



US Economy: No recession in sight Policy uncertainty enormous

March 2017

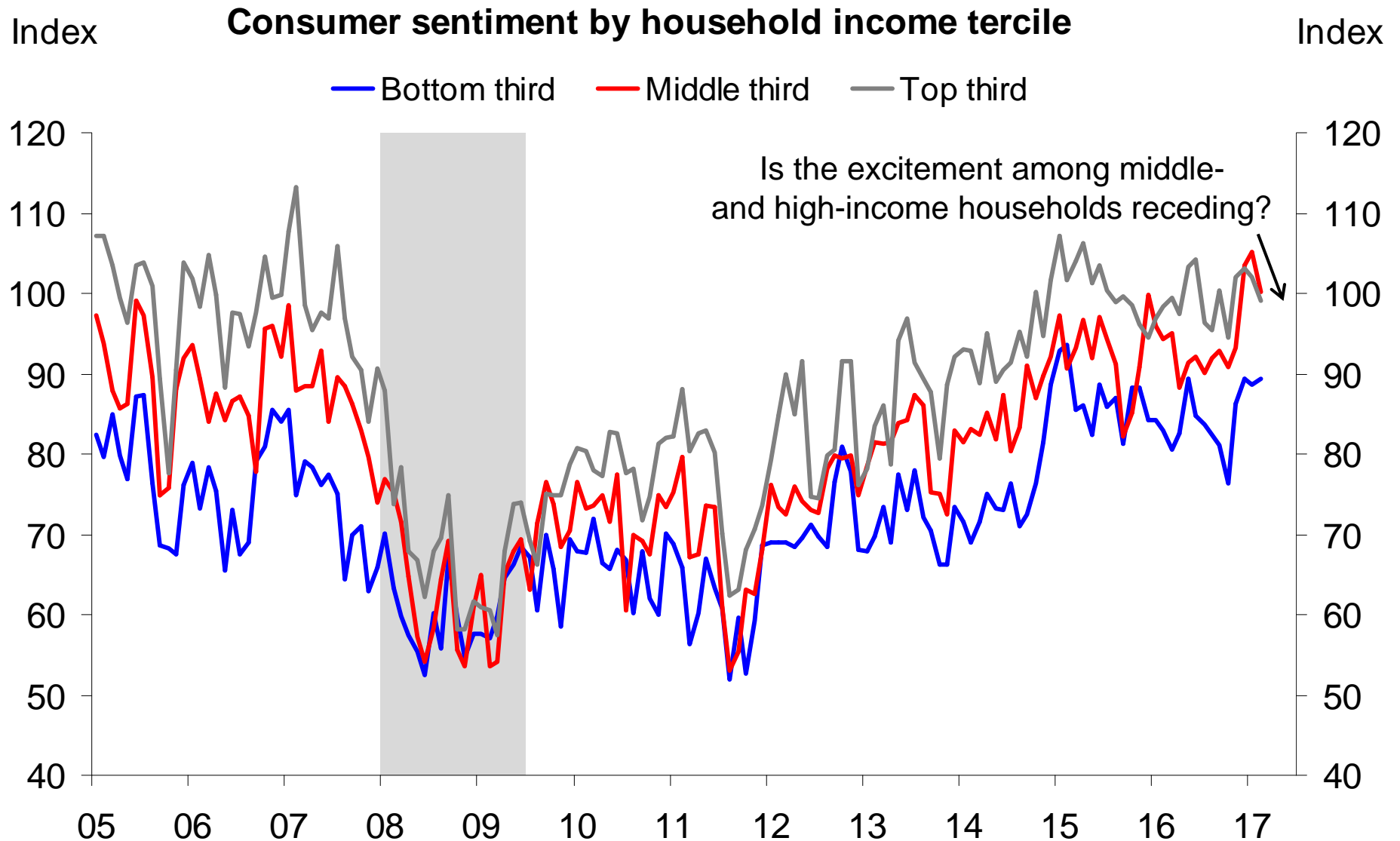
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DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MCI (P) 057/04/2016



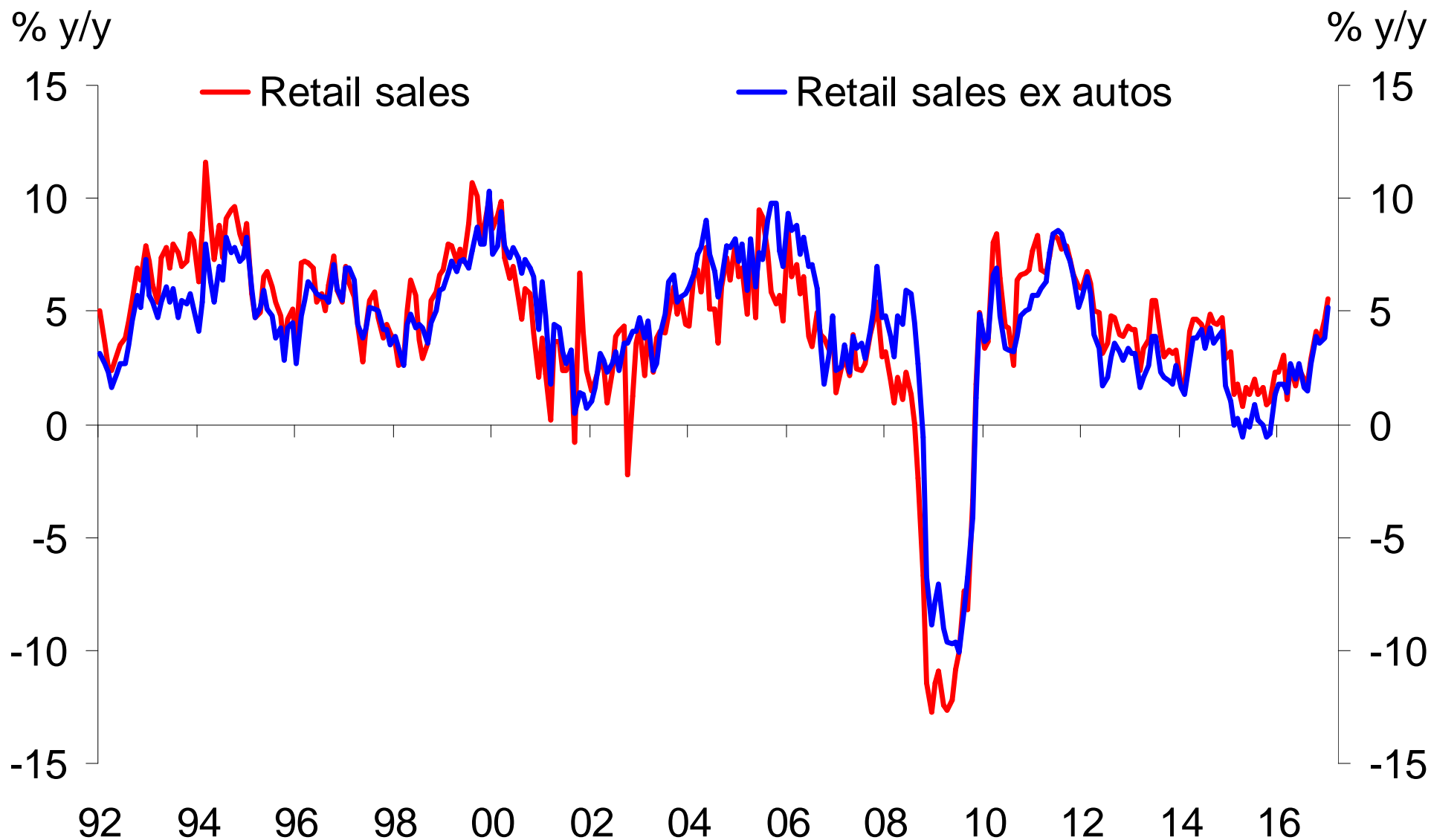
Economic Outlook

Consumer optimism fading?



Source: U.Mich., CB, Haver Analytics, DB Global Markets Research

Retail sales trending higher



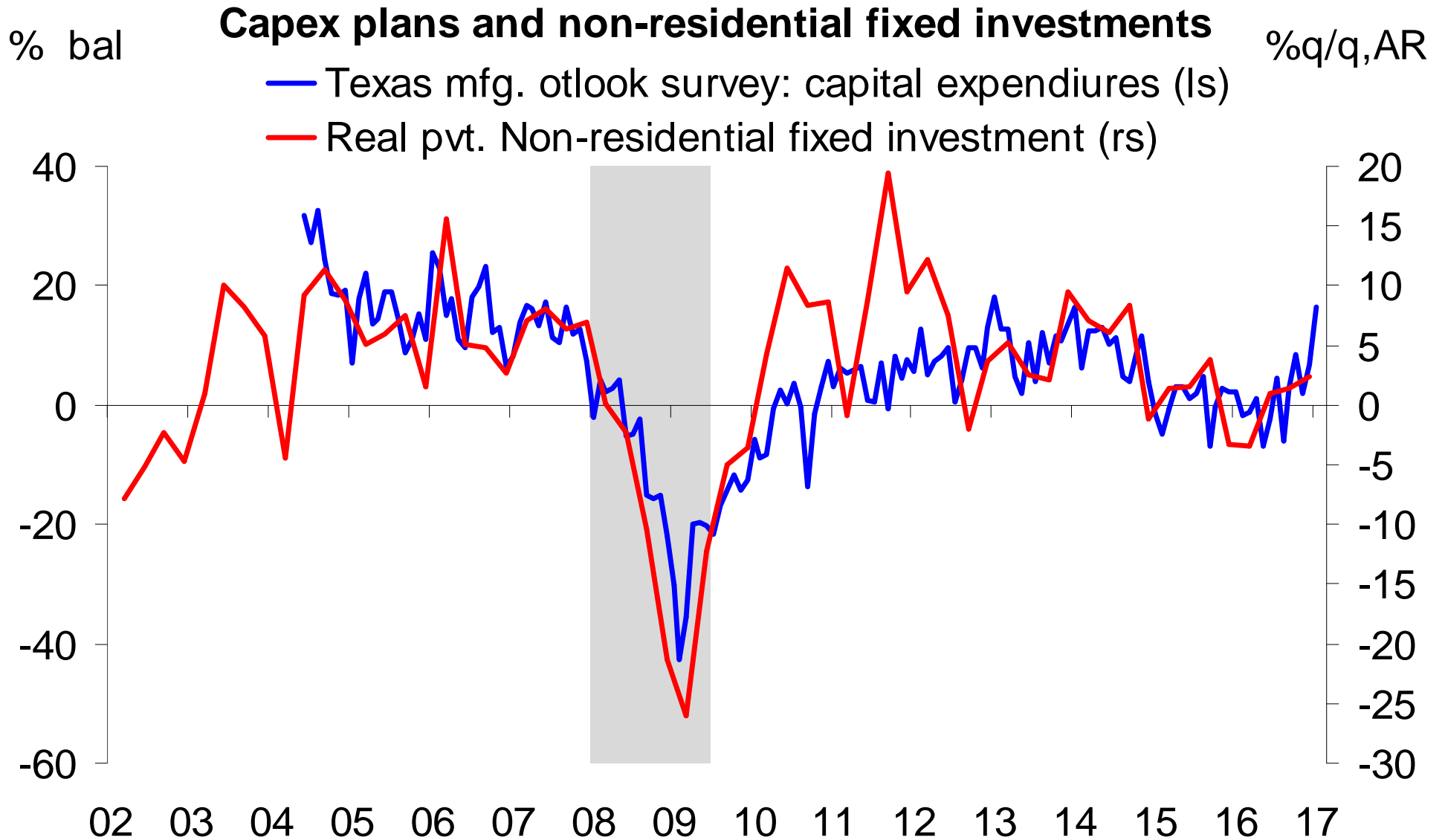
Source: Census, Haver Analytics, DB Global Markets Research

Capex set to grow faster



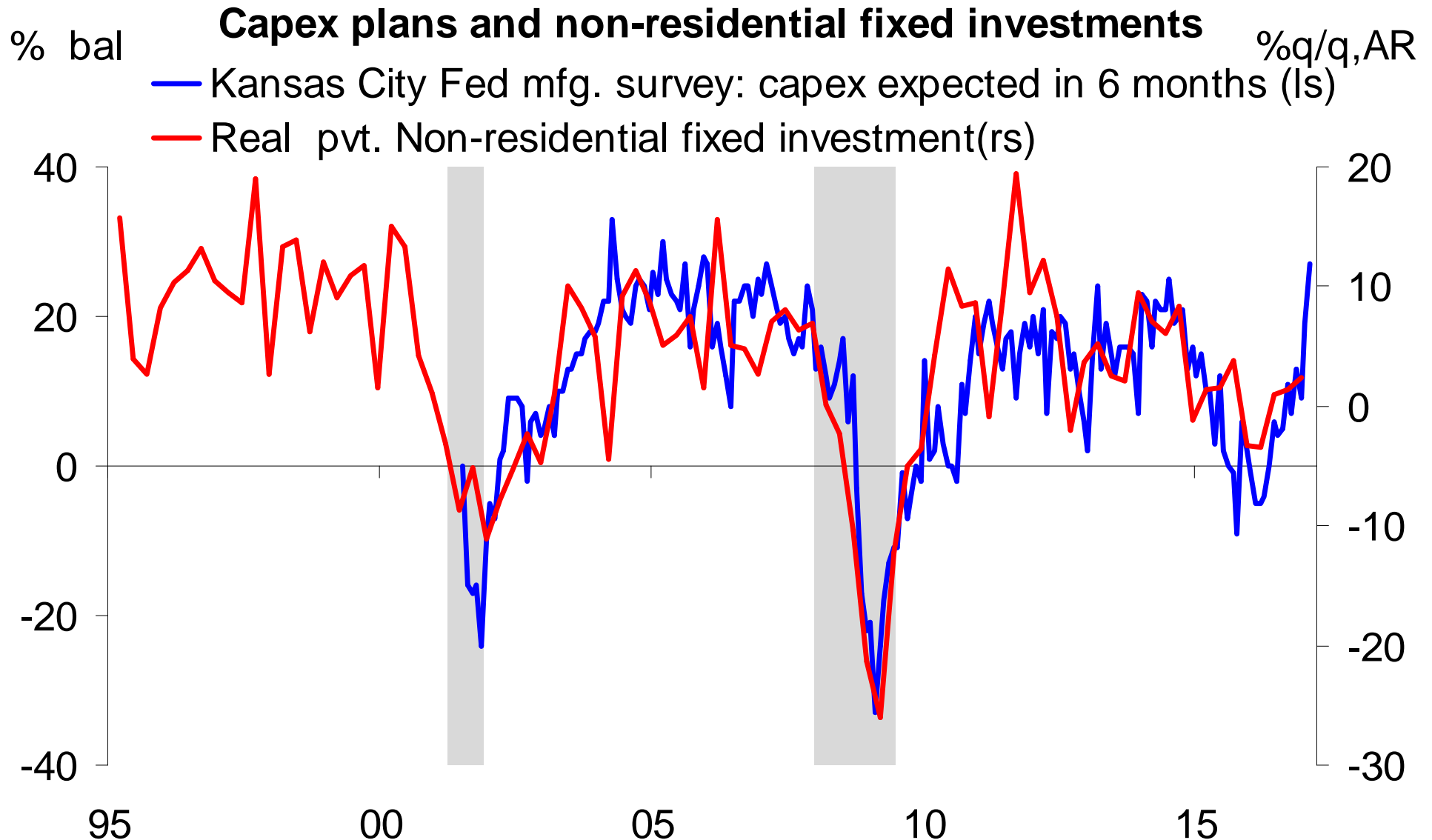
Source: NFIB, Haver Analytics, DB Global Markets Research

Dallas Fed survey points to higher capex...



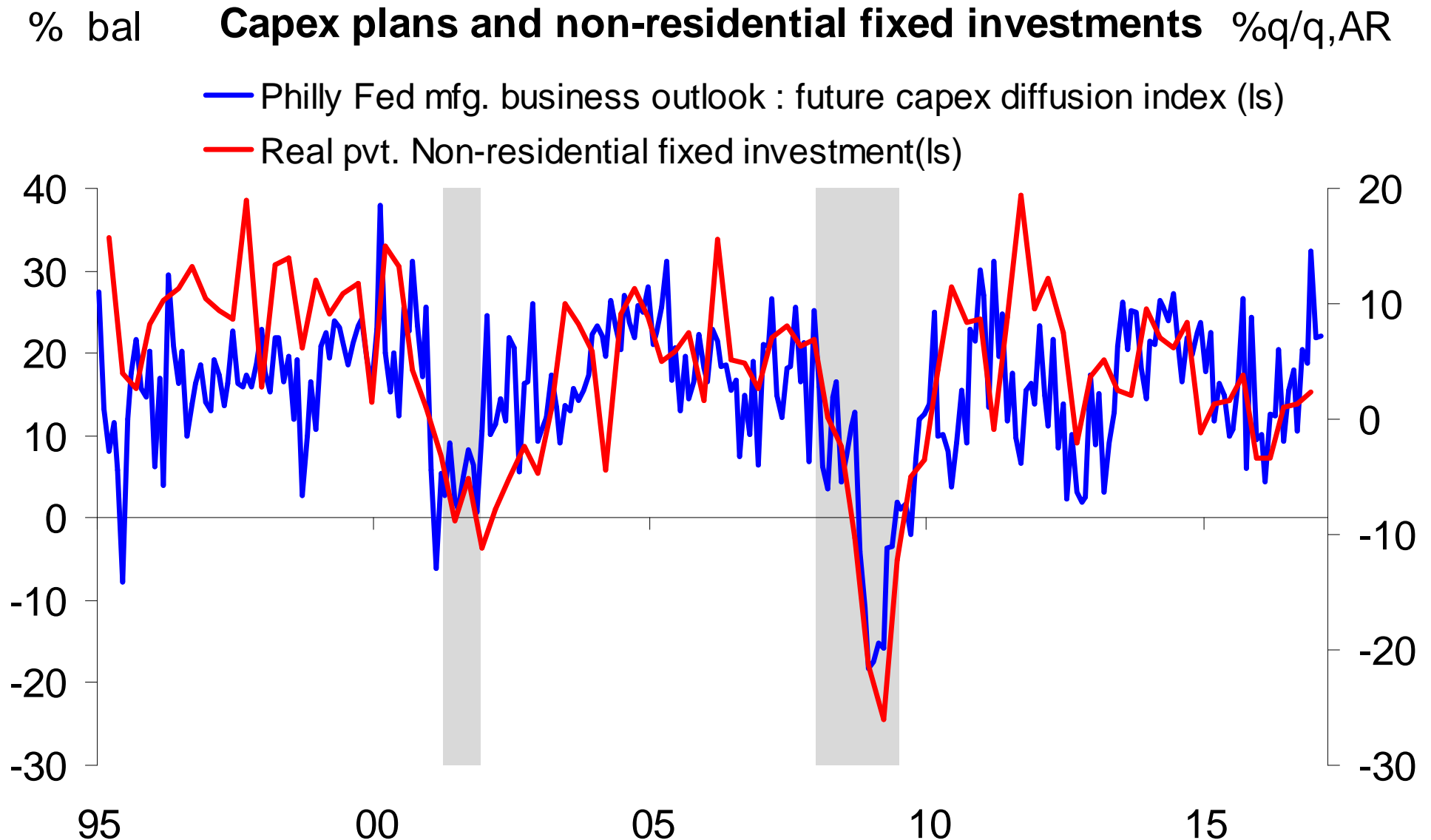
Source: Federal Reserve Bank of Dallas, BEA, Haver Analytics, DB Global Markets Research

...Kansas City Fed survey points to higher capex...



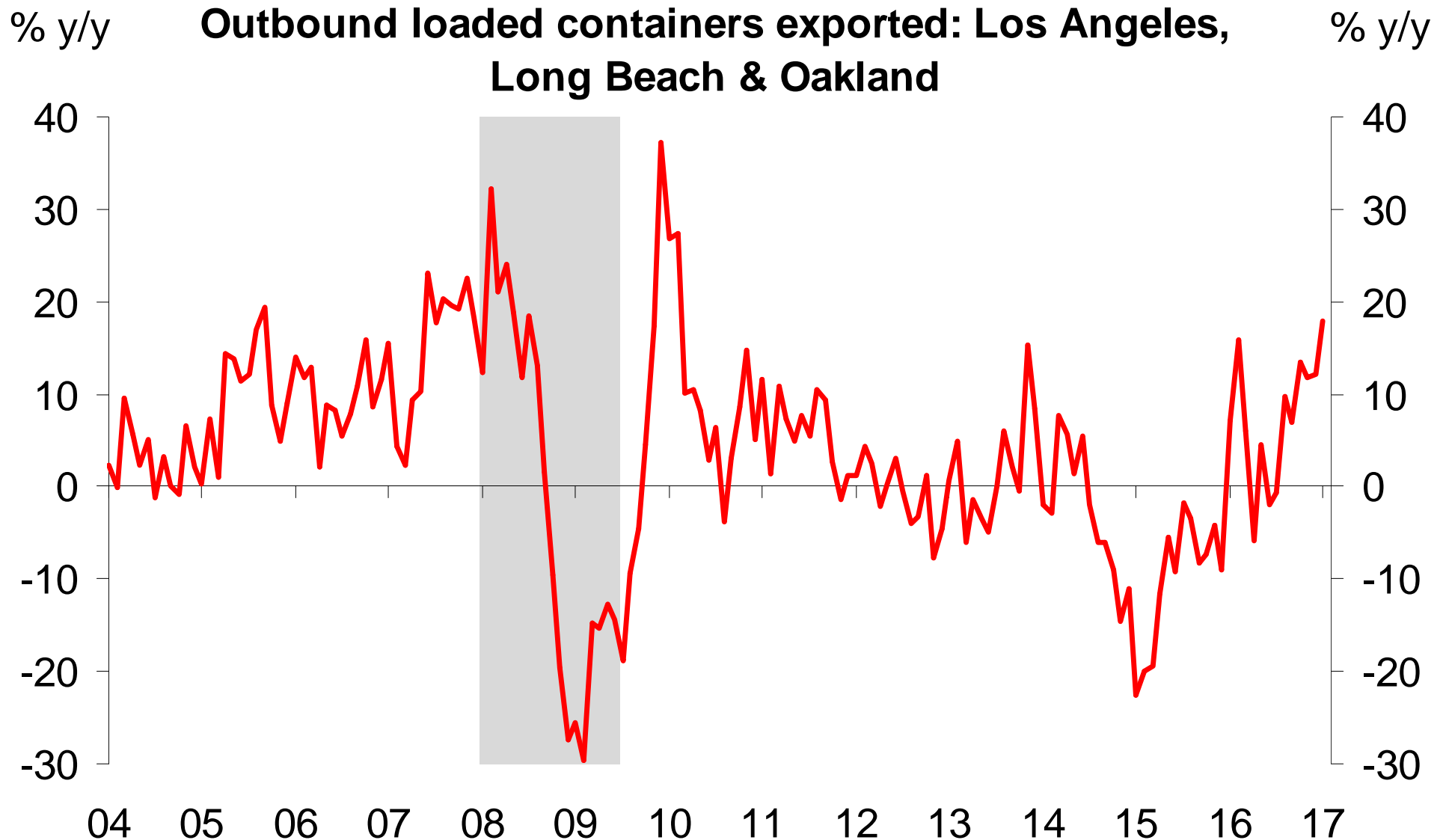
Source: Federal Reserve Bank of Kansas City, BEA, Haver Analytics, DB Global Markets Research

