Looking for growth...

May 2013

THE BOSTON CONSULTING GROUP

The backdrop

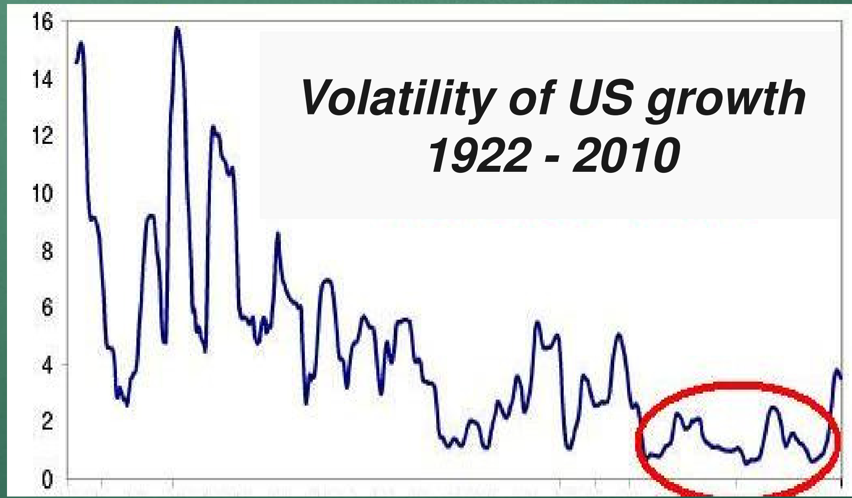
Great Moderation

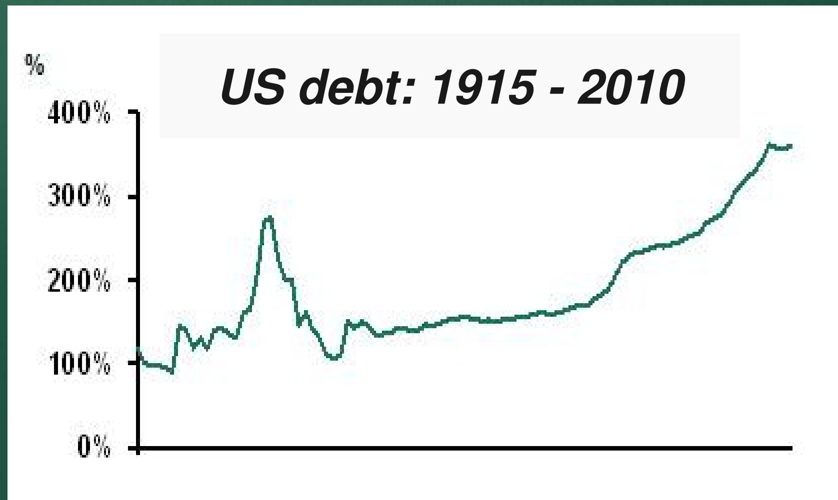
Great Disinflation

Great Roll Back of the State

Great leveraging

Great Globalisation

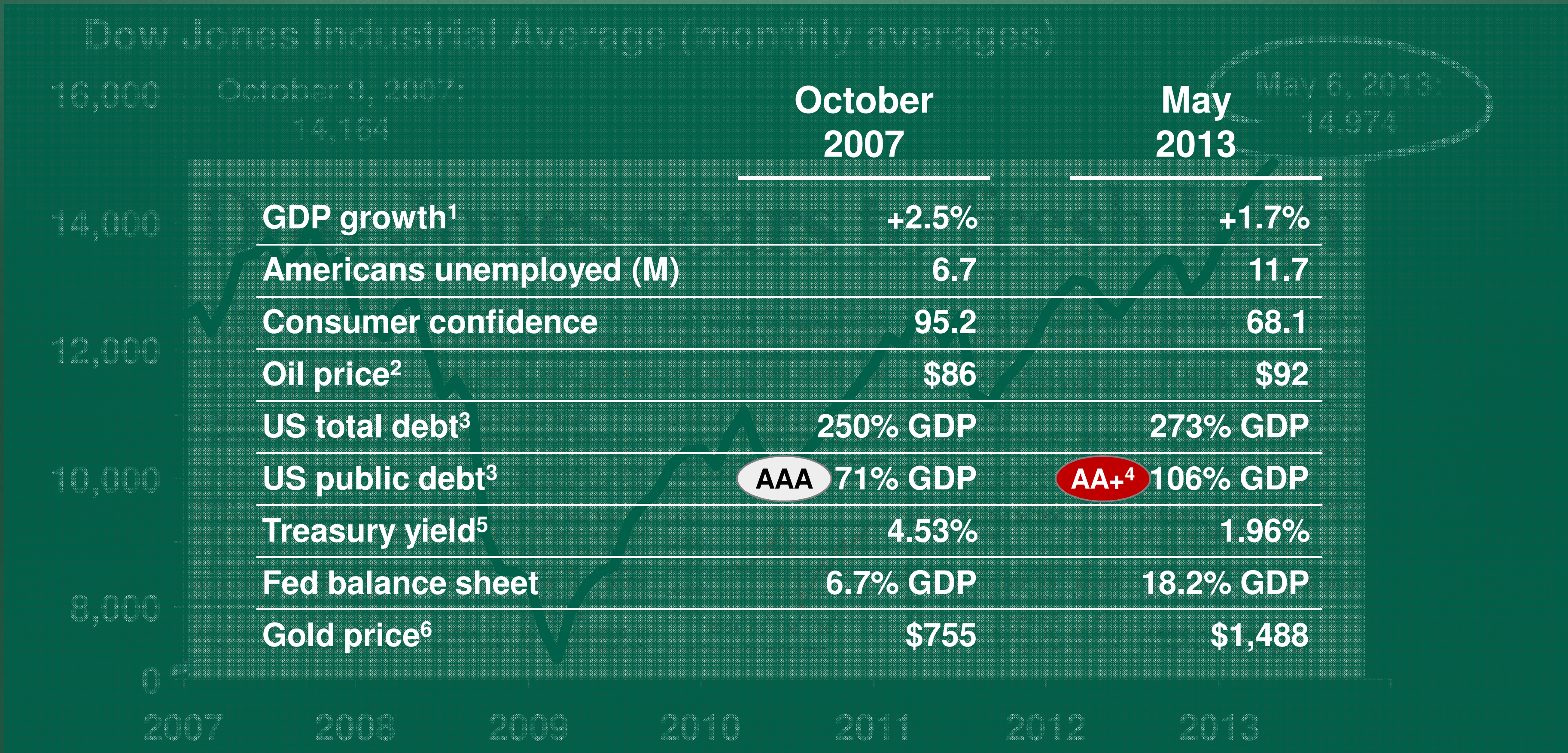




Dow Jones has reached a new peak

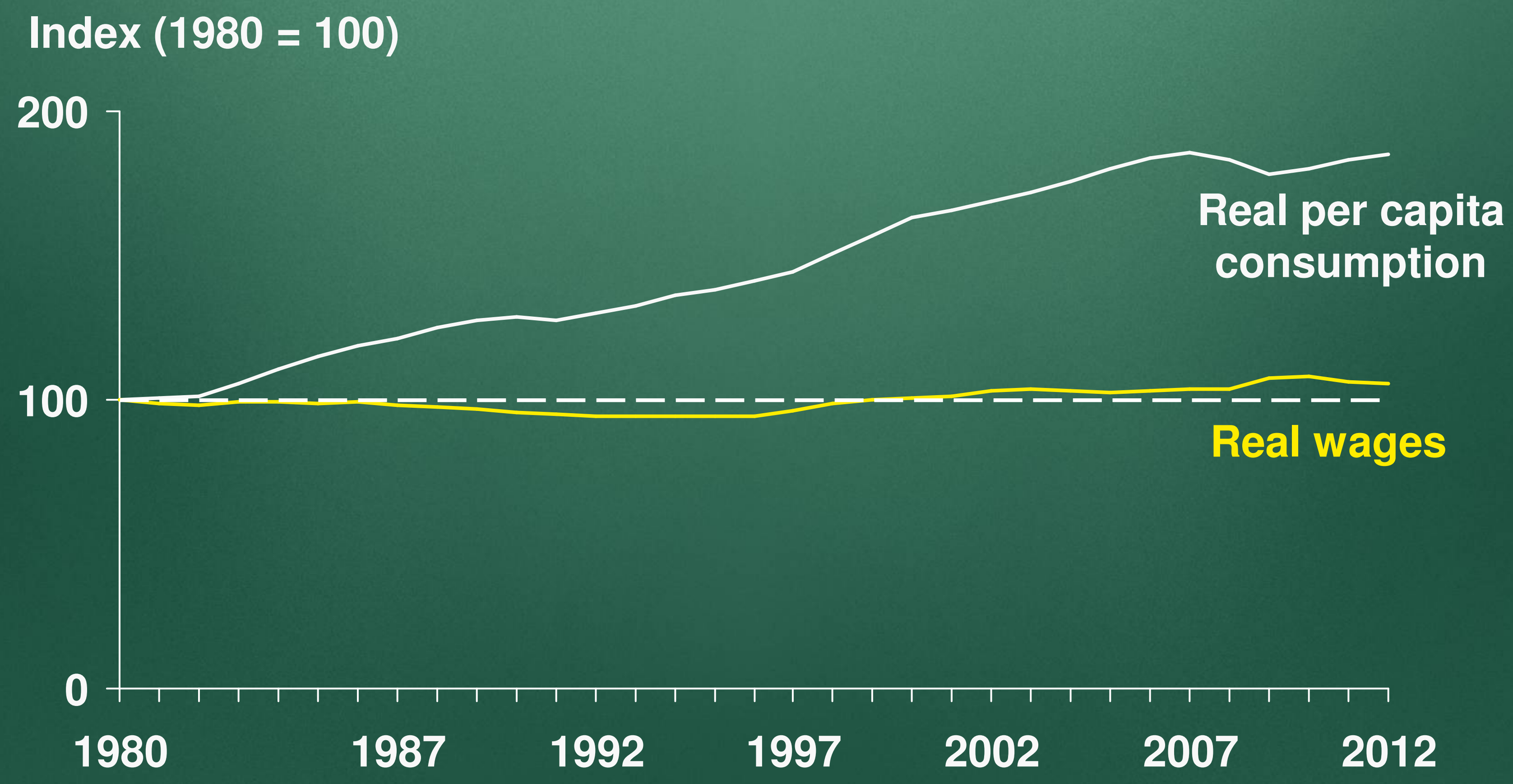
Dow Jones Industrial Average (monthly averages)

Dow Jones has reached a new peak, but ...



	October 2007	May 2013
GDP growth[1]	+2.5%	+1.7%
Americans unemployed (M)	6.7	11.7
Consumer confidence	95.2	68.1
Oil price[2]	$86	$92
US total debt[3]	250% GDP	273% GDP
US public debt[3]	AAA 71% GDP	AA+[4] 106% GDP
Treasury yield[5]	4.53%	1.96%
Fed balance sheet	6.7% GDP	18.2% GDP
Gold price[6]	$755	$1,488

The US boom was not built on strong foundations

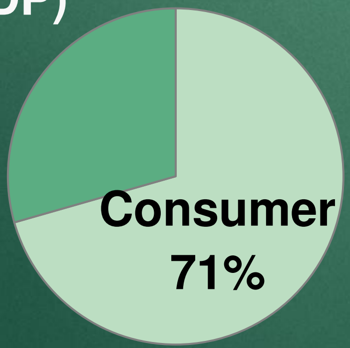


Source: EIU

Households saving and deleveraging

US economy is fuelled by consumption...

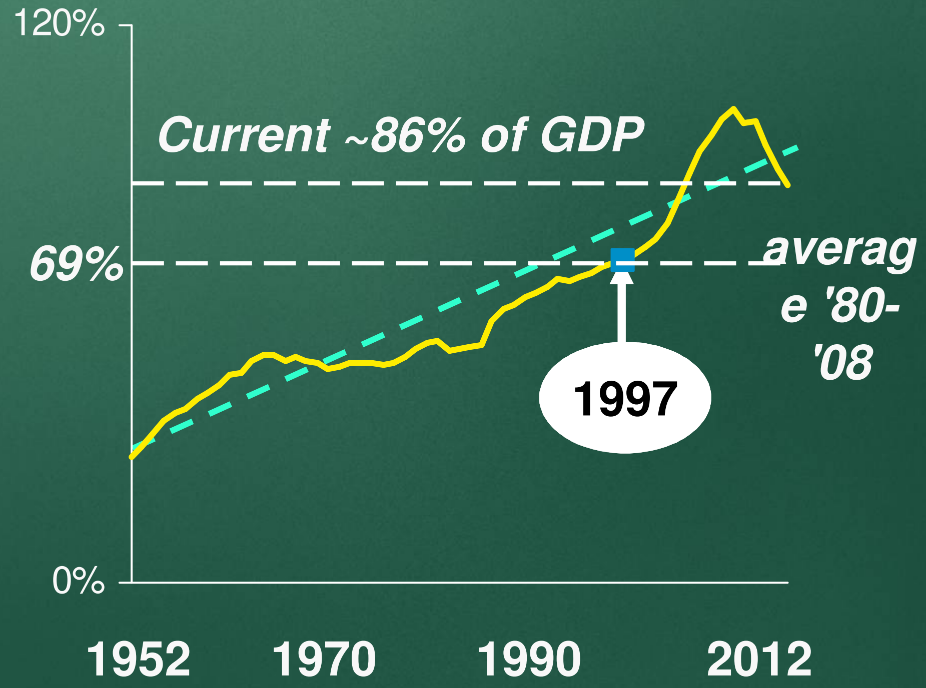
2012 (% GDP)



Personal savings rate: 1985 – 2012 (%)

... but now needs to deleverage

Historical household debt (% of GDP)

