The National Economic Outlook

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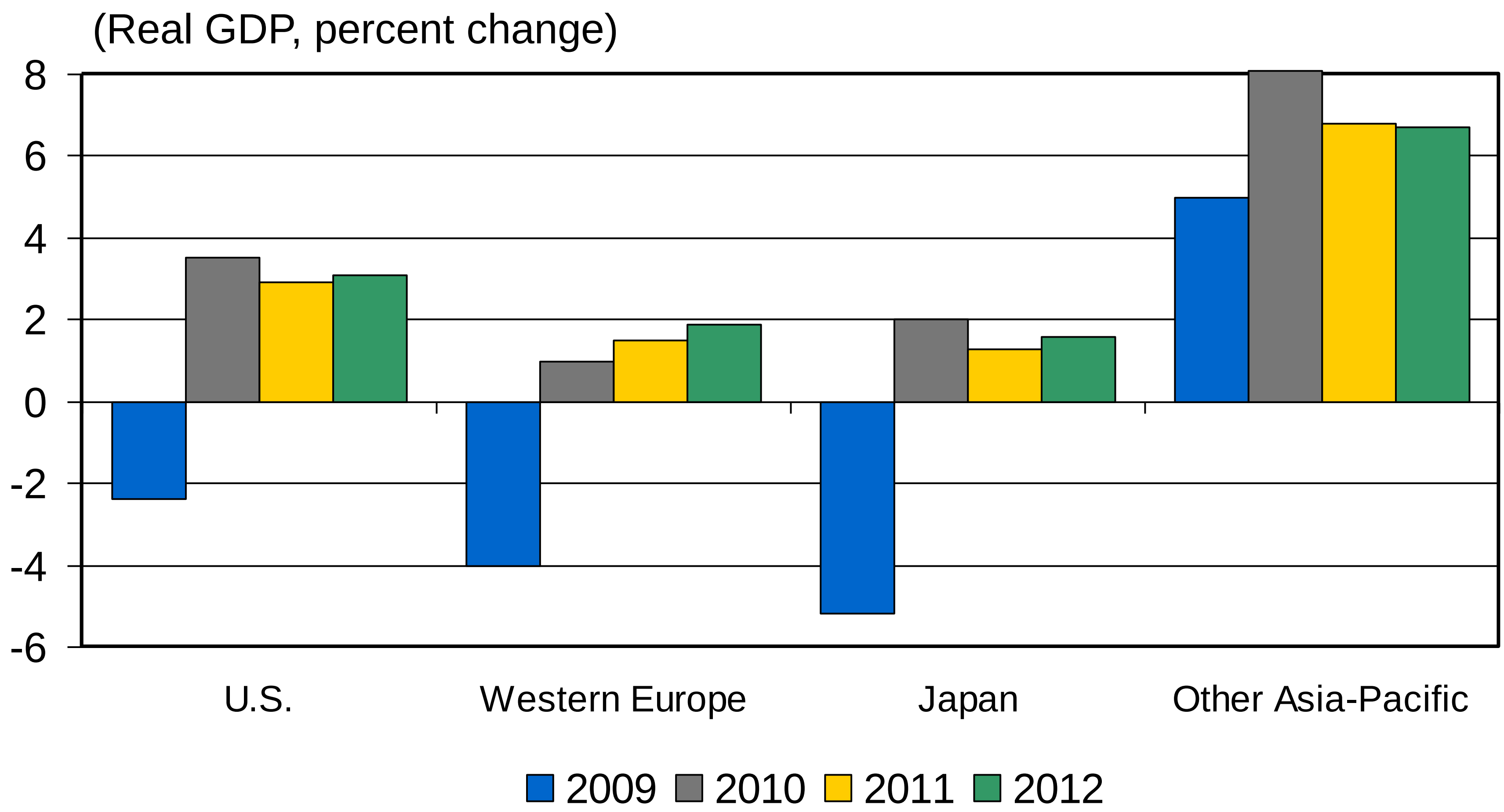
The Global Picture

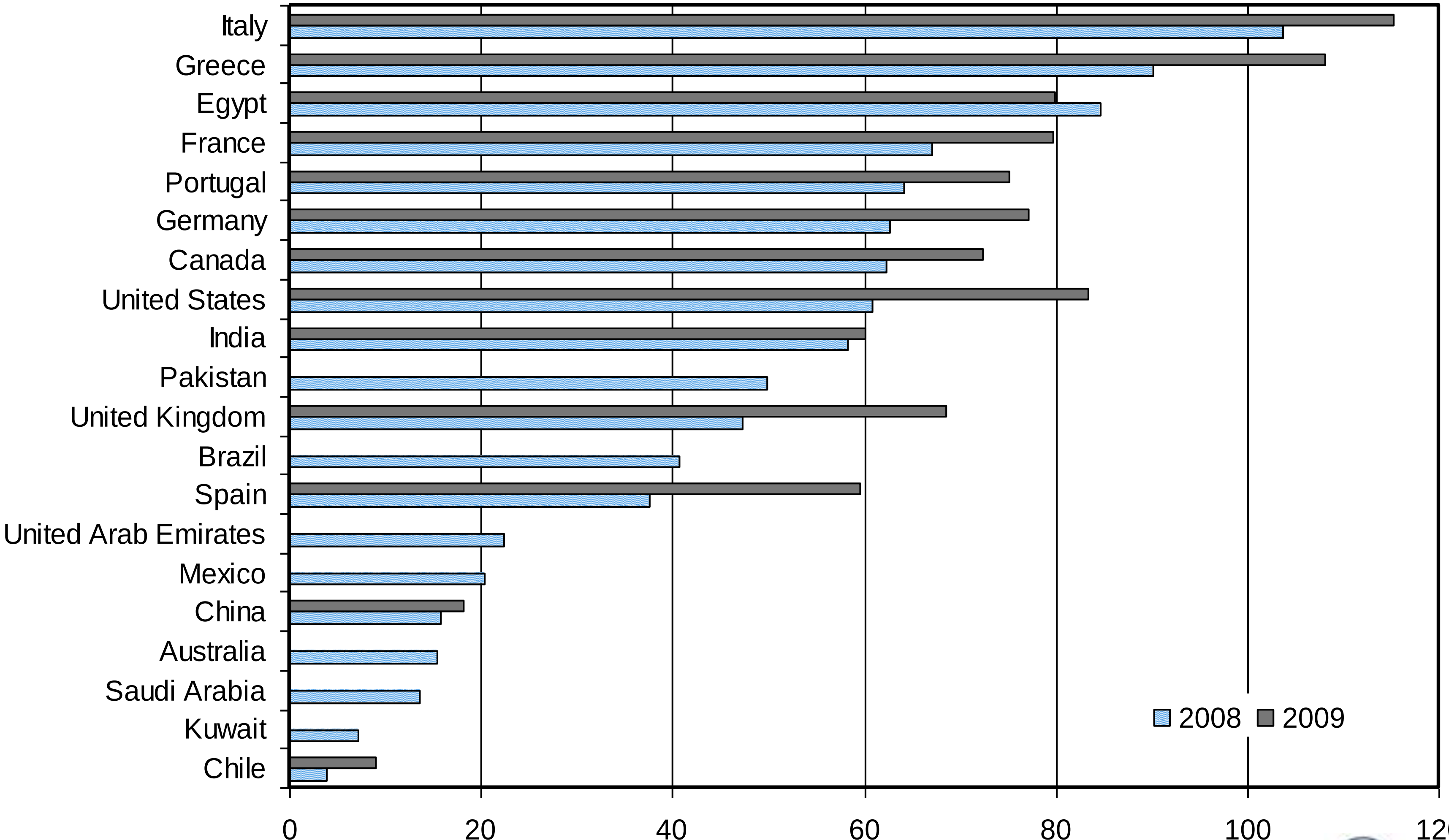
- A multi-speed world—Asia in the fast lane, Europe in the slow lane, and the United States somewhere in between
- Commodity prices have been rising, but general inflation should not be a problem, thanks to economic slack
- Interest rates are likely to remain very low in the developed markets
- The dollar is likely to appreciate further against the euro, but is likely to depreciate against many other currencies
- Debt levels have a lot to do with the speed and shape of the recovery and are the key risk in the outlook

A Multi-Speed Recovery



Ticking Time Bombs: Government Debt

(Gross debt, percent of GDP)

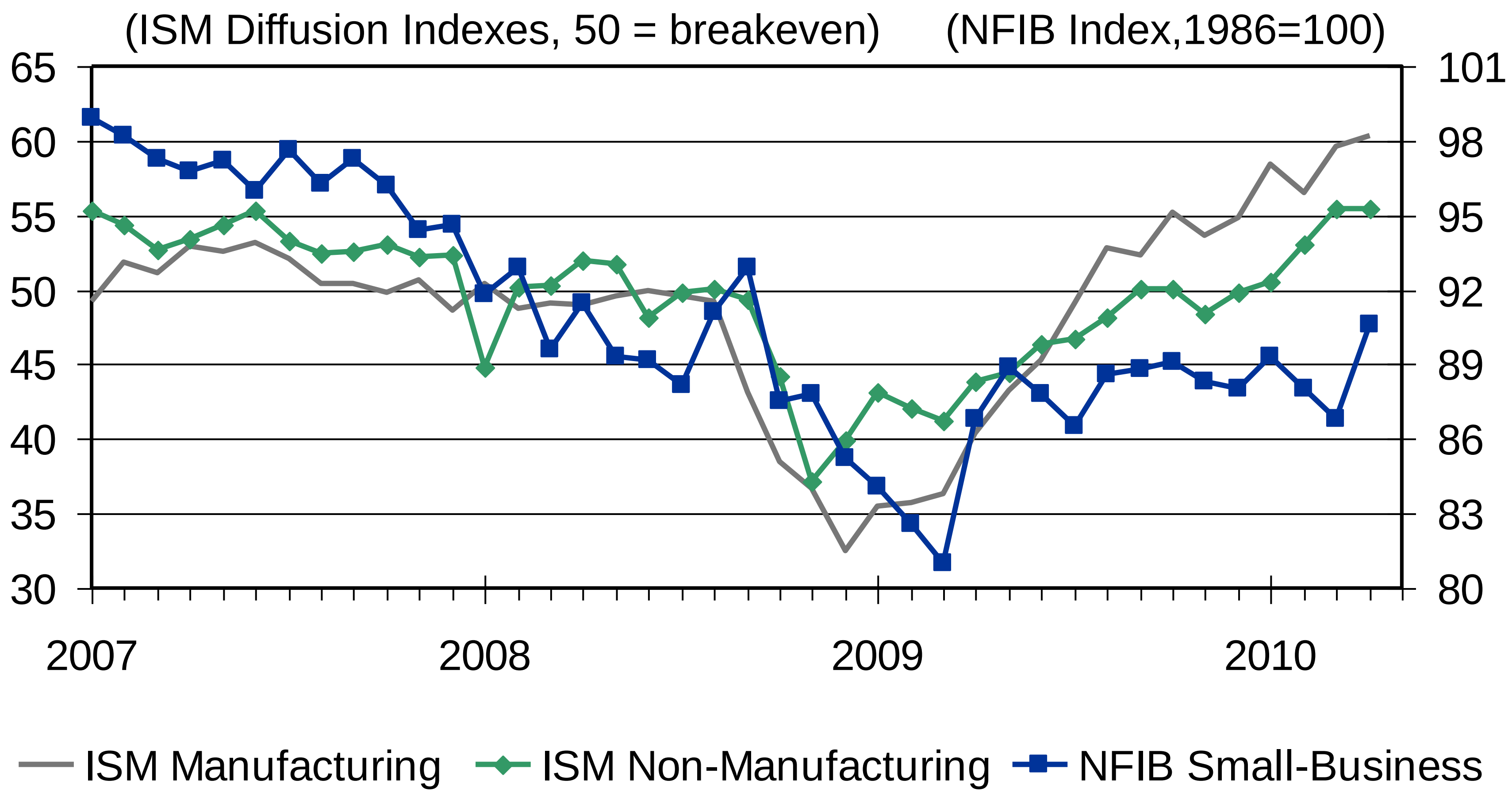


Source: CIA Fact Book

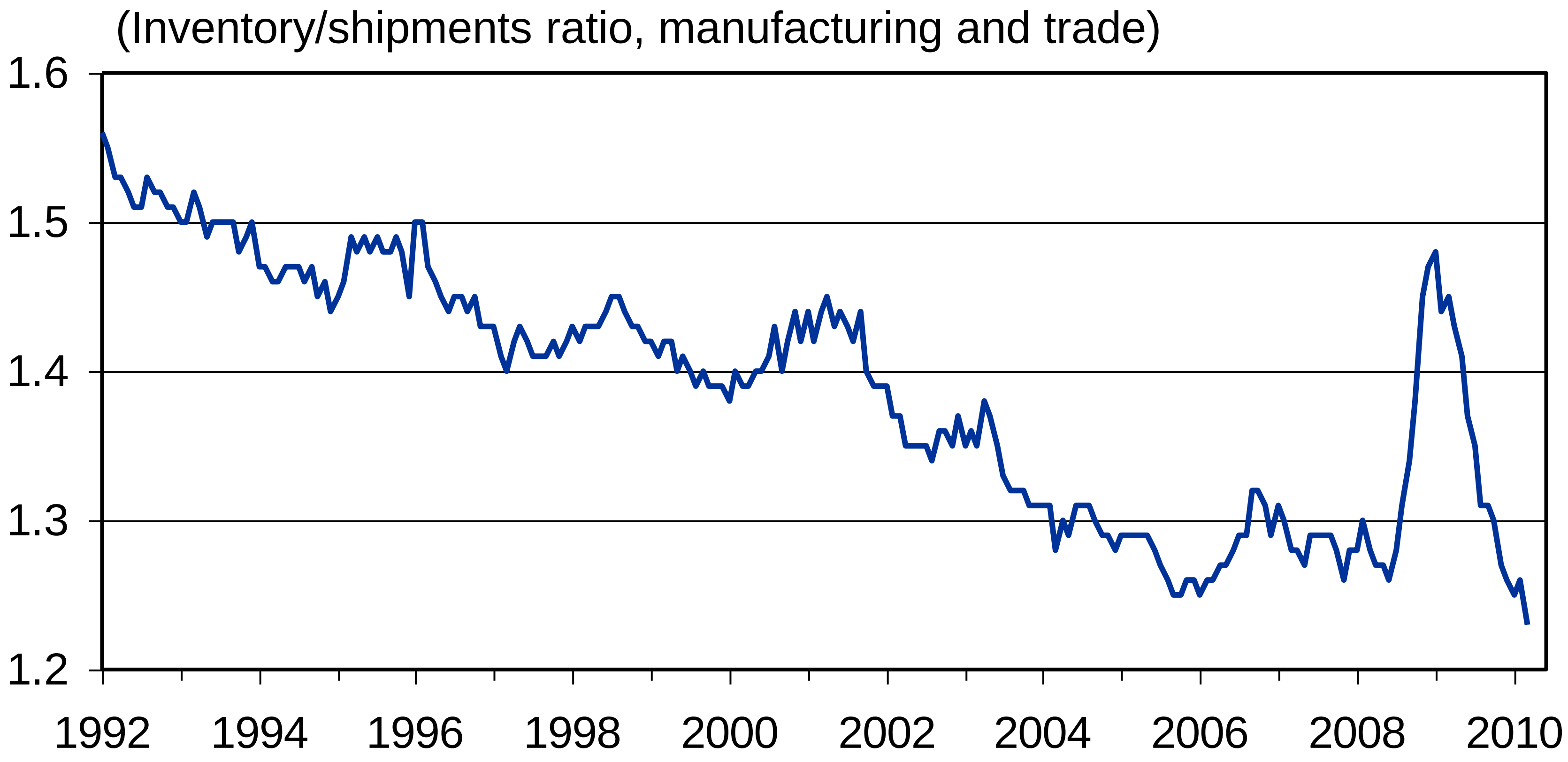
The U.S. Recovery Is Broadening

- Consumer spending growth still faces headwinds but it is now rising at its fastest in three years
- Exports, business spending on equipment and software and inventory rebuilding are boosting growth
- Non-residential construction and state-and-local spending remain a drag on the recovery
- Housing will continue to “bounce along the bottom” in 2010—but 2011 looks more promising
- Employment growth is key to consumer and housing gains
- Shadow over the recovery: A massive fiscal adjustment is still needed

