Indiana Economic Outlook

Indiana State Budget Committee

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U.S. Economic Outlook
The US economic expansion will continue

• Several forces held back growth in the first quarter—harsh weather, West Coast port disruptions, and the plunge in oil and gas drilling.

• Consumers will step up spending in response to lower energy prices and robust gains in employment, real income, and net worth.

• The recovery in homebuilding will gain momentum as labor markets improve and credit standards ease.

• A strong dollar, reductions in energy-related investments, and a slowdown in inventory accumulation will be restraints on growth.

• Interest rates will rise significantly from late 2015 through 2017 as monetary accommodation is gradually withdrawn.

• Oil prices are expected to reach a cyclical low this spring and then recover as supply growth slows.
US real GDP growth and the unemployment rate

Real GDP and unemployment rate

- Annual percent change
- Percent of labor force

Real GDP growth (Left scale) - Unemployment rate (Right scale)
## Key US economic indicators

<table>
<thead>
<tr>
<th>Key indicators</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial production</td>
<td>4.2</td>
<td>1.9</td>
<td>2.9</td>
<td>3.1</td>
</tr>
<tr>
<td>Payroll employment</td>
<td>1.9</td>
<td>2.1</td>
<td>1.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Light-vehicle sales (Millions)</td>
<td>16.4</td>
<td>16.9</td>
<td>17.2</td>
<td>17.7</td>
</tr>
<tr>
<td>Housing starts (Millions)</td>
<td>1.00</td>
<td>1.12</td>
<td>1.31</td>
<td>1.46</td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>1.6</td>
<td>-0.4</td>
<td>2.1</td>
<td>2.4</td>
</tr>
<tr>
<td>Core CPI</td>
<td>1.7</td>
<td>1.7</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Brent crude oil price ($/barrel)</td>
<td>100</td>
<td>55</td>
<td>65</td>
<td>73</td>
</tr>
<tr>
<td>Federal funds rate (%)</td>
<td>0.1</td>
<td>0.3</td>
<td>1.2</td>
<td>2.9</td>
</tr>
<tr>
<td>10-year Treasury yield (%)</td>
<td>2.5</td>
<td>2.2</td>
<td>2.9</td>
<td>3.6</td>
</tr>
</tbody>
</table>
Interest rates will rise from exceptionally low levels

Interest rates

<table>
<thead>
<tr>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
</tr>
<tr>
<td>10</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>


- Federal funds
- 10-year Treasury
- 30-year mortgage
- BAA corporate
Services recorded the largest employment increases during the 12 months ended March 2015

Total change = 3.1 million
US employment growth will decelerate as the economic expansion matures

Payroll employment

Percent change, annual rate

-8 -6 -4 -2 0 2 4

With the population aging, labor-force participation and employment rates will not return to prerecession levels.
Labor compensation will accelerate as markets tighten and the Affordable Care Act is implemented.
The drop in gasoline prices means substantial near-term savings for US households

Retail gasoline price and annualized spending on motor fuels

- Retail gasoline price
- Spending on motor fuels per household (Right scale)
The recovery in light-vehicle sales nears completion; low gasoline prices boost demand for light trucks
The consumer spending expansion will broaden in 2015

### Nominal consumer spending

<table>
<thead>
<tr>
<th>Category</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicles &amp; parts</td>
<td></td>
</tr>
<tr>
<td>Medical care &amp; products</td>
<td></td>
</tr>
<tr>
<td>Computers &amp; software</td>
<td></td>
</tr>
<tr>
<td>Recreation services</td>
<td></td>
</tr>
<tr>
<td>Transportation services</td>
<td></td>
</tr>
<tr>
<td>Food &amp; beverages</td>
<td></td>
</tr>
<tr>
<td>Home furnishings</td>
<td></td>
</tr>
<tr>
<td>Apparel</td>
<td></td>
</tr>
</tbody>
</table>

- **2016**
- **2015**
- **2014**
The recovery in housing markets will strengthen

• Our forecast has been revised to show a more gradual recovery in housing starts in 2015–20.
• Sustained job growth will support increases in housing demand.
• Credit availability is improving for home buyers and builders.
• In 2016–17, rising mortgage rates will restrain growth in home sales.
• Multifamily units will account for about one-third of housing starts.
• Young adults are delaying homeownership.
• Baby boomers are starting to downsize.
Housing starts and home prices are recovering

Housing starts and home prices

- Housing starts (Left scale)
- FHFA house price index* (Right scale)

* Purchase-only index
Single-family home sales and construction are not expected to reach 2005 peaks.
A gradual acceleration in the global economy

- Global growth will gradually pick up, but foreign trade will remain a drag on the US economy through 2017.

- The Eurozone’s recovery is gaining momentum, aided by monetary stimulus, euro depreciation, and pent-up demand.

