

**US Economic Outlook:
More of the same: moderate
growth, low rates, chronic worries**

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Base forecast: moderate growth with lower inflation and low interest rates

■ Moderate growth

- A tug of war between positives and negatives
- Business, households gradually turning more expansionary
- Fiscal policy, weak export markets are restraints

■ Lower inflation with low interest rates

- The unemployment rate will be elevated for years
- Commodity prices are drifting lower; oil price has already moved much lower
- High unemployment, tame inflation, and downside risks to the economy will keep the Fed supporting growth (as much as it can) for a long time

Investors are focused on risks to the economy

- **Upside risks**
 - Nothing bad happens
- **Downside risks**
 - Euro area fiscal and financial fallout
 - US fiscal cliff, policy uncertainty
 - China hard landing
 - Iran/Israel tensions and the oil market

Look for a little better growth in 2012

US economic forecast

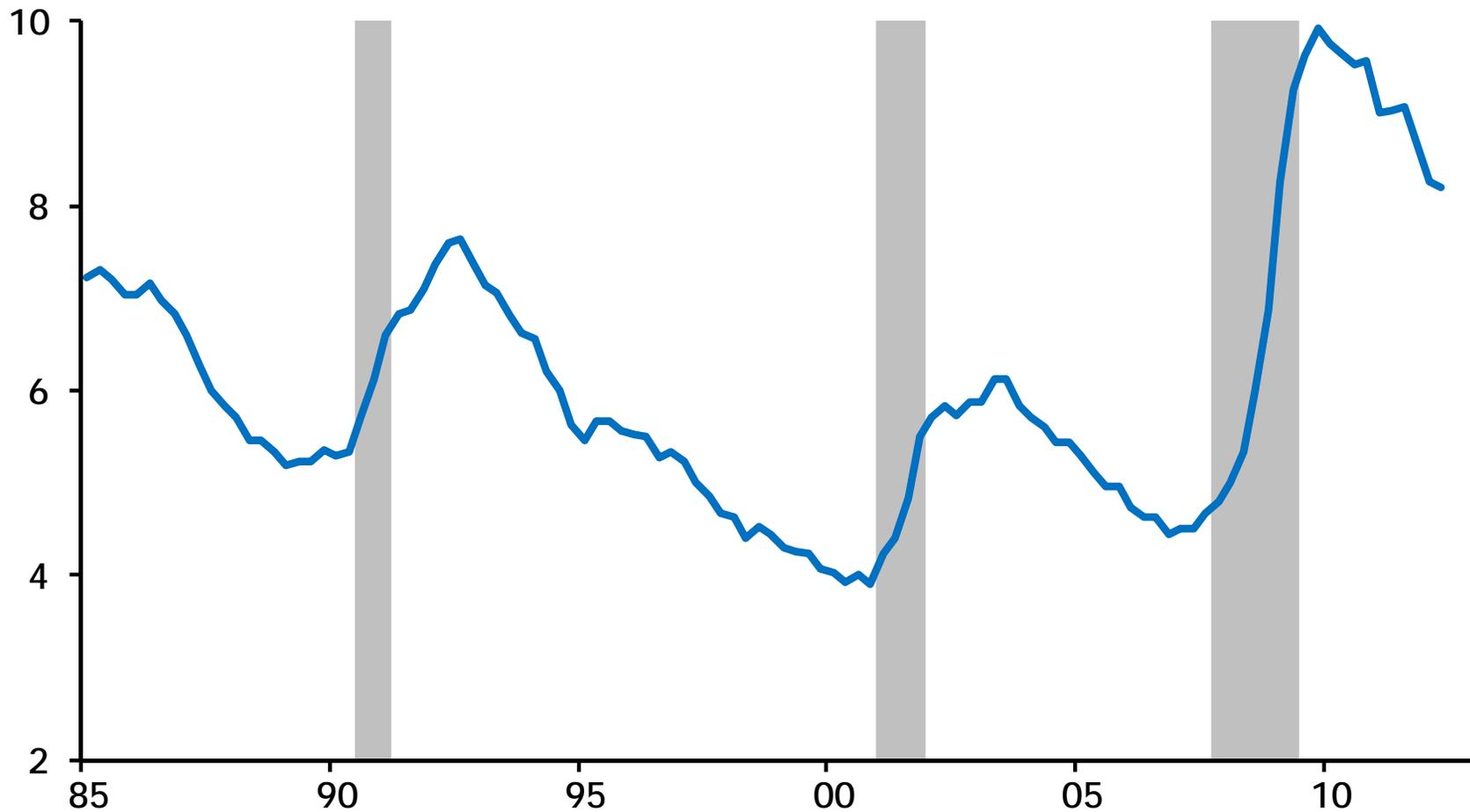
%ch, saar

	<u>1H12</u>	<u>2H12</u>	<u>1H13</u>	<u>2H13</u>
Real GDP	2.2	2.0	1.9	2.8
Core CPI	2.0	1.7	1.6	1.6
Unemployment (% , eop)	8.1	8.1	7.9	7.7
Fed Funds rate (% , eop)	0.13	0.13	0.13	0.13
10-year Treasury (% , eop)	1.40	2.25	2.25	2.50

Jobs are a key driver of the real estate market: The unemployment rate is high but falling

