

The U.S. Economic Outlook

Patrick Newport
U.S. Economist
March 2009

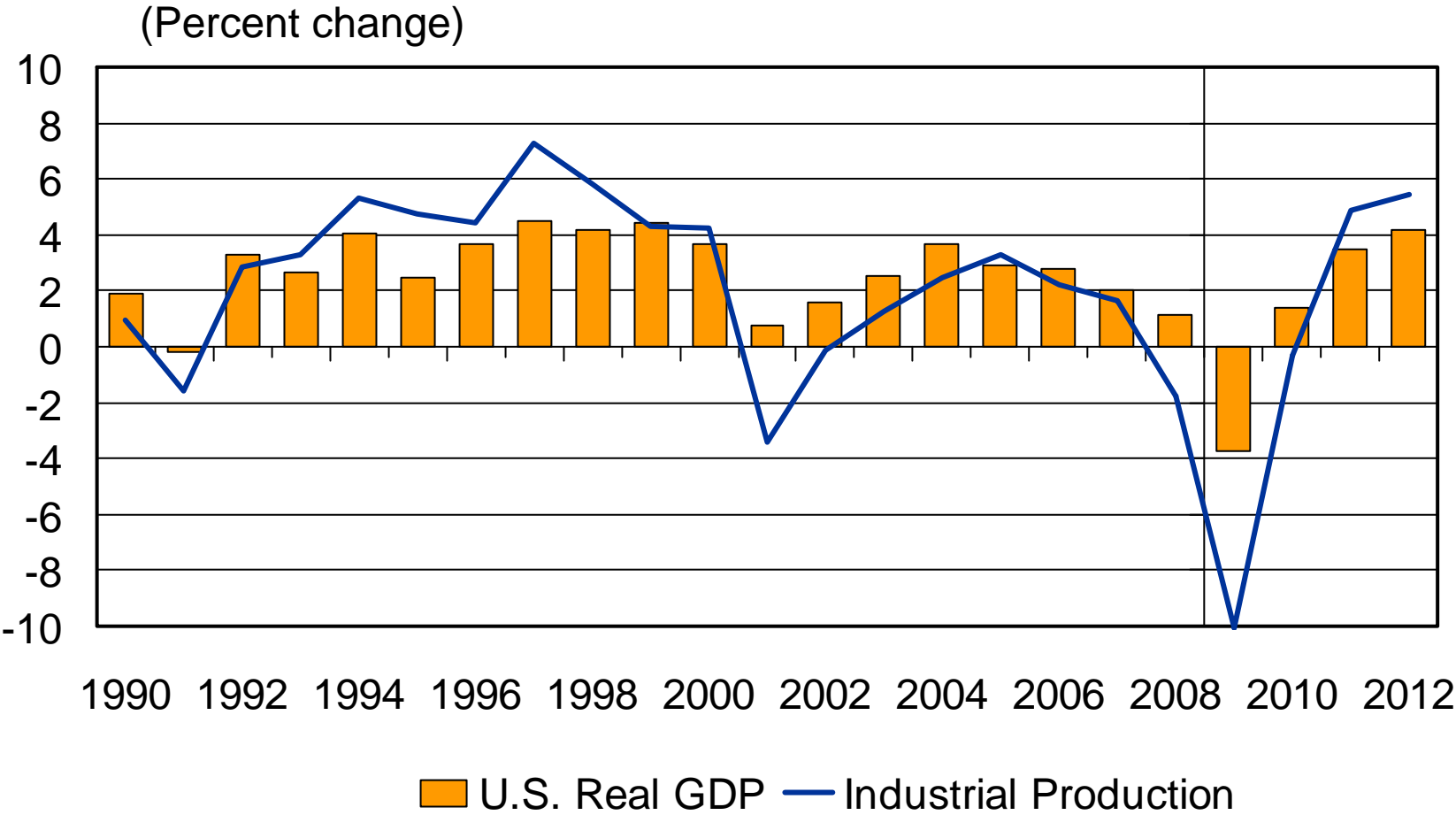


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Worst Recession in the Post-War Era

- Maybe the biggest **global** housing and credit bubble in history has burst
- Households, businesses, governments facing tighter – or shut-off – credit, and massive wealth destruction
- Rest-of-the-world going into severe recession too, undermining exports; “de-coupling” has proved a fantasy
- Lower oil prices offer some cushion
- Fed is doing all it can; and major fiscal stimulus is coming
- But the global recession is proving the worst in the post-war era

Severe Recession Is Here



Where Do We Stand in The Financial Crisis?



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Global Financial System: Pressure Rises as Global Recession Intensifies

- Revised projected loss estimates on U.S. credit assets
 - \$2.2 trillion (International Monetary Fund)
 - Global bank losses: US\$1.65
 - U.S. banking system: US\$1.00

Recession Forces Intensifying Pressures on Loan Losses

- Cumulative losses through 2008:Q4
 - Global financial system losses: \$1.0 trillion
 - Global banking sector losses: \$800 billion
 - North American banks
 - US\$500 billion
 - Core capital ratios have fallen well below critical threshold of 8%

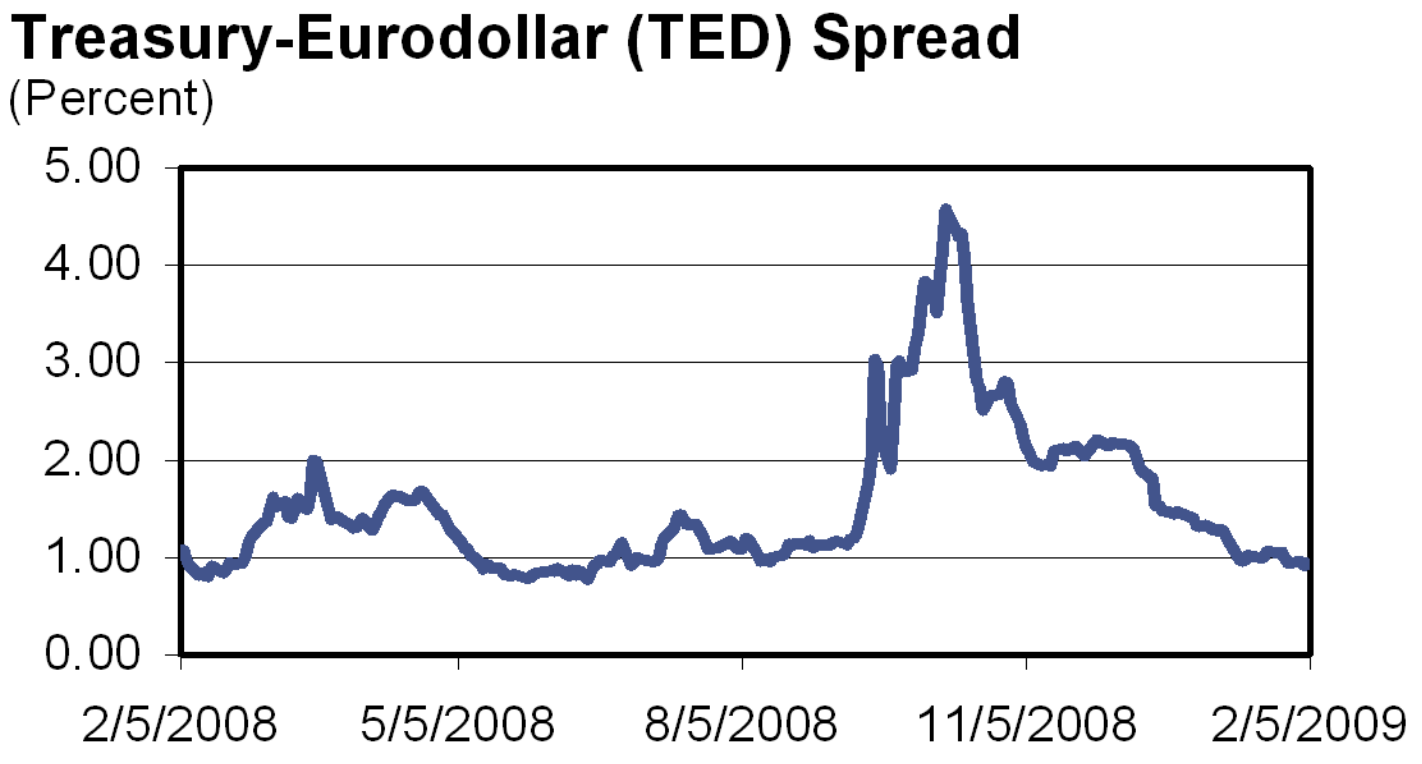
Public Capital Essential To Avoid Depression-Like Credit Crunch

- North American banks
 - About \$530 bn. of recapitalization so far
 - \$250 bn. private capital (2007:Q3 to 2008:Q3)
 - \$276 bn. public capital (2008:Q4)

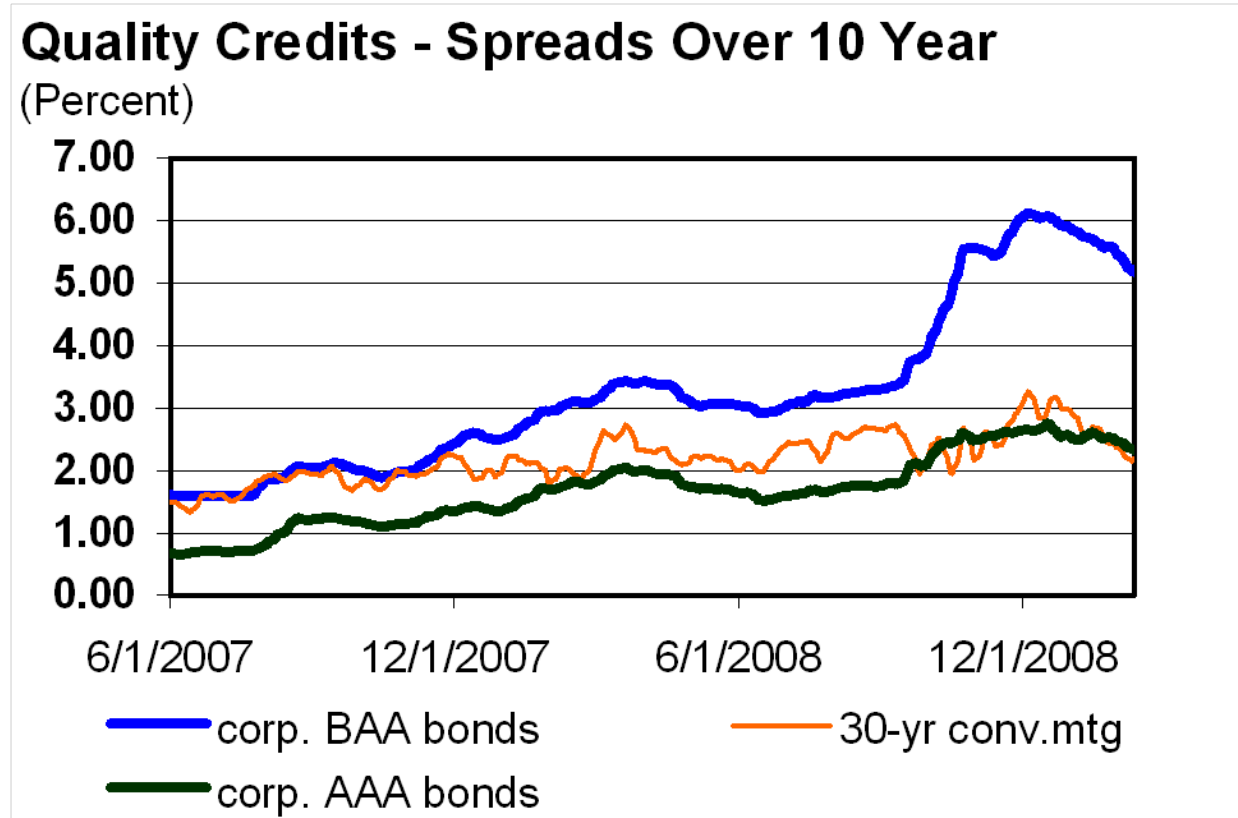
Additional Capital Critical for Financial System Stability

- North American banks: large capital requirements in 2009
 - Potential internal capital in 2009: \$70 to \$100 bn.
 - \$20 to \$40 billion from higher net interest income
 - \$50 to \$80 billion from lower dividends
 - Still needed: \$250 - \$300 bn.

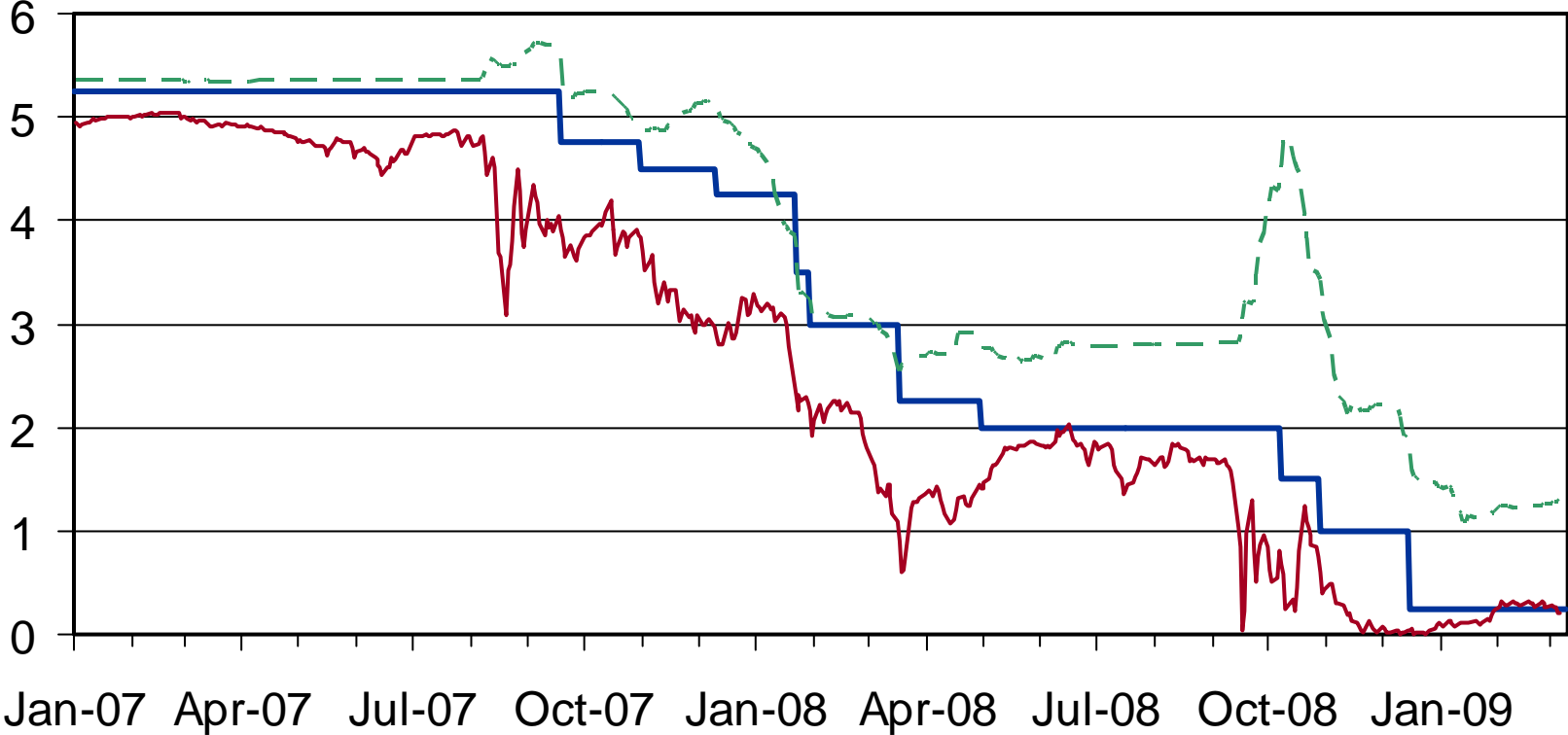
Some Positive Signs – Functioning of Interbank Markets Continues to Improve



And Risk Aversion Has Improved – But Exclusively for Highly Rated Credits



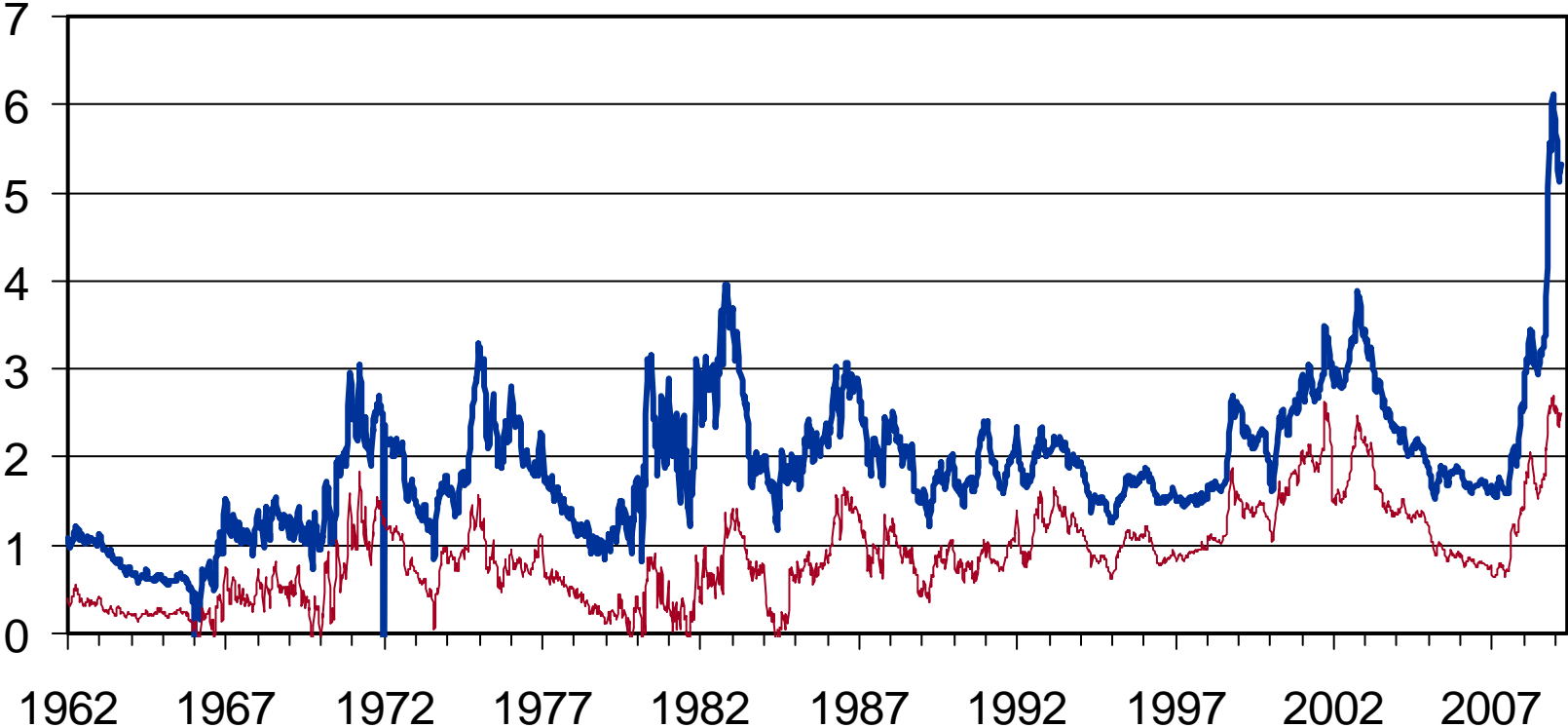
T-Bill Yields Near Zero



— Federal Funds Target — 3-Month LIBOR — 3-Month T-Bill

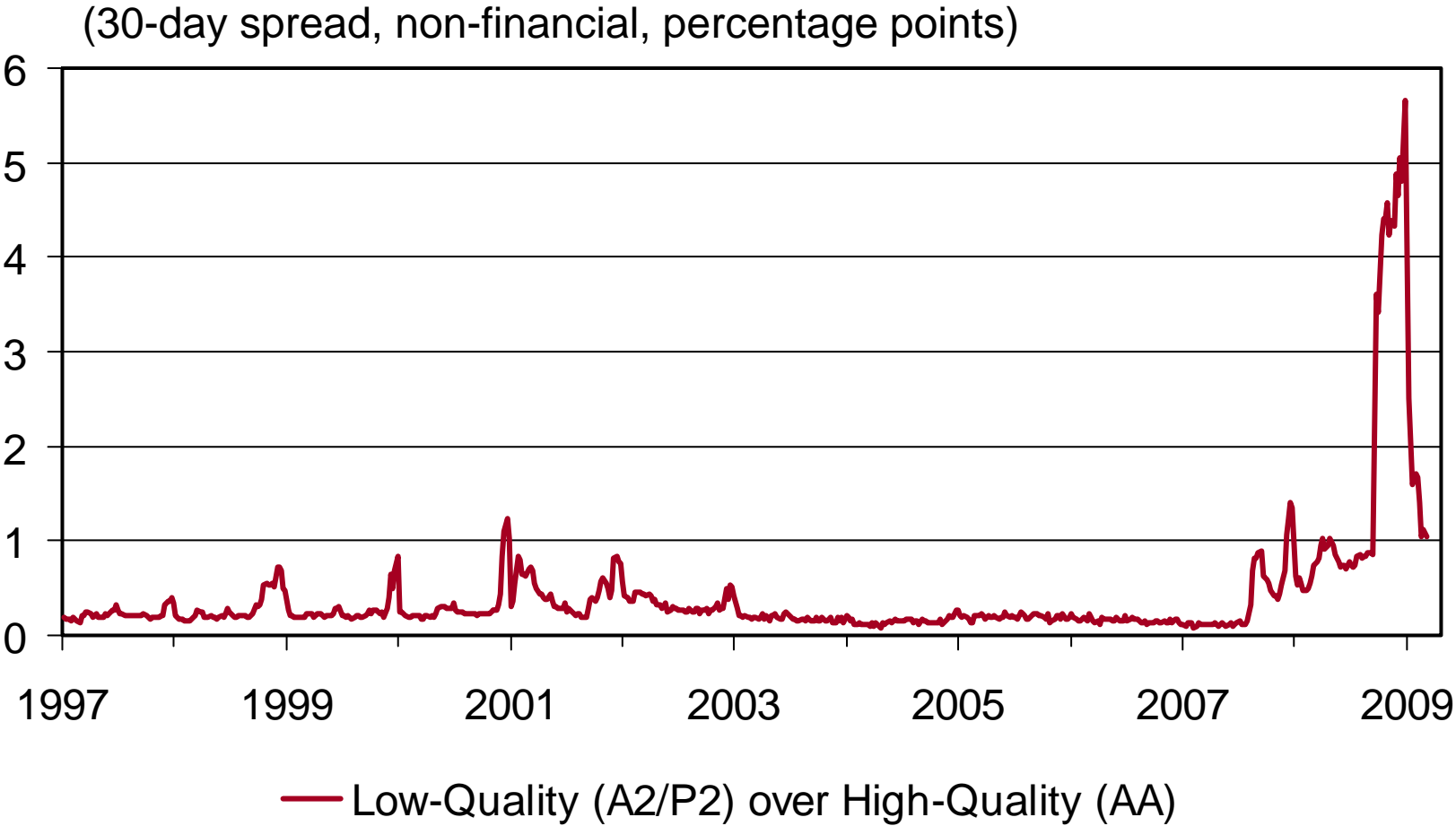
Corporate Bond Spreads Blow Out

(Corporate Yield Less 10-Year Treasury, percentage points)

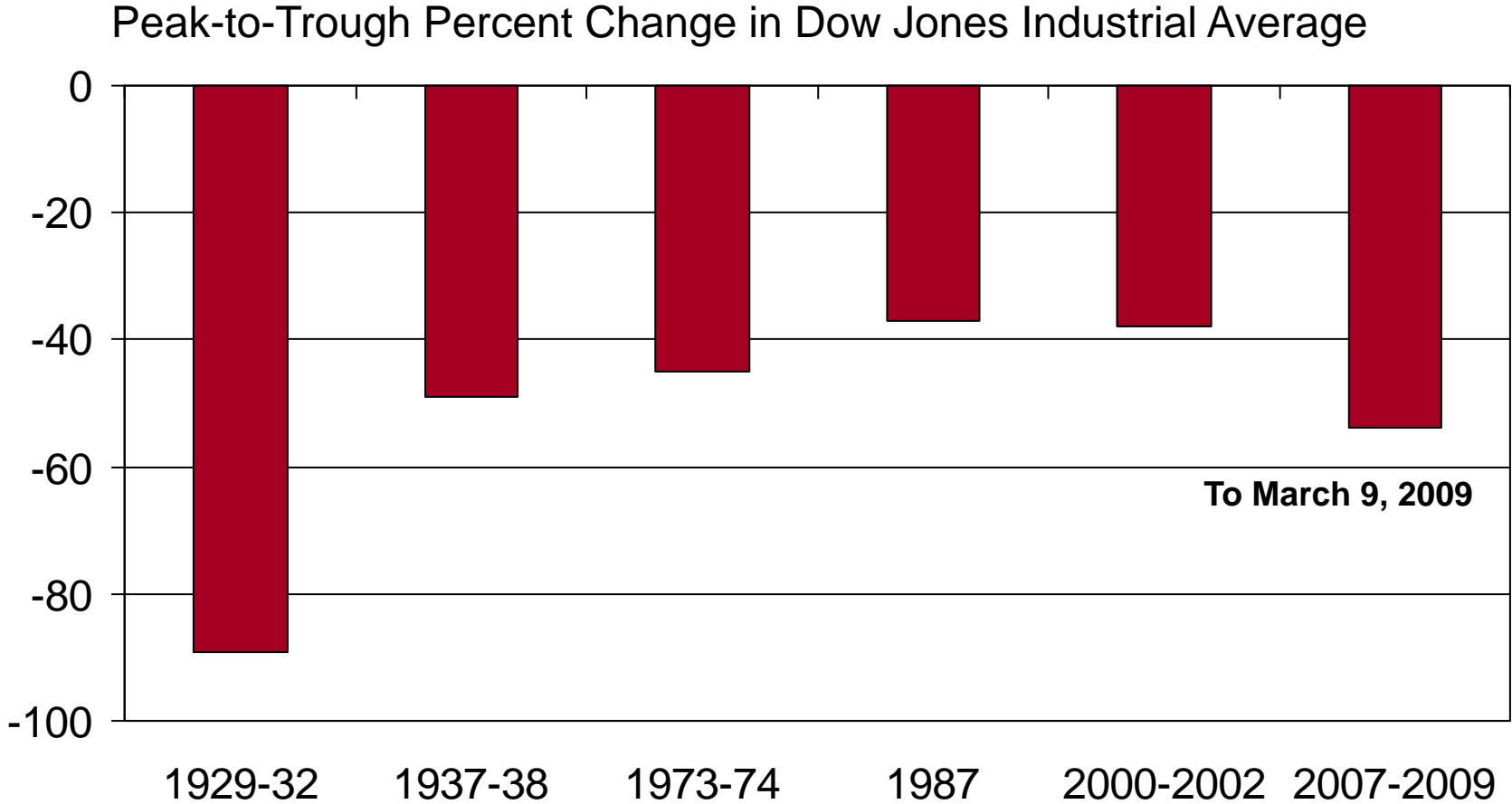


— BAA Spread — AAA Spread

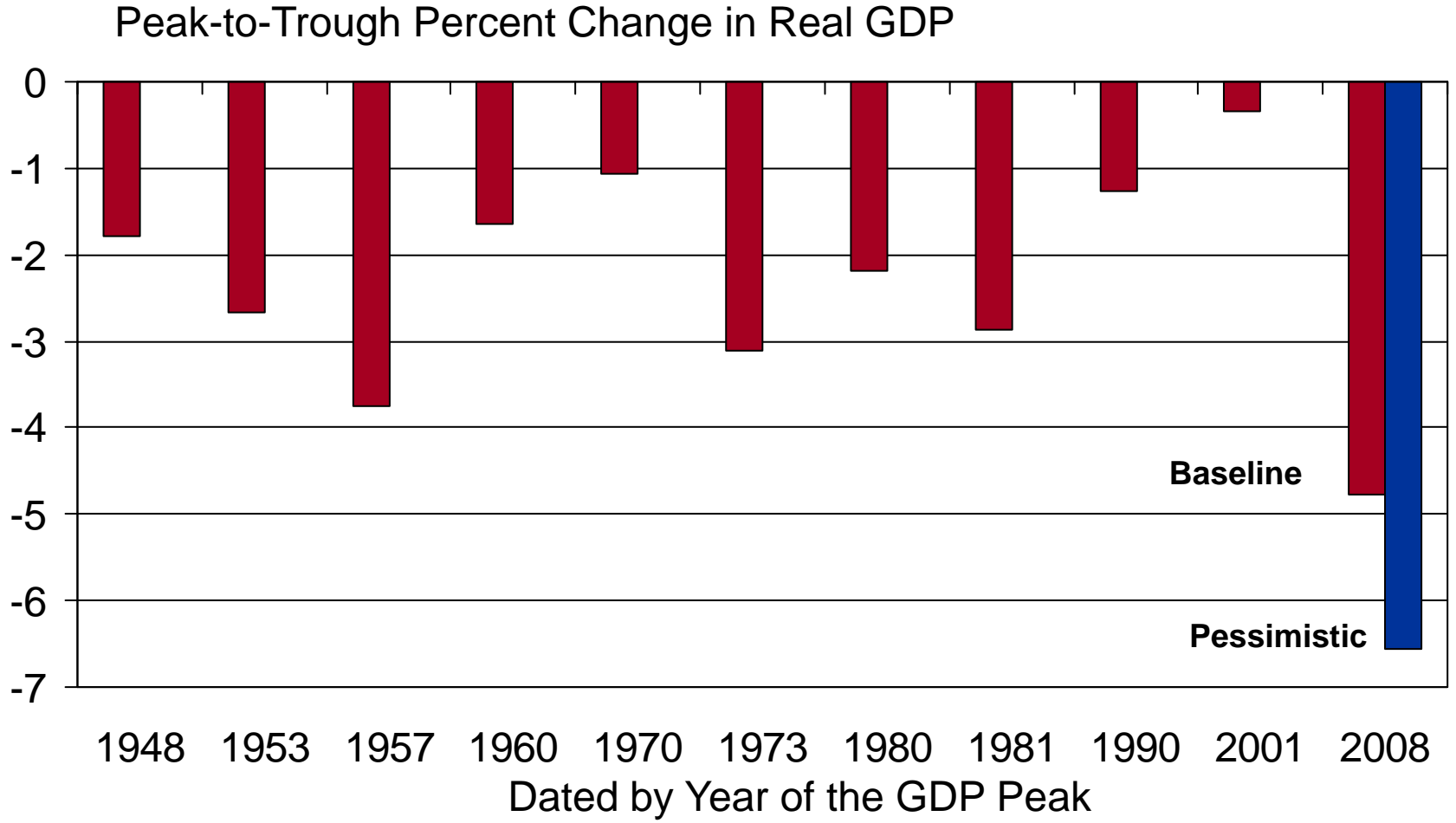
Commercial Paper Spreads Have Narrowed



Stock Market Decline: Worst Since the Great Depression



GDP Declines in Post-War Recessions



Historical Comparisons of Outcomes of Post-War Banking Crises in Industrial Nations

AVERAGE DROP IN REAL PER CAPITA GDP GROWTH (Peak growth year to trough growth year)

Past Crises: Actual Outcome

Eighteen Post-War Financial Crises over 2%

“Big Five” Financial Crises over 5%

Current Crisis: IHS Global Insight Projections

U.S. Baseline Scenario 7.3% (2004: 2.7%; 2009: -4.6%)

U.S. Pessimistic Scenario 8.3% (2004: 2.7%; 2009: -5.6%)

Source for data on past crises: Reinhart and Rogoff (2008)

