The U.S. Economic Outlook

Nigel Gault
Chief U.S. Economist, IHS Global Insight

FTA Revenue Estimation & Tax Research Conference
Charleston, West Virginia
October 17, 2011

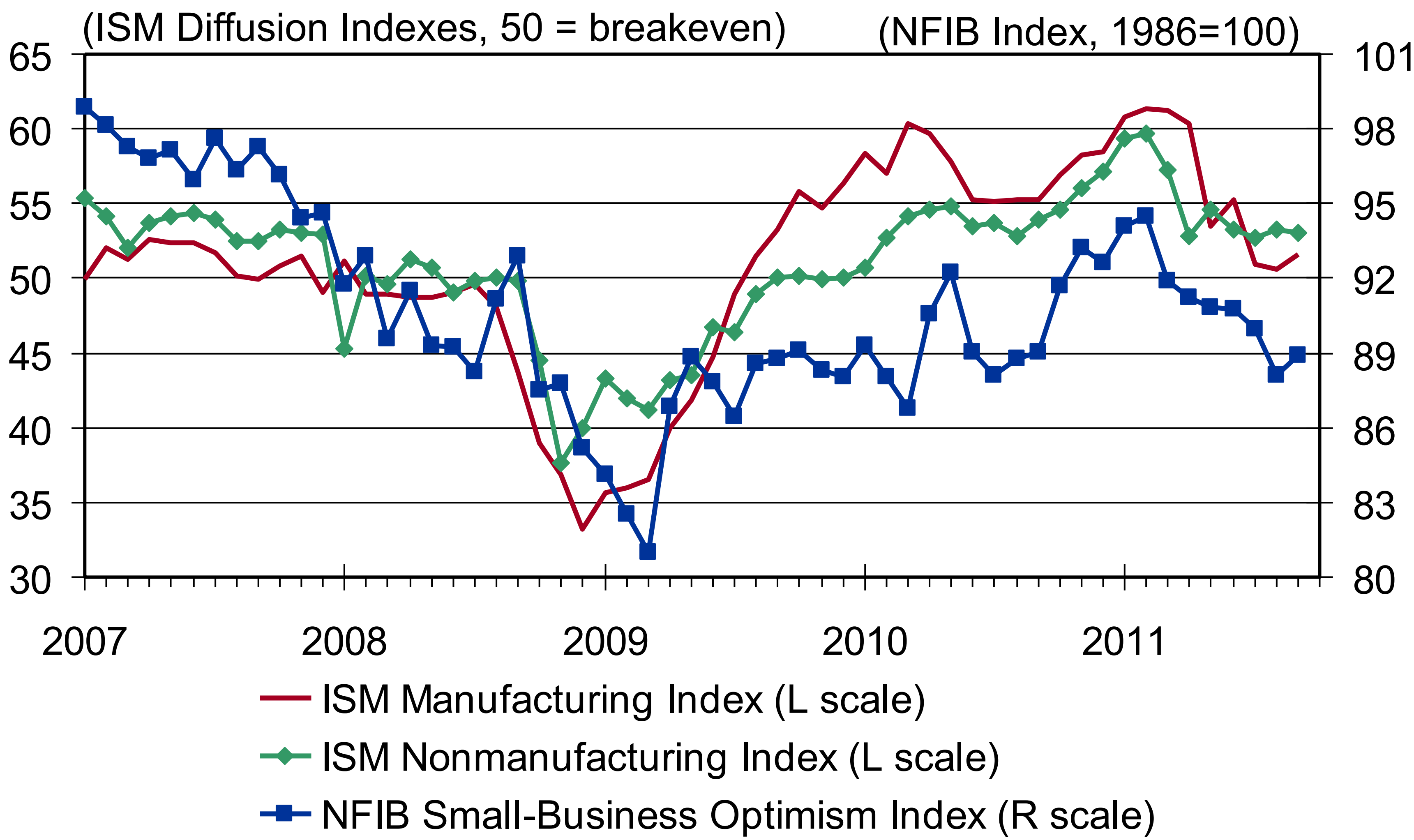
What Has Happened to the Recovery? The Bad News

- Growth very weak; usual pattern after a severe financial crisis
- Commodity price surge and Japan disaster hit H1 growth
- Confidence in U.S. policy-making has hit new lows
- The debt-ceiling outcome offered neither short-term fiscal support nor long-term fiscal reforms; huge uncertainty remains
- Fed running out of options
- Global growth slowing; Eurozone recession likely
- Financial fall-out from Eurozone sovereign debt crisis could be severe if policy-makers cannot act more decisively

What Has Happened to The Recovery? The Good News

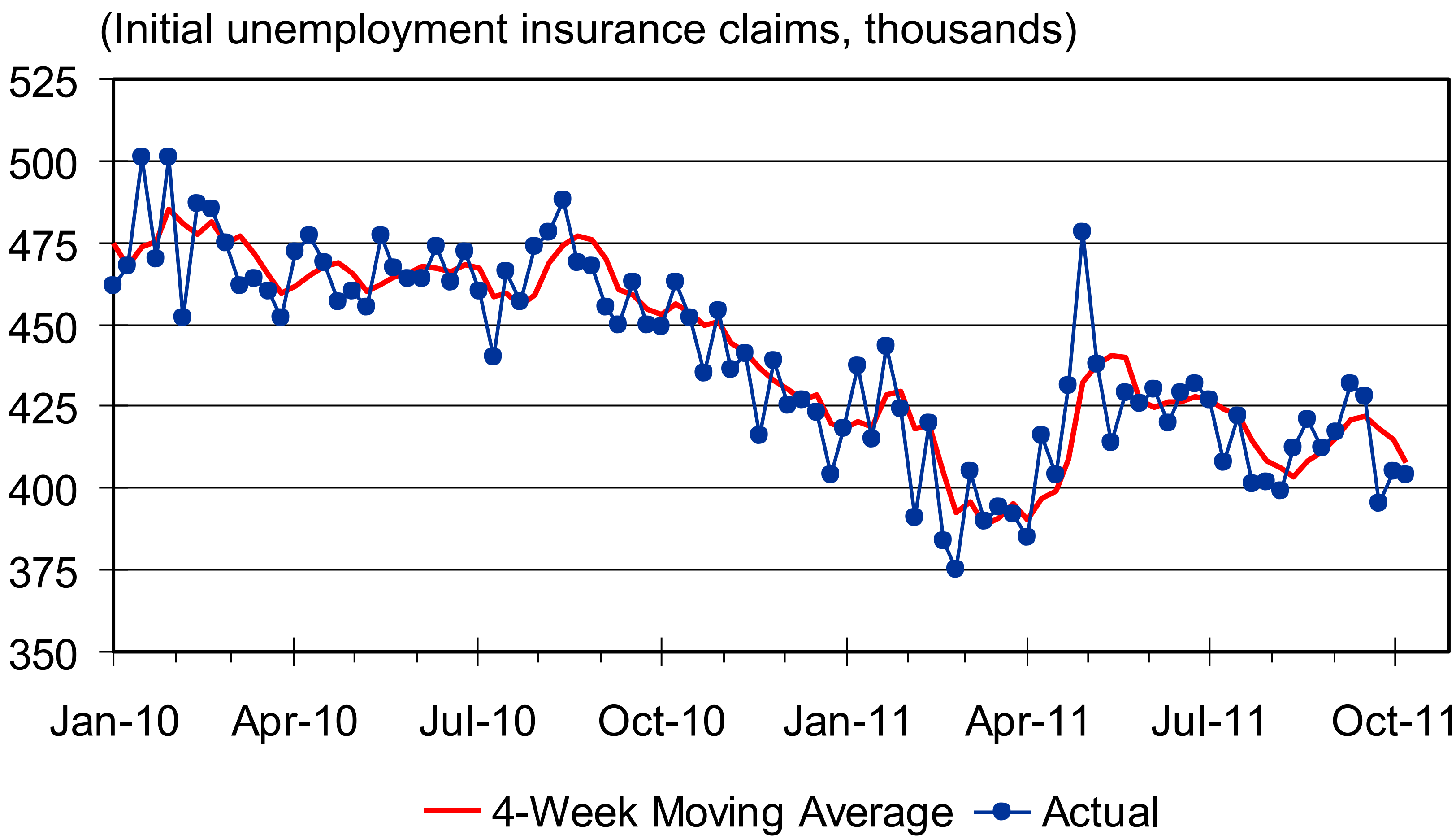
- Leading indicators don't yet point to U.S. recession
- Stock market is down but financial stress indicators are nothing like 2008, or even 2007
- Japan shock effects receding, commodity price pressures easing
- The downside to battered sectors like housing is limited
- Pent-up demand is building
- Consumer sentiment is at recession levels, but spending hasn't followed sentiment down
- It would probably take more shocks to make a recession (rather than just weak growth) the most likely outcome

