

Lower the floor or raise the ceiling? US fiscal and economic outlook

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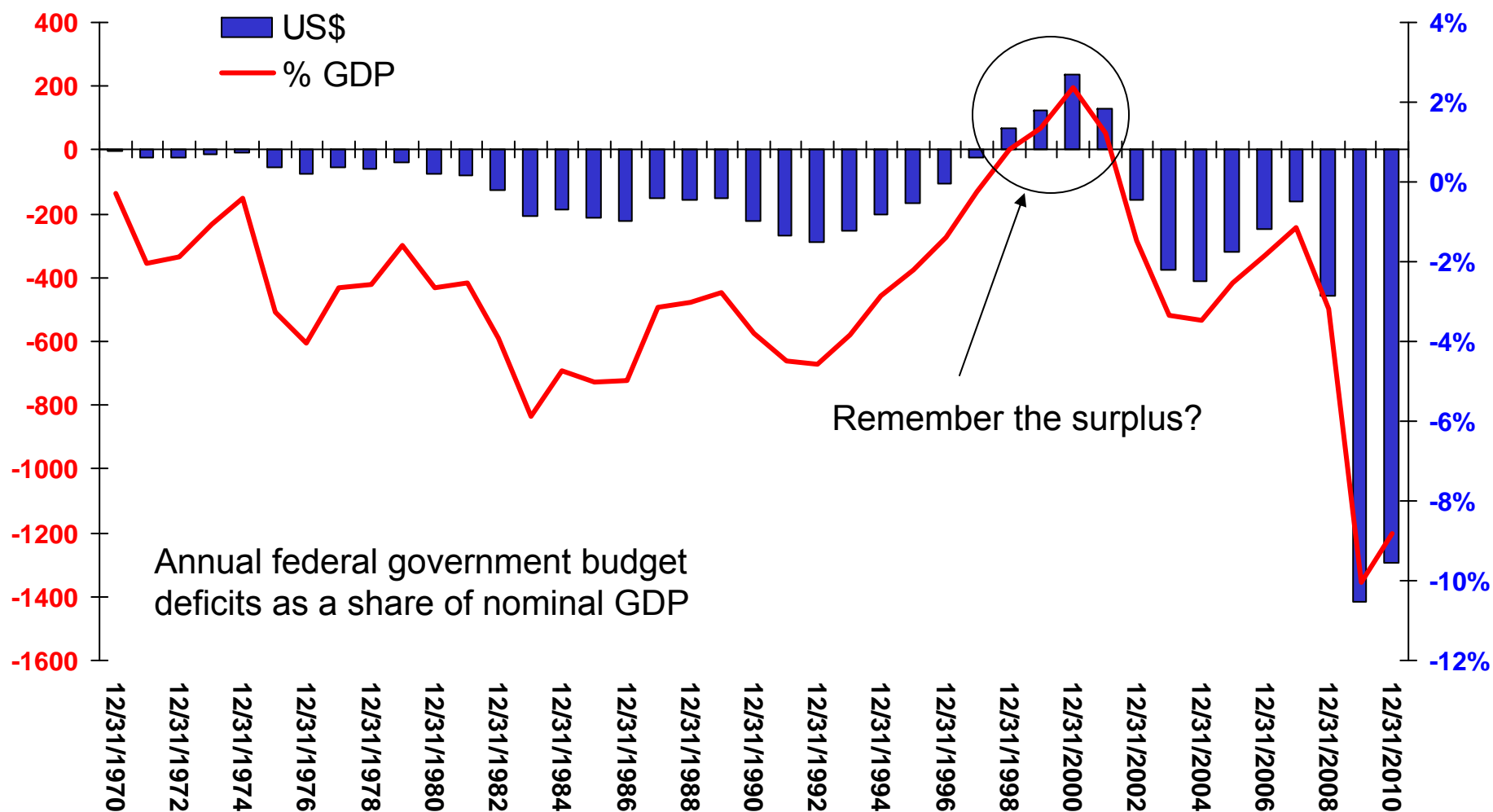
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Key points