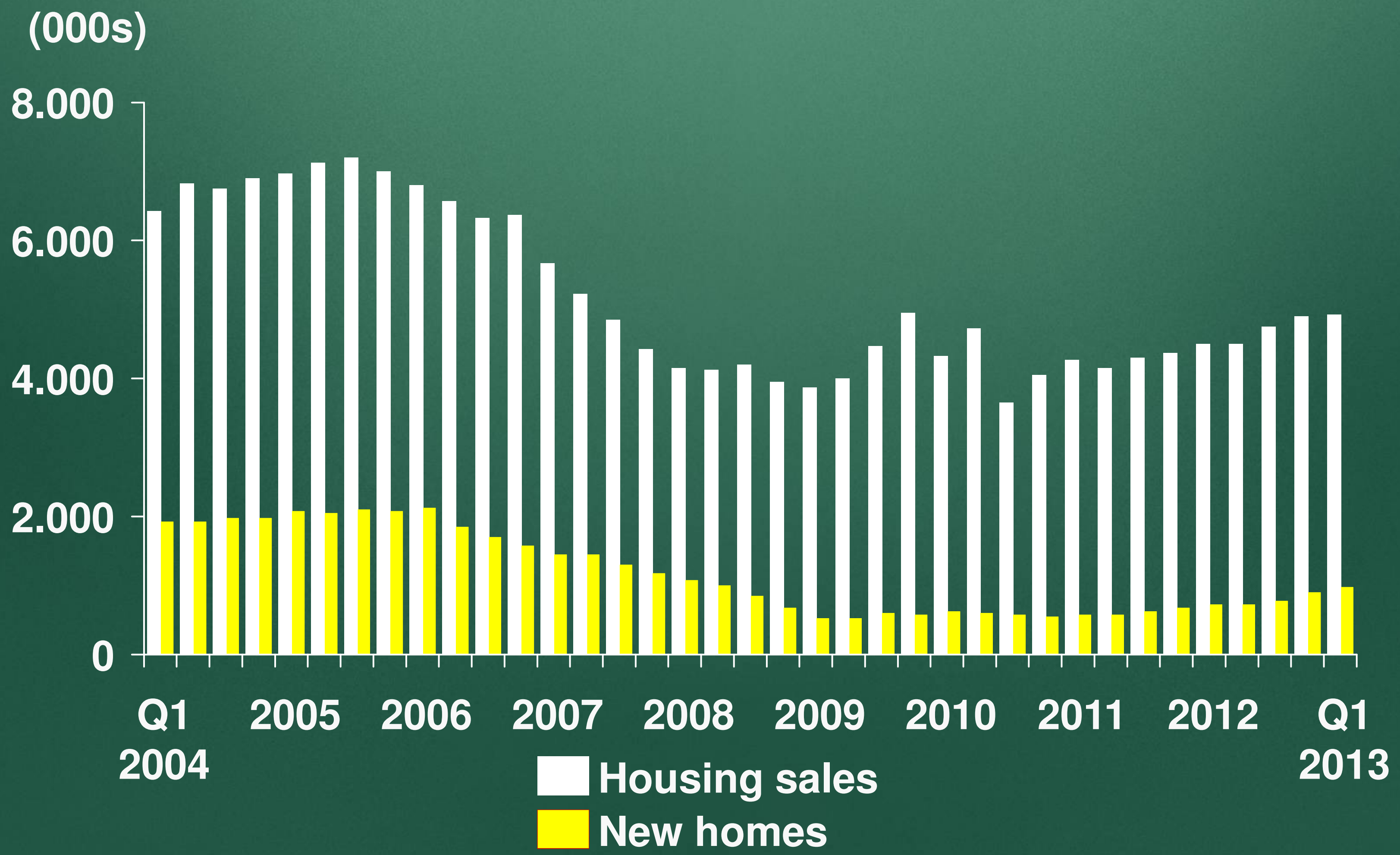


Source: EIU, Thomson Reuters Datastream (U.S. Bureau of Economic Analysis)

US house prices – lots of people still feel poorer

Source: The Schiller Index

US housing starts and homes sales still well below pre-crisis levels

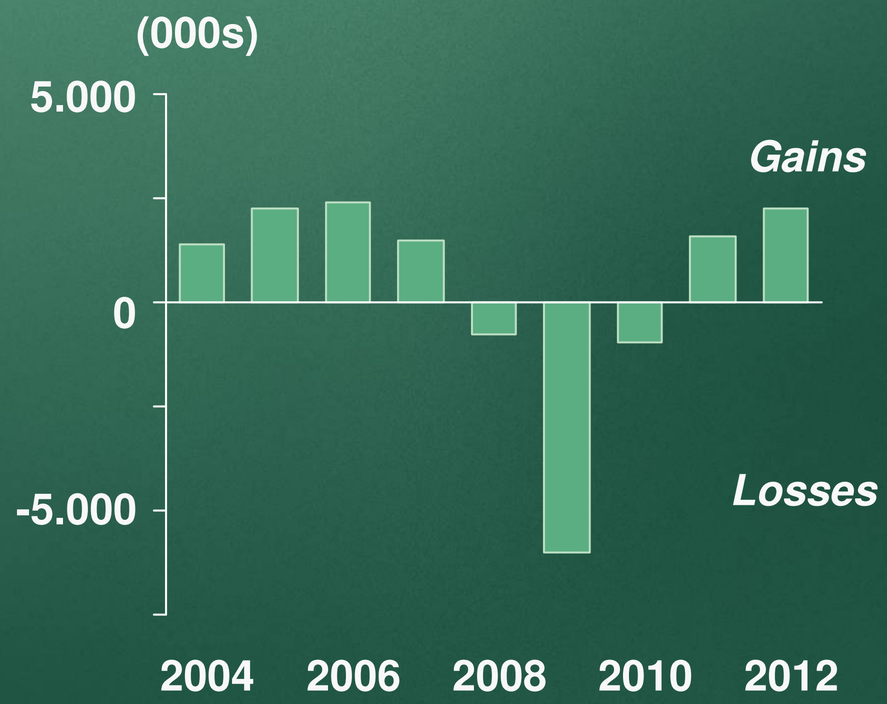


Source: Thomson Reuters Datastream (U.S. Census Bureau, National Association of Realtors)

Confidence still low, but job some creation

Consumer Confidence has not recovered

Yearly changes in US employment



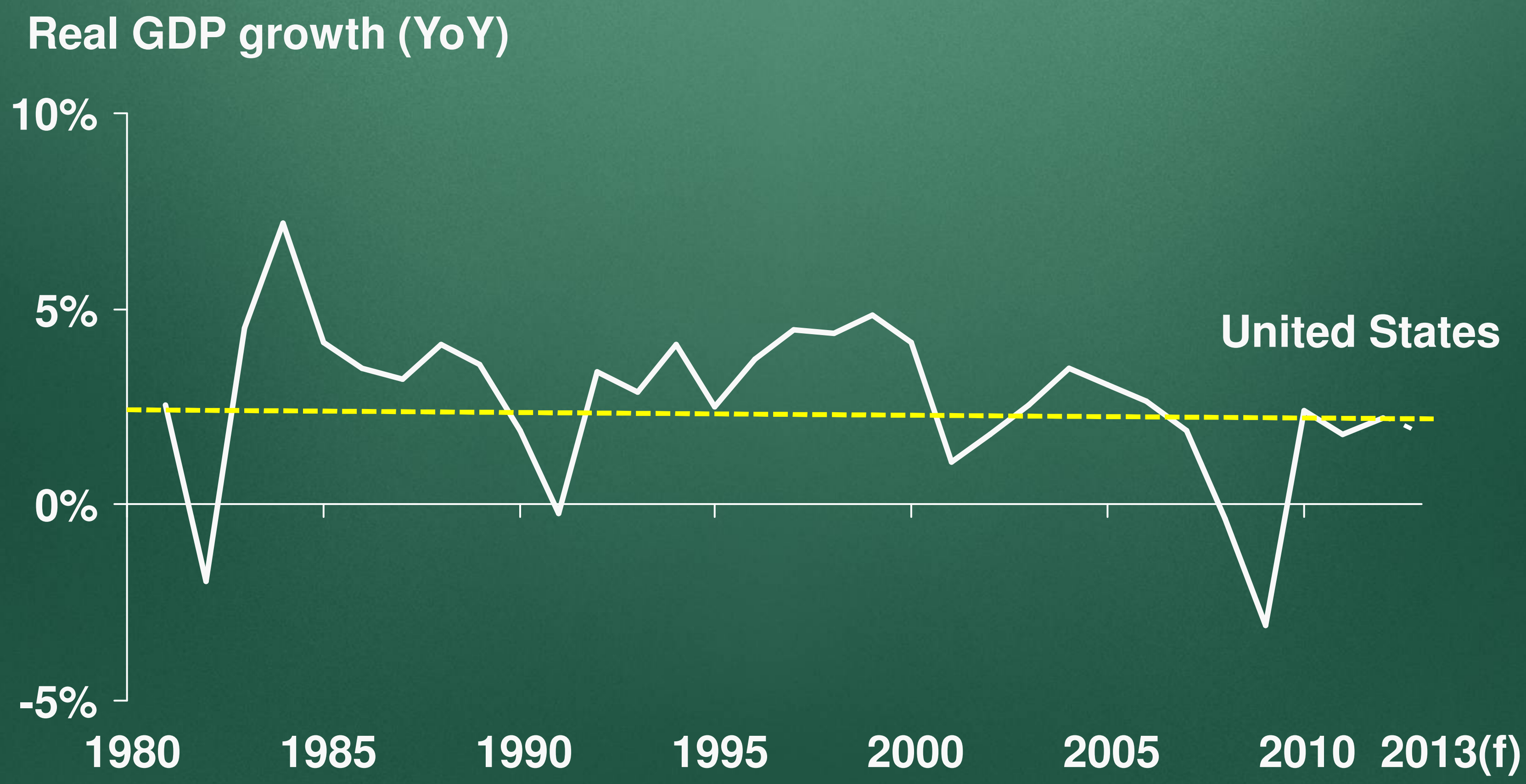
Source: Thomson Reuters Datastream (The Conference Board, U.S. Bureau of Labor Statistics)

And recent retail data has been encouraging

US retail sales and car sales per capita (indexed to Jan 2007 = 100)

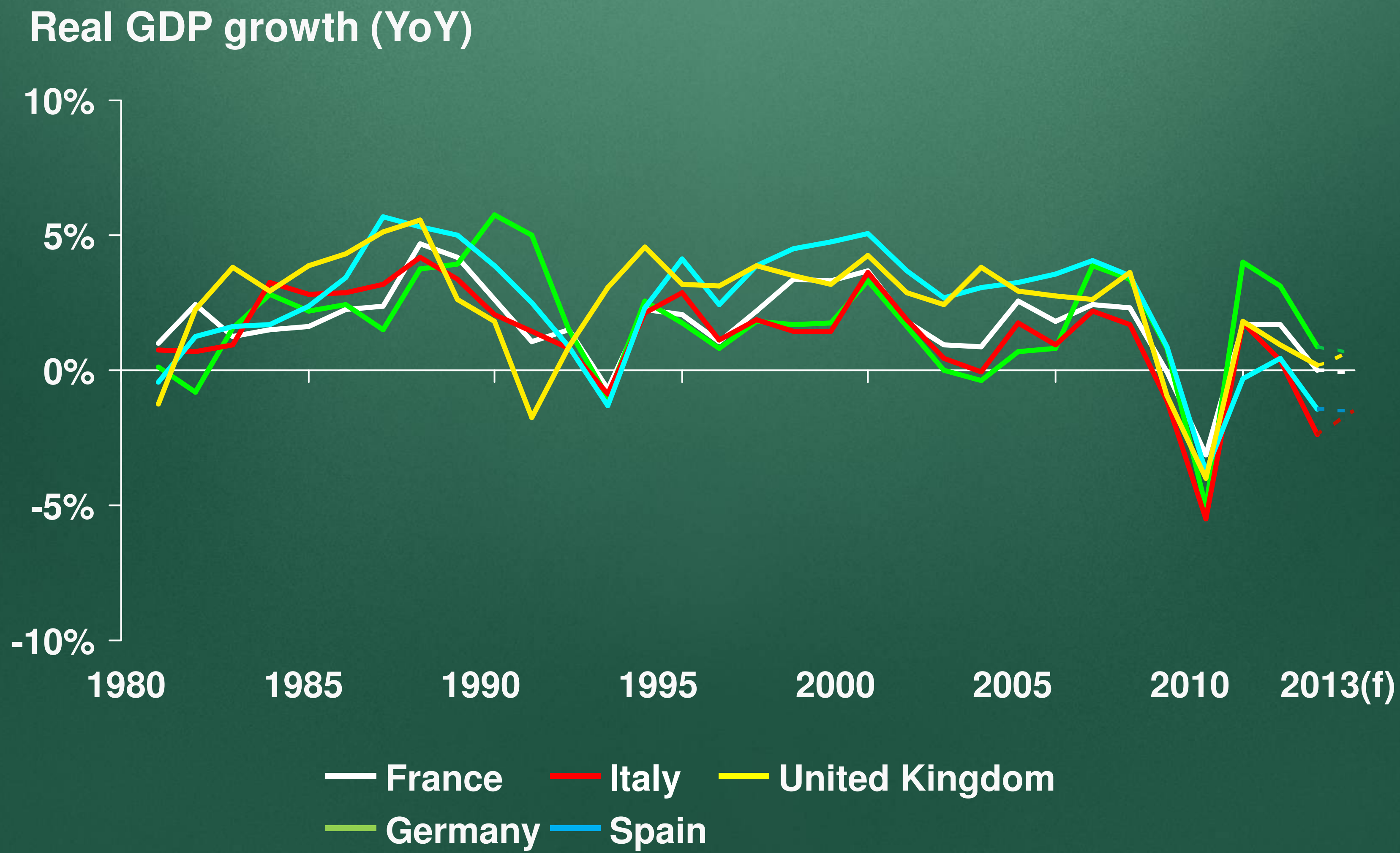
1. US retail sales excluding food services
Source: U.S. Census Bureau

So some growth, but lower than pre-crisis



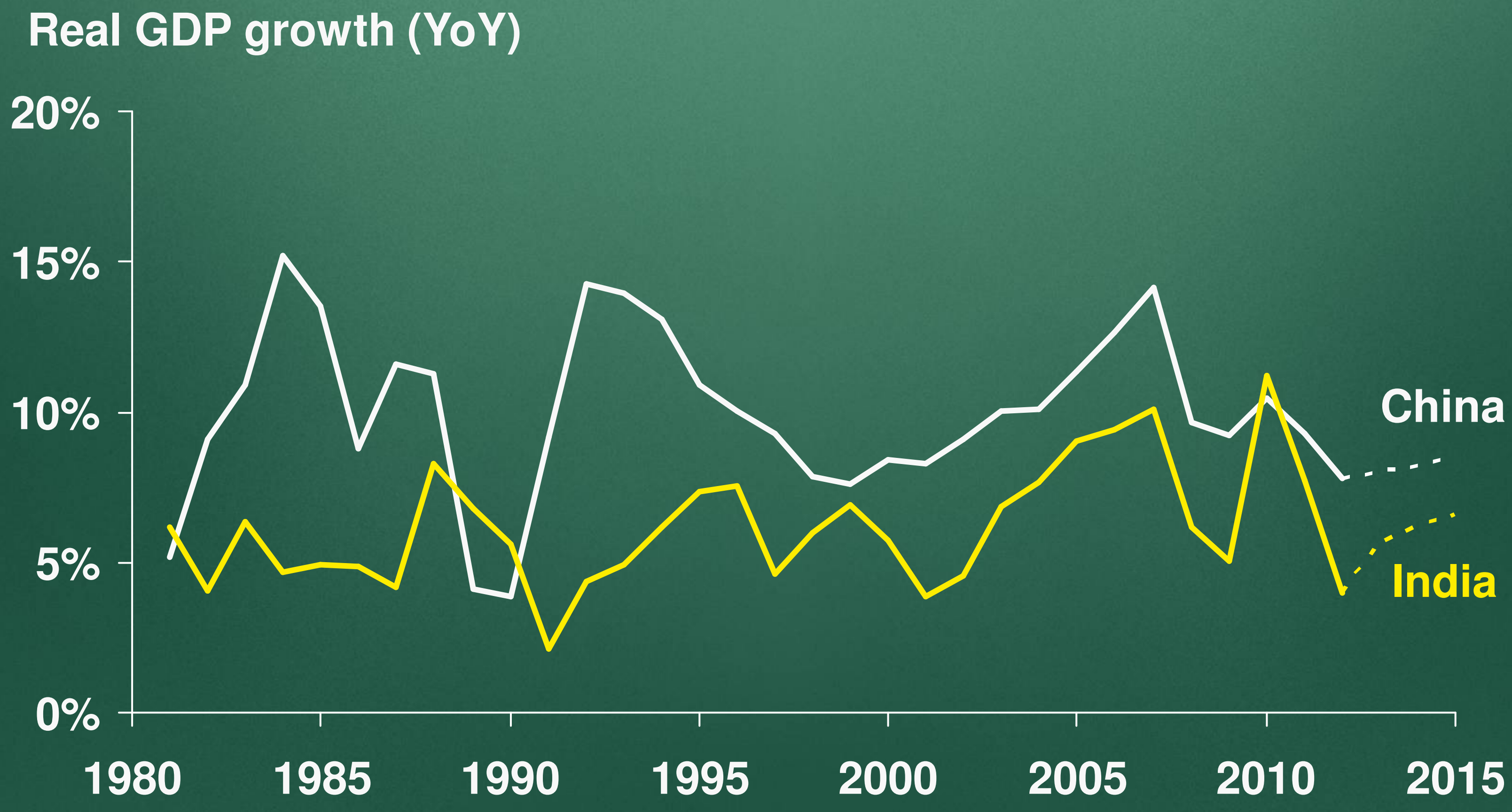
Source: IMF, World Economic Outlook Database

