

Interesting Times

US Economics

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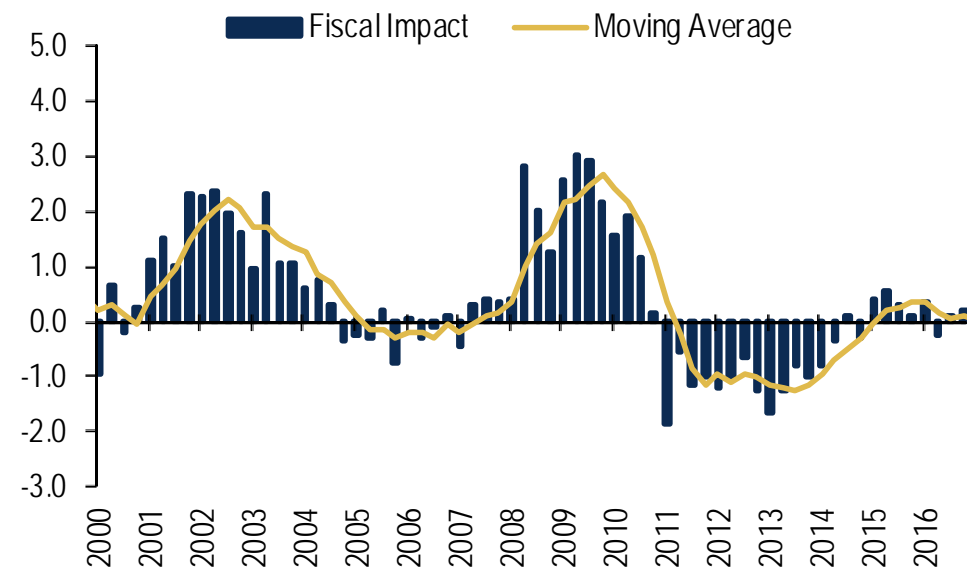
Refer to important disclosures on page 12-16.

Pre-Trump: Headwinds fading

- ***Repeated tax increases & spending cuts***
- ***..and ugly brinkmanship***
- ***Pushed deficit down to 2.5% of GDP...***
- ***..but 1% headwind to growth***
- ***Fading of the strong dollar shock also***

Fiscal Impact

(contribution of fiscal policy to real GDP growth)



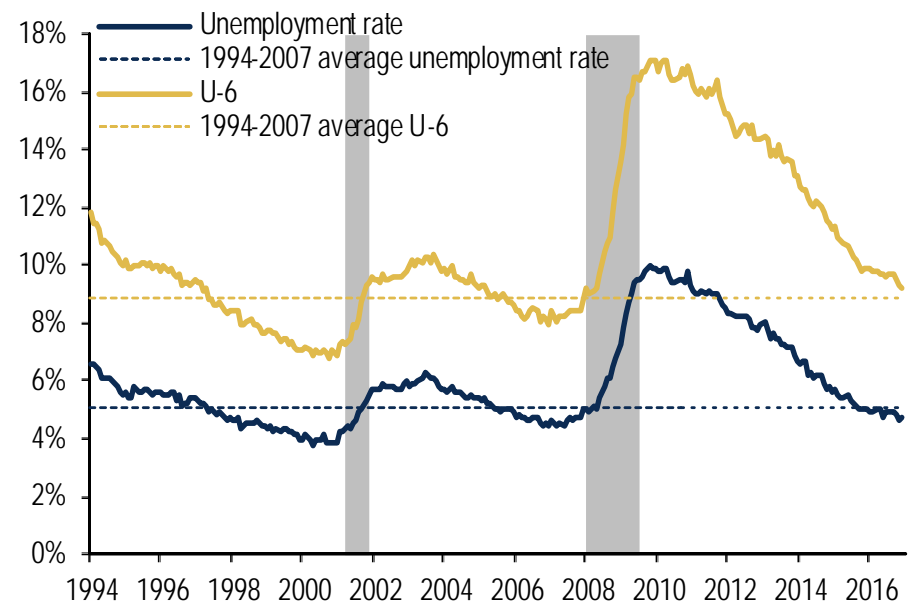
Source: Hutchins Center on Fiscal and Monetary Policy at Brookings

