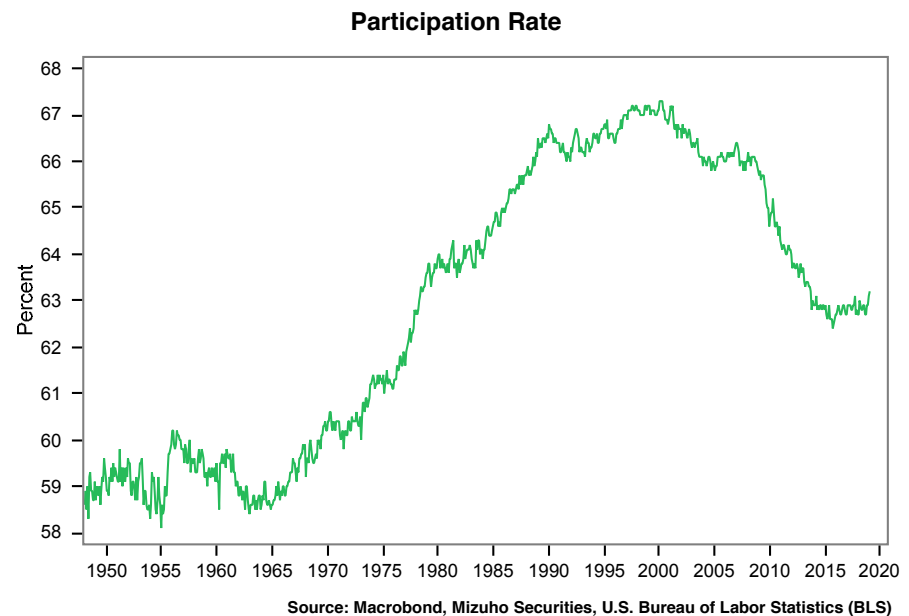


Shallow Growth Trajectory Returns!

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Private and confidential



MIZUHO

Conclusions

- **Recession forecasts based on the yield curve are overinflated.** The inverted curve is needed, but is not sufficient to end a cycle. Underlying balance sheets need to be in a position where a curve flattening will bite. Our balance sheet tracking suggest the pre-conditions for a recession are not in place. As such, the yield curve flattening is a key contributor to our slowing growth call. The widening of both corporate and mortgage spreads that occurred late last year are also key considerations in our forecast. A topping out in fiscal policy stimulus and operating earnings will only be partially offset by the possibility of a refund boost to growth in 2Q19.
- **The domestic economy is returning to a shallow growth trajectory after two quarters of over 3% growth in the middle of last year.** The shift from accommodative to normalized monetary policy and the resulting flattening of the yield curve and the firming of the dollar were key factors behind this loss of growth momentum. The globally synchronized upturn in growth also lost momentum as central banks attempted to follow the Fed's lead to normalize when their economies were not yet self-sustaining.
- **We see the domestic economy tracking towards 2%-2.25% quarterly growth as 2019 matures. Inflation is expected to average close** the Fed's target as the dollar and excess supply of tradable goods combine to offset service inflation pressures. A setback in housing and rents help keep inflation below target for the first time in years as a supply demand imbalance is worked though by the housing and rental industries.
- The macro scenario suggested by our credit analysis and Fed tracking suggest that the Fed is done hiking rates for now. In fact, the flat, 2-year/10-year, portion of the curve suggests the Fed is already at the terminal rate or slightly beyond. **The distortions evident in the money markets also suggest the Fed has over tightened through its portfolio unwind.** Although we do not expect a reversal in rate the unwind should be tapered as soon as possible.
- The latest IMF global forecast of 3.6% growth appears very high given global macro uncertainties.

Model Based Real GDP Forecast

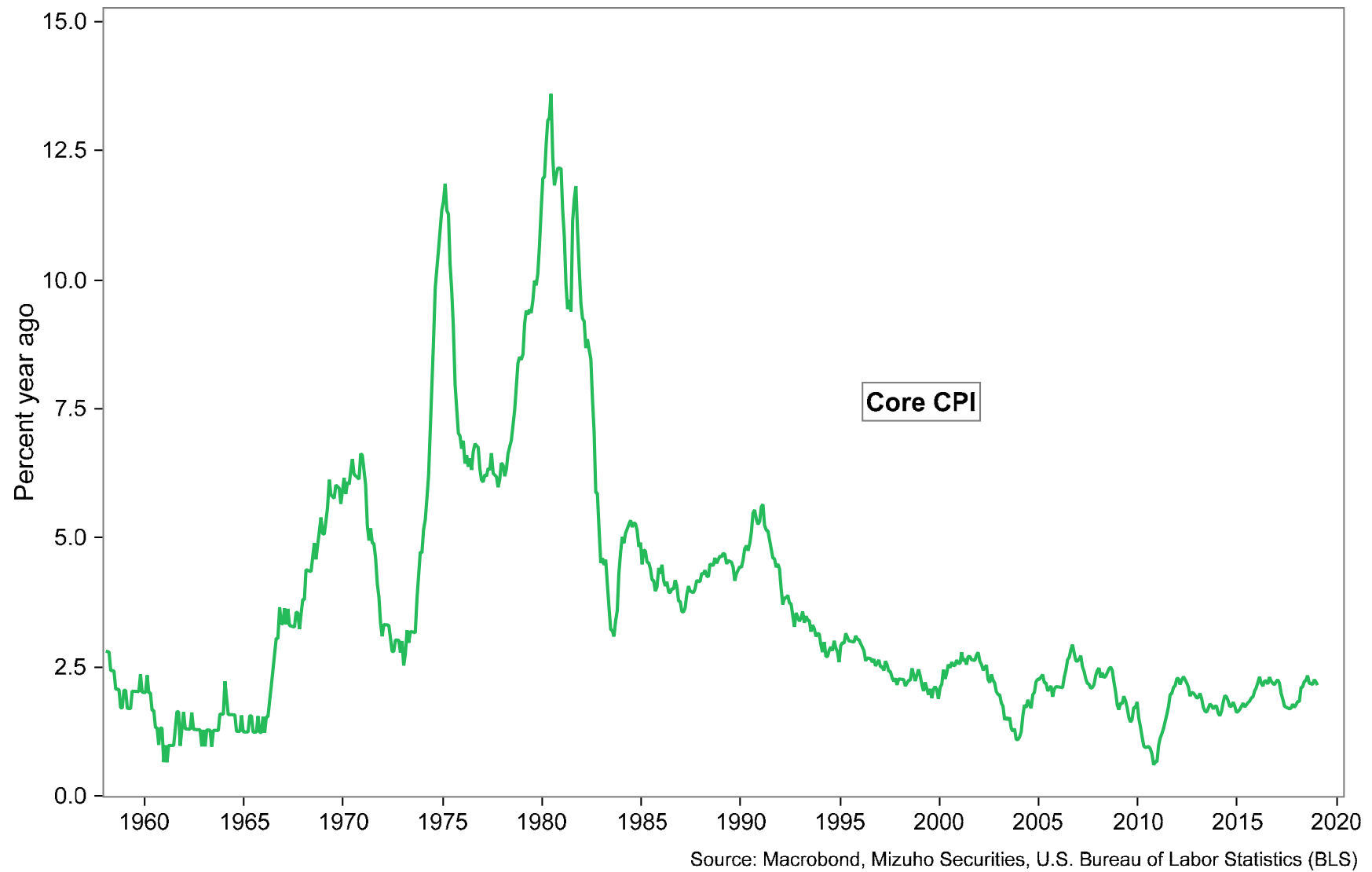
Mizuho U.S. Macro Forecast

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	2017.0	2018.0	2019.0
Real GDP (Q/Q%):	2.2	4.2	3.5	2.1	2.3	2.4	2.5	2.4	2.2	2.9	2.5
Core PCE Deflator (y/y%)	1.9	2.2	2.2	2	2.1	2.2	2.3	2.2	1.8	2.1	2.2
Fed Funds Rate %*	1.75	2	2.25	2.5	2.5	2.5	2.5	2.5	1.5	2.5	2.5
10-year Note (%)**	2.74	2.86	3.06	2.69	2.70	2.80	2.90	3.00	2.4	2.7	3.0

