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The Outlook for the U.S. Economy: Sunny Skies But Developing Storm Clouds?

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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

- We're into the 8th year of expansion . . . The average expansion lasts about 5 years.
- Real GDP growth during this expansion has averaged about 2.25% per year. Historically, growth has averaged about 3% per year.
- There are many reasons for weaker growth: Deleveraging, tighter access to credit, reregulation, higher taxes, demographics, and less innovation.
- Inflation has been below the FOMC's 2% target for most of the past five years.

Forecasting Basics

- **Joke of the Day!** Economic forecasting is an imprecise exercise.
- Forecasters have a lot of hurdles to overcome: Imperfect data and models, assumptions about economic policy, unexpected developments (shocks) can't be accounted for.
- So, we assume—to a large degree—that the past is prologue, but recognize that households, firms, and governments can change their behavior. Incentives matter!
- **Bottom line:** Look at long-run trends and then attempt to assess where the economy is currently relative to trend.

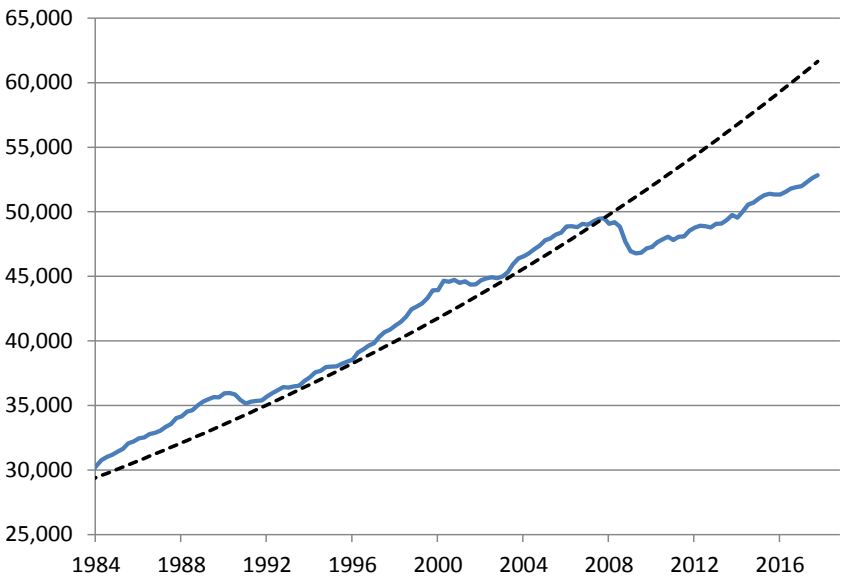
So Many Questions!

- Is 2.25% economic growth still the norm?
- Or, will tax reform boost the economy's short- and long-term prospects?
- How should we think about the increase in the budget deficit due from tax cuts and increased spending?
- Is inflation temporarily low?
- Are we stuck in a low interest rate regime?
- If so, what does that imply for the economy and monetary policy?

The Future Ain't What it Used to Be?

Per Capita Real GDP, 1984 to Present

Billions of \$2009

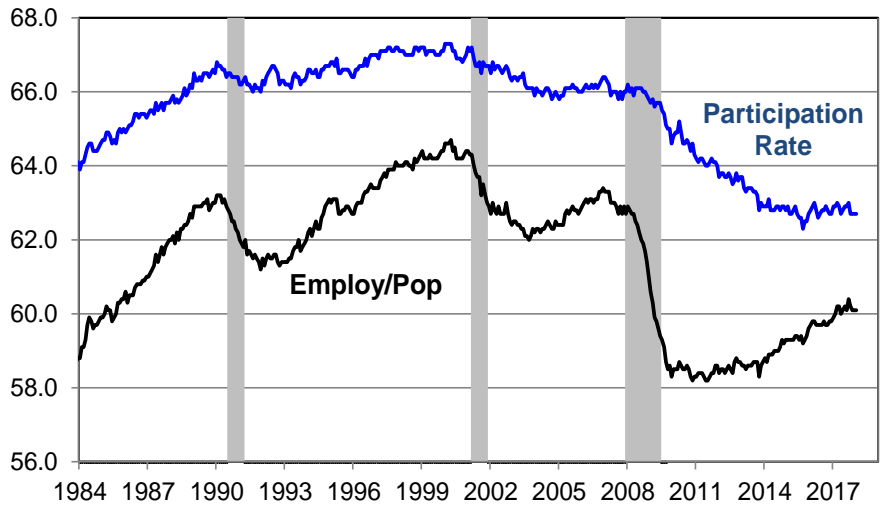


SOURCE: U.S. Bureau of Economic Analysis

Data through 2017:Q4

The Labor Force Participation Rate and the Employment-to-Population Ratio, 1984 to Present