Key Leading Indicators Have Slipped, but ISM Indexes Still Above Breakeven

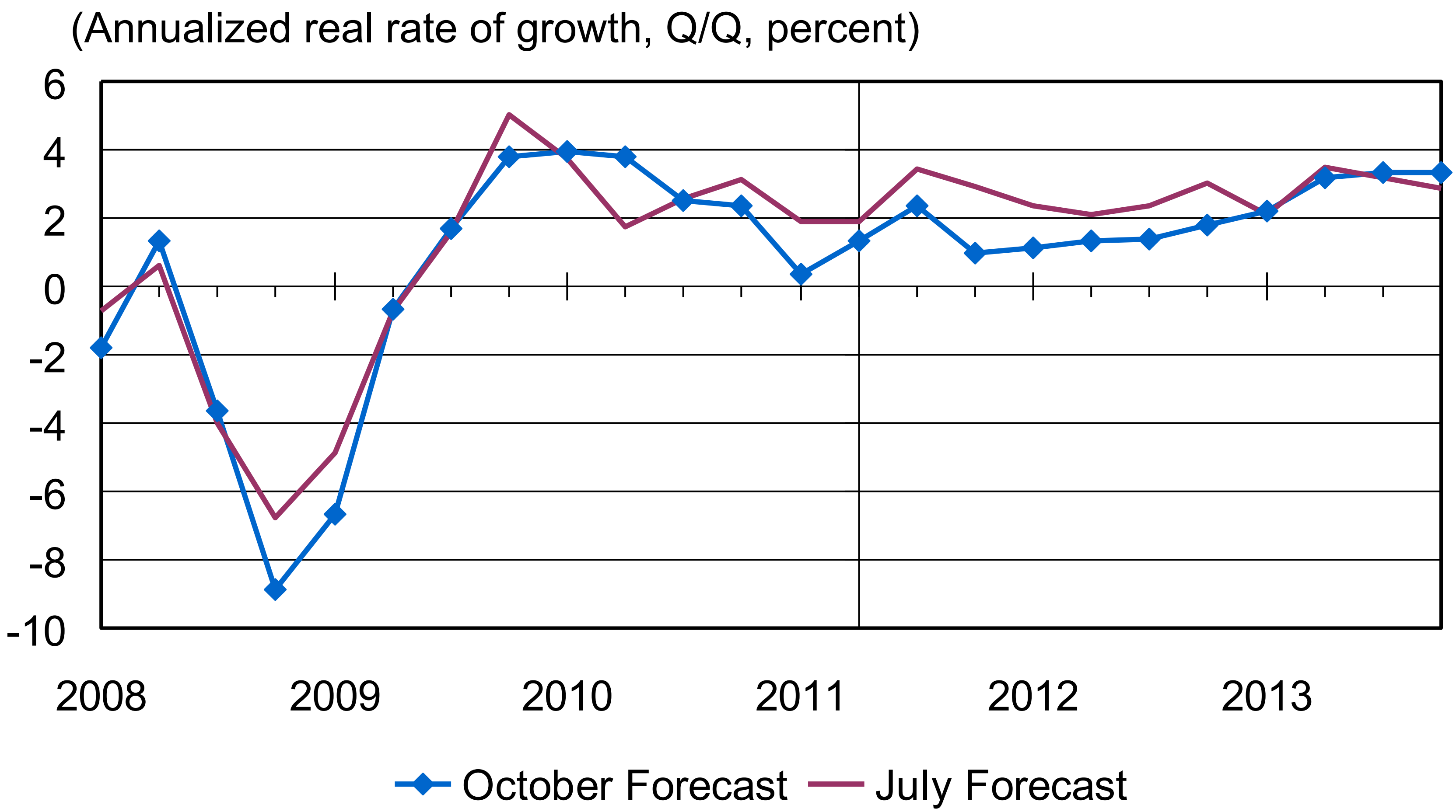


ISM = Institute for Supply Management; NFIB = National Federation of Independent Business

No Surge in Initial Claims



Deep Recession, Slow Recovery



IHS GLOBAL INSIGHT

Summary Outlook Tables

The Source for Critical Information and Insight™

U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2010	2011	2012	2013
Real GDP	3.0	1.7	1.4	2.4
Final Sales	1.4	1.9	1.4	2.3
Consumption	2.0	2.1	1.9	1.8
Light Vehicle Sales (Millions)	11.6	12.5	13.2	14.7
Residential Investment	-4.3	-2.1	4.3	17.9
Housing Starts (Millions)	0.58	0.59	0.67	0.94
Business Fixed Investment	4.4	8.7	4.3	5.8
Federal Government	4.5	-1.9	-2.7	-3.6
State and Local Government	-1.8	-2.4	-2.7	-0.9
Exports	11.3	6.7	3.4	7.5
Imports	12.5	4.6	2.4	3.8

Other Key Indicators

(Percent unless otherwise noted)