In contrast, European growth has remained stubbornly depressed



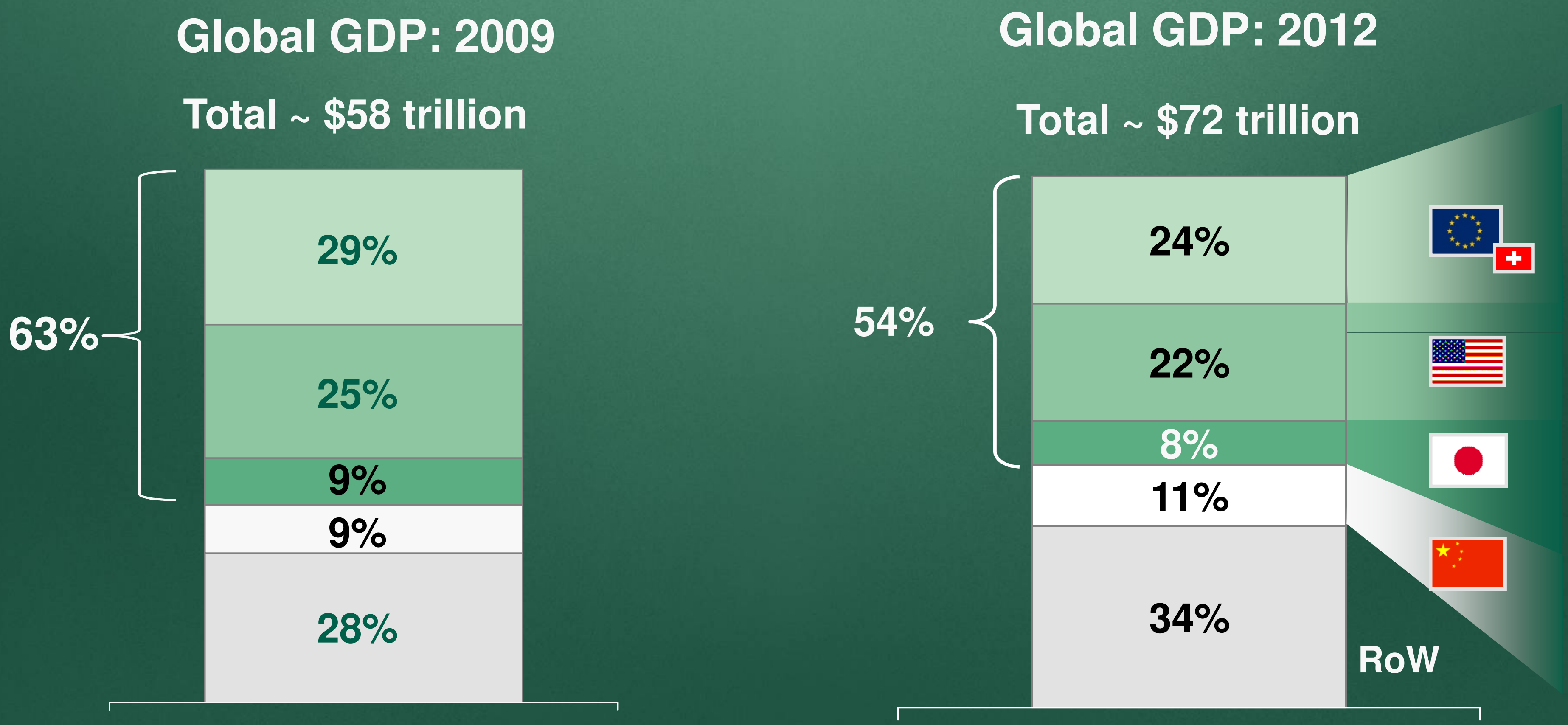
Source: IMF, World Economic Outlook Database

While GDP growth in China and India well above developed economies, but slowing



Source: IMF, World Economic Outlook Database

The *Old World* still matters...

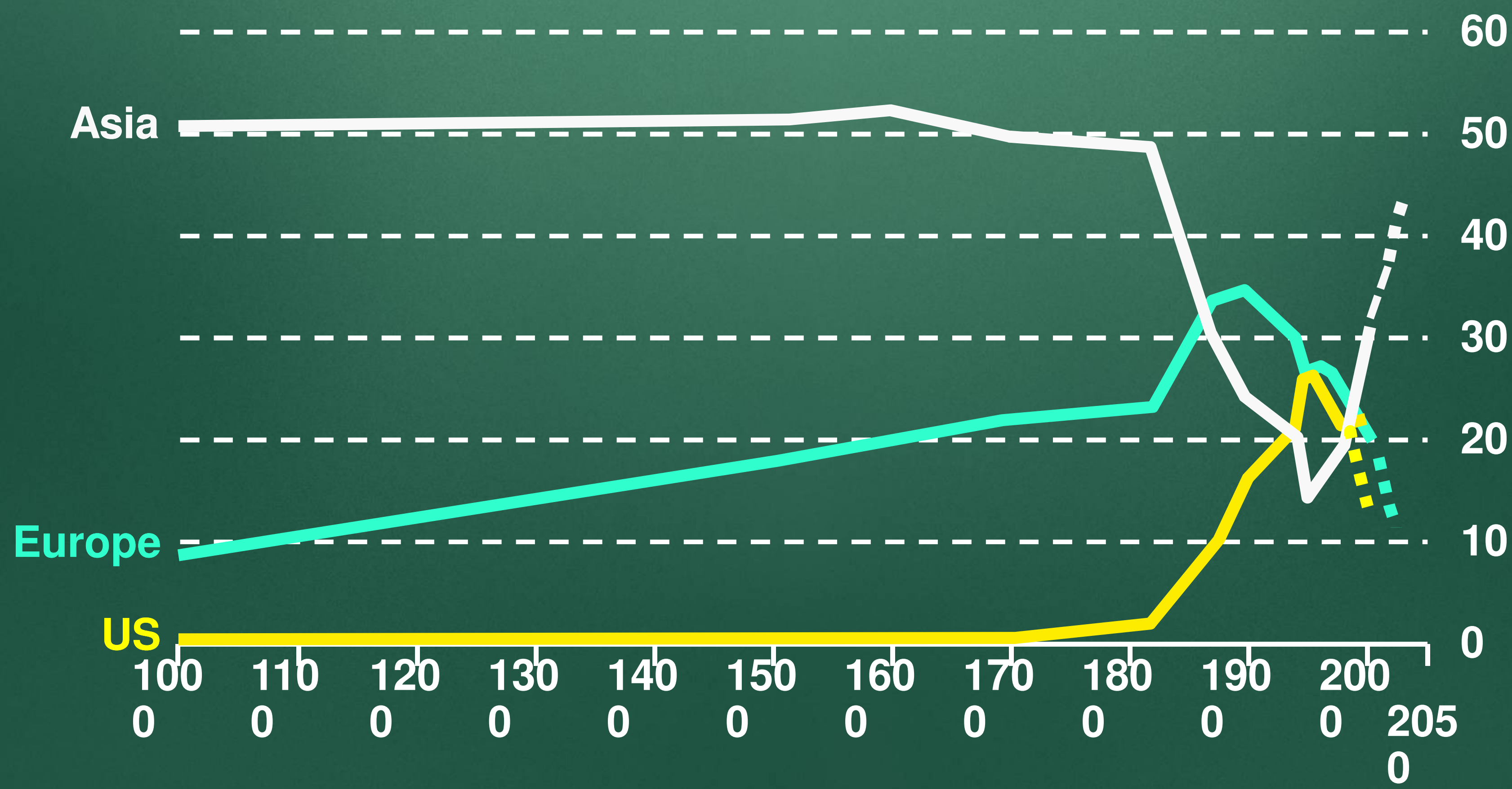


83% of Global Trade touches EU, US, and Japan

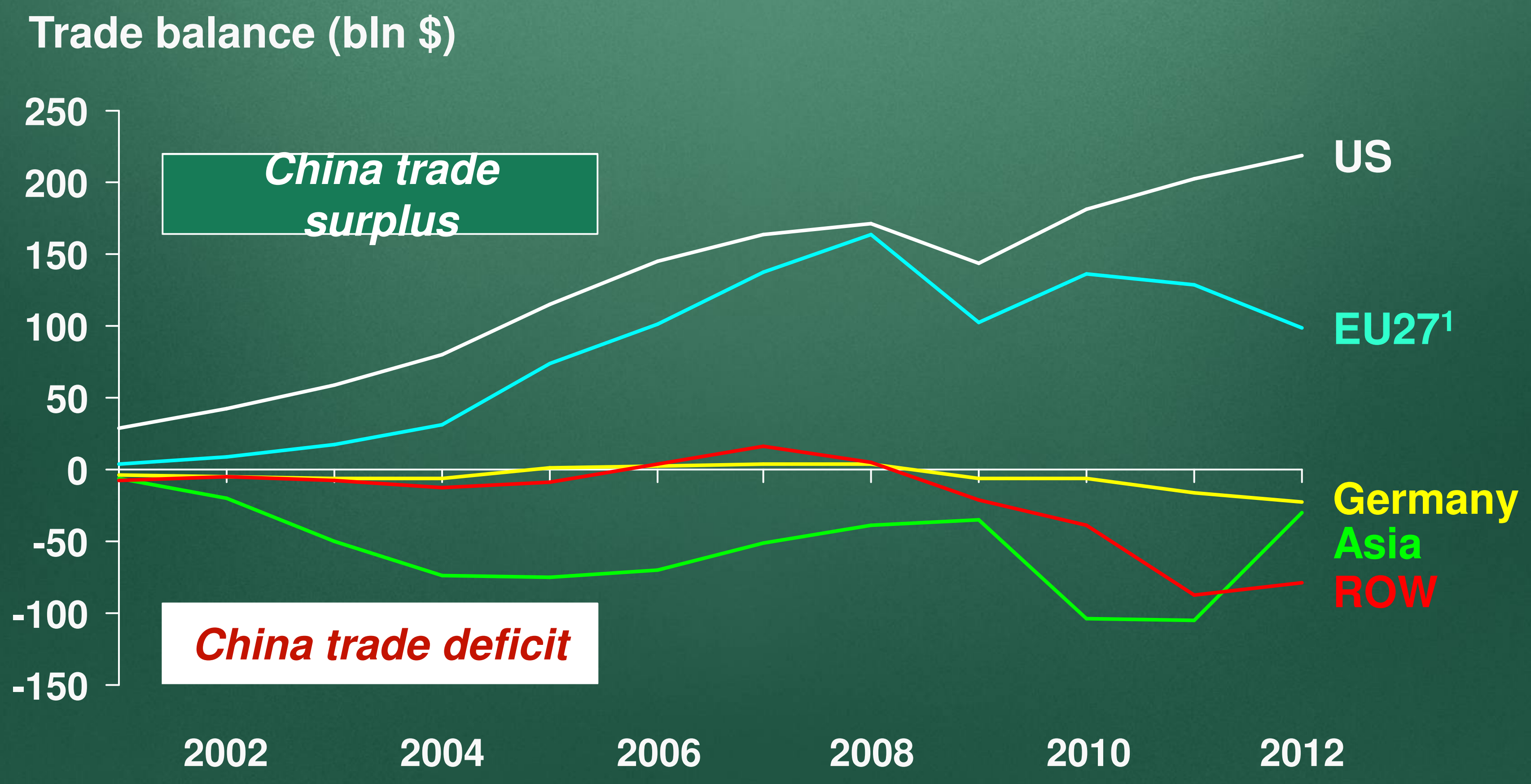
Source: IMF, World Economic Outlook Database

...But the *Old World* is losing ground

Share of world GDP (%)



