

The Global Recession and the End of the Commodity Bubble

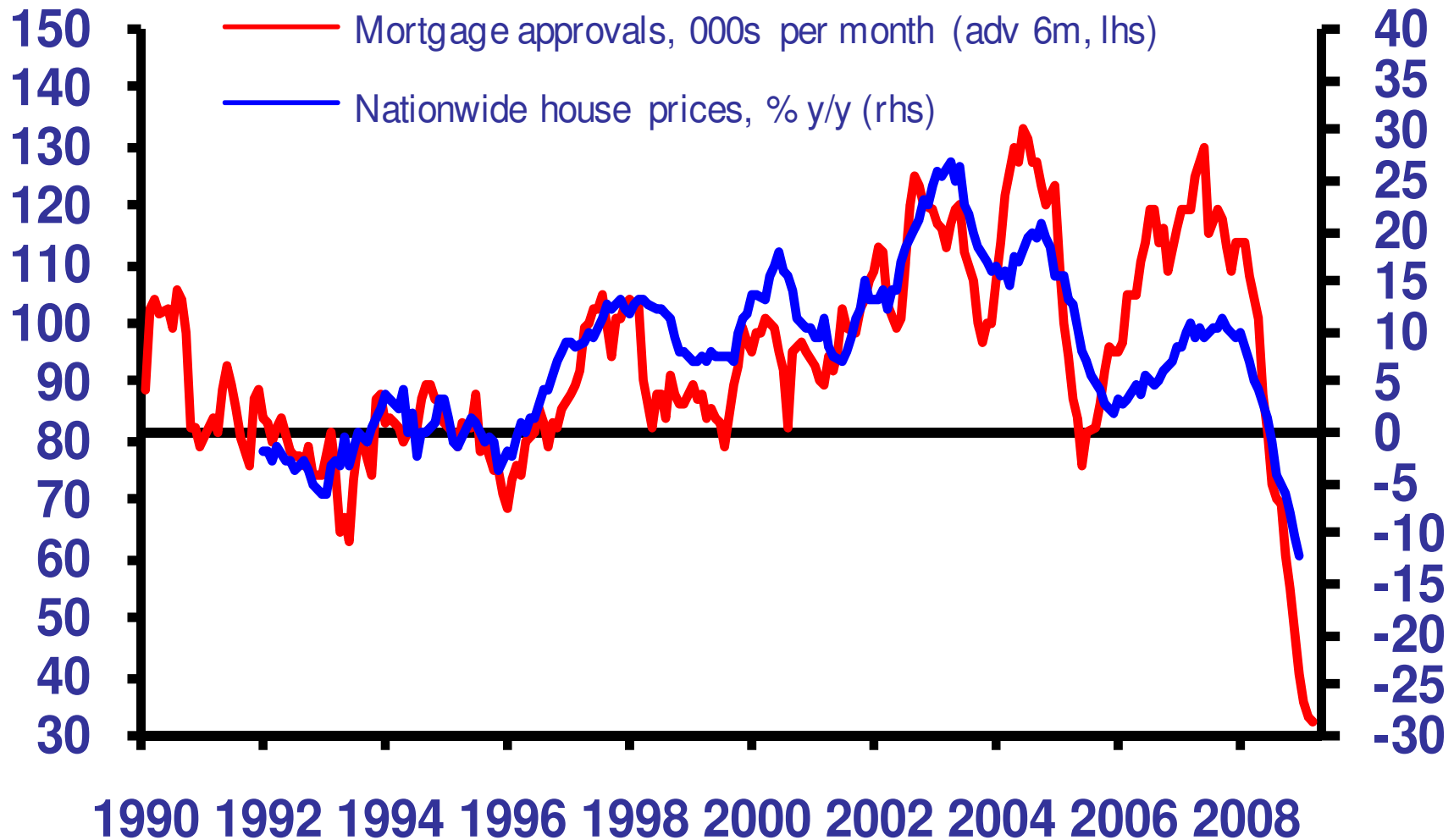
By Julian Jessop



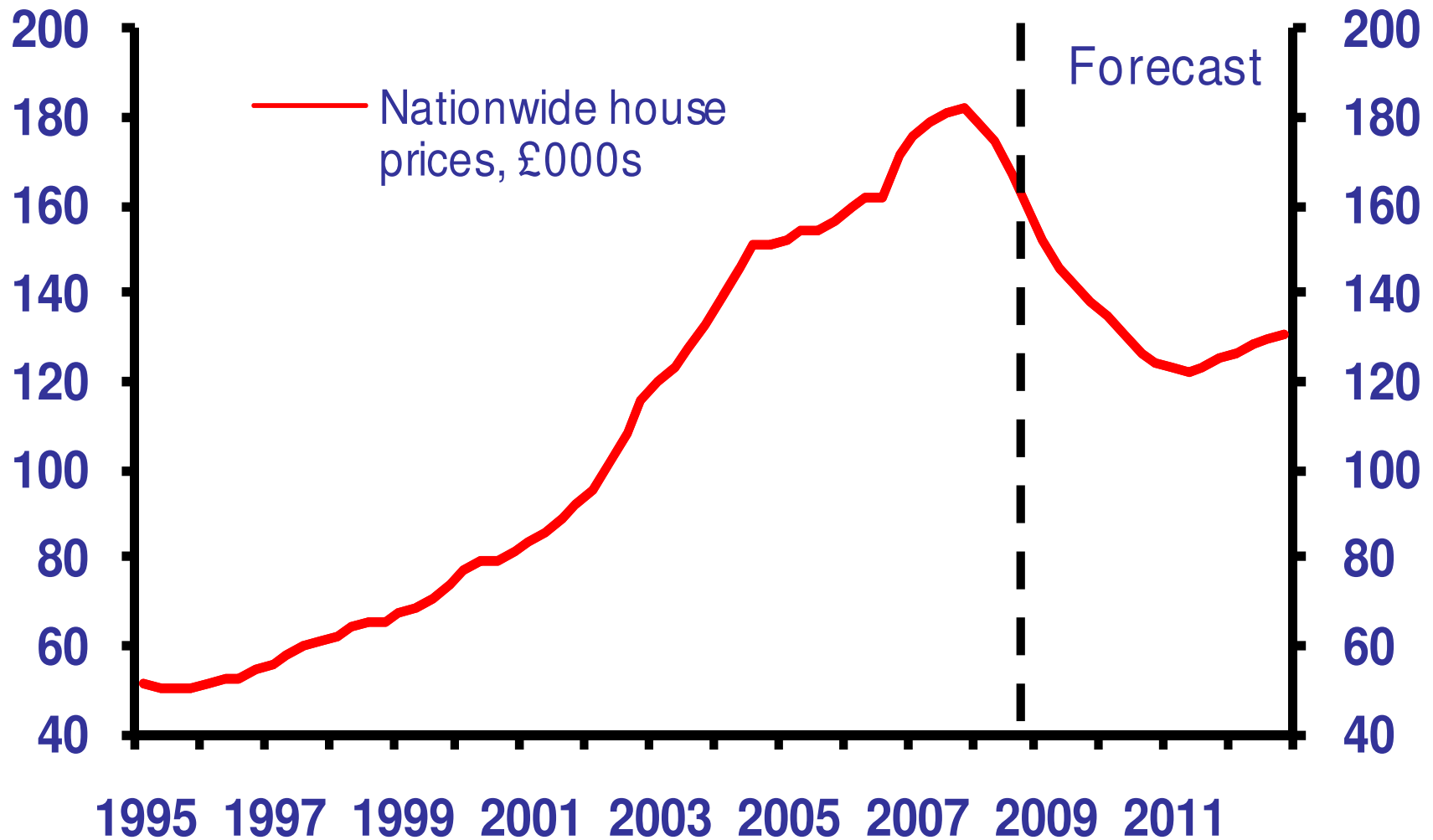
1. Plan of My Talk

- **The end of the bubble in house prices.**
- **The credit crunch.**
- **What the recession will look like.**
- **The end of the bubble in commodity prices.**
- **The outlook for inflation and interest rates.**
- **Risks and uncertainties.**

