The Economic Outlook for the U.S. and Indiana

Jim Diffley
Senior Director
Chief Regional Economist
IHS Global Insight
December 15, 2010

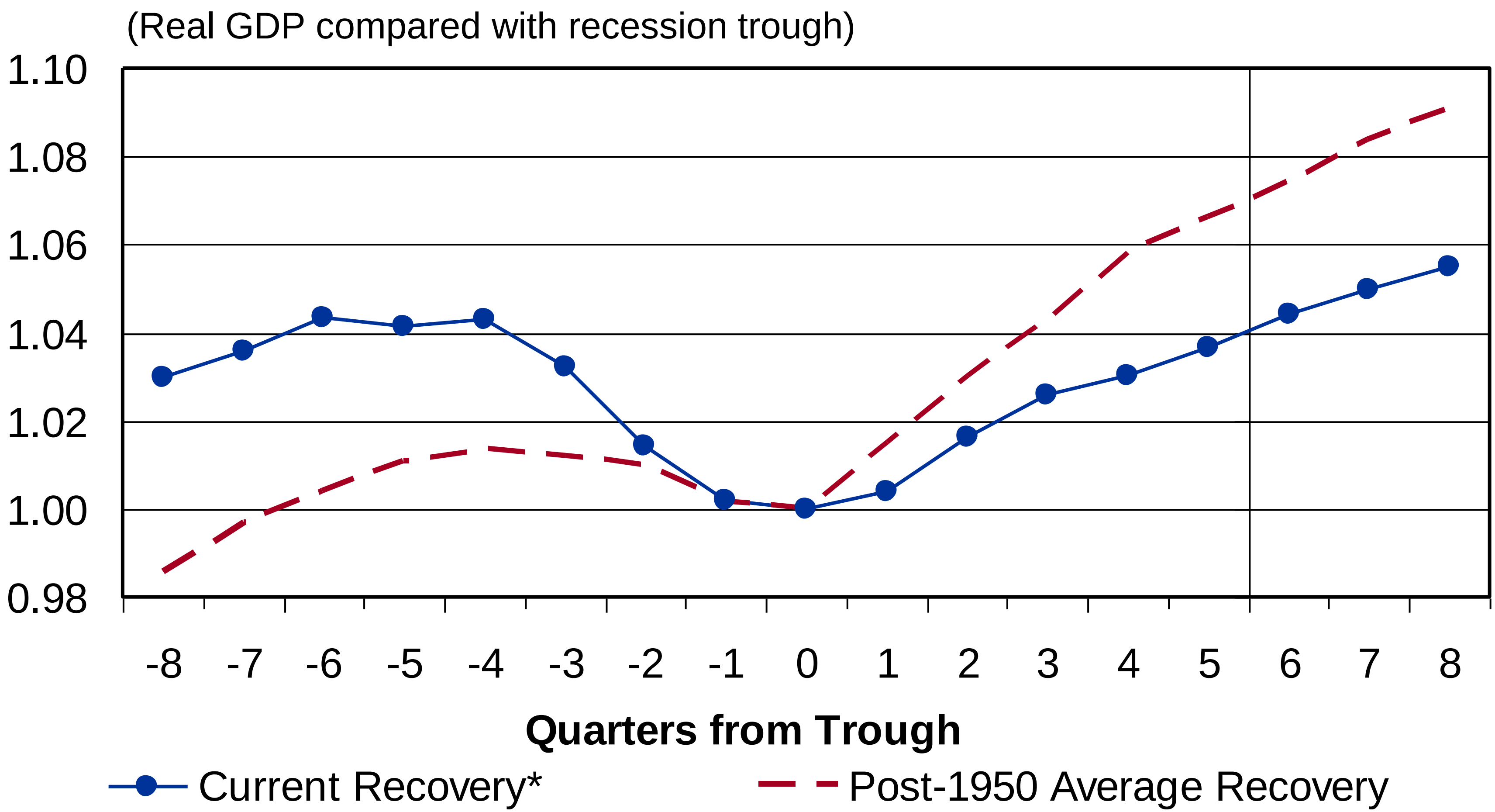
IHS GLOBAL INSIGHT

The Source for Critical Information and Insight™

The U.S. Recovery: Uneven and Subpar

- Recession “over”, but GDP hasn’t regained previous peak yet
- Growth boost from fiscal stimulus and inventories is fading
- Recent data slightly more upbeat, but headwinds are still blowing from consumer and business caution
- The key problem is the hangover from the financial boom and bust
- QE II is here; it’s not a cure-all
- It’s too early to tighten fiscal policy when the private sector is gripped by an “epidemic of thrift”

Deep Recession, Slower Recovery



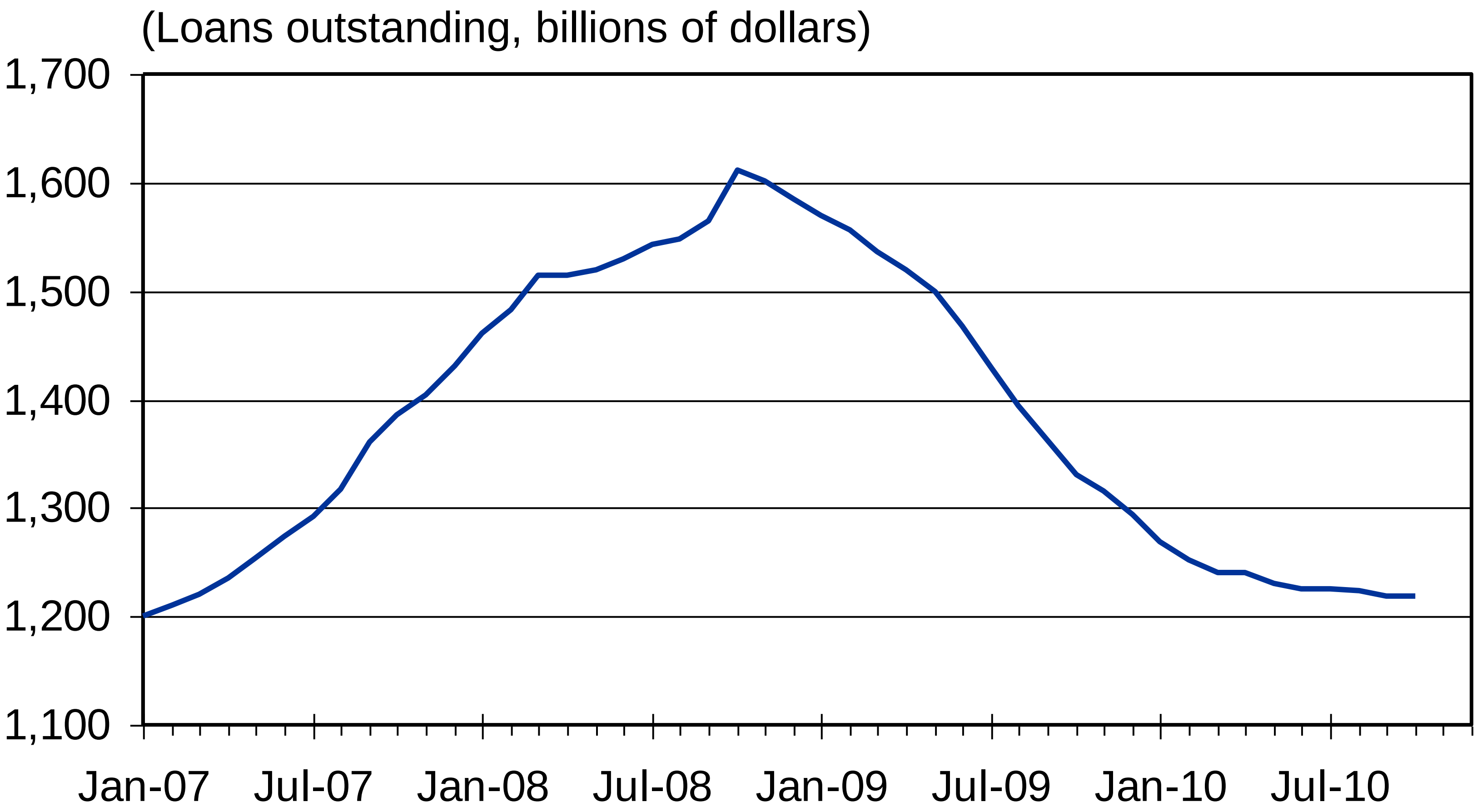
* 2009Q2 trough

Financial Clouds Lifting, Slowly

GLOBAL INSIGHT

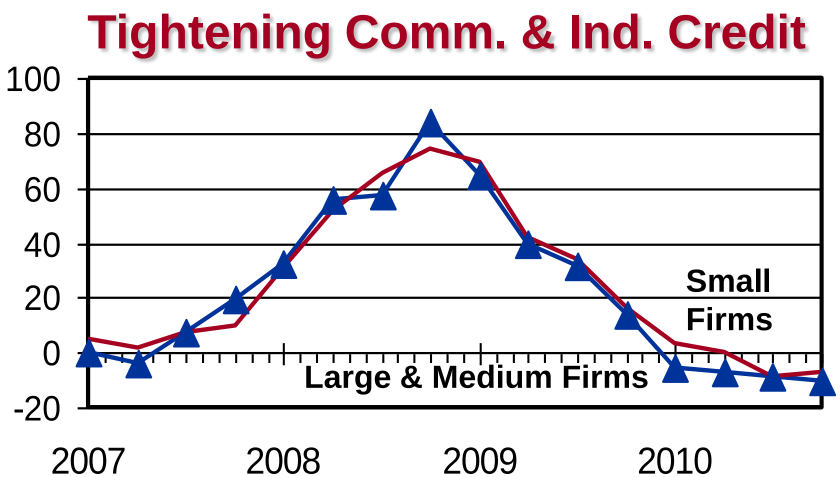
The Source for Critical Information and Insight™

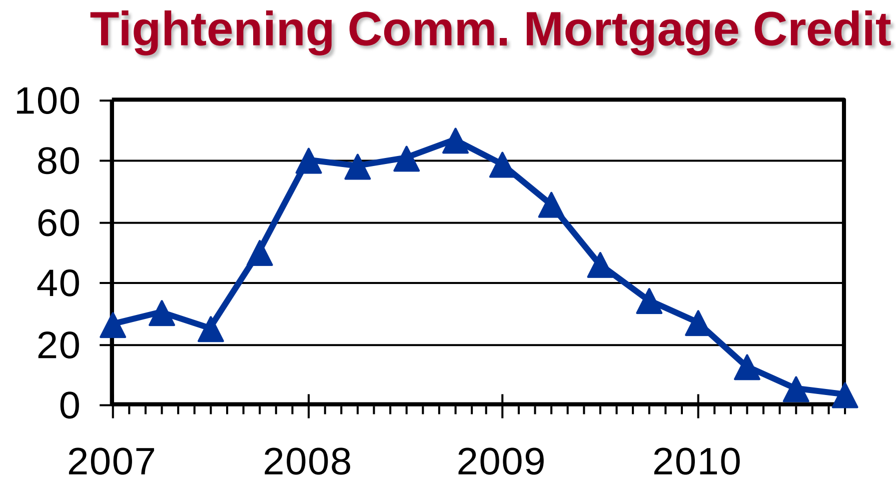
Bank Commercial and Industrial Loans: Bottoming Out?

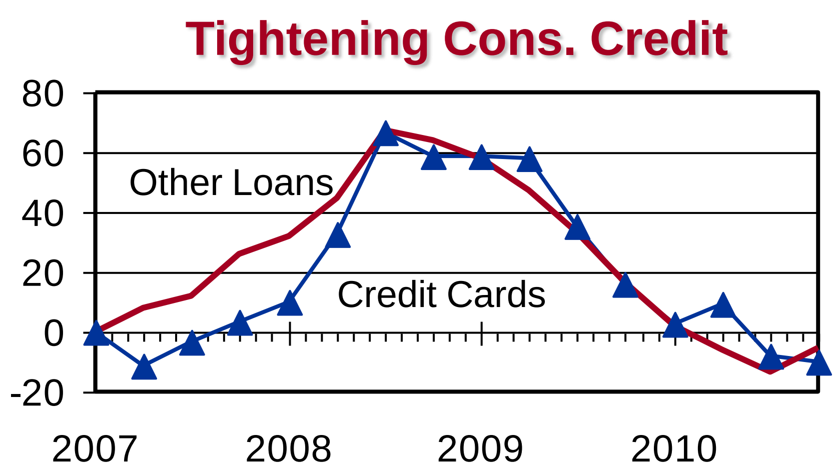


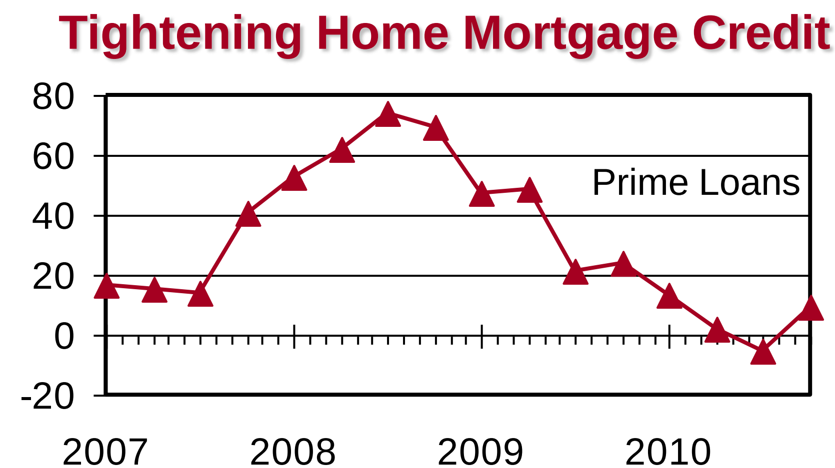
Bank Credit: Beginning to Loosen

(Percent)







