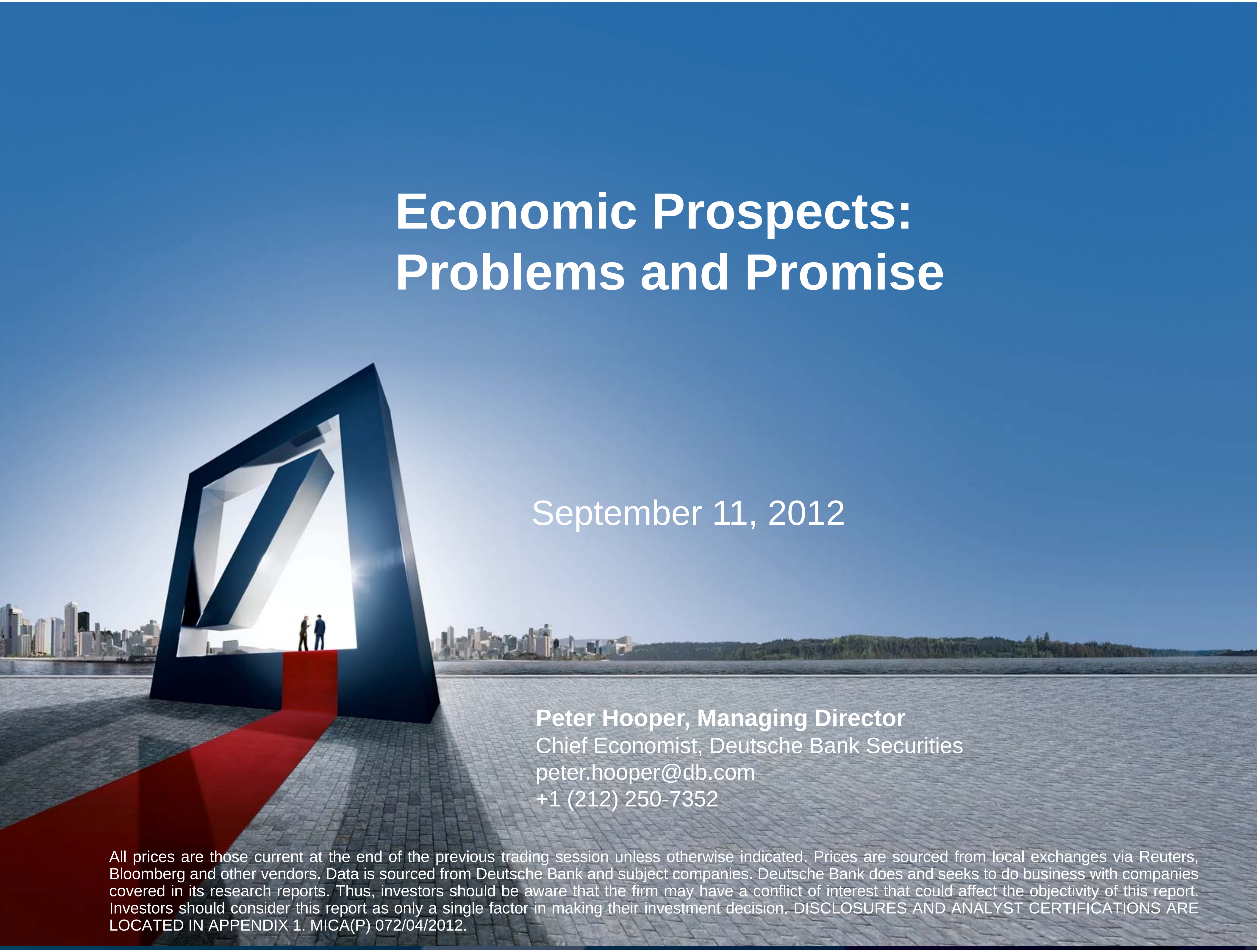

Economic Prospects: Problems and Promise

September 11, 2012

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DB Views

Fed will ease again this week. More QE will exacerbate exit challenges, but economic prospects weak enough to warrant action.

Euro risk is likely to be with us for several more years.

US fiscal uncertainties loom large.

US has potential to be an engine of global growth again.

Source: DB Global Markets Research

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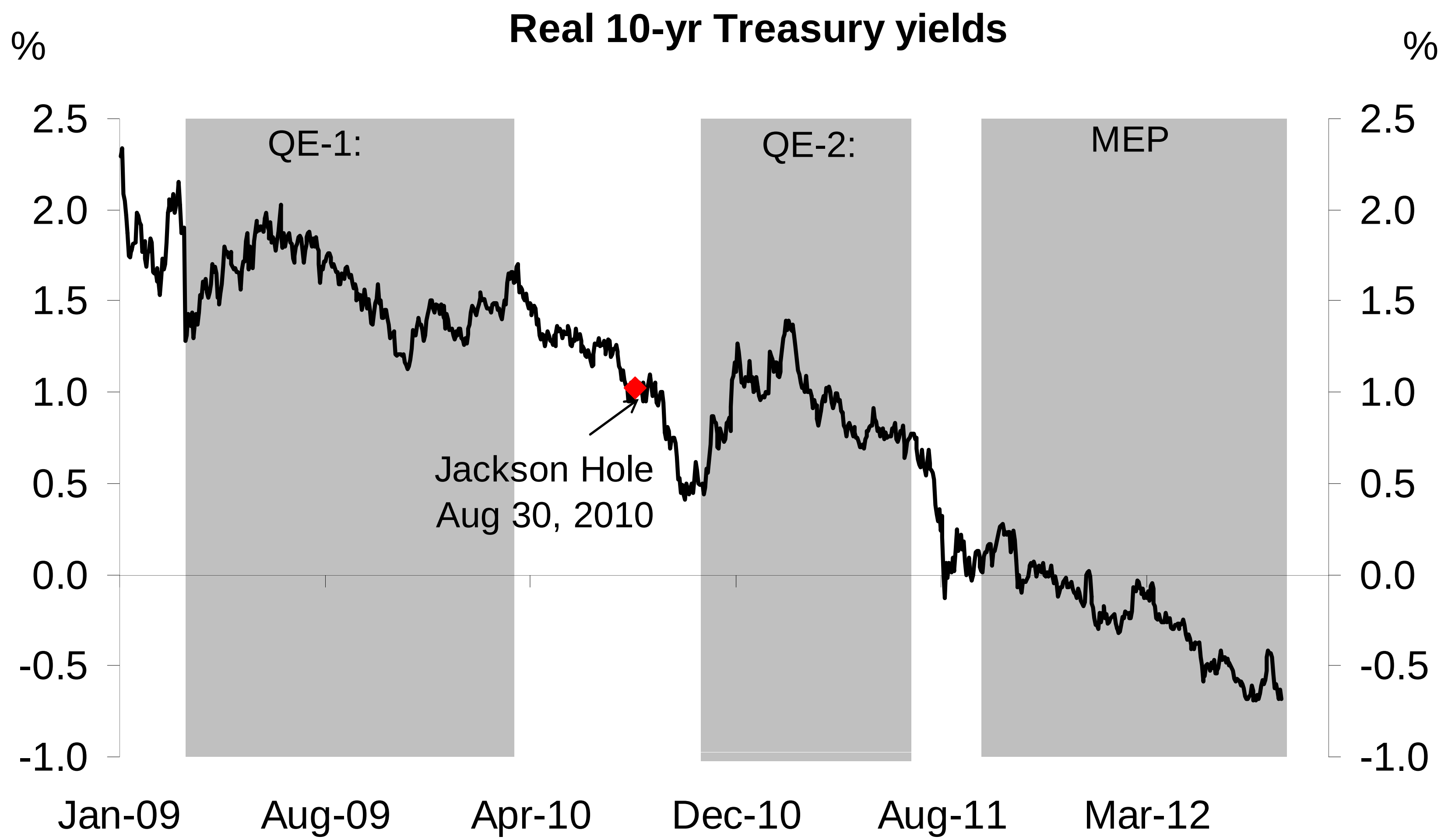
Fed BSPs pushed real interest rates lower



