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Headwinds and Tailwinds: the Economic Outlook

2016 NMHC Research Forum

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Two other possible titles

Is this as good as it gets?

Does anyone here know what to do next?

The current economy in context

- Expansion began in July 2009, making this the 82nd month!
- Average expansion is 58.4 months
- Does this point to an imminent downturn simply out of age?
- No, there is no evidence that length is in itself a predictor of the next move
- The probability of recession is about 10%

How has this expansion progressed?

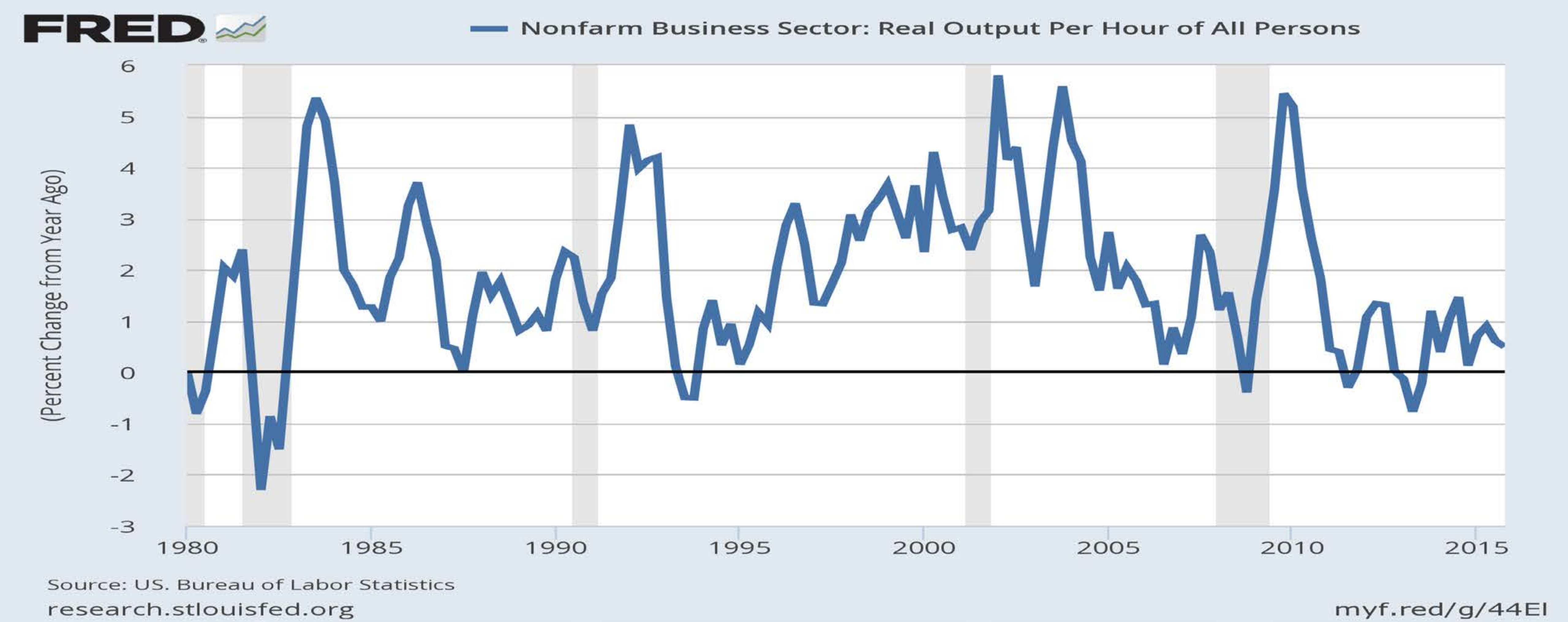
- After the deepest, longest and most severe recession since the Great Depression we have had, while long, the weakest recovery and expansion on record
- Over half of Americans, when polled, think we are still in recession
- The troubling headwind: we are 19% below the prerecession trend and that will only widen over time

What is at play?

