

The Global Economy: Uncomfortably Close to the Edge

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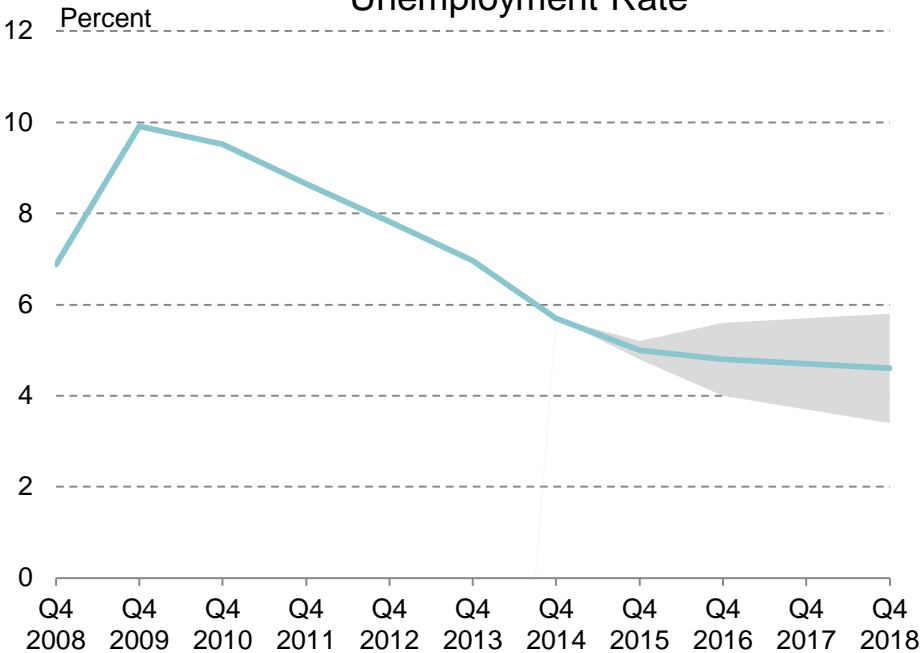
October 1, 2015

The Global Outlook

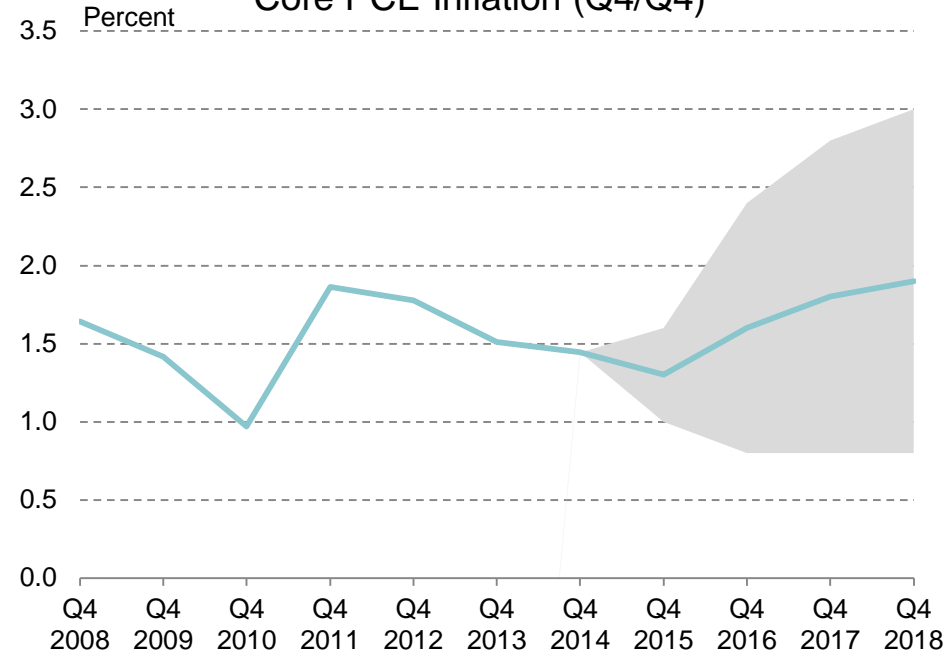
| Real GDP Growth (Y/Y) | 2014 | 2015 | 2016 |
|--|------------|------------|------------|
| Global Output Growth (PPP weights) | 3.3 | 3.0 | 3.5 |
| Euro Area: Evident improvement | 0.9 | 1.6 | 1.9 |
| Japan: Sluggish expansion at best | -0.1 | 0.6 | 1.3 |
| UK: Solid growth continues. | 3.8 | 2.6 | 2.5 |
| China: Growth slows gradually, but downside risks have increased. | 7.3 | 6.7 | 6.4 |
| India: Steady expansion | 7.2 | 7.3 | 7.4 |

In the United States: Moderate Growth, Below-Target Inflation

Unemployment Rate



Core PCE Inflation (Q4/Q4)

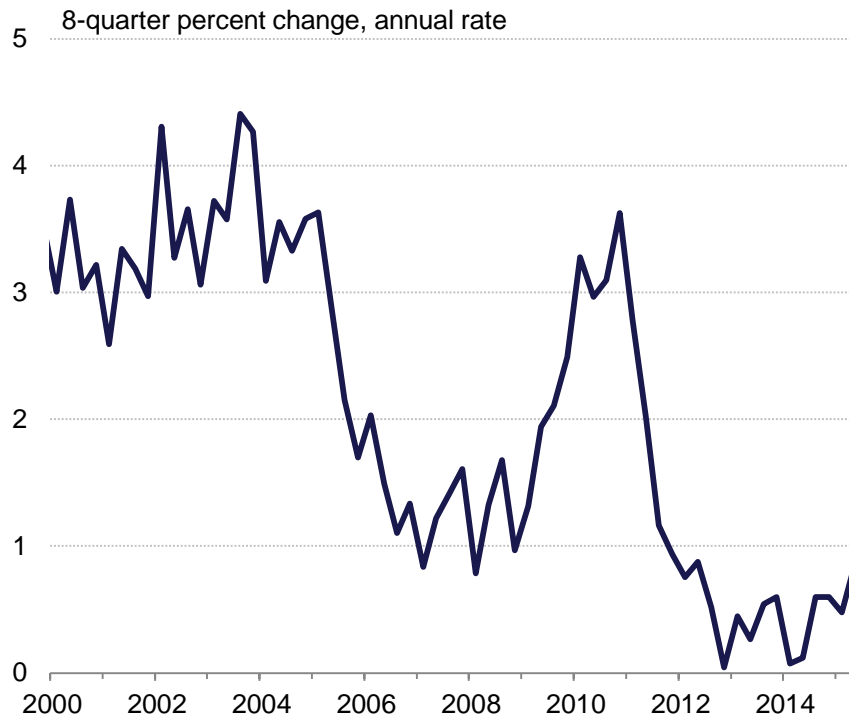


| Forecast | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------------------|------|------|------|------|------|
| Real GDP Growth (Q4/Q4) | 2.5 | 2.3 | 2.2 | 2.0 | 1.8 |
| Unemployment (Q4) | 5.7 | 5.0 | 4.8 | 4.7 | 4.6 |
| PCE Price Inflation (Q4/Q4) | 1.1 | 0.2 | 1.7 | 1.9 | 1.9 |
| Core PCE Price Inflation (Q4/Q4) | 1.4 | 1.3 | 1.6 | 1.8 | 1.9 |

