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U.S. Economy Revival: One Key to Renewed Global Expansion

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Relatively solid and improved growth for the American economy is the forecast for the rest of 2013 and 2014 as several significant negative "Macro Risks" fade from the scene and positives emerge.

Principally, as the U.S. goes so will the Global Economy. A pickup in the U.S. economy and in Japan as that country aggressively reflates its economy should help the world finally come out of its depressed growth and financial difficulties.

Most likely is relatively slow U.S. economic growth compared with much of history, but better and more "normal" economic performance going forward than in recent years. In 2012, the U.S. economy disappointed, with real GDP growing only 2%, fourth quarter-over-fourth quarter. High unemployment persisted. Growth in corporate revenues and profits declined sharply. The Global Economy also had a difficult year, with Global Economy real GDP increasing by only 2.3%. *But through the rest of 2013, the U.S. and Global economies should improve. 2014 should be even better*.

The "Basic Prospect" elaborated by Decision Economics, Inc. (DE) foresees renewed U.S. economic growth in the second half and beyond, the unemployment rate moving lower, price inflation relatively low but increasing some, and growth in earnings picking up. The Federal Reserve will keep providing support with the U.S. central bank continuing to hold short-term interest rates near zero through this and next year and by increasing its balance sheet further on the pathbreaking "Open-Ended" Quantitative Easing (QE) that began in September 2012. This should keep long-term interest rates relatively low, albeit with yields moving higher,

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and financial conditions conducive to increased growth and employment.

The Federal Reserve has made clear that it will remain accommodative for a long while more, although perhaps less so later this year by lessening the pace of securities purchases for its balance sheet. But, currently, short-term interest rates are not intended to rise during 2014. Low short- and long-term interest rates and a bigger central bank balance sheet help stock prices, increase household sector wealth, improve household financial conditions, and reduce the risk to financial institutions of lending to households. In turn, consumer sentiment can lift up and, with lags, consumer spending respond positively.

All told, with this picture, stronger growth in Asia, and Europe's downturn bottoming out, the Global Economy should grow faster than in 2012, in a range from 2-1/2% to 2-3/4%, then by 3%-or-more in 2014.

Naturally, there are significant "Ifs," or "Macro Risks," that could negatively impact the realization of these forecasts. But downside macro risks are fewer than in the past and there is now significant upside. *Basically, if the U.S. economy improves, so will the world economy*.

Basic Prospect and Macro Risks

The Basic Prospect for the U.S. and Global economies through 2013 and 2014 is stronger expansion after a growth recession in 2012.

The Basic Prospect, or Baseline, does have negative "Macro Risks" associated with it that could impede, abort, or somehow change the prospect and its probability. But, many of these risks have faded in importance. Some remain such as: 1) the recession in Europe; 2) uncertainty surrounding the China prospect; 3) whether sovereign debt problems in some Eurozone countries could push them into more of a crisis and the European economy go down further; 4) the American consumer and whether spending will pick up more after years of weakness and deleveraging; 5) weakness in U.S. business profits and the effect on business spending, and 6) fiscal policy actions in Washington.

On the positive side is the reemergence of Japan, now economically viable again, with the possibility of upside surprises in economic growth, business activity, and from the weight of Japanese investment monies in global financial markets.

In the U.S., financial deleveraging is well along; for households particularly. Nonfinancial corporations are arguably in the best financial shape ever. And, financial institutions, despite new and more stringent rules, more oversight and increased capital requirements, are set to lend more off a large base of excess reserves. Loan demand and loans outstanding are picking up.

The U.S., of course, on renewed growth after several years of very anemic and subdued recovery and expansion, out-of-synch with most of history, essentially in a growth recession, will be extremely important for the global prospect.

For the U.S., the prospect is a continuing and growing expansion for the next several years in what now looks to ultimately be an extended upturn, stronger and more broad-based than in recent years, initially led by consumption (about 70% of real GDP), housing and residential construction (about 3% of the economy), then later improved business spending, hiring and new enterprise, a pickup at the state and local government level, and increased trade.