2. UK Mortgage Approvals and House Prices (1990 – 2008) (Latest = September)

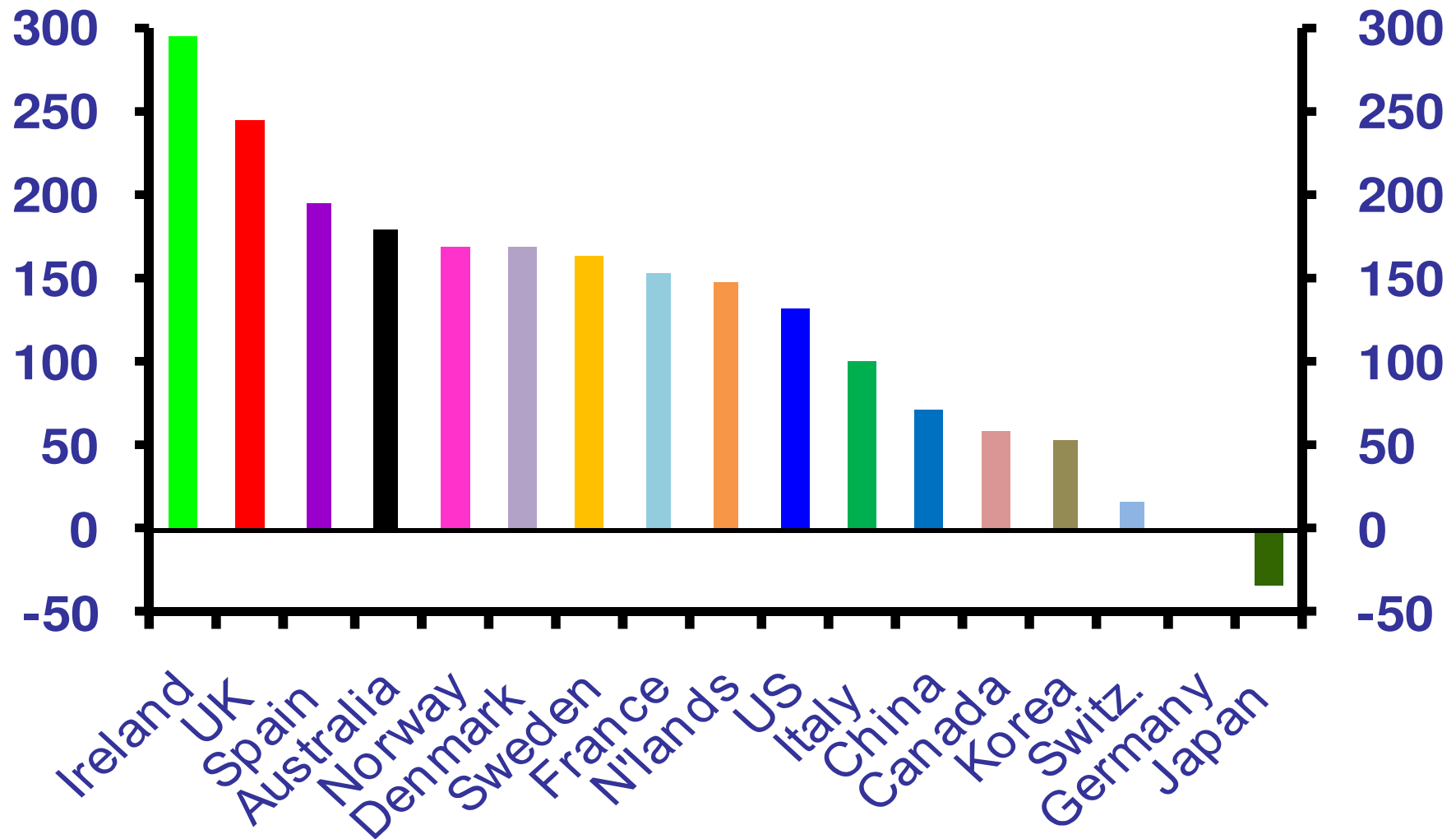


3. UK Nationwide House Prices (1995 – 2012) (Latest = August)



Sources: Thomson Datastream and Capital Economics

4. Cumulative Rise in Average House Prices (1997 to the Peak) (%)



5. Price Falls Needed to Return House Price to Income Ratios to Their Long-Run Average (%)

	Total	Falls to date	Yet to come?
Spain	42	7	37
Ireland	42	11	35
Netherlands	42	0	42
Australia	39	0	39
UK	35	13	25
France	32	0	32
Denmark	28	4	25
Italy	27	0	27
US	26	18	10
Norway	24	0	24
Sweden	23	0	23
Canada	14	0	14

