

The Outlook for the U.S. Economy: Struggling for Escape Velocity

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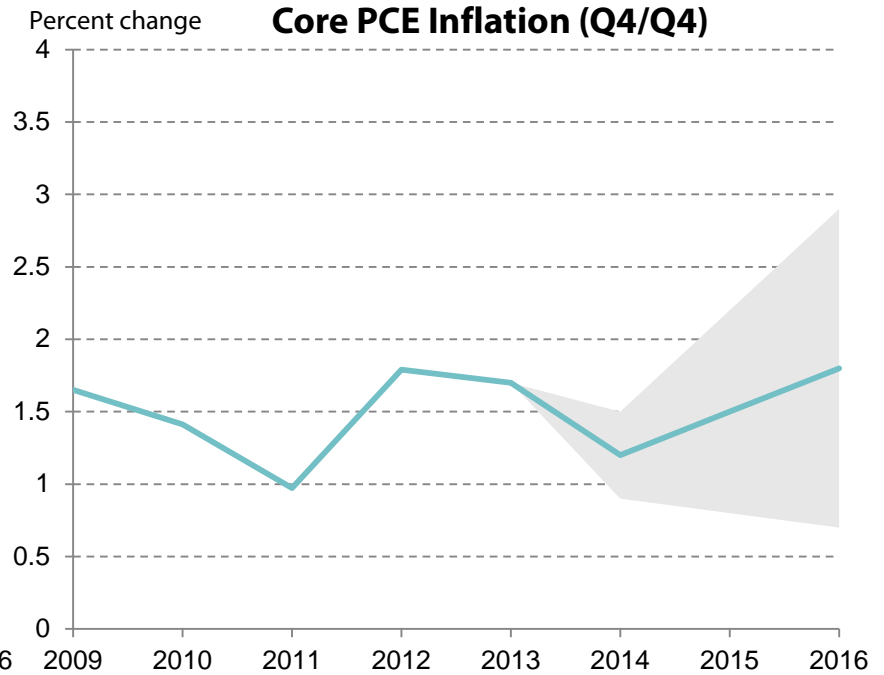
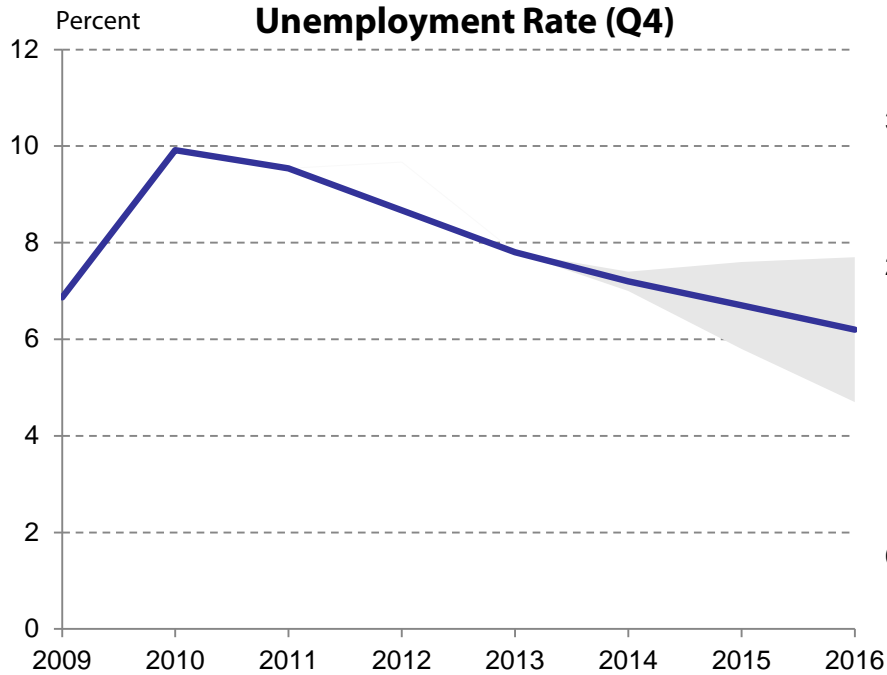
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October 1, 2013

Slower Growth and Lower Inflation



Forecast	2012	2013	2014	2015
Real GDP Growth (Q4/Q4) <i>(April Forecast)</i>	2.0	1.9 <i>(2.3)</i>	2.9 <i>(3.1)</i>	3.2 <i>(3.3)</i>
Unemployment (Q4)	7.8	7.2	6.7	6.2
PCE Price Inflation (Q4/Q4) <i>(April Forecast)</i>	1.7	1.2 <i>(1.6)</i>	1.4 <i>(1.7)</i>	1.7 <i>(1.8)</i>
Core PCE Price Inflation (Q4/Q4)	1.7	1.2	1.5	1.8