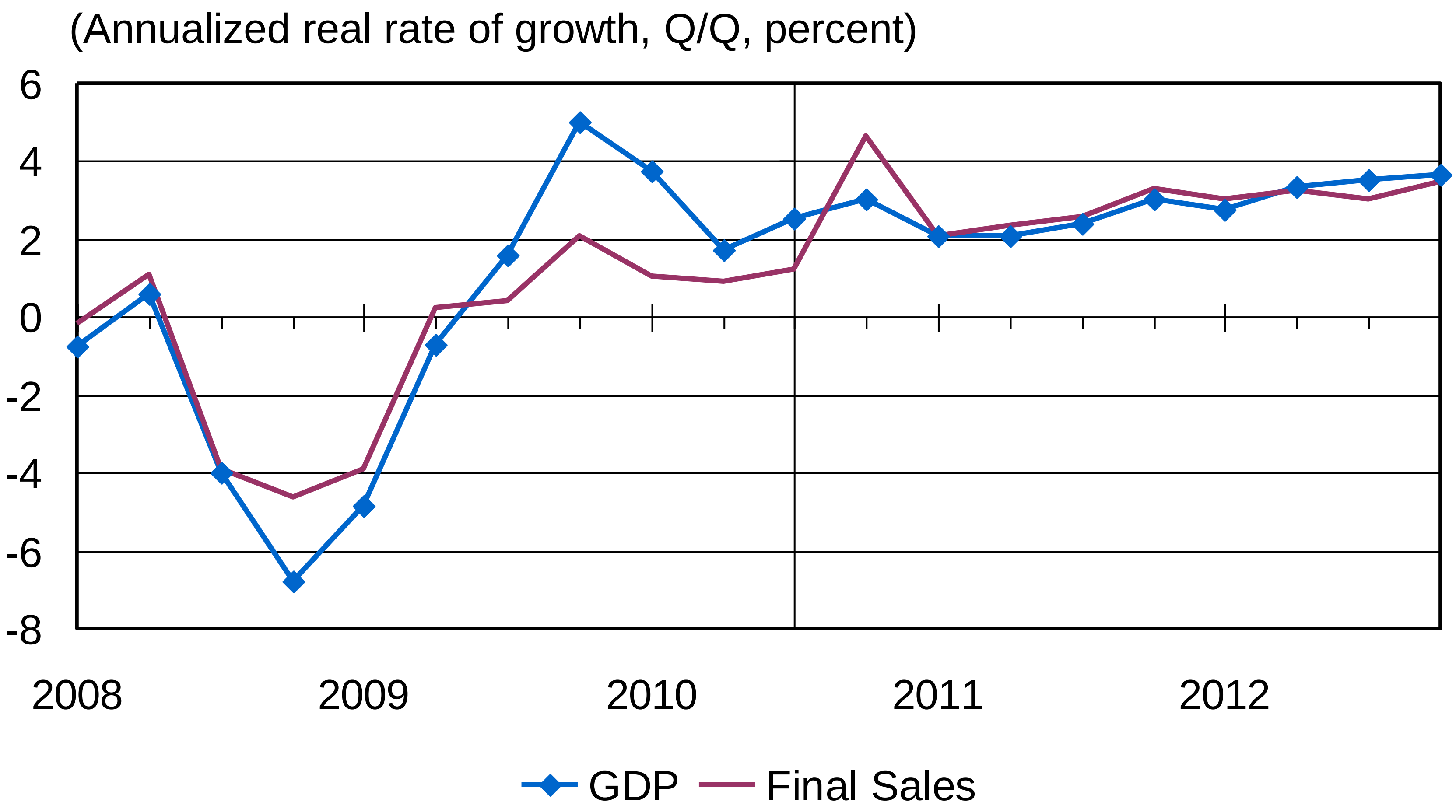


Source: Diffusion Indexes from Fed Senior Loan Officer Survey

Decline In Initial Unemployment Insurance Claims Resumes

(Initial unemployment insurance claims, 4-week moving average, thousands)

Inventory Cycle Support For Growth Has Peaked



U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2009	2010	2011	2012
Real GDP	-2.6	2.8	2.4	3.0
Final Sales	-2.1	1.3	2.6	3.1
Consumption	-1.2	1.7	2.7	2.4
Light Vehicle Sales (Millions)	10.4	11.5	12.8	14.8
Residential Investment	-22.9	-3.5	-0.3	28.7
Housing Starts (Millions)	0.55	0.59	0.70	1.09
Business Fixed Investment	-17.1	5.4	5.7	7.7
Federal Government	5.7	4.6	-0.3	-3.5
State and Local Government	-0.9	-1.2	0.1	0.0
Exports	-9.5	11.6	7.9	8.1
Imports	-13.8	12.8	5.4	5.2

Other Key Indicators

(Percent unless otherwise noted)

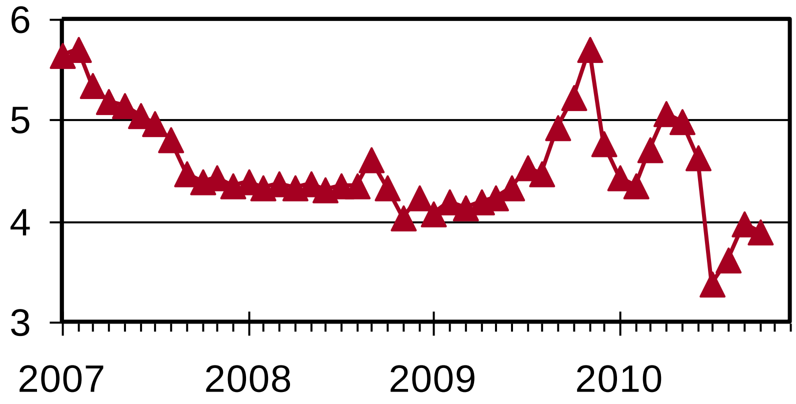
	2009	2010	2011	2012
Industrial Production (% growth)	-9.3	5.4	2.9	4.0
Employment (% growth)	-4.3	-0.5	1.2	2.1
Unemployment Rate	9.3	9.6	9.5	8.9
CPI Inflation	-0.3	1.6	1.3	1.8
Oil Prices (WTI, US$/bbl)	62	79	83	89
Core PCE Price Inflation	1.5	1.4	1.1	1.4
Federal Funds Rate	0.16	0.18	0.17	1.27
10-year Government Bond Yield	3.26	3.17	2.77	3.43
Dollar (Major Currencies, 2005=1)	0.93	0.90	0.87	0.88

The Housing Cycle:
Still At The Bottom

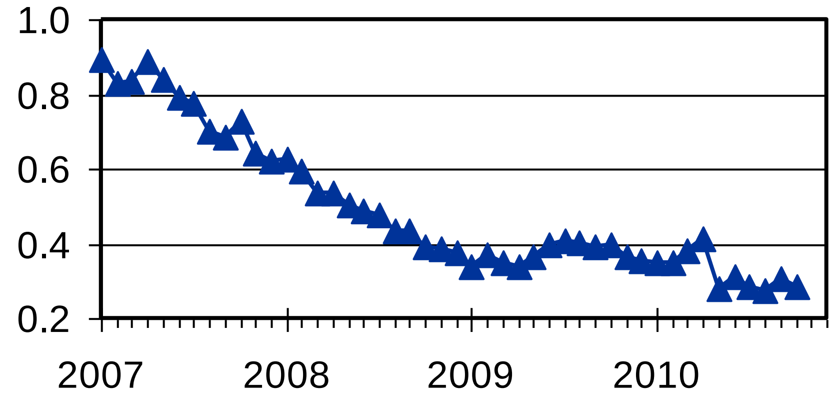
The Source for Critical Information and Insight™

