

US Economic Outlook

Stronger economy meets fiscal drag

NOMURA



- ❑ US Economics
- ❑ Ellen Zentner; Executive Director
- ❑ Senior US Economist
- ❑ ellen.zentner@nomura.com
- ❑ (212) 667-9668

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2013 Outlook in a nutshell

Strengthening of fundamentals meets fiscal headwinds

- ❑ Weak wage and salary growth continues, driven by high unemployment and low-quality job creation.
- ❑ Borrowing is unlikely to drive the economy forward. We expect personal consumption to broadly track growth in personal income.
- ❑ We expect the FOMC to continue its long-term asset purchases through Q1 2014.
- ❑ A strengthening of the housing market should support investment, job creation, and aggregate demand.
- ❑ Wealth effect and housing market are two very important drivers of a stronger recovery in 2013 and beyond.
- ❑ Fiscal tightening equal to 1.5% of GDP in 2013 will hold back growth.

See "[US forecast update](#)", *Special Report*, 14 March 2013

“Blessed are the young for they shall inherit the national debt” – Herbert Hoover, Thirty-First President, 1929-1933

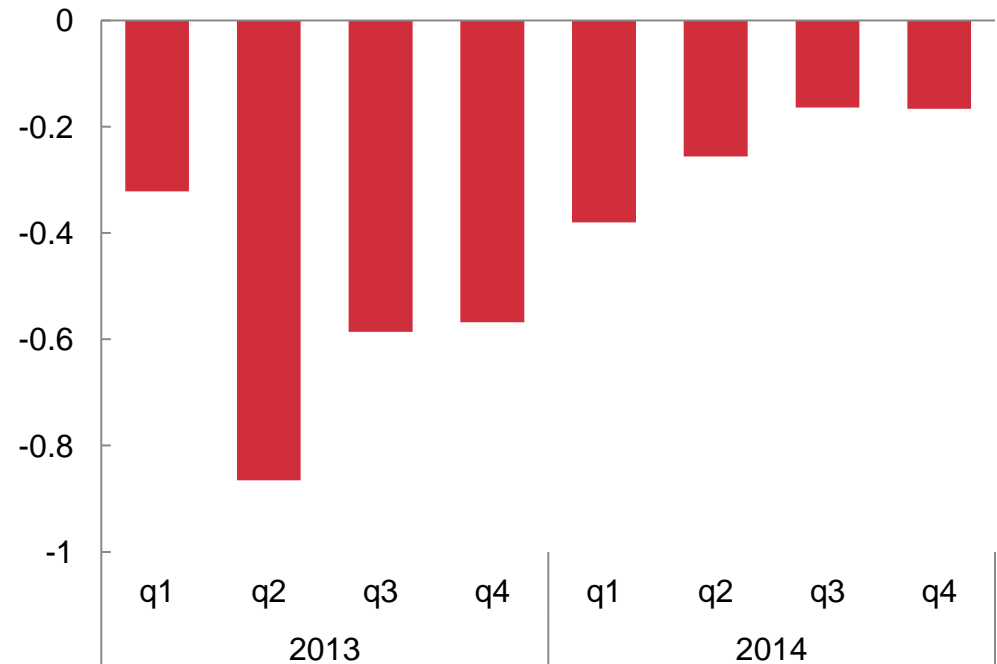
- ❑ The US federal budget deficit has topped \$1 trillion for four straight fiscal years.
- ❑ Total public debt outstanding is now more than \$16.7 trillion (103% of GDP).
- ❑ The US pays a low interest on outstanding debt, about 2.6% (and declining).
- ❑ Still, the gov't paid more than \$359 billion in interest in FY2012.
- ❑ We won't always enjoy these ultra low interest rates.
- ❑ We have breached the level of “debt intolerance”.

Impact of Spending cuts which began on 1 March

Estimated impact on US GDP growth of cuts in Federal spending that took effect on 1 March (percent, deviation from baseline)

- Permanent implementation of the scheduled spending cuts will reduce GDP growth (Q4/Q4) by:
 - 0.6 percent in 2013
 - 0.25 percent in 2014
- Our forecast assumes these cuts will be implemented permanently.

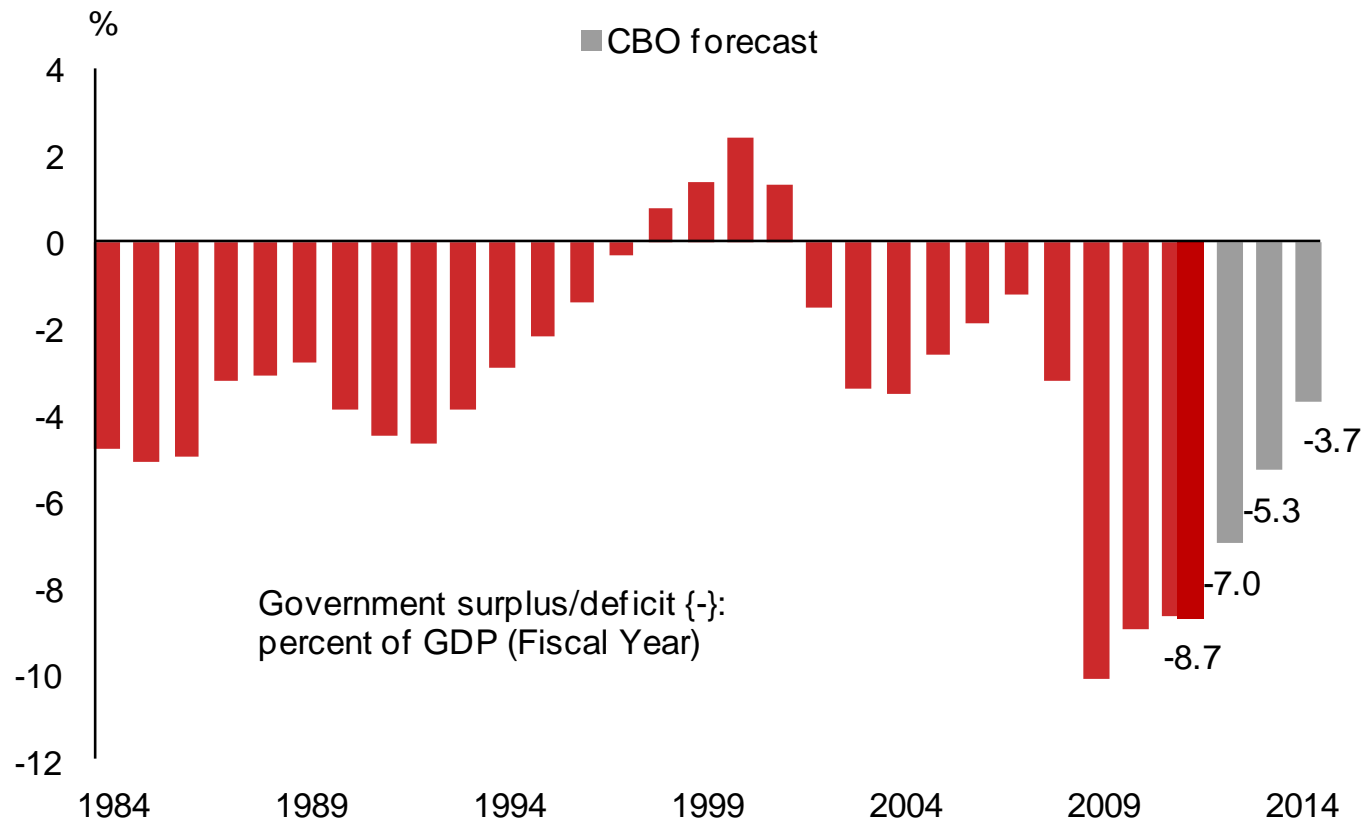
Change in quarterly growth rates (% , annual rate)