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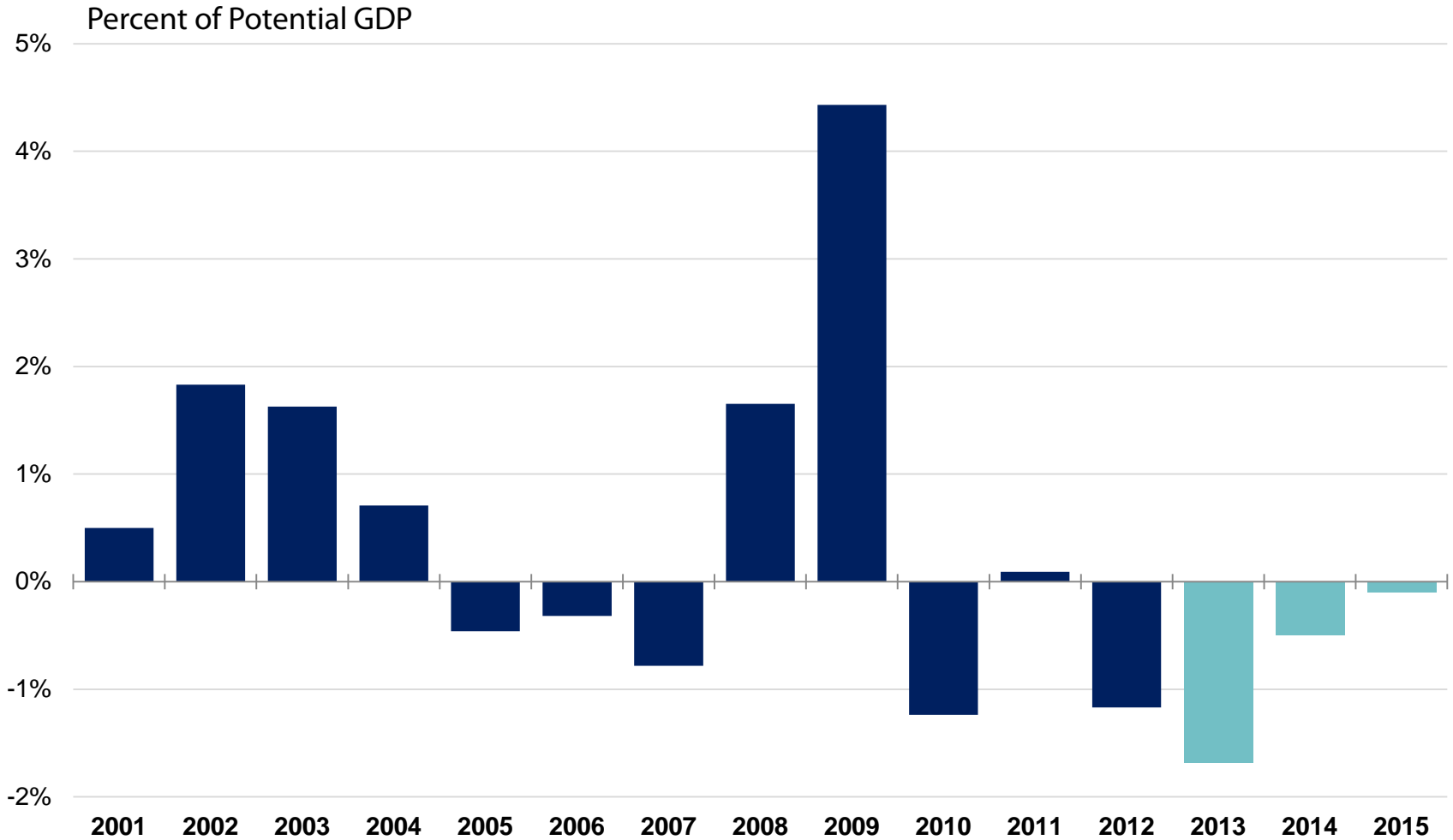
Note: Gray-shaded areas represent 70% confidence bands.

The Foreign Outlook

	Real GDP Growth (Y/Y)	2013	2014	2015
Euro Area: The recession is ending, but the recovery will be slow.		-0.2	1.0	1.4
UK: The expansion is gaining traction.		1.3	2.0	2.2
Japan: The first two arrows lift growth this year, with a minor hit from higher taxes next year.		2.0	1.5	1.9
China: Growth likely to continue, but downside risks are accumulating.		7.6	7.5	7.5
India: Like other vulnerable emerging economies, growth will be stuck on the slow track, with risks to the downside.		4.8	5.5	5.9

Bottom Line: Net exports will be neutral in this year but a modest drag in 2014 and 2015.

Fiscal Drag Beginning to Wane



Note: For 2001 to 2012, budget deficit without automatic stabilizers. Source: Congressional Budget Office. For 2013-2015, Author's estimate of fiscal drag.

Fiscal Dysfunction Remains

Government Shutdown

- Reduces Growth in 2013:Q4*
 - -0.3 percent for a 2-week shutdown
 - -0.5 percent for a 3-week shutdown
 - -0.7 percent for a 4-week shutdown
- Growth boosted by roughly same amount in 2014:Q1
- **A brief shutdown is disruptive, but not likely a systemic macro event**

The Debt Ceiling

- **A binding debt ceiling would impose immediate and substantial fiscal restraint**
- Financial volatility and heightened uncertainty
- Depressed household and business confidence
- **A major macro systemic event**

*Macroeconomic Advisers Estimate

Monetary Policy: Thanks (for Nothing)

Asset Purchases

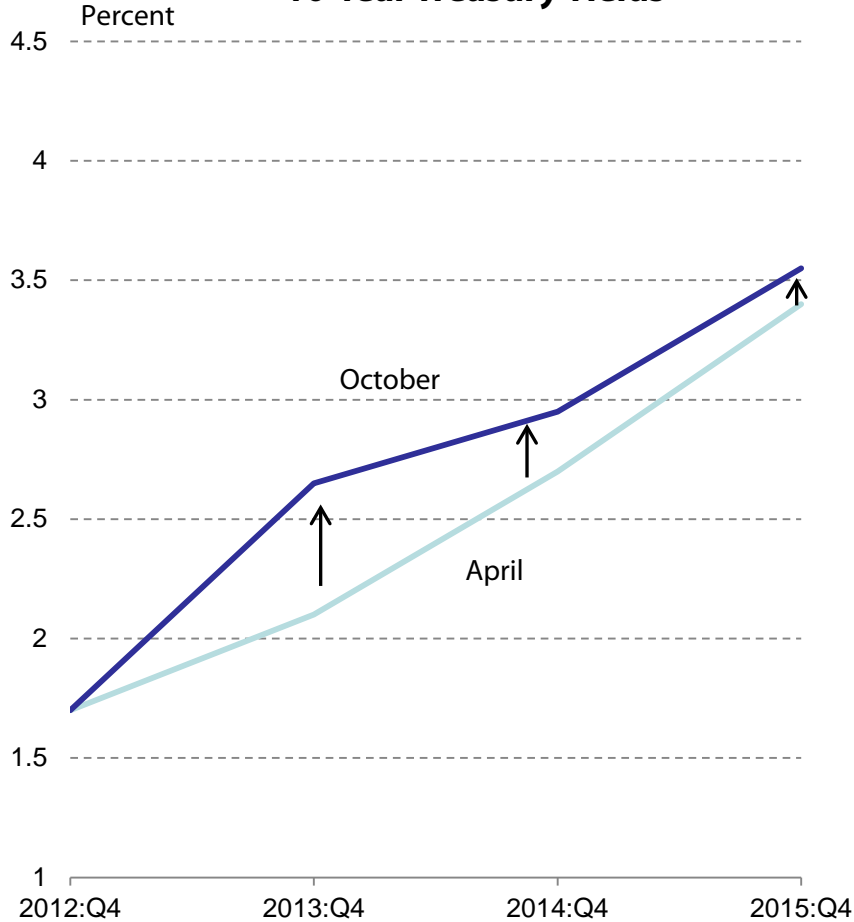
- Asset purchases will be scaled back gradually, with purchases ending shortly after mid 2014.
- **QE3 purchases will total about \$1.5 trillion.**
- Assets will not be sold, but will be allowed to gradually run off the Fed's balance sheet.

