

---

# ***The State of the U.S. Economy***

**Thomas Lam  
Treasury Economist  
Vice-President  
Global Markets, UOB Group  
May 9, 2007**

***Disclaimer:***

***The views expressed in this presentation are those of the author and do not represent those of UOB Group.***

***\*\*\*The contents of this presentation may not be reproduced without the permission of the author\*\*\****

# Topics

---

## **1. The Current & Future State of the Economy**

- Growth & Inflation
- Short-term & Long-term Rates

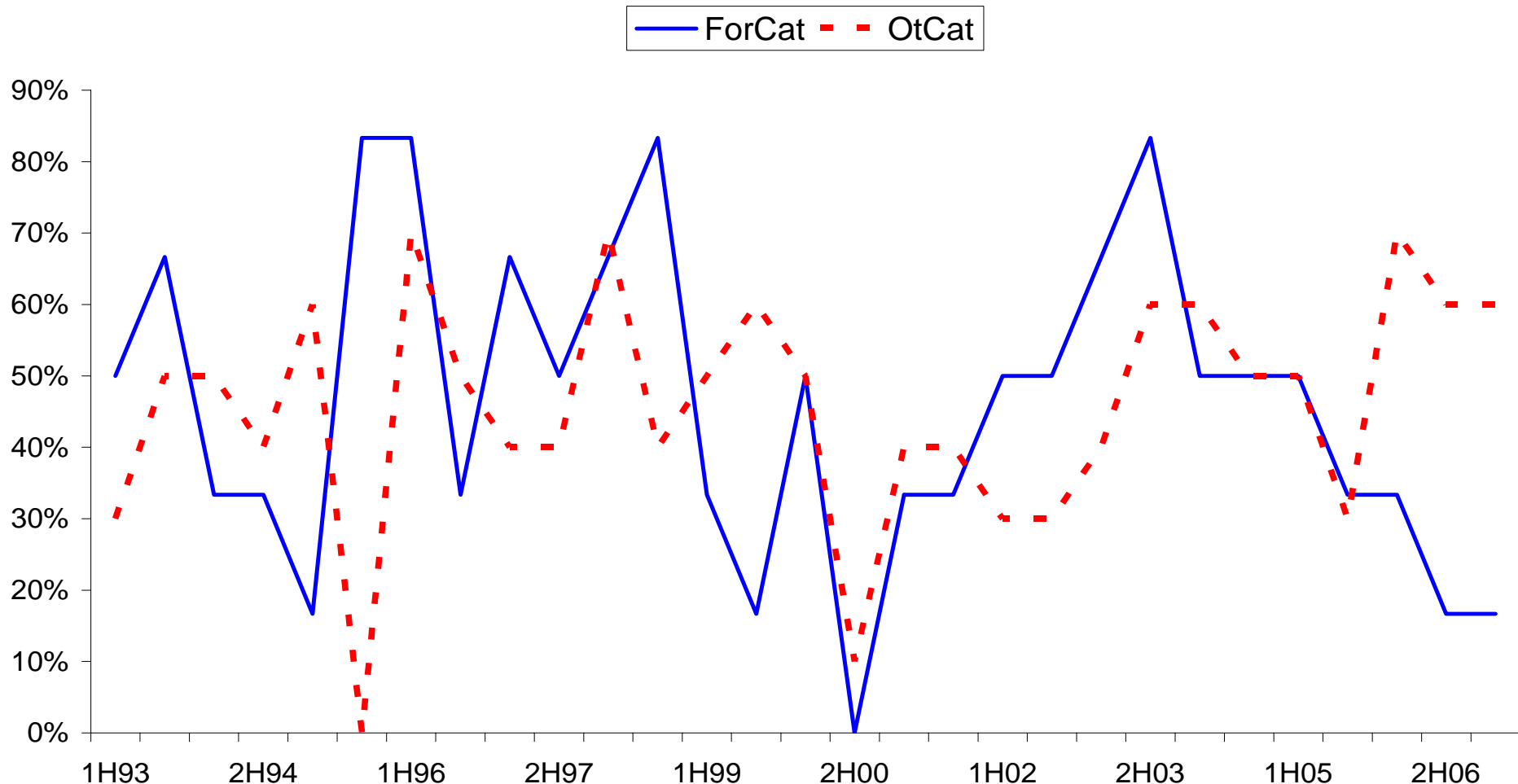
## **2. Accompanying Risk Factors & Forecast Assumptions**

---

# Economic Growth

# An Alternative Snapshot of Output

## Real Final Sales to Domestic Purchasers (Diffusion Indexes)

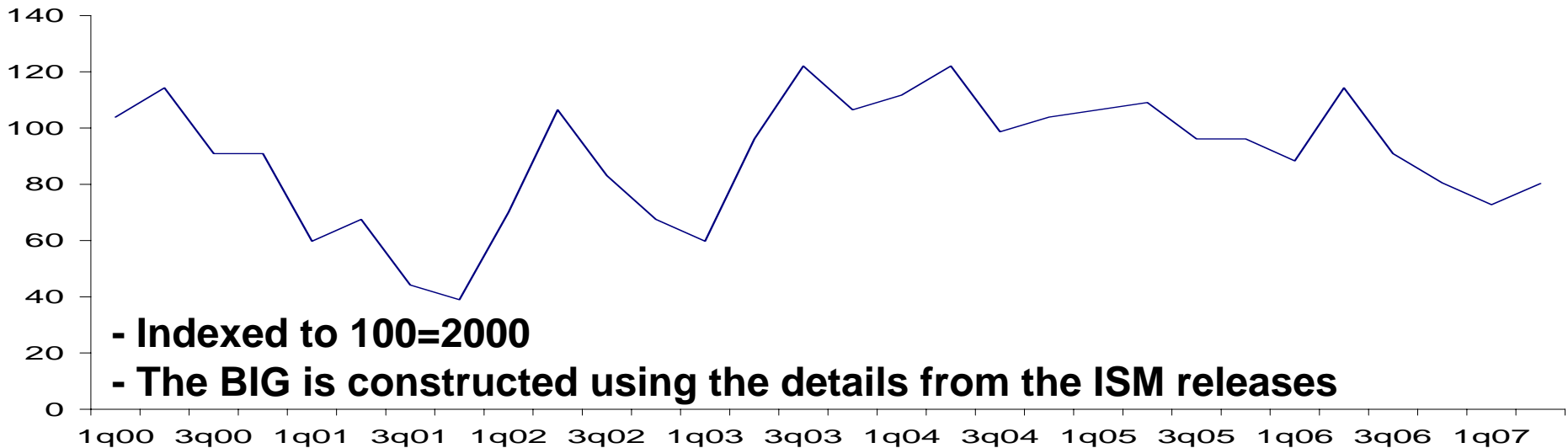
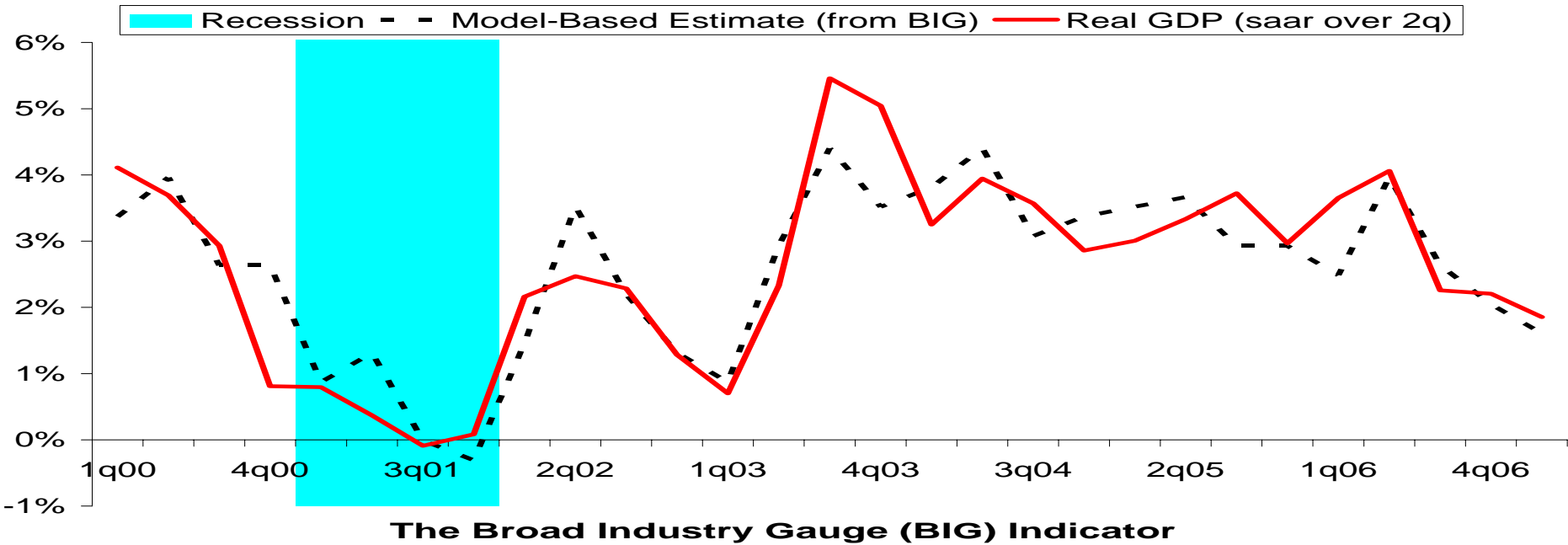


**Note:**

- Forward Categories (ForCat)=Durable gds, residential inv and biz capex
- Other Categories (OtCat)=Other final dmd categories (ex. inventory and NX)
- 1H07 data is an average of 1q07 and 4q06

