2.4	7.0	6.0	3.7	5.7	5.3
7.1	6.0	Asia Pacific ³	3.9	7.3	6.1	1.0	3.6	3.4
8.5	7.2	Emerging Asia ⁴	6.2	8.5	7.2	1.3	4.7	4.2
5	3.9	Latin America ⁵	-2.0	5.6	4.1	6.1	9.1	8.4
-	-	Emerging Europe ⁶	-5.4	3.7	3.7	6.8	5.8	6.2
4.5	4.8	MENA ⁷	2.4	4.5	4.8	5.3	5.3	6.0
8.7	7.4	BRICs	5.4	8.5	7.5	2.2	5	4.7
4	3.4	World	-0.6	4.1	3.4	1.6	3.2	3

1 Includes U.S., Canada, Japan, UK, Eurozone, Sweden, Denmark, Australia, New Zealand, Israel

2 Includes all countries in the table above not included in 1.

3 Includes Japan, Australia, New Zealand, China, India, Hong Kong, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Vietnam, South Korea, Taiwan and Thailand

4 Asia Pacific excluding Japan, Australia and New Zealand

5 Includes Brazil, Argentina, Mexico, Chile, Peru, Colombia and Venezuela

6 Includes Czech Republic, Hungary, Slovakia, Poland, Romania, Bulgaria, Turkey, Russia

7 includes Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, United Arab Emirates, Syria, Jordan, Lebanon, Morocco, Tunisia, Algeria, Libya and Israel