Civilian unemployment rate

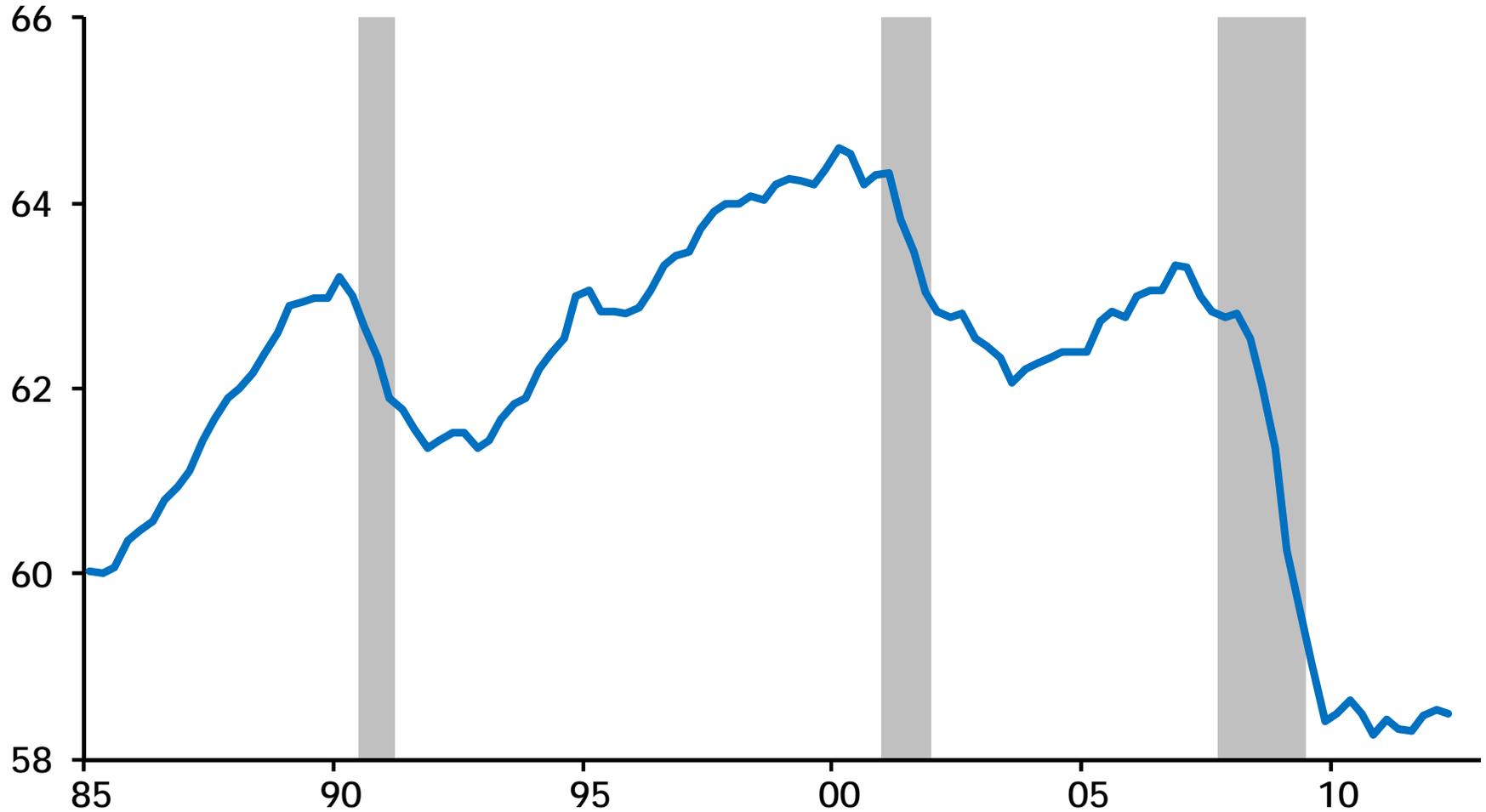
percent, sa



But the employment rate is not rising at all

Ratio of employment to the working-age population

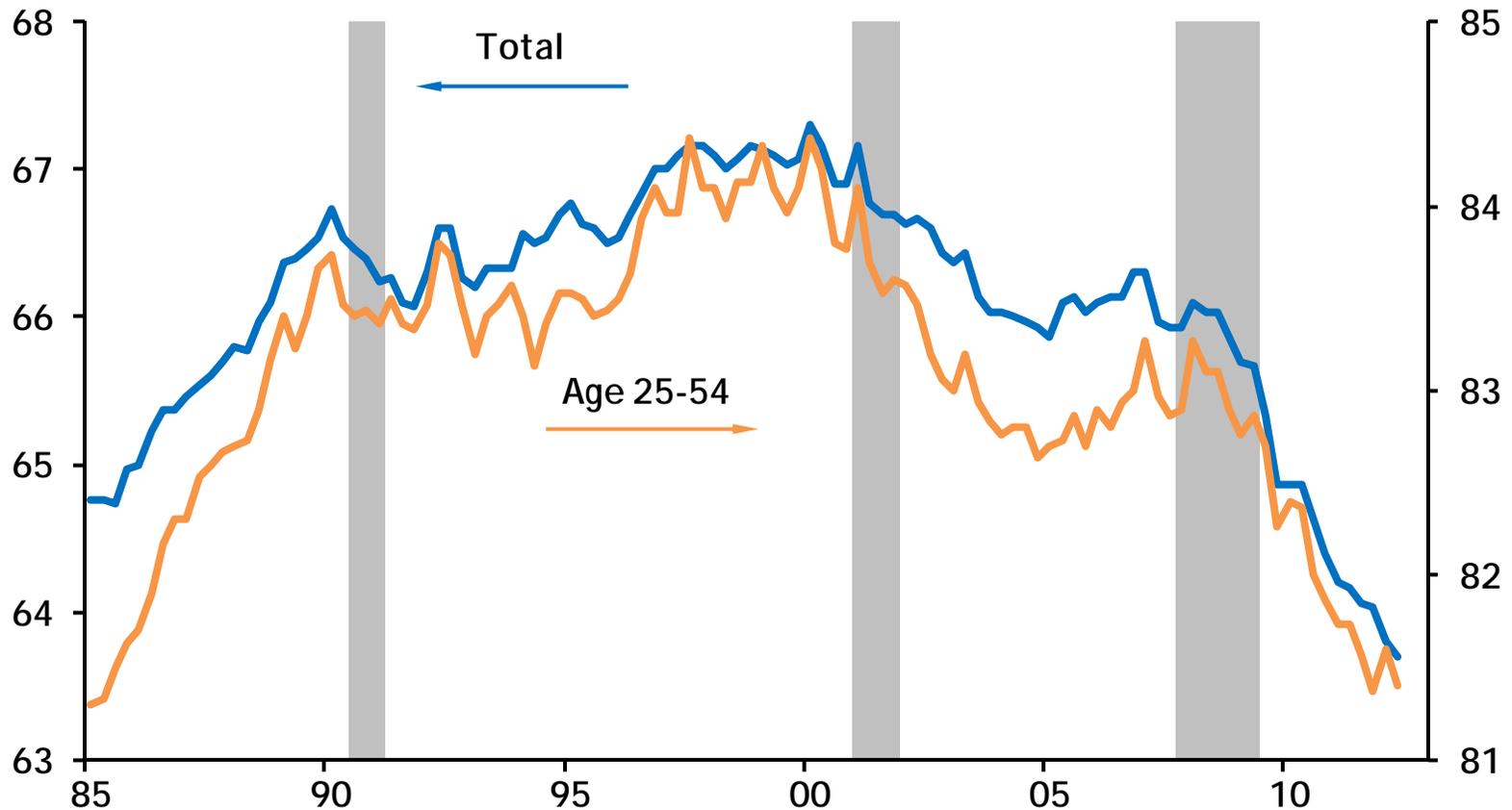
Percent, sa



Many people have stopped looking for work, - - not employed and not unemployed, either