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

U.S. Productivity Disappoints and Potential Output Growth Is Slow

Nonfarm Business Output per Hour



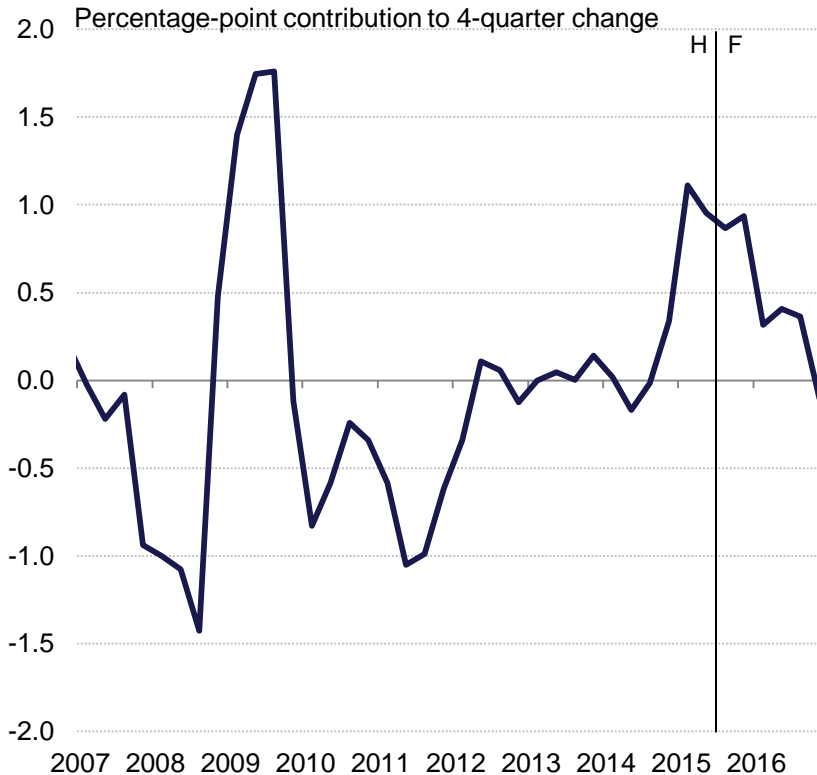
Potential Output Growth

| | <u>2002-</u> <u>2007</u> | <u>2008-</u> <u>2018</u> | <u>2019-</u> <u>2025</u> |
|------------------------------|-----------------------------|-----------------------------|-----------------------------|
| Potential GDP | 2.8 | 1.7 | 2.0 |
| Potential Labor Force | 0.9 | 0.5 | 0.5 |
| Potential Labor Productivity | 1.9 | 1.2 | 1.5 |

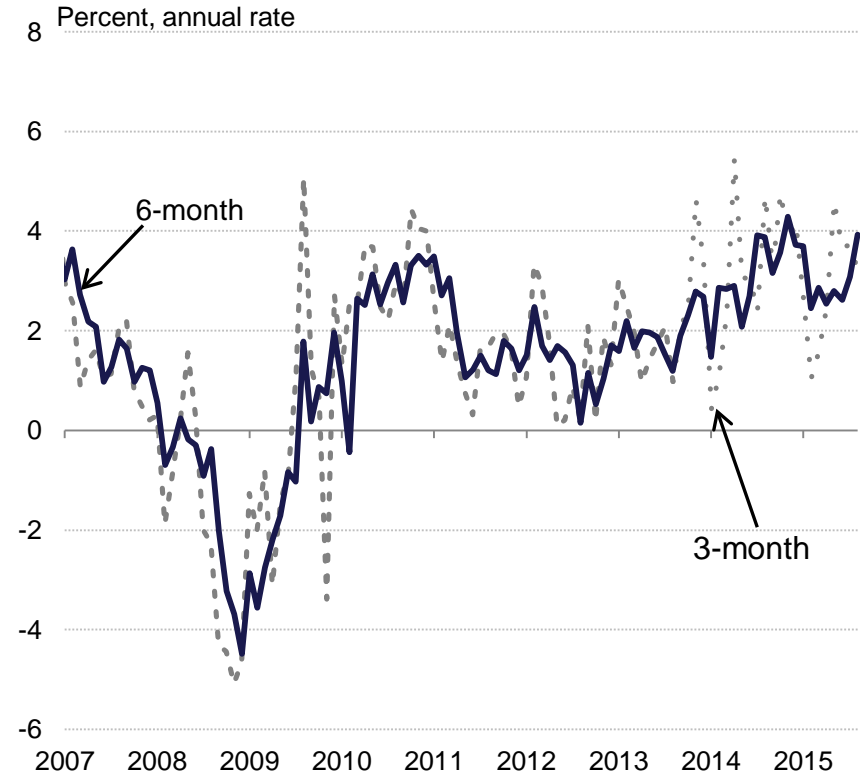
Source: BEA.

Consumption Fundamentals Are Solid: Jobs, Balance Sheets, and Energy Prices

Contribution of Energy Price Changes to Growth of Real Disposable Personal Income



