Event Transcript

# Global Economic Prospects: Fall 2013

David J. Stockton, Peterson Institute for International Economics
Nicholas R. Lardy, Peterson Institute for International Economics
Arvind Subramanian, Peterson Institute for International Economics

Peterson Institute for International Economics, Washington, DC
October 1, 2013

*Unedited transcript*

Adam Posen: Good afternoon, ladies and gentlemen. We have an even busier crowd than usual as befits our semiannual global economic prospects meeting. You'll all be excited to know I just tweeted the fact that we are under way. Welcome back for the Peterson Institute for International Economics. I'm Adam Posen, the president of the Institute and it's my pleasure to have so many friends and stakeholders of the Institute, and for that matter of the global economy, with us today for our semiannual global economic prospects meeting.

The real stars of the show are of course Dave Stockton, Arvind Subramanian, and Nicholas Lardy, and we'll be getting to their presentation shortly. But as I was trained to do by Fred Bergsten, never let a moment go without reminding people just how valuable we are. So I want to remind you as I am now wont to do, before you read the wheel, listen to PIIE. In other words, every six months the IMF and the OECD and all them official types, strut out their forecast and they're all very good and nice. But we hold ours a week ahead in both the fall and the spring and we're now delighted to have Dave Stockton, who I'll introduce in a moment, leading this charge of all our forecasting efforts in bringing together our knowledge, some of which is not exactly model-based forecast numbers, but bringing it in to something where we hope we can say something useful about the US basically every six months, usually about China with Nick Lardy not always, and then a rotating chair or two of our other fellows.

Today we're very lucky to have Arvind Subramanian talking about the emerging markets turmoil and specifically about India where he's been a leading public figure.

I think the turnout today and the number of people watching online as event speaks for itself, but just to rub it in, we usually get things right. So we had our last one of these, April 1st, April fool's day as Dave modestly said, but we weren't fooling anybody. Dave, Jacob Kirkegaard, and Barbara Kotschwar at that point made some, I think, very useful and important calls.

Dave in particular had suggested that the Fed was going to—I think the image he used was a football image. They were going to keep running until they were fully across the goal line; something my New England Patriots could learn from. And that with unemployment to be where he forecasted it to be, the Fed would be slow to tighten and he and Joe Gagnon were right in leaning against the wind that tapering was a done deal.

Jacob Kirkegaard, who many of you know, is our delightful and always inspiring lead person on Europe in the European crisis, made the call that now in retrospect looks easy, but at the time was very contentious that Cyprus and Italy were not going to fall apart and were not going to spill over into financial crisis reemerging in the euro area, and he was right. Of course Jacob keeps saying that and keeps being right and maybe someday it won't be. But to give him credit, he stood up when people were losing their heads about Cyprus. And I think he said to me that he now expects Mr. Leta to win the confidence vote in Italy. So keep your eye on our blog where Jacob contributes regularly on Europe.

Finally I want to point out—I don't know if she's in the room because I gave her something else to do—Barbara Kotschwar, who is doing work on Latin America for us, did a really stimulating presentation six months ago about how Latin America is really dividing into two camps; a very clearly state-oriented set of models, and a very much more market-oriented, not just Chile one, and Venezuela the other, but the whole range of Latin American economies. And she pointed out a little ahead of the curve that Brazil's fundamentals were a lot shakier than people thought. And that, again, all three of these calls look pretty good so far, and we hope for more of the same in today's presentation.

So, presumably my brilliant director of operations will come out of this door and get the right PowerPoint up. In the meantime I will take the pleasure of introducing Dave Stockton. Dave, as many of you know, was head of the division of Research and Statistics at the Federal Reserve for 11 years. That means he was the chief economist of the Board of Governors. He briefed and led the FOMC in their forecast through the years. And recently, now I guess it's about a year ago almost, Dave joined us. His premier was in the November World Economic Prospects that we did, yes indeed. And he splits his time between us and Macroeconomic Advisers where he is a senior adviser. And we're delighted to grab as much of his time and insight as we can. So Dave, please.