Labor force participation rate

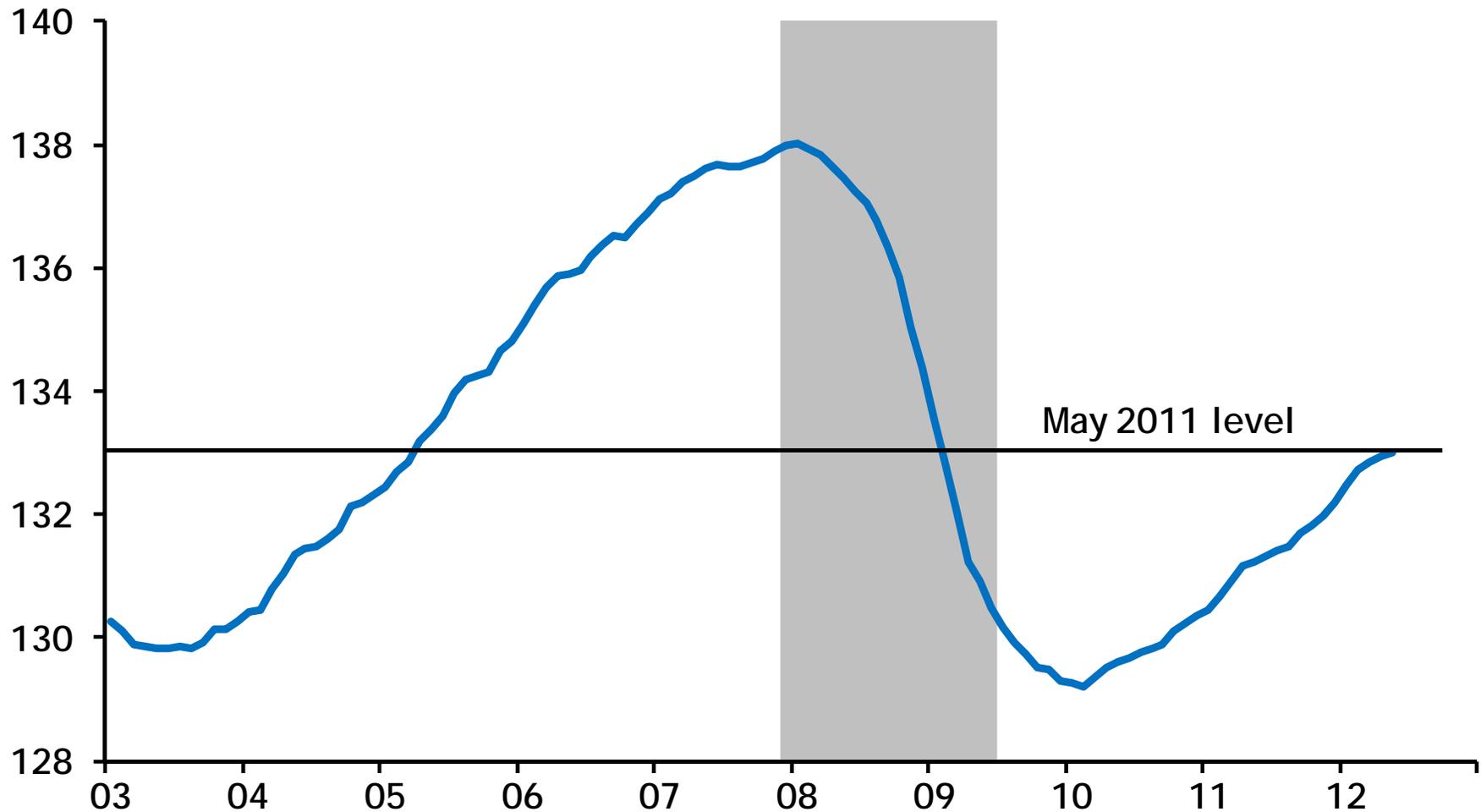
Pct, sa, both scales



An important issue for real estate, employment is still well below 2007 levels

Nonfarm payroll employment

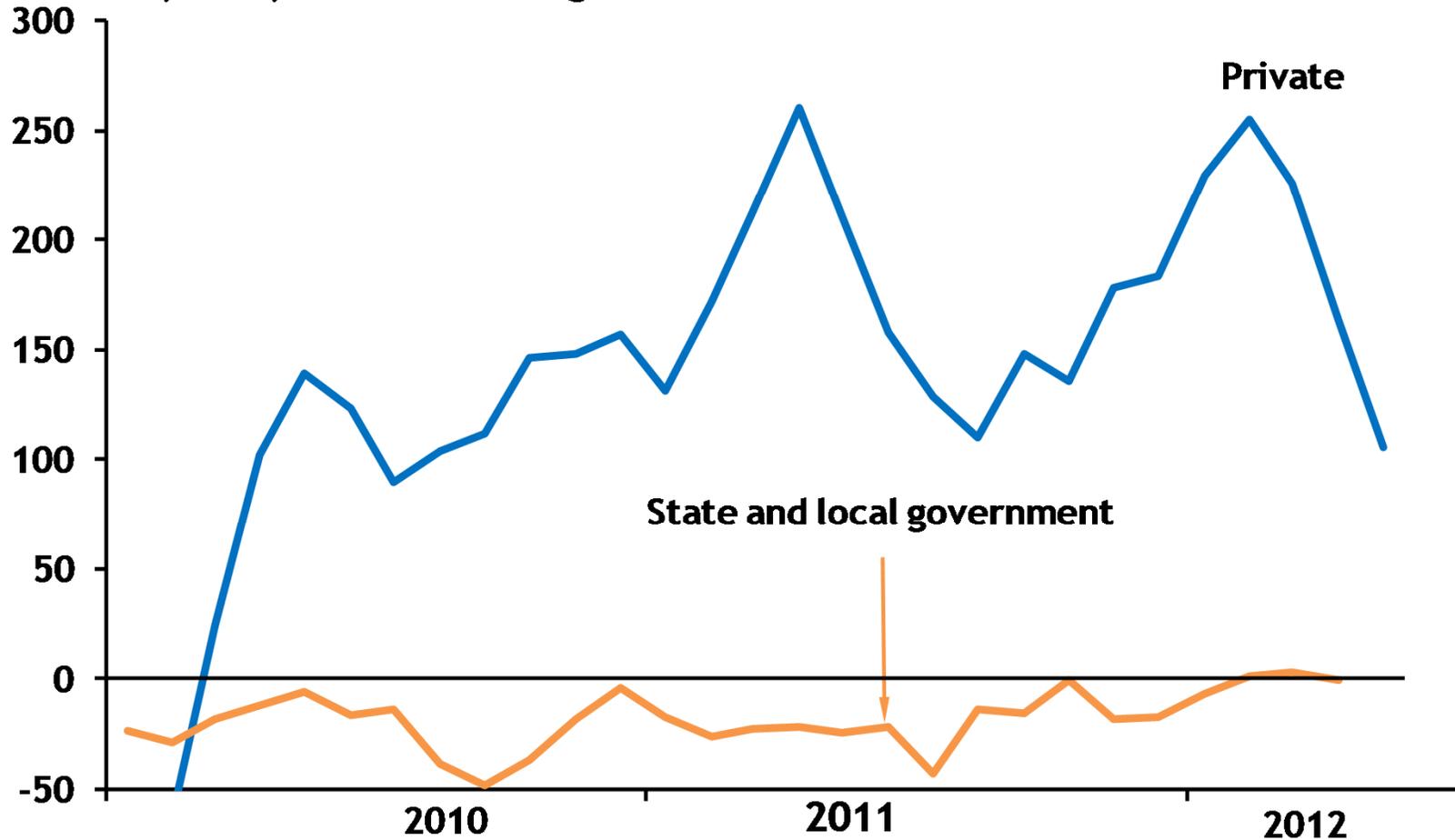
Mn, sa, ex 2010 Census workers



Job growth slowed again this spring; the reason is still being debated

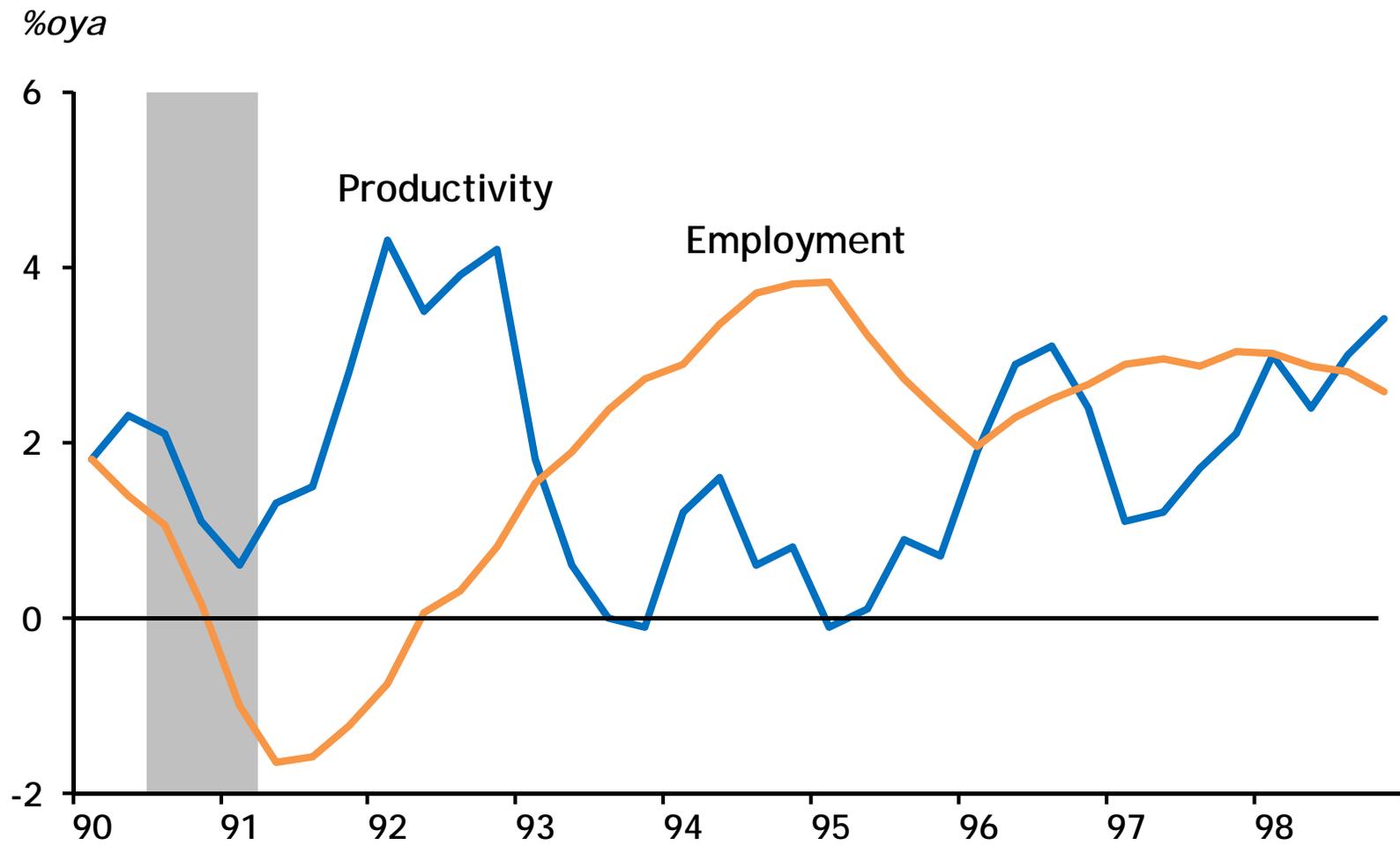
Payroll employment

Ch '000s, samr, 3-month mov avg



We look for better job growth by the fall, and an eventual repeat of the mid-1990s

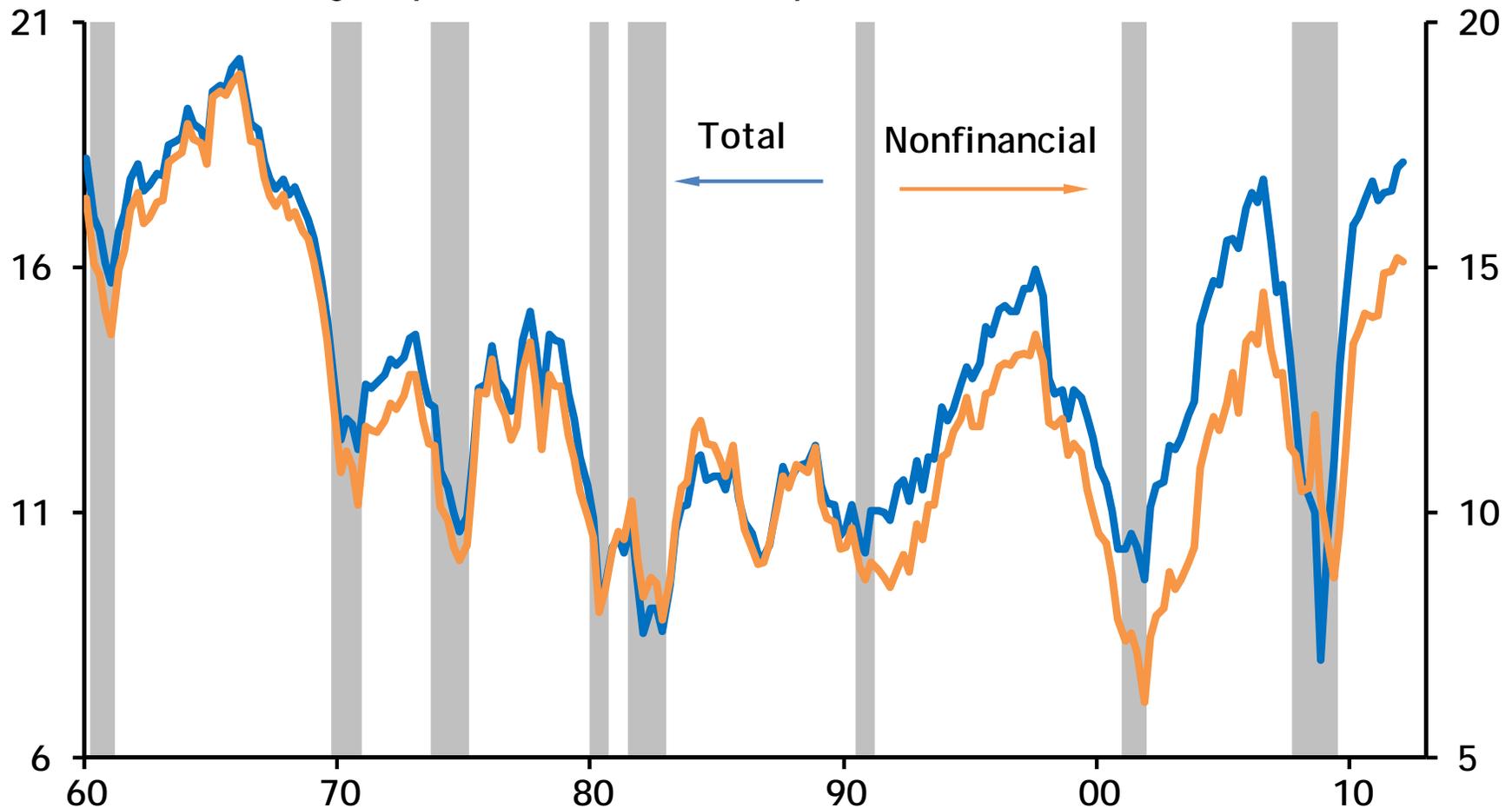
Labor productivity and employment, 1990-1998



