

United States Economic Performance

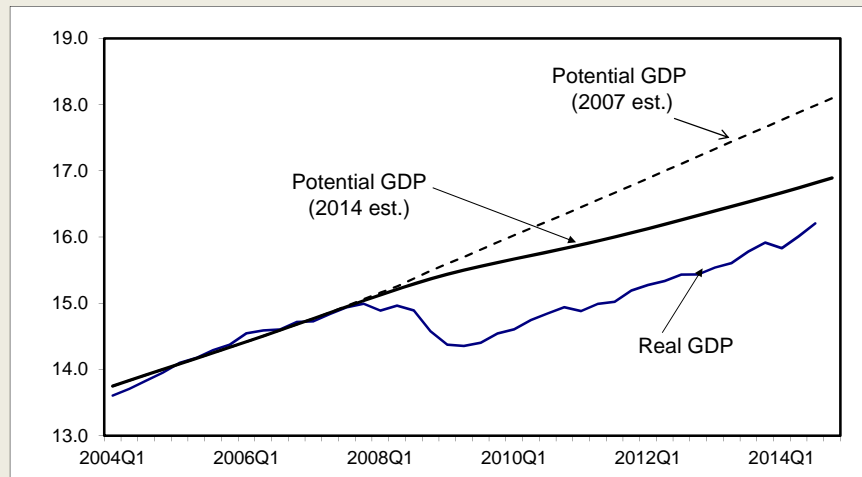
Barry Bosworth
Brookings Institution
January 2015

Economic Recovery Perceived As Complete

- Resource utilization near full-employment levels
 - Unemployment at 5.6% and projected lower
 - Capacity utilization at historical norm
 - GDP growth projected at 3-3½% for 2015
- However, most of adjustment is on the supply-side.
 - Smaller labor force and capital stock
 - Reduced estimates of potential GDP