Key Single-Family Housing Indicators: No Underlying Improvement Yet

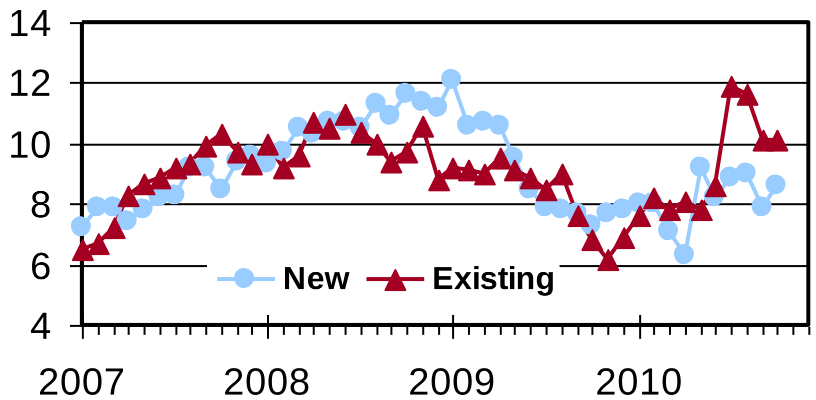
Existing Home Sales*



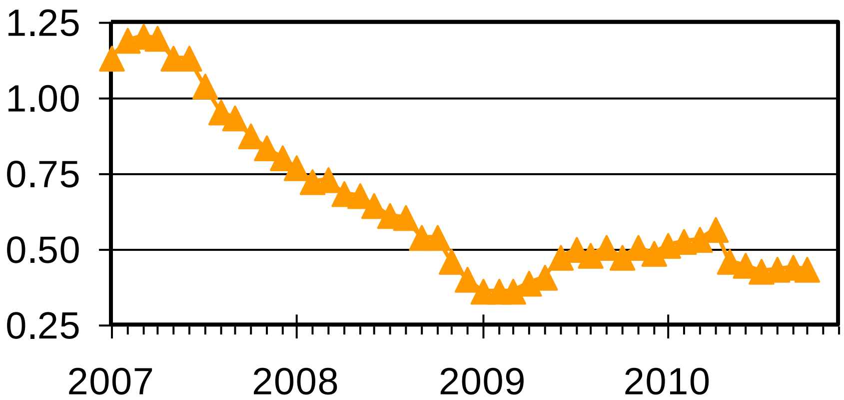
New Home Sales*



Months' Supply of Homes**



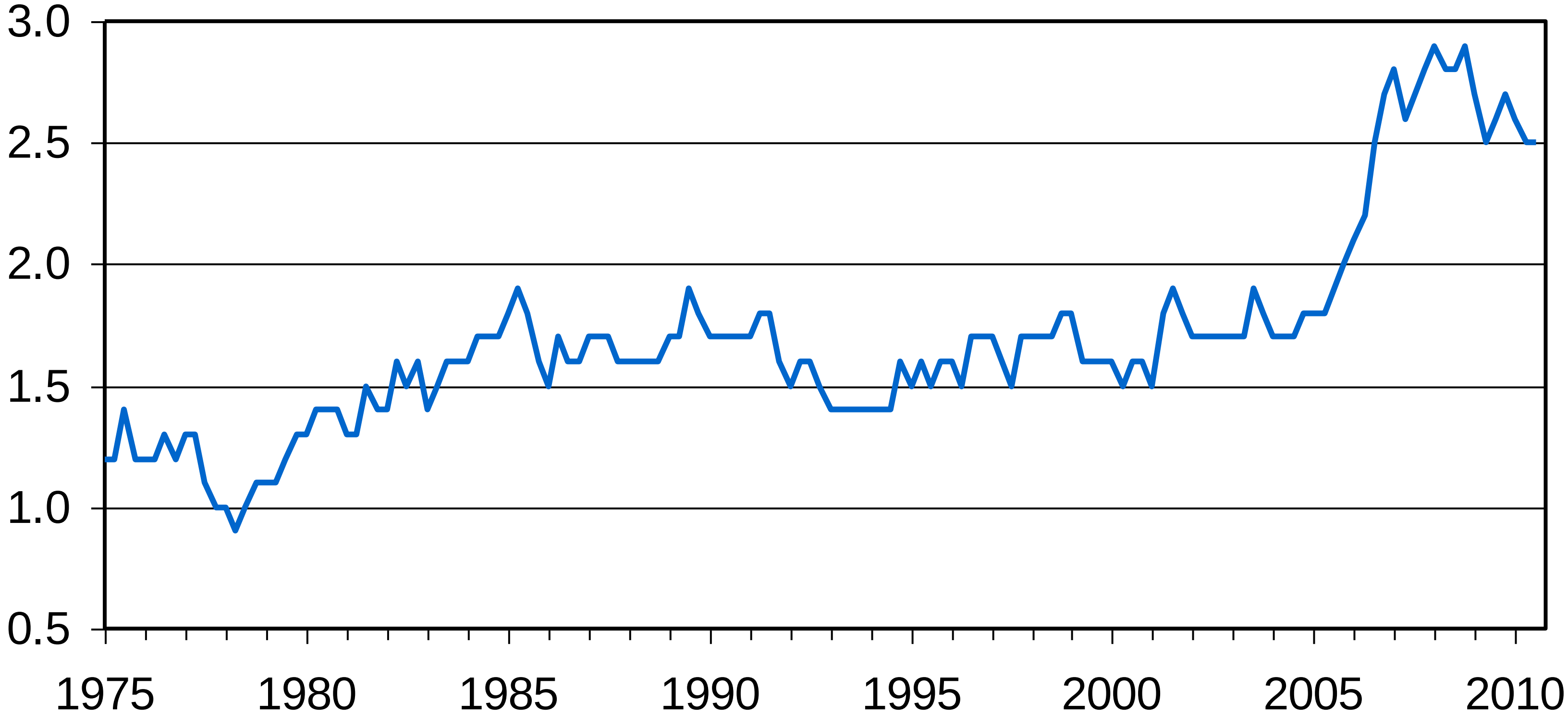
Housing Starts*



*Millions, SA; **Single-Family Homes for sale divided by monthly selling rate

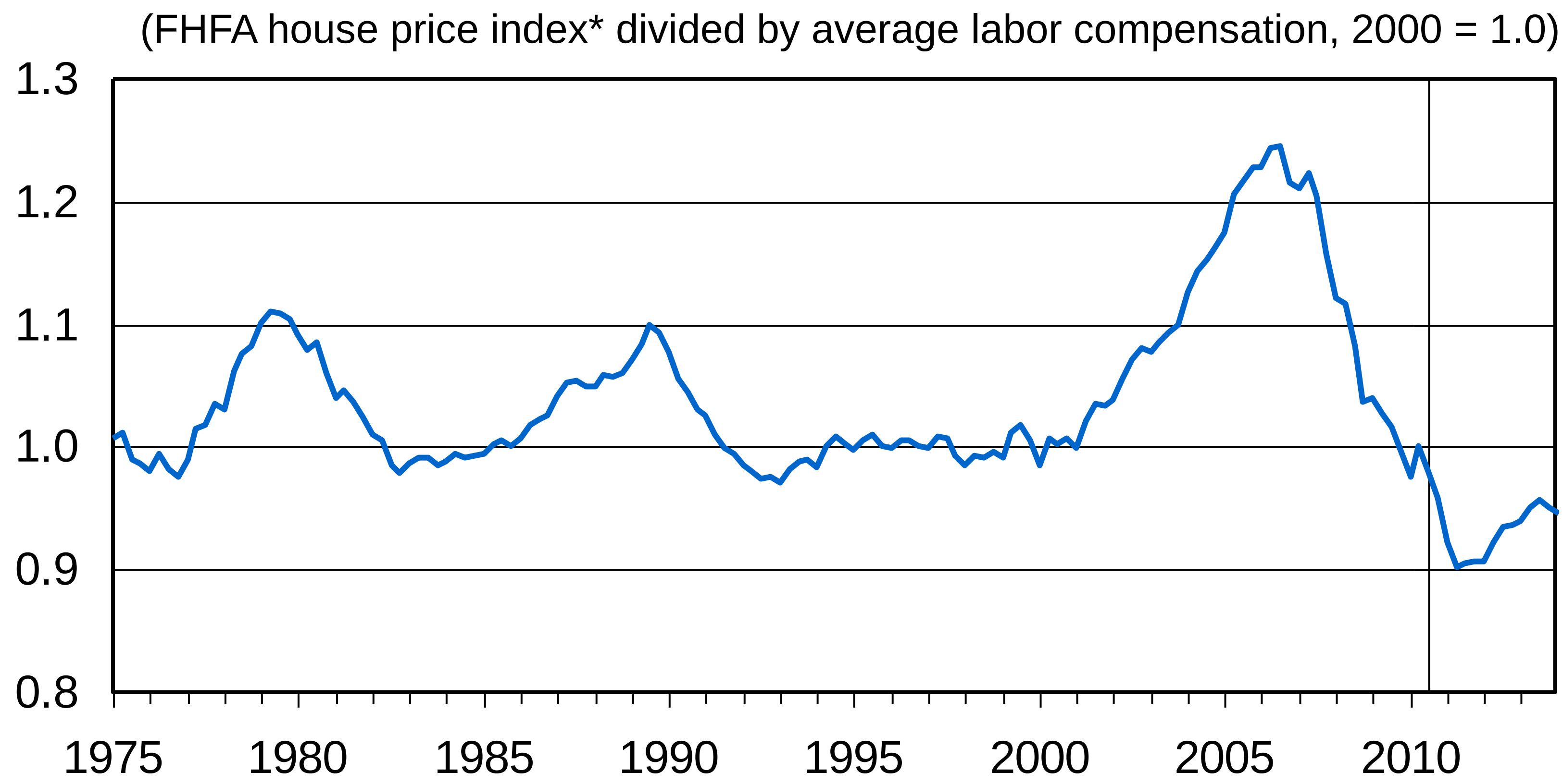
The Housing Overhang

(Proportion of homeowner inventory vacant and for sale, percent)



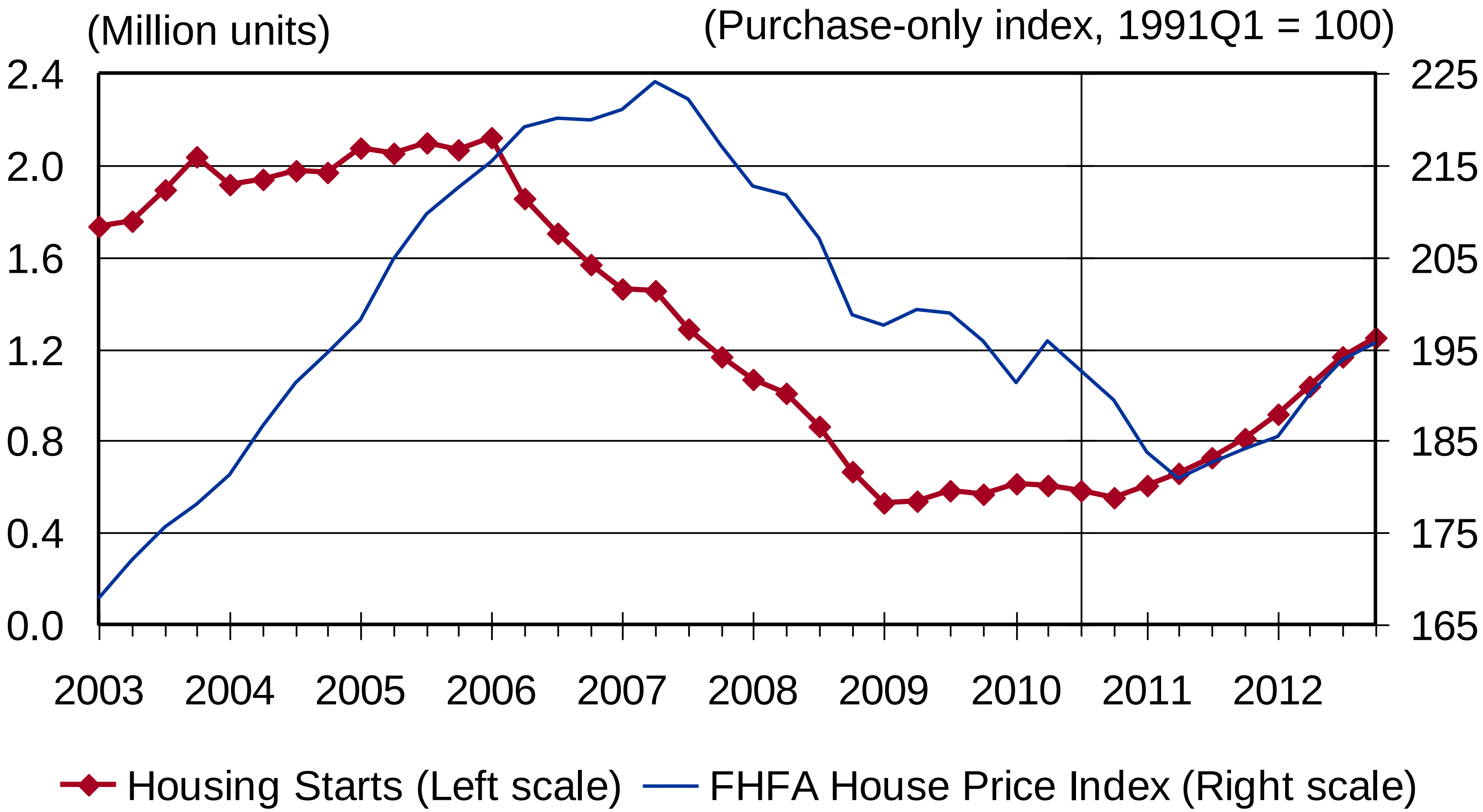
Source: Census Bureau

House Price Adjustment Has Gone a Long Way: Probably Not Complete



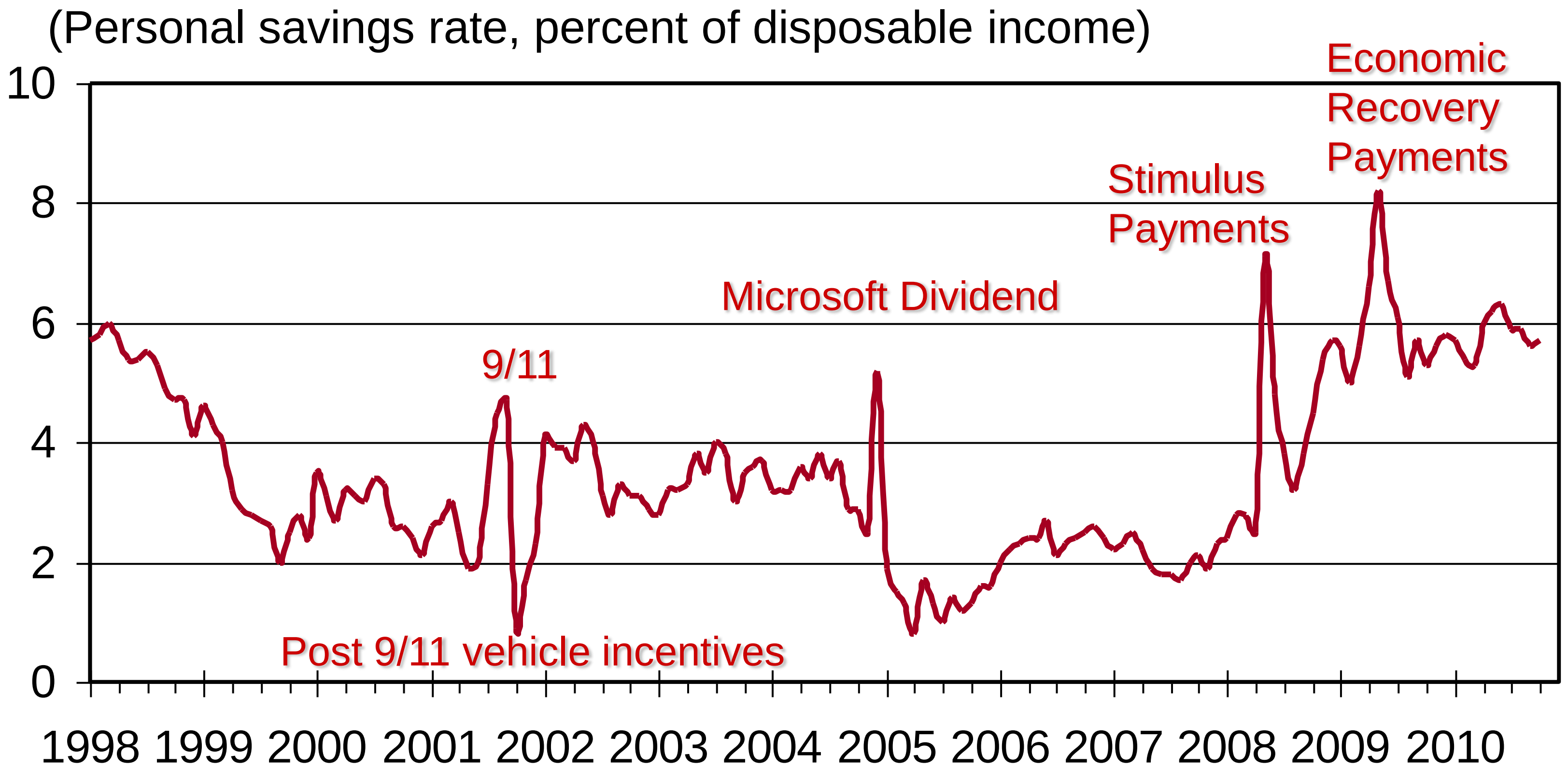
* Purchase-only index from 1991 onwards

Housing Starts Have Hit Bottom: Prices Not Quite There Yet



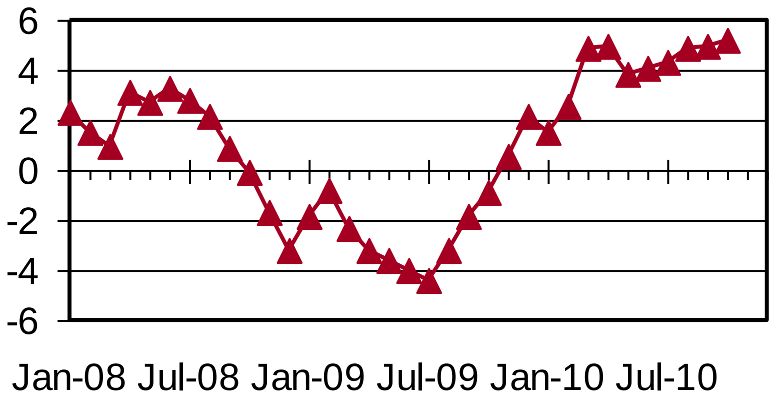
The Consumer :
Reviving, But Without Vigor

