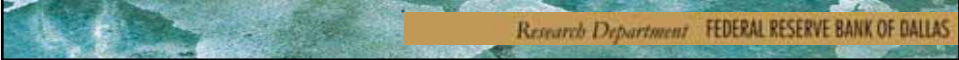




Changing Risks in the Global Economy

Presented to:
Global Interdependence Center
Santiago, Chile
March 5, 2007


By:
Harvey Rosenblum
Executive Vice President & Director of Research
Federal Reserve Bank of Dallas



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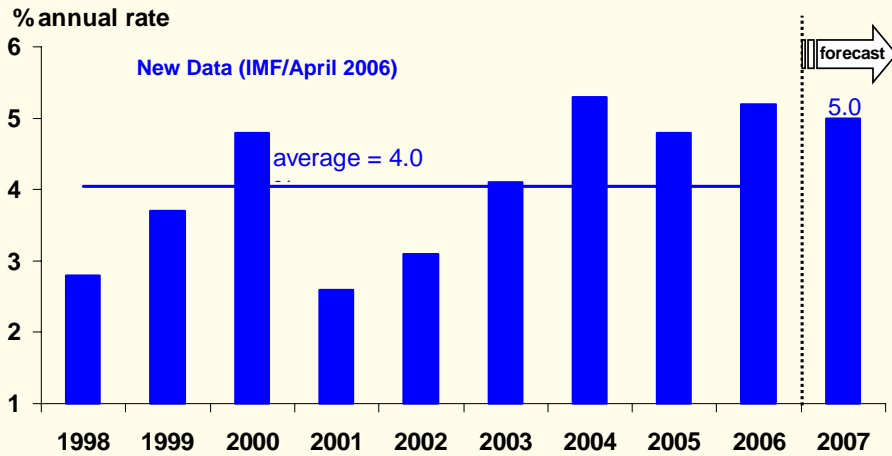


Is the Economy Getting Less Risky?



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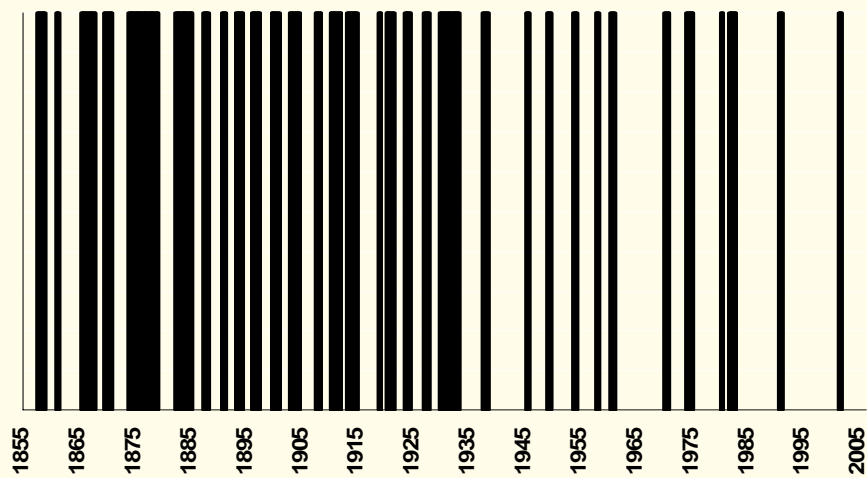
Global GDP Growth To Remain Healthy



Source: World Economic Outlook (IMF) World Development Indicators (World Bank); Forecast by H. Rosenblum

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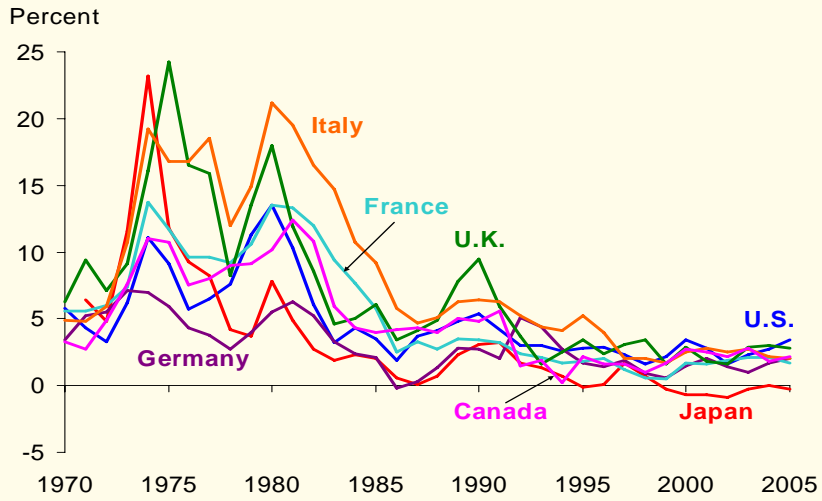
Fewer Economic Downturns