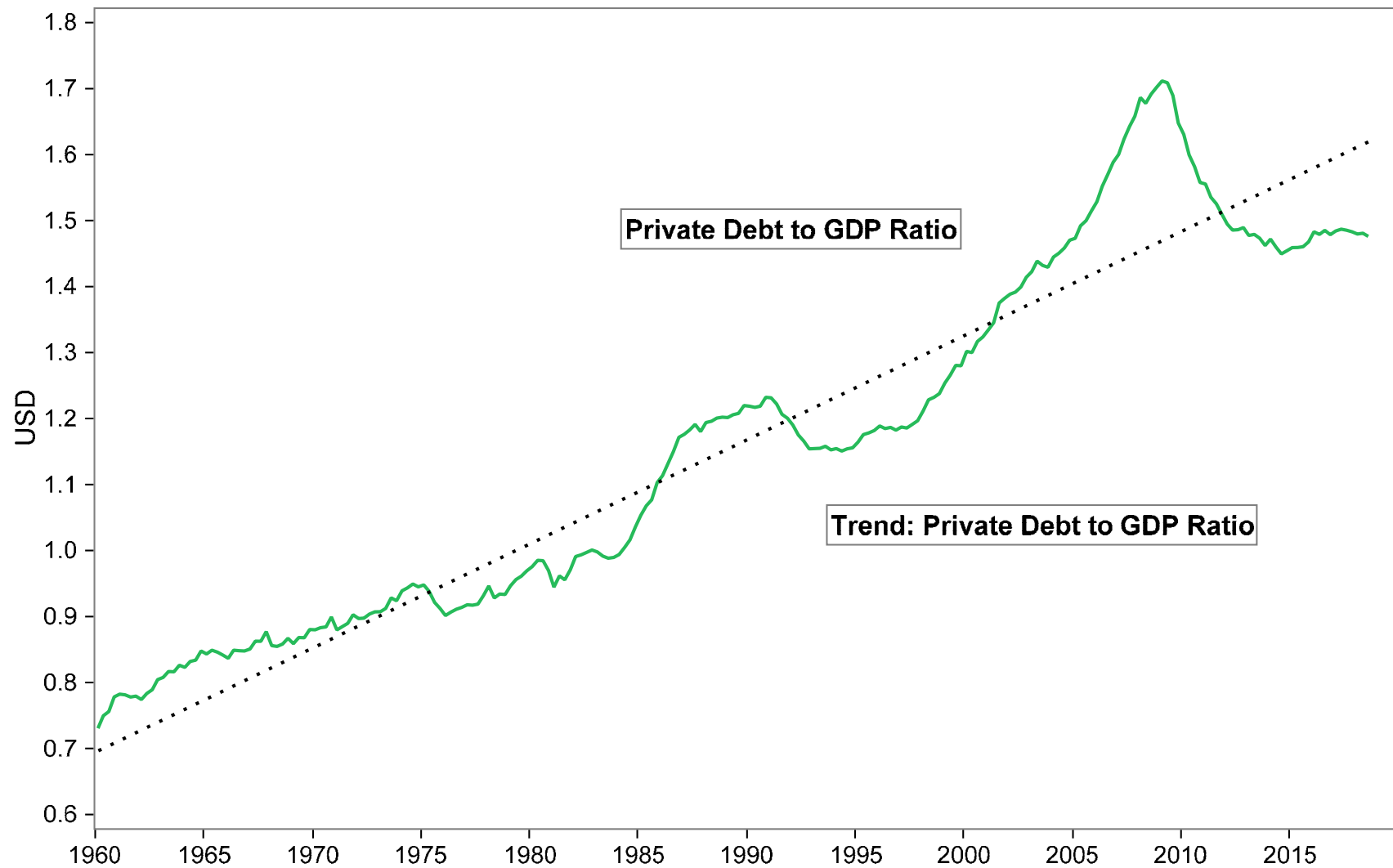
*Upper end of range

** End of
quarter

Inflation is no longer determinant of the business cycle

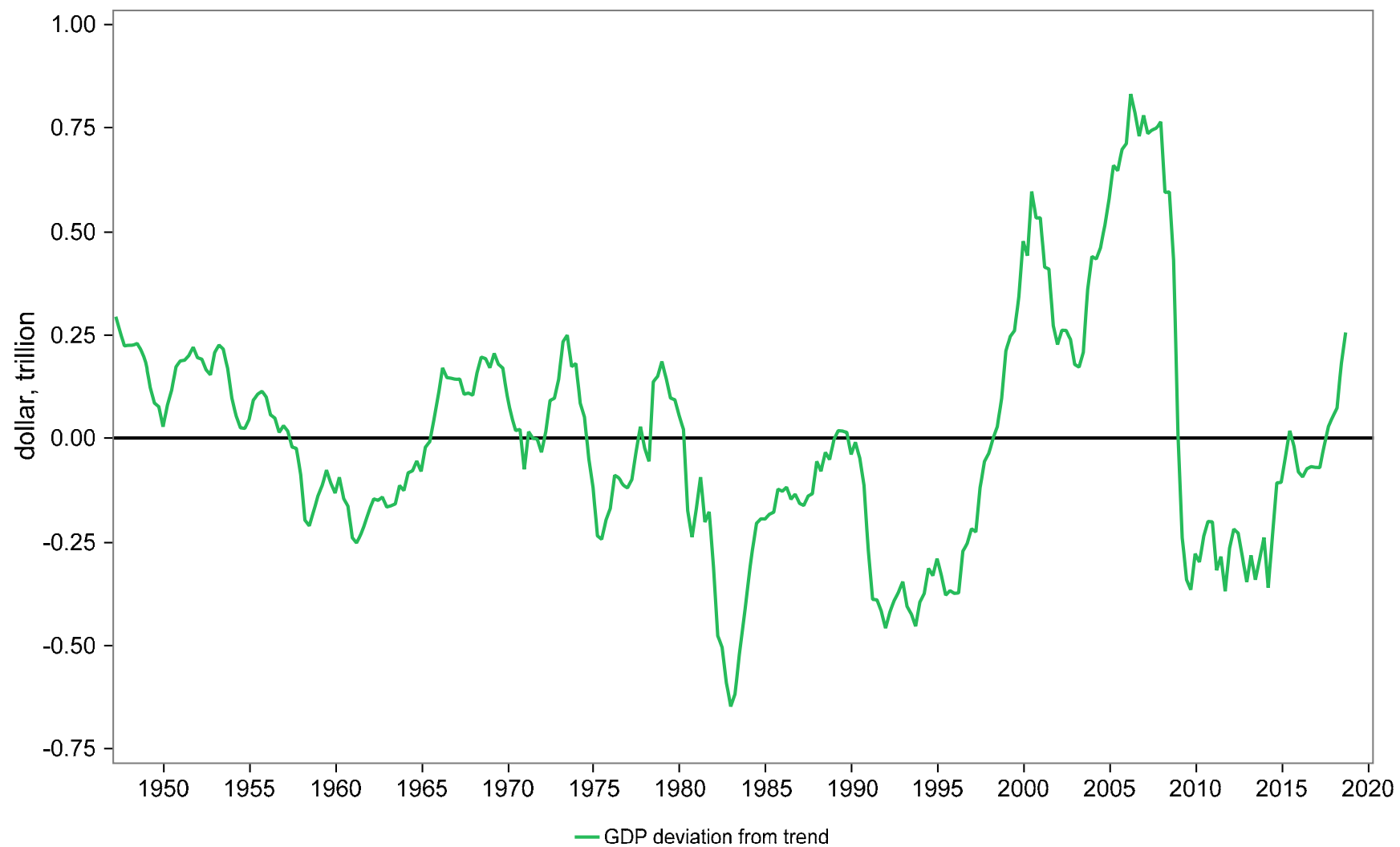


Credit now key determinant of business cycle



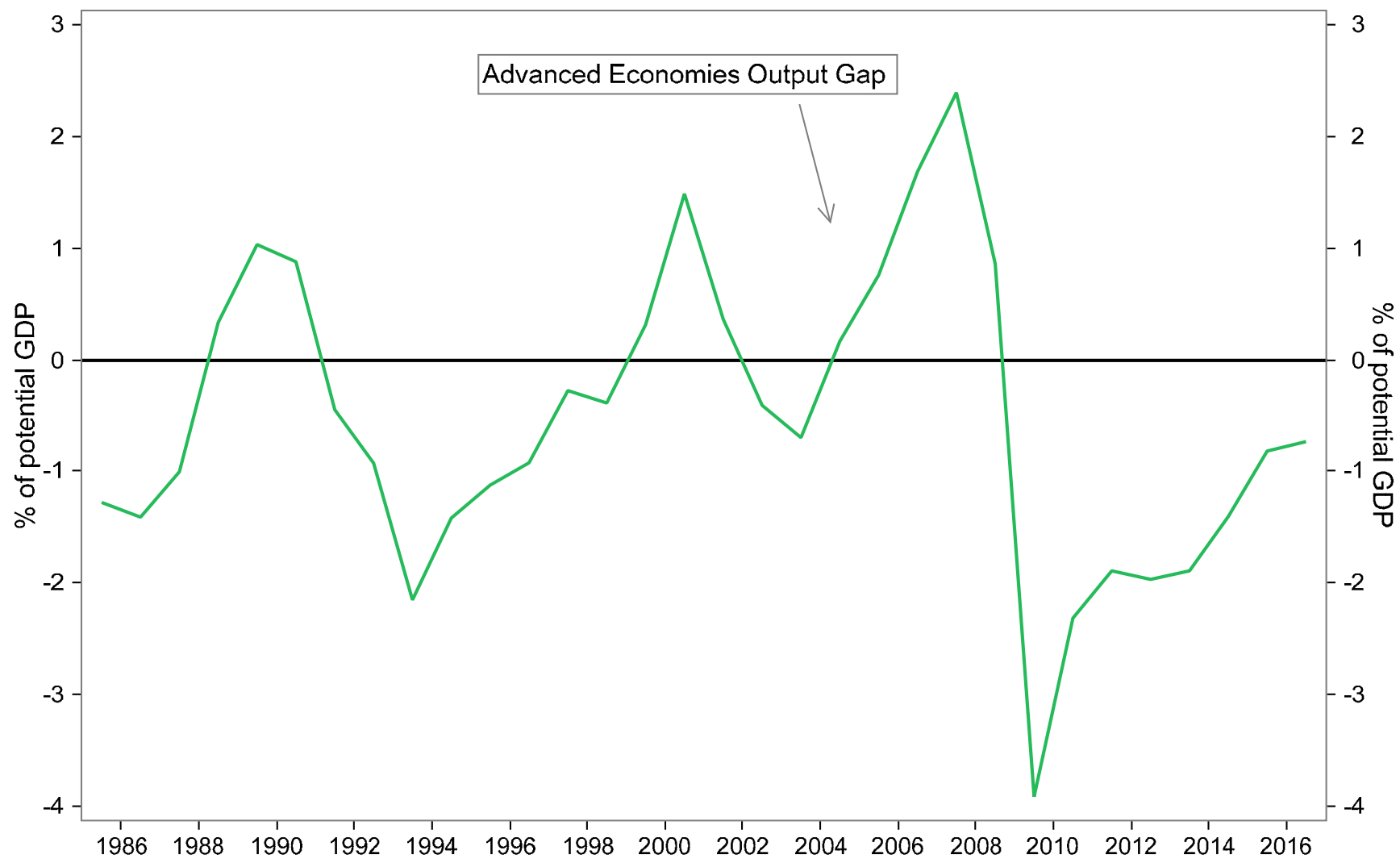
Source: Macrobond, Mizuho Securities, U.S. Bureau of Economic Analysis (BEA), Federal Reserve

Credit cycles evolve differently than inflation cycles



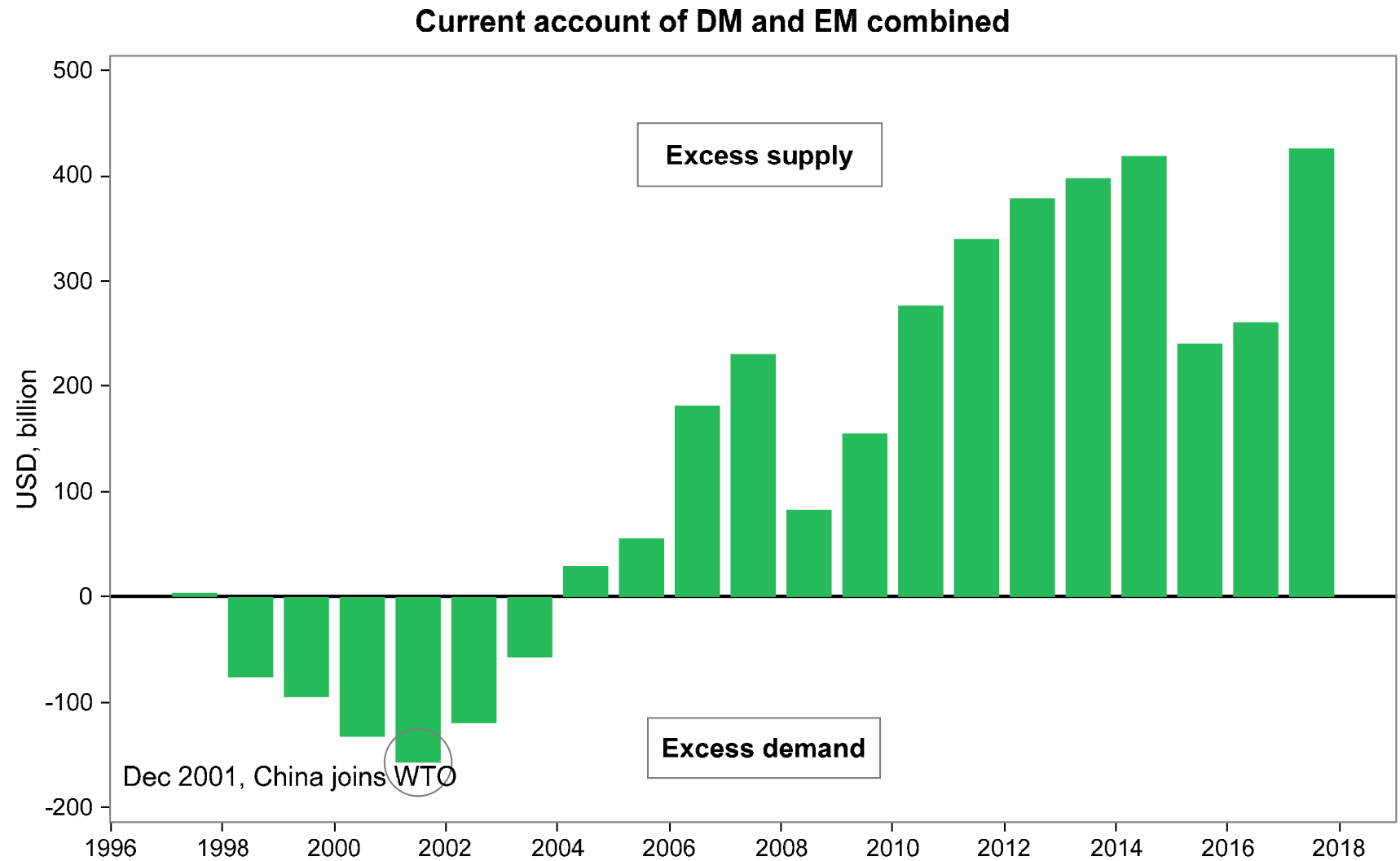
Source: Macrobond, Mizuho Securities, U.S. Bureau of Economic Analysis (BEA)

