



The State of the SD Economy

Presentation to the Governor's
Council of Economic Advisors

January 31, 2017

Ralph J. Brown, Professor Emeritus of Economics

University of South Dakota



Outline of Presentation

Overview of US economy

US economy forecast

SD economy

Summary & Conclusions

US Forecast

Global Insight Forecast – January 03, 2017

Real GDP

Consumption,

Housing Starts

Federal Budget

Interest Rates and Inflation



GDP

This is the most tentative forecast that I have seen IHS make in 25 years.

The outcome of the election has spiked “animal spirits.”

“Animal spirits” is a term used by John Maynard Keynes in his 1936 book The General Theory of Employment, Interest, and Money.

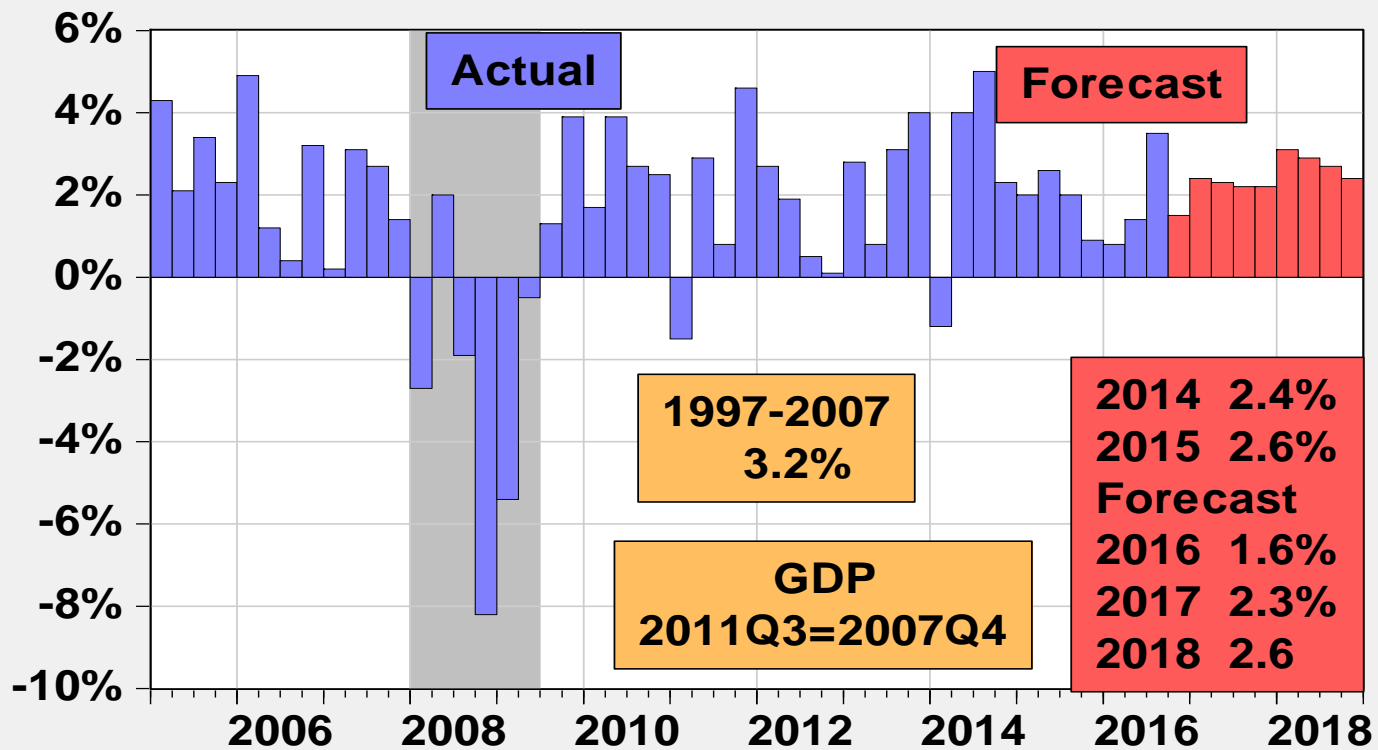
It refers to consumer and business optimism not necessarily based on hard data.

Looking ahead into 2017 and 2018, IHS expects growth GDP growth of 2.3% in 2017 and 2.7% in 2018.

Wells-Fargo thinks the optimism may be overdone and projects the 2.3% in 2017 and 2.2% in 2018.

2.0 to 2.5% Growth

GROSS DOMESTIC PRODUCT



Source: BEA and IHS



Components of GDP are:

**GDP = Consumption (69%)
Investment (17%)
Government (18%)
Net Export (-4%)**

Consumption

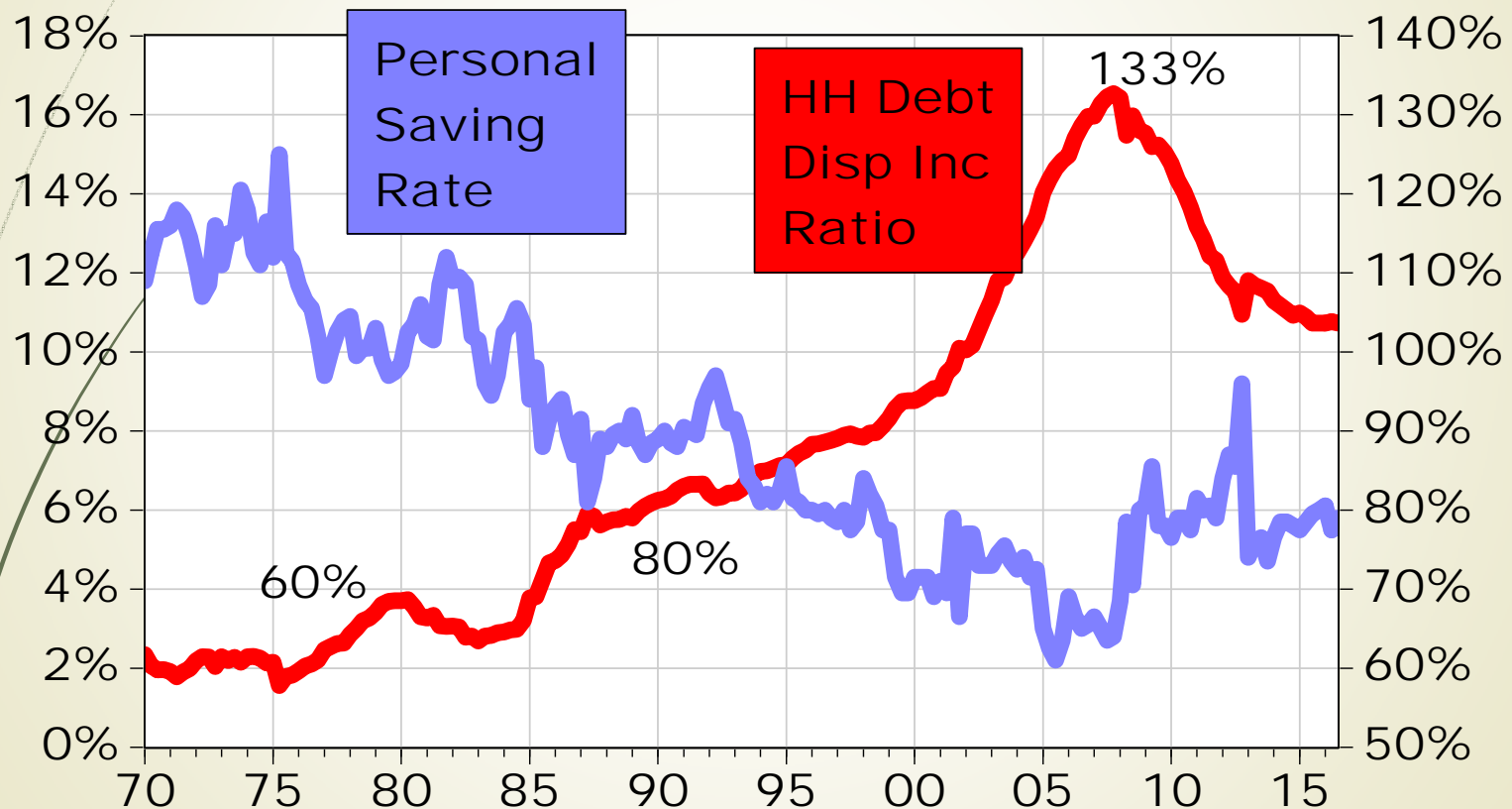
Consumption spending will pick up in 2017 and 2018 reaching 2.7% in 2017 and 3.2%, respectively.

The Conference Board Consumer Confidence Index in December hit its highest level since 2007 and the Michigan Consumer Sentiment Index since 2004.

Projected tax cuts and infrastructure spending will boost real income and consumer spending in late 2017 and 2018.

Deleveraging Continues

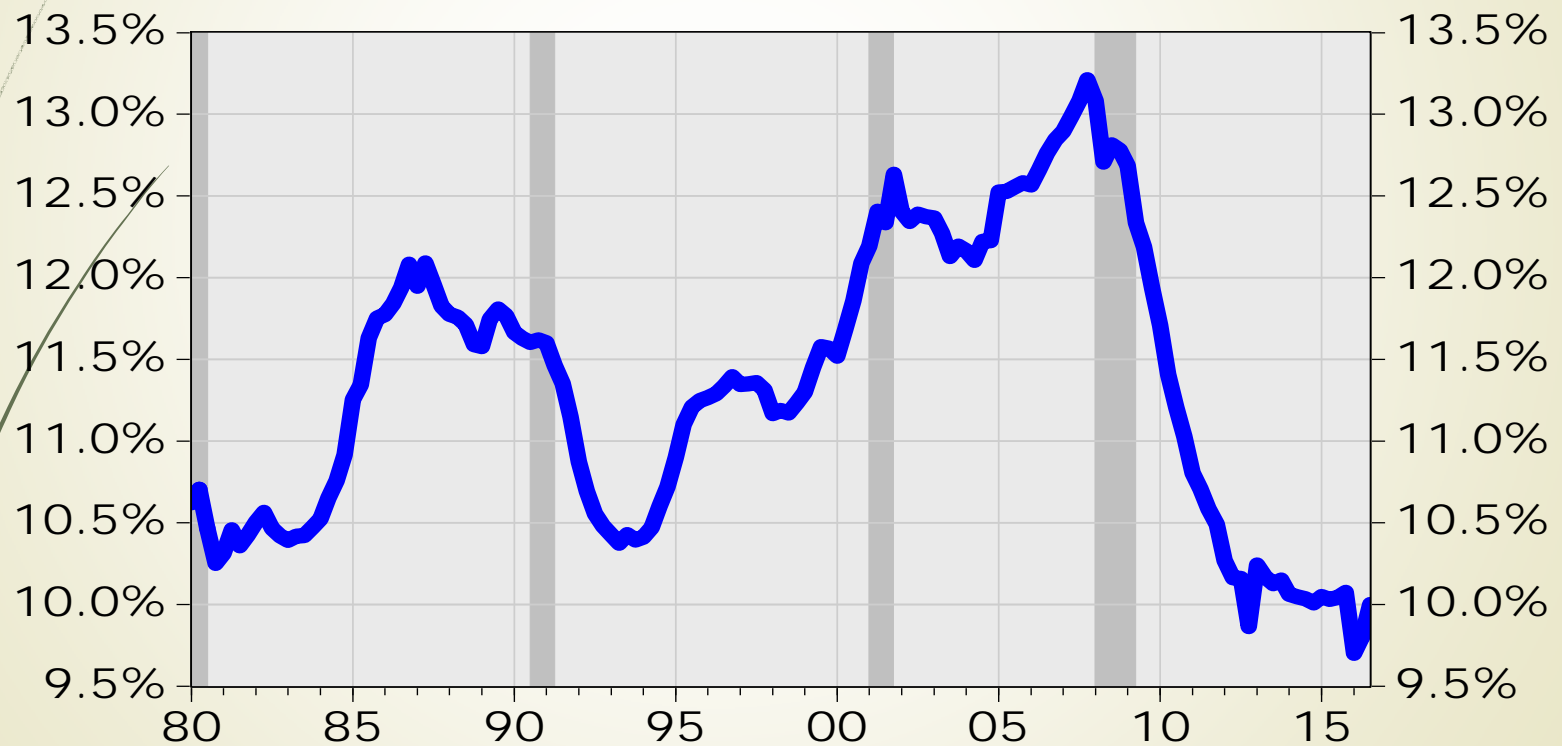
HOUSEHOLD DEBT AND SAVING RATE



Source: BEA and FED

Record Low Debt Service

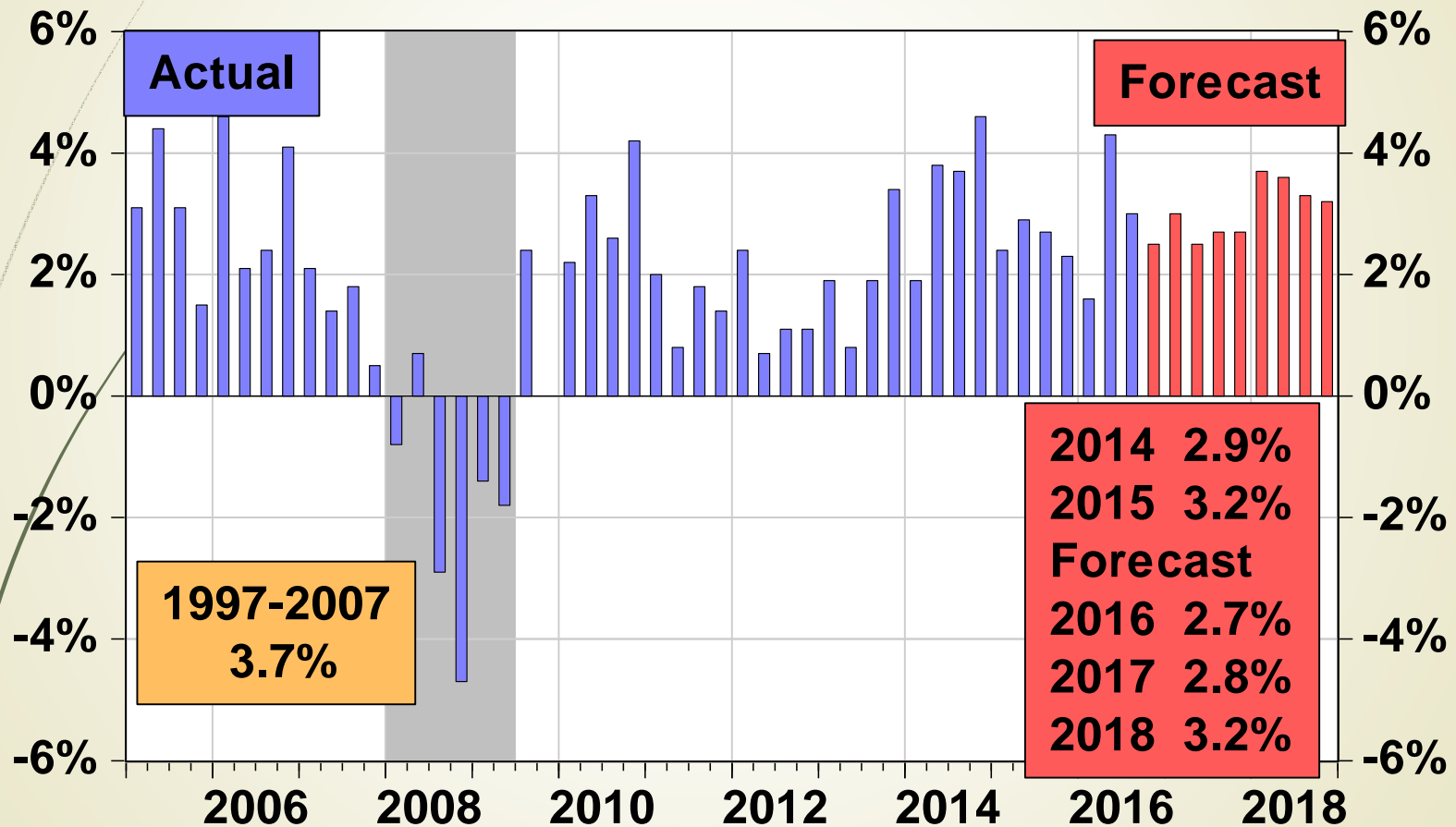
HH DEBT SERVICE AS % OF
DISPOSABLE PERSONAL INCOME



Source: BEA and Federal Reserve System

Faster Growth Projected

REAL CONSUMPTION



Source: BEA and IHS

Investment Sector

The business sector has become quite optimistic with expected tax cuts, infrastructure spending, less regulation, and easier to repatriate profits.

