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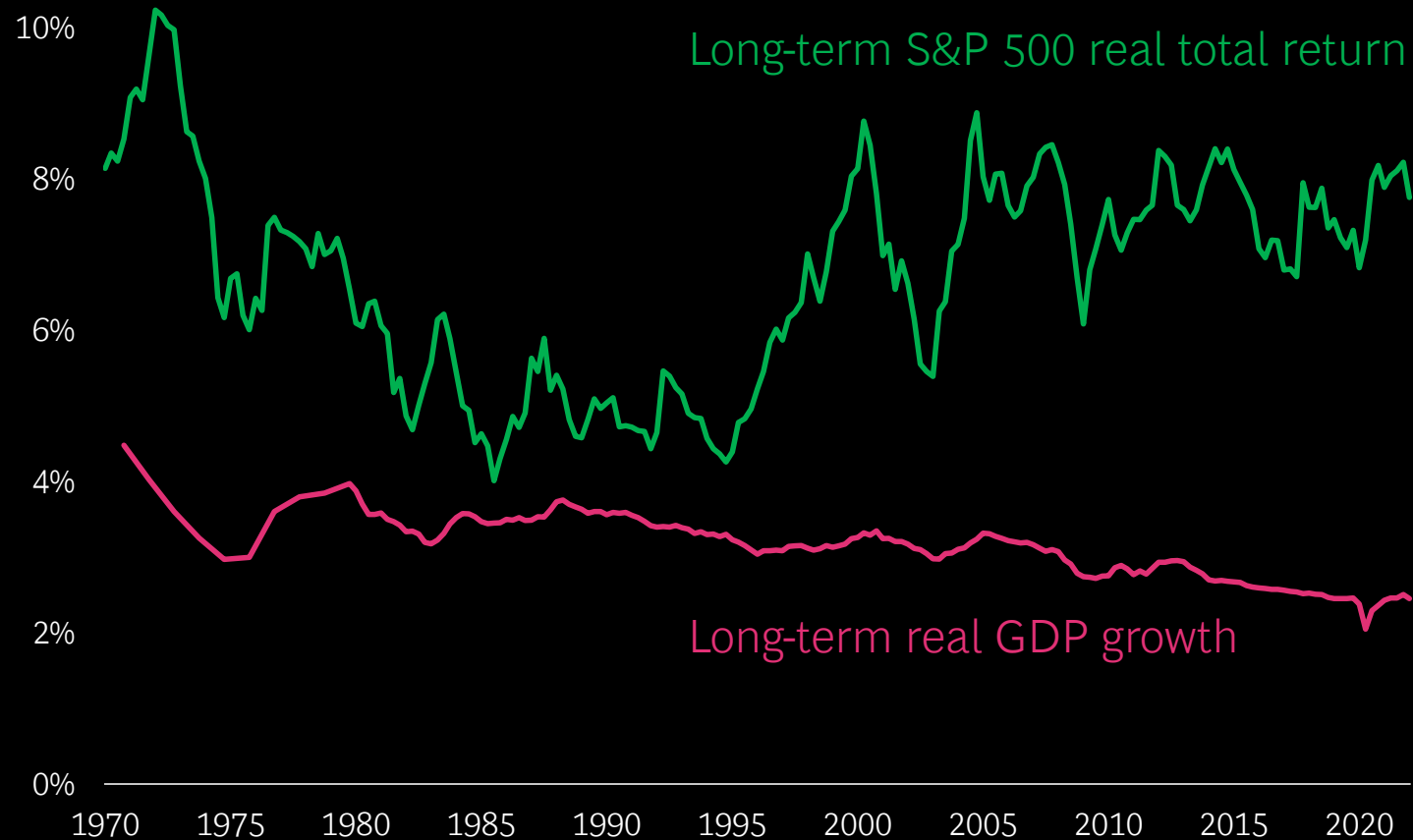


Structural Risks in the US Economy

Philipp Carlsson-Szlezak, Managing Director & Partner, Global Chief Economist



HOUSTON, 20 MAY 2022



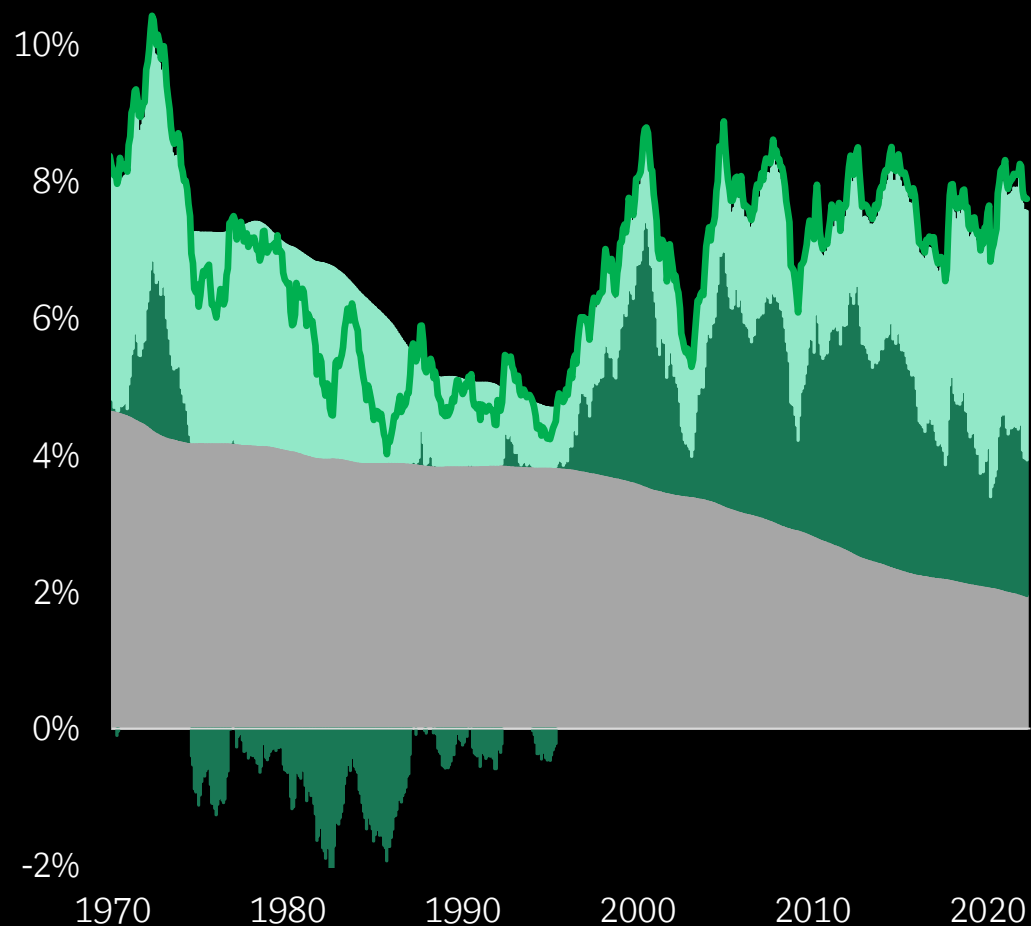
Growth/Returns
Paradox of the
last ~30 years

Can it persist?

Note: 30-year total return and 30-year GDP growth rate; S&P 500 data through April 2022; Real GDP data (annual through 1979, quarterly after) through 1Q2022
Source: BEA, Shiller/Yale, BCG Center for Macroeconomics

Is "good macro" world at risk as rates and value chains wobble?

