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Perspectives on the Global and U.S. Economy

The Economic Club of Las Vegas

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Key Points Today

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- Global economy – especially several major emerging markets – will benefit from drop in commodity prices and weak FX

- Global growth at 3% this year, far short of expectations

- U.S. economy in sustained economic expansion, and will head toward its 8th year of growth by mid 2016 – just 2.2% annualized gain from Q2 2009 through Q2 2015

- Risks and opportunities are balanced – expect more import competition given weak currencies among major exporters

2016 Outlook Summary

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- Strongest sectors of U.S. economy in 2016 likely to be:
  - Housing, chemicals, business services, and health care
  - Consumer spending on services
- Oil price decline to provide positive underpinning for net importers – China and India
- Weak currencies among several emerging markets will yield a dividend next year
- Euro area growth to improve from 2015 pace
- U.K. strength next year to edge down from current 3% pace

Global Data Buffet

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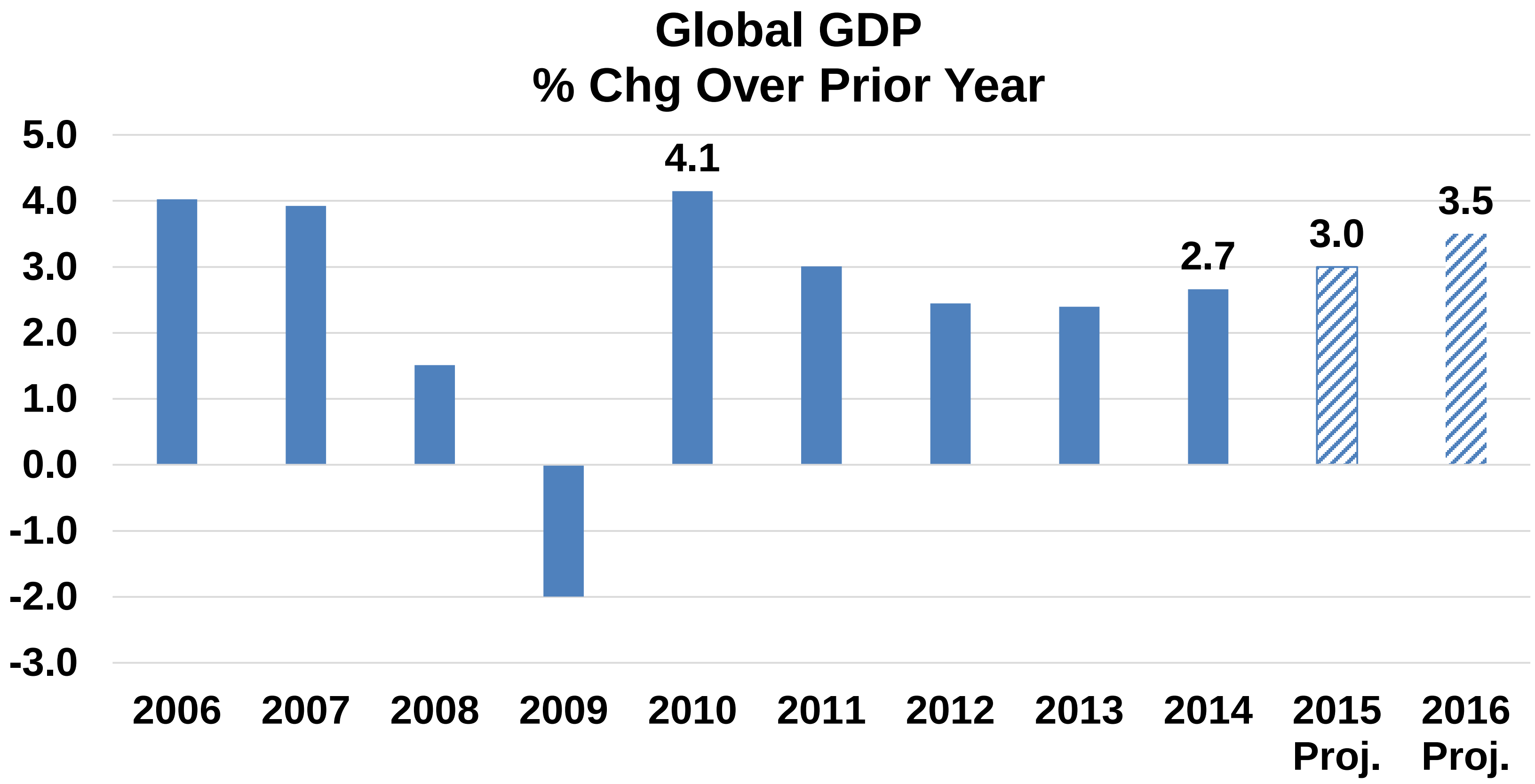
- Accelerating growth in U.S., Europe; slowdowns in major emerging markets likely to stabilize by mid-2016 with recoveries marked by increases in consumer spending and exports; low inflation and low interest rates
- U.S. GDP growth of 3.9% as of Q2 2015 and nearly 3% on a year-over-year basis
- U.K. GDP growth of 2.6% as of Q2 2015
- Euro Area GDP growth of 1.5% as of Q2 2015, accelerating from under 1% last year
- India's inflation has declined from over 10% in 2013 to under 4% as of August
- China in deflation with official GDP growth of 7% in Q2 2015
- Indonesia's economy in a slowdown with GDP growth below 5%
- Brazil's recession and weak growth now extending into the 3rd year with inflation above 9%
- Economic expansions in mature markets range from 1% to 3% pace
- Shrinking Purchasing Managers' Indexes: Brazil, Canada, China, Indonesia, Russia, S. Africa, S. Korea, Turkey
- Inflation at historic lows in many countries; global inflation at 2% as of Q2 2015

Global GDP



Note: Global growth rate, inflation adjusted, at market exchange rates; historical data are IMF World Economic Outlook (October 2015); author's estimate for 2015-16 outlook