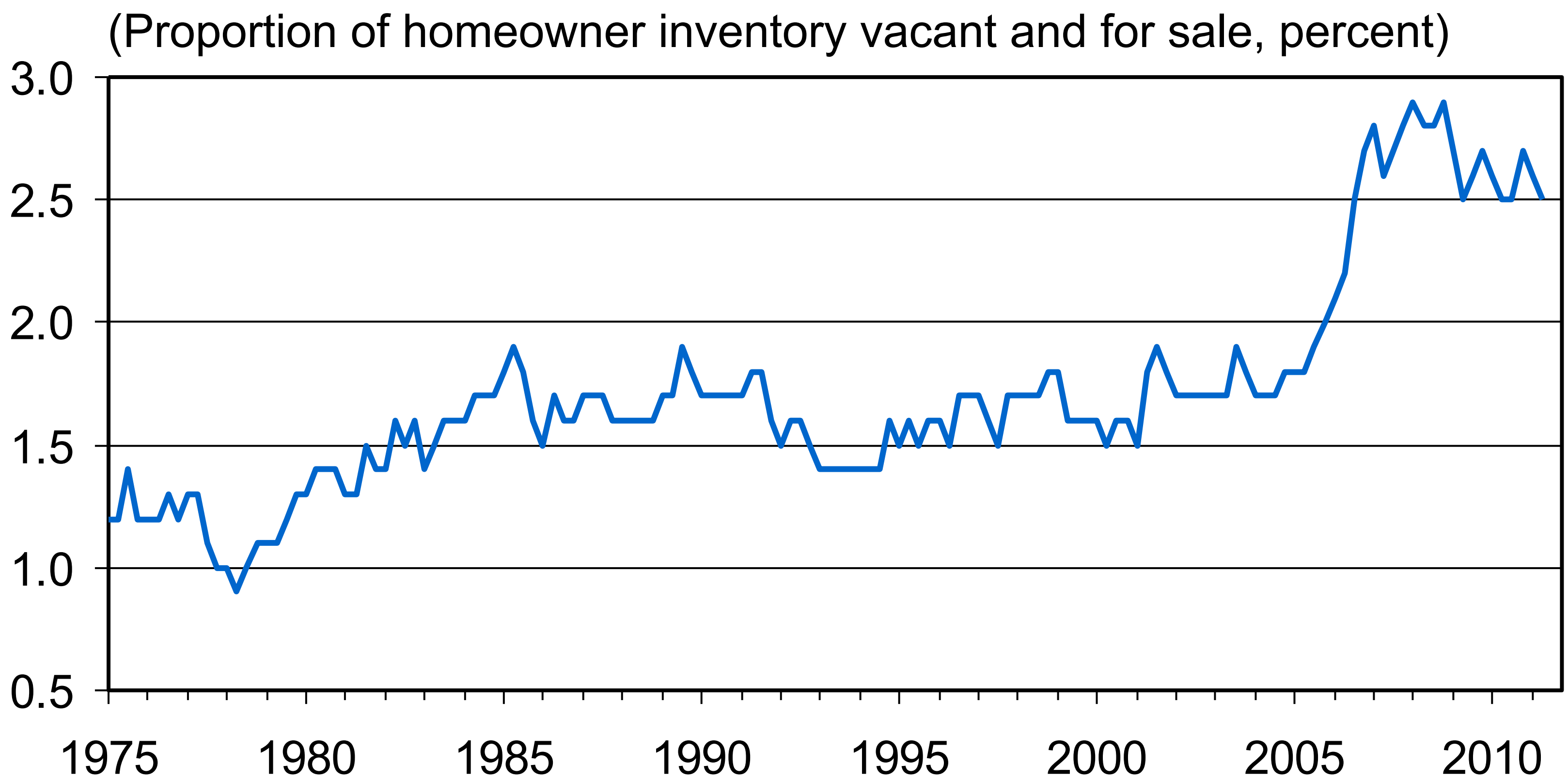
	2010	2011	2012	2013
Industrial Production (% growth)	5.3	3.6	1.6	3.2
Employment (% growth)	-0.7	0.9	0.6	1.3
Unemployment Rate	9.6	9.1	9.3	9.1
CPI Inflation	1.6	3.0	1.3	1.9
Oil Prices (WTI, $/bbl)	79	91	89	98
Core PCE Price Inflation	1.4	1.5	1.4	1.6
Federal Funds Rate	0.18	0.11	0.10	0.11
10-year Government Bond Yield	3.21	2.76	2.32	2.84
Dollar (Major Currencies, 2005=1)	0.90	0.85	0.88	0.86

The Housing Cycle:
Still At The Bottom

GLOBAL INSIGHT

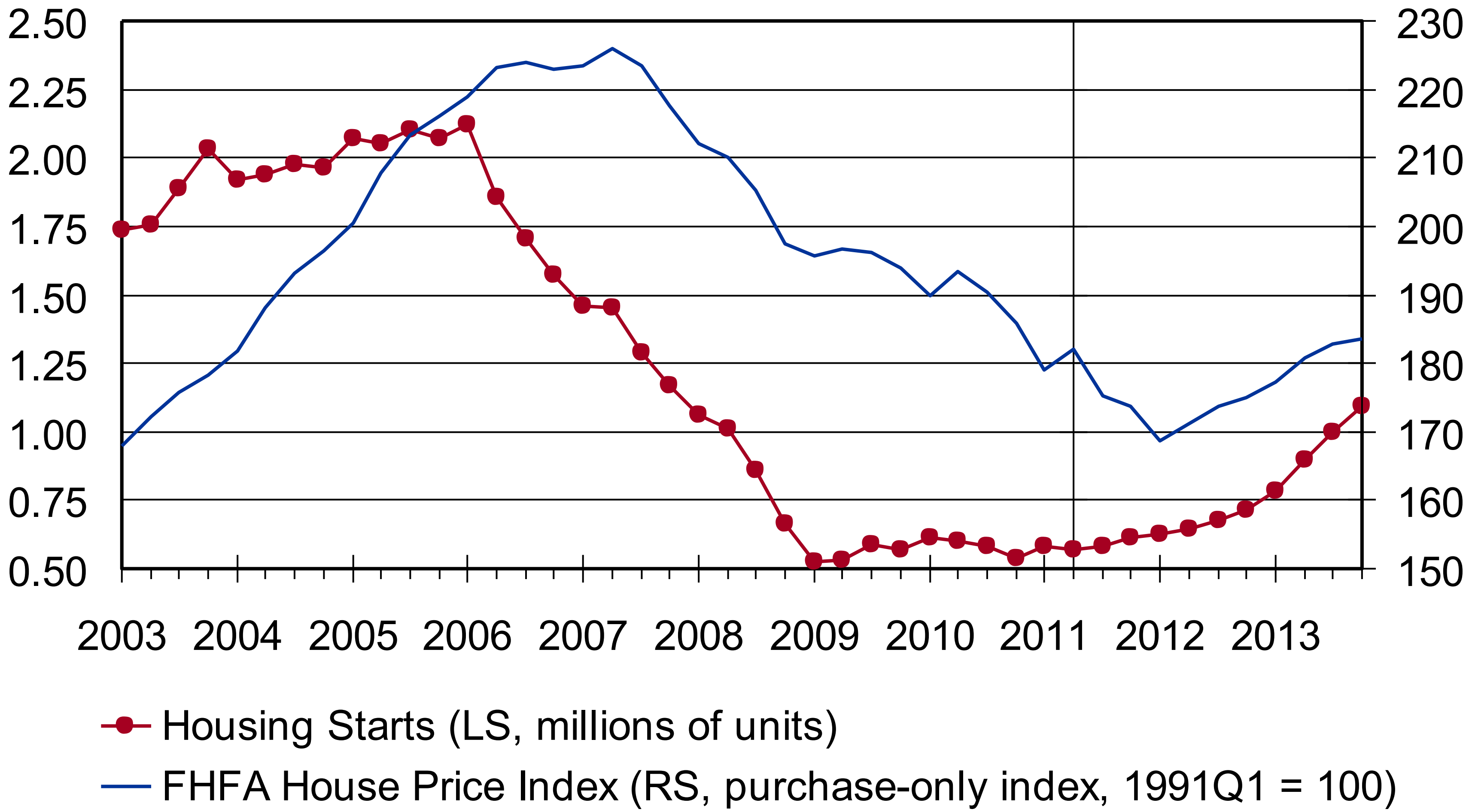
The Source for Critical Information and Insight™

