



US Economic Outlook*

2015/2016 Forecast

PNREC Presentation
April 23, 2015

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Hilltop Economics LLC

**Based in part on Consensus Economics, Inc*
CONSENSUS FORECASTS®



U.S. Economy Outlook 2015-2016 Themes

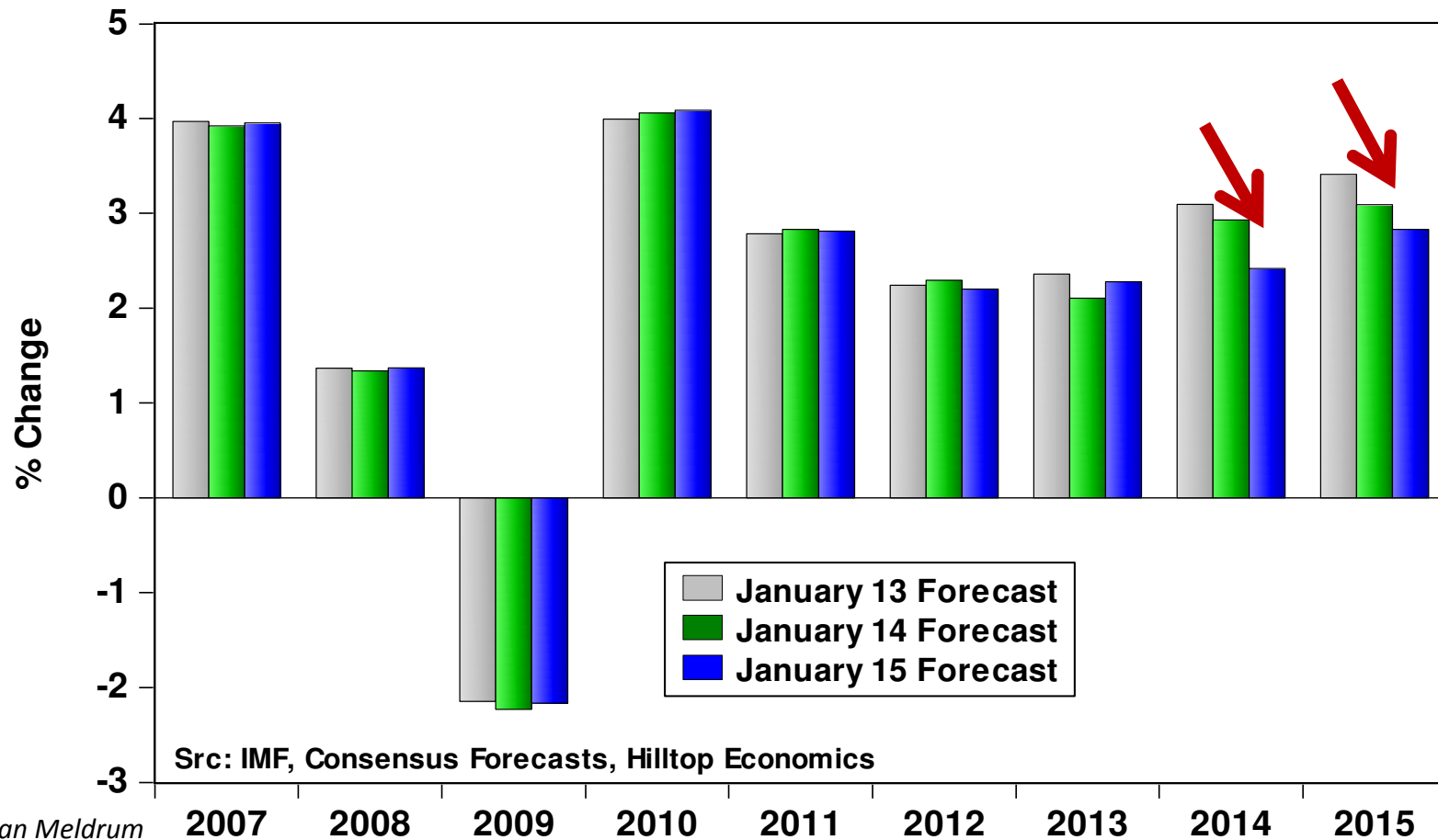
- Subdued performance of the past seven years begins to give way to better growth
 - Economy settling in to “new” structure
 - Financial crisis impact continues to slowly fade
- Economic factors drive decision making
 - Consumer: jobs and incomes
 - Businesses: profits, growth expectations, capacity needs, better balance sheets
 - Fed: low but potentially increasing inflation and healthier job growth (QE & crisis mode a thing of the recent past)
 - Uncertainty over economic policy returning to “normal”
- *Caveat: policy makers & forecasters have consistently over-anticipated stronger economic growth*



Forecasters Overestimated Global Growth

2015: +2.8% as of Jan 15, down from 3.1% in Jan 14 and 3.4% in Jan 13)