Global Commodity Price Declines

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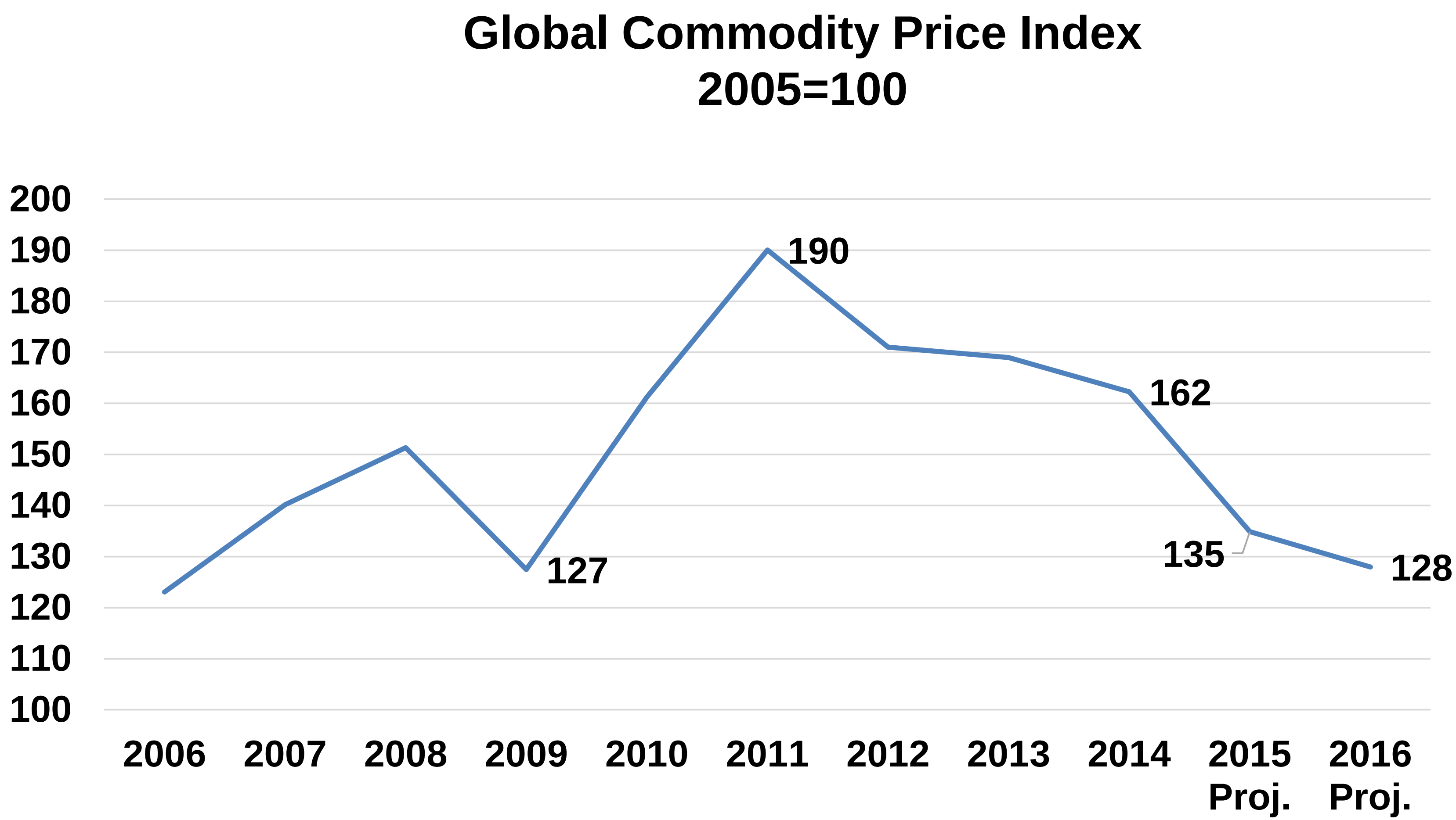

Source: IMF World Economic Outlook, October 2015; non-fuel, includes food and beverages and industrial

USD Up Cycle

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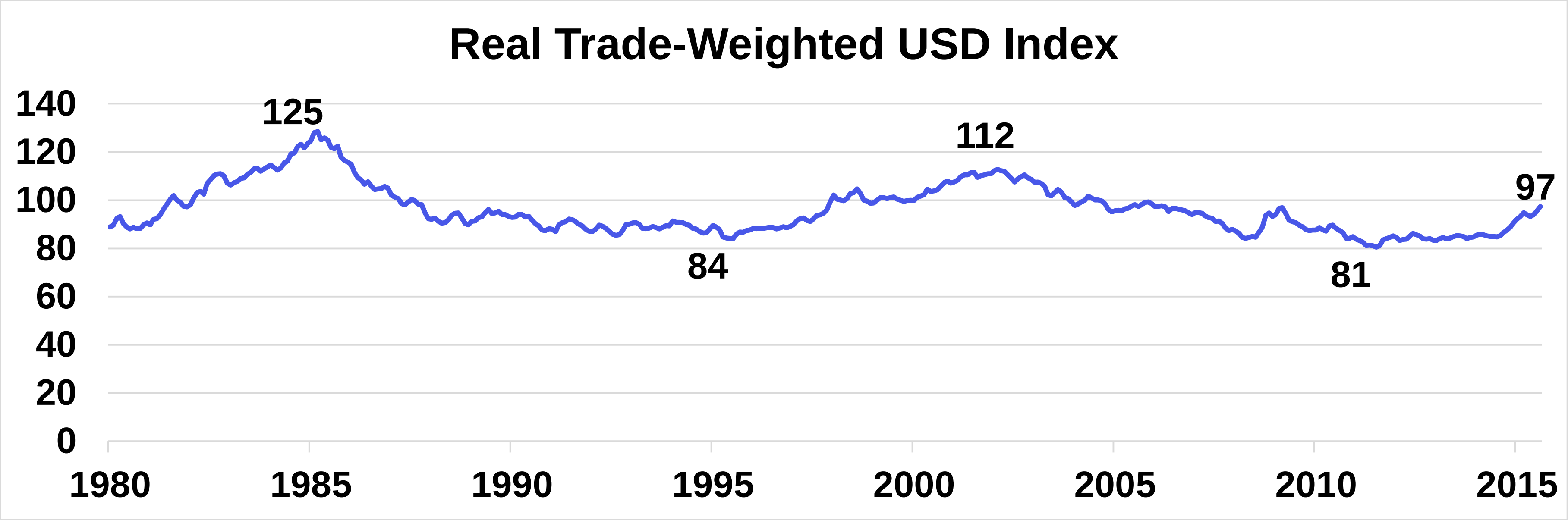
- USD bull run may be through initial phase: Expectations adjustment resulting from improved growth outlook and Fed closer to policy pivot point
- Real trade-weighted USD up 20% since 2011 trough over nearly 4 years
- Two prior USD up cycles shown in chart lasted 6+ years and were cumulative gains of 52% in the early 1980s and 34% in the 1990s