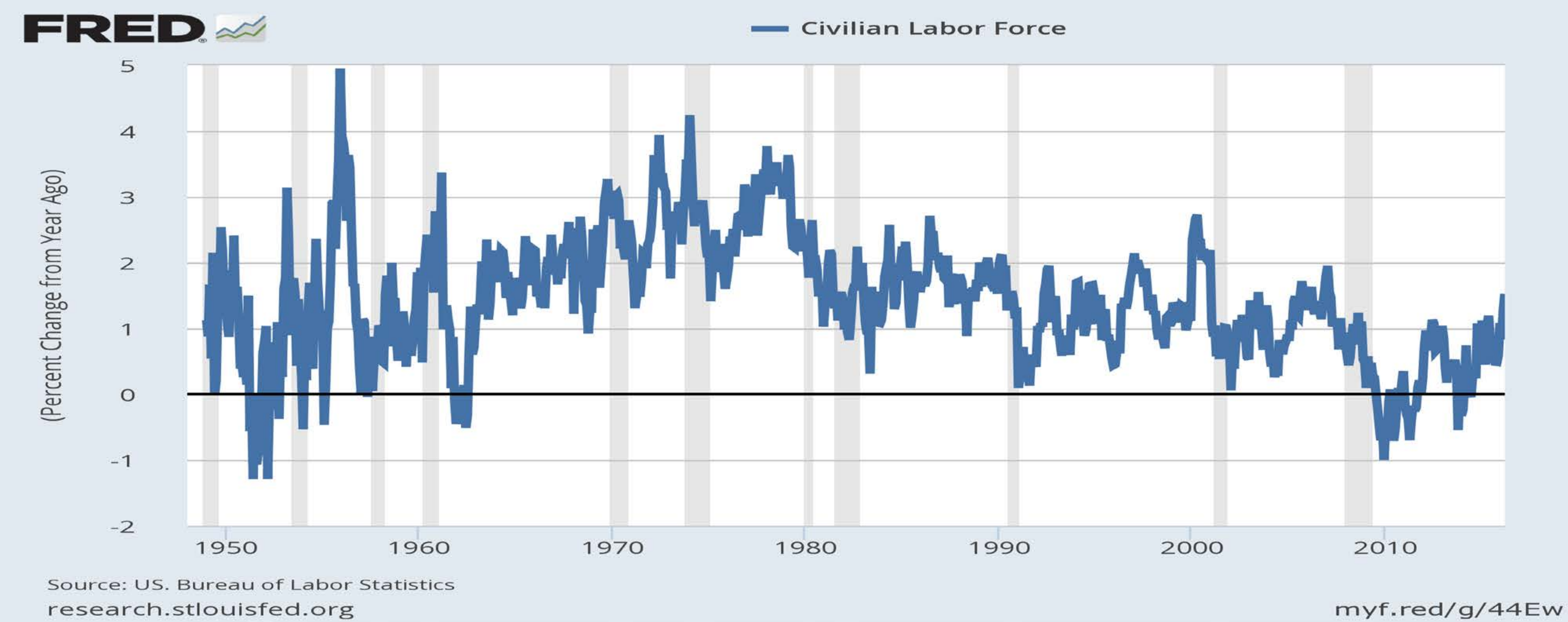
- This slowdown apparently related to changes in demographics, a reduction in entrepreneurial risk taking in small businesses and a drop in the growth of productivity

- We can only hope this is not the new normal, often called Secular Stagnation

Productivity – the ultimate indicator



Add this to the changing labor force



The Strengths

- Household assets are rising in value, debt is declining, and thus wealth is rising
- The low cost of energy is positive for most of us
- Corporations are awash in cash that can fund future expansion
- Jobs in the private sector are being created

The Weaknesses

- Household income, adjusted for inflation, is still going nowhere
- Continued fiscal uncertainty, including in the states, stifles growth
- Firms will not invest in this atmosphere and households are still a cautious about expanding spending
- The younger generation in a labor market bind that will have repercussions for years
- The decline in labor market participation and productivity are troublesome for future potential growth

The Opportunities

- Expansion will be easy given the availability of labor and capital with minimal effect on prices
- Entrepreneurship is key but can government will get out of the way
- We can get our fiscal house in order if only Congress and the President would take on the hard decisions (Illinois, are you listening?)