# The BIG Picture

**Real GDP Guidance from the Broad Industry Gauge**

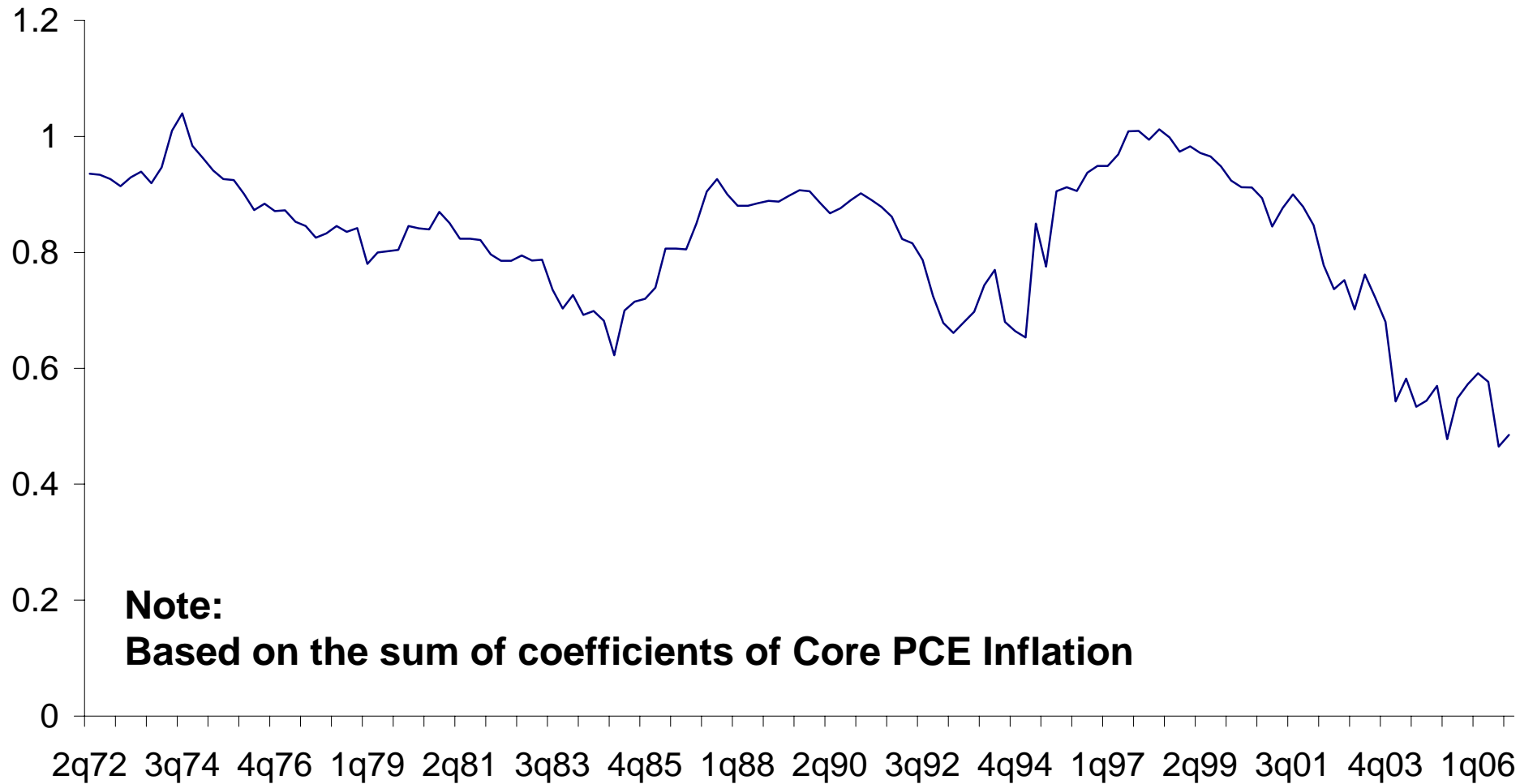


---

# Consumer Inflation

# The Relevance of Persistence

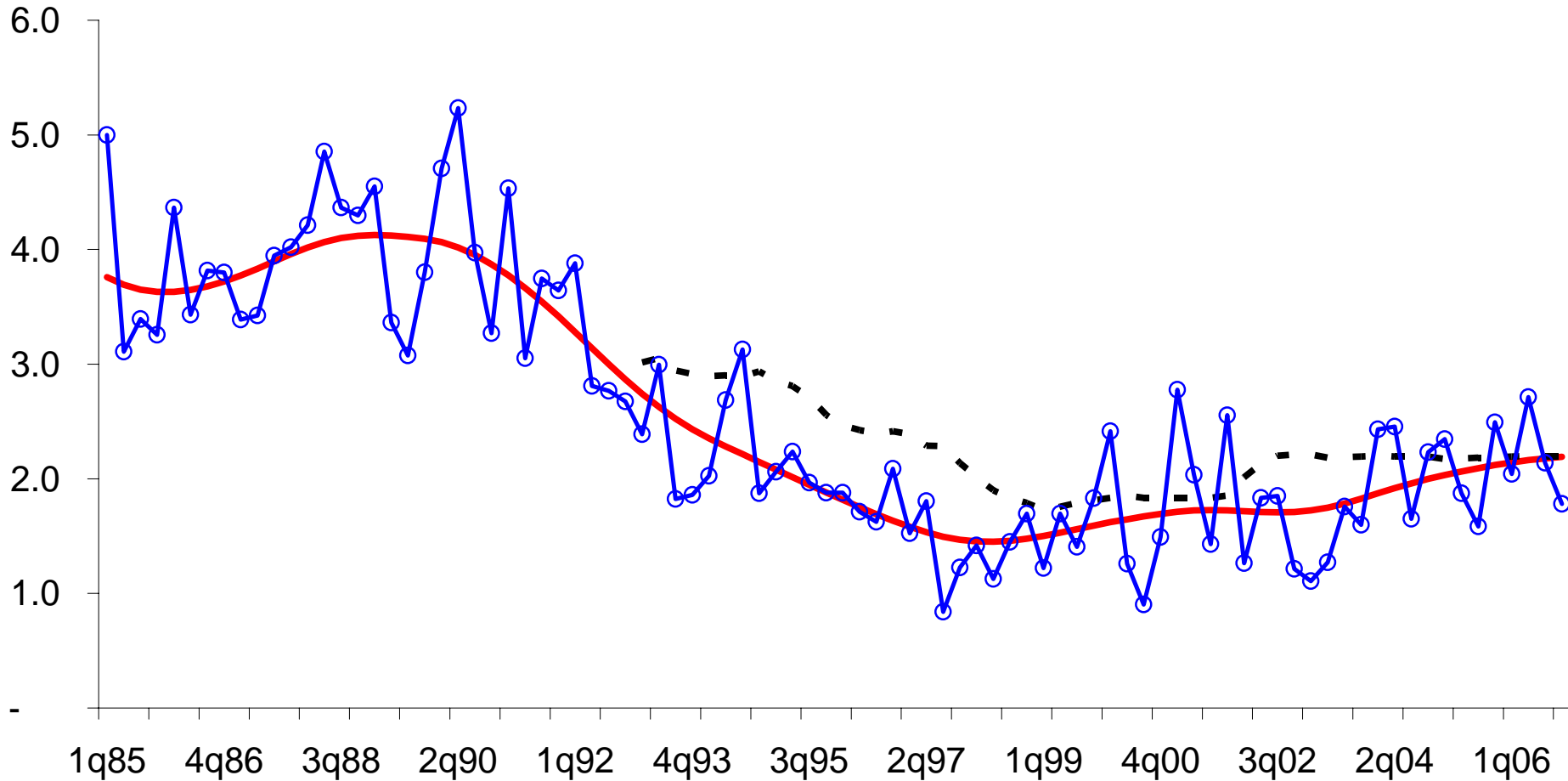
## Steady Decline in Inflation Persistence



# Inflation Dynamics

## The Inflation Dynamics (%)

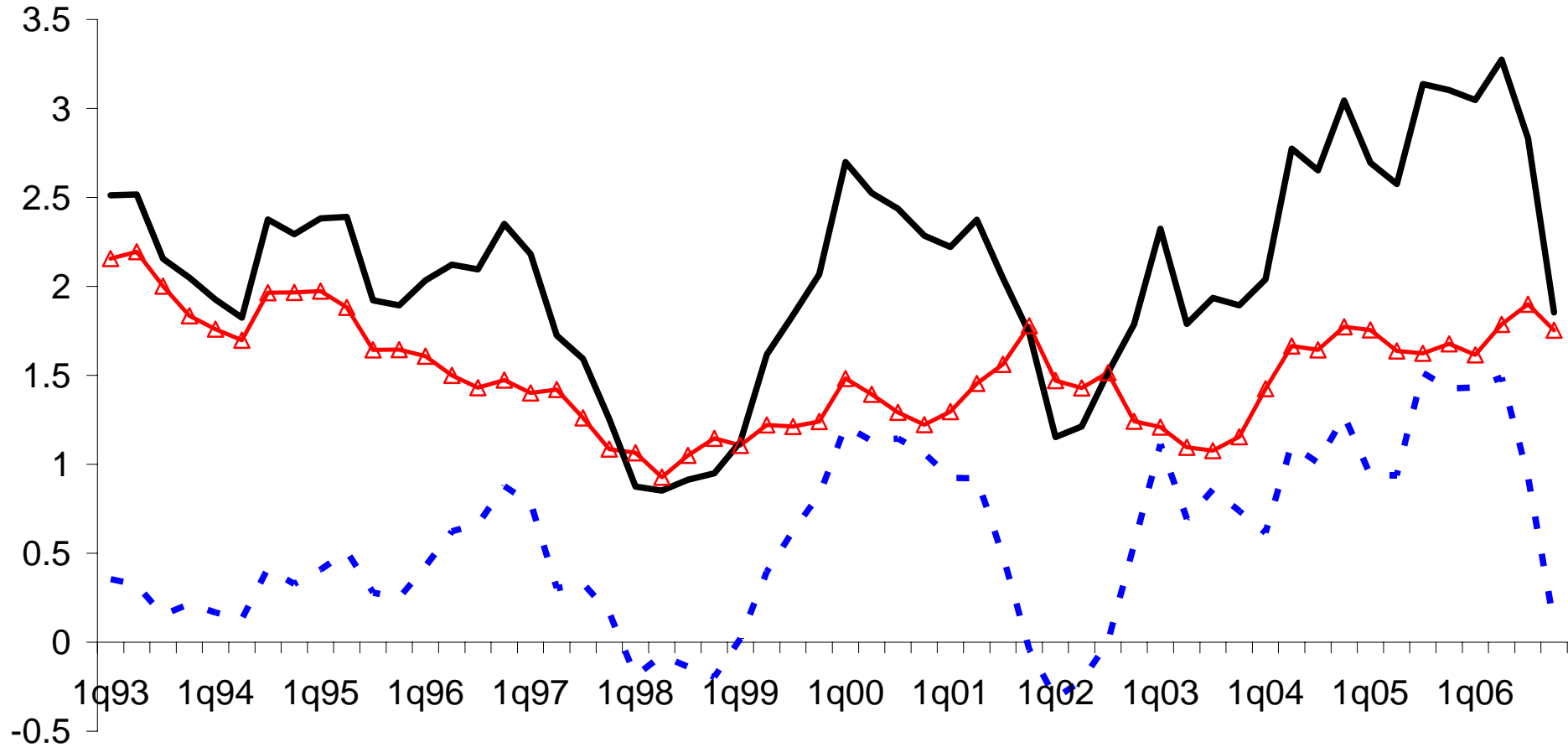
— Trend Inflation    - - LT Inflation Expectations    ○ Core PCE PI (saar)



