



The State of the SD Economy

Presentation to the Governor's
Council of Economic Advisors

October 24, 2017

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Outline of Presentation

Overview of US economy

US economy forecast

SD economy

Summary & Conclusions

US Forecast

IHS MARKIT Forecast – October 9, 2017

Real GDP

Consumption,

Housing Starts

Federal Budget

Interest Rates and Inflation



GDP

BIG NEWS: Forecast Downgraded - NO TAX CUTS OR INFRASTRUCTURE PLAN EXPECTED IN 2018 OR 2019 according IHS Markit.

GDP growth will average 2.2% in 2017 and accelerate to 2.4% in 2018 and 2.2% in 2019.

The difference in the baseline and optimistic (tax cuts and infrastructure) forecast in GDP growth is 3.4% vs 2.4% growth in 2018 and 3.1% vs 2.2% in 2019.

IHS estimates hurricanes Harvey and Irma shaved growth by 1.2% in the 3rd quarter and will add 0.9% in the 4th quarter.



Consumer spending will still remain the growth engine.

Strong employment growth, real disposable income, and asset values all support growth.

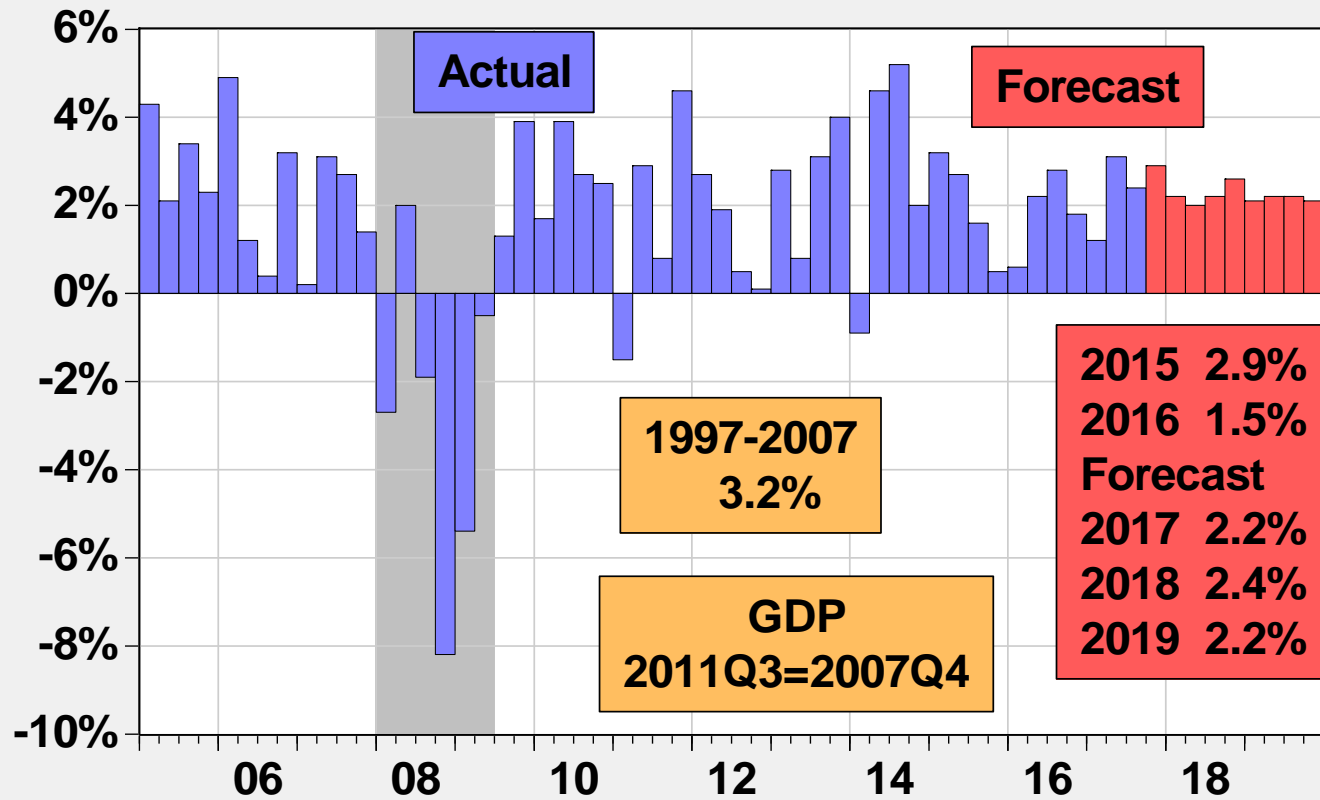
Spending on non-residential structures will slow in 2018 after years of solid growth.

Construction has stumbled but the weakness is temporary.

Trade is good with stronger world demand .

Growth Pretty Steady

GROSS DOMESTIC PRODUCT



Source: BEA and IHS



Components of GDP are:

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

Consumption

Consumption spending is expected to be a steady contributor to economic growth at 2.5% in 2018 and 2.3% in 2019. This is a downward revision from previous forecasts.

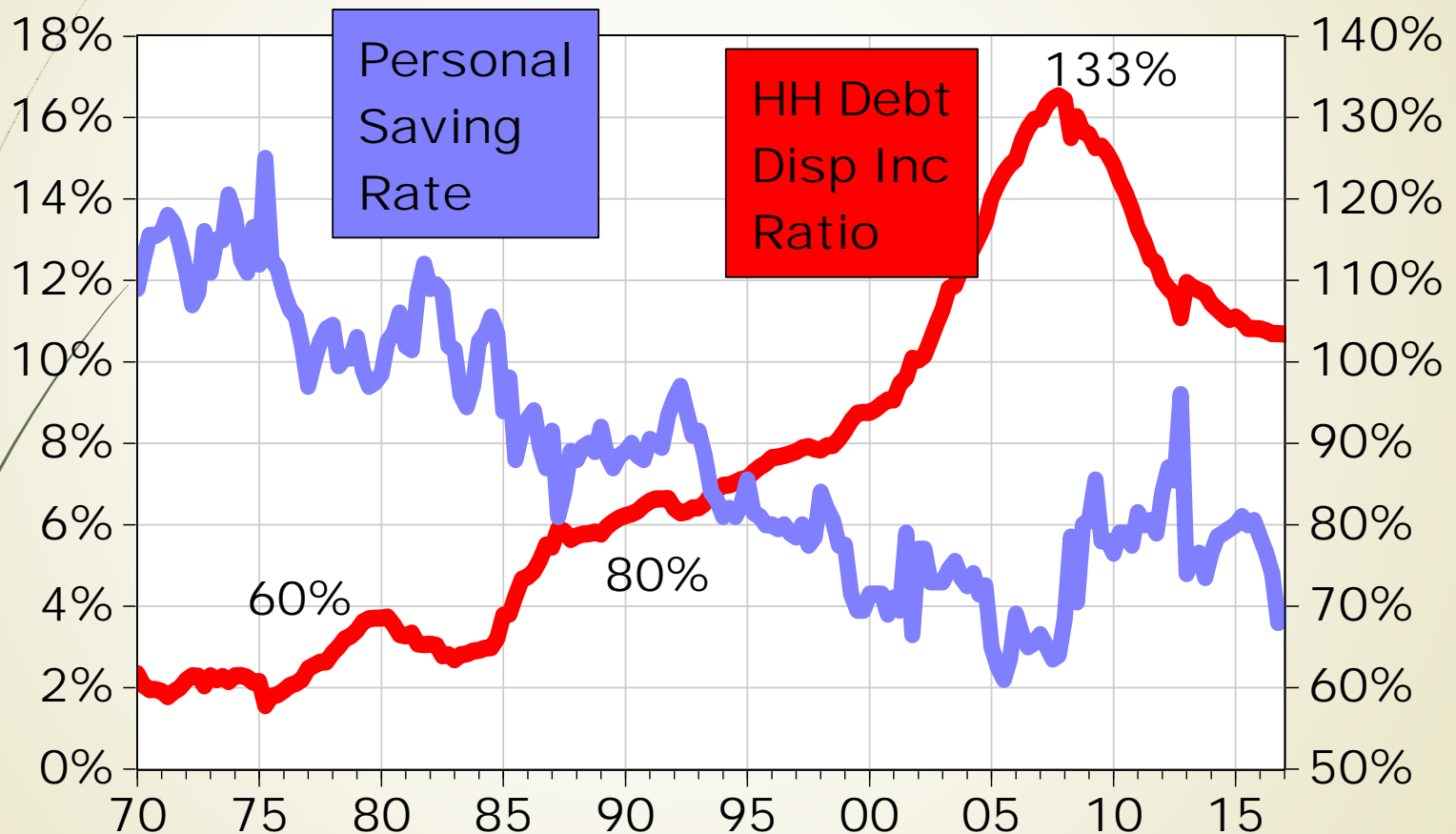
Unlike previous IHS forecasts, no tax cuts are expected in 2018. The political environment makes tax reform difficult to accomplish in 2018.

Online sales growth continues in the double-digit range at 12.1% in 2017.

Holiday sales are expected at +3.5% y/y slightly lower than last year.

Deleveraging Continues

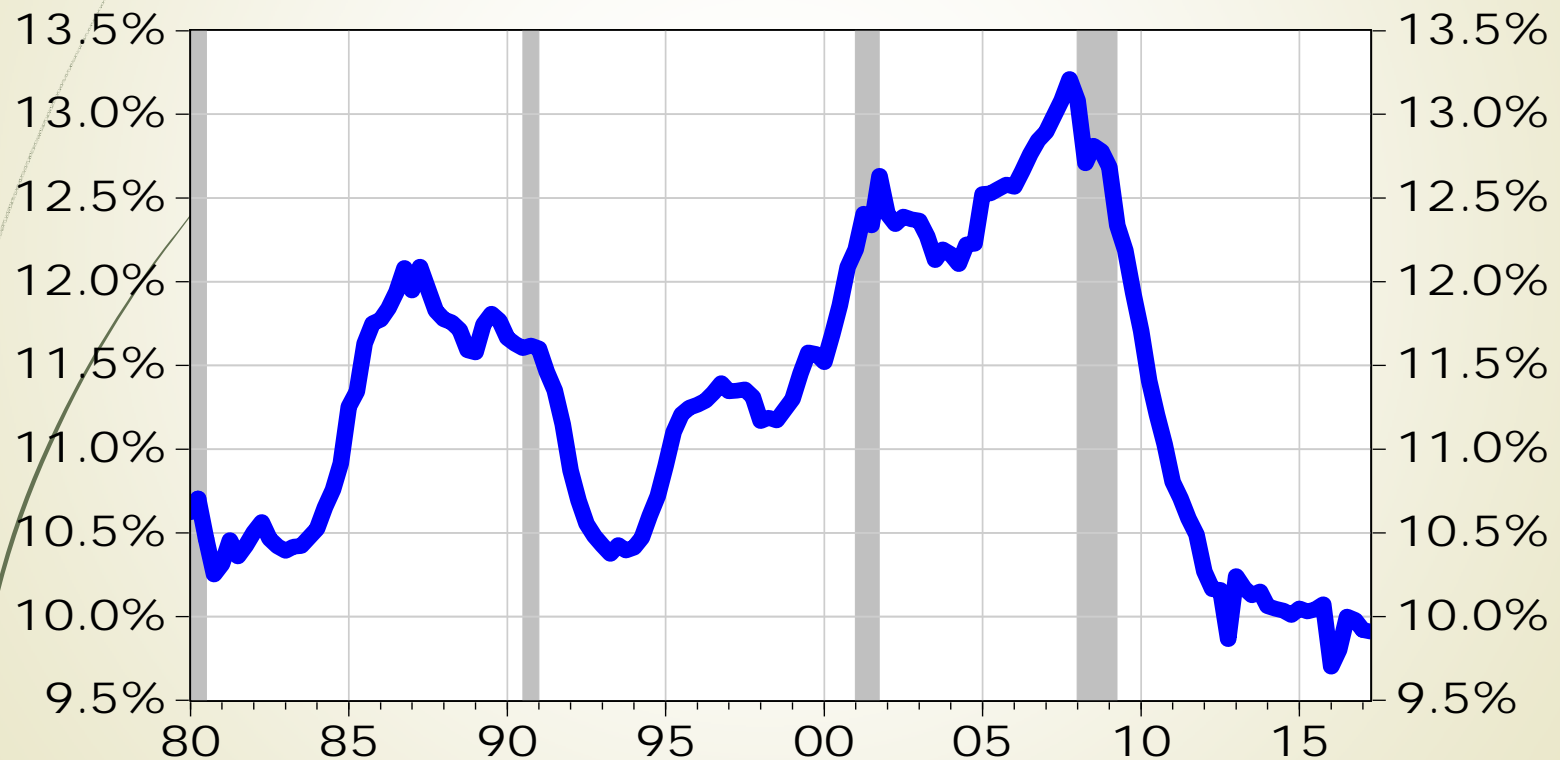
HOUSEHOLD DEBT AND SAVING RATE



Source: BEA and FED

Record Low Debt Service

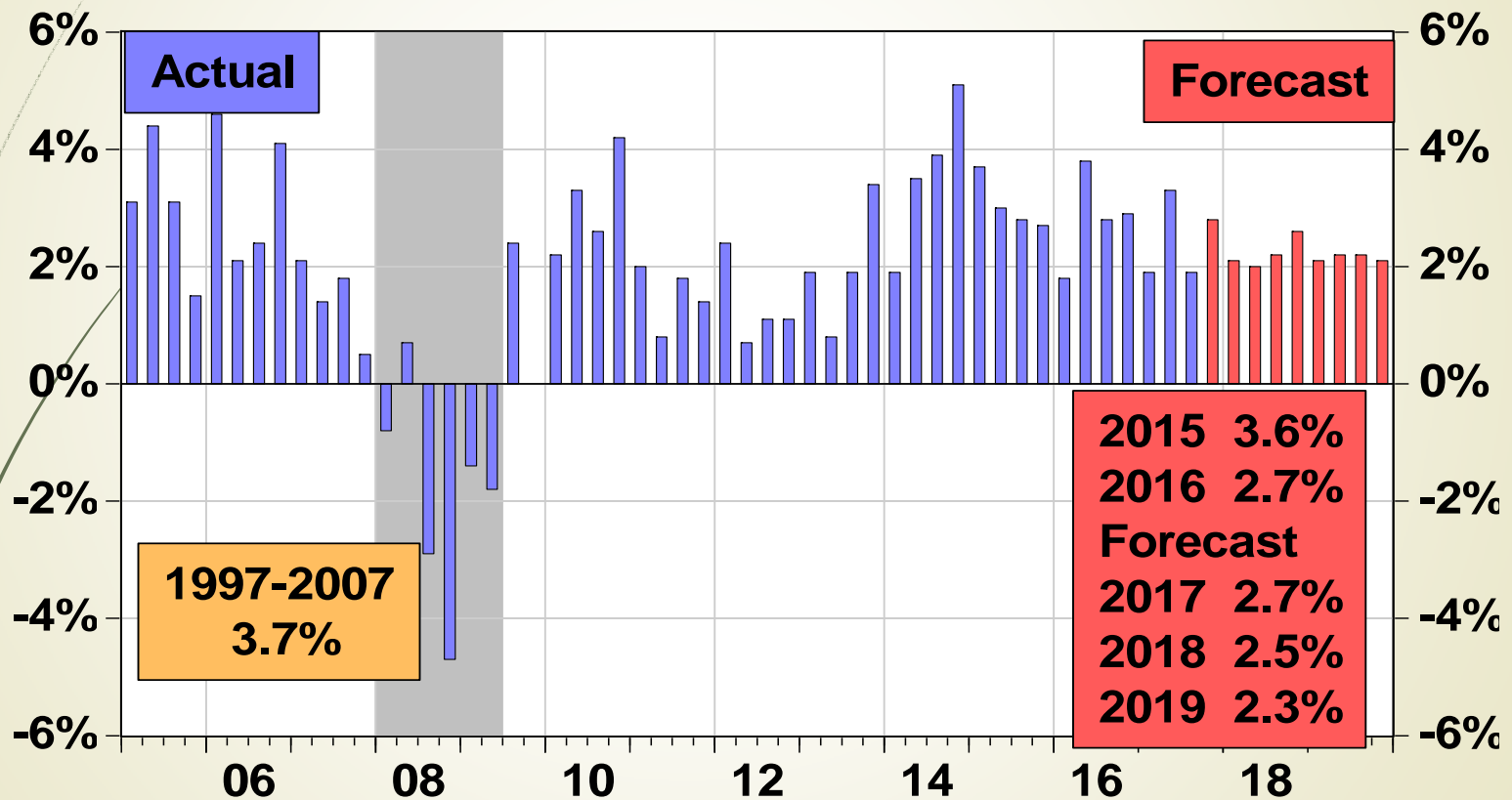
HH DEBT SERVICE PAYMENTS AS % OF
DISPOSABLE PERSONAL INCOME



Source: BEA and Federal Reserve System

Slower Growth Projected

REAL CONSUMPTION



Source: BEA and IHS

Investment Sector

Low oil prices has cooled the recovery of capital spending in the energy sector. The rig count hit a 71 year low in 2016.

