Economic Update

Port Finance Seminar

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The World Economy: Is the Risk of a Boom-Bust Rising?

As the U.S. Economy Slows, Will Other Regions Pick Up the Slack?

What Happens to U.S. Trade as a Result?
Is the Risk of a Global Boom-Bust Rising?

- 2006 will be the third year of above-trend global growth
- U.S. growth will be strong in the first half – how much of a housing-induced slowdown in the second half?
- European and Japanese growth have rebounded – but for how long?
- There appears to be no slowing yet in China’s boom
- Record or near-record commodity prices are helping many emerging markets
Growth in the World Economy: 3.7% in 2006

(Percent change)

Real GDP  Industrial Production
Signs of Stress?

- Core inflation is edging up
- Bond markets are getting a little more jittery
- Crude oil prices keep getting hit by shocks and new fears
- Stock markets in the Middle East have plummeted, despite the continued high oil prices
- While a repeat of the Emerging Markets crisis of the 1990s seems unlikely, many economies are vulnerable to high interest rates in the G-7 countries and a drop in commodities prices
As the U.S. Slows, Will Others Pick Up the Slack?

- U.S. consumer spending is likely to slow as the housing market cools – the only question is how much
- Consumer spending in Japan is showing signs of life...
- ...However, European consumers remain very cautious
- While consumer spending in China and India will eventually rival that of the U.S., it will take years before the “baton is passed” to these emerging giants
Real GDP Growth Is Still Uneven Across the World
## World Real GDP Growth Contributions

<table>
<thead>
<tr>
<th>Region</th>
<th>Percent of World Growth, 2000–05</th>
<th>Percent of World GDP in US$, 2005</th>
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</thead>
<tbody>
<tr>
<td>Asia-Pacific</td>
<td>37</td>
<td>24</td>
</tr>
<tr>
<td>China</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>India</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Japan</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>United States</td>
<td>29</td>
<td>28</td>
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<tr>
<td>Western Europe</td>
<td>15</td>
<td>30</td>
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</tbody>
</table>
United States – At a Crossroads?

- Big uncertainties for the United States
  - How much will core inflation rise?
  - How bad will the housing slump be?

  The rise in U.S. interest rates will be determined by the answer to these questions

- Strong productivity gains and Federal Reserve Board vigilance will keep inflation under control

- Good news: Robust capital spending (thanks to very strong corporate profits) and exports (thanks to a weaker dollar and a strengthening world economy) will offset weaker growth in U.S. consumer spending and housing

- Risk: Will protectionist pressures get worse as the economy slows? (DP World P&O Ports deal was not a good sign)
United States

(Percent)

Real GDP Growth

Inflation

Real Exchange Rate*

Current Account Balance**

*FRB broad index, March 1973=100
**Billions of U.S. dollars
The U.S. Trade Deficit is a Result of Imbalanced U.S. Trade though the Problem is Two-way

- The U.S. is dependent on lending from foreigners to finance its record trade deficit
- Trading partners are dependent on the U.S. consumer for the demand to keep them employed
- The global trade imbalance requires a global solution:
  - Higher U.S. savings, including federal deficit reduction and a cooling of housing and consumer markets
  - Faster domestic growth in Western Europe and Asia
  - U.S. dollar depreciation; Asian currency appreciation
- A further dollar slide of 10% is expected, with as much as 30% possible, promoting U.S. exports and dampening U.S. import demand, though over several years
Eurozone – How Long Will the Rebound Last?

• Good news: Capital spending and exports have strengthened while inflation remains tame

• Key uncertainty: When will consumer spending pick up?

• European business confidence remains much stronger than consumer confidence

• Business surveys are stronger than the hard data

• Headwinds
  • Rising interest rates
  • An even stronger euro
  • Tighter fiscal policy
  • Political turmoil and paralysis
Eurozone

(Percent)

Real GDP Growth

Exchange Rate per US$*

Inflation

Current Account Balance**

*Year-end
**Billions of U.S. dollars
Real GDP Growth Rates Vary Across Europe

(Percent change)

France  Germany  Italy  Spain  U.K.

2004  2005  2006  2007

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Japan – Good Progress, But Many Challenges Lie Ahead

- Corporate and financial restructuring has come a long way – but the adjustment is still incomplete
- A more pro-active monetary policy is bringing an end to the era of deflation
- The growth rebound has been broad-based
- Challenges
  - A stronger yen
  - Higher interest rates
  - Tighter fiscal policy
Japan

(Percent)

Real GDP Growth

Inflation

Exchange Rate per US$

Current Account Balance

*Year-end
**Billions of U.S. dollars
Asia will remain a powerhouse of global growth in 2006, with only a modest deceleration.