...Philly Fed survey points to higher capex



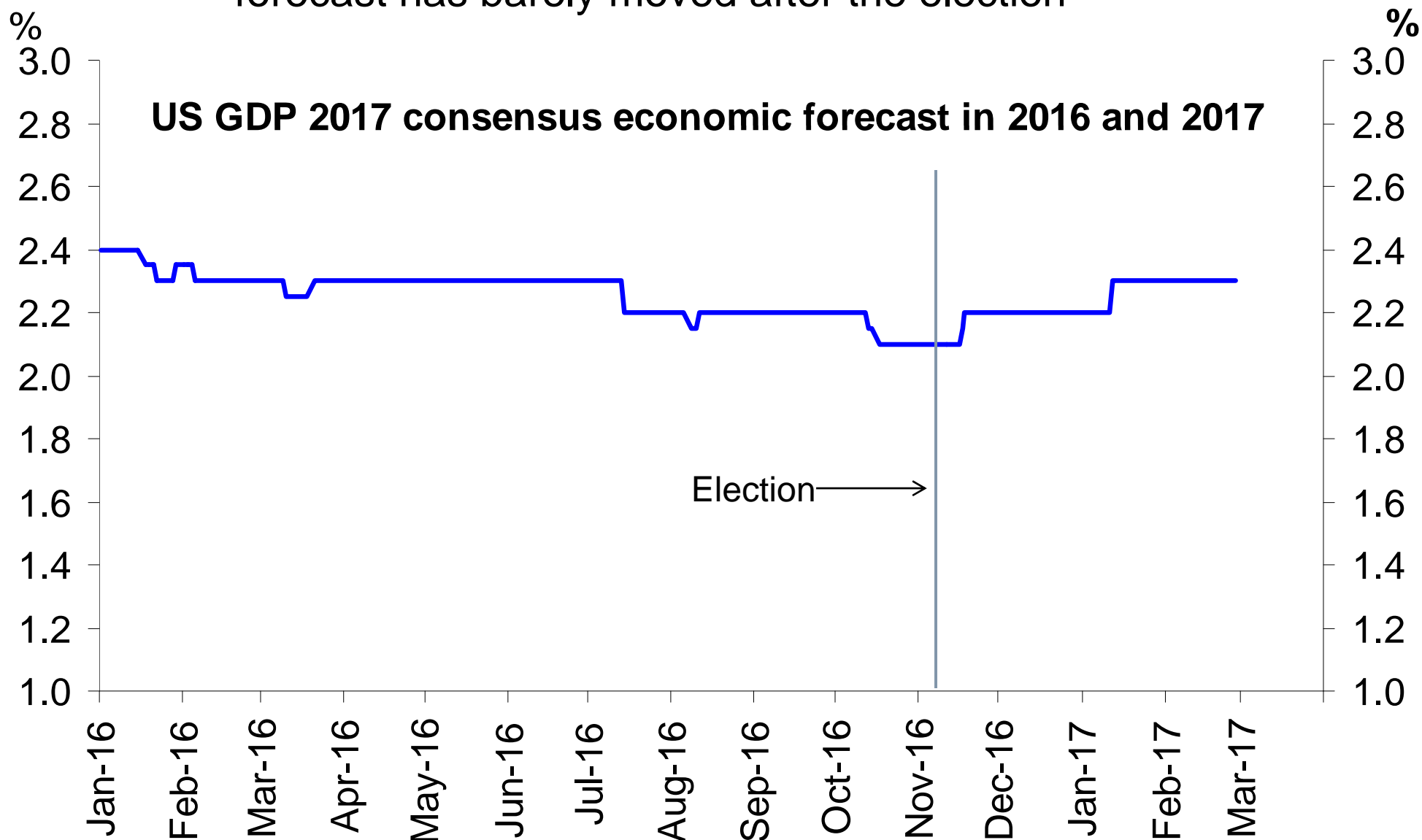
Source: Federal Reserve Bank of Philadelphia, BEA, Haver Analytics, DB Global Markets Research

Container traffic pointing to acceleration in global growth



Source: PortLA, PortLB, PortOAK, Haver Analytics, DB Global Markets Research

Big difference between economics profession and optimism in stock markets and rates markets: Consensus 2017 US GDP forecast has barely moved after the election



Source: Bloomberg Finance LP, DB Global Markets Research



US economy near full employment and 2% inflation

10 upside risks to US inflation in 2017

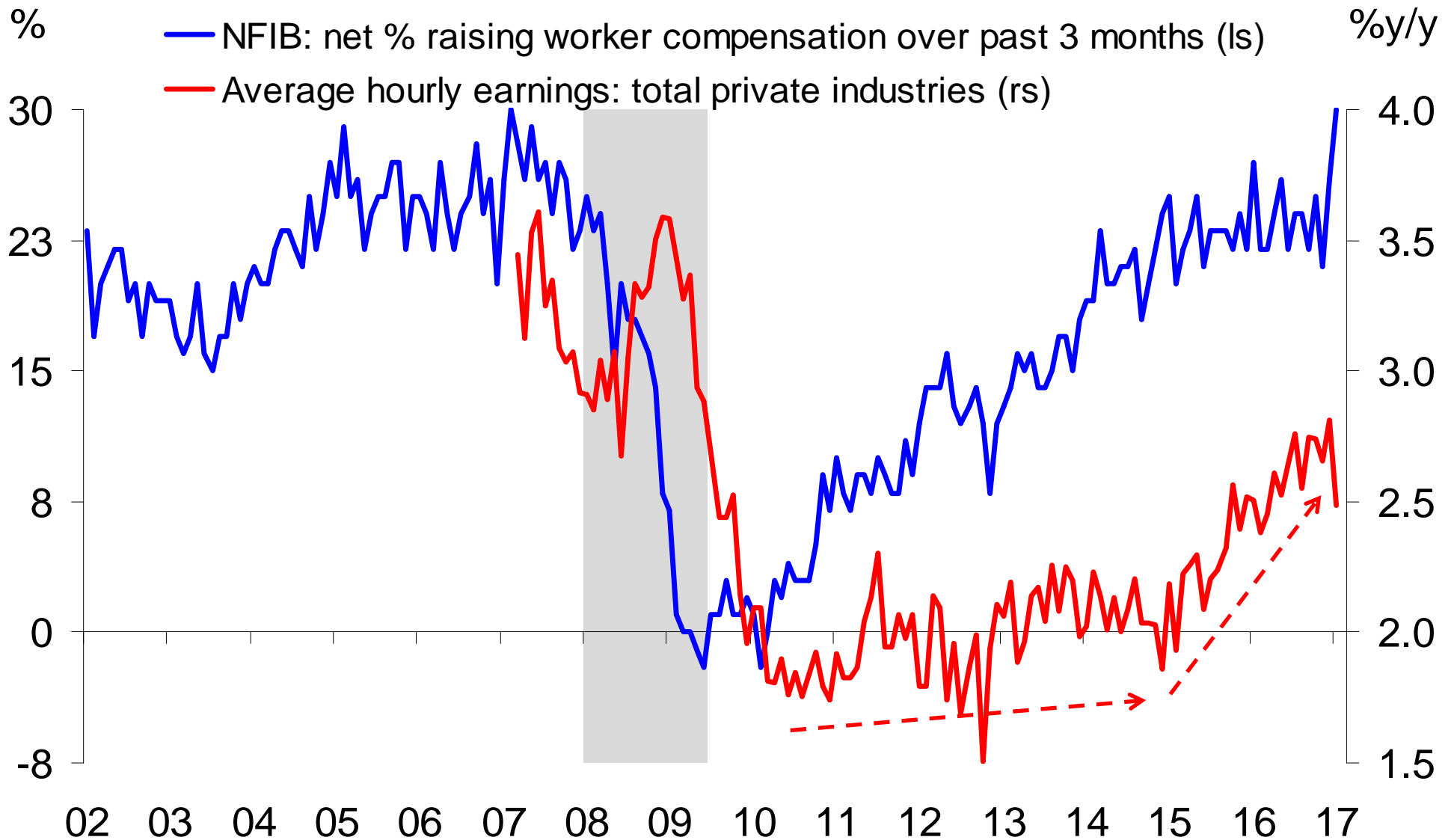


1. The fact that the Fed wants to raise rates three times this year tells us that they are worried about the economy moving towards overheating
2. The economy is already at full employment, confirmed by anecdotes of higher minimum wages and labor shortages across industries
3. Average hourly earnings have trended higher since 2014
4. US may be reversing on the “strong dollar” policy to boost US exports
5. Import prices are trending higher
6. Producer prices are trending higher
7. Breakeven inflation expectations are trending higher
8. Lower corporate taxes will boost growth and hence also inflation
9. Increased infrastructure spending will lift growth and hence also inflation
10. Lower household taxes will raise growth and hence also inflation

All variables in the Fed’s model of inflation point to higher inflation in 2017:

Inflation = F(Inflation expectations, unemployment rate, oil prices, import prices)

Latest observation for wages inconsistent with other labor market indicators

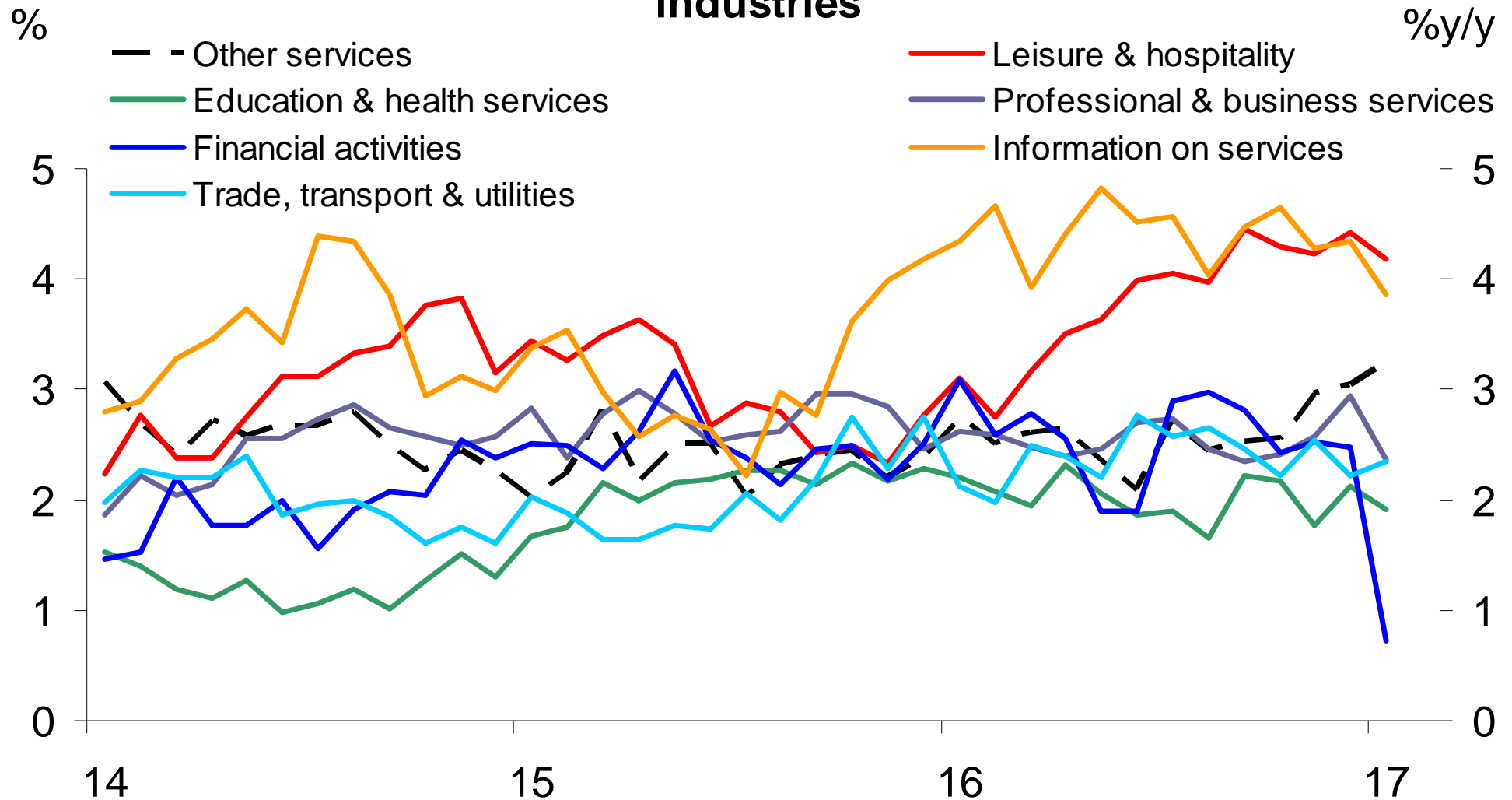


Source: NFIB, BLS, Haver Analytics, DB Global Markets Research

Decline in January average hourly earnings driven entirely by financial sector



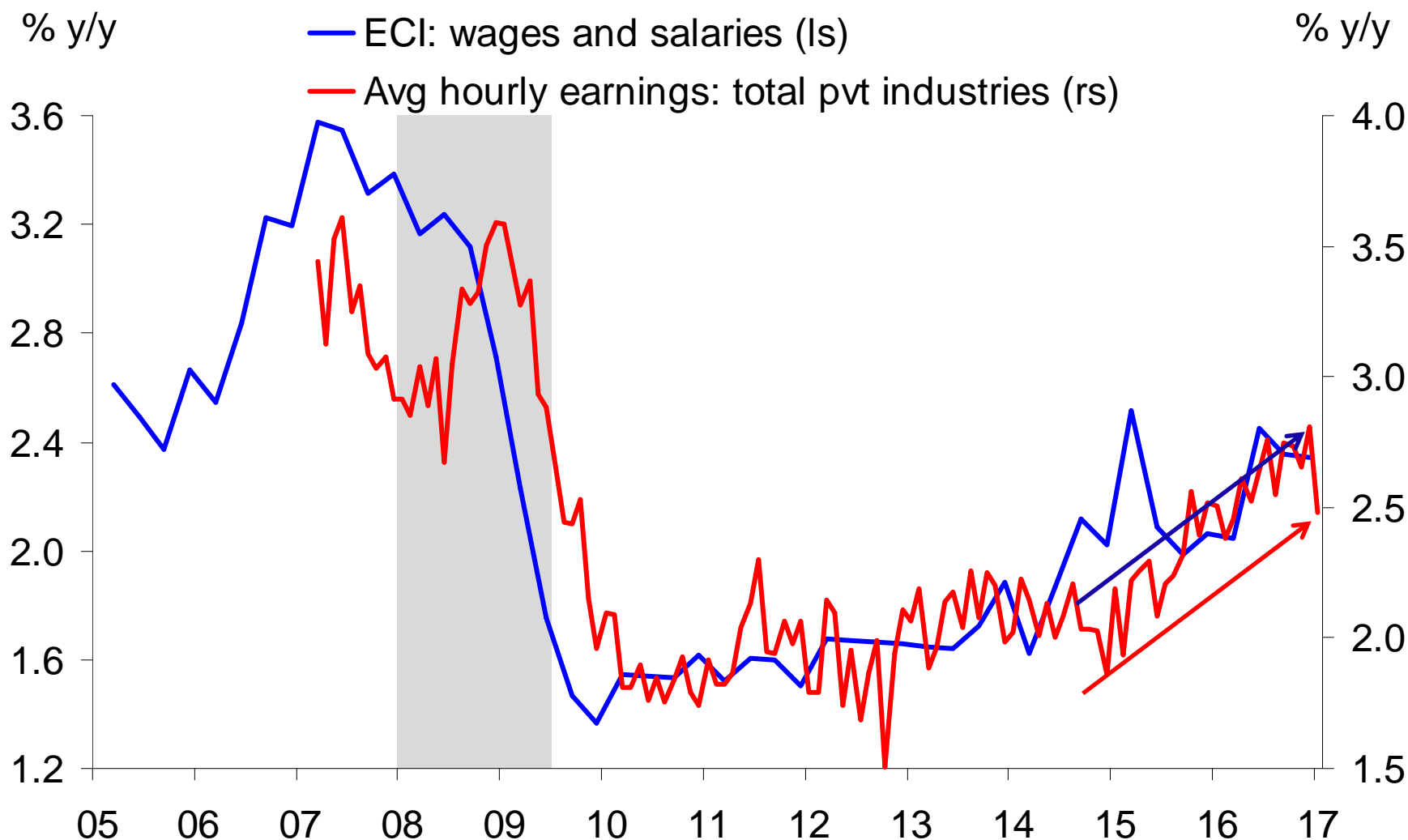
Average hourly earnings in private service providing industries



Source: BLS, Haver Analytics, DB Global Markets Research

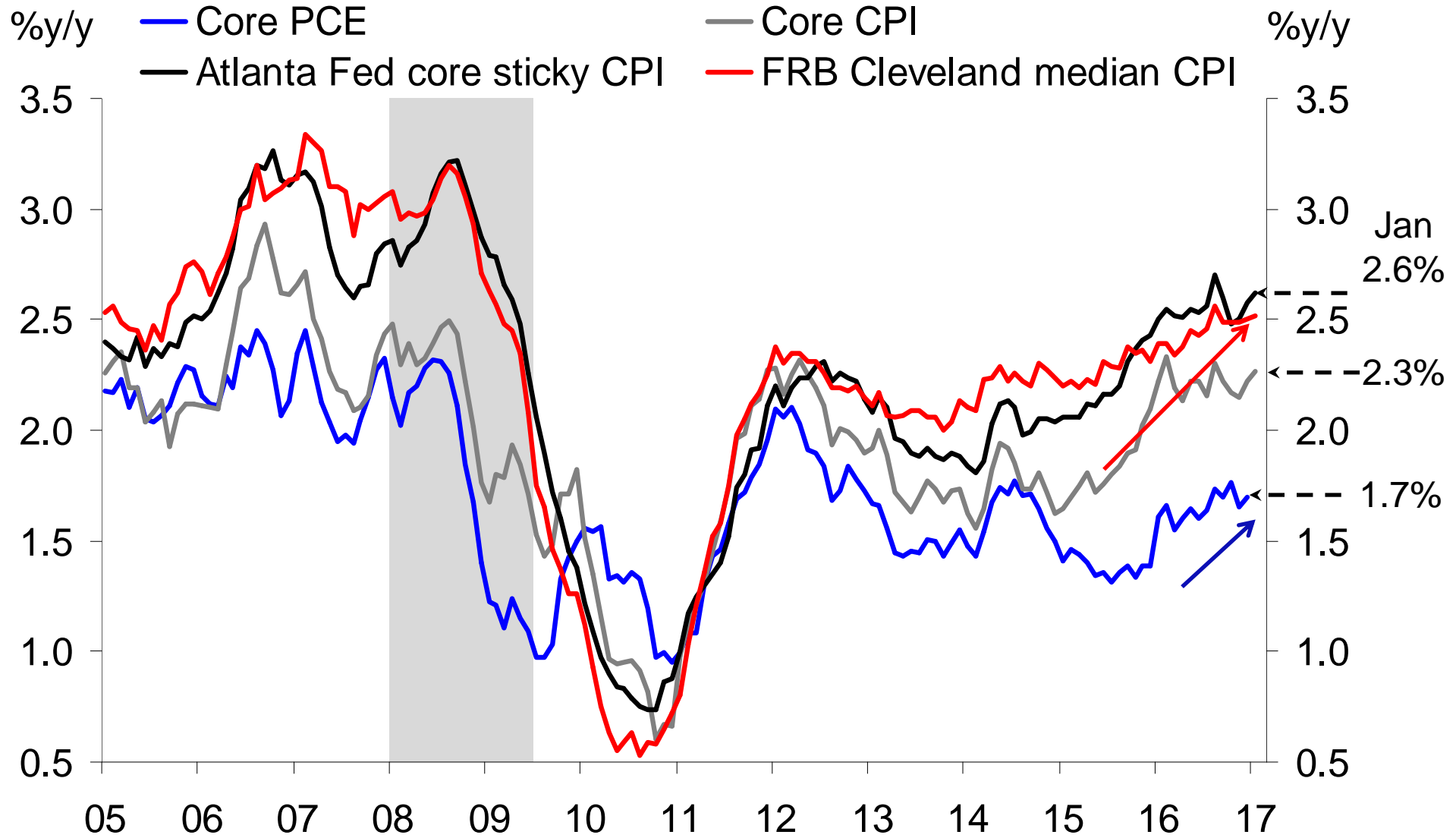


Wages have trended higher since 2014



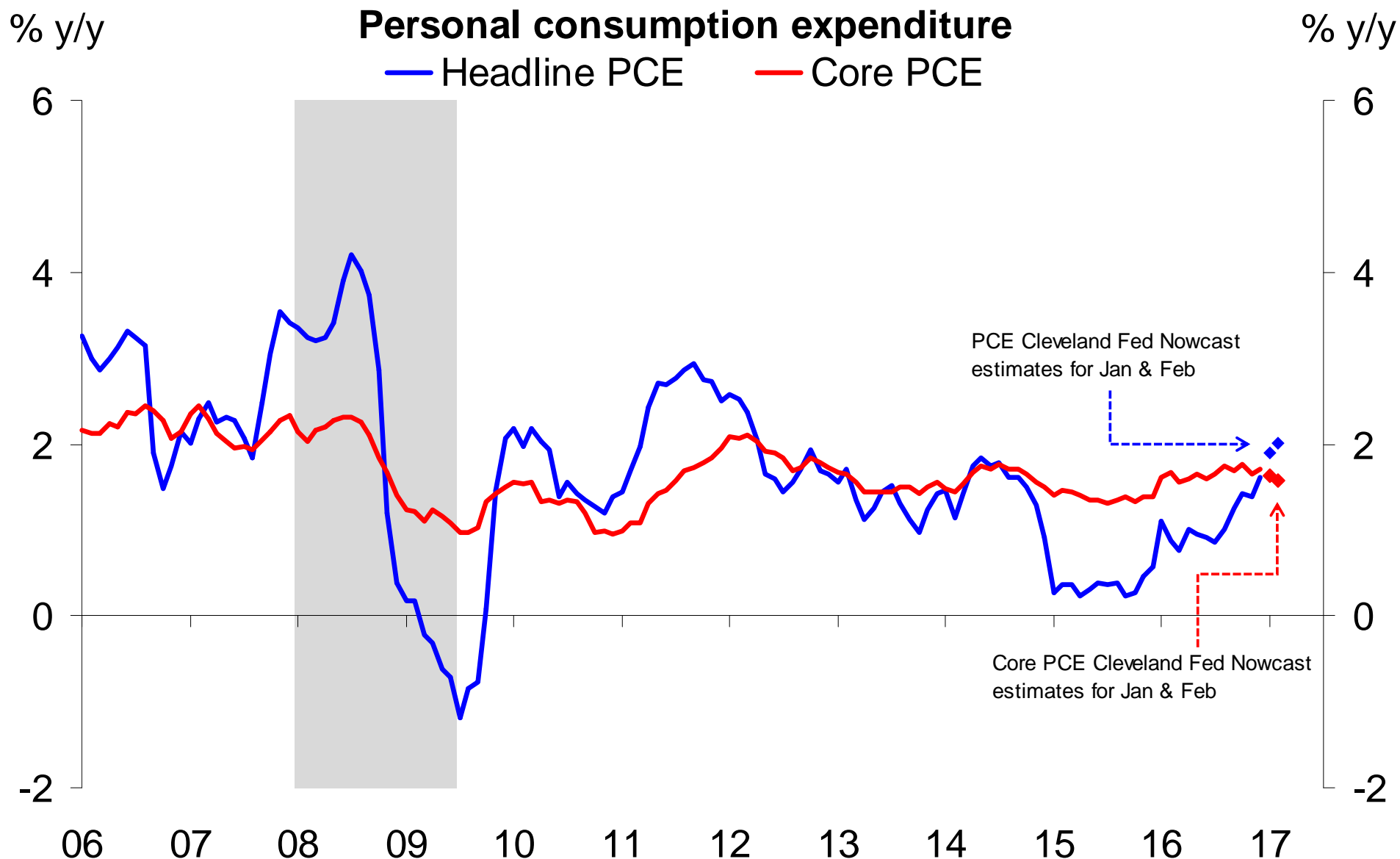
Source: BLS, DB Global Markets Research

Is this the white of the eyes of inflation?



