

US Economic Outlook

■ Weathering the headwinds

NOMURA



- ❑ US Economics
- ❑ Ellen Zentner; Executive Director
- ❑ Senior US Economist
- ❑ ellen.zentner@nomura.com
- ❑ March 2012

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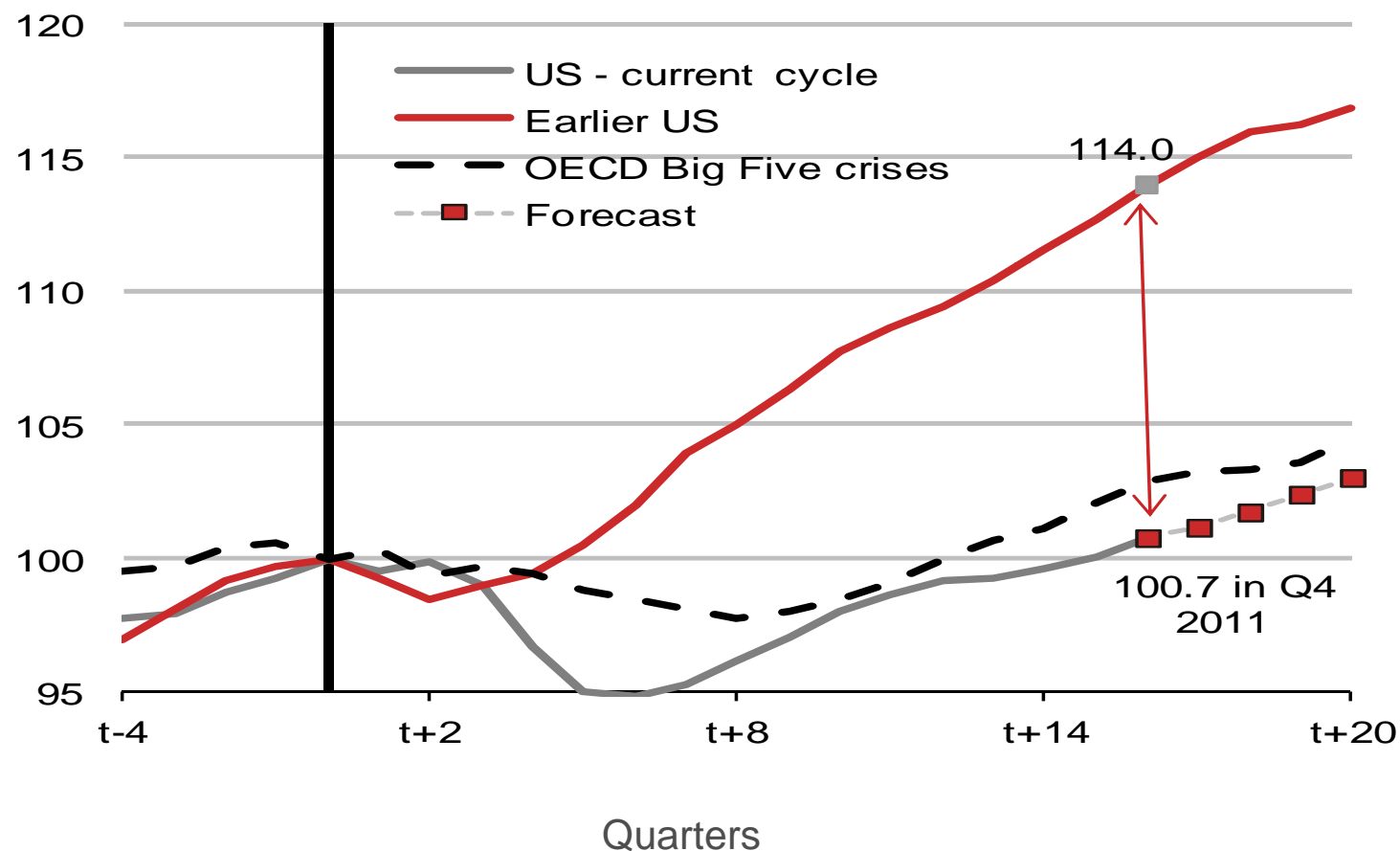
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The Outlook: Dominant Themes in the “Big Picture”

- The US economy remains in a “Rogoff-Reinhart” world
 - Household balance sheets constrain spending
 - Government fiscal imbalances persist
- “Underlying” (core) inflation remains low / Economic “slack” high
- “Unusual uncertainty” persists
 - Rising gas prices
 - Fear of “contagion” from European sovereign debt crisis
 - Implementation challenges in Dodd-Frank & “Obama-care”
 - Uncertainty over US fiscal policy - after the election significant reforms are needed to the Federal Budget, taxes, and mortgage finance
- Monetary policy options are limited but are likely to be used

Tracking earlier post-crisis recoveries

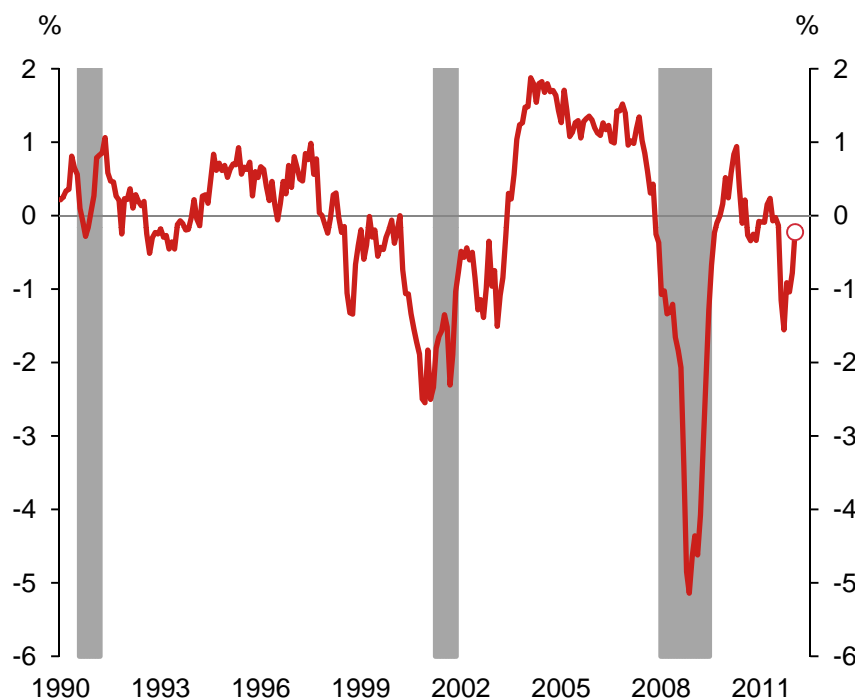
Real GDP around recessions and financial crises (Index, time $t = 100$)



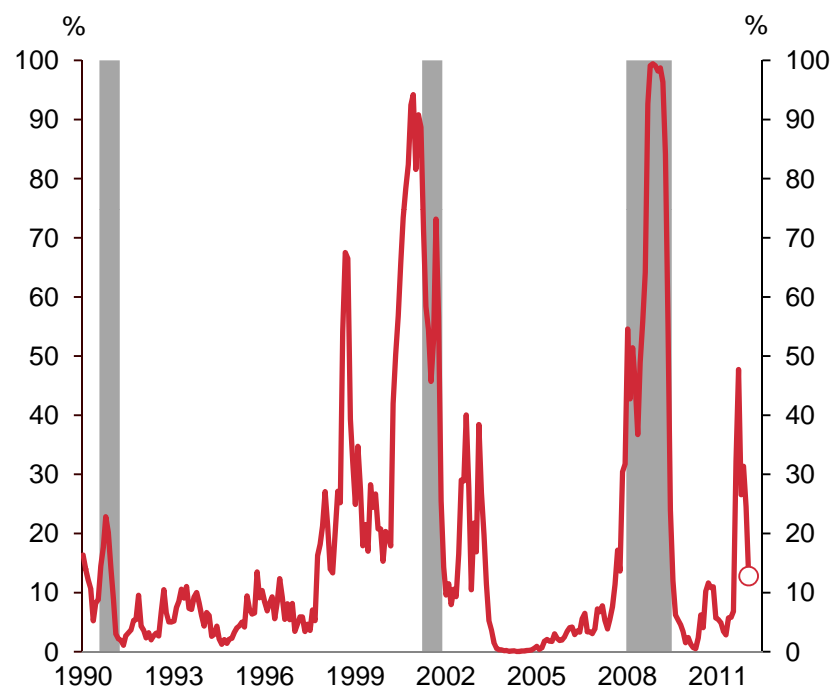
Source: OECD, Nomura Global Economics; Note: "Earlier US" is average of last 10 recessions; OECD Big Five financial crises first identified by Kaminsky and Reinhart (1999); Countries are Spain (1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1997); We use 1997 for Japan (instead of 1992) as this was the start of the most intense phase of the financial crisis there.

Financial conditions have improved

Projected impact of financial conditions on employment growth over next 12 months



Probability of a recession in the next six months based on financial conditions

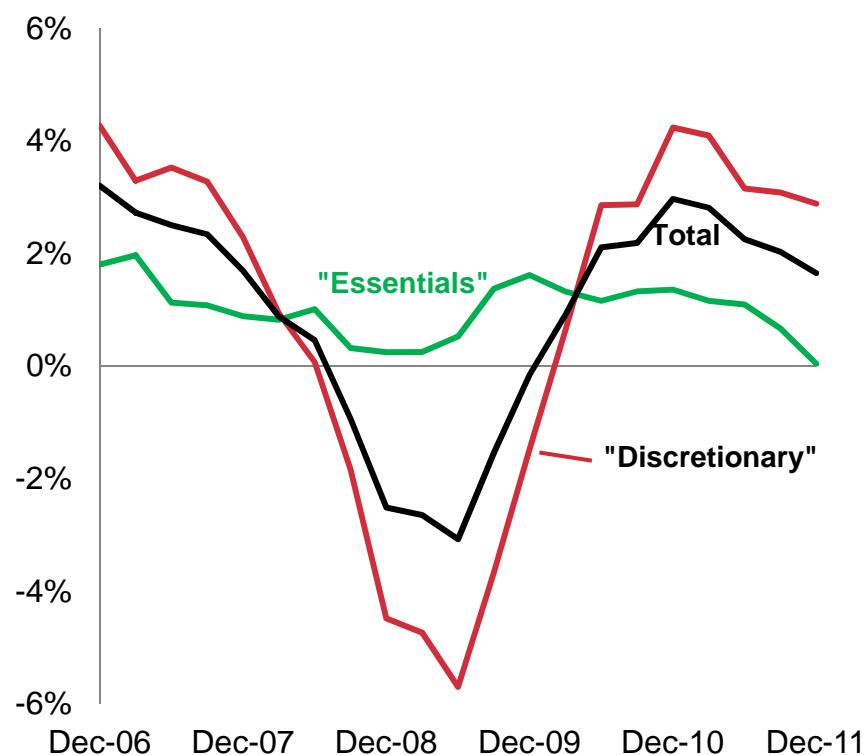


Note: Estimates are based on a simple VAR model for the US economy that includes four key financial variables: A-rated industrial corporate credit spreads, equity prices, retail mortgage rates, and responses to the National Federal of Independent Businesses' (NFIB) survey on small businesses' access to credit. The model is used to estimate how shocks to those variables affect the outlook for employment over the next 12 months. The projected impact on employment is then used in a separate "Probit" model to estimate the probability of a recession occurring sometime in the next six months.