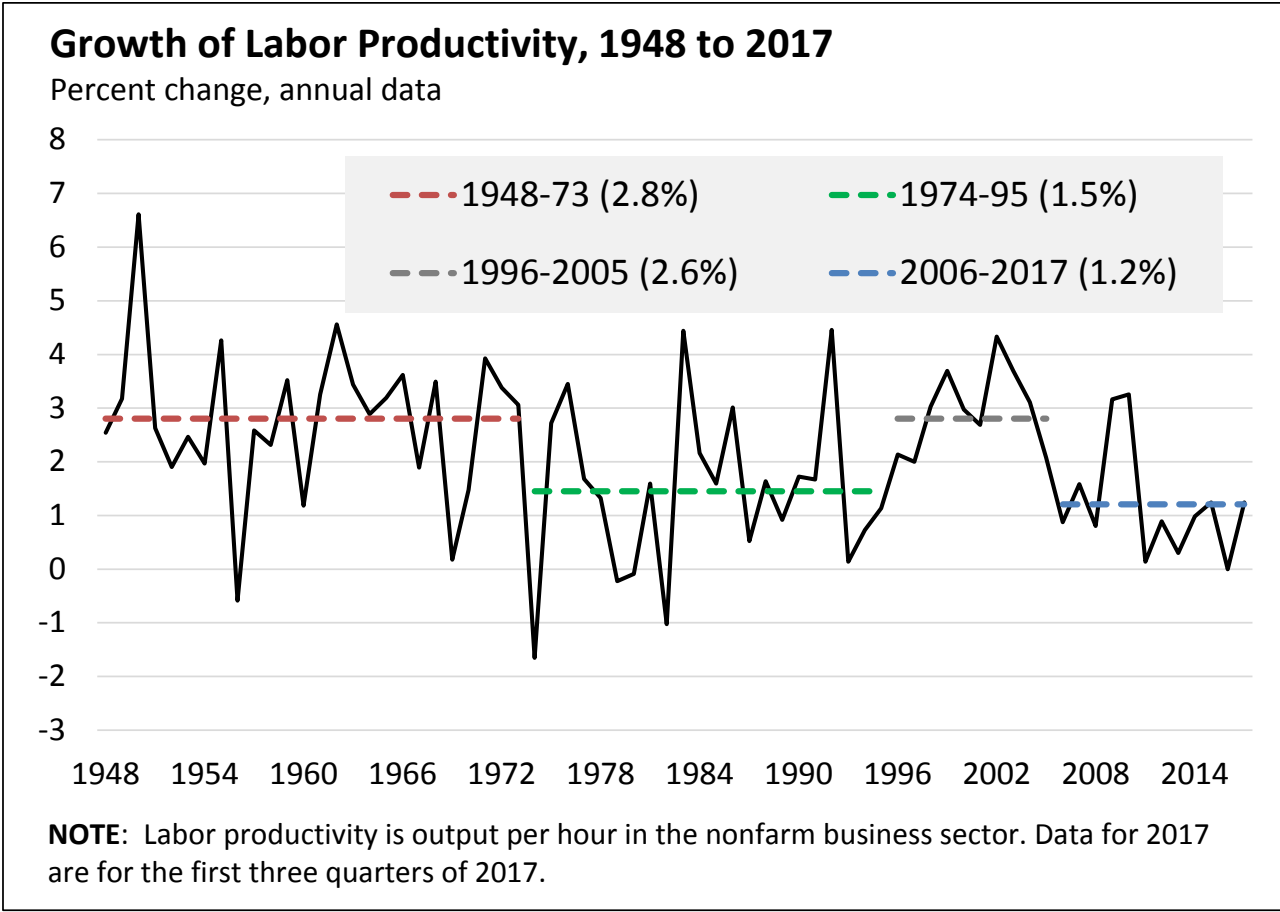
Percent



Source: Bureau of Labor Statistics.

Data through January 2018.

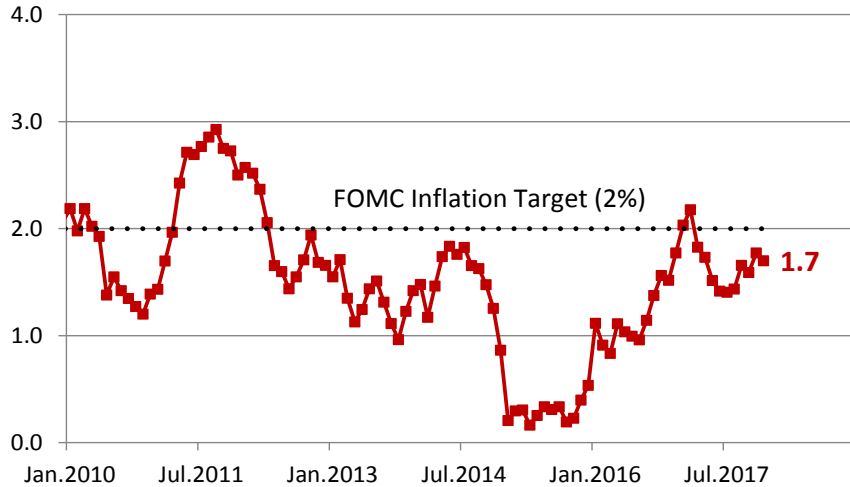
The Future Ain't What it Used to Be?



The Future Ain't What it Used to Be?

The Fed's Preferred Inflation Measure

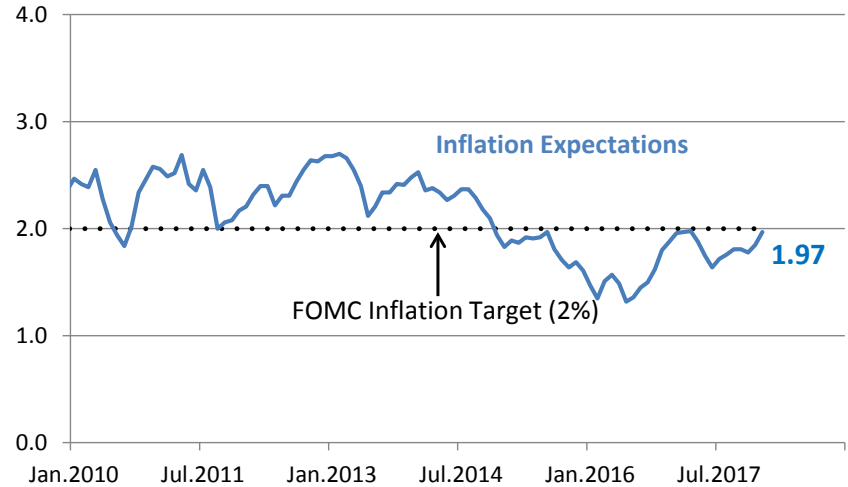
Percent change from a year earlier



NOTE: Inflation calculated from the personal consumption expenditures price index. Last observation is September 2017. Source is the Bureau of Economic Analysis.