Equipment spending is projected to increase into 2017 and 2018 after a slow year in 2016.

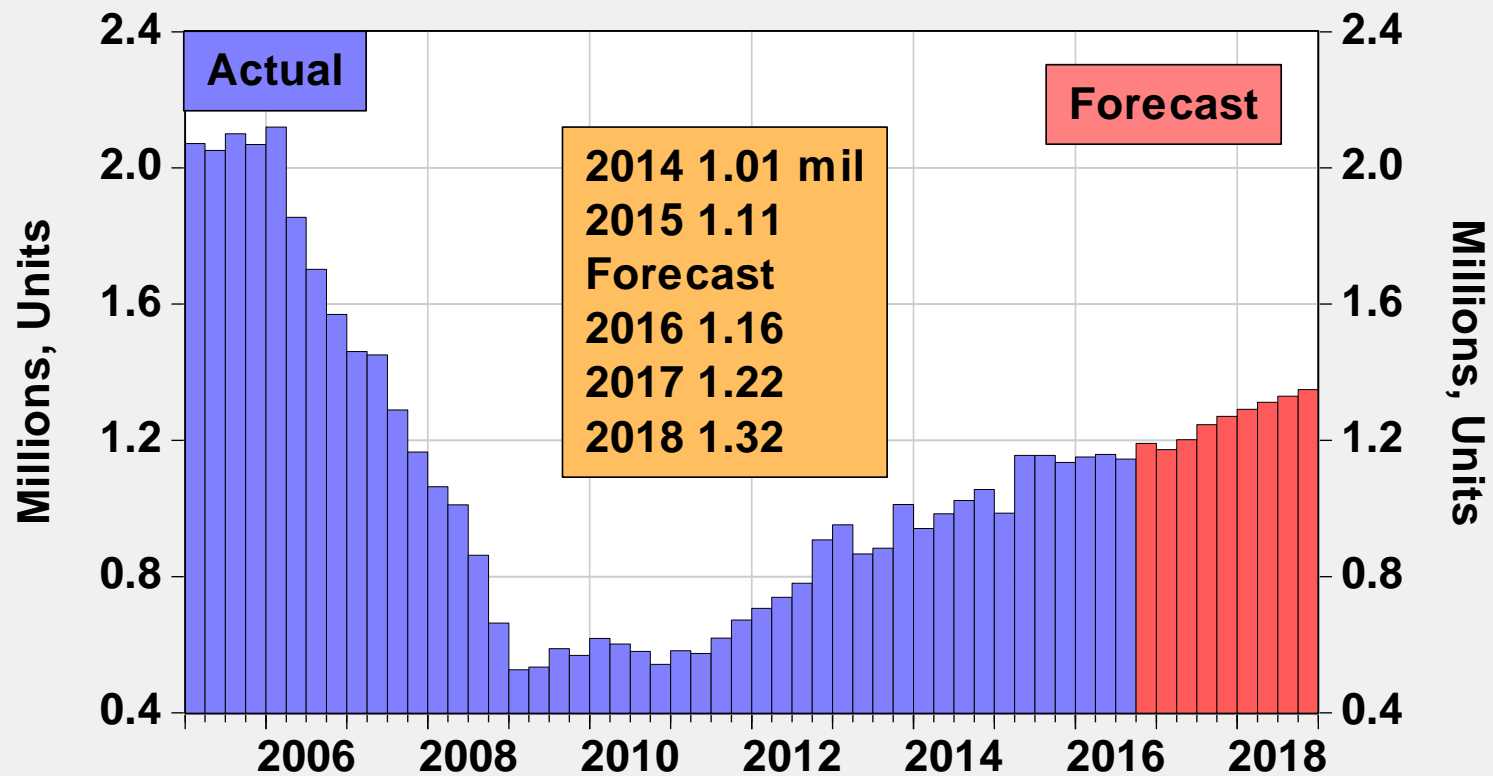
Beginnings of a recovery in oil prices continuing into 2018 will spark an upturn in capital spending in the energy sector.

In the housing sector, they project steady growth; however, higher mortgage rates will hurt affordability and may limit price increases and transactions.

Overall, 2017 and 2018 should see pretty good growth in nonresidential fixed investment.

Recovery Proceeds

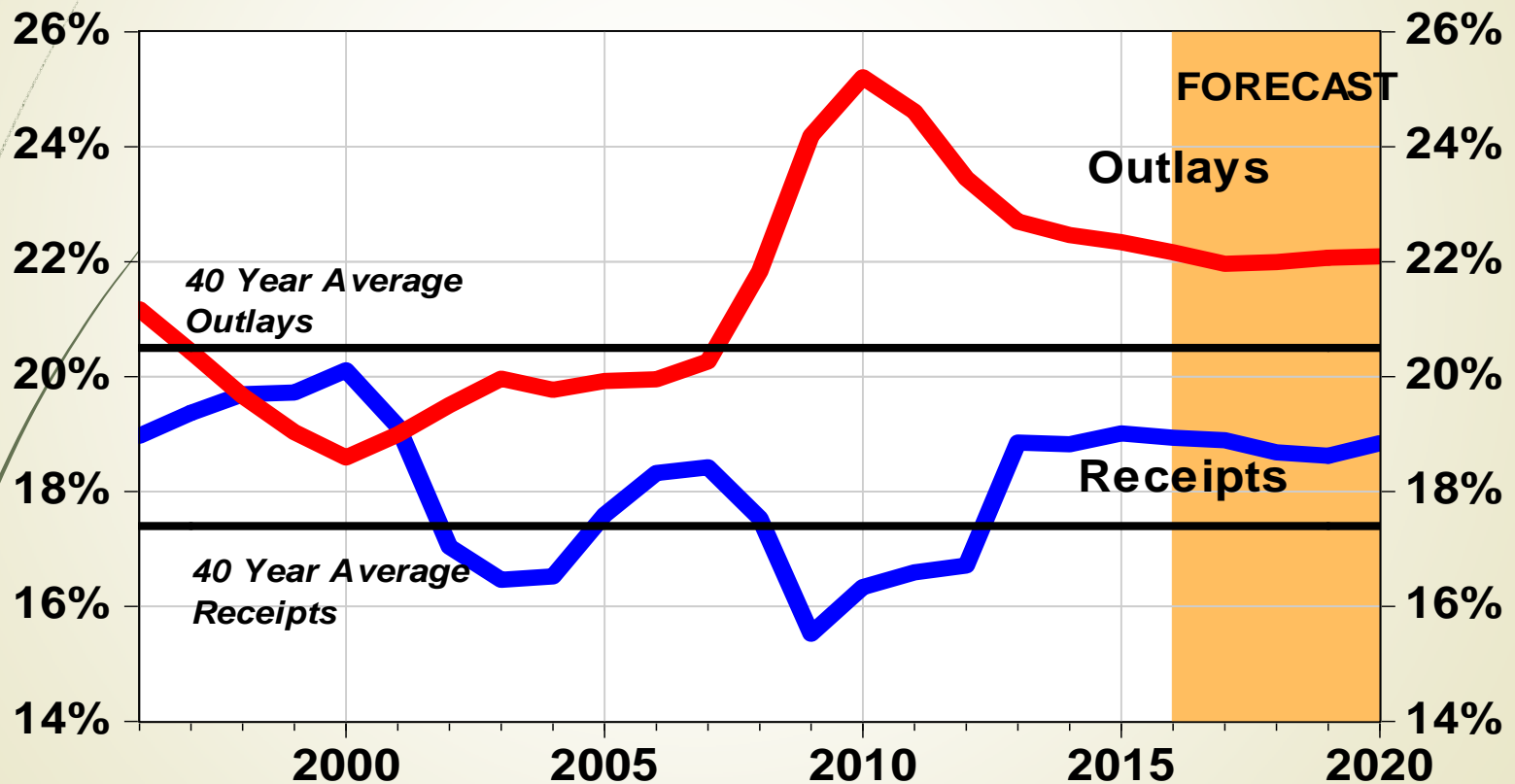
HOUSING STARTS



Source: US Census and IHS

Government Sector

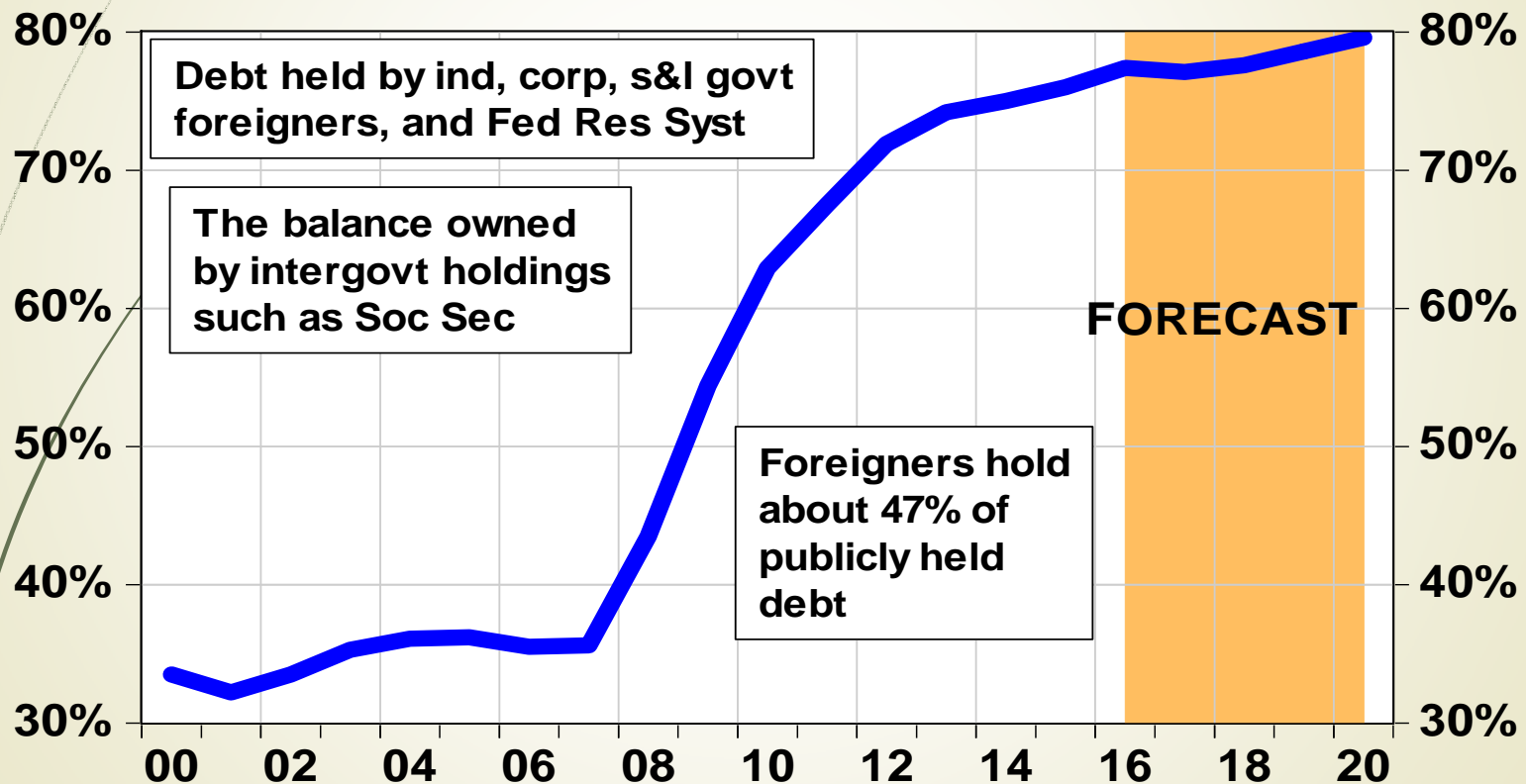
FEDERAL GOVERNMENT AS % OF GDP



BEA AND IHS

Debt Held by Public

FEDERAL DEBT HELD BY PUBLIC AS % OF GDP



Source: IHS



The Fiscal Picture

IHS reports NASBO indicates many states are experiencing revenue disappointments. Both income and sales tax revenue have fallen short of their targets.

The good news for SD is the Amazon agreement.

IHS's baseline forecast incorporates their refined thinking (guessing) about corporate tax changes.

IHS has lowered the federal tax statutory rate from 35% to 20%. However, one of the big issues determining the effective rate is tax loopholes.

According IHS, "our expectation is that the new administration will fail to remove as many preferences and loopholes as promised, leading to a 4-percentage point lower effective rate."



Foreign Sector

\$ at highest level since 2003 and expected to continue strong. The Euro will settle at about par with the US \$ and the pound will fall to as low as \$1.15.

GDP growth for the nation's major currency trading partners is assumed to average 1.7% through 2026. A pickup in growth in Euroland will help offset some the effect of the strong \$ on the trade balance.

"The elephant in the room: The IHS forecast currently does not incorporate proposed changes to trade and immigration policies by the incoming administration because, as of now, projecting what policies will look like a year from is quesswork."

Employment & Unemployment

Pretty good job growth this past year at 187,000 per month.

The December 2016 numbers did see some pick up wage growth to 2.9% per year.

Payroll employment growth is expected to slow to 1.3% in 2017 and 1.2% in 2018, down from 2.1% in 2015 and 1.7% in 2016.

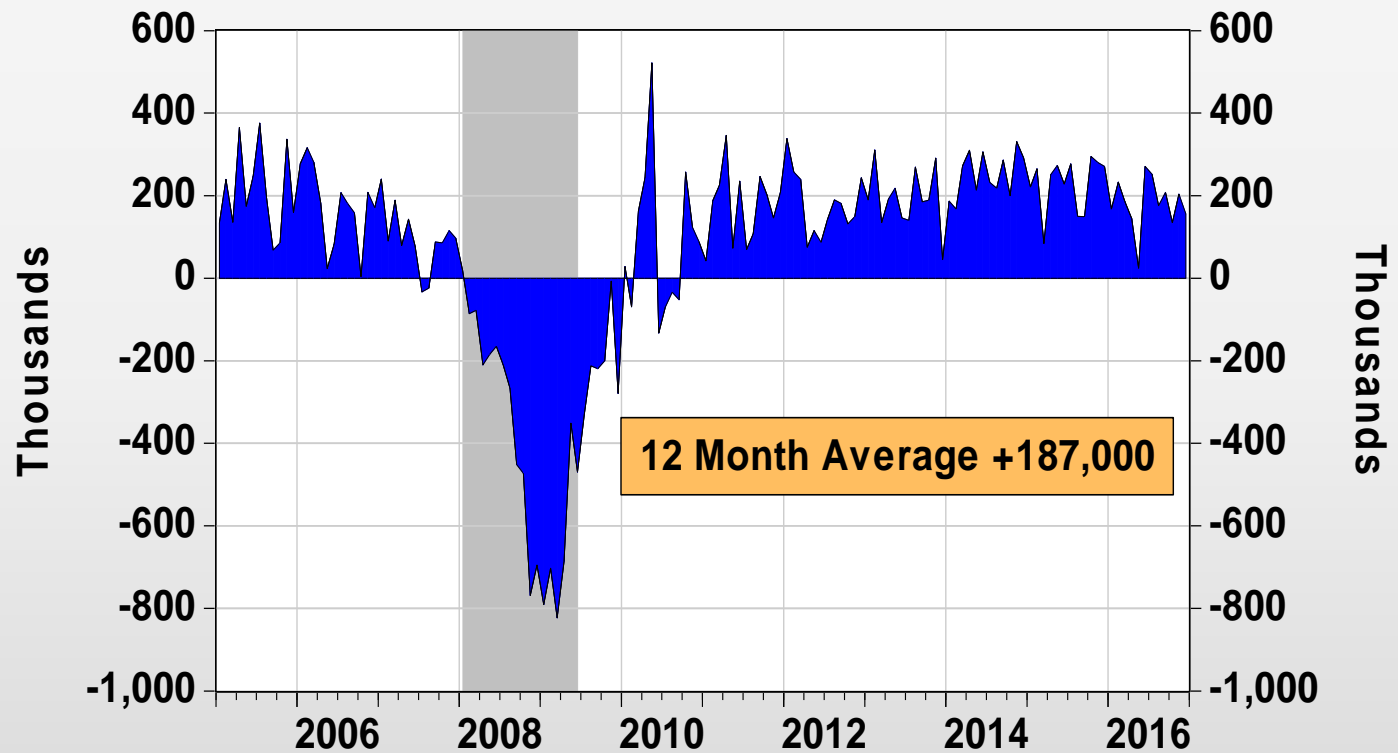
Unemployment rate averaged 5.3% in 2015 and 4.9% in 2016, 4.6% in 2017, 4.3% in 2018.