Note: The "fiscal impact" is estimated by applying multipliers to changes in tax and spending policies

Pre-Trump: Hitting full employment

- **Hence, despite weak growth**
 - **Have hit U-3 average**
 - **Will hit U-6 average by 1H 2017**
- **Inflation 101**
 - **A long lagging indicator**
 - **Once starts, hard to stop.**

Unemployment rate vs U6
(%)

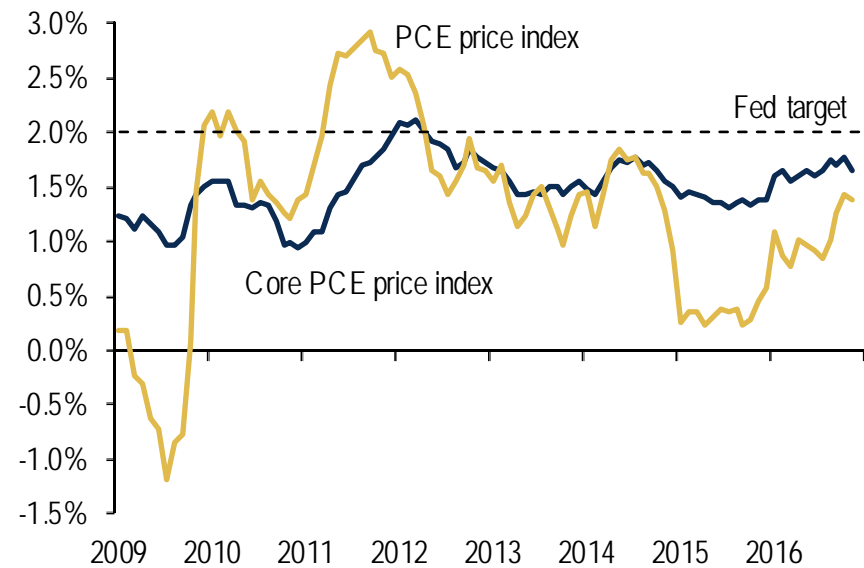


Pre-Trump: Reflation

Average hourly earnings
(% yoy, 3mo mavg)



Moving back to target
(%)



1. *Get economy to full employment*

- *Plant foot on accelerator*
- *Heal damaged sectors*

2. *Exit very slowly*

- *Pause if trouble emerges*
- *Focus on downside risks*
- *Make certain wages and prices recover*

3. *Prepare for the next recession*

- *Hope have enough ammunition*
- *Hope other central banks can help*

Markets were pricing in less than 1 hike in 2016



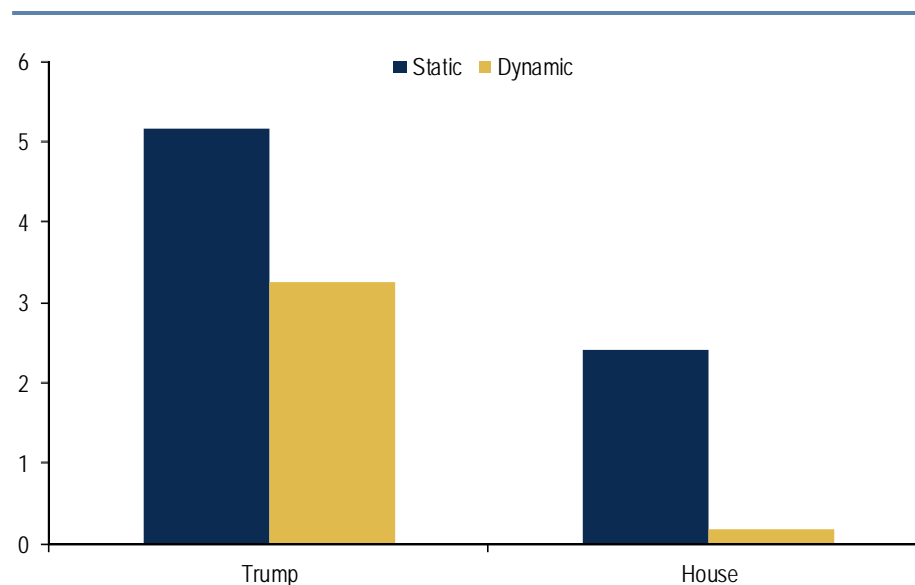
- ***Near term growth-friendly Trump***
 - ***Deregulation***
 - ***Big tax cuts***
 - ***Big spending increases***
- ***Near term growth-unfriendly Trump***
 - ***Reverse free trade***
 - ***Increase deportations***
 - ***Replace Yellen with rules-based Chairman***
 - ***Geo-political uncertainty***