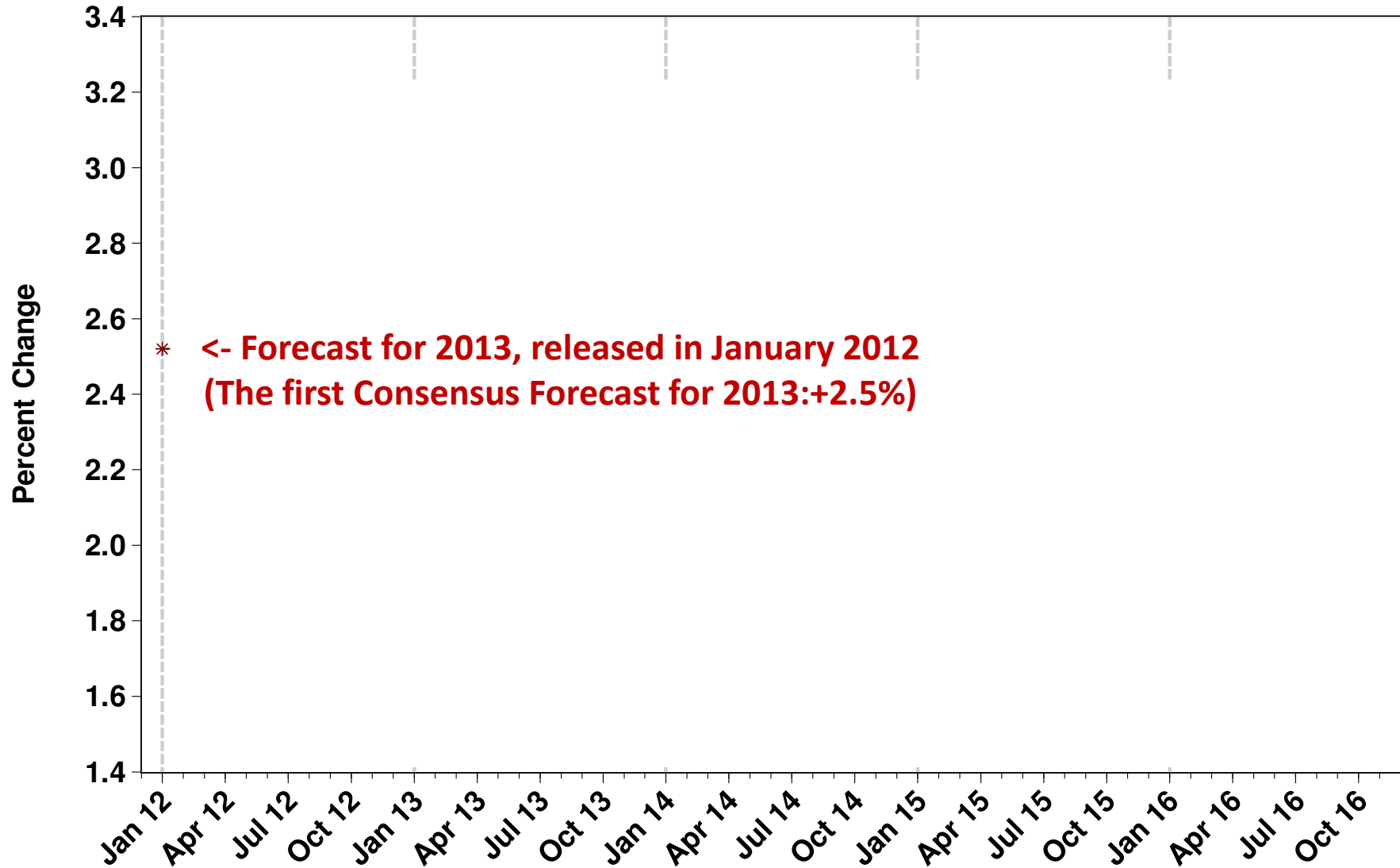
World Real GDP Forecasts



Src: IMF, Consensus Forecasts, Hilltop Economics

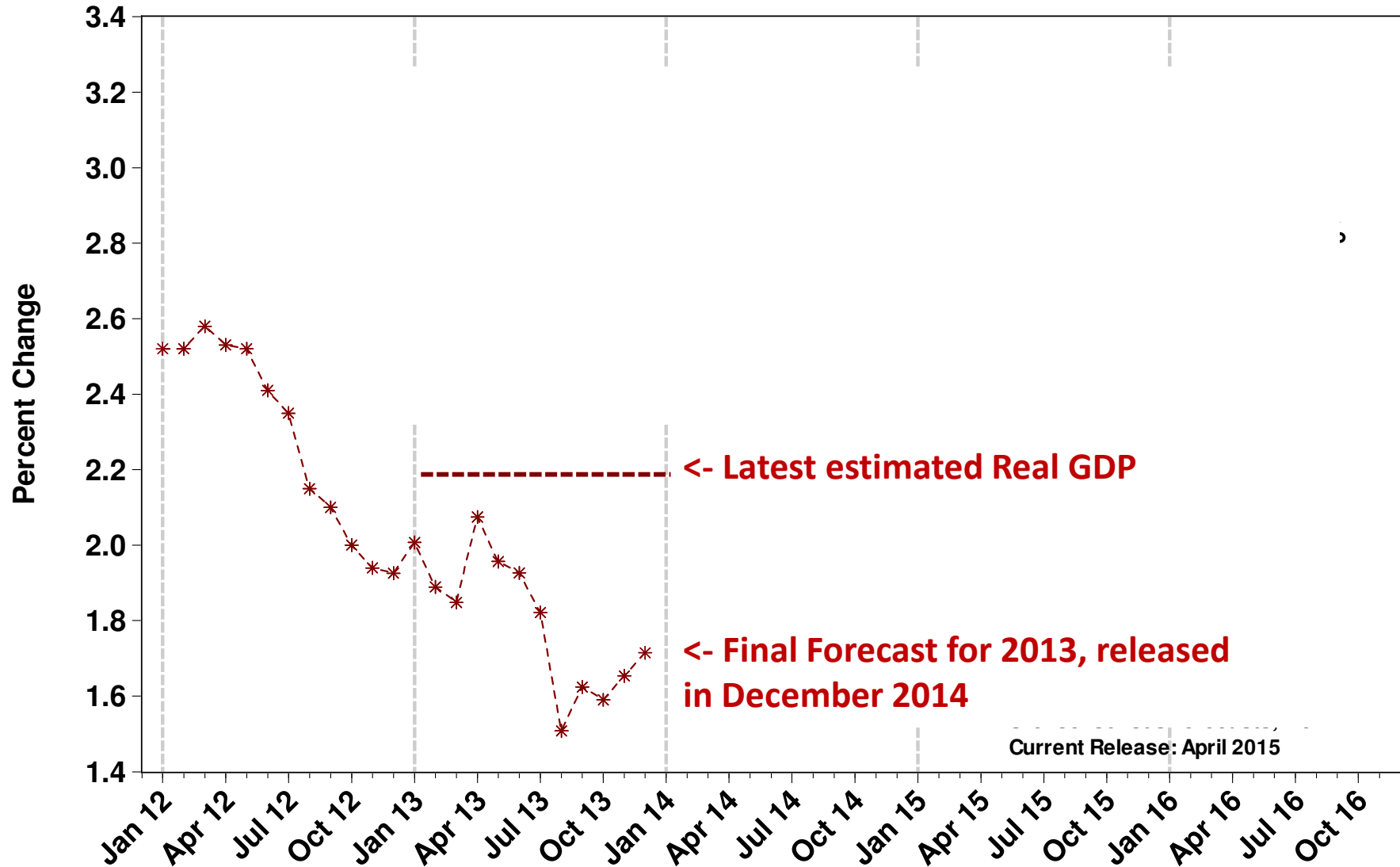


U.S. Real GDP Forecast by Month Released



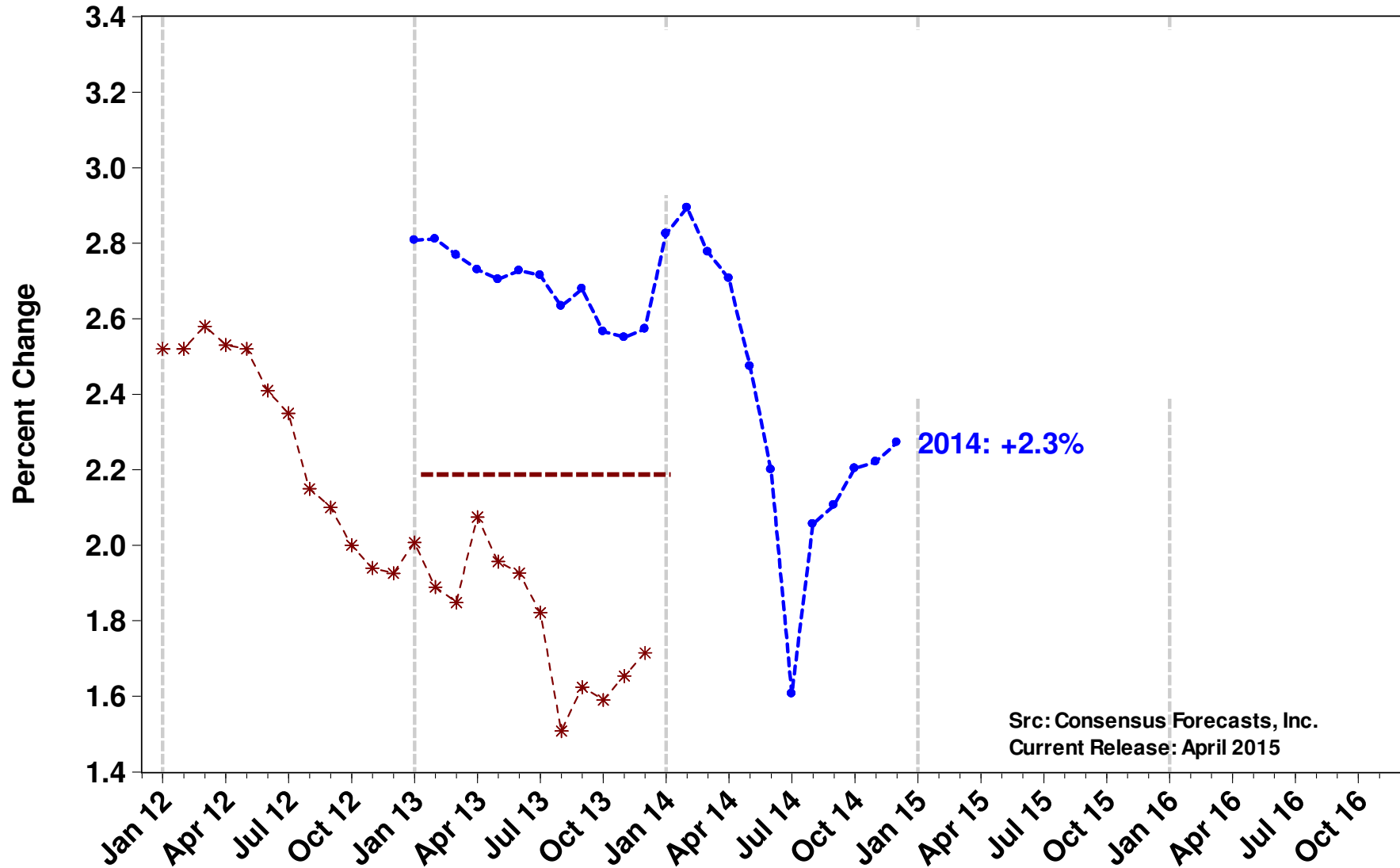


U.S. Real GDP Forecast by Month Released

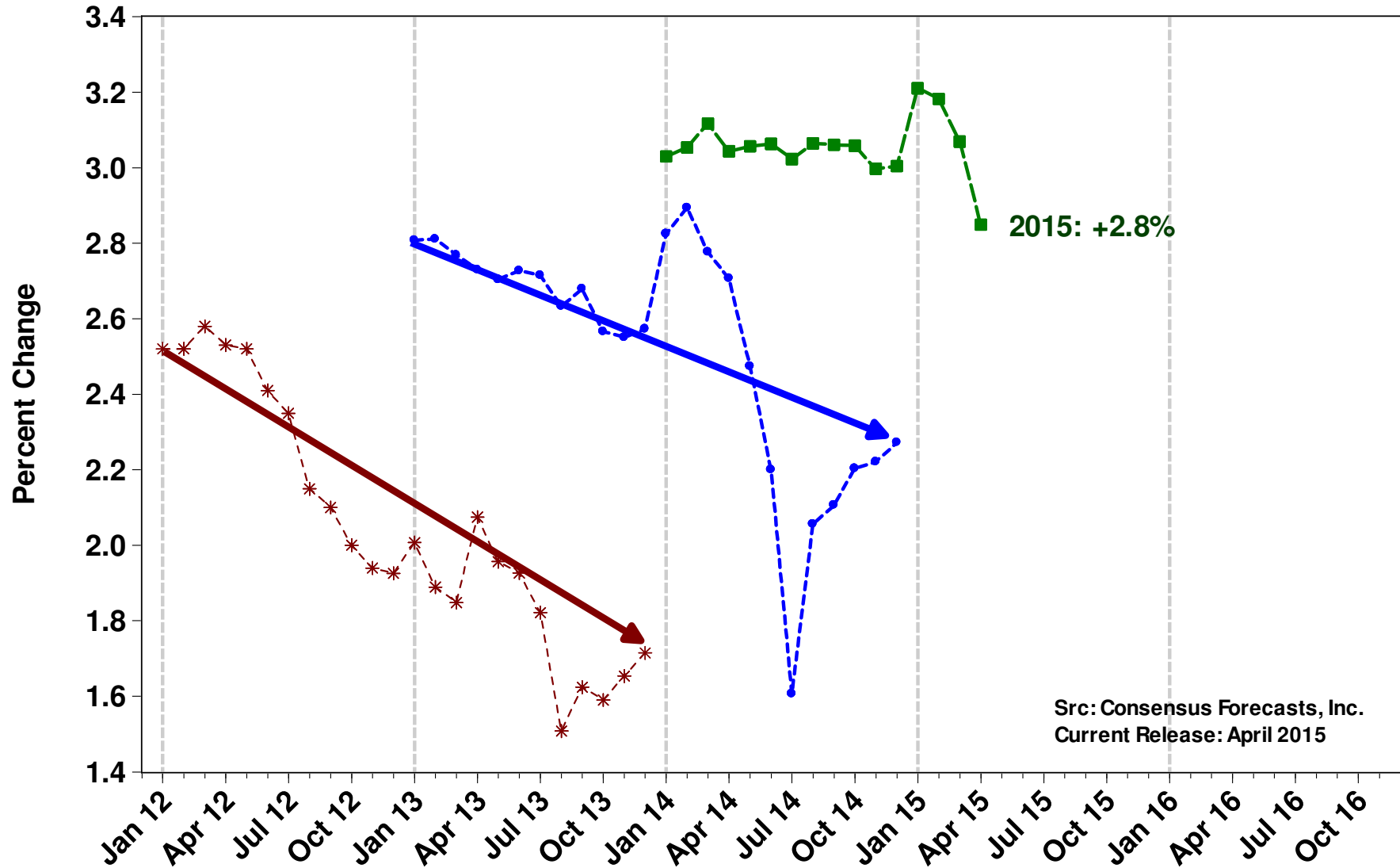




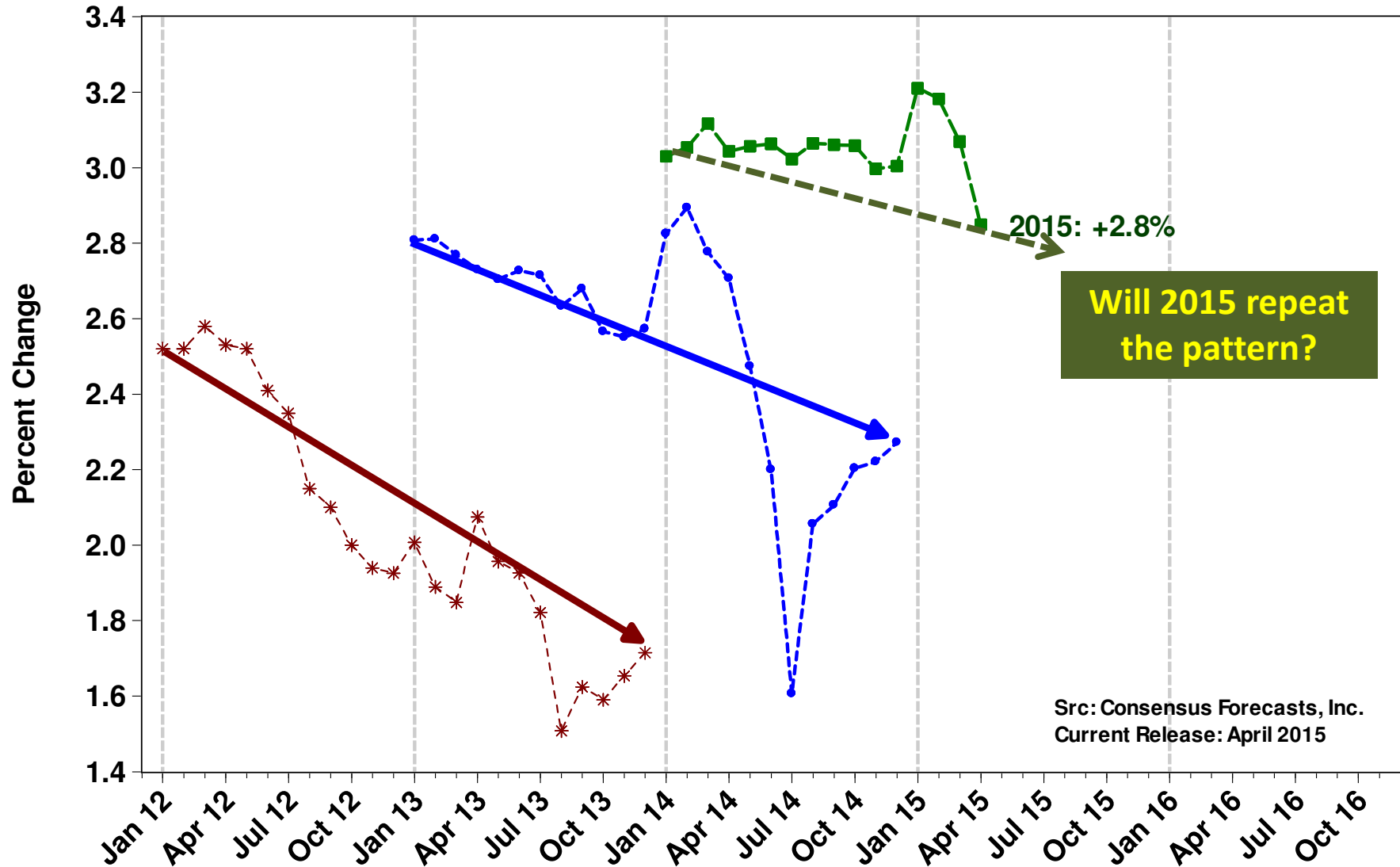
U.S. Real GDP Forecast by Month Released



U.S. Real GDP Forecast by Month Released



U.S. Real GDP Forecast by Month Released



Src: Consensus Forecasts, Inc.
Current Release: April 2015



What Suppressed Growth?

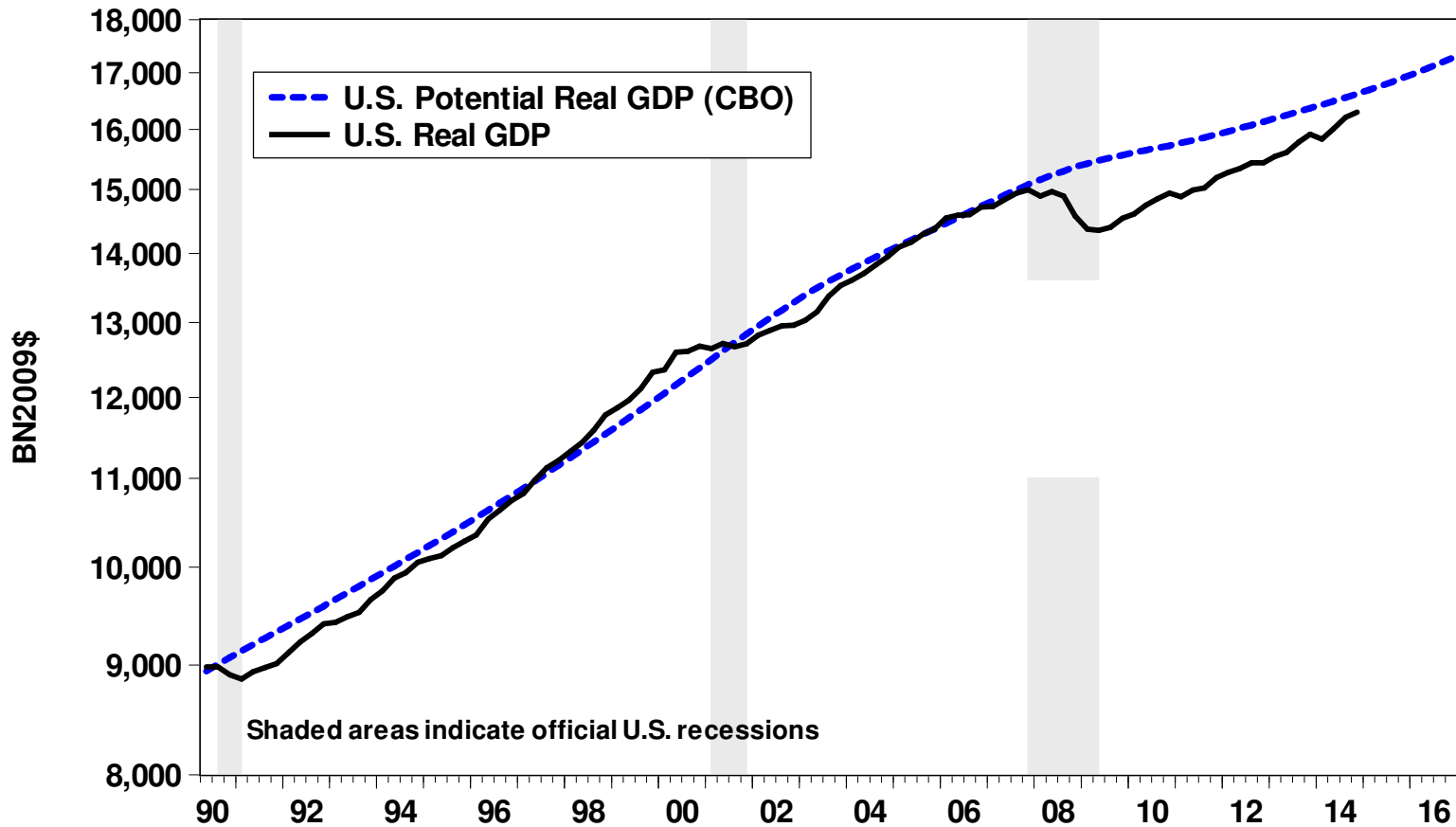
(What has caused the over-forecast problem?)

- A **financial crisis** caused the Great Recession
 - An inventory cycle overlaid the financial crisis
 - Initial inventory snap-back in 2010 did not spark a strong recovery cycle
- Recoveries from financial crises slower due to:
 - Asset excesses & balance sheet hangovers that clear very slowly
 - Expanded government debt increases stresses on markets
 - Economic **policies change dramatically, increasing uncertainty** that increases risk aversion and
 - Businesses delay or avoid making investments
 - Consumers delay or cancel purchasing decisions, increase saving
- Models (and forecasters) embed historical relationships that are too optimistic for the “new” regime
 - Usually have a “regression to the mean” bias
 - Included the boom years of the 00s, slow to adjust to a new set of behavioral relationships (which still are not clear)



Potential Growth Has Slowed

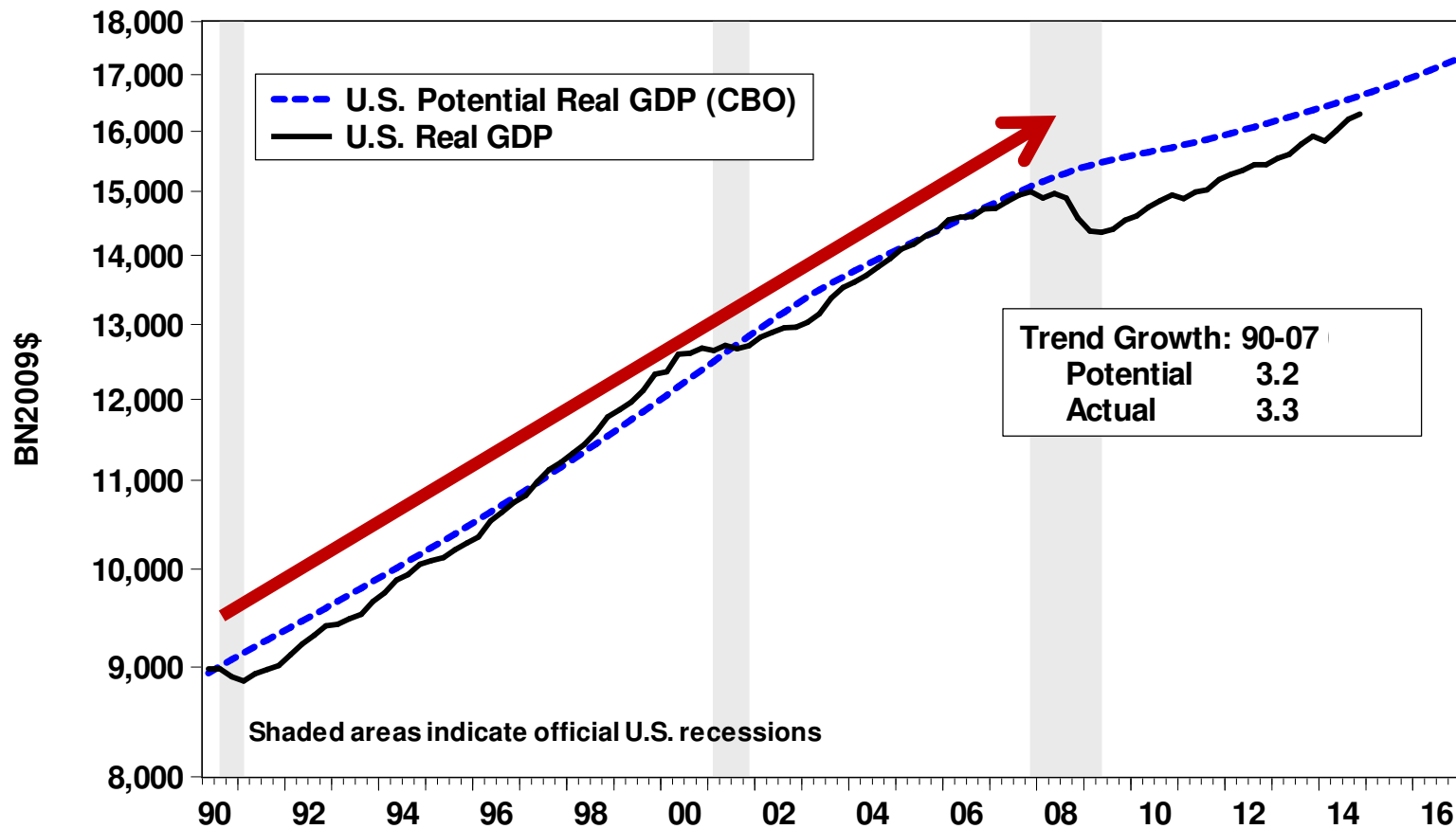
2014 CBO revision; real GDP still hasn't reached potential



Potential GDP Growth: CBO estimates of how fast the economy could expand if operating at a high rate of resource use. Maximum SUSTAINABLE growth, not a technical maximum; may be exceeded for short periods of time.

