

The General Economic Outlook

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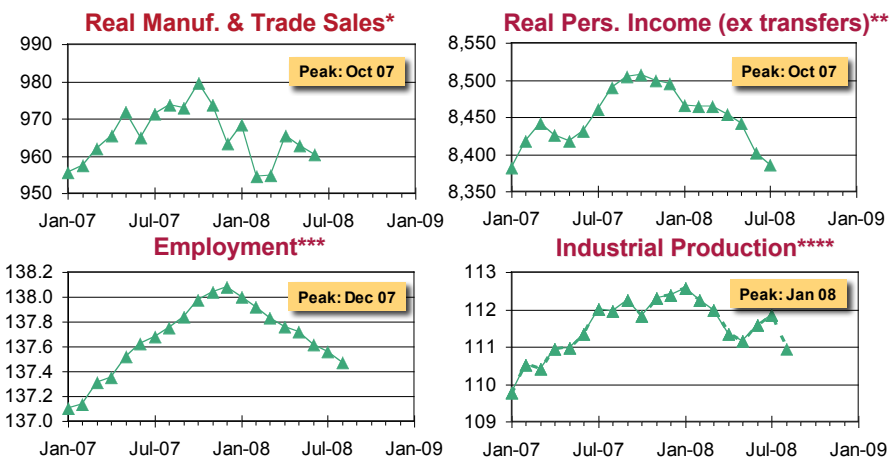
W-Shaped Growth Path Is The Most Likely One

- **First-half of the year better than expected for GDP growth, but...**
- **Financial crisis is not over**
- **Housing still declining, consumer credit squeeze tightening**
- **Stimulus boost has proved short-lived, though lower oil prices are helping**
- **Rest-of-the-world growth prospects are worsening, threatening the export boom**
- **No sustained upturn before mid-2009**

Financial Crisis Deepens

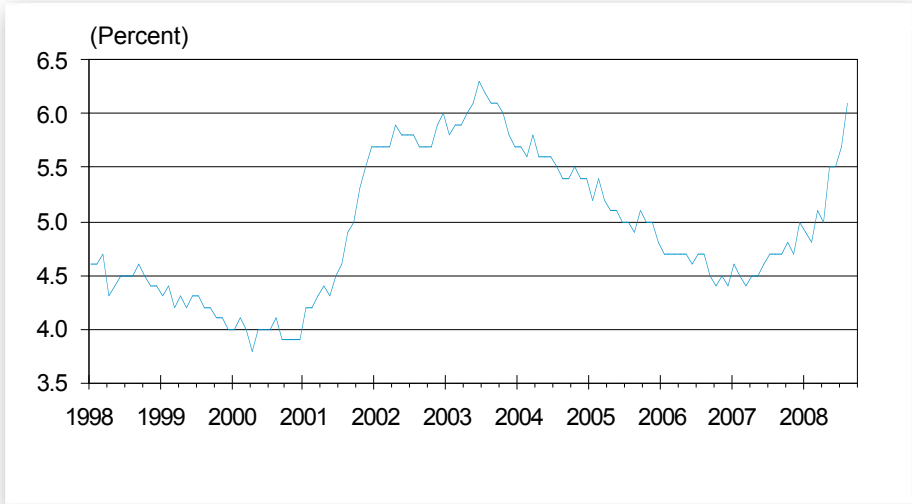
- Lehman Brothers goes under
- BoA buys Merrill Lynch
- AIG seeking \$40 billion in loans from Fed?
- Fed broadens collateral against loans to include equities
- Ten banks create \$70 billion loan facility
- Implications: credit crunch worsens
- Fed rate cut back in play
- Second fiscal stimulus package becomes more likely