Federal Funds Rate

- FOMC thresholds for a rate hike:
 - Unemployment rate goes below 6.5 percent,
 - Inflation one to two years ahead is projected to exceed 2.5 percent.
- **In this forecast, unemployment crosses 6.5 percent in Spring 2015.**

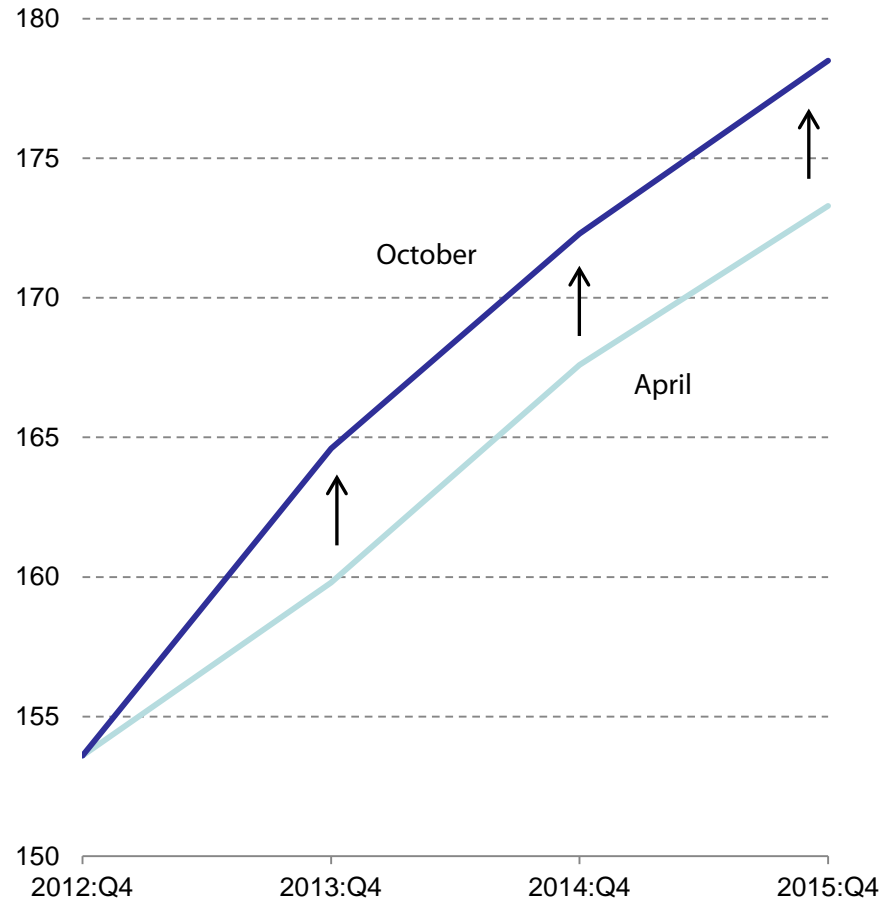
