The Economic Outlook for the United States after the Election

Presentation to the Nomura Macroeconomic Conference
Tokyo, November 13, 2012
Martin Neil Baily
Brookings
US economic growth is sustained but slow. Macroeconomic Advisers forecast is optimistic but there are downside risks.

SOURCE: BEA, Macroeconomic Advisers (released 10/10/12)
Why is the US economy recovering? Why is the recovery so weak?

- Consumers are spending, housing starts and residential construction are growing.
- The recovery is slow because of the weakness in the labor market, reluctance to lend, the overhang of mortgage foreclosures and underwater mortgages, the weakness in government spending, business investment has flat-lined and exports are slowing.
- The recovery should continue this year and may strengthen next year. The biggest risks are a renewed crisis in Europe, a slowdown in China, an oil price spike, and the prospect of the fiscal cliff.
- Quantitative easing has caused concern about “monetary inflation”. However, inflation expectations remain contained, wage inflation is low and there is still slack in labor and product markets.
Huge employment decline. Job growth has been slow because GDP growth has been slow.

Decline from peak US employment\(^1\)
Percentage from peak month prior to recession

- 8.7 million jobs lost from peak-to-trough (Dec 2007 to Dec 2009)
- 4.5 million net job gains since the start of 2010 (Jan 2010 through Oct 2012)
- U.S. employment today (Oct 2012) is 4.2 million below peak of December 2007

1 Total non-farm employment, seasonally adjusted
2 Preliminary numbers subject to change

People with only a high school degree or less have been disproportionately hit

U.S. unemployment rate during the recovery

<table>
<thead>
<tr>
<th>Category</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>College graduates</td>
<td>4.2</td>
</tr>
<tr>
<td>Young college graduates</td>
<td>14.5</td>
</tr>
<tr>
<td>Young high school graduates</td>
<td>24.7</td>
</tr>
<tr>
<td>Young people without high school diploma</td>
<td>36.4</td>
</tr>
</tbody>
</table>

SOURCE: Bureau of Labor Statistics
Geographic mobility in the US has been declining since 1990 and is at a 50-year low

Annual domestic migration rate, 1948–2009
% of residents who have changed addresses during the past year

In the 1950s and 1960s, 1 in 5 Americans changed residences every year . . .

. . . but that figure has now dropped to 1 in 10

Long-run average = 18%

Data from 1970–1981 are interpolated due to data constraints.

Historically high-growth businesses are the lifeblood of job creation, but the level of startups remains depressed.

High-growth businesses are “young” businesses, and 1% of firms generate ~40% of net new jobs, generating 88 net new jobs in any given year, vs 2-3 for average firm.

SOURCE: SBA, Kauffman Foundation
US household debt has fallen in absolute terms; two-thirds has been due to defaults

Household debt, Q4 2008–Q4 2011

<table>
<thead>
<tr>
<th>Year</th>
<th>Home mortgages (including home equity loans)</th>
<th>Consumer credit</th>
<th>Other credit</th>
<th>Q4 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q4 2008</td>
<td>13,801</td>
<td>195</td>
<td>461</td>
<td>151</td>
</tr>
<tr>
<td>Q4 2011</td>
<td>13,222</td>
<td>873</td>
<td>861</td>
<td>2,521</td>
</tr>
</tbody>
</table>

1 The share of decrease attributed to repayment vs. default is estimated using Q1 2011 data
2 “Other credit” comprises commercial mortgages, other bank loans, other loans and advances, and municipal securities.

NOTE: Numbers may not sum due to rounding.

SOURCE: US Federal Reserve; McKinsey Global Institute
Improving Financial Conditions

Households Reduce Financial Obligations

* The ratio of debt-service payments to disposable personal income, where debt-service includes estimated required payments on outstanding mortgage and consumer debt, plus auto lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments.

** Nonaccrual loans and loans past due 30 days or more and still accruing interest.

Source: Federal Reserve Board; Last data plotted for Household financial obligation ratio is Q1-2012 for Consumer loan delinquency rate is Q2-2012.

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Pace of Deleveraging Slows

Personal Saving Rate

Effect of payroll tax increase and unemployment benefit decline

Source: Bureau of Economic Analysis, Macroeconomic Advisers, LLC; Forecast published on September 6, 2012.
Housing Recovery - Finally Underway?

Housing Starts & Residential Investment Turn Up

Thous. units, seasonally adj. ann. rate

4-quarter percent change

Private housing starts

(lef) Expected long-term average 2011-2020*

Residential investment

(right)

Source: U.S. Census Bureau; U.S. Department of Commerce; Macroeconomic Advisers, LLC; Forecast published on September 6, 2012.
The enormous increase in the Federal Reserve Balance Sheet has been a concern to some, but actual core inflation has been moderate.

**YoY Percent Change in Personal Consumption Price Index**
*(Excluding Food and Energy)*

- **Fed's informal target range**

*SOURCE: Bureau of Labor Statistics*
Political deadlock has created some possibility of a “fiscal cliff,” which could cause a recession in 2013.

GDP, trillion 2005 USD, Seasonally adjusted annual rates

In the fiscal cliff scenario real GDP falls 3.0% in 2013q1 and 1.3% in 2013q2, leading to 3% lower GDP by 2013q4 relative to the baseline.