Note: based on simulations of the Fair Model. Source: CBO, Nomura

The deficit/GDP ratio is improving

But becomes a problem again by 2009 on rising health care expenditures



Source: CBO, Nomura

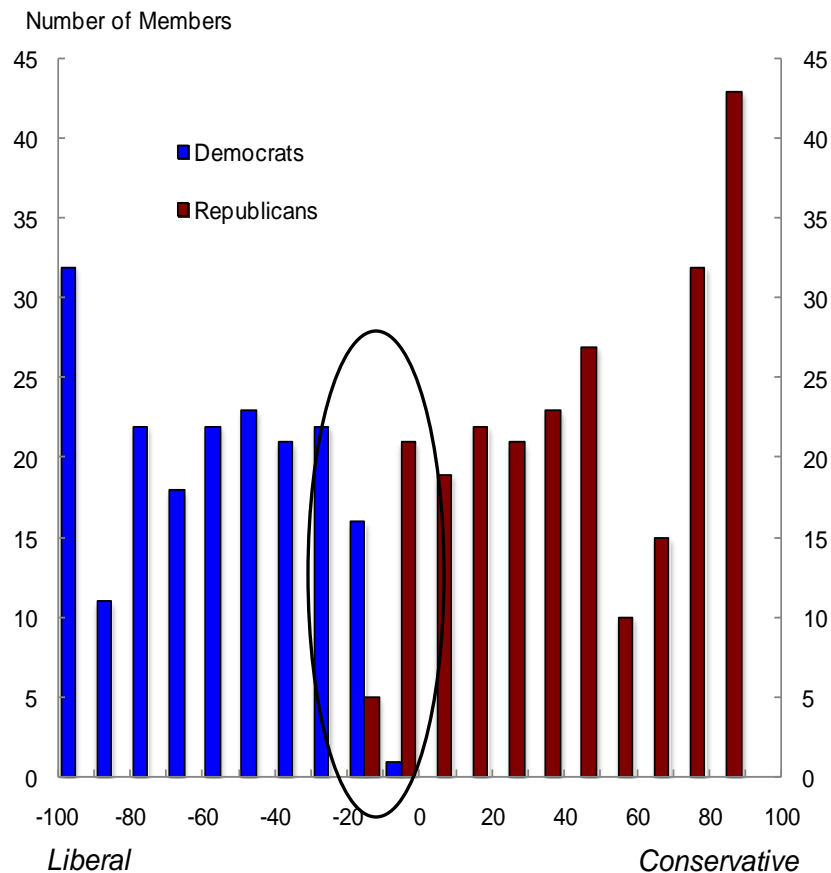
The fiscal debate ahead

- The debt limit looms large again.
 - We have already breached the debt limit, but it has been suspended through mid-May.
 - The debt limit will most likely become binding by early August.
- Budget negotiations will remain contentious.
 - Little progress has been made in bridging a large ideological gap between the two sides.
- We expect long-term issues to be dealt with, to the extent possible, in a version of the “normal” budget process for FY2014.
- Ratings agencies have the US debt rating on “negative watch” with a further downgrade penciled in if no credible long-term debt reduction plan is reached.

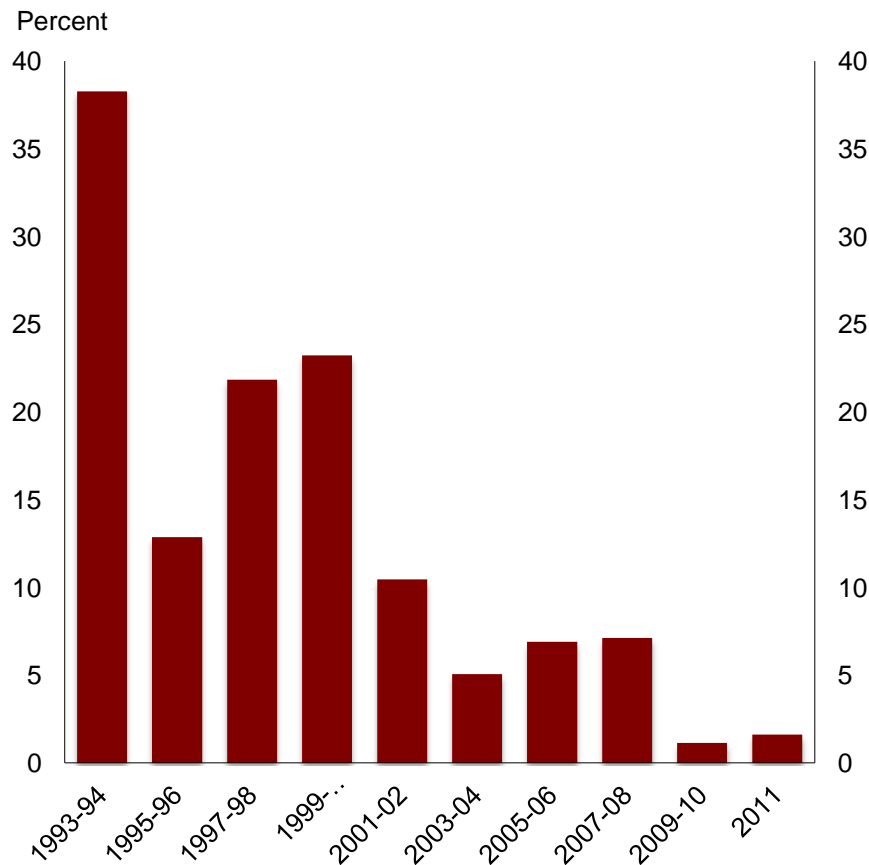
The Partisan Divide in Congress

The house has become more partisan on economics, and that trend should continue

Distribution of House Members by their Liberal/Conservative Voting Record on Economic Issues in 2011 by Party