Long-Term Inflation Expectations

(Inflation expectations based on TIPS)



NOTE: Inflation calculated from the personal consumption expenditures price index. Inflation expectations are 5-year, 5-year forward break-even inflation rates.

A New Normal for Inflation?

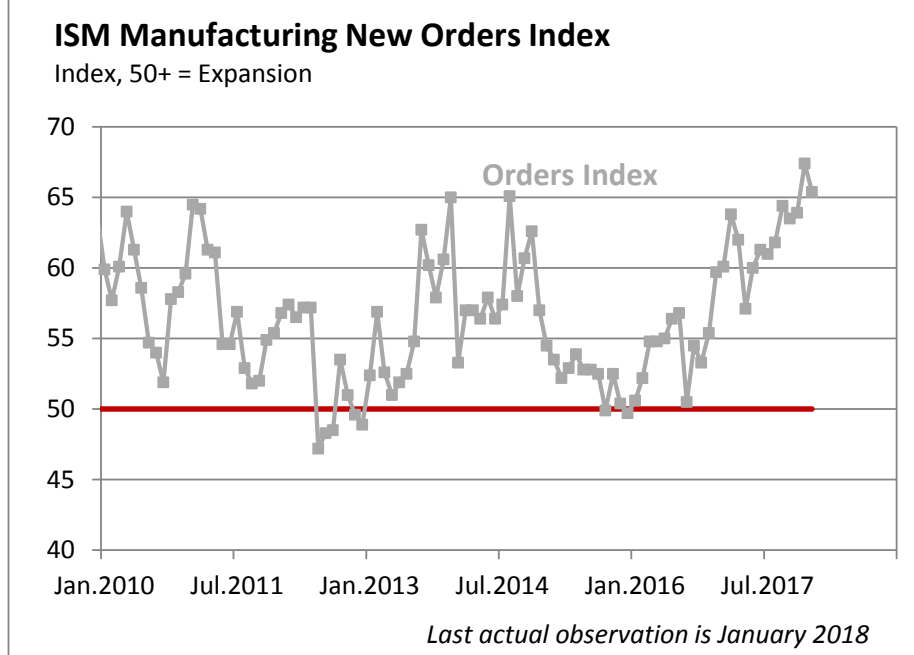
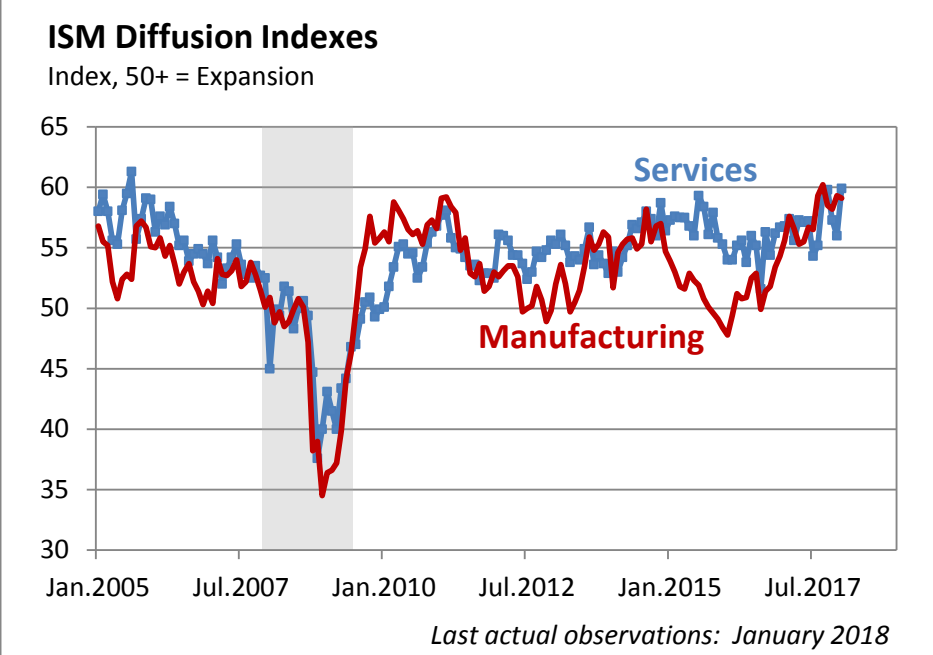
- Some economists are beginning to wonder if 2% inflation is attainable in light of fundamental changes in the economy.
- For example, the fracking revolution in the United States seems to have permanently lowered the price of crude oil (“shale band”).
- Others wonder whether the “Amazon effect” has exerted similar effects on retail prices.

Current Economic Developments

Current Economic Conditions

- Solid labor market conditions and low inflation.
- Consumer optimism supports spending on autos and other big-ticket items.
- Global growth looks pretty strong—even Europe is experiencing strong growth!
- Financial market volatility! Melt-up . . . Melt-down . . .
- Healthy forward momentum in the second half of 2017 bodes well for 2018 and 2019.
- Businesses are optimistic.