Excess capacity is a global issue



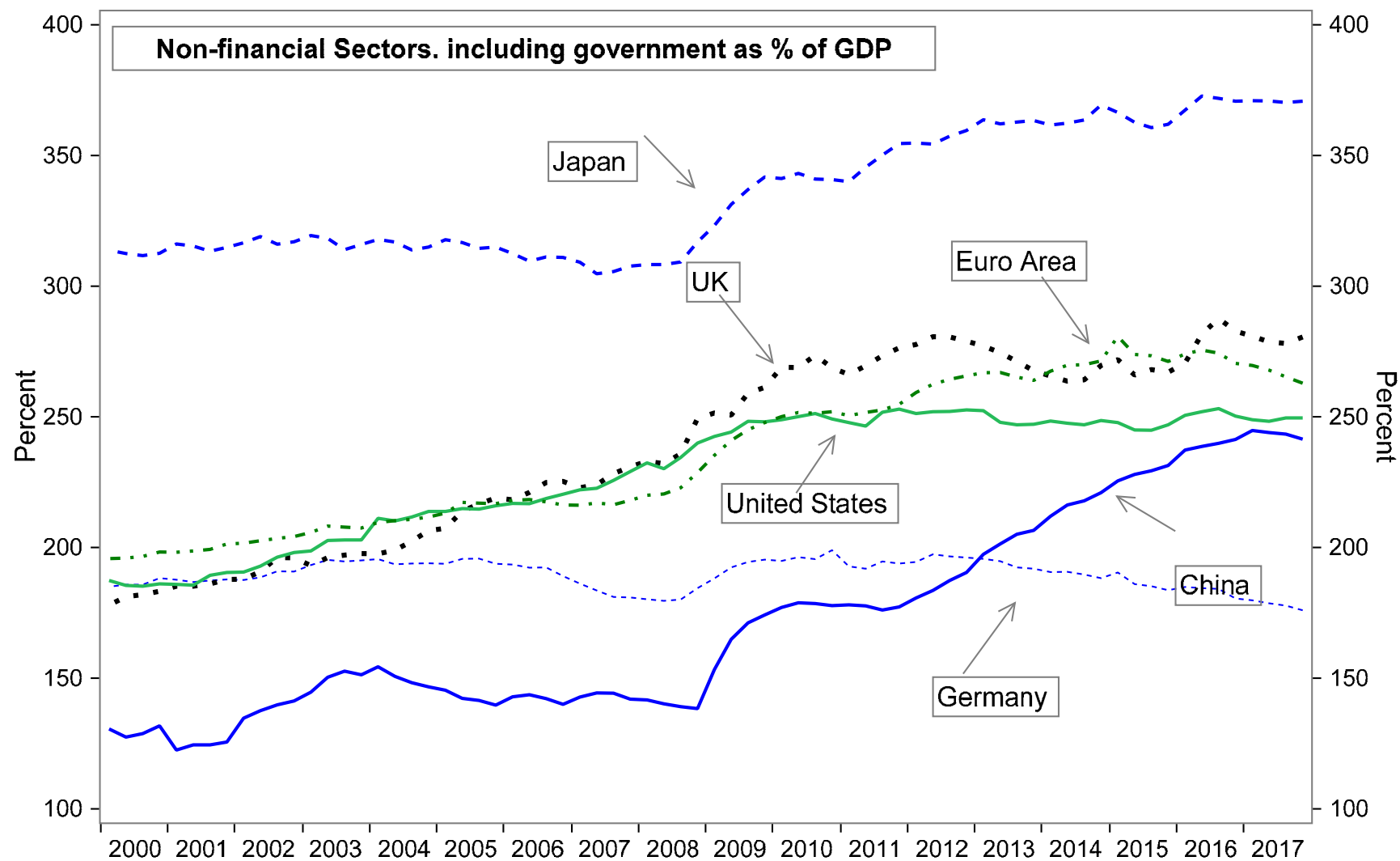
Source: Macrobond, Mizuho Securities, International Monetary Fund (IMF)

Shift from current account deficit to surplus reflect global excess supply



Note: Shaded areas indicate world recessions (OECD+6 major non-members). Source: Macrobond, Mizuho Securities, IMF, OECD

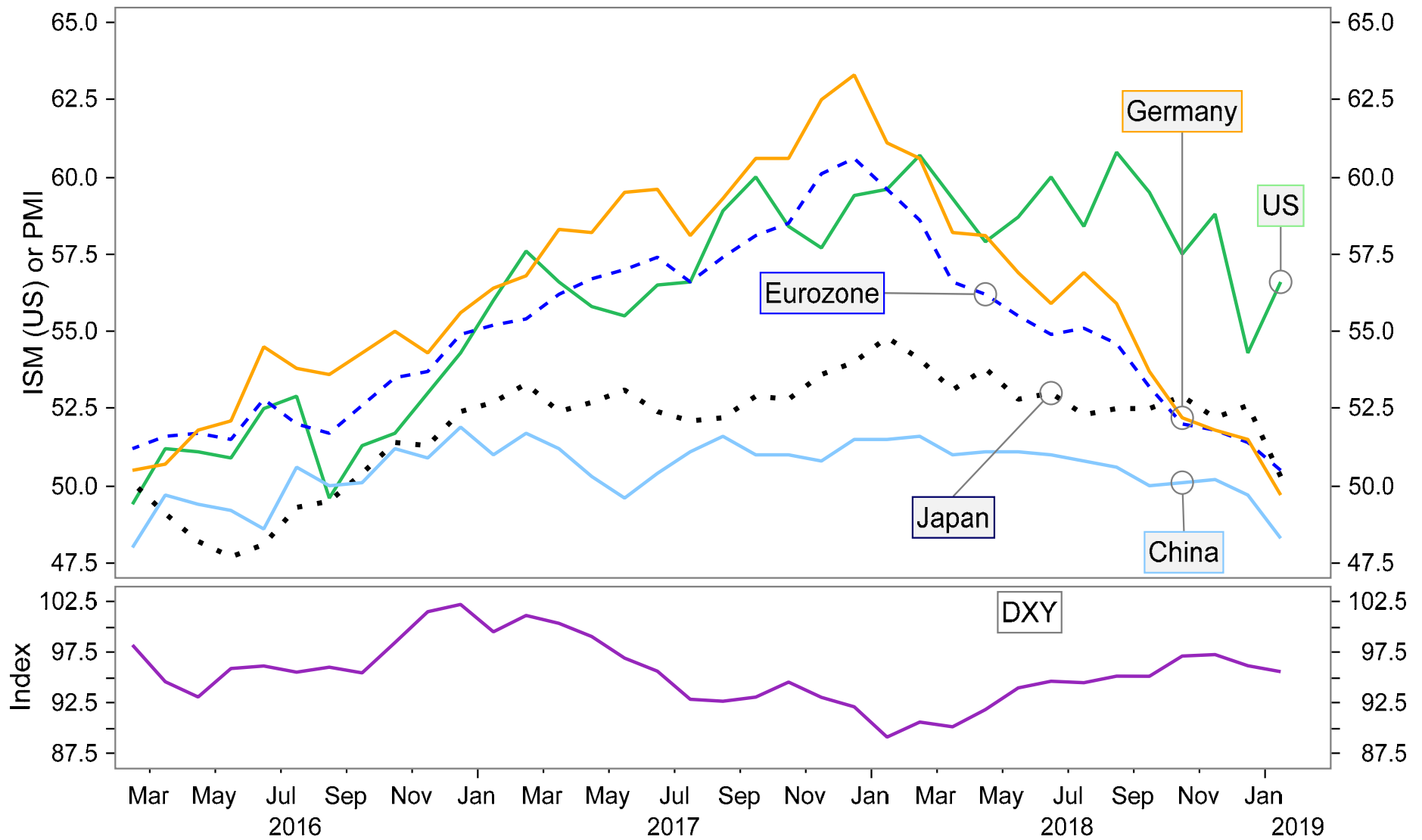
Debt is a major global headwind and limits effectiveness of fiscal policy



Source: Macrobond, Mizuho Securities, BIS (The Bank for International Settlements)

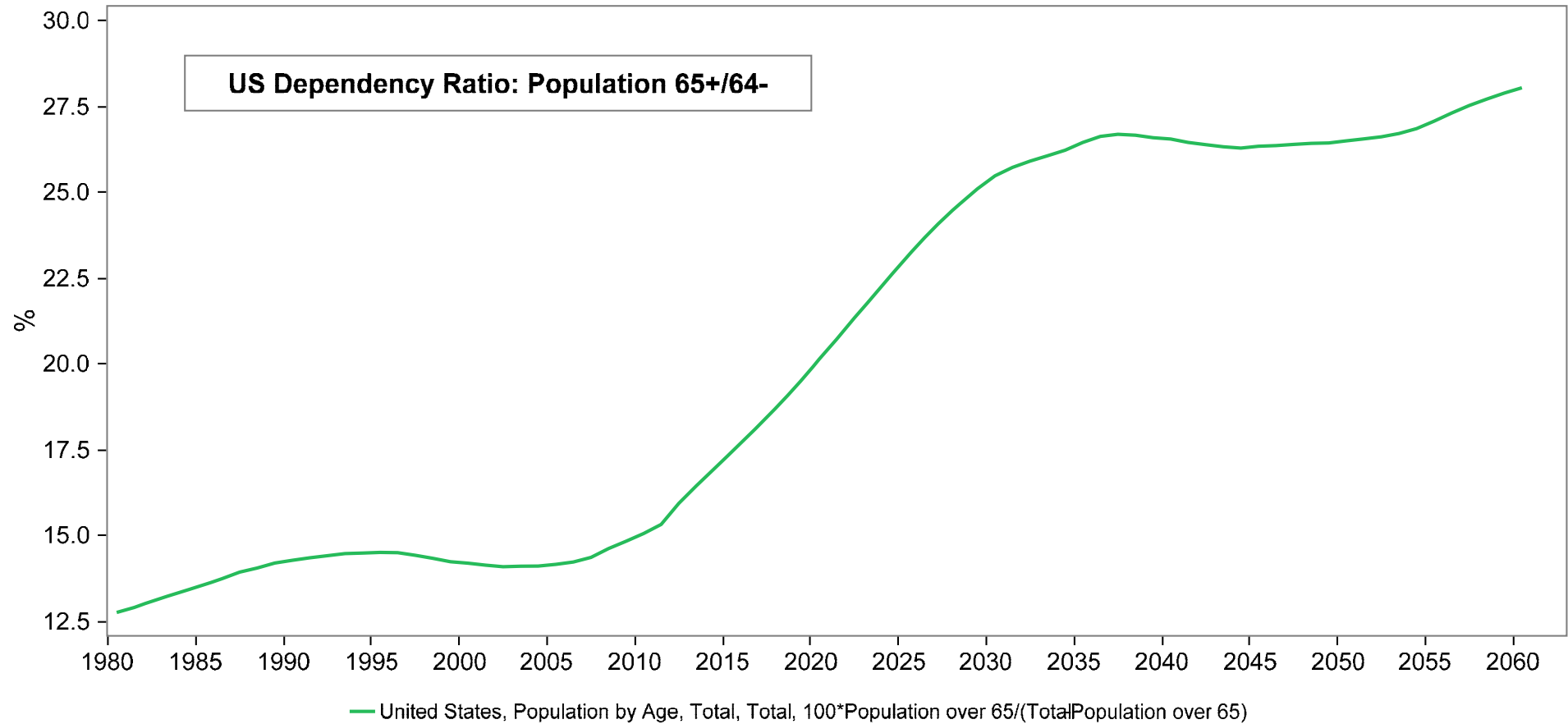
High debt load and excess supply limit growth globally

Manufacturing Indices vs DXY



Source: Macrobond, Mizuho Securities USA, Bloomberg

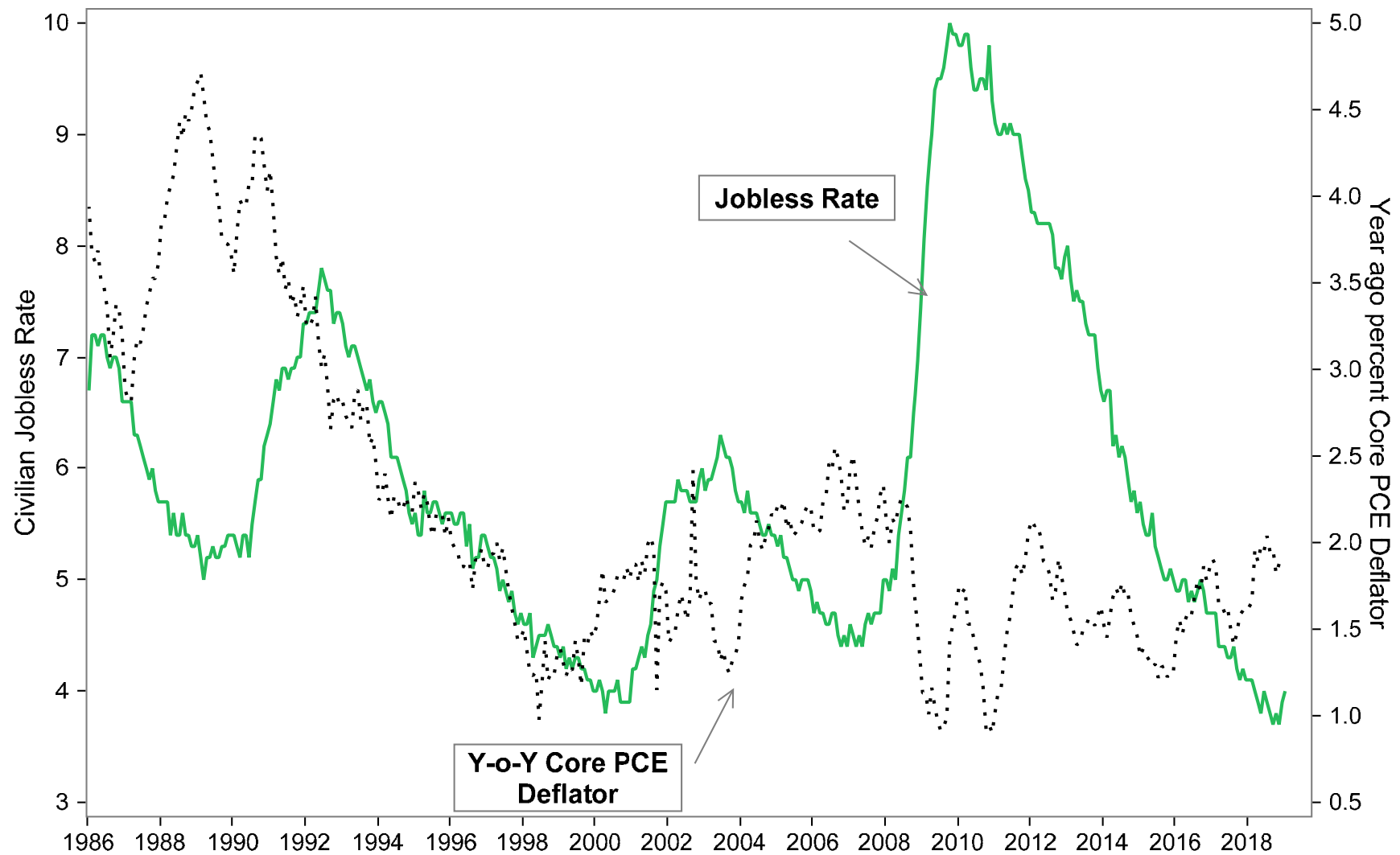
Demographics an important limitation on US growth and even more so globally