Overlap of Liberal Republicans and Conservative Democrats in the House Based on Economic Votes (percent of all members)



Source: National Journal, Nomura

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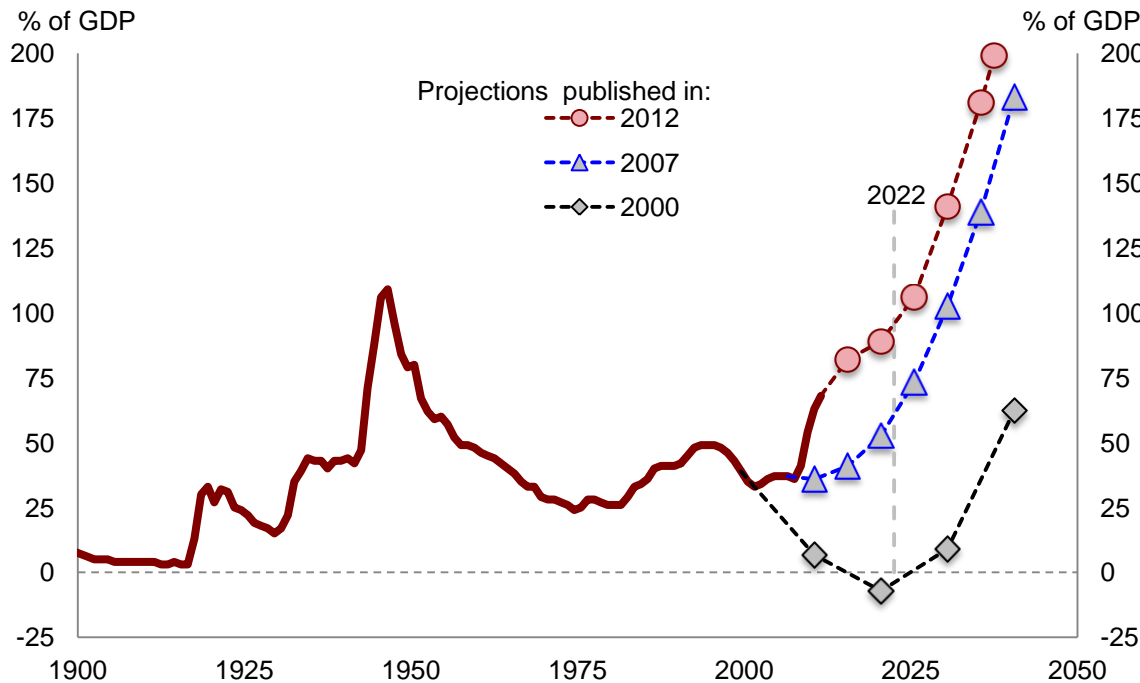
The long-term fiscal challenge

- ❑ The debate over fiscal policy should be shaped by the nature of the long-term fiscal problem.
- ❑ The cyclical improvement in the US fiscal accounts as the economy continues to recover is likely to be significantly offset by two other factors.
 - An eventual normalization of interest rates which would increase interest costs.
 - The combined effects of the aging of the population and rapidly increasing healthcare costs on entitlement spending (the biggest factor driving the long-term problem).
- ❑ Stabilizing the US fiscal outlook over the long-term requires some combination of:
 - A reduction in healthcare cost growth
 - Reductions in benefits
 - Higher taxes
- ❑ This is challenging as:
 - There is no silver bullet for containing the cost of healthcare
 - Entitlements are among the most popular government programs

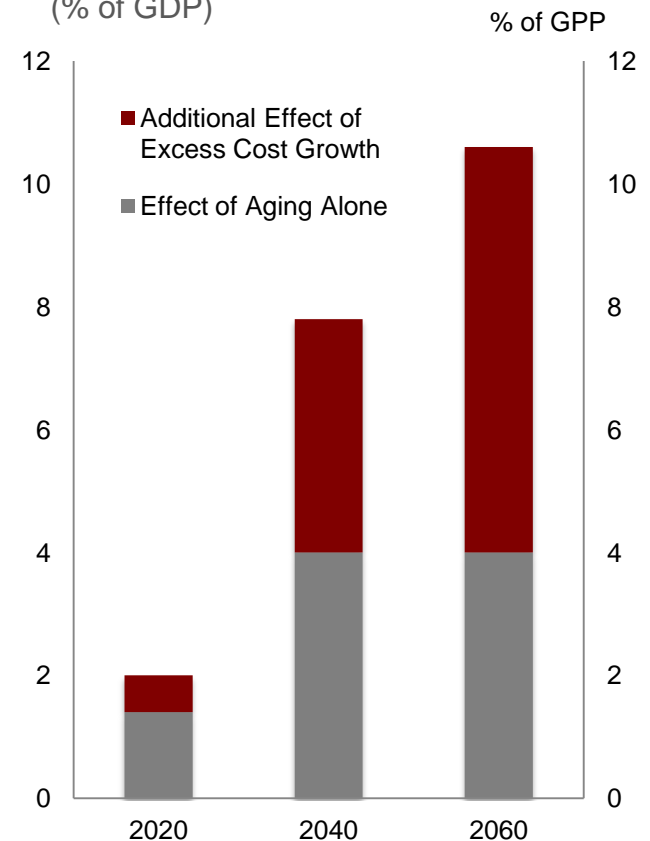
Healthcare

Containing healthcare costs is the single most important long-term challenge

Federal debt held by the public, 1900-2011, and as projected in CBO's long-term analysis of current policies published in 2000, 2007, and 2012 (percent of GDP)



Impact of aging and health care cost growth on CBO's projections of annual Federal spending under current policies (% of GDP)



Legacy of financial crises

- ❑ The credit-to-GDP ratio balloons in the 10 years leading up to financial crises
- ❑ Retrenchment lasts as long as the credit surge
- ❑ In the 10 years following the crisis:
 - ❑ Deleveraging of private debt damps credit and employment growth (and lasts for about 7 years)
 - ❑ Housing prices remain significantly lower (by 15-20%)
 - ❑ Unemployment remains significantly higher (in 2/3 of the observations never returning to pre-crisis level)
 - ❑ Inflation remains lower
 - ❑ GDP growth is about 1% lower in the decade post-crisis (we have averaged 2.1% growth in the current recovery)
- ❑ It has taken governments **23 years** on average to return debt-to-GDP ratios to sustainable levels.

