Presentation Outline

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•Unlimited, but conditional, purchase of short dated government bonds

•Substantially reduced the probability of depression like left-tail risks

•Move debate from focusing on the fat tails of a bimodal distribution to the belly of a rickety, new normal distribution

•ECB has finally embraced its role as a lender of last resort

- Objectives of unconventional monetary policy in a new normal economy at the zero interest rate bound

- Maintain system-wide financial stability and thus prevent debt deleveraging from becoming disorderly
  - This is achieved by being the lender of last resort and providing liquidity to both private banks and sovereign states
  - To ease financial conditions such that diseased balance sheets are given a chance to heal over time
    - This is achieved by active and targeted financial asset purchase programs that focus on the normalization of liquidity, interest rates and credit risk premia
    - Reduce the real cost of capital to levels well below the expected real return such that animal spirits are kindled and aggregate demand is expanded gradually over time despite deleveraging
      - This is achieved through large scale, aggressive purchases of risk free or near risk free financial assets such that healthy private balance sheets are incentivized to take risk

- At its most simplistic, unconventional monetary policy tries to reduce the real return on savings to a point at which the incentive to save begins to fall and the incentive to invest or consume begins to increase

- When large, developed economies like the US, Europe and Japan are all concurrently facing private and public balance sheet deleveraging and rising ex ante national savings rates, unconventional monetary policy can be an invaluable tool for protecting aggregate demand from the deflationary clutches of Keynes' paradox of thrift

- The global economy remains mired with

- structural problems of excessive indebtedness

- maldistribution

- inadequate policy responses

- growing inequalities

- insufficient global coordination

- Unconventional monetary policies cannot address these problems but can provide a bridge to real outcomes, especially if mated with appropriate policies that

  - Reduce imbalances and inequalities
  - Enhance investment and production
  - Become activist with a secular economic vision
  - While the deflationary left tail in the Eurozone has been truncated, outright economic growth in the Eurozone will remain elusive in 2013
  - Fiscal tightening, especially in the less competitive and socio-politically less table countries of the Eurozone, will deepen the economic recession during 2013 and test the will of both fiscal and monetary policymakers to stay on the policy path they have championed

- We expect the Eurozone to contract between 1-1.5% in 2013

- The US is much further along the path to real economic healing

- The Fed has been aggressive in communicating and implementing unconventional monetary policy, which has facilitated the gradual deleveraging of private balance sheets without compromising aggregate demand, prfits and employment relative to the Eurozone

- We expect the US economy to grow about 1-1.5% in 2013, but with risks to the downside

- In 2013, we expect real residential investment to grow by some 10-12% from a depressed base thereby contributing at least 0.3% to real economic growth

- Real growth in housing will come with positive multipliers such that the total positive impact on the US economy could be 0.5-0.6%

- Our best guess is that in most outcomes of the US election, policymakers will reduce the fiscal cliff from $600-$700 billion to about $200-$250 billion which will create a 1.5% drag on US GDP

- China is undergoing a garden variety cyclical economic slowdown driven by a reduction in inventories via a decline in aggregate demand from both the Eurozone and US. China is the world's factory, and its customers are reducing their spending
- China is entering its own New Normal

- China is on the cusp of the middle income transition. To raise per capita GDP from $6,000 to $12,000, China will need to execute a reduction in national savings and an increase in economy wide innovation and productivity, all at the same time

- Politically, China is facing an unusually uncertain handoff
- China has the balance sheet and the knowledge to continue executing its economic development plan, as long as political stability is maintained, income inequality is addressed, and the external demand environment does not deteriorate substantially

- We expect China to grow 6.5-7% in 2013

- In competitive, profit motive driven economies, the rate of growth in sales can only slow to a point before it dips below the embedded costs of production and sets into motion an aggregation of cost cutting, labor shedding and inventory reductions that constitute a typical recession

    - The probability of more widespread recessions has increased, given the coordinated slowdown in global aggregate demand. This is where policymakers must focus their attention
    - We expect a slight moderation in global inflation to 2-2.5% versus 2.8% in 2012

- Developed economies inflation will slow to 1-1.5% and developing economies inflation will slow to 4-4.5%