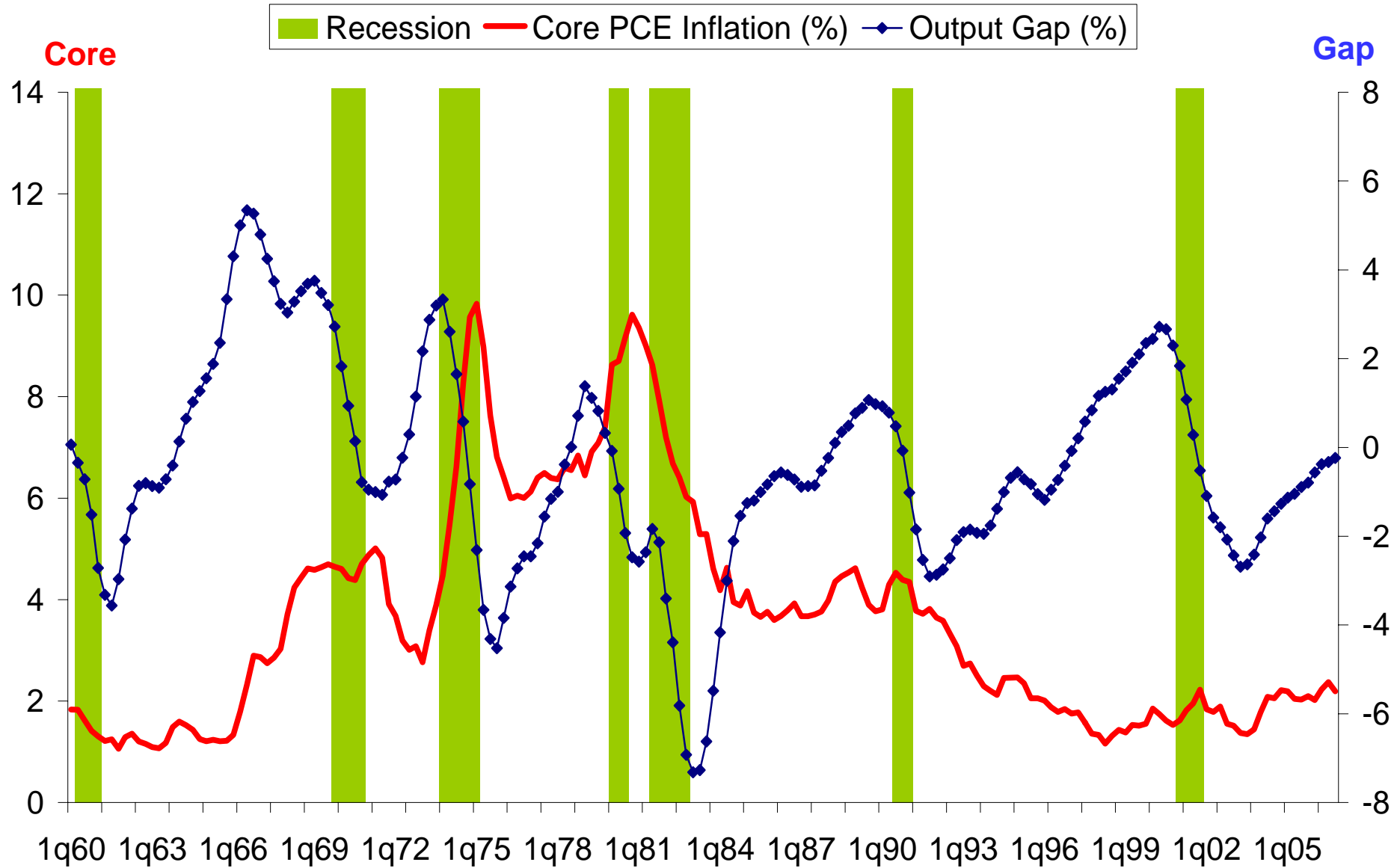
# Inflation Breakdown

## PCE Inflation Breakdown (4q % Chg)

- - F&E Contri    -△- Core Contri    — Headline PCE Inflation



# Slack & Core Inflation

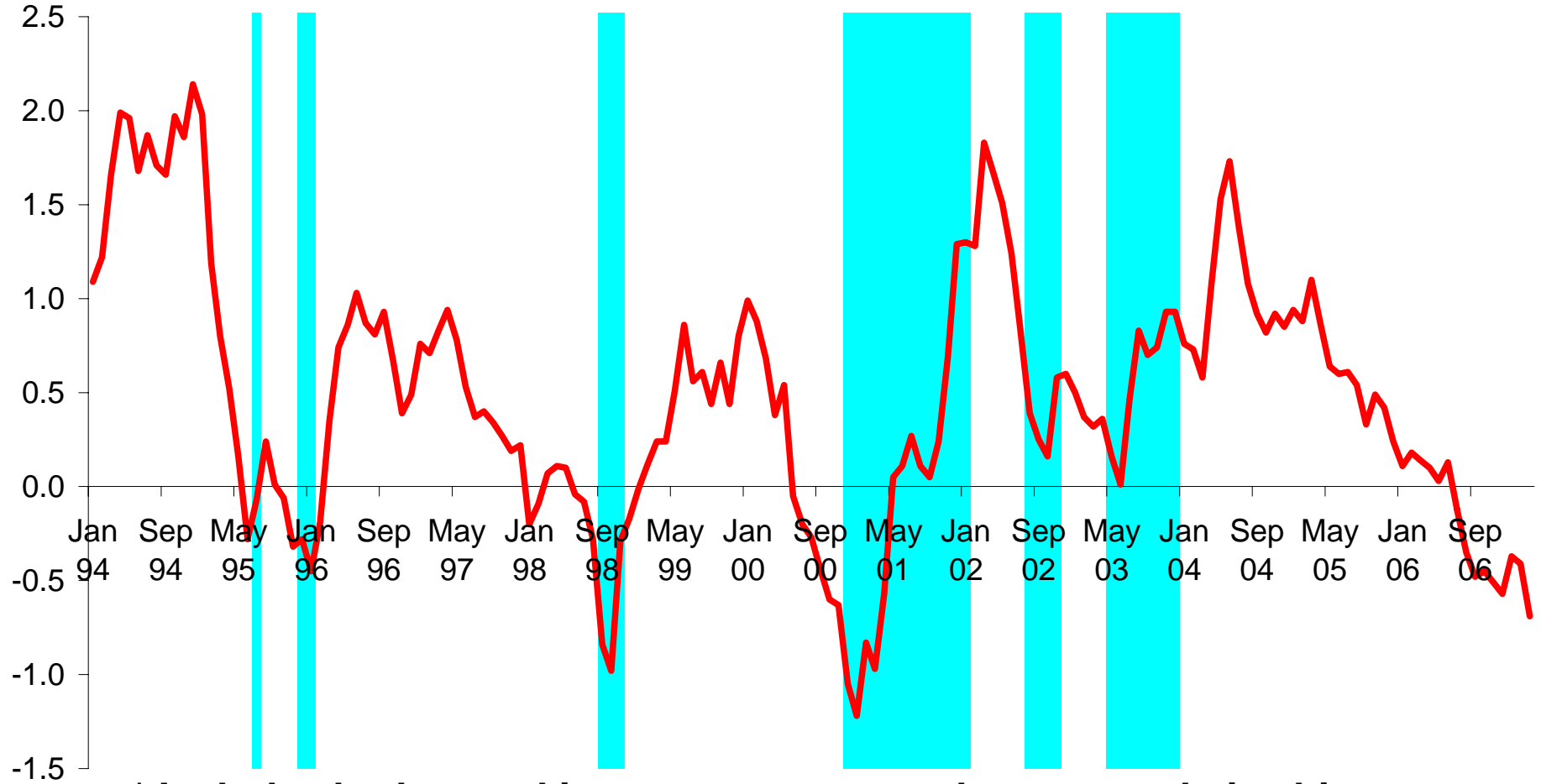


---

# Interest Rates

# Monetary Policy Implication

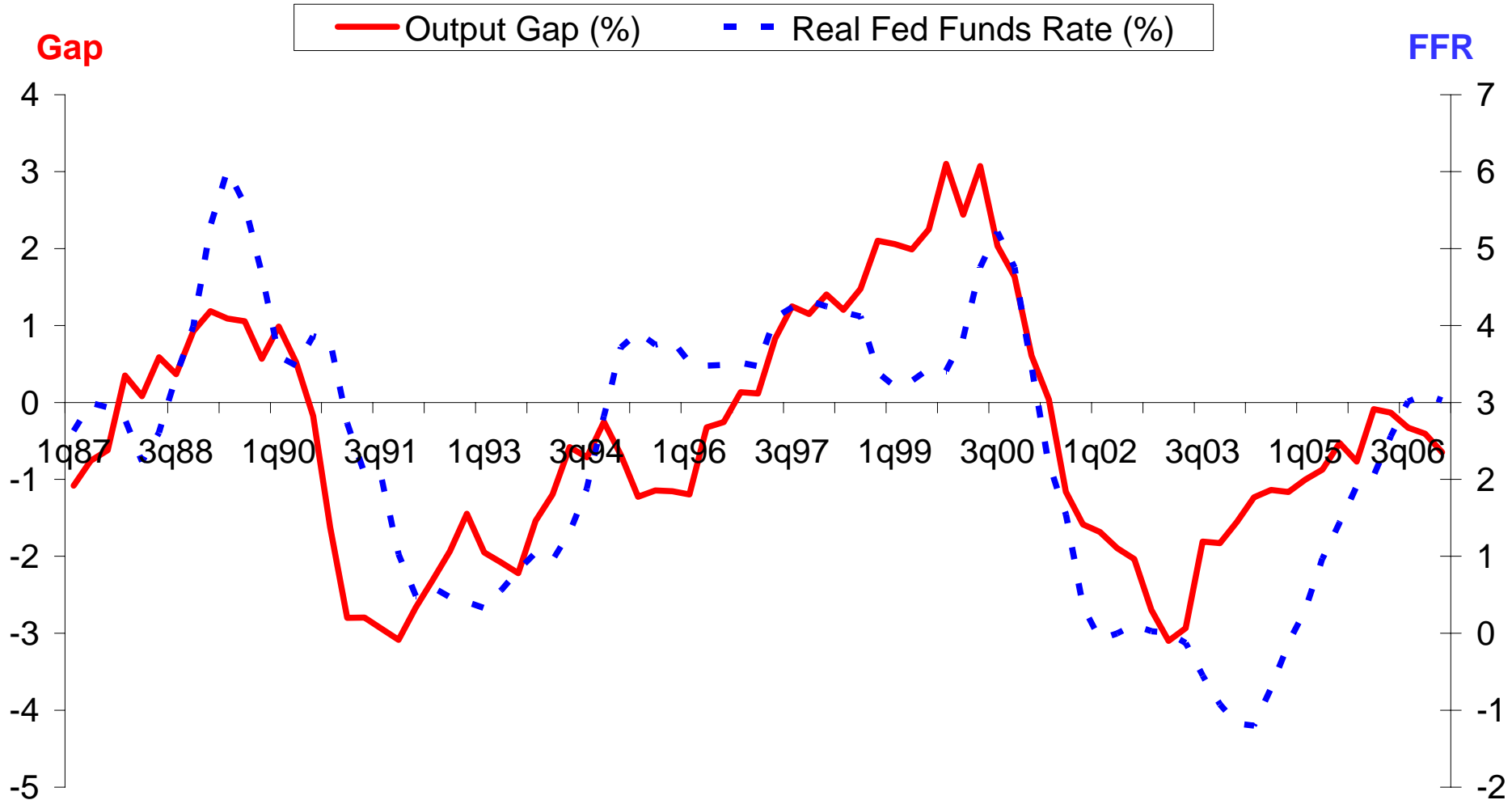
The 2-yr UST Yield minus Fed Funds Rate (%)  
& Episodes of Policy Accommodation\*



\* Includes both actual interest rate cuts and accommodative bias

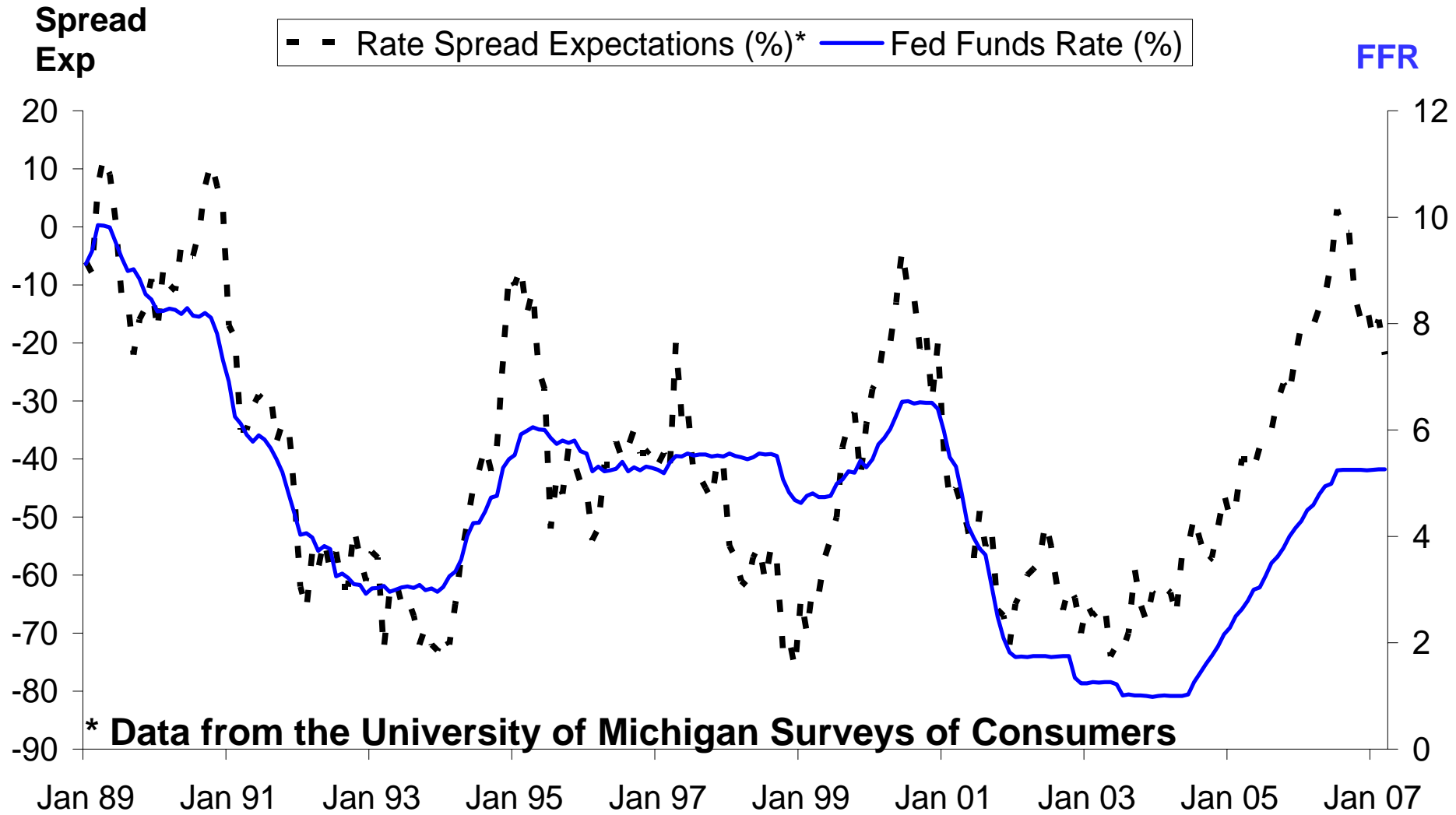
# Subtrend Growth & Fed Sensitivity

## Output Gap & Inflation-Adjusted Fed Policy



# The Survey Says

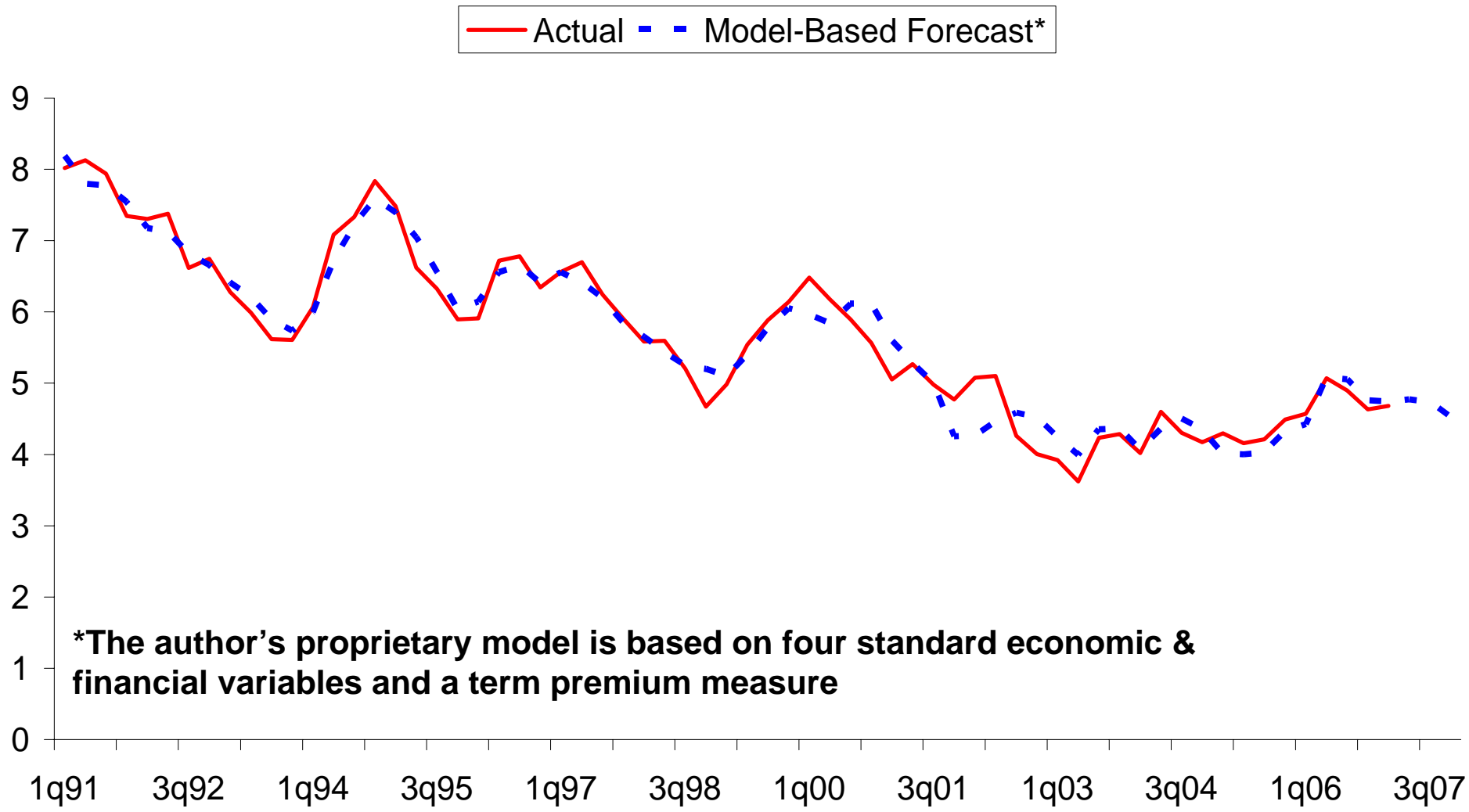
## Greater Risk of Lower Funds Rate?



