The State of the SD Economy

Presentation to the Governor's Council of Economic Advisors

August 30, 2018

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Outline of Presentation

Overview of US economy

US economy forecast

SD economy

Summary & Conclusions

US Forecast

IHS MARKIT Forecast – August 10, 2018

Real GDP

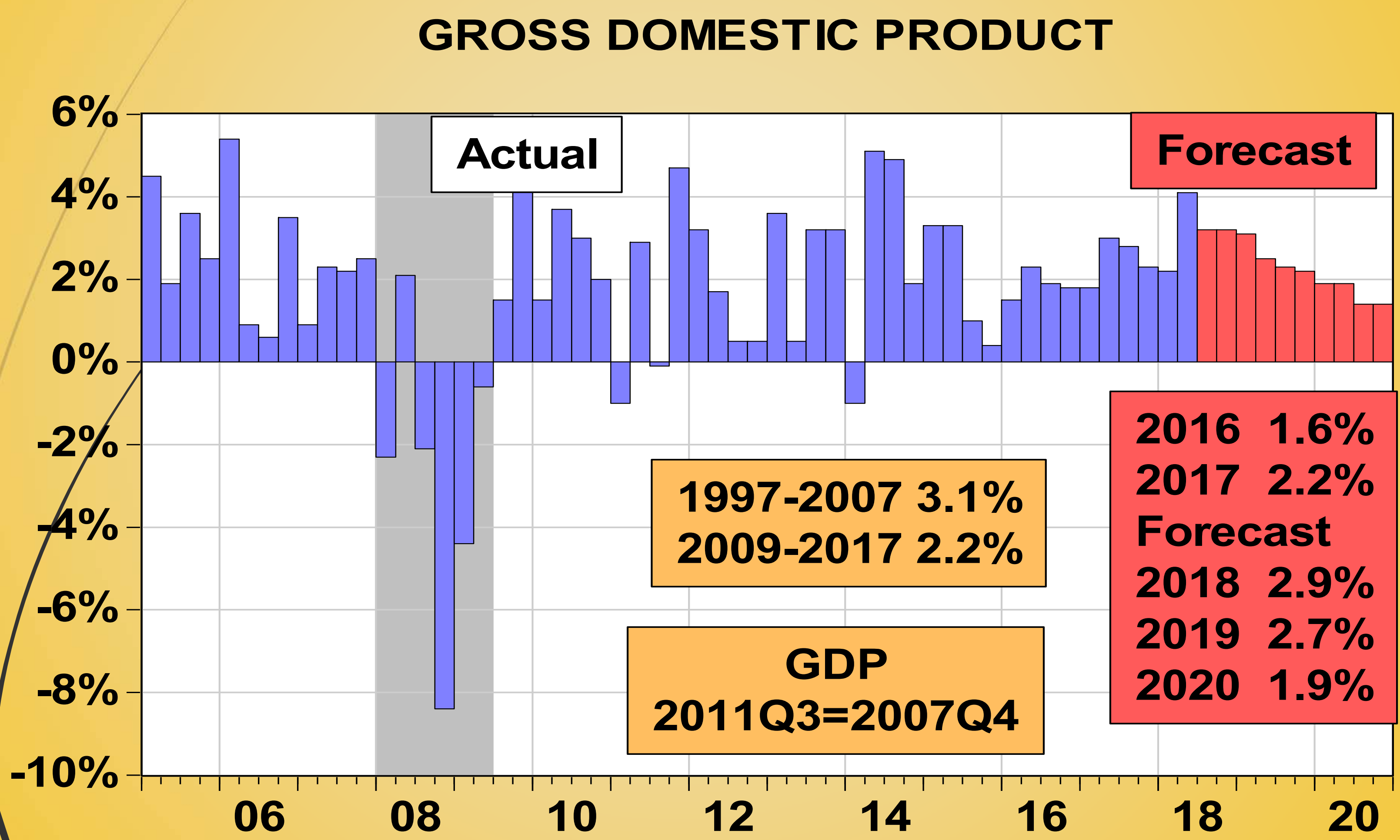
Consumption,

Housing Starts

Federal Budget

Interest Rates and Inflation

Good Recent Growth



Source: BEA and IHS

GDP

We are now in the 110th month of expansion. The record is 120 months. The record is 1991 to 2001.

Good growth in 2018 and 2019 at 2.9 and 2.7%, respectively. In 2020, growth slows to 1.9% and about 1.7% thereafter.

Consumer spending will continue to contribute to growth supported by improving HH finances, lower taxes, strong labor market, real income increases, and rising home prices. Growth of 2.5% in 2018 and 2019.

Business fixed investment, inventory restocking, housing markets all should drive GDP growth in 2018 and 2019.

Components of GDP are:

GDP = Consumption (69%)

Investment (17%)

Government (18%)

Net Export (-4%)

Consumption

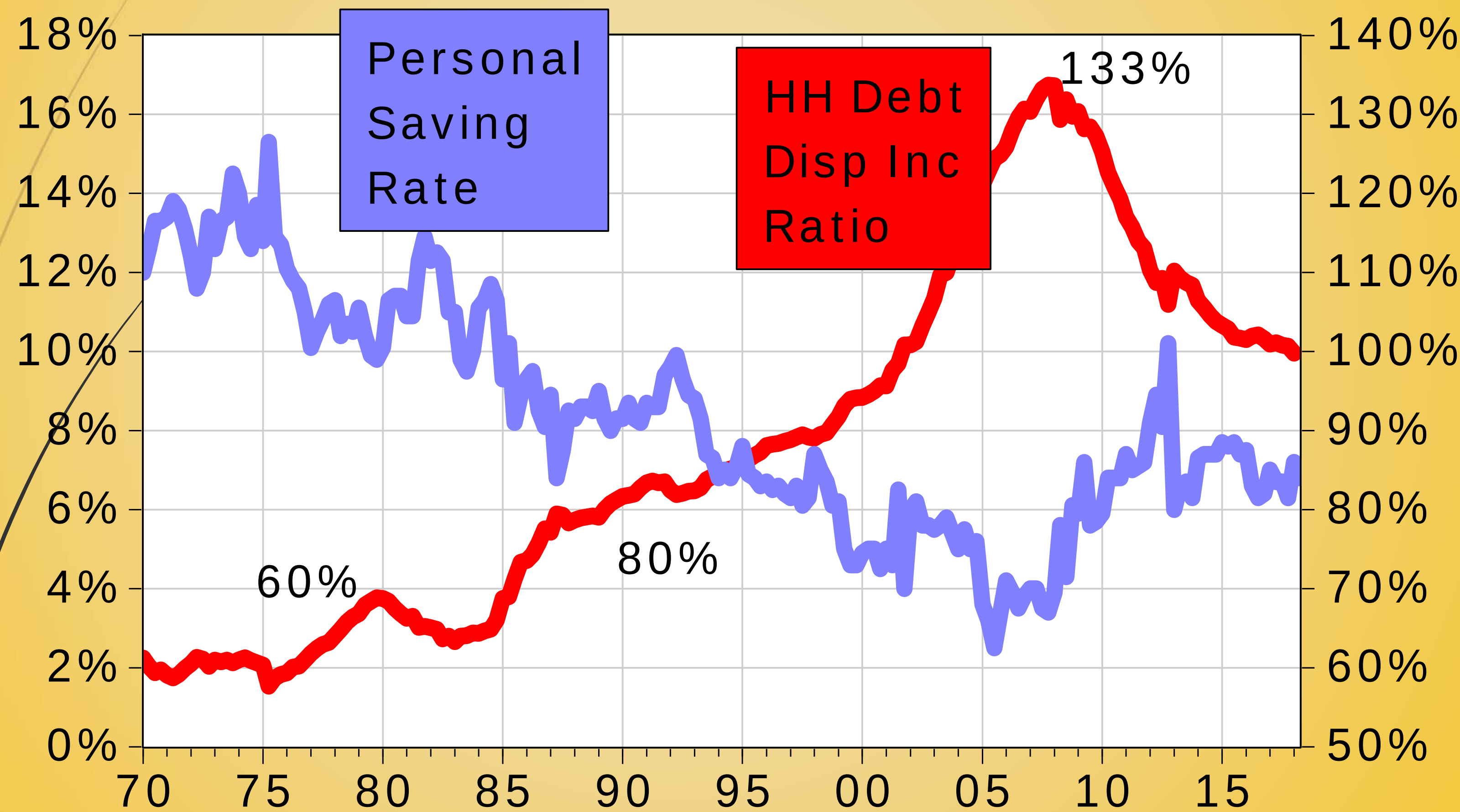
As previously mentioned, consumer fundamentals looks strong.

Projected growth is at 2.5% through 2019 and 2.3% in 2020.

University of Michigan’s Consumer Sentiment and the Conference Board’s Consumer Confidence Index remain close to historical highs.