The evidence suggests that an entrenched private sector upturn is in-process that will be hard to dislodge, led by consumption and housing. Business capital spending usually lags any upturn in consumption and is more likely to pick up significantly in 2014. Finance and entrepreneurship should become more active. Financial intermediaries have been quite cautious and are beginning to pick up the pace, over the next year-and-a-half to lend more, and more aggressively so.

The pace of U.S. real economic growth also will depend on fiscal actions in Washington, i.e., how much fiscal drag will be in-place, and on economic growth in other countries and global regions. Federal government purchases, after adjustment for inflation, are expected to decline and permanently so, on federal government budget restraint and fiscal consolidation. This will produce lower growth in real GDP that can mask what is going on in the private sector. State and local government spending, on the decline since 2009, should turn positive over the next year.

Tight fiscal policy, i.e., reductions in the pace of growth of federal government purchases and outlays, along with tax increases, is now locked-in for many years, the questions being how much, the composition of the reductions in expenditures and increases in tax revenues, whether or not there will be tax reform, and how federal government payments to support the health and retirement of an aging population will be rationalized.

The reduction to real economic growth from the declines expected in real federal government purchases should be about 0.75 percentage points per year, possibly more, making it hard for growth in real GDP to move much beyond 3%. But, ex-federal government purchases, *the private sector likely will expand smartly*, perhaps rising, at some point, by as much as 4% per annum.

Table 1
U.S. Basic Prospect: Some Selected Aspects (Odds 65% as of Mid-2013)

	Years		
	2012	**2013**	**2014**
U.S. Economy			
Real GDP (% Chg.)*	2.0	2.1	2.9
Inflation and Unemployment			
CPI-U (% Chg., Ann.)	2.1	1.5	1.7
Unemployment Rate (%; Q4 Avg.)	7.8	7.1	6.5
Interest Rates (%; Q4 Avg.)			
3-mos. T-bill	0.08	0.09	0.14
10-yr. U.S. Treas.	1.79	2.90	3.65

	Years		
	2012	2013	2014
Profits			
S&P500 Operating Earnings ($s; Ann. Avg.)	103.6	109.0	118.8
(% Chg.; Ann.)	4.9	5.2	9.9
Equity Market			
S&P500 (Index; Ann. Avg.)	1380	1624	1753
S&P500 (Index; Q4 Avg.)	1418	1701	1815
S&P500 (% Chg.; Q4-over-Q4)	9.5	17.7	6.7
U.S. Dollar			
Dollar/Trade-Wted. (Nominal)	0.735	0.760	0.784
Dollar/Euro (Level)	1.286	1.319	1.366
Federal Budget Deficit			
($ Bils., Unified, FY)	-1,089	-679	-607
Gross Public Debt/GDP (%)	98.9	100.5	99.3
Eurozone (17 Countries)			
Real GDP (% Chg.; Ann. Avg.)	-0.5	-0.3	0.8
Europe (EU, 27 Countries)			
Real GDP (% Chg.; Ann. Avg.)	-0.4	-0.2	1.0
Global Economy			
(47 Countries, 93% of World Output)			
Real GDP (% Chg.; Ann. Avg.)	2.3	2.5	3.2

*Q4-over-Q4; data from 2013, 2014 forecasts.

Source: Decision Economics, Inc. (DE).

In the United States, the fundamentals surrounding consumption and housing are much improved, although spending, while better, is nowhere near what used to be the case. Growth in real consumption is expected at around 2% in 2013, about the same as in 2012, although to pick up to a 2-1/2%-or-more rate in the second half. In 2014, when the fundamentals of jobs and income, household wealth, consumer sentiment and household financial conditions will be providing more support, the expectation is for a 2.8% gain. Real residential construction, in a strong upturn since 2011, led by much stronger home sales and housing starts, should rise near a large 14% in 2013 and by about 11% in 2014. *These are the main drivers of the renewed U.S. growth upturn that is expected.*

The pace of aggregate consumption has been far, far below historical trend for almost seven years now, including the time, 2007-09, of the Great Recession. Large declines in the growth of consumption, compared with prior history, rising by only 1.5% per annum since 2005, have been the main source of the anemic and subdued U.S. economic growth that has occurred. Between 1955 and 2005, trend growth in real consumption averaged 3-1/2% a year. The consumer economy, now nearly $12 trillion in nominal terms, also includes housing and real residential construction. Together, these spending aggregates account for 73% to 74% of U.S. real GDP. *Can consumption get out of its growth rut? Very likely it can—the answer is yes.* This can occur from improved consumer fundamentals but also, in part, because of increased lending by financial institutions, especially next year.