Source: Carmen and Vincent Reinhart, "After the Fall", FRBKC Jackson Hole Symposium, 2010; Reinhart, Reinhart, and Rogoff, "Public Debt Overhangs"; Nomura

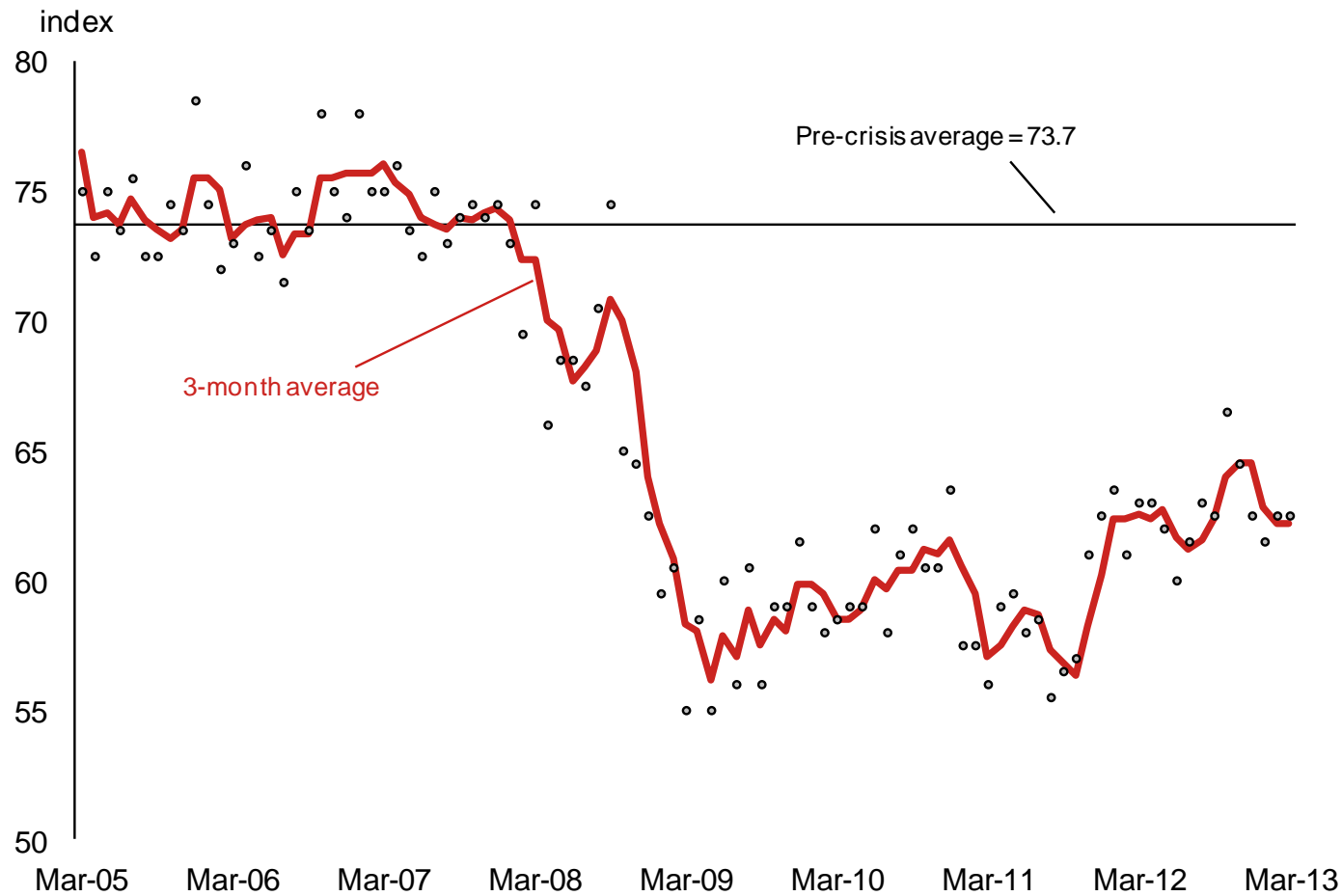
The US consumer in 2013

- ❑ By the end of 2012, US households nearly fully recovered the \$16 trillion lost in wealth since the housing meltdown and financial crisis.
- ❑ Households have also been reducing debt levels for four years.
- ❑ Household balance sheet adjustment is largely complete.
- ❑ Trends in consumer spending have diverged greatly across income groups.
- ❑ Weak wage and salary growth, elevated energy prices, and disproportionate tax burden is holding back spending among lower-income households.
- ❑ Rising prices for real estate and financial assets have emboldened upper-income households.

See "[Spendthrift households to the rescue](#)", *Special Report*, 13 March 2013

Expected income has not recovered...

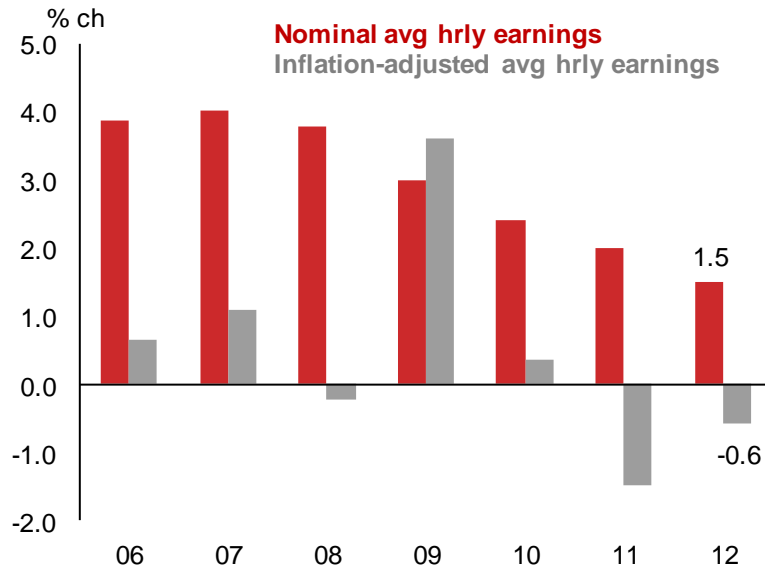
expected family income over the next 12 months