Source: Macrobond, Mizuho Securities, U.S. Census Bureau

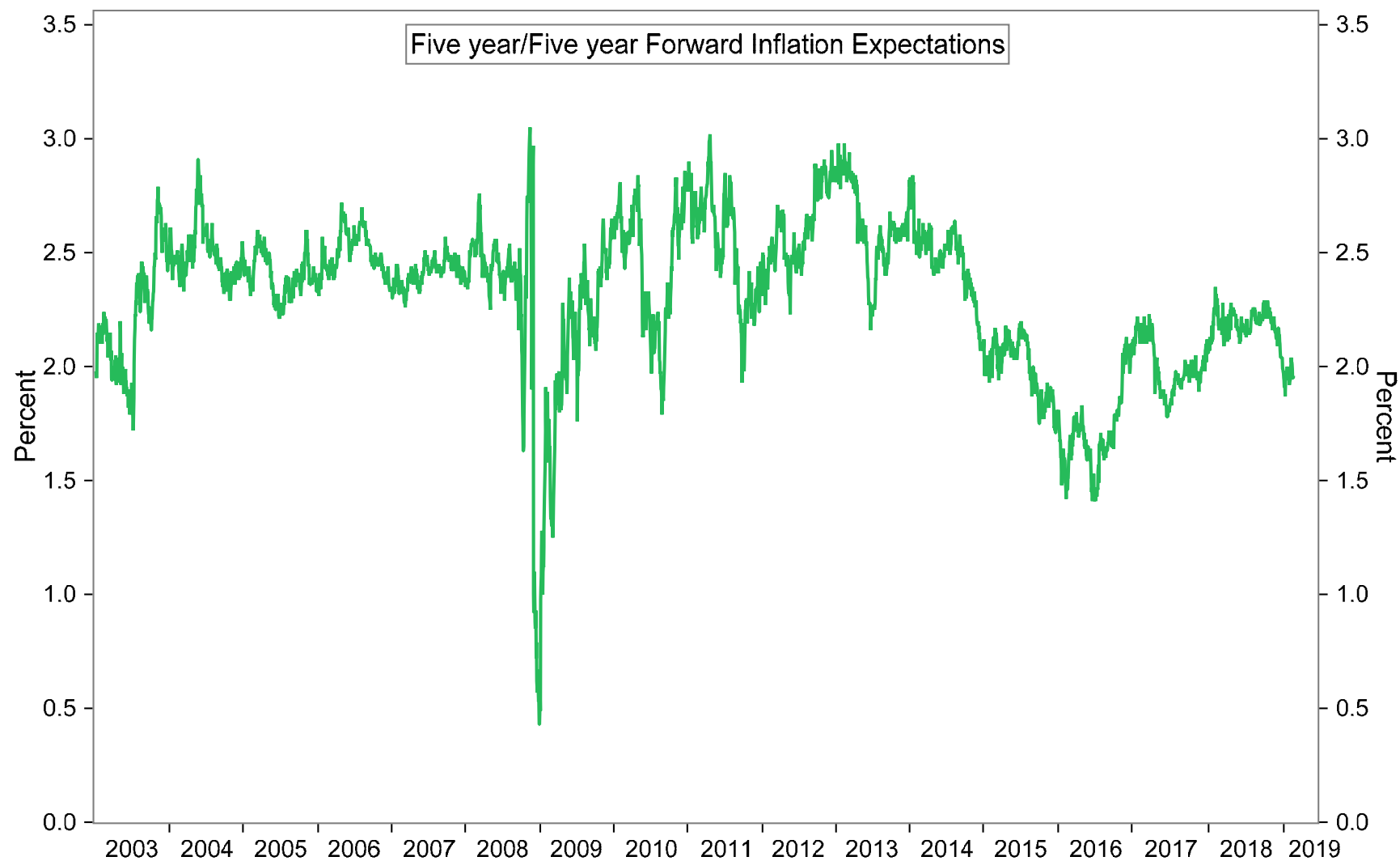
Monetary Policy

Fed has been to worried about Phillips Curve related inflation concerns



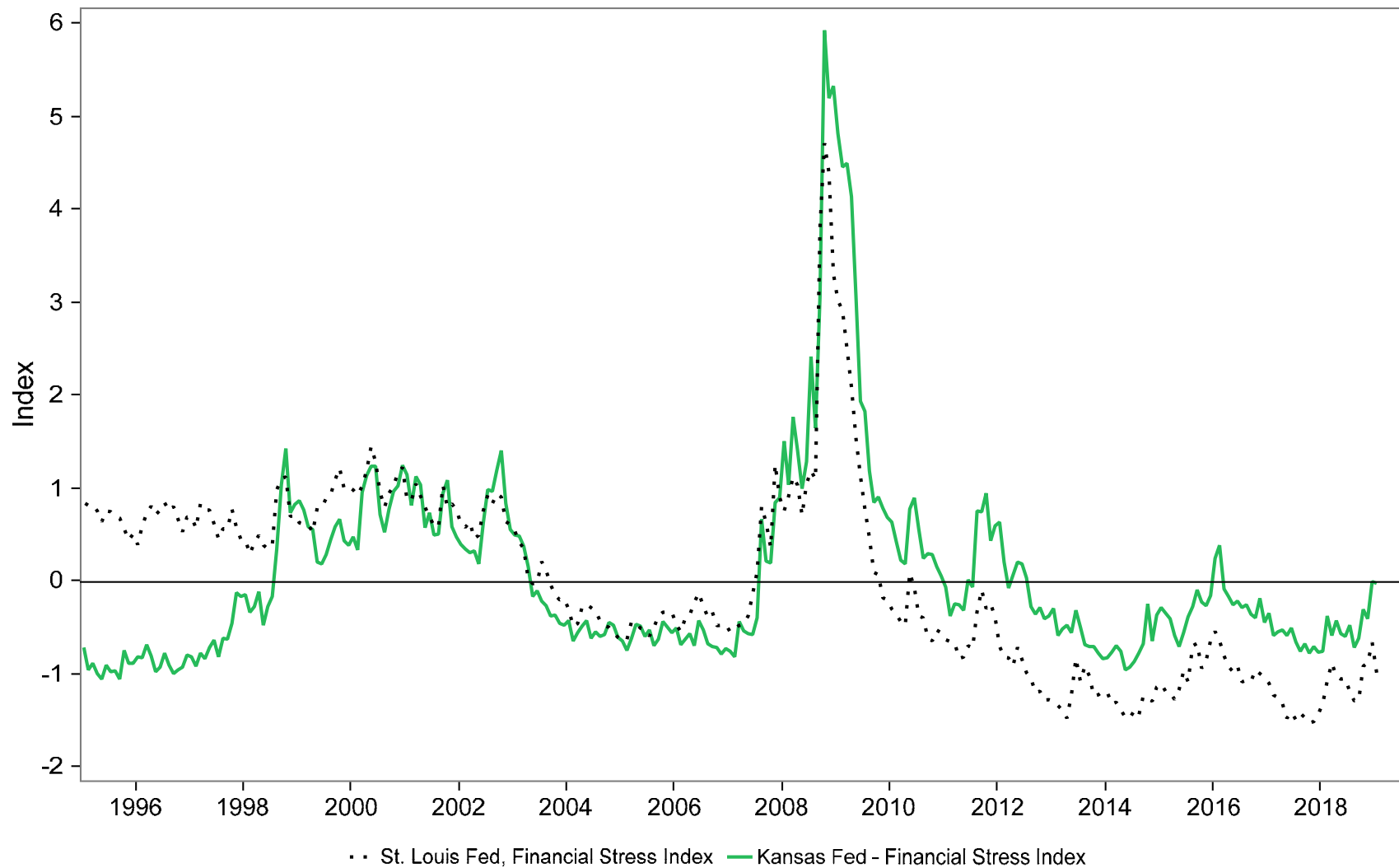
Source: Macrobond, Mizuho Securities, U.S. Bureau of Labor Statistics (BLS), U.S. Bureau of Economic Analysis (BEA)

Inflation expectations are well anchored



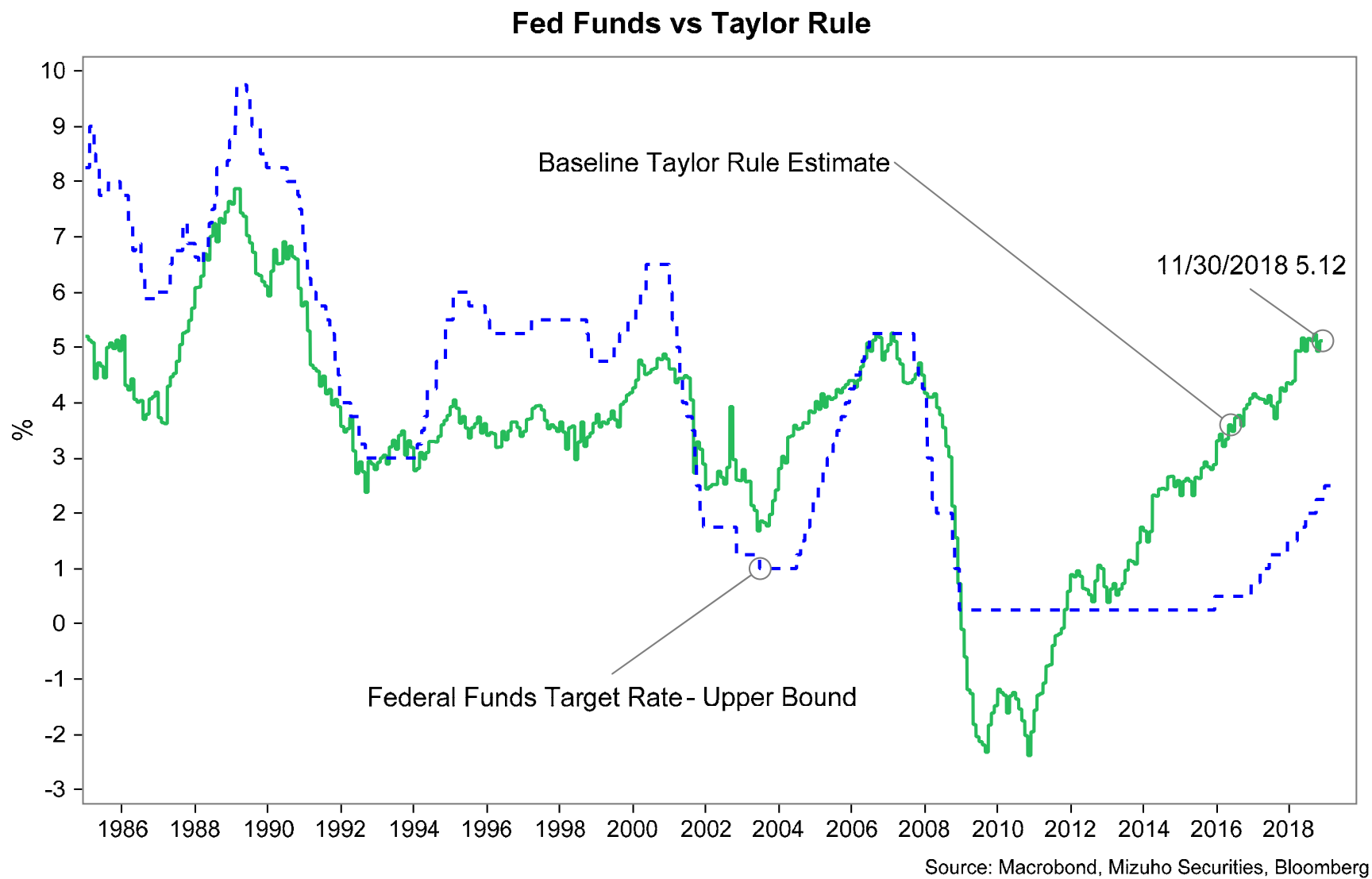
Source: Macrobond, Mizuho Securities, Federal Reserve Bank of St. Louis