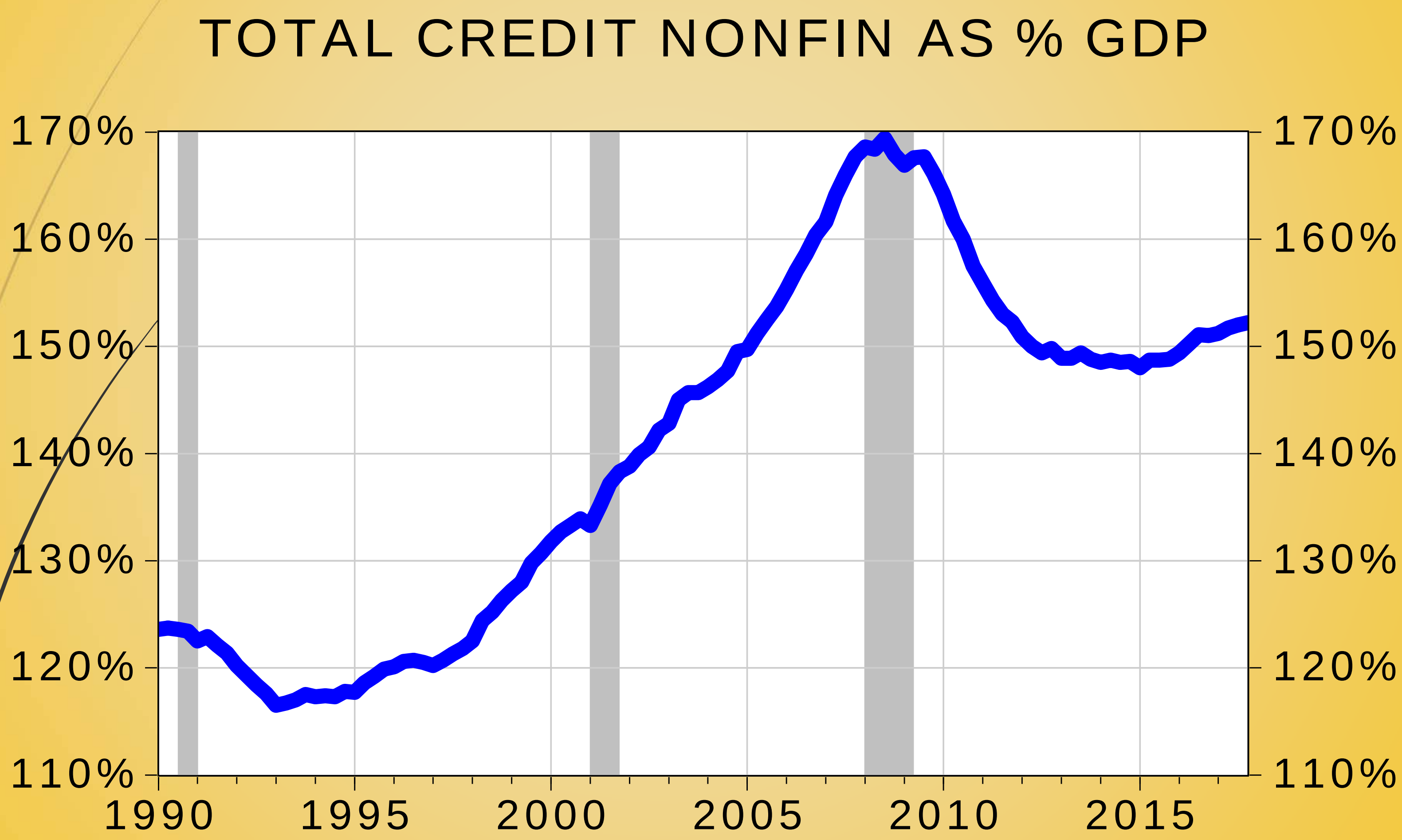
Deleveraging Plateaus

HOUSEHOLD DEBT AND SAVING RATE



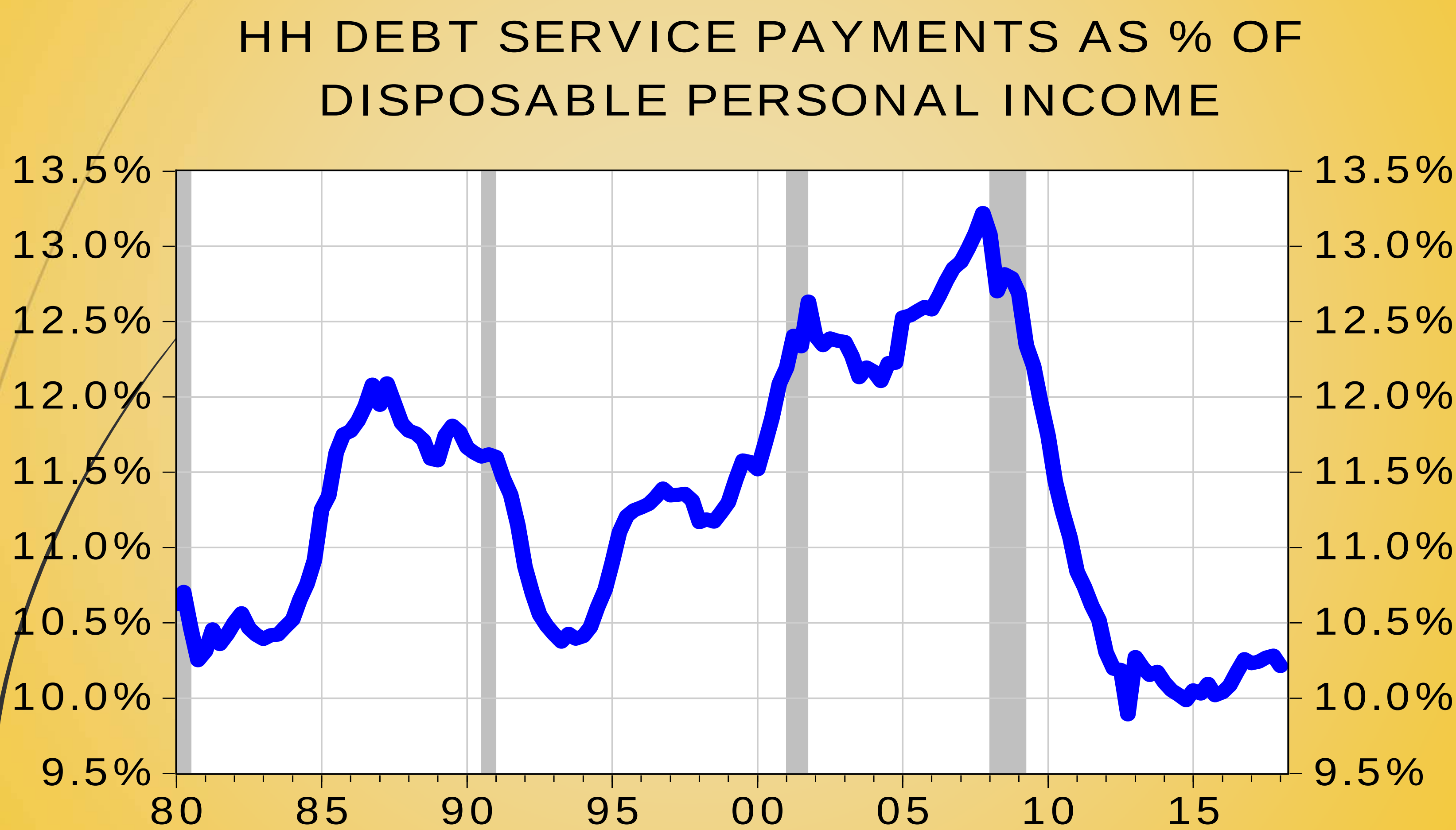
Source: BEA and FED

Also Fairly Flat



Source: Federal Reserve System

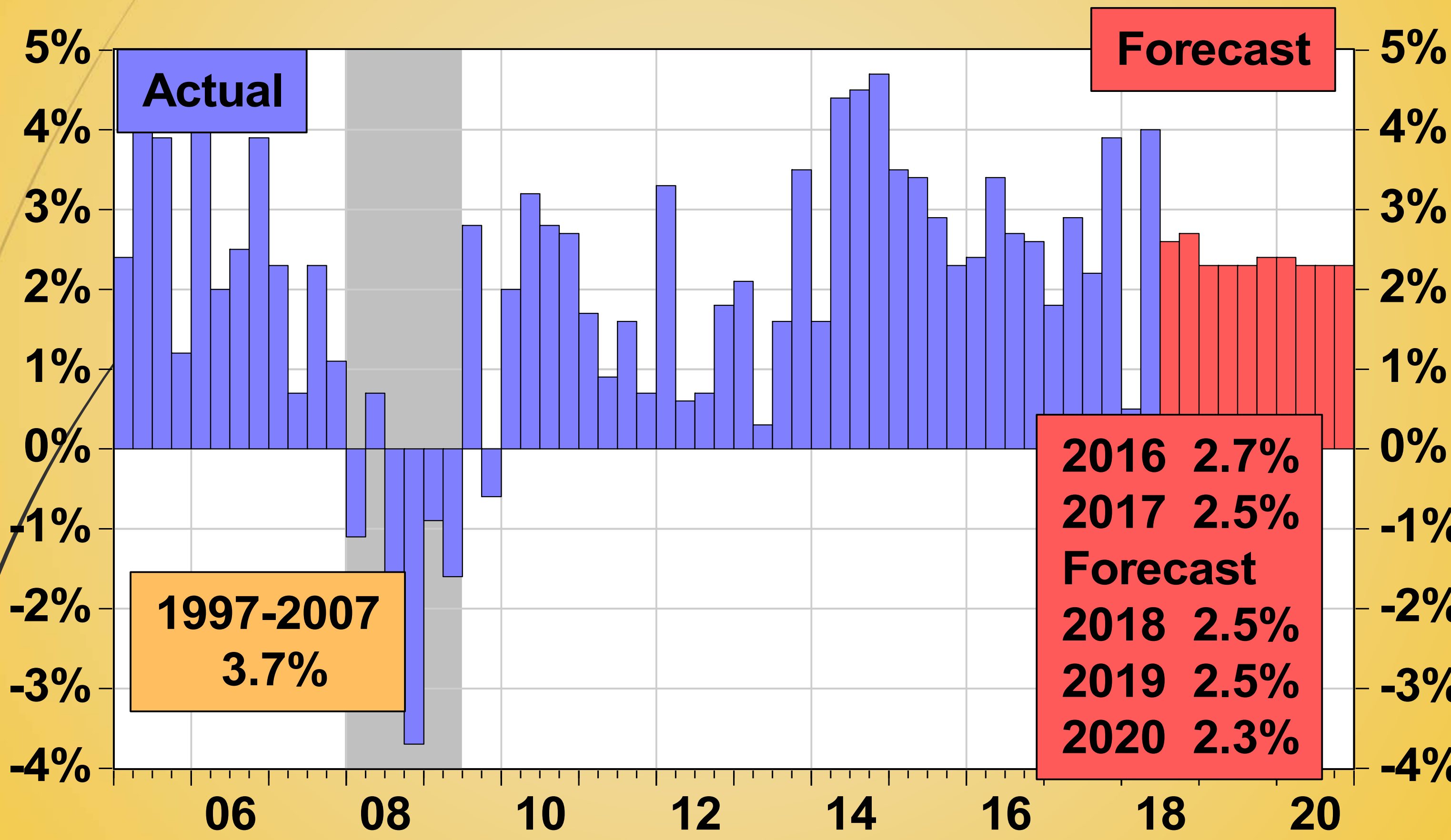
Record Low Debt Service



Source: BEA and Federal Reserve System

Steady Growth Ahead

REAL CONSUMPTION



Source: BEA and IHS

Investment Sector

Fixed business investment showing solid growth.

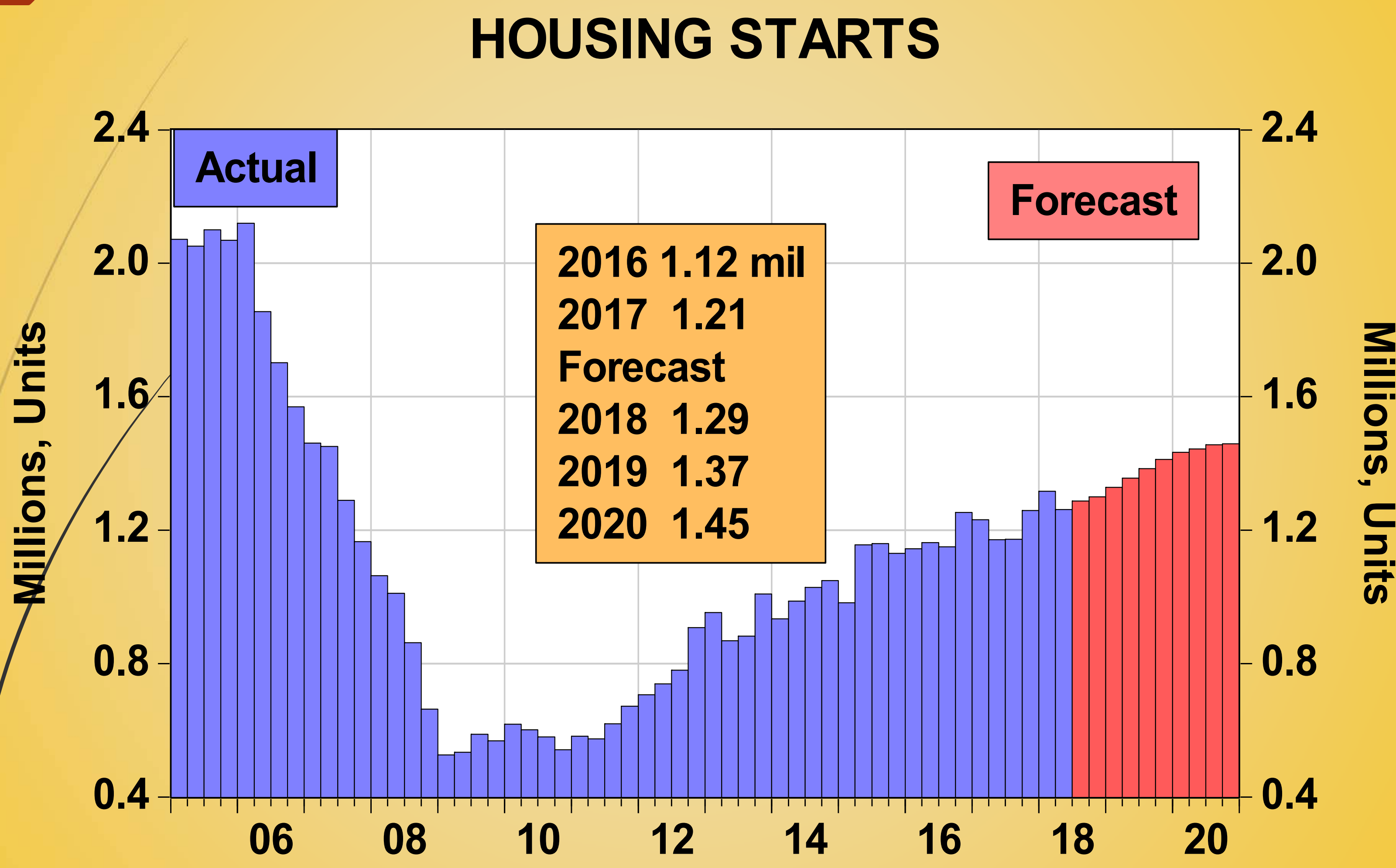
2018 7.1% 2019 5.5% 2020 3.6%

Growth supported by TCJA, energy-related drilling and expanded expensing.

Low inventory/sales ratio will drive inventory investment for the near term.

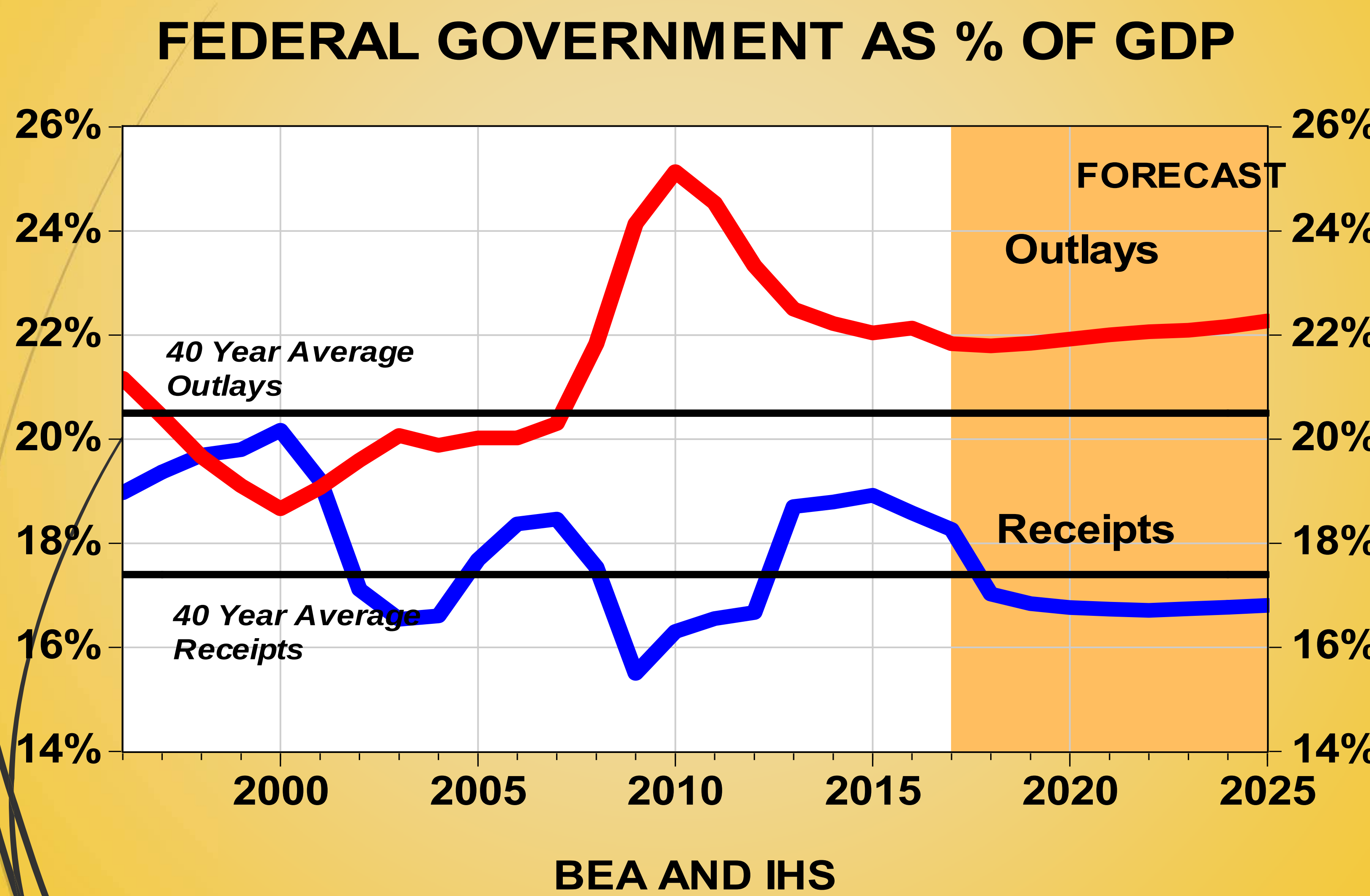
Current weakness in the housing market is temporary because economic growth is solid and household formation will drive growth.

Recovery Continues

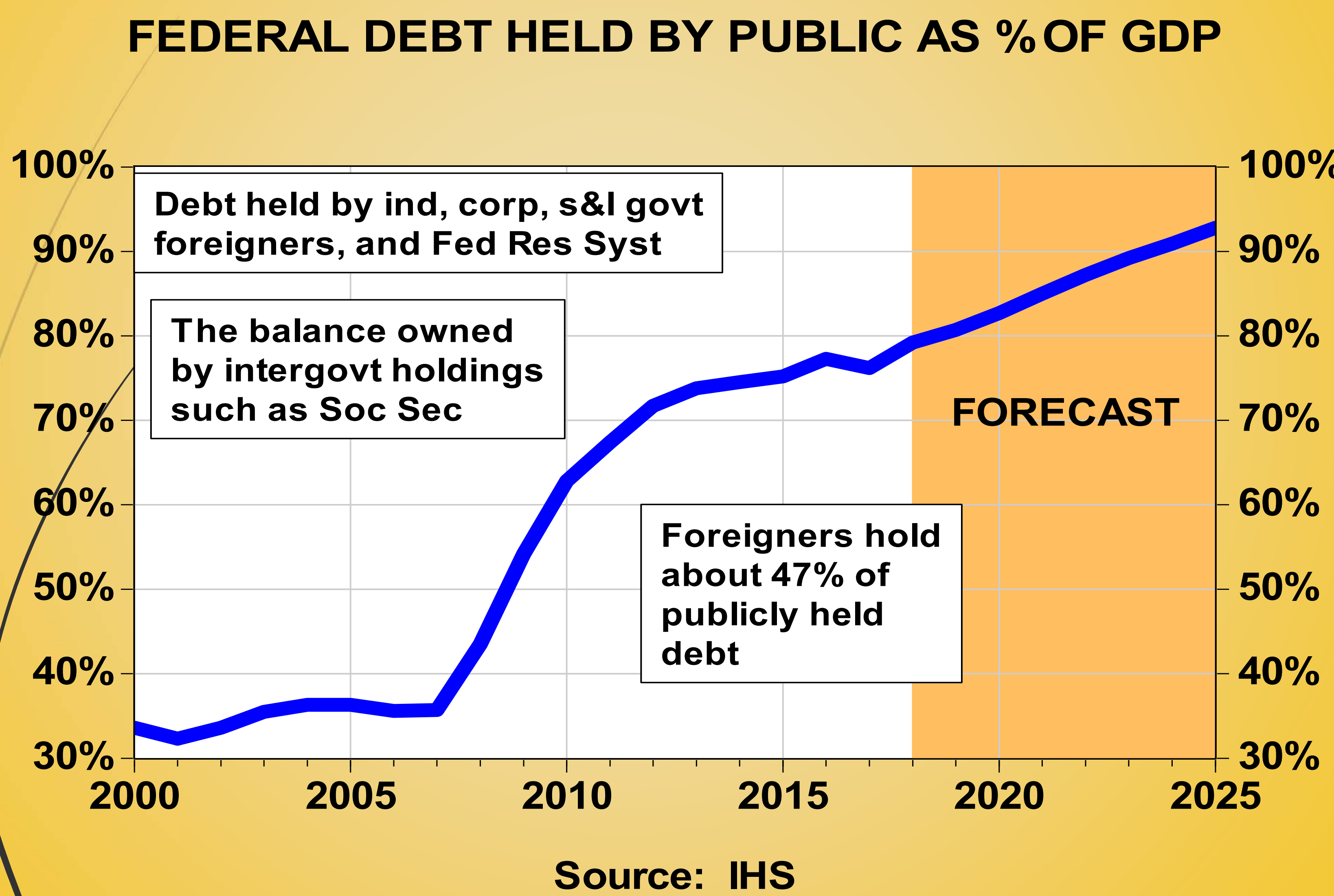


Source: US Census and IHS

Government Sector



Debt Held by Public



The Fiscal Picture

IHS assumes entitlement spending will follow current program guidelines.

Federal budget deficits will rise from 3.1% of GDP in 2015 to 4.8% of GDP in 2018 and 5.0% in 2019 and remain above 5% of GDP throughout the 2025 forecast period.

In other words, IHS does not see that the TCJA will significantly spur growth after 2019 or recoup the cost of tax cuts.

IHS projects the debt/GDP rising to 93% by 2025.

Foreign Sector

The $ is expected to strengthen over the next four quarters driven by the need to finance expected deficits and higher interest rates causing capital inflows.

A great deal of uncertainty on the trade front as the US and China follow a tit for tat strategy. Uncertainty about the demand for net exports, cost pressures, and supply chain disruptions clouds the outlook.

At this point, inclusion of the “trade war” has little impact on the IHS forecast. The outlook is still strong with strong near-term momentum and financial conditions remain supportive.

