Politics and Policy
A Post-Election Look at the Consumers and Banks
THEMES

The Importance of Looking Beneath the Surface

• The rise of the discontented

Key Economic Policy Issues

• Shaping the consumer landscape for years to come

The Current State of Finance

• What’s ahead for the Fed?
The Roots of Today’s Discontent
PERFORMANCE IN DEVELOPED MARKETS

- Post-crisis growth has been modest across regions

Major Developed Markets

Source: Haver Analytics
PROGRESS ON DELEVERAGING

- *In aggregate, consumer balance sheets are in much better condition*

**Household Financial Obligation Ratio**

- Percent

**Household Debt as Percent of DPI**

- Percent

*Source: Haver Analytics*
REBUILDING SAVINGS

- *Households have been more frugal since the financial crisis*

The world spends more and saves less as it ages

Annual per capita normalised flows of money

- Labour income
- Consumption

People across the world save more between 25 and 60 and consume more at the end of life

U.S. Personal Saving Rate

Source: Haver Analytics

Sources: National Transfer Account, Morgan Stanley Research
OTHER POSITIVE TRENDS

- *Joblessness is down*
- *Asset values are up*

### Unemployment Trends

- **Unemployment Rate**
- **Broad Measure (U6)**

### Asset Values

- **S&P 500 (left)**
- **Case-Shiller HPI (right)**

*Source: Haver Analytics*
SPENDING AND CONFIDENCE

• Wallets are open, and spirits are high

Real Personal Consumption Expenditures

Consumer Confidence

Source: Haver Analytics
LINGERING BURDEN

- Some families are still struggling to work their way out from under debt

Source: Haver Analytics
A DIFFICULT LESSON

- **Those with more modest levels of education have struggled**

![Bar chart showing change in employment and median income by educational attainment.]

**Change in Employment in the Current Expansion by Educational Attainment**

- College: 20%
- Less Than College: 5%
- High School, No College: 0%
- Less Than High School: -5%

**Change in Median Income in the Current Expansion by Educational Attainment**

- College: 30%
- Less Than College: 15%
- High School, No College: 0%
- Less Than High School: -10%

*Source: Haver Analytics*
INEQUALITY OF FORTUNE

- Beneath the surface, disappointing outcomes
- Deep dissatisfaction with “the system”

Change in Mean Family Income, 2010-2014

“What do you think is the most important problem facing the U.S. today?”

- Economy in General: 17%
- Dissatisfaction with Government: 15%
- Unemployment: 11%
- Immigration: 8%
- Healthcare: 6%
- Race Relations: 6%

Sources: Census Bureau, Gallup
Challenges for the Next Regime
GLOBAL ECONOMIC TIES

• **The free flow of goods, capital and people are now seen by many as detrimental to economic performance**

Sources: International Monetary Fund, United Nations
DEMOGRAPHICS AND IMMIGRATION

• Promoting fertility rarely works
• Accepting new entrants successfully is key

Fertility Rates Per Woman, 2015

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate</th>
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</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1.4</td>
</tr>
<tr>
<td>U.K.</td>
<td>1.9</td>
</tr>
<tr>
<td>Japan</td>
<td>1.5</td>
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<tr>
<td>U.S.</td>
<td>1.9</td>
</tr>
<tr>
<td>Canada</td>
<td>1.6</td>
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Immigrant Population, 2013

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>China</td>
<td>1%</td>
</tr>
<tr>
<td>Japan</td>
<td>5%</td>
</tr>
<tr>
<td>U.K.</td>
<td>10%</td>
</tr>
<tr>
<td>Germany</td>
<td>15%</td>
</tr>
<tr>
<td>U.S.</td>
<td>20%</td>
</tr>
<tr>
<td>Ireland</td>
<td>25%</td>
</tr>
<tr>
<td>Canada</td>
<td>15%</td>
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Sources: CIA, United Nations
DEBT AND DEFICITS

- *Fiscal stimulus may be the best way to boost growth*
- *Careful calibration will be needed to keep debt under control*

**Trump and the Deficit**
Some independent estimates show tax-cut proposals would widen growing budget deficits over the next decade.