The Personal Saving Rate Has Risen

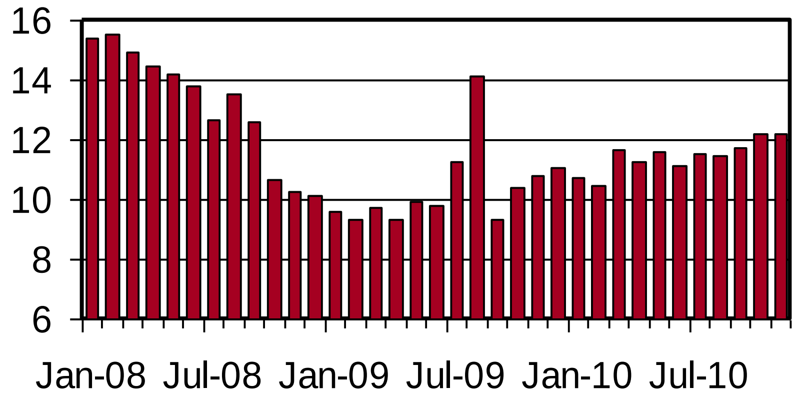


Consumer Indicators

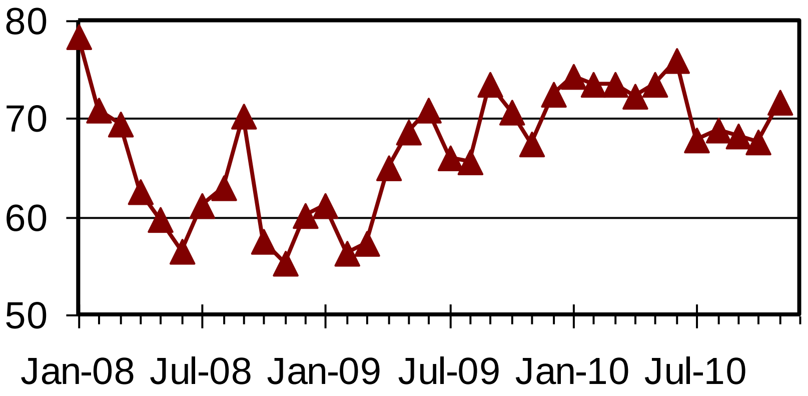
Retail Sales ex-Autos and Gasoline*



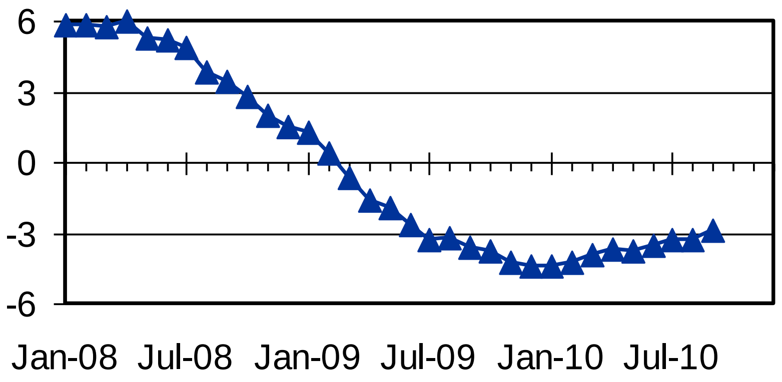
Light Vehicle Sales**



Consumer Sentiment***

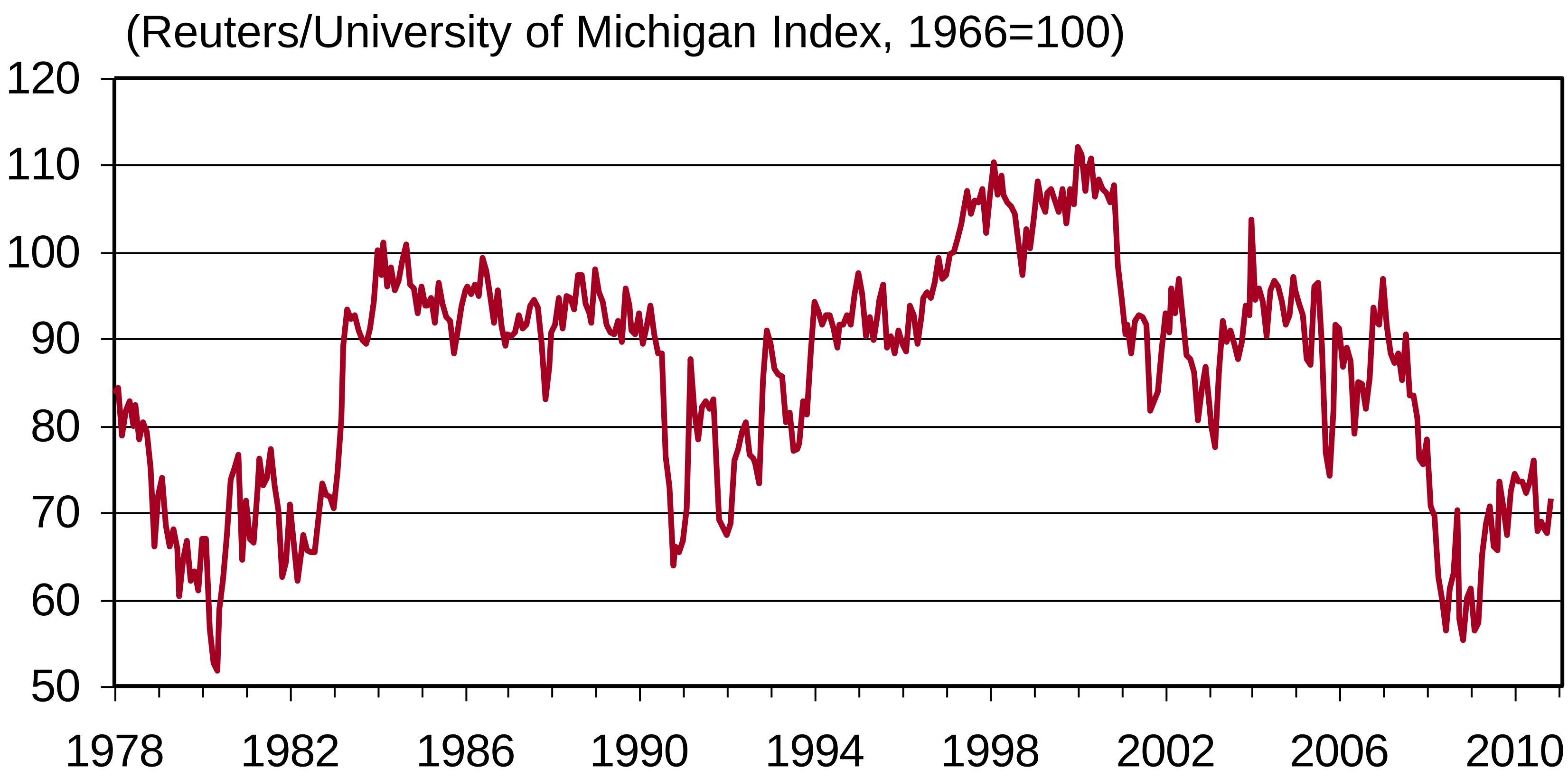


Consumer Credit Growth*

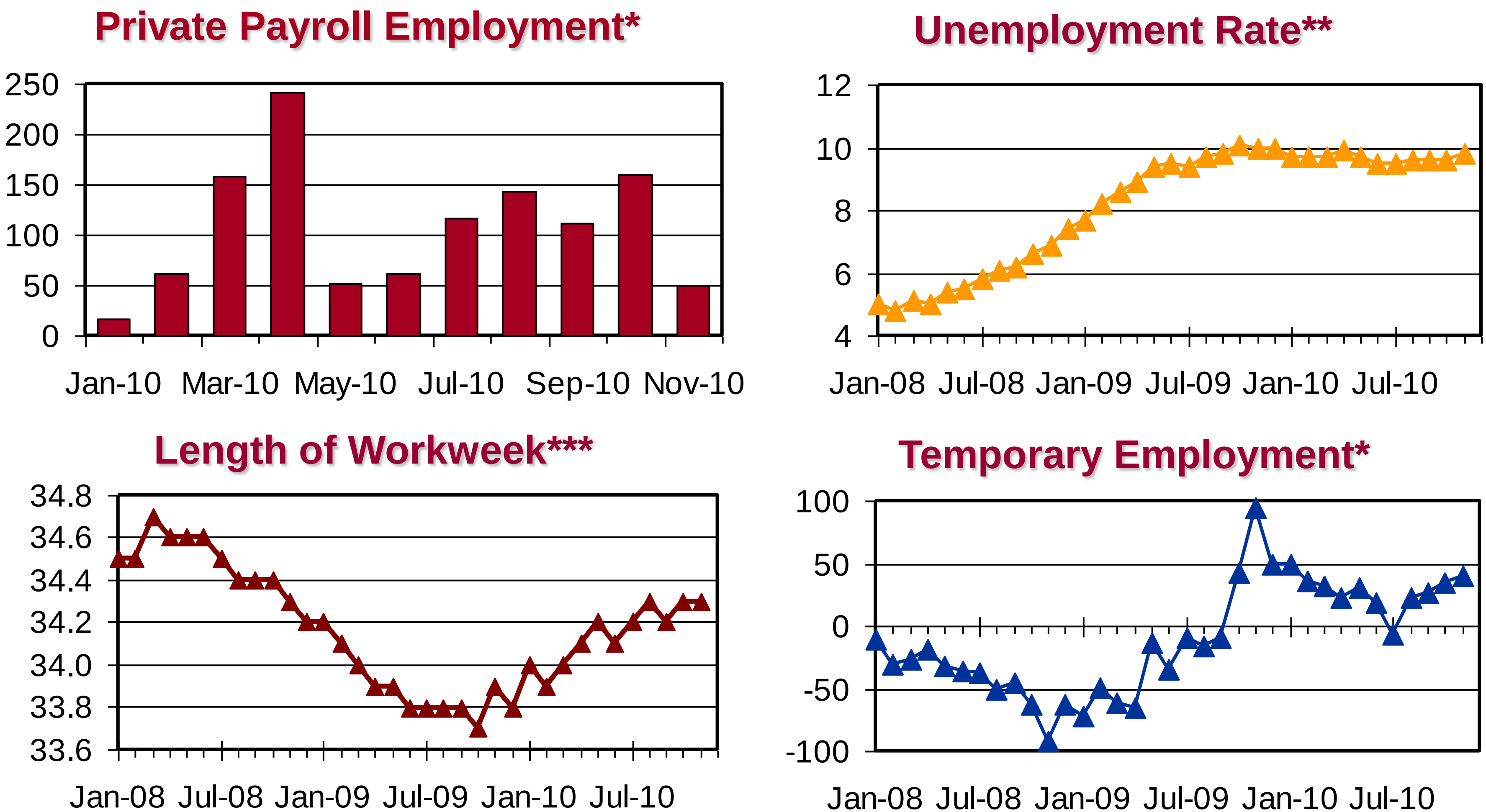


*Y/Y % change; **Millions, annualized, SA; ***Reuters/Michigan Index

Consumer Sentiment Off the Floor But Still Weak

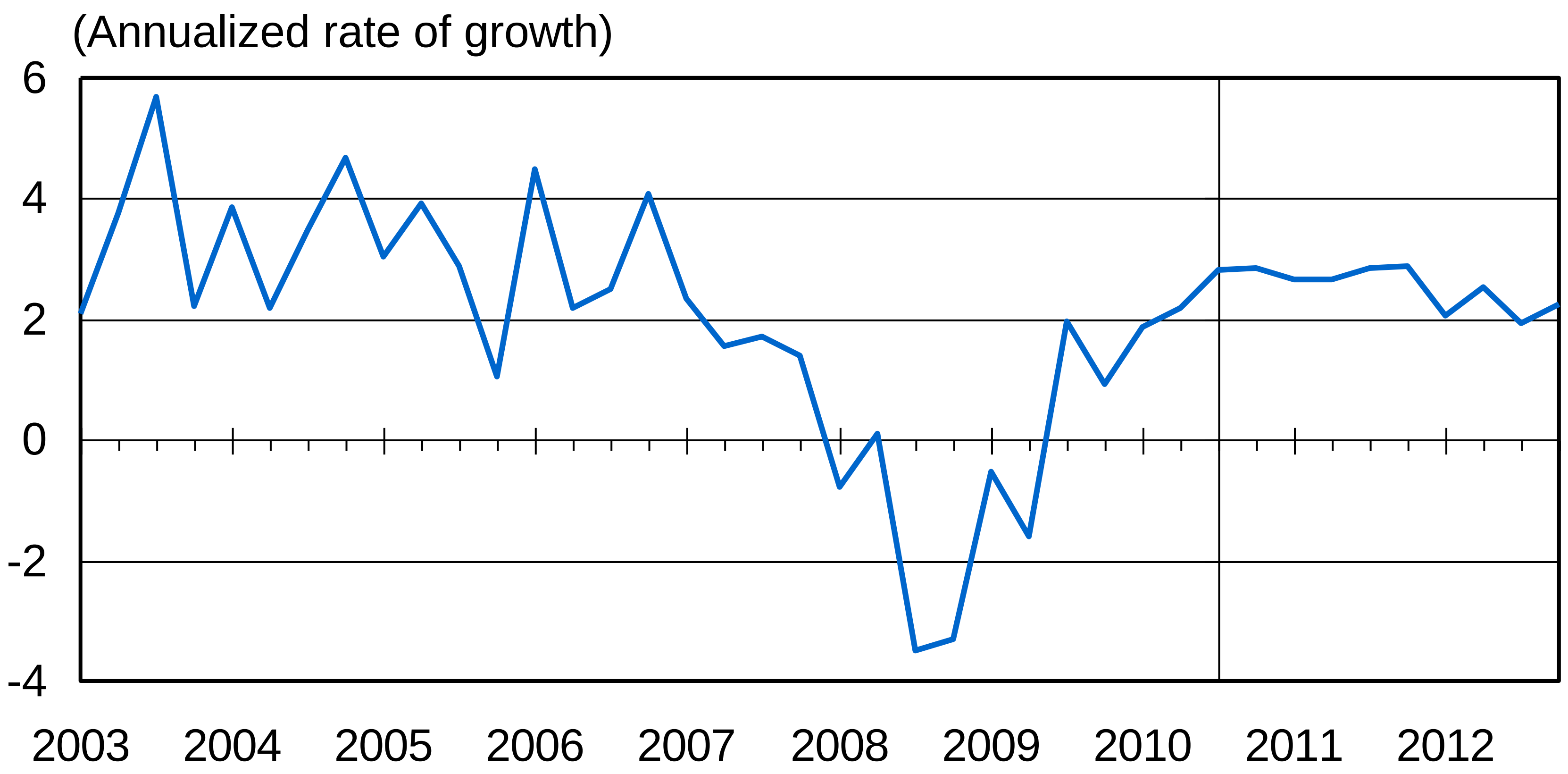


Employment Is Turning, But Not Rapidly