Black bars are months of contraction

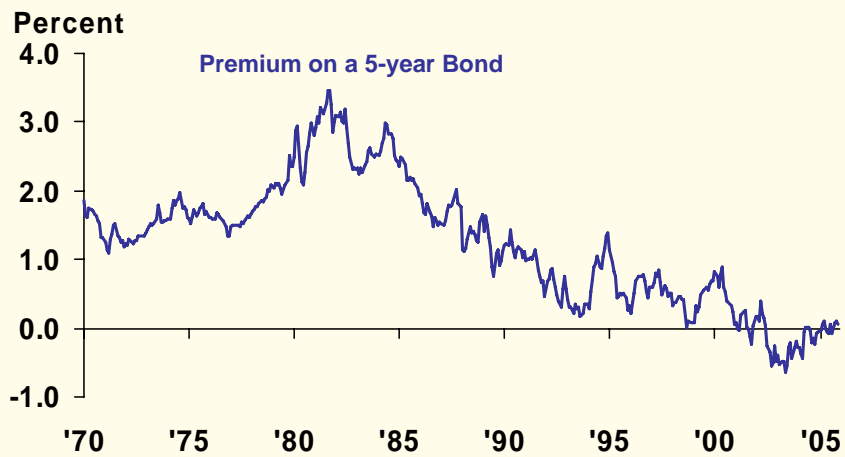
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Global Decline in Inflation



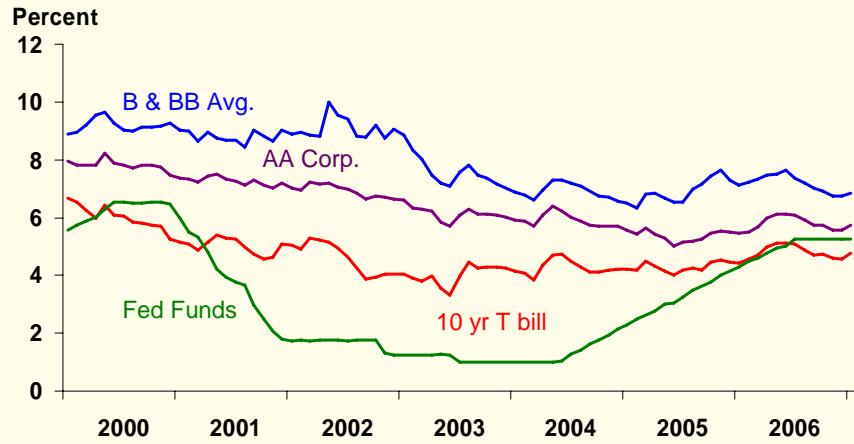
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Inflation Uncertainty Premium Disappearing



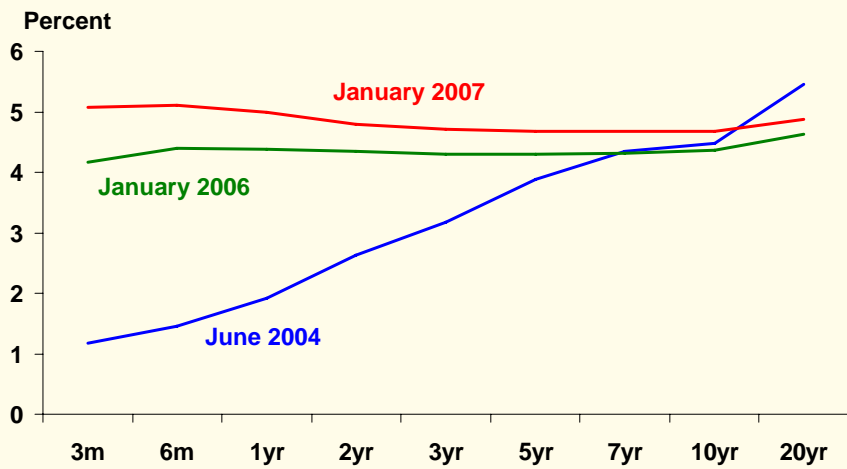
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Selected Interest Rates