Decomposition of S&P 500 30-year total return



Real EPS growth...

...global value chains

Multiple change...

...low inflation & rates

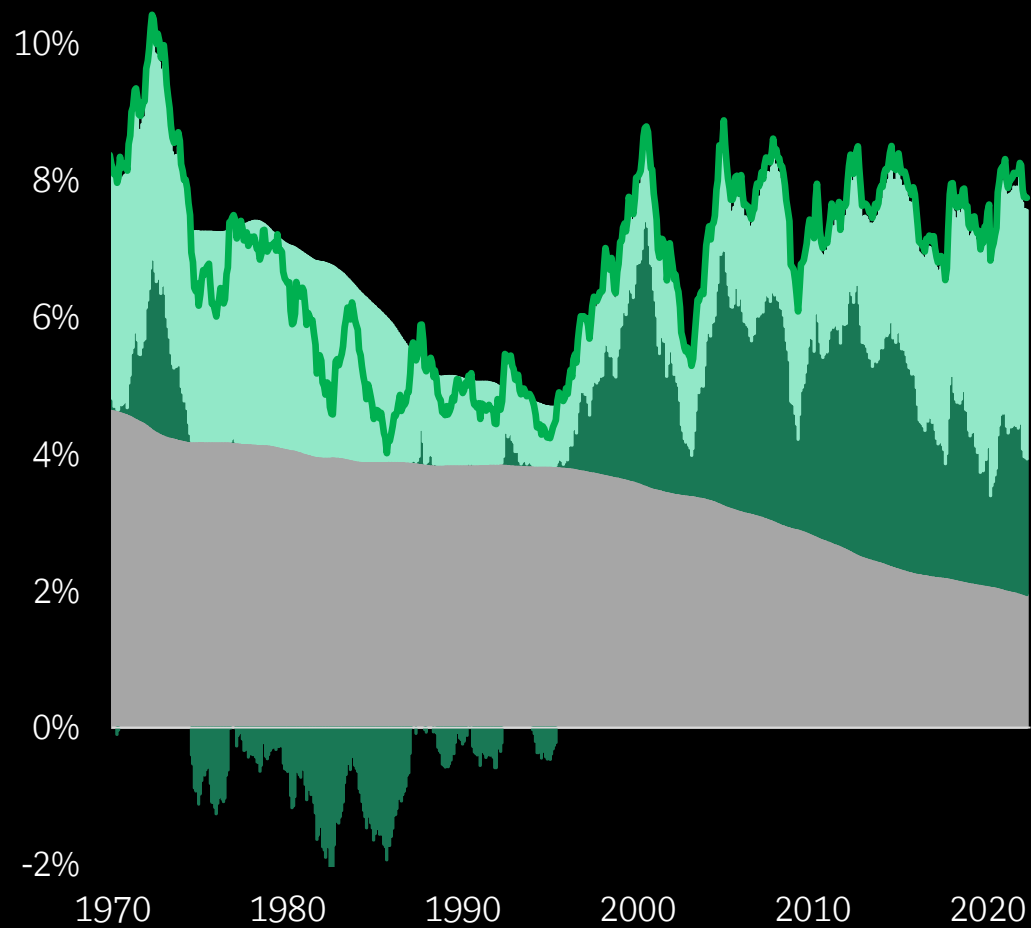
Dividends...

...high valuations and buybacks

Note: Data through April 2022
Source: Shiller/Yale, BCG Center for Macroeconomics

Can strong real
EPS growth
persist?

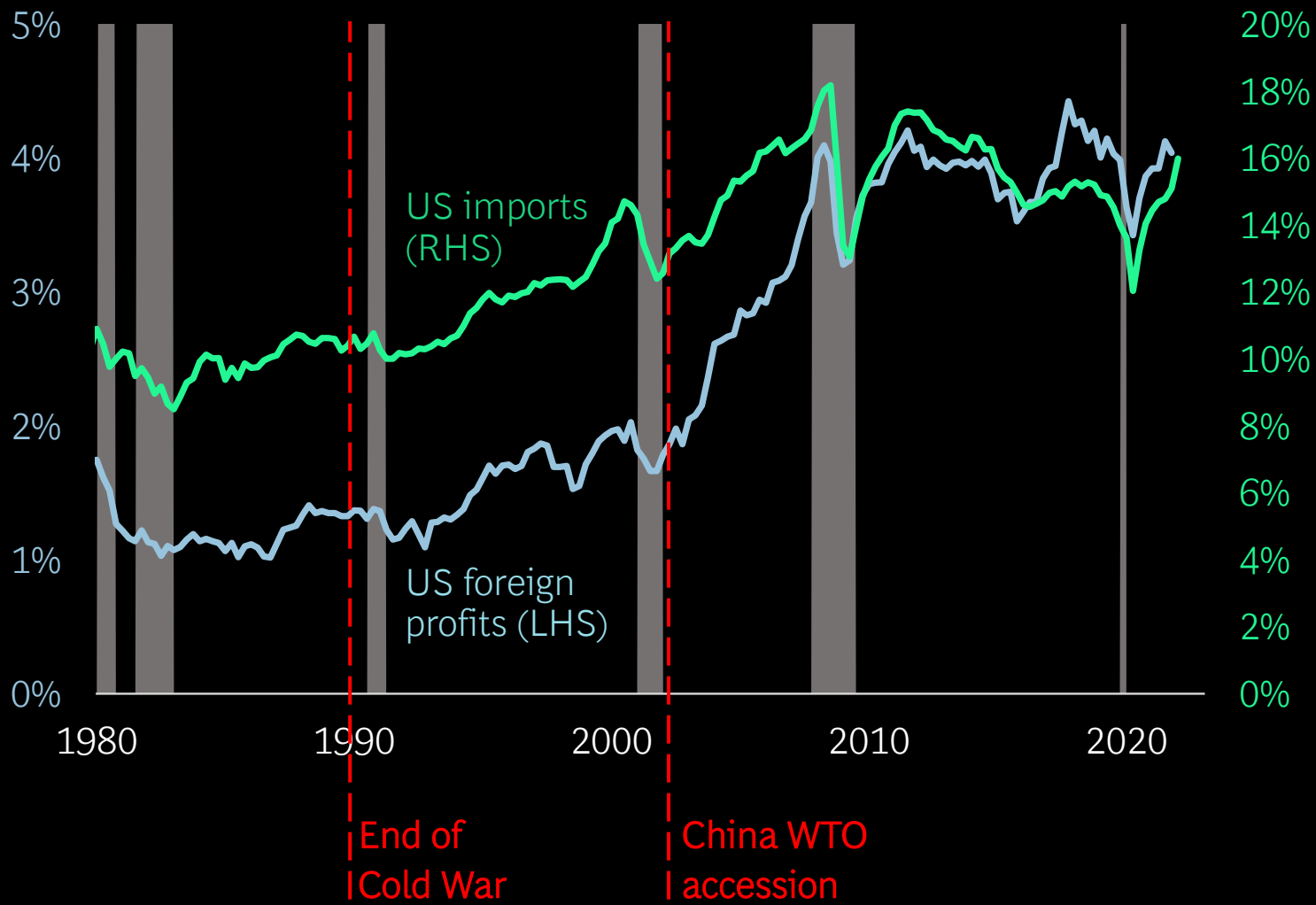
Decomposition of S&P 500 30-year total return



