The Economic & Geopolitical Outlook: What Are the Risks and Opportunities Ahead?

Bernard Baumohl
Chief Global Economist
www.EconomicOutlookGroup.com
We are at a “Pivotal Moment” in US Economic History!

The economy is well into its 11th straight year of growth, the longest stretch ever!

The fundamentals still look very good:

• Unemployment rate (3.7%). Tightest labor market in 50 years!
• Wages have been edging higher and consumers are spending.
• Inflation remains dormant!
• Borrowing costs are among the lowest ever seen.
• There’s ample capital looking for investments.
• Technological innovations continue to transform the fabric of our economy and society.

But worries of recession are becoming more prevalent.
Is this business cycle about to peak?
Three most common causes of past recessions

1. **High “real” interest rates.** It shuts down borrowing and spending; delinquencies surge.
   

2. **A major geopolitical eruption** that causes oil prices to spike. Sharply higher energy costs can bring economic activity to a screeching halt.
   

   
What could puncture this economy?

- A trade war with China that spirals out of control. The world economy is in danger of shutting down as global exports shrinks and countries devalue currencies.

- Federal Reserve can not bail out this economy with lower rates! Monetary policy is being held hostage to political events. Nor is there room for more fiscal stimulus, given $1 trillion deficits.

- Geopolitical threats are flashing “RED.” (Iran, North Korea, South China Sea, Hong Kong, Venezuela, India/Pakistan, Brexit)

- Threat of extreme political warfare as the 2020 presidential campaign ramps up. A highly polarized political climate may depress consumer and business spending.
Main Forecast for U.S. GDP growth


Sources: BEA, Office of Management & Budget; Federal Reserve, The Economic Outlook Group.
Alternate Forecast for U.S. GDP growth

Scenario 2: The trade war continues to escalate in 2020. No deal seen before presidential election.

Prob: 30%

Recession risk in 2020: 35%
**Alternate Forecast for U.S. GDP growth**

**Scenario 3:** US and China reach a comprehensive trade deal mid-2020. World economy rebounds.

<table>
<thead>
<tr>
<th>Year</th>
<th>Real growth by year (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>-2.8</td>
</tr>
<tr>
<td>2009</td>
<td>-0.3</td>
</tr>
<tr>
<td>2010</td>
<td>2.5</td>
</tr>
<tr>
<td>2011</td>
<td>1.6</td>
</tr>
<tr>
<td>2012</td>
<td>2.2</td>
</tr>
<tr>
<td>2013</td>
<td>1.7</td>
</tr>
<tr>
<td>2014</td>
<td>2.6</td>
</tr>
<tr>
<td>2015</td>
<td>2.9</td>
</tr>
<tr>
<td>2016</td>
<td>1.5</td>
</tr>
<tr>
<td>2017</td>
<td>2.3</td>
</tr>
<tr>
<td>2018</td>
<td>2.9</td>
</tr>
<tr>
<td>2019</td>
<td>2.3</td>
</tr>
<tr>
<td>2020</td>
<td>2.5</td>
</tr>
<tr>
<td>2021</td>
<td>3.1</td>
</tr>
</tbody>
</table>

*Source: The Economic Outlook Group,*

Prob: 15%
It all comes down to the consumer: Spending will increase but at a moderate pace.

Factors that **support** household spending 2019 and 2020:

1. Robust job market.
2. Rising wages + minimal inflation = boosts purchasing power.
3. Surge in mortgage refinancing has increased spendable income.
4. Relatively low gasoline prices leaves more cash in consumer pockets.
5. Consumer confidence on the economic outlook still firm, if wobbly.
6. eCommerce + digital payments + faster deliveries = encourages impulse buying.

Factors that will **suppress** growth in spending:

1. After 10 yrs. of shopping, consumer demand naturally wanes.
2. Household debt now at a record $13.8 trillion. Delinquencies inching higher.
3. Demographic changes will alter the composition of spending.
Unemployment at historic lows; Yet job openings still greatly exceed those unemployed!