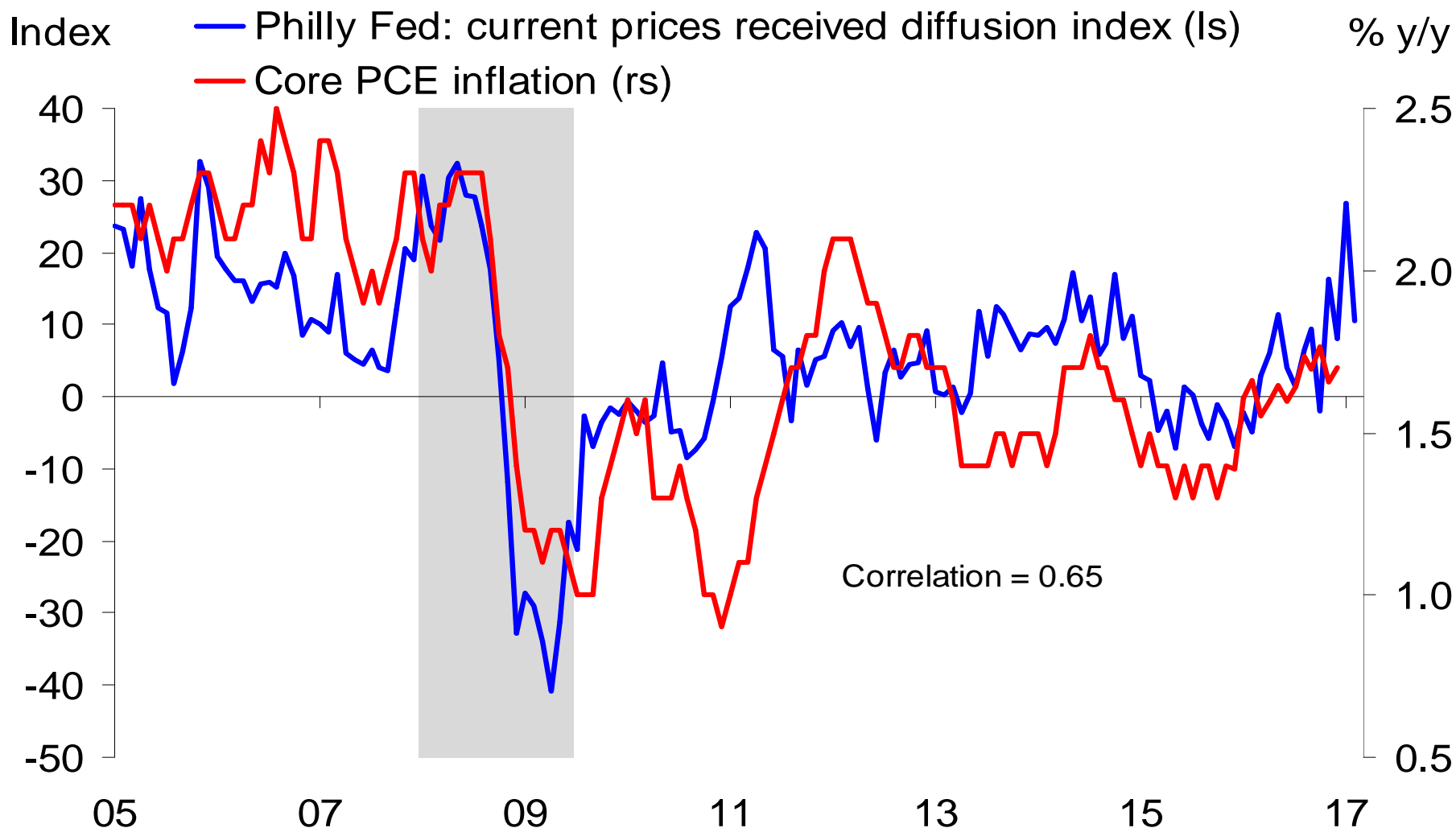
Source: BEA, BLS, FRBCLE, FRBATL, Haver Analytics, DB Global Markets Research

Fed sees mixed inflation picture ahead



Source: FRB Cleveland, BEA, Haver Analytics, DB Global Markets Research

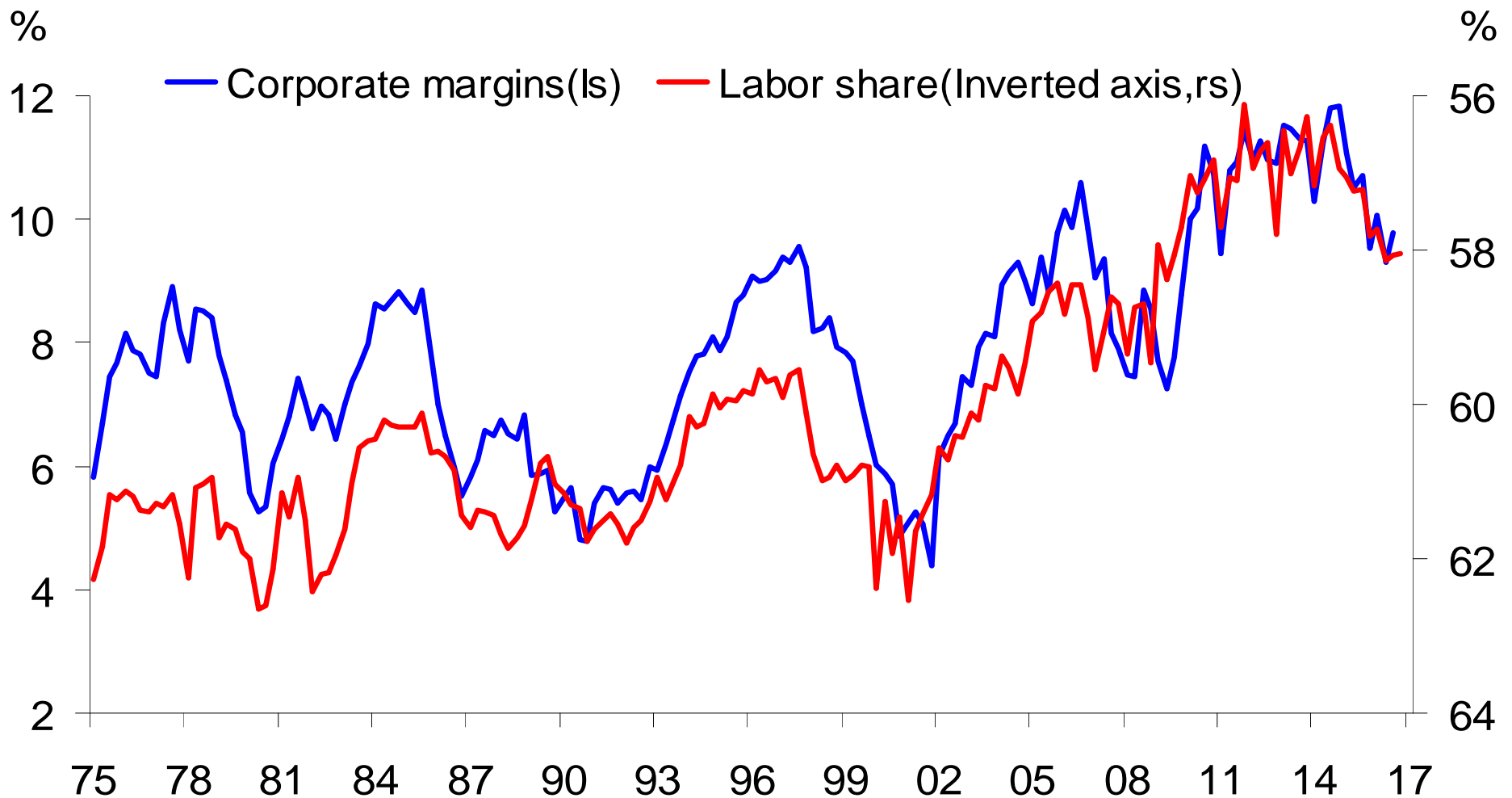
Upside risks to inflation in 2017



Note: Current Prices Received reports the change in Prices Received compared to the previous month for reporting manufacturing firms. The diffusion index is calculated by taking the percent reporting increases and subtracting the percentage reporting decreases.

Source: FRBPHIL, BEA, Haver Analytics, DB Global Markets Research

Higher wages will put some pressures on margins



Note: 'Corporate margins' refer to US non-fin profits after tax (with IVA and CCAAdj)/GVA of Non financial corp. "Labor share" is the portion of current dollar output devoted to labor compensation

Source: BEA, Haver Analytics, DB Global Markets Research



Mr. Trump's plan

Mr. Trump's plan



Growth boosting policies proposed by Trump

- Massive stimulus-'at least double' Clinton's 5-year \$275 billion infrastructure plan.
 - Create many jobs in construction, steel manufacturing and other sectors with special focus on transportation, water, telecom and energy.
- Protectionist stance: introduce tariffs / duties
 - Tough on China: 45% tariffs, label as FX manipulator, bring trade cases against China, both in the U.S and at the WTO
 - Renegotiate NAFTA, reject TPP, unlikely to support T-TIP
- Corp.: slash tax rate from 35% to 15%, one-off offer to repatriate foreign profits at 10%, move from worldwide to territorial tax
Personal: collapse current seven tax brackets to three tax brackets, cut top rate, repeal estate tax
- Reduce regulatory burden, repeal parts of Dodd-Frank
 - Eliminate most intrusive regulations, like the Waters of The U.S. Rule, scrap the EPA's Clean Power Plan which will cost \$7.2 billion a year
- Tough stance on immigration: build Mexico wall, end birthright citizenship
 - Protect economic well-being of lawful immigrants by curbing uncontrolled foreign worker admissions
- Repeal and replace Obamacare with Health Savings Accounts (HSAs)
 - Establish high-risk pools to ensure access to coverage for individuals unable to maintain continuous coverage.
 - Allow people to purchase insurance across state lines, in all 50 states
 - Maximize flexibility for states via block grants to design innovative Medicaid programs for low-income citizens
- Create a dynamic booming economy that will create 25 million new jobs over the next decade.
 - Accelerate growth to average 3.5 % per year with potential to reach 4 % growth.
- Make the U.S energy independent. Unleash \$50 trillion in untapped shale, oil, and natural gas reserves
 - Eliminate barriers to energy production, creating at least a half million jobs a year, \$30 billion in higher wages, and cheaper energy.
- An additional federal investment of \$20 billion towards school choice, provide low-income households an Expanded Earned Income Tax Credit in the form a Childcare rebate and a matching \$500 contribution for their savings accounts.
 - Minimum wage determined at state / local level

Source: DB Global Markets Research



Infrastructure



Trade



Tax



Regulation



Immigration



Health care



Economy



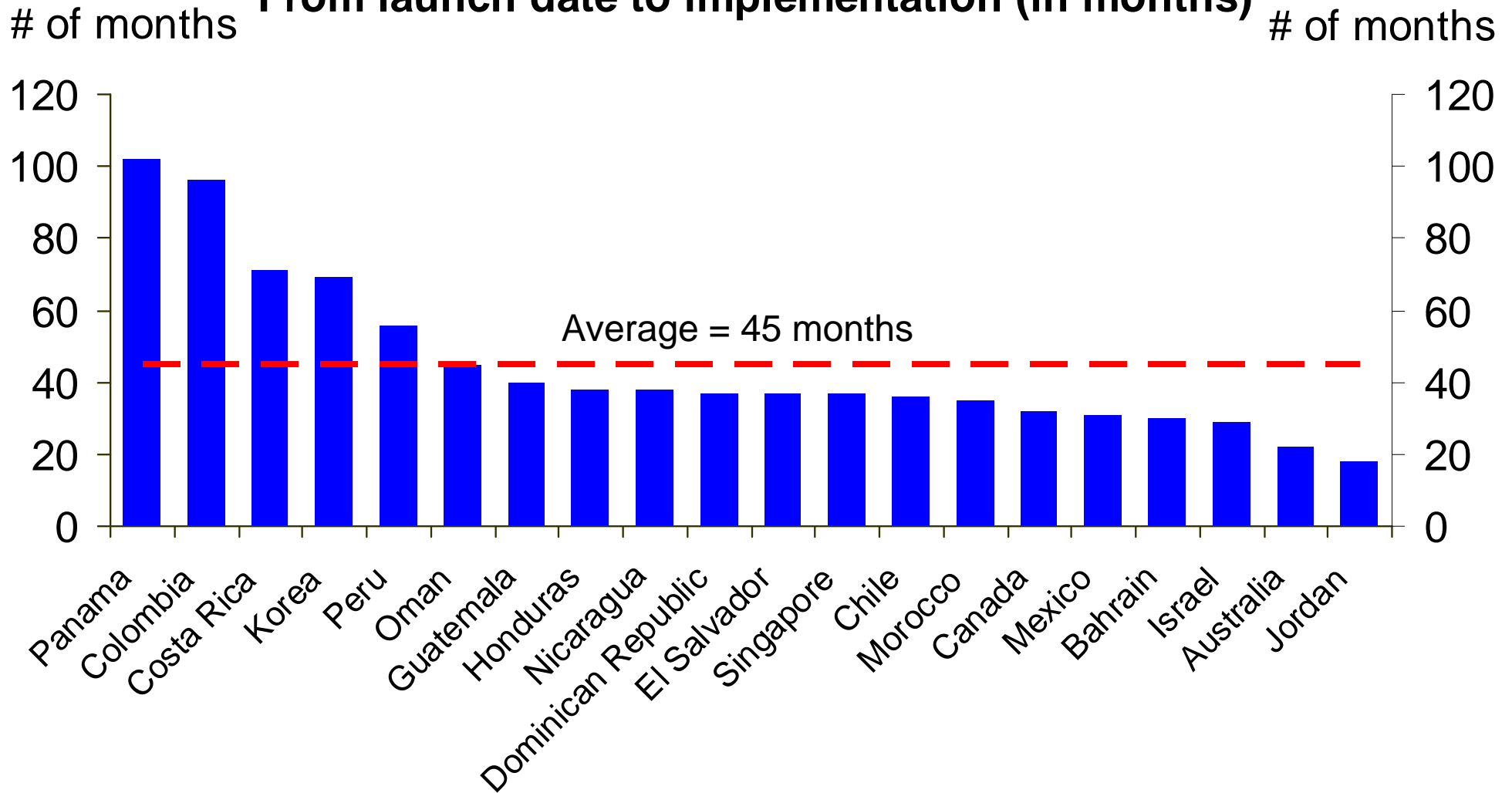
Energy

Others

On average it takes about four years to put together a trade deal



Duration of US free trade agreement negotiations: From launch date to implementation (in months)

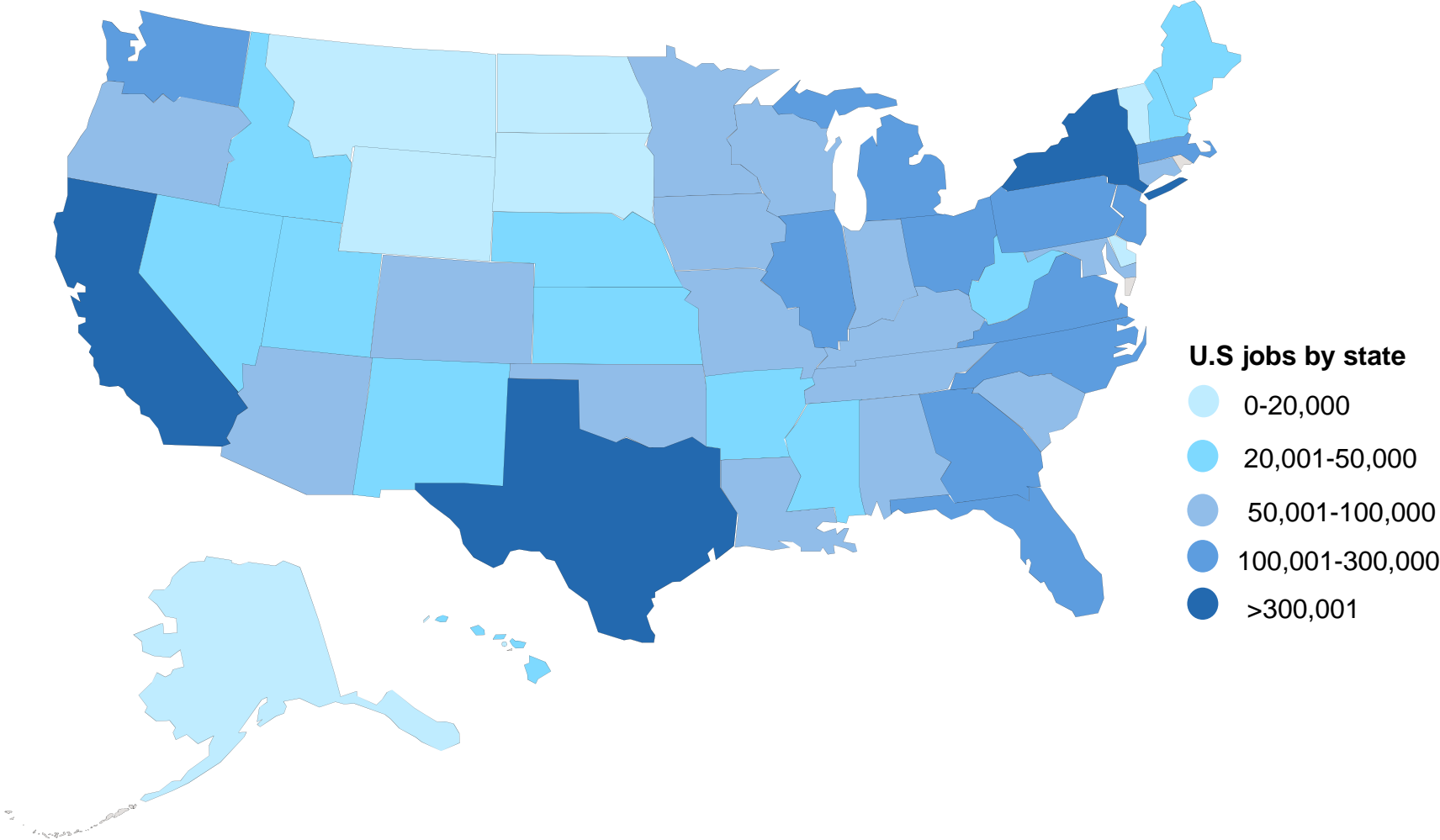


Source: Freund and McDaniel, Peterson Institute for International Economics, DB Global Markets Research

5 million jobs in total depend on trade with Mexico



U.S. Jobs that depend on trade with Mexico



Note: This is a net figure and includes jobs directly and indirectly tied to trade, meaning it takes into account, 1. Jobs currently supported by the production of goods for export that would be lost if we stopped trading with Mexico; 2. Jobs that would return to the United States to produce goods we currently import; and 3. Jobs currently supported by the income individuals and companies save by having access to lower cost imports - See more at: <https://www.wilsoncenter.org/article/growing-together-economic-ties-between-the-united-states-and-mexico#sthash.dy0hBKaD.dpuf>.

Source: Wilson Center, Growing Together: Economic Ties between the US & Mexico, DB Global Markets Research

What does the US import from the rest of the world? Cars. Except from China, where it is electronics and apparel



US imports as a percent of total imports from each country by end-use classification

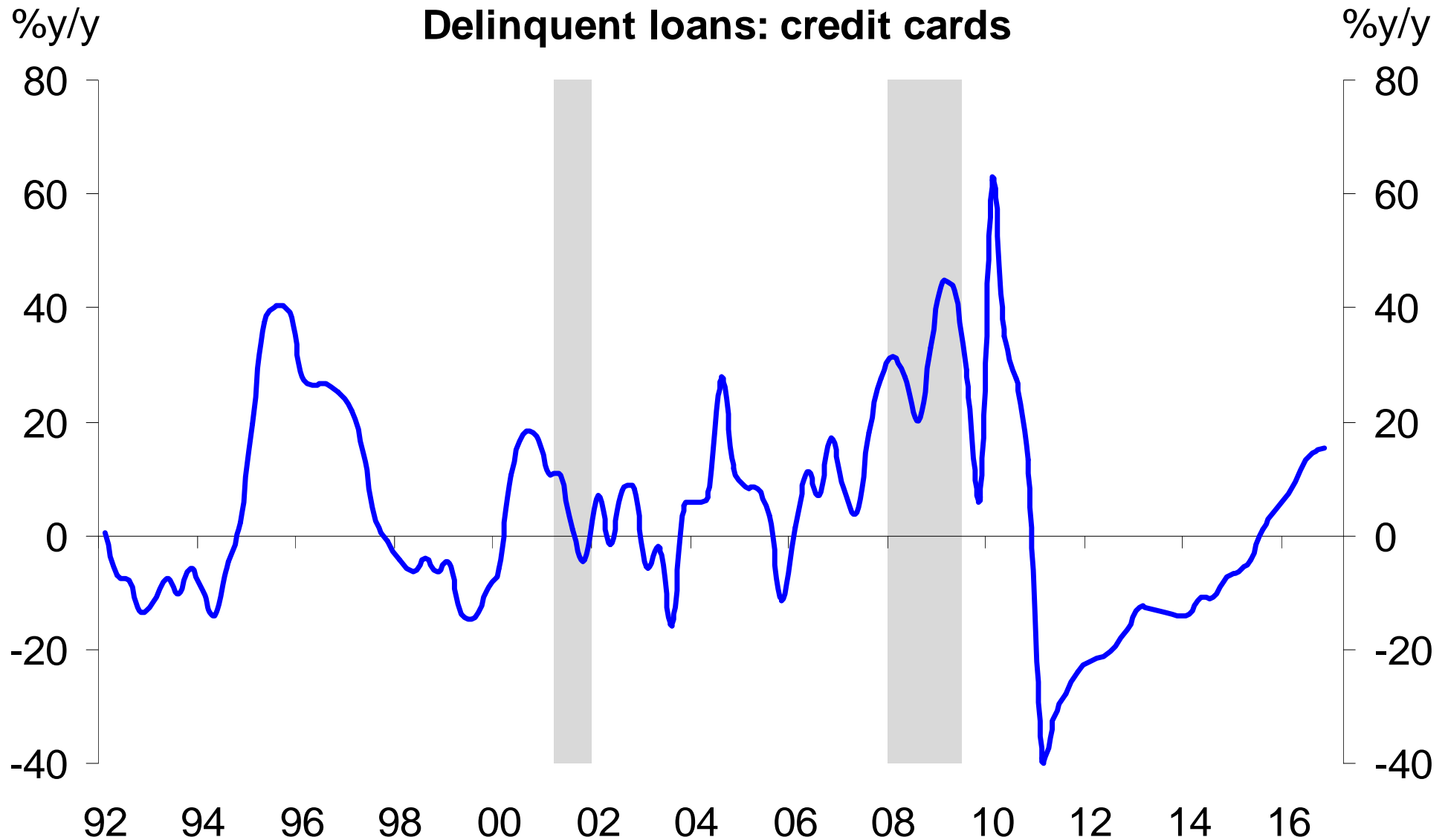
Exporter:	Most important US imports	Second most important imports	Third most important imports	Fourth most important imports
Mexico	<u>Car parts</u>	<u>Trucks and buses</u>	<u>Cars</u>	Computers
Germany	<u>Cars</u>	Pharma	Airplanes	<u>Car parts</u>
Japan	<u>Cars</u>	<u>Car parts</u>	Machines	Airplanes
Korea	<u>Cars</u>	Cell phones	<u>Car parts</u>	Petroleum
Canada	Oil	<u>Cars</u>	Re-imports	<u>Car parts</u>
United Kingdom	Pharma	<u>Cars</u>	Re-imports	Airplanes
China	Cell phones	Apparel	Computers	Computer access.