Real EPS growth...
...global value chains

Note: Data through April 2022
Source: Shiller/Yale, BCG Center for Macroeconomics

US foreign profits and imports, % of GDP

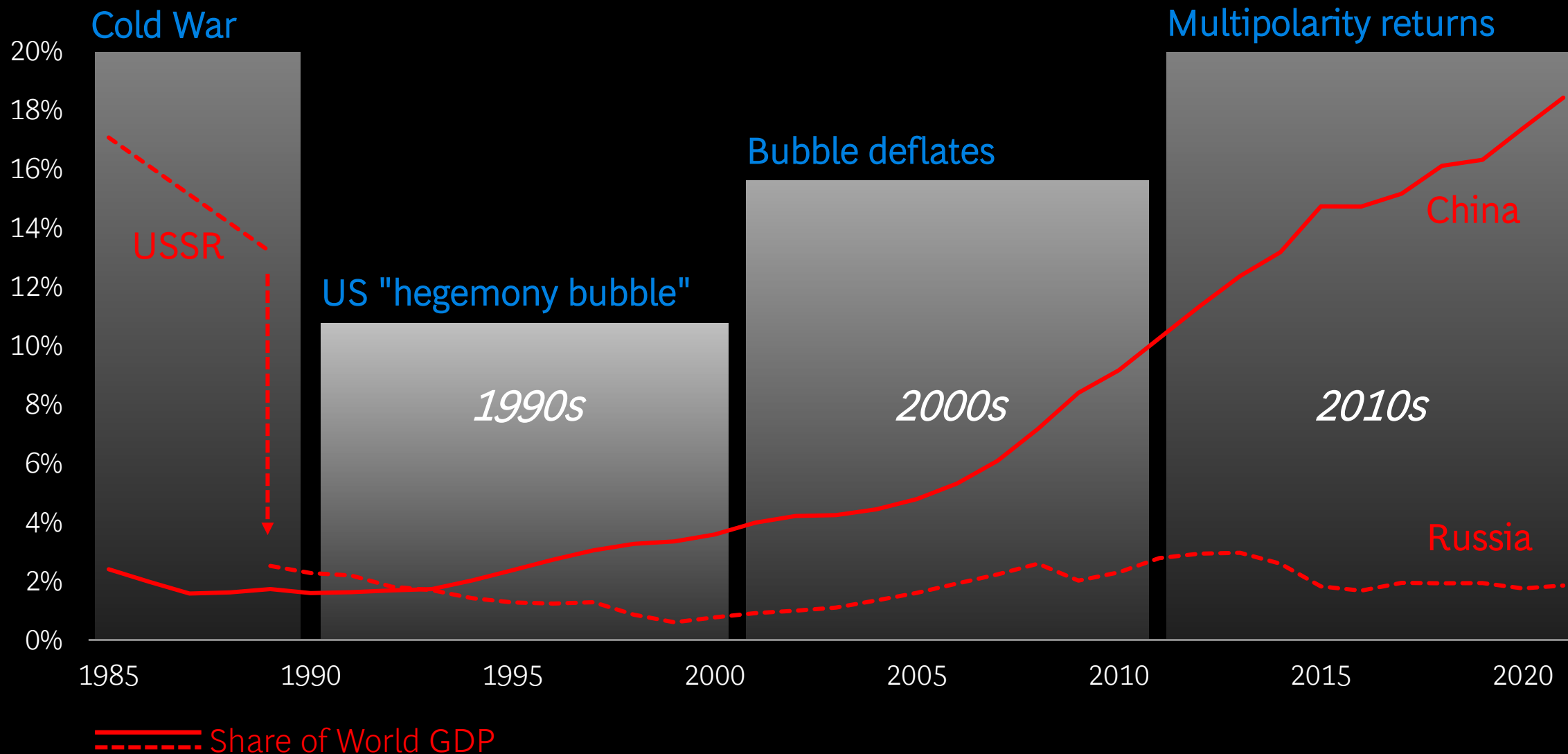


Geopolitical thaw drove global value chains

EPS structurally aided by falling cost base (imports) and access to faster growing markets

Source: BEA, NBER, BCG Center for Macroeconomics

But geo-economic foundations threatening to come full circle



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1990s hegemony bubble... dream of a unipolar world

Convergence of economic freedom...

“ By joining the W.T.O., China is [...] agreeing to import one of democracy's most cherished values: economic freedom. ”

...and democracy

“ Now there's no question China has been trying to crack down on the Internet. (*Chuckles.*)
Good luck! (*Laughter.*)
That's sort of like trying to **nail Jello to the wall.** (*Laughter.*) ”

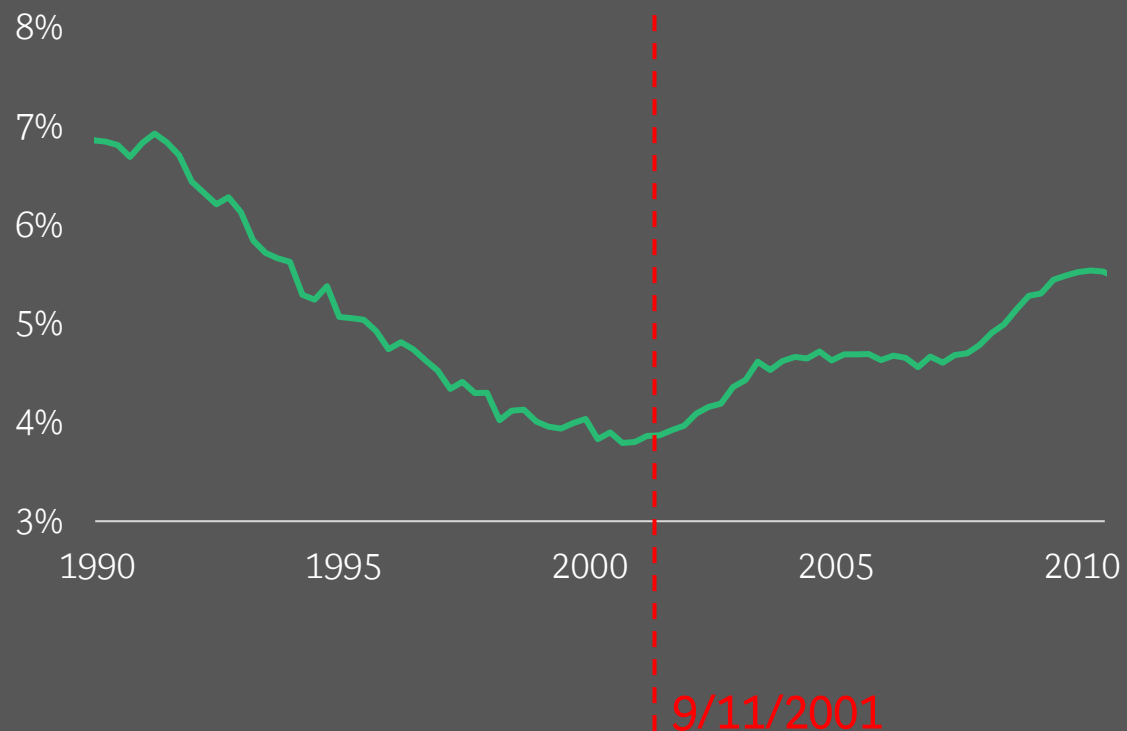
- Bill Clinton (Advocating China Trade Bill March 9, 2000 — **which passed the Senate 83 to 15**)

