

A photograph of a forest path. The path is narrow, made of dirt and small stones, and is heavily covered in green moss. The path leads into a dense forest of tall, thin trees. The ground is covered in various types of ferns and other green plants. The overall scene is very green and lush, suggesting a temperate rainforest environment.

The U.S. Economy

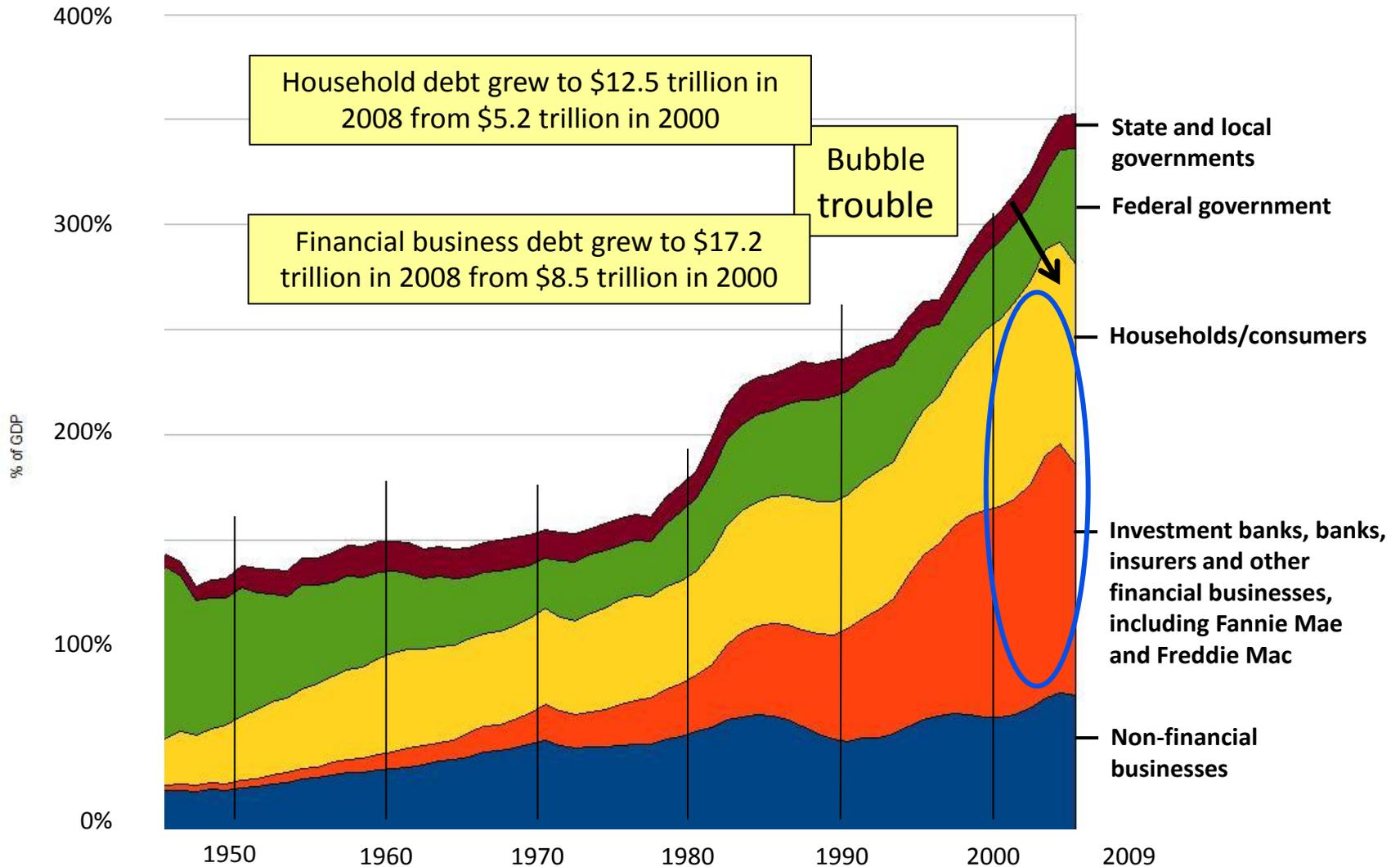
Progress on the Path to Economic Recovery

or, “We Aren’t Out of the Woods Yet”

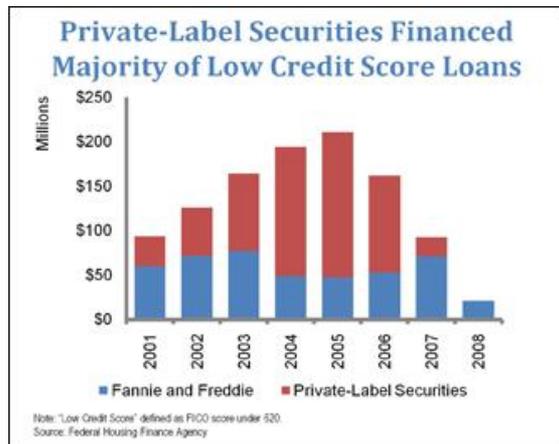
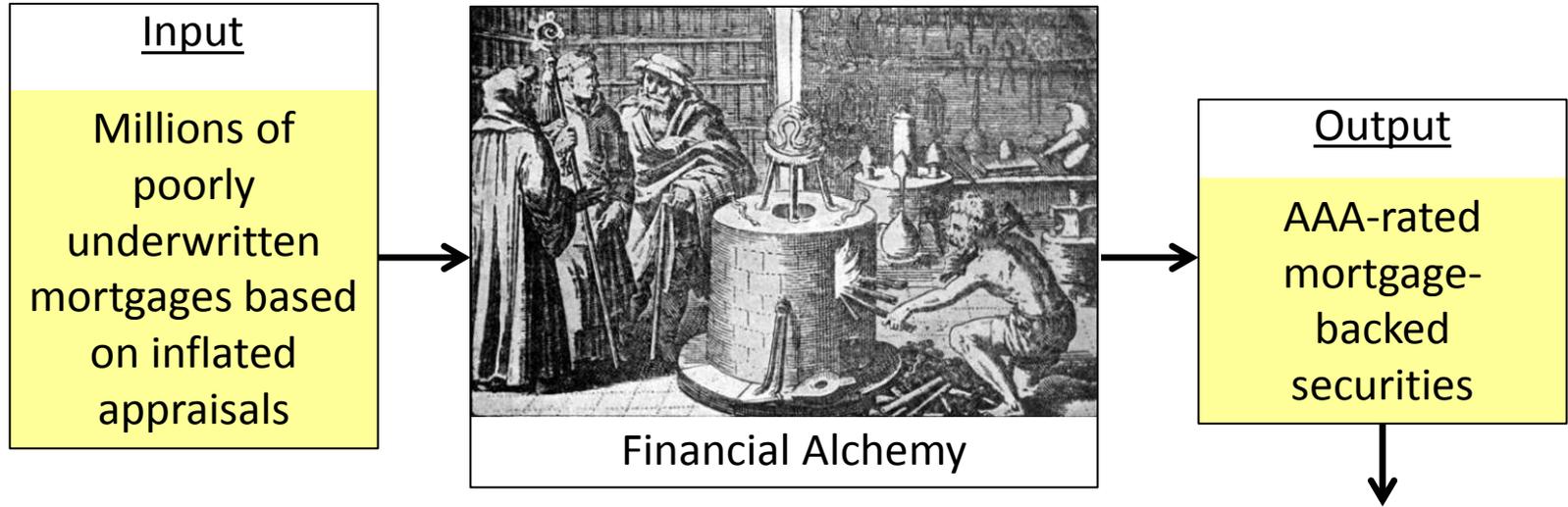
Daniel D. Crowley
Chairman

2012 Annual HealthSmart Forum
April 16, 2012

Components of U.S. Debt as a Percentage of GDP



How the Bubble Machine Worked



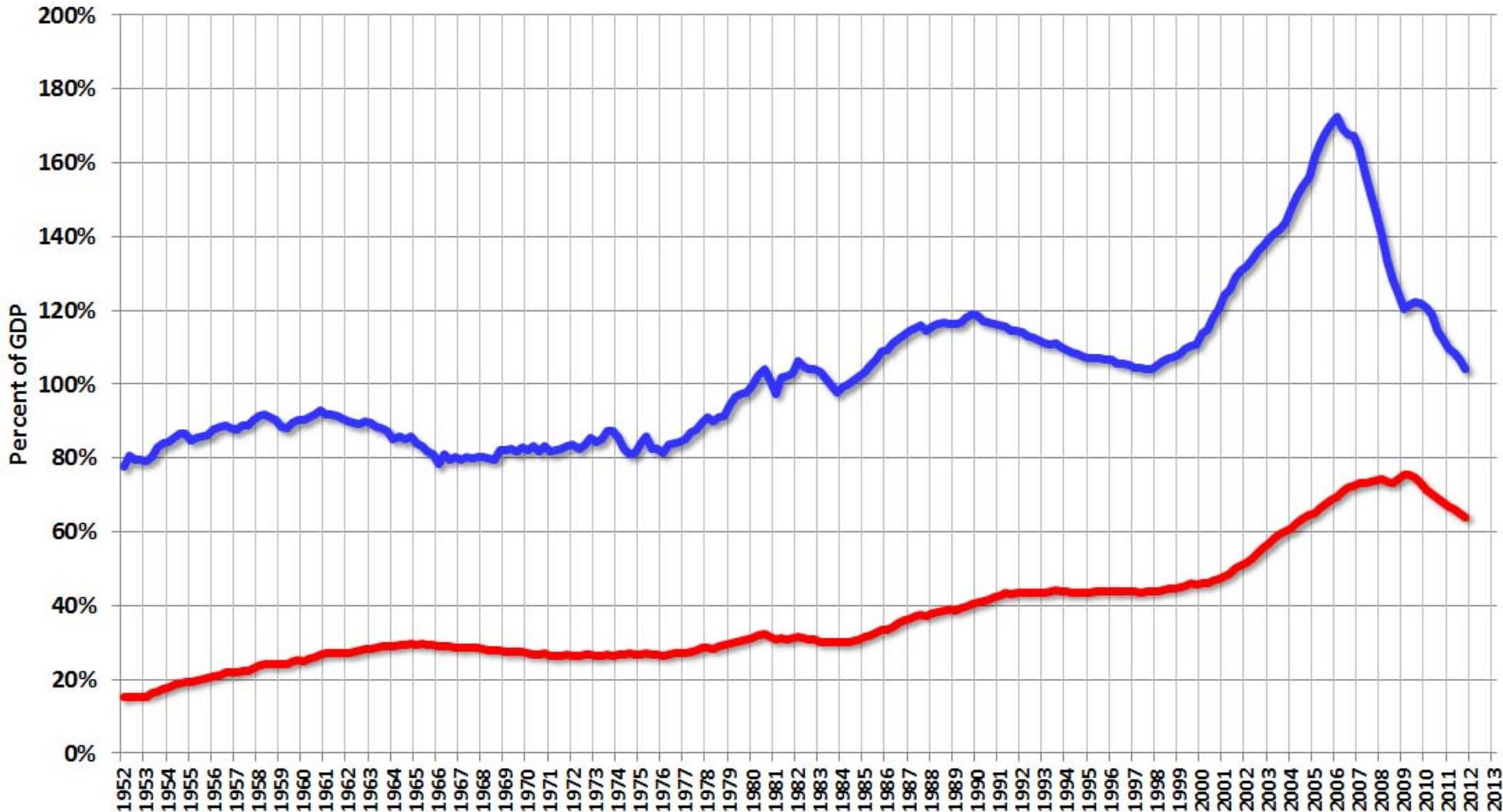
Bankers leveraged these securities up to 30x and insured against losses via unregulated credit default swaps

This alchemy inflated housing prices, fueling home building, household borrowing and consumption. It drove economic growth and employment...until it all stopped.