Employment & Unemployment

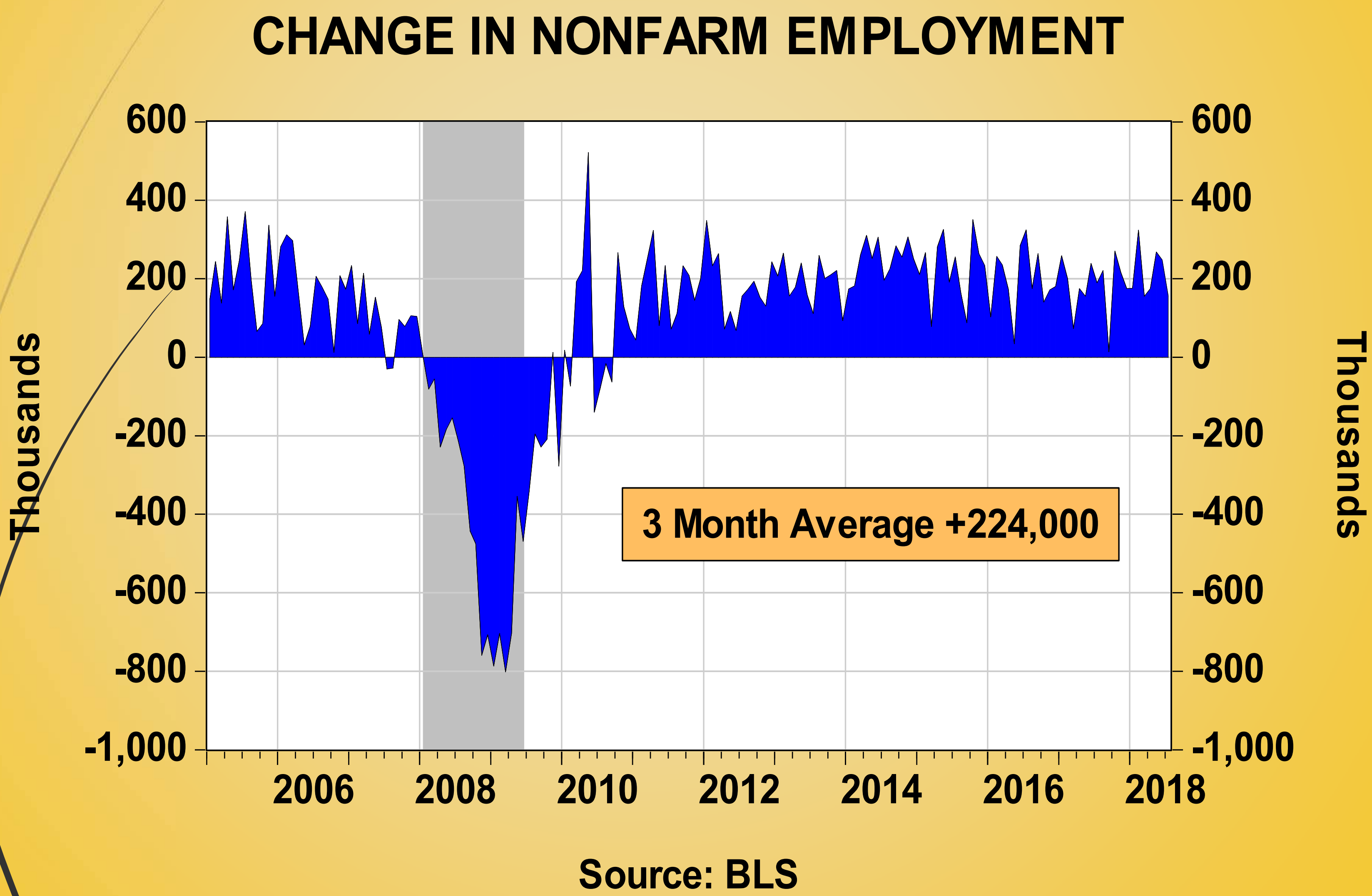
Solid gains in employment will be driven by robust growth in production.

This strong growth will boost both wage growth and inflation pressures.

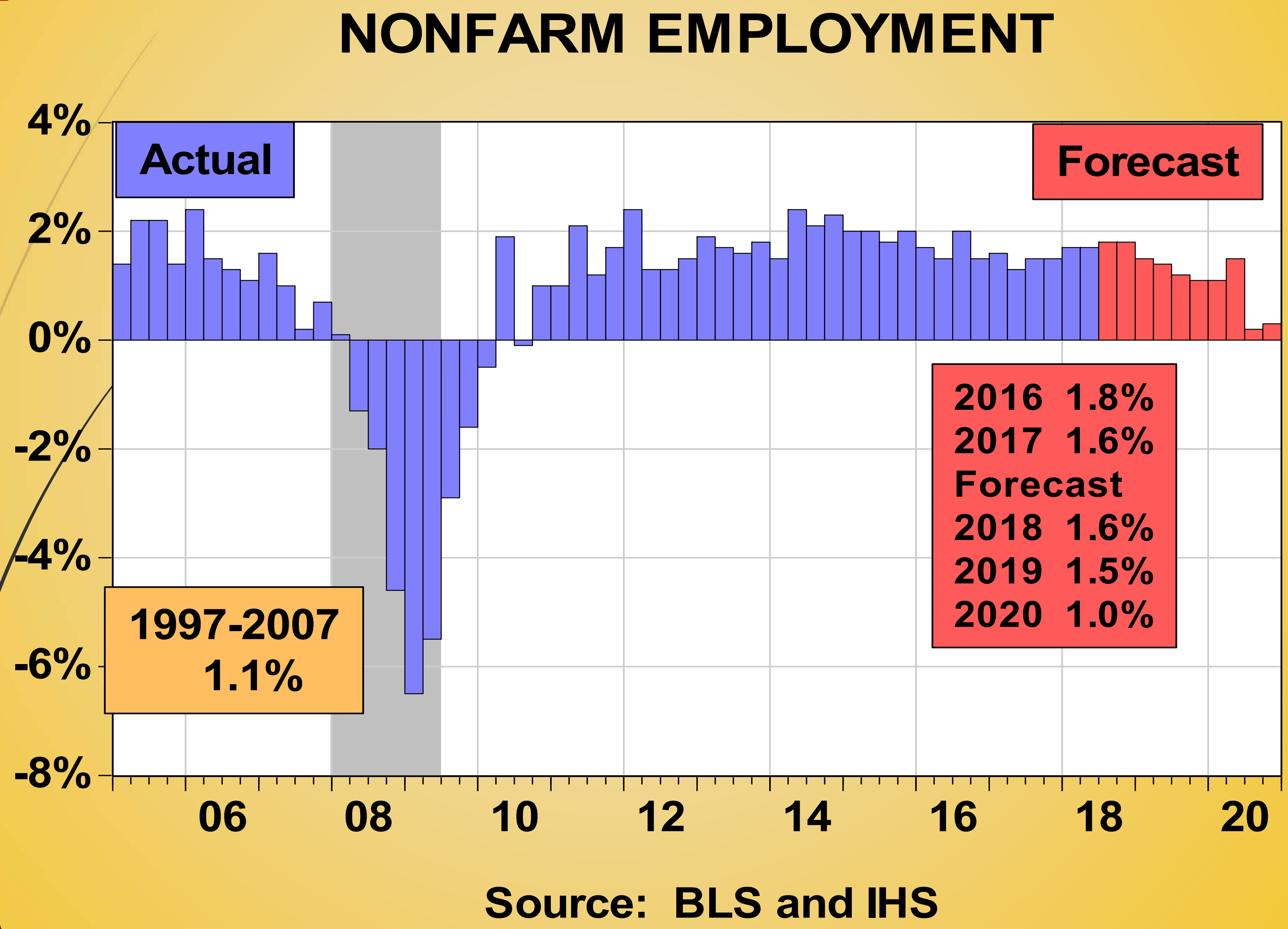
The unemployment rate averaged 4.4% in 2017. IHS projects 3.9% in 2018, 3.5% in 2019, and 3.6% in 2020.

One positive, is that the growth in hourly labor compensation will likely accelerate from 2.5% in 2017 to 3.2% in 2018 and then continue higher to 3.9% by 2012.