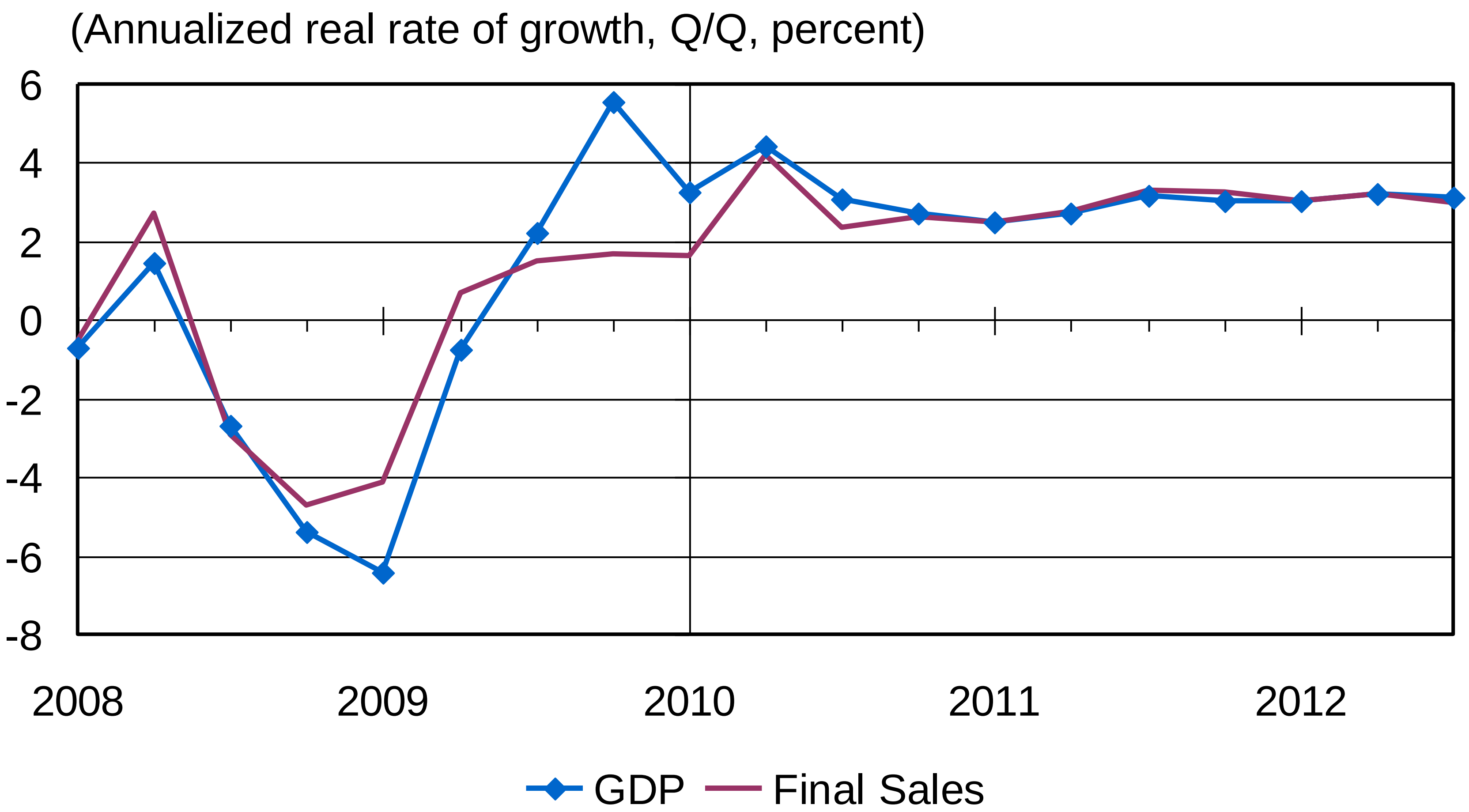
Cyclical Indicators Rising; Small Business Lagging



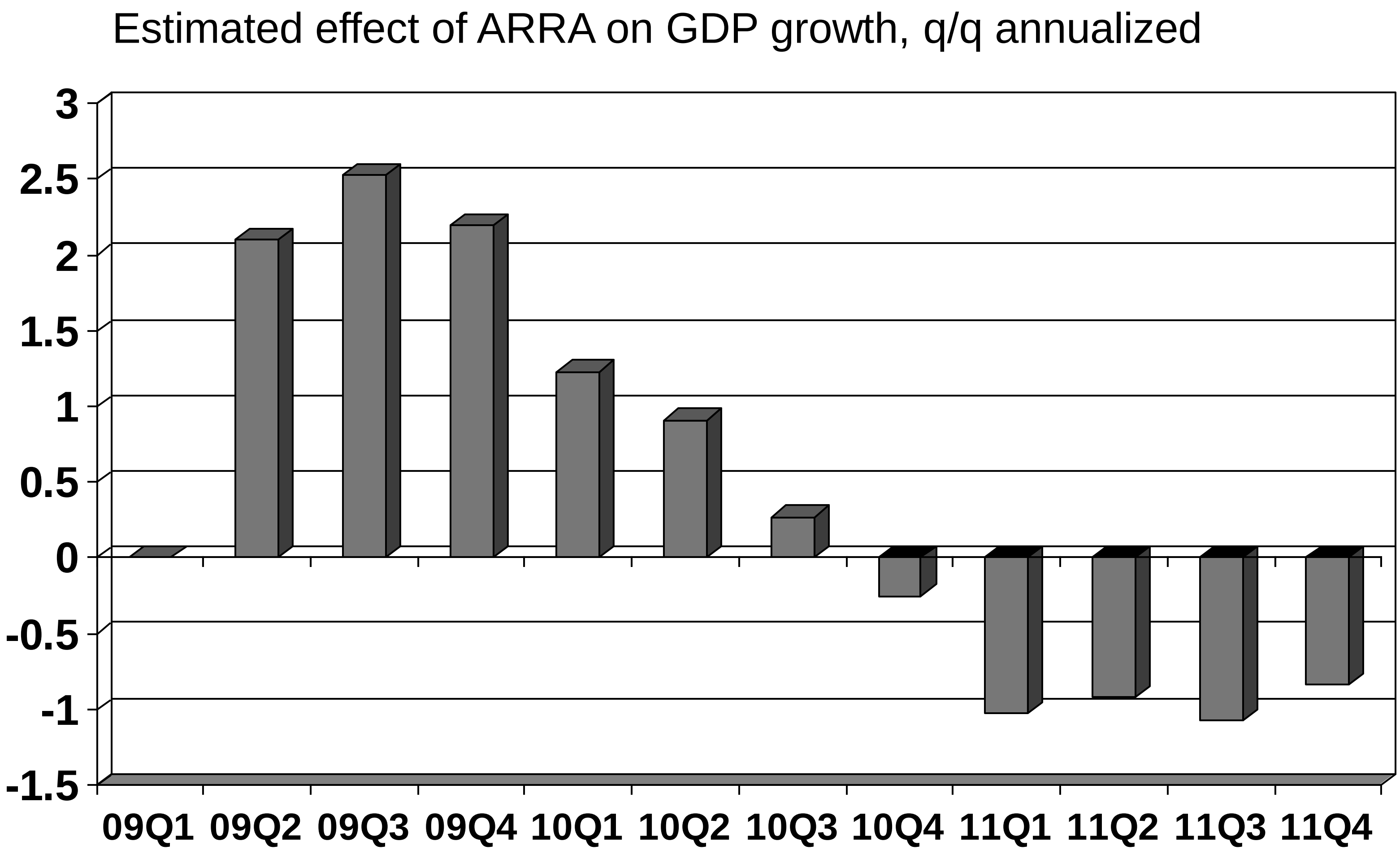
Inventories Now Back In Better Balance



Inventory Cycle Has Boosted Growth

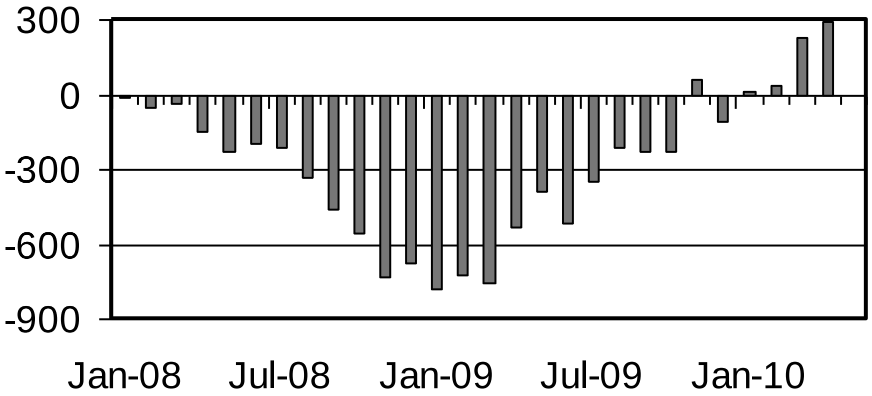


Fiscal Stimulus Has Supported Growth

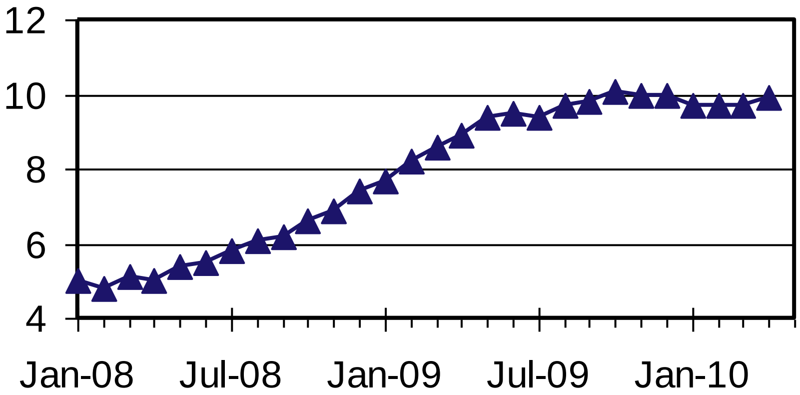


Employment Is Turning

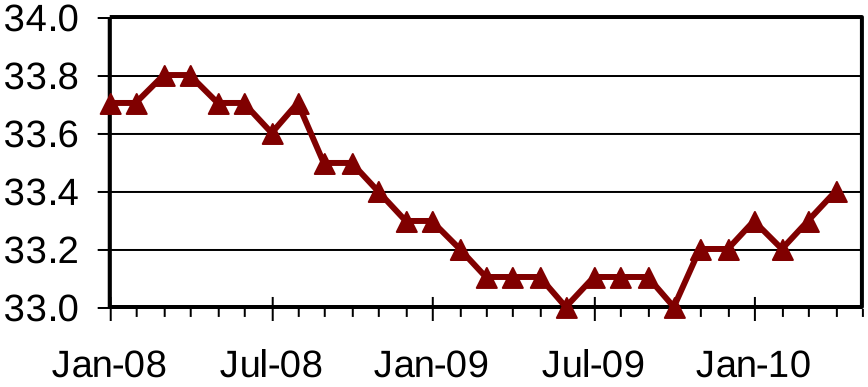
Payroll Employment*



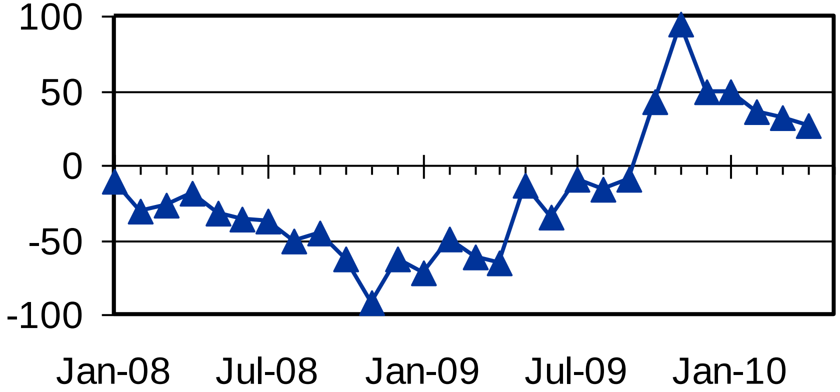
Unemployment Rate**



Length of Workweek***



Temporary Employment*



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

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U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2009	2010	2011	2012
Real GDP	-2.4	3.5	2.9	3.1
Final Sales	-1.7	2.2	2.8	3.1
Consumption	-0.6	2.8	2.9	2.4
Light Vehicle Sales (Millions)	10.3	11.8	13.8	15.6
Residential Investment	-20.5	2.8	24.7	22.2
Housing Starts (Millions)	0.55	0.70	1.17	1.55
Business Fixed Investment	-17.8	4.0	7.4	10.4
Federal Government	5.2	3.3	-2.2	-3.6
State and Local Government	-0.2	-0.9	0.6	0.4
Exports	-9.6	11.7	7.1	6.9
Imports	-13.9	11.9	8.7	5.7