Financial system stress measures suggest Fed has moved to quickly

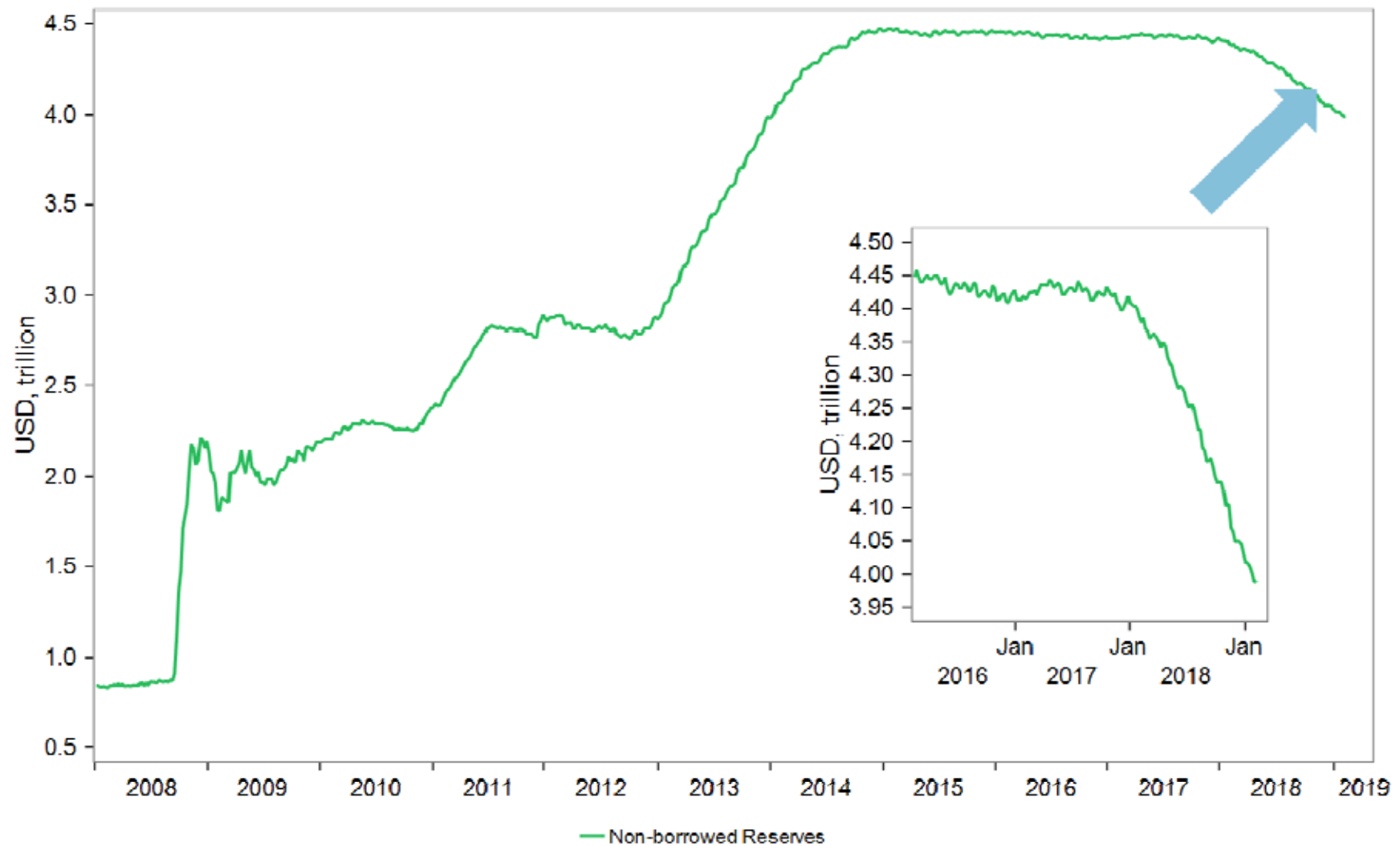


Source: Macrobond, Mizuho Securities, Federal Reserve Bank of St. Louis, Federal Reserve Bank of Kansas City

Monetary policy becoming less accommodative

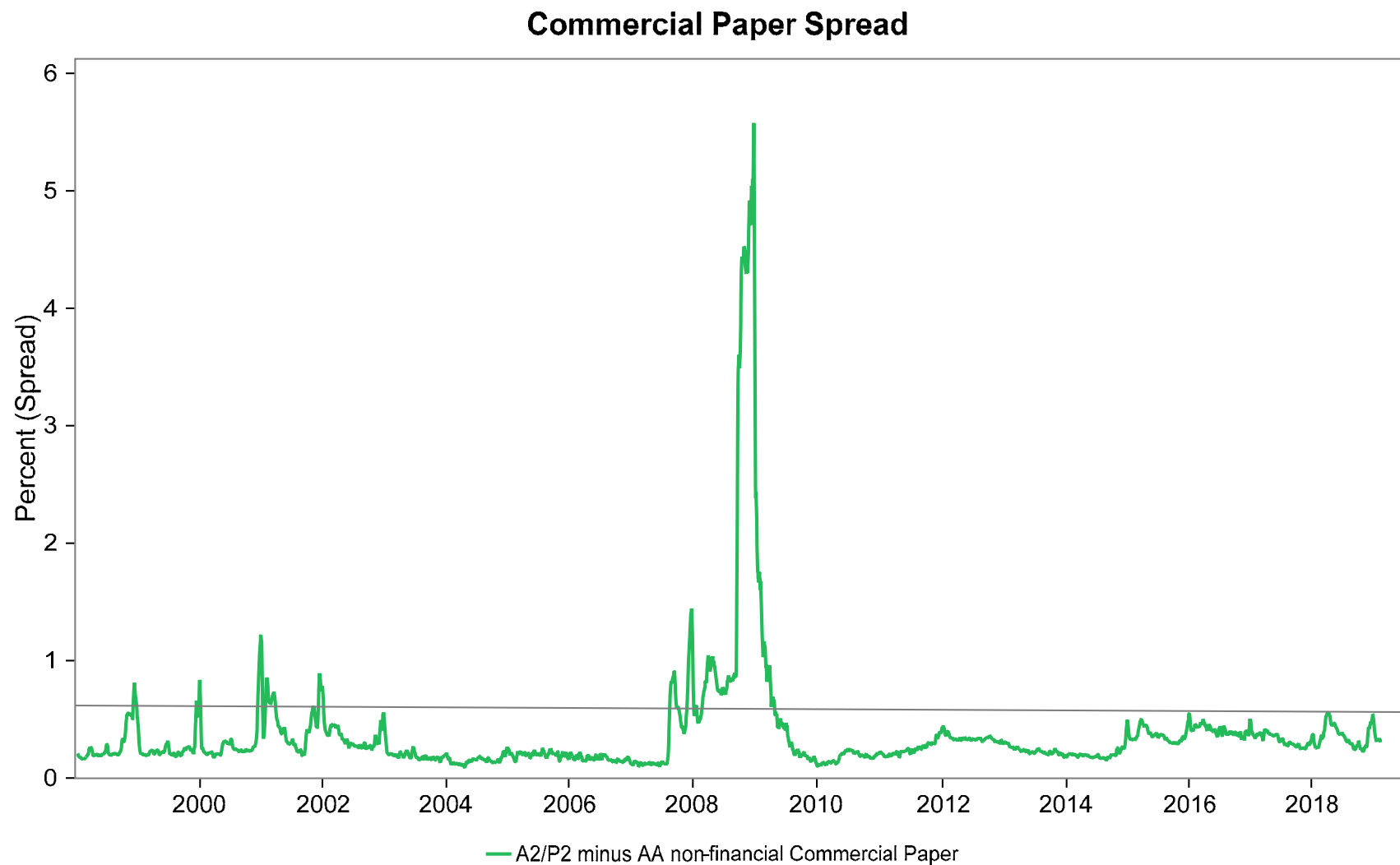


Portfolio unwind by Fed has been modest but money markets rates have spiked



Source: Macrobond, Mizuho Securities, Federal Reserve

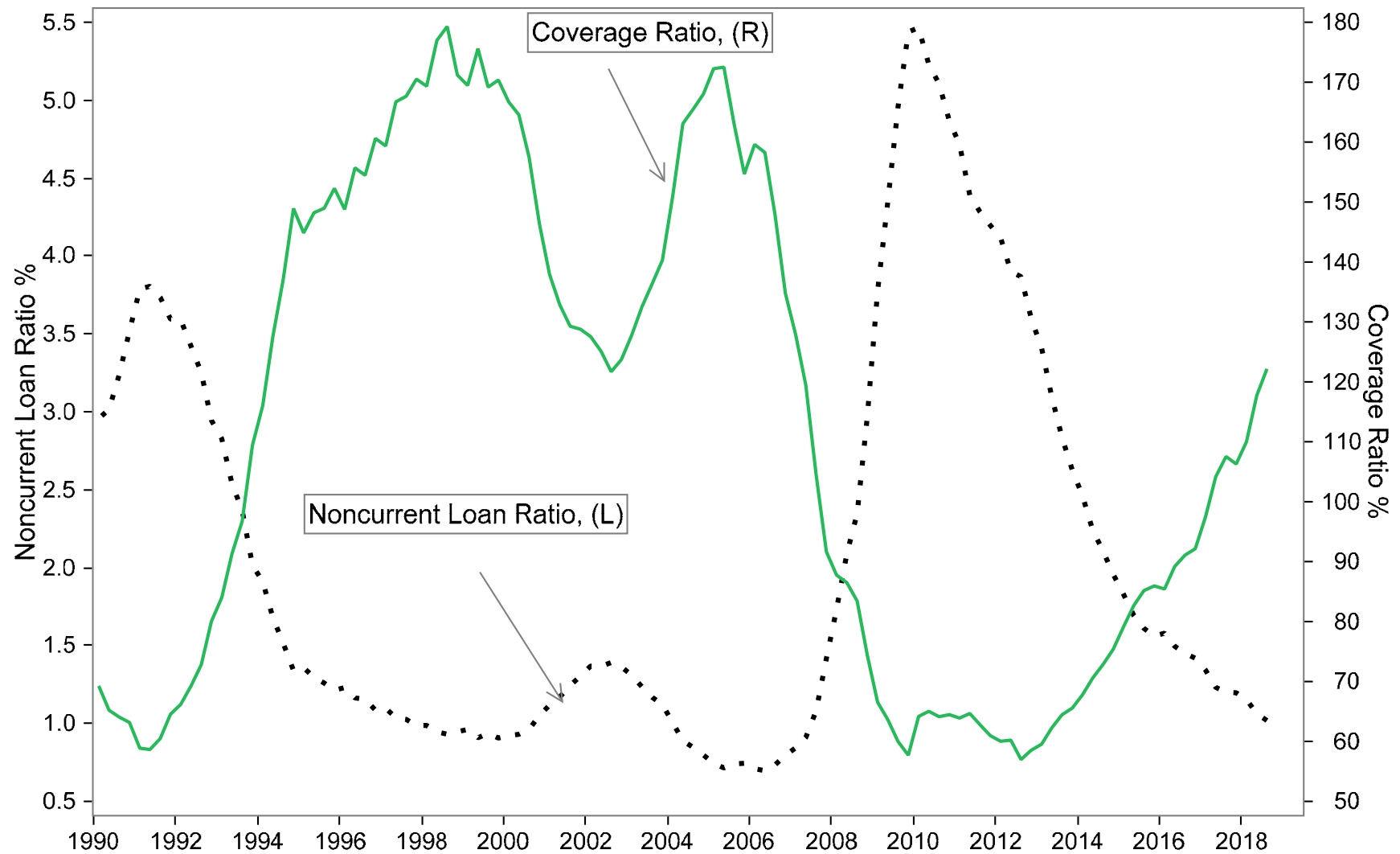
Liquidity concerns will limit shadow banking growth