Source: Census Bureau 2015, DB Global Markets Research



Downside risks to the US economy

Rising trend in credit card delinquencies is worrying

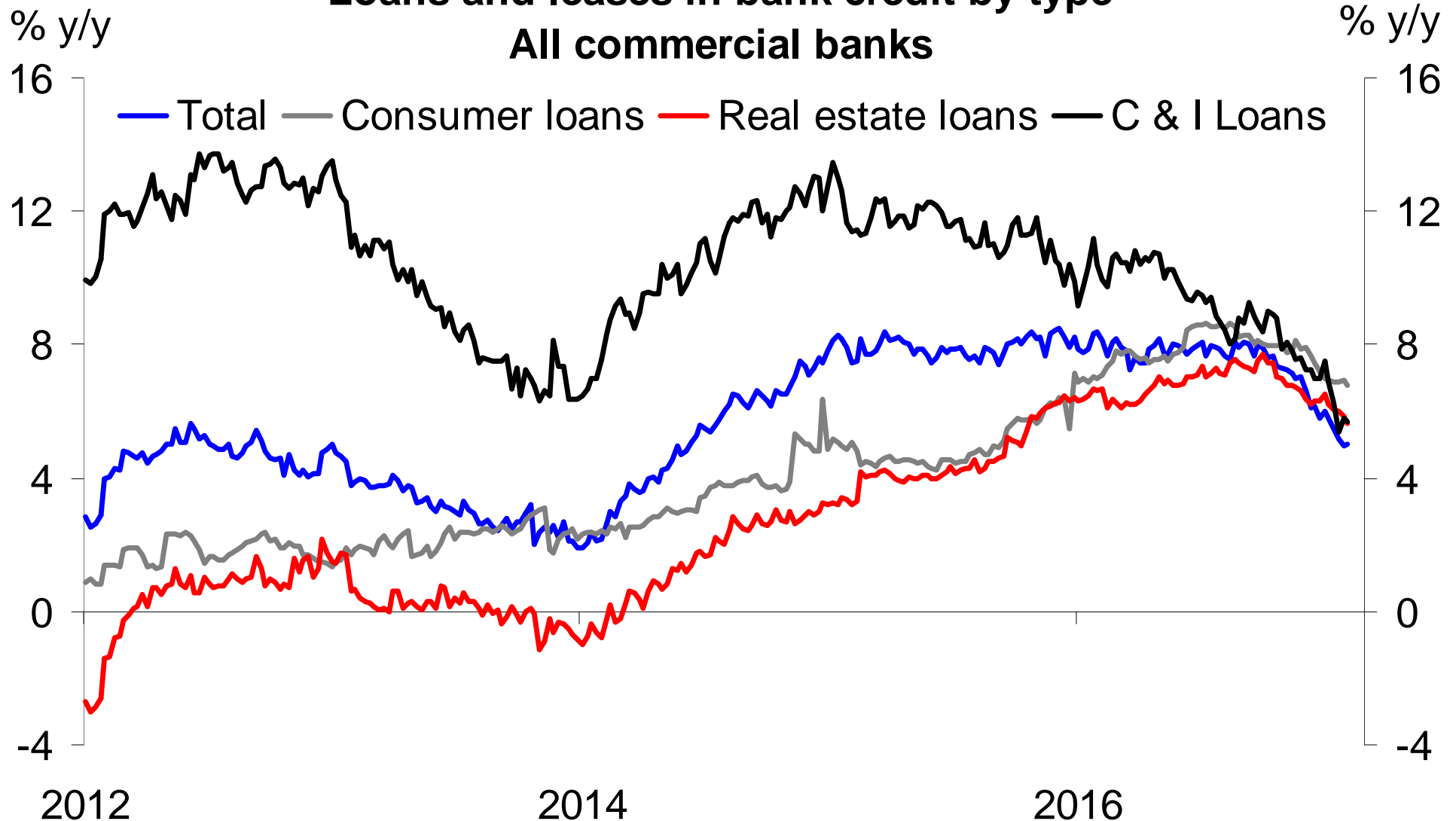


Source: FRB, Haver Analytics, DB Global Markets Research

Higher rates has pushed bank lending growth down

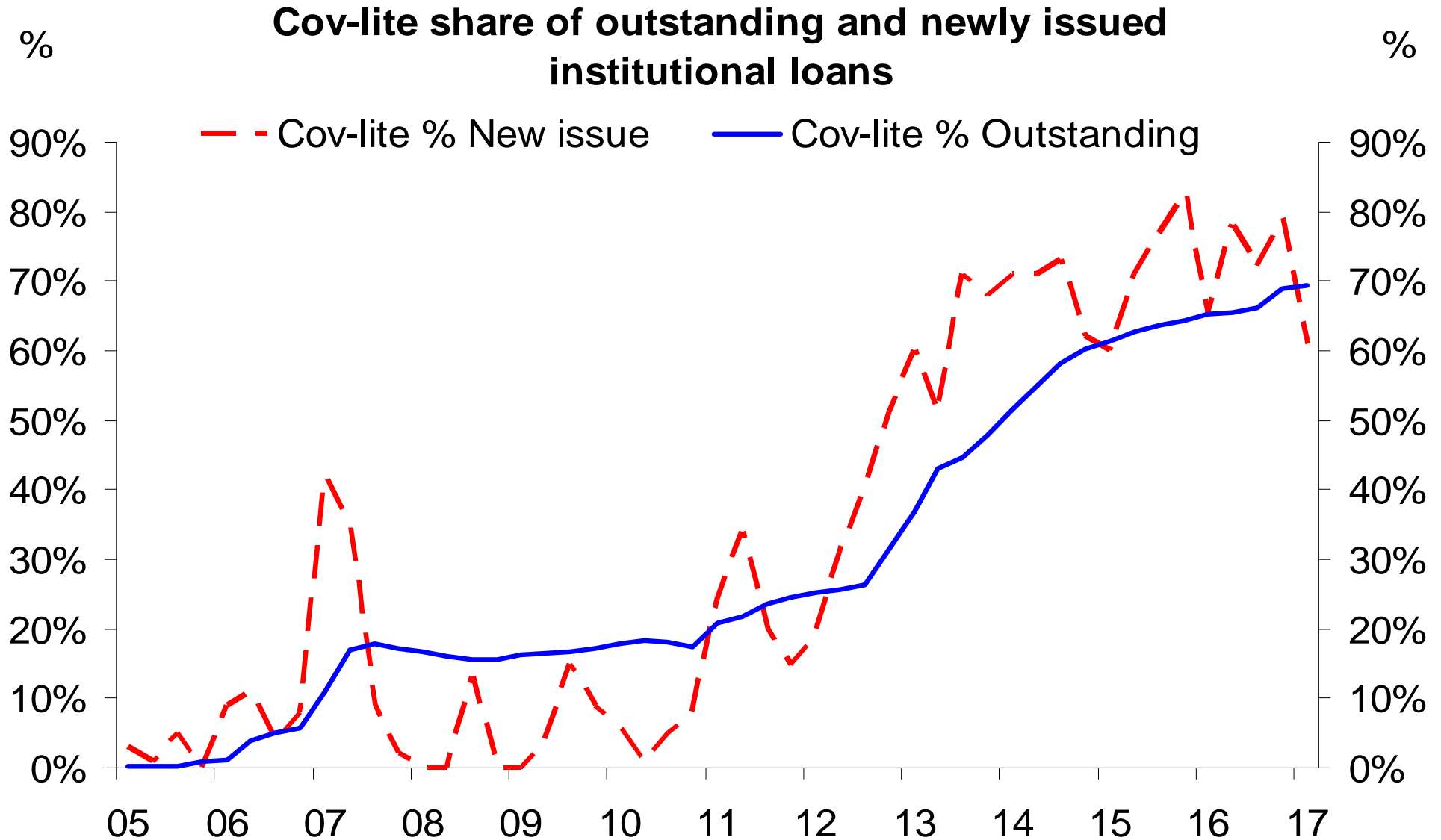


Loans and leases in bank credit by type All commercial banks



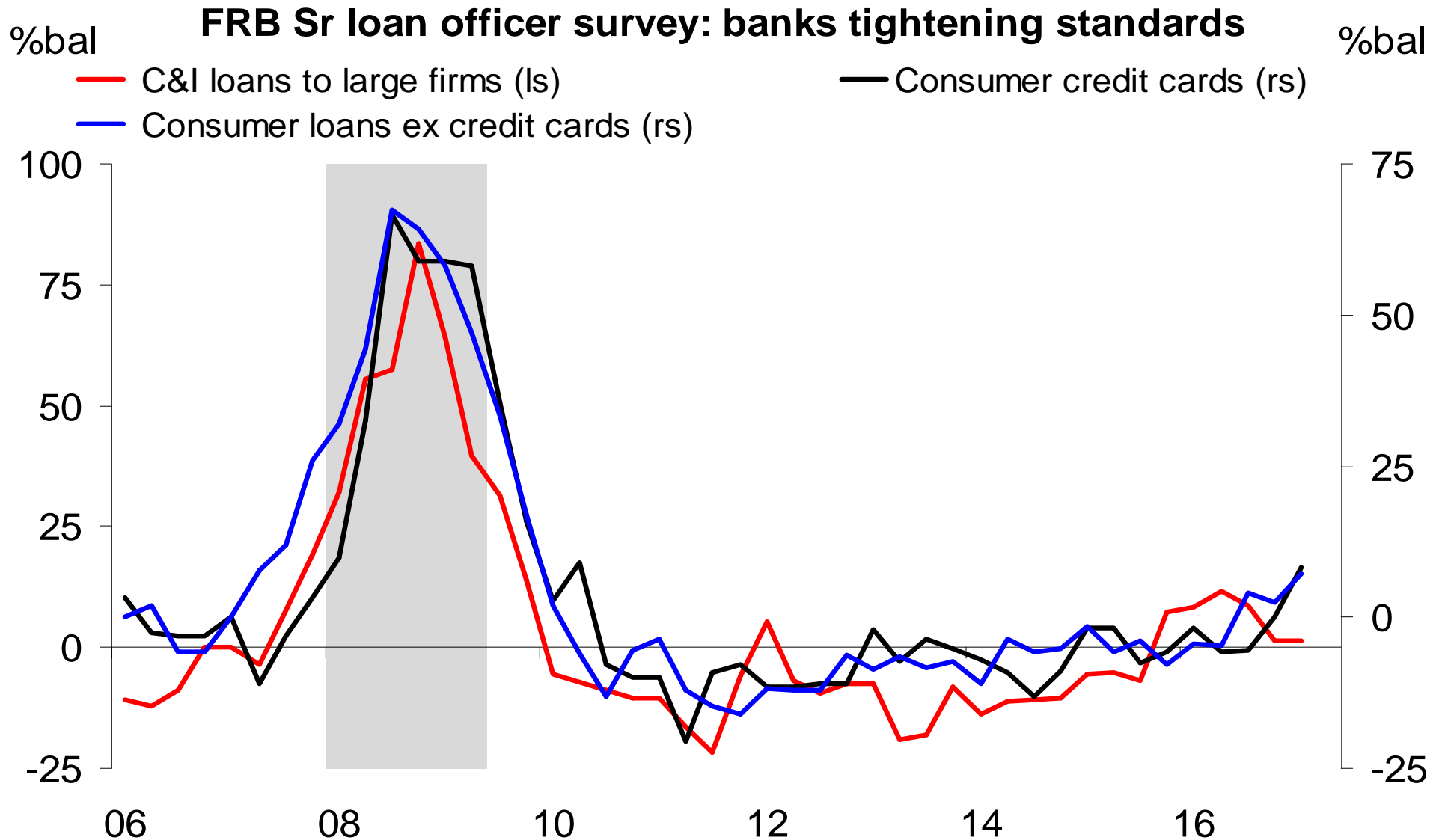
Source: FRB, Haver Analytics, DB Global Markets Research

Cov-lite high



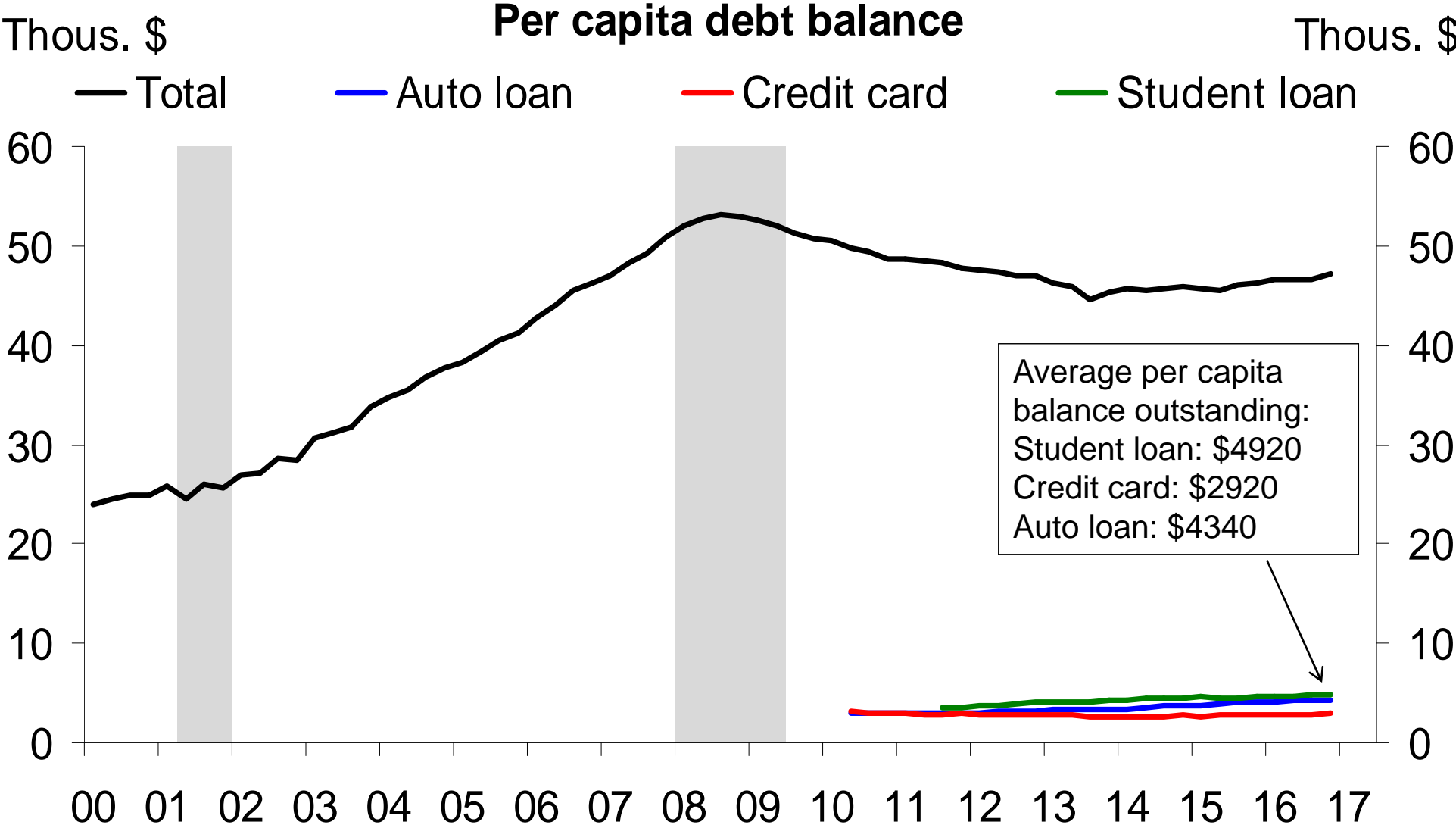
Source: S&P LCD, DB Global Markets Research

Credit conditions tightening recently



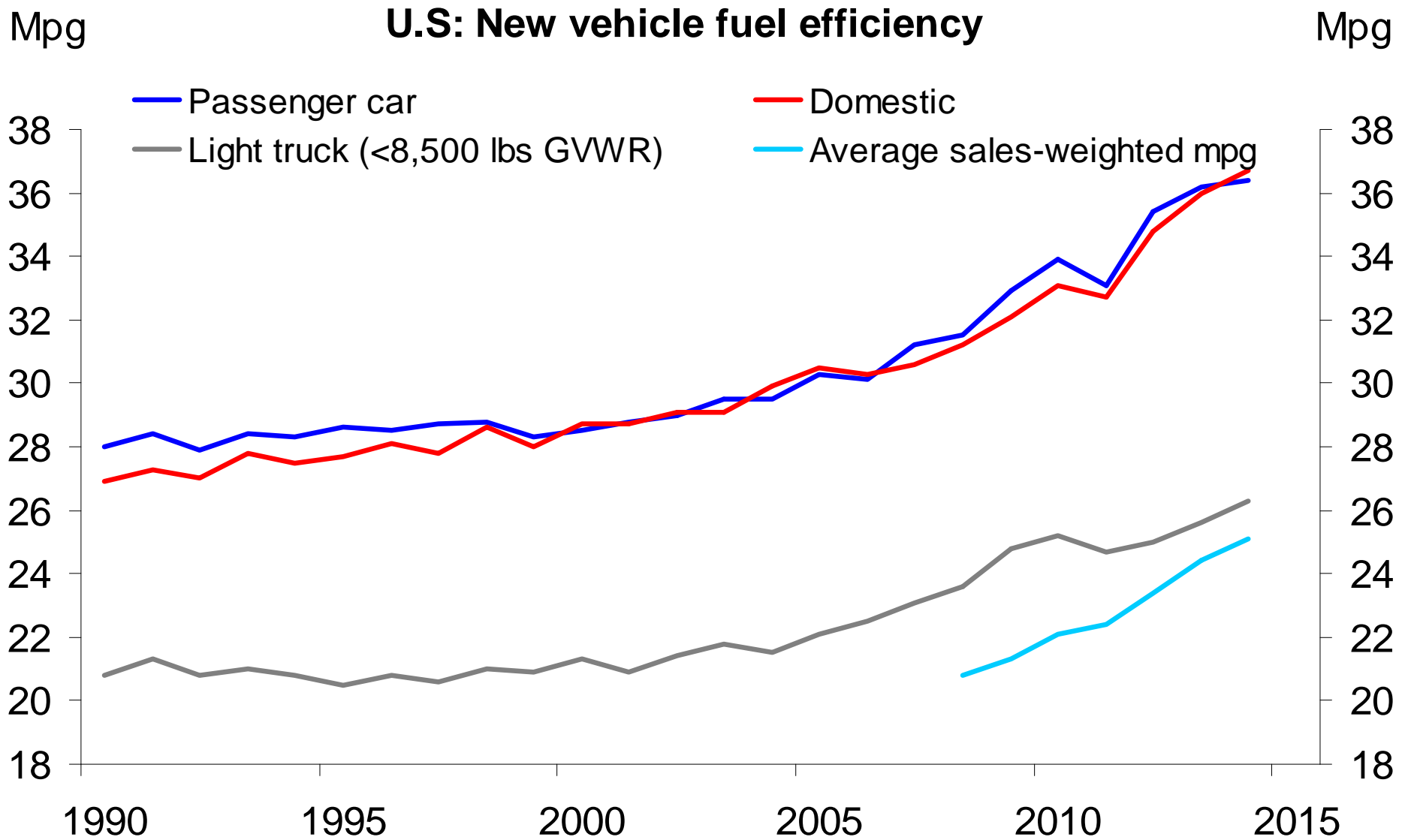
Source: FRB, Haver Analytics, DB Global Markets Research