Recession: From Mild to Deep

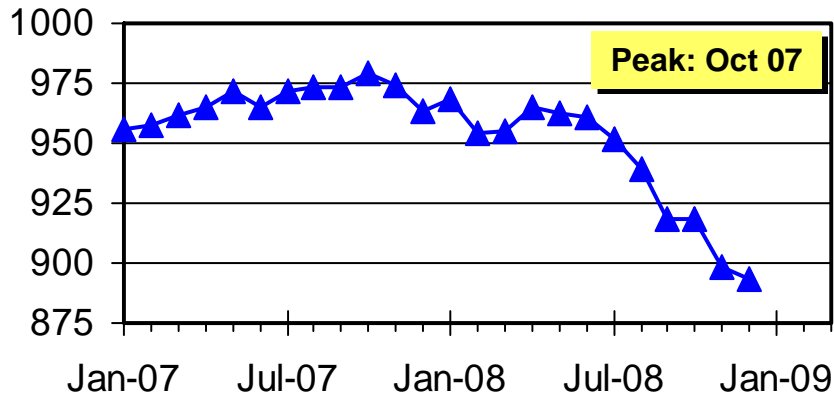


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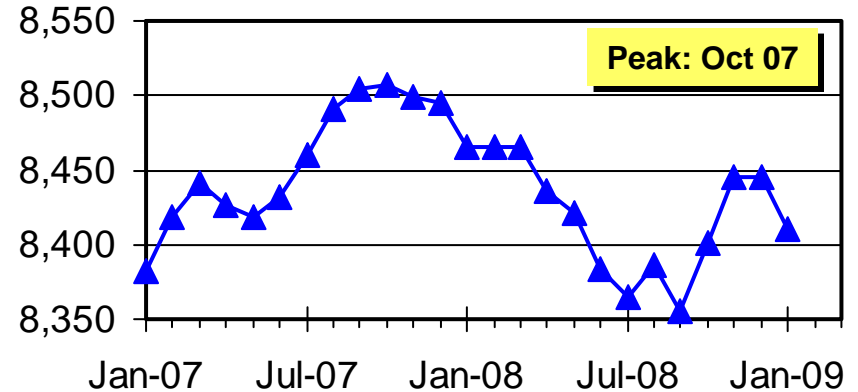
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NBER's Key Monthly Recession Indicators

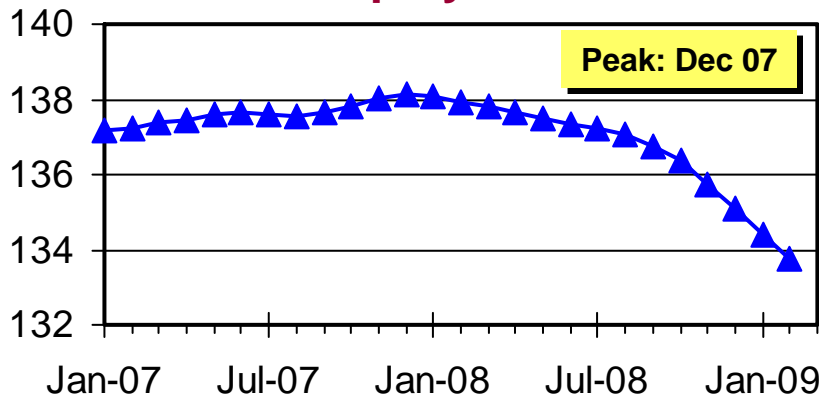
Real Manuf. & Trade Sales*



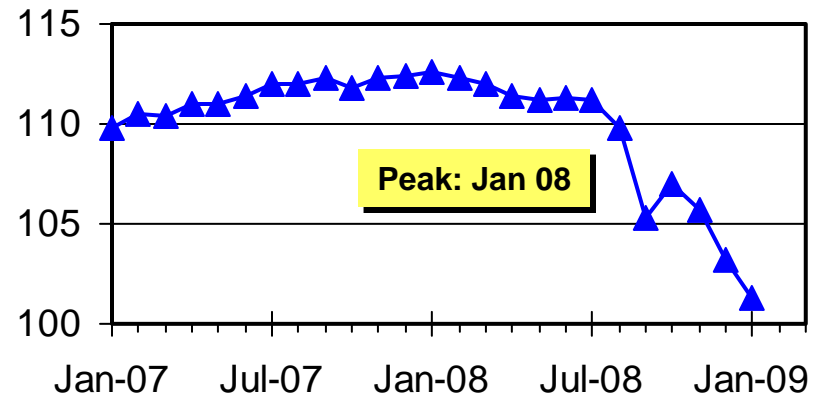
Real Pers. Income (ex transfers)*



Employment**

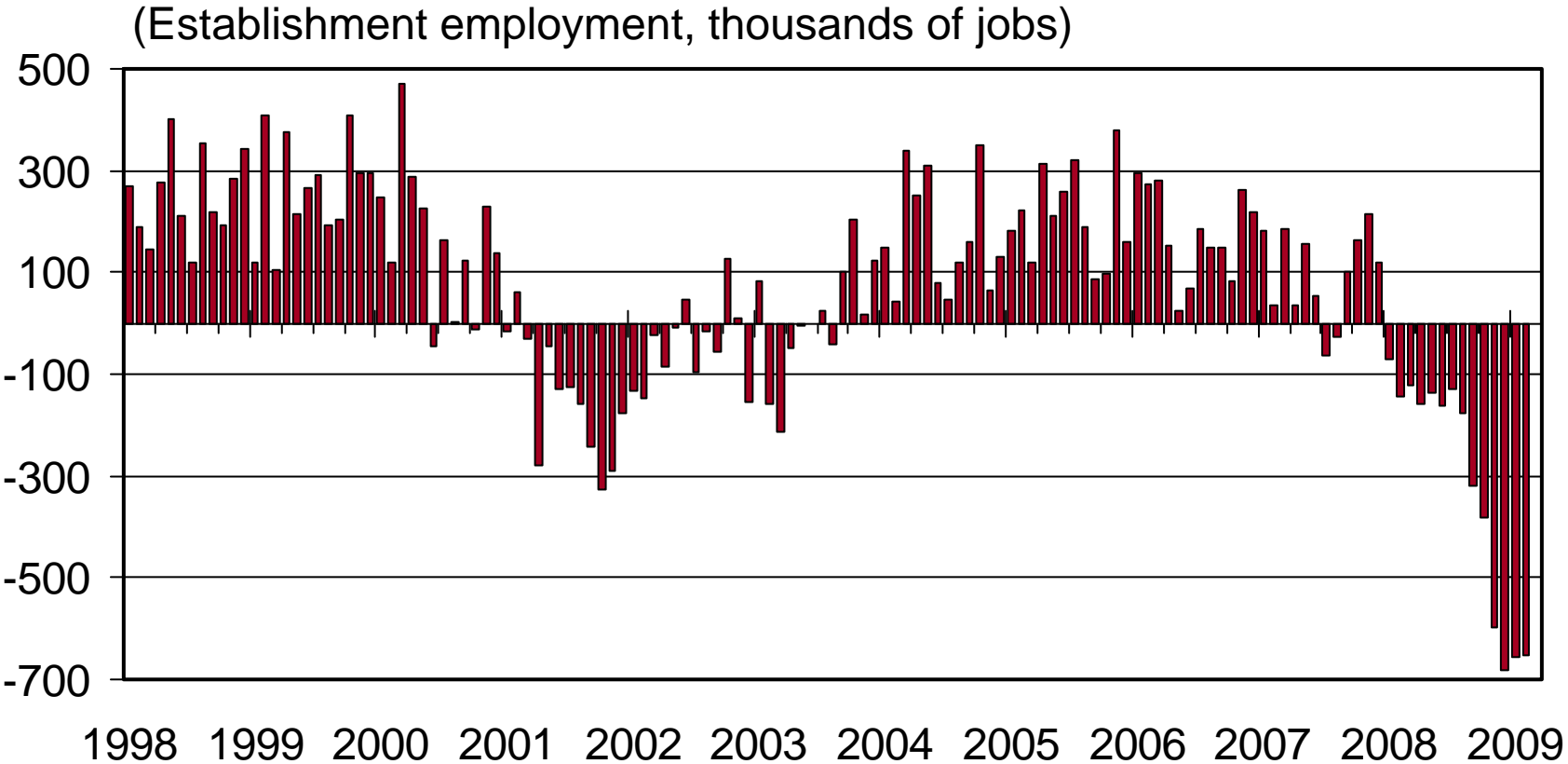


Industrial Production***

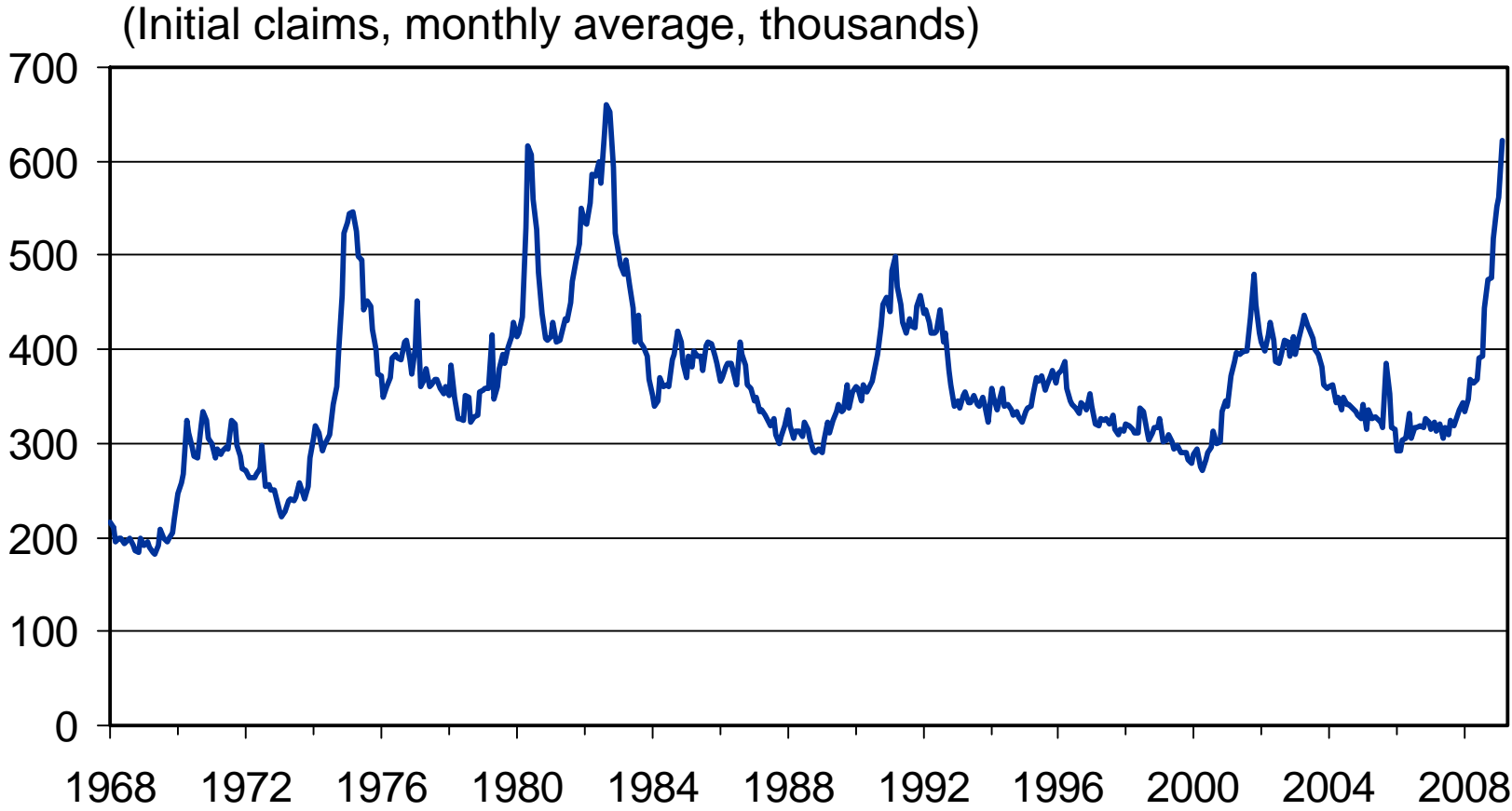


*Billions of 2000 dollars, SAAR; **Millions, SA; ***Index, 2002=100, SA

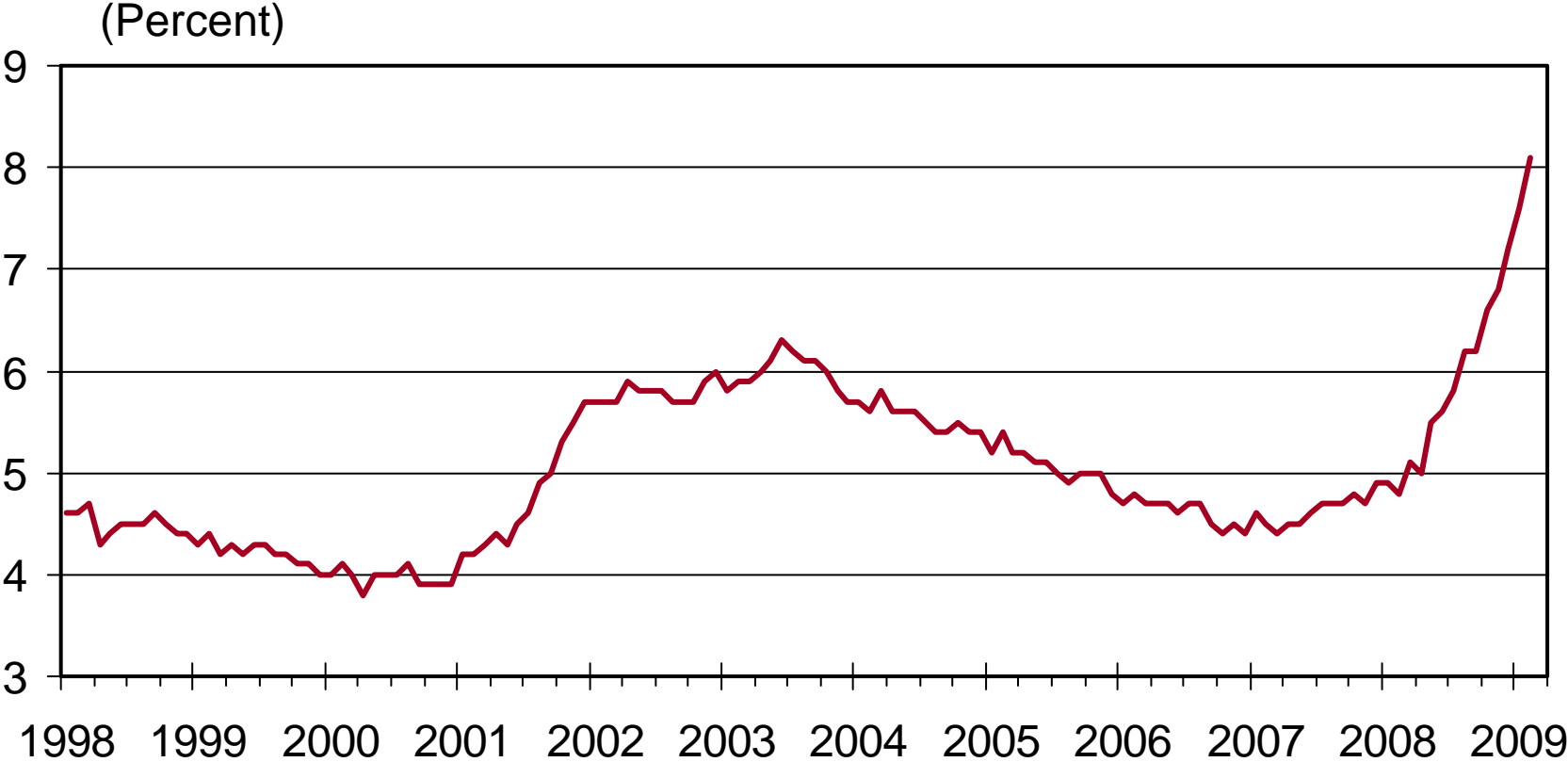
Employment Falling Sharply



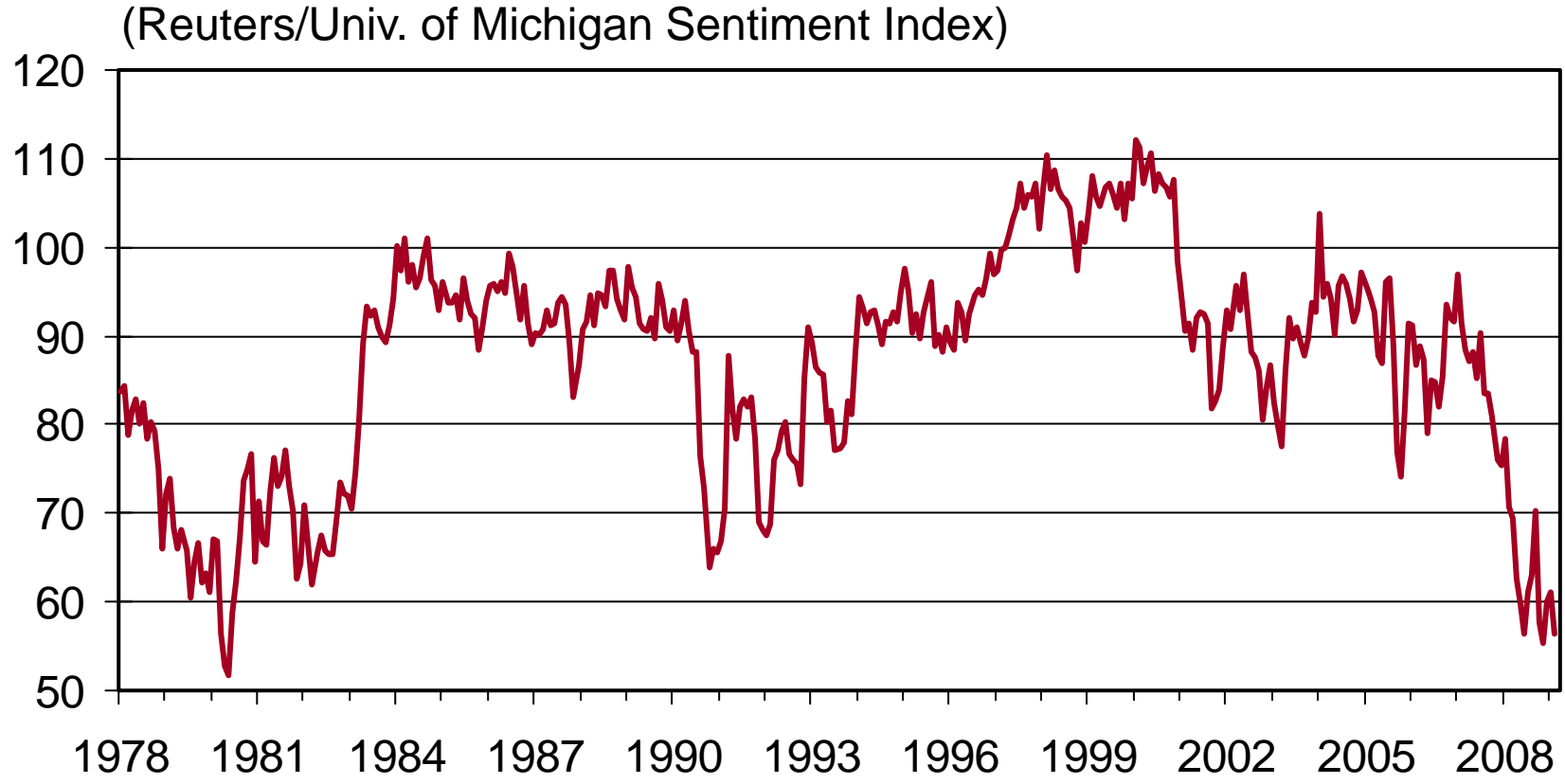
Unemployment Insurance Claims Spiking



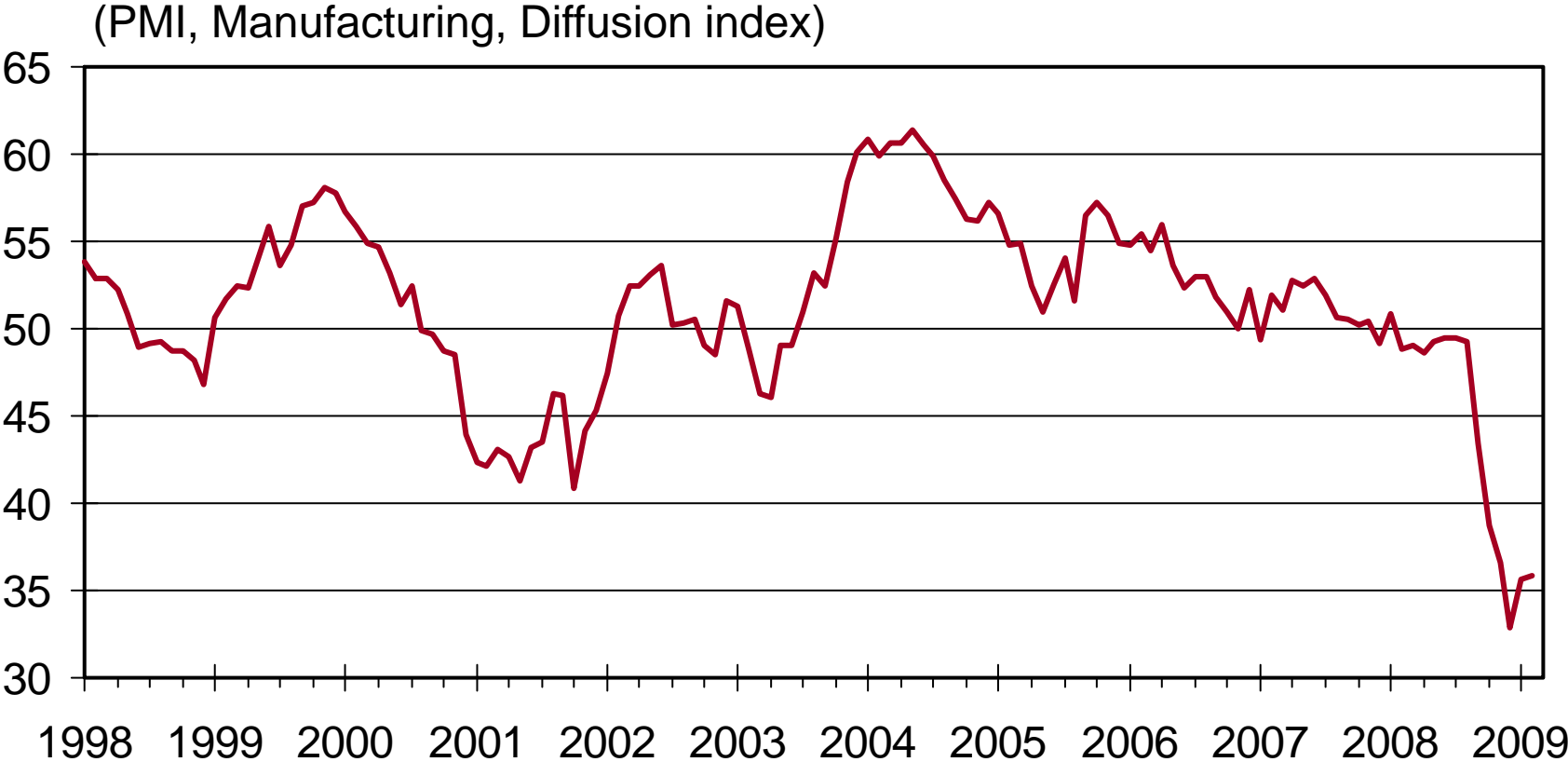
Unemployment Rate Rising



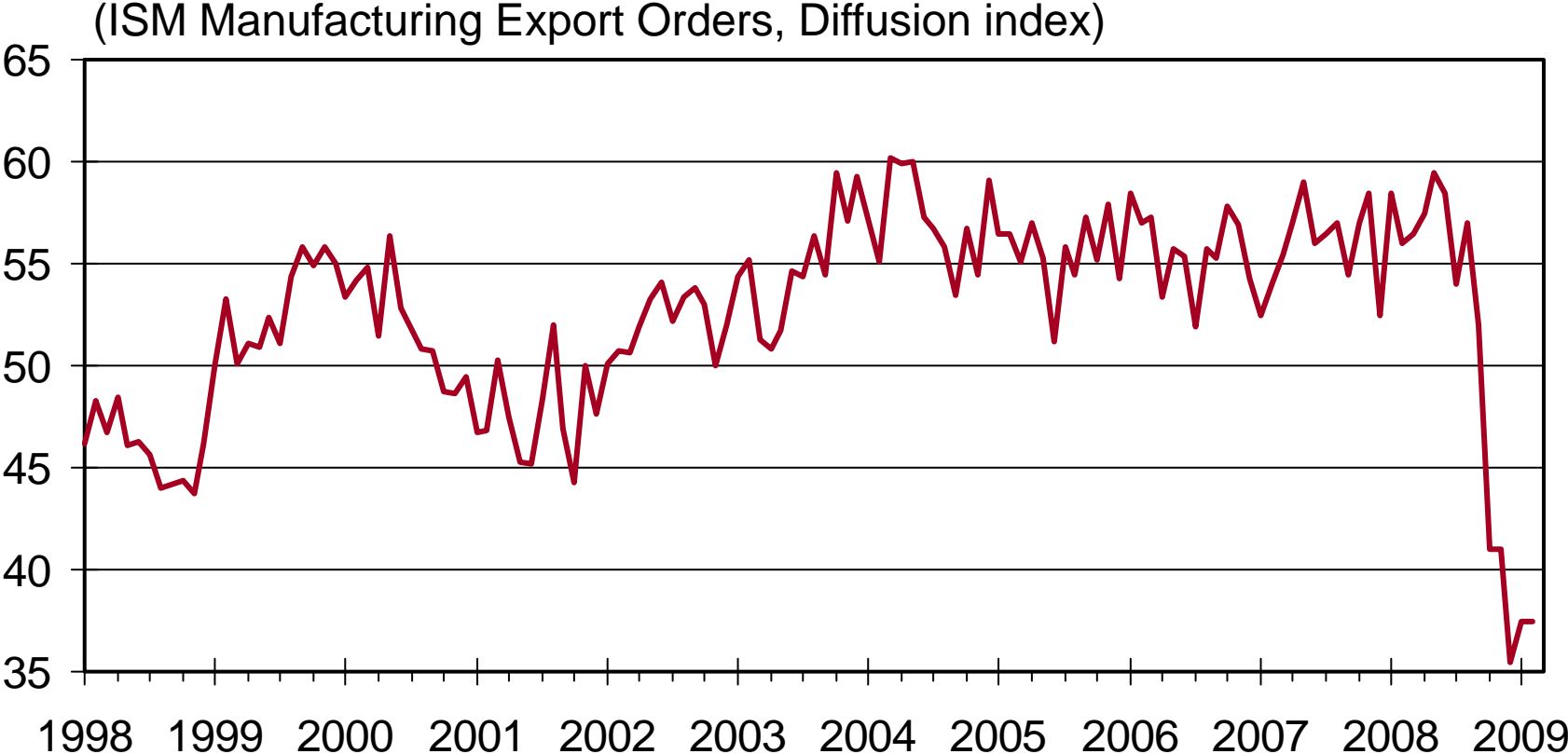
Consumer Sentiment Deep in the Recession Zone



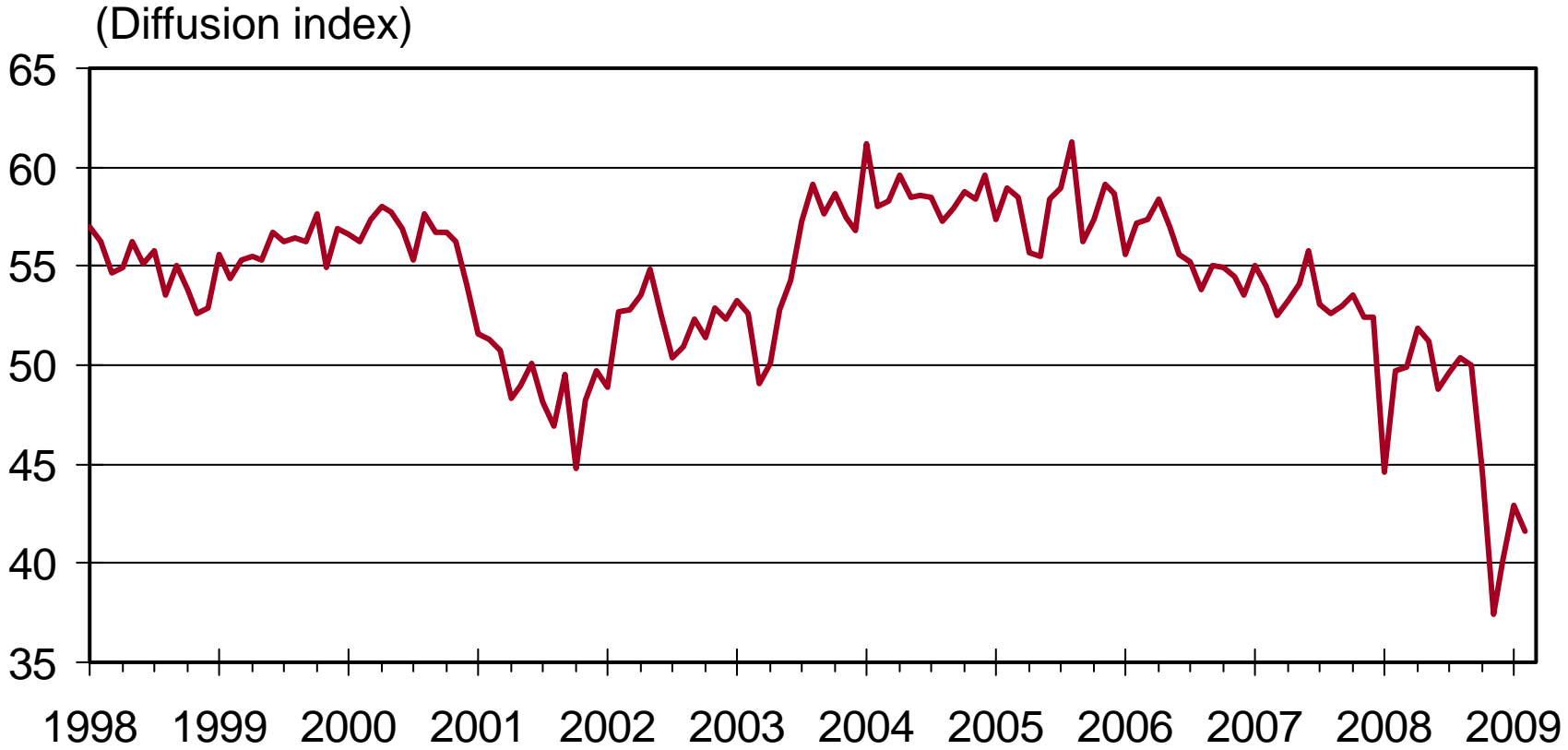
ISM Manufacturing Index in the Recession Zone