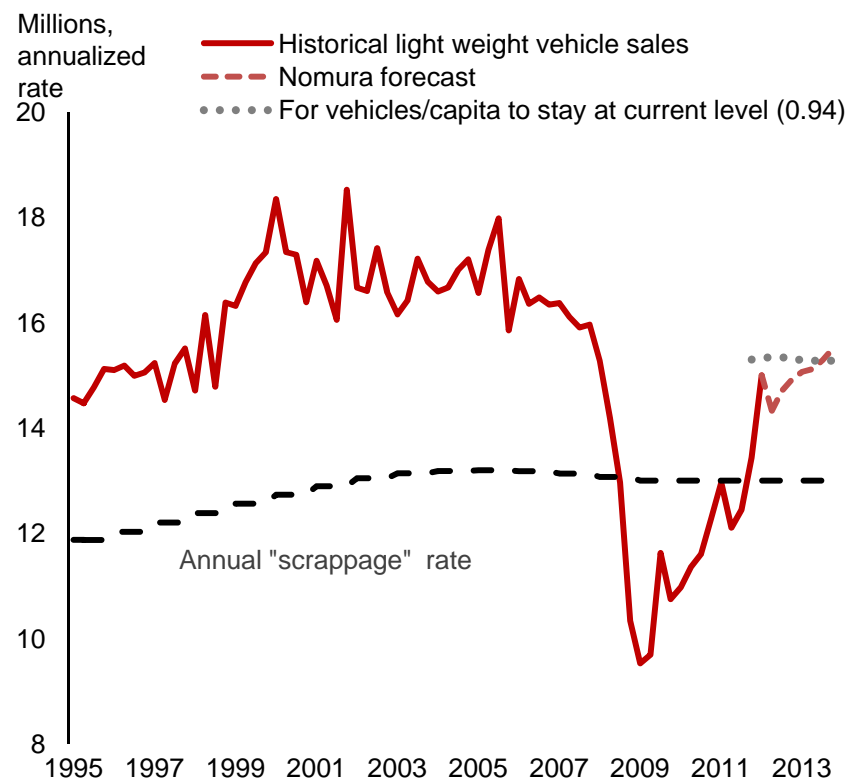
Source: Nomura Global Economics

Consumers getting bolder

Spending: Essential and Discretionary



Sales of light-weight motor vehicles

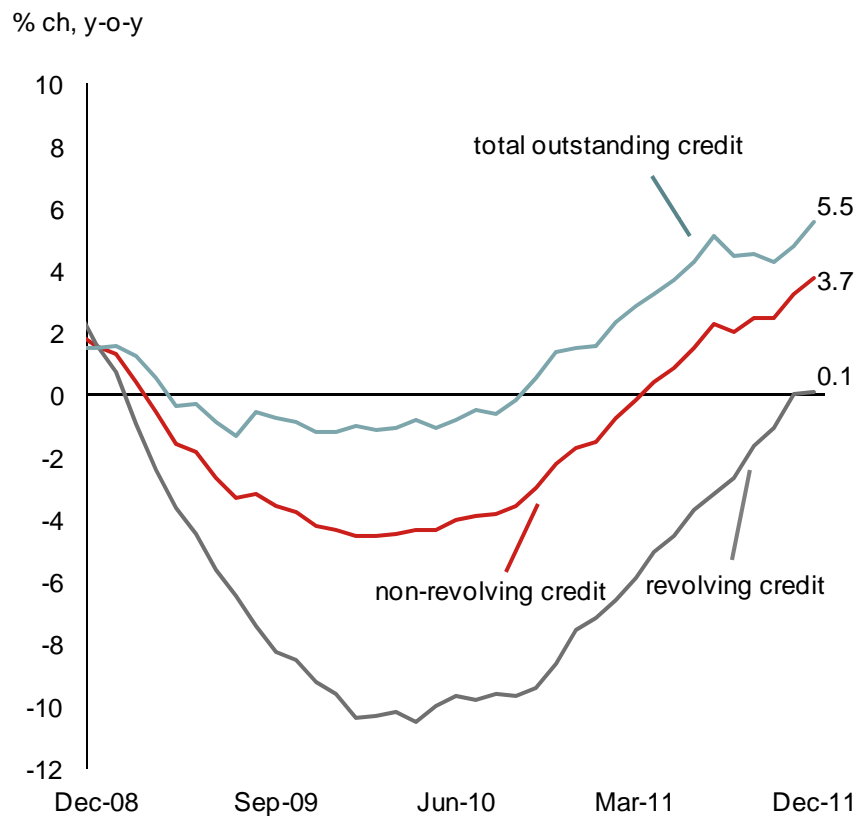


Source: Census Bureau; BEA; Nomura Global Economics

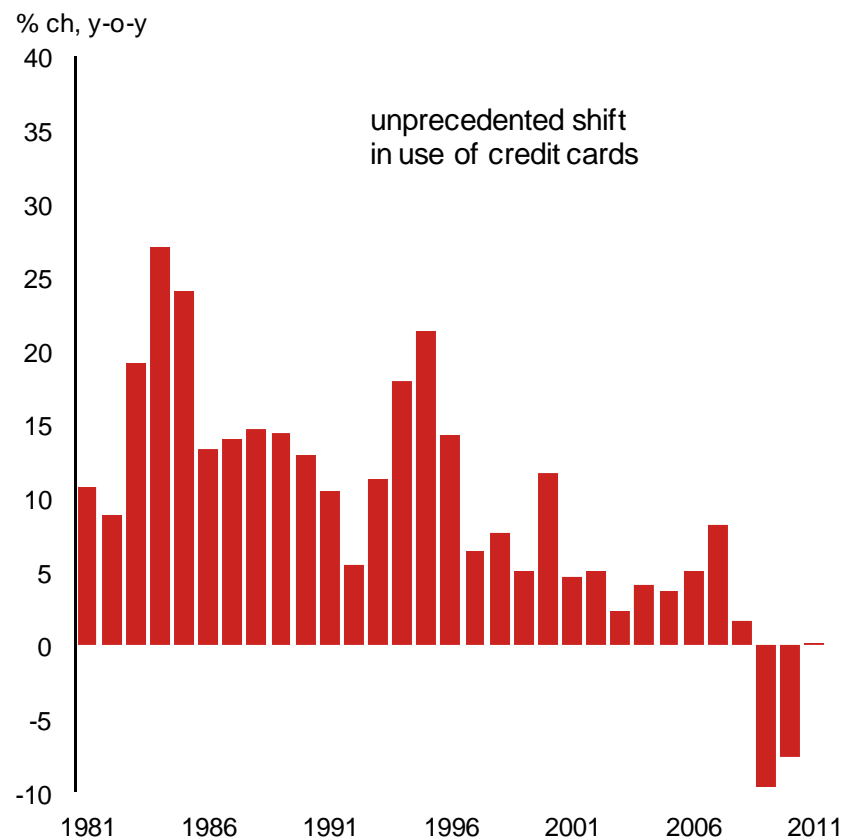
Consumer credit

Student and auto loans are rising, households still reluctant to use credit cards

Growth in consumer credit by type



Historical look at revolving credit (credit cards)



Source: Federal Reserve; Nomura Global Economics

Lower unemployment, but weak wage growth

Unemployment and labor force participation



Unemployment rate (%)

Aug-11 9.06

Jan-12 8.26

Difference between Aug 2011 and Jan 2012
 impact of (ppt)

