United States Economic Outlook
Current conditions and near-term outlook

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The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.
Roadmap

- Current conditions: where we are now
- Looking ahead
- A longer-run perspective on the U.S. economy
Current conditions: Where we are now
Quick sketch of current conditions

- Economy operating at or near potential
- Continued solid growth in economic activity
- Some headwinds have turned to tailwinds—e.g., overseas growth—plus fiscal stimulus
- Labor market tight & tightening further
- Inflation getting close to the Fed’s long-run goal of 2 percent, and has picked up noticeably in recent months
US Economy operating at or near potential

Sources: BEA; BLS; CBO; NBER; author's own calculations.

Bil. chn. 2009 $

Long-run trend/potential

Real GDP

Q1’18 - 0.6%
Q2 real GDP growth expected at 3+ percent

- Real GDP grew at a 2.2 percent annualized clip in Q1.
- That’s in line with average growth over the past 5 years: 2.3 percent.
- Projections for current quarter, Q2, around 4 percent.

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<th>Q2 growth projection</th>
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<td>Simple new orders + ADS index model</td>
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<td>Blue Chip</td>
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<td>New York Fed nowcast</td>
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<td>Atlanta Fed nowcast</td>
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Purchasing manager surveys point to robust growth in manufacturing, services

Source: Institute for Supply Management
Small business survey shows a gradually tightening labor market and markedly improved optimism

Sources: National Federation of Independent Businesses, author's calculations
Robust payroll gains continue

Source: BLS, author’s calculations
Unemployment rate now 3.8 percent, well below policymakers’ long-run projection

Source: BLS, FRB-FOMC
Headline PCE inflation slowed in early 2017, now rebounding

Sources: BEA
Early 2017 slowing also present in core inflation measures

Sources: BEA, FRB Dallas
Looking ahead
The view from the FOMC: 2018 and beyond

- At four of the eight FOMC meetings – March, June, September, and December – members give projections for GDP, unemployment and inflation over the coming two or three years
- Last “Summary of Economic Projections” (“SEP”) was in June
- As of June, FOMC members saw:
  - GDP growth tapering from 2.8 percent to 2.0 percent over 2018 – 2020
  - Unemployment dipping to 3.5 percent in 2019 & 2020
  - Inflation rising to over 2.1 percent
- Slightly stronger outlook compared with March SEP
GDP growth expected to slow toward long-run potential rate

Sources: BEA, FR FOMC
Unemployment expected to be in the mid-3s

Sources: BEA, FR FOMC
Inflation expected to rise to long-run target level

Sources: BEA, FR FOMC
Fed funds rate expected to rise gradually above 3 percent

Sources: BEA, FR FOMC
Summing up

- U.S. economy currently experiencing solid growth, a tightening labor market, and – at least over the past several months – inflation rising from subdued levels
- Labor market is strong; important secular trends
- The outlook over the next several quarters is for solid GDP growth that eventually slows to a long-run sustainable rate, unemployment dipping further below 4 percent, and inflation gradually rising to the Fed’s long-run 2 percent goal
A longer-run perspective on the U.S. economy
Long run overview

• Real output growth has slowed considerably over the past few decades
  • Mostly a result of demographics, but also slower productivity growth
• Inflation is also much lower now than it was 25 years ago
• Interest rates are also a lot lower than they were 25 years ago
  • Partly reflects lower inflation
  • Also lower real (inflation-adjusted) interest rates
• Many of these patterns are not unique to the U.S., may indicate a new normal
Real GDP growth has slowed over the past few decades

Sources: BEA, author's calculations
This partly reflects slower labor force growth...

Sources: BLS, author’s calculations
...but also slower productivity growth since the 1990s

Sources: BEA, BLS, author’s calculations
Average growth rates by decade

Sources: BEA, BLS, author's calculations
Labor force growth shaped in part by long-run movements in population growth

Source: BLS, author's calculations
Labor force participation rose in the 1970s and 1980s, has declined since the 1990s.

Sources: BLS, author’s calculations
Why has productivity growth slowed?

- Not U.S.-specific, happening quite broadly
- Open question, different views on why—some more pessimistic, some more optimistic
  - Pessimistic: All the big-impact innovations have already been made
  - Optimistic: Innovation comes in waves, takes time for full potential of general purpose technologies to be realized
- Difference between 1.7 percent/year (average of 1980s, 1990s) and 1.0 percent/year (2010s) is huge for long-run well-being
  - Do average living standards double every 40 years or every 70 years?
Inflation rose in the 1960s and 1970s, has fallen since the early 1980s

Sources: BEA, author's calculations
Long-term nominal interest rates have also declined

Sources: FRB Board of Governors, author’s calculations
Real interest rates also declined since the 1980s

Sources: FRB Board of Governors, BEA, author’s calculations
The new normal?

• Recent behavior may represent the “new normal”
• Demographics → labor force growth around 0.6 percent per year for the next 20 years
• Productivity growth is a wildcard: pace over the past 10 years is 1.1 percent per year.
• Those numbers together → GDP growth of 1.7 percent per year
• That’s close to the long-run forecast of FOMC members, 1.8 percent growth rate
The new normal?

- FOMC also assumes low interest rates (nominal and real) are here to stay for awhile; they project a long-run federal funds rate of 2.8 percent
  - By comparison, FFR averaged about 4 percent for 15 years prior to Great Recession
  - Implies a long-run real rate of 0.8 percent, assuming inflation averages 2 percent
  - This is also in the ballpark of what you can extract from Treasury yield curve data
Thanks for your attention!
A closer look at the labor market
Unemployment rate dips below 4 percent; this doesn’t happen often!

Sources: BLS, NBER
Shift in age distribution away from young, toward old since 1960s

Percent of LF

Sources: BLS, author’s calculations
Demographic shifts make comparison to late 1960s unemployment more subtle than meets the eye.

Sources: BLS, author's calculations
Aging effects on labor force participation

Sources: BLS, FRB Atlanta
Long run LFPR projections: Steady decline

Sources: BLS
Over past 20 years, LFPRs have fallen for younger, risen for old

Sources: BLS, FRB Atlanta
In spite of rising LFPR for 55+, aging population means more nonparticipation due to retirement

Sources: BLS, FRB Atlanta
Increasing nonparticipation by young reflects more school enrollment

Percent of 16+ population

Nonparticipants citing "school"

Sources: BLS, FRB Atlanta
Downward drift in prime age LFPRs

Percent

Sources: BLS, FRB Atlanta

Federal Reserve Bank of Dallas
Another growing reason for nonparticipation: disability

Percent of 16+ population

Sources: BLS, FRB Atlanta
A positive LFPR story: Nonparticipation due to discouragement almost back to pre-recession level

Percent of 16+ population

Sources: BLS, FRB Atlanta
Why do falling LFPRs matter?

- Lower LFPR means higher “dependency ratio”—i.e., more non-workers per worker.
- Output per person = (output per worker) x (workers per person)
- For given productivity, lower LFPR reduces output per person → lower standard of living.
One last point on labor market: Declining dynamism

- Declining “dynamism” in US economy
- Lot of effort by economists to understand causes
- Usually thought of as less firm formation & entrepreneurship
- But also a labor market dimension: less turnover

Rate of establishment formation

Source: BLS, Business Employment Dynamics survey
Long run trend toward less “churning” in the labor market

Percent of LF

Gross flows through unemployment (% of LF)

Sources: BLS, author’s calculations; series corrected for 1994 CPS redesign