NBER's Key Monthly Recession Indicators

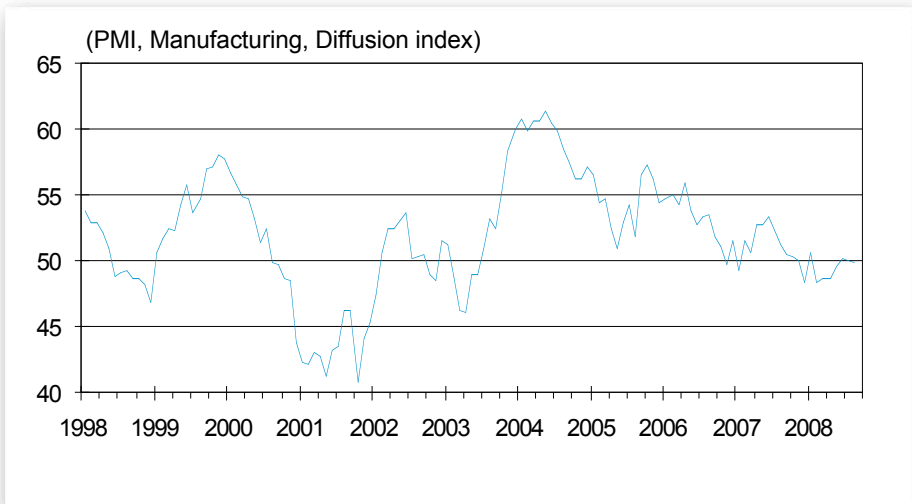


*Billions of 2000 dollars, SAAR; **Billions of 2000 dollars, SAAR; ***Millions, SA; ****Index, 2002=100, SA

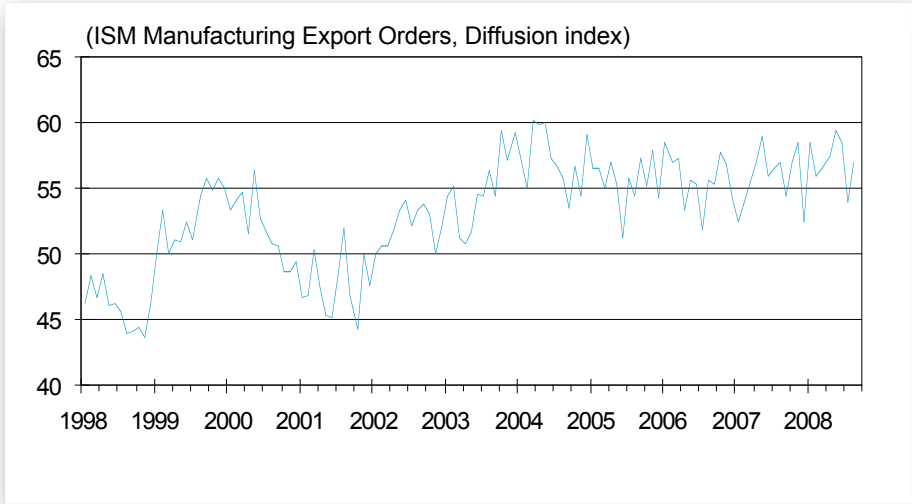
Unemployment Rate Rising



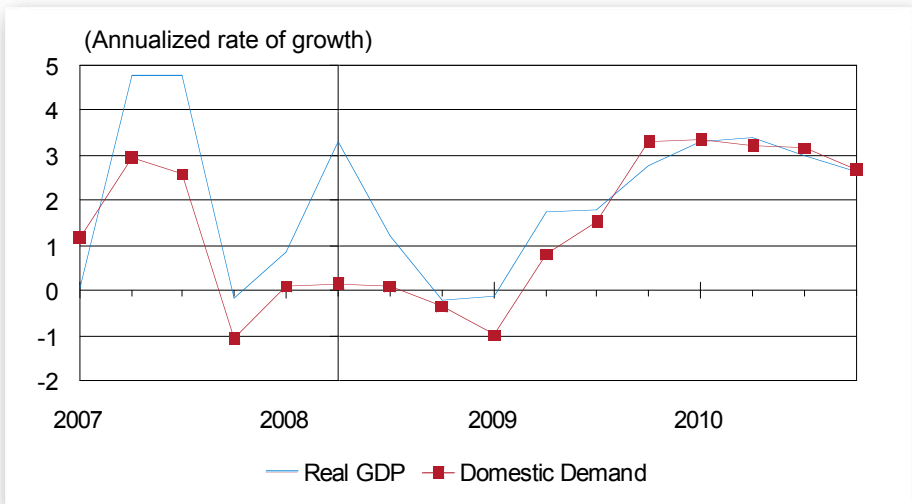
ISM Manufacturing Index Has Slipped, But Is Far From 2001 Levels



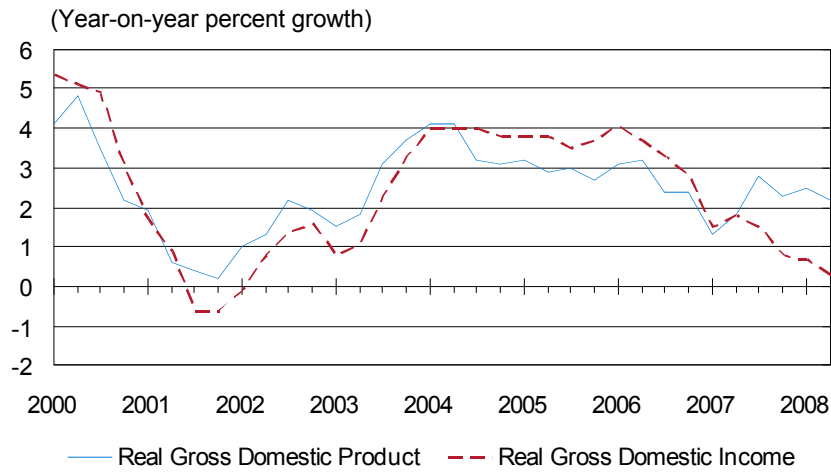
Exports Are Supporting Manufacturing



The Downturn Is Dampened by Foreign Trade



Is GDP Telling The Real Story?



