The State of the SD Economy

Presentation to the Governor's Council of Economic Advisors

October 30, 2018

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Outline of Presentation

Overview of US economy

US economy forecast - Macroeconomic Advisors by IHS Markit

SD economy

Summary & Conclusions

US Forecast

Macroeconomic Advisors, By IHS MARKIT
Forecast – October 10, 2018

Real GDP

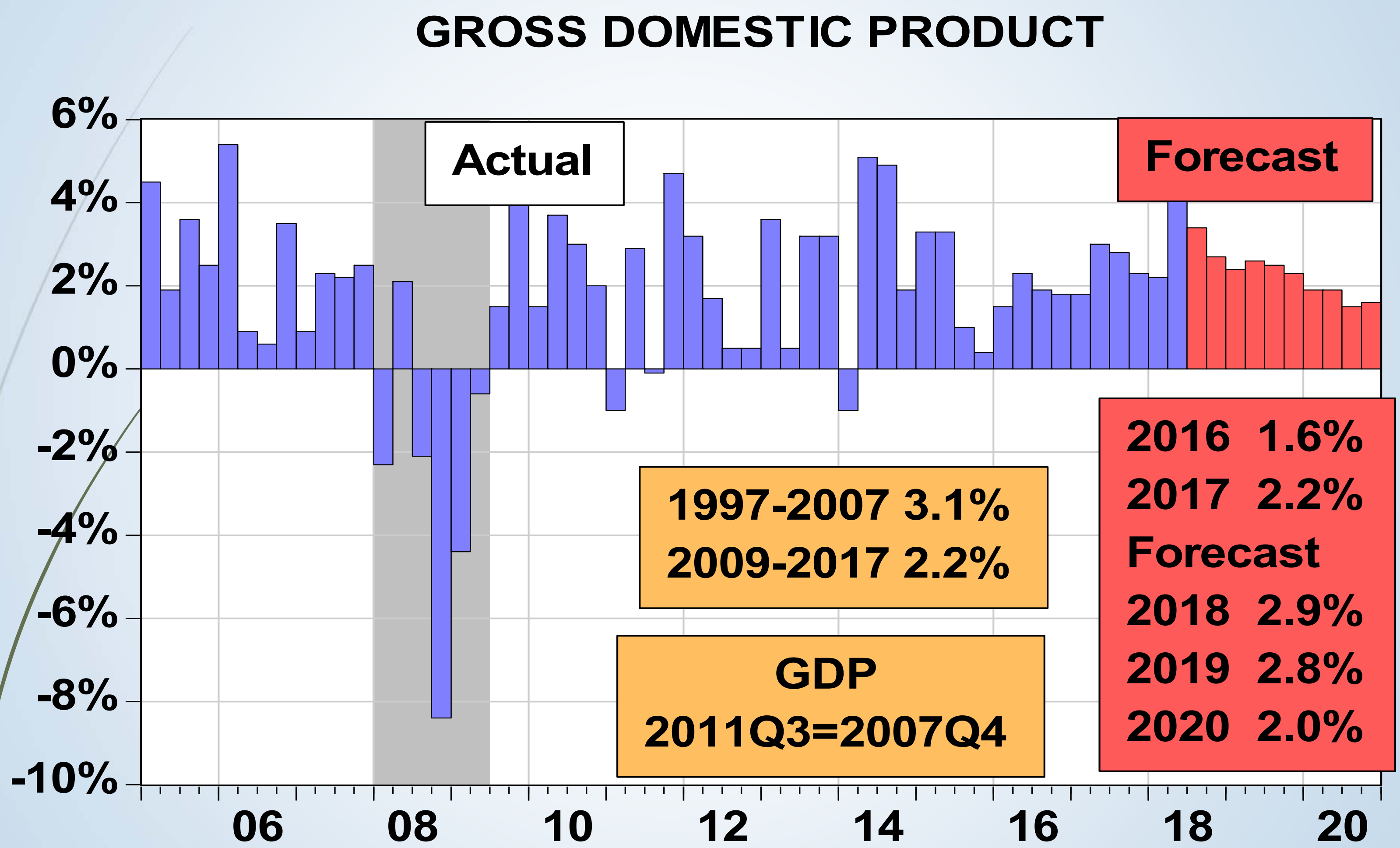
Consumption,

Housing Starts

Federal Budget

Interest Rates and Inflation

Good Growth 2018-2019



Source: BEA and IHS

GDP

Good growth in 2018 and 2019 at 2.9% and 2.8%, respectively. In 2020, growth slows to 2.0% and about 1.5% thereafter. Chance of recession 25%.

Currently, supportive financial conditions and stimulative fiscal policy assure above-trend growth… for awhile. Next year, the waning effects of fiscal stimulus and higher interest rates will inevitably slow the economy first to 2% trend then below trend.

Consumer spending will continue to contribute to growth with 2.6% in 2018 and 2.8% in 2019.

Tariffs undermine domestic demand but potentially shift production towards the US. They expect the former to exceed the later. This is because the US does not produce many of the goods subject to tariffs.

Components of GDP are:

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

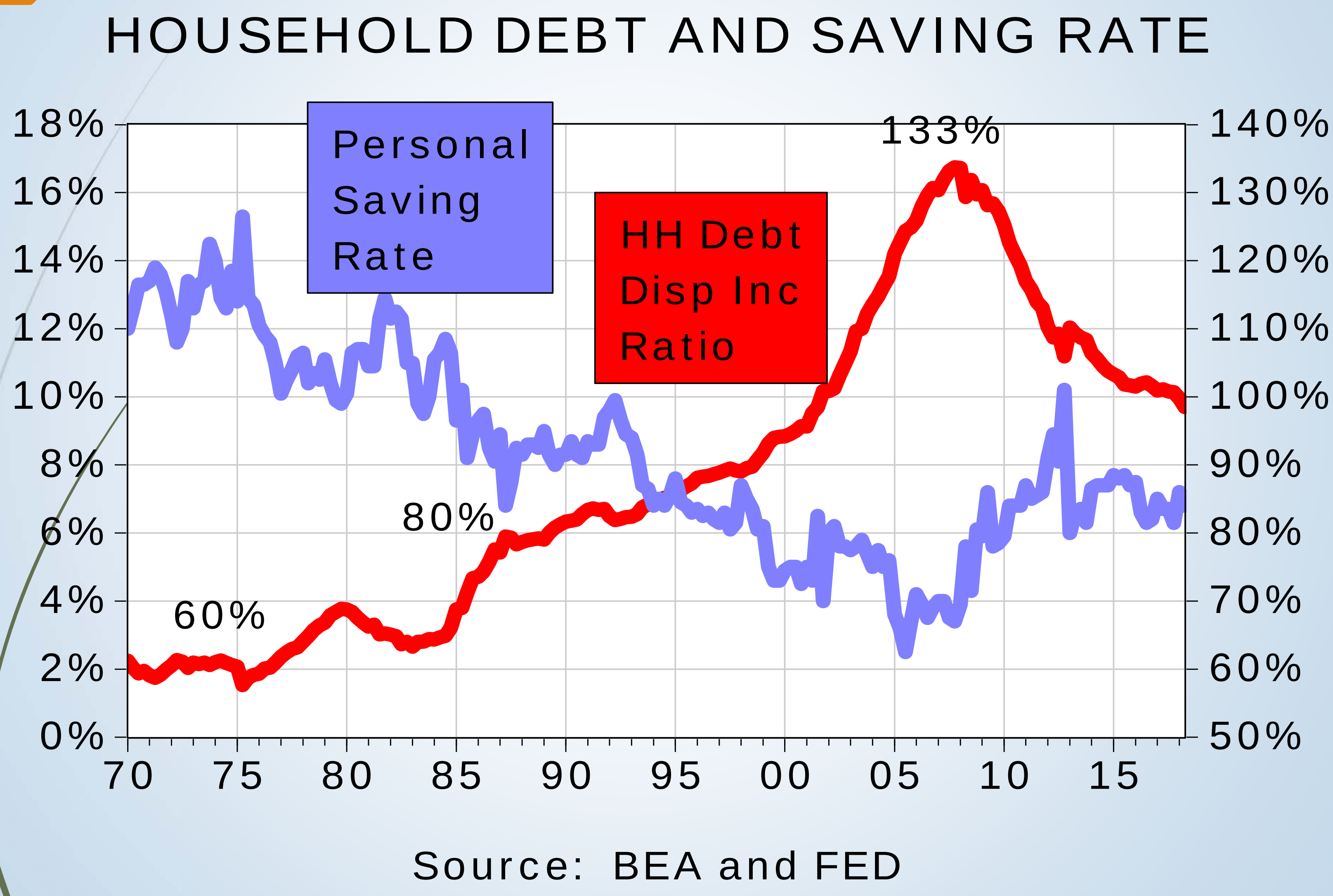
Consumption

As previously mentioned, consumer fundamentals looks strong.

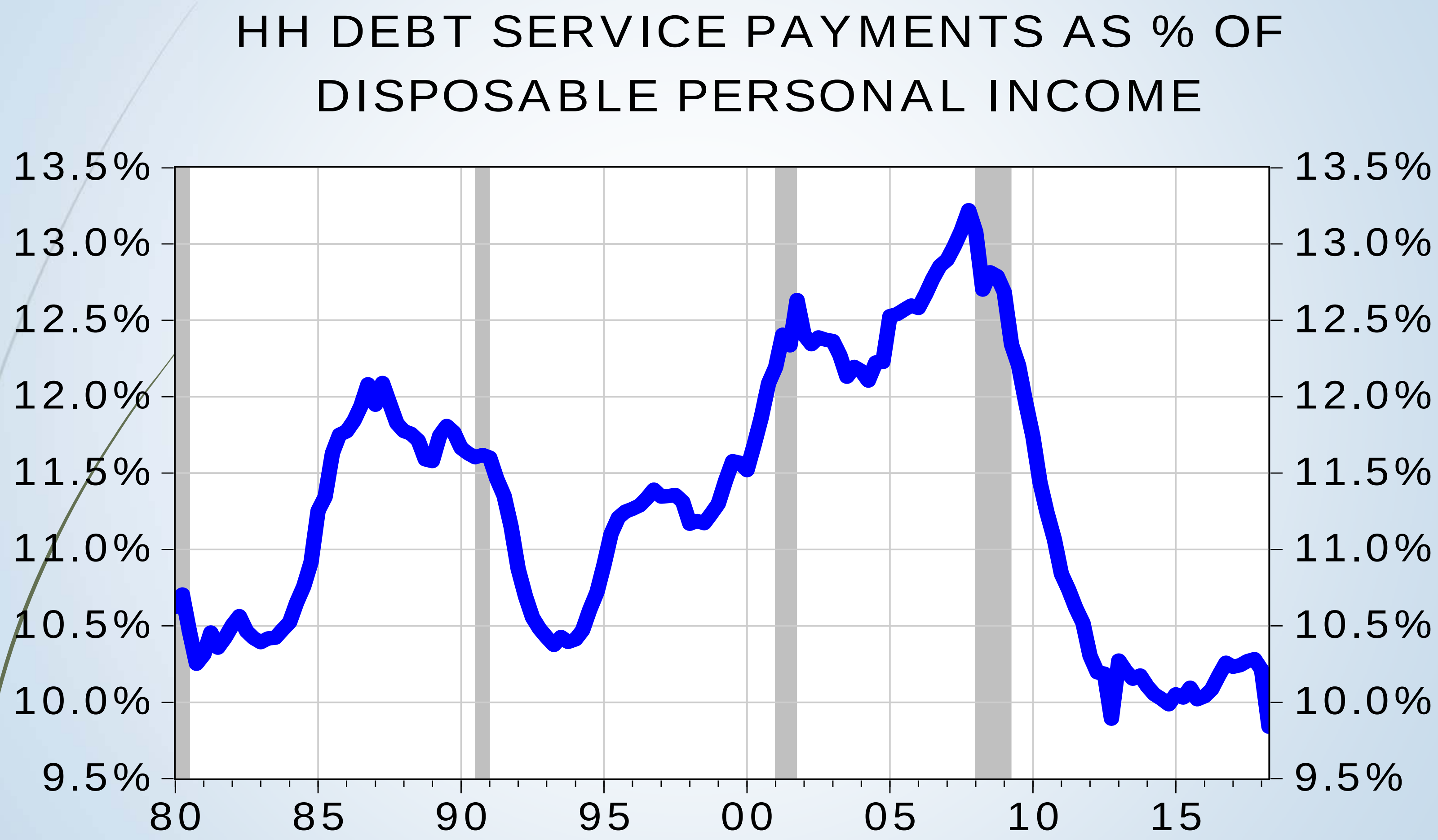
Projected growth is at 2.6% in 2018, 2.8% in 2019, and 2.5% in 2020.

The newly-in-force tariffs are expected to shave one-tenth of a percentage point off growth in 2019, due to higher prices. Looking ahead, they expect average growth of 2.0% over the 2020-2022 period.

Deleveraging Plateaus



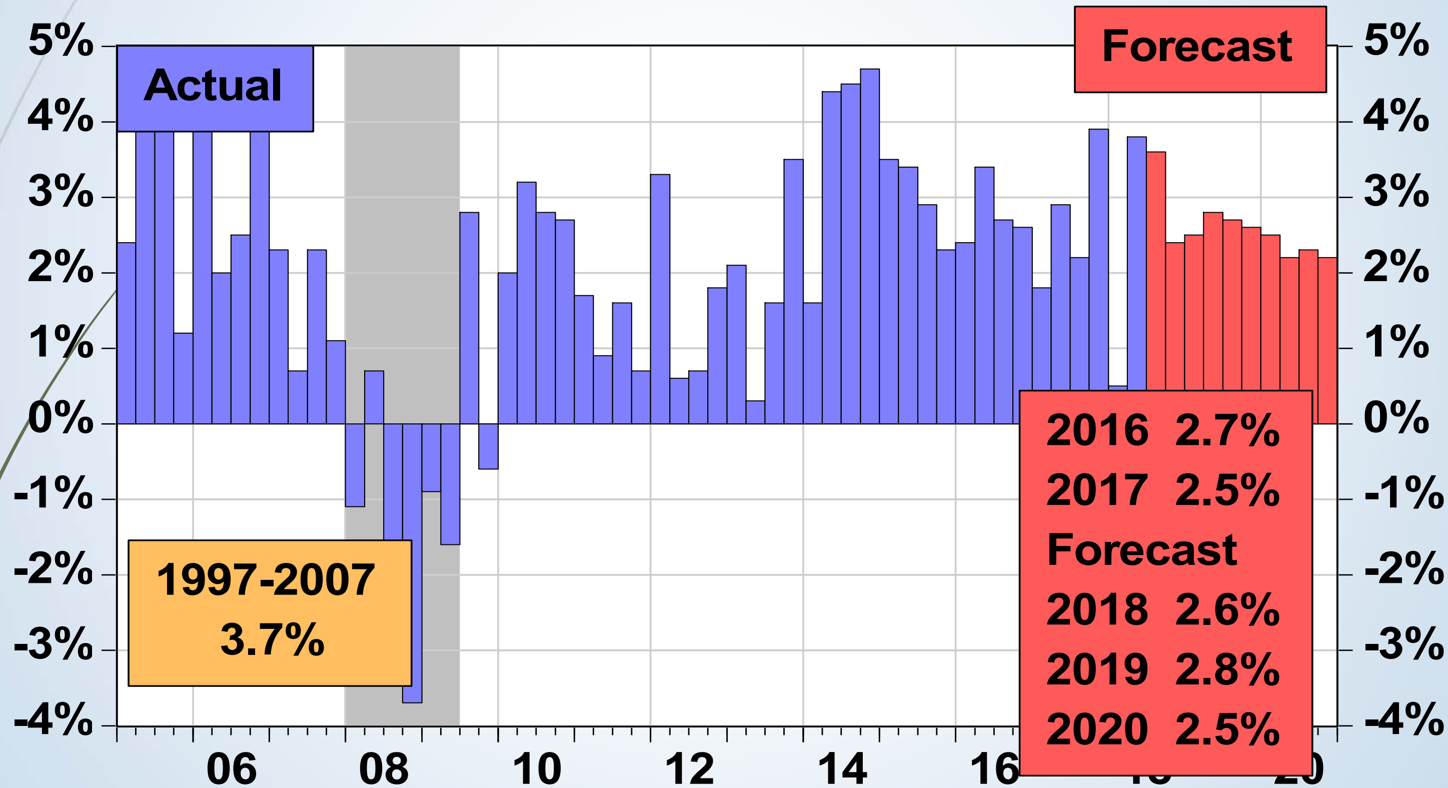
Record Low Debt Service



Source: BEA and Federal Reserve System

Steady Growth Ahead

REAL CONSUMPTION



Source: BEA and IHS

Investment Sector

Fixed business investment showing solid growth peaking in 2018.