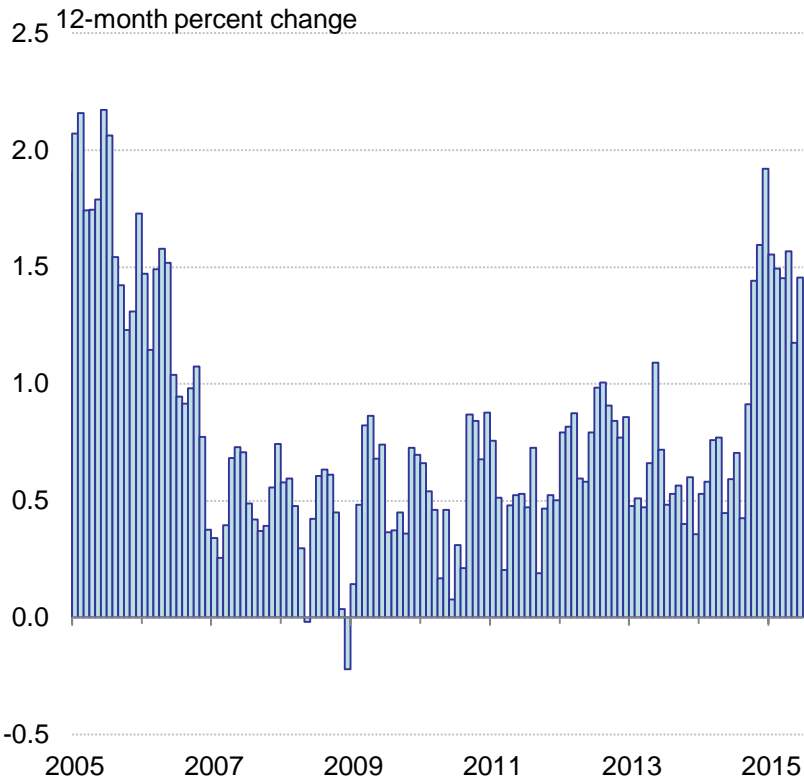
Real PCE



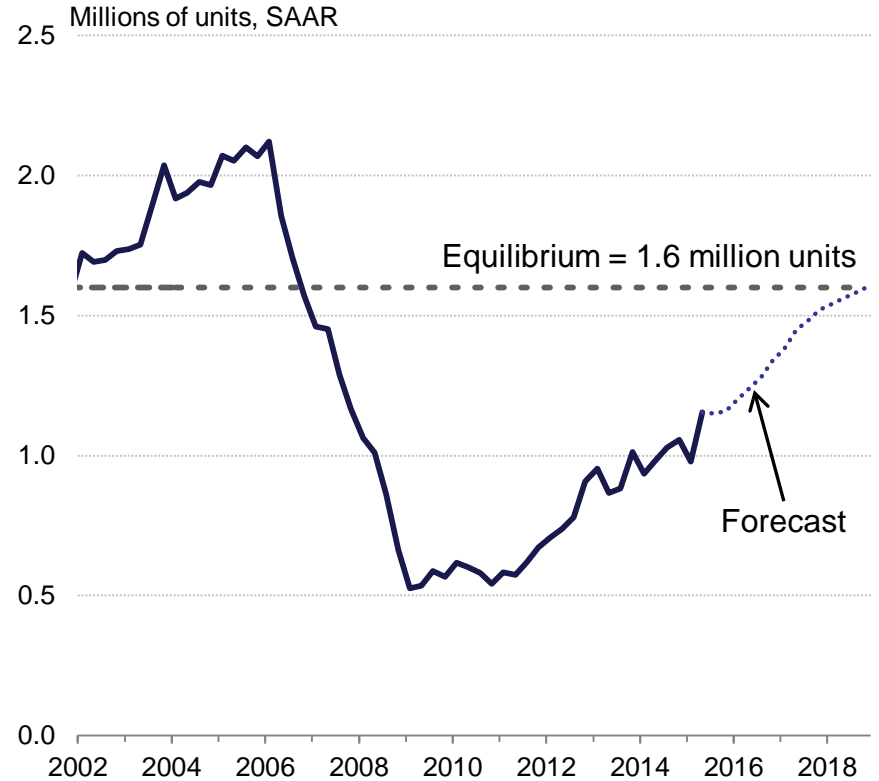
Source: MPI/Macroeconomic Advisers, BEA.

Housing on Firmer Footing...For Now

Household Formation



Total Housing Starts



Source: Census.

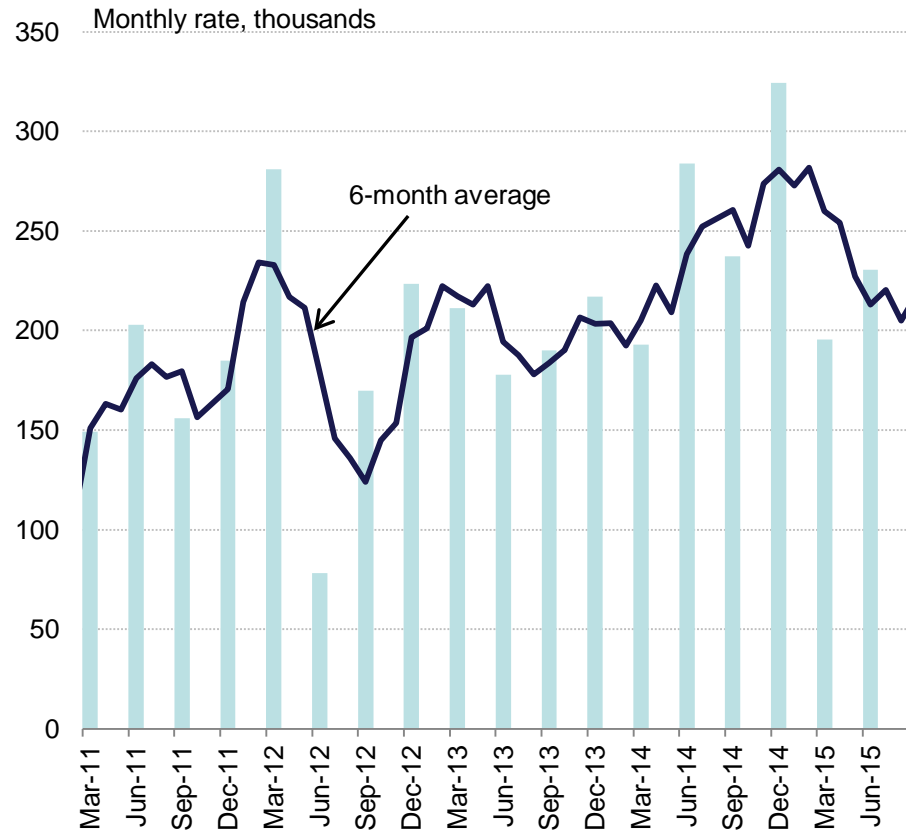
Manufacturing Is Under Pressure



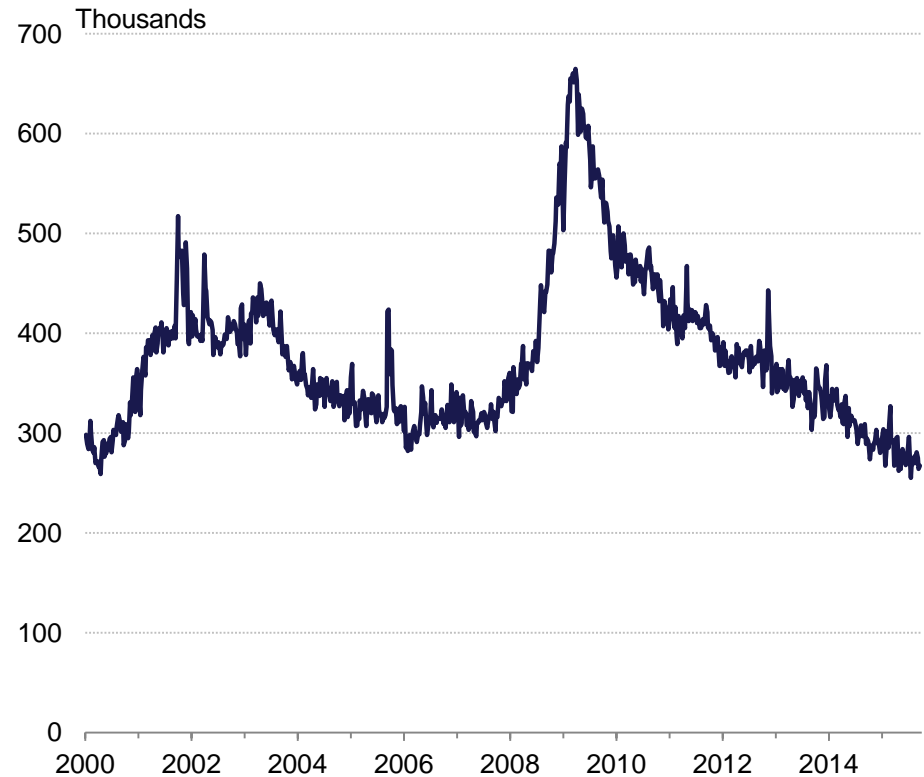
Source: Federal Reserve, Institute for Supply Management.