U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2007	2008	2009	2010
Real GDP	2.0	1.8	1.0	2.9
Domestic Demand	1.4	0.3	0.3	2.9
Consumption	2.8	1.0	0.9	2.6
Light Vehicle Sales (Millions)	16.1	14.0	14.1	15.0
Residential Investment	-17.9	-21.2	-7.6	18.3
Housing Starts (Millions)	1.34	0.94	0.99	1.35
Business Fixed Investment	4.9	4.0	-1.7	2.5
Government	2.1	2.3	-0.2	-0.9
Exports	8.4	9.5	6.6	7.2
Imports	2.2	-1.6	0.8	6.3

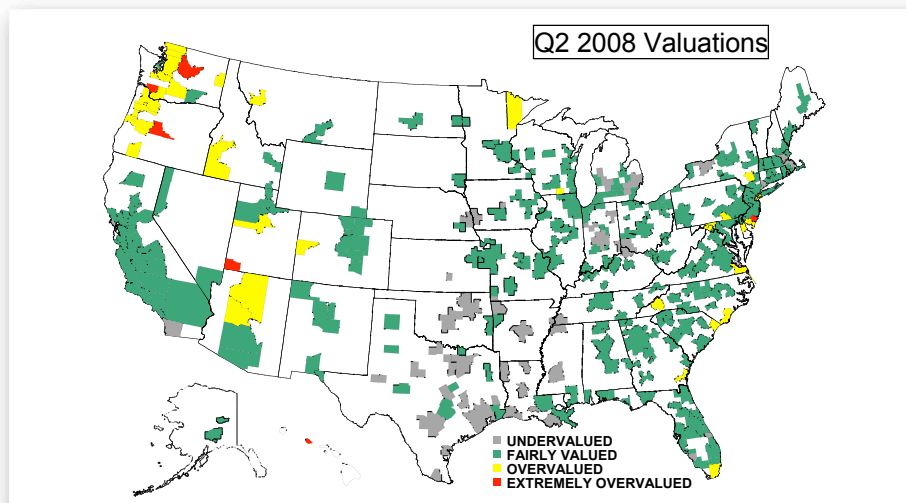
Other Key Indicators

(Percent unless otherwise noted)

	2007	2008	2009	2010
Industrial Production (% growth)	1.7	0.1	0.1	2.8
Employment (% growth)	1.1	0.0	-0.1	1.2
Unemployment Rate	4.6	5.4	6.1	5.9
CPI Inflation	2.9	4.6	2.5	2.0
Oil Prices (WTI, US\$/bbl)	72	114	110	108
Core PCE Price Inflation	2.2	2.3	2.2	2.1
Federal Funds Rate	5.02	2.32	2.43	4.32
10-year Government Bond Yield	4.63	3.80	3.94	5.19
Dollar (Major Currencies, 2000=1)	0.77	0.72	0.72	0.72

The Housing Downturn

House Prices: Overvaluations Becoming Less Extreme



Source: National City

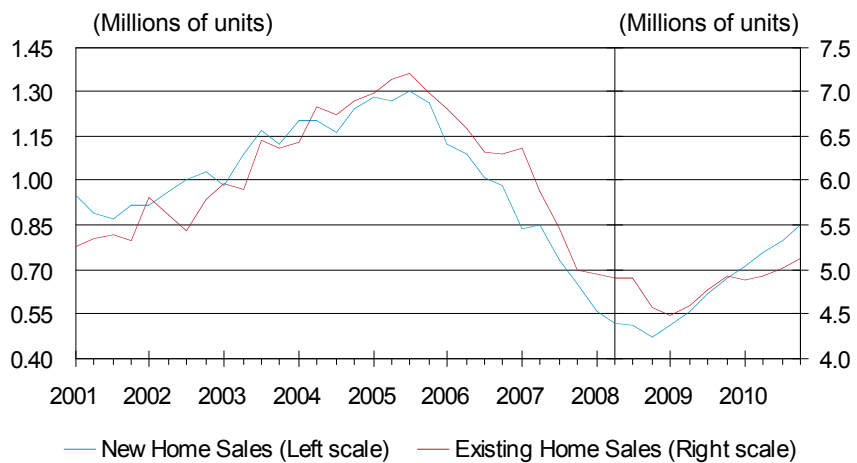


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Home Sales Probably Not Quite at Bottom Yet