Let’s now shift to the immediate term

- What issues override all others at this point: The Fed, the World Economy, and the election
- The World: As goes China so goes the US? No, but; and don’t forget oil….
- The election: what of immigration, trade, regulation and price setting?

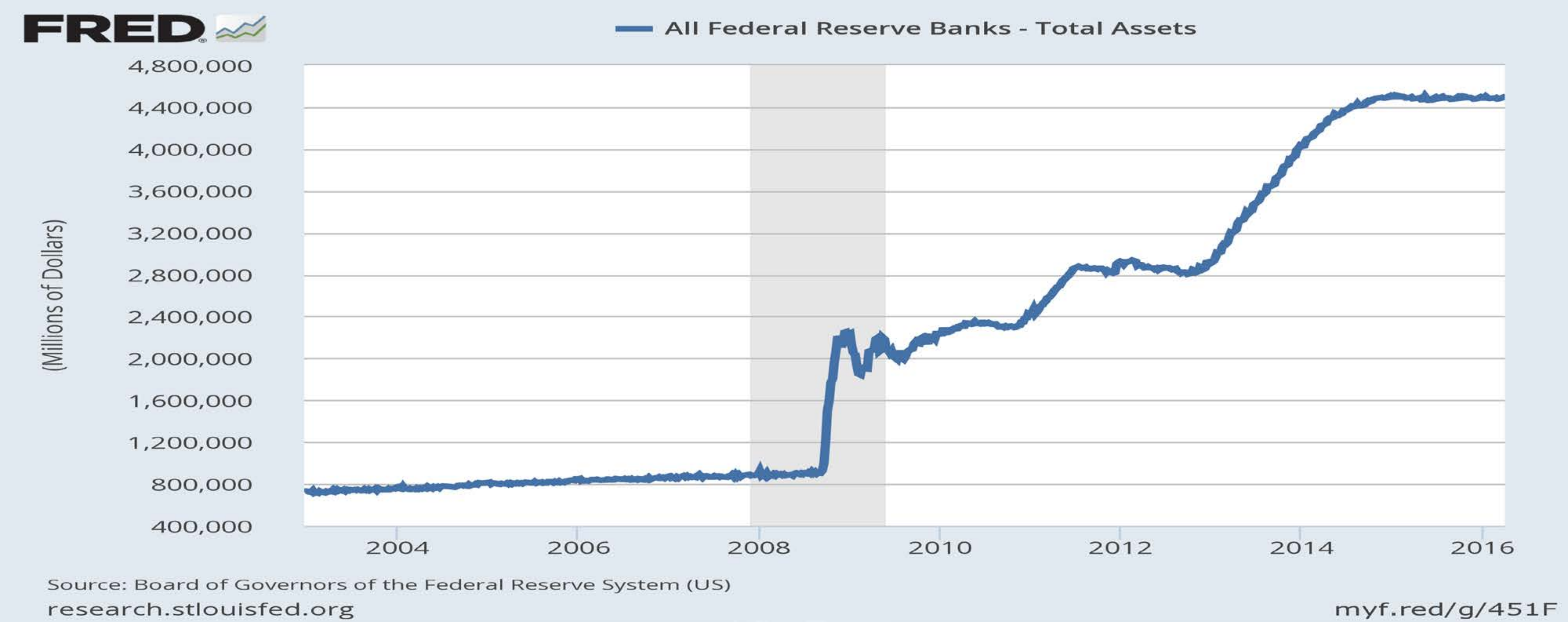
The Fed in uncharted territory: How it got here

- The Great Recession prompted the Fed to focus solely on growth and employment since inflation and inflationary expectations were, and continue to be, tame
- First action was to lower short term rates via the Fed Funds market, then intervene in the commercial paper market and eventually the bond market