Source: FRB, Haver Analyttics, DB Global Markets Research

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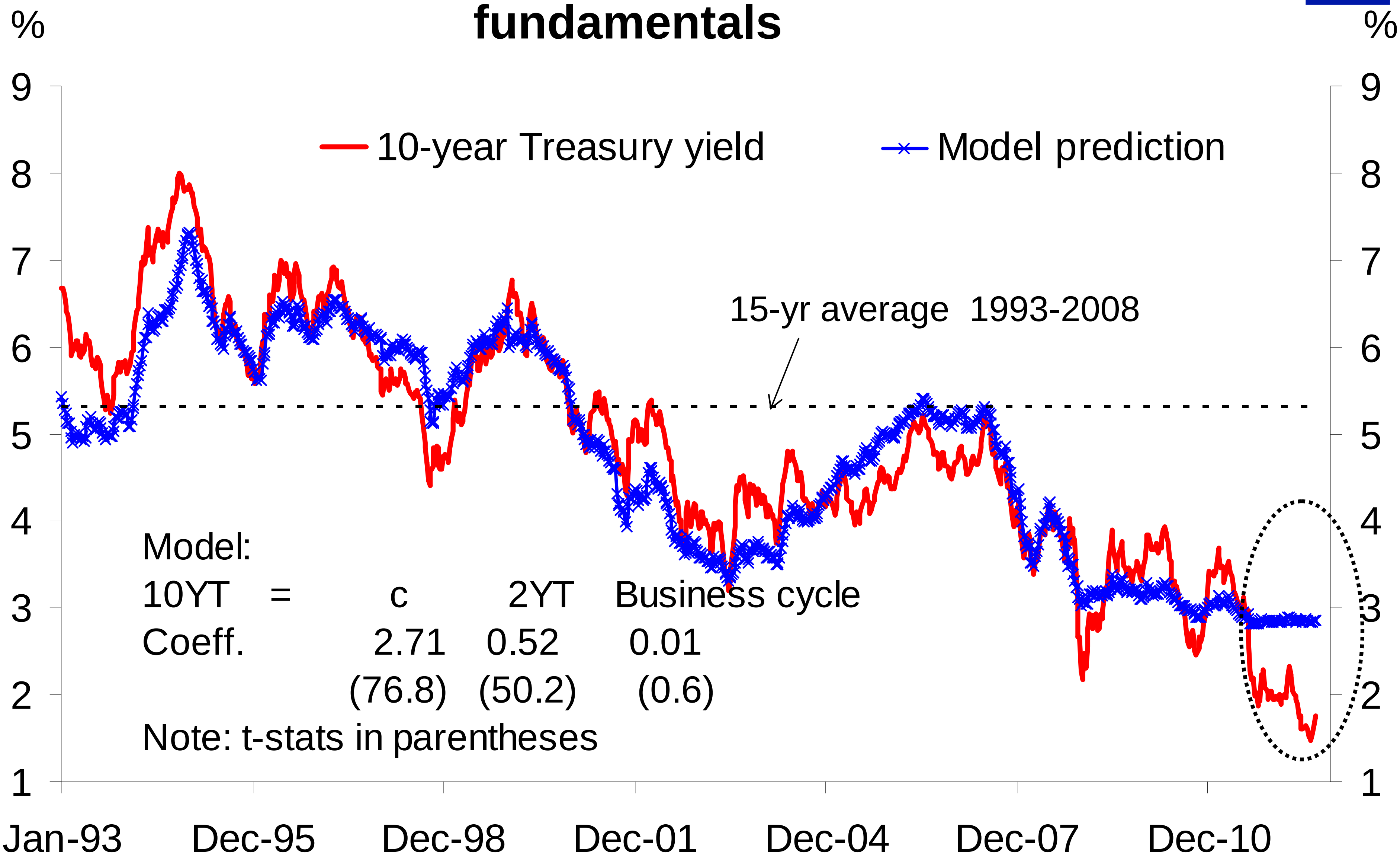
US 10y yield running well below business cycle fundamentals



Note: Explanatory variables used in the model are 2y treasury yield and Aruoba-Diebold-Scotti Business Conditions Index