Two Key Barometers Look Good



Current Economic Conditions

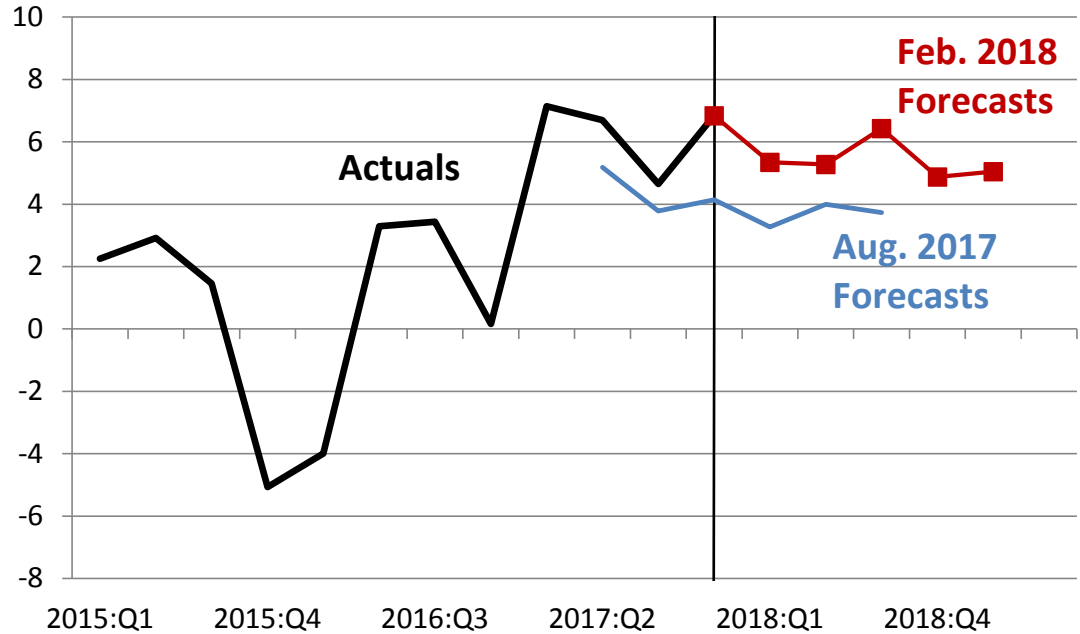
WHAT PURCHASING MANAGERS ARE SAYING ...

- “Sales nationally and internationally are strong in Q1. We are increasing our CapEx spend by 30% to 40% over [the] previous year.” (Chemical Products)
- “We have heard reports of additional business due to the recent reduction of tax rates.” (Machinery)
- “Business outlook is positive on all fronts right now with our customers.” (Computer & Electronic Products)
- “Our usual winter slowdown has not occurred, and we are very busy with new orders.” (Furniture & Related Products)
- “Executive management [is] excited about tax breaks for CapEx purchases in the new tax bill.” (Information)

Forecasters: Expect More CapEx

What Are Forecasters Predicting for Real Business Capital Expenditures (Fixed Investment)?