Potential Growth Has Slowed

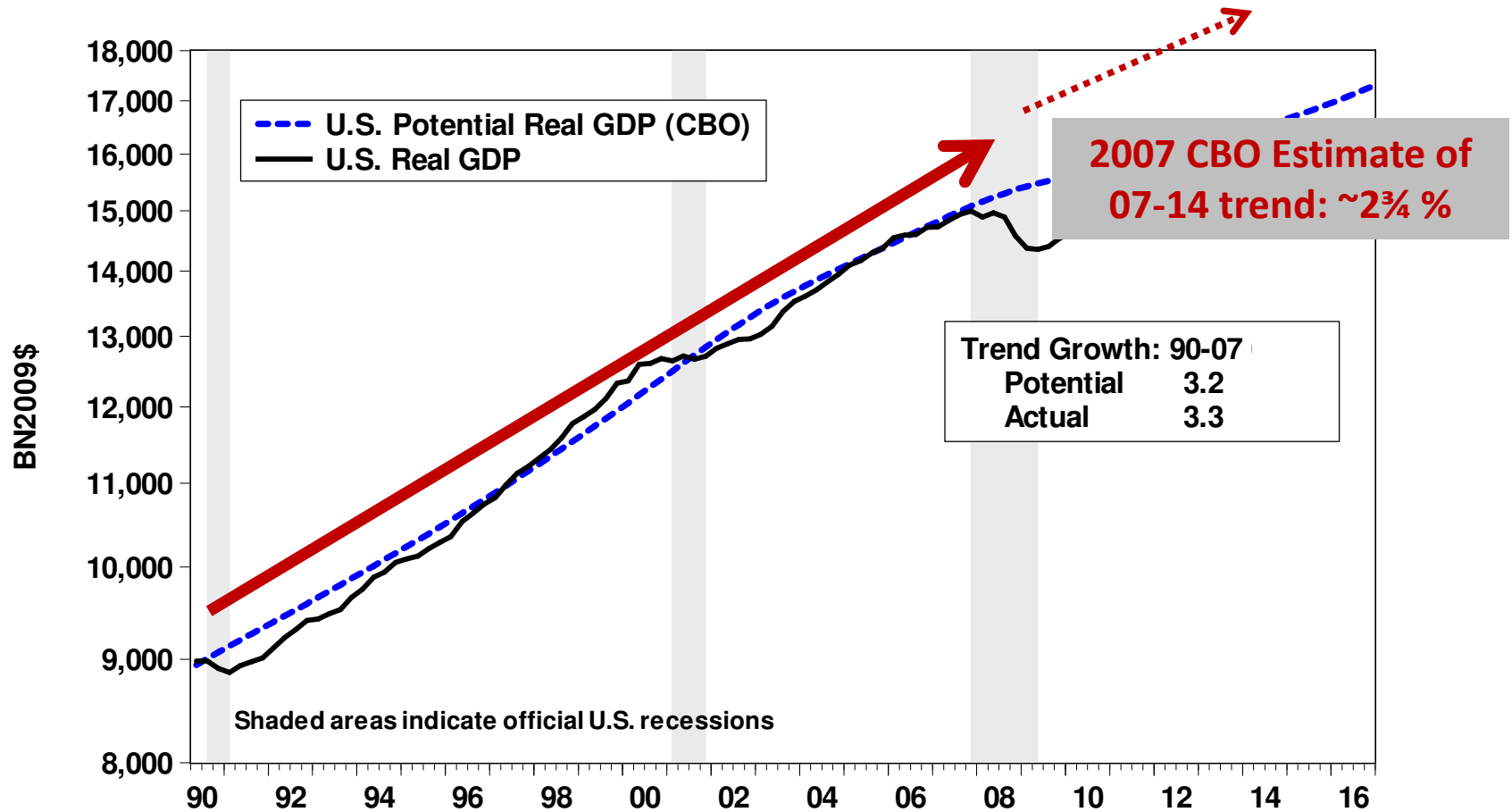
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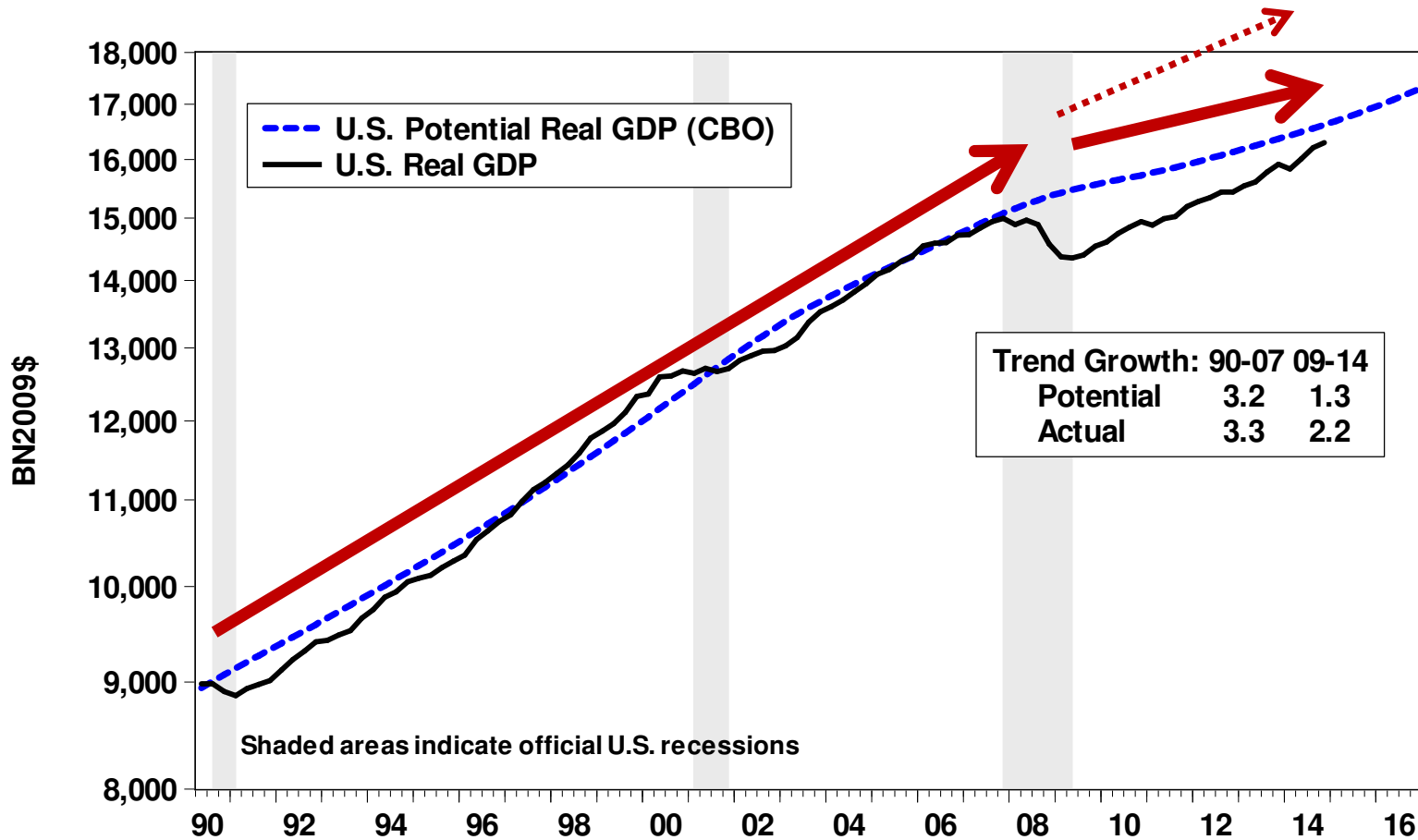
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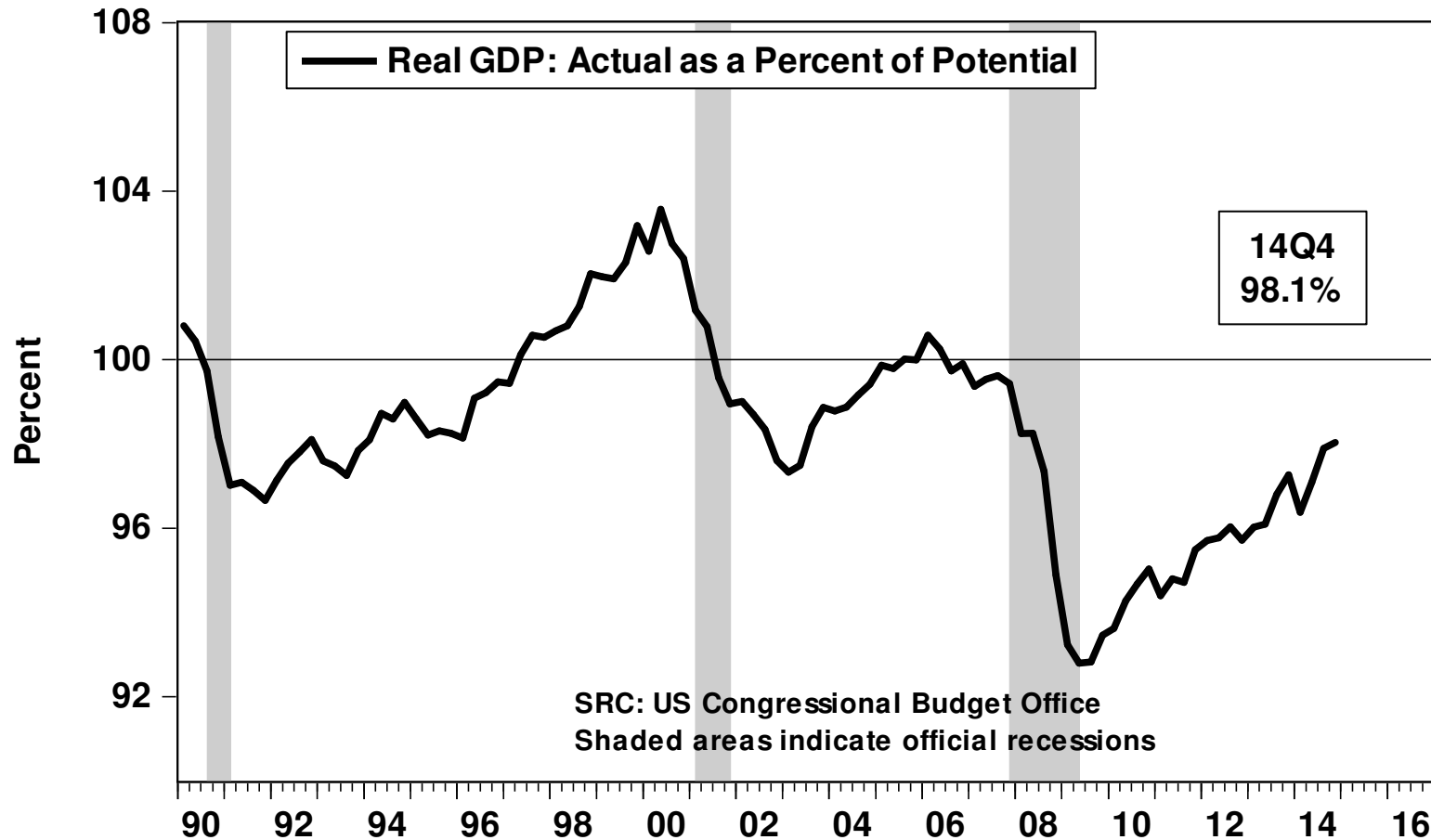


Potential GDP Growth: CBO estimates of how fast the economy could expand if operating at a high rate of resource use. Maximum SUSTAINABLE growth, not a technical maximum; may be exceeded for short periods of time. **The 2014 estimate of trend potential GDP was almost 1½ %/YR slower than the 2007 estimate for 09-14.**

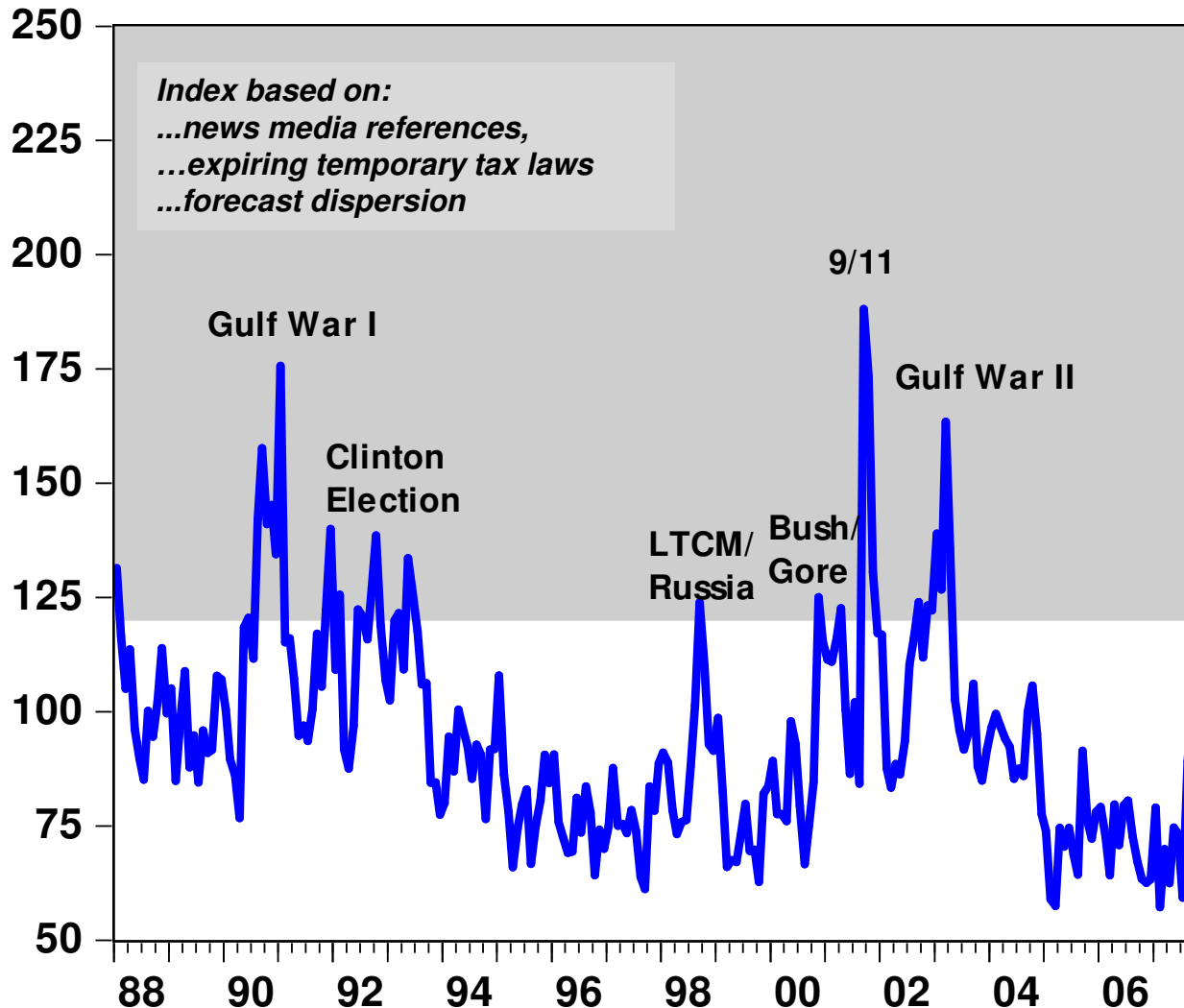
Long Slow Process to Close the Output Gap