The labor force participation rate has picked up a little as of late but still low.

Wage growth has picked up to 2.9% in December and should continue at a higher rate in 2017 and 2018.

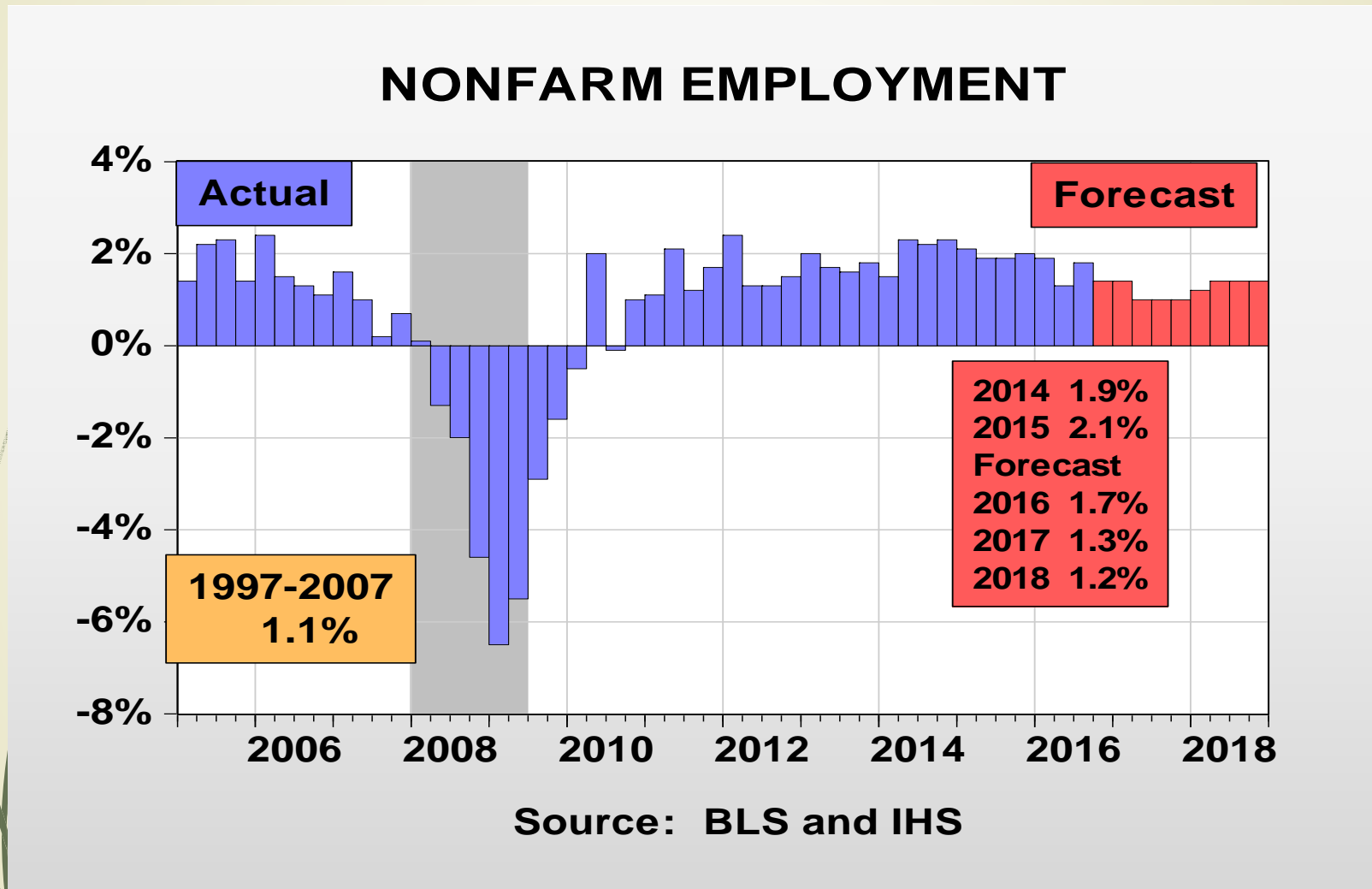
Solid Growth

CHANGE IN NONFARM EMPLOYMENT

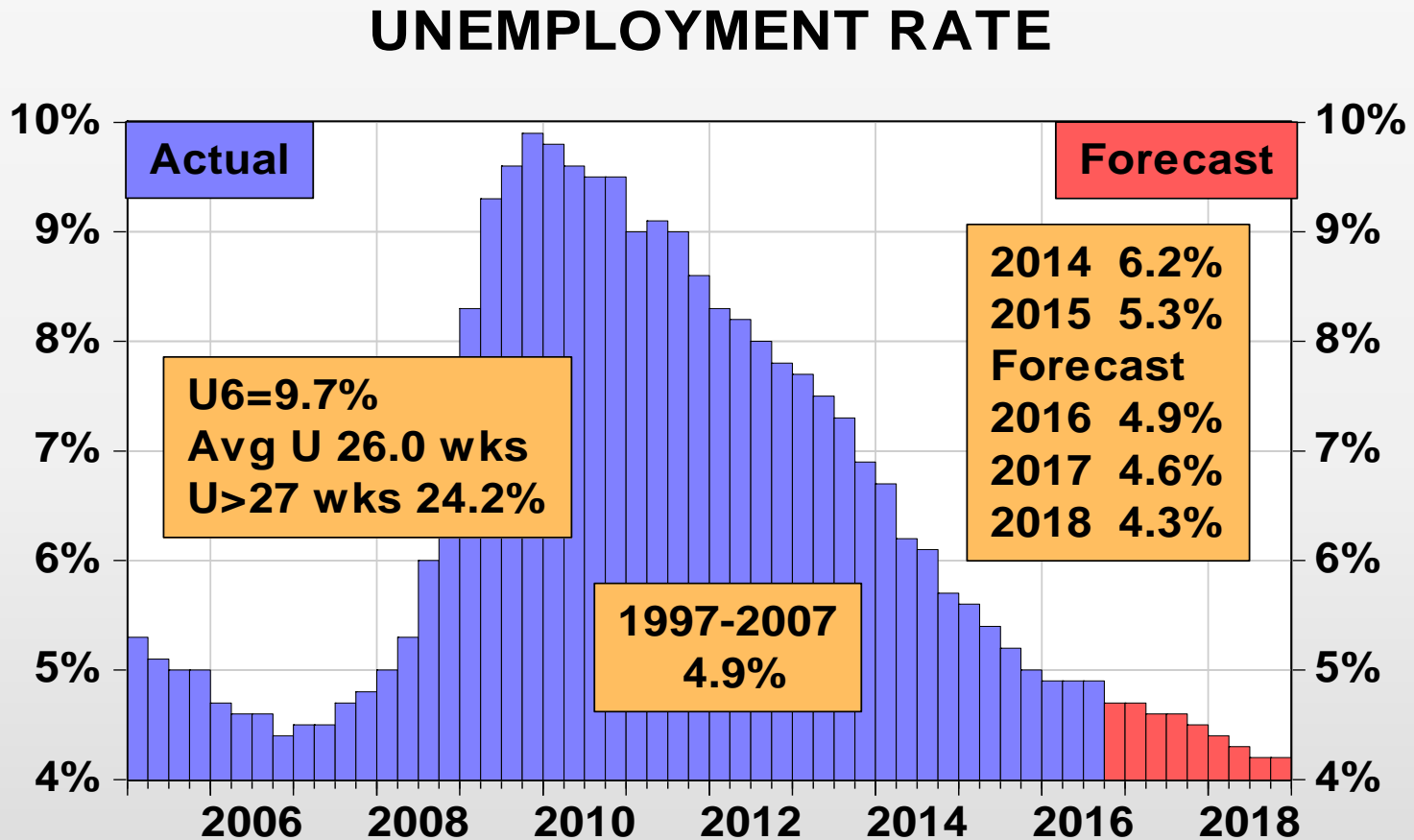


Source: BLS

Future Job Growth Slows



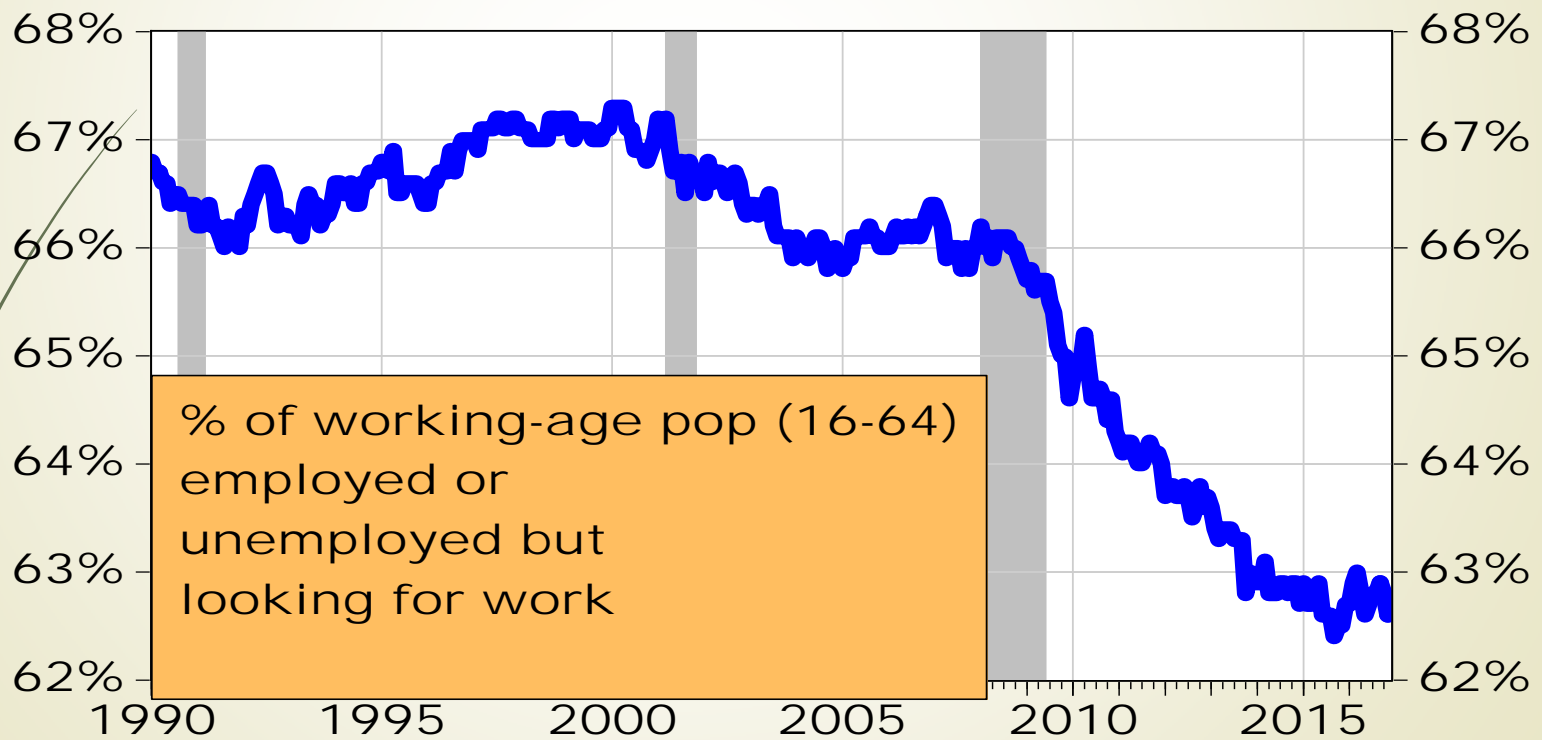
Low U3 Unemployment



Source: BLS and IHS

Labor Participation Rate Not Much Improvement

LABOR FORCE PARTICIPATION RATE



% of working-age pop (16-64)
employed or
unemployed but
looking for work

Source: BLS

Inflation & Interest Rates

As expected, the FOMC raised the federal funds rate from 0.25% to 0.50% in December.

IHS forecasts that the federal funds rate will be increased 25 basis points three more times in 2017 and 2018 bringing the “equilibrium” rate to 3.0% by 2019.

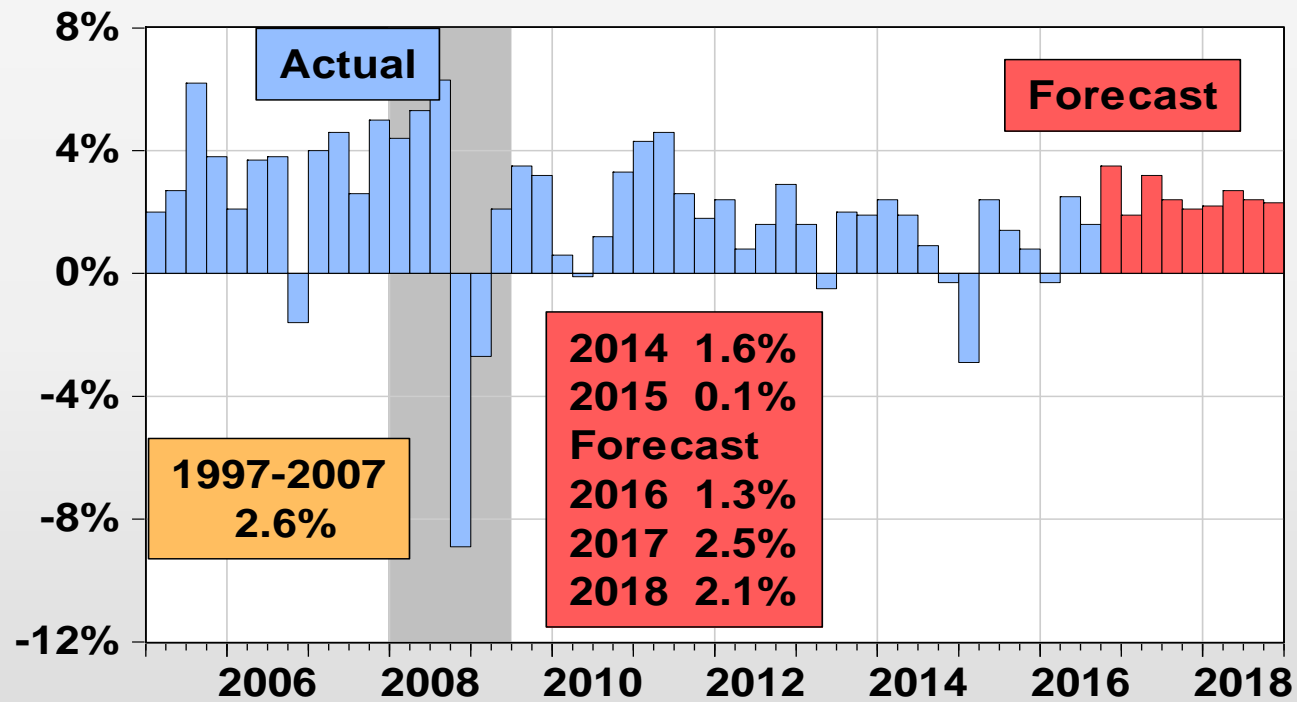
IHS projects west Texas intermediate crude oil prices at \$69 by 2020.

IHS expects the 10 year Treasury note, currently at about 2.4%, to reach 4.0% by 2020 and the 30 year Treasury to reach 4.5%.

Inflation is still very low with the CPI reaching 2.5% in 2017 and 2.1% in 2018.

