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Four Things You Need to Know About the U.S. Economy

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Disclaimer

The views I will express today are my own and do not necessarily reflect the positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

The Big Picture

- The economy is likely to see above-trend growth over the second half of the year.
- New President, new policies—but until they are enacted, it's difficult to know their economic effects.
- The labor market is healthy, interest rates have popped, and inflation expectations are rising.
- Market-based expectations for a rate hike in December are very high, but monetary policy will likely remain very easy for the foreseeable future.

#1: We're at Full Employment

- In the aftermath of the Great Recession, the U.S. unemployment rate peaked at 10% in October 2009.
- The recession was particularly difficult for some workers (e.g., the less-educated and those employed in the housing and manufacturing industries).
- But we're into the eighth year of the expansion, and the unemployment rate is below 5%.
- Job gains this year have averaged 181,000/month.

Estimates of the economy's trend job growth are well under 100,000.

Estimates of the Long-Run Trend in Monthly Jobs Growth

	Lower Bound	Upper Bound	Mid-Point
Atlanta Fed (2016)*	40,000	140,000	80,000
SF Fed (2016)	50,000	110,000	80,000
Aaronson, et. al. (2014)	50,000	75,000	62,500

Chicago Fed (2016)	2015	2016	2020
Time-Varying	60,000	50,000	70,000

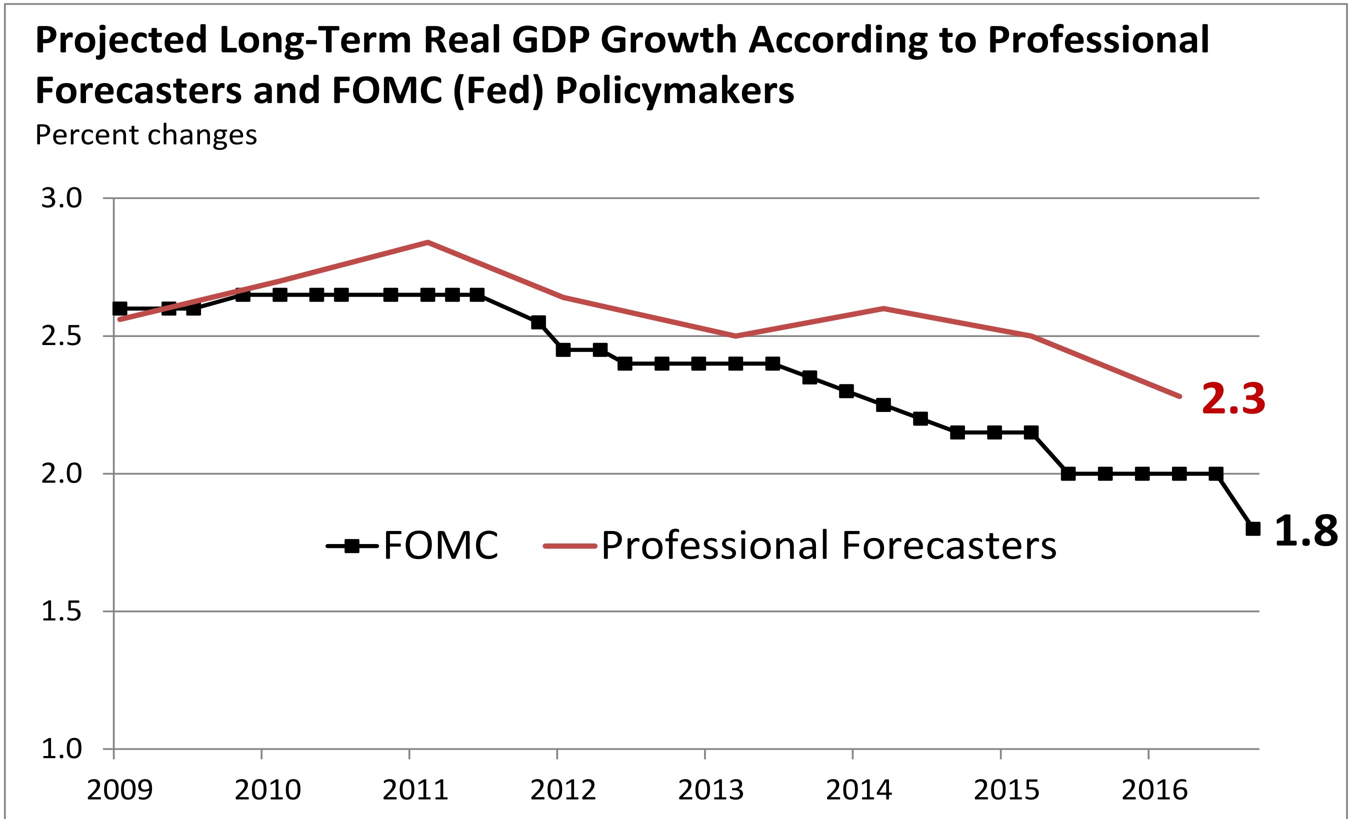
	Avg., 2021-2026
CBO (Aug. 2016)	64,000

*Atlanta Fed mid-point is their baseline estimate reported on their Macroblog from July 15, 2016.