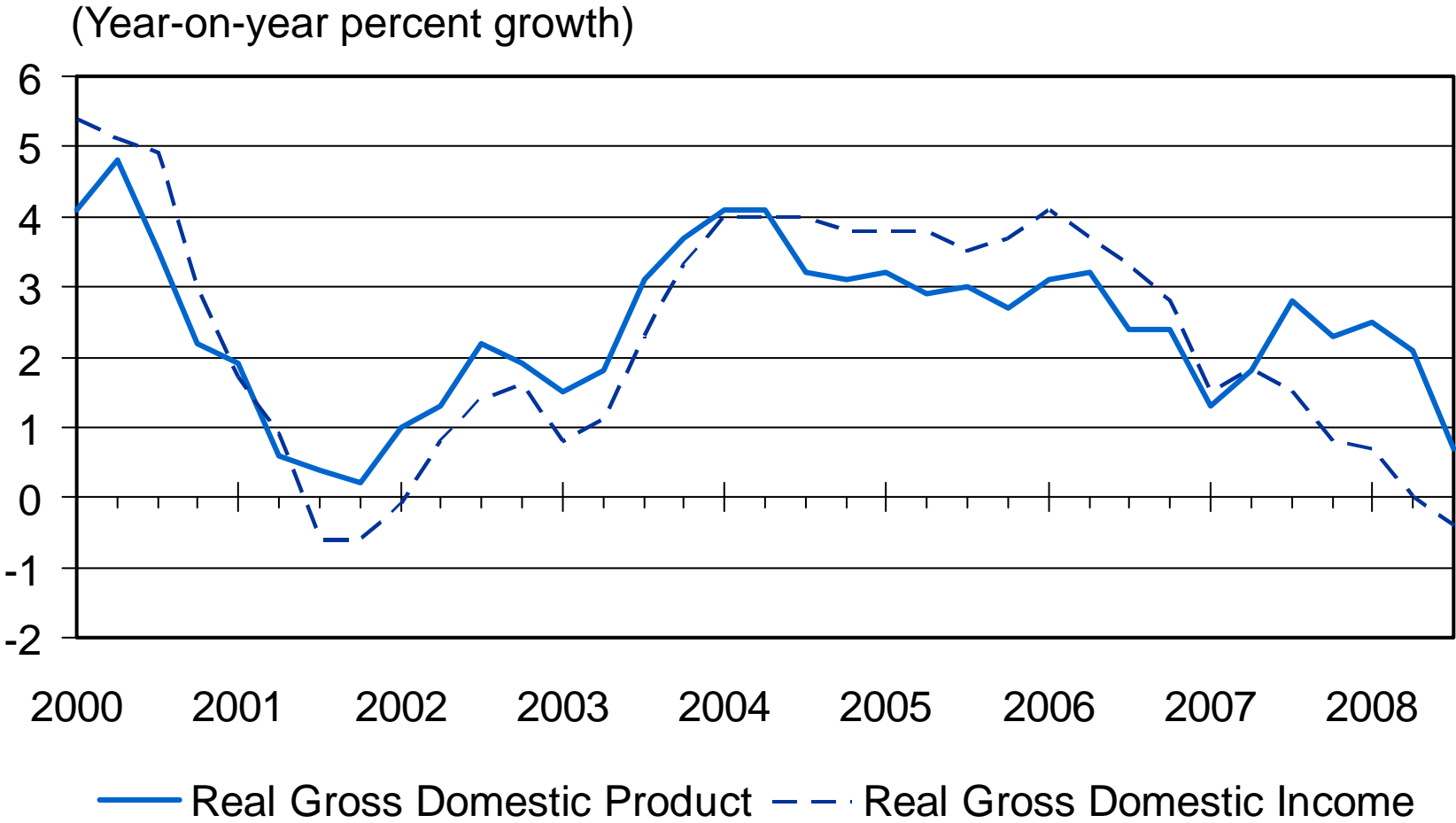
Exports Orders Diving



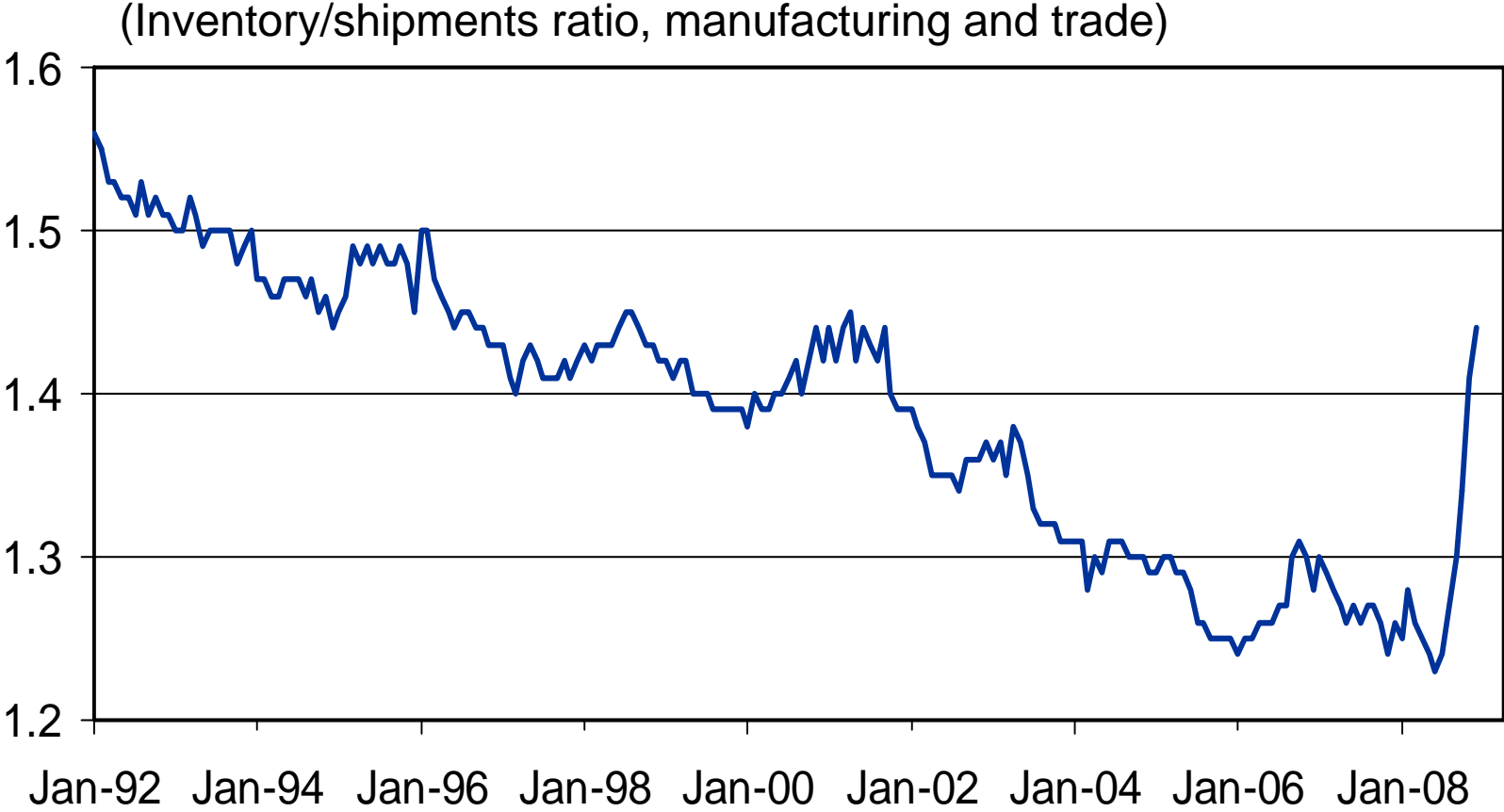
ISM Non-Manufacturing Index Tumbles Again



Is GDP Telling the Real Story?



An Inventory Overhang Is Building



U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2008	2009	2010	2011
Real GDP	1.1	-3.7	1.4	3.5
Domestic Demand	-0.2	-4.0	2.3	3.4
Consumption	0.2	-1.2	2.0	2.2
Light Vehicle Sales (Millions)	13.1	9.5	11.6	13.8
Residential Investment	-20.7	-25.0	8.1	28.5
Housing Starts (Millions)	0.90	0.51	0.82	1.24
Business Fixed Investment	1.7	-18.8	-0.5	13.1
Government	6.0	5.1	1.1	-3.5
Exports	6.2	-14.7	-1.9	9.7
Imports	-3.4	-13.8	5.6	7.1

Other Key Indicators

(Percent unless otherwise noted)

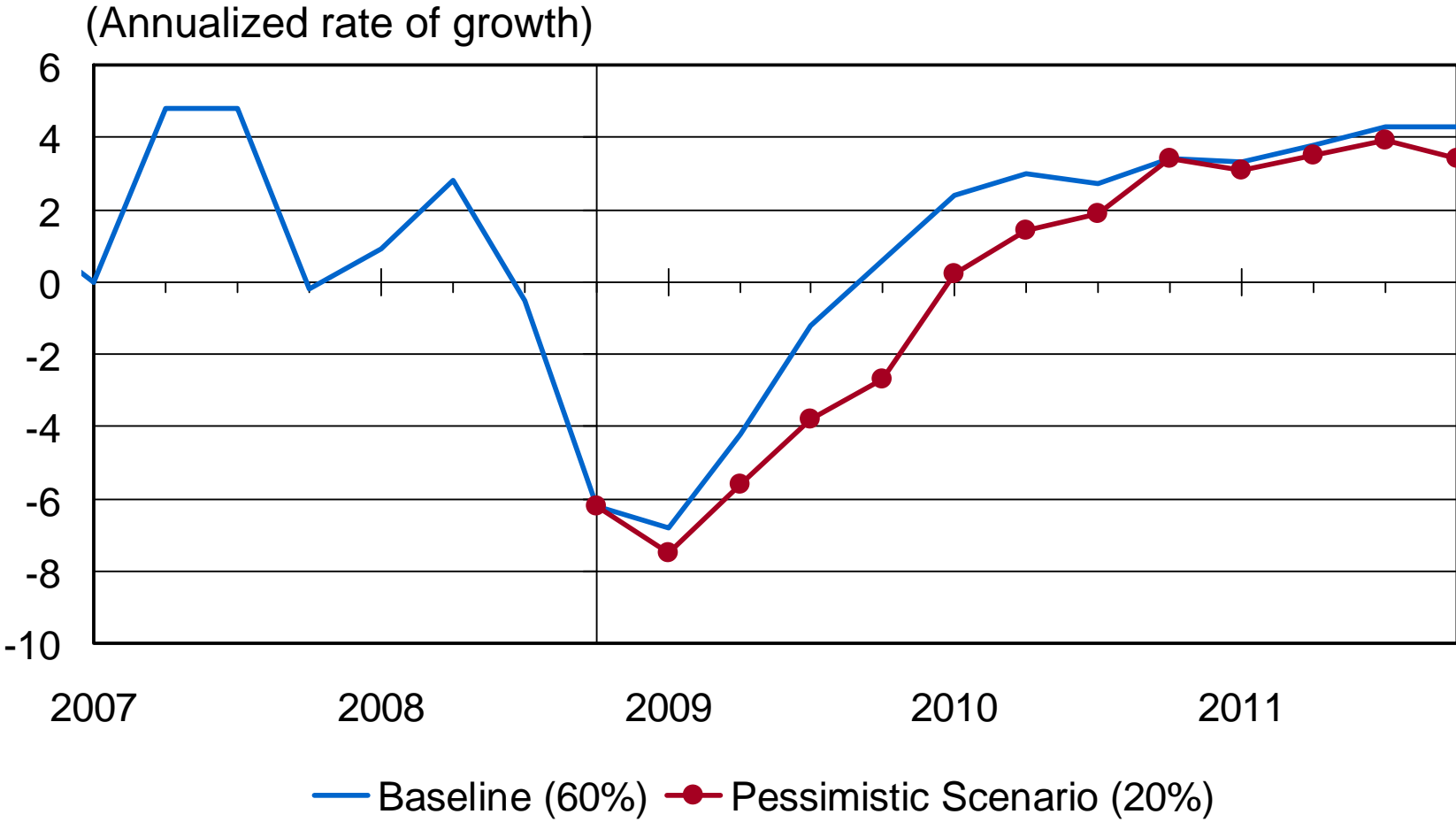
	2008	2009	2010	2011
Industrial Production (% growth)	-1.8	-10.0	-0.3	4.9
Employment (% growth)	-0.4	-3.6	-0.8	1.5
Unemployment Rate	5.8	9.2	10.2	9.6
CPI Inflation	3.8	-1.9	1.5	2.4
Oil Prices (WTI, US\$/bbl)	100	38	49	61
Core PCE Price Inflation	2.2	0.9	0.9	1.4
Federal Funds Rate	1.93	0.14	0.21	1.70
10-year Government Bond Yield	3.67	2.77	2.89	3.84
Dollar (Major Currencies, 2000=1)	0.71	0.81	0.78	0.74

Downside Risks

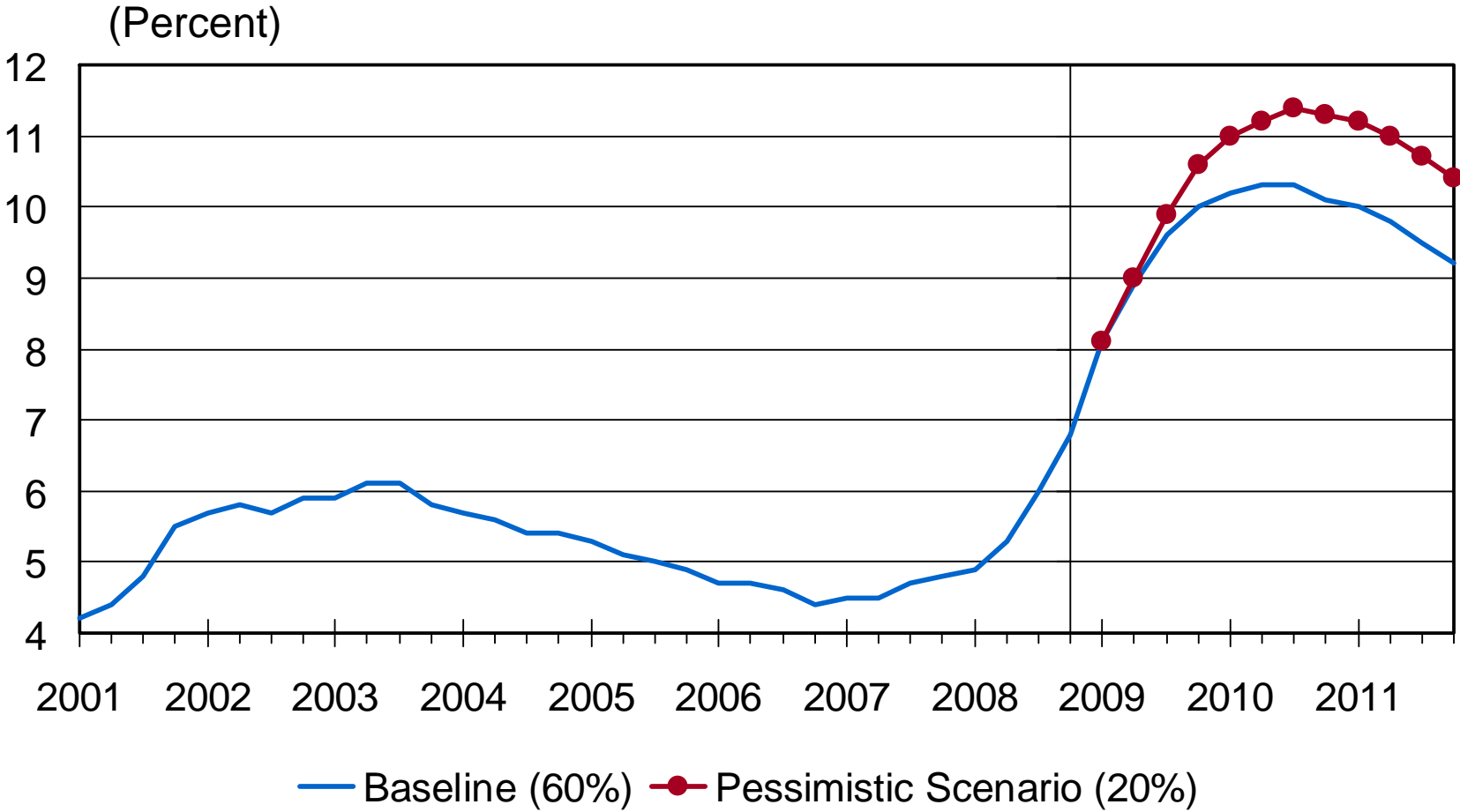


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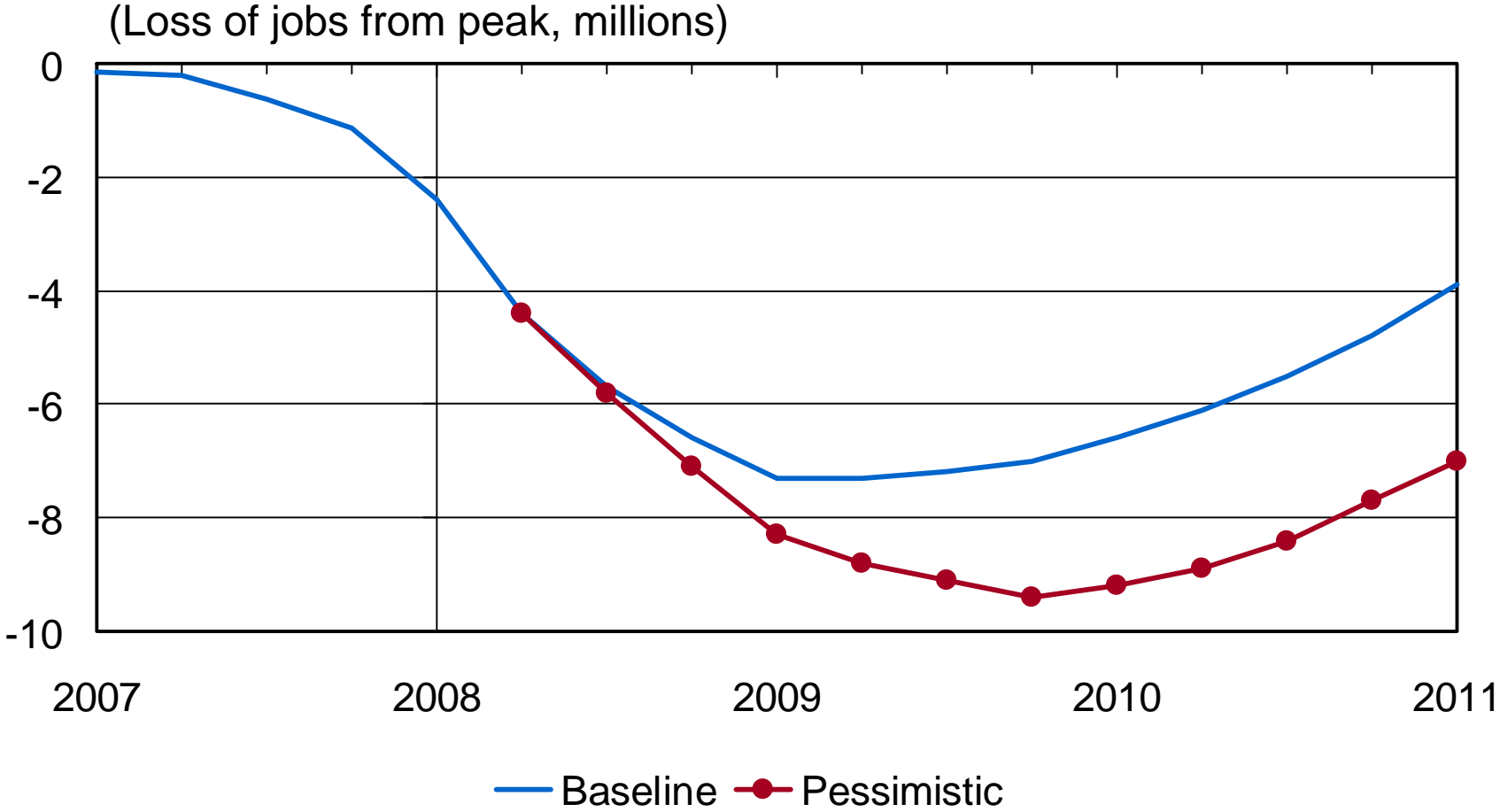
GDP Growth Outlook



Unemployment Outlook



Employment Outlook



Fiscal Stimulus Prevents An Even Worse Outlook



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Fiscal Stimulus

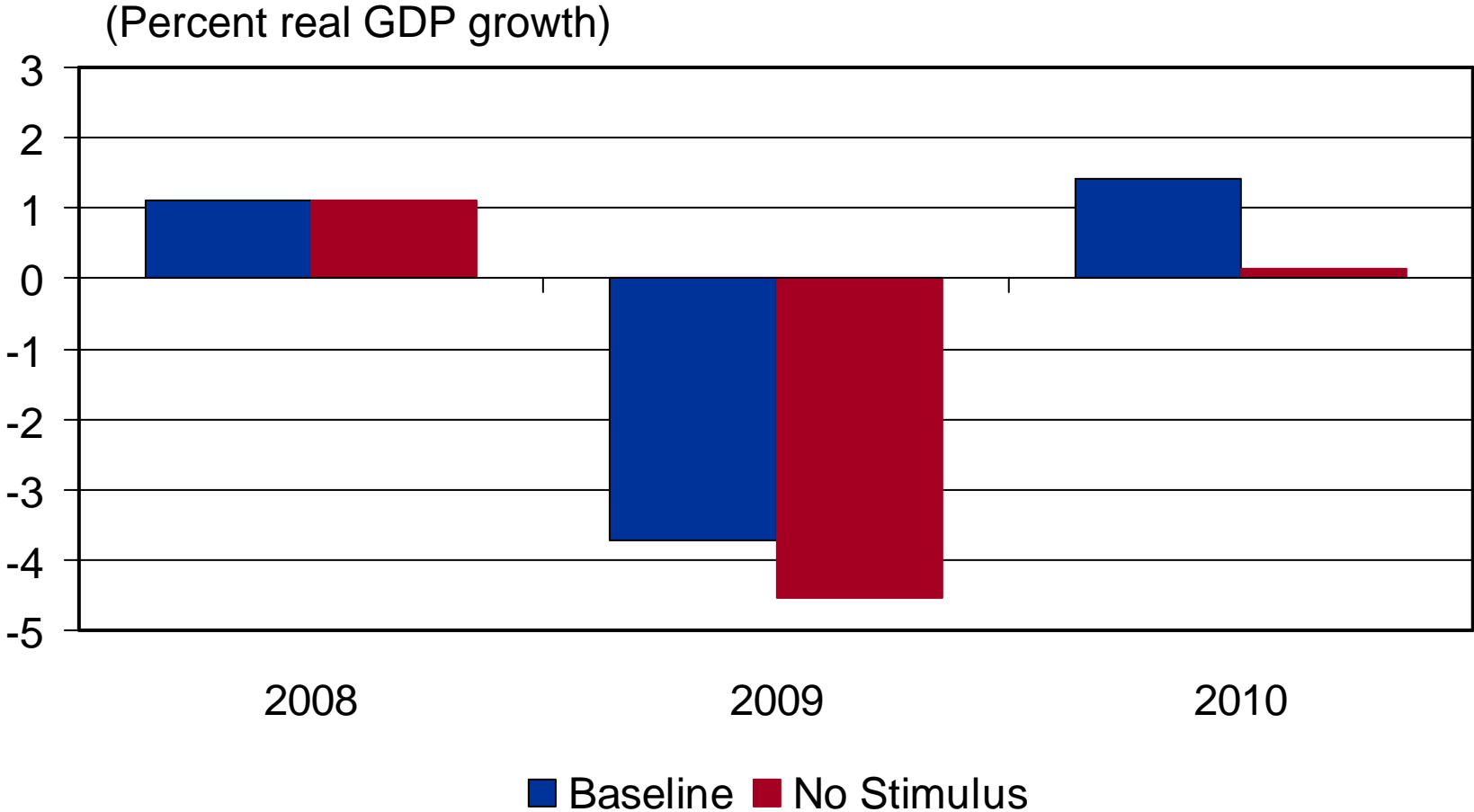
- The Final Compromise - \$787 billion
- Only \$717 billion excluding AMT relief, which we don't see as “real” stimulus

How Much Stimulus Comes Early?

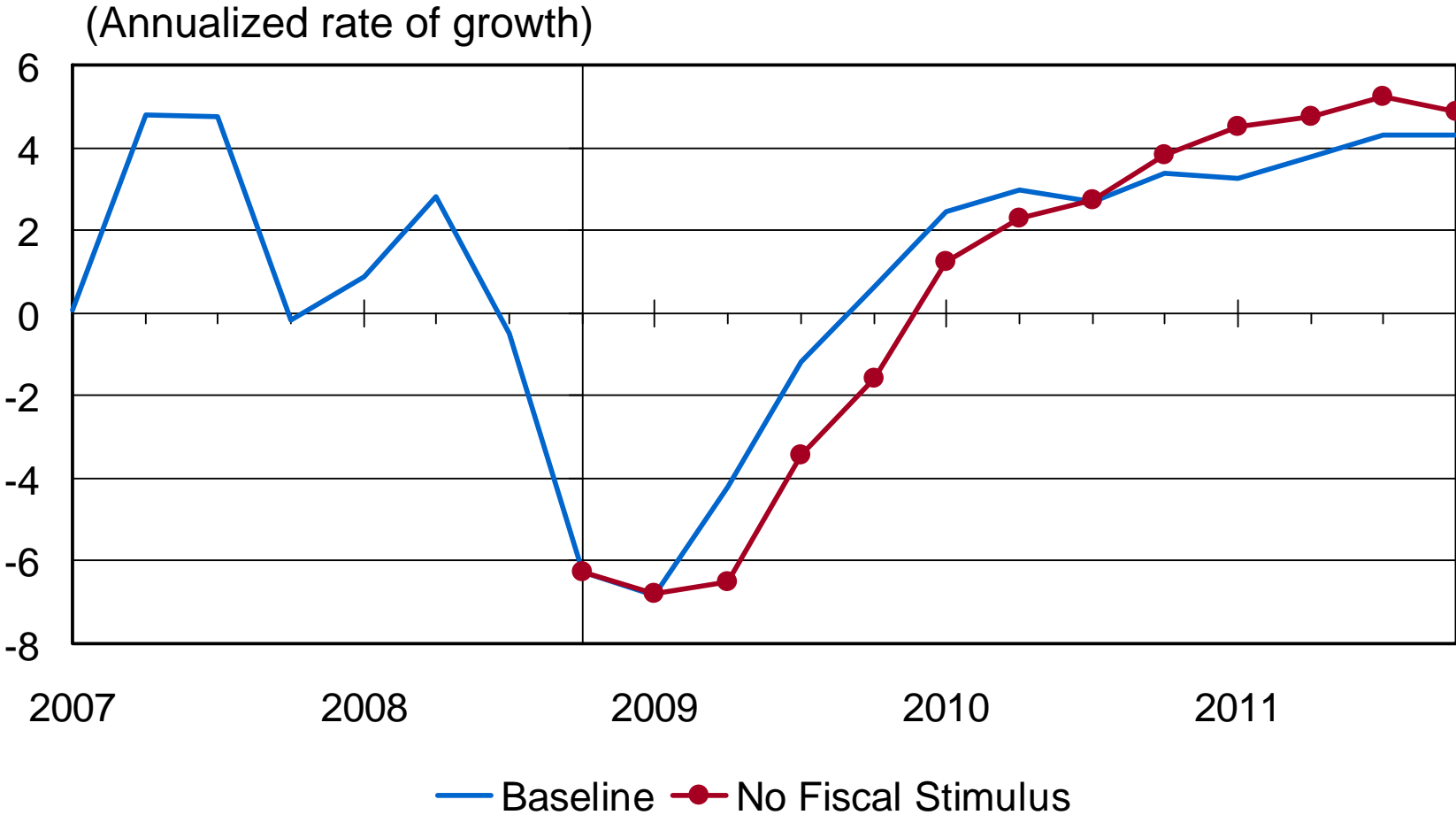
Our assumptions

- Total – \$561 billion over two calendar years
 - Personal “Tax Cuts” – \$143 billion
 - Personal Transfers (e.g., extended UI) – \$97 billion
 - Corporate Tax Cuts - \$88 billion
 - State and Local Transfers (incl. Medicaid)– \$149 billion
 - Infrastructure & Other– \$82 billion
- Time Path:
 - 2009: \$252 billion
 - 2010: \$309 billion