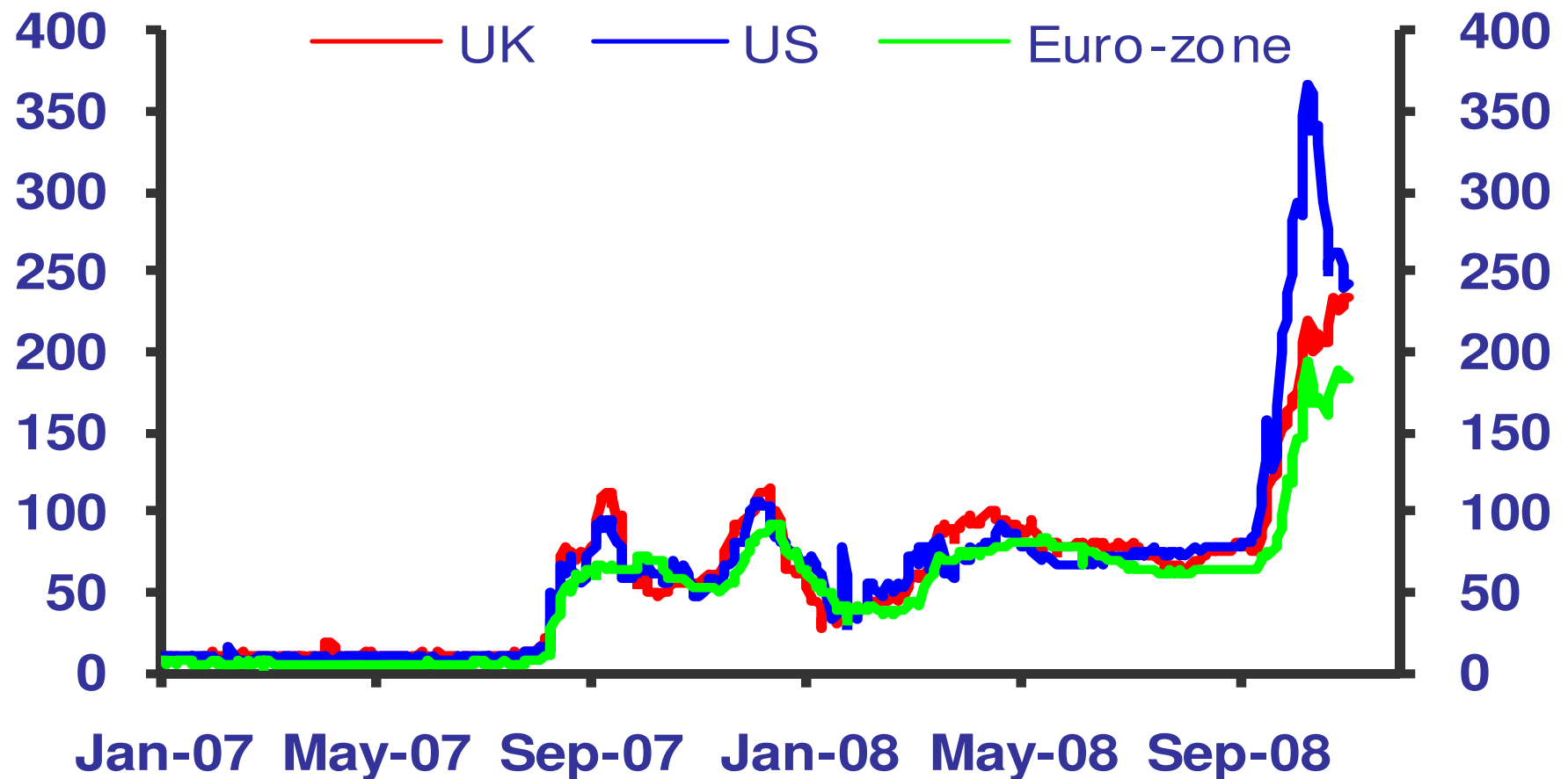


Sources: Thomson Datastream and Capital Economics

6. Housing Conclusions

- **House price corrections in the US and UK have further to run.**
- **Asia may not suffer. But across continental Europe, house price falls of at least 20% to 30% look the most likely outcome.**
- **Several reasons to be worried:**
 - Direct impact on spending;**
 - Wealth destruction, need to rebuild savings;**
 - Further losses for the banks.**

7. 3 Month Interbank Rates Minus 3 Month Overnight Interest Swap Rates (bps) (2007 – 2008) (Latest = 31 October)



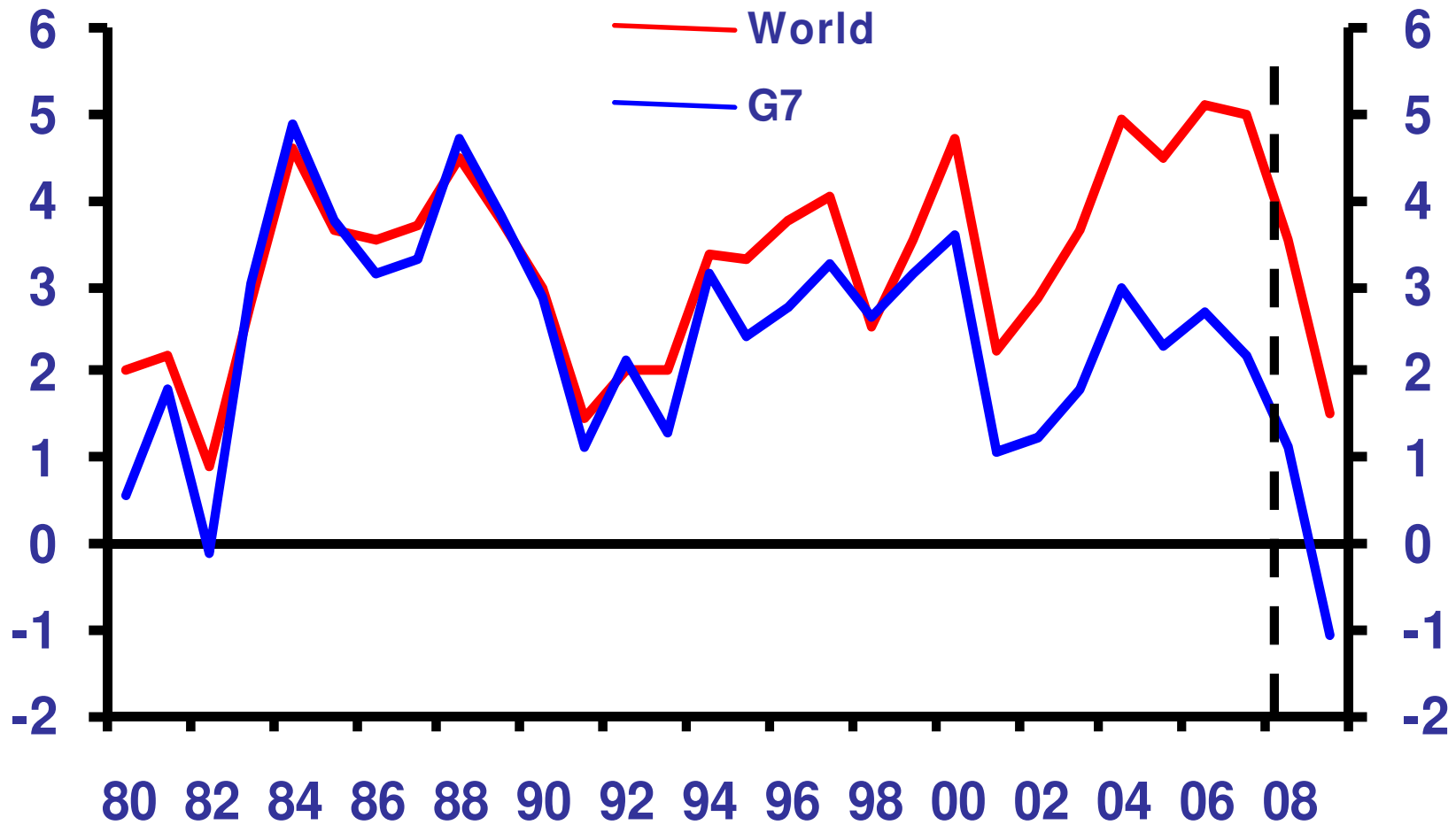
8. Bank Capital and Bank Lending

- **Capital raised from the market and from bailouts is enough to offset losses so far ...**
- **... but falling property values, shrinking profits, recession and rising unemployment mean there are further large losses to come.**
- **Bank lending to contract by 10% in the US and UK, and stagnate at best in the euro-zone.**

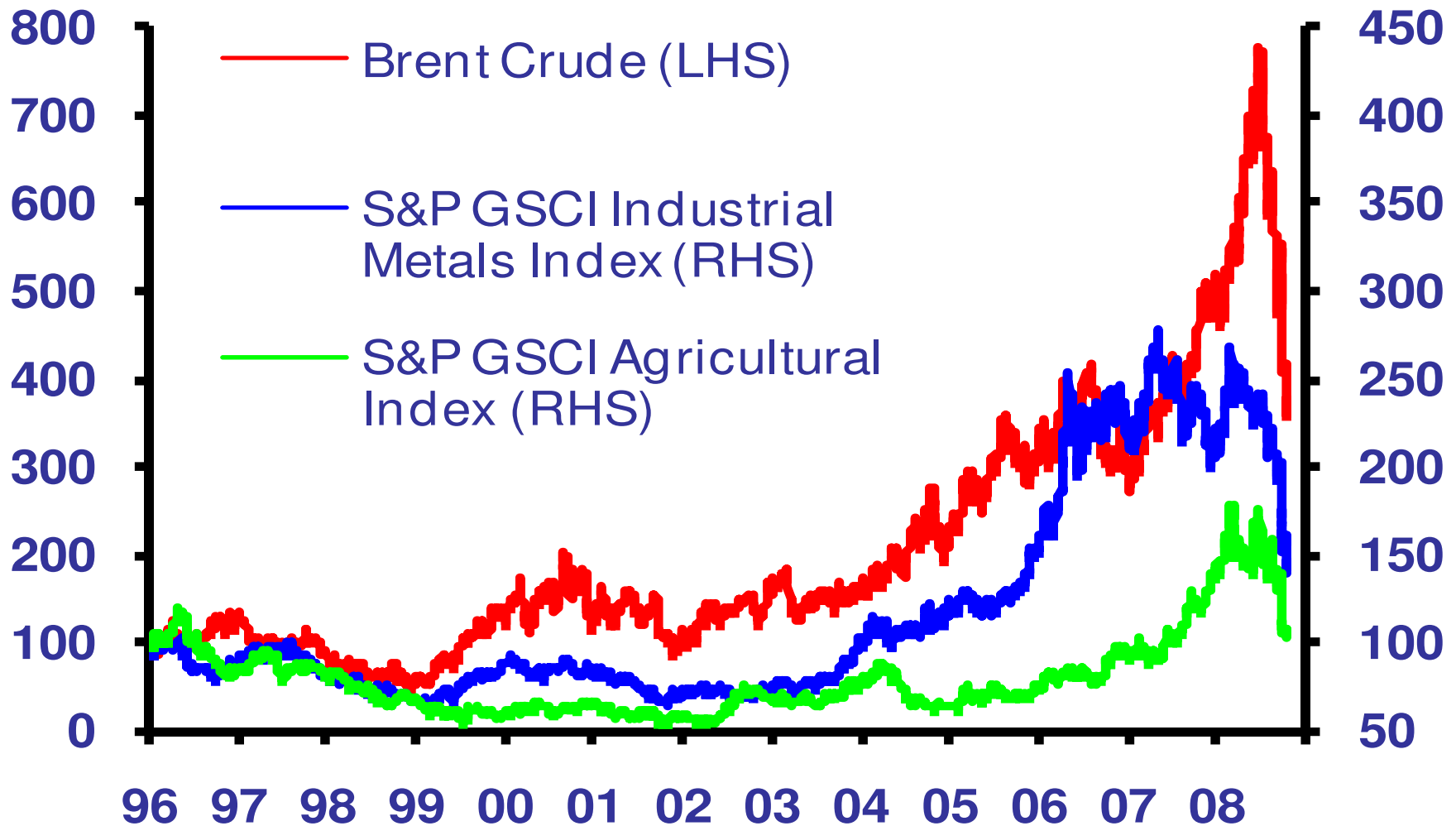
9. Capital Economics GDP Growth Forecasts (% Annual)

