The Foreign Outlook: New Economy Hopes, Old Economy Problems

presented by
Andrew Hodge

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Review of Recent Events

U.S. Fed has been raising rates. It’s the same story in Europe and Canada.

Oil and commodity prices, except Ag, are generally rising, may threaten Europe/Asia

Greatest concerns: oil, equity market volatility

Asia is growing rapidly — even Japan is growing

Russian economy is doing “okay”

Only Latin America has serious problems, excluding Mexico which is more tied to the U.S.
Oil Price in Dollars Hurts
Euro Price Hurts Even More

US$/barrel

Euro/barrel

1999
2000

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The Dollar

The dollar has been strong on US growth, capital inflows, and problems for the euro and yen.

Slower US growth, higher foreign growth may turn dollar around.

Later possible loss of US confidence, deficits could add to decline.

Depreciation would moderate import growth, raise import prices.

Dollar drop could aggravate any equity decline.
US External Debt Service not a problem now
Global Growth Overview

- U.S. slowing, but “new” economy growth outpaces others
- Canada strong, Mexico accelerating
- Asia in Recovery. biggest risk now is oil.
- Growth in W. Europe is gaining strength.
- E. Europe: growth tied to Western Europe
- Commodity price improvement is helping Africa
- Middle East: oil prices up, economies recovering
- Latin America was in recession last year, but is recovering this year. It is still fragile

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World GDP (ex US)

World Growth booming after 98-99 recessions
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</table>

NOTE: Latin America excludes Mexico; Asian regions exclude Japan
US Productivity Gains Here to Stay

Good News

- Clear acceleration. A 5.1% rate vs year ago
- Supported by higher computer and communications investment
- Future Internet gains
- E-mail products 0 marginal cost. Increasing returns (networks) What charge?
- Free “Consumer Surplus” New Hedonics/revisions

Bad News/Questions

- Gains partly cyclical
- Needs future innovation to stay above zero
- Computer deflator distortion
- Quality declines? HMO air travel
- Foreign countries catch up in application. Innovation? Wireless?

Conclusions:
Productivity gains mostly for real. Unique to US so far
Future gains will require labor force economies
Will hold near term at near 4% rate
US Productivity Accelerates
Led by Manufacturing

Output Per Hour, Manufacturing
Output Per Hour, Nonfarm Business

Percent Change Year Ago

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World High Tech Sectors

How Fast Are These Markets Growing? (Percent Growth of World Sales in Constant Prices)

Knowledge
HiTech Goods
ICT
Drugs & Medicines
Financial

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US has Gained Share of World ICT Market
(Percent Share of Total World Production)
Who Has The Fastest ICT Growth?
(1999 percent real growth rate in the ICT sector)
Communication Tech Leaders

Production Growth Rate of Communication Equipment

U.S. | Japan | Germany | Mexico | Korea

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Canada and Mexico

Canada

Real GDP growth for 2000 — 4.5%, with 3.3% in 2001.

Interest rates expected to increase to above U.S. rates by 2003. CA$ rises to 70 cents by 2003.

Mexico

Higher oil prices, booming US economy, and foreign investment will support real GDP growth of 5.6% in 2000 and 4.4% in 2001.

Inflation will fall below 10%. The exchange rate depreciates to MP$12.8 by 2003.
W. Europe

Oil is biggest problem now. Gas at $4 /gallon. Income deflation, strikes, consumer confidence.


Growth has returned. Manufacturing now strong.

Inflation still low, disposable income growth supporting consumer demand until now. Exports strong, euro weak.

Interest rates still low, but rising to defend the euro and prevent inflation. ECB Refi rate at 4% by year-end.

Fiscal policy much easier than last few years.

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W. Europe

Industrial Production Rising Rapidly on Weak Euro

Germany
France
United Kingdom
Italy

% Change Year Ago, 3-Mo. Mov. Avg.

-6  0  4  8
96  97  98  99

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Strong manufacturing sector growth underway
Exports still very strong, exchange rates not a problem
Domestic demand continues to strengthen
Even Indonesia is growing, high oil price helps
Key risk now is oil for those importers. Other concerns for Asia are more long-run
- Financial Reform
- Corporate Governance
- Reduction of debt-overhang
- Economic restructuring, end of Chaebols and Keiretsus?
Recession is over, but growth remains weak. Oil? Consumer and business confidence are rising, but still low.

Financial situation continues to improve

- The progress on financial reform is slow, but more and more effective. Softbank to buy Nippon Credit Bank.
- Finally sold Long-Term Credit Bank. Financial institutions are merging (Industrial Bank of Japan, Fuji and Dai-Ichi Kangyo have formed an alliance, for example) and restructuring.

Fiscal policy will be a drag on growth in 2000 and 2001

Private sector recovery will drive growth of 1.9% and 3.1% in 2000 and 2001.

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Japan - New Economy

Internet is driving household purchases

- Household PC Sales
- Household Mobile Phone Sales

Percent Change Year Ago

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Middle East and Africa: Growth by Market Size

Size of Bubble = Real GDP in 1999

South Africa $127 bil.

Real GDP Growth, Avg. 2000-02
Emerging Europe: Growth by Market Size

Size of Bubble =
Real GDP in 1999

Thousands 1990 US$

Real GDP Growth, Avg. 2000-02

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Risks

- A collapse in the global equity market
  - “Bubble” bursts in United States.
- Oil price spike hits most vulnerable
- Relapse into crisis in Asia or Japan
- Europe slumps again
- Brazil relapses (35% probability
- Fed/ECB actions cause recessions?
- Protectionism reduces trade growth

Conclusion

Weaker growth now more likely than global recession or stronger growth.

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