A weaker area of activity is net exports, reflecting continuing economic weakness in Europe and rising U.S. demand for imports. Better economic growth is set to occur in Asia, led by Japan, emerging now from a long period of troubled times on a huge set of reflationary policies. These include massive monetary stimulus, fiscal stimulus, coming reforms in Japanese bureaucracies and in the labor market with a focus on deregulation and major shifts, seismic, in Japanese politics and society.

In the U.S. labor market, a key to how goes the consumer and aggregate consumption is the unemployment rate. This has been moving lower, reaching 7.5% in mid-2013 compared with 8.2% in mid-2012, and is expected to reach 7% by the end of 2013 and 6.5%-or-so by end-2014. Inflation is forecast to be low and relatively stable, ranging between 1% and 1-3/4%, at an average annual rate. For 2013, corporate profits as measured by the S&P500 Operating Earnings, are projected at about $109, a 5.2% increase over 2012. In 2014, a near 9% gain is forecast.

The pickup in economic activity forecasted for the U.S., if it occurs, should reverberate around the world.

Asia, if no further significant decline occurs in the growth of the Chinese economy, should help generate renewed growth in sales and earnings for U.S. companies later in 2013 and 2014; in turn, this should help drive up business capital spending and hiring that will extend and broaden the U.S. economic expansion.

Other sources of optimism include: 1) continuing reductions in business costs, particularly from subdued hiring, smart management, and new technology; 2) a rapid pace of innovations, especially Internet-related; 3) increased use of new info-tech equipment and software in substituting for labor in production; 4) better revenues as product prices firm; and 5) a general pickup globally.

New, and repeated, stock market highs should occur on rising earnings and relatively low interest rates, irregularly so, but on a continuing basis. Rising stock and housing prices will help improve consumer balance sheets and increase household wealth; in turn, supporting a higher pace of consumption spending.

America's situation should help lift global economic growth to a 2.5%-to-2.75% range in 2013. In 2014, the projection for Global Economy growth is 3%-to-3-1/2%, the best in years. In 2012, the Global Economy rose by only 2-1/2%—flirting with a recession (defined as real economic growth for the Global Economy under 2%).

Macro Risks: Minuses and Pluses—The "Spacecraft" Analogy

The U.S. Baseline Prospect and risks to it might be thought of as a spaceship (the American economy) launched into orbit—mainly by the Quantitative Easing (QE) of the Federal Reserve—but low-flying, not so high as desired nor safely so, and subject to collision with meteorites in space. Spinning around in space are meteorites (such as the Eurozone Crises) that could hit and knock the spaceship off course. The Federal Reserve is planning to keep applying bursts of propulsion with its Open-Ended QE until the spacecraft reaches a certain altitude, one that can be maintained (stronger real economic growth and a lower unemployment rate). *At that point, less monetary policy stimulus (bursts of propulsion) will be applied, but with the tapering gentle so as to maintain the new higher orbit*.

Europe's Recession. *One meteorite, or negative macro risk, threatening the U.S. and Global orbit has to do with the ongoing recession in Europe*, which has lasted over a year-and-a-half for a number of countries after a short recovery from the 2008-09 recession. About 85% of the European Union (EU), which represents a large portion of global real GDP, has been in recession. Particularly depressed are the economies of Spain, Italy, Portugal and Greece. But, even some countries in Northern Europe, such as the Netherlands and Belgium, have been dragged down.

The Eurozone and European downturns, which began in Ireland, then Greece and Portugal, spread as a result of negative internal and external trade interactions and were worsened by lender conditionality and austerity in countries that needed, or might need, a "bailout." The European downturn was intensified by a sharp deceleration in Asian real economic growth, led by China, and disappointingly weak growth in the U.S..

