



### Contagion Benefits

The Euro-zone is a currency union, and as such, member countries have ceded the right to implement separate and independent monetary policies. This monetary straitjacket aside, the Euro-zone nations have achieved almost no real political or fiscal integration. Thus, adverse repercussions from the Greek debt crisis quickly spread, and the dominant euro countries – notably Germany – show little political will to commit to the massive outlays that would be needed to contain the crisis. Recently, even, a government rescue of a Spanish bank shook markets. Moving much closer to true political union would enable Greece and similar debt-ridden countries in the Euro-zone to attain sustainable long-term economic stabilization, and eventually aspire to the status and performance of more fiscally disciplined countries such as Germany and

France. Though debt-burdened itself, the US has already benefited from Europe's troubles through **lower mortgage rates, flight to long-term Treasuries and other federal instruments, and lower oil prices**. The consequent strengthening of the dollar implies higher Libor and Money Market rates, and has the effect of reducing the US budget deficit. Less favorably, US exports to Europe will probably slow, suggesting some weakening in the stock price of US multinationals. For the near-term future, inflation is an absolute non-factor (falling *below* the targeted band) in the traditional industrialized economies. Pockets of high inflation driven by local conditions are observable in some emerging economies. Decent to brisk demand growth is anticipated for much of Asia, as well as Australia and Canada.

### Inflation Low, Growth Steady, Confidence Improving

The US recovery has been steadily broadening but at a modest pace, as seen in the recent downward revision of first quarter GDP growth from 3.2% to 3.0%. The trend in orders for capital goods (13.3% increase in first quarter), consumer spending, and the housing market seems promising, though still fragile. Consumers and businesses alike are benefiting from lower oil prices. The Treasury boomlet traceable to European debt worries is having a notable effect in lowering mortgage rates, providing much-needed support for home buying and related consumer spending. With inflation very low, the Federal Reserve has no reason to deviate in the near term from holding its target funds rate close to zero.

Unemployment is still high, but at least the US economy is now shifting up to a pattern of adding payroll jobs each month. However, improving labor market conditions could portend a rising jobless rate over the short term, as previously discouraged workers resume actively looking for jobs. Though sluggish, private-sector progress continues to be steady and real. US non-farm business productivity growth recently registered 2.6%, the smallest rise in a year, and thus a reasonable predictor of future job growth. For now, despite various financial storm clouds, **the threat of a double-dip recession does not overhang the US economy**. Full-year real GDP for 2010 is projected to grow by 3.5%: a solid, but not stellar, recovery.

### US Outpaces Europe

One can draw comfort from the adage, "Slow and steady wins the race." Tame inflation, a gradually mending job market, and no recurrence of a wholesale collapse in real estate all support **guarded optimism**. The Fed pegs upcoming inflation at between 1.5% and 2% annually through 2012, and if anything, these numbers may prove fractionally high, given recent readings as low as 0.9%. Unemployment is expected to fall to the 8.1% to 8.5% range by the end of 2011. Ongoing near-zero Fed interest

rates leave no monetary policy maneuverability on the stimulative side to deal with the risk, however remote, of a possible economic downturn. That risk seems greater for Europe, as austerity moves there could drive the continent back into recession. In the US, we expect foreign demand will be slack and a strong dollar will dampen exports. Still, for the US economy in aggregate, current prospects indicate **slow but steady** growth.