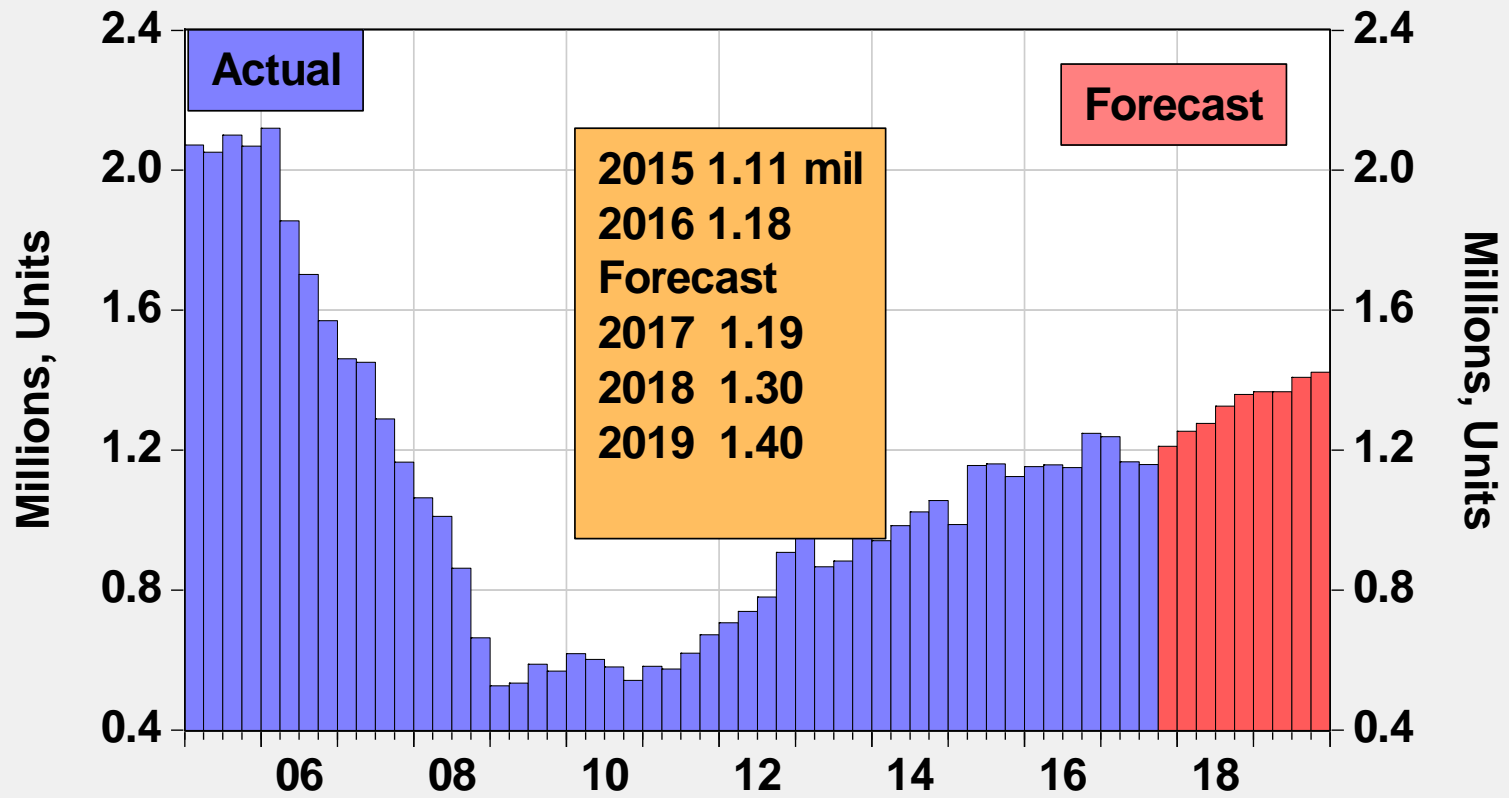
The construction sector is stumbling; however, the lull is temporary as household formation will support future residential building.

Housing prices continue to rise at an unsustainable rate, but-not-yet-alarming rates, at 5-10% rates in most places.

Business fixed investment spending is forecasted to see respectable growth next year.

Recovery Proceeds

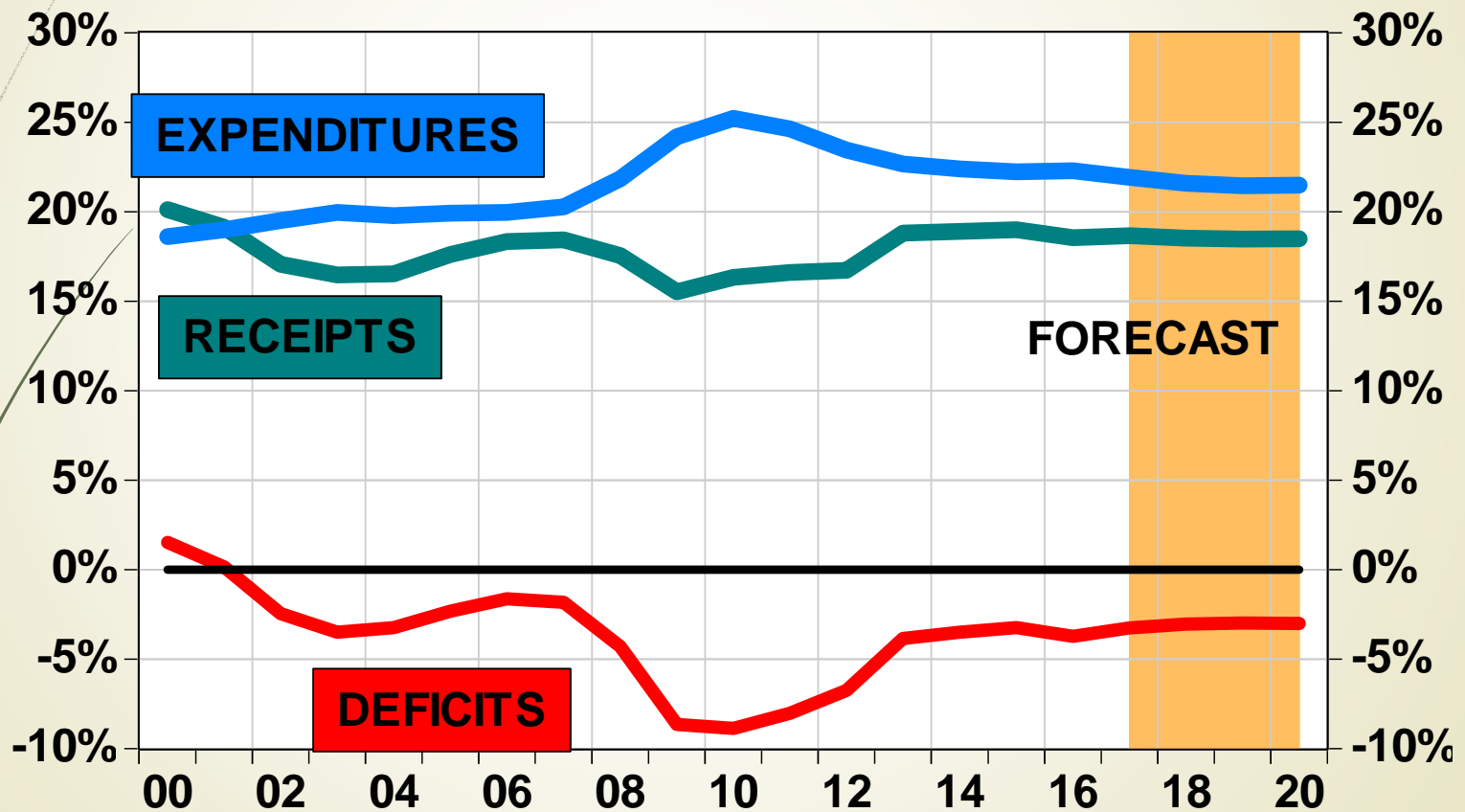
HOUSING STARTS



Source: US Census and IHS

Government Sector

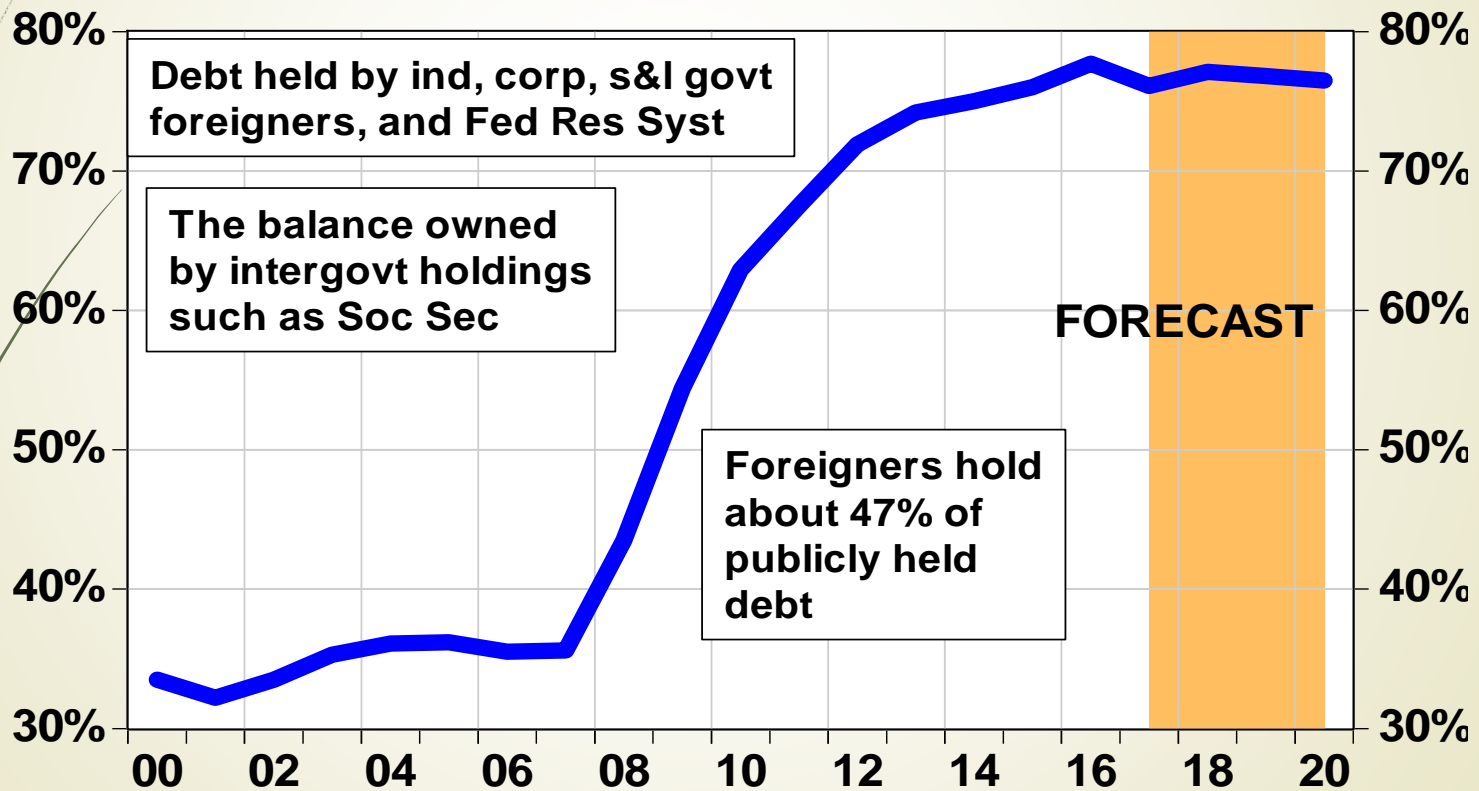
FEDERAL GOVERNMENT AS % OF GDP



Source: IHS

Debt Held by Public

FEDERAL DEBT HELD BY PUBLIC AS % OF GDP



Source: IHS



The Fiscal Picture

IHS MARKIT feels that sweeping tax reform is unlikely in 2018 or 2019 and therefore this month it has removed any stimulus that they might provide.

They have also removed 2019 infrastructure spending from their baseline forecast.

In their optimistic scenario, they do include tax reform fewer regulations. They assign a 15% probability to this alternative.



Foreign Sector

IHS MARKIT expects the \$ to slide about 8% this year after a post-election runup.

This will be followed by a steady multi-year decline throughout the forecast period yielding a 9.4% drop by the end of 2027.

The recent improvement in the economies of Japan and Europe have led to improvement in their currencies. Furthermore, across the globe other economies will pick up, further weakening the \$.

All of this should lead to an improvement in US exports. Imports will also pickup next year as the demand for capital goods improves.

Employment & Unemployment

The 33 thousand drop in nonfarm payroll ends an 83 month stretch of monthly job gains.

The FED is likely to fully discount the September job loss in their decision-making.

