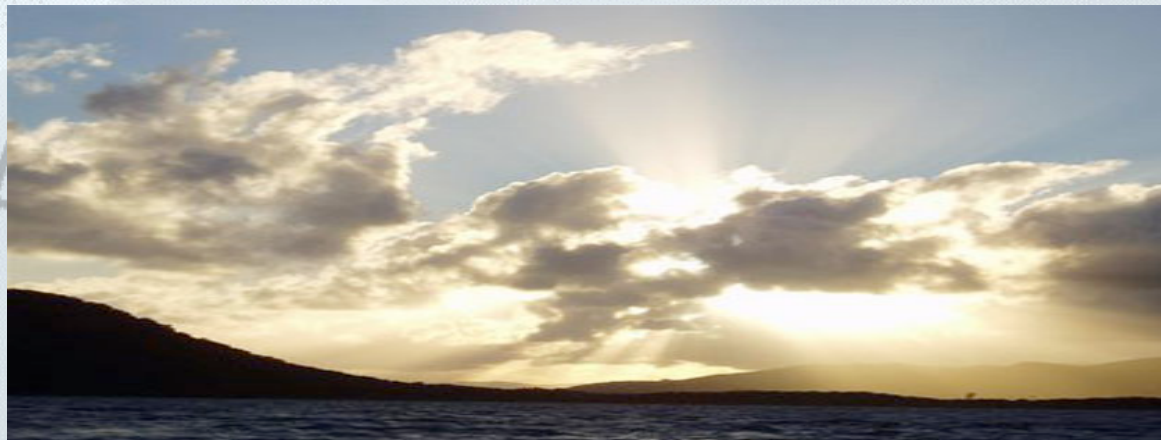


The Economic Outlook for the US and California

Christopher Thornberg

Founding Partner, Beacon Economics



Trends vs. Fundamentals

Trends

- GDP growth below average, output 'gap' has yet to shrink
- Large number of displaced workers, employment still below pre-recession levels
- Resale housing market slowing, pace of new construction still depressed
- Governments dealing with deficit and pension issues
- Bank credit still tight, Fed tapering
- Wobbly Europe, slowing China, Russian aggression
- Don Sterling wants to keep the Clippers and we weren't invited to Kim and Kanye's wedding

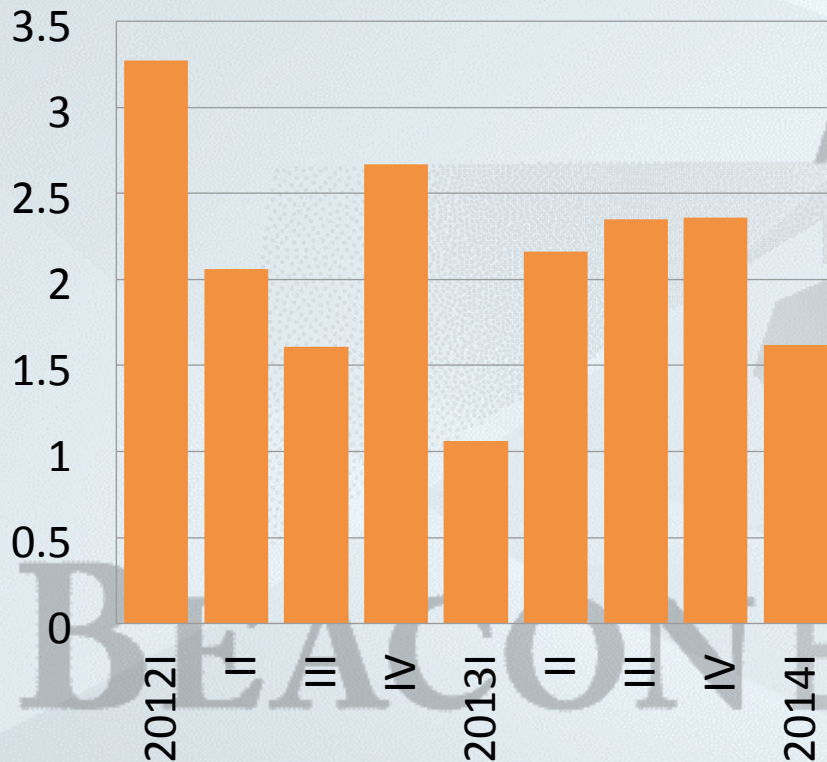
Fundamentals

- Employment is growing, personal incomes starting to grow faster
- Wealth levels have grown to new high levels, consumer credit finally starting to expand
- Foreclosures down, home-ownership rates have stabilized, mortgage lending starting to loosen up
- Corporate / proprietor earnings are great
- \$US still low, export competitiveness high
- We are in the midst of a new domestic energy boom

Add it up: 2014 better than 2013, 2015 better yet

GDP: Forget Q1

GDP and Final Demand

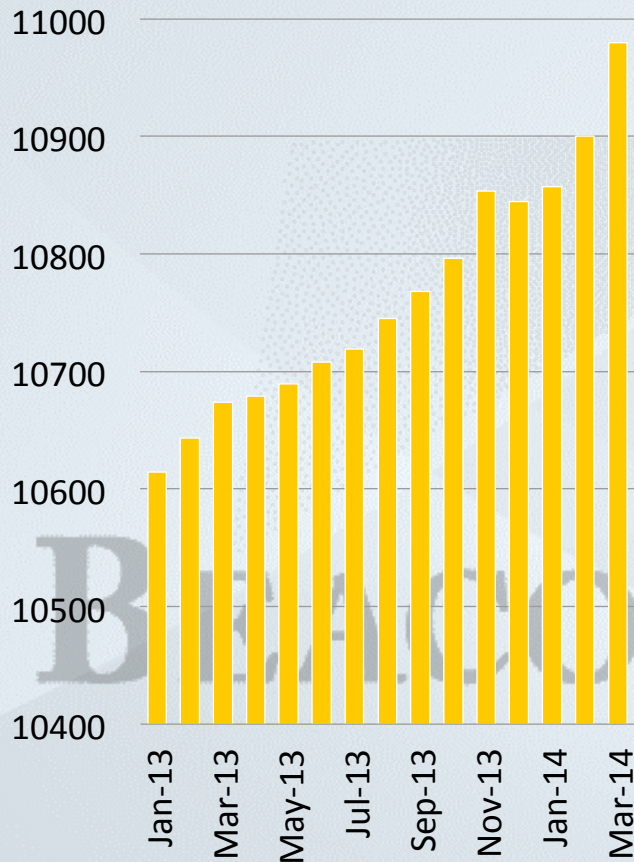


■ Non Defense Final Demand

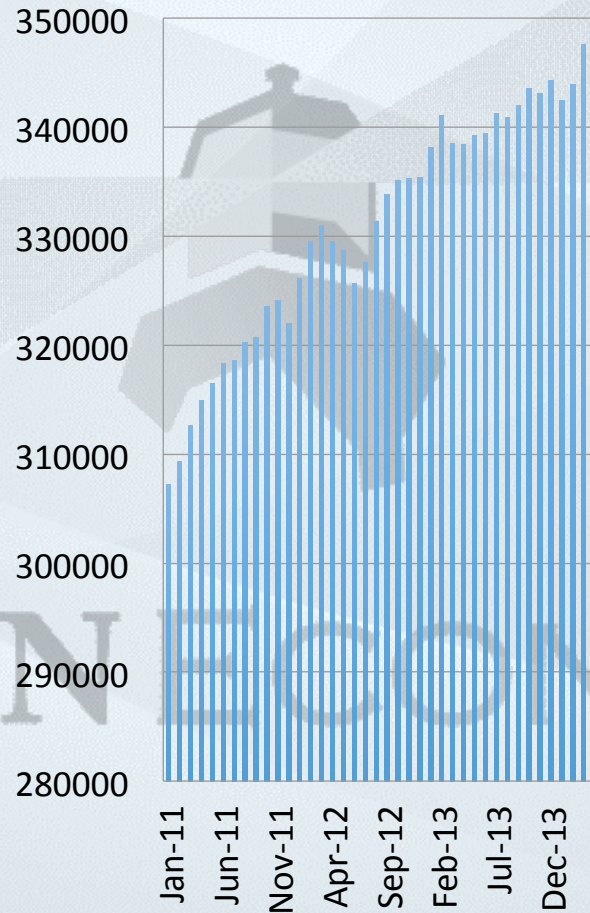
	2013			2014
	II	III	IV	I
GDP	2.5	4.1	2.6	-1.0
Personal consumption	1.2	1.4	2.2	2.1
Durable goods	0.5	0.6	0.2	0.1
Nondurable goods	0.3	0.5	0.5	0.1
Services	0.5	0.3	1.6	1.9
Gross investment	1.4	2.6	0.4	-2.0
Structures	0.4	0.4	-0.1	-0.2
Equipment	0.2	0.0	0.6	-0.2
Intellectual property	-0.1	0.2	0.2	0.2
Residential	0.4	0.3	-0.3	-0.2
Change in inventories	0.4	1.7	0.0	-1.6
Net exports	-0.1	0.1	1.0	-1.0
Exports	1.0	0.5	1.2	-0.8
Imports	-1.1	-0.4	-0.2	-0.1
Government	-0.1	0.1	-1.0	-0.2
National defense	0.0	0.0	-0.7	-0.1
Nondefense	-0.1	-0.1	-0.3	0.2
State and local	0.1	0.2	0.0	-0.2