Emerging Market Monetary Policy

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- Several emerging market central banks have adopted conventional monetary policy principles and strategies (e.g., India, Brazil) but also attempting to limit bubbles
- Others have struggled with adopting monetary policy objectives which focus on price stability at the expense of short-term economic growth (e.g., Turkey)

India
- Inflation has declined from over 10% in 2013 to below 4% as of August 2015
- Governor Rajan has led Reserve Bank of India to reduce policy interest rate to 6.75%
- Likely to edge interest rates lower as inflation expectations stay within 4% target range

Brazil
- Inflation above 9%; central bank holding interest rates at highest level of any EM at 14.25%
- Weak currency has contributed to sticky inflation even though the economy is in recession

Turkey
- High inflation of 7% has contributed to currency weakness: central bank lowered the policy interest rate from 10% to 7.50% even as inflation remains high
- Political economic forces prevail and could impact long term growth potential

China
- Incremental policy changes to help bank liquidity in the context of a housing correction; recent reduction in deposit and lending rates are still modest adjustments; expect more reductions in reserve requirements and more market determined FX

Globalization Forces

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- Take-off stage of economic development
- Capital markets interconnected
- Oil
- Strong dollar
- IT

Drivers for Global Growth Uptick In 2016

- Ultra-stimulative monetary policy – global interest rates very low
- ECB QE2
- Weak oil and EM FX (e.g., 1998)
- Improving domestic demand growth in mature markets
- Commodity pricing trough
- Inflation low

U.S. Business Cycle

- 33 cycles since mid-1800s
- Current economic expansion started in June 2009
- It is now in its 25th quarter of expansion
- Since WWII, only 3 expansions have lasted as long as current one
- 1961, 1982, and 1991

Expansions do not die of old age

It matters that this expansion is still going after 6 years

Better to have sustained, somewhat lower growth than recessionary setbacks

- BEA's National Income and Product Accounts
- Billions of chained (2009) dollars
- Time series data since WWII*
- Calculate cumulative % change from trough for each of the 9 business cycles
- Compare average performance of the 9 cycles to current cycle performance
- In the following slides, the blue line is the current expansion and the green dashed line is the average of prior cycles
- The data are measured from 6 quarters prior to the trough and 24 quarters beyond the trough

* For detailed components of consumer spending on services, used 6 prior business cycles

U.S. Real GDP

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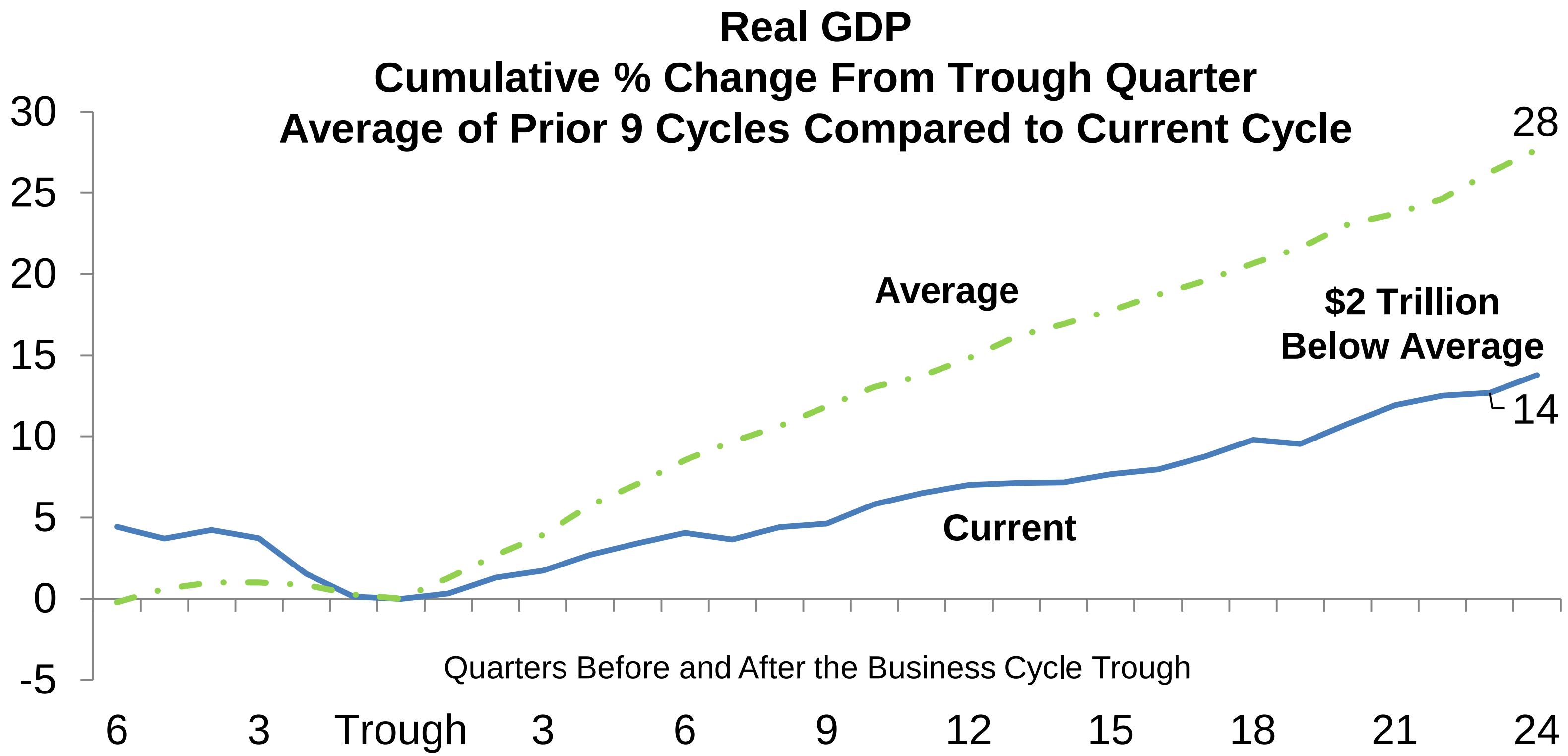

