

The Outlook for the U.S. Economy

**North American Power Credit
Organization**

Euler Hermes Economics / Dan North
Louisville, KY
September 22nd, 2016



Euler Hermes: Global Leader in Trade Credit Insurance

- Founded in 1893
- AA- S&P Rating and A+ AM Best Rating
- Offices in 52 countries providing coverage in over 200 foreign markets
- Backed by blue-chip ownership of the Allianz Group
- Insure over \$150 Billion in US sales and over \$1 Trillion globally.
- International Risk Database monitors over 45 million companies worldwide

Credit Insurance: Protection against bankruptcy and slow payment losses

- Safer sales growth in the US or overseas
- Knowledge to better manage risk
- Improved borrowing options
- Credit function support
- Reduce bad debt reserves
- Get paid for what you sell

How does credit insurance work?

Credit insurance covers the risk of non-payment when a business offers a trade credit to a corporate customer.



Agenda

- 1 The Global Outlook, Brexit, Canada**
- 2 The U.S. Outlook - Positives
- 3 The U.S. Outlook - Negatives
- 4 Other Considerations
- 5 Conclusions

The Global Outlook

GDP: Everything produced by the economy, broadest measure of economic health, grows around 3.3% on average

	2014	2015	2016	2017
World GDP Growth	2.7	2.6	2.4	2.8
Eurozone	1.0	1.6	1.6	1.6
Japan	-0.1	0.6	0.7	1.0
Canada	2.5	1.1	1.3	2.2
U.S.	2.4	2.4	1.7	2.2
Brazil	0.1	-3.9	-3.5	0.6
China	7.3	6.9	6.5	6.4
India	7.2	7.6	7.3	7.5

Brexit: What will the withdrawal process look like?

At least 2 years of negotiation

Withdrawal negotiation for the EU

June 28-29:

UK notifies the **European Council** which agrees for guidelines for the terms of negotiation

European Commission negotiates the withdrawal agreement

European Parliament approves the withdrawal agreement by simple majority

Council of the European Union (excl. the UK) agrees to withdrawal agreement by qualified majority

Negotiation for a new trade agreement

European Commission presents recommendations to the Council of the EU

Council of European Union opens negotiations & appoints negotiator/ special committee

Start of negotiations between the **European Commission** and the special committee

Consultancy / approval of the **European Parliament** on the new agreement

Ratification of the final agreement by **member states at a national level**

New agreement expected start of 2019 (at the earliest)

An extension of the deadline is possible but has to be voted by all EU Member States

Heading toward a long period of uncertainty? Negotiations for the TTIP started in 2006 and the Treaty is still not ratified

Brexit: Medium-term impact on countries outside the UK

Not much of a direct economic impact on the United States. But the vote itself is disturbing as it represents a growing trend of anti-globalization, anti-trade, and destructive political discord.

Impact of a Brexit outside the United Kingdom (2017-2019, cumulative)

		Soft Leave - EU exit with a Free Trade Agreement						Hard Leave - EU exit without a Free Trade Agreement					
		Exports of goods (EURbn)	Exports of services (EURbn)	FDI (EURbn)	Earnings (EURbn)	GDP growth (pp)	Business insolvencies growth (pp)	Exports of goods (EURbn)	Exports of services (EURbn)	FDI (EURbn)	Earnings (EURbn)	GDP growth (pp)	Business insolvencies growth (pp)
High impact	Netherlands	-2.5	-0.2	-8.2	-0.1	-1.5	2.0	-3.2	-0.4	-13.4	-0.2	-2.4	2.5
	Ireland	-0.8	-0.2	-1.2	0.0	-0.9	1.5	-1.0	-0.3	-2.0	0.0	-1.4	2.0
	Belgium	-2.0	-0.1	-1.0	0.0	-0.7	1.0	-2.6	-0.2	-1.7	0.0	-1.0	1.5
Significant impact	Germany	-5.2	-0.4	-2.1	0.0	-0.2	< 1	-6.8	-0.6	-3.4	0.0	-0.4	1.2
	France	-1.9	-0.5	-3.2	0.0	-0.2	< 1	-2.4	-0.8	-5.2	0.0	-0.4	1.1
	United States	-2.2	-0.9	-13.5	-0.4	-0.1	< 1	-2.9	-1.4	-22.0	-0.6	-0.2	1.1
	Spain	-1.0	-0.4	-1.8	0.0	-0.2	< 1	-1.3	-0.6	-2.9	0.0	-0.3	1.0
	Portugal	-0.2	-0.1	-0.1	0.0	-0.2	< 1	-0.2	-0.1	-0.1	0.0	-0.3	1.0
Moderate impact	Italy	-1.2	-0.2	-0.4	0.0	-0.1	< 1	-1.6	-0.3	-0.6	0.0	-0.2	< 1
	Slovakia	-0.1	0.0	0.0	0.0	-0.2	< 1	-0.2	0.0	0.0	0.0	-0.2	< 1
	Finland	-0.2	0.0	-0.1	0.0	-0.1	< 1	-0.2	0.0	-0.1	0.0	-0.2	< 1
	Romania	-0.1	0.0	0.0	0.0	-0.1	< 1	-0.1	0.0	0.0	0.0	-0.1	< 1
	Greece	-0.1	-0.1	0.0	0.0	-0.1	< 1	-0.1	-0.1	-0.1	0.0	-0.1	< 1
	Austria	-0.2	0.0	-0.1	0.0	-0.1	< 1	-0.3	-0.1	-0.2	0.0	-0.2	< 1
Low impact	Greater China	-2.5	-0.1	-1.9	-0.1	0.0	< 1	-3.2	-0.2	-3.1	-0.2	0.0	< 1
	Poland	-0.5	-0.1	-0.1	0.0	0.0	< 1	-0.7	-0.1	-0.2	0.0	-0.1	< 1
	Denmark	-0.4	0.0	-0.4	0.0	0.0	< 1	-0.5	-0.1	-0.6	0.0	-0.1	< 1
	Sweden	-0.5	-0.1	-0.7	0.0	0.0	< 1	-0.7	-0.1	-1.2	-0.1	0.0	< 1
	Czech Republic	-0.3	0.0	0.0	0.0	0.0	< 1	-0.4	0.0	-0.1	0.0	0.0	< 1
For information	Eurozone	-15.2	-2.2	-18.2	-0.2	-0.4	1.0	-19.9	-3.6	-29.7	-0.4	-0.6	1.5
	% of total	0.5%	0.2%	1.9%	1.4%			0.6%	0.3%	3.1%	2.4%		

The Positives

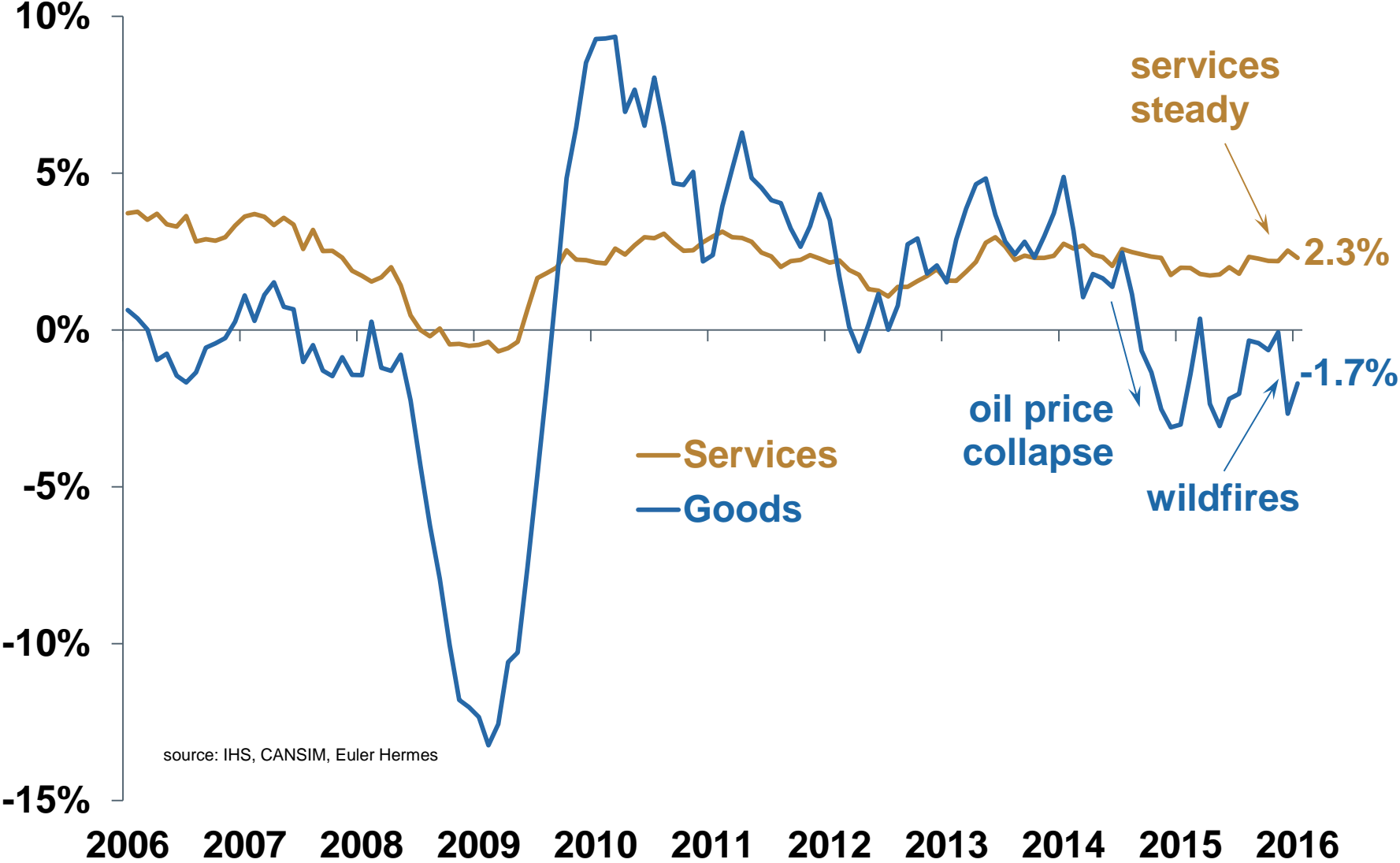
- Resilient economy despite significant obstacles. GDP 2016 forecast +1.3%, +2.2% for '17 (average since '80s of 2.4%)
- GDP y/y as of June +1.1%, but ex-energy +1.7%
- GDP y/y as of June in goods -1.7%, but in services (70% of GDP) +2.3%
- Consumer strong in Q1 and Q2 at +2.4% and +2.2%
- Housing strong outside of oil patch
- Accommodative monetary policy, low interest rates
- Fiscal stimulus planned
- US GDP expected to accelerate in H2, offering support to exports

The Negatives

- Wildfires were costliest natural disaster in Canadian history; CAD3.6bn
- Disappointing exports of -3% y/y despite weak CAD
- Energy sector still in -4.2% y/y contraction
- Employment growth slowing to +0.4% y/y in June, slowest since Aug '14
- Fall in CAPEX a strong headwind for manufacturing. Manufacturing sales -1.9% y/y; metals and machinery sales y/y -6% to -7%.
- Risk of housing bubble; prices 10.9% y/y, highest in 6 yrs. Vancouver record +24.3%
- High consumer debt
- Insolvencies +2% in 2017

Steady services sector (70% of GDP) supports economy

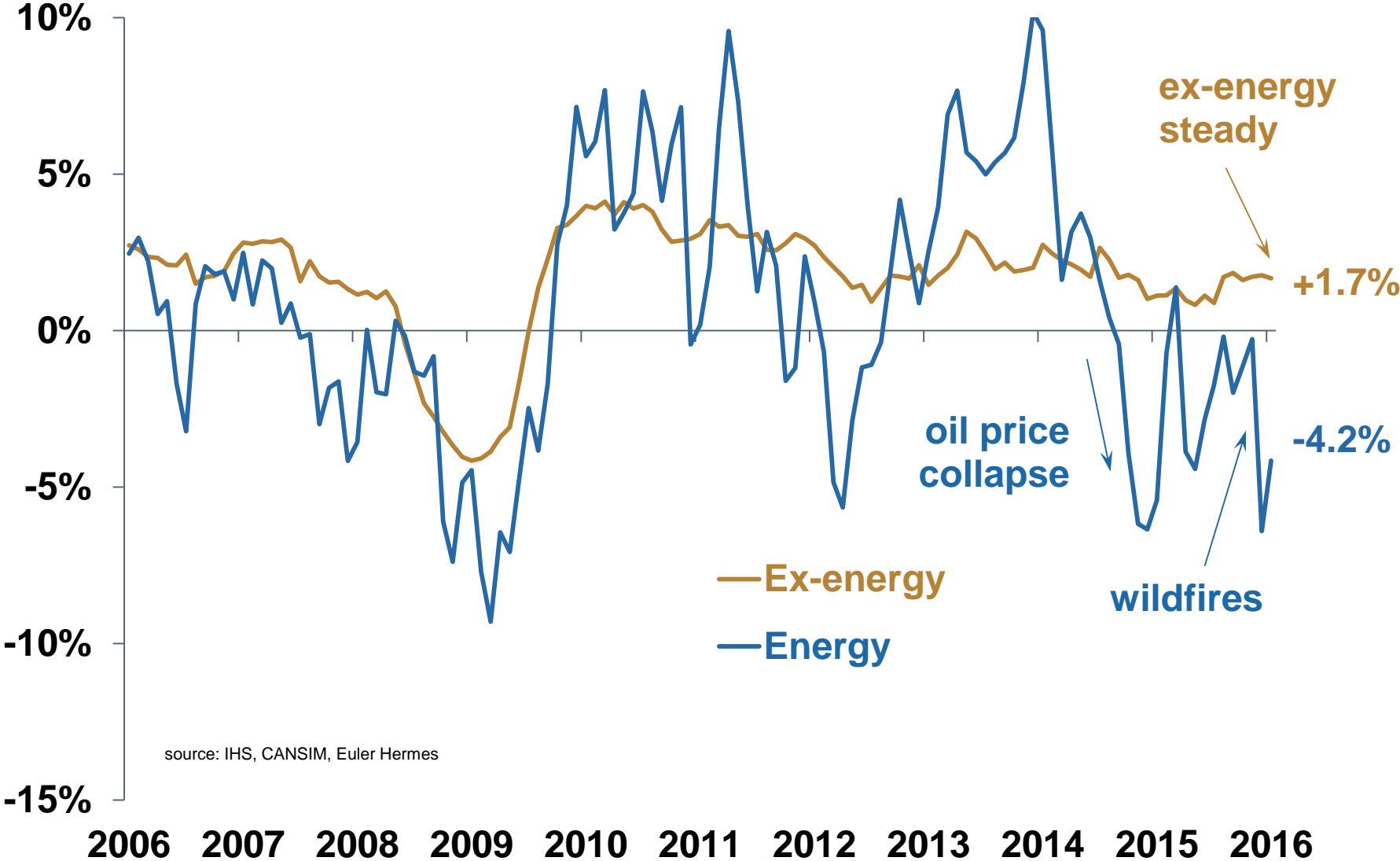
GDP by Sector, y/y%



source: IHS, CANSIM, Euler Hermes

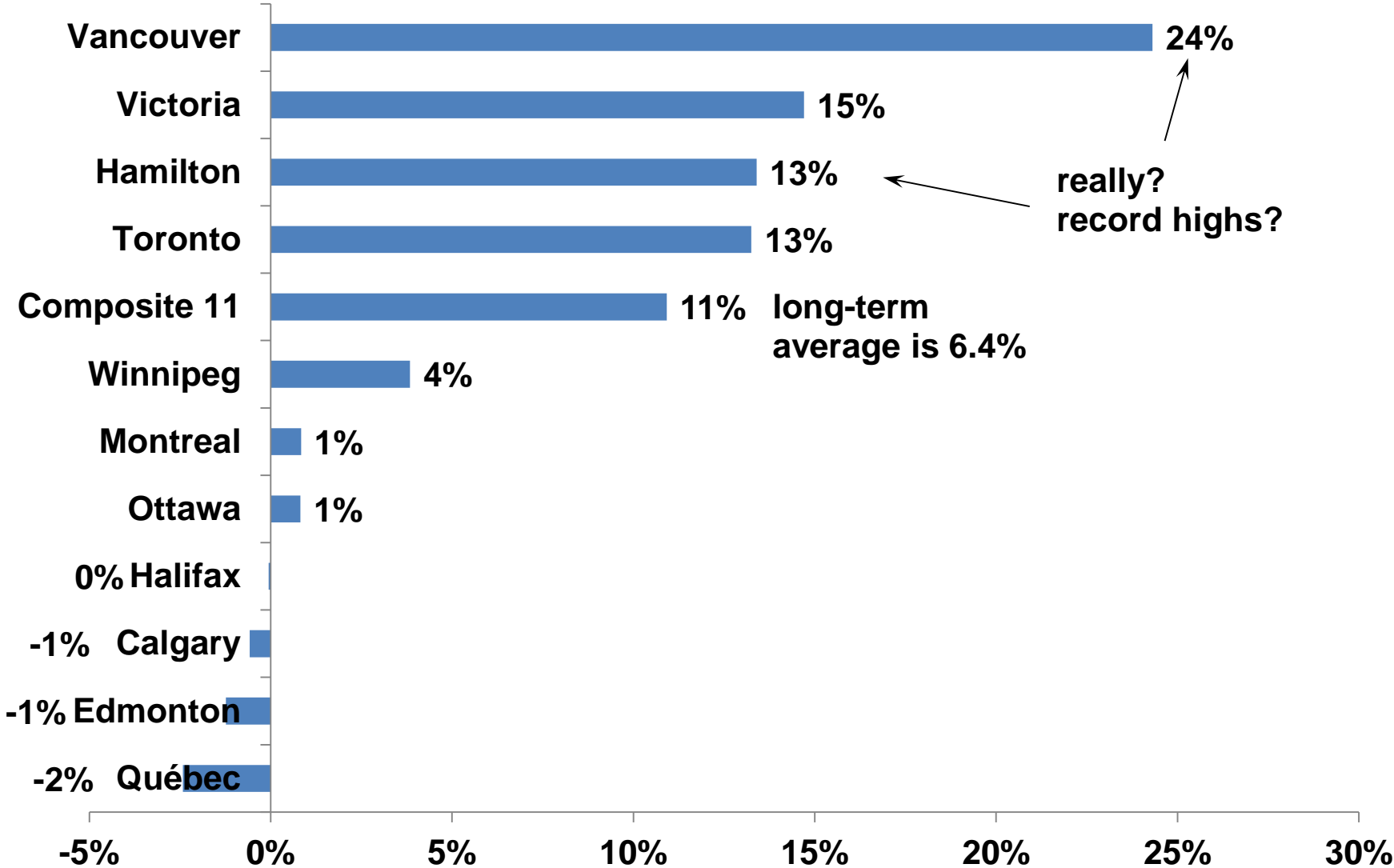
Outside of the energy sector (10% of GDP), economy doing OK