due in part to high ECONOMIC POLICY UNCERTAINTY

U.S. OUTPUT GAP



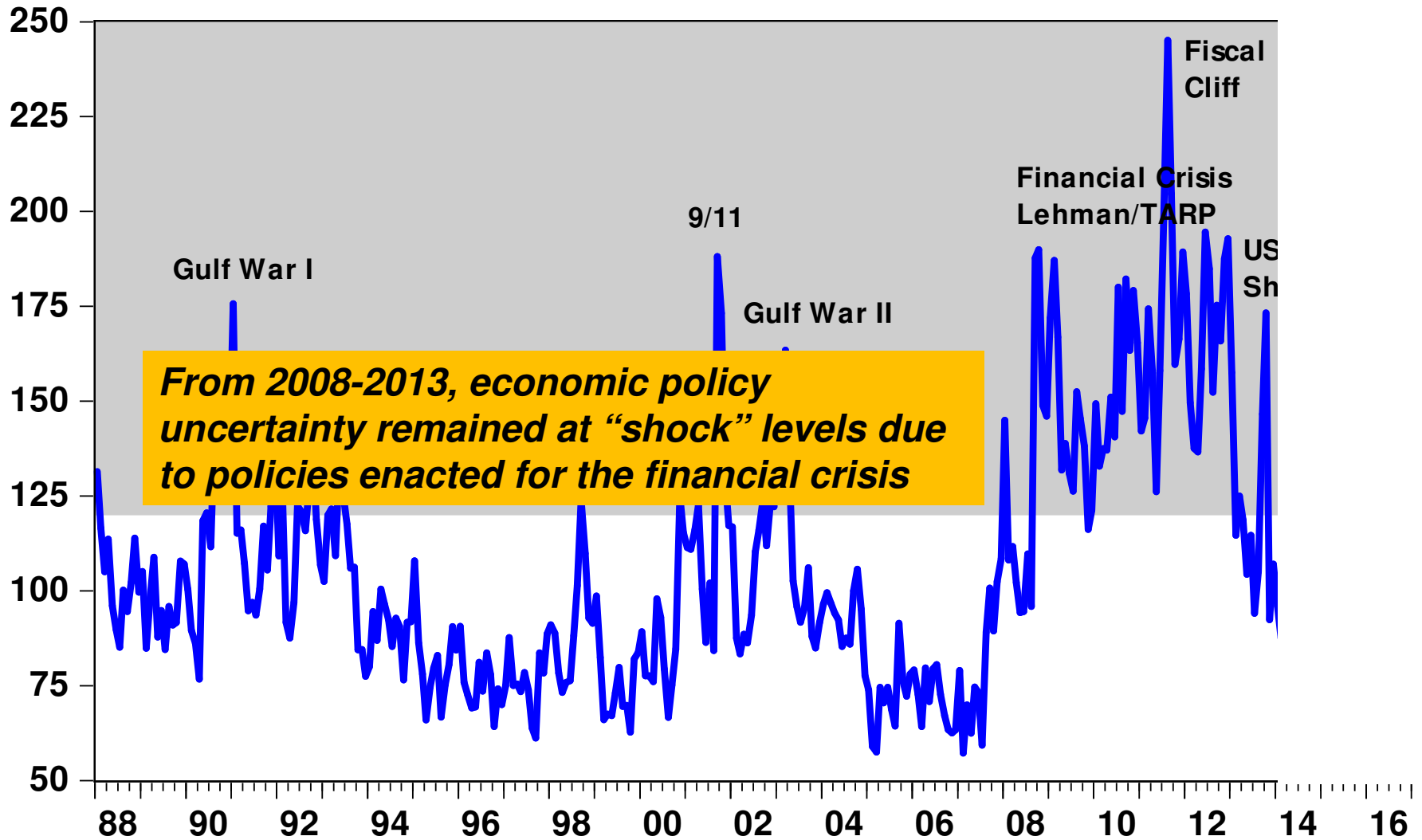
Economic Policy Uncertainty



**Until 2008,
economic policy
uncertainty rose
briefly, usually for
political shocks**

Source: Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com

Economic Policy Uncertainty

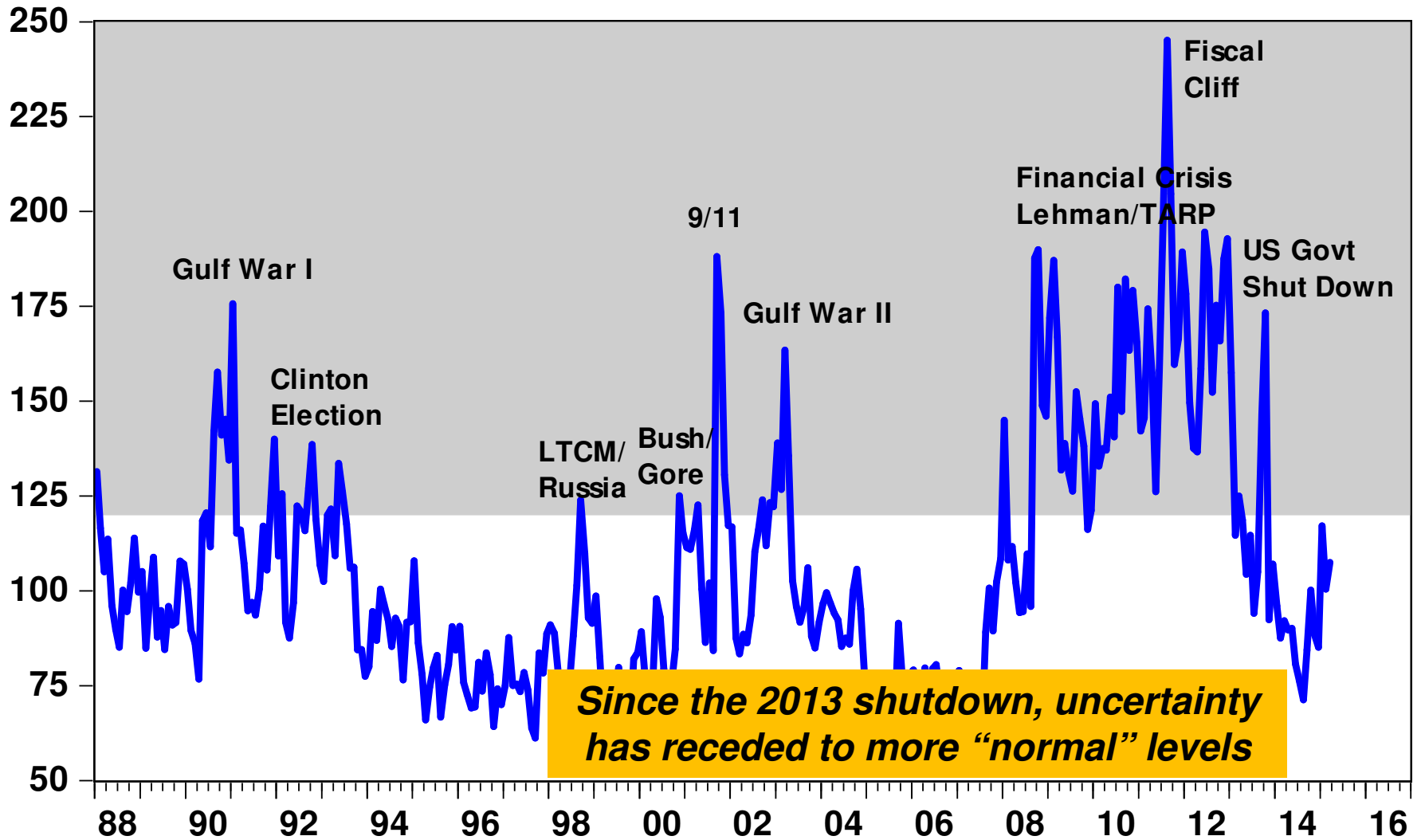


Source: Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com

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Economic Policy Uncertainty



Source: Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com

Lower Uncertainty Contributes to Confidence Gains in Consumers

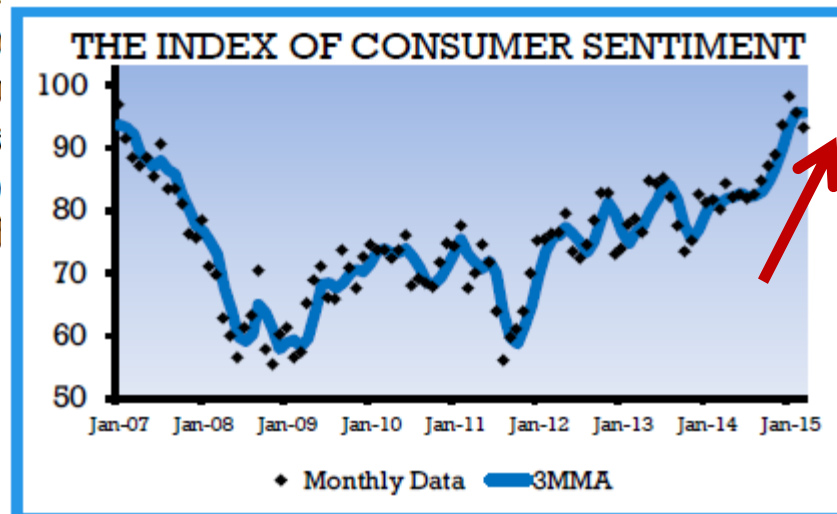
The Conference Board Consumer Confidence Index® Rebounds

31 Mar. 2015 (<https://www.conference-board.org/data/consumerconfidence.cfm>)

surveys of consumers
UNIVERSITY OF MICHIGAN

March 27, 2015

ANN ARBOR. Consumer optimism reached a ten-year peak of 95.5 in the 1st quarter of 2015—its highest level since the 3rd quarter of 2004. Although optimism has increased since the start of the recovery, it has eased back slightly since the start of the surge in confidence was largely due to lower energy prices and the small retreat since then was due to the unusually harsh winter. Most of the gain was among lower income households, which are more sensitive to higher utility costs.



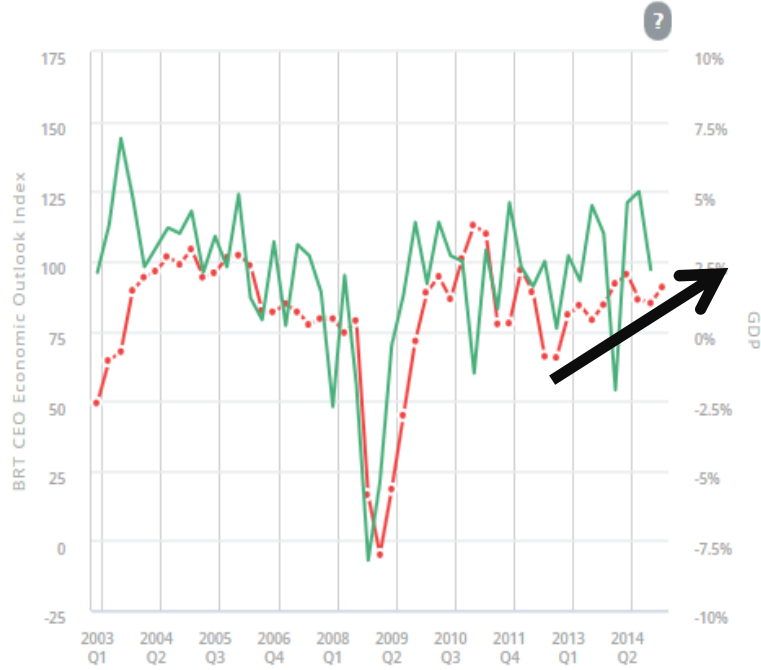
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Modest Uptick in Business Optimism, Especially for Investment, but Still Below Economy's Full Potential

CEOs say Congressional Action on Trade Would Boost U.S. Jobs, Competitiveness, Economic Growth

CEO Economic Outlook

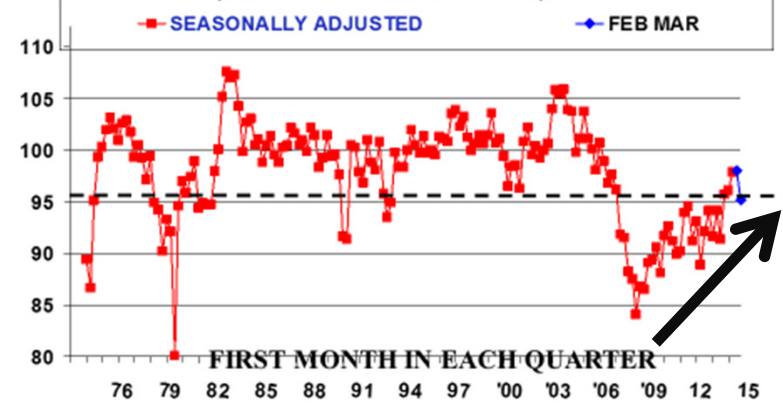


Src: <http://businessroundtable.org/resources/ceo-survey/2015-Q1>

?
 --- CEO Economic Outlook Index
?
 — % Change in Quarterly GDP Annualized(Bil 2009\$)

Business Optimism Also Improves a Little

SMALL BUSINESS OPTIMISM INDEX
(QUARTERLY, 1986 = 100)



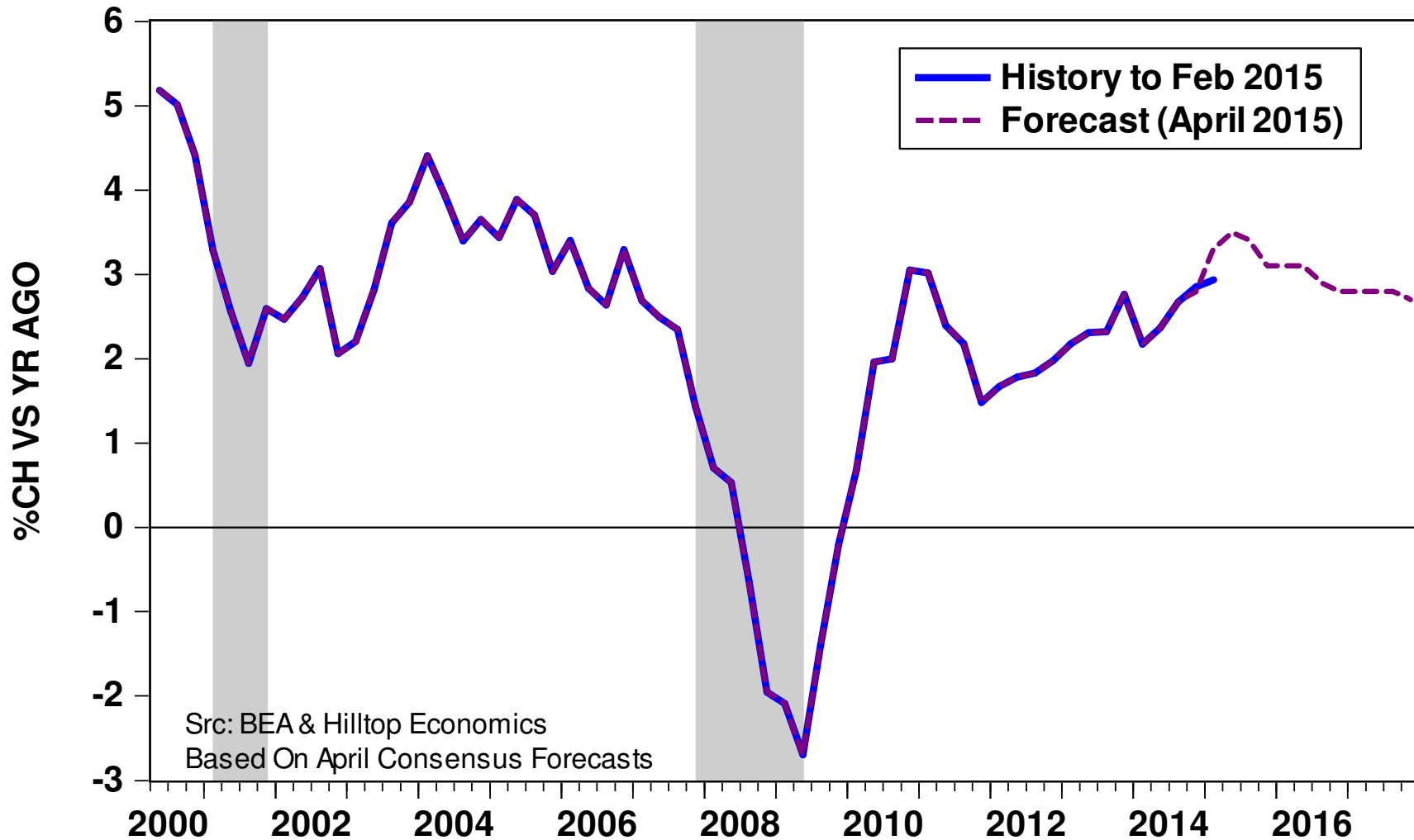
SRC: NATIONAL FEDERATION OF INDEPENDENT BUSINESS
April 14, 2015 Press Release



Key Components in GDP Drive Growth to +2.8% in 2015 and 2016

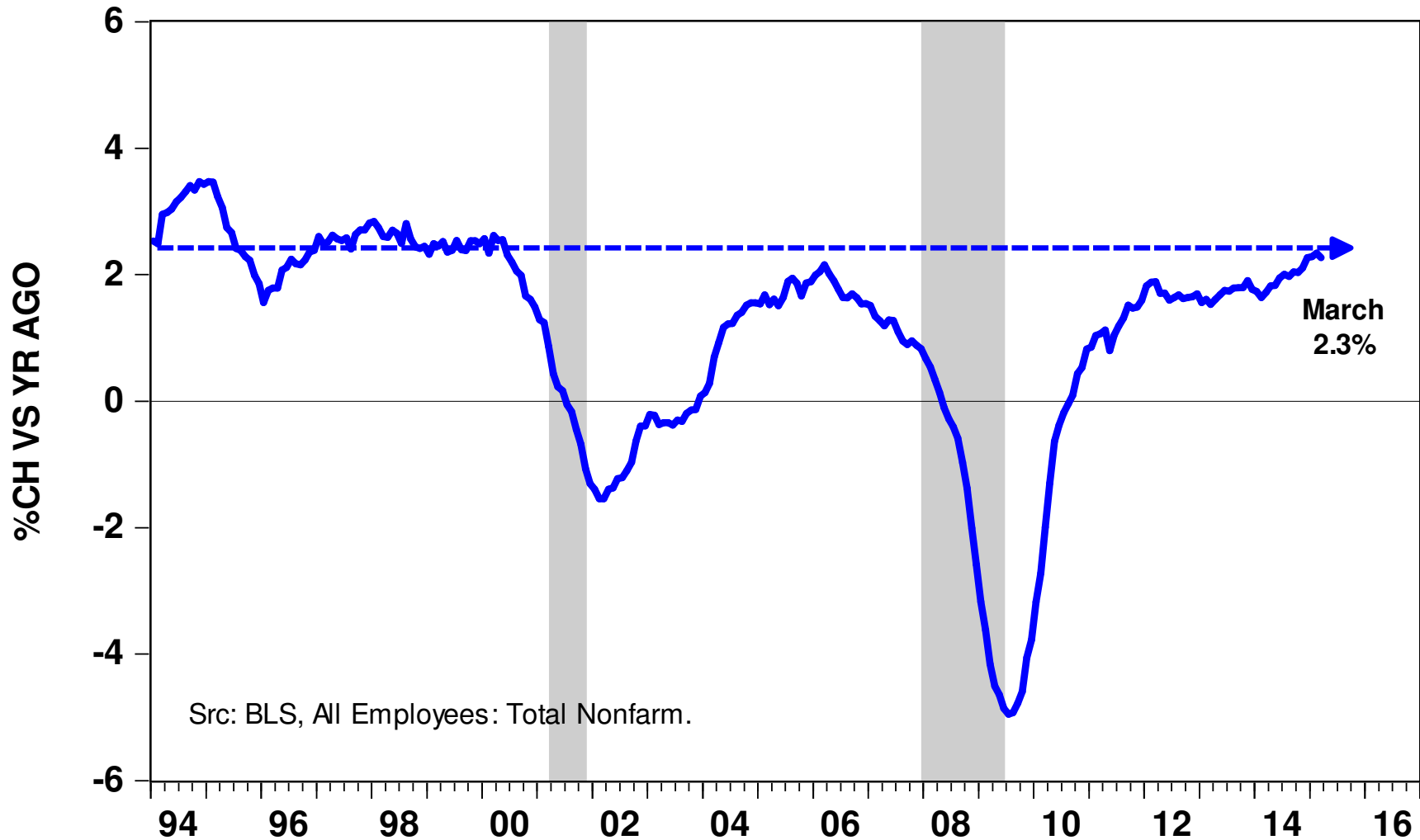
- **Economic policy uncertainty** back in more “normal” range
 - Confidence measures (business & consumer) back in favorable ranges
 - Giving greater chance the consensus will be right this year
- **Consumer** behavior has found a more conservative pattern
 - Job prospects continue to improve
 - Less credit-dependent, less debt, saving more,
 - Low oil prices contribute to better economic environment
 - Spending more judiciously
 - Housing recovers a little more by 2016 as needs build
- **Businesses** begin to invest based on economic opportunities
 - Policies less uncertain (e.g. Dodd-Frank & ACA)
 - Risk aversion slowly receding
 - Topline growth improving modestly
 - Capital costs, while rising, remain low

Real Consumer Spending (68% of GDP): 2015 Strongest growth (+3.3%) Since 2005





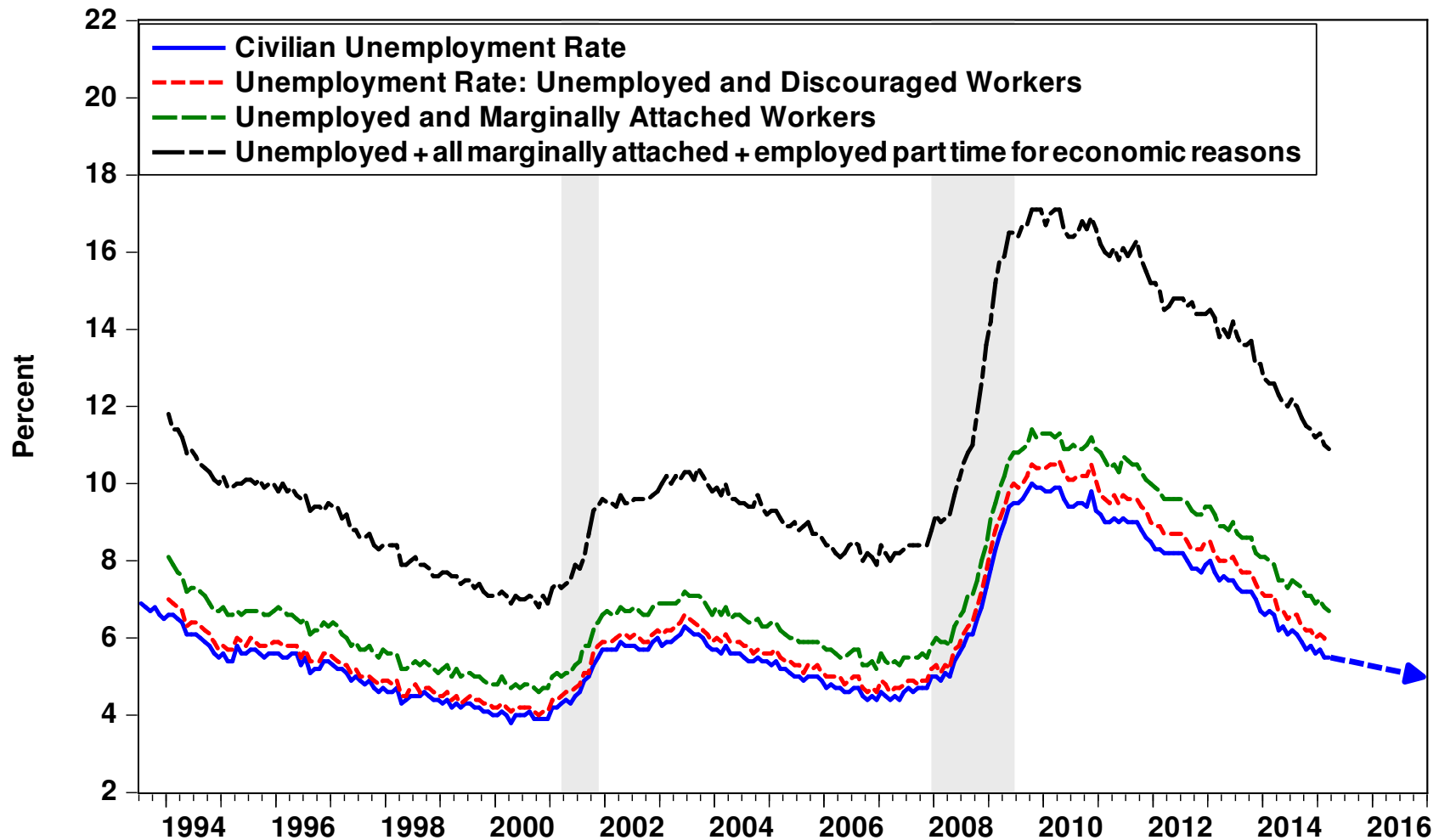
Jobs Growing At Healthiest Pace Since 2000



Src: BLS, All Employees: Total Nonfarm.