Consumer Spending

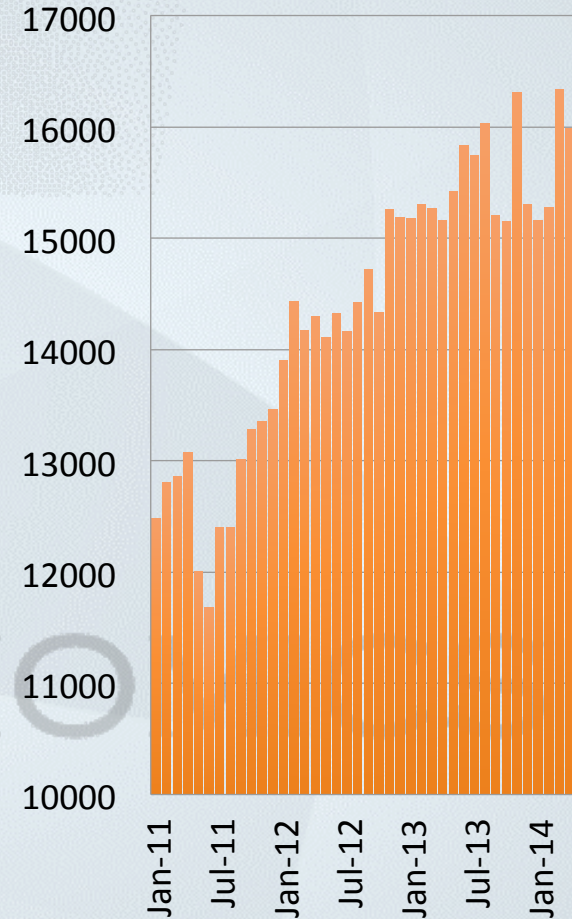
Monthly Real Personal Consumption



Retail Sales through April

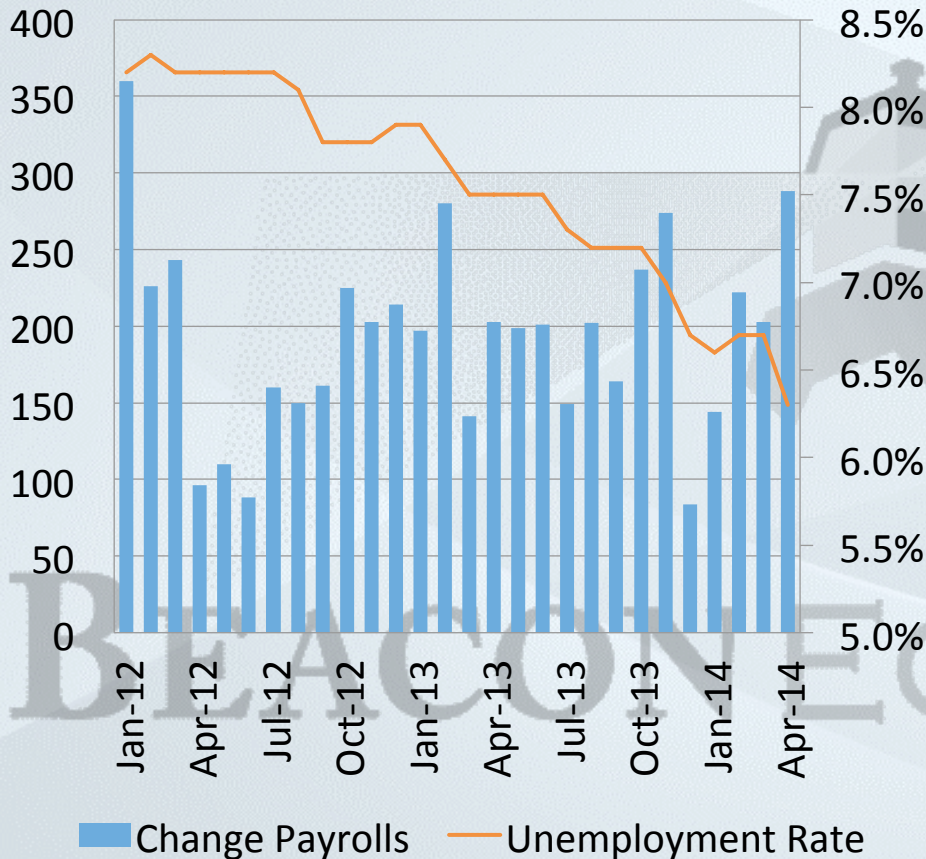


Auto Sales through April

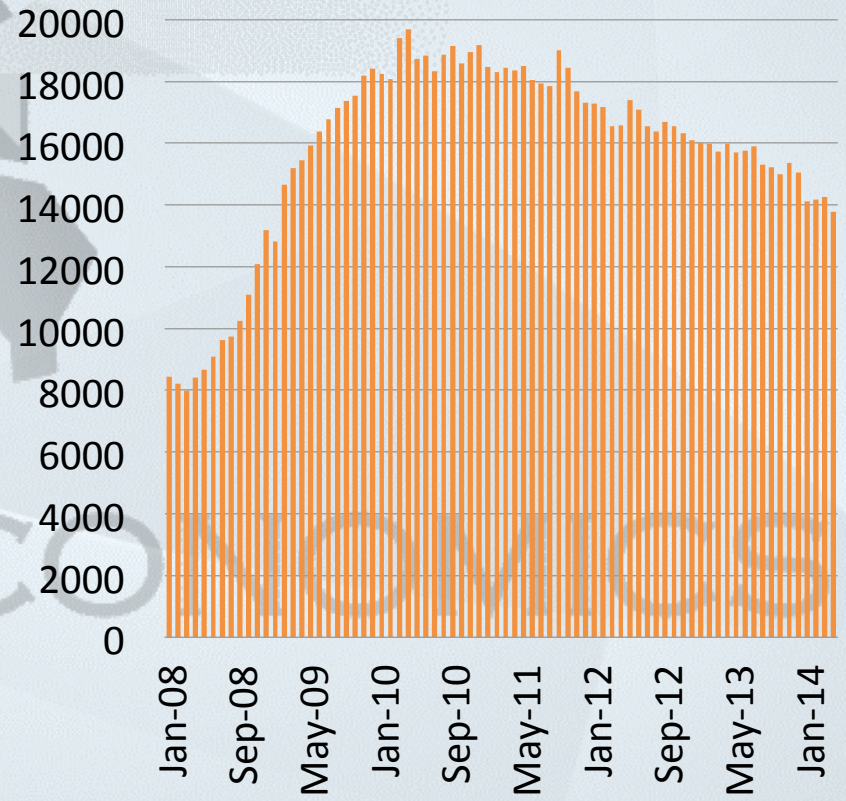


Labor Markets

Labor Markets

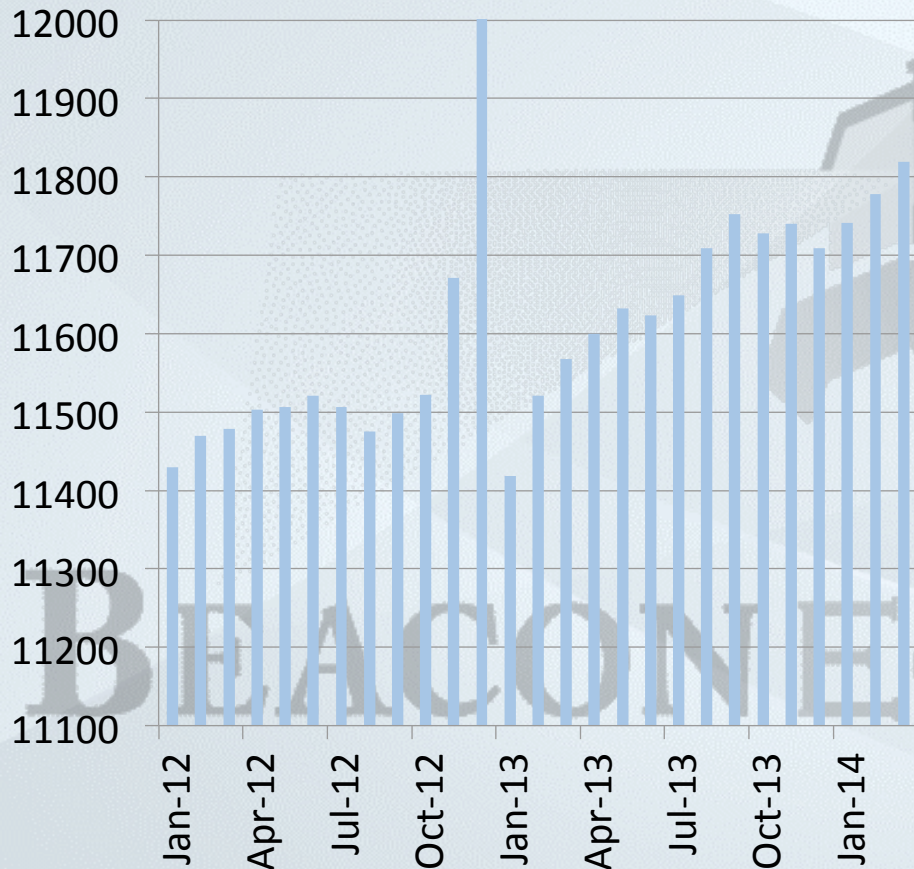


Distressed Workers (LT Unemployed, PT Economic, Discouraged Workers)

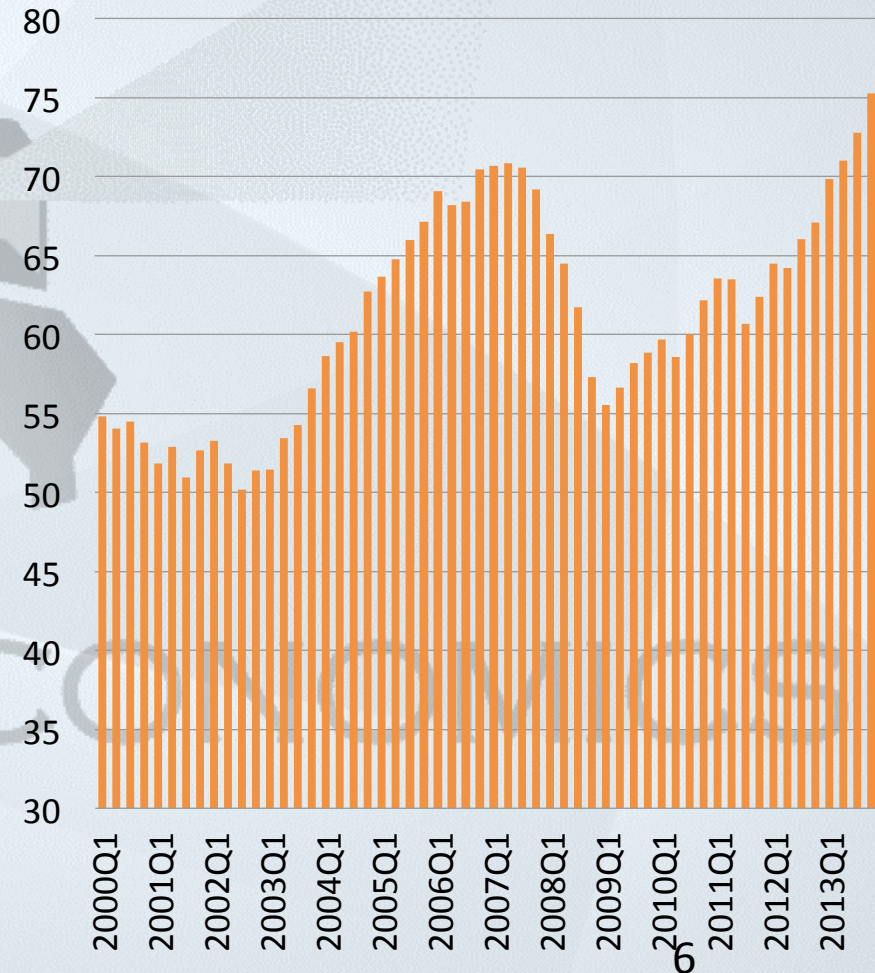


Better Household Finances

Real Disposable Income

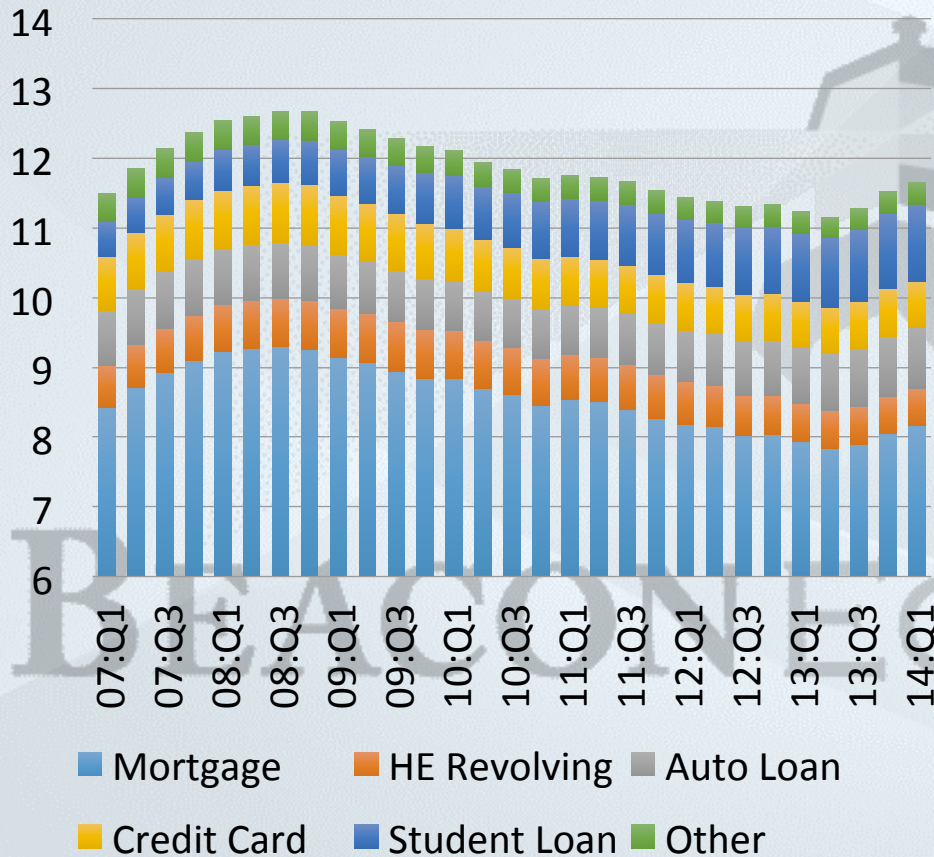


Real Household Net Worth to Q4



The End of Deleveraging

**Outstanding Consumer Debt
(Trillions) to Q1**



**Household Financial
Obligations Ratio**



Industrial Outlook

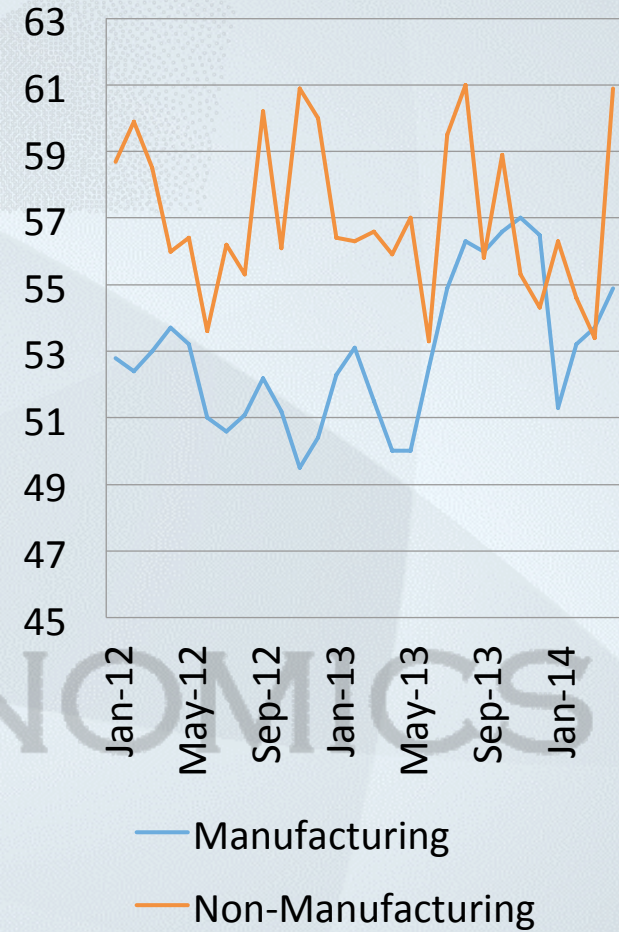
**Industrial Production:
Total to April**