GDP by Sector, y/y%



source: IHS, CANSIM, Euler Hermes

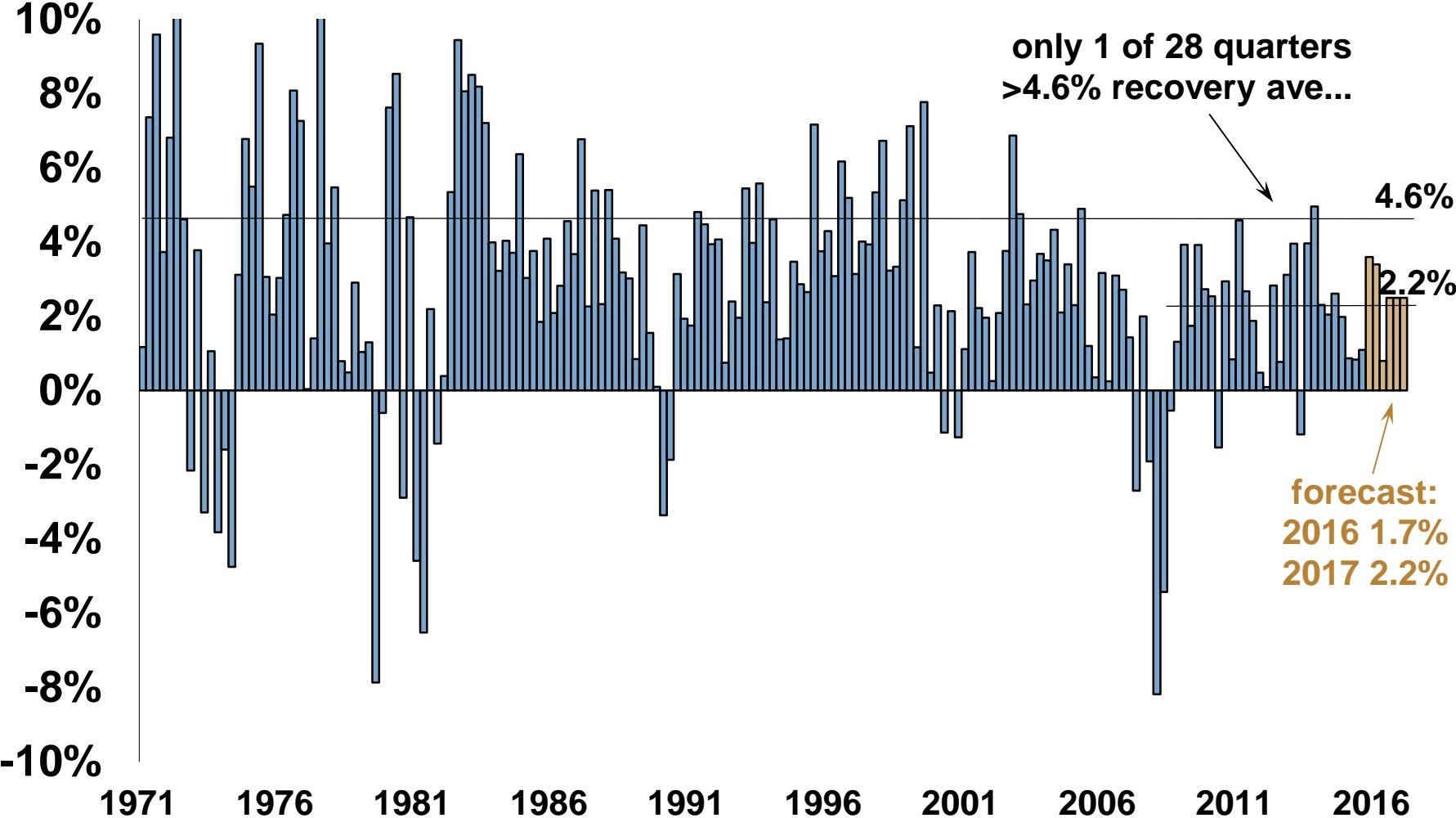
Housing Prices, y/y%



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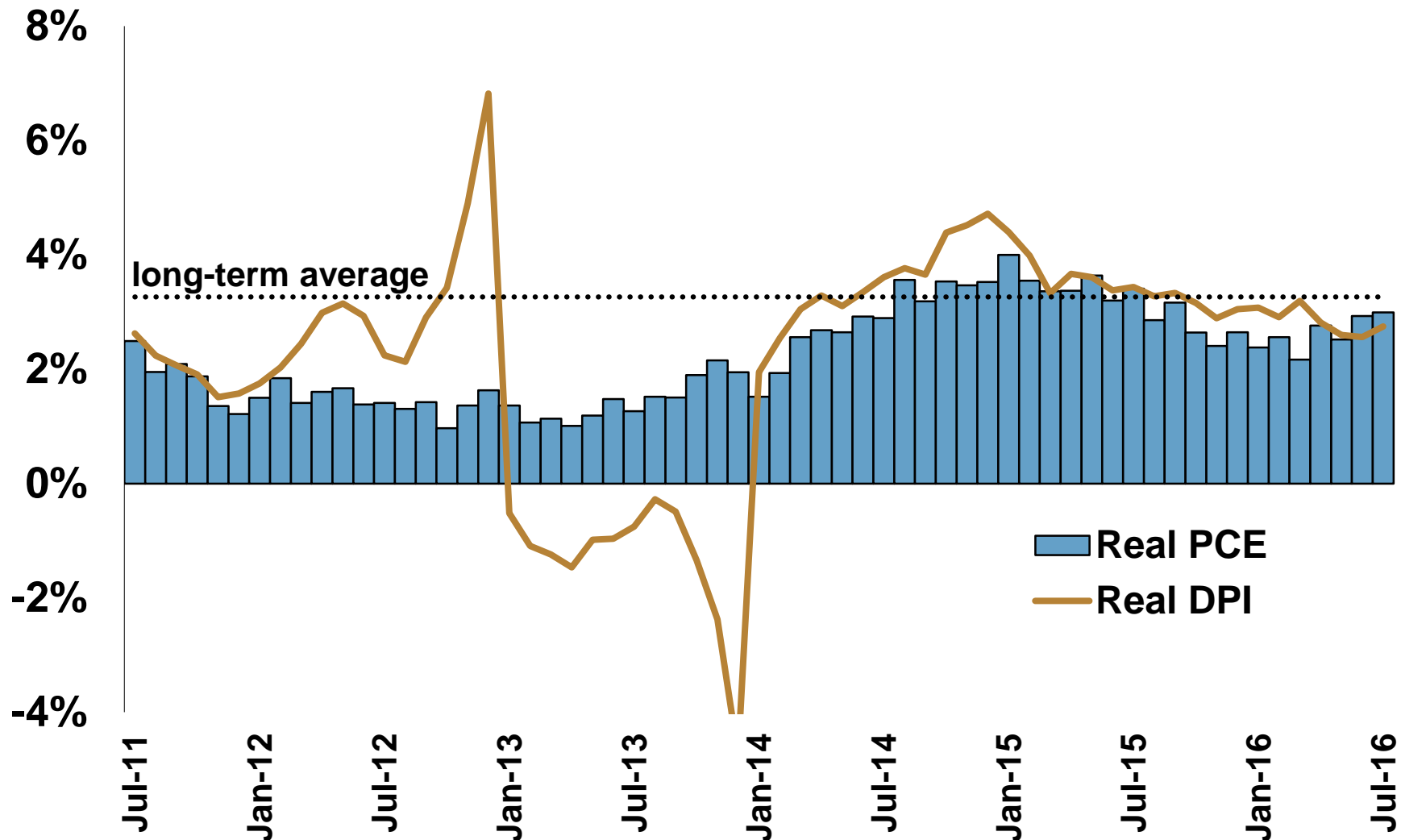
Real Gross Domestic Product (GDP) annualized quarterly growth rate



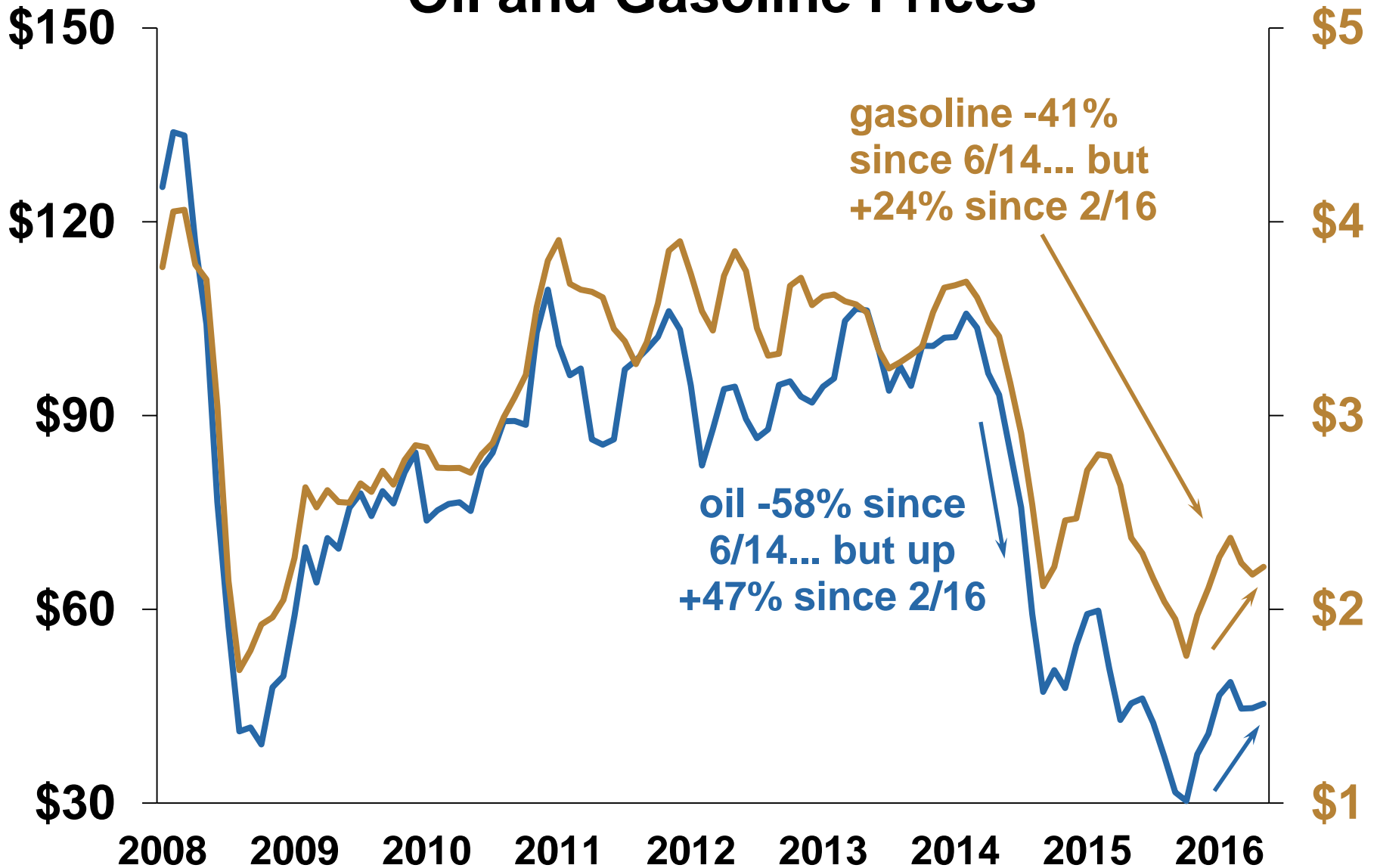
Source: IHS, BEA, Euler Hermes

Personal consumption positive but tepid with forecast 2.7% for 2016. Headwinds...

Real Personal Consumption Expenditures (PCE) & Disposable Personal Income (DPI) y/y % growth rate