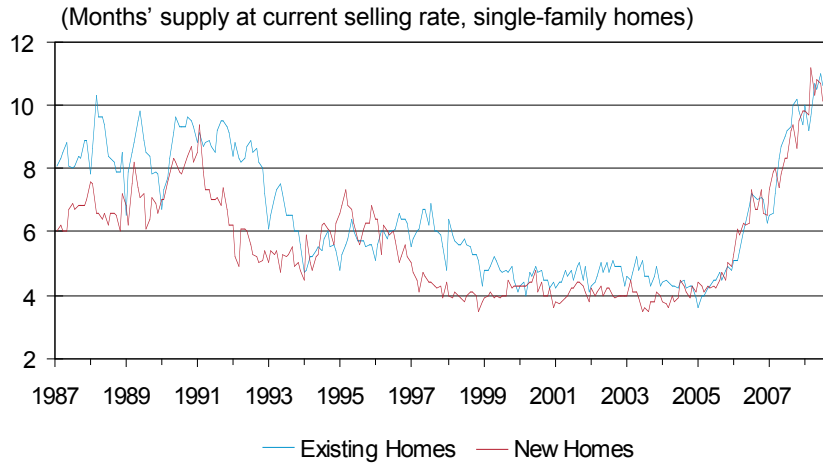


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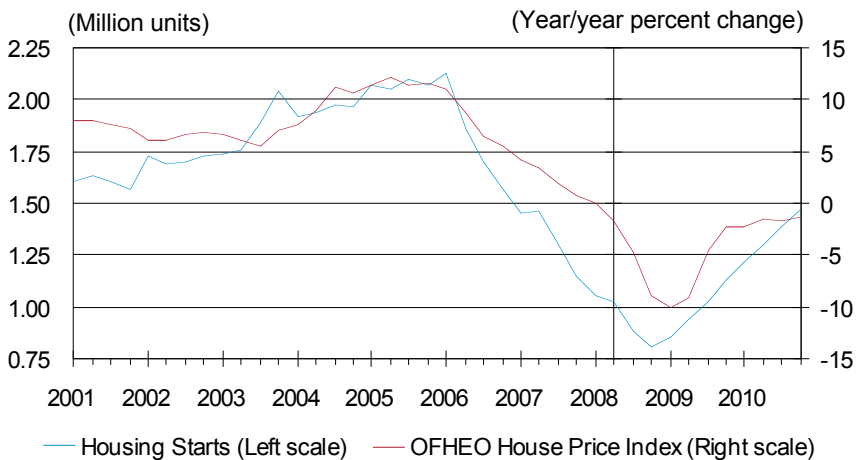
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Bloated Supplies of Homes for Sale