Source: Macrobond, Mizuho Securities, Federal Reserve

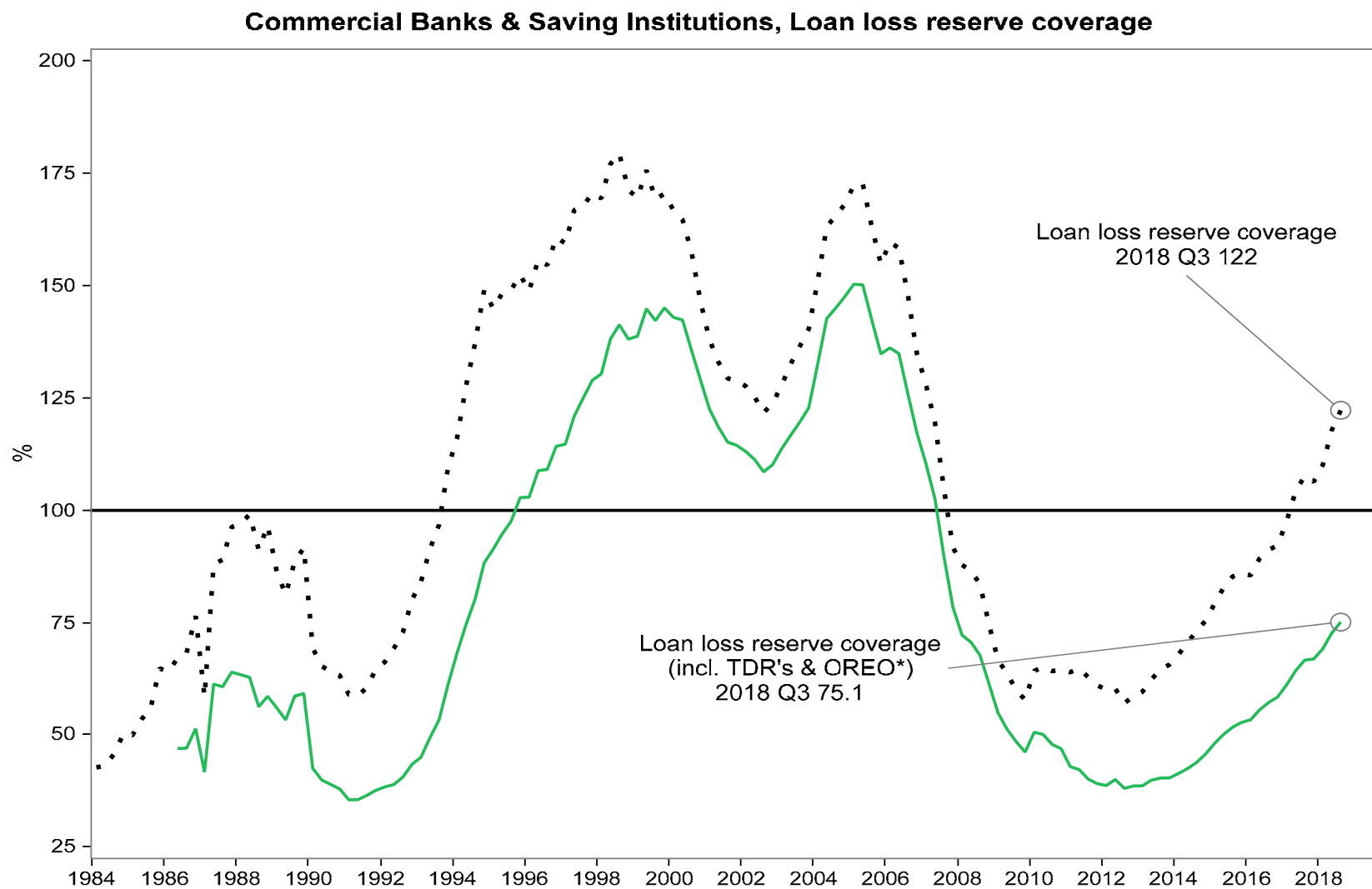
Credit Considerations

Post crises banking system restructuring nearing completion



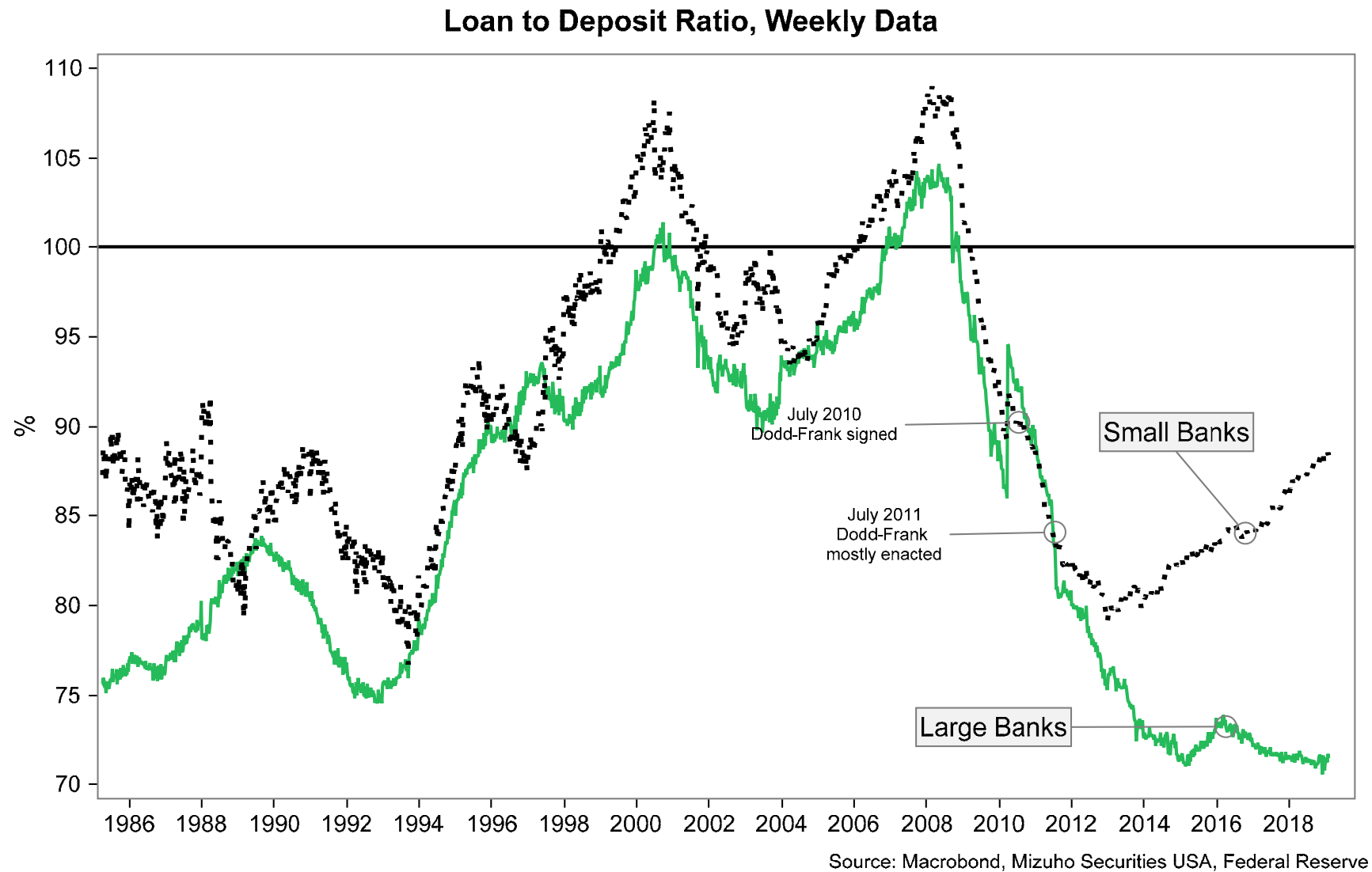
Source: Macrobond, Mizuho Securities, Federal Deposit Insurance Corporation

But an alternative view of banking system restructuring is less constructive

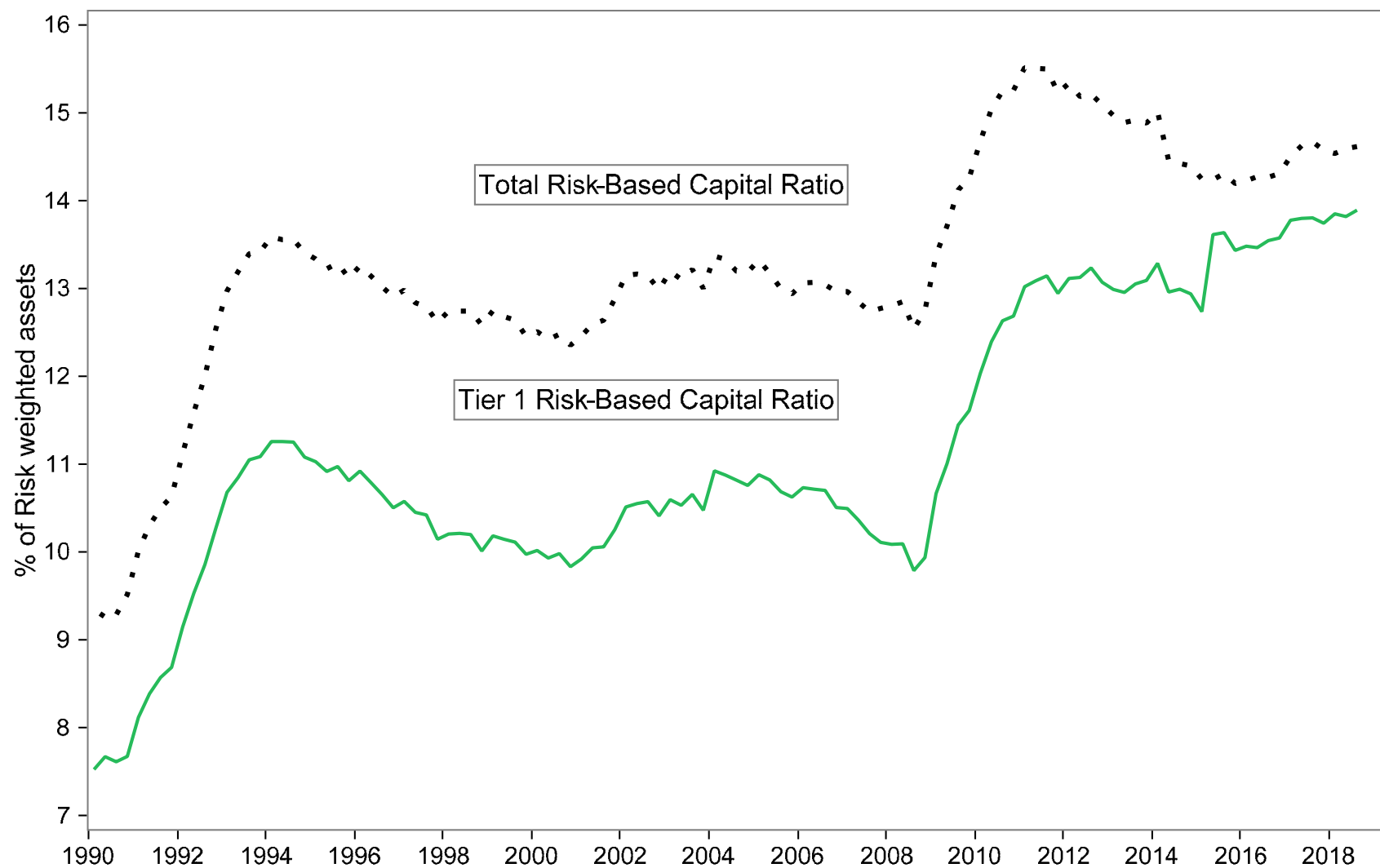


*TDR=Troubled debt restructurings, OREO=Other real estate owned. Source: Macrobond, Mizuho Securities, FDIC