- The average of 9 prior expansions grew a cumulative 28% from the trough
- The current expansion is one-half that pace at 14% gain since Q2 2009
- If the current expansion had been at average speed, it would translate into an additional $2 trillion of real income or over $6,500 per person*

* Civilian noninstitutional population

U.S. Consumer Spending on Durable Goods

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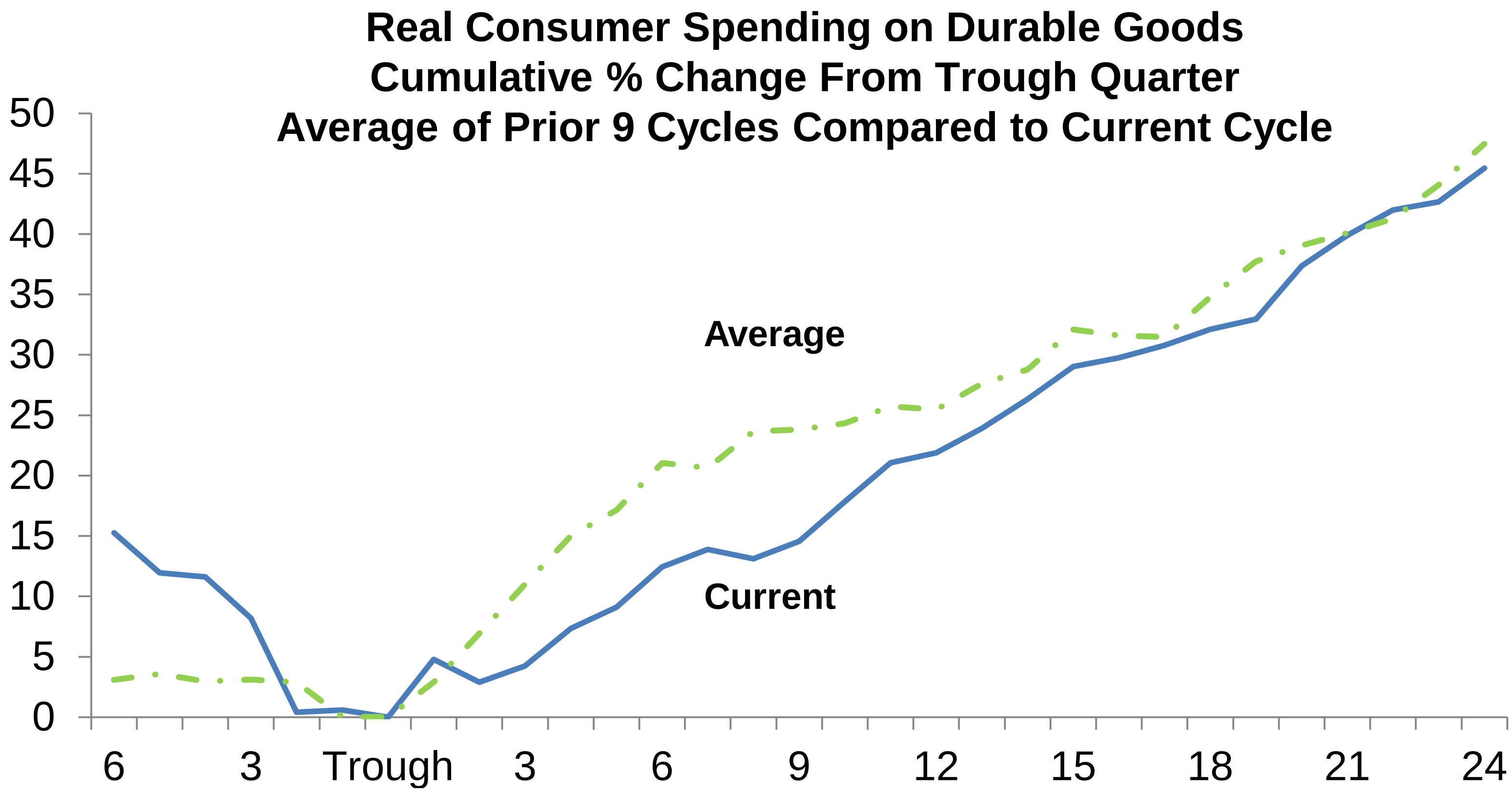

- Consumer spending on durable goods has nearly matched the average pace of expansion
- The demand is centered on automotive purchases
- But even spending on appliances and furniture have done well
- Funding channels are open and wealth effect supports this sector of the economy