Economy weakness from within and from outside Eurozone and Europe hurt exports. Financial fragility in a number of countries led to funding needs from the European Center for some which, in turn, was accompanied by tough lender conditionality. This weakened the Eurozone economy further. Financial crises within Europe in sovereign debt-ridden and potentially troubled economies, contractions of loan asset values on bank balance sheets, a credit crunch, and bailouts necessitated at the sovereign level for several countries intensified the downturn. There was a backlash against austerity in the body politic of a number of countries and political instability as a consequence. Political upheaval and subsequent changes in leadership helped prevent appropriate macroeconomic policies from being implemented. The chaotic political leadership in numerous countries made changes in policies difficult and late, complicating the crises. The whole Eurozone arrangement and fabric was threatened and still is in question. Ireland may be emerging from nearly three years of recession. The U.K. is doing better. But Europe is still shaky and the outlook clouded.

Despite some attempts to accommodate, the monetary policy of the European Central Bank (ECB) has been crisis-centered rather than setting up monetary stimulus that all Europe needs—a lower key policy interest rate to weaken the euro, provision of credit to the banking system or companies as the Bank of England (BOE) has done, and even some sort of expansion of the ECB balance sheet, a European-style QE, and commitment to maintain it until the European economies improve substantially. Governments in the loose confederation of countries that are the Eurozone make this difficult.

On the fiscal side, the policies of the Troika—the European Union (EU), the International Monetary Fund (IMF), ECB—heretofore have been quite restrictive. Austerity has turned out to be counterproductive as countries in reasonably good financial condition hesitated to lend to insolvent countries or those who might become so. Lender conditionality for loans that were made—as too often has been the case in these kinds of situations—was punishing to a number of economies and made the economic situation in each a good deal worse.

The failure of the political economy of policymaking has made the European situation considerably more difficult and intransigent, with long delays in recognition of the economic downturns, in the formation of policy and its implementation.

The European downturn, which began towards the end of 2011, spread throughout the Continent, touching even countries such as Germany and France. Growth in Eurozone real GDP in 2012 was negative, at -0.5%. In 2013, another decline, -0.3%, is forecast. And, in 2014, only a meager recovery is expected—real GDP growth at 0.8% in the Eurozone and 1% in Europe. The ongoing crises and their uncertain outcomes through Europe's large role in global trade and finance remain an ongoing negative and impediment to a renewed world economic upturn.

Trade the Transmission Mechanism to the Rest-of-the-World. While mild in real GDP terms, the widespread and long European recession poses a significant risk to the U.S. and Global Economy. The transmission mechanism has been, and continues to be, weakening exports within Europe and elsewhere—particularly the exports of China. China's economic weakness, in turn, has depressed trade flows within and across Asia and this has reduced U.S. exports. In real terms, U.S. exports rose to a new record in the second quarter of 2012 but then slowed to a much slower pace. With the U.S. economy growing by 1%-to-2%, inflation-adjusted, U.S. import growth also has slowed. This has limited the declines in U.S. real net exports and thus the negative impact on real GDP. But, less imports means fewer exports of other countries for whom the U.S. is a significant end market. Numerous businesses—financial, transactional, and trade-related—have been negatively affected.

Domestic demand in much of Europe has weakened as economies contracted in the face of austerity-driven increases in taxes, reductions in central government outlays, reduced pensions, difficult financial conditions, a credit crunch, and the disarray in confidence and politics that such circumstances create.

Eventually, an economy in recession will bottom-out on its own and begin to rise again as shifts in growth occur to bring about an upturn. In the absence of macroeconomic policies to facilitate a turnaround, however, the European downturn has continued longer than necessary with some risk even that Europe does not bottom-out and recover as expected.

The European risk to the world economy is that the downturn might worsen even more, injecting yet another negative impulse into the Chinese, Asian and Japanese economies by lessening their exports. In such a situation, financial conditions would deteriorate more; Spain and Italy might require bailouts in order to stay solvent; and the, as yet, relatively resilient economies of France and Germany might not remain so. In aggregate, negative impulses stemming from Europe and Asia together would reduce U.S. exports, weaken the U.S. industrial sector, lead to less jobs creation, and potentially limit consumer spending—the expected pillar of growth in the Basic Prospect.