Housing Starts Dip Further, Prices to Fall Sharply in 2008

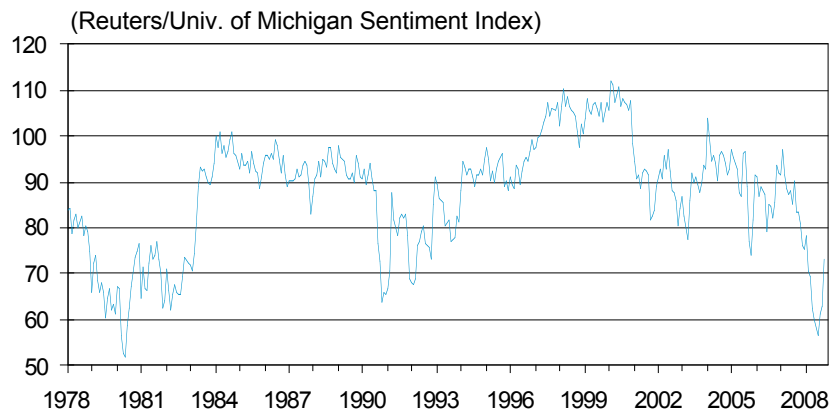


Consumer Spending Weakening

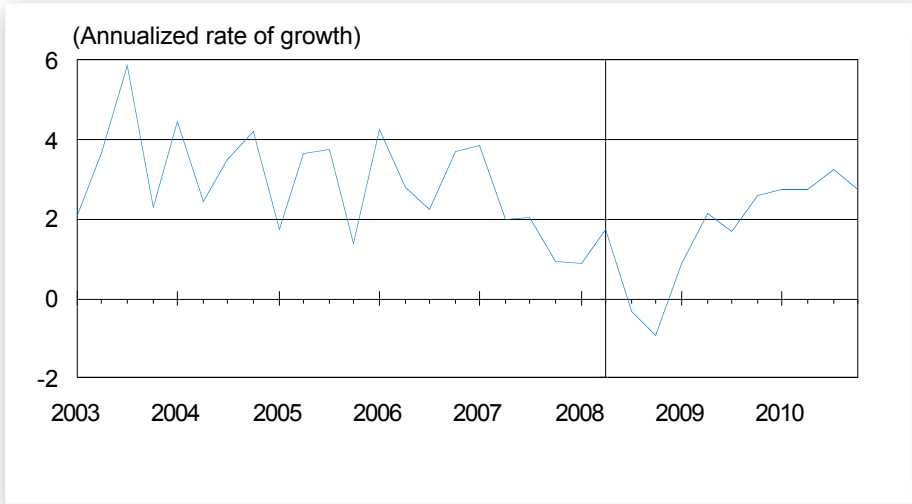


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Consumer Sentiment Is In The Recession Zone

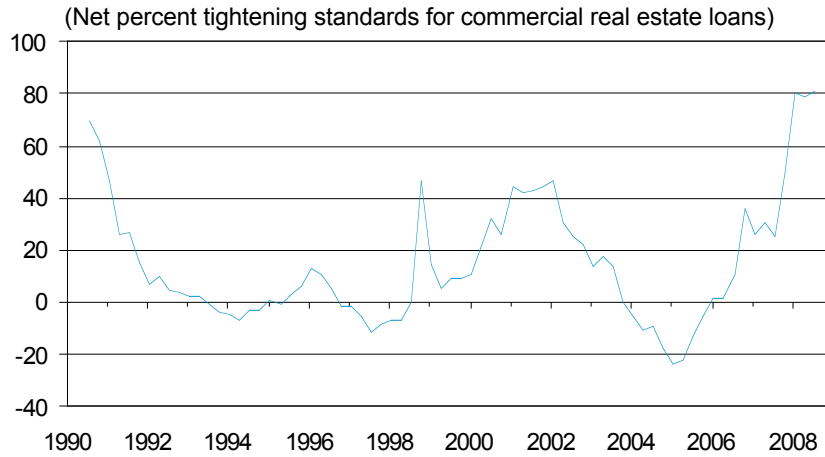


Consumer Spending Growth Turning Negative



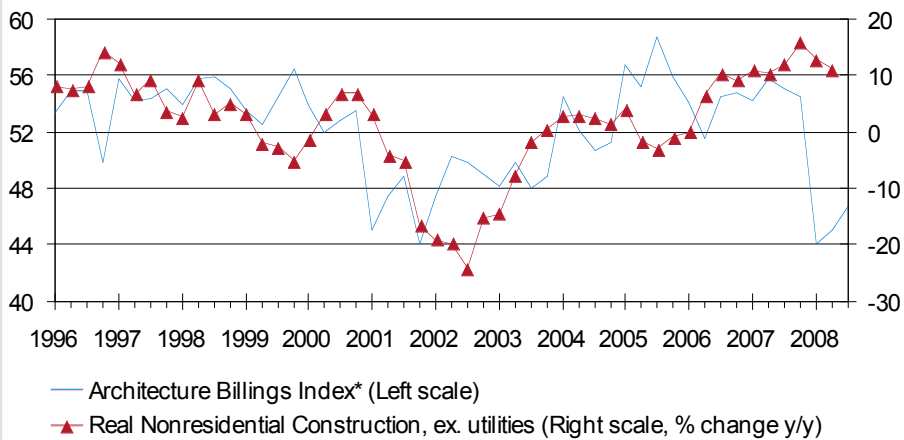
Business Investment Softening

Commercial Real Estate Loan Standards Tightening



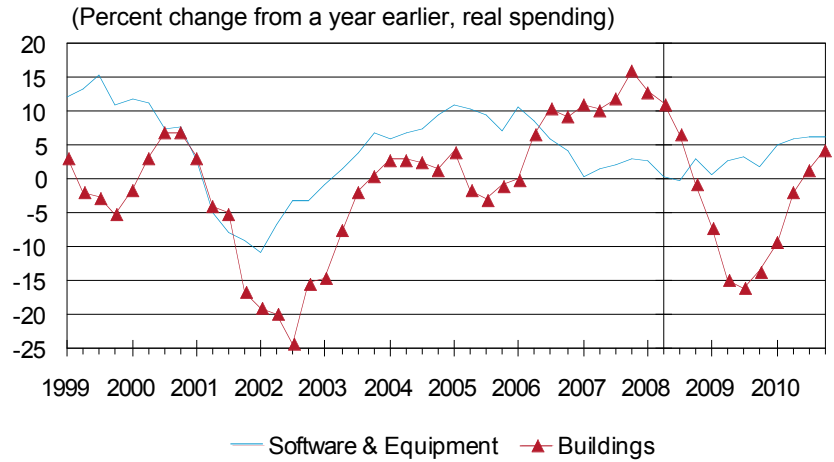
Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