Behind the figures: China does not run a surplus with everyone

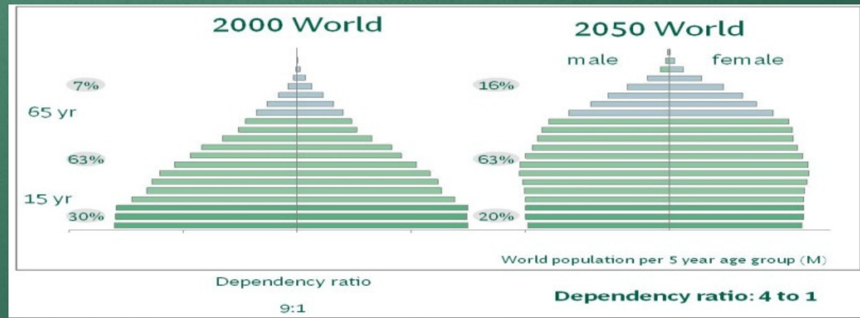


1. Except Germany
Source: ITC calculations based on UN COMTRADE statistics

Four major drags on growth in the developed world – particularly Europe

Too much debt

Demographics



Eurozone in crisis

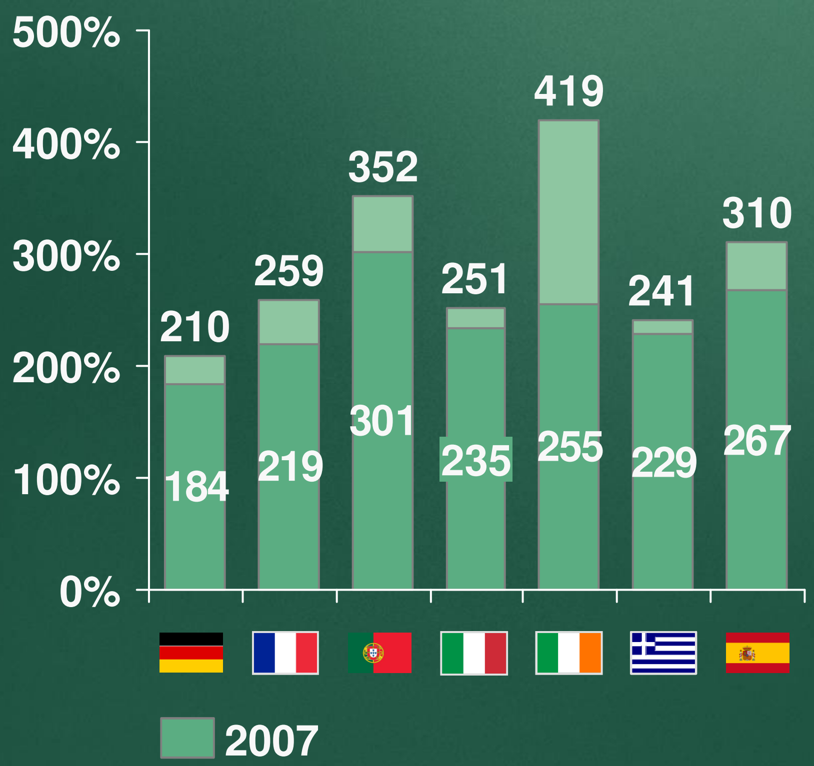
Imbalances/Uncompetitiveness

Source: The Economist, BCG Analysis

Global imbalances reflect underlying lack of competitiveness

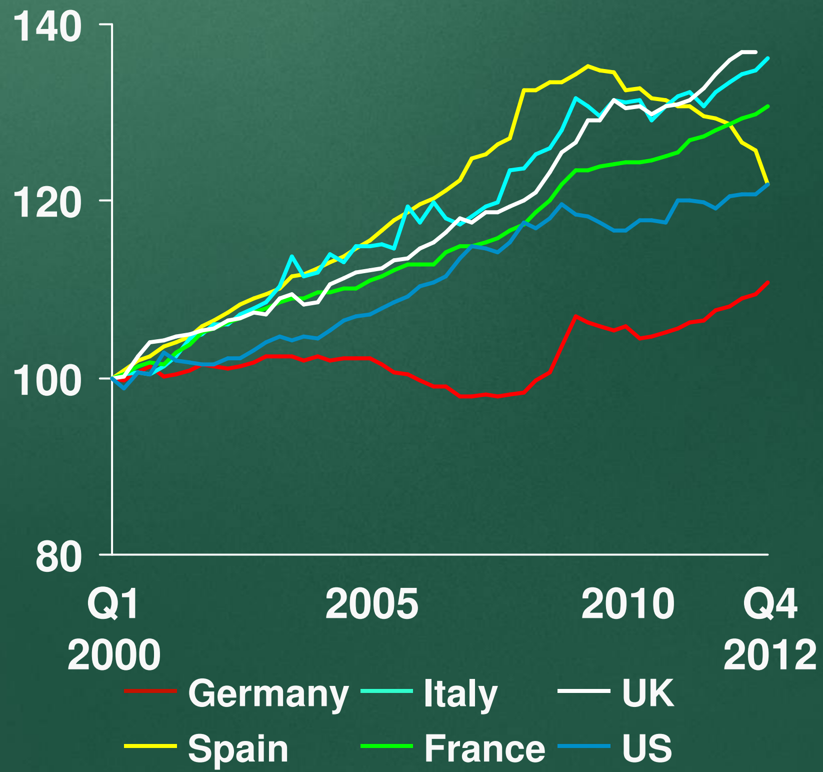
Too much debt

Total debt (2011, % of GDP)



Countries lack competitiveness …

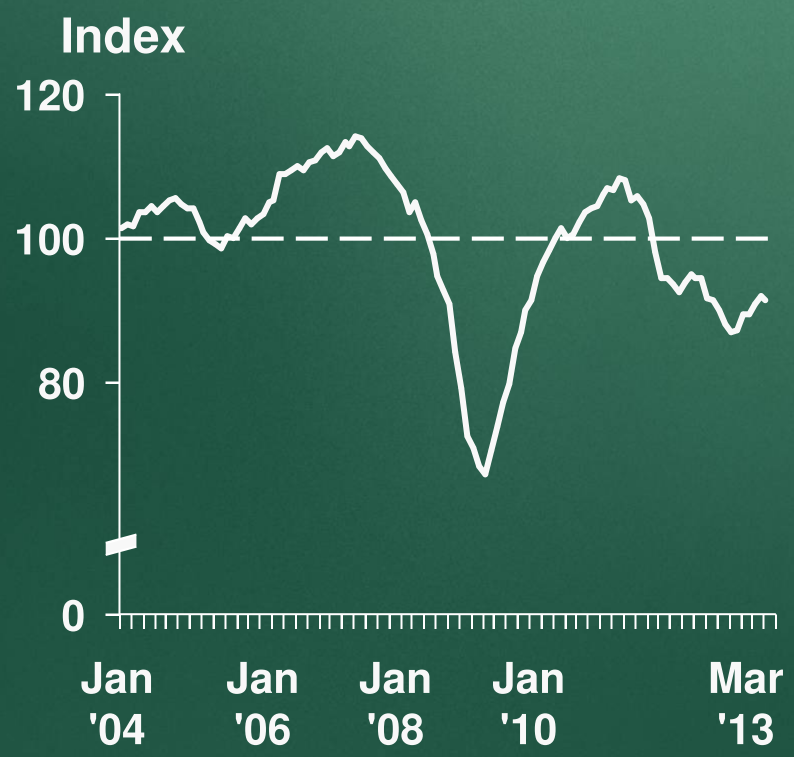
Unit labor costs
Index, 2000 = 100



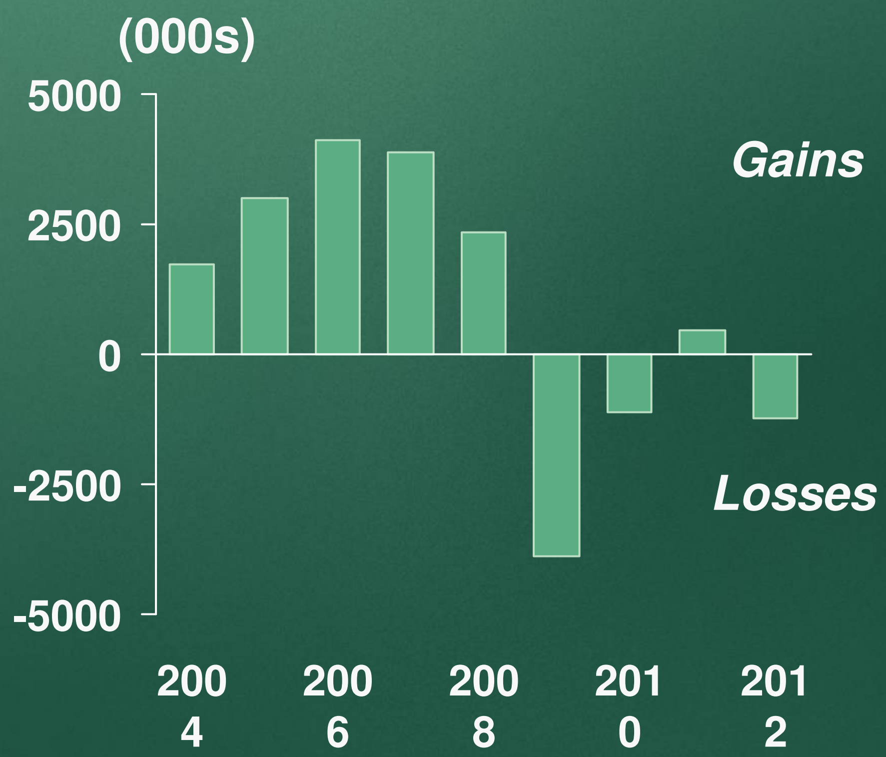
Source: Thomson Reuters Datastream (OECD)

In Europe, uncertainty and layoffs since 2009

Double dip in Economic Sentiment



Yearly changes in EU employment

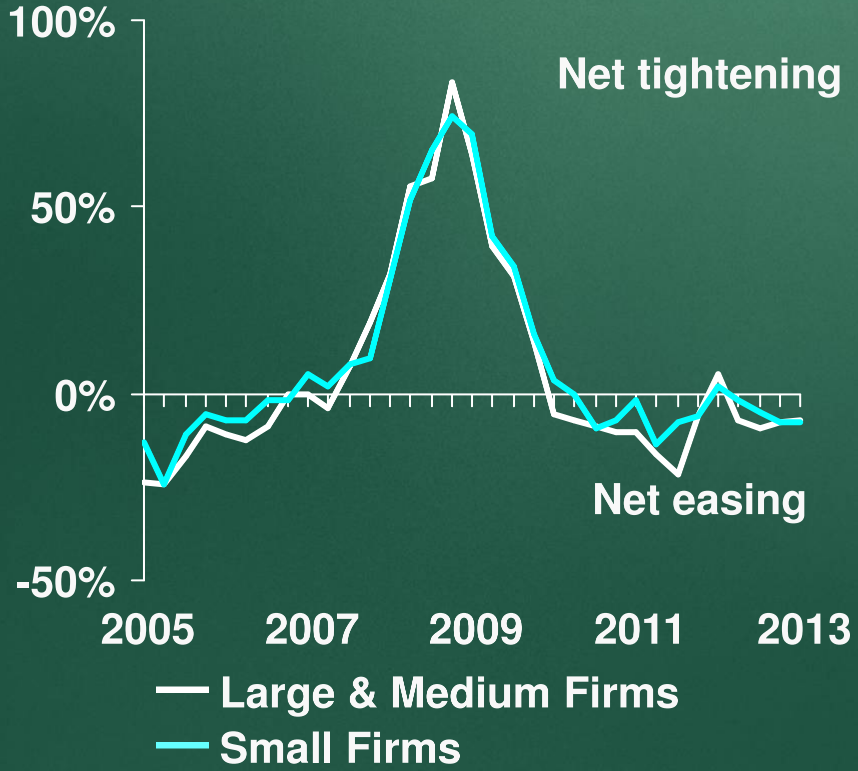


Note: Employment statistics for EU27
Source: Thomson Reuters Datastream (DG ECFIN, Eurostat)

Unlike US, in EU restricted financing persists

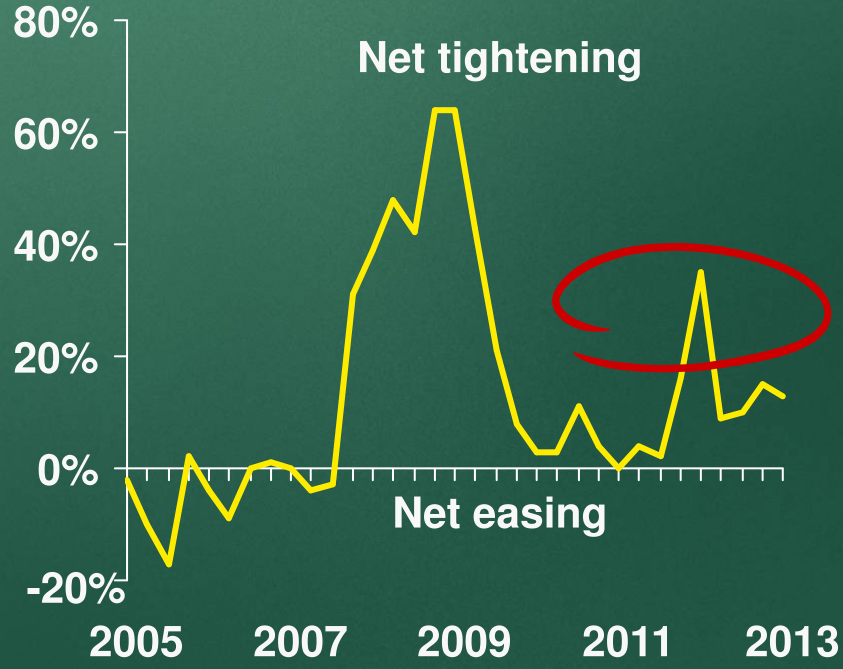
US banks starting to ease credit

US banks tightening credit (%)



But in EU, credit access still limited

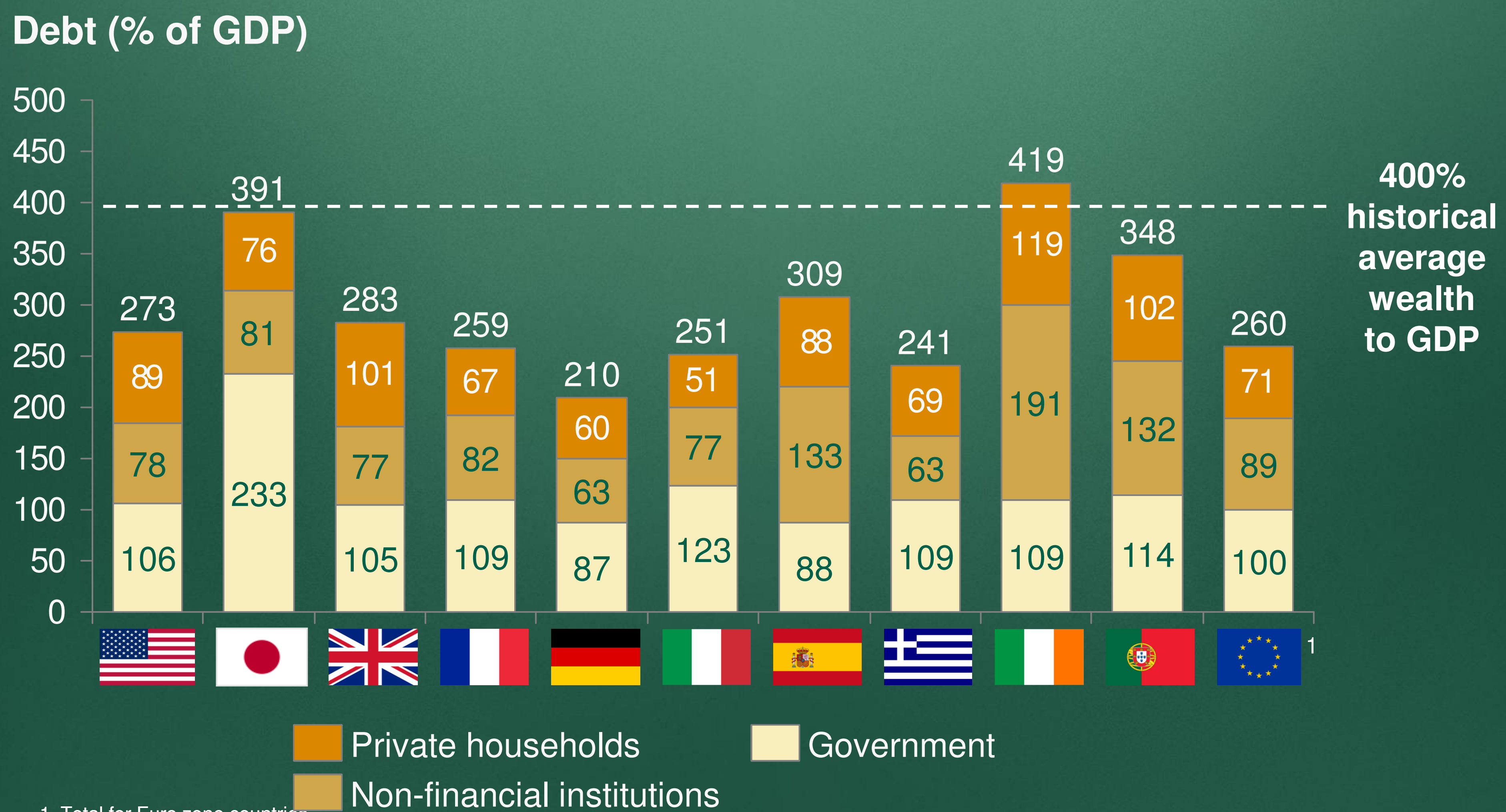
EU banks tightening credit (%)



