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

(Real GDP compared with recession trough)

Quarters from Trough

-8 -7 -6 -5 -4 -3 -2 -1 0 1 2 3 4 5 6 7 8

Current Recovery* Post-1950 Average Recovery

* 2009Q2 trough
Financial Clouds Lifting, Slowly
Bank Commercial and Industrial Loans: Bottoming Out?

(Loans outstanding, billions of dollars)
Bank Credit: Beginning to Loosen

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

(Annualized real rate of growth, Q/Q, percent)
# U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

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

(Percent unless otherwise noted)

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

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

(FHFA house price index* divided by average labor compensation, 2000 = 1.0)

* Purchase-only index from 1991 onwards
Housing Starts Have Hit Bottom: Prices Not Quite There Yet

(Million units) (Purchase-only index, 1991Q1 = 100)


- Housing Starts (Left scale)
- FHFA House Price Index (Right scale)
The Consumer: Reviving, But Without Vigor
The Personal Saving Rate Has Risen

(Personal savings rate, percent of disposable income)
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

(Reuters/University of Michigan Index, 1966=100)
Employment Is Turning, But Not Rapidly

Private Payroll Employment*

Unemployment Rate**

Length of Workweek***

Temporary Employment*

*Thousands, monthly change, SA; **Percent; ***Hours, SA
Consumer Spending Stabilizing, But Not a Strong Driver of Recovery

(Annualized rate of growth)
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
Business Equipment Demand Recovering

(Non-defense capital goods ex-aircraft, 3-mo moving average, US$ billions)
The U.S. Dollar: Secular Weakness Against EMG Currencies

(2005=1.0, inflation-adjusted)

Major Currency Index

Other Important Trading Partners Index
Core Inflation Is Still Easing

(Percent change from a year earlier)

All-Urban CPI Core PCE Price Index
Wage Inflation Not An Issue

(Percent change, year-on-year)

2007 2008 2009 2010 2011 2012

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

Fed Funds vs. 10-Year Treasury Yield

(Percent)

1999 2001 2003 2005 2007 2009 2011

Federal Funds 10-Year Treasury Yield

- Federal Funds
- 10-Year Treasury Yield
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

(Percent growth, nominal, year-on-year)

Current Spending

Current Receipts

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

Current Spending

Current Receipts
GDP Growth Outlook

(Annualized rate of growth)

-8 -6 -4 -2 0 2 4 6

2008 2009 2010 2011 2012

Baseline (60%)  Pessimistic Scenario (20%)  Optimistic Scenario (20%)
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
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%
Recovery gathers momentum in 2011

Employment Growth 2011, %

US: 0.9%
... though a while before we return to peak

Year of Return to Peak Employment

Return To Peak
- 2010 to 2011
- 2012
- 2013
- 2014 to 2015
- Past 2015
Indiana Outlook
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

percent change year ago
Thousands

-8 -6 -4 -2 0 2 4
2008 2009 2010 2011 2012 2013 2014

- Growth - L - Level - R

Growth - L
Level - R

Copyright © 2010 IHS Global Insight. All Rights Reserved.
Wage Gains Return
(nominal total wages and salaries)

- Indiana
- US
Cars and Houses

New Car Registrations - L
Housing Starts - R
## Forecast Summary

(Percent unless otherwise noted)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>-5.7</td>
<td>0.3</td>
<td>1.2</td>
<td>2.1</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.5</td>
</tr>
<tr>
<td>Personal Income</td>
<td>-2.4</td>
<td>2.8</td>
<td>3.2</td>
<td>3.3</td>
</tr>
<tr>
<td>Housing Starts (000)</td>
<td>13.1</td>
<td>13.1</td>
<td>15.2</td>
<td>21.9</td>
</tr>
<tr>
<td>Retail Sales</td>
<td>-7.1</td>
<td>6.2</td>
<td>4.8</td>
<td>5.4</td>
</tr>
<tr>
<td>Gross State Product</td>
<td>-3.6</td>
<td>2.7</td>
<td>1.5</td>
<td>2.9</td>
</tr>
</tbody>
</table>
Thank you!

Jim Diffley
Senior Director
Chief Regional Economist
IHS Global Insight