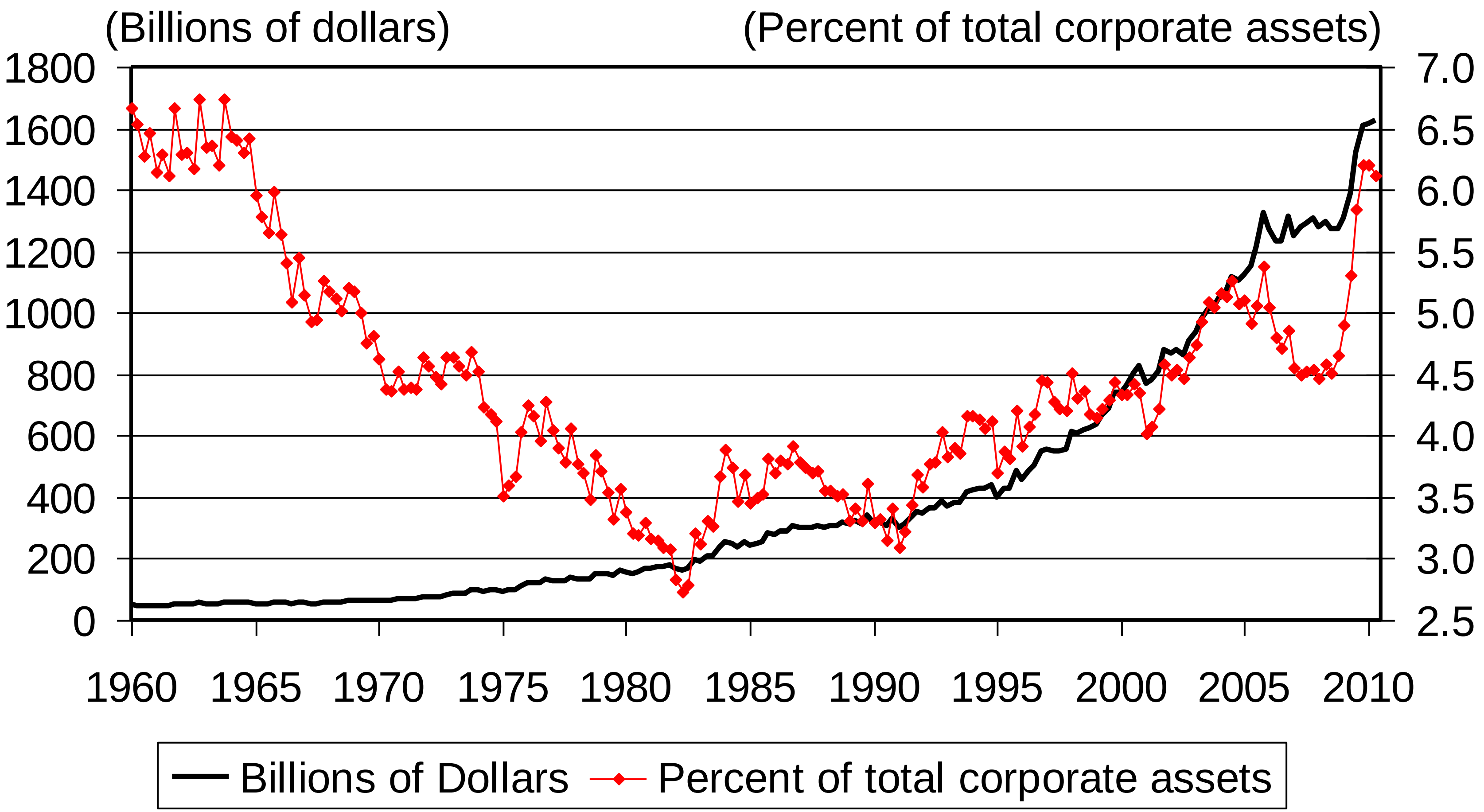
*Thousands, monthly change, SA; **Percent; ***Hours, SA

Consumer Spending Stabilizing, But Not a Strong Driver of Recovery



Inflation and Interest Rates

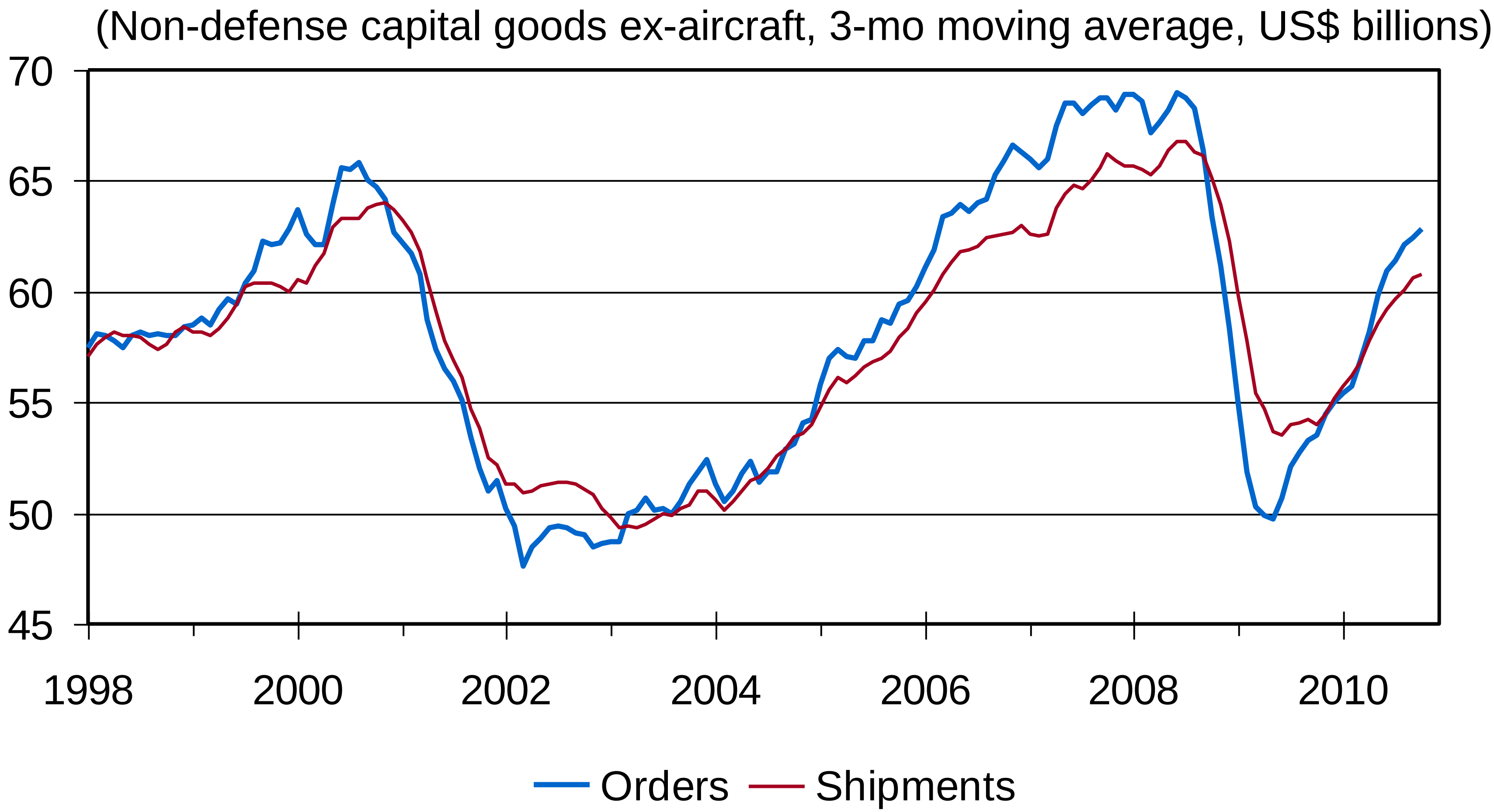
The Growing Corporate Cash Pile*: A Long-Established Trend



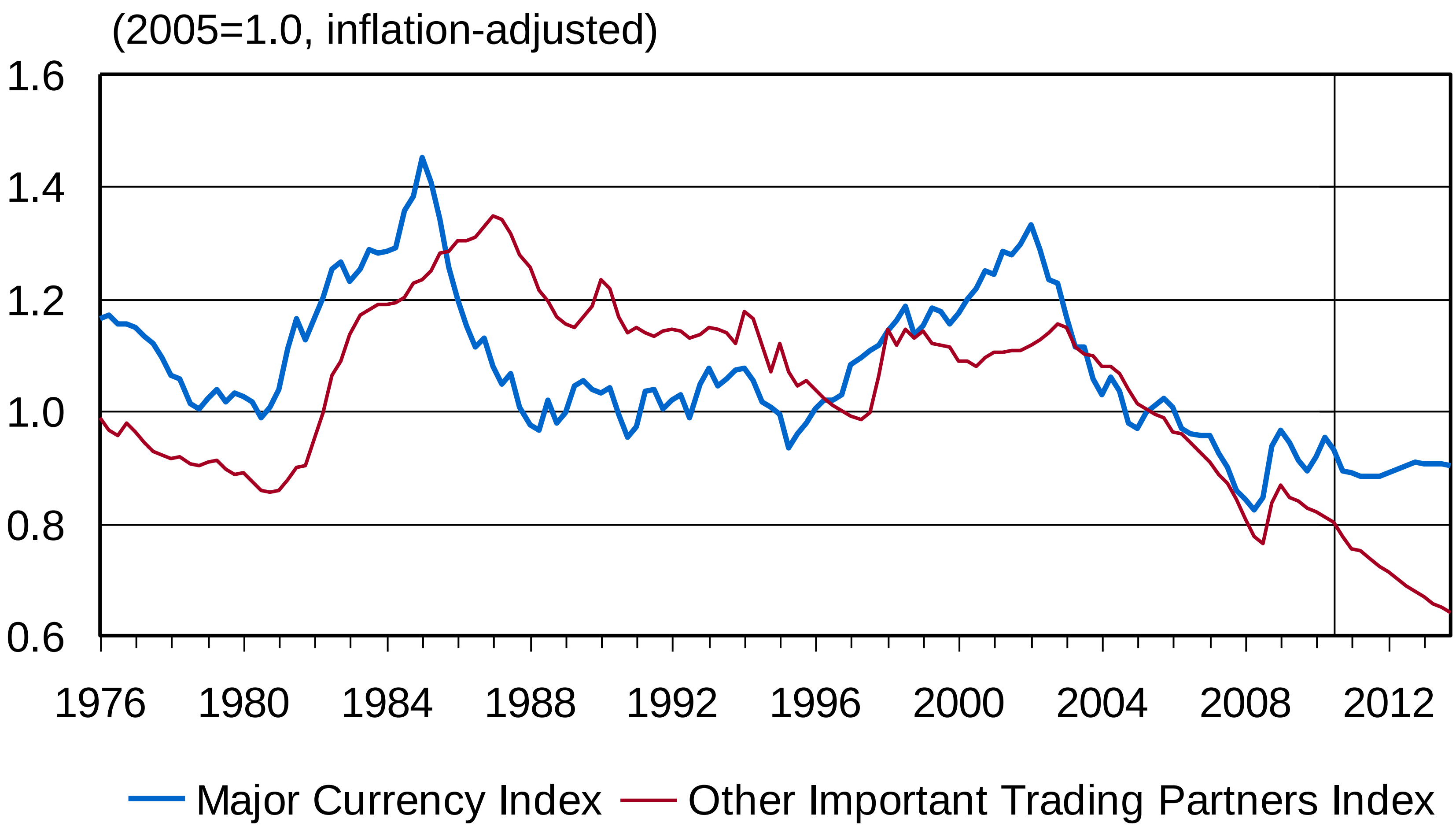
*Nonfarm nonfinancial corporations' liquid assets (foreign deposits, checkable deposits and currency, time & savings deposits, money market fund shares, security RPs, commercial paper, Treasuries, agency and GSE-backed securities. Source: Federal Reserve Board