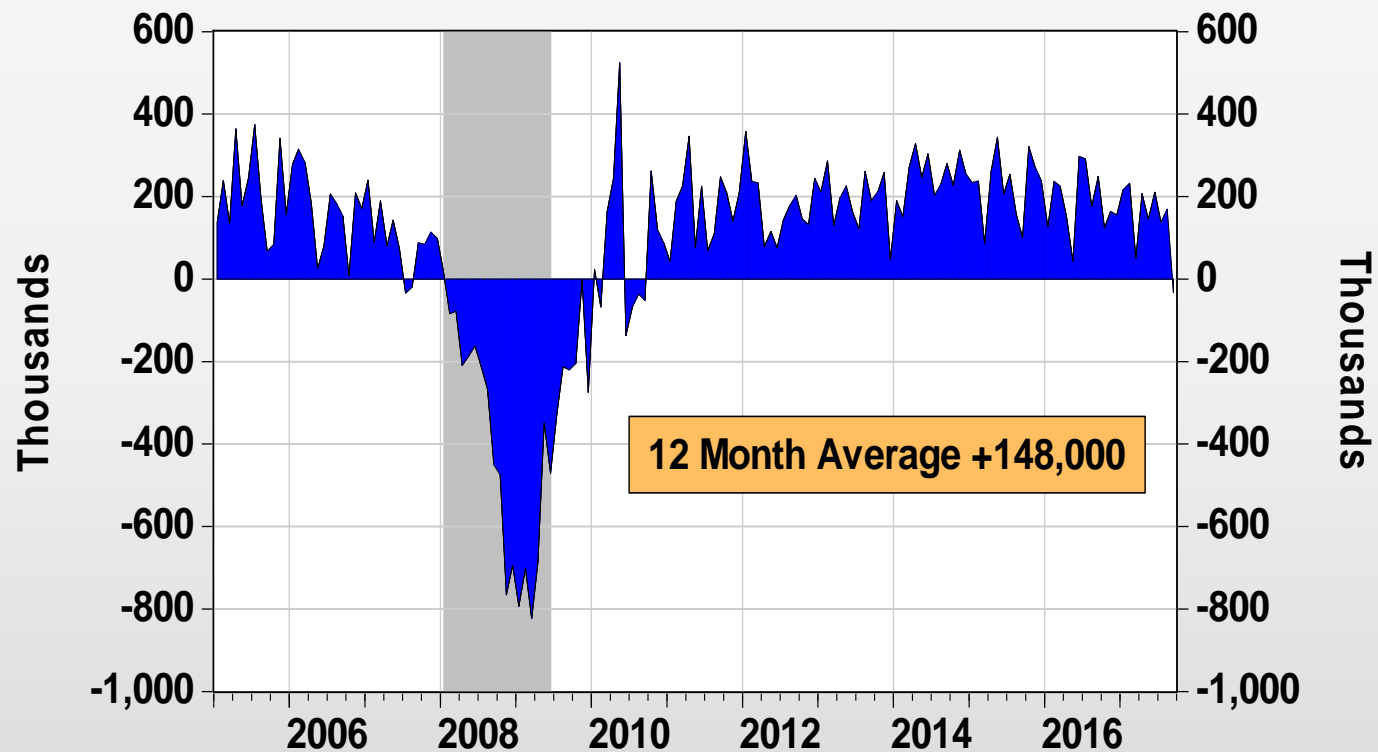
IHS estimates that the hurricanes reduced jobs by 249 thousand jobs in September.

Payroll employment growth is expected to slow to 1.5% in 2017, 1.3% in 2018, and 1.1% in 2019.

The unemployment rate will average 4.4% in 2017 and 4.3% in 2018 and 2019.

83 Month Growth String

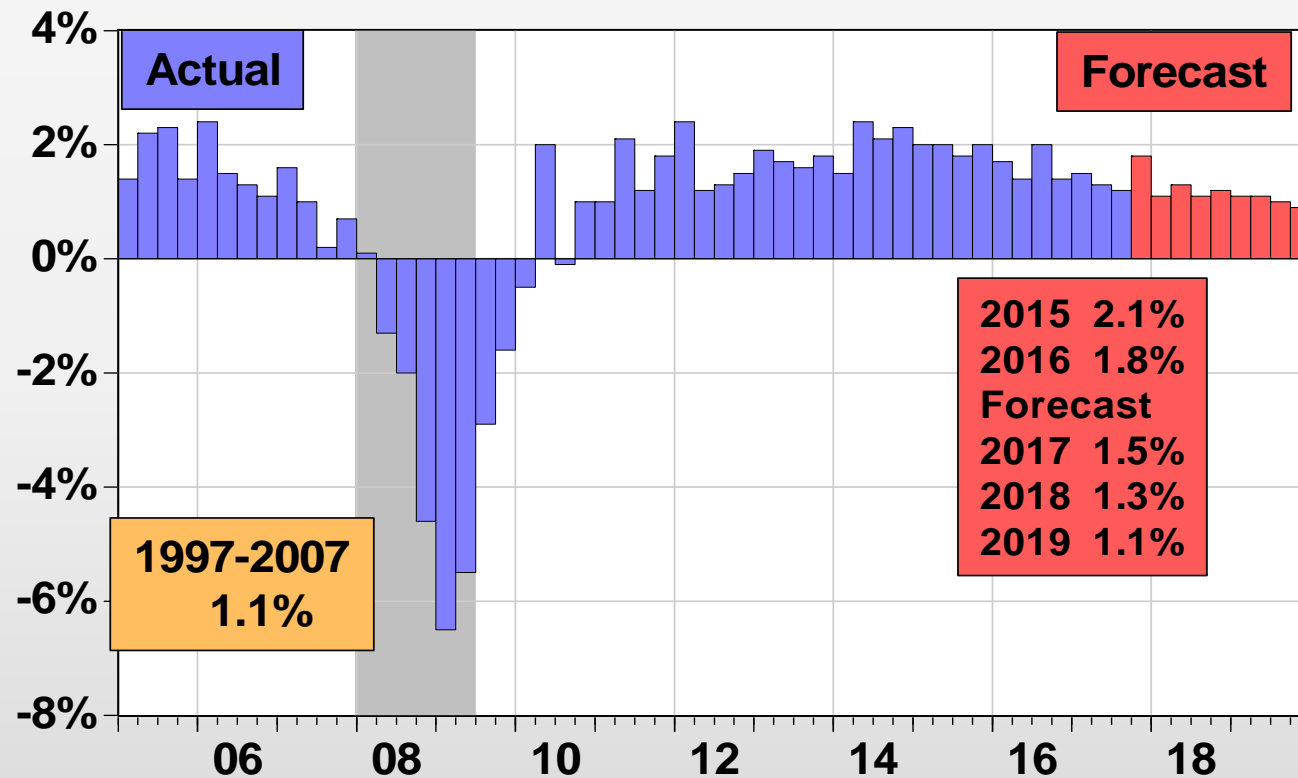
CHANGE IN NONFARM EMPLOYMENT



Source: BLS

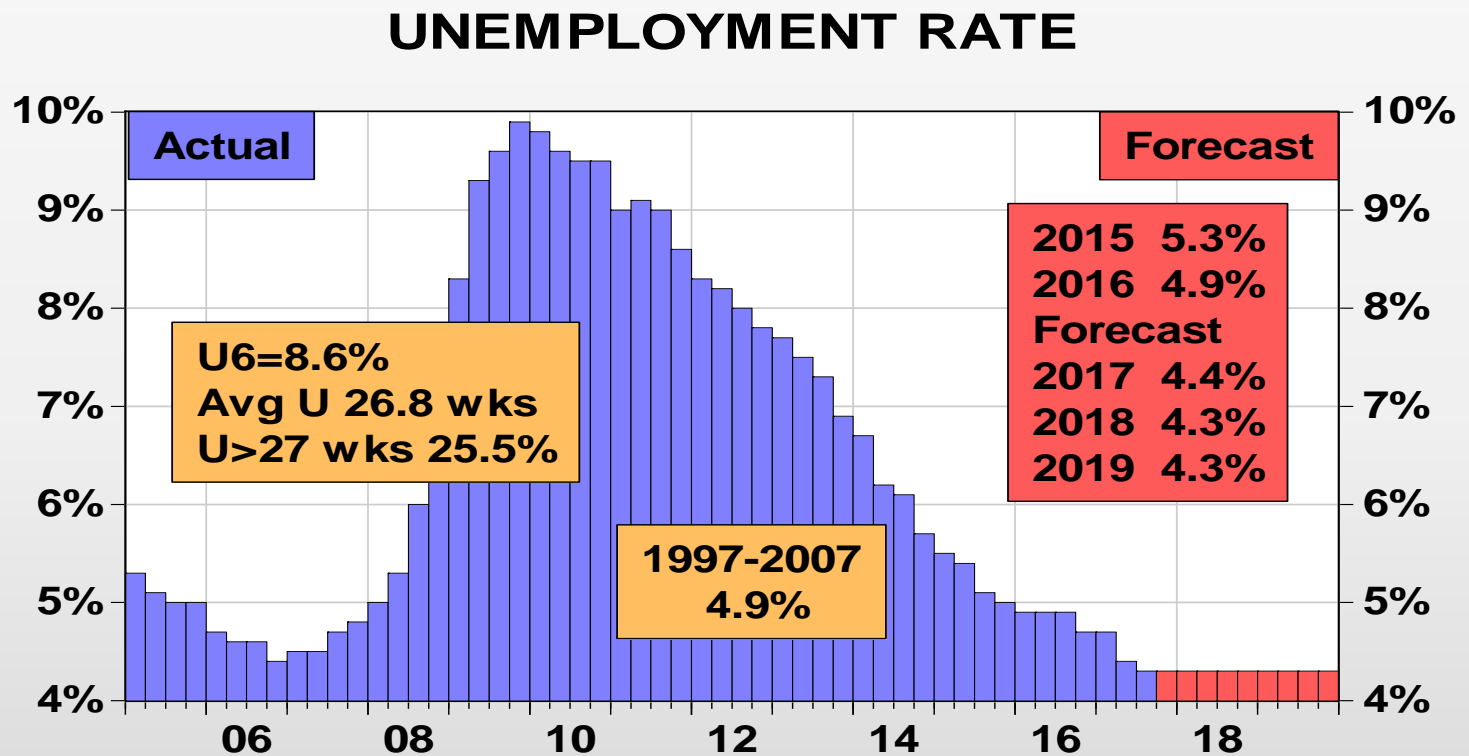
Future Job Growth Steady

NONFARM EMPLOYMENT



Source: BLS and IHS

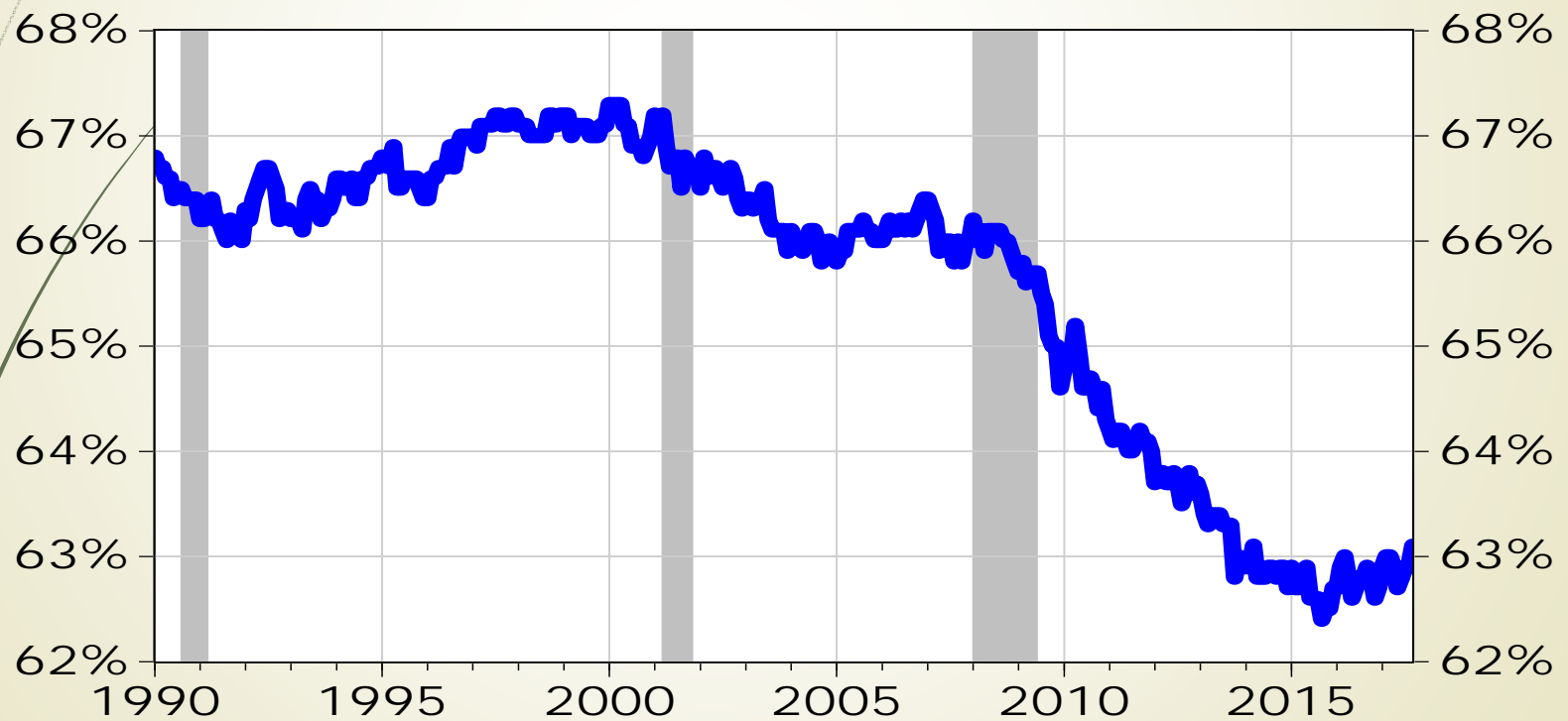
Low U3 Unemployment Stuck at 4.3%



Source: BLS and IHS

Labor Participation Rate Not Much Improvement

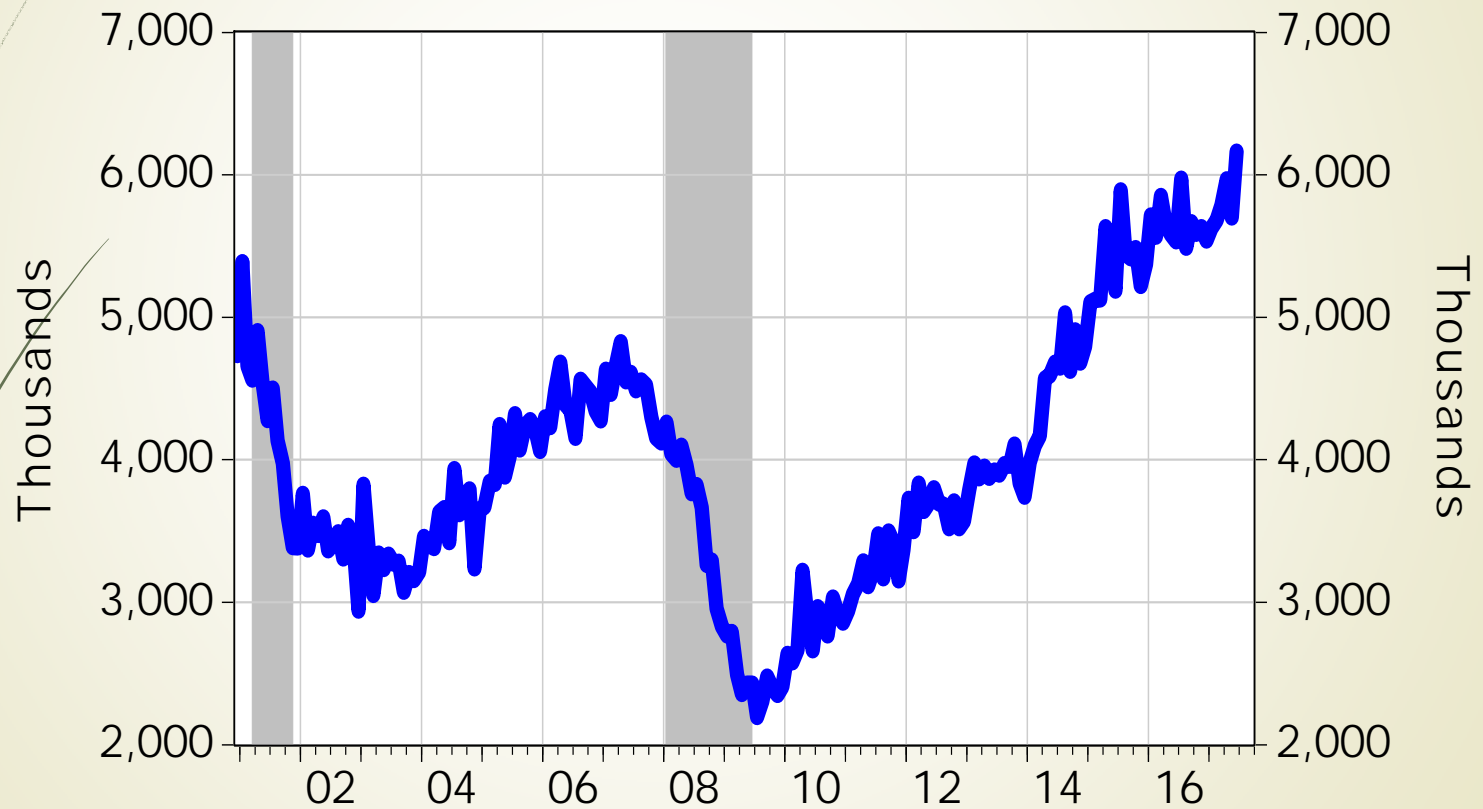
LABOR FORCE PARTICIPATION RATE



Source: BLS

RECORD JOB OPENINGS

JOB OPENINGS, NONFARM



Source: BLS

Inflation & Interest Rates

The FED is expected to raise the Federal Funds rate 25 basis points in December. Ultimately reaching 3% by 2020.

