



The Global Economy: Gaining Some Momentum

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The Global Outlook: Gradual Improvement



Real GDP Growth (Y/Y)	2016	2017	2018
Global Output Growth (PPP weights)	3.0	3.5	3.7
US: a bump in growth	1.6	2.2	2.2
Euro Area: modest improvement	1.7	1.8	1.8
Japan: more of the same	1.0	1.3	1.0
UK: slower growth ahead	1.8	1.7	1.3
China: gradual slowdown still most likely	6.7	6.5	6.2
India: expansion on track	7.4	7.3	7.6
Russia: modest upturn	-0.5	1.2	1.3
Brazil: bottoming out at best	-3.6	0.1	1.4

Source: Consensus Forecasts for 2016, PIIE for 2017-2018. Annual average over annual average.

Whoops!

US Election Probabilities: Divided Government Most Likely



	Presidential		Senate		House	
PredictWise	73%	Dem	57%	Dem	89%	Rep
Princeton Election Consortium	84%	Dem	56%	Dem		
538	58%	Dem	56%	Dem		
New York Times Upshot	70%	Dem	62%	Rep		

Source: <http://predictwise.com/politics/>, <http://election.princeton.edu/category/2016-election/>,
<http://fivethirtyeight.com/politics/elections/>, <http://www.nytimes.com/section/upshot>.

Note: As of 4:00 pm EST 9/28/2016.

Source: D. Stockton, PIIE GEP Fall 2016, September 29, 2016.

But PIIIE was not asleep on the job.



Why not assume this outcome?

- Coattails are longest when POTUS election is uncertain (high turnout/low strategic voting) but clear victory margin
- Correlation between Senate/House and Presidential races has gone up
 - Polarization increases the correlation
 - There's no meaningful 3rd option for Congress
- Polling data on Trump support unreliable
 - White non-urban women are (the only?) swing voters; millennial turnout is the other variable

What's Changed in Markets?



	28-Sep	7-Apr	Change	Change since election
Ten-year Treasury Yield	1.57%	2.38%	81bp	55bp
Baa Corporate Bond Yield	4.26%	4.62%	36bp	13bp
USD broad trade-weighted value	122.0	124.6	2.1%	1.3%
Wilshire 5000 Stock Price Index	98	108	9.8%	12.1%
House Prices, Case-Shiller	189.1	195.5	3.4%	2.7%
Brent Crude Oil	\$45.49	\$52.04	\$6.55	\$9.21

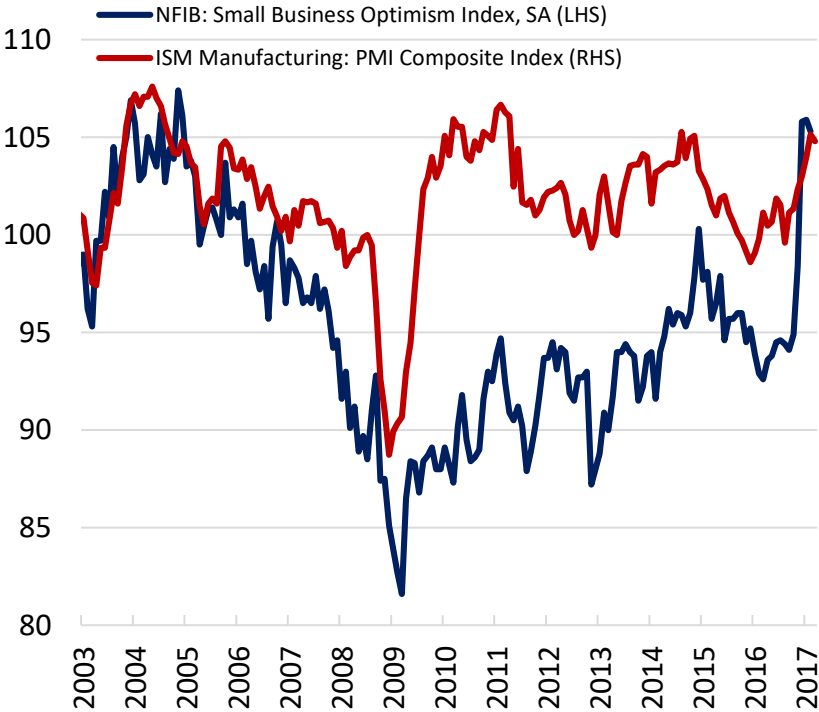
Note: The Case-Shiller index is taken as of the end of September for column 2, the end of March for column 3, and the difference between the end-of-March and end-of-October values for column 4.

Source: FRED.