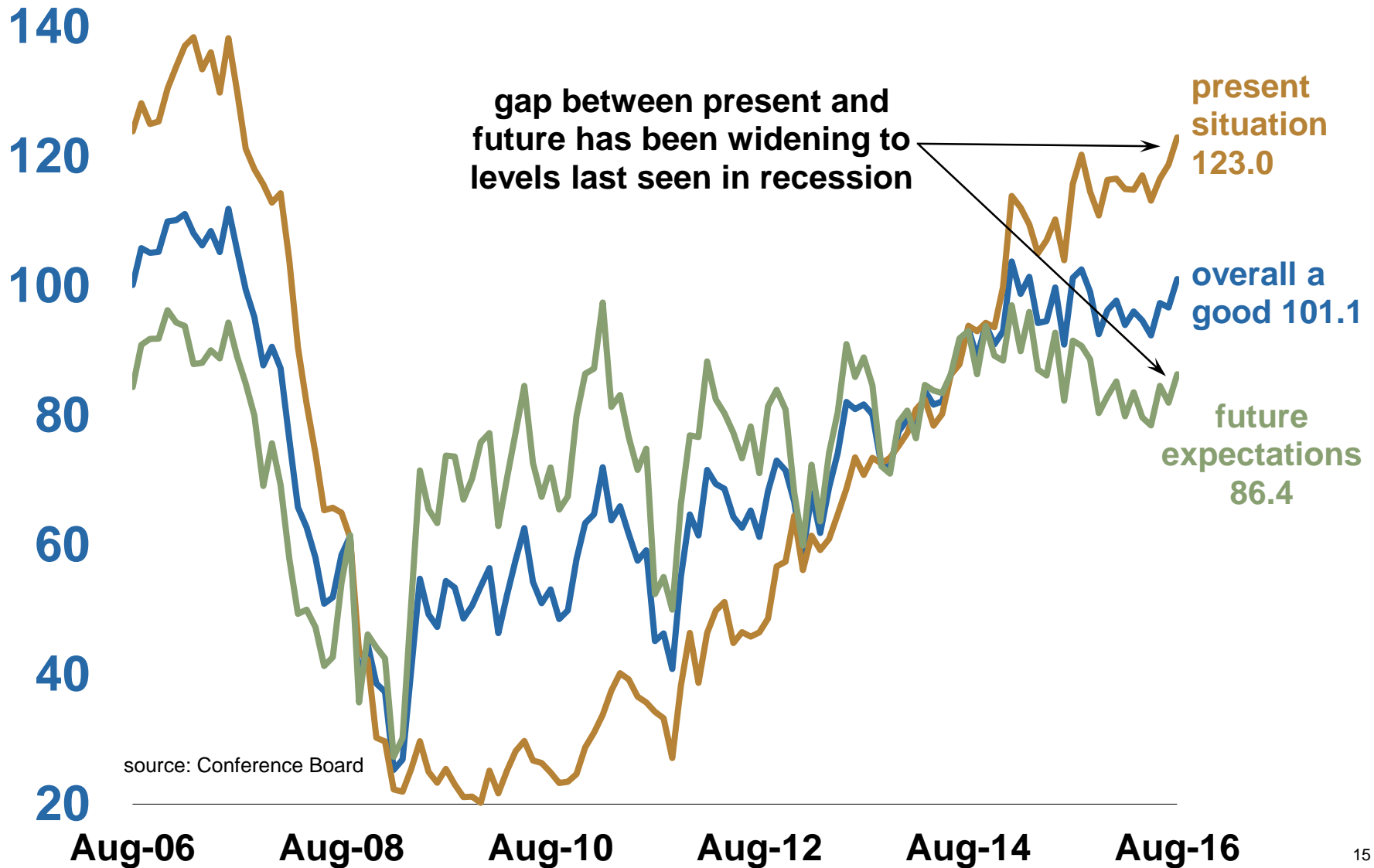


Oil and Gasoline Prices

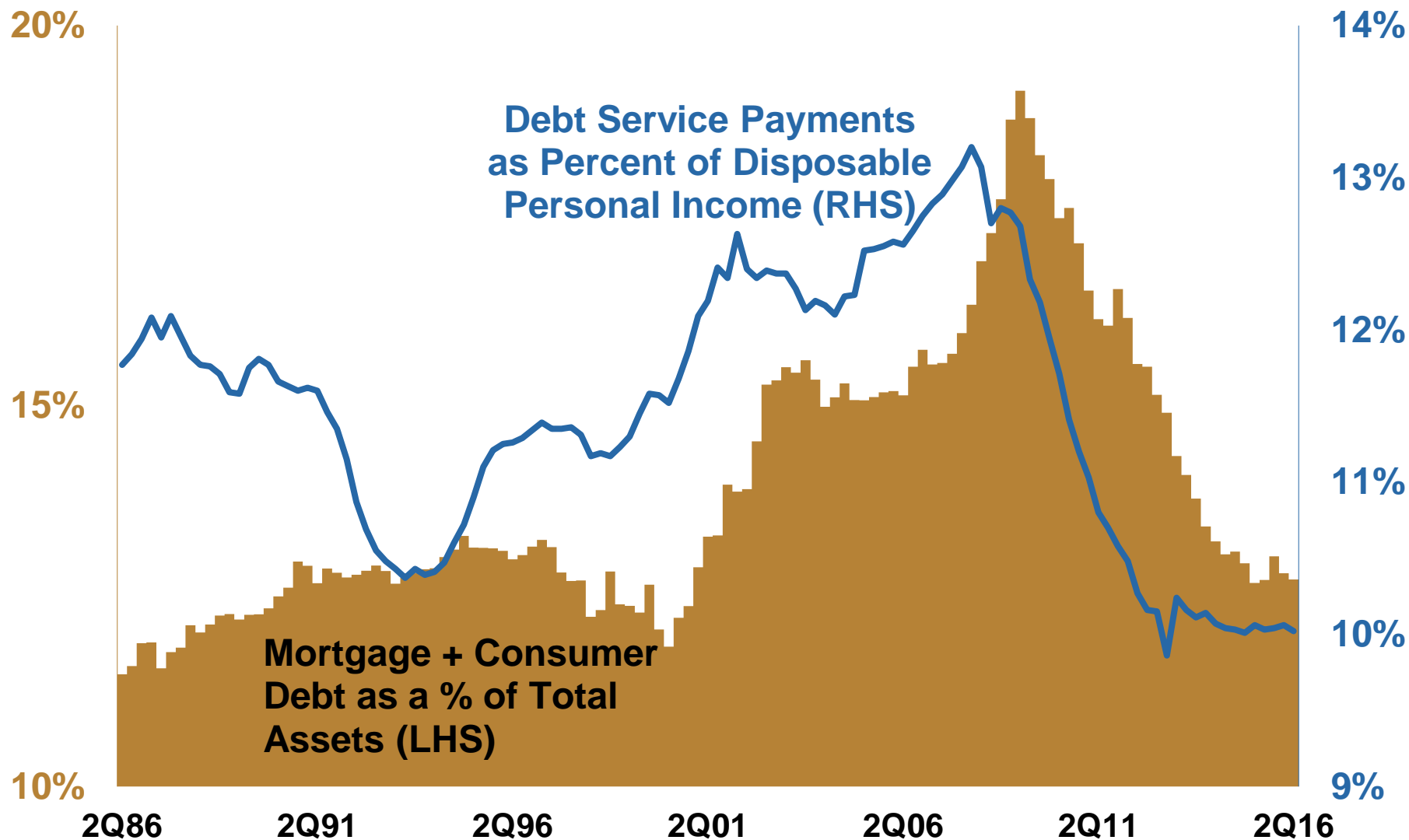


Overall consumer confidence good, but gap between present and future situations is largest since recession, suggesting unease over election

Conference Board Consumer Confidence

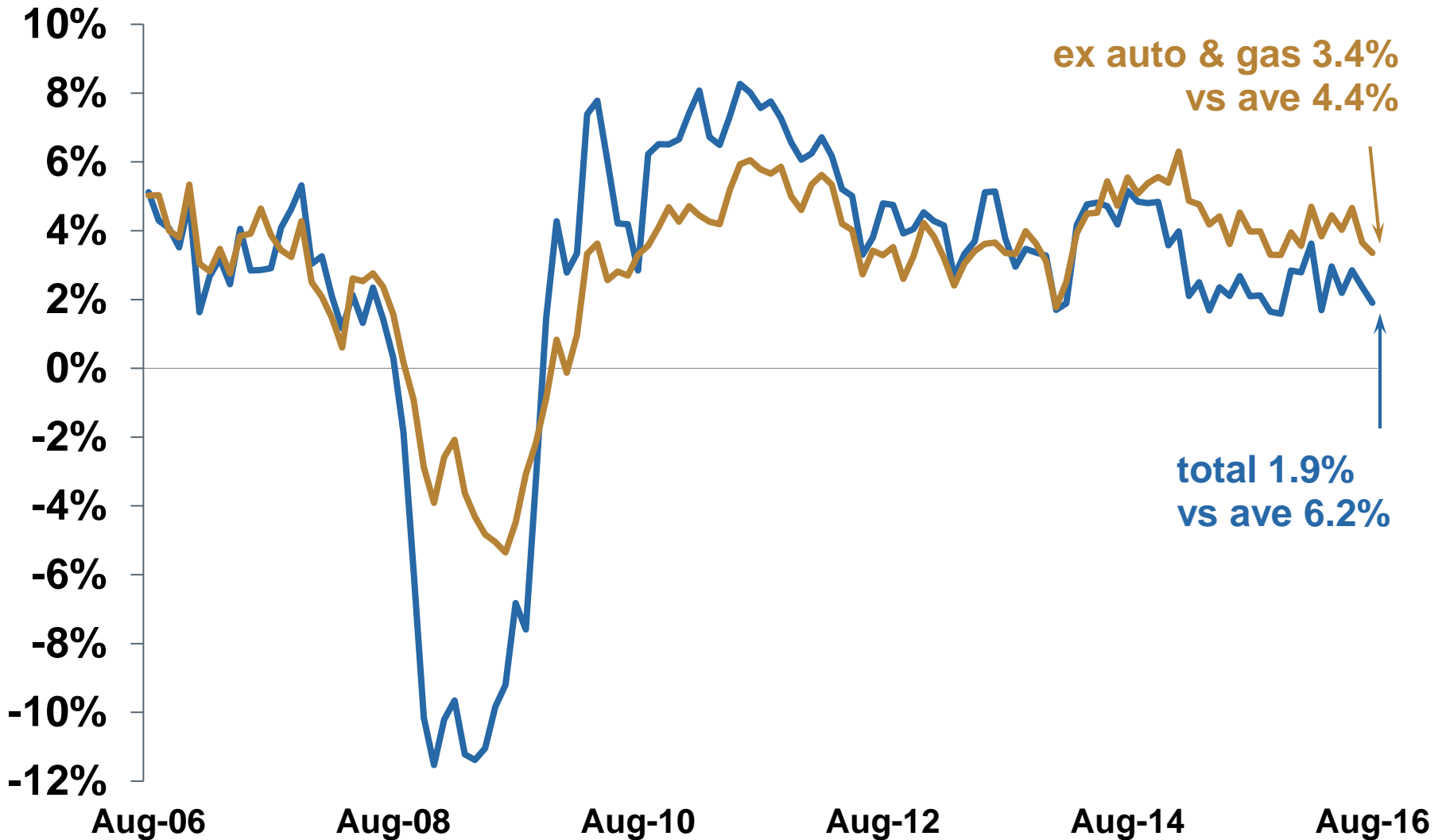


Consumer Debt Burden



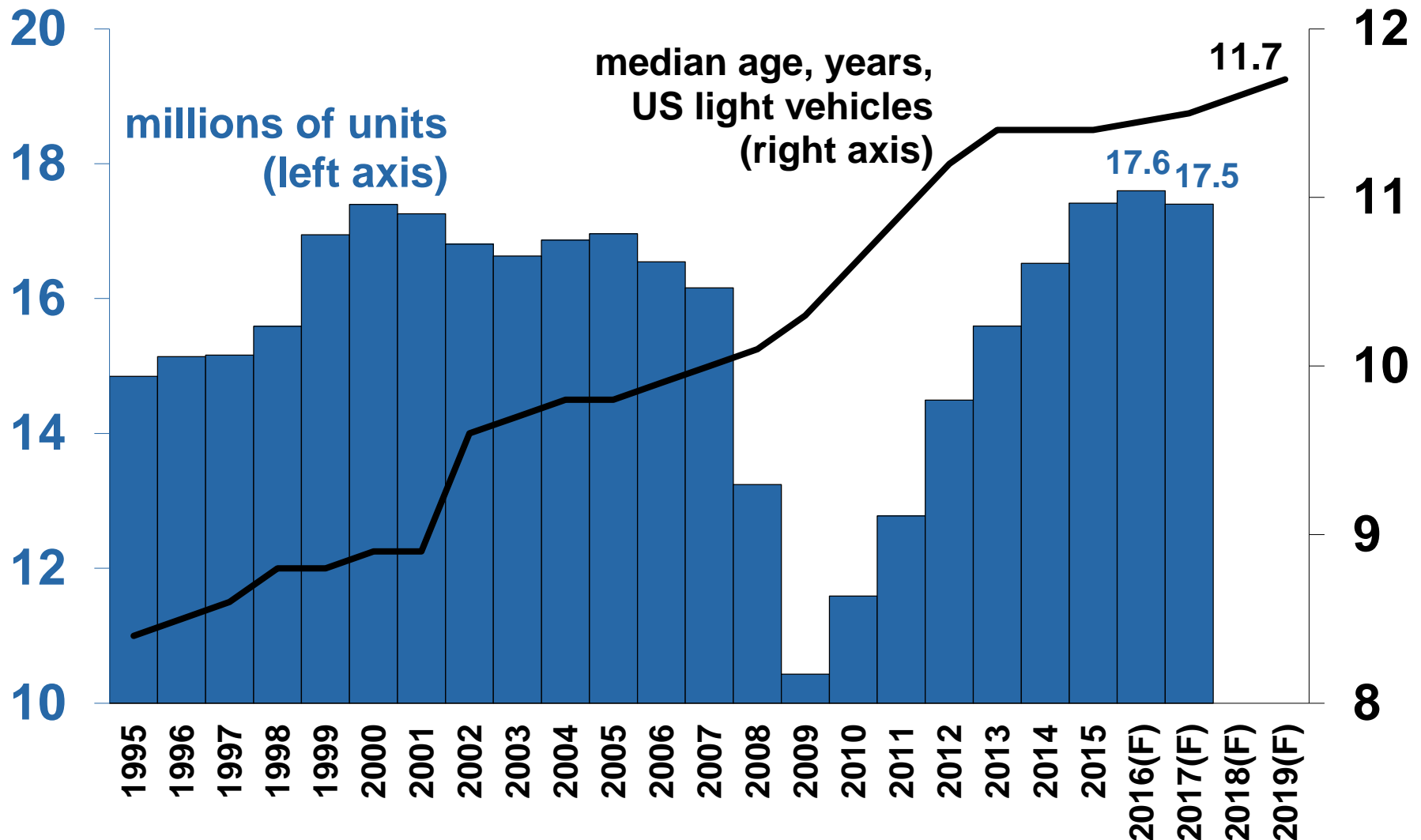
Retail sales in 2015 weakest since 2009, still tepid this year