Source: FRB, DB Global Markets Research

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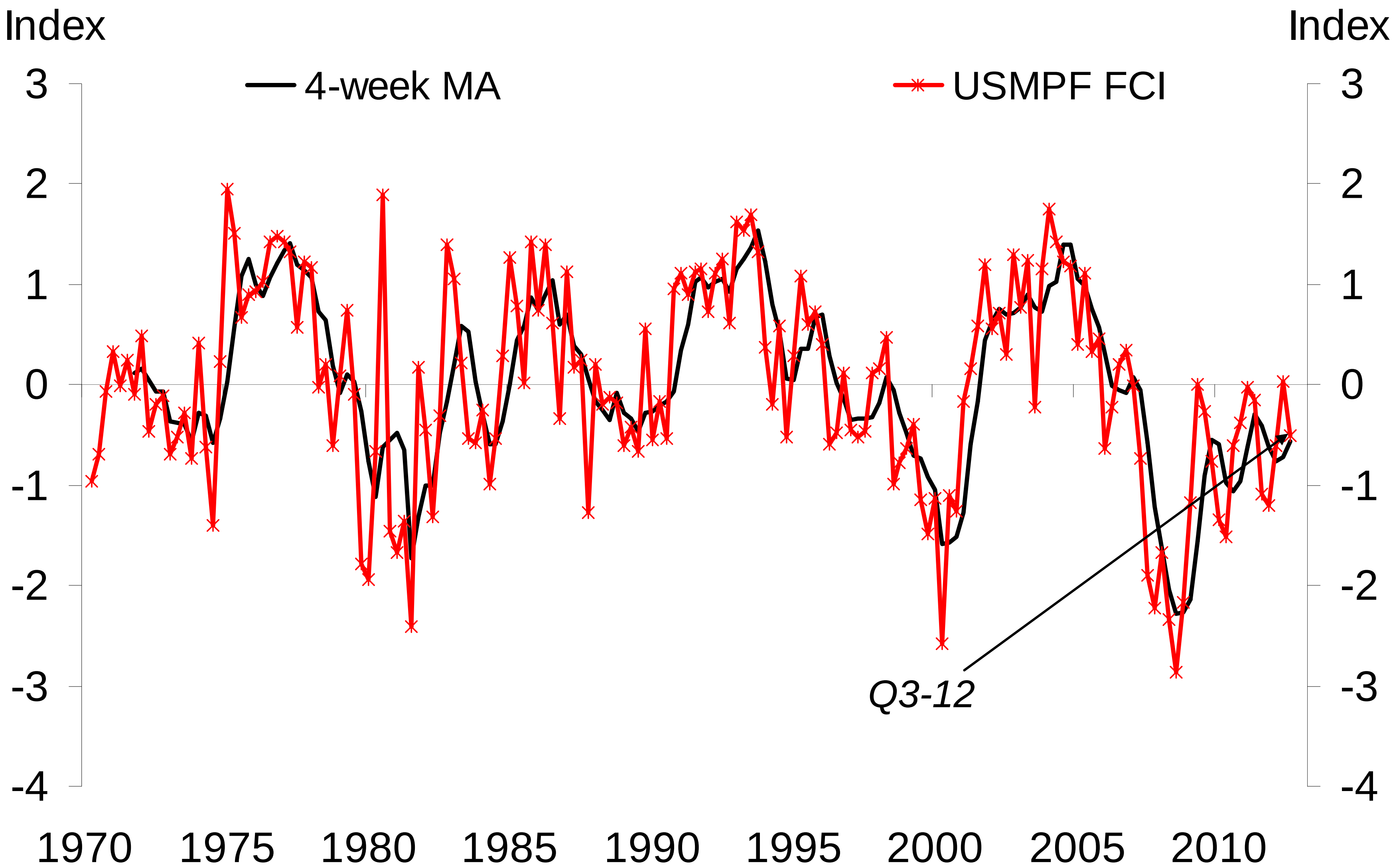
Financial conditions still a moderate drag



Source: US Monetary Policy Forum Report 2010, DB Global Markets Research

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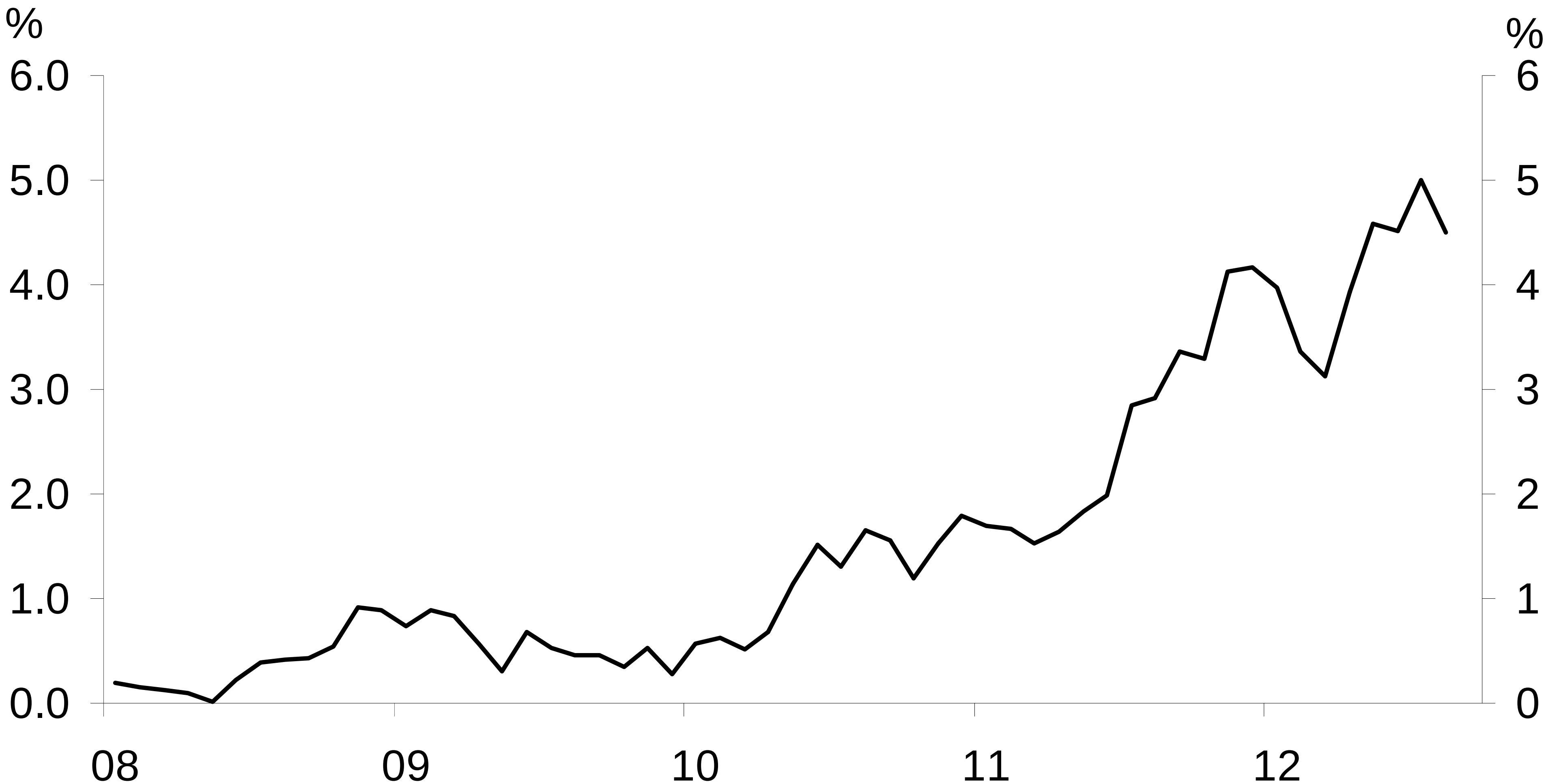
Euro risk is elevated

Avg. Italy & Spain 10-yr Govt bond spreads rel. to bunds*



* Measured as difference between German 10 year treasury yields and average of (Italy and Spain 10 year treasury yields).