	2008	2009	2010
US	1.4	-1.5	0.0
UK	1.0	-1.5	-1.0
Euro-zone	1.2	-1.0	0.5
Japan	0.3	-0.2	1.1

10. Annual GDP Growth (%) (1980 - 2009)



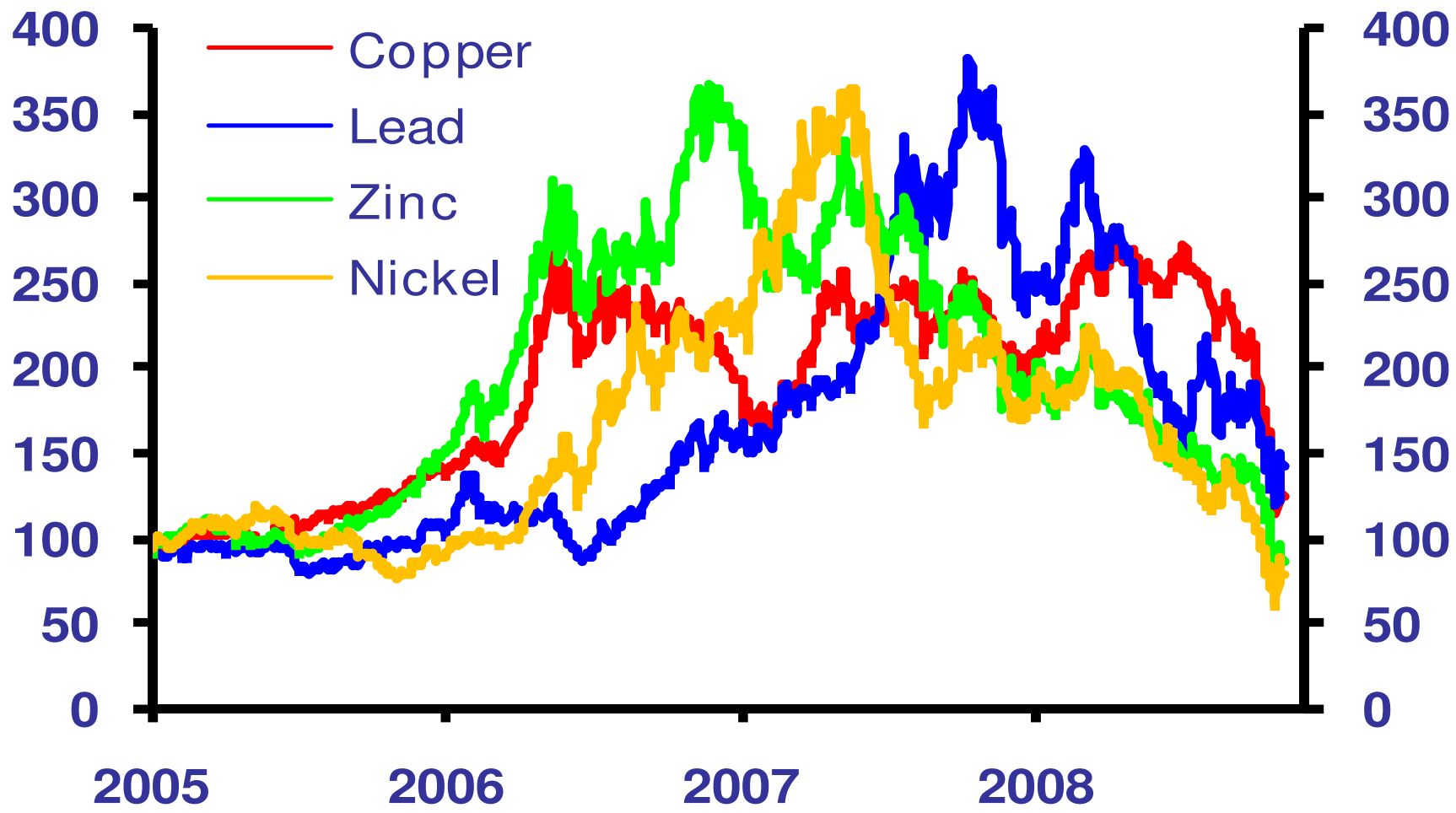
11. Commodity Price Indices (1996 = 100) (\$ Terms) (Latest = 3 November)