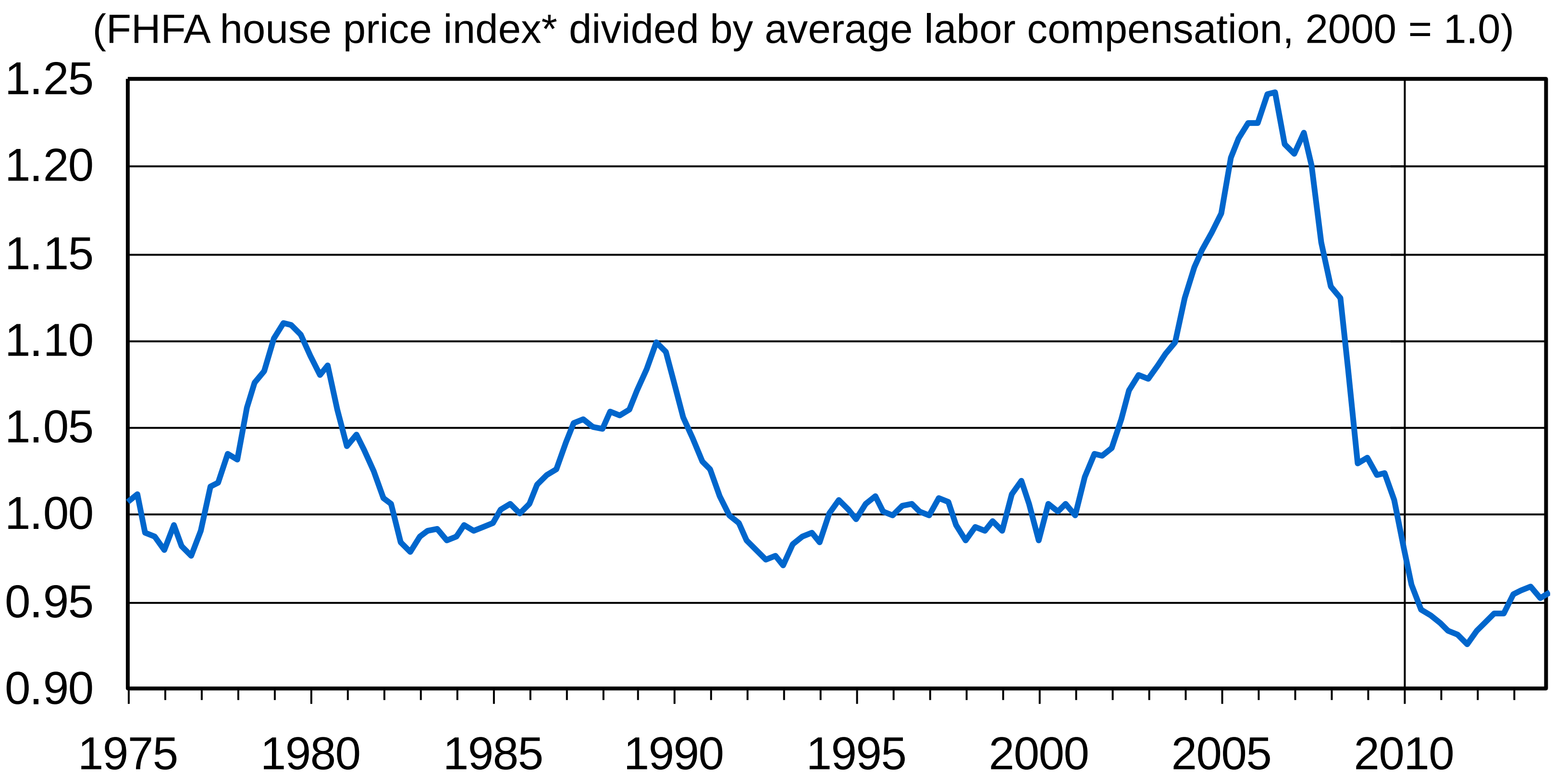
Other Key Indicators

(Percent unless otherwise noted)

	2009	2010	2011	2012
Industrial Production (% growth)	-9.7	5.8	4.7	3.2
Employment (% growth)	-4.3	-0.3	1.9	2.6
Unemployment Rate	9.3	9.6	9.1	8.3
CPI Inflation	-0.3	1.8	1.7	2.1
Oil Prices (WTI, US$/bbl)	62	78	84	89
Core PCE Price Inflation	1.5	1.2	1.6	1.7
Federal Funds Rate	0.16	0.22	1.70	3.35
10-year Government Bond Yield	3.26	3.68	4.08	4.62
Dollar (Major Currencies, 2005=1)	0.93	0.94	0.93	0.91