**Overall UNEMPLOYMENT RATE:** 3.7% – August 2019

- Less than a high school degree (5.4%)
- High School graduates (3.6%)
- Some College or Associate Degree (3.1%)
- Graduates with Bachelor’s Degree & Higher (2.1%)

**Job openings:** Total Nonfarm

- Number of unemployed

**August unemployed:** 6.0 million

**July Job openings:** 7.2 million

Source: Bureau of Labor Statistics

The Economic Outlook Group
Historic tug-of-war over inflation:
eCommerce is the greatest deflationary force in modern economic history

Factors depressing inflation
- eCommerce
- Globalization
- Stronger dollar
- Improved productivity
- Changing demographics
- Low interest rates
- Moderate energy prices
- Decline in union membership

Factors pushing inflation higher
- Rising wages
- Tariffs
- Firms testing pricing power

Fed’s target is 2.0%
Inflation 1.6%
(core PCE price index July YOY)
Companies are scaling back investments. Hard to deploy capital when there are so many economic and geopolitical uncertainties.

-- Evidence mounts of recession in manufacturing. Is a full-blown economic recession next?
-- Trade tensions slash global trade and cause havoc with international supply chains.
-- Corporate profits are under pressure due to rising labor costs, tariffs and limited pricing power.
-- Passage of the USMCA stalled in Congress. US election politics may jeopardize US ratification.
-- How will the outcome of 2020 presidential election impact trade, tax and spending policies?
Above "50" indicates new orders are expanding
Below "50" indicates new orders are contracting

Source: Institute for Supply Management
New home construction to remain listless next 18 months. Will rebound in 2021 with an improving economy and greater demand.

Total housing starts and permits: Annual total, in thousands

<table>
<thead>
<tr>
<th>Year</th>
<th>Housing Starts: % Growth</th>
<th>Housing Permits: % Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>900 (1.2 Mill)</td>
<td>1000 (1.2 Mill)</td>
</tr>
<tr>
<td>2009</td>
<td>780 (1.1 Mill)</td>
<td>860 (1.1 Mill)</td>
</tr>
<tr>
<td>2010</td>
<td>650 (1.0 Mill)</td>
<td>710 (1.0 Mill)</td>
</tr>
<tr>
<td>2011</td>
<td>570 (0.9 Mill)</td>
<td>620 (0.9 Mill)</td>
</tr>
<tr>
<td>2012</td>
<td>510 (0.8 Mill)</td>
<td>550 (0.8 Mill)</td>
</tr>
<tr>
<td>2013</td>
<td>460 (0.7 Mill)</td>
<td>490 (0.7 Mill)</td>
</tr>
<tr>
<td>2014</td>
<td>420 (0.6 Mill)</td>
<td>450 (0.6 Mill)</td>
</tr>
<tr>
<td>2015</td>
<td>390 (0.5 Mill)</td>
<td>410 (0.5 Mill)</td>
</tr>
<tr>
<td>2016</td>
<td>360 (0.4 Mill)</td>
<td>380 (0.4 Mill)</td>
</tr>
<tr>
<td>2017</td>
<td>340 (0.3 Mill)</td>
<td>350 (0.3 Mill)</td>
</tr>
<tr>
<td>2018</td>
<td>320 (0.2 Mill)</td>
<td>330 (0.2 Mill)</td>
</tr>
<tr>
<td>2019</td>
<td>300 (0.1 Mill)</td>
<td>310 (0.1 Mill)</td>
</tr>
<tr>
<td>2020</td>
<td>300 (0.1 Mill)</td>
<td>310 (0.1 Mill)</td>
</tr>
<tr>
<td>2021</td>
<td>300 (0.1 Mill)</td>
<td>310 (0.1 Mill)</td>
</tr>
</tbody>
</table>

Sources: The Department of Commerce, The Economic Outlook Group
Decrepit infrastructure holds back economic growth:

But money and politics often gets in the way of much-needed repairs.

EXAMPLES:

- Philadelphia still relies on underground pipes installed *before* the Civil War.
- 84,000 bridges considered functionally obsolete.
- 58,000 bridges deemed “structurally deficient,” yet still carry 180 million cars a day!