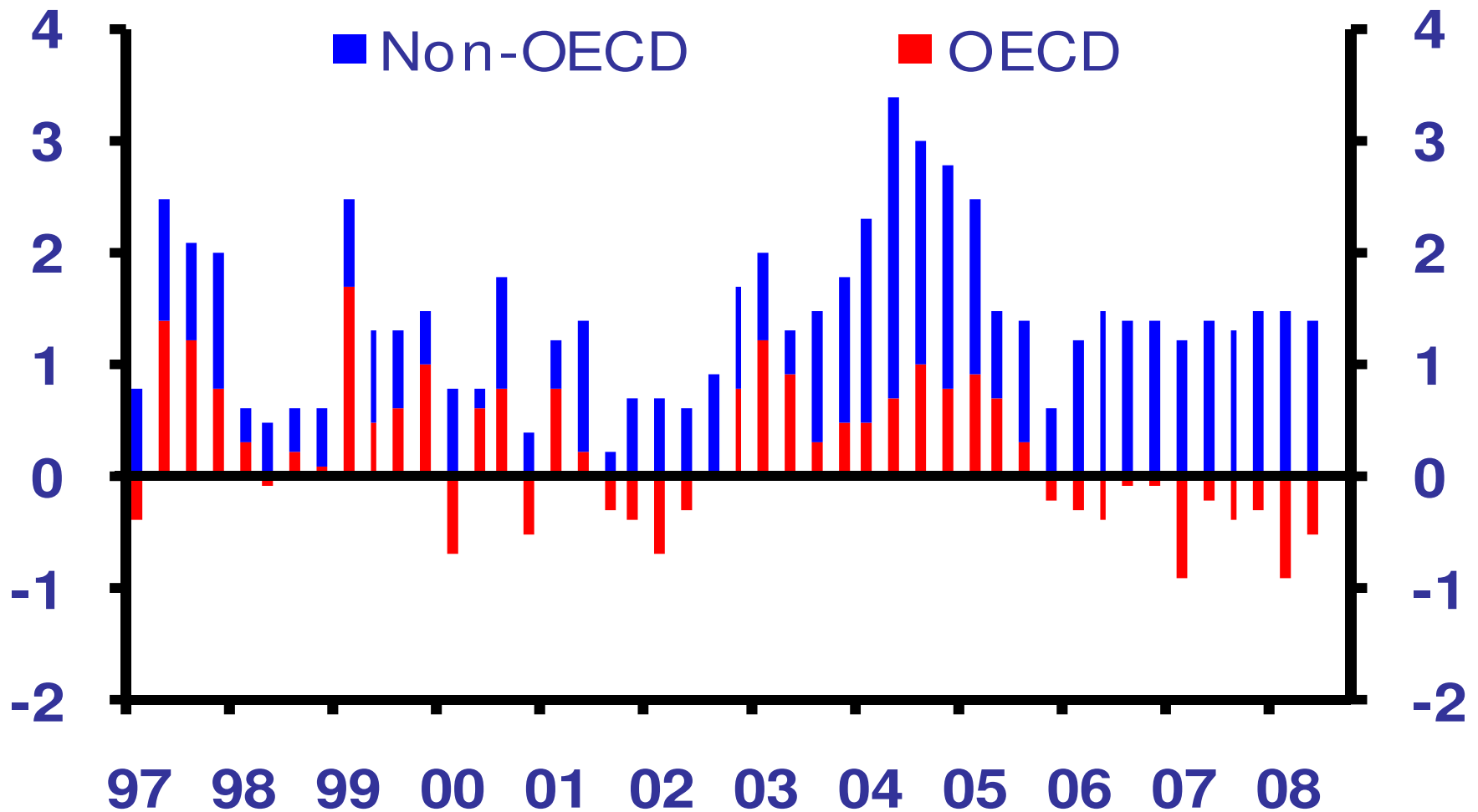
12. Bullish Arguments for Commodities

- **Strong growth in final demand especially from developing countries.**
- **Reduced capacity of supply to respond. This reflects a range of constraints, including**
 - **previous years of under-investment;**
 - **finite natural resources (oil, land, water);**
 - **limited scope for further productivity improvements (especially in agriculture);**
 - **increased frequency of supply shocks (due to global warming and geopolitical risks).**

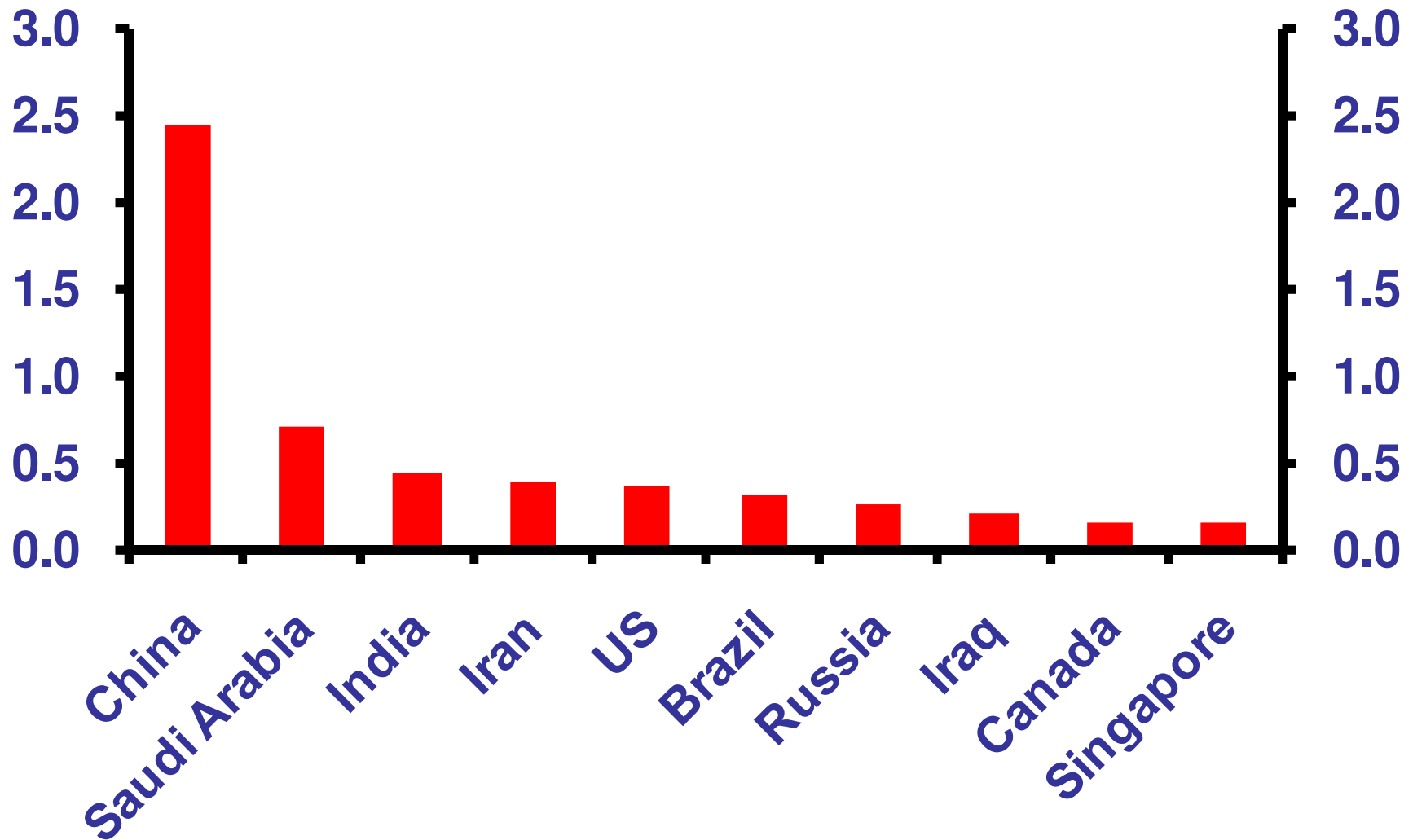
13. Metal Prices (Jan 2005 = 100) (2005 – 2008) (Latest = 3 November)