Financial Conditions – Tighter on Net

10-Year Treasury Yields



Higher interest rates

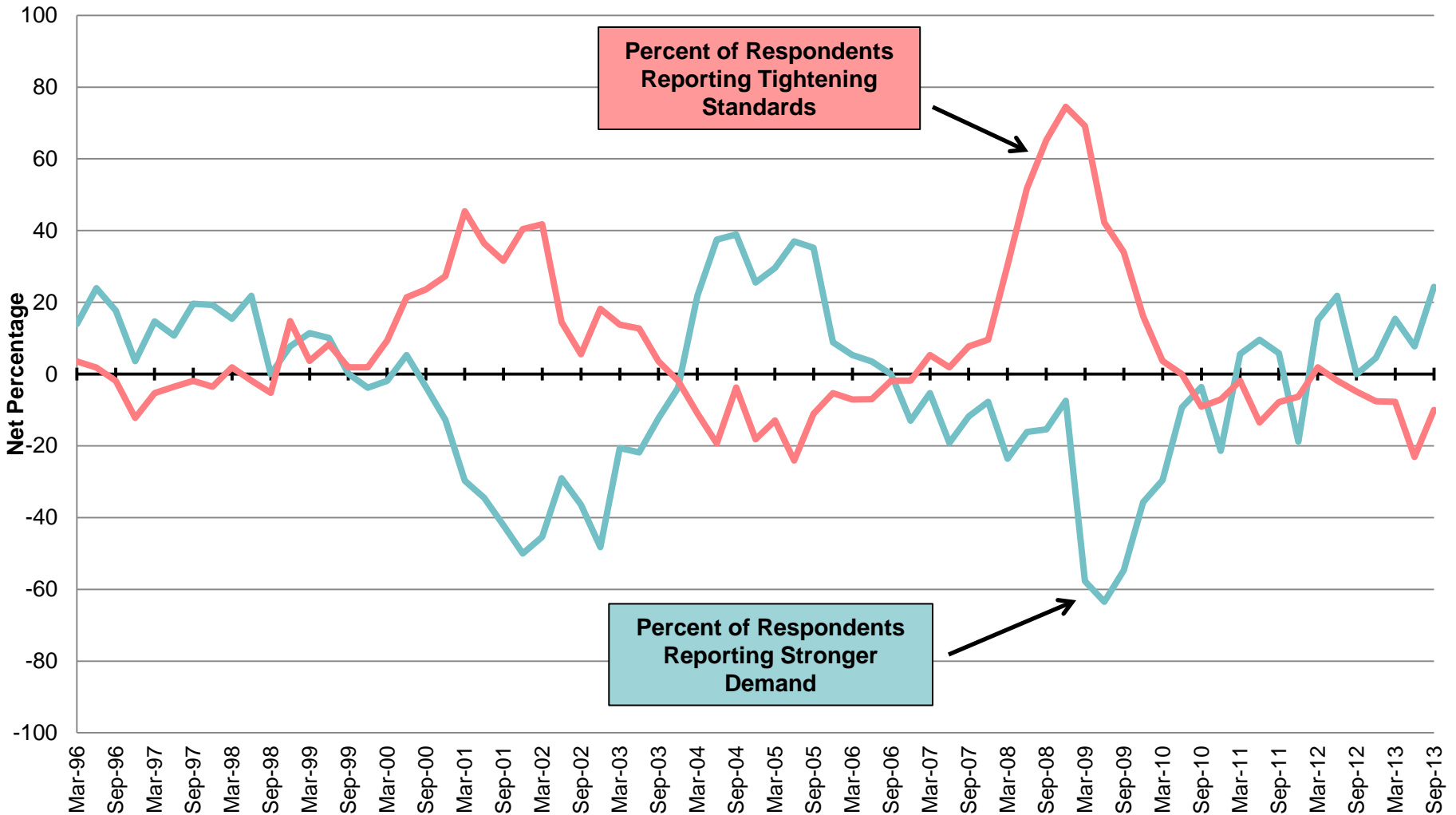
Core Logic Housing Price Index



Higher house prices

Credit: Easier Access and Stronger Demand

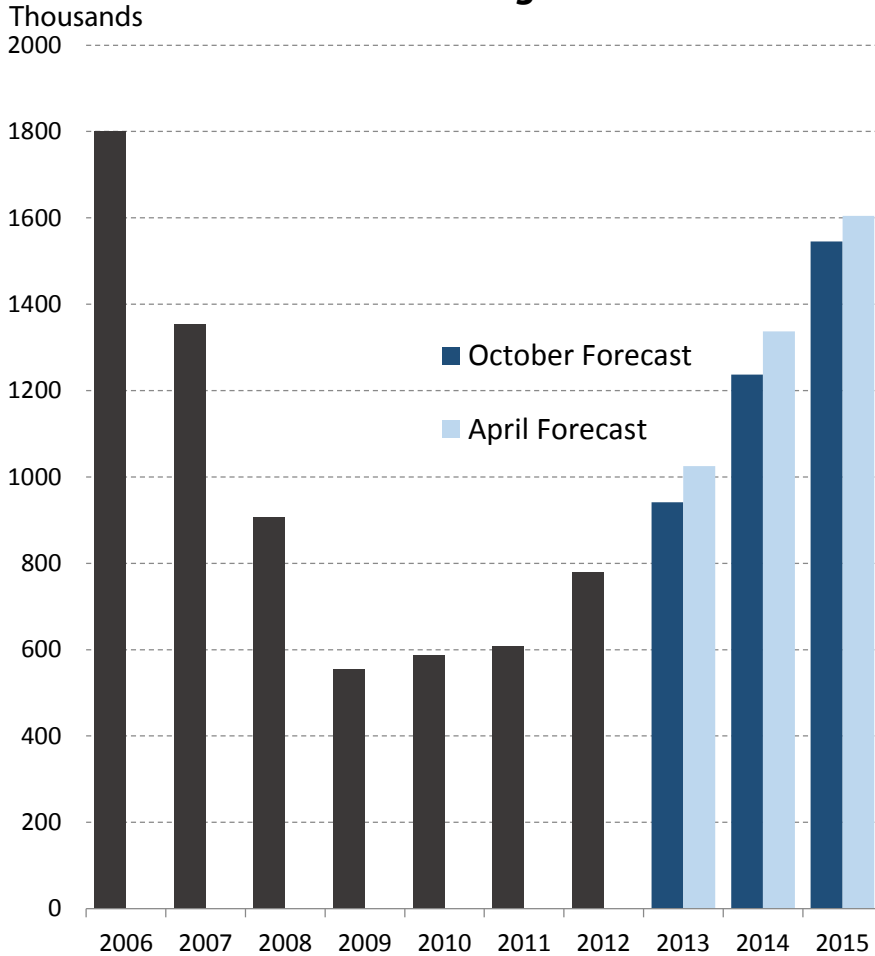
Commercial and Industrial Loans to Small Firms