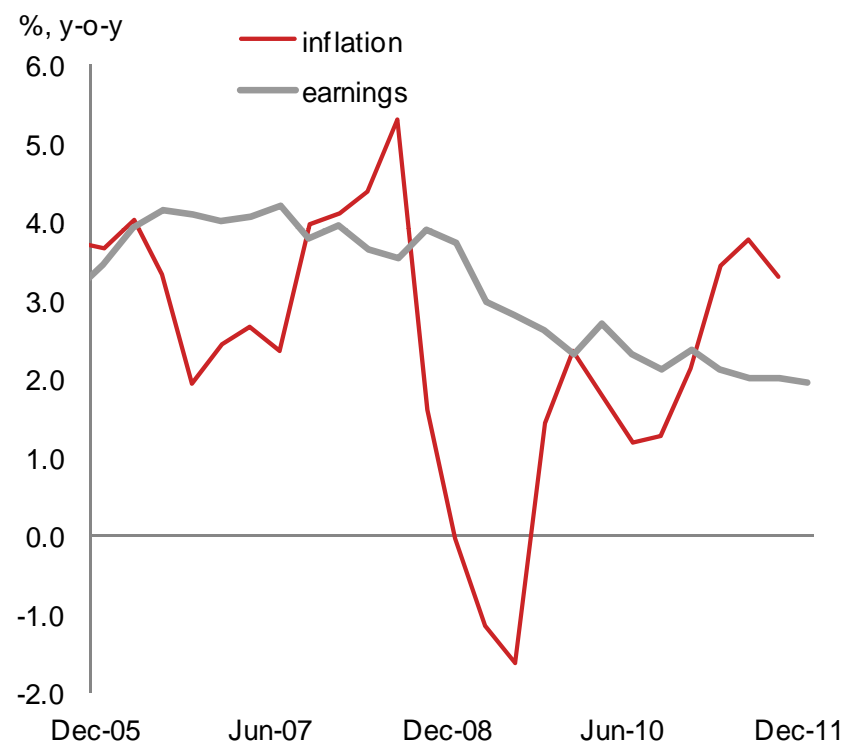
Population change (2398k increase) 0.9

Change in employment (1883k increase) -1.2

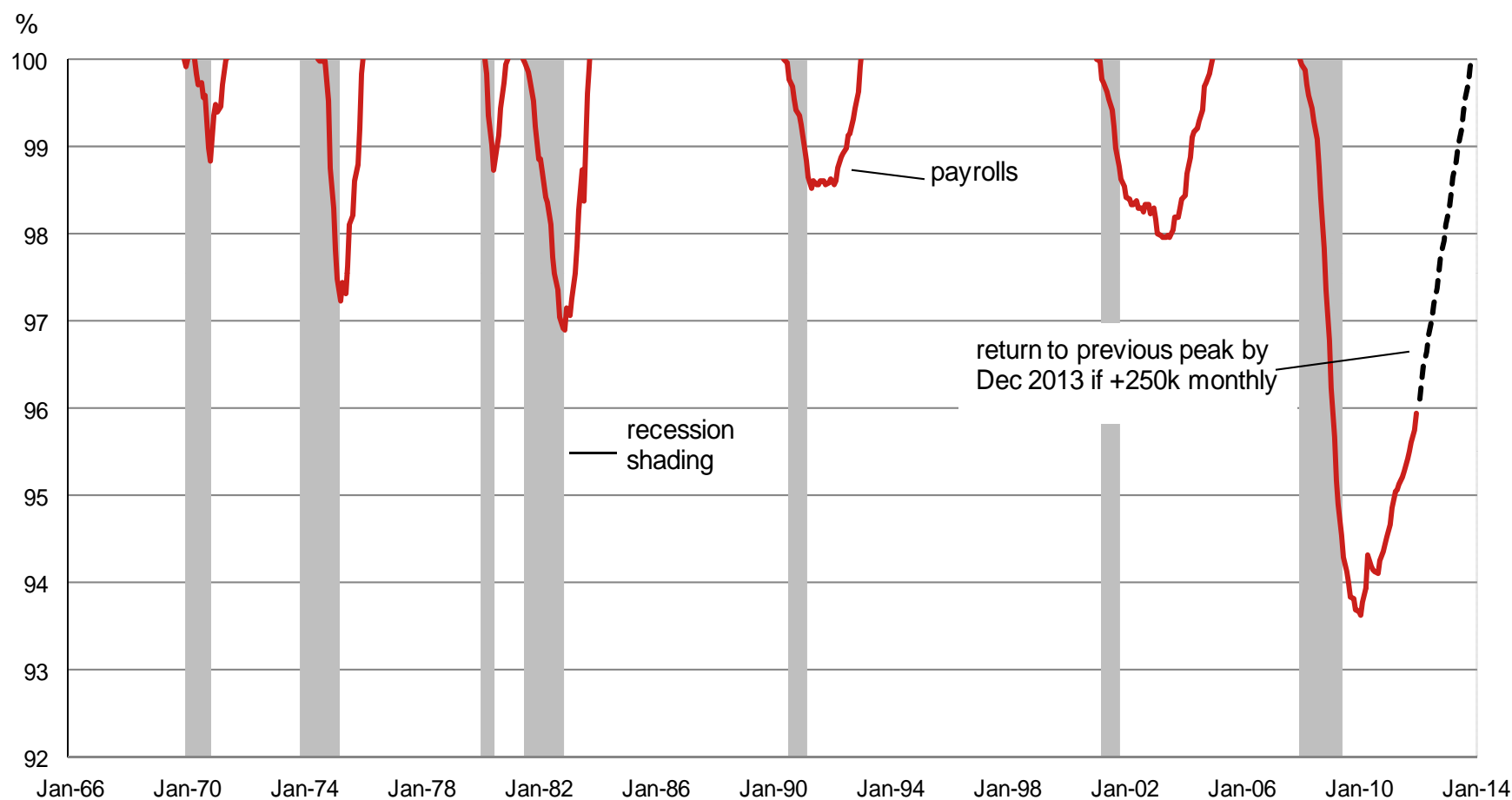
Change in p-rate (0.34 ppt down) -0.5

Source: Bureau of Labor Statistics; Nomura Global Economics

Average hourly earnings



Nonfarm payrolls still 4.1% below peak

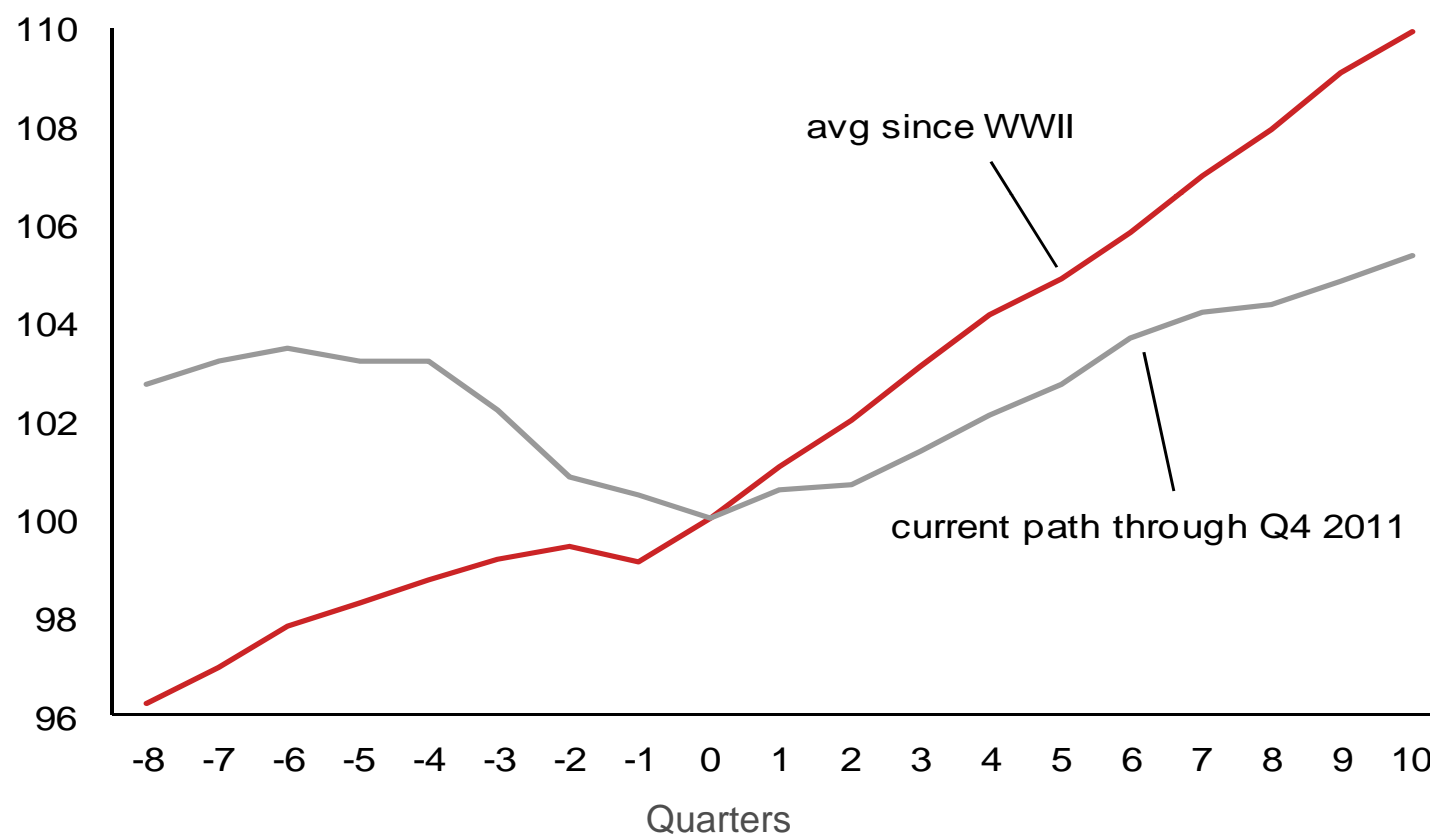


Source: Bureau of Labor Statistics; Nomura Global Economics

Consumer spending underperforming

Weak credit cycle, deleveraging holding back more robust recovery

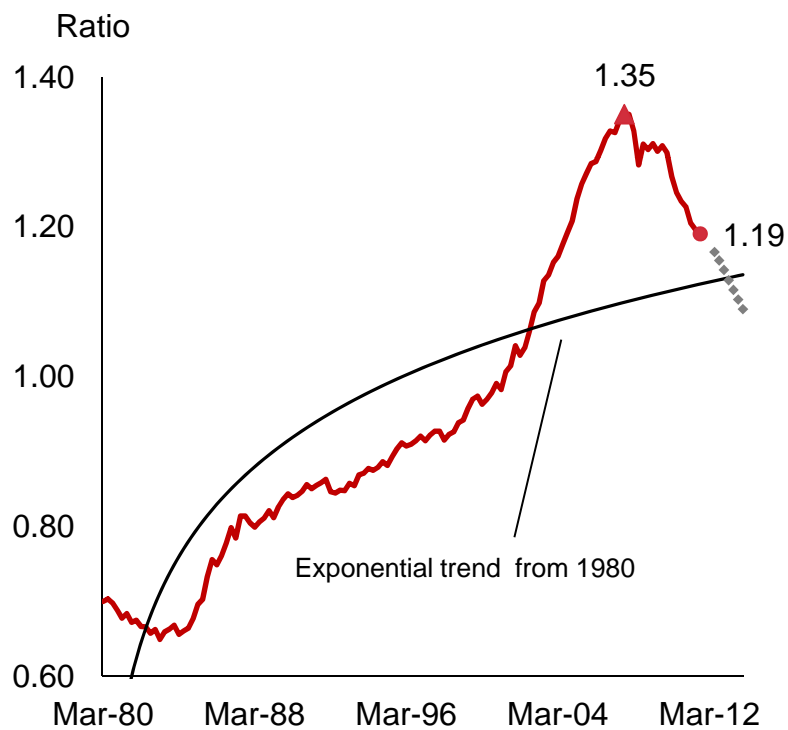
index = 100 at trough of business cycle