IHS GLOBAL INSIGHT

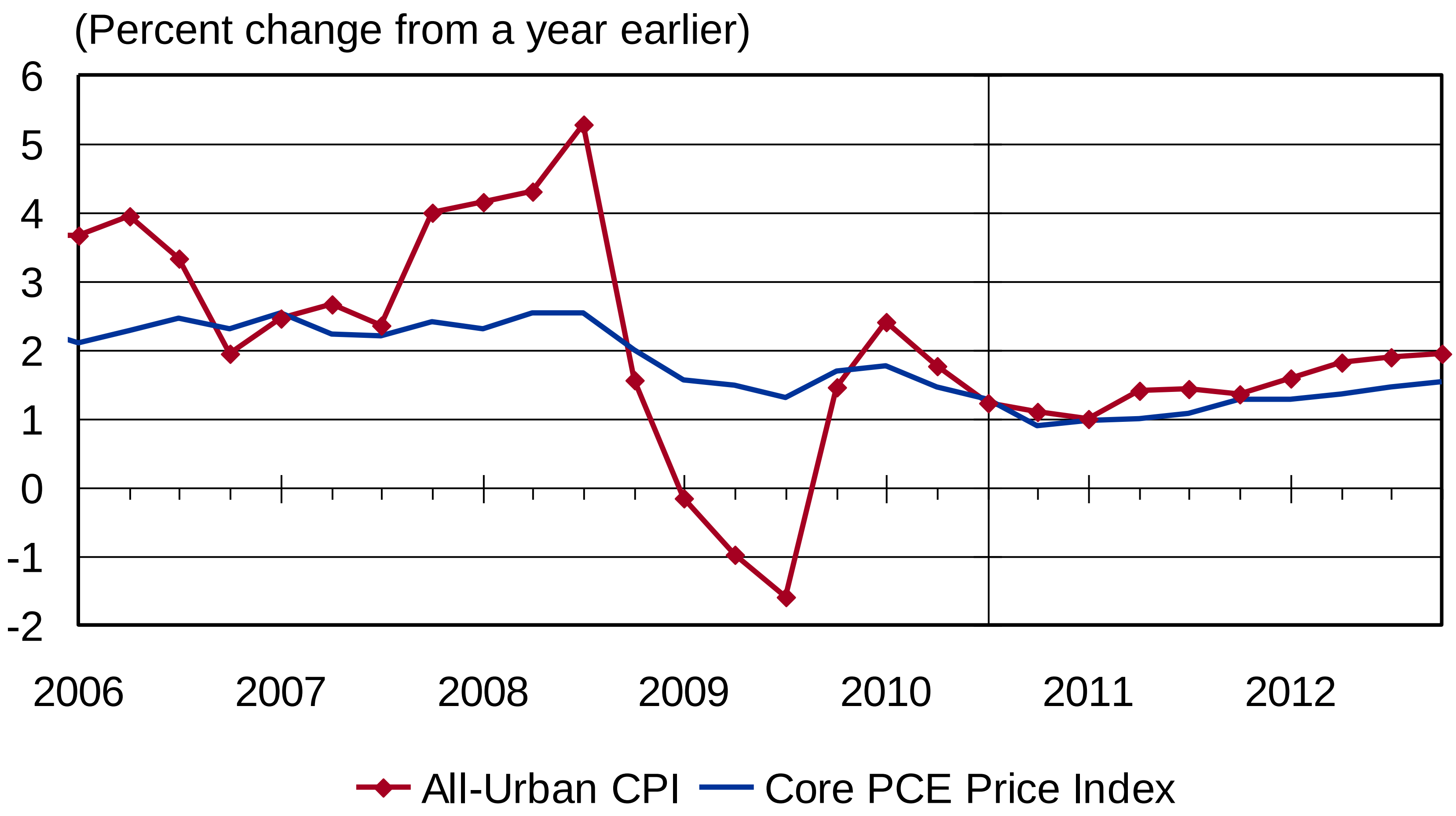
Business Equipment Demand Recovering



The U.S. Dollar: Secular Weakness Against EMG Currencies

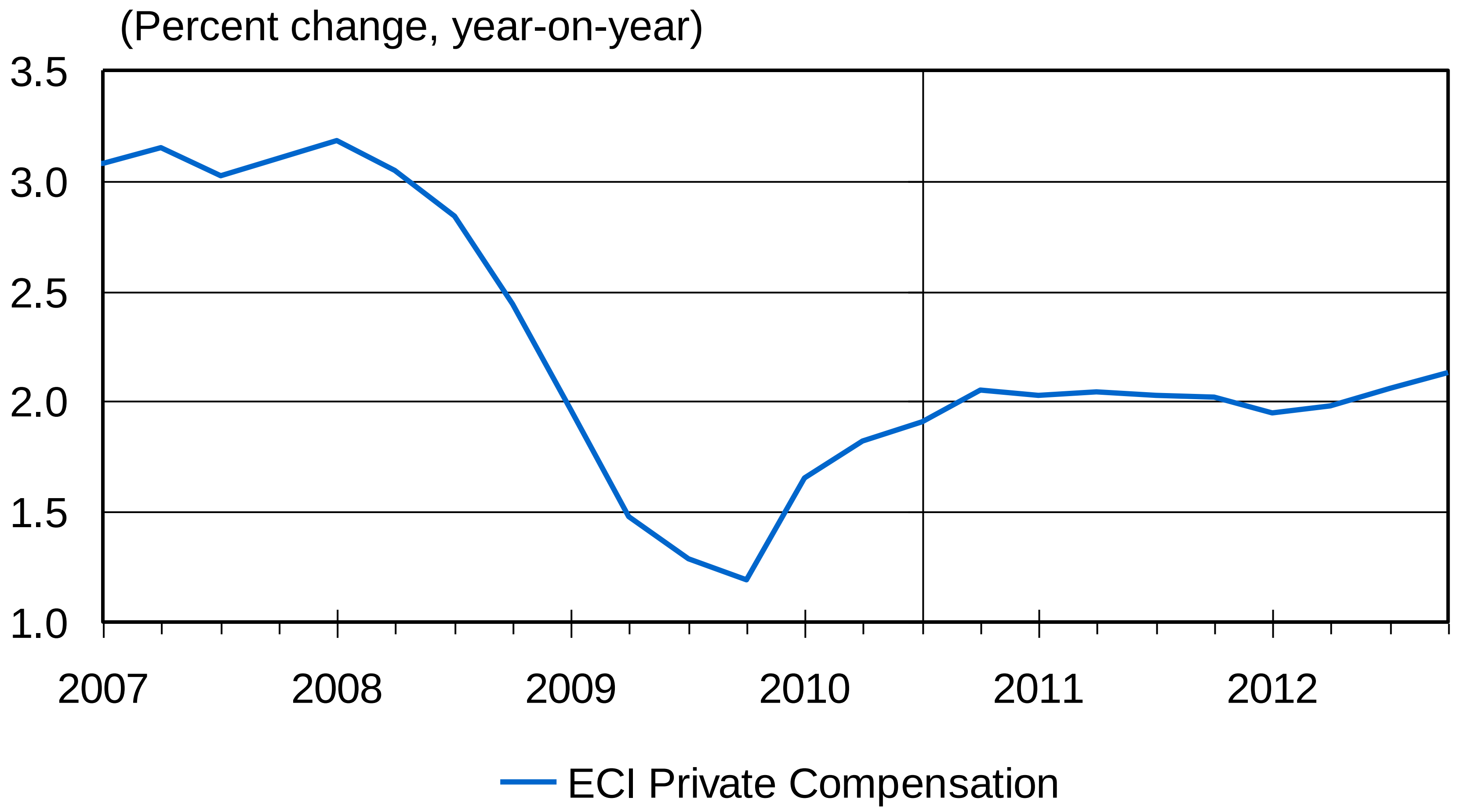


Core Inflation Is Still Easing

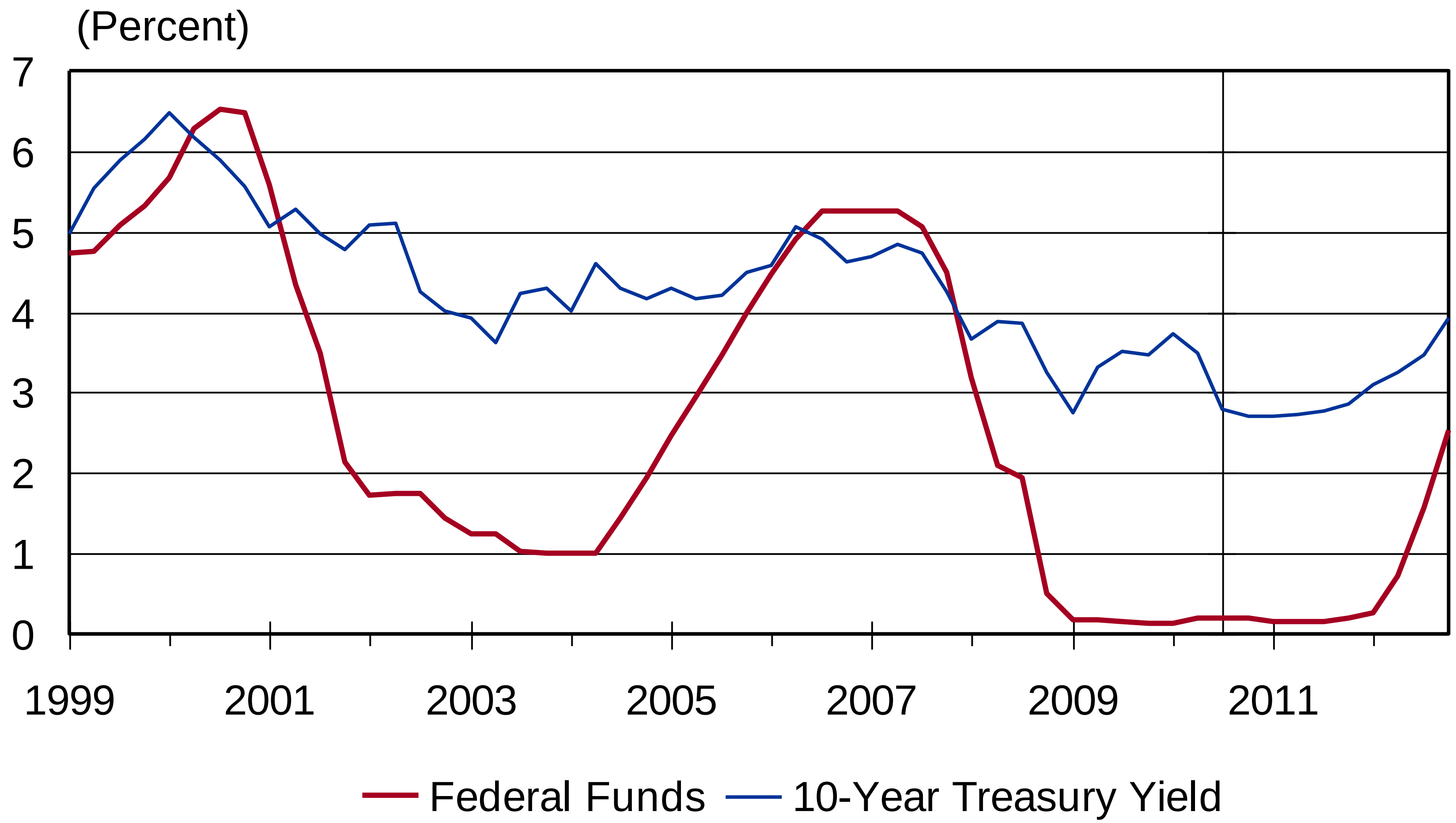


IHS GLOBAL INSIGHT

Wage Inflation Not An Issue



Federal Funds Rate to Stay Near Zero Until 2012: QE II Keeps Long Rates Low



What Can QE II Accomplish?

- Don't expect too much from QE II
- Quantitative easing is powerful in a crisis...
- ...but financial markets are not in meltdown now...
- QE II of $500bln-$1 trl can push down long-term interest rates (25-50bps?), already in the market...
- ...and help growth a tenth or two in 2011...
- ...not a game-changer

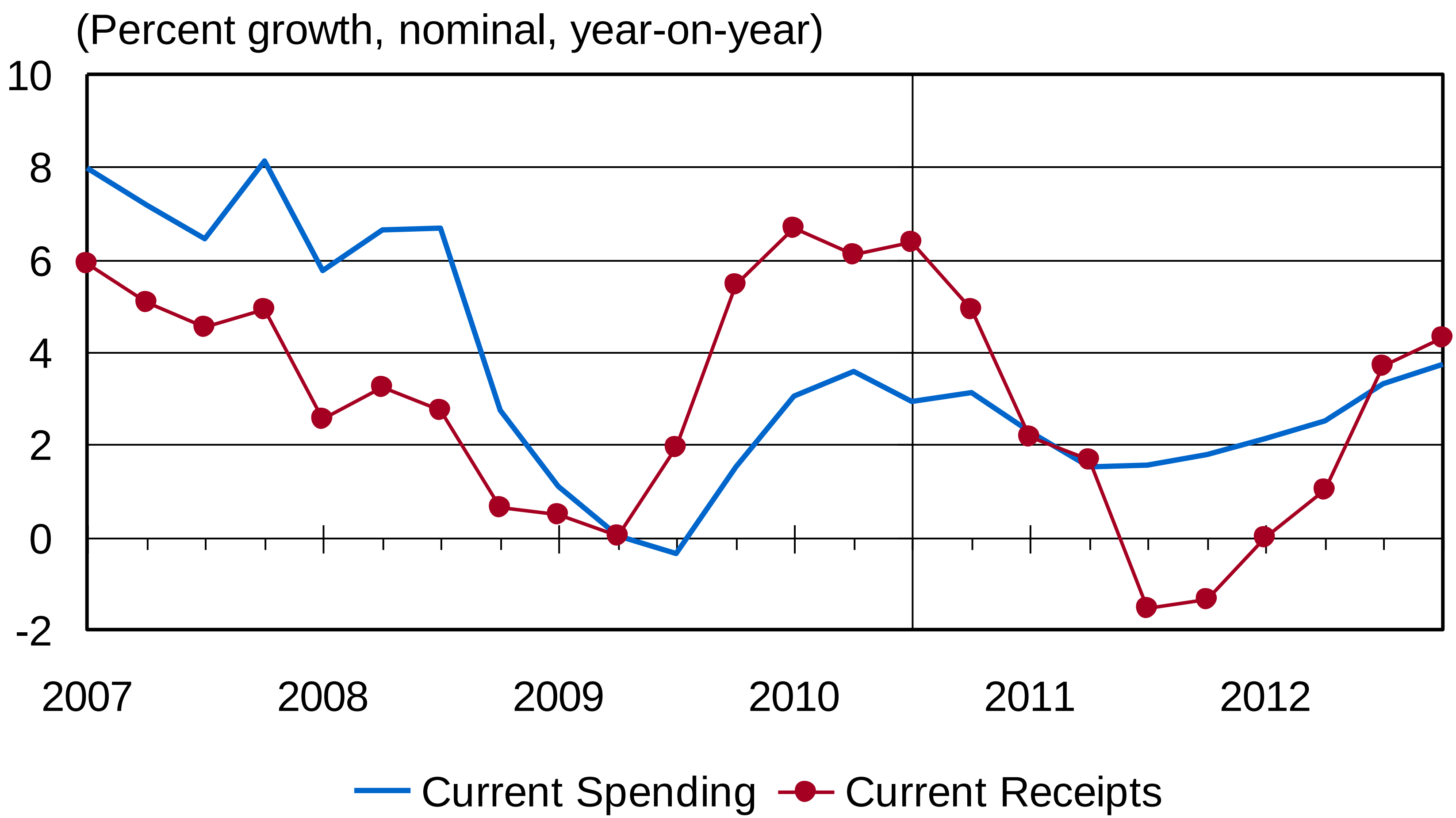
Federal Fiscal Policy Assumptions

- Long-run tightening essential... but immediate tightening risky... and markets are not demanding it
- We assume:
  - Bush tax cuts extended for two more years (1.1% of GDP in CY 2011)
  - Emergency UI program extended into 2011
  - Making Work Pay tax credit ends 2011 (0.3% of GDP in CY 2011)
- Upper-income tax cuts (0.3% of GDP) assumed to expire in 2013
- Further income-tax increases in 2014 and beyond