Source: Bbk, BDIT, BDE, Haver Analytics, DB Global Markets Research

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Euro risk here to stay for a good while

- **Muddle through will persist because of political attachment to euro in core and periphery and high cost of failure/exit.**
- **Don't expect a US solution: full fiscal union and euro-bonds not in the Euro area's foreseeable future.**
- **Solution that will maximize membership is "conditional assistance," with ESM doling out assistance and ECB providing lots of liquidity so long as members make needed progress on fiscal and structural reforms (OMT).**
- **Reforms unpopular, monitoring and enforcing conditions means stress in markets.**
- **EA is two years into a 5-year adjustment program. Expect substantial fiscal drag and weak growth into 2015.**
- **EA reforms have further to go, but EA also does not get credit it deserves for progress already made.**

Source: DB Global Markets Research

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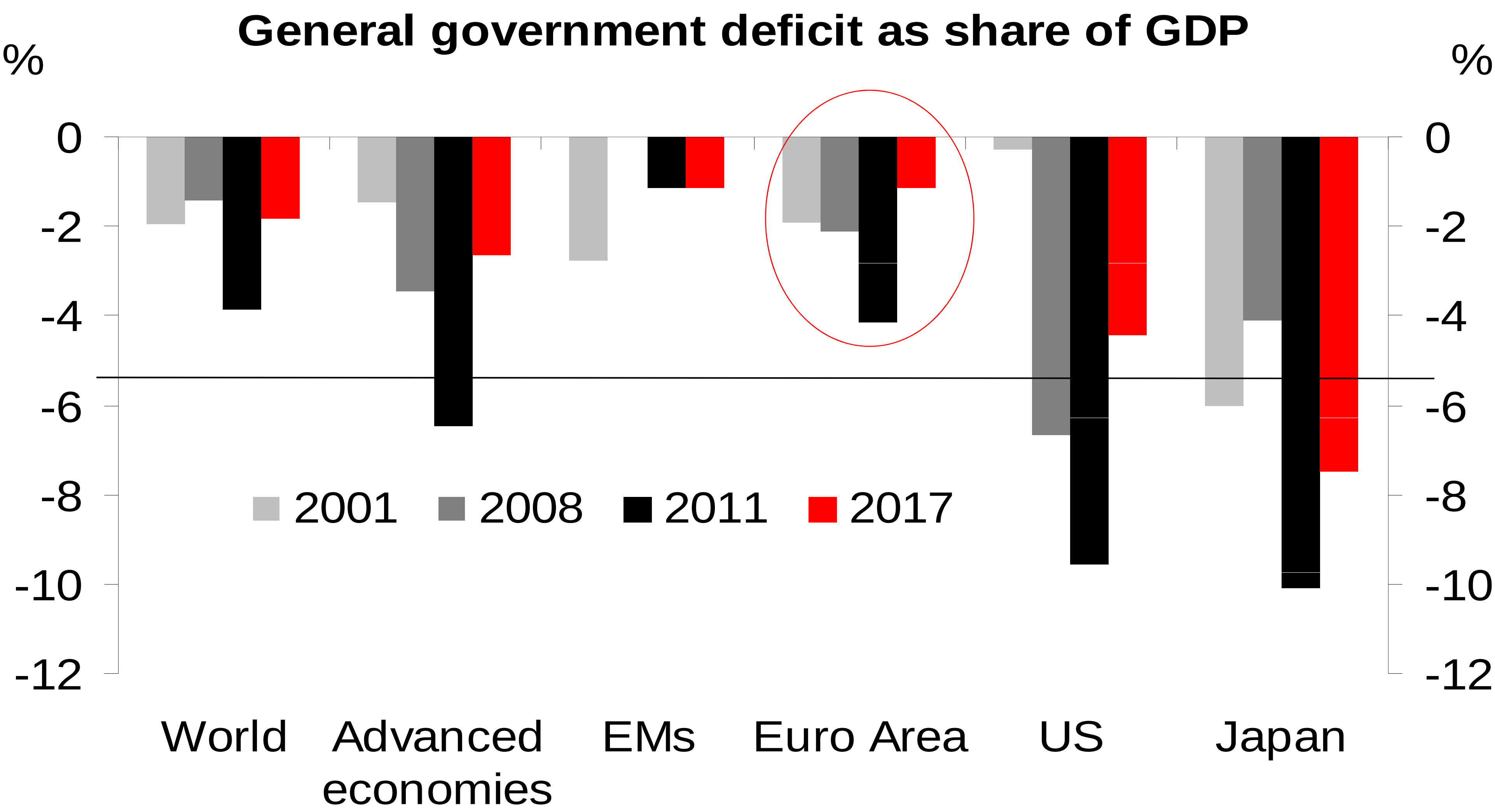
Euro Area fiscal position relatively good



Source: IMF, Haver Analytics, DB Global Markets Research

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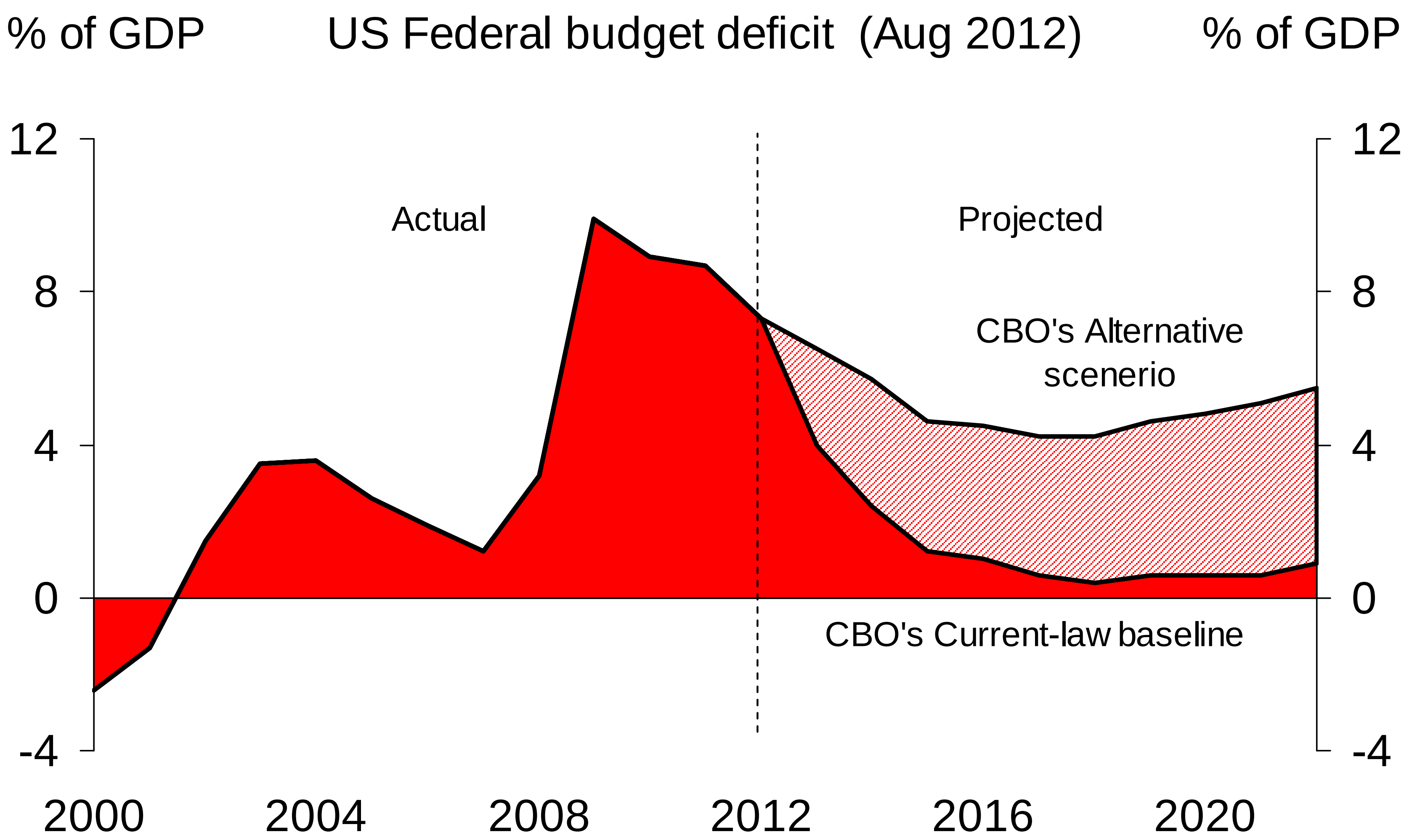
US fiscal cliff looms