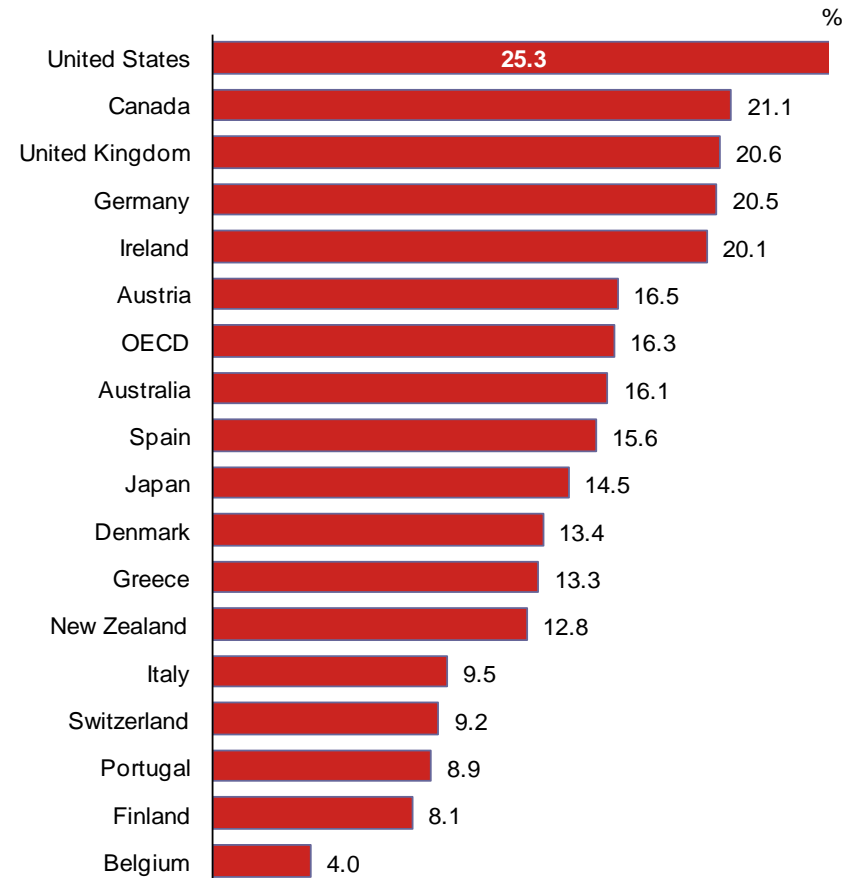
Source: University of Michigan, Nomura

...and is tied to a weak labor market

Earnings have suffered from high unemployment and lower-quality job creation



Share of low paying jobs by country, 2010

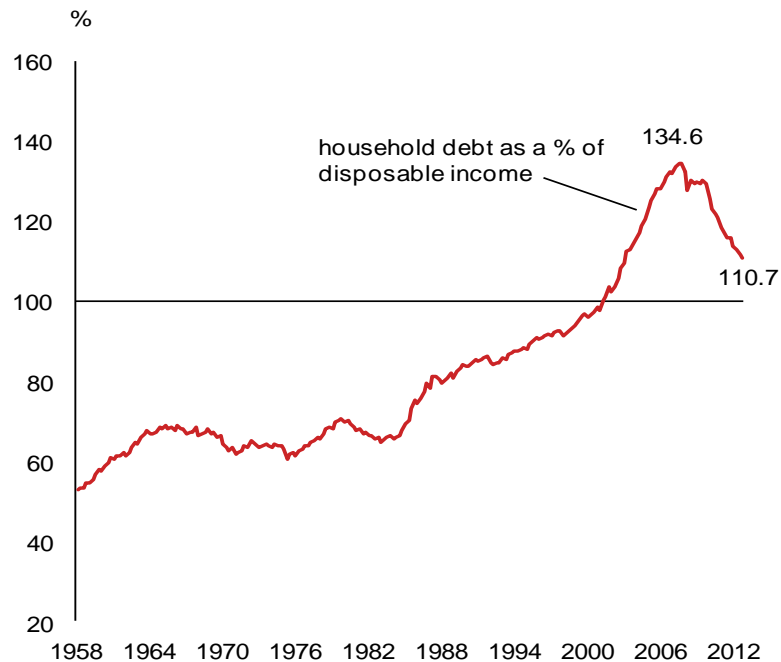


Source: BLS, OECD, Nomura. Note: Low-paying jobs defined as earning less than two-thirds of the national median hourly wage.