Source: Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices

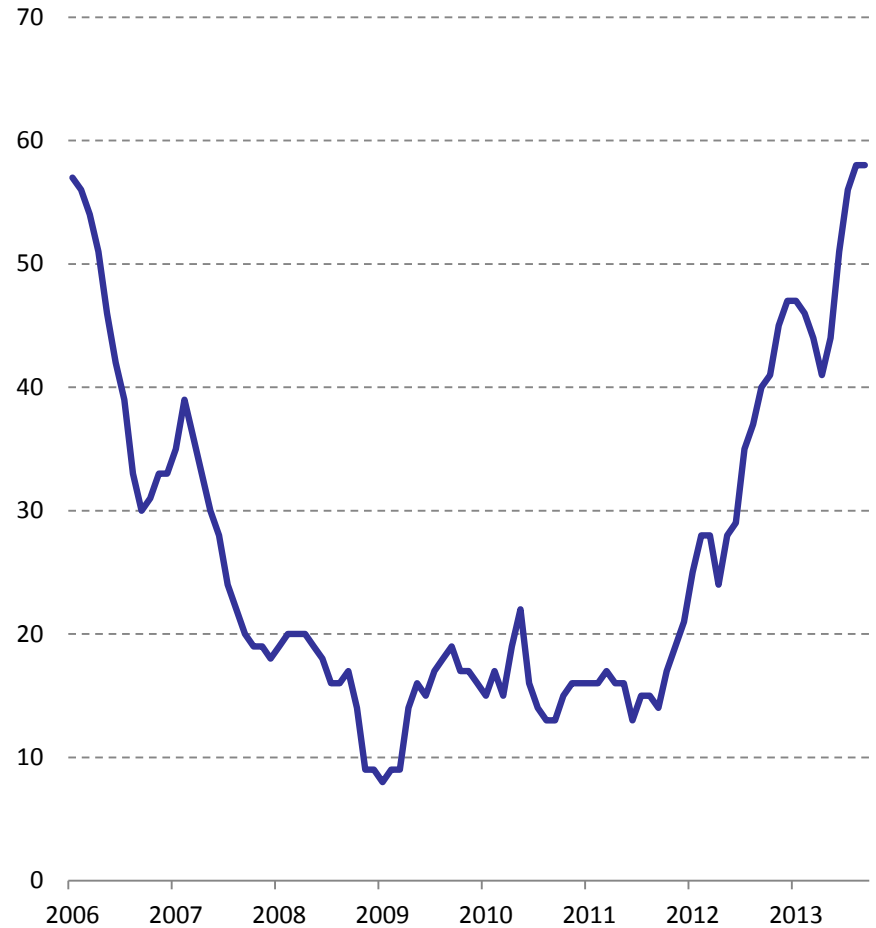
Housing Takes a Hit, but Recovery Intact

Annual Housing Starts



Sources: Housing Starts 2006-2012, U.S. Census Bureau. 2013-2015 Author's Estimate.

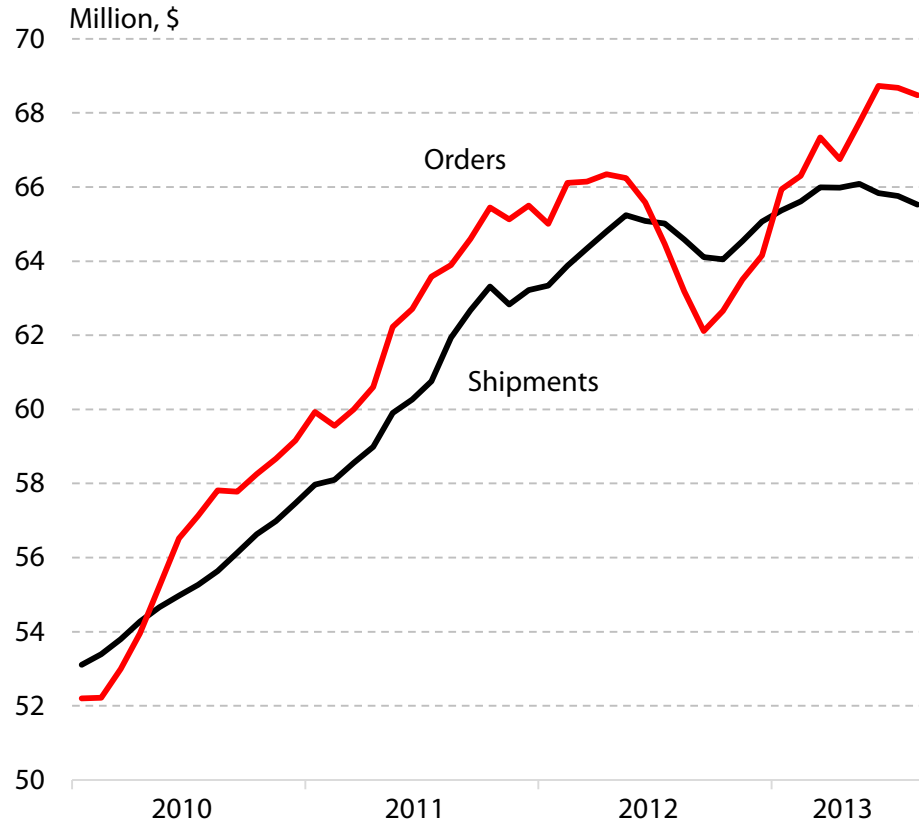
NAHB/Wells Fargo Housing Market Index



NAHB/Wells Fargo HMI is based on a survey of NAHB members' expectations of present sales, sales six months in the future, and traffic of prospective buyers for new homes.

Some Improvement in Business Conditions

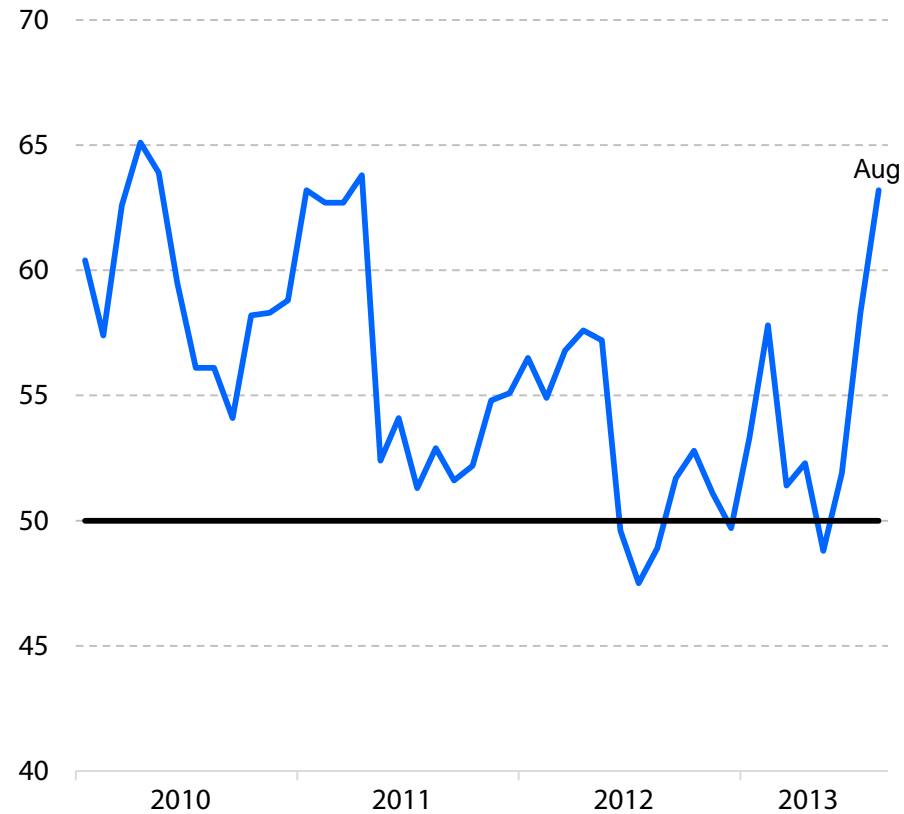
Core Orders and Shipments for Capital Goods