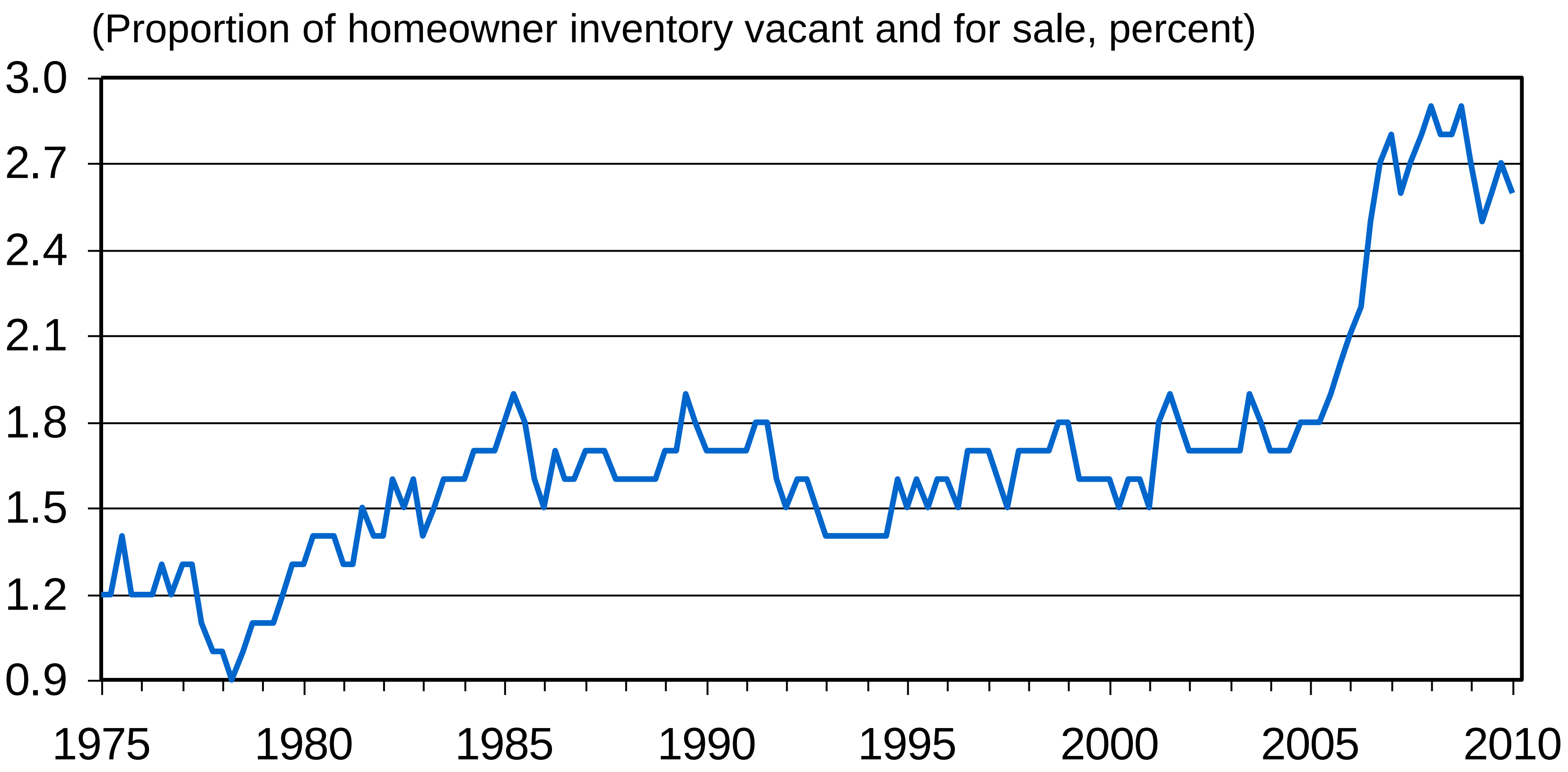
The Housing Cycle

House Price Adjustment Has Gone a Long Way



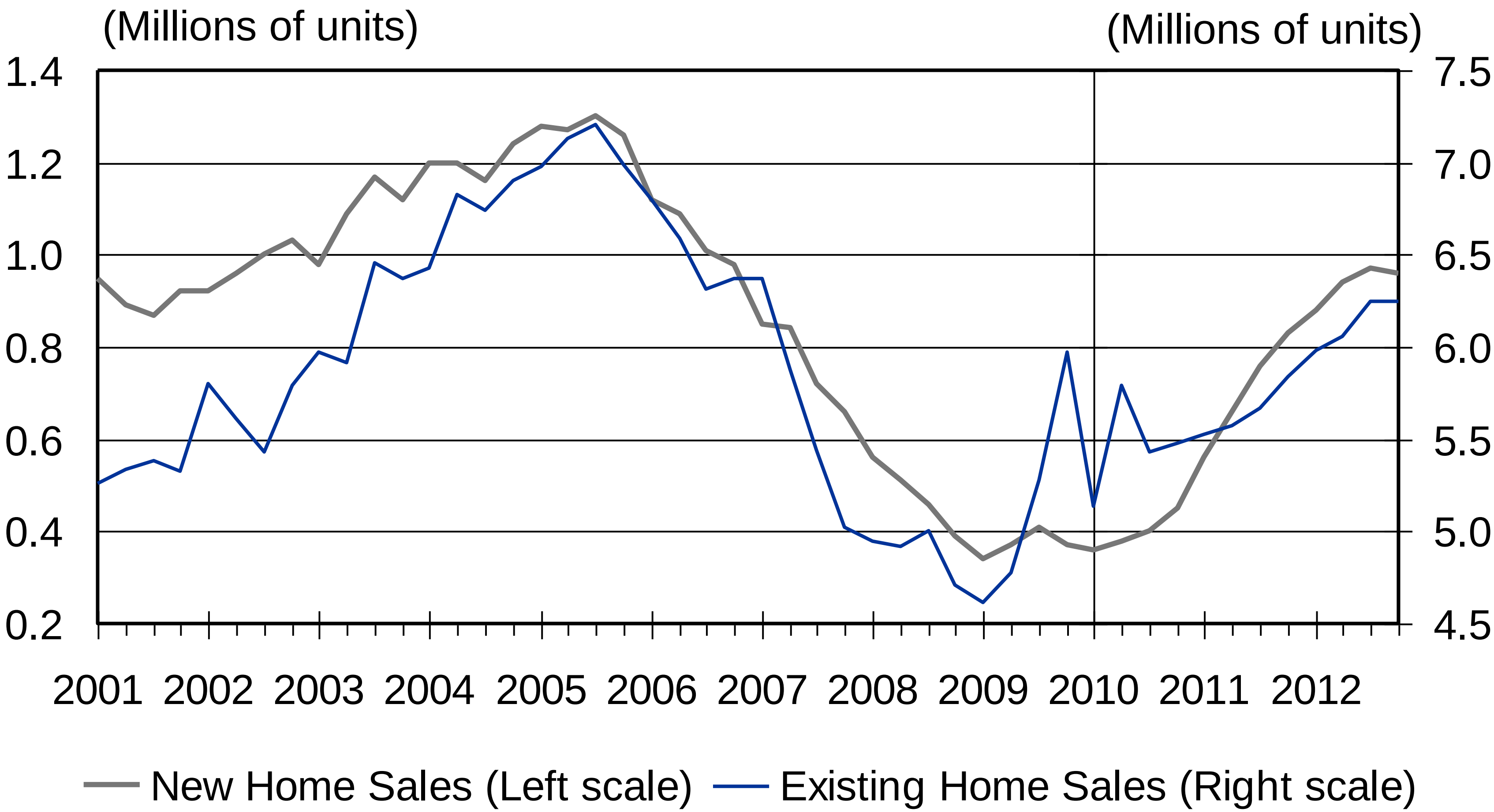
* Purchase-only index from 1991 onwards

Housing Supply Overhang Still Severe

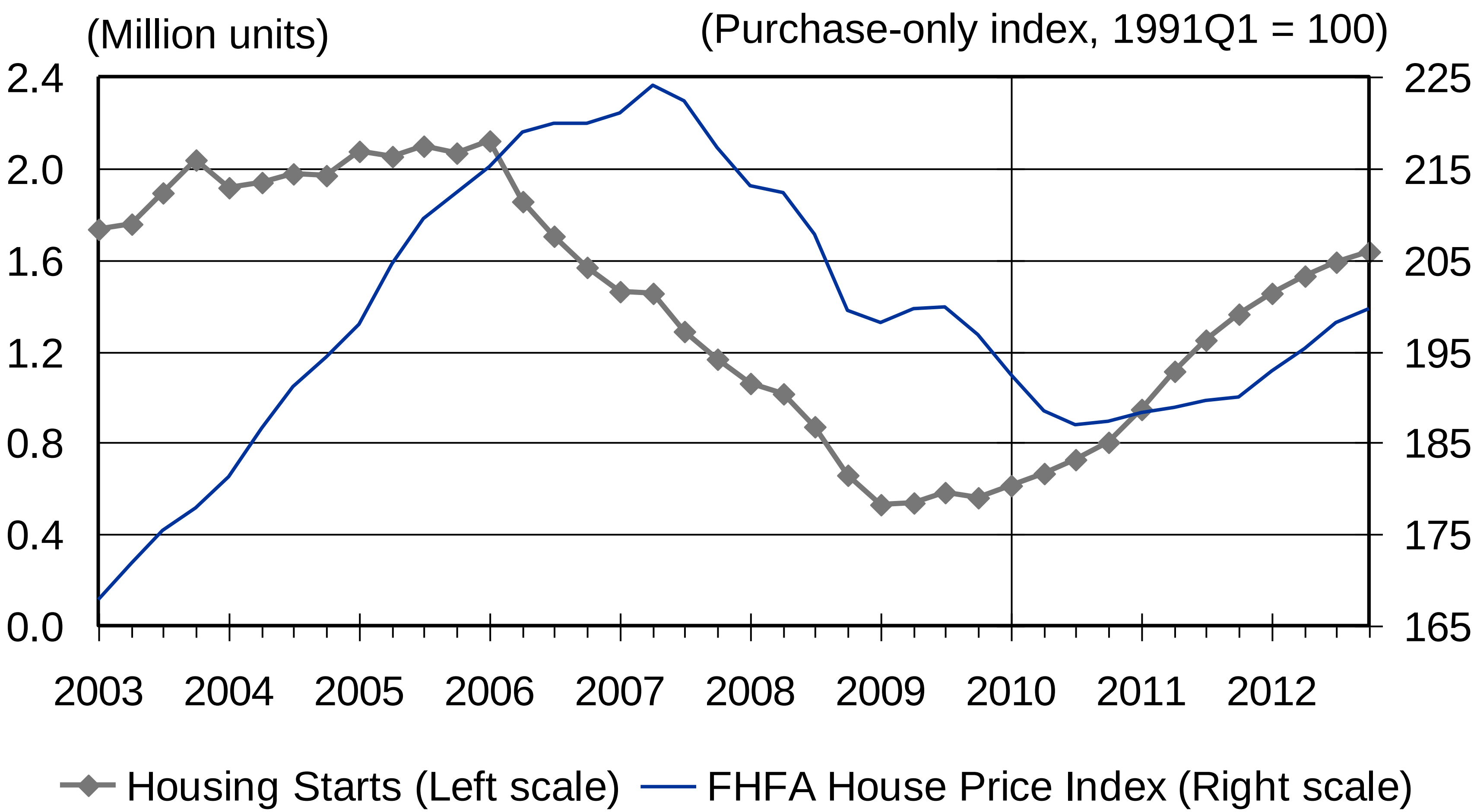


Source: Census Bureau

Home Sales Turning – But Swung Up and Down by the Homebuyers’ Tax Credit



Housing Starts Have Hit Bottom: Prices Not Quite There Yet



The Consumer: Coming to Life

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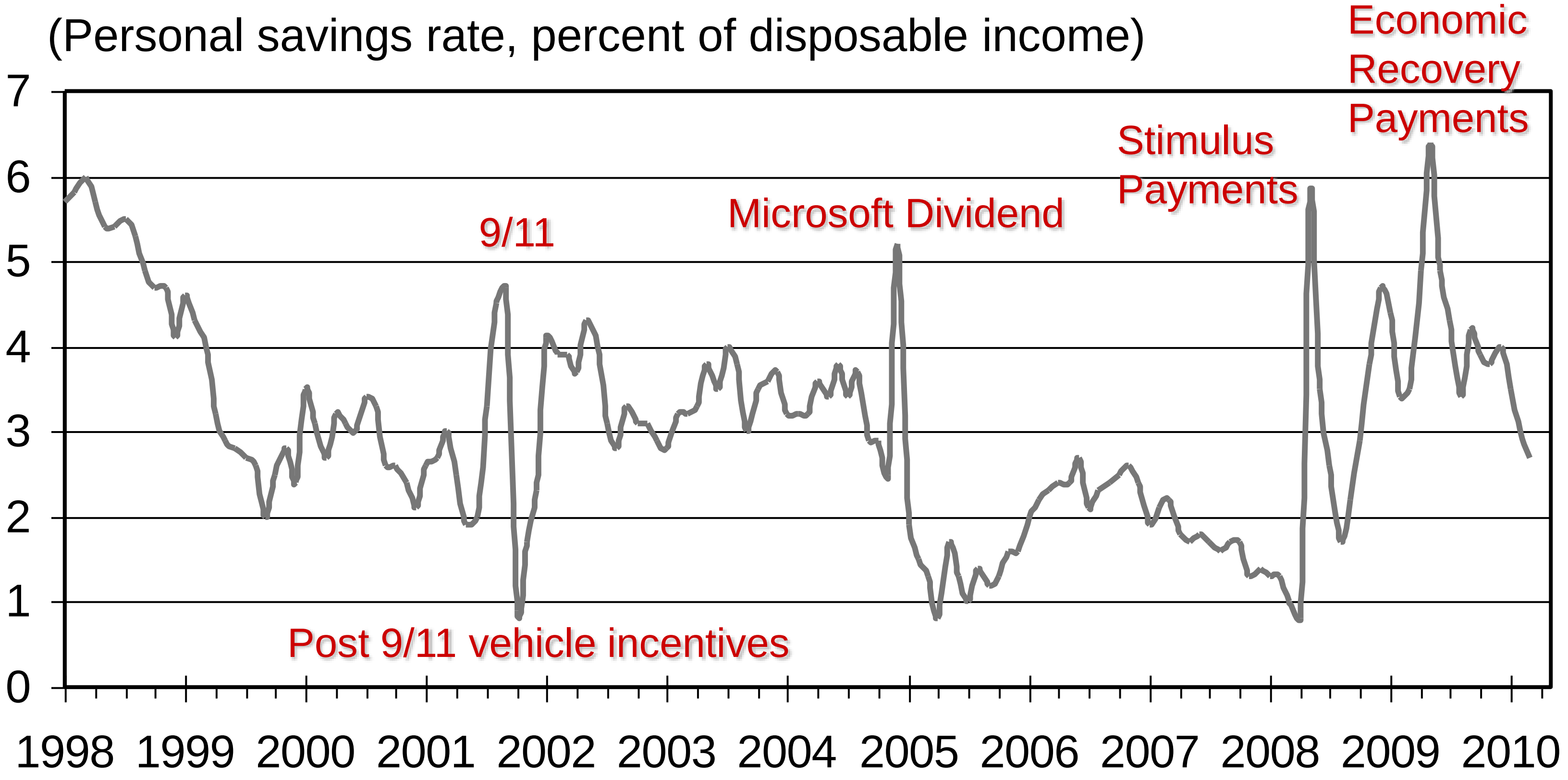
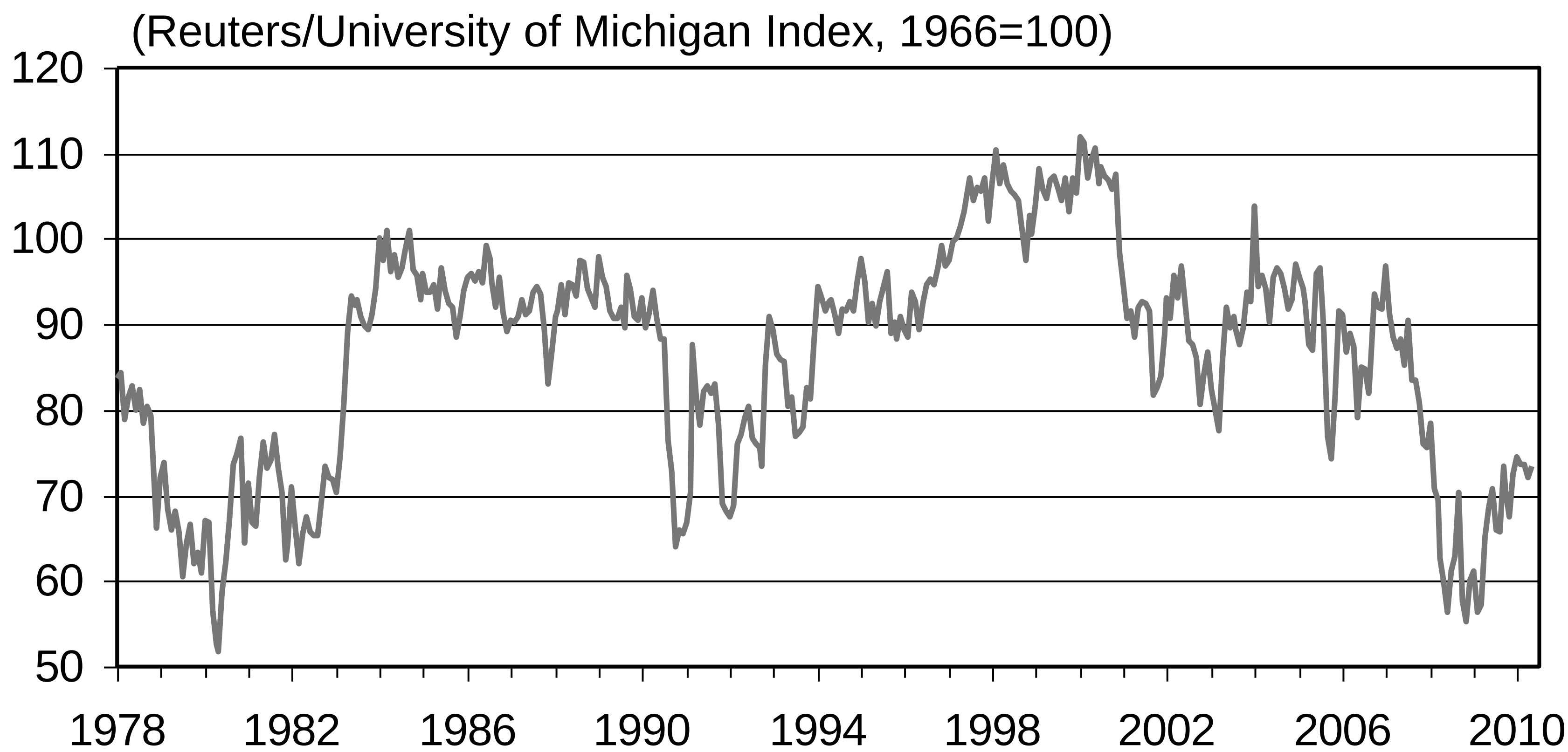
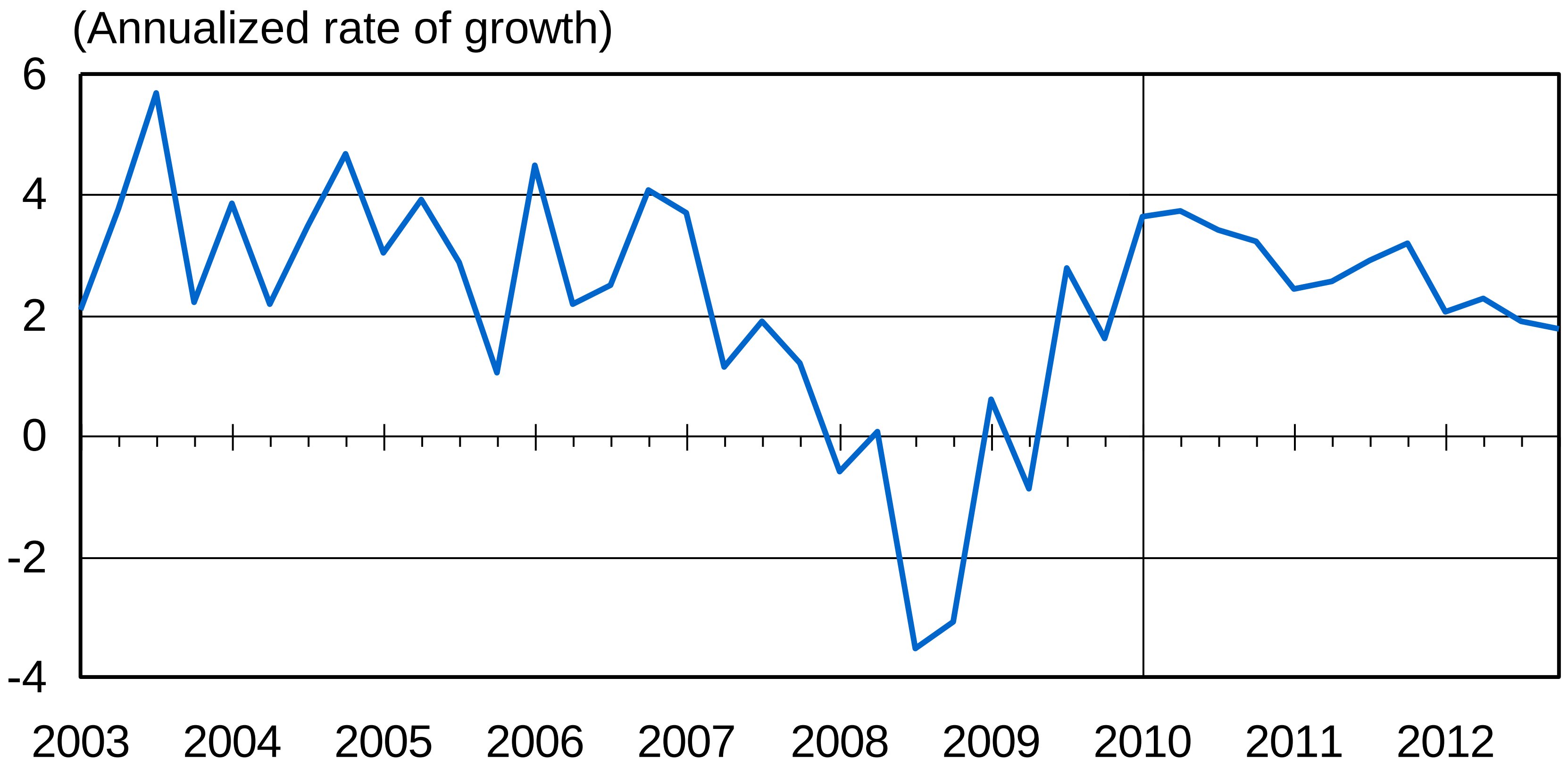
The Personal Saving Rate Has Fallen Again



Consumer Sentiment Still Weak



Consumer Spending Stabilizing, But Not a Strong Driver of Recovery



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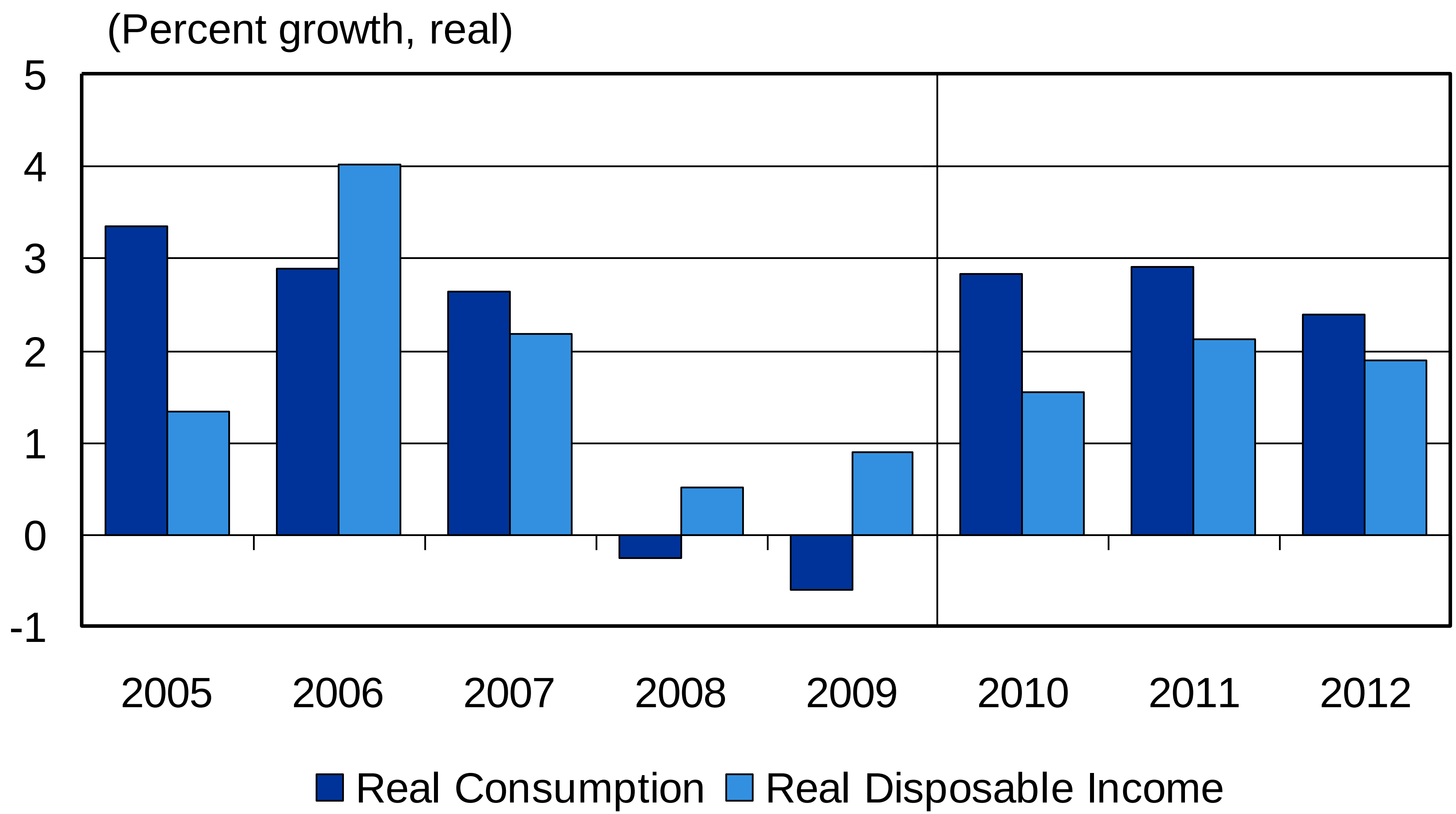
Consumption Growing Again; Outpacing Income