Retail Sales, y/y



Auto sales have been strong and are forecasted to continue being strong

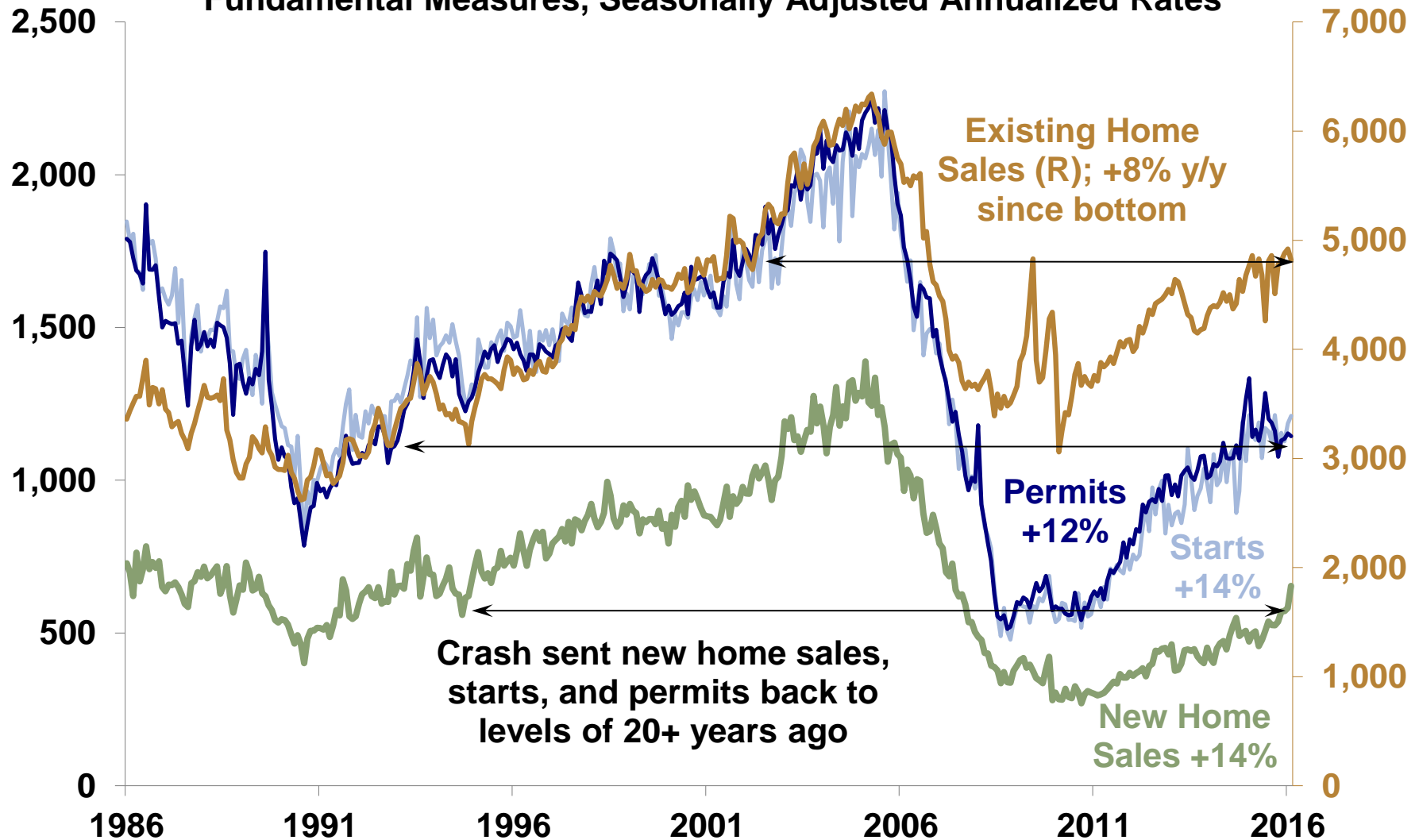
Auto Sales and Age of Fleet



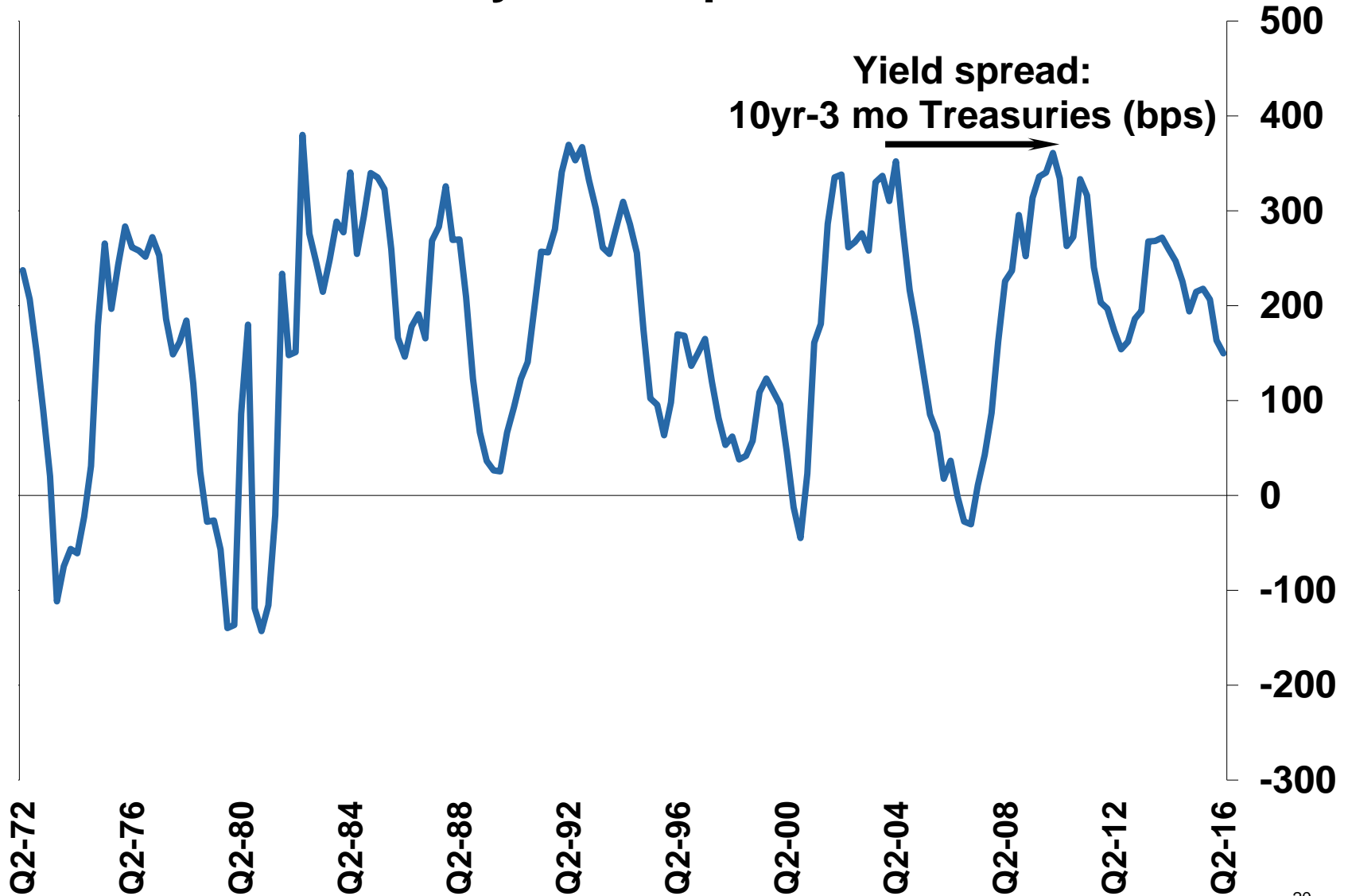
Positive: Housing measures have grown rapidly since trough, but... it's a long way back

U.S. Housing Market

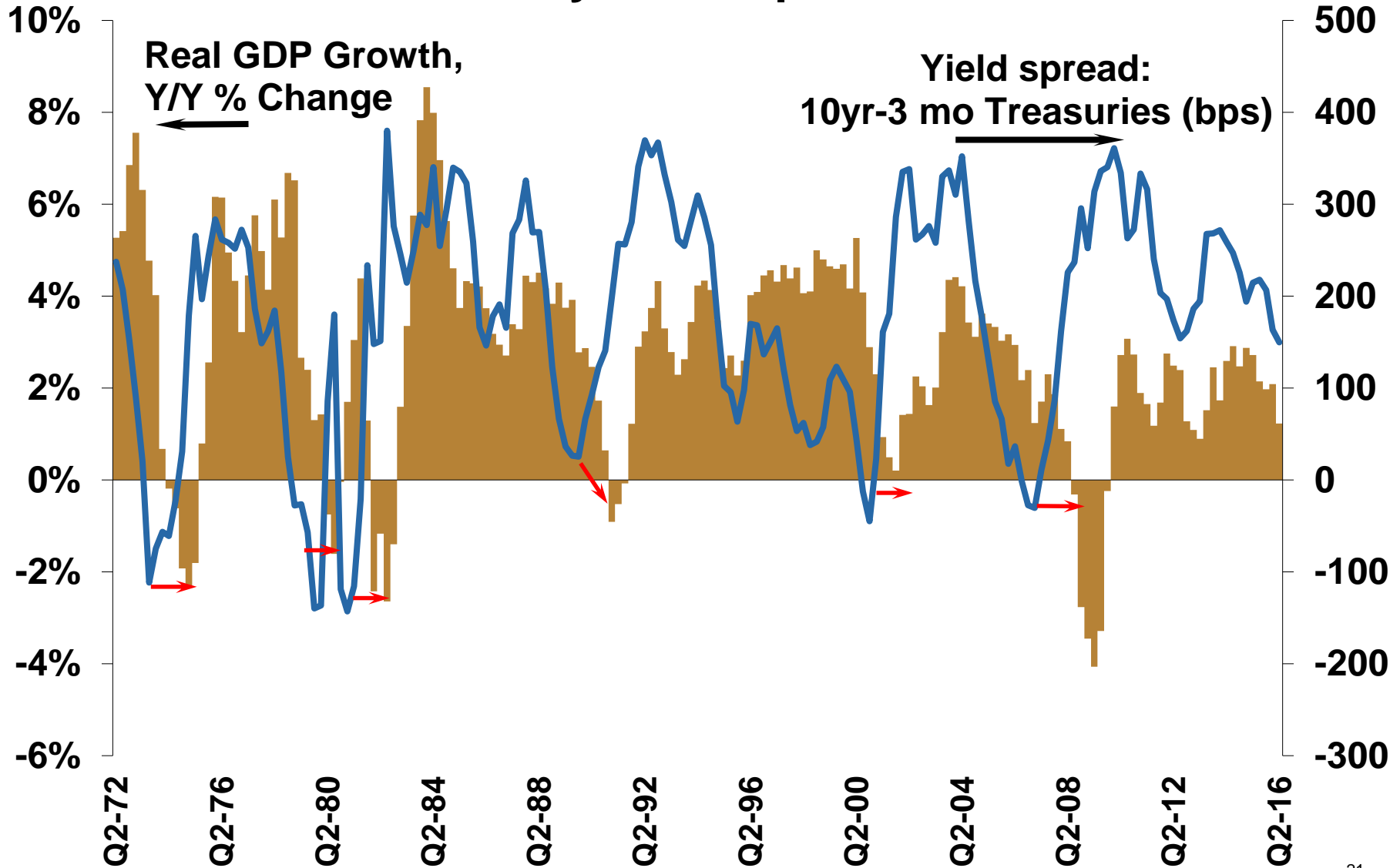
Fundamental Measures, Seasonally Adjusted Annualized Rates



The Treasury Yield Spread vs. GDP



The Treasury Yield Spread vs. GDP



- Positives:
- Income, consumption still growing
- Energy prices still low
- Confidence strong
- Consumer debt falling
- Auto sector strong
- Housing contributing
- Positive yield spread

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- Negatives:
- Monetary policy
- Falling yield spread
- Strong USD, weak exports
- Slump in manufacturing
- Shrinking corporate profits & investment
- Structural unemployment
- Low productivity
- Rising bankruptcies

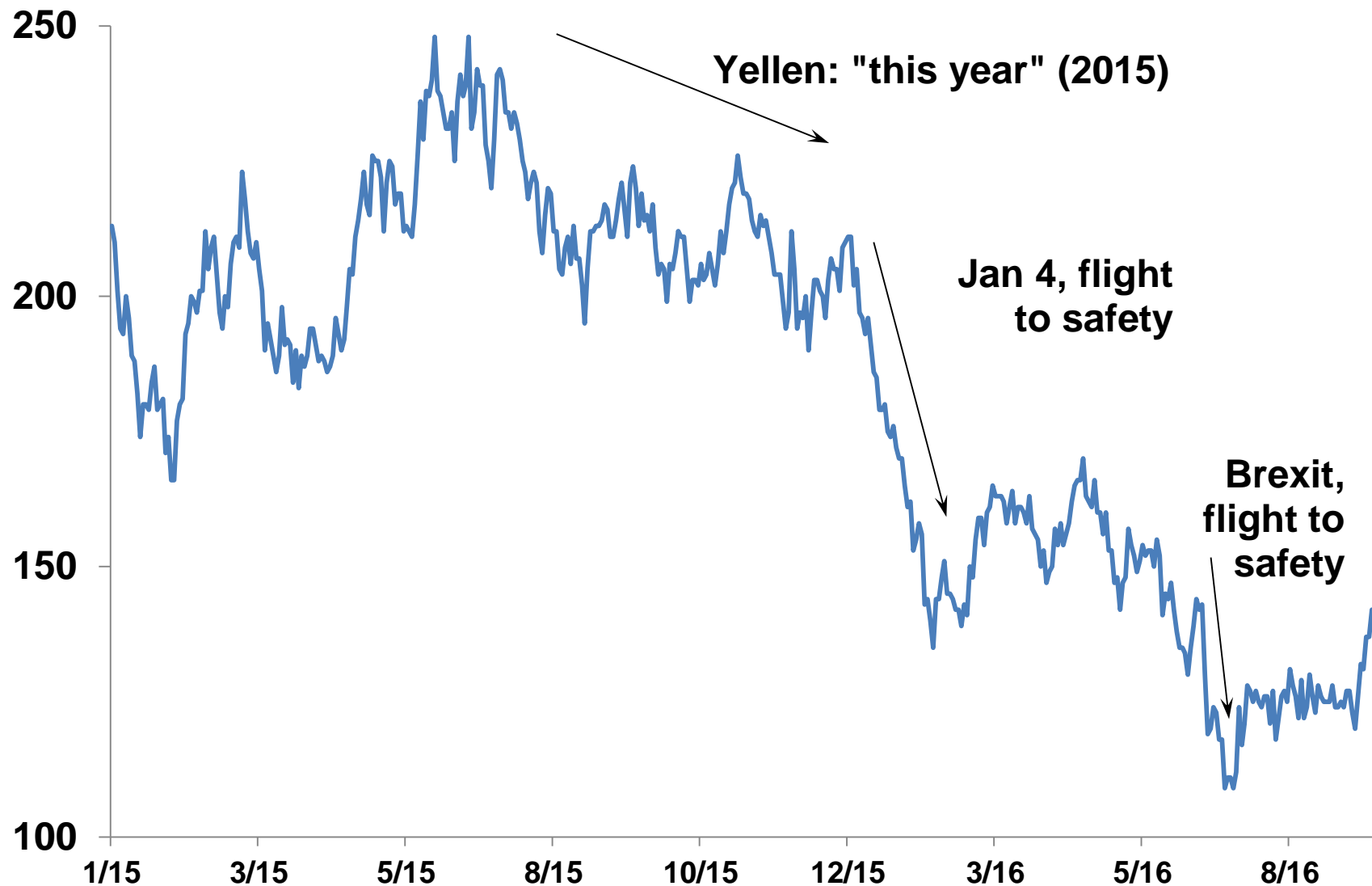
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- Fed set interest rates to 0% in Dec 2008 for emergency conditions. 3 months later the stock market bottomed, 6 months later the recession ended.
- Yet the Fed has kept rates at 0% for 8 years after the emergency ended, and also printed money through QE.
- But still we are in 2% growth-land. Monetary policy reached the limits of its effectiveness.
- Retirees, savers have suffered, and assets have been (over?) inflated.
- Fed now starting first tightening cycle in 11 years. Some market participants have never seen anything but 0% rates, or a Fed hike.
- At same time Europe, Japan, China, Canada central banks (50% of world GDP) are loosening or becoming more accommodative.
- Fed painted itself into corner, had to raise at wrong time.
- How to raise rates without deflating assets too quickly, upsetting global financial markets, harming EM economies, spurring currency devaluations, strengthening the \$US too much, and flattening the yield spread?

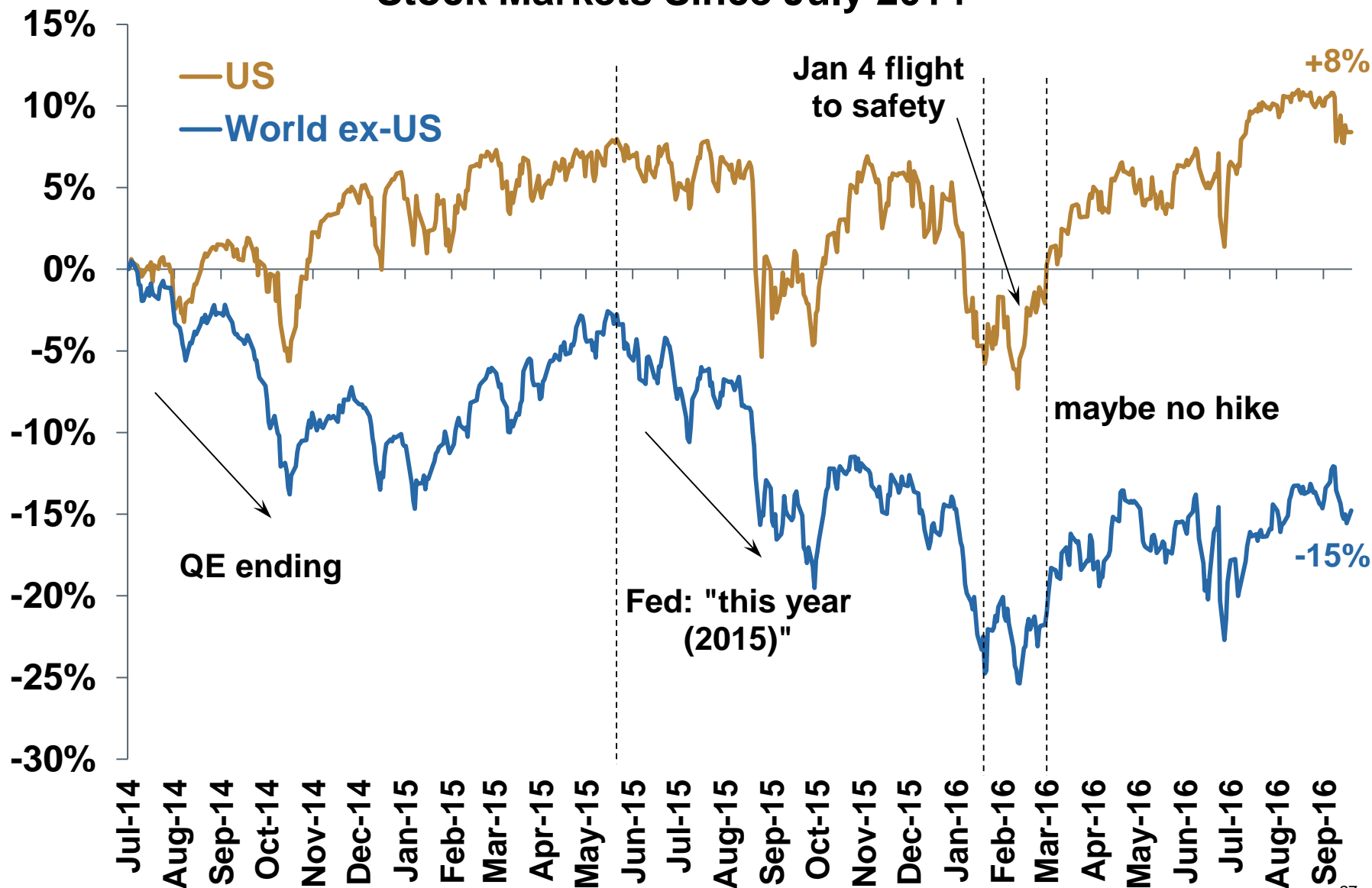
Fed raises interest rates, sending the yield spread the wrong way (global crises pile on)

The Treasury Yield Spread (10yr-3mo, daily)