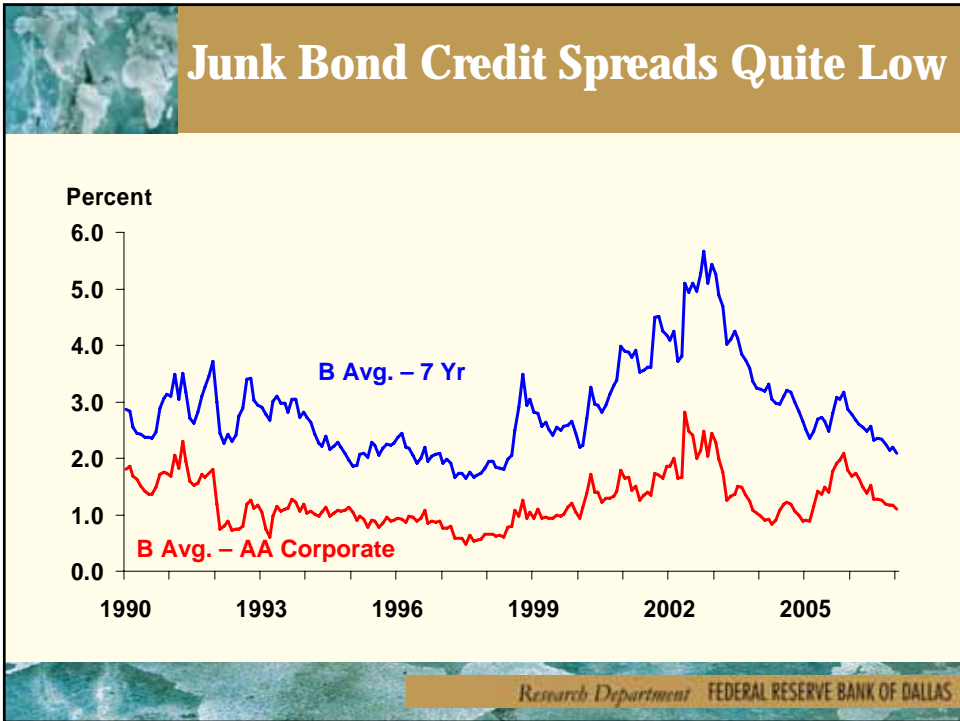
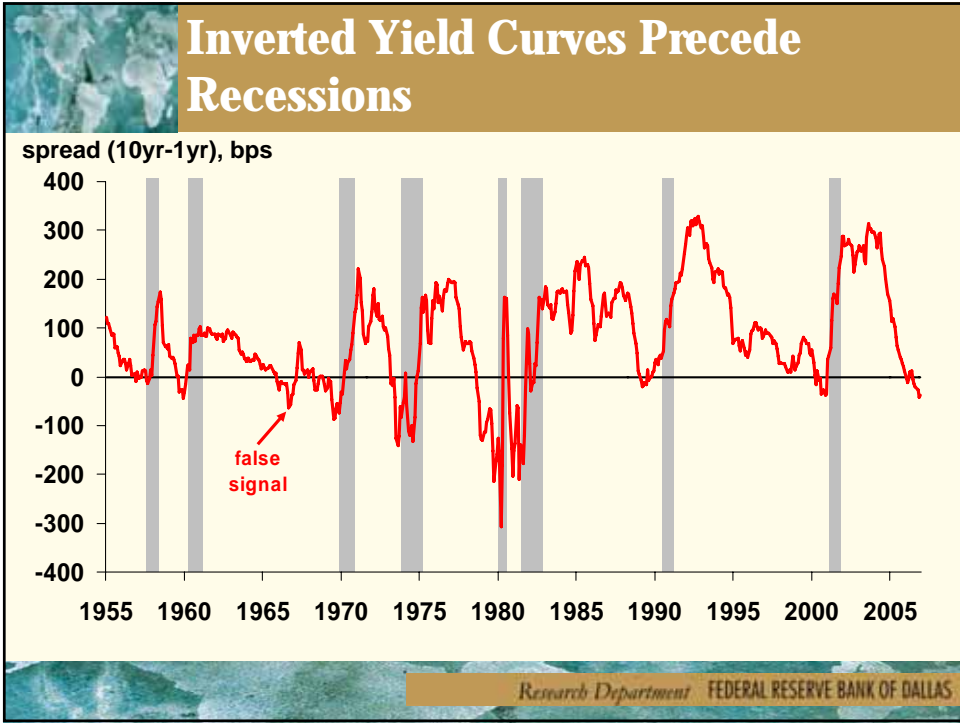


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Yield Curve Becomes Inverted



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Junk Bond Financing Increases In Importance

Percent of S&P-rated Corporate Bonds

	<u>1980</u>	<u>2006</u>
Investment grade AAA, AA, A, BBB	68%	29%
Below investment grade BB and below	32%	71%