Domestic profits are elevated, and business is not as defensive

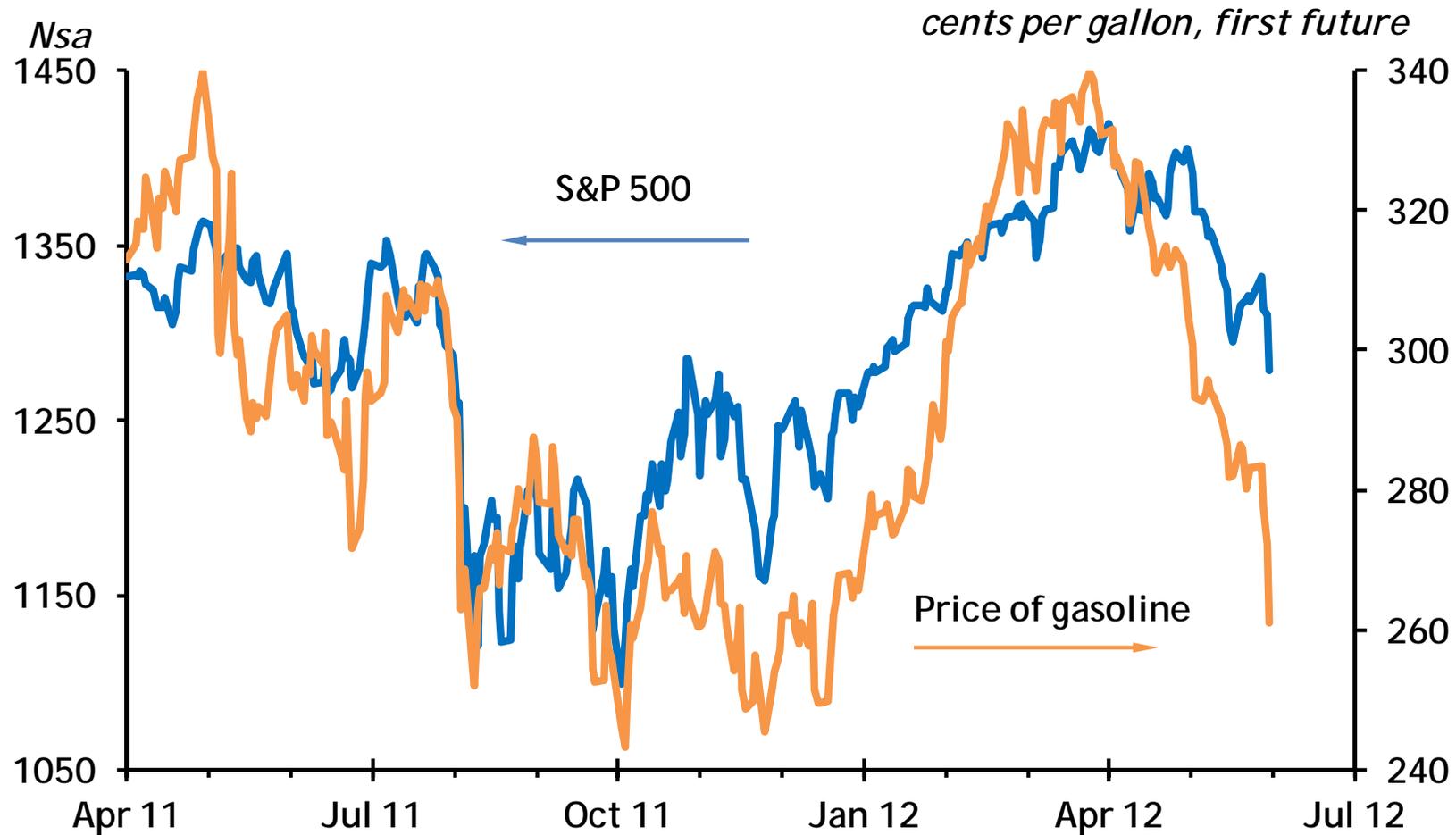
Profit margins on domestic operations

% , both scales, adjust profits as share of corp GDP



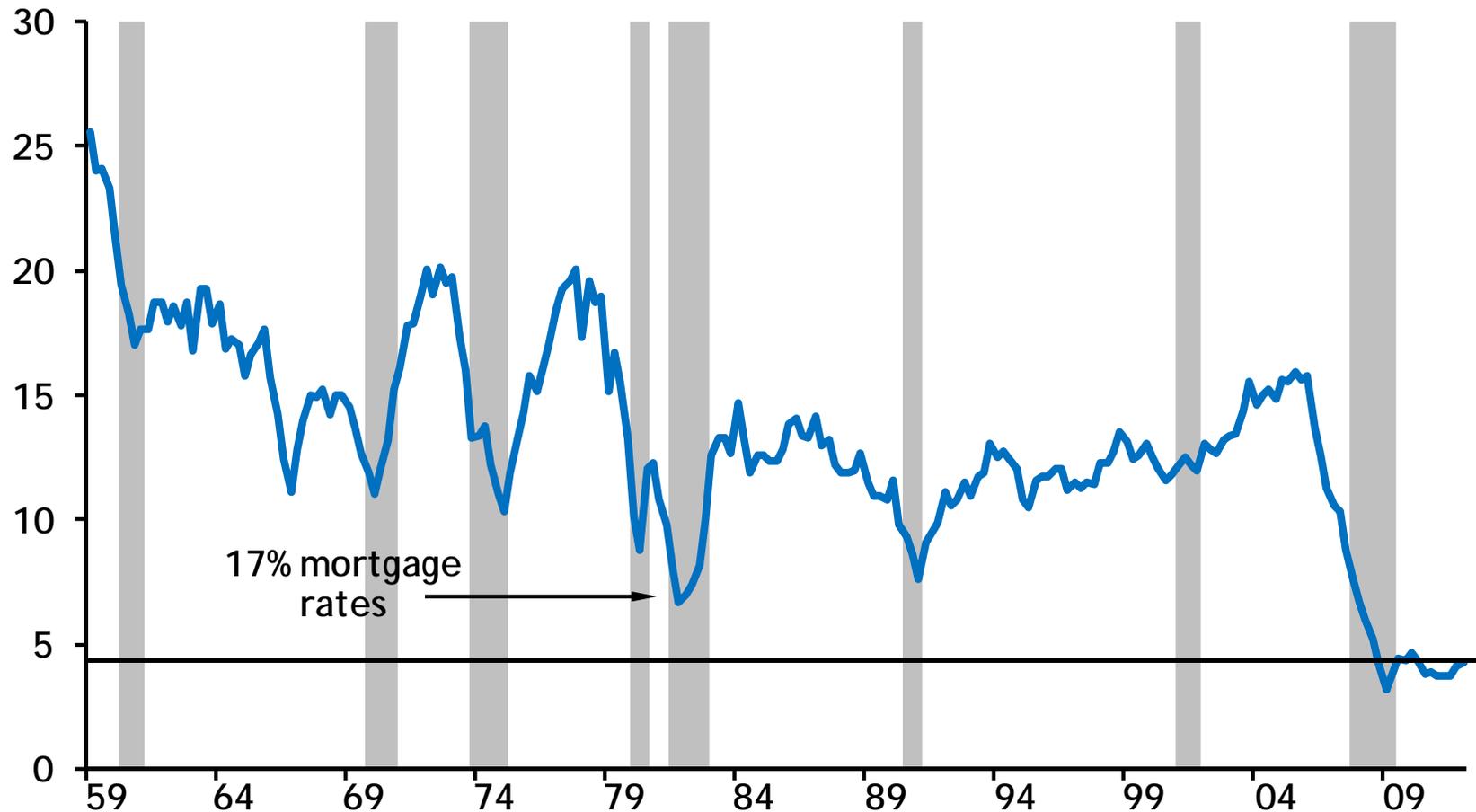
But there are recent pluses and minuses

Equity prices and gasoline futures price



The housing market is still severely depressed

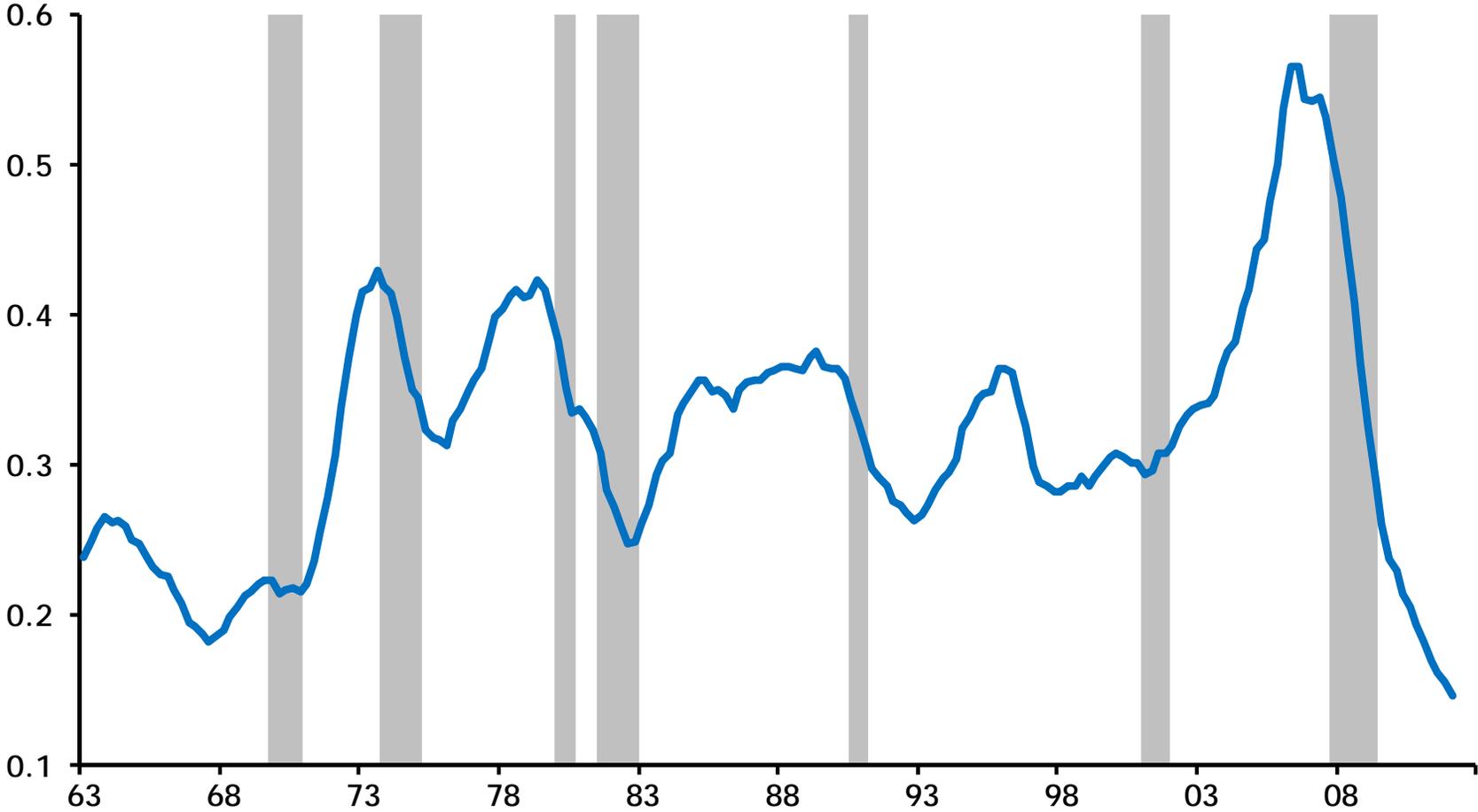
Single-family housing starts per 1000 households