SOURCE: Moody’s Analytics, August 2012 Baseline and Fiscal Cliff Alternative Scenario
Effect on fiscal cliff components on deficit and GDP

$ billions; total effect $503 billion

<table>
<thead>
<tr>
<th>Component</th>
<th>Deficit</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defense</td>
<td>24</td>
<td>0.1</td>
</tr>
<tr>
<td>Nondefense</td>
<td>40</td>
<td>1.3</td>
</tr>
<tr>
<td>Bush cuts (high)</td>
<td>108</td>
<td>0.7</td>
</tr>
<tr>
<td>Bush cuts (low/middle)</td>
<td>42</td>
<td>0.4</td>
</tr>
<tr>
<td>Payroll/UI</td>
<td>288</td>
<td>0.4</td>
</tr>
</tbody>
</table>

% GDP; total effect 2.9%

Source: Chart created by Wonkblog using data from the CBO report "Economic Effects of Policies Contributing to Fiscal Tightening in 2013."
Energy Prices Volatile, but Expected to Decline

![Graph showing WTI crude oil spot price over time with volatility from 2000 to 2014.](image)

Source: Wall Street Journal; Macroeconomic Advisers; Forecast published on September 6, 2012

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U.S. Natural Gas Production, 1990-2035

Gas is Expected to be the Fuel Used in 80 percent of New Generating Capacity

Concluding Comments

• A favorite explanation of the slow US recovery among conservatives is that Obama has created regulatory uncertainty—Affordable Care Act, Dodd-Frank financial regulation, energy and tax policy. Evidence is pretty thin. Obama is very unpopular in the business community but it is not clear how much this has affected their actions.

• A major new fiscal stimulus would help demand growth but politically this is difficult or impossible and it could create financial stress. A big priority is to avoid premature fiscal contraction—notably the fiscal cliff. Agreement on a long term budget plan would improve both consumer and business confidence.

• The United States economy is on a recovery path, but weakness in Europe and elsewhere is a big concern; China seems to be stabilizing.

• Changing energy technology could be an important driver of US investment. It will not bring back millions of manufacturing jobs but if environmental concerns can be solved (a big question), there is the potential for substantial investment and employment growth in extraction; revamping the transportation infrastructure; new electricity generating facilities; and in manufacturing such as plastics and petrochemicals. An important role for government as a facilitator.
Appendix

Fiscal Cliff Specifics
## THE FISCAL CLIFF

### LEGISLATION / PROVISIONS

<table>
<thead>
<tr>
<th>Description</th>
<th>Impact on Deficit*</th>
<th>Multiplier After 4 Qtrs**</th>
<th>Fiscal Drag Billions of Dollars</th>
<th>Fiscal Drag 2013 Growth***</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2011</td>
<td>-221</td>
<td>0.7</td>
<td>-206</td>
<td>-1.3</td>
</tr>
<tr>
<td>- AMT patch expired December 31, 2011, reducing payments in spring 2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Bush Tax Cuts expire December 31, 2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Class Tax Relief and Job Creation Act of 2012</td>
<td>-121</td>
<td>0.7</td>
<td>-113</td>
<td>-0.7</td>
</tr>
<tr>
<td>- Payroll tax holiday expires December 31, 2012</td>
<td>-95</td>
<td>0.7</td>
<td>-89</td>
<td>-0.6</td>
</tr>
<tr>
<td>- Emergency unemployment benefits expire December 31, 2012</td>
<td>-26</td>
<td>0.7</td>
<td>-24</td>
<td>-0.2</td>
</tr>
<tr>
<td>Affordable Care Act</td>
<td>-18</td>
<td>0.7</td>
<td>-17</td>
<td>-0.1</td>
</tr>
<tr>
<td>- New tax on earnings &amp; investment incomes of high-income taxpayers on January 1, 2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Expiring Tax Provisions</td>
<td>-65</td>
<td>0.0</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>- Partial expensing of investment property expires on December 31, 2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget Control Act of 2011</td>
<td>-65</td>
<td>2.0</td>
<td>-173</td>
<td>-1.1</td>
</tr>
<tr>
<td>- Spending Sequester, January 1, 2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduction in Medicare Payment Rates</td>
<td>-11</td>
<td>2.0</td>
<td>-29</td>
<td>-0.2</td>
</tr>
<tr>
<td>- Doc Fix expires December 31, 2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Changes in Revenues and Spending ****</td>
<td>-105</td>
<td>0.5</td>
<td>-74</td>
<td>-0.5</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td>-606</td>
<td></td>
<td>-612</td>
<td>-3.8</td>
</tr>
</tbody>
</table>

* Billions of Dollars; CBO, "Economic Effects of Reducing the Fiscal Retractment That is Scheduled to Occur in 2013" (May 2012)
** See "Fiscal Stimulus to the Rescue," Macroeconomic Advisers' Macro Focus (Volume 4, Number 1, January 15, 2009), page 3.
*** Fourth-quarter-to-fourth-quarter
**** Not linked to specific policies; mostly reflecting revenue changes

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