Architecture Billings Lead Nonresidential Construction



* Source: American Institute of Architects

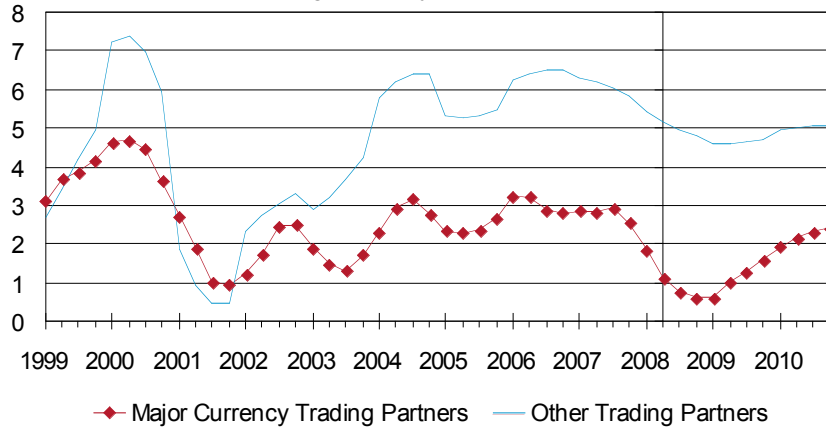
The Business Capital Spending Cycle: Construction Is Peaking



Foreign Trade: How Much Can We Rely On Export-Led Growth?

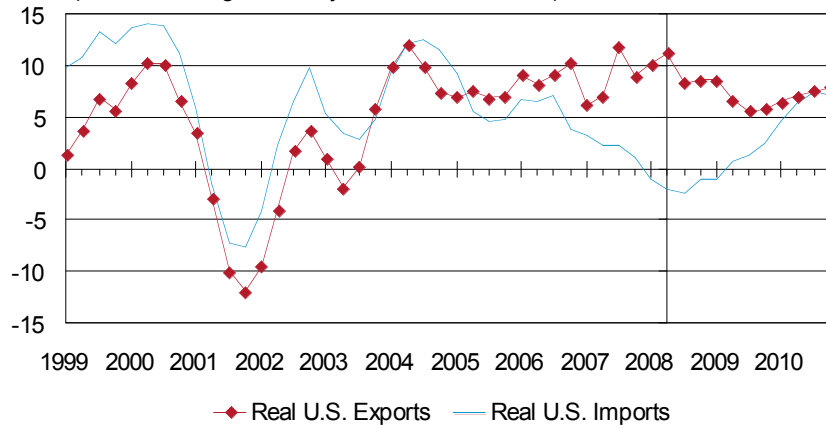
Growth In Export Markets Is Slowing

(Real GDP, percent change from a year earlier)



Export Growth Expected to Ease

(Percent change from a year earlier, volumes)