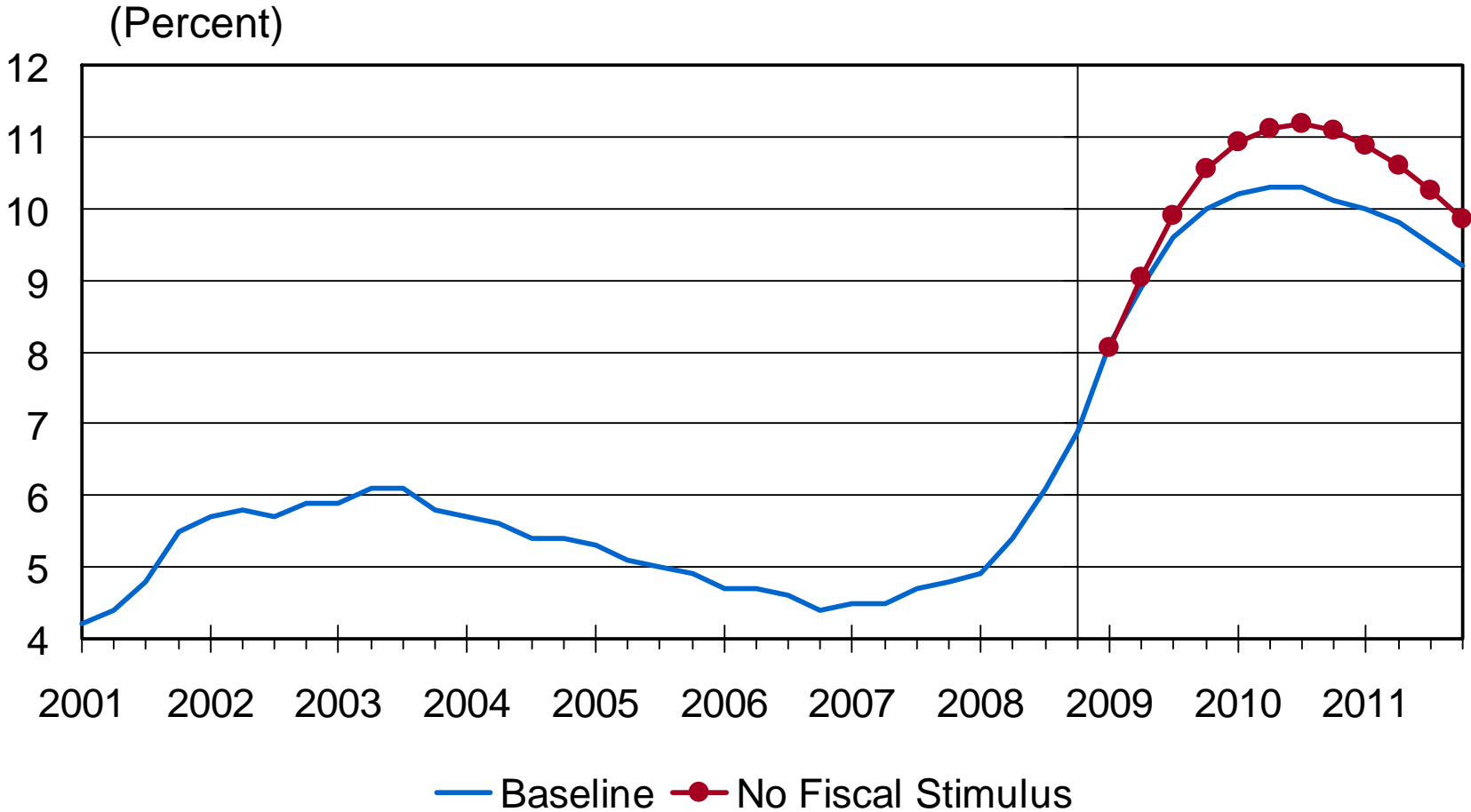
Fiscal Stimulus Impacts



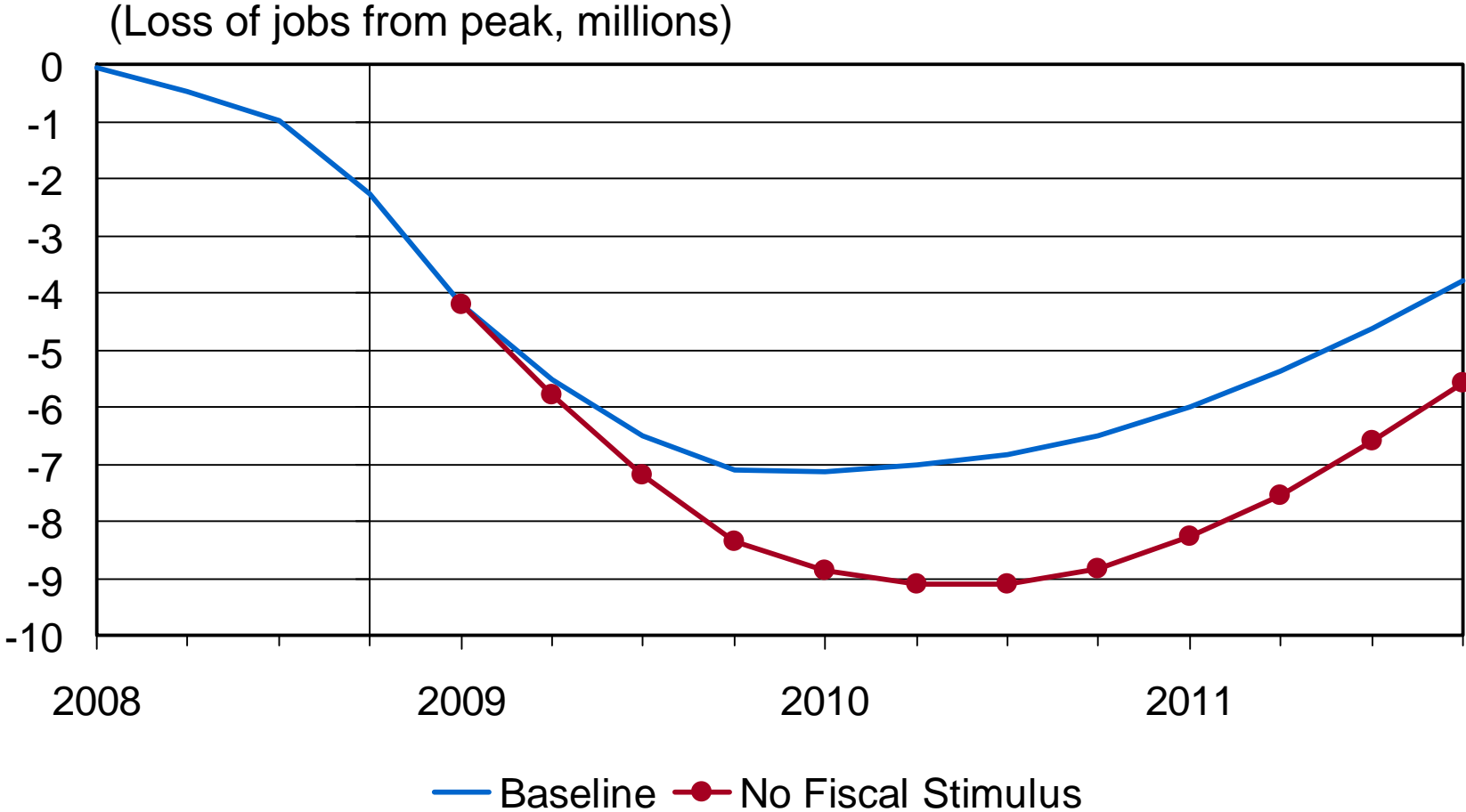
GDP Growth Outlook



Unemployment Outlook



Employment Outlook

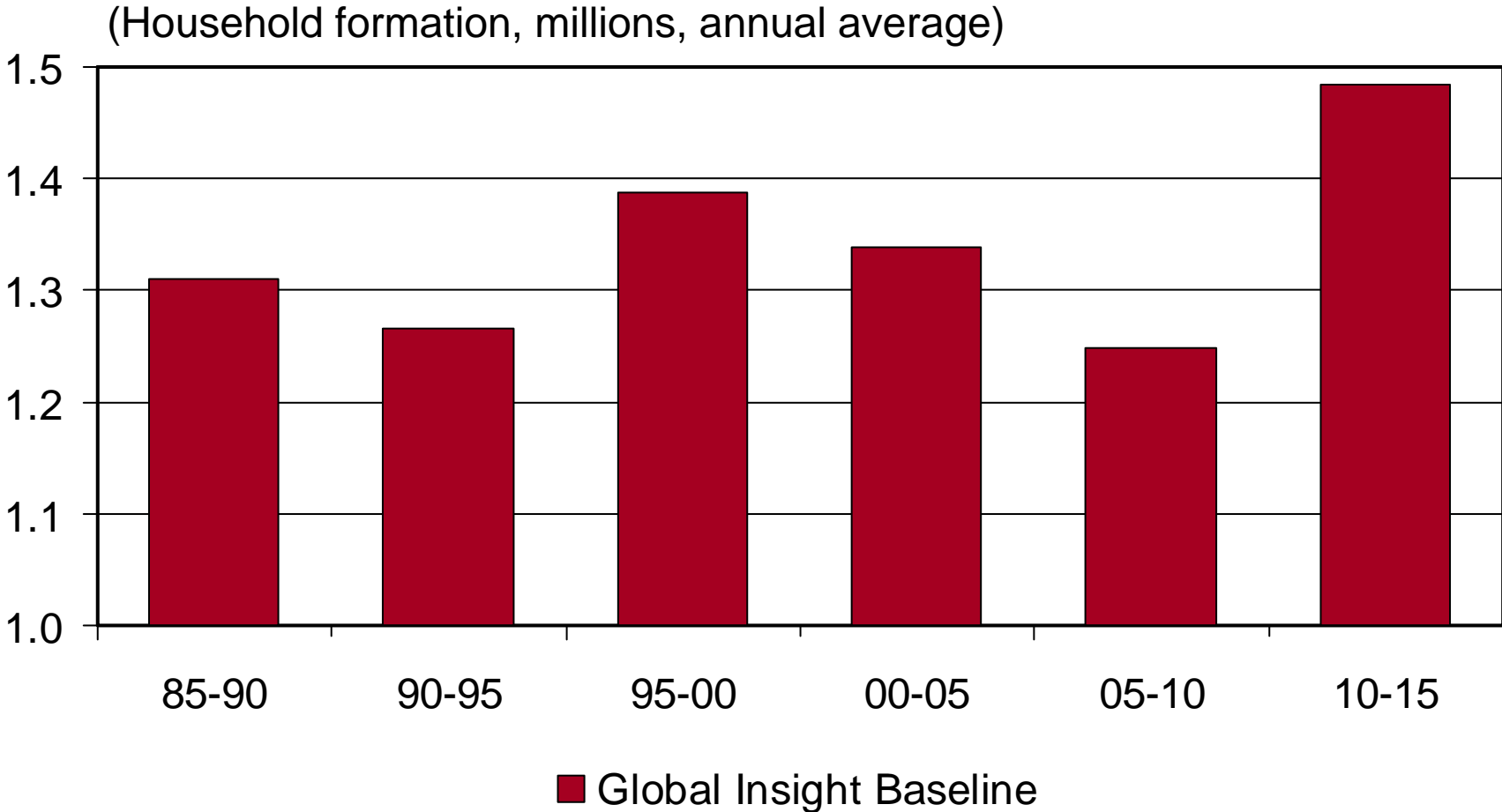


The Housing Downturn

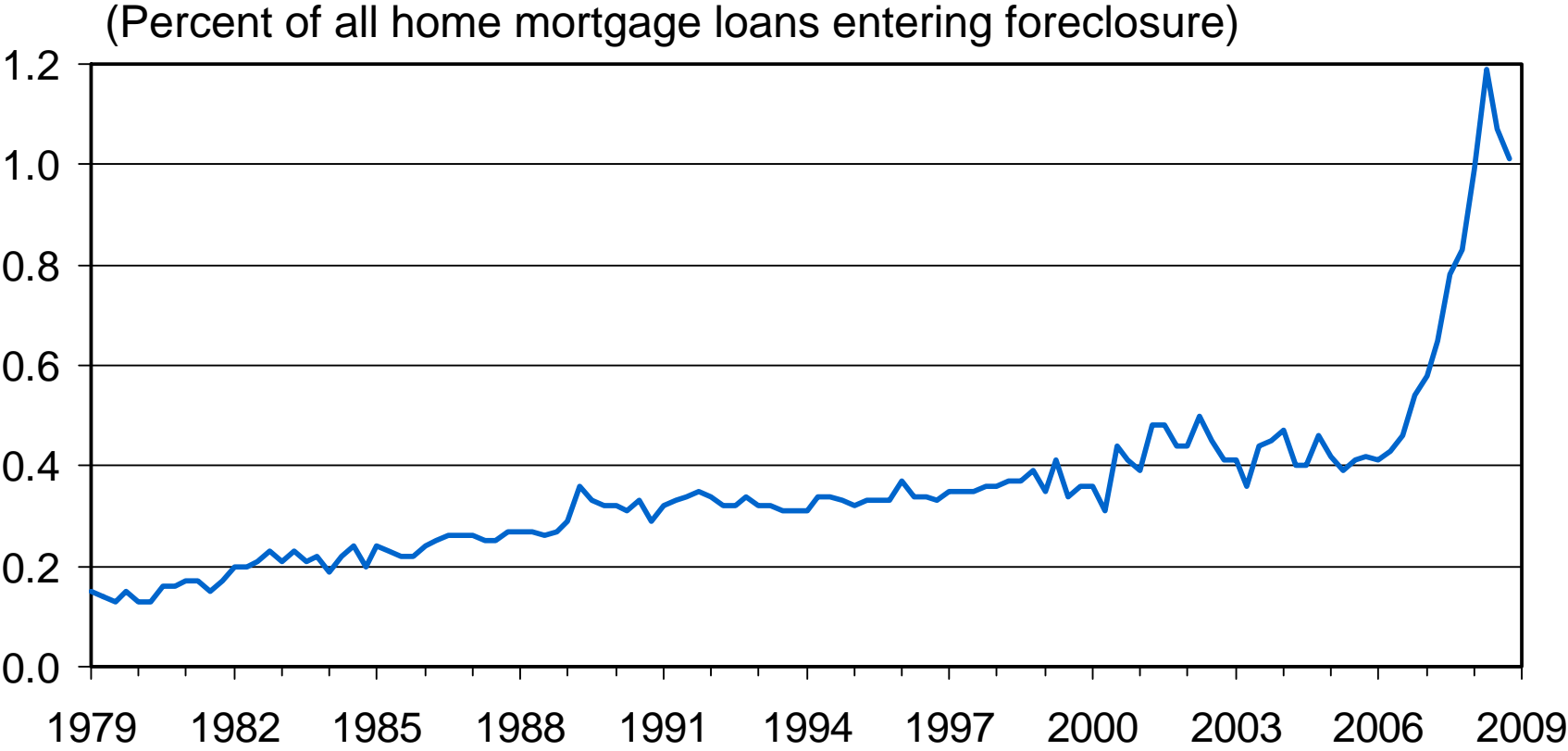


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Demographics Remain Favorable for Housing

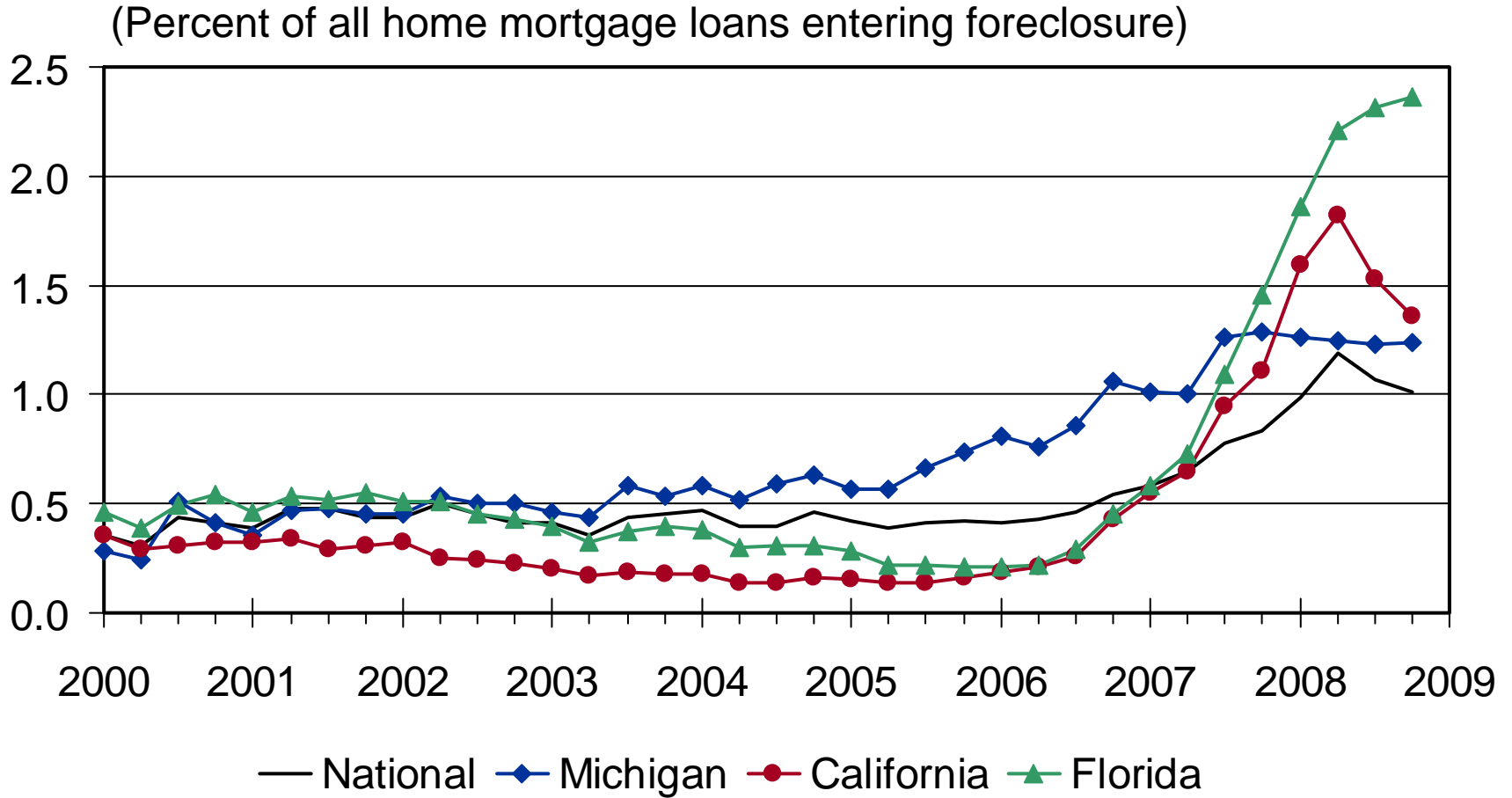


Foreclosure Rate Has Hit New Highs



Source: Mortgage Bankers Association

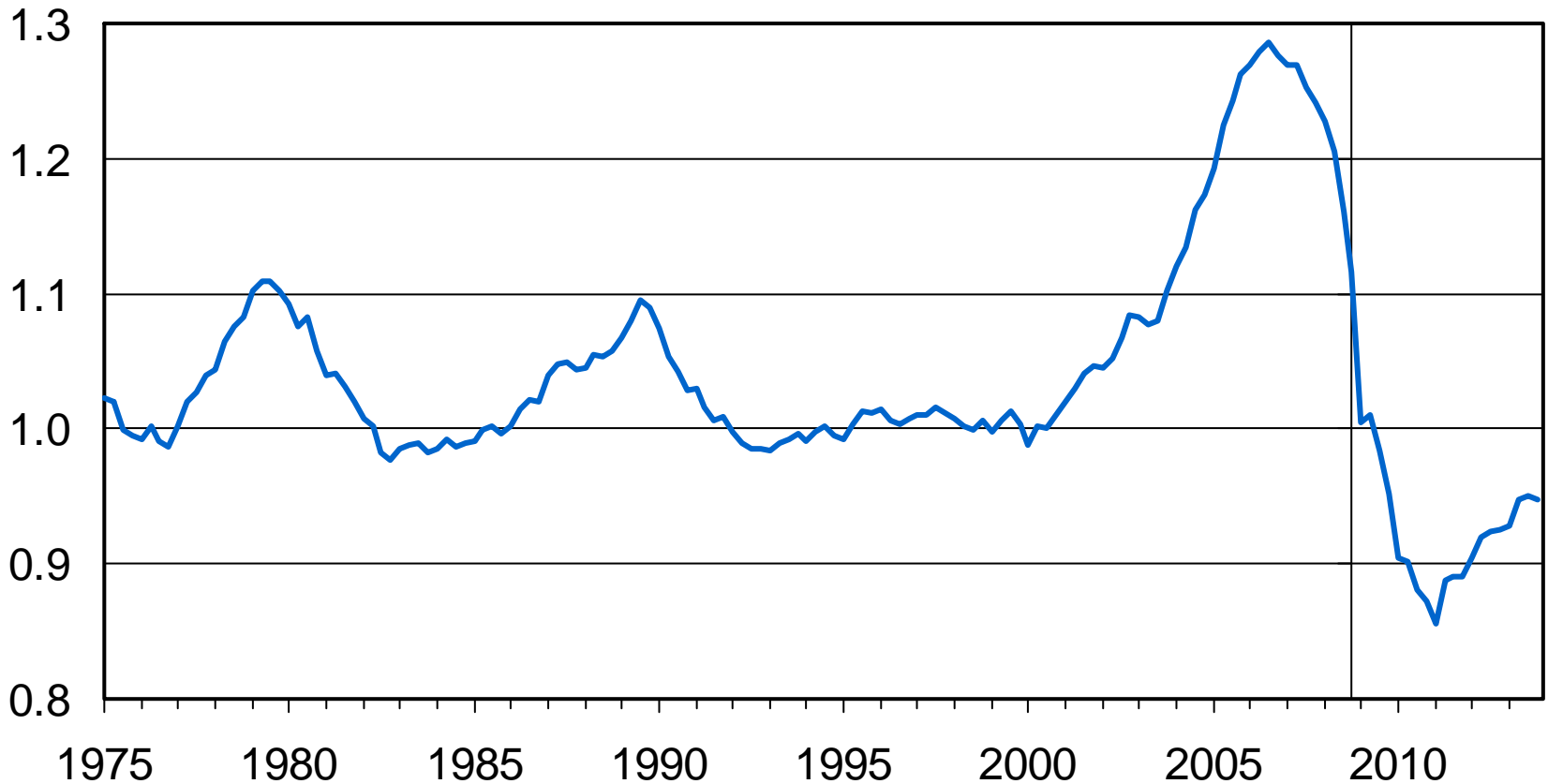
Key State Foreclosure Variations



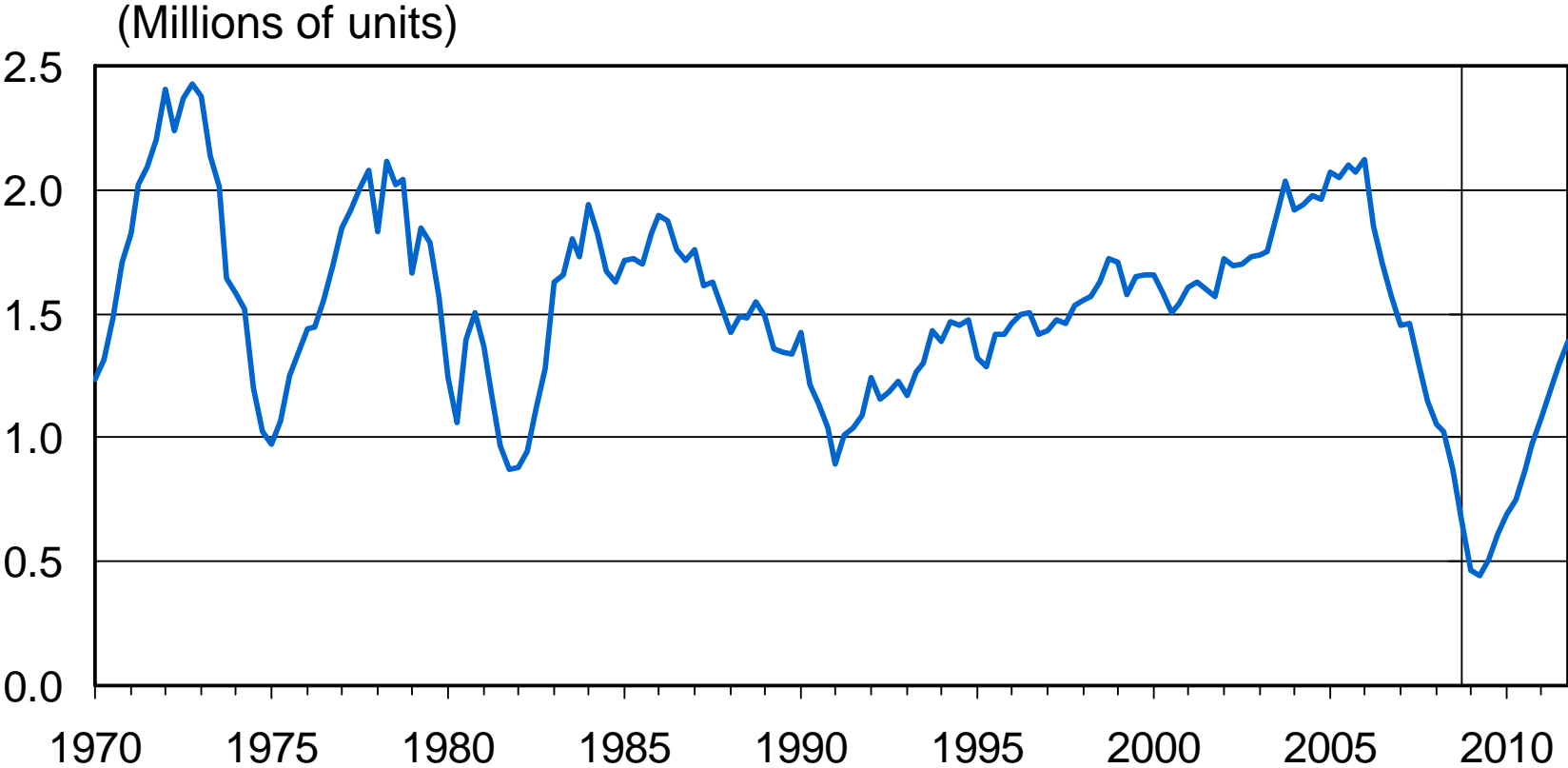
Source: Mortgage Bankers Association

House Prices Will Probably Overshoot on the Downside

(FHFA house price index divided by average labor compensation, 2000 = 1.0)

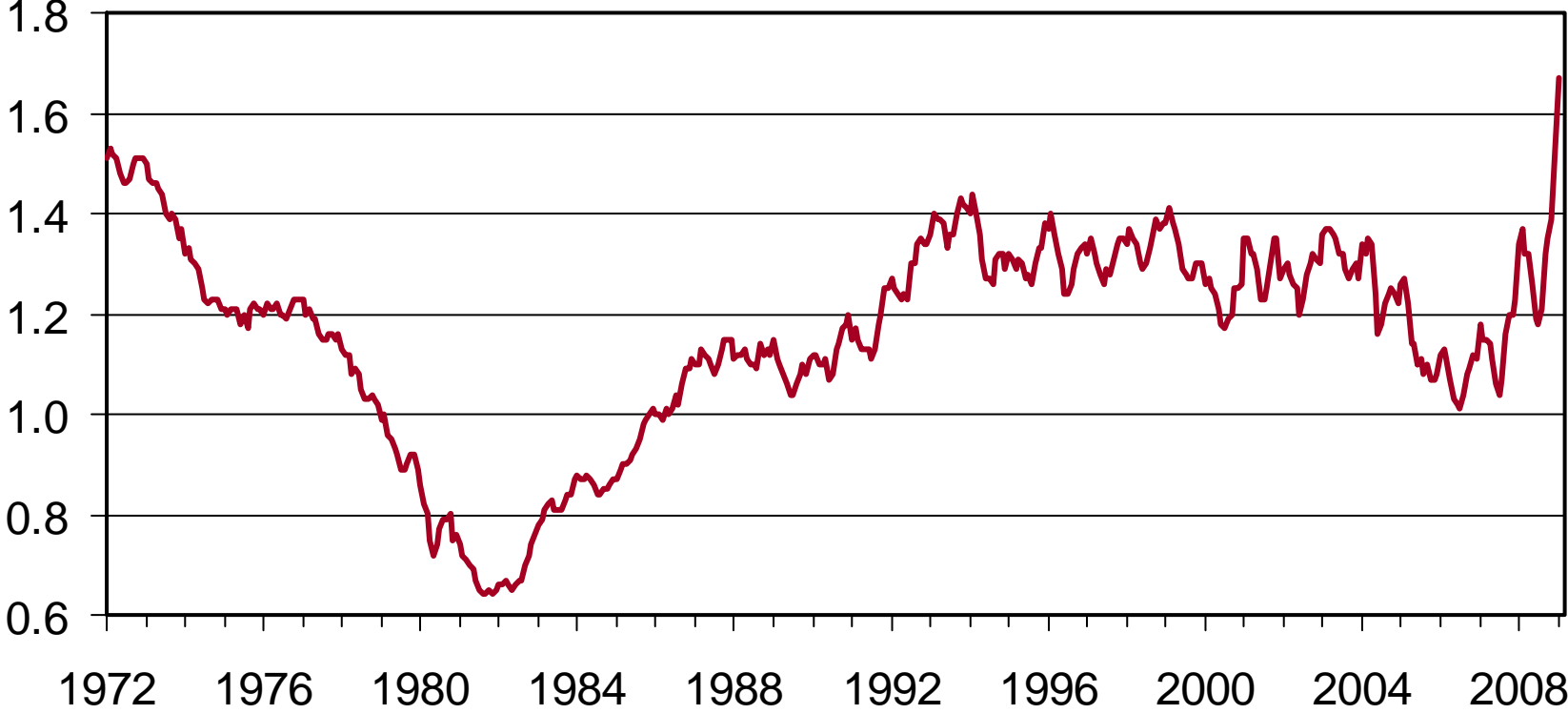


Housing Starts Have Not Hit Bottom Yet



Housing Affordability Has Improved

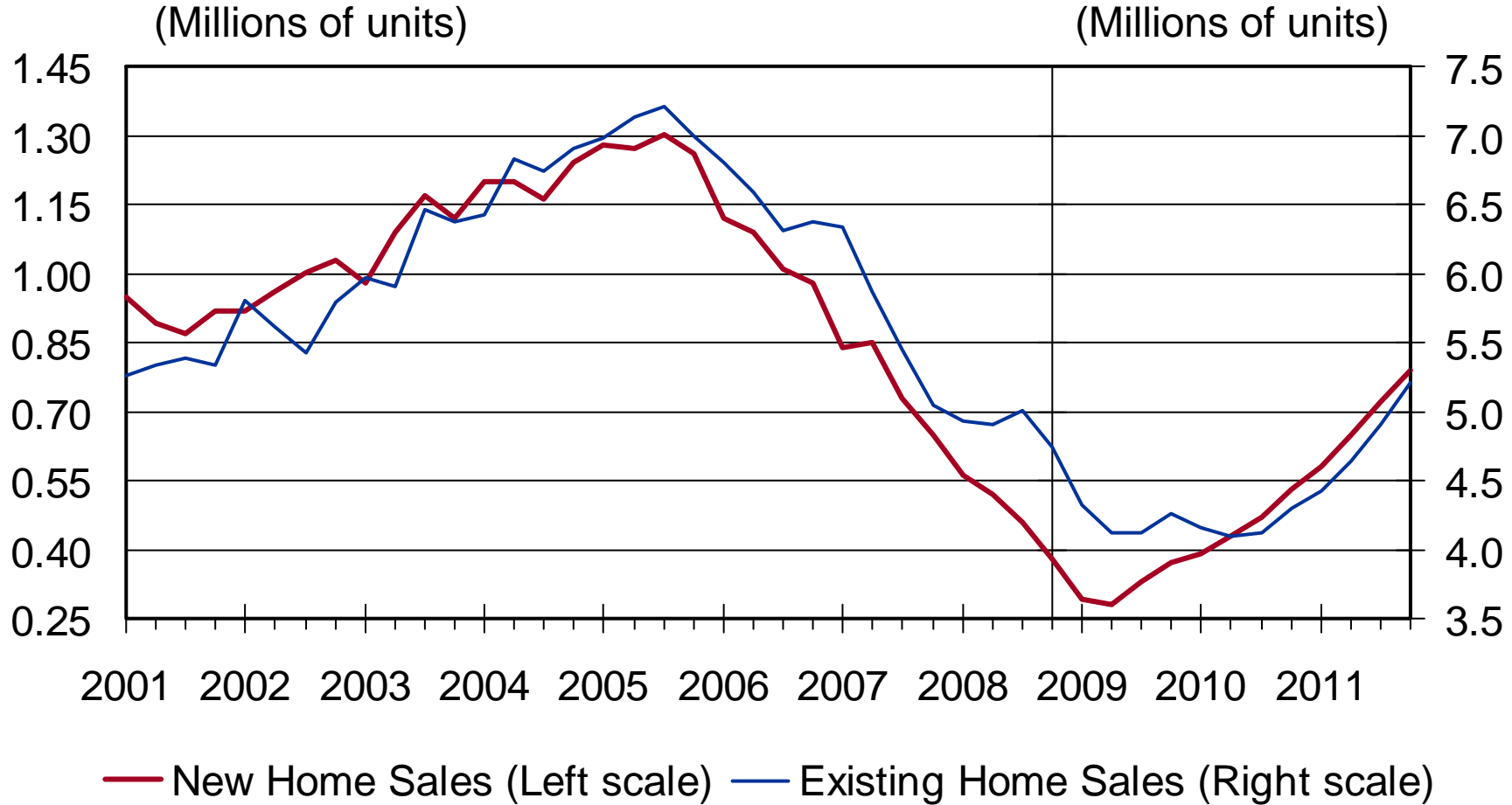
A higher index means homes are more affordable.



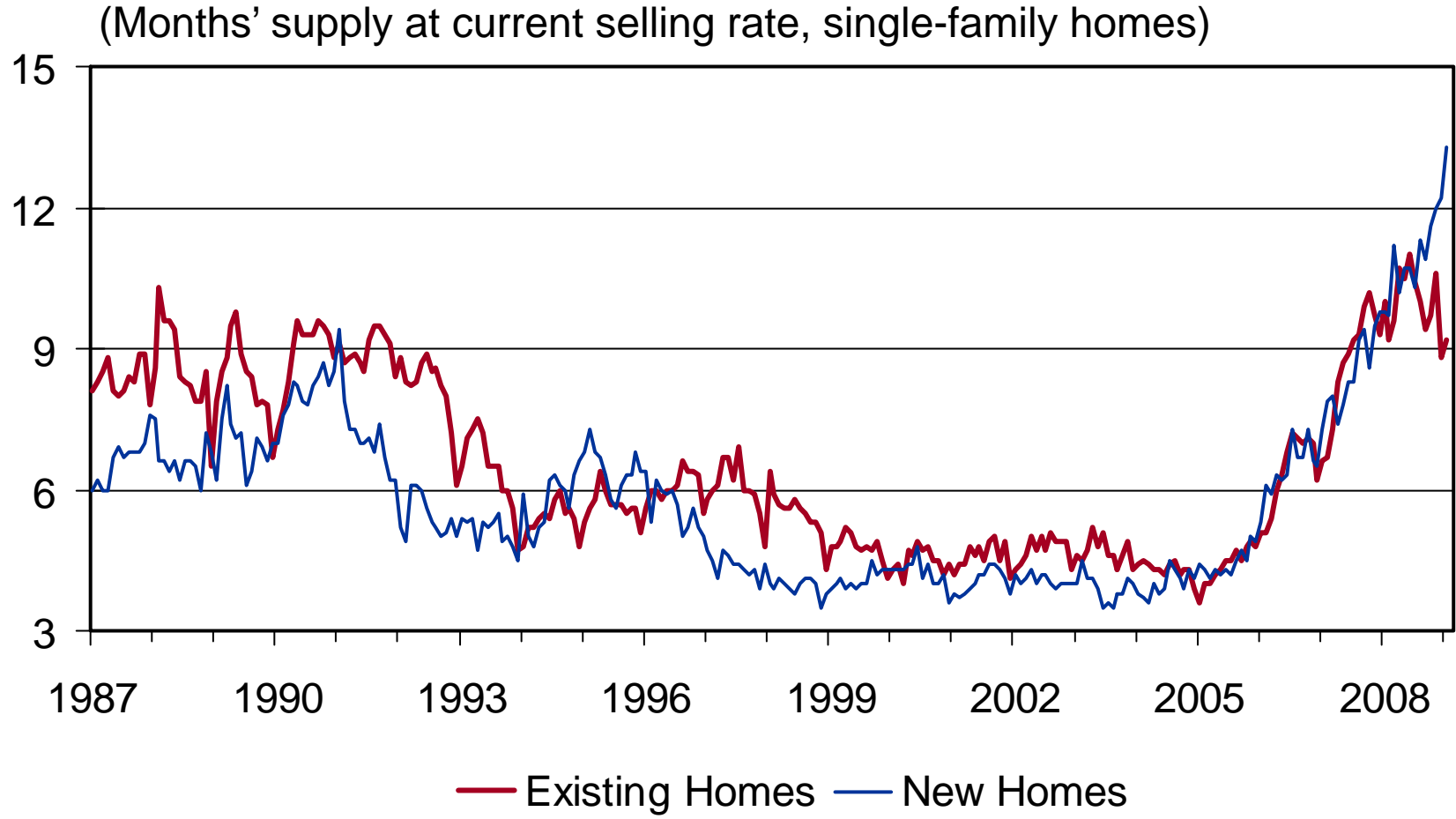
— Affordability Index for Existing Single-Family Homes

Source: National Association of Realtors

Home Sales Probably Not at Bottom Yet

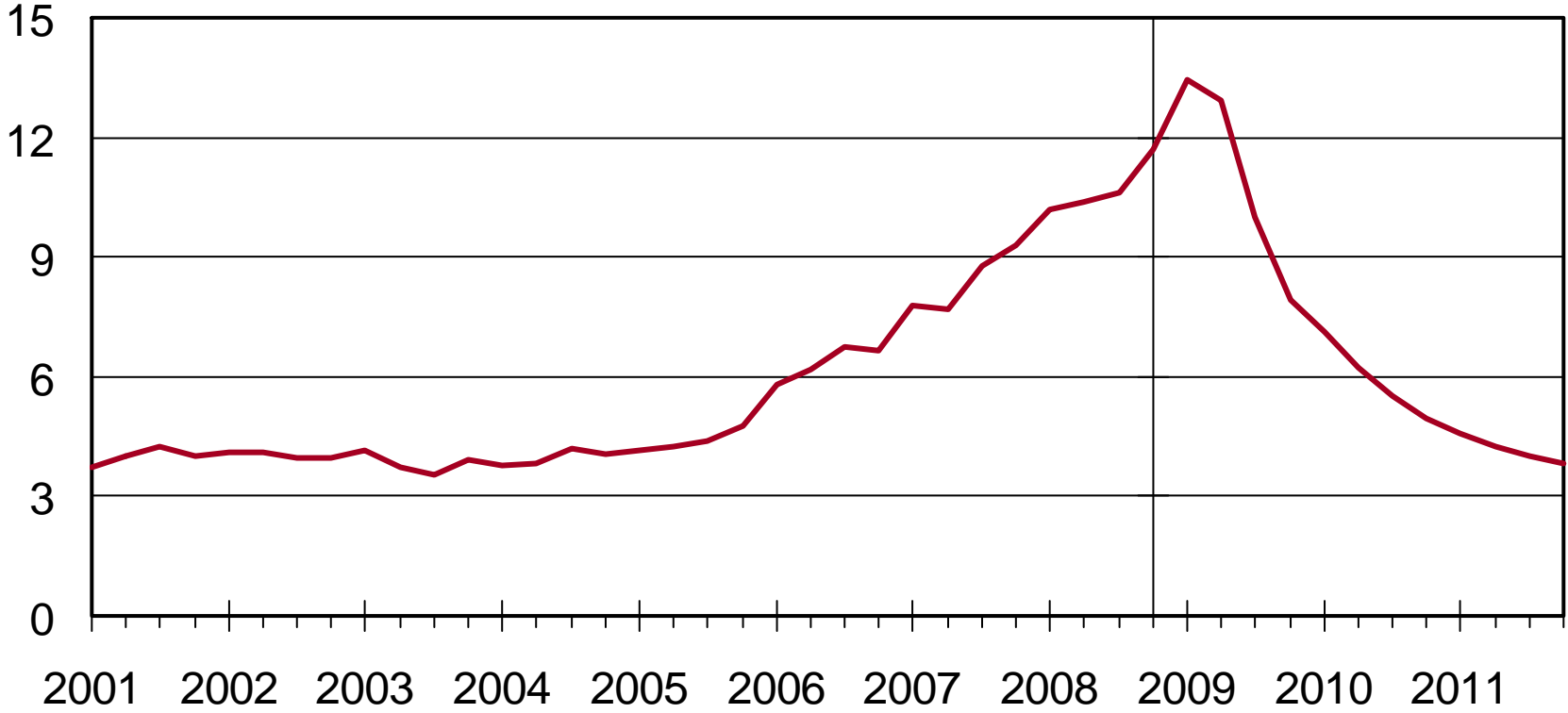


Bloated Supplies of Homes for Sale



Inventory Overhang Near Its Peak

(Months' supply at current selling rate, single-family homes)