Still Low But Rising

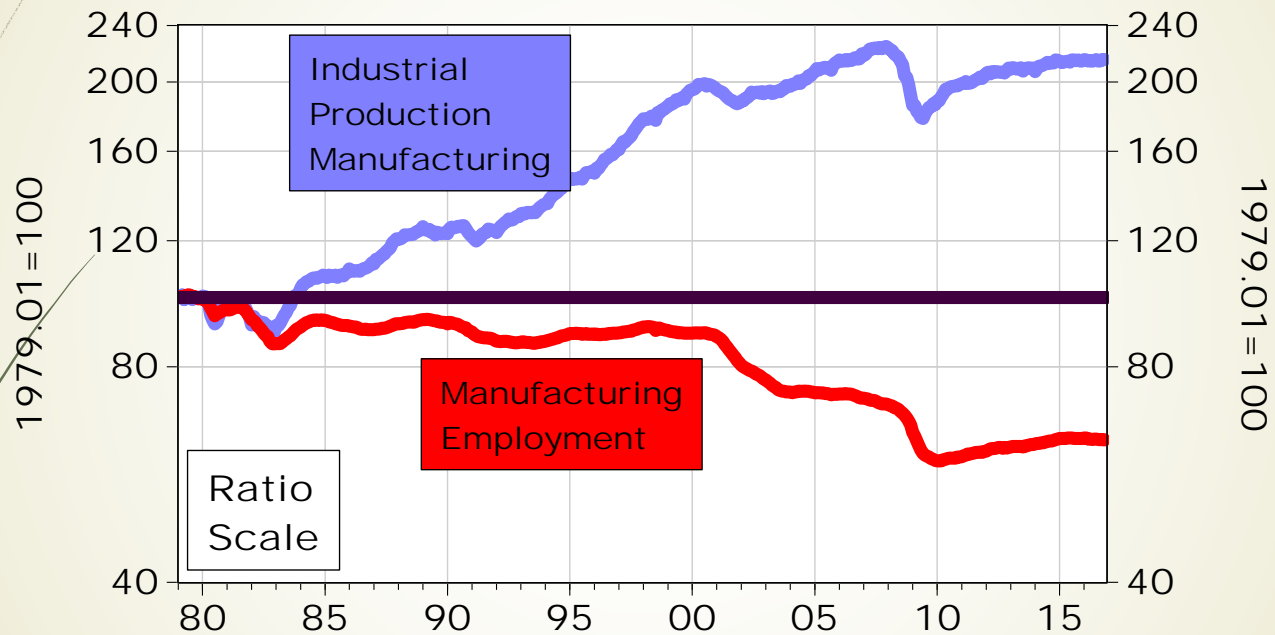
INFLATION: CPI



Source: BLS and IHS

A Discussion on Manufacturing

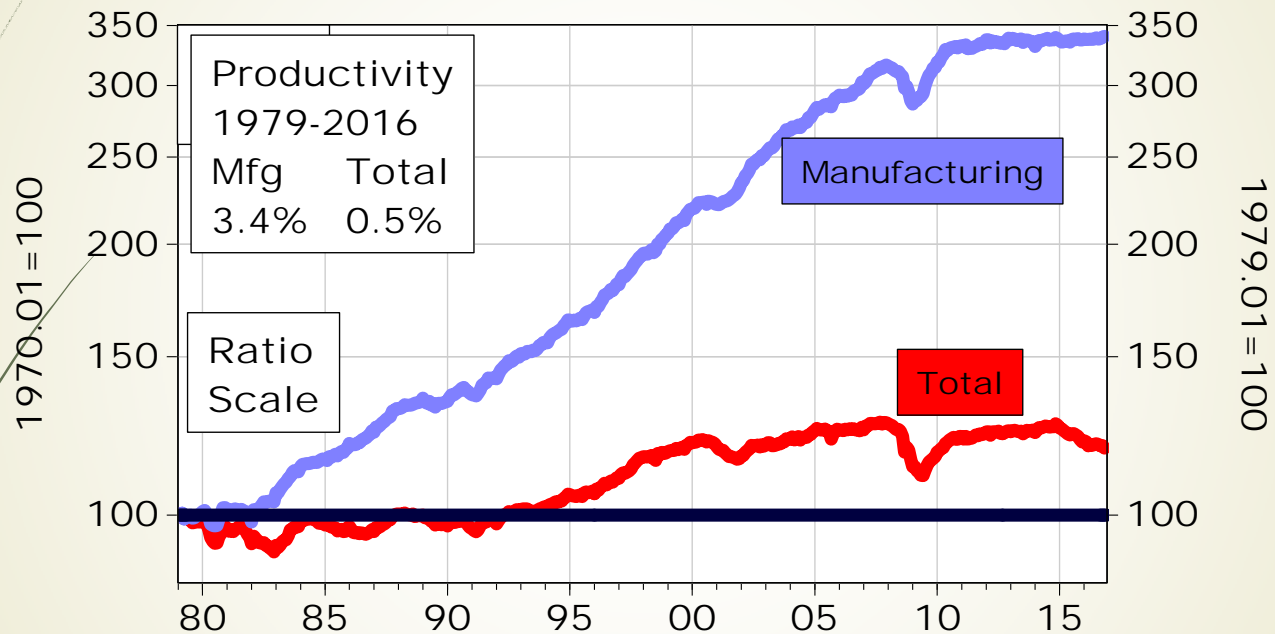
Manufacturing: Output and Employment



Source: Federal Reserve Bank of St. Louis

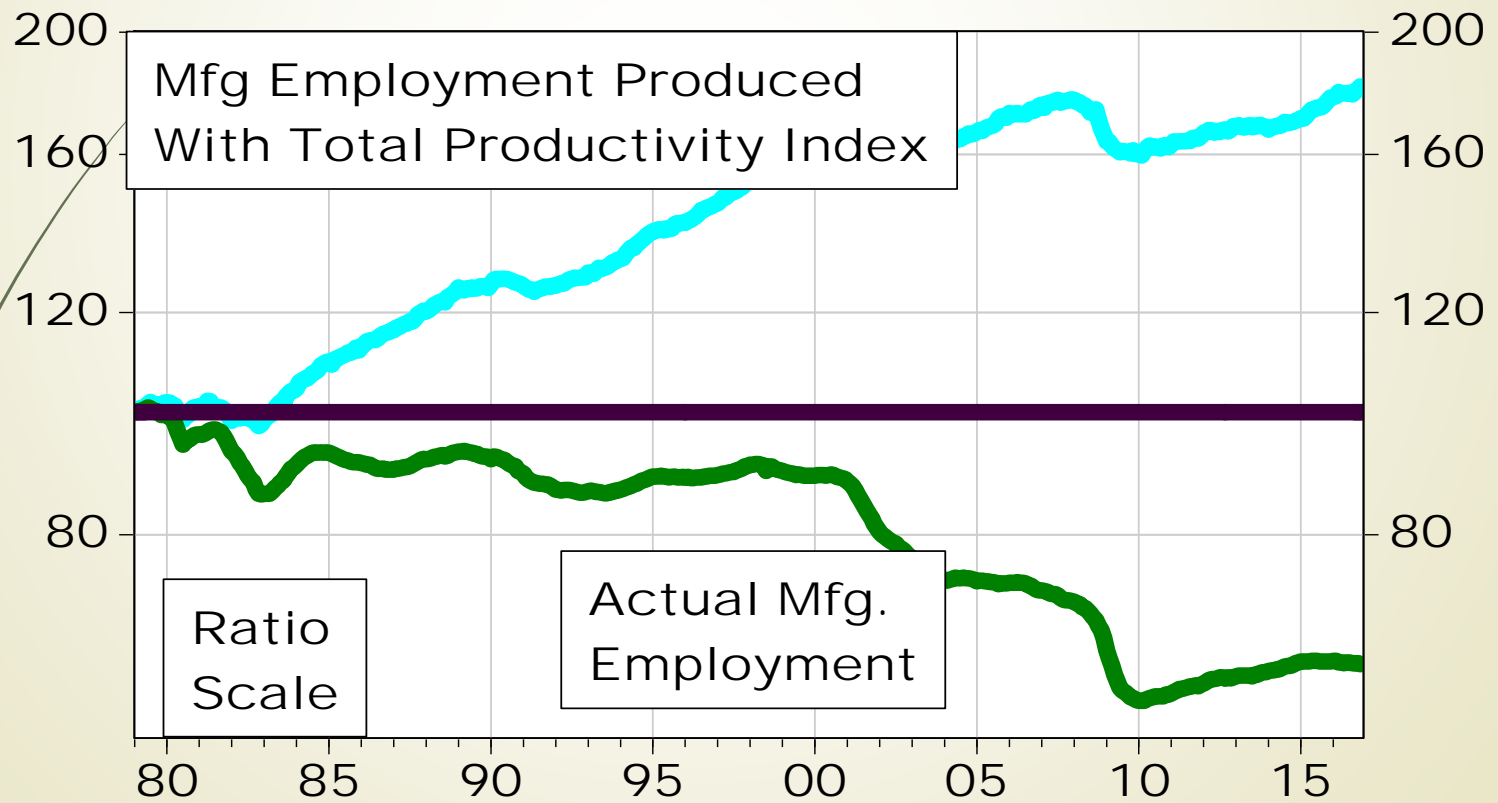
Manufacturing Productivity

Output per Employee: Total & Mfg.



Source: Federal Reserve Bank of St. Louis

Employment Required to Produce Actual Output With Lower Productivity Index





STRUCTURAL CHANGE Nonfarm Employment

	Mfg%	Service%
1950	31%	62%
1960	28%	65%
1970	25%	69%
1980	21%	73%
1990	16%	78%
2000	13%	81%
2010	9%	86%
2015	9%	86%
2020	?	?



Implications



Productivity - Baumol Cost Disease

Wages - dual labor markets

Cyclicalilty



IHS GLOBAL INSIGHT FORECAST January 2017

Variable	2015	2016	2017	2018
GDP	2.6%	1.6%	2.3%	2.6%
Recession Probability 15%				
NA Emp	2.1%	1.7%	1.3%	1.2%
Oil(Brent)	\$53	\$44	\$52	\$57
Housing	1.11	1.16	1.22	1.32
CPI	0.1%	1.3%	2.5%	2.1%
Un Rate	5.3%	4.9%	4.6%	4.3%