Note: The budget deficit denoted in positive sign whereas surplus in negative

Source: CBO, DB Global Markets Research

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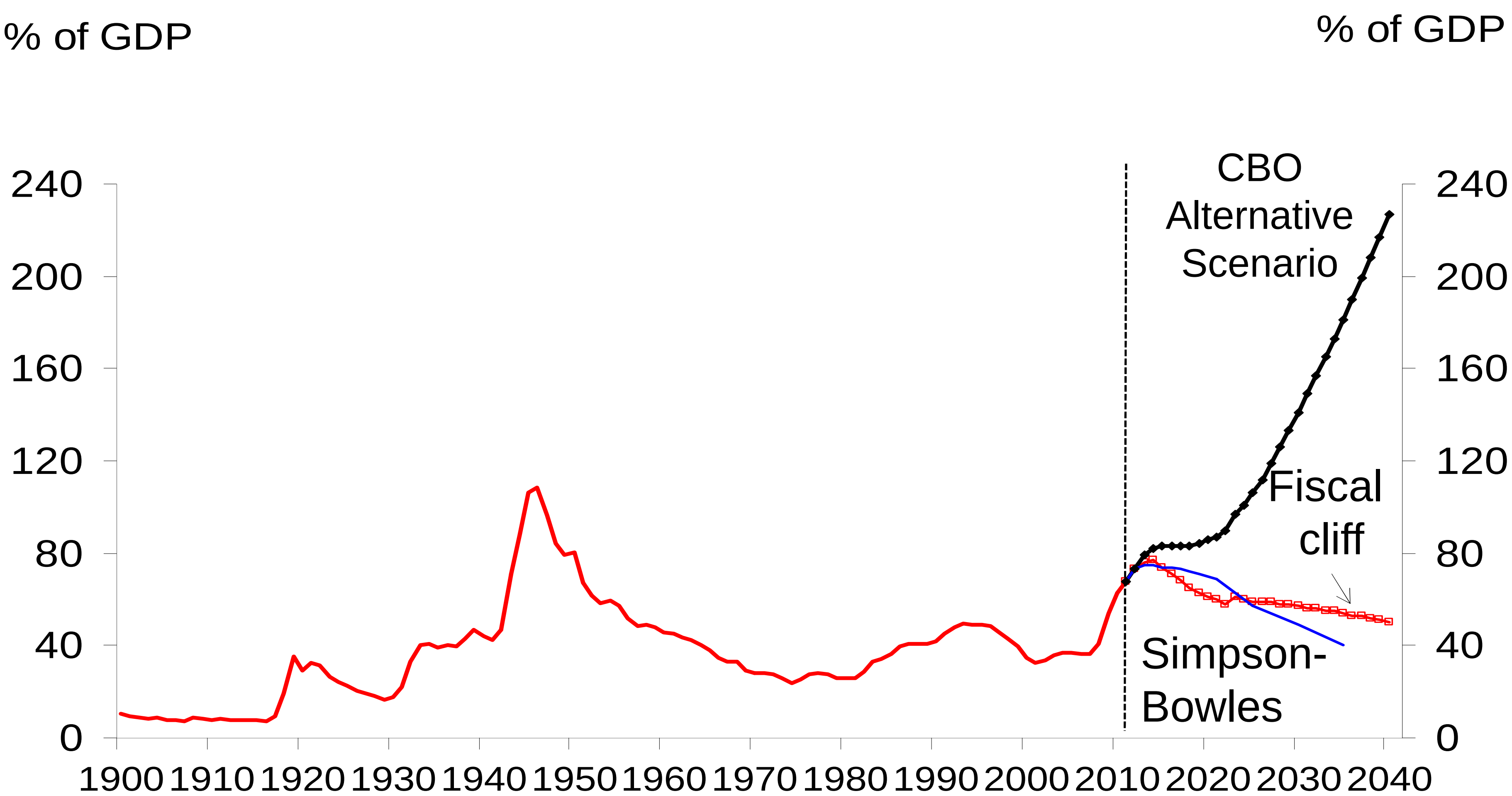
Mountain of debt lies beyond the cliff



Source: usgovernmentspending.com, Fiscal Commission, CBO, DB Global Markets Research

