Press Release

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EUCLID Global Economic Outlook Webcast
Update #2 and Assessment

Good afternoon.

This revised webcast will review and evaluate EUCLID's initial 2009 GEO paper and discuss further trends for 2009 and 2010.

Our overall forecast for the end of 2009 and early 2010 is that global economic activity will be weakened by the ongoing convulsions of the US economy. At this point, it is possible to characterize the current crisis not only as "the great recession" but indeed as "**a credit depression**."

While it is clear that a certain level of deleveraging and 'purification' of US-related financial excesses has taken place, the resulting state is that of **stabilizing decline** in economic output.

The global imbalances which had developed in the 1980s and 1990s led to the deployment of **economic structures which are no longer sustainable**, including **overgrown financial, real estate and retail sectors** in the United States and other OECD countries. As a result, the current recession indicates **a necessary restructuring and redistribution of economic activities**. This is particularly painful for certain leading economies, notably the United States and – to an extent - the United Kingdom. China and India are already engaged in such a structuring of their economies to reduce their dependency on exports. This credit depression has had particularly painful consequences on select export-driven economies, notably Germany and Japan. In the case of Japan, the double-digit drop in exports is one of the major symptoms of this credit depression which is not only financial but has direct bearing on the real economy.

As of June 2009, we confirm the overall outlines of our initial forecast and predict nearly-stabilized yet continuing decline in global GDP. However, we observe **a progressive decoupling between growth and vulnerable economies**. Another possible decoupling, of a different nature, may be that of means of exchange and store of value. As a result, we may see the emergence of gold as regaining semi-monetary status in the sense of serving as a store of value rather than fiat currency. However, this leads us to **the question of inflation or deflation forecasting** for the end of 2009 and beyond. EUCLID confirms the assessment that the **deflationary pressure remains intense**, both in the area of asset valuation and general pricing. However, we ultimately expect inflation to become visible in a number of product categories - excluding real estate – probably as early as mid-2010. We note however another possible decoupling between electronically-generated and market-usable currency. As a result, it has proved impossible to use helicopter drops of currency apart from the progressive down-flow of massive government spending.

In this regards, we observe that **long-term interest rates** are increasing, which we forecast as a lasting trend in vulnerable economies, such as the United States, Japan and Europe. In EUCLID's view, the central banks' efforts to contain this increase in mid and long term interest rates against market forces cannot ultimately be successful. This phenomenon will limit the US government's ability to borrow apart from monetization. Hence, this likely increase in long-term interest rates will also have a negative impact on real estate values which is one factor explaining our forecast that median prices will not experience a significant rebound until 2012.

Finally, the decoupling or divergence which EUCLID had forecast in regards to the monetary policies of the US Federal Reserve and ECB cannot be fully confirmed, although the ECB as been more low-key with its quantitative easing operations. This is a sign that the Euro-zone is teetering on the edge of deflation and that the EU central bank is certainly willing to intervene to forestall this development.

Overall, the structural imbalances which were a major factor in the current crisis are continuing to unfold, a process which has a profound impact on international exchanges.

PREVIOUS FORECAST EVALUATION

While confirming the essential outlines of the October 2008 Economic Outlook, EUCLID notes that the US dollar has remained surprisingly strong in spite of an adverse environment. Our assessment that the US currency must ultimately undergo a phase of decline is nevertheless maintained.

SITUATION IN THE UNITED STATES

The **behavioral shift among US consumers** is a decisive element that will affect growth and GDP for at least two years. Retail sales will remain significant lower – as much as 25% down from their 2005-2007 levels in some sectors. This adjustment requires a profound restructuring of the US economy that is bound to be resisted and painful. The risk remains high that this decline in total economic output may reach **threshold levels with crisis-level consequences**, for instance in the area of pension funds and public finances at the city, county and state level. With this forecast, we issue a warning on the possibility that a new quantum or threshold event may have systemic consequences in the US and globally. Such an event could be the default of a major institution, market or financial instrument. Another area of concern is the **commercial real estate market** which also has the potential to destabilize recovery efforts. Finally, it should be noted that a severe **H1N1 outbreak** could have severe consequences and should be considered as a significant risk.

On the positive side, EUCLID concurs with the emerging consensus that the crisis is no longer degenerating but instead seeing early results from the massive government stimulus package. If the US economy can also be properly restructured, it may be hoped that a **slow and gradual recovery** will be confirmed in 2010.

Unemployment is following the overall pattern of a stabilizing decline; jobs are still being lost, albeit at a slower pace. A number of these jobs can be considered as permanently lost, and this phenomenon is an indicator that as of August 2009, we are still months away from a meaningful recovery. The real level of unemployment and **underemployment** in the United States – U6 - is closer to 20% than 15%, with an upswing potential to 25%.

INTEREST RATES

As previously discussed, the bond market is ultimately the driving factor when it comes to the long term interest rates that in turn affect mortgage rates. Again, we notice a possible decoupling, this time between central bank controlled interest rates and market driven rates. At this point, the US government's resort to **massive deficits and unsustainable obligations** explains the pressure of the bond market. Hence, the uptick in long-term interest rates is a significant indicator.

ENERGY OUTLOOK

EUCLID confirms its 2008 forecast that while demand for oil is no longer increasing in a number of major economies, supply destruction is a key factor explaining the recent increase in the price of oil. Our forecast is that oil will remain above $60-$65 per barrel and gradually return to triple digits once economic activity recovers. However, any threshold event discussed above could result in a double-dip recession which would in turn reduce the pressure on oil prices.

SUMMARY

The global economic outlook for the end of 2009 remains moderately pessimistic. The painful structural adjustment is working its way in spite of occasional government **efforts to revive unsustainable patterns**. Among these unsustainable patterns is the reliance on the US dollar as sole reserve currency, together with US treasury bonds as "reserve savings." The convulsive "decouplings" which we have discussed in this report are at the center of the emergence of a new financial, monetary, economic and perhaps geopolitical order.

For further information, please visit www.euclid.int.

Thank you.

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