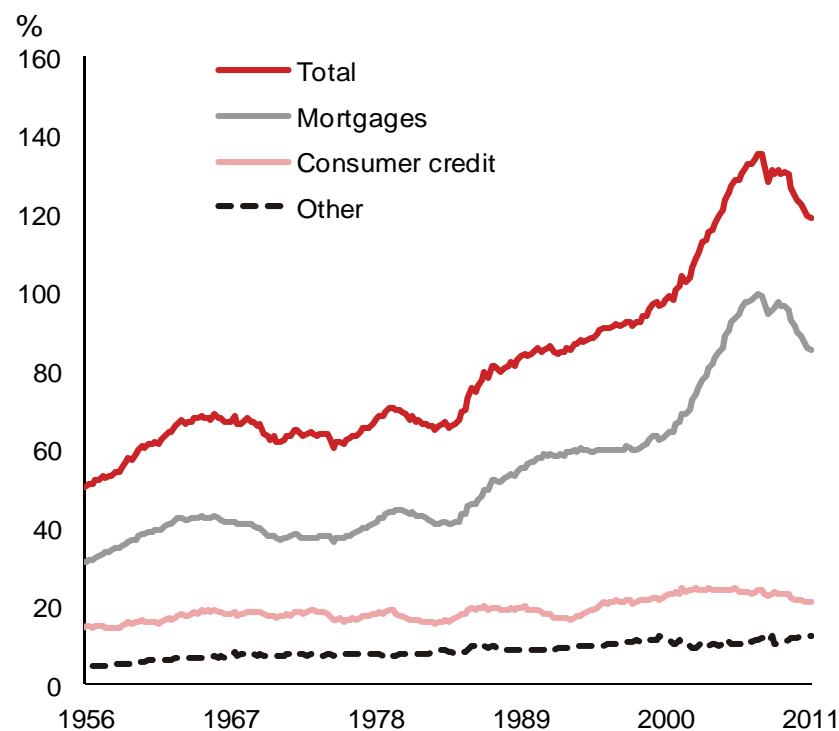
Source: Bureau of Economic Analysis; Nomura Global Economics

Consumer outlook: debt constrained

Ratio: Household debt to after-tax income



Debt-to-after-tax-income (by type)

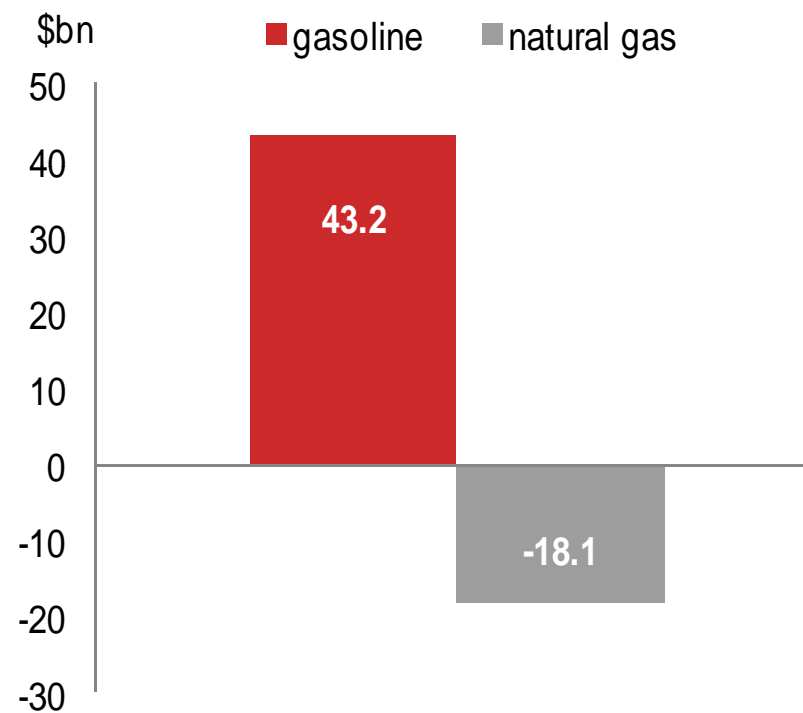
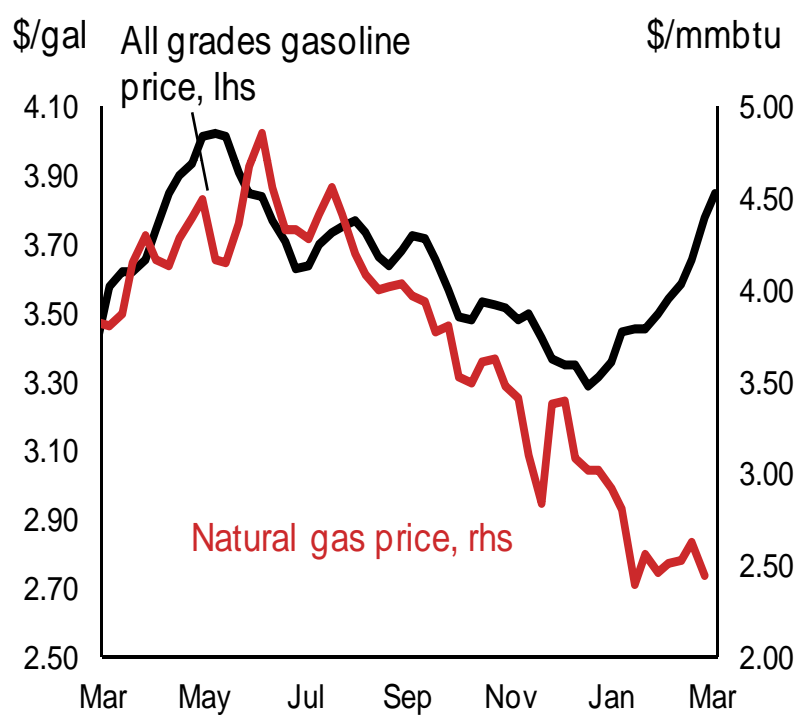


Source: BEA; Federal Reserve; Haver Analytics; Nomura Global Economics

Gasoline prices have risen sharply

But natural gas prices have been falling

Annualized cost/savings to households



Source: Energy Information Administration; Bureau of Economic Analysis; Nomura Global Economics