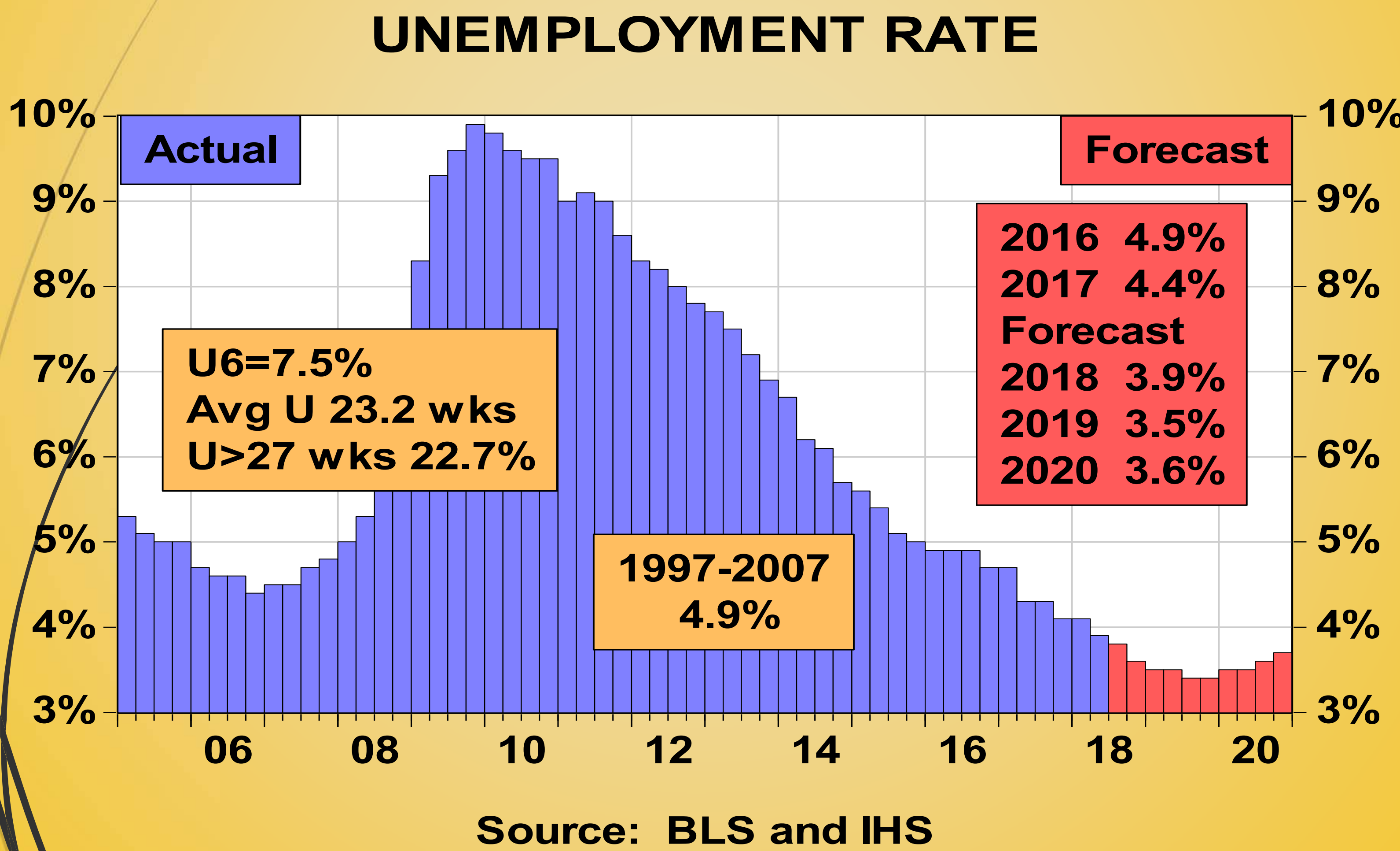
Employment Growth



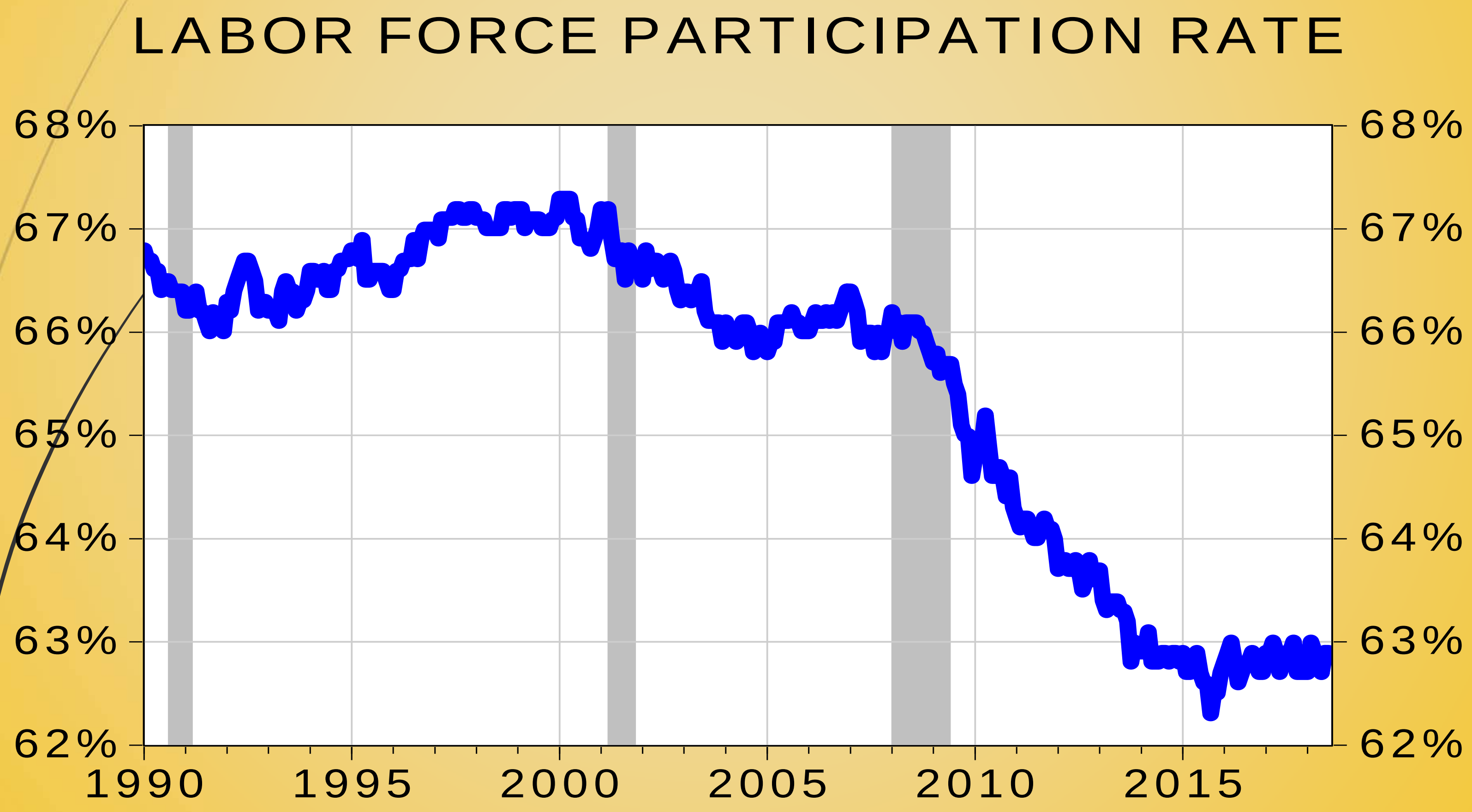
Future Job Growth Steady



Low U3 Unemployment Rate Still Falling

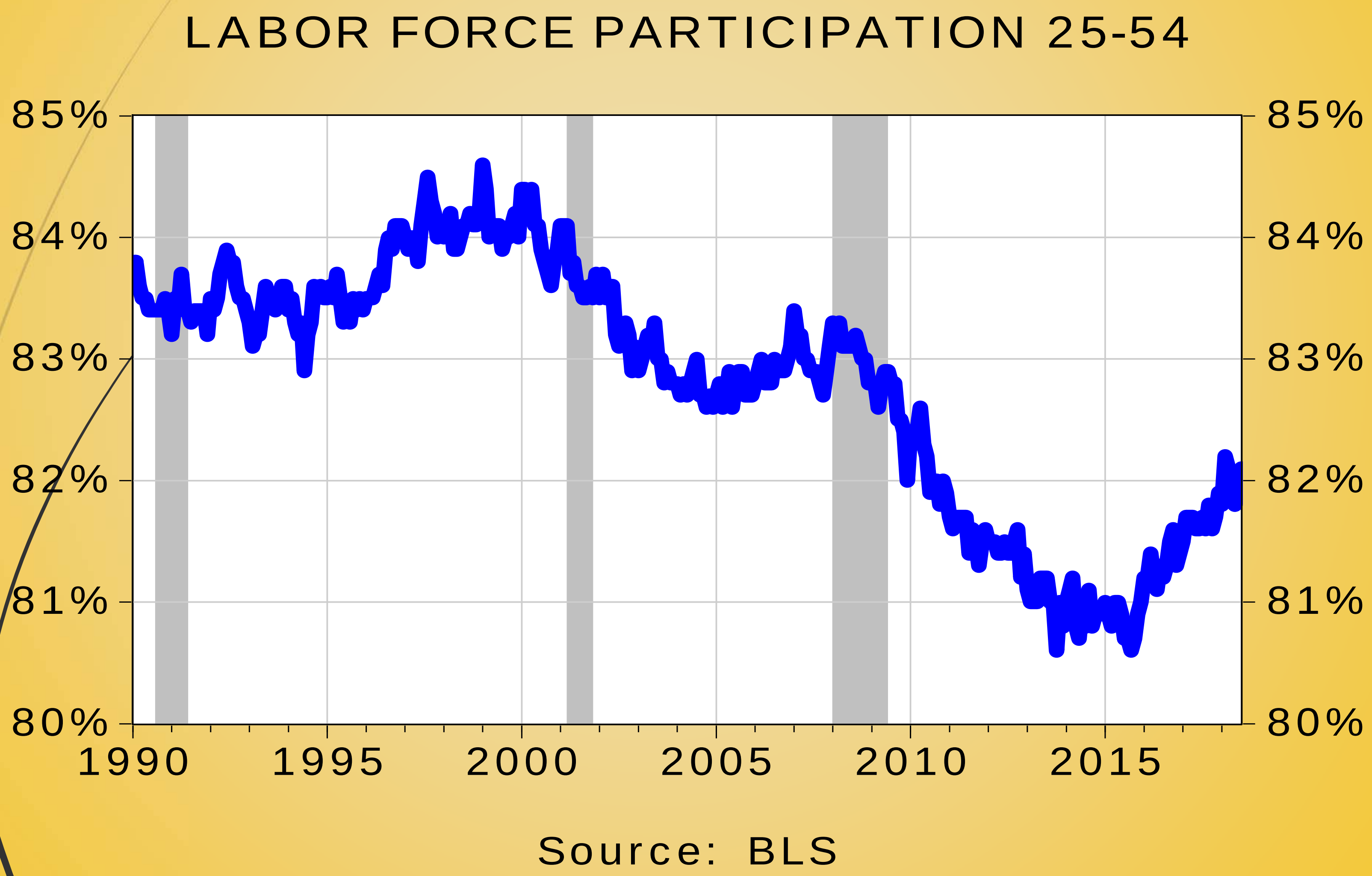


Labor Participation Rate Still Low

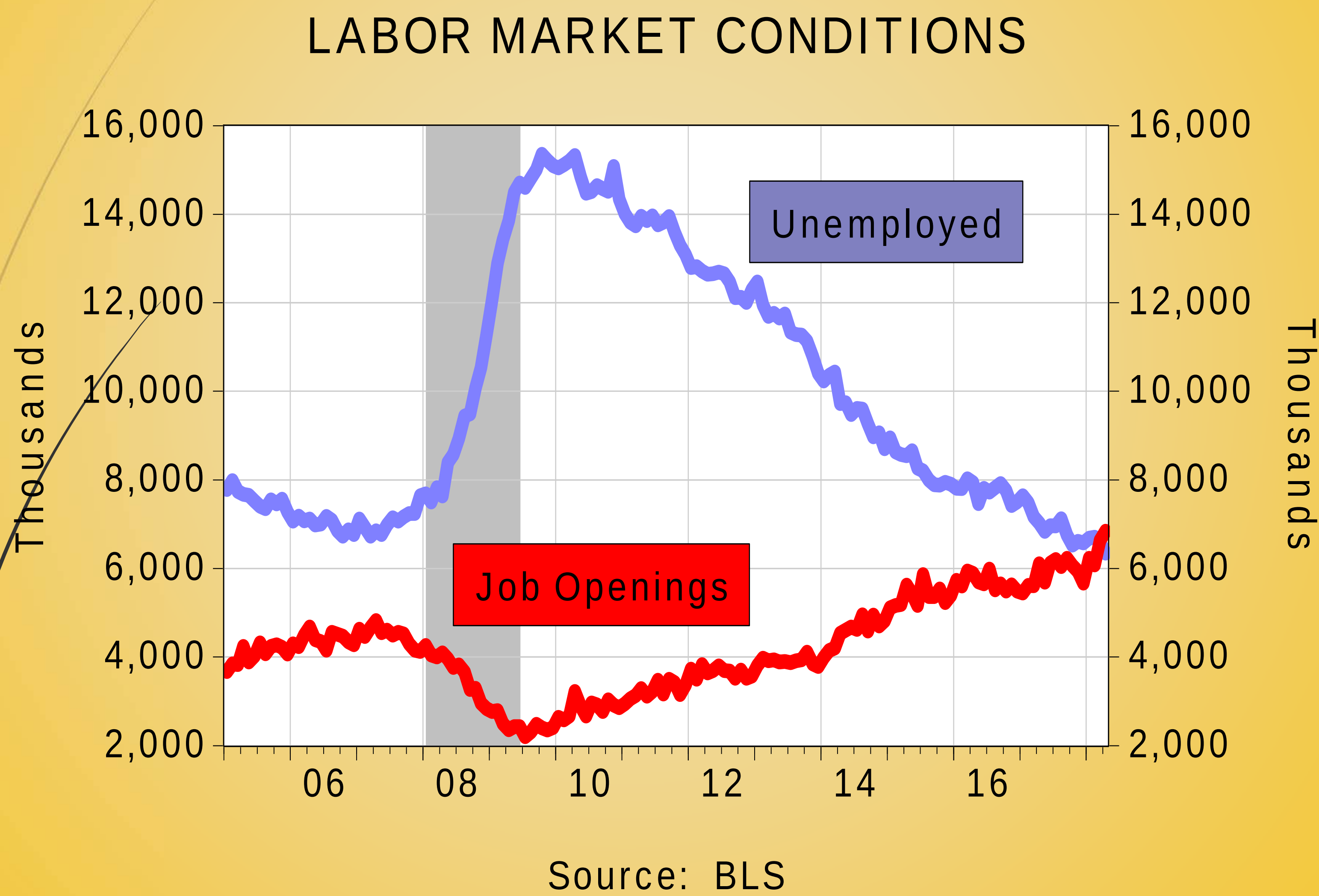


Source: BLS

Some Increase Prime Age



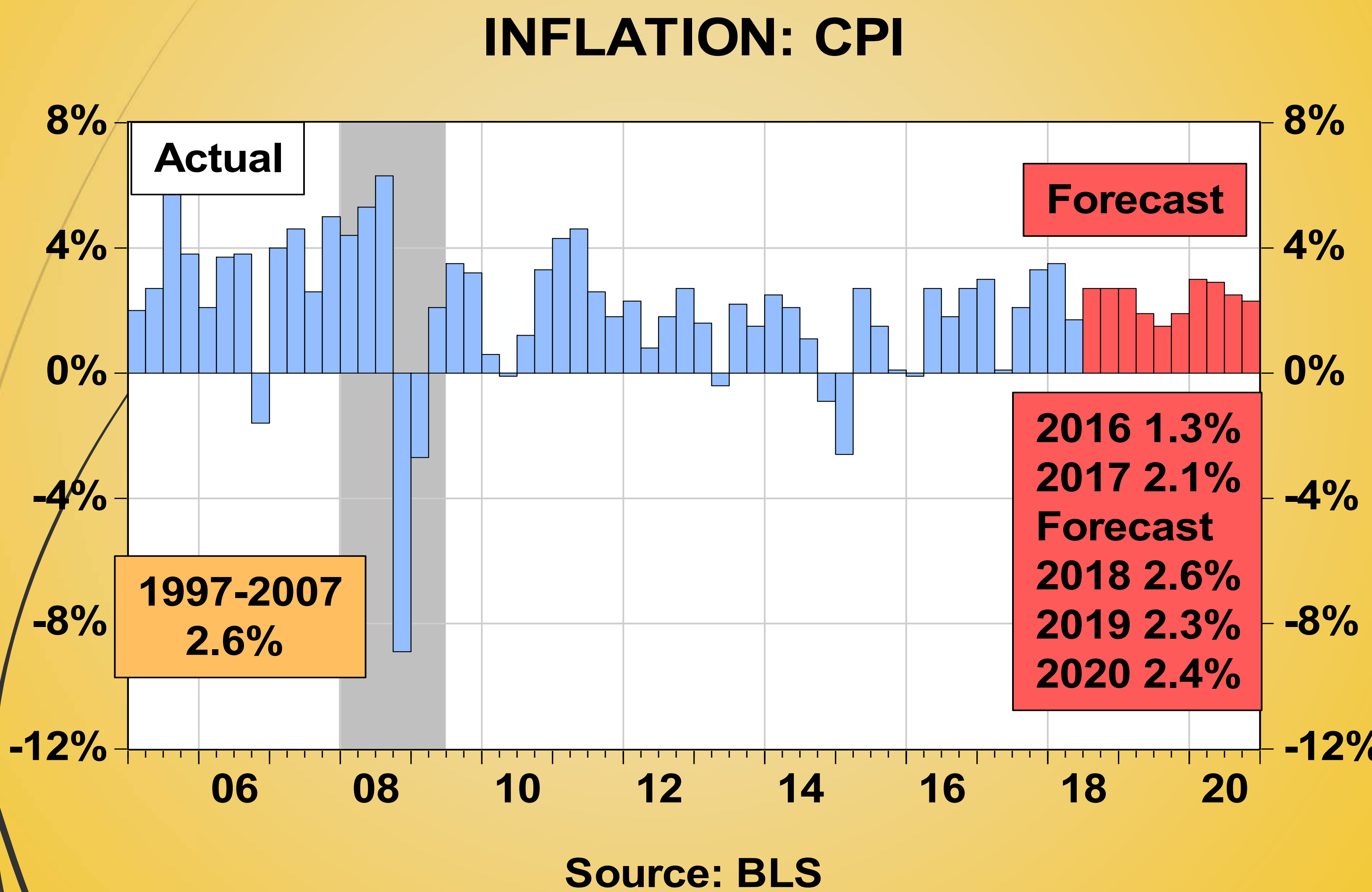
Tight Labor Market



Inflation & Interest Rates

- **The FED will increase the Federal Funds rate four times in 2018. Post-2018, they will increase the Federal Funds rate to 3.5% by 2020.**
- **Further Fed rate hikes, shrinkage in the Fed balance sheet, higher inflation premia, and higher rates abroad will push Treasury rates higher over the next few years, The 10-year Treasury note should rise to 3.5% by 2020.**
- **They see the CPI rising to 2.6% in 2018, 2.3% in 2019, and 2.4% in 2020.**
- **The PCE excluding food and energy increased 1.6% in 2017 and will rise to 2.1% in 2018 and 2.2% in 2019 and 2020.**

Still Very Low



MAJOR RISKS

Loss of confidence leading to a two-quarter recession starting 2019Q3.

This will be the longest expansion back to 1854.

If the economy enters a recession it will be due to a fall in fixed residential and nonresidential investment.

Rising prices have left the commercial real-estate market vulnerable to a decline which spreads to business equipment spending. This pessimism will spillover to the household market causing recession. (20%)

IHS MARKIT FORECAST AUGUST 2018

Variable	2016	2017	2018	2019	2020
GDP	1.6%	2.2%	2.9%	2.7%	1.9%

Recession Probability 20%

NA Emp	1.8%	1.6%	1.6%	1.5%	1.0%
Oil(Brent)	$44	$55	$74	$80	$81
Housing	1.18	1.21	1.29	1.37	1.45
CPI	1.3%	2.1%	2.6%	2.3%	2.4%
Un Rate	4.9%	4.4%	3.9%	3.5%	3.6%

Wells Fargo Forecast August 2018

	2017	2018	2019	
GDP	**2.3%**	**2.9%**	**2.8%**	
NA EMP	**182 thou**	**205 thou**	**165 thou**	
CPI	**2.1%**	**2.5%**	**2.5%**	
10-YR T Note	**2.33%**	**2.96%**	**3.48%**	

Key Variables Tracking SD Economy

Nonfarm employment

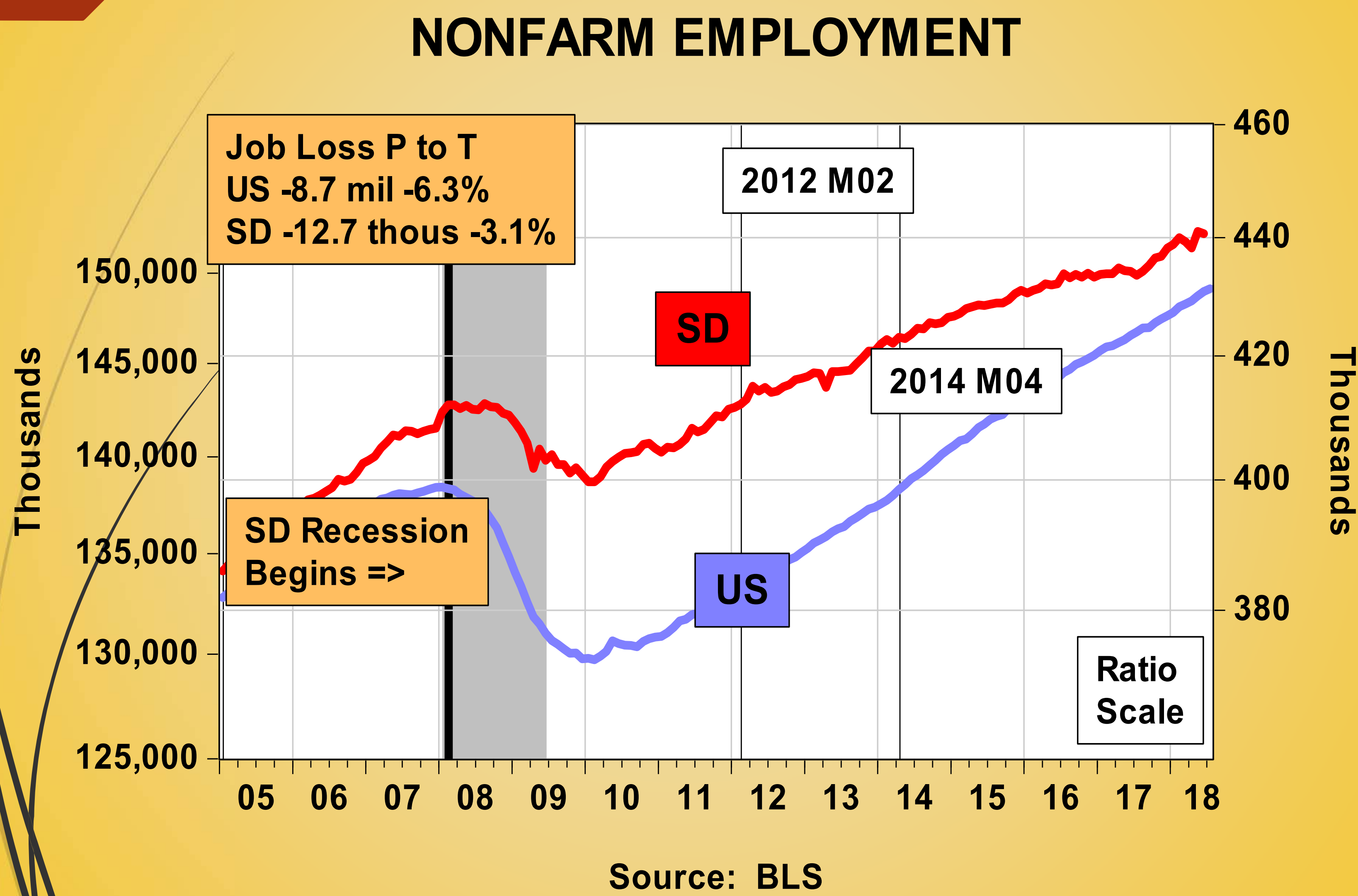
Housing starts

Real nonfarm personal income

Taxable sales

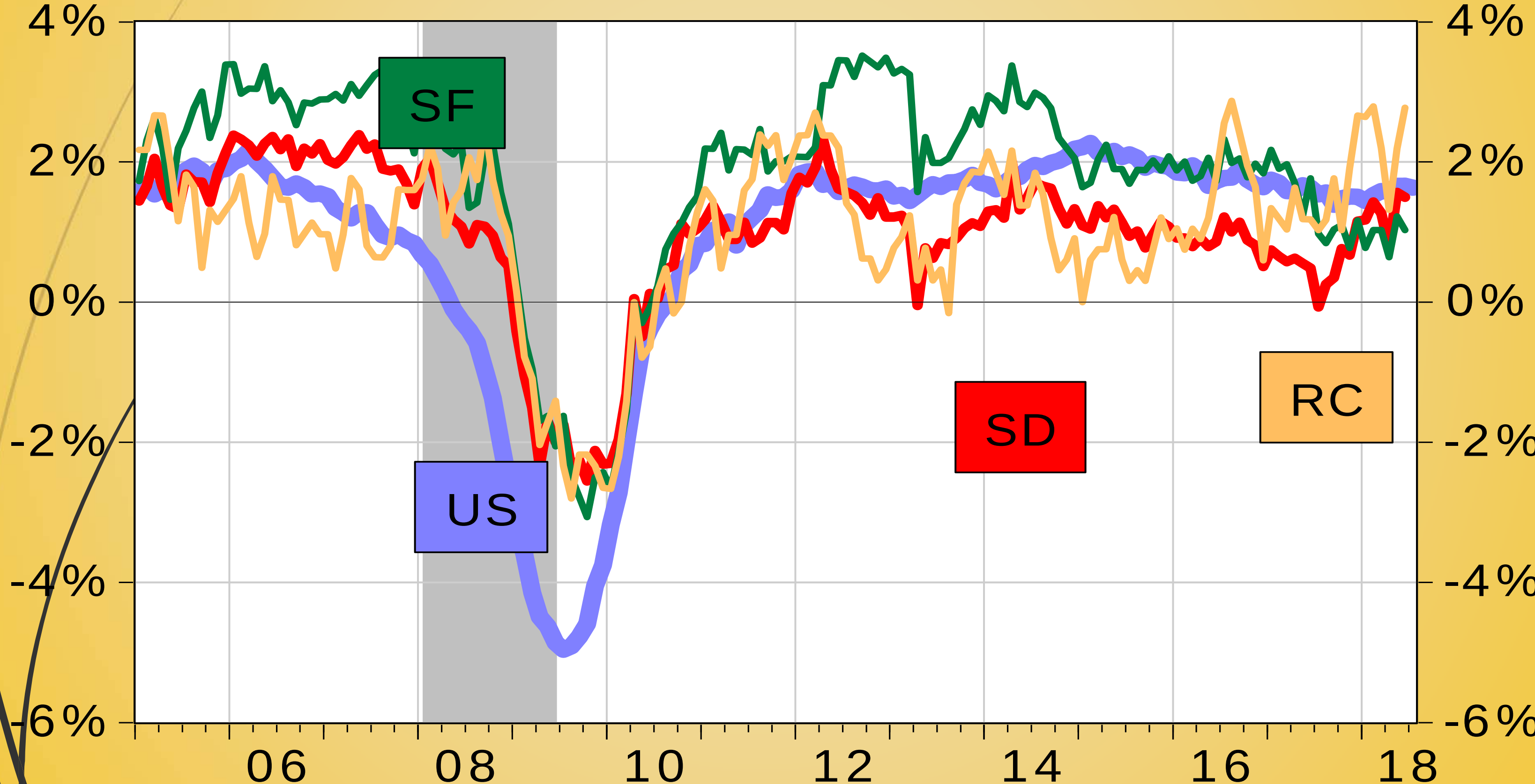
Leading indicator

Pick Up


NONFARM EMPLOYMENT
Job Loss P to T
US -8.7 mil -6.3%
SD -12.7 thous -3.1%
2012 M02
2014 M04
SD
US
SD Recession
Begins =>
Ratio
Scale
Thousands
150,000
145,000
140,000
135,000
130,000
125,000
460
440
420
400
380
Thousands
05
06
07
08
09
10
11
12
13
14
15
16
17
18
Source: BLS