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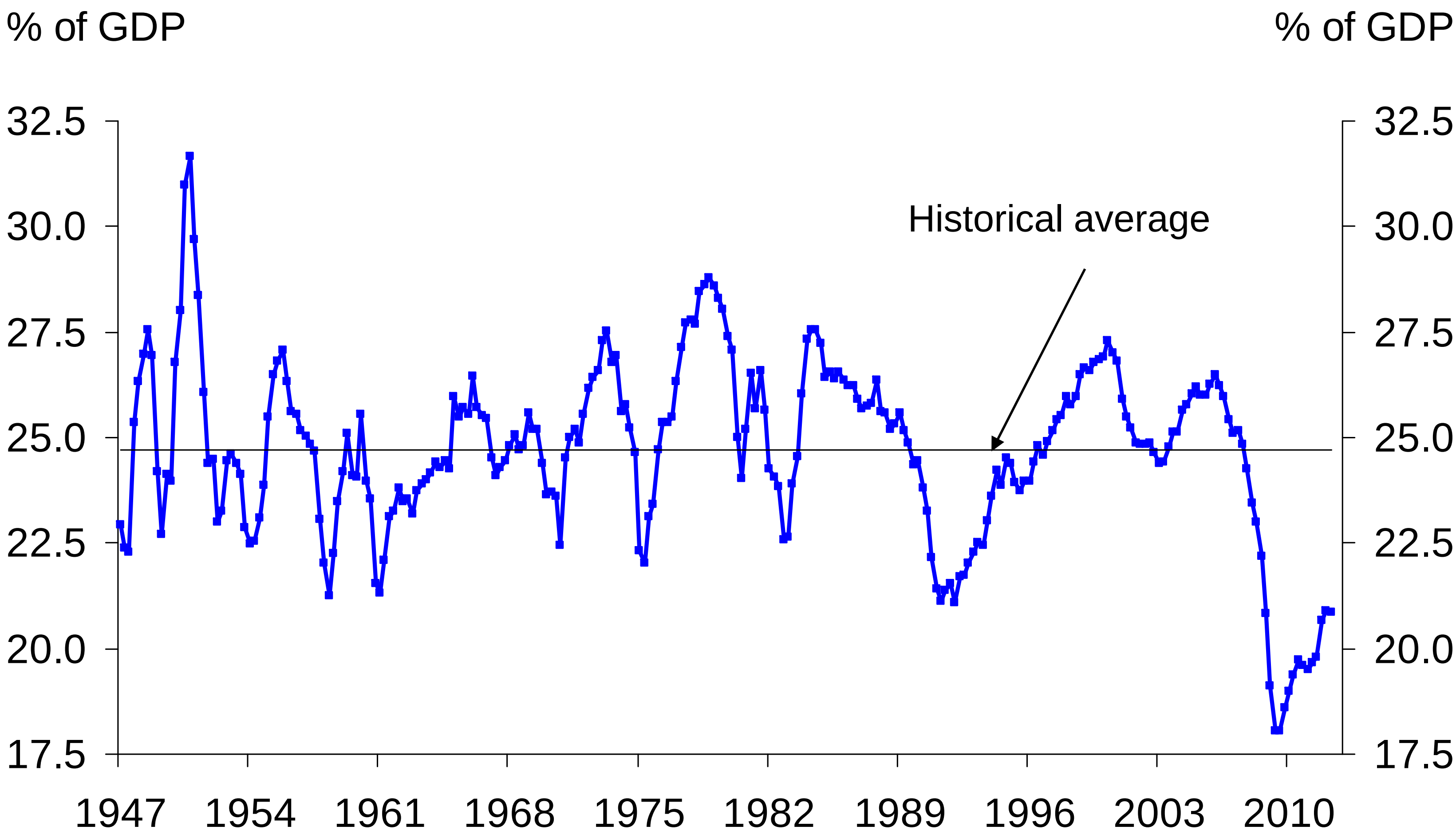
US poised to be an engine of global growth

Private fixed investment/GDP at historic low



*Discretionary spending here includes personal consumption expenditure on durable goods and gross domestic private investment.

Source: BEA, Haver Analyttics, DB Global Markets Research

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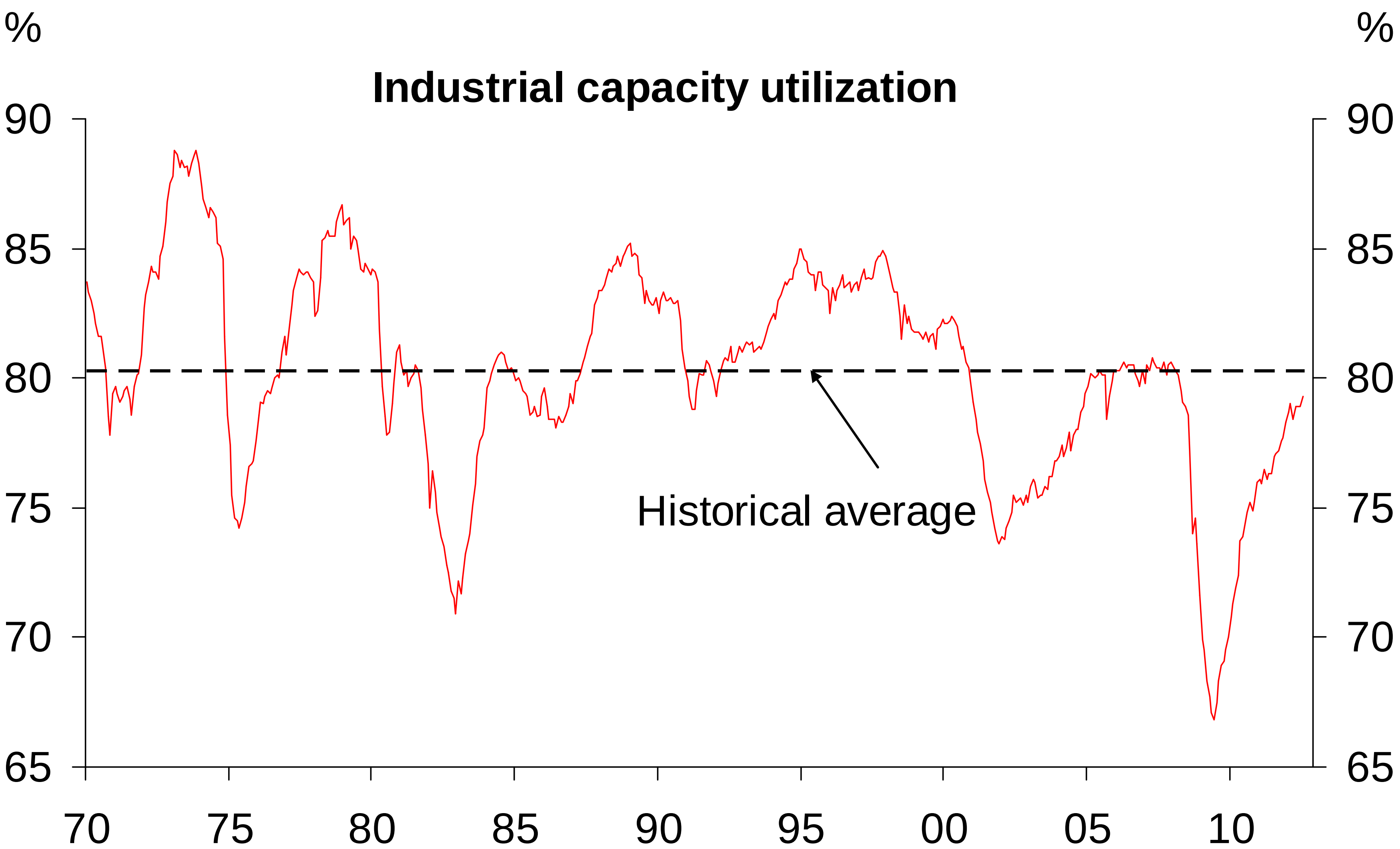
Capacity utilization back to historical norm