- There are more than 650 water main breaks a day on average in the US; 240,000 a year.
- Leakages and spills waste an average of **5.8 billion gallons of water each day!**

Sources: American Society of Civil Engineers, American Water Works Association, Center for Neighborhood Technology
US - China trade war: A game theory gone wrong!

Trump and Xi have blundered into a minefield of tariffs, retaliation and other provocations. Both feel pressure to demonstrate toughness to their constituents.

US goals:
1. Slash the US trade deficit with China
2. Get China to codify a new trading relationship with the US.
   • Protect US intellectual property.
   • End forced joint ventures & transfer of proprietary technology.
   • Stop exports of counterfeit goods.
   • End its cyber warfare against US firms & military.
   • Seek strong measures to monitor and enforce future trade agreements.

China’s goals: Maintain domestic economic & political stability at all costs!
• Avoid formalizing trade reforms into law; emphasize agreements as memorandum of understandings.
• Seek immediate rollback of all punitive US tariffs once a deal is made.
• Otherwise stall, bob & weave and offer minimal concessions until after US elections.
To avoid paying higher tariffs on goods from China, US firms have imported more from other suppliers in Asia. (% change in exports to the US 1st half 2019 vs. 1st half in 2018)

Source: US Commerce Department (Trade on C.I.F. Basis)
US vs. China: Who has the capacity to endure more economic and political pain?

1. Will there be sufficient political cohesion in the White House for a protracted trade war as we get closer to 2020 elections?

   Tension is brewing in the WH between China hawks (Lighthizer and Navarro) and the pragmatists (Mnuchin and Kudlow). Who will have Trump’s support as the presidential race heats up?

2. Xi Jinping may be president “for life” but the Politburo is getting impatient.

   • Xi still needs to listen to both Communist Party hardliners AND those favoring market-oriented reforms.
   • Several of China’s top policymakers are US trained economists. (Liu He, Yi Gang)
   • China celebrates the 70th anniversary of its founding in October. Symbolizes liberation from Western dominance.
   • Xi will closely monitor US polls in the 2020 presidential election.
   • Chinese leaders believe Trump’s criticism of the Federal Reserve reflects his fear the US economy is in trouble.

3. Do not underestimate China’s ability to withstand US pressure.

   • Weaponize the RMB vs. US dollar --or-- scale back net new purchases of US treasuries
   • Encourage local shadow banks to resume lending to private firms
   • Further slash RRR and other interest rates
   • Impose new red tape on US firms operating in China
   • Boycott purchases of US goods
   • Ignore US sanctions against North Korea and Iran
   • Slash tariffs on imported goods from US competitors
### United States