Source: Macroeconomic Advisers, Haver Analytics

Nondefense capital goods ex. aircraft, three-month moving average.

PMI Manufacturing New Orders Index

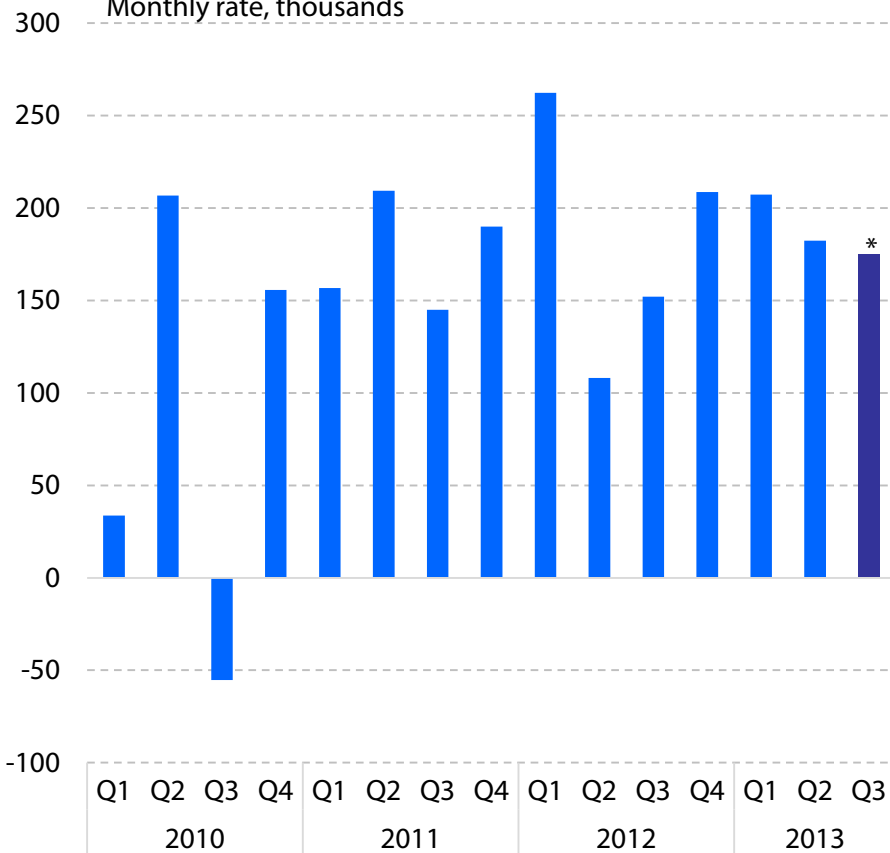


Source: Macroeconomic Advisers, Haver Analytics

The Labor Market: No Sign Yet of a Breakout to the Upside

Change in Nonfarm Payrolls

Monthly rate, thousands



Sources: Macroeconomic Advisers, Haver Analytics, Author's Calculations

* Estimate; assumes nonfarm payroll increase of 185,000 in September.