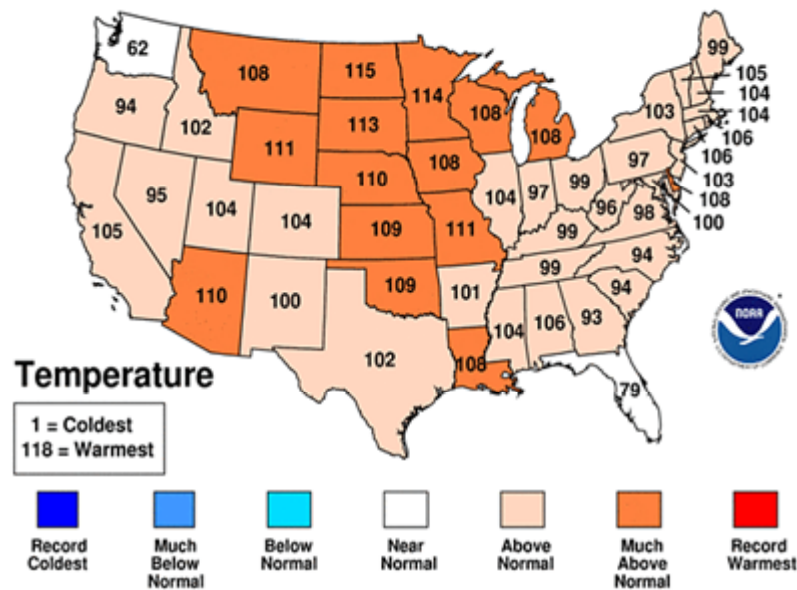
Weather patterns matter

January 2012, 4th warmest on record

January 2011 temps below normal

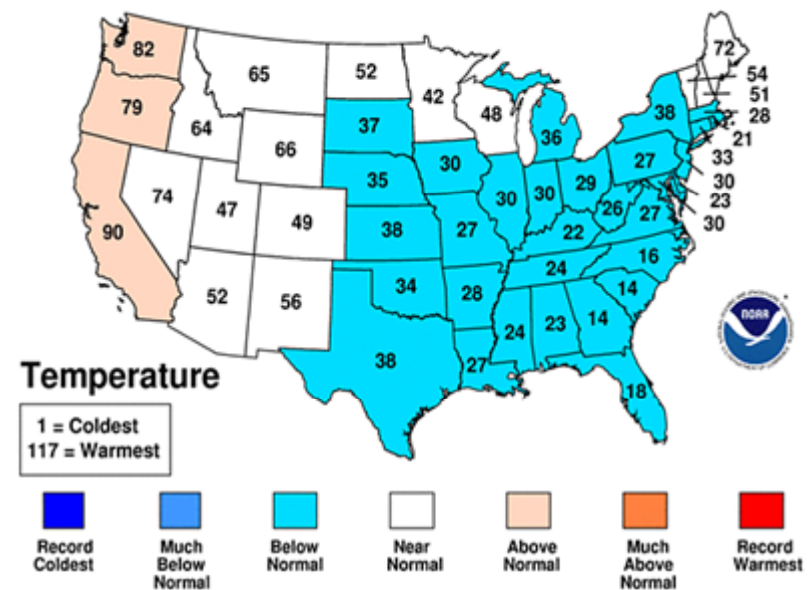
January 2012 Statewide Ranks

National Climatic Data Center/NESDIS/NOAA



January 2011 Statewide Ranks

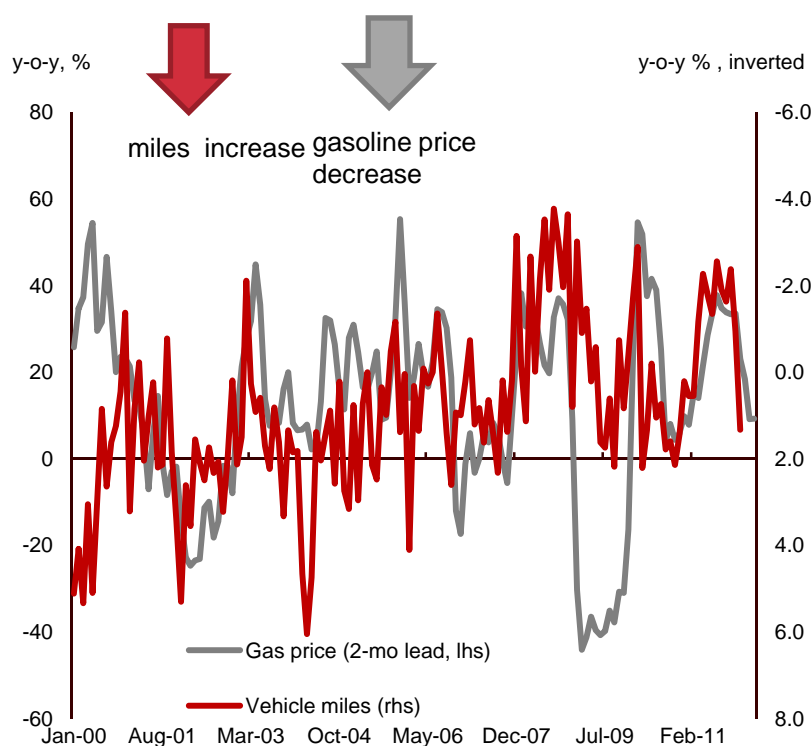
National Climatic Data Center/NESDIS/NOAA



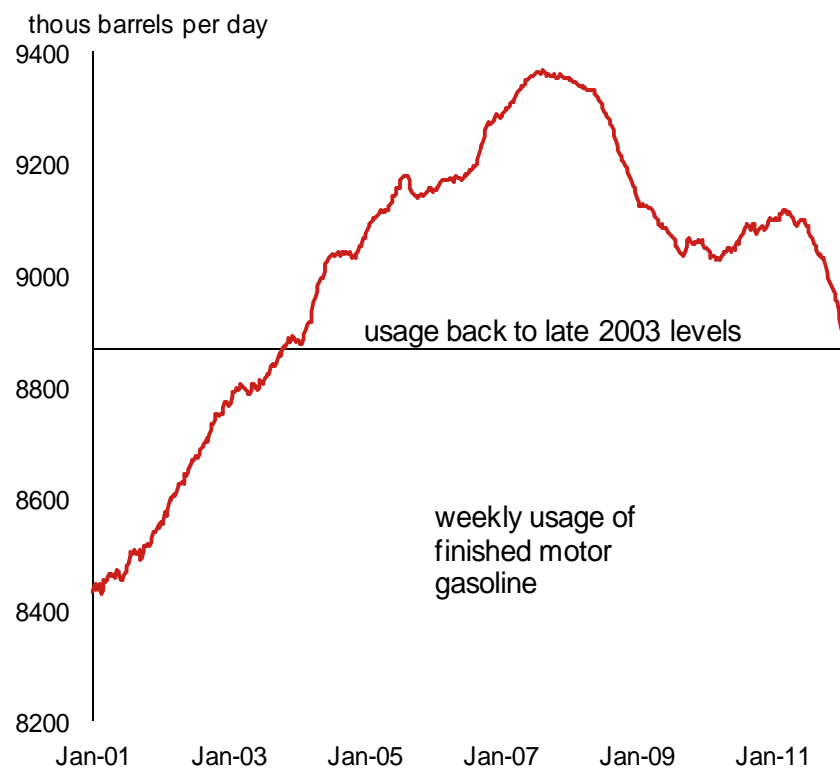
Source: NOAA; Nomura Global Economics

Household respond with a 2-month lag to high gas

Consumers are driving less



Consuming less gas

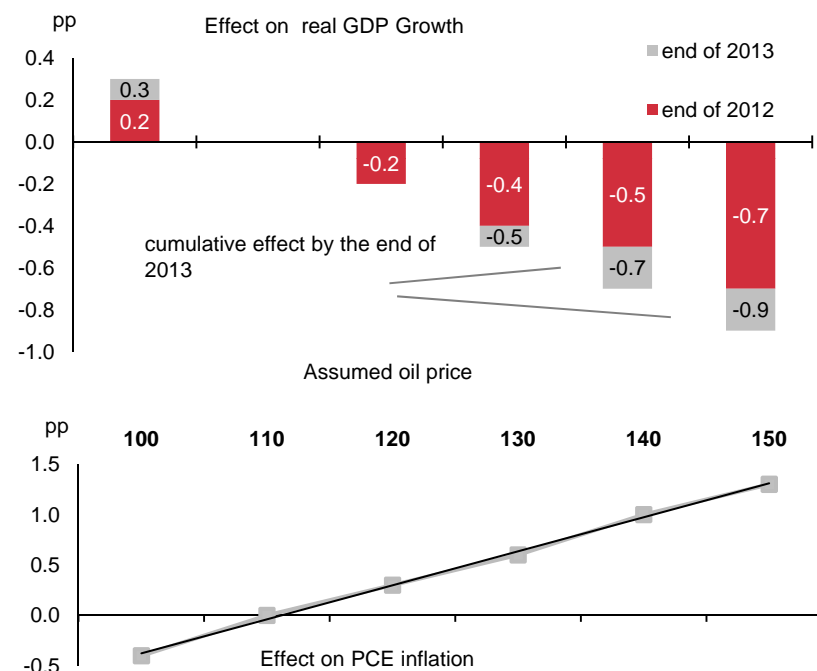
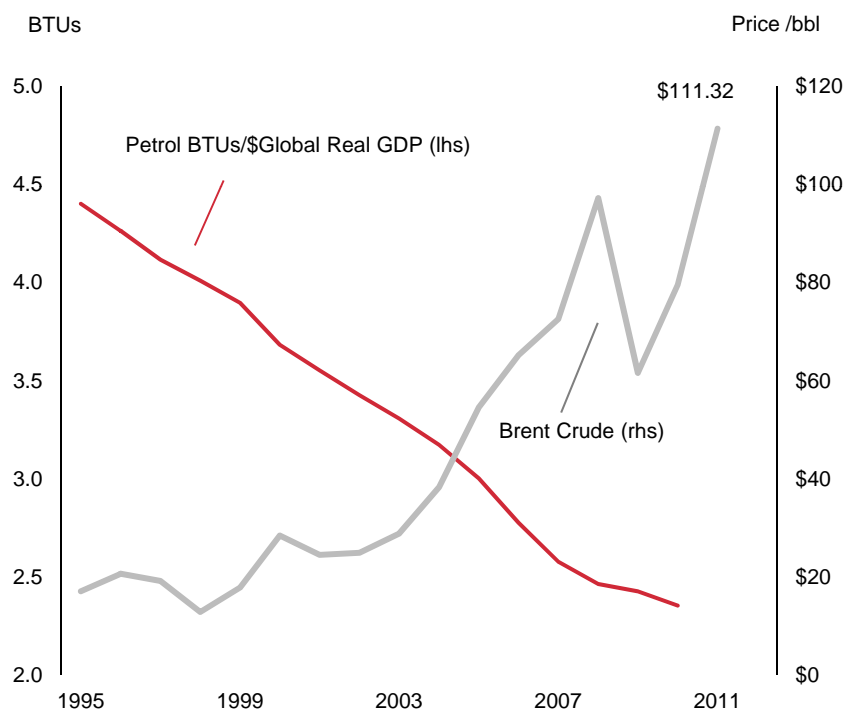


Source: Energy Information Administration; Federal Highway Administration; Nomura Global Economics