However that is not a “for sure” as the still low inflation rate is still a concern.

The FED expects to continue its balance sheet “normalization” program started this month.

The 10-Treasury note yield, currently at 2.3%, should rise to 4.1% by the end of 2019.

Inflation is still very low with the CPI reaching 2.1% in 2017, 1.7% in 2018, and 2.2% in 2019.

Oil prices will remain in the low \$50s in 2018 and rise to about \$58 by 2019.

The big question is who will Trump nominate as the FED chair in 2018?



FED Policy a Whole Discussion in of Itself

Mystery of low inflation with low unemployment rate. Is the Phillips Curve dead?

Should FED continue to tighten even though PCE inflation is below 2% target?

What happens to debt service when interest rates rise?

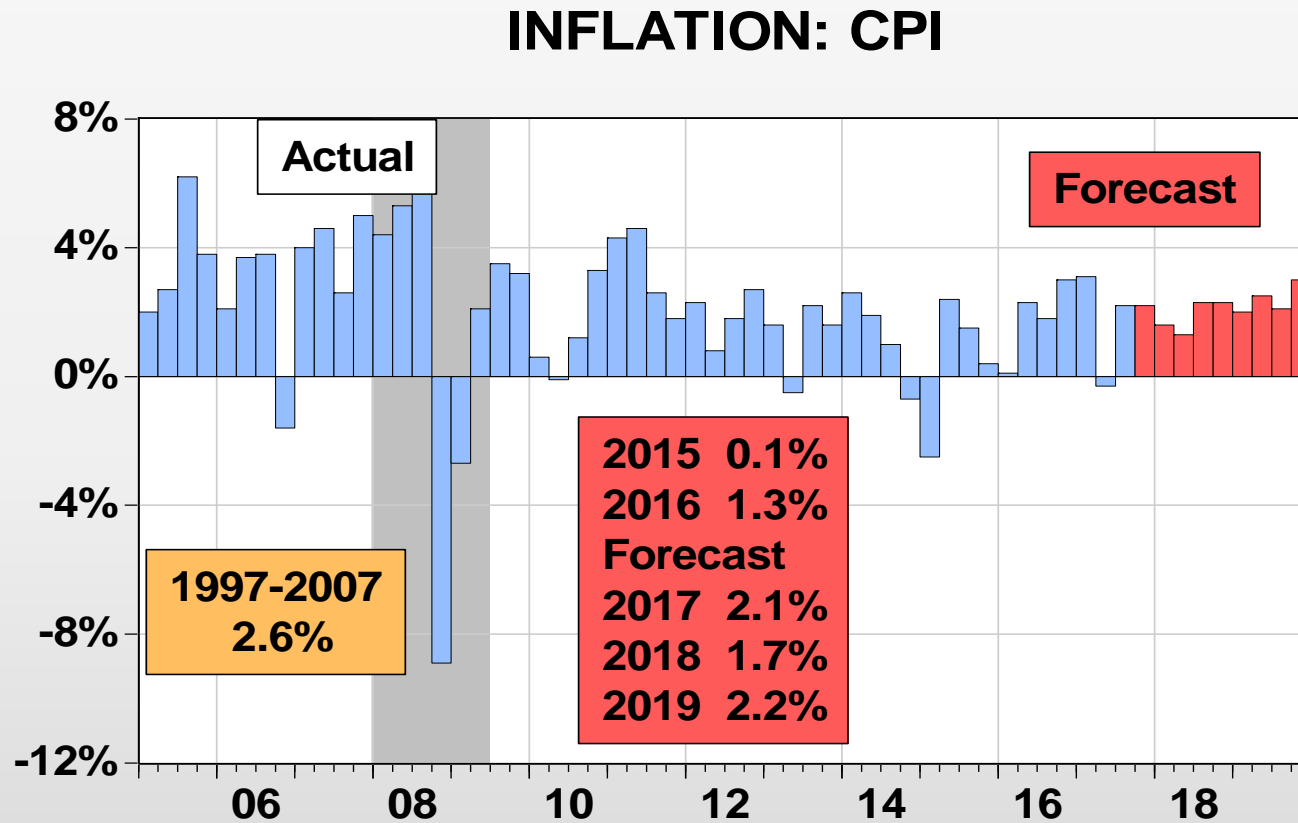
Is excessive debt becoming an area of concern?

What about bubbles in asset markets?

Under present low-rate policy what "firepower" does FED have left in case of recession?

Who will Trump choose as FED Chairman?

Still Very Low



Source: BLS and IHS

IHS GLOBAL INSIGHT FORECAST OCTOBER 2017

<u>Variable</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
GDP	2.9%	1.5%	2.2%	2.4%	2.2%
Recession Probability 20%					
NA Emp	2.1%	1.8%	1.5%	1.3%	1.1%
Oil(Brent)	\$53	\$44	\$53	\$52	\$58
Housing	1.11	1.18	1.19	1.30	1.40
CPI	0.1%	1.3%	2.1%	1.7%	2.2%
Un Rate	5.3%	4.9%	4.4%	4.3%	4.3%