Huge divergence in lending by size of institution

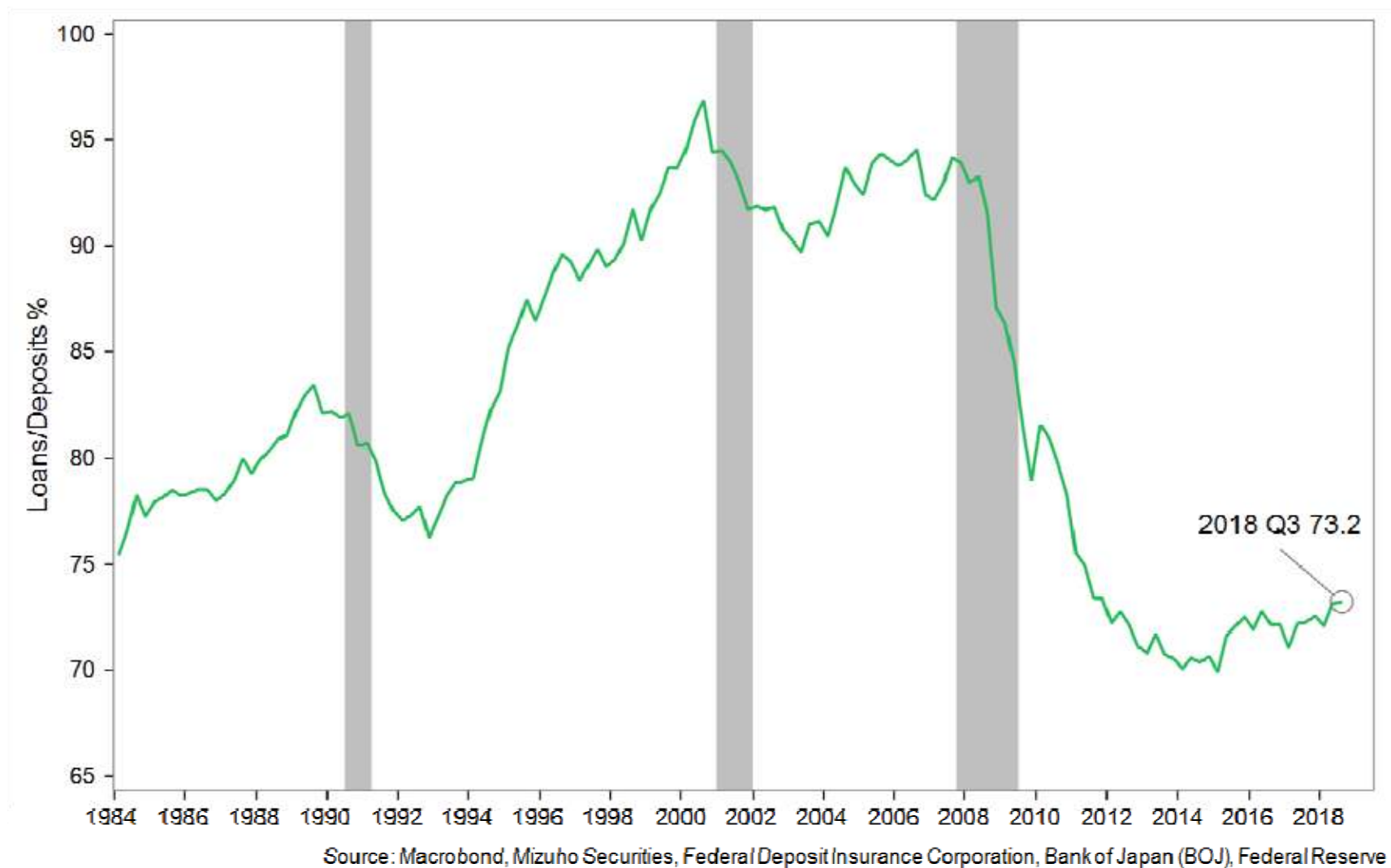


Banking system restructuring largely complete



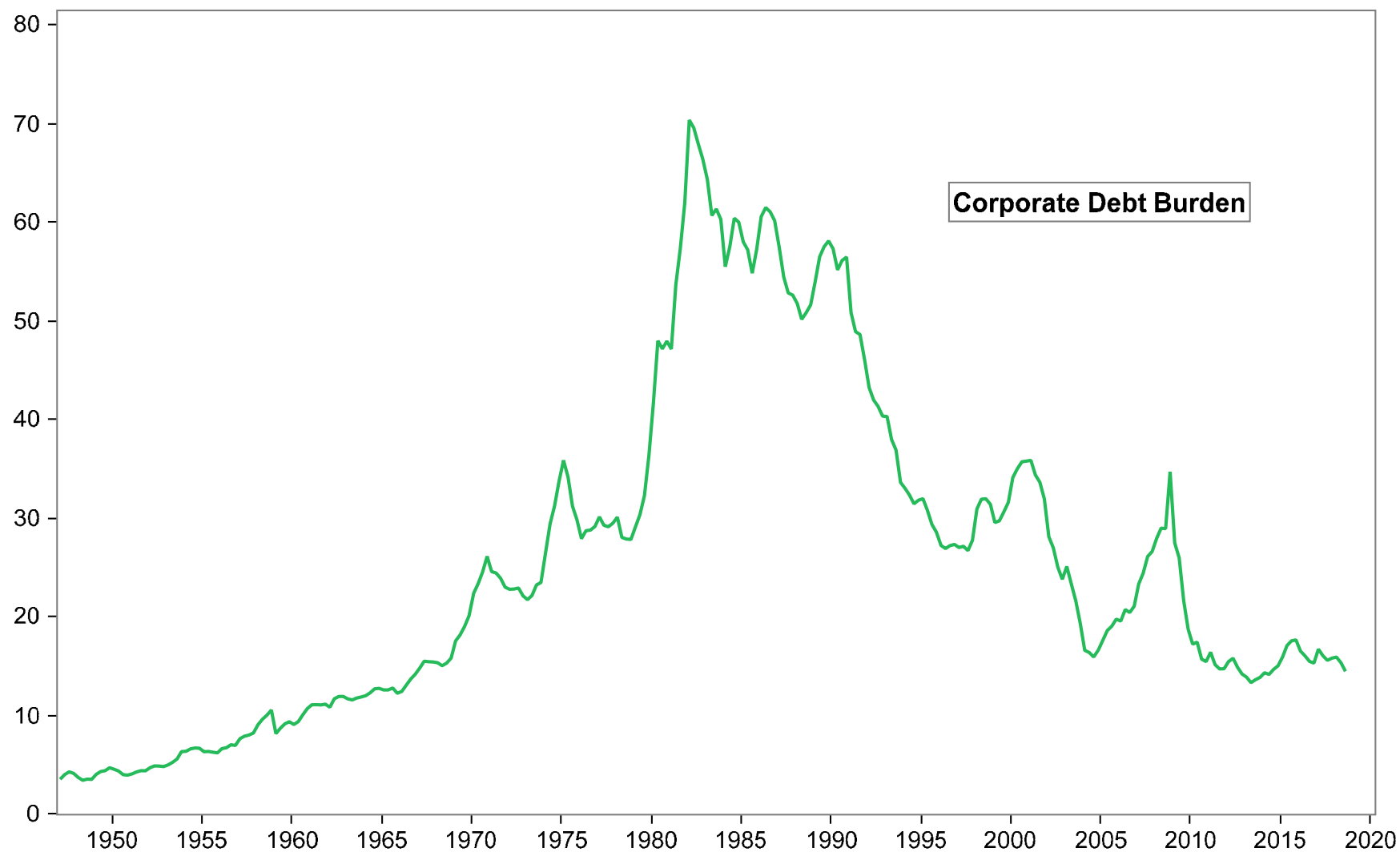
Source: Macrobond, Mizuho Securities, Federal Deposit Insurance Corporation

Cautious bank lending behind shallow growth trajectory



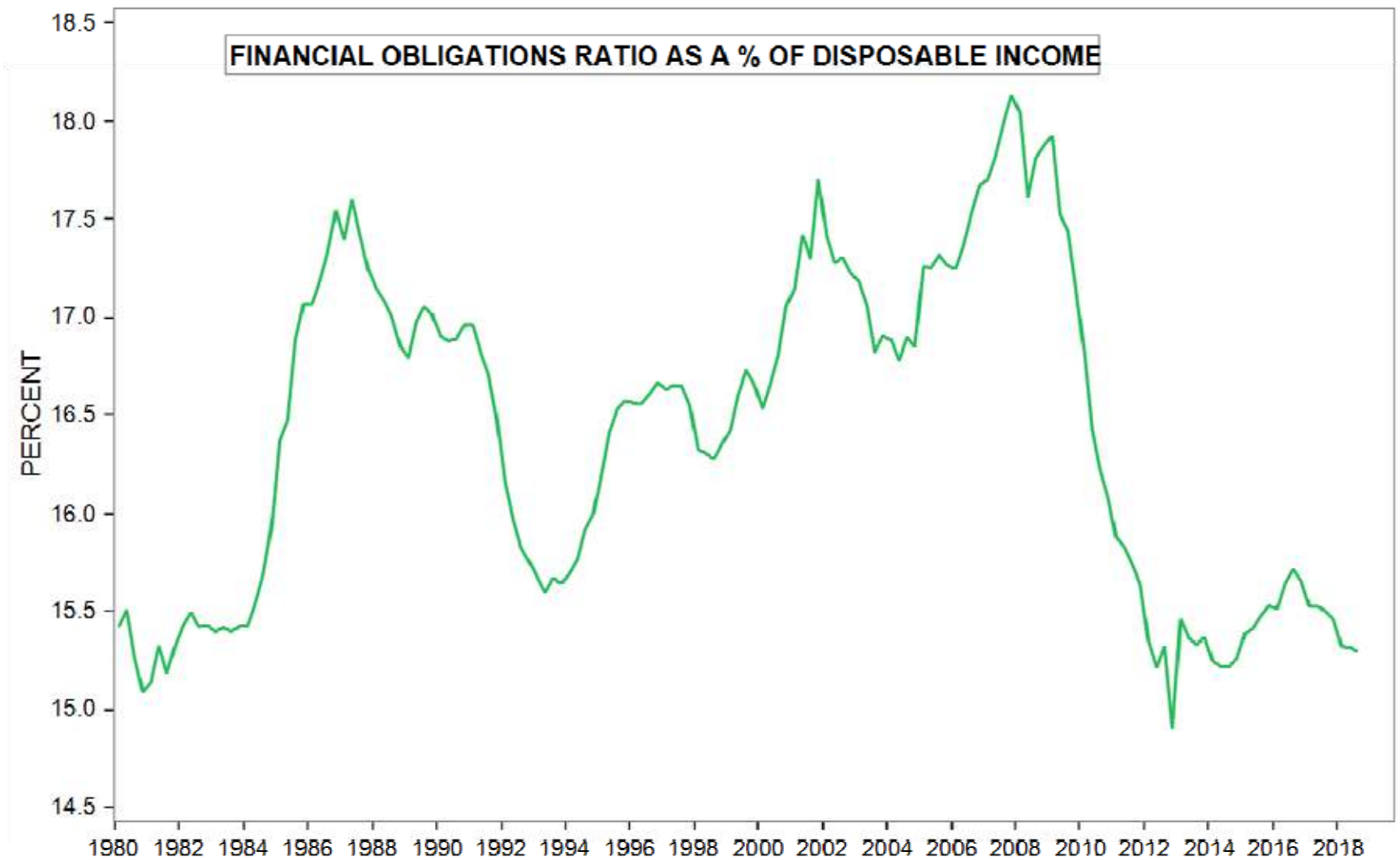
Non-bank balance sheets
remain healthy!

Corporate debt burden remains low



Source: Macrobond, Mizuho Securities, U.S. Bureau of Economic Analysis (BEA)

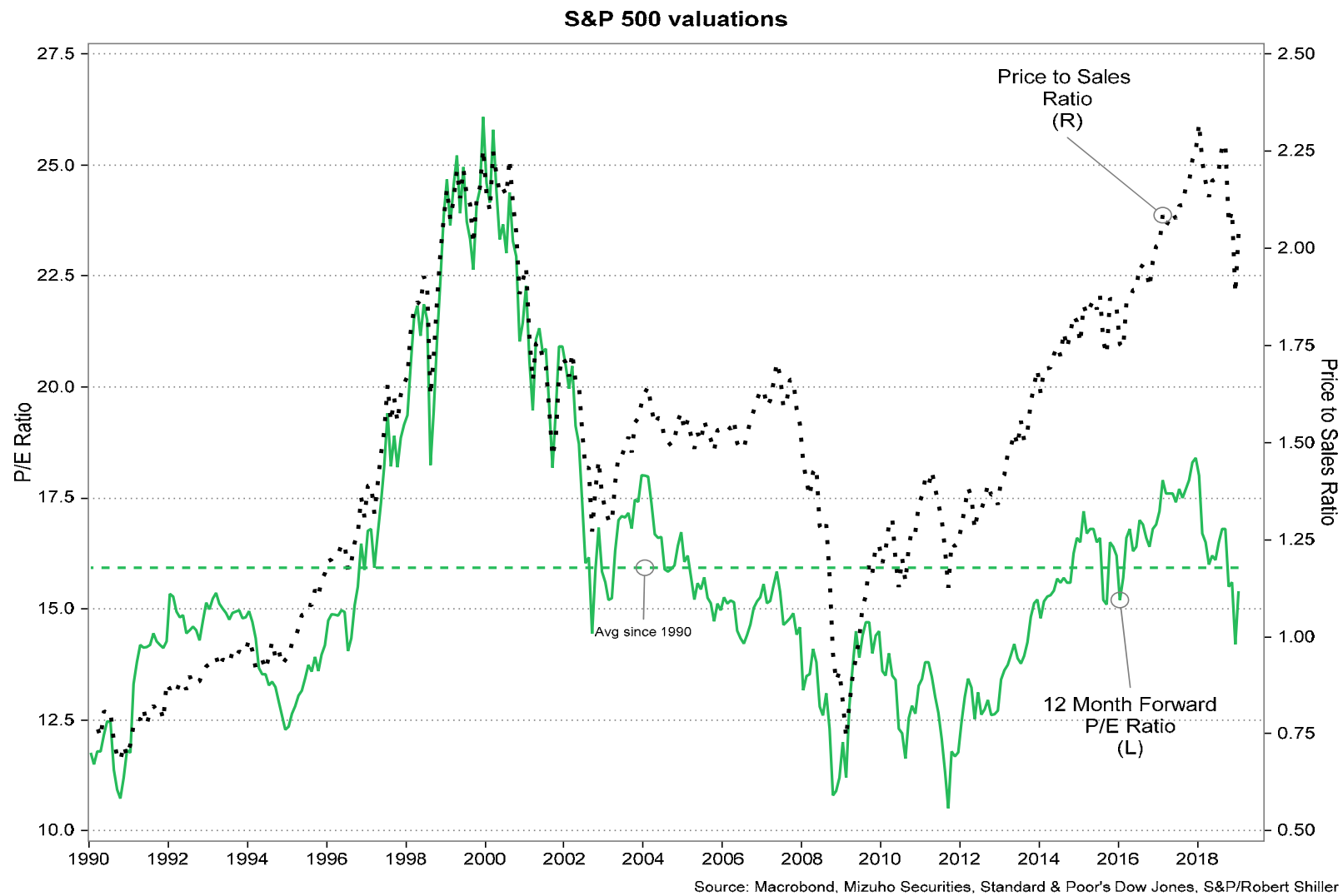
Household debt burden reflects rising short rates