The China Risk: *One If, or Macro Risk, is hesitation in the Chinese economy*. While it decelerated significantly—from near 12% growth, year-over-year, during 2011-12 to about 7.5%—this reduction in growth was intentional, motivated by restrictive monetary, fiscal, and regulatory policies. The policy-induced movement from a frothy economy, with inflation in the 6%-to-7% range, to a more stable economy with a more desirable 2%-to-3% inflation rate, induced a sizeable negative impulse to Asian growth in 2012. It was also most certainly a source of weaker growth in German exports and for the European economy.

In 2013, financial excesses in the banking system and in property surfaced. Chinese policymakers have been squeezing them out in order to set up more solid and sustained growth without financial instabilities. The resulting hesitation in growth remains a negative global and U.S. risk given the Chinese economy's size. China also is hesitating to stimulate its economy more until the excesses are worked out. Sideways to somewhat slower growth in China has had a ripple effect in Asia and throughout the world economy, principally through trade. The lack of a China growth upturn negatively affects Asia, reduces commodity prices, hurts commodity exporters, and weakens Europe. This limits growth in U.S. exports which, in turn, reverberates through the economies of North America into the world economy, contributing to a weaker pace of global economic activity.

China's economic growth rate probably has now stabilized at 7%-to-7-1/2% with inflation in a very low range of 2% to 3%. But, until the excesses in the financial system of China are fully squeezed-out, any upturn for the Chinese economy is suspect and further stimulative monetary and fiscal policies probably will not be implemented. The Chinese economy also is going through a purposeful shift to more consumption from being export- and industrial-driven. Until these adjustments are made, the Chinese economic prospect is for sideways to even lower growth. This drags on Asian economies, hopefully to be offset by a lift up in Japanese economic activity.

The Earnings Weakness Risk. *Another negative macro risk for the U.S. resides in the sharp declines in the growth of company revenues and earnings in the last few quarters.*

Taking the S&P500 companies as a sample of the U.S. economy, data on S&P500 Operating Earnings from the third quarter of 2012 through the first quarter of 2013 show a sharp deceleration. This continued in the second quarter and is expected also for 2013:3, and is causing hesitation in business spending and hiring. Whereas revenue and earnings growth in 2011 ranged from high single-digits to low double-digits, S&P500 Operating Earnings are now growing at only a low single-digit pace. Profit margins remain quite good, however, suggesting that productivity improvement is occurring at the company level that perhaps is not being picked up in the macro data.

In many U.S. business cycles, with lags, declines in the growth of company revenues and earnings have been precursors of recession. This is because companies tend to cut back on hiring, spending, production and inventories in the face of what is perceived as permanently lower growth in sales and earnings. Sometimes long lags occur before companies come to such a conclusion. But in more recent business cycles, S&P500 companies have not hesitated to quickly limit hiring on revenue and earnings weakness. *So, the earnings weakness is a flag of warning.*

In the Baseline Prospect, solid consumer spending, a better U.S. economy, a bottoming-out of the European downturn, a much stronger Japanese economy, and improvement in Chinese economic growth lead to higher U.S. company revenues and a higher pace of earnings growth, more business hiring and spending, and a stronger economy. But this is far from assured. *The downside risk from continued weak growth in earnings lies with the business sector, where capital spending and hiring could be delayed and the U.S. economy do less well.*

Federal Reserve "Open-Ended" QE: A Macro Plus

In September 2012, the Federal Reserve launched a version of Quantitative Easing (QE) which promised ("Forward Guidance") to keep short-term interest rates essentially at zero for as long as necessary to achieve an unemployment rate at least as low as 6.5%. The central bank also indicated that it would purchase additional securities for its balance sheet to keep "financial conditions" supportive until "substantial" improvement occurred in the labor market. Financial conditions refer to the level and structure of interest rates, the U.S. dollar, the equity market, and various other derivative effects that flow from Federal Reserve actions that impact these asset prices. Having set targets for "Full Employment" (defined collectively as a range of 5.2%-to-6%) and "price stability" (2% inflation), the Fed's promise, *if stuck to*, means "permanence" for easy monetary policy, or open-ended accommodative monetary policy, until the stated conditions are met.