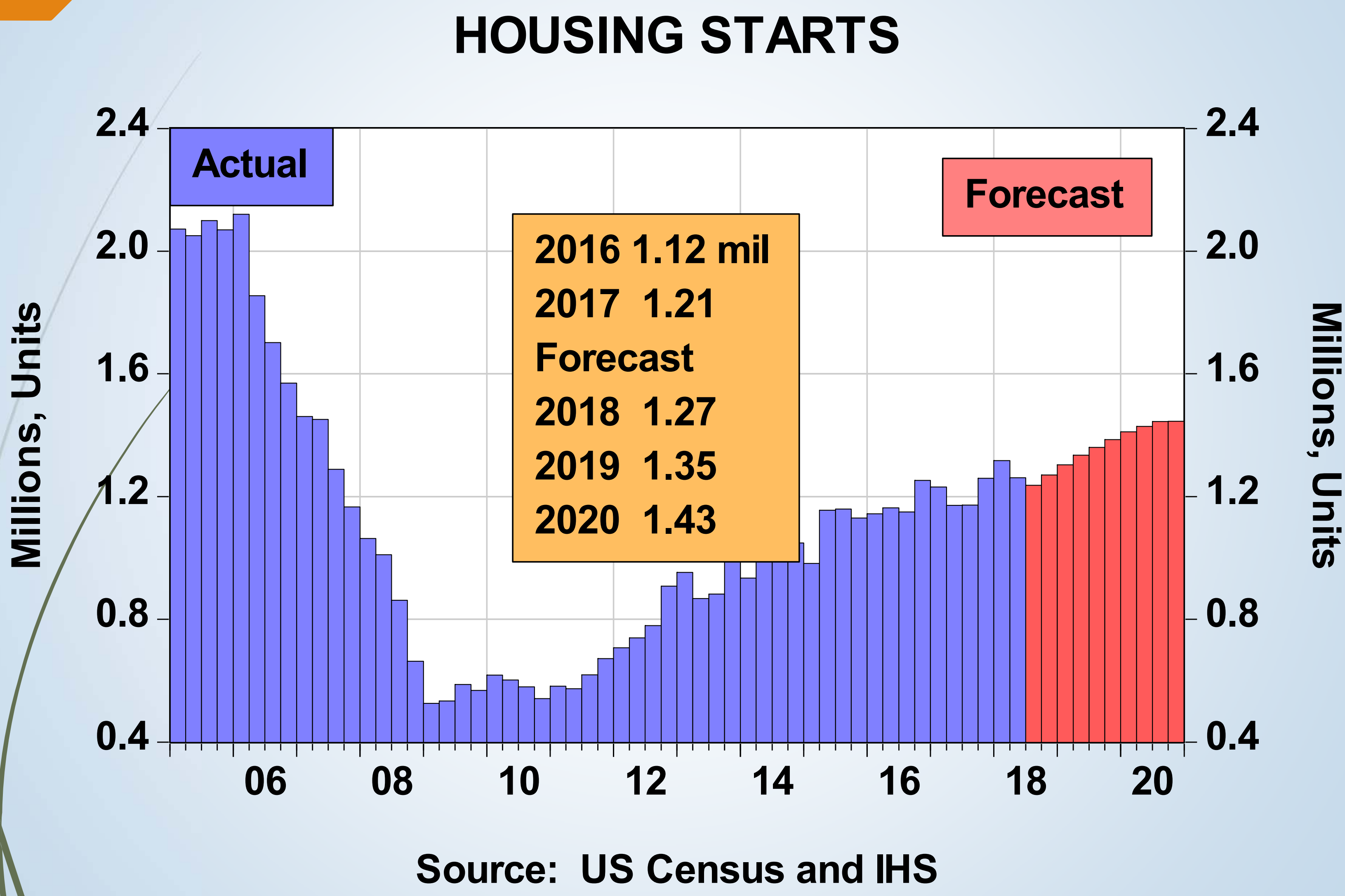
2018 7.0% 2019 4.8% 2020 3.5%

Growth supported by TCJA, energy-related drilling and expanded expensing. Some concern over uncertainty over tariff and trade issues.

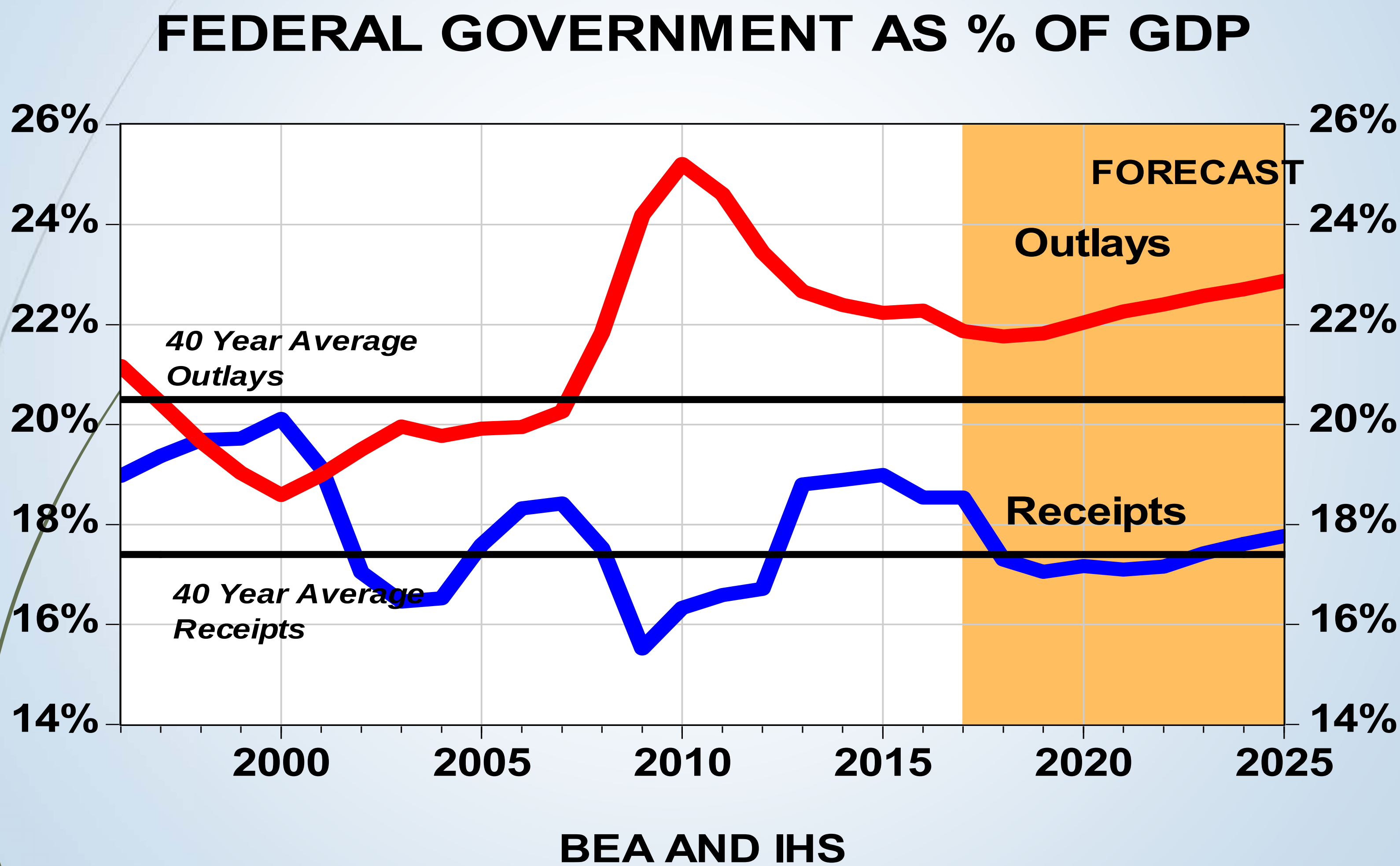
Low inventory/sales ratio will drive inventory investment for the near term.

Current housing slump is temporary.   Higher interest rates and a housing shortage at particular price points will slow growth but be offset by economic growth and higher household formation.

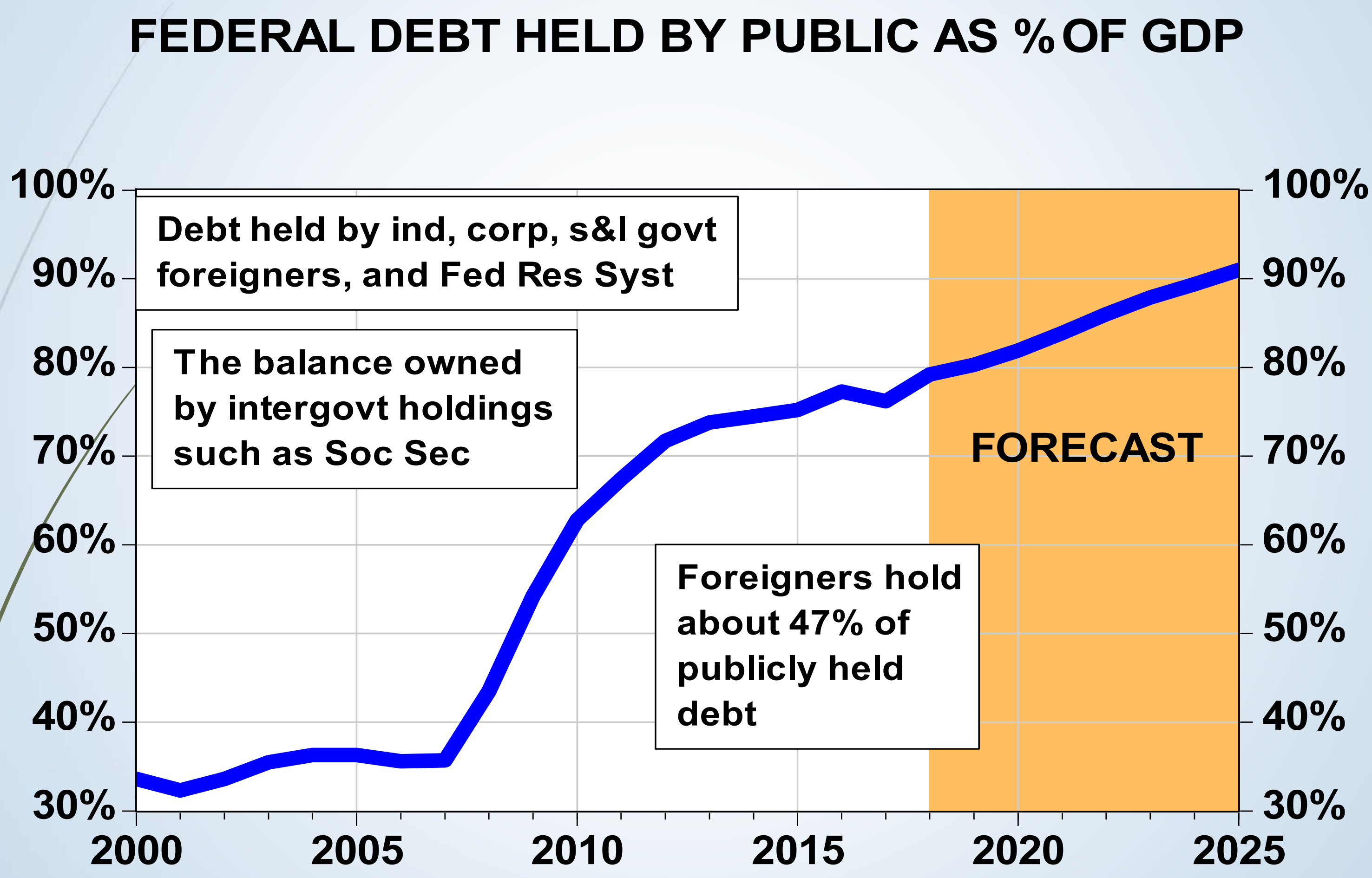
Recovery Continues



Government Sector



Debt Held by Public



Source: IHS

The Fiscal Picture

Federal budget deficits will rise from 3.6% of GDP in 2015 to 4.8% of GDP in 2018 and 5.0% by 2022 and remain above 5% of GDP throughout the 2028 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.

Annual deficits will exceed $1 trillion by 2020. IHS projects the debt/GDP ratio rising to 79% in 2018 and 91% 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. Also faster relative US growth supports imports at the expense of exports.

According to IHS, new tariffs will have little impact on forecast, small change in PCE. The assumptions in their simulations are:

1. One-third of impact of tariffs is offset by resourcing them to other countries,

2. Another one-third is offset by Chinese suppliers absorbing the cost of tariffs,

3. US importers will compress margins,

4. FED will stay course of gradual tightening keeping inflation in check.

Employment & Unemployment

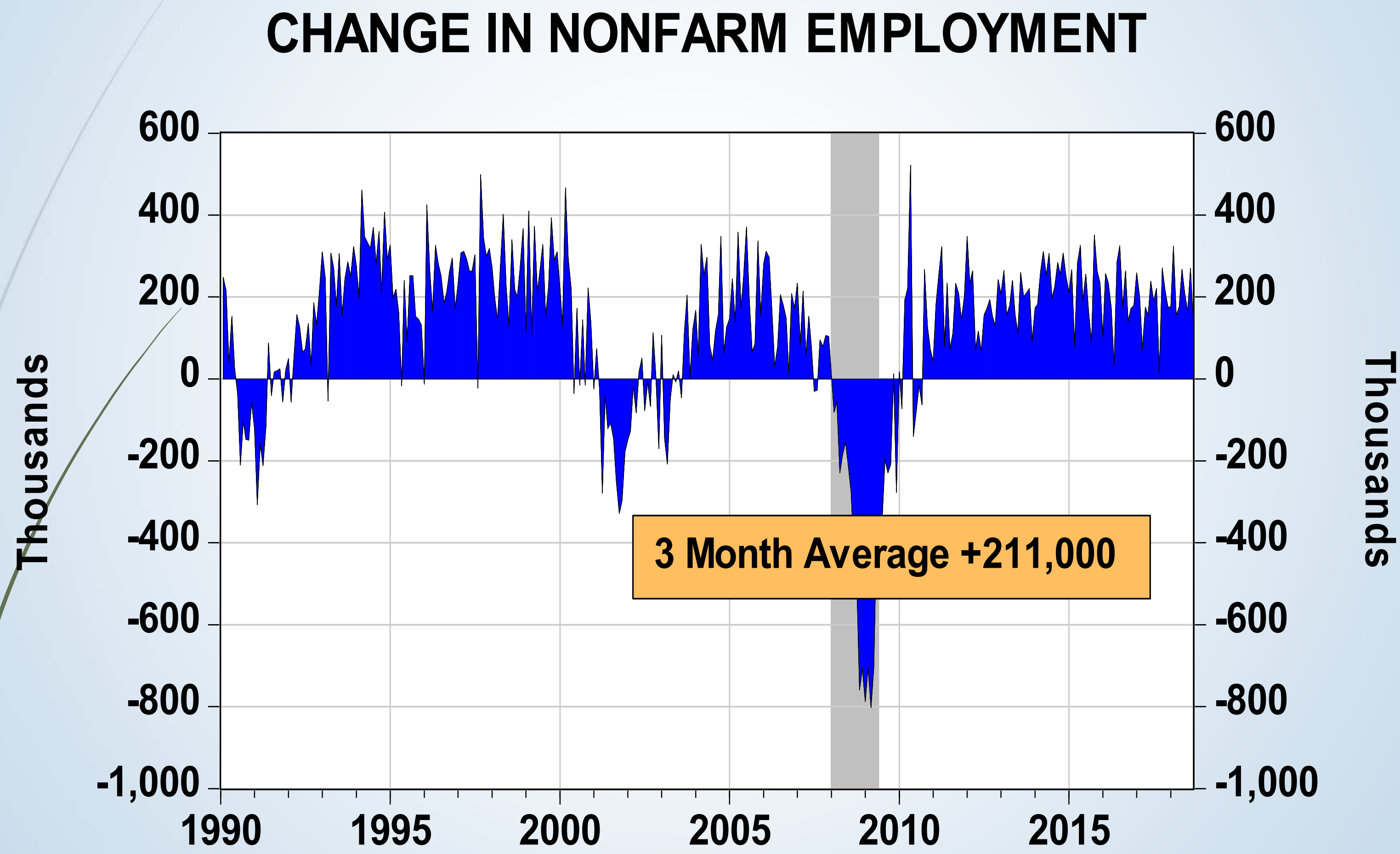
Solid gains in employment will be driven by robust growth in production.

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.