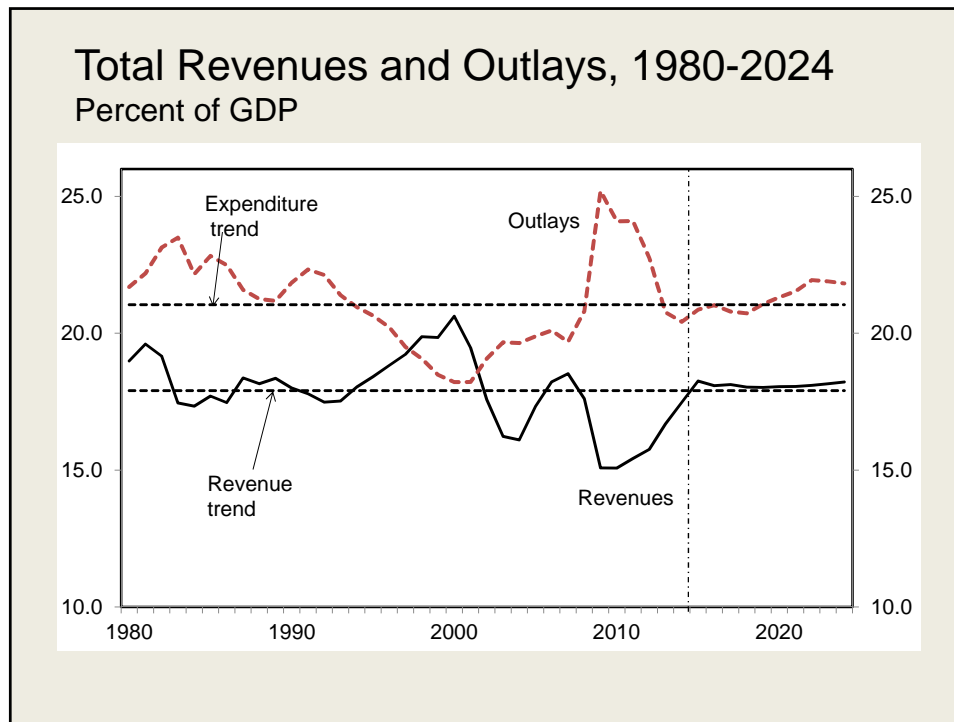
Actual and Potential GDP

trillions of dollars



Sources of Optimism

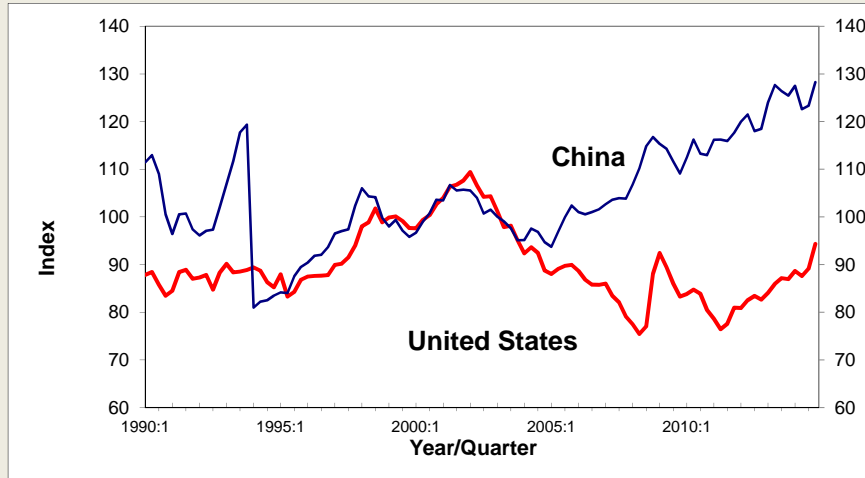
- Budget battles and fiscal drag largely over
- High consumer optimism with consumption increases in line with income growth
- Energy price collapse provides a strong boost to domestic demand
- Business investment has returned to pre-crisis rate.
- Core-inflation is well-below target of 2%.
- External deficit (3% of GDP) is well-below pre-crisis level.



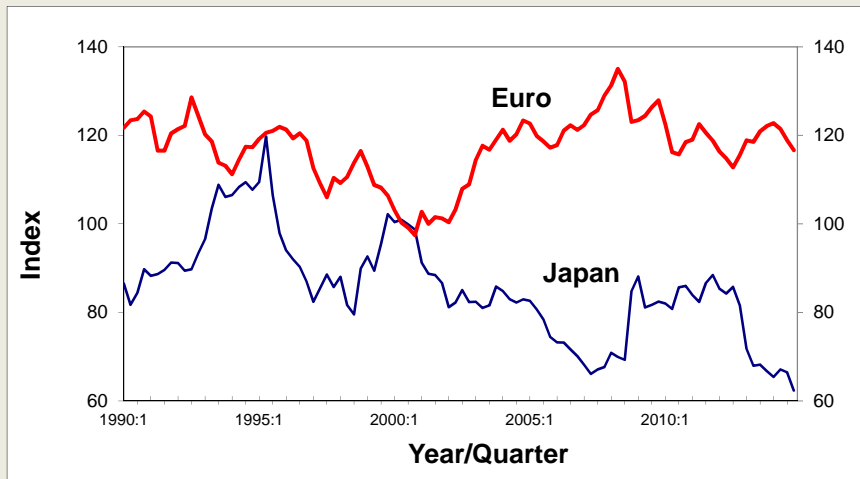
Sources of Concern

- Weak global economy
 - Can the United States sustain growth as an outlier
 - Major divergence of monetary policies
 - Very large exchange rate appreciation will drag down trade performance.
- Weak recovery of housing market
- Poor productivity performance is limiting real wage growth.