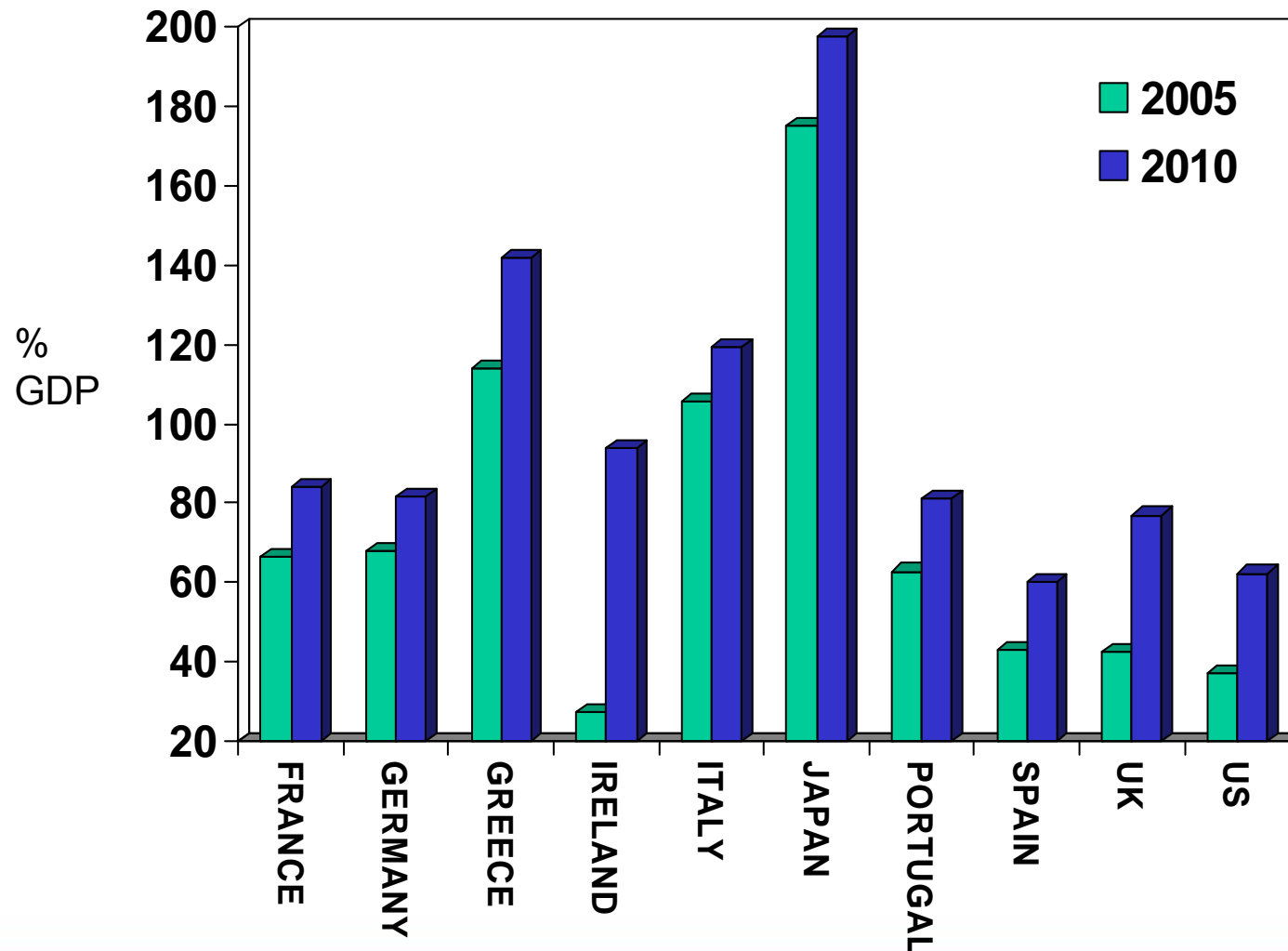
- A serious deficit-reduction debate is underway
 - Despite wide policy differences, this is encouraging and long overdue
- Agreement on some basic steps may happen soon
 - A serious, long-term deal won't happen until after the election
- A credible plan will require revenue increases
 - These won't come quickly or easily, but they are unavoidable
- The debt ceiling will be raised, amidst much drama
 - The US will not default on its debt
- The US economy is still recovering...
 - ... but higher energy and food prices are creating headwinds