"Nail jello to the wall"



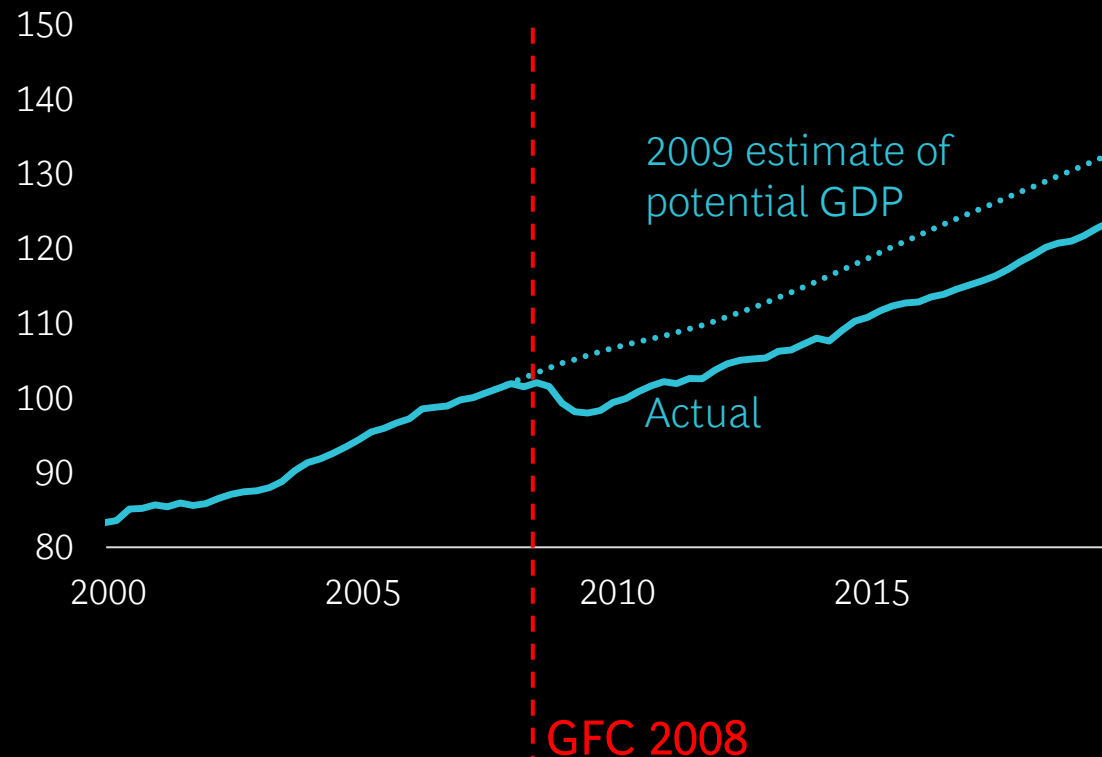
2000s: Hegemony bubble deflates geopolitically after 9/11...

US military spending, % of GDP



...and economically, as GFC damages economic credibility

Real GDP index vs. 2009 estimate of potential

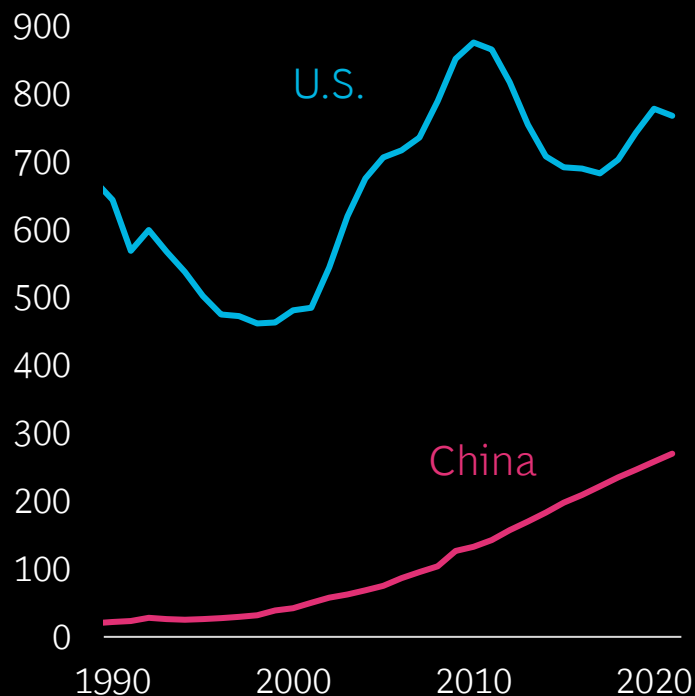


Source: BEA, NBER, CBO, BCG Center for Macroeconomics

2010s: Return of geopolitical competition

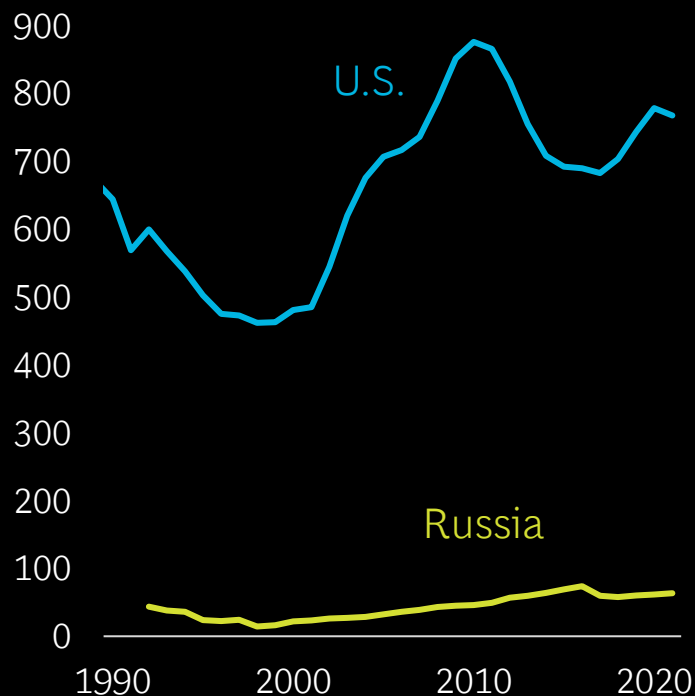
New rival

Military spending (Real billion \$)



Old rival

Military spending (Real billion \$)



Flux in US leadership

European trade: TTIP

Asian trade: TTP

Nuclear: Iran (JCPA)

