The Challenges and Opportunities Facing the United States Economy over the Coming Five Years

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The Outlook of the American Economy over the Next Five Years by the IMF

- On 21st April the IMF published its latest World Economic Outlook. It forecasts that the output of the American economy will grow by 2.8% in 2011, 2.9% in 2012 and 2.7% in 2013, 2014, 2015 and 2016.
- The $15 trillion U.S. economy, which currently accounts for almost 20 percent of global GDP, would decrease to about 17.7 percent of the international total by 2016. During the next five years, according to the IMF forecast, it will grow by a mere $3.5 trillion.

Challenges and Opportunities

- Currently, the American economic recovery remains uncertain, and the world situation is undergoing a complex and profound change. U.S. faces challenges and opportunities at the same time.
- Crisis is also opportunity to use new technology, and to restructure economic base.

First Challenge Facing the U.S. Economy -- Economics in Crisis

- Which theory of economics we can use to handle the global financial crisis?
  - New Keynesian economics versus rational economics.
- How to make economic policies?
  - In future, stagnation, inflation or stagflation maybe result from inappropriate macroeconomic policies.
  - Wrong theory of economics may transform current great recession into a great depression.

An Example

- The monetarists believe that significant policy mistakes by monetary authorities that lead an ordinary recession to descend into the Great Depression.
- This policy caused a shrinking of the money supply which greatly exacerbated the economic situation.

Second Challenge Facing the U.S. Economy -- The Debt Crisis

- According to the IMF's World Economic Outlook, the federal government not only lacks a "credible strategy" for dealing with its skyrocketing debt, but that it is continuing to expand deficit spending at a time when it should be contracting.
- The IMF says that the U.S. debt crisis has a one in four chance of plunging the world into global recession over the next 12 months.

Debate over Debt

- President Obama proposed spending cuts and higher taxes on the rich to slash the U.S. budget deficit by $4 trillion over 12 years, saying Republican plans for deeper reductions were too radical.
- Republicans said Obama's speech showed he was not serious about deficit reduction. They said the steps he outlined would not fix the problem and his proposed tax hikes would hurt the economy.

Third Challenge Facing the U.S. Economy -- State governments incurred serious financial deficits

- 44 states and the District of Columbia are projecting budget shortfalls totaling $112 billion for fiscal year 2012.
- Since 2008, 46 states have cut services to residents. More than 30 states, meanwhile, have increased taxes.
- Texas legislative session in January with a budget shortfall of up to $27 billion over the two years.

Fourth Challenge Facing the U.S. Economy -- Global Economic Imbalance

- Americans spend too much money on consumer goodies and save too little for the future. Chinese consumers save a lot for retirement but don't spend enough along the way.
- We have a global economic system.
- We do not have a global central bank.
- We do not have a global treasury department .
- We need to have a new global macroeconomics that can strengthen macroeconomic-policy communication and coordination among main countries.

First Approach to the Challenges -- The Management of Expectations

- "According to the management of expectations, monetary policy is -- at its heart -- the problem of managing and coordinating expectations in the economy." Morris and Shin (2008)
- "Charles Goodhart has coined the term "expectationalists" to denote this school of thought that includes not only Michael Woodford, but other leading monetary economists such as Alan Blinder, Lars Svensson, and Ben Bernanke." Morris and Shin (2008)
- Basic thought: Grugman (1998), Woodford (2001,2003,2005), Eggertsson and Woodford (2003), Svensson (2004), Morris and Shin (2008).

The foundation of the management of expectations: Sticky Expectations

- Sticky expectations
  - rational inattention, Sims (2003)
  - sticky information, Mankiw and Reis (2002)
  - sticky expectations, Carroll (2005)
- Chinese sticky expectations and its management of expectations, Laya Li (1989, 1991, 1995).
- The research agency of Chinese central bank and Huaqiao university held a conference to discuss the management of expectations in last month in Beijing.

The Depression versus Today
-- In the View of Management of Expectations

- One potential similarity between the 1930s and now is that both crises are lack of confidence among investors and bank depositors.
- A large-scale loss of confidence led to a sudden reduction in consumption and investment spending in these two crisis.
- In crisis, the management of expectations is the management of confidence.

QE2: An Example of the Management of Expectations

- In this view, the Great Depression was mainly caused by monetary contraction.
- The Federal Reserve allowed the money supply as measured by the M2 to shrink by one-third from 1929–1933, thereby transforming a normal recession into the Great Depression.
- What the economy needs in these two crisis, this thinking goes, is some inflation. In other words, input more money into economic system. This is why Bernanke is pushing for QE2.