**Durable Goods
Orders**

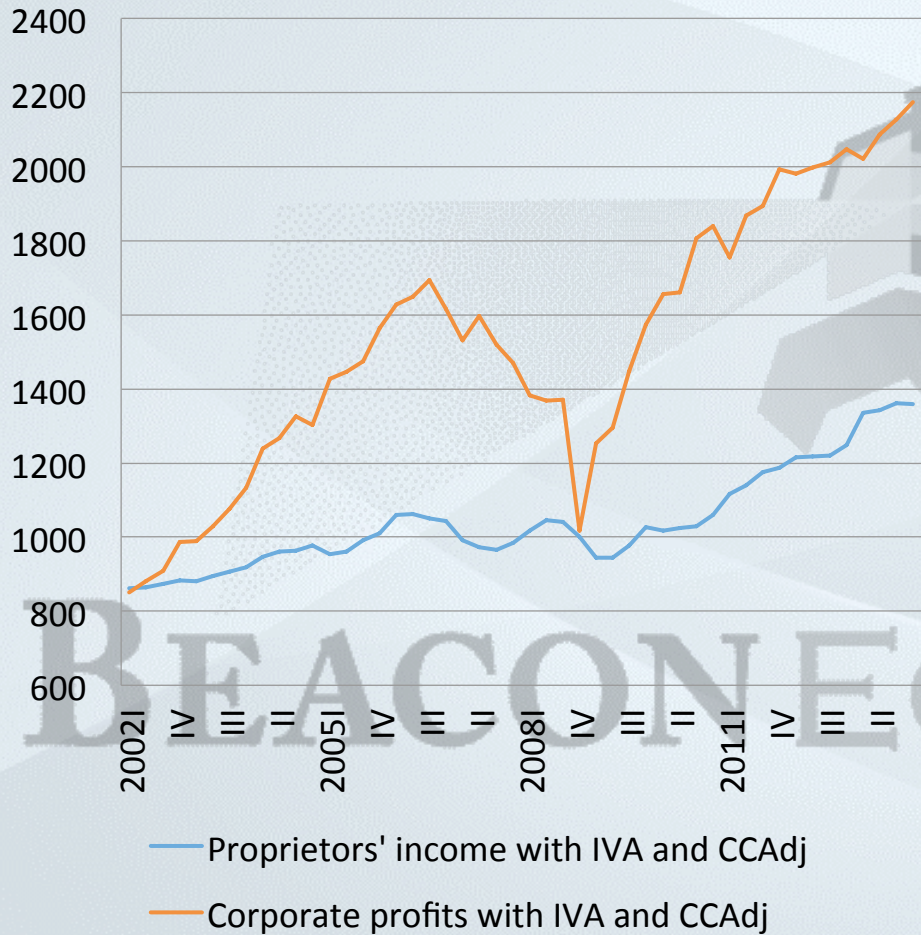


ISM Indexes

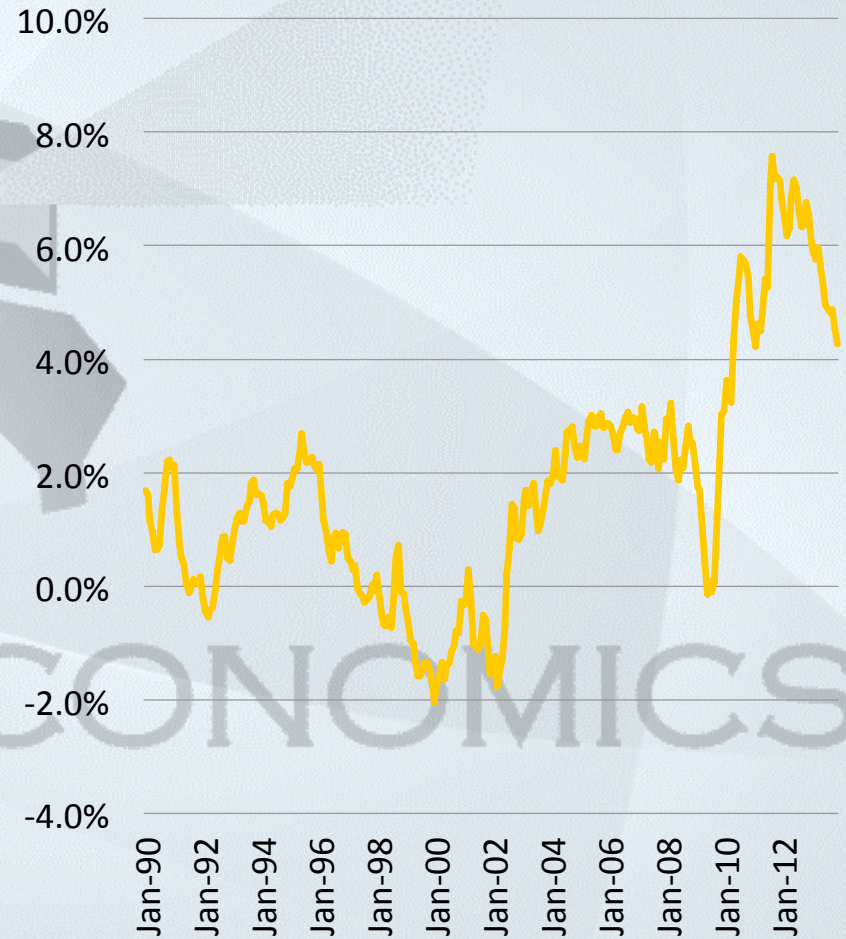


Earnings: Great

BEA Profits through Q4 13



Equity Spread over 10 year Bond

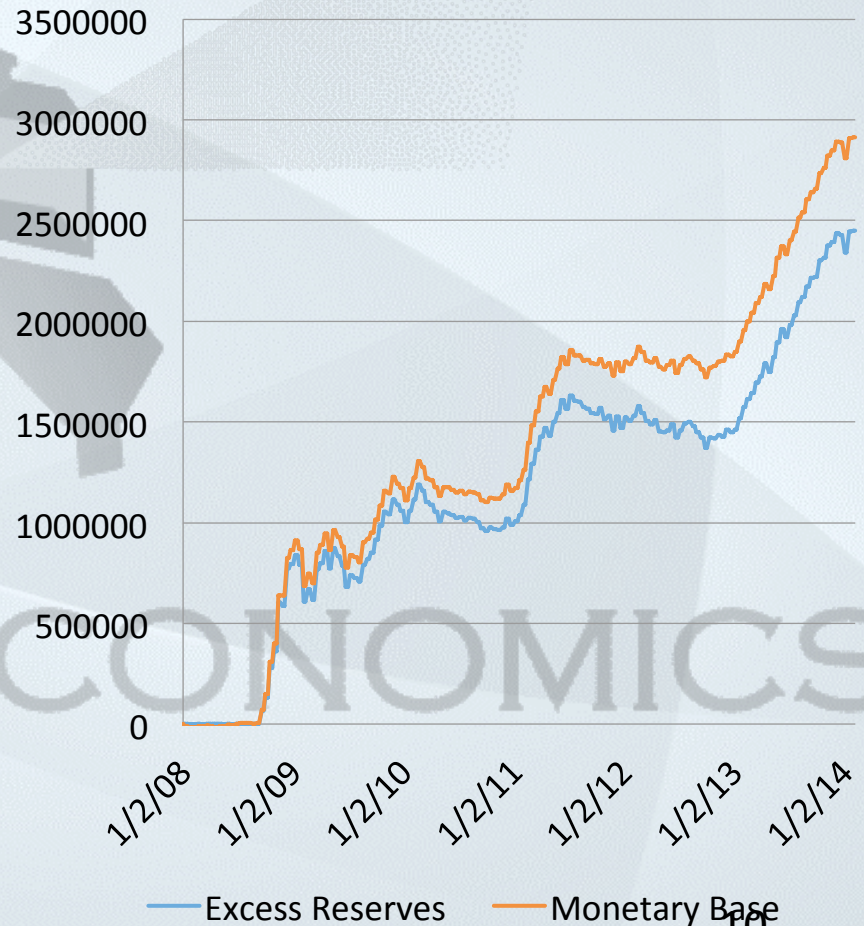


Rates Stable Despite Tapering

Daily 10 Year Treasury Rates

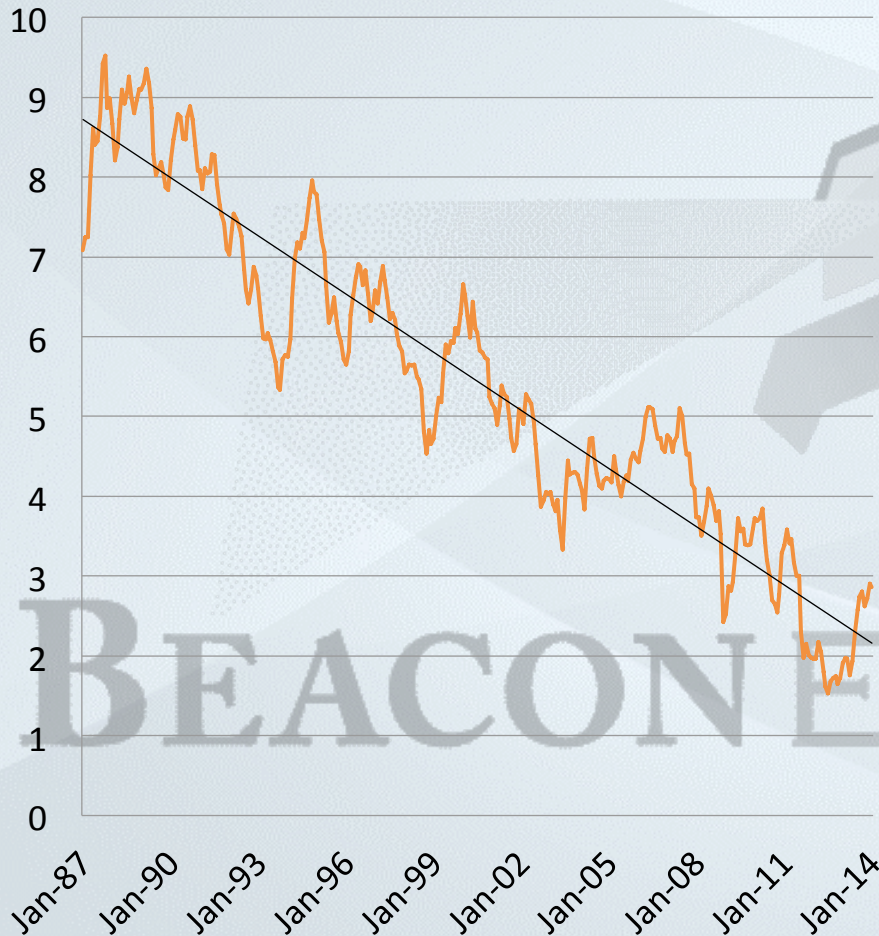


Cumulative Increases in Monetary Base and Excess Reserves

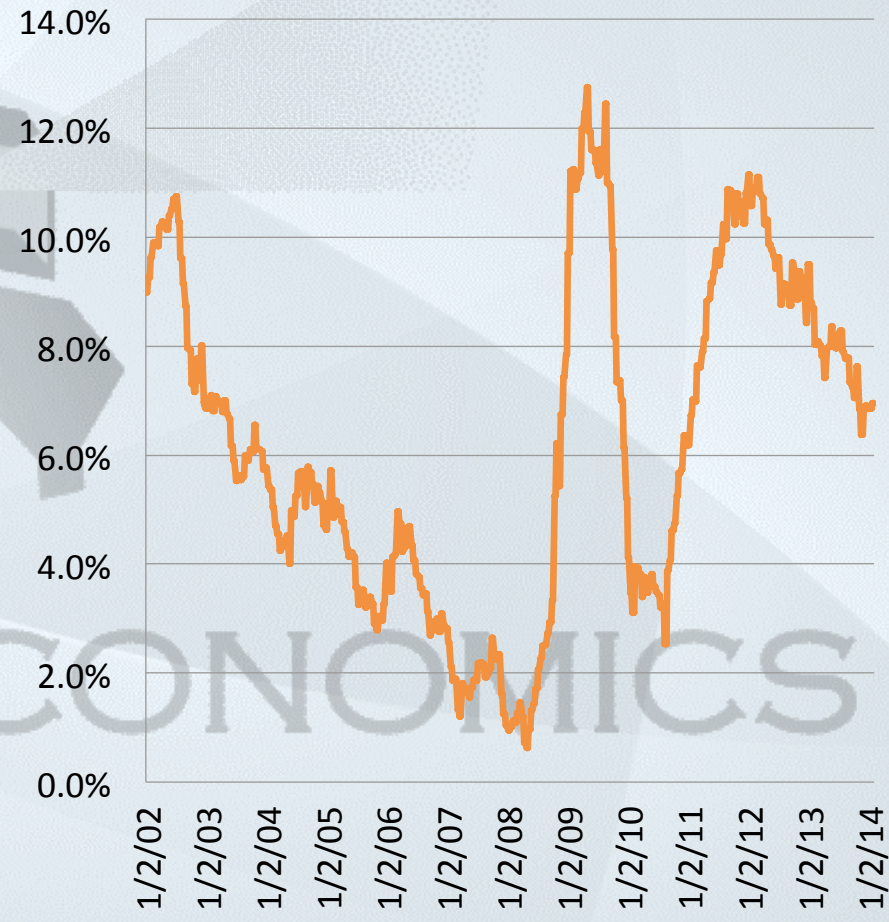


Where are rates heading?