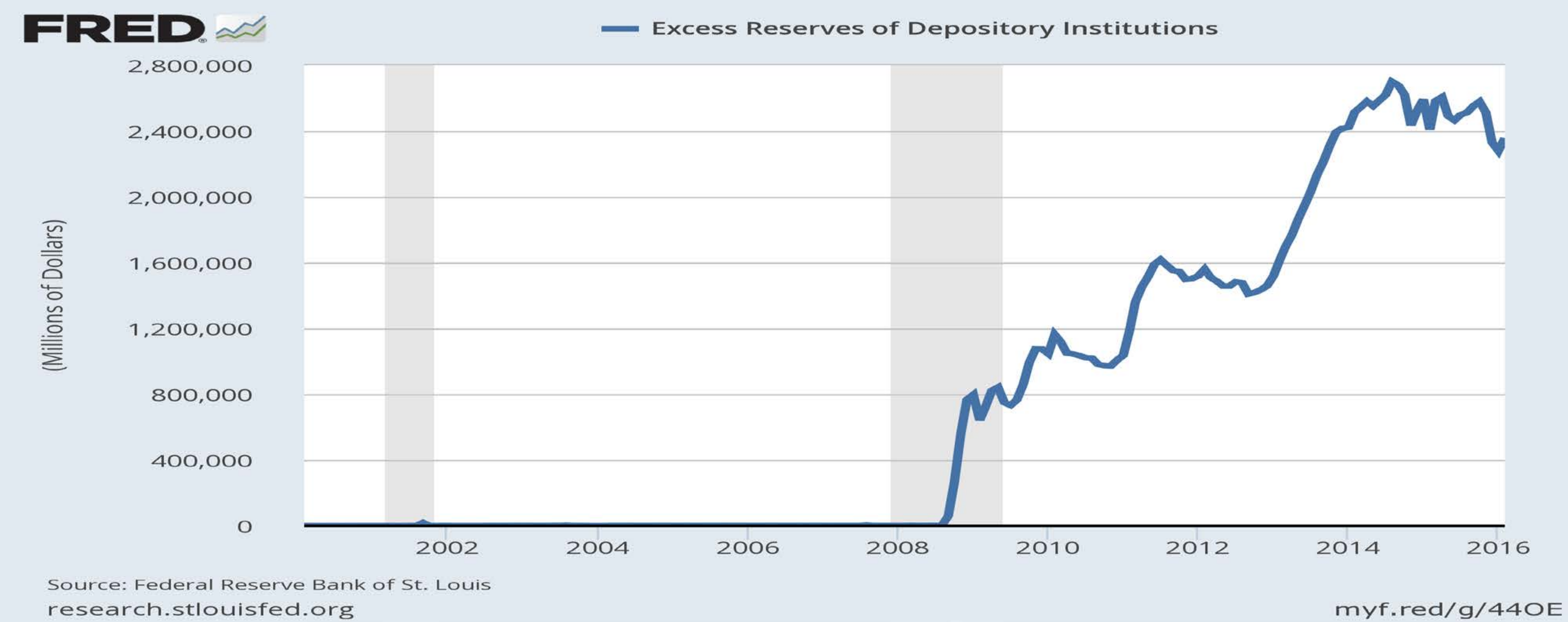
How does the Fed unwind its position?

- Interest rates hit the zero-lower-bound and are now rising (unlike some in Europe where there negative rates!)
- Fed used Quantitative Easing to pump up liquidity
- The banks refused to lend and households decided to mend their balance sheets by paying down debt (a good thing in the long run, bad in the short run)