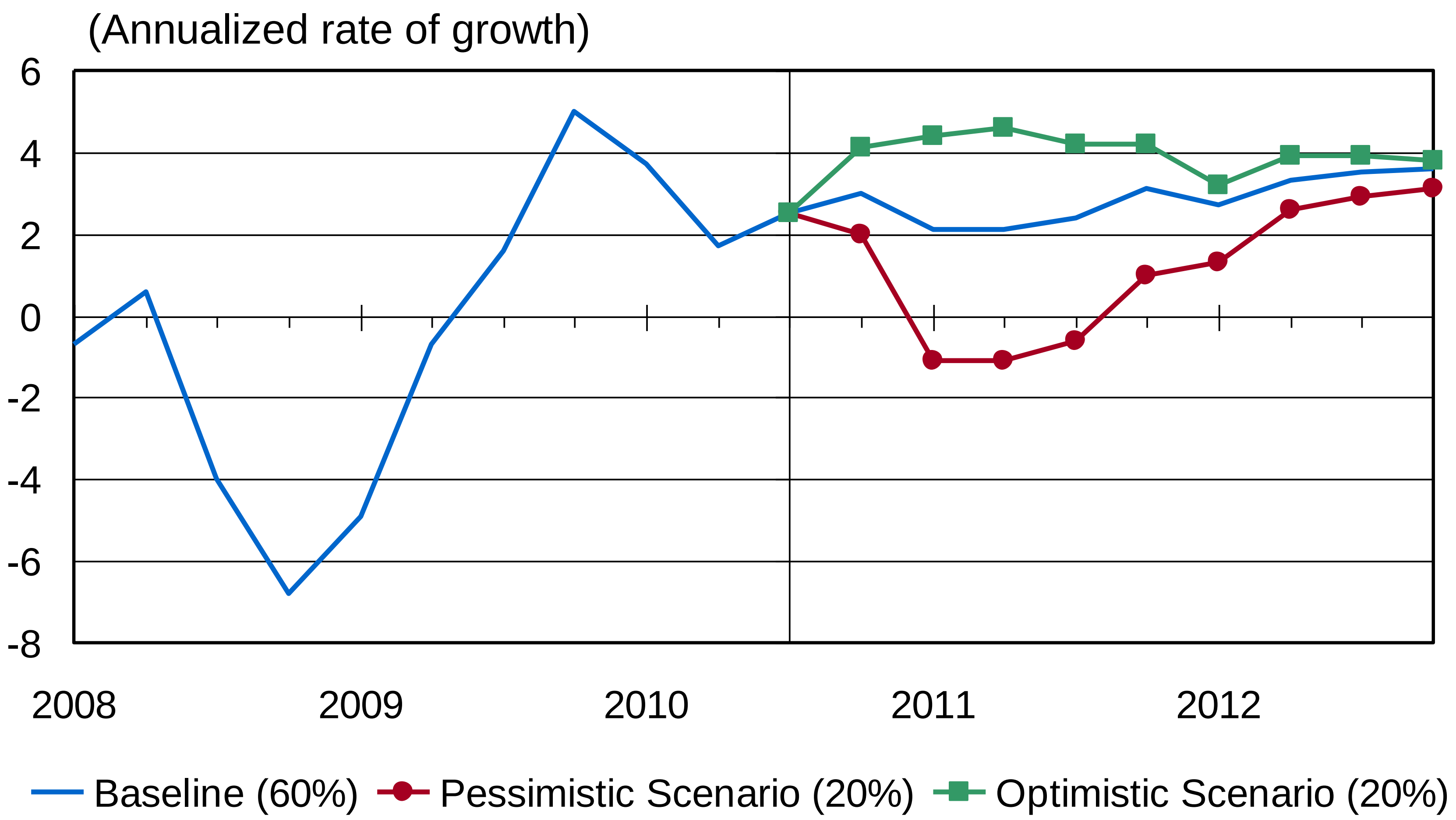
The Tax Compromise and Its Implications

- Includes most of what we expected plus...
- Payroll tax cut of 2 percentage points for employees for 2011 (worth $120 billion, 0.8% of GDP)
- Full expensing of equipment and software spending for 2011
- Likely impact on GDP growth around 0.6% for 2011 (i.e. 3.0%, up from 2.4%)

State and Local Spending Constrained: Receipts Driven by Federal Transfers, Not by the Economy



GDP Growth Outlook



Bottom Line

- Deep recession, slow recovery
- The tax package improves 2011 growth prospects
- Inflation to stay low; deflation is the risk
- Fed is trying more asset purchases; don’t expect too much
- A deficit reduction plan is needed—but not yet action
- The question is not whether taxes will rise but when and how

Regional Outlook

The Source for Critical Information and Insight™

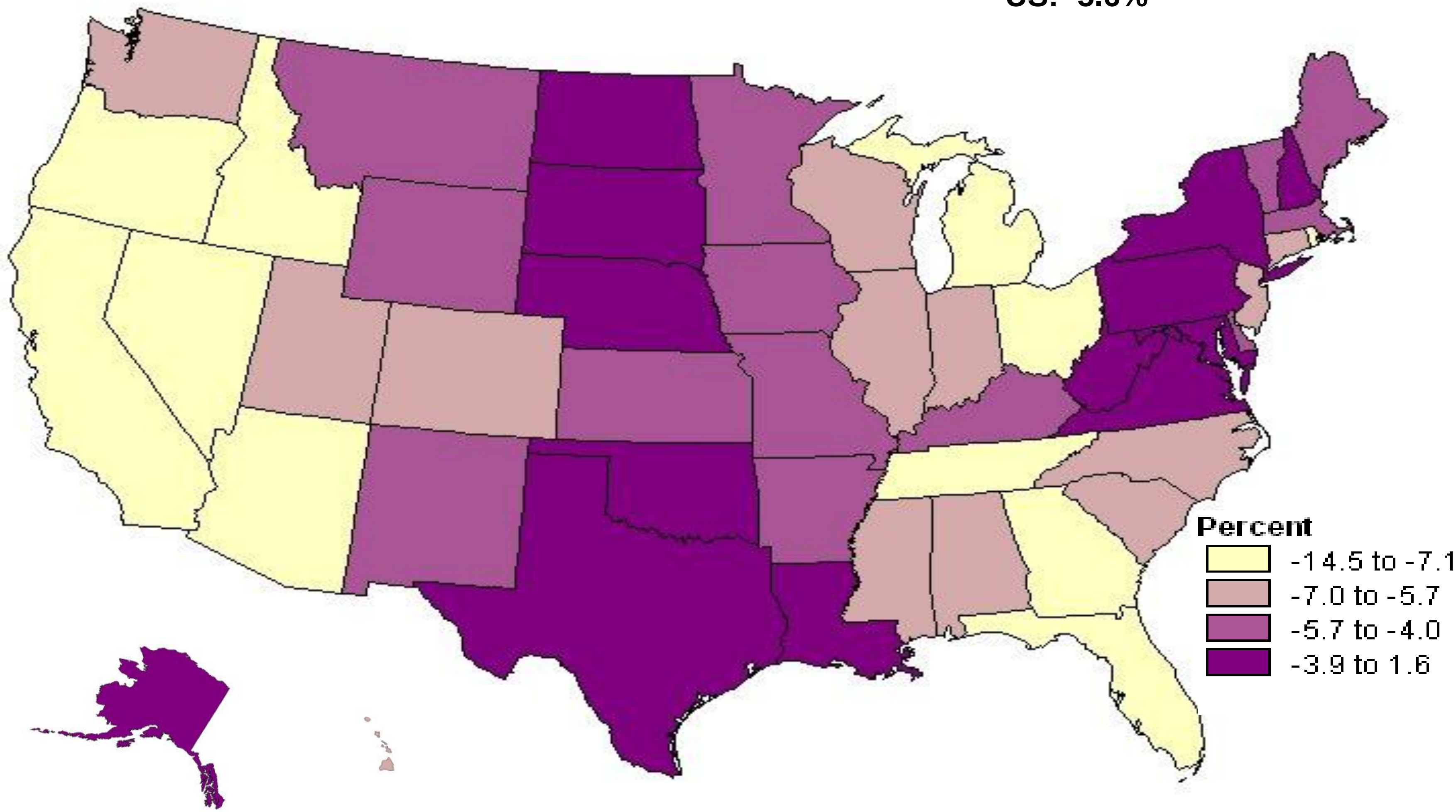
Regional Dynamics 2010

- Forty-six states have seen payroll expansion this year
- With business spending the key driver, Texas, Massachusetts, and Indiana have expanded briskly
- The leading role of manufacturing has brightened the outlook in the industrial midwest
- Lack of any housing upturn keeps parts of Sunbelt in recession