Research at the U.S. central bank and elsewhere (DE, e.g.,) suggests that QE has been successful in reducing interest rates, lowering the U.S. dollar, and raising stock prices. This, in turn, has helped stimulate a strong expansion in housing, stronger auto sales, a substantial improvement in the financial condition of households and in the balance sheets of companies, improved sentiment, and a more solidly-based economic expansion in the private sector. According to DE research, improvement in household financial positions is a prerequisite to stepped-up consumer spending.

This "Open-Ended" Quantitative Easing, having virtually guaranteed short-term interest rates close to zero at least through 2014 and perhaps into 2015, portends continuing relatively low, although rising and higher, long-term interest rates. Low interest rates make a currency relatively less attractive compared with other currencies where interest rates might be higher, or expected to move higher. Lower interest rates help stock valuations. Long-term interest rates affect the cost of capital, hurdle rates and investments, and low long-term interest rates, particularly mortgage rates, lead to stronger housing activity, higher housing prices, increases in household wealth, and greater consumption.

Japan "Back-in-the-Game": A Big Plus

One of the biggest changes in the global economy is taking place in Japan.

After years of not much economic growth, punctuated by a number of recessions, price deflation, negative consumer psychology, weak consumer spending, rising public sector deficits, a skyrocketing debt-to-GDP ratio, a declining stock market, and as a drag on Asian and world economic growth, *Japan is finally "Back-in-the-Game."*

Because of the long-time high and highly overvalued yen, Japanese exports slowed, trade surpluses declined, imports picked up, price deflation remained, and stimulative macroeconomic policies, particularly outlay-centric fiscal stimulus, failed to work.

The long period of depressed conditions in Japan, almost two decades of declining fortunes for what once was one of the most dominant countries and economies in the world, has brought political change and new policies that are radically changing the Japanese situation and how that country interacts with others in the world economy.

The motive force for one of the sharpest and swiftest declines for any currency in history was the shifting of monetary policy to a doubling of the monetary base, set in April 2013 to last over the next two years. A 2% inflation target was established. All this was part of an attempt to reflate the Japanese economy. The increases in, and expected for, the supply of yen brought sharp declines in the Japanese currency which, in turn, stimulated the stock market, is now helping Japanese exports, lifting consumer sentiment, increasing company profits, and already is producing a surprisingly strong Japanese economy—up at over a 3% annualized rate so far in 2013.

The yen still has a long way down to go, initially forecast by DE in mid-2012 to be headed for well-in-excess of 100 against the U.S. dollar; over time down even more.

In addition to the new leadership at the Bank of Japan (BOJ) and the shift in monetary policy, the new government is providing a large dose of fiscal stimulus, almost 100 billion yen, and promising major reforms, especially on deregulation, later in 2013.

The combination of monetary stimulus, a declining currency, fiscal stimulus, reform, and changes in the political and societal atmospherics of the country suggest an historical change of considerable significance—bottom-line much higher real economic growth that could provide substantial stimulus to the economies of Asia, including China, and then the rest-of-the-world.

From a recession in the second half of 2012, the Japanese economy has lifted up to over a 3% rate of growth so far this year and could move even higher in 2014. Deflation, entrenched in Japan and in the psyche of households and businesses, is beginning to end. Very likely, with further declines in the yen, increased economic growth and an improving labor market, Japanese price inflation will switch from negative to positive. Higher import costs and increases in prices should permanently end the Japanese deflation.

The huge seismic shift going on in the third largest economy in the world should bring increased economic growth in Asia and then, because of the size of Asia in the global economy, a better performance in the economies of Europe and the United States.

Whenever the economy of a large country shifts from low growth-to-high growth or vice-versa—the latter China during 2011—the economies of other countries closely tied in trade likely will show significant responses.