Key Variables Tracking SD Economy

Nonfarm employment

Housing starts

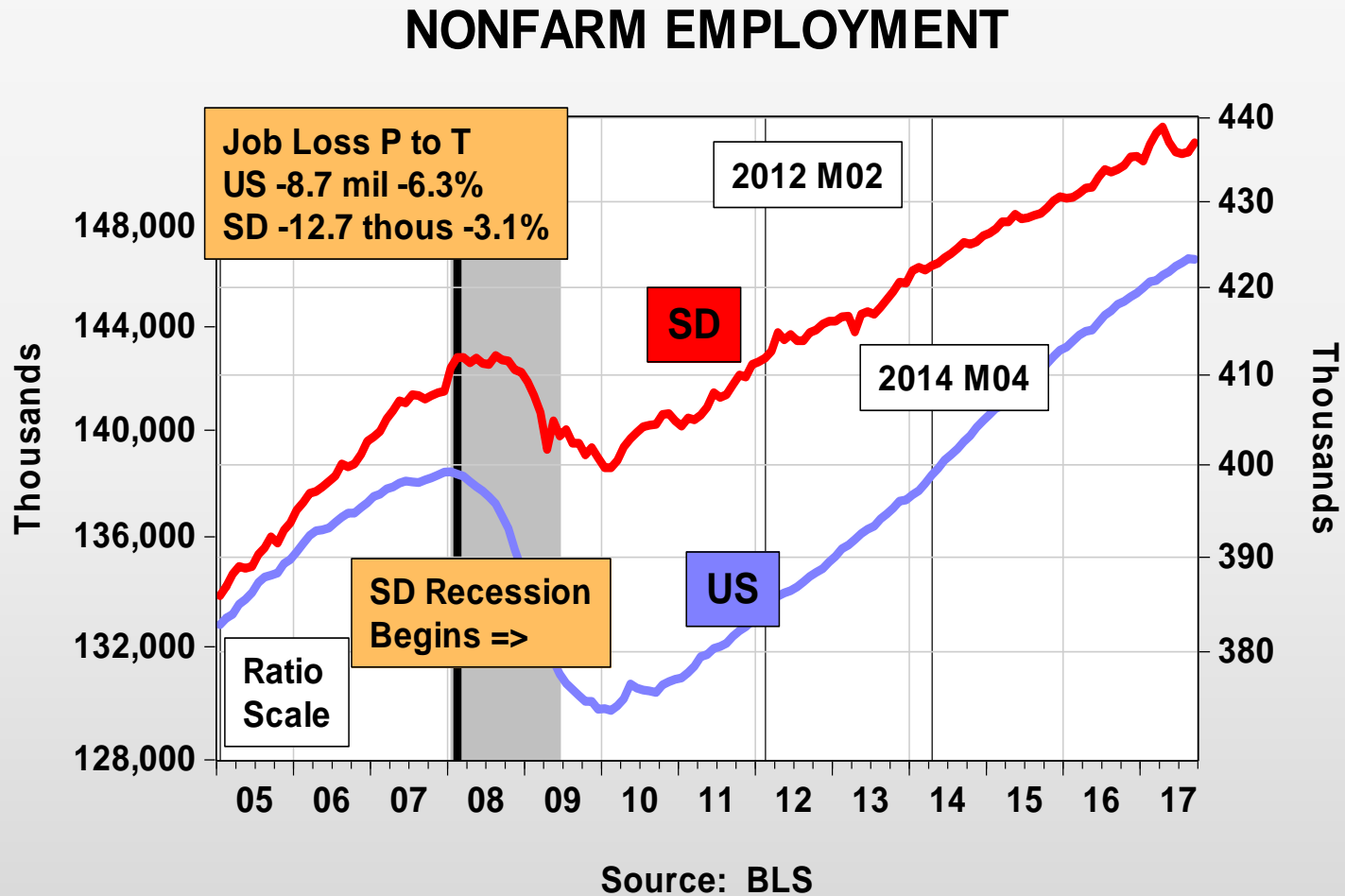
Real nonfarm personal income

Taxable sales

Leading indicator

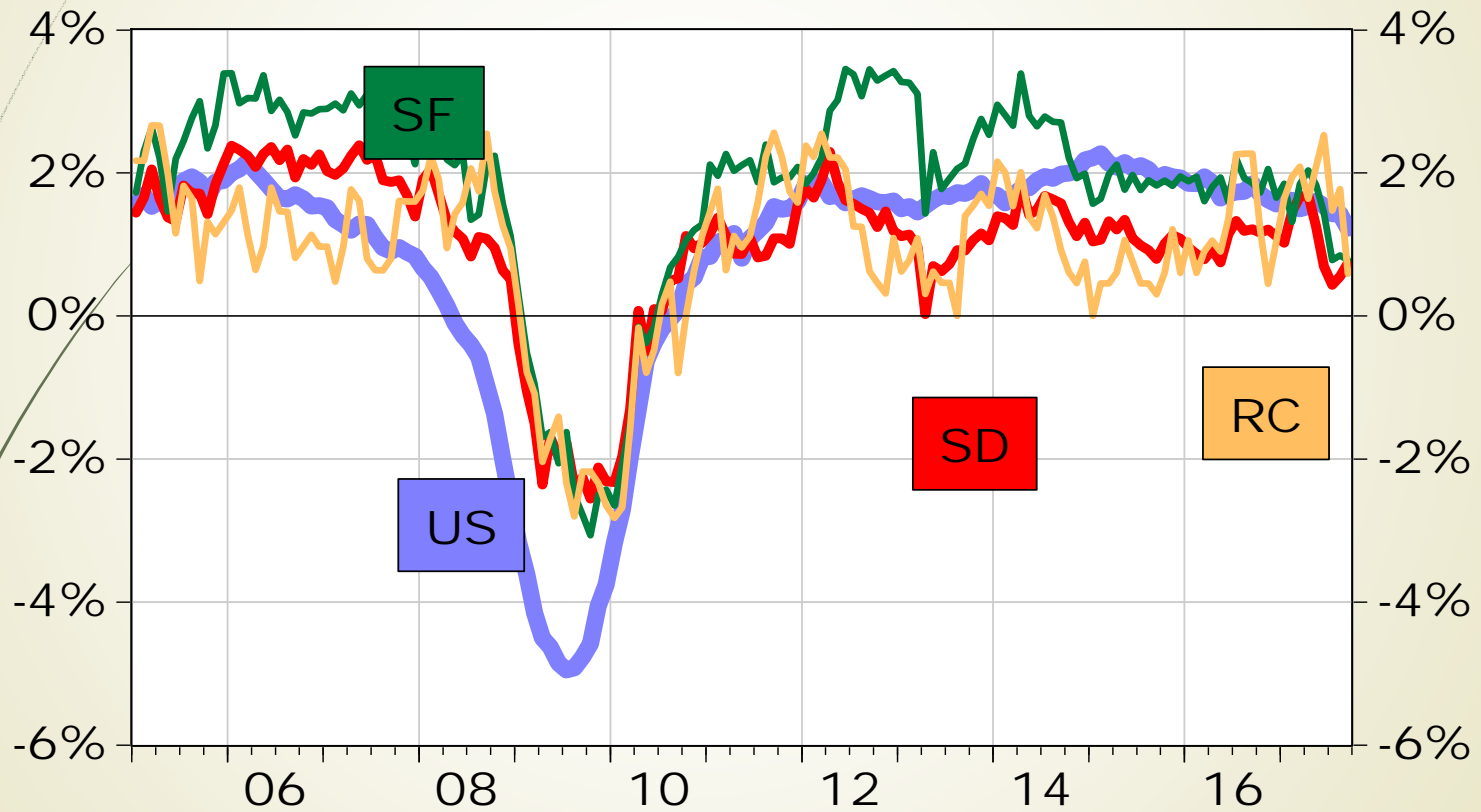


Slow Down But Not Much



Interesting

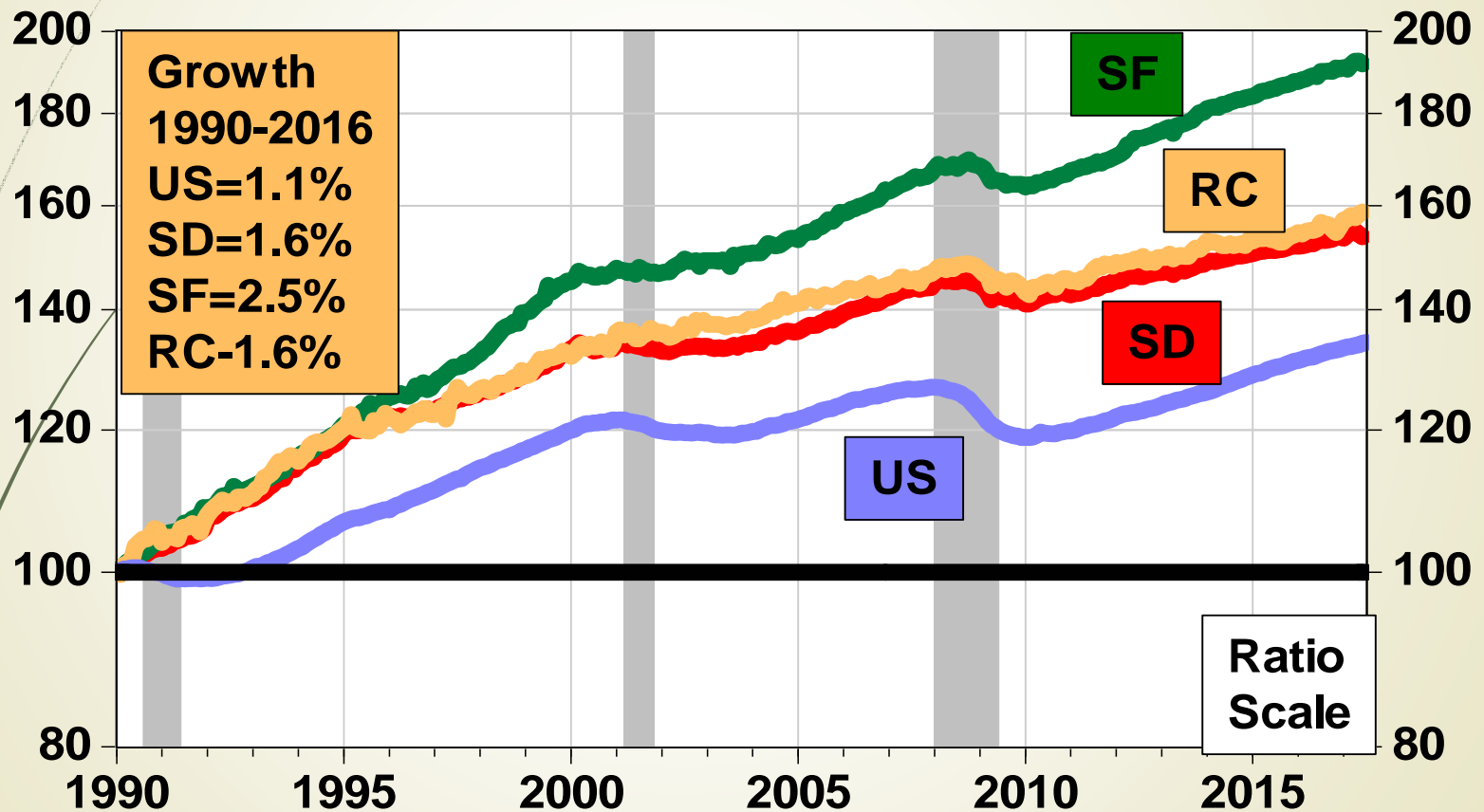
NONFARM EMPLOYMENT



Source: BLS

SF Easily Outpaces the Rest

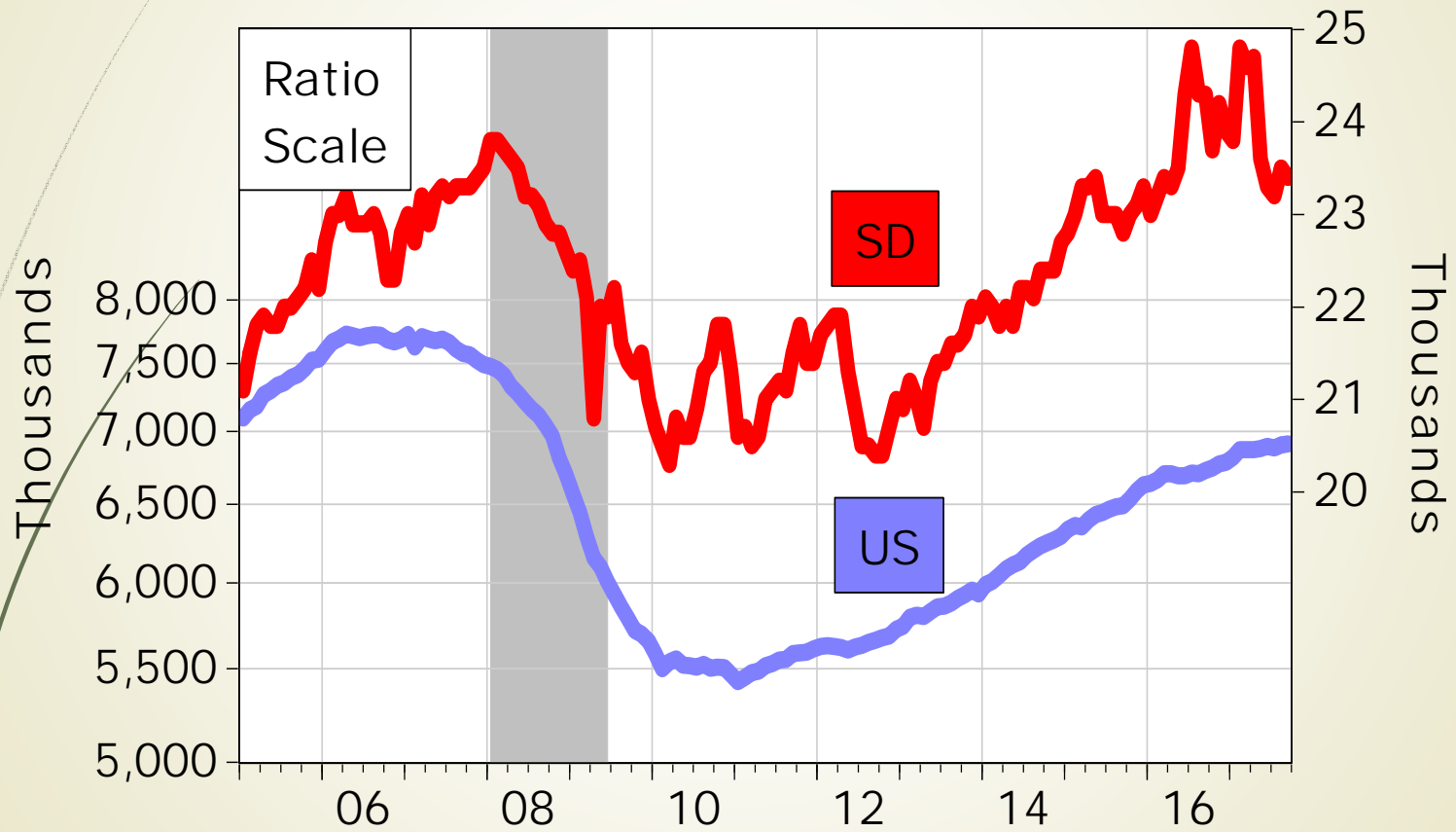
NONFARM EMPLOYMENT



Source: BLS

Recent Slowing

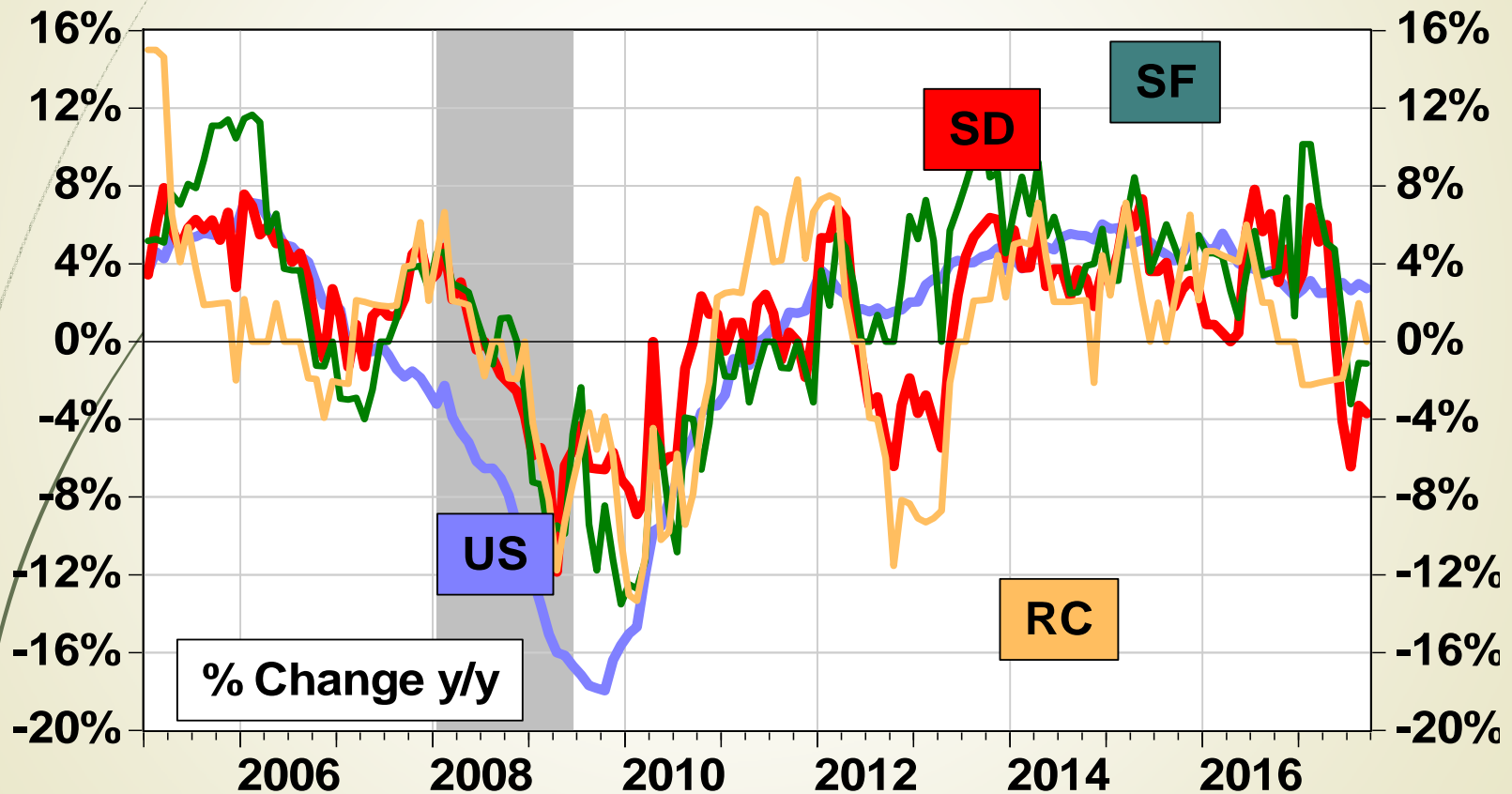
CONSTRUCTION EMPLOYMENT



Source: BLS

Negative Growth

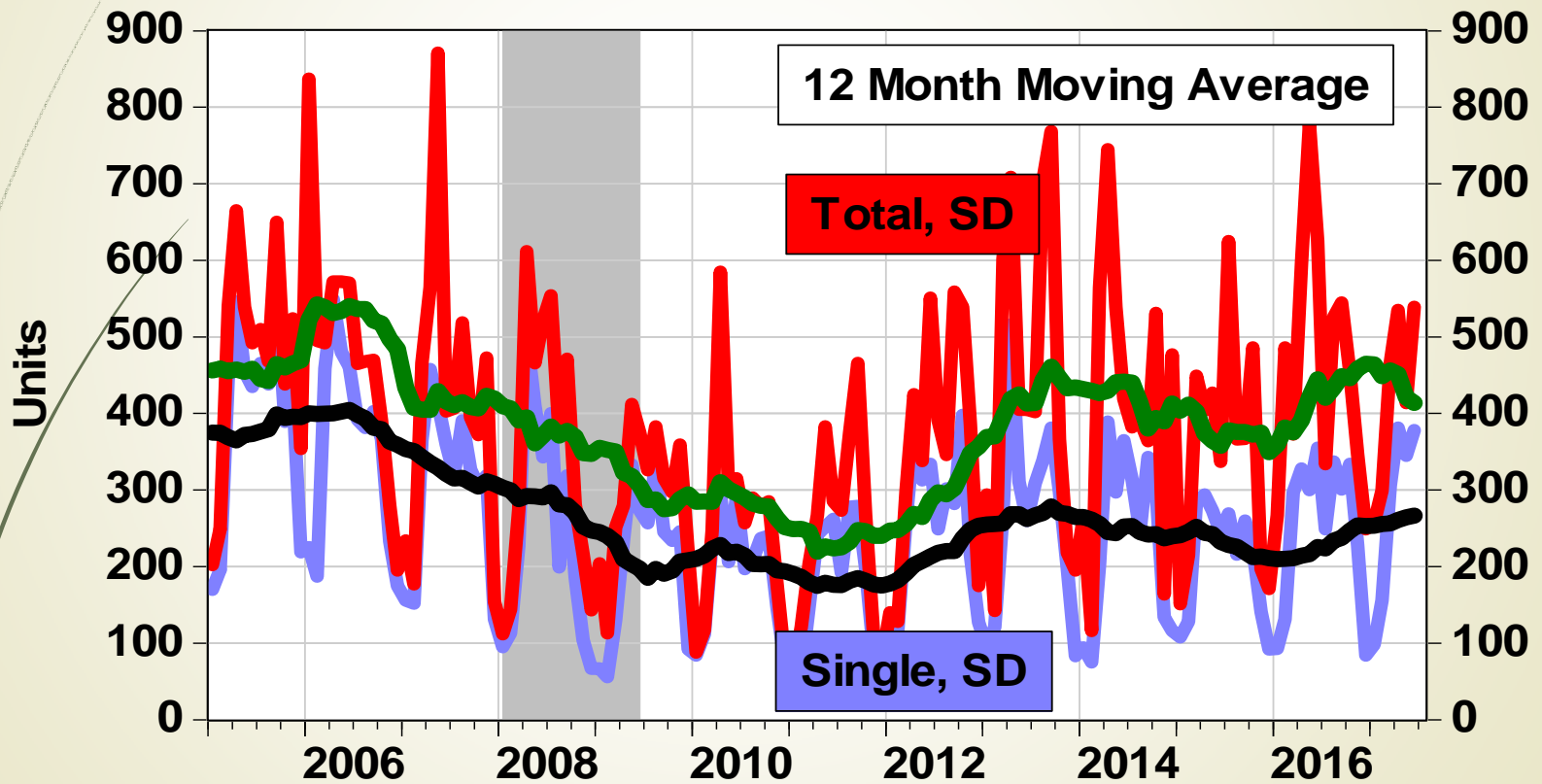
CONSTRUCTION EMPLOYMENT



Source: BLS

Some Growth

SD Building Permits, Total & Single

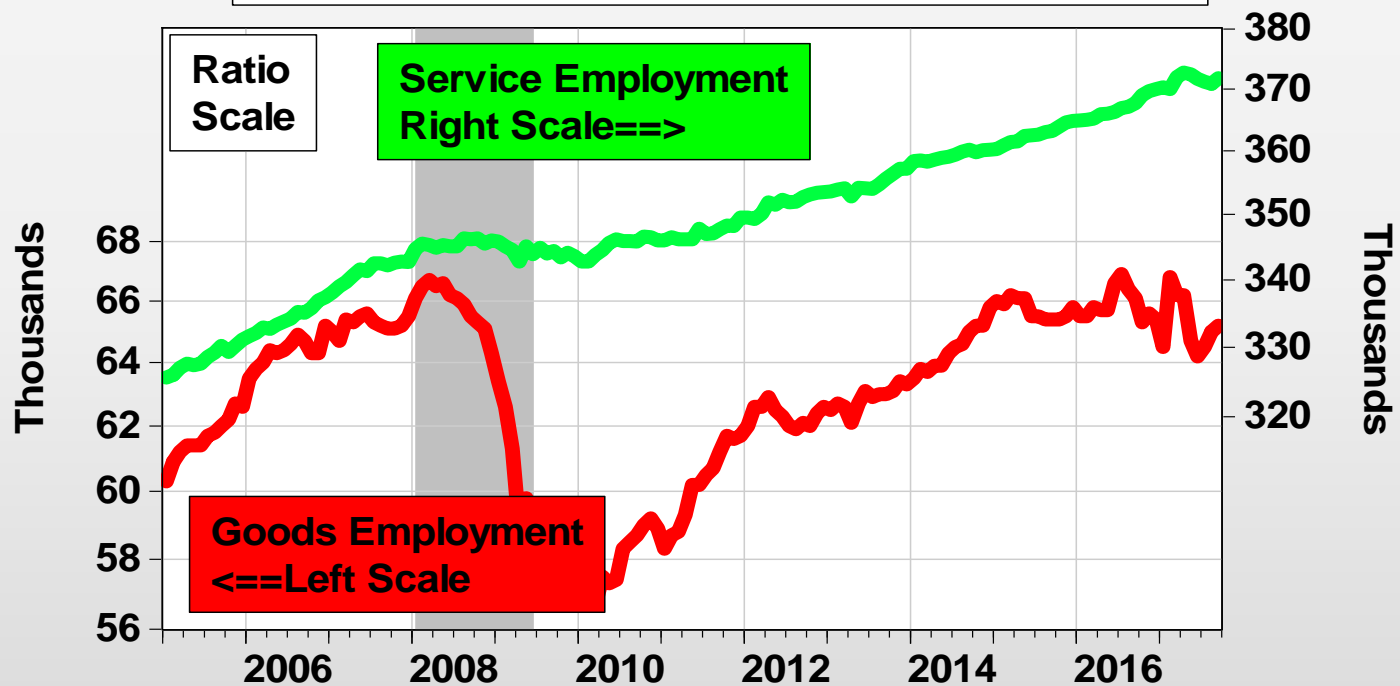


Source: Census Bureau

Which is More Cyclical?