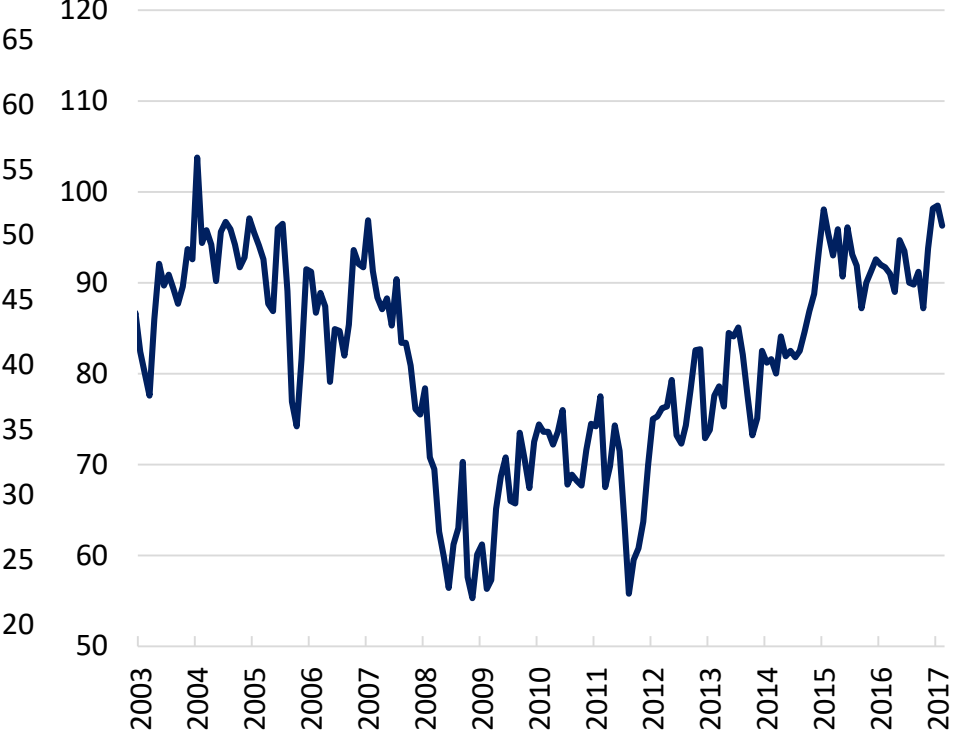
What's Changed Elsewhere: Improving Confidence



Business Confidence



University of Michigan Consumer Sentiment



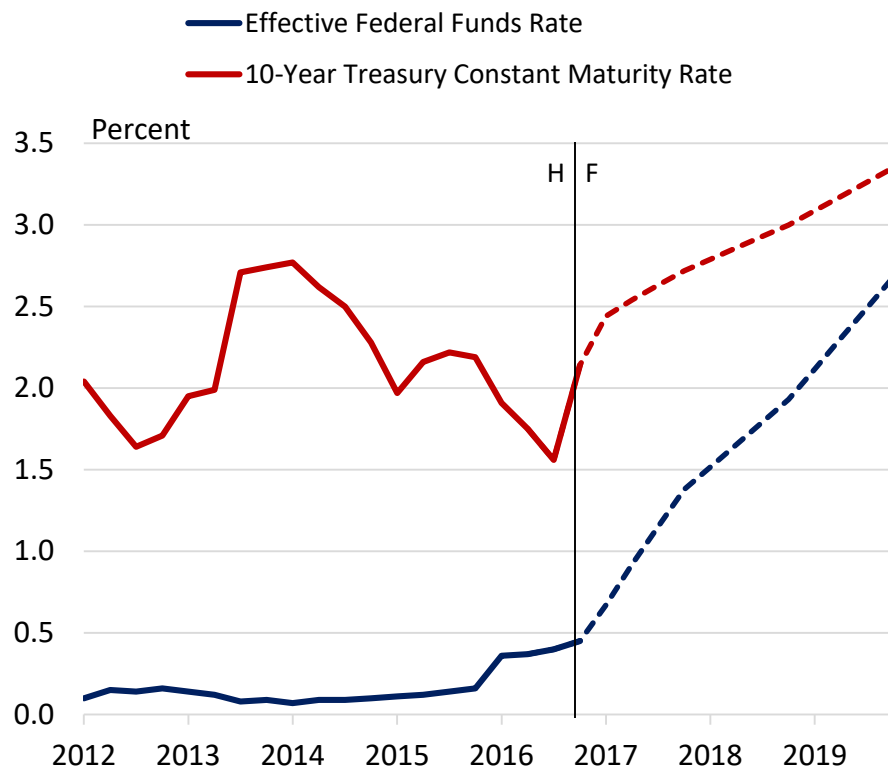
Source: Institute for Supply Management, National Federation of Independent Business, and University of Michigan via Haver Analytics.

Fiscal Policy: Some Stimulus is Coming



- Tax cuts (not reform):
 - Corporate rate reduction: \$100 billion per year
 - Personal tax cuts: \$20 billion per year
- Spending:
 - Defense increase: \$30 billion per year
 - Nondefense increase: \$10 billion per year
 - Infrastructure investment: \$20 billion per year
- Deficit-increasing actions of \$180 billion per year – about 1 percent of GDP, phasing in 2018-2019.