U.S. Consumer Spending on Services

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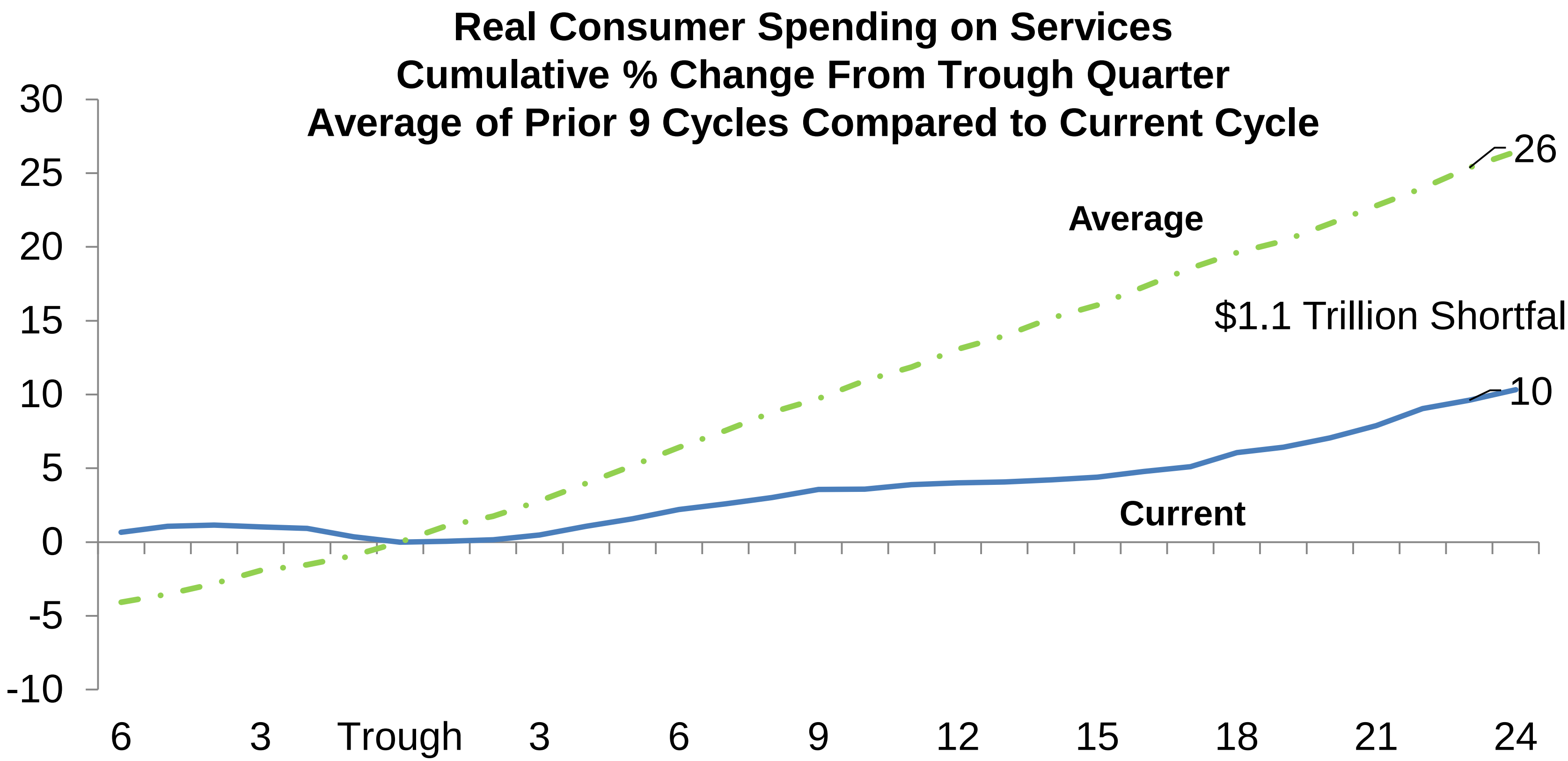

- The big hole in GDP in current cycle is demand for consumer services
- As of Q2 2015, $1 trillion below average
- Represents 60% of the below-average GDP performance

U.S. Capital Spending

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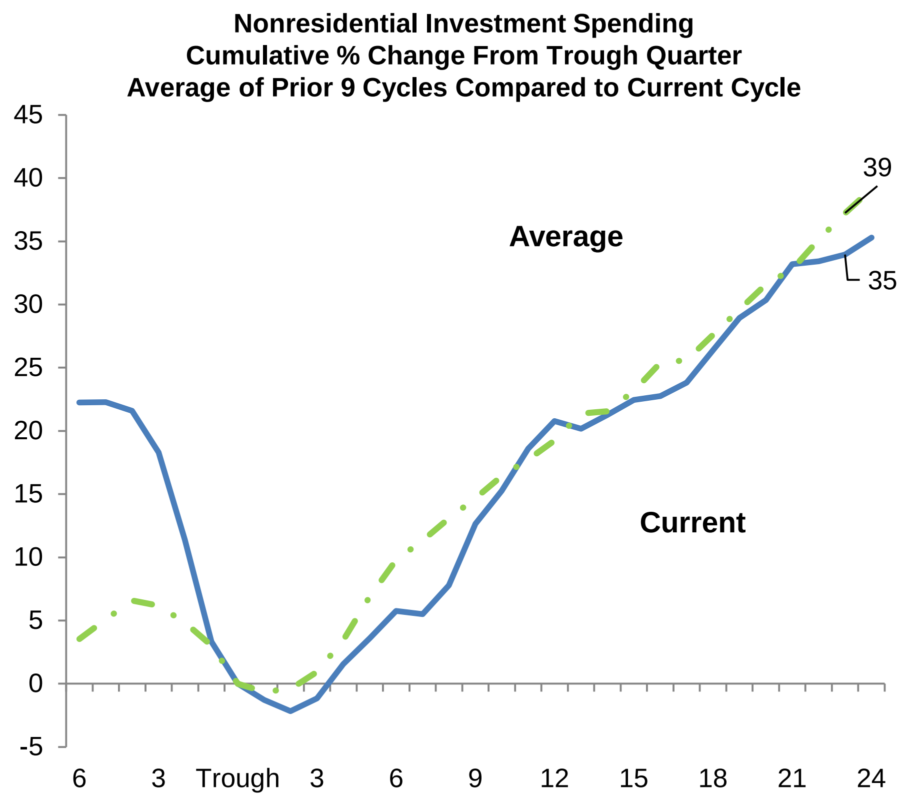