#### Baseline Forecast: 2019 - 2021

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real Gross Domestic Product (GDP):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>2.2</td>
<td>4.2</td>
<td>3.4</td>
<td>2.2</td>
<td>3.1</td>
<td>2.0</td>
<td>1.8</td>
<td>2.2</td>
<td>2.0</td>
<td>2.7</td>
<td>2.1</td>
<td>2.3</td>
<td>2.2</td>
<td>2.7</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>Personal Consumption Expenditures:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PCE %</td>
<td>0.5</td>
<td>3.8</td>
<td>3.5</td>
<td>1.4</td>
<td>1.1</td>
<td>4.7</td>
<td>2.5</td>
<td>3.1</td>
<td>2.2</td>
<td>3.0</td>
<td>1.9</td>
<td>3.4</td>
<td>2.7</td>
<td>3.8</td>
<td>3.0</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Inflation, end of period, year-over-year:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI %</td>
<td>2.4</td>
<td>2.9</td>
<td>2.3</td>
<td>1.9</td>
<td>1.9</td>
<td>1.6</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
<td>2.0</td>
<td>2.0</td>
<td>2.2</td>
<td>2.5</td>
<td>2.7</td>
<td>2.7</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>Unemployment Rate (end of period):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>4.1</td>
<td>4.0</td>
<td>3.7</td>
<td>3.9</td>
<td>3.8</td>
<td>3.7</td>
<td>3.6</td>
<td>3.5</td>
<td>3.8</td>
<td>3.9</td>
<td>4.0</td>
<td>4.1</td>
<td>4.1</td>
<td>3.9</td>
<td>3.9</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>Non-farm Payrolls, monthly avg. thousand:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>228</td>
<td>243</td>
<td>189</td>
<td>233</td>
<td>174</td>
<td>152</td>
<td>143</td>
<td>150</td>
<td>135</td>
<td>140</td>
<td>125</td>
<td>125</td>
<td>135</td>
<td>155</td>
<td>160</td>
<td>165</td>
</tr>
<tr>
<td><strong>Treasury 10-yr Note Yield % (end of period):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.74</td>
<td>2.85</td>
<td>3.06</td>
<td>2.76</td>
<td>2.42</td>
<td>2.00</td>
<td>1.65</td>
<td>1.80</td>
<td>1.85</td>
<td>1.70</td>
<td>2.00</td>
<td>2.25</td>
<td>2.70</td>
<td>3.10</td>
<td>3.80</td>
<td>4.10</td>
</tr>
<tr>
<td><strong>Federal funds rate % (end of period):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.63</td>
<td>1.88</td>
<td>2.13</td>
<td>2.38</td>
<td>2.38</td>
<td>2.38</td>
<td>2.13</td>
<td>1.88</td>
<td>1.86</td>
<td>1.88</td>
<td>1.88</td>
<td>1.88</td>
<td>2.13</td>
<td>2.38</td>
<td>2.63</td>
<td>2.63</td>
</tr>
</tbody>
</table>
Outlook for WTI oil: $55 - $70 bbl next two years

However add another $5 to $15 premium when geopolitical tensions increase

Sources: US Energy Information Administration, The Economic Outlook Group
## GDP Growth - Global Economy

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2.6</td>
<td>1.6</td>
<td>2.2</td>
<td>1.8</td>
<td>2.5</td>
<td>2.9</td>
<td>1.6</td>
<td>2.4</td>
<td>2.9</td>
<td>2.2</td>
<td>2.3</td>
<td>2.6</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.7</td>
<td>1.4</td>
<td>-0.9</td>
<td>-0.3</td>
<td>1.2</td>
<td>1.6</td>
<td>1.7</td>
<td>2.5</td>
<td>1.9</td>
<td>1.0</td>
<td>1.3</td>
<td>1.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.7</td>
<td>0.7</td>
<td>0.3</td>
<td>1.8</td>
<td>2.9</td>
<td>2.2</td>
<td>1.9</td>
<td>1.8</td>
<td>1.4</td>
<td>1.0</td>
<td>0.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Japan</td>
<td>4.6</td>
<td>-0.4</td>
<td>1.6</td>
<td>1.5</td>
<td>-0.1</td>
<td>1.1</td>
<td>1.0</td>
<td>1.9</td>
<td>0.8</td>
<td>0.9</td>
<td>0.6</td>
<td>1.7</td>
</tr>
<tr>
<td>Canada</td>
<td>3.1</td>
<td>3.1</td>
<td>1.7</td>
<td>2.2</td>
<td>2.5</td>
<td>0.9</td>
<td>1.4</td>
<td>3.0</td>
<td>1.9</td>
<td>1.5</td>
<td>1.1</td>
<td>2.4</td>
</tr>
<tr>
<td>India</td>
<td>8.4</td>
<td>8.6</td>
<td>6.7</td>
<td>4.9</td>
<td>7.4</td>
<td>8.0</td>
<td>8.1</td>
<td>7.2</td>
<td>6.8</td>
<td>6.5</td>
<td>6.3</td>
<td>7.3</td>
</tr>
<tr>
<td>China</td>
<td>10.5</td>
<td>9.5</td>
<td>7.8</td>
<td>7.7</td>
<td>7.3</td>
<td>6.9</td>
<td>6.7</td>
<td>6.8</td>
<td>6.6</td>
<td>6.2</td>
<td>5.8</td>
<td>6.1</td>
</tr>
<tr>
<td>Brazil</td>
<td>7.5</td>
<td>2.7</td>
<td>0.9</td>
<td>2.3</td>
<td>0.1</td>
<td>-3.5</td>
<td>-3.5</td>
<td>1.4</td>
<td>1.1</td>
<td>0.9</td>
<td>1.0</td>
<td>1.7</td>
</tr>
<tr>
<td>Mexico</td>
<td>5.2</td>
<td>4.0</td>
<td>3.9</td>
<td>1.4</td>
<td>2.3</td>
<td>2.7</td>
<td>2.9</td>
<td>2.1</td>
<td>2.0</td>
<td>0.4</td>
<td>0.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Australia</td>
<td>2.8</td>
<td>2.6</td>
<td>3.6</td>
<td>2.4</td>
<td>2.6</td>
<td>2.5</td>
<td>2.4</td>
<td>2.4</td>
<td>2.7</td>
<td>2.0</td>
<td>1.8</td>
<td>2.6</td>
</tr>
<tr>
<td>Russia</td>
<td>4.0</td>
<td>4.3</td>
<td>3.4</td>
<td>1.3</td>
<td>0.6</td>
<td>-2.8</td>
<td>-0.2</td>
<td>1.6</td>
<td>2.5</td>
<td>1.5</td>
<td>1.3</td>
<td>2.2</td>
</tr>
<tr>
<td>World</td>
<td>4.2</td>
<td>3.0</td>
<td>2.6</td>
<td>2.9</td>
<td>3.0</td>
<td>2.8</td>
<td>2.6</td>
<td>3.3</td>
<td>3.2</td>
<td>3.0</td>
<td>2.6</td>
<td>3.3</td>
</tr>
</tbody>
</table>