— New Home Inventory/Sales Ratio

Consumers Retrenching



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Bad News Almost Everywhere For Consumer Finances

Negative Forces

- Falling Employment
- Falling Real Wages
- Declining Housing Wealth
- Declining Stock Market
- Tightening Credit Conditions
- Mounting Debt Burdens
- Low Saving Rate

Positive Forces

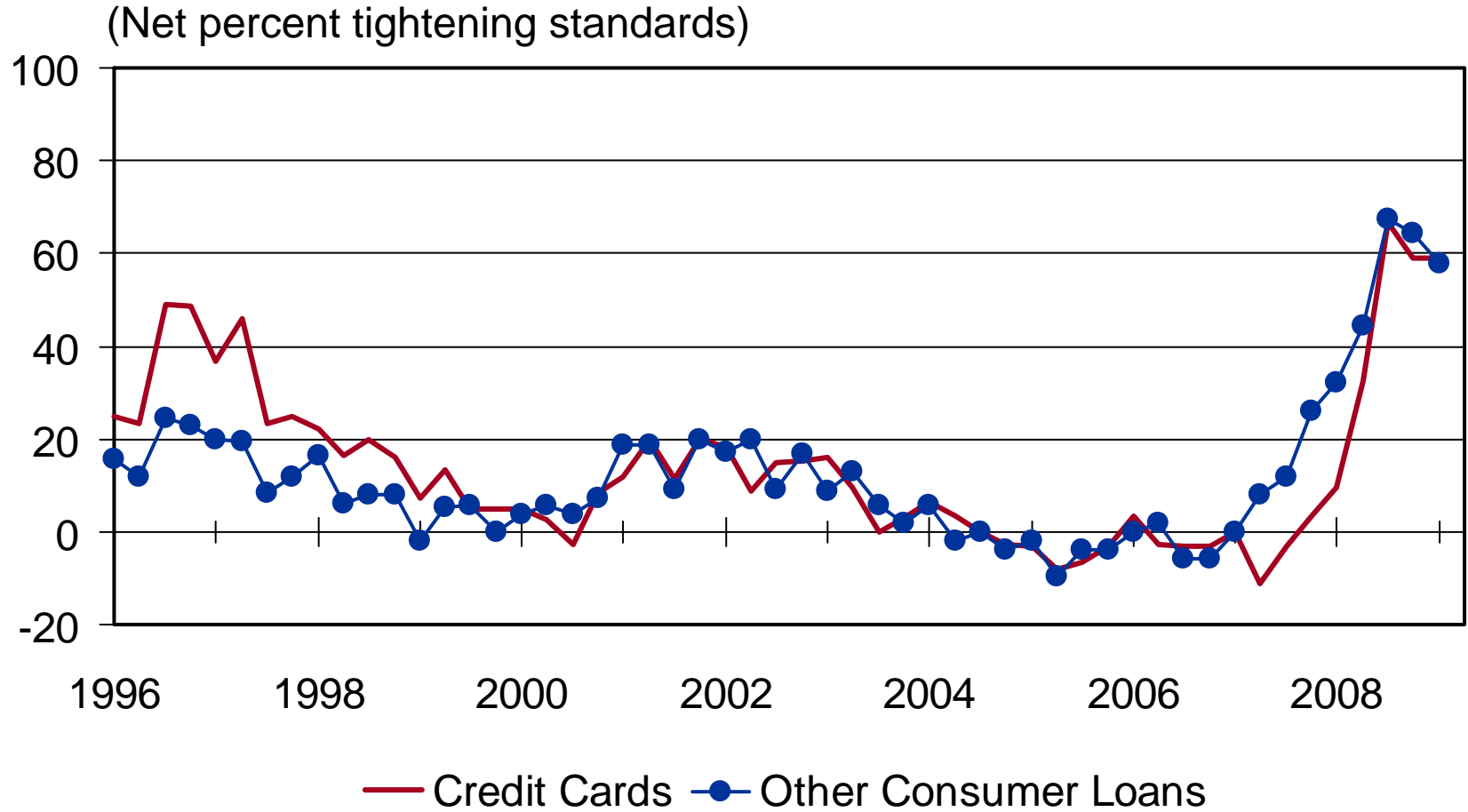
- Gasoline Prices Falling
- More Fiscal Stimulus Coming

Household Net Worth Has Plunged

- End-Q3 2007 to end-Q3 2008: down \$7.1 trillion
- End-Q3 2008 to March 9, 2009: down \$5.2 trillion*
- Total loss: \$12.3 trillion* (down 19%)
- If wealth effect on consumption is 5 cents on the dollar, that means a \$615 billion hit to consumer spending
- That's 6.2% off consumer spending

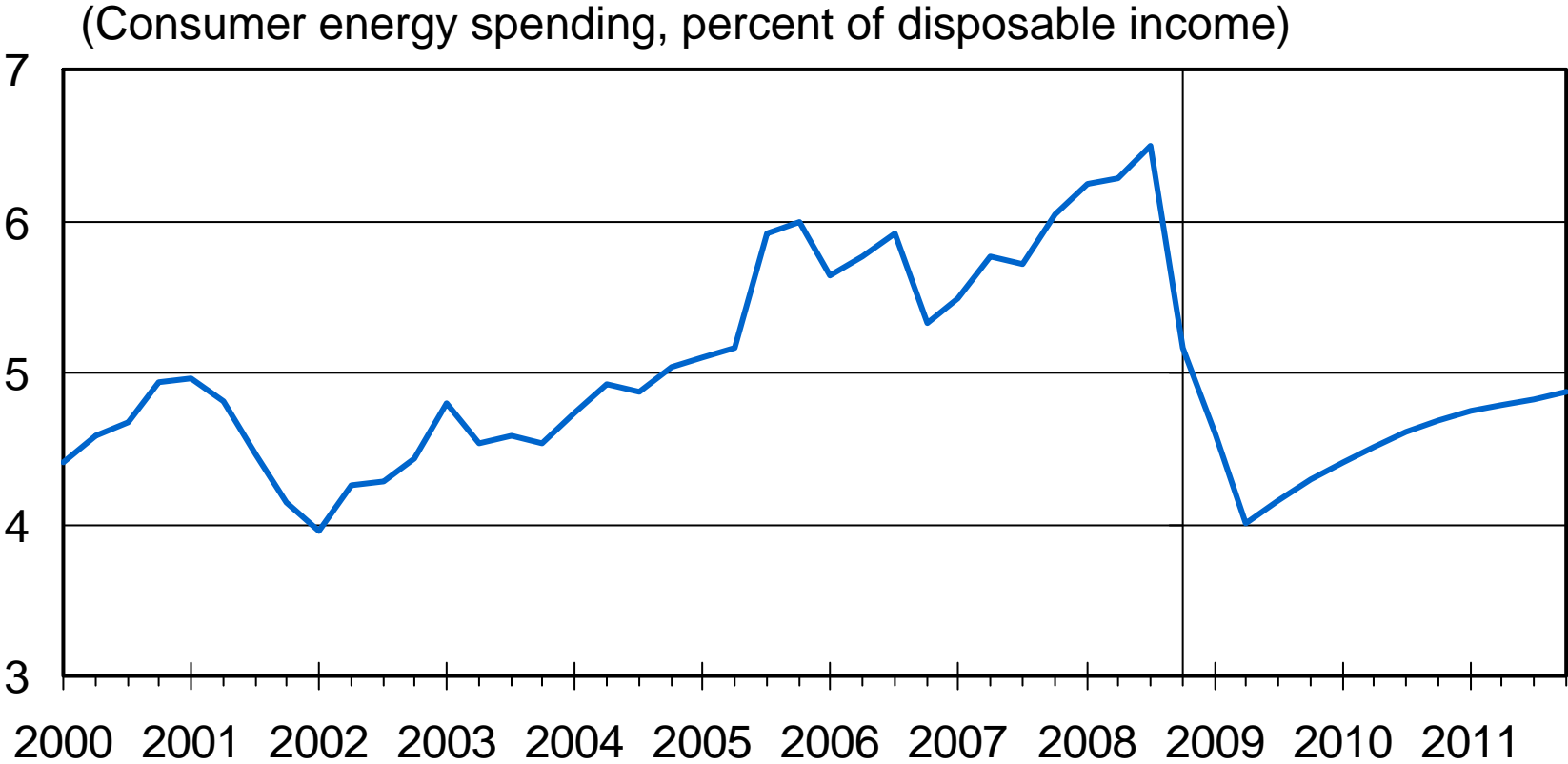
* Mar 9 wealth figures are IHS Global Insight estimates

Consumer Loan Standards Tightening



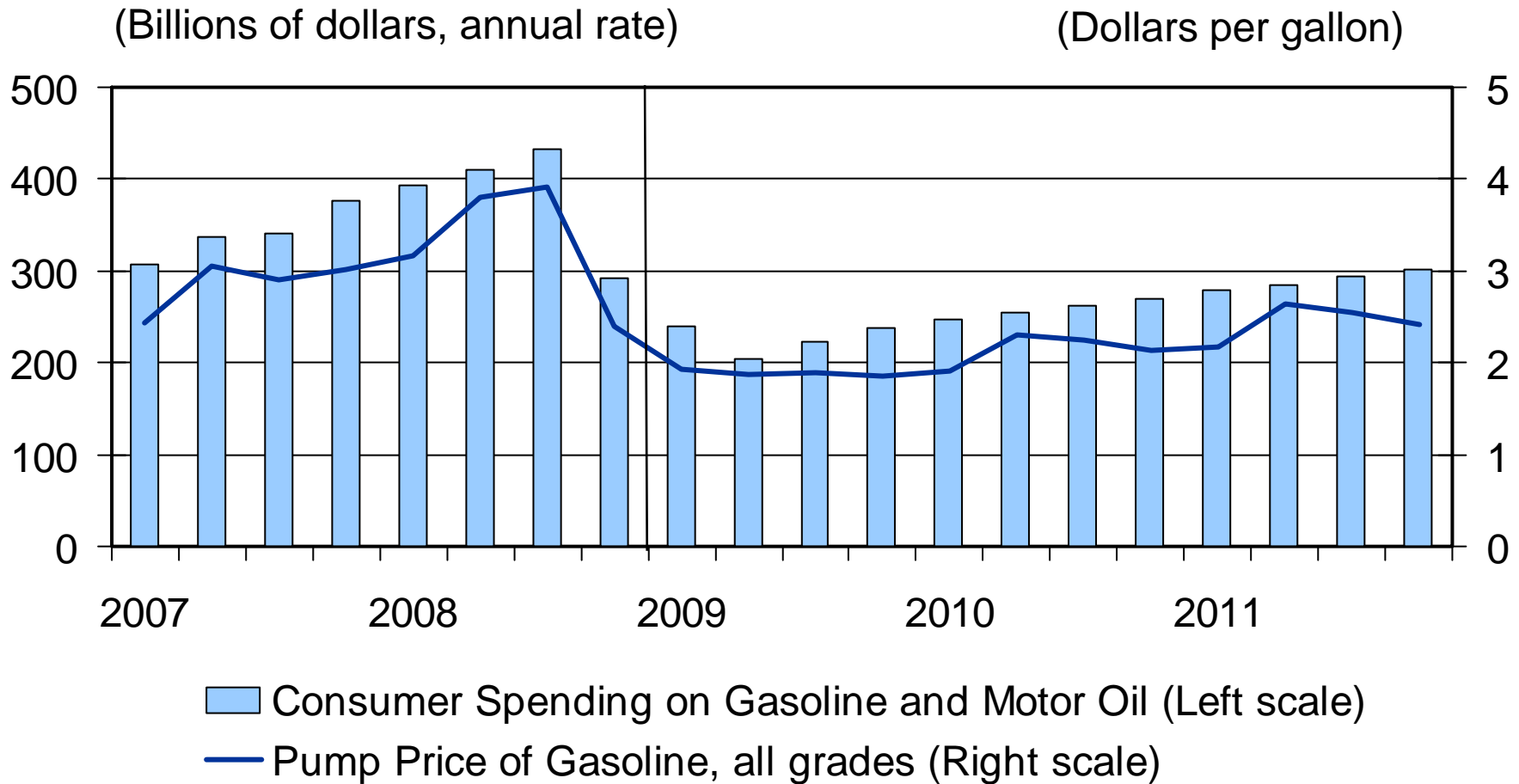
Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

Energy Bite Will Ease

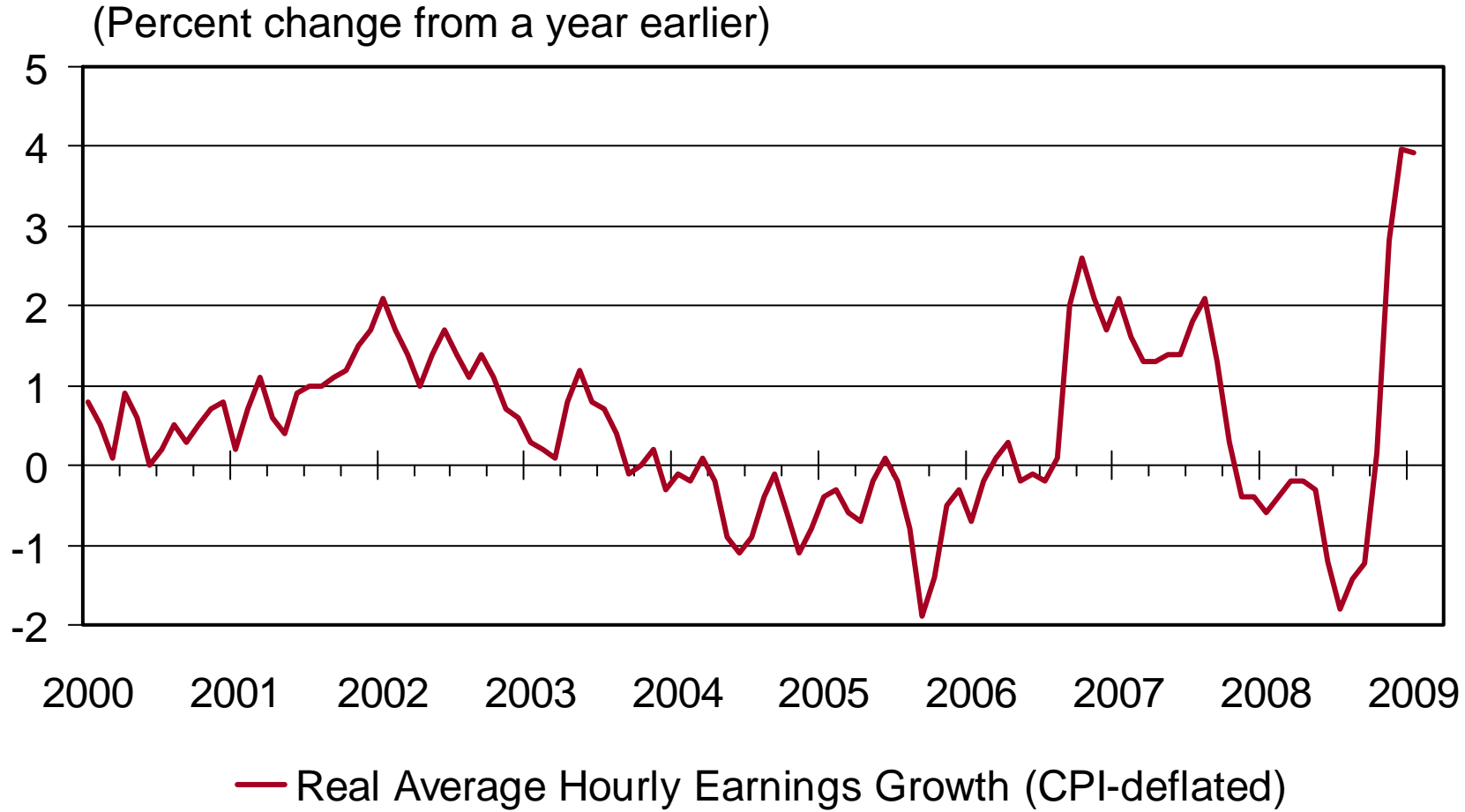


Gasoline Burden Has Peaked

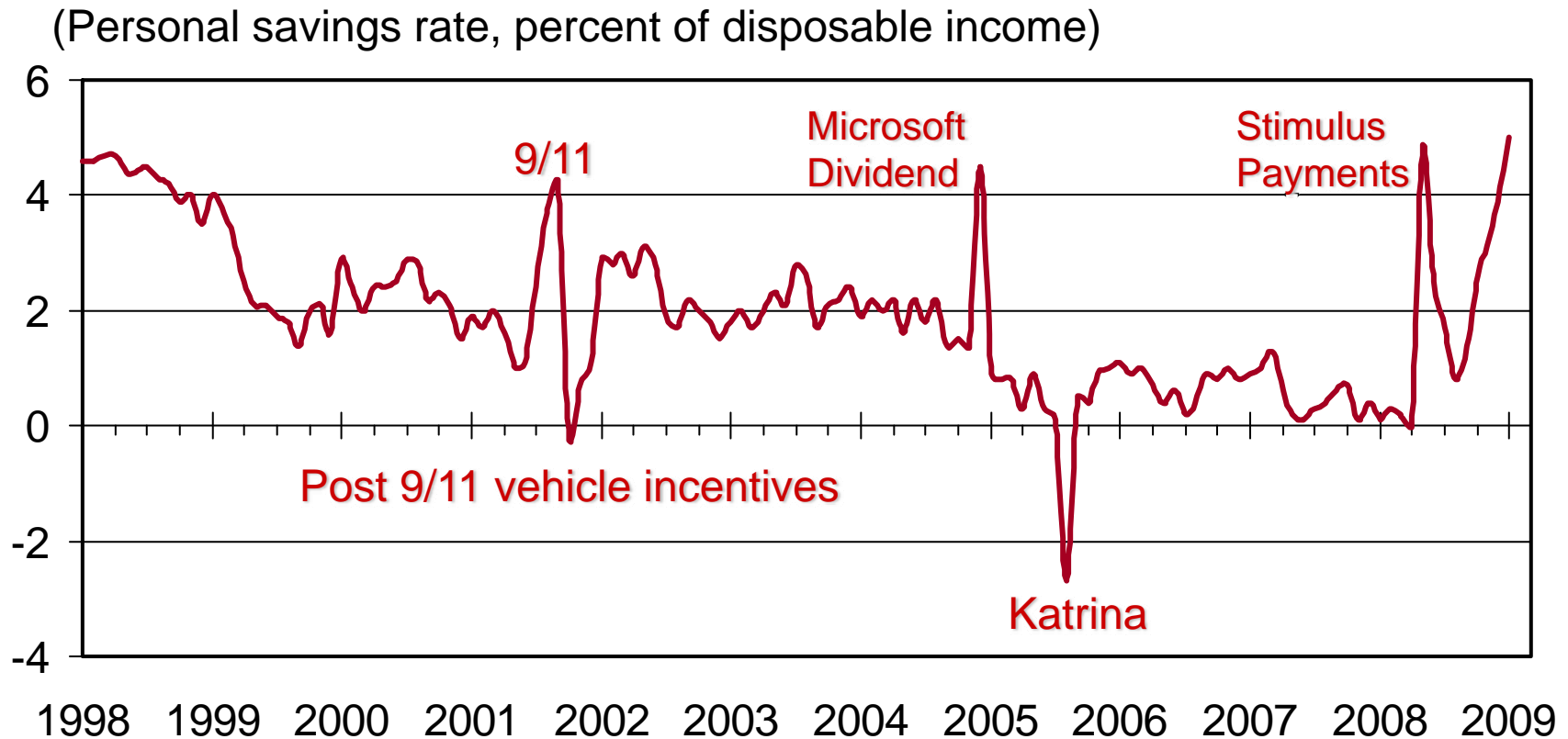
Every 10 cents on the pump price costs consumers \$12 billion per year (0.12% of disposable income)



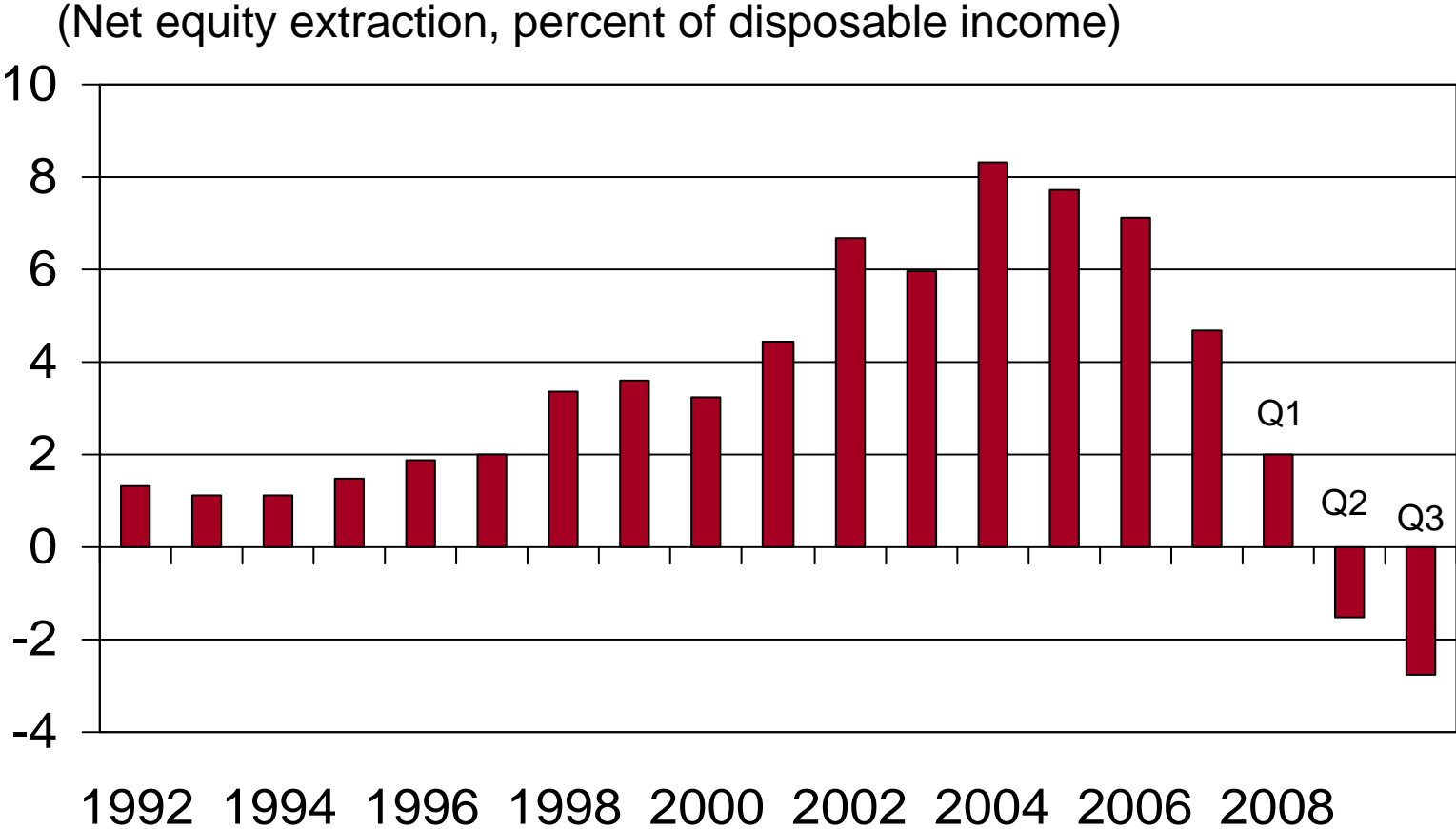
Real Wage Gains Will Resume



The Personal Saving Rate Spiking – And It's Not Just a Blip This Time

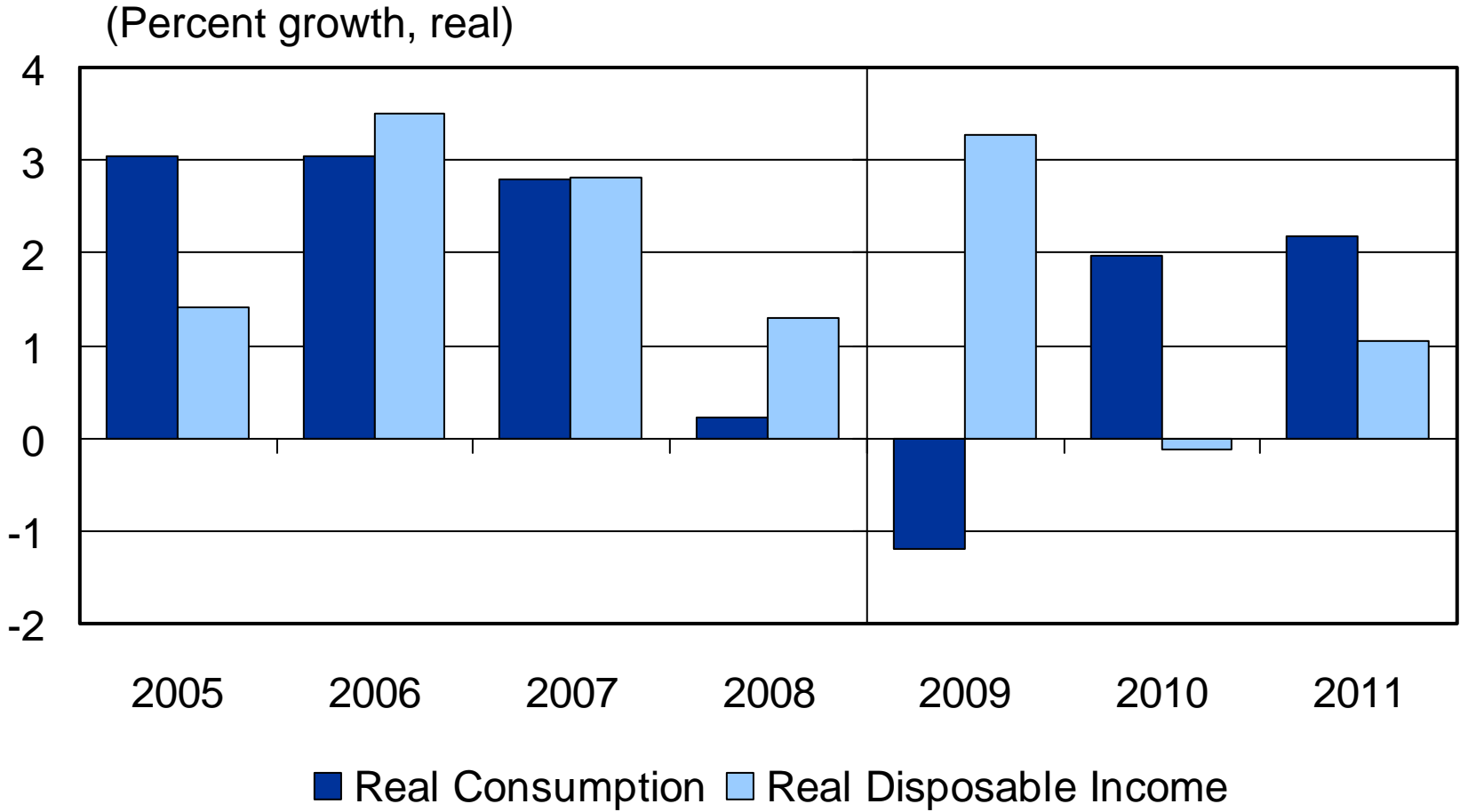


The Party's Over: Mortgage Equity Withdrawal



Source: Federal Reserve - Kennedy/Greenspan data updated as of December 2008

Consumption Will Fall In 2009



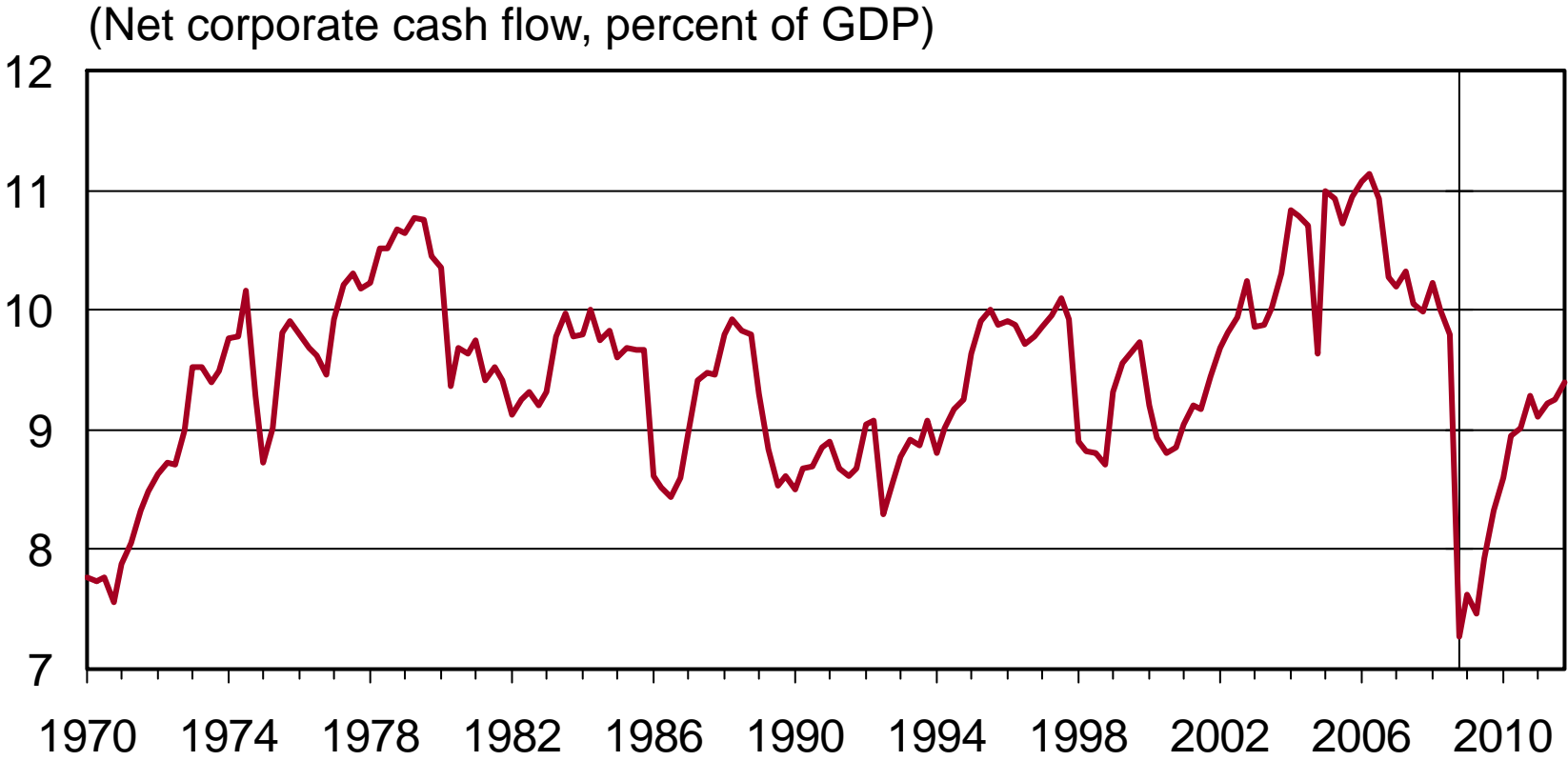
Business Investment Contracting



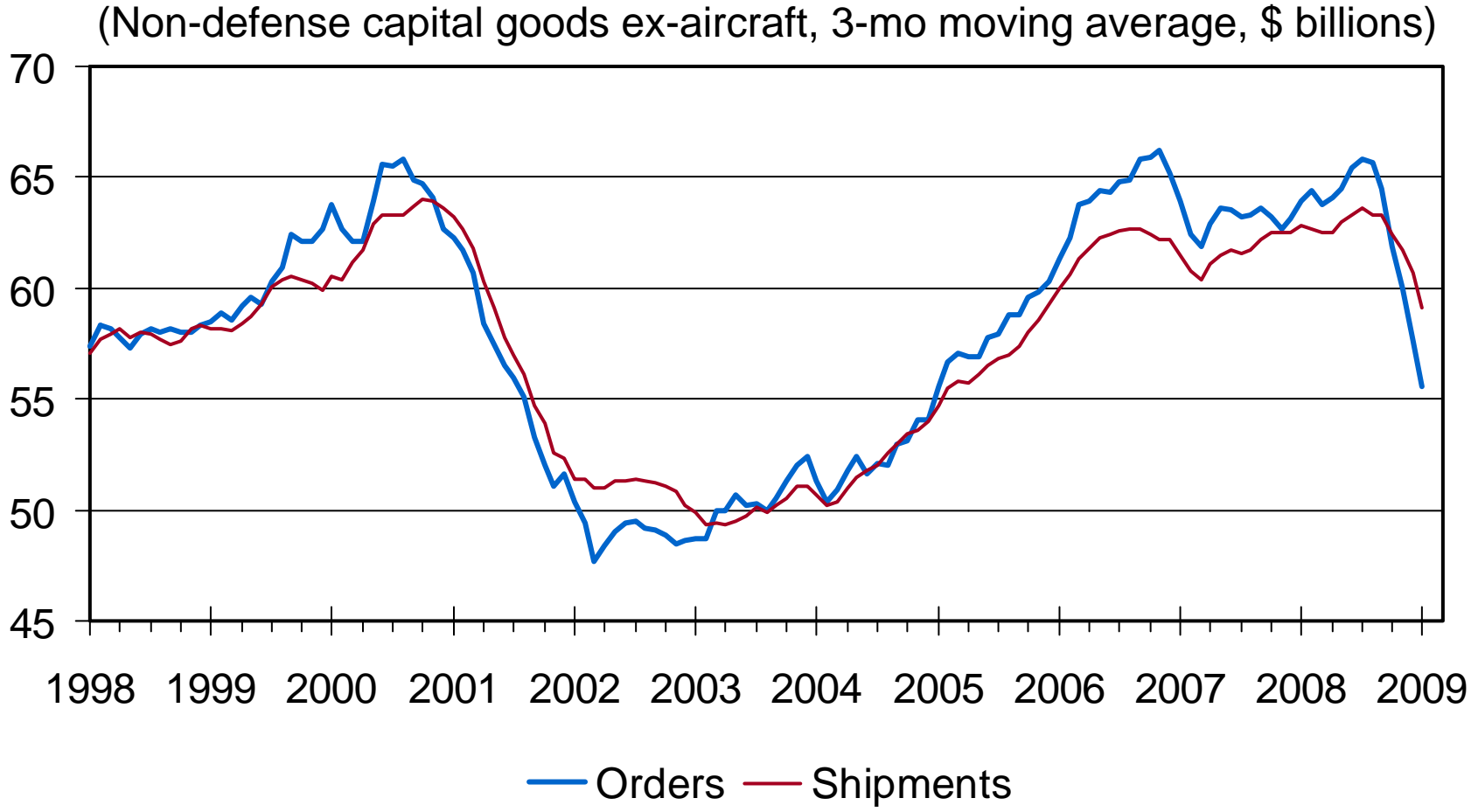
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Corporate Cash Flow Hit Record Levels; But Now Weakening