Household Net Worth Clobbered

Household Real Estate Value and Household Mortgage Debt as Percent of GDP

— Household Real Estate Value as Percent of GDP — Mortgage Debt as Percent of GDP



<http://www.calculatedriskblog.com/> Source: Federal Reserve Flow of Funds

Where the Jobs Went

“The weakness in household balance sheets and the associated pullback in spending are directly responsible for the lion’s share of employment losses in the U.S. economy. This deficiency remains the most significant impediment to a robust recovery.

“Our research suggests that 65 percent of the job losses from 2007 to 2009 came from the drop in household spending induced by the collapse in home prices and its effect on a highly levered household sector.”

-- Atif Mian, professor of economics, finance and real estate at the University of California, Berkeley
Amir Sufi, professor of finance at the University of Chicago Booth School of Business

To Review: Debt Crisis Aftermath

- History shows that debt crisis recoveries are slower and weaker than other recession recoveries
 - Consumption is reduced
 - Credit no longer fuels spending
 - Income is diverted to debt repayment and/or savings
 - Industries with excess capacity lay off workers and consolidate
 - Reduced investment in new facilities and equipment
 - Debt overhang constrains private credit expansion
 - Impaired banks are less willing to lend

Lower Fed interest rates alone can't stimulate the economy

Note: Consumer spending accounts for more than 70% of the U.S. economy

The Prescription

“The deleveraging episodes of Sweden and Finland in the 1990s are particularly relevant today. They show two distinct phases of deleveraging:

“In the first, households, corporations, and financial institutions reduce debt significantly over several years, while economic growth is negative or minimal and government debt rises.

“In the second phase, growth rebounds and government debt is reduced gradually over many years.

“Today, the United States most closely follows this debt-reduction path. Debt in the financial sector relative to GDP has fallen back to levels last seen in 2000, before the credit bubble. US households have reduced their debt relative to disposable income by 15 percentage points, more than in any other country; at this rate, they could reach sustainable debt levels in two years or so.”

-- McKinsey Global Institute, 2012

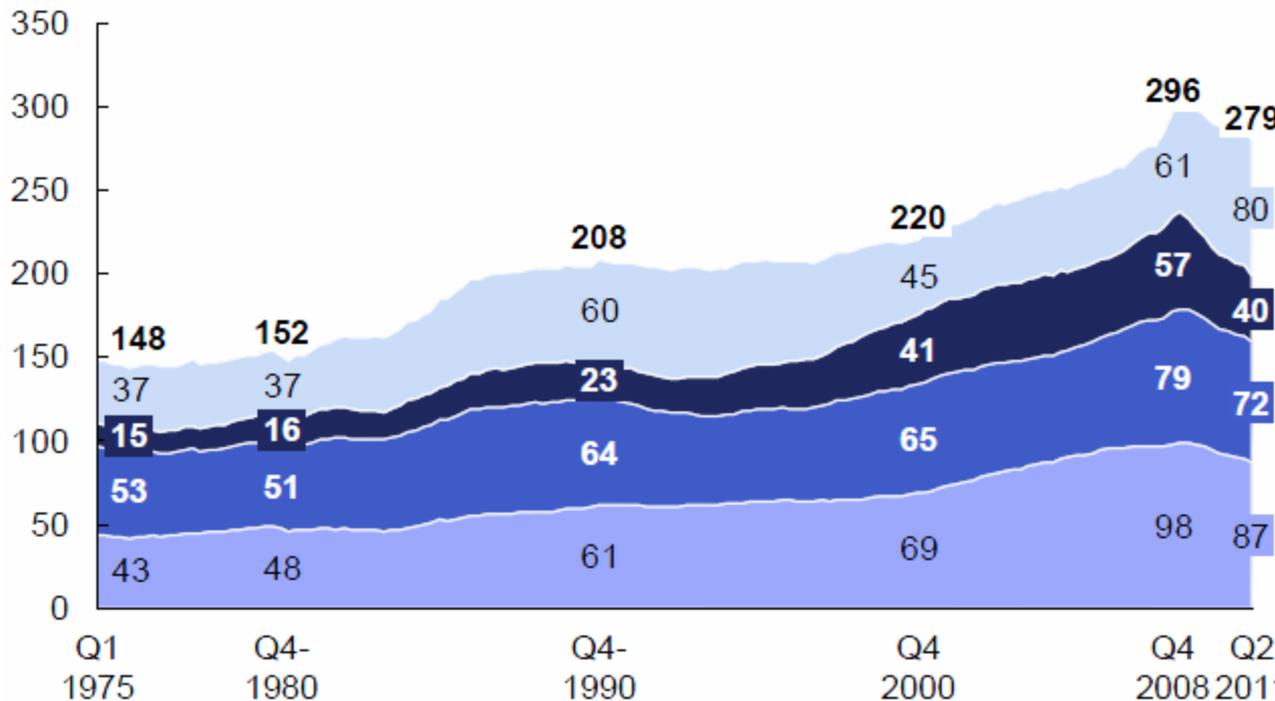
Following the Prescription

The United States has undergone rapid private-sector deleveraging since 2008

- Government
- Financial institutions
- Nonfinancial corporations
- Households



Total U.S. Public and Private Sector Debt as a % of GDP



Change		Total
Percentage points		
Q4 2000– Q4 2008	Q4 2008– Q2 2011	
75	-16	
16	19	
16	-17	
14	-7	
29	-11	

Four Years Later, How Are We Doing?

- Four key areas
 - Household Economic Health
 - Banking/Financial System
 - Housing Markets
 - Employment

Household Economic Health

Historical precedent suggests that US households could be as much as halfway through the deleveraging process.

-- McKinsey Global Institute, 2012

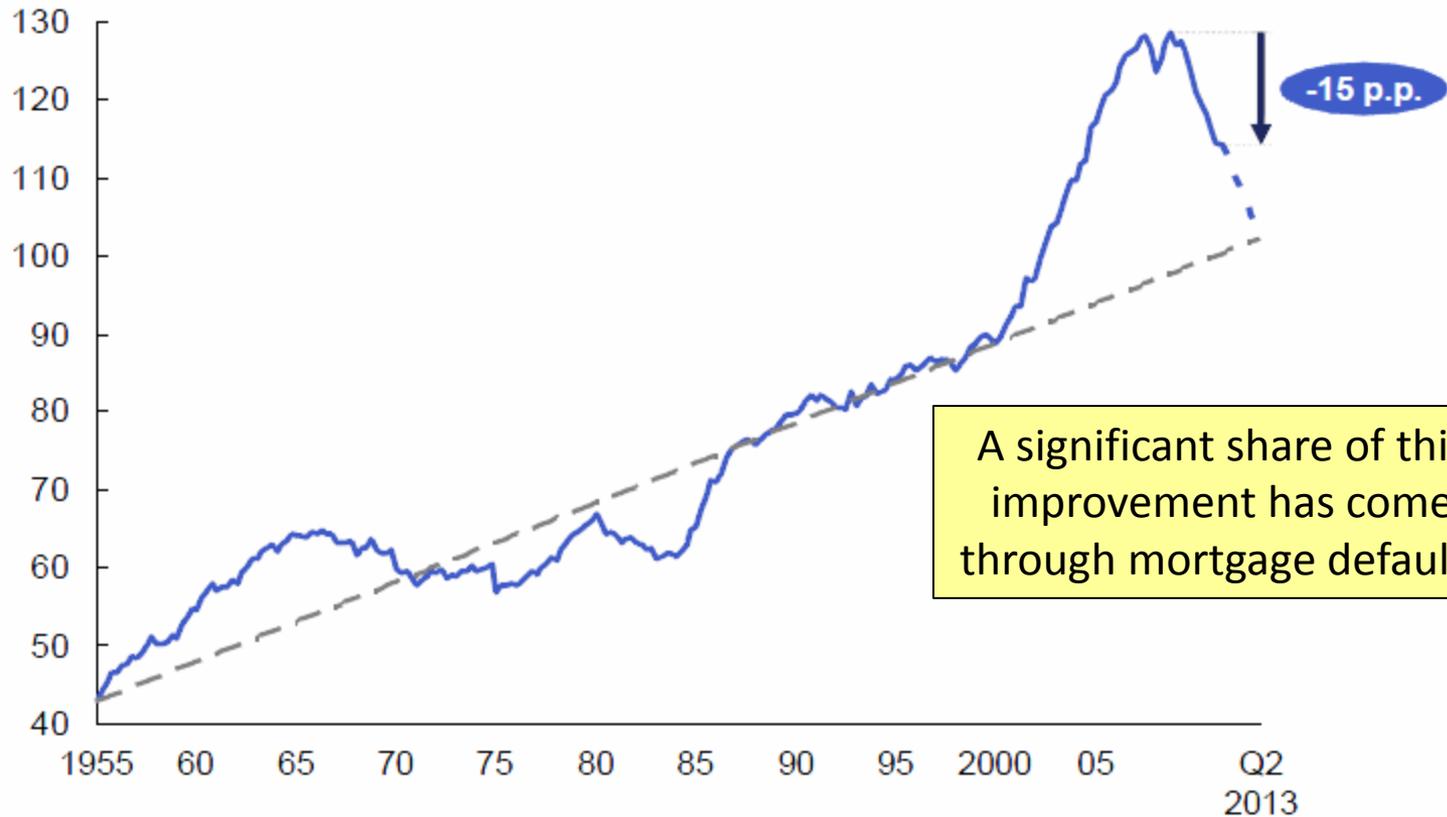
Household Debt Improving

The US household debt ratio could return to its long-term trend in 2013

Household debt

% of disposable personal income, seasonally adjusted

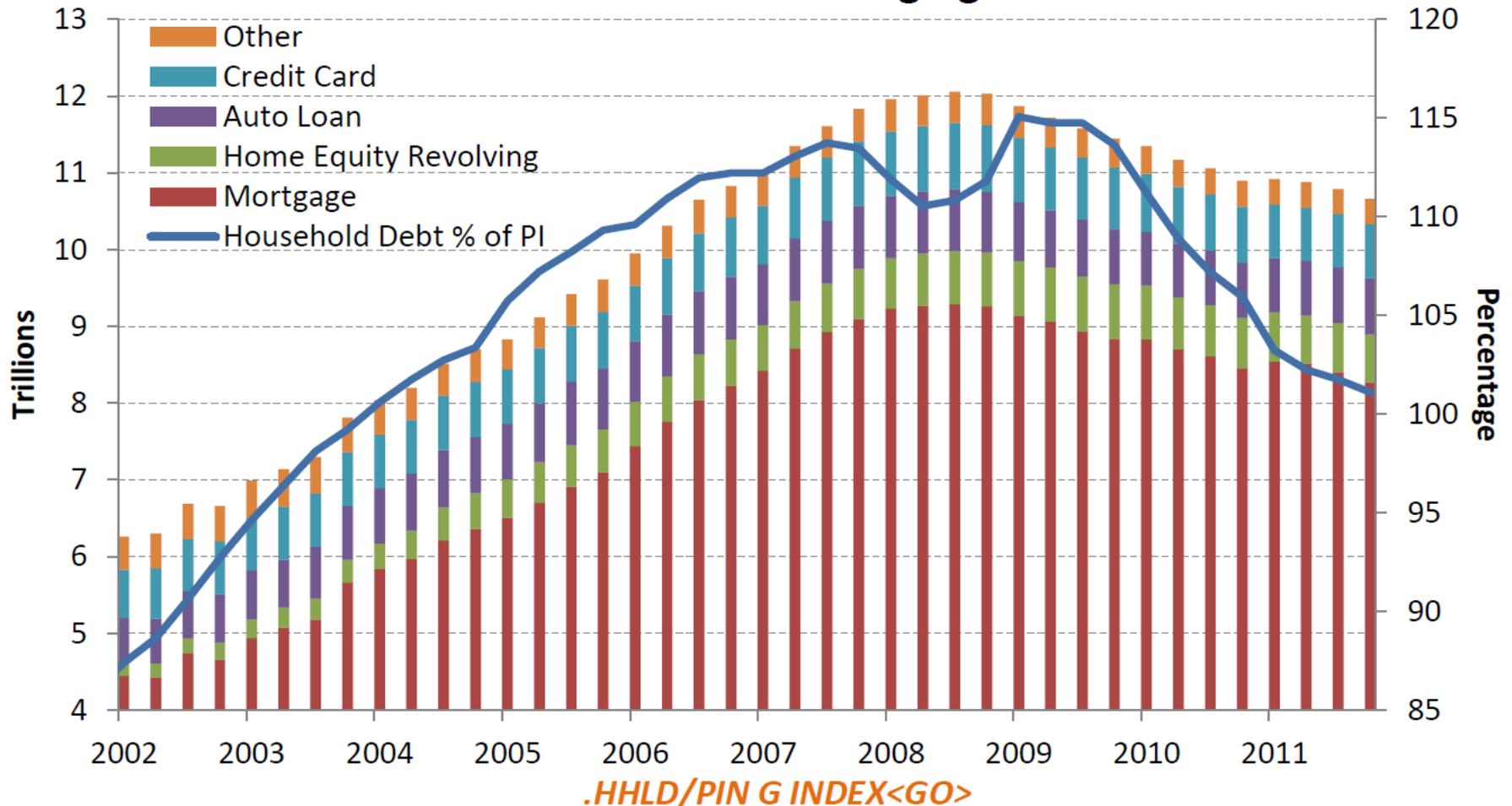
- Historical
- - Trend line based on 1955–2000 data
- - - Projected¹