Hire and Quit Rates

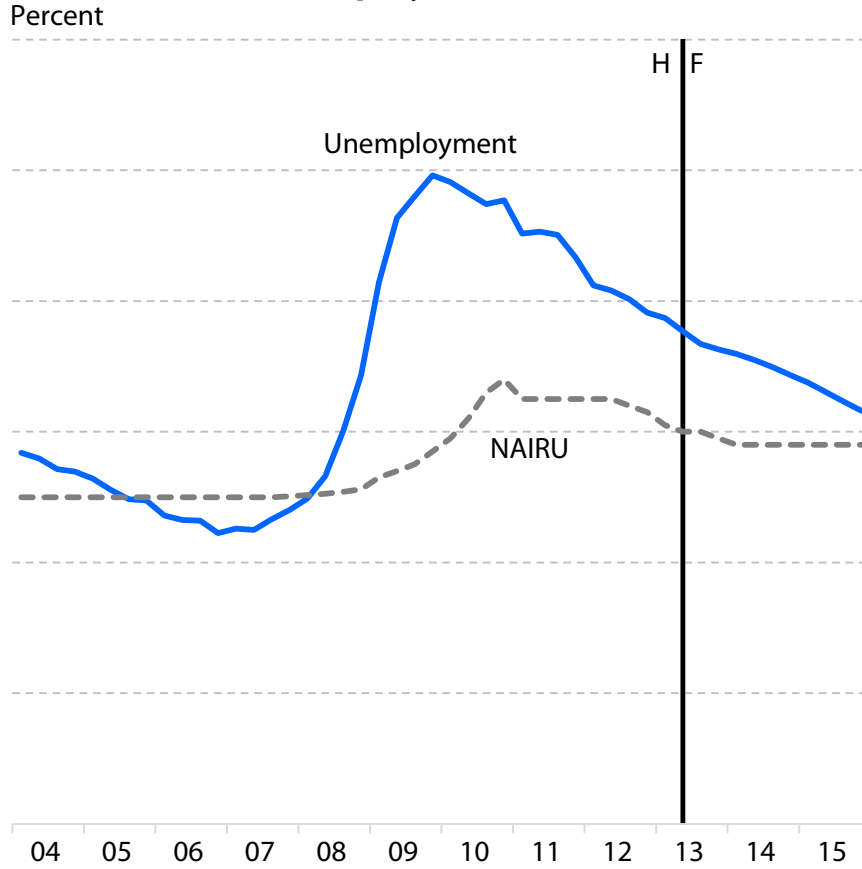
Percent



Source: BLS JOLTS

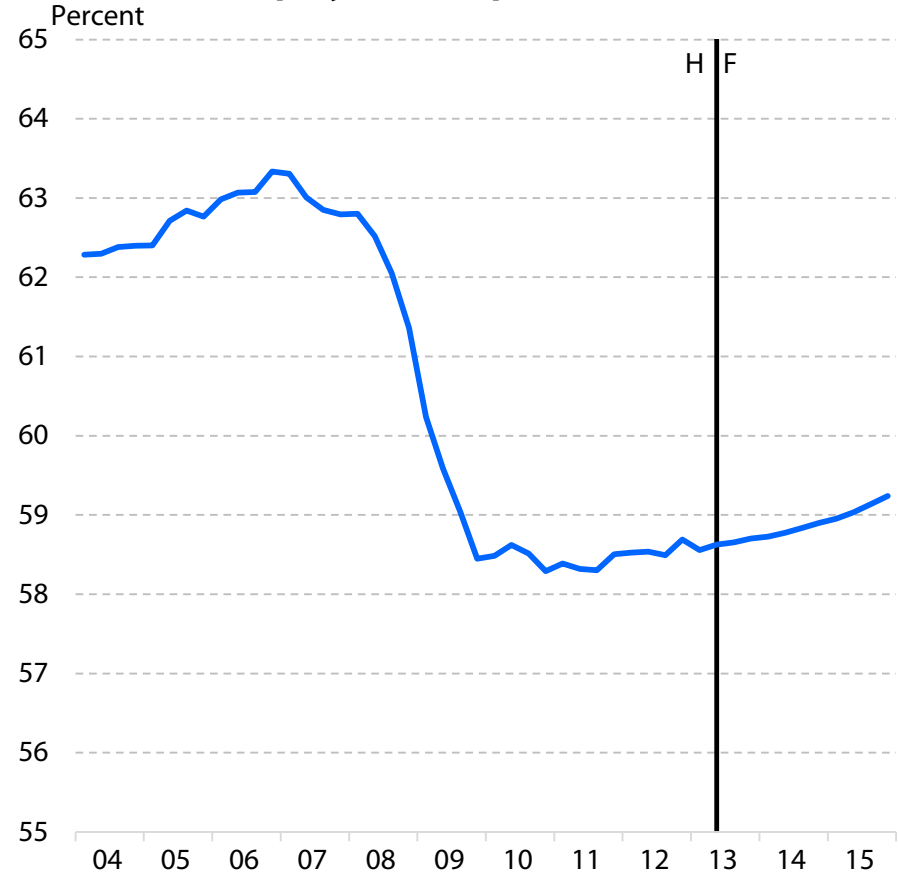
Is Slack Declining in the Labor Market?

Unemployment Rate



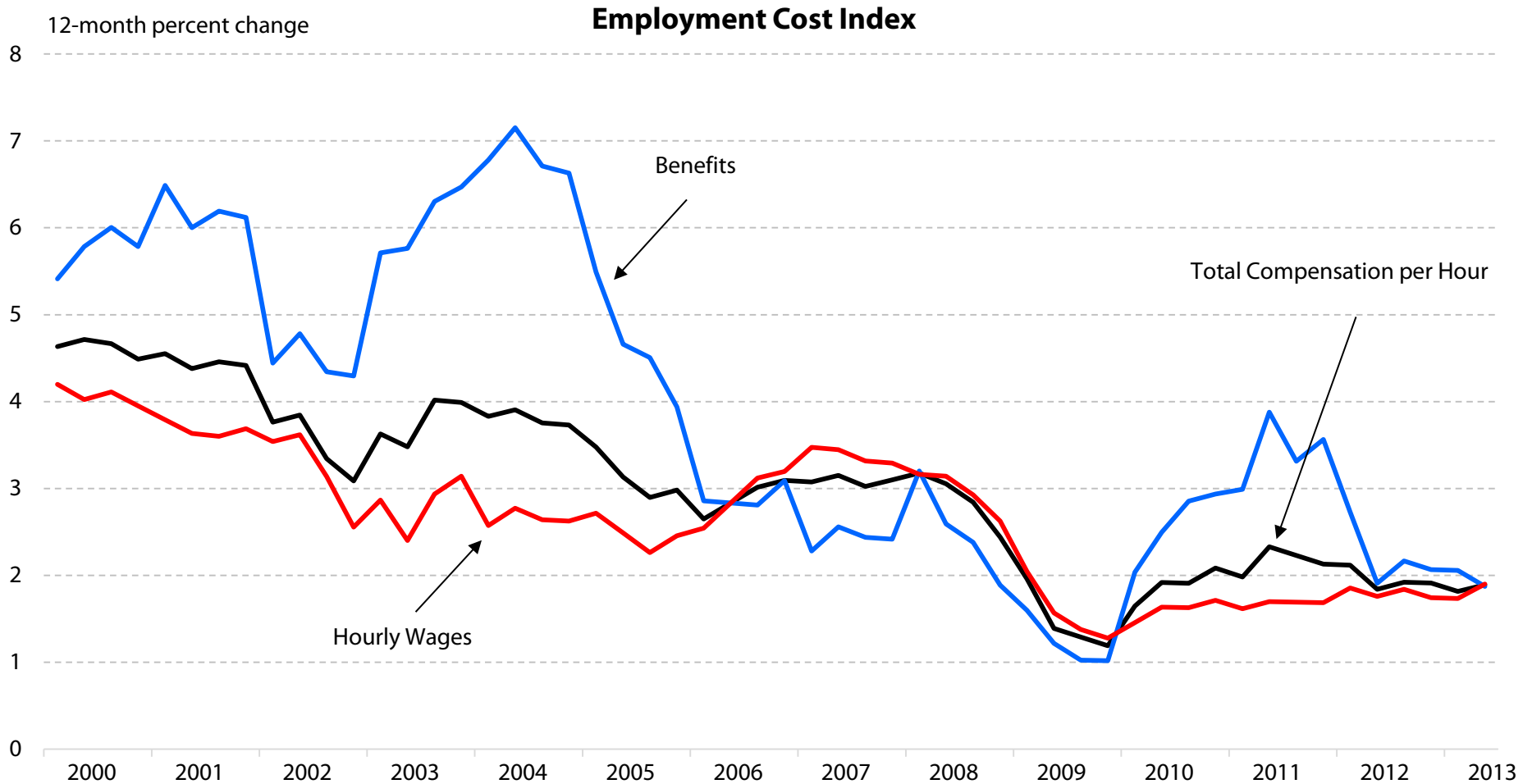
Sources: Macroeconomic Advisers, Haver Analytics, Authors' Calculations