\* Data from the University of Michigan Surveys of Consumers

# The 10-year US Treasury Yield

The Likely Progression of the 10-year US Treasury Yield (%)

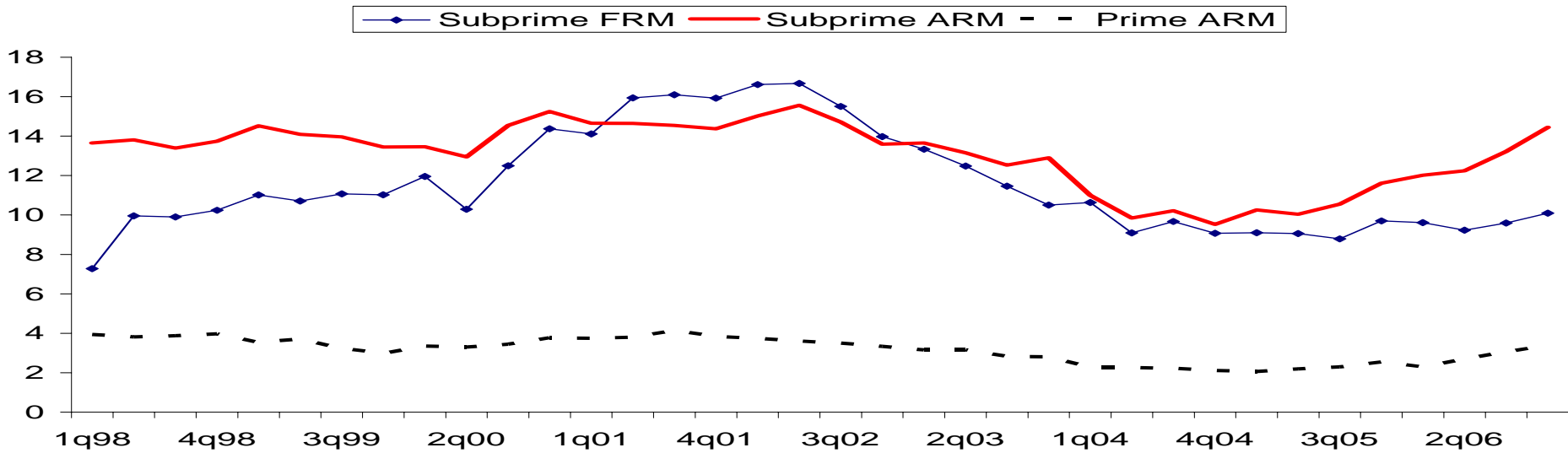


---

# **Risk Factors & Assumptions**

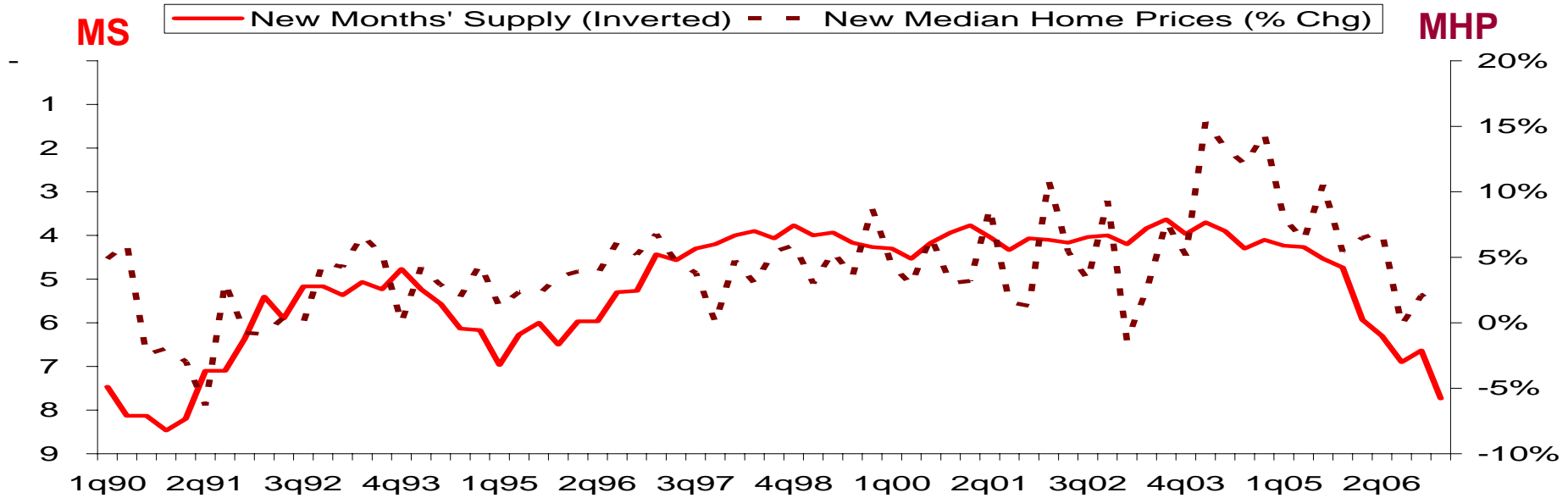
# Mortgage Delinquency

## Subprime & Prime Delinquency Rates (%)

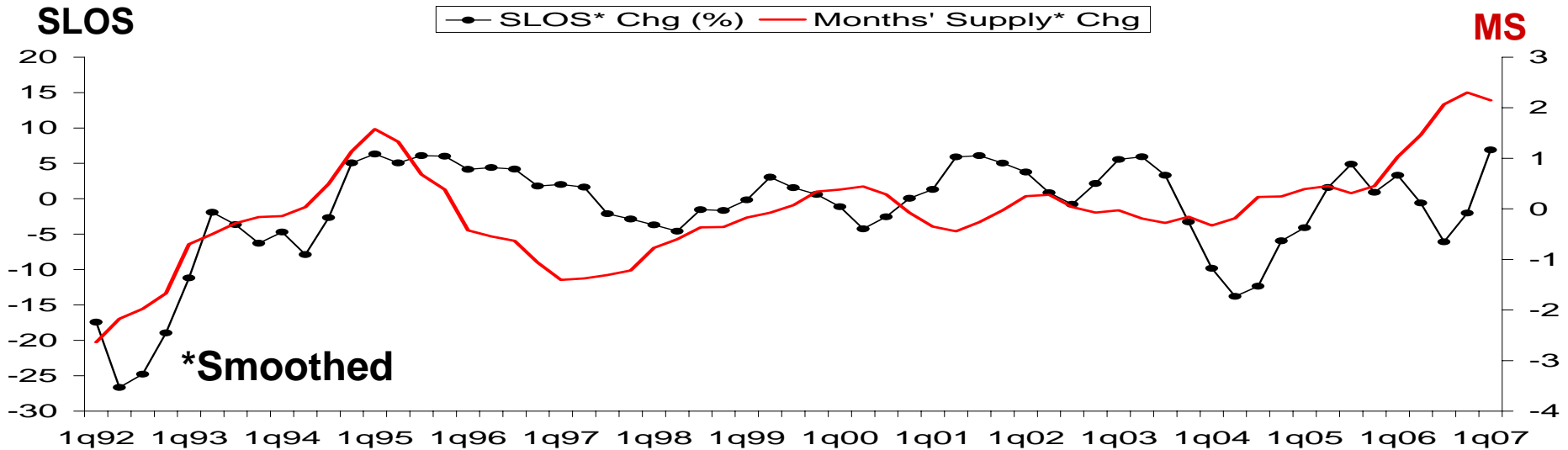


# Housing Imbalance...

## Housing Market Imbalance & Home Prices

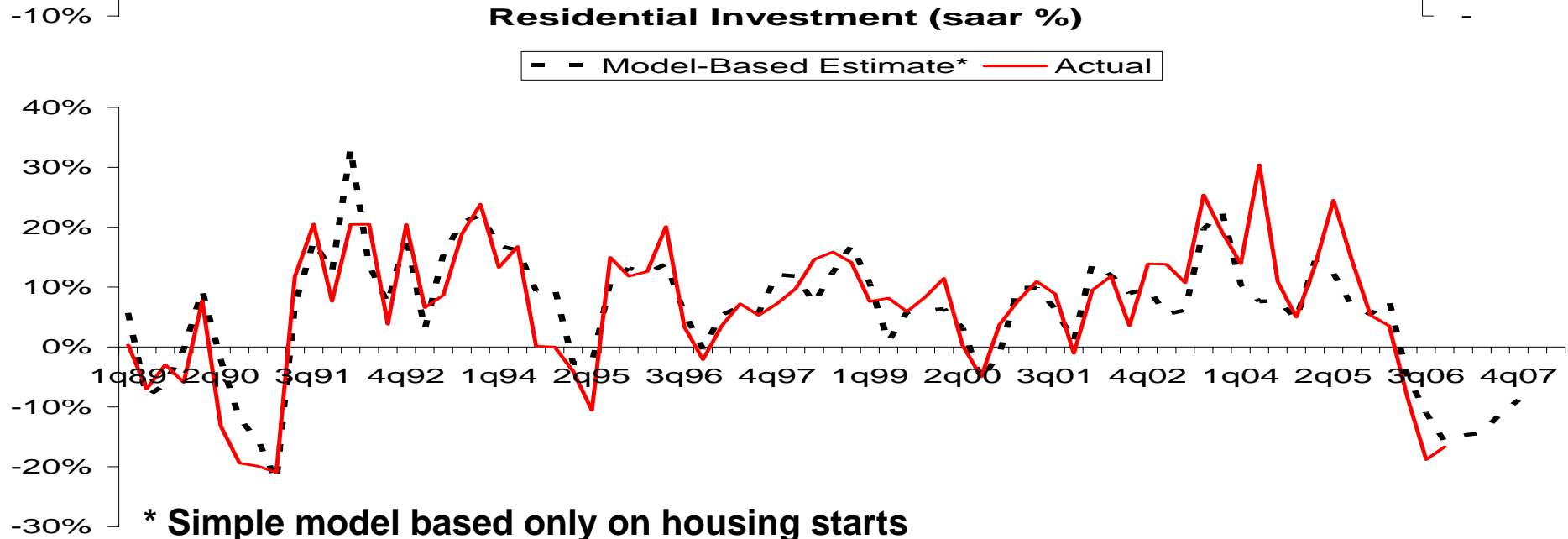
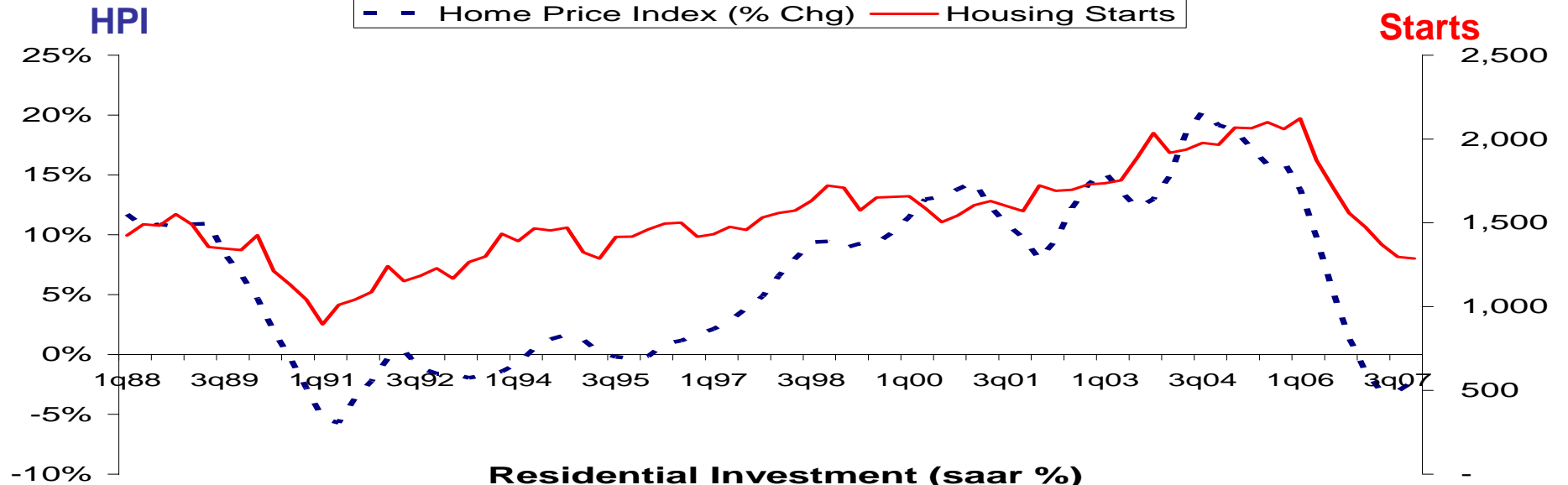


## Potential Impact on Lending Standards?



# Residential Spending Trajectory?

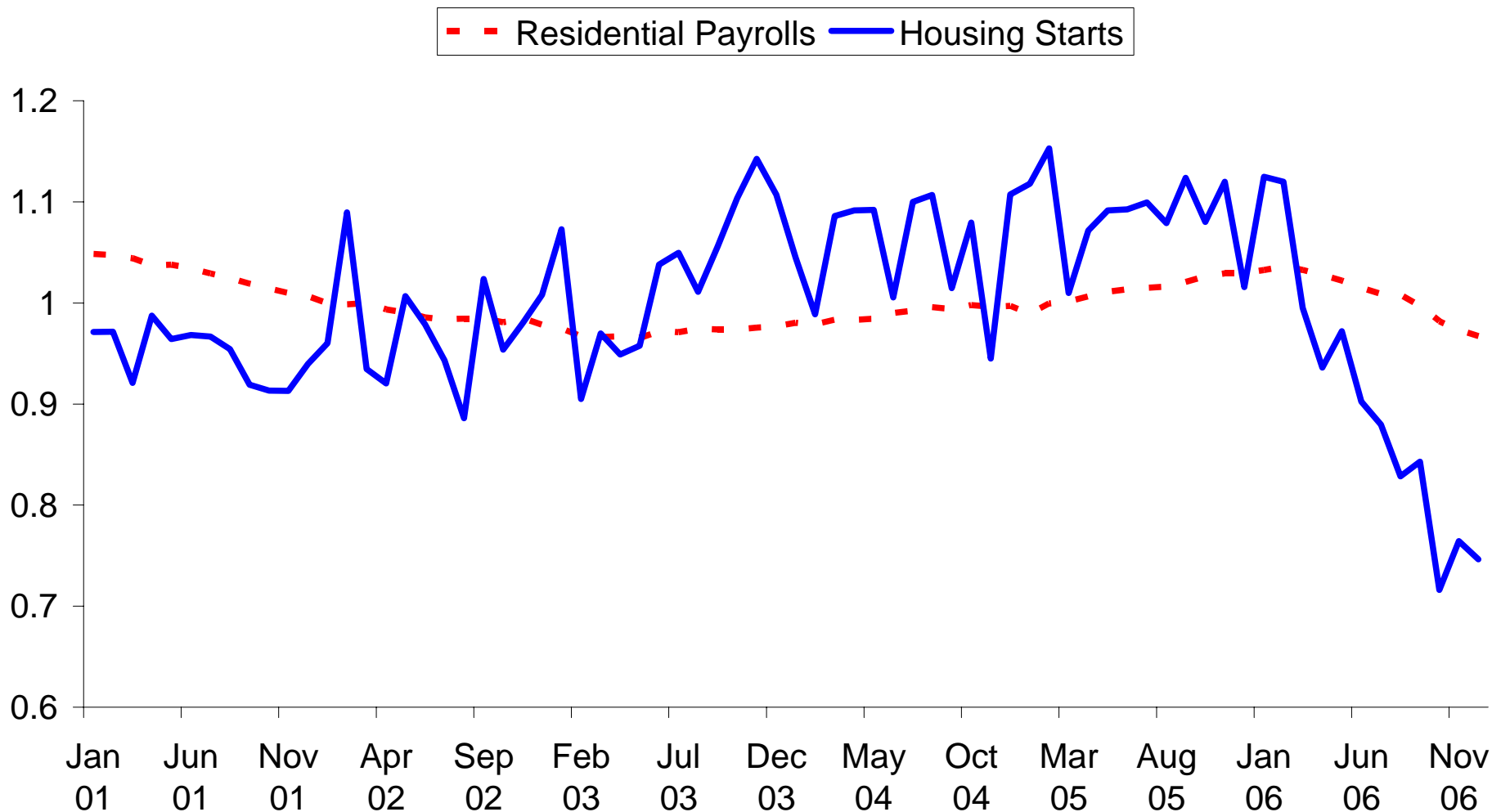
Lower Home Prices Exert Downward Pressure on Starts