The Labor Market Continues to Improve

Change in Nonfarm Payrolls



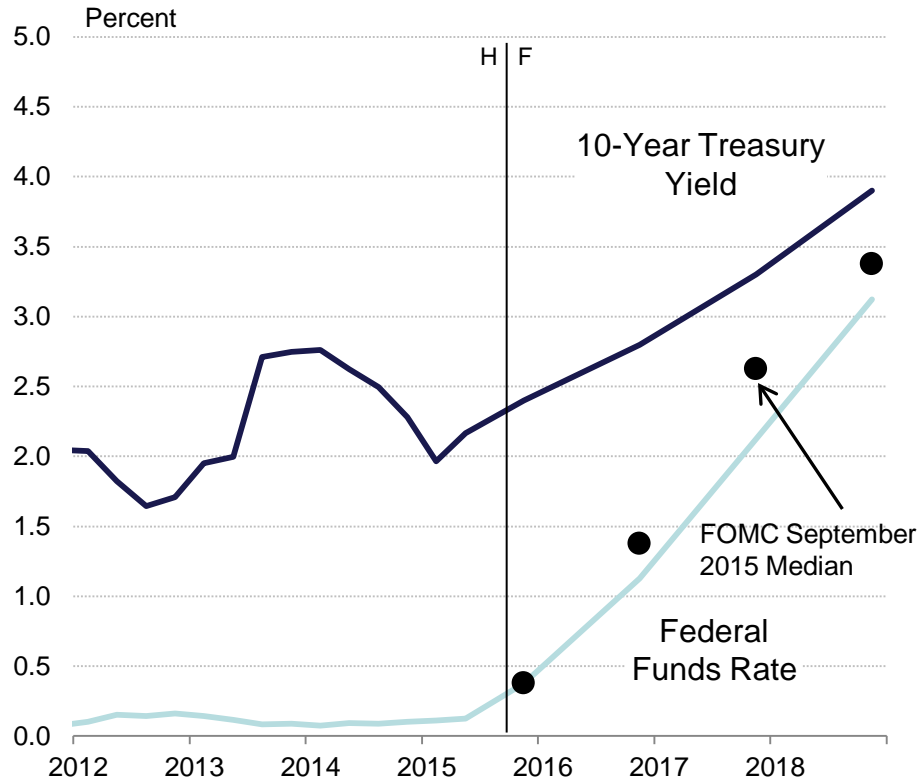
Initial Jobless Claims



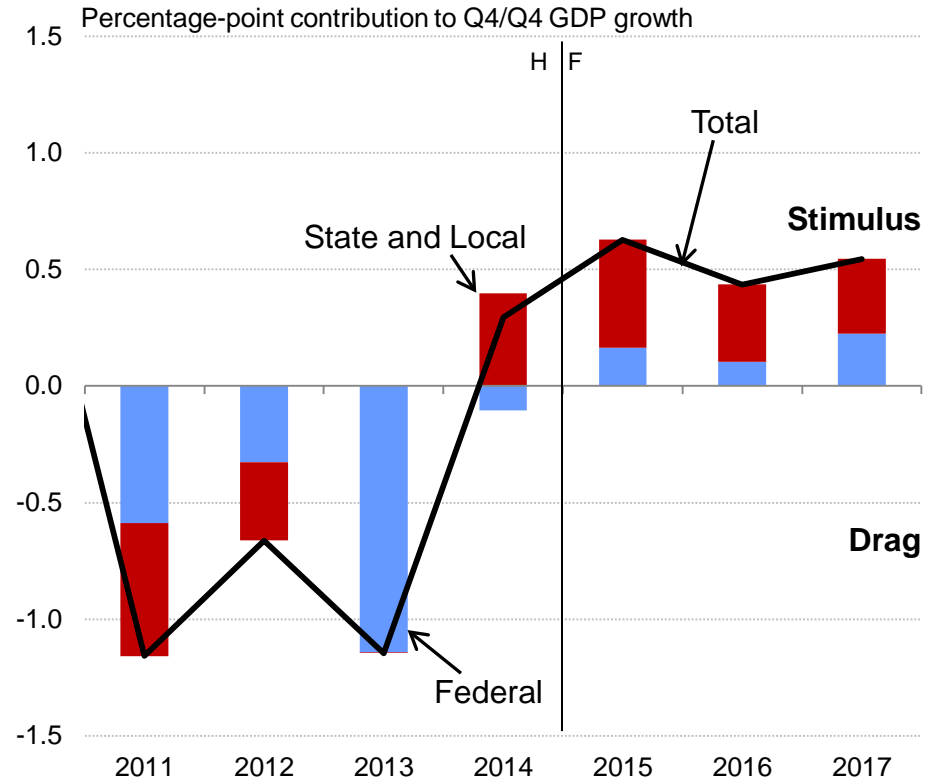
Source: BLS, Department of Labor.

Tighter Monetary Policy and a Fiscal Boost from State and Local Governments

Interest Rates



Fiscal Impetus



Source: MPI/Macroeconomic Advisers, Federal Reserve.

What If China Falters?

An Alternative Scenario:

- China growth slows 3 percentage points below baseline
- Other Asia, Brazil, and Chile suffer similar shortfalls in activity
- Dollar appreciates an additional 4 percent
- Equity risk premium jumps 10 percent (leading to lower stock prices)
- Price of crude oil drops \$10/bbl below baseline