Divergence

NONFARM EMPLOYMENT

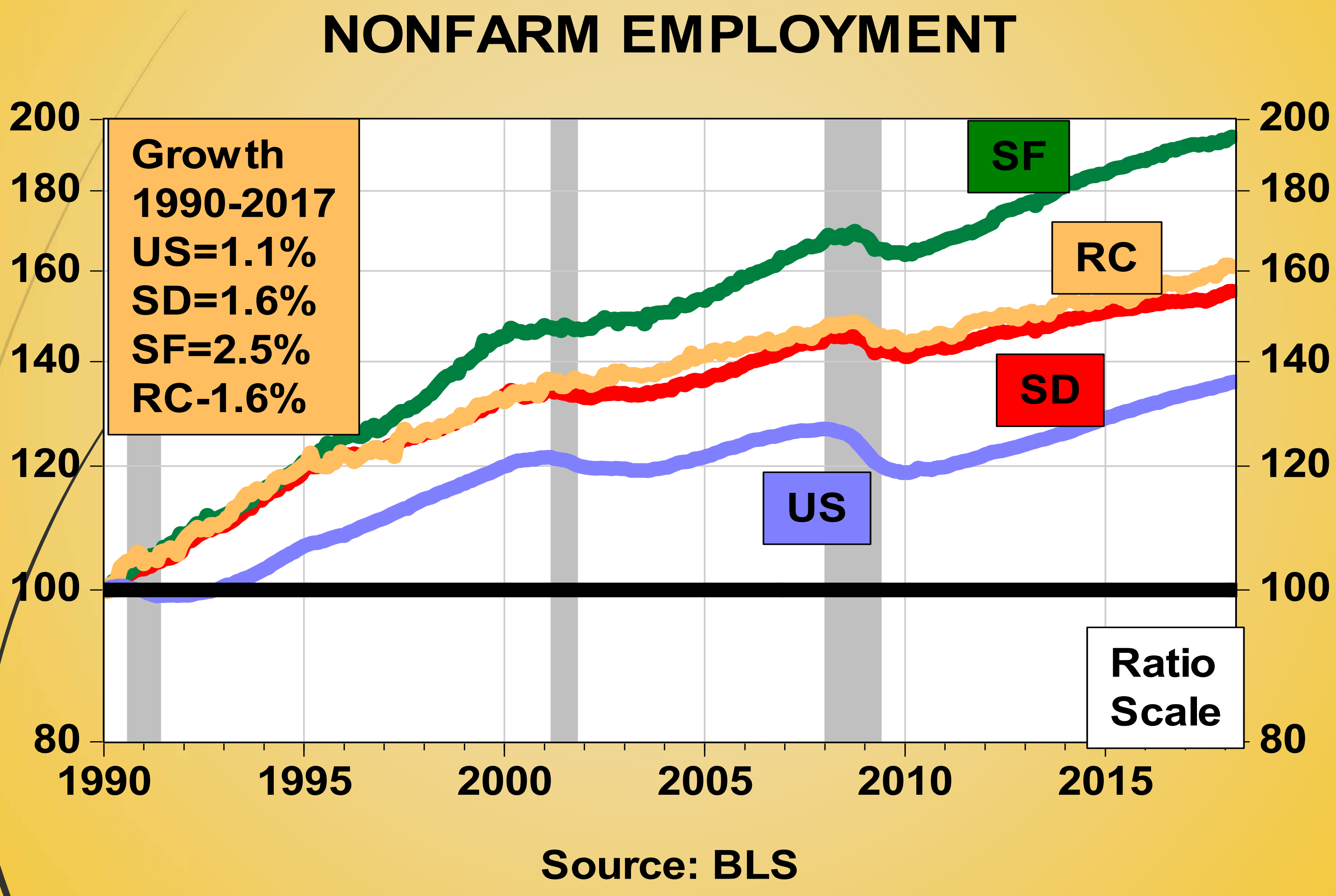


Source: BLS

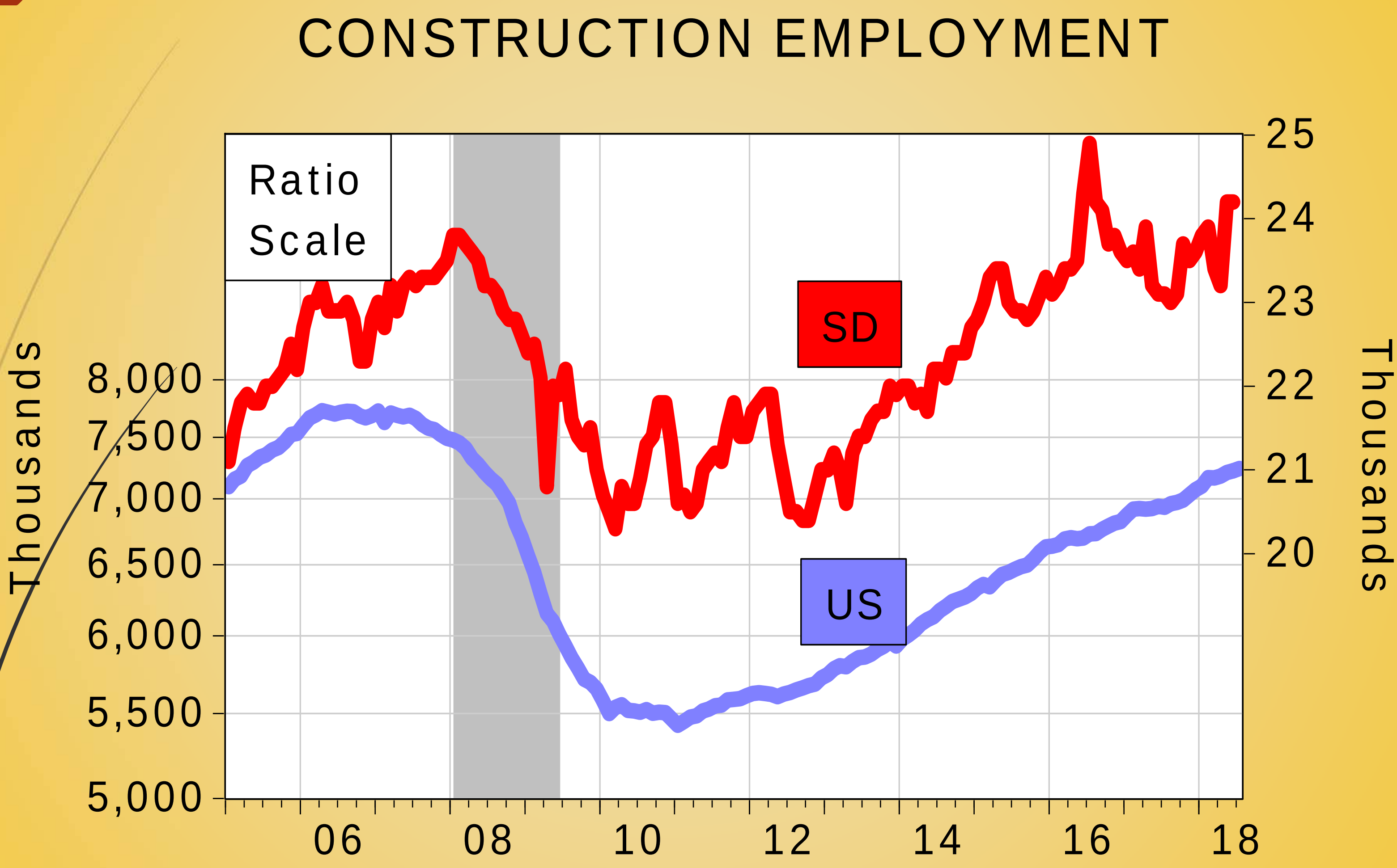
ECONOMY AT A GLANCE (Employment Y/Y) JULY

INDUSTRY	SD	SF	RC
Total NonFarm	1.4%	1.2%	1.5%
Min,log,const	5.6%	1.1%	3.7%
Manufacturing	3.7%	3.5%	3.6%
Trade,tran,util	-0.6%	-1.2%	1.4%
Information	0.0%	-3.8%	0.0%
Finance	0.0%	0.0%	0.0%
Prof,business	4.9%	3.3%	3.7%
Educ,health	1.0%	1.9%	0.8%
Leisure,hosp	0.4%	1.2%	2.4%
Other services	4.8%	3.3%	2.9%
Government	0.4%	2.0%	3.5%