\* Simple model based only on housing starts

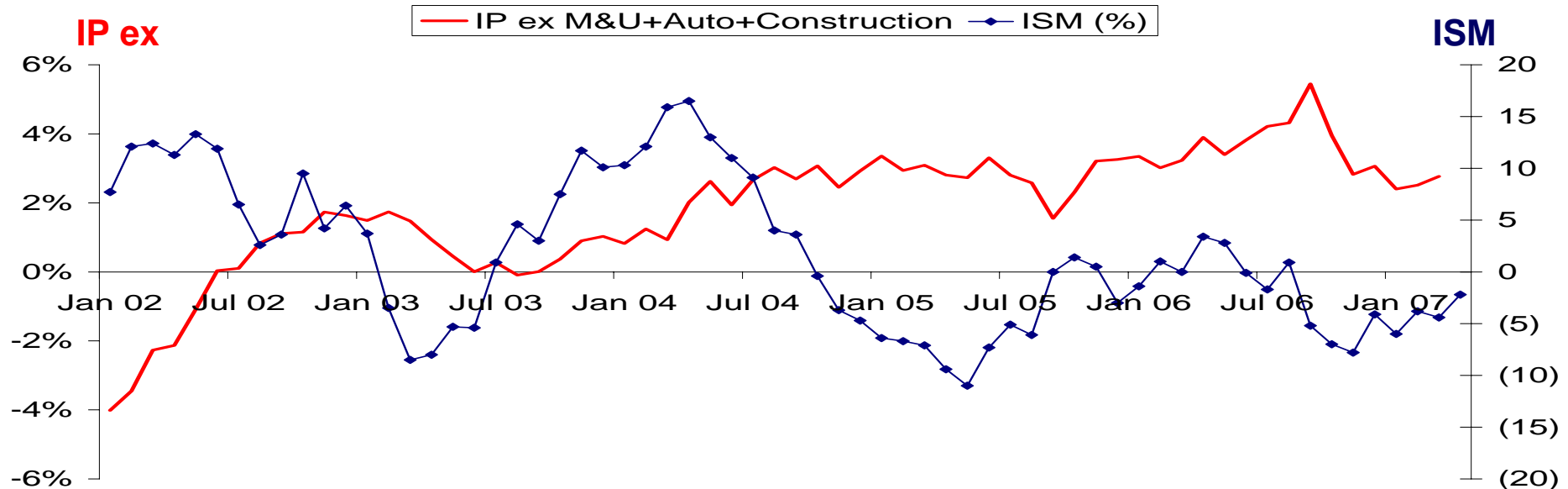
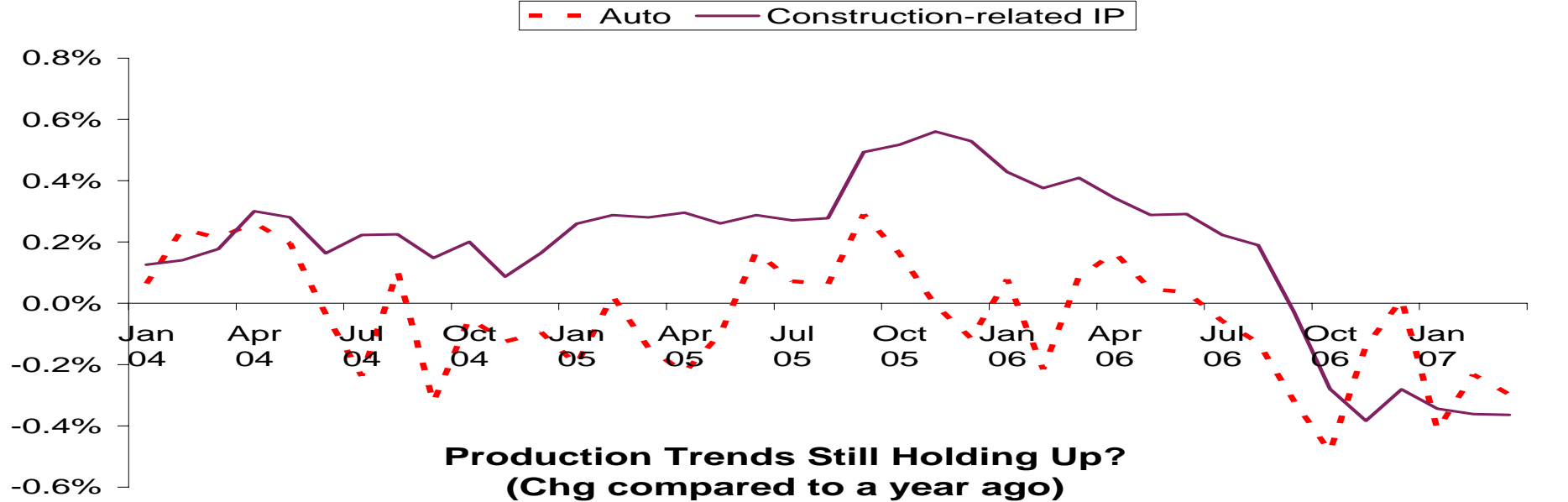
# Downside Risks on Residential Payrolls

## Detrended Residential Payrolls & Housing Starts



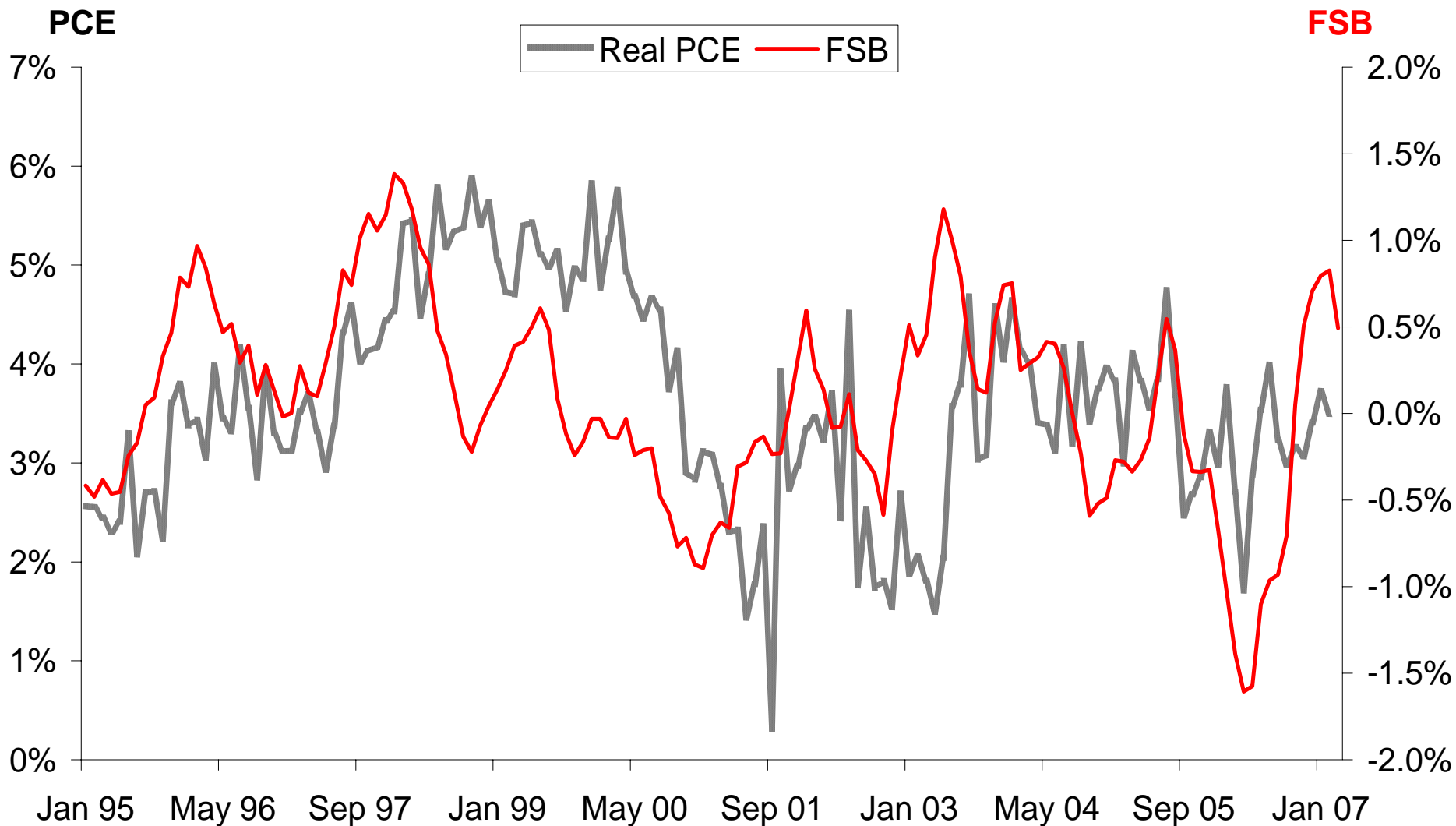
# The Patchy Mfg Sector

## The Drag from Auto and Housing-Related Manufacturing



# Consumer Spending: The Silver Lining?

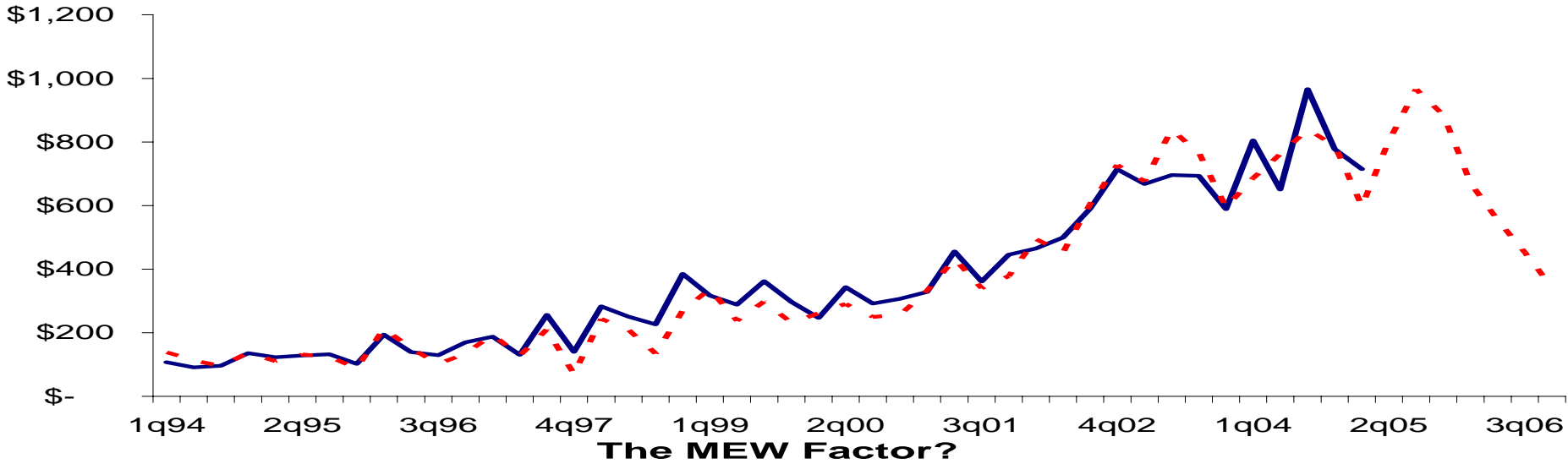
## Future Spending Barometer (FSB) & Consumer Spending