Business Investment: A Mixed Picture

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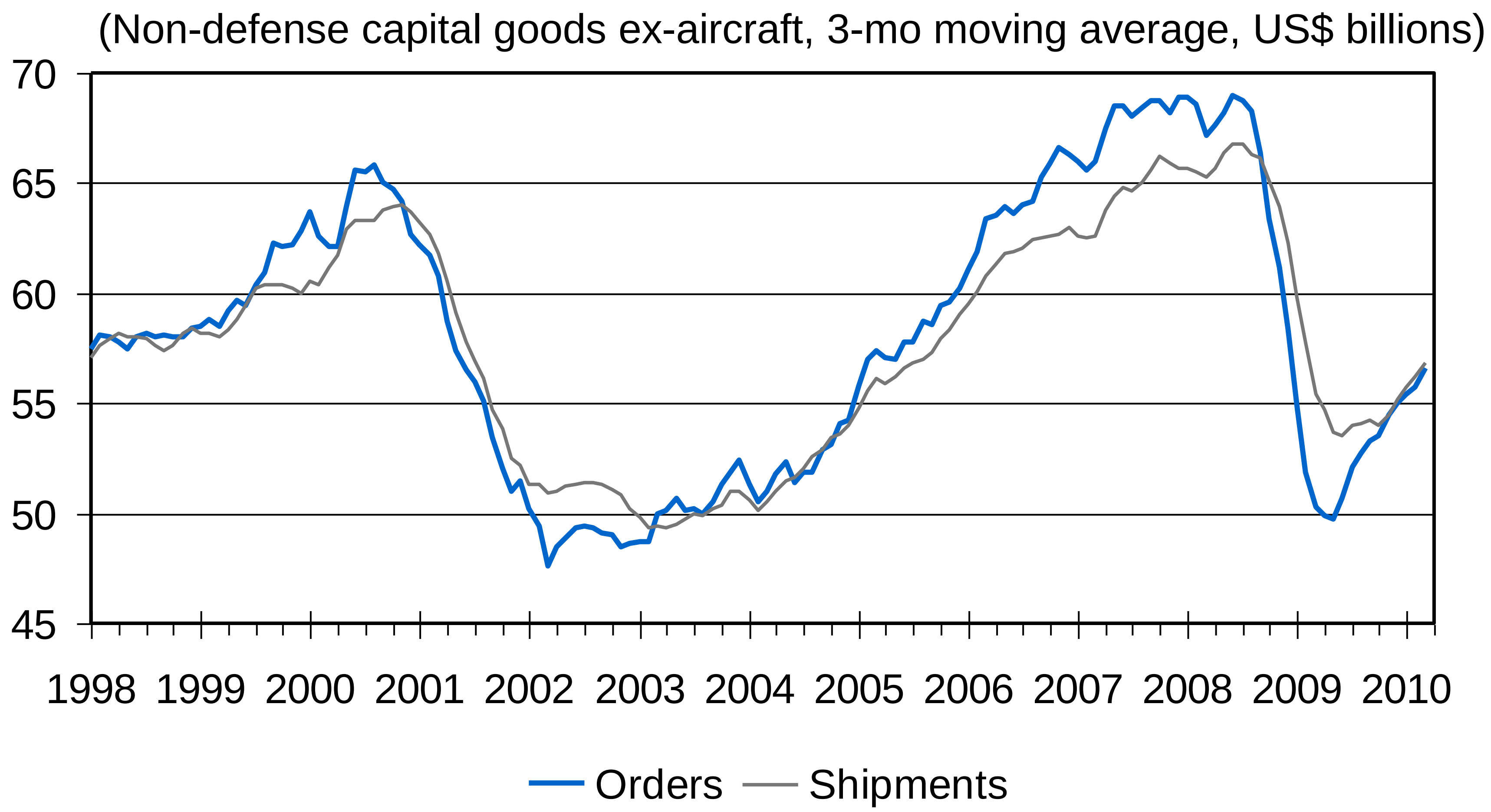
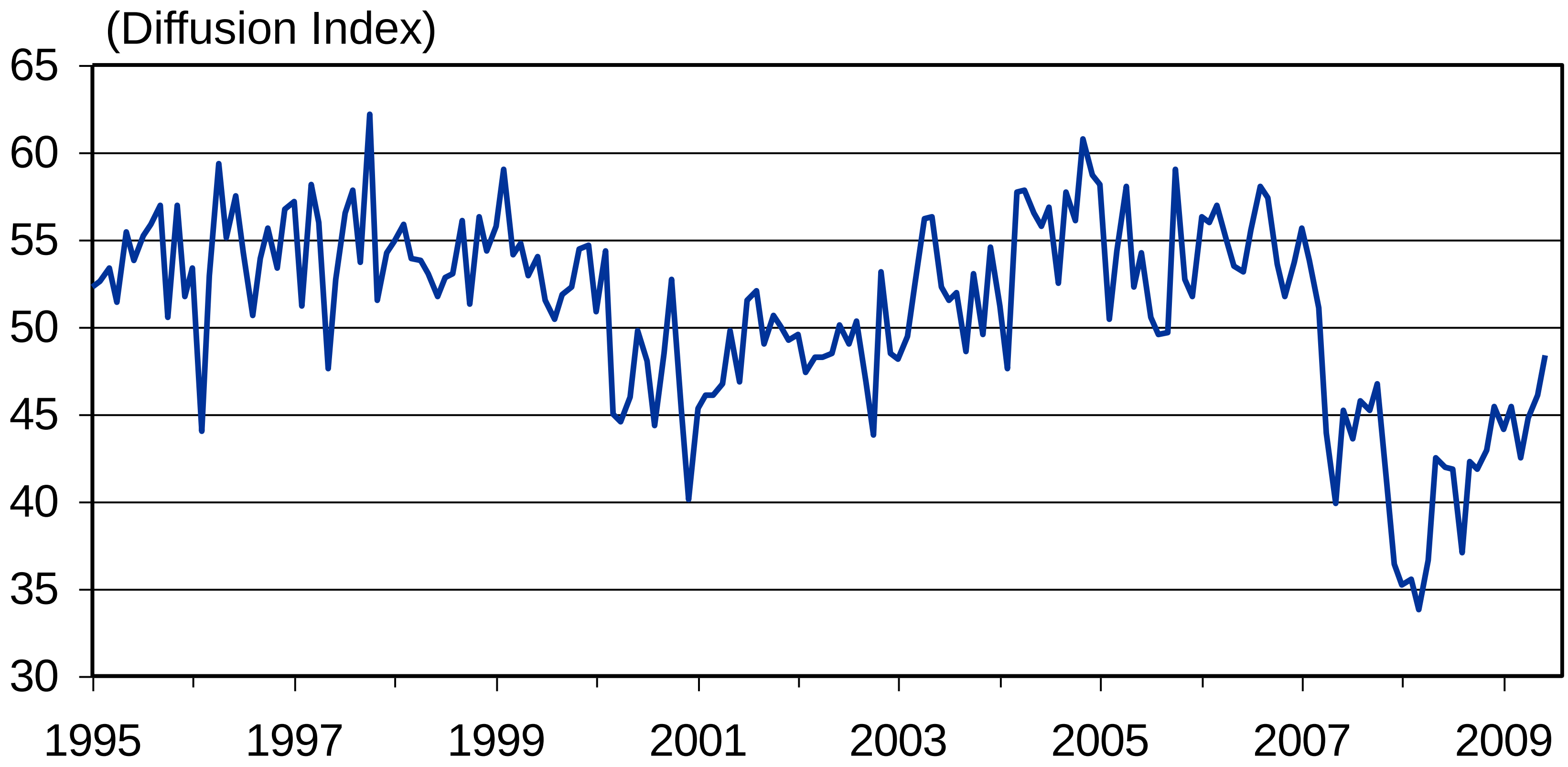
Business Equipment Demand Beginning to Recover

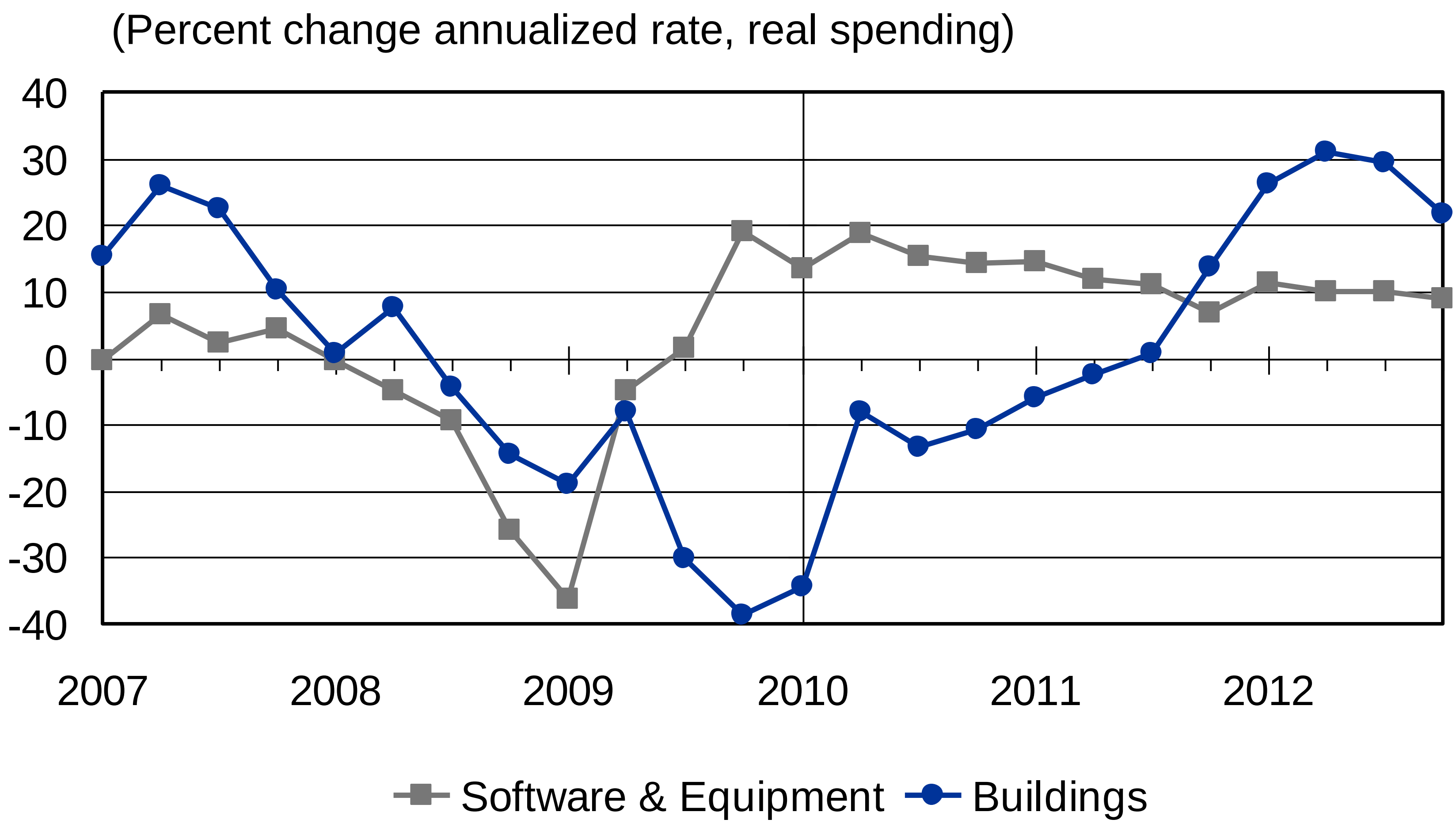


Nonresidential Construction:
Architects' Billings Still Soft, But Off The Floor



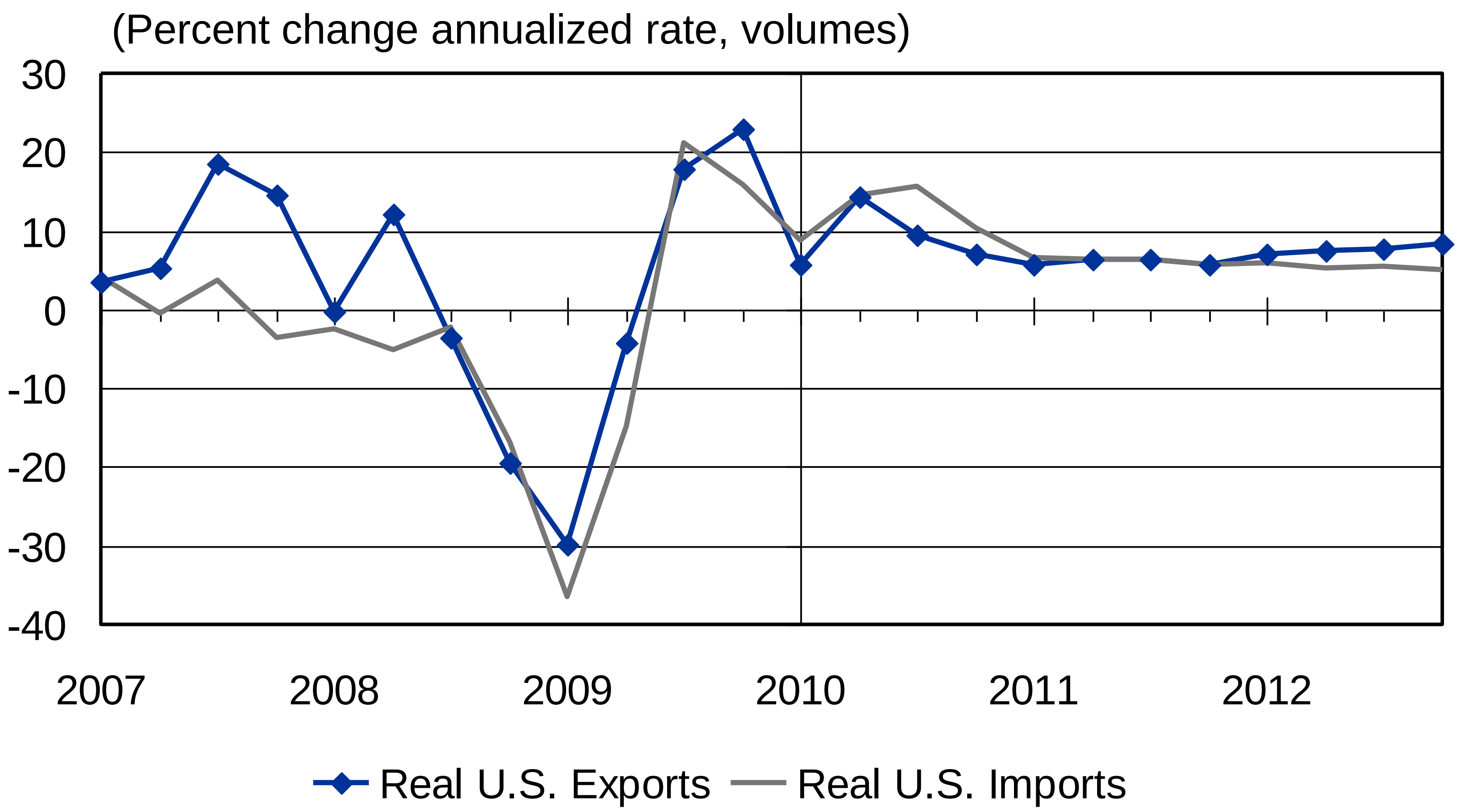
* Source: American Institute of Architects