The Homeowner Vacancy Rate Is Little Changed



Source: Census Bureau

A Prolonged Trough for Housing Starts: Prices Not At Bottom Yet

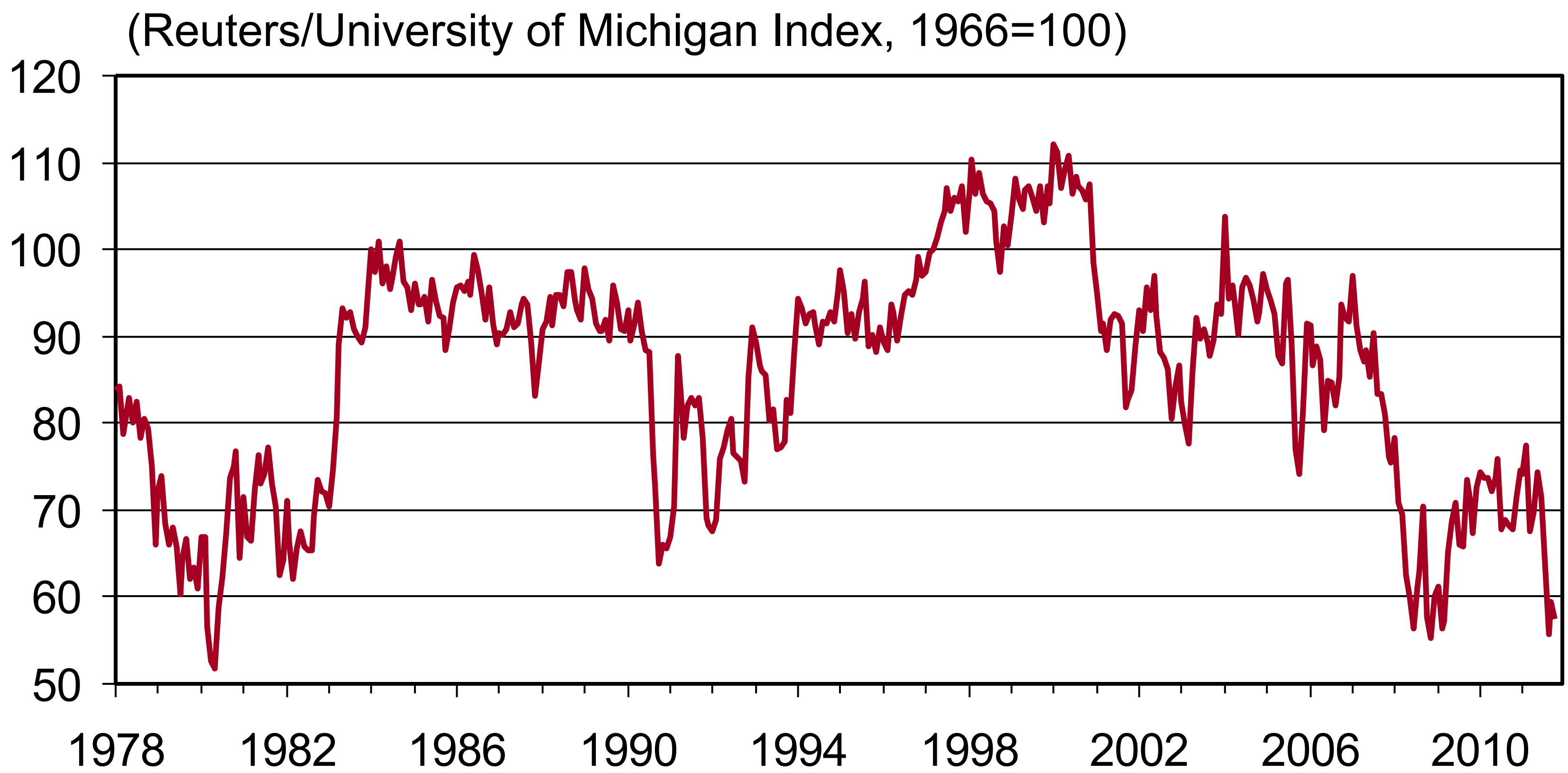


The Consumer:
Too Many Negatives

IHS GLOBAL INSIGHT

The Source for Critical Information and Insight™

Consumer Sentiment Is In Recession Territory



Consumer Finances: Too Many Negatives

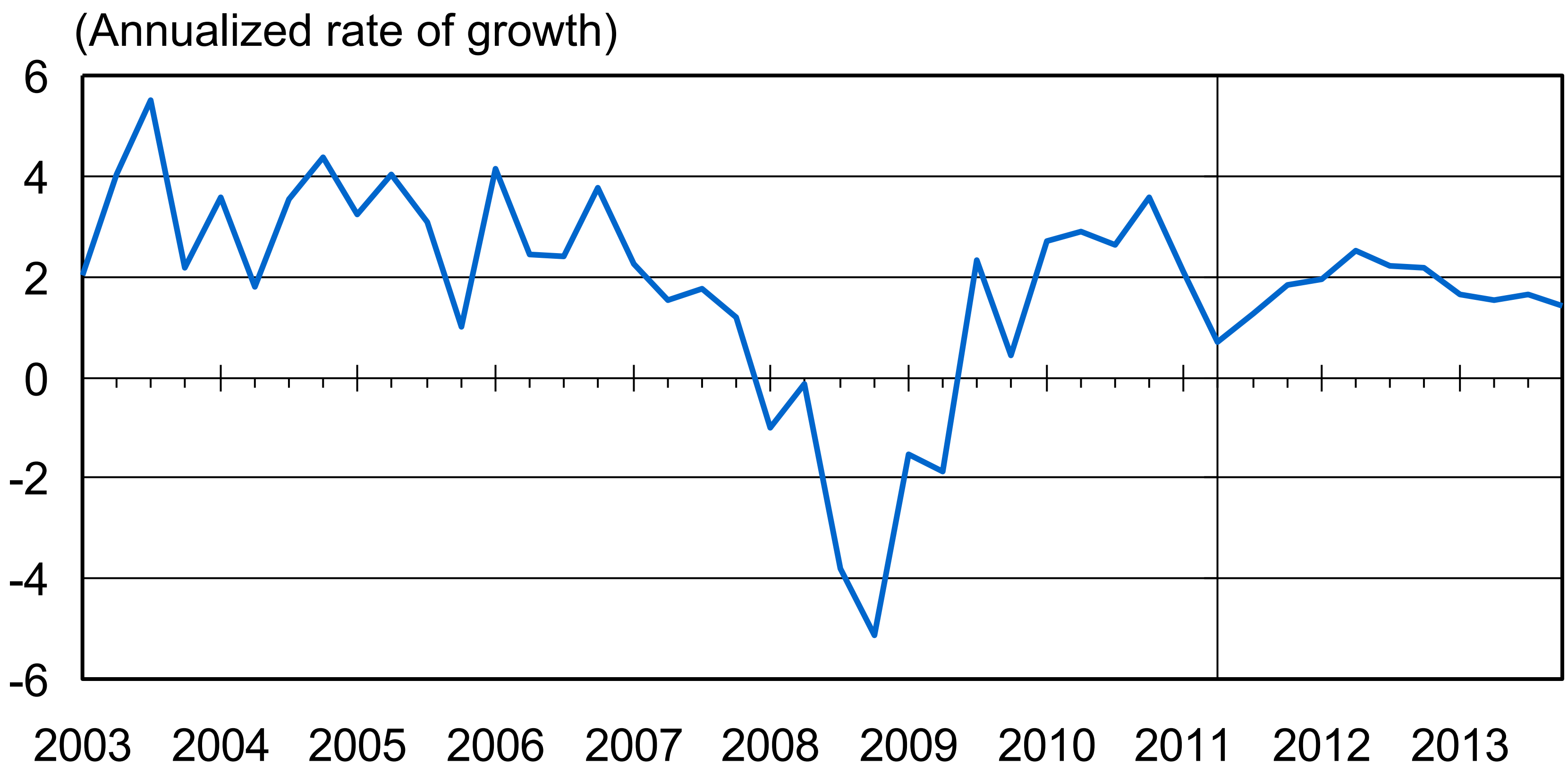
Negative Forces

- High Unemployment