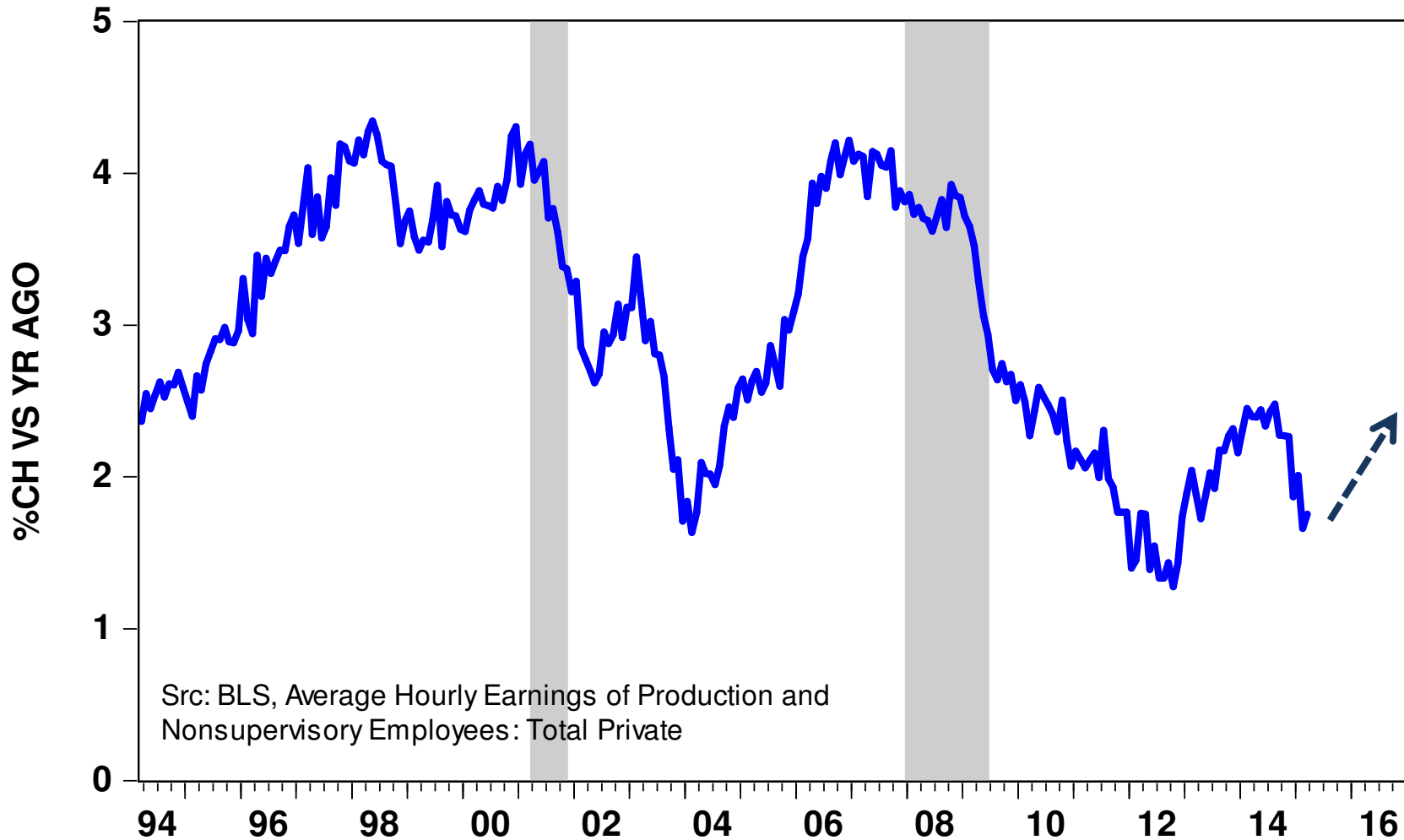
All Measures of Unemployment Rate Still Falling

...getting closer to "full" employment by 2016



Modest Wage Gains Temper Positive Job Impact

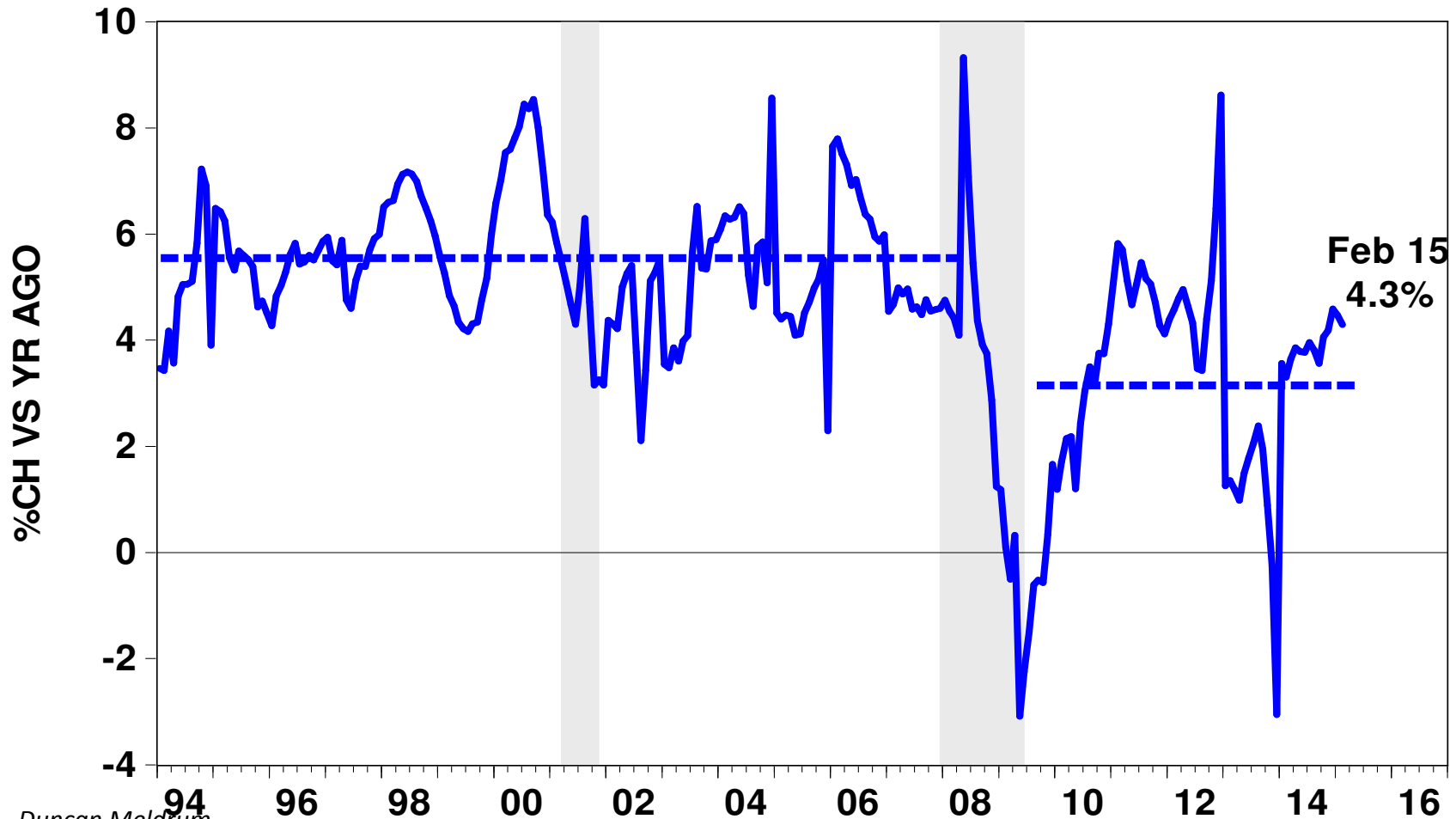
Wage gains should accelerate as unemployment falls



Income Left Over After Taxes:

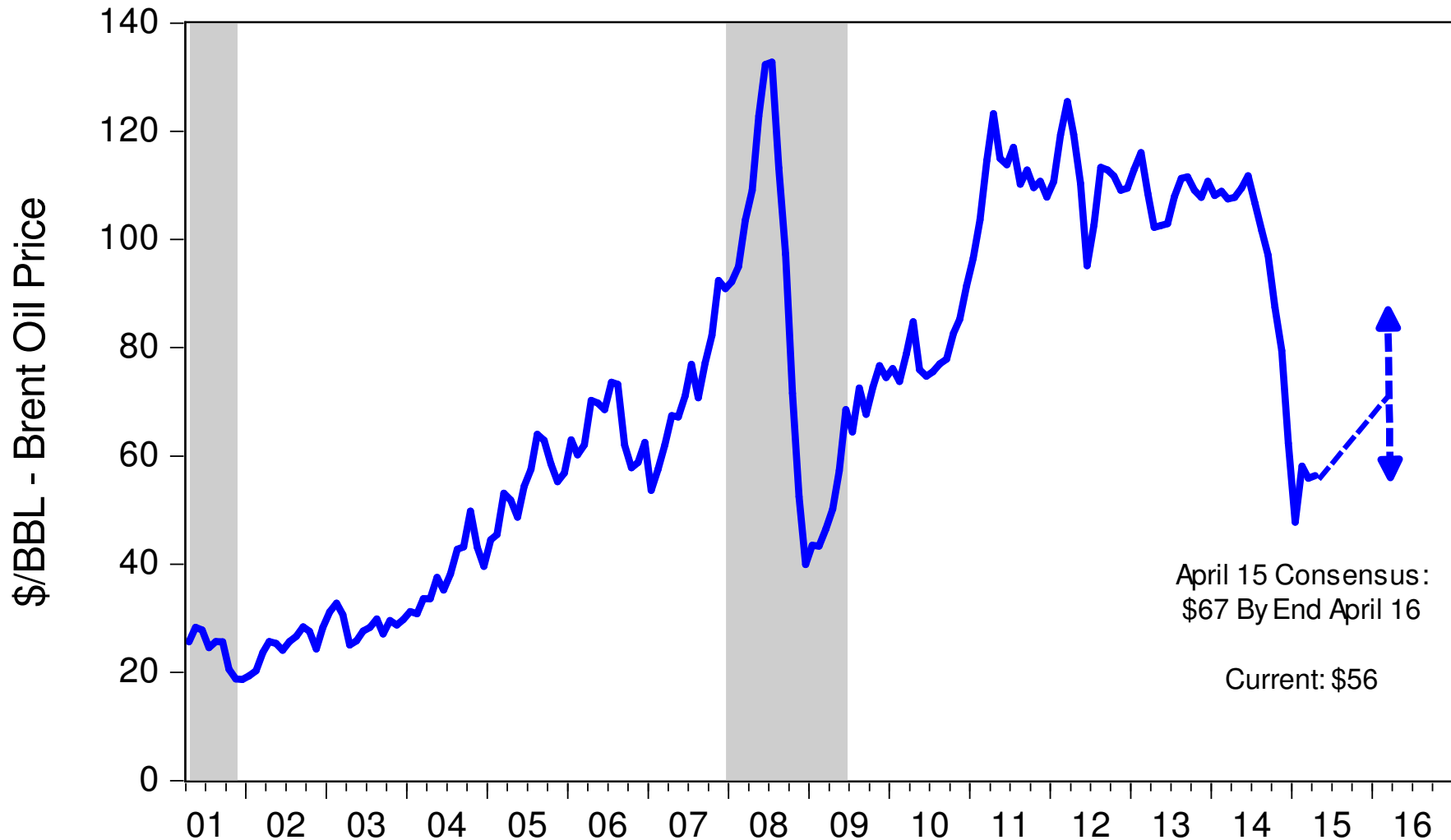
Weak growth since 2009 contributed to modest consumer spending growth

Disposable Personal Income Growth



Global Oil Price Collapse Helps US Consumers

Expected to rise a little, but wide band of uncertainty



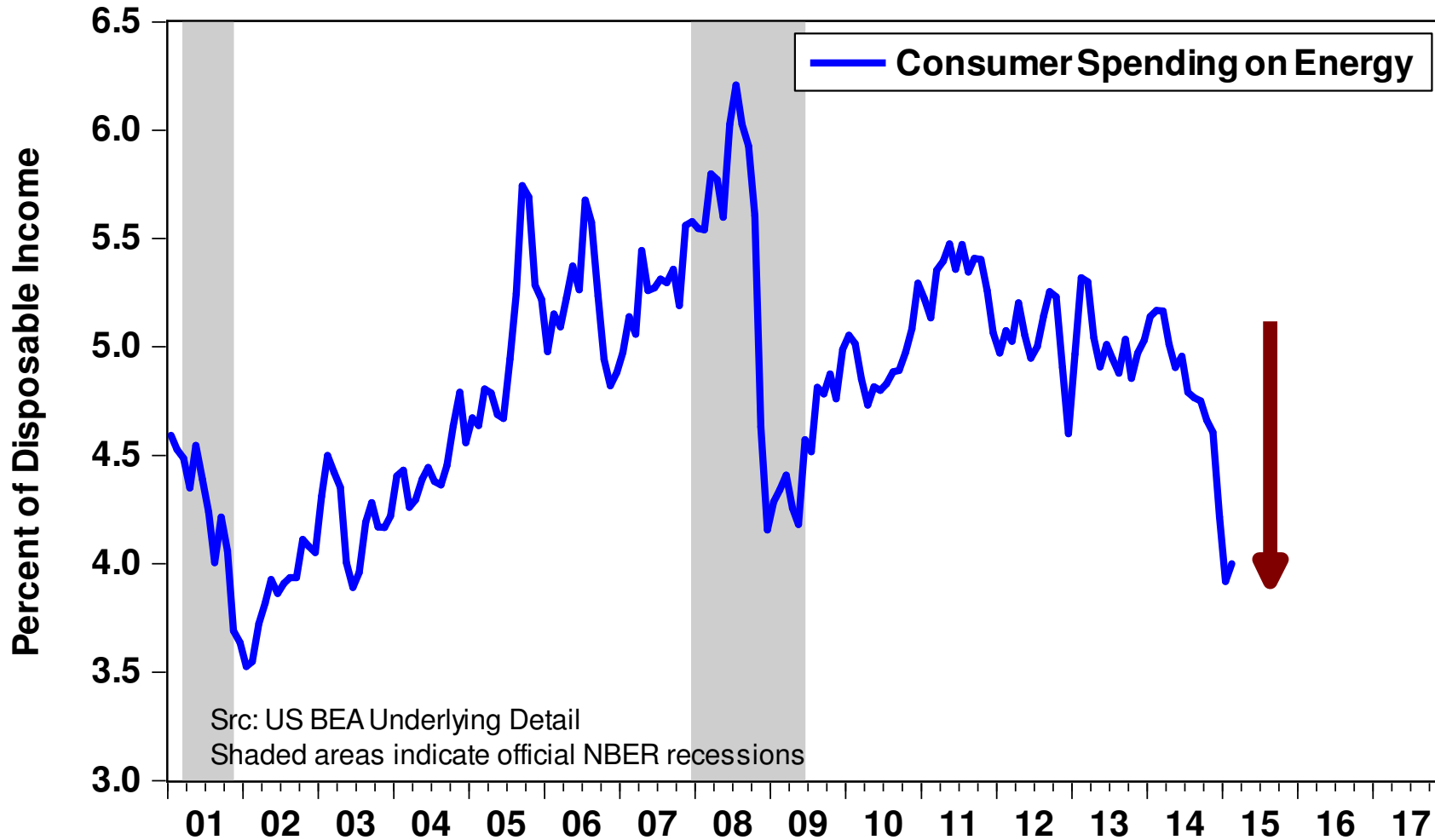
April 15 Consensus:
\$67 By End April 16