SOUTH DAKOTA SERVICE AND GOODS PRODUCING EMPLOYMENT

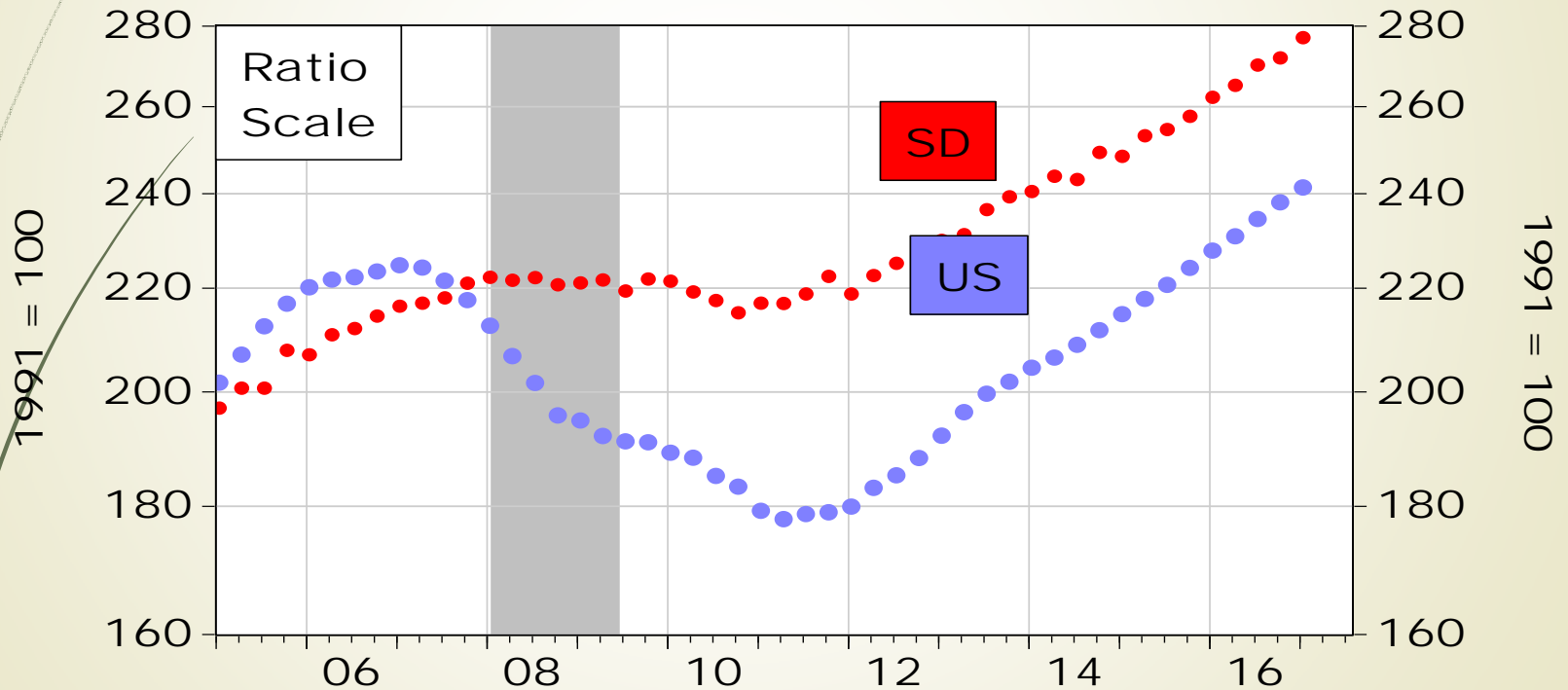
Goods-Producing = Manufacturing+Construction