A significant share of this improvement has come through mortgage defaults

Households Making Slow Progress

Household Deleveraging

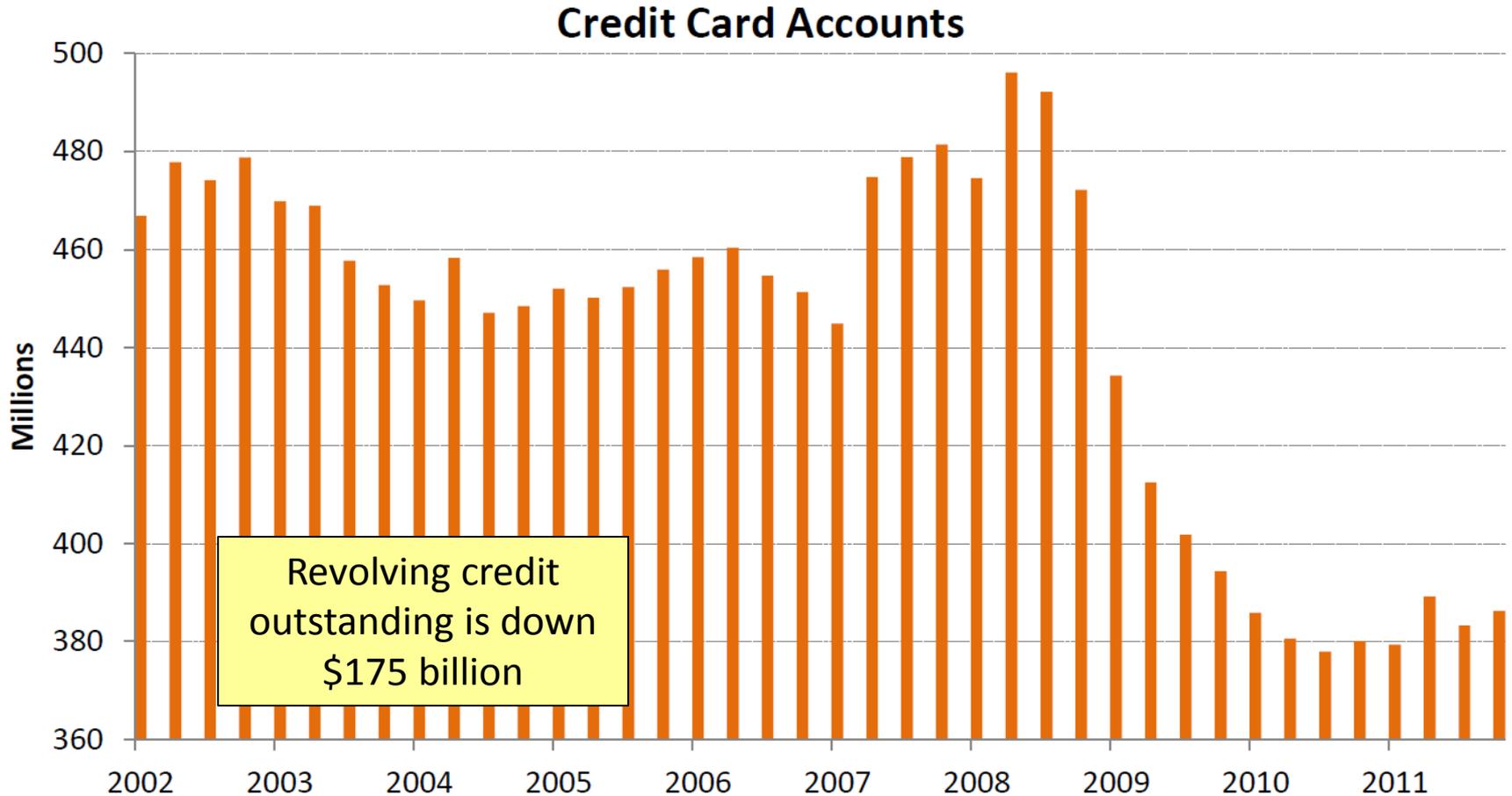


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Source: New York Federal Reserve, Bloomberg

BloombergBriefs.com

120 Million Fewer Credit Cards



Source: New York Federal Reserve, Bloomberg

BloombergBriefs.com

Households Economizing

Real Families Tell How They Reduce/Avoid Debt

- Dine at home
- Drink cheaper wine
- Pack a brownbag lunch
- Finish college faster
- No more lavish vacations
- No vacation home or timeshare
- Budget everything
 - Avoid impulse buying
 - Pay with cash
 - Put children on budgets
- Nix cable, watch broadcast TV
- Drive less, ride the bus more
- Surrender mortgaged house to the bank
- Sell owned house
 - Replace it down-market
 - Get lower property taxes
 - Use proceeds to repay debt
- Sell wine collection
- Work more hours
- Buy designer clothes only at thrift stores
- Fewer trips to the salon
 - Dye at home
- Give away high-maintenance pets

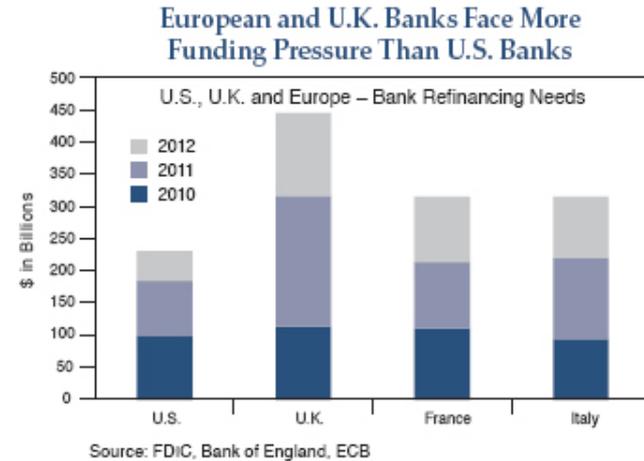
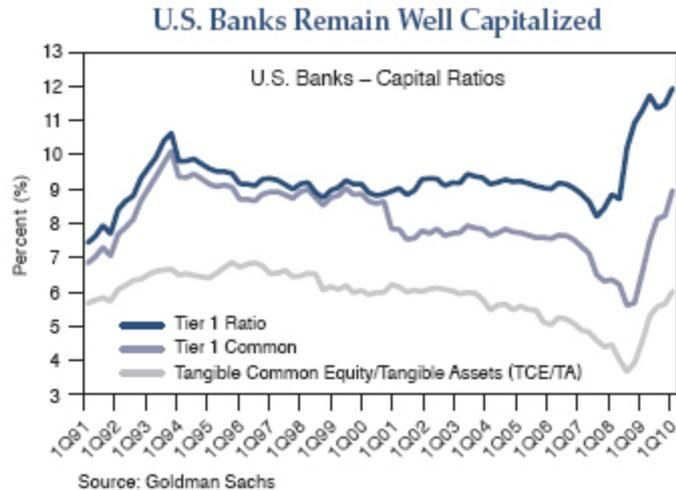
Source: LA Times 3/25/2012

Banking/Financial System

U.S. Financial-sector debt has declined from \$8 trillion to \$6.1 trillion and stands at 40 percent of GDP, the same as in 2000.

-- McKinsey Global Institute, 2012

Banks Relatively Healthy

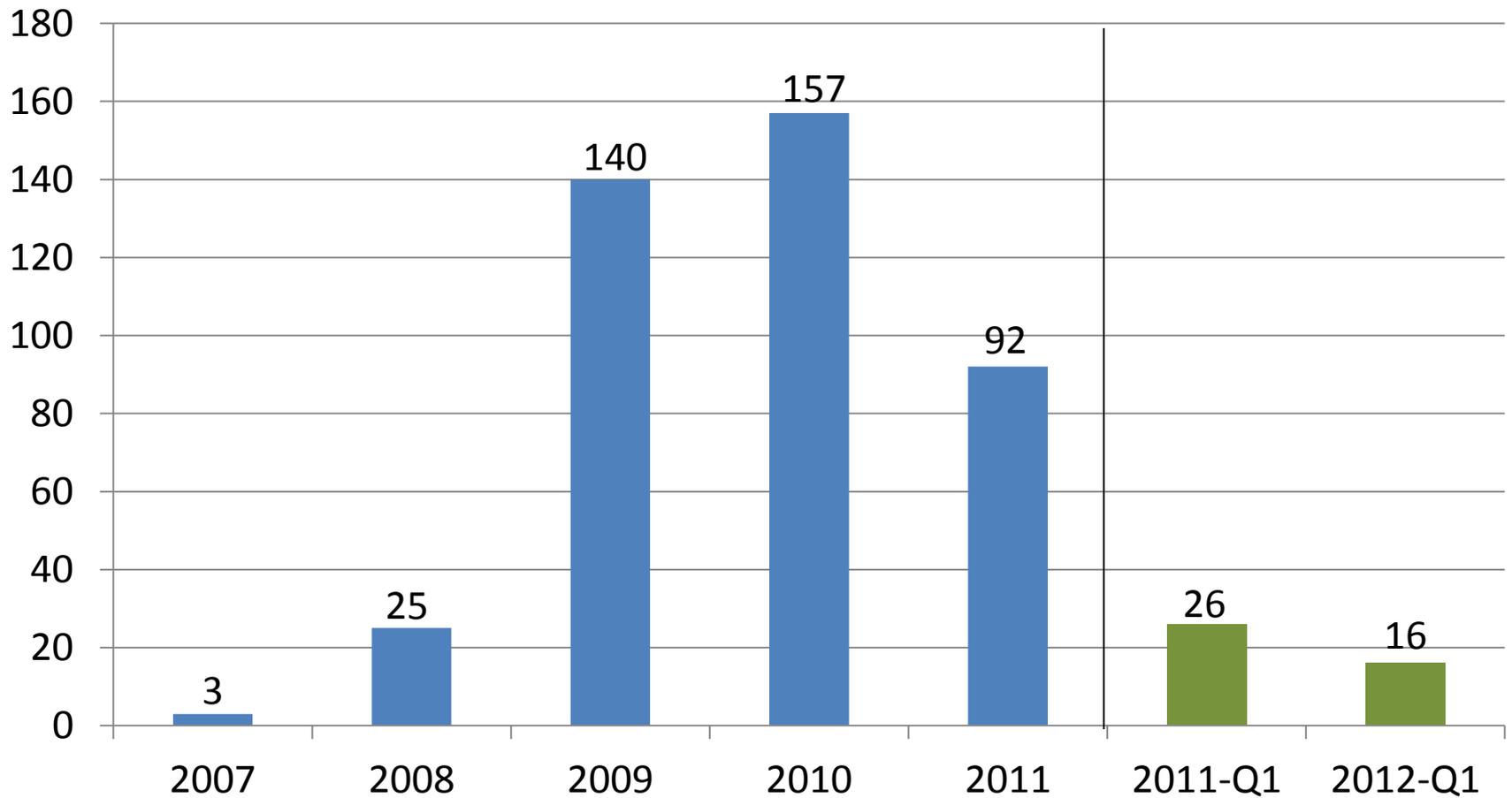


The results of the stress tests conducted by the United States Federal Reserve on the largest American banks show that most are enjoying solid financial health...