U.S. Budget Deficit and Sovereign Debt Crisis: Fading from the Scene

One previous negative Macro Risk that has faded is the U.S. deficit and sovereign debt problem.

For some time, a risk to the U.S. economic prospect had been outsized and unsustainable federal budget deficits and growing public debt—in 2012 a -$1.3 trillion deficit and over a 100% ratio of gross public debt-to-GDP.

With several years of federal government budget deficits over $1 trillion a year and ratio of gross public debt-to-GDP rising to unprecedented peacetime levels, the deficit and sovereign indebtedness of the United States have made it impossible to engage in any further net fiscal stimulus. This, indeed, is the fallout and one aspect of a kind of imposed austerity that occurs from high and rising deficits and indebtedness.

But, what has happened is that despite the twists and turns in the politics and dysfunctionality of "Washington," progress *has* been made on the U.S. federal budget deficit and in the debt-to-GDP prospect.

As one consequence of several restrictive fiscal actions that were not planned in any reasonable and systematic manner—the Budget Control Act of 2011 ($1 trillion of reductions in the caps on discretionary federal government spending over ten years), a $1.2 trillion ten year sequester last year and $600 billion of tax increases—the U.S. federal budget deficit has been diminishing. Cyclical improvement in the economy is helping tax receipts and reducing the deficit as well. The gross public debt-to-GDP ratio has improved some although still awaiting stronger growth in nominal GDP to move to much lower levels. *But this is now the direction!*

These actions, totaling almost $3 trillion over ten years and the cyclical improvement in tax receipts have caused the U.S. deficit and sovereign debt problem to fade considerably as a macro risk. Indeed, there is now potential for positive surprises, especially if federal government purchases and outlays continue to be reduced.

Damage is being done, of course, in that restrictive fiscal actions and fiscal consolidation are limiting economic growth. But, as a result, the probability of a U.S. sovereign debt crisis now is low and will be so for some time. In addition, the *fiscal restraint will undoubtedly induce a longer period of accommodative monetary policy, a policy mix of "Tight Fiscal-Easy Money"* like that in the 1990s that proved to be a long-run positive for the economy.

Geopolitics

Yet another risk to the Basic Prospect lies in potential conflict in the Middle East and the turmoil of societal and political upheaval. The latest examples of this are the Arab Spring and upheaval in Egypt, another change in leadership and now the military repression of Egyptians, with outcomes uncertain; the ongoing crisis and civil war in Syria; uncertainty over Iran and its nuclear capabilities; and the continuing presence of Al Qaeda. *The possibility of spreading confrontation anywhere in the Middle East conjures up rising crude oil prices and the economic and inflationary damage such a negative price shock would bring.*

The possibility of all-out conflict between Israel and Iran represents an ongoing geopolitical risk for the United States and its Allies. Any confrontation that might lead to restrictions in the supply of oil or higher crude oil prices is the nub of the risk. Spikes up in crude oil prices lead not only to higher energy costs but to higher prices across a wide range of goods and services. These, in turn, can restrain consumption, with a potential subsequent adverse impact on business and economic growth.

The recessionary thrust of any oil price spike emanating from a crisis in the Middle East is cause for concern and watching. Such an effect occurred in 2007-09 following unexpected increases in crude oil prices to near $150/barrel. However, other economic and financial disruptions also were occurring at that time, so that high crude oil prices only aggravated a situation that was already fragile.

American Consumer: A Wild Card But Now A Plus

For the U.S. economy—and thus to a great extent the Global Economy—the outlook appears reasonably bright for 2013 and beyond. Principally, this stems from a long period of adjustments by the American consumer, perhaps now set to lift spending in the aggregate and therefore the U.S. economy onto a higher growth orbit.

Naturally, there are always Macro Risks surrounding any outlook, and they need to resolve favorably for the global economy to expand at a stronger pace. However, if U.S. consumption sustains an upturn in growth, one key to renewed growth, the economy continues to exhibit strong housing and construction, the European recession bottoms-out and the Continent recovers, Japan and eventually China revive to take Asian economies up along with them, renewed growth for the U.S. and global economy will be the reality rather than just a theme.

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