- Heavy Wealth Loss
- Tight Credit Conditions
- High Debt Burdens
- High Prices – esp. Gasoline, Food
- Future Tax Increases Likely

Positive Forces

- Fiscal Stimulus (temporary)
- Pent-Up Demand
- Gasoline Prices Should Fall, Food Inflation Should Ease

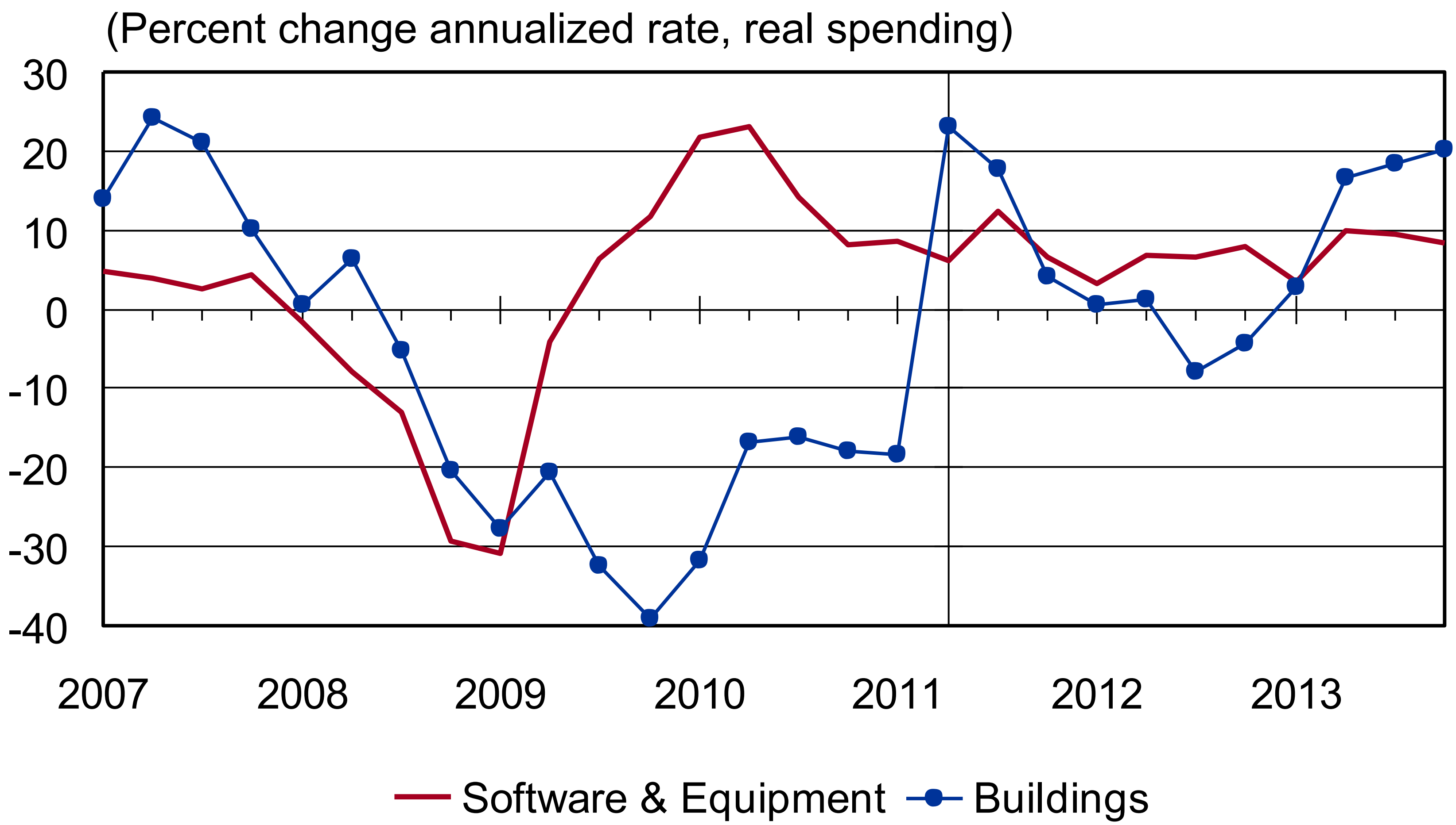
Consumer Spending Is Not A Strong Driver of Recovery, But It's Doing Better Than Sentiment



Business Investment:
Are Structures Joining The Recovery?