Out of the 19 banks evaluated by the Federal Reserve, 15 proved resilient under the conditions simulated by the stress tests. The adverse conditions include a hypothetical record unemployment rate of 13 percent and a sudden [further] depreciation of the American housing market by 21 percent.

-- (TheNicheReport.com) — 3/16/2012

Number of FDIC Bank Failures



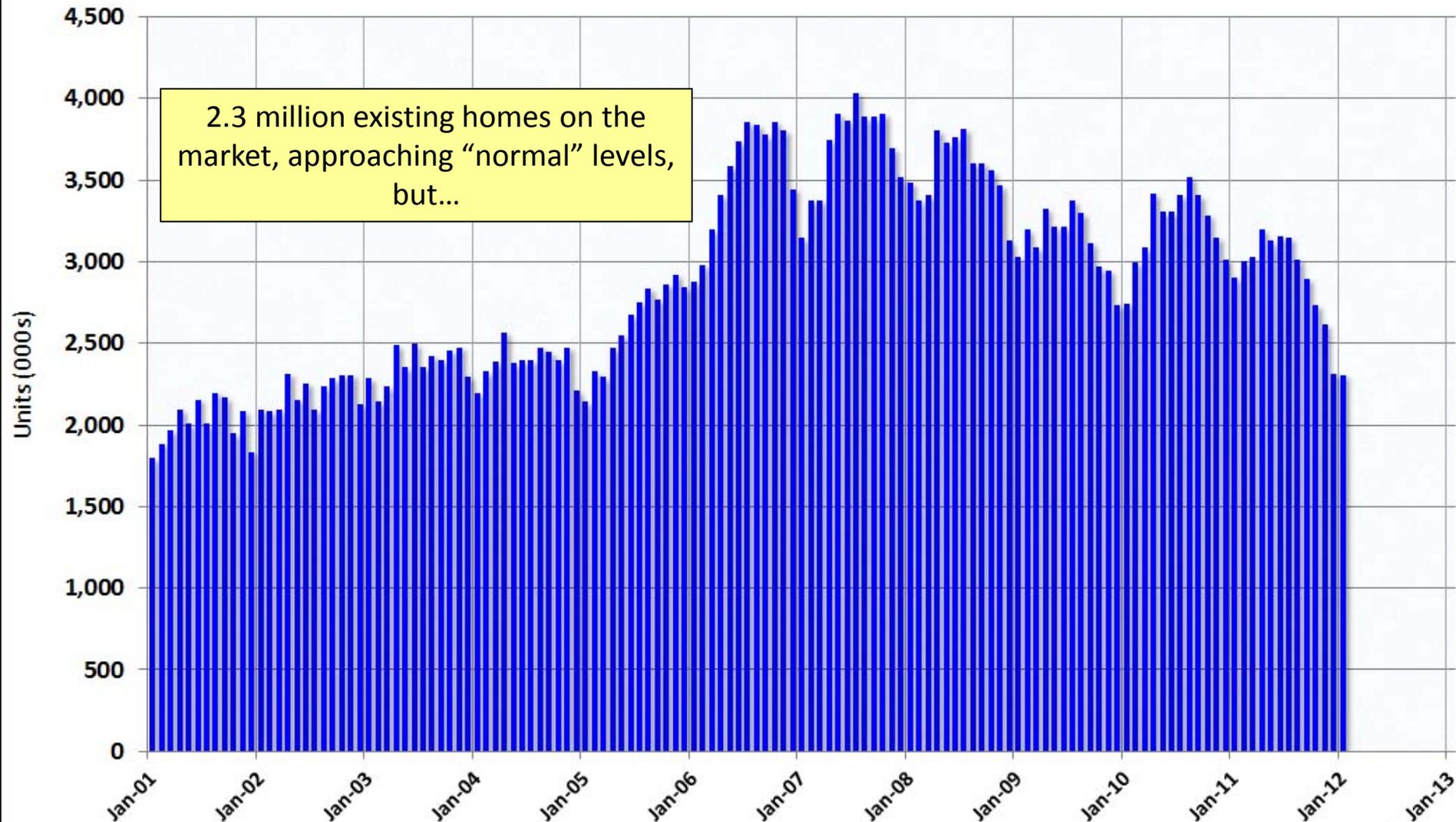
Housing Markets

“Housing is getting better – there, I said it.”

-- Jamie Dimon, Chairman, President and CEO
JP Morgan Chase

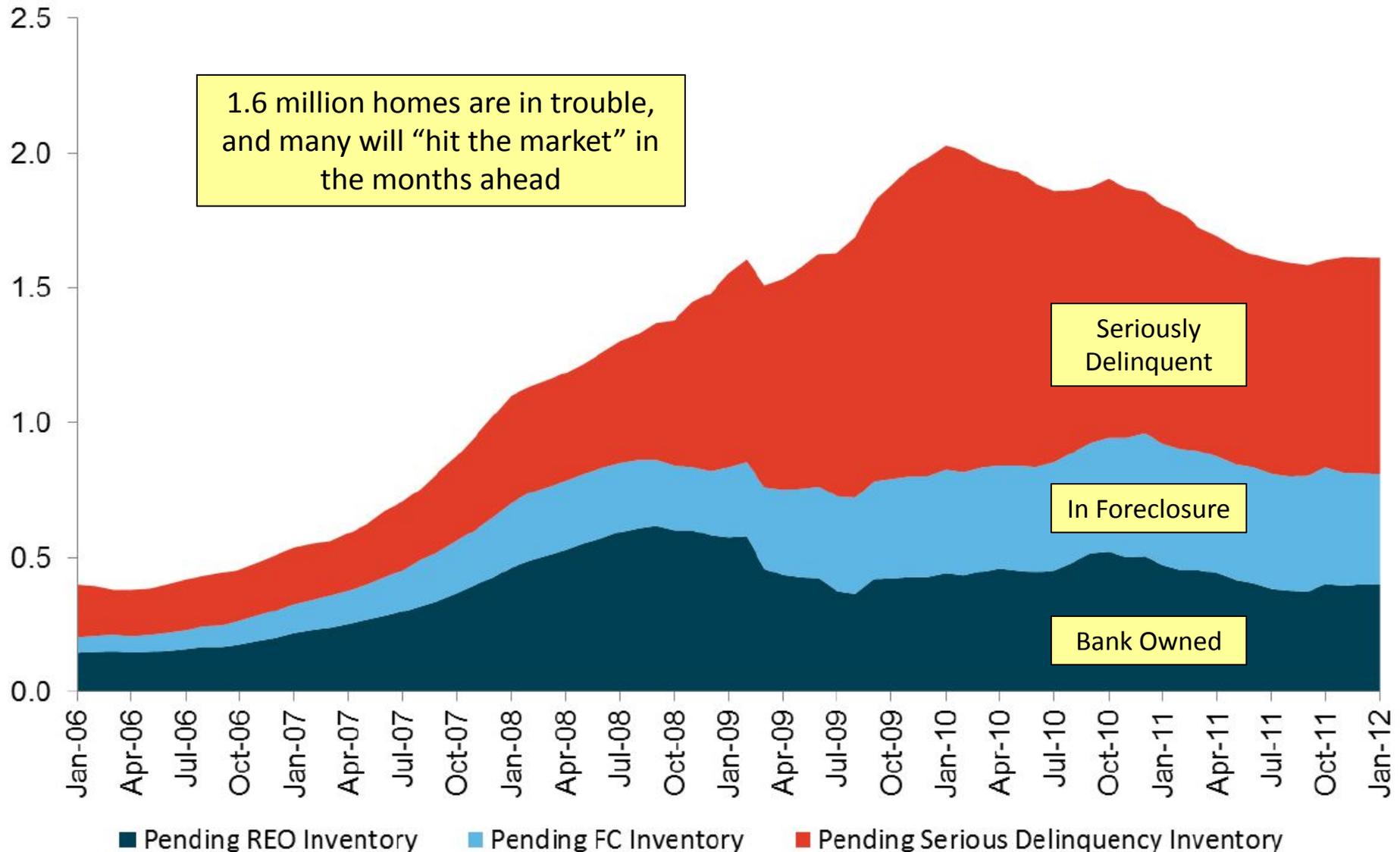
Declining Inventory of For-Sale Homes

Existing Home Inventory



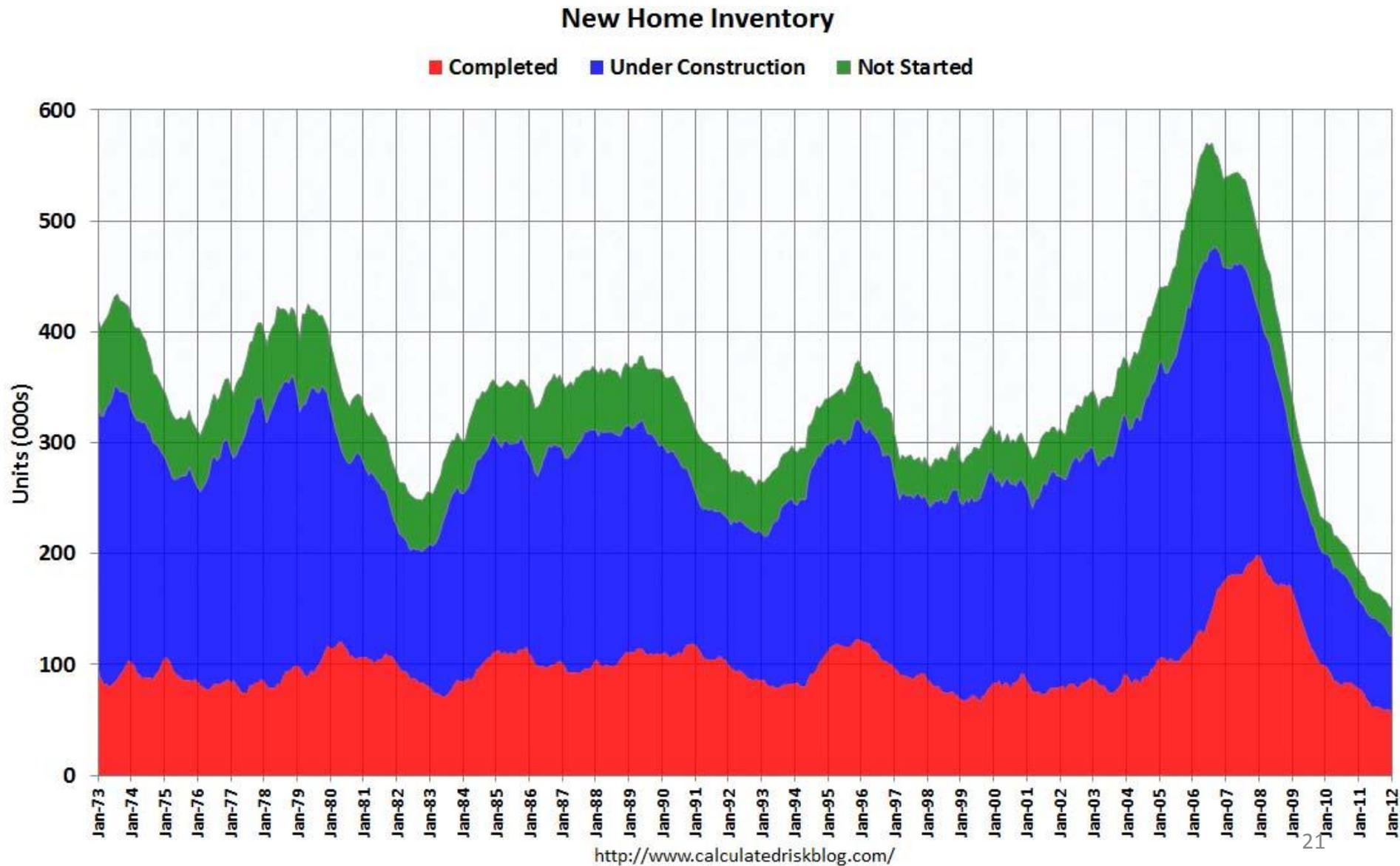
2.3 million existing homes on the market, approaching "normal" levels, but...