Household debt levels look healthy



Source: FRBNY, Equifax, DB Global Markets Research

Cars have become much more energy efficient in recent years

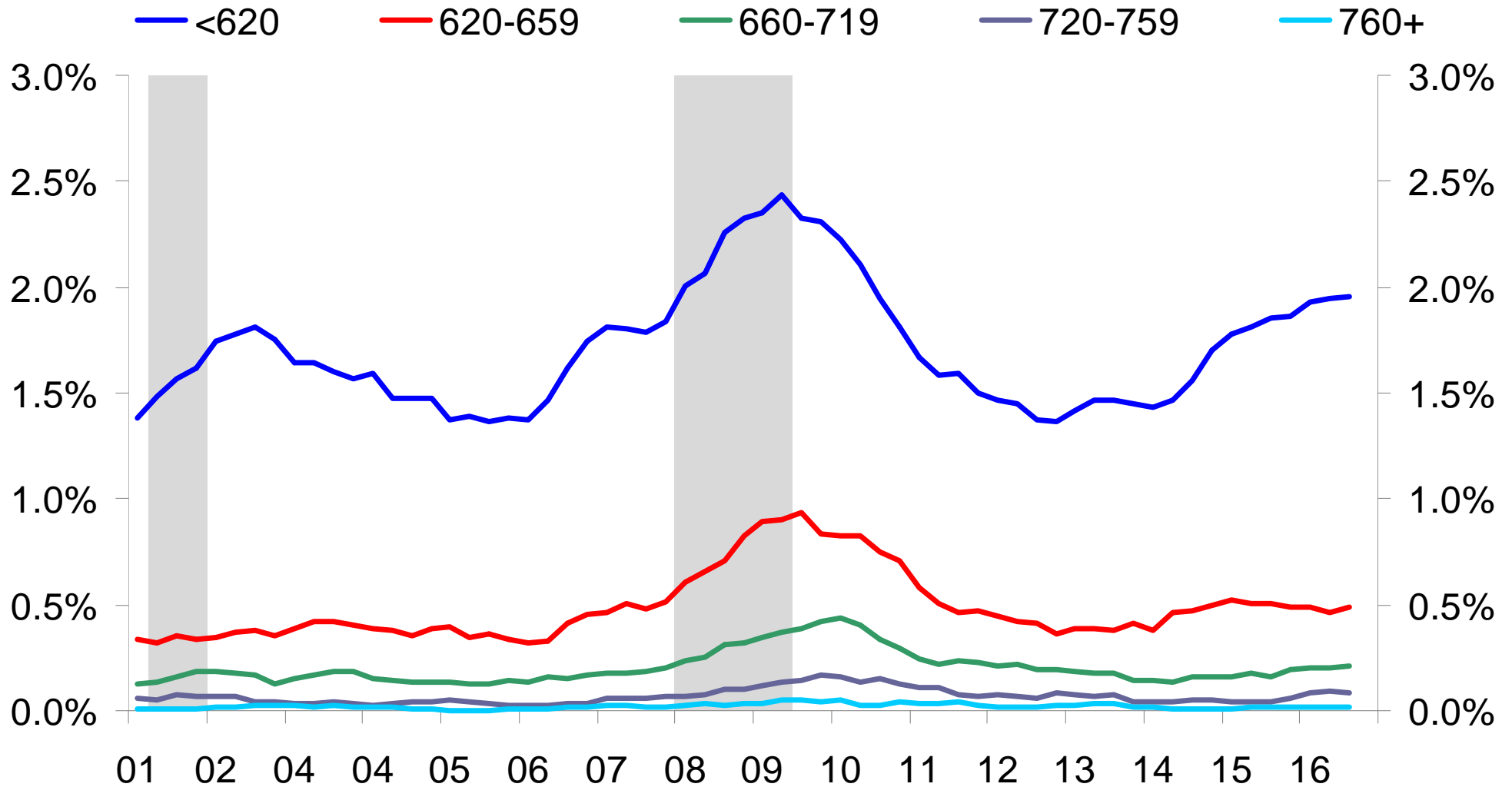


Source: UMTRI, Bureau of Transportation Statistics, DB Global Markets Research

Auto loans: Delinquency rates up for subprime and flat for everyone else



Flow into 90+ delinquency by credit score at origination, 4-q moving average



Source: New York Fed Consumer Credit Panel / Equifax, DB Global Markets Research

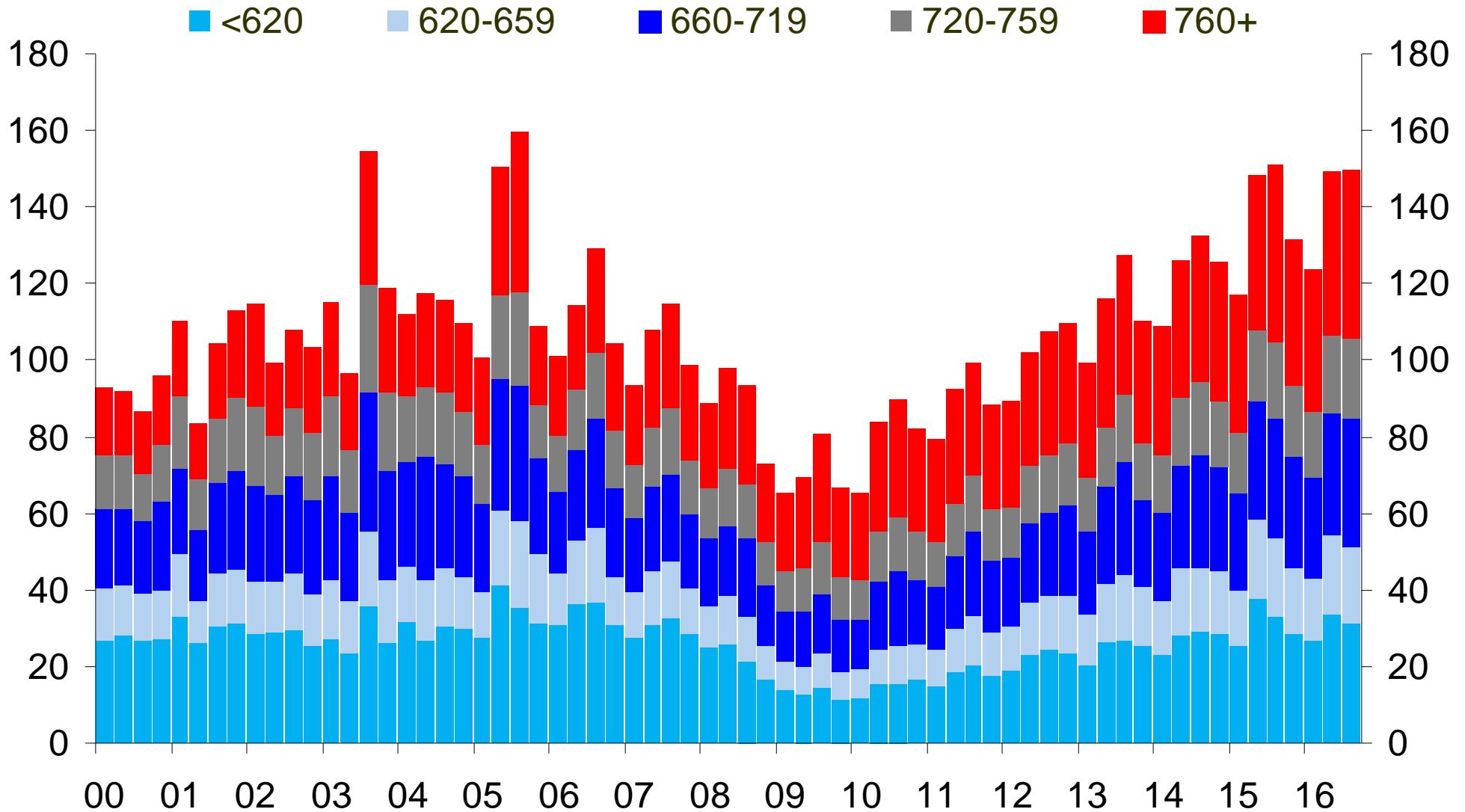
Auto loan origination: Modestly higher for subprime and a lot higher for everyone else



Auto loan originations by credit score

\$ billion

\$ billion

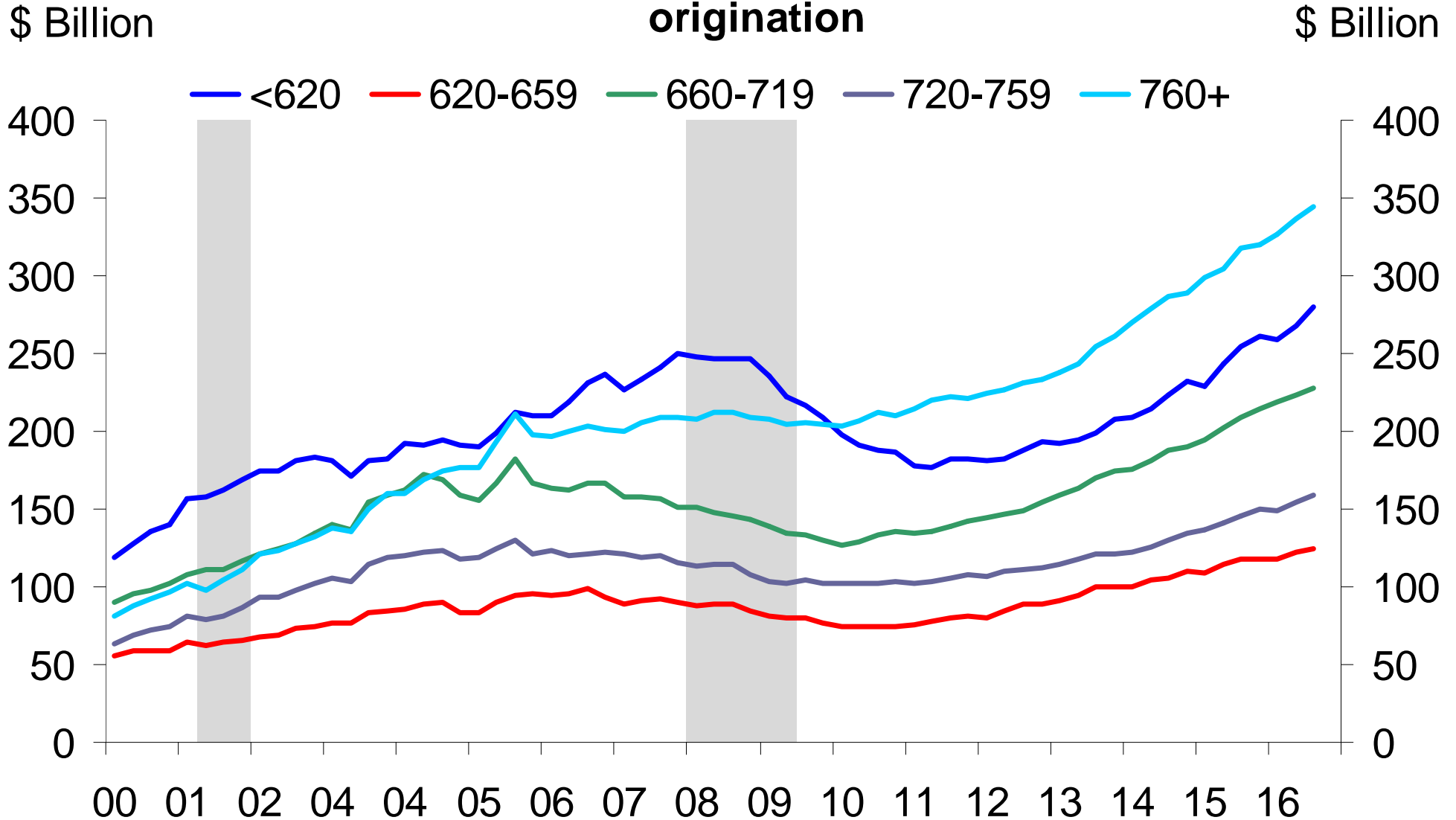


Source: New York Fed Consumer Credit Panel / Equifax, DB Global Markets Research

Outstanding auto loan balances: Around \$300bn for subprime and \$900bn for others



Outstanding auto loan balances by credit score at origination



Source: New York Fed Consumer Credit Panel / Equifax, DB Global Markets Research

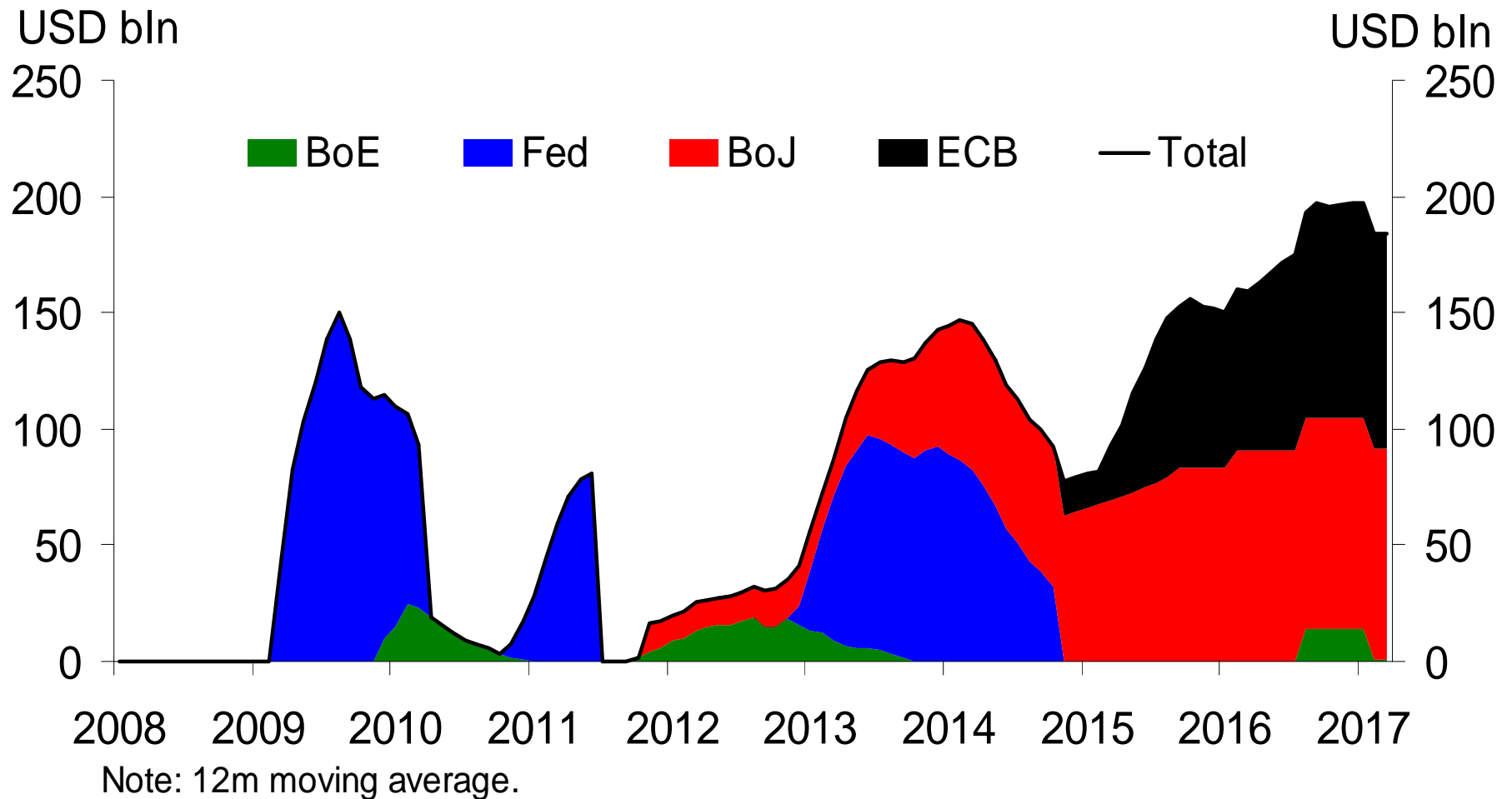


European impact on US rates

Still plenty of liquidity being added to markets:
ECB, BoJ, and BoE buying a combined \$200bn every month



Monthly Fed, ECB, BoE, and BoJ asset purchases

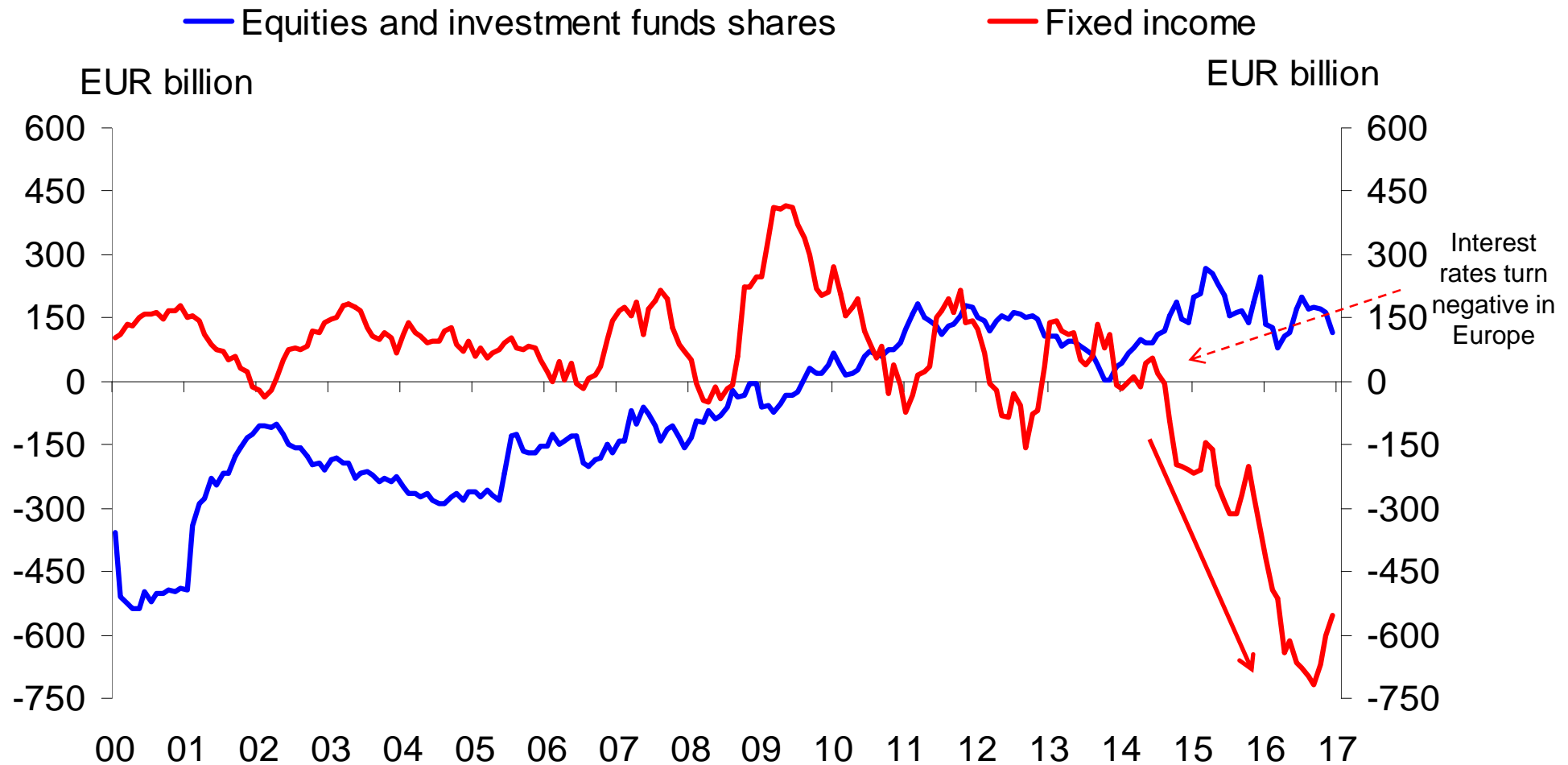


Source : DB Global Markets Research

Bond investors fleeing European negative interest rates at a record pace.
 This will continue to put downward pressure on US interest rates

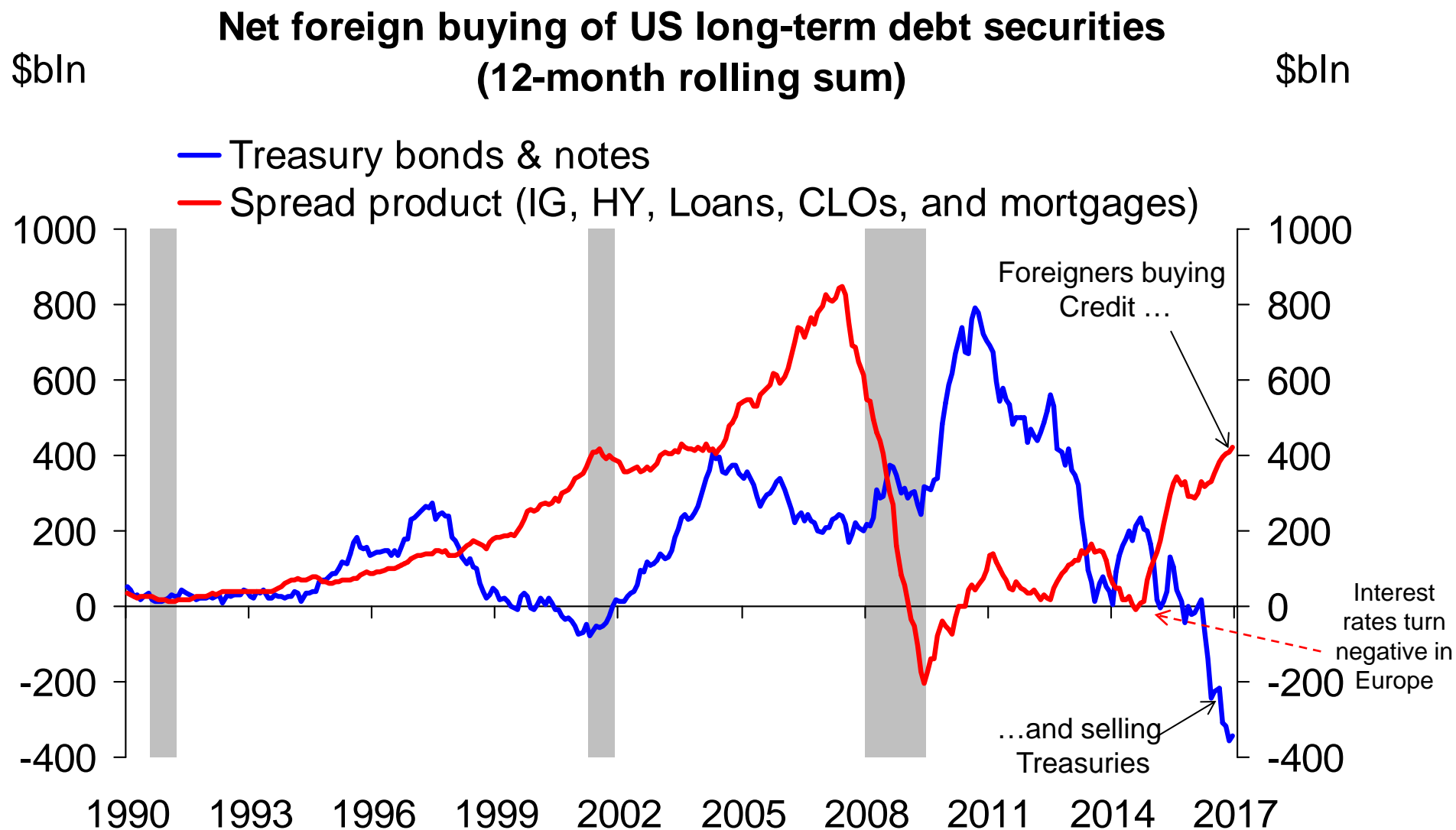


**Euro area: BOP: financial account: Net portfolio investment
 12 month rolling sum**



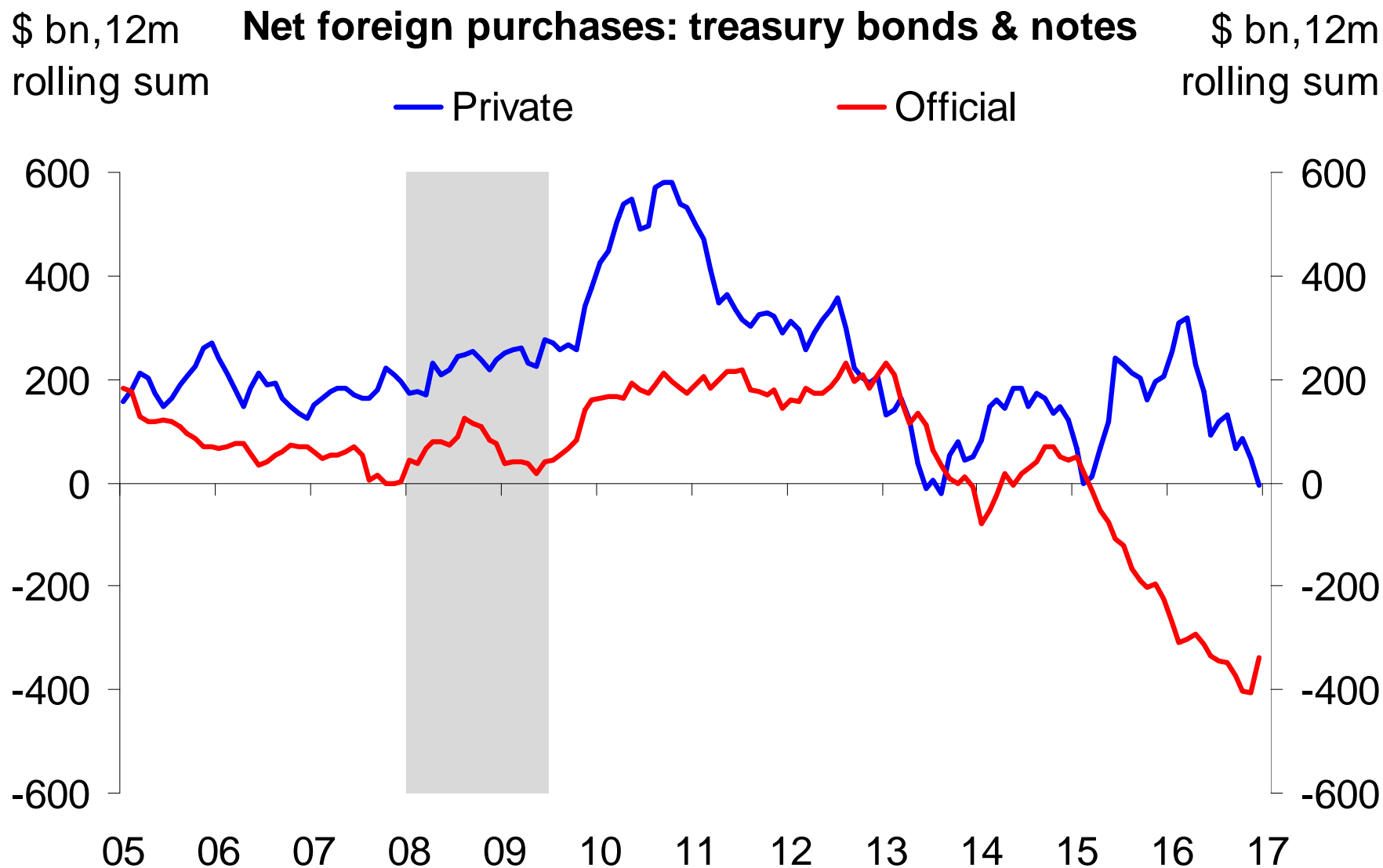
Source: ECB, Haver Analytics, DB Research