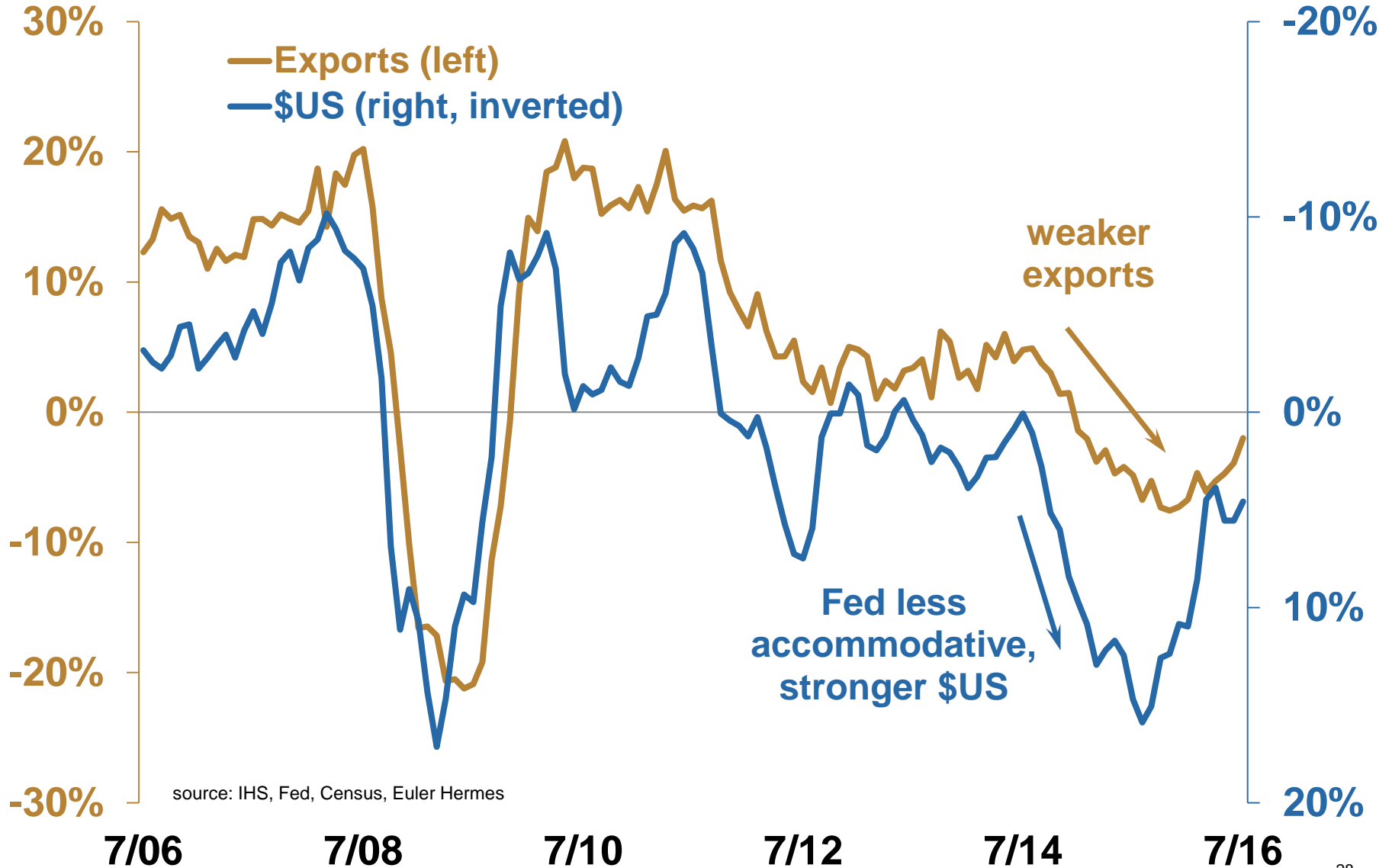


Fed tightens, over-inflated global stock markets fall

Stock Markets Since July 2014



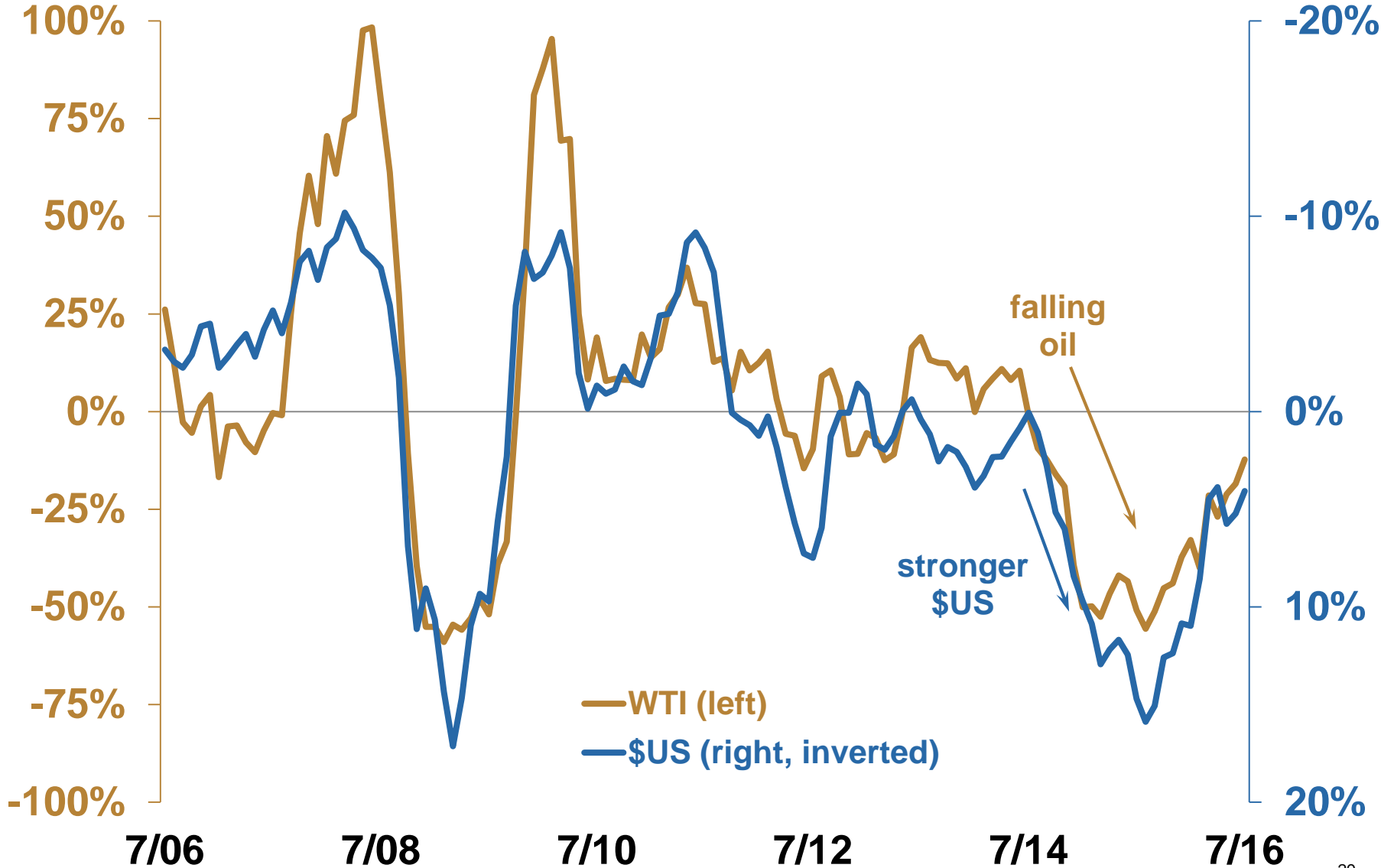
\$U.S. Broad Index vs. Exports, y/y % Growth



source: IHS, Fed, Census, Euler Hermes

Oil prices are still down y/y because of strong \$

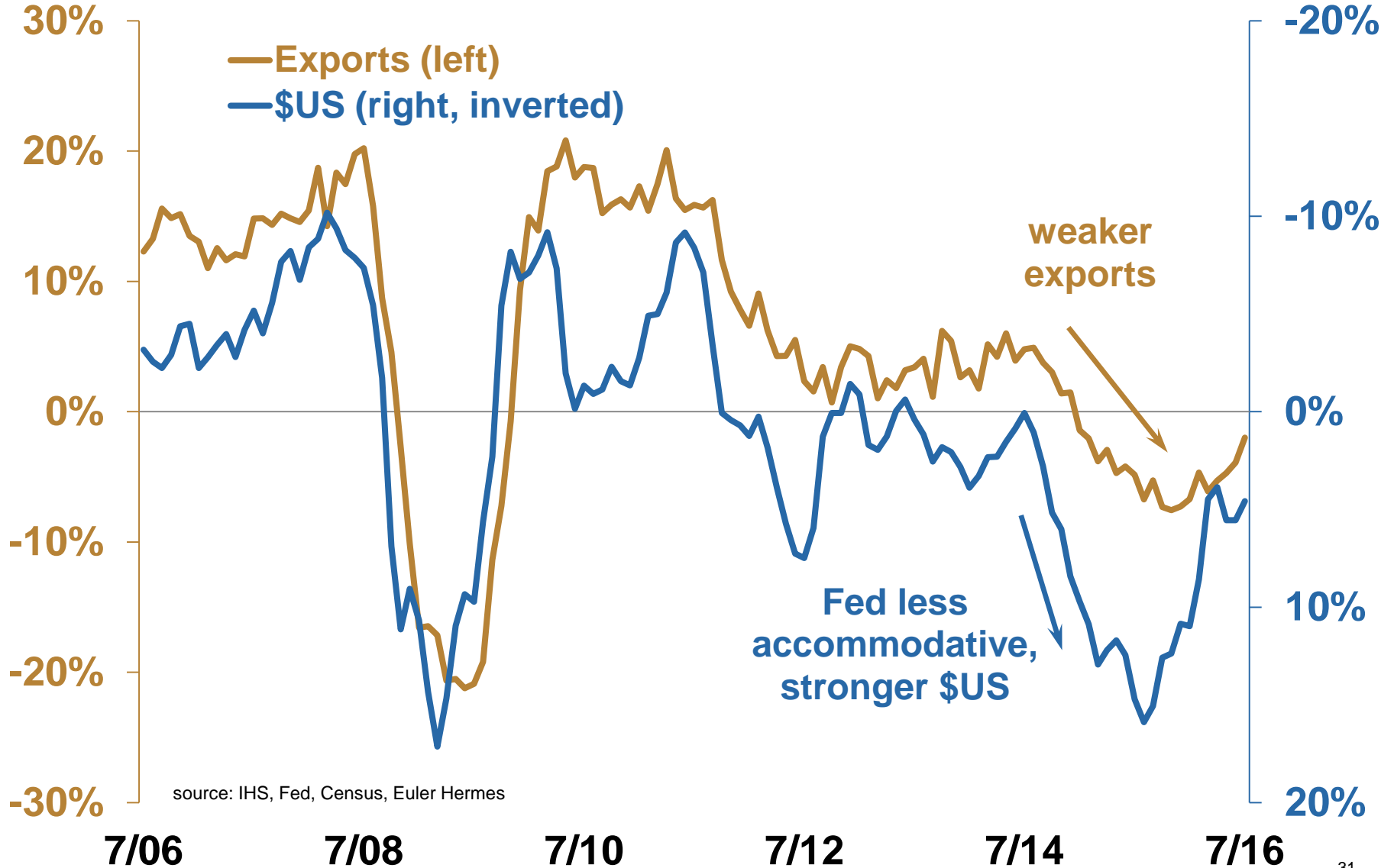
\$U.S. Broad Index vs. WTI Oil, y/y % Growth



A Wash: Effects of a Stronger \$US

Negatives	Positives
makes imports cheaper - bad for competitors	makes imports cheaper - good for consumers and mfgs using imports
makes imports cheaper - bad for wage earners	makes imports cheaper - good for wage payers
lowers commodity prices - bad for producers	lowers commodity prices - good for consumers
makes exports less competitive	increases capital inflow
decreases repatriated profits	decreases inflation
decreases tourism to U.S.	increases tourism from U.S.
puts downward pressure on interest rates - bad for lenders	puts downward pressure on interest rates - good for borrowers
puts downward pressure on foreign investment assets	puts upward pressure on U.S. investment assets
puts downward pressure on GDP	associated with strong economy, enhances \$ status

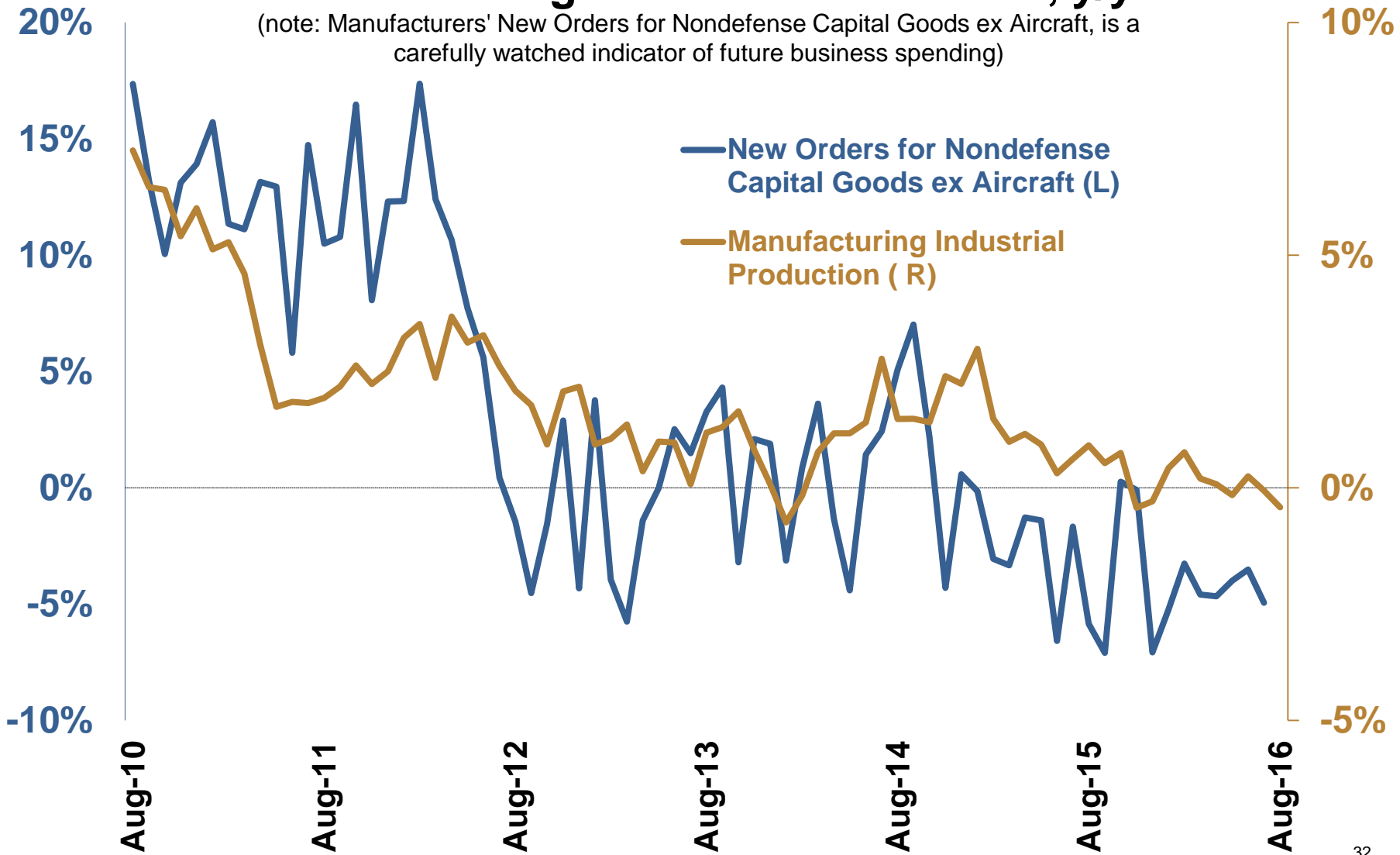
\$U.S. Broad Index vs. Exports, y/y % Growth



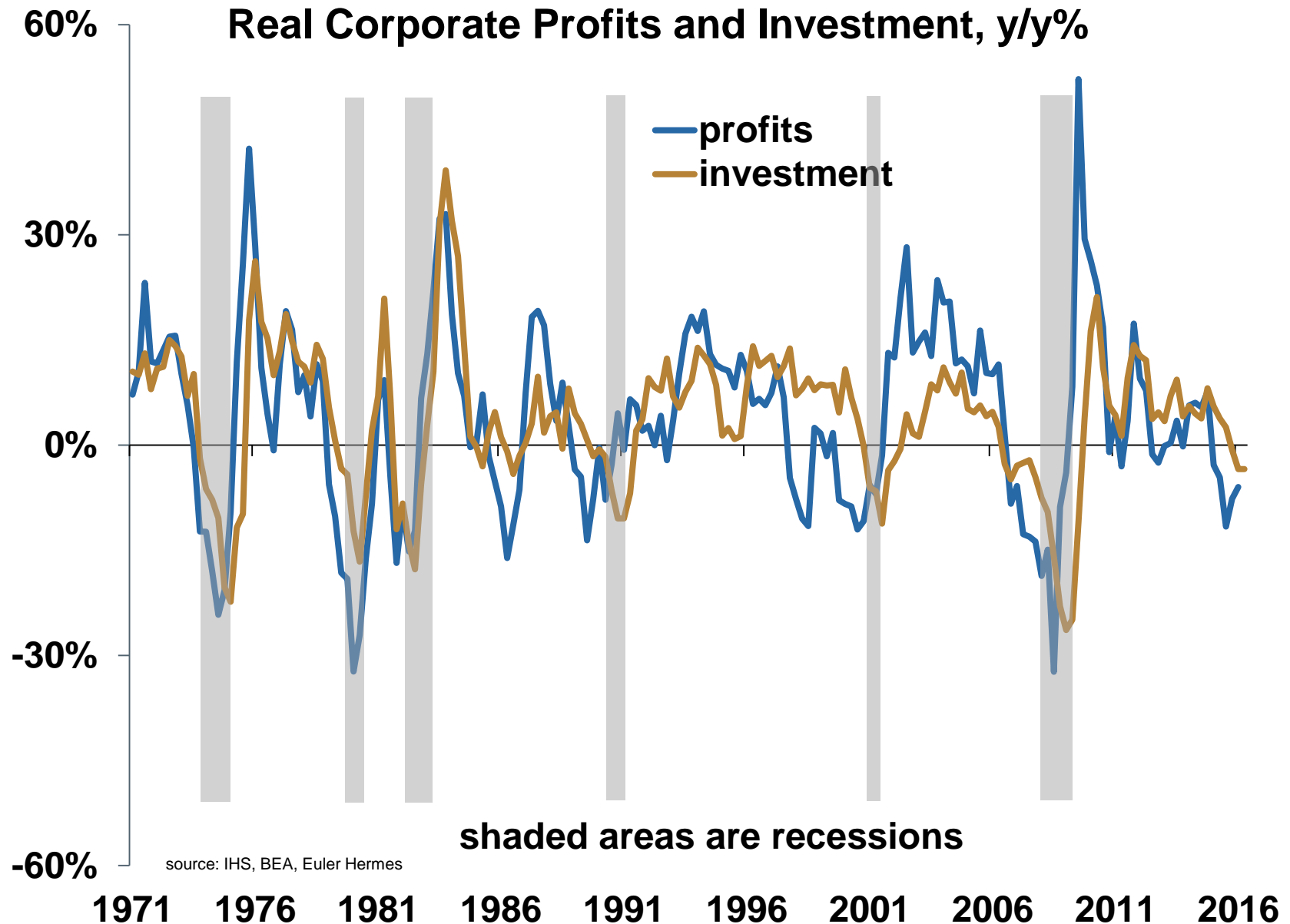
Manufacturing struggling due to weak export orders, fall in machinery orders from the oil patch