Climate: Paris Accords

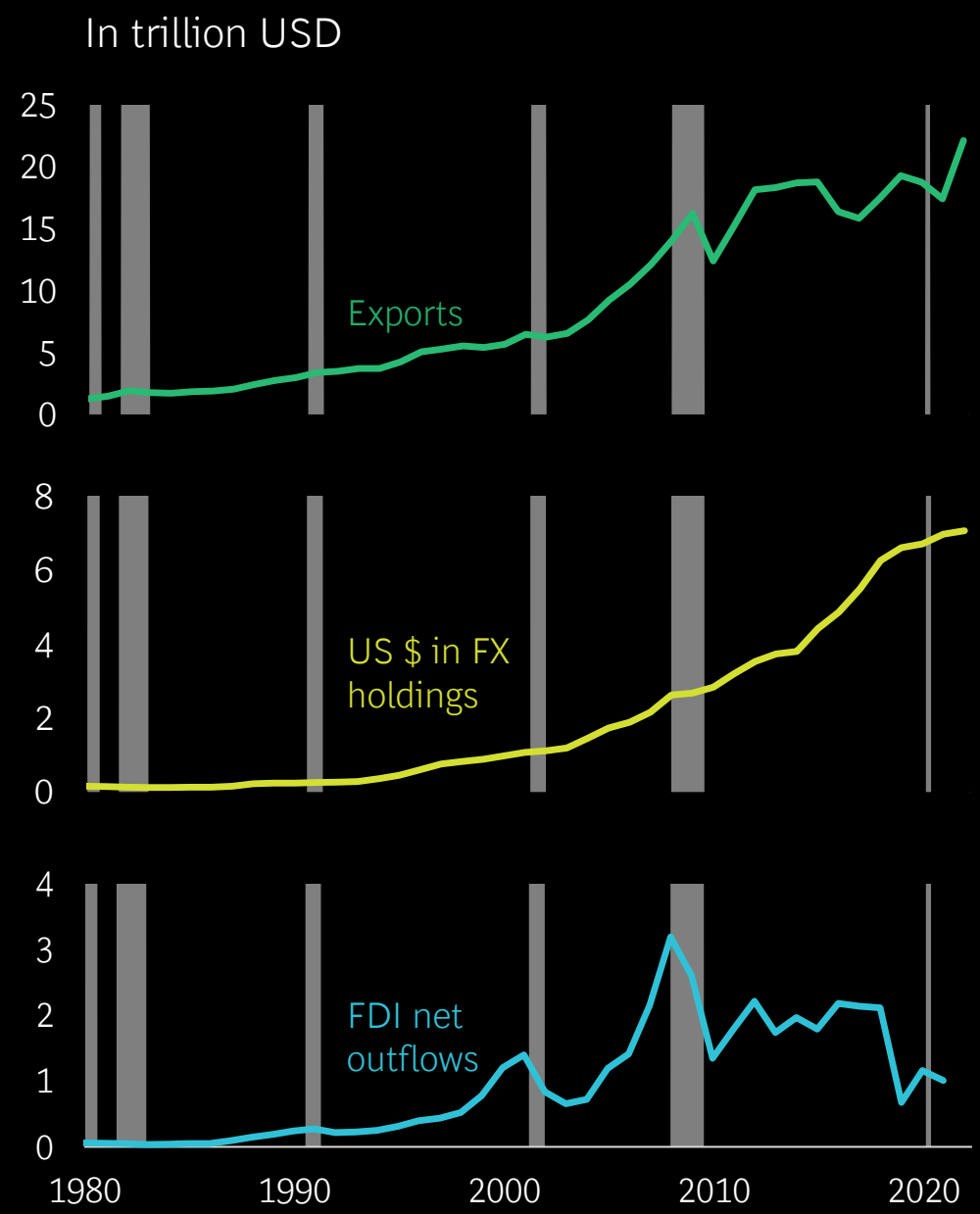
Middle East: Afghan. exit

Note: Units in 2020\$ billion
 Source: SIPRI, BCG Center for Macroeconomics

Despite challenges, global value chains remain intact

And can remain resilient even as risks are higher

Geopolitical decay is tangible, but perception also shaped by overhang of the 1990s hegemony bubble



Global trade structurally still high/growing

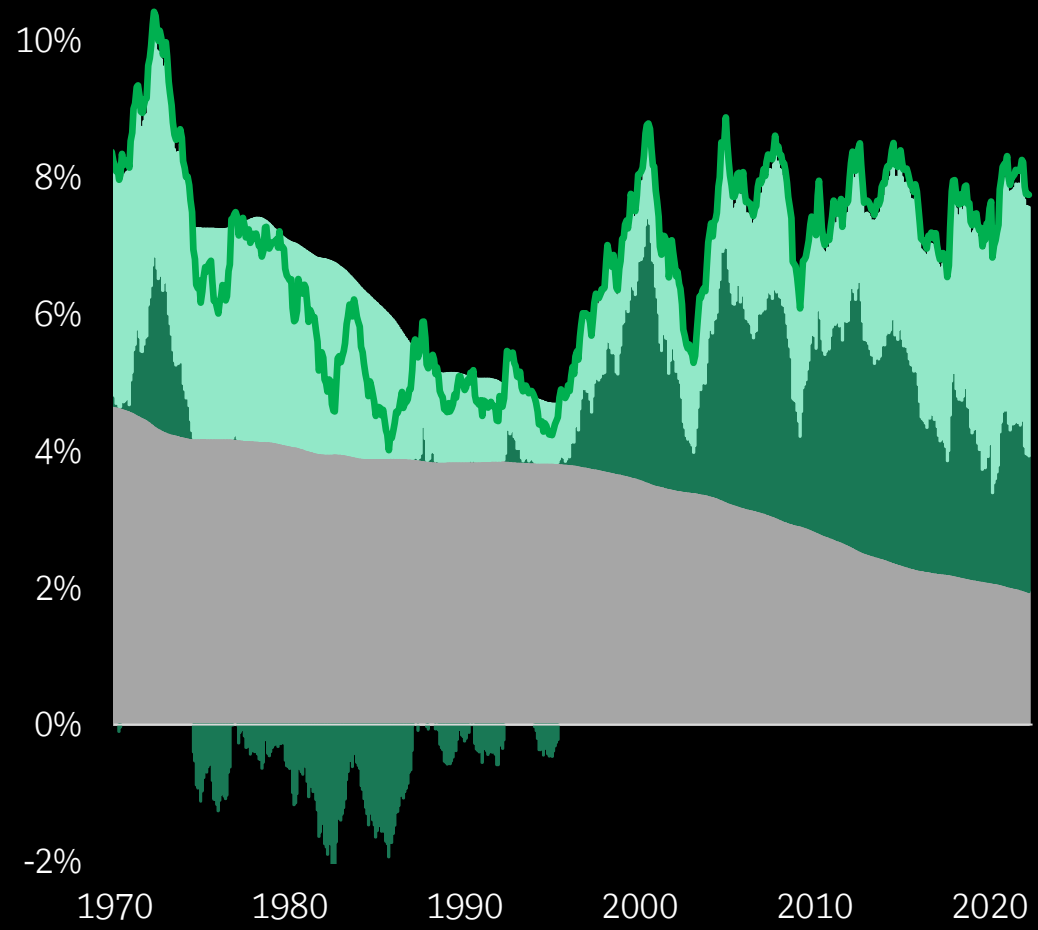
Dollar remains dominant reserve FX

Global FDI flows lower but consistent with stalled, yet high, global value chains

Note: Data through 2021
Source: NBER, IMF, BCG Center for Macroeconomics

Can the high valuation regime persist?