Business Capital Spending Cycle: Construction Lags



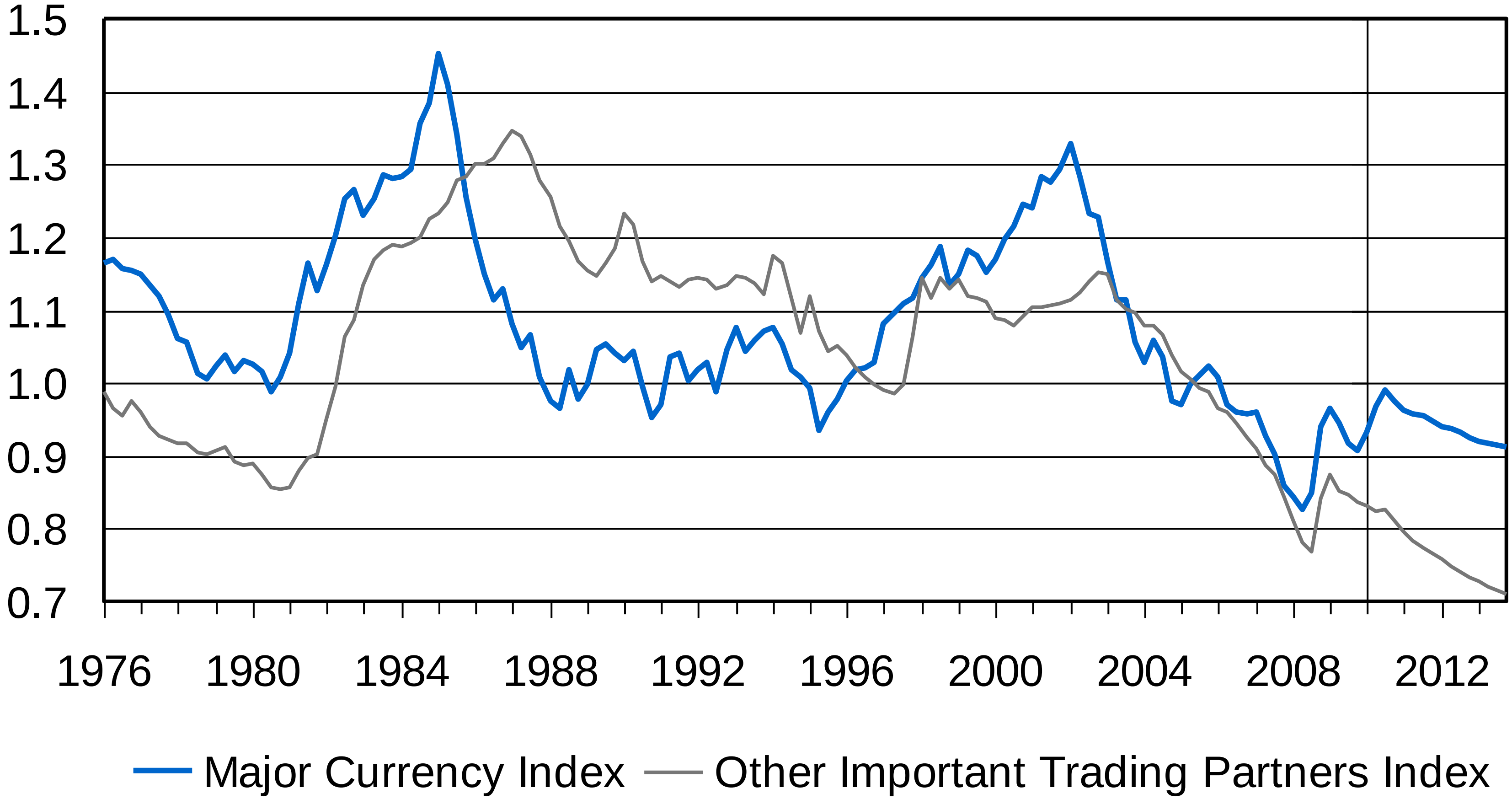
Foreign Trade:
Exports and Imports Rebounding

Imports And Exports Both Bounce

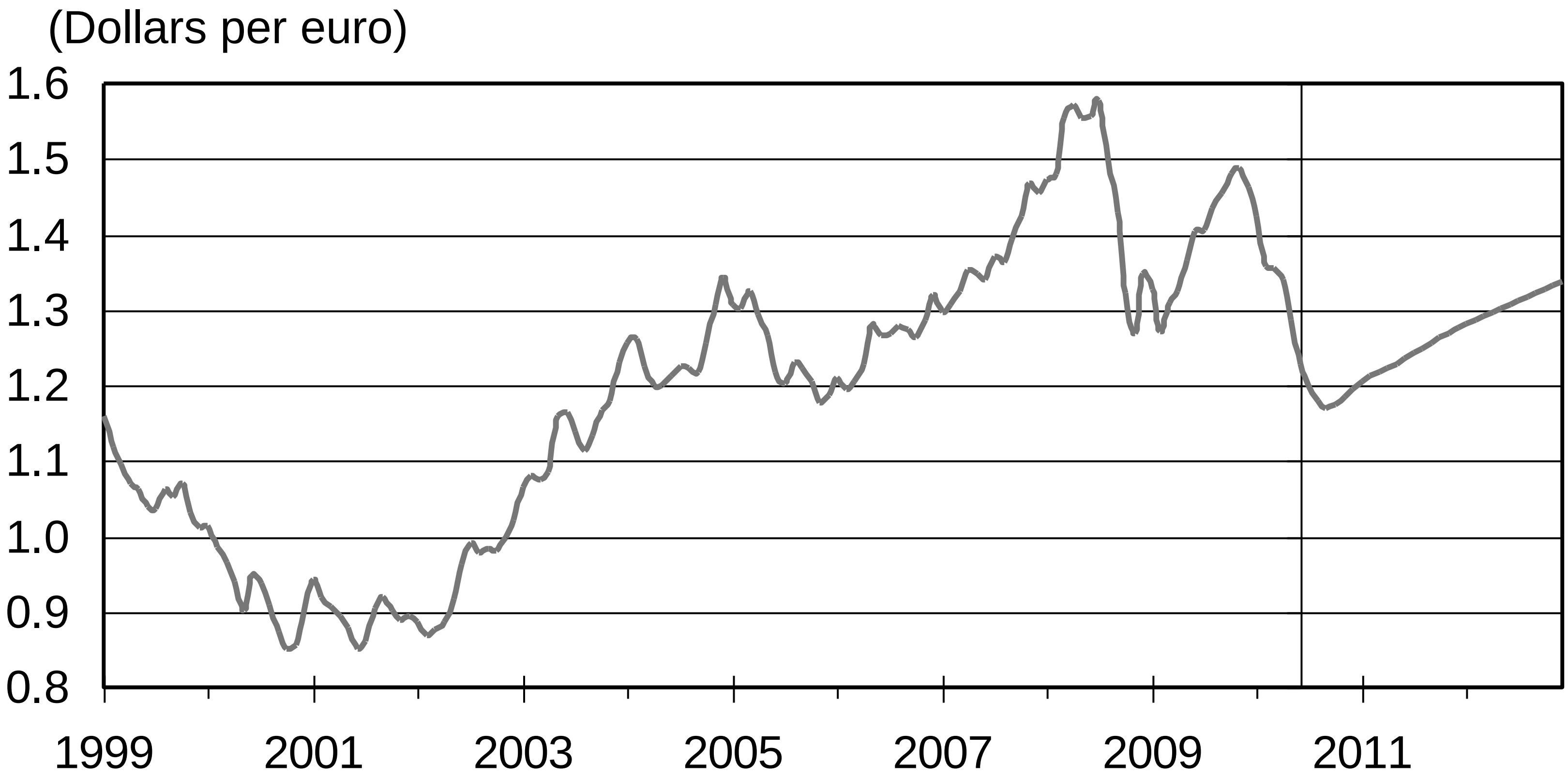


The U.S. Dollar: Secular Weakness

(2005=1.0, inflation-adjusted)



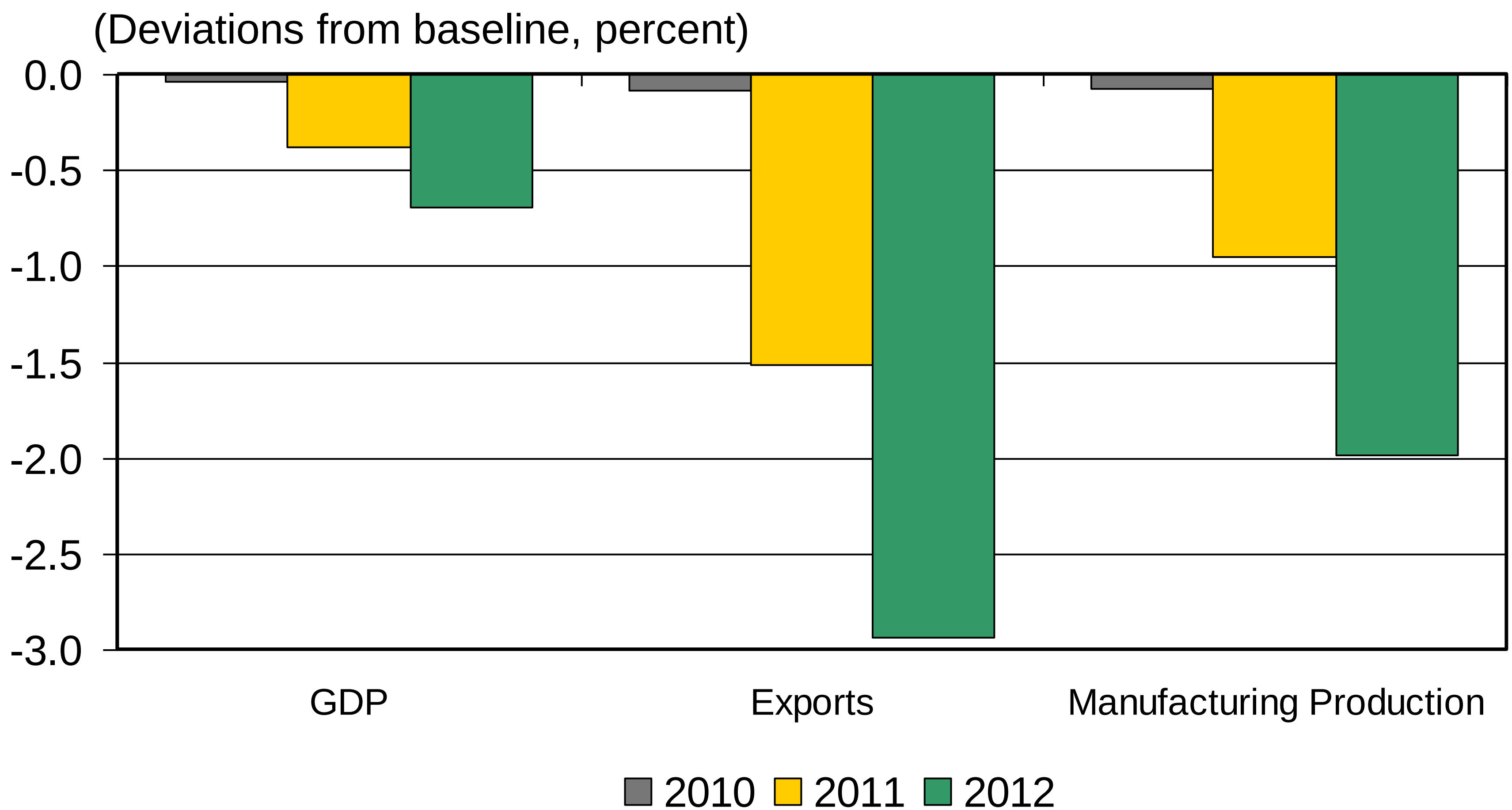
Euro Assumption



U.S. Risks from Eurozone Debt Crisis

- Short-term Risks
  - Financial contagion via European bank losses, flight to liquidity
  - Weaker euro hits exports, hurts overseas profits translation
  - Weaker Eurozone growth hits exports
  - Upside risks: lower oil prices, lower U.S. interest rates support domestic demand
- Long-term Risk
  - All sovereign debt (including U.S.) becomes seen as toxic

A Downside Scenario: U.S. Implications of Euro at Parity, Eurozone Growth 1% Lower



