# Fiscal Cliff-hanger: The US Economic Outlook, Part I

*David J. Stockton predicts more anemic economic growth over the next year and a half but a bright spot in housing.*



Steve Weisman: Following the re-election of President Obama and the return to Capitol Hill of a Democratic Senate and a Republican House of Representatives, the economic outlook in the United States is looking as cloudy as ever. This is Steve Weisman at the Peterson Institute for International Economics, with our new senior fellow, David Stockton, who's joining the institute at the beginning of the year of 2013, to talk about his discussion of the economic outlook in the United States. Welcome, David.

David Stockton: Thank you, Steve, happy to be here.

Steve Weisman: First perhaps, just to repeat your presentation today, overall what is the economic outlook for the United States in the next year or two after struggling to get out of the great recession? And second, what kind of shadow is cast over it by the fiscal cliff -- the expiration of tax cuts and the implementation of budget cuts at the beginning of the new year.

David Stockton: I think the outlook for the economy over the next 12 to 18 months continues to be one of a very grindingly slow recovery from the financial crisis. I think one can look for 2013, in essence, to look and feel a lot like the last couple of years have, with growth running somewhere in the 2 percent range, continued payroll employment gains, maybe a small down drift in the unemployment rate, but still nothing that feels like a normal robust type recovery.

As far as the fiscal cliff, I think it's casting a rather considerable shadow on the economy right now and probably will continue to do so, at least for the first half of 2013. There are many difficult decisions that have to be taken, both those that will be taken hopefully to avoid the fiscal cliff, but if we go over the fiscal cliff, many decisions will need to be taken about how we actually claw our way back from that. So I think there will be households and businesses facing a lot of uncertainty about the fiscal policy outlook for at least another six months.

Steve Weisman: Let me ask you about that uncertainty. A lot of people say businesses are holding back in hiring and in making investment decisions simply because of the concern over the fiscal cliff. Are you one of those who think that that's been a big factor in suppressing the growth up until now?

David Stockton: I don't think it's been a big factor, but clearly it has had an effect, especially on business investment, where we've seen a weakening in recent months and especially in orders for new capital equipment. I think that is likely to continue, at least for a time, as businesses really want to better understand whether or not policymakers will take us over the fiscal cliff, in which case the outlook for the economy would be seriously impaired, especially if we did not see signs that the body politic was immediately working towards moving to a solution that would provide longer term fiscal sustainability.

Steve Weisman: I'm going to ask you about housing and other signs of hope in the economy and then we'll go to the fiscal cliff in Part II of this interview. You did mention in your presentation that housing is one of the brighter signs.

David Stockton: I think perhaps the most encouraging development that has occurred in the housing sector, we're seeing some really widespread evidence—both widespread by different measures and widespread by geography—that house prices are beginning to firm. I think firmer house prices are going to have a number of beneficial effects on the economy. One, I think it will take some people who've been on the sidelines of the housing market and put them in with the realization that perhaps their fears of the house price declines are now abating. I think it's going to boost the net worth of many households and engender their ability to consume. I think some homes whose mortgages had been under water will no longer be so, allowing those households to refinance mortgages. I think in general, it probably will provide some overall bolstering of the financial condition of many of our financial institutions and probably increase their ability and wherewithal to increase funding.

Steve Weisman: Before we leave the subject, I want to ask you about the interesting downside that you cited, which is the result of the long-term unemployment, people being out of the labor market for so long. and the prospects for—even if unemployment goes down—lower earnings.

David Stockton: I think many people have been concerned that this very long period of prolonged high unemployment might lead the United States over the long run to look like Europe did, where in the 1990's high unemployment rates begat higher structural unemployment, meaning persistently higher unemployment rates. I don't think that's going to be the case in the United States, in part because we simply don't have a generous safety net to allow people to in fact be unemployed for long periods of time.

But I do think there is considerable evidence that periods or long spells of unemployment seriously damage people's earnings profiles. In some cases that's simply because they've had to move to jobs to which they are less well equipped and therefore are less productive. In other cases, long periods of high unemployment send messages or are perceived as messages by employers about the productivity of individuals and that feeds back negatively long-term onto their own earnings. And I think people that have been touched by long periods of high unemployment that have been so common in this period of great recession are likely to suffer the most in terms of long-term reduction in their earnings potential.

Steve Weisman: Let's end Part I there and go to Part II to talk about the fiscal cliff more specifically.