QE in one graph: a $3.5 trillion gamble



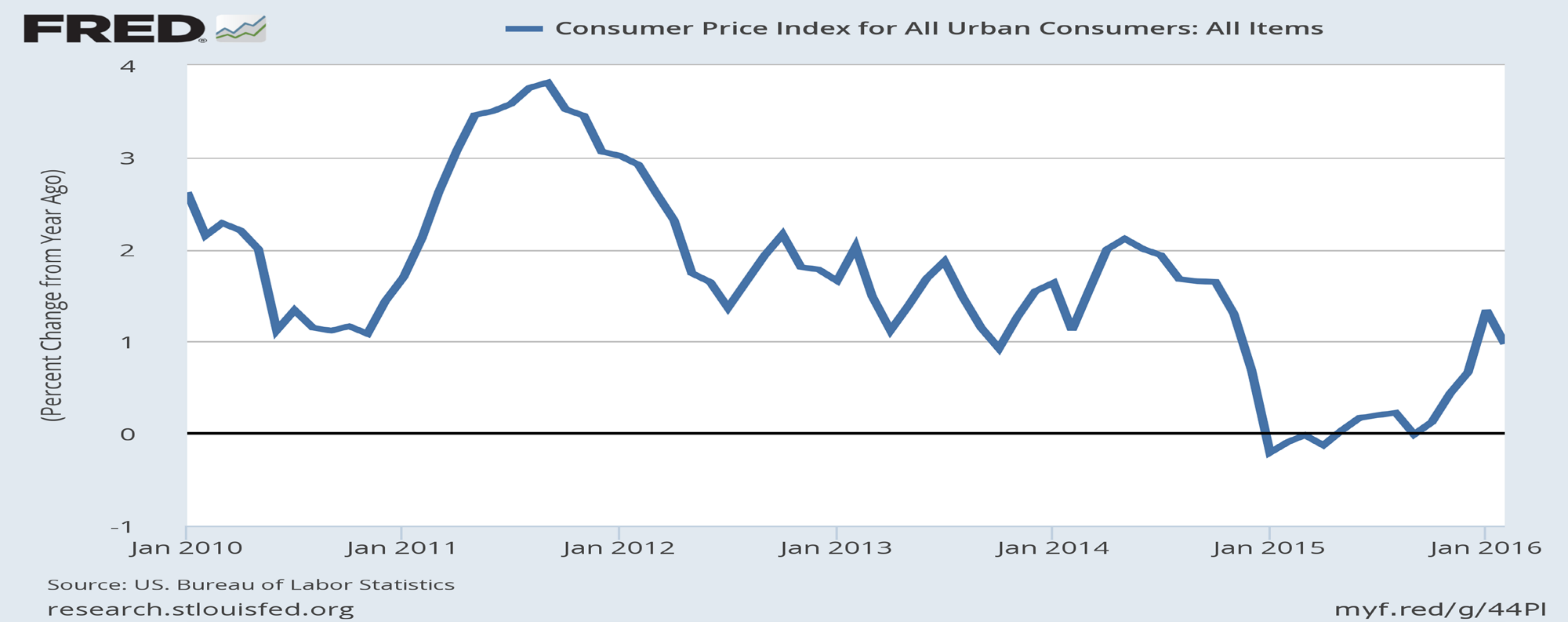
Where has all the money gone?