Inflation and Interest Rates

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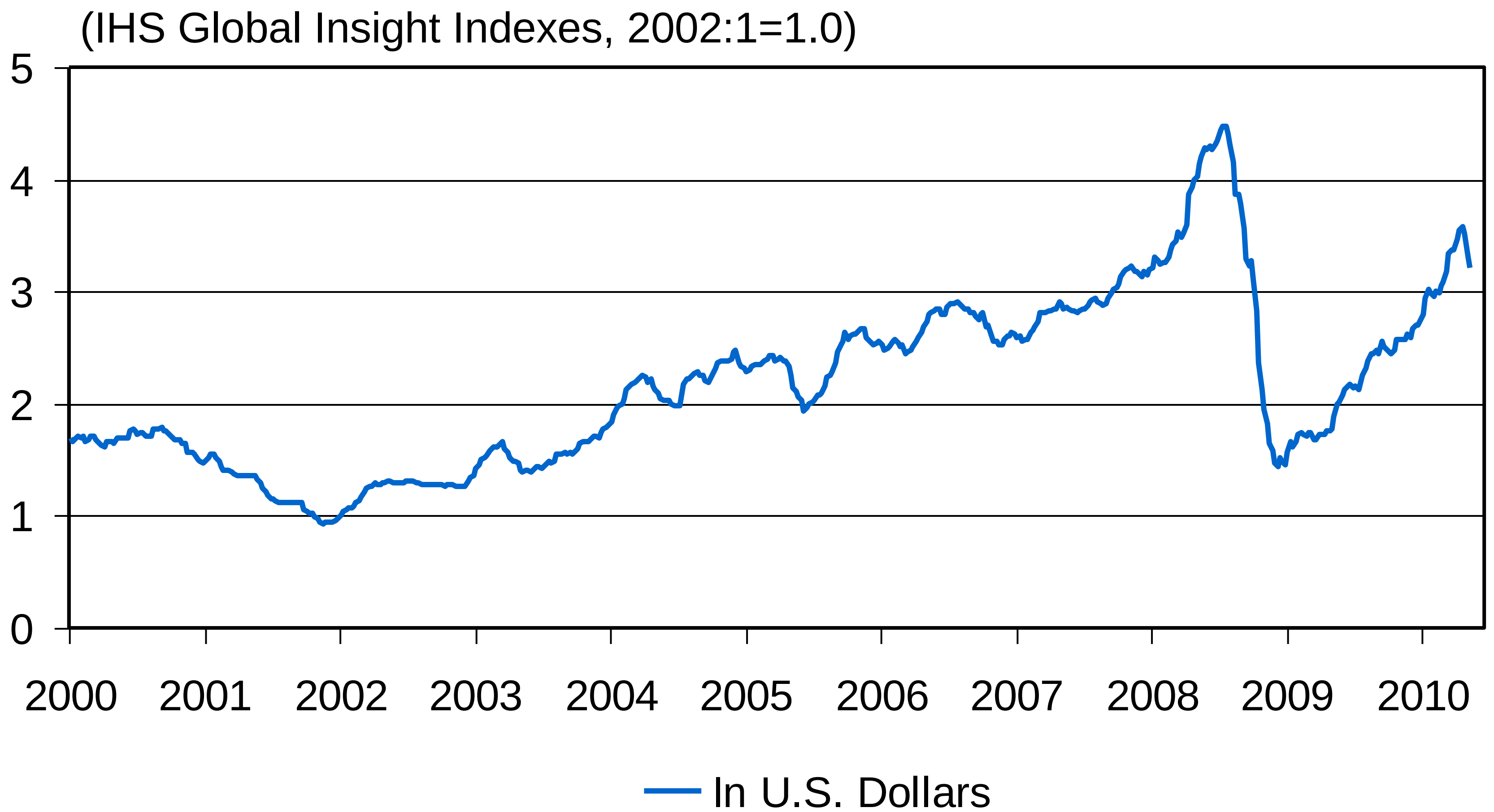
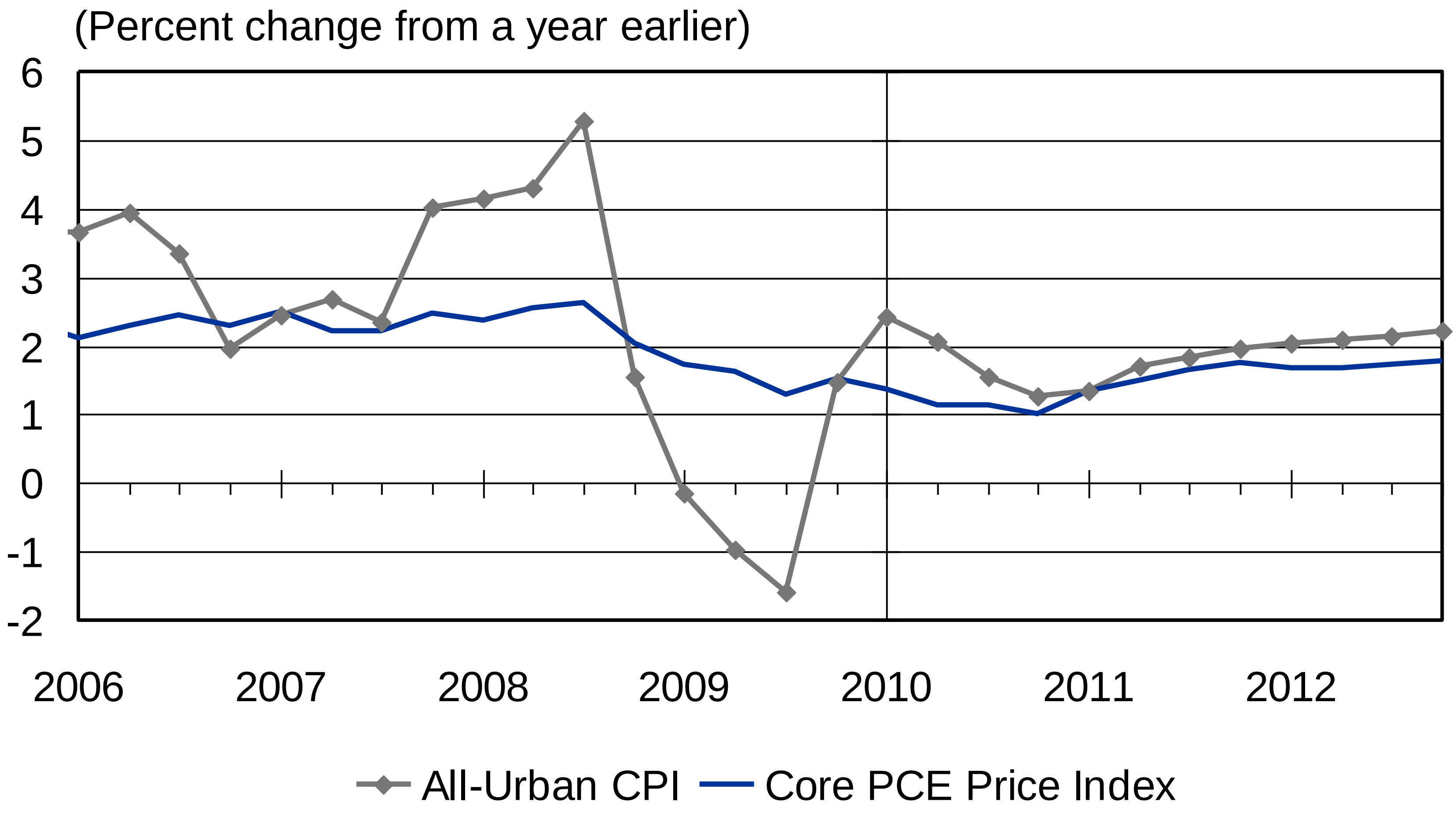
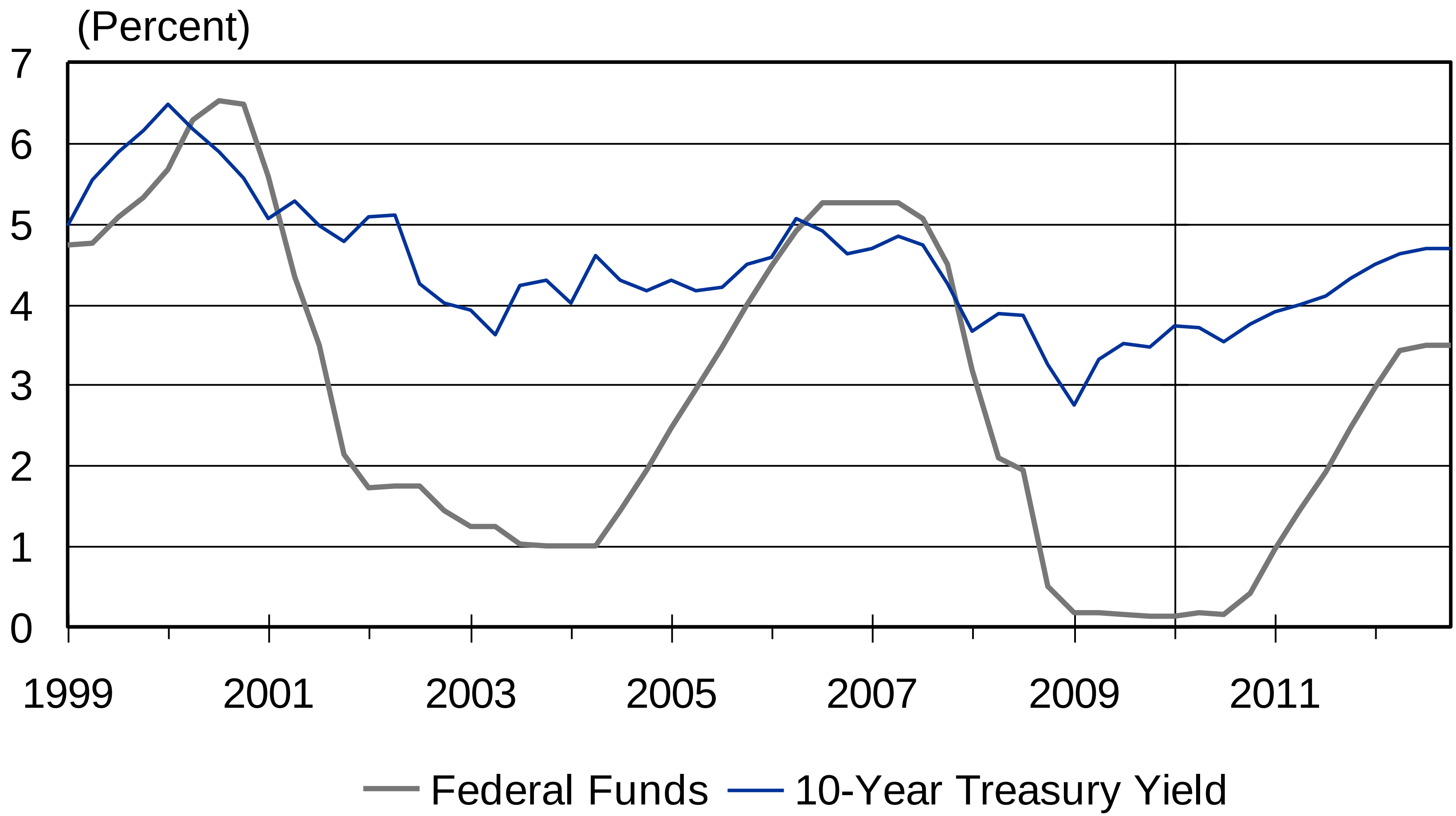
Industrial Materials Prices Have Rebounded – Now Correcting?



Headline CPI Inflation Is Positive Again; But Core Inflation Is Easing



Federal Funds Rate to Stay Near Zero Well Into 2010



Federal Government Budget: Harsh Realities

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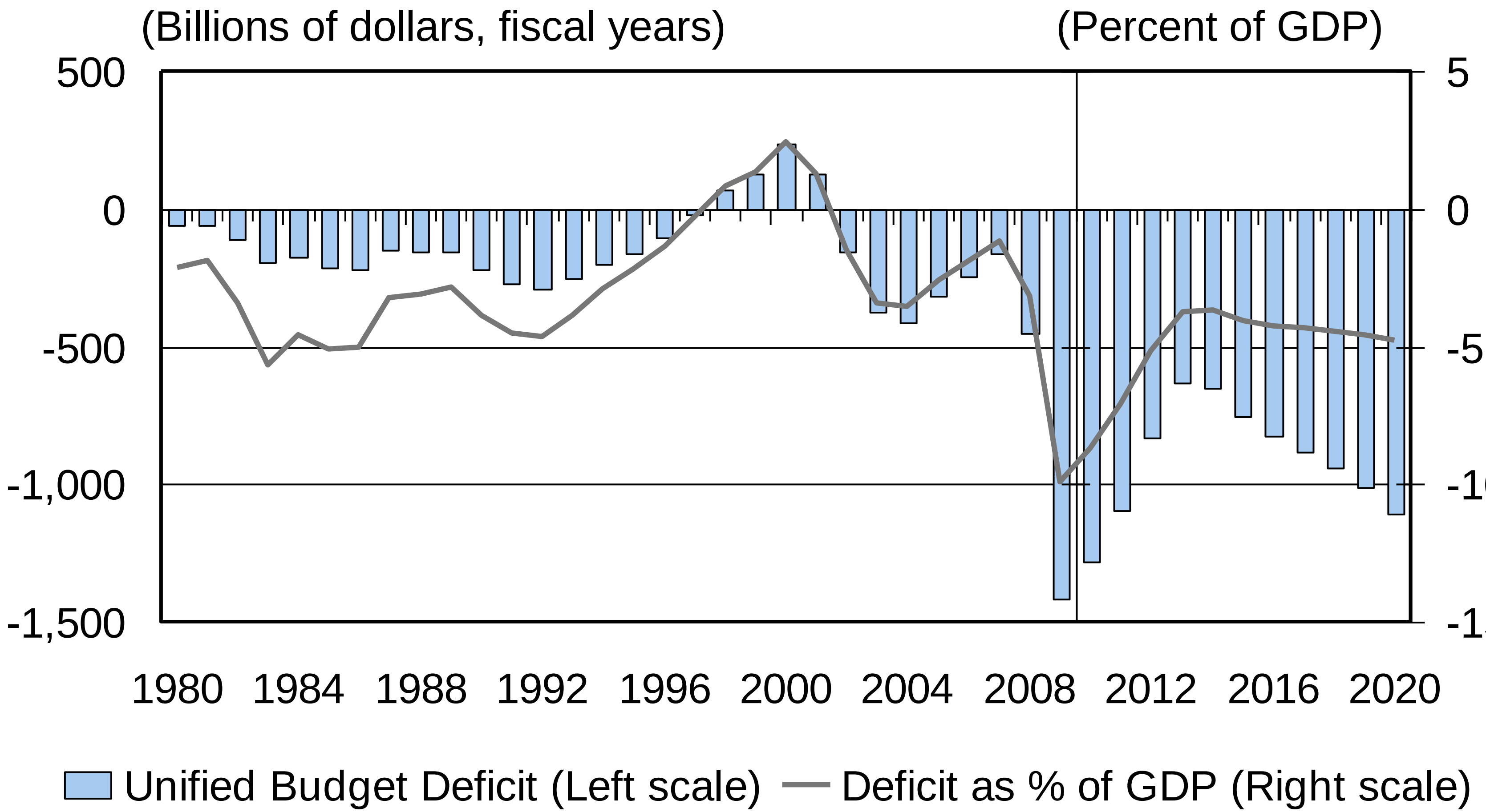
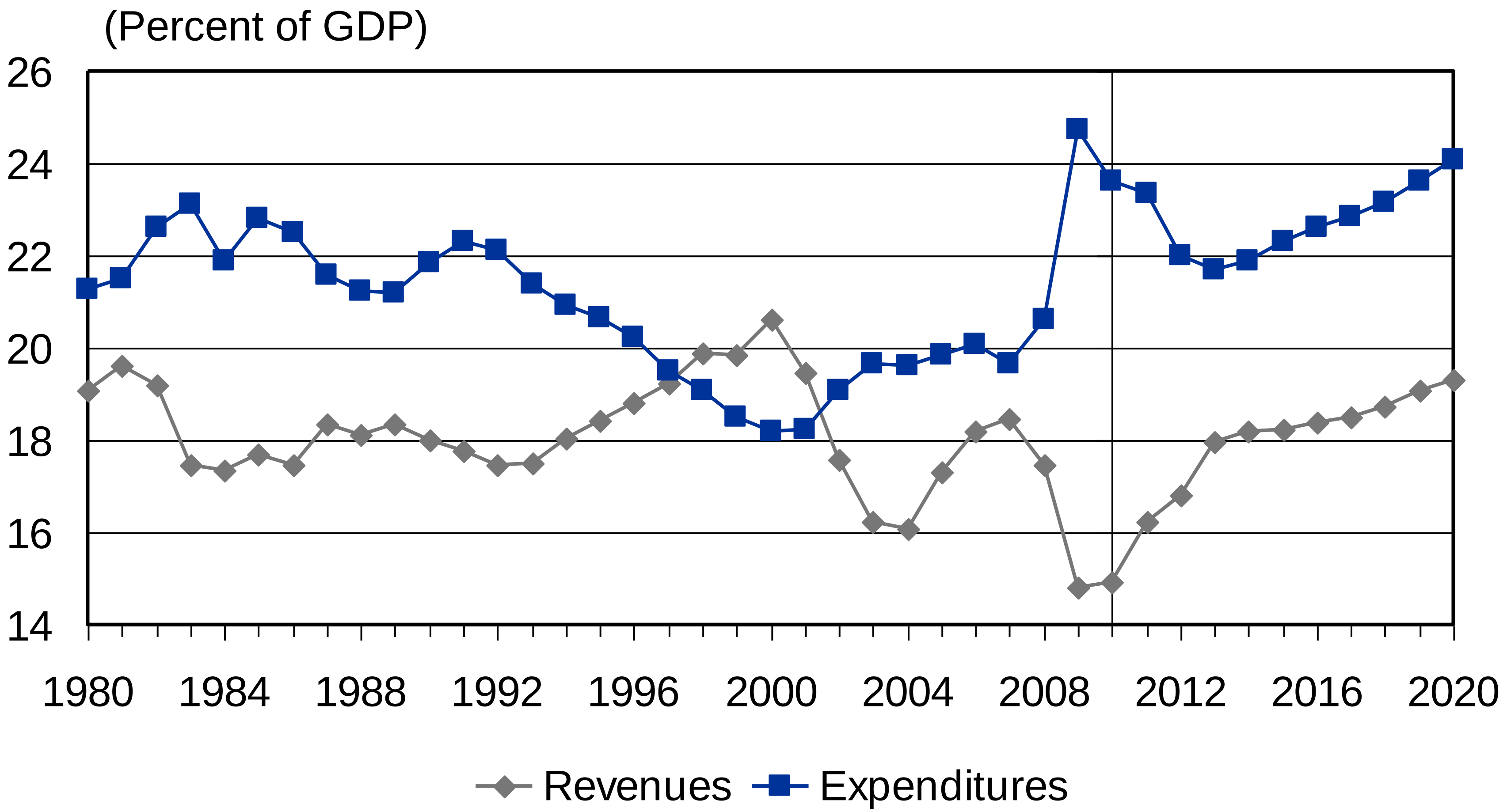
A Record U.S. Federal Budget Deficit