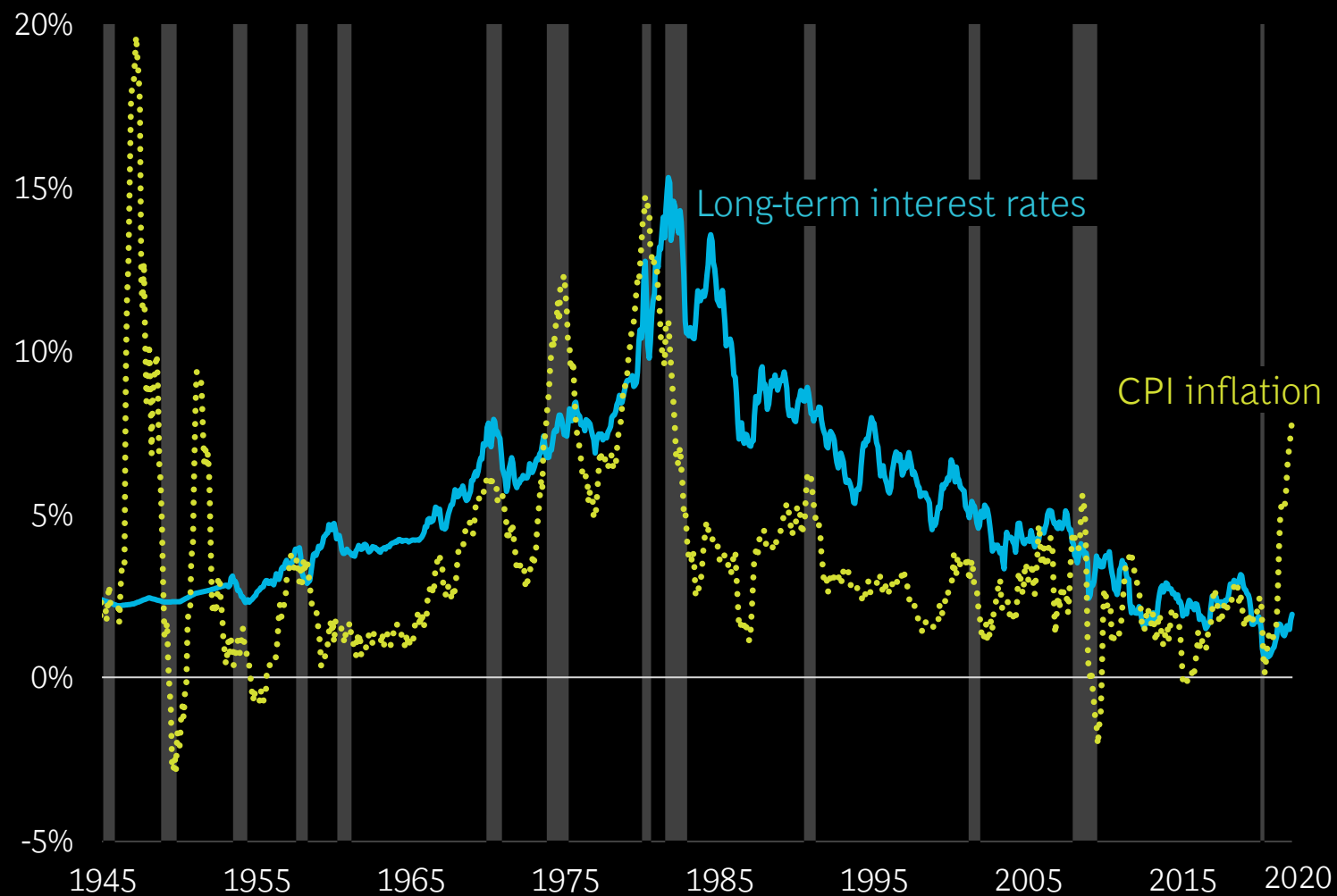
Decomposition of S&P 500 30-year total return



Multiple change... ..low inflation & rates

Note: Data through April 2022
Source: Shiller/Yale, BCG Center for Macroeconomics

Long-run US inflation and interest rates

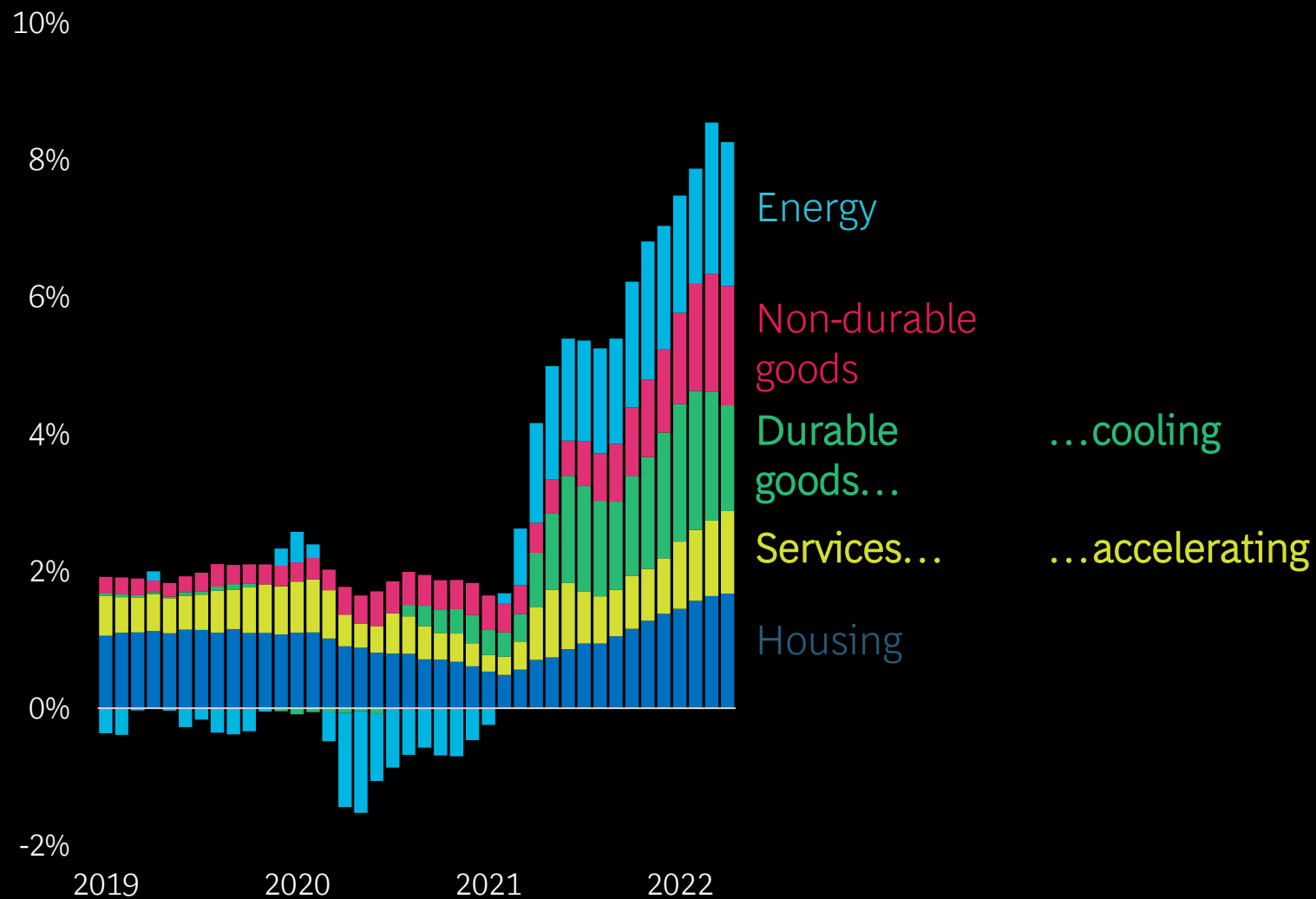


Low inflation and rates have underpinned high valuation regime

Will COVID inflation break it?