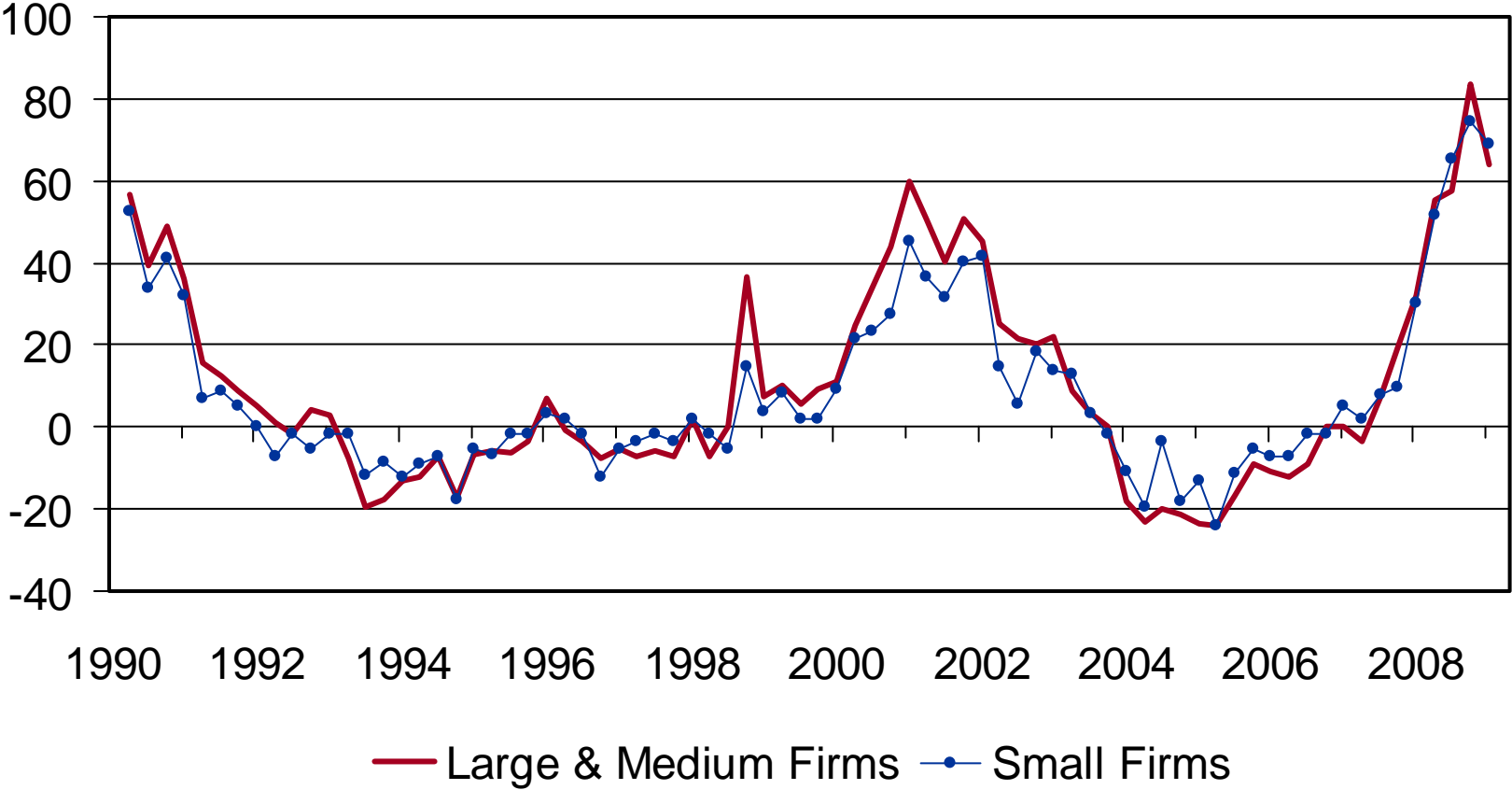


Business Equipment Orders Have Peaked



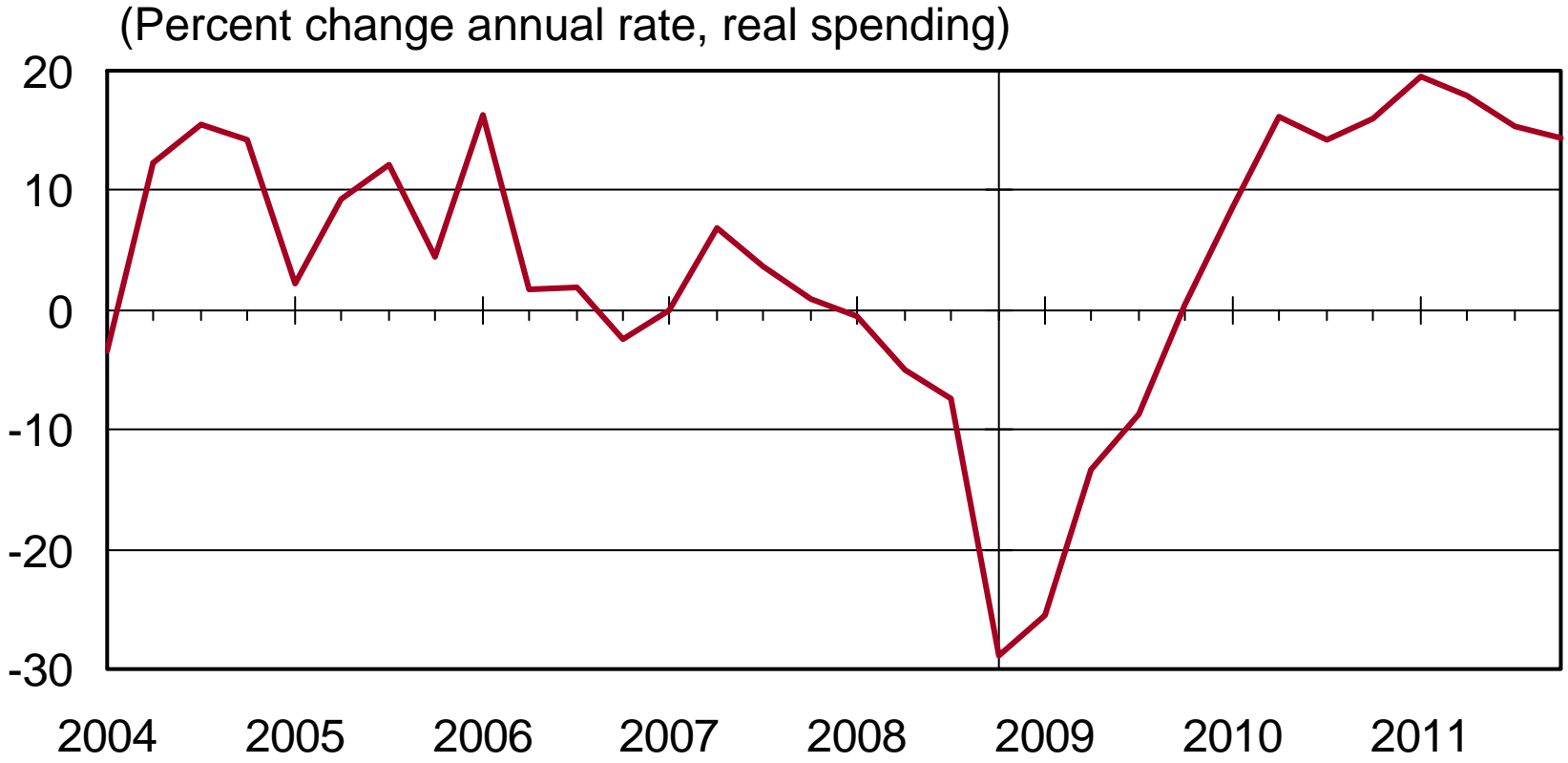
Commercial and Industrial Loan Standards Tightening

(Net percent tightening standards for commercial and industrial loans)

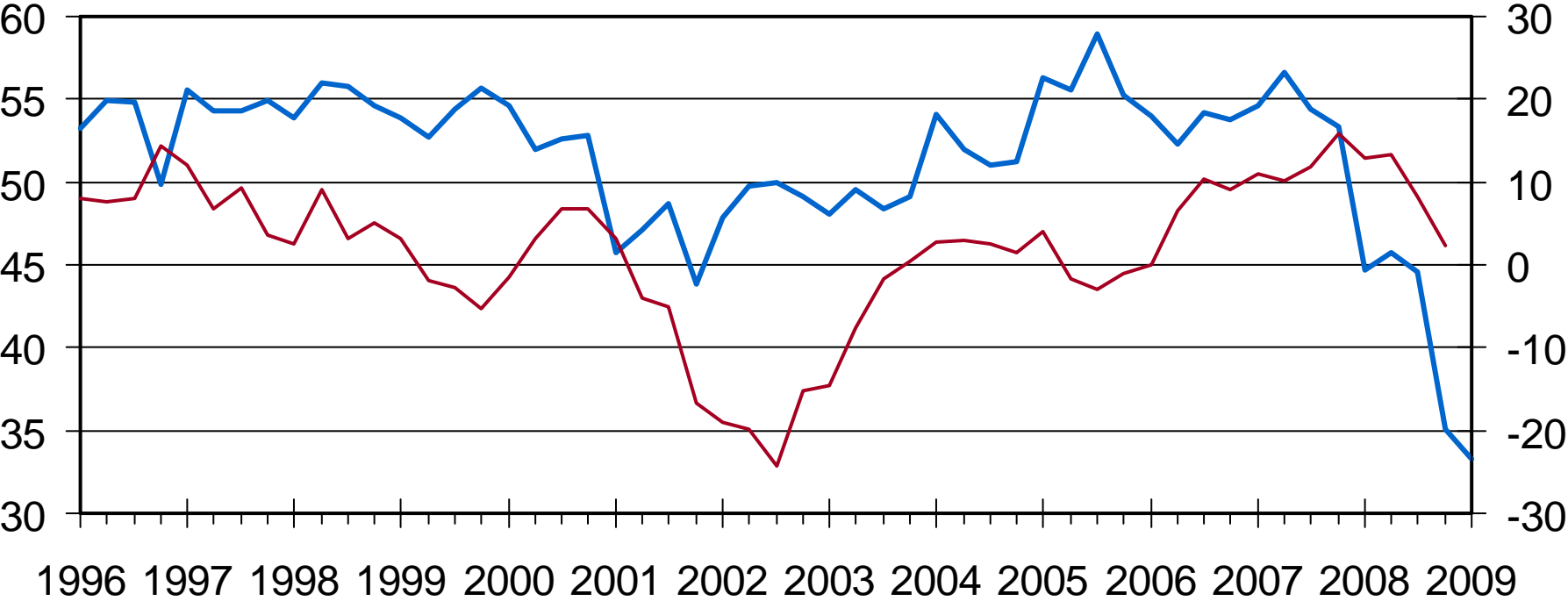


Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

Equipment Spending Declining



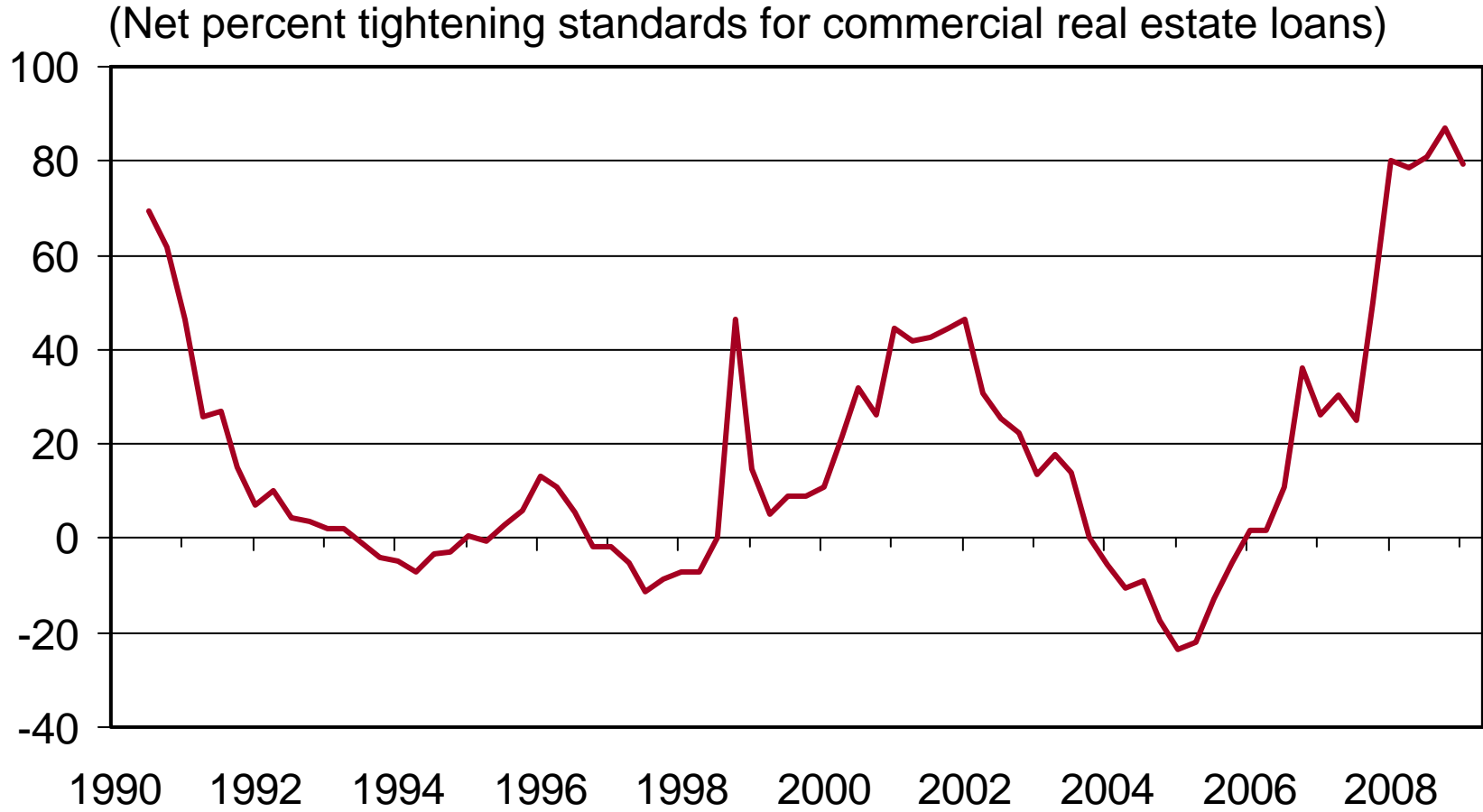
Architecture Billings Lead Nonresidential Construction



— Architecture Billings Index* (Left scale)
 — Real Nonresidential Construction, ex. utilities (Right scale, % change y/y)

* Source: American Institute of Architects

Commercial Real Estate Loan Standards Tightening



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

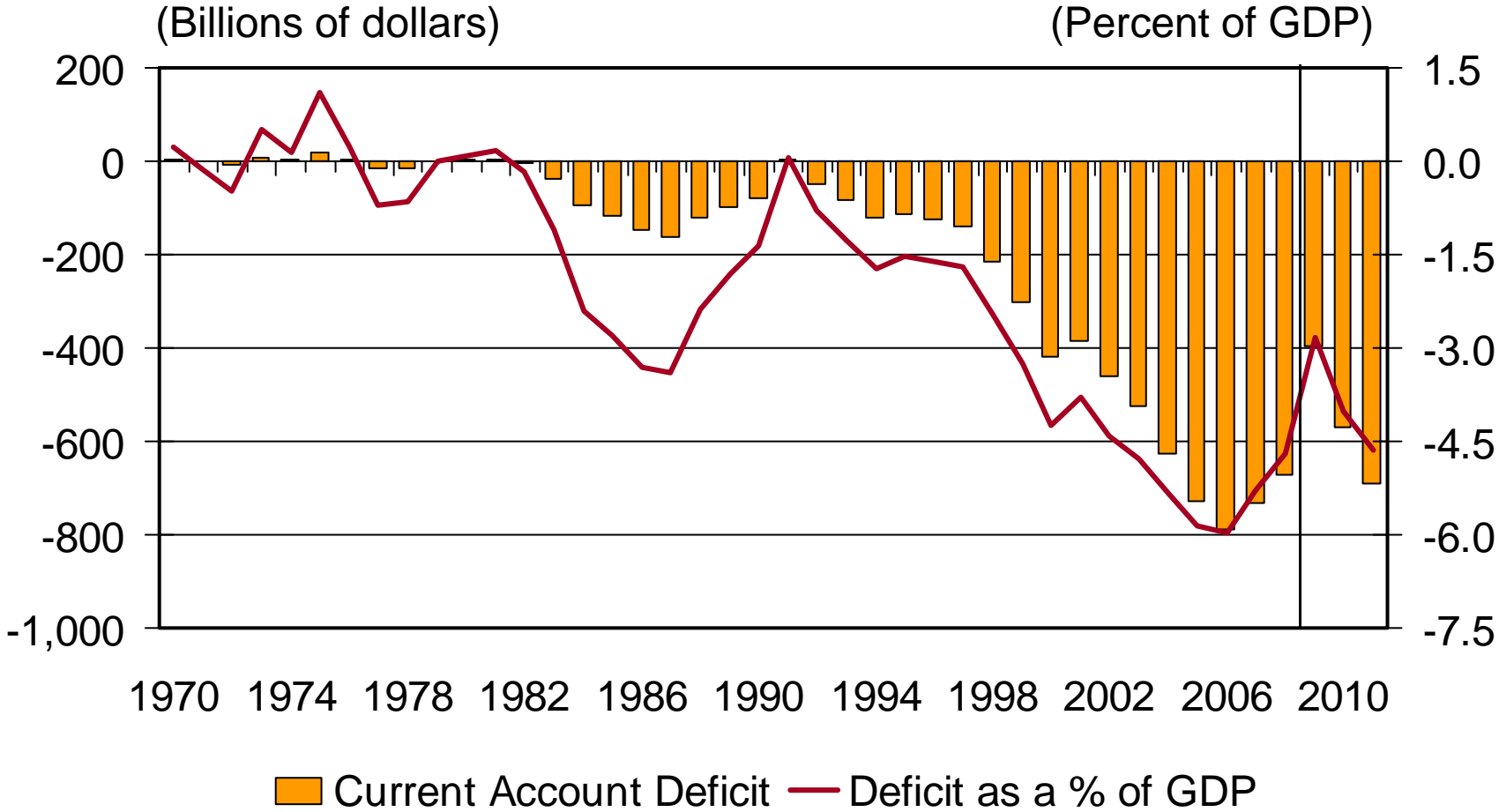


Foreign Trade: World Trade Is Contracting Sharply

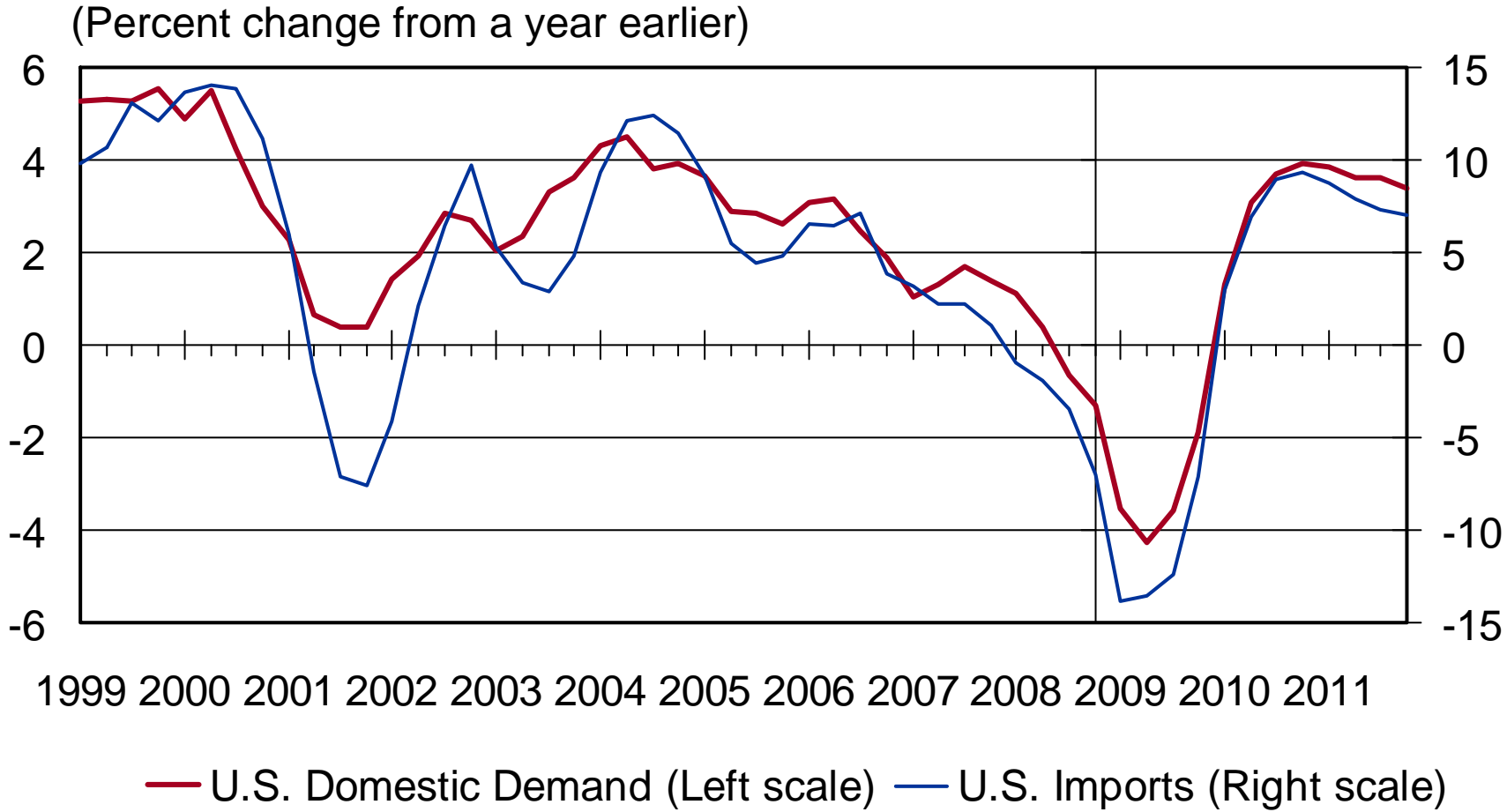


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Current Account Deficit: Will Plunge With Oil Prices

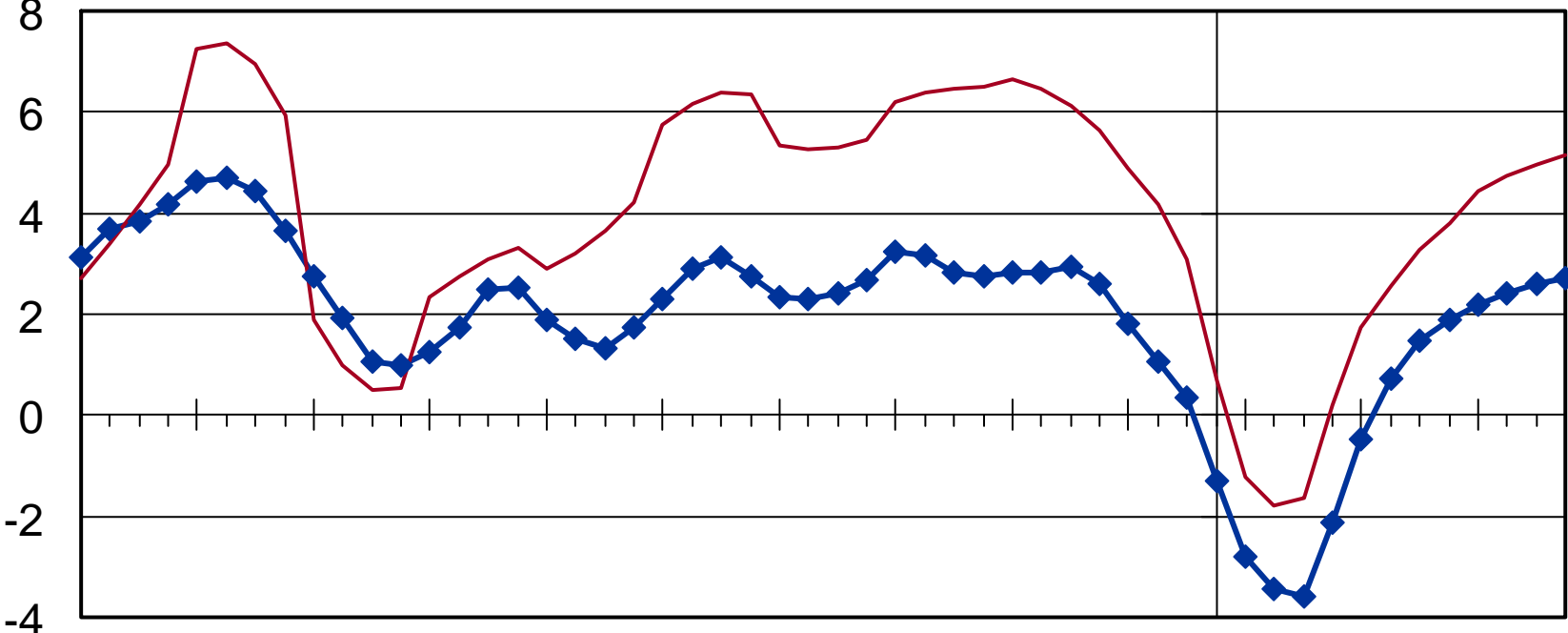


U.S. Import Growth Slows as Domestic Demand Growth Slows



Growth in Export Markets Is Disappearing

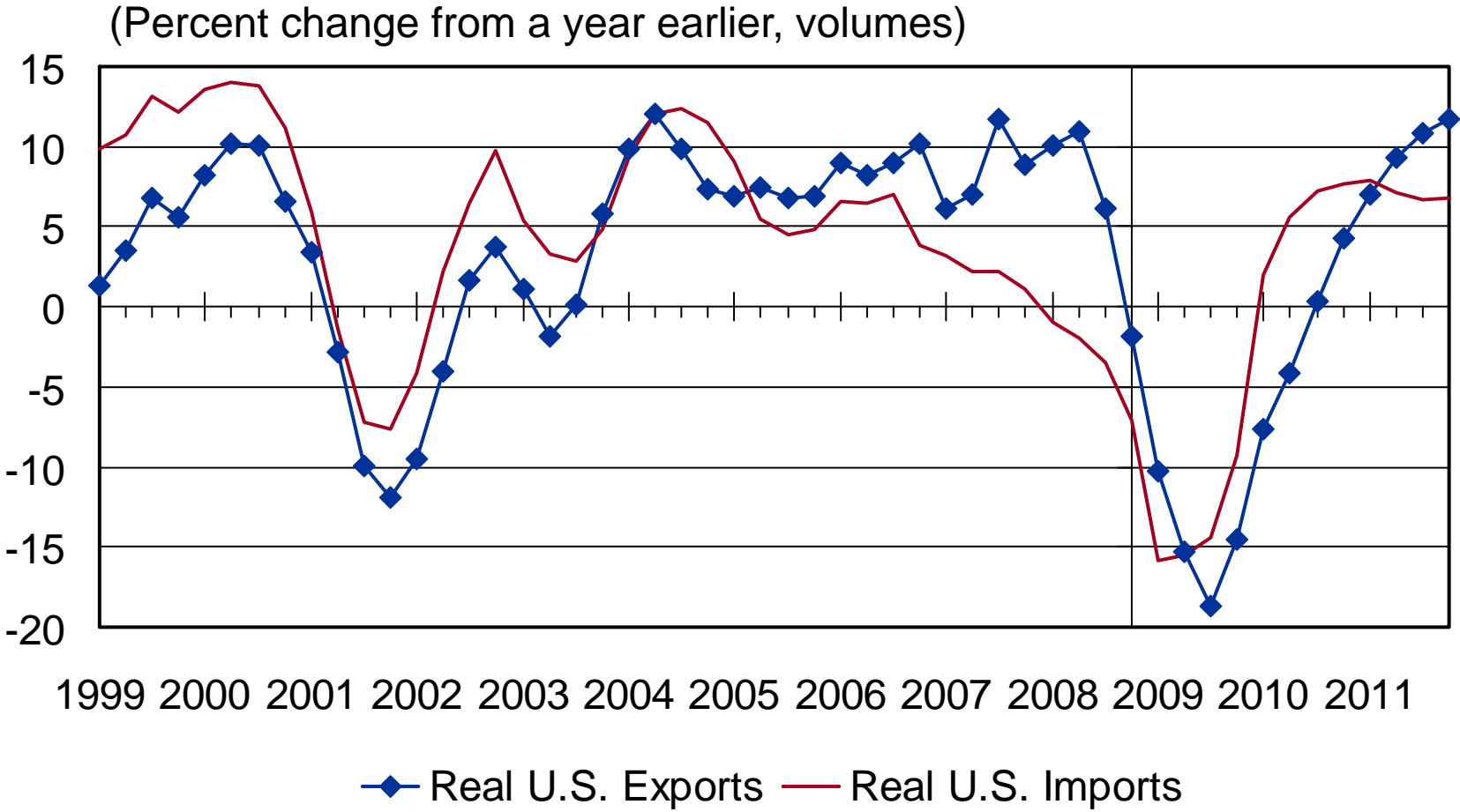
(Real GDP, percent change from a year earlier)



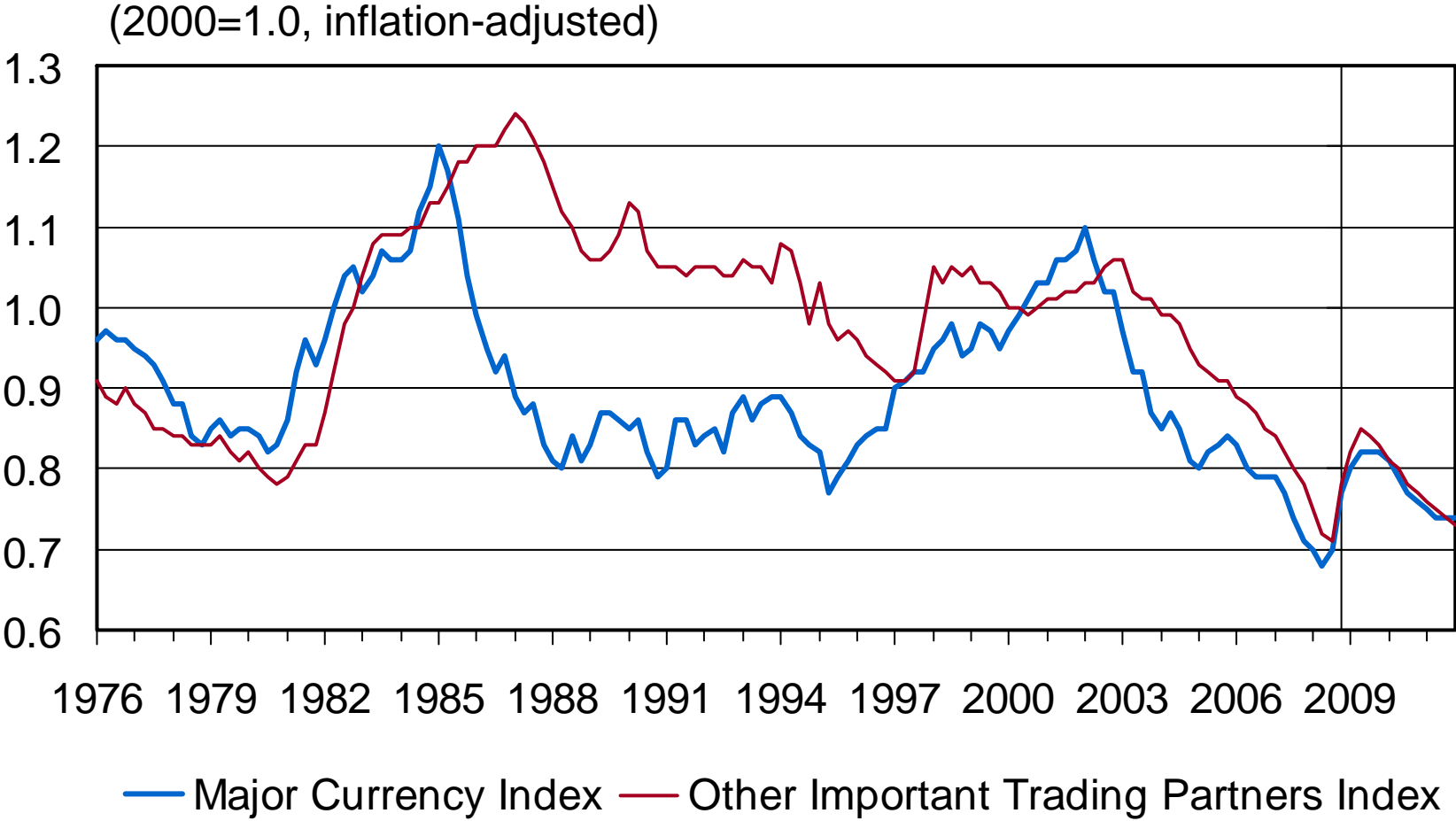
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011

◆ Major Currency Trading Partners — Other Trading Partners

Exports Will Fall



The U.S. Dollar: How Big A Bounce?