Momentum is shifting from exports to domestic demand, resulting in more-balanced growth – although growth is still too export-dependent.

Central banks are gradually raising interest rates to counter inflationary pressures, but policies remain accommodative and inflation remains under 4% in most Asian economies.

High saving rates relative to investment rates mean that these economies will continue to be capital exporters (i.e. to the U.S.).

Exchange rates across Asia will rise as part of a global trade adjustment.
Asia-Pacific’s Key Economies

- China’s rapid growth will eventually decelerate as the government curbs excessive state investment
- India will maintain high growth, led by its software, biotech, and business and financial services industries
- South Korea’s economy is accelerating as consumer spending rebounds and capital investment strengthens
- A gradual slowdown in exports to the U.S. and China will temper growth in Taiwan and Hong Kong
Real GDP Growth in Asian Economies

(Percent change)

- China
- South Korea
- India
- Taiwan
- Hong Kong

- 2004
- 2005
- 2006
- 2007
China as a Global Economic Power

• China’s rapid, sustained expansion has been driven by exports and investment

• Growth will moderate as investment and exports decelerate, while imports accelerate and consumer spending picks up moderately

• Price controls in the energy sector have created inefficiencies and excess investment in energy-intensive industries

• Under the new 2005 managed float, the renminbi will appreciate modestly and gradually, by about 3–5% annually

• Concern remains with what happens with the growing incompatibility between China’s closed and rigid political system and its increasingly market-oriented economic system
China

(Percent)

Real GDP Growth

Inflation

Exchange Rate per US$*

Current Account Balance**

*Year-end
**Billions of U.S. dollars
India Will Sustain 6–7% Real GDP Growth

- Economic reforms are slowly gaining momentum, opening the economy to more trade and foreign investment.
- Information technology services, pharmaceuticals, business outsourcing, and financial services are driving export growth, leveraging India’s strengths in engineering and analytically skilled workers.
- India’s population of 1.1 billion is growing 1.5% annually.
- But India is still a relatively closed economy with high tariffs, non-tariff barriers, a overbearing bureaucracy, inadequate infrastructure, and a big fiscal deficit.
India

Real GDP Growth

Inflation

Exchange Rate per US$*

Current Account Balance**

*Year-end
**Billions of U.S. dollars
Other Emerging Markets Are Still Growing

(Real GDP, percent change)

- Central Europe & Balkans
- Commonwealth of Indep. States
- Middle East & Africa
- Latin America & Caribbean

Latin America Is Growing, But Risks Are High

- A growing world economy, competitive currencies, and high commodity prices are supporting Latin American growth, but a retreat from market reforms of the 1990s dims longer-term prospects.

- Mexico’s economy has rebounded, but progress on structural reforms has been slow and transition to the new President adds uncertainty.

- In Brazil, corruption scandals weaken the ruling party, while high interest rates are restraining growth.

- Argentina’s economy has rebounded strongly, but production bottlenecks are fueling double-digit inflation.

- In Venezuela, the oil export windfall has enabled President Chavez to increase public spending, but macroeconomic imbalances are accumulating under price and exchange rate controls.

- Chile’s growth will be supported by high copper prices, a favorable investment climate, and fiscal surpluses.
U.S. Trade Outlook
U.S. Merchandise Trade Outlook Reflects the Impact of Exchange Rates, Business & Consumer Spending

(Real Value of All Goods Trade, Year-over-year percent change)

Source: Global Insight U.S. Macroeconomic Forecasting Service
Ocean Container Trade Volume Will Continue to Grow Faster than the World Economy

2006:
- GDP: 3.7%
- TEUs: 8.2%

Source: Global Insight World Service and World Trade Service
Our forecast of U.S. container port traffic, done for the Supply Chain Council of the National Retail Federation and as published monthly in *Port Tracker*, is for no congestion for the next six months at any of the key U.S. container ports.

There will be continued challenges to system performance due to continued volume growth, especially from Asia.

There are continued concerns with the tight conditions in the rail system and ongoing challenges for trucking.

The industry should be able to repeat the overall success of the 2005 and keep any terminal and network congestion that develops to a minimum through continued refinement to operations and continued vigilance over performance.
Import Volumes Build Towards a New Record Peak

East Coast Total Import Volume

Source: Port Tracker
Bottom Line

- There is a growing risk of a boom-bust at the global level.
- While in the near term Japanese and European growth has picked up, they don’t replace the U.S. and China as the primary growth engines.
- Emerging markets are benefiting from global growth, but are increasingly vulnerable to higher interest rates and lower commodity prices.
- U.S. maritime trade growth this year will be stronger than last year, with export growth faster than import growth.
Thank You

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