Key Variables Tracking SD Economy

Nonfarm employment

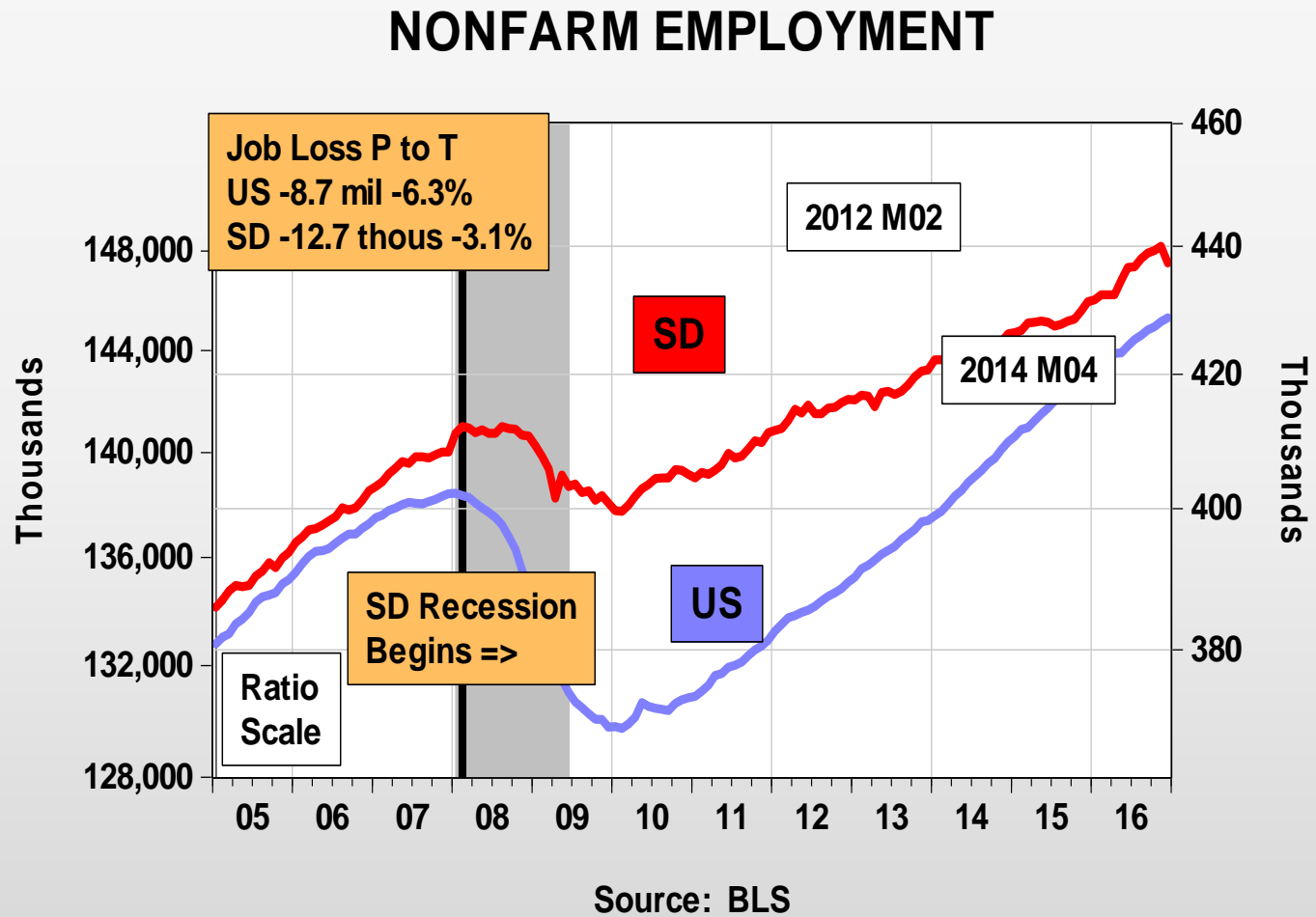
Housing starts

Real nonfarm personal income

Taxable sales

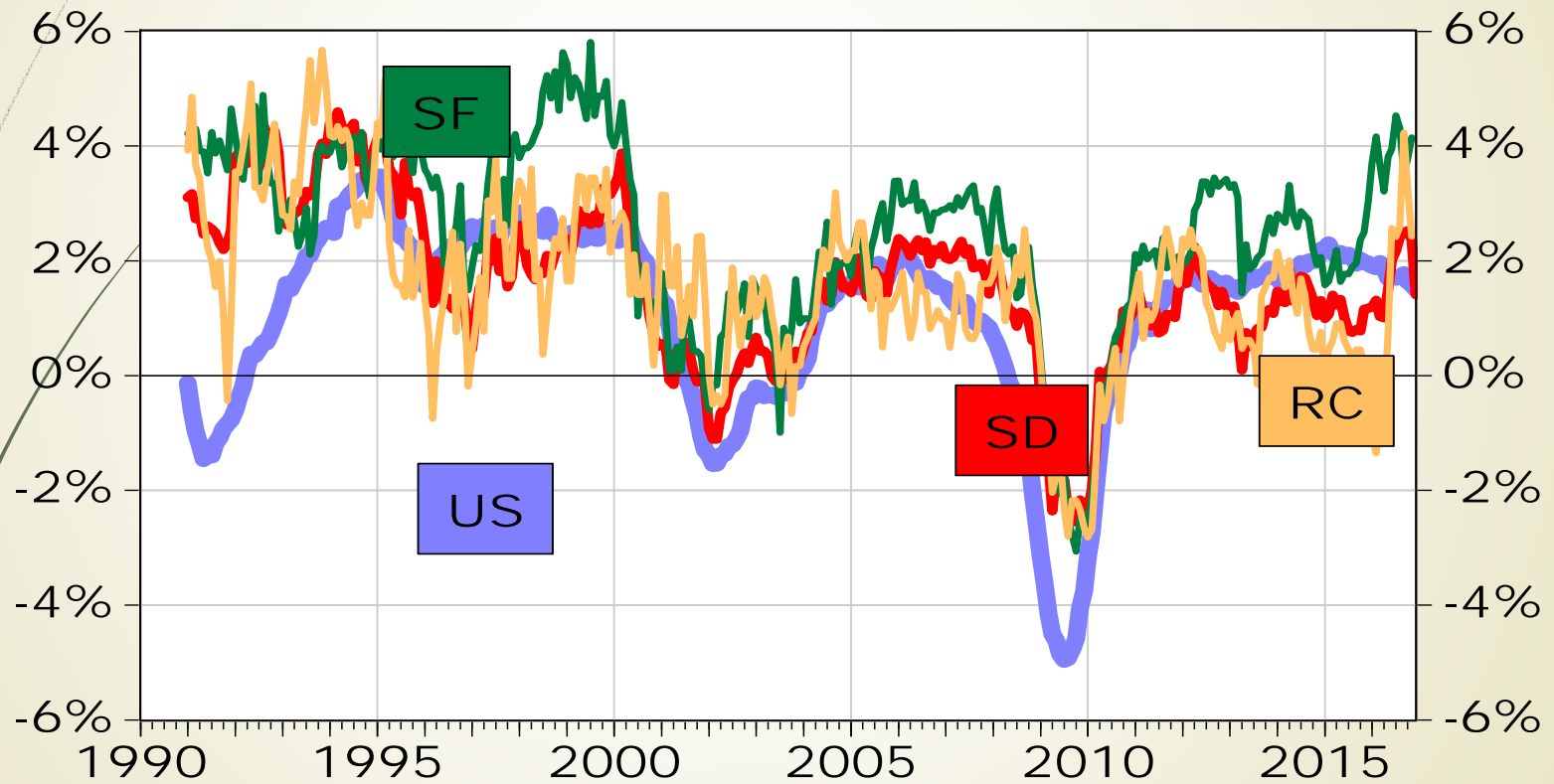
Leading indicator

Steady Growth



Interesting

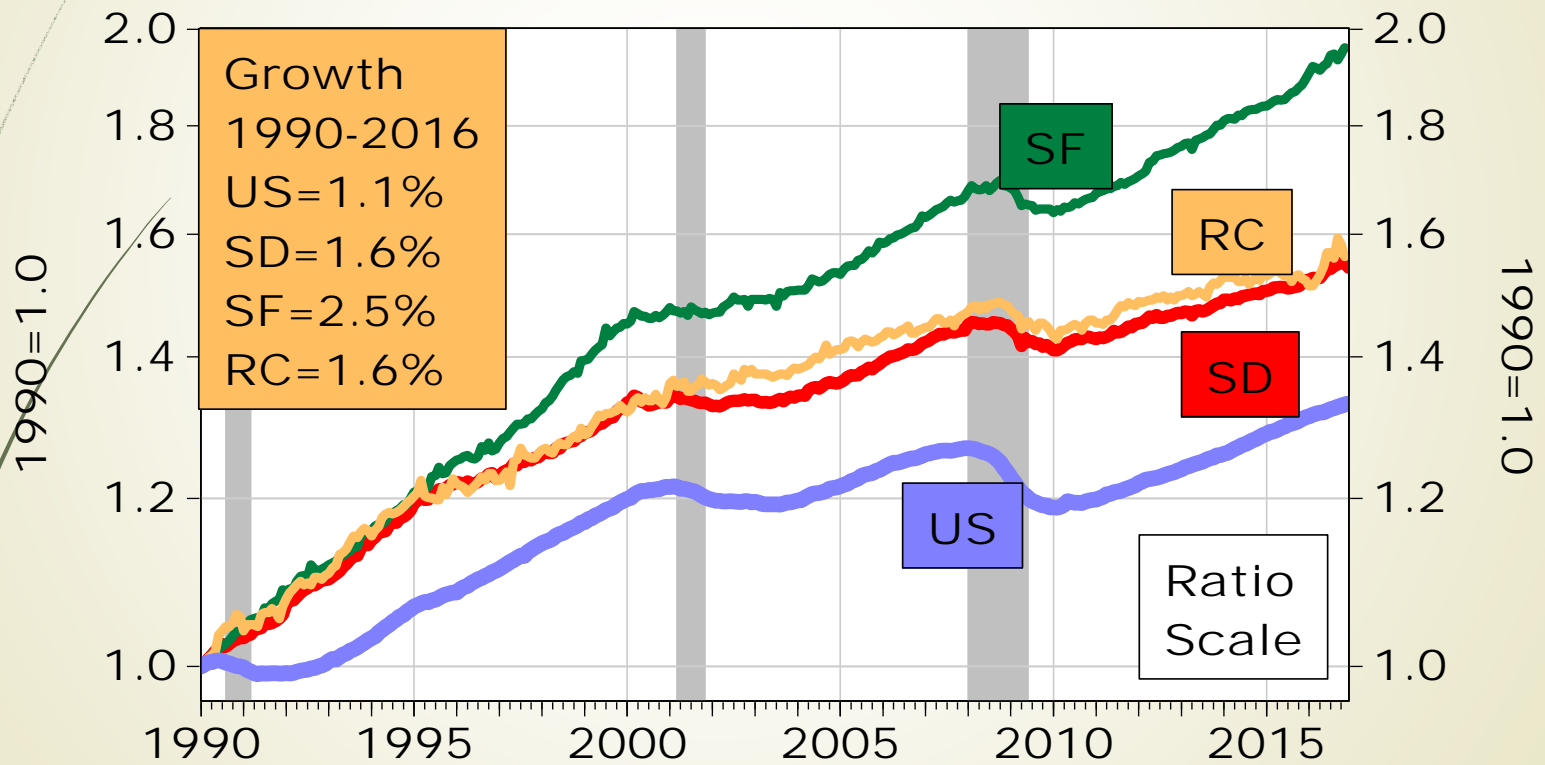
NONFARM EMPLOYMENT



Source: BLS

SF Easily Outpaces the Rest

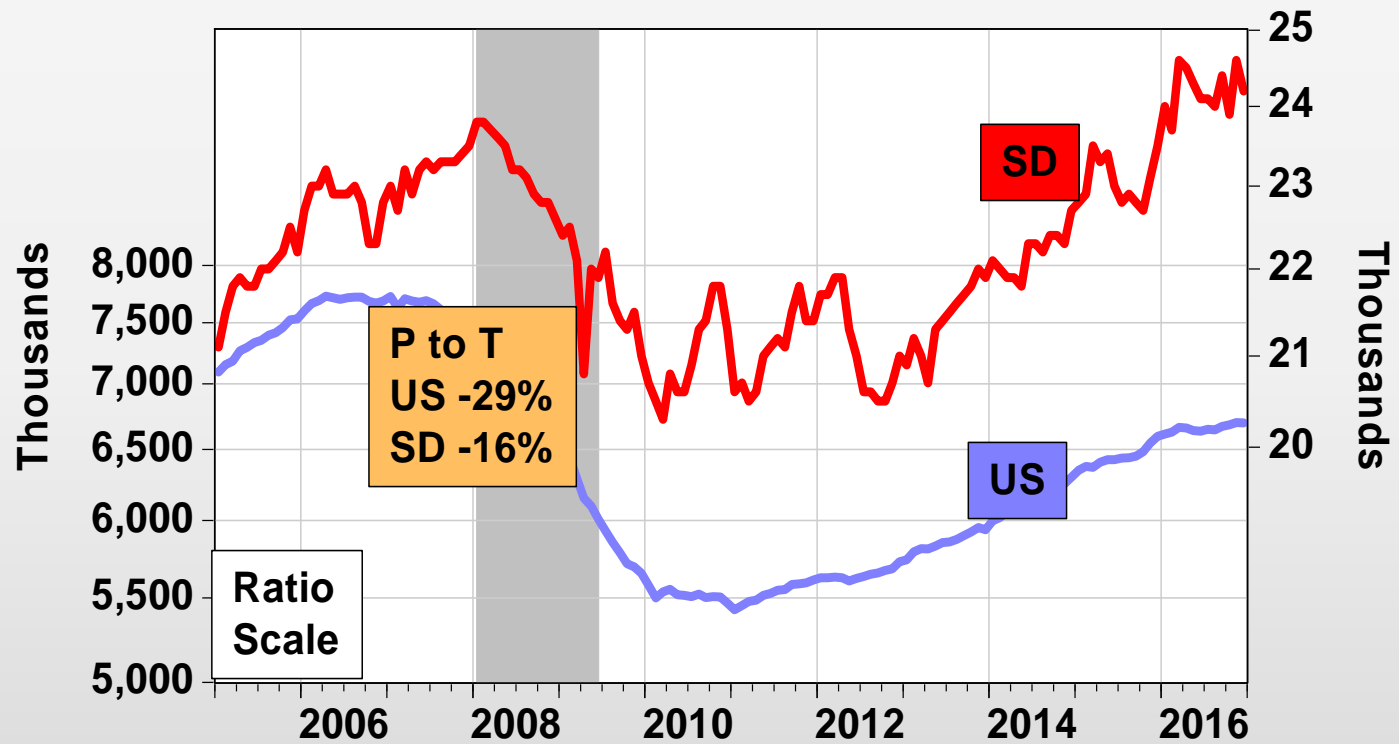
NONFARM EMPLOYMENT



Source: BLS

Above Peak

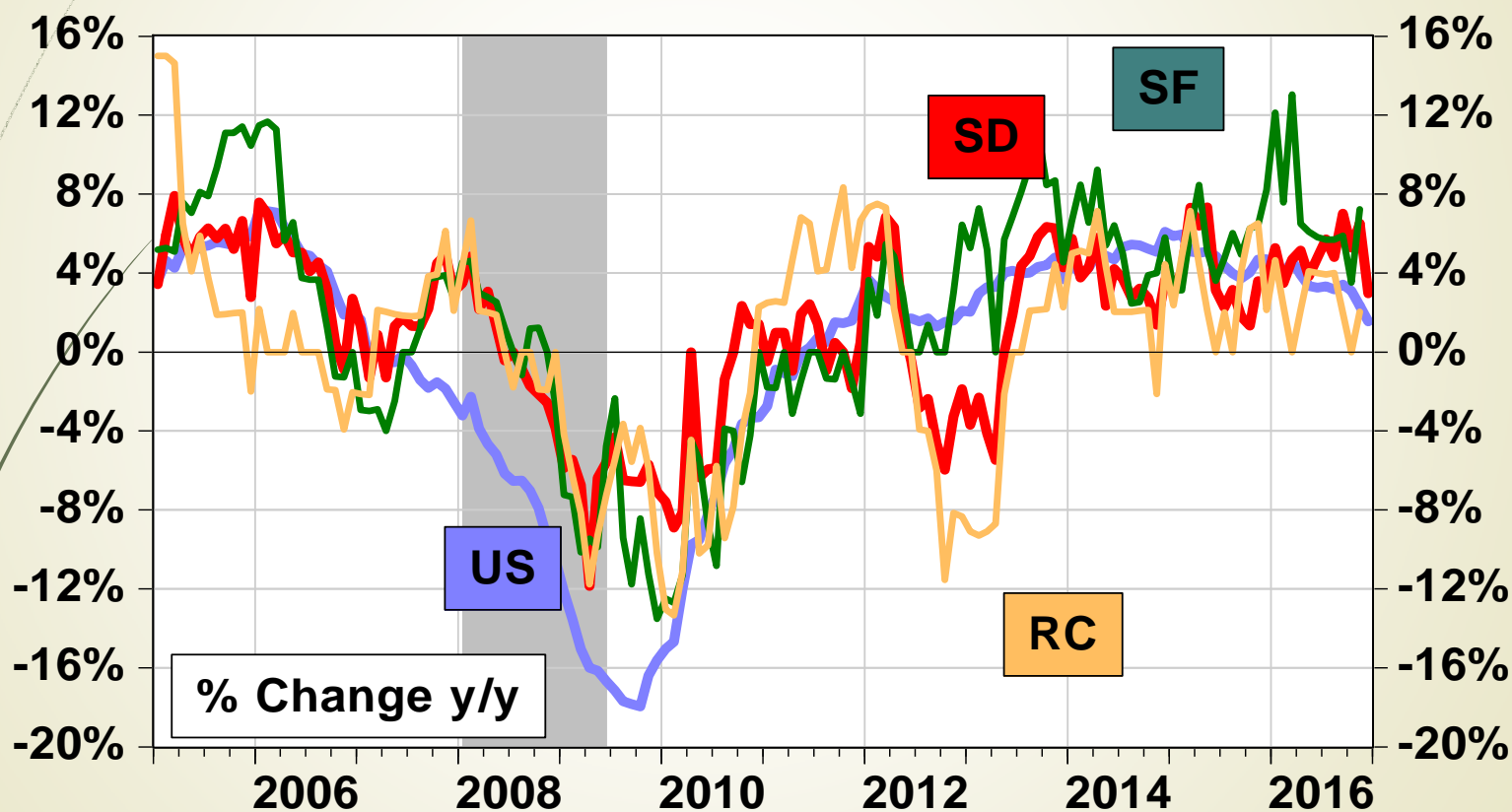
CONSTRUCTION EMPLOYMENT



Source: BLS

Positive Growth Since 2011

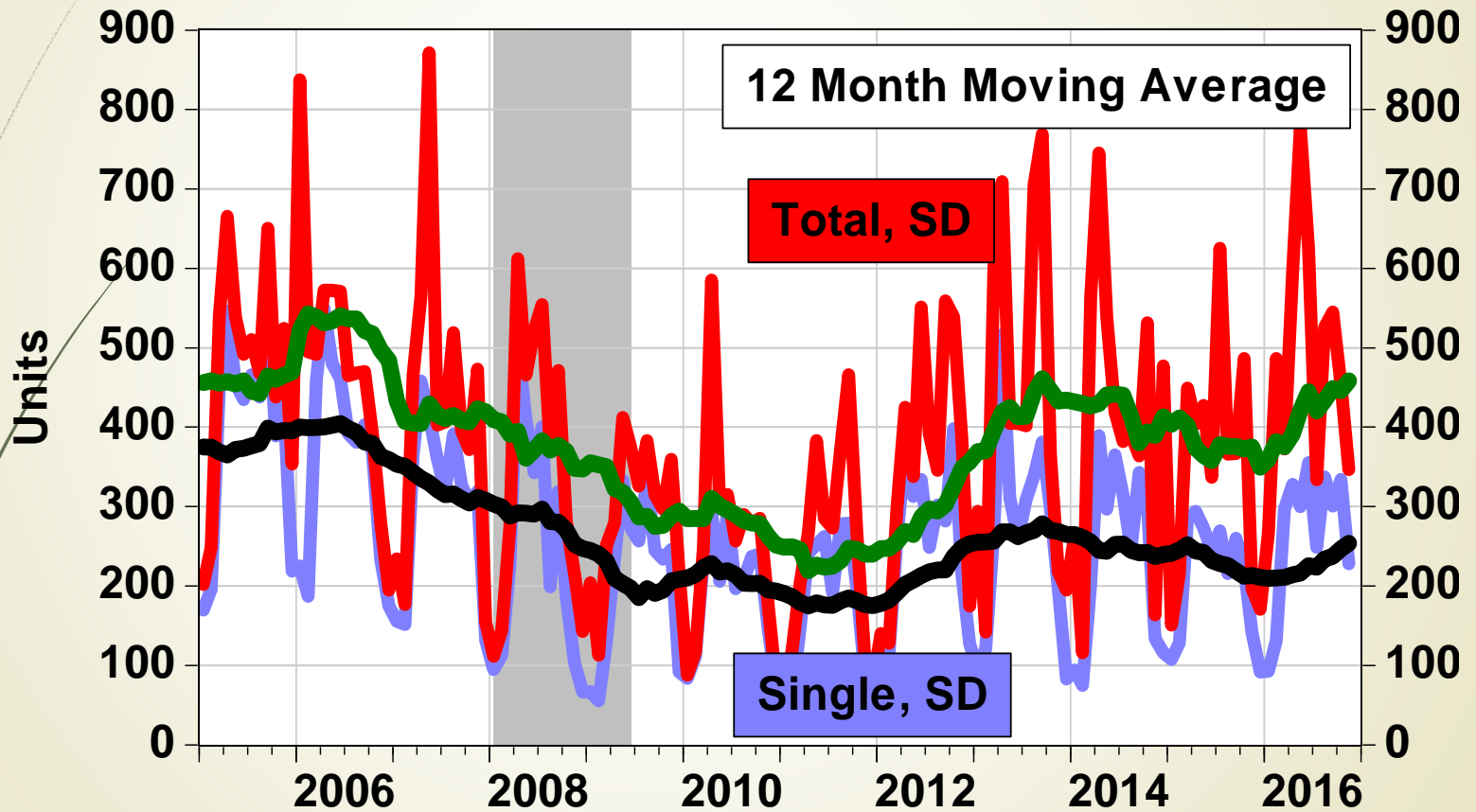
CONSTRUCTION EMPLOYMENT



Source: BLS

Good Growth

SD Building Permits, Total & Single

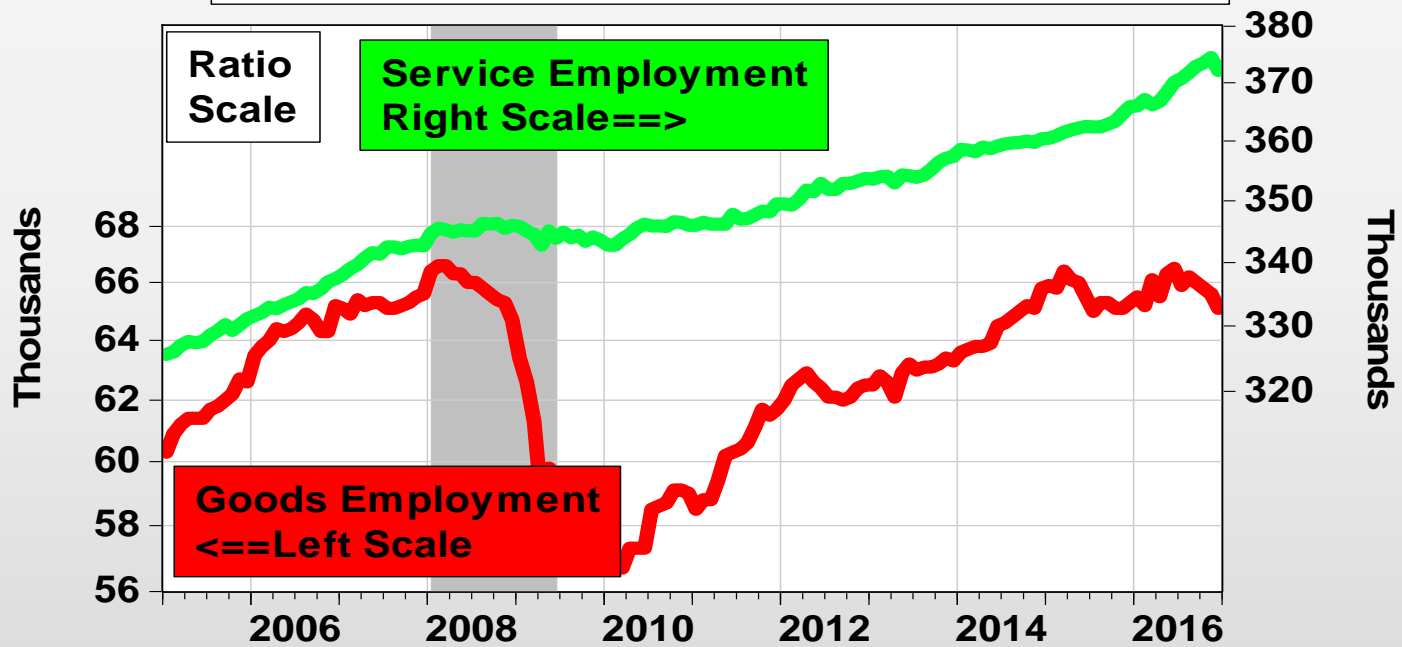


Source: Census Bureau

Which is More Cyclical?