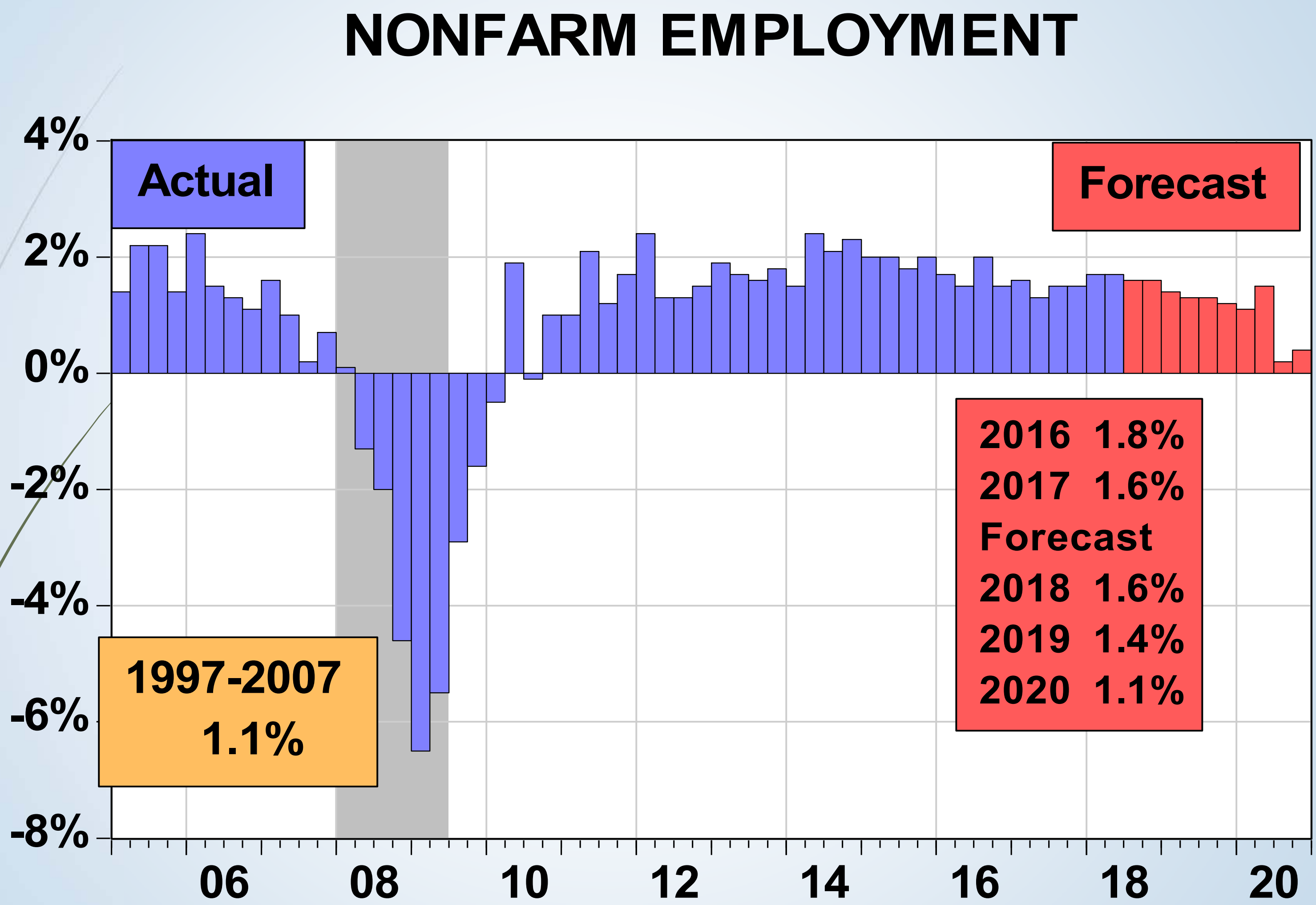
One positive, is the expected upward drift in the labor force participation rate through mid-2020 reflecting a gradual unwinding of the “discouraged-worker” effects.

Employment Growth



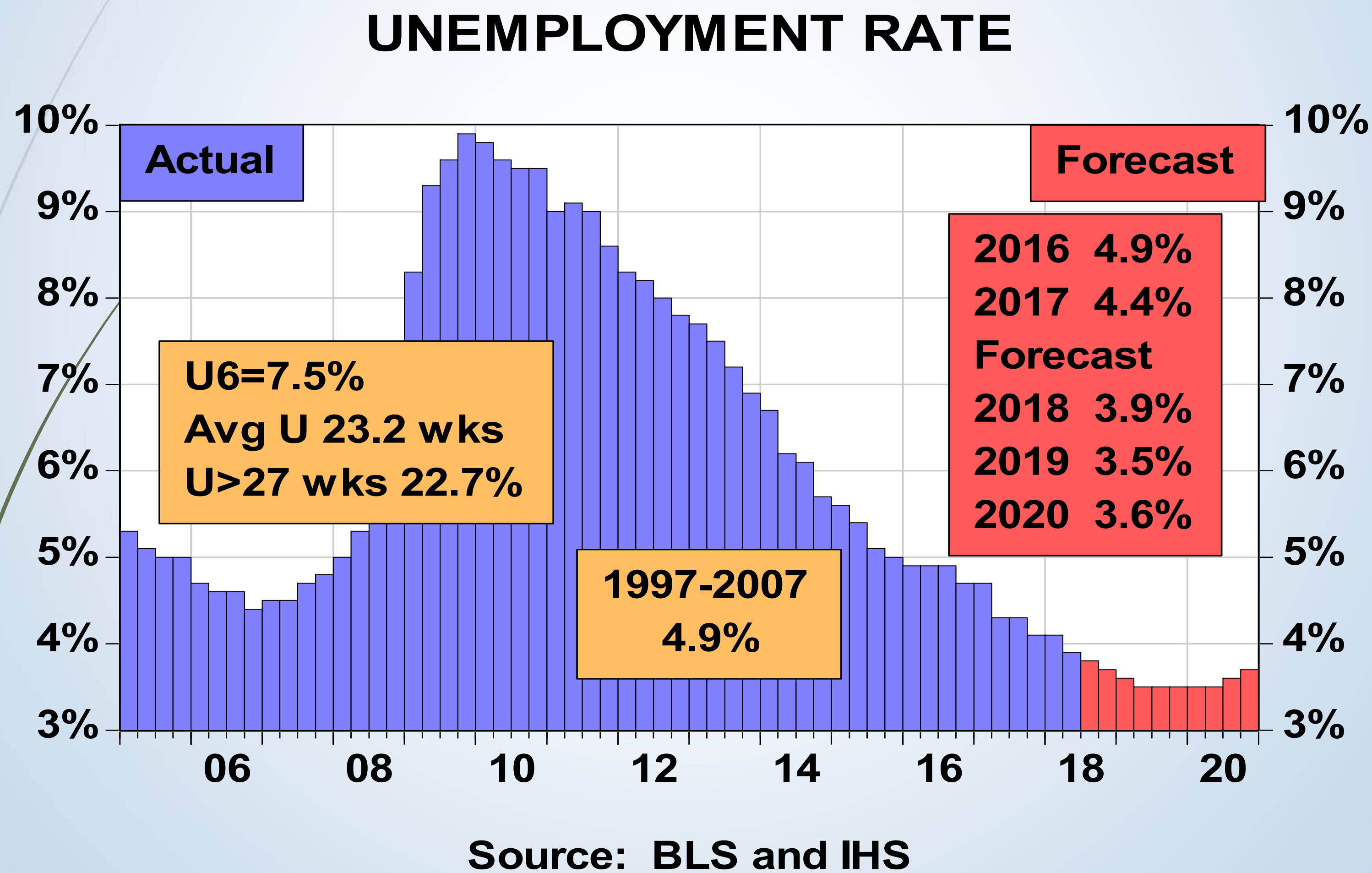
Source: BLS

Future Job Growth Steady



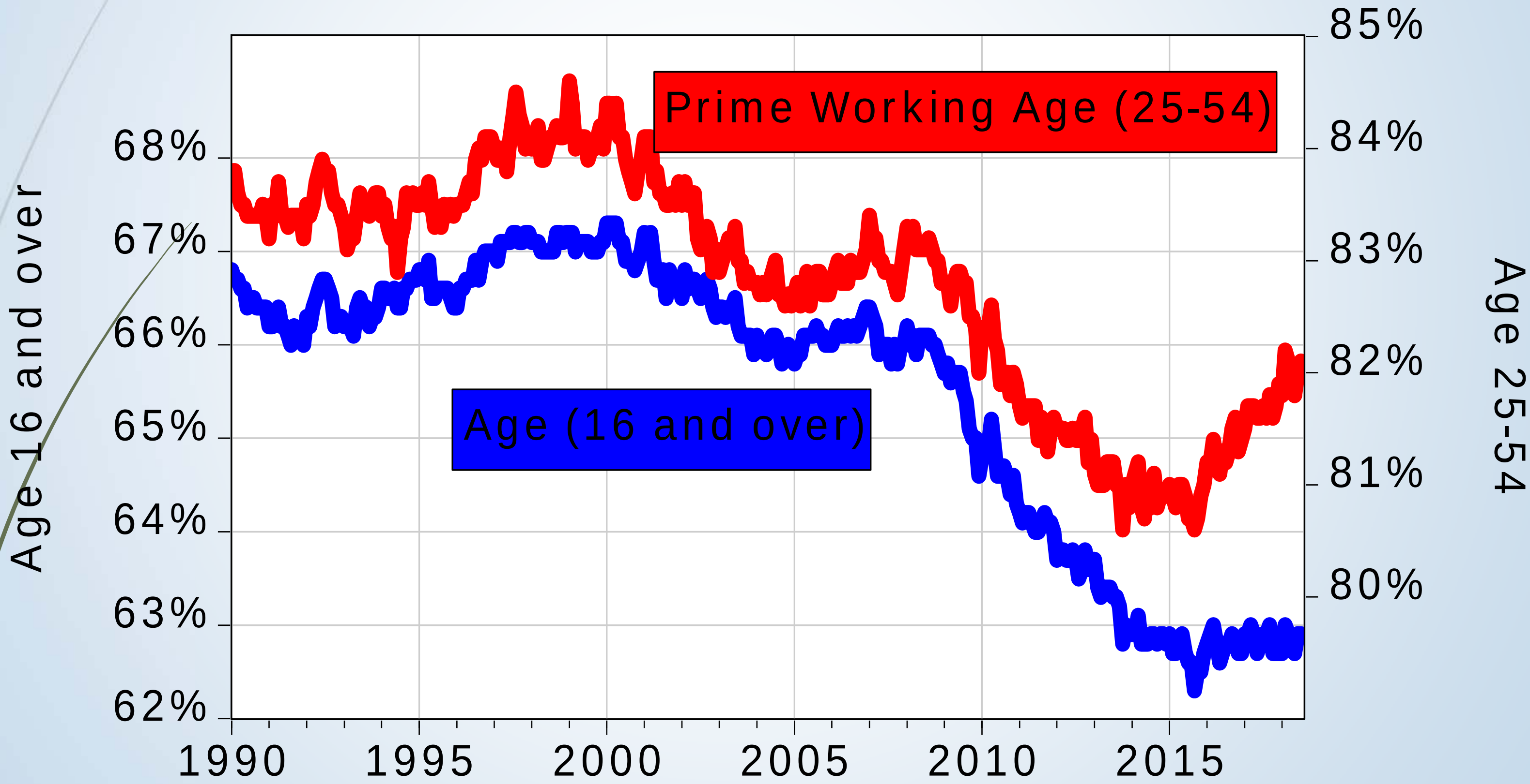
Source: BLS and IHS

Low U3 Unemployment Rate Still Falling



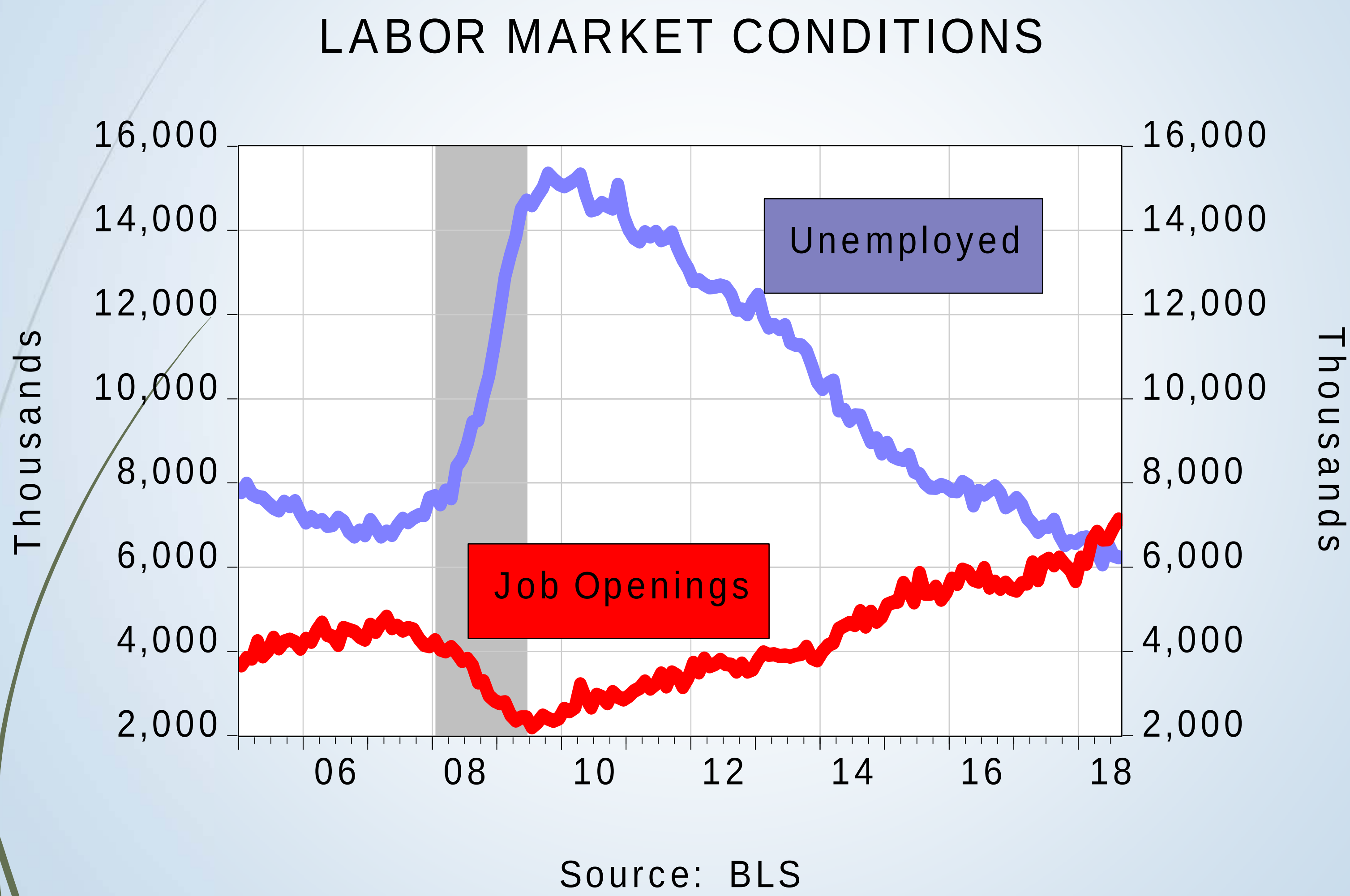
Increase Prime Working Age

LABOR FORCE PARTICIPATION



BLS

Job Openings > Unemployed



Inflation & Interest Rates

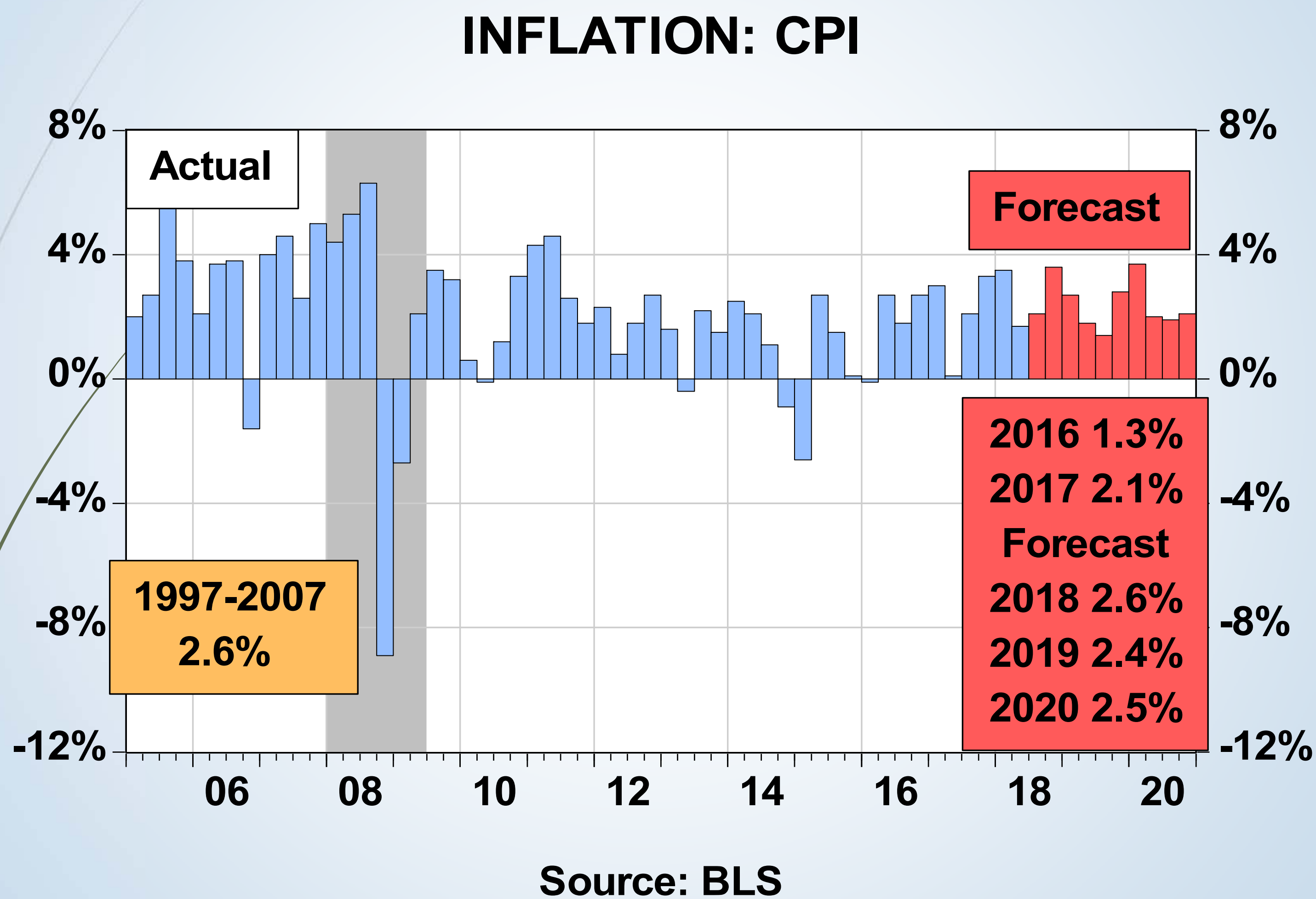
The FED will increase the Federal Funds rate four times in 2018. Post-2018, they will increase the Federal Funds rate to 3.5% by 2020.