The Source for Critical Information and Insight™

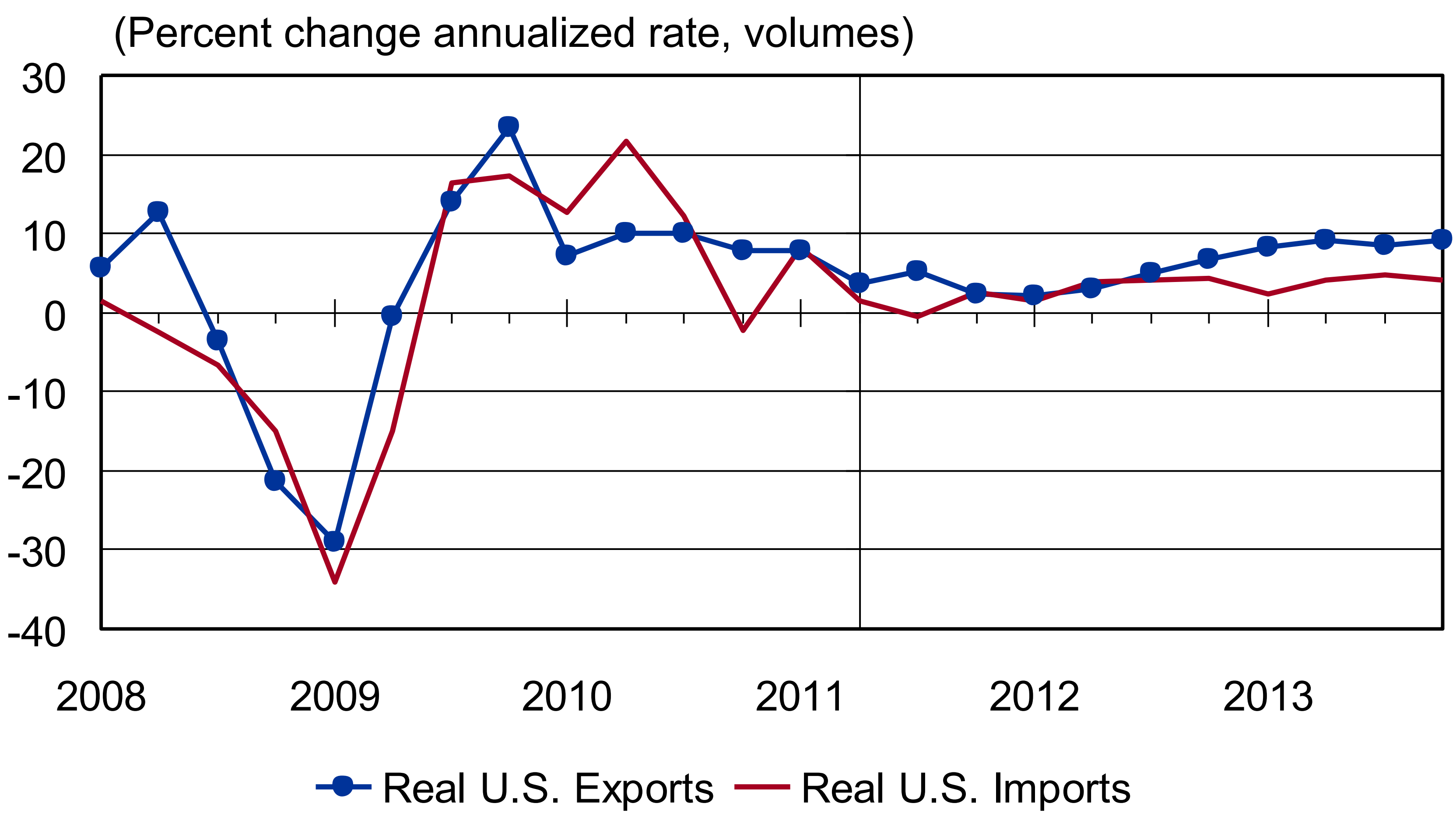
Business Capital Spending Cycle: Construction Dawn Premature?