Recession fallout: debt shifts from private to public sector



US public debt: Better than Europe, but not by much

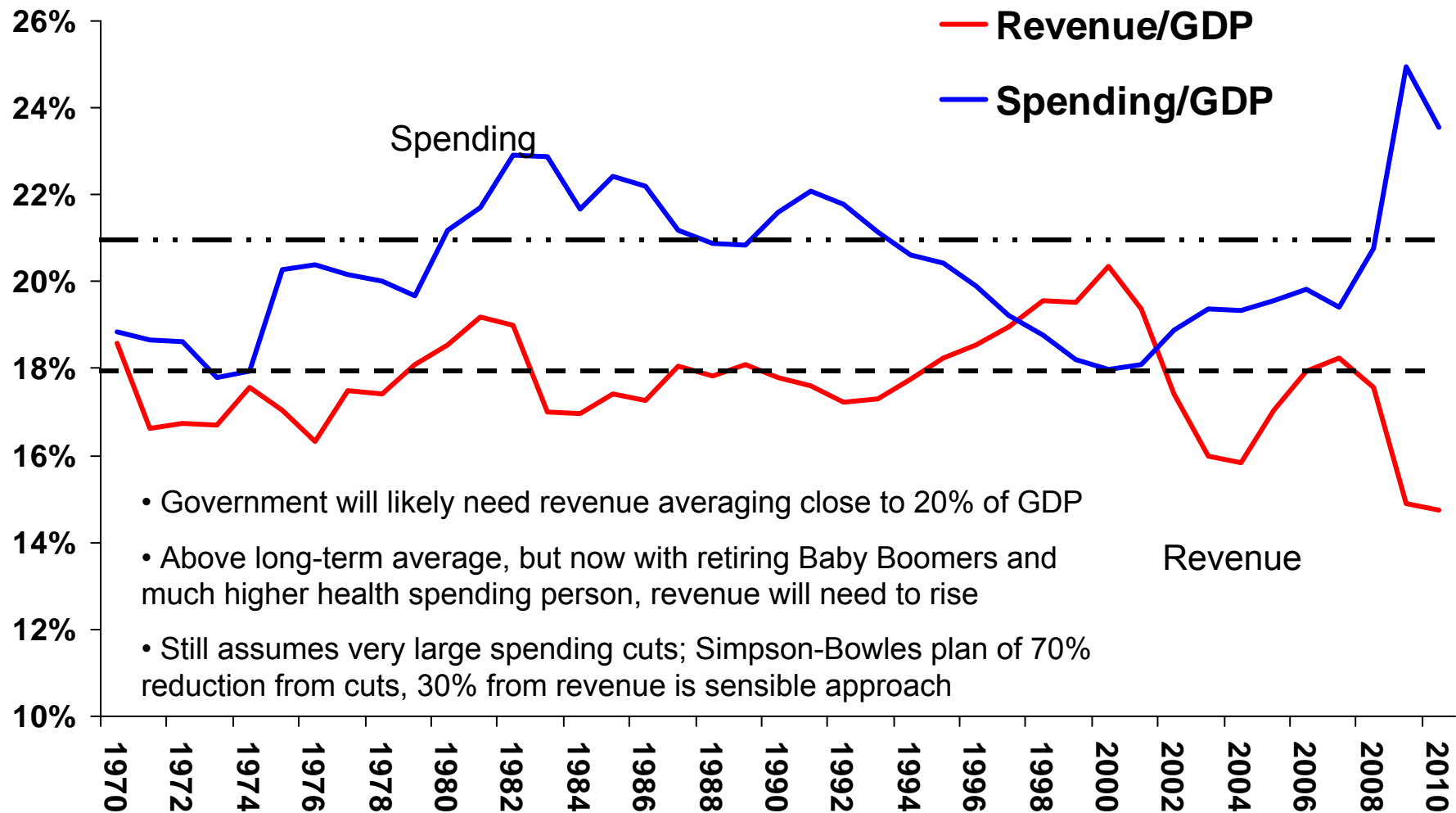


US public debt was 62% of GDP in 2010, up from 37% five years earlier

Debt over 60% of GDP can be a source of concern

One reason why S&P downgraded its outlook for US debt

Serious deficit reduction will require at least some new revenue



Playing with fire: The debt ceiling as political football

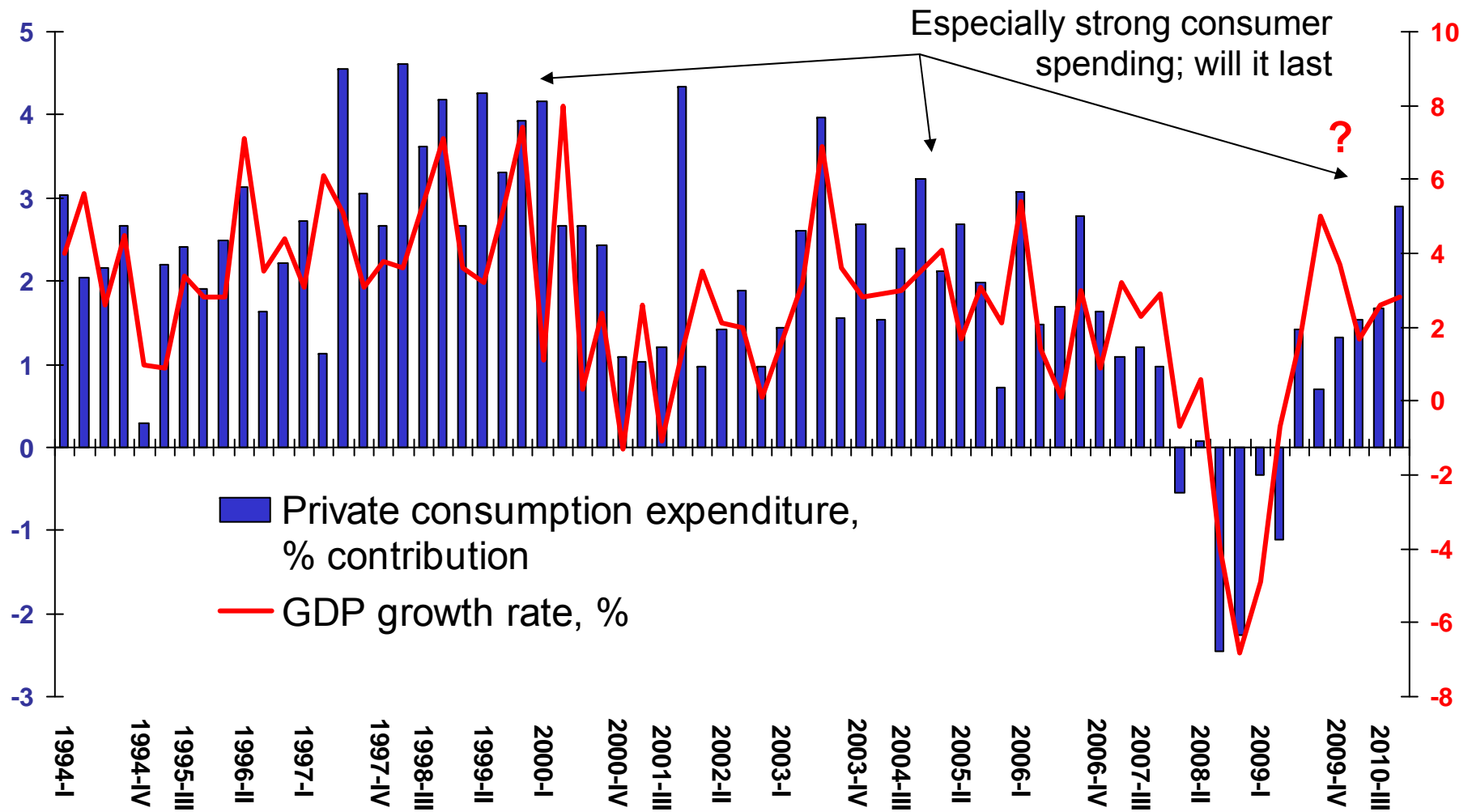
- Republicans will insist on budget cuts before raising debt ceiling
 - Obama is insisting on a “clean” bill, but that will change
 - As with the current-year budget deal, compromises will be made