Foreigners hunting yield in the US after interest rates turned negative in Europe and Japan



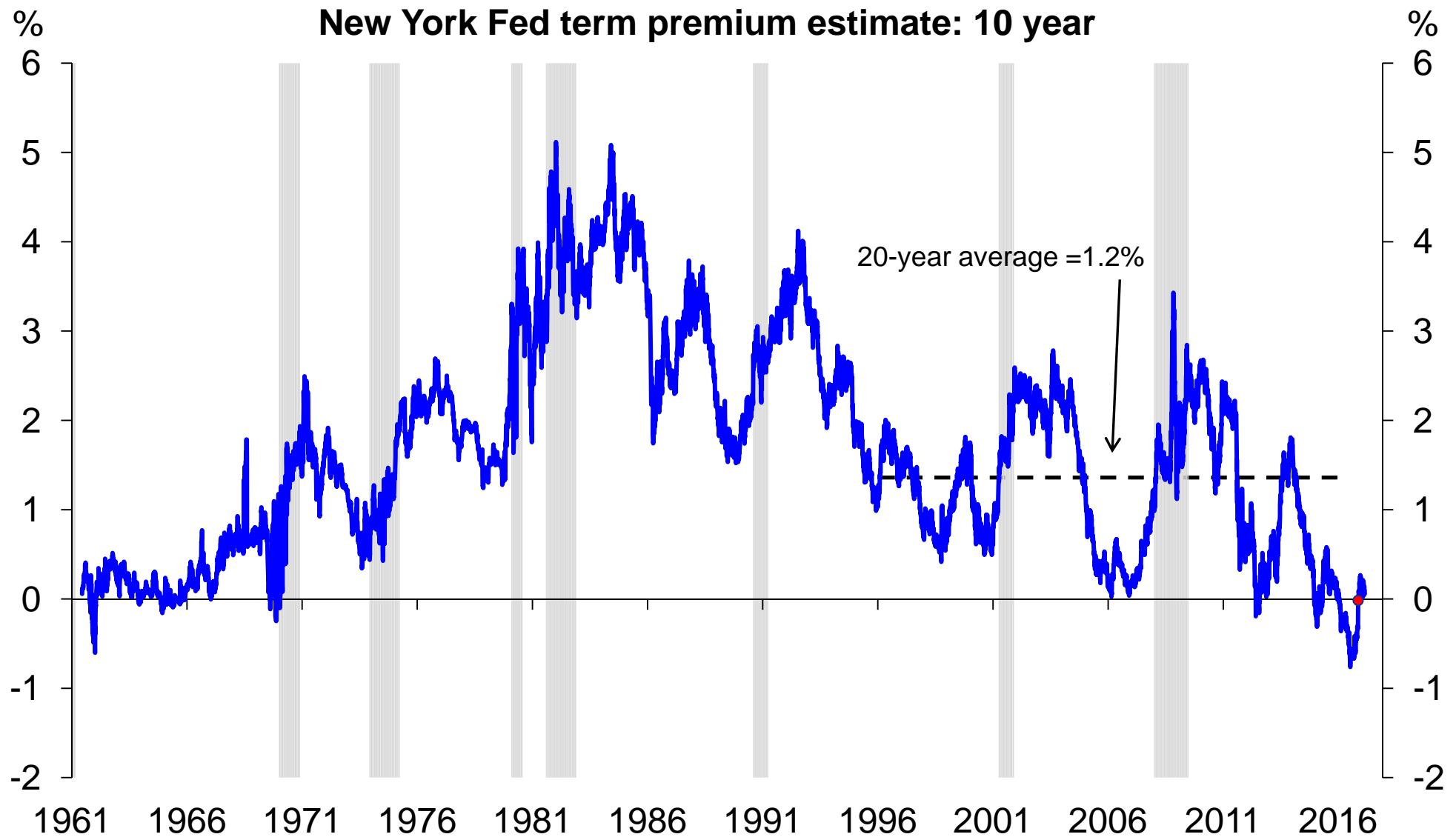
Source: Treasury, Haver Analytics, DB Global Markets Research

Foreign private buyers losing appetite for US Treasuries



Source: Treasury, Haver Analytics, DB Global Markets Research

Rates normalization is here:
Term premium turning positive, but still far away from 20-year average

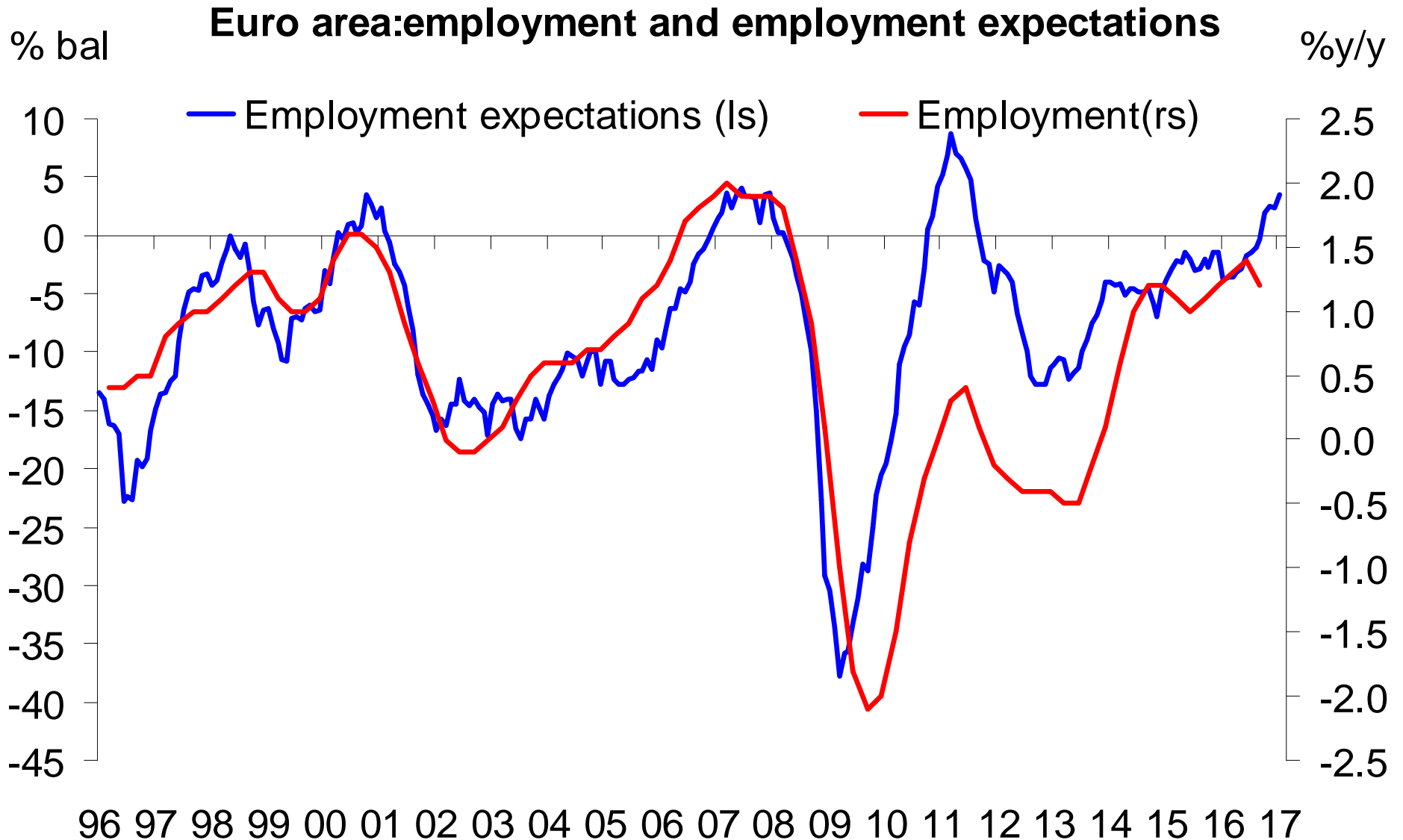


Source: FRBNY, Haver Analytics, DB Global Markets Research



Outlook for Europe, Japan, China

European recovery continues

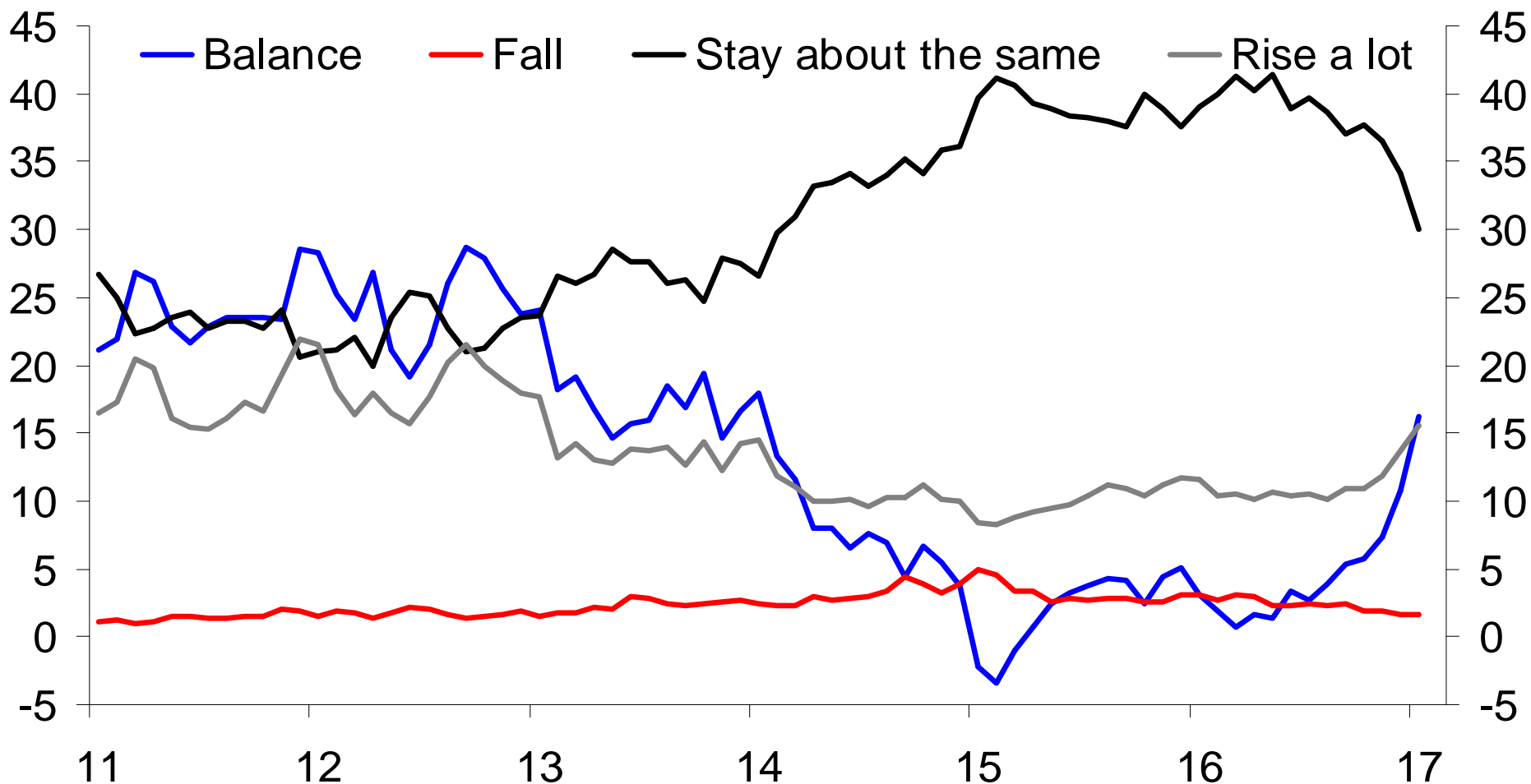


Source: European Commission, Statistical Office of the European Communities Haver Analytics, DB Global Markets Research



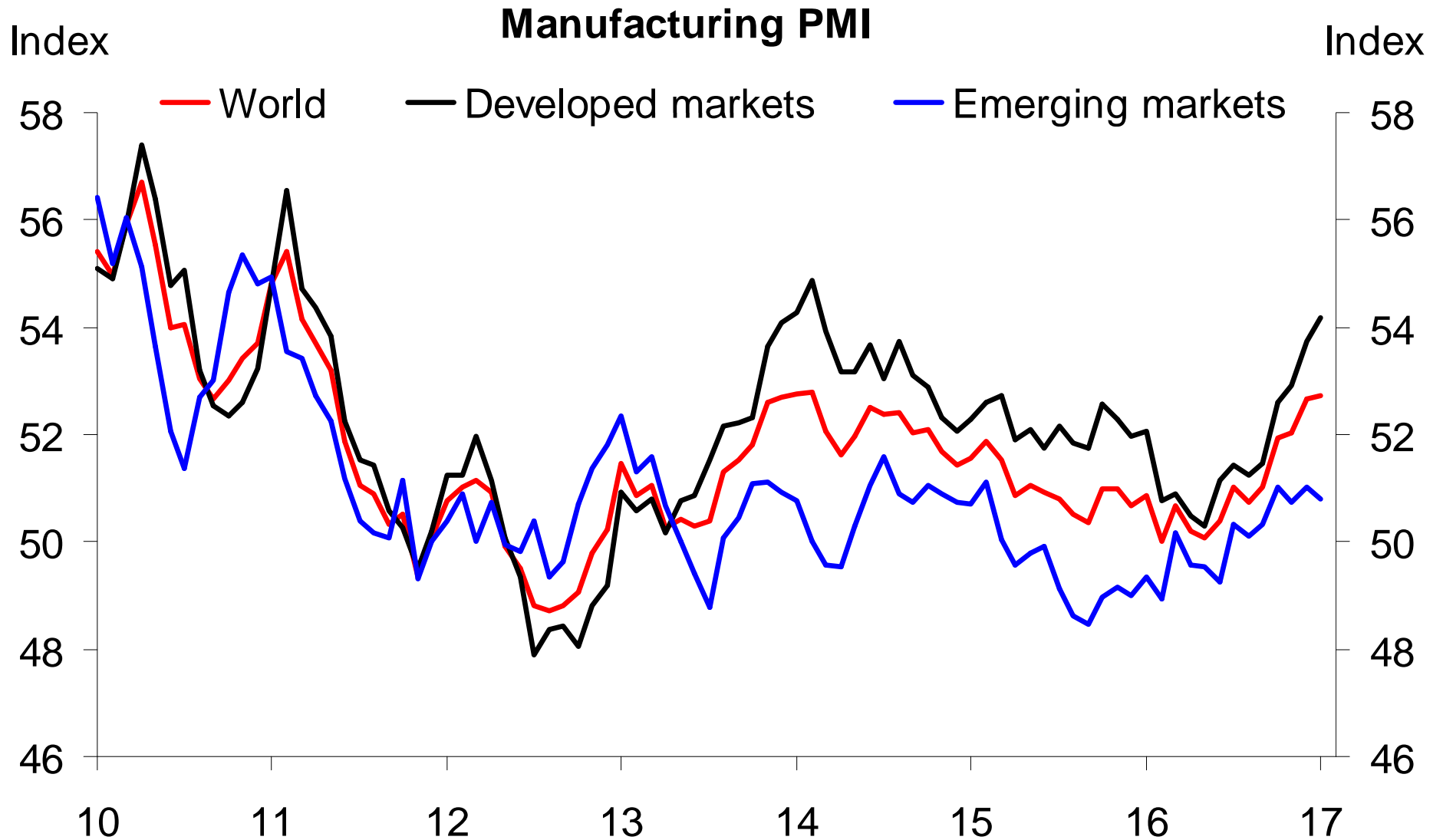
Europe: Consumer sentiment improving

% Bal **EC consumer survey: inflation expectations for next 12M** % Bal



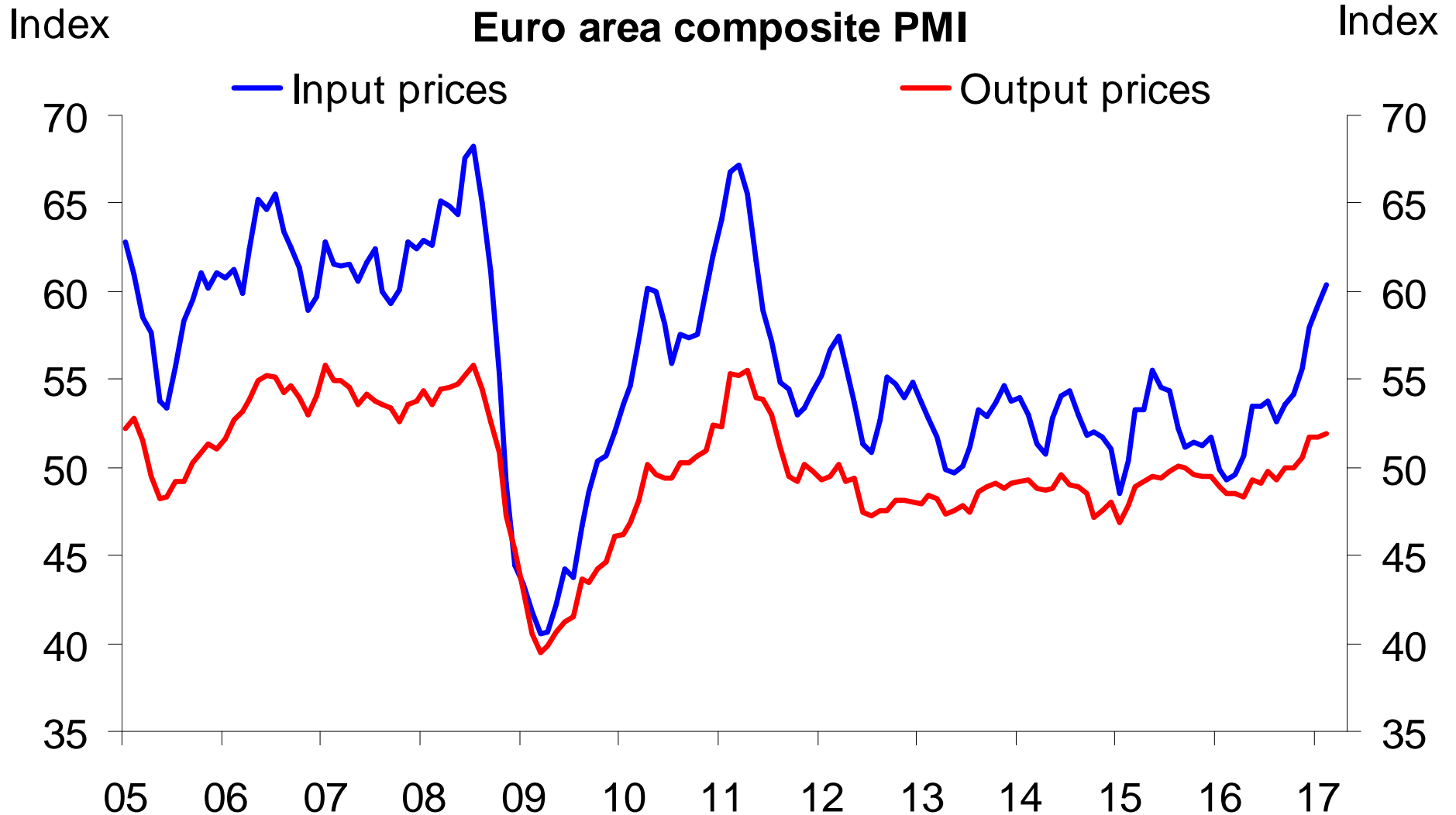
Source EC, Haver Analytics, DB Global Markets Research

Global expansion still solid



Source: IHSM, JPM, Haver Analytics, DB Global Markets Research

European price PMIs trending higher



Source: ISHM, Haver Analytics, DB Global Markets Research

Italian wages stagnating



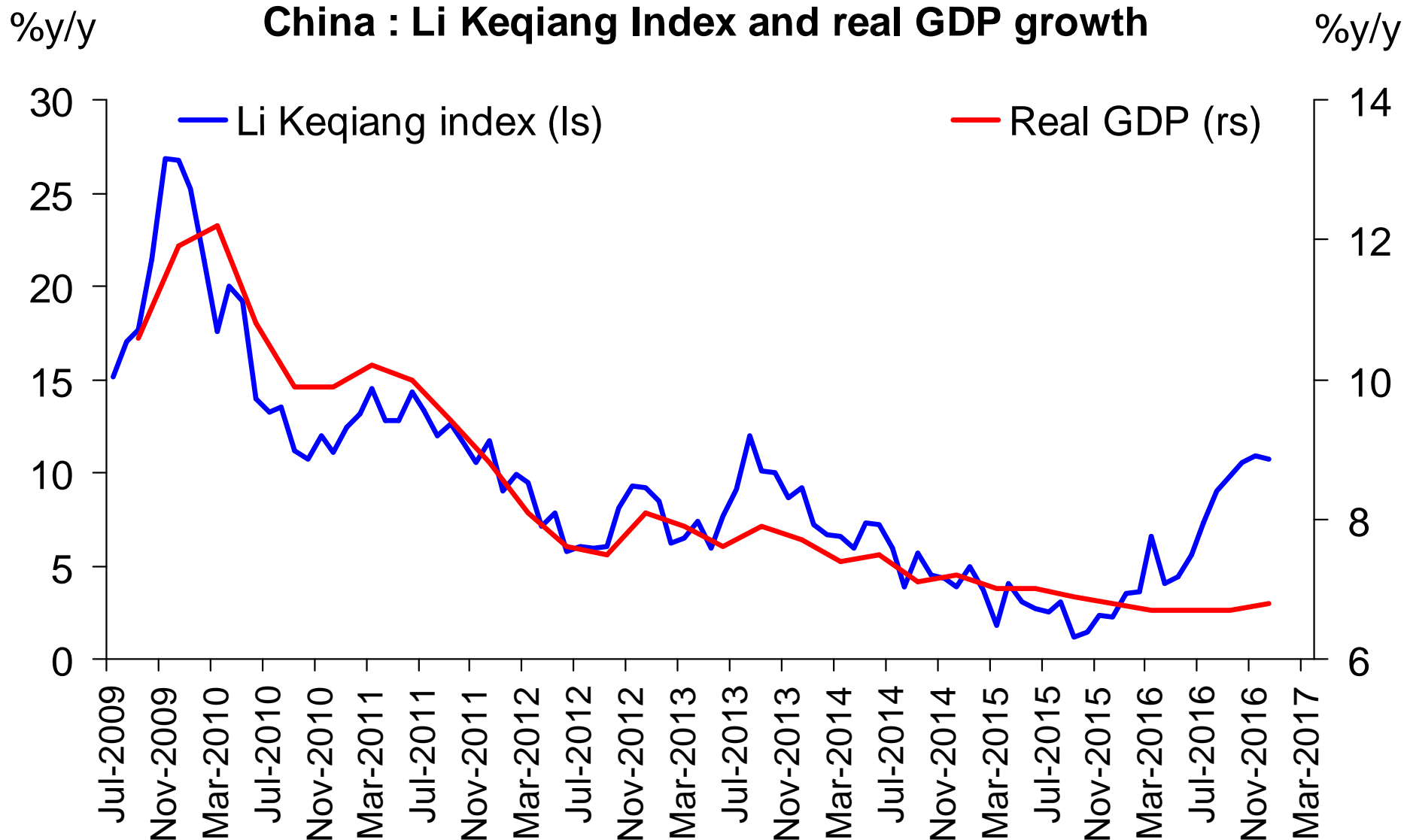
Wages according to collective labour agreements by agreement