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Stock Market Gains Add To Financial Wealth


	<u>2006 Gains (%)</u>
Dow	15.8
S & P 500	13.3
Wilshire 5000	13.7

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Yield Curve Recession Forecast
Inconsistent with Credit Spreads
and Equity Market Indicators

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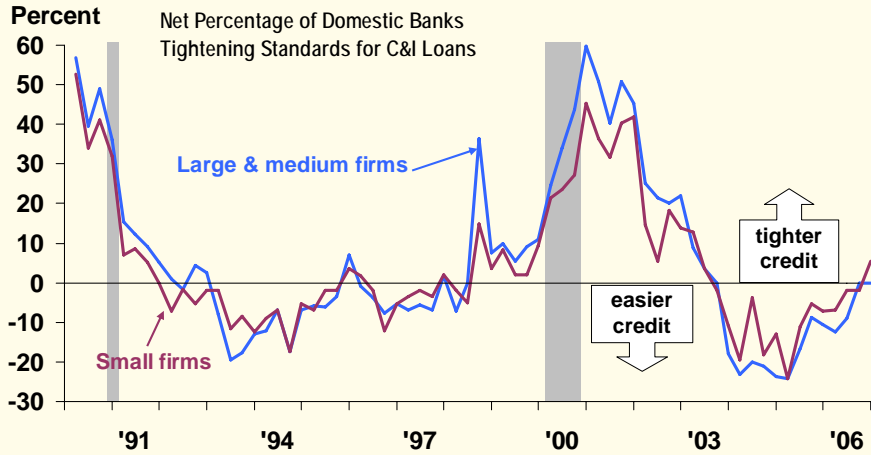


The Role of Banks

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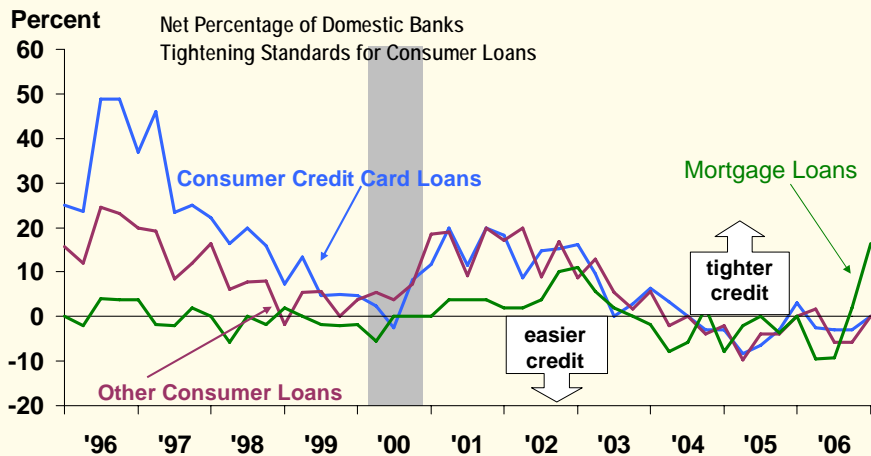


Firming Bank Credit Standards For Business Loans



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Firming Bank Credit Standards For Consumer Loans




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Banking Industry In Top Shape

- Near-record profits
- Low loan delinquencies
- Credit losses declining, but noncurrent loans on the rise
- Few problem banks

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- 
- Is this the beginning of the next cycle of reduced appetite for risk?
 - If so, when will it show up in the pricing of risk?

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Issues for Central Banks in a World of Globally-Linked Capital Markets

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A Forward-looking Taylor Rule

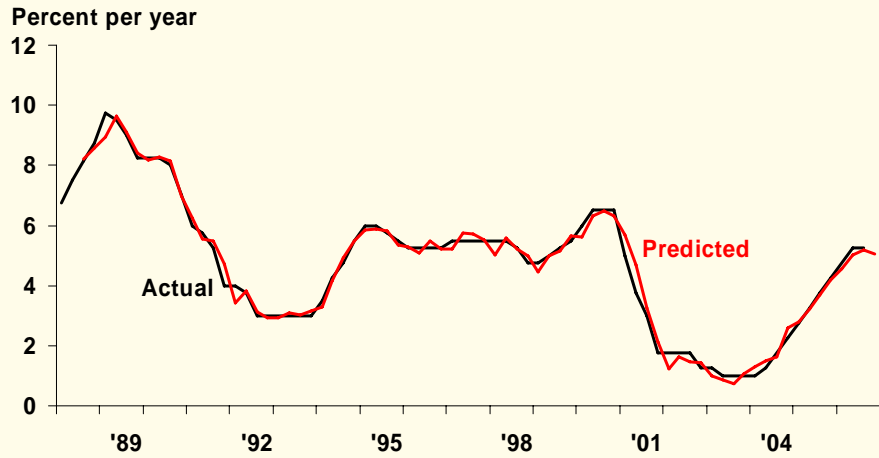
Fed Funds-Rate Response to a 1-percentage Point Increase In Each of Three Determinants