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 3.57% by 2020.

They see the CPI rising to 2.6% in 2018, 2.4% in 2019, and 2.5% 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



IHS MARKIT FORECAST OCTOBER 2018

Variable	2016	2017	2018	2019	2020
GDP	1.6%	2.2%	2.9%	2.8%	2.0%

Recession Probability 25%

NA Emp	1.8%	1.6%	1.6%	1.4%	1.1%
Oil(Brent)	$44	$55	$74	$81	$82
Housing	1.18	1.21	1.27	1.35	1.43
CPI	1.3%	2.1%	2.6%	2.4%	2.5%
Un Rate	4.9%	4.4%	3.9%	3.5%	3.6%

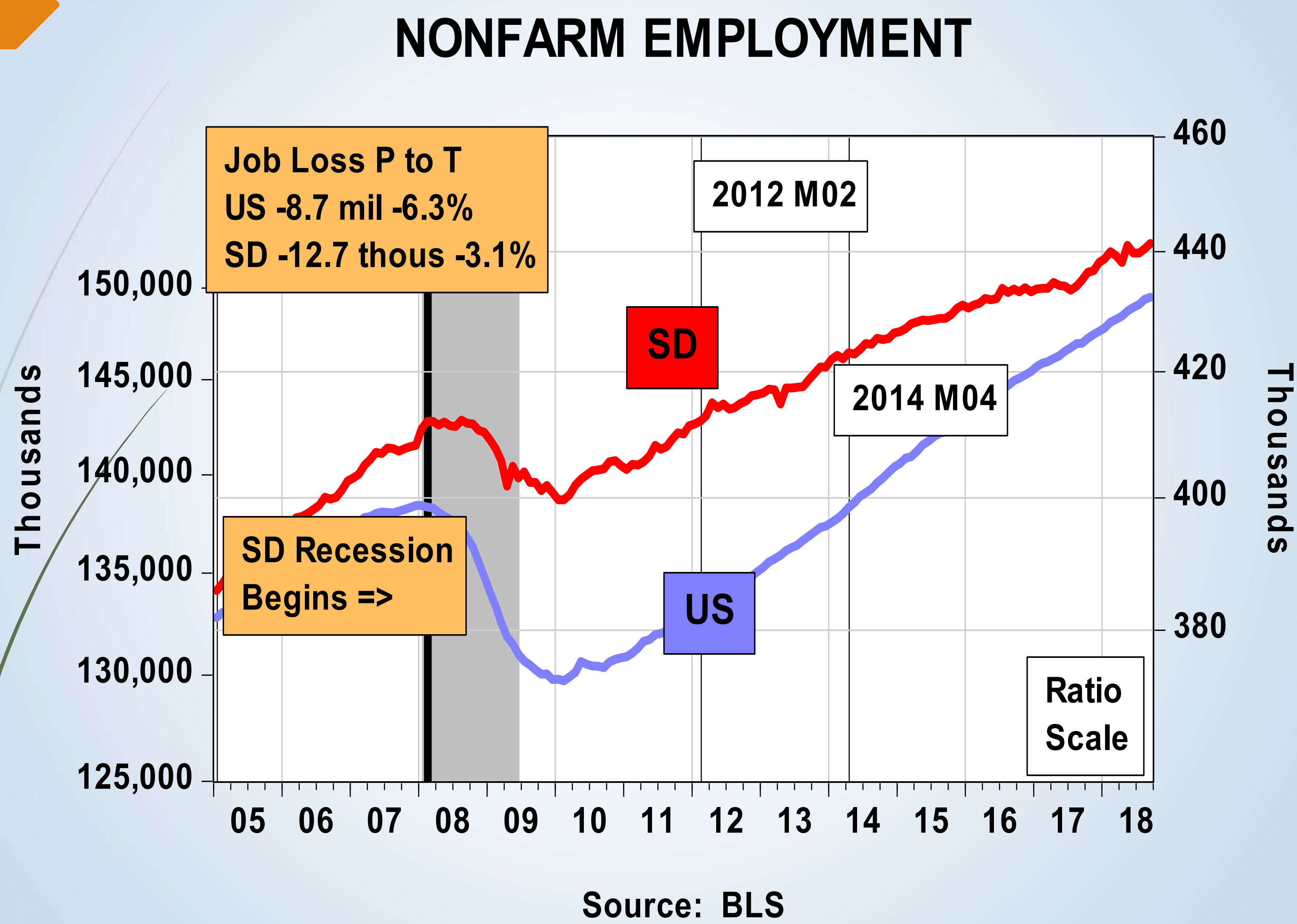
Wells Fargo Forecast October 2018

	2018	2019	2020	
GDP	**2.9%**	**2.8%**	**2.2%**	
NA EMP	**201 thou**	**165 thou**	**120 thou**	
CPI	**2.5%**	**2.8%**	**2.6%**	
10-YR T Note	**3.00%**	**3.59%**	**3.96%**	

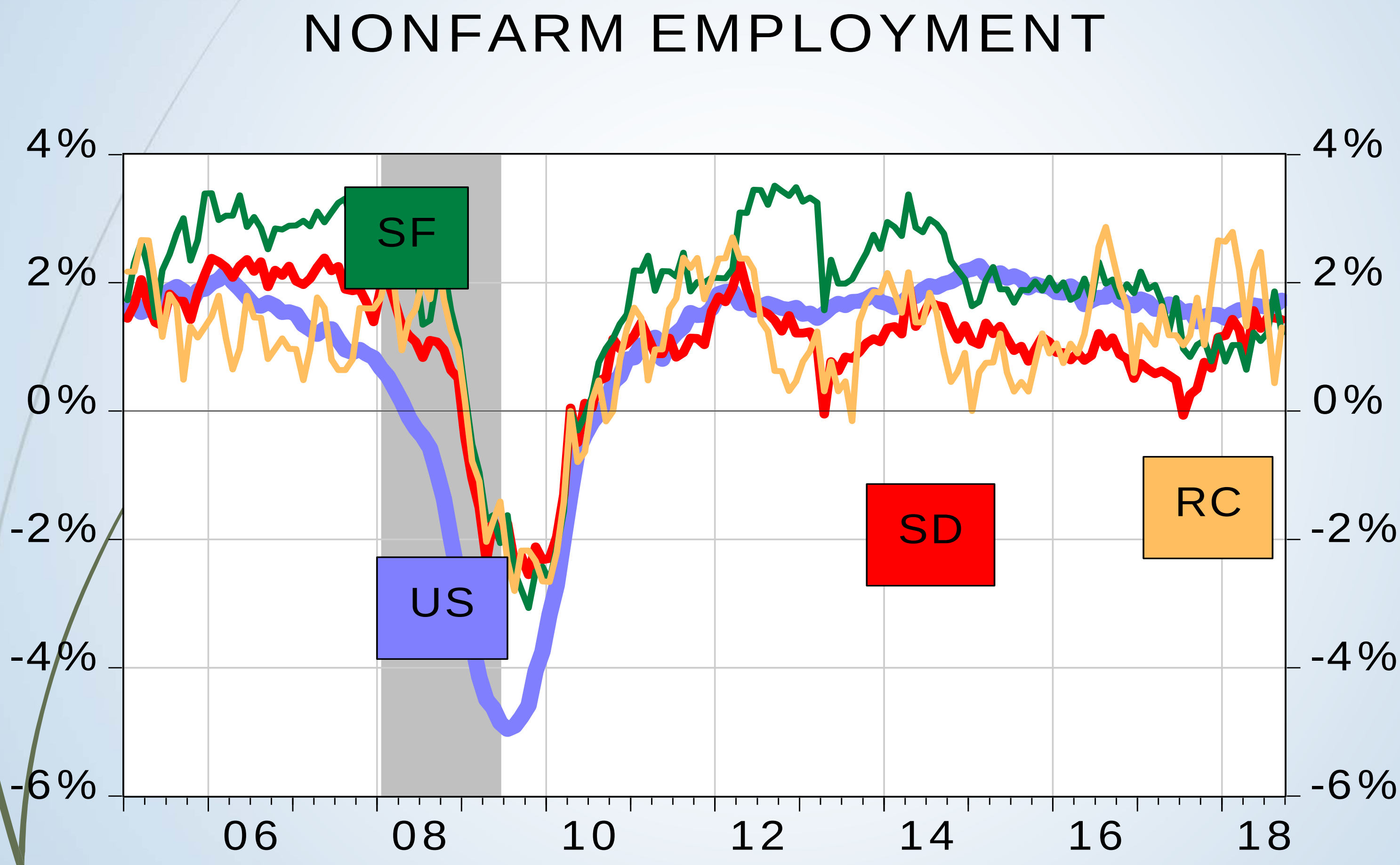
Key Variables Tracking SD Economy

- Nonfarm employment
- Housing starts
- Real nonfarm personal income
- Taxable sales
- Leading indicator

Steady


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

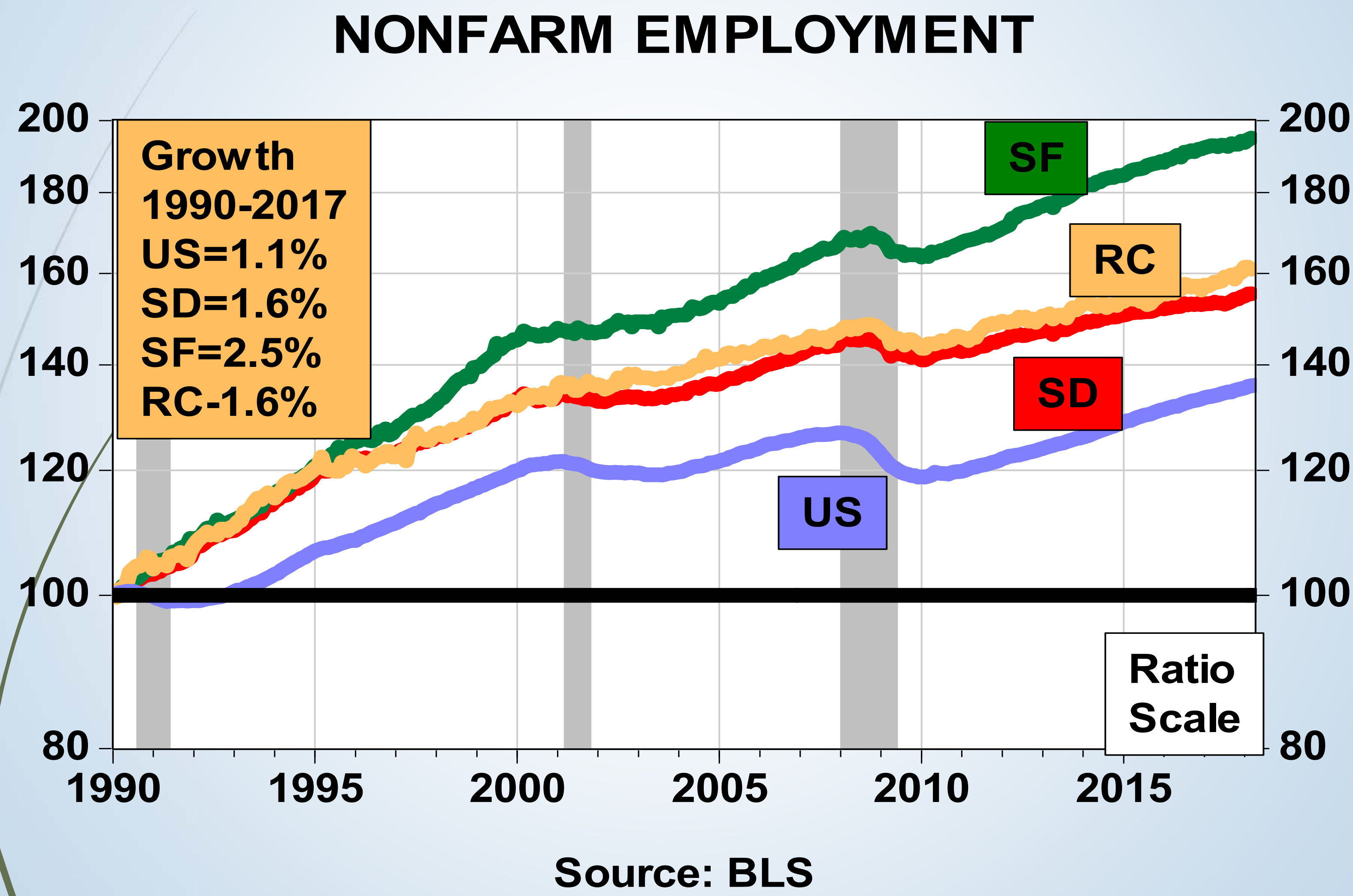


Source: BLS

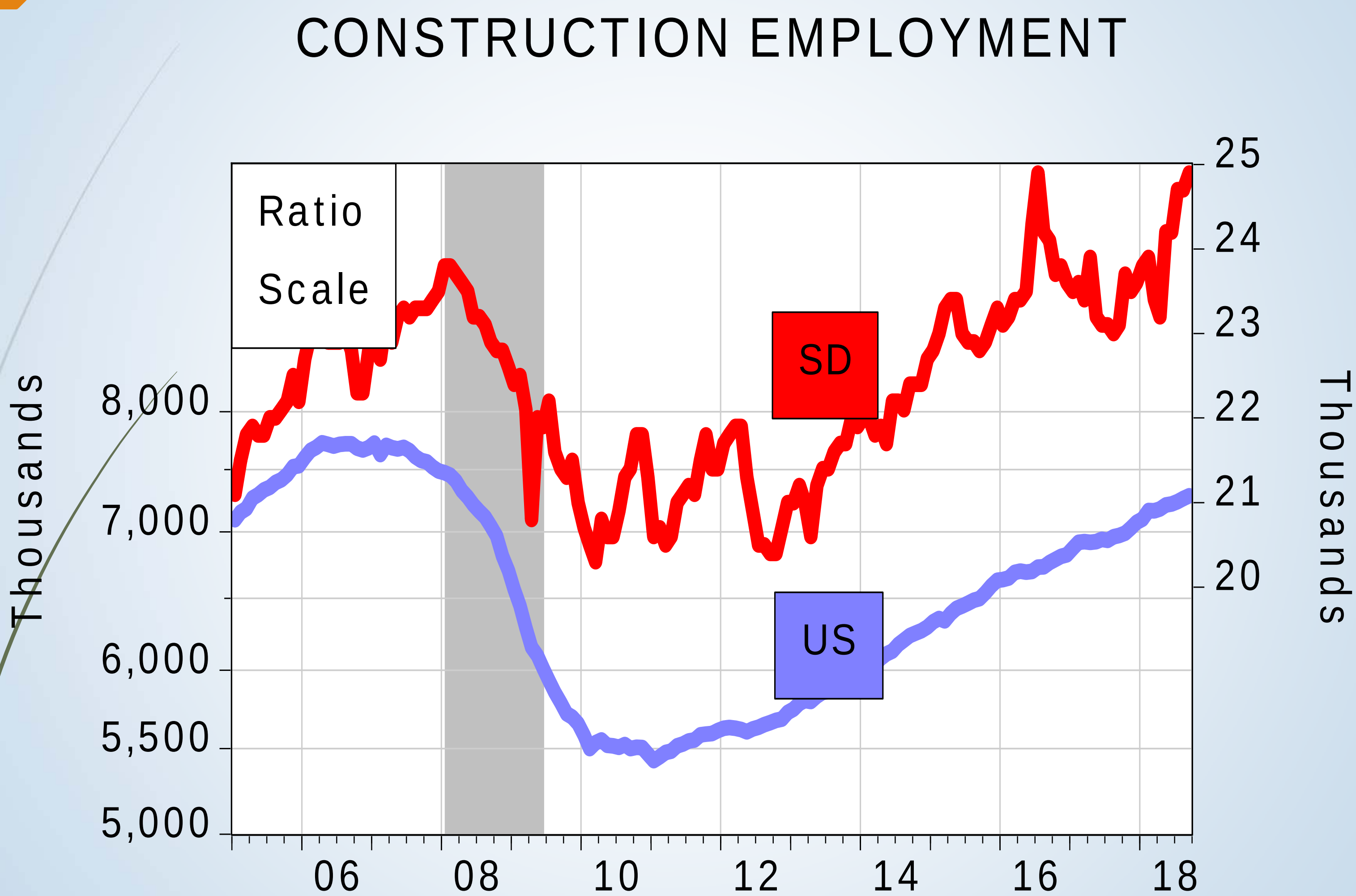
ECONOMY AT A GLANCE (Employment Y/Y) SEP