Shadow Inventory: Still High, But Not As High

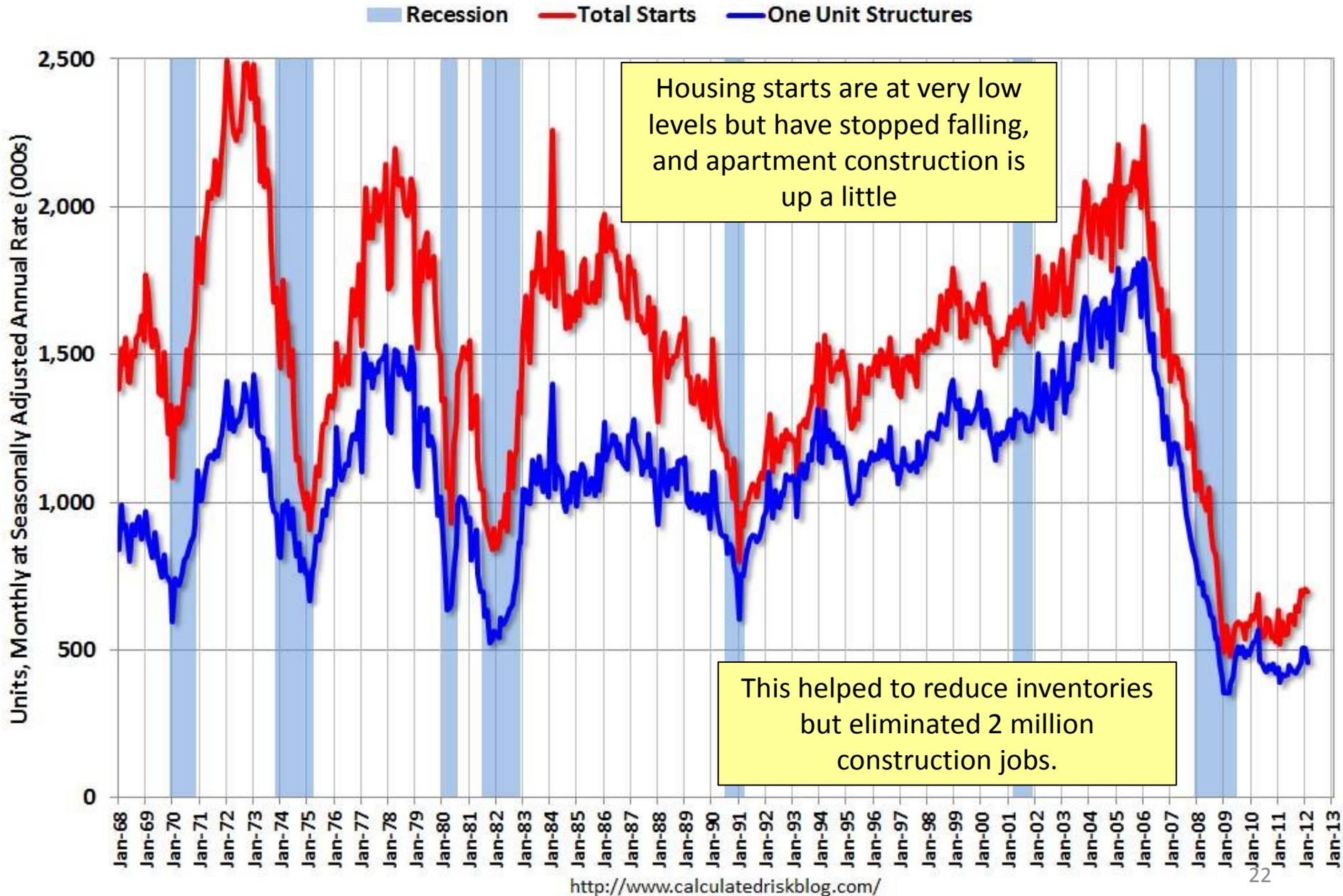


Source: CoreLogic January 2012

Fewer *New* Homes Coming to Market



Housing Starts Have Stabilized



Housing Markets Summary

- Regional markets vary widely
 - Problems concentrated in Florida, California, Nevada, Arizona
 - Many other markets relatively normal, if not healthy
- Pent-up demand from delayed household formation
 - Only half of the expected 1.2 million households per year were formed in recent years
 - Households will form as employment improves
- Rent-Own equation favors buying in many areas

Note Regarding Texas

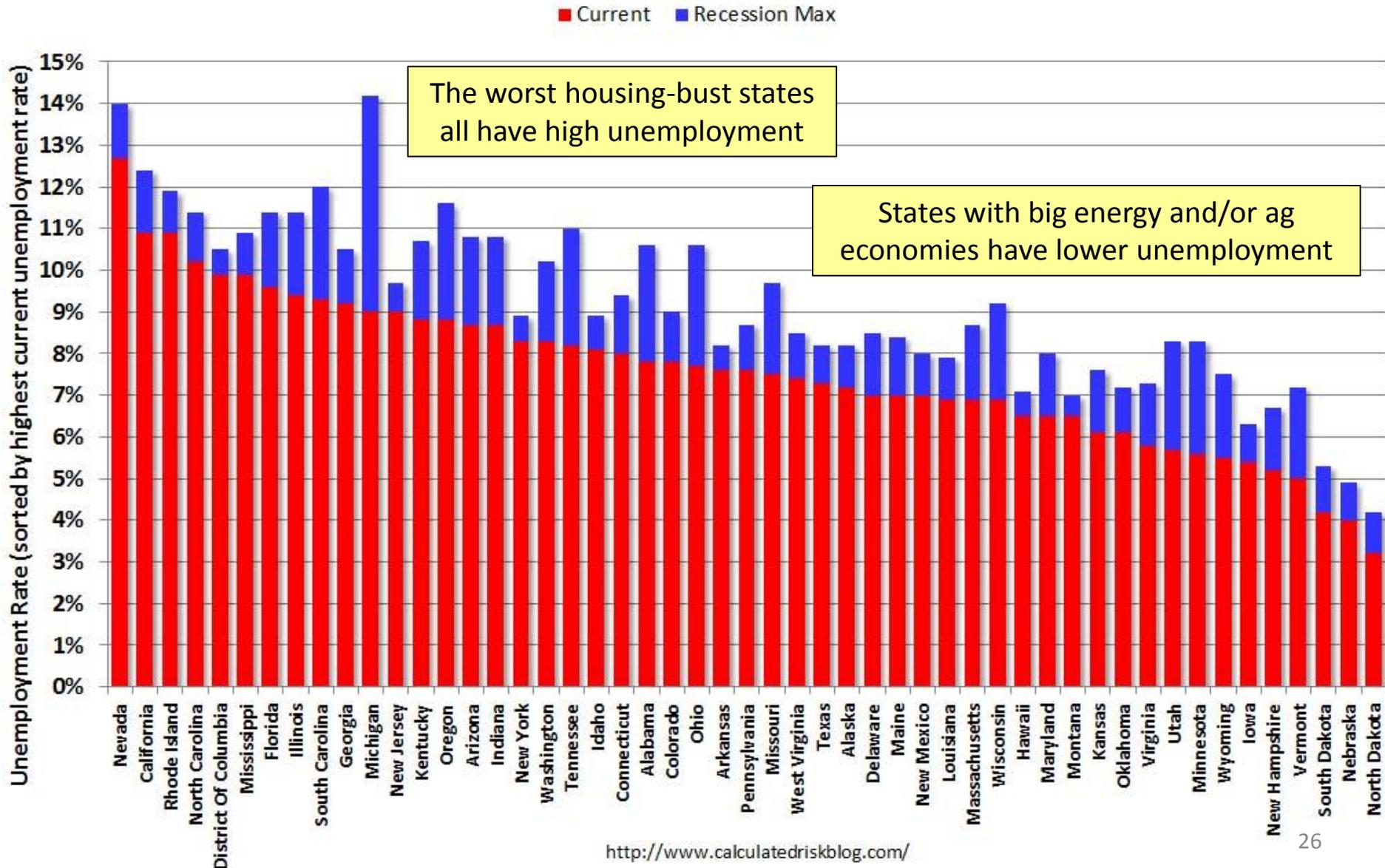
- Texas avoided the worst excesses of the housing boom and bust thanks to its constitution – SECTION 50(a)(6), ARTICLE XVI
 - “The principal loan amount at the time the [cash-out home equity] loan is made must not exceed an amount that, when added to the principal balances of all other liens against your home, is more than 80 percent of the fair market value of your home.”
 - This, together with other elements of the article, prevented excessive home-as-ATM activity that got so many homeowners in trouble in other states.
- Strong global energy and agricultural markets and a business-friendly, low-tax, pro-growth culture helped, too.

Employment

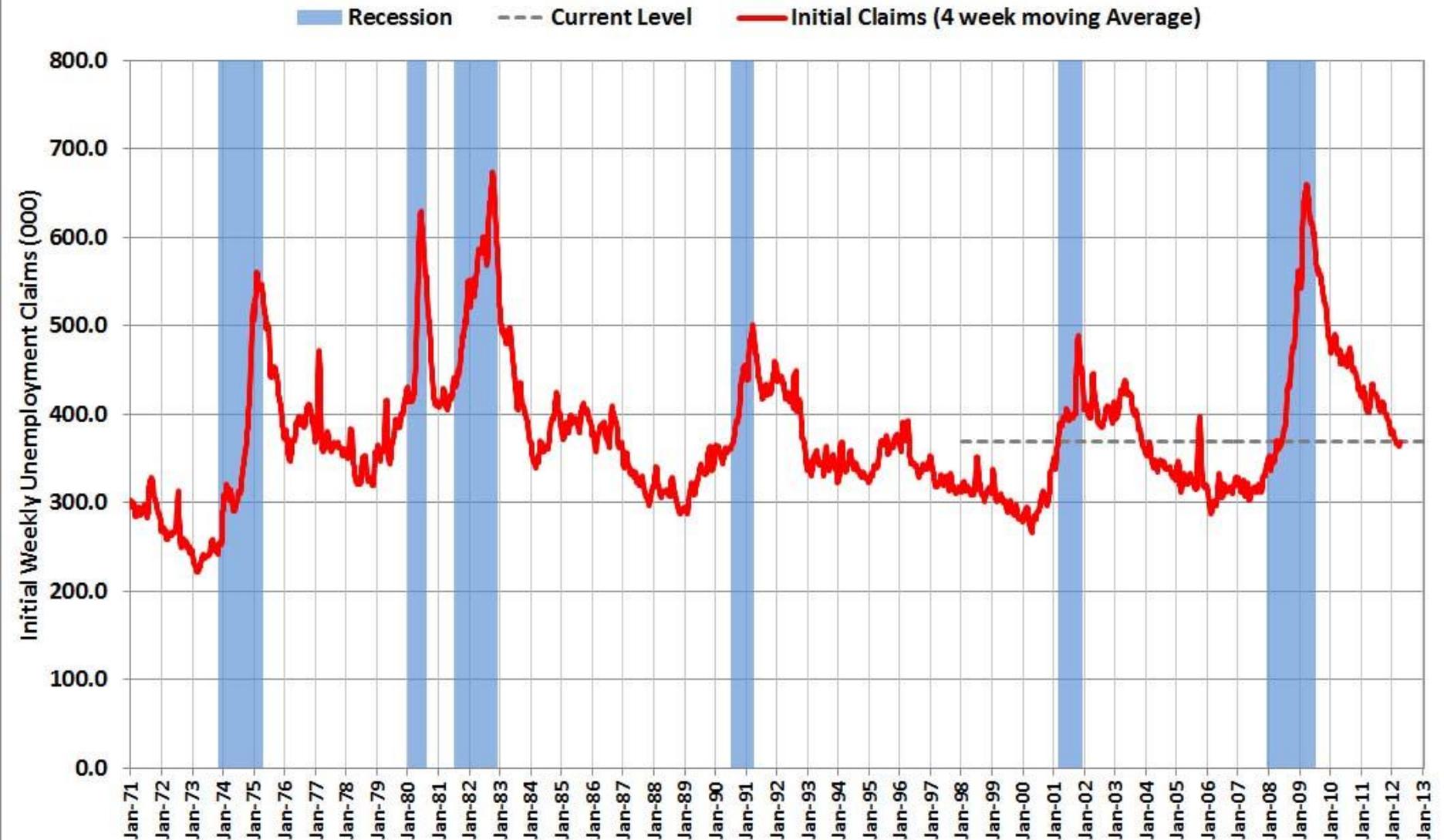
Job destruction abated as the economy stabilized and began to recover, enabling a period of sustained modest job growth in the private sector.

