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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We Are Living In A Period Of Epic Uncertainty And That Could Slow Growth More Than Expected

Want to know the path of the US and international economy the next 18 months? Some analysts suggest you might as well resort to Tarot cards for answers.

A silly response? Yes, but its mere suggestion reflects a growing exasperation among economic forecasters. Rarely have there been so many major economic, political and geopolitical variables in flux simultaneously. We are now living in a period of epic uncertainty and the truth is no mathematical model of the economy is of much value as a forecasting tool given the many issues in full swirl.

Check it out. Economists now have to contend with a bizarre US presidential campaign, the consequences of the Brexit vote on the UK and Europe, a puzzling Federal Reserve interest rate policy, an emerging bond price bubble, another looming banking crisis in Italy, China's still shaky economy, the collapse of the Brazilian and Venezuelan economies, and at least half a dozen serious geopolitical threats that can erupt anytime.

This gallimaufry of concerns has made the future terribly murky.

But there is a caveat here. If there's one pattern we have observed in the past, it is that when the outlook is so clouded, business leaders and consumers typically scale back spending out of an abundance of caution.

That retrenchment, we believe, will commence the second half of this year and may continue into next year. As a result, we have revised down our forecasts for the US and key foreign economies.

The changes are presented here:

- **US economic growth this year has been downgraded to 2.1% (from 2.3% originally) and 2.6% in 2017 (vs. 2.9%).**

- **Eurozone will see real GDP expand by 1.3% in 2016 (instead of 1.6%), and 1.6% next year (vs. 1.8%).**

- **UK economic activity is in danger of coming to a screeching halt as a result of the vote to leave the EU and the domestic political muddle that followed. We see virtually no growth occurring next year, which is a substantial step down from our initial projection of a 2.6% increase in GDP on the assumption voters would choose to remain within the European organization.**

- **Japan will continue to struggle the next two years. The failure of Abenomics, especially the inability of the government to follow through with structural reforms as promised, plus the surge in the value of the yen (as foreign investors seek out safe haven currencies), and finally the impotence of negative interest rates to revive business activity, will limit growth to barely 0.5% in 2016 and 2017.**

- **Canada will also see its economy slow this year due to the drop in commodity prices and the deceleration in US activity. Canadian GDP will increase 1.6% (rather than 1.7%) this year, but we do expect growth to remain at 2.5% in 2017 as oil prices edge higher, along with greater cap spending and hiring.**

- **India's economy should remain impervious to the weakness in the UK and Europe, largely because of significant foreign capital inflows to the country and strong domestic demand. As a result, growth should expand by 7.5% in 2016 and an even faster 7.8% in 2017.**

- **The outlook for China has always been more difficult to assess because of skepticism over their economic data. The broader, more profound, question is whether China's economic woes are finally receding --- or is the day of reckoning getting closer? We believe Communist party leaders fear the latter is the higher probability scenario. Top CP officials appear to be in emergency mode to do everything possible to avoid such an outcome by boosting the availability of credit, ordering state own enterprises to boost up spending, and scaling back on economic reforms. We expect real GDP growth (based on**

official calculations) will struggle to exceed much beyond 6% for both this year and next. Our own estimate is that their economy is more likely to expand closer to 4.5% this year and barely 4% in 2017.

• Brazil has become the poster child for the phrase "anything that can go wrong, will go wrong." This is a country that seemingly never misses an opportunity… to miss an opportunity. The economy is in the middle of its worst recession in a century. Brazil's chronic political scandals has led to impeachment hearings of its president, Dilma Rousseff. But there doesn't seem to be much public support either for its vice president, Michel Temer, the country's leader in the interim. In addition to the domestic political crisis, Brazil has been struggling to finance the construction of the facilities needed to host the Olympics in August. Add to these woes the spread of the Zika virus and calls by the World Health Organization to postpone the Olympics or relocate them to another country. (Neither is likely to happen.) Last, but certainly not least, Brazil's currency, the real, has been soaring in value lately as foreign investors seek higher yields in the global marketplace. But a strong real will hurt Brazil's exporters at a time when they can least afford it. These are among the reasons why we see the economy continuing to contract in 2016 (minus 4.1%) and 2017 (minus 0.8%).

• Mexico has fared better than most emerging countries in recent years, yet it too will see a slight deceleration in growth due to the US economic slowdown and still soft oil prices. The economy is seen expanding 2.2% this year (versus 2.4%) and 2.6% (instead of 2.8%) in 2017.

• Russia's economy remains in dire shape. Tax revenues are falling, income from oil exports continue to plunge, and Moscow has been forced to tap its now rapidly depleting sovereign wealth fund to finance government spending. After suffering a recession in 2015, we see another contraction this year (minus 2%) and virtually no growth in 2017.