U.S. Real GDP

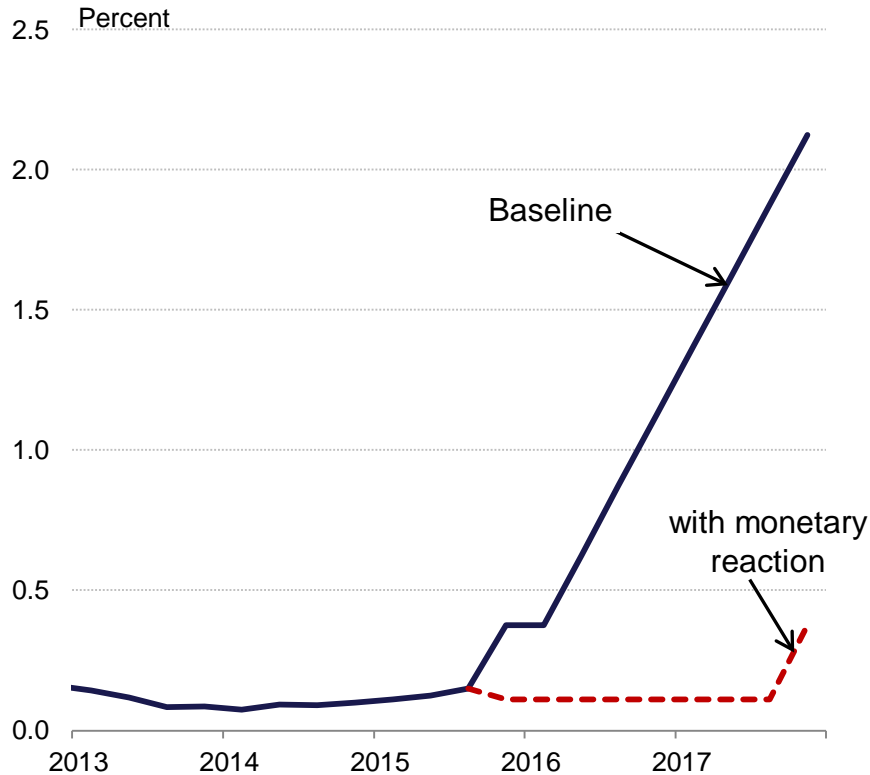
| | <u>2015</u> | <u>2016</u> | <u>2017</u> |
|--|-------------|-------------|-------------|
| Baseline | 2.3 | 2.2 | 2.0 |
| <i>Alt. scenario</i> | 2.0 | 1.2 | 1.2 |
| <i>Alt. scenario with monetary policy response</i> | 2.0 | 1.4 | 1.6 |

U.S. Core PCE Inflation

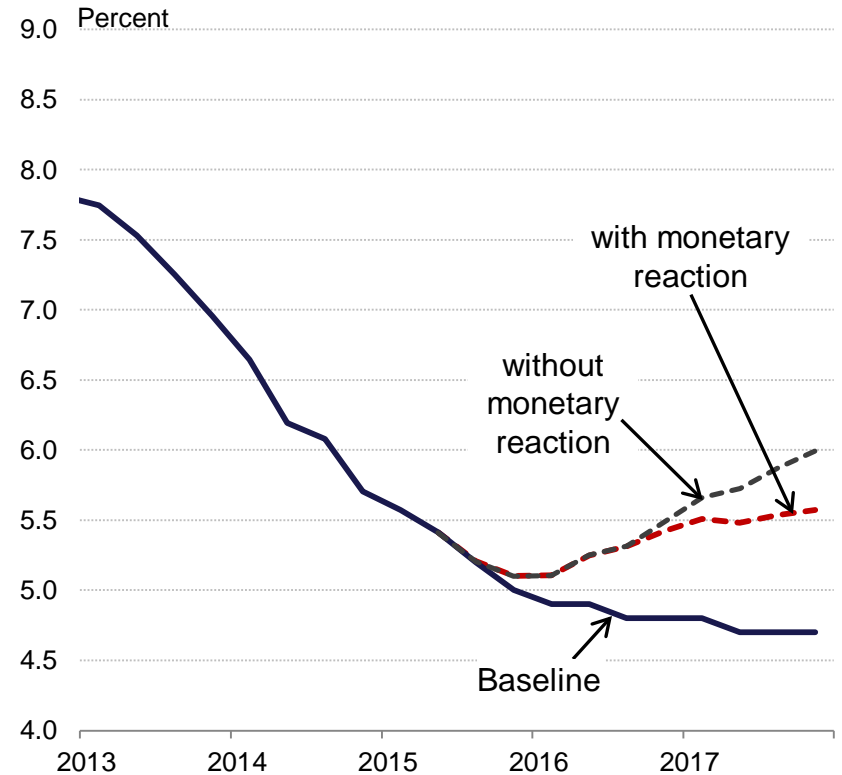
| | <u>2015</u> | <u>2016</u> | <u>2017</u> |
|--|-------------|-------------|-------------|
| Baseline | 1.3 | 1.6 | 1.8 |
| <i>Alt. scenario</i> | 1.2 | 1.2 | 1.5 |
| <i>Alt. scenario with monetary policy response</i> | 1.2 | 1.2 | 1.6 |

What If China Falters? (2)