World and US not as vulnerable to oil price increases

World is less dependent on oil today

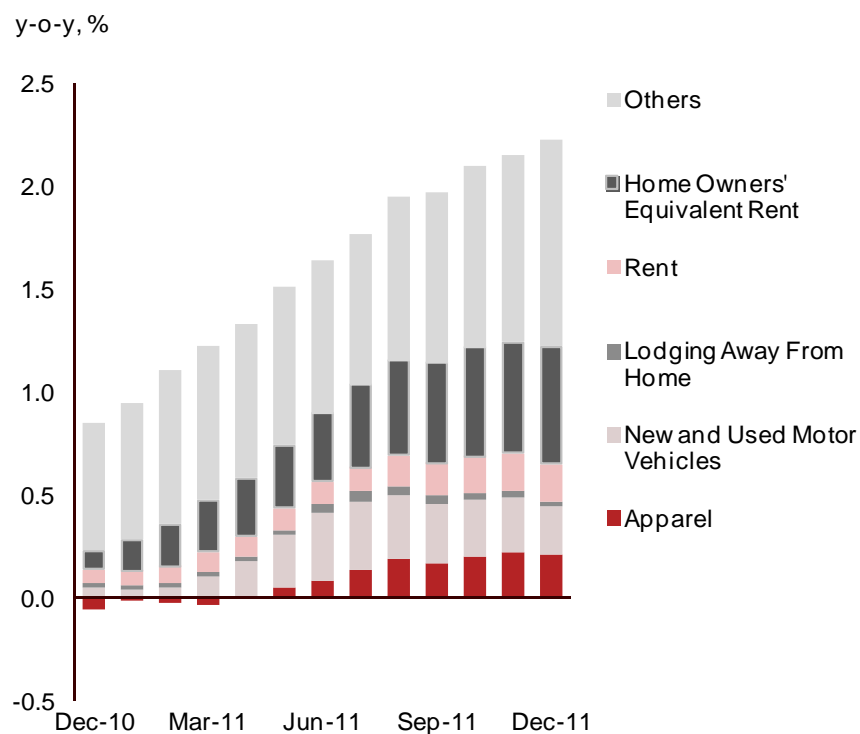
\$10/bbl increase = 0.2pp hit to US GDP



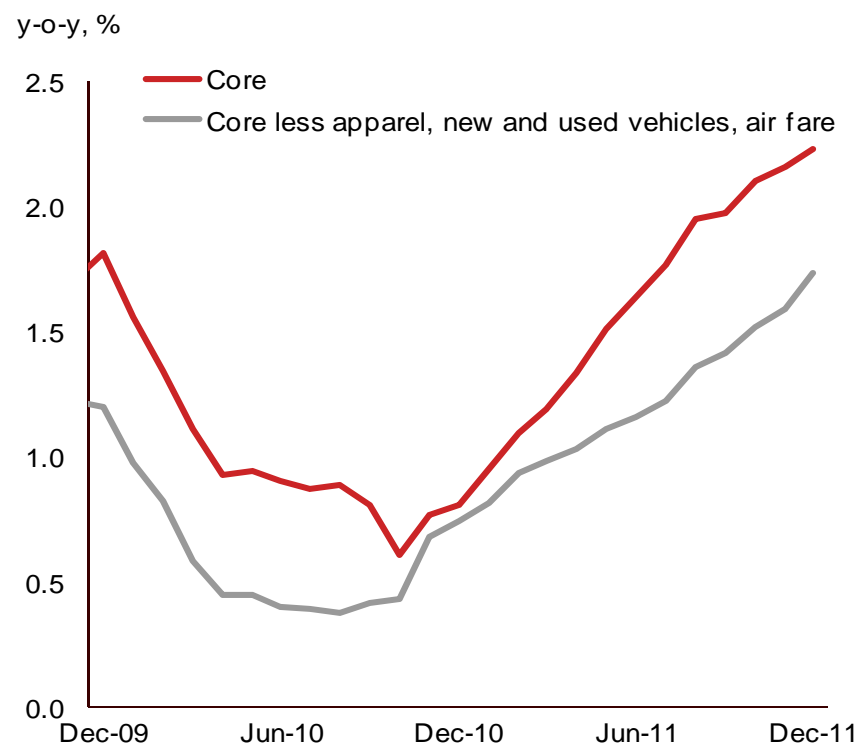
Source: Energy Information Administration; IMF; Nomura Global Economics

What has been leading core inflation higher?

Core CPI decomposition



...excluding the volatile components

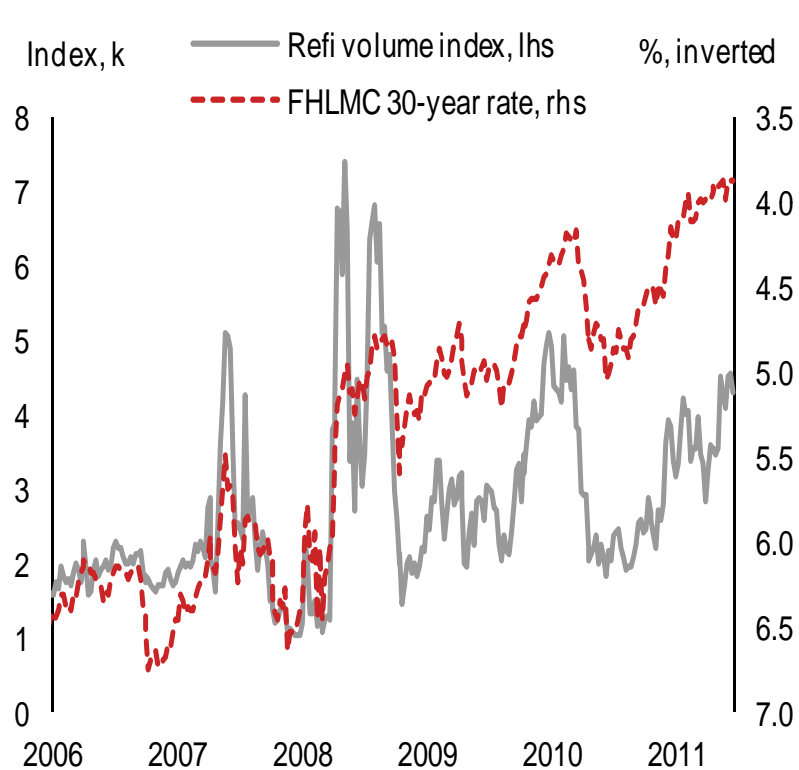


Source: BLS; Nomura Global Economics

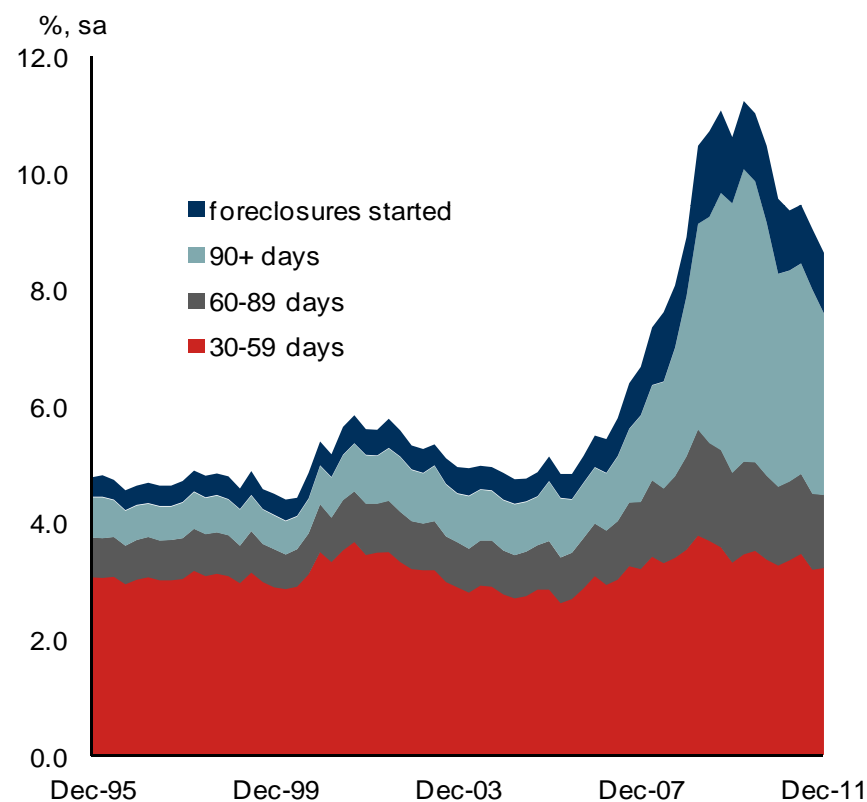
Mortgage morass constrains spending

(but constraints on balance sheets are easing)