Note: Inflation data through April 2022; equity and interest rate data through May.
Source: Shiller/Yale, Bloomberg, BCG Center for Macroeconomics

Contribution to headline inflation (Y/Y %)



Covid inflation is seeing risky rotation from durables to services...

...cooling
...accelerating

How big is the risk to the inflation regime?

Source: BLS, BCG Center for Macroeconomics

5Y5Y inflation compensation (Long-term market expectation of inflation)

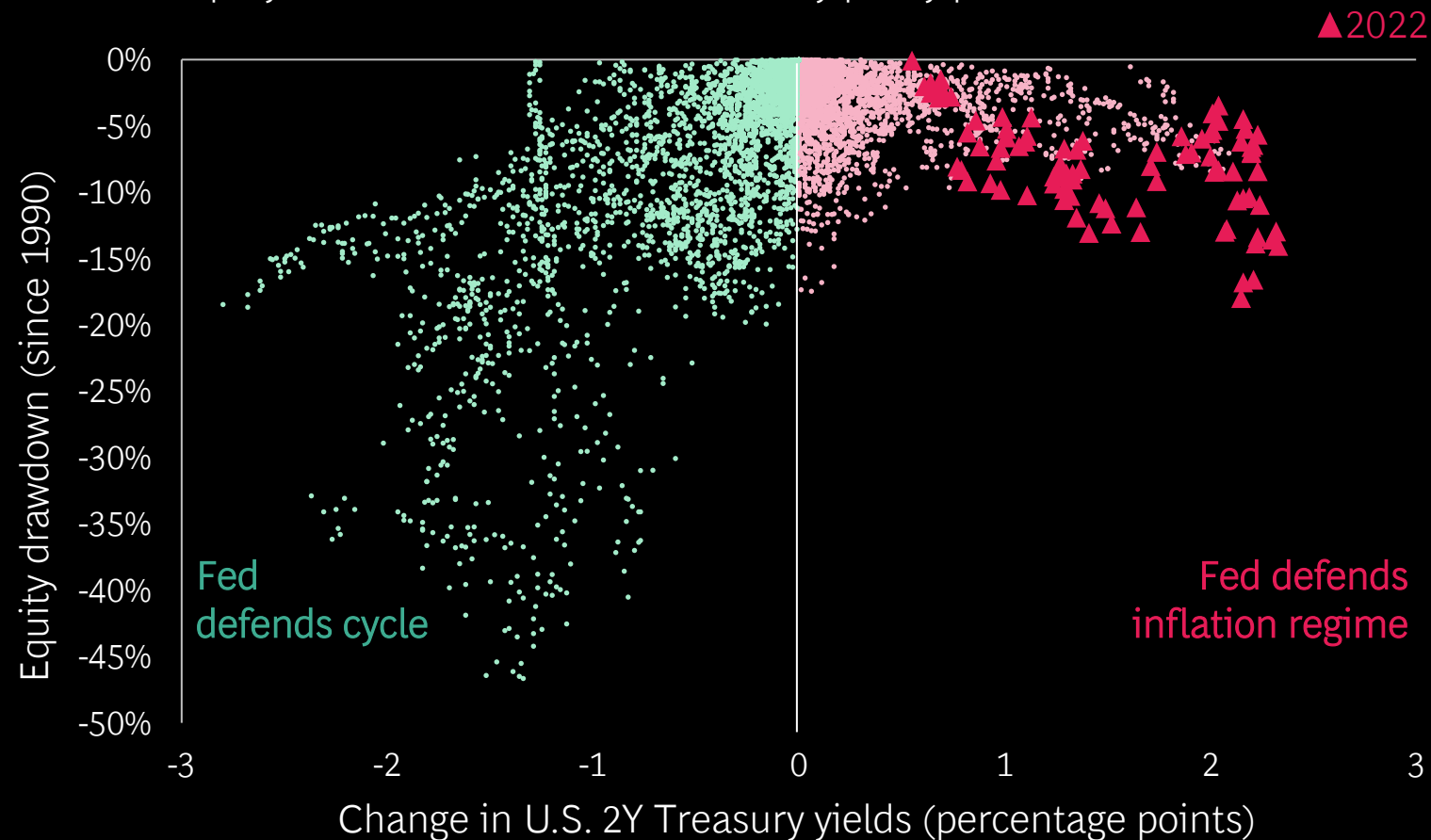


Note: 5y5y data through 5/17/2022
 Source: NBER, Bloomberg, BCG Center for Macroeconomics

But **inflation expectations** remain anchored...

Leaving the chance for a healthy 'soft-landing'

Equity market drawdown vs. monetary policy path



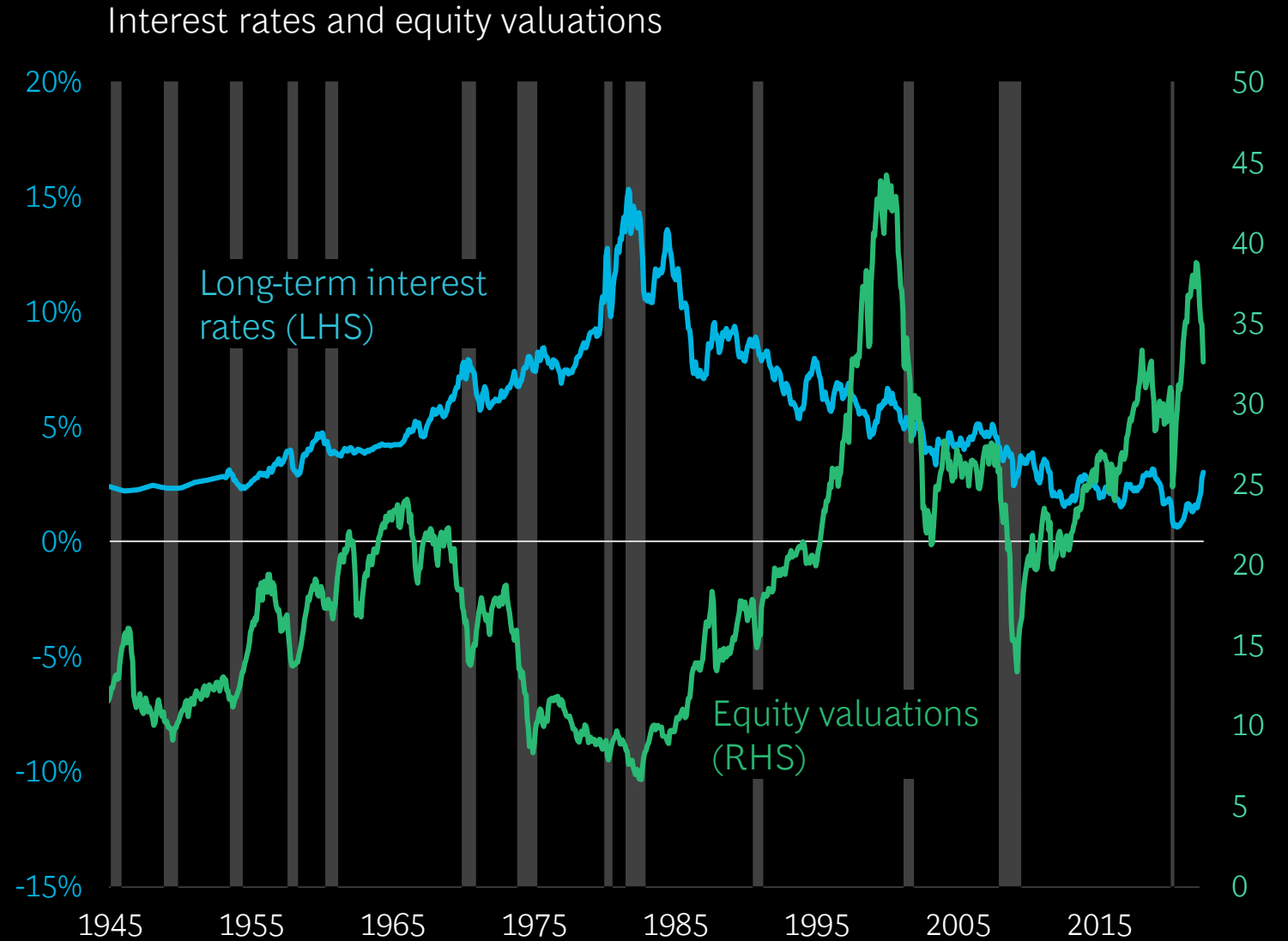
Fed will defend the inflation regime first, not the cycle.