INDUSTRY	SD	SF	RC
Total NonFarm	1.4%	1.7%	1.9%
Min,log,const	7.8%	3.3%	3.8%
Manufacturing	2.5%	4.3%	0.0%
Trade,tran,util	-0.6%	-1.6%	0.7%
Information	0.0%	-3.8%	0.0%
Finance	1.0%	0.0%	0.0%
Prof,business	6.7%	8.8%	1.9%
Educ,health	0.3%	0.6%	2.5%
Leisure,hosp	0.2%	1.3%	3.6%
Other services	3.6%	3.4%	2.9%
Government	0.6%	2.6%	0.9%

SF Outpaces the Rest

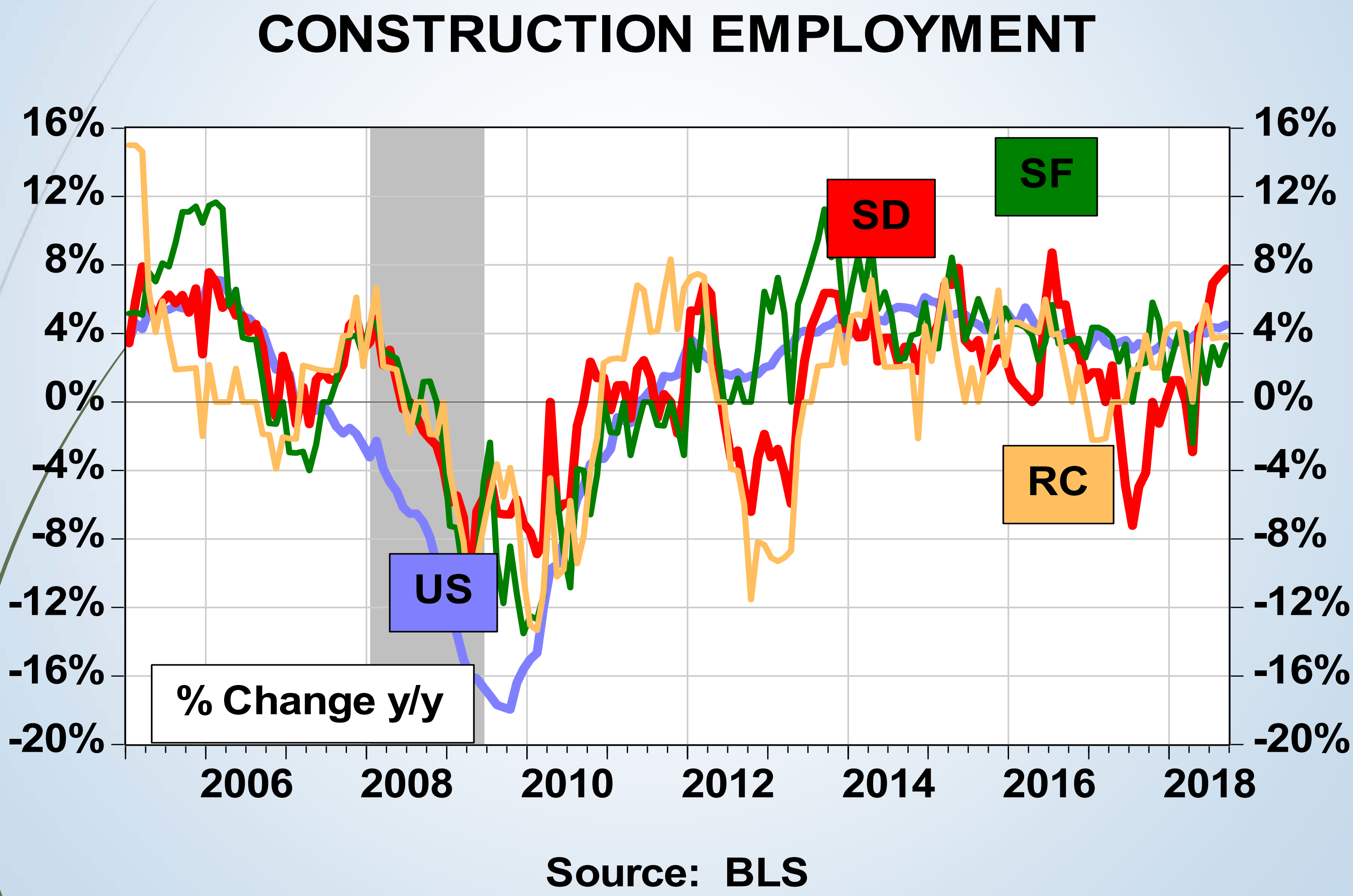


Still High



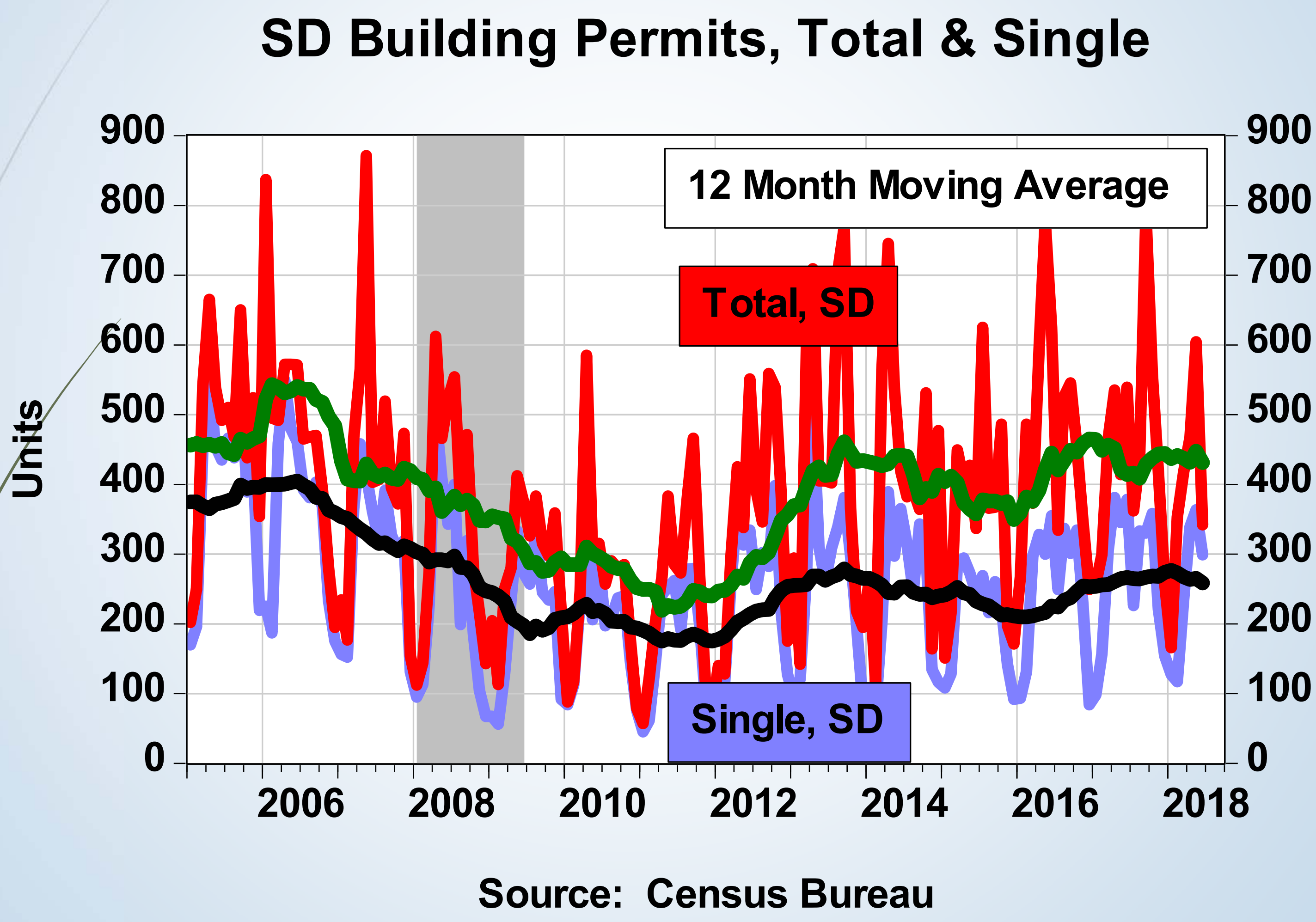
Source: BLS

Growth



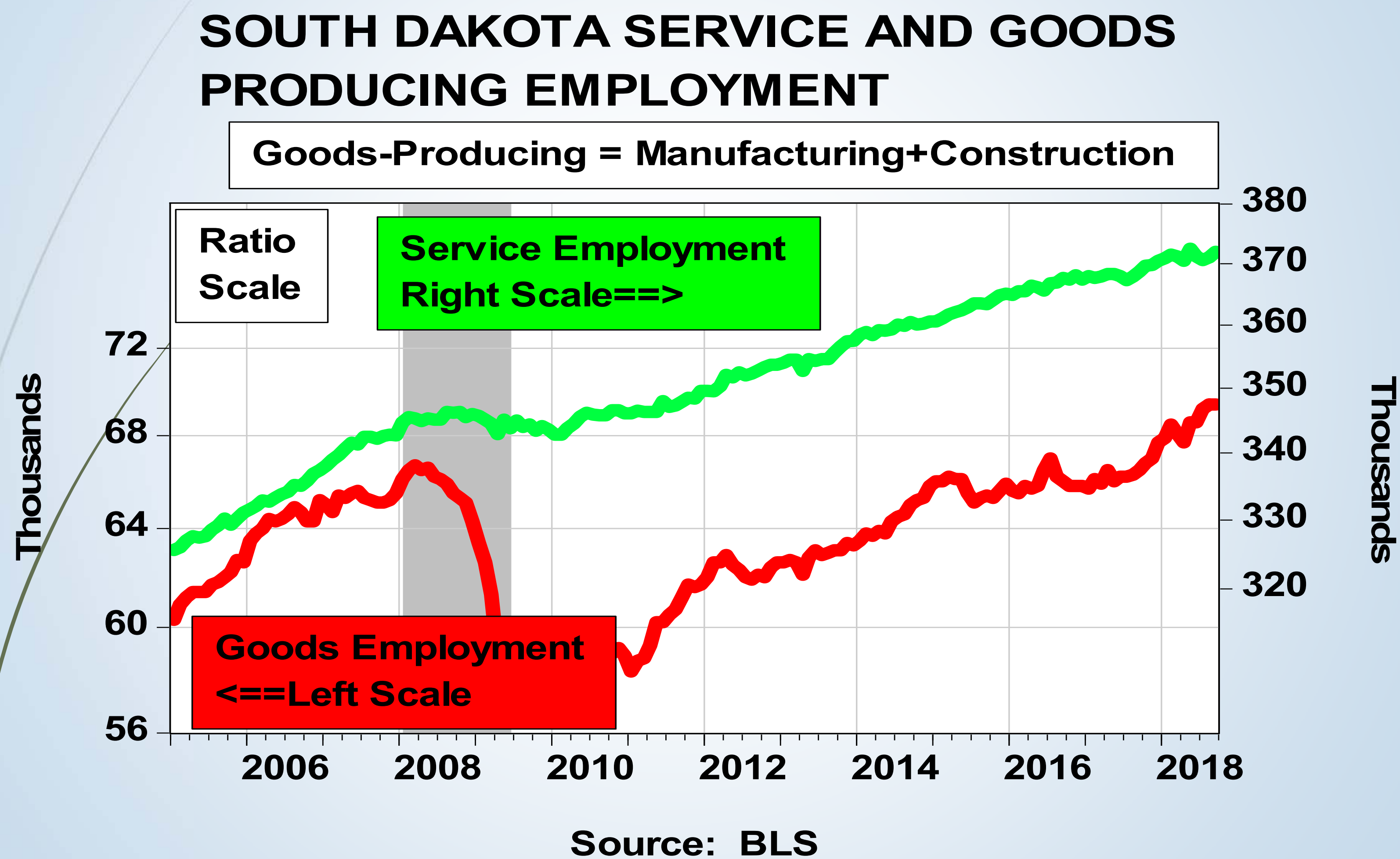
CONSTRUCTION EMPLOYMENT
16%
12%
8%
4%
0%
-4%
-8%
-12%
-16%
-20%
SF
SD
US
RC
% Change y/y
2006
2008
2010
2012
2014
2016
2018
Source: BLS

Steady

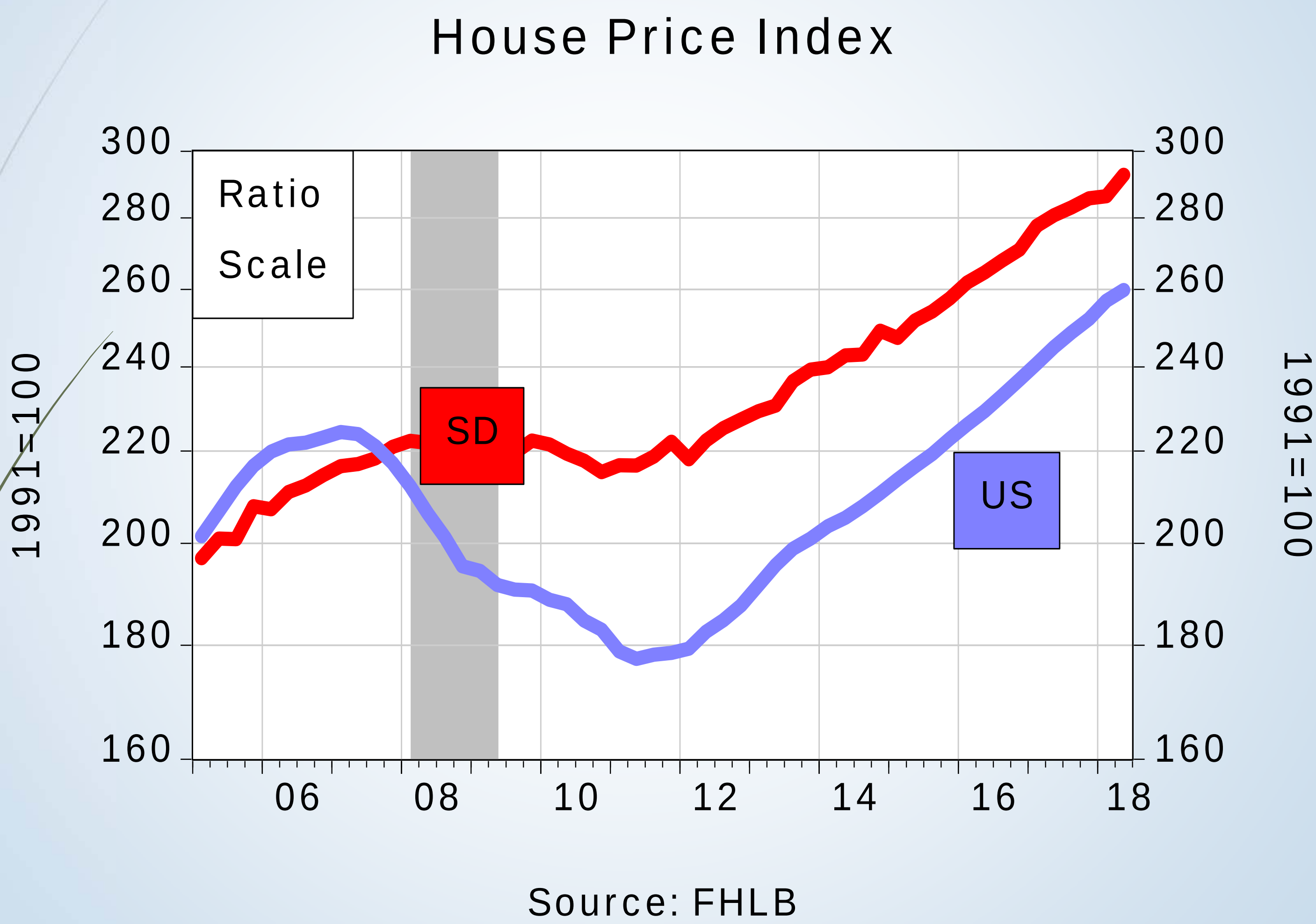


SD Building Permits, Total & Single
Units
900
800
700
600
500
400
300
200
100
0
2006
2008
2010
2012
2014
2016
2018
12 Month Moving Average
Total, SD
Single, SD
Source: Census Bureau