SOUTH DAKOTA SERVICE AND GOODS PRODUCING EMPLOYMENT

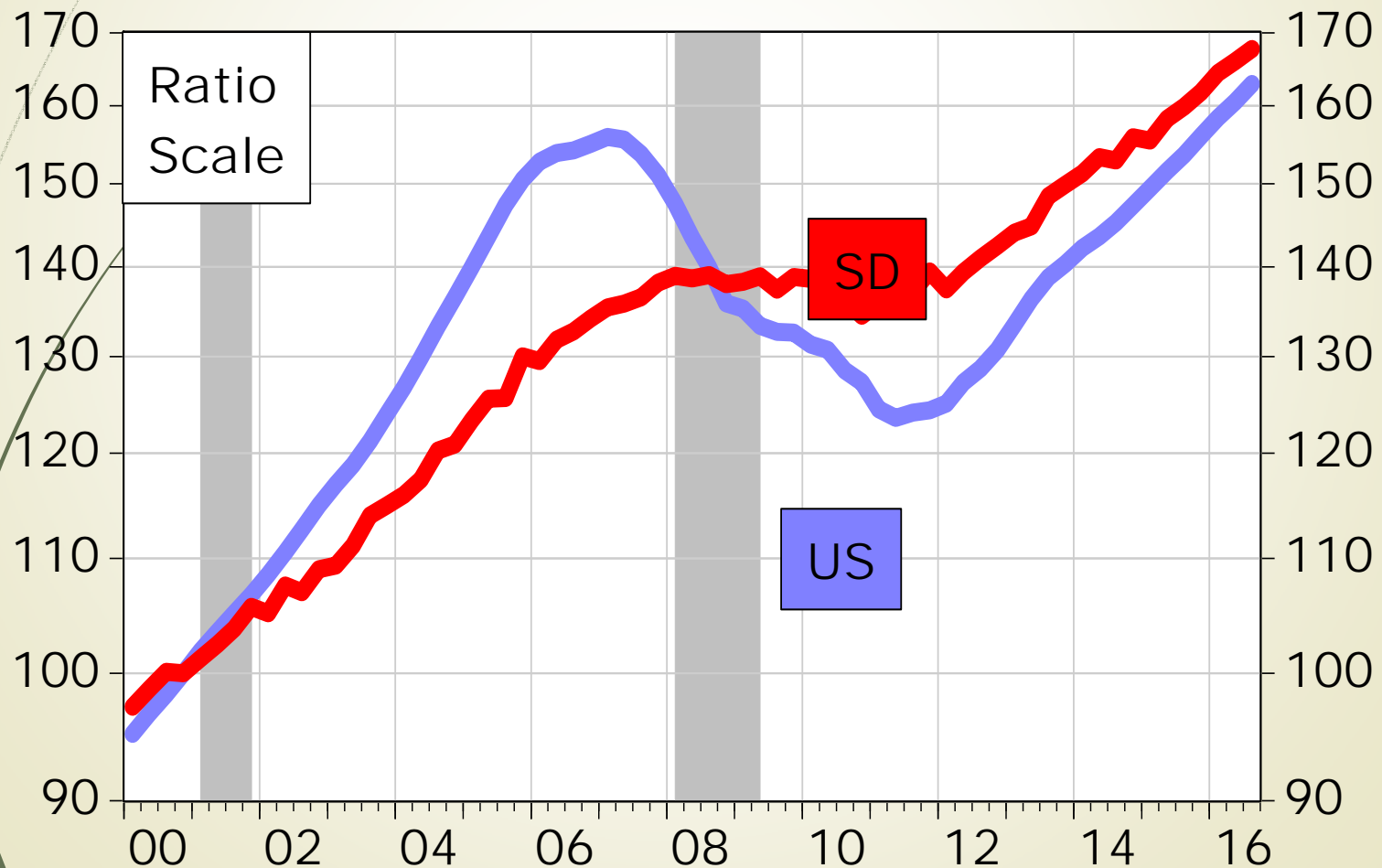
Goods-Producing = Manufacturing+Construction