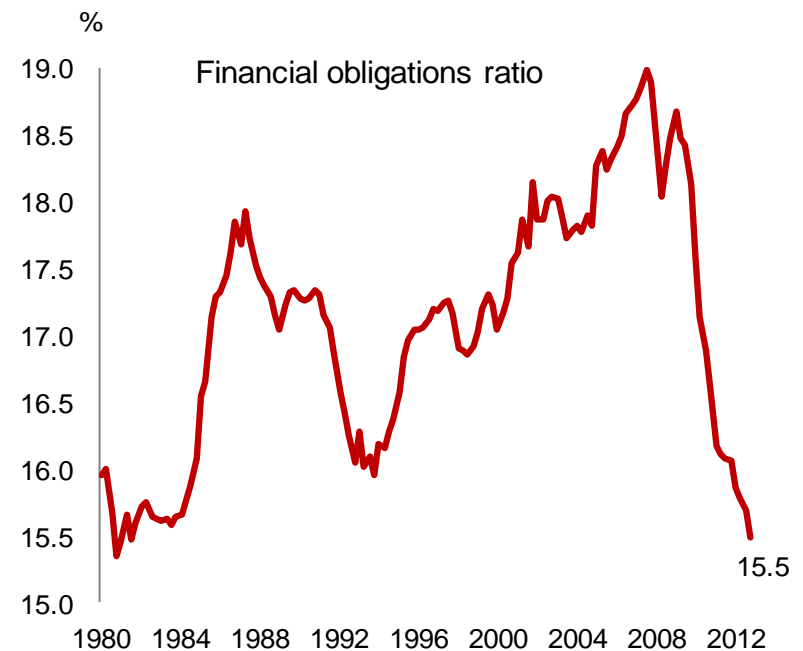
Households are still debt constrained

...but balance sheet adjustment is largely complete and low interest rates help

Ratio: Household debt to after-tax income



FOR: Payments to after-tax income

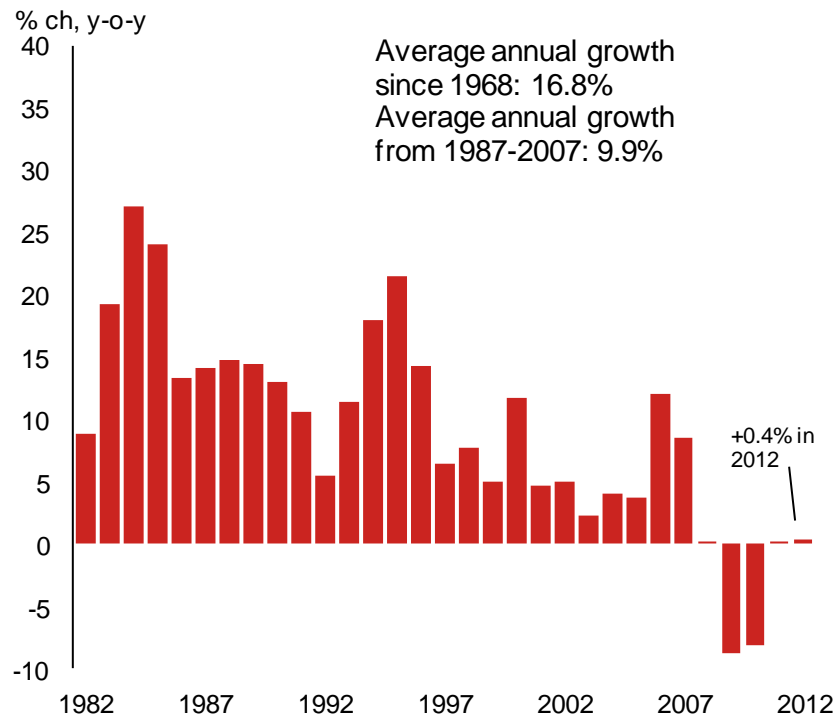


Notes: The financial obligations ratio (FOR) is a broader measure than the debt service ratio (DSR). It includes automobile lease payments, consumer debt payments, rental payments on tenant-occupied property, payments on mortgage debt, homeowners' insurance and property tax payments. The DSR only includes payments on outstanding mortgage and consumer debt.

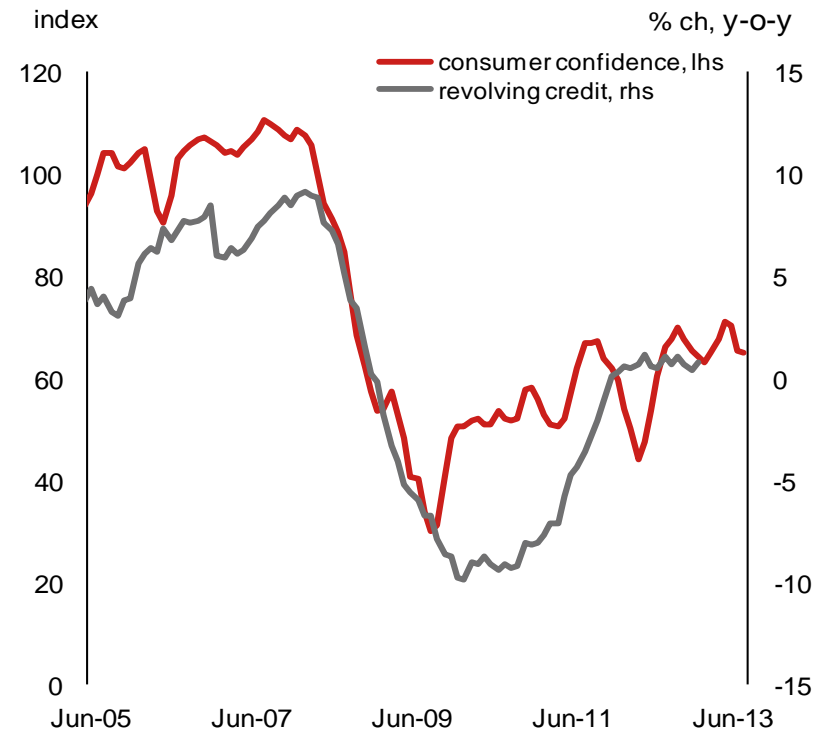
Source: Bureau of Economic Analysis, Federal Reserve, Haver Analytics, Nomura