Note: Bank lending survey: The question asked reads: Over the past three months, how have your bank's credit standards as applied to the approval of loans or credit lines to enterprises changed?
Source: Thomson Reuters Datastream (Federal Reserve, ECB)

EU debt levels clearly not sustainable

Long-term asset values around 4 times GDP



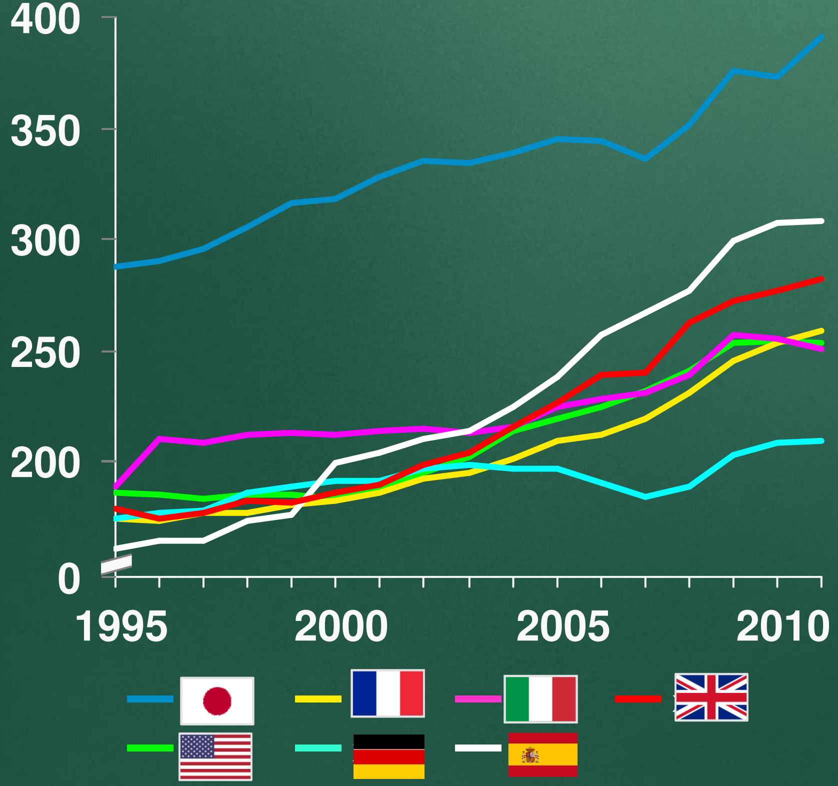
1. Total for Euro zone countries
Note: Debt data as of 2011
Non-consolidated total liabilities of governments, households, and non-financial corporations (loans only) at market prices
Source: Eurostat; Federal Reserve; Thomson Reuters Datastream; BCG analysis

But unlike the US, there is little deleveraging

Only Italy and the US have started deleveraging recently

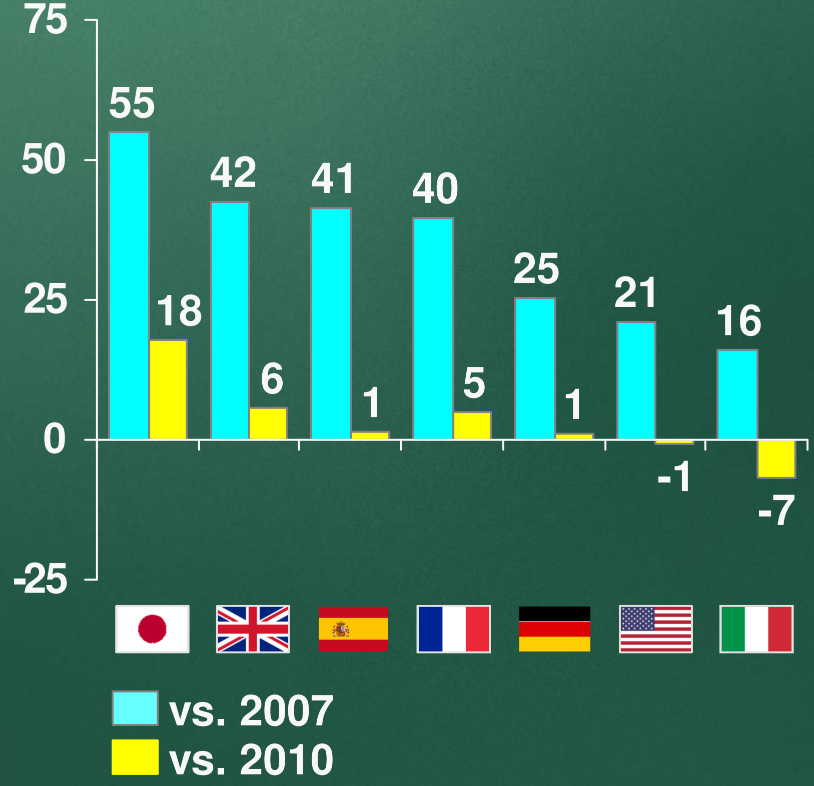
Total debt[1] to GDP for selected countries

in %



Total debt to GDP 2011 vs. 2007/2010

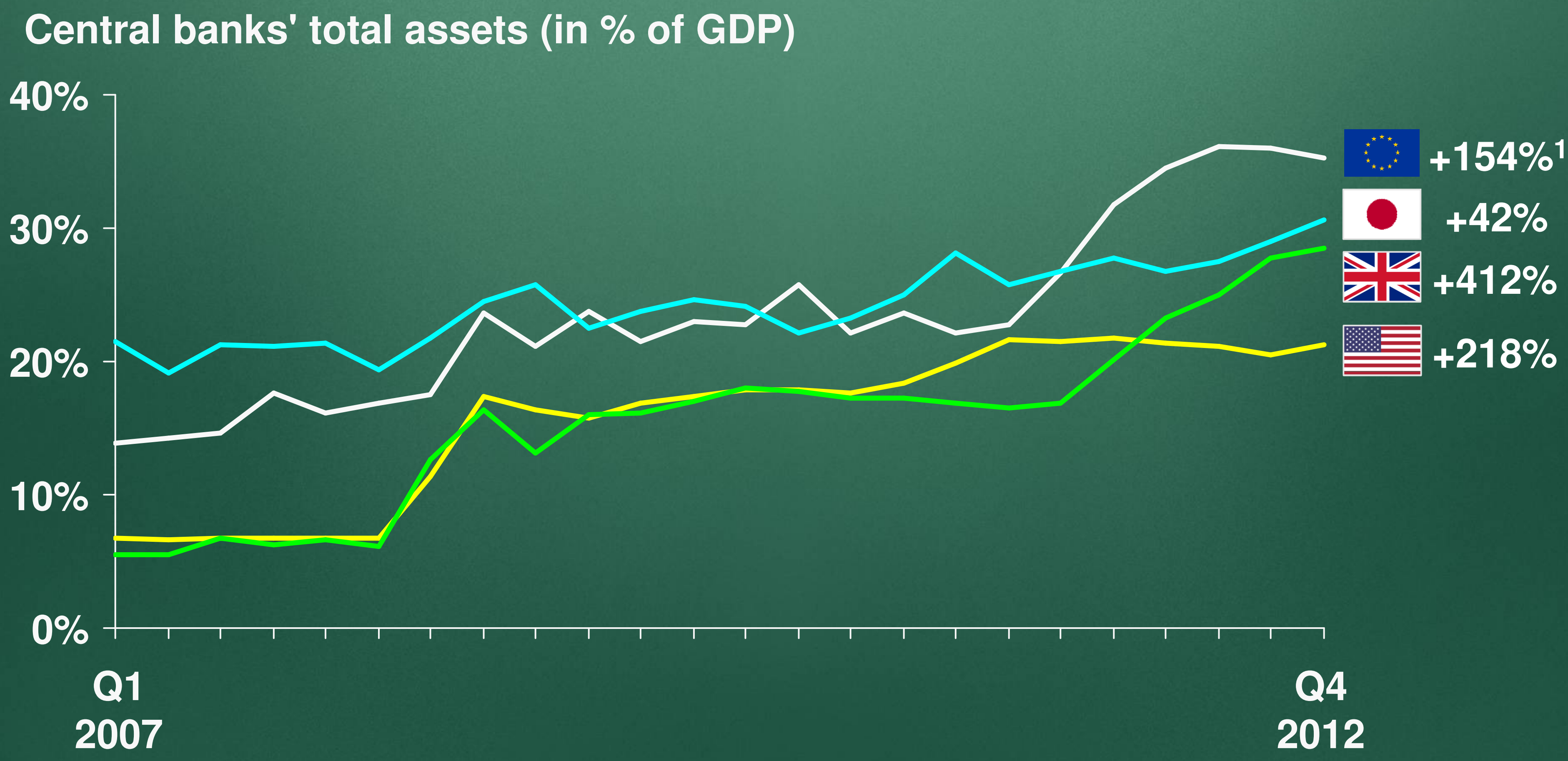
in percentage points



1. Total debt includes government, nonfinancial-corporation and household debt

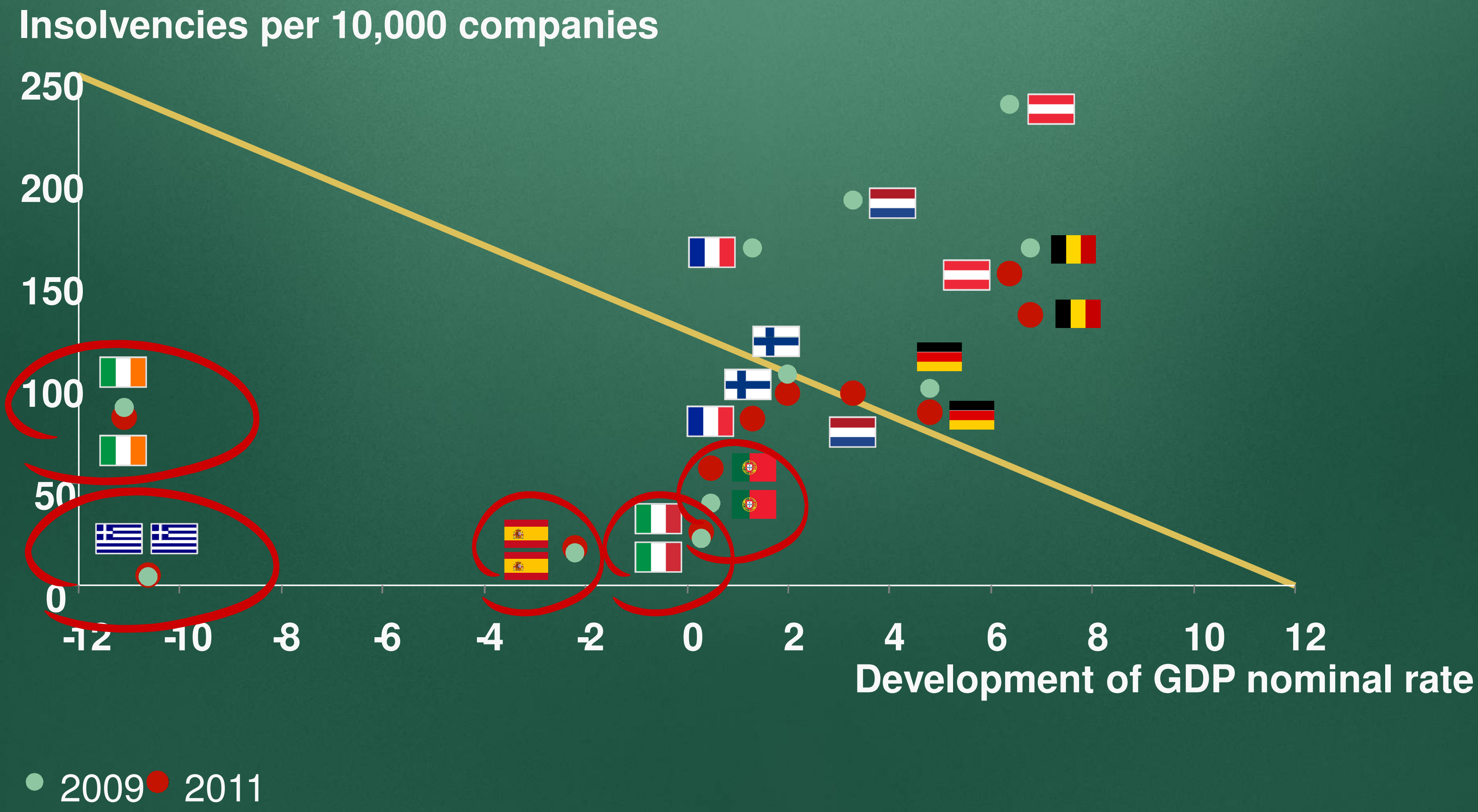
Source: Thomson Reuters Datastream, BCG analysis

Printing money has not worked



1. Consolidated balance sheet for the Eurosystem
Source: National central banks, Thomson Reuters Datastream, BCG analysis

Economic crisis leads to bankruptcies … or not



Source: Creditreform; BCG analysis

Companies: The rise of the zombie!

"They are alive – but barely – thanks to government help, ultra-loose monetary policy and, often, the reluctance of lenders to write down bad loans since the crisis.