 - No alternative: the government CAN'T and WON'T default on its debt
 - Consequences would be catastrophic
 - Interest rates would soar; dollar would crash
 - Liquidity would dry up; banks stop lending
 - Far worse than the 2008-09 financial crisis
 - Global economy would enter a recession



- Lawmakers only gradually learning that this is nothing like a government shutdown
 - Brinksmanship not a wise course at such a delicate time for the global economy; markets are easily frightened

US economic outlook

US economy has been on a more sustainable footing



Source: US Bureau of Economic Analysis

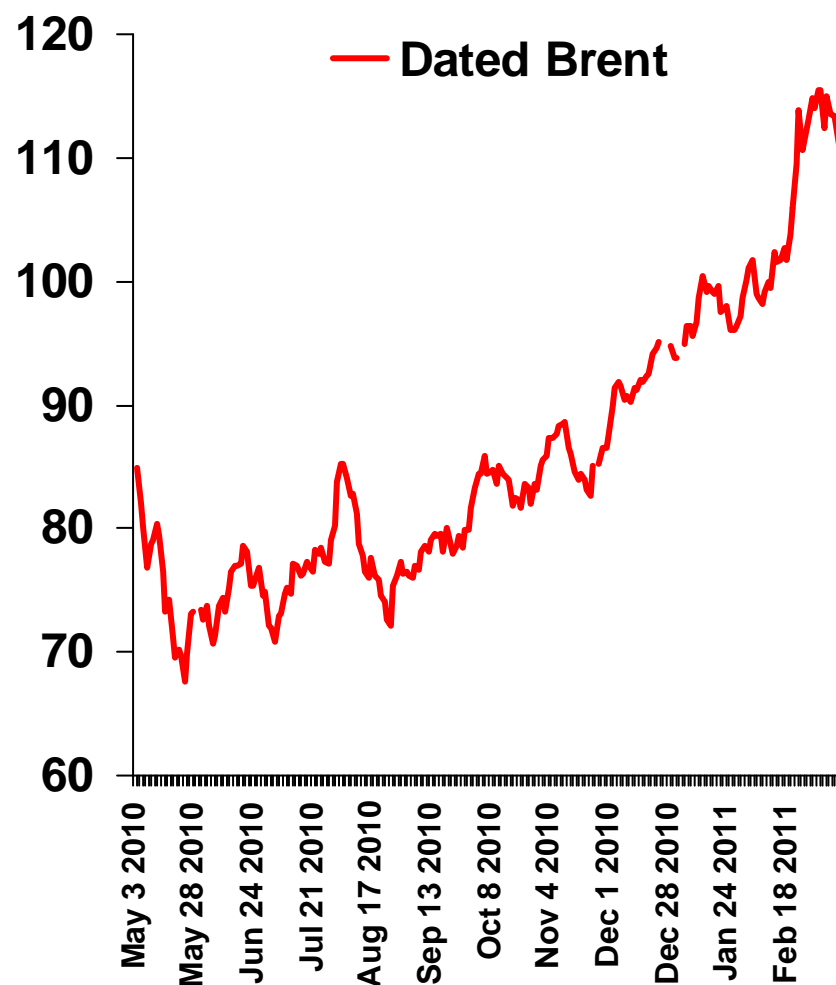
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Oil and food prices have been shocks to the economy