Trade-Weighted Real Exchange Rate: China and the United States



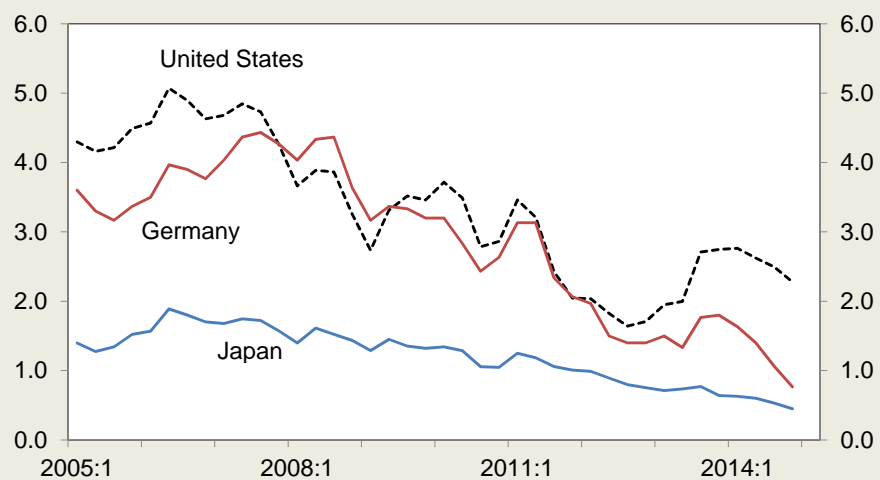
Trade-Weighted Real Exchange Rate: Euro Area and Japan



Normalization of Monetary Policy

- FRB intention to begin raising federal funds rate in 2015
 - Timing is dependent on growth
 - Growth above 3% suggests increase at midyear
 - Less than 3% implies delay into the fall
 - Substantial increase already factored into bond rates.
 - Optimistic growth projections, such as IMF, suggest a funds rate of 1-2% in 2016.