Monetary Policy is Beginning to Tighten – Gradually

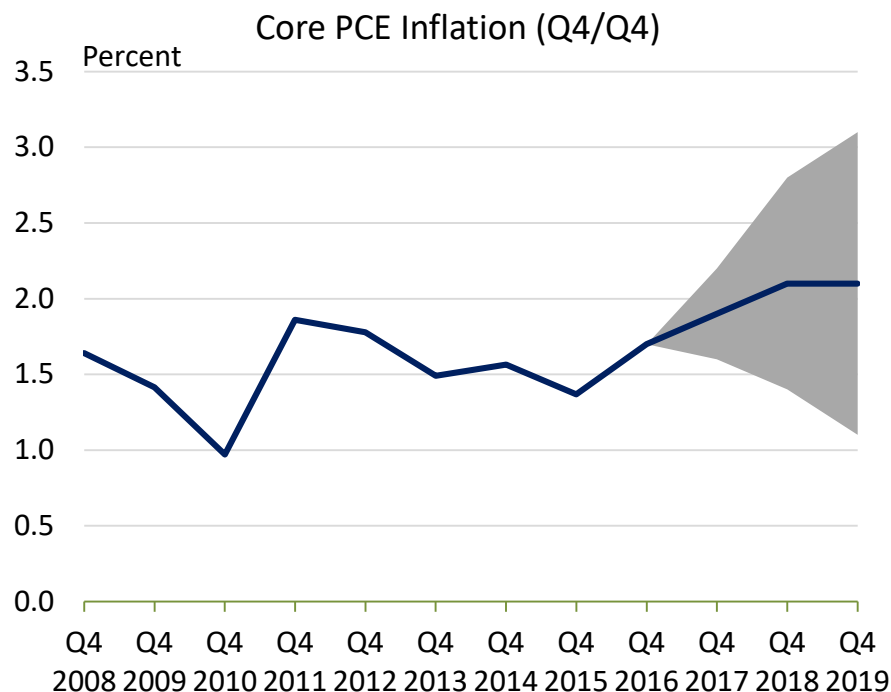
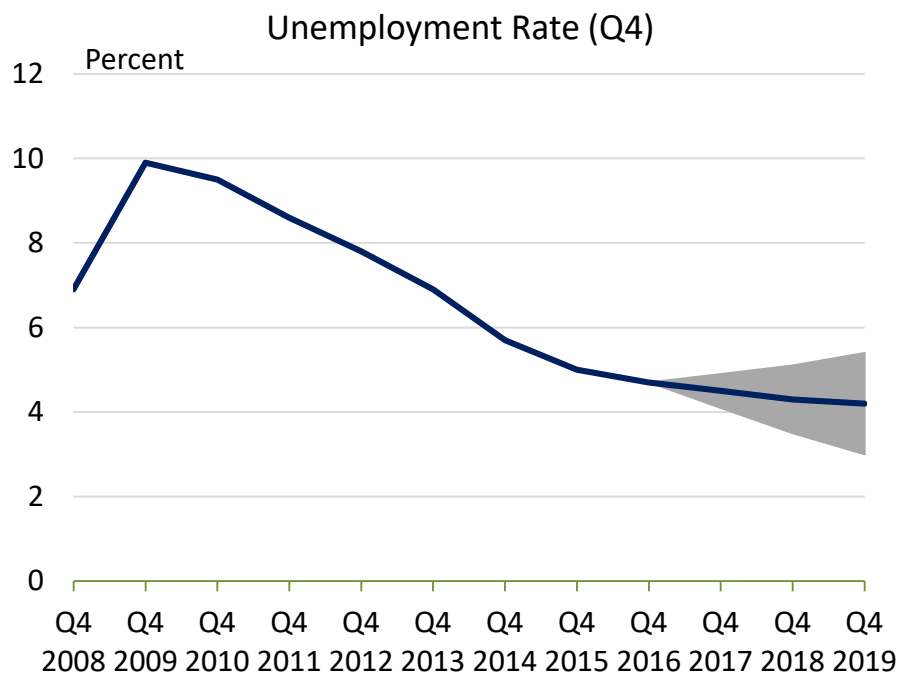


Balance Sheet Adjustment to Begin

- Fed announcement this summer or fall.
- Reinvestments taper back late this year.
- “Substitutes” for a December rate hike.
- Barring surprises, on auto pilot.
- The balance sheet will be permanently larger.

Source: Federal Reserve, Author / LH Meyer.