Significant Regional Variation

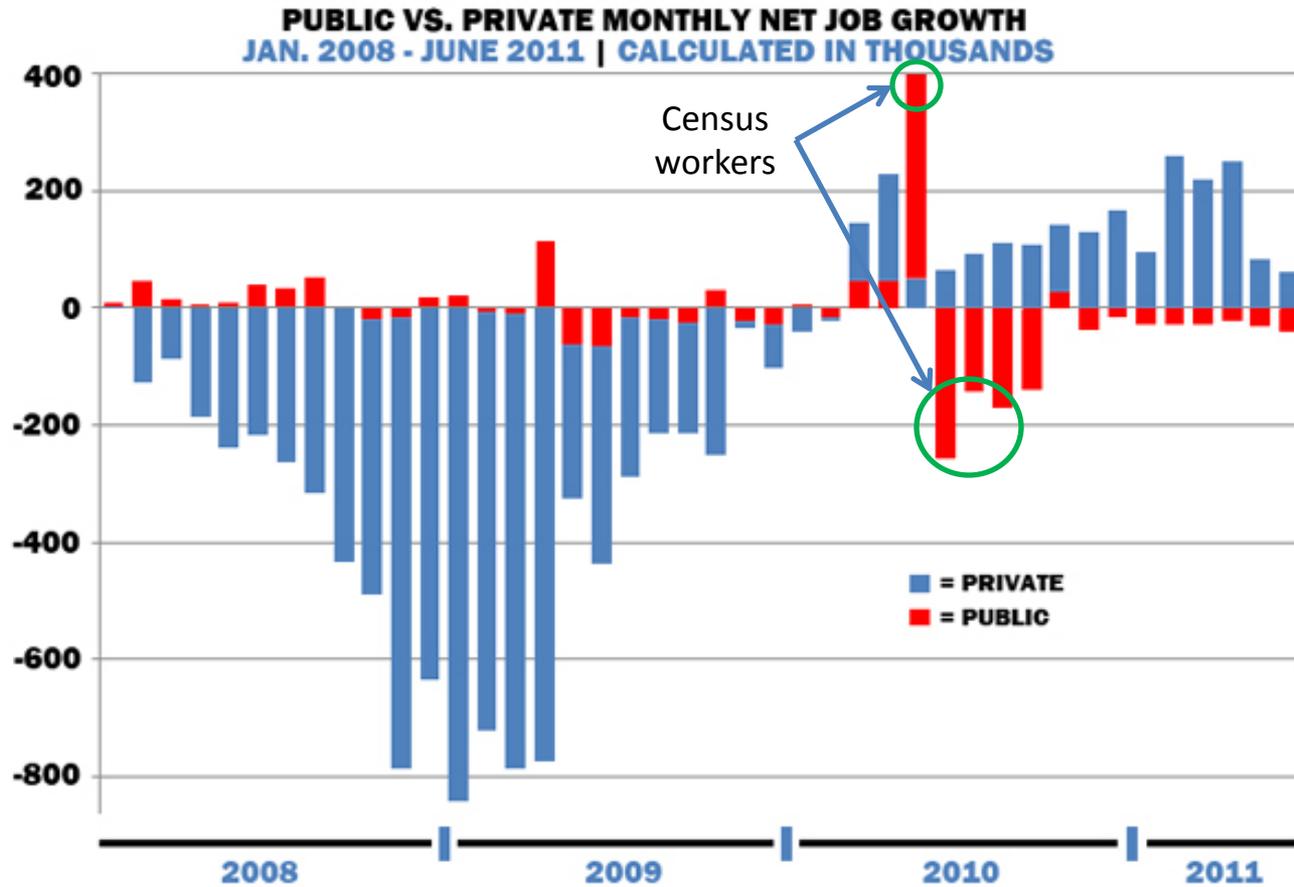
State Unemployment Rate: Current Rate and Max for 2007 Recession



Initial Weekly Unemployment Claims



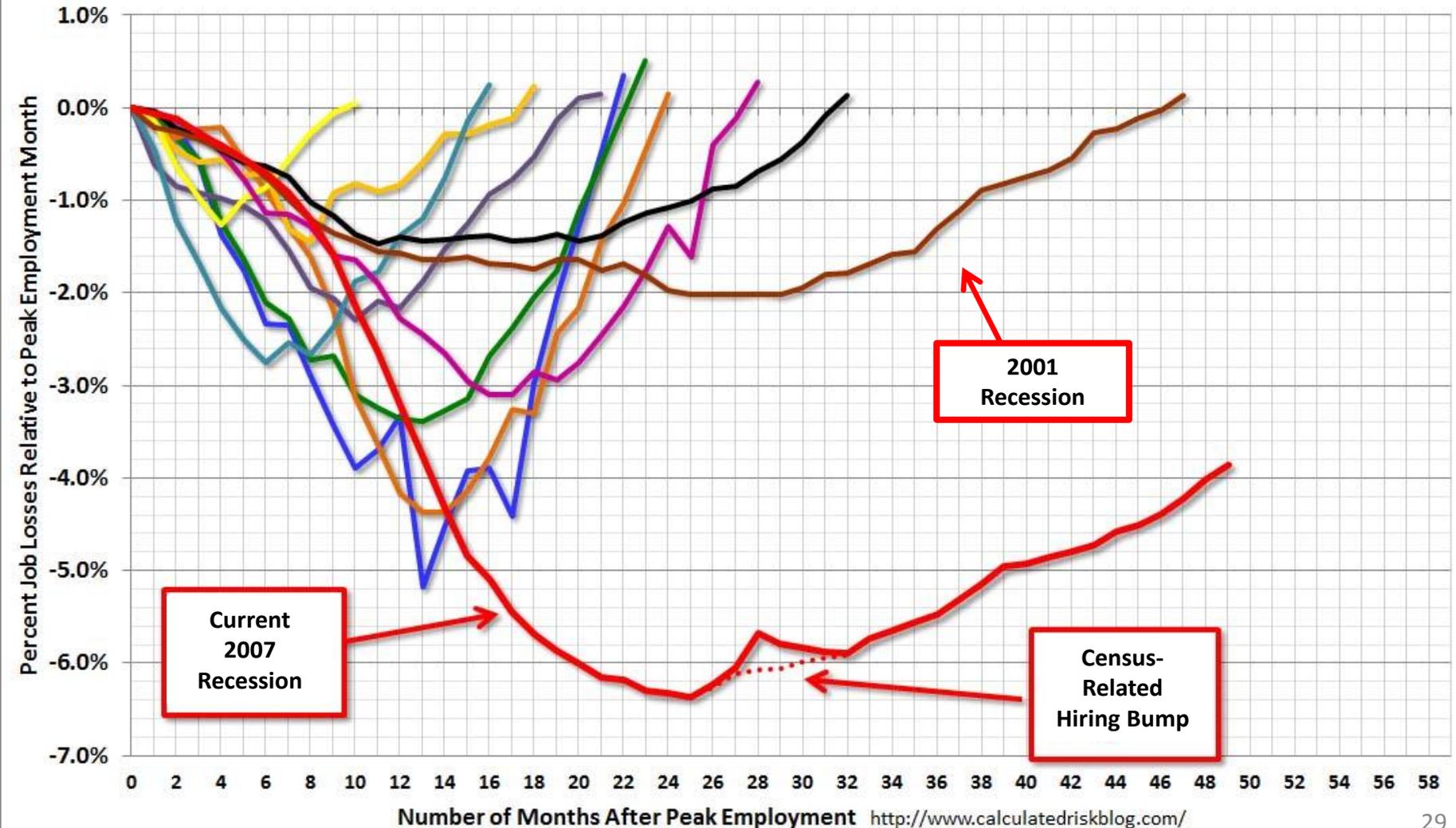
Fast Fall, Slow Climb Back



Job Losses in This vs. Other Recessions

Percent Job Losses in Post WWII Recessions

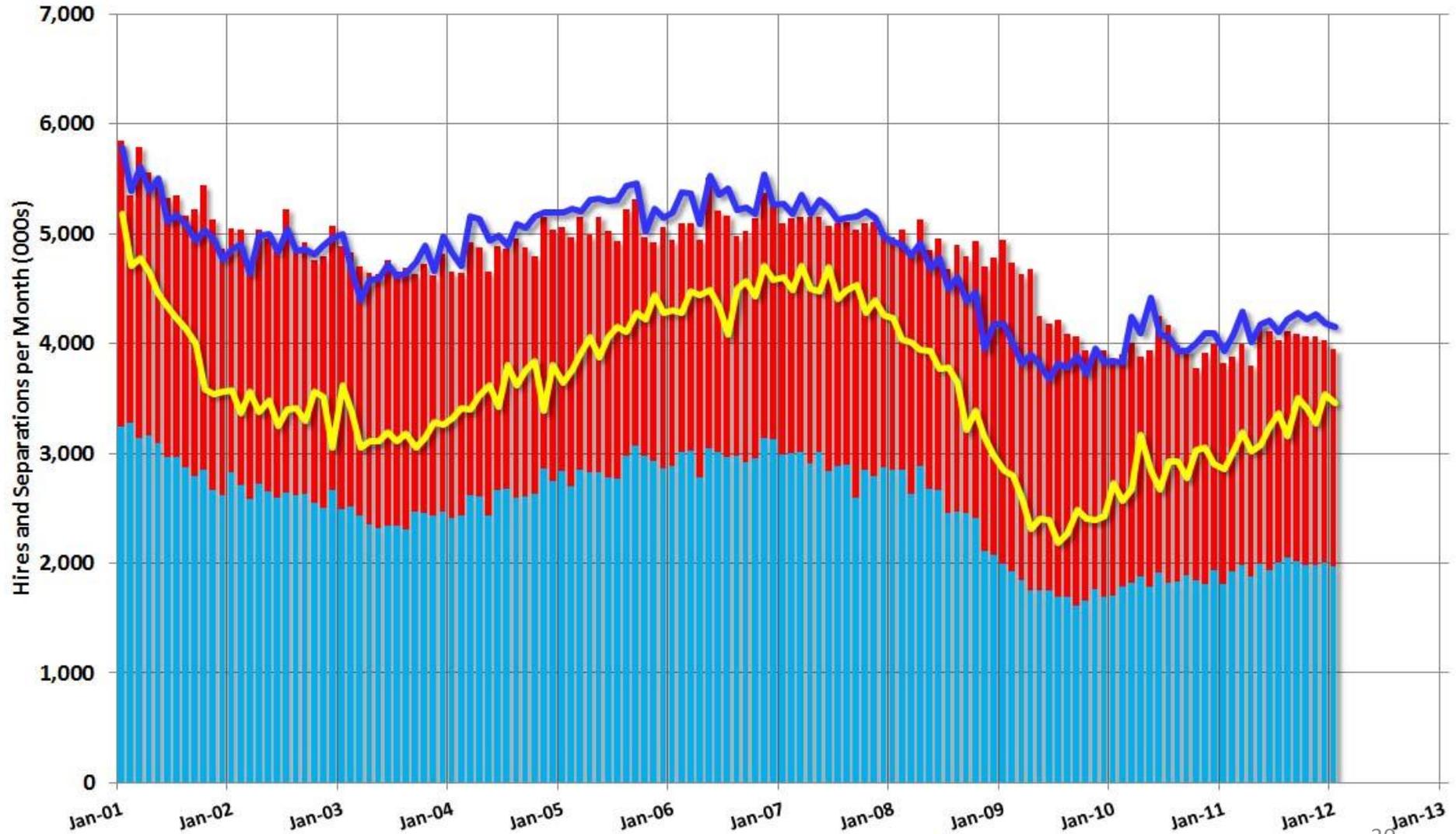
1948 1953 1957 1960 1969 1974 1980 1981 1990 2001 2007