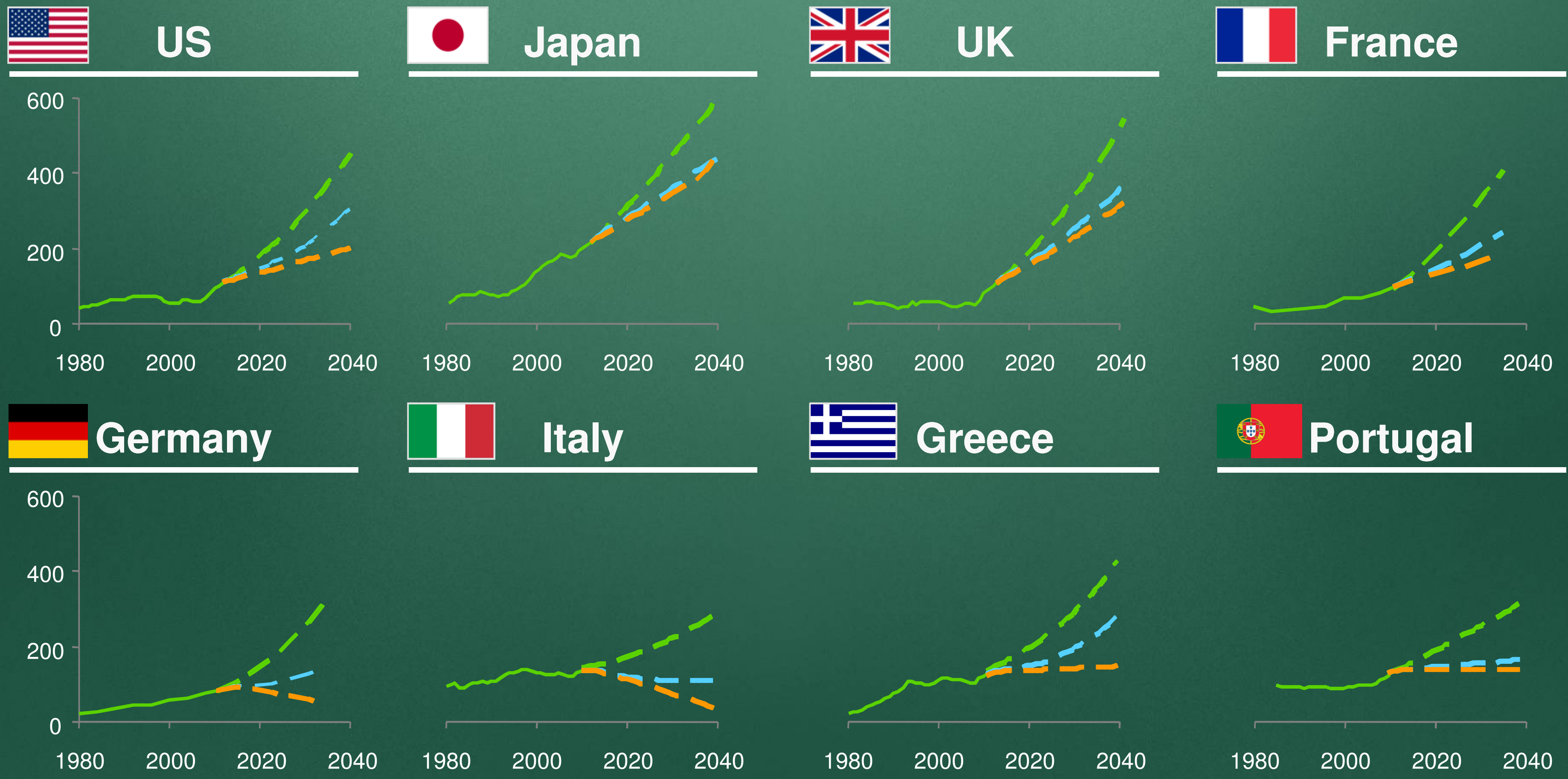
The concern is that these companies – which spend so much of their cash servicing interest payments that they are **unable to invest in new equipment or future growth areas** – could be at least partly to blame for the weak recovery in Europe, hogging resources that could go to more productive areas.

The growing fear is that **the continent could be following the path of Japan**, where low interest rates, looser government policy and the failure of the big banks to foreclose on unprofitable and highly indebted companies is thought to have contributed to two decades of weak growth.

Source: Financial Times (January 9, 2013); BCG analysis

Drastic measures are necessary to check the rapid growth of current and future liabilities

Public gross debt/GDP prediction



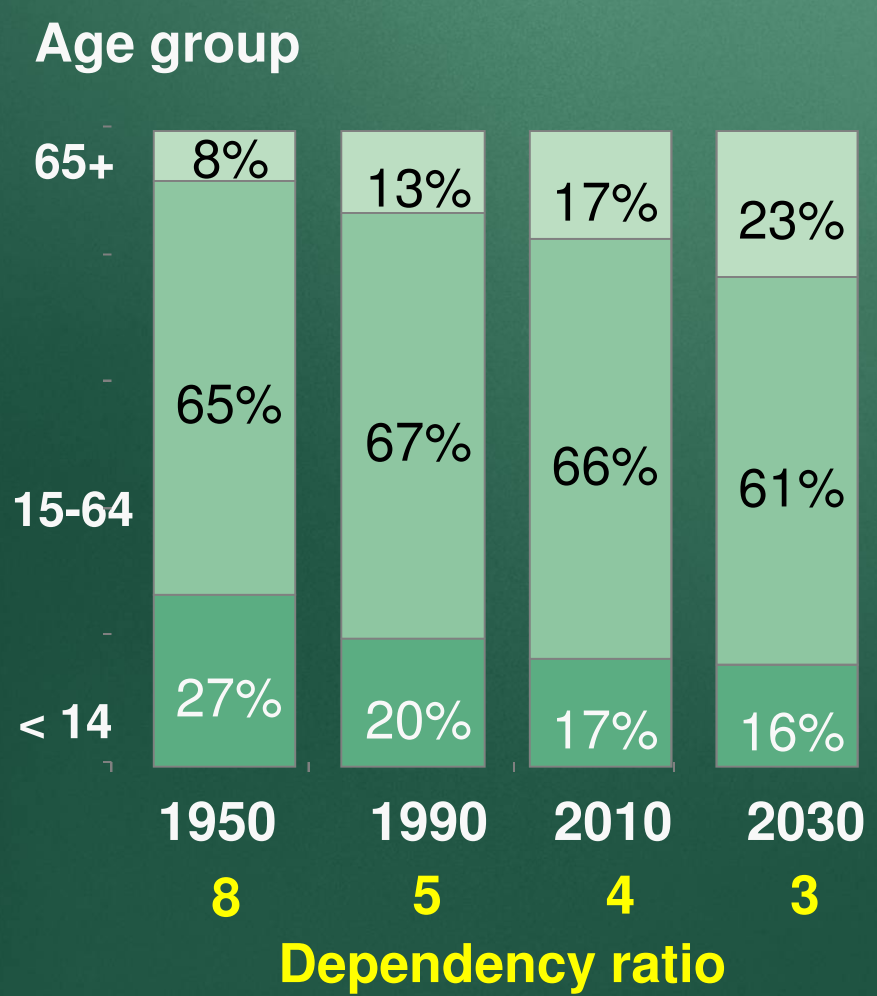
No change in fiscal policy and age-related spending

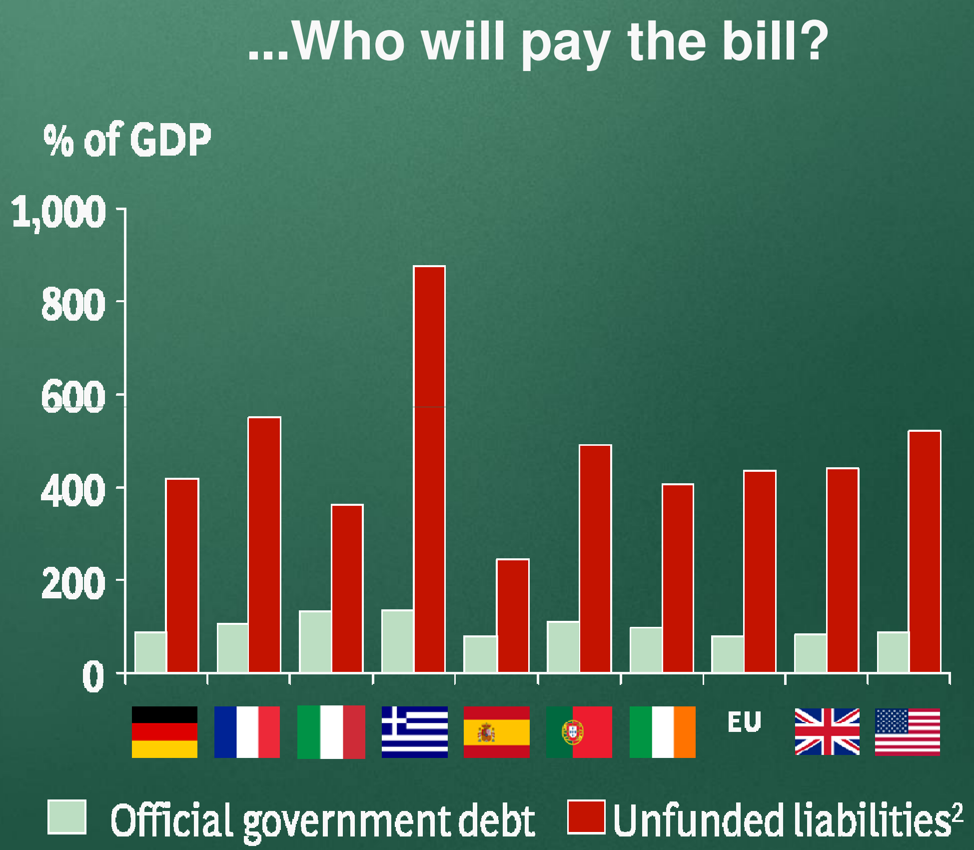
Small gradual adjustment (fiscal balance improves by 1 percentage point of GDP over the next 5 years)

Small gradual adjustment with age-related spending held constant at level of 2011 (in % of GDP)

Source: "The future of public debt: prospects and implications", BIS Working Paper, March 2010

Developed world is aging relentlessly

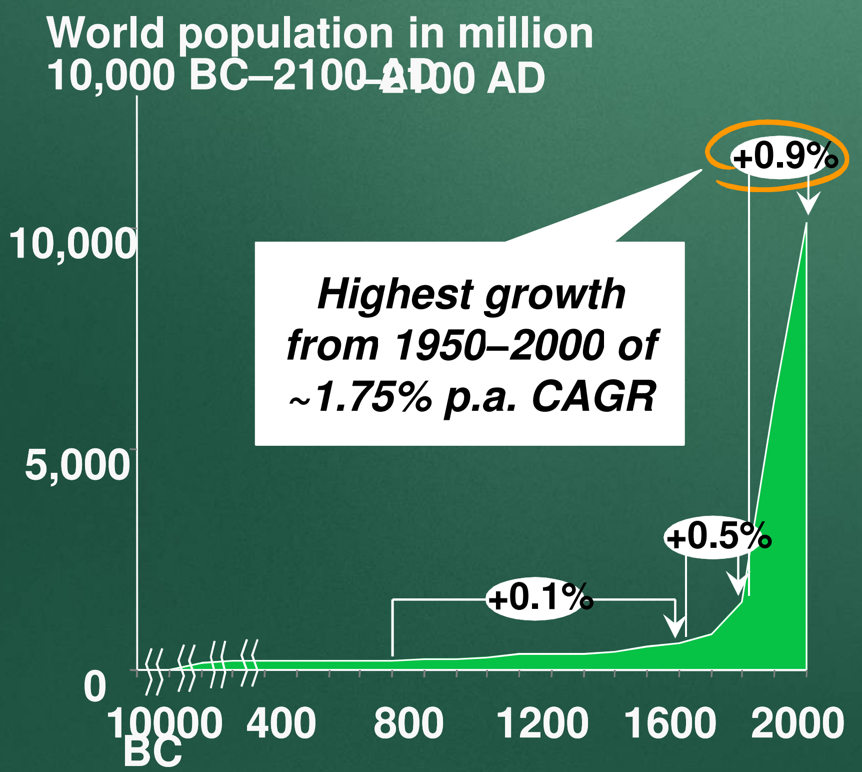




The growth formula is broken

Economic Growth = Workforce

Population evolution ...



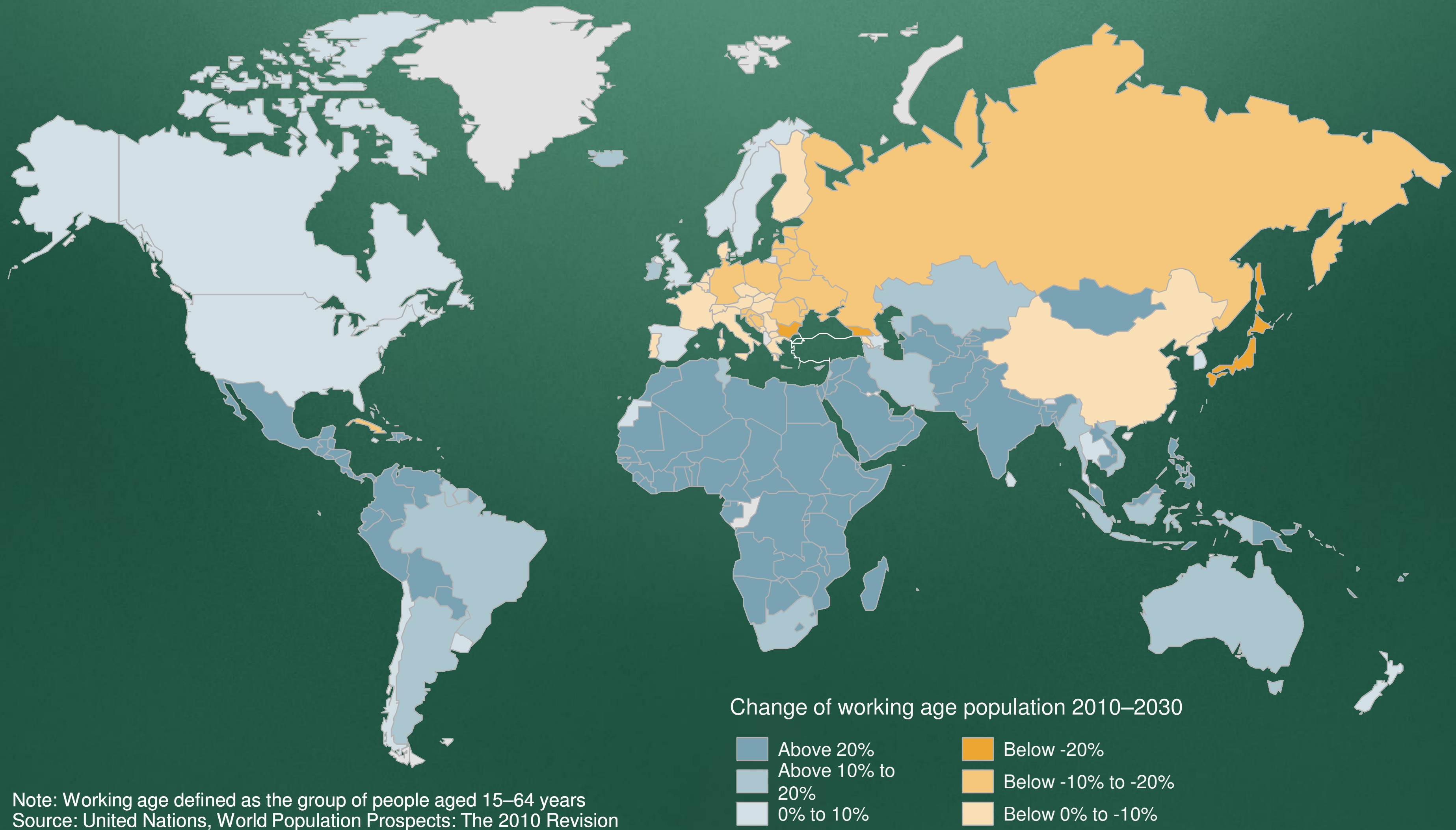
Note: Historical estimates of World Population estimates reflect "lower estimates" of US Census Bureau. Data by 2009 from US Census Bureau, starting 2010 from UN World Population Prospects
Source: US. Census Bureau, Historical Estimates of World Population, 2012; United Nations, Department of Economic and Social Affairs, Population Division (2011). World Population Prospects: The 2010 Revision; Robert Gordon, "Is U.S. economic growth over? Faltering innovation confronts the six headwinds", NBER Working Paper 18315, http://www.nber.org/papers/w18315