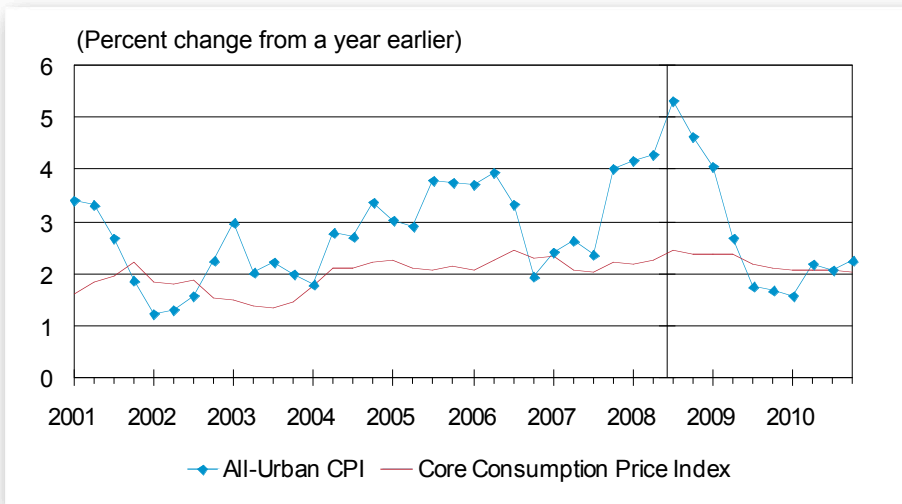


Inflation and Interest Rates

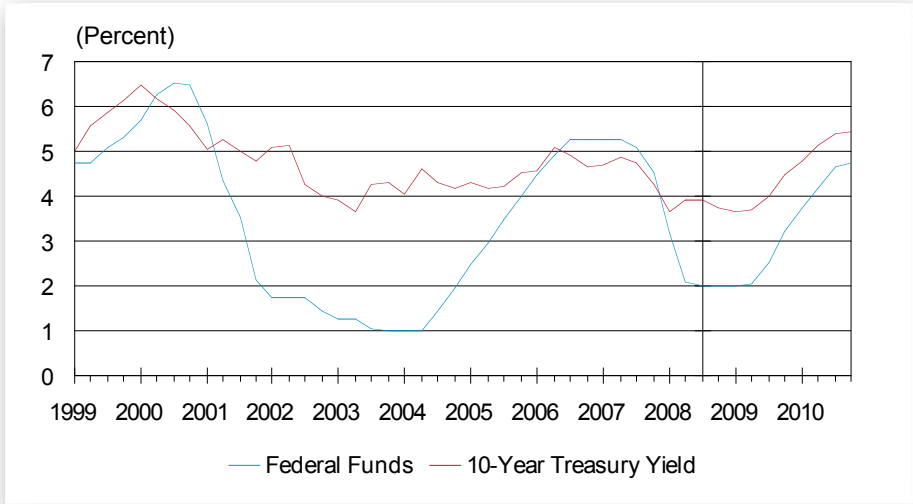


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Headline Inflation Has Spiked Higher; Core Inflation Has Edged Higher