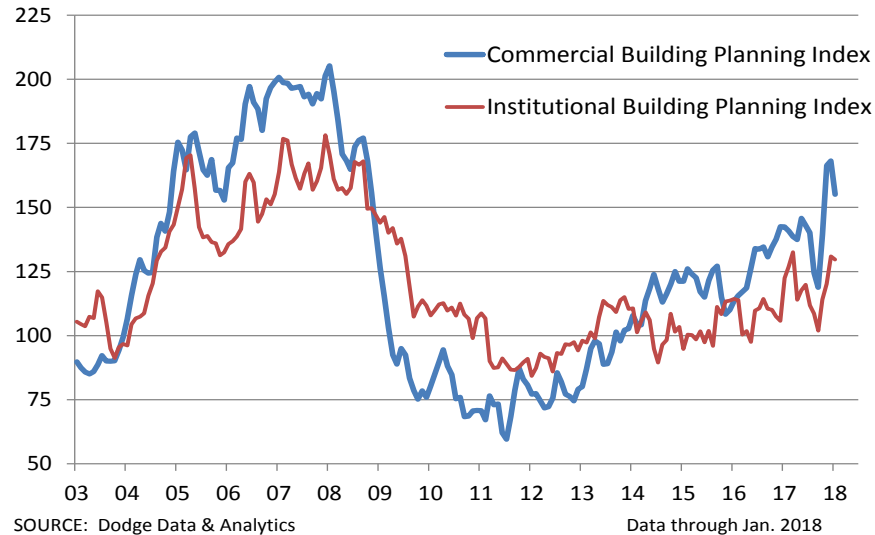
Percent changes at annual rates



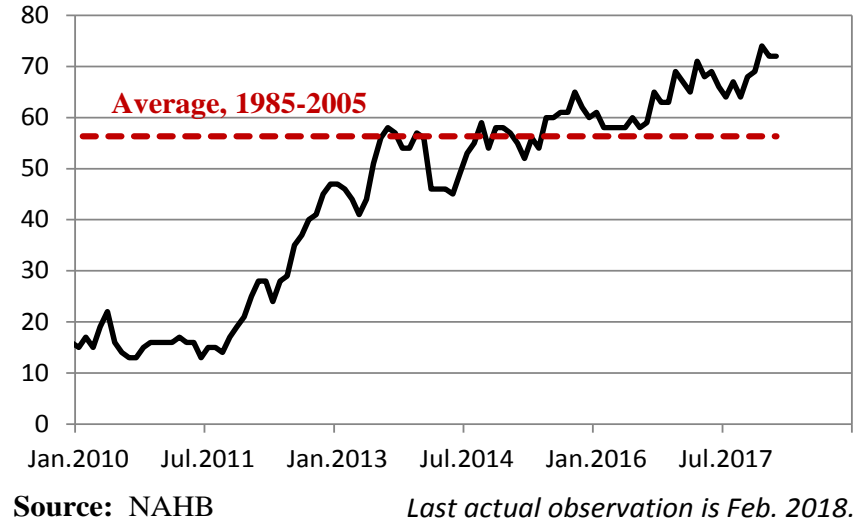
SOURCE: Survey of Professional Forecasters, Aug. 2017 and Feb. 2018.

Construction Outlook Appears to be Improving

Dodge Momentum Indexes: Commercial and Institutional Building
2000 = 100

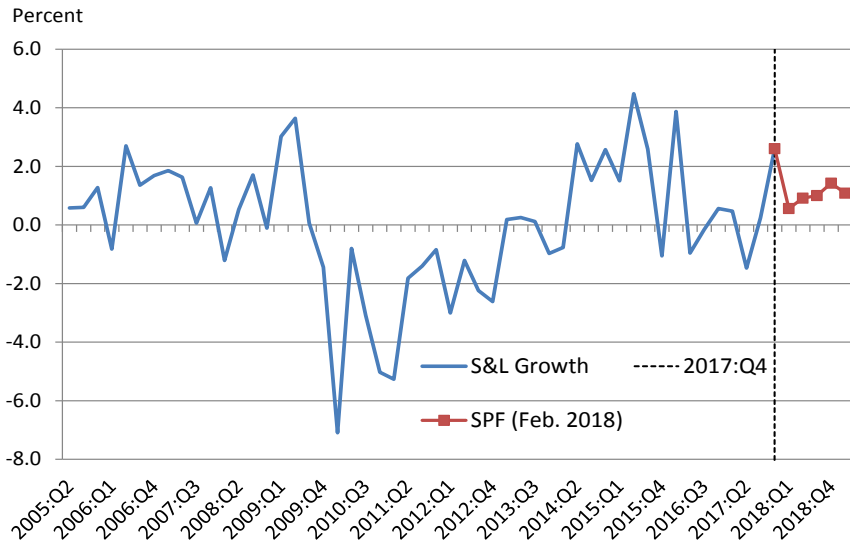


National Home Builders Housing Market Index
Index, All Good = 100



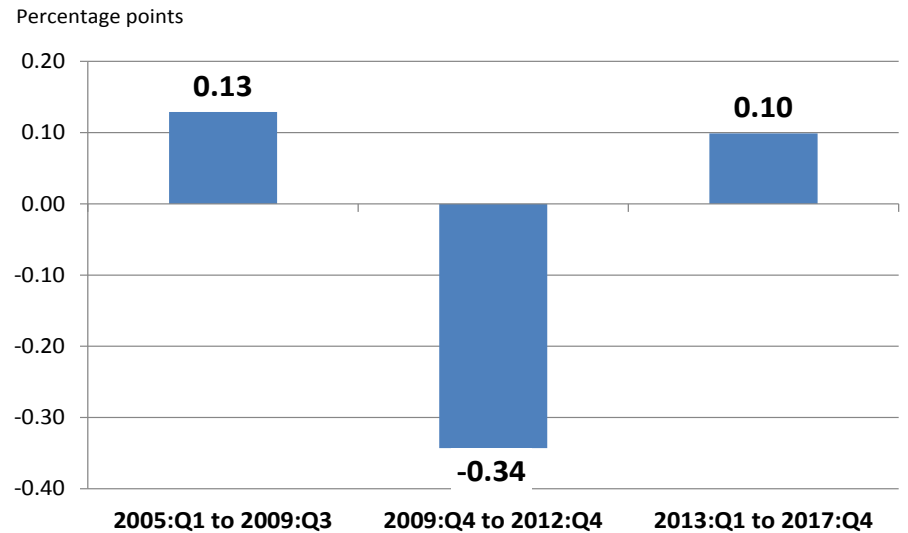
Near-Normal Growth in State & Local Government Spending

What Are Forecasters Predicting for State & Local Real Expenditures?