Federal Funds Rate

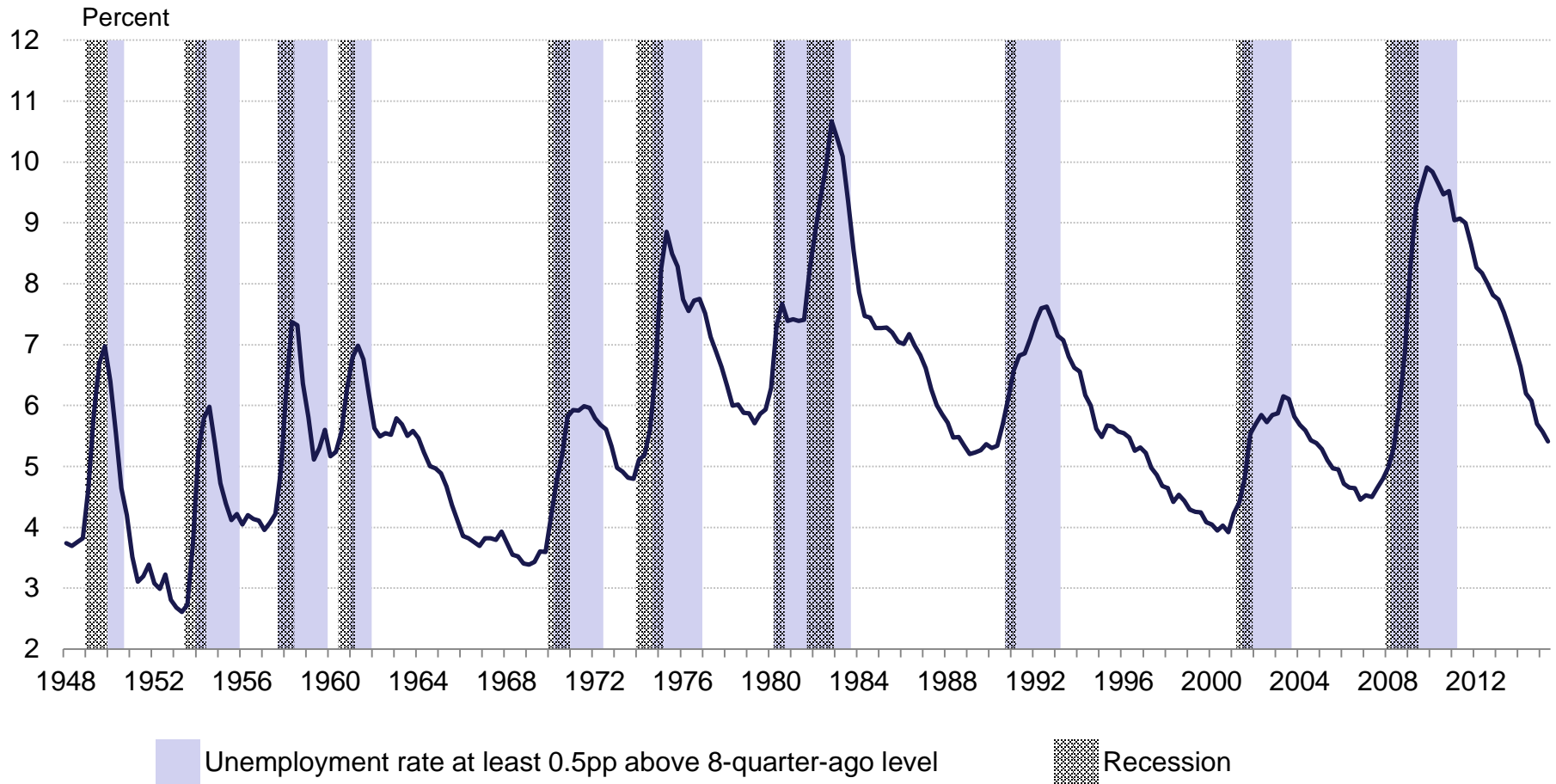


Unemployment Rate



Source: MPI/Macroeconomic Advisers.

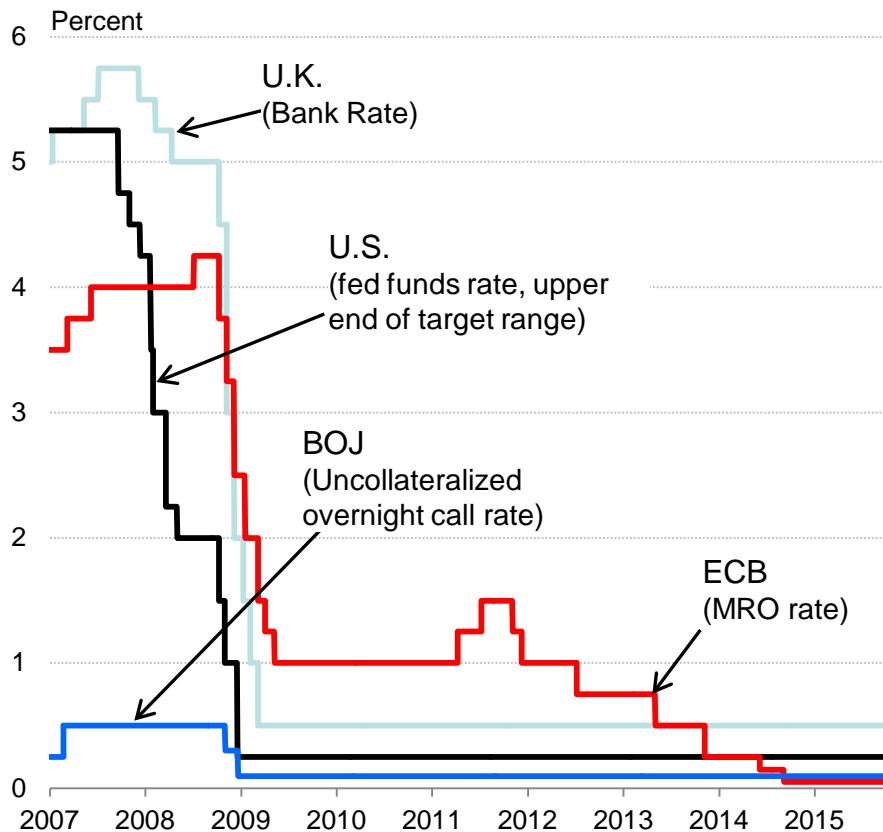
A Key Caveat: Modest Increases in the Unemployment Rate are Rare



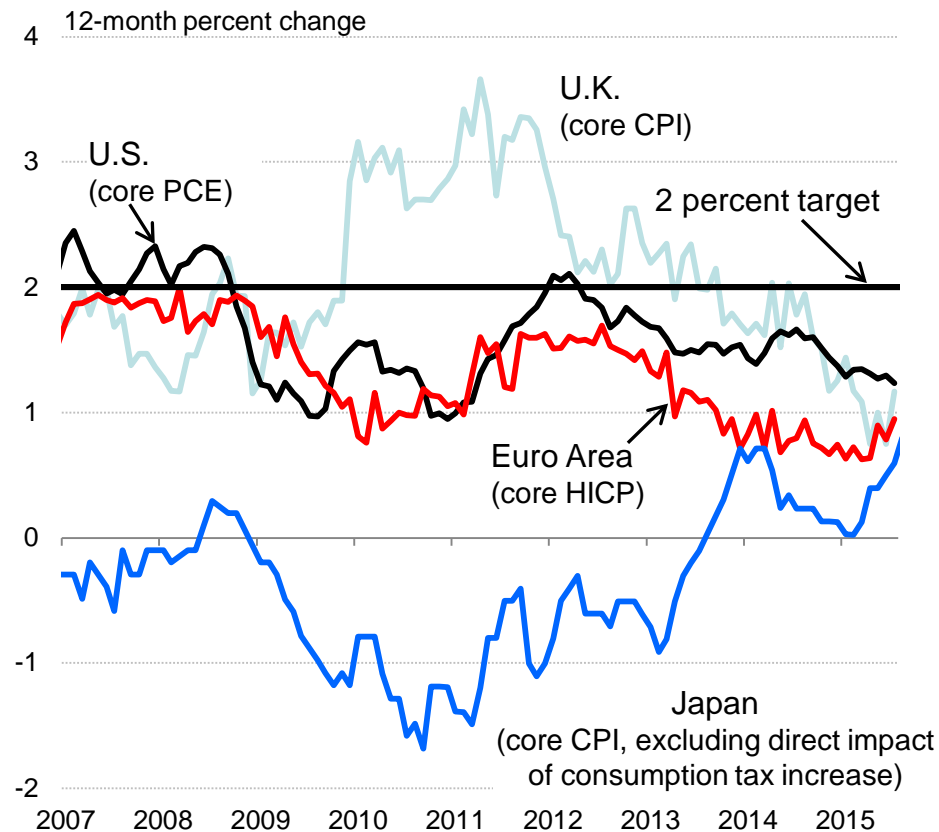
Source: BLS, NBER.