With Lack of confidence, QE2 Is Not Enough and Key Is Investment

- QE2 is a way to prevent a big depression. But how much money it created is used to invest? How much money it created is just kept in the bank systems to improve their balance sheet? And How much money it created become hot money.
- Without confidence, consumers, producers and bank just want to keep money. The economy is still in liquidity trap.
- For walking out from liquidity trap, U.S. need to invest more. If U.S. government cannot create more financial deficit to invest, where U.S. can get money enough to invest?

Are There Any Room for U.S. to Make New Policies?

- Republicans and conservative Democrats in Congress do not want to authorize additional financial deficit.
- Fed doesn’t want to change interest rate in the recent months.
- Except for QE, it’s not clear that the Fed has any new tools to handle the crisis.
- But there is still room for U.S. to improve imbalance global economy. And China is key factor for U.S. improving her economy.

It Is Time for U.S. to Pay More Attention to China

- In consideration of the sovereign debt crisis in Europe, the nuclear disaster in Japan and the turbulence in the Middle East, it is time for U.S. to pay more attention to China now.
- The combined economic aggregate of U.S. and China has accounted for one third of the world's total, while trade value between them has amounted to one fifth of the global total.
- The ties between China and the United States surpass the boundaries of bilateral relations and are increasingly affecting the whole world.
- The world needs its two largest economies to work together.

Second Approach to the Challenges -- Urges Countries with Trade Surplus to Increase the Value of Their Currency

- American urges countries with trade surplus to increase the value of their currency. One of those key countries is China.
- Although the yuan has risen by about 5 percent against the dollar since last June , Washington still argues that the Chinese currency remains undervalued.

Inflation and Rising Wages Will Increase Chinese Currency Value Potentially

- In April, Chinese CPI rose 5.3 percent. That was down from March's 32-month high of 5.4 percent.
- The Chinese government has a target of 4 percent annual inflation, but it could be tough to achieve that goal given increasing labor costs and rising commodity and fuel prices.
- Inflation will push price of China's export commodity higher in the future.
- China is trying to increase wage to stimulate consume. Chinese minimum wage will double in less than five years.
- These will increase Chinese currency value potentially.

U.S. Goods Exports to China

- According to Chinese Customs, the volume of Sino-U.S. trade in 2010 was $385.34 billion with a nearly 30% annual increase. In 2010, China's import volume from the U.S. was $102.04 billion with an increase of 31.7% year–on-year.
- According to U.S. Department of Commerce statistics, from 2001 to 2008, U.S. goods exports to China rose from $19.2 billion to $71.5 billion, an increase of 272 percent, while U.S. exports to other countries and regions increased by only 72 percent during the same period.
- U.S. exports to China from 2001 to 2008 provided the country with 2.57 million new job opportunities.

Third Approach to the Challenges -- Ask Other Countries to Buy More U.S. Bond

- China remained the largest holder of U.S. securities with a total of $1.611 trillion as of the end of June, the U.S. Treasury department said.
- During the global financial crisis, China did not trim its holdings of U.S. treasury bonds, but increased them.
- Japan was the second largest foreign holder with $1.393 trillion and the United Kingdom held $798 billion as of June 2010, Treasury said.
- QE2 hurts credibility of US bond.

Fourth Approach to the Challenges -- Lure in More Foreign Direct Investments

- For walking out from the liquidity trap, U.S. facing essential challenge is lack of investment.
- American need to lure in more foreign direct investments to solve its financial problem and help stimulate its economy. And America can gain some traction over the economy from the new investment.