• Looked at from 30,000 feet up, we see world economic growth braking in 2016 to 2.4% (from our original forecast of 3.0%) and 2.9% (vs. 3.7%) next year.

Let me make a few additional points.

We often get questions about the prospect of recession the next 18 months. While we do not see a US downturn this year, the chance of one occurring in 2017 will depend on the comfort level Americans have with who next occupies the White House.

This has undoubtedly been the wackiest presidential campaign in modern times. Historians and archeologists will spend years trying to figure out what was behind the apparent extinction of leaders with normal political chromosomes.

For now, we have to state that the forecast of 2.6% growth in 2017 is based on the assumption that Hillary Clinton becomes the next President. In contrast, a Donald Trump victory will introduce so much more uncertainty on virtually ALL domestic and foreign policy issues that we could see a virtual shut down in corporate hiring, cap ex investments, and household spending for most of next year.

What we can say is that given the current tightness of the race between the two presumptive party nominees, we have raised the chance of recession next year from less than 25% a month ago, to 40%.

What of Brexit!

Equally bizarre has been the thunderous shock from voters in the UK who chose to leave the EU, followed by David Cameron's decision to step down as PM. Not only is Great Britain politically rudderless now, it calls into the question the entire cohesiveness of the EU itself. Global financial markets are adrift as investors and business leaders to try to assess how Brexit will affect the future relationship of the UK with the rest of Europe. Dozens of questions surface here. Who will take over as PM? Will the country invoke article 50 of the Lisbon treaty, and if so, when? Will it really take two years before a divorce from the EU is finalized and when we will learn of the new trade, financial, and immigration agreements the UK has with the Continent?

And into this cauldron of uncertainty we must also add the cloudy outlook for U.S. monetary policy! Given the multitude of economic and geopolitical risks in the global marketplace and the Federal Reserve's inclination to move cautiously, we expect the next rate increase will take place in December, at the earliest. Our forecast calls for the nominal mid-point for the fed funds rate to reach 1.63% at the end of 2017, which means it will be a still highly stimulative zero rate when adjusted for inflation.

Bottom line:

Rarely has the political and economic outlook been so opaque. Faced with such uncertainty, private demand often slows markedly and investors rush to load up on safe US sovereign debt. That last step explains why the 10-year and 30 yr. US treasury yields have fallen to record lows.

And should there ever be a slow news day on the domestic front in the coming months--- something highly improbable -- --- we suspect the turmoil in the UK, Eurozone, Brazil, Venezuela, Russia, China, and the Middle East will easily fill that void.

These are interesting and exciting times all right--- but also a period that's confusing and worrisome. Such a combination is not very conducive to economic growth.

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Key Economic Forecasts

- Actual
- Forecast

United States

	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017
Real Gross Domestic Product (GDP):												
%	0.6	3.9	2.0	1.4	1.1	2.5	2.4	2.5	2.0	3.0	2.9	2.6
Personal Consumption Expenditures:												
PCE	1.8	3.6	3.0	2.4	1.5	2.3	2.4	2.7	2.4	3.0	2.7	2.8
Inflation, end of period, year-over-year:												
CPI %	-0.1	0.1	0.0	0.7	0.9	1.6	1.6	1.8	1.8	1.9	2.2	2.3
Unemployment Rate (end of period):												
%	5.5	5.3	5.1	5.0	5.0	4.8	4.7	4.5	4.5	4.5	4.5	4.9
Non-farm Payrolls, monthly avg. thousand:												
	195	231	174	282	209	120	140	165	210	220	220	210
Treasury 10-yr Note Yield % (end of period)												
	1.93	2.38	2.06	2.27	1.78	1.49	1.58	1.78	2.10	2.30	2.55	2.90
Federal funds rate % (end of period)												
	0.13	0.13	0.13	0.38	0.38	0.38	0.38	0.63	0.88	1.13	1.38	1.63

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.5	2.4	2.4	2.1	2.6
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.5	1.3	1.6
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.6	0.0
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	0.5	0.5	0.5
Canada	2.7	0.7	-2.8	3.1	3.1	1.7	2.2	2.5	1.2	1.6	2.5
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.8	7.5	7.8
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.2	6.0
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-4.1	-0.8
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.3	2.5	2.2	2.6
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.5	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.7	-2.0	0.3
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.6	2.4	2.9

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017
USD/Yen	91	93	81	77	87	105	119	120	106	118
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.09	1.12	1.15

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017
Crude oil per barrel	46	78	95	107	111	111	58	38	53	66
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.00	2.27	2.50