Current: \$56



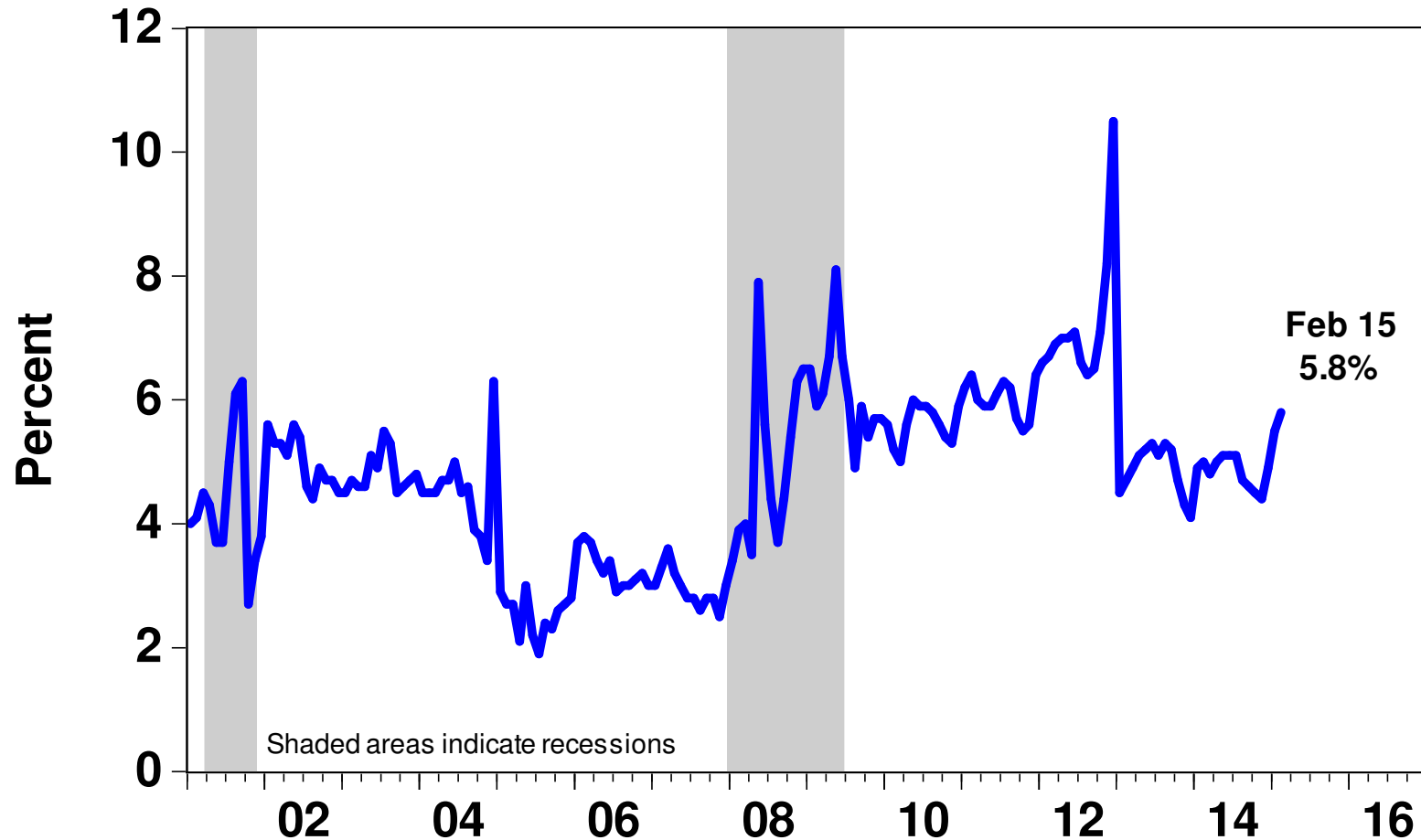
Low Energy Prices Benefit Consumer

Energy price collapse equal to about 1% of disposable income



Consumers More Likely Saving the Energy Dividend and/or Paying Down Debt...

U.S. Personal Saving Rate (%)

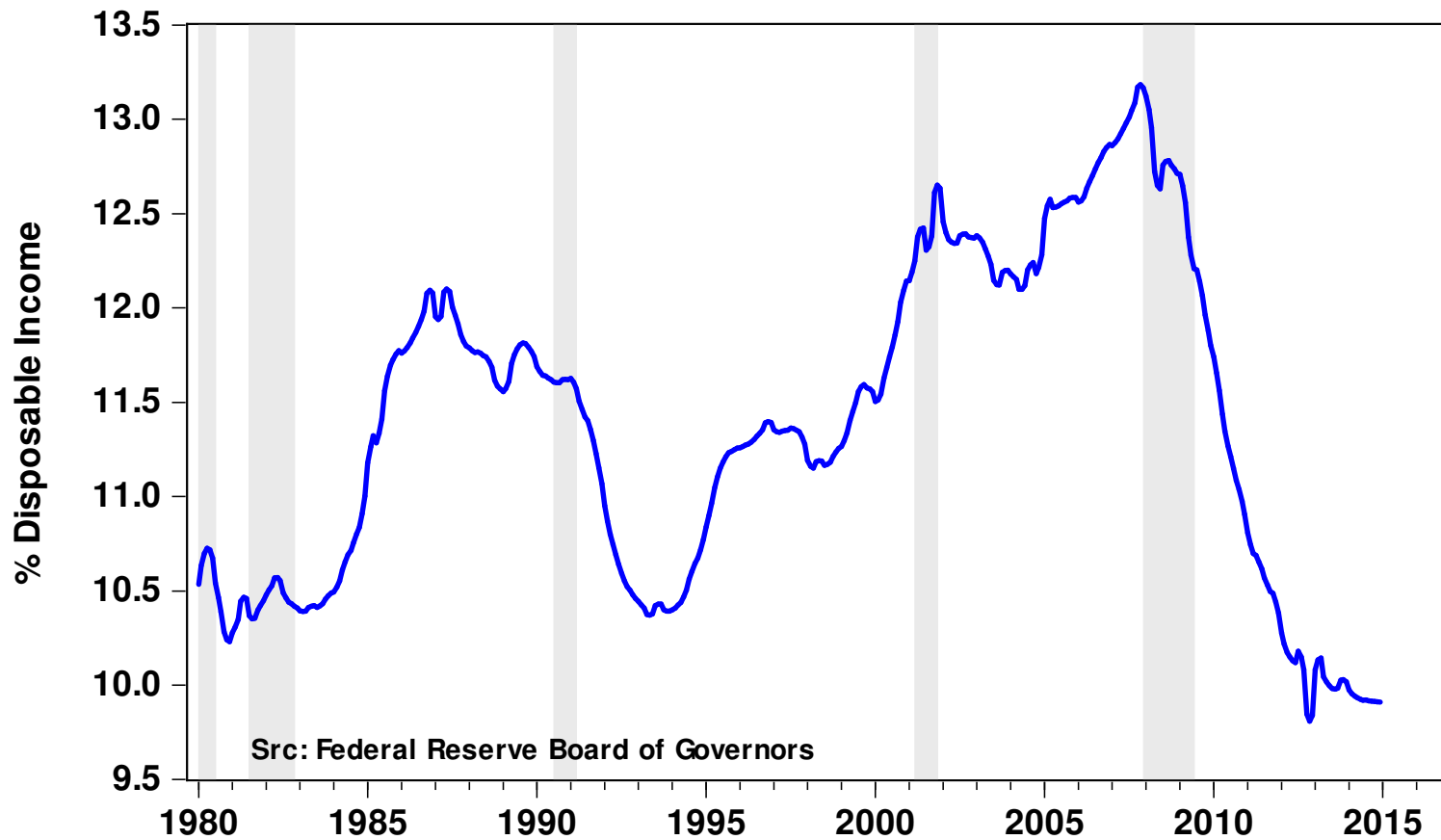




Consumers Paid Down Debt

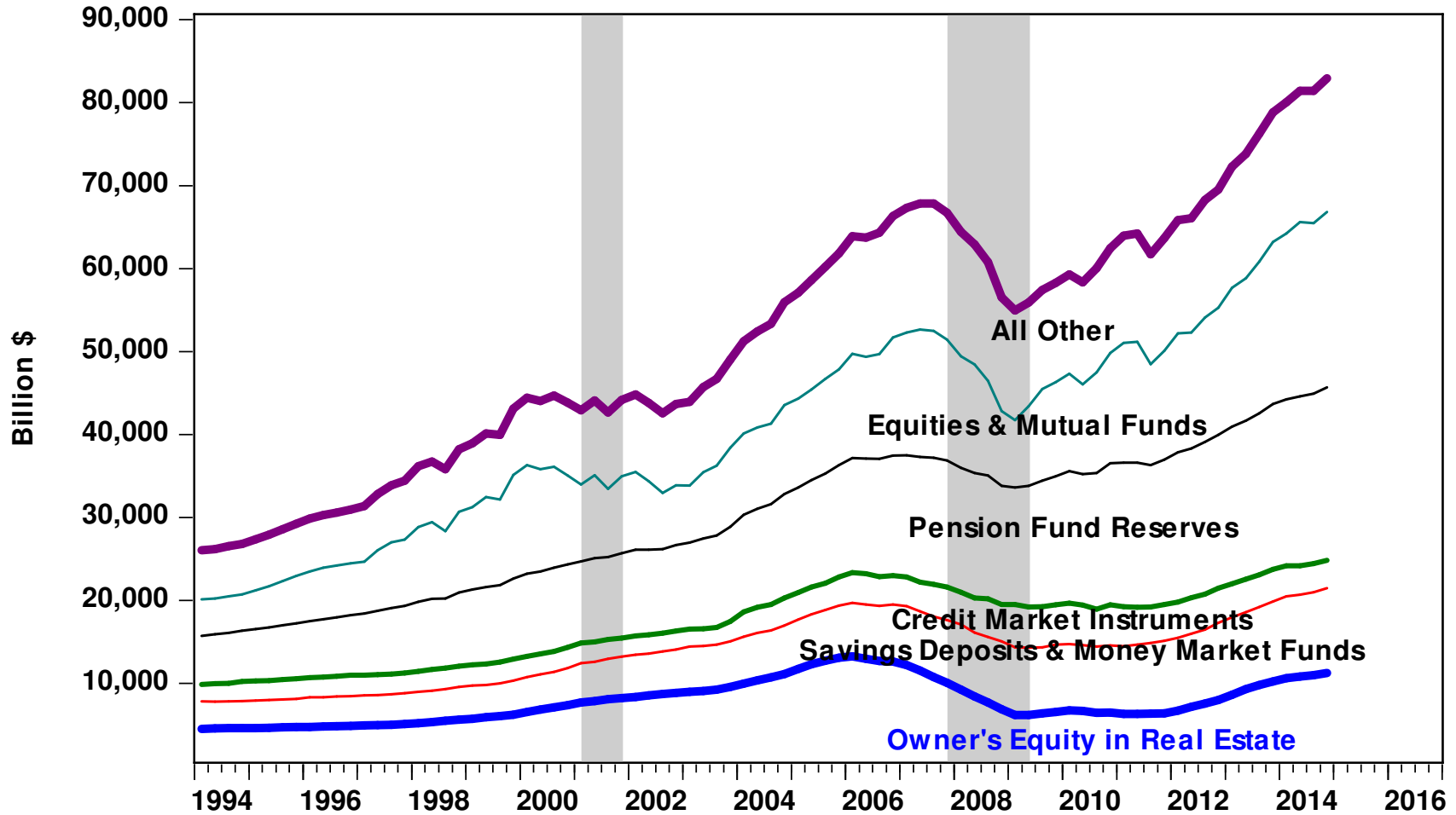
Lowering the debt service drag – helped by low interest rates.

Household Total Debt Service Payments



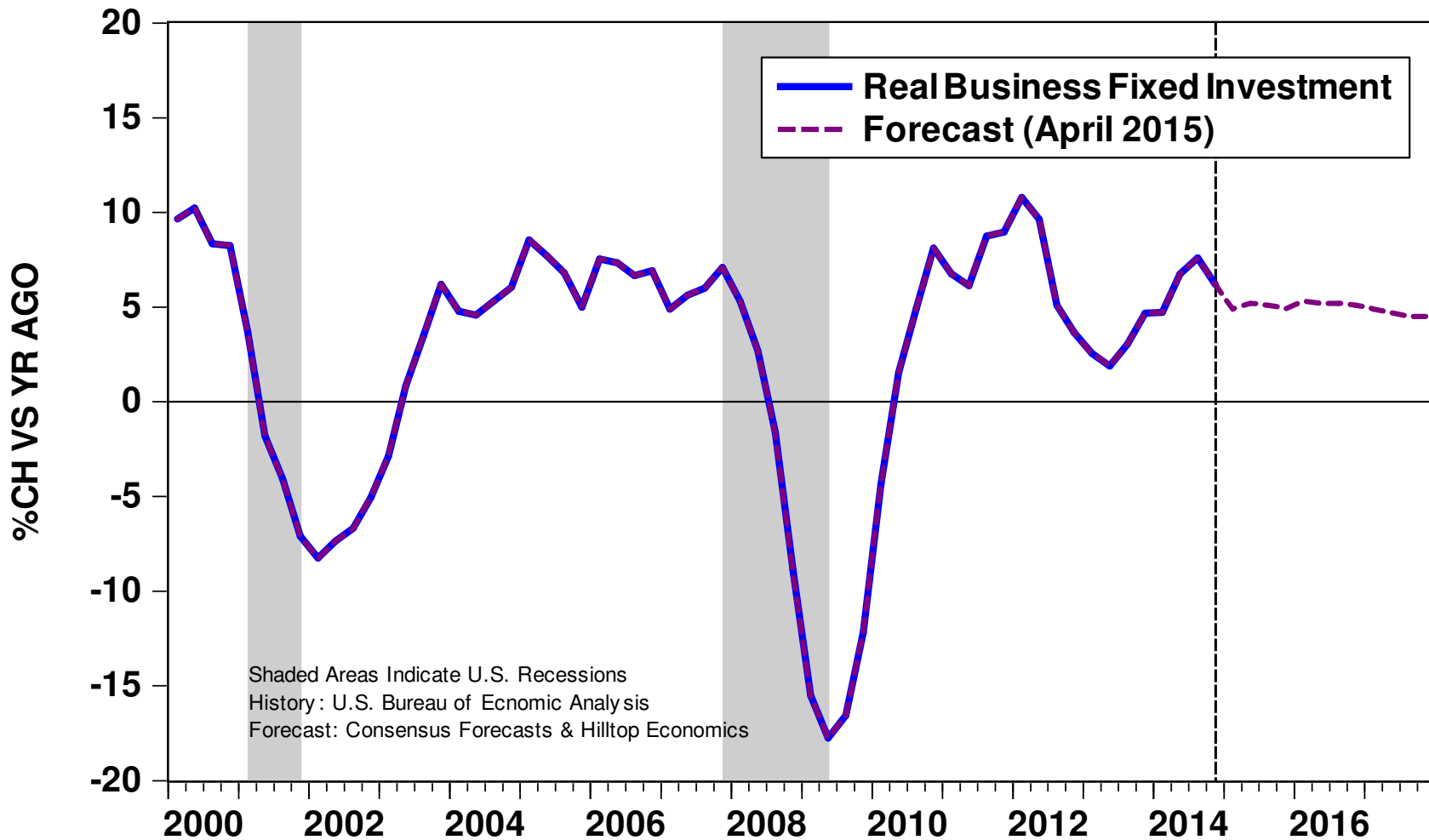
Household Net Wealth Recovered

Real estate equity still below 2006 peak, financial market-wealth well above; benefiting upper income households more than mid-lower income households

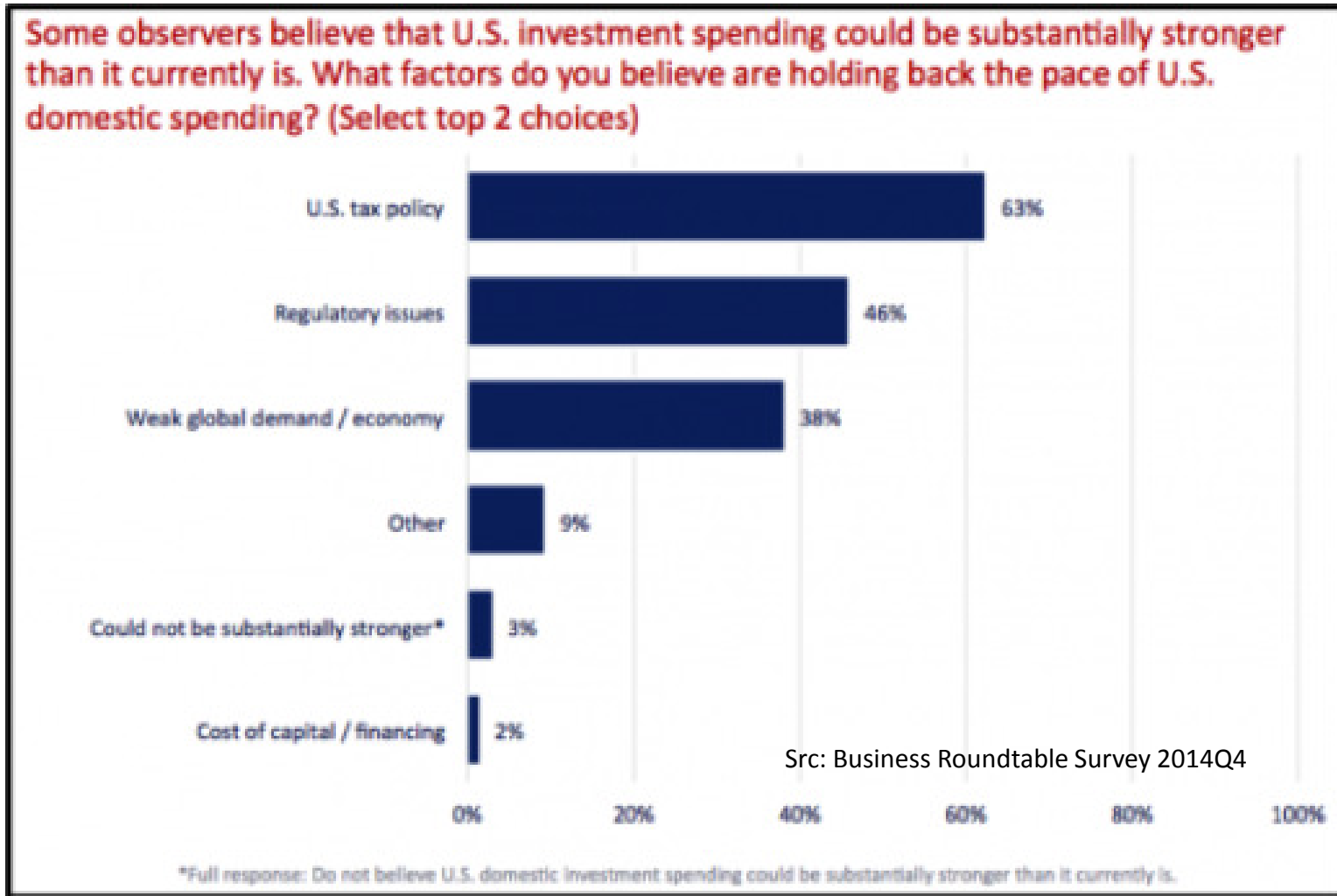


Real Business Investment (13% of GDP):