- Consumer sentiment, spending softened in the first quarter
 - Gasoline prices approaching \$4/gallon nationally; already there in many places
- We raised our average 2011 oil price to US\$101/barrel
 - Up around \$US10/b since the start of the year
- 10% increase in the oil price, if sustained for a year, cuts growth by 0.2 percentage points
- We expect oil price to fall later in the year, easing the pressure on consumers



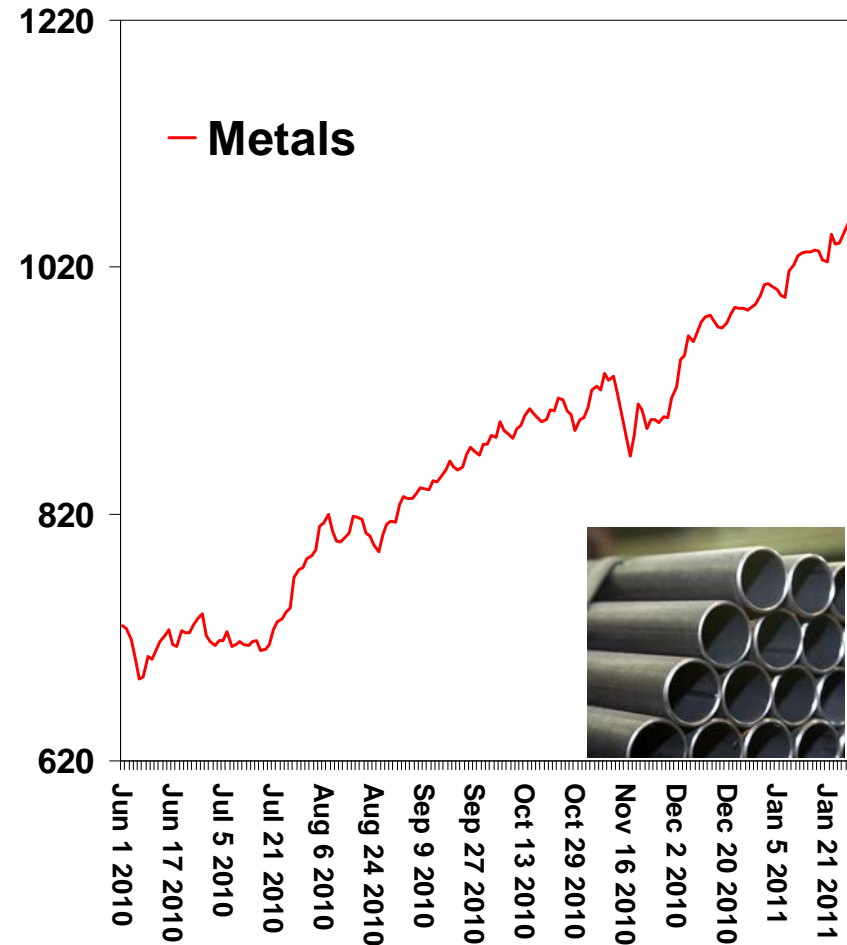
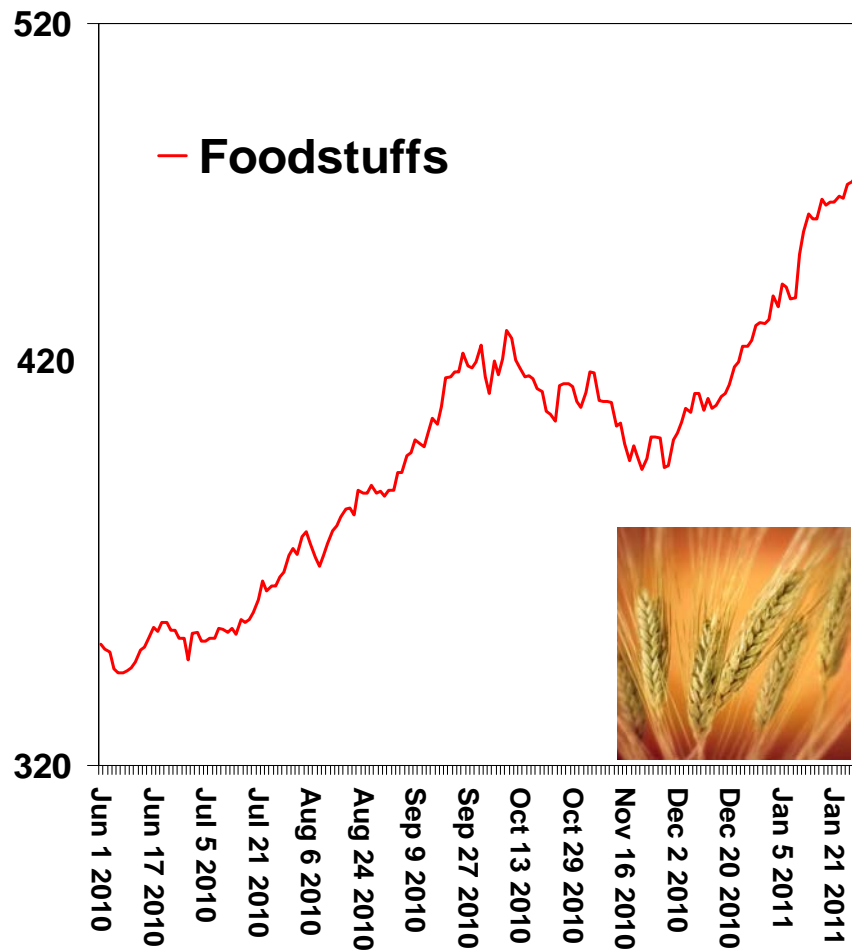
US\$ per barrel