SF Outpaces the Rest

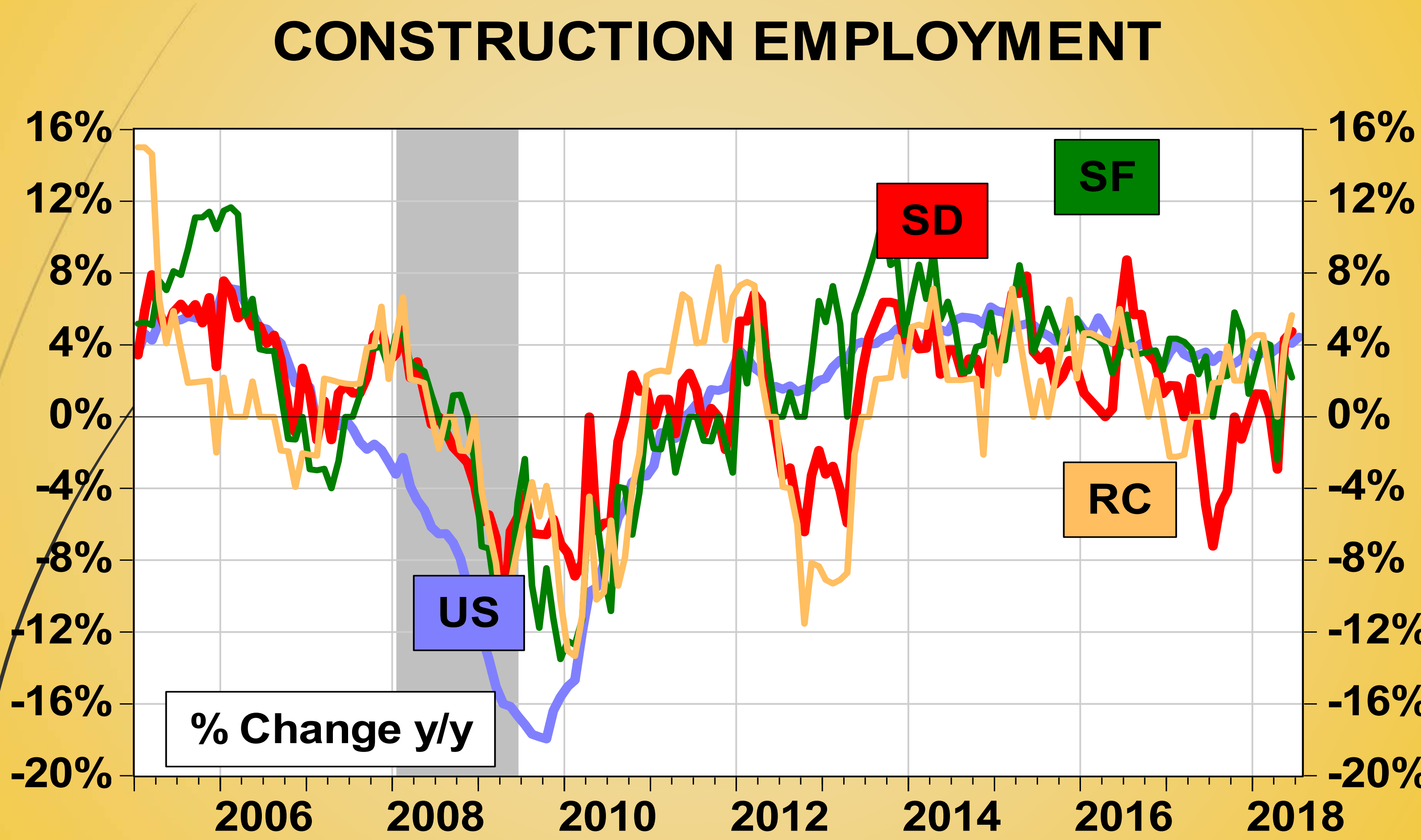


Still High



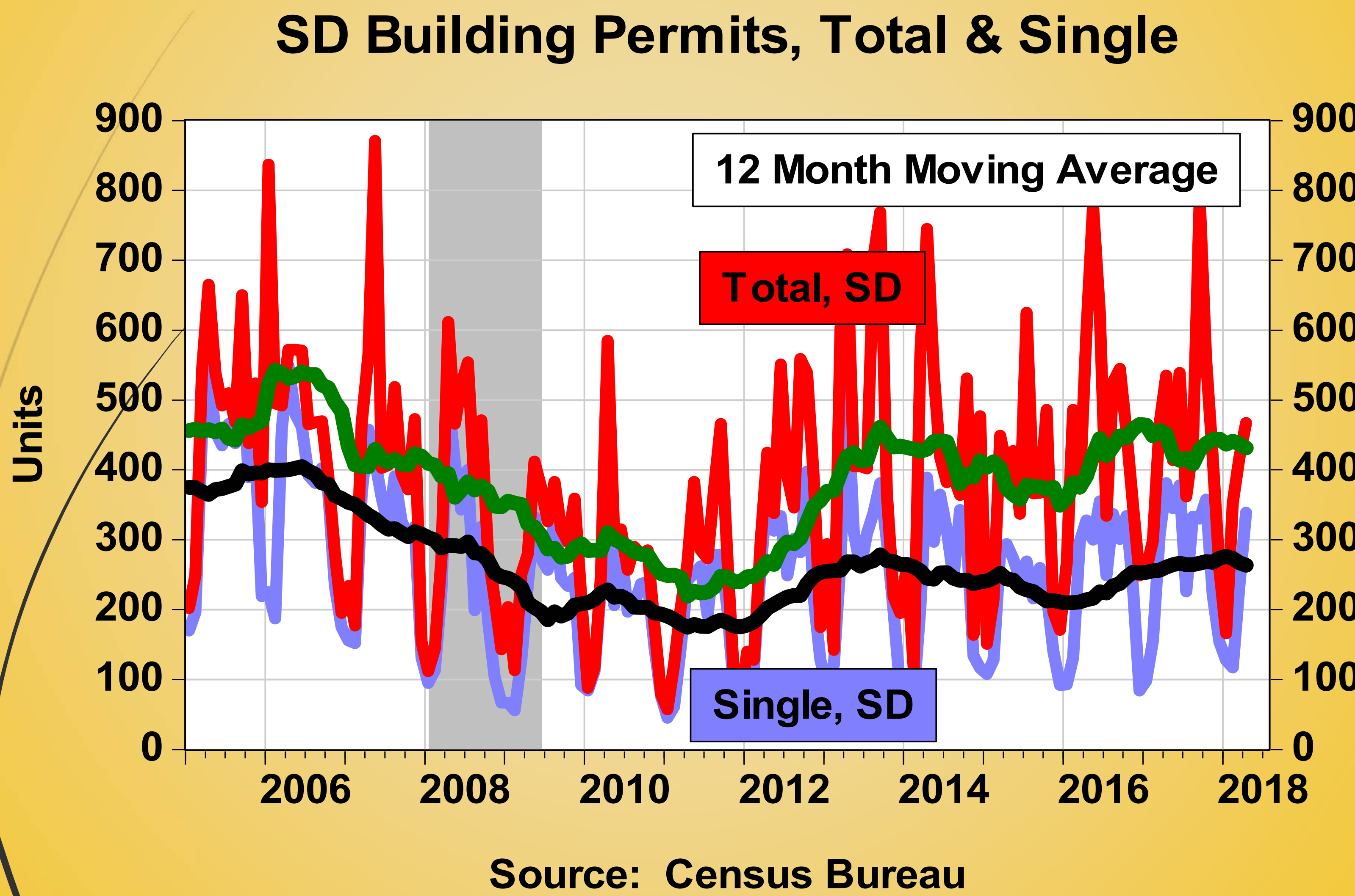
Source: BLS

Growth

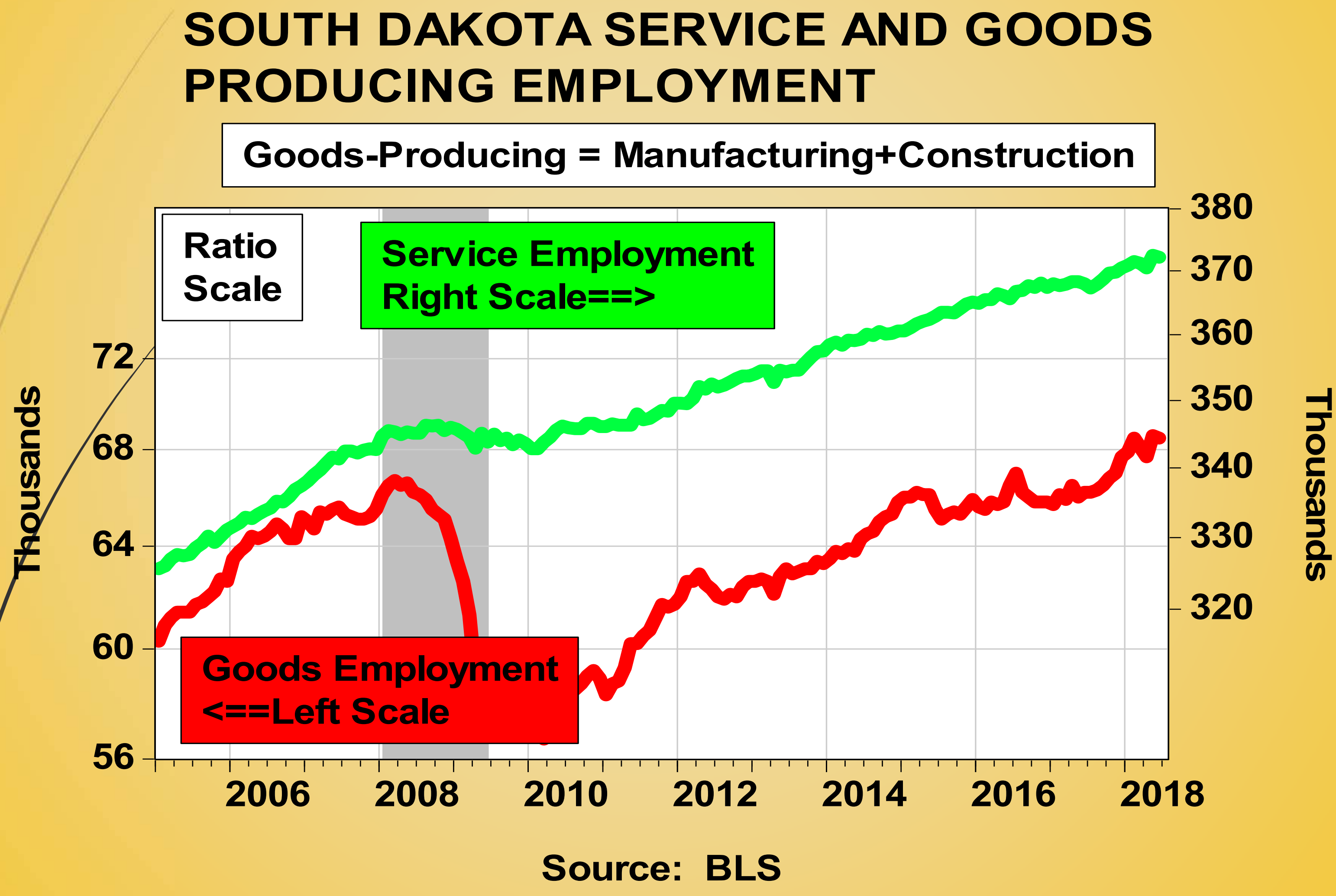


Source: BLS

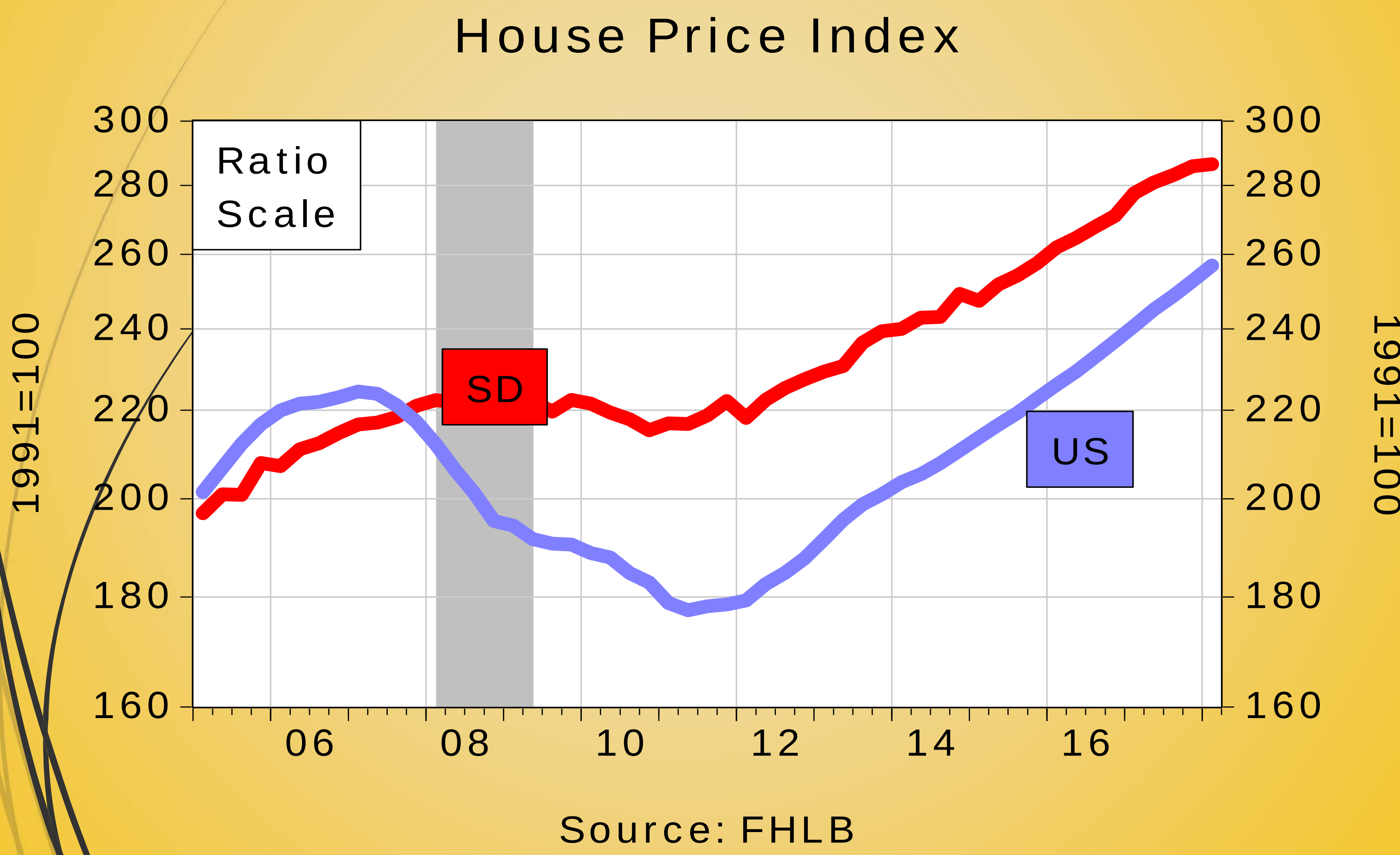
Some Growth


SD Building Permits, Total & Single
12 Month Moving Average
Total, SD
Single, SD
Units
900
800
700
600
500
400
300
200
100
0
2006
2008
2010
2012
2014
2016
2018
Source: Census Bureau

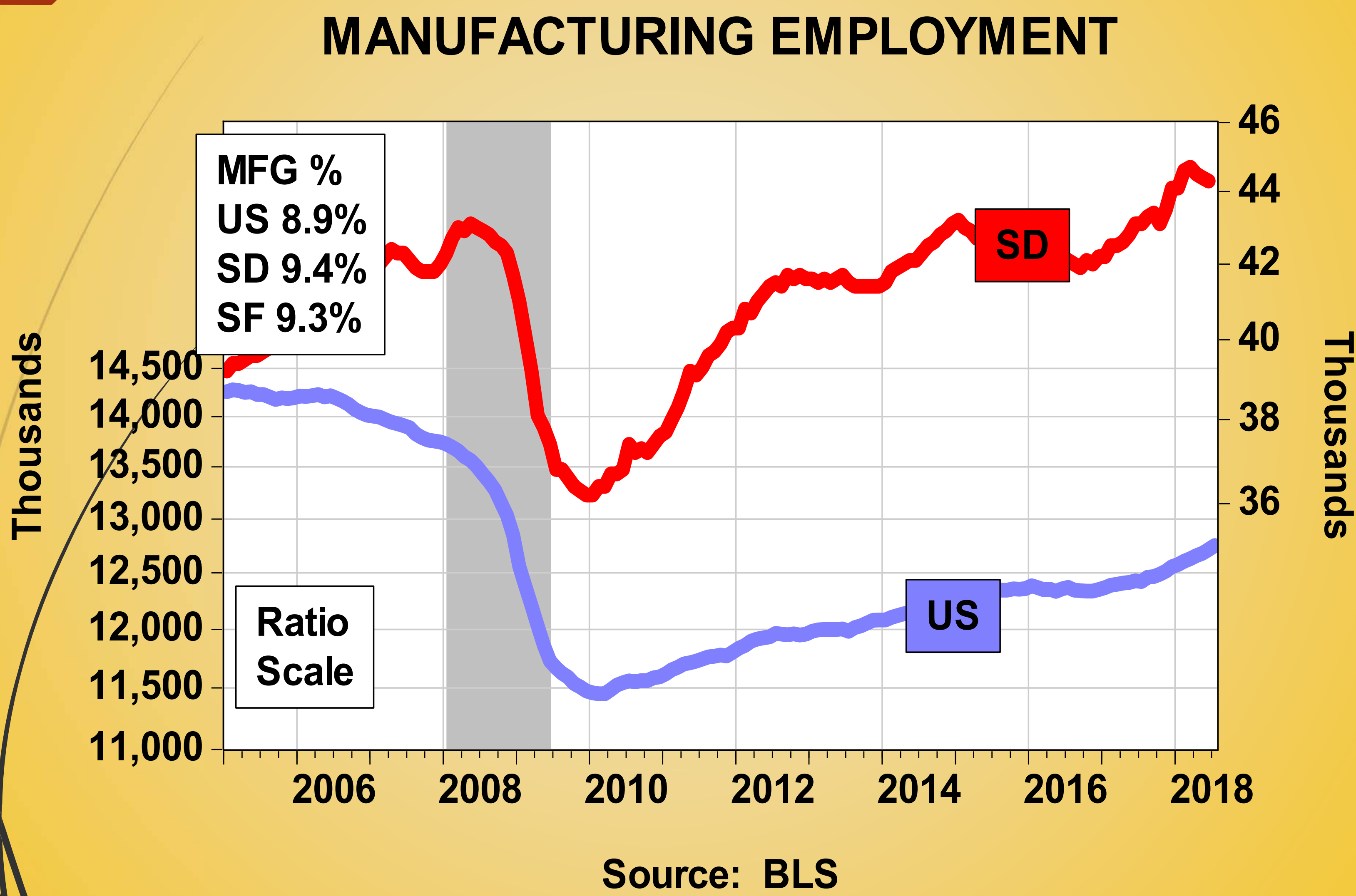
Which is More Cyclical?



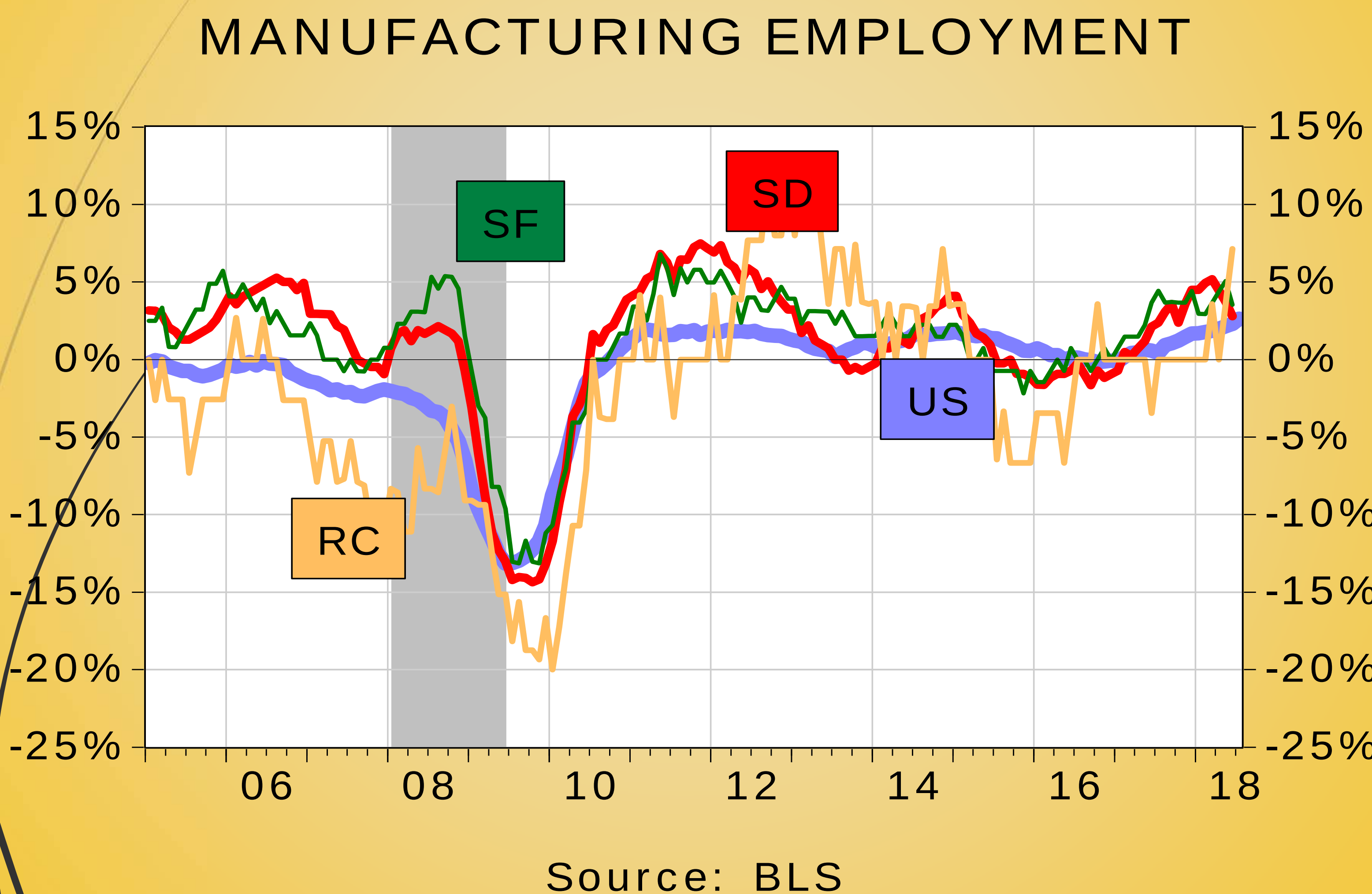
SD Peaked Later and Decline Less Severe



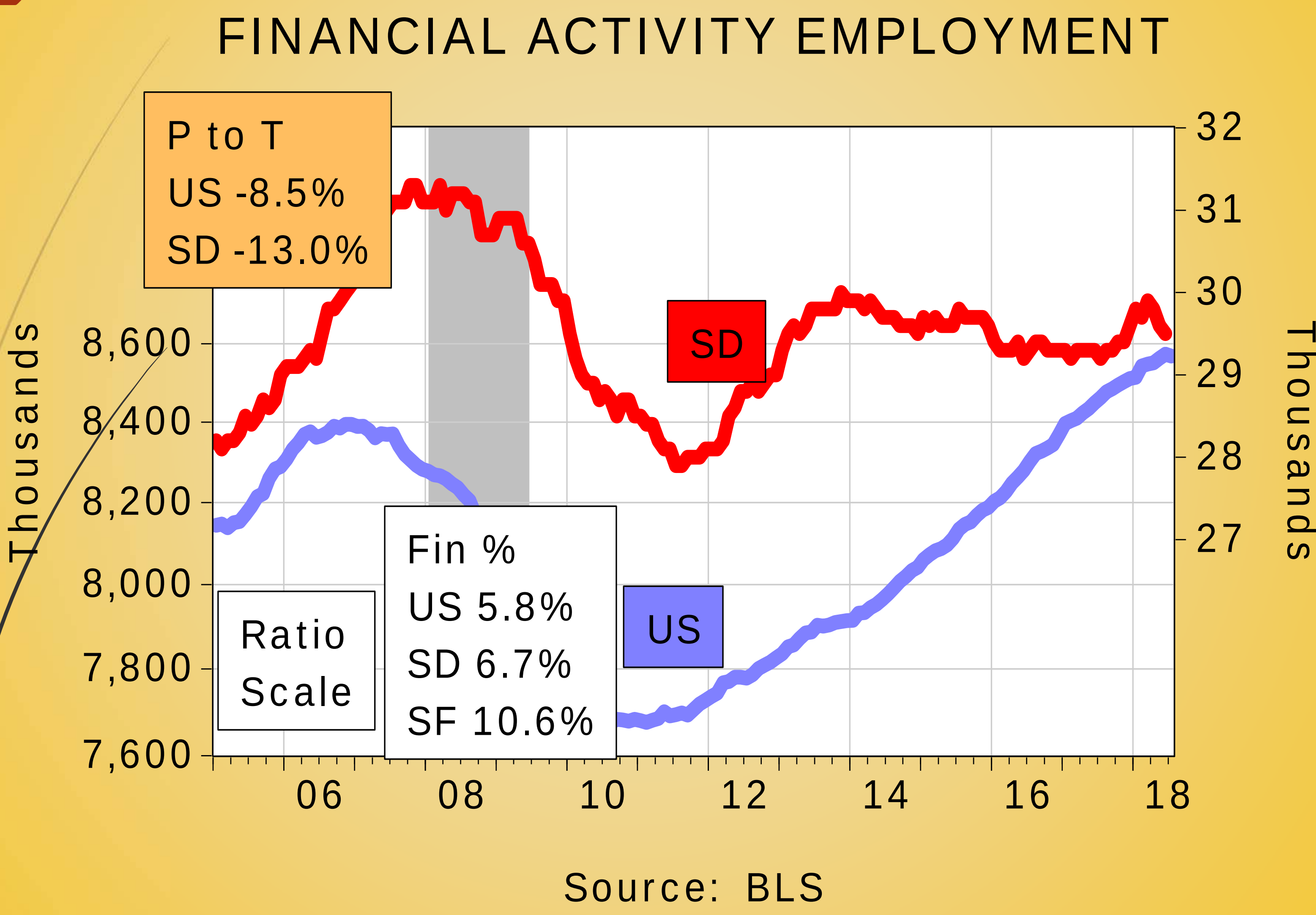
High Level


MANUFACTURING EMPLOYMENT
MFG %
US 8.9%
SD 9.4%
SF 9.3%
Ratio
Scale
SD
US
Thousands
14,500
14,000
13,500
13,000
12,500
12,000
11,500
11,000
46
44
42
40
38
36
Thousands
2006
2008
2010
2012
2014
2016
2018
Source: BLS

