

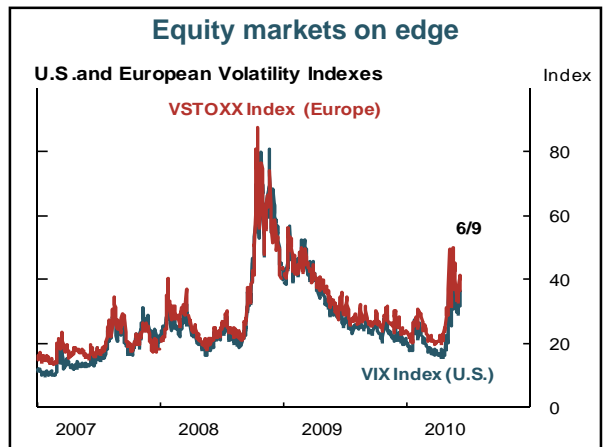
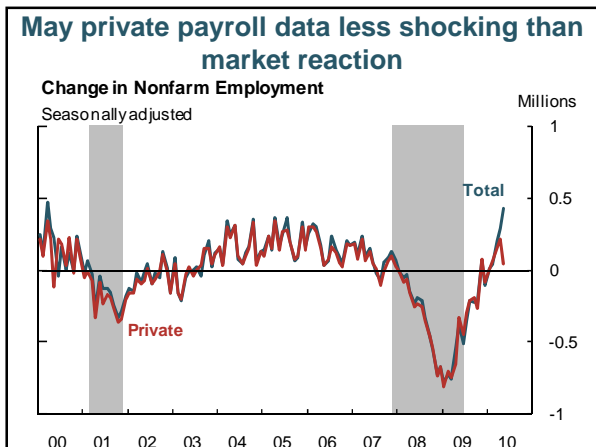
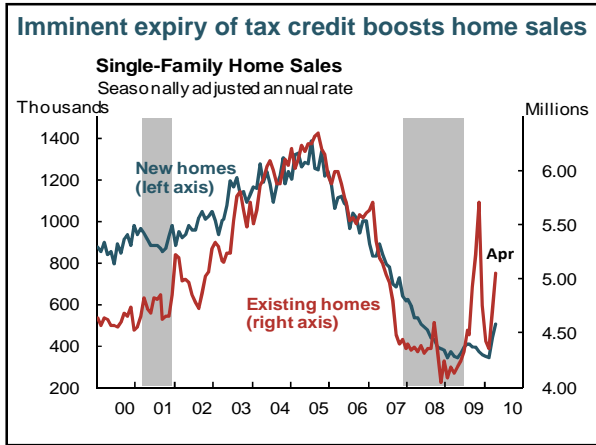
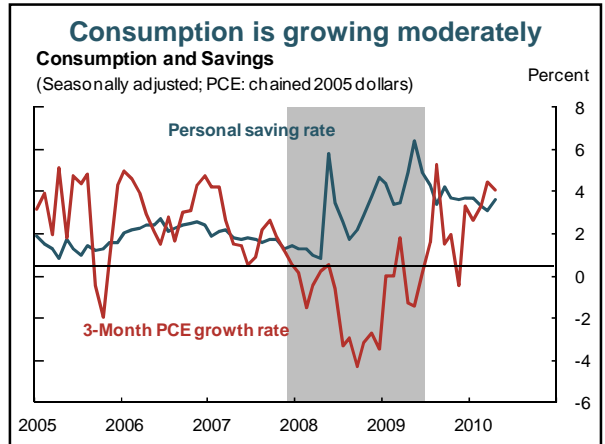
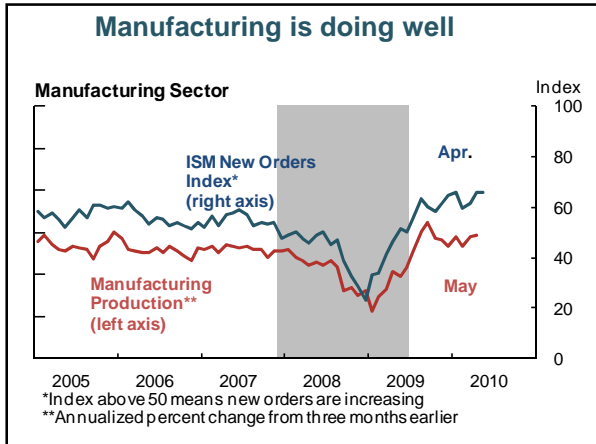
June 10, 2010