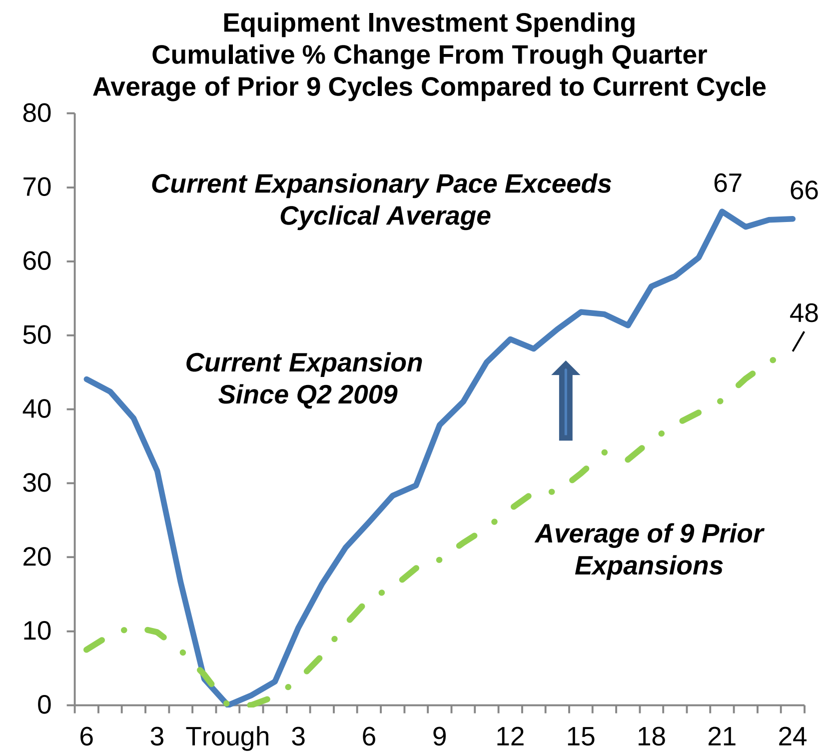

- In the aggregate, nonresidential investment spending is growing at historical average rate
- First half 2015 setback
- Business spending on equipment is the outperformer among all major end markets
- This lays substantive groundwork for productivity growth in the years ahead

U.S. Private Construction Spending

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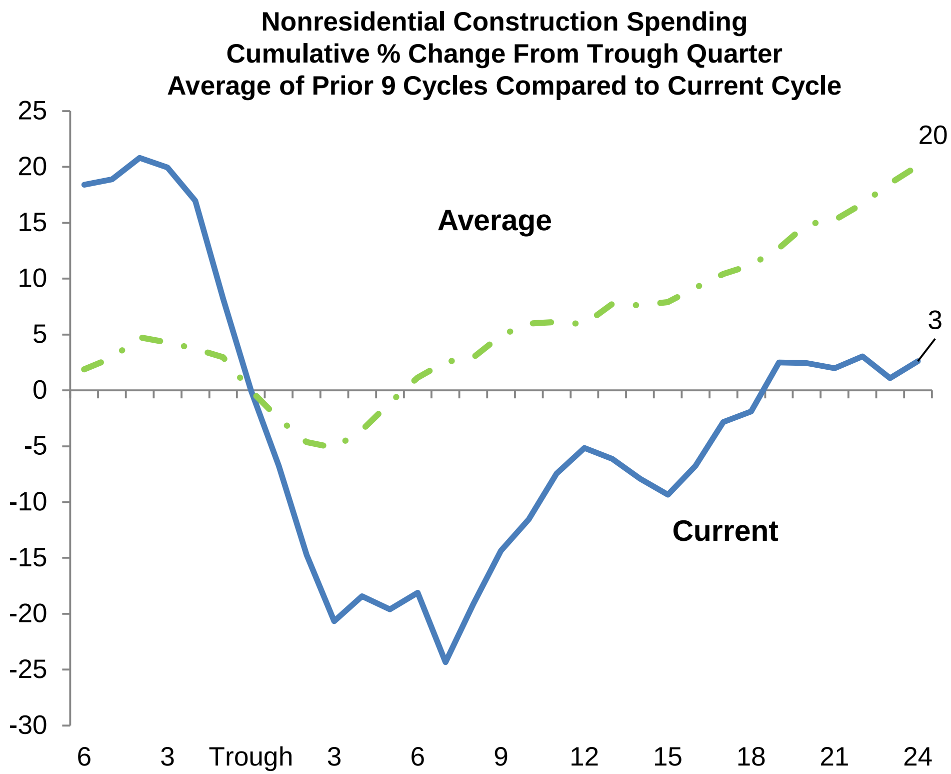
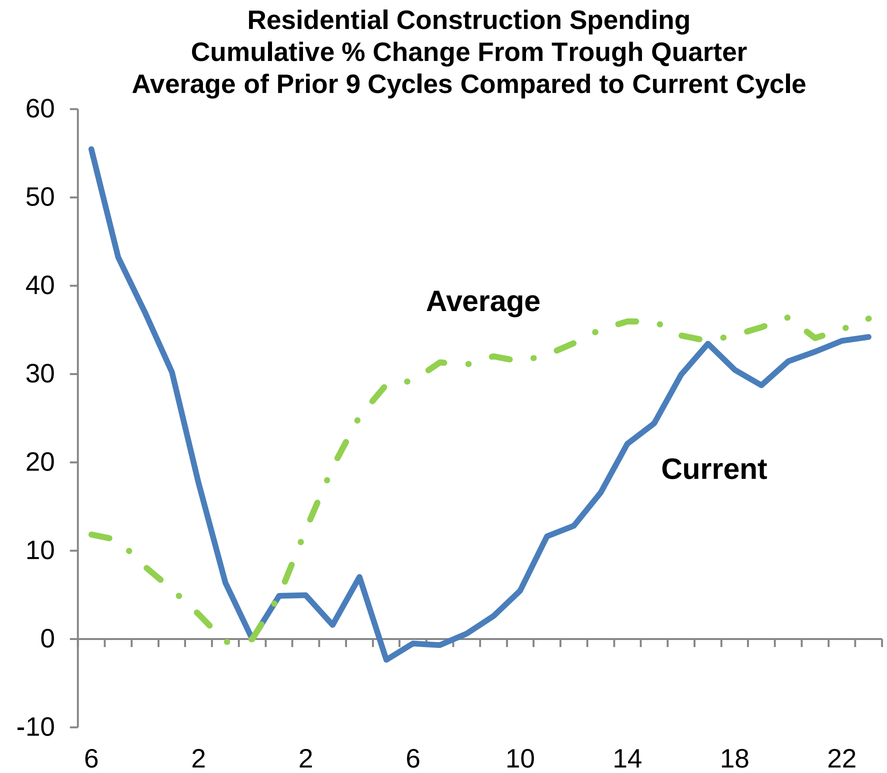
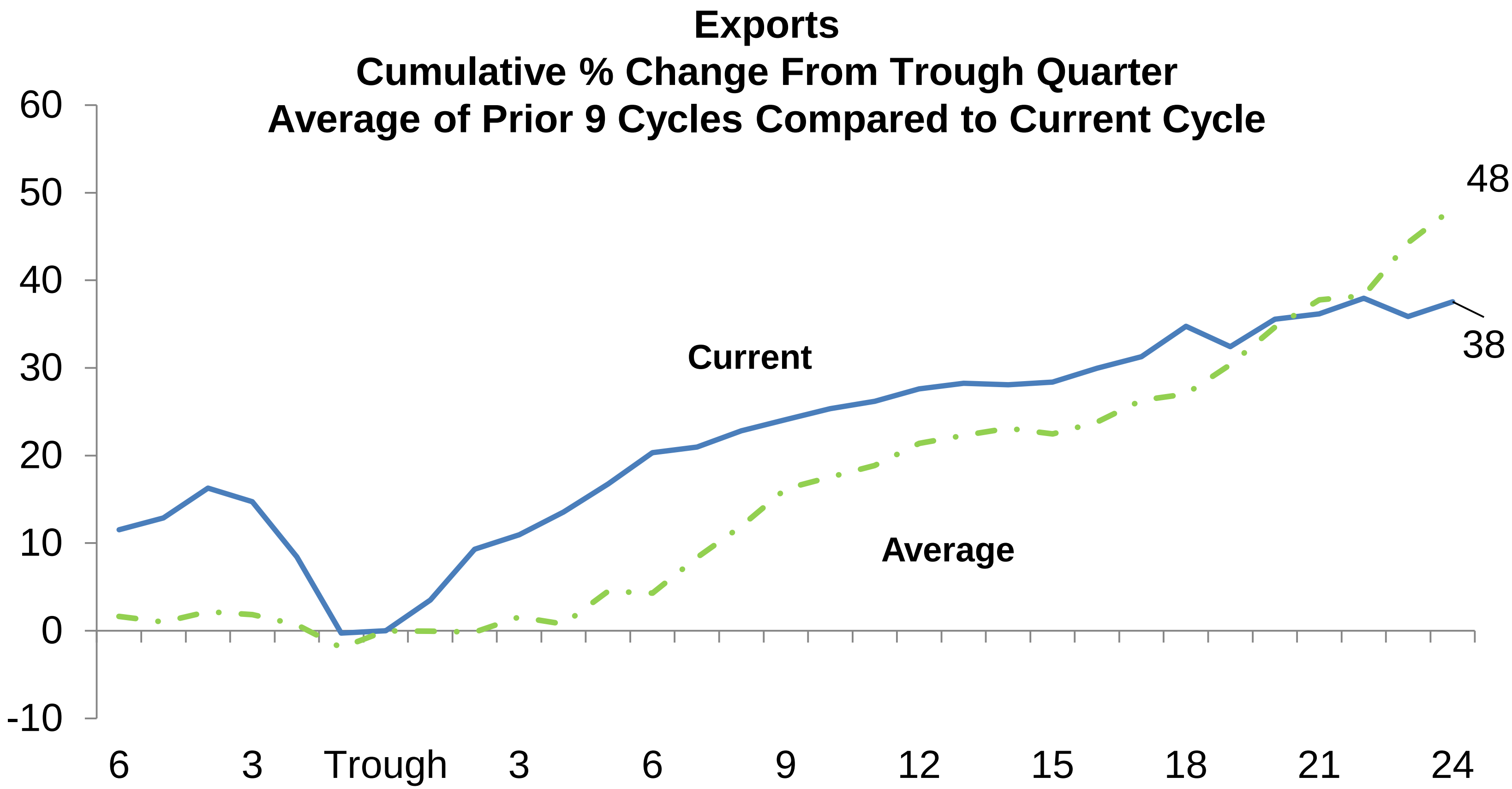