... and are reluctant to add debt

Unprecedented shift in the use of credit cards

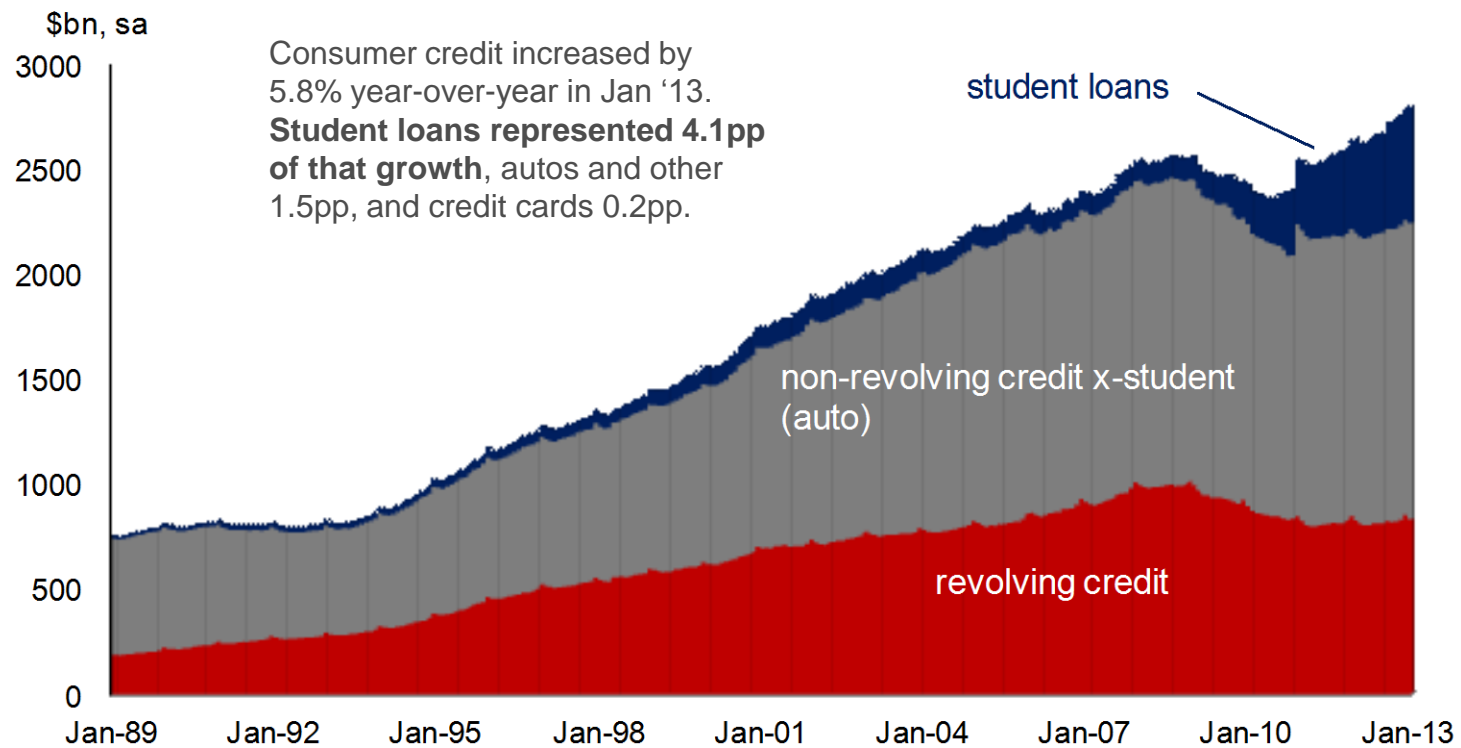


Revolving credit vs consumer confidence



Source: Federal Reserve, Nomura

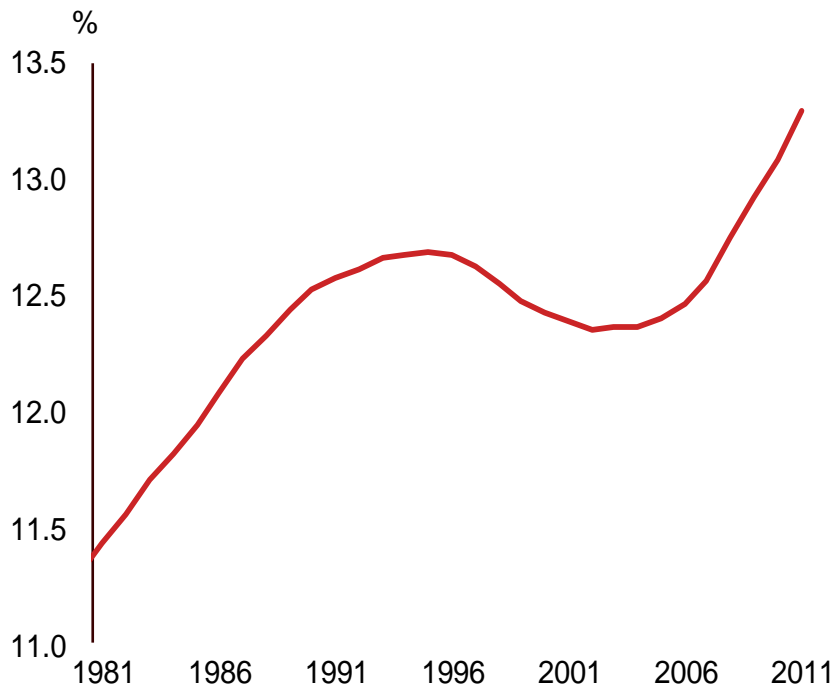
... outside of student and auto loans



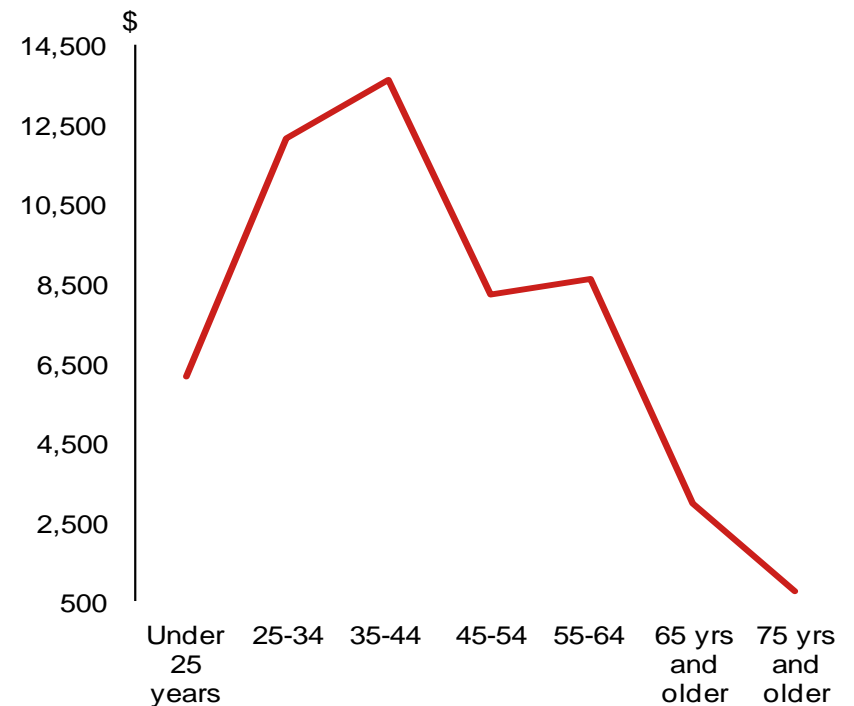
Source: Federal Reserve, Nomura

Demographic shifts are a big drag

Share of the population over 65



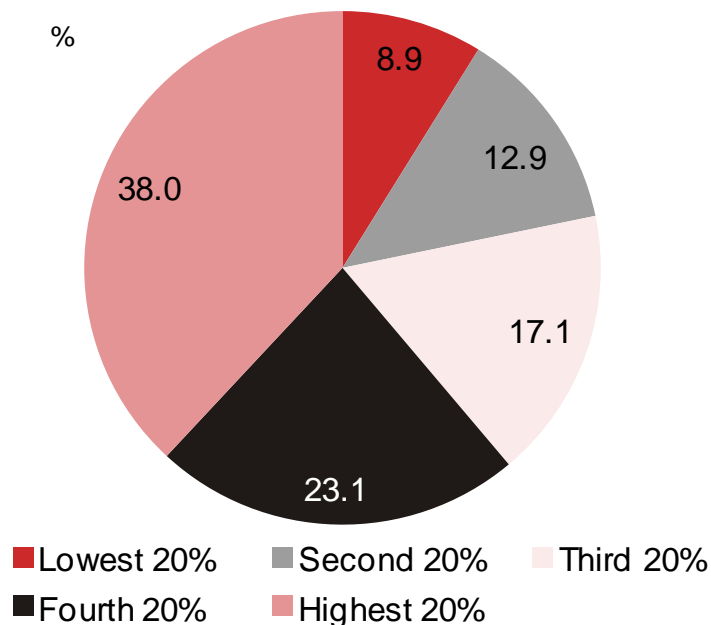
Net change in total liabilities by age (2011)