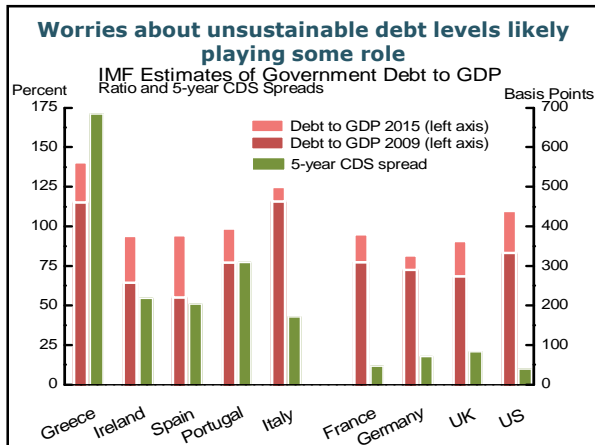
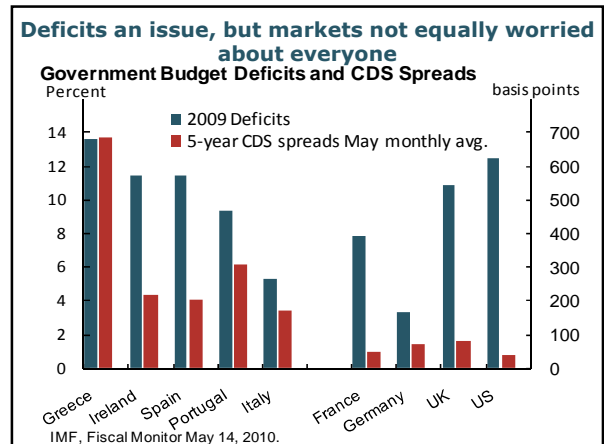
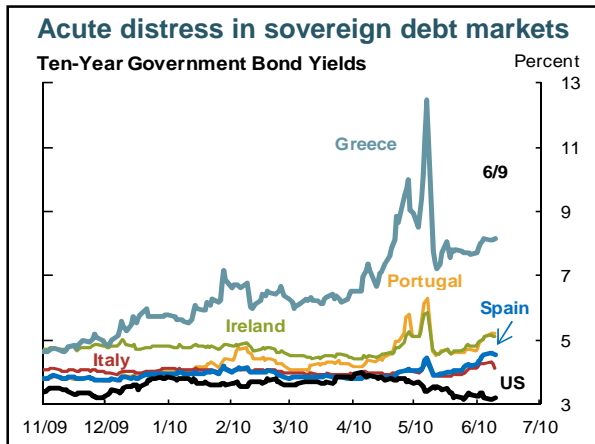
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*Bharat Trehan, research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook:*

- Despite concerns raised by the crisis in Europe and some recent data that came in below expectations, we continue to project a moderate recovery.
- Manufacturing continues to do well. Production jumped by 1 percent in April and is up 6 percent over the past 12 months. The latest employment report showed that manufacturers hired 29,000 workers last month and 126,000 since the beginning of the year.
- Real personal consumption expenditures were unchanged in April, following two months of growth at a 6 percent annual rate. The latest consumer confidence surveys, as well as vehicle sales data for May, suggest that consumption should keep growing at a moderate pace.
- Home sales have been strong recently, boosted by the imminent expiration of the home buyer tax credit. Other information on the construction sector is worse. The unemployment rate for construction workers is more than twice as high as the aggregate unemployment rate.
- The broader labor market remains sluggish. The unemployment rate fell from 9.9 percent to 9.7 in May, but it had already been at this level from January to March. The latest drop just reversed the April increase.
- Payroll employment rose by 431,000 in May, but this reflected the hiring of 411,000 temporary census workers. Private sector employment increased by just 41,000, substantially below financial market expectations. U.S. stocks fell sharply the day the May employment report was released. However, occasional low monthly employment growth rates in the middle of expansions are not uncommon.

- The stock market's extreme reaction to the employment data is an indication of the nervousness that prevails in the wake of the European debt crisis, though volatility levels are not as high as when Lehman Brothers collapsed. The impact is most obvious in European stock markets.
- Financial stress is also very evident in the European sovereign debt markets, where credit spreads have widened for some countries. Greece has been the most affected, while Portugal, Ireland, Italy, and Spain have been less so. In contrast, U.S. interest rates have declined, symptomatic of investors' flight to quality.
- Large budget deficits are clearly an issue for many countries. But the United Kingdom and the United States have large deficits and markets do not think that these countries will default. Italy has the smallest deficit except for Germany, but markets still appear to be worried about an Italian default.
- Italy does have a large public debt though, which is about as large, relative to GDP, as Greece's. But, looking only at current and projected debt levels, it becomes hard to distinguish the countries that markets are worried about from the countries markets are not worried about.
- History may matter as well. Data compiled by two prominent researchers show that the countries of most concern are those that have defaulted more frequently in the past. (See Carmen M. Reinhart and Kenneth Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009.) None of those defaults are recent, but there were defaults that occurred during the Great Depression. That is relevant to the present because the financial shocks of the past few years are among the biggest that have happened since that time. (For Germany, all but two defaults date from before its unification in 1871.)
- While there is some risk that Europe's sovereign debt crisis could get much worse, the most likely outcome is that it will not. In that case, its effects on the U.S. economy are likely to be small. U.S. bank exposure is relatively limited and trade with the Euro zone is small relative to U.S. GDP. As mentioned above, the crisis has pushed down U.S. interest rates, which will help the U.S. economy.
- Thus, we continue to expect that the economy will grow at a moderate pace and that inflation will remain contained.





### Seems history matters as well

#### Defaults (and reschedulings) since 1800 or year of independence to 2008

Country	Share of years in default	Total number of defaults
Greece	50.6	5
Portugal	10.6	6
Italy	3.4	1
Spain	23.7	13
France	0.0	0
Germany	13.0	8
United Kingdom	0.0	0
United States	0.0	0

Reinhart and Rogoff (2009)