The Advanced Economies: Little Room to Respond

Policy Interest Rates

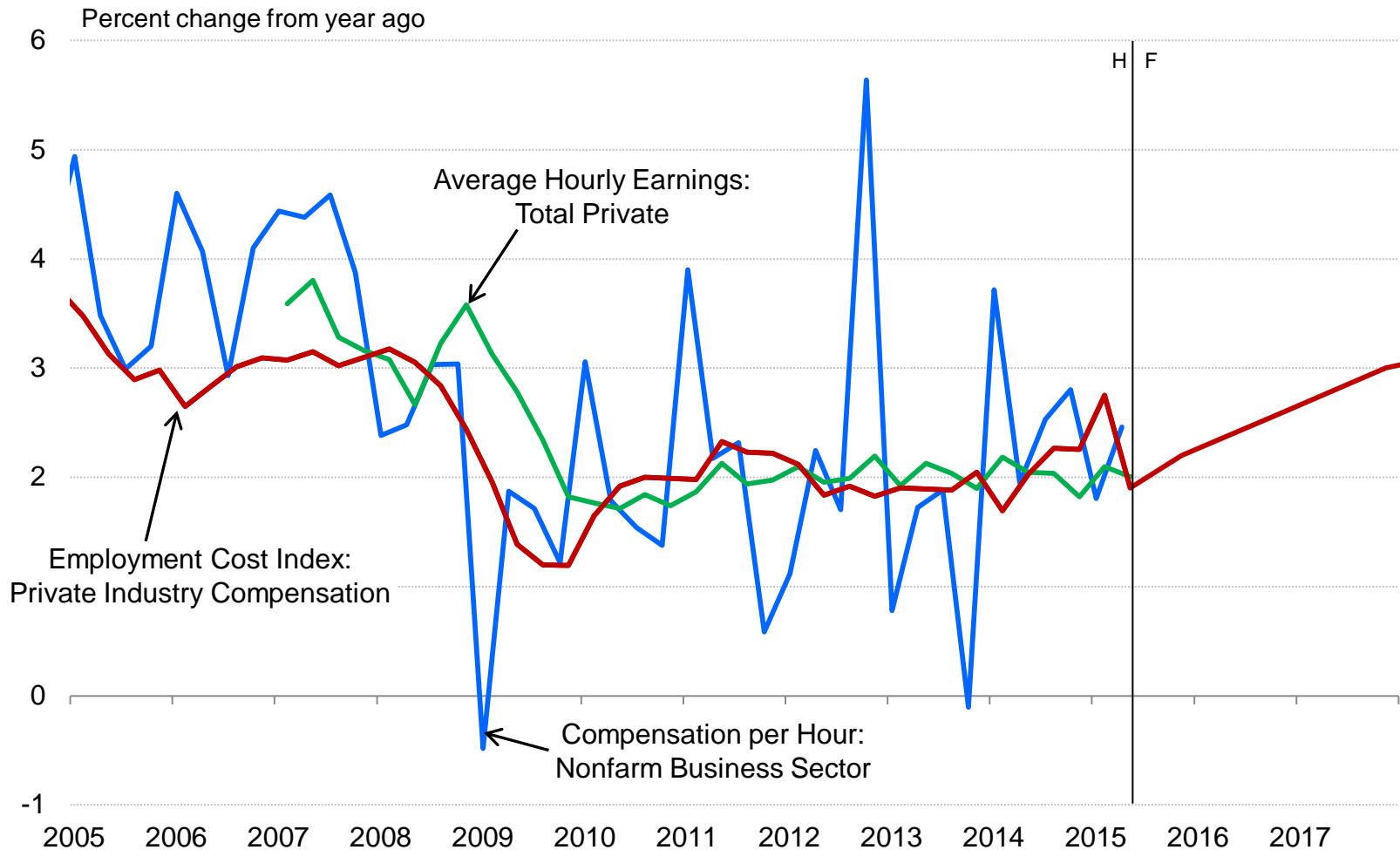


Core Consumer Price Inflation



Source: Bloomberg.

Labor Compensation Remains Subdued



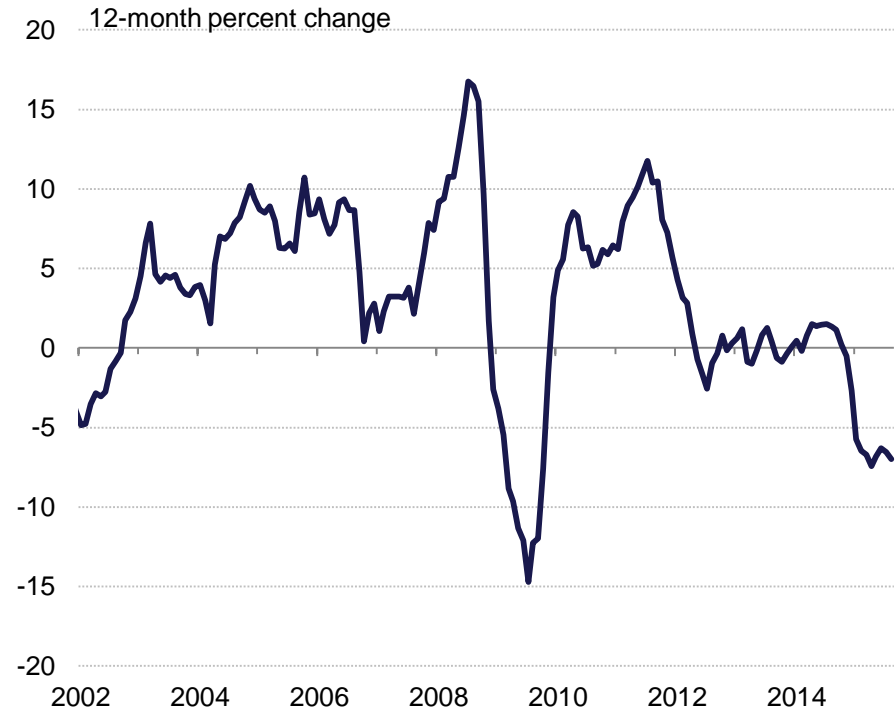
Source: BLS, BEA.