Source: FRB, Haver Analytics, DB Global Markets Research

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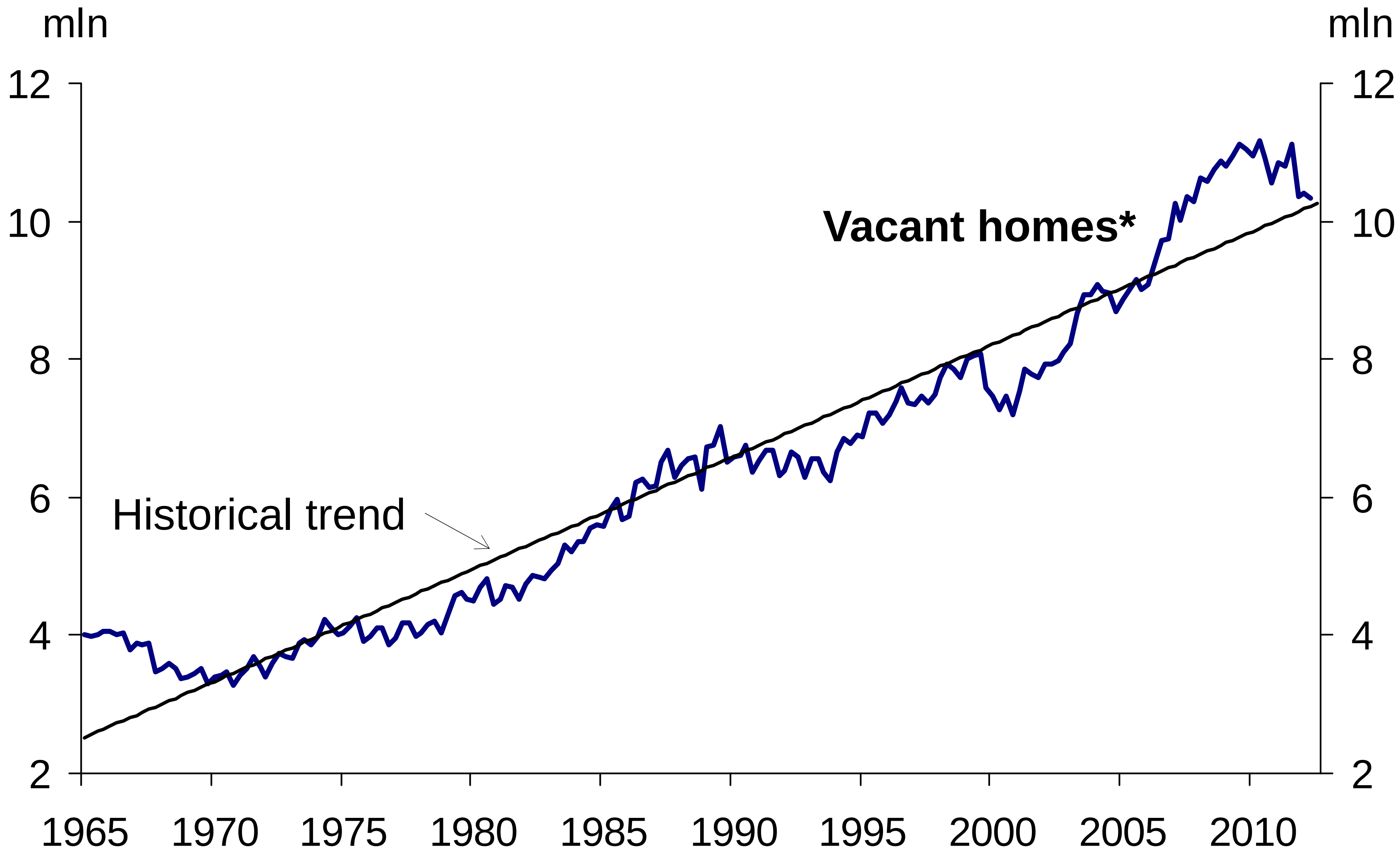
Excess stock of vacant homes has disappeared



* Includes homes for sale, homes for rent, and homes held off the market for other reasons; excludes seasonal homes and second homes not used a primary residence.

Source: Census, Haver Analytics, DB Global Markets Research

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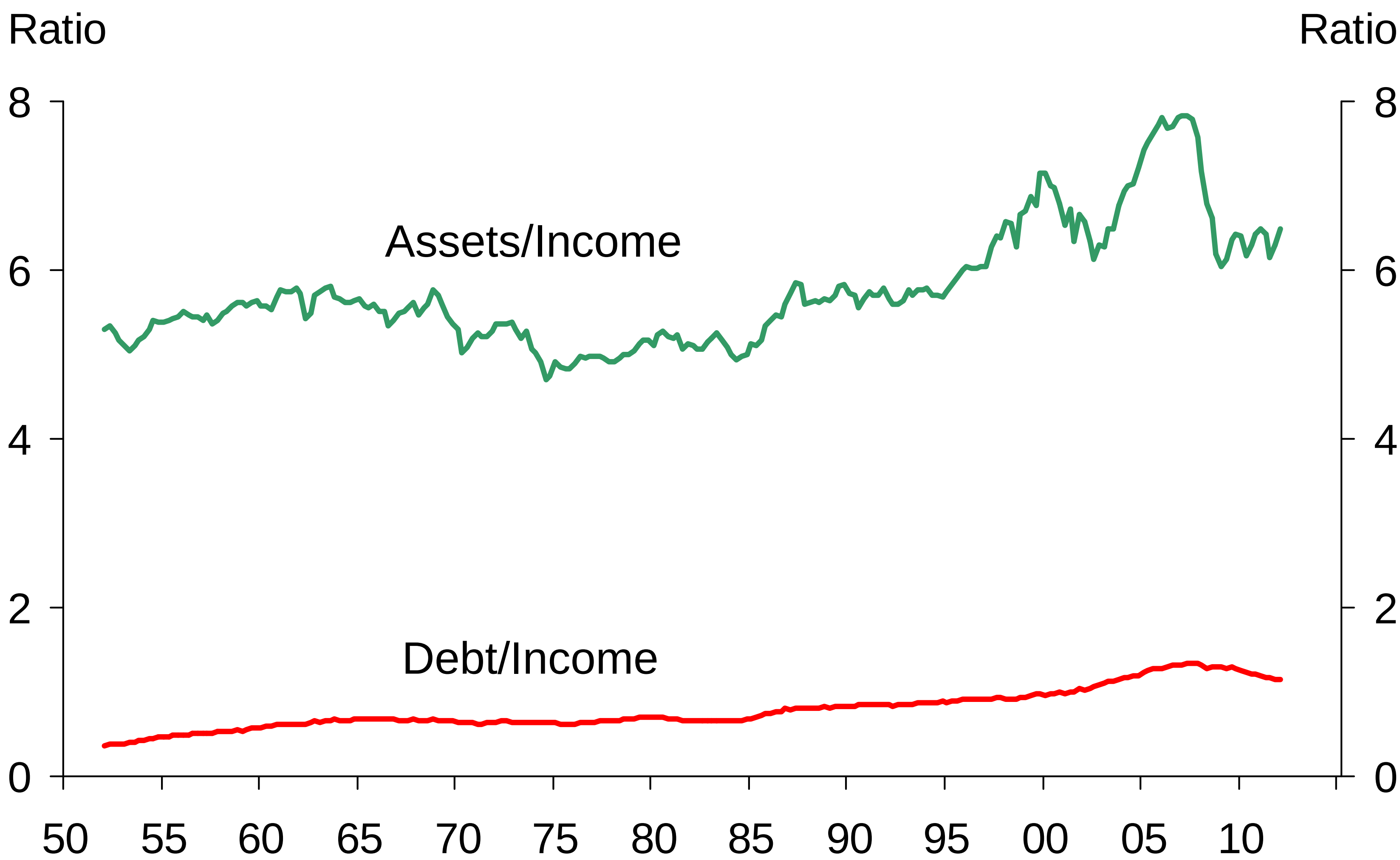
Household deleveraging and asset recovery