The US Outlook: An Overshoot Is Now Likely



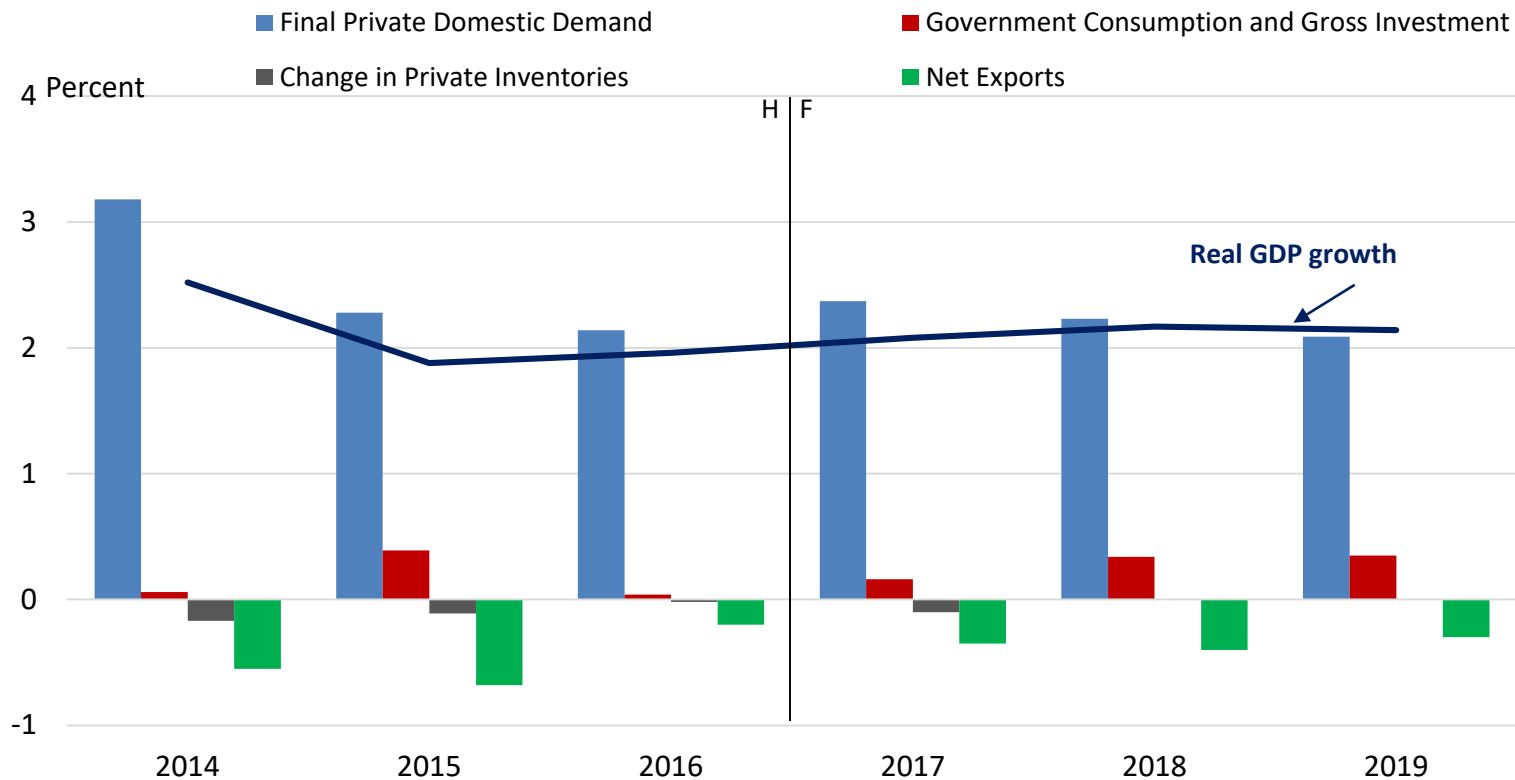
Forecast	2015	2016	2017	2018	2019
Real GDP Growth (Q4/Q4)	1.9	1.9	2.1	2.2	2.1
Unemployment (Q4)	5.0	4.7	4.5	4.3	4.2
PCE Price Inflation (Q4/Q4)	0.4	1.4	1.9	2.1	2.1
Core PCE Price Inflation (Q4/Q4)	1.4	1.7	1.9	2.1	2.1

Note: Gray-shaded areas represent 70% confidence bands.

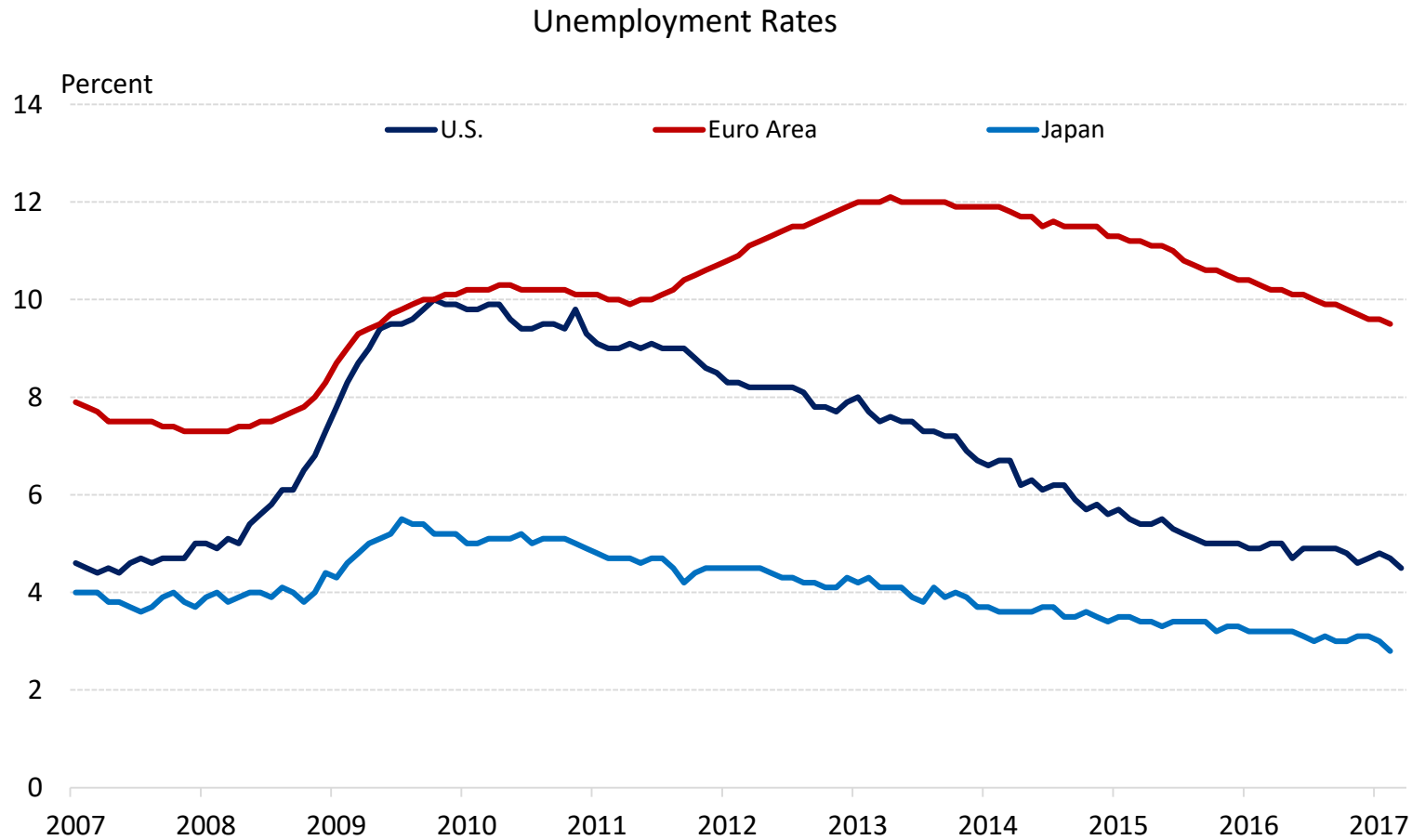
The Overshoot Could Have Been Larger: Strong Domestic Demand but Weak Net Exports