Source: BLS

SD Peaked Later and Decline Less Severe

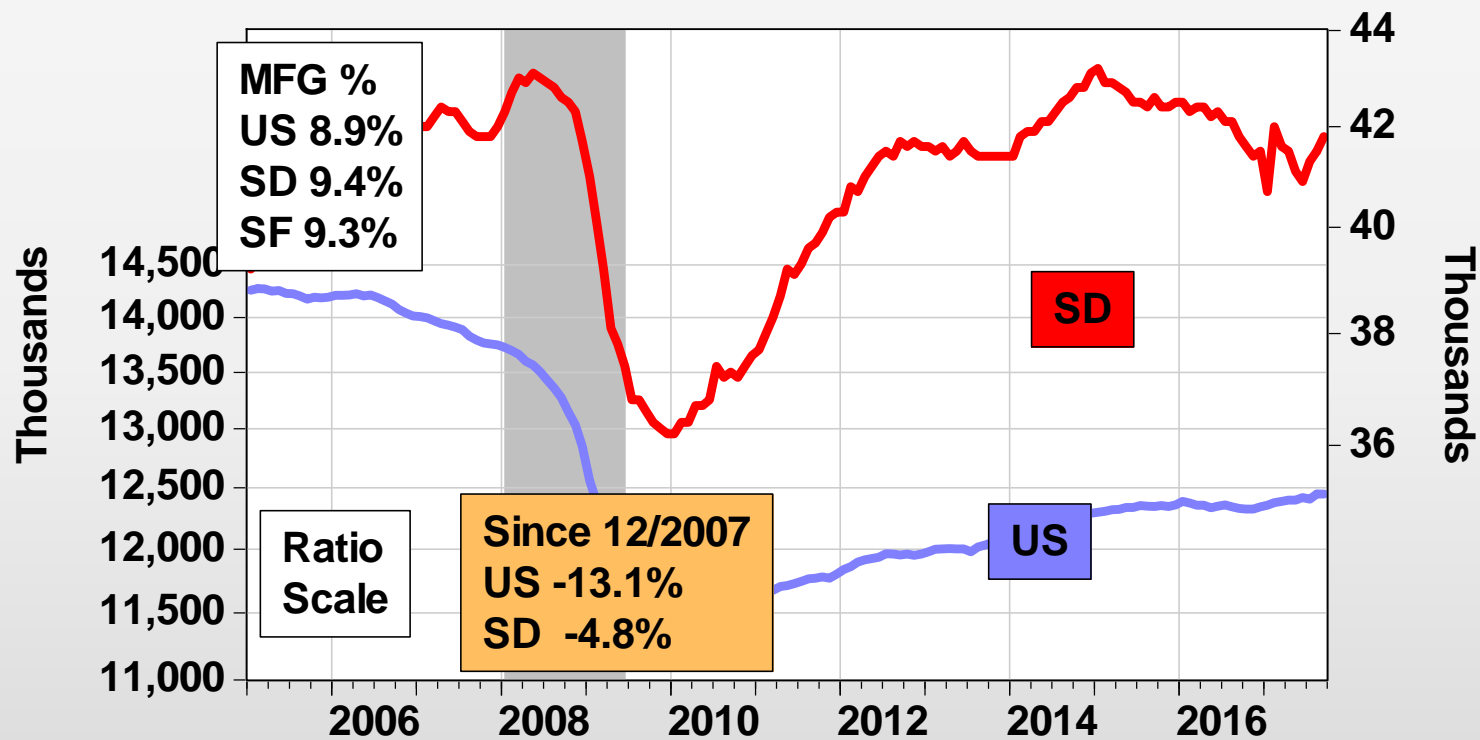
HOUSE PRICE INDEX



Source: FHLB

Not Much Growth

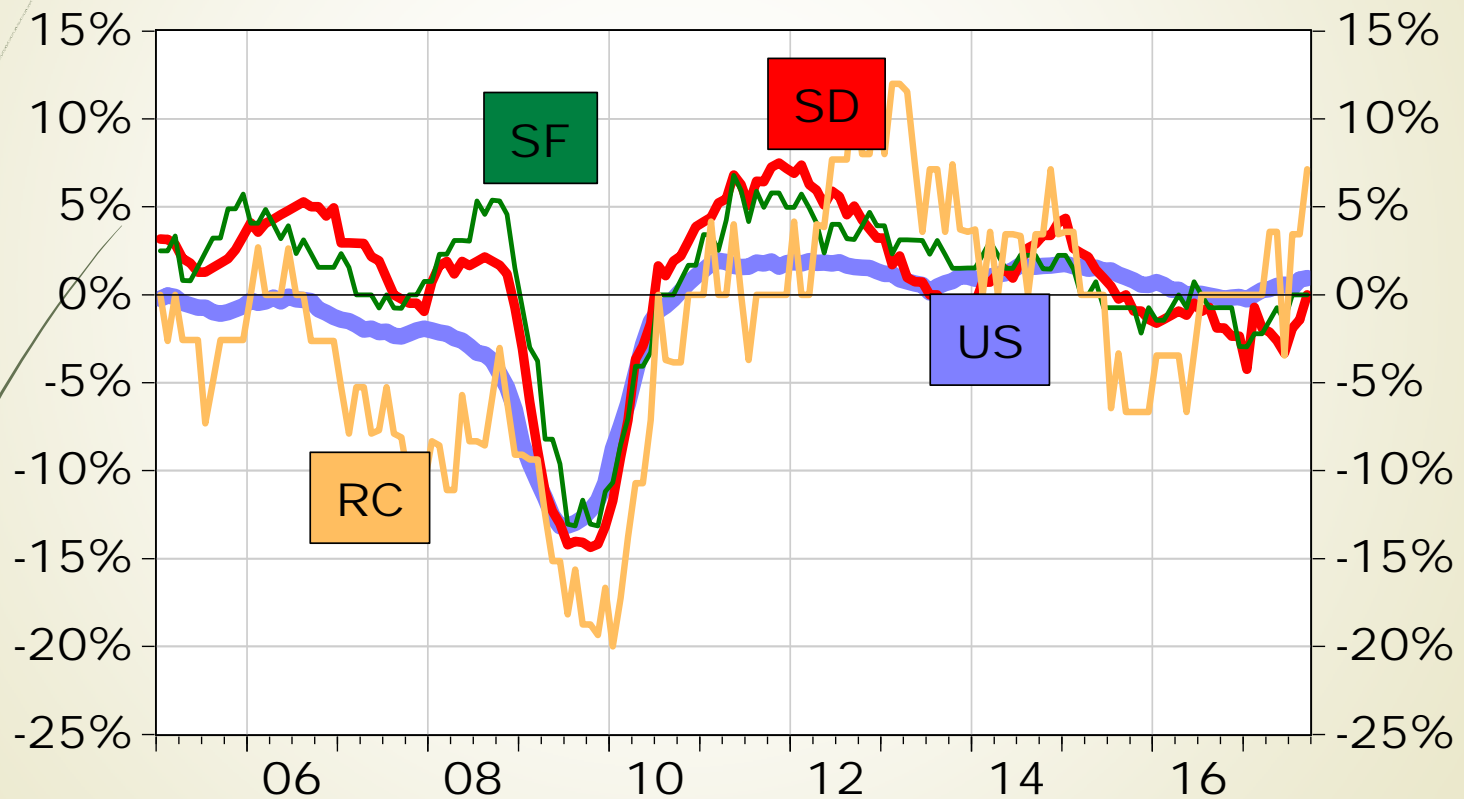
MANUFACTURING EMPLOYMENT



Source: BLS

Divergence

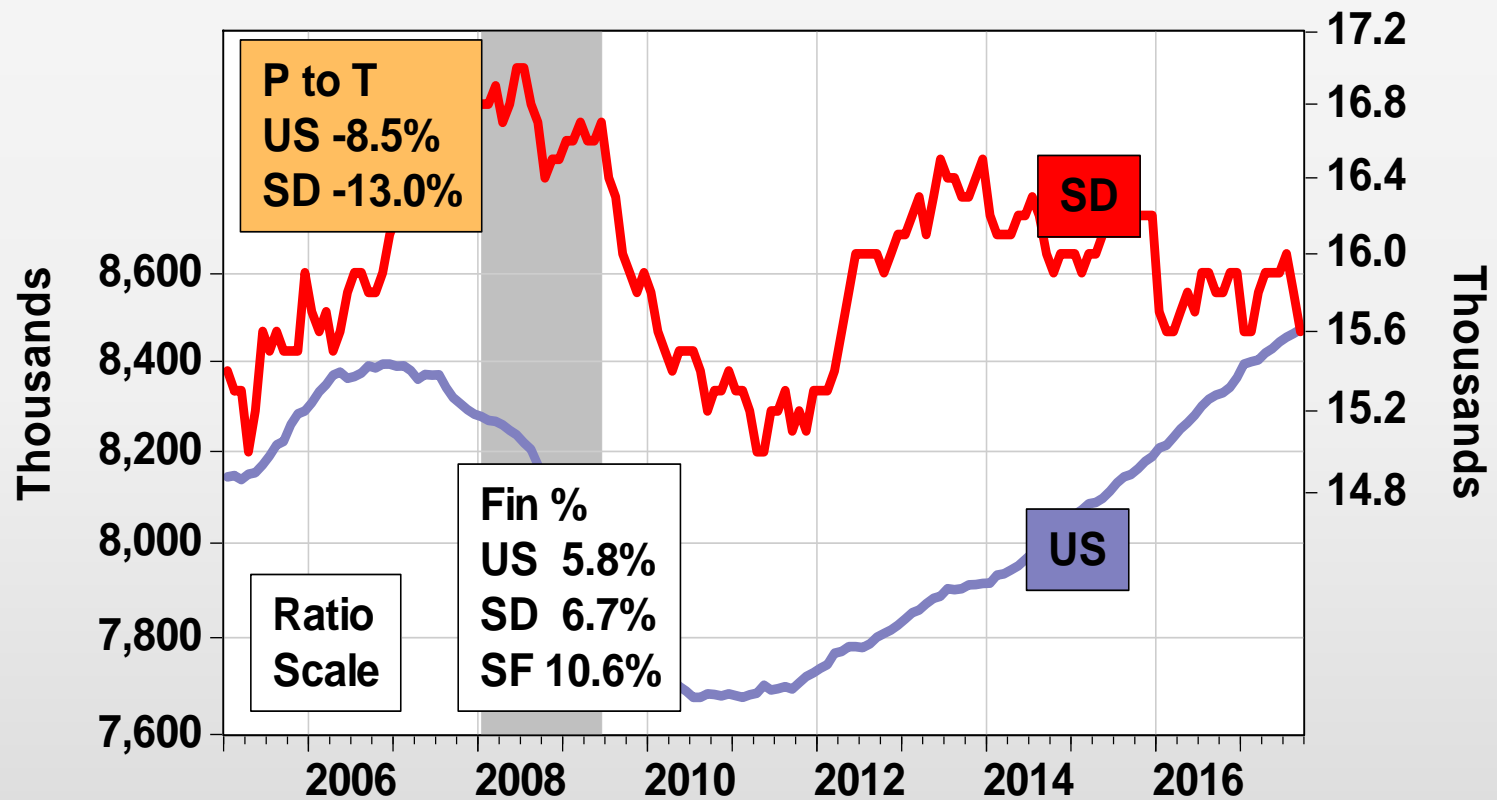
MANUFACTURING EMPLOYMENT



Source: BLS

SD More Volatile

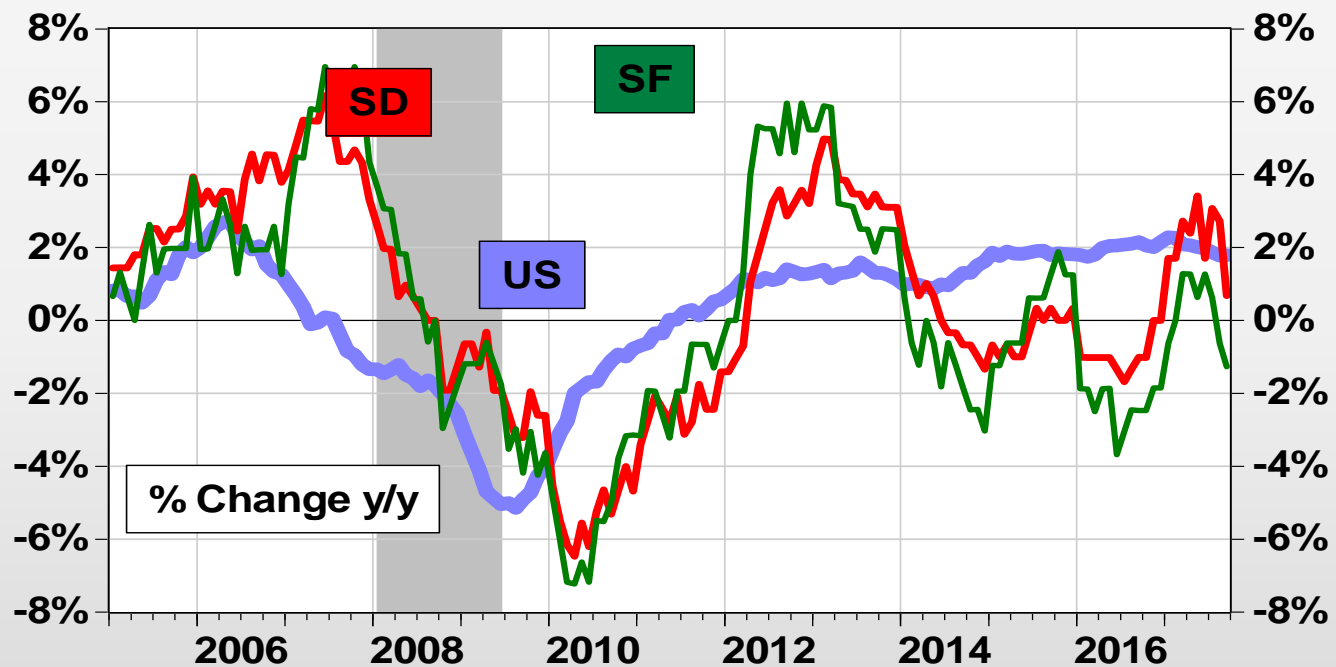
FINANCIAL ACTIVITY EMPLOYMENT



Source: BLS

Note SD and SF Different Than US

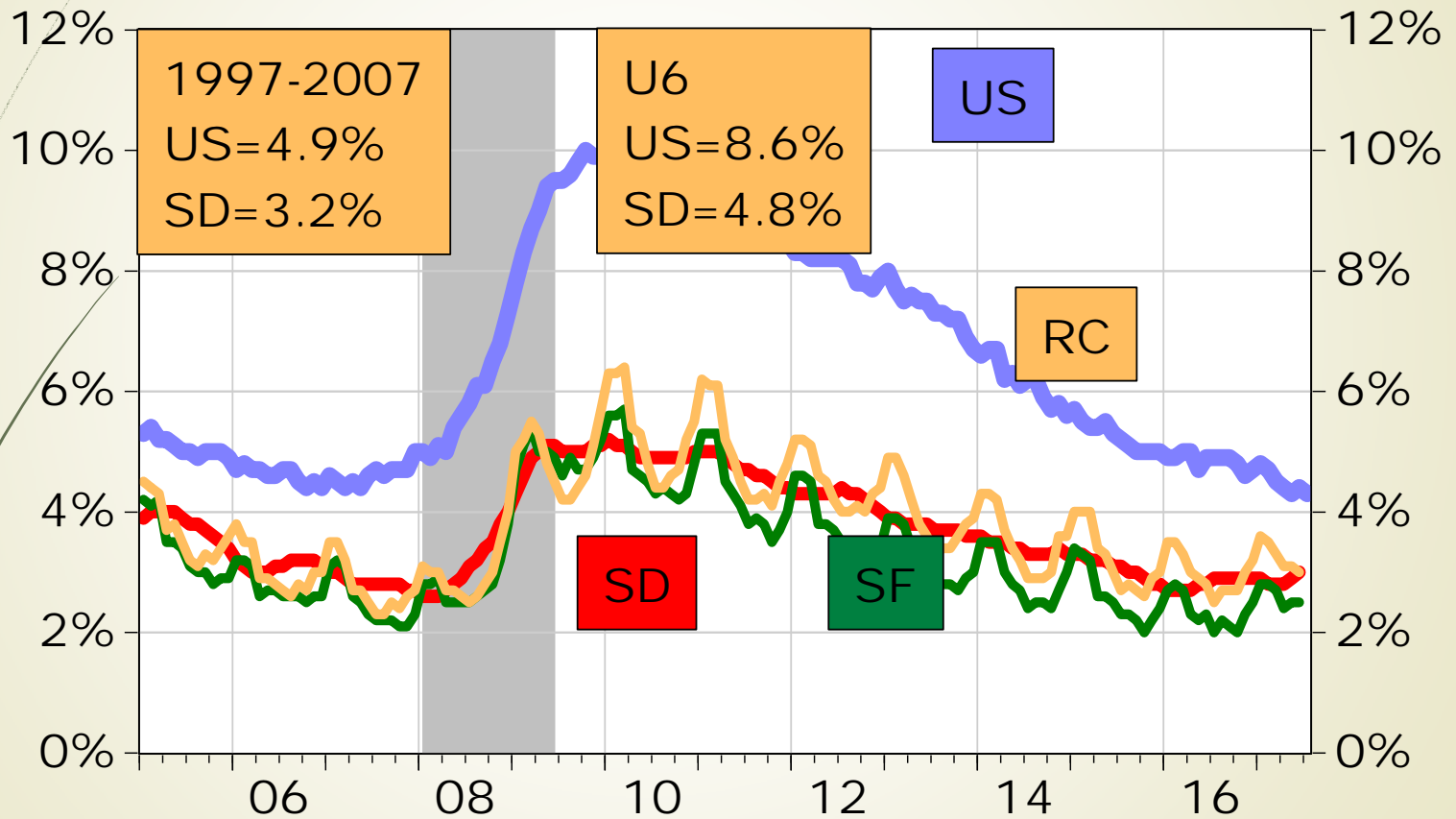
FINANCIAL ACTIVITY EMPLOYMENT



Source: BLS

US 4.3% SD 3.4% SF 2.8% RC 3.4%

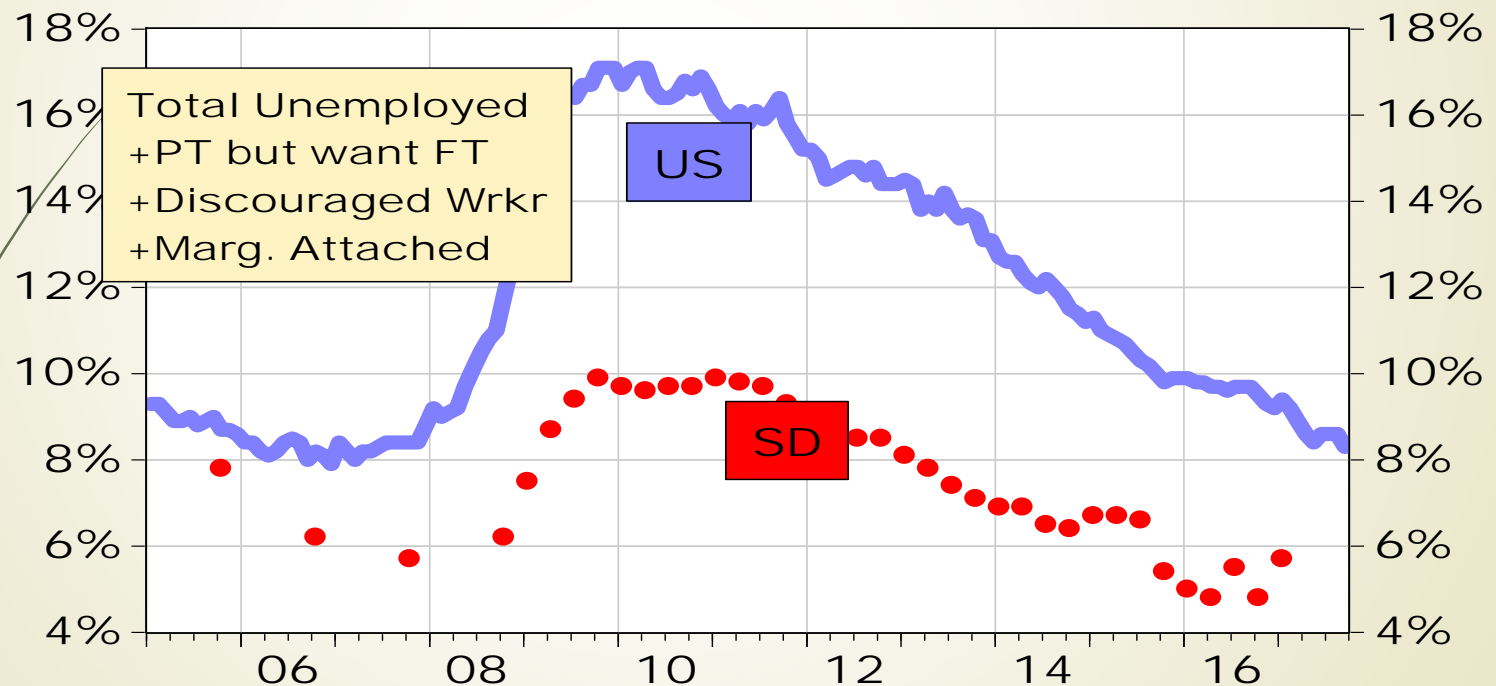
UNEMPLOYMENT RATES



Source: BLS

Definite Improvement SD Lowest of All States

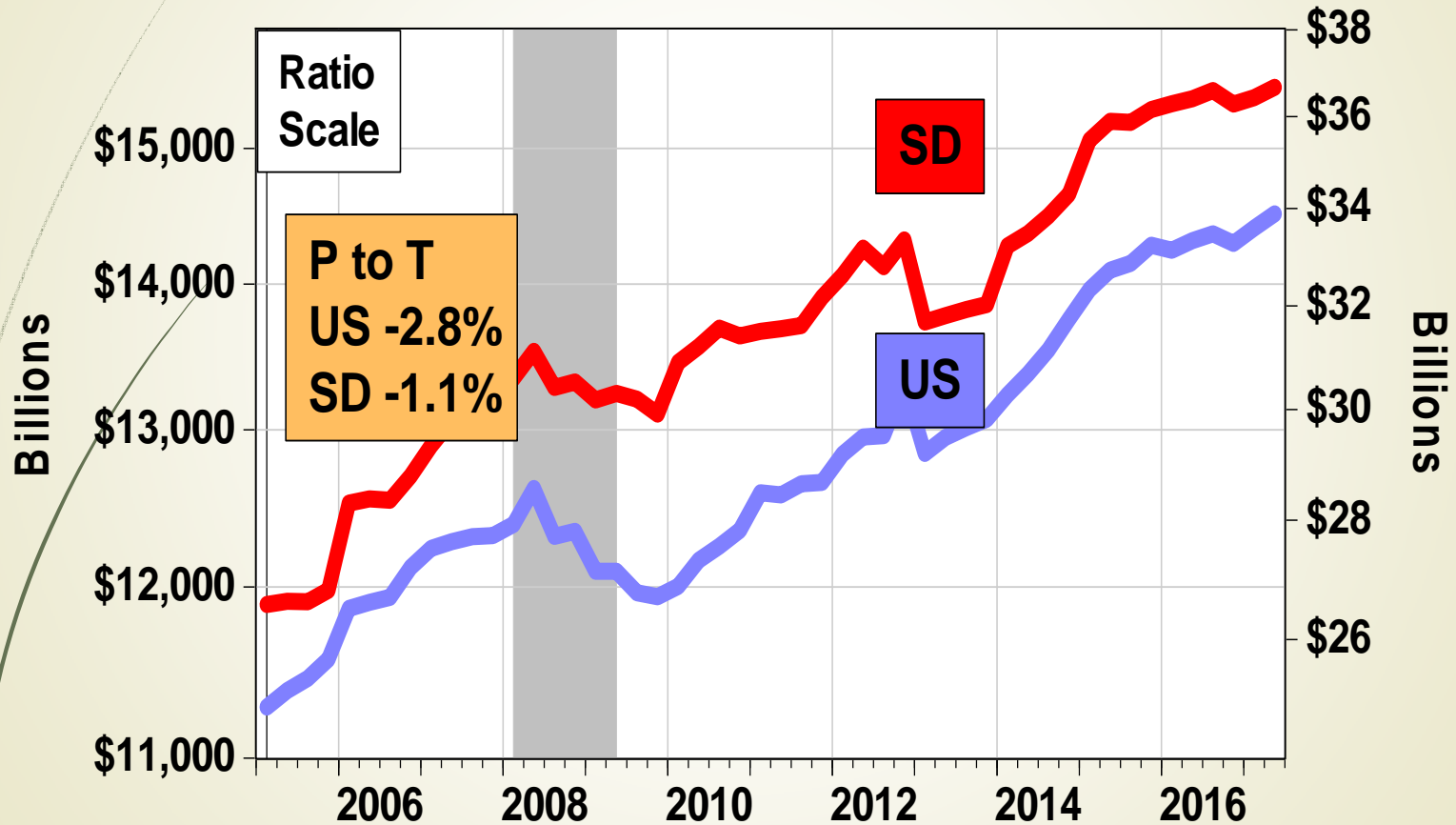
U6 UNEMPLOYMENT RATE



Source: BLS

Real Growth But Slower

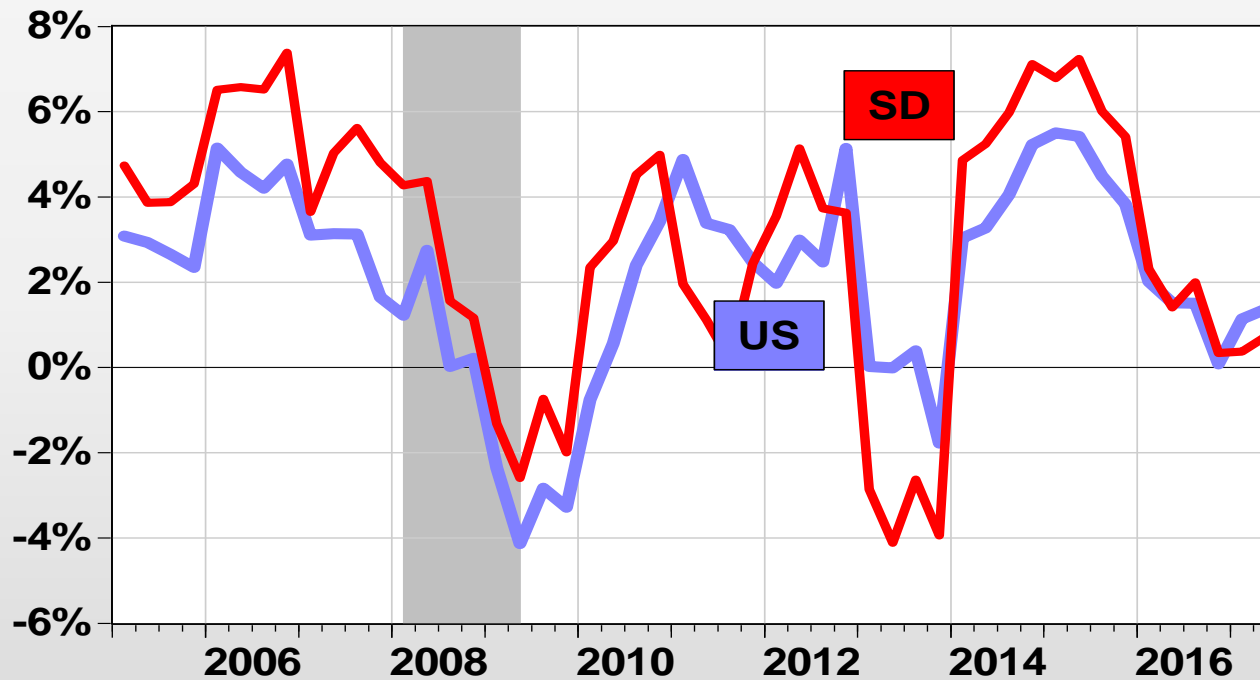
NONFARM PERSONAL INCOME (2009 \$)