Russia and China will shrink

Latin America and Africa keep growing

No more growth in the West

Brazil and India continue growing



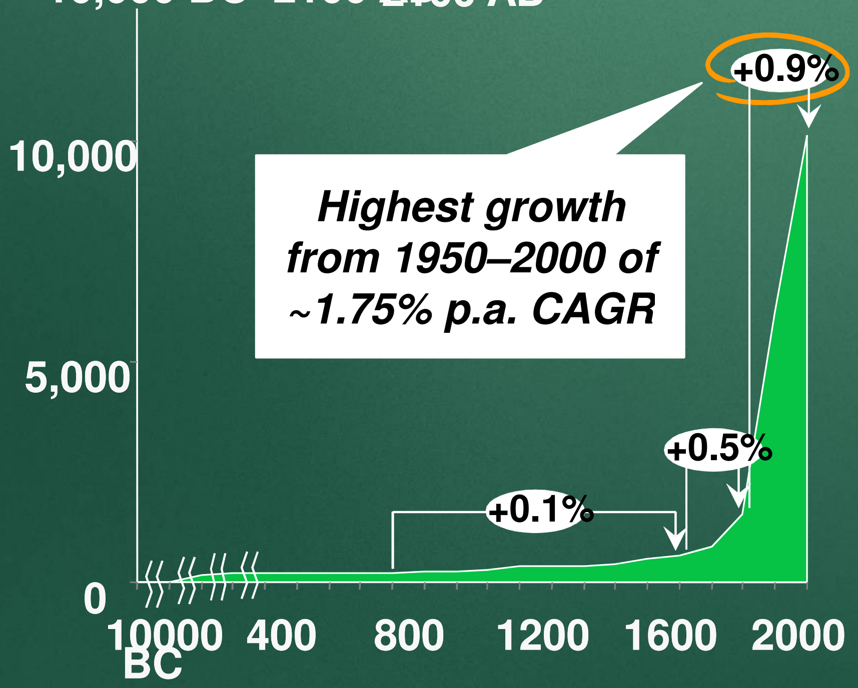
Note: Working age defined as the group of people aged 15–64 years
Source: United Nations, World Population Prospects: The 2010 Revision

The growth formula is broken

Economic Growth = Workforce

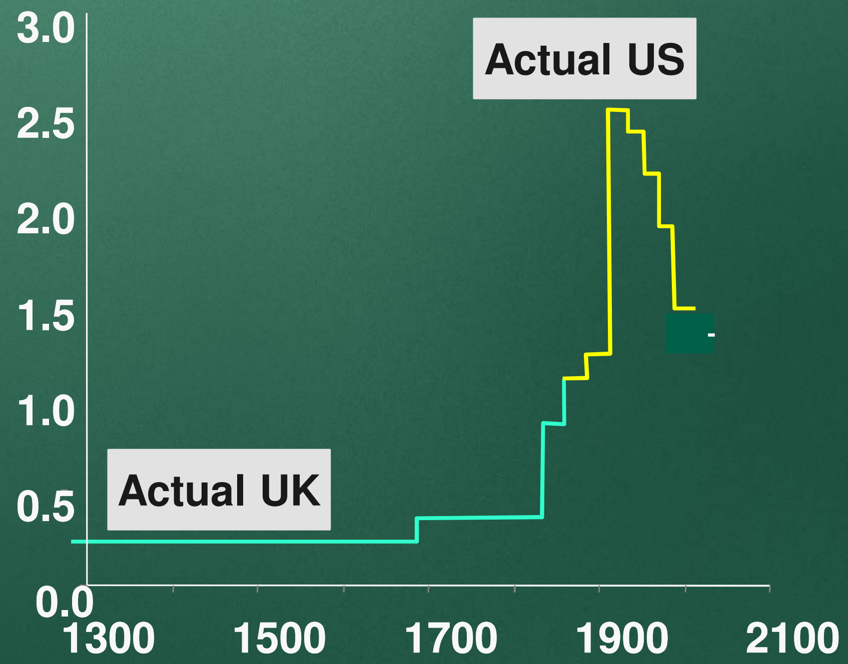
Population evolution …

World population in million
10,000 BC–2100 AD



… GDP growth per capita

Percent p.a.



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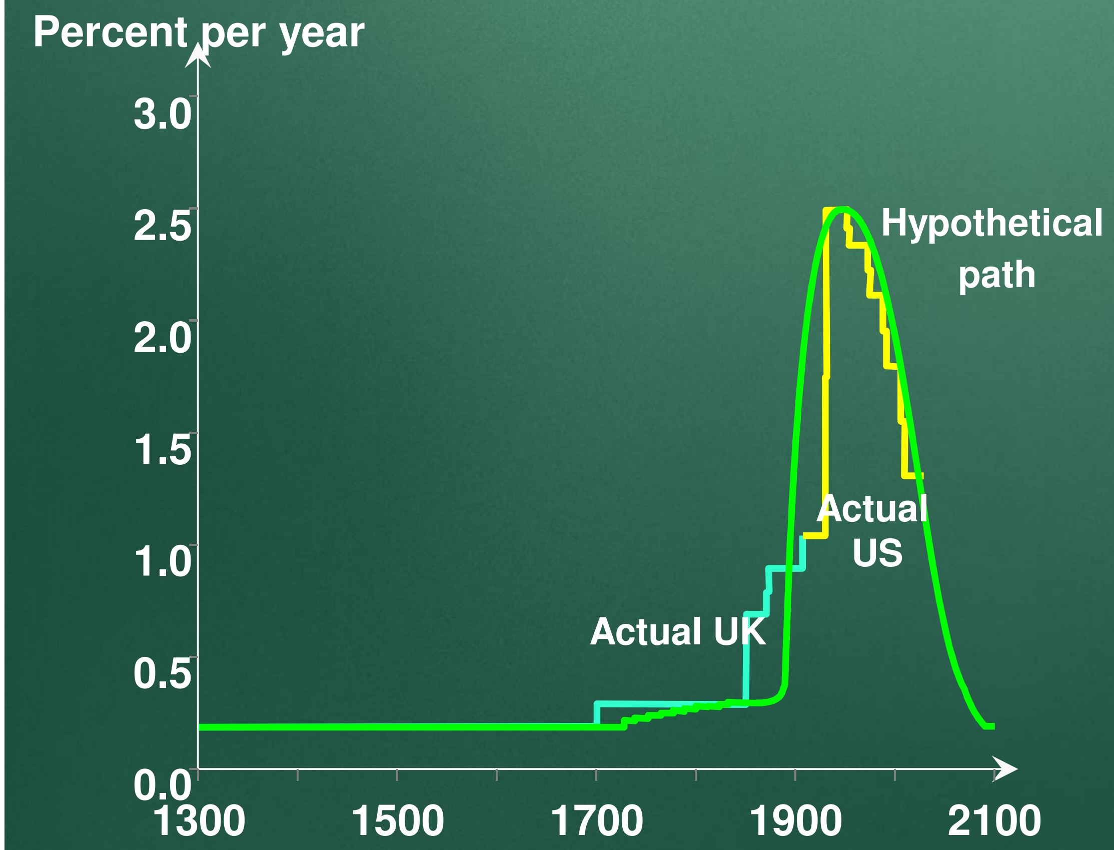
Headwinds for further productivity gains

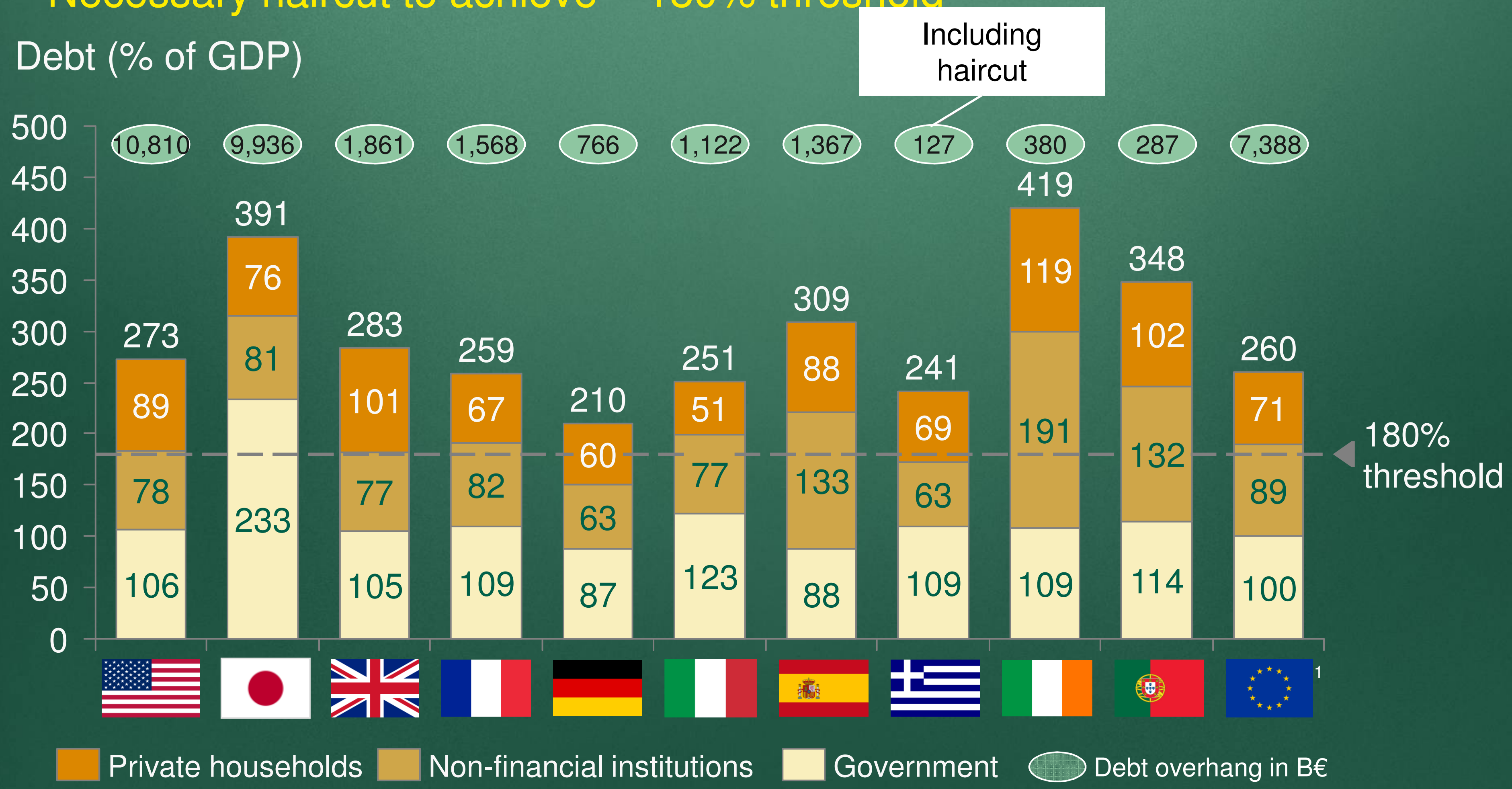


- Innovation with less impact on productivity than in the past
- The West is falling behind on education
- Intensified international competition increases labor cost pressure
- Efforts to reduce CO_2/the end of cheap resources
- Underinvestment in assets by public and private sector
- Increased income inequality

Source: Robert Gordon, "Is U.S. economic growth over? Faltering innovation confronts the six headwinds", NBER Working Paper 18315, http://www.nber.org/papers/w18315

Back to Mesopotamia?