Contributions to Q4/Q4 Growth of Real GDP



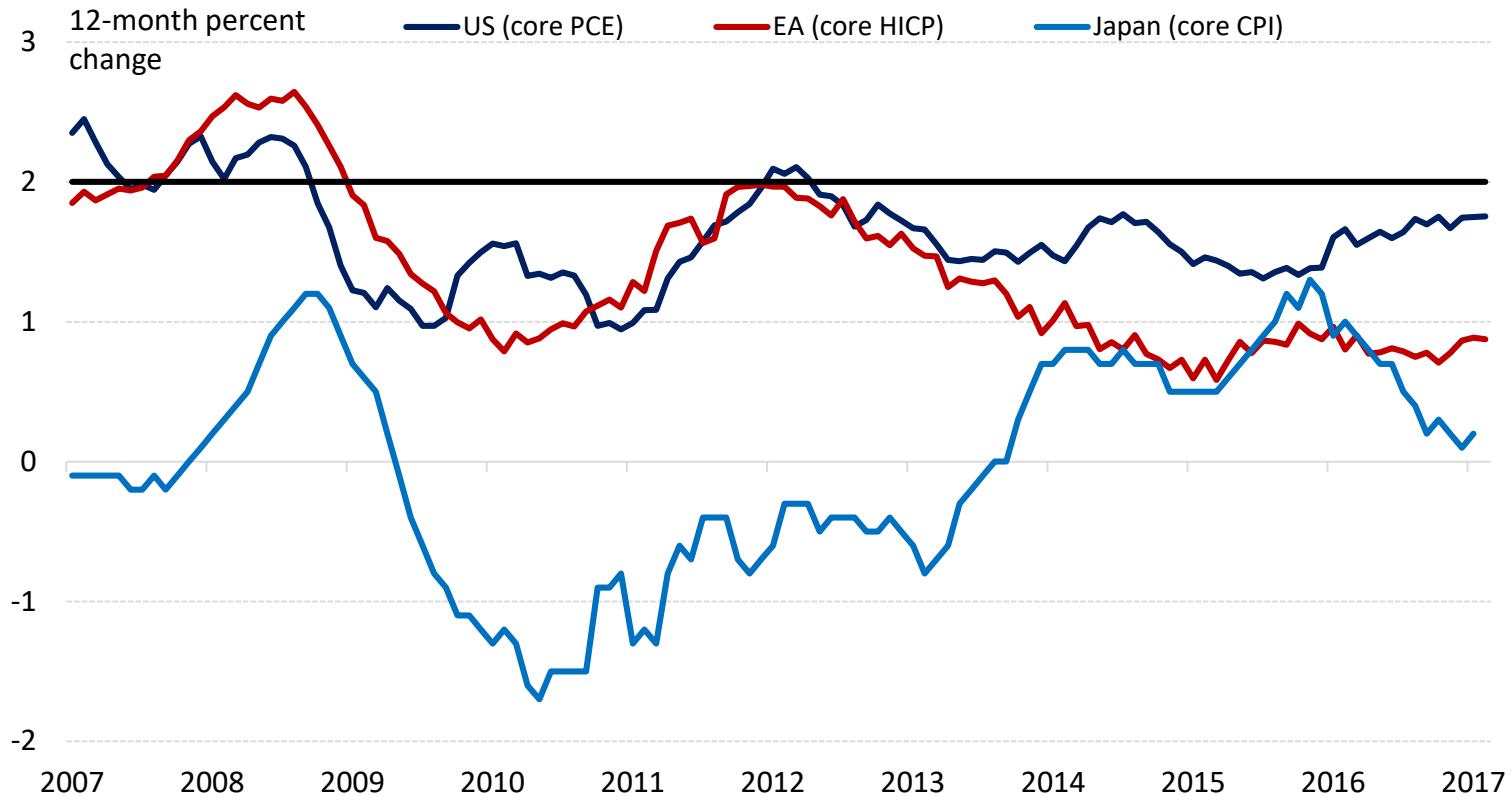
Global Divergence is Still in Play: Unemployment