Durable Goods Orders and Manufacturing Industrial Production, y/y

(note: Manufacturers' New Orders for Nondefense Capital Goods ex Aircraft, is a carefully watched indicator of future business spending)



Source: IHS, Federal Reserve, ISM, Euler Hermes

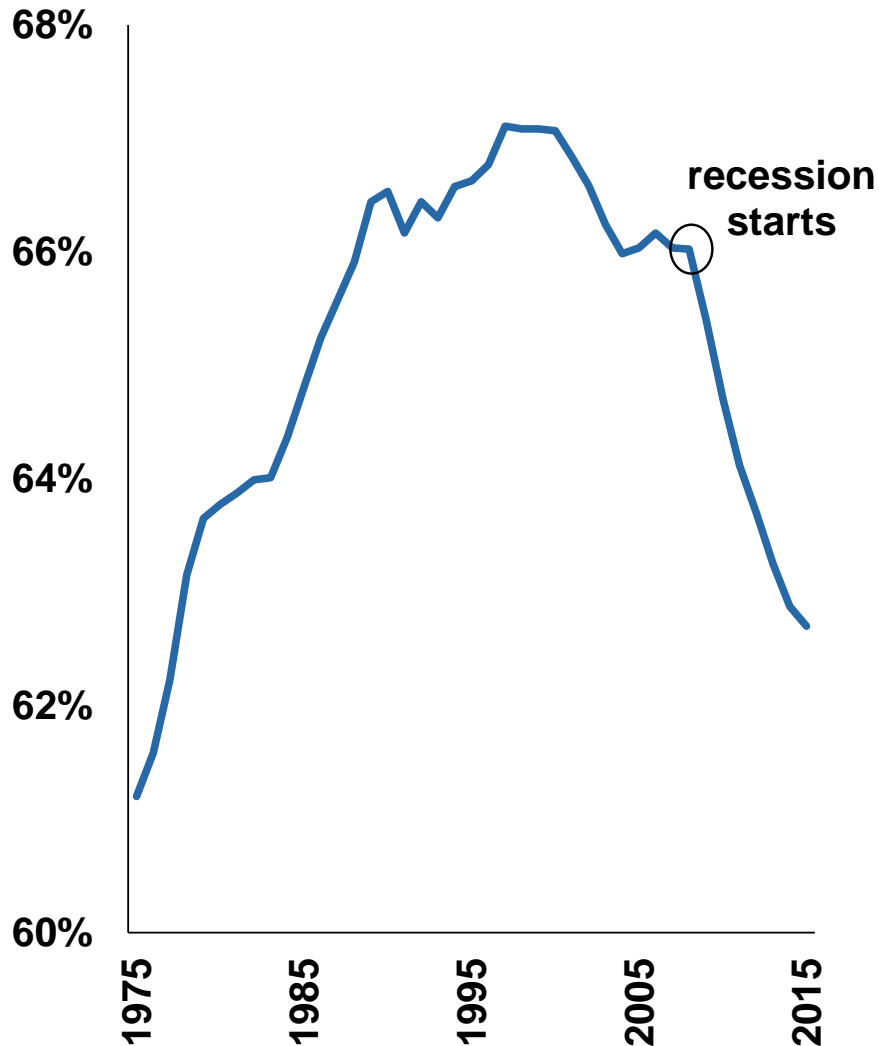


Structural Unemployment is a Major Impediment to Growth

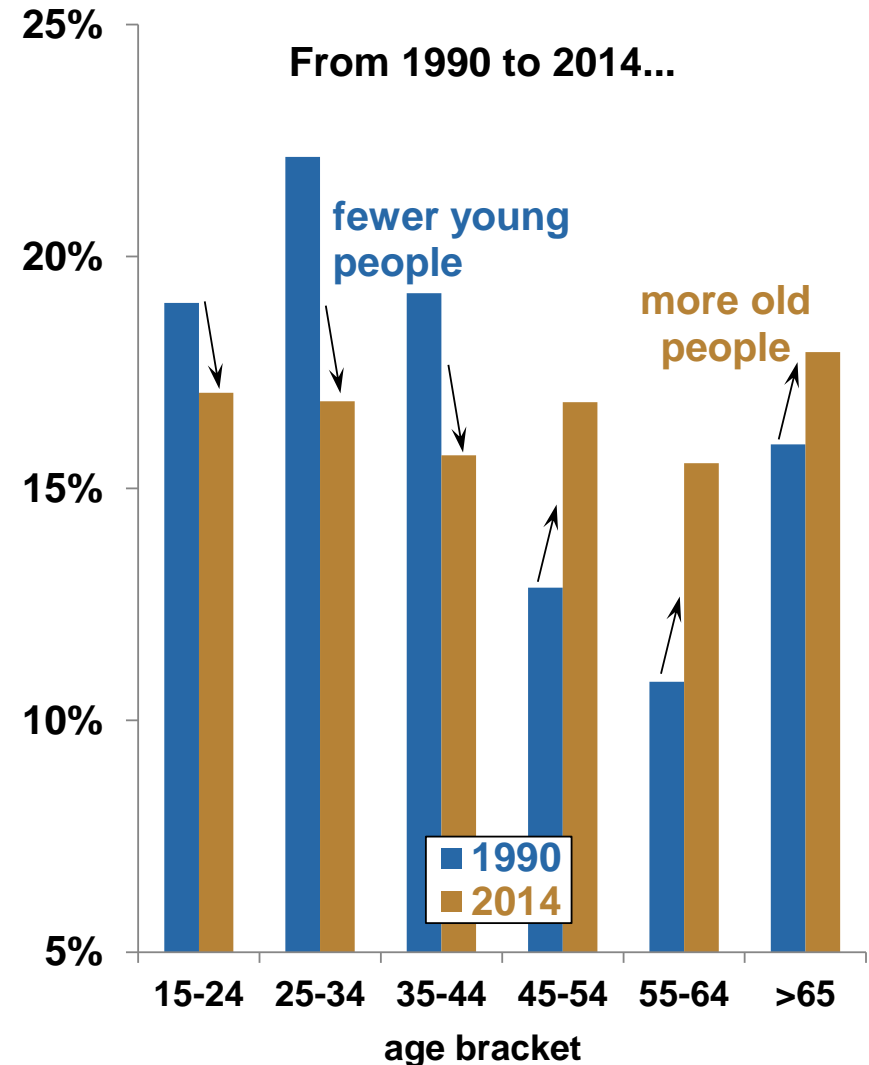
- Labor force participation rate (labor force/population) is plunging; weak economy, Boomers not being replaced fast enough.
 - Need more skilled legal immigration

Structural Unemployment is a Major Impediment to Growth

Labor force participation rate falling...



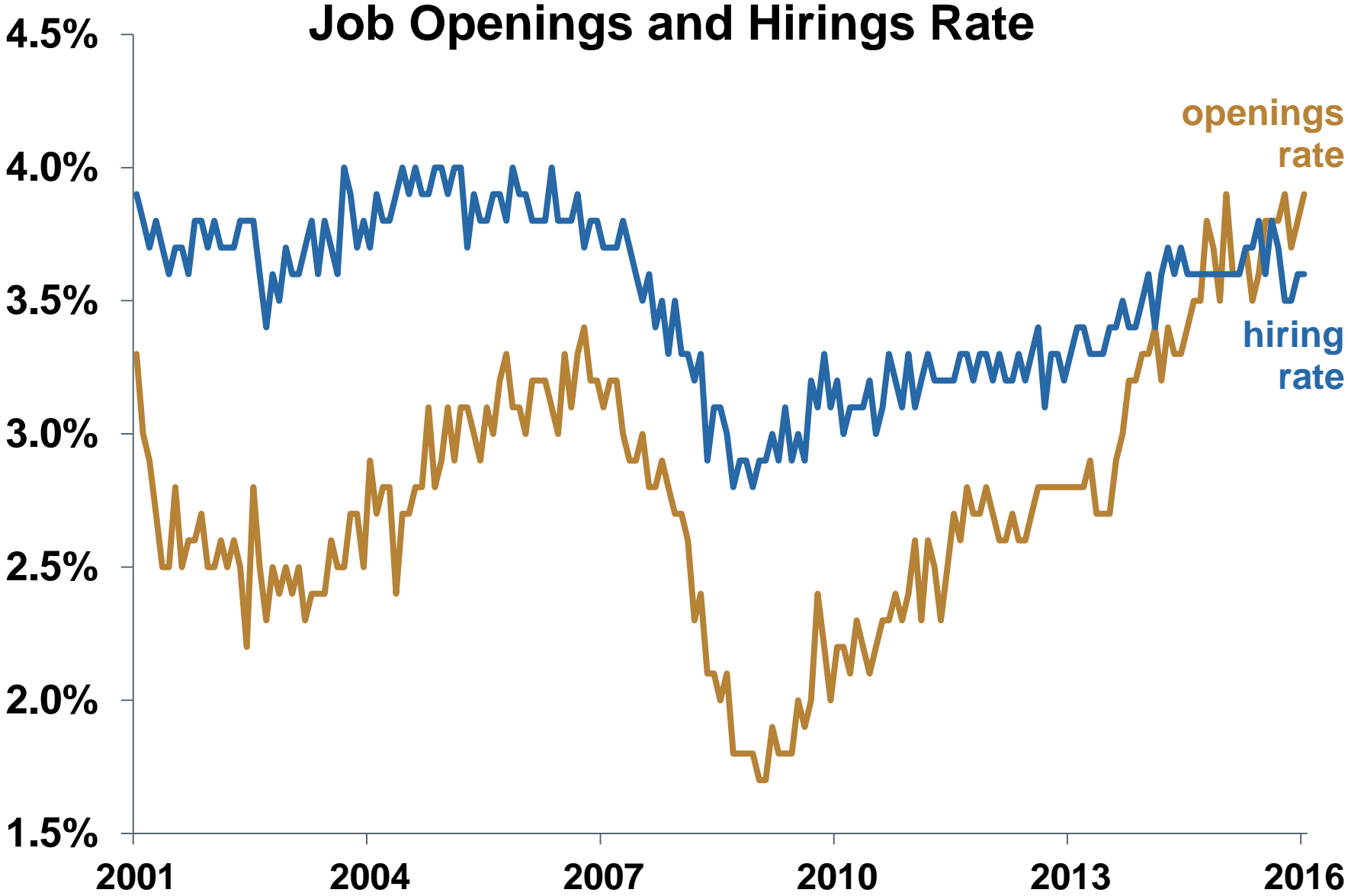
because of ageing population (in part)



Structural Unemployment is a Major Impediment to Growth

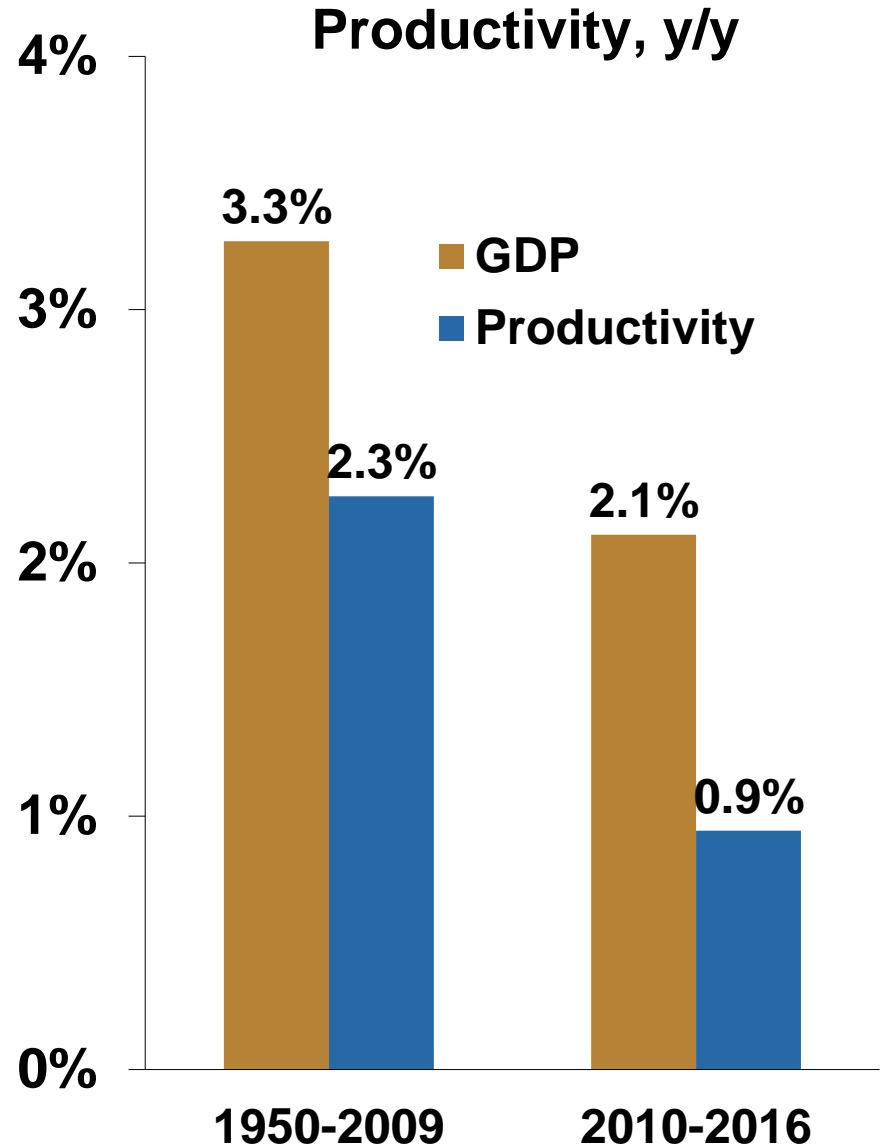
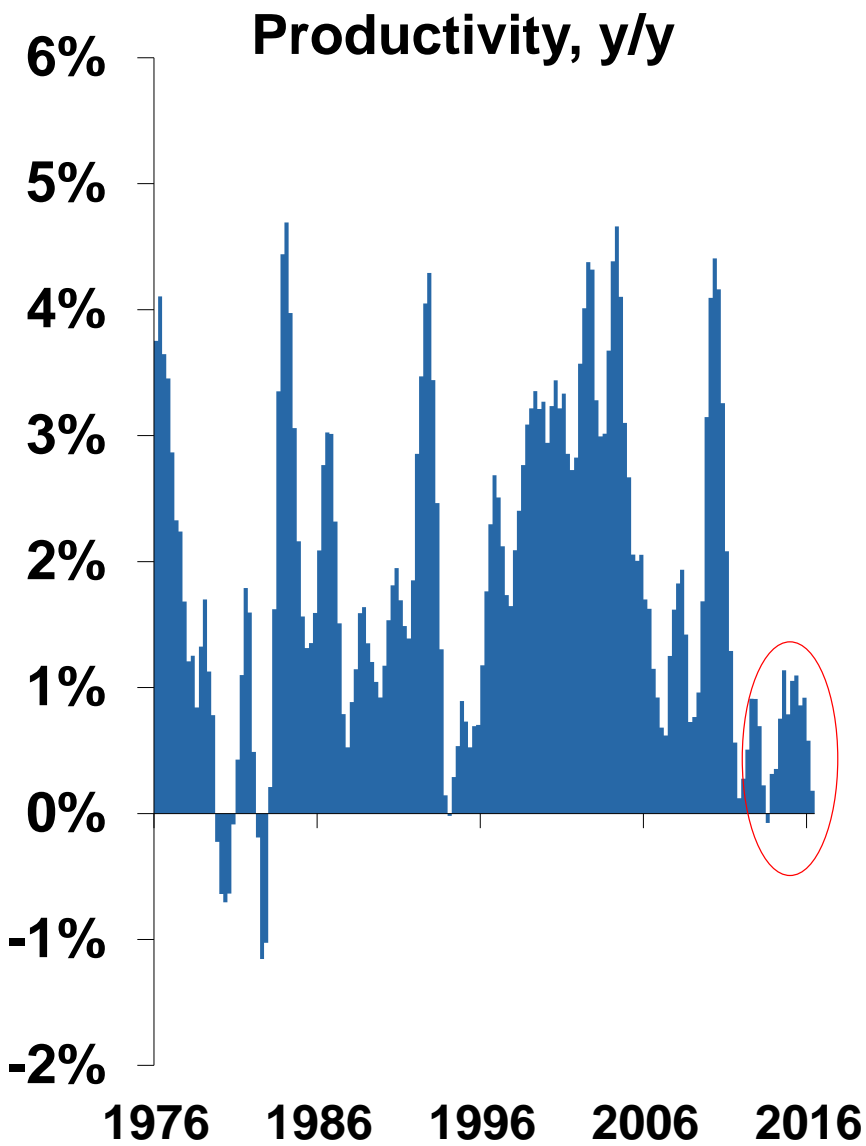
- Labor force participation rate (labor force/population) is plunging; weak economy, Boomers not being replaced fast enough.
 - Need more skilled legal immigration
- Skills mismatch due in part to education / training. Near record high job openings rate.
 - Need more vocational education / training
 - Need more skilled legal immigration