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Commodity prices are helping to drive inflation...



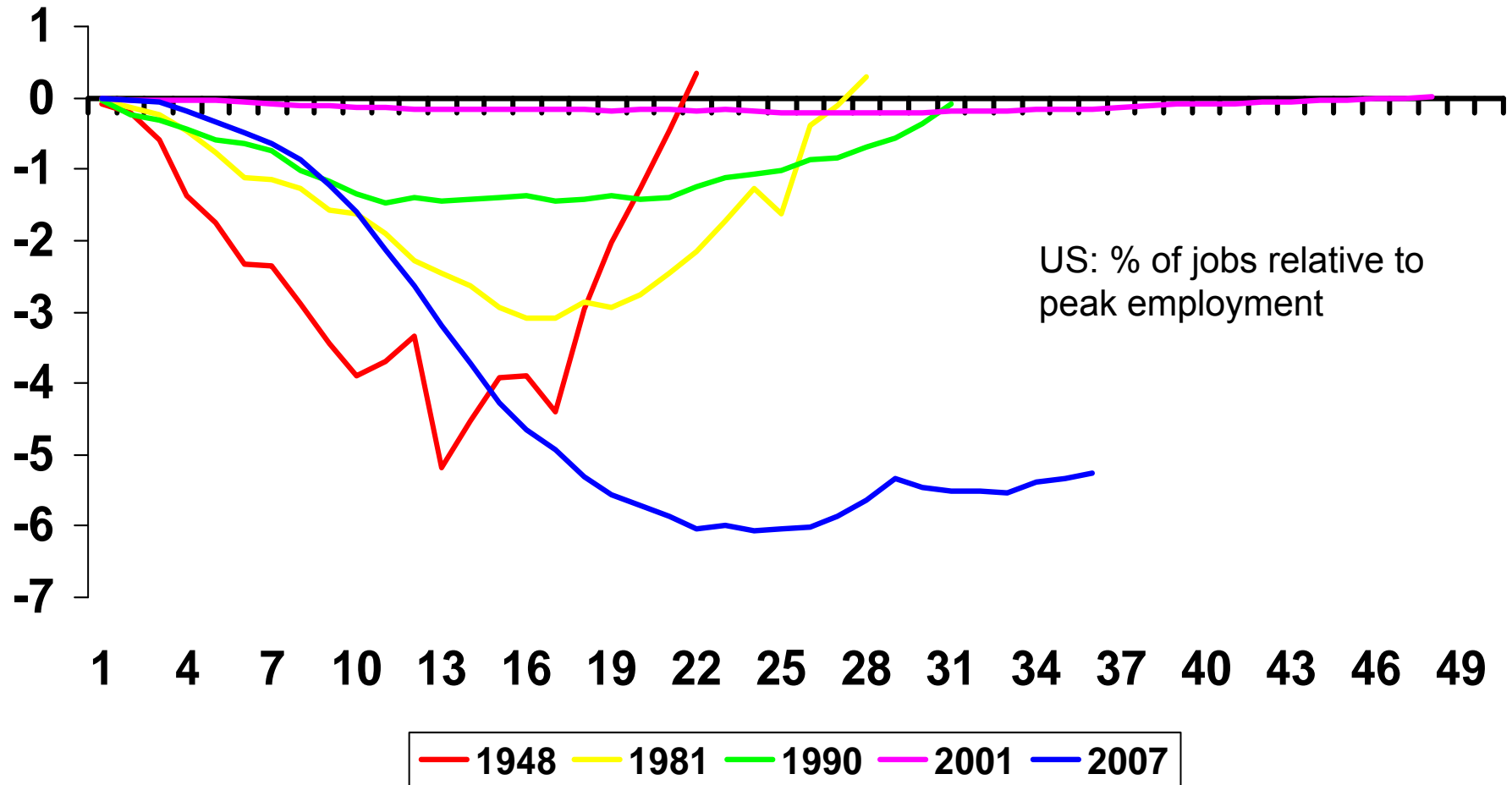
Commodity Research Bureau; Indices, 1967=100. Source: Haver