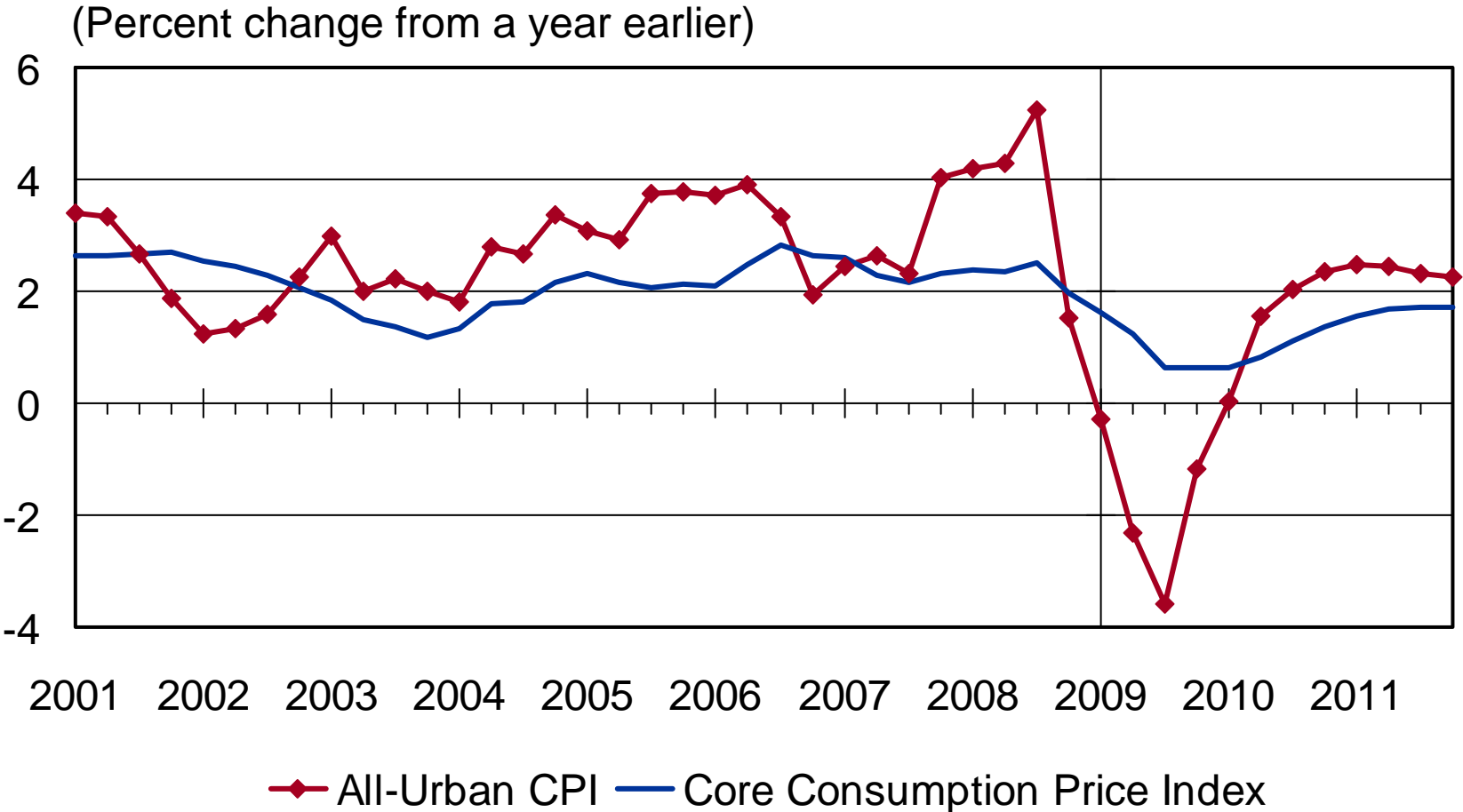


Inflation and Interest Rates

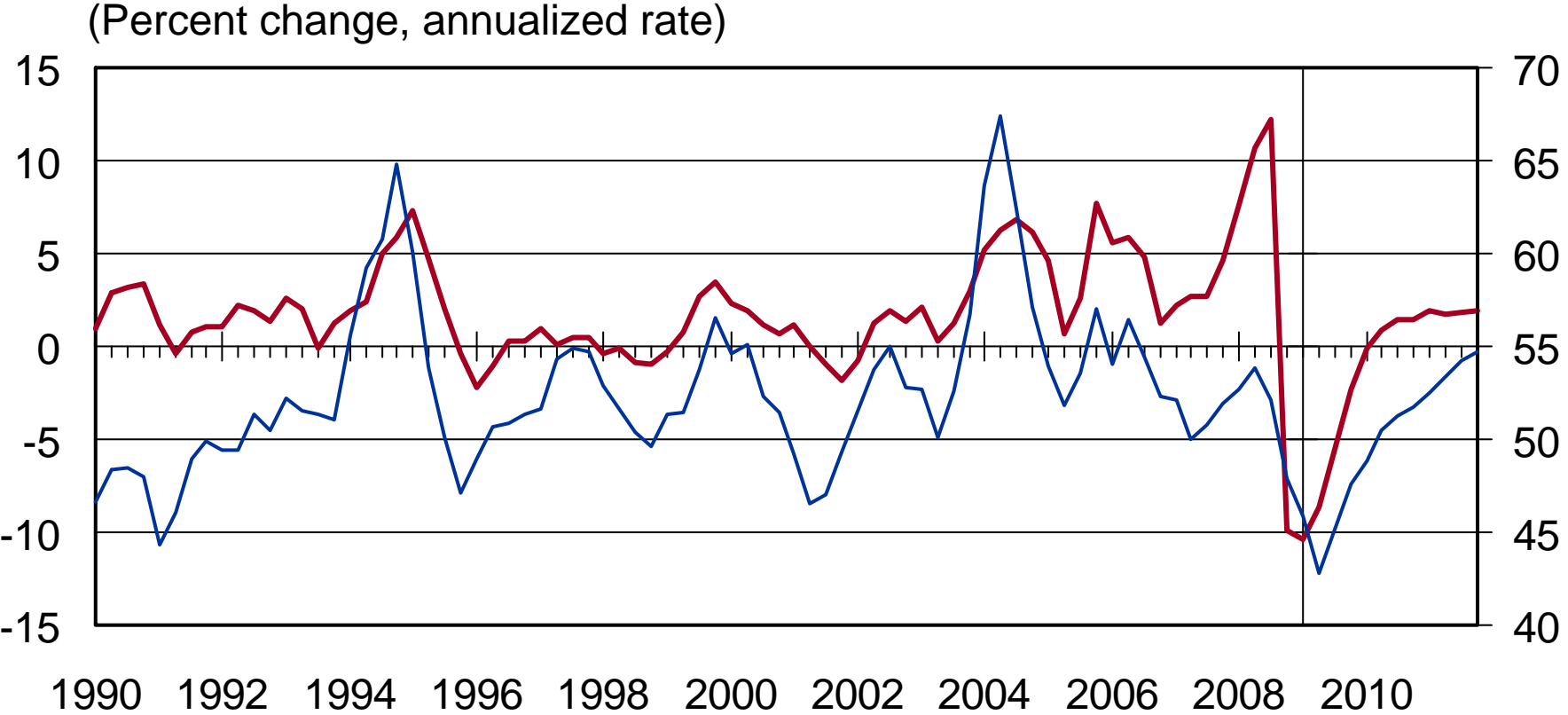


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Headline CPI Will Decline; Core Inflation Will Ease



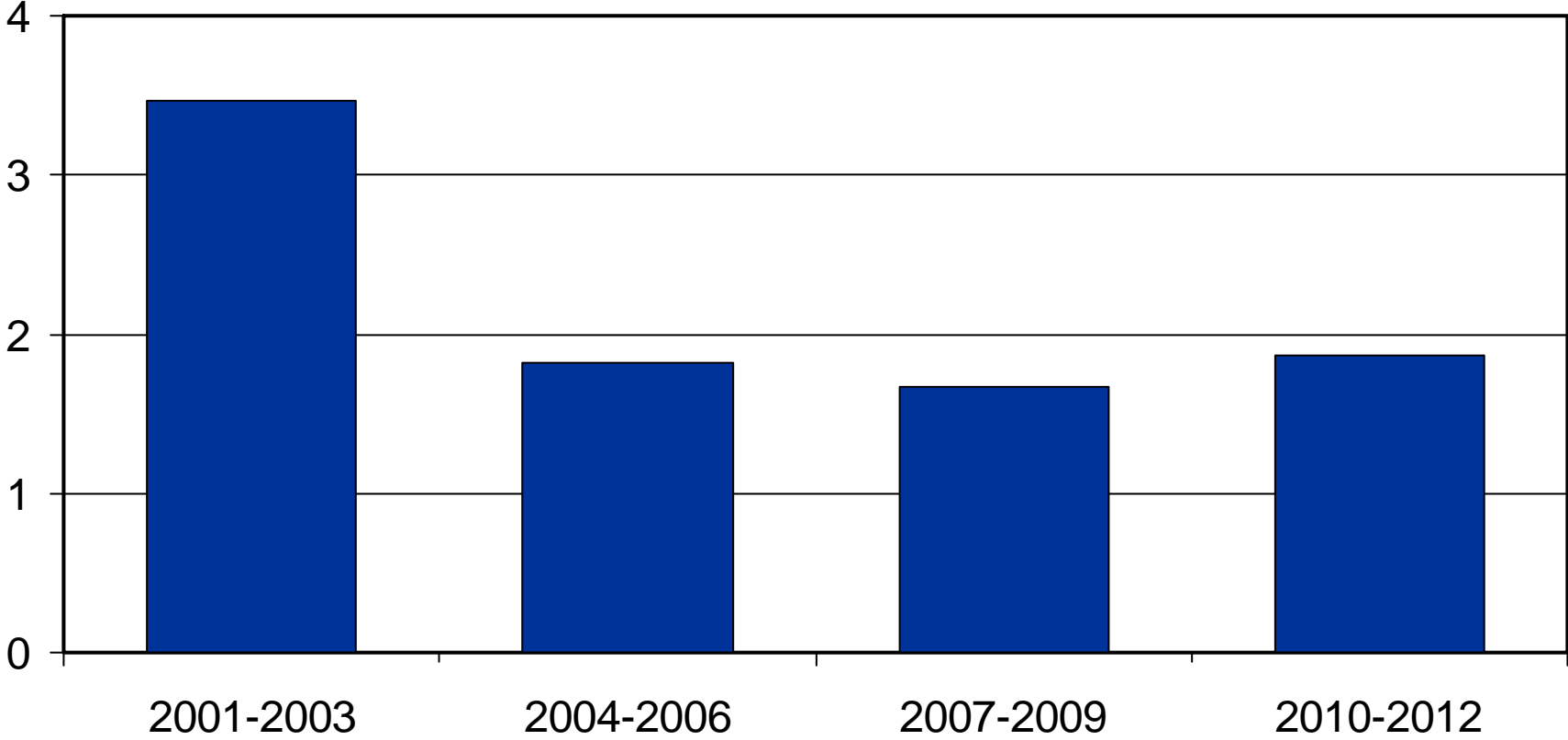
Producer Prices Reversing Course



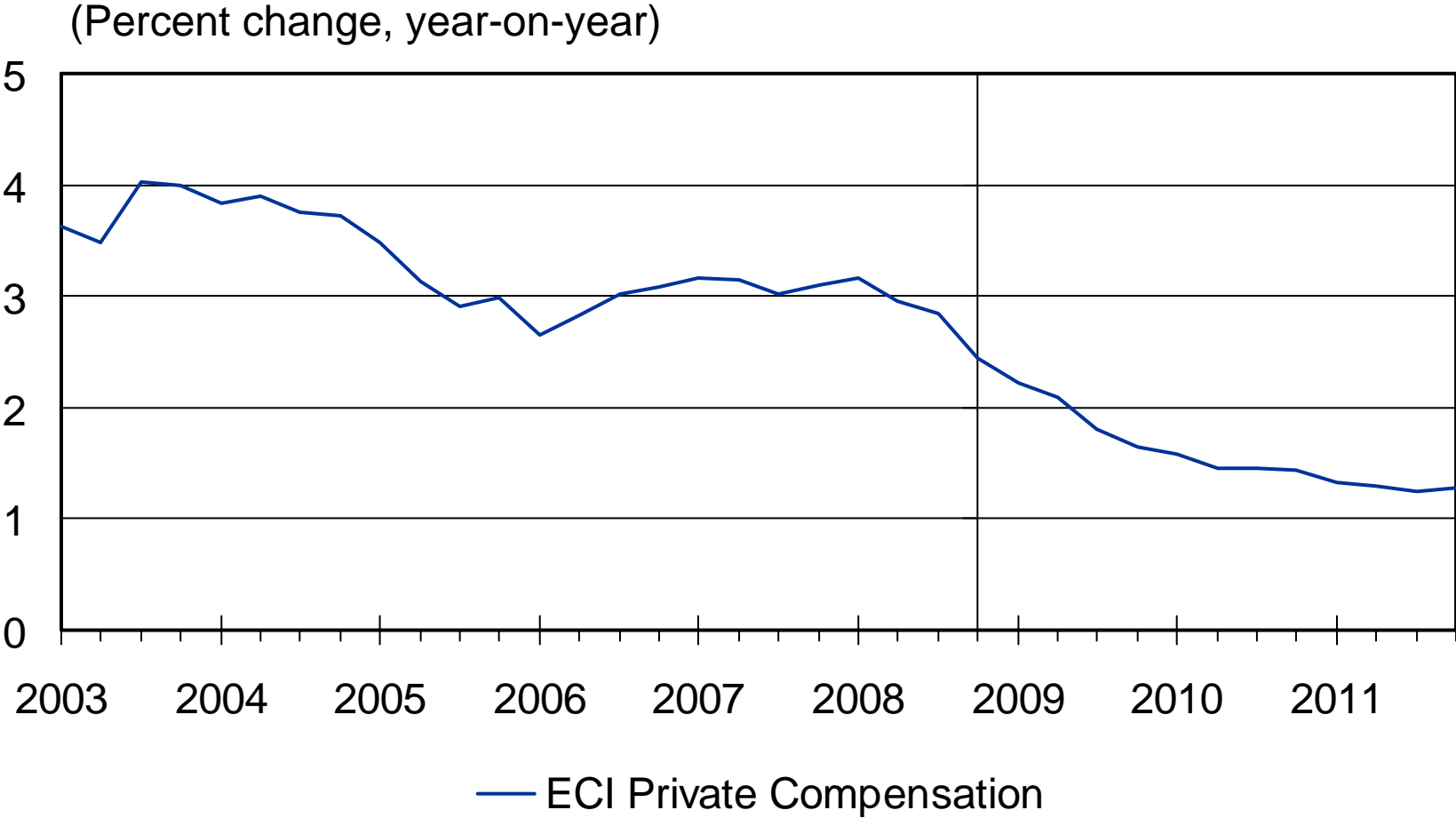
— PPI - Industrial Commodities, excl. Energy — ISM Deliveries Index

Productivity Growth Has Decelerated

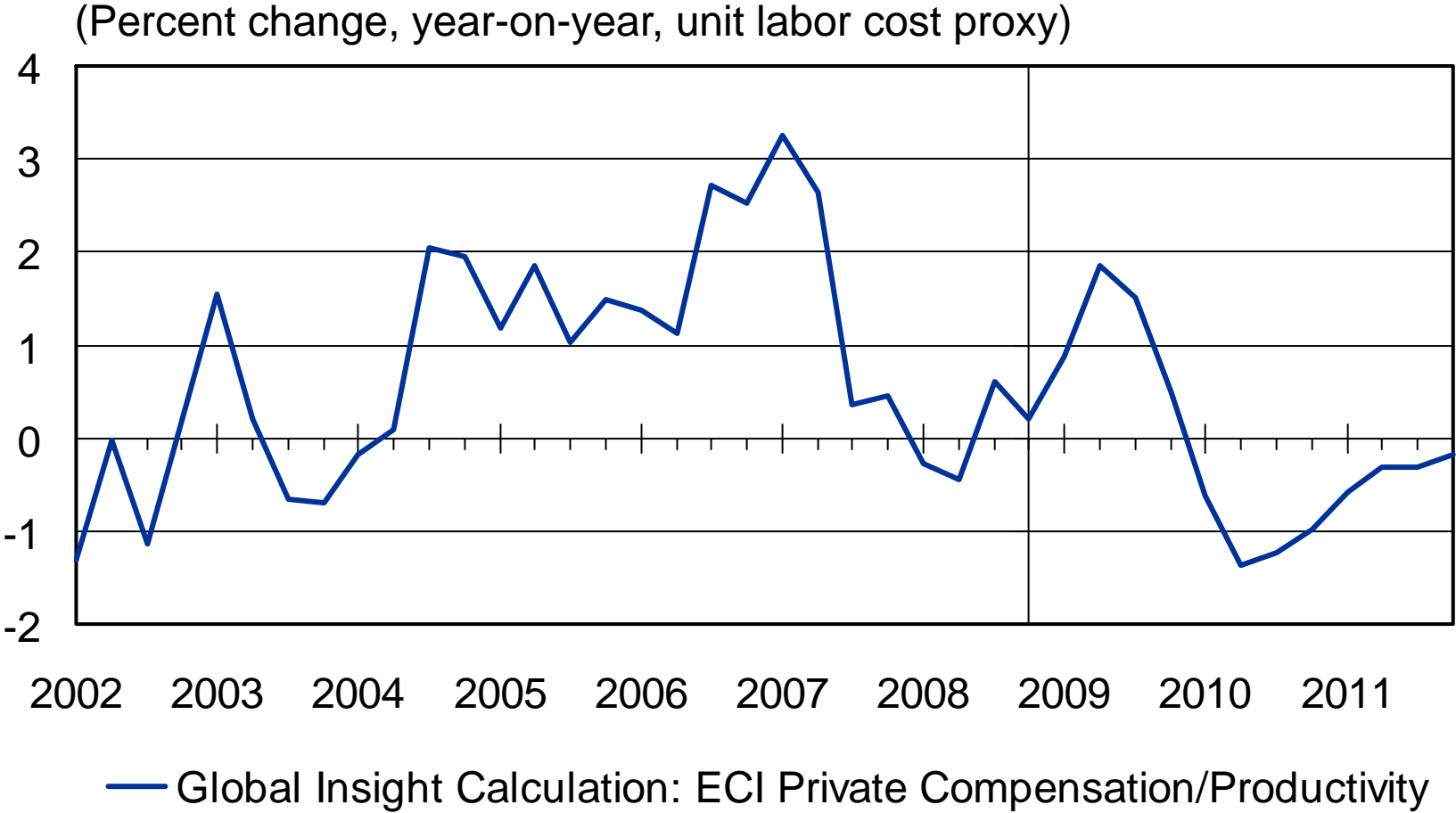
(Nonfarm businesses, average annual percent change)



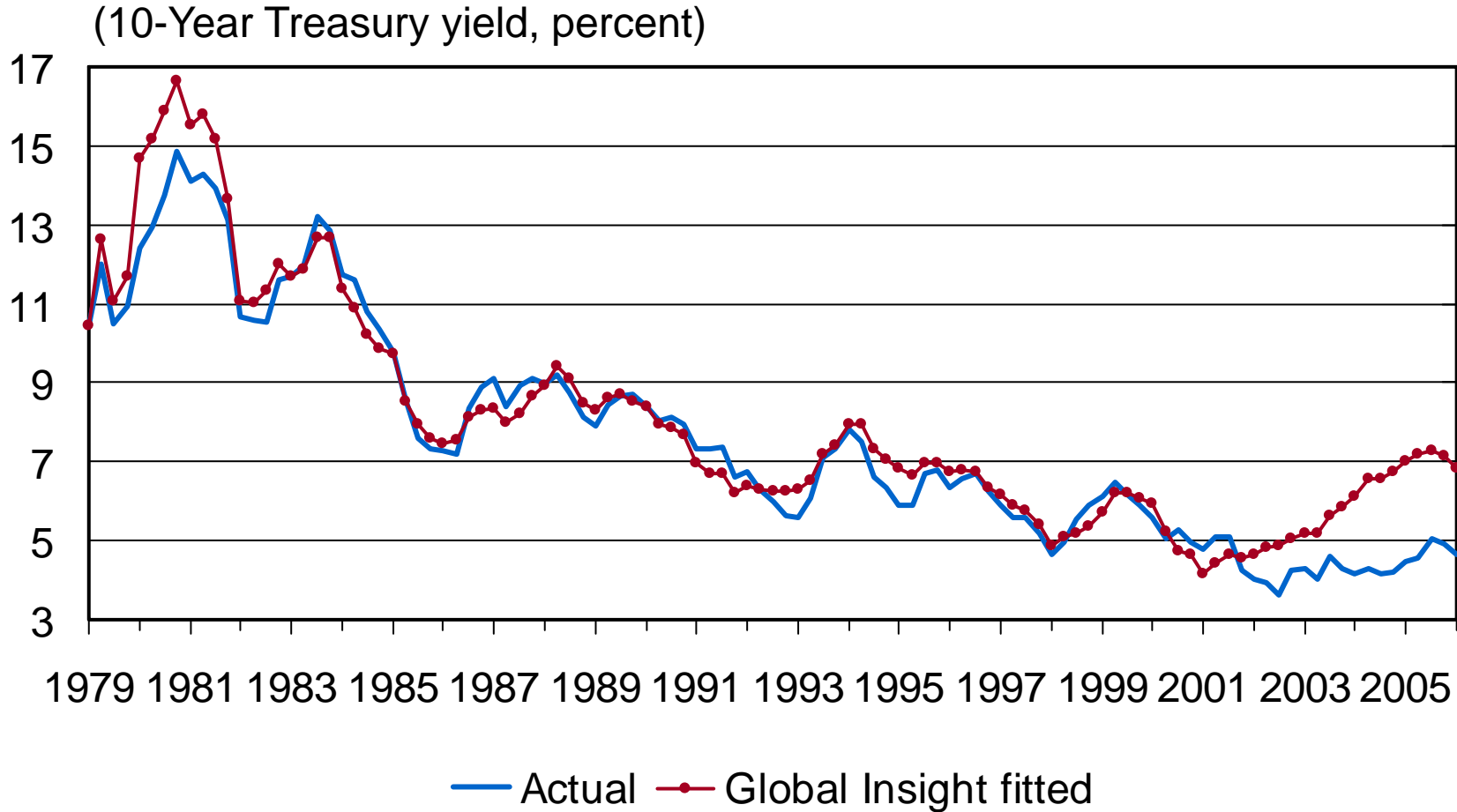
Wage Inflation Will Decline



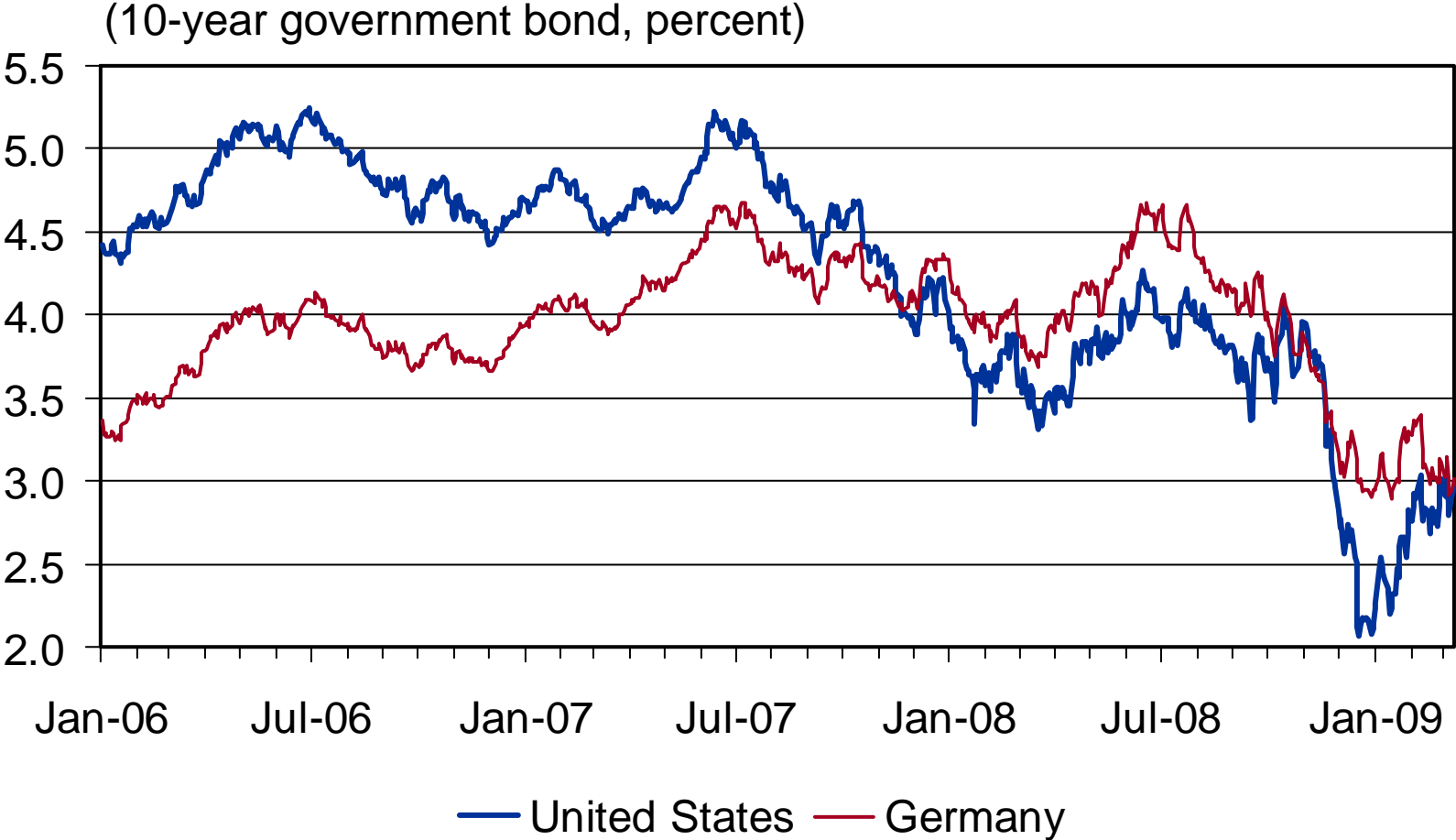
Labor Cost Pressures Have Eased



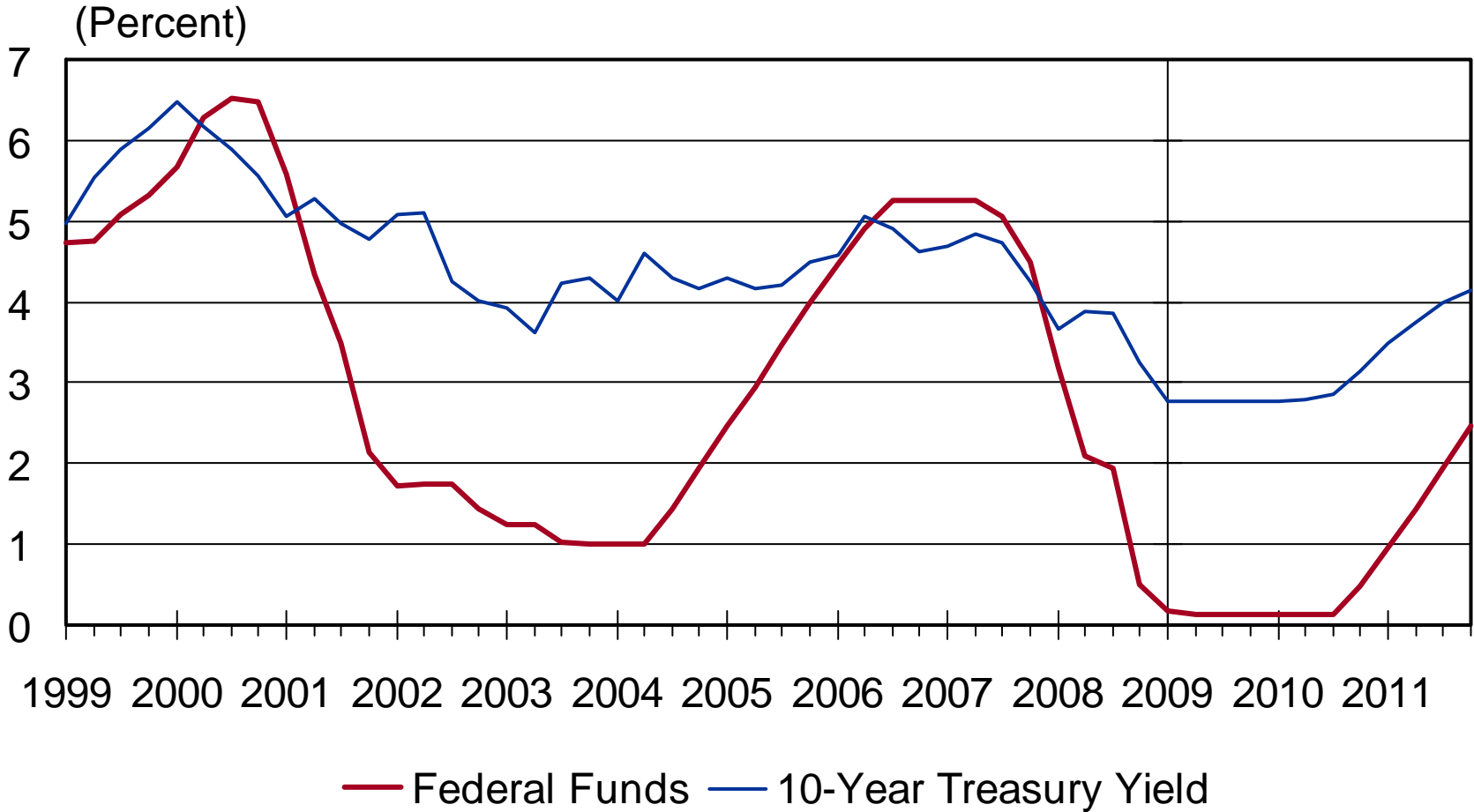
Long-Term Yields Have Been Surprisingly Low