Refinancing vs 30-year fixed mortgage rate



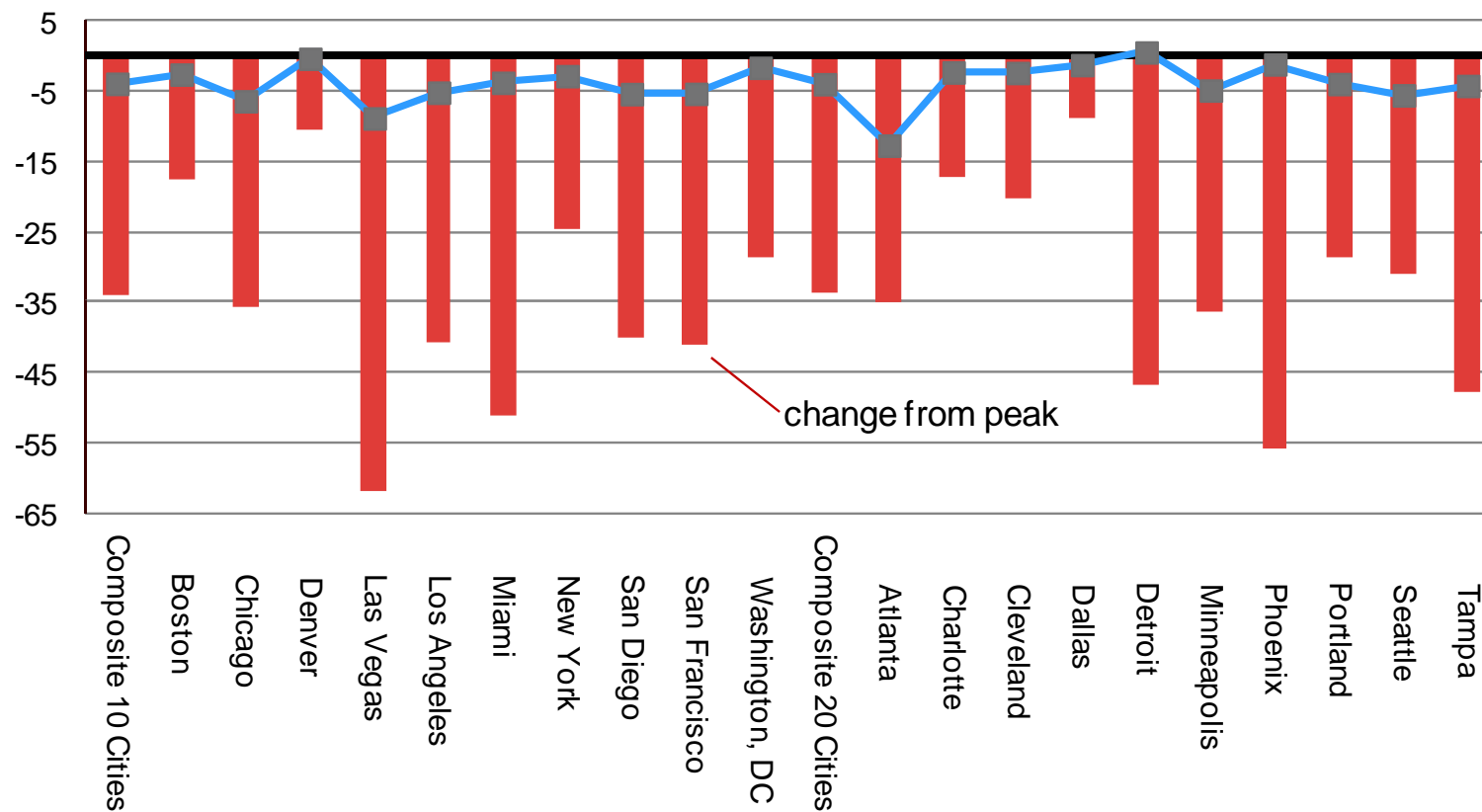
Foreclosures are slowing



Source: Mortgage Bankers Association; Freddie Mac; Nomura Global Economics

Home prices nearing a bottom in many metros

Change from peak & from one year ago

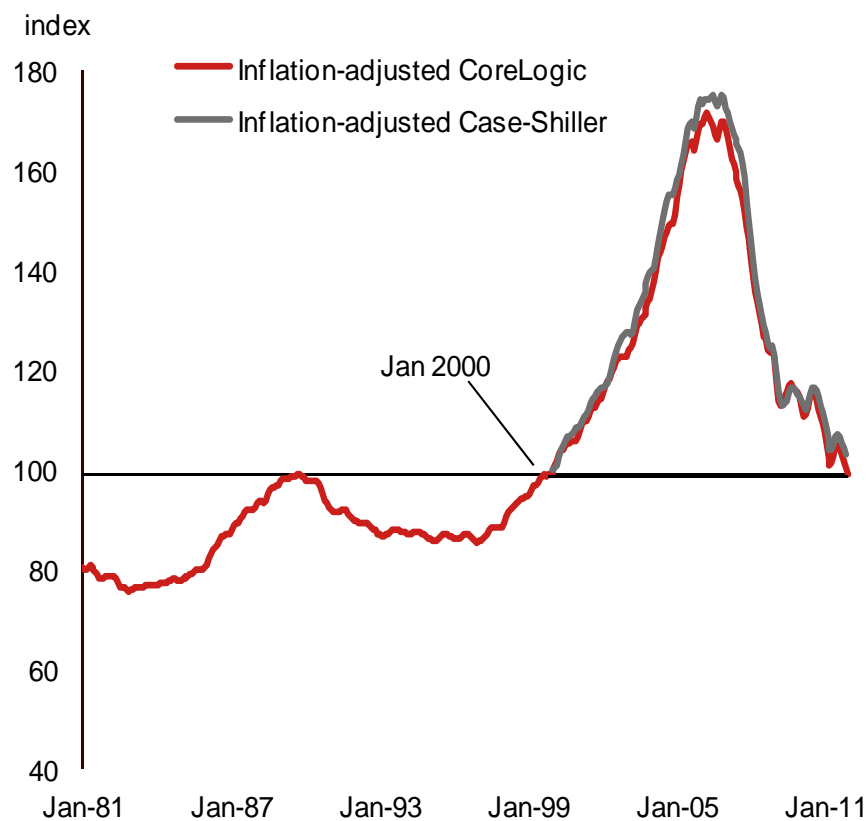


Source: S&P/Case-Shiller Home Price Indices; Nomura Global Economics

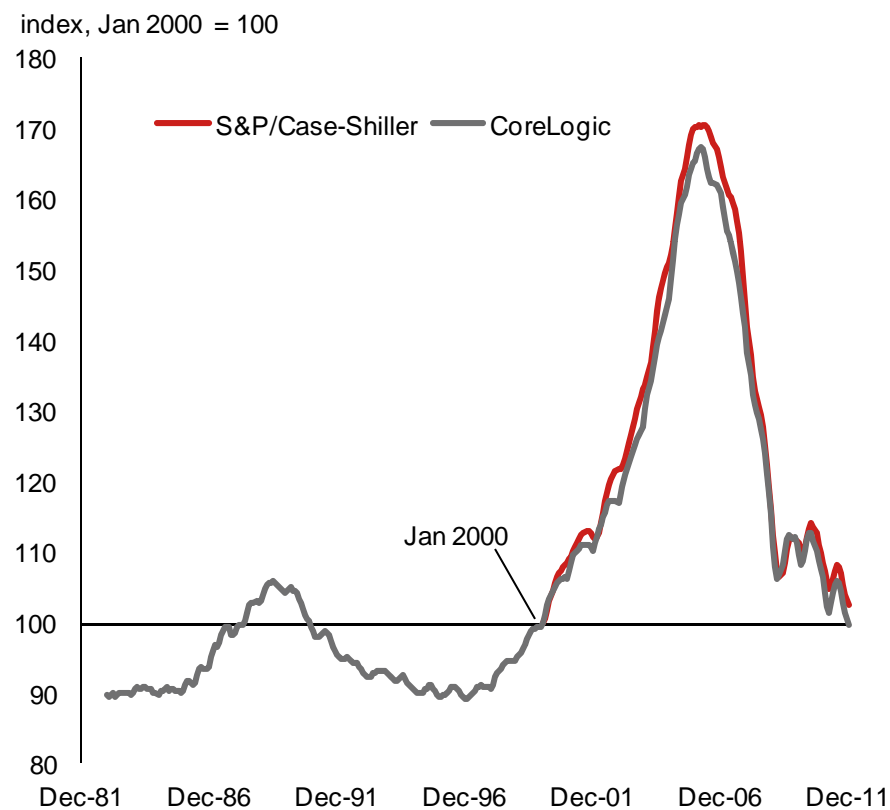
Home prices

Inflation-adjusted and price-to-rent ratio indices are back to early 2000 levels

Inflation-adjusted home prices



Price-to-rent ratio

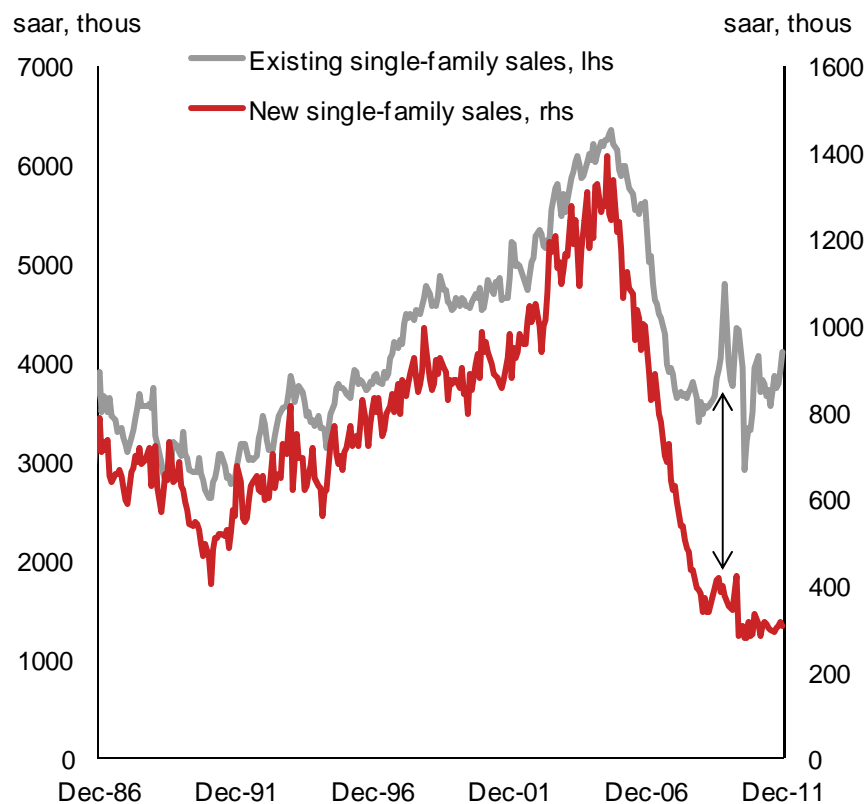


Source: S&P/Case-Shiller ; CoreLogic; Bureau of Labor Statistics; Nomura Global Economics