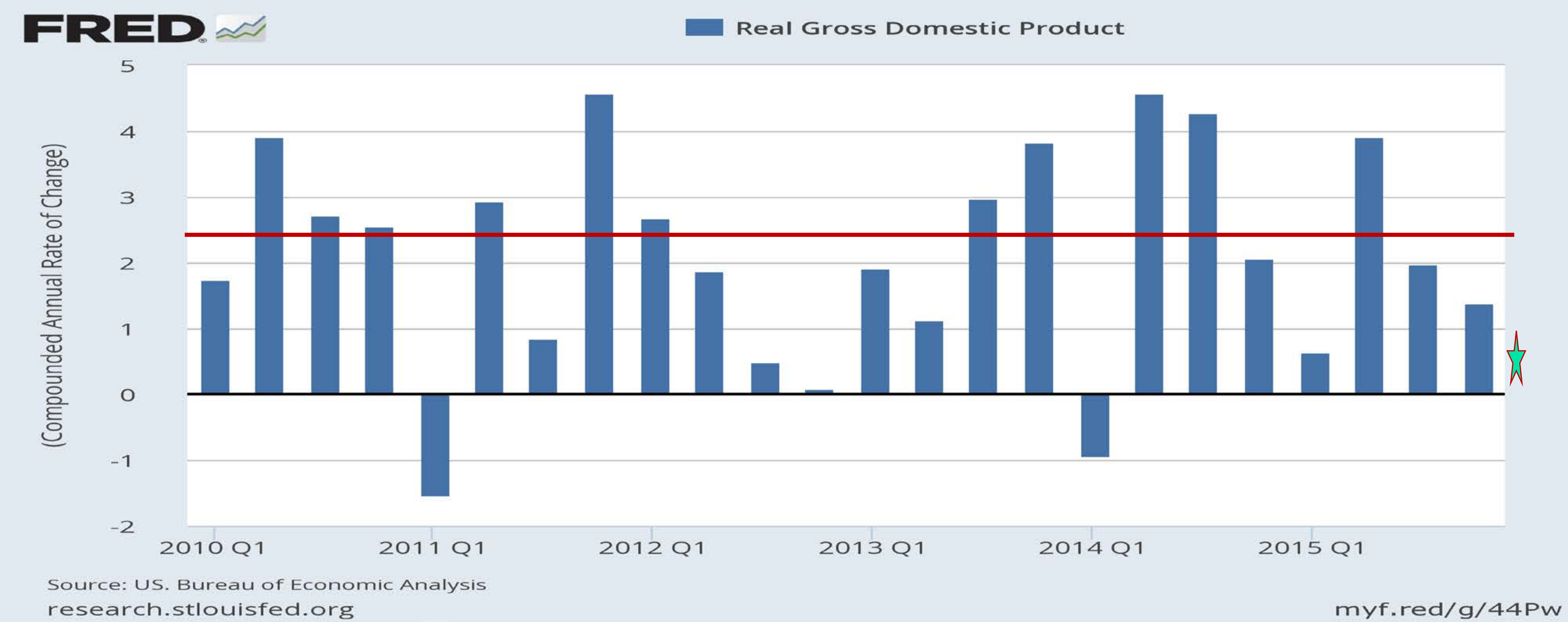
So, what's next?

- The Fed needs to decide what to do with all these assets while also deciding whether or not to raise interest rates further and when
- There will be winners and losers, so what to do and when?
- What or who should matter? Would a small rise in rates have any effect at all?

Inflation appears to be a non-issue



But Growth is still an (the?) issue



What might happen?

- Must consider effect on confidence, growth, employment, the dollar, trade and savers
- Rise in rates could strengthen already strong dollar, reducing exports
- Will housing, which is still not back from the shock, be affected?
- What if growth stalls – will credibility of the Fed be affected?

Just for those who have faith in forecasts

Variable	Median[1]				Central tendency[2]				Range[3]			
	2016	2017	2018	Longer run	2016	2017	2018	Longer run	2016	2017	2018	Longer run
Change in real GDP	2.2	2.1	2.0	2.0	2.1 - 2.3	2.0 - 2.3	1.8 - 2.1	1.8 - 2.1	1.9 - 2.5	1.7 - 2.3	1.8 - 2.3	1.8 - 2.4
December projection	2.4	2.2	2.0	2.0	2.3 - 2.5	2.0 - 2.3	1.8 - 2.2	1.8 - 2.2	2.0 - 2.7	1.8 - 2.5	1.7 - 2.4	1.8 - 2.3
Unemployment rate	4.7	4.6	4.5	4.8	4.6 - 4.8	4.5 - 4.7	4.5 - 5.0	4.7 - 5.0	4.5 - 4.9	4.3 - 4.9	4.3 - 5.0	4.7 - 5.8
December projection	4.7	4.7	4.7	4.9	4.6 - 4.8	4.6 - 4.8	4.6 - 5.0	4.8 - 5.0	4.3 - 4.9	4.5 - 5.0	4.5 - 5.3	4.7 - 5.8
PCE inflation	1.2	1.9	2.0	2.0	1.0 - 1.6	1.7 - 2.0	1.9 - 2.0	2.0	1.0 - 1.6	1.6 - 2.0	1.8 - 2.0	2.0

Contact and Source Information

- mmiller@depaul.edu
- FRED: https://research.stlouisfed.org/fred2/
- Federal Reserve: www.federalreserve.gov