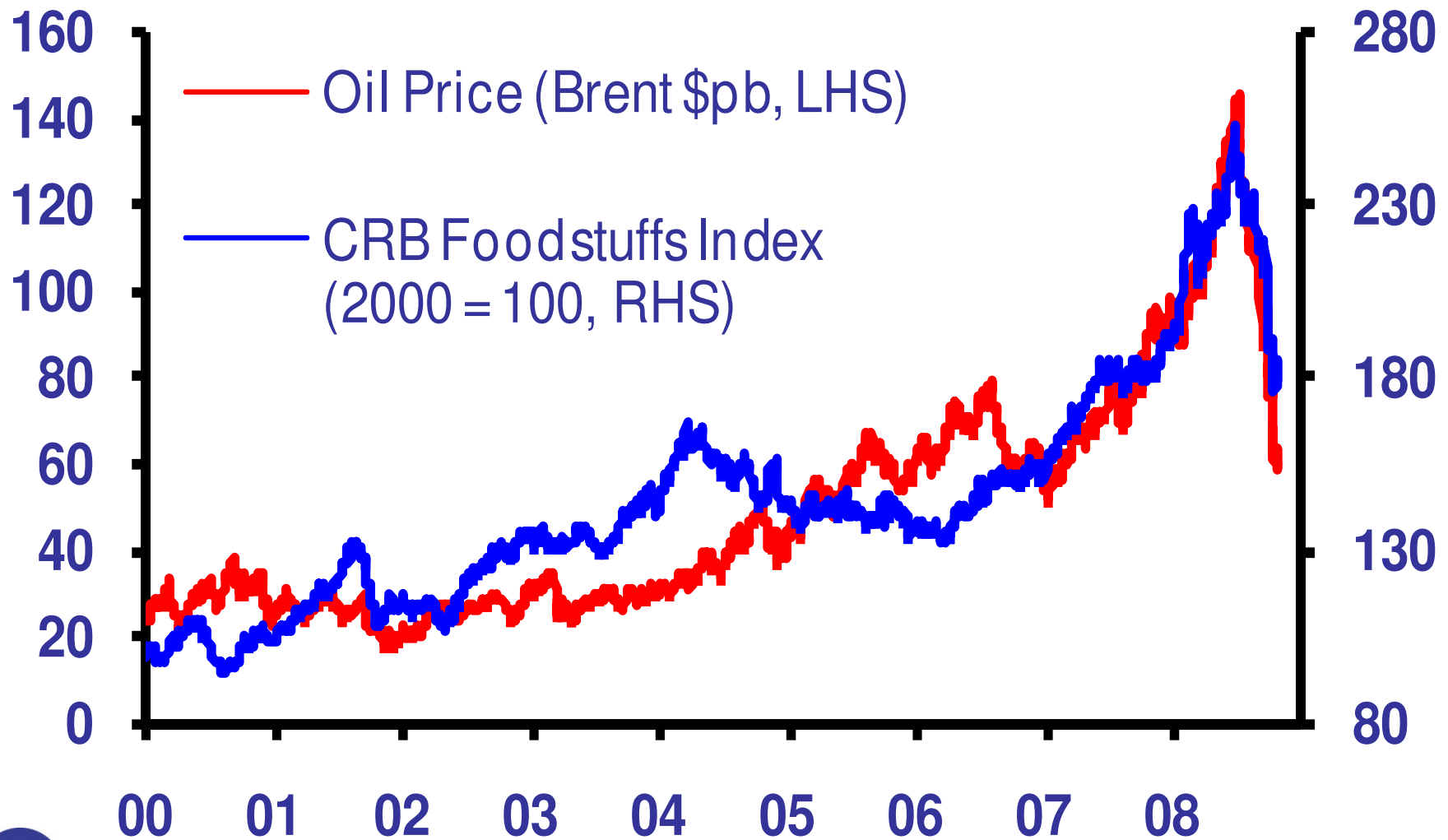
14 Change in Oil Demand (1997 – 2008 Q2) (Mn. Barrels Per Day, Change vs. Year Earlier)



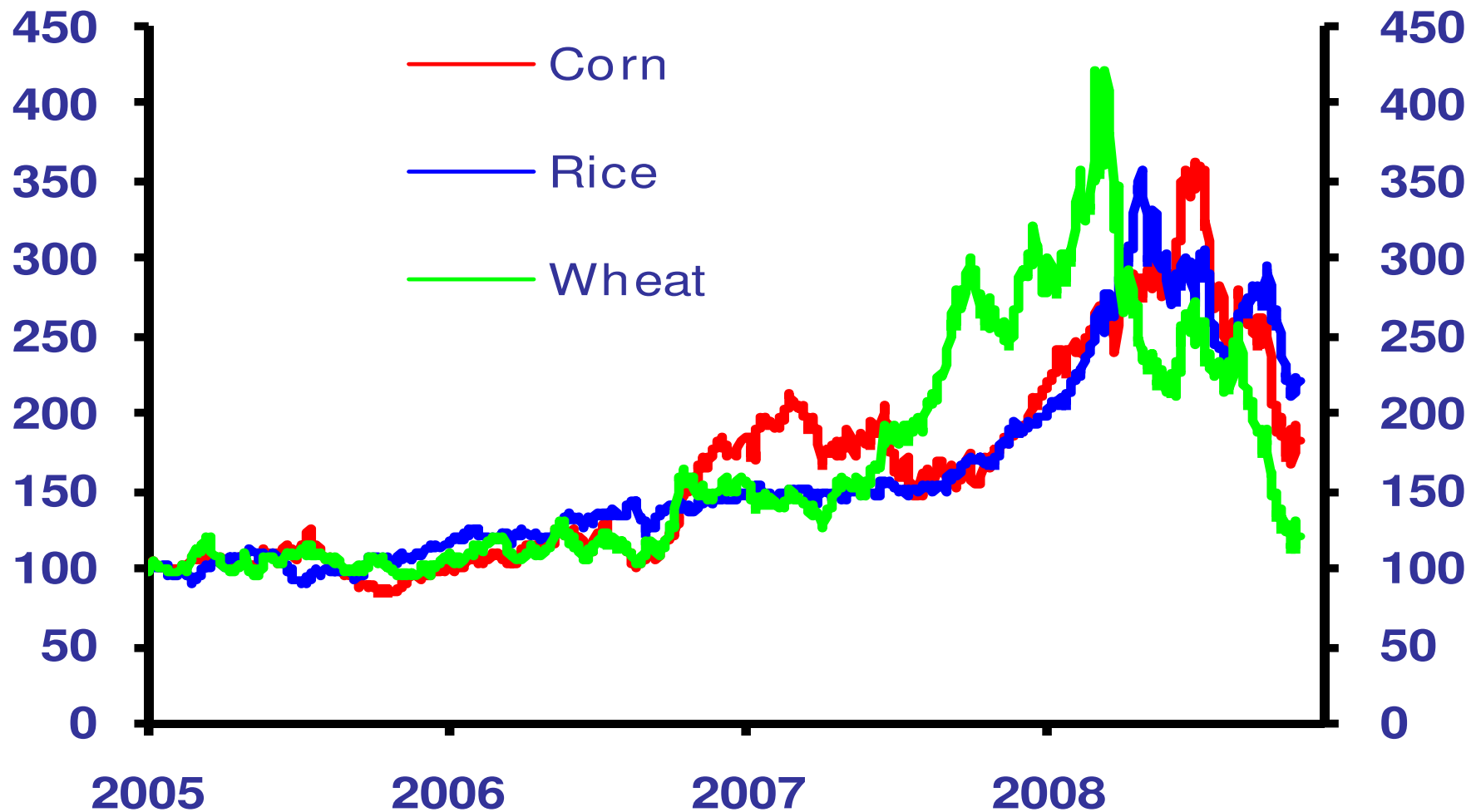
15. Annual Average Growth in Oil Consumption (2003 - 2008) (Mn. Barrels Per Day)