Job Openings Are Increasing

Hires and Separations Monthly (SA) from
Job Openings and Labor Turnover Survey (JOLTS), Source: BLS

Quits Layoffs, Discharges and Other Hires Job openings



Shrinking industries



Growing industries



Renewables & Environment

Circle size indicates the relative number of U.S. private sector jobs created or lost, 2007-2011

Internet
Online Publishing

Philanthropy

E-Learning

Public Policy

International Trade & Development

Think Tanks

Venture Capital

Computer Games

Health, Wellness & Fitness

Oil & Energy

Utilities

Medical Devices

Management Consulting

Hospital & Health Care

Marketing & Advertising

Information Technology

Financial Services

Real Estate

Pharmaceuticals

Telecommunications

Banking

Construction

Automotive

Retail

Supermarkets

Capital Markets

Warehousing

Restaurants

Newspapers

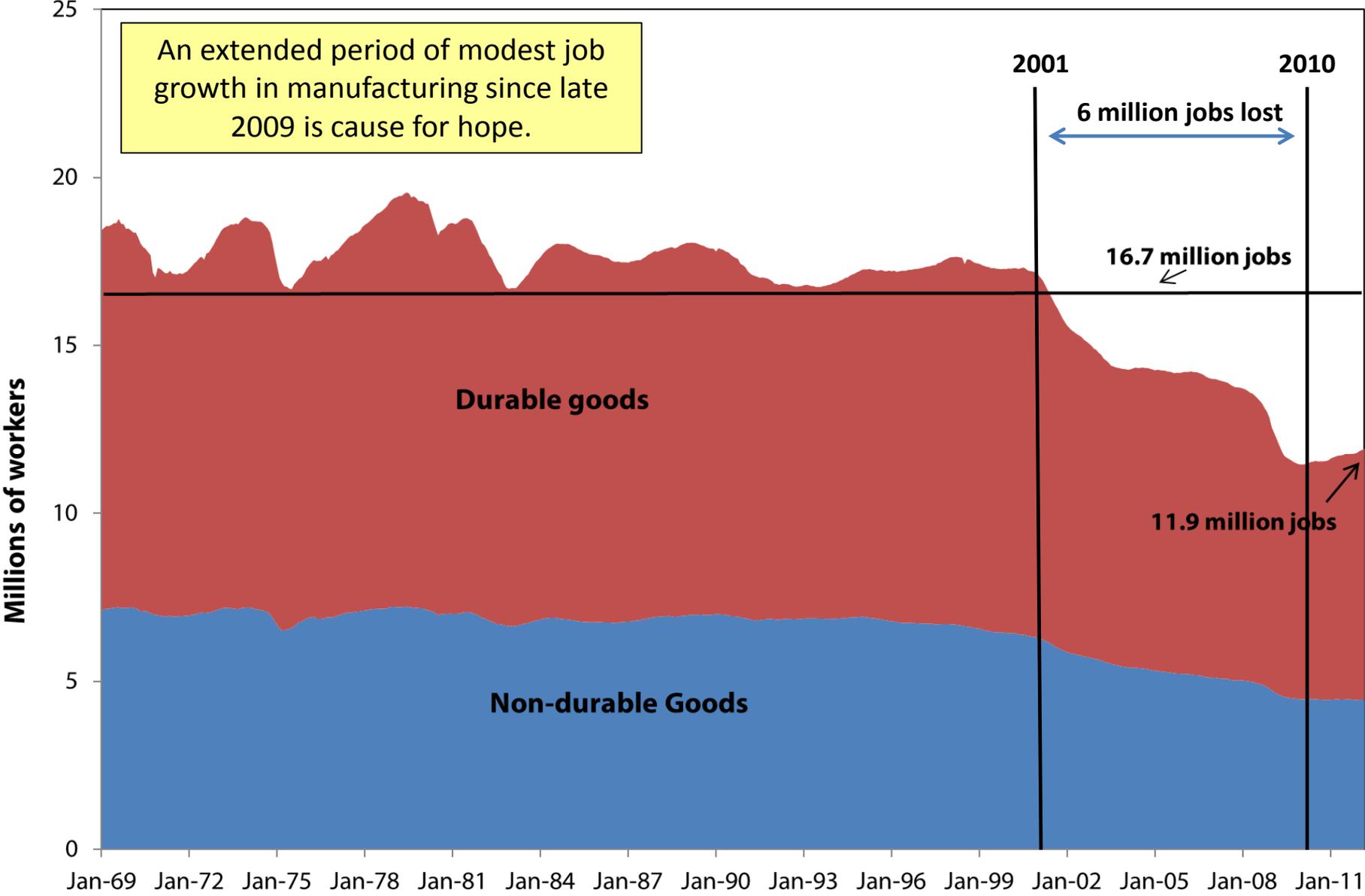
Most job growth in mature economies involves complex interactions, not routine production or transaction work.

United States, 2001-09, millions of employees

Type of job	Jobs lost	New jobs created
Interactions Exchanges involving complex problem solving, experience, context (eg, lawyer, nurse)		4.8
Transactions Exchanges that can be scripted, routinized, automated (eg, bank teller, retail cashier)	-0.7	
Production Process of converting physical materials into finished goods (eg, factory worker, farmer)	-2.7	

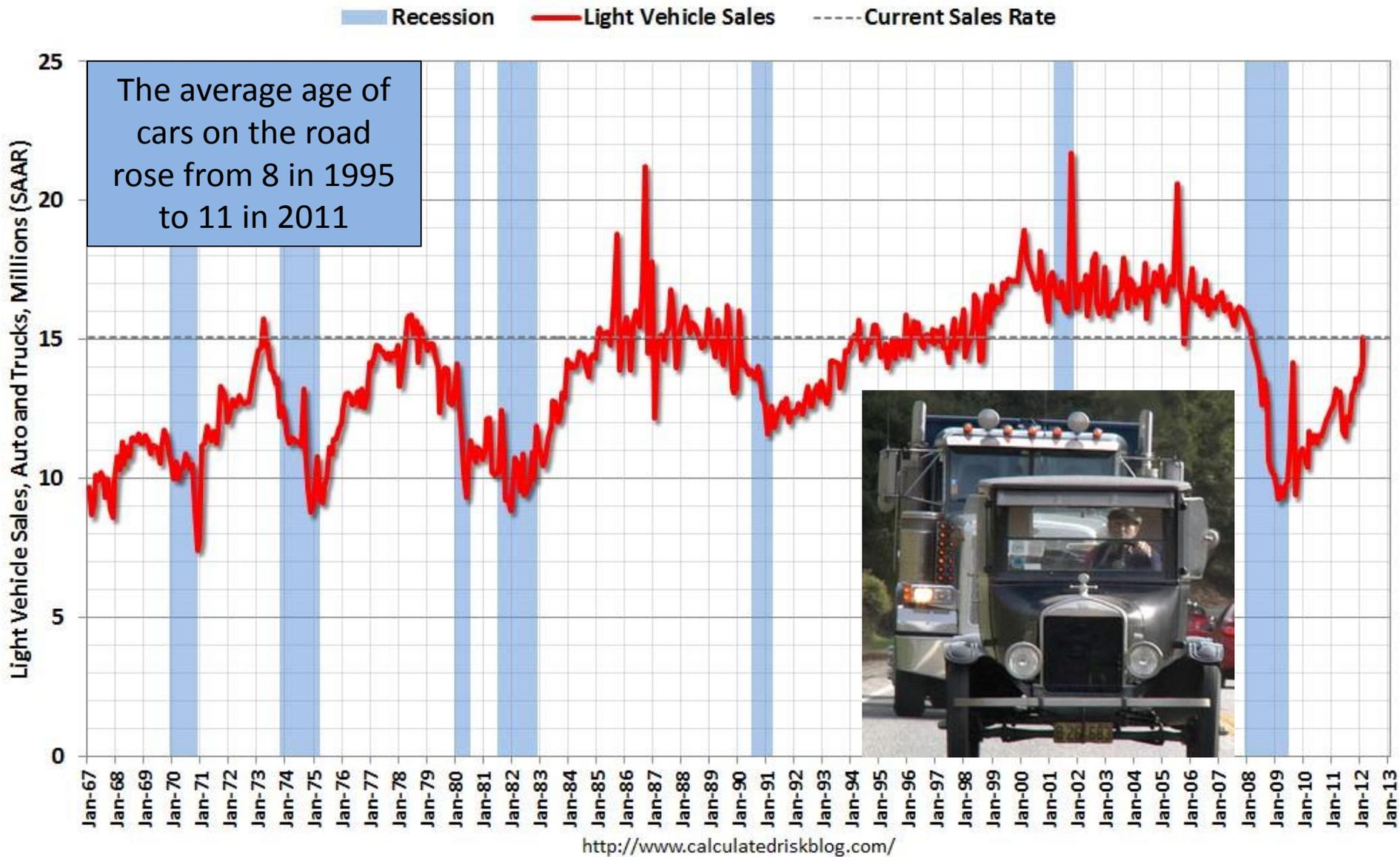
Source: US Bureau of Labor Statistics; McKinsey Global Institute analysis

U.S. manufacturing employment, 1969 - March 2012



Sources: Bureau of Labor Statistics, Current Employment Statistics (bls.gov/ces , downloaded 3/4/2012) and Economic Policy Institute

Aging Cars and Improved Household Finances Are Supporting Vehicle Sales and Manufacturing