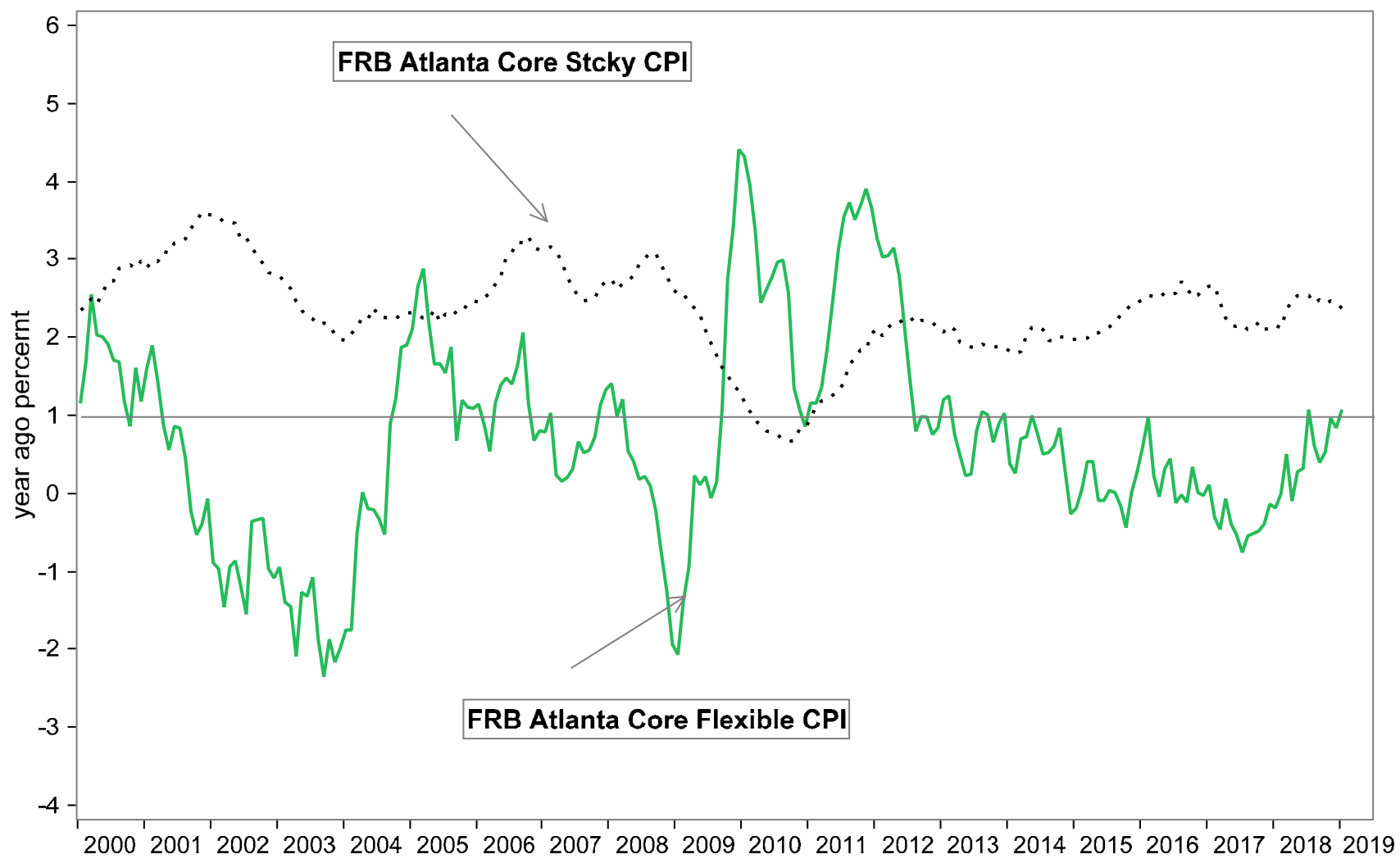
Source: Macrobond, Mizuho Securities, Federal Reserve

Valuation Considerations

Divergent valuation measures

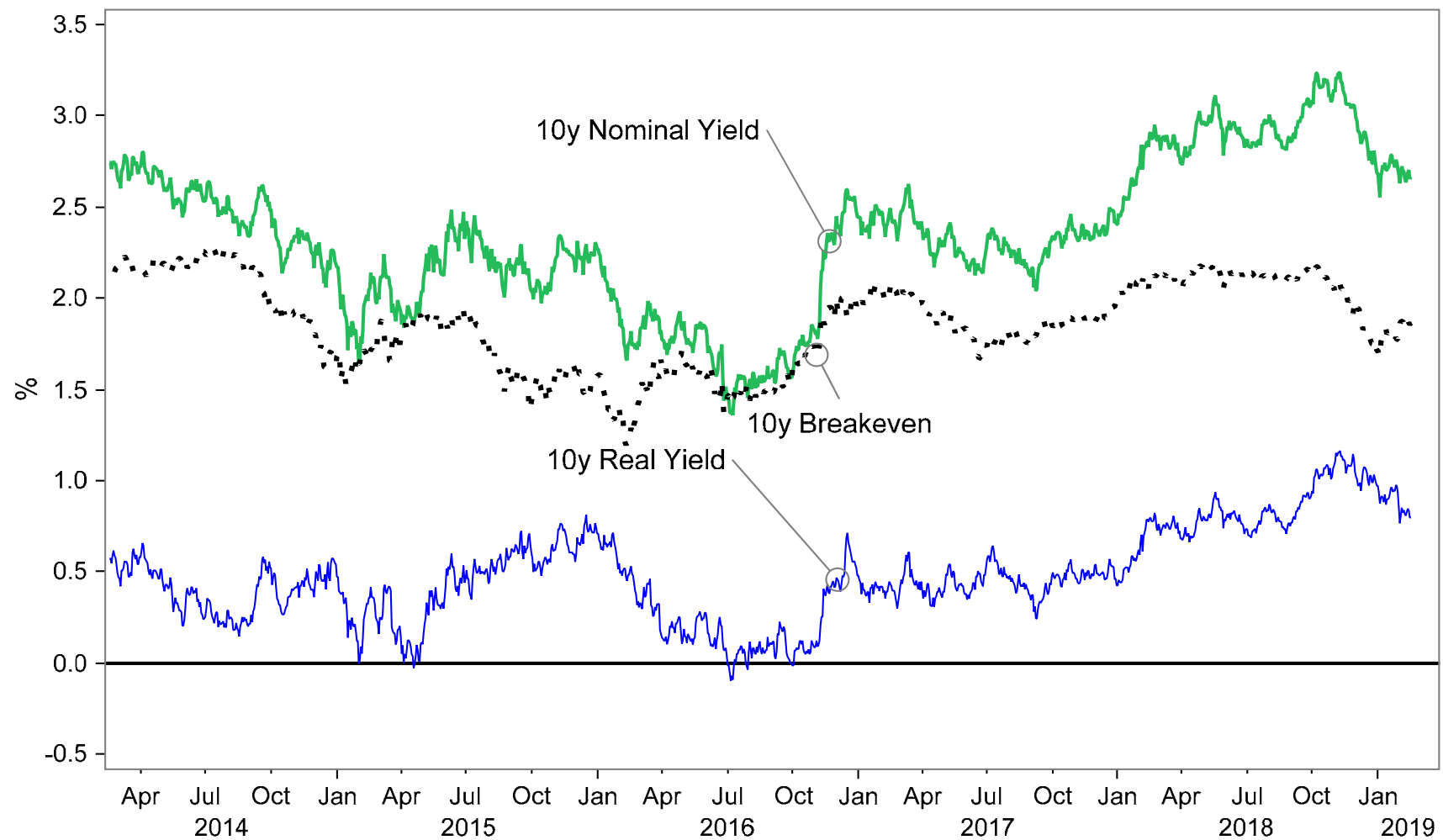


Deflation risks less of a factor



Source: Macrobond, Mizuho Securities, Federal Reserve Bank of Atlanta

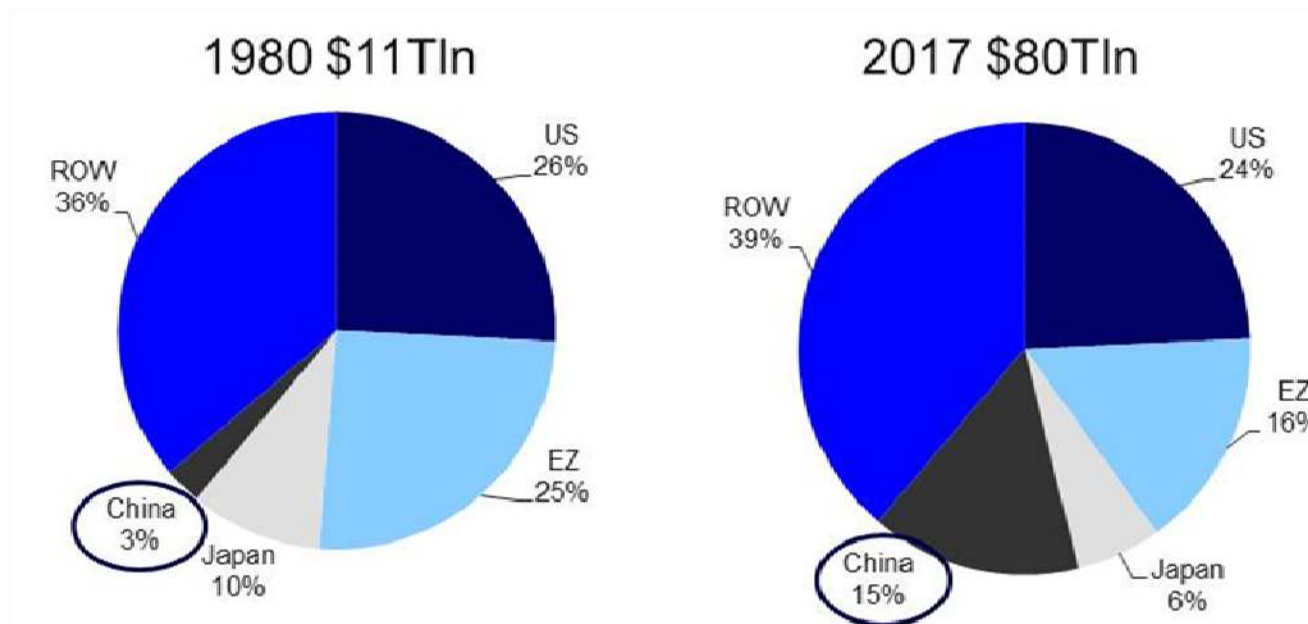
Long-term real yields have peaked



Source: Macrobond, Mizuho Securities, Bloomberg

International appendix

World GDP Breakdown, Pre-Reagan (1981-1989) vs now



Nominal GDP	1980 \$Tln	2017 \$Tln
US	2.86	19.39
EZ	2.83	12.61
Japan	1.09	4.87
China	0.30	12.01
ROW	4.02	30.98
World	11.10	79.87

Source: IMF, Mizuho Securities USA. Note: For 2017, IMF estimates were used for Eurozone (EZ), Rest of World (ROW) and the World total of \$80 trillion.

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