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Better job creation, but a very slow recovery



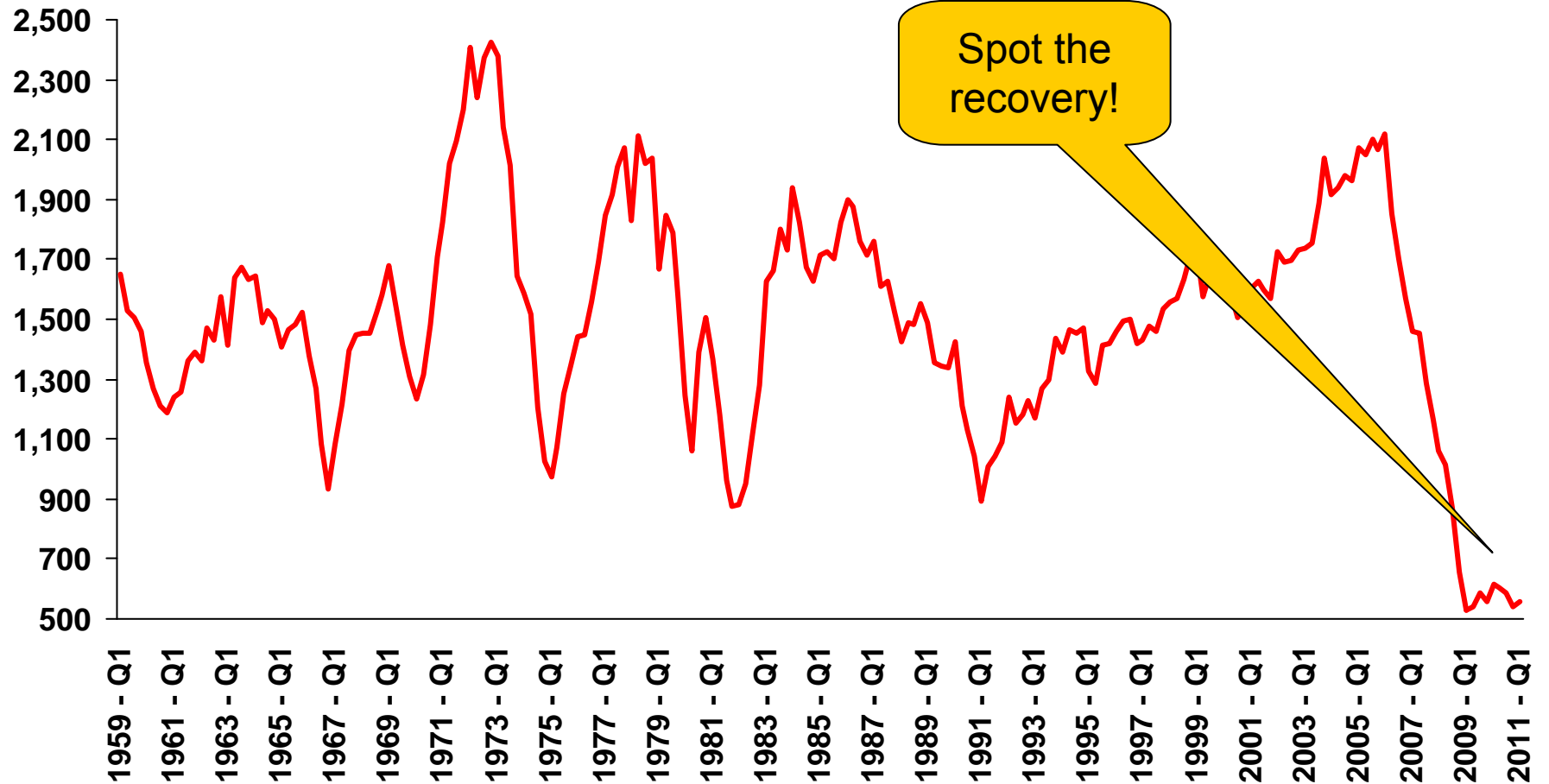
Months from peak employment. Sources: Bureau of Labour Statistics; EIU.