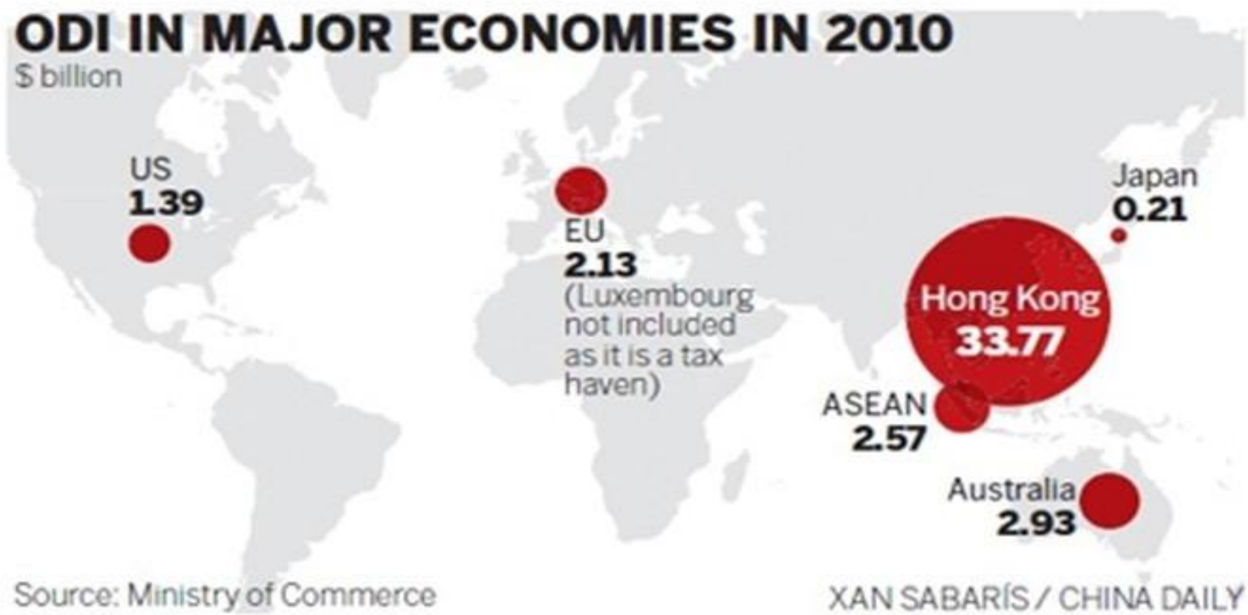
China's Foreign Exchange Reserves and Her Oversea Direct Investment (ODI)

- The surge in China's foreign exchange reserves, to a record more than $3 trillion by the end of March, has made it urgent for Beijing to encourage domestic companies to invest more abroad.
- In 2009, China not only became the largest investor among developing countries, but also the fifth largest investor in the world - preceded by the United States, France, Japan and Germany.
- A report by the U.S. Asia Society said that China's ODI is set to surge, with assets to reach between $1 trillion and $2 trillion worldwide by 2020.

U.S. welcomes Foreign Direct Investment (FDI) from China

- The U.S. faces with its soaring fiscal deficits and lack of investment for future growth, it is time to lure more Chinese direct investment for the benefits of both economies as well as the global recovery.
- Various representative offices set up in China by U.S. state governments have been engaging in active discussions with Chinese companies for luring Chinese direct investment.
- Chinese FDI is "good for the American workers and good for American businesses," Locke said at the Woodrow Wilson Center days before the two countries hold their third round of Strategic and Economic Dialogue in Washington.

U.S. Received Only about $1.39 Billion of Chinese Investment in 2010



China's ODI in the non-financial sector hit $59 billion last year, up 36.3 percent year-on-year, statistics released by the Ministry of Commerce on Jan 18 showed.

Investment: another important problem between U.S. and China.

- China's commerce minister called the United States government not to discriminate direct investments from China, contending U.S.' profiling and screening of Chinese investment proposals "neither fair nor transparent".
- A survey report says the top challenge for U.S. companies in China is the bureaucracy. Other administration and legal issues such as "unclear" laws and regulations, and inconsistent regulatory interpretation are the "third and fourth most difficult problem" U.S. companies face.

Potential Political Obstacles

- There are potential political obstacles for Chinese ODI in U.S., especially from the U.S. Congress.
- The U.S. Asia Society report is not optimistic about prospects of Chinese investment in the U.S.. It said the U.S. believes that Chinese investment is largely driven by political reasons rather than the profit motive.
- State governments in the U.S. are showing growing interest in Chinese investment but "Congress isn't always welcoming".
- An executive from Huawei Technologies Co Ltd said the company is interested in expanding in the U.S., but restrictions due to political reasons are a major challenge.

Summary

- Without investors' confidence, QE2 or QE3 can create both money and inflation, but they cannot create investment enough.
- With the debt crisis, U.S. government cannot create more financial deficit to invest.
- In the liquidity trap, U.S. facing main challenge is not lack of money, but lack of investment.
- Europe, Japan and the Middle East struggle to solve their economic problems, too.
- U.S. welcomes Foreign Direct Investment (FDI) from China, which benefits the U.S. economy to walk out from the recession.
- Because inflation and rising wages will increase Chinese currency value potentially, in the future, Chinese currency value maybe is not the main problem between U.S. and China. New one is investment.
- We need to have a new economics and a new political philosophy to explain these challenges and opportunities.

Thank You Very Much!