Good news structurally – even if a challenge cyclically

Note: Drawdown measured as negative deviation from 6-month rolling max of the S&P500. Change in U.S. Treasury yields is the difference between the measured period and date of prior equity max. Data from 1990 through May 2022. Source: Bloomberg, BCG Center for Macroeconomics

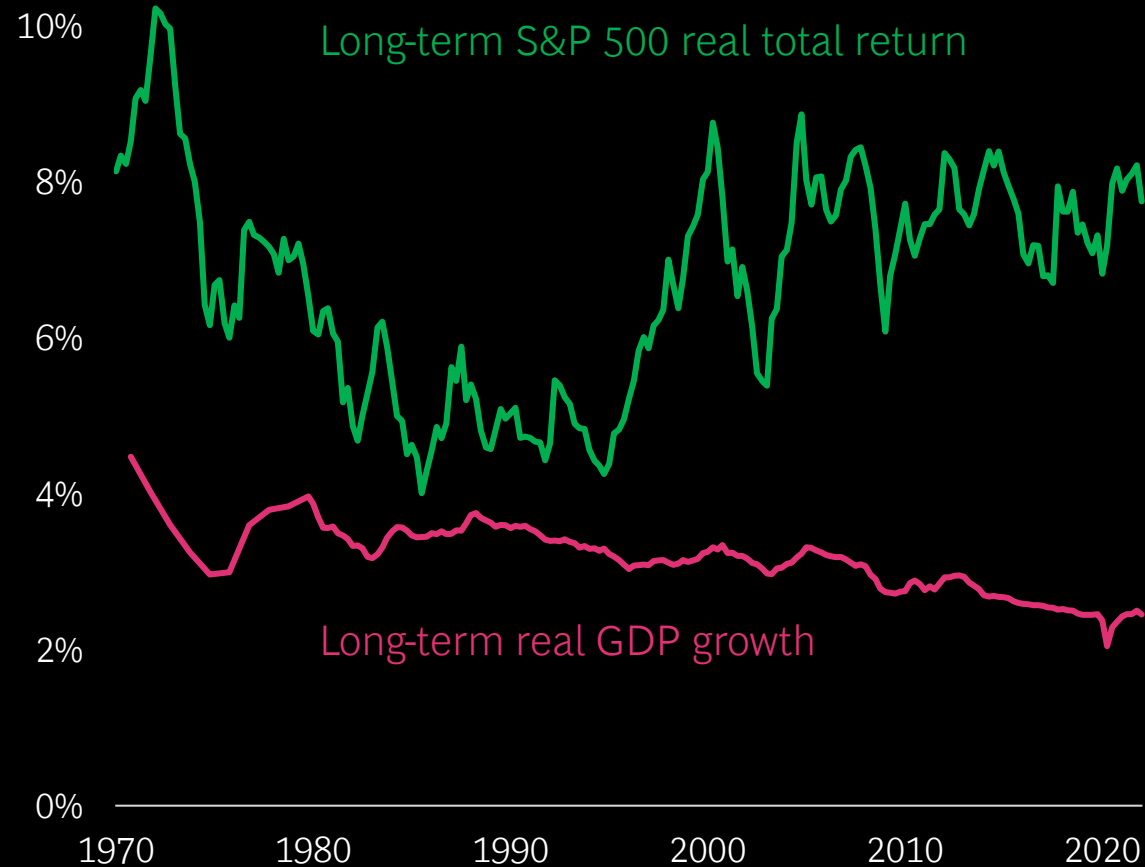
Though risks are up,
high valuation
regime can persist

However, the
structural valuation
upshift cannot be
repeated



Note: Equity and interest rate data through May 2022. Equity valuations CAPE – cyclically adjusted price ratio on S&P 500.
Source: Shiller/Yale, Bloomberg, BCG Center for Macroeconomics

So, will **growth/returns** paradox...



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Source: BEA, Shiller/Yale, BCG Center for Macroeconomics

...persist?

Structural risks are highest in a generation, but...

- **Global value chains** can remain integrated even as further upside is challenged
- **Inflation regime** unlikely to collapse and low-rate environment can persist

A secular **technology boost** would help... with growth, inflation, geopolitical advantage, ...

Technology's **macro impact has been modest** but tight cycle and labor market are the conditions for that to change

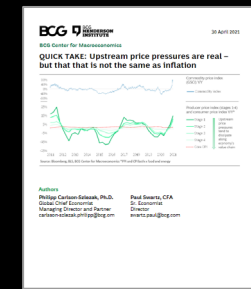
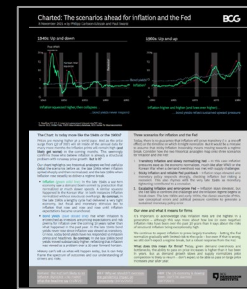
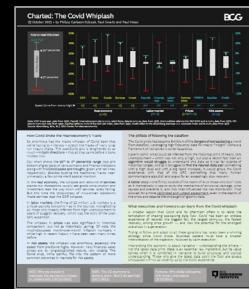
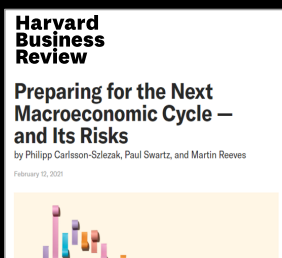
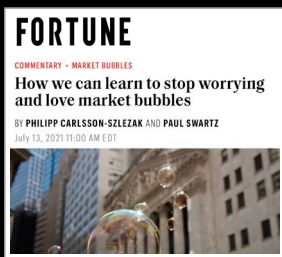
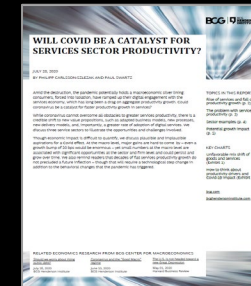
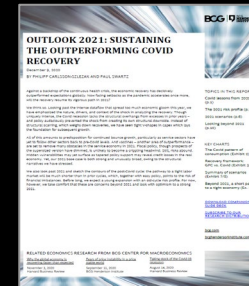
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He regularly publishes technical research for BCG clients and is a frequent contributor to Harvard Business Review, Fortune, World Economic Forum and other business publications.

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