- Nonresidential construction spending remains weak and is up only 3% since Q2 2009
- Residential construction recovery has been saucer shaped in stark contrast to typical cycle
- Even so, the cumulative growth in residential construction is on par with historical performance – up about 36% since Q2 2009



- Export growth has been one of the best performances during expansion
- Up 38% from trough, was on par with the average cyclical growth until U.S. dollar began to strengthen
- Exports represent nearly 13% of GDP as of Q2 2015

U.S. Consumer Spending on Housing and Utilities Services

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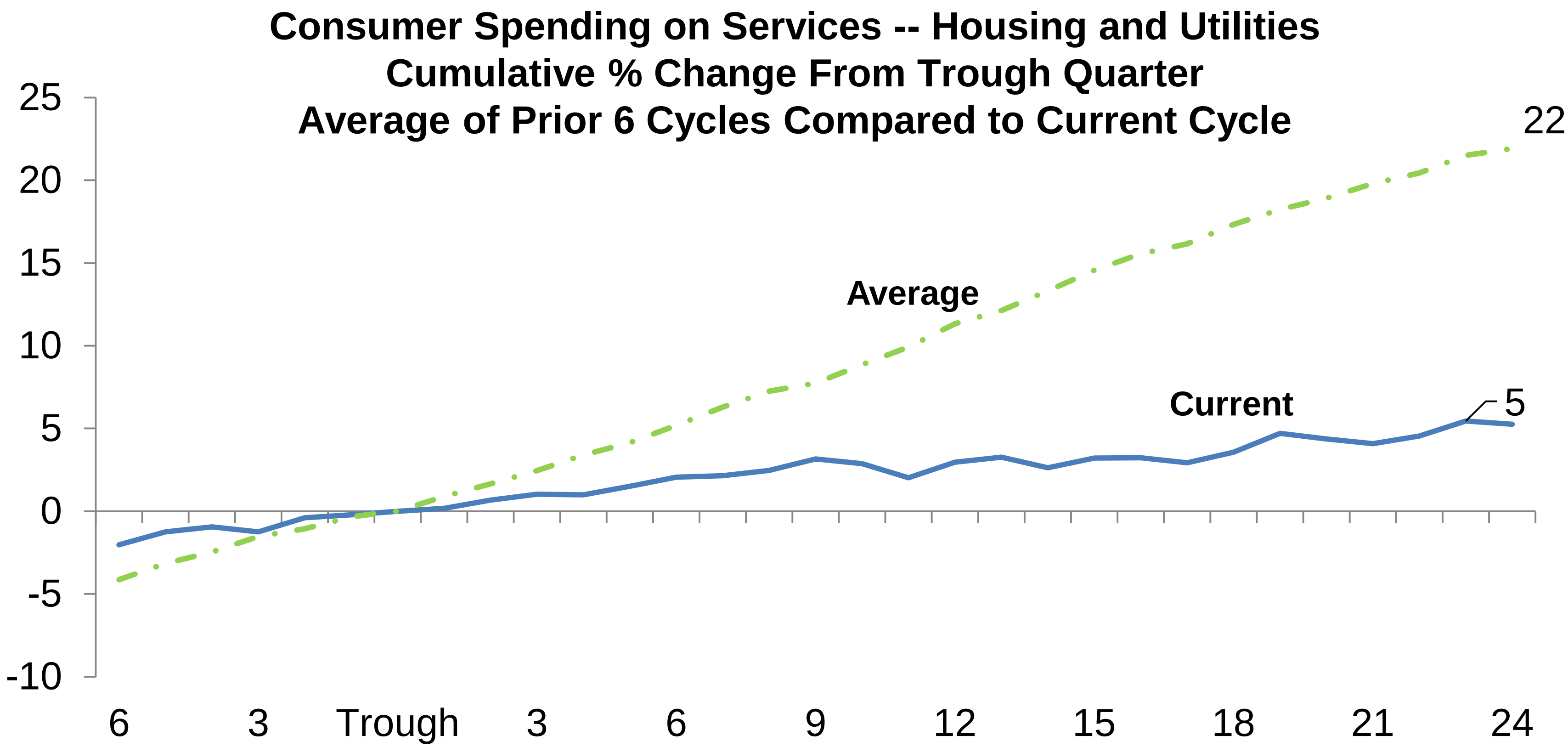