Global Divergence is Still in Play: Inflation



Core Consumer Price Inflation



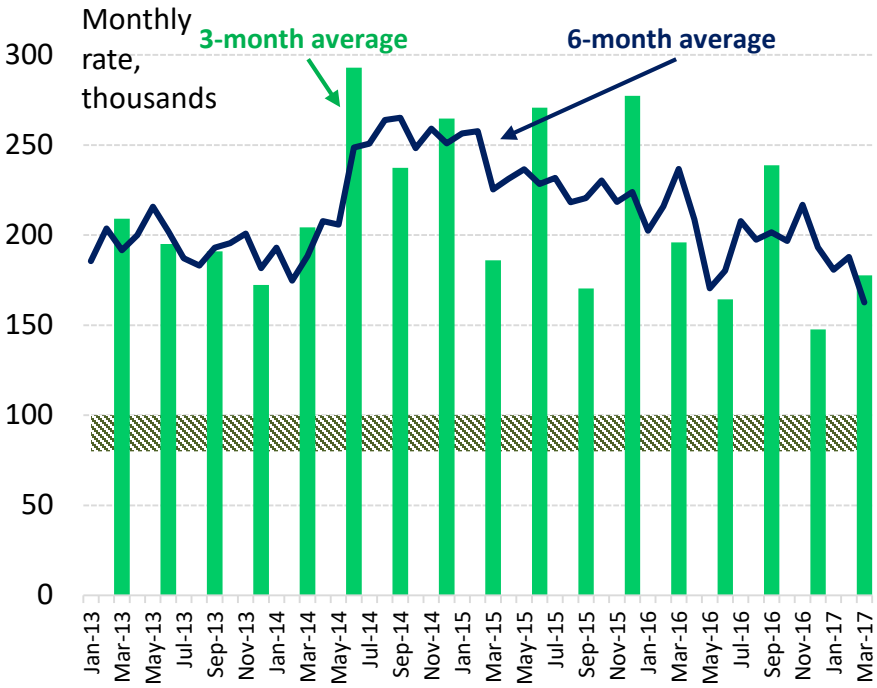
Note: The core CPI measure for Japan excludes the impact of fresh food and energy prices. It is estimated by the Bank of Japan and is not an official statistic.

Source: BEA via FRED, Eurostat via Haver Analytics, Bank of Japan.

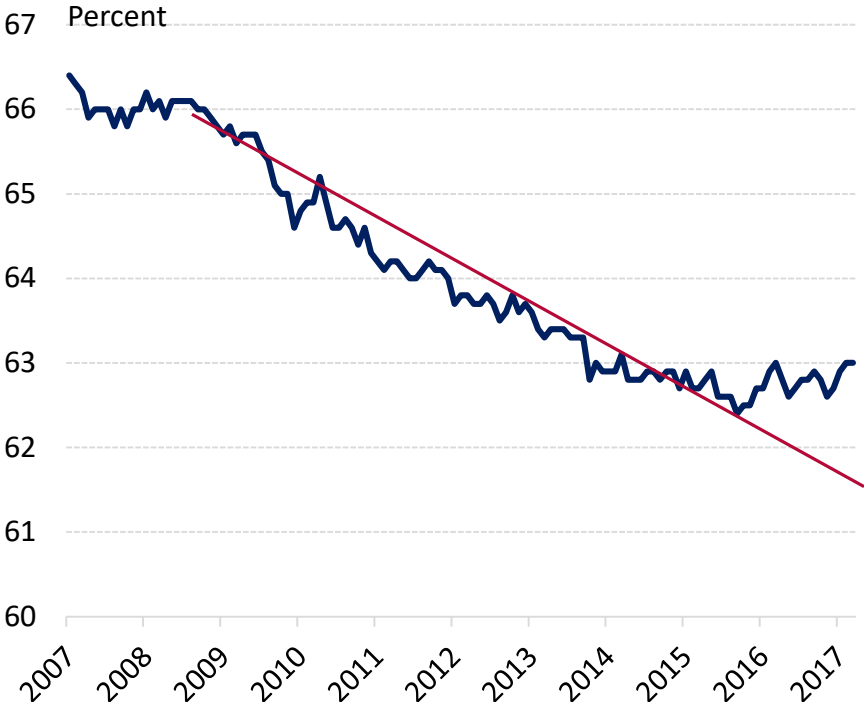
Solid Gains in Payrolls and Firmer Participation