SOURCE: Survey of Professional Forecasters

Contributions to Real GDP Growth from Real State & Local Expenditures



SOURCE: Bureau of Economic Analysis

Growth in Public Capital Spending Lags in Some Areas

Real Public Capital Stock Per Worker, Selected Categories

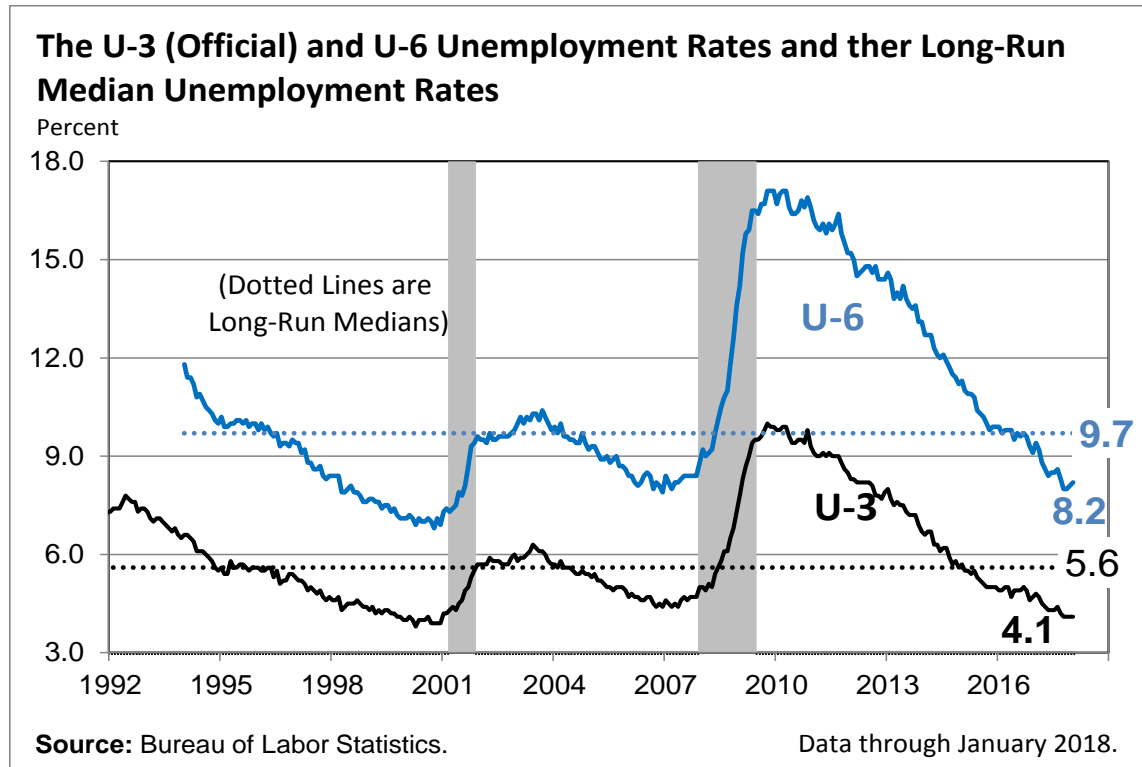
Chain-weighted, 2009 dollars

	<i>Per Worker Amounts (\$)</i>			<i>Growth Rates</i>	
	1997	2007	2016	1997 to 2007	2007 to 2016
Total	\$36,581	\$39,599	\$42,193	0.80	0.71
Structures	29,139	31,601	33,414	0.81	0.62
Health Care	1,025	1,002	1,101	-0.23	1.06
Education	4,292	5,419	6,041	2.36	1.21
Public Safety	943	974	951	0.33	-0.26
Transportation	1,242	1,591	1,794	2.51	1.35
Power	914	939	1,048	0.27	1.22
Highways	8,701	9,169	9,390	0.53	0.26
Military	2,704	2,273	2,124	-1.72	-0.75
Addenda					
Growth rate of real GDP per worker				1.84	0.94

NOTE: Total government capital stock.

SOURCE: BEA and Author's calculations

Unemployment Rates are Low, Regardless of How Measured



Where are Job Openings the Most and Least Plentiful by Industry?

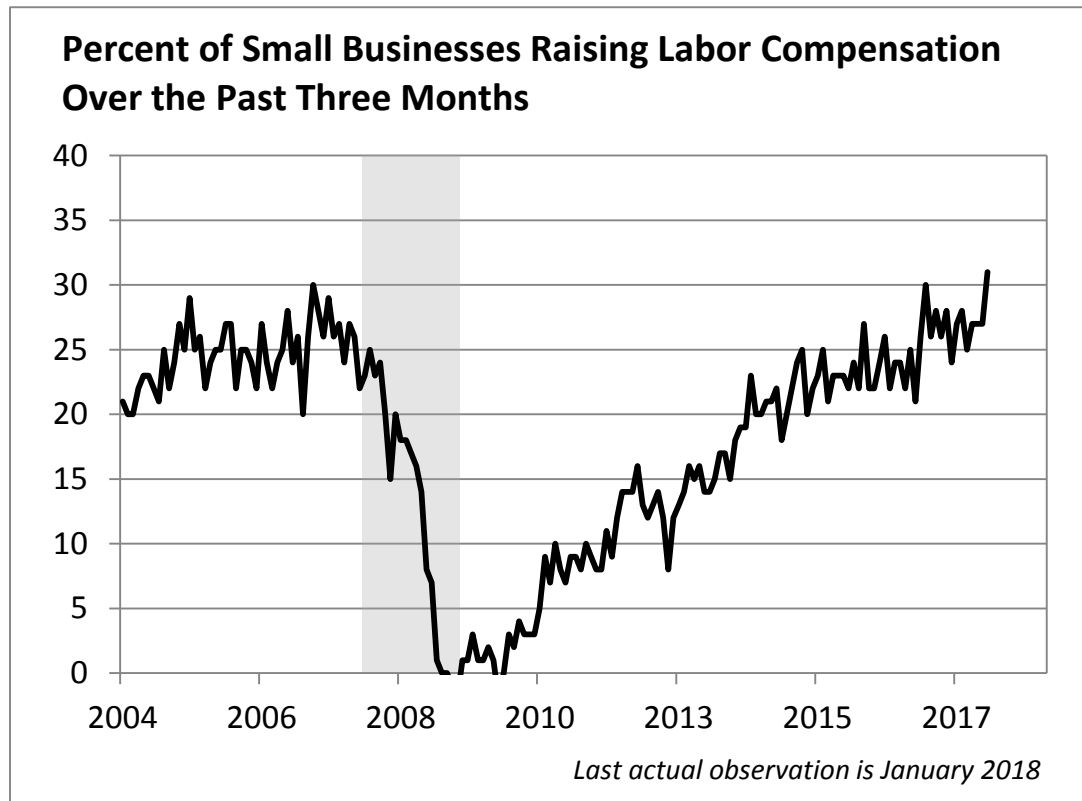
Change in Job Openings Over the Past Year