10 Yr Bond Rate

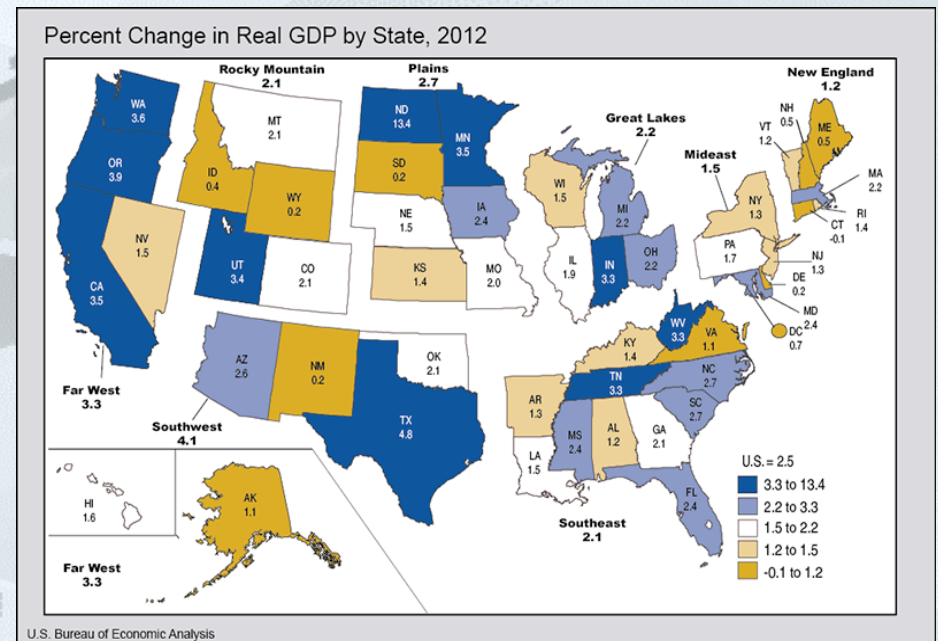


Net Monetary Base Growth



Regional Growth: Who's Hot and Not

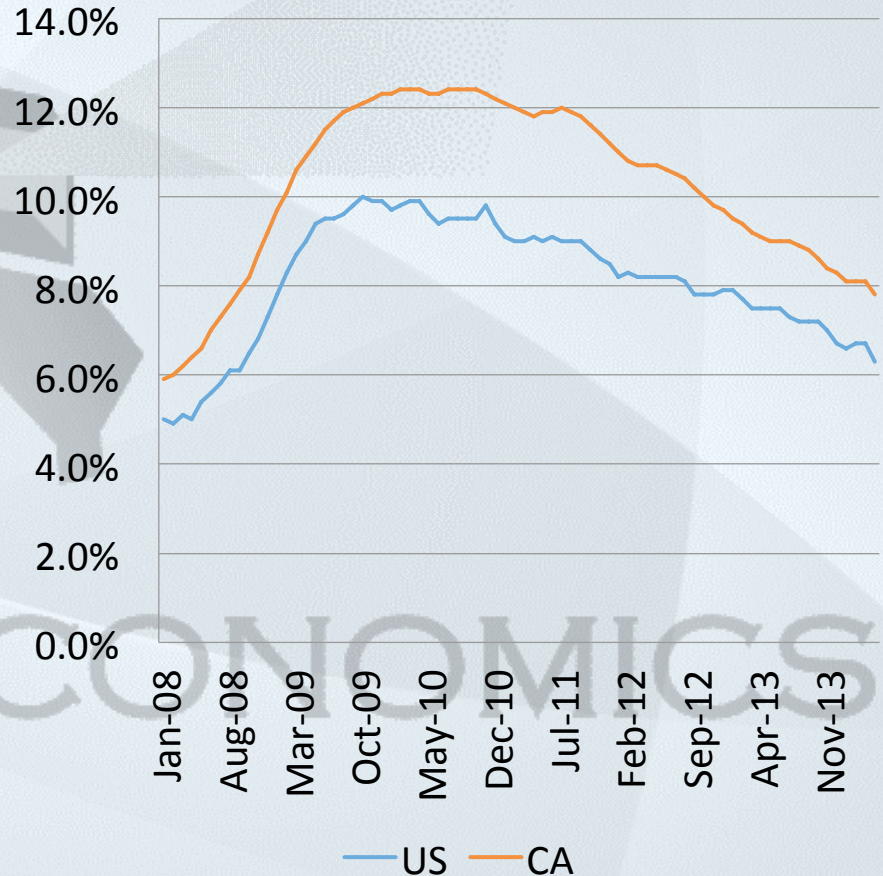
Growth %		Abs Growth	
Nevada	3.4%	Texas	322.4
North Dakota	3.3%	California	319.6
Texas	2.9%	Florida	192.8
Colorado	2.7%	New York	117.4
Oregon	2.6%	Georgia	74.4
Florida	2.6%	North Carolina	70.1
Utah	2.4%	Ohio	67.1
Arizona	2.2%	Colorado	63.2
California	2.1%	Arizona	56.1
Hawaii	2.1%	Wisconsin	56.1
Wisconsin	2.0%	Minnesota	53.9
South Carolina	2.0%	Washington	53.5
Minnesota	2.0%	Massachusetts	50
Georgia	1.9%	Indiana	43.9
Washington	1.8%	Oregon	43.8
Oklahoma	1.8%	Missouri	40.3
North Carolina	1.7%	Nevada	39.4
Delaware	1.7%	Tennessee	37.8



Regional Employment

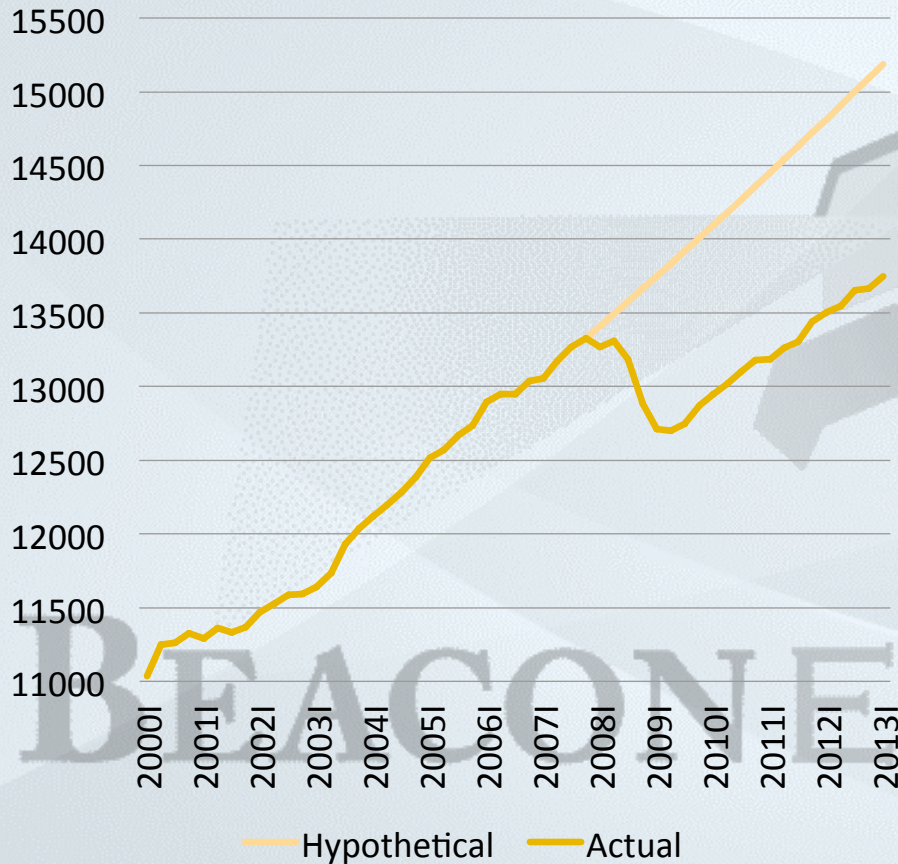
	1 Yr	2 Yr	Payroll	
United States	1.7%	3.4%		14.0%
California	2.3%	5.6%	15,425	
Los Angeles	2.3%	4.7%	4,173	
Inland Empire	2.8%	6.8%	1,250	
Orange County	1.9%	4.8%	1,477	
San Diego	2.2%	5.0%	1,340	
East Bay	1.7%	5.6%	1,048	
San Francisco	3.1%	8.1%	1,096	
Sacramento	2.9%	5.4%	885	
San Jose	4.3%	8.8%	994	
Ventura MSA	2.0%	4.0%	291	
Fresno	3.8%	8.3%	314	
Bakersfield	1.5%	3.9%	253	
Stockton	2.0%	4.8%	203	

Unemployment Rates

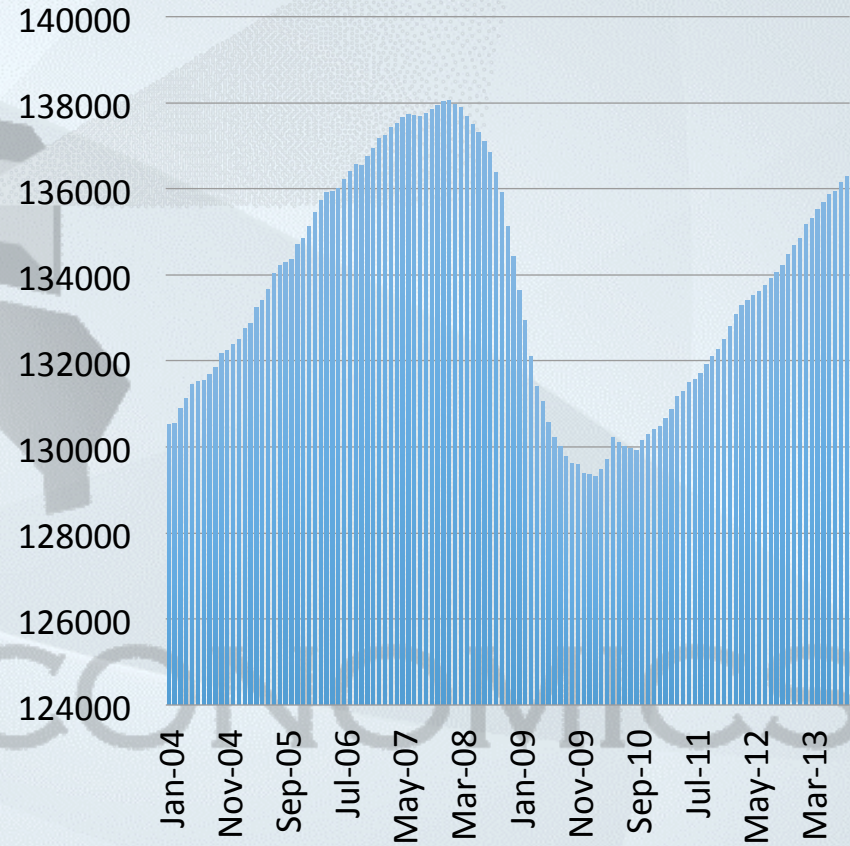


The Disappointing Recovery

US GDP

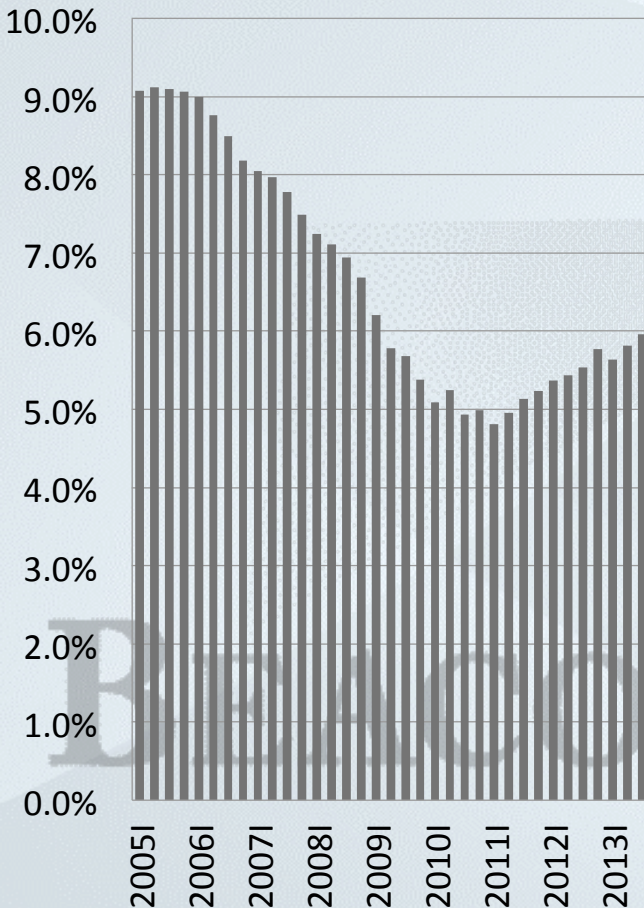


US Payroll Employment

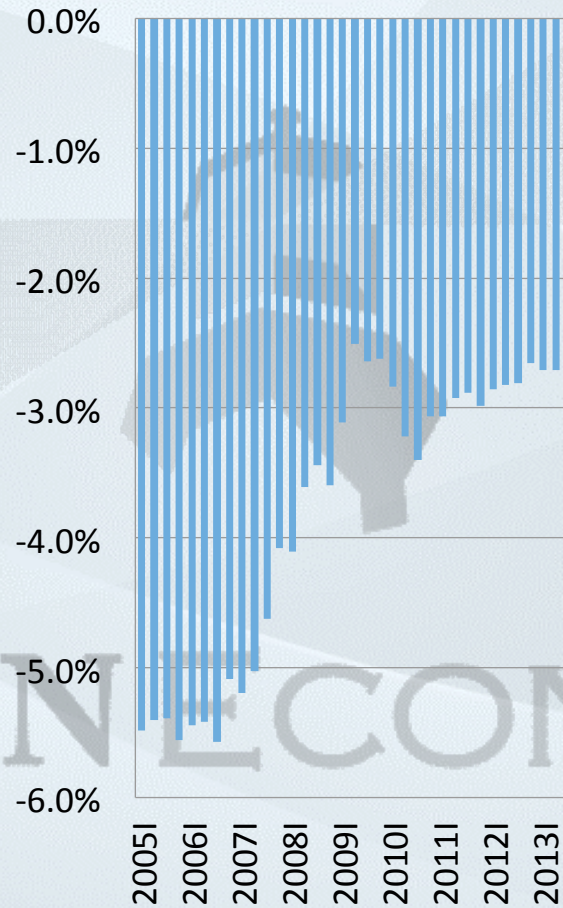


What's wrong with the economy?