#2: U.S. GDP Growth has the Slows

- During this expansion, real GDP growth rate has averaged about 2%—the weakest since the 1930s.
- Prior to the Great Recession and Financial crisis, real GDP growth averaged 3% per year.
- Many aspects of our future society depend crucially on how high the sustainable growth rate of real GDP turns out to be.
- The key question is why has growth slowed and what will it take to turn it around?

Do professional forecasters have rose-colored glasses or is the Fed too bearish?



SOURCE: Survey of Professional Forecasters and Federal Reserve Summary of Economic Projections.

#3: Labor Productivity Growth Stinks

- Labor productivity is the value of output produced (real goods and services) divided by hours worked.
- Few metrics in macroeconomics are more important than the growth rate of productivity.
- Productivity depends on many things: skill levels, technology, investment rates, government policies.
- **IMPORTANT!** Faster productivity growth = faster real GDP growth = faster growth of real wages = rising living standards.

What Drives Economic Growth?

- Economists have identified four key factors:
  - Investment in plant and equipment as a share of GDP
  - Educational attainment per person
  - R&D: The search for new ideas
  - Number of people in the economy
- One big solution to the problem of low productivity growth: The discovery of new ideas.

Possible explanations for the slowdown in labor productivity growth .

1. We've run out of new "big ideas"—i.e., all the low-hanging fruit has been picked.

2. It's a head-fake: bad data or we can't measure new innovations accurately.

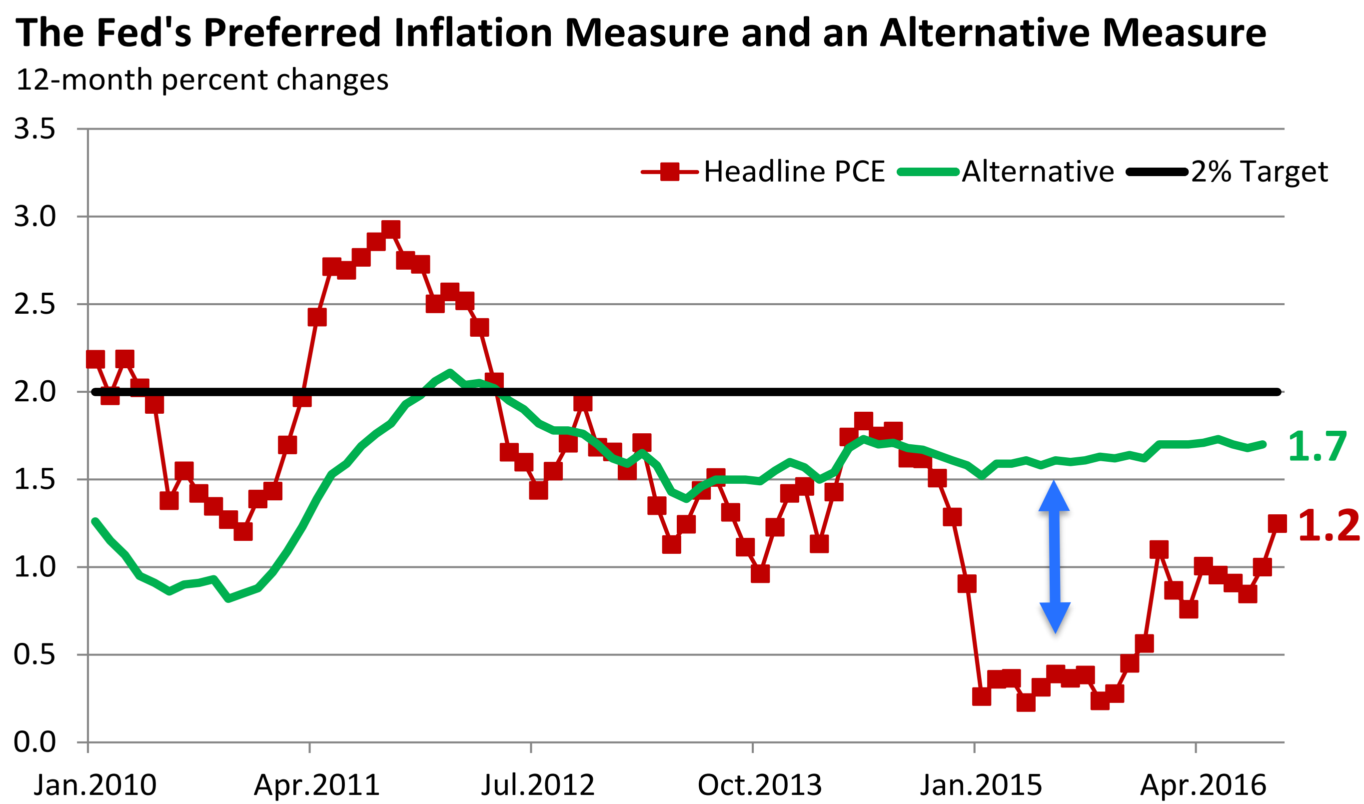
3. Government policies are hindering not helping.