Two tax plans

- **Corporate tax reform**
 - *Rate drops from 35% to 15% or 20%*
 - *Close loopholes*
 - *Border adjustment*
 - *Interest not deductible*

- **Personal tax reform**
 - *Three brackets: 12%, 25% and 33%*
 - *Ryan plan closes more loopholes*
 - *Eliminates estate tax*

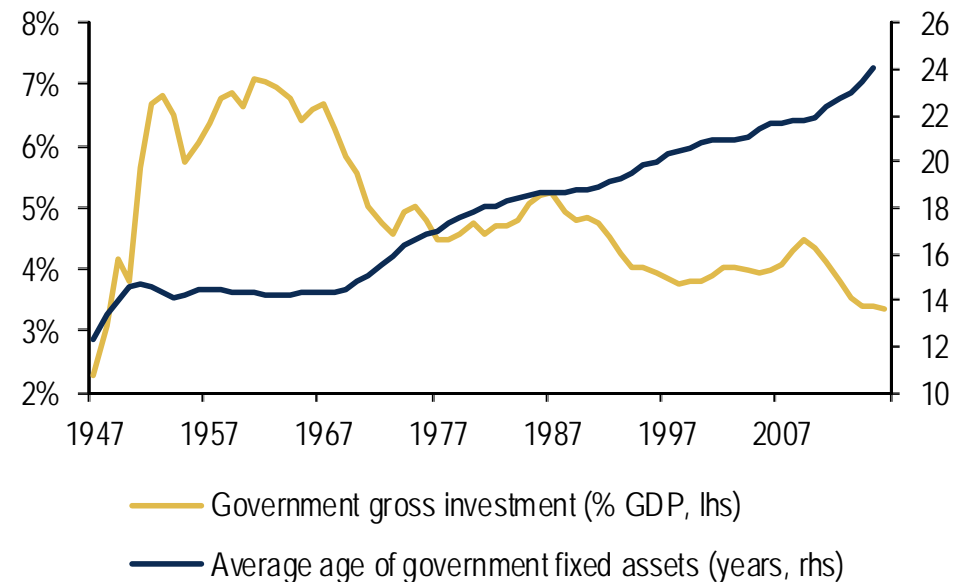
Tax plan estimates (\$ in trillions over decade)



Infrastructure spending: A bridge too far

- **Big under-investment**
 - *Low share of GDP aging fast*
 - *ASCE grade: “D+”*
 - *Both repair and big projects*
- **Prospects**
 - *Wide range of numbers...*
 - *...but no specifics*
 - *House Republicans did not run on*
 - *Long implementation lags*
 - *Private-public partnership?*