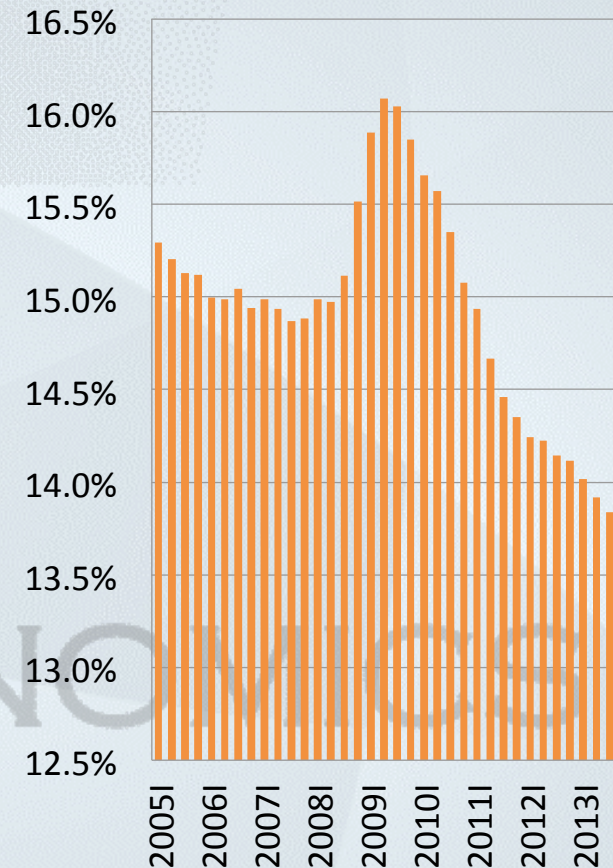
Private Construction % GDP



Trade Balance as % GDP

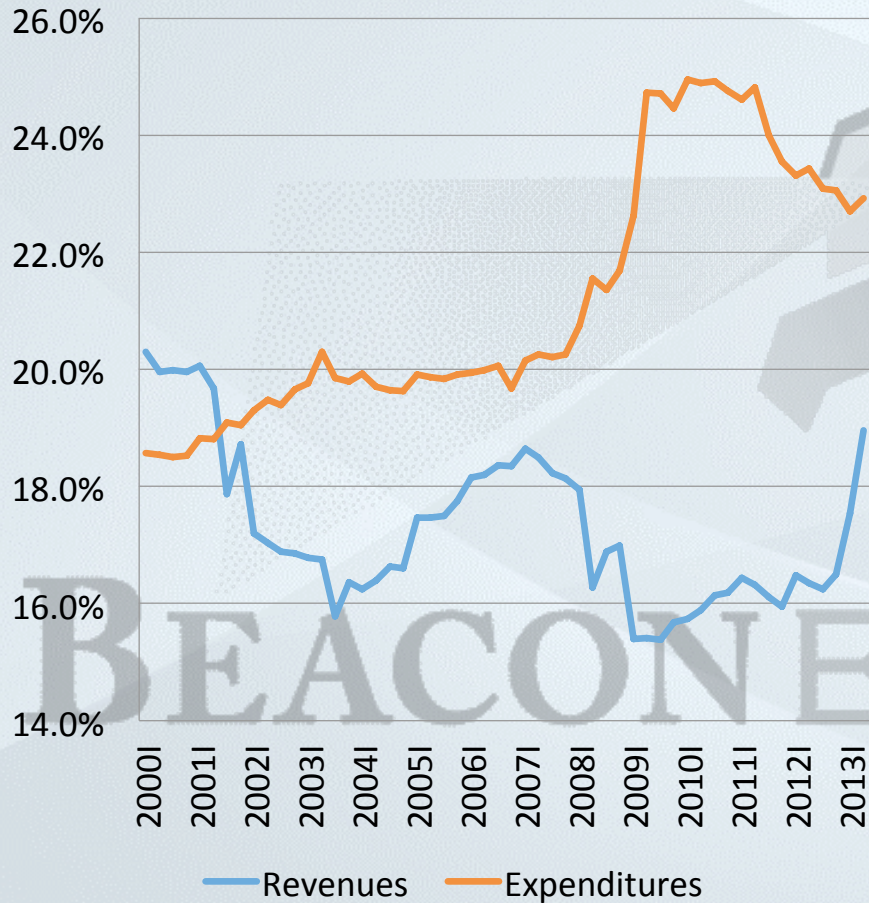


Government Non-Defense Direct % GDP

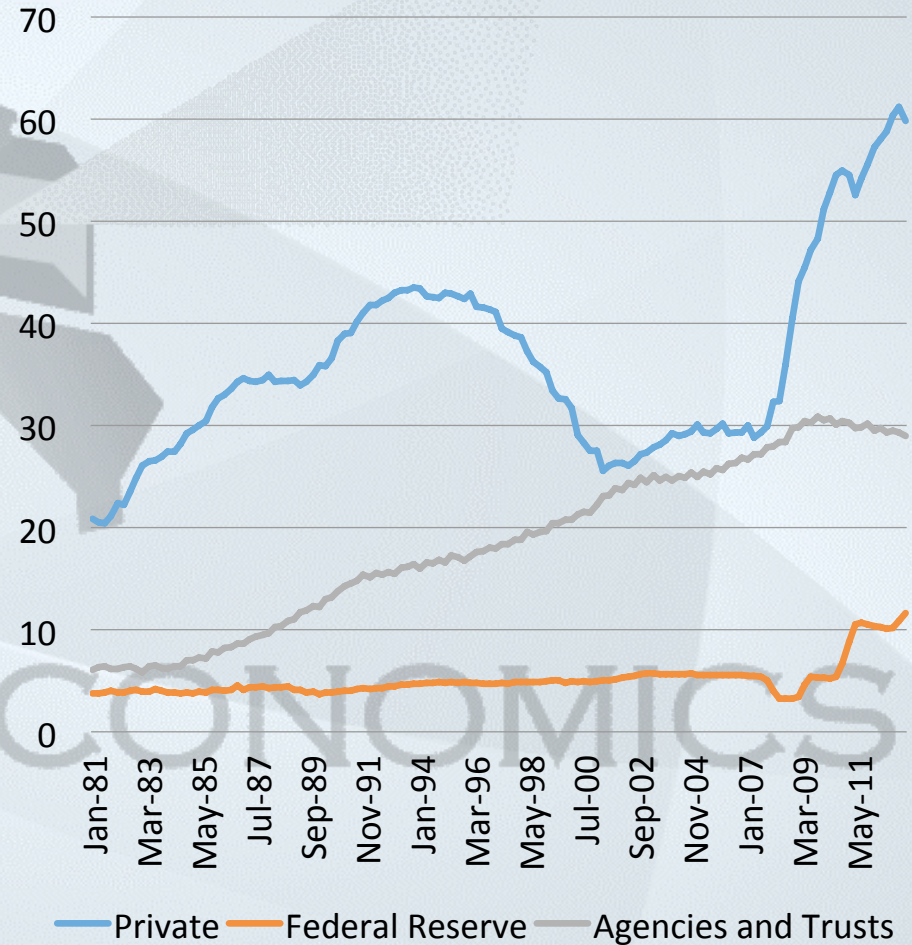


The Deficit: Not an Issue, for now

Federal Revenues and Expenditures as % GDP

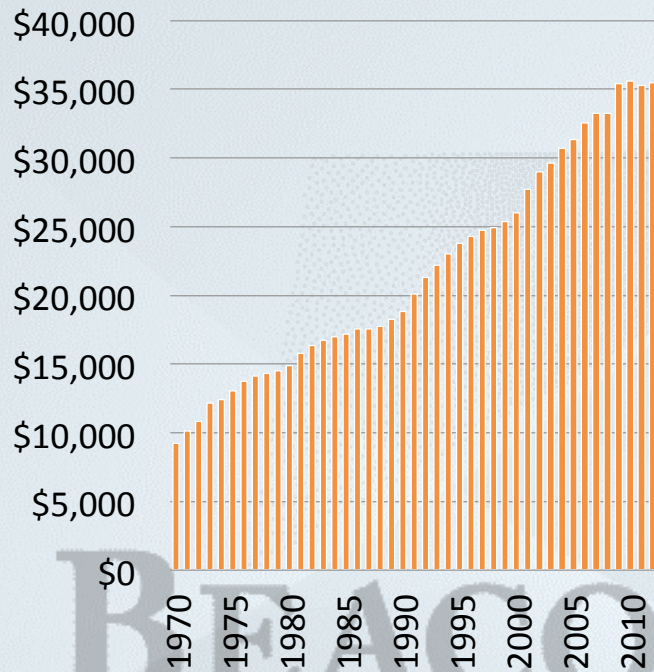


Federal Debt as % GDP by Holder

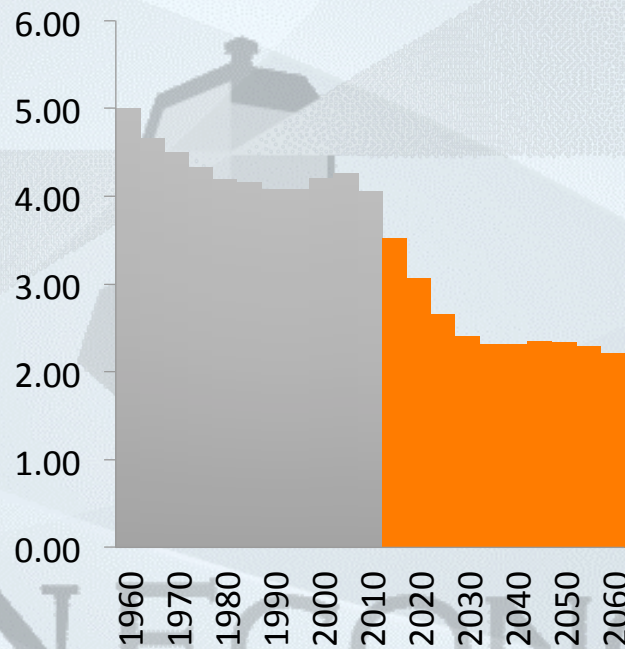


Focus on the real issues!

Real Public Spending Per Retiree



US Support Ratio and Projections



Per capita expenditure (PPP int. \$)

USA	\$8,608
Norway	\$5,674
Switzerland	\$5,564
Netherlands	\$5,123
Denmark	\$4,564
Canada	\$4,520
Austria	\$4,482
Germany	\$4,371
Belgium	\$4,119
France	\$4,085
Ireland	\$3,894
Sweden	\$3,870
Australia	\$3,692

