At a meeting of the *American Business Forum on Europe* on March 1, 2010, Joseph Quinlan, Chief Market Strategist, Investment Strategies Group, Bank of America, gave a most interesting presentation on the state of the transatlantic economy and the fallout from the great recession of 2008-2009. Since you might not have been able to hear this important speech, we are sending you an abridged version below. The link to the entire speech can be found on the ABFE website at http://www.abfe.biz/Events.html.

Mr. Quinlan's presentation was based on the study "The Transatlantic Economy 2010" just released by the Center of Transatlantic Relations, Johns Hopkins University to be found at http://transatlantic.sais-jhu.edu/transatlantic-topics/transatlantic-economy-series.htm

The Fallout from the Great Recession of 2008-2009

By many measures 2009 was a very challenging year for all transatlantic stakeholders—consumers, workers, companies and countries. The collateral damage from the recession is evident from the following:

After surging over the 2002-2007 period, U.S. foreign affiliate income earned in Europe peaked in the first half of 2008 before declining sharply thereafter. U.S. affiliate income fell 25% in the first nine months of 2009 from the same period a year earlier. We estimate that affiliate income totaled $137 billion for all of 2009, down 23% from the peak in 2007.

Not surprisingly, the U.S. economic downturn has taken its toll on the earnings of European affiliates operating in the United States. Between 2002 and 2007, affiliate earnings rose more than three- fold, surging from $26.7 billion in 2002 to $72 billion in 2007. In 2008, however, European affiliates saw their U.S. earnings decelerate sharply. The downturn was extended in 2009, with total European affiliates dropping 22% in the January-September period 2009 versus a year ago.

Affiliate earnings of French companies fell 30%. British and Dutch affiliates saw their U.S. earnings slip by roughly 12% and 20%, respectively, in the first nine months of 2009. Overall, German companies were a great exception: affiliate earnings of German companies in the U.S. rose nearly 230% in the period January-September 2009, compared with a year earlier. As the U.S. economy recovers in 2010, affiliate earnings for other European affiliates should also rebound.

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Because earnings are a significant component of foreign direct investment, it is not surprising to report that as affiliate income declined on both sides of the Atlantic last year, so did transatlantic foreign direct investment flows. For instance, foreign direct investment from the Netherlands to the U.S. plunged 48% in the January- September time frame versus the same period a year earlier. Investment from the United Kingdom fell 65% over the same period. Investment from France held relatively steady, at less than 1% less than the same period the previous year. German investment bucked the trend, however, growing by 96% in this period.

U.S. investment flows to Europe also exhibited a decelerating trend in 2009. U.S. capital flows to Europe declined 44% in the first nine months of the year versus the prior year. Declines were reported in Germany, the Netherlands, Spain and a handful of other nations.

After hitting a cyclical peak in 2007, transatlantic merger and acquisition (M&A) deals fell rather steeply in 2009. For instance, U.S. M&A deals in the EU27 totaled just $32 billion in 2009, a 60% decline from the prior year. Meanwhile, EU27 M&A deals in the United States also declined in 2009, by roughly 86%. Total deals were valued at $22.5 billion in the year, well off the peak levels of 2007, when total M&A deals in the U.S. topped nearly $200 billion. Beyond the drop in deal- making: the rising cost of capital, weaker corporate earnings, and the cyclical downturn in the transatlantic economy. All three variables have converged both to end the five- year boom in transatlantic M&A.

Trends in transatlantic trade were similar to trends in transatlantic investment and foreign affiliate income. U.S. exports to Europe in the first three quarters of 2009, for example, fell by nearly 20% from the same period a year earlier, one of the steepest declines in years. U.S. imports from Europe fell 24% in the first three quarters of 2009 versus the same period in 2008.

Despite the lower value of the dollar relative to the euro, U.S. exports to the United Kingdom U.S. imports from Europe fell 24% in the first three quarters of 2009 versus the same period in 2008. Exports of goods and services to France and Germany fell 9.5% and 20% respectively through the first three quarters of 2009 from the same period in 2008.

In sum, the United States and Europe remain each other’s most important foreign commercial markets, a fact still not fully appreciated by opinion leaders on both sides of the transatlantic. Put simply, no other commercial artery in the world is as integrated and fused together as the transatlantic economy.