Where we've been: Jobs

Peak to September 2010 Employment Change, %

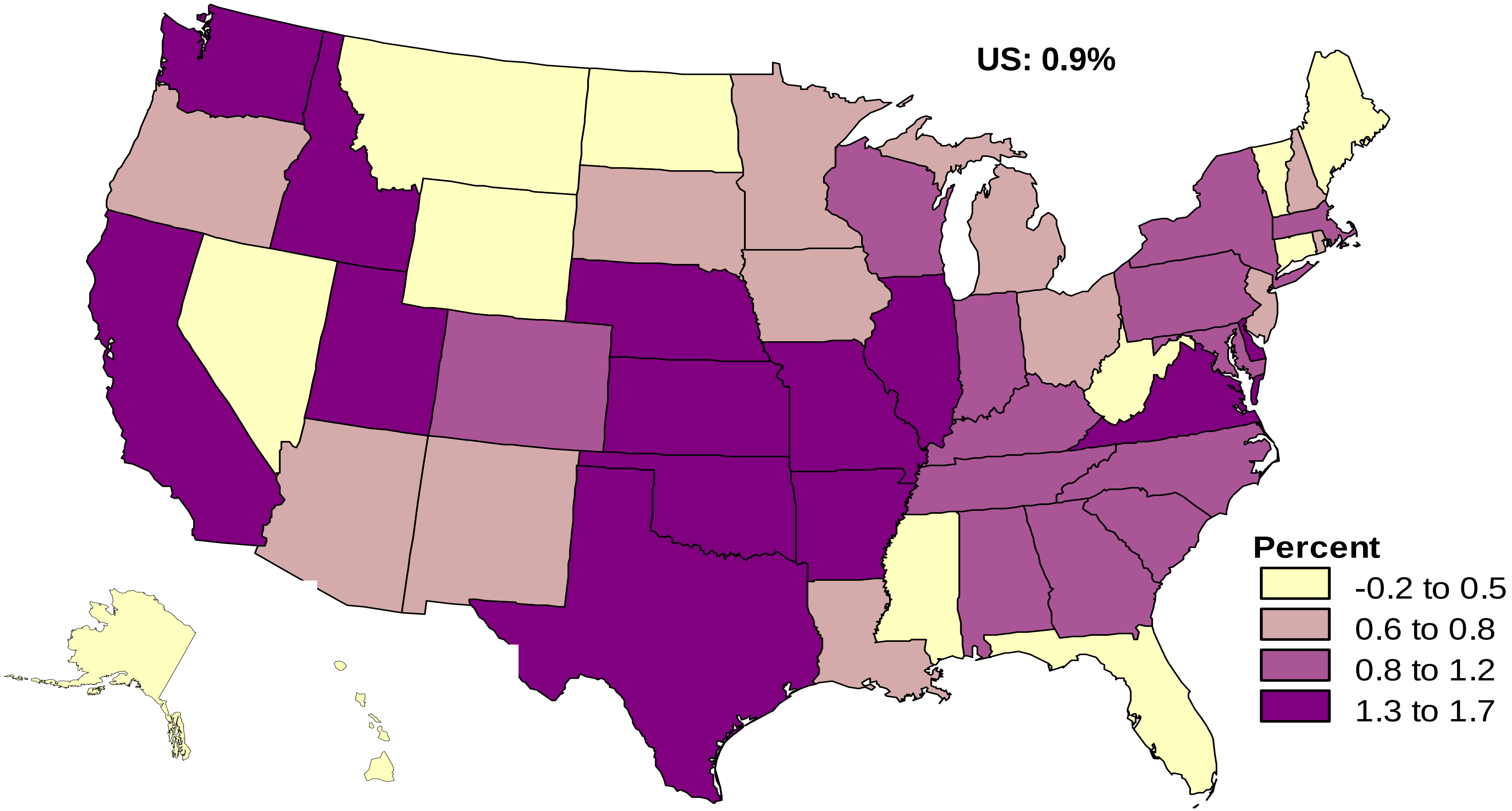
US: -5.6%



IHS INSIGHT

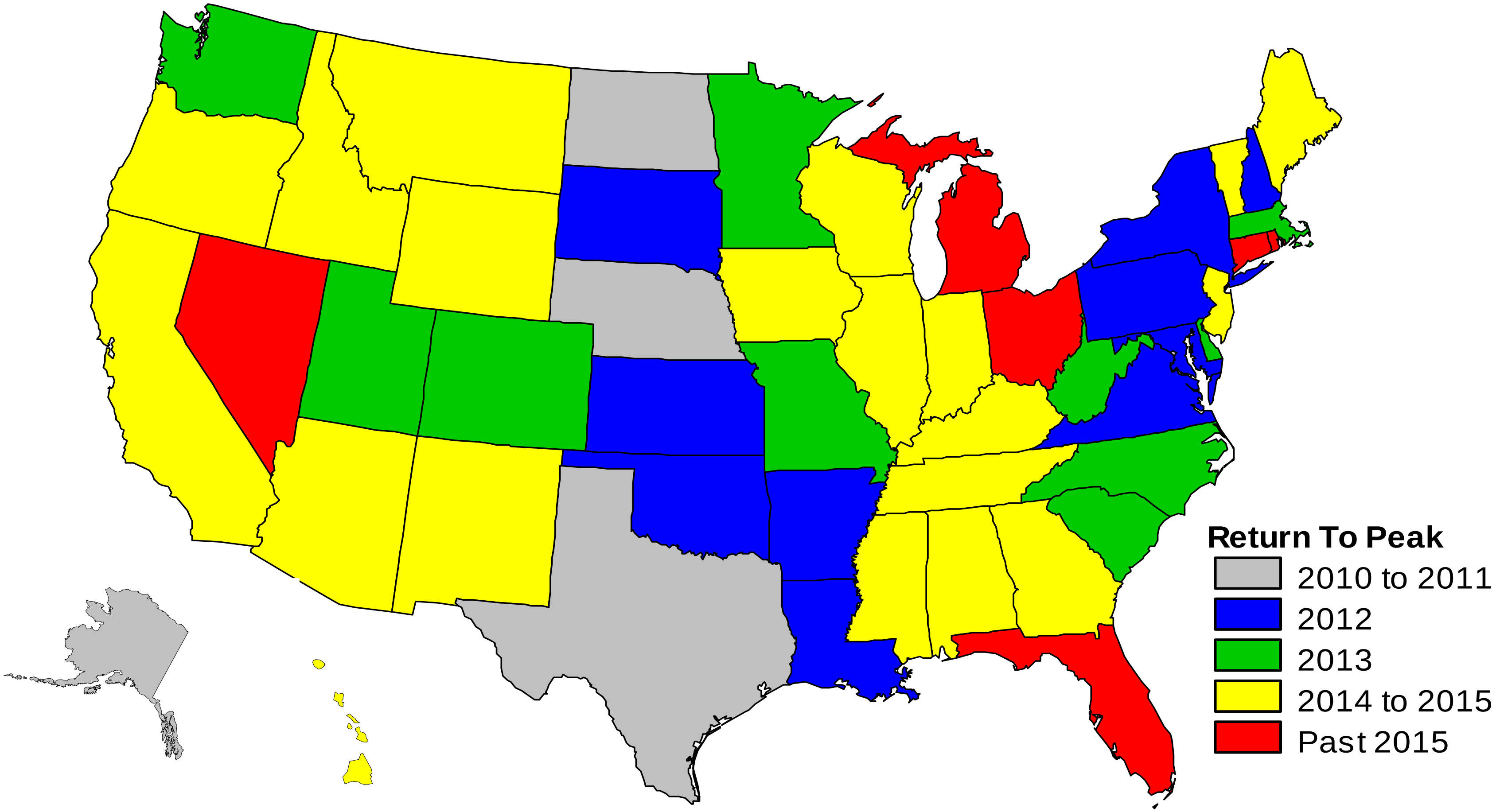
Recovery gathers momentum in 2011

Employment Growth 2011, %



… though a while before we return to peak

Year of Return to Peak Employment



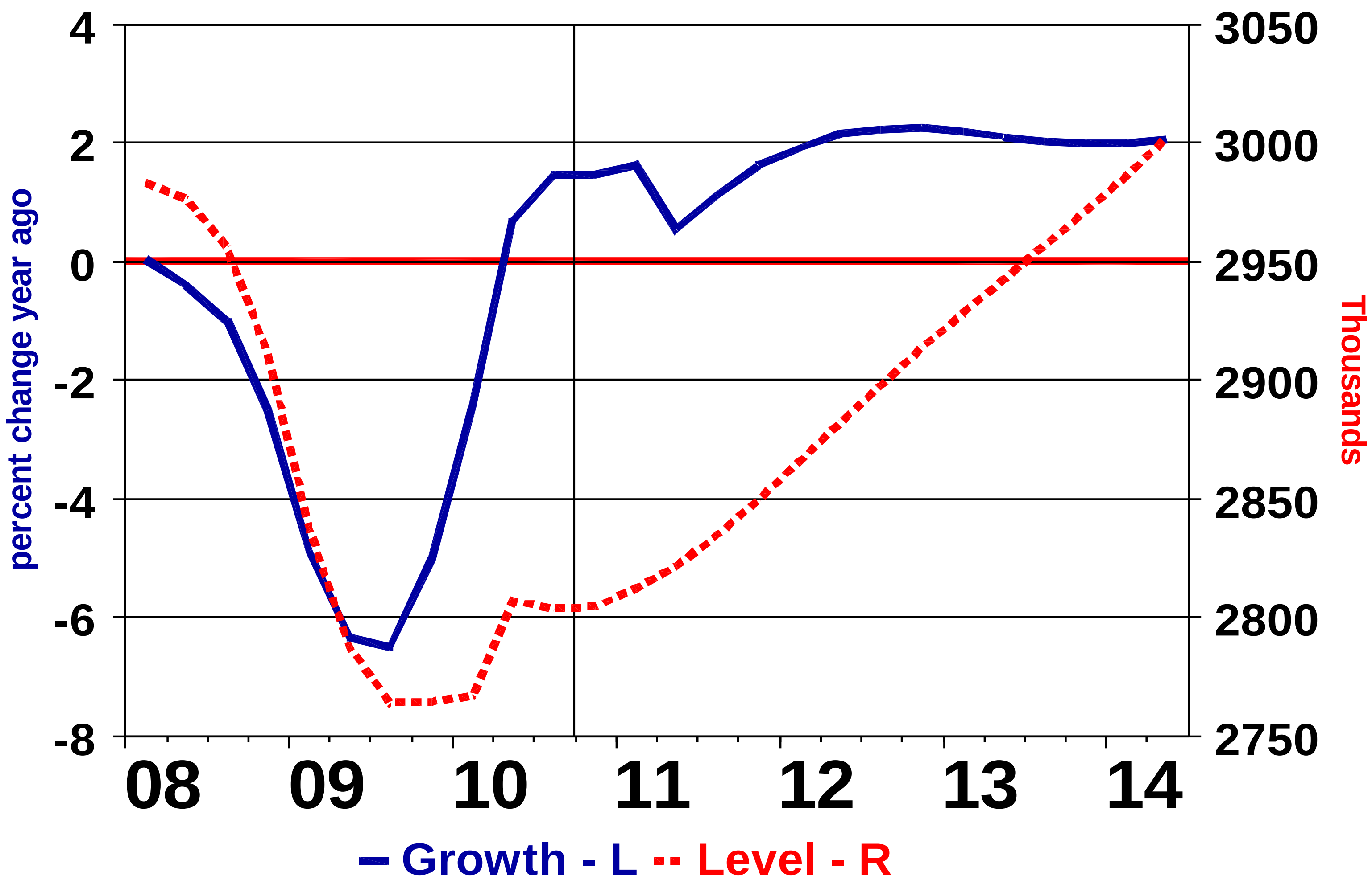
Indiana Outlook

The Source for Critical Information and Insight™

Bottom Line

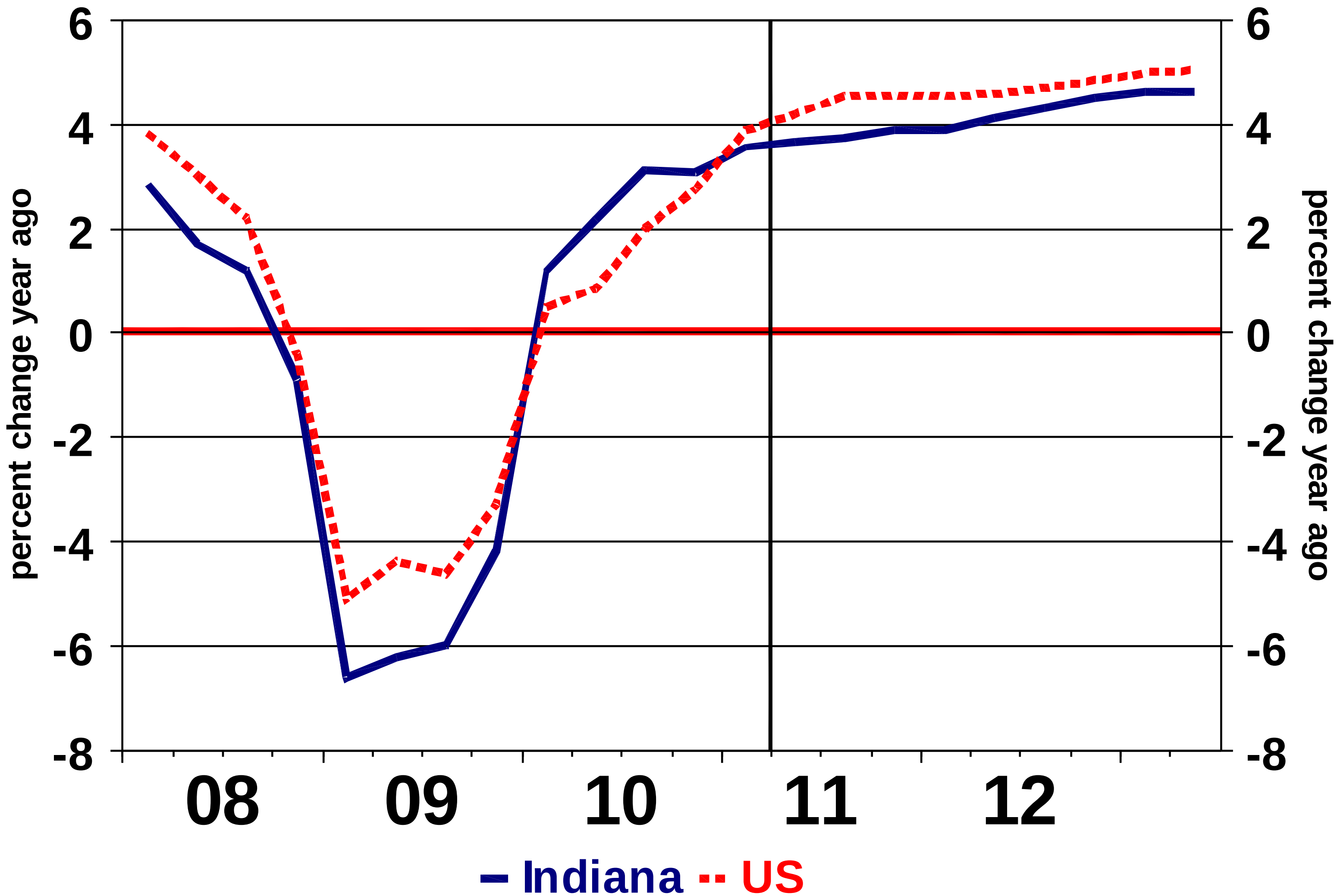
- Deeper, earlier recession than most
- Among 2010 growth leaders
  - Transportation equipment rebound
  - Low paying temp and business services jobs
- Slow recovery, but a recovery is indeed in place
- Medium term performance near average among states
  - Outpacing other midwest manufacturing giants

Indiana Employment Forecast

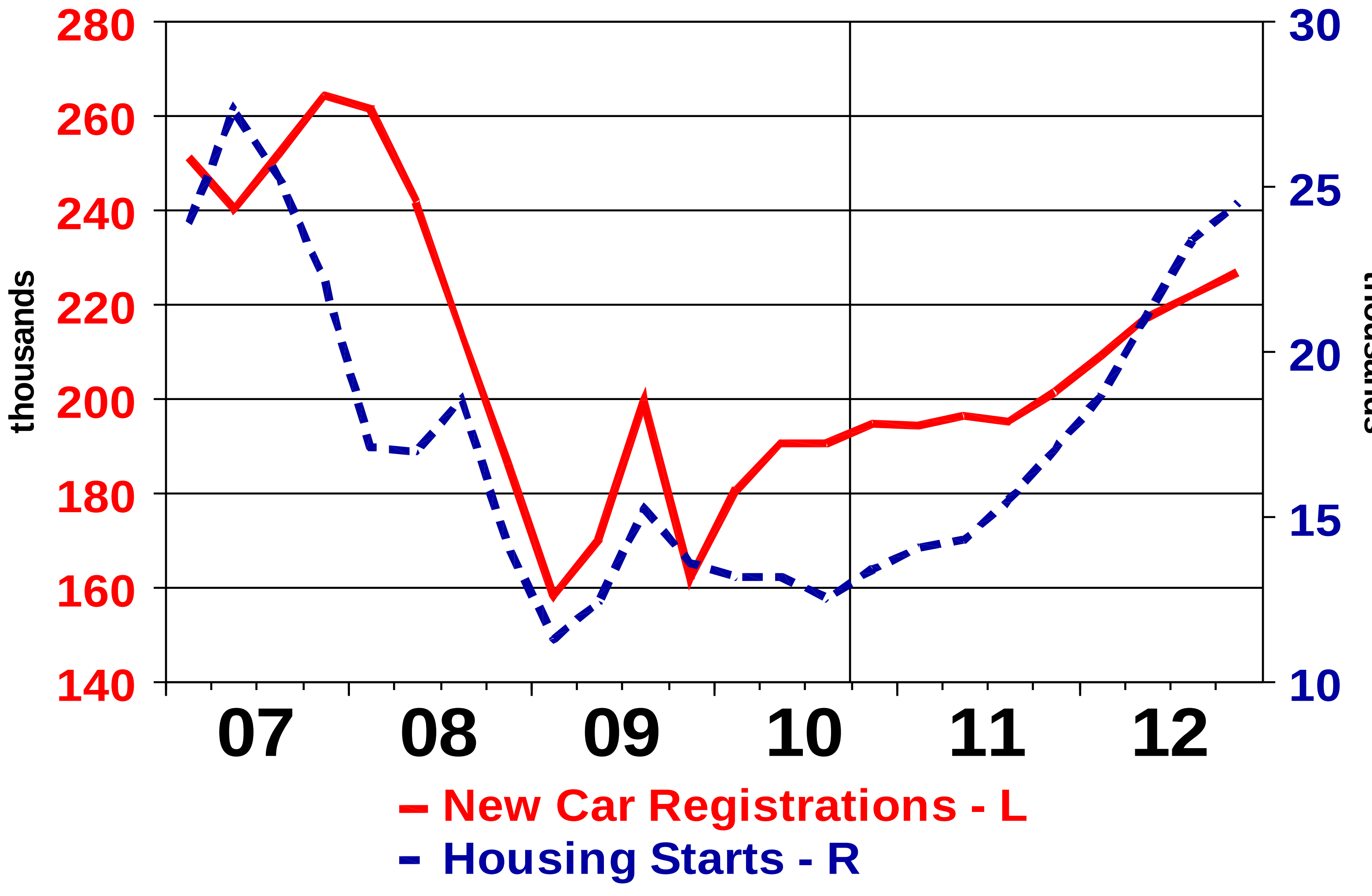


Wage Gains Return

(nominal total wages and salaries)



Cars and Houses



Forecast Summary

(Percent unless otherwise noted)

	2009	2010	2011	2012
Employment	-5.7	0.3	1.2	2.1
Unemployment Rate	10.0	10.0	10.0	9.5
Personal Income	-2.4	2.8	3.2	3.3
Housing Starts (000)	13.1	13.1	15.2	21.9
Retail Sales	-7.1	6.2	4.8	5.4
Gross State Product	-3.6	2.7	1.5	2.9

Thank you!

Jim Diffley
Senior Director
Chief Regional Economist
IHS Global Insight

The Source for Critical Information and Insight™