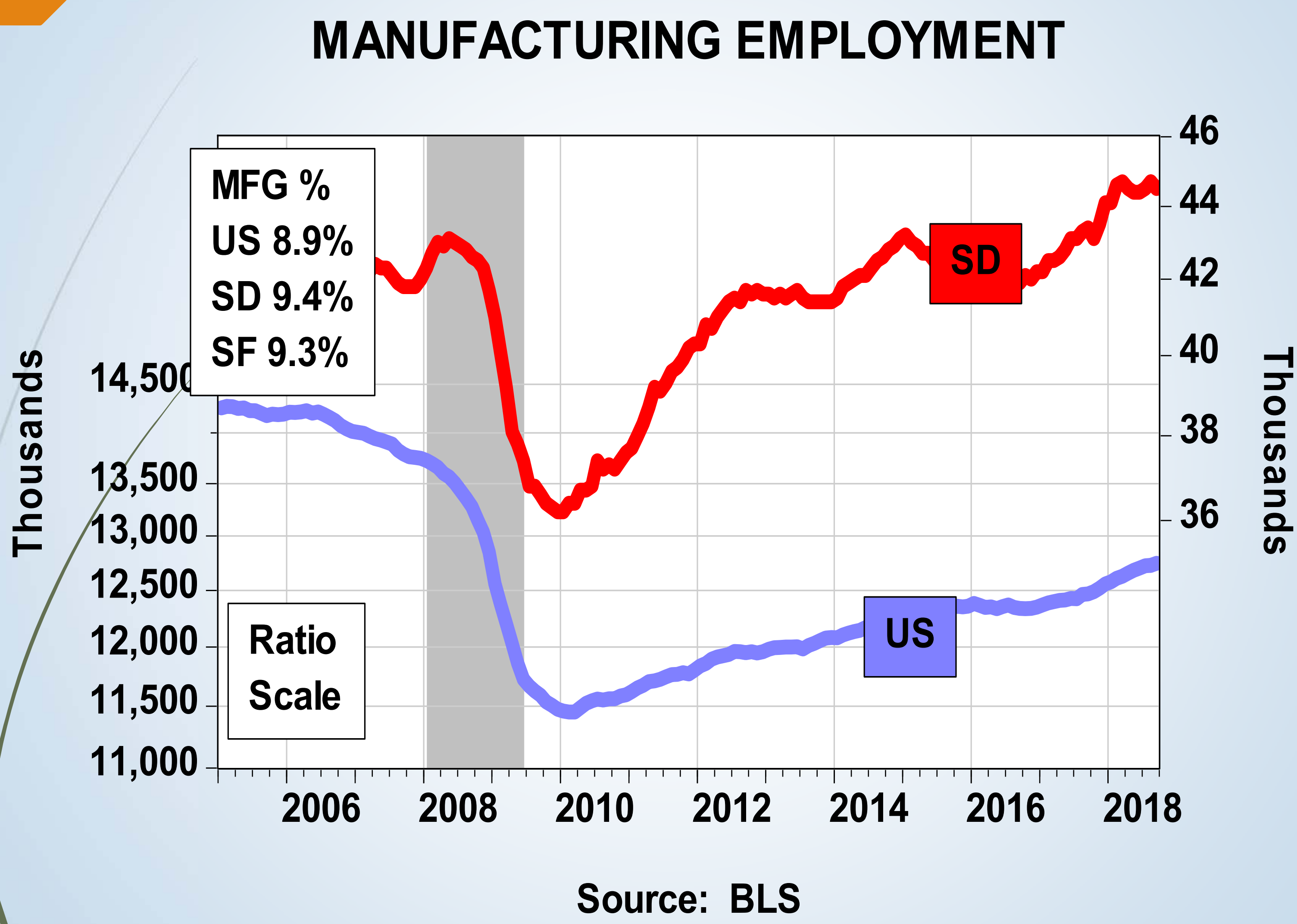
Which is More Cyclical?



SD Peaked Later and Decline Less Severe



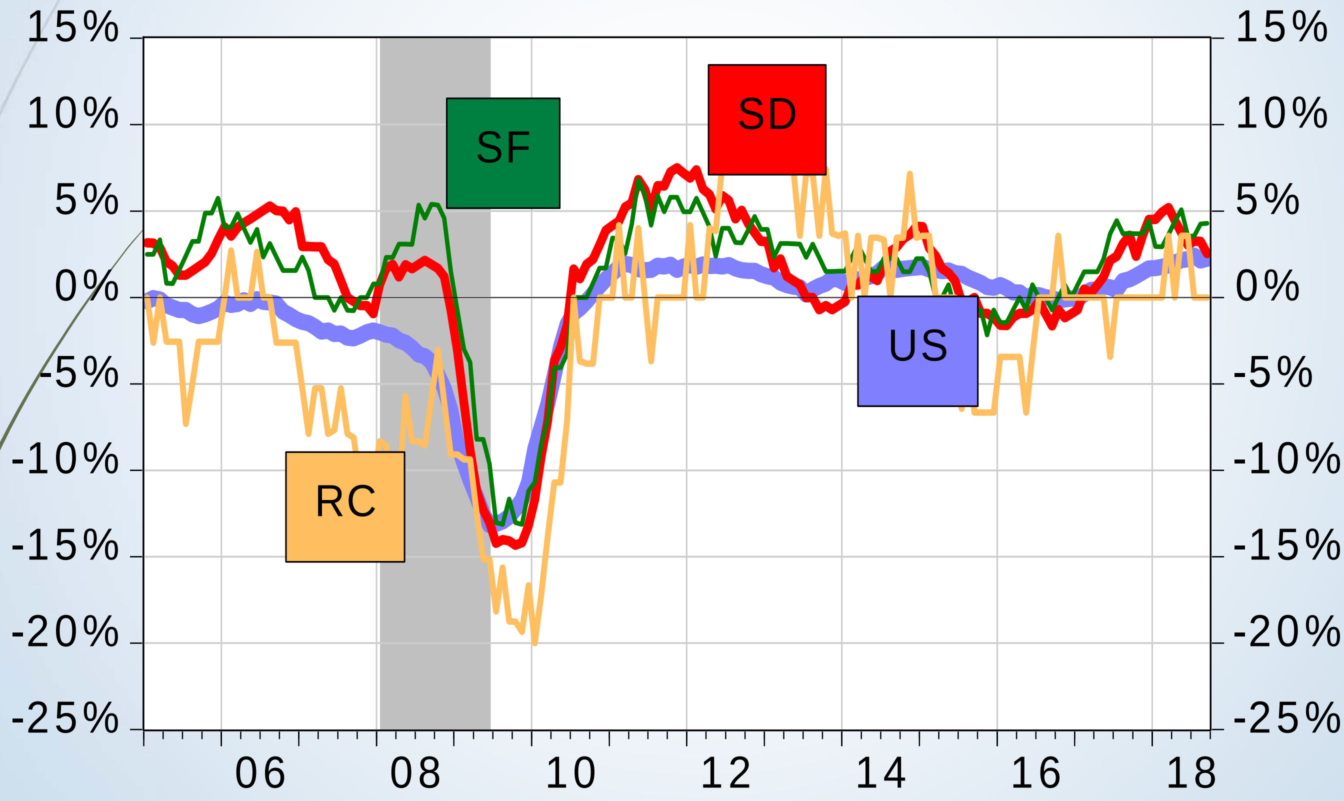
High Level



MANUFACTURING EMPLOYMENT
MFG %
US 8.9%
SD 9.4%
SF 9.3%
Ratio
Scale
SD
US
Thousands
14,500
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