Percent change, Dec. 2016 to Dec. 2017

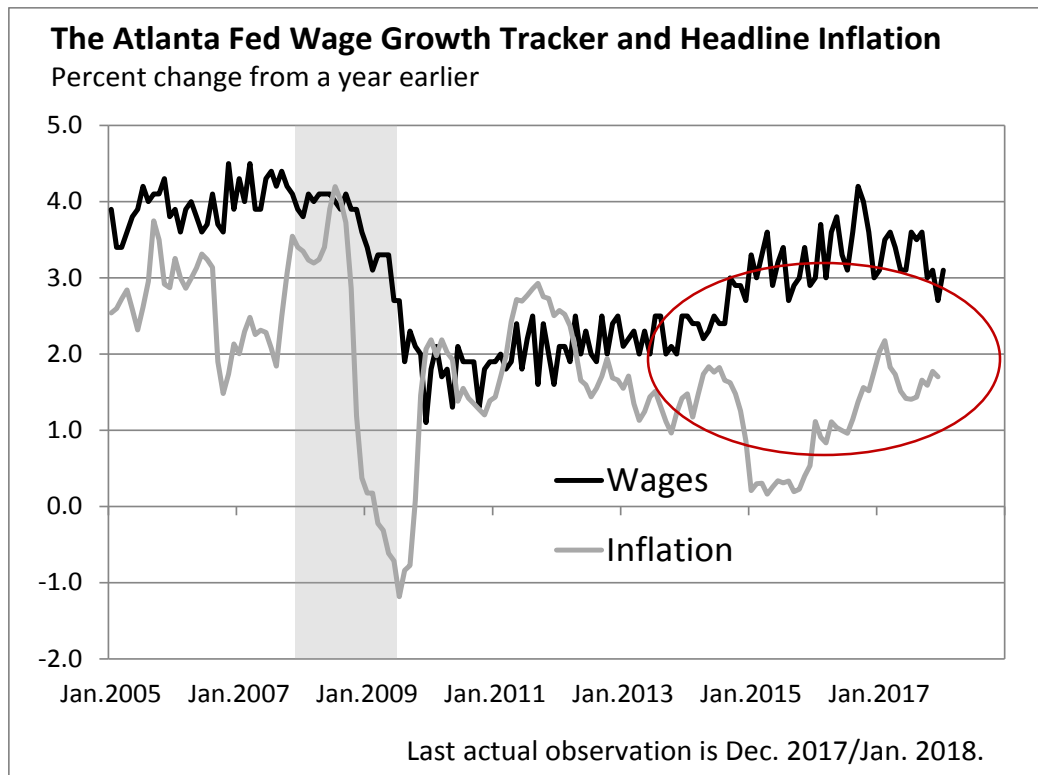
Leisure & Hospitality	21.9%
Construction	12.9%
Government	9.9%
Trade, Transportation & Utilities	6.9%
Manufacturing	6.4%
Education & Health Care Services	-1.9%
Professional Business Services	-3.3%

SOURCE: Bureau of Labor Statistics

Wage Growth is Picking Up According to Small Businesses



Wage Growth is Picking Up but Inflation Remains Below 2%.

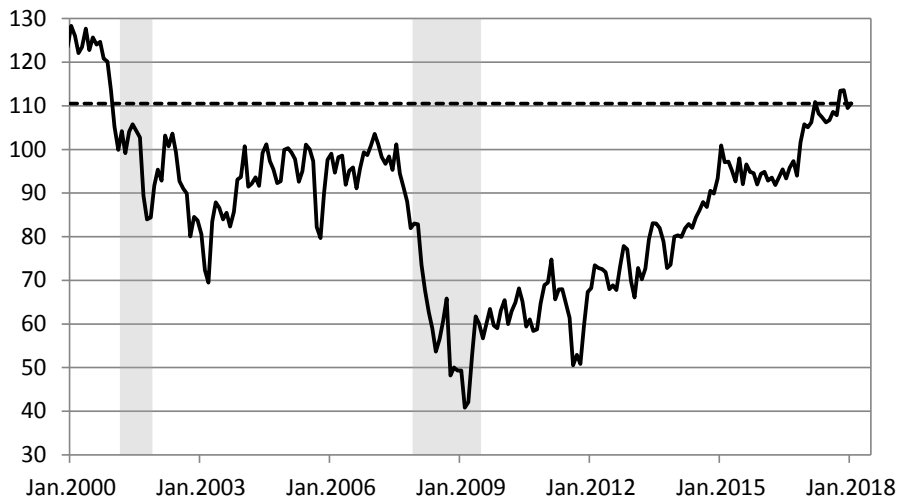


A widening gap is good because it signals improving purchasing power of households (inflation-adjusted wages).

Are Households Too Optimistic?