# The Contentious MEW Factor

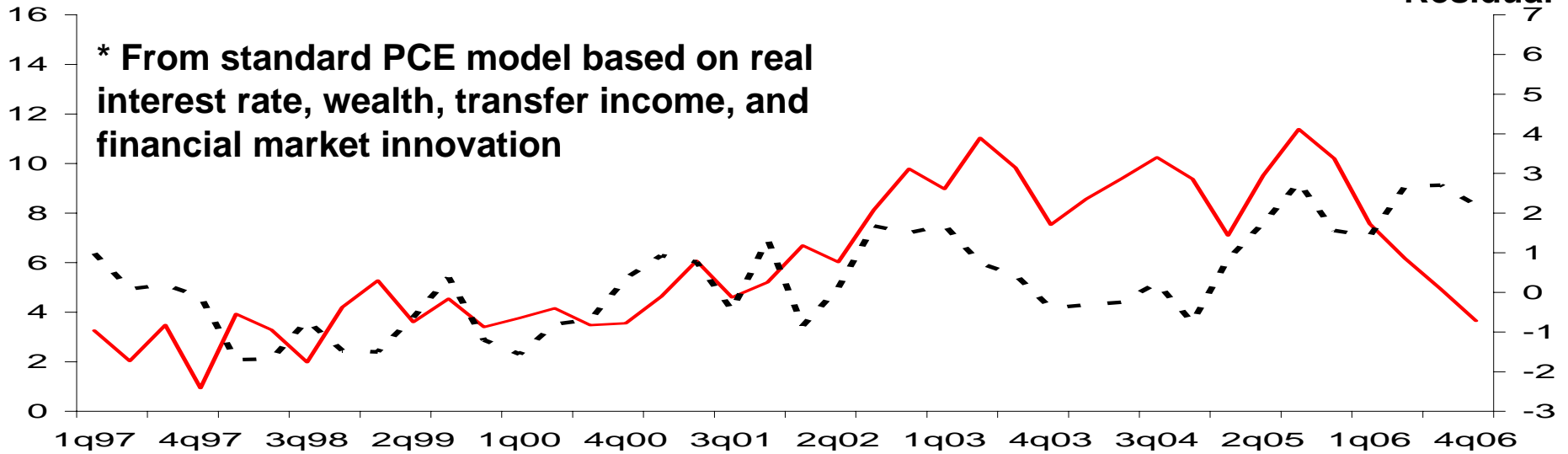
## Mortgage Equity Withdrawal (\$ Bln)

— Greenspan & Kennedy EST - - Author's EST



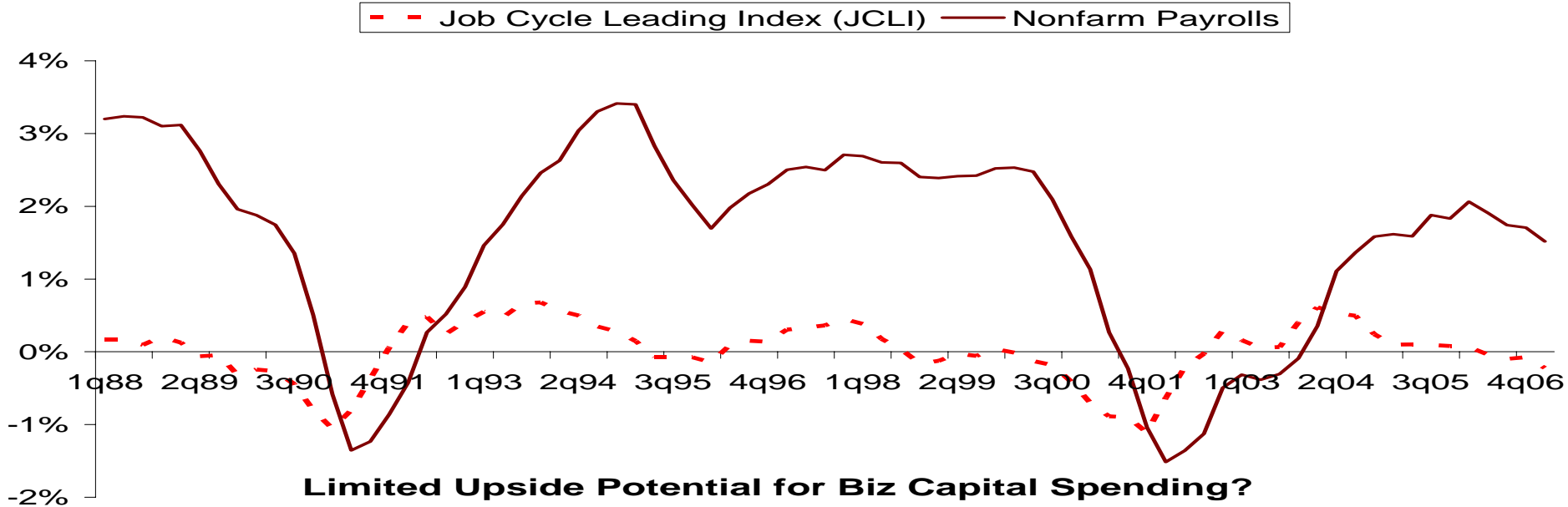
## MEW

— MEW (% of DPI) - - PCE Model Residual\* (%)