Long-Term Interest Rates



Fed To Stay Close to Zero

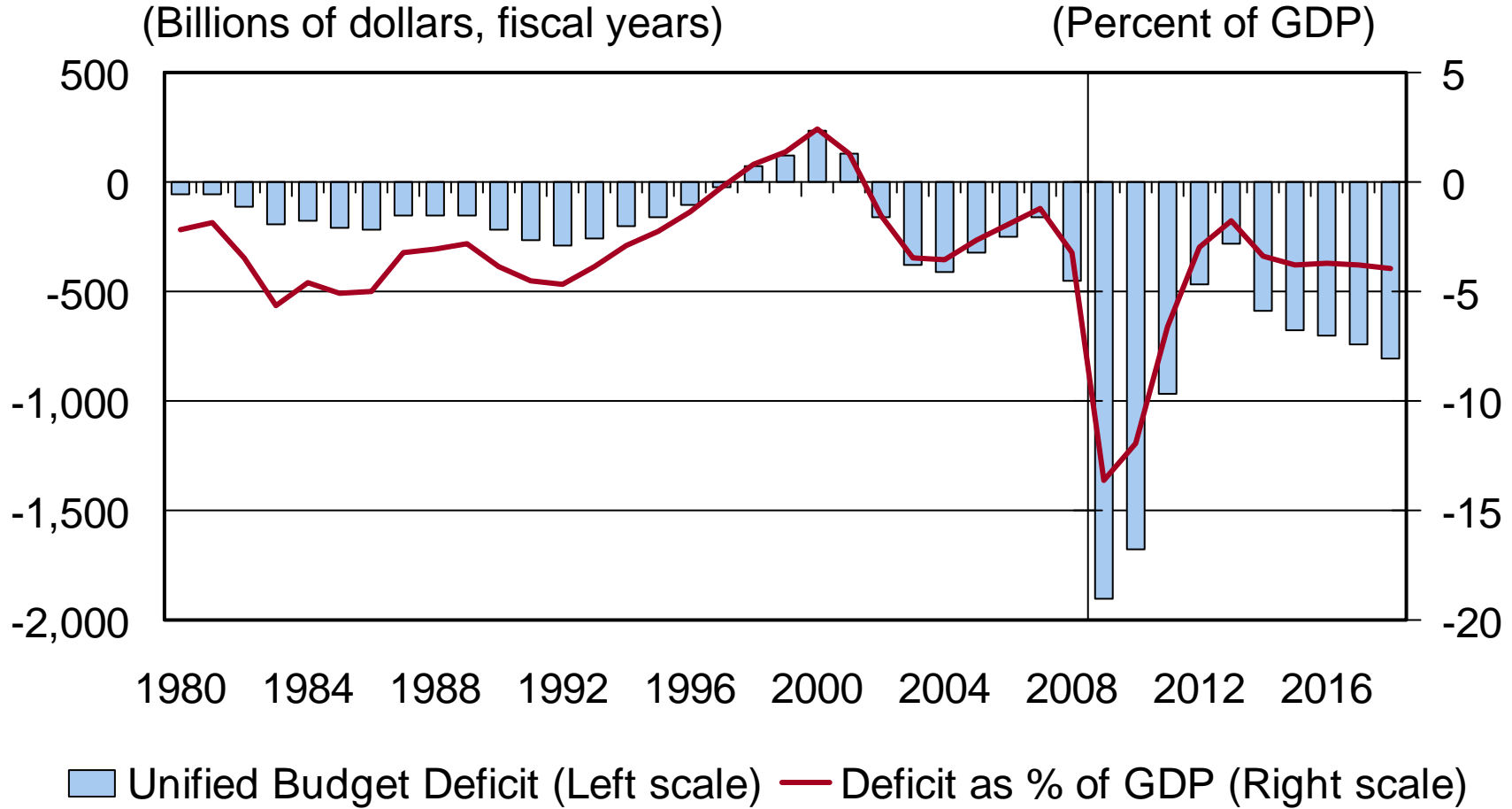


Government Budget Outlook

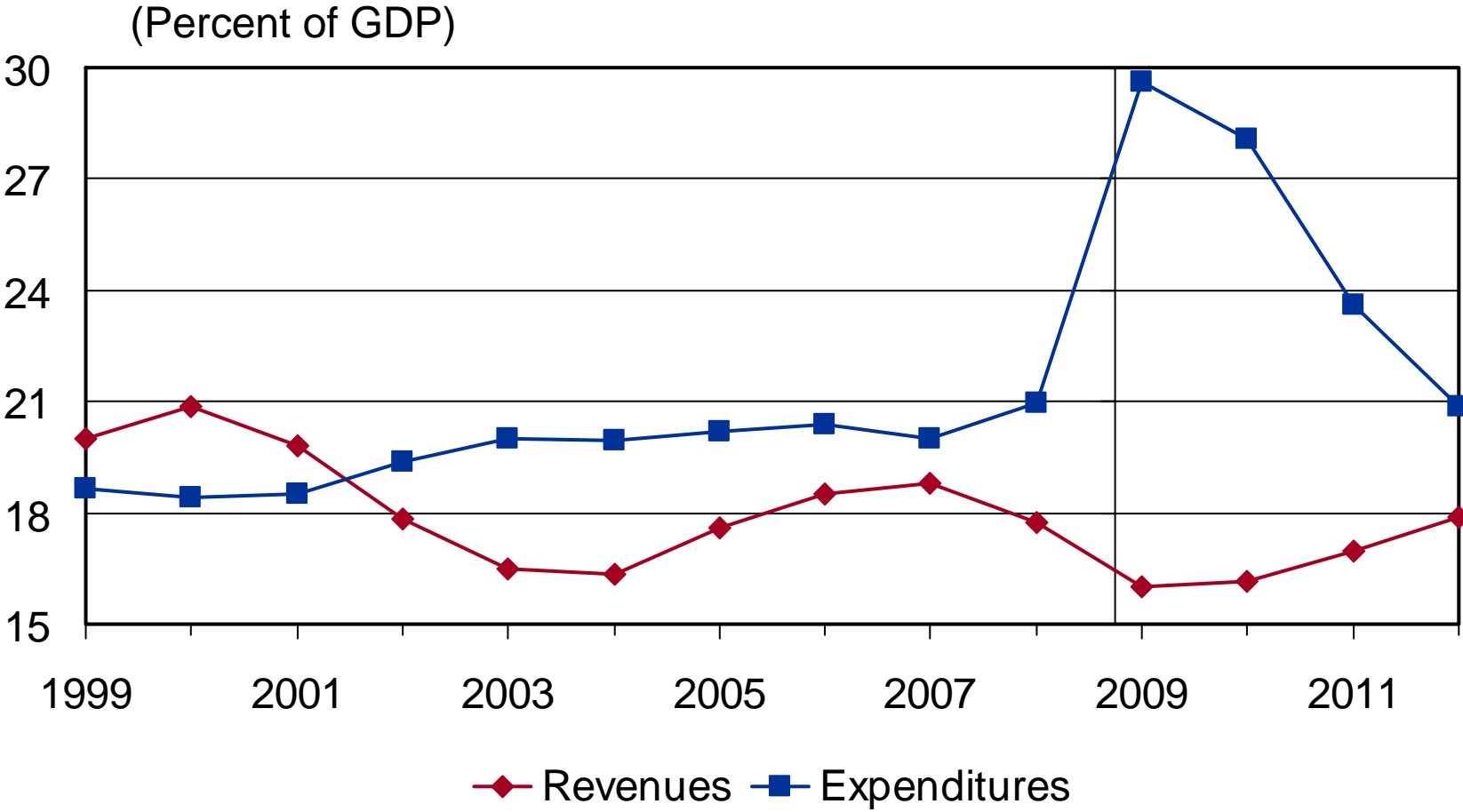


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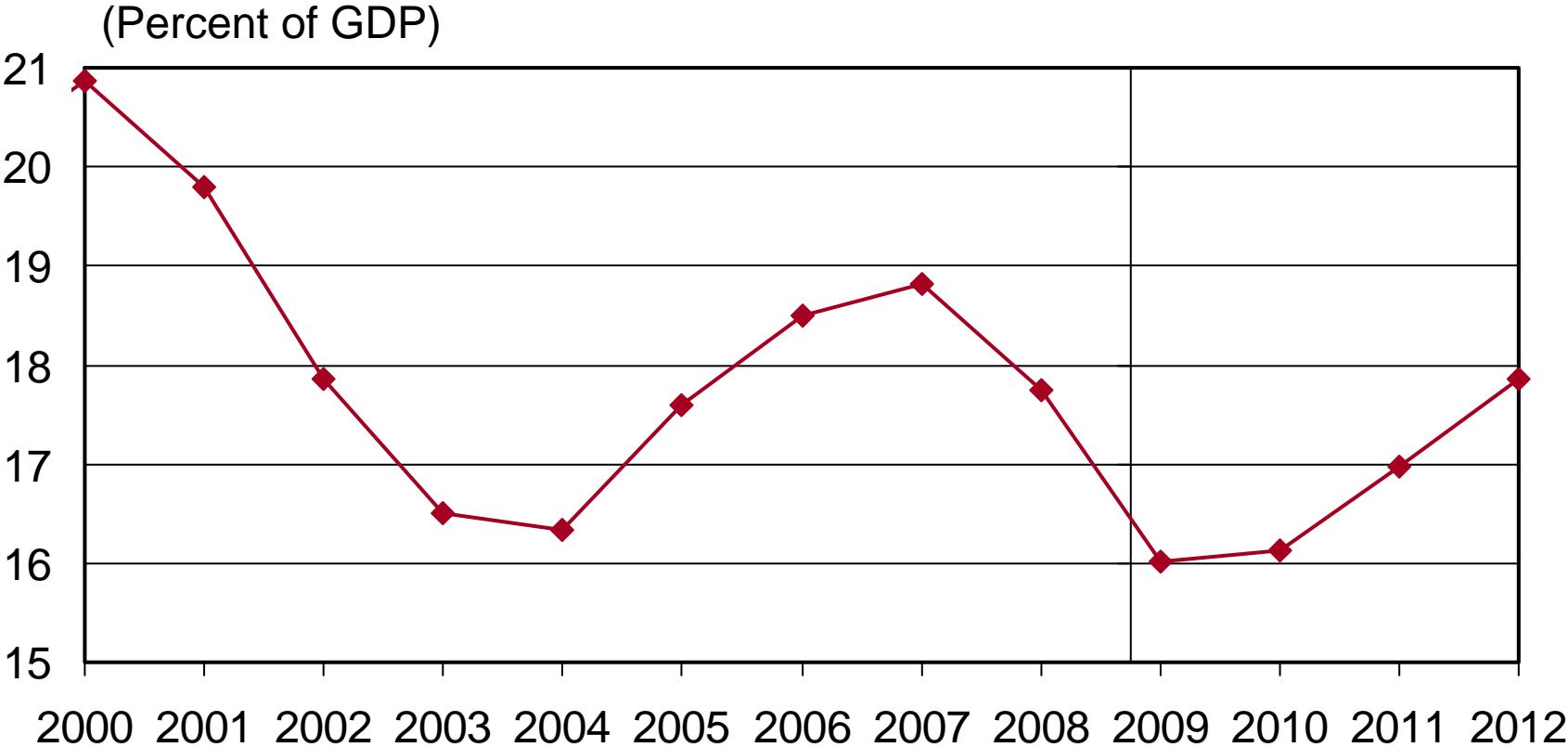
A Record U.S. Federal Budget Deficit in Fiscal 2009



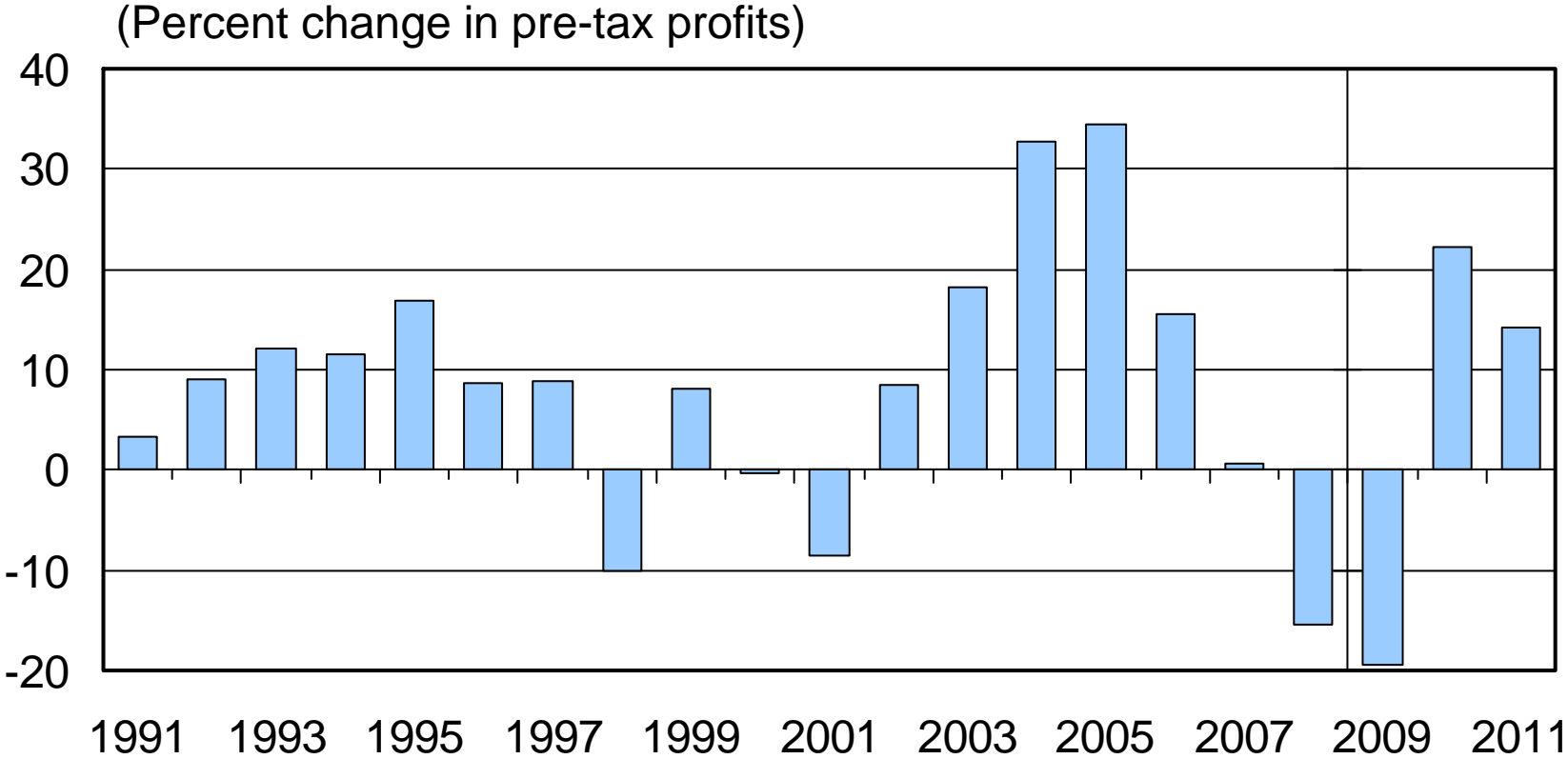
Federal Spending Surges, Revenues Weaken



Federal Revenues Decline



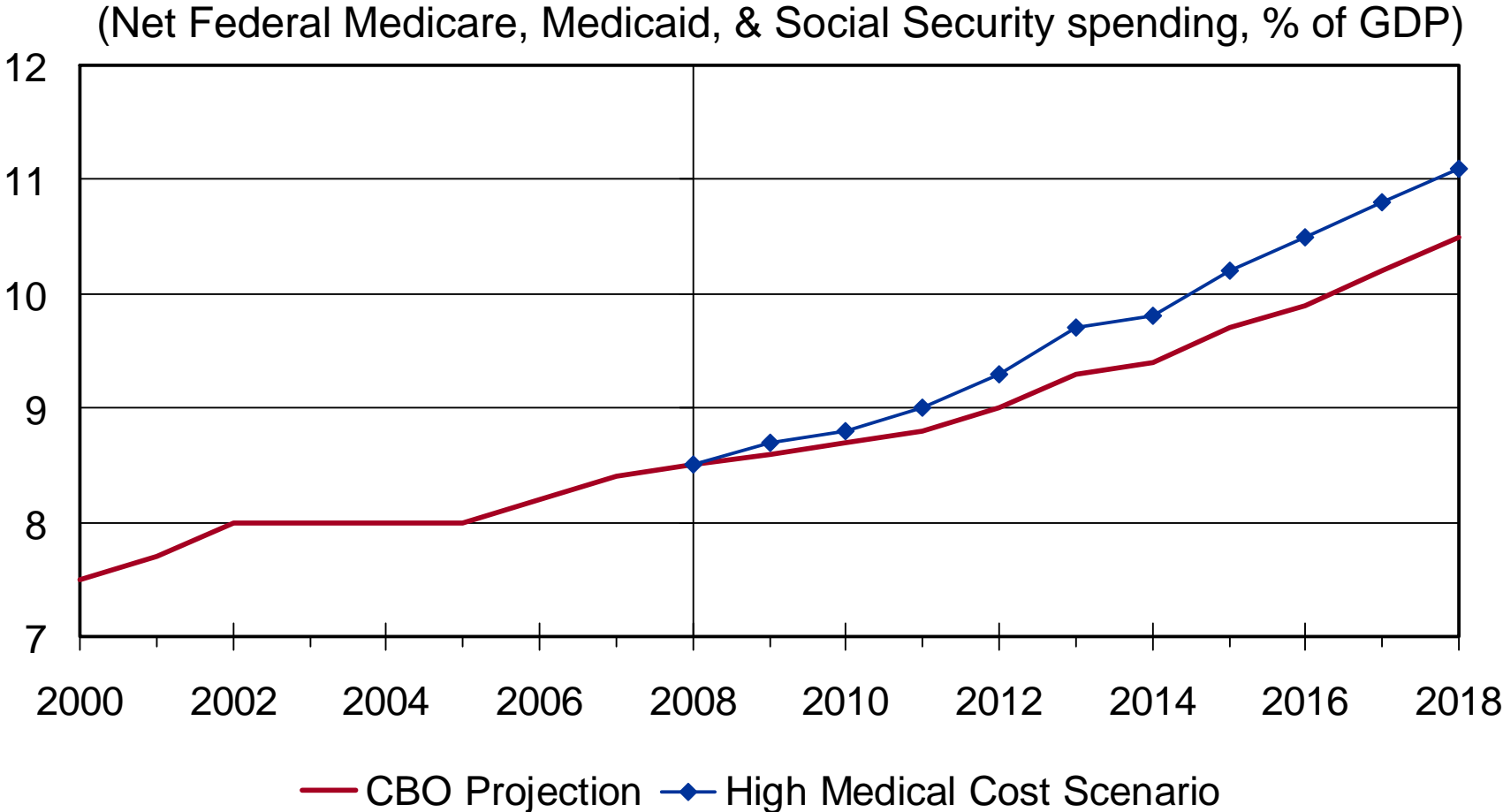
The Profits Boom Is Out of Steam



Warning: Taxes Will Have To Rise Eventually

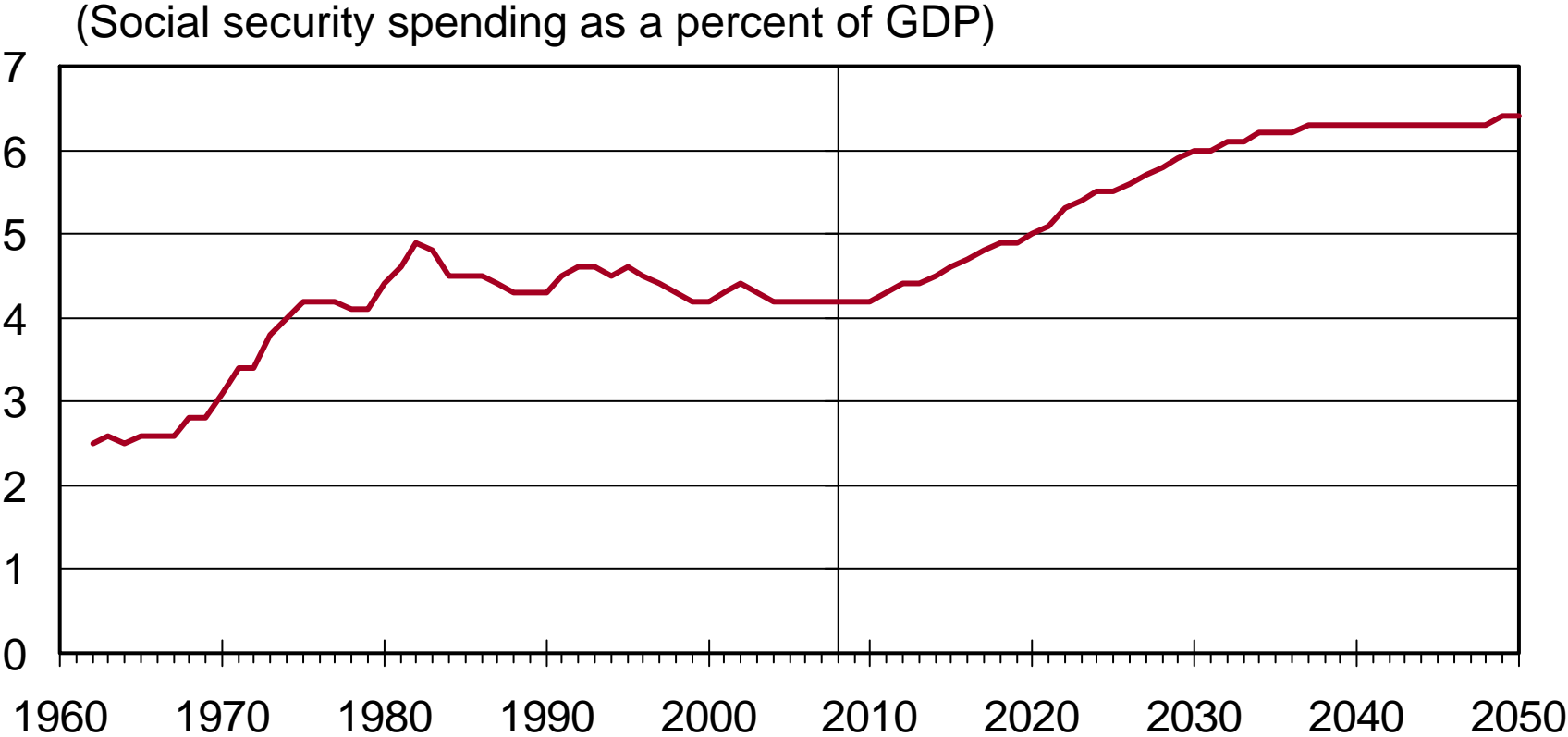


A Poisoned Chalice For The Presidential Victor?



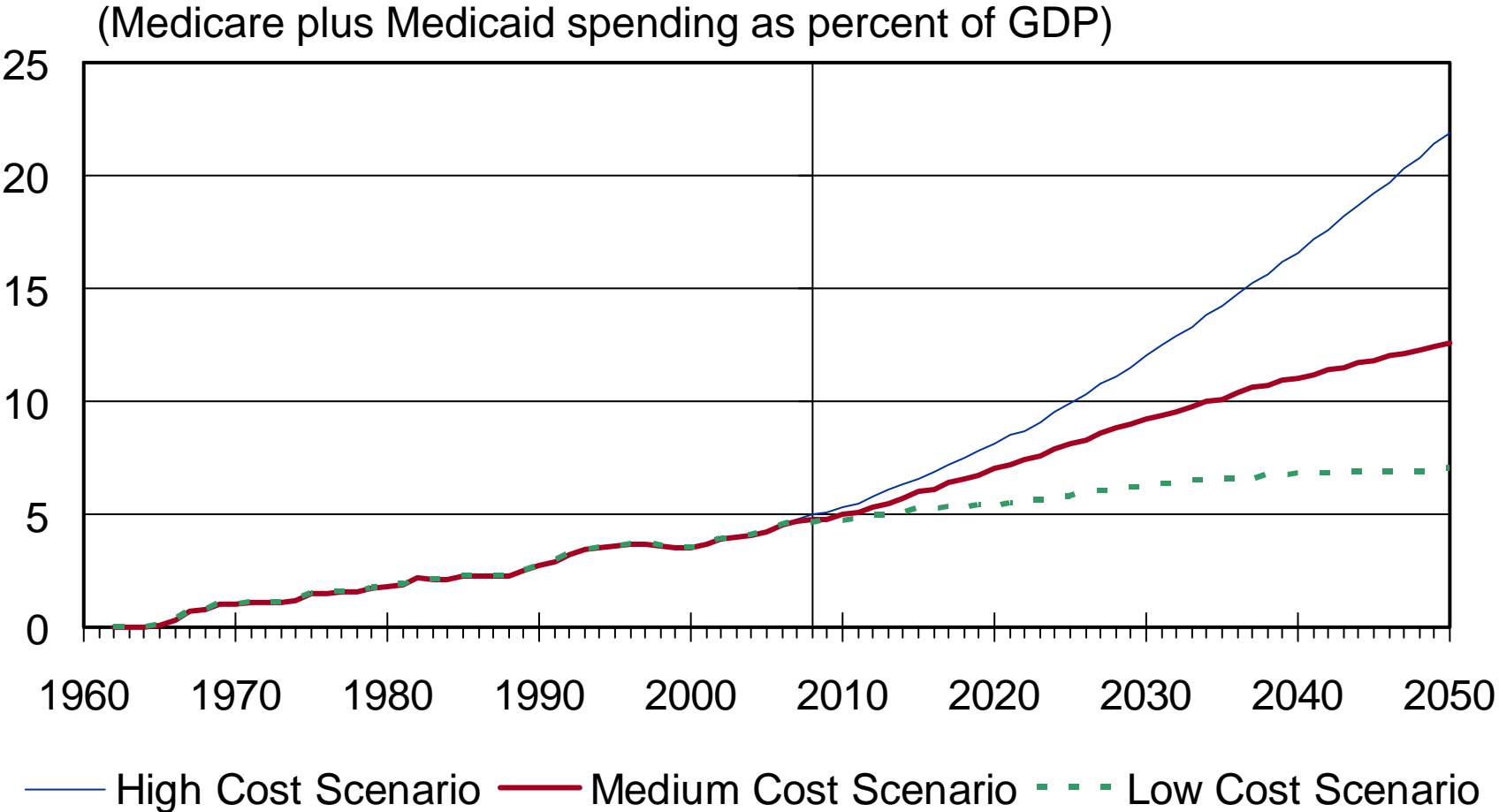
Source: CBO Long-Term Budget Outlook, December 2007

The Long Term: Social Security Hasn't Been Tackled Yet



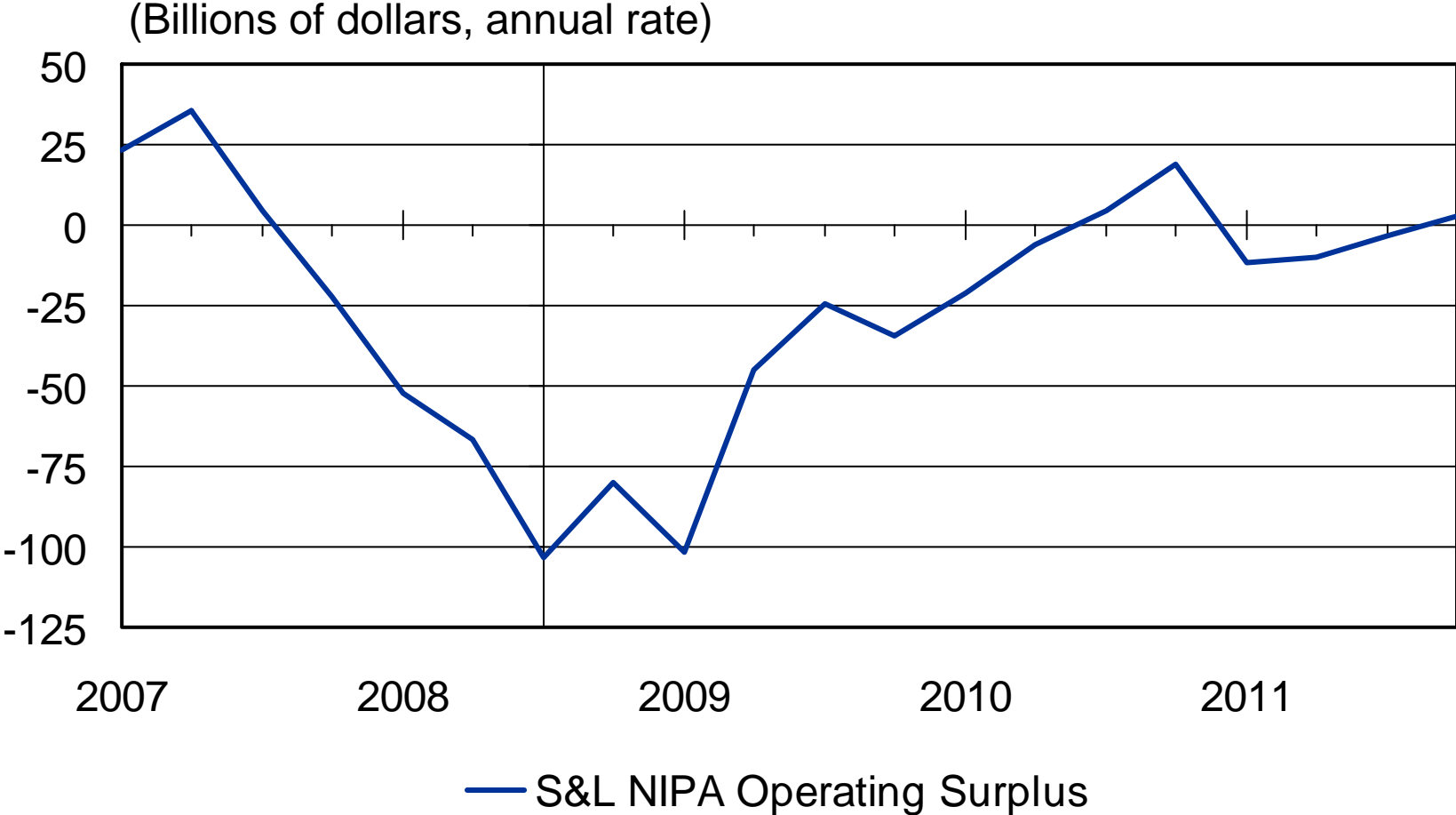
Source: CBO Long-Term Budget Outlook, December 2007

The Long Term: Medical Spending Is the Biggest Problem



Source: CBO Long-Term Budget Outlook, December 2007

State and Local Finances in Trouble



Bottom Line

- Economy in free-fall right now – recession long and deep
- More fiscal action on the way – more public capital injections into financial institutions and a major stimulus package
- Fed has cut to zero – but impact limited; unconventional measures will be extended
- Upside Risk: Government intervention stabilizes credit markets, fiscal stimulus kick-starts rapid upswing
- Downside Risk: Vicious spiral between economy and credit markets worsens

Thank you!

Patrick Newport

U.S. Economist

patrick.newport@ihsglobalinsight.com



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