Source: BLS

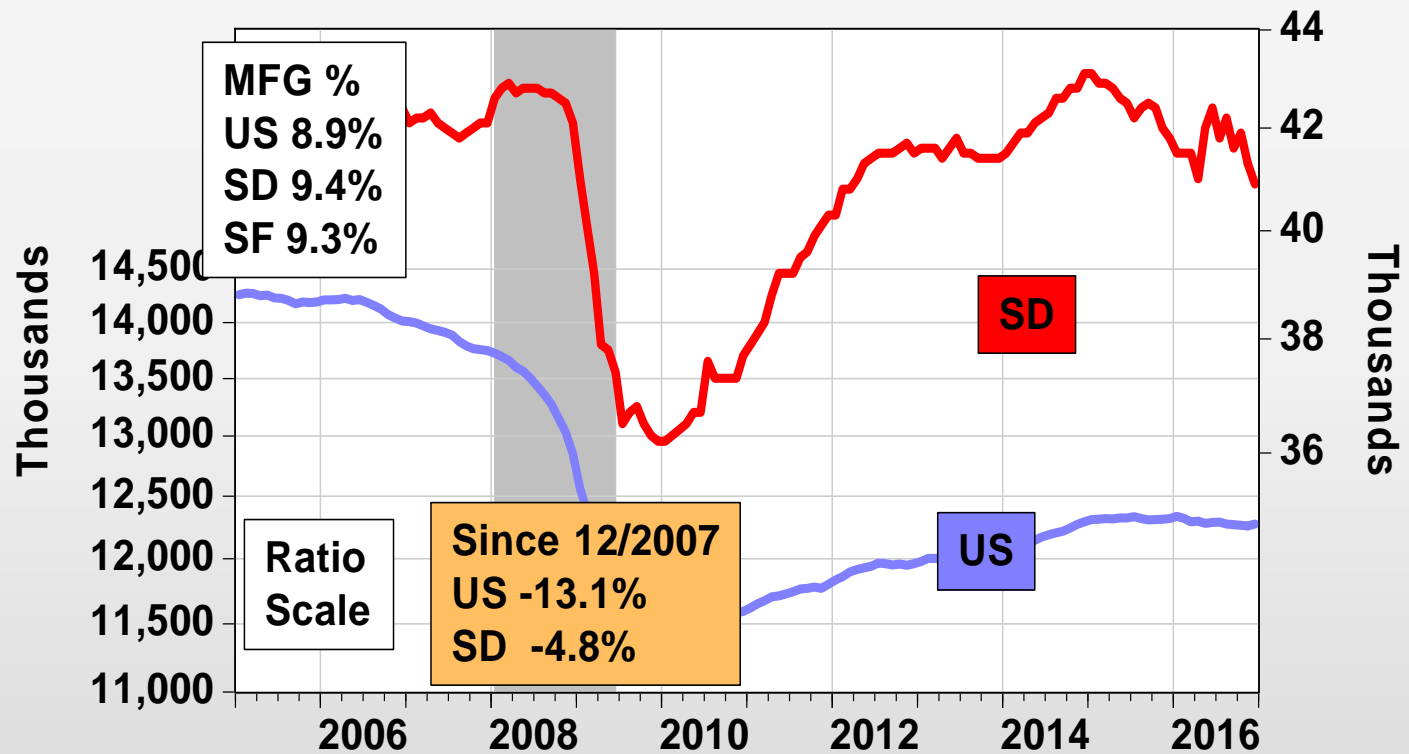
SD Peaked Later and Decline Less Severe

HOUSE PRICE INDEX



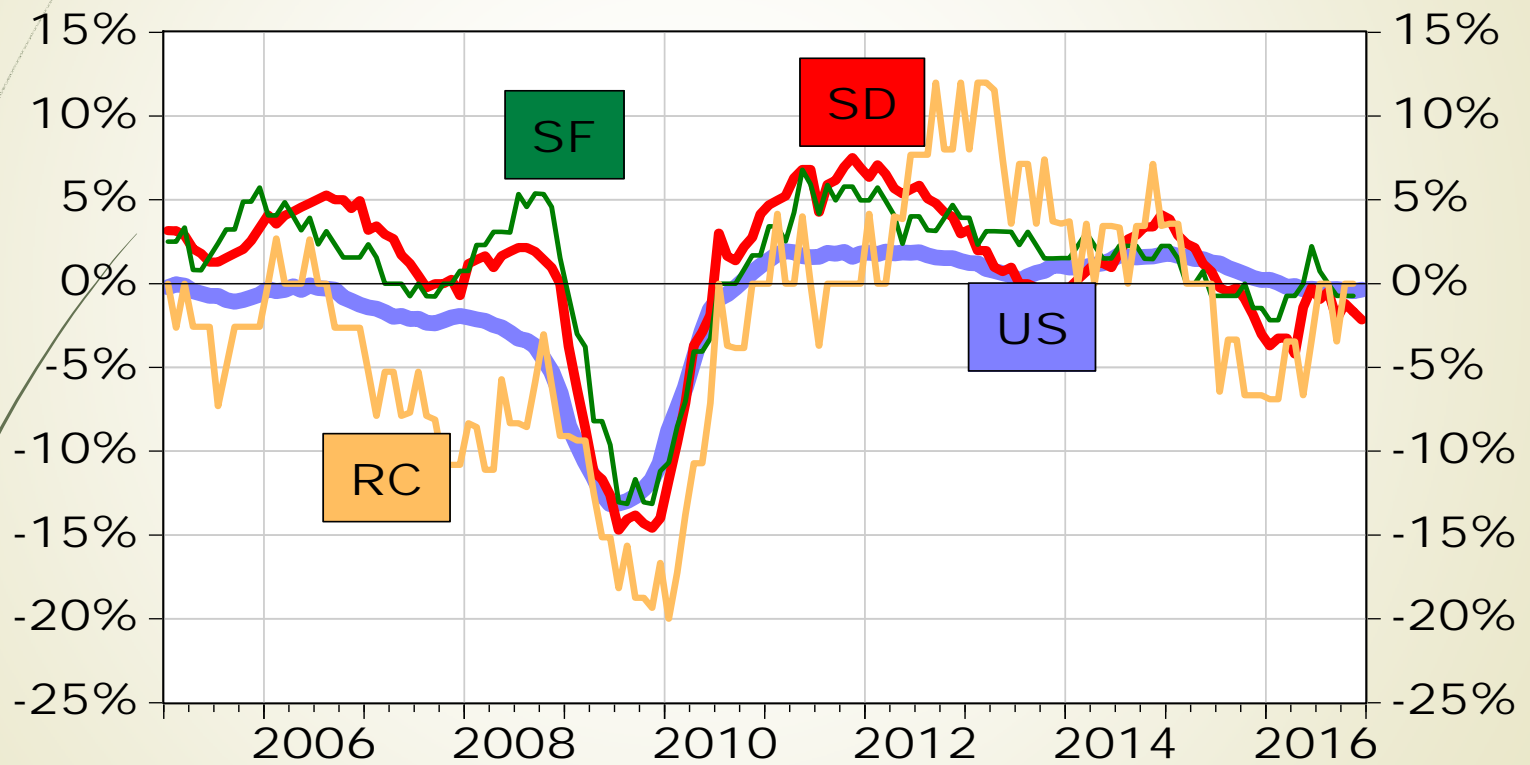
SD - Volatility But Growth

MANUFACTURING EMPLOYMENT



Divergence

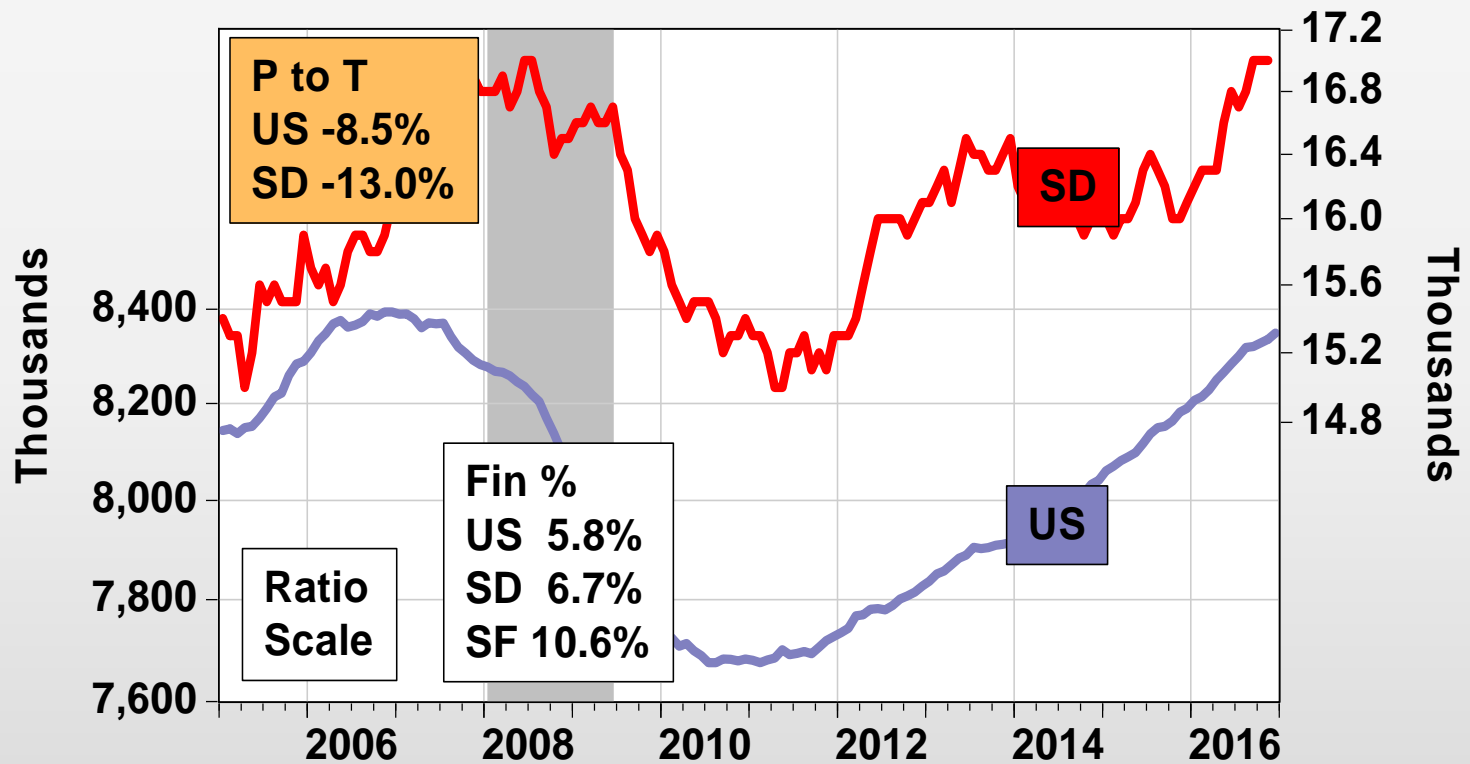
MANUFACTURING EMPLOYMENT



Source: BLS

SD at Pre-Recession Peak

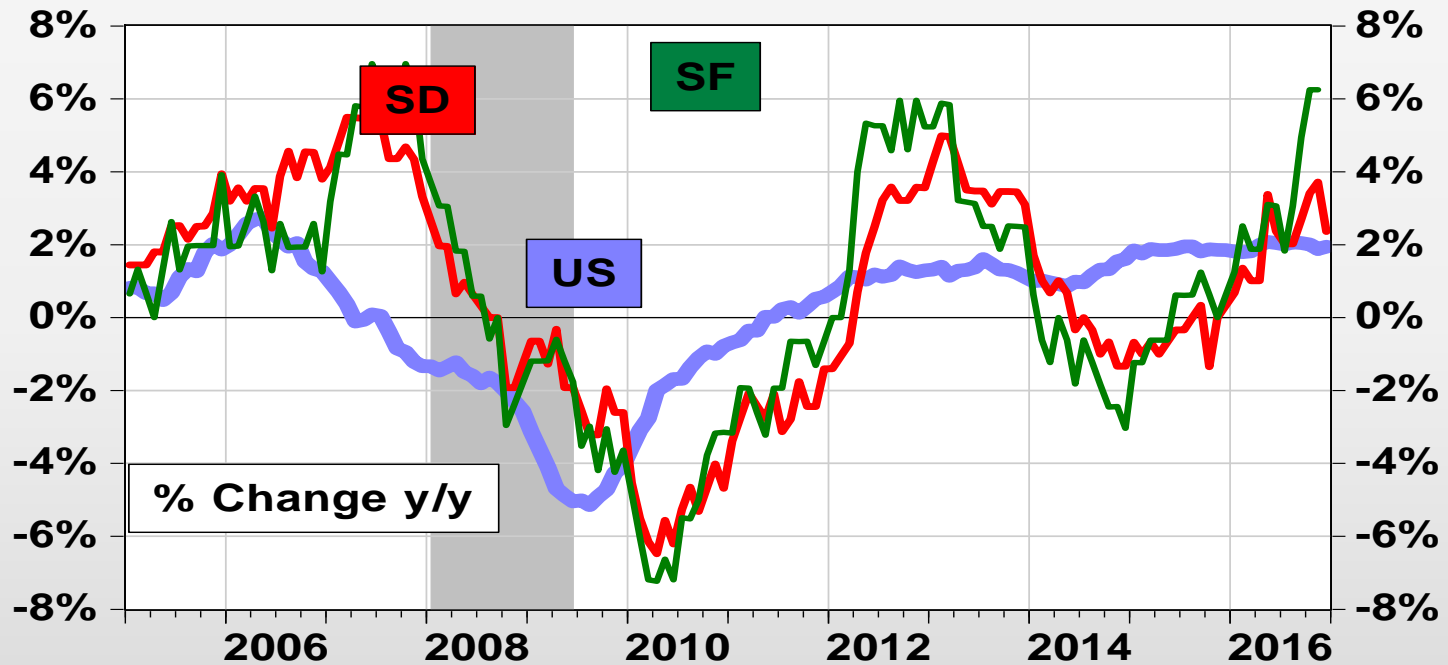
FINANCIAL ACTIVITY EMPLOYMENT



Source: BLS

Note SD& SF Different Than US

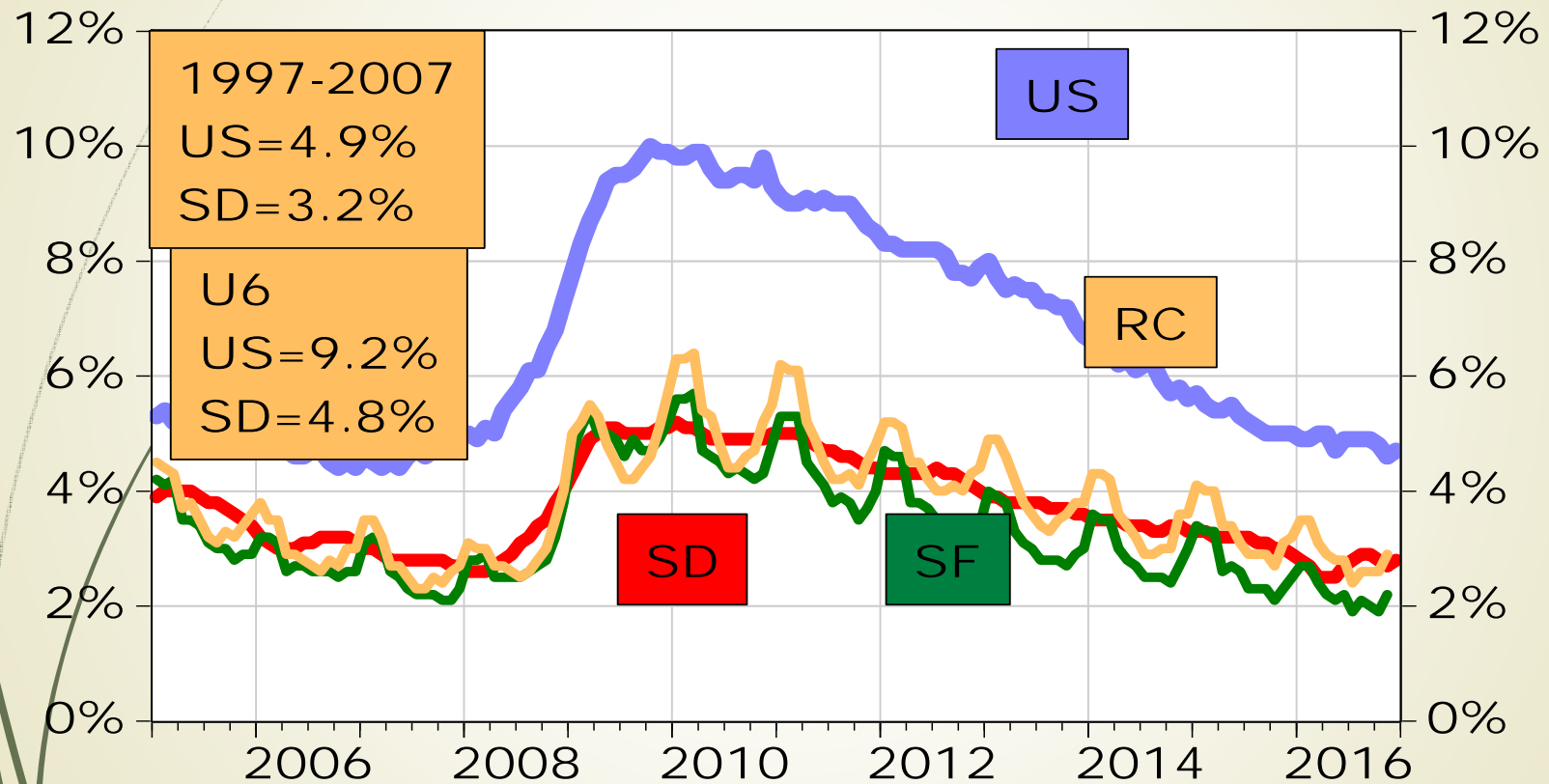
FINANCIAL ACTIVITY EMPLOYMENT



Source: BLS

SD 2.8% SF(SA) 2.8% 2.2% (NSA)

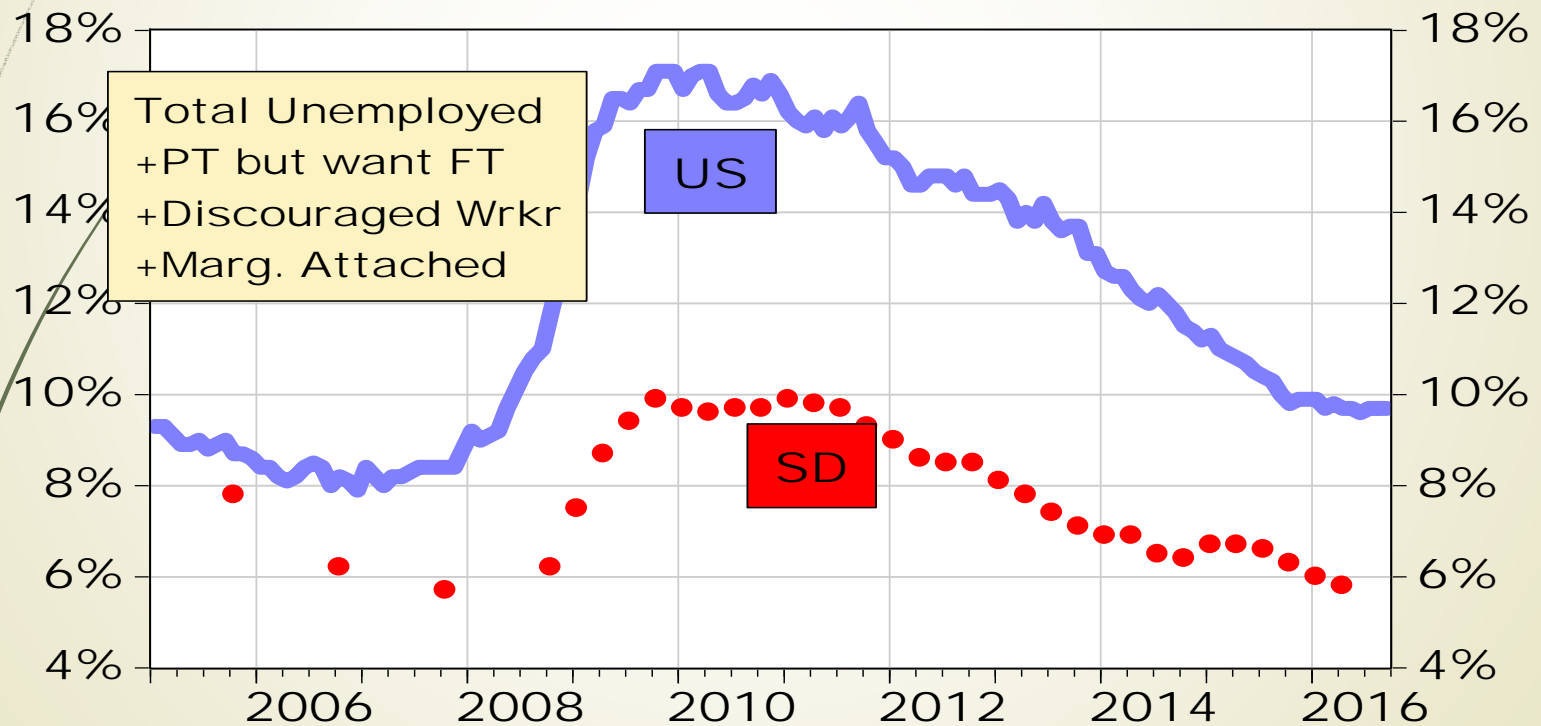
UNEMPLOYMENT RATES



Source: BLS

Definite Improvement SD Lowest of All States

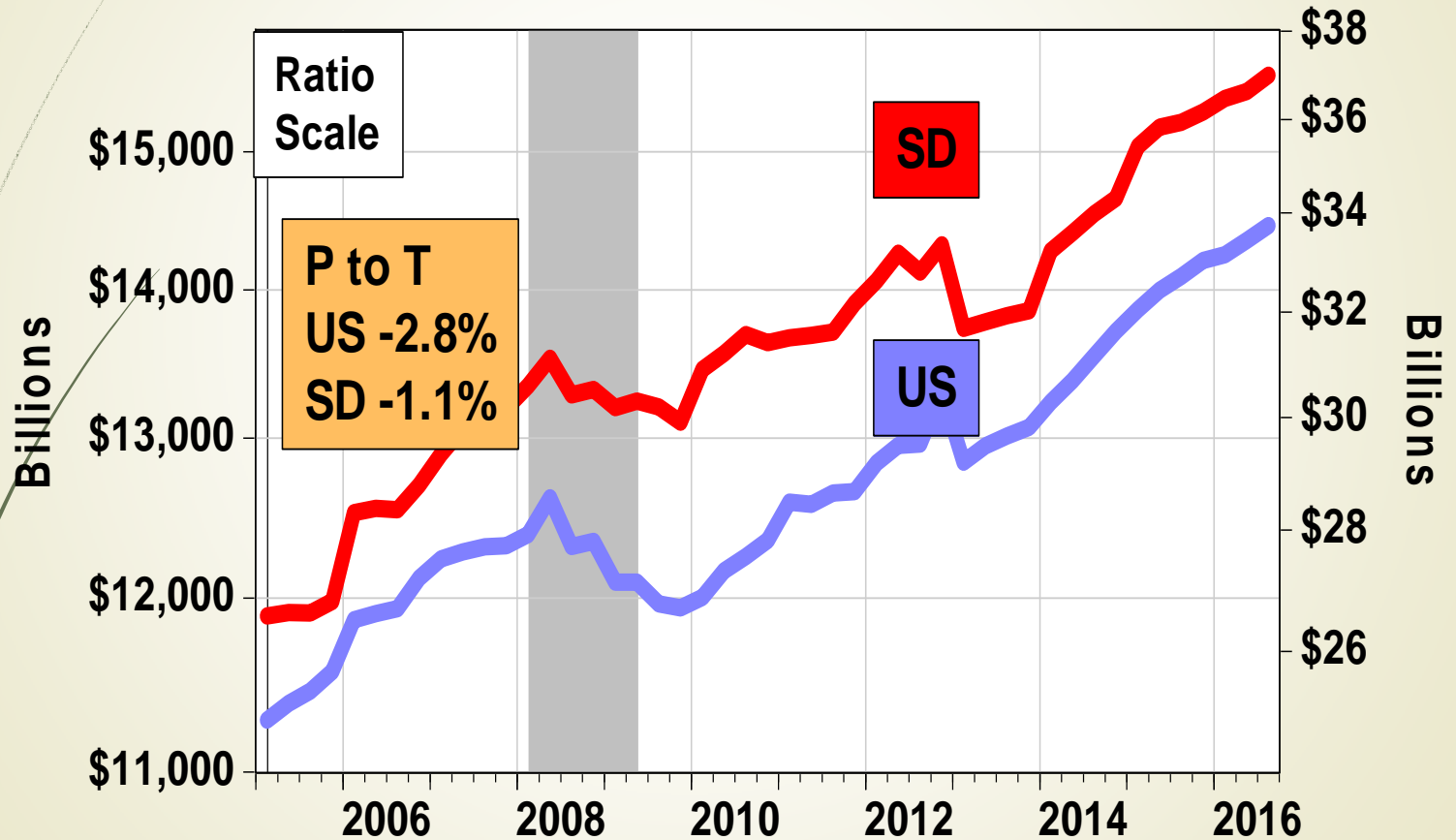
U6 UNEMPLOYMENT RATE



Source: BLS

Continued Real Growth

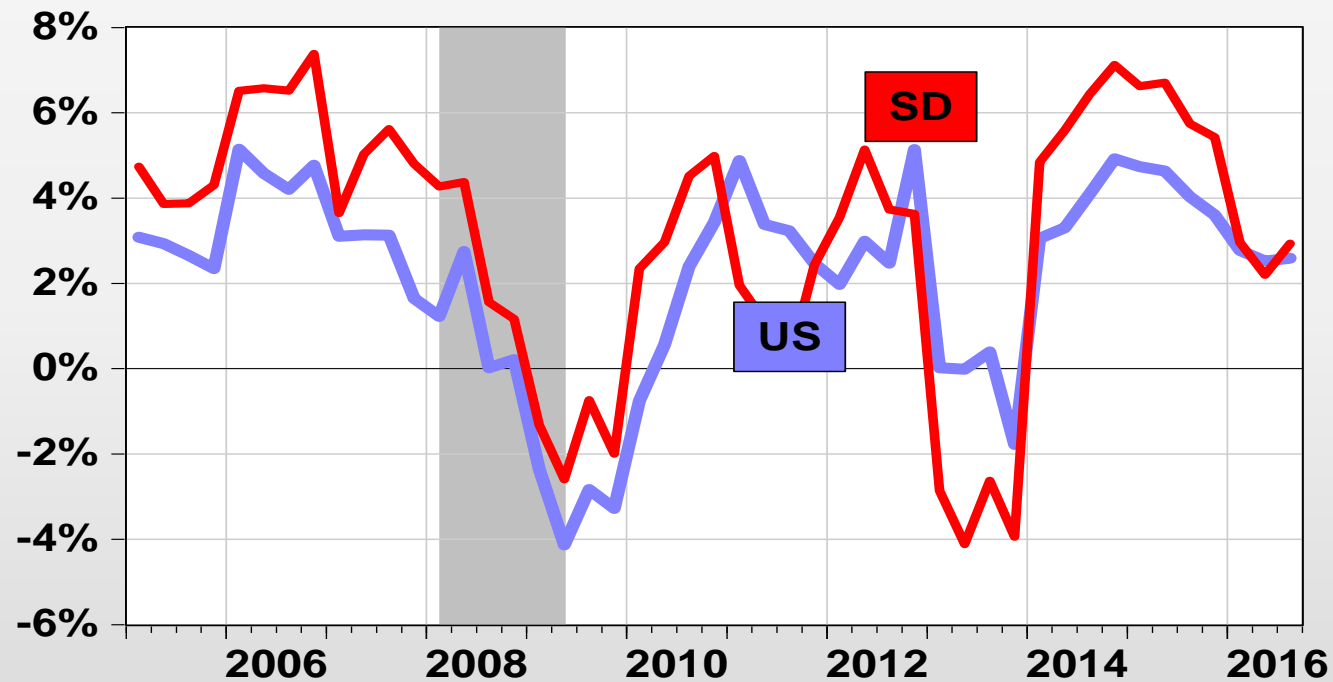
NONFARM PERSONAL INCOME (2009 \$S)