- China’s growth will slow to 6.5% in 2015, restrained by imbalances in credit, housing, and industrial markets.

- The plunge in commodity prices and policy mistakes are contributing to recessions in Russia, Argentina, Brazil, and Venezuela.

- Growth paths in emerging markets will depend on structural reforms that raise productivity and allocate capital more efficiently.

- Asian markets offer the best opportunities for US exports.
The dollar’s real exchange value has appreciated, reaching an 12-year high against major currencies.
## Risks to the US forecast

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Characteristics</th>
</tr>
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</table>
| **Recovery stalls**    | • Low household formation rates stall the housing recovery.  
                          • Consumers spend more cautiously as asset prices retreat.  
                          • Weak growth in foreign economies hurts exports.  
                          • The Federal Reserve (Fed) delays interest-rate hikes to mid-2017.                     |
| (Probability = 15%)    |                                                                                                                                                 |
| **Recovery reignites** | • Stronger job and wage growth spark consumer spending.  
                          • Housing markets rebound more vigorously.  
                          • Stronger global economic growth lifts US exports.  
                          • The Fed raises interest rates more quickly in 2015–16.                                   |
| (Probability = 15%)    |                                                                                                                                                 |
| **Baseline forecast**  | • The Fed starts to raise interest rates in September 2015.  
                          • Housing markets steadily recover in 2015–19.  
                          • Global economic growth picks up moderately.  
                          • There are no major changes in federal government tax or spending policies.              |
| (Probability = 70%)    |                                                                                                                                                 |
Bottom line for the US economy

• Real GDP growth is projected to pick up to 2.8% this year, led by a broadly based acceleration in consumer spending.

• Consumer spending will be supported by gains in employment, real disposable income, and household wealth.

• Homebuilding will rise as household formation recovers.

• Real capital spending will increase about 4–6% annually in 2015–17 as more businesses need to expand capacity.

• Net exports will restrain US economic growth through 2017, largely due to the dollar’s appreciation.

• The Federal Reserve will begin to raise the federal funds rate in September; interest rates will increase through 2017.

• Core inflation will stay mild.
Regional and Indiana Economic Outlook
U.S. Regional Outlook

• States in the West and Sunbelt will continue to growth fastest.
  • These states saw the worst housing busts.
  • Population growth fastest in these regions.
  • People go where the jobs are, but jobs also go where the people are.
• Manufacturing gains, especially from the auto sector supply chain, have been a key to the improving Midwestern economy.
• Growth in unconventional oil and gas development has also boosted growth in many sectors, including in non-producing states.
  • Steel pipe, machinery, transportation, construction.
• Most states are net “winners” from low oil and natural gas prices, due to savings to consumers.
Employment growth concentrated in West, Southeast for 2015
Employment growth set to improve in 2015

Indiana employment

Source: IHS
Indiana wage growth lagged nation in 2014
Weighted annual average wage, all sectors

Indiana wage growth vs. United States

Source: IHS
Indiana housing starts will improve in 2016 and beyond
Auto sales growth to slow as recovery matures

Indiana total housing starts and new car registrations

Pre-recession peak was 40,000 starts in 2003.

Source: IHS
Population continues to move south, west; Northeast getting left out in the cold

Compound annual average growth, 2015 to 2020
# Indiana Forecast Summary

## Key indicators

<table>
<thead>
<tr>
<th>Percent change</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total employment</td>
<td>1.5</td>
<td>1.9</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>5.9</td>
<td>5.8</td>
<td>5.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Real personal Income</td>
<td>1.2</td>
<td>4.0</td>
<td>2.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Real gross state product</td>
<td>2.1</td>
<td>2.7</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Personal consumption</td>
<td>3.5</td>
<td>2.5</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td>expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Housing starts (Thousands)</td>
<td>17.6</td>
<td>18.2</td>
<td>21.2</td>
<td>24.7</td>
</tr>
<tr>
<td>Share of multi-family (%)</td>
<td>28.4</td>
<td>25.5</td>
<td>23.0</td>
<td>18.2</td>
</tr>
</tbody>
</table>
Bottom line for the Indiana economy

• Near-term economic growth will continue to be favorable.

• Manufacturing, especially related to the transportation sector, has spurred Indiana’s economic recovery over the past five years.
  • Manufacturing provides 17% of state’s payroll jobs, first in the nation.
    • National average is 9%.

• Sales of cars and light trucks a huge factor; demand from oil and gas industry for steel pipe, machinery, etc., has also helped.

• Domestic demand maturing, strong dollar reduces competitiveness.

• Expanding service employment is key to long-run economic growth.
  • High-tech area is where value is being added.
  • Requires ongoing investment in education, R&D, infrastructure.

• Long-term slow population growth a potential drag on economy.
Thank you!