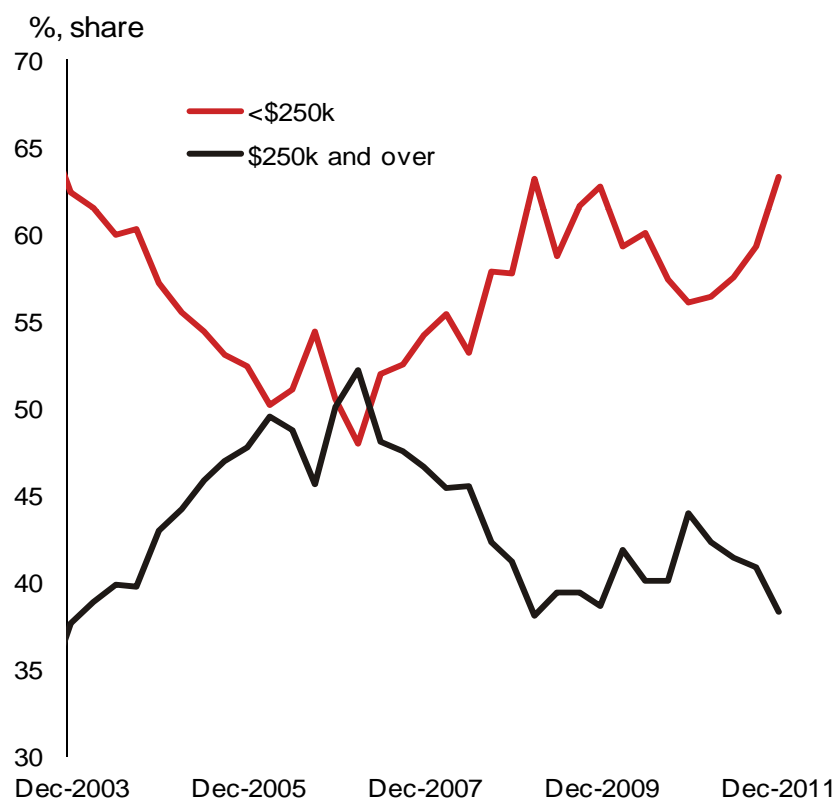
Home sales – a distressing gap

The interplay between existing and new homes

The “distressing” gap



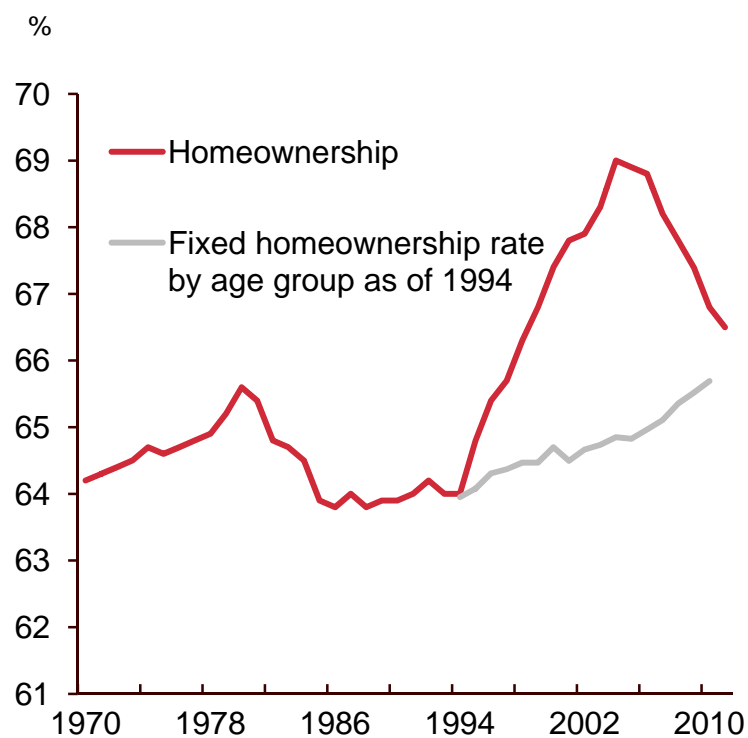
Building cheaper homes to compete



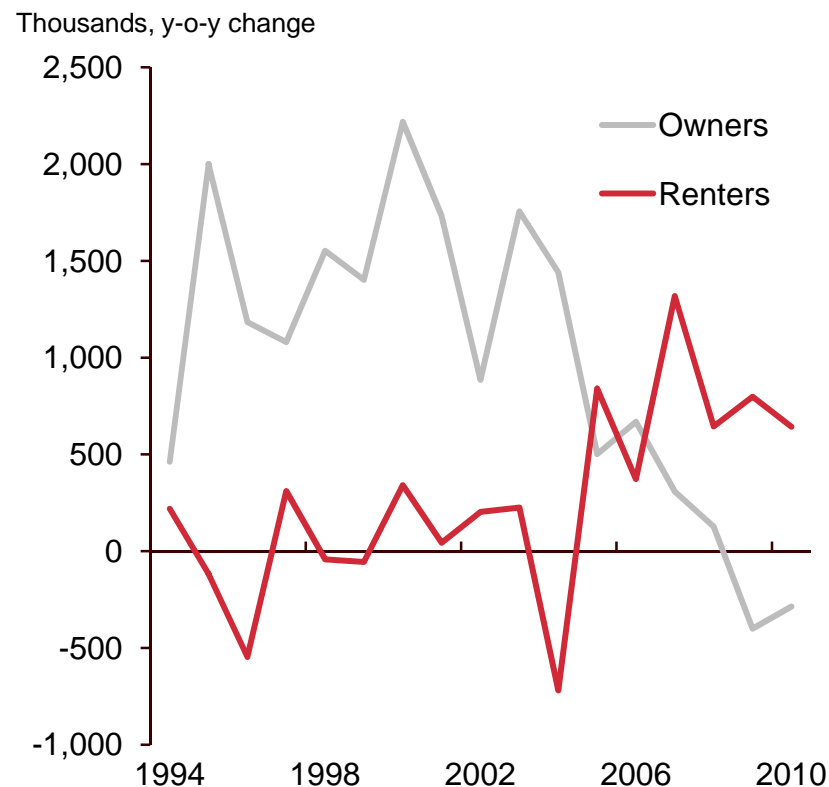
Source: National Association of Realtors; Census Bureau; Nomura Global Economics

Housing: rental rebound long before ownership

Homeownership rate



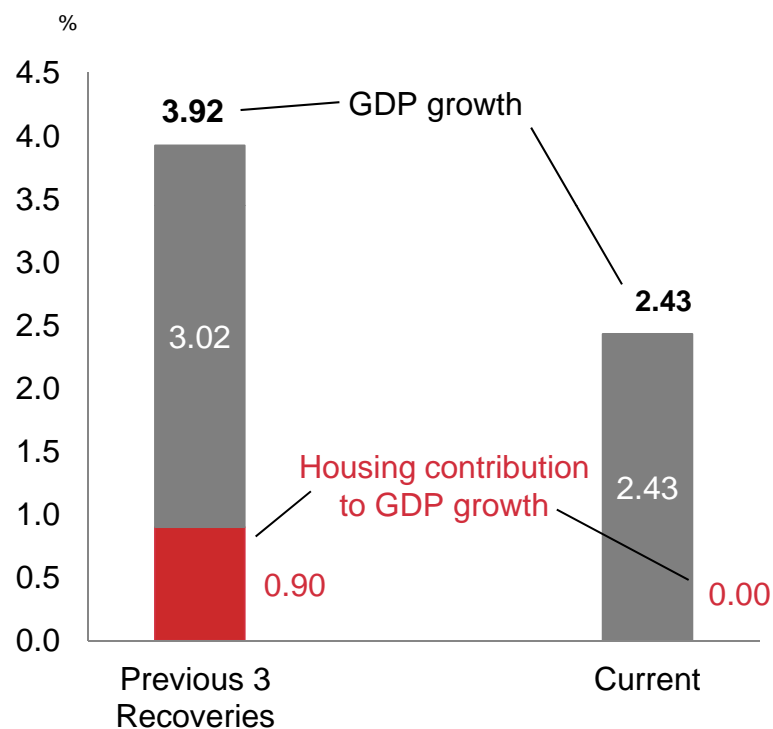
Household formation by renters and owners



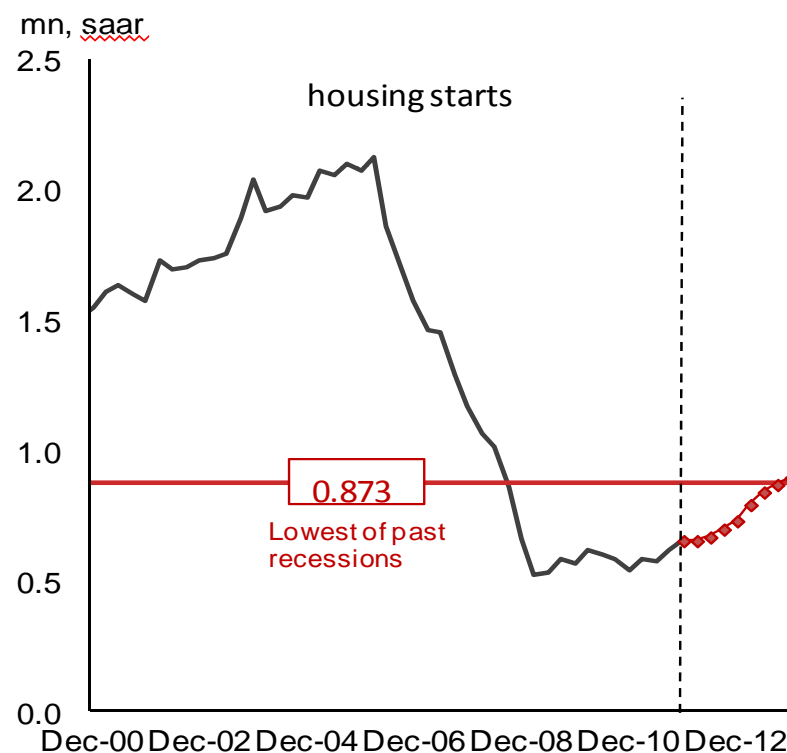
Source: Nomura Global Economics

Housing: the missing link in the recovery

Housing boosted growth in other recoveries...



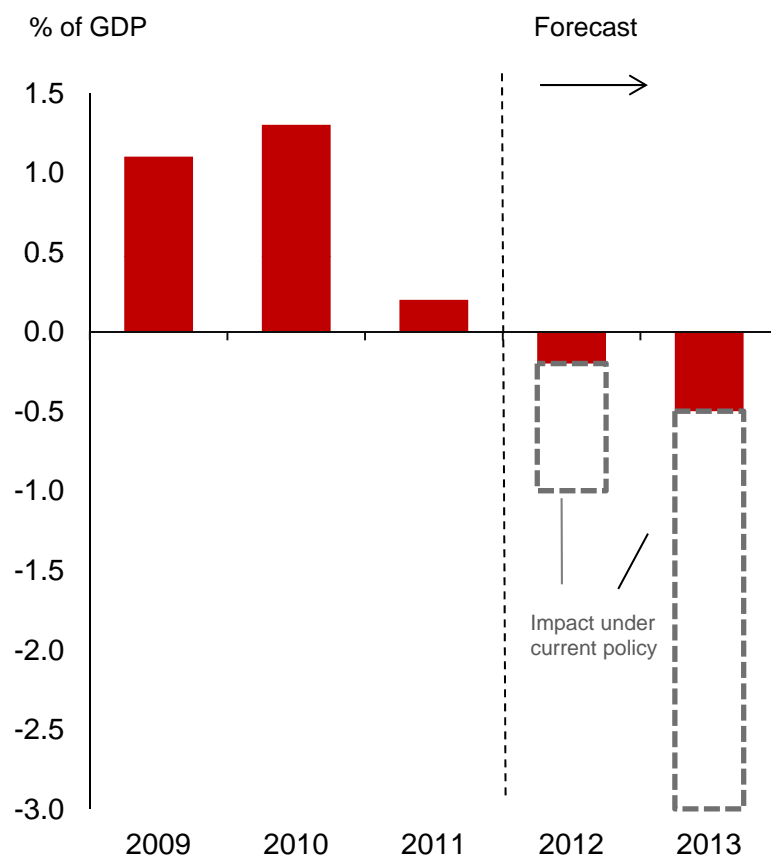
...but now is nowhere to be seen



Source: Census Bureau; BEA; Nomura Global Economics

Fiscal consolidation should be an increasing drag

Impact to GDP under current fiscal policy



What needs to be addressed

Recently Congress and the president have:

Implemented full-year extensions of the payroll tax cut and extended unemployment benefits

Immediately following the election:

Long-term fiscal deal encompassing:

- Bush-era tax cuts
- Other expiring taxes
- Long-term Entitlement reform
- Automatic spending cuts (BCA sequester)
- Increase the debt ceiling

Likely in 2013:

- Broad-based tax reform
- Mortgage finance/GSE reform

Source: Bureau of Economic Analysis; Nomura Global Economics

Disclosure Appendix A-1

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