Divergent Growth

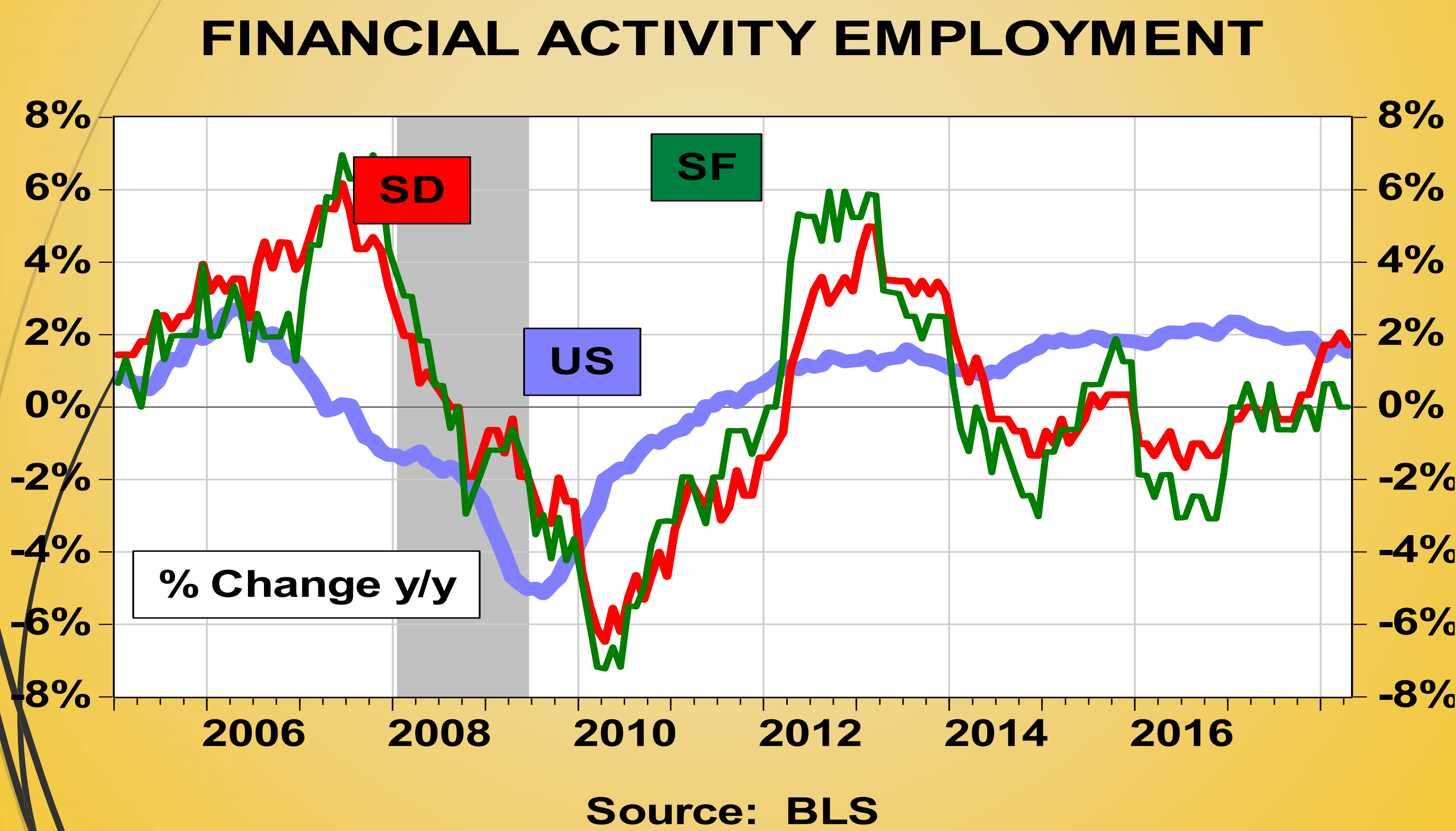


Very Flat

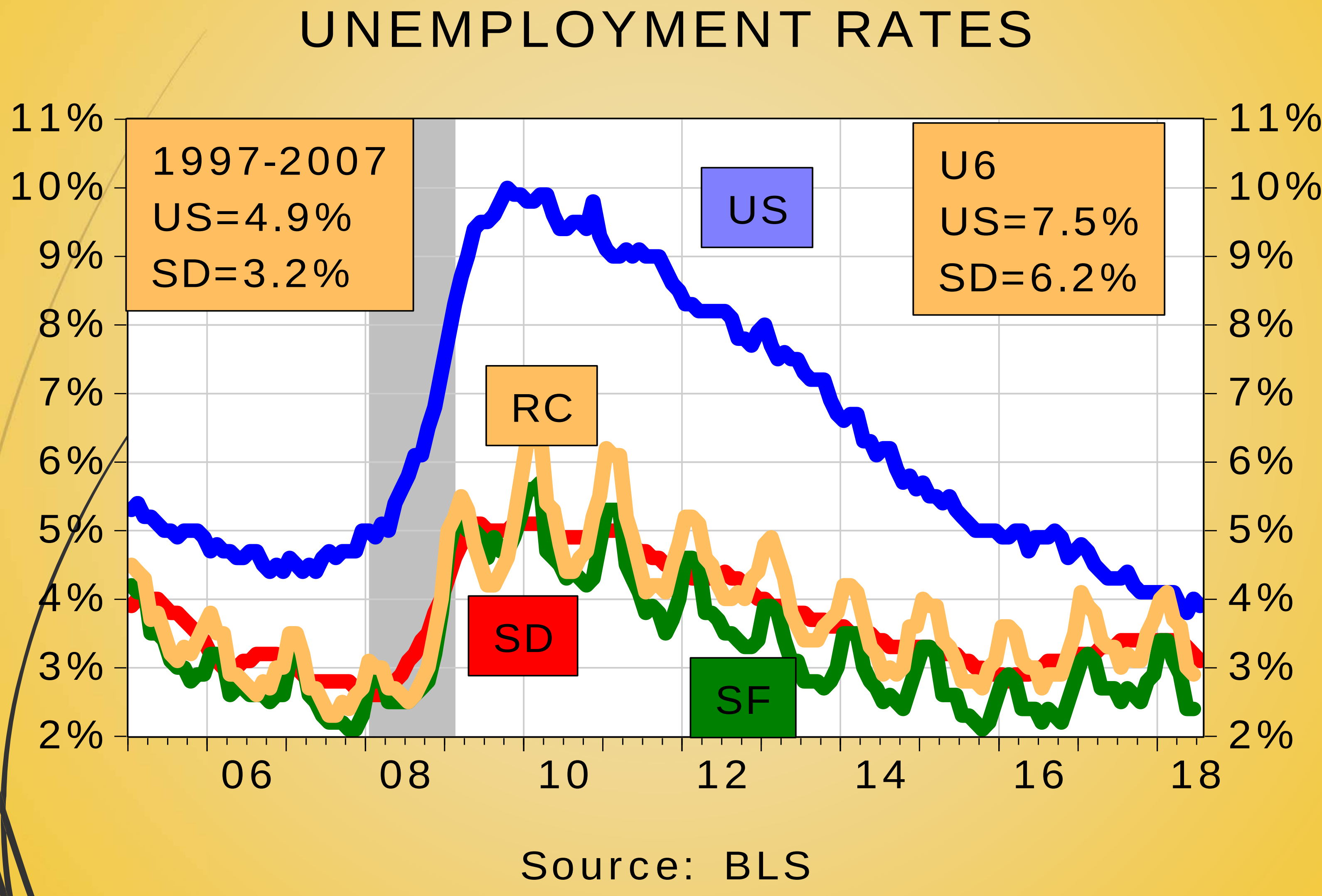


FINANCIAL ACTIVITY EMPLOYMENT
P to T
US -8.5%
SD -13.0%
Thousands
8,600
8,400
8,200
8,000
7,800
7,600
SD
US
Ratio
Scale
Fin %
US 5.8%
SD 6.7%
SF 10.6%
32
31
30
29
28
27
Thousands
06
08
10
12
14
16
18
Source: BLS