IHS GLOBAL INSIGHT

Foreign Trade:
Still A Plus For Growth,
Though Export Prospects Have Dimmed

Exports Expected to Outpace Imports



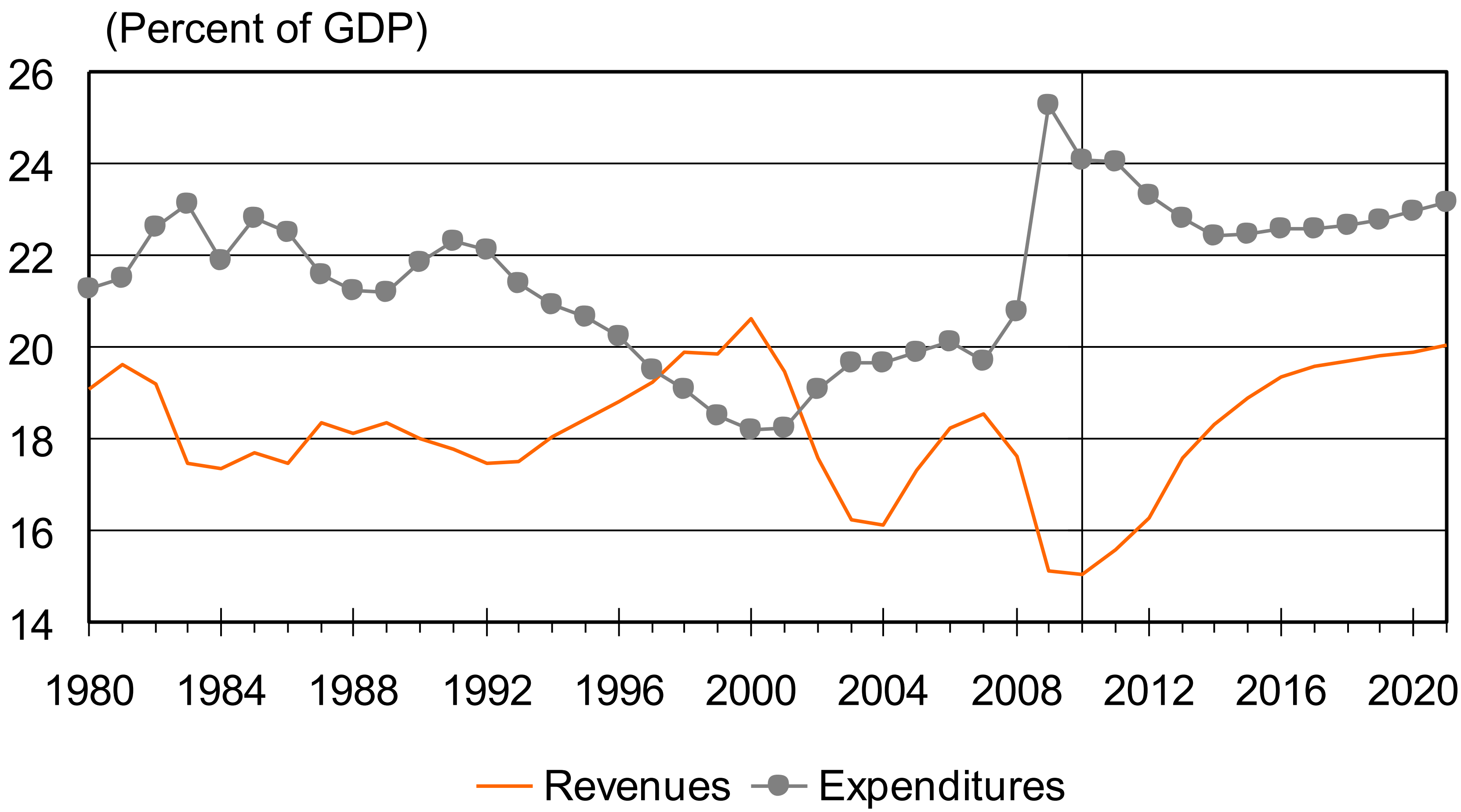
Fiscal Policy

The Source for Critical Information and Insight™

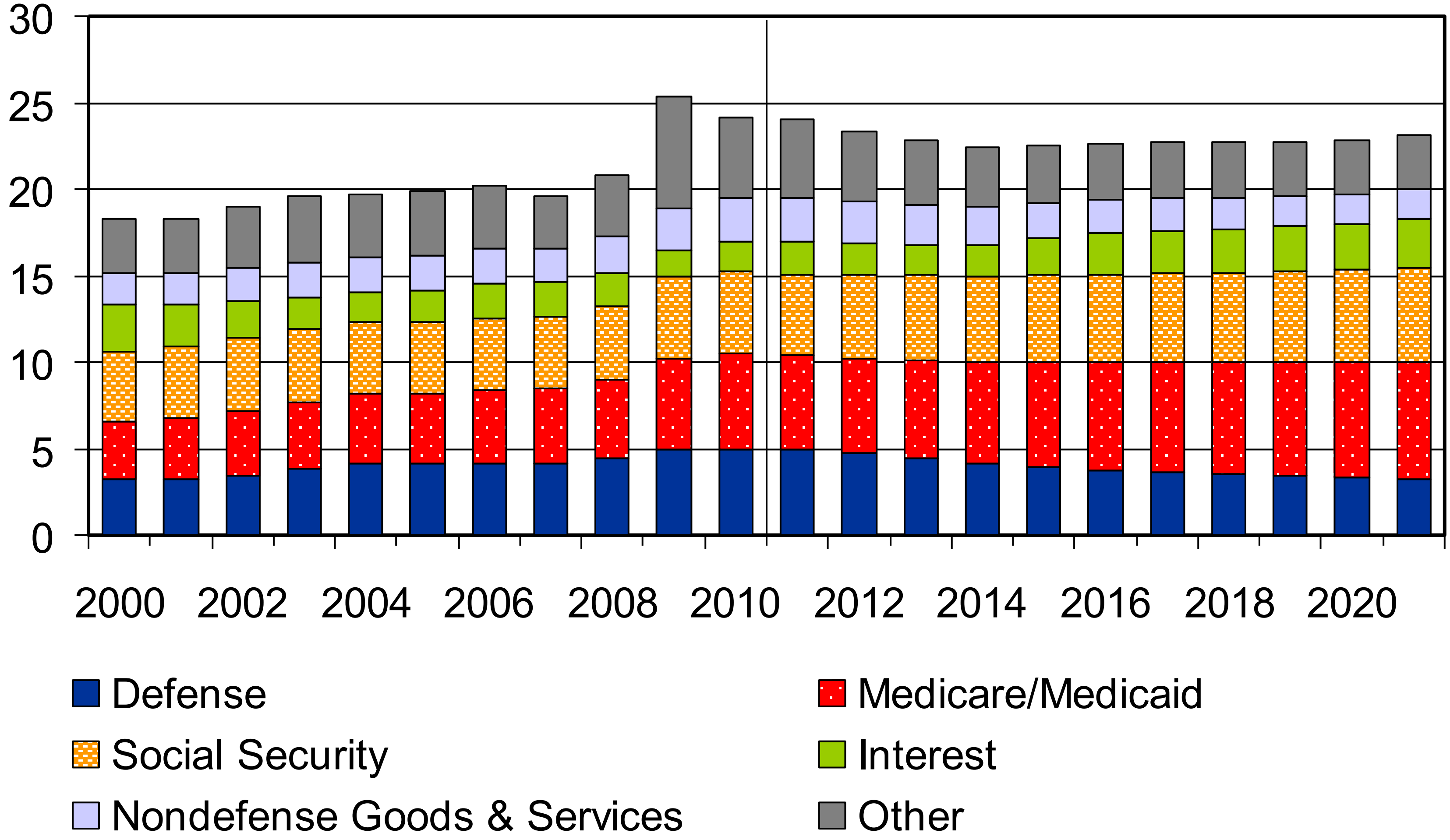
Our Fiscal Policy Assumptions

- Discretionary spending caps implemented, as agreed under debt-ceiling deal
- Supercommittee fails...
- ...but sequester is replaced by entitlement savings and tax increases to be determined after the 2012 elections
- 2% payroll tax cut and emergency UI benefits extended into 2012, and later phased out, not suddenly removed
- But nothing on top of that from the President's jobs plan
- These assumptions stabilize (but do not cut) the debt-to-GDP ratio

The Federal Budget Gap: We Expect Action On Both Sides of the Ledger…



Big Squeeze on Discretionary Spending – Defense and Non-Defense



Recession Risks

The Source for Critical Information and Insight™

Will We Fall Back Into Recession?