4. It's being delayed—just wait!

#4: Low Inflation is the New Normal

- The Fed's preferred inflation measure has been below the 2% target rate since mid-2012.
- A key tenet of central bank practice is that an inflation target anchors inflation expectations.
- If the target is viewed as credible by the public, then inflation should deviate very little from the target.
- There may be periods, though, when sharp changes in some prices cause inflation to deviated from the target.

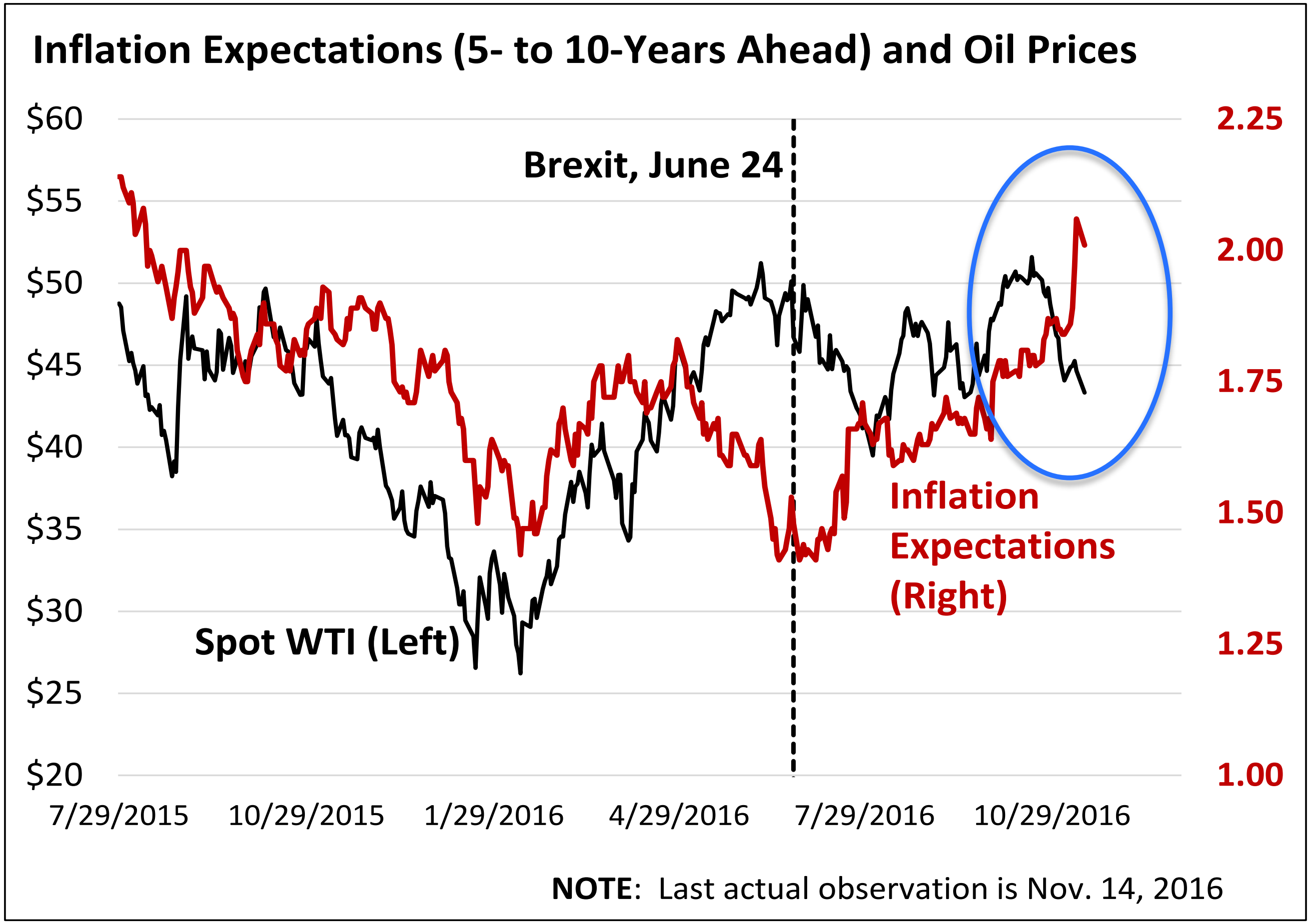
Falling oil prices lowered headline inflation but not many other prices.



SOURCE: BEA and FRB Dallas.

NOTE: Data through Sept. 2016.

The bond market's inflation fear gauge is ignoring the drop in oil prices!



Fearless Forecast for the next 3 Years.

- Projected averages, 2016 to 2019:
  - Real GDP growth: Around 2%
  - Unemployment rate: About 4.75%
  - Headline inflation: 2%
- Punchline: More of the same—unless something unexpected happens!