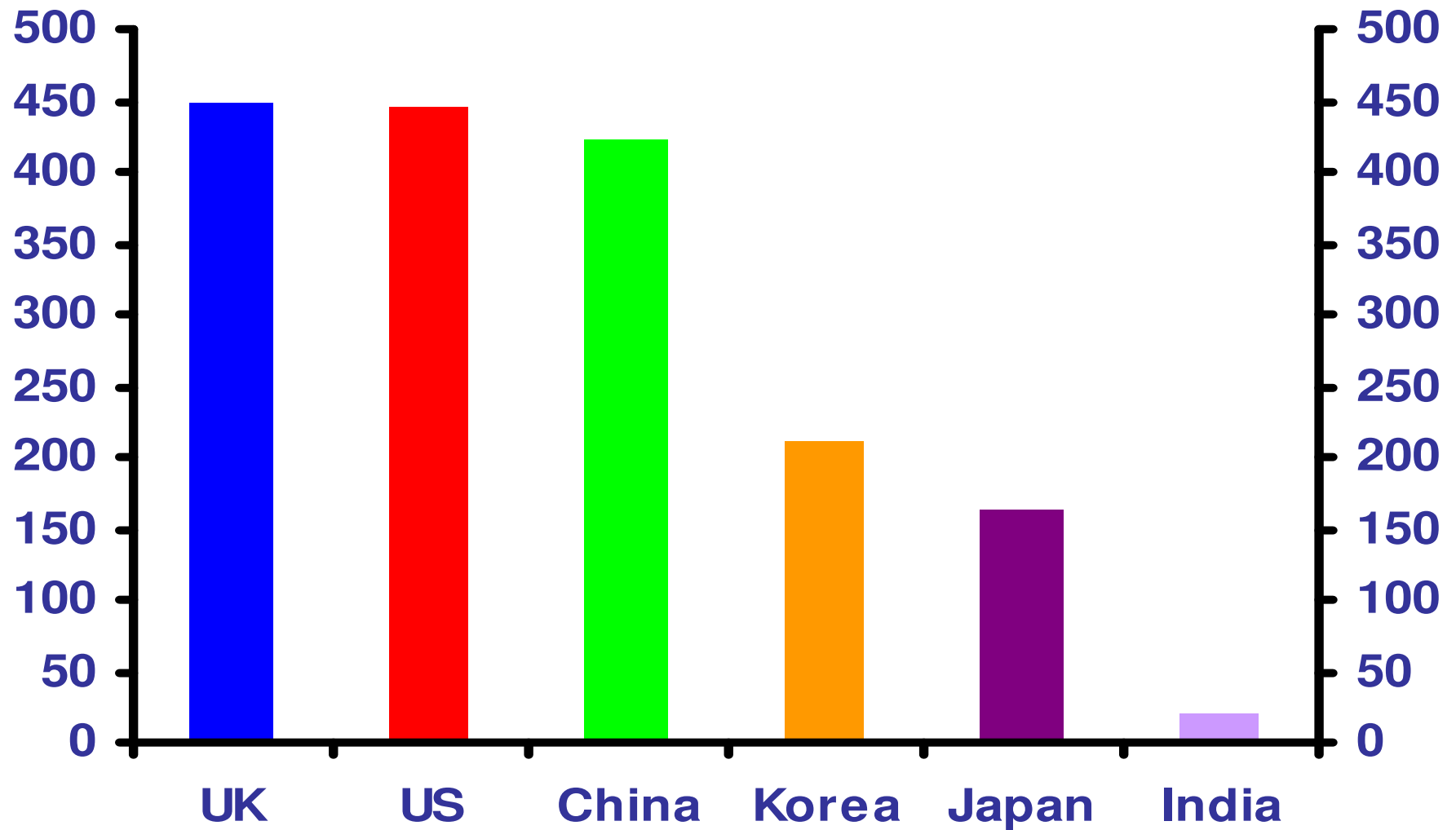
16. Oil & Agricultural Commodity Prices (2000 – 2008) (Latest = 3 November)



17. Agricultural Commodity Prices (Jan 05 = 100) (2005 – 2008) (Latest = 3 November)



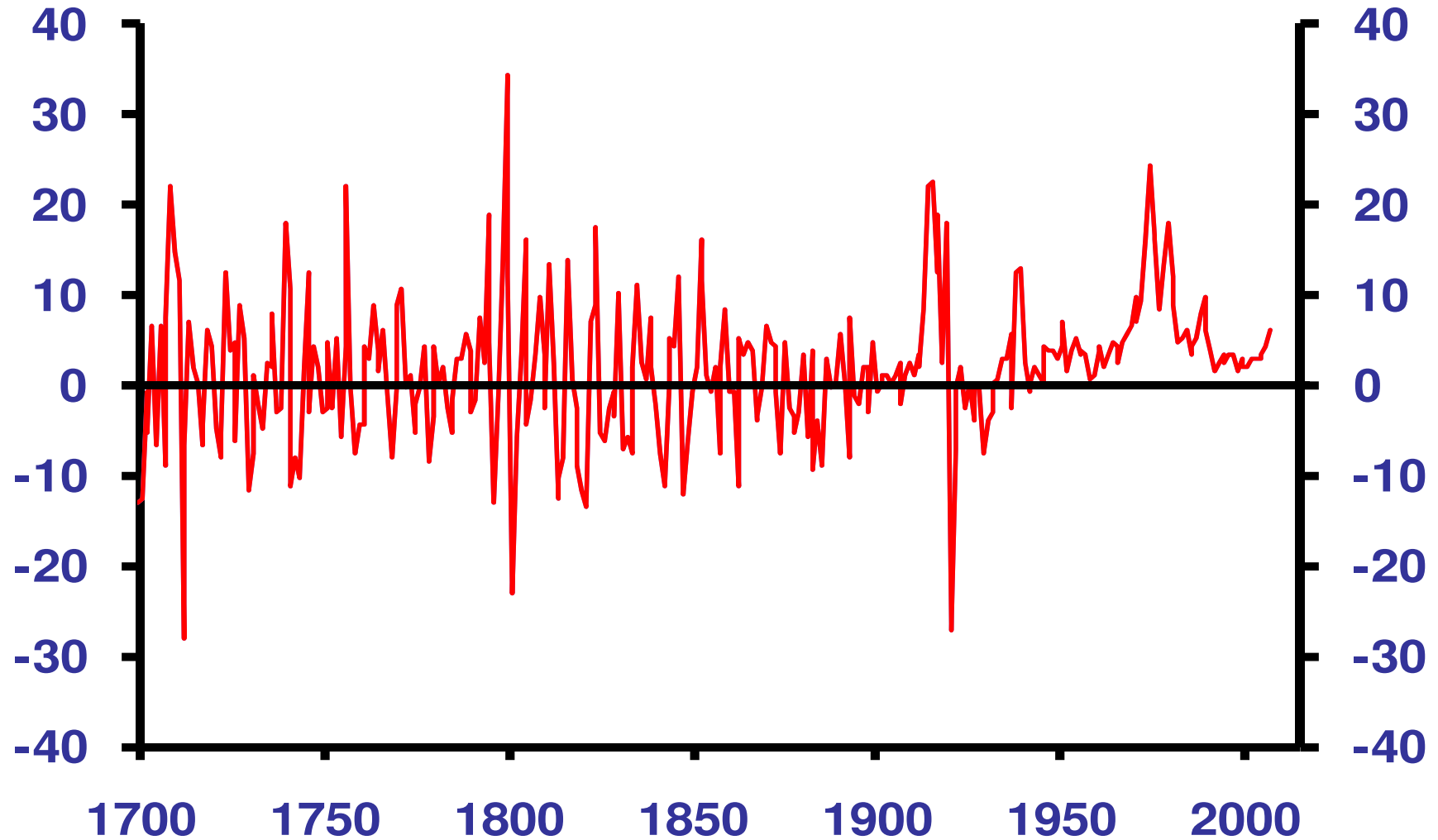
18. Per Capita Daily Calorie Intake of Meat (2001 – 2003)



19. Key Points on Commodities

- **Like most bubbles, the rise in commodity prices had some solid foundations ...**
- **... but then went too far.**
- **Demand and supply responses to bring commodities back down to earth now kicking in.**
- **Speculative and other financial factors also have part to play in both directions.**