Change in Nonfarm Payrolls



Labor Force Participation:
A Pause in the Downtrend Limits Overshoot



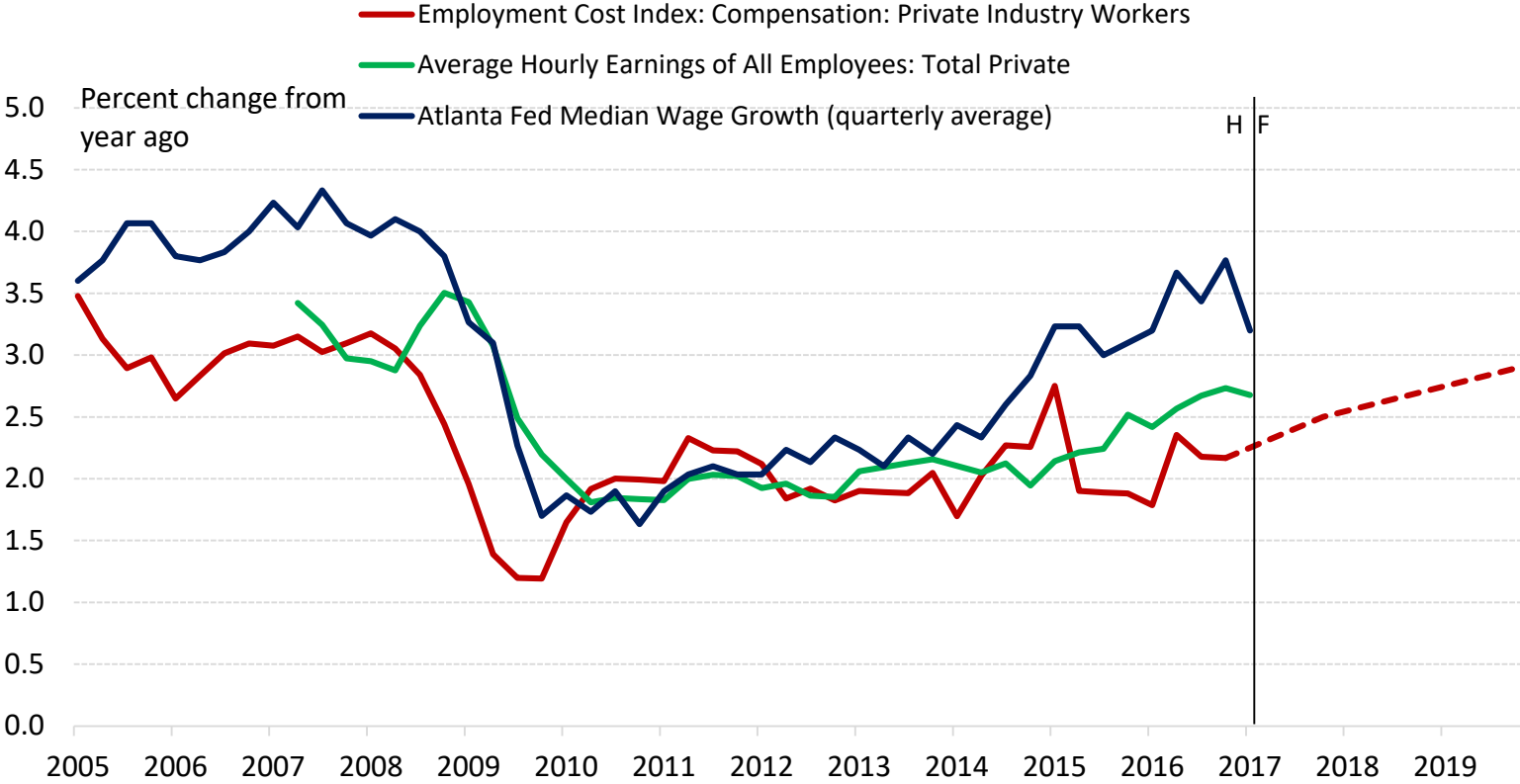
Note: Shaded area is range of payroll gains consistent with growth of the labor force.

Source: BLS via FRED.