Source: FRB, Haver Analytics, DB Global Markets Research

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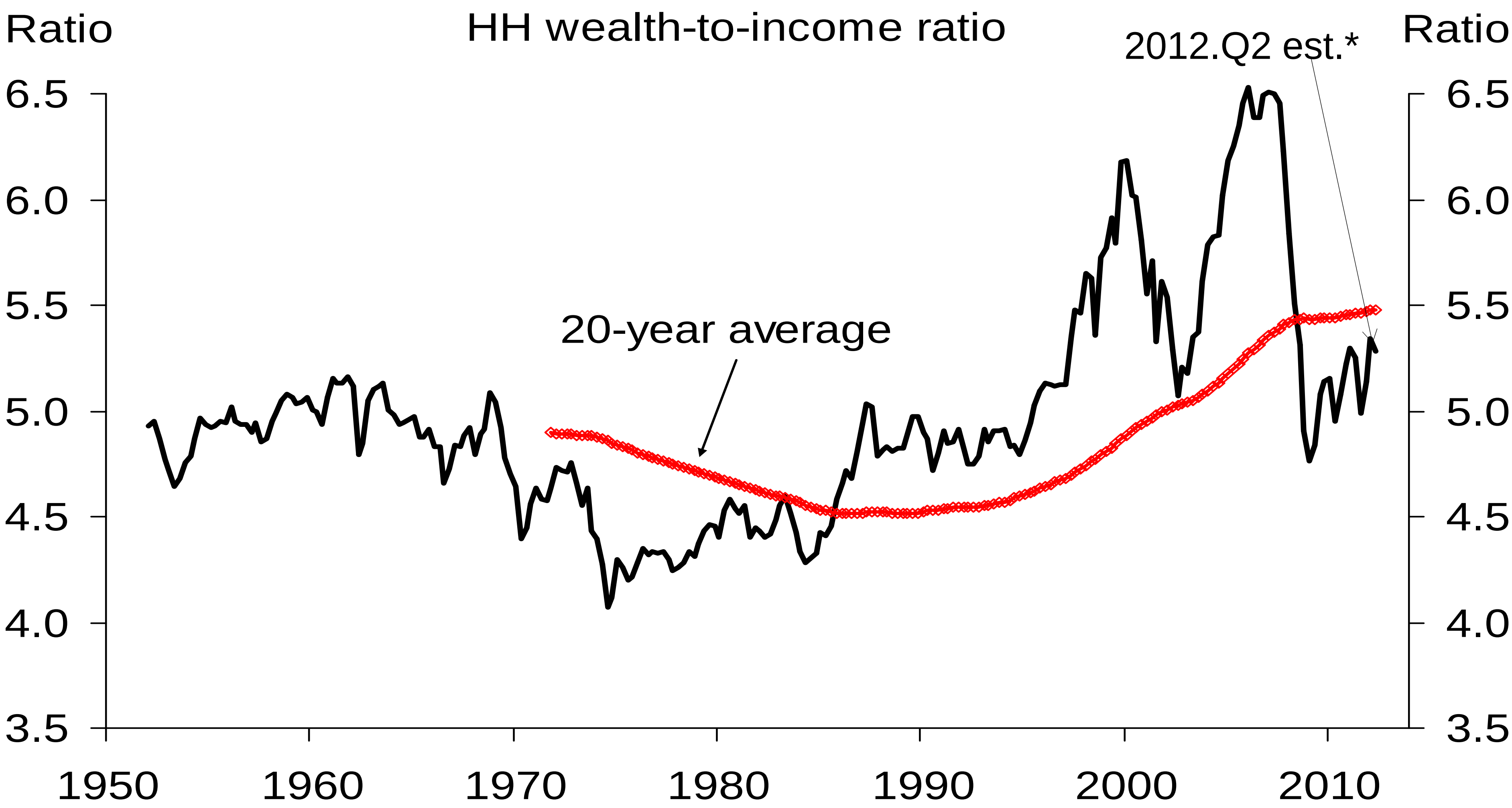
Household balance sheets looking more normal



*Assumption: house prices fall by 2% by end of 2012 and stock rises by approx. 1% each quarter in 2012 on %QoQ basis, Nominal DPI increases by 4.2%

Source: BEA, FRB, Haver Analytics, DB Global Markets Research

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Key points

Fed will ease again this week. More QE will exacerbate exit challenges, but economic prospects weak enough to warrant action.

Euro risk is likely to be with us for several more years.

US fiscal uncertainties loom large.

US has potential to be an engine of global growth again, as capital stock utilization rises, HH balance sheets have adjusted.

Source: DB Global Markets Research

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Peter Hooper is currently Managing Director and Chief Economist for Deutsche Bank Securities. He joined Deutsche Bank Securities in the fall of 1999, first as Chief International Economist and shortly thereafter as Chief US Economist. He became Chief Economist and co-head of global economics in 2006. Prior to joining Deutsche Bank, Hooper enjoyed a distinguished 26-year career at the Federal Reserve Board in Washington, D.C. While rising to senior levels of the Fed staff, he held numerous positions, including as an economist on the FOMC and as Deputy Director of the Division of International Finance.

Hooper produces weekly and quarterly publications for Deutsche Bank with a focus on US and global economic developments and Fed policy; he also comments on US and global economic and financial developments in the news media. His US Economics team has been ranked No. 1 in fixed income research by Institutional Investor in 2010 and 2011. Hooper currently serves as a member of the Economic Advisory Panel of the Federal Reserve Bank of New York, a member and former chairman of the Economic Advisory Committee of the American Bankers Association, a founding member of the US Monetary Policy Forum, a member of the Economic Leadership Council for the University of Michigan, and a member of the Forecasters' Club of New York.

Hooper earned a BA in Economics (cum laude) from Princeton University and an MA and Ph.D. in Economics from University of Michigan. He has published numerous books, journal articles, and reviews on economics and policy analysis.

Appendix 1

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Peter Hooper

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