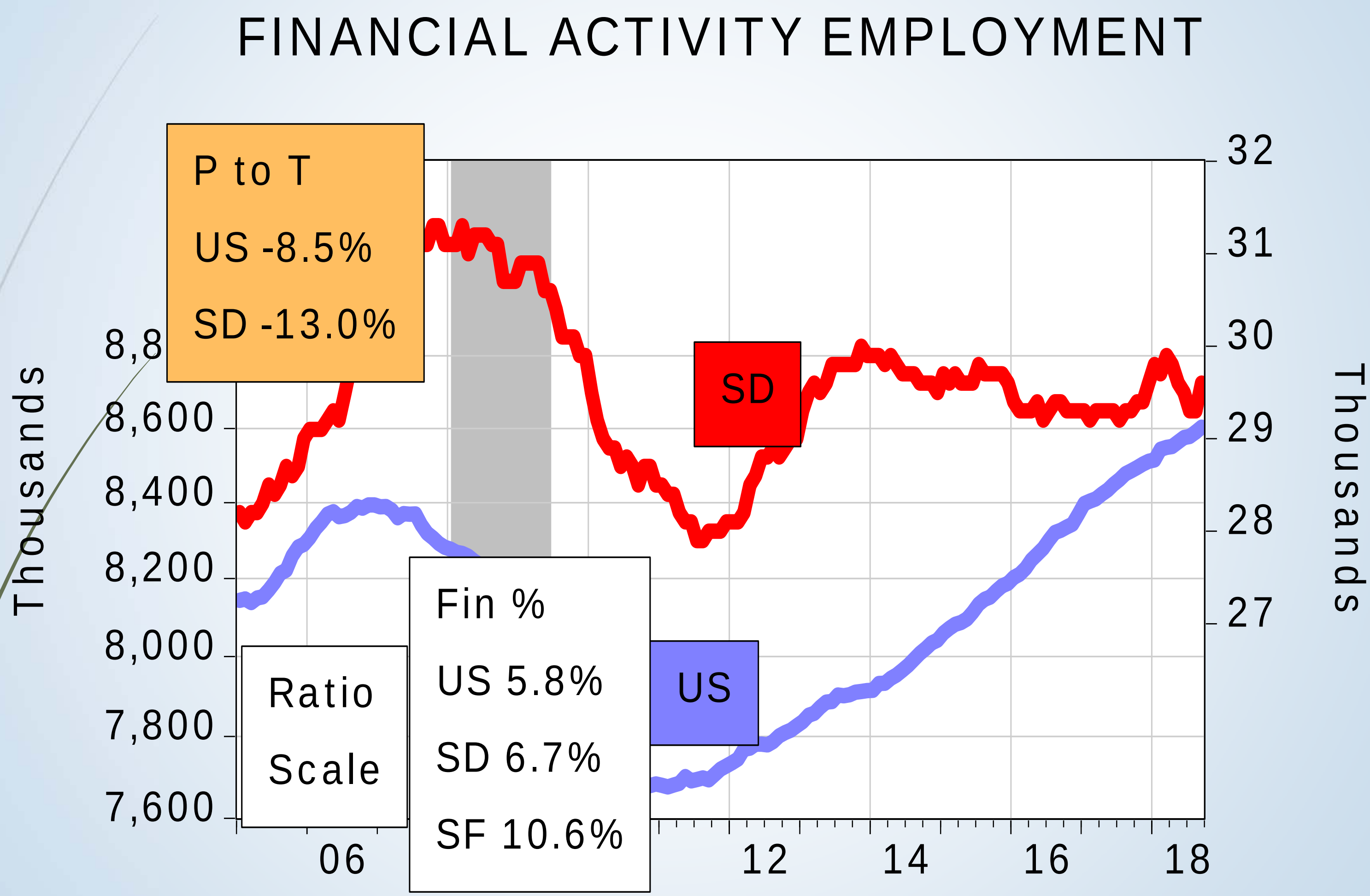
Divergent Growth

MANUFACTURING EMPLOYMENT



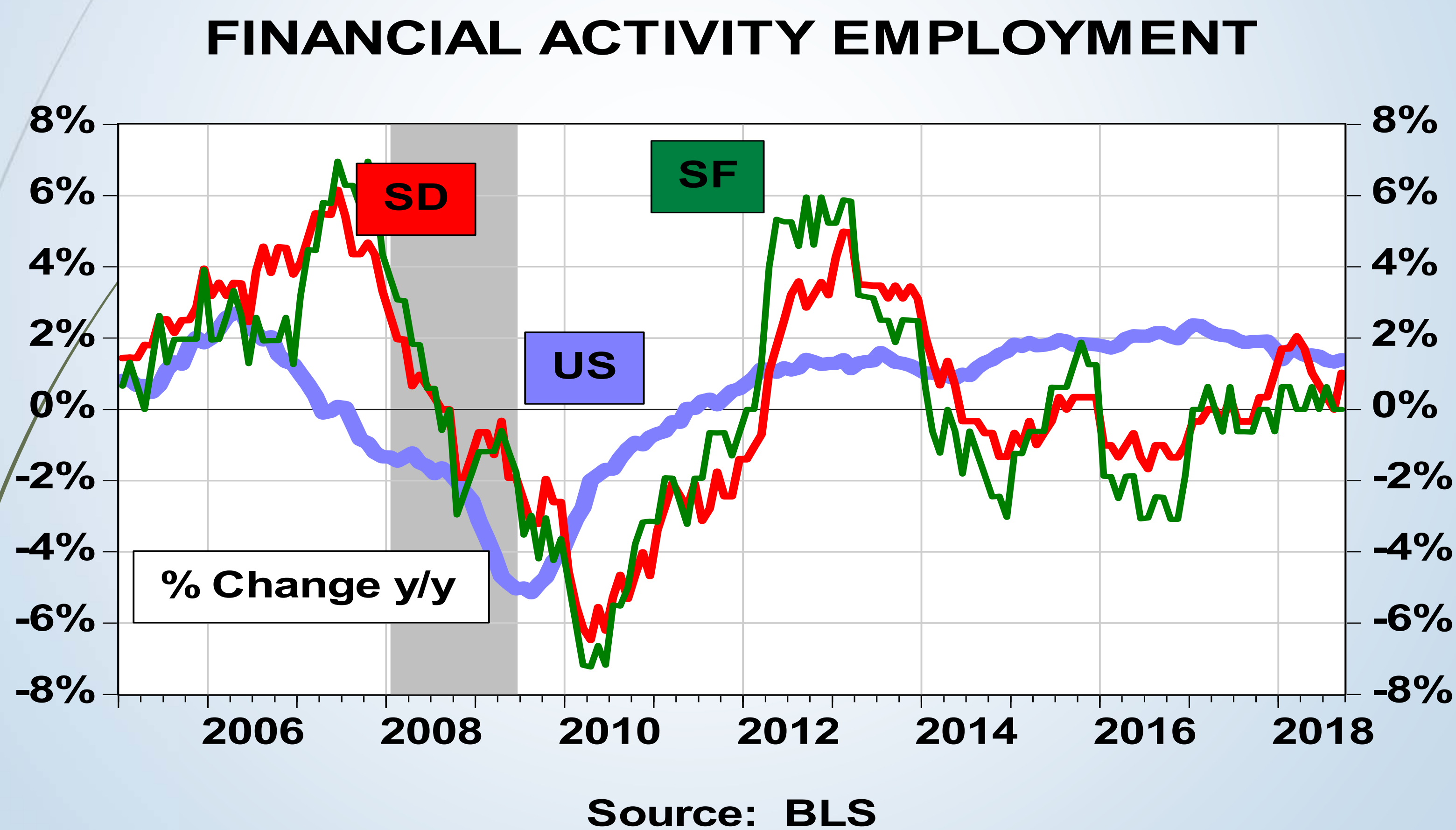
Source: BLS

SD Very Flat

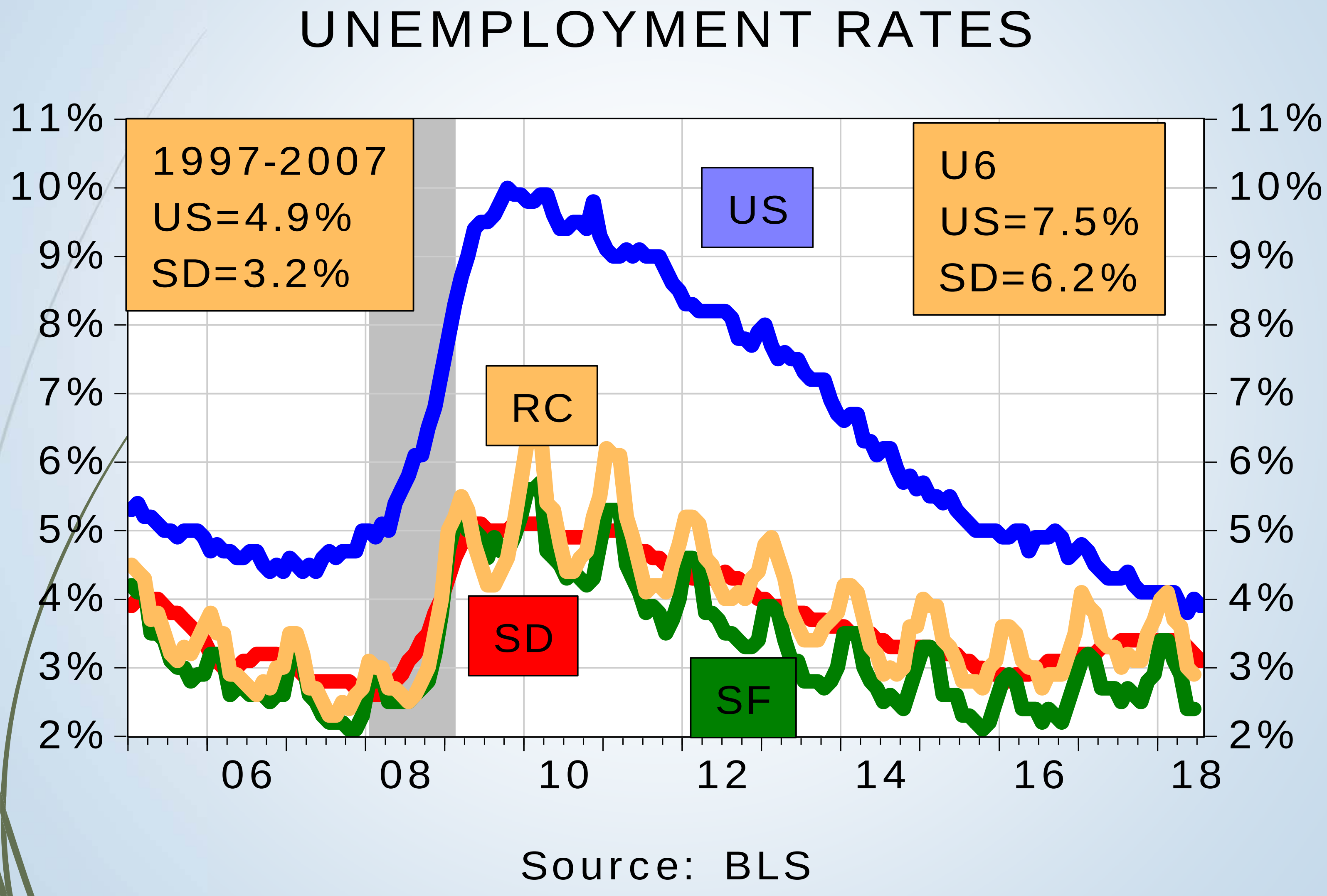


Source: BLS

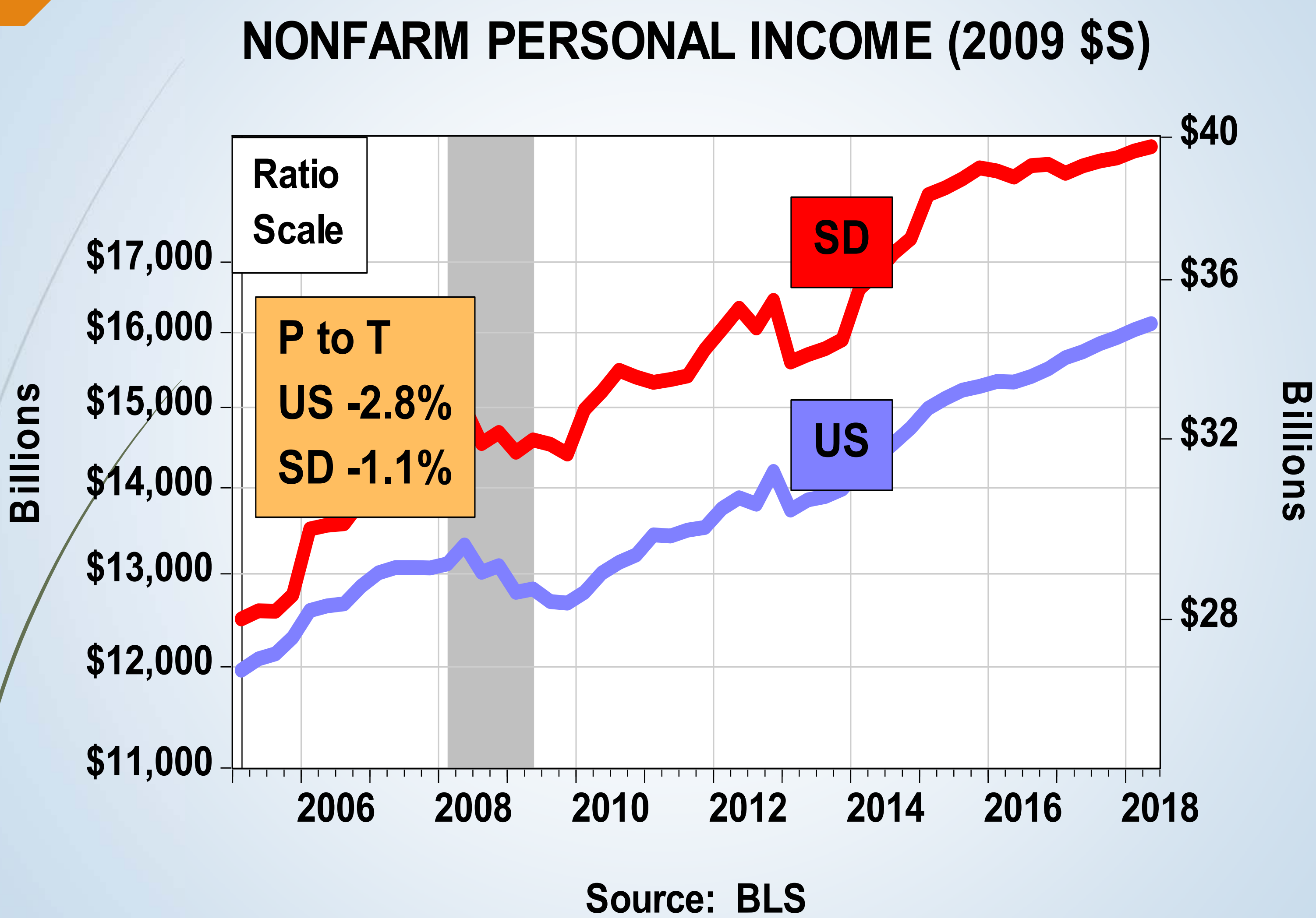
Note SD and SF Different Than US



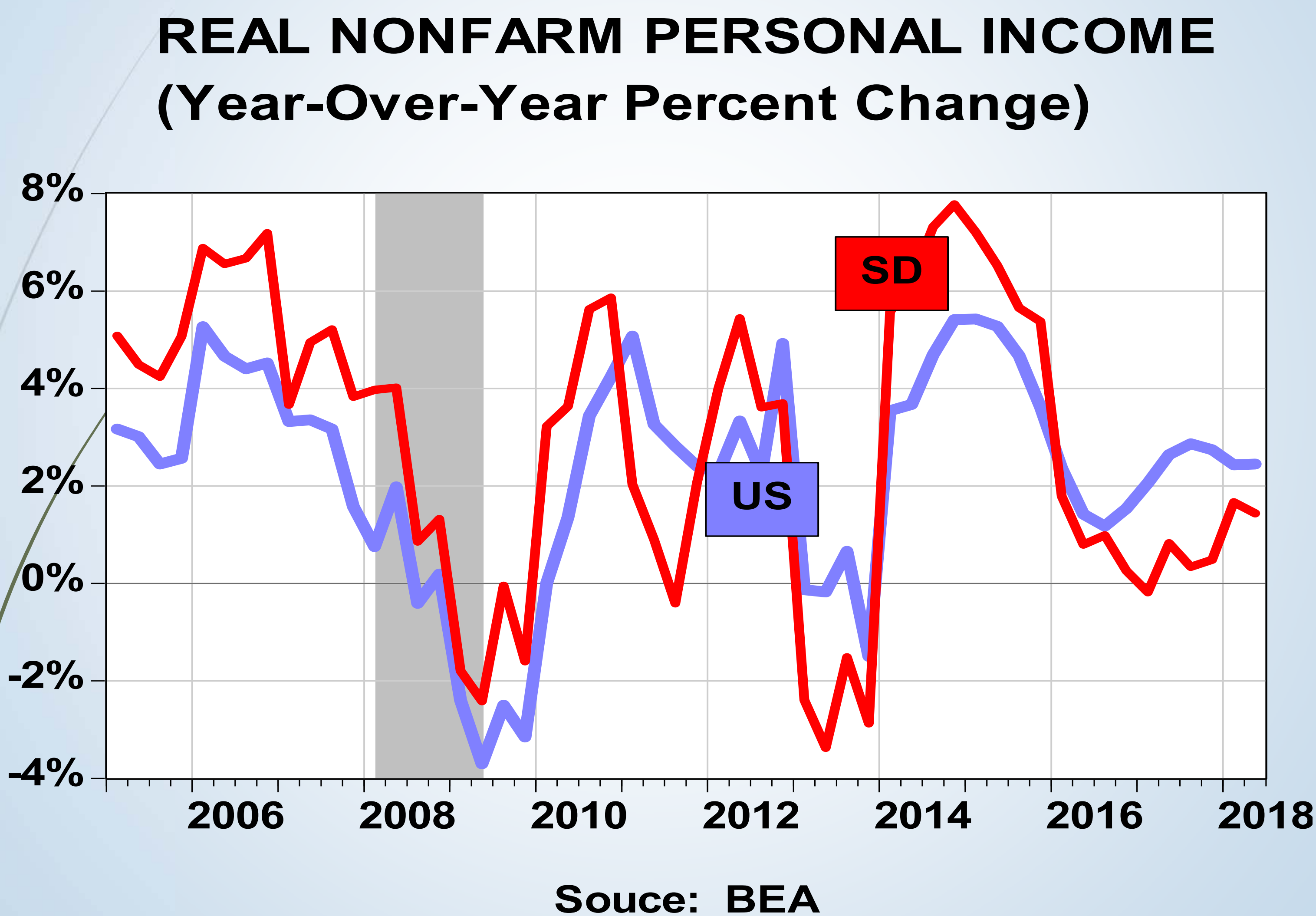
US 3.7% SD 3.0% SF 2.3% RC 2.8%



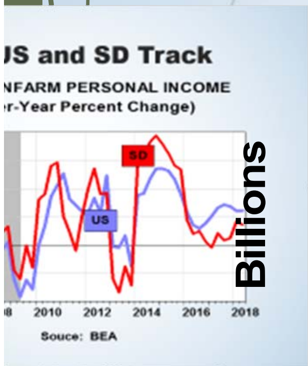
Real Growth

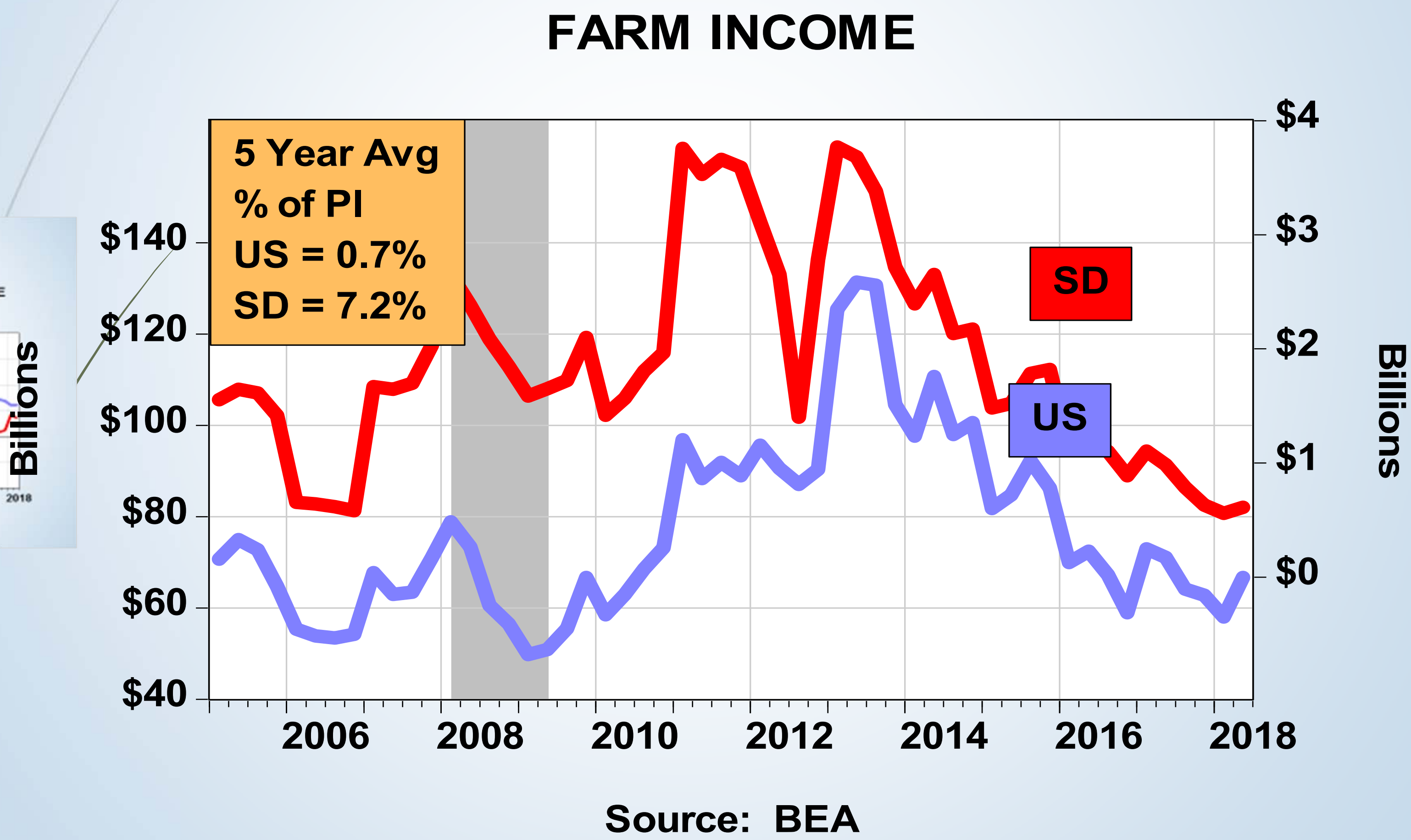

NONFARM PERSONAL INCOME (2009 $S)
Ratio
Scale
P to T
US -2.8%
SD -1.1%
SD
US
$17,000
$16,000
$15,000
$14,000
$13,000
$12,000
$11,000
Billions
$40
$36
$32
$28
Billions
2006
2008
2010
2012
2014
2016
2018
Source: BLS