Openings rising faster than hirings suggest employers can't find the right people – the skills gap



Source: IHS, BLS, Euler Hermes

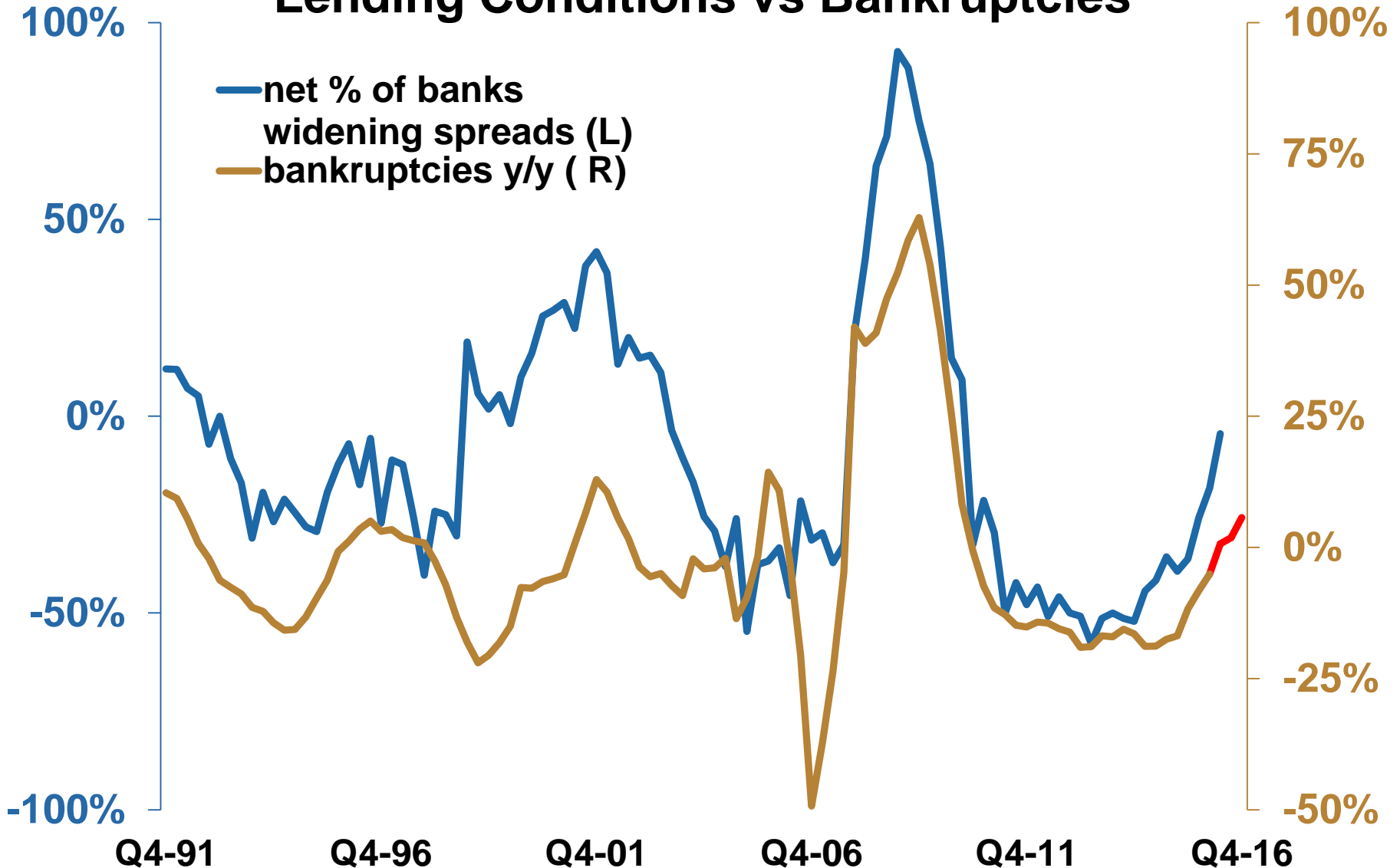
Productivity, due in part to skills gap, has been very weak, impeding growth. 3 negative Qs, worst since WWII



Sources: IHS, Fed, Euler Hermes

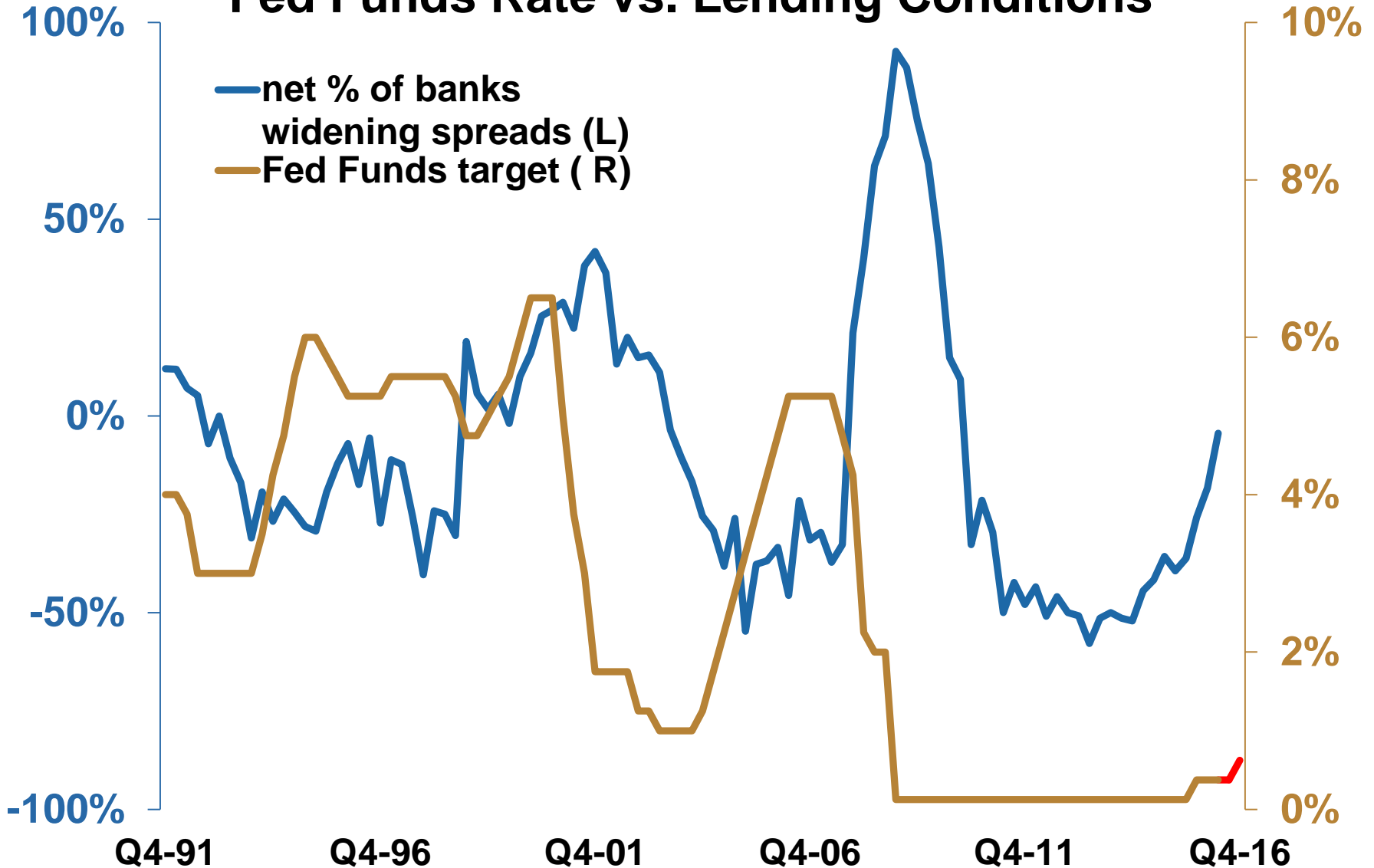
Lending conditions tighten with Fed hikes, suggesting bankruptcies may have bottomed. EH forecasts 7% increase in insolvencies in 2016.

Lending Conditions vs Bankruptcies



Lending conditions tighten with Fed hikes, suggesting bankruptcies may have bottomed. EH forecasts 7% increase in insolvencies in 2016.

Fed Funds Rate vs. Lending Conditions

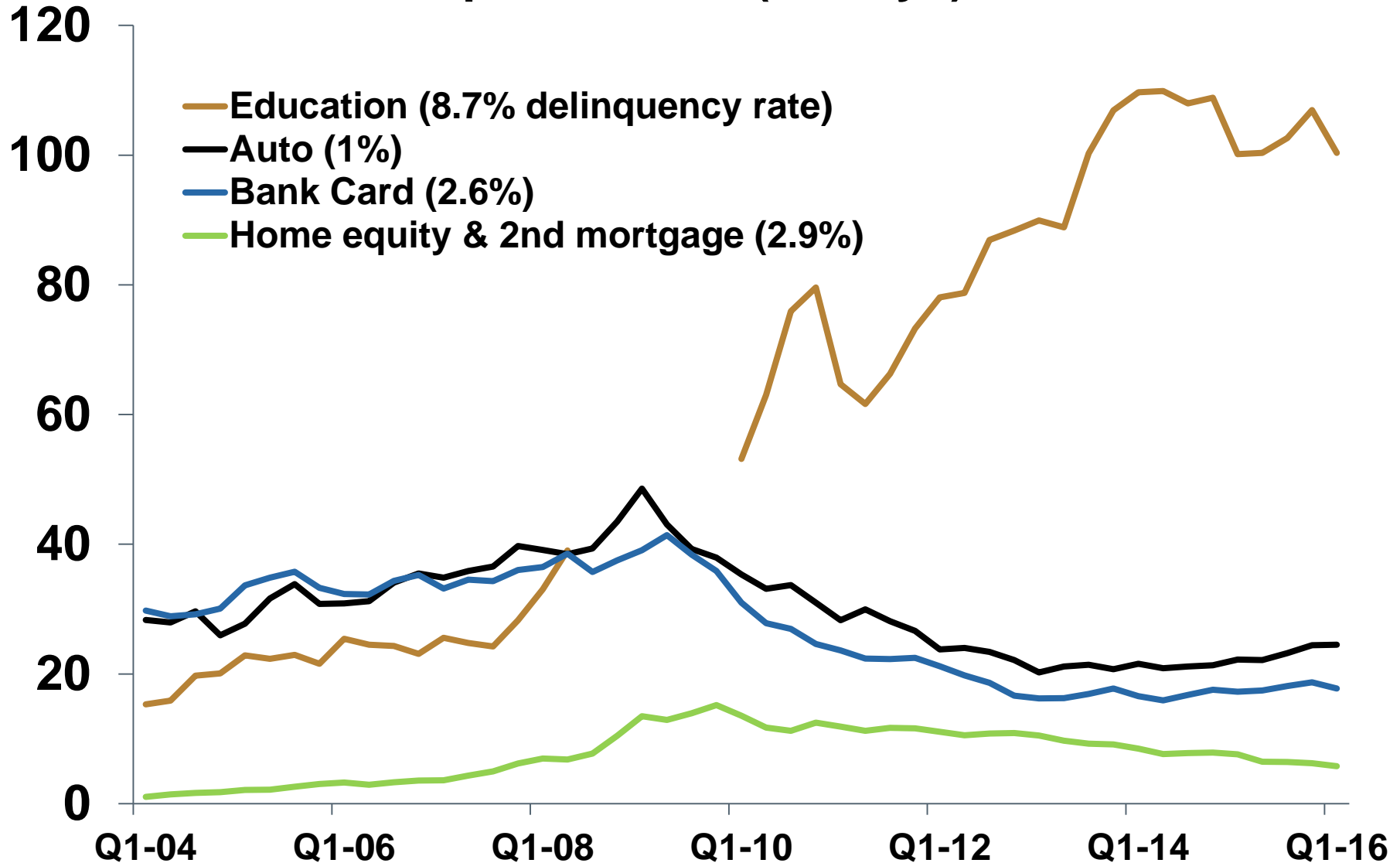


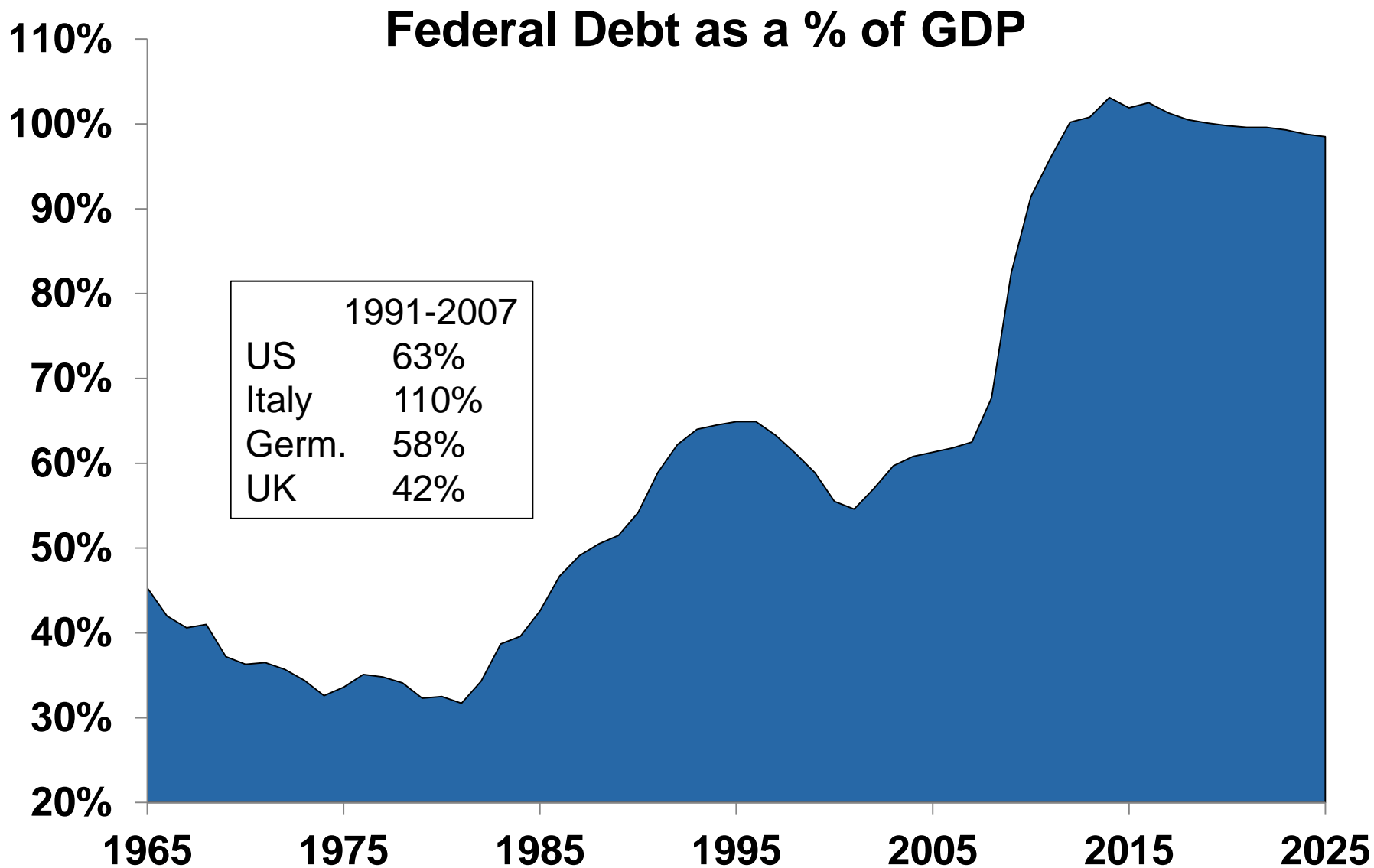
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Long-term negative: student loans are out of control