Any bounce in sales would boost housing starts

Inventory of unsold new homes

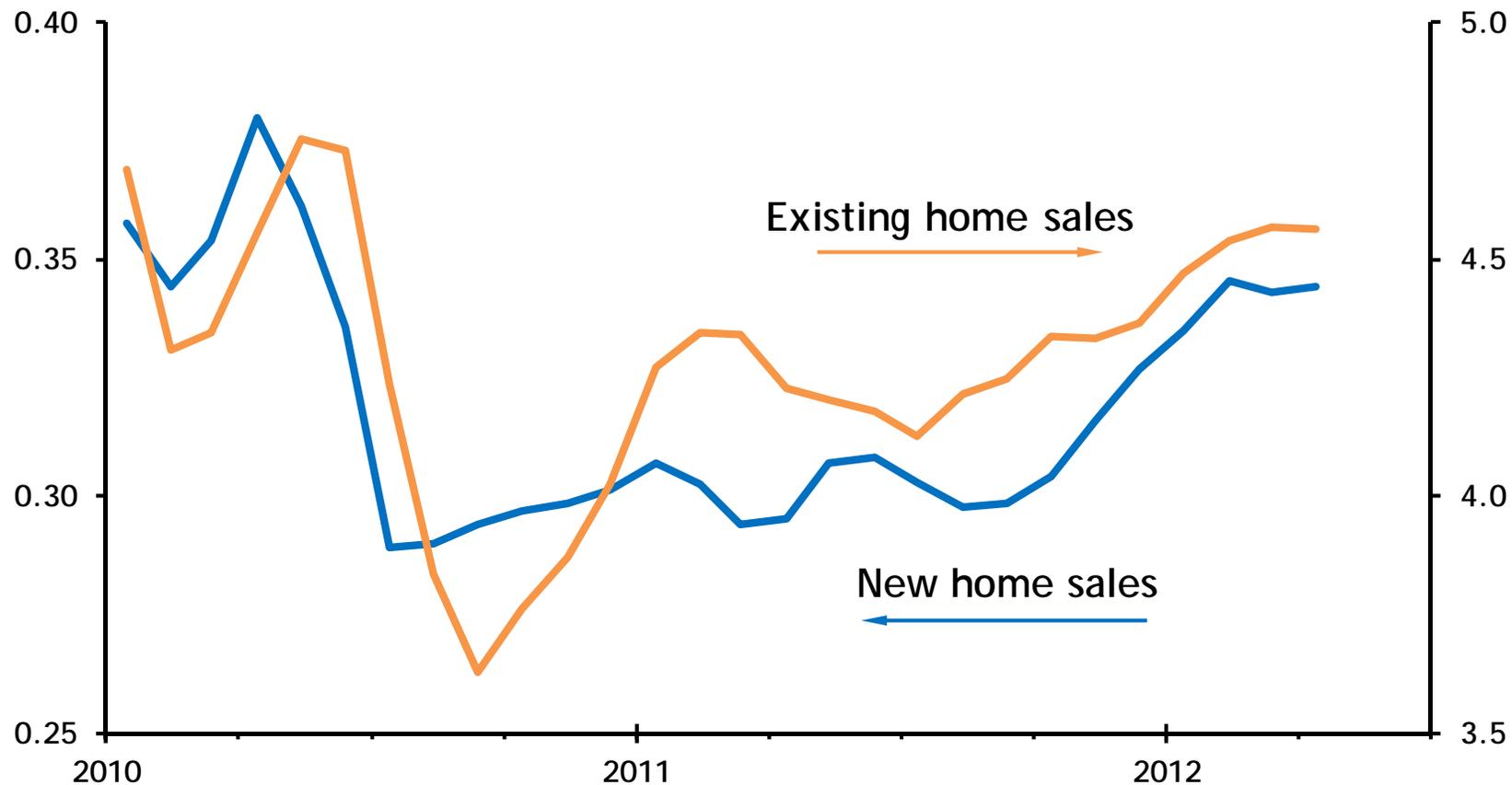
millions of units, saar, single-family



Home sales have finally started to lift a bit

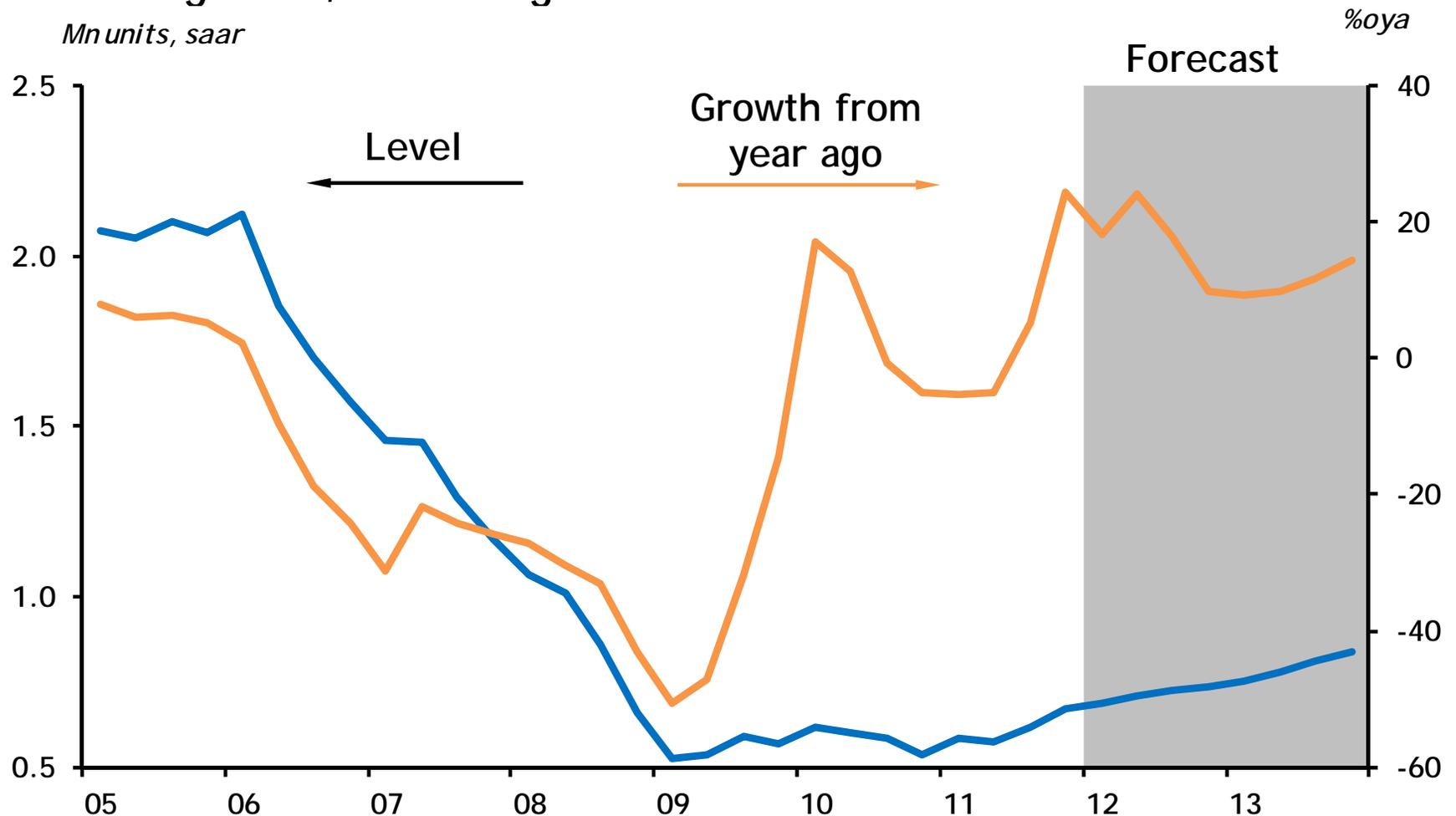
New and existing home sales

Mn units, saar, 3-mo mov avg, both scales



Homebuilding is coming up off the bottom ...