Cost / Working Age Person

\$2,059

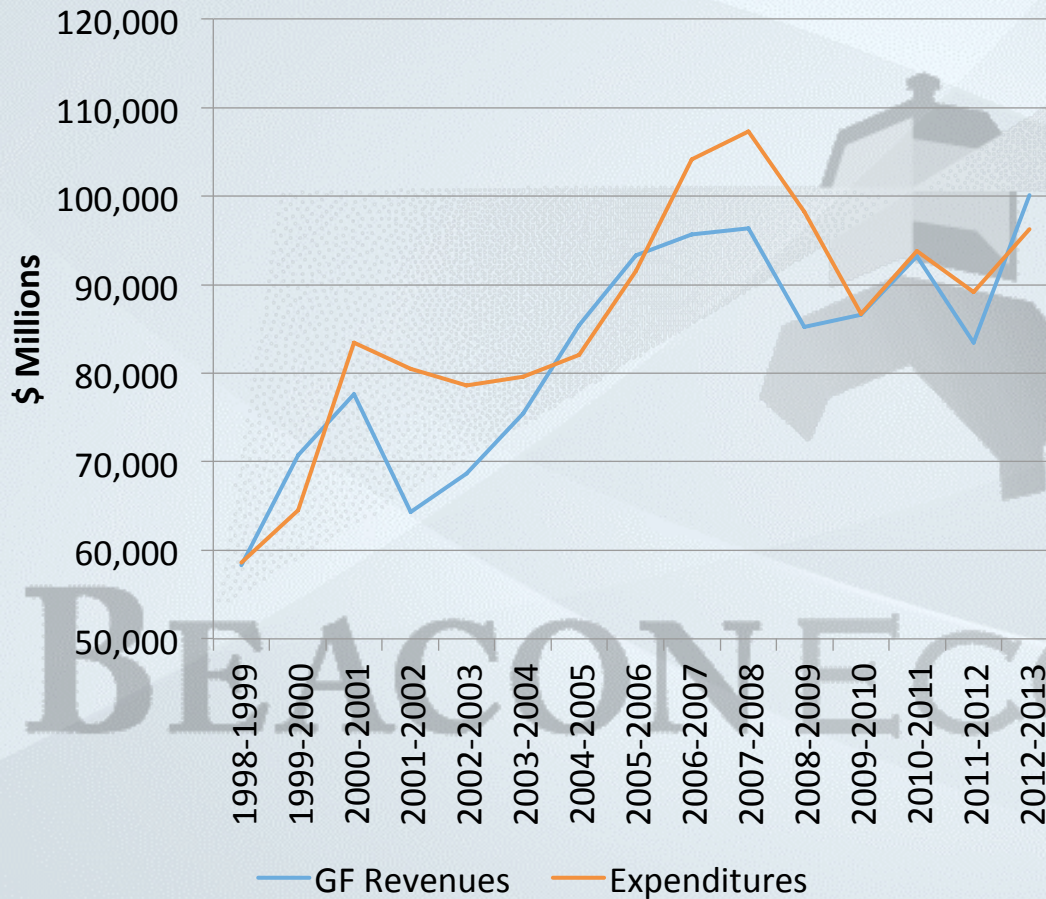
\$8,795

\$29,823

* Based on per capita growth half the rate from 1970 to 2010

The Budget Outlook

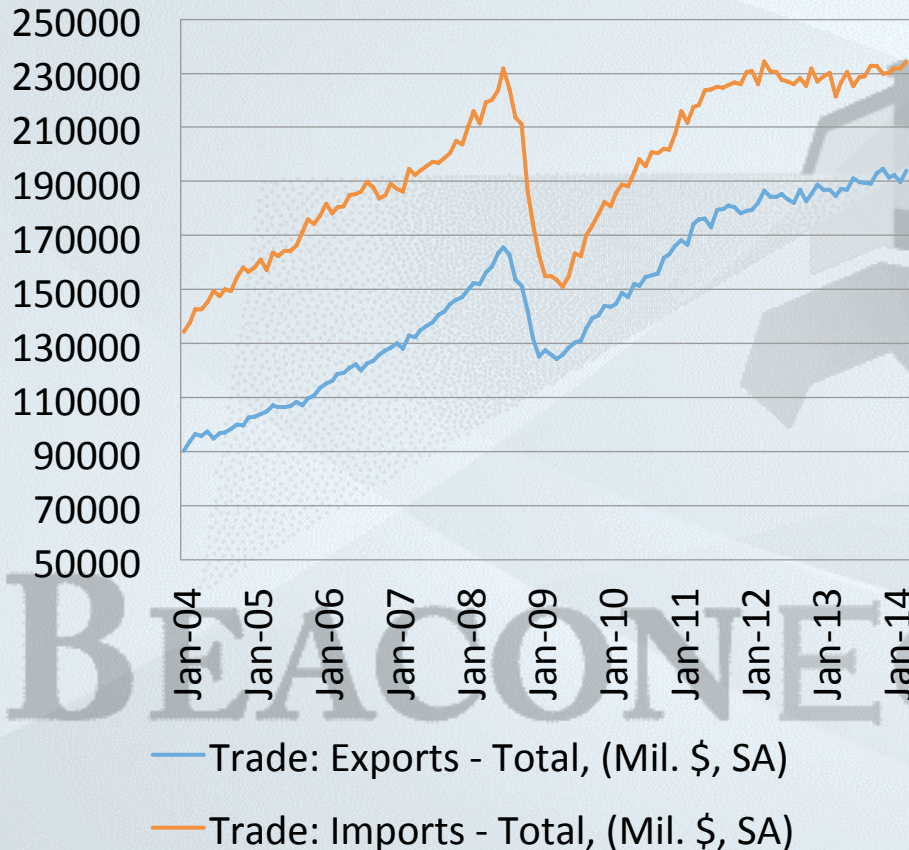
California Revenues and Expenditures



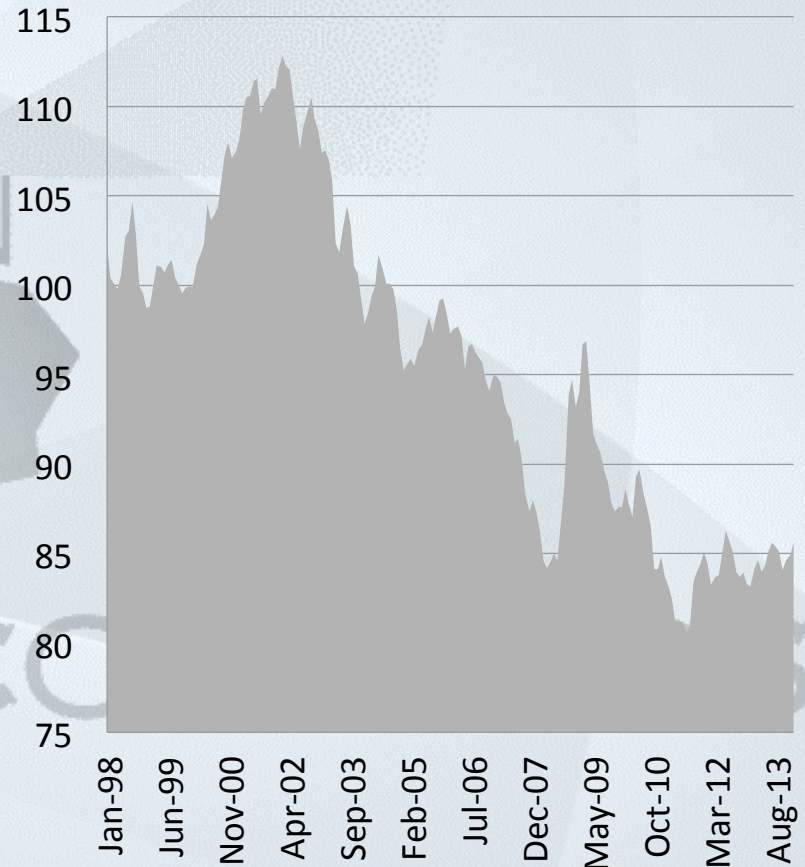
- Prop 30 is temporary
- State is way behind on infrastructure investments / maintenance
- The budget will be excessively sensitive to changes in the financial markets
- Pensions are still largely underfunded
- Prison settlement yet to be worked out

Global Markets

Nominal Flows



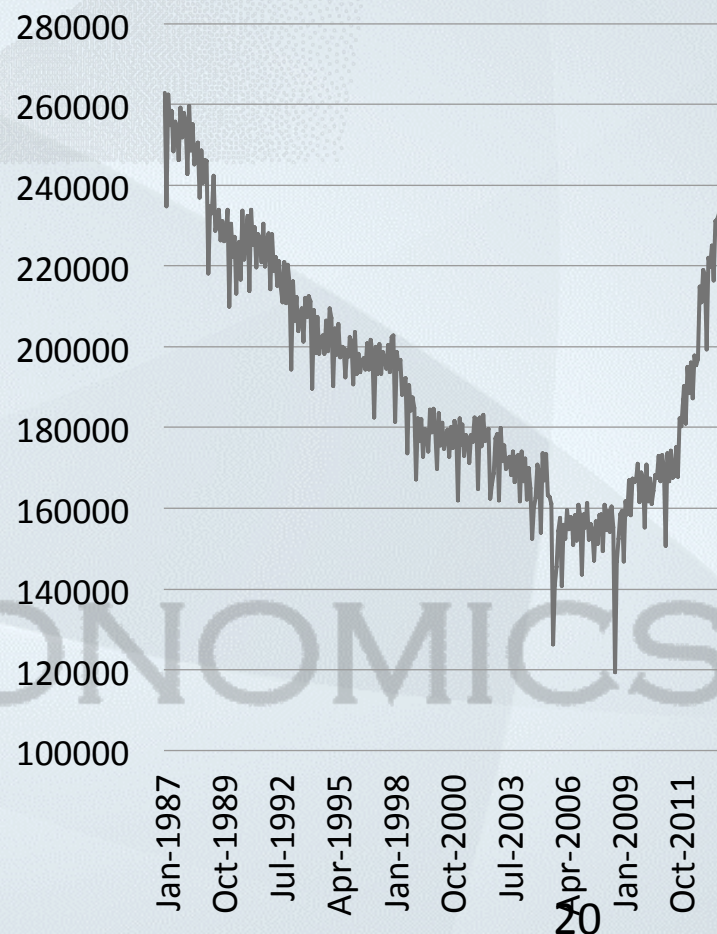
Broad Index \$US- Real to January



Global Outlook

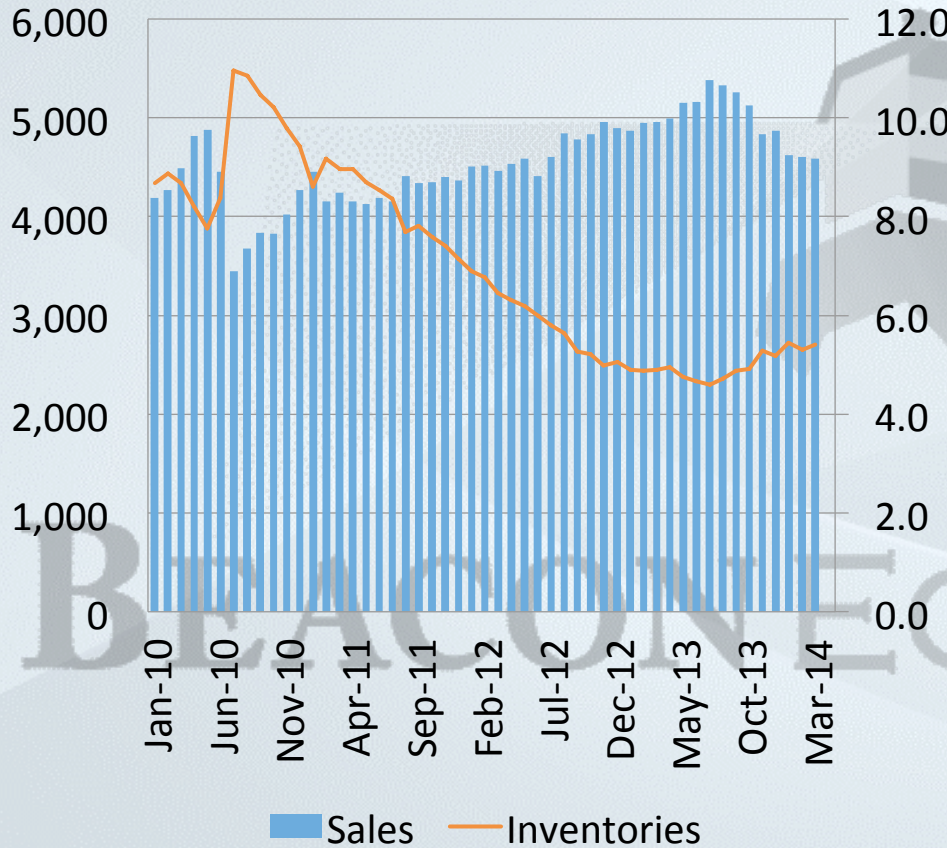
	% change on year ago				Industrial production latest
	Gross domestic product				
	latest	qtr*	2014†	2015†	
United States	+2.3 Q1	+0.1	+2.6	+3.0	+3.5 Apr
China	+7.4 Q1	+5.7	+7.3	+7.0	+8.7 Apr
Japan	+3.0 Q1	+5.9	+1.2	+1.3	+7.4 Mar
Britain	+3.1 Q1	+3.3	+2.9	+2.5	+2.3 Mar
Canada	+2.7 Q4	+2.9	+2.3	+2.5	+3.6 Feb
Euro area	+0.9 Q1	+0.8	+1.2	+1.5	-0.1 Mar