Determinant	Fed Funds-Rate Response	
	Initial (percentage points)	Eventual (percentage points)
Expected Inflation	+1.0	+1.9
Unemployment Rate	-1.0	-2.1
Expected GDP Growth	+0.4	+0.7

Source: E. Koenig, Southwest Economy, May/June 2004

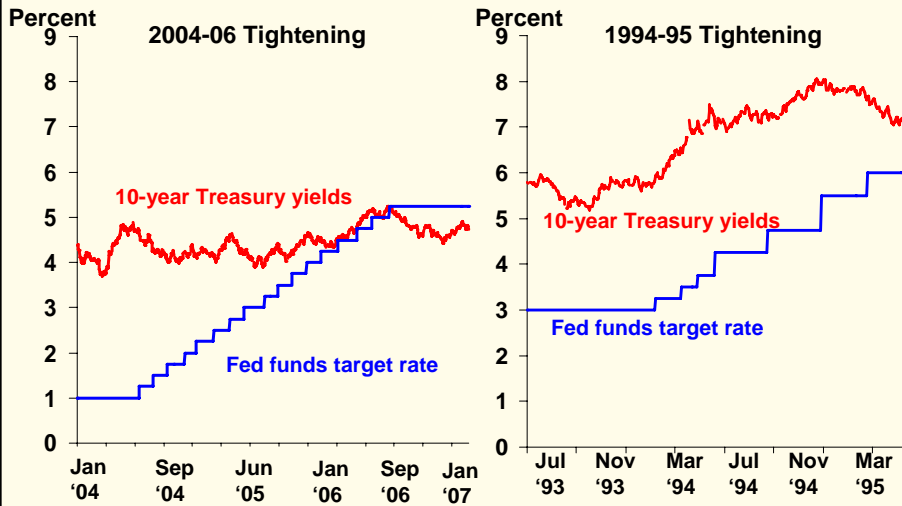
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The Taylor Rule Explains Fed Policy Fairly Well



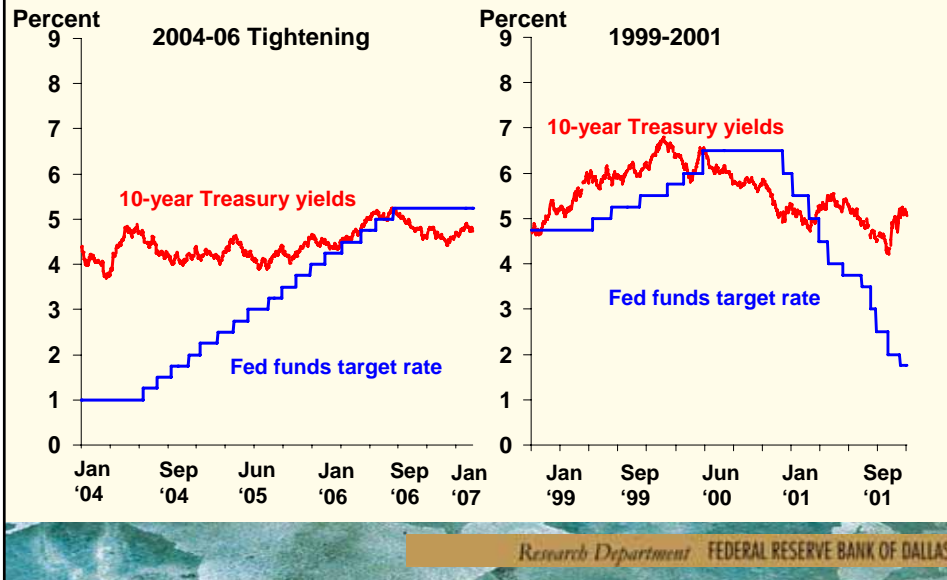
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Interest Rates Behave Differently in Three Eras



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Interest Rates Behave Differently in Three Eras



Lingering Issues

- In today's globalized financial markets, long-term interest rates respond less, if at all, to changes in short-term interest rates
- The response of aggregate demand to changes in short-term rates may be more sluggish
- Will monetary policy guides like the Taylor Rule need to be adjusted?