Housing starts, level and growth



... and housing is now adding to real GDP growth

Housing: direct contribution to real GDP growth

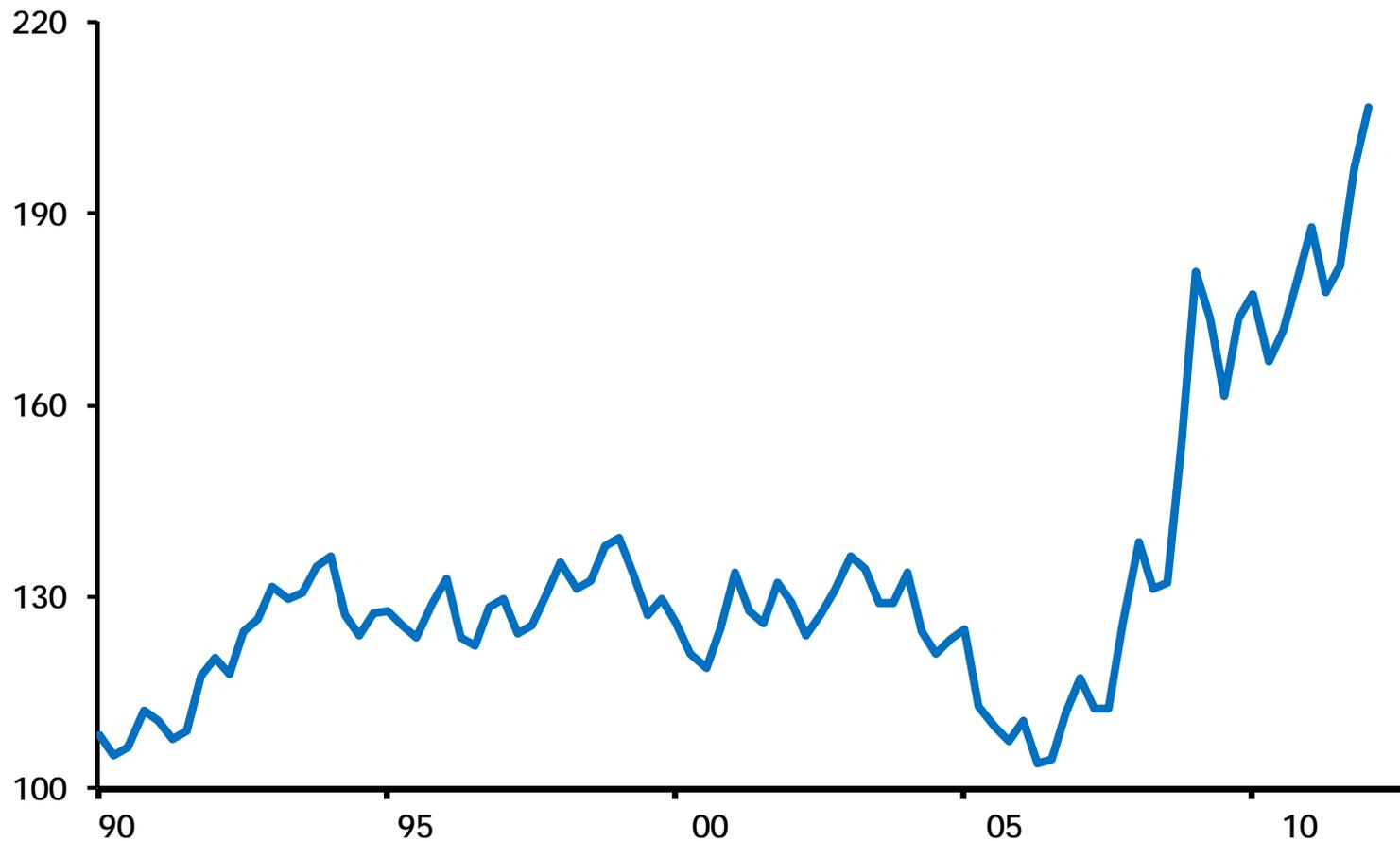
Pct pt contrib to annualized growth



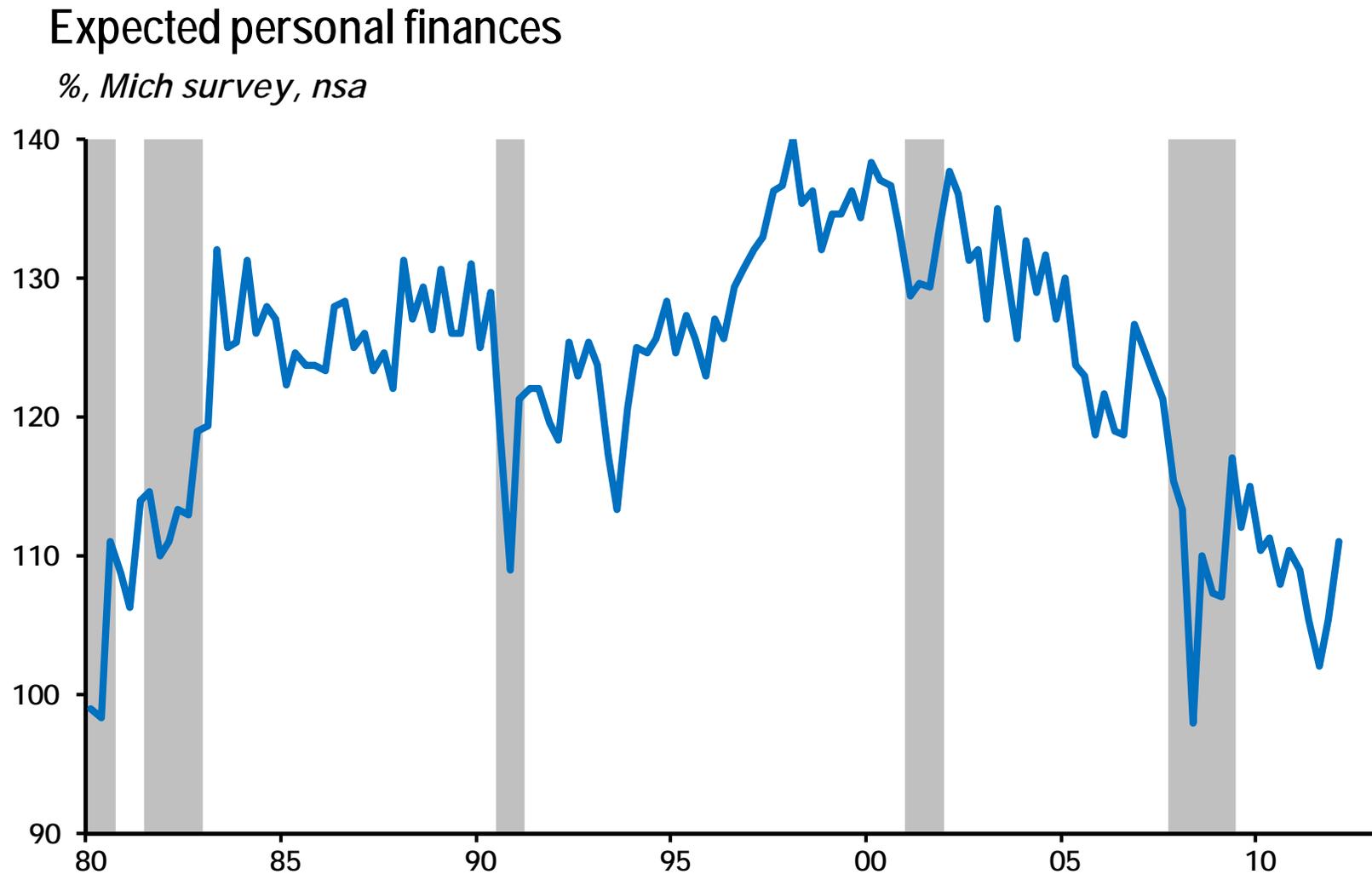
Housing has gotten very affordable,

Housing Affordability

NAR index, 100=qualify for mortgage, qtr avg



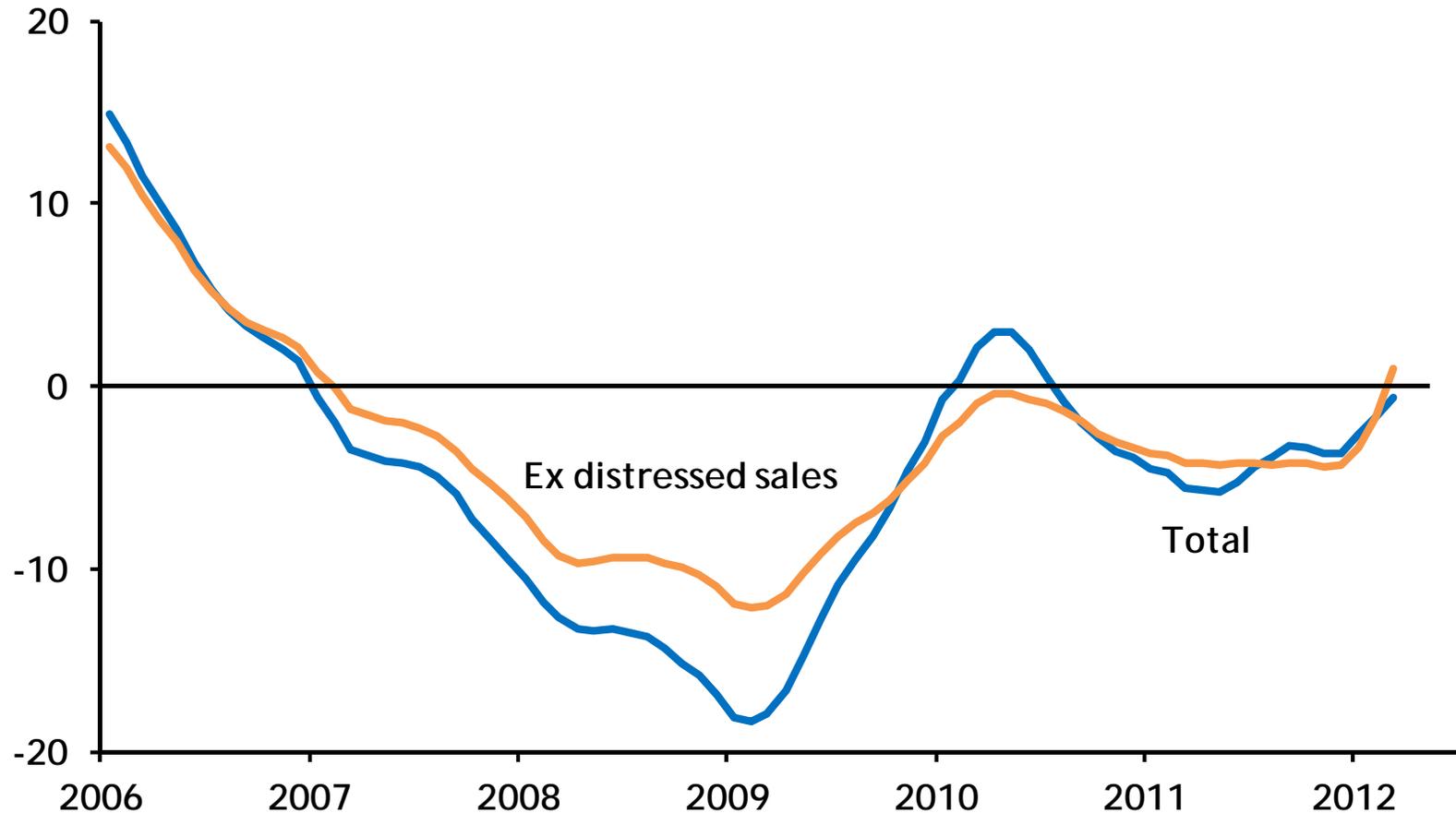
... but people are worried about the future
and mortgage credit is tight