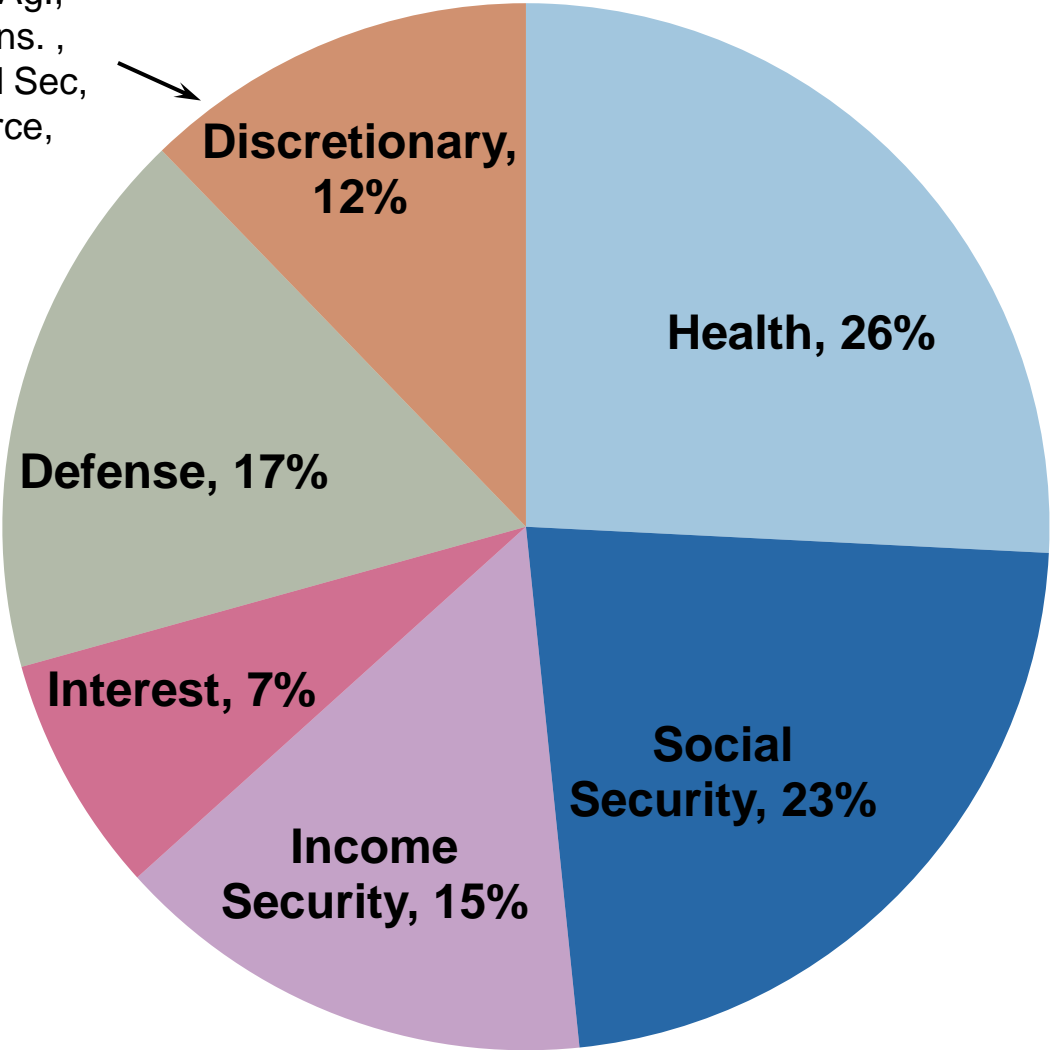
Delinquent Loans (30 days), \$bn





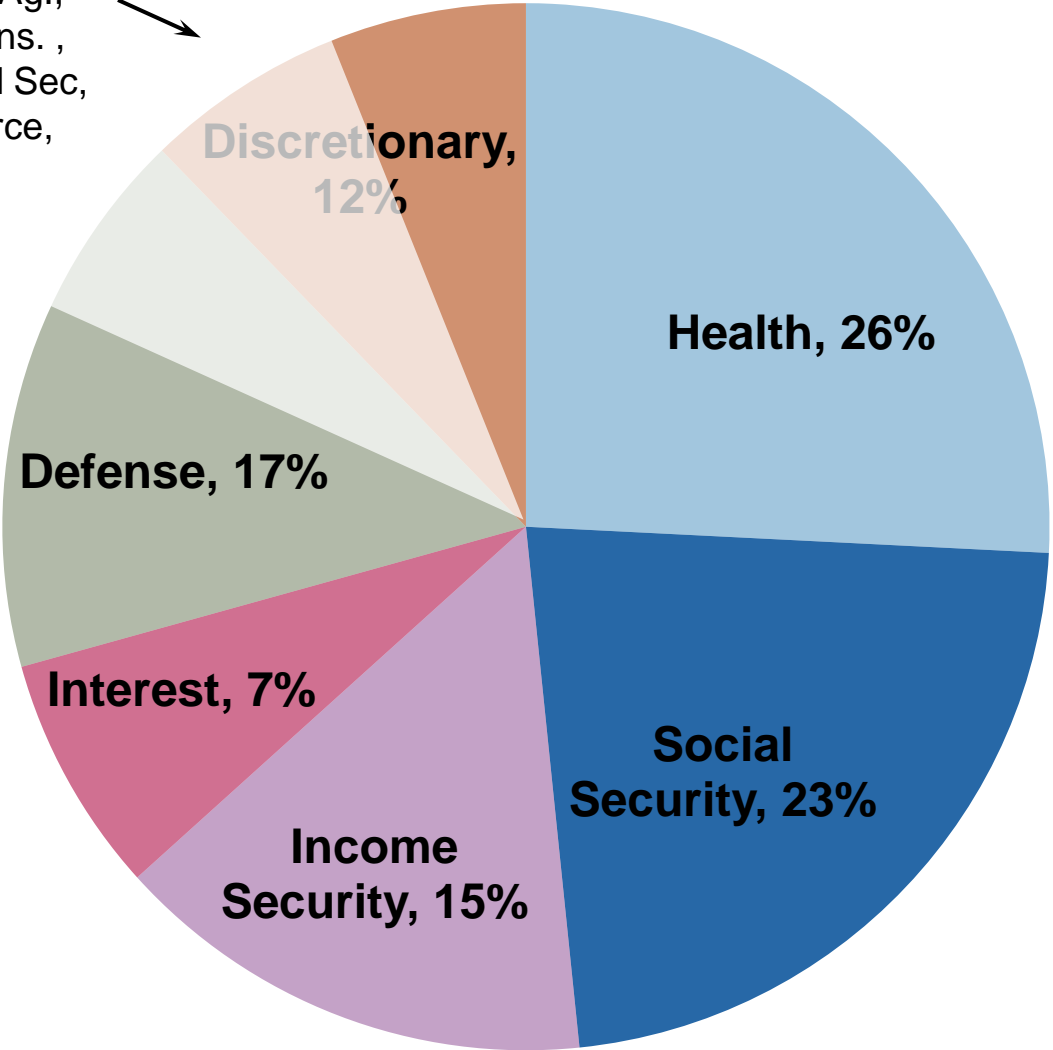
2015 Budget Outlays, \$3.7T

HUD, Labor, Edu. Ag.,
State, Justice, Trans. ,
Energy, Homeland Sec,
Treasury, Commerce,
Interior, EPA



2015 Budget Outlays, \$3.7T

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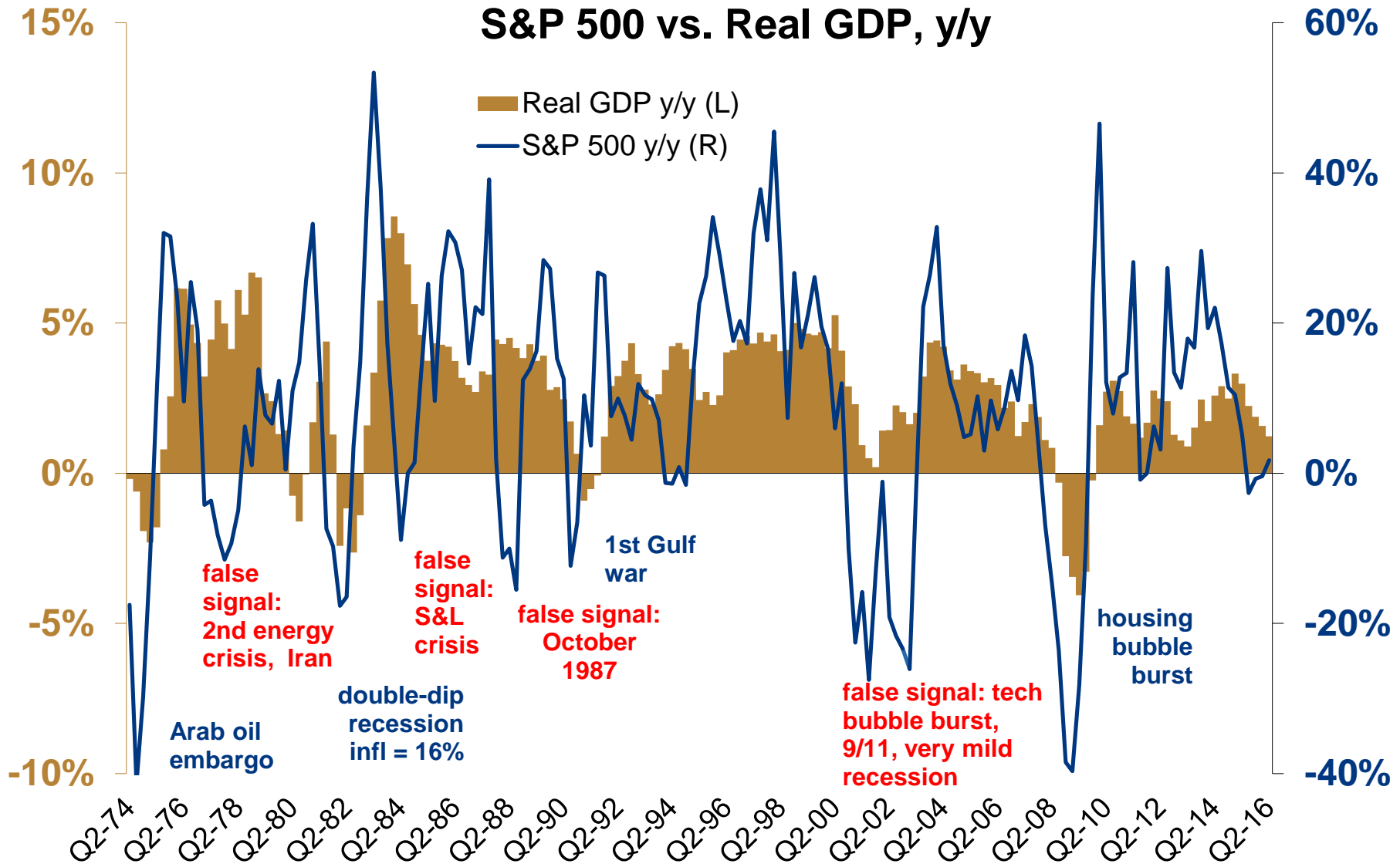
- Entitlement spending will be one the major issues for our time.
- One generation is not going to get all their benefits.
- The next generation will be taxed to exhaustion to provide them.
- 2030 Medicare can only pay 85% of claims.
- 2034 Social Security can only pay 77% of benefits.
- But it is not hopeless, it can be fixed, the math is simple, skilled legal immigration could help. Just no political will to fix it.
- No substantive reform in any budget proposal.

Not much of a negative: direct effects of Chinese slowdown

U.S.	\$ 000's	% of GDP
GDP	17,348,075	100.0%
Exports	2,341,950	13.5%
Exports to China	123,676	0.71%

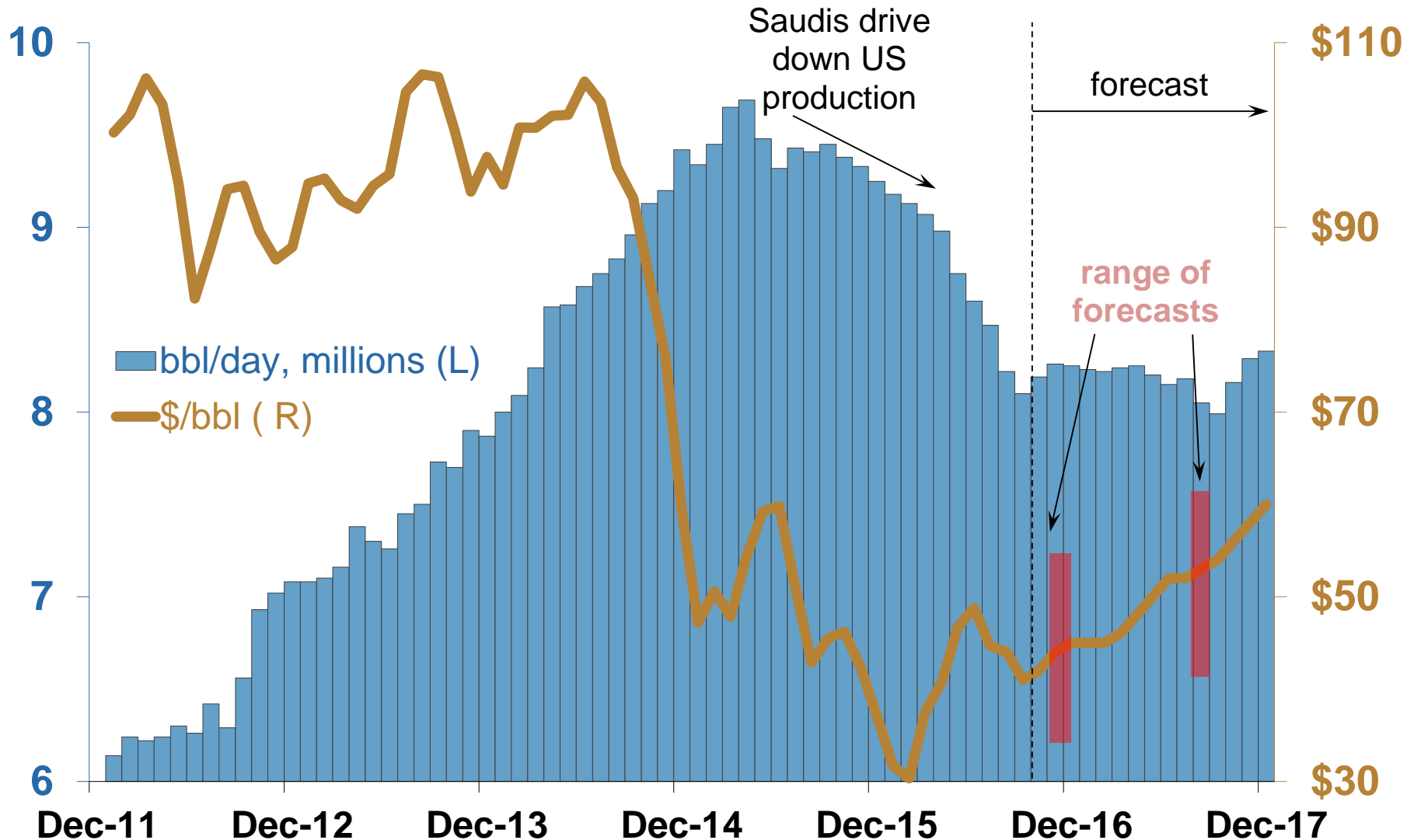
- **But financial market contagion always a concern,**
- **As is downward pressure on commodity prices, and**
- **Expansion into other markets (dumping)**

Not necessarily a negative: the stock market – it's not the same thing as the economy



- Oil prices in the long term are driven by supply and demand
- But in the shorter term other factors can cause dramatic swings in prices which are much more unpredictable
 - Weather
 - Supply disruption
 - Fear of supply disruption
 - Investor and trader sentiment
 - Strategies of major players, such as OPEC letting prices slide
 - Technological breakthroughs such as fracking and horizontal drilling
 - Geopolitical uncertainty
 - Inflation
 - Value of the U.S. Dollar

EIA Forecasts, Crude Oil (WTI) Production and Price



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- Positive yield spread
- Negatives:
- Monetary policy
- Falling yield spread
- Strong USD, weak exports
- Slump in manufacturing
- Shrinking corporate profits & investment
- Structural unemployment
- Low productivity
- Rising bankruptcies
- GDP growth a very limited 1.7% in 2016, 2.2% in 2017.
- Prescriptions? Lower corporate taxes / holiday, broaden tax base & eliminate subsidies, reduce red tape delays and regulation, entitlement reform, debt reduction, passage of trade agreements, skilled legal immigration, political compromise.

Thank you for your attention!

[For additional information, visit
www.eulerhermes.us](http://www.eulerhermes.us)



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