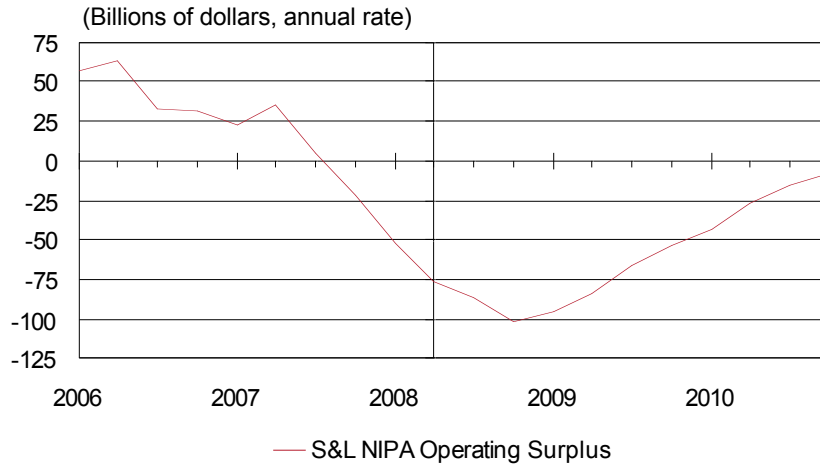
Fed On Hold



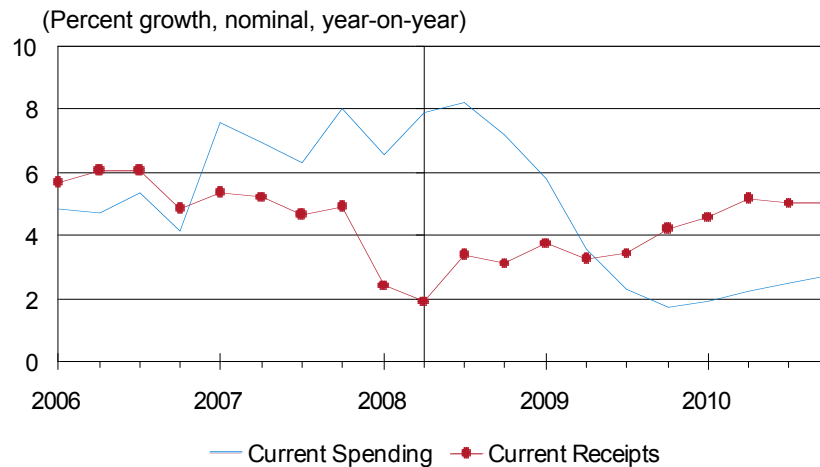
State and Local Finances



State and Local Finances in Trouble



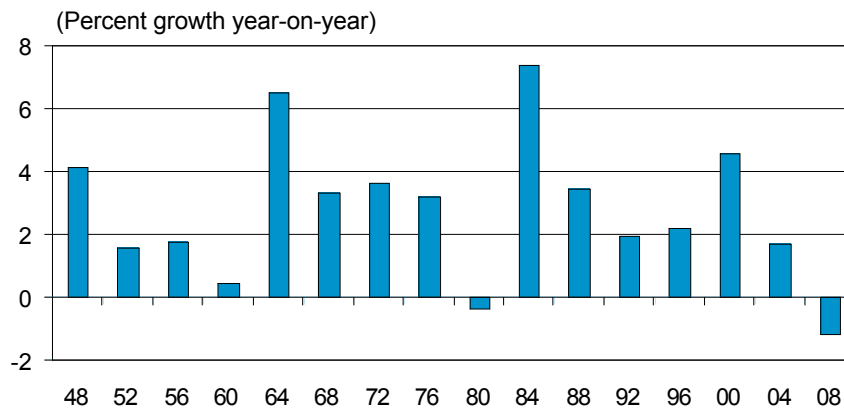
State and Local Spending Growth Must Slow



The Economy and the Presidential Election Outcome

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The Economy Is a Huge Negative for the Republicans

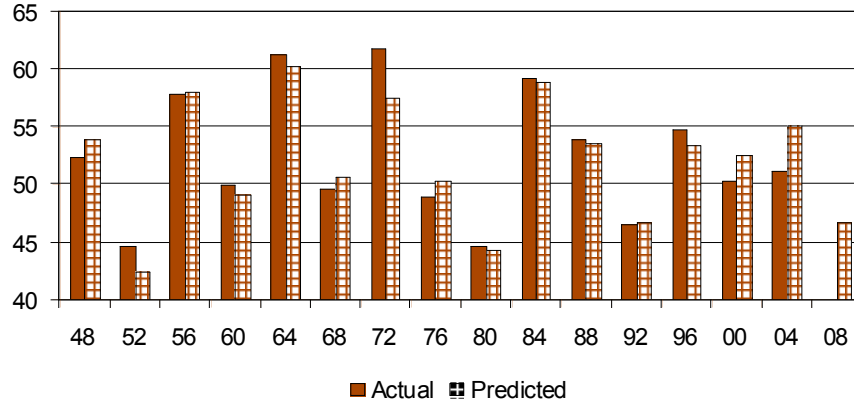


■ Y/Y Growth in Real Disposable Income Per Capita in Q3 of Election Years

Q3 2008 calculation excludes economic stimulus payments.
Including stimulus payments, real PDI growth per capita would be -0.6% in Q3 2008 instead of -1.2%.

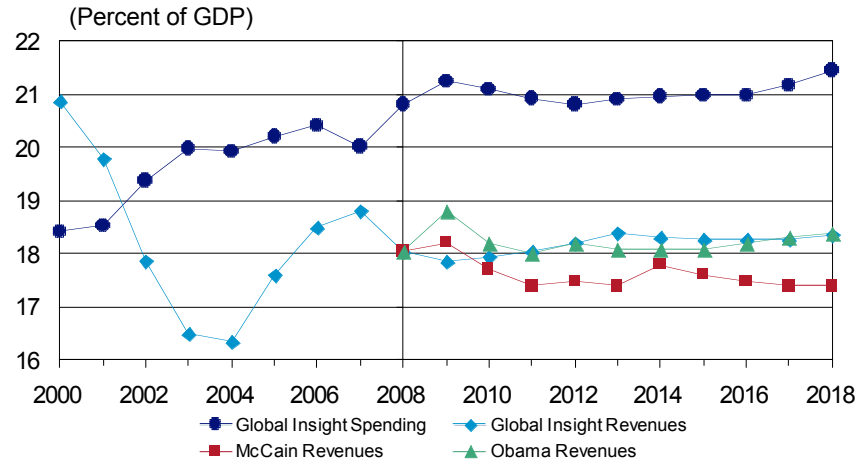
GI Election Model Points to the Democrats

(Percentage of 2-party presidential vote for incumbent party)



The Presidential Election: A Choice on the Role of Government

Federal Revenue and Spending Paths



Source: Tax Policy Center (for McCain and Obama Revenues)

Bottom Line

- **Economy flirting with recession now – outright GDP declines expected at the end of 2008**
- **W-shaped growth profile: Tax rebates supported growth at mid-year but their impact is fading**
- **Fed on hold – caught between weak economy and high inflation**
- **Upside Risk: Lower oil prices**
- **Downside Risk: Weaker export growth from global slowdown and stronger dollar**
- **Election: Economy favors Obama; whoever wins will have trouble translating fiscal objectives into action**

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