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

- Real Manuf. & Trade Sales*
  - Peak: Oct 07

- Real Pers. Income (ex transfers)**
  - Peak: Oct 07

- Employment***
  - Peak: Dec 07

- Industrial Production****
  - Peak: Jan 08
Unemployment Rate Rising

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

(ISM Manufacturing Export Orders, Diffusion index)

The Downturn Is Dampened by Foreign Trade

(Annualized rate of growth)

Real GDP
Domestic Demand
Is GDP Telling The Real Story?

Real Gross Domestic Product Real Gross Domestic Income

(Year-on-year percent growth)

U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

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

(Percent unless otherwise noted)

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

### The Housing Downturn
House Prices: Overvaluations Becoming Less Extreme

Source: National City

Home Sales Probably Not Quite at Bottom Yet

(Millions of units)  (Millions of units)

2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

- New Home Sales (Left scale)
- Existing Home Sales (Right scale)
Bloated Supplies of Homes for Sale

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

Housing Starts Dip Further, Prices to Fall Sharply in 2008

(Million units) (Year/year percent change)

-15 -10 -5 0 5 10 15

-15 -10 -5 0 5 10 15

Housing Starts (Left scale) OFHEO House Price Index (Right scale)
Consumer Spending Weakening

Consumer Sentiment Is In The Recession Zone

(Reuters/Univ. of Michigan Sentiment Index)
Consumer Spending Growth Turning Negative

(Annualized rate of growth)

Business Investment Softening
Commercial Real Estate Loan Standards Tightening

(Net percent tightening standards for commercial real estate loans)

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

(Percent change from a year earlier, real spending)

- Software & Equipment
- Buildings

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

Headline Inflation Has Spiked Higher; Core Inflation Has Edged Higher

(Percent change from a year earlier)

0 1 2 3 4 5 6
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

All-Urban CPI — Core Consumption Price Index
Fed On Hold

![Chart showing Federal Funds Rate and 10-Year Treasury Yield over years 1999 to 2010. The chart indicates periods where Federal Funds rate was higher than the 10-Year Treasury Yield, and vice versa.]

State and Local Finances

![Image related to State and Local Finances.]

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State and Local Finances in Trouble

(Billions of dollars, annual rate)

State and Local Spending Growth Must Slow

(Percent growth, nominal, year-on-year)
The Economy and the Presidential Election Outcome

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

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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