Consumer Confidence

Index

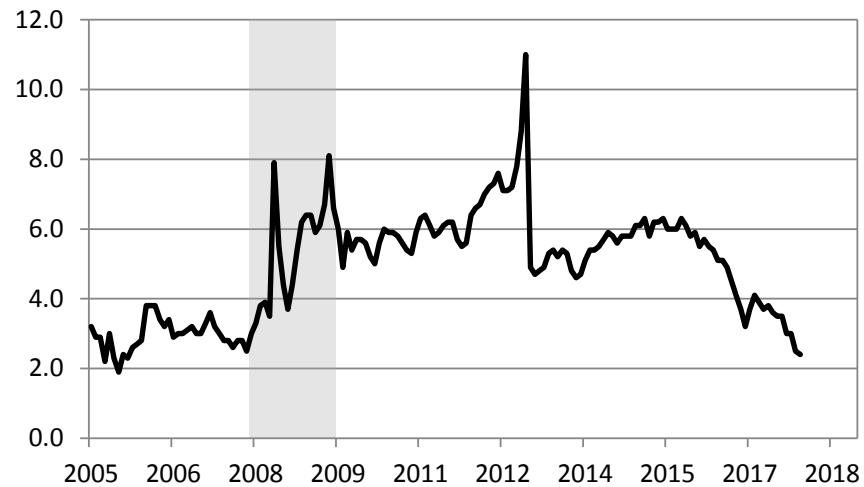


NOTE: Avg. of Michigan and Conference Board surveys.

Last monthly observation is Jan. 2018.

Personal Saving Rate

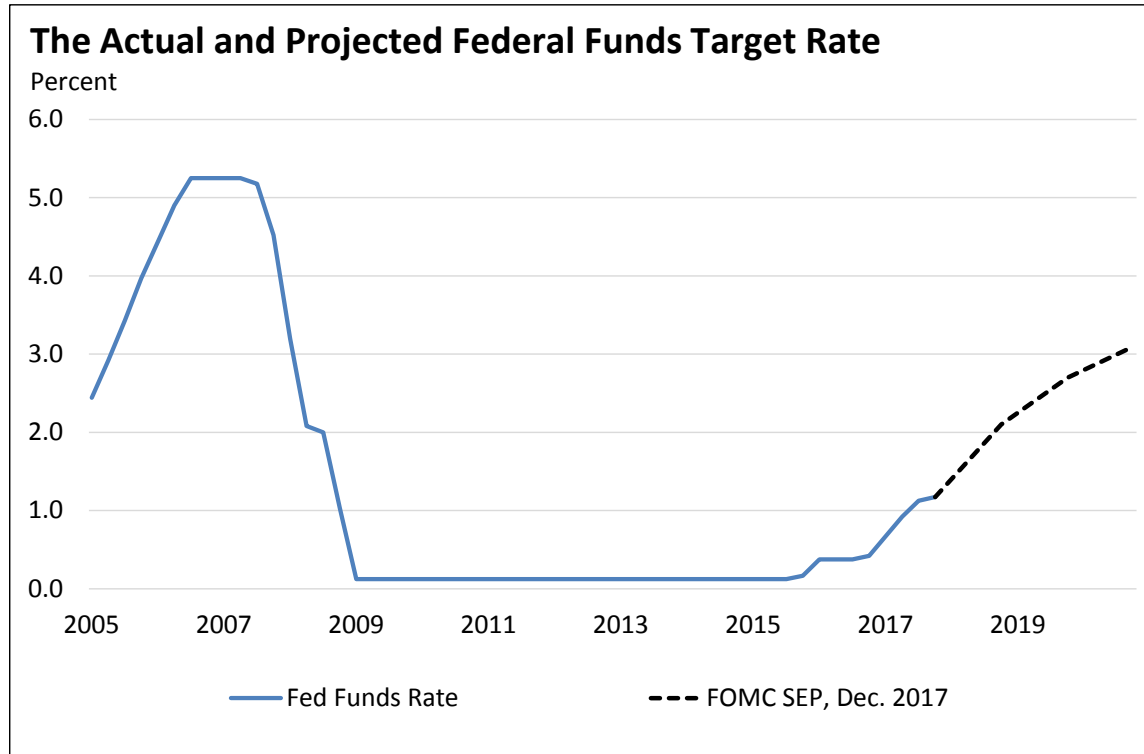
Percent of disposable personal income



SOURCE: BEA

Last actual observation is December 2017

The FOMC: We're Bullish on the U.S. Economy!



“Information received since the Federal Open Market Committee met in December indicates that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. Gains in employment, household spending, and business fixed investment have been solid, and the unemployment rate has stayed low.” [FOMC Statement, Jan. 31, 2018]

Why You Should be Optimistic

- Cuts in marginal tax rates, coupled with increases in household wealth, should keep consumer spending and housing construction growing at healthy rates.
- Tax law changes will encourage firms to boost capital spending, hiring, and repatriate foreign profits.
- All else equal, these developments will tend to raise productivity, real wages, and economic growth.
- Unless inflation ramps up, the FOMC will be patient in withdrawing monetary stimulus.

Kliesen's Forecast Last Year (2017)

- Projected averages, 2017 to 2019:
 - Real GDP growth: 2.25% to 2.75%
 - Unemployment rate: 4% to 4.5%
 - Headline inflation: 2% (some upside risk)
- Punchline: Policy changes, if realized and designed appropriately, could boost economic growth by 0.5% to 0.75%. But inflation will need to stay low.

Kliesen's Forecast, Circa 2018

- Projected averages, 2018 to 2020:
 - Real GDP growth: 2.5% to 3.0%
 - Unemployment rate: 3.75% to 4.25%
 - Headline inflation: 2% (some upside risk)
- Punchline: Policy changes will boost economic growth. Inflation fears have crept into the market, so the Fed will need to remain vigilant.

QUESTIONS?