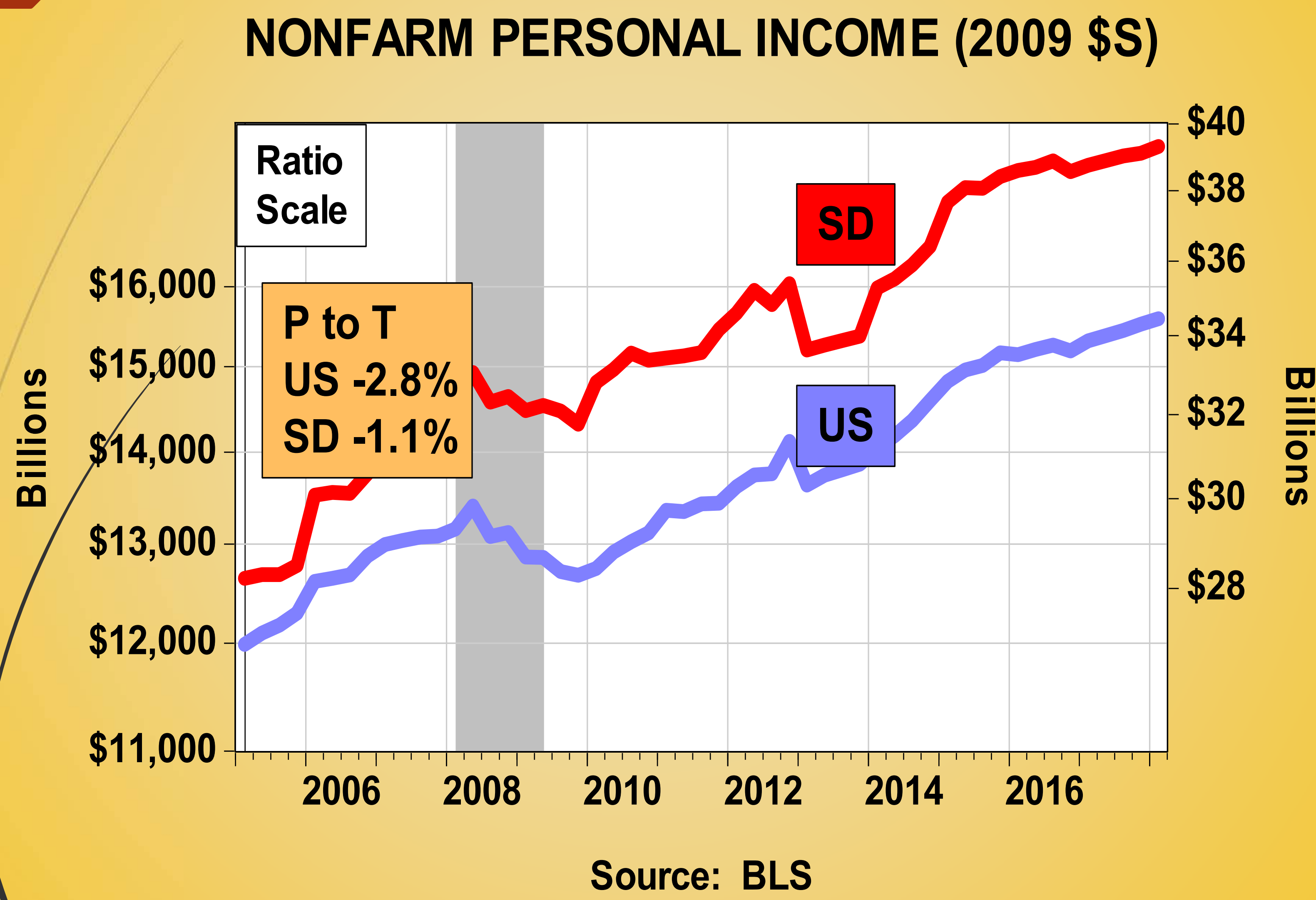
Note SD and SF Different Than US



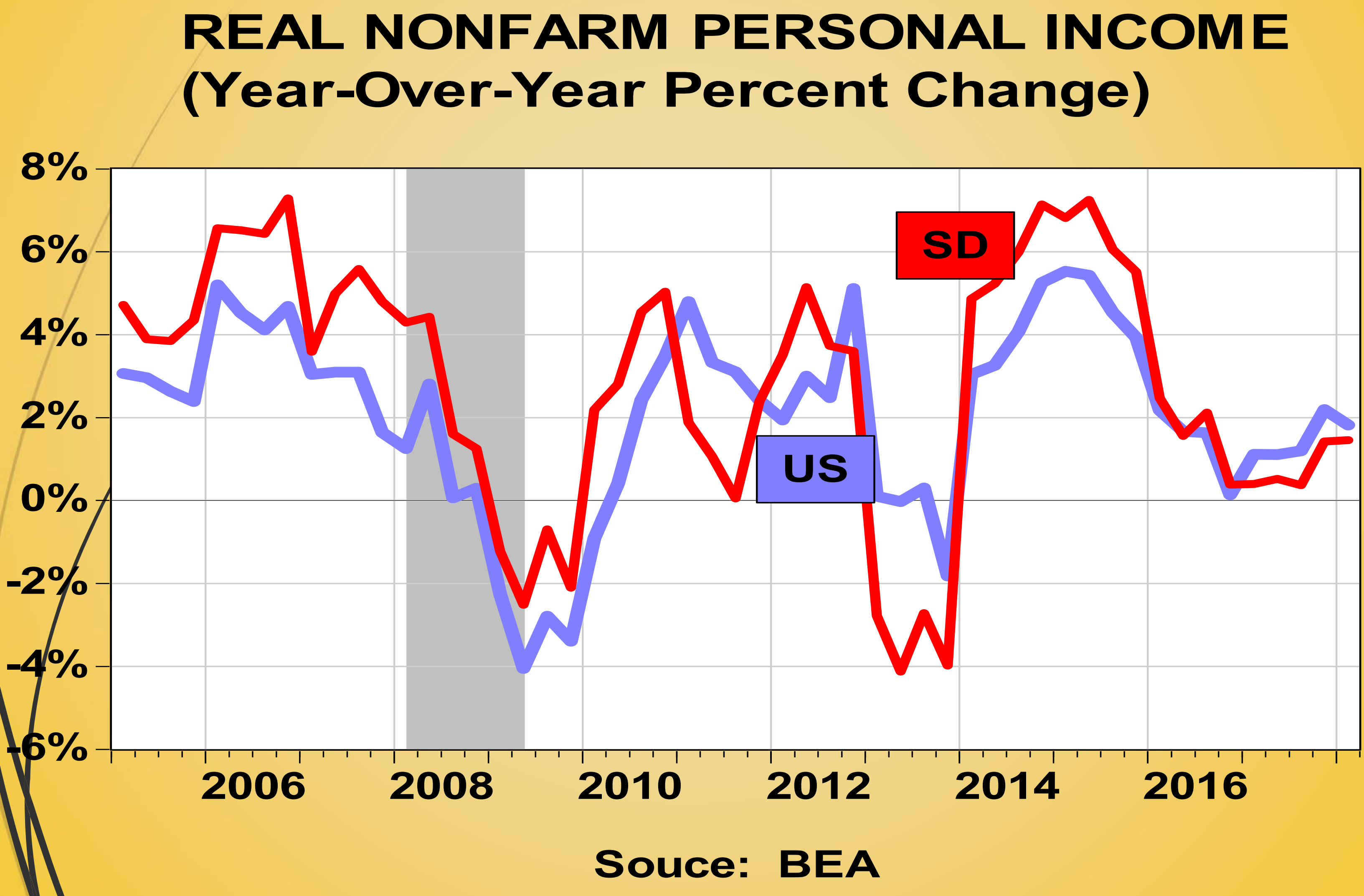
US 4.0% SD 3.1% SF 2.1% RC 2.5%



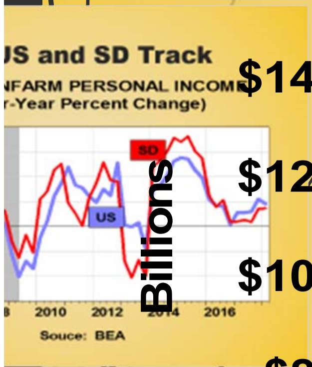
Real Growth

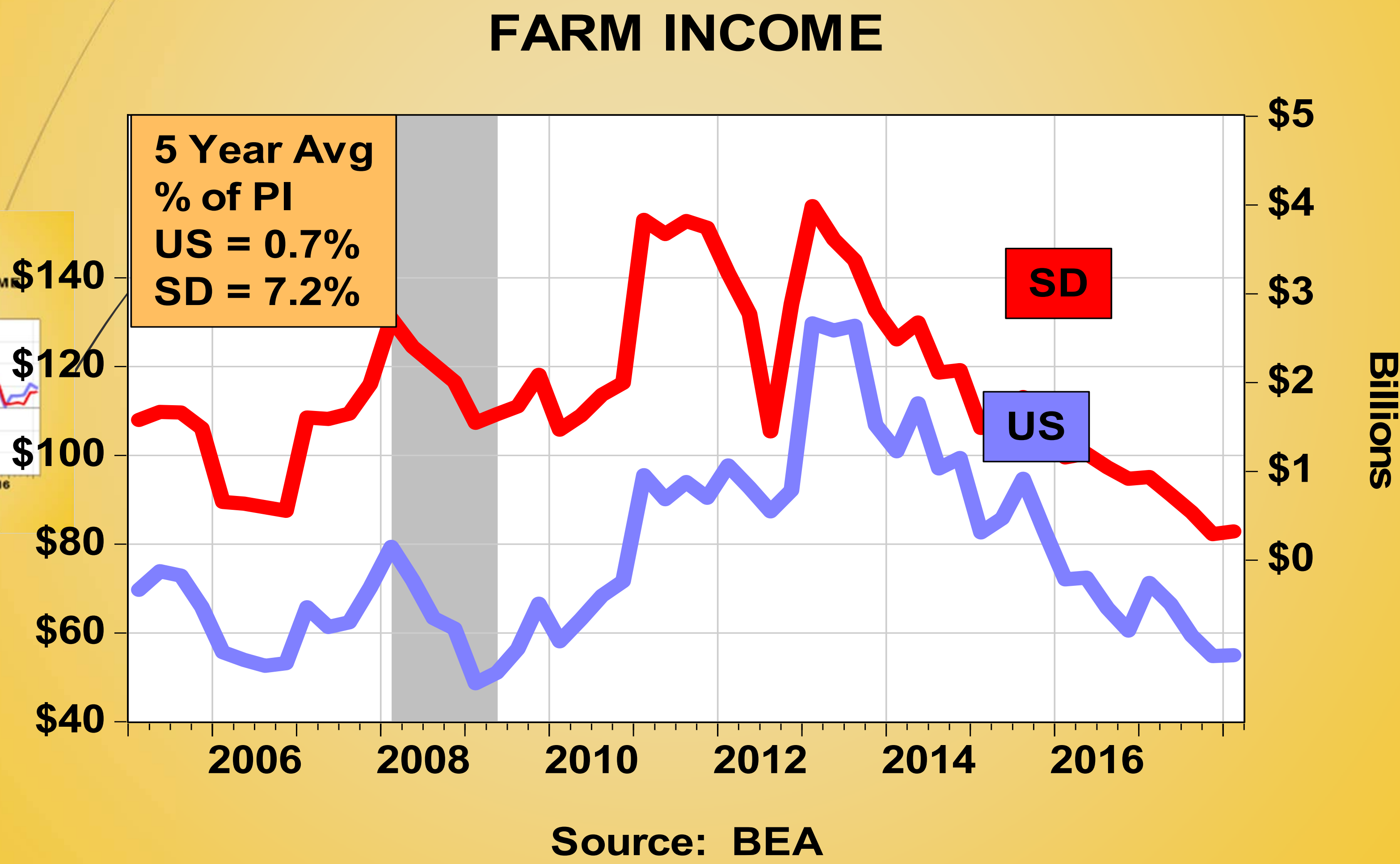

NONFARM PERSONAL INCOME (2009 $S)
Ratio Scale
P to T
US -2.8%
SD -1.1%
SD
US
Billions
$16,000
$15,000
$14,000
$13,000
$12,000
$11,000
$40
$38
$36
$34
$32
$30
$28
Billions
2006
2008
2010
2012
2014
2016
Source: BLS

US and SD Track

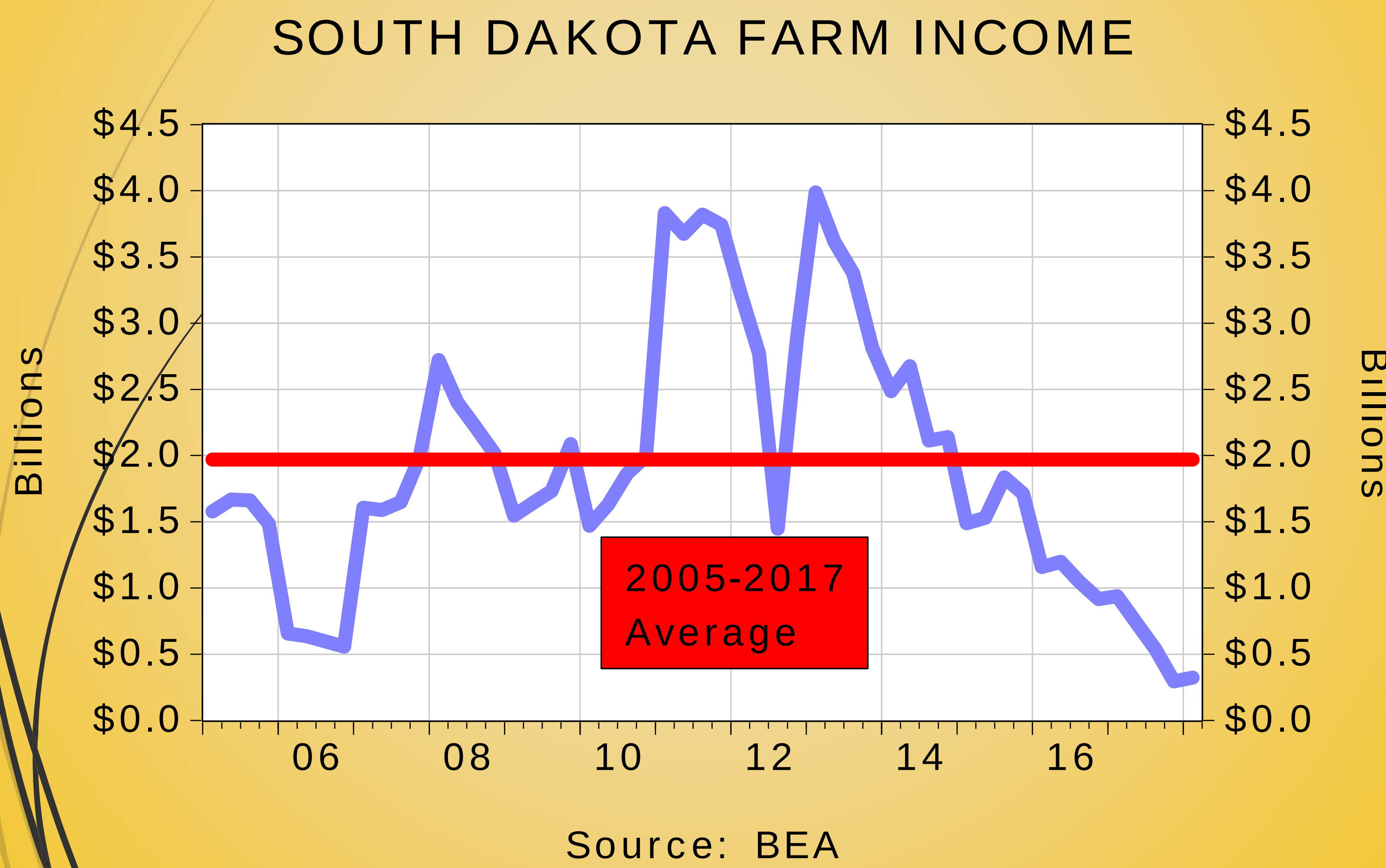


Farm Down Sharply – Low Prices

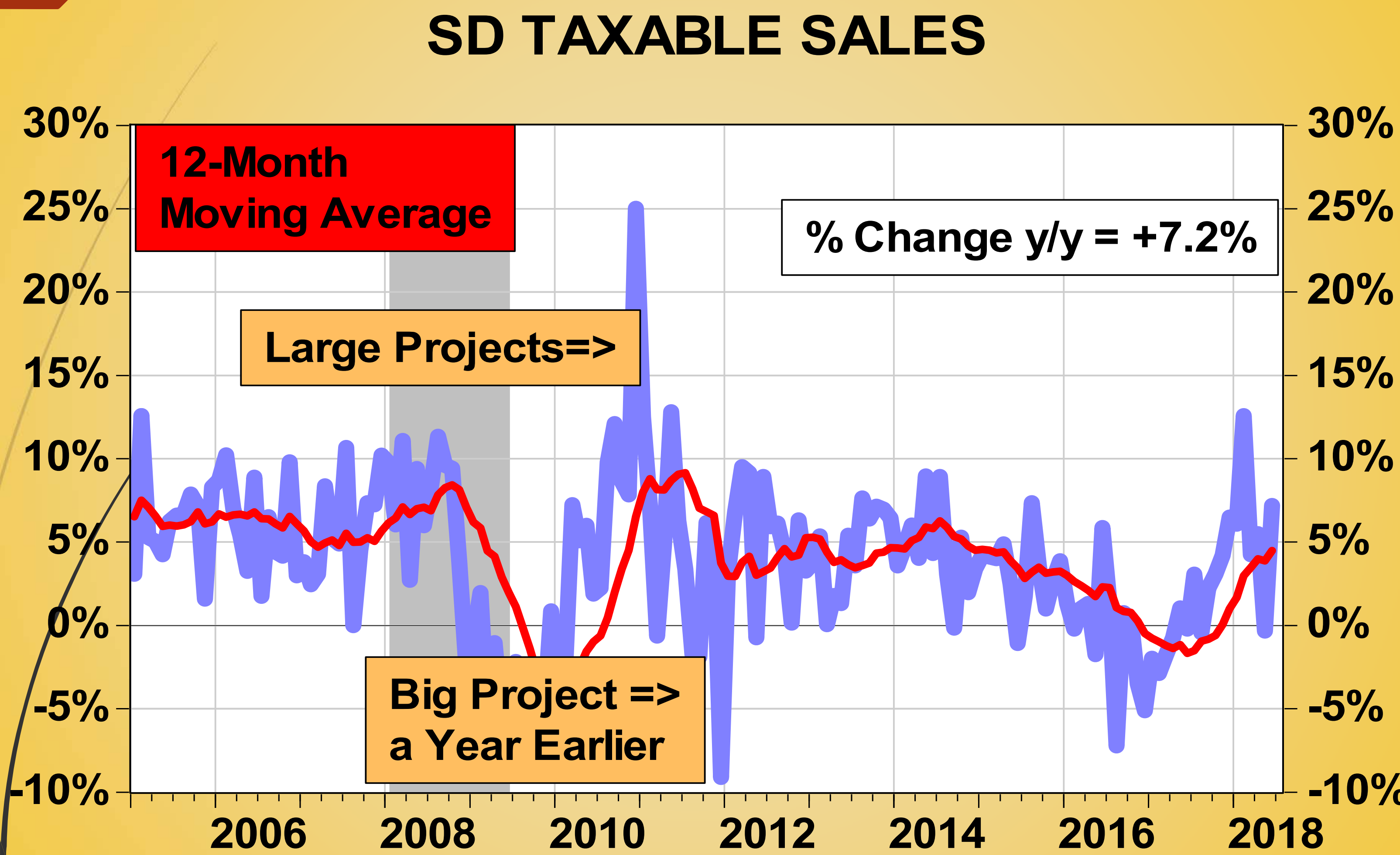




Way Below Average

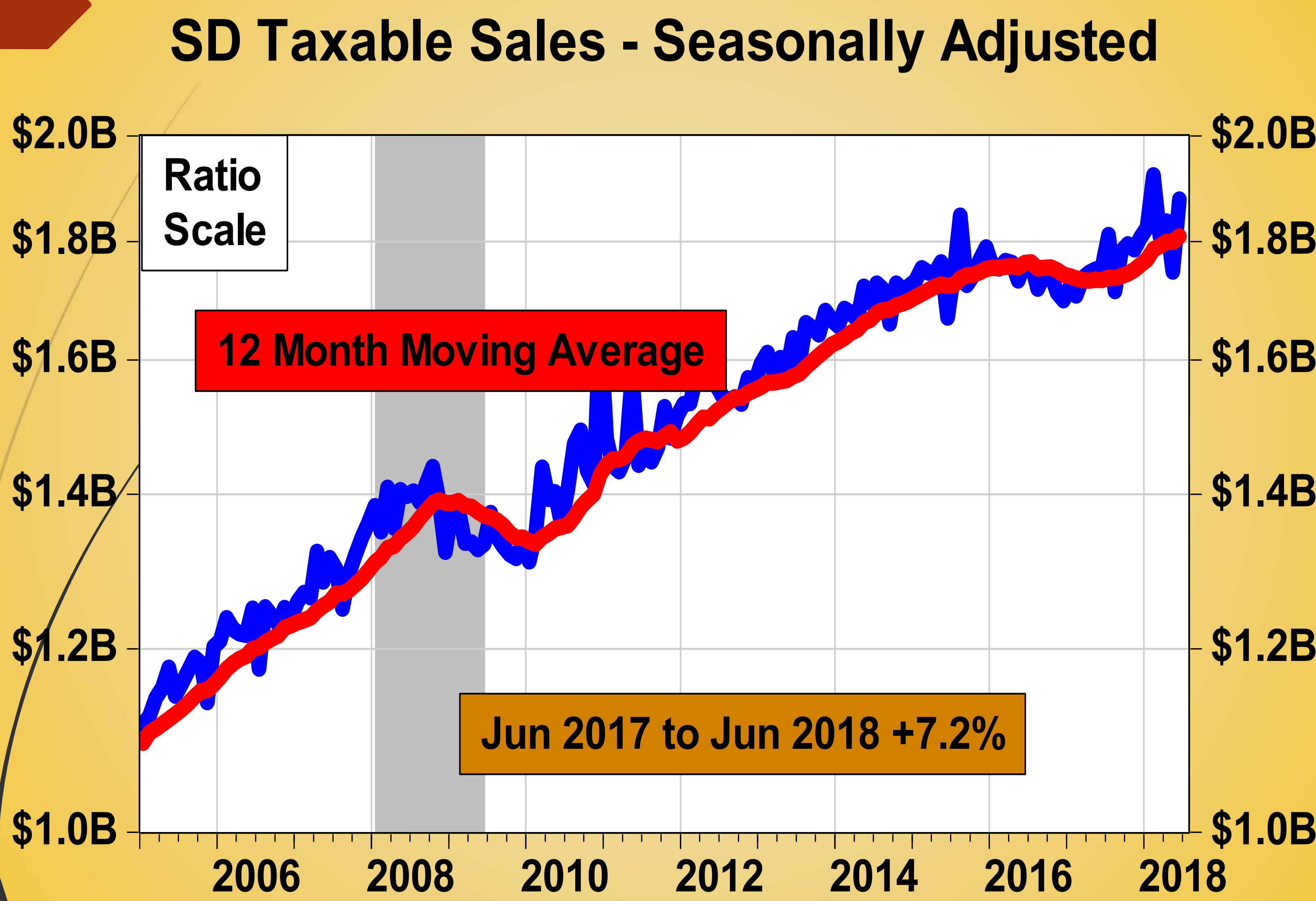


Recent Uptick



Source: SD Department of Revenue

Recent Pickup



Source: SD Department of Revenue

Mid-American States Leading Indicators - GOSS

July 2018 Index > 50 Growth

Overall 54.3

New Orders 52.6

Sales 55.2

Delivery lead time 57.1

Inventories 50.5

Employment 56.1

Goss Comments

- “In 2017, South Dakota ranked 49th in the nation, and ninth in the nine-state region in terms of the export of goods. These exports supported approximately 9,500 jobs, directly and indirectly in the state. The state’s new export orders for March of 70.6 indicates that South Dakota exports remain very strong,” 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