20. UK Consumer Prices (% y/y) (1700 – 2008) (Latest = September)

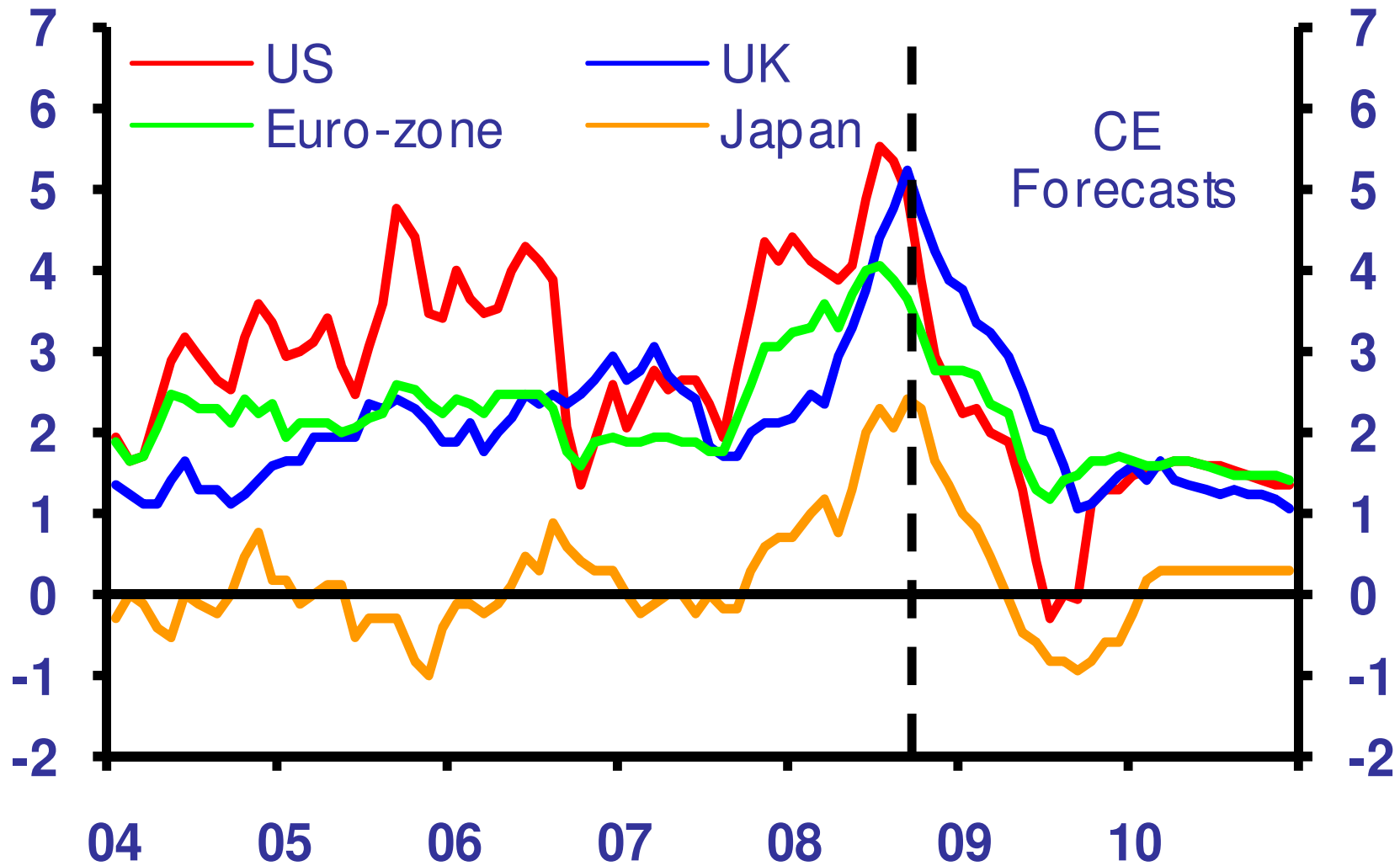


Sources: Global Financial Data and Thomson Datastream

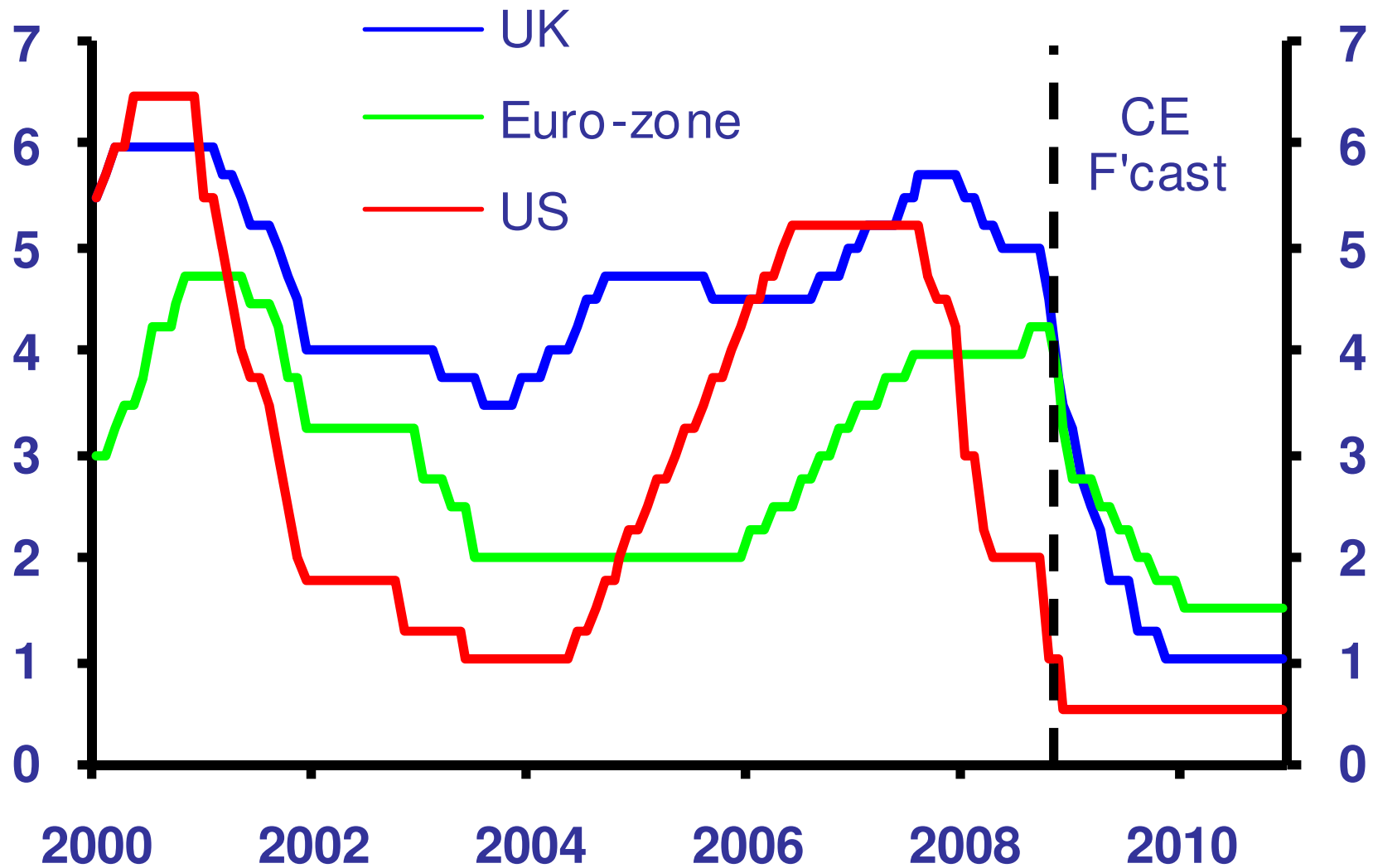
21. Prospects for Inflation

- **Core inflation excluding food and energy has remained subdued.**
- **Inflation expectations falling.**
- **Broad money and credit stagnant.**
- **Unemployment rising.**
- ***Deflation* is the greater threat.**

22. Inflation Forecasts (% y/y) (2004 - 2010)



23. Interest Rate Forecasts (%) (2000 – 2010)



24. Risks and Uncertainties

- **Protectionism – here and in developing world.**
- **Geopolitical risks – breakup of the euro-zone?**
- **Debt-deflation spirals.**
- **Pensions crises.**
- **To end on a positive – we may underestimate the effectiveness of policy stimulus.**

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