Summary

We are making progress, but aren't out of the woods yet

A Cautionary Note

Ceridian-UCLA Pulse of Commerce Index™

Recession Pulse of Commerce Index

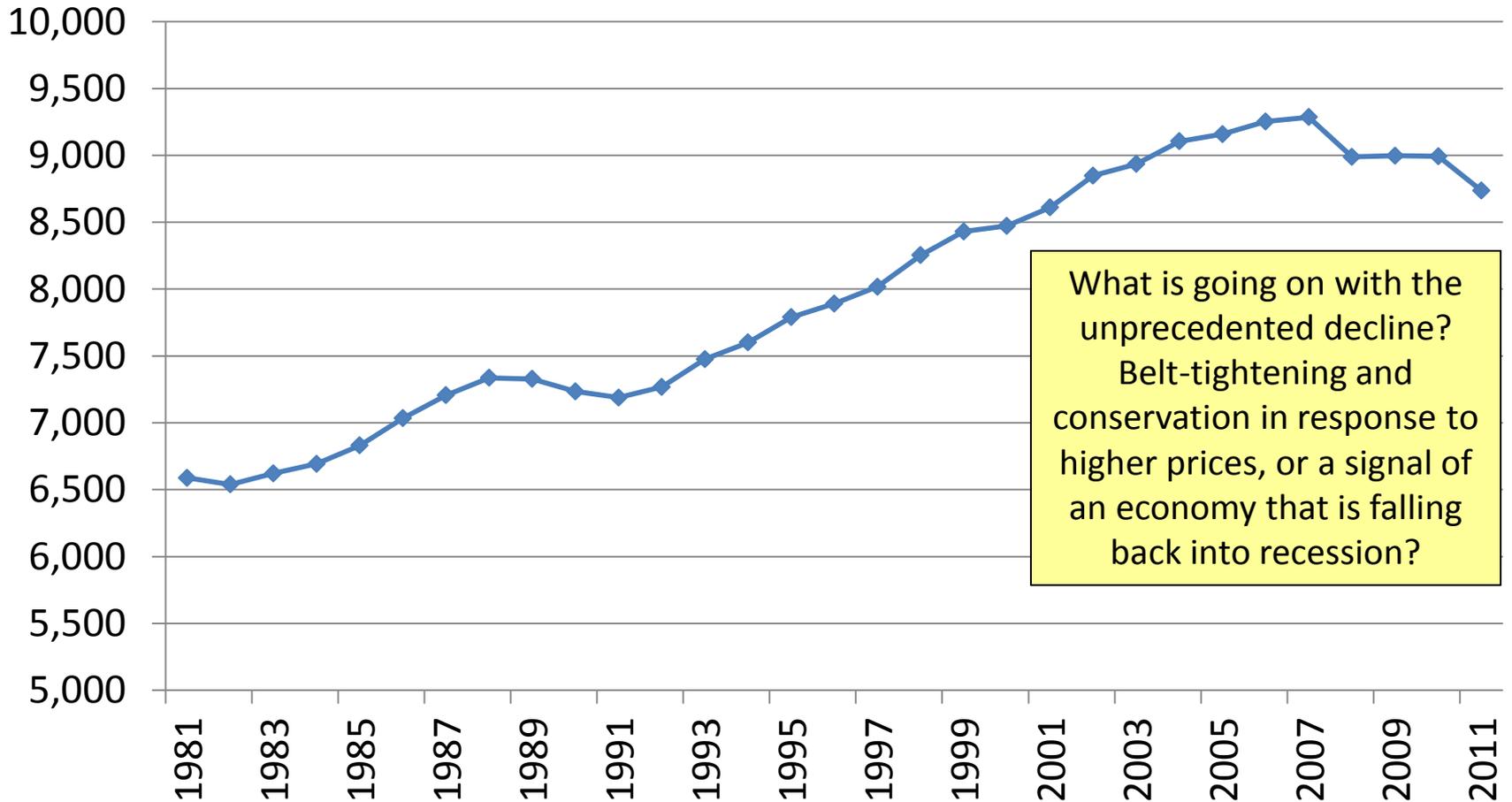


This index is based on over-the-road truck diesel fuel usage and can indicate changes in the intensity of business activity.

It is not signaling economic strength.

Finished Motor Gasoline – Product Supplied

(barrels in thousands)

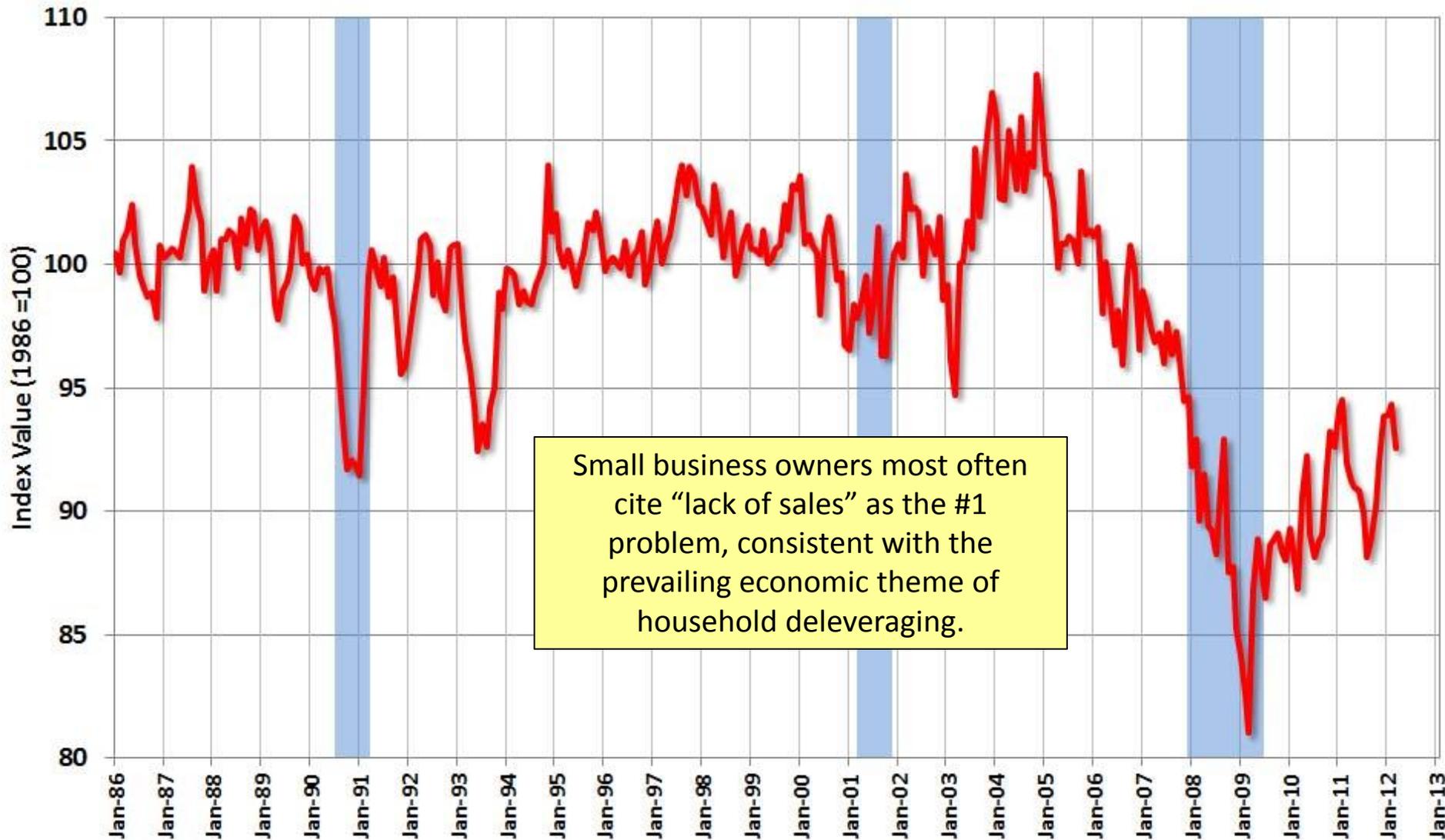


What is going on with the unprecedented decline?
Belt-tightening and conservation in response to higher prices, or a signal of an economy that is falling back into recession?

Source: U.S. Energy Information Administration

Optimism: Still Low but Improved

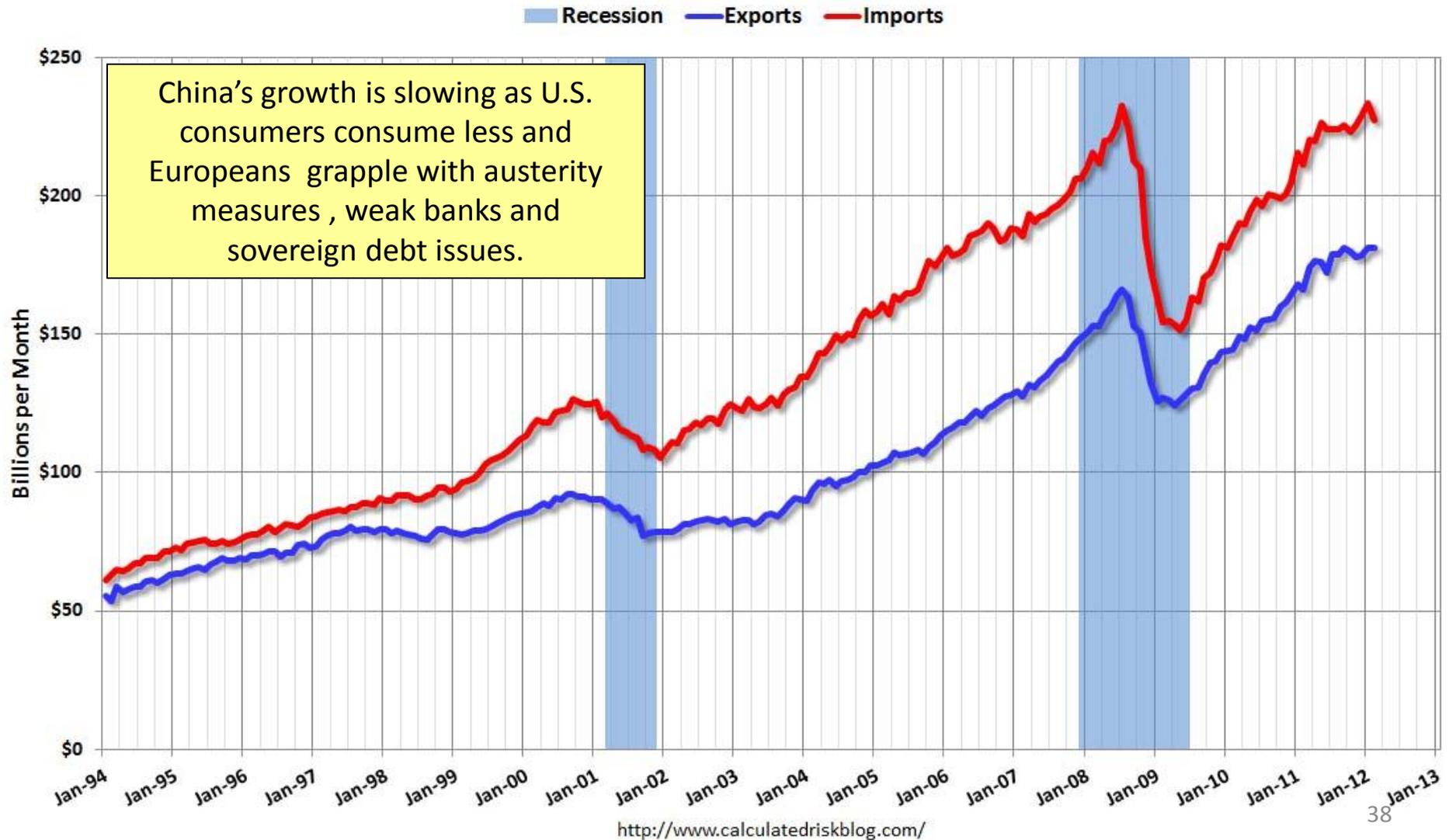
Small Business: Optimism Index



Small business owners most often cite "lack of sales" as the #1 problem, consistent with the prevailing economic theme of household deleveraging.

Trade Has Recovered But Remains a Concern

U.S. Trade, Exports and Imports, Billions Dollars per Month (SA)



Which will it be in the near term?

Escape Velocity

The speed needed to "break free" from a gravitational field without further propulsion

- Strong corporate profits and balance sheets can support investment
- Pent up consumer demand (e.g. aging cars, delayed household formation)
- Improving U.S. competitiveness
- Net private sector job growth
- Export growth
- Improving domestic energy supply/demand situation

Terminal Velocity

The speed at which an object ceases to accelerate due to the drag force exerted by the fluid through which it is moving

- Demographics (aging Baby Boomers)
- Ongoing household deleveraging reducing demand for goods and services
- Political dysfunction and government spending constraints
- European economic weakness reducing demand for U.S. exports
- Slowing economic growth in China reducing demand for U.S. exports

US households have reduced their debt relative to disposable income by 15 percentage points, more than in any other country; at this rate, they could reach sustainable debt levels in two years or so."

-- McKinsey Global Institute, 2012

Looking Ahead

- The economy will get better in time
 - Consumers are reducing debt levels
 - Banks are generally sound again
 - The excess housing supply is being absorbed
 - Overall, businesses don't have a debt problem
 - They will expand and hire as consumers begin to spend again
 - Energy supply/demand balance is positive
 - U.S. was a net petroleum exporter last winter
 - The U.S. is becoming more competitive
- HealthSmart is doing well
 - Growing with our customers and making selective acquisitions to expand service capabilities
 - Investing in technology to improve efficiency, quality and service



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