There are tentative signs that house prices are stabilizing

CoreLogic measure of house prices

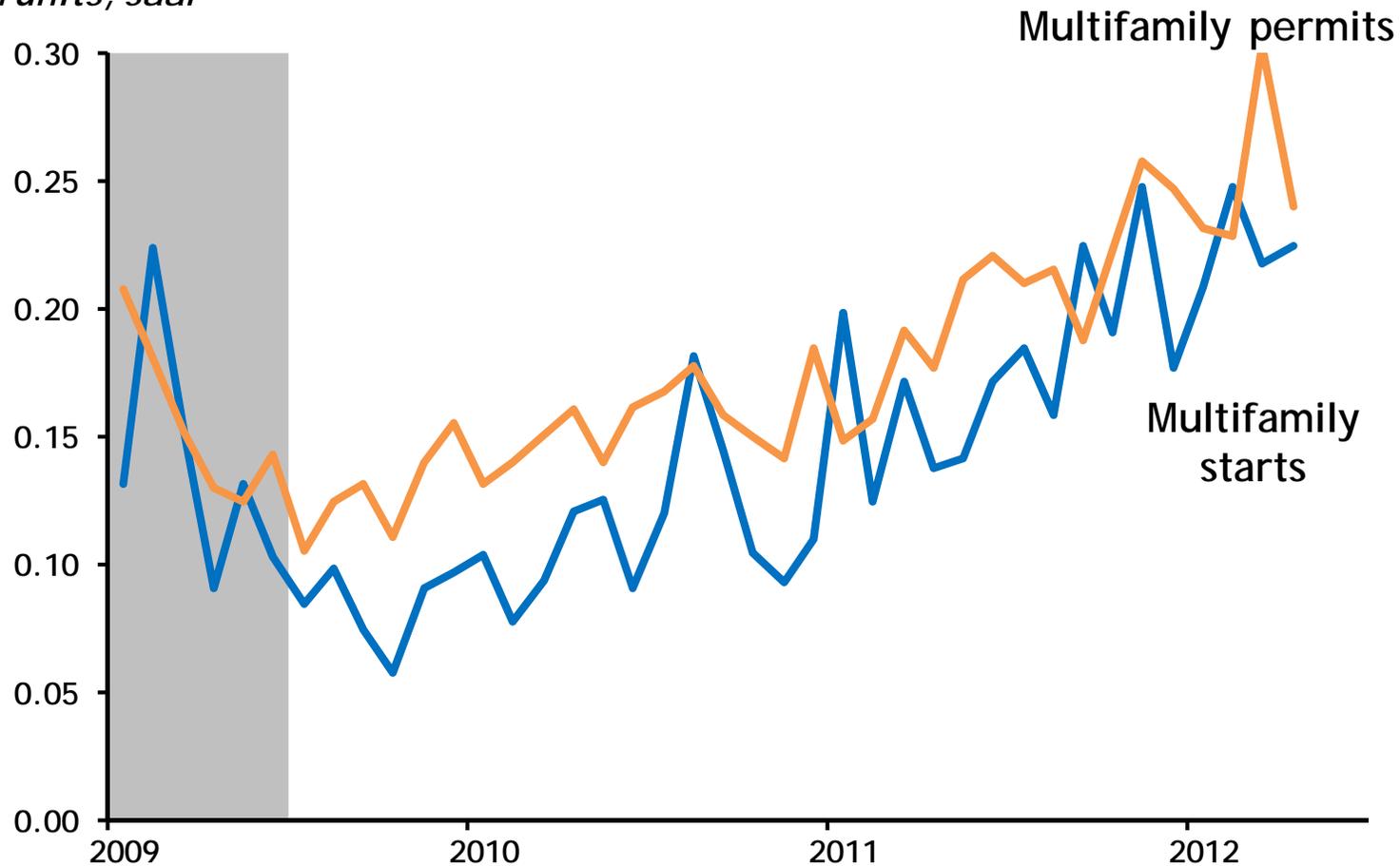
Percent change from year ago



The shift to renting is boosting multifamily construction from its lows

Multifamily housing activity

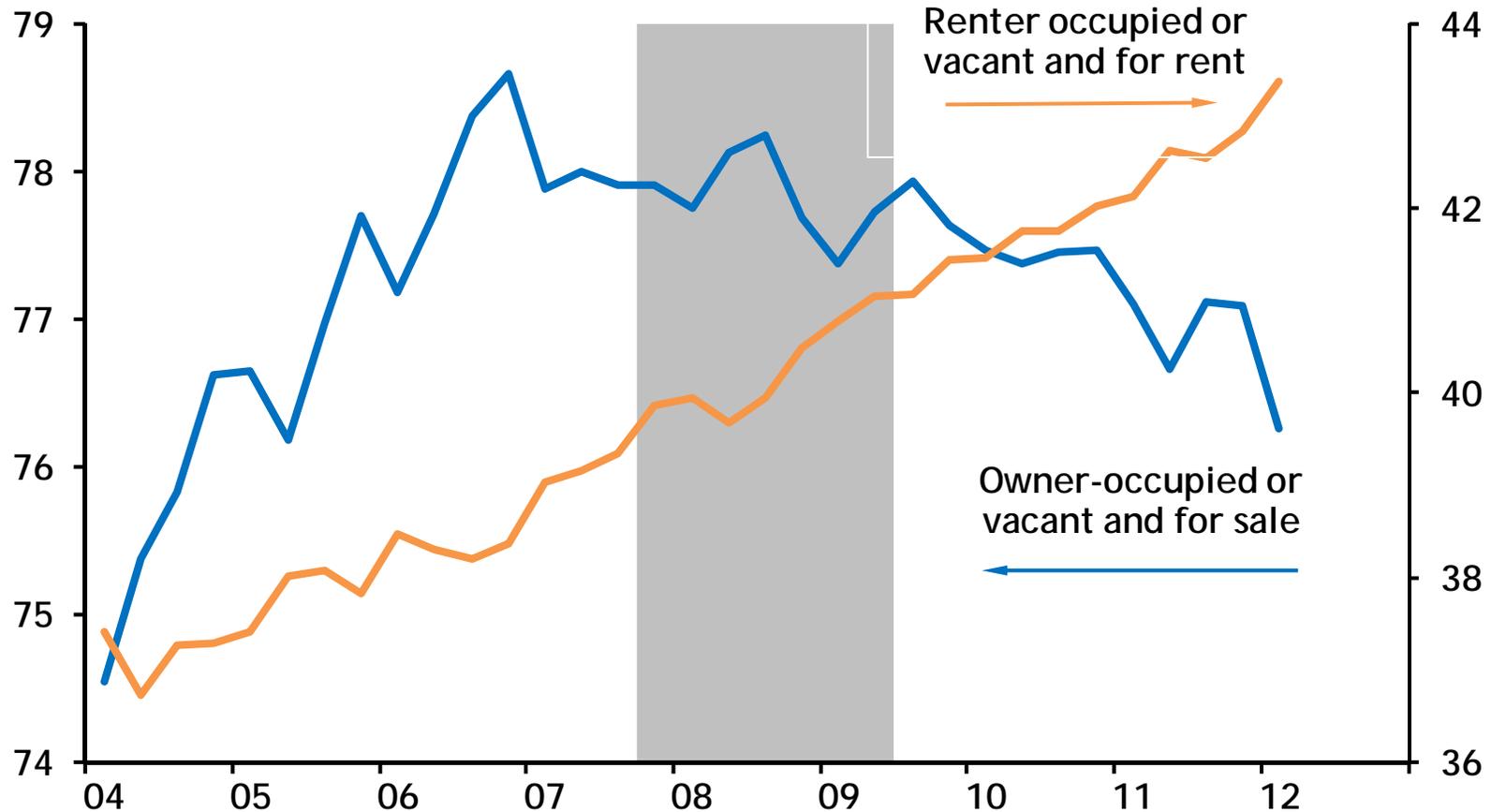
Mn units, saar



And a switch from Own-to-Rent is also bringing more rental supply

US housing stock: owner units and rental units

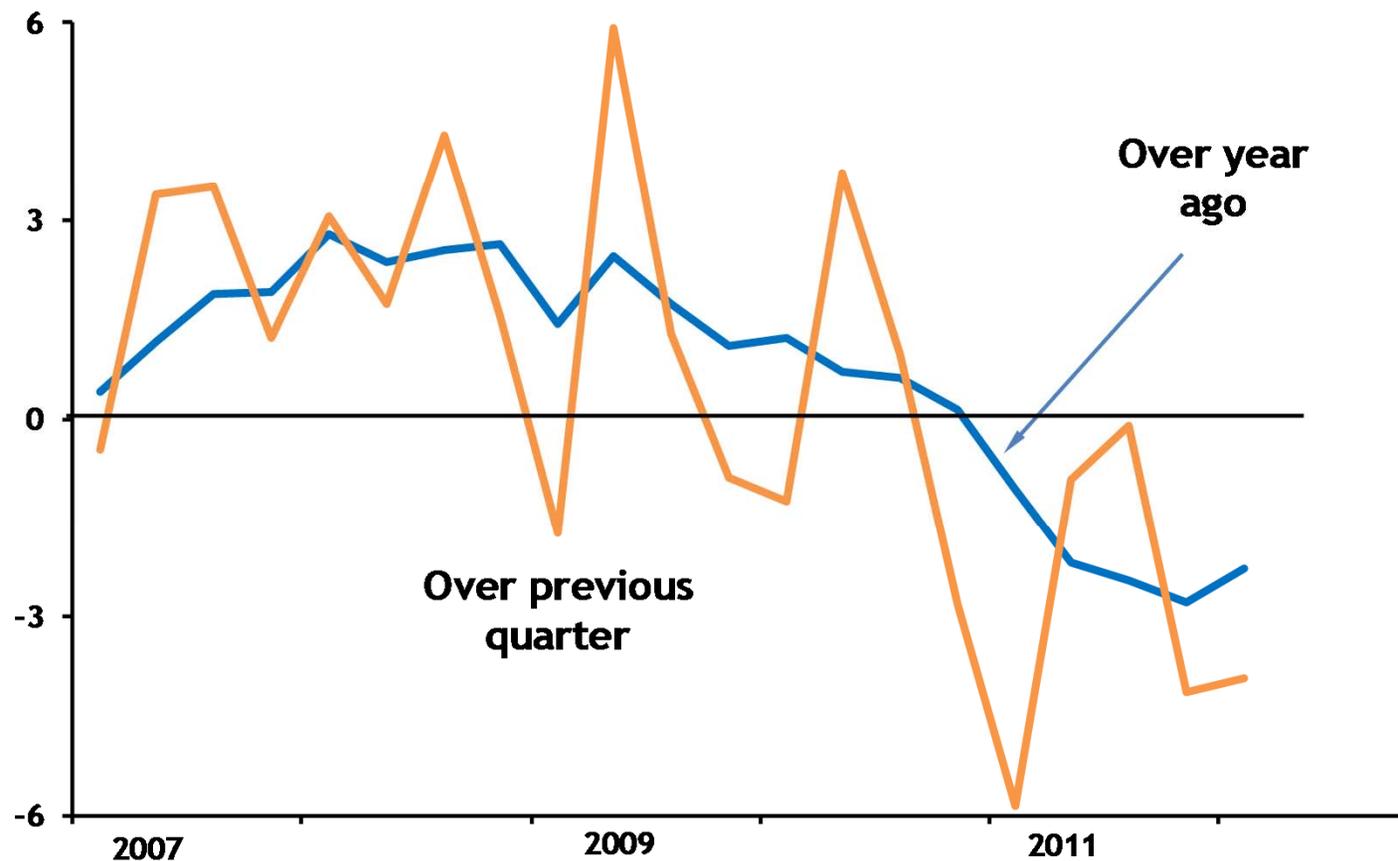
Mn units, nsa, both scales



Tighter fiscal policy has been a big drag on growth and job growth

Real government spending

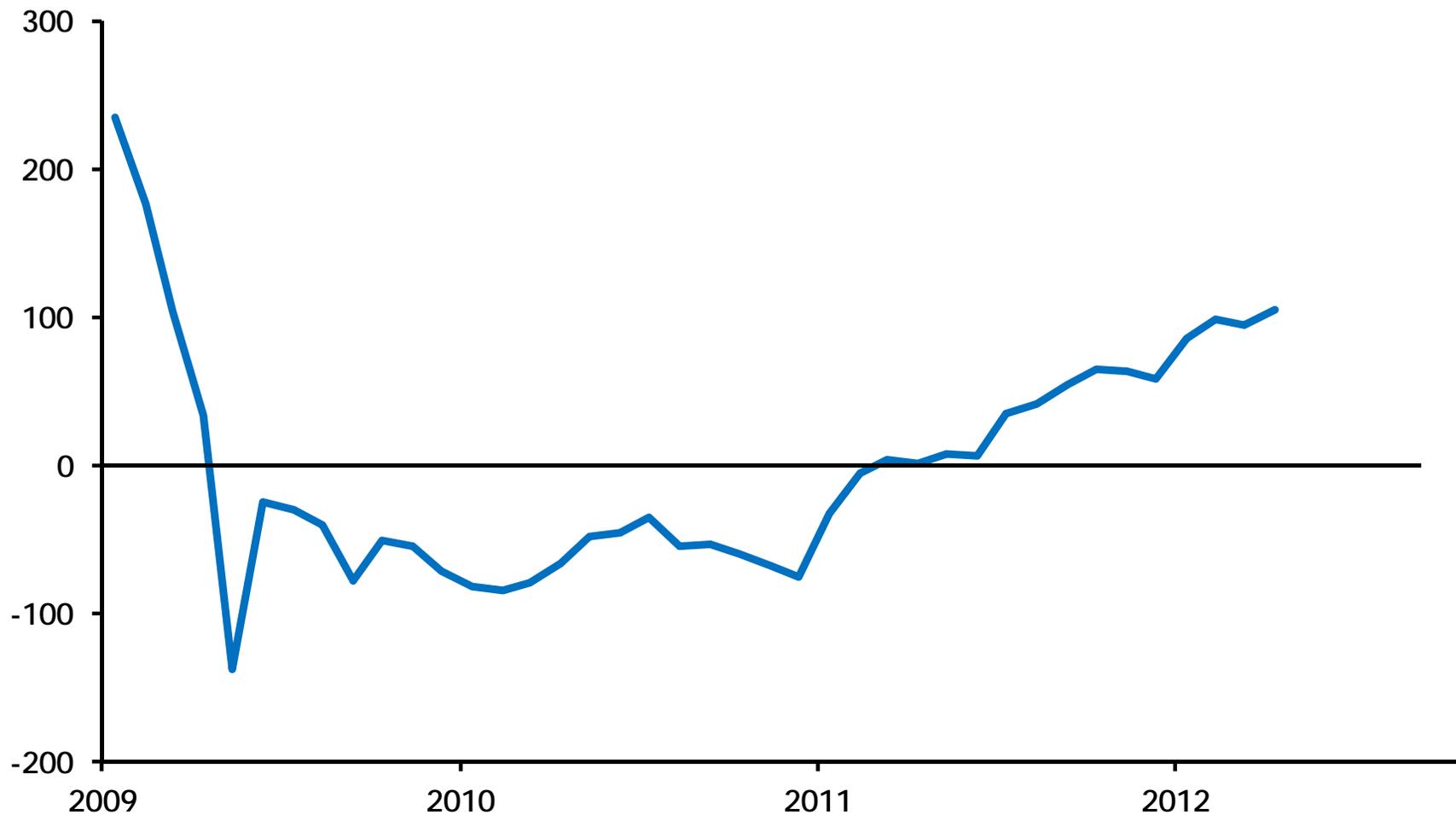
%ch saar



Unwinding of fiscal stimulus works through the tax and transfer mechanisms, too

Personal taxes less govt transfers

\$bn, saar; taxes include contrib to social insurance



The fiscal cliff: Current law calls for huge cutbacks in early 2013, and likely recession

The January fiscal cliff

Calendar year 2013	\$bn	% of GDP
Sunsetting of Bush tax cuts	\$309	2.0%
Expiration of payroll tax holiday	\$125	0.8%
Expiration of emergency unemployment benefits	\$40	0.3%
Budget Control Act spending cuts	\$98	0.6%
Total	\$572	3.7%