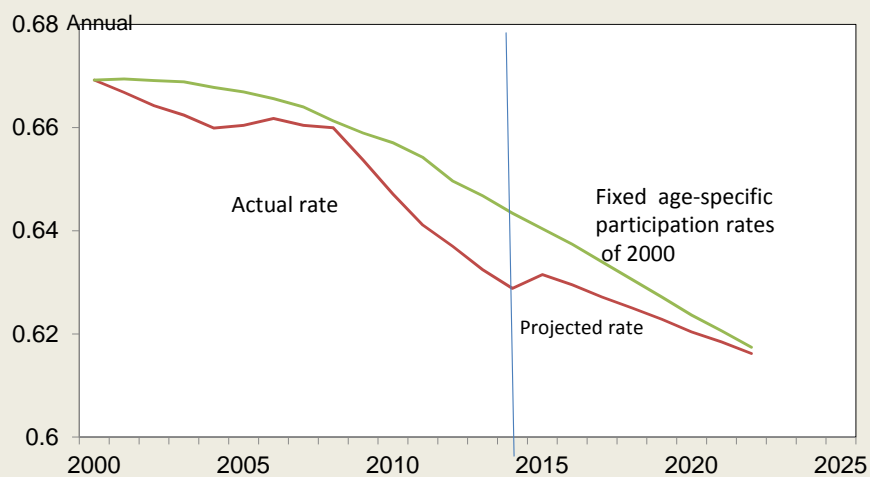
Ten-year Bond Rates



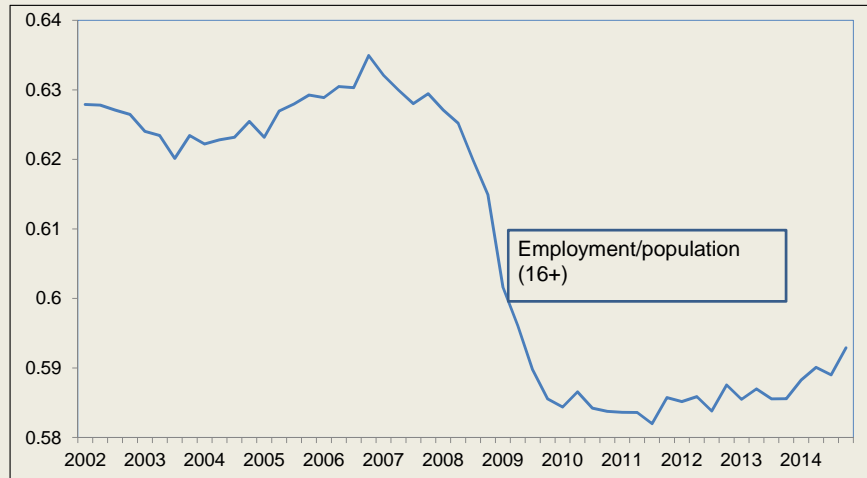
Supply-side Revisions

- Large decline in labor force participation
 - Not foreseen in earlier projections.
 - Largely demographically induced-aging of population of labor force age
 - Discouraged worker component fades at very gradual rate.
- Cyclically-induced fall in capital accumulation
- Lower anticipated growth in TFP

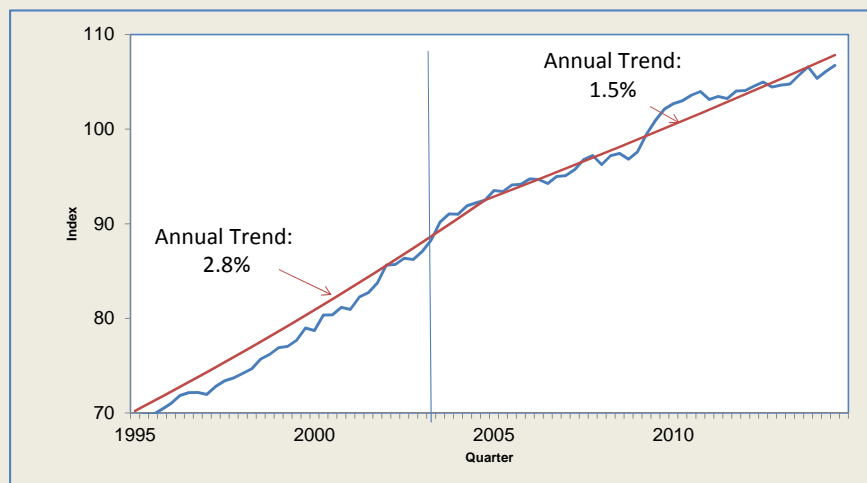
Actual and Demographically-Adjusted Labor Force Participation, 2000-2022



Employment-Population (16+) Ratio



Labor Productivity in the Nonfarm Business Sector, 1995:1-2014:3



CBO Revisions to Potential GDP Growth annual percentage change

	<u>2007 projections</u>		<u>2014 projections</u>	
	<u>2007-2017</u>	<u>2013-2017</u>	<u>2014-2017</u>	<u>2018-2024</u>
	<u>Total Economy</u>			
Potential Output	2.6	2.5	1.9	2.2
Potential Labor Force	0.7	0.5	0.5	0.6
Potential Labor Force Productivity	2.0	2.0	1.4	1.6
	<u>Nonfarm Business Sector:</u>			
Contribution from:				
Potential Hours	0.6	0.4	0.3	0.5
Capital Services	1.1	1.1	0.8	1.0
Potential TFP	<u>1.4</u>	<u>1.4</u>	<u>1.2</u>	<u>1.2</u>
<u>Total</u>	3.1	2.9	2.3	2.6

Source: CBO, An Update to the Budget and Economic Outlook: 2014 to 2024.

Real Wage Growth

- Recovery of overall economy not matched by greater growth in real wages.
 - Slow productivity growth (return to 1972-95 pattern)
 - Significant decline in labor's share
 - Small effect from terms of trade
 - Slower growth in fringe benefit costs provides a small improvement.
- Problem is intensified by continued increase in income inequality.