Source: Istat, DB Global Markets Research



Chinese business cycle coming back

China : Li Keqiang Index and real GDP growth



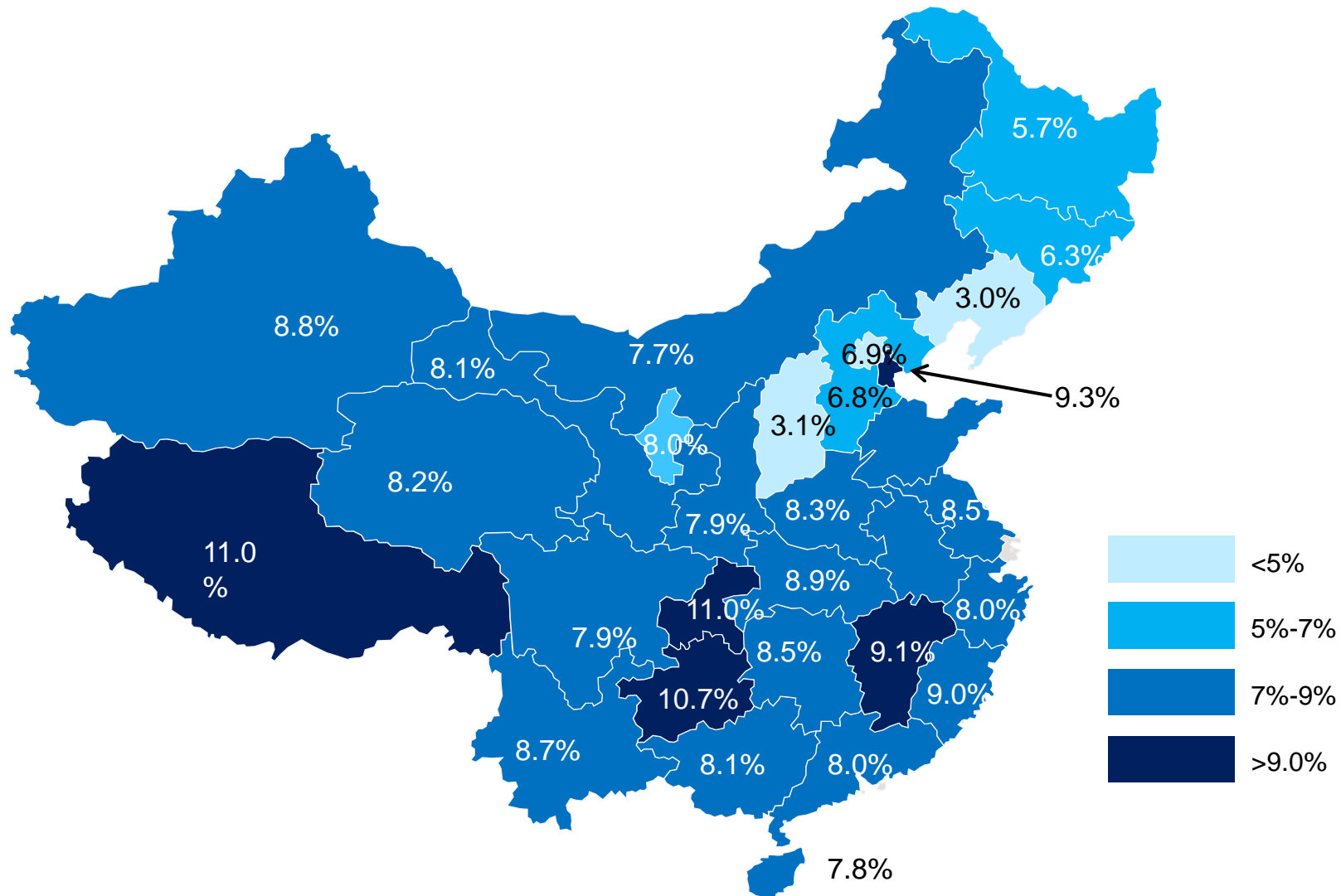
Note: Li Keqiang index is a weighted average of annual growth rates in outstanding bank loans, electricity production, and rail freight volume

Source: Bloomberg Finance LP, CNBC, Haver Analytics, DB Global Markets Research

Big differences in GDP growth across Chinese provinces



Real GDP growth (%/y) in China by provinces

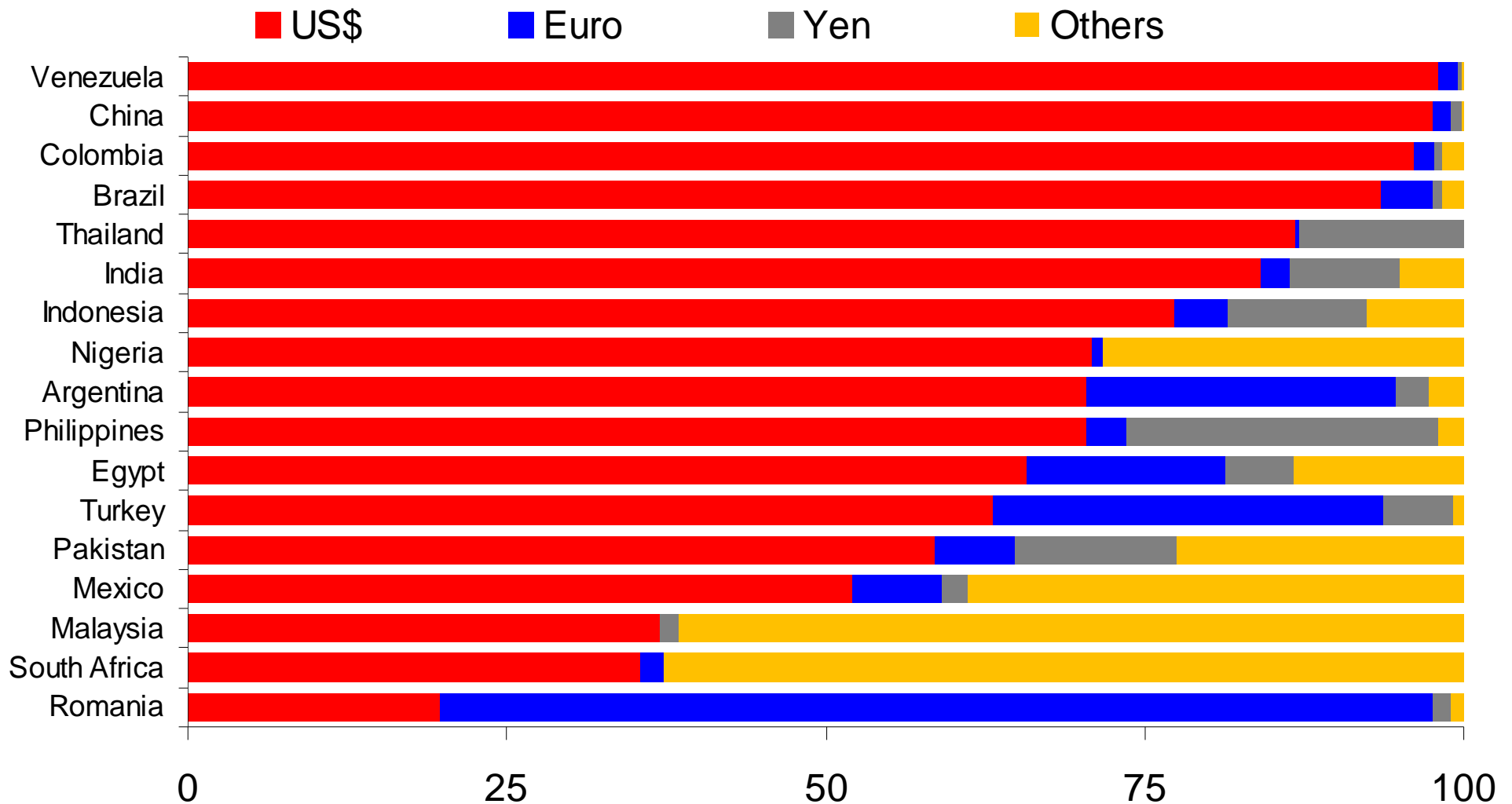


Source: CEIC, 2015, China Statistical Yearbooks , DB Global Markets Research

Dollar appreciation will hurt EM issuers in USD



EM currency composition of external debt in 2015 (in percentage)

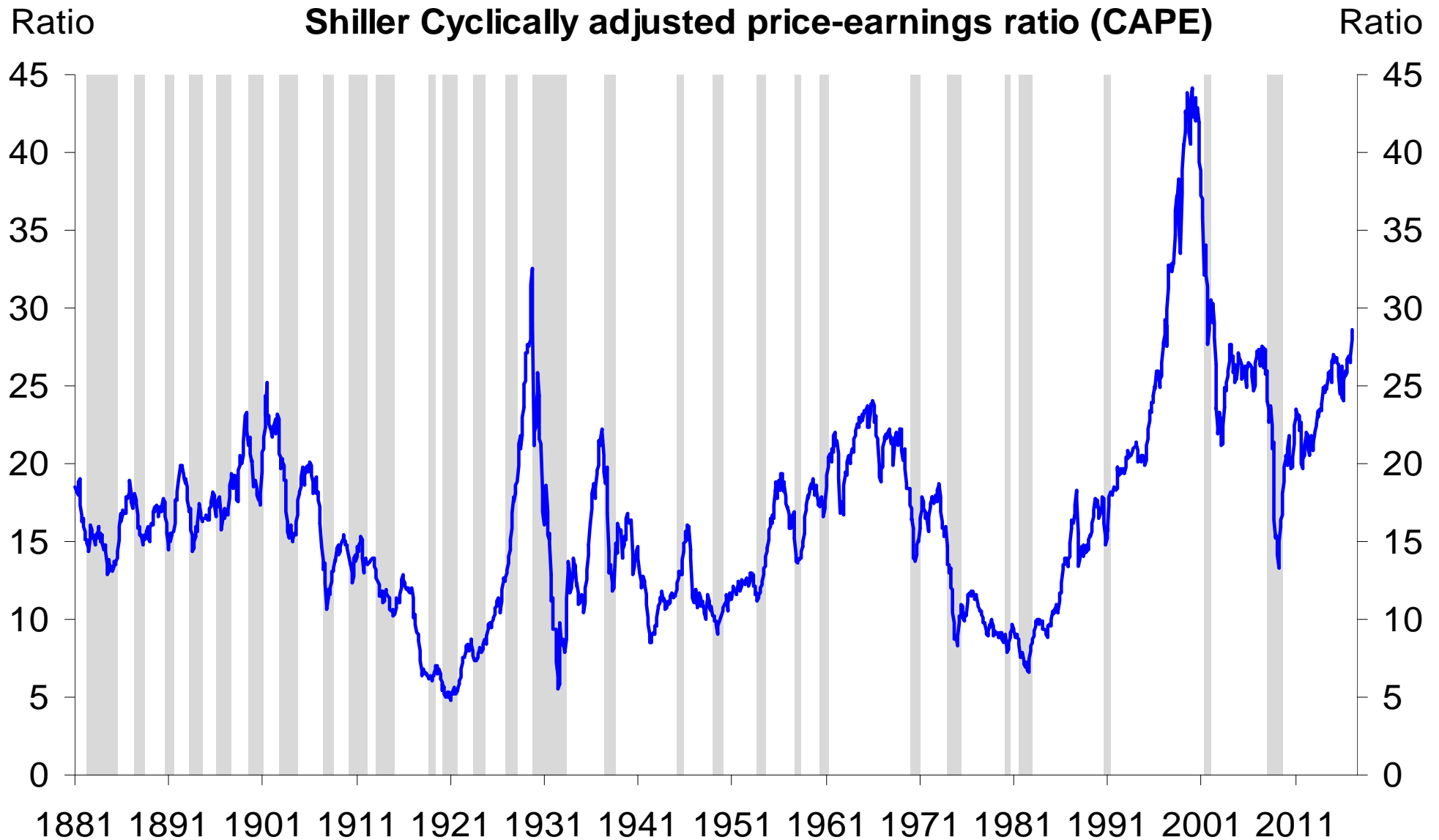


Source: World Bank, Haver Analytics, DB Global Markets Research



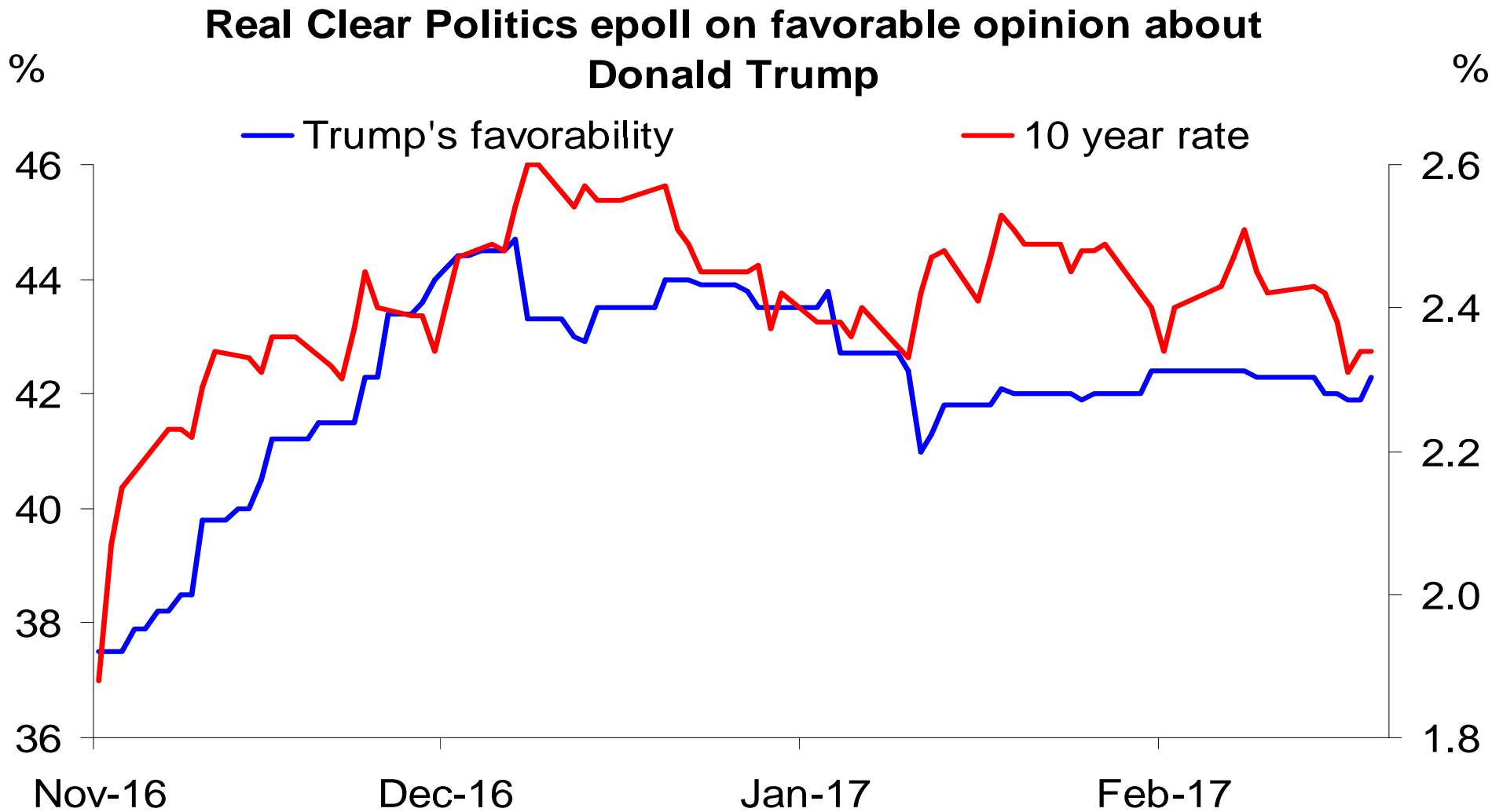
Investment implications

Stocks beginning to look expensive



Source: Robert J. Shiller, DB Global Markets Research

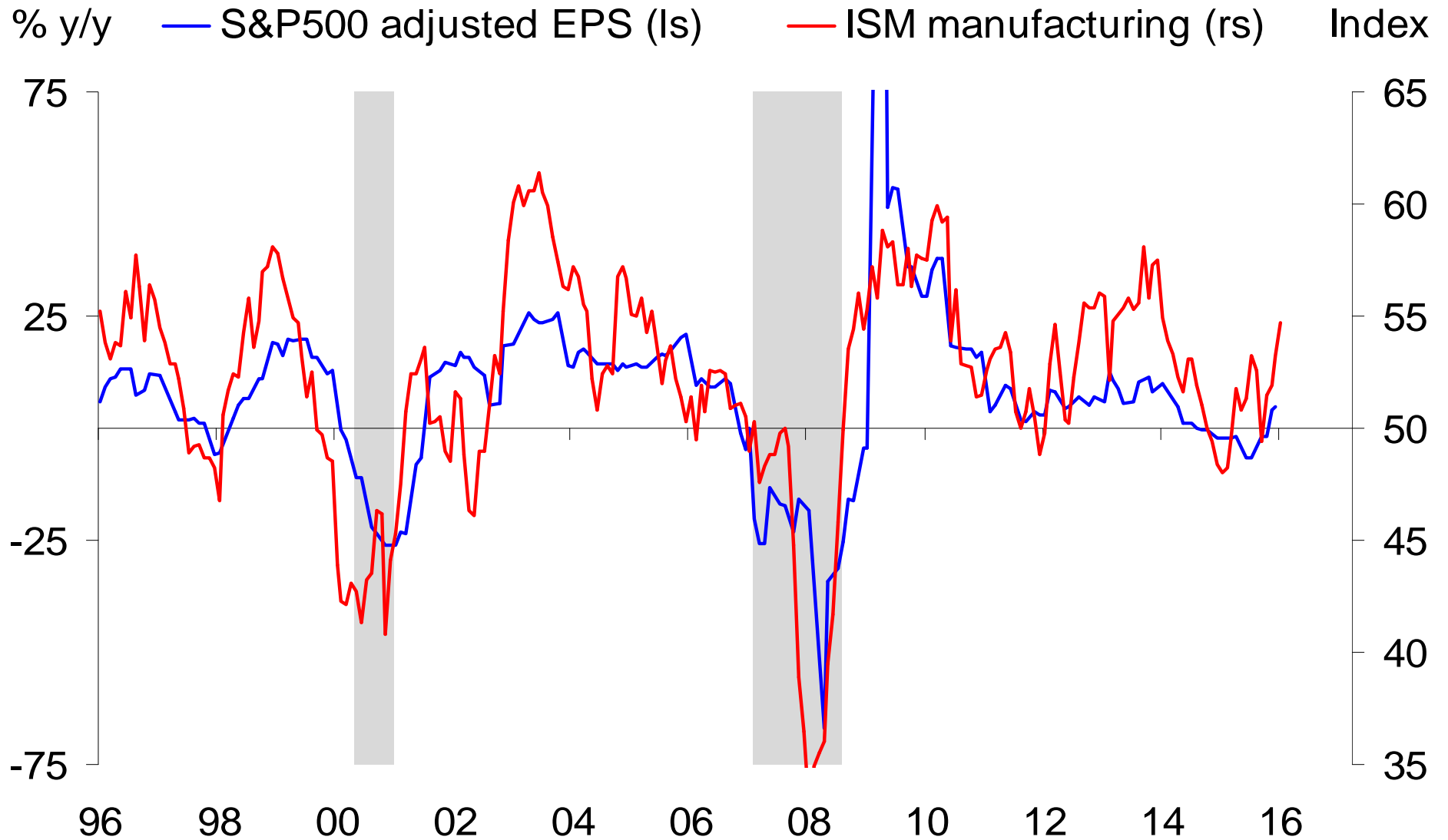
10-year rates moving around with Trump favorability



*Latest observation as on Feb 26, 2017 from Real Clear Politics

Source: Real Clear Politics (http://www.realclearpolitics.com/epolls/other/trump_favorableunfavorable-5493.html), FRB, Haver Analytics, DB Global Markets Research

Solid upside risks to earnings

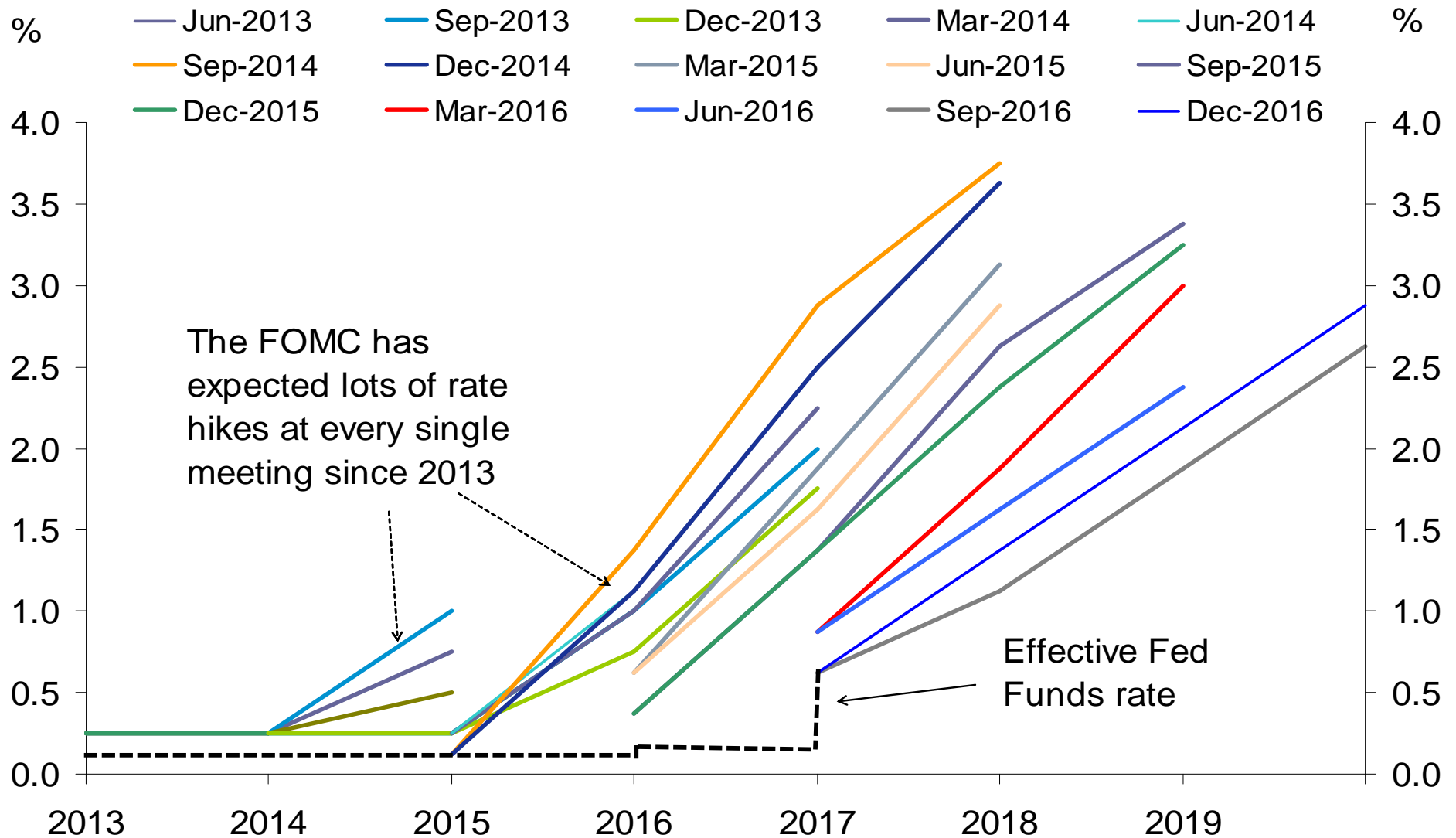


Source: Bloomberg Finance LP, DB Global Markets Research

The FOMC has been too optimistic for many years



FOMC mid points on different meeting dates



Source: FRB, DB Global Markets Research

How over/undervalued are home prices today relative to historical averages of home price/rent and home price/income?