### Growth Leaders
- India
- China
- Indonesia
- Vietnam
- Peru
- Israel

### Moderate Growth
- Australia
- US
- Chile

### Sluggish Growth
- UK
- Canada
- Russia
- Japan

### In or Near Recession
- Eurozone
- Argentina
- Brazil
- Mexico
- Venezuela
- Iran
So...what could possibly go wrong?
Recession Warning Signs: 12 Key Indicators to Monitor Now!

**Consumer spending patterns:**
- Consumer purchases of durable goods (BEA)
- Consumer delinquency rates (FRB)
- Confidence levels; 3-month moving average (CB & UofM)
- New single family home sales / Pending Homes sales (Census; NAR)

**Employment data**
- Average weekly OT hours worked; manufacturing (BLS)
- Applications for unemployment benefits (BLS)

**Business:**
- ISM manufacturing – new orders (ISM)
- Ratio of building permits to new starts (Census)
- Chemical Activity Barometer (ACC)
- Wholesale Inventories (Census)

**Banking:**
- Senior loan officer survey by Federal Reserve (FRB)

**Capital Markets:**
- Inversion of the yield curve (10-yr. minus 2 yr & 3-M)
Biggest hazards on the radar screen

Risk Level

Moderate: **A full blown global trade and currency war triggers new financial crises**
- Trade talks w/China collapse; US threatens more tariffs on Europe, India, Vietnam.
- Volume of world trade shrinks. Global wave of competitive currency devaluations.

HIGH: **Exogenous shocks pose the greatest threat to the economy.**
1. **Foreign state launches cyber attack that paralyzes parts of the US economy.**
2. US and Chinese military confrontation: South China Sea, Hong Kong, Taiwan.
3. Saudi Arabia retaliates against Iran. Threat of full scale war looms.
4. Iran enriches uranium above 20%. Prompts US or Israel to strike back militarily.
5. India and Pakistan edge closer to nuclear war as tensions soar over Kashmir.
We are now in the midst of a Cyber World War!

Russia and China view CYBER warfare as an *ideal weapon* against the US!

- It’s cheaper, can do major damage, is contact-free warfare…and allows for deniability.
- For a fraction of the price of a MIG-29, Russia, China & North Korean hackers can sabotage US electrical grids, nuclear plants, communication networks and financial markets.