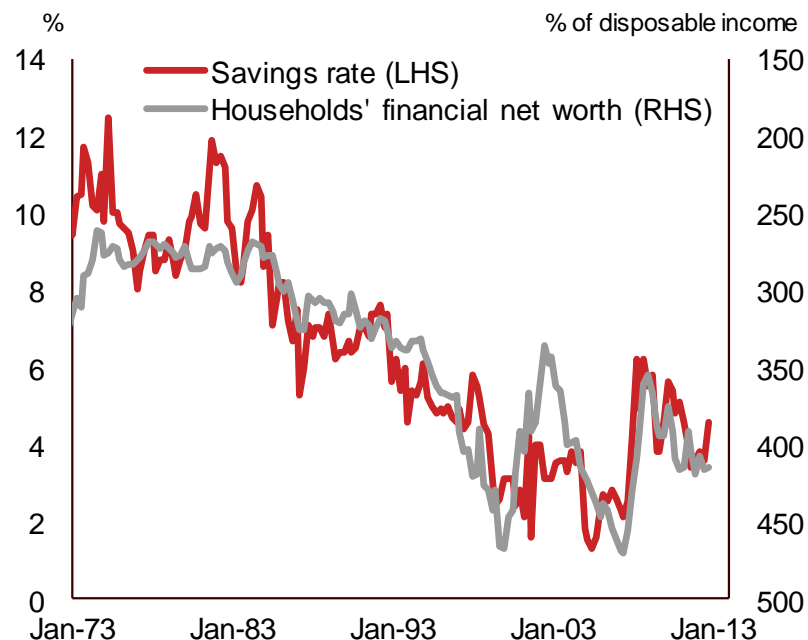
Source: BLS consumer expenditure survey data, Nomura

Spending behavior of upper income households matters a great deal

Share of annual expenditures by income group, 2011



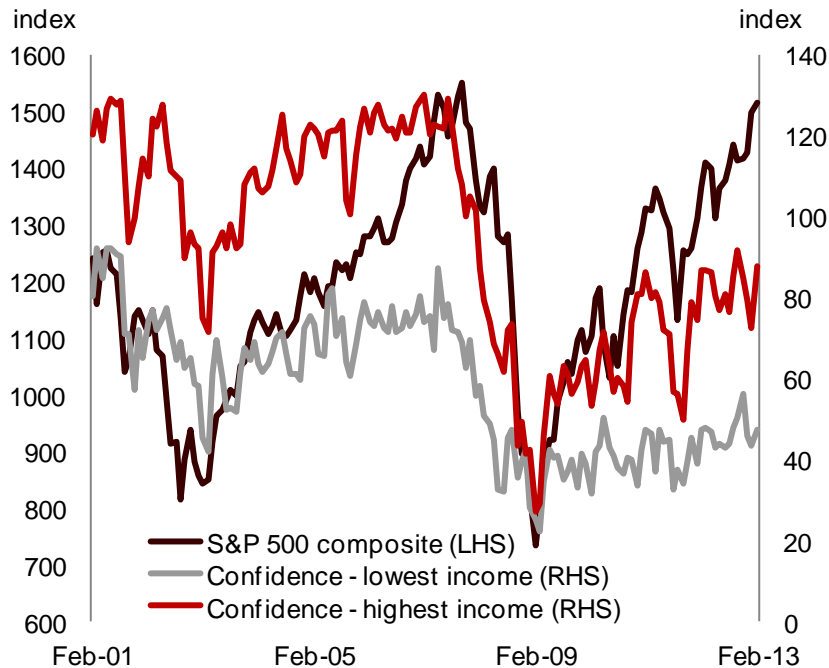
Household savings rate vs households' financial net worth (quarterly average)



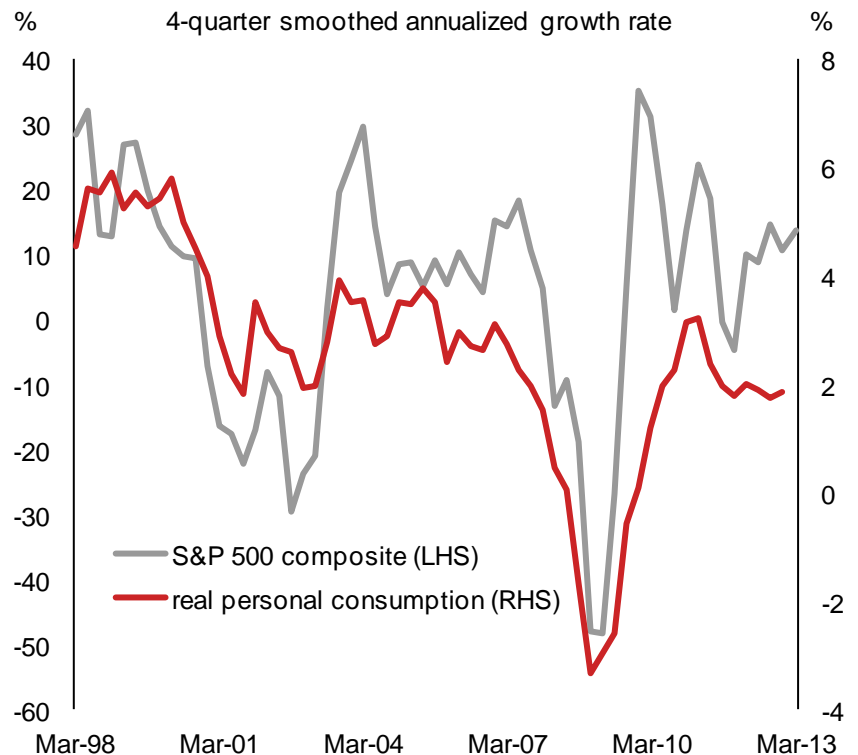
Source: BLS, University of Michigan, Nomura

Spending and confidence tracks equities

Confidence rises and falls with the stock market



Rise in equities explains stronger-than-expected spending in Q1 2013



Source: Conference Board, BEA, Haver Analytics, Nomura

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