Country	1) Home price/income (% above historical average)	2) Home price/rent (% above historical average)	Current average over/undervaluation of home prices (=average of column 1) and 2) (%)
New Zealand	59	114	87
Canada	47	112	79
Sweden	48	74	61
Australia	50	71	61
Norway	34	79	56
Belgium	43	47	45
United Kingdom	30	44	37
France	22	28	25
Denmark	18	31	24
Spain	16	25	21
Ireland	1	30	15
Netherlands	17	6	11
Finland	-3	26	11
Switzerland	-1	3	1
United States	-9	8	-1
Germany	-5	-2	-3
Italy	-3	-7	-5
Greece	-10	-16	-13
Korea	-40	5	-17
Japan	-29	-21	-25

Source: OECD, DB Global Markets Research

Investment implications summarized

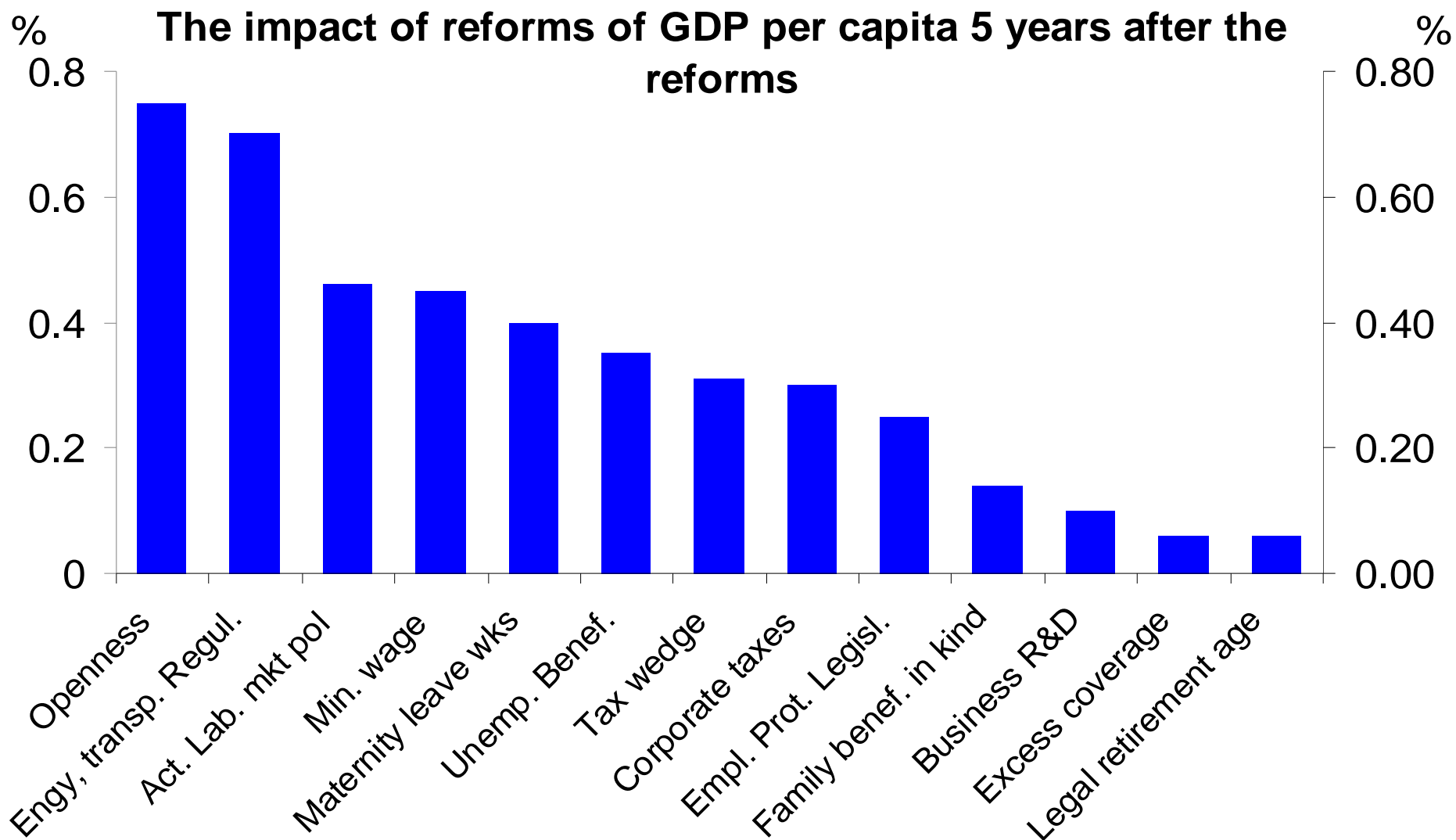


Fed outlook – Fed hikes coming	Fed expects three hikes in 2017. The 8-year hunt for yield is coming to an end and the secular stagnation narrative is gone.
Bond markets - Rates higher	The economy is already at full employment and adding fiscal expansion will boost growth, inflation, and rates.
Stock markets - Stocks higher	Fiscal expansion and deregulation likely to be positive for equities, Trump sector rotation to continue.
FX - USD higher	Higher US growth and rates means higher dollar.
Commodities - Downside risks continue	Property bubble in China is worrying. Slowing Chinese growth and excess capacity likely to put downward pressure on Australia, Latam, and Canada.
Emerging markets - Many imbalances in EM	EM suffering from higher US rates. Structural problems exposed in a number of emerging markets.

Source: DB Global Markets Research



Impact on growth of structural reforms

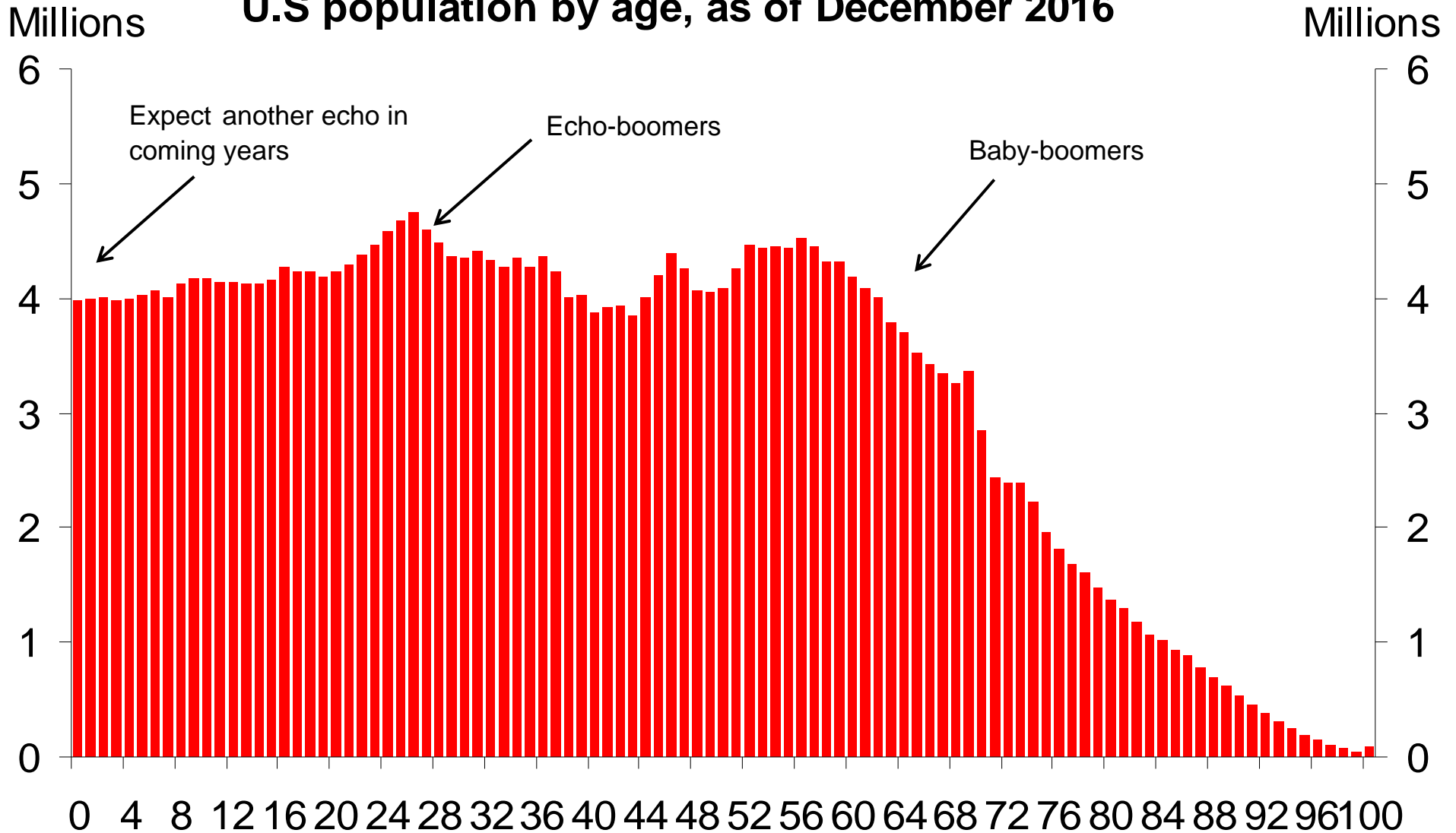


Source OECD, DB Global Markets Research

There are 4.6mn 26-year olds in the US, More than any other group



U.S population by age, as of December 2016

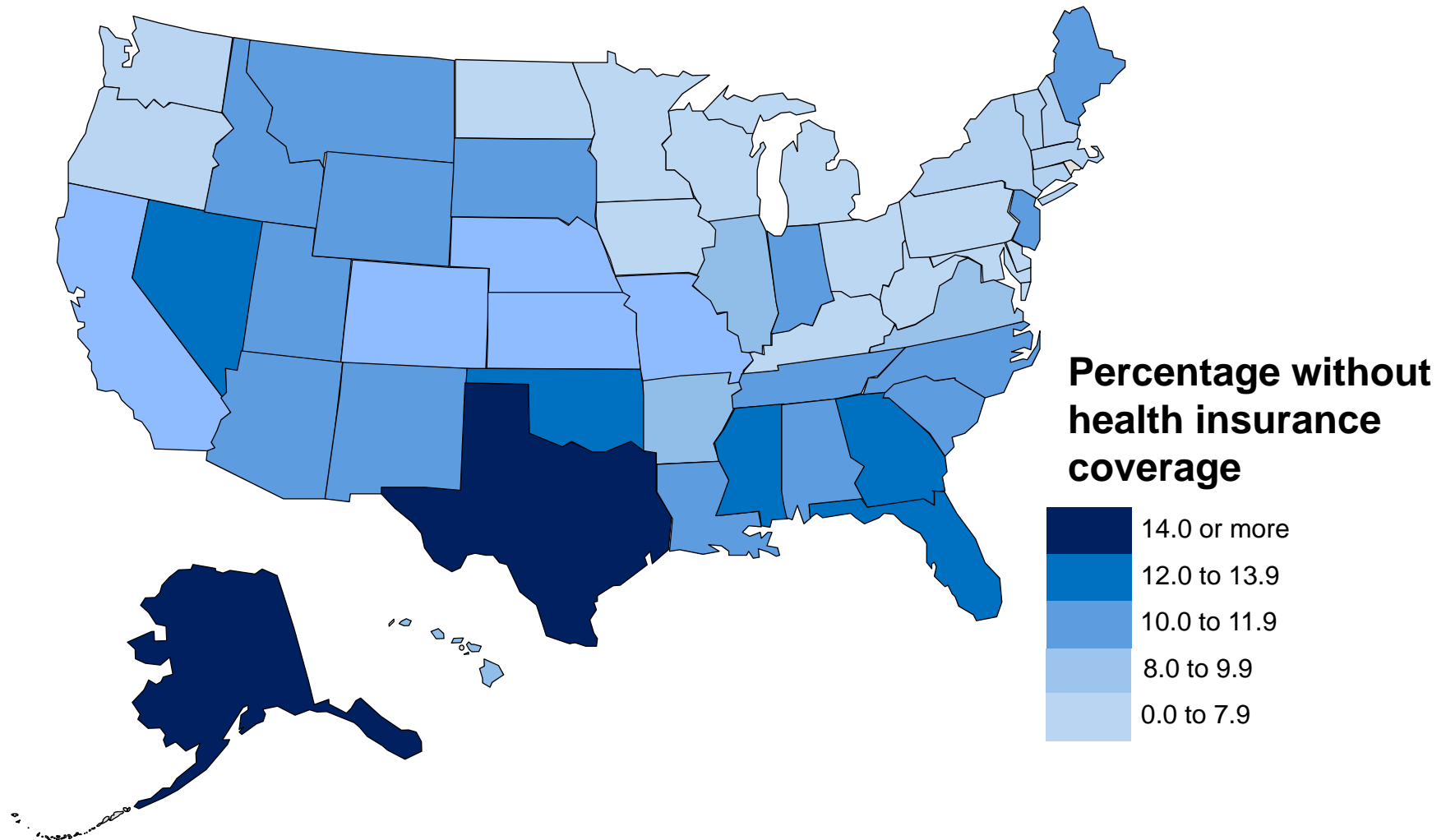


Source: Census, Haver Analytics, DB Global Markets Research

Where do those without health insurance live?



Uninsured rate by state: 2015

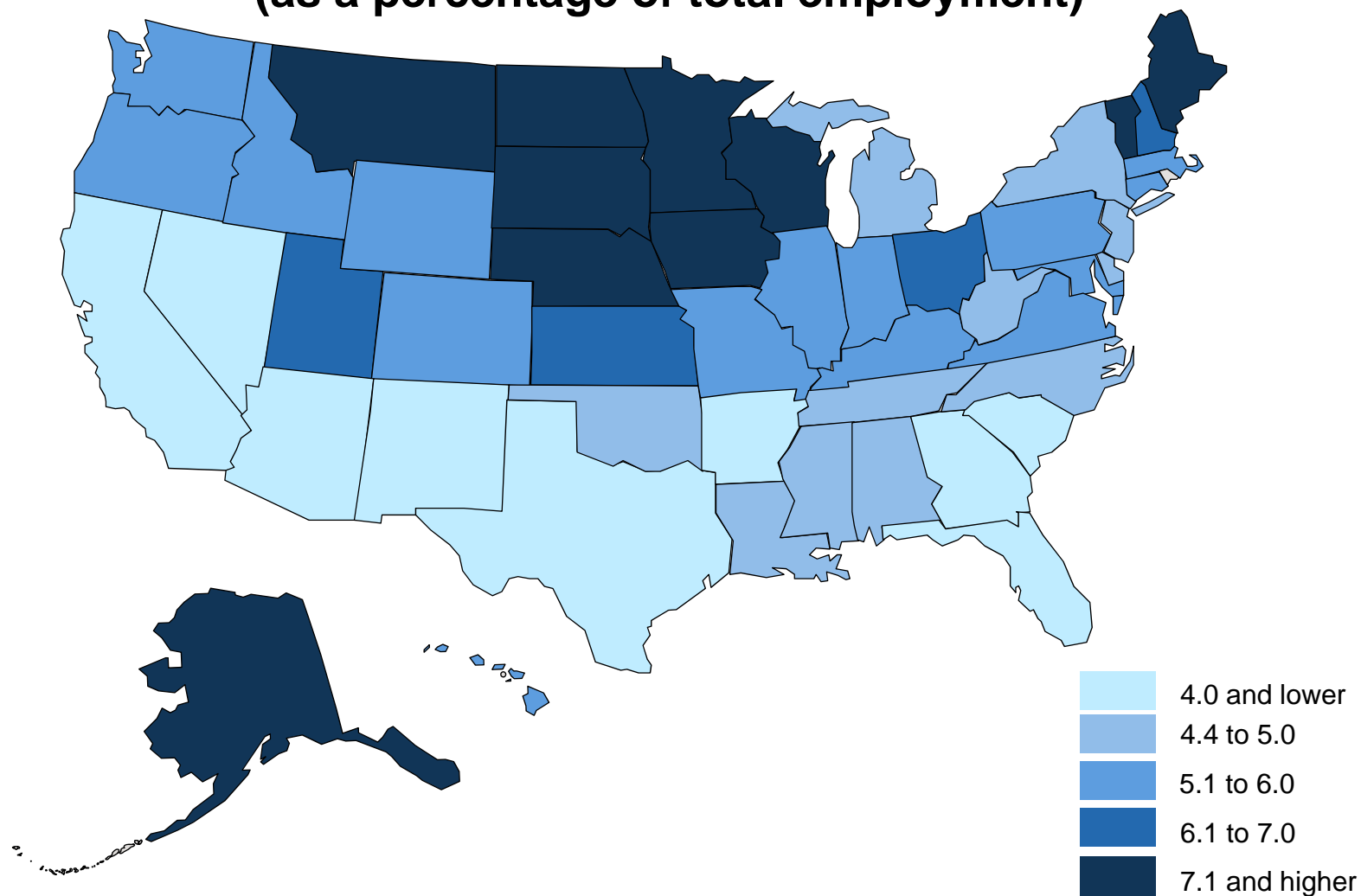


Source: U.S. Census Bureau, 2015 1-Year American Community Survey.



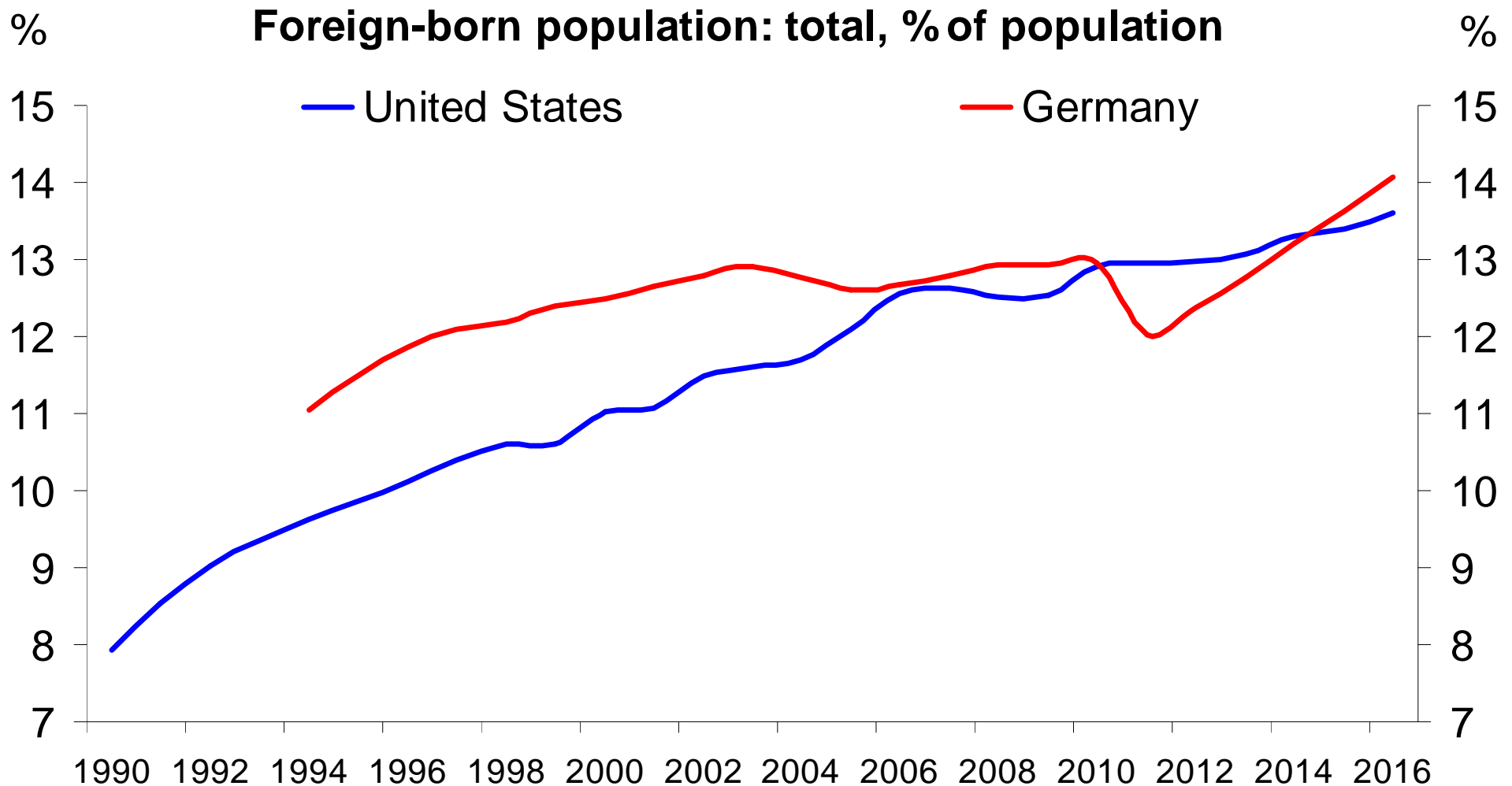
The closer you live to Canada the more jobs you have

**Multiple-jobholding rates by state, annual averages, 2015
(as a percentage of total employment)**



Source: U.S. Bureau of Labor Statistics, Current Population Survey.

Foreign-born population higher in Germany than in the United States



Note: The foreign-born population data shown here include people born abroad as nationals of their current country of residence. The difference across countries between the size of the foreign-born population and that of the foreign population depends on the rules governing the acquisition of citizenship in each country. This indicator is measured as a percentage of population.

2015 and 2016 figures are estimated from OECD International Migration Outlook report 2016.

Source: OECD, OECD International Migration Outlook Report 2016, DB Global Markets Research



Torsten Slok, Ph.D.

- **Chief International Economist, Managing Director**
- **Deutsche Bank Securities, Inc.**
- Torsten Slok joined Deutsche Bank Securities in the fall of 2005.
- Mr. Slok's Economics team has been top-ranked by Institutional Investor in fixed income and equities for the past five years. Slok currently serves as a member of the Economic Club of New York
- Prior to joining the firm, Mr. Slok worked at the OECD in Paris in the Money and Finance Division and the Structural Policy Analysis Division. Before joining the OECD he worked for four years at the IMF in the Division responsible for writing the World Economic Outlook and the Division responsible for China, Hong Kong, and Mongolia.
- Mr. Slok studied at University of Copenhagen and Princeton University. He has published numerous journal articles and reviews on economics and policy analysis, including in Journal of International Economics, Journal of International Money and Finance, and The Econometric Journal.



Appendix 1

Important Disclosures

*Other Information Available upon Request

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://qm.db.com/qer/disclosure/DisclosureDirectory.eqsr>.

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