Wage Inflation: Some Modest Firming



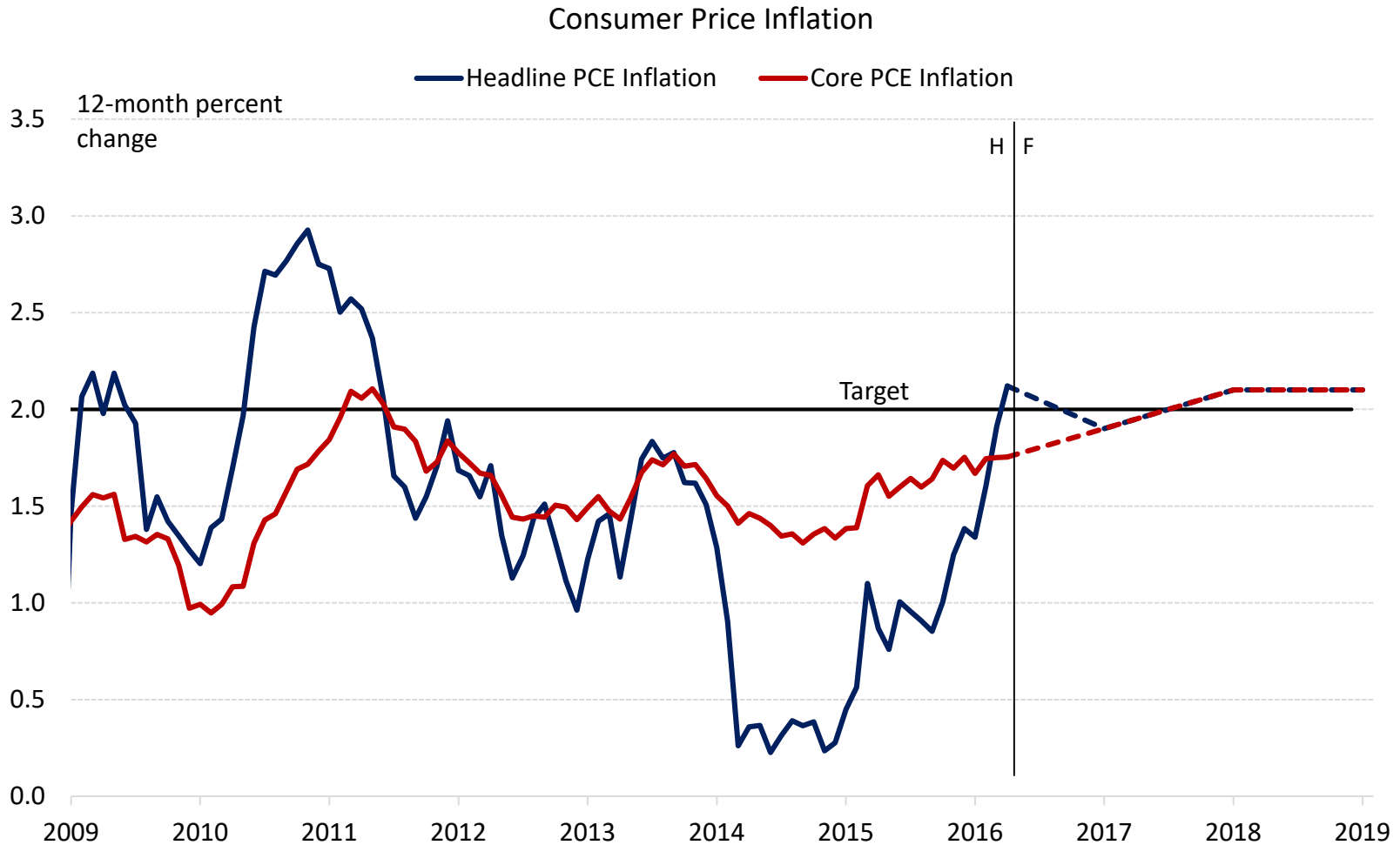
Labor Compensation



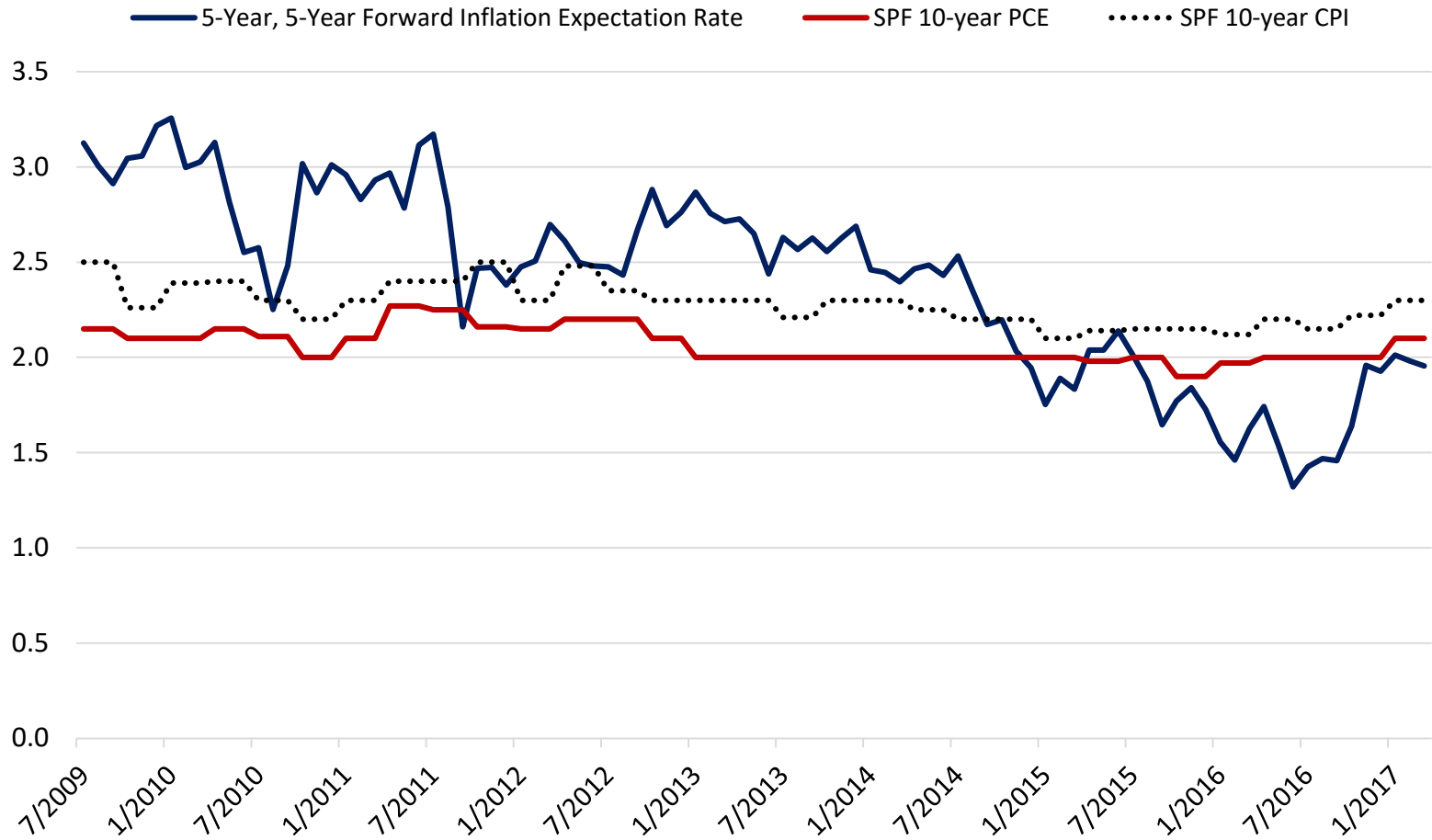
Note: Atlanta Fed indicator for Q1 2017 was calculated as the average of January and February 2017.

Source: BLS via FRED, Atlanta Fed, Author / LH Meyer.

So Price Inflation Overshoots Target – But Just a Bit



Watch Inflation Expectations: Anchored for Now



Risks to the Outlook



- A growing perception of governmental incompetence
 - Government shutdown in face of stalemate
 - Flirting with debt default
 - Could lead to a quick reversal of improvements in financial markets and confidence
- Fed uncertainties
 - Appointments, inflation commitment
 - Could lead to a spike in interest rates
- A notable upside: Synchronized upturn in global activity, trade, and inflation.