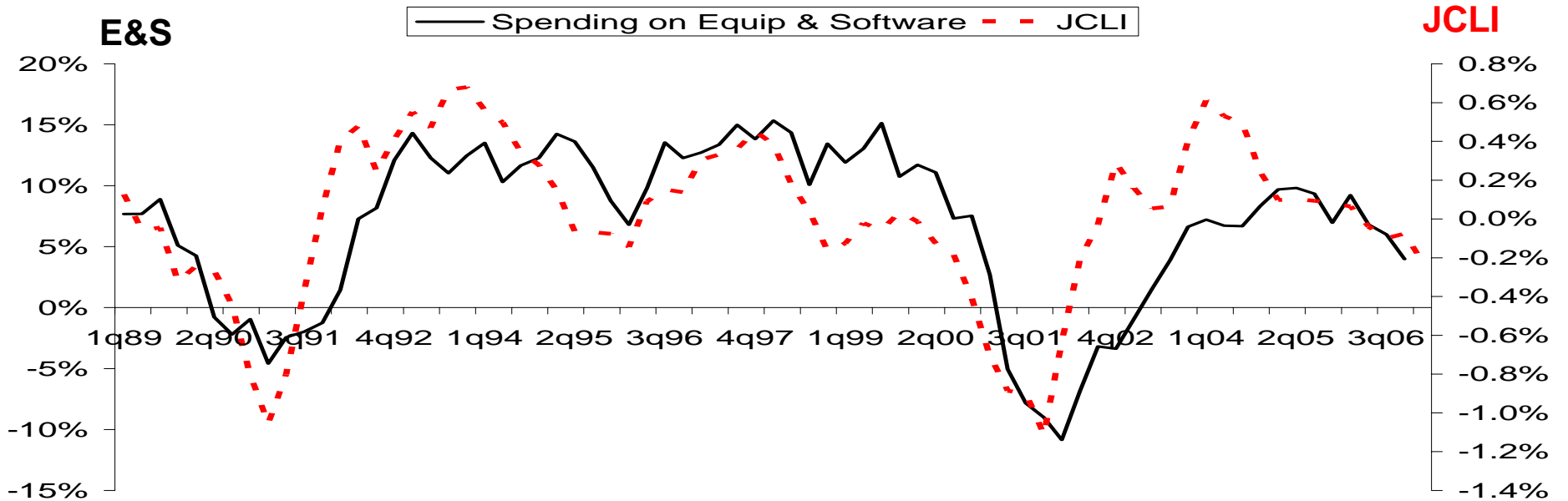


# Capex & Subdued Hiring Trends

## Employment Trends have Slowed

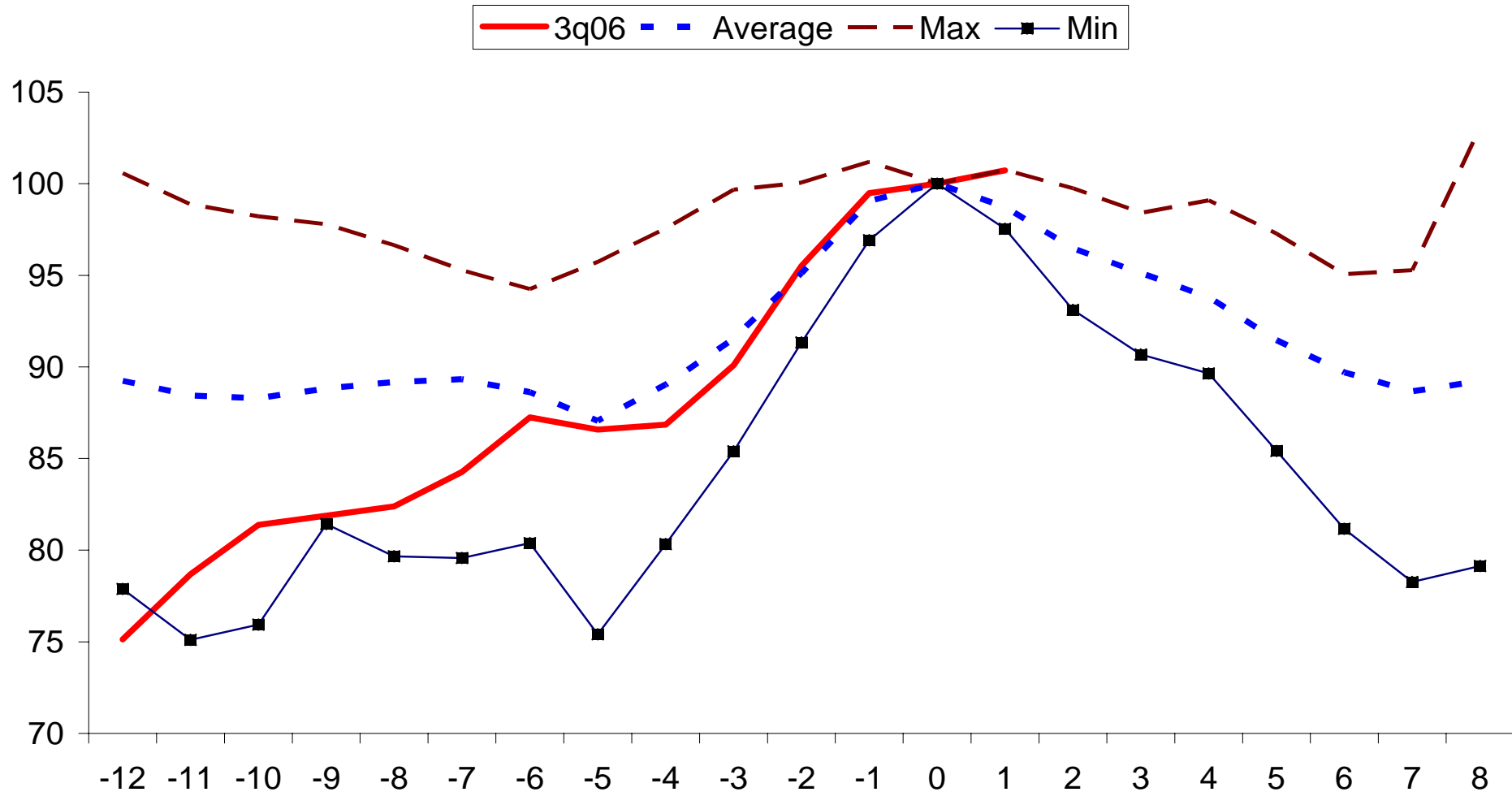


## Limited Upside Potential for Biz Capital Spending?



# Profit Margins...Historical Perspective

## Likely Profit Margin Trajectory?



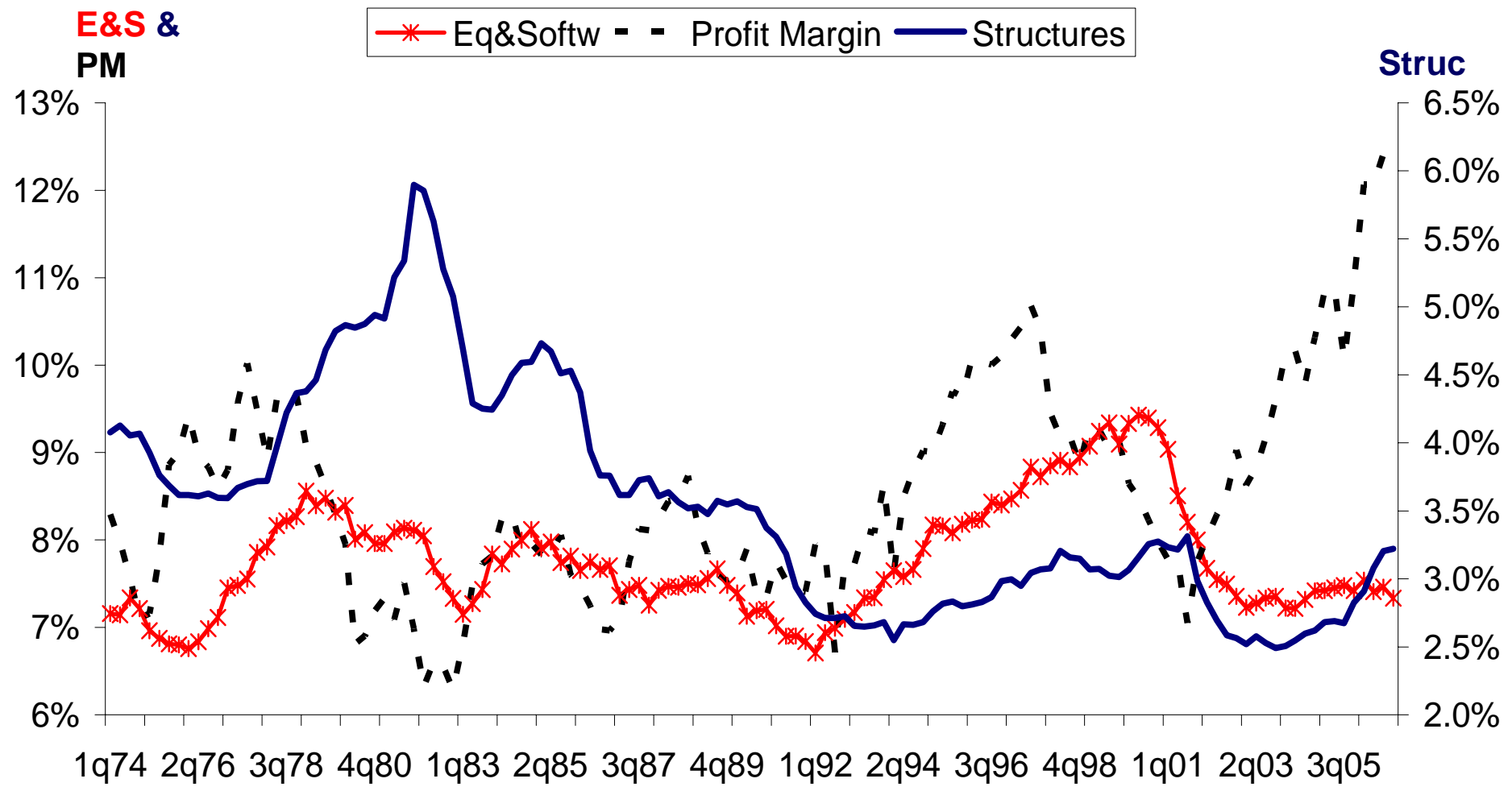
0=Peak

(-)=Pre-peak quarters

(+)=Post-peak quarters

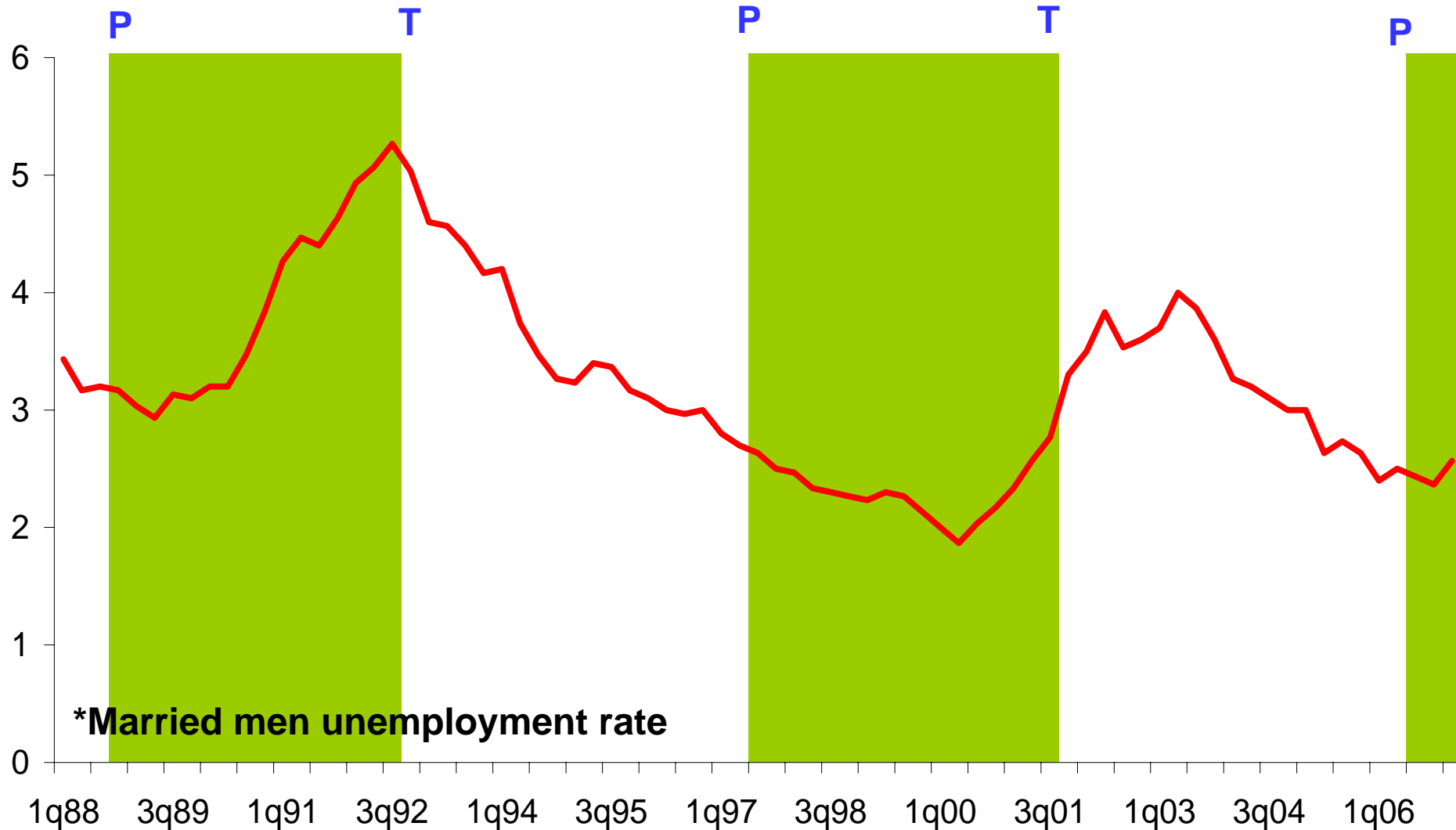
# The Dynamics of BFI

## The Categories of Biz Fixed Investment: Lead-Lag Relationship (% of GDP)



# The Unemployment Rate Puzzle?

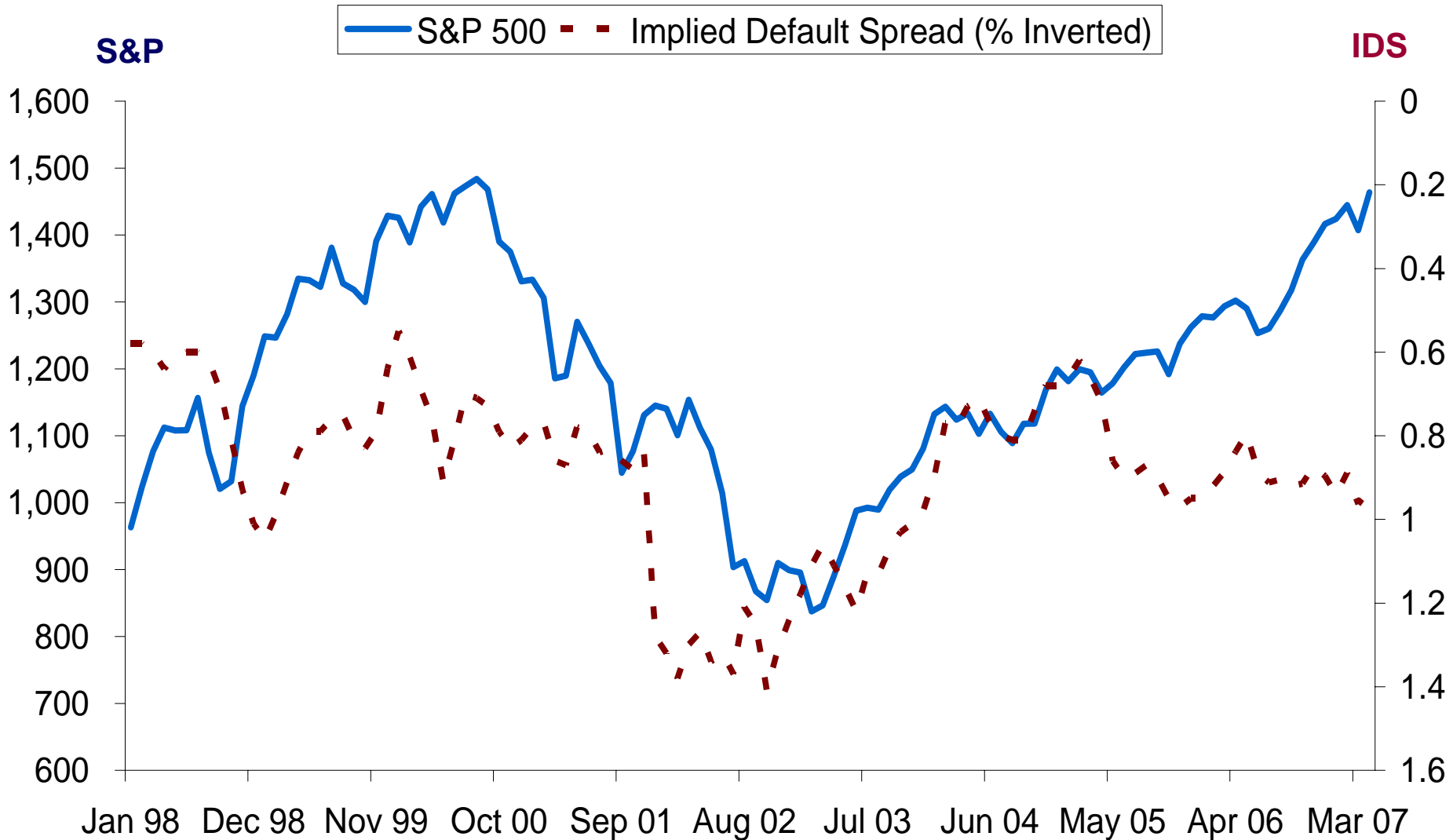
## Unemployment Rate\* (%) & Profit Margin Cycle



\*Married men unemployment rate

# Investor Psychology & Risk Spread

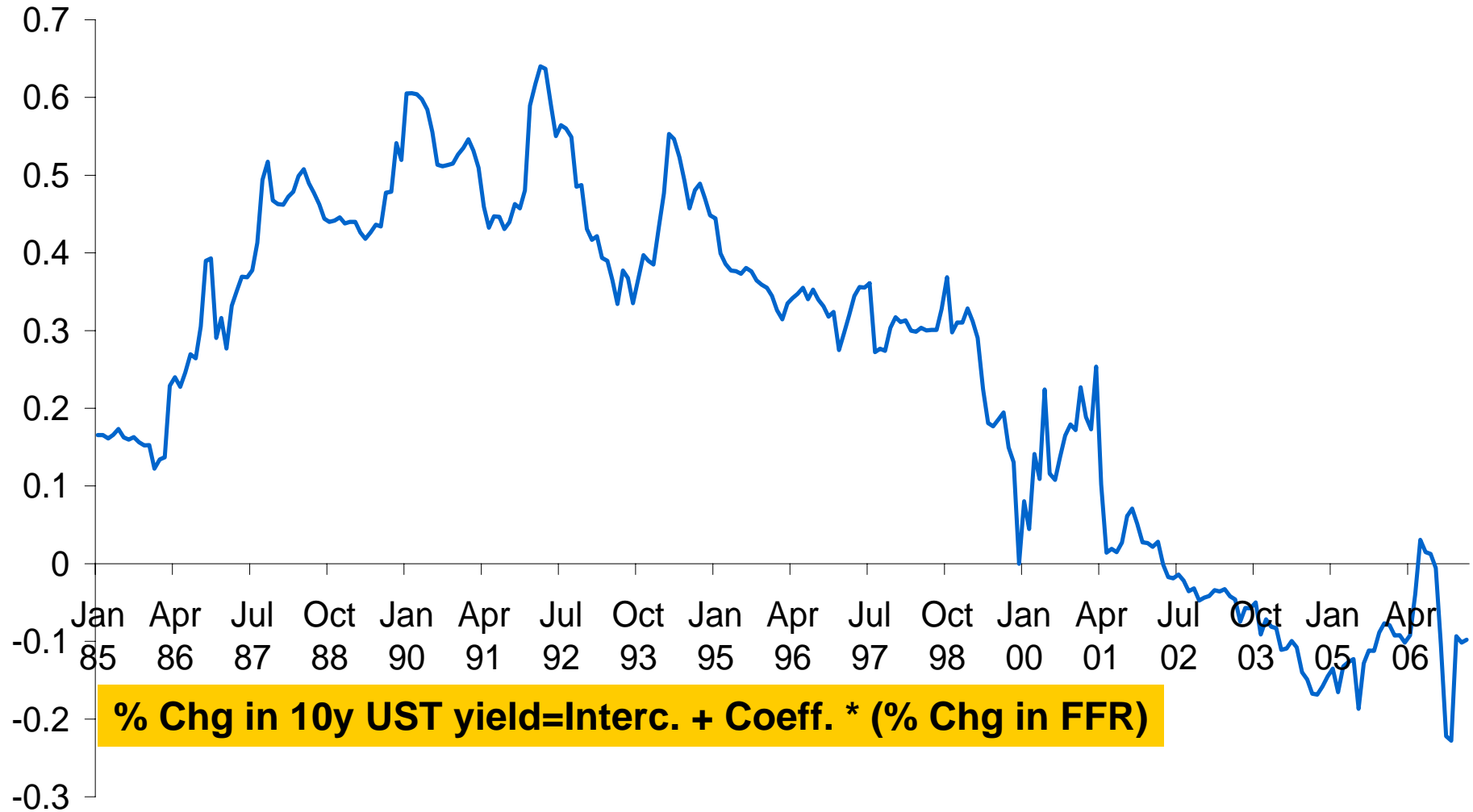
## Sustainable or Spooky?