**Total federal deficit/surplus**
As a percentage of GDP

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<tr>
<td>Deficit</td>
<td>-10</td>
<td>-8</td>
<td>-6</td>
<td>-4</td>
<td>2</td>
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**Projections**
- Baseline forecast
- House GOP tax plan
- Trump tax plan

Source: Congressional Budget Office, Tax Policy Center, Cornerstone Macro

**10-Year U.S. Treasury Yield**

Source: Bloomberg
HEALTH CARE

- Single payer? More consumerism?
- Bending the cost curve will be critical

Health Care Expenditures, 2015

Life Expectancy at Birth, 2014

Source: OECD
INDUSTRIAL POLICY

• There are many myths of manufacturing
• We need to foster the formation of entirely new industries

U.S. Manufacturing

Manufacturing Share of GDP, 2014

Sources: Haver Analytics, World Bank
The Financial Landscape
BANKING TRENDS

• Valuations have been lifted since the election
• Lending activity is very strong

Sources: Thomson Reuters, Haver Analytics
THE STATE OF THE INDUSTRY

Bank capital is solid

• Stress testing has been very influential

Credit conditions are accommodative

• Bank standards are reasonable, and credit spreads are narrow

“Headline risks” persist

• Wells Fargo, Deutsche Bank, etc.
CURRENT INTEREST RATES

- Monetary policy is very easy in developed markets
- Safe assets are popular...at any price

Central Bank Deposit Rates

Sovereign Yield Curves

Sources: Haver Analytics, FT
THE DOWNSIDE OF LOW INTEREST RATES

- Low rates are damaging for pensions and life insurers
- Are investors stretching too far for yield?

Investors grappling with lower interest rates have to take bigger risks if they want to equal returns of two decades ago.

**Estimates of what investors needed to earn 7.5%**

<table>
<thead>
<tr>
<th>Year</th>
<th>Bonds</th>
<th>U.S. Large Cap</th>
<th>U.S. Small Cap</th>
<th>Non-U.S. Equity</th>
<th>Real Estate</th>
<th>Private Equity</th>
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<tbody>
<tr>
<td>1995</td>
<td>100%</td>
<td>20%</td>
<td>5%</td>
<td>14%</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>2005</td>
<td>52%</td>
<td>33%</td>
<td>8%</td>
<td>13%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>2015</td>
<td>12%</td>
<td>22%</td>
<td>8%</td>
<td>13%</td>
<td>12%</td>
<td>12%</td>
</tr>
</tbody>
</table>

*Expected return 7.5%  Standard deviation* 6.0%

*Likely amount by which returns could vary
Source: Callan Associates

**State Pension Finances**

- **Pension Debt (left)**
- **Funded Ratio (right)**

Source: Pew Charitable Trusts
ISSUES FOR THE FED

How aggressively to lean against inflation prospects?

- Actual and expected inflation appear to be on the rise

Congressional interference

- Audits, Taylor Rules, and other curbs on independence are a risk

Appointments

- Watch the VC for supervision
PARTING THOUGHTS

We need to recall why international commerce is so beneficial

• Curbing trade may not produce the outcomes that some might think

Supply-side strategies should be considered with care

• Revenue neutrality is unlikely

Leave the Fed alone

• Independence is essential for the setting of proper monetary and supervisory policy
Carl Tannenbaum is the Chief Economist for The Northern Trust. In this role, Mr. Tannenbaum briefs clients and colleagues on the economy and business conditions, prepares the bank’s official economic outlook and participates in forecast surveys. He is a member of the bank’s investment policy committee, its capital committee, and its asset/liability management committee.

Mr. Tannenbaum publishes weekly commentaries and is frequently interviewed by media outlets such as The Wall Street Journal, Bloomberg, and Reuters.

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