Oil Production to January, 000s of barrels

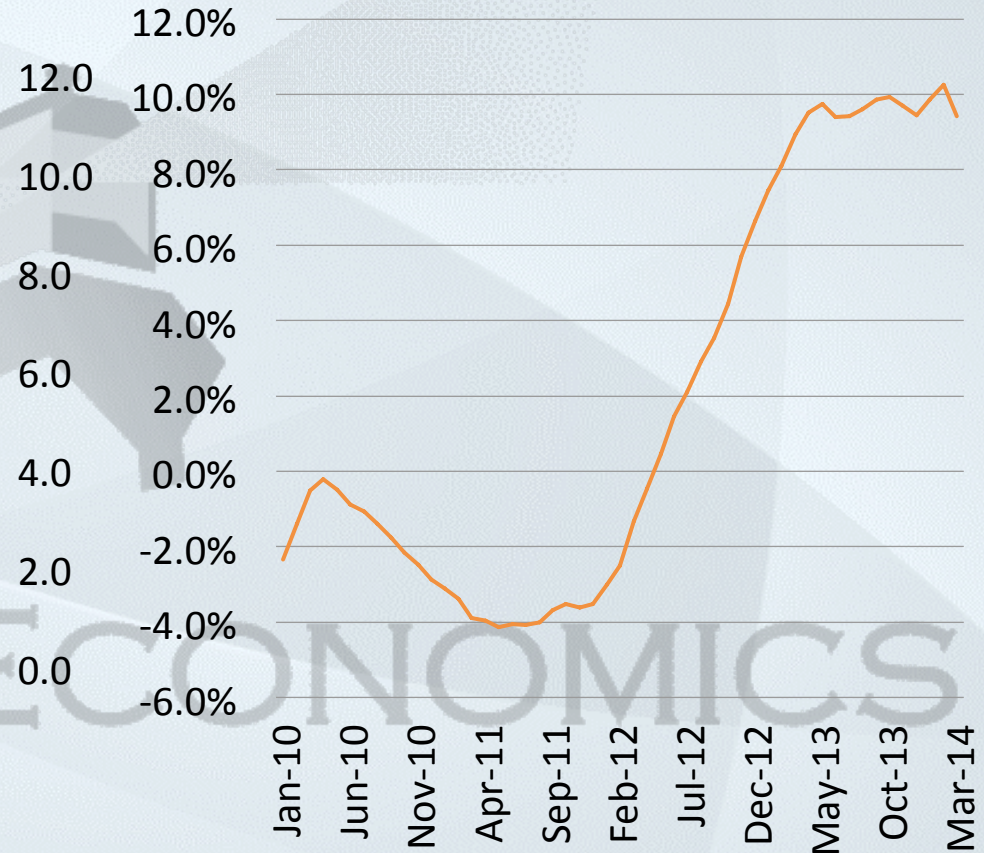


Housing Markets

NAR Homes Sales and Months Supply



Core Logic HPI Y—o-Y Growth



State Real Estate

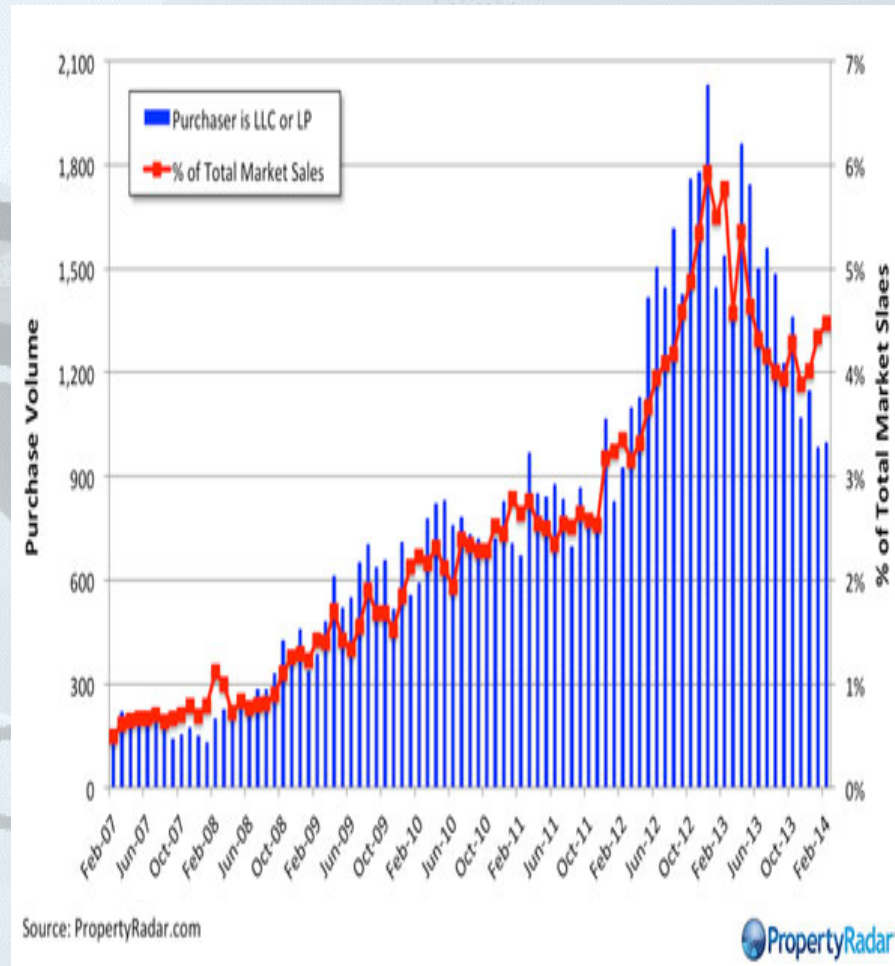
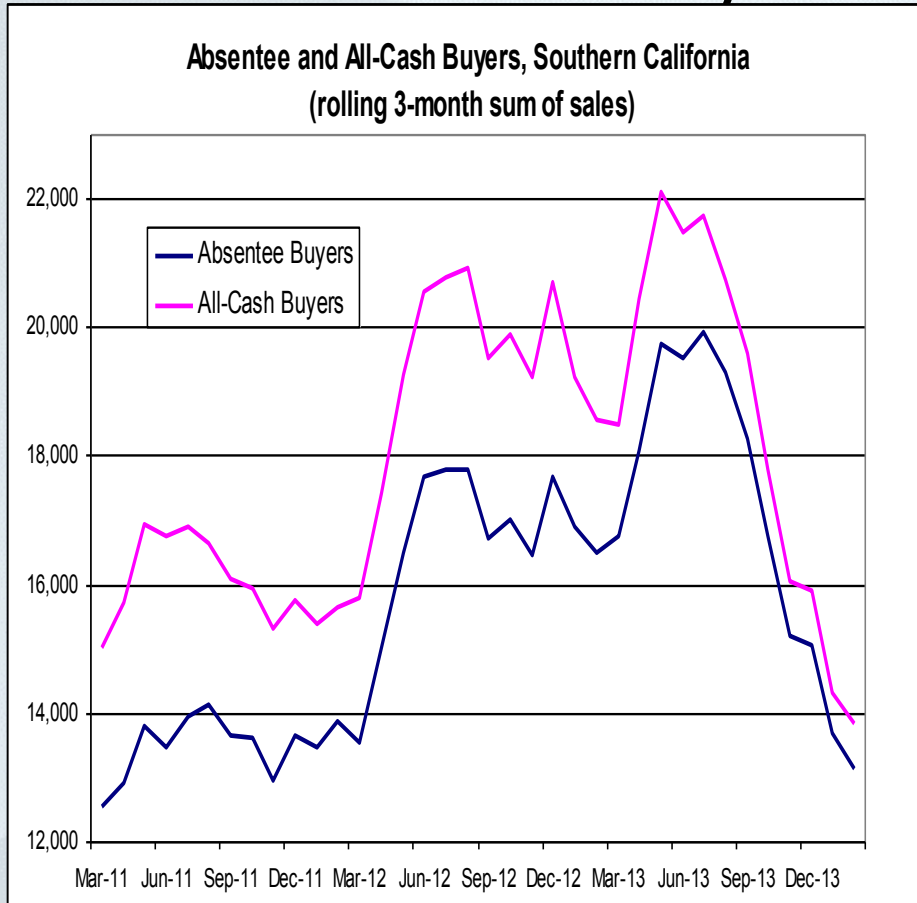
State Sales and Prices