# Interest Rate Dynamics

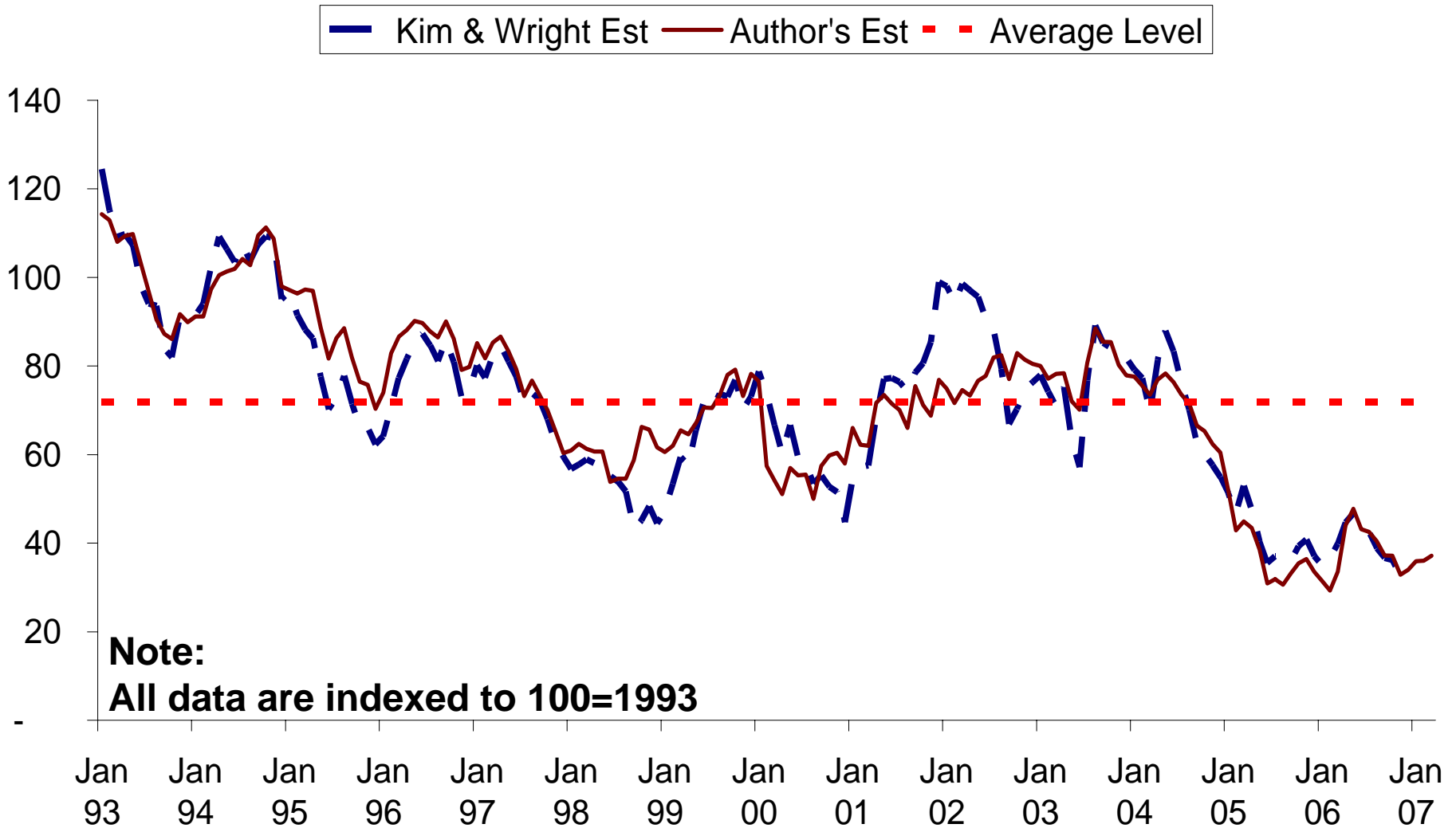
## The "Responsiveness" of the 10-year US Treasury Yield

Rolling  
Coefficient



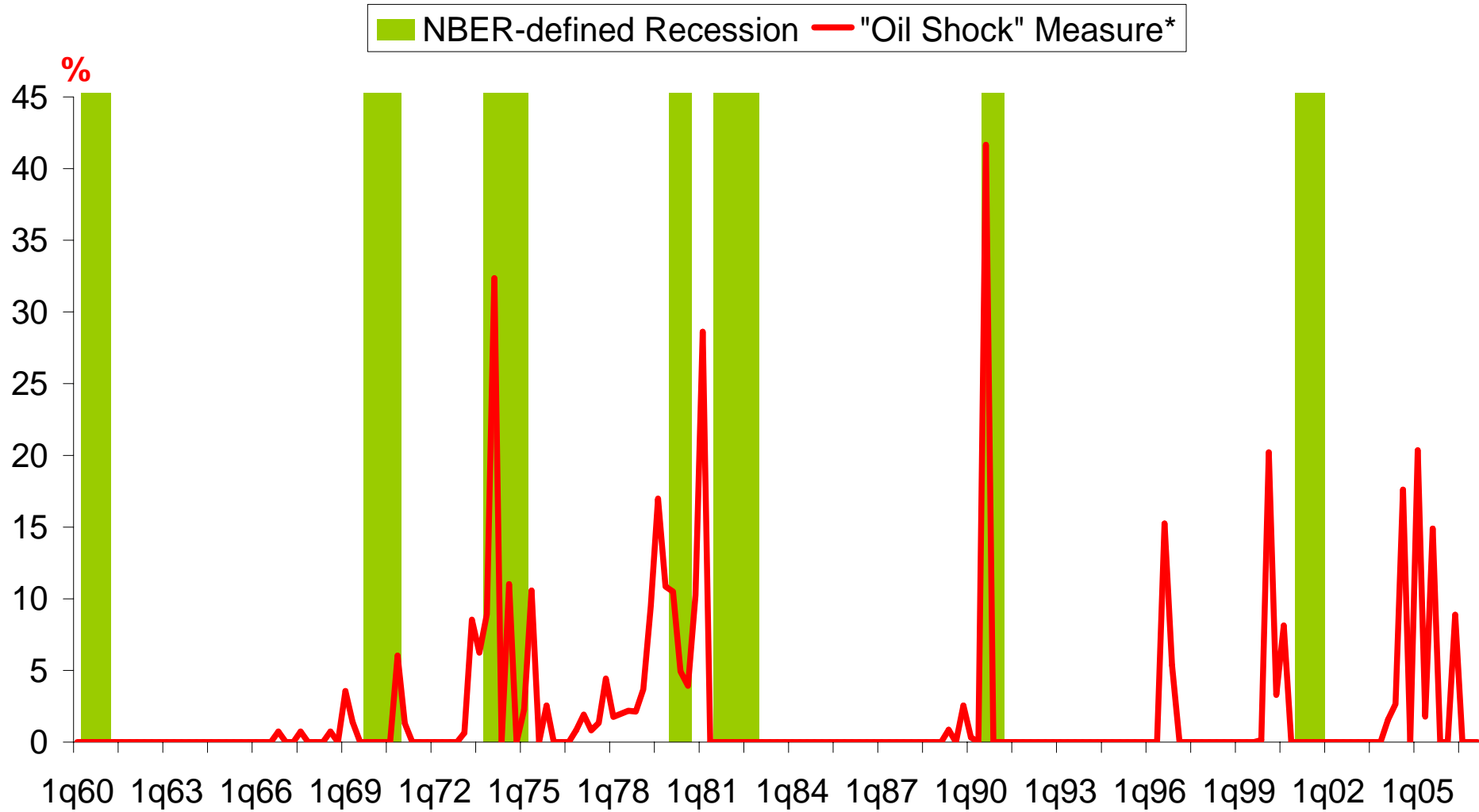
# The "Conundrum" Factor

## Implied Forward Term Premium on the 10-year US Treasury Yield



# Oil Shocks

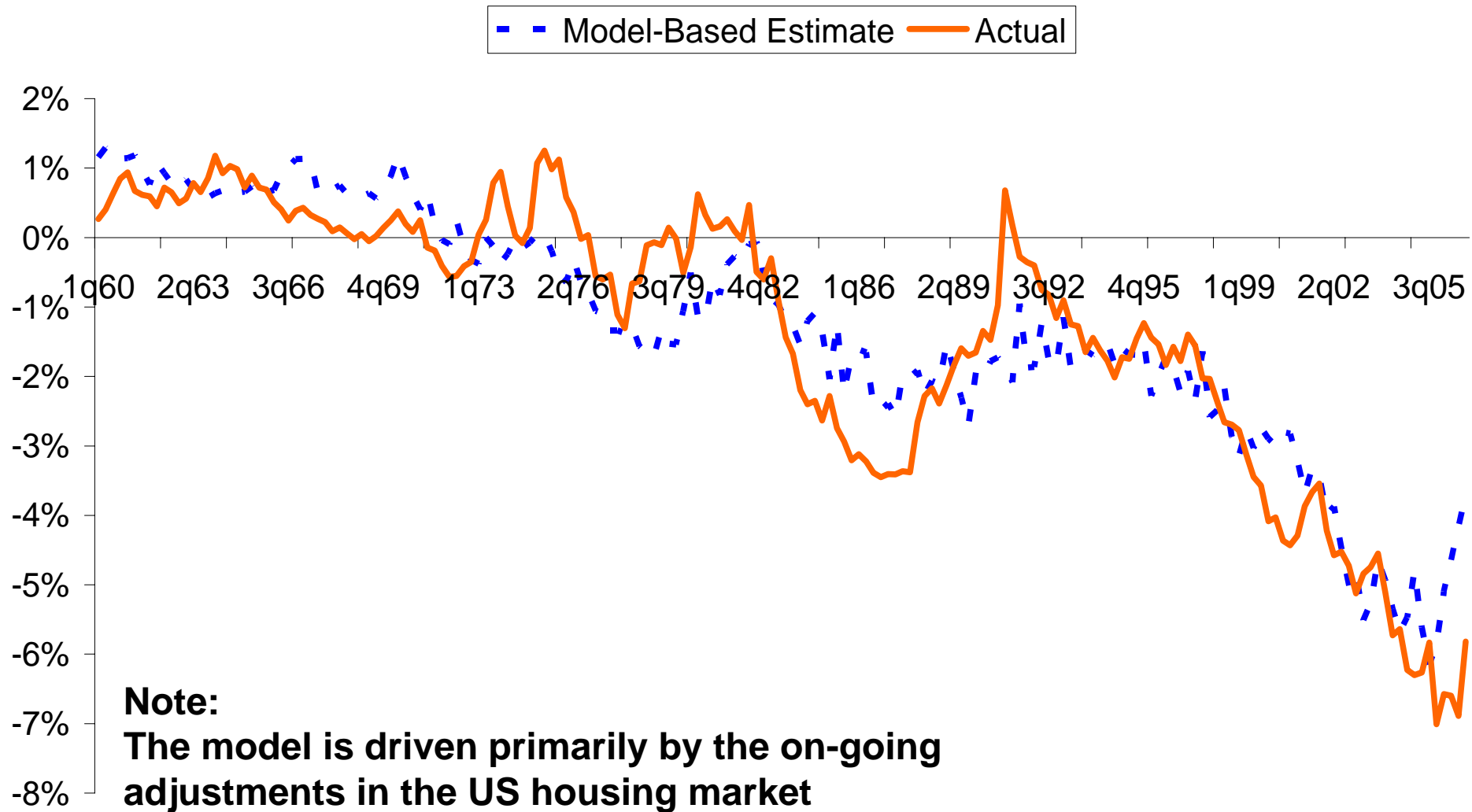
## "Oil Shocks" & Recessions



\* Based on Hamilton's Net Oil Price Increase Measure

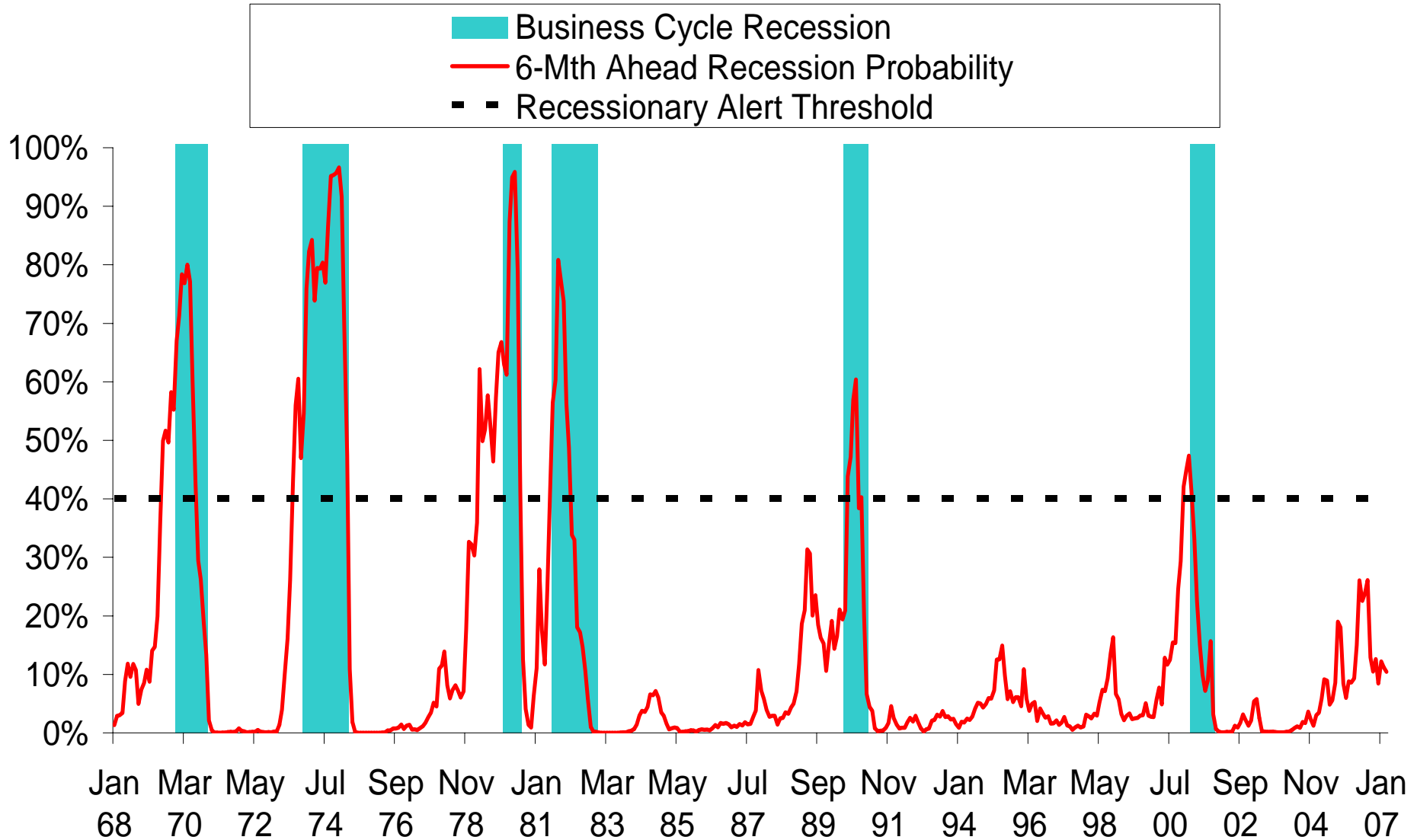
# The Much Debated Current Account

## Current Account Deficit



# Business Cycle Model

## Guidance from the Business Cycle Composite Index (BCCI)



---

# ***Thank You***

**Thomas Lam  
Treasury Economist  
Vice-President  
Global Markets, UOB Group  
May 9, 2007**

***Disclaimer:***

***The views expressed in this presentation are those of the author and do not represent those of UOB Group.***

***\*\*\*The contents of this presentation may not be reproduced without the permission of the author\*\*\****