Source: BLS

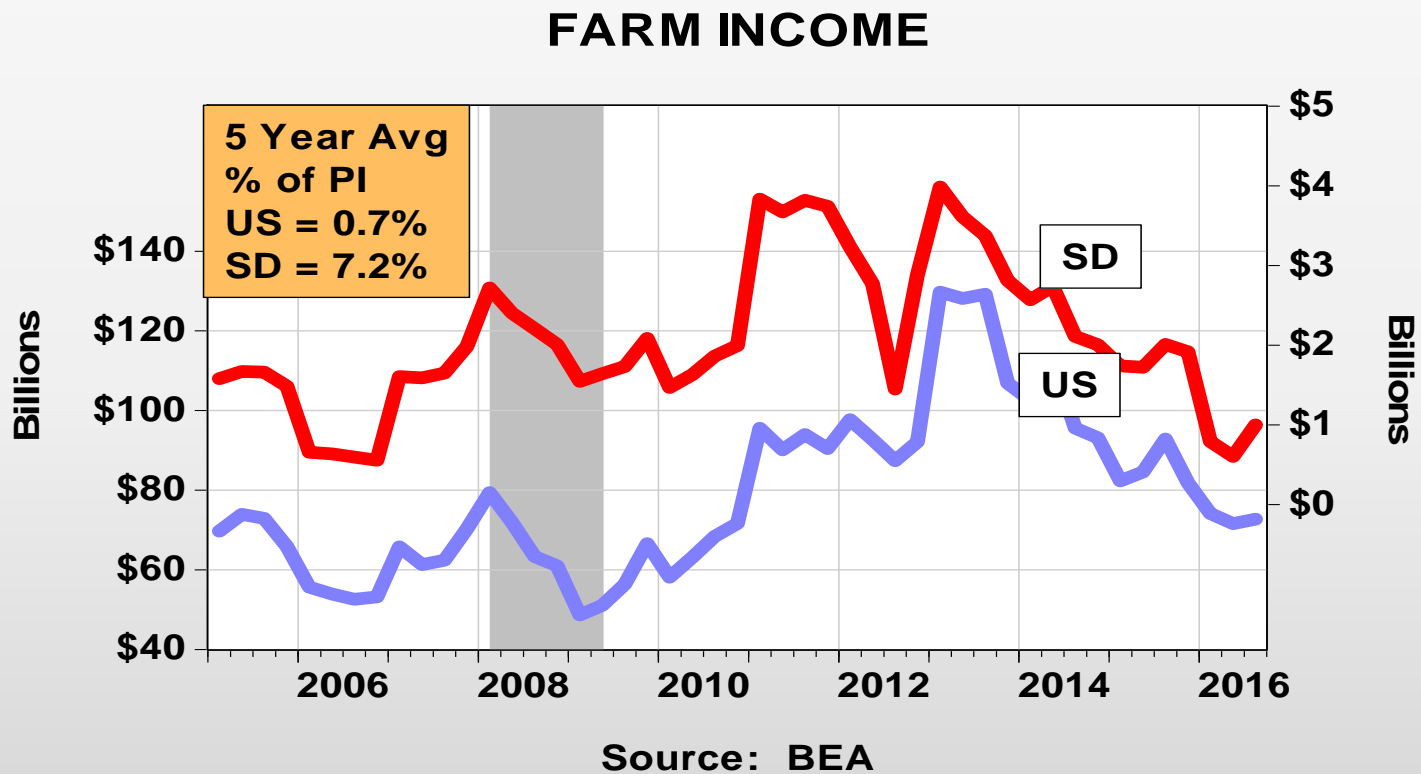
US and SD Track

REAL NONFARM PERSONAL INCOME (Year-Over-Year Percent Change)



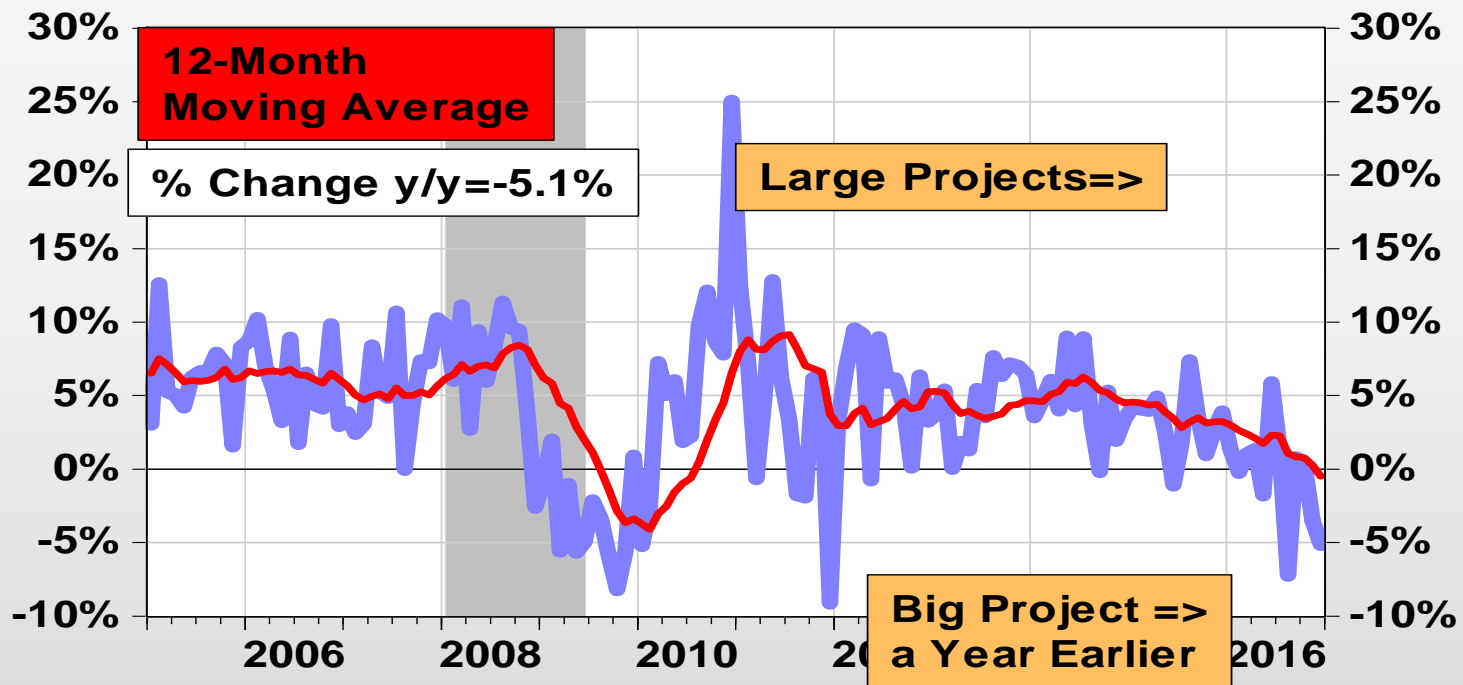
Source: BEA

Farm Down Sharply - High Prodn Low Prices



Low Inflation, Poor Farm Economy, and Online Sales Growth

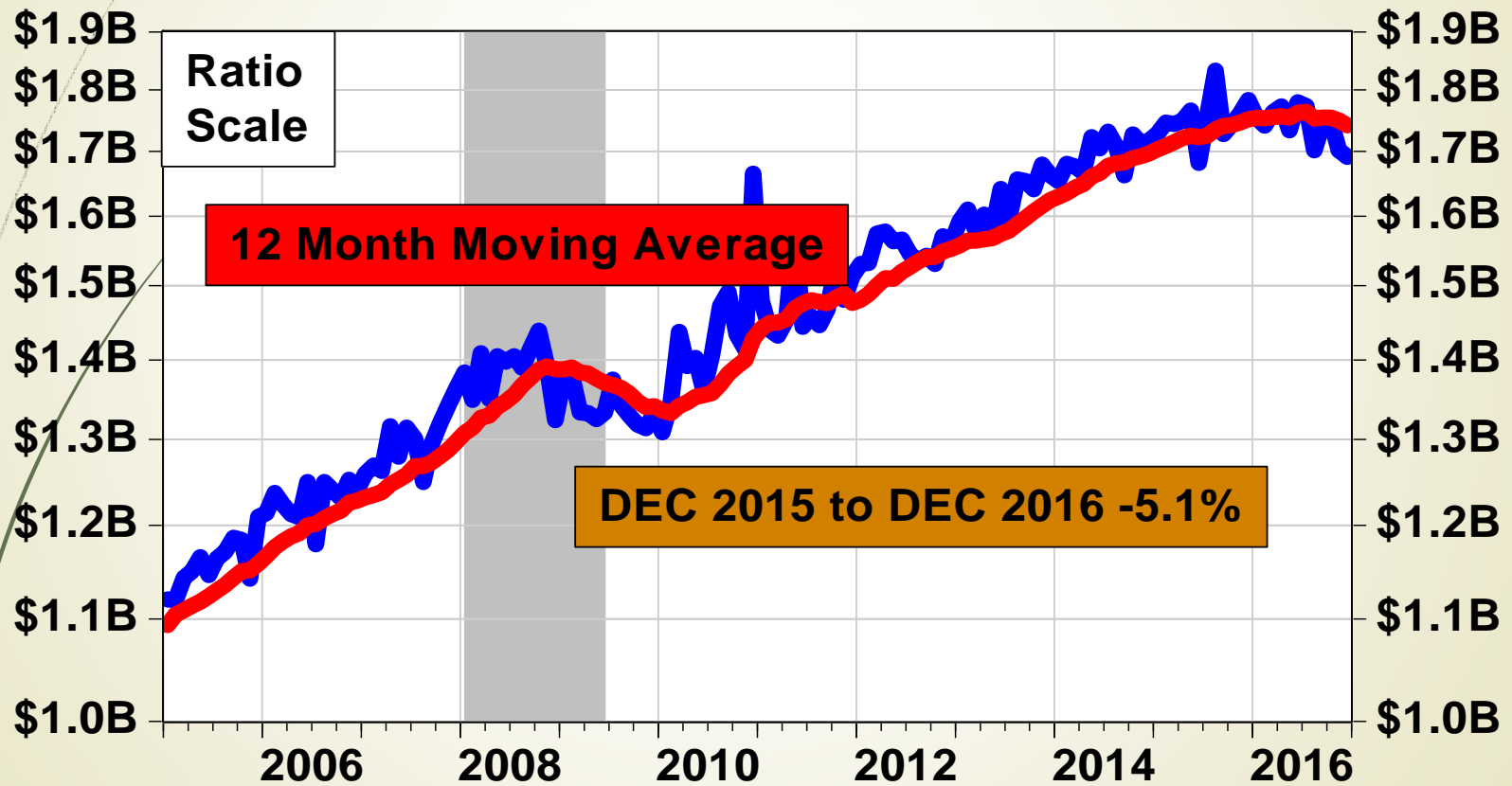
SD TAXABLE SALES



Source: SD Department of Revenue

Negative Growth

SD Taxable Sales - Seasonally Adjusted



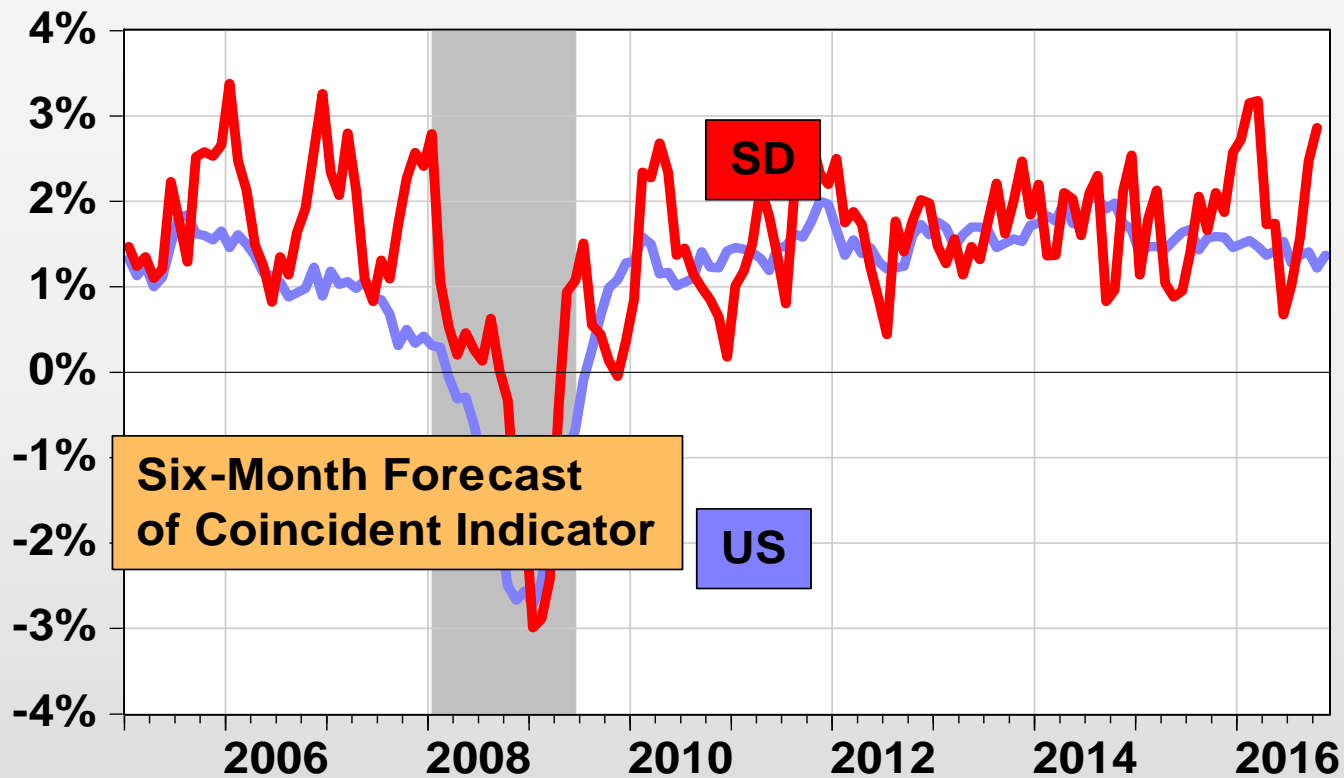
Source: SD Department of Revenue

The Good News Amazon




Forecasting Growth: Uptick

LEADING INDICATOR: US & SD



Source: Fed Res Bank of Philadelphia



Mid-American States Leading Indicators - GOSS

December 2016 Index > 50 Growth

Overall 56.5

New Orders 53.7

Sales 50.0

Delivery lead time 62.1

Inventories 63.0

Employment 53.5

“I expect South Dakota to add 6,000 jobs in the first half of 2017 for an annualized growth rate of 2.7%, well above the U.S. and regional average.”



Forecast Risks-Long List

Risk of world recession - Very low

Resurgence of inflation risk - years of aggressive monetary policy

Oil price surge - always risk of supply shock

Emerging market stress - years of debt

Chinese hard-landing - capital flight and lack of structural reforms

More cyber attacks - becoming more disruptive and costly

US \$ appreciation - larger trade deficits

EU crisis - mass migration, Brexit, and populist anti-EU movements

Geopolitical risks - escalation of violence in Mid-East and oil disruption

Trade war - a 35% tariff will not go unnoticed

Conclusions

SD economy growing at moderate rate

SF economy growing at faster rate

US economy growing slowly

Only 15% chance of recession

The End