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US housing? Don't ask



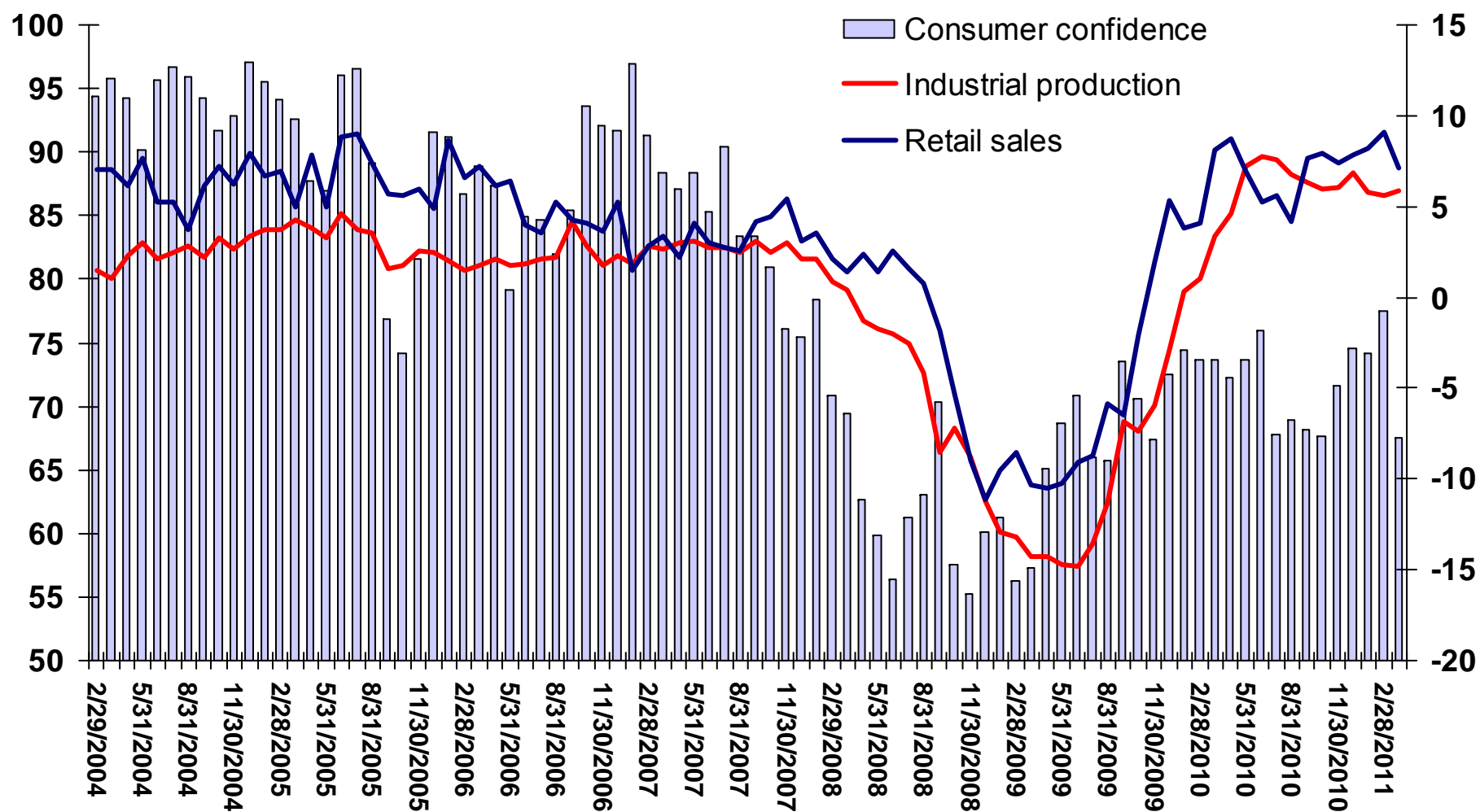
US housing starts, '000s, SAAR.
Source: Bureau of the Census

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Despite the tentative recovery, the economy is finding its footing



Retail sales, IP, % change YoY

Source: Federal Reserve, Commerce Dept

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