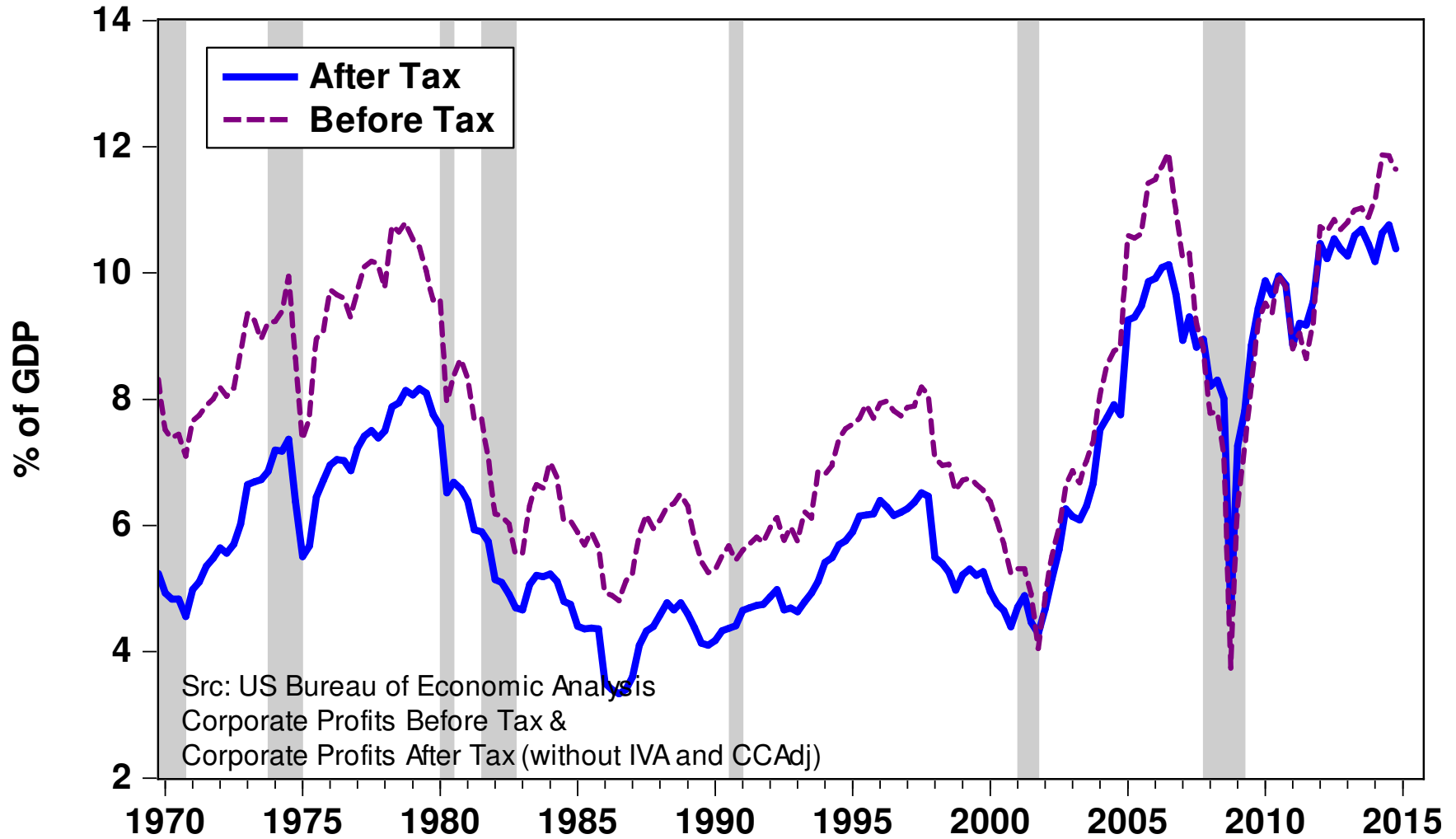
2015 growth slips to still-healthy +4.7%, as energy sector dampens total



Uncertainty Matters to Business

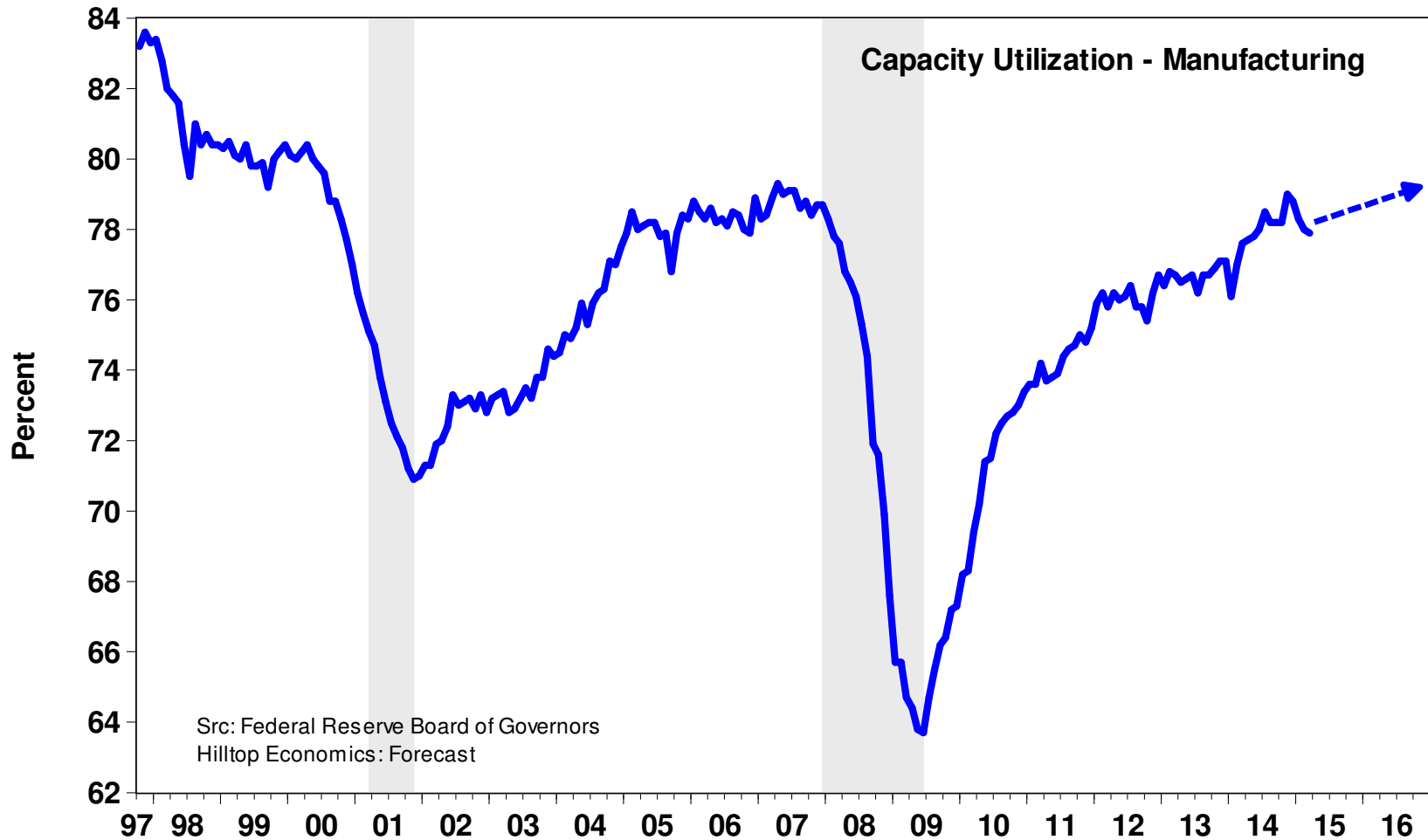


Corporate Profits Favorable for Investment



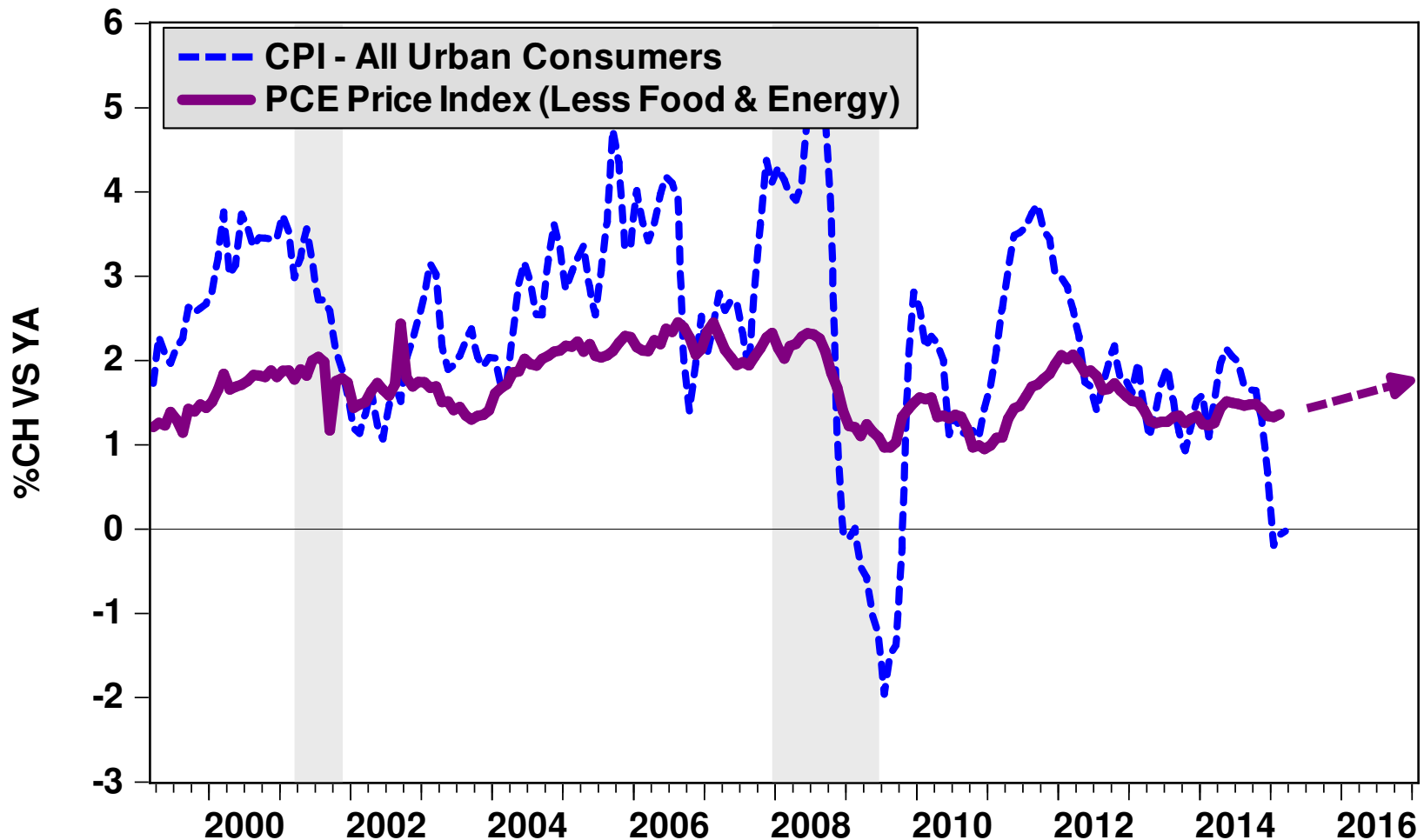
Output Exceeding Capacity Growth

At least since 2014: some price pressures, but a strong impetus to invest in manufacturing and, as output gap closes, the broader economy



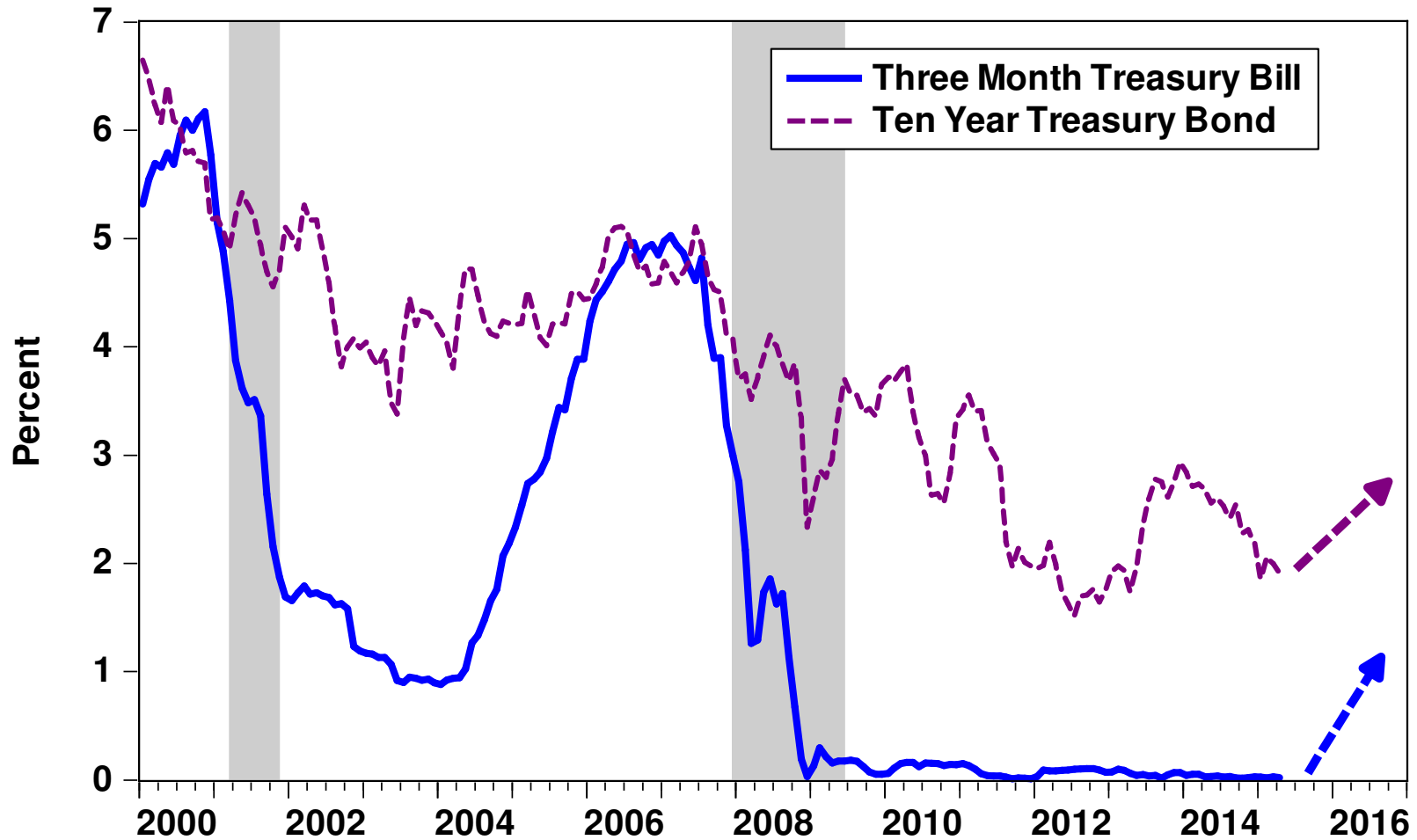
Core Inflation Holds Close to 2% Through 2016

(CPI stays near 0 in 2015, bounces to 2 - 2½% in 2016 with the oil price increase, tightening labor markets and rising utilization.)