David Stockton: Thank you Adam. There certainly is a lot to discuss this afternoon. I think in terms of both the US economy and the global economy. I characterize the US economy is still struggling to achieve escape velocity. It is still the case, but we haven't broken out with the sort of 2 percent growth range that we've been in now for quite some time.

And indeed I think earlier this year, I was pushing back on what I thought was excessive optimism that the sequester and the tax increases that occurred earlier at the turn of the year and then again in March wouldn't leave a mark on US economic activity. Indeed I think now looking at the activity this year; one clearly sees that in fact that fiscal drag was an important factor weighing down on the economy. But I think fundamentally it was poised to begin to grow more rapidly.

Since the April forecast we've had a new set of headwinds and they've all come from Washington. And I think that's both certainly on the fiscal side and I think to some degree on the monetary side as well.

So since April I've revised down my forecast to show slower growth and lower inflation. I think one factor clearly was that the fiscal policy was weighing at least as heavily on the economy as I thought. There was less momentum coming in to the year than many thought.

But in addition, I think the Feds' premature talk of tapering in the spring resulted in some tightening of financial conditions that in fact has been counterproductive and has been a factor weighing on activity this year as well. The delay of tapering a couple of weeks ago certainly helped ease financial conditions a little bit from where they had been. But we're still not back to where we were in April.

This forecast by the way, I should note, incorporates an assumption of a one-week government shutdown that has the effect of rounding down this year's growth by about a tenth and rounding up next year's growth by about a tenth. I'll talk a little bit more about that assumption and the risks associated with that assumption in a few moments.

Despite the fact that I have revised down the growth of GDP for this year and next, I also have a lower unemployment rate in this forecast than in the last one, but that isn't because of good news about the labor market. In fact, it is news about continued weakness in labor force participation that I think is masking a certain significant weakness still in US labor markets.

Inflation, I think, also is probably underappreciated about piece of news about the economy thus far this year. It has moved down even further and is now well below the Federal Reserve's 2 percent inflation objective. All that said, the basic contours of this forecast are still pretty much the same as they were six months ago. The expectation that there will be some acceleration of activity and then inflation will gradually move back towards its objective, but now at a weaker rate and with lower inflation than previously.

The foreign outlook has also presented some rather significant cross currents with the picture brightening for the major advanced economy. This is at least many of the major advanced economies but dimming for the emerging markets.

For the euro area, the recession appears to be ending but the recovery is still likely to be slow and it's—I think I completely agree—Adam's characterization last November of policy having put both a floor and a ceiling to growth still looks to be the right story here. And while much has been made of the end of the recession, meaning the growth wind from a modest negative to a modest positive; that really is I think not a meaningful change in economic outlook.

In UK, the expansion looks like it's gaining traction; exports stronger, more housing, more consumption. I think the odds are that in fact with concerted application of monetary accommodation, they will see some acceleration.

In Japan, this year their first two arrows look to have been successful on a monetary and fiscal side, lifting growth some. I'm anticipating that there will be a combination of consumption, tax increase, offset to some degree by additional fiscal stimulus measures but not buy enough to preserve growth of this year's 2 percent rate is a little bit of a hit but not anything that would derail an ongoing expansion in Japan.

And then the emerging markets that Arvind and Nick will be discussing, I think we have two examples of contrasting developments where China, I think, growth is still likely, but a bit more slower. Risks are accumulated in the downside, but China as Nick is going to talk about is much more of an indigenous slowdown.

In Arvind's case in India and many of the other emerging market economies, I think we've moved on to a slower growth track. There has been fallout from the Fed's talk of tapering in terms of its effects on capital flows. And I think that is likely to be lasting for at least some time now.

From a parochial perspective, I think adding this all up in terms of the global outlook, I think net exports look to be likely to be a neutral factor for growth this year, but be a modest drag in 2014 and 2015.

It is still the case that the forecast that I'm showing of an acceleration in activity in the US economy hinges very importantly on a waning of the fiscal drag. As you can see by the bars, the drag this year I'd estimated one-three quarters percentage point. I think we'll have about a .5 percentage point drag next year. Again, this assumes sequestration remains in place, it assumes a modest shutdown in the federal government, and it assumes very importantly that we don't hit the debt limit and that that does not become a binding constraint.