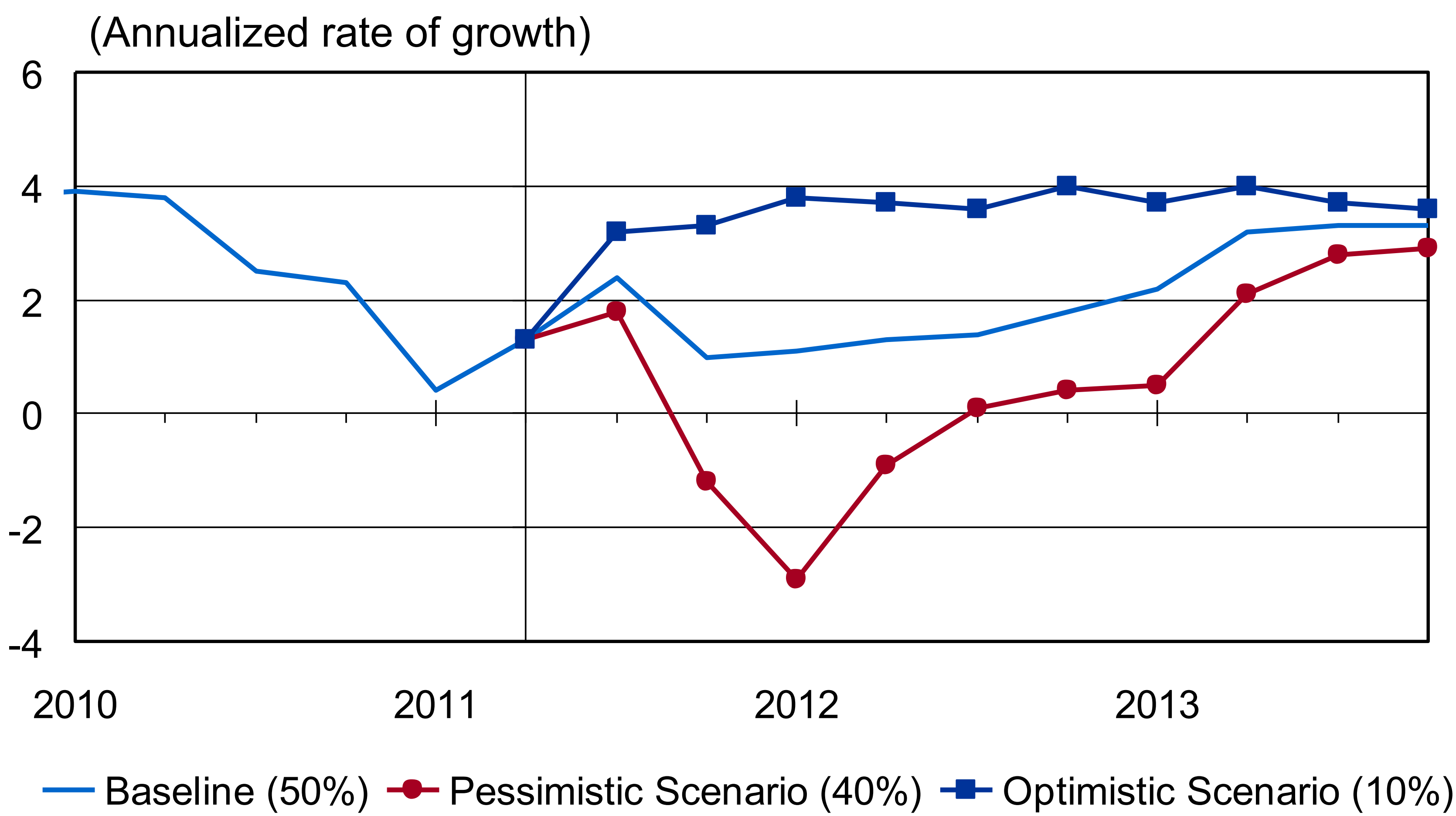
Why?

- An economy near stall speed is vulnerable to shocks
- Fed can't help much
- Risks of policy mistakes
  - Premature fiscal tightening
  - Policy paralysis
- Eurozone is the immediate risk
- Oil shocks a perennial threat

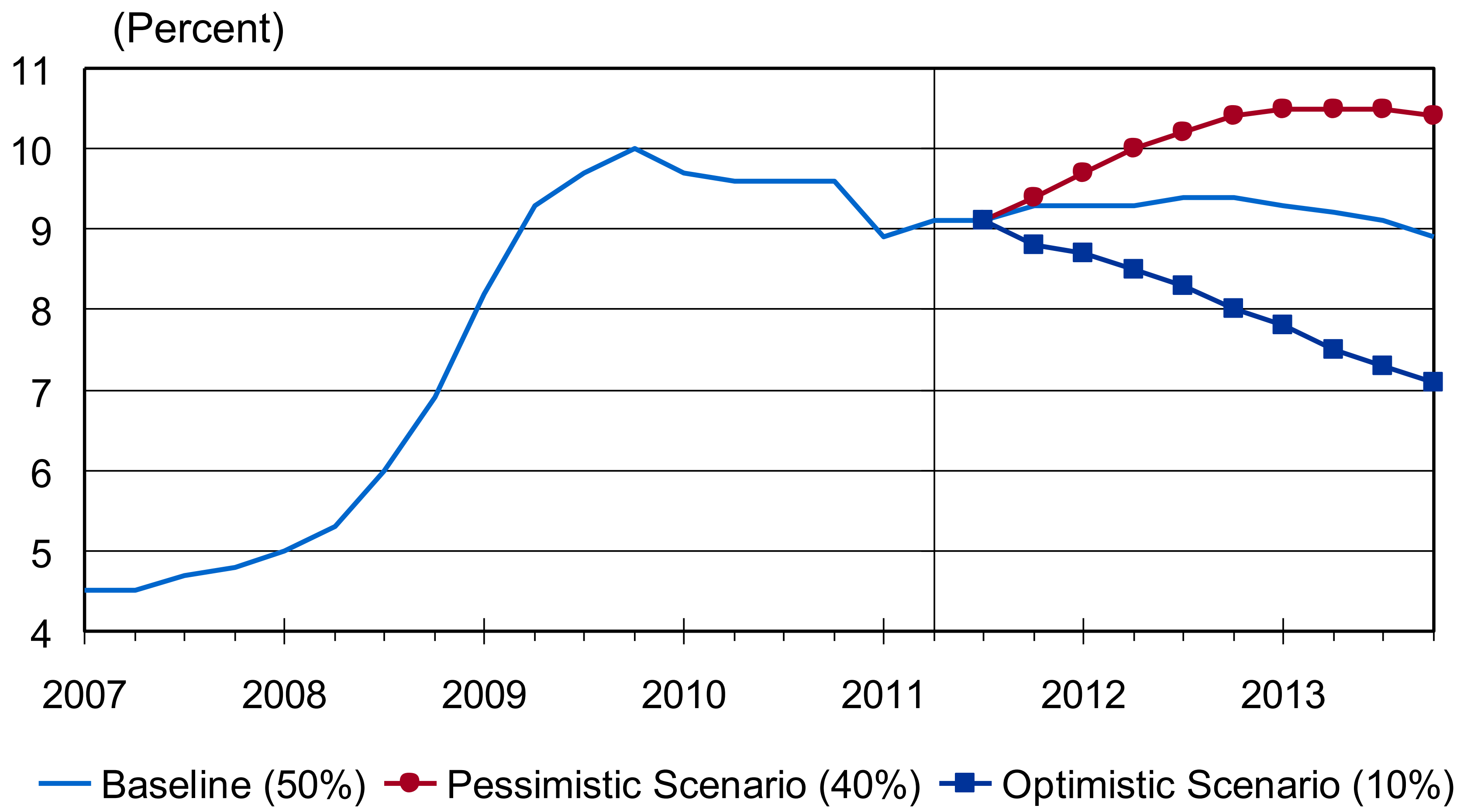
Why Not?

- U.S. banks in better shape than 2008
- Nonfinancial corporations balance sheets are strong
- Exposures to Eurozone sovereign debt are better understood than exposures to sub-prime debt were
- Europe unlikely to allow a major institution to collapse

GDP Growth Outlook



Unemployment Outlook



Implications and Bottom Line

- Most likely outcome is anemic growth, not recession
- Recovery very muted; growth doesn’t beat 3% until 2014 (helped, at last, by a housing revival)
- Fed powers are limited; no panaceas
- Fiscal stimulus; the question is how fast it’s withdrawn, not whether it will be ramped up
- Still huge fiscal uncertainty; supercommittee task looks impossible
- January 1, 2013 could be another crisis deadline
- Growth at around “stall speed” leaves the economy highly vulnerable to recession risks (40% odds)

Thank you!

Nigel Gault
Chief U.S. Economist
nigel.gault@ihsglobalinsight.com

IHS GLOBAL INSIGHT

The Source for Critical Information and Insight™