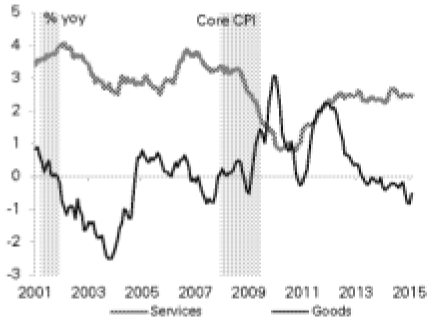
issues discussed earlier. Consequently, even though the stronger dollar will weigh on net exports and help dampen inflation pressures, the drop in energy will ultimately be a boon to consumers. Regarding the negative impact on energy-related spending and hiring, it is worth noting that employment within the transportation sector, arguably the industry best positioned to benefit from lower fuel costs, is more than three times larger than the energy sector as a percentage of total employment (4.6% vs. 1.4%). The reason we have not lowered our GDP forecast for 2015 or beyond is that we believe that dollar appreciation will be offset by the stimulus from lower oil prices. Hence, we are maintaining our top-down forecast from last December, but the mix of underlying output growth has changed—we have factored in a larger drag from international trade, but this is largely offset by stronger domestic spending

If the economy is able grow 3% this year, the unemployment rate is likely to continue declining at its current pace, which is roughly one percentage point per year. Our forecast assumes the unemployment rate will fall to 4.7% by yearend, which is well below the Fed's central tendency of 5.0% to 5.2%. This further expected tightening in the labor market, which will be accompanied by rising hiring and quit rates, should exert upward pressure on labor costs. In turn, this should add to policymakers' confidence that inflation will trend back toward their 2% target, thus allowing the Fed to begin the process of monetary policy normalization at the September 16-17 FOMC meeting. As always, there are risks to the economic and financial outlook.

- With respect to output growth, there is a risk that recent dollar appreciation exerts a larger-than-anticipated drag on the US economy than what we have assumed in our forecast. This would also put further downward pressure on goods inflation and likely stay the commencement of interest rate normalization a bit longer.
- Another downside risk is that the second-order effects of lower energy prices on capital spending and energy-related employment are larger than what we currently anticipate. At the same time, the boost to domestic spending from lower energy prices may not fully come to fruition if households and businesses chose to save a meaningfully greater portion of the energy tax cut.
- In terms of the upside risks to growth, the rapid appreciation of the dollar may already be reflective of divergent central bank policies. In turn, the pace of dollar appreciation may slow significantly over the coming quarters, and could even reverse, resulting in less drag on net exports and domestic production than we currently assume.
- Another upside risk is the labor market. As the job market continues to strengthen and the unemployment rate declines meaningfully further, wage and income growth may rise faster than expected, thus providing households with even more spending power than we envision.
- The final upside risk pertains to inflation. The aforementioned potential for faster wage gains, combined with a more dramatic recovery in energy prices relative to our projection — possibly the result of less dollar appreciation, stronger overseas growth and substantially less oil production — may push headline inflation more quickly back toward the Fed's 2% target. With respect to all of the aforementioned risks, this is perhaps the one that financial markets are least prepared for.

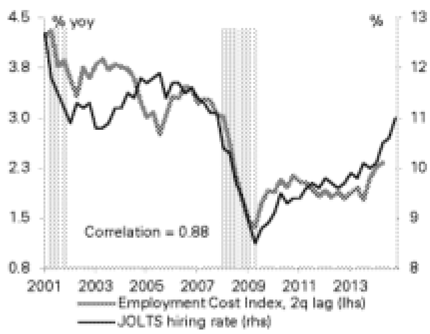
Joseph A. LaVorgna, [redacted]
Brett Ryan,
Aditya Bhave,

Figure 8: Goods prices will continue to fall but this should be offset by services



Source: BLS, Haver Analytics, Deutsche Bank Research

Figure 9: A rising hiring rate points to an acceleration in wage costs



Source: BLS, Haver Analytics, Deutsche Bank Research

Figure 10: External balances & financial forecasts

	2013	2014F	2015F	2016F
Fiscal balance, % of GDP	-4.0	-2.9	-2.6	-2.9
Trade balance, USD bn	-476	-532	-596	-778
Trade balance, % of GDP	-2.8	-3.1	-3.3	-4.1
Current account, USD bn	-400	-453	-507	-661
Current account, % of GDP	-2.4	-2.6	-2.8	-3.5
Financial forecasts	Current	Q2-2015	Q4-2015	Q1-2016
Official	0.12	0.13	0.63	0.88
3M rate	0.26	0.26	0.75	1.18
USD per EUR	1.09	1.04	1.00	0.98
JPY per USD	119	121	125	126
USD per GBP	1.49	1.47	1.36	1.33

Source: National authorities, Deutsche Bank Research, as of March 30