The U.S. Economic Outlook

Presented by:
Sara Johnson
Senior Research Director, Global Economics
IHS Global Insight

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A Subdued U.S. Economic Expansion

- U.S. economic growth has slowed as support from the inventory cycle and fiscal stimulus has diminished
- Consumer caution and business hiring restraint are reinforcing each other
- Homebuilding will gradually recover; commercial construction has further to fall in 2011
- Exports and business equipment investment will lead growth
- Inflation is a long way off; deflation is the immediate threat
The U.S. Economic Expansion Proceeds at a Slower Pace

Deeper Recession, Slower Recovery: Comparison with Previous Cycles

* Assumes 2009 Q2 trough
ISM Indicators Still Signal Growth; Small Business Lagging Behind

(ISM Diffusion Indexes, 50 = no change) (NFIB Optimism Index, 1986=100)

U.S. Employment Will Slowly Recover, Reaching its 2007 Peak in Late 2013

(Percent change, annual rate)
Forces Driving State Revenues Begin to Improve

(Percent change, calendar years)

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(Percent change, fiscal years ending June 30)
After a Strong Rebound in 2010, Corporate Profits Growth Will Subside

The Stock Market’s Lost Decade
Cross-Currents Affecting Consumer Finances and Spending

Positive Forces
• Upturn in Employment
• Real Income Growth
• Stock Market Recovery
• Low Interest Rates

Negative Forces
• High Unemployment
• Reduced Wealth
• Tight Credit
• High Debt Burdens

The Drop in Household Net Worth Led to a Rise in the Saving Rate

(Percent of disposable income) (Ratio)

0.0 2.5 5.0 7.5 10.0 12.5
0.0 1.5 3.0 4.5 6.0 6.5

Saving Rate Household Net Worth/Disposable Income
Consumer Spending Is Restrained by Weak Disposable Income Growth

Nominal Consumer Spending Is Rising, Boosting Sales Tax Receipts
Light Vehicle Sales Are Recovering, with Cars Overtaking Light Trucks

(Millions of units, annual rates)

• The recession led to a drop-off in household formation
• Home affordability has greatly improved, boosting demand
• But the expiration of the second homebuyers' tax credit has caused a temporary setback in home sales and prices
• High mortgage foreclosure rates are adding to excess supply
• Job growth is critical to a sustained housing recovery
Housing Affordability Is Helped by Low Home Prices and Mortgage Rates

* A value of 1.0 indicates a household earning the median income can afford a median-priced single-family home.

Housing Starts Will Gradually Revive

(Millions of units)
Business Equipment Orders and Shipments Are Recovering

(Nondefense capital goods exc. aircraft, 3-month moving avg., $ billions)

Business Investment Cycles: Equipment Leads, Structures Lag

(Year-over-year percent change, 2005 dollars)
Real Export and Import Growth Reflect Business Cycle and Exchange Rates

Capital Goods Lead Export Growth
A Two-Speed Global Economic Recovery, Led by Emerging Markets

(Real GDP, percent change)

The Dollar Will Depreciate Against Emerging Markets’ Currencies

(Real Trade-Weighted Dollar Index, 2005=1.0)
A Mild Outlook for Inflation

(Year-over-year percent change)

Industrial Materials Prices Are Undergoing a Mild Correction

(IHS Global Insight Indexes, 2002:1=1.0)
**Crude Oil and Natural Gas Prices Have Diverged**

($/barrel, WTI) ($/million Btu, Henry Hub)

**Interest Rates Will Stay Low Through 2011 with More Quantitative Easing**

(Percent)

- Federal Funds
- 10-Year Treasury
- 30-Year Mortgage Rate
A Chronic Federal Budget Deficit

Economic Growth Will Narrow, Not Close, the Federal Budget Gap
Rising Government Spending on Social Security and Health Care

Federal Personal Income Tax Rates Will Rise for Everyone
Risks to the U.S. Forecast

**Downside Risks**
- Financial market instability returns, credit remains tight, and the housing recession drags on
- Businesses are reluctant to hire or invest
- Consumers retrench after another setback in asset values

**Upside Risks**
- Credit channels function smoothly, supporting investment
- Rapid technological progress boosts real income growth
- Robust growth in many emerging markets fuels exports

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U.S. Real GDP Growth in Alternative Scenarios

(Percent change, annual rate)

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<tr>
<th>Year</th>
<th>Baseline (60%)</th>
<th>Pessimistic (25%)</th>
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Bottom Line

- Economic recoveries in the aftermath of a financial crisis are usually slow, and this one is no exception
- Households will spend cautiously as they rebuild their savings
- Business equipment investment, exports, consumer durables, and home-building will drive the expansion
- Excess capacity will keep wage and price inflation subdued
- The federal government needs an “exit strategy” from deficit spending or financial markets will eventually impose one
- The risk of a double-dip recession is 25%

Thank You!

Presented by:
Sara Johnson
Senior Research Director, Global Economics
IHS Global Insight
sara.johnson@ihsglobalinsight.com