Foreign Attacks on the Government

- Hackers successfully penetrated the US electrical grid & nuclear plants (2018)
- US election facilities and voter records were penetrated by Russia (2016, 2018)
- Ukraine’s power grid went down in winter due to a dispute with Russia (2015)
- Foreign hackers stole 22 million accounts from US Government Office of Personnel Management (2012-14)

Theft of consumer ID:

- Equifax - 143 million consumer records (2017)
- Yahoo - 3.5 billion household accounts (2016 – 2017)

Source: Multiple sources
1. Companies should undertake “rigorous” stress tests to determine their greatest vulnerabilities.
   • Conduct “what if” scenarios: Introduce adverse hypothetical scenarios (e.g. systemic power failure or events that can disrupt operations, revenue flow, access to the internet & intranet and block credit lines.)
   • How to cope under such dire circumstances and remain both operational and profitable?

2. Consider cyber theft insurance, upgrade software, and finally hire firms to hack into your system.
   • Average time it takes a U.S. firm to identify a breach = 201 days
   • Average time it takes to contain the breach = 70 days
   • Average cost of a single data breach = more than $4 million  (Source: IBM)

3. Geopolitical threat anticipation:
   • Dedicate a risk management team to engage in geopolitical forecasting, especially where one has foreign exposure (e.g., customers, supply chain sources, key investors, real estate, banking relationships.)

4. Customers demand reliability of service --- or they’ll walk!  Be proactive. Focus on being agile.
   • Prepare in advance a governance plan that can be implemented quickly to mitigate any harmful fallout from an external shock.  *Your firm’s reputation is always at risk.*
# Key Foreign Exchange Rates

(Per U.S. dollar, year-end level)

<table>
<thead>
<tr>
<th>Currency</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro (in US dollars)</td>
<td>1.20</td>
<td>1.15</td>
<td>1.13</td>
<td>1.18</td>
<td>1.19</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>113</td>
<td>111</td>
<td>109</td>
<td>111</td>
<td>114</td>
</tr>
<tr>
<td>UK pound (in US dollars)</td>
<td>1.35</td>
<td>1.27</td>
<td>1.21</td>
<td>1.29</td>
<td>1.42</td>
</tr>
<tr>
<td>Canadian dollar</td>
<td>1.25</td>
<td>1.36</td>
<td>1.33</td>
<td>1.30</td>
<td>1.26</td>
</tr>
<tr>
<td>Chinese yuan</td>
<td>6.51</td>
<td>6.88</td>
<td>7.01</td>
<td>7.04</td>
<td>6.96</td>
</tr>
<tr>
<td>Brazil’s real</td>
<td>3.31</td>
<td>3.87</td>
<td>4.10</td>
<td>4.11</td>
<td>4.12</td>
</tr>
<tr>
<td>Mexican pesos</td>
<td>19.79</td>
<td>19.68</td>
<td>20.10</td>
<td>20.50</td>
<td>19.85</td>
</tr>
</tbody>
</table>

The Economic Outlook Group

US Dollar strengthens | US Dollar weakens
Top priority of Pres. Xi Jinping and Communist Party Leadership:

Maintain economic & political stability in China AT ALL COST!

BACKGROUND:
1. Since the 1970s, China has pursued a hybrid mix of Communism & Capitalism.
3. But its success as a global manufacturing hub brought new problems that stumped the CP.
4. China loses labor cost advantage; Excess industrial capacity means idling plants or more dumping.
5. Debt levels have exploded at state-owned industries and private firms leading to defaults.
6. Financial stress, loss of competitiveness, trade war with the US = slowest GDP growth in 27 years!
7. WHAT’S NEXT? Ramp up domestic stimulus -- and wait out the US trade conflict thru 2020 election.
"Is this economic cycle about to end?"

An inverted yield curve has been a (near) perfect predictor of recessions.
Access to bank loans still fairly easy; No evidence yet that lenders are turning cautious out of concern about the outlook and loan defaults.

(Federal Reserve: Senior loan officer opinion survey on bank lending practices)

Above zero = more banks get tougher issuing credit
Below zero = more banks make it easier to obtain credit

Bank lending standards to small firms
Bank lending standards to medium and large firms

Shaded areas indicate U.S. recessions

Source: Board of Governors of the Federal Reserve System (US)
Homebuilders confront a perfect storm!