Source: BLS

US and SD Track

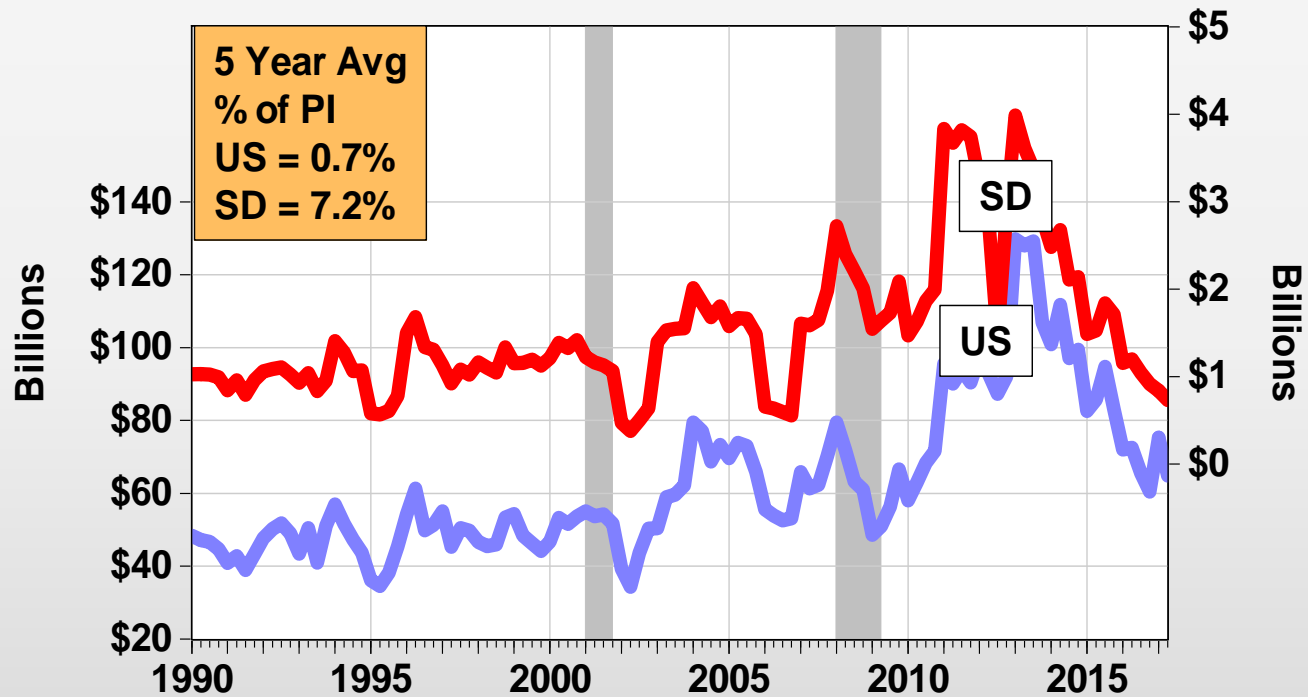
REAL NONFARM PERSONAL INCOME (Year-Over-Year Percent Change)



Source: BEA

Farm Down Sharply – Low Prices

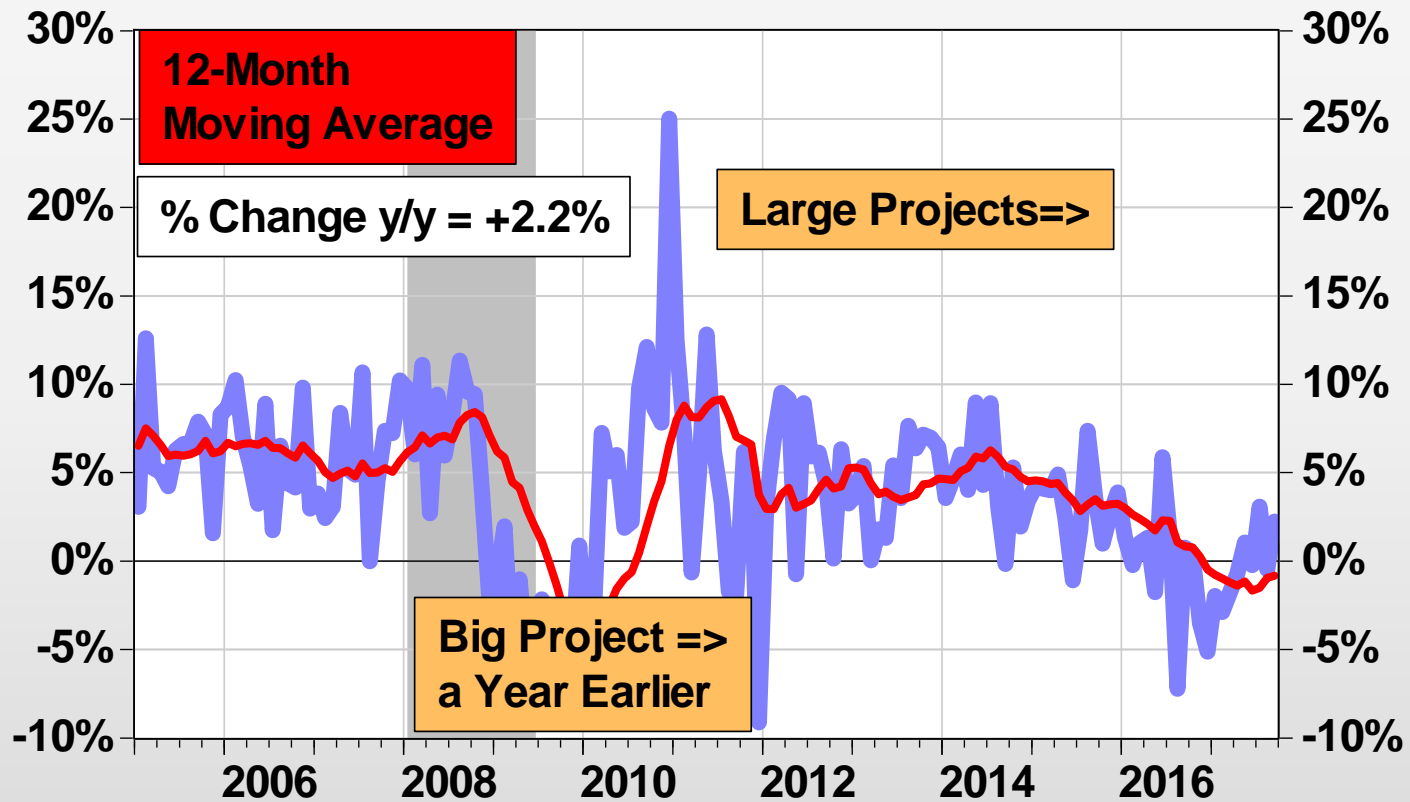
FARM INCOME



Source: BEA

Low Inflation, Poor Farm Economy, & Online Sales

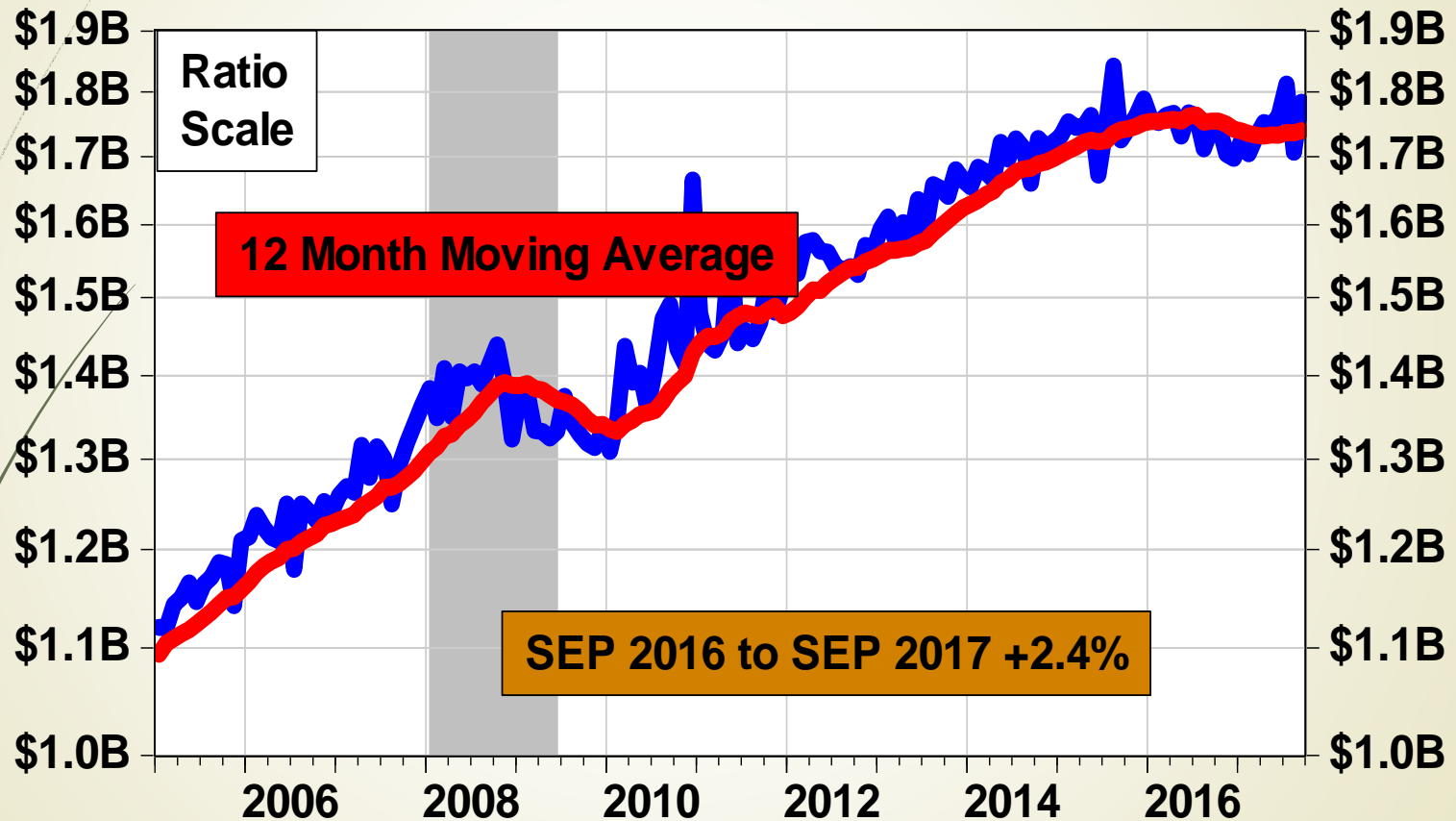
SD TAXABLE SALES



Source: SD Department of Revenue

Little Growth

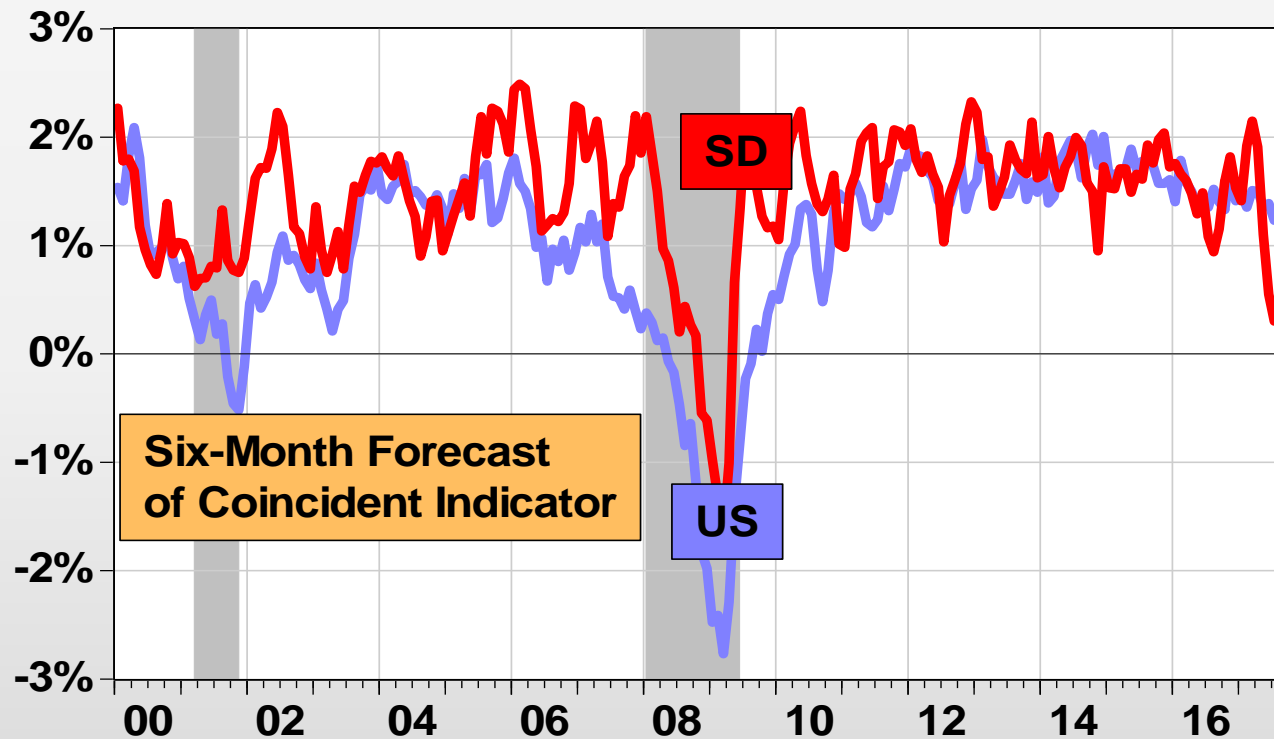
SD Taxable Sales - Seasonally Adjusted




Source: SD Department of Revenue

Forecasting Slower Growth

LEADING INDICATOR: US & SD



Source: Fed Res Bank of Philadelphia



Mid-American States Leading Indicators - GOSS

September 2017 Index > 50 Growth

Overall 46.6



New Orders 50.4

Sales 55.7

Delivery lead time 43.8

Inventories 42.1

Employment 41.2

- 
- 
- ▶ **“Over the past 12 months, South Dakota experienced a decline in manufacturing employment of 1 percent, or approximately 400 manufacturing jobs. Almost all of the loss was recorded by the state’s durable goods manufacturing sector,” said Goss.**

Conclusions

SD economy growing at slower pace

SF economy growing at faster rate

US economy growing slowly

20% chance of recession

The End