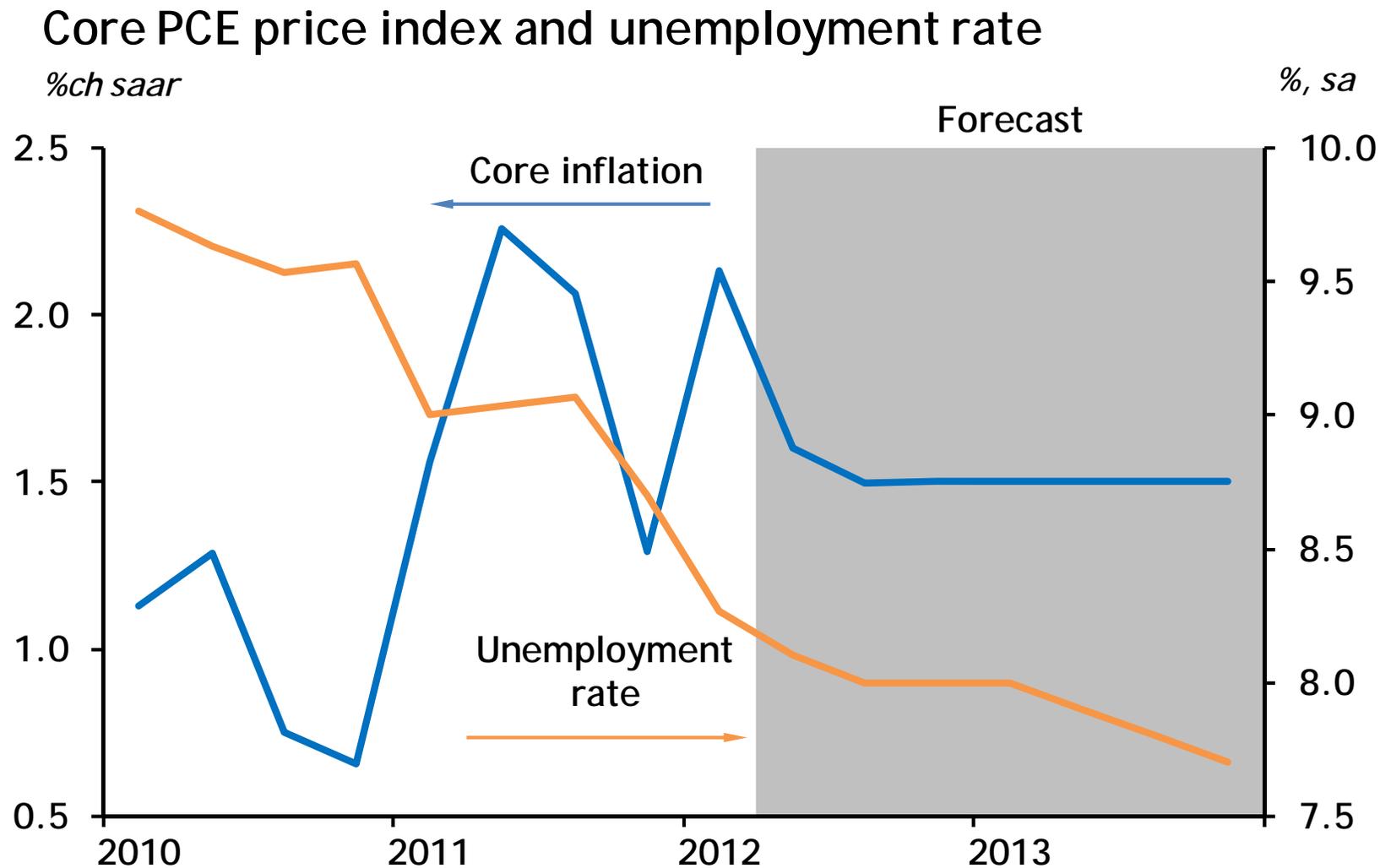
Forecast: a bit more fiscal restraint in 2013 than in 2012, whatever the election outcome

Deficit decomposition under JPM policy assumptions

FY, % of GDP	2009	2010	2011	2012f	2013f
Deficit	-10.2	-8.9	-8.6	-7.7	-6.1
Automatic stabilizers	-2.1	-2.3	-1.9	-1.7	-1.7
TARP	-1.1	0.8	0.2	-0.1	0.0
Structural deficit	-7.0	-7.4	-7.0	-5.8	-4.5
Fiscal thrust or drag	4.1	0.4	-0.4	-1.2	-1.4
Memo: fiscal thrust assuming all of fiscal cliff is realized	4.1	0.4	-0.4	-1.2	-3.3

Note: fiscal thrust is the negative of the change in the structural deficit, adjusted to remove TARP

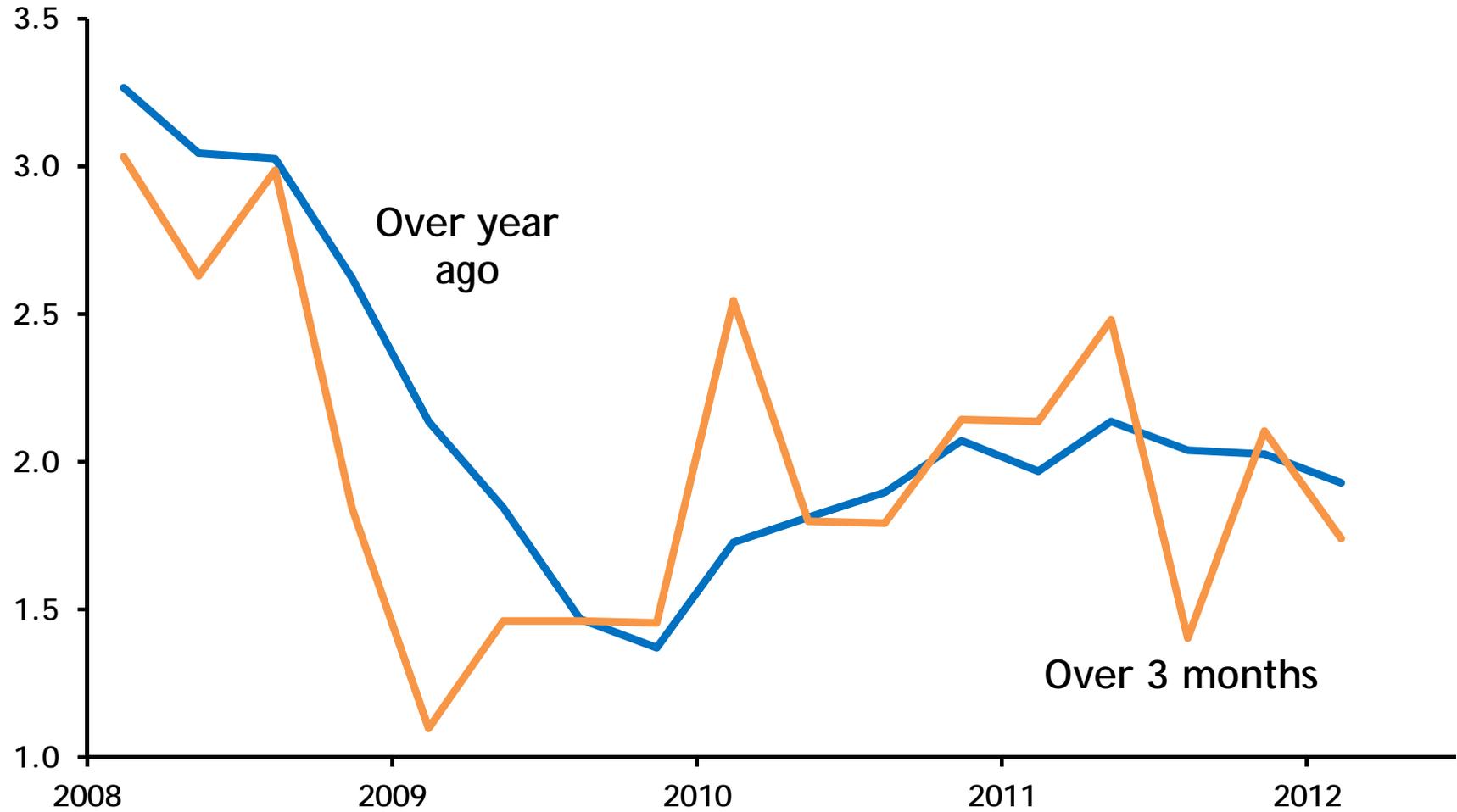
Baseline, the Fed stays on hold: 1.5% inflation with a declining unemployment rate



A key inflation influence looks well-anchored

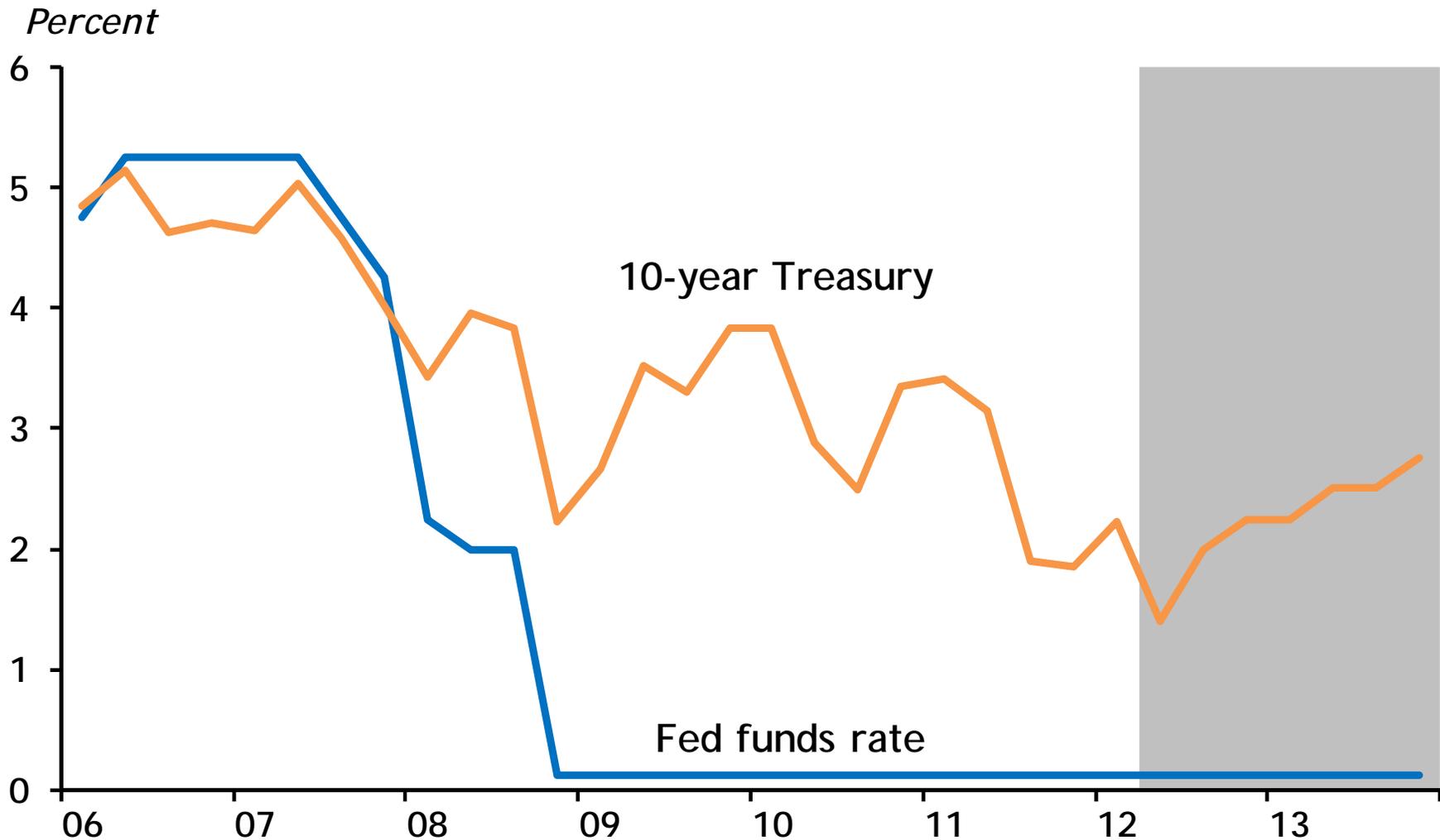
Employment cost index, labor cost per hour

%ch saar



The forecast looks for rates to rise
a little from current low levels

US benchmark interest rates



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