Cost of building material has increased due to tariffs.
(Steel, aluminum, softwood lumber, plastic pipes, screws, bolts)

Severe shortage of skilled labor.
• Number of residential construction workers is down 20% from 2006.
• After the housing bust, many found more lucrative opportunities in the shale oil-related industry.
• One in four construction workers were immigrants. (Source: NAHB)

The burden of excessive government regulations:
• Local, state and federal requirements account for 25% of constructing cost of a home.

Scarcity of suitable land: Price of lots in preferred locations have skyrocketed.
• Builders moving out into “Xburbs” to construct more affordable homes.
• But high-end homes still provide greater margins for builders.
Housing demand has been lackluster!

- Household formation has slowed:
  --- aging demographics
  --- birth rates are lowest in 30 years
  --- severe curbs on immigration
  --- US population growth now slowest in 80 years
  --- Household formation to slow from 1.40 million (2018) to 1.22 million (2023)

- Millennials and Gen Zs are more budget conscious.
  --- High college debt burdens (record $1.6 billion) have made renting more attractive
  --- Pressure to build private savings because of doubts on solvency of SS and Medicare
  --- Witnessed financial crisis: saw home values plummet and how friends/families declared bankruptcy
  --- Uncertain about future economy given the trade war and fears of a global recession.

- Provisions of the 2017 Tax Act raised the after-tax cost of homeownership
- Banks tightening lending standards given lateness in the credit cycle.
- Lack of affordable entry level homes:
  --- Large investment firms buying thousands of homes for rent; record numbers of flippers in the market.
Demographic changes will alter the composition of spending

<table>
<thead>
<tr>
<th>TRADITIONAL</th>
<th>BABY BOOMERS</th>
<th>GENERATION X</th>
<th>MILLENNIALS</th>
<th>GENERATION Z</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experiences</td>
<td>Great Depression WWI and WWII Korean War</td>
<td>Cold War w/ Soviet Union Nuclear Weapons Civil Rights Sexual Revolution Korean War Space Exploration GI Bill Housing boom Cuban Missile Crisis</td>
<td>Energy crisis Dual incomes Downsizing Watergate Single parents Vietnam War Space exploration</td>
<td>Computer age Middle East wars AIDS China’s emerges Jobs go offshore Home sales surge Bank 1-stop shop Globalization Record college debt SS solvency worries</td>
</tr>
</tbody>
</table>

- **Retiring baby boomers**
  - They are downsizing, selling off possessions, moving into smaller homes.
  - Result: No interest in buying “stuff.” Will focus more on health, fitness and travel.

- **Millennials:** They’re greater in size than baby boomers but display a different set of values. More risk averse.
  - Many are heavily burdened with college debt. (Currently a record $1.5 trillion)
  - Skeptical about the solvency of SS & Medicare. Pressure to save more income.
  - Experienced the Great Recession; witnessed families lose their homes or declare bankruptcy.
  - More practical spenders. Prefer Uber over car buying, streaming not cable, cell phone not landlines, home rental not purchase.
  - Result: More inclined toward experiential spending, travel, entertainment, healthy eating,
Don’t write off malls! Services are replacing failing retail B&M stores

U.S. retailers were occupying nearly 5 times more space per person than other consumer nations. That was not sustainable as online shopping surges.

<table>
<thead>
<tr>
<th>Country</th>
<th>Square Feet</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>7.3 sq. ft.</td>
</tr>
<tr>
<td>France</td>
<td>1.7 sq. ft.</td>
</tr>
<tr>
<td>Japan</td>
<td>1.7 sq. ft.</td>
</tr>
<tr>
<td>UK</td>
<td>1.3 sq. ft.</td>
</tr>
</tbody>
</table>

Macy’s, JC Penney, Sears are shutting doors in malls around the country

So who is moving in?

Health care centers, Fitness gyms, Food/restaurants, Education outlets, Entertainment venues ----
And, yes, even stores like Amazon.

Sources Terry Lundgren, Macy’s CEO, The Economic Outlook Group