THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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From A Fiscal Cliff To A Bungee Chord Economy

Washington's proclivity to emasculate all negotiations on fiscal policy is nothing new. So it is with genuine relief that at least one major issue has been resolved, taxes. Global financial markets have responded favorably this morning to news of the latest tax accord. The essential elements of the agreement are as follows:

- Household income up to $400,000 ($450,000 if married) would see their top rate rise to 39.6%, up from 35% in 2012. The capital gains and dividend tax rates for these high-income groups will increase to 20% from 15%.

- For everyone else, investment tax rates will remain at 15% or below.

- It will also keep the expanded parameters for the American Opportunity Tax Credit, the Child Tax Credit and Earned Income Tax Credit for 5 more years.

- The Alternative minimum tax will be permanently indexed to inflation, which means the measure will prevent close to 30 million middle-class taxpayers from paying a hefty tax increase for 2012.

- Phase out tax breaks on personal exemptions and itemized deductions for those making $250,000 (married couples making $300,000).

- Passed an AMT patch and permanently indexed it to inflation.

• Estate Taxes: No tax is required on inheritances of up to $5 million ($10 million for married couples). Above that amount, a 40% estate tax is applied. Total amounts will also be indexed to inflation each year.

• Unemployment benefits: The law will continue a federal extension of unemployment benefits for one year.

• Payroll taxes: It will increase to 6.2% from 4.2% on an employee's first $113,700 of income.

• Business will enjoy a one year extension of the R&D tax credit; the tax incentive to hire more youths and veterans, and monies spent on renewable energy has also been extended through 2013.

OK, what happens now? We're not home free yet.

With this agreement, the nation averted what would have been a Mexican cliff dive into recession. But the economy is not home free yet. Only part of the poison pill that gave us the fiscal cliff has been addressed. From our perspective, what Congress did in the last 48 hours is effectively strap on a bungee chord to the economy. That is, we fell off the cliff briefly on January 1st, then bounced back safely onto the cliff after both houses passed tax accord.

But next comes phase two of the poison pill, cutting federal spending and raising the debt ceiling. These are especially incendiary topics for Democrats and Republicans. Talks are expected to be more heated this round because the role of government in the economy goes to the very core of the philosophical divide between the two parties. For now at least, Congress has given federal agencies a two month reprieve from the across-the-board spending cuts that were originally scheduled to start today. But if no agreement is reached on the debt ceiling and on future spending, then the combination of a government shutdown and the mandated cuts in federal expenditures could once again shove the economy back off the cliff edge.

Bottom line:

An economy that is trapped in a fiscal bungee chord hell cannot function properly. And what a shame that is. The U.S. is really poised to show much stronger growth. Companies are eager to ramp up capital investments and boost hiring. Households are prepared to unleash five years of pent-up demand. However, both are likely to remain cautious until Washington can settle on a plan to reduce spending and settle on a new debt ceiling.

Our base line forecast assumes that a deal on both will be reached late in the first quarter. That agreement should set the stage for an acceleration in economic activity the rest of the year.

Remember, the momentum for growth in the US has been building. All the major metrics have been pointing in the right direction --- jobs, housing, car sales, the recovery in household wealth, the growing pile of cash held by companies, the repair of bank balance sheets, and the expected rebound in exports now that the economies of China and even Europe are starting to stabilize. Clearly, the fundamental structure of the US economy is better now than it has been in more than five years. All that is needed to release all this potential is a final agreement in the next few weeks that will gradually phase in cuts in federal spending over the next 10 years. We believe such an accord will materialize in March. That is both a forecast --- and a prayer!

- Actual
- Forecast

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United States

	I 2012	II 2012	III 2012	IV 2012	I 2013	II 2013	III 2013	IV 2013	I 2014	II 2014	III 2014	IV 2014
Real Gross Domestic Product (GDP):												
%	2.0	1.3	3.1	1.2	2.7	4.1	3.5	3.9	2.9	3.0	3.4	3.7
Personal Consumption Expenditures:												
PCE	2.4	1.5	1.6	1.0	2.7	3.8	3.4	4.0	2.6	2.9	3.1	3.5
Inflation, end of period, year-over-year:												
CPI %	2.7	1.7	2.0	1.9	2.5	3.0	3.2	3.5	3.0	2.8	2.9	3.3
Unemployment Rate (end of period):												
%	8.2	8.2	7.8	7.9	8.2	7.7	7.5	7.3	7.1	7.0	6.8	6.4
Non-farm Payrolls, monthly avg. thousand:												
	225	67	168	130	168	210	240	275	245	285	300	330
Treasury 10-yr Note Yield % (end of period)												
	2.2	1.7	1.6	1.8	2.5	3.3	3.5	3.5	3.5	3.5	3.8	3.8
Federal funds rate % (end of period)												
	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.5

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014
US	1.9	-0.3	-3.1	2.4	1.8	1.9	3.5	3.3
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.9	0.5	0.8
United Kingdom	3.1	0.6	-4.8	1.4	0.7	0.2	1.8	2.2
Japan	2.1	-0.7	-5.1	3.9	-0.7	1.6	0.7	1.9
Canada	2.7	0.7	-2.8	3.2	2.5	2.2	2.7	3.0
India	8.9	6.1	6.7	8.5	7.2	5.5	6.1	7.0
China	14.2	9.6	9.2	10.4	9.2	7.7	8.4	8.8
Brazil	5.7	5.1	-0.6	7.5	2.7	1.3	3.9	4.8
Mexico	3.3	1.4	-6.6	5.5	4.0	3.7	4.0	4.9
Australia	4.0	2.3	1.2	2.8	2.0	3.0	3.5	4.3
Russia	8.1	5.6	-7.9	4.0	4.3	3.3	3.9	4.5
World	4.9	2.0	-0.6	4.2	2.7	2.8	4.0	4.3

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014
USD/Yen	91	93	81	77	87	88	78
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.38	1.45

Oil (NYMEX future) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014
Crude oil per barrel	43	80	91	99	92	110	85
Gasoline	1.61	2.57	3.00	3.27	3.30	3.95	3.40

Major Stock Indexes

	End 2010	End 2011	End 2012	% Change '12	End 2013	% Change '13
DJIA	11,577	12,218	13,104	7.3	14,519	10.8
S&P 500	1,258	1,258	1,426	13.3	1,671	17.2
NASDAQ	2,653	2,605	3,019	15.9	3381	12
RUSSELL 2000	784	741	849	14.6	985	16