Interest Rates: The Fed Moves in 2015

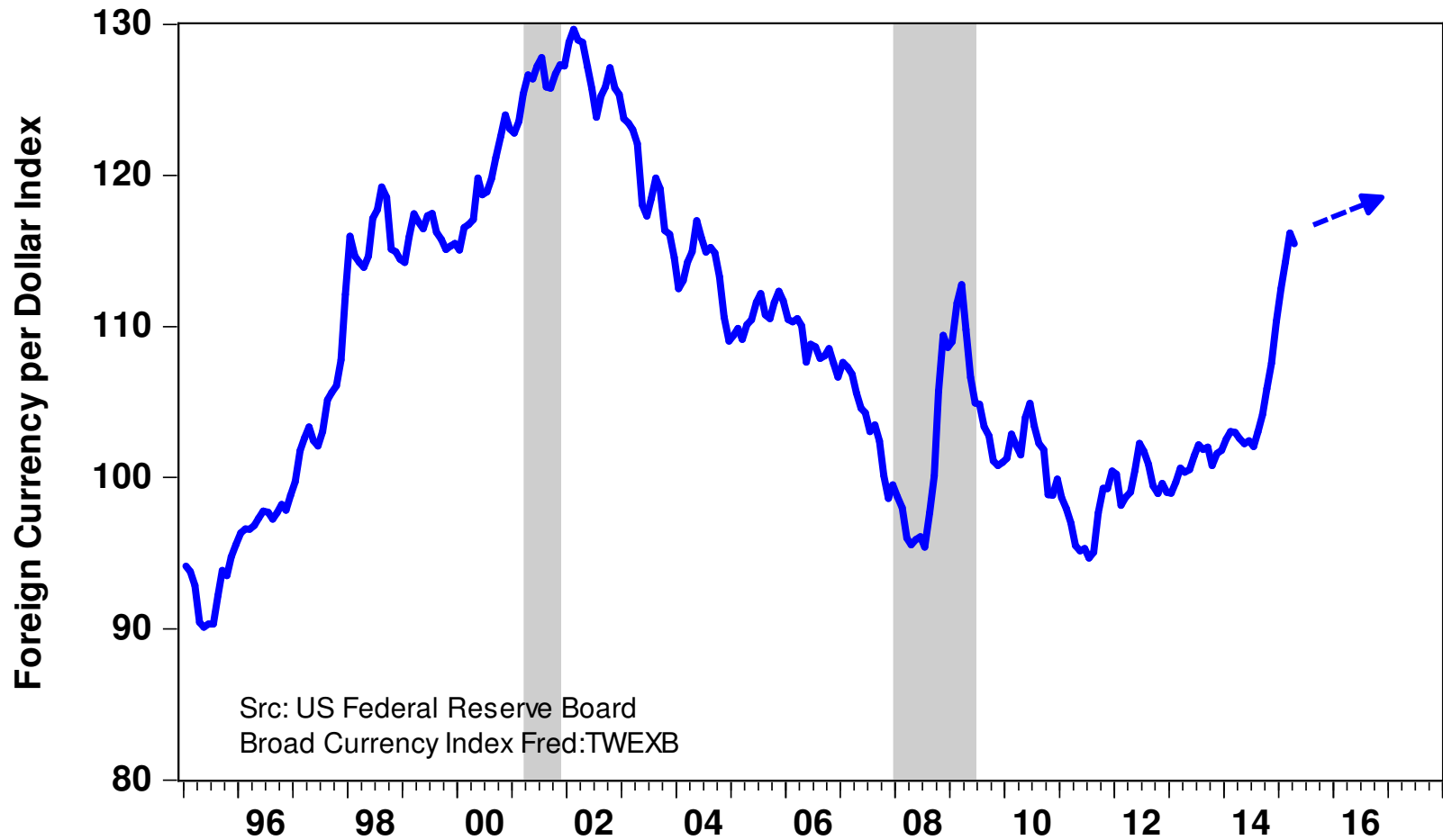
Eventually, and slowly(?); looking for September move





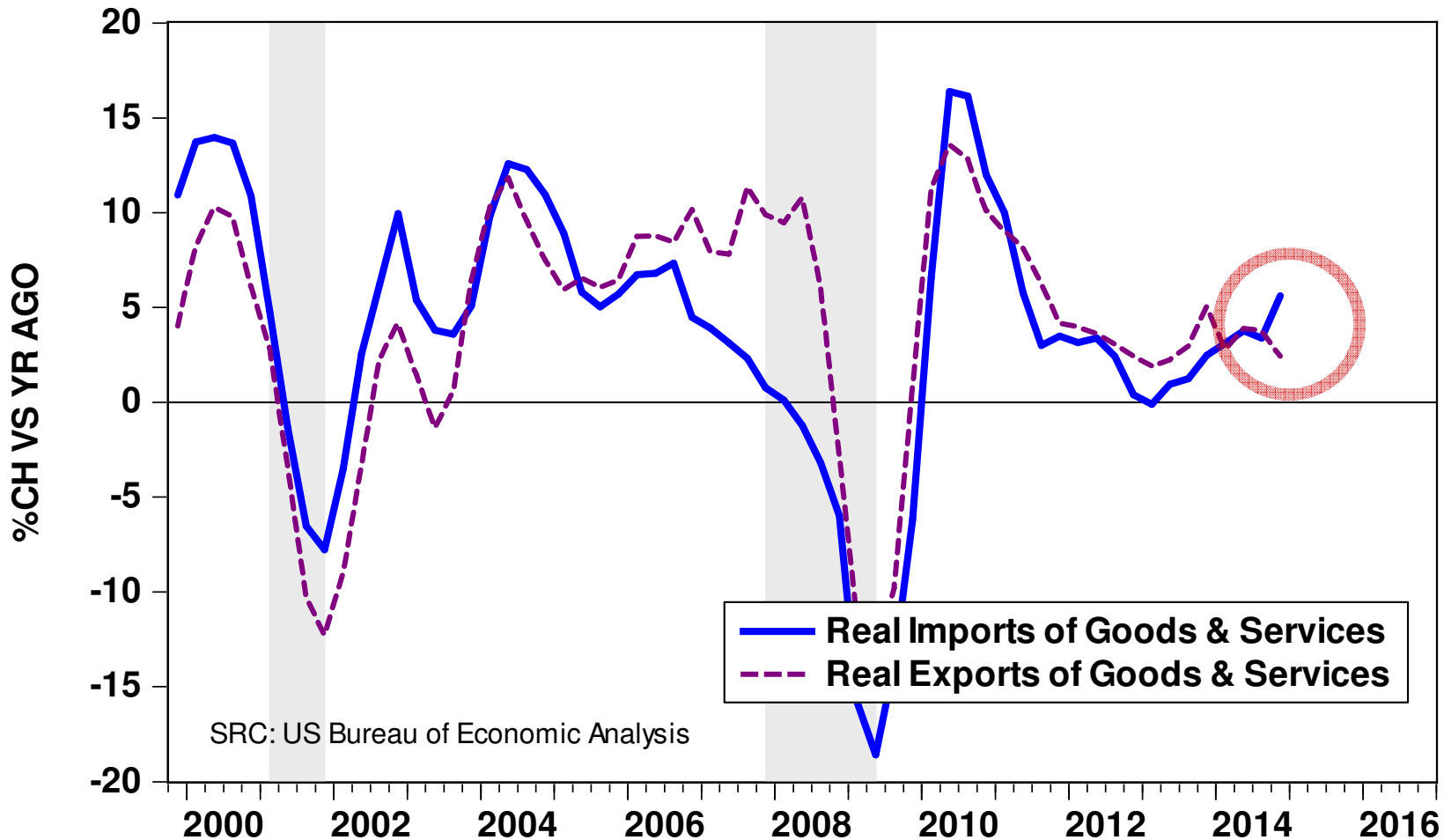
Dollar Expected to Stay Strong

*Rising US interest rate vs foreign interest rates;
Strong dollar tempers import price pressures*



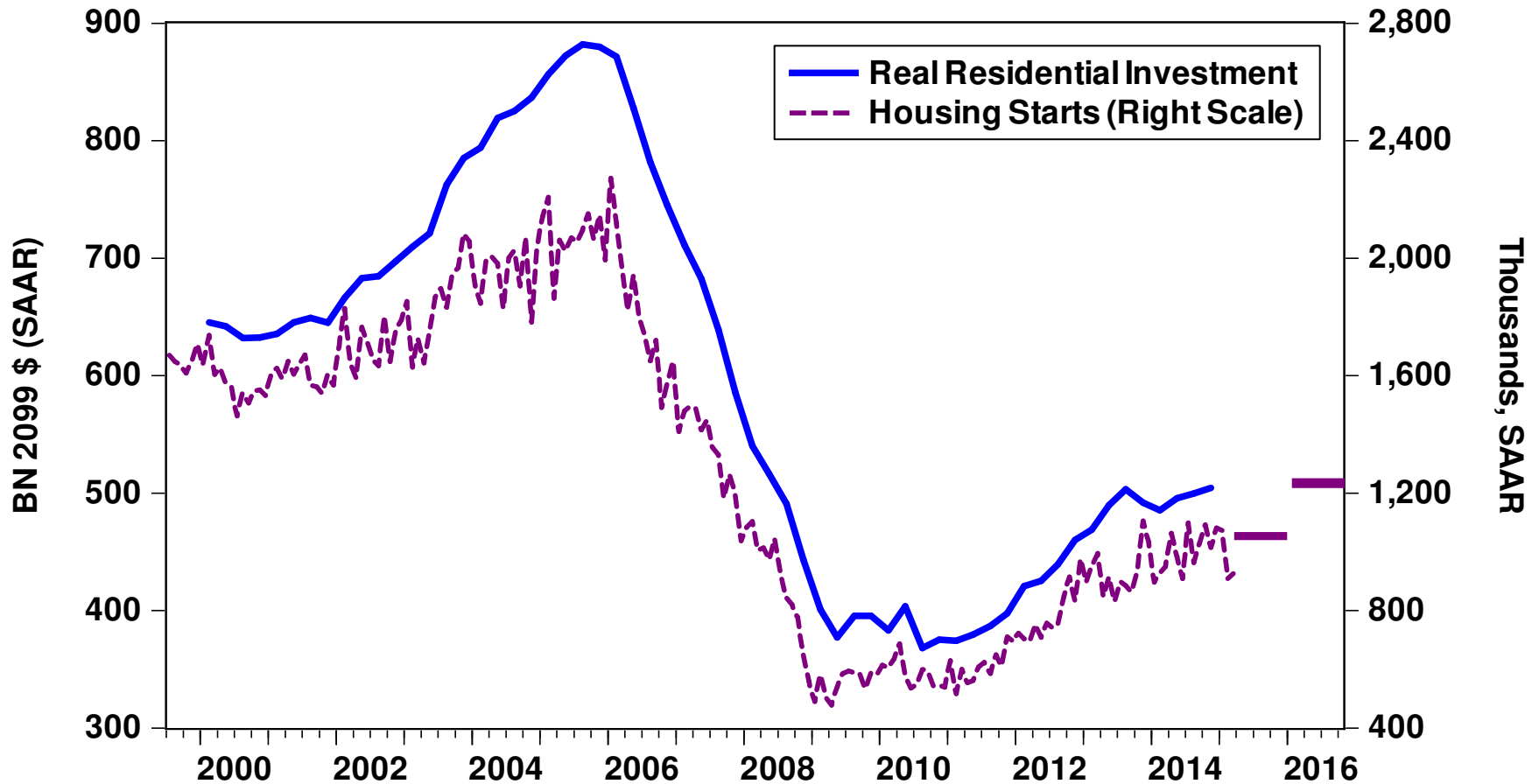
Real Exports vs Imports(-3% of GDP):

Strong dollar, relatively stronger US economy beginning to show in real data...dampens GDP growth a little, but oil net trade reversal mitigates



Residential Investment (3% of GDP)

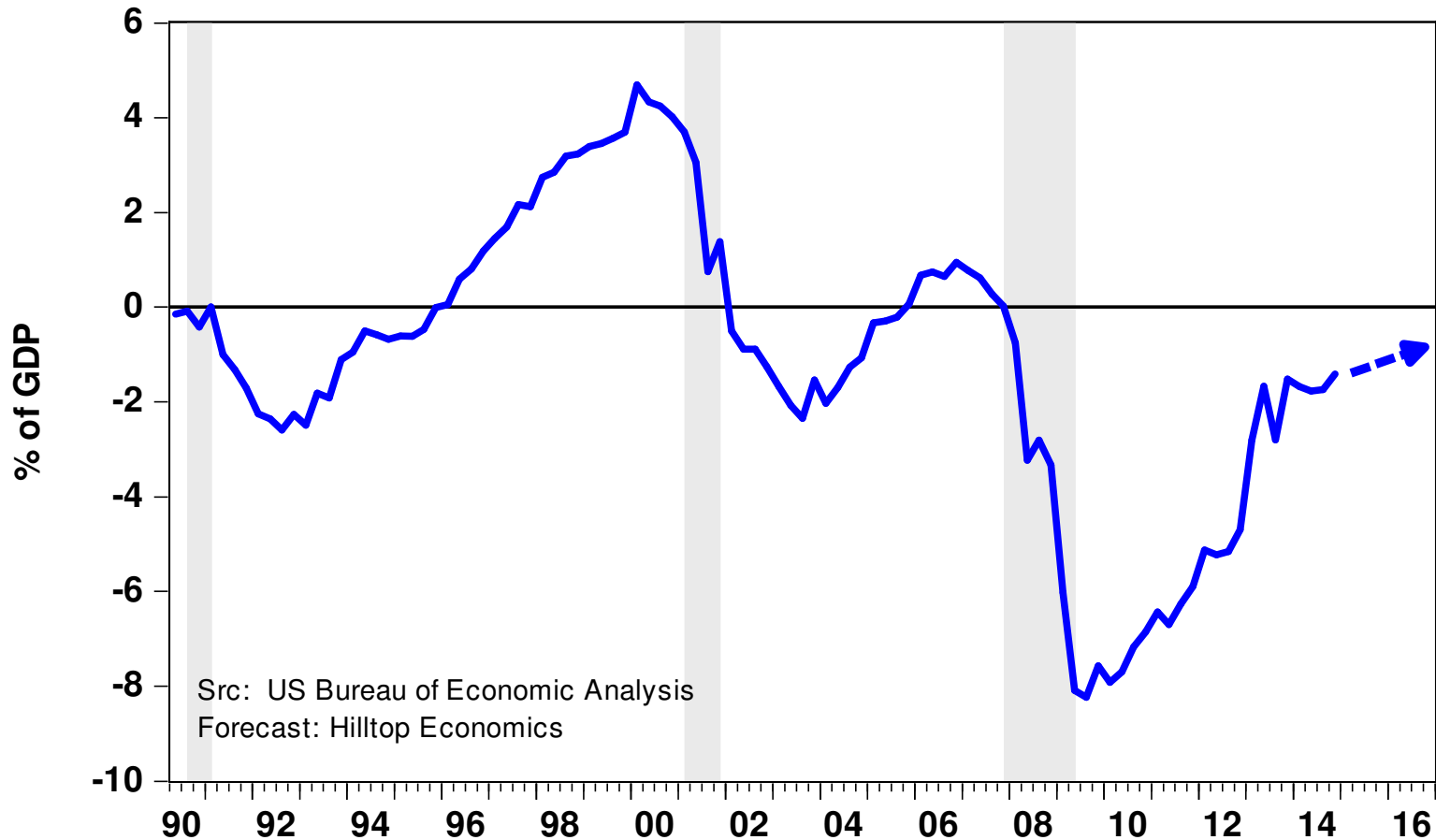
*Housing up 12% in 2015, interest rate increases may actually **STIMULATE** housing starts once the Fed begins to move*



Government (18% of GDP)

Federal, State & Local spending adds just a little to GDP growth in 2015

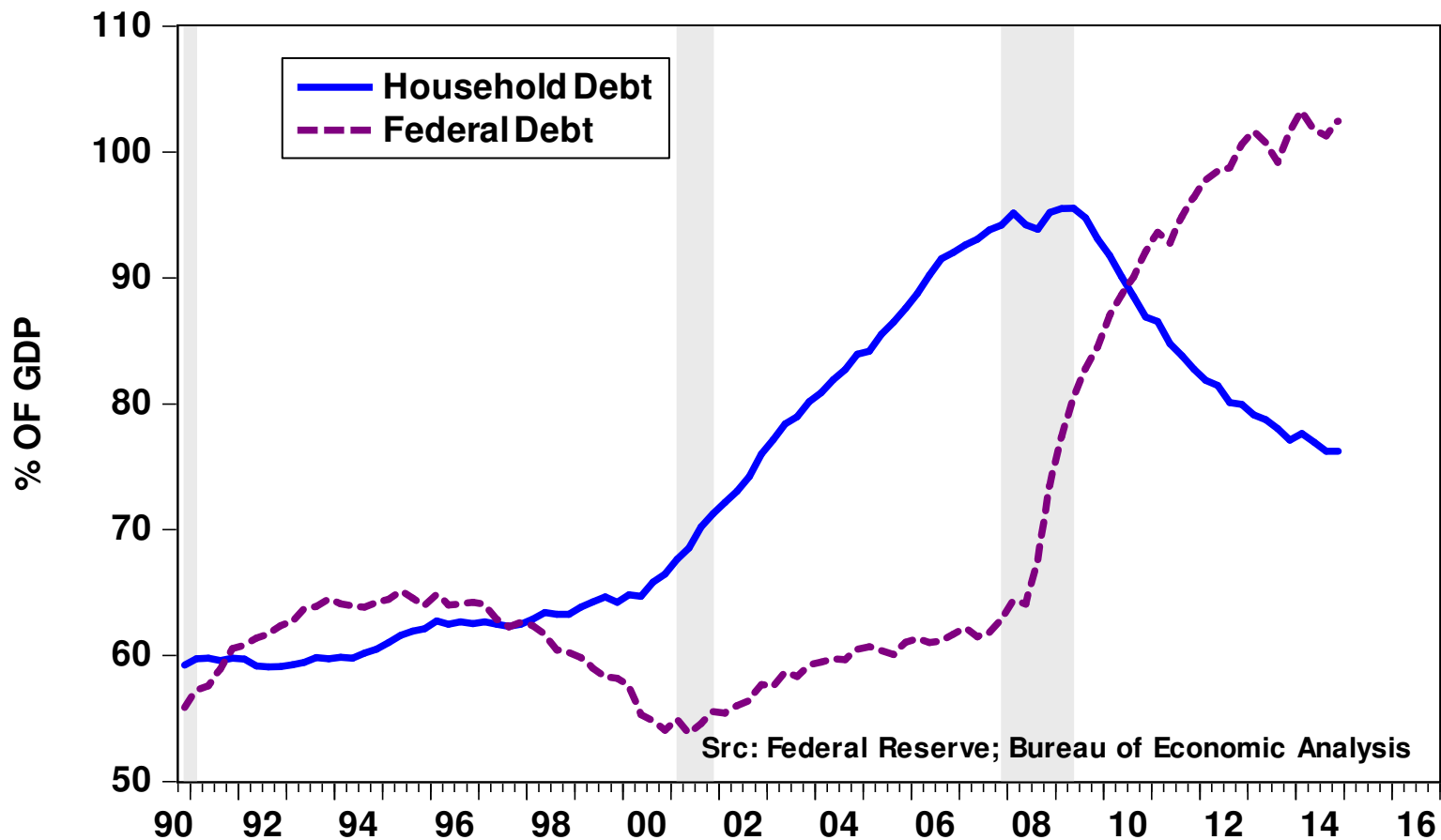
Government Gross Saving (Federal, State & Local)





Federal Debt Remains a Serious Issue

(But the reduction in household debt and changed attitudes towards debt by the private sector reduces impact of federal debt on the overall economy)



Src: Federal Reserve; Bureau of Economic Analysis



U.S. Outlook Summary

- **The economy grows a little more strongly in 2015 and 2016**
- **Consumer spending and business investment drive growth**
- **Inflation remains under control as Fed raises rates.**
 - Oil prices recover
 - Labor markets tighten
 - Capacity utilization rises modestly
 - Dollar strengthens further, somewhat easing inflation pressures
- **Government spending increases remain weak**
 - Fed, State and Local governments continue to work on debt issues
- **This benign economic outlook has risks:**
 - Global geopolitical risks
 - ECB/Japan monetary policy mistakes disrupting global finance markets
 - China slowing more than anticipated, with global ripple effects
 - 2016 election -> increased economic policy uncertainty