Necessary haircut to achieve ~ 180% threshold

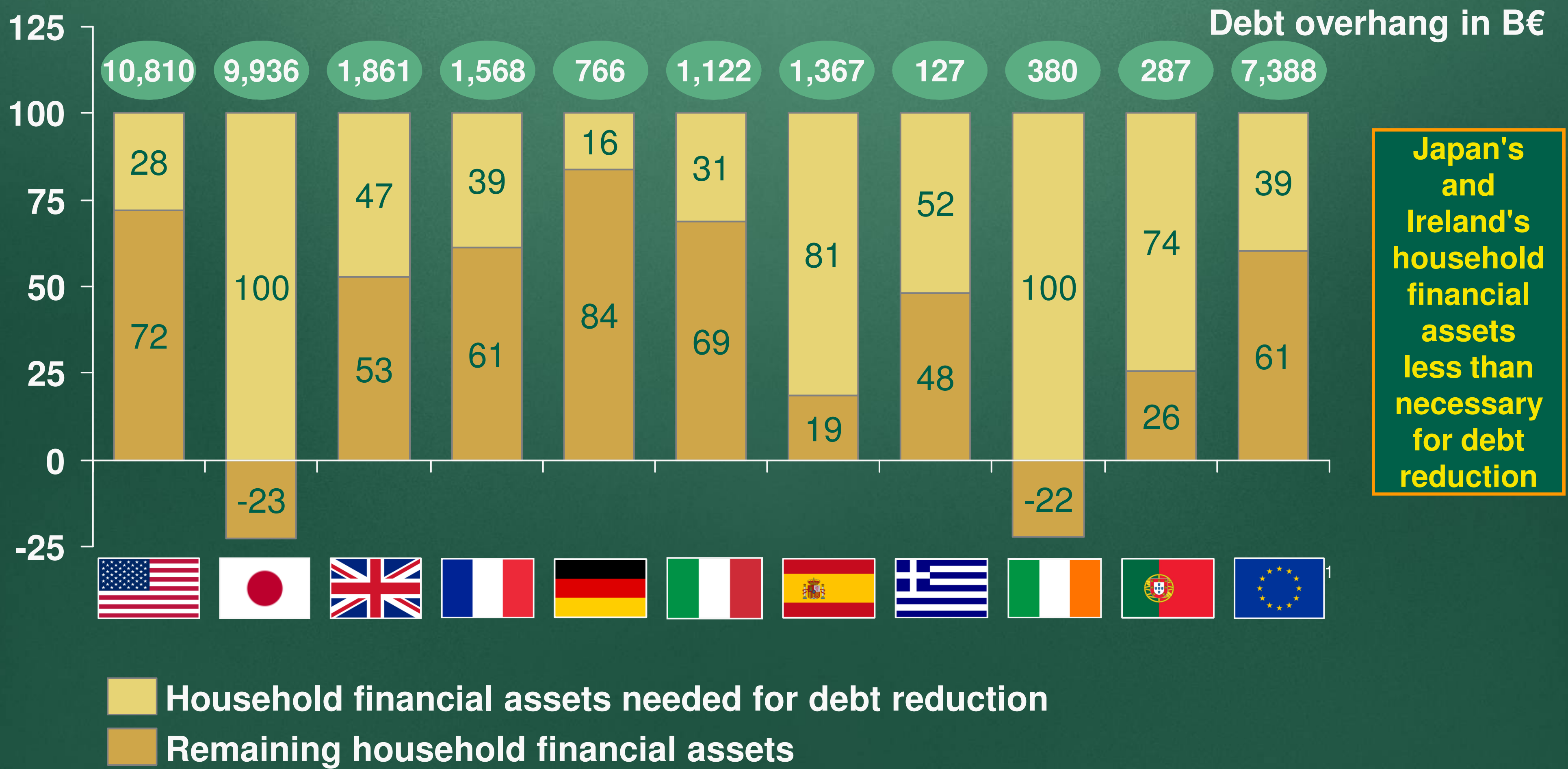


1. Total for Euro zone
Note: Debt data as of 2011
Non-consolidated total liabilities of governments, households, and non-financial corporations (loans only) at market prices
Source: Eurostat; Federal Reserve; Thomson Reuters Datastream; BCG analysis

Required one-time wealth tax

Necessary debt reduction to reach sustainable debt-to-GDP ratio

Necessary debt reduction and remaining HH financial assets (%)



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Cyprus = Mesopotamia


Cyprus secures €10bn bailout ● Fears rise over future rescues ● Bank shares hit

Eurozone shifts burden of risk from taxpayers to investors

By Peter Spiegel in Brussels

The €10bn Cypriot rescue is a watershed for how the eurozone deals with failing banks, with European leaders now committed to "pushing back the risks" of paying for bank bailouts from taxpayers to private investors, the chairman of the group of eurozone finance ministers has said.

Jeroen Dijsselbloem, president of the eurogroup, was speaking hours after Cyprus reached an 11th-hour €10bn bailout deal with international lenders that avoids a levy on bank accounts but will force large losses on big deposits in the island's two largest lenders.

European bank stocks and the euro suffered sharp losses following his comments amid concerns over the safety of bank deposits in any future bailouts. The single currency fell more than 1 per cent against the dollar, wiping out all its earlier gains following relief that a deal had been struck in Cyprus

Up in arms: Cypriots protest outside a eurogroup meeting being held at the European Council building in Nicosia on Sunday night

Bail-Out

Euro group and IMF will pay €10B to rescue Cyprus

Bail-In

Equity shareholders, bond holders and uninsured depositors will face "haircuts"

Laiki Bank closure

- €4.2B in uninsured deposits will be transferred to a "bad bank" which will be wound up over time
- All deposits of less than €100,000 are safe and will go to Bank of Cyprus

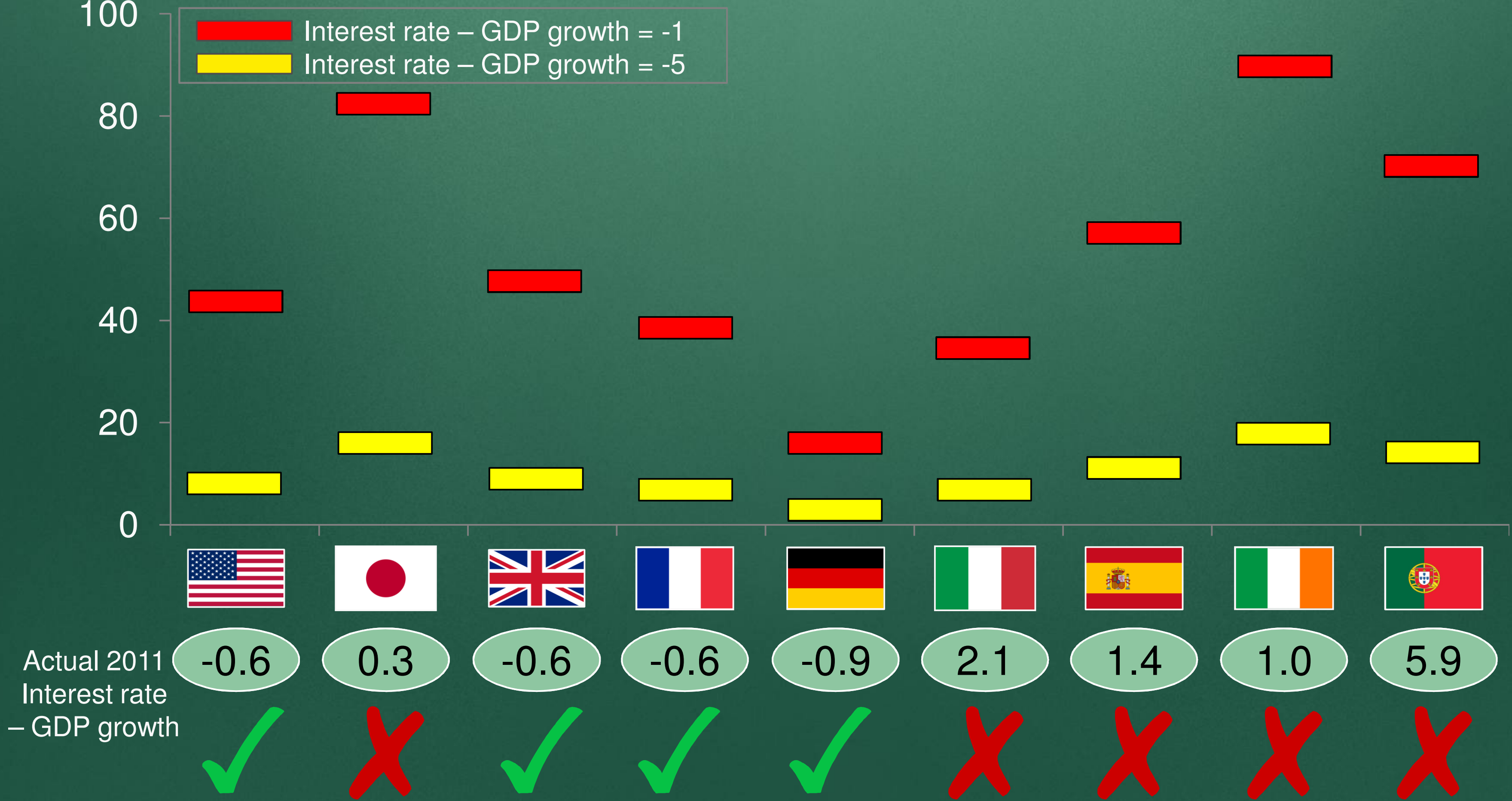
Bank of Cyprus recapitalization

- Contribution of private investors and uninsured depositors
- Uninsured deposits are estimated to amount to €10B—of which 37.5% to 60% will be converted into equity

Source: Financial Times,, 26 March 2013, Economist "The Cypriot deal: Second time unlucky", 30 March 2013

Financial repression?

Number of years to reach 180% threshold



Note: 2011 data, Portugal interest paid as of 2010
Non-consolidated total liabilities of governments, households, and non-financial corporations (loans only) at market prices
Source: OECD; BCG analysis

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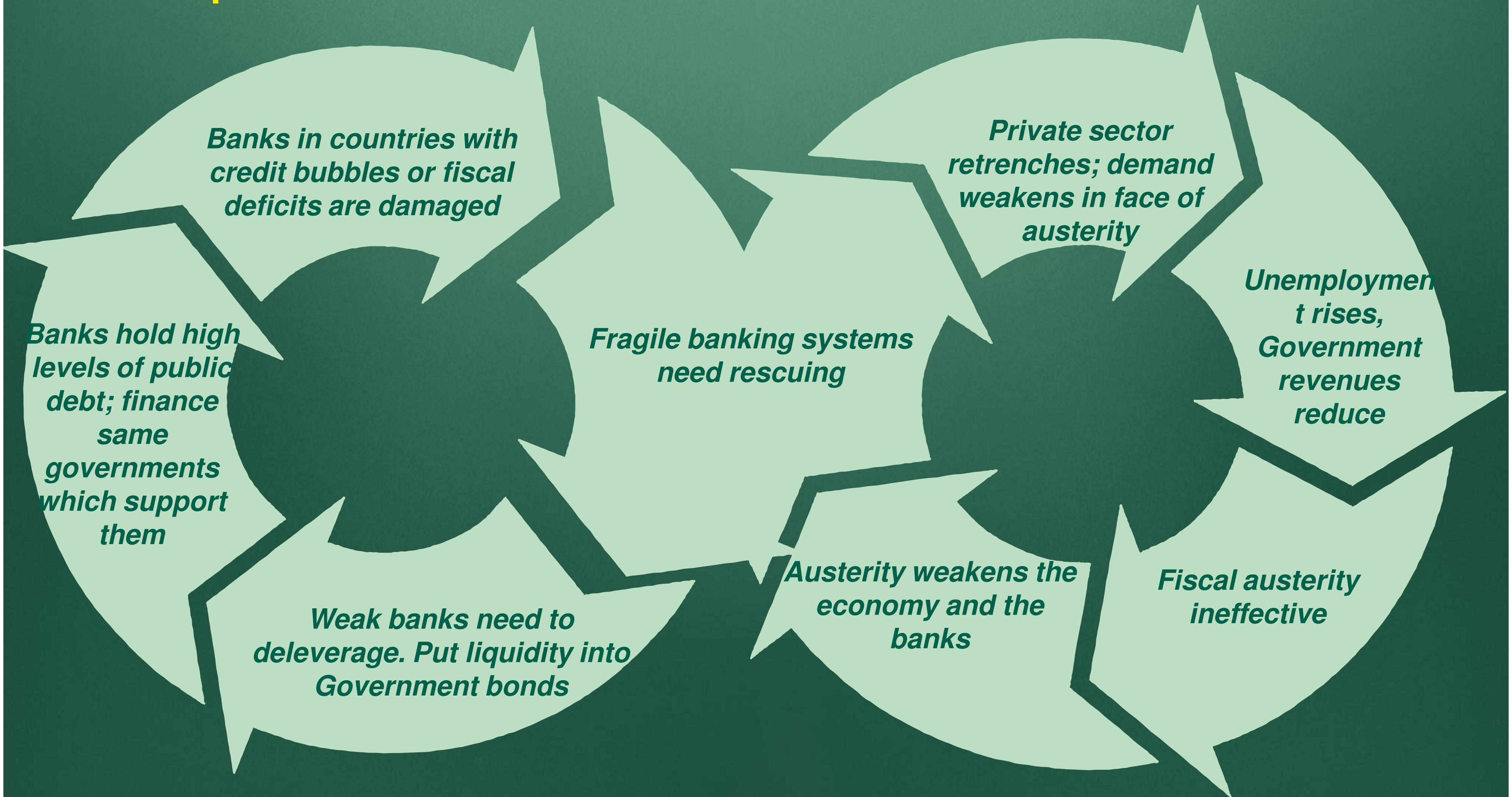
Europe: a bit of a mess



Is this the biggest Ponzi Scheme in world history

- **Record high levels of public and private debt**
- **Unfunded promises**
- **The broken growth fo**
- **Falli**
- **M**   **et base**
- **The end of cheap resources?**

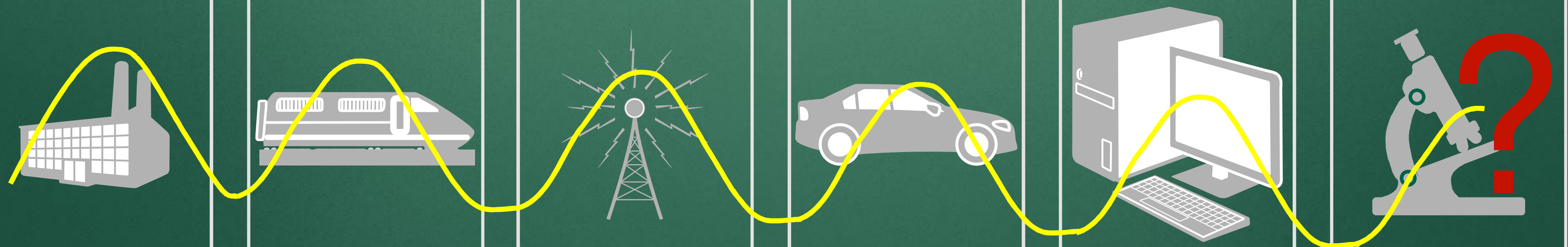
What can be done?

How to solve the euro crisis?

	Six possible options	Address debt overhang	Restore competitiveness
1	**Internal devaluation** • Deflationary. depressionary route • Painful structural reforms	✗	✗
2	**Permanent transfers from north to south** • Debt reduction • Unilateral transfers	✗	✗
3	**Grow out of the problem** • Debt and demography render this option impossible	✗	✗
4	**Organized debt restructuring and growth agenda**	✓	✓
5	**The inflation solution** • Monetary easing • Weak Euro • Fiscal easing in the core	✓	✓
6	**Debt restructuring and Euro zone exits**	✓	✓

Will there be a next "Kondratiev" cycle?

Wave 1	Wave 2	Wave 3	Wave 4	Wave 5	Wave 6



1785 1840 1900 1950 1990 20XX

Wave 1	Wave 2	Wave 3	Wave 4	Wave 5	Wave 6
Steam engine Textile industry	Rail Steel industry	Electricity Chemistry Combustion engine	Petrochem Automobile (mass production)	Comm.s and Information technology	Bio-technology Healthcare New energies

Source: Schumpeter

This says it all

Jean-Claude Juncker
Prime Minister of Luxembourg
Former President of the Eurogroup

"We all know what to do, we just don't know how to get re-elected after we've done it.

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Thank you

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