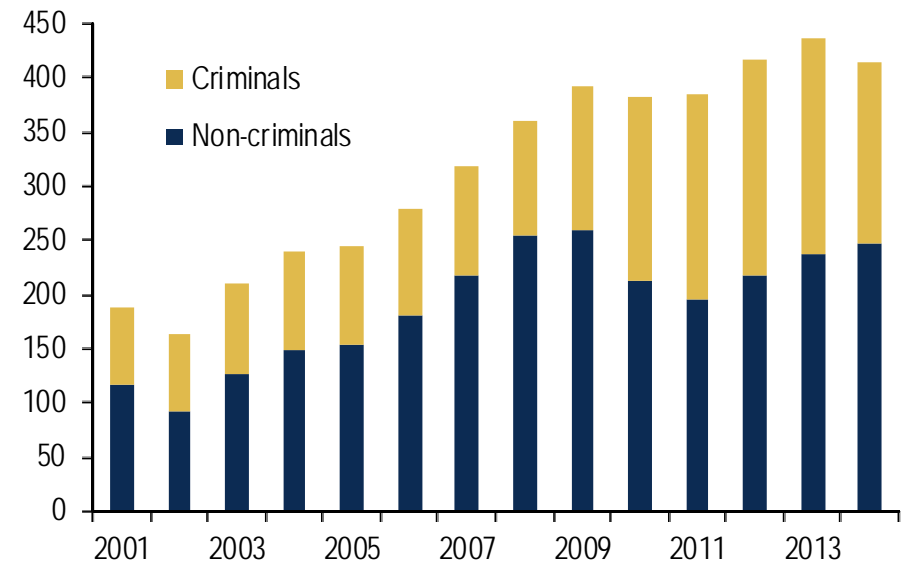
Infrastructure share of GDP and average age



Immigration policy: Increased enforcement

- ***Smaller stuff***
 - ***Increase deportations to 500,000***
 - ***Small increase in enforcement budget***
 - ***Enhance the fence***
- ***Significant growth shock***
 - ***11 million undocumented;
8 million working***
 - ***5% of employment***
 - ***10%-plus: farming, maintenance,
restaurants, construction.***

Deportations by Department of Homeland Security
(000s, fiscal year)



- ***Border adjustment***
- ***Mexico***
 - ***Deeply integrated supply chains***
 - ***Jawboning impacts the margin***
 - ***A tariff disrupts supply chains***
- ***China***
 - ***Numerous non-tariff barriers***
 - ***Many WTO cases already***
 - ***Aggressive opening gambit?***

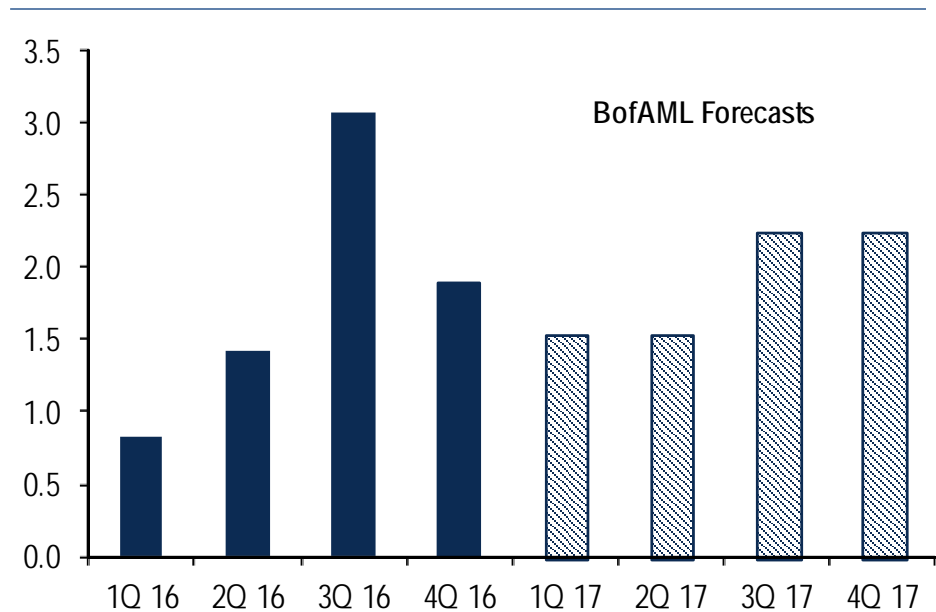
Trade: Big flows, small gap
(\$bn saar)



Baseline scenario: A little of everything

- **Growth stimulus**
 - *Ryan-style tax reform*
 - *Small defense and infrastructure*
 - *Small boost from deregulation*
- **Modest anti-globalization**
 - *No tariff currency "wars"*
 - *Deportations of 500,000 per yr*
- **Down-up growth pattern**
 - *GDP: 2% in 2017, 2 ½% in 2018*
 - *Inflation and Fed creep higher*

Real GDP growth
(% qoq saar)



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