Months Supply

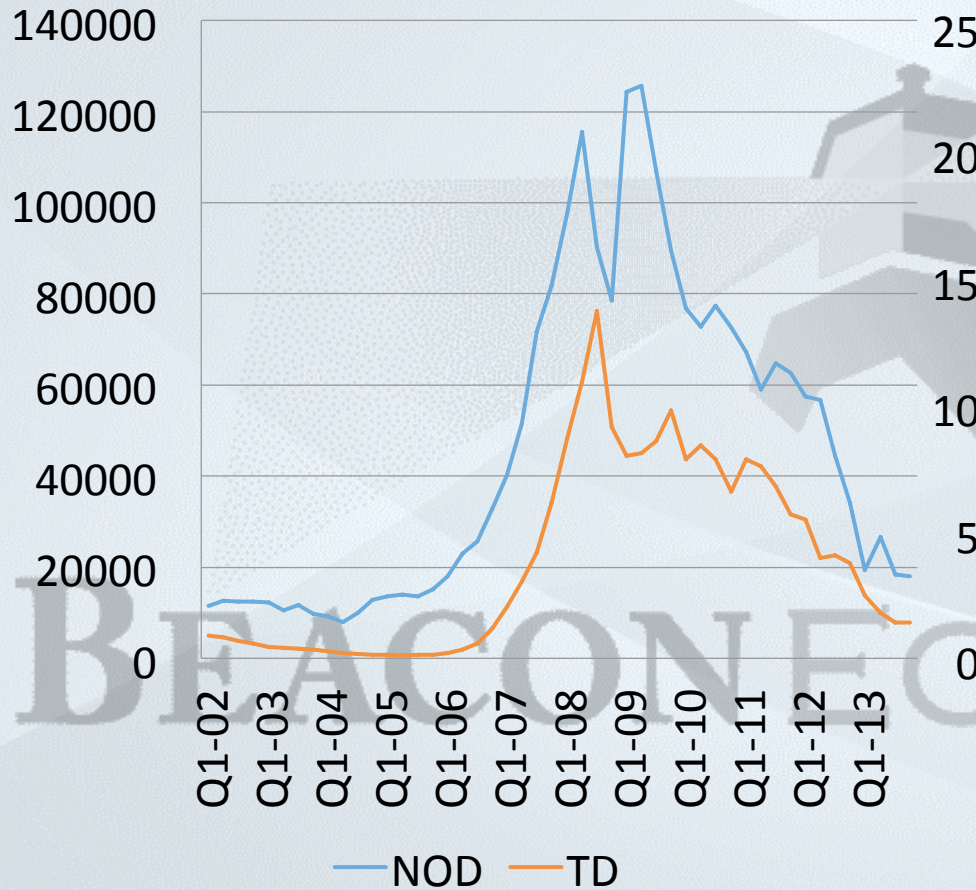


The Pullback by Investors

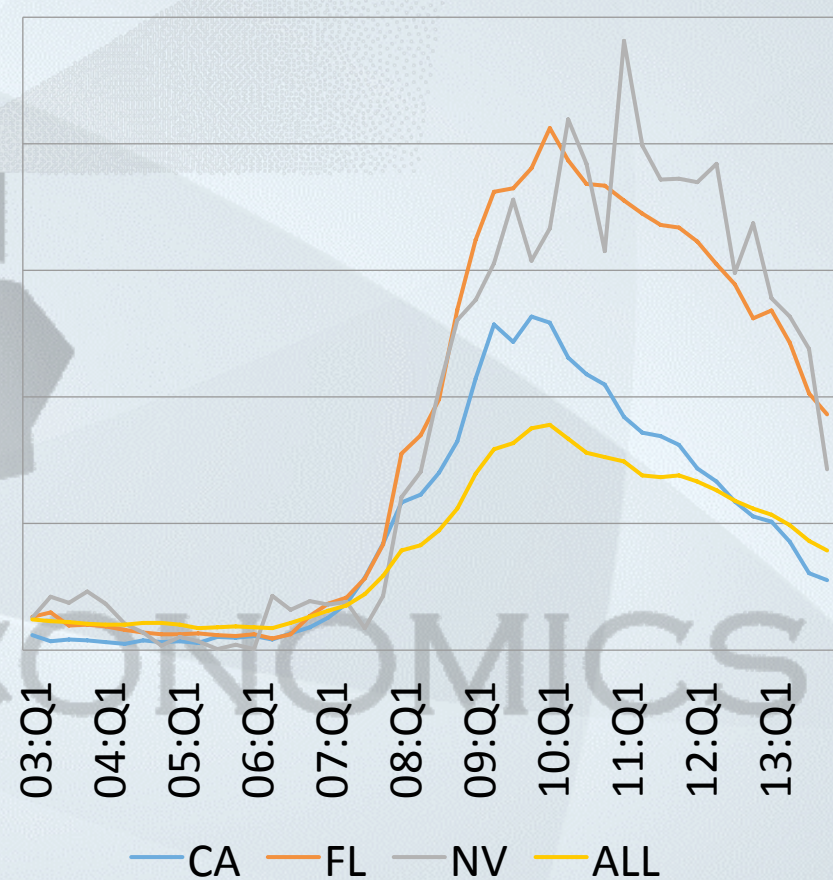


Defaults and Foreclosures

State Foreclosure Activity

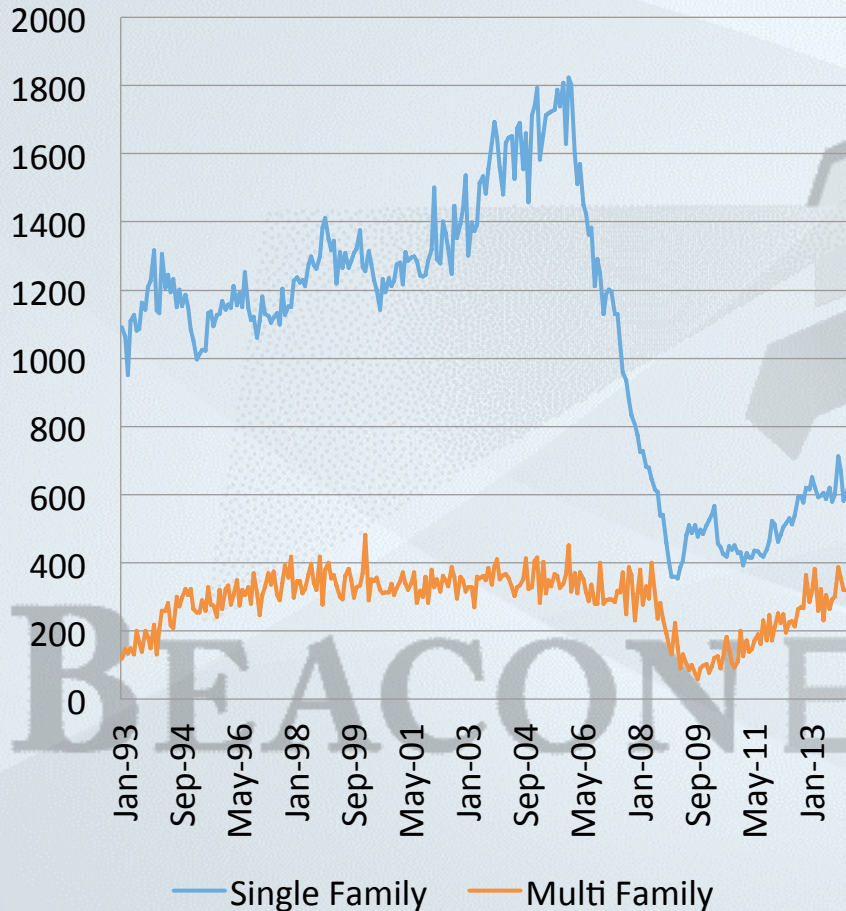


Delinquency Rate



The Construction Paradox

Housing Starts to March

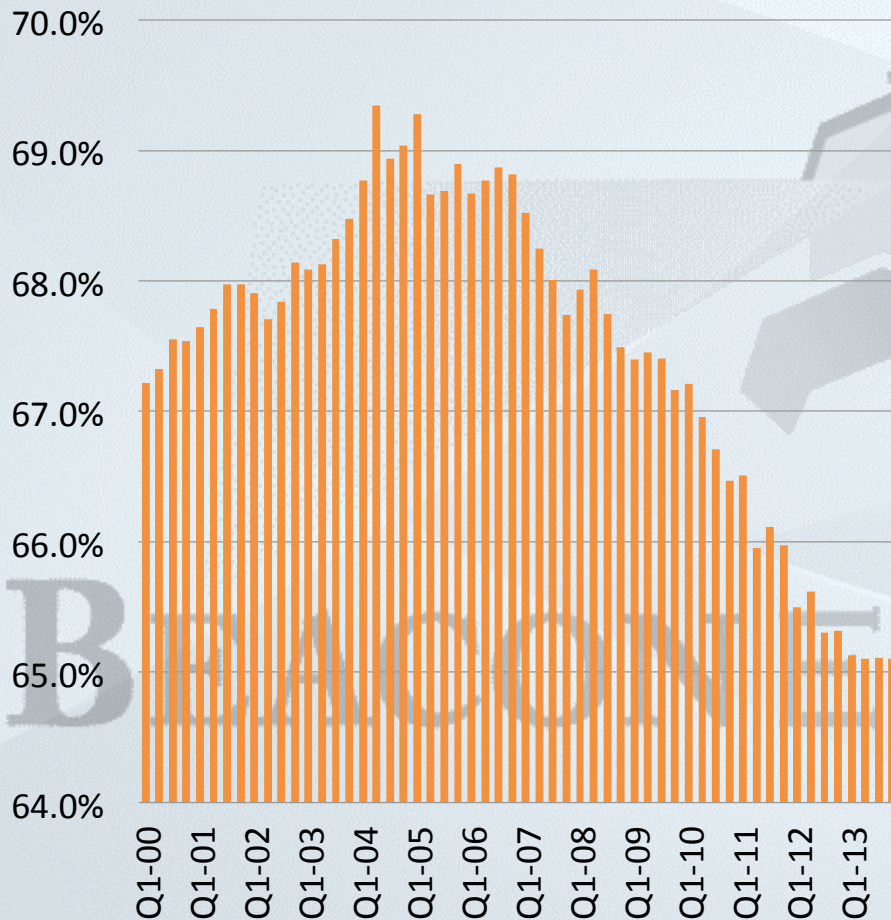


New Home Sales



Leading Indicators

Ownership % Households

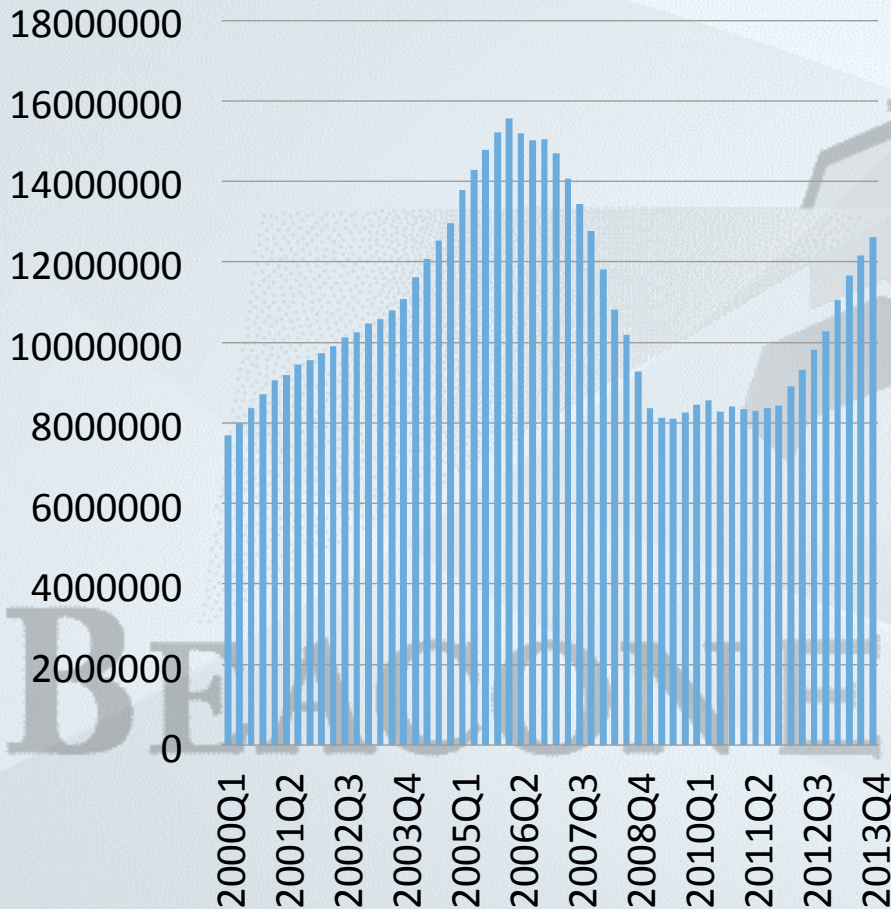


Home Ownership / Rental Price Disparity

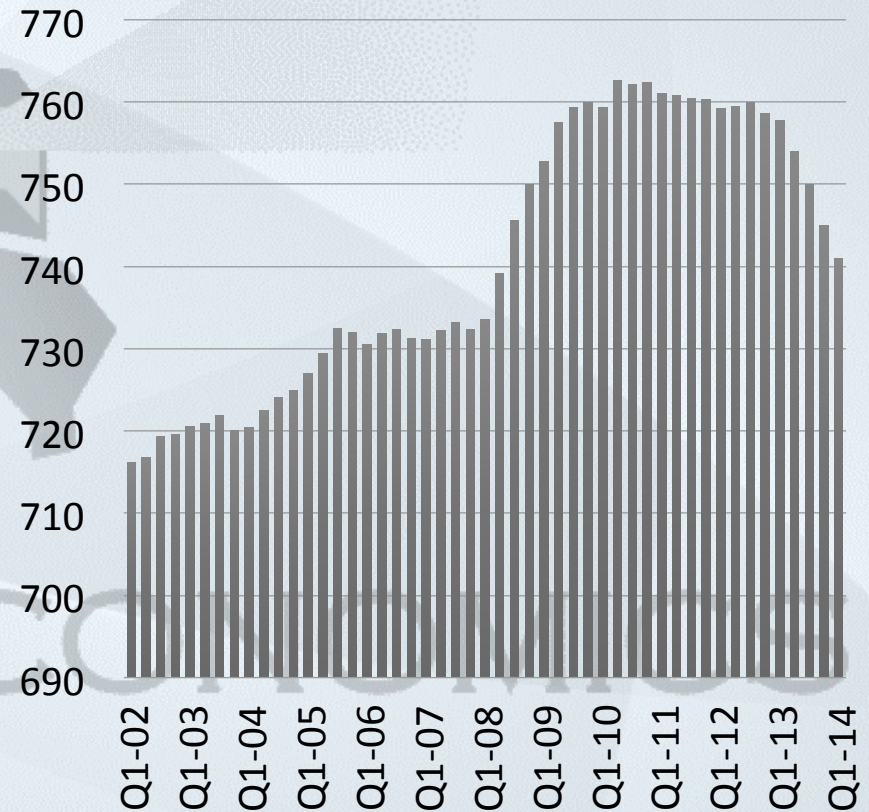


Yin and Yang...

Home Equity



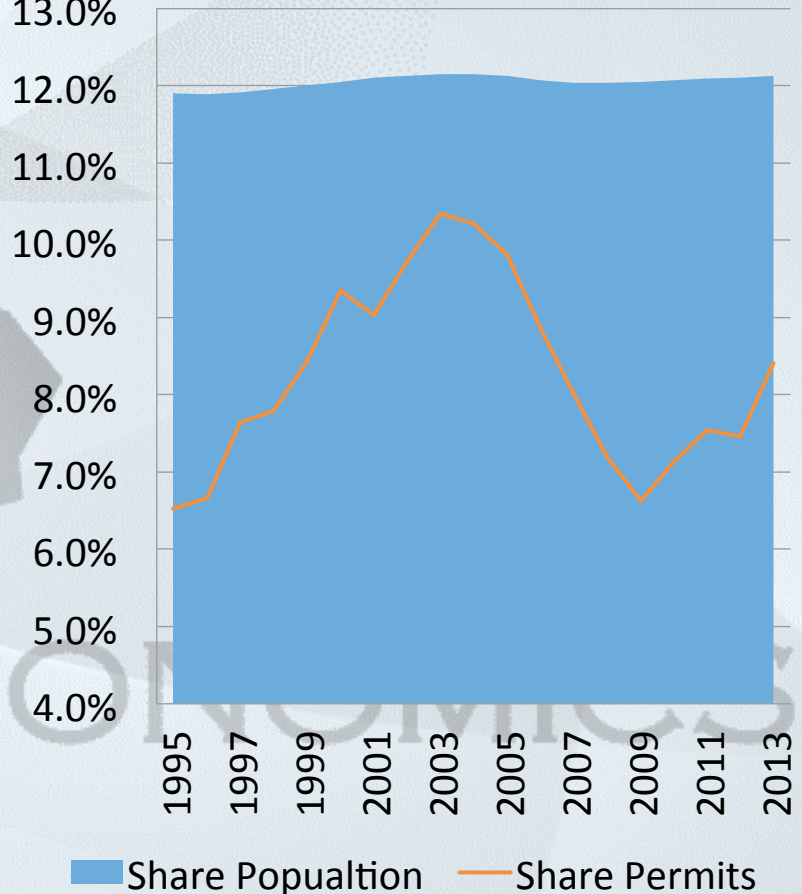
Fannie Mae Weighted Average Fico Score



Where Does the State Stack Up?

Metropolitan Area	2013 % Chya	2013 % Chya	2013 % Chya
U.S.	\$176.6	11.3%	13.0%
San Jose-Sunnyvale-Santa Clara	\$705.0	31.7%	12.0%
Honolulu, HI	\$625.8	1.5%	11.0%
Anaheim-Santa Ana-Irvine, CA	\$600.2	23.8%	10.0%
San Francisco-Oakland-Fremont, CA	\$593.9	32.6%	9.0%
New York-Wayne-White Plains, NY-NJ	\$432.8	5.1%	8.0%
San Diego-Carlsbad-San Marcos, CA	\$412.3	14.7%	7.0%
NY: Nassau-Suffolk, NY	\$385.4	3.0%	6.0%
New York-Northern New Jersey	\$368.2	1.2%	5.0%
Bridgeport-Stamford-Norwalk, CT	\$360.1	7.8%	4.0%
Washington-Arlington-Alexandria	\$348.7	11.9%	
Los Angeles-Long Beach-Santa Ana, CA	\$345.5	22.8%	
NY: Newark-Union, NJ-PA	\$334.4	2.6%	
Boston-Cambridge-Quincy, MA-NH	\$332.2	6.6%	
Seattle-Tacoma-Bellevue, WA	\$312.6	17.8%	
Barnstable Town, MA	\$307.9	5.6%	
Burlington-South Burlington, VT	\$278.4	13.1%	

State Building in Proportion



In the Long Term?

2011 Taxes Fees Paid as share PI		Total Domestic Net Migration by Income 08-13	
1	Alaska	36.4%	
2	Wyoming	22.2%	Under \$25,000
3	New York	18.7%	\$25,000 to \$50,000
4	Delaware	18.1%	\$50,000 to \$99,999
5	North Dakota	17.8%	Over \$100,000
6	West Virginia	17.0%	Total
7	New Mexico	16.5%	
8	South Carolina	16.4%	Texas
9	Vermont	16.2%	Under \$25,000
10	Hawaii	15.9%	\$25,000 to \$50,000
11	California	15.7%	\$50,000 to \$99,999
12	Mississippi	15.6%	Over \$100,000
13	Wisconsin	15.6%	
	United States		
	Total	14.7%	

So what does it mean?

Big Themes for the 2014

- Consumers will continue to spend on better income, wealth results
- Housing recovery to rebound by end of year, look out for apartment oversupply in some places
- Commercial will continue slow recovery
- Exports, business spending to grow steadily
- Energy sector continuing to boom
- Market rise sustainable
- Fed to continue to taper, long term rates to drift up slowly—flatter yield curve ahead
- Gains in state and local to have some modest offset for Fed cuts

Future issues remain

- Bank credit still tight
- Government spending constrained
- European situation could heat up next year, China debt worries
- Our political environment is still poisonous
- Construction activity far to go to get back to normal
- State short on affordable housing / needs CEQA reform
- State budget surplus in name only
- Healthcare crisis still to be dealt with
- We still have to deal with national / state entitlement reform



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