- This represents 16% of the below average GDP performance

Memo: Consumer spending on all services is $1.1 trillion below average as of Q2 2015

U.S. Consumer Spending on Health Care Services

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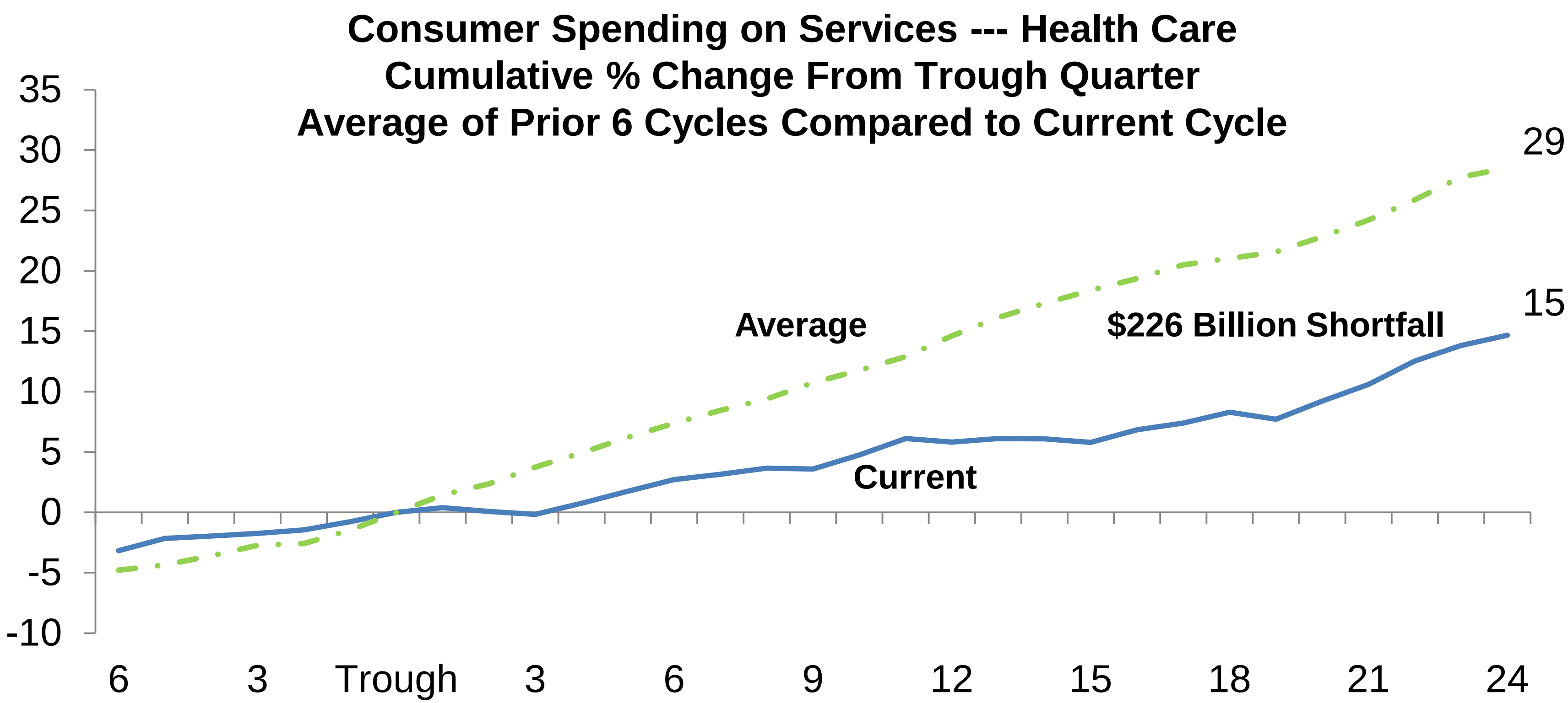

- Consumer spending on health care services is well below historical average
- If this grew at the historical pace, it would represent $226 billion in demand
- Health care services spending growth is below average due to two forces at play: a positive supply shock (health care reform) and some trimming of discretionary purchases

Top Five Job Creating Sectors
Contributions to Job Gains by Sector
And Year-Over-Year Job Growth
September 2014 – September 2015

- Job growth at 2% with 2.8 million jobs created since September 2014
- Wage growth at 2.2% during last 12 months

	Contribution to Overall Job Gains	Year-Over-Year Job Growth
Professional and Business Services	22%	3.2%
Education and Health Care	21%	2.6%
Leisure and Hospitality	15%	2.9%
Retail Trade	11%	2.0%
Construction	7%	3.3%

In Closing

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- Global economy entering period well beyond financial crisis and 7 years of expansion in the U.S.
- Acceleration in growth likely next year
- Expect global GDP gains to improve in the next 12 – 24 months
- U.S. businesses have several strengths centered in energy, manufacturing, capital goods, IT, and healthcare