Employment-Population Ratio



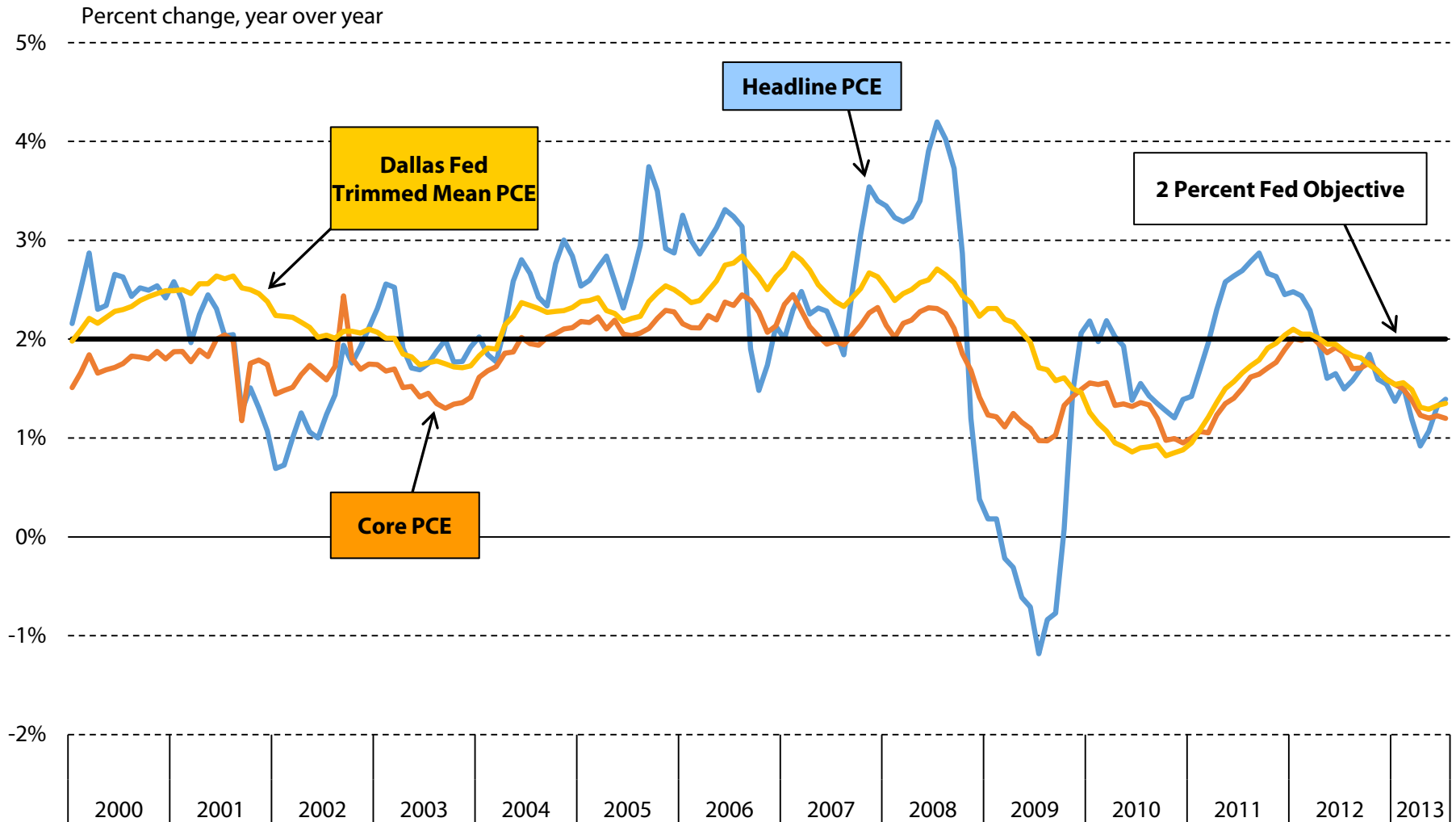
Sources: Macroeconomic Advisers, Haver Analytics, Authors' Calculations

Growth of Labor Compensation Remains Subdued



Source: Bureau of Labor Statistics

Price Inflation Well Below Target



Sources: US Department of Commerce, Bureau of Economic Analysis and Federal Reserve Bank of Dallas.

Conclusions

- The US economy has not yet transitioned to faster growth.
- Barring further self-inflicted wounds, growth is poised to pick up.
- The economy continues to need support from accommodative monetary policy.
- Hitting the debt ceiling would have grave consequences for the US economy and financial markets.