US and SD Track



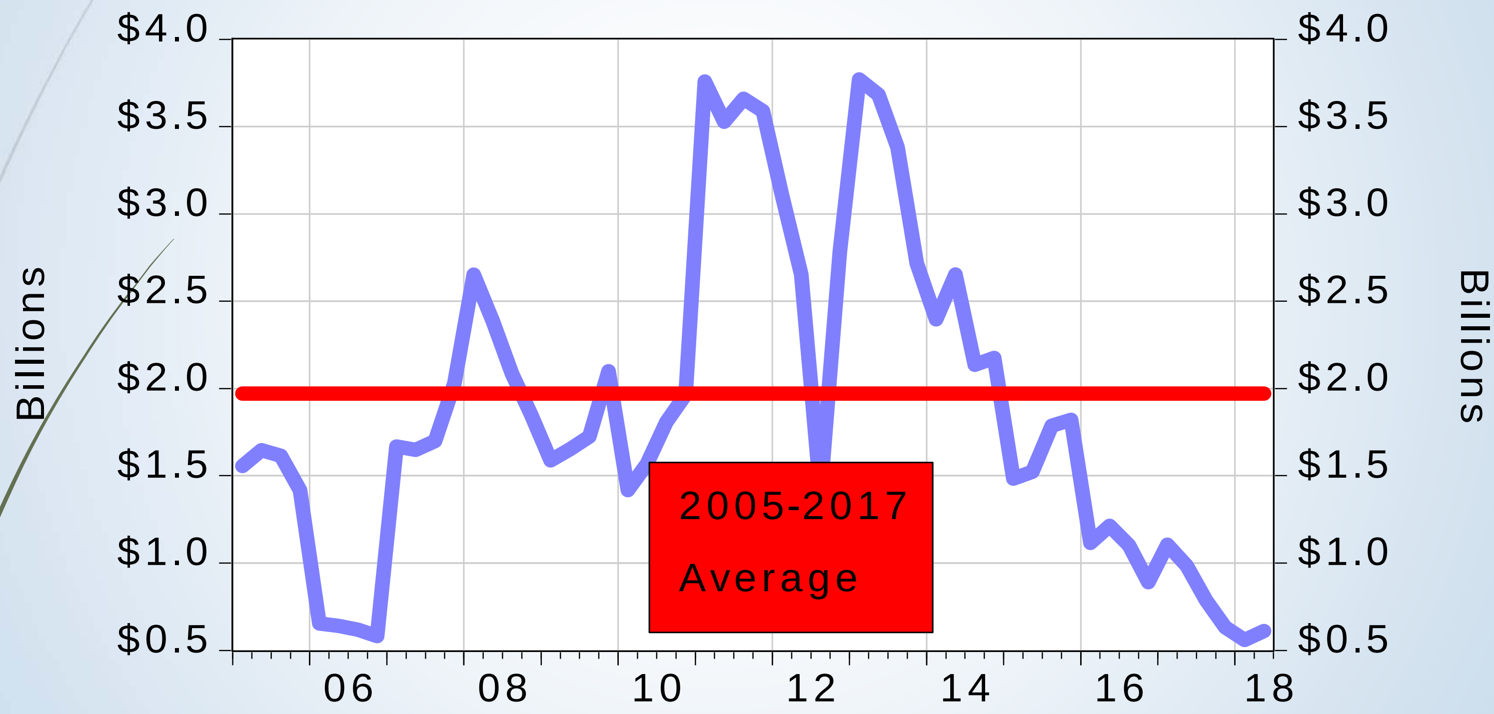
Farm Down Sharply – Low Prices





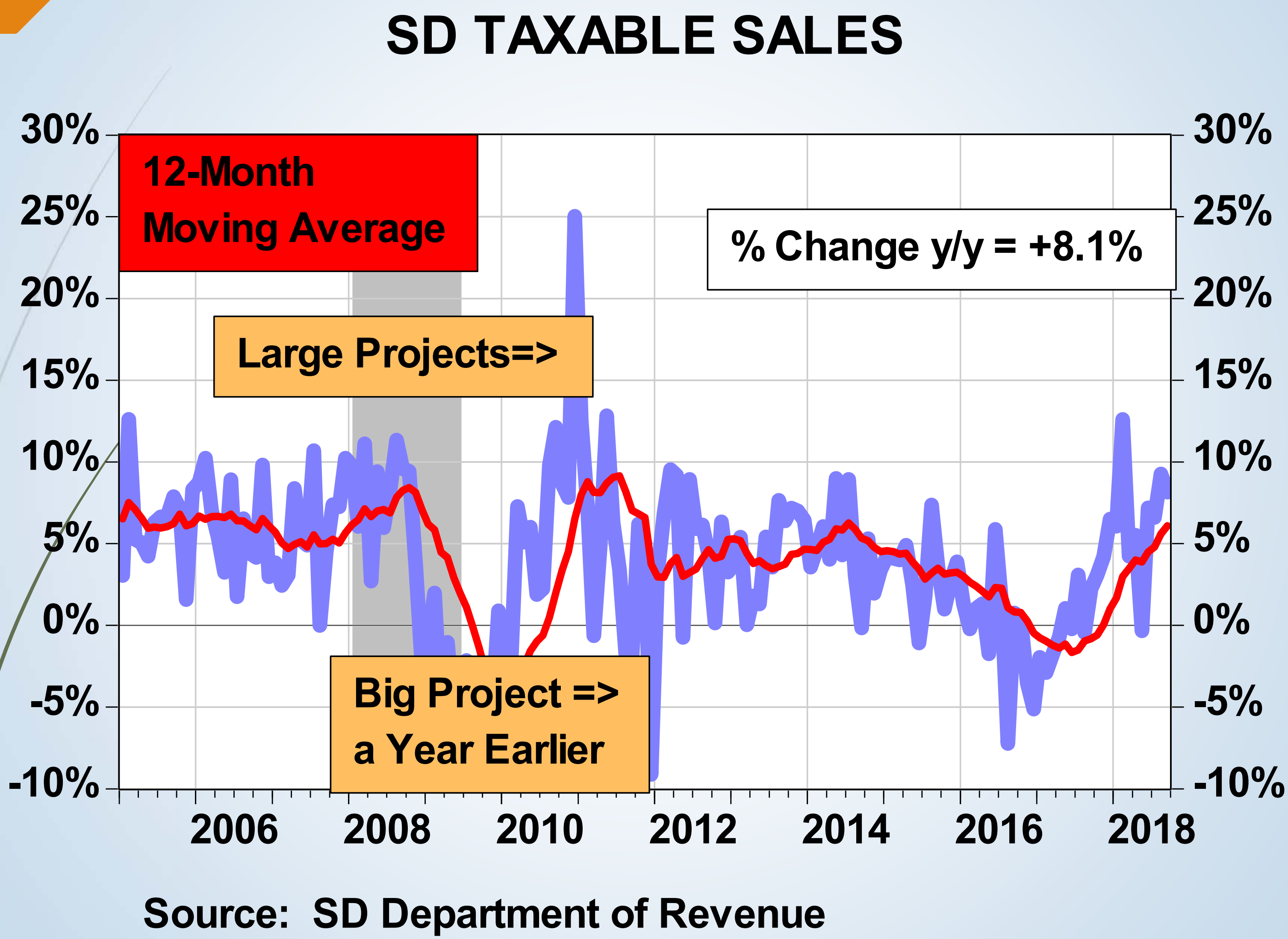
Way Below Average

SOUTH DAKOTA FARM INCOME

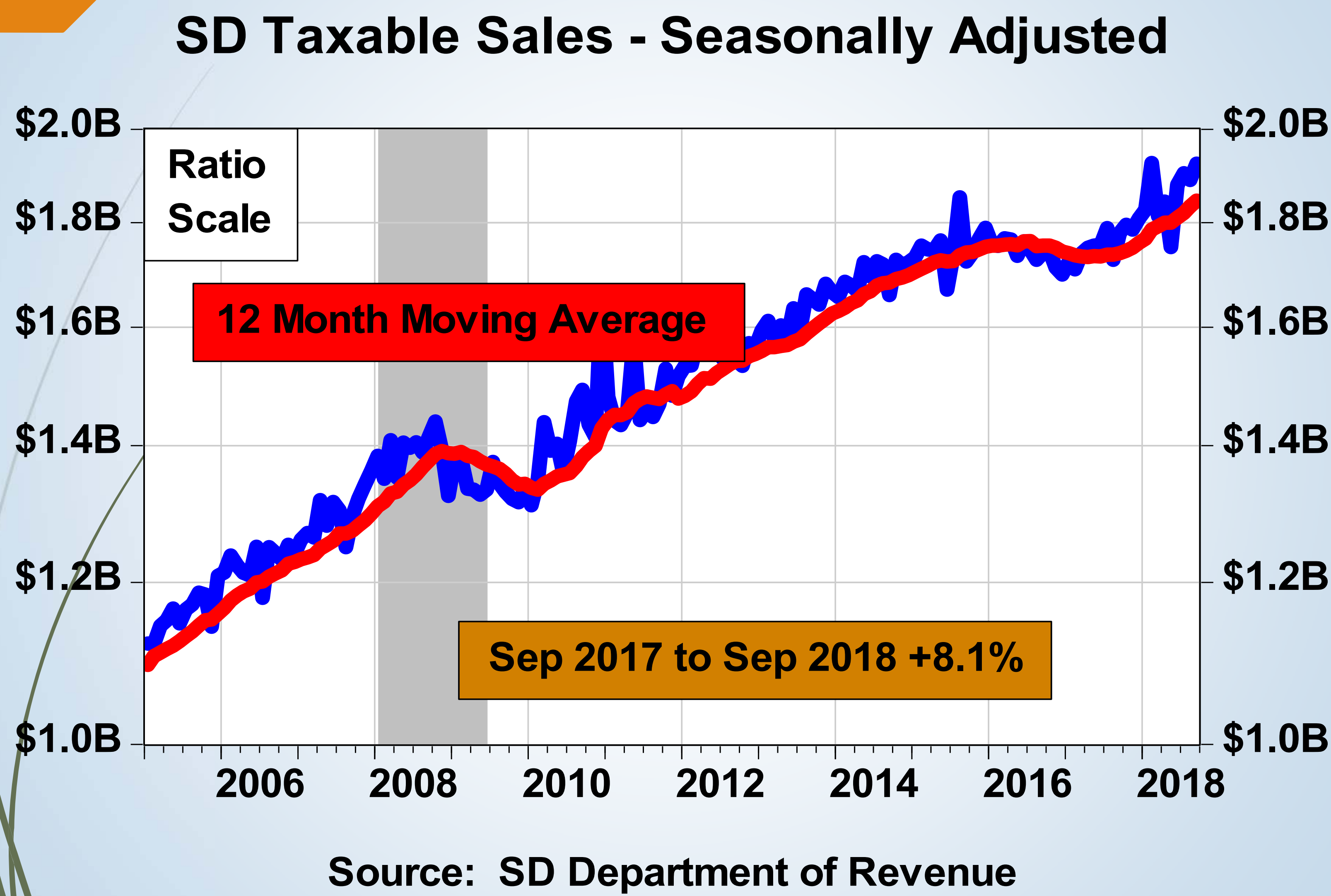


Source: BEA

Recent Uptick

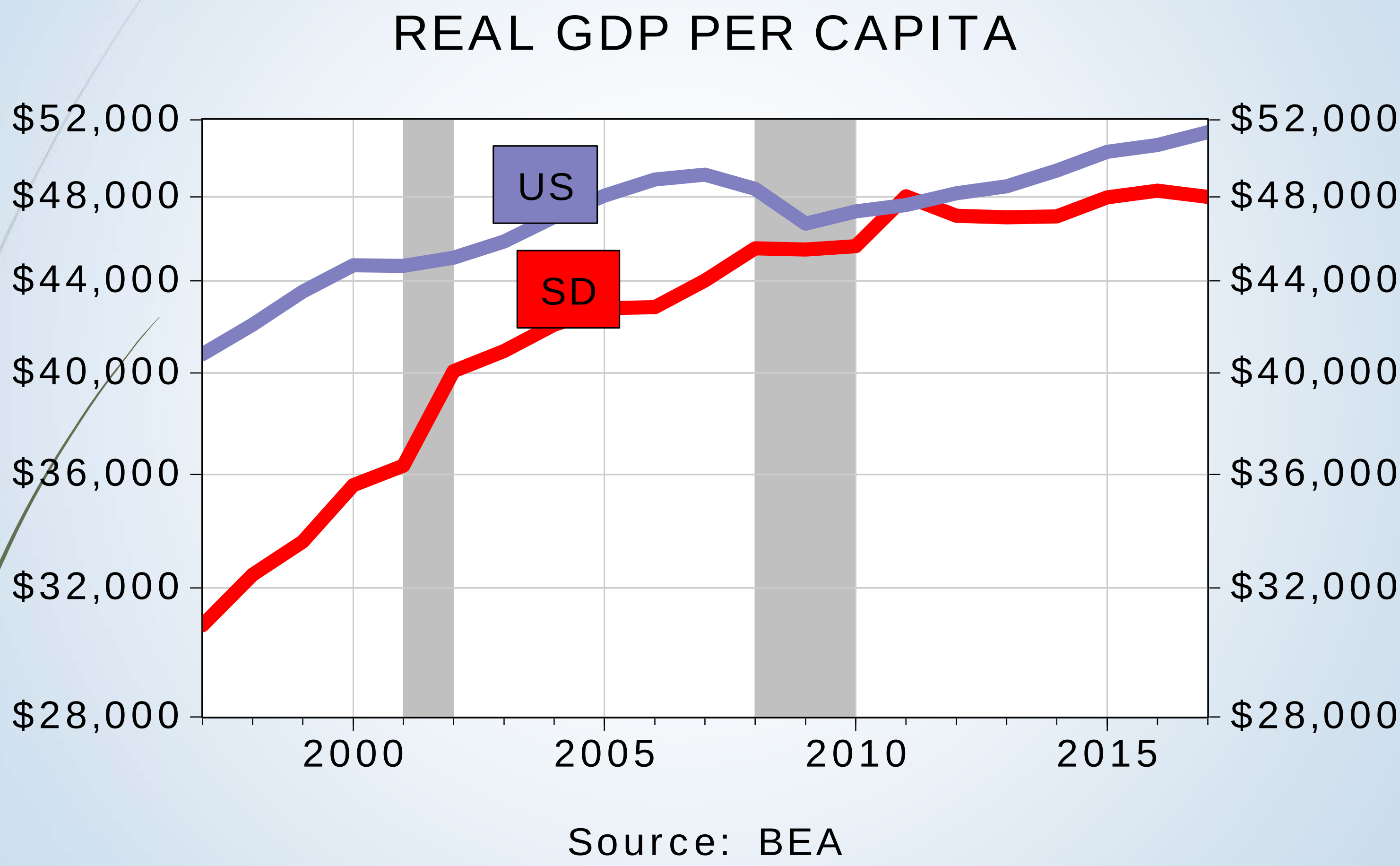


Recent Pickup

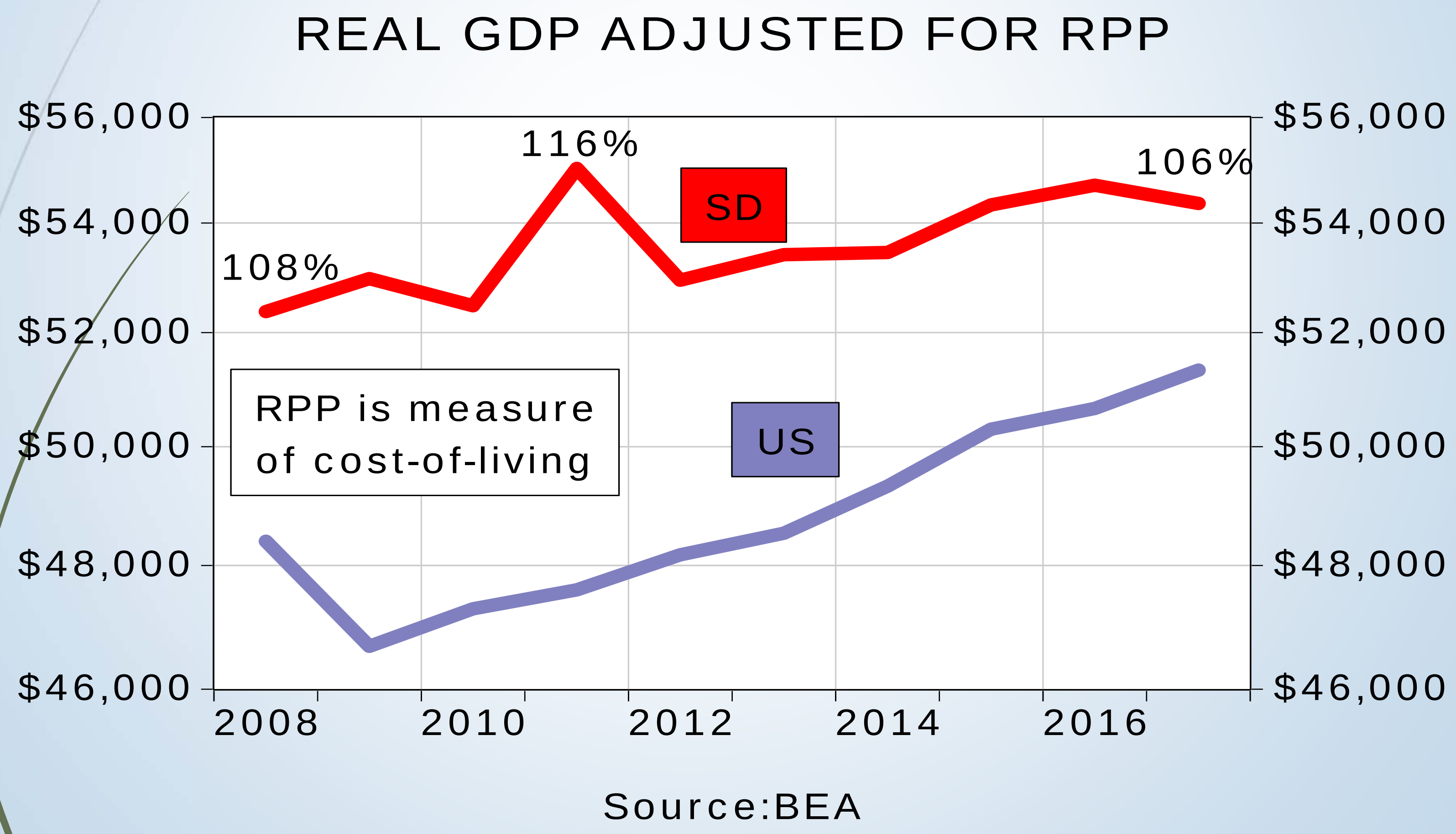


HOW IS SD DOING?

SD is Gaining on US



Cost-of-Living Adjusted Real GDP



Mid-American States Leading Indicators - GOSS

2018 Index > 50 Growth - September

Overall 50.4

New Orders 54.6

Sales 50.1

Delivery lead time 48.7

Inventories 49.0

Employment 49.7

Goss Comments

- “Over the past 12 months, according to U.S. Bureau of Labor Statistics data, South Dakota employers increased the hourly work week by 0.4 percent, equal to the regional median, and average hourly pay by 4.1 percent, which was well above the regional median,” said Goss.
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Conclusions

SD economy growing at slower pace

SF economy growing at faster rate

US economy growing nicely

25% chance of recession

The End