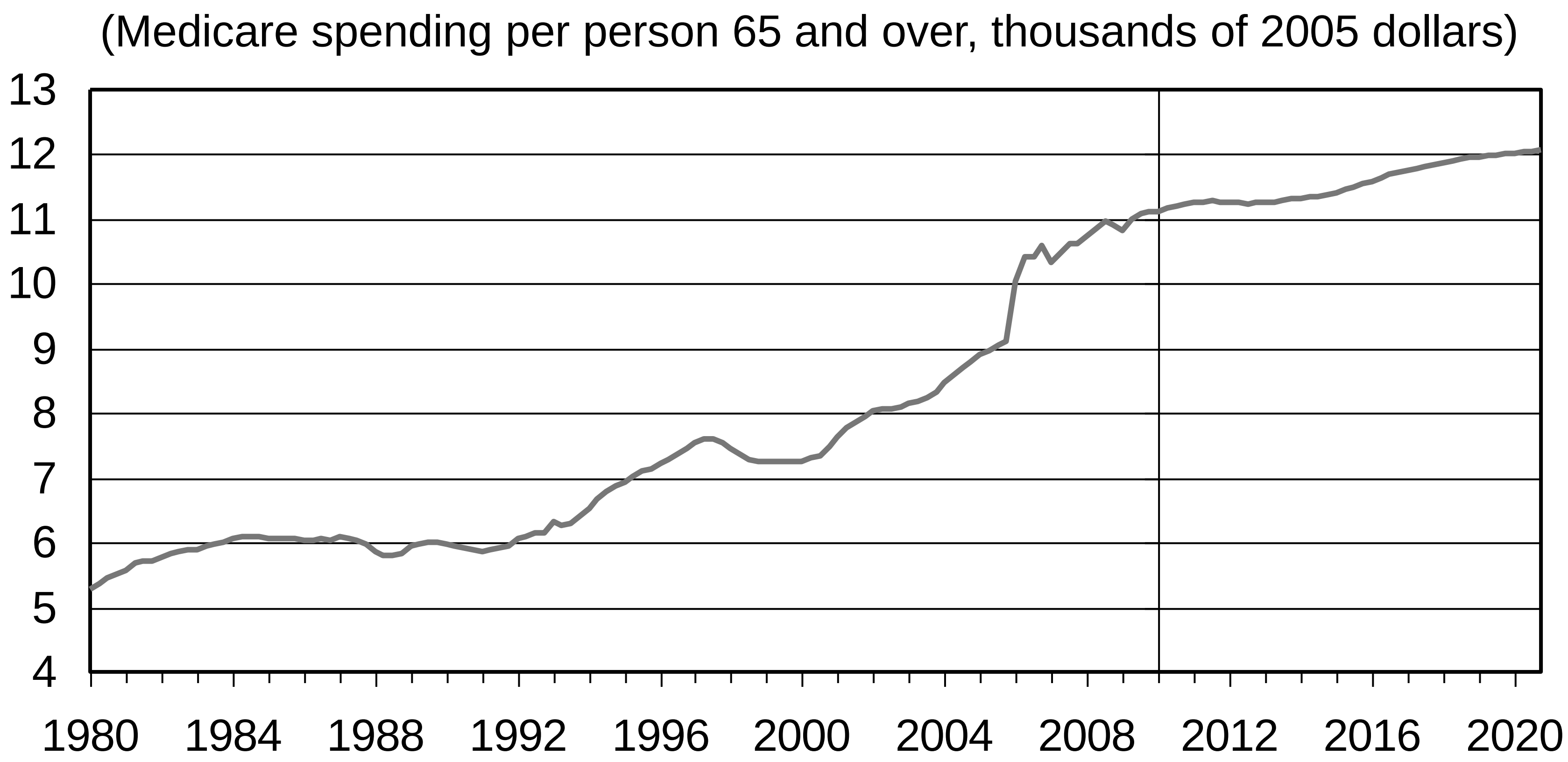


Federal Debt Burden Rising

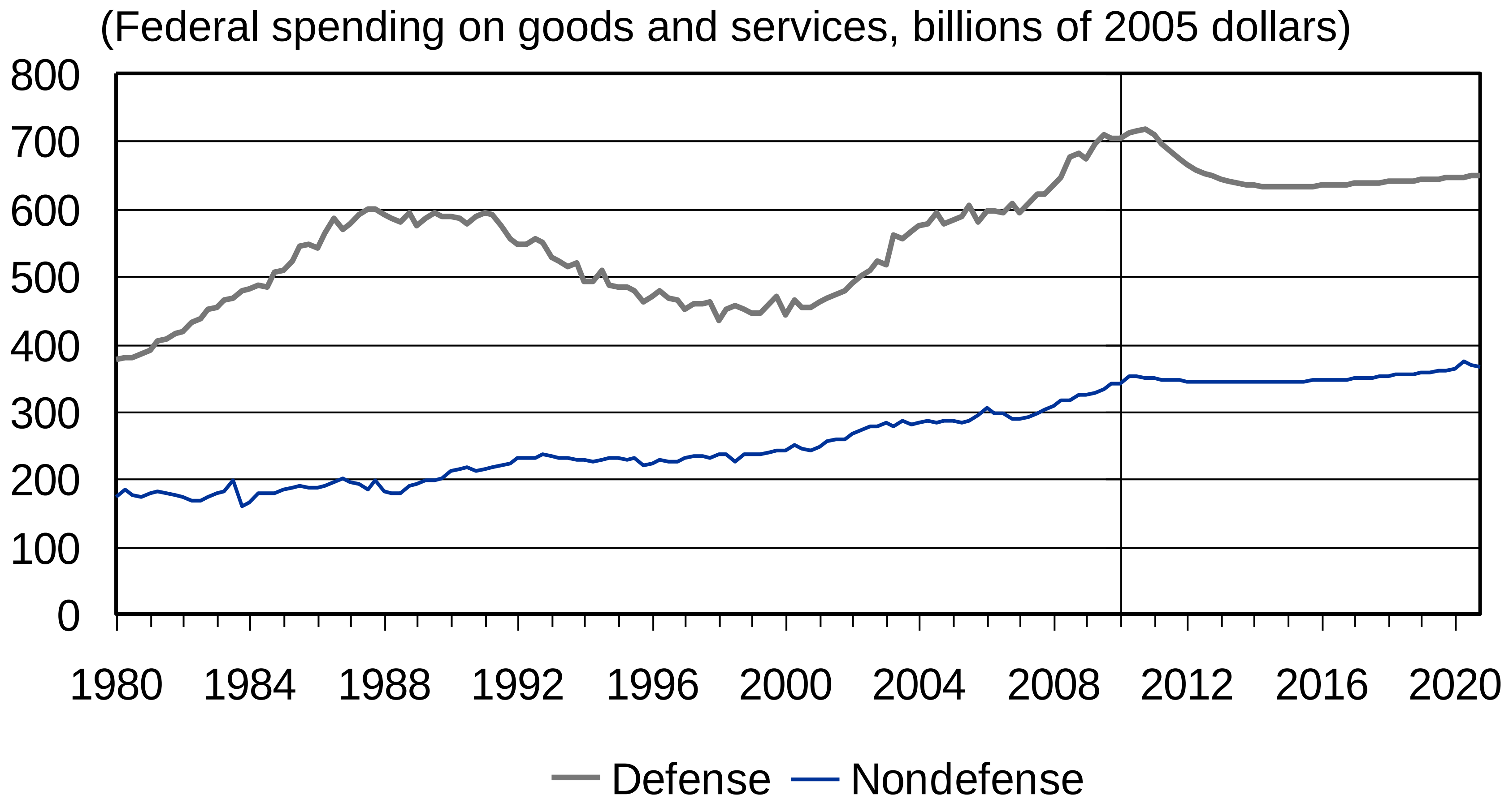
The Federal Budget Gap



We Have Assumed Medicare Restraint…

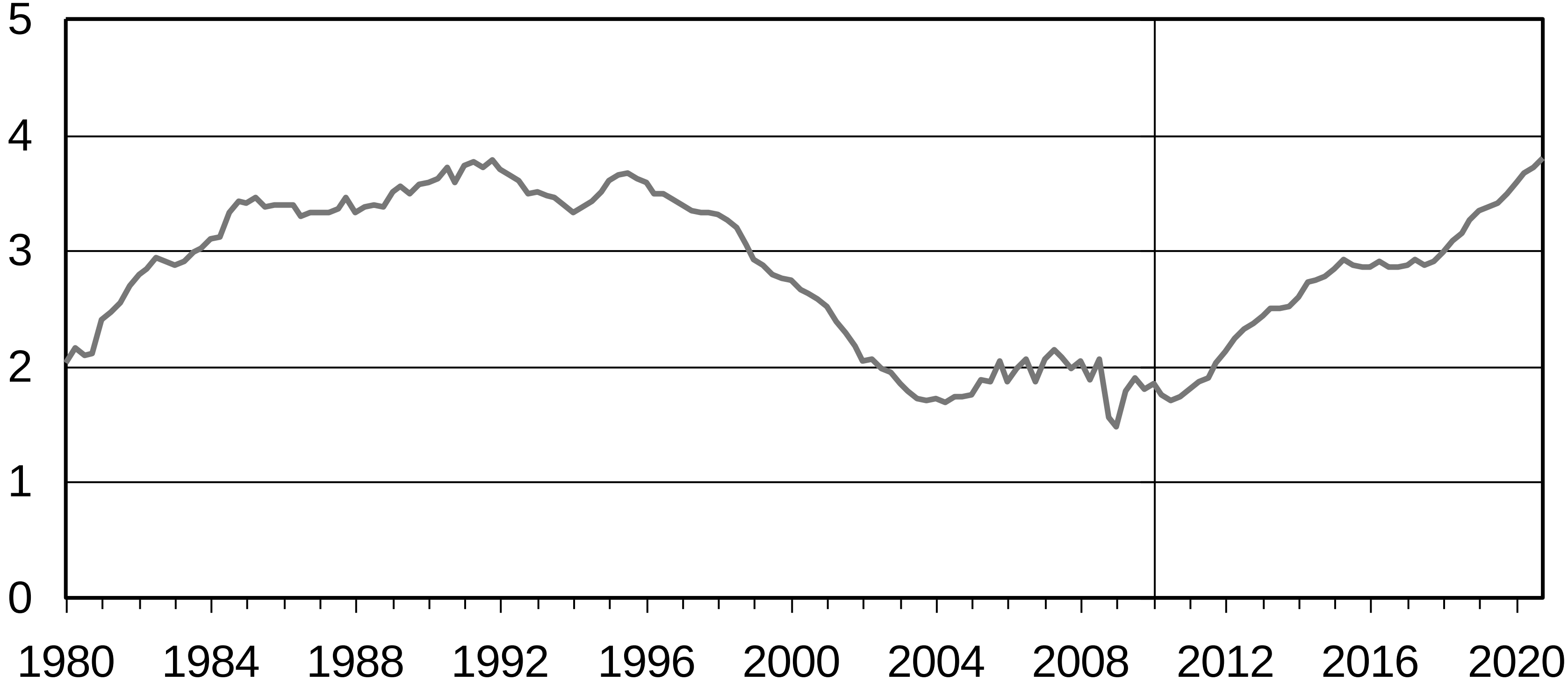


…And Direct Spending Restraint…

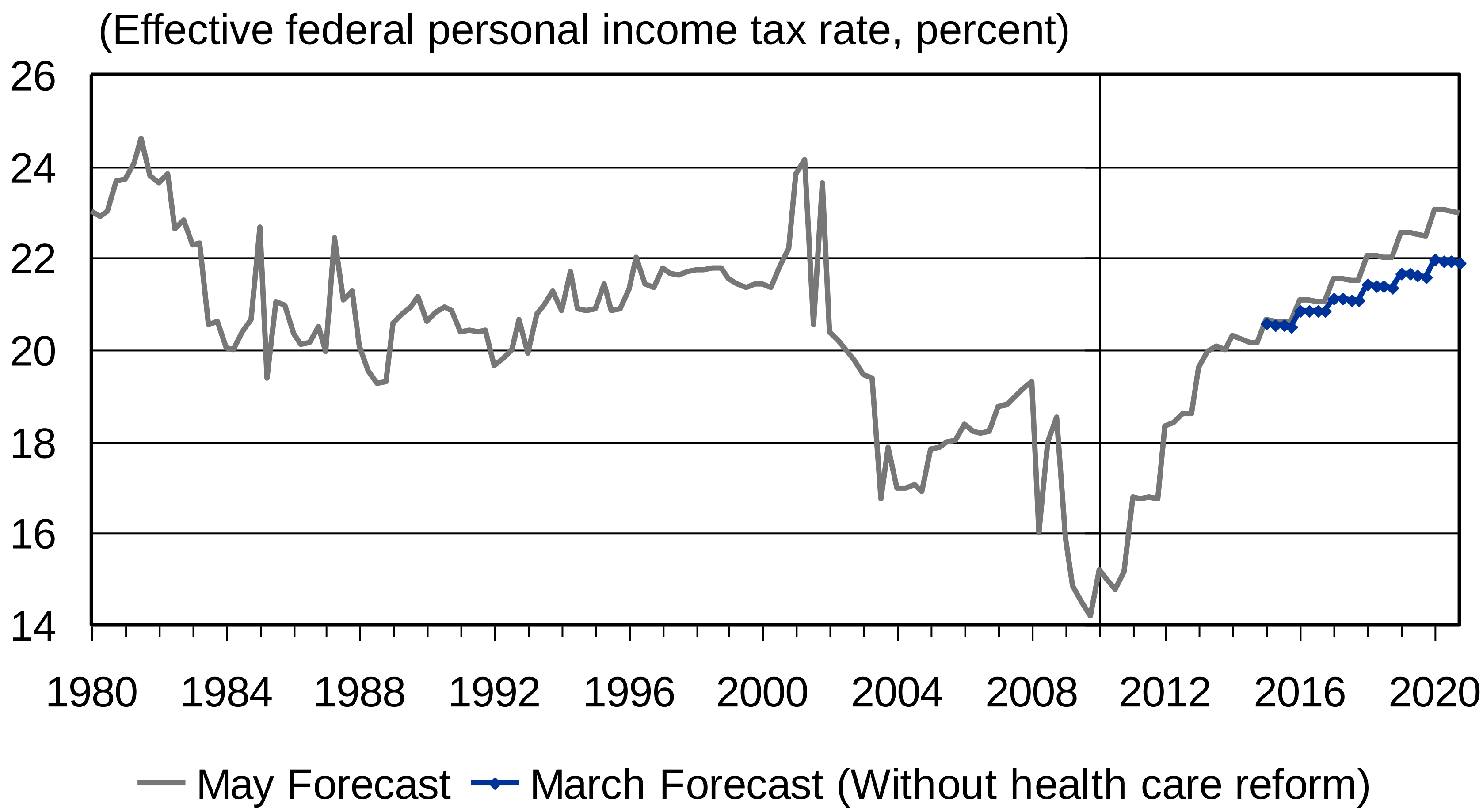


…But the Interest Bill Will Mount

(Net interest payments, federal government, percent of GDP)



Taxes Must Rise For Everybody



Implications

- Growth initially driven by the inventory cycle and stimulus, but now broadening
- Exports, business equipment spending moving higher
- Nonresidential construction, state and local spending declining
- Consumer demand improving but not the same driving force as in previous recoveries
- Inflation stays low; Fed does not need to rush to tighten
- Eurozone crisis poses multiple risks (not all bad ones)
- Markets will not always be so eager to finance the U.S. twin deficits; a deficit reduction plan is needed

Thank you

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