No Price Pressures in the Pipeline

Import Prices Excluding Fuels

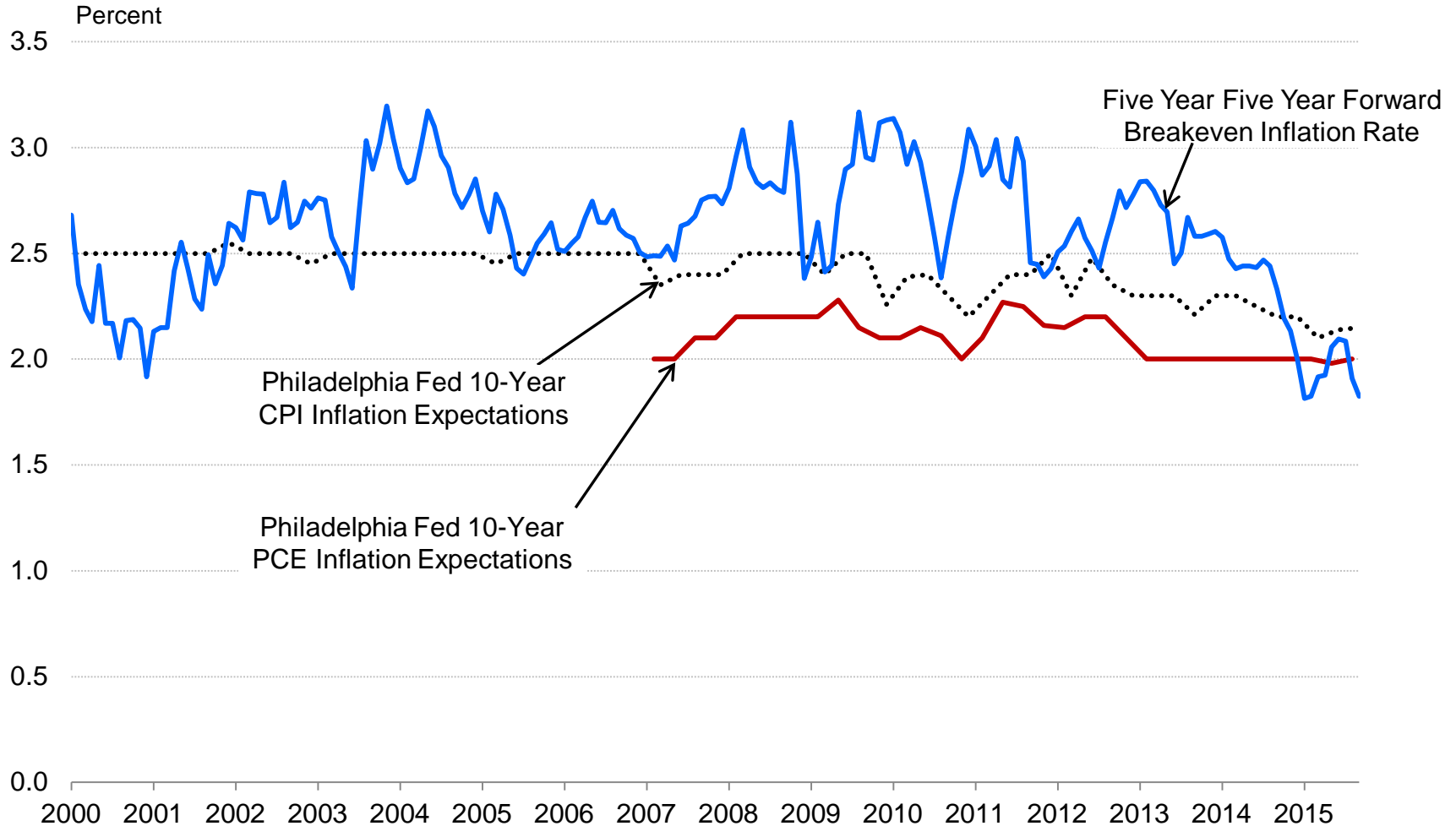


PPI Processed Intermediate Goods



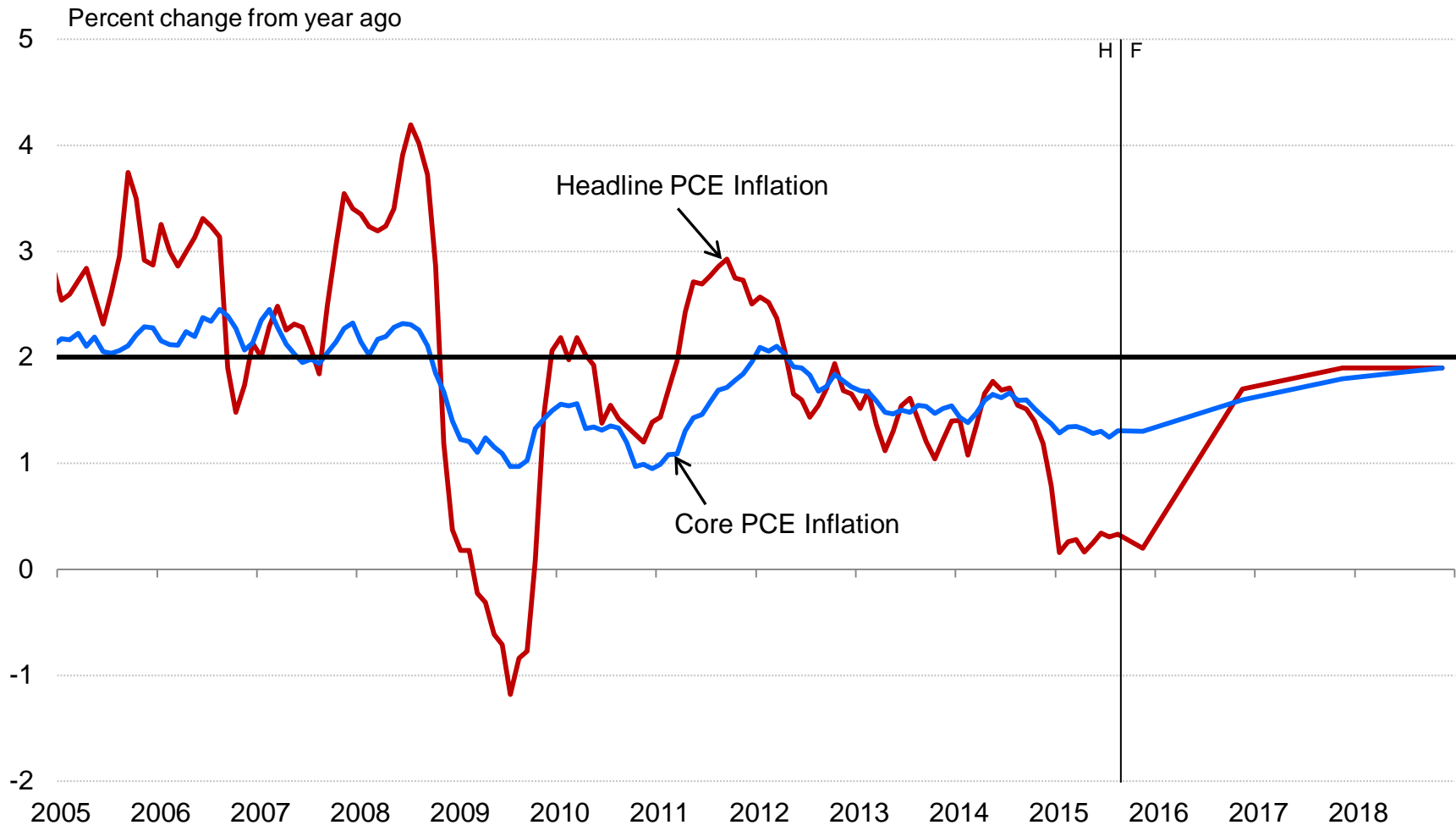
Source: BLS.

Inflation Expectations: Stable?



Source: FRB Philadelphia, Bloomberg.

Price Inflation Will Remain Below Target



Source: BEA.

Conclusions

- The most likely outcome is that the global economy muddles through, with some improvement next year.
- The downside risks have risen.
- And the economic consequences of those